



Fitch Affirms Kaiser's IFS Ratings at 'A+', Outlooks Revised to Positive

Fitch Ratings-Chicago-12 October 2017: Fitch Ratings has affirmed the 'A+' (strong) Insurer Financial Strength ratings assigned to Kaiser Foundation Health Plan, Inc. and its insurance company subsidiaries (collectively KFHP) and revised the Rating Outlooks to Positive from Stable.

Today's rating actions follow a periodic review of KFHP's ratings. Key rating drivers include the company's strong business profile, very strong financial performance and earnings, and strong capitalization and leverage characteristics. The Outlook revision reflects steady growth in the Kaiser organization's net worth in recent years and corresponding reduction in current and expected financial leverage ratios. The revision also reflects Fitch's heightened emphasis on the benefits to KFHP's business profile from the Kaiser organization's integrated payor-provider model.

KEY RATING DRIVERS

Fitch believes KFHP has a strong business profile. Key factors underlying this assessment are KFHP's leading market share in California and solid market shares in seven other states, diverse product lines that include meaningful enrollment from employer group, Medicare and individual products, and significant size/scale characteristics. The company's Business Profile also reflects KFHP's heightened exposure to economic and regulatory issues derived from the geographic concentration of its enrollment, approximately 73% of which was from California at June 30, 2017.

Other key considerations include operational, competitive and financial benefits derived from the organization's vertically integrated business model. KFHP and associated company Kaiser Foundation Hospitals (collectively Kaiser) along with the Permanente Medical Group constitute a unique vertically integrated system that provides health plan and health care services

under the trade name Kaiser Permanente. Fitch believes that this vertically integrated model reduces many of the inherent conflicts that typically exist between health insurance payors and health care providers. Further, Fitch believes that the benefits of Kaiser's integrated model to KFHP's business profile have become more evident and pronounced as payors and providers industry-wide struggle to contain healthcare costs and strive to move toward value-based models that increase the alignment of their respective interests.

Kaiser's large revenue and earnings bases are key considerations supporting its very strong financial performance and earnings characteristics. The company's revenues totaled \$65 billion in 2016 and EBITDA and net income averaged \$5.0 billion and \$2.7 billion, respectively, from 2014 through 2016. The organization's ability to manage service and delivery costs within its closed healthcare delivery network contributes to EBITDA-based margins in the 7% to 9% range and bolsters its ability to offer products and services at competitive prices. First-half 2017 earnings increased significantly over the prior-year period reflecting operating revenue growth, a flat medical benefit ratio, and a decline in administrative expenses. The increase also reflects higher investment income, principally from equity-method alternative investments such as private equity investments and a reduction in impairment losses.

Kaiser maintains strong capitalization and financial leverage characteristics. Key considerations include Fitch's expectations that the organization's debt-to-EBITDA and financial leverage ratios (FLR) will approximate 2.0x and 20%-25%, respectively, over the next 12-24 months. Fitch notes that KFHP has issued the majority of the debt in Kaiser's capital structure and that KFHP, and affiliates of KFHP and KFHP, have guaranteed payment of KFHP's various bond issues. At June 30, 2017, Kaiser's debt-to-EBITDA (prior four quarters) and FLR were 1.4x and 26%. Due principally to retained earnings, the organization's net worth increased significantly in recent years, growing from \$14.3 billion at year-end 2012 to \$30.5 billion at June 30, 2017. The five-year CAGR in Kaiser's net worth exceeds the CAGR of the organization's outstanding debt and the five-year CAGR in Kaiser's net worth exceeds the CAGR of publicly traded peers' growth in shareholders' equity, many of which conduct significant share repurchases.

Fitch notes that hospital and clinic construction and capital maintenance requirements associated with Kaiser's vertically integrated business model can generate high financing needs, as can potential expansion plans into current or existing markets. Further, the organization's pension and retirement liabilities remain significantly underfunded (\$16 billion at year-end 2016) and the value of these obligations is affected by changes in discount rates which are generally positively correlated with market interest rates. Favorably, Fitch believes that the value of Kaiser's projected pension and retirement obligations would likely decline in a rising interest rate environment.

Kaiser's consistent and very strong interest coverage ratios are important factors underlying the company's very strong debt service capabilities and financial flexibility. The organization's operating EBITDA-based interest coverage ratios are expected to be in the mid-double-digits over the next 12-24 months, a decline from recent levels but still very strong ratios. From 2014 through 2016, Kaiser's operating EBITDA-based interest coverage ratio averaged 25.2x. Fitch believes that Kaiser maintains adequate financial flexibility based on its large liquid sources of funding and capital whose favorable flexibility is partially offset by large potential liquidity needs. Primary sources of financial flexibility include a \$2.4 billion credit facility that expires in September 2022, a \$2.4 billion commercial paper (CP) program and a large liquid investment portfolio (including \$3.7 billion of U.S. government securities at June 30, 2017) that exceed the organization's insurance-related and debt obligations. The organization also has proven access to the debt capital markets. At June 30, 2016, there were no amounts outstanding under the company's credit facility and there was \$749 million outstanding under its CP program.

In addition to affirming the existing ratings on KFHP and its subsidiaries, Fitch has assigned 'A+' IFS ratings to Kaiser Foundation Health Plan of Washington and Kaiser Foundation Health Plan of Washington Options, Inc. These companies were acquired by the Kaiser organization in February 2017 and are beneficiaries of a guaranty agreement by and among, KFHP, KFHP and KFHP's subsidiary health insurance carriers.

RATING SENSITIVITIES

Key rating sensitivities that could lead to an upgrade of KFHP's and its subsidiaries' IFS ratings include:

--A movement in Kaiser's business profile score to Fitch's "very strong" categorization reflecting the agency's heightened comfort with the competitive benefits Kaiser derives from its integrated payor-provider model combined with the following financial metrics;

--Sustained debt-to-EBITDA ratios no higher than 2.0x and FLRs in the 20%-25% range;

--Sustained very strong earnings and financial performance evidenced by EBITDA-to-revenue margins and net returns on average capital of approximately 7% and 5%-6%, respectively;

--No meaningful increase in the unfunded status of the organization's pension and retirement obligations or volatility in net worth from those obligations;

--No meaningful increase in the geographic concentration of KFHP's enrollment derived from California.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings with a Positive Outlook:

Kaiser Foundation Health Plan, Inc.;

Kaiser Foundation Health Plan of the Northwest;

Kaiser Foundation Health Plan of Georgia, Inc.;

Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.;

Kaiser Foundation Health Plan of Colorado;

Kaiser Permanente Insurance Company

--IFS at 'A+'.

Fitch has assigned ratings with Positive Outlooks to:

Kaiser Foundation Health Plan of Washington

Kaiser Foundation Health Plan of Washington Options, Inc.

--IFS at 'A+'.

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Applicable Criteria

Insurance Rating Methodology (pub. 26 Apr 2017)
(<https://www.fitchratings.com/site/re/897260>)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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Unsolicited Issuers:

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Kaiser Foundation Health Plan of Washington	-	Long Term Issuer Default Rating	Unsolicited
Kaiser Foundation Health Plan of Washington	-	LT Financial Strength Rating	Unsolicited

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Kaiser Foundation Health Plan of Washington Options, Inc.	-	LT Financial Strength Rating	Unsolicited

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