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Ratings

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Highmark Inc.

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Anchor	a

Business Risk	Strong
Competitive position	Strong
IICRA	Low
Financial Risk	**Very Strong**
Capital and earnings	Excellent
Risk exposure	Moderately high
Funding structure	Neutral

+

Modifiers	0

Governance	Neutral
Liquidity	Adequate
Comparable ratings analysis	0

=

SACP	a

+

Support	0
Group support	0
Government support	0

=

A/Stable/--

Financial strength rating

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Strengths	Risks
Strong Blue Cross Blue Shield (BCBS) brand equity and local market presence	Constrained operating performance on the hospital side, which may also be hurt if the increased medical costs related to COVID-19 are not offset by the savings expected from deferred elective procedures
Diversified product portfolio across commercial and government business and an extensive provider network	Possible headwinds in capitalization from substantial capital investments in Allegheny Health Network (AHN) hospitals
Increasing geographic diversification after pending affiliation with HealthNow New York health plan	Concentrated operations in Pennsylvania, a state with strong competition and a stringent regulatory environment
Extremely strong capitalization with redundancy at the 'AAA' level per our risk-based capital (RBC) model	Potential volatile capital and earnings from concentration in highly regulated U.S. health insurance sector

The Pittsburgh, Pa.-based plan is the fourth-largest BCBS plan in its markets. At year-end 2019, Highmark Inc. (Highmark Health Plan) covered more than 4 million members in Pennsylvania (PA), Delaware (DE), and West Virginia (WV). After the recently announced affiliation with HealthNow New York Inc., Highmark will add additional 670,000 members to its platform and will extend its geographic reach to Western New York (approval pending).

Highmark maintains a strong competitive position reflecting its leading market share in its core insurance markets; extremely strong capitalization; and moderately conservative financial leverage. Its competitive position also reflects its extensive provider networks, a growing value-based network that includes affiliate AHN, local market expertise, good product diversification in commercial and government-sponsored health plans, and good earnings from its diversified business segment. Its divisions include the health plan, United Concordia Dental (UCD) dental business, stop loss insurance group, health solution IT business, and integrated AHN provider system (twelve hospitals).

The recently announced affiliation agreement with HealthNow New York offers an expanded geographic reach. We view this affiliation as playing to Highmark's strength of executing on its strategy to consolidate with other BCBS plans, while gaining operational efficiencies and scale. We expect this affiliation to become bottom-line accretive to Highmark right away, however, we do not project the company to reap the benefits from operational synergies until at least 2022, when most cost-saving benefits will be realized. Pending regulatory approval, the transaction is not expected to close until 2021.

Profitability could be strained this year due to higher costs stemming from the COVID-19 pandemic. Highmark's operating performance was stable through 2019 with an average three-year (2017-2019) return on revenue (ROR) of about 4%, but we expect higher claims stemming from the pandemic in 2020. But the significant canceling and deferring of elective procedures in 2020 and into 2021 will provide savings to offset higher costs from COVID-19, though the amount of those savings--whether a portion of the higher costs, equal to the higher costs, or even exceed the higher costs--is less certain.

Outlook: Stable

The stable outlook on Highmark reflects our expectation that it will sustain its leading market positions and profitability in line with similarly rated peers. We forecast adjusted EBIT ROR of about 2% in 2020-2021, with capital remaining redundant at the 'AAA' level, financial leverage of 25%, and EBITDA fixed-charge coverage of roughly 8x-10x.

Downside scenario

We could lower our ratings by one notch in the next 12-24 months if the company is unable to consistently meet our operating performance expectations with EBIT ROR in the low-single digits, or if financial leverage rises above 40%. A moderate decline in operating performance in the next couple of years may indicate Highmark is unable to sustain traction with its strategic initiatives for its AHN segment.

Upside scenario

We could raise our ratings in the next two years if Highmark can boost and sustain its operating margins to a level similar to higher rated peers' (closer to the higher end of 5% EBIT ROR). On the other hand, if it can meaningfully and successfully expand its presence outside of its core PA markets and keep financial leverage below 40% and EBITDA fixed-charge above 8x, we could consider an upgrade.

Key Assumptions

- Real U.S. GDP contraction of 5.2% in 2020 and growth of 6.2% in 2021
- Average U.S. payroll employment of 143.1 million in 2020 and 147.2 million in 2021
- 10-year Treasury note yield of about 1.1% in 2020 and 1.5% in 2021

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the COVID-19 pandemic and its subsequent impact on economic forecasts. As the situation evolves, we will update our assumptions and estimates accordingly.

Key Metrics

	--Year ended Dec. 31--				
(Mil. $)	**2020***	**2019**	**2018**	**2017**	**2016**
Total medical membership (000s)	4,000-4,200	4,004	4,193	4,263	4,580
Total revenue	17.8-18.2	18,446	18,958	18,423	18,365
Total premiums	12,500-13,100	13,172	13,773	13,139	13,446
Medical loss ratio (%)	85.5-87.5	81.7	81.5	82.6	85.9
Adjusted EBIT	450-550	725	771	822	439
Net income	300-400	843	571	1062	60
Return on revenue (%)	1.5-2.5	3.9	4.1	4.5	2.4
Financial leverage (%)	25-28	25.4	28.8	31.0	37.7
Fixed-charge coverage (x)	8.0-10.0	9.3	8.5	8.6	6
S&P Global capital adequacy/redundancy	AAA	AAA	AAA	AAA	AAA

*Forecast data reflect S&P Global's base-case assumptions.

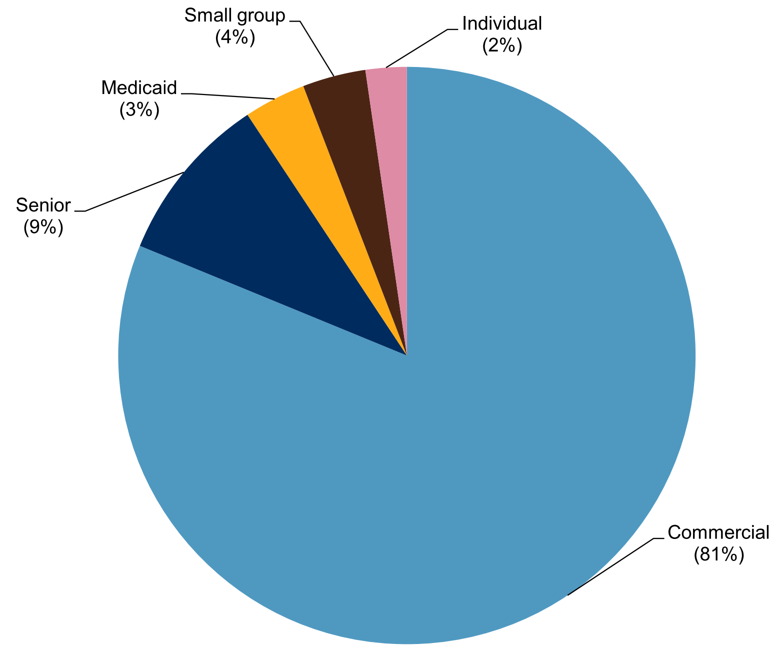
Business Risk Profile: Strong

Highmark Health Plan is the fourth-largest BCBS health plan and largest commercial health insurer in PA, DE, and WV. It competes in all major commercial insurance segments, including the individual and Affordable Care Act markets, Medicare/Medicaid and had more than 4.0 million members in Dec 2019. Highmark Inc. operating revenues were about $16 billion in 2019. This is offset by its three-state commercial market concentration that limits growth in this segment and exposes the company to political, regulatory, and economic policies that could affect capital and earnings. However, due to a recent strategic affiliation with HealthNow NY, it is trying to diversify its geographic reach and expand its services to other states, which we view as a credit positive, but, due to a small customer and revenue base, we don't think this is enough to warrant a rating change.

Chart 1

Highmark Health Plan Is Diversified Within All Health Insurance Segments

Membership mix as of Dec. 31, 2019

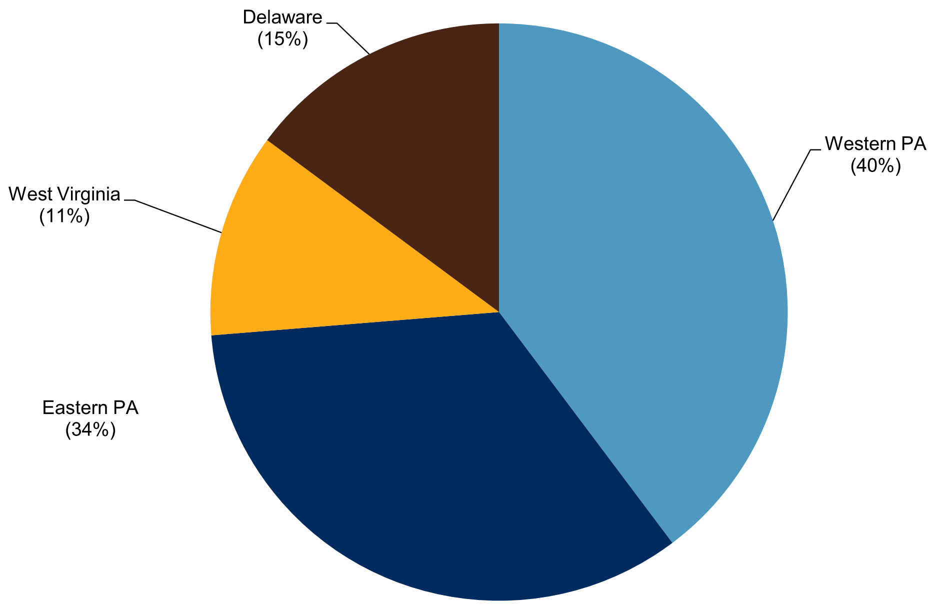


Source: Company filings.

Chart 2

Highmark Has Members In Three States, But Most Members Come From PA

Membership mix as of Dec. 31, 2019

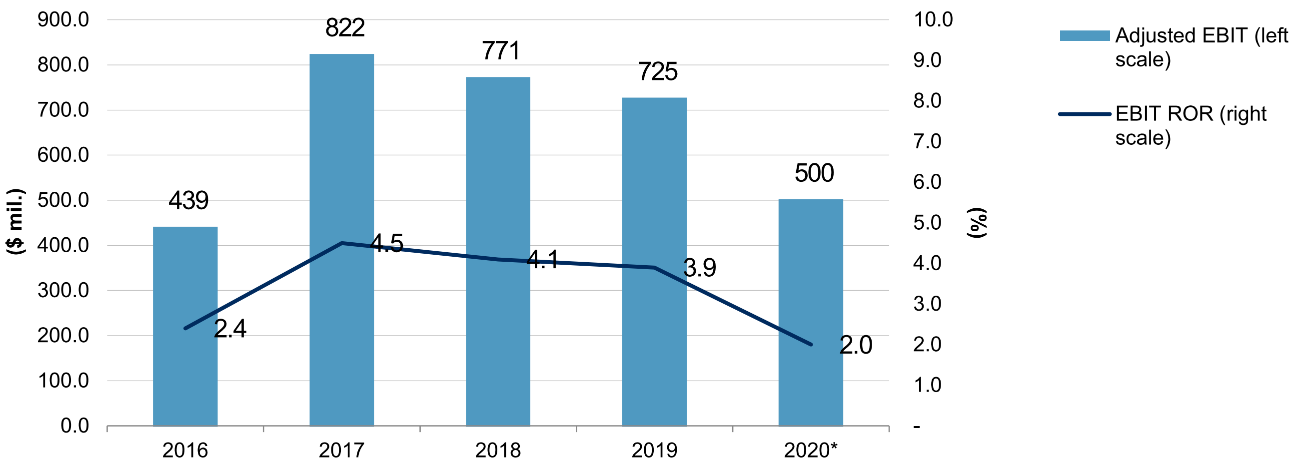


Source: Company's presentation.

Highmark Inc. remains the most important business segment of the group and contributed about 60% of operating earnings and ~75% of total revenue in 2019. Operating performance remained strong for the third consecutive year in 2019 (about 4.0% ROR) with individual segment margins vastly outperforming expectations due favorable membership mix and risk adjustment revenue. Absent COVID-19, we expected operating performance to return to a more-normal run-rate EBIT ROR as the company implements various initiatives to boost enrollment while generating appropriate margins to fund its integrated delivery strategy with AHN. Incorporating COVID-19 medical trends adds a greater degree of uncertainty to our 2020 forecast. We expect higher medical costs related to the pandemic, offset by the significant deferring and cancellation of elective procedures. Full-year 2020 results could come in higher or lower than 2019, likely in the 1.5%-2.5% range, depending on how these positive and negative variables net out.

Chart 3

Highmark's EBIT And ROR Have Seen Robust Growth In Recent Years



Source: S&P Global Ratings.

Highmark focuses on entering into efficient strategic partnerships, new initiatives, and innovative solutions to lower health-care costs. In 2019, together with the other 17 independently owned and locally operated BCBS sister companies, it formed a partnership with Civica Rx to create a new subsidiary dedicated to lowering generic drug costs. We view this as a positive credit factor since this lowers the company's expenses on drugs--which are growing each year.

AHN returned a profit in the past three years (2017-2019). We do not expect margin expansion from AHN in the next two years since it is investing in its expansion plan, service lines, and infrastructure. Investment in AHN remains a significant effort for management as the company improves its quality score, fosters partnership with health systems in key markets, maintains an adequate network for its members, and keeps coverage affordable while providing a competitive edge over competitors in its western PA market. The pandemic has exposed AHN to further risks that could result in financial pressure including short-term cash-flow challenges from government directives to limit nonmedically urgent procedures, though these restrictions were removed on April 27, 2020.

AHN has been integral component of Highmark's integrated delivery and financing system since 2013. In 2019, services provided to Highmark and Gateway Health Plan membership by AHN contributed about half of the system's $3.4 billion net patient service revenue. Driving volume and market share growth are various construction and expansion projects to provide additional capacity, strengthen certain clinical service lines, and increased same day access to physicians. Projects underway include a new 160-bed hospital in Wexford, Penn., completion of a new cancer center at Allegheny General Hospital, the last of its six new regional cancer centers, completion of the final, of four, neighborhood hospitals that are located in key markets where Highmark has strong health plan membership but limited providers, and expansion at Saint Vincent Hospital in Erie. In addition, Grove City Medical Center, midway between Pittsburgh and AHN's facility in Erie, joined the system on Dec. 31, 2019.

Highmark Health and AHN have broadened their provider network with affiliations and partnerships that extend outside of Pittsburgh. In western PA, including Pittsburgh, provider and health plan competition comes largely from the Univ. of Pittsburgh Medical Center (UPMC). Highmark and UPMC reached an agreement, effective July 1, 2019, that allows Highmark's commercial members in broad networks access to UPMC locations and services at in-network rates until about 2024 (dates vary among providers). Management anticipates continued rising demand for services as AHN creates capacity and expands clinical offerings for Highmark members who have financial incentives to use AHN. But we believe that shifting market share will remain challenging given the high level of regional competition.

Highmark Health's ancillary diversified business, comprises Highmark Insurance Group, which offers stop loss insurance and managed care reinsurance services); UCD, which offers dental solutions; and Highmark Health Solutions, which delivers business solutions to health plan payers. These lines focus on growth and margin maintenance and/or improvement in each division. We expect this segment to provide considerable operating earnings for Highmark in 2020.

Financial Risk Profile: Very Strong

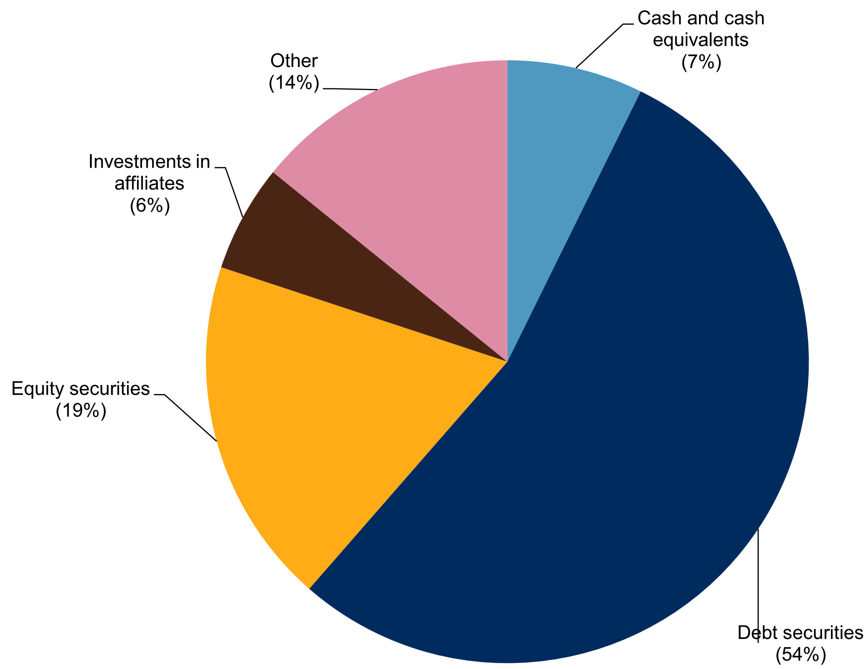
Highmark's extremely strong capital and earnings risk profile reflects its risk-adjusted capital, which is redundant at the 'AAA' level, and we expect this to continue in our base case through 2021, albeit at a lower level of redundancy as the company continue to invest in AHN. This will also affect its RBC ratio, which we expect to dip slightly but remain well above the 550% threshold. Its statutory RBC ratio rose to 705% from 674% in 2019 due to net unrealized capital losses and equity transfers to support the integrated delivery strategy. At year-end 2019, Highmark Inc. reported an adjusted statutory surplus of $3.67 billion--a 0.8% decrease from year-end 2018, largely reflecting the increase in the nonadmitted subsidiaries, prepaid expenses, and prepaid pension asset.

Highmark Health's primary source of capital and liquidity is internally generated cash. We don't expect the company to issue any significant debt to fund strategic initiatives in the next two years. Despite its not-for-profit structure, Highmark Health has a good record of accessing external capital. Its debt obligations include Highmark Inc.'s senior $250 million notes due 2041 and $350 million notes due 2021, as well as AHN's tax-exempt $1 billion bonds issued to refund existing bonds and pay for new projects. We expect financial leverage (including unfunded pension and imputed lease obligations) of about 25% with EBITDA interest coverage of 8x-10x through 2021--both supporting the rating.

We view Highmark's risk position as moderate, reflecting its post-retirement benefit and pension obligations. Highmark Health's gross pension and postretirement obligations totaled $4.3 billion at year-end 2019, or 56% of total adjusted capital. Its pension plan was 94% funded and its other postretirement benefits were funded at 68% at year-end 2019. The recognized underfunded amount of its pension plan and other postretirement benefits declined to $306 million at year-end 2019 from $478 million in 2018. Its pension plans are closed to new hires, so we do not expect this deficit to grow. Its investment portfolio is fairly diversified with no significant sector or obligor concentrations, and limited exposure to alternative assets or speculative-grade bonds. At year-end 2019, the consolidated group had $9.1 billion in invested assets: 54% in fixed-income securities, 19% in equities, 7% in cash and short-term investments, 6% in investments in affiliates, and 14% in alternative investments.

Chart 4

Invested Assets Chart



Data as of year-end 2019.

Other Key Credit Considerations

Governance

Highmark's strategic planning process is in line with its core capabilities, and management has demonstrated its ability to execute its strategic decisions successfully. Given the changing competitive health care landscape, adequate reimbursement for government-sponsored health plans, and its large investment to expand and upgrade/renovate AHN, we think Highmark's top management is preserving financial stability in operating earnings and capital adequacy.

Liquidity

Highmark Health's relatively conservative investment portfolio (about 7% in cash and short-term securities, 54% in bonds) and the nature of its short-term health plan segment liabilities support its ample liquidity. We expect its operating company liquidity ratio to remain above 157% through 2020. AHN also sustains adequate liquidity, maintaining 80-95 days' cash on hand. Additional access to liquidity is available through Highmark Inc.'s undrawn $275 million revolving credit facility expiring June 2021. United Concordia Dental has an undrawn $15 million revolving credit facility due February 2021. Highmark Health doesn't have any other significant collateral-posting requirements or rating triggers that would constrain our view of its liquidity.

Environmental, social, and governance (ESG)

We believe Highmark's ESG exposure is in line with that of the broader U.S. health insurance industry. Social risks like the rising cost of health care, shifting consumer preferences, and persistent political/regulatory risk dominate Highmark's ESG profile since the nature of its business is intertwined with the U.S. economy and society at large. We believe Highmark's strong BCBS brand and growing value-based provider arrangements (which help reduce medical costs) are key strengths that will help it address some of its social risks. We believe Highmark's current leadership team has improved the company's overall execution and long-term competitiveness during the past several years.

Enterprise risk management (ERM)

Highmark's ERM is of low importance to our rating given its moderately low-risk product portfolio. Its main risks are underwriting and pricing, legislative and regulatory, and investment. Relative to other Blue plans, we believe Highmark has a fairly developed ERM program, and it continues to quantify formally its specific risk capacity, risk appetite, and risk target metrics in line with similarly rated peers. Risks relating to network access and participation, and the significant reinvestment of internally generated cash to expand and upgrade/renovate AHN, remain elevated.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria - Insurance - General: Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities

Held By Insurance Companies, Aug. 29, 2014

- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	**Very Strong**	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	**a+/a**	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of July 17, 2020)*

Highmark Inc.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Senior Unsecured	A-
Holding Company	Highmark Health
Domicile	Pennsylvania

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.