Analysis of the Reasonableness of Assumptions Used For and Feasibility of Projected Financials of:

Heywood Healthcare, Inc.
For the Years Ending September 30, 2021
Through September 30, 2029

Tel: 617-422-0700
Fax: 617-422-0909
www.bdo.com

One International Place
Boston, MA 02110-1745

July 9, 2021

Michael R. Abbatiello, MPPM, CPA
VP of Finance, CFO, and Assistant Treasurer
Heywood Healthcare, Inc.
242 Green Street
Gardner, MA 01440

RE: Analysis of the Reasonableness of Assumptions and Projections Used to Support the Financial Feasibility and Sustainability of the Proposed Project

Dear Mr. Abbatiello:

Enclosed is a copy of our report on the reasonableness of assumptions used for and feasibility of the financial projections for Heywood Healthcare, Inc. Please contact me to discuss this report once you have had an opportunity to review.

Sincerely,

BDO USA, LLP

TABLE OF CONTENTS

Page

Tel: 617-422-0700
Fax: 617-422-0909
www.bdo.com

One International Place
Boston, MA 02110-1745

July 9, 2021

Michael R. Abbatiello, MPPM, CPA
VP of Finance, CFO, and Assistant Treasurer
Heywood Healthcare, Inc.
242 Green Street
Gardner, MA 01440

RE: Analysis of the Reasonableness of Assumptions and Projections Used to Support the Financial Feasibility and Sustainability of the Proposed Project

Dear Mr. Abbatiello:

We have performed an analysis related to the reasonableness and feasibility of the financial projections (the "Projections") of Heywood Healthcare, Inc. ("Heywood" or "the Applicant") related to its Determination of Need ("DON") filing related to the construction of a new perioperative surgical care pavilion (the "Proposed Project"), described further below. This report details our analysis and findings with regards to the reasonableness of assumptions used in the preparation of the Projections and feasibility of the projected financial results prepared by the management of Heywood ("Management"). This report is to be used by Heywood in connection with its DON Application – Factor 4 and should not be distributed or relied upon for any other purpose.

I. EXECUTIVE SUMMARY

The scope of our review was limited to an analysis of the nine-year financial projections for the Applicant for the fiscal years ending 2021 through 2029 prepared by Management and the supporting documentation in order to render an opinion as to the reasonableness of assumptions used in the preparation and feasibility of the Projections.

The Projections exhibit a cumulative operating EBITDA surplus of approximately 6.0 percent of cumulative projected revenue for Heywood for the nine years from fiscal year ("FY") 2021 through FY 2029. Based upon our review of the relevant documents and analysis of the Projections, we determined the anticipated operating EBITDA surplus is a reasonable expectation and based upon feasible financial assumptions. Accordingly, we determined that the Projections are reasonable and feasible, and not likely to have a negative impact on the Applicant's patient panel or result in a liquidation of Heywood's assets. A detailed explanation of the basis for our determination of reasonableness and feasibility is contained within this report.

II. RELEVANT BACKGROUND INFORMATION

Heywood Healthcare is the parent and operates exclusively for the benefit of (1) Henry Heywood Memorial Hospital (the "Hospital"), which is a not-for-profit acute care hospital located in Gardner, Massachusetts providing inpatient, outpatient, and emergency care services for residents of central Massachusetts, (2) Heywood Medical Group, Inc. ("HMGI"), which operates several physician practices in north central Massachusetts, (3) Athol Memorial Hospital ("Athol"), which is an acute care, critical access not-for-profit community hospital providing inpatient, outpatient, and emergency care for residents of Worcester and Franklin counties, (4) Heywood Healthcare Charitable Foundation, Inc. (the "Charitable Foundation"), which acts on behalf of the Applicant for all fundraising initiatives, (5) Quabbin Healthcare ("Quabbin"), which is a not-for-profit behavioral health and addiction recovery facility located in Petersham, Massachusetts, (6) Athol Memorial Hospital NMTC Holdings, Inc. ("NMTC"), which is a not-for-profit corporation organized to promote the development and construction of Athol's various capital projects, and (7) Heywood Hospital Realty Corporation (the "Realty Corp."), which owns certain medical office buildings.

The Applicant proposes to construct a perioperative surgical pavilion. The Proposed Project is a 40,115 square foot addition with six operating rooms ("ORs"), a central core for storage of sterile instrumentation, separate clean and dirty elevators for transport of instrumentation to the central sterile processing department, 21 pre/post procedure rooms, and medical office space to accommodate multiple outpatient surgical specialty clinics. The Applicant's current surgical suite has remained largely unchanged since it was constructed in 1961. The new ORs will be larger than the existing four ORs and will be able to accommodate new, specialized equipment and will include laminar flow, considered best practice for surgical site infection prevention in orthopedic surgery. The current ORs are too small to accommodate certain pieces of equipment which limits the types of procedures that can be performed. Additionally, the inclusion of outpatient clinic space for procedural-based specialties will provide greater convenience and an enhanced experience for patients.

III. SCOPE OF REPORT

The scope of this report is limited to an analysis of the nine-year financial projections for Heywood, the Applicant, for the fiscal years ending 2021 through 2029, prepared by Management, and the supporting documentation in order to render an opinion as to the reasonableness of assumptions used in the preparation and feasibility of the Projections. Reasonableness is defined within the context of this report as supportable and proper, given the underlying information. Feasibility is defined as based on the assumptions used the

Proposed Project is not likely to result in a liquidation of the underlying assets or the need for reorganization.

This report is based on prospective financial information provided to us by Management. BDO understands the prospective financial information was developed as of June 18, 2021 and represented the most current version of detailed multi-year prospective financial information available at the time BDO performed its procedures and is still representative of Management's expectations as of the drafting of this report. BDO has not audited or performed any other form of attestation services on the projected financial information related to the operations of Heywood.

If BDO had audited the underlying data, matters may have come to our attention that would have resulted in our using amounts that differ from those provided. Accordingly, we do not express an opinion or any other assurances on the underlying data presented or relied upon in this report. We do not provide assurance on the achievability of the results forecasted by the Applicant because events and circumstances frequently do not occur as expected, and the achievement of the forecasted results are dependent on the actions, plans, and assumptions of Management. We reserve the right to update our analysis in the event that we are provided with additional information.

IV. SOURCES OF INFORMATION UTILIZED

In formulating our opinions and conclusions contained in this report, we reviewed documents produced by Management as well as third party industry data sources. The documents and information upon which we relied are identified below or are otherwise referenced in this report:

1. Financial Model for the Applicant for the periods ending September 30, 2019 through September 30, 2029;
2. FY21 Proposed Budgets Presentation to the Finance Committee, dated September 21, 2020;
3. Surgical Pavilion Update Presentation to the Board of Trustees, dated January 21, 2021;
4. Surgical Pavilion Update Presentation to the Finance Committee, dated January 5, 2021;
5. Surgical Pavilion Update Presentation to the Finance Committee and Board of Trustees, dated June 2020;
6. Heywood Hospital Surgical Pavilion Budget Estimate from Consigli, dated June 21, 2021;
7. Audited Consolidated Financial Statements for Heywood Healthcare, Inc. for Years Ended September 30, 2020 and 2019;
8. Audited Consolidated Financial Statements for Heywood Healthcare, Inc. for Years Ended September 30, 2019 and 2018;
9. Audited Consolidated Financial Statements for Heywood Healthcare, Inc. for Years Ended September 30, 2018 and 2017;
10. Audited Consolidated Financial Statements for Heywood Healthcare, Inc. for Years Ended September 30, 2017 and 2016;
11. Actual to Budget Comparison for the Periods Ending September 30, 2019, September 30, 2020, and May 31, 2021;
12. Internal Financial Statements for the Month Ending May 31, 2021 for the Applicant;
13. Construction Loan Interest Detail from Waterstone Properties;

14. Heywood Hospital Investment Policy, approved May 25, 2021;
15. Lease Between Heywood Green Street, LLC and Henry Heywood Memorial Hospital, Inc.;
16. Public Announcement Concerning a Proposed Healthcare Surgical Pavilion Project;
17. 2018 Tax Return for Henry Heywood Memorial Hospital;
18. Articles of Incorporation for the Applicant, dated May 14, 1907;
19. Certificate of Change of Directors or Officers of Non-Profit Corporations for the Applicant, dated May 20, 2013;
20. Draft Determination of Need Application and Supporting Files for the Applicant;
21. RMA Annual Statement Studies, published by The Risk Management Association;
22. Definitive Healthcare data;
23. IBISWorld Industry Report, Hospitals in the US, dated January 2021; and
24. Determination of Need Application Instructions dated March 2017.

V. <u>REVIEW OF THE PROJECTIONS</u>

This section of our report summarizes our review of the reasonableness of the assumptions used and feasibility of the Projections.

The following tables present the Key Metrics, as defined below, which compare the operating results of the Projections to market information from RMA Annual Studies (“RMA”), IBISWorld, and Definitive Healthcare as well as the Applicant’s historical performance, to assess the reasonableness of the projections.

Key Financial Metrics and Ratios	Projected								
Heywood Healthcare, Inc.	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Profitability									
Operating Margin (%)	0.7%	1.8%	1.8%	1.7%	1.0%	1.1%	1.2%	1.1%	1.0%
Excess Margin (%)	2.9%	2.2%	2.1%	2.1%	1.4%	1.5%	1.6%	1.5%	1.4%
Debt Service Coverage Ratio (x)	3.0x	4.1x	4.2x	4.3x	3.8x	4.0x	4.2x	4.2x	4.2x
Liquidity									
Days Available Cash and Investments on Hand (#)	120.0	71.5	79.5	85.6	87.9	91.8	95.8	99.3	102.6
Operating Cash Flow (%)	5.4%	4.9%	4.9%	4.9%	4.2%	4.3%	4.3%	4.2%	4.2%
Solvency									
Current Ratio (x)	1.1x	1.1x	1.1x	1.2x	1.2x	1.2x	1.2x	1.3x	1.3x
Ratio of Debt to Total Capitalization (%)	48.6%	46.8%	44.8%	42.5%	40.6%	38.7%	36.8%	34.9%	33.1%
Ratio of Cash Flow to Debt (%)	16.5%	15.9%	16.5%	17.4%	15.8%	17.4%	18.7%	19.6%	20.7%
Unrestricted Net Assets ($ in millions)	$ 75	$ 80	$ 85	$ 90	$ 94	$ 98	$ 102	$ 106	$ 110
Total Net Assets ($ in millions)	$ 81	$ 87	$ 92	$ 98	$ 102	$ 106	$ 111	$ 115	$ 119

Key Financial Metrics and Ratios	Actual					Industry Data (1)		
Heywood Healthcare, Inc.	**2016**	**2017**	**2018**	**2019**	**2020**	**RMA - Medical and Surgical Hospitals**	**IBIS - Hospitals in the US**	**Definitive Healthcare**
Profitability								
Operating Margin (%)	0.7%	-0.9%	-1.9%	0.9%	1.6%	2.2%	16.3%	-7.6%
Excess Margin (%)	1.8%	0.5%	-0.9%	1.3%	1.8%	1.1%	7.6%	1.4% (2)
Debt Service Coverage Ratio (x)	2.5x	1.6x	1.0x	2.5x	3.3x	NA	1.2x	NA
Liquidity								
Days Available Cash and Investments on Hand (#)	82.1	82.8	73.3	75.4	138.6	NA	NA	17.0
Operating Cash Flow (%)	9.3%	5.5%	3.4%	3.8%	4.6%	NA	55.7%	NA
Solvency								
Current Ratio (x)	1.0x	1.0x	1.0x	1.1x	1.1x	1.9x	1.1x	1.2x
Ratio of Debt to Total Capitalization (%)	26.3%	24.8%	44.8%	44.2%	50.7%	42.3%	NA	NA
Ratio of Cash Flow to Debt (%)	66.4%	43.1%	11.6%	13.3%	12.4%	NA	NA	NA
Unrestricted Net Assets ($ in millions)	$ 58	$ 61	$ 62	$ 64	$ 68	NA	NA	NA
Total Net Assets ($ in millions)	$ 65	$ 68	$ 69	$ 71	$ 74	$60	NA	NA

Footnotes:

(1) Industry data ratios based on each data source's respective definitions and may differ from the ratio definitions listed below.

(2) Profit before taxes margin from RMA data and net income margin from Definitive Healthcare data treated as an equivalent to excess margin.

The Key Metrics fall into three primary categories: profitability, liquidity, and solvency. Profitability metrics are used to assist in the evaluation of management performance in how efficiently resources are utilized. Liquidity metrics, including common ratios such as “days of available cash and investments on hand”, measure the quality and adequacy of assets to meet current obligations as they come due. Solvency metrics measure the company’s ability to take on and service debt obligations. Additionally, certain metrics can be applicable to multiple categories. The table below shows how each of the Key Metrics are calculated.

Key Financial Metrics and Ratios Ratio Definitions	Calculation
Profitability	
Operating Margin (%)	Income (Loss) from Operations Divided by Total Unrestricted Revenues
Excess Margin (%)	Excess (Deficit) of Revenue over Expenses Divided by (Total Unrestricted Revenues + Total Nonoperating Gains, Net)
Debt Service Coverage Ratio (x)	(Income (Loss) from Operations + Depreciation and Amortization + Interest) Divided by Maximum Annual Debt Service
Liquidity	
Days Available Cash and Investments on Hand (#)	(Cash, Board Designation, and Donor Restricted Investments) Multiplied by 365 Divided by (Total Expenses Less Depreciation and Amortization)
Operating Cash Flow (%)	Cash Flow from Operating Activities Divided by Total Unrestricted Revenues
Solvency	
Current Ratio (x)	Current Assets Divided by Current Liabilities
Ratio of Debt to Total Capitalization (%)	Total Debt Divided by Total Capitalization (Total Debt and Unrestricted Net Assets)
Ratio of Cash Flow to Debt (%)	Cash Flow from Operating Activities Divided by Total Debt
Unrestricted Net Assets ($ in millions)	Total Unrestricted Net Assets
Total Net Assets ($ in millions)	Total Net Assets

1. Revenue

We analyzed the revenue forecast within the Projections. Revenue for the Applicant includes net patient service revenue ("NPSR") and other revenue.

Approximately 91.0 percent of revenue is derived from net patient service revenue. NPSR is projected to grow 16.4 percent in FY 2021. Thereafter, NPSR is projected to grow between 2.7 percent and 4.5 percent annually over the projection period which is within range of historical growth of 6.9 percent in FY 2017, 7.6 percent in FY 2018, 4.0 percent in FY 2019, and 0.8 percent in FY 2020.[1] Growth in NPSR in the Projections is based on the following:

[1] Please note, FY 2020 results for the Applicant were significantly impacted by the COVID-19 pandemic. We understand the Applicant experienced a loss of NPSR and incremental expenses related to the purchase of personal protection equipment, disinfecting supplies, additional facility cleaning services, and increased technology expenses to support remote working.

A. **FY 2021 Growth** – NPSR in FY 2021 is based upon the Board approved budget, updated with actuals through April 30, 2021. As noted above, NPSR growth in FY 2021 is 16.4 percent, which is above historical levels. This higher level of growth reflects a recovery in volume from COVID levels, additional growth in service, and improvements in revenue cycle management.

B. **Rate Adjustments** – NPSR for FY 2022 through FY 2029 reflects governmental rate adjustments, non-Blue Cross commercial rate adjustments, and Blue Cross commercial rate adjustments. Governmental rate adjustments are 2.0 percent annually based on the market basket. Commercial rate adjustments range from 3.0 percent to 5.0 percent annually based on rate negotiations that are either underway or completed.

C. **Incremental Revenue Related to the Proposed Project** – In addition to rate adjustments, the projected revenue also reflects incremental revenue related to the Proposed Project. Additional revenue is projected beginning in FY 2025 through FY 2029[2] related to an increase in procedures, particularly in gastrointestinal surgeries. Management calculated an increase in all procedures from a FY 2019 baseline to achieve a breakeven level of procedures.[3] This results in an increase from 6,627 procedures in

[2] The Projections include incremental revenue and expenses beginning in FY 2025. We understand as of the date of preparation of our report that the first procedure may be performed at the new surgical pavilion in FY 2024; however, given an uncertainty in timing, the Projections utilize a start date in FY 2025. The Projections include a full five-year period from FY 2025 through FY 2029 of impact of the Proposed Project.
[3] At a point in time, Management's plan was to construct a standalone ambulatory surgical center ("ASC"); however, we understand the plans changed over time to construct a new surgical pavilion at the Hospital. As such, initially surgical procedures were classified whether they would be eligible to be performed at the ASC. The procedures referenced above reflect ASC-eligible procedures. Given all procedures would now be "eligible", this was deemed as conservative as these growth rates could be applied to all procedures rather than just the subset.

FY 2019 to 7,641 procedures in FY 2025, an increase of 1,014 procedures, or growth of 15.3 percent. Routine incremental growth of 5.0 percent is expected in FY 2026 and FY 2027. Further, gastrointestinal surgeries are expected to double with the hiring of 6 additional full-time equivalents ("FTEs"), from the current 6 FTEs. As discussed above, the Proposed Project will include the construction of six ORs, which will replace the Applicant's four current ORs at the Hospital. This will allow the Applicant to recapture procedures that had to be sent to other centers due to capacity constraints as well as allow for the Applicant to perform certain procedures that previously the current ORs did not have space for. Overall procedures are expected to increase 49.0 percent from FY 2019 levels, which is consistent with a 50% increase in number of ORs.

Other revenue is projected to grow 0.8 percent in FY 2021 and remain flat for the remainder of the projection period. This growth is within the historical range of actual growth, which ranges from -0.1 percent to 71.9 percent from FY 2017 through FY 2020. As of May 31, 2021, the Applicant's fiscal year-to-date ("YTD") actual other revenue was on track to achieve the FY 2021 projection.

In order to determine the reasonableness of the projected revenue, we reviewed the underlying assumptions upon which Management relied. Based upon our review, Management relied upon the historical operations and anticipated market movements. The nine-year CAGR for total operating revenue in the Projections of 4.0 percent falls below Heywood's revenue growth rates in the prior four fiscal years (FY 2017 through FY 2020). Based upon the foregoing, it is our opinion that the revenue growth projected by Management is based on reasonable assumptions and is feasible for Heywood.

2. Operating Expenses

We analyzed each of the categorized operating expenses for reasonableness and feasibility as it related to the Projections.

The operating expenses in the analysis include salaries, employee benefits, supplies, professional fees and purchased services, state taxes, interest, and depreciation and amortization. Salaries account for approximately 50.0 percent of total operating expenses, supplies account for approximately 12.0 percent of total operating expenses, and professional fees and purchased services account for approximately 23.0 percent of total operating expenses throughout the projection period.

Salaries in FY 2021 are based upon the Board approved budget, updated with actuals through April 30, 2021, which represents growth in salaries of 17.9 percent from FY 2020. Salaries for FY 2022 through FY 2029 are grown at 2.75 percent annually. Projected growth in salaries falls within historical growth which ranged from 2.7 percent to 8.3 percent from FY 2017 to FY 2020. Additionally, beginning in FY 2025, the Projections reflect an increase in salaries related to the hiring of additional six FTEs for gastrointestinal surgeries and a reduction of two FTEs related to efficiencies gained with having one suite accommodating both inpatient and outpatient surgeries.

Supplies in FY 2021 are based upon the Board approved budget, updated with actuals through April 30, 2021, which represents growth in supplies of 12.3 percent from FY 2020. Supplies for

FY 2022 through FY 2029 are grown at 2.00 percent annually. Projected growth in supplies falls within historical growth which ranged from -5.0 percent to 12.9 percent from FY 2017 to FY 2019 (excluding FY 2020 which experienced a reduction in supplies expense of 53.7 percent due to COVID-19). Incremental supplies are also included within the Projections beginning in FY 2025 related to the Proposed Project. The incremental supplies relate to the projected volume growth from the increase in procedures to a breakeven level as well as an increase in gastrointestinal surgeries with the hiring of additional FTEs to support these procedures.

Professional fees and purchased services in FY 2021 are based upon the Board approved budget, updated with actuals through April 30, 2021, which represents growth in professional fees and purchased services of 15.7 percent from FY 2020. Professional fees and purchased services for FY 2022 through FY 2029 are grown at 2.00 percent annually. Incremental expenses are included within the Projections beginning in FY 2025 related to the annual rental/lease expense from the financing of the Proposed Project as discussed further below. Further, professional fees and purchased services include a reduction in expense related to operating efficiencies that will be generated beginning in FY 2025.

Based upon the foregoing, it is our opinion that the operating expenses projected by Management reflects are based on reasonable assumptions and are feasible for the Applicant.

3. Shortfall Gap Closure

Management incorporates a shortfall gap closure within its financial forecast for FY 2022 through FY 2024. This shortfall reflects future initiatives and strategic plans which are not yet identified and therefore are not allocable to detailed line items in the income statement. We understand based on discussions with Management that the Applicant undergoes this process as a part of its regular forecasting. We further understand the senior team of the Applicant has recently met to begin the process of identifying areas to close the shortfall gap for FY 2022 and identified items including 340b savings, reduction in certain insurance coverages, and provider based clinic efficiency, among other potential initiatives. Additionally, we reviewed the Applicant's actual operating income in comparison to the Applicant's budget for the prior two fiscal years and the YTD period and noted the Applicant exceeded budget in each of these periods. As such, it is feasible that the Applicant will continue to close the shortfall gaps included in the Projections.

4. Capital Expenditures and Proposed Project Financing

We reviewed the project costs within the Projections related to the Proposed Project of which $38.0 million is classified as maximum capital expenditures ("MCE") per the DON regulations. We reviewed supporting documentation building up the total maximum capital expenditures including an estimate from Consigli related to the construction cost and an estimate of interest from Waterstone Properties. We understand the Consigli estimate was last revised on June 21, 2021 and reflects the increase in price of construction materials following the COVID-19 pandemic. We understand the Applicant is still assessing the amount of current equipment that can be reused in the Proposed Project and as a result the equipment budget is still in process. The supporting documentation reviewed represents approximately 75.0 percent of the total MCE.

In addition to capital expenditures, we also reviewed the proposed financing of the Proposed Project. The project costs related to the Proposed Project are included within the Projections as a cash outflow in FY 2022 and in FY 2025 through FY 2029 in the form of rent expense. We understand, as of the drafting of our report, the Applicant's Board of Trustees approved MCE of $35.0 million as of January 21, 2021. We further understand, per Management, that costs in excess of the previously approved Board amount will be funded through the Applicant's cash and expected to be approved. We note the cash required to meet the revised MCE of $38.0 million has been included within the cash flows of the Projections. The Applicant has entered into a lease over a 30-year term with Waterstone Properties Group, Inc. to construct the surgical pavilion. No debt financing is anticipated.

VI. FEASIBILITY

We analyzed the Projections and Key Metrics for the Proposed Project. In preparing our analysis we considered multiple sources of information including industry metrics, historical results, and Management expectations. It is important to note that the Projections do not account for any anticipated changes in accounting standards. These standards, which may have a material impact on individual future years, are not anticipated to have a material impact on the aggregate Projections.

Within the projected financial information, the Projections exhibit a cumulative operating EBITDA surplus of approximately 6.0 percent of cumulative projected operating revenue for the nine years from 2021 through 2029. Based upon our review of the relevant documents and analysis of the Projections, we determined the anticipated operating surplus is a reasonable expectation and based upon feasible financial assumptions. Accordingly, we determined that the Projections are reasonable and feasible, and not likely to have a negative impact on the patient panel or result in a liquidation of assets of Heywood.

Respectively submitted,

Erik Lynch
Partner, BDO USA LLP