Buchanan Ingersoll & Rooney PC

409 North Second Street
Suite 500
Harrisburg, PA 17101-1357
T 717 237 4800
F 717 233 0852
www.bipc.com

Jack M. Stover
717 237 4837
jack.stover@bipc.com

RECEIVED
Corporate & Financial Regulation
MAR 27 2017
Pennsylvania
Insurance Department

March 27, 2017

VIA HAND DELIVERY

Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

Re: *Order No. ID-RC-13-06*

Dear Deputy Commissioner DiMemmo:

Please find attached a document titled Allegheny Health Network Strategic and Financial Plan 2017-2020 filed by Highmark Health.

Thank you for your consideration.

Very truly yours,

Jack M. Stover

JMS/gmt
Enclosure
cc: Lawrence J. Beaser, Esquire (via email)
Patrick T. DeLacey (via Email)

ALLEGHENY HEALTH NETWORK STRATEGIC AND FINANCIAL PLAN

2017-2020

Positioning AHN as a thriving competitor in a dynamic regional health care landscape and delivering on its mission to provide low cost, high quality health care

EXECUTIVE SUMMARY

Almost four years ago, Highmark Inc. (HM) enabled the formation of Allegheny Health Network (AHN) to ensure that HM customers and the Western Pennsylvania (WPA) community would retain access to a competitive high quality health care system that would help control premium costs for all health care consumers. Since that time, Highmark and AHN have worked together and have made significant progress to reinforce their financial strength and stability and have continued to build the core operational and technology platforms needed to support their long-term strategy. This strategy has been focused on redesigning the delivery of care and re-investing in the community network (both AHN and independent community providers) to advance their stated goals and preserve a future for community health care delivery in a time of great turbulence for the healthcare industry. In the process, HM, AHN, and its community partners have established Pennsylvania (PA) as a hub for healthcare transformation and investment and offered PA employers/policyholders a true value-based alternative to the traditional system of fee-for-service (FFS) driven care.

With the turnaround phase behind them, Highmark Health (HH), HM and AHN now are focused on the future and are preparing for and executing against the fundamental changes which are taking place in the healthcare marketplace – including market consolidation, potential vertical integration, and the approaching end of the Consent Decree(s) to which HM and UPMC are parties and which govern the termination of their contractual relationships (Consent Decrees(s)). The time has come for HH, HM and AHN to make final preparations to ensure that AHN has all of the competitive capabilities and HM has the competitive access each needs to effectively serve their respective constituencies, not just in WPA but across the Commonwealth.

To effectively compete and ultimately succeed in this intense, dynamic and highly competitive environment, HH, HM and AHN need a level playing field with their primary WPA competitor, UPMC -- especially given the aggressive moves being made by UPMC and others in PA to consolidate assets. Being able to effectively compete includes the need to have the flexibility to make timely, strategic investments as required to execute on the HH strategy; to build out the remaining services and care models needed to provide patients with a full set of value-based service; and to mitigate what otherwise would be a health care market that would restrict choice and access, and allow care costs and insurance prices to increase without constraint.

It is in this context that HH, AHN and HM have prepared this strategic and financial plan (the Plan). The following pages provide additional detail on the significant progress HH, HM and AHN have made since the formation of AHN, where the integrated delivery and financing system (IDFS) is today, where it is going and how it plans to execute.

HH's success in implementing its strategy will enable it to stay on track in its transformational journey to re-configure a new, integrated health coverage and care model that redefines the

consumer experience, is focused on value-based delivery, and that HH, HM and AHN believe will work better for everyone. It will also continue to ensure that HM customers and the WPA community retain access to a competitive, high quality health care system that would help control premium costs for all health care consumers.

The Original Promise of the HM-AHN affiliation and progress to date

At the time of AHN's formation, the WPA market was facing the potential of having only one true system option for comprehensive care, which had the potential of increasing costs for the WPA community and reducing the availability of services particularly in the outlying communities. HM intervened to assure that its WPA employers/members had another option, one that would be dedicated to the premise that health care buyers/consumers deserved care in their communities at an affordable cost and with a high degree of service. Realizing that goal required substantive investment to recapitalize AHN, sustain community care (for both AHN and independent facilities and individual practitioners), and transition the delivery of care to the new model. Succeeding in that goal would require nothing short of a transformation in how clinicians, healthcare professionals, insurers, and members/patients worked together.

Four years into that journey, HH, HM, AHN, and their community partners have made substantial progress. With HM's help, AHN has made necessary infrastructure investments in all of its hospitals, re-opened the West Penn Hospital (WPH) Emergency Department, opened four Health and Wellness Pavilions, placed critical services back into the local communities (including oncology and women's health services, as well as urgently needed services in the community of Braddock), partnered with the majority of independent hospitals in the community to provide necessary specialty support in the community, created a clinically-integrated network (CIN) led by AHN and community physicians, and implemented a market leading information technology platform. The collective investment has created a viable alternative in the market that delivers a lower-cost, better-quality option, with an emphasis on empathy and caring for the patient.

2016 was a year of acceleration for the value-based delivery system. AHN created a new standard for access by launching same-day appointments in a market that was averaging 19 days wait time for a primary care physician appointment and 38 days for a specialist appointment. A "Living Proof" marketing campaign highlighted the high degree of patient touch and caring that AHN provides for its patients. AHN, its community hospital partners, and now the CIN have worked and are working together to create a lower-cost network for the market and collaboration on new care models that promise continued cost reduction.

The success of these efforts can be seen in the growth in volume at both the community hospitals and AHN and the dramatic increase in AHN earnings before interest, taxes, depreciation and amortization (EBITDA) from ($24 million) in 2013 to $116 million in 2016. AHN revenue has grown 30% over that time frame.

The current strategic context

The environment in which HM, AHN, and their independent community partners operate is more dynamic than ever. The fundamental trends affecting healthcare – rising costs, patient dissatisfaction, and lack of coordination – continue to plague the industry. The changes in the regulatory environment suggested by the new administration in Washington have created increased uncertainty and will likely force another fundamental adjustment to market conduct, coverage, and reimbursement. The individual consumer/patient faces the prospect of losing affordable coverage and/or access to services. All of this is intensified by the impending end of the Consent Decree(s).

In reaction, payors and providers are seemingly following one of two strategies. The first is to attempt to preserve the current system through structural and service consolidation, and a re-investment in the assets, systems, and services that create economic value under a FFS model. The second is to embrace the transition to value, where the need for lower total cost drives pushing care into lower cost settings in the community, redesigning care delivery models around the patient, coordinating care across providers, improving access, simplicity, and transparency, and investing in lower-cost assets.

With the speed of change and the level of uncertainty at a peak, HH, AHN and HM have put together a strategy to move to value-based care at scale as fast as possible. HH, HM and AHN – and many of the community independents – believe that this position will be the right answer under any regulatory or reimbursement structure that is put in place and will also most fully align with the collective missions of the organizations.

The 2020 strategy for HH//AHN/HM

HH, AHN and HM have a two-step vision for the future – reinvent the model of healthcare at scale in WPA and use that platform as a means to advance HH's mission going forward. This aligns with AHN's mission to deliver lower-cost, high-quality health care to the residents of WPA. HH has a 5-part strategy for delivering that vision that includes building unique offerings for consumers/patients, growing sustainably by focusing on customers who want to buy on value, putting clinicians in charge of developing the new models of clinical practice that make sense to them and to their patients, and building partnerships across PA to enable the delivery of these new models in the community. As shown above, the strong foundation in place is reason to believe these bold goals can be accomplished.

That said, HH's strategies require additional investment over the next five years with a particular focus on building out services to close any remaining perceived or real gaps in service for AHN and its community partners and in pushing forward clinical transformation quickly across the population. While HH believes this value-based model of care will be the preferred model of the majority of customers in the market, it is critical to invest now given the pending end of the Consent Decree(s) so that the services can be put in place and the market has time to understand

the value of these services before they make choices based on a new paradigm. In this fast changing market environment, and given how central HM is to both AHN's and its community partners' efforts to put this model in place, HM's current lack of flexibility to invest in a more timely way puts HM and AHN at a competitive disadvantage and ultimately jeopardizes the sustainability of community-based, value-based care in WPA (and likely beyond).

Value for the PA community of a successful AHN/HM

The success of HH's 2020 strategy will provide great benefit to the PA community at large. First, the employers/patients/members in the community will be able to access a system of healthcare that is built for and around the individual. The goal of value-based healthcare – high quality, great experience, and great outcomes at an affordable cost – has been elusive but is for the first time on the cusp of being realized in WPA if HM, AHN, and their community partners can continue their transition. If AHN and HM fail, the alternative is likely a highly consolidated, high-cost healthcare system which removes service from the community. Second, the success of the 2020 strategy will ensure PA as a hub for healthcare innovation, which will in turn attract research and investment dollars and generate high-paying jobs for the region. Third, the success of HH in turn ensures the continued viability of community providers who can be given the resources, services, and integrated relationships to survive and transition as needed to a more sustainable model. Finally, the success of the HH strategy will ensure that employers/patients/members have choice and competition and all the market benefits which come therein.

Financial Forecast

The financial forecasts of AHN are most materially impacted by the levels of investment necessary in the system to prepare for the transition of volume leading up to and as a result of the expiration of the Consent Decree(s). The transition of volume is expected to occur moderately over the next two years. When the Consent Decree(s) end in 2019, the volume is projected to transition more rapidly to AHN.

In anticipation of the impending termination of access for HM members to UPMC at the end of the Consent Decree(s) in June 2019, in 2017 and 2018, AHN will be focused on a variety of investments, including, most importantly, in service lines and service areas expected to experience the greatest disruption from the termination of the Consent Decree(s) –and the most volume transitioning to AHN and the independent community providers. Management will also focus on the ongoing effort to increase employer and consumer perceptions of the system and to make accretive operational adjustments through ongoing capital spend on existing facilities. Lastly, AHN will continue to evolve how it is delivering care to both prepare the AHN system to compete in a value-based world over the longer term, and to enable the leveraging of those learnings across the HH footprint beyond WPA.

The Plan assumes HM will provide funds to HH/AHN of up to $850 million over the period 2017-2018 for the investments contemplated at AHN. HM also will forgive loans previously provided to HH/AHN of approximately $720 million, a significant portion of which has been already accounted for in the primary metric of HM financial strength (i.e., risk based capital (RBC)). The financial transactions between HM and HH/AHN will be made in accordance with applicable regulatory requirements, which will assure that HM maintains an appropriate level of financial strength. These transactions will allow HM to deliver on its mission of making affordable health care available, which requires that it have access to high quality providers at a reasonable cost. HM will provide such funding via capital contributions that will be sourced from existing cash and investment balances, projected annual operating cash flow and the expected gains and earnings available from HM investments. AHN will provide the remaining funding necessary through either cash flows or outside financing.

The financial forecasts for AHN also contemplate a repositioning of its balance sheet to place it on a firm footing for growth. In the current state, the balance sheet carries debt that originated pre-affiliation with HM and through the various affiliation agreement terms. It is critical for the future growth and expansion of AHN to better position the balance sheet.

Following these investments, both AHN and HM are projected to be strong. Both organizations and the subset of the business within them that represent the IDFS project positive operating performance in all years, with an increase from 2017 to 2020. These WPA IDFS financial results provide adequate earnings to support HM's RBC level. Additionally, AHN is projected to generate sufficient cash flow to fund all of its liabilities and ongoing costs in 2019 and 2020, and the WPA IDFS is projected to generate returns sufficient to support the business.

HH management has considered the impact of a less favorable market scenario to both HM and AHN. Even in this scenario, the cash flows from the WPA IDFS are projected to be at levels enabling HM to provide annual funding to AHN to support capital expenditures.

Management of HM, AHN, and HH recognize that under the Approving Determination and Order issued by the Pennsylvania Insurance Department (PID) in connection with Highmark's initial affiliation with the West Penn Allegheny Health System (WPAHS), certain actions by the PID may be necessary to enable the Plan. Accordingly, built into the Plan is the assumption that such actions are taken. Almost four years ago, the PID took the bold action to enable the formation of AHN, to save 17,000 jobs, and to ensure that the WPA community would have access to a competitive health care environment. HM, AHN, and HH have executed on the plan to provide that competitive health care environment while also delivering financial value to the community, AHN patients and HM customers through health care costs that are lower than they would have been but for the affiliation. HH as an enterprise has made remarkable progress in the almost four years since the initial affiliation and has a well thought-out strategy that will translate

into the realization of the vision of a transformed health care system – one that is focused on value not volume, for the benefit of the members of the WPA community and beyond.

THE ORIGINAL PROMISE OF THE HM-AHN AFFILIATION AND PROGRESS TO DATE

At the time of AHN's creation, the WPA region was facing the potential loss of viable competition for high-end healthcare. WPAHS was in financial trouble and facing a potentially crippling second bankruptcy. WPAHS was one of two systems in the market that offered high-end quaternary and tertiary care, and in fact in the past had been considered the pre-eminent medical facility in the region with a heritage of innovation and quality. At the same time, HM and UPMC were in a contract negotiation that threatened the affordability of care in the community and/or the access for community members to all services.

The HM-AHN affiliation was consummated with the primary goal of preserving for the WPA community access to affordable, high quality health care. HM and AHN believed that preserving competition in the market would stabilize costs, promote innovation, and ensure choice for customers. At the time of the affiliation, HM and AHN committed to making investments that would recapitalize AHN, turn around its financial performance, and improve the services being delivered. Secondarily, preservation of competition would also ensure that independent providers – both physicians and hospitals – would have a partner in preserving their viability.

The key to delivering on the promise of the HM-AHN affiliation was the creation of a model of healthcare that truly offered value to customers, in the form of better experience (simplicity and transparency), better access, and better outcomes, all at an affordable cost. Understanding that this was so far unachieved in the industry, HM and AHN set out on their bold vision supported by the common cultures of the organizations, their mission-driven focus, the combined strength of their financial resources and management talent, and the strong partnerships and connections they had to both community members/institutions and organizations across the country. Delivery of the goal required large investment to recapitalize AHN (which had missed a generation of infrastructure investments due to its financial history), build out a broader network across the full spectrum of care, invest in community partners to preserve their services, financial viability, and independence, and upgrade clinical capabilities.

The investments made over the last four years have been substantial. Among the various investments are the following:

- New ambulatory care/surgery center, hybrid operating room, cardiac magnetic resonance imaging, and cardiac unit at Allegheny General Hospital

- Reversing the decision to close West Penn Hospital; reopening of emergency department; and opening of new catheterization labs, expansion and enhancement of intensive care, emergency and obstetrics facilities and neonatal intensive care unit at the hospital
- Creation of a new cancer institute, women's center, neurosurgery, gastro-intestinal, and liver/kidney disease services at Jefferson Hospital
- Enhancement and expansion of intensive care unit and opening of a new Level II trauma center at Forbes Hospital
- Enhancement of inpatient units at Saint Vincent Hospital
- Opening of new outpatient centers in the communities of Wexford, Peters Township, Bethel Park, Monroeville, and Millcreek Township in Erie County
- Enhancing/replacing critical infrastructure across the AHN system
- Growing the employed physician staff by over 500 physicians
- Implementation of the Epic medical records technology across all the ambulatory centers and four hospitals
- Build out of a home services company – Healthcare@Home
- Acquisition of Premier Medical Associates, a major high performing multi-specialty practice
- Addition of clinical service support at over 28 community hospitals

2016 was a particularly significant year for the system as it made major strides in delivering on the promise of value based care, including:

- Same-day appointments for primary care physicians and specialists were launched to great acclaim and satisfaction by the market
- The piloting of multiple new care models in the market including major innovations in cancer, diabetes, women's health, chronic obstructive pulmonary disease, and congestive heart failure
- The launch of the AHN CIN with support of independent physicians across the market
- The launch of the "Living Proof" marketing campaign, which showcased for the public the compassionate, human-centered care that AHN was delivering
- New partnerships with community hospitals supported by new reimbursement programs from HM supporting high-quality, clinically integrated car

The results across the HH system in 2016 show the extent to which these accomplishments and investments have delivered on the promise of turning around AHN. AHN EBITDA reached $116 million in 2016 from a starting point of ($24 million) in 2013. The earnings margin of 4+% was achieved despite taking actions in conjunction with HM to reduce overall utilization and to largely forego hospital-based billing, a common industry practice that raises rates for services that can be provided in a lower-cost setting. The latter decision costs AHN multiple earnings margin points each year but was made to preserve the affordability of care in the community. Revenues at AHN grew 30%+ over the same period as employers and community

members embraced AHN's capabilities and value-based offerings. At the same time, community hospital volumes remained largely stable despite the general market decline thanks to partnerships with AHN and HM that maintained services in the community. HM also benefitted by retaining 96%+ of its commercial membership and 94% of its overall membership, and experienced a $680 million turnaround in financial results for 2016 thanks in part to the cost savings driven from the partnership with providers and the growing percentage of its members that prefer to use the lower-cost AHN/community hospital network. HH believes these results not only position the organization for future success but also substantiate the premise of the affiliation.

CURRENT STRATEGIC CONTEXT

Industry Trends

There currently exists an underlying disconnect between what the health care industry is delivering and what health care customers want. The normal market mechanisms that would ensure the connection between price, value delivery, and supply and demand do not work very well in the semi-regulated health care system present in the United States today. Costs have been escalating at an unsustainable rate to the point that many customers can no longer afford the health care they want. Access to care is challenged throughout the industry – that includes specific physician specialties and basic primary care. Patient desires for an easy to use, transparent system are not met, and even basic quality is hard to understand. The current incentives and payment system are not well aligned to promote provider care delivery change. Consumers are paying more (often more than they can afford) while becoming increasingly dissatisfied with their experience, thereby creating an environment highly susceptible to disruption.

Perhaps as a result, the predicted evolution of the industry from a volume-driven FFS construct toward one that is more consumer-conscious and "value-based" appears to have accelerated and perhaps reached a tipping point in the most recent years. The accelerated pace of change is being driven by a set of factors including the breakdown in the industry's cross-subsidization model, a new degree of consumer activism in demanding value for care, and the pace of innovation threatening to upset the traditional industry norms.

It is the government's broader intervention in health care with the passing of the Affordable Care Act (ACA) that has been the biggest catalyst for the industry in recent years. Since its passage, the Centers for Medicare & Medicaid Services (CMS) and several states have shown a willingness to make broad, highly complex changes to the health care financing system in an effort to re-align payment to value. While catalyzing and effective in decreasing the uninsured, there is much ambiguity still as to the effectiveness of the changes in either bending the long-

term cost trend or in promoting fundamental transformation of care delivery at the front-line practice level. The rapid pace of change has introduced a great deal more complexity and strategic uncertainty into the environment by putting pressure on traditional margins, creating volatility in risk pools and payor market segments, and promoting new forms of consolidation for scale and capability-building.

The passage of the Medicare Access and CHIP Reauthorization Act (MACRA) has added another element of government-mandated change into the provider community. While waiting for the final rules for MACRA to be clarified, AHN also has had to contemplate which funding path it will seek to follow to prepare the organization for the impact of the new payment models under the Merit-based Incentive Payment System (MIPS) or the Advanced Alternative Payment Models (APMs).

The most recent developments in industry regulation suggested by the initial draft of the American Health Care Act (AHCA) will add another level of uncertainty into the market payment environment. As the debate and structure of the AHCA bill takes place, all players in the industry will need to be flexible and ready to adapt to the changes it creates.

In the face of these industry changes, payers and providers have adopted a wide range of strategies, each seeking to protect core business and enable organizational flexibility and/or survivability in the long-run. These have included horizontal and vertical integration, new business investment and/or business diversification, renewed forms of cost reduction, and non-traditional business partnerships. Many of these moves have also created a need for each health care company to re-examine its basic philosophy on the value of scale and what the core competencies of each player in the value chain should be.

That said, two basic paths have emerged that industry players are following. One is a recommitment to the preservation and extension of the current FFS model as long as possible. Players committed to this path have been pursuing in full force the strategies that have been in place for years: consolidation to create economies of scale and better negotiating power in the markets, consolidation of services in higher-cost settings, expansion of services that are profitable in a FFS environment (e.g., higher-end surgeries), re-investment in traditional structures. This has been a preferred strategy of many players in the industry for years, in the hopes of preserving economics until changes in the market forced a change.

Increasingly, a second path is emerging – the one which HM and AHN are embracing with full force. That path is a full commitment to building a value-based system, which requires a full-scale cultural change in the way that clinical services are sold and delivered. This involves moving care to lower-cost settings, redesigning care models to promote integration and clinical standardization and passing those benefits along to employers and members, re-aligning payment to quality and cost performance, and embracing novel forms of integration and partnership. This second path is beginning to offer an alternative to the traditional model of medicine and holds the

promise of correcting some of the more fundamental issues with the system today. The transition to that model, however, requires substantial investment to build the capabilities and new processes to support the necessary type of care. The divergence in these two paths is likely to shape the healthcare competitive landscape for years to come.

In the local PA market, these dynamics are playing out at an increasing pace. Adding to the dynamics in WPA is the impending end of the Consent Decree(s), which is forcing reinvestment by players across the system to move into one of the two models. Providers are increasingly looking to commit to one of the two models. The competitive dynamics have spread across the state and re-alignment is beginning to occur. In this context, HH needs to move even faster to secure the capabilities and positioning needed for its value-based delivery system to compete on equal footing and to respond to the moves being made by other players, not just in WPA but across the state.

Overall, the competitive environment in WPA is shaping up by 2019 to be one of the industry's clearest pure examples of an integrated system dedicated to FFS health care (and the high-end costs and services that come with it) competing directly with an integrated system dedicated to value-based delivery. As stated above, HH believes fully that the long-term market choices will fall in favor of HH and AHN, but as the market fully digests these tradeoffs it is anticipated that there will be a curve of adoption/readiness that will muddy the transition for the next few years.

HM-AHN 2020 STRATEGY

HH is pursuing a five part strategy that it believes will re-center healthcare around the patient with models created and led by the clinicians who serve them. The strategy has a number of facets including:

- *Customer Value Creation* – Building products and services that are aligned to patients' demands for value – namely, access, experience, and quality at an affordable cost

- *Sustainable Growth* - Focusing on businesses and customers where HM-AHN's commitment to customer value most resonates. That includes building on HH's history of investing in diversified healthcare businesses that can add jobs and value to the community

- *Clinician-led Care Delivery Transformation* – Creating care models underlying products and services that are oriented around reducing waste in the healthcare system by putting clinicians in the driver's seat

- *Core business performance* – Improving the core systems that are required for delivering insurance and care (e.g., billing platform, Epic)

- *Unparalleled Execution* – Building the right leaders, systems, and processes to ensure transformational execution

Against that overall strategy, AHN has set high-level goals that are supportive of the AHN mission. First, AHN will deliver on its value proposition – superior access and experience scores (as measured by traditional industry metrics and likely more customer-oriented metrics developed over the timeframe) at a lower total per member per month cost to its end customers (the customers of its payers or the individual policyholders) with better than or equal to quality relative to today. Second, AHN will further its competitive position with improved market positioning and brand recognition across WPA. Third, AHN will achieve its financial targets as laid out in the Plan. Fourth, AHN will contribute (as projected) to the strength of the overall HH system.

Over the next two years, the HH-AHN strategy will focus on the transitional period to occur after the expiration of the Consent Decree(s). This will include closing service gaps and building out the competitive cost and value proposition that will ensure that HM members have affordable access to virtually all of the clinical services they will need. Community providers – both physicians and hospitals – will be integral partners (and ultimately beneficiaries) of the strategy as HM works to ensure that access points and services will be available in all communities and that long-standing community providers will be able to transition as appropriate to the value-based model.

More specifically, AHN will be putting investment into the community to bolster the provision of specific services – namely, cancer, women's health, and emergency services. In each case, HM and AHN believe that the community-based model that they have today in concert with their community partners is a superior model in terms of cost, quality, and experience for patients in that they get to stay closer to home for care. The community partners are essential to delivery of these services, and HM and AHN will seek to partner with them to ensure patients stay in the community for care and are not driven to higher-cost, urban settings. HM and AHN believe that their model is already winning over the population (as evidenced by growing volumes and reputation at AHN in each service), but that more needs to be done to overcome the historical marketing campaigns that have influenced the community. In addition to these services, HM and AHN (with funding provided by HM) will be investing in the Erie market (as recently announced) to ensure that HM customers have access to all services they need in that market and in the clinical care models needed to drive to a lower-cost network. All of this investment will bring the community better care in lower cost settings.

VALUE FOR THE PA COMMUNITY OF A SUCCESSFUL HH-AHN-HM STRATEGY

There is much at stake over the next few years for not just AHN and HM but also the PA community at large. The success of the HH-AHN-HM strategy benefits the community in four substantial ways.

First, as originally intended, the creation of the value-based healthcare system led by AHN and HM and inclusive of the community partners will preserve for community residents access to high-quality clinical services at an affordable cost. As the progress to date shows, the community has responded to the new value-based offerings. The next few years are critical for AHN and HM as the last building blocks to a fully competitive and strategically differentiated network are put in place. Additional investments are required to close perceived service gaps in the market, as well as new clinical models that will deliver value-based care, and new community investments that will bolster access and service in the community. Some of these gaps are real but others are only a function of the acceptance curve that comes with the introduction of a transformative product to an industry. With the right promotion and investment, AHN and HM believe they will showcase to the market the value of the new model and ensure that community members can make the best choice for themselves. Failure to make these investments may result alternatively in a lack of understanding on behalf of the market and a potential decline at HM that would put policyholders and potentially the whole value-based model at risk. Hence, the need for HM and AHN to invest boldly and swiftly.

Second, the success of the new value-based model will cement PA as a hub of clinical innovation for the nation. The entire health care industry is looking at the competitive dynamics in WPA to see how the market reacts to the growing divergence between the FFS providers and the value-based providers like HM, AHN, and its community partners. HH has already established innovative partnerships with many industry leaders including Johns Hopkins University for clinical research, Carnegie Mellon University for technology innovation and incubation, Google for new device experimentation, numerous technology companies for clinical research, and other strategic investors and vendors looking to prove out their value-based offerings on the HM-AHN canvas. HM's role as one of the leading Blue Cross/Blue Shield plans and the first to invest in provider assets at scale has drawn attention from sister plans and may lead to the establishment of research hubs here in PA. All of these partnerships and affiliations serve the community by bringing in the state-of-the-art practices and technologies for care while creating jobs for the region.

Third, the success of the AHN-HM model preserves the community hospital/provider model. HM and AHN both need the community providers to exist and, in fact, to thrive in order to

deliver on their model of care. They have invested heavily over the years in service support and reimbursement to these providers so that they have the resources not only just to survive financially but to transition their model to one that best serves their community and is sustainable over time. HH acknowledges the importance of these community providers and is committed to preserving the localized care they provide. The preservation of the community provider system not only allows for better healthcare, but it preserves jobs in many smaller markets around the region.

Finally, the preservation of the community hospital model and AHN as a quaternary/tertiary hub serves the explicit purpose of preserving choice and access for community members. Consumers do not want to be forced into only one model or provider for care. They want choice and they want the ability to stay with the health plan they have enjoyed in many cases for many years. They want to be assured that they can still get the services they need – the success of the HH-AHN-HM strategy will do that and limit disruption to membership.

FINANCIAL FORECAST

This financial forecast includes and is based upon assumptions, estimates and other information that is considered to be forward-looking. Although this financial forecast is predicated on AHN's detailed strategic plans and represents management's best estimates and expectations, it is subject to future events, risks, uncertainties and market conditions that may cause actual results to differ materially from those set forth in this financial forecast.

Overview

In 2017 and 2018, AHN continues its steady progress of recapitalizing the core of its business, strengthening its core operations, and making focused operating and capital investments that are important for long term success in the market place. With modest but continuing volume increases in 2017, the operating loss narrows to $27 million and AHN projects a $14 million operating gain in 2018.

In 2019 and 2020 as the Consent Decree(s) end, AHN benefits from substantially increased volumes coming from HM and from the strategic capital reinvestment program. In 2019 and 2020, as a result of an anticipated increase in volume, operating income rises to $151 million and $175 million, respectively.

In millions	2016	2017	2018	2019	2020
Total Operating Revenue	$ 2,898	$ 3,077	$ 3,227	$ 3,705	$ 3,851
Total Operating Expense	2,936	3,104	3,213	3,554	3,676
Operating Income (Loss)	$ (38)	$ (27)	$ 14	$ 151	$ 175
Operating Margin	*(1.3%)*	*(0.9%)*	*0.4%*	*4.1%*	*4.5%*
Net Income (Loss)	$ (49)	$ (29)	$ (17)	$ 136	$ 167
Net Margin	*(1.7%)*	*(0.9%)*	*(0.5%)*	*3.7%*	*4.3%*
EBITDA	$ 101	$ 137	$ 187	$ 350	$ 381
EBITDA Margin	*3.5%*	*4.5%*	*5.8%*	*9.4%*	*9.9%*
DCOH	73	75	79	78	89
Debt to Capital	85.6%	48.3%	41.9%	38.4%	36.3%
Total Discharges	86,457	88,538	91,132	100,927	104,517
Outpatient Registrations	1,294,198	1,309,468	1,361,605	1,540,080	1,560,576

EBITDA is positive in all periods and rises faster than net income during the projection period. EBITDA is a non-GAAP measure of operating earnings that excludes interest, taxes, and depreciation and amortization costs and is a widely used proxy measure for operating cash flow generation. AHN EBITDA is $137 million and $187 million during 2017 and 2018 respectively. EBITDA increases to $350 million and $381 million respectively for 2019 and 2020. In order to apply an additional level of conservatism to the projected volumes and cost control measures in the later years, reductions of EBITDA in 2019 and 2020 were applied to the projections in the Plan in a combination of revenue and expense factors.

EBITDA levels in 2017 and 2018 are projected to be positive and growing. In order to maintain adequate levels of liquidity throughout 2017 and 2018, HM intends to fund the ongoing capital expenditures at AHN to the extent that AHN cash flows are not sufficient to fund them. Also during the projection period, HH funds certain strategic initiatives at AHN. Financing options are planned that are sufficient to maintain the overall liquidity levels at AHN and to substantially maintain its financial position until 2019 when earnings and related cash flows rise sufficiently. By 2020, the improved earnings and cash flows of AHN, along with the return of capital expenditures to more normalized levels, allow AHN to maintain sufficient cash flow.

During this timeframe, AHN continues to expand its employed physician staff. Physicians added during this period will be targeted to service line and service area coverage.

AHN will transition, deleverage and consolidate its capital debt structure, including by refinancing its existing bank debt, to achieve long term capital stability and provide more extensive liquidity within AHN itself as it begins to operate under one consolidated obligated

group structure. The projected growth at AHN supports recapitalizing AHN's debt structure, providing AHN with the financial flexibility needed to invest in capital infrastructure and strategic imperatives.

For the last four years, AHN has substantially reduced the ongoing operating loss and commenced a period of internal investment that has nearly doubled since 2014 compared to historical averages. The robust capital expenditure investment and revitalization of AHN will continue at elevated investment levels throughout the 2017-2020 time-frames in order for AHN to remain a highly competitive health system. Those investments will substantially address the remaining AHN infrastructure needs, a process that began at the inception of AHN almost four years ago.

In summary, the AHN financial projections for 2017-2020 highlight volume growth and the generation of improved operating margin levels with significant ramp up in 2019 that leverages a strong health system footprint and stabilized cost base. During the early years of the financial projections, AHN, with HM's support, continues to make focused investments in the access, patient experience, service lines and other growth initiatives to position the health system to accommodate the projected rotation of HM customers into the AHN health system upon the expiration of the Consent Decree(s). The ramping financial benefits of these strategic investments are a significant driver in the operating margin improvements reflected within the financial projections.

This financial forecast supports the continued steps necessary to achieve a vibrant AHN and to contribute to the overall stability and success of the IDFS during a period of significant transition. AHN's net revenue, net income and EBITDA are projected to improve each year driven by steady to strong volume increases, revenue growth, better expense containment and overall operating performance. The capital structure is reset and rationalized for long term financial funding support. The earnings improvements along with the debt level reductions result in significant de-levering of AHN by 2020. Operating cash flows improve and capital expenditure levels return to normal levels.

Key Financial Indicators

	2016	2017		2018		2019		2020	
Volumes									
Discharges	86,457	88,538	2.4%	91,132	2.9%	100,927	10.7%	104,517	3.6%
Adjusted Discharges	178,304	181,454	1.8%	188,001	3.6%	212,263	12.9%	218,639	3.0%
Emergency Department Visits	297,868	296,992	-0.3%	302,619	1.9%	320,853	6.0%	322,289	0.4%
Outpatient Registrations	1,294,198	1,309,468	1.2%	1,361,605	4.0%	1,540,080	13.1%	1,560,576	1.3%
Physician Office Visits	2,756,386	2,895,669	5.0%	3,004,338	3.8%	3,342,652	11.3%	3,385,004	1.3%
Operating Results (in millions)									
Total Revenue	2,898	3,077		3,227		3,705		3,851	
Total Operating Expenses	2,936	3,104		3,213		3,554		3,676	
Operating Margin	(38)	(27)		14		151		175	
Total Non-Operating Income/Expense	$ (11)	$ (2)		$ (31)		$ (15)		$ (8)	
Net Income	$ (49)	$ (29)		$ (17)		$ 136		$ 167	
Financial Metrics									
FTE's	16,708	17,502	4.8%	17,746	1.4%	19,175	8.1%	19,344	0.9%
EBITDA (in millions)	$ 101	$ 137		$ 187		$ 350		$ 381	
Operating Margin %	-1.3%	-0.9%		0.4%		4.1%		4.5%	
Net Income %	-1.7%	-0.9%		-0.5%		3.7%		4.3%	
EBITDA %	3.5%	4.5%		5.8%		9.4%		9.9%	
Days Cash on Hand	73	75		79		78		89	
Days in A/R	41.8	40.8		39.4		39.5		39.5	
Total Debt (in millions)	$ 1,417	$ 907		$ 920		$ 920		$ 920	
Debt to Unrestricted Equity	(31.2)	1.3		0.9		0.8		0.7	
Debt to EBITDA	14.0	6.6		4.9		2.6		2.4	

VOLUMES

AHN is expecting modest volume growth in 2017 and 2018 ramping up growth in 2019 corresponding with the expiration of the Consent Decree(s). Per the table above, overall, total AHN inpatient volumes are projected to increase by approximately 2.4% in 2017 and 2.9% in 2018, ramping to 10.7% in 2019 and 3.6% in 2020. Outpatient registrations are projected to increase 1.2% in 2017, and then increase 4.0% in 2018, 13.1% in 2019, and 1.3% in 2020. AHN's volume forecast takes into account the impact of HM health plan enrollment changes, including the impact of the expiration of the Consent Decree(s).

Over the next two years through 2018, AHN will be focused on organic, programmatic growth in clinical service lines to improve its market position in the competitive WPA environment. Planned programmatic changes for 2017 are supported by the employment of new physicians, ramp up of recently added physician practices, as well as program expansion across most major hospital facilities.

There are several key strategic investments that have been layered into AHN's baseline financial forecast. These investments will allow AHN to deliver high quality care within the region at critical access points and are projected to generate incremental patient volumes for AHN, primarily through improved access for HM customers post-Consent Decree(s).

REVENUE

AHN's revenue improvement over the forecast period is primarily driven by the higher projected volumes, near-term improvement in revenue cycle operations, and contracted annual increases from commercial and government payers, and reflect the optimization of quality incentive payments and fee schedule reimbursements. Net patient service revenue (NPSR) improves by 6.8% in 2017 and 5.1% in 2018, with an increase of 14.6% seen in 2019 correlating to the increase in inpatient discharges (10.7% growth) and outpatient registrations (13.1% growth) seen in 2019. In 2020, the NPSR levels off at a 4% increase in line with 2020 volume projections.

Payer rates and inflationary adjustments have been modeled in the financial forecast. Government payer rates reflect anticipated rate changes to the Medicare program resulting from coding and a two-midnight rule adjustment. Revenue enhancements from improved revenue cycle operations have been built into the financial forecast.

AHN recognizes that a change in the way Medicare reimbursements are calculated will occur through MACRA, but at this point is not positioned to forecast these impacts given the uncertainty of the legislation's implementation guidance.

EXPENSES

AHN's operating expenses are held to minimal per unit growth levels throughout the forecast period in order to leverage the established physician base and fixed cost structure. Overall, operating expense increases 5.7% in 2017 and 3.5% in 2018, largely correlating with patient volume growth. An operating expense increase of 10.6% is projected in 2019 to account for the ramp up in projected patient volumes. As incremental volumes transition to AHN in 2019, AHN projects to maintain the same fixed cost structure, lowering the cost per case. In 2020, operating expense levels out with a 3.4% increase in line with volume projections.

DIVERSIFIED BUSINESSES

Diversified businesses continue to be an important part of AHN's longer term growth strategy which includes growth in diversified revenue streams from related business platforms. Currently, AHN diversified businesses include durable medical equipment, home health and hospice, infusion therapy and rehabilitation businesses and its group purchasing organization. AHN expects to increase market share for patients requiring these services as the focus on the continuum increases its emphasis on post-acute care services. At the same time, AHN expects to realize efficiencies in the diversified business operating structure which it expects will contribute to improved operating margins. AHN continues to evaluate opportunities to diversify its business operations. In some cases, these diversified businesses are structured as joint ventures and the minority interest is recorded as a non-operating expense.

NON-OPERATING ACTIVITIES

Non-operating activities primarily include interest expense, investment income and other income or expenses associated with AHN's joint venture investments.

Interest expense increases as a result of projected rising interest rates. Investment results are projected to increase slightly each year over the projection period as a result of the expected increase in interest rates and accompanying improvement in liquidity and investment balances.

Balance Sheet and Assumptions

(Dollars in Millions)	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
ASSETS					
Cash & Investments	$ 498	$ 560	$ 586	$ 665	$ 797
Receivables	364	378	384	434	450
PPE, Net	1,099	1,211	1,393	1,453	1,423
Goodwill and other intangible assets, net	115	113	110	108	106
Other Assets	590	587	650	655	658
TOTAL ASSETS	**$ 2,666**	**$ 2,849**	**$ 3,123**	**$ 3,315**	**$ 3,434**
LIABILITIES & NET ASSETS					
Debt	$ 1,417	$ 907	$ 920	$ 920	$ 920
Other Liabilities	1,010	972	925	922	897
Total Liabilities	2,427	1,879	1,845	1,842	1,817
Total Net Assets	239	970	1,278	1,473	1,617
TOTAL LIABILITIES & NET ASSETS	**$ 2,666**	**$ 2,849**	**$ 3,123**	**$ 3,315**	**$ 3,434**

Capital Expenditures. Projected capital spend has been estimated by facility by year projected at $942 million through 2020. These capital needs were estimated based on a clinical and operational assessment of asset age and condition during 2016 within the context of strategic investment priorities. The timing of the projected capital spend by year could be impacted by changes in operational priorities and by various constraints, including but not limited to regulatory, vendor/procurement timeframes or other capacity-related constraints.

Debt. Projected debt declines from 2016 to 2017 due to the forgiveness of debt from HM as previously discussed.

Additional balance sheet indicators were reflected previously in the Plan.

Cash Flow Statement and Assumptions

A condensed summary of the projected 2016-2020 cash flow statements and key assumptions follow:

in millions	2016	2017	2018	2019	2020
Cash Flow from Operating Activities:	64	28	77	194	239
Cash Flow from Investing Activities:	(147)	(282)	(387)	(262)	(236)
Cash Flow from Financing Activities:	111	260	316	87	4
Net Increase in Cash and Cash Equivalents	28	6	5	19	7
Beginning Cash and Cash Equivalents	138	166	172	177	196
Ending Cash and Cash Equivalents	166	172	177	196	203

Cash flow from operations is projected to increase each year in the projection period 2017-2020, as noted above, based on projected improvement in operating results, EBITDA and volumes across AHN, particularly in 2019 and 2020 following the expiration of the Consent Decree(s).

Cash flow from investing activities represents a significant outflow each year of the projection period based on the significant level of capital investment being made in the system in both core capital infrastructure as well as strategic investments in key service lines and service areas.

Cash flow from financing activities is higher in 2017 and 2018 due primarily to projected capital transfers from both HM and HH to provide support for the ongoing capital infrastructure and strategic initiatives as AHN continues its turnaround. The level of capital transfers declines in 2019 with no capital transfers required in 2020.

KEY OPPORTUNITIES, RISKS, AND MITIGATION STRATEGIES

AHN assessed potential opportunities and risks to the financial forecast, and looked at factors that could have a material effect on the forecast and also contemplated a number of mitigation strategies, including the development of investment and action scenarios for different levels of volume and providing for flexibility in the investment structures.

CONCLUSION

In summary, as described in this Plan, HH, AHN and HM have made steady and significant progress since the formation of AHN to stabilize and strengthen the AHN system and to deliver on their collective promise to create a customer-focused, value-based IDFS that works for everyone – that ensures that the residents of WPA, including the many HM customers in the region, will continue to have access to a competitive, innovative, high quality health care system that provides a choice of providers and delivers care affordably. As demonstrated by this Plan, HH, AHN and HM have the leadership, the roadmap to the future, and the financial strength and stability to execute on their shared vision, and they remain firmly committed to re-configuring the health care model to one that delivers differentiated value across the full spectrum of health care needs – a model that, put simply, is focused on *getting health care right* – and they intend to do just that.