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CREDIT OPINION
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UPMC, PA

Update to credit analysis

Summary

UPMC's credit profile (A2 stable) reflects its formidable market position and demonstrated ability to execute strategies through a centralized management model, which will allow the system to improve margins and reduce leverage over time. Ongoing and extensive revenue and expense initiatives will be supported by a disciplined approach to financial planning that will help compensate for an industry-wide escalation of labor costs and inflationary pressures which will weigh on margins through 2023. While the 2023 debt issuance will elevate leverage metrics, sizable absolute cash is expected to remain stable with bond proceeds available to support high capital spending over the next several years. Additionally, the rating acknowledges UPMC's proven track record of absorbing leverage and meeting forecasts. The A2 expects that unrestricted cash and investments will provide for adequate, but below peer median, resources relative to consolidated operations given the scale of the system when including insurance services. That said, days cash is notably stronger as measured to just the health services division.

UPMC will continue to benefit from its long-established strengths including alignment with the University of Pittsburgh (University), a diversified market position with a broad geographic footprint, premier clinical reputation, and substantial insurance services. The health plan is expected to be a driver of revenue growth with expansion of the Medicaid business across a larger geography in Pennsylvania. In addition to margin compression and modest leverage metrics, other offsetting considerations include an increased dependency on the state for adequate rates as the Medicaid business grows within the health plan and intense competition in certain Pennsylvania markets.

Credit strengths

» UPMC's alignment with the University, a diversified market position with a broad geographic footprint, premier clinical reputation, and substantial insurance services will continue to support its distinctly leading market capture

» Margins, though thinner than historic, are expected to steady at FY 2022 levels, then strengthen over the next several years, as initiatives aimed at revenue enhancement and cost reductions compensate for labor, supply, and throughput challenges

» Sizable absolute cash is expected to remain stable, with bond proceeds available to support high capital spending over the next several years

» Debt structure risk will remain limited and lines of credit are available to bolster working capital

» Management's demonstrated ability to address operating challenges will continue to undergird resiliency; well-developed integration competencies will reduce risks

Credit challenges

» Unrestricted cash and investments to total debt and days cash will be adequate but below similarly rated peers; days cash is notably stronger as measured to just the health services division

» Industry-wide expense pressures will weigh on consolidated margins for several years; plans for high capital spend could temper the financial profile further if operations do not meet expectations

» UPMC will remain at risk for lower than average consolidated margins with the health plan representing approximately 50% of system revenues; the health plan is not part of the Obligated Group, although it is included in the systemwide gross revenue pledge

» Competition will remain high in certain Pennsylvania markets as other healthcare systems extend their geographic reach through acquisitions or new construction

Rating outlook

The stable outlook expects consolidated margins to stabilize at current levels then strengthen, over the next several years, as UPMC's payor provider model will continue to provide revenue diversification and mitigate risk. The outlook also anticipates that days cash on hand and cash-to-total debt will be sustained at proforma levels until cash flow rebuilds to allow for incremental strengthening.

Factors that could lead to an upgrade

» Sustained strengthening of margins to historic levels

» Notable reduction of operating and balance sheet leverage metrics

» Growth in liquidity

Factors that could lead to a downgrade

» Inability to meet operating targets

» Weakening of debt or cash metrics below proforma levels

» Dilutive acquisitions or mergers

Key indicators

Exhibit 1
UPMC, PA

	2018	2019	2020	2021	2022	2022 Pro-forma
Operating Revenue ($'000)	18,777,344	20,609,276	22,857,417	24,366,484	25,532,003	25,532,003
3 Year Operating Revenue CAGR (%)	16.0	17.1	16.8	9.1	7.4	7.4
Operating Cash Flow Margin (%)	4.2	3.2	4.6	5.3	2.4	2.4
PM: Medicare (%)	47.0	46.1	46.5	46.1	47.3	47.3
PM: Medicaid (%)	18.1	18.1	18.2	18.6	18.2	18.2
Days Cash on Hand	104	93	141	145	108	122
Unrestricted Cash and Investments to Total Debt (%)	109.5	112.4	151.9	165.6	134.6	122.3
Total Debt to Cash Flow (x)	4.4	4.6	3.5	3.0	4.8	5.8

Based on audited financial statements for UPMC for year ended December 31; Investment returns normalized at 5%. FY 2020 margins exclude $236 million of proceeds from the sale of a portion of Chartwell. FY 2020 and 2021 balance sheet metrics include Medicare Advance Funds. Pro-forma 2022 includes Series 2023 borrowing.
Source: Moody's Investors Service

Profile

UPMC ($25.5 billion revenue FY 2022) is an integrated delivery and financing system (IDFS) based in Pittsburgh, Pennsylvania, serving residents of western and central Pennsylvania, southwestern New York, and western Maryland. UPMC's 40 hospitals and more than 800 clinical locations comprise the largest health care delivery system in Pennsylvania. UPMC employed more than 5,200 physicians as of December 31, 2022. UPMC is the largest nongovernment employer in the Commonwealth. UPMC also offers a variety of insurance products that cover approximately four and a half million lives.

Detailed credit considerations

Market position: distinctly leading position will grow from investments in clinical enterprise and insurance services expansion

UPMC will remain a key quaternary and tertiary provider, benefitting from its preeminent national clinical reputation and relationship with the University. Additionally, UPMC's unrivaled business platform as a highly developed integrated delivery and financing system and broad and diversified footprint will continue to translate into strong local and regional market positions (60% market share in Allegheny County, 44% market share of a 29-county region and 27% in central Pennsylvania). Market capture has been notably enhanced by the System's well executed growth. Also widening patient draw will continue to compensate for stagnant population trends in the Pittsburgh area.

UPMC's considerable clinical investments in its southwest, central and northwest PA and New York regions and new models of primary care are expected to increase access and provide lower cost sites of care. With the pandemic having accelerated demand for nonhospital outpatient settings, UPMC's competitive position will benefit from its expanding geography as it pursues growth of outpatient settings over the next few years. Growing scale and broadening market capture provide potential for an improved revenue mix which will reduce reliance on less demographically favorable Allegheny County, which has higher than average Medicare utilization rates.

The pace of UPMC's momentum will be constrained by central Pennsylvania's increasingly competitive, consolidating marketplace. In Allegheny County, UPMC's remains the distinctly leading provider as compared with the Allegheny Health Network, the clinical delivery component of the integrated delivery and financing system controlled by Highmark Health. In central Pennsylvania, UPMC will continue to face intensifying competition from Penn State Health, Geisinger Health System, and Lancaster General Hospital, an affiliate of Penn Medicine. Each of these Systems are investing capital into access points across these geographies.

The system's insurance services division, which offers diverse products in the commercial, employer, individual and government market segments, will remain a key business for UPMC, comprising approximately 50% of system revenues. Insurance services, a natural hedge to the provider business, diversifies business risk and will provide financial synergies as membership grows in UPMC's various provider services markets. However, the highly competitive environment for insurance services in Pennsylvania will continue to present significant pricing pressures which could drive operating variability for UPMC's consolidated margins given its relative size to the enterprise. Also, we believe that the growth in exposure to governmental products carries certain limitations, including a cap on rates, and the exposure to policy changes.

Operating performance, balance sheet and capital plans: margins will remain modest in 2023, though sizeable cash reserves will be maintained

Margins are expected to show the same level of moderate performance in fiscal 2023 as seen in fiscal 2022. The system reported a 2.4% operating cash flow (OCF) margin at FYE 2022 (reclassifying interest expense to operating expenses). Margins will continue to be impacted by the nationwide labor shortages and inflationary pressures which accelerated expense growth and hampered inpatient throughput in fiscal 2022. We expect the OCF margin will hover in a range close to the fiscal 2022 level, before rebuilding to the mid single digit level, but remain sufficient to support capital spending and allow for maintenance of sizeable cash reserves.

Management's demonstrated ability to execute strategies will allow the system to strengthen margins and reduce leverage over time. Ongoing and extensive revenue and expense initiatives will be supported by disciplined financial planning that will help compensate for the industry-wide escalation of costs.

Capital spending will be elevated at about $1 billion in FY 2023. Currently, UPMC's largest capital projects are its investments in its core western Pennsylvania market including the UPMC Mercy Pavilion, Vision and Rehabilitation Institutes and a new tower at UPMC Presbyterian.

Liquidity

Sizable absolute cash is expected to remain stable, with bond proceeds available to support high capital spending over the next several years. At FYE 2022 UPMC's $7.4 billion of unrestricted cash and investments provided for 108 days cash on hand and 135% unrestricted cash and investments to total debt. Though metrics are modest to the consolidated enterprise, days cash would be notably stronger as measured to just the health services division. As of the FYE 2022, Medicare funds were fully repaid, with UPMC's wealth remaining above pre-pandemic levels. Giving effect to the Series 2023 financing, unrestricted cash and investments will grow by $800 million of taxable proceeds, with $8.3 billion of liquidity providing for pro-forma 122 days cash on hand and 122% unrestricted cash and investments to total debt. Additionally, the availability of lines of credit will provide for some flexibility.

UPMC's wealth is highly diversified across asset classes and managers. We note that 68% of the investment balance is available on a monthly basis, representing a greater level of liquidity of wealth then in past years.

Debt structure and legal covenants: debt structure risk will remain limited

Though the 2023 debt issuance will elevate leverage metrics, debt structure risk is limited and UPMC's sizable absolute cash is expected to remain stable with bond proceeds available to support high capital spending over the next several years. On a pro-forma basis Moody's adjusted MADS and total debt to cash-flow reflect UPMC's more modest margins at 2.5 times and 5.8 times, respectively. However, total debt to revenue of 27% is indicative of the system's scale relative to the moderate amount of leverage it has outstanding. As margins rebuild, leverage relative to operations will be absorbed.

Legal security

UPMC's parity debt is a joint and several commitment of the obligated group secured by a lien on gross revenues. The Obligated Group under the 2007 Master Trust Indenture consists of the Parent Corporation, UPMC Presbyterian Shadyside Hospital, UPMC Magee Womens Hospital, UPMC Passavant and UPMC St. Margaret. The system also includes several additional hospitals throughout western Pennsylvania, international operations and a variety of insurance subsidiaries as part of its integrated delivery and financing system. The Insurance Division, which is not in the OG, accounts for nearly 50% of system operating revenues (before eliminations). Though the health plan is not part of the Obligated Group, it is included in the systemwide gross revenue pledge.

Debt structure

Debt structure risk will remain very manageable with the majority of UPMC's approximately $6.8 billion of pro-forma long-term debt issued as fixed rate obligations and a modest amount of long mode variable rated demand bonds outstanding.

Headroom to covenants will be adequate. The most restrictive covenants include 1.25 times actual debt service (ADS) coverage and 60% unrestricted cash to 2007 MTI debt.

Debt-related derivatives

UPMC will have low exposure to derivative risk. UPMC's debt-related derivative contracts have a total notional amount of approximately $76 million. UPMC's payment obligations on these contracts are on parity with UPMC's rated debt. As of FYE 2022 UPMC had posted no collateral.

Pensions and OPEB

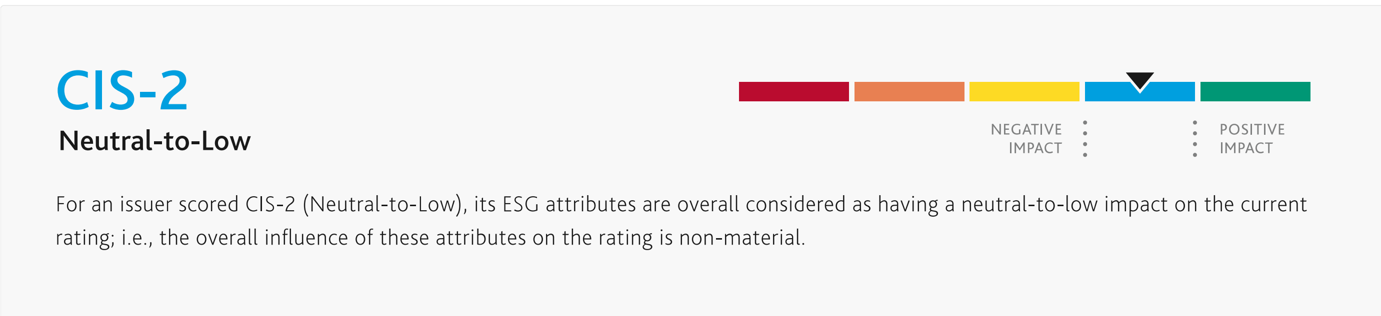
UPMC and its subsidiaries maintain cash balance defined benefit pension plans, defined contribution plans, and nonqualified plans that cover substantially all of UPMC's employees. UPMC's comprehensive liability of $193.5 million for its retirement plans reflected 93% funding at FYE 2022. UPMC lease obligations equate to a $920 million of debt equivalent.

ESG considerations

UPMC, PA's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 2

ESG Credit Impact Score

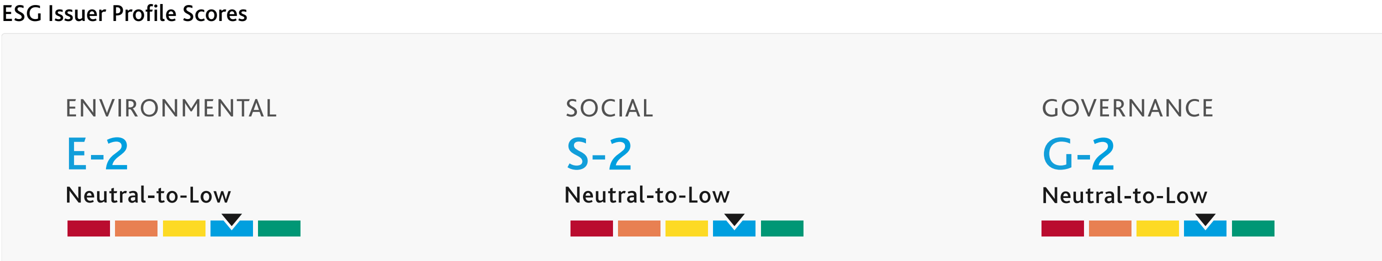


Source: Moody's Investors Service

UPMC's **CIS-2** reflects the system's neutral exposure to environmental, social, and governance risks. UPMC is an integrated delivery and financing system (IDFS) based in Pittsburgh, Pennsylvania, serving residents of western and central Pennsylvania, southwestern New York, and western Maryland. UPMC's 40 hospitals and more than 800 clinical locations comprise the largest health care delivery system in Pennsylvania. The system's scale, broad market capture, good governance, and solid unrestricted cash and investment balances are key mitigants to risks related to demographic and societal trends and organizational structure.

Exhibit 3

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

UPMC's E-IPS of neutral-to-low (**E-2**) reflects the absence of significant environmental risks. We assess its environmental risk as neutral-to-low across all of the various sub-factors. UPMC has pursued a Policy of Environmental Responsibility through numerous programs focused on sustainability and reducing its environmental footprint.

Social

UPMC S-IPS is neutral (**S-2**) reflecting a balance of a positive assessment of customer relations with moderate exposure to other social risks that are in line with sector wide averages. UPMC's positive customer relations score (1) reflects its very strong clinical and medical research reputations and its important role as the academic medical center for University of Pittsburgh, a state-related university, as well as the favorable impact its focus on access and equity, and programs such as affordable housing, have on the communities it serves. UPMC's clinical enterprise and comprehensive health insurance offerings, with broad geographic distribution in the Commonwealth, result in strong patient demand that carries a very high case mix. The demographic and societal trends score is moderate at (3) owing to a high reliance on government payors and the potential for regulatory and reimbursement changes to have a material impact on finances and cash flow, a particular vulnerability for UPMC as both a payor and provider. This risk is mitigated by UPMC's diversified market positions with a broad geographic footprint, premier clinical reputation, substantial scale as an IDFS and solid balance sheet.

Governance

UPMC's G-IPS of neutral-to-low (**G-2**) reflects neutral scores across the sub-factors with the exception of organizational structure which carries moderate exposure (3) as the system's sizable and growing insurance operation, which accounts for approximately 50% of total system revenue, sits outside of the obligated group. However, the insurance operations inclusion in the systemwide gross revenue pledge and the high degree of integration and centralization of UPMC's operating model mitigate this risk. Governance is typical for a not-for-profit health system. Senior management is comprised of a mix of individuals with deep experience at UPMC and other large organizations. There is a long history of commitment to very good disclosure practices including voluntary compliance with all relevant provisions of the Sarbanes-Oxley Act since 2006. Also, well-developed integration competencies will reduce risks of future acquisitions or mergers. Finally, UPMC and the University are increasingly focused on their already strong relationship.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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