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

Harrington HealthCare System, Inc.

For the Years Ending September 30, 2020
Through September 30, 2024

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January 21, 2020

Harry Lemieux, VP, Support Services and Chief Information Officer
Tom Sullivan, VP, Finance and Treasurer
Harrington HealthCare System
100 South Street
Southbridge, MA 01550

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

Dear Messrs. Lemieux and Sullivan:

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

Sincerely,

BDO USA, LLP

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

Dear Messrs. Lemieux and Sullivan:

We have performed an analysis related to the reasonableness and feasibility of the financial projections (the “Projections”) of Harrington HealthCare System, Inc. (“Harrington” or “the Applicant”) related to the proposed acquisition of a second CT scanner and associated renovation (the “Proposed Project”) at Harrington Memorial Hospital, Inc. (the “Hospital”). This report details our analysis and findings with regard to the reasonableness of assumptions used in the preparation of the Projections and feasibility of the projected financial results prepared by the management of Harrington (“Management”). This report is to be used by Harrington 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 five-year financial projections for the Applicant for the fiscal years ending September 30, 2020 through 2024 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 3.6 percent of cumulative projected revenue for Harrington for the five years from fiscal year (“FY”) 2020 through 2024. 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 Harrington’s assets. A detailed explanation of the basis for our determination of reasonableness and feasibility is contained within this report.

II. RELEVANT BACKGROUND INFORMATION

Harrington was established in October 2009 to organize, operate, and support a comprehensive health system including hospital and other healthcare services for all persons. Harrington includes the Hospital and Harrington Physician Services, Inc. (“HPS”). The Hospital is an acute care hospital that was established in 1931 located in Southbridge, Massachusetts. The Hospital provides inpatient, outpatient, and emergency care services to the residents of south-central Massachusetts and northeastern Connecticut.

The Proposed Project relates to the acquisition of a second CT scanner and associated renovation at the Hospital to provide redundancy and more efficient access for emergency room patients. The Proposed Project is not expected to generate more volume or impact provider price, total medical expenses, or provider costs. A second CT scanner located within the footprint of the emergency department will allow CT scans to be performed more efficiently resulting in a more timely diagnosis and treatment plan for emergency department patients, particularly for stroke related diagnoses. Additionally, with the introduction of a second CT scanner at the Hospital, the existing CT scanner in the radiology department will be more accessible to outpatients and inpatients requiring testing.

III. SCOPE OF REPORT

The scope of this report is limited to an analysis of the five-year financial projections for Harrington, the Applicant, for the fiscal years ending September 30, 2020 through 2024, 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 Projects are 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 September 15, 2019 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 Harrington.

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 or projections 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 is 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 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 Harrington for the periods ending September 30, 2020 through September 30, 2024;
2. Proposed 2020 Budget Presentation to the Finance Committee on September 13, 2019;
3. Change Order to the Construction of the Addition & Renovation to the Emergency Department dated October 15, 2019;
4. Preliminary Proposal from Siemens Healthineers dated November 5, 2019 related to the CT Scanner;
5. Draft Harrington Application Form for DON Application;
6. Draft Capital Expenditure Tables for DON Application;
7. Draft Audited Consolidated Financial Statements for Harrington HealthCare System, Inc. for Fiscal Year Ended September 30, 2019 and 2018;
8. RMA Annual Statement Studies, published by The Risk Management Association;

9. Definitive Healthcare data;
10. IBISWorld Industry Report, Hospitals in the US, dated November 2019; and
11. Determination of Need Application Instructions dated March 2017.

V. REVIEW OF THE PROJECTIONS

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**				
Harrington HealthCare System, Inc.	**2020**	**2021**	**2022**	**2023**	**2024**
Profitability					
Operating Margin (%)	-0.8%	-1.4%	-1.4%	-1.3%	-1.3%
Excess Margin (%)	0.7%	0.4%	0.1%	0.2%	0.3%
Debt Service Coverage Ratio (x)	4.0x	3.8x	3.8x	3.4x	4.7x
Liquidity					
Days Available Cash and Investments on Hand (#)	104.0	110.5	115.5	121.0	127.0
Operating Cash Flow (%)	2.4%	2.3%	2.7%	2.3%	2.3%
Solvency					
Current Ratio (x)	1.2x	1.2x	1.2x	1.3x	1.3x
Ratio of Long Term Debt to Total Capitalization (%)	27.2%	26.1%	24.6%	24.3%	23.4%
Ratio of Cash Flow to Long Term Debt (%)	15.3%	15.8%	19.7%	17.0%	18.0%
Net Assets Without Donor Restrictions ($ in thousands)	$ 70,880	$ 71,805	$ 71,590	$ 71,822	$ 72,255
Total Net Assets ($ in thousands)	$ 78,425	$ 79,350	$ 79,134	$ 79,366	$ 79,800

Key Financial Metrics and Ratios	Actual			Industry Data (1)		
Harrington HealthCare System, Inc.	2017	2018	2019 (2)	RMA - Medical and Surgical Hospitals	IBIS - Hospitals in the US	Definitive Healthcare
Profitability						
Operating Margin (%)	-5.0%	-2.9%	0.5%	1.8%	8.6%	-4.0%
Excess Margin (%)	-1.2%	0.0%	1.6%	1.0%	NA	3.6% (3)
Debt Service Coverage Ratio (x)	4.6x	3.3x	4.9x	NA	NA	NA
Liquidity						
Days Available Cash and Investments on Hand (#)	129.1	120.2	113.4	NA	NA	36.6
Operating Cash Flow (%)	3.5%	-0.3%	0.5%	NA	6.0%	NA
Solvency						
Current Ratio (x)	0.9x	0.9x	1.1x	1.4x	1.9x	1.3x
Ratio of Long Term Debt to Total Capitalization (%)	30.0%	30.0%	29.8%	37.8%	NA	NA
Ratio of Cash Flow to Long Term Debt (%)	19.5%	-1.9%	2.7%	NA	NA	NA
Net Assets Without Donor Restrictions ($ in thousands)	$ 66,882	$ 68,949	$ 68,339	NA	NA	NA
Total Net Assets ($ in thousands)	$ 75,532	$ 77,713	$ 75,883	$51,592	NA	NA

Footnotes:

(1) Industry data metrics based on each data source's respective definitions and may differ from the definitions listed below. Further, we note industry metrics only include hospitals and do not reflect health systems, including physician organizations.

(2) Excess margin in 2019 excludes pension settlement costs.

(3) 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 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 is calculated.

Key Financial Metrics and Ratios Ratio Definitions	Calculation
Profitability	
Operating Margin (%)	(Loss)/Gain on Operations Divided by Total Operating Revenue
Excess Margin (%)	Excess of Revenue over Expenses Divided by (Total Operating Revenues + Non-Operating Income)
Debt Service Coverage Ratio (x)	(Excess of Revenue over Expenses + Depreciation and Amortization + Interest) Divided by (Principal Payments and Interest)
Liquidity	
Days Available Cash and Investments on Hand (#)	(Cash and Board Designated Investments) Divided by [(Total Operating Expenses Less Depreciation and Amortization) Divided by 365 Days]
Operating Cash Flow (%)	Total Cash Flows from Operations Divided by Total Operating Revenue
Solvency	
Current Ratio (x)	Current Assets Divided by Current Liabilities
Ratio of Long Term Debt to Total Capitalization (%)	Long Term Debt Divided by Total Capitalization (Long Term Debt and Unrestricted Net Assets)
Ratio of Cash Flow to Long Term Debt (%)	Total Cash Flows from Operations Divided by Long Term Debt
Net Assets Without Donor Restrictions ($ in thousands)	Total Unrestricted Net Assets
Total Net Assets ($ in thousands)	Total Net Assets

1. Revenue

We analyzed the projected revenue within the Projections. Revenue for the Applicant includes net patient service revenue and other operating revenue.

Total operating revenue is projected to grow 0.8 percent in FY 2020 and decline 0.6 percent in FY 2021. Thereafter, Management held revenues flat at 0.0 percent growth for FY 2022 through FY 2024. We understand beyond FY 2020 the Projections reflect simplifying assumptions as expected inflationary increases in revenues and expenses would largely offset. As such, Management only incorporated identifiable changes to revenues and expenses (i.e., volume, headcount, etc.) within the Projections.

Revenues in FY 2020 reflects the budget presented to the finance committee. Per the budget presentation, growth in FY 2020 is due to a growth in services at the Hospital and HPS, a 3.5

percent price increase, the Medicare wage index reduction impact, a consistent level of Behavioral Health services, a consistent payor mix, and the elimination of emergency room physician billing. The decline in FY 2021 reflects an impact from the wage index. As discussed above, the Proposed Project is not projected to have any impact on volume and thus net patient service revenue.

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 five-year compound annual growth rate ("CAGR") for total operating revenue in the Projections of 0.05 percent falls below Harrington's revenue growth rates in FY 2018 and FY 2019, which were 3.9 percent and 1.6 percent, respectively. Based upon the foregoing, it is our opinion that the revenue growth projected by Management reflects a reasonable estimation of future revenue of Harrington.

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 and wages, direct fringe benefits, professional compensation, depreciation, supplies and expenses, uncompensated care pool assessment, and interest expense. Total expenses are projected to grow 2.1 percent in FY 2020. Thereafter, total expenses are projected to grow at a rate ranging from -0.03 percent to 0.01 percent from FY 2021 through FY 2024. The annual growth in total expenses falls within the range of historical expense growth in FY 2018 and FY 2019 of 1.8 percent and -1.7 percent, respectively.

Expenses in FY 2020 reflect the budget presented to the finance committee, except for the incremental expenses discussed further below related to the Proposed Project. Per the budget presentation, the change in expenses in FY 2020 reflect a 2.0 percent / 4.0 percent registered nurse wage program, an increase in interest expense resulting from reduced capitalization of interest expense, an increase related to a new lease for Radiology Equipment, and a decrease due to the elimination of emergency department physician salaries.

Depreciation and supplies expense in the Projections reflect incremental expenses annually related to the Proposed Project. The Projections reflect equipment depreciating over a seven-year life and the associated renovations/construction depreciating over a 40-year life. Supplies expense reflects incremental maintenance expense related to the CT scanner.

Based upon the foregoing, it is our opinion that the operating expenses projected by Management reflects a reasonable estimation of future expenses of the Applicant.

3. Capital Expenditures and Proposed Project Financing

We reviewed the project costs within the Projections related to the Proposed Project which totaled $827 thousand. The total project costs include the cost of the CT scanner and the associated renovations for the space for the scanner. We reviewed the preliminary proposal for the equipment from Siemens Healthineers, as well as the change order from the American Institute of Architects related to the construction.

In addition to capital expenditures, we also reviewed the financing of the Proposed Project. It is our understanding that the expenditures related to the Proposed Project are expected to be funded through the Applicant's cash on hand. The capital expenditures are included within the Applicant's cash flows with no additional debt financing anticipated. We note that the Projections include capital expenditures of $6.76M in FY 2020, of which the Proposed Project represents approximately 12.2 percent. We note the model indicates a decline in the total cash balance through the projection period, however, the days available cash and investments on hand increases. Therefore, there appears to be sufficient room to accommodate the financing for the Proposed Project within the Application's normal capital expenditures without the need for debt financing.

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 3.6 percent of cumulative projected operating revenue for the five years from 2020 through 2024. 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 Harrington.

Respectively submitted,

Stephen Doneski

Steve Doneski
Partner, BDO USA LLP