The Next Big Thing?

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THE NEXT BIG THING?

ABI WLC PANEL DISCUSSION

The Next Big Thing?

Today's Speakers

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The Next Big Thing?

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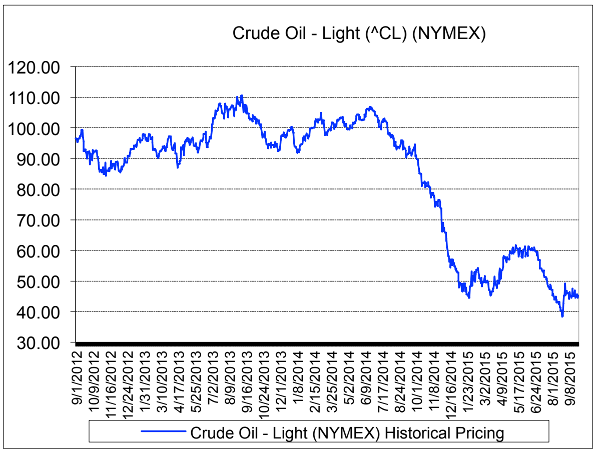
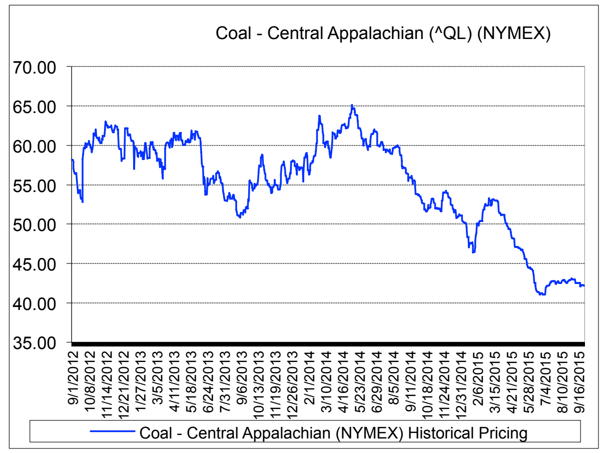
OIL & GAS

Oil & Gas Industry Observations

Historical Commodities Oil & Gas, Coal (CapIQ)





Dramatic decline in prices for oil, gas and coal are expected to be "Low or Lower for Longer" with the market continuing to seek the bottom prices

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Oil & Gas Industry Observations

This recovery is different than other recoveries as there has been a fundamental shift in the supply-demand fundamentals

- US production is up 63% Canada up 30% and the rest of the world is flat
- Global demand is down in part from China and other developing countries
- OPEC is not controlling pricing with reductions in production and strife in the Middle East has not impacted production
  - This may signal that preserving market share may be more important than price as well as putting pressure on the US shale production.
- New trading partners are emerging for example Mexican Energy Reform appears real with huge need for infrastructure so US-Canada-Mexico as well as Russia dealing with India and Asia
- M & A transactions will evolve and accelerate further influencing trade partners
- Recovery will be tempered by Global Behavior
- Innovation has been led by independents who will play a pivotal role in exploration and production
- National and integrated oil companies will seek to acquire assets, talent, and innovation. Investors with a long hold mentality will have plenty of opportunity to buy assets from cash strapped companies

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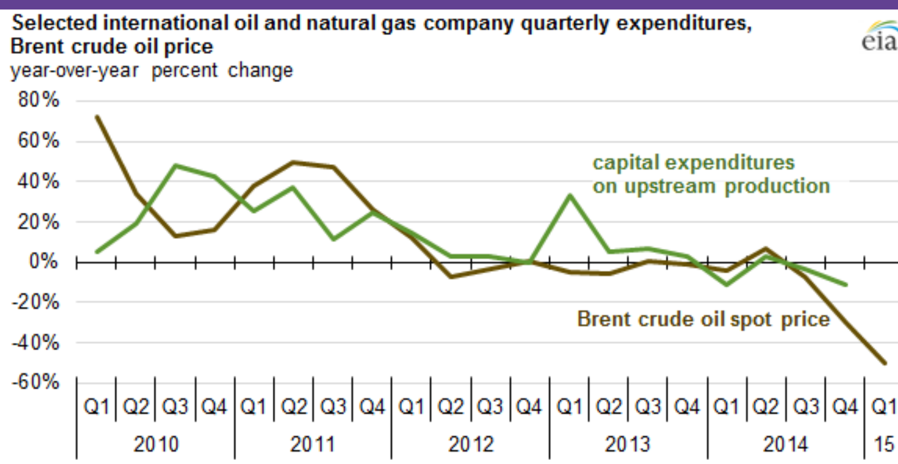
Oil & Gas Industry
Outlook for Restructuring

Capital Expenditure (U.S. Energy Information Administration)



Oil and gas companies are capital intensive and as such there is an insatiable need to find funding to drill and maintain leases. Financing has depended on the value and quality of reserves and the appetite of lenders to lend against those reserves

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Oil & Gas Industry
Outlook for Restructuring

Oil & Gas Trends

- This past year has seen management of companies cost cut, suspend drilling activity, sell noncore assets, limit capital spending, shut down uneconomic or low profit wells, renegotiate supplier contracts and close offices in an attempt to preserve and prioritize cash
- The "redeterminations" required by lenders secured with reserves, which occur in the spring and fall, will lead to reduced borrowing availability and cash will get even more critical
- The impact of these redeterminations and how lenders handle the borrowing exposure will impact the number of restructurings and out of court transactions
- Companies will retain professionals to negotiate most of the transactions converting debt to equity outside of court and use the Chapter 11 process to sell assets and implement the debt conversions to equity
- There will be a significant amount of litigation to enhance recoveries between creditors
- True unsecured creditors may be limited due to the very active M & M lien activity in this industry
- So far the suppliers have been able to anticipate and manage however this service sector will see its own filings and layoffs etc.
- Watching who comes to the table to buy assets will be very interesting

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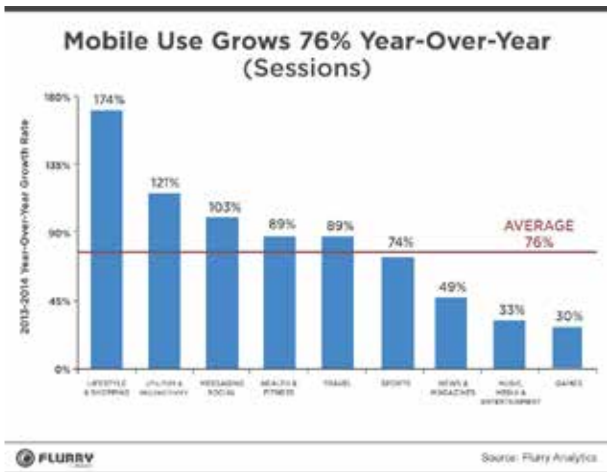
CONSUMER PRODUCTS & RETAILERS

Consumer Products & Retailers Observations

Industry Observations

- Consumers are increasing using mobile apps and bowser for shopping. The expanded use of the internet and technology has forced retailers and consumer products companies to change their operating models to provide seamless experience to todays connected consumers.



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Consumer Products & Retailers Key Trends

Omni Channel Operating Model

- Expand traditional retail landscape from physical footprints to encompass eComm and mobile

- rethink operating model to bridge the gap between the online and physical world in order to remain competitive
  - Pricing and promotions consistent across channels
  - Merchandising and assortment defined and buying planned at the enterprise level
  - Supply chain optimized to move product and provide visibility from source to fulfillment location
  - Customer relations - 360 view of customer utilized to offer personalized services
  - Distribution –Fast, flexible and personalized delivery to point of need
  - Inventory – Enterprise owned inventory visible and accessible across touch point

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Consumer Products & Retailers Key Trends

Customer Insight

- Advanced and predictive analytics improve understanding of customers
    - Leverage the explosion of data to better understand customers
    - reallocate talent and investment dollars to the channels driving growth
    - Use customer insight to change customer loyalty programs and rewards
    - Implement process and procedures to analyze all the data and do something with it

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Consumer Products & Retailers Key Trends

Real Estate Shift

- Assessing, aligning and repurposing physical space to manage costs and meet changing consumer demand
  - rethink real estate strategy as consumers shift their shopping patterns away from traditional stores
  - Take a customer centric view and focus beyond location for bricks and mortar stores
  - Focus on experience, personalization, speed and availability and format customization

Consumer Products & Retailers Key Trends

Cyber Risks

- Companies must anticipate and manage new risks
  - Recognize increased need for privacy protection as mobile payments, social networks and “Big Data” collection grow
  - Develop comprehensive security strategy and proactively manage breaches by implementing crisis management plans and tools

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Consumer Products & Retailers Key Trends

What Do These Trends Mean In The Restructuring World?

The environment has changed drastically in the last 3-5 years with information become exponentially more available about customer's preferences and choices

- Innovation is critical
  - Big players are innovating and trying to learn how to act and feel like small players to customers
  - Price point competition can be seen by the success of Family Dollar and Dollar Tree and Dollar General
  - Margins are thinner across the board and smaller retailers may not have the balance sheet to withstand the competition
  - Figuring out your problem or doing a self-assessment before you run out of cash is critical
    - Cash burn prediction and season performance will tell you how long you have to fix the problem.
    - Getting an FA in soonest can't be emphasized enough.

Consumer Products & Retailers Key Trends

Who Is At Risk?

- America is overstored – 45 retail sq. ft. / person. Second place UK 9 retail sq. ft. (http://www.forbes.com/sites/robinlewis/2014/03/24/the-great-retail-demassification-part-1/)

- Develop a strong Omni Channel so customers are driven to the brand and use a variety of channels in a customer shopping experience

- All retailers including big boxes need to develop a digital experience

- Anyone who is selling non unique products will be replaced by Amazon

- Small town retailers should avoid geographic areas that have large chains selling similar products

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Consumer Products & Retailers Key Trends

Who Is At Risk? (cont'd)

- Business structural changes can shake a company to its foundation and we will see more of this in the future – Examples are Musicland, Tower Records, Radio Shack –
  - Questions that you need to ask is who would care if this company failed and could customers get their products elsewhere?
  - Do they have customers buying?
  - Do they have a good product or distribution process?
  - Where is the value add?
  - Do they have supportive vendors?
  - Does the cost structure make sense?
  - Who are the competitors and how do they compete at our expense?
  - The business has to make sense in the current environment

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Consumer Products & Retailers Key Trends

Who Is At Risk? (cont'd)

- Once the problem has been identified, then an assessment needs to be made about whether or not the company has the liquidity to address the problem – then act
- Operational fixes are hard and require a great deal of time to implement
- Out of court is where most of these operation changes will occur for companies who succeed with the Bankruptcy code used to effect an implementation of lease rejection, capital structure, sale or liquidation

HIGHER EDUCATION

Top Five Trends: Education Industry

Trend	Key challenges
Effective education and outcomes	• Objective measures (higher earnings, job opportunities) easy to measure but insufficient • Measuring outcomes isn't easy (sustained learning, leadership, productive citizens) • Performance-based funding adopted by 30 states
Digital revolution – impact on business model	• Expanded ways to deliver "tailored" education to meet student preferences • Data mining and analytics provides new tools to monitor student learning and progress • Outsourcing services to third parties to develop and expand online programs (recruitment, curriculum development, student services)
Financial sustainability	• Trustees cite financial sustainability as most important issue • 89% of business officers focusing more on enrollment management • NACUBO foresees greater tuition discounting
Governance	• AGB National Commission on College and University Board Governance recommends improving value for students, focus more on long-range planning, rethinking power-sharing agreements with faculty and holding themselves accountable for board behavior, self-dealing and conflicts of interest
Compliance Issues	• Deferred maintenance cannot be ignored much longer • Compliance must be addressed • Risk assessment processes and management must be formalized

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Higher Education Trends

Is College Worth It?

- Studies done by the New York Federal Reserve, the Federal Reserve Bank of San Francisco and the Federal Reserve Bank of Cleveland find that the annualized "return on investment" in a college degree stands at about 15%, largely the same for several decades, and demonstrate that a college education pays off (and does so in spite of debt).
- Financial returns of a college education, though measurable, are not sufficient to prove whether its "worth it." **What matters: are colleges doing their job effectively in educating an employable student.**
- According to Inside Higher Education, 68.5% of adults say that college isn't worth the cost.
- The attention on student debt is partially driven by examples of debt burdened students that are not representative of the total graduate population. The share of income young adults are devoting to loan repayment has remained fairly steady over the last two decades, *New York Times* .
- The Brookings Institution shows that onerous debt burdens are not common; only 7% of young borrowers hold balances of $50,000 or more and less than 4% have loans of more than $100,000.

Higher Education Trends

Is College Worth It? (cont'd)

- The gradual public shift away from "Is college worth it?" to "How do I pick the best college for the return on my investment" will continue to keep the pressure on universities to substantiate academic quality and cost effectiveness
- Key performance indicators are being used increasingly to guide management and boards in assessing 'effectiveness' and 'value'
  - Evaluation of institutional performance is of increasing importance to higher education institutions
  - The best KPIs are those that measure outcomes
  - Monitor data-gathering and reporting practices
  - An annual risk assessment process

The gradual public shift away from "Is college worth it?" to "How do I pick the best college for the return on my investment?" will continue to keep the pressure on universities to substantiate academic quality and cost effectiveness

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Higher Education Trends

The Digital Revolution Will Continue to Change the Business Model

- According to the Online Learning Consortium, the number of academic leaders rating the learning outcomes in online education as the same or superior to those in face-to-face instruction grew from 57% in 2003 to 74% in 2013
- The number of students taking at least one online course (now 7.1 million) continued to grow at a rate far in excess of overall enrollments
- The Campus Computing Project reports that a small but significant (and growing) number of campuses are contracting with third-party providers for various services (recruitment, curricular development, student services) to help develop or expand their online programs
- More colleges are creating affiliated entities, says Inside Higher Ed, to offer online education such as those already offered by Harvard and MIT

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Higher Education Trends

Financial Sustainability

- The Association of Governing Boards of Universities and Colleges (AGB) governance survey of trustees, reported that **fiscal sustainability is *the* most important area to be addressed**
- According to an Inside Higher Education survey:
  - 66% of business officers believe higher education is in the midst of a financial crisis
  - with less than 25% having strong confidence in the sustainability of their institutions' financial model for the next five years
- Almost all business officers (89%) are focused more on enrollment management today than they did five years ago

Higher Education Trends

Governance Will Be Challenged as Never Before

- The changes in higher education will place stresses on traditional governance assumptions and lead to new ways for institutions to make decisions
  - The AGB recognized this reality when it set up its National Commission on College and University Board Governance to make fresh recommendations on the role of governing boards
- The commission's Consequential Boards report asks board members to restore public faith in higher education by improving value for students, focusing more long-term planning, rethinking the power-sharing agreements with faculty, and holding themselves accountable for bad board behavior including self-dealing and conflicts of interest
- Board members will need to be educated to provide effective oversight
  - An AGB survey found that three-quarters of college and university trustees say that online learning will be "important" or "essential" to their institutions within the next five years, but only about one in five says the board is prepared to make decisions about educational technology on campus

Higher Education Trends

Compliance Issues

- Deferred maintenance cannot be ignored much longer
  - A report by *The Chronicle of Higher Education* describes how maintenance has been neglected during the economic difficulties of the past five years
  - The 2014 annual report on facilities from Sightlines documents the growing backlog of deferred maintenance on university campuses
- Compliance must be addressed, particularly around sexual assaults
  - Leaders have struggled to find the right tone and policy, apparently thinking that the stricter the policy the less likely it will come under criticism
  - University of Virginia President Teresa Sullivan adopted one of the most direct approaches, facing the issue: "We have a problem and we are going to get after it"
- There will be a high cost to ignoring risk of any kind
  - A survey by AGB and United Educators found colleges and universities still lack "formal risk assessment processes"
  - The survey reports that while they are increasingly making oversight of institutional risk a priority, institutions' confidence that they are following good practices has decreased

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Four-Year Public Colleges & Universities

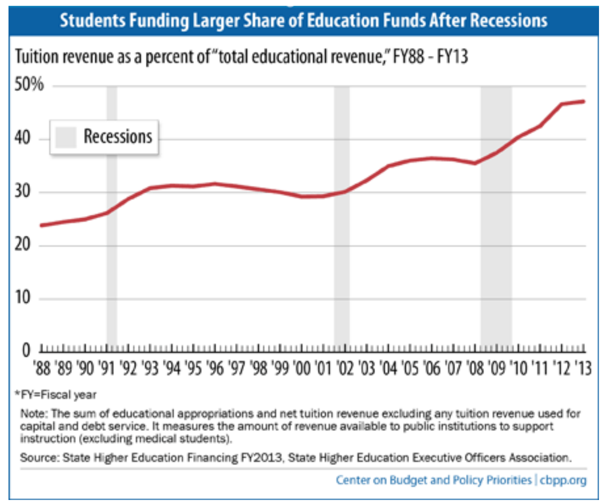
Summary

- Public universities will be more challenged than privates to grow operating revenue, with both tuition and state funding revenue growth hindered
- Public university operating margins have contracted in recent years, with median expense growth surpassing median revenue growth in both FY 2012 and FY 2013
- We forecast this trend to continue over the next 12-18 months as publics absorb growing expense pressures including post-retirement benefits
  - Flagships and large systems benefit from economies of scale and tuition diversification with higher paying out-of-state and international students
- In a few states, a growing proportion of state funding for higher education is designated for payment of pension and benefits, reducing availability of funds for general operating support
- Stand-alone regional public universities, with limited revenue diversification, will be more challenged as they will be increasingly competing with community colleges and other educational or employment options

Moody's Outlook Negative Since January 2013 Current Trends 2015

Key Takeaways

- Price sensitivity, as evidenced by the ongoing national discourse on college affordability, will constrain net tuition revenue growth
- State funding for public universities will grow, but remain lower than historic levels and may come with strings attached
- Revenue growth will decline, pressuring operating performance
  - Moody's predicts the annual change in aggregate operating revenue for four-year colleges and universities will decline and remain below 3% over the next 12-18 months, supporting the negative sector outlook



Moody's Outlook Negative Since January 2013 Current Trends 2015

Key Takeaways (cont'd)

Changing educational delivery models and online education intensify competition

- The ongoing evolution of online education and other changes to educational delivery models will increase uncertainty in an already competitive landscape
- These changes will present the most risk for colleges that lack distinctive brands and have weak student selectivity

Competition for research and patient care funds intensifies, but academic medical centers are well positioned

- Research funding will be increasingly competitive to secure
- Even top research universities are budgeting conservatively for grants and contracts
- Gifts and grants from individuals, corporation and private foundations will increasingly fund research activity
  - These private funding sources tend to provide more limited indirect cost recovery (administration and facilities expenses), if any, further challenging top line revenue growth for research-intensive institutions
- Philanthropy, particularly for biomedical research, remains strong, and gift revenue at academic medical center universities is much higher than the broader higher education universe

Ten Actions to Respond to the Risks and Challenges to Sustained Financial Performance

- Develop relevant strategy that is linked to financial projections that guide informed decisions
- Strongly consider opportunities for mergers, acquisitions of programs and affiliations with educational and private businesses
- Define unique market niche and core strengths to build on
- Analyze and understand instructional costs
- Leverage technology in all ways possible
- Define the institution's key risks to achieving goals, protecting reputation and sound financial stewardship
- Measure performance of key student, faculty and institutional indicators
- Develop student outcome metrics
- Analyze student markets to increase the percentage of applicants with a very strong interest in the institution (i.e. self-selecting you)
- Strengthen board knowledge of risks and trends and involvement is strategy

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THE TRUST INDENTURE ACT -- NEW INTERPRETATIONS OF AN OLD LAW AND THE FUTURE OF OUT OF COURT RESTRUCTURINGS

What is the Trust Indenture Act of 1939?

Overview

- Depression era statute enacted in response to perceived inequities in the public debt markets

- In general, the TIA requires appointment of a suitably independent and qualified trustee to act for the benefit of public holders of debt securities, and specifies various substantive provisions for the trust indenture that must be entered into by the issuer and the trustee

Prohibition Against Non-consensual Debt Restructurings

TIA Section 316(b) Information

- TIA Section 316(b) provides:

  "Notwithstanding any other provision of the indenture ... the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder ... ."

- Given that the statute was enacted in 1939, there is surprisingly little case law interpreting Section 316(b)

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Prohibition Against Non-consensual Debt Restructurings

TIA Section 316(b) Recent Updates

- Until recently, many practitioners were either unaware of TIA §316(b) or counseled that it prevented only non-consensual changes to a holder's legal right to receive payment of principal or interest
  - For example, exchange offers have frequently been coupled with a consent solicitation to modify or eliminate various protective covenants
  - Such exit consents have been effective tools to reduce the incentive to holdout and not participate in an exchange offer that is acceptable to a majority of creditors

- Two recent decisions in the Southern District of New York, however, have interpreted § 316(b) as providing broad protections against not only changes to a holder's legal right to payment, but against any corporate action that would threaten the holder's practical right to get paid
  - *Marblegate Asset Management v. Education Management Corp.* (S.D.N.Y. 2014)
  - *BOKF v. Caesars Entertainment Corporation* (S.D.N.Y 2015)

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Education Management Corporation

Case Overview

- Education Management Corporation and its affiliated entities ("EDMC") sought to restructure approximately $1.5 billion of debt. EDMC was effectively precluded from filing for bankruptcy because doing so would have rendered EDMC ineligible for federal funding under Title IV of the Higher Education Act of 1965

- EDMC's debt consisted of $1.553 billion of secured debt and $217 million of unsecured notes that were issued by a subsidiary and guaranteed by the parent company. The indenture for the unsecured notes provided that the parent guarantee could be released either by majority vote of the unsecured noteholders or by a corresponding release of the separate parent guarantee in favor of the secured lenders. For this reason, the offering circular for the notes warned investors not to assign any value to the parent guarantee

Education Management Corporation

Agreement Details

- After reaching agreement with the holders of about 80% of both its secured and unsecured debt, EDMC went forward with a proposed exchange offer and consent solicitation that offered secured creditors a 55% recovery and unsecured creditors a 33% recovery. Recognizing that 100% of unsecured creditors may not consent to the proposed restructuring, the offering materials disclosed that, in the absence of 100% consent, the company would implement an alternative transaction, under which:
    - the secured lenders would release the parent guarantee of their loans, triggering the automatic release of the parent guarantee of the unsecured notes,
    - the secured lenders would foreclose on substantially all of EDMC's assets,
    - the secured lenders would sell the assets back to a new subsidiary of EDMC,
    - the new subsidiary would distribute debt and equity to the consenting creditors consistent with that proposed in the exchange offer; and
    - the dissenting creditors would receive no payment on their unsecured notes

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Education Management Corporation

Final Rulings

- EDMC argued that § 316(b) was not implicated because (i) the guarantee was removed in accordance with the indenture itself and did not require any noteholder's consent and (ii) the alternative transaction did not alter or amend the indenture or a dissenting holders' legal right to payment

- The Court, however, held that § 316(b) protects not only a holder's narrow legal right to payment, but also its practical ability to get paid

- As the alternative transaction left dissenting holders with only a legal right to payment from a now worthless subsidiary, the Court held it was "precisely the type of debt reorganization that the Trust Indenture Act was designed to preclude," and denied the defendant's request to remove the parent guarantee

- The District Court's decision is now on appeal to the Second Circuit

Caesars Entertainment Corporation

Case Overview

- Caesars Entertainment Corporation ("CEC"), along with its subsidiaries, including Caesars Entertainment Operating Company, Inc. ("CEOC"), own and manage dozens of casinos in the United States

- CEC acquired CEOC in January of 2008 in a $30 billion LBO transaction that left CEOC with $22 billion of debt, most of which was guaranteed by CEC. At the time, CEOC was CEC's only asset

- Like EDMC, CEC has maintained that its guarantee of CEOC's debt was one of convenience and done principally to allow for consolidated financial statements. The indentures covering about $12 billion of first and second lien debt provided that the CEC guarantee would automatically terminate if CEOC were no longer a Wholly Owned Subsidiary of CEC (expressly defined to mean 100% owned by CEC)

Caesars Entertainment Corporation

Reasons For Filing

- Beginning in 2013, CEC and CEOC engaged in a number of transactions ostensibly designed to de-lever CEOC and provide it with additional liquidity. Among other things, these transactions resulted in the transfer of several properties and assets from CEOC to newly formed subsidiaries of CEC* as well as 5% of CEOC's equity to third parties and an additional 6% of CEOC equity to fund an Employee Stock Option Plan

- First and second lien bondholders filed suit in the Southern District of New York demanding that CEC pay on its guarantee and, among other things, moved for summary judgment asking the Court to find that CEC's guarantee of CEOC's debt was not automatically terminated when CEOC ceased to be a Wholly Owned Subsidiary because terminating the guarantee would violate the TIA

*The propriety of CEOC's asset transfers is beyond the scope of this note, but it is safe to say that it is a matter of much dispute and the subject of current litigation in CEOC's chapter 11 case (commenced in January 2015).

Caesars Entertainment Corporation

Recent Rulings

- In a recent decision, although Judge Scheindlin refused to rule as a matter of summary judgment that the TIA prevented the termination of CEC's guarantee, she did express a view that the TIA provides very broad protection against any practical, and not just legal, impairment of a note holders right to receive payment
- Recognizing the importance of the issue and the split among lower courts that have considered it, Judge Scheindlin certified her decision denying summary judgment for interlocutory appeal to the Second Circuit and noted that the following questions are ripe for Circuit Court level review:
  - "First, what rights does section 316(b) of the TIA protect? Does it protect noteholders' practical rights to principal and interest, as this Court and several others have held, or only their legal rights, as other courts have concluded?"
  - "Second, assuming that section 316(b) protects more than a bare legal right, what is the appropriate standard to assess impairment? Must plaintiffs show that a nonconsensual out-of-court restructuring occurred? If so, must there be an amendment to the debt instrument itself?" Id.
  - "Third, as of when (and how) should the impairment be evaluated? Must a court evaluate each transaction separately at the time it was undertaken? Or is the impairment to be evaluated as of the date for demand of payment? May a court consider multiple transactions collectively?" Id.
- As of the writing of this note, the Second Circuit has not yet stated whether it will accept the interlocutory appeal or, as has also been requested, whether it will incorporate it and hear it as part of the pending EDMC appeal

HEALTHCARE

Healthcare Overview

Macro Economics

- The health care industry is one of the world's largest and fastest-growing industries

- Consumes over 10 percent of gross domestic product (GDP) of most developed nations
  - Can form an enormous part of a country's economy
  - Total FYE 2015 budget was $1 trillion, 52% of which was allocated to Medicare
  - 25% of the total US federal government budget

- Total US health expenditure (sum of public and private health expenditure) is approximately 17% of GDP, among the highest in the world

- According to the most recent data available from the World Bank, the US spent $9,146 / capita on healthcare, only Norway and Switzerland were higher at $9,700 and $9,200 respectively

Healthcare Overview

Market Defined (Sectors)

- Hospitals
- Medical and dental practices
- Health care equipment and services
  - Companies that provide medical equipment, medical supplies, and health care services, such as hospitals, home health care providers, and nursing homes
- Pharmaceuticals, biotechnology and related life sciences
- Other
  - Nurses, midwives, physiotherapists, scientific or diagnostic laboratories, pathology clinics, residential health facilities, or other allied health professions, e.g. optometry, hydrotherapy, medical massage, yoga therapy, music therapy, occupational therapy, speech therapy, chiropody, homeopathy, chiropractors, acupuncture, etc

Healthcare Overview

Regulatory Environment

- Budget Control Act of 2011 (“BCA”) established budget sequestration in 2013 (automatic spending cuts to federal spending on select outlays)
  - Medicare reduced by a fixed 2% per year versus percentages relating to other categories of spend

- Patient Protection and Affordable Care Act (“ACA”)
  - Attempts to tie reduction in payment rate updates to economy-wide multifactor productivity
  - Specifies payments updated annually by the increase in CPI be reduced by the percentage of the 10-year moving average increase in private nonfarm business multifactor productivity
    - Rate of increase which was 3% now will be < 2%
  - The Centers for Medicare & Medicaid Services (“CMS”), federal agency that runs Medicare, is changing reimbursement process to incenting hospitals for quality and value
    - Example: Deducts for re-admits (measure of poor performance)
  - Imposes reductions on top of Sequestration

- Massive fixed costs subject to interest rate, wage and general inflation—need volume to adapt in the interim but must to transition to lower acuity settings for long term survival

Healthcare Overview

Drivers of Distress

- Reduced and/or delayed reimbursements
- Litigation; tort and labor
- Management issues
  - Changing landscape…failure to act
  - Not a crash and burn, a slow decent to a crash landing/failure
- Failed / bad mergers
- Future drivers; interest rate increases, changing reimbursement, and continued competition for volume

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Healthcare Overview

Market Reaction

- Substantial M&A activity across all sectors
  - Access to capital
  - Alignment within the continuum of care; doctors, ambulatory care, rehab, home health
  - IT costs
  - Leverage organizational costs
  - Ability to "communize" practices

- Government influence in the sale and bankruptcy process. What are the risks and how can they be managed?
  - CMS has significant influence
  - 9-12 month process to qualify a hospital / provider…delayed reimbursement
  - DILIGENCE, DILIGENCE, DILIGENCE; negotiate limitation of offset/recoupment; include risk of recoupment in valuation; negotiate willingness to use a temporary provider number (risk: lenders may be incented to favor liquidation vs. sale due to higher recoveries)

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Healthcare Overview

Who Survives?

- Large regional systems (likely urban), potentially within insured platforms
  - Greater access to capital to consolidate and control costs and supply chains
  - Ability to attract doctors and network to provide patient flow

- Accountable Care Organizations ("ACO")
  - Shift in reimbursement from procedure-based, fee-for-service to fee-for-quality, disease or condition-based reimbursement with capitated payment to healthcare delivery organizations on a per-case and per-capita basis

- Balancing commercially insured vs. Medicare patients, while attractive is not enough. Must reduce costs via communization of procedures and practices across the network. Raising rates of the commercially insured to pay for Medicare/Medicaid shortfalls not a viable long term strategy

Healthcare Overview

Who Survives? (cont'd)

- Rural hospitals; can they be full service? No. Immediate or emergent care but they have to concentrate specialties
  - Need rehab and family medicine, and home health services, out-patient procedures; low acuity
  - Tele-medicine

- Serving the disadvantaged and fulfilling non-profit missions has to be supplemented by foundations etc.

- How might the US Government react to financial distress?
  - Trade off between consolidation v. anti-trust/anti-competition
  - Will it adjust/modify the impact to "save" hospitals
  - State v. Federal

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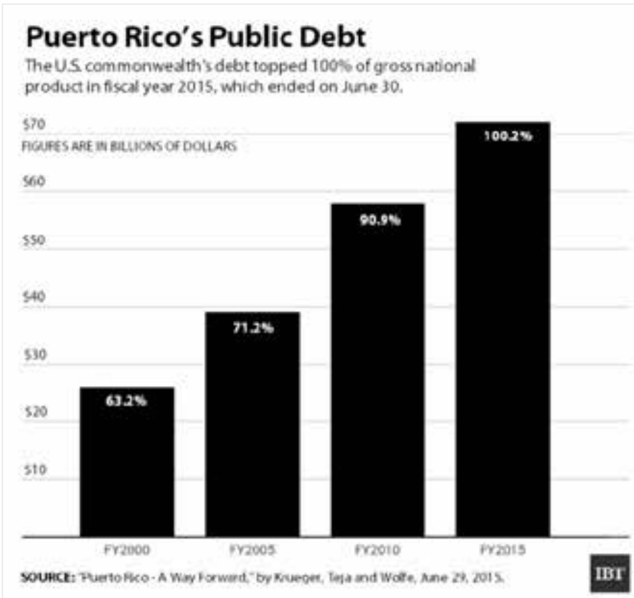
PUERTO RICO

Puerto Rico's Recession

Puerto Rico's Economy Has Been In Recession For Almost 10 Years



- Public sector debt has grown every year since 2000 now stands at $72 billion and 100% of GDP
- Optimistic projections and poor expenditure control – annual revenue projections have systematically underestimated tax revenues by $1.5 billion per year
- Tax Bargaining – to manage inevitable cash crunch Treasury negotiates tax amnesties and tax for pre-payments
- Ineffective monitoring – accounting systems simply incapable of providing reliable real-time data

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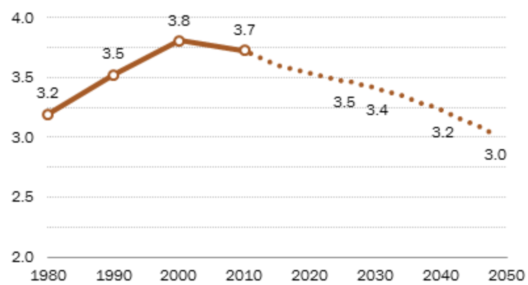
Puerto Rico's Recession

Puerto Rico's Population Decline

Puerto Rico's Population Projected to Decline Through 2050

In millions



Note: Solid line represents decennial census population counts; dotted line represents population projections. Data labels are for 1980, 1990, 2000, 2010, 2025, 2030, 2040 and 2050.

Source: U.S. Census Bureau population projections for Puerto Rico (http://1.usa.gov/WGdgwP) and Decennial Censuses (1980,1990, 2000,2010), Integrated Public Use Microdata Series (IPUMS)

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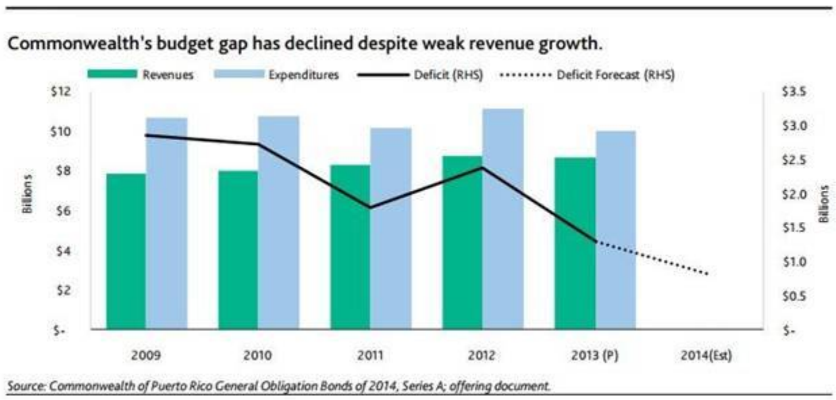
- Outmigration averaging 48,000 people per year since 2010 and expected to shrink 1% per year through at least 2020
- Remaining population is increasingly elderly and outside the labor force – only 40% of the adult population (versus 63% on the US mainland) is employed or looking for work
- 46% of the population lives below the poverty line and 39% of the population receives government assistance for living expenses (up from 37% in 2012 and 34% in 2004)
- Employers disinclined to hire – US minimum wage is very high relative to local average (77% of work force earns equivalent of minimum wage versus 28% on mainland) and local regulations for overtime, paid vacation and dismissal are costly and more onerous than on mainland
- Workers disinclined to take jobs – welfare system provides benefits that often exceeds minimum wage employment (household of 3 eligible for food stamps, AFDC, Medicaid and utilities subsidies could receive $1,743 per month versus take-home from minimum wage of $1,159)

Puerto Rico's Recession

Puerto Rico's Budget Deficit



- Significant projected funding shortfalls and no further access to capital markets
  - Without significant reform, Government projects its expenditures will exceed its revenues by $27.8 billion over the next 5 years
  - Even with proposed reform measures, Government projects a funding gap of $15.9 billion over the next 5 years
- Given the size of the funding gap, Puerto Rico will need significant debt service relief

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Puerto Rico's Recession

Conclusion

- No existing framework for restructuring Puerto Rican debts
  - Currently, only state municipalities are eligible to restructure their debts under chapter 9 of the bankruptcy code
  - Puerto Rican legislature drafted its own insolvency law in 2014, but that law was held to be unconstitutional (appeal is pending)
- Possible Federal Action
  - Bills are pending in the House and Senate to treat Puerto Rico as a state for chapter 9 purposes – political support for the bills is currently unlikely and, even if passed, chapter 9 would only be available for Puerto Rico municipalities and instrumentalities and not for the Commonwealth itself (would be very good news for the GO bonds though)
  - Impose Financial Control Board
  - Bridge financing or federal guarantee (not likely as a stand alone, but support might be found if coupled with a financial control board or other oversight)

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