



Q4'2013 Earnings Review

Key points

- Solid results despite challenging volume backdrop. Q4 EBITDA was previewed earlier in January, so the real news in Q4 results was more detail on operating metrics and HCA's outlook. In the context of a very weak volume environment, HCA's Q4 EBITDA growth (+6.7% YoY) is very respectable and reflects strong expense management and improving pricing/mix.
- We are particularly encouraged by HCA's recent quarterly surgical trends (see Figure 3). While Q4 same-store inpatient admissions and adjusted admissions dipped 1.8% and 1.0% YoY, respectively, HCA's Q4 SS surgeries improved +1.4% YoY (+1.6% outpatient surgery / +0.9% inpatient surgery) and helped drive revenue per adjusted admissions (RPAA) pricing growth of +4.8% YoY. This marks the third consecutive quarter of improving surgeries, and we believe any sustained trend in surgical volume could represent an upside risk to 2014 guidance. DB's Hospital Volume survey has picked up recent strength in surgeries, too.
- 2014 guidance seems like a reasonable, but conservative starting point. HCA guided for EBITDA of \$6.6-\$6.85 billion (vs. consensus of \$6.82 billion). Guidance reflects SS revenue growth of 3%-5% (vol 1-2% / pricing/mix 2-3%), flat margins and ~300 bps of EBITDA growth headwinds from lower HITECH and higher stock-based comp. ACA adds ~1.5% to growth (at the mid-point) or ~\$100M. Organic/base growth works out to be ~2% to ~5% growth adjusting for the headwinds and ACA.
- Framework for ACA impact still evolving, with lots of moving parts to HCA's key assumptions. HCA's 2014 outlook assumes ACA benefit of 1-2% of EBITDA (\$65M-\$135M), although it is back-half (Q3/Q4) weighted. HCA said it would re-visit its key assumptions by mid-year at the earliest, but its high-level base case is for 7-9% reduction in uninsured, but partially offset by declines in pricing/volume from exchange mix. The key variables that HCA is tracking for its reform model are: (1) enrollment figures for exchanges and Medicaid expansion; (2) the proportion of enrollment that is net newly insured; (3) health plan selection (metallic), network design and network participation for the exchanges; and (4) out-of-network activity. Our sense is that the offsets built into HCA's model could prove conservative given the strength of its networks (i.e. less impact from narrow network if its access points such as ED are more convenient). Given the slow ramp of exchange enrollment in key markets (FL / TX) and HCA's lower exposure to Medicaid expansion states, we believe 7-9% reduction of uninsured patient mix seems like a reasonable starting point.
- Reiterate Buy rating / \$58 price target. We see HCA as a best-in-class operator with strong assets, a flexible balance sheet and a good track record for opportunistic capital deployment.

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We believe any sustained trend in surgical volume could represent an upside risk to 2014 guidance

Adjusting for certain non-operating headwinds and ACA, HCA's 2014 guidance assumes organic/base growth of ~2% to ~5% growth

HCA's 2014 outlook assumes ACA benefit of 1-2% of EBITDA (\$65M-\$135M), although it is back-half (Q3/Q4) weighted