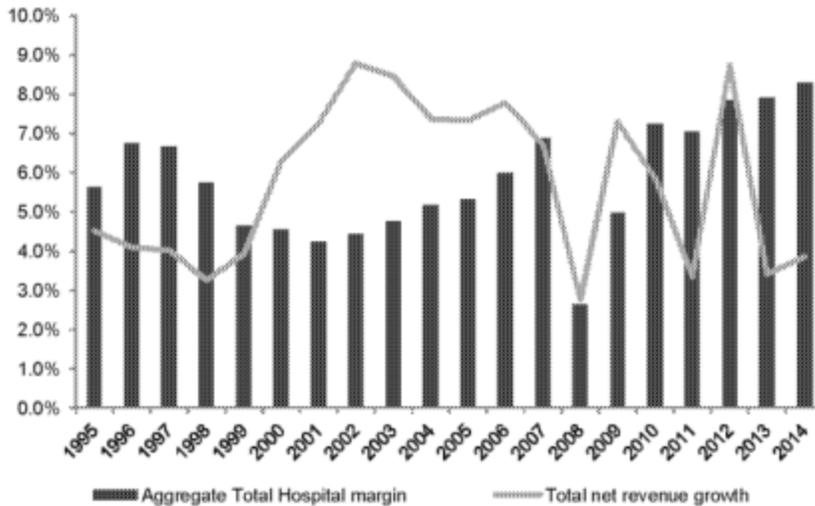




Figure 22: U.S. hospital revenue and margin trends



Source: Deutsche Bank, American Hospital Association

Affordable Care Act

The Affordable Care Act reduced the amount of uncompensated care (UCC) provided by hospitals by \$7.4B to \$27.3B in 2014, according to the US Department of Health and Human Services (HHS). These figures are based on estimated decreases in the total number of uninsured and expanded Medicaid coverage. \$5.0B of UCC reduction was due to the expansion of Medicaid in 28 states and Washington D.C., which is a 26% reduction in baseline UCC costs. The remaining \$2.4B is from the 22 Medicaid non-expansion states, which is a 16% reduction in baseline UCC costs. Additionally, HHS projected incremental \$1.4B of UCC savings if Medicaid non-expansion states increased their coverage similarly to expansion states.

From the hospitals' perspective, 6.1% of total expenses were due to UCC costs. These costs are classified as bad debt expense and charity care, which are defined by the HHS as:

- * "Bad debt refers to an amount hospitals anticipated receiving for services but in fact never received"
- * "Charity care is the value of services rendered for which hospitals never anticipated receiving payment, because the patient's inability to pay was determined early in the course of care"

Uncompensated care is largely federally funded through Medicare and Medicaid. In 2013, \$13.5B was from Medicaid disproportionate share hospital (DSH) and upper payment limit (UPL) payments, while \$8B was from Medicare DSH, bad debt, and indirect medical education payments.

In light of the increase in insured patient volumes and subsequent decline in UCC costs, the ACA enacted reductions in the Medicare and Medicaid reimbursement rate to hospitals. We believe the impact of the reduction in UCC costs should outweigh the impact of reduced reimbursement rates resulting in a net positive impact on hospital financials, though the tailwind from falling UCC costs cycled in late 2015 and we would not expect material upside to growth going forward from this factor.