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RATING ACTION COMMENTARY

Fitch Rates UPMC's (PA) Series 2023, 2023A, 2023B and 2023C Bonds 'A'; Outlook Positive

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Fitch Ratings - New York - 21 Mar 2023: Fitch Ratings has assigned an 'A' rating to the following series of bonds expected to be issued by or on behalf of UPMC (PA):

--$800,000,000 UPMC Taxable Revenue Bonds series 2023;

--$475,000,000 Pennsylvania Economic Development Financing Authority series 2023A;

--$100,000,000 Pennsylvania Economic Development Financing Authority series 2023B;

--$40,000,000 Monroeville Finance Authority series 2023C.

In addition, Fitch has affirmed UPMC's Issuer Default Rating (IDR) and revenue bond ratings on UPMC's outstanding parity debt issued by UPMC or on behalf of UPMC through various issuing authorities at 'A'.

The Rating Outlook is Positive.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
UPMC Health System (PA)	LT IDR	A Rating Outlook Positive	Affirmed	A Rating Outlook Positive
UPMC Health System (PA) /General Revenues/1 LT	LT	A Rating Outlook Positive	Affirmed	A Rating Outlook Positive

VIEW ADDITIONAL RATING DETAILS

The $800 million series 2023 bonds are expected to be issued as taxable, fixed rate bonds. The series 2023A, 2023B and 2023C will be issued as fixed rate, tax-exempt bonds. The proceeds from the taxable series 2023 will be used for various corporate purposes, and the proceeds of the tax-exempt series 2023A series will be applied to finance various capital expenditures. The proceeds from the series 2023B and 2023C will be used to refund UPMC's Pennsylvania Economic Development Financing Authority series 2013A and Monroeville Finance Authority 2013B bonds. The bonds will be sold via negotiation the week of April 3, 2023 via negotiation.

Concurrent with the 2023 issuance, UPMC will issue a $250 million a variable rate Pennsylvania Economic Development Financing Authority series 2023D that Fitch was not asked to rate, which will refund a $200 million JP Morgan private placement loan and increase it to $250 million, yielding $50 million of new money proceeds.

SECURITY

The bonds are secured by a gross revenue pledge of the obligated group (OG) and will constitute parity debt under UPMC's 2007 master trust indenture. The Insurance Division, which is not in the OG, but owned by the corporate parent, accounted for approximately 49% of fiscal 2022 system operating revenues (before eliminations).

ANALYTICAL CONCLUSION

The affirmation of the IDR at 'A' is based on UPMC's leading market share position in its core markets of Western Pennsylvania and its significant level of revenues diversity. The ratings are further supported by UPMC's large insurance division, which accounted for close to half of the consolidated system operating revenues in fiscal 2022 (year-end December 31), which provides a certain level of revenue predictability.

The Rating Outlook remains Positive based on the expectation that operating performance that weakened in fiscal 2022 (YE December 31), due to industry headwinds and various strategic investments, will over time build up to operating EBITDA margins in the mid 4% to 5% range. Despite the $1.3 billion of new money in the 2023 issuance, UPMC's leverage metrics will be initially only mildly weakened due to $800 million of taxable proceeds boosting liquidity.

While UPMC's operating EBITDA margins have historically been lower than the 'bbb' midrange' operating risk assessment suggests, Fitch views the presence of the large, profitable UPMC health plan, as naturally dampening operating profitability, but providing a natural hedge as a less volatile source of revenues.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

Leading Market Position Enhanced by Large Insurance Division

UPMC's leading market share in Allegheny County and the western Pennsylvania market remains a significant credit strength. Fitch views UPMC's revenue diversification and integrated delivery model, large aligned physician base, extensive health plan division and sizeable geographically distributed delivery network with a 40 hospital and extensive ambulatory network, as a material credit differentiator. The insurance plans are a source of revenue stability for the system while strongly supporting UPMC's health care presence in the state.

Fitch views favorably the approximately 49% of UPMC's revenues generated by its health plan division, which serves as a natural hedge against revenue volatility, as was amply demonstrated during the initial periods of the pandemic, when volumes declined in the hospital division.

Favorably, less than 19% of UPMC's gross patient revenue were represented by Medicaid and self-pay in fiscal 2022, supporting the 'bbb' assessment for revenue defensibility.
UPMC holds a leading 44% market share in the 29 counties of Western Pennsylvania (including Allegheny County) with a population of about 4 million, and a very strong 60% in its Allegheny County core market, with population of 1.2 million. Allegheny County is a

competitive market served by two integrated delivery systems, UPMC and the Allegheny Health Network (AHN; Highmark's affiliation with West Penn Allegheny Health System).

The 1% decline in UPMC's respective market shares was due to AHN opening a 160-bed hospital in 2021, and several micro hospitals, but UPMC maintains the clear leading position and has a larger share of the high acuity market, particularly in neurology, cardiology and orthopedics. UPMC Presbyterian is also a leading provider of solid organ transplantation in the U.S. and provides those services in its joint venture specialty transplant facility in Palermo, Italy. UPMC expects its market share to potentially further strengthen when its two major projects at its main Pittsburgh location are completed over the next couple of years.

UPMC's several insurance plans command the highest market share of the western Pennsylvania market, which is split between UPMC, Highmark and the national insurers. UPMC holds a lead in all but the commercial group plan, where Highmark is largest with 42% share against UPMC's 24% share. The lower share of the commercial market was partially due to UPMC's decision to exit some commercial plans in 2022 that were not financially sustainable.

All other insurance plans registered increases in enrollment, with an overall increase of 9% in enrollment and 7.6% increase in insurance revenues versus the 2.3% increase in net patient revenues. The insurance plan membership has continued to grow robustly year-over-year since it was launched over 20 years ago, doubling its membership to 4.5 million as of Jan. 1, 2023 from 2.3 million in 2013, and increasing by 9% in fiscal 2022.

Pennsylvania's population increased by 1.4% over the last five years, as has Allegheny County's (0.9%), but has an older profile than that of the U.S., with median income and poverty relatively in line with those of the U.S.

Operating Risk: 'bbb'

Weak Operating Margins Offset by Insurance Plans

Following two years of higher operating EBITDA margins in fiscal years 2020 and 2021, which benefited from CARES Act relief funding, the steady stream of insurance premium revenue, as well as the sale of a portion of an infusion therapy and special pharmacy, fiscal 2022 results were somewhat weaker. Fiscal 2022 ended with an operating loss of $2 million, translating to an operating EBITDA margin of 3.3%, lagging management's expectation of operating EBITDA margin in the mid 4% range (the operating loss does not include $242 million of academic and research support, which UPMC reports as non-operating expense).

Fitch continues to believe that UPMC's strong market position, revenue diversification and scale provide the system with the opportunity to better manage its own revenues and expenses within its integrated network in the long run. However, Fitch expects that given current industry headwinds, achieving improved profitability of better than mid 4% operating EBITDA margin will likely take a few years. Management expects that performance in fiscal 2023 will be similar to the prior year with operating EBITDA margin of about 3.3%.

Despite the continued expectation of lower profitability over the near term, Fitch is assessing a mid-range overall operating risk profile, given the accretive health insurance operations and manageable capital needs that will be partially supported by the proceeds of the 2023 issuance. Due to its sizable insurance division, which accounts for about 49% of operating revenues, UPMC's operating cash flow margin is lower than that of provider-only systems due to the lack of depreciation expense related to the health plans.

However, Fitch believes that the presence of the fully mature and profitable health plan provides an offset to potential revenue volatility in the provider division, as was evident during the recent two years under the pandemic conditions.

The 2022 operating loss included a $76 million lease impairment write off, which if viewed as a one-time, non-recurring expense, would increase the operating EBITDA margin to 3.6%. The major contributors to the weaker results was the 10.6% increase in staffing expenses, which included elevated use of agency nursing and a sizeable staffing market salary adjustment. While volumes are generally returning to pre-pandemic levels, there is a marked shift to outpatient versus inpatient delivery, with the resultant lower reimbursement impact.

Management has formulated a margin improvement plan that addresses labor costs by reducing premium staffing and improving productivity through work standardization, optimizing service lines, particularly those focused on UPMC's centers of excellence, increasing clinical standardization and care access both on outpatient side through more responsive appointment scheduling, and reducing ALOS, which spiked during the pandemic, to create needed inpatient capacity.

After scaling back capex in 2020 and 2021 to around $800 million, UPMC capex has returned to close to $1 billion, equal to approximately 1.2x depreciation expense, a level which is projected to be maintained for the next several years. The system's capex investment includes $2 billion in support of two large strategic projects underway: the 650-bed tower at UPMC Presbyterian (completion Fall 2026) and a nine-story UPMC Vision and Rehabilitation Tower at UPMC Mercy (completion late spring 2023), as well as a number of smaller expansions and ambulatory projects throughout UPMC's service areas.

UPMC's routine capital for construction and information technology (IT) is now about $400 million annually with another $325 million in capital commitments related to the two major projects. UPMC has limited capex flexibility given its competitive markets, but has a healthy average age of plant of 10.4 years.

Financial Profile: 'a'

Liquidity and Leverage Metrics Temporarily Lower

UPMC's leverage and liquidity metrics gradually improved until 2022, when the unfavorable investment environment, combined with the weaker operating performance, caused cash-to-adjusted debt to decline from the prior year. Fitch notes that UPMC's liquidity has always been low vis-a-vis the system's debt position due to the large insurance division. UPMC's strong financial profile is based on UPMC recovering cash-to-adjusted debt and net-adjusted debt-to-adjusted EBITDA (NADAE) consistent with Fitch's strong 'a' assessment towards the end of Fitch's stress case scenario.

UPMC reported cash and unrestricted investments at $7.4 billion at Dec. 31, 2022, down from $8.6 billion in the prior year (which excluded Medicare advance funds and deferred payroll taxes), translating to 118% of cash-to-adjusted debt, a decline from 132% at 2021 year-end. Fitch made no adjustment to unrestricted cash and investments or the long-term debt at $6.3 billion, as UPMC repaid substantially all of the Medicare advanced funds and tax deferrals in fiscal 2022, its defined pension plan was funded at 93%, meeting Fitch's 80% threshold, and operating lease expenses are reflected as a liability on its balance sheet. Fitch has historically factored into its analysis the fact that UPMC's insurance division reduces DCOH due to the medical claims flowing through its expense base.

UPMC's NADAE was reported at a favorable -1.6x at fiscal 2022 year-end, but will initially be negatively affected by the 2023 issuance. Fitch's forward-looking scenario assumes a portfolio stress of 11.8% based on UPMC's actual asset allocation and applies standard revenue stress in the initial two years of the stressed case.

Assuming that operating EBITDA margins will slowly improve to 4.5% to 5% by the end of Fitch's five-year forward looking base case scenario and that no material new debt is issued over the five-year period, cash-to-adjusted debt will meet the 120% cash-to-adjusted debt threshold and NADAE will be in a favorably negative position in the outer years of Fitch stressed case scenario, which is consistent with the 'a' strong financial profile in the context of a midrange revenue defensibility and midrange operating risk profile.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations were applied in this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Margin compression below Fitch's current expectations;

--High capital spending that requires significant additional cash or debt commitments such that cash-to-adjusted debt falls materially below 120%.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained improvement in unrestricted cash-to-adjusted debt at a levels maintained at better than 120%;

--Meeting Fitch's expectation for operating EBITDA margins sustained in the minimum mid-4% to 5% range.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

With 40 hospitals and more than 800 clinical locations in the region, along with 5,375 employed physicians and close to 4.5 million covered lives in its network of health insurance plans, UPMC is the largest health care system and non-governmental employer in Pennsylvania, as well as one of the largest integrated health care delivery networks in the country. It is also one of the world's leading organ transplant centers. UPMC reported total revenues of over $25.5 billion in fiscal 2022 (year-end December 31).

Over the last four years, UPMC's revenue base, assets and liabilities have grown with the growth of its health plans and targeted acquisitions. The system has not identified any acquisition targets at this time, but is always open to transactions that would be accretive. In addition to its provider and insurance operations, it continues to invest in UPMC Enterprises, which focuses on emerging technologies in translational sciences and digital solutions.

UPMC's international division owns or operates or plans to operate as partnership or joint ventures facilities in Ireland, Italy, Kazakhstan, China, and Croatia. The latest addition is the recent acquisition of a 101-bed orthopedic hospital in Dublin.

Edward Karlovich, UPMC's chief financial officer, has recently announced his plan to retire in six months. The system will be conducting a national search for his replacement.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations were applied in this rating determination.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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APPLICABLE CRITERIA

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub. 18 Nov 2020) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v2.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Allegheny County Hospital Development Authority (PA)	EU Endorsed, UK Endorsed
Maryland Health & Higher Educational Facilities Authority (MD)	EU Endorsed, UK Endorsed
Monroeville Finance Authority (PA)	EU Endorsed, UK Endorsed
Pennsylvania Economic Development Financing Authority (PA)	EU Endorsed, UK Endorsed
UPMC Health System (PA)	-

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