Catholic Health Initiatives

*Imagine better health.®*

# Quarterly Report

## As of September 30, 2018, and for the three months ended September 30, 2018 and 2017

**Information Concerning Catholic Health Initiatives**

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*This Quarterly Report should be reviewed in conjunction with the information contained in the Annual Report dated September 28, 2018 (the "Annual Report"), which can be found at [http://emma.msrb.org](http://emma.msrb.org).*

*Certain of the discussions included in this Quarterly Report may include forward-looking statements. Such statements are generally identifiable by the terminology used such as "believes," "anticipates," "intends," "scheduled," "plans," "expects," "estimates," "budget" or other similar words. Such forward-looking statements are primarily included in PARTS II, III, IV and V. These statements reflect the current views of management with respect to future events based on certain assumptions, and are subject to risks and uncertainties. Catholic Health Initiatives, a Colorado non-profit corporation (the "Corporation"), undertakes no obligation to publicly update or review any forward-looking statement as a result of new information or future events.*

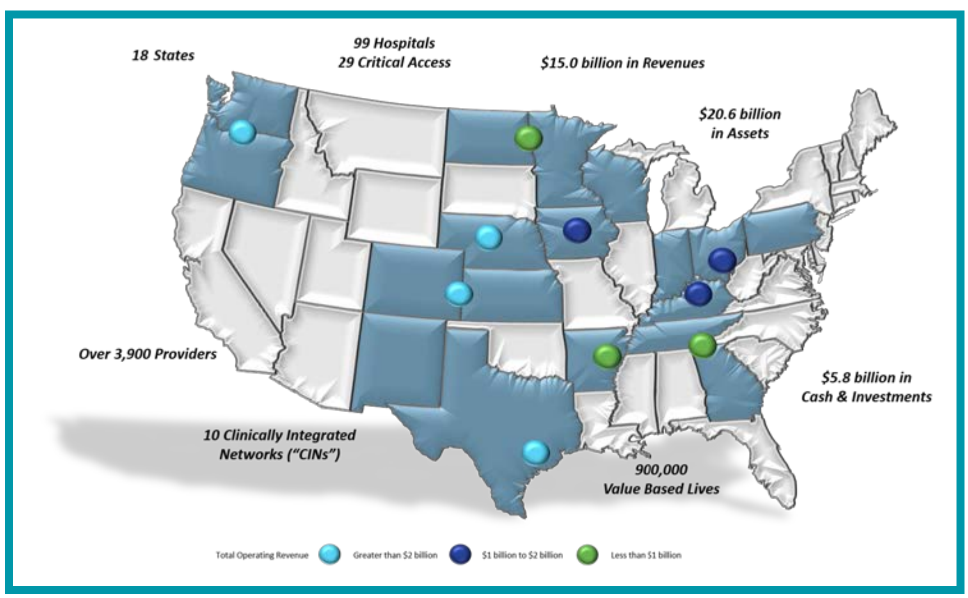
*References to "CHI" in this Quarterly Report are to the Corporation and all of the affiliates and subsidiaries ("Participants") consolidated with it pursuant to U.S. generally accepted accounting principles ("GAAP"). References to the Corporation are references only to the parent corporation, and should not be read to include any of the Participants.*

*Unless otherwise noted, all financial information in this Quarterly Report, for the three months ended September 30, 2018 and 2017, refers to continuing operations only.*

# PART I: OVERVIEW

Catholic Health Initiatives ("CHI") is a group of non-profit and for profit organizations that comprise one of the nation's largest Catholic health care systems, serving more than four million people each year through operations and facilities that span the continuum of care, including acute care hospitals; physician practices; long-term care facilities; assisted-living and residential-living facilities; community-based health services; home care; research and development; medical and nursing education; reference laboratory services; virtual health services; managed care programs; and clinically integrated networks. Today, CHI has operations in 18 states, with a service area that covers approximately 54 million people, or nearly 17% of the U.S. population.

CHI is currently comprised of ten regions that are operated as integrated health systems including several joint operating agreements ("JOAs"), joint operating companies ("JOCs") or joint ventures. The geographic diversity and total operating revenues by region for the fiscal year ended June 30, 2018 are depicted in the accompanying map.



# PART II: Q1 FY2019 HIGHLIGHTS & SUMMARY

CHI's operating EBIDA improved $2.3 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, adjusting for transactional gains and other items (as further outlined on page 11). Total revenues increased $32.6 million or 0.9% on a consolidated basis and increased $120.9 million or 3.3% on a same store basis for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. Total net patient services revenues increased $120.6 million or 3.5% and net patient services revenues per adjusted admission increased $451 or 3.4% on a same store basis for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to increased acuity and service mix changes across many markets.

Volumes on an adjusted admission and same store basis increased a modest 0.2% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. CHI continued to maintain improved total labor costs as a percentage of net patient services revenues of 49.9% for the three months ended September 30, 2018, compared to 50.4% for the three months ended September 30, 2017, or a $17.6 million improvement (on a percentage of net patient services revenues basis).

On a regional basis, the Colorado region sustained strong performance with an operating EBIDA before restructuring, impairment and other losses of 14.0% for the three months ended September 30, 2018. The Texas region improved significantly with an operating EBIDA before restructuring, impairment and other losses of $35.9 million for the three months ended September 30, 2018, compared to a loss of $4.1 million for the three months ended September 30, 2017, due primarily to Hurricane Harvey impacting operations in the prior year period. Other regional results were mixed, most notably in the Nebraska region, which was impacted by declines in volume and acuity due in part to increased populations in high deductible insurance plans where patients are taking on more of a financial responsibility for their healthcare and may be less inclined to pursue care.

Total restructuring, impairment and other losses increased $7.0 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017 (as further outlined on page 17).

Non-operating income for the three months ended September 30, 2018 declined $64.8 million compared to the three months ended September 30, 2017, due primarily to lower investment income, offset partially by changes in the fair value of interest rate swaps above prior year levels.

| | | Key Operating Indicators for Continuing Operations<br>Three Months Ended September 30, | | |
|---|---|---|---|---|
| *($ in millions)* | *Unaudited* | **2018** | **2017** | **Increase (Decrease)** |
| Operating EBIDA | | $214.8 | $222.8 | $(8.0) |
| *Operating EBIDA margin* | | *5.8%* | *6.0%* | |
| Loss from operations | | $(73.4) | $(77.9) | $4.5 |
| *Operating loss margin* | | *(2.0)%* | *(2.1)%* | |
| Net Income[1] | | $75.0 | $135.3 | $(60.3) |
| *Net income margin* | | *1.9%* | *3.5%* | |

[1] Excess (deficit) of revenues over expenses.



This document is dated as of November 29, 2018.

# PART III: STRATEGIC AFFILIATIONS & DIVESTITURES

CHI actively engages in ongoing monitoring and evaluation of potential facility expansion, relationships with academic health center partners, mergers, acquisitions, divestitures, and affiliation opportunities consistent with its strategic goal of creating, maintaining and/or strengthening its clinically integrated networks ("CINs") in key existing markets and, in certain cases, new markets. CHI's strategic vision is supported by focused system growth in both existing and new markets, as evidenced by recent acquisition activity and strategic divestitures, and realignments, certain of which are described below.

## A. Pending and Completed Affiliations/Acquisitions/Transactions

**Civica Rx**. In September 2018, CHI joined with six major, nationally recognized health systems to form Civica Rx, a nonprofit generic drug company that will help patients by addressing shortages and high prices of life saving medications. Once manufacturing approval is obtained from the FDA, Civica Rx will either directly manufacture generic drugs or sub-contract manufacturing with reputable organizations. Its initial goal is to stabilize the supply of essential generic medications administered in hospitals, since many of the medications are in chronic short supply. Civica Rx expects to have its first products on the market as early as 2019.

**CommonSpirit Health (CHI – Dignity Health).** On December 6, 2017, the Corporation and Dignity Health executed a Ministry Alignment Agreement pursuant to which the Corporation and Dignity Health agreed to align their respective ministries into a single, Catholic, non-profit health system. The new organization plans to establish its corporate headquarters in Chicago and operate under CommonSpirit Health. Local facilities will continue operating under their current names.

Dignity Health owns and operates 40 acute care hospitals in California, Arizona and Nevada and 400+ care centers across 22 states. As of and for the fiscal year ended June 30, 2018, Dignity Health reported approximately $18.1 billion of total assets, $8.4 billion of net assets and $14.2 billion in total operating revenue.

CommonSpirit Health will be led by an office of the CEO. Kevin E. Lofton, currently the Chief Executive Officer of CHI and Lloyd Dean, currently the President and Chief Executive Officer of Dignity Health, will both serve as CEOs, each with specific and independent responsibilities and decision-making authority.

The governing board for CommonSpirit Health, the Board of Stewardship Trustees, has been selected and will become effective when the alignment closes. The new Board of Stewardship Trustees will include six members from each legacy board and the two CEOs and an additional member to be determined after the alignment is completed.

The indebtedness and obligations of the Corporation will remain solely those of the Corporation, the majority of which is secured by and subject to the provisions of its Capital Obligation Document, and the indebtedness and obligations of Dignity Health will remain solely those of Dignity Health, secured by and subject to the provisions of its Master Trust Indenture, until the organizations can be consolidated into a single credit.

While completion of the proposed transaction is subject to certain customary closing conditions, the Colorado Attorney General's office has determined that the alignment would not result in a material change in the Corporation's charitable purpose, which allows the transaction to move forward with no further action required by the Colorado Attorney General, and the California Attorney General's office has provided conditional consent to the proposed transaction, following a statewide review process and public comment period. There is no assurance that the remaining closing conditions will be satisfied, or such approvals will be received. The parties filed notifications under the Hart-Scott-Rodino Act ("HSR"), and the HSR waiting period expired on April 2, 2018. The parties may close the transaction before April 2, 2019 without having to file another HSR notification.

## B. Pending and Completed Divestitures and /or Restructurings

***KentuckyOne Health.*** In November 2012, KentuckyOne entered into a Joint Operating Agreement ("Kentucky JOA") and an Academic Affiliation Agreement ("AAA") (collectively "Agreements") with University of Louisville ("U of L"), University Medical Center, Inc. ("UMC"), which owns the University of Louisville Hospital, and other parties.

On December 17, 2016, KentuckyOne, UMC and U of L agreed to restructure the Kentucky JOA. The operations, management and control of the University of Louisville Hospital was transferred back to UMC effective July 1, 2017. The AAA was also restructured, and various transition services agreements were entered into in connection with the transfer of the University of Louisville Hospital to UMC.

In May 2017, the Corporation approved a plan to sell most or substantially all of KentuckyOne's Louisville market acute care operations, including certain operations and facilities owned by Jewish Hospital and St. Mary's Healthcare, Inc. ("JHSMH"). As a result, the Corporation will refocus the Kentucky region on a smaller community footprint, centered in central and eastern Kentucky.

Effective September 1, 2017, the Corporation assumed complete ownership of KentuckyOne when the Corporation purchased the non-controlling interest from the other partner for $150 million in cash consideration.

In December 2017, the Corporation entered into a non-binding letter of intent to negotiate a definitive agreement for the sale of most or substantially all of KentuckyOne Louisville-area acute care operations, and as a result, CHI recorded impairment charges of $272.0 million for the write-down of assets held for sale to their estimated fair value, less estimated costs to sell, as a result of this anticipated transaction. The impairment charge was recorded as a reduction in net assets through discontinued operations.

In June 2018, an updated non-binding letter of intent for the purchase of JHSMH was received and based upon the terms of that letter of intent, CHI recognized additional impairment charges of $105.5 million in discontinued operations and $11.8 million in continuing operations, to adjust the JHSMH property and equipment values to the lower of their carrying value or their fair value net of cost to sell. CHI anticipates closing on a sale during fiscal year 2019.

Effective June 28, 2018, the sale of the Southern Rehab Hospital to Vibra Healthcare was finalized. Effective July 1, 2018, Saint Joseph Martin was sold to Appalachian Regional Healthcare.

The following summarizes selected financial results of JHSMH included in the CHI consolidated statements of changes in net assets as discontinued operations:

| *($ in millions)* | Three Months Ended September 30, 2018 | 2017 | Increase (Decrease) |
|---|---|---|---|
| | *Unaudited* | | |
| **JHSMH** | | | |
| Operating revenues | $180.0 | $181.7 | $(1.7) |
| Operating EBIDA before restructuring, impairment and other losses | $(17.7) | $(20.4) | $2.7 |

The CHI consolidated balance sheets include JHSMH total assets held for sale of $19.9 million and total liabilities held for sale of $77.3 million at September 30, 2018.

***QualChoice.*** In May 2016, the Corporation approved a plan to sell or otherwise dispose of certain entities of QualChoice, a consolidated CHI subsidiary, whose primary business is to develop, manage and market commercial and Medicare Advantage health insurance programs, as well as a wide range of products and administrative services. In June 2018, the Corporation entered into an asset purchase agreement for the sale of its Medicare

Advantage health insurance operations in the State of Washington to be effective in January 2019. In addition, the Corporation also entered into a non-binding letter of intent for the sale of the QualChoice Health commercial operations in the State of Arkansas. Those negotiations related to the QualChoice Health commercial operations are ongoing with the expectation that a purchase agreement will be executed during fiscal year 2019.

The Corporation continues to actively manage QualChoice and has steadily improved operations since the announcement to sell or otherwise dispose of the operations, moving from an operating EBIDA loss before restructuring, impairment, and other losses of $(85.4) million in fiscal year 2016 to a positive operating EBIDA before restructuring, impairment and other losses of $8.6 million in fiscal year 2018 - a $94 million improvement over the two fiscal year periods.

The following summarizes the financial results of QualChoice reported in the CHI consolidated statements of changes in net assets:

| | Three Months Ended September 30, | | |
|---|---|---|---|
| *($ in millions)* | **2018** | **2017** | **Increase** |
| **QualChoice** | | *Unaudited* | |
| Operating Revenues | $143.6 | $132.6 | $11.0 |
| Operating EBIDA before restructuring, impairment and other losses | $4.3 | $(4.3) | $8.6 |

The September 30, 2018, CHI consolidated balance sheets included QualChoice total assets held for sale of $181.3 million and total liabilities held for sale of $150.4 million.

# *PART IV: SELECTED FINANCIAL DATA*

The selected financial data that follows has been prepared by management, based on (i) CHI's unaudited interim financial statements as of September 30, 2018, and June 30, 2018, and for the three months ended September 30, 2018 and 2017. The unaudited financial statements include all adjustments, consisting of normal recurring accruals, which management of CHI considers necessary for a fair presentation of the combined financial position and results of operations for these periods. The unaudited interim financial statements for the three months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2019.

The CHI consolidated financial information should be read in conjunction with the unaudited financial statements, related notes, and other financial information of CHI included in Appendix A of this Quarterly Report.

The results of operations for recently acquired entities that have been accounted for as acquisitions are included in the CHI consolidated financial and operating information from the respective dates of acquisition.

CHI participates in JOAs with hospital-based organizations in Colorado, Iowa and Ohio. The agreements generally provide for, among other things, joint management of the combined operations of the local facilities included in the JOAs through JOCs. CHI retains ownership of the assets, liabilities, equity, revenues and expenses of the CHI facilities that participate in the JOAs. Transfers of assets from facilities owned by the JOA participants are generally restricted under the terms of the agreements. The financial statements of the CHI facilities managed under all JOAs are included in the CHI consolidated financial statements.

As of September 30, 2018, CHI has investment interests of 65%, 50%, and 50% in JOCs based in Colorado, Iowa, and Ohio, respectively. CHI's interests in the JOCs are included in investments in unconsolidated organizations and totaled $444.6 million and $435.8 million at September 30, 2018 and June 30, 2018, respectively. CHI recognizes its investment in all JOCs under the equity method of accounting. The JOCs provide various levels of services to the related JOA sponsors, and operating expenses of the JOCs are allocated to each sponsoring organization.

Certain joint venture agreements do not result in the consolidation of the jointly owned entities with the

Corporation. The results of those operations are instead reflected in the consolidated financial statements of CHI under the line item “Changes in equity of unconsolidated organizations”.

*A. **The following table provides condensed consolidated balance sheets as of September 30, 2018 and June 30, 2018.***

| **CHI**<br>**Condensed Consolidated Balance Sheets** *($ in thousands)* | **September 30, 2018**<br>*Unaudited* | **June 30, 2018** |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and equivalents | $287,951 | $510,456 |
| Net patient accounts receivable | 2,157,692 | 2,121,582 |
| Assets held for sale | 206,379 | 195,698 |
| Other current assets | 863,632 | 764,272 |
| Total current assets | 3,515,654 | 3,592,008 |
| Investments and assets limited as to use: | | |
| Internally designated investments | 5,221,604 | 5,308,868 |
| Restricted investments | 1,177,184 | 1,163,995 |
| Total investments and assets limited as to use | 6,398,788 | 6,472,863 |
| Property and equipment, net | 8,040,187 | 8,110,767 |
| Other assets | 2,430,320 | 2,419,669 |
| Total assets | $20,384,949 | $20,595,307 |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $1,984,300 | $2,181,021 |
| Liabilities held for sale | 233,735 | 251,710 |
| Short-term and current portion of debt | 2,184,080 | 2,184,106 |
| Total current liabilities | 4,402,115 | 4,616,837 |
| Other liabilities | 2,506,235 | 2,504,785 |
| Long-term debt | 6,311,519 | 6,341,931 |
| Total liabilities | 13,219,869 | 13,463,553 |
| Net assets: | | |
| Unrestricted | 6,858,292 | 6,829,063 |
| Temporarily restricted | 207,545 | 207,695 |
| Permanently restricted | 99,243 | 94,996 |
| Total net assets | 7,165,080 | 7,131,754 |
| Total liabilities and net assets | $20,384,949 | $20,595,307 |

***B. The following table presents condensed consolidated statements of operations for the three months ended September 30, 2018 and 2017.***

| **CHI**<br>**Condensed Consolidated Statements of Operations** | | **Three Months Ended September 30,**<br>**2018** | **2017** |
|---|---|---|---|
| **Revenues** | *($ in thousands)* | *Unaudited* | |
| Net patient services revenues | | $3,527,754 | $3,494,810 |
| Other | | 200,636 | 200,959 |
| Total operating revenues | | 3,728,390 | 3,695,769 |
| **Expenses** | | | |
| Salaries and employee benefits | | 1,761,113 | 1,765,987 |
| Supplies, purchased services and other | | 1,731,256 | 1,692,800 |
| Depreciation and amortization | | 207,322 | 225,588 |
| Interest | | 80,942 | 75,110 |
| Total operating expenses before restructuring, impairment and other losses | | 3,780,633 | 3,759,485 |
| Loss from operations before restructuring, impairment and other losses | | (52,243) | (63,716) |
| Restructuring, impairment and other losses | | 21,201 | 14,170 |
| **Loss from operations** | | (73,444) | (77,886) |
| Nonoperating gains | | 148,410 | 213,231 |
| **Excess of revenues over expenses** | | $74,966 | $135,345 |

## *1. CRITICAL ACCOUNTING POLICIES*

The preparation of financial statements in conformity with GAAP requires that management make assumptions, estimates and judgments affecting the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. Actual results could differ materially from the estimates. A description of CHI's significant accounting policies can be found in *Note 1 of the Consolidated Interim Financial Statements (unaudited) for the Three Months Ended September 30, 2018 included in Appendix A of this Quarterly Report.*

# PART V: MANAGEMENT'S DISCUSSION & ANALYSIS

***The following table provides key balance sheet metrics as of September 30, 2018 and June 30, 2018.***

| CHI<br>Key Balance Sheet Metrics | September 30, 2018<br>*Unaudited* | June 30, 2018 |
|---|---|---|
| **Consolidated Balance Sheet Summary** | | |
| Total assets | $20.4 billion | $ 20.6 billion |
| Total liabilities | $13.2 billion | $ 13.5 billion |
| Total net assets | $ 7.2 billion | $ 7.1 billion |
| **Financial Position and Leverage Ratios (Unaudited)** | | |
| Total cash and unrestricted investments | $5.5 billion | $5.8 billion |
| Days of cash on hand[1] | 141 | 149 |
| Total debt | $8.5 billion | $8.5 billion |
| Debt to capitalization[2] | 55.3% | 55.5% |

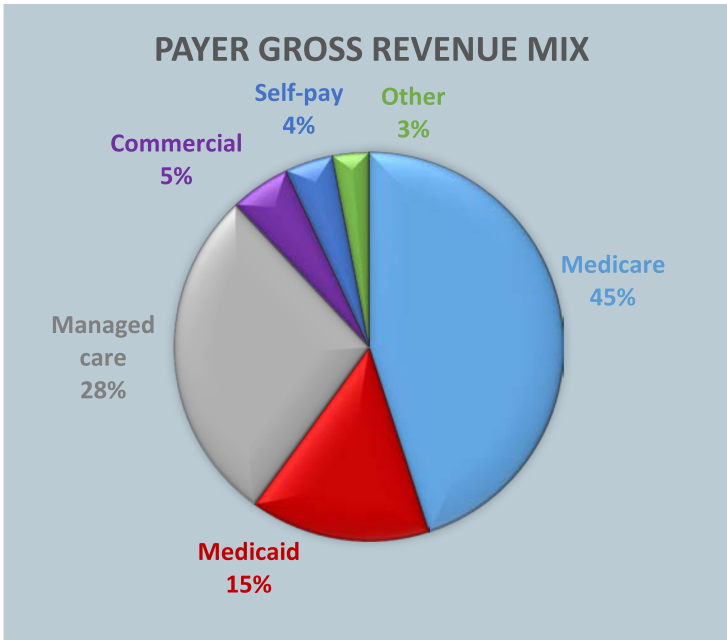
[1] (Cash and equivalents + Investments and assets limited as to use: Internally designated investments)/((Total operating expenses before restructuring, impairment and other losses - Depreciation and amortization)/365). For the days of cash on hand one day of operating expenses represented $39.2 million at September 30, 2018 and $39.1 million at June 30, 2018.
[2] (Short-term and current portion of debt + Long-term debt)/(Short-term and current portion of debt + Long-term debt + Unrestricted net assets).

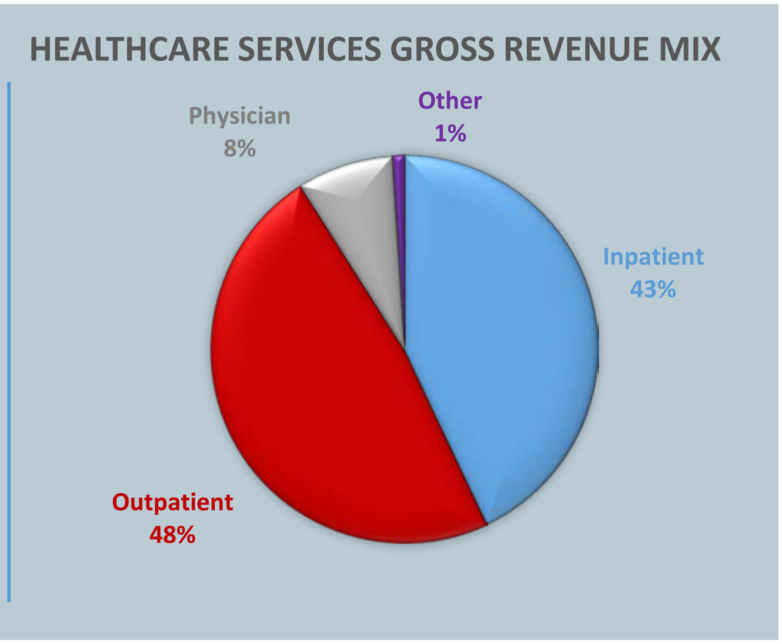
***The following table presents key operating metrics and utilization statistics for the three months ended September 30, 2018 and 2017.***

| CHI<br>Key Operating Metrics and Utilization Statistics | Three Months Ended September 30,<br>2018 | <br>2017 |
|---|---|---|
| | *Unaudited* | |
| **Consolidated Revenues, Expenses and Key Operating Metrics*** | | |
| Total net patient services revenues | $3.5 billion | $3.5 billion |
| Total operating revenues | $3.7 billion | $3.7 billion |
| Total operating expenses before restructuring, impairment and other losses | $3.8 billion | $3.8 billion |
| Operating EBIDA before restructuring, impairment and other losses[1] | $236.0 million | $237.0 million |
| Operating EBIDA margin before restructuring, impairment and other losses[2] | 6.3% | 6.4% |
| Operating loss before restructuring, impairment and other losses | $(52.2) million | $(63.7) million |
| Operating loss margin before restructuring, impairment and other losses[3] | (1.4)% | (1.7)% |
| Operating EBIDA[4] | $214.8 million | $222.8 million |
| Operating EBIDA margin[5] | 5.8% | 6.0% |
| Operating loss | $(73.4) million | $(77.9) million |
| Operating loss margin[6] | (2.0)% | (2.1)% |
| Net income[7] | $75.0 million | $135.3 million |
| Net income margin[8] | 1.9% | 3.5% |
| **Utilization Statistics** | | |
| Acute admissions | 110,828 | 118,386 |
| Acute inpatient days | 518,048 | 544,203 |
| Acute average length of stay in days | 4.7 | 4.6 |
| Long-term care days | 106,200 | 103,216 |
| Medicare case-mix index | 1.9 | 1.8 |
| Adjusted admissions[9] | 255,943 | 264,053 |
| Inpatient ER visits | 61,318 | 64,529 |
| Inpatient surgeries | 33,789 | 36,746 |
| Outpatient ER visits | 444,565 | 472,235 |
| Outpatient non-ER visits | 1,335,934 | 1,354,146 |
| Outpatient surgeries | 57,111 | 57,779 |
| Physician visits | 2,687,878 | 2,652,951 |

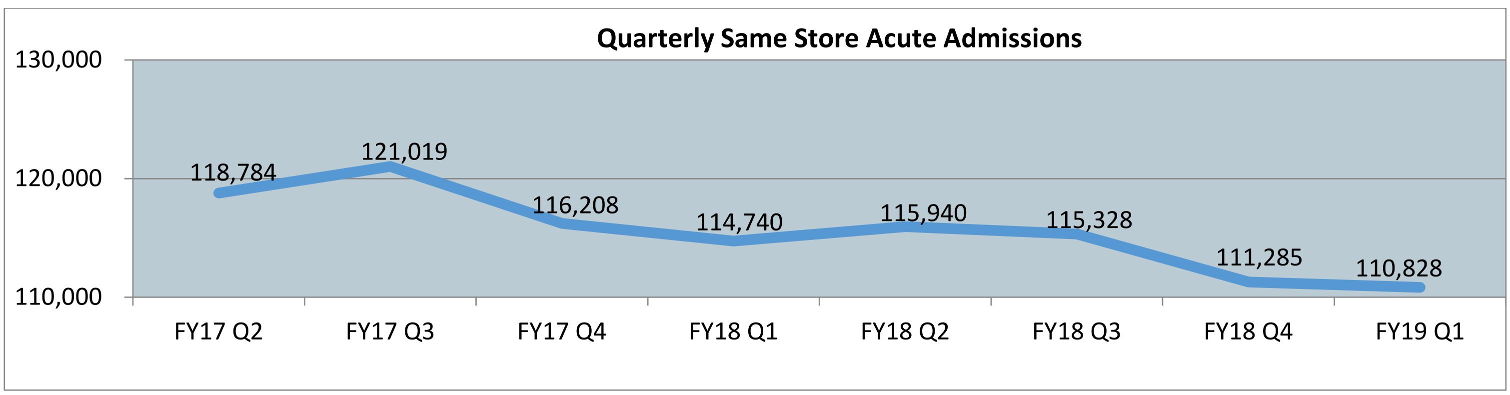
* Includes business combination gains.
[1] Income (loss) from operations before restructuring, impairment and other losses + depreciation and amortization + interest.
[2] Income (loss) from operations before restructuring, impairment and other losses + depreciation and amortization + interest/total operating revenues.
[3] Income (loss) from operations before restructuring, impairment and other losses/total operating revenues.
[4] Income (loss) from operations + depreciation and amortization + interest.
[5] Income (loss) from operations + depreciation and amortization + interest/total operating revenues.
[6] Income (loss) from operations/total operating revenues.
[7] Excess (deficit) of revenues over expenses
[8] Excess (deficit) of revenues over expenses/(total operating revenues + nonoperating gains (losses).
[9] (Total gross patient revenues/total gross inpatient revenues) x acute admissions.

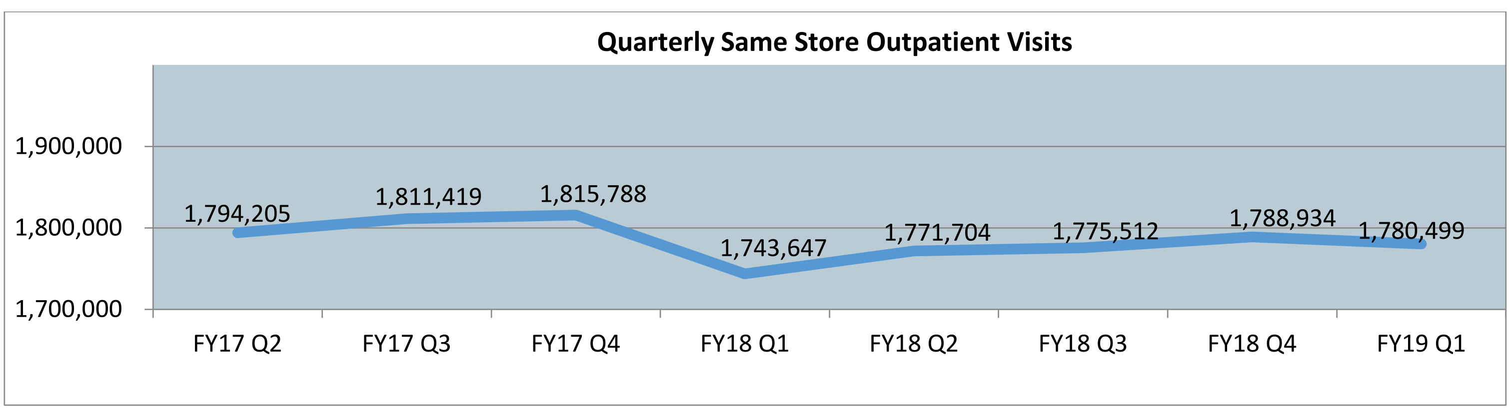
***The following charts represent the payer gross revenue mix and healthcare services gross revenue mix for the consolidated operations as of September 30, 2018.***




***The following charts represent quarterly patient volume activity for the consolidated operations over the previous eight quarters on a same store basis.***



# 1. SUMMARY OF OPERATING RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

**OPERATING EBIDA/LOSS FROM OPERATIONS**

Operating EBIDA before restructuring, impairment and other losses, excluding transactional gains and other items, improved $9.3 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to increased net patient services revenues combined with favorable expense management. Loss from operations before restructuring, impairment and other losses, excluding transactional gains and other items, improved $1.7 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017.

Same store net patient services revenues per adjusted admission was $13,782 for the three months ended September 30, 2018, compared to $13,331 for the three months ended September 30, 2017, or a $451 and 3.4% increase. Same store expenses per adjusted admissions before restructuring was $14,771 for the three months ended September 30, 2018, compared to $14,337 for the three months ended September 30, 2017, or a $434 and 3.0% increase. Same store total net patient services revenues increased $120.6 million, or 3.5%. Impacting same store net patient services revenues were $77.9 million in contract rate increases and other improvements, provider fee revenue improvements of $40.0 million, increases in acuity of $21.3 million, and increased volumes of $8.0 million, offset by service mix and payer mix declines of $26.6 million. Same store total operating expenses increased $116.7 million, or 3.2%, which includes inflationary increases as well as increased supplies, medical professional fees, and consulting expenses.

Operating EBIDA before restructuring, impairment and other losses, excluding transactional gains and other items, is as follows:

| | Three Months Ended September 30, | | Increase |
|---|---|---|---|
| | 2018 | 2017 | (Decrease) |
| *($ in millions)* | *Unaudited* | | |
| Operating EBIDA before restructuring, impairment and other losses, excluding transactional gains and other items | $236.0 | $226.7 | $9.3 |
| Operating EBIDA margin before restructuring, impairment and other losses, excluding transactional gains and other items | 6.3% | 6.2% | |
| Nebraska net patient service revenue adjustments[1] | - | 13.6 | |
| Ohio compliance adjustment[2] | - | (7.3) | |
| Gains on real estate sales | - | 4.0 | |
| Operating EBIDA before restructuring, impairment and other losses | $236.0 | $237.0 | $(1.0) |
| Operating EBIDA margin before restructuring, impairment and other losses | 6.3% | 6.4% | |

[1] Related to favorable bad debt adjustments.
[2] Related to a reimbursement documentation matter.

Operating loss before restructuring, impairment and other losses, excluding transactional gains and other items, is as follows:

| ($ in millions) | Three Months Ended September 30, 2018 | 2017 | Increase |
|---|---|---|---|
| | *Unaudited* | | |
| Operating loss before restructuring, impairment and other losses, excluding transactional gains and other items | $(52.2) | $(53.9) | $1.7 |
| Operating loss margin before restructuring, impairment and other losses, excluding transactional gains and other items | (1.4)% | (1.5)% | |
| Nebraska net patient service revenue adjustments[1] | - | 13.6 | |
| Ohio compliance adjustment[2] | - | (7.3) | |
| Gains on real estate sales | - | 4.0 | |
| Depreciation increase on IT assets due to change in useful life | - | (20.1) | |
| Operating loss before restructuring, impairment and other losses | $(52.2) | $(63.7) | $11.5 |
| Operating loss margin before restructuring, impairment and other losses | (1.4)% | (1.7)% | |

[1] Related to favorable bad debt adjustments.
[2] Related to a reimbursement documentation matter.

Operating EBIDA before restructuring, impairment and other losses, excluding transactional gains and other items, over the trailing four quarters is as follows:

| ($ in millions) | QTD 9/30/2018 | QTD 6/30/2018 | QTD 3/31/2018 | QTD 12/31/2017 |
|---|---|---|---|---|
| | *Unaudited* | | | |
| Operating EBIDA before restructuring, impairment and other losses, excluding transactional gains and other items | $236.0 | $235.1 | $259.8 | $298.1 |
| Operating EBIDA margin before restructuring, impairment and other losses, excluding transactional gains and other items | 6.3% | 6.3% | 7.0% | 7.8% |
| Ohio compliance adjustment[1] | - | 3.6 | - | - |
| Operating EBIDA before restructuring, impairment and other losses | $236.0 | $238.7 | $259.8 | $298.1 |
| Operating EBIDA margin before restructuring, impairment and other losses | 6.3% | 6.3% | 7.0% | 7.8% |

[1] Related to a reimbursement documentation

The table below presents various regional financial metrics for CHI for the three months ended September 30, 2018 and 2017. Further information on CHI's regional operating results is discussed within the regional operating trends section below.

***Catholic Health Initiatives Operations Summary – Three Months Ended September 30, 2018 and 2017***

| Region | QTD 9/30/2018 Operating EBIDA before restructuring, impairment and other losses | QTD 9/30/2017 Operating EBIDA before restructuring, impairment and other losses | QTD 9/30/2018 Operating EBIDA margin before restructuring, impairment and other losses | QTD 9/30/2017 Operating EBIDA margin before restructuring, impairment and other losses | QTD 9/30/2018 Operating revenues percentage of CHI consolidated | QTD 9/30/2017 Operating revenues percentage of CHI consolidated |
|---|---|---|---|---|---|---|
| | *($ in thousands)* | | *Unaudited* | | | |
| Pacific Northwest | $69,258 | $72,881 | 9.9% | 10.8% | 18.8% | 18.2% |
| Colorado | 85,888 | 69,198 | 14.0% | 11.6% | 16.5% | 16.1% |
| Texas | 35,922 | (4,126) | 6.2% | (0.8)% | 15.6% | 14.0% |
| Nebraska | 22,818 | 66,142 | 4.6% | 12.9% | 13.3% | 13.9% |
| Iowa | 16,972 | 13,674 | 6.6% | 5.4% | 6.9% | 6.9% |
| Kentucky | 20,341 | 31,539 | 7.9% | 11.4% | 6.9% | 7.5% |
| Ohio | 12,226 | 4,513 | 5.9% | 1.7% | 5.6% | 7.4% |
| Arkansas | (10,123) | 2,440 | (5.2)% | 1.3% | 5.2% | 5.1% |
| North Dakota/Minnesota | 7,041 | 19,155 | 4.0% | 10.4% | 4.7% | 5.0% |
| Tennessee | 11,896 | 13,514 | 7.0% | 8.4% | 4.6% | 4.4% |
| National business lines[1] | 9,332 | 7,563 | 10.0% | 10.6% | 2.5% | 1.9% |
| Other[2] | (1,122) | (19,817) | N/A | N/A | (0.6)% | (0.4)% |
| Total Regional | 280,449 | 276,676 | 7.5% | 7.5% | 100.0% | 100.0% |
| Corporate services and other business lines[3] | (44,428) | (39,694) | N/A | N/A | 0.0% | 0.0% |
| Total CHI Consolidated | $236,021 | $236,982 | 6.3% | 6.4% | 100.0% | 100.0% |

[1] Includes Home Care and Senior Living business lines.
[2] Includes the operations of Albuquerque Health Ministries and Lancaster Health Ministries MBOs as well as regional eliminations. For the three months ended September 30, 2017 results also included MedSynergies contract costs which did not occur in the current quarter end.
[3] Includes CHI Corporate and First Initiatives Insurance, Ltd. ("FIIL"), CHI's wholly-owned captive insurance company as well as CHI system eliminations.

## OPERATING REVENUE AND VOLUME TRENDS

Same store total operating revenue, net patient services revenues, and other operating revenue changes are summarized below. Normalized amounts have been adjusted to exclude transactional gains and other items as noted above.

***Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017***

| Same Store Revenue *($ In millions)* | 2018 *Unaudited* | 2017 | Increase (Decrease) |
|---|---|---|---|
| Net patient services revenues | $3,527.4 | $3,406.8 | $120.6 |
| Other operating revenue | 203.9 | 203.6 | 0.3 |
| Total operating revenue | 3,731.3 | 3,610.4 | 120.9 |
| Net patient services revenues normalized[1] | 3,527.4 | 3,403.2 | 124.2 |
| Other operating revenue normalized[2] | 203.9 | 196.9 | 7.0 |
| Total operating revenue normalized | $3,731.3 | $3,600.1 | $131.2 |

[1] Excludes the $13.6 million Nebraska favorable bad debt adjustments for the three months ended September 30, 2017 and the $10.1 million Ohio unfavorable reimbursement documentation matter impact for the three months ended September 30, 2017.
[2] Excludes the $2.7 million favorable JOA income share impact as a result of the Ohio reimbursement documentation matter for the three months ended September 30, 2017 and the $4.0 in real estate gains for the three months ended September 30, 2017.

Same store patient volume increases (decreases) are summarized below.

***Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017***

| Same Store Patient Volumes | Increase (Decrease) | Increase (Decrease) |
|---|---|---|
| | *Unaudited* | |
| Adjusted Admissions | 0.2% | 391 |
| Acute Admissions | (3.4)% | (3,912) |
| Acute Inpatient Days | (2.2)% | (11,586) |
| Inpatient ER Visits | (4.8)% | (3,102) |
| Inpatient Surgeries | (6.1)% | (2,204) |
| Outpatient ER Visits | (1.0)% | (4,513) |
| Outpatient Non-ER Visits | 3.2% | 41,365 |
| Outpatient Surgeries | 2.6% | 1,443 |
| Physician Visits | 1.6% | 41,479 |

**OPERATING EXPENSES**

Increases (decreases) in same store total operating expenses before restructuring, impairment and other losses are summarized below.

***Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017***

| Same Store Expense *($ In millions)* | 2018 | 2017 | Increase (Decrease) |
|---|---|---|---|
| | *Unaudited* | | |
| Total labor | $1,761.0 | $1,716.9 | $44.1 |
| Supplies | 612.3 | 579.1 | 33.2 |
| Purchased services | 422.2 | 415.3 | 6.9 |
| Medical professional fees | 138.6 | 115.7 | 22.9 |
| Interest | 80.9 | 75.1 | 5.8 |
| Depreciation and amortization | 207.3 | 218.3 | (11.0) |
| All other | 558.3 | 543.4 | 14.9 |
| Total operating expenses | $3,780.6 | $3,663.8 | $116.8 |

Same store labor and supply indicators are summarized below.

***Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017***

| Same store labor and supply indicators | 2018 | 2017 |
|---|---|---|
| | *Unaudited* | |
| Labor % of net patient services revenues | 49.9% | 50.4% |
| Labor % of total operating expense | 46.6% | 46.9% |
| Supplies % of net patient services revenues | 17.4% | 17.0% |
| Supplies % of total operating expense | 16.2% | 15.8% |

Same store total labor costs increased $44.1 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to an increase in average hourly rates of $22.5 million and an increase in FTEs of 909 or $21.6 million.

Same store medical professional fees increased $22.9 million, or 19.8%, for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to the movement of certain employed physicians to a professional fee contract model, primarily in the Texas region.

Same store supplies as a percentage of net patient services revenues were 17.4% for the three months ended September 30, 2018 and 17.0% for the three months ended September 30, 2017, respectively, and included $28.5 million in increased medical-surgical utilization supplies expenses and $4.7 million in increased pharmacy supplies expenses.

Same store interest expense increased $5.8 million, or 7.8% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due largely to increased variable-rate debt interest costs as a result of rising short-term interest rates. Total debt outstanding decreased $30.4 million during the three months ended September 30, 2018, due to regularly scheduled debt service payments.

Same store depreciation and amortization expenses decreased $11.0 million, or 5.0% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, as a result of $20.1 million in increased expenses in the prior year period due to changes in the estimated remaining useful life of certain information technology assets.

## REGIONAL OPERATING TRENDS

The Corporation periodically reviews its allocation methodology for corporate support services and may adjust those allocations based on the strategic needs and resource consumption of the regions and CHI overall. These changes in allocation methodologies may increase or decrease a region's operating results from year to year, but have no impact on the consolidated results of CHI.

The Pacific Northwest, Colorado, Texas, Nebraska and Kentucky regions represent CHI's five largest operating regions, and for the three months ended September 30, 2018, represented 71.1% of CHI's consolidated operating revenues. Additional information on these regions is discussed below.

***Pacific Northwest*** - The region's operating EBIDA before restructuring, impairment and other losses totaled $69.3 million for the three months ended September 30, 2018, and decreased $3.6 million, compared to the three months ended September 30, 2017. Net patient services revenues increased $23.1 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and included increases in volume of $4.9 million, $14.7 million in favorable contract increases and $3.5 million of service mix changes.

Total net revenue per adjusted admission increased 3.1% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, while total operating expense per adjusted admission increased 5.1% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. Total operating expenses increased $35.1 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to increased labor, purchased services, medical professional fees, and depreciation expenses. Total labor as a percentage of net patient services revenues increased to 50.8% for the three months ended September 30, 2018, compared to 50.4% for the three months ended September 30, 2017, which represents an unfavorable expense variance of $2.8 million. Supply expense as a percentage of net patient services revenues decreased to 13.4% for the three months ended September 30, 2018, compared to 13.5% for the three months ended September 30, 2017, which represents a favorable expense variance of $1.1 million. Depreciation and amortization expenses increased $6.8 million, or 22.1% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to facility expansion and renovation activities, which has increased capitalized assets and related depreciation.

***Colorado*** - The region's operating EBIDA before restructuring, impairment and other losses totaled $85.9 million for the three months ended September 30, 2018 and increased $16.7 million compared to the three months ended September 30, 2017. Total other operating revenues increased $18.9 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due primarily to increased medical premium revenues. Net patient services revenues decreased $0.4 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and included decreases in volume of $3.7 million and

$6.2 million in decreased provider fee revenue from the state-based reimbursement programs, offset by $10.3 million in favorable contract and acuity increases. The state-based reimbursement programs also included increased program expenses of $1.4 million for the three months ended September 30, 2018 and provided an overall operating EBIDA decrease of $7.6 million compared to the three months ended September 30, 2017.

Total net revenue per adjusted admission increased 2.3% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, while total operating expense per adjusted admission increased 3.6% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. Operating expenses increased $6.9 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to continued implementation of expense management and productivity improvements. Total labor as a percentage of net patient services revenues decreased to 38.1% for the three months ended September 30, 2018, compared to 39.4% for the three months ended September 30, 2017, representing a favorable expense variance of $7.8 million. Supply expense as a percentage of net patient services revenues increased to 15.1% for the three months ended September 30, 2018, compared to 14.6% for the three months ended September 30, 2017, which represents an unfavorable expense variance of $2.9 million.

***Texas*** - The region's operating EBIDA before restructuring, impairment and other losses totaled $35.9 million for the three months ended September 30, 2018 and increased $40.0 million compared to the three months ended September 30, 2017. Operating results for the three months ended September 30, 2017 were impacted by Hurricane Harvey in August 2017, which resulted in a decrease of $25.8 million to total operations as a result of decreased patient volumes due to rescheduling of procedures and visits, increased labor costs due to overtime and paid time off granted to employees. Net patient services revenues increased $69.8 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and included $26.8 million in increased provider fee revenue from the state-based reimbursement programs, increases in volume of $21.6 million, and $21.4 million in contract rate increases and a managed care payer settlement. The state-based reimbursement programs also included increased program expenses of $5.5 million for the three months ended September 30, 2018 and provided an overall operating EBIDA increase of $21.3 million compared to the three months ended September 30, 2017.

Total net revenue per adjusted admission increased 8.2% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, while total operating expense per adjusted admission decreased 2.0% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. Total operating expenses increased $19.2 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, as a result of growth in patient volumes and inflationary increases, slightly offset by continued implementation of expense management and productivity improvements across the region. Total labor as a percentage of net patient services revenues decreased to 41.0% for the three months ended September 30, 2018, compared to 47.9% for the three months ended September 30, 2017, representing a favorable expense variance of $39.0 million. However, medical professional fees expense increased $13.4 million and purchased services expense increased $10.2 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to a shift in classification of certain services and physician compensation arrangements. Supply expense as a percentage of net patient services revenues decreased to 19.0% for the three months ended September 30, 2018, compared to 19.8% for the three months ended September 30, 2017, representing a favorable expense variance of $4.5 million.

***Nebraska*** - The region's operating EBIDA before restructuring, impairment and other losses totaled $22.8 million for the three months ended September 30, 2018 and decreased $43.3 million compared to the three months ended September 30, 2017. Results for the three months ended September 30, 2017 included $13.6 million in favorable net patient services revenues adjustments and $4.0 million in real estate gains. Net patient services revenues decreased $13.4 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and includes decreases in volume of $12.7 million and the $13.6 million favorable adjustment to net patient services revenues in the prior year period that did not recur in the current year period, offset by $12.9 million in favorable contract rate increases and other items.

Total net revenue per adjusted admission decreased 2.7% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, while total operating expense per adjusted admission increased 5.0% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. Total operating expenses increased $23.1 million for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, due to increased labor, purchased services, medical professional fees, and rental expenses. Total labor as a percentage of net patient services revenues increased to 57.6% for the three months ended September 30, 2018, compared to 53.4% for the three months ended September 30, 2017, representing an unfavorable expense variance of $19.5 million. Supply expense as a percentage of net patient services revenues increased to 16.6% for the three months ended September 30, 2018, compared to 15.8% for the three months ended September 30, 2017, representing an unfavorable expense variance of $3.6 million.

***Kentucky*** - The region's operating EBIDA before restructuring, impairment and other losses (excluding discontinued operations) totaled $20.3 million for the three months ended September 30, 2018 and decreased $11.2 million compared to the three months ended September 30, 2017. Net patient services revenues decreased $13.1 million (on a same store basis) for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and included volume decreases of $21.4 million, and unfavorable shifts in payer mix of $1.4 million, offset by acuity improvements of $4.6 million and $5.1 million in favorable contract rate increases and other items. A portion of the volume decreases is related to the transfer of certain homecare operations to another CHI affiliate. Total operating expenses decreased $8.5 million (on a same store basis) for the three months ended September 30, 2018, compared to the three months ended September 30, 2017.

Total net revenue per adjusted admission increased 2.0% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, while total operating expense per adjusted admission increased 3.7% for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. Total labor as a percentage of net patient services revenues increased to 45.8% for the three months ended September 30, 2018, compared to 45.0% for the three months ended September 30, 2017, representing an unfavorable expense variance of $1.9 million. Supply expense as a percentage of net patient services revenues increased to 20.2% for the three months ended September 30, 2018, compared to 18.6% for the three months ended September 30, 2017, representing an unfavorable expense variance of $4.0 million.

***CHI Corporate services and other business lines*** - Operating EBIDA before restructuring, impairment and other losses totaled $44.4million for three months ended September 30, 2018 and decreased $4.7 million compared to the three months ended September 30, 2017. Changes in support services activities relate to a variety of factors, including strategic transfers of support activities from the regions and other service lines to corporate services to build corporate support functions, and new implementations of system-wide services. Support services allocations to the regions consider the strategic needs and resource consumption of the regions and CHI overall. Expense decreases have occurred within various support services concentrated within Information Technology, Clinical Engineering and Onshore Risk and Insurance.

***Restructuring, Impairment and Other Losses***

| ($ in thousands) | Three Months Ended September 30, 2018 | 2017 |
|---|---|---|
| | Unaudited | |
| Changes in business operations | $16,929 | $7,939 |
| Severance costs | 3,592 | 6,025 |
| Impairment charges | 680 | 206 |
| Total restructuring, impairment and other losses | $21,201 | $14,170 |
| Non-cash expenses related to restructuring, impairment and other losses | $680 | $206 |

Restructuring, impairment, and other losses include charges relating to changes in business operations, severance costs, long-lived asset impairments and acquisition-related costs. Changes in business operations include costs incurred periodically to implement reorganization efforts within specific operations to align CHI's operations more cost effectively. The non-cash portion of total restructuring, impairment and other losses includes impairment charges.

***Nonoperating Results***

| | Three Months Ended September 30, | |
|---|---|---|
| *($ in thousands)* | 2018 | 2017 |
| | *Unaudited* | |
| Investment income, net | $138,331 | $214,937 |
| Losses on early extinguishment of debt | - | 208 |
| Realized and unrealized gains (losses) on interest rate swaps | 13,953 | (3,982) |
| Other nonoperating (losses) gains | (3,874) | 2,068 |
| Total nonoperating gains | $148,410 | $213,231 |

## 2. SUMMARY OF CHI BALANCE SHEETS AS OF SEPTEMBER 30, 2018 AND JUNE 30, 2018

Total assets were $20.4 billion and $20.6 billion at September 30, 2018 and June 30, 2018, respectively, representing a decrease of 1.0%, or $210.4 million, during the three months ended September 30, 2018. The decrease was attributable primarily to a decrease of $309.8 million in cash and unrestricted investments during the three months ended September 30, 2018.

Total cash and equivalents, and unrestricted investments were $5.5 billion and $5.8 billion at September 30, 2018 and June 30, 2018, respectively, representing a decrease of 5.3%, or $309.8 million during the three months ended September 30, 2018. CHI spent a net $191.8 million in investing cash flow activities, including $151.1 million of on-going capital investment activity, which include IT infrastructure investments, as well as new hospital construction and facility renovations across CHI during the three months ended September 30, 2018. Financing cash flow decreases for the three months ended September 30, 2018 totaled $19.3 million and includes net debt and interest payments and net swap collateral receipts. Working capital changes and cash flows from operations, including investments and assets limited to use, decreased $98.7 million for the three months ended September 30, 2018.

Days of cash on hand decreased to 141 days at September 30, 2018, from 149 at June 30, 2018. For purposes of the days of cash on hand calculation, one day of operating expenses represented $39.2 million and $39.1 million at September 30, 2018 and June 30, 2018, respectively.

Net patient accounts receivable of $2.2 billion and $2.1 billion at September 30, 2018 and June 30, 2018, respectively, representing a slight increase of 1.7%, or $36.1 million, during the three months ended September 30, 2018. Total liabilities were $13.2 billion and $13.5 billion at September 30, 2018 and June 30, 2018, respectively, representing a decrease of 1.8%, or $243.7 million, during the three months ended September 30, 2018, including a $196.7 million decrease in accounts payable and accrued expenses as a result of working capital changes.

Total debt was $8.5 billion at both September 30, 2018 and June 30, 2018 and includes a decrease of $30.4 million due to regularly scheduled debt service payments during the three months ended September 30, 2018.

The debt-to-capitalization ratio decreased to 55.3% at September 30, 2018, from 55.5% at June 30, 2018. Total unrestricted net assets increased 0.4%, or $29.2 million during the three months ended September 30, 2018, due primarily to $75.0 million in excess of revenues over expenses, offset by a $31.2 million net loss from discontinued operations.

## 3. CERTAIN CONTRACTUAL OBLIGATIONS

### CAPITAL OBLIGATION DOCUMENT

The obligations of the Corporation to pay amounts due on its commercial paper notes, revenue bonds, guarantees and certain swap agreements are evidenced by Obligations issued under the Capital Obligation Document ("COD"). Obligations also evidence the Corporation's obligations to banks that provide funds for the purchase of indebtedness tendered for purchase or subject to mandatory tender for purchase and not remarketed under the Corporation's self-liquidity program, funded loans and for general purpose revolving lines of credit.

At September 30, 2018, the Corporation's outstanding indebtedness evidenced by Obligations issued under the COD totaled $7.9 billion. Payment obligations under the COD are limited to the Obligated Group (defined in the COD), which only includes the Corporation. Certain covenants under the COD are tested based on the combination of the Obligated Group and Participants. However, holders of Obligations have no recourse to Participants or their property for payment thereof.

### INDEBTEDNESS

| *($ in millions)* | **September 30, 2018** |
|---|---|
| **COD Debt** | |
| Fixed Rate Bonds[1] | $4,279 |
| Variable Rate Bonds[2] | 508 |
| Long Term Rate Bonds[3] | 142 |
| Direct Purchase Bonds[4] | 1,853 |
| Commercial Paper Notes | 881 |
| Short term bank loans and lines of credit[5] | 250 |
| **Total COD Debt** | **$7,913** |
| | |
| **Non-COD Debt** | |
| Other MBO Debt[6] | $378 |
| Capital Leases | 110 |
| Note Payable | 99 |
| **Total Non-COD Debt** | **$587** |
| **Total CHI Debt** | **$8,500** |

[1] Excludes unamortized original issue premium, discount and issuance costs.

[2] Includes bonds that bear interest at variable rates (currently determined weekly) and are subject to optional tender for purchase by their holders, FRNs that bear interest at variable rates (currently determined weekly and monthly), for a specified period and are subject to mandatory tender as set forth below and direct purchase debt of affiliates that is placed directly with holders, bears interest at variable rates determined monthly based upon a percentage of LIBOR or SIFMA plus a spread, and is subject to mandatory tender on certain dates.

[3] Long-term rate bonds bear interest at a fixed rate for a specified period and are subject to mandatory tender at the end of such period as set forth below.

[4] Direct purchase debt of the Corporation is placed directly with holders, bears interest at variable rates determined monthly based upon a percentage of LIBOR or SIFMA plus a spread, and is subject to mandatory tender on certain dates as set forth below.

[5] Excludes a revolving line of credit with BNY Mellon in the amount of $69 million, with an expiration date of June 28, 2019. As of September 30, 2018, the line was undrawn.

[6] Other MBO debt is comprised primarily of $184.5 million of CHI St. Luke's affiliate debt, $93.5 million of Centura affiliate debt and $39.6 million of St. Leonard Master Trust Indenture debt.

The required principal payments on the total CHI long-term debt during fiscal year 2019 is approximately $697.7 million.

As of September 30, 2018, the Corporation had one revolving line of credit with PNC Bank in the amount of $250 million that is fully drawn and matures on July 3, 2019.

## A. Direct Purchase Debt

The Corporation's direct purchase debt is subject to mandatory tender on the dates set forth in the following table. Prior to the mandatory tender of direct purchase debt, management expects that it would analyze the then current market conditions and availability and relative cost of refinancing or restructuring alternatives which could include without limitation, conversion to another interest mode, refinancing or repayment.

| *($ in millions)* Series | Par Outstanding September 30, 2018 | Mandatory Tender Date |
|---|---|---|
| Colorado 2017B[1] | $333.7 | 12/19/2018 |
| Washington 2008A[1, 2] | 118.9 | 1/29/2019 |
| Taxable 2018B | 200.0 | 8/30/2019 |
| Colorado 2011C[2] | 117.0 | 9/30/2019 |
| Providence Series 2009A | 6.5 | 10/1/2019 |
| Providence Series 2009B | 5.6 | 10/1/2019 |
| Providence Series 2009C | 4.0 | 10/1/2019 |
| Colorado 2004B6[2] | 54.2 | 9/25/2020 |
| Taxable 2013E | 125.0 | 12/18/2020 |
| Taxable 2013F | 75.0 | 12/18/2020 |
| Taxable 2017A | 250.0 | 7/1/2021 |
| Colorado 2015-1 | 35.0 | 8/1/2021 |
| Colorado 2015-2 | 63.5 | 8/1/2021 |
| Taxable 2018A | 275.0 | 8/2/2021 |
| Colorado 2013C | 100.0 | 12/18/2023 |
| Colorado 2015A | 17.1 | 8/1/2024 |
| Colorado 2015B | 27.3 | 8/1/2024 |
| Washington 2015A | 45.4 | 8/3/2024 |
| **Total** | **$1,853.2** | |

[1] The Corporation and the Bank are in the process of renewing the agreements for a one year period.
[2] Includes a "term out" provision that varies among agreements, which permits repayment after the mandatory tender date absent any defaults or events of default.

The Corporation's direct purchase agreements are publicly available, and can be accessed through the Digital Assurance Certification LLC website ("DAC") at www.dacbond.com and the Municipal Securities Rulemaking Board ("MSRB") through the Electronic Municipal Market Access ("EMMA") website of the MSRB, which can be found at http://emma.msrb.org.

## B. Long – Term Rate Bonds

The Corporation's long-term rate bonds are subject to mandatory tender on the dates set forth below. Prior to the mandatory tender of long-term rate bonds, management expects that it would analyze the then current market conditions and availability and relative cost of refinancing or restructuring alternatives, which could include without limitation, conversion to another interest mode, refinancing or repayment.

| *($ in millions)* Series | Par Outstanding September 30, 2018 | Mandatory Tender Date |
|---|---|---|
| CO 2009B-3 | $40.0 | 11/6/2019 |
| KY 2009B | 60.0 | 11/10/2021 |
| CO 2008D-3 | 41.9 | 11/12/2021 |
| **Total Long-Term Rate Bonds** | **$141.9** | |

## C. Floating Rate Notes ("FRNs")

The Corporation's FRNs are subject to mandatory tender on the dates set forth below. Prior to the mandatory tender of the FRNs, management expects that it would analyze the then current market conditions and availability and relative cost of refinancing or restructuring alternatives, which could include without limitation, conversion to another interest mode, refinancing or repayment.

| *($ in millions)* **Series** | **Par Outstanding September 30, 2018** | **Mandatory Tender Date** |
|---|---|---|
| KY 2011B-1 | $52.7 | 1/31/2020 |
| KY 2011B-2 | 52.7 | 1/31/2020 |
| CO 2008C-2 | 26.5 | 11/12/2020 |
| CO 2008C-4 | 26.5 | 11/12/2020 |
| WA 2013B-1 | 100.0 | 12/31/2020 |
| WA 2013B-2 | 100.0 | 12/31/2024 |
| KY 2011B-3 | 52.7 | 1/31/2025 |
| **Total FRNs** | **$411.1** | |

## D. Variable Rate Bonds

The Corporation's variable rate demand bonds are subject to optional and mandatory tender. As of September 30, 2018, variable rate demand bonds are outstanding in the amount of $96.7 million, supported by the Corporation's self-liquidity, not by a dedicated liquidity or credit facility. See *Part V: 4. Liquidity and Capital Resources - Liquidity Arrangements*.

## E. Taxable Commercial Paper

The Corporation's commercial paper note program permits the issuance of up to $881 million in aggregate principal amount outstanding, with maturities limited to 270-day periods. The Corporation has directed the commercial paper dealers to tranche the commercial paper maturities so that no greater than approximately one-third of the outstanding balance matures in any one month, and no more than $100 million matures per dealer within any five business-day period while the outstanding balance of the commercial paper is greater than $500 million. The Corporation has, from time to time, directed its dealers to deviate from such directions, and may do so again in the future. As of September 30, 2018, $881 million of commercial paper notes were outstanding. The commercial paper notes are supported by the Corporation's self-liquidity, and not supported by a dedicated liquidity or credit facility. See *Part V: 4. Liquidity and Capital Resources - Liquidity Arrangements.*

## F. Swap Agreements

The Corporation or its affiliates are currently party to 34 swap transactions that had an aggregate notional amount of approximately $1.5 billion at September 30, 2018. The 34 transactions have varying termination dates ranging from 2019 to 2047. The swap agreements require the Corporation (or with respect to certain swap agreements, affiliates of the corporation) to provide collateral if its respective liability, determined on a mark-to-market basis, exceeds a specified threshold that varies based upon the rating on the Corporation's long-term indebtedness. The swap agreements of Memorial East Texas and Centura Health do not require collateral postings. The fair value of the swaps is estimated based on the present value sum of anticipated future net cash settlements until the swaps' maturities. Cash collateral balances are netted against the fair value of the swaps, and the net amount is reflected in other liabilities in the accompanying consolidated balance sheets. At September 30, 2018, the net swap liability reflected in other liabilities was $34.9 million, net of swap collateral posted of $153.9 million. The swap agreements, excluding the Centura Health swap, are secured by Obligations issued under the COD. *(See Note 8 in the Consolidated Interim Financial Statements (unaudited) as of September 30, 2018 and 2017.)*

| Obligated Party | Type | Outstanding Notional September 30, 2018 | Termination Date |
|---|---|---|---|
| CHI[1] | Total Return | $72.0 | 4/10/2019 -1/16/2020 |
| CHI | Fixed Payer | 150.9 | 5/1/2025 |
| CHI | Fixed Payer | 217.8 | 3/1/2032 |
| CHI | Fixed Payer | 96.6 | 9/1/2036 |
| CHI | Fixed Payer | 125.6 | 9/1/ 2036 |
| CHI | Fixed Payer | 19.3 | 9/1/2036 |
| CHI | Fixed Payer | 99.0 | 12/1/2036 |
| CHI | Fixed Payer | 148.5 | 12/1/2036 |
| CHI St. Luke's | Fixed Payer | 119.0 | 2/18/2031 |
| CHI St. Luke's | Fixed Payer | 92.5 | 2/15/2032 |
| CHI St. Luke's | Fixed Payer | 100.0 | 2/15/2047 |
| CHI St. Luke's | Fixed Payer | 100.0 | 2/15/2047 |
| Centura Health[2] | Fixed Payer | 14.5 | 5/20/2024 |
| Madonna Manor | Total Return | 27.0 | 8/15/2020 |
| Memorial East Texas | Fixed Payer | 24.0 | 2/15/2035 |
| Memorial East Texas | Fixed Payer | 16.8 | 2/15/2028 |
| St. Joseph Regional Health[3] | Total Return | 49.8 | 8/15/2020 |
| St. Joseph Regional Health | Fixed Payer | 45.2 | 1/1/2028 |
| St. Joseph Regional Health | Basis | 30.0 | 3/1/2028 |
| **Total Notional Amount** | | **$1,548.5** | |

[1] Represents 13 Total Return Swaps.
[2] Not secured by CHI COD obligations.
[3] Represents 4 Total Return Swaps.

## 4. *LIQUIDITY AND CAPITAL RESOURCES*

**Cash Equivalents and Internally Designated Investments**

CHI holds highly liquid investments to enhance its ability to satisfy liquidity needs. Asset allocations are reviewed monthly and compared to investment allocation targets included within CHI's investment policy. At September 30, 2018 and June 30, 2018, CHI had cash and equivalents and internally designated investments (including net unrealized gains and losses) as described in the table below.

| *($ in thousands)* | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Cash and equivalents | $287,951 | $510,456 |
| Internally designated investments | 5,221,604 | 5,308,868 |
| **Total** | **$5,509,555** | **$5,819,324** |

CHI maintains an Operating Investment Program (the "Program") administered by the Corporation. The Program is structured as a limited partnership with the Corporation as the managing general partner.

The Program contracts with investment advisers to manage the investments within the Program. Substantially all CHI long-term investments are held in the Program. The Corporation requires all Participants to invest in the Program. The Program consists of equity securities, fixed-income securities and alternative investments (e.g., private equity, hedge funds and real estate interests). The asset allocation is established by the Finance Committee of the Board of Stewardship Trustees. At September 30, 2018, the asset allocation for the Program's Long-Term Pool was 47% equity securities, 31% fixed-income securities, 23% alternative investments, and 0% cash and equivalents. Alternative investments within the Program have limited liquidity. As of September 30, 2018, illiquid investments not available for redemption totaled $410.9 million, and investments available for redemption within 180 days at the request of the Program totaled $869.3 million. The asset allocation for the Program's Intermediate Pool was 100% fixed-income securities. As of September 30, 2018, 92.4% of the Program's assets were invested in the Long-Term Pool, with 7.6% of assets invested in the Intermediate Pool. The Program's return was 2.3% for the three months ended September 30, 2018.

**LIQUIDITY ARRANGEMENTS**

The Corporation maintains several liquidity facilities that are dedicated to funding optional or mandatory tenders of its variable rate debt and paying the maturing principal of the commercial paper notes in the event remarketing proceeds are unavailable for such purpose. At September 30, 2018, no amounts were drawn on these lines. The Corporation's dedicated self-liquidity lines are set forth below and can be found at http://emma.msrb.org.

**CHI Dedicated Self-Liquidity Lines – September 30, 2018**

| **Bank** *($ in millions)* | **Committed Amount** | **Expiration** |
|---|---|---|
| BNY Mellon[1] | $50.0 | 12/14/2018 |
| Northern Trust | 65.0 | 6/28/2019 |
| PNC Bank | 125.0 | 8/23/2019 |
| MUFG Union Bank | 75.0 | 9/27/2019 |
| J.P. Morgan | 50.0 | 9/30/2019 |
| **Total Self-Liquidity Lines** | **$365.0** | |

[1] The Corporation is in discussions with BNY Mellon to renew the existing line for 364 days.

## *5. LIQUIDITY REPORT*

CHI posts a liquidity report monthly, which can be found at www.catholichealthinitiatives.org and http://emma.msrb.org.

# *PART VI: LEGAL PROCEEDINGS*

**PENDING LITIGATION/REGULATORY MATTERS**

CHI operates in a highly litigious industry. As a result, various lawsuits, claims and regulatory proceedings have been instituted or asserted against it from time to time. CHI has knowledge of certain pending suits against certain of its entities that have arisen in the ordinary course of business. In the opinion of management, CHI maintains adequate insurance and/or other financial reserves to cover the estimated potential liability for damages in these cases, or, to the extent such liability is uninsured, adverse decisions will not have a material adverse effect on the financial position or operations of CHI.

**General Observation Relating to Status as Health Care System.** CHI, like all major health care systems, periodically may be subject to investigations or audits by federal, state and local agencies involving compliance with a variety of laws and regulations. These investigations seek to determine compliance with, among other things, laws and regulations relating to Medicare and Medicaid reimbursement, including billing practices for certain services. Violation of such laws could result in substantial monetary fines, civil and/or criminal penalties and exclusion from participation in Medicare, Medicaid or similar programs.

**St. Joseph–London.** St. Joseph London ("SJHS") is party to a corporate integrity agreement ("CIA") with the Office of Inspector General that imposes certain compliance oversight obligations solely at SJHS's facility following a 2014 settlement with the federal government, the Commonwealth of Kentucky and others to resolve civil and administrative monetary claims raised in a *qui tam* lawsuit relating to certain diagnostic and therapeutic cardiac procedures performed at SJHS's facility and the financial relationship with certain cardiac physicians and physician groups. The CIA expires in February 2019.

Numerous civil lawsuits were also filed against the Corporation and SJHS claiming damages for alleged unnecessary cardiac stent placements and other cardiac procedures. One such case, *Kevin Ray Wells, Sr. v. Catholic Health Initiatives, et. al.,* Case No. 12-CI-00090 remains unresolved. In August 2016, the jury in that matter found in favor of the plaintiff and awarded compensatory damages in an amount just under $1.3 million and punitive damages of $20.0 million. Post-trial motions were filed and, while the trial court did not set aside the verdict, it did reduce the punitive damage award to $5.0 million. The rulings of the trial court were then appealed. Oral argument before a three-judge panel of the appellate court was held on July 13, 2018 in Louisville, Kentucky. On August 10, 2018, the appellate court unanimously and fully reversed the trial court judgment and remanded the case back to the lower court for a new trial. All damages were vacated. Plaintiff has filed a request for discretionary review with the Kentucky Supreme Court. The parties have submitted their briefs and are now awaiting a decision from the Kentucky Supreme Court. Management believes that adequate reserves have been established and that the outcome of the current litigation will not have a material adverse effect on the financial position or results of operations of CHI.

**Washington State Attorney General Civil Litigation.** The Washington State Attorney General's office ("WA AG") filed two civil lawsuits in late summer/early fall of 2017.

In the first action, on August 31, 2017, the WA AG filed a civil lawsuit in the U.S. District Court for the Western District of Washington against Franciscan Health System and Franciscan Medical Group (collectively "CHI Franciscan Health"), and two physician practices, The Doctors Clinic ("TDC") and WestSound Orthopaedics, PS ("WSO"). The lawsuit seeks to unwind CHI Franciscan Health's 2016 transactions with TDC and WSO, claiming that they resulted in increased prices and decreased competition for adult primary care and orthopedic physicians' services on Kitsap Peninsula in violation of federal antitrust laws and the Washington Consumer Protection Act, and further seeks monetary disgorgement, civil penalties and fees. The Court has denied both a motion to dismiss from CHI Franciscan Health and an early motion for summary judgment from the WA AG regarding the WA AG's claim that the agreement between CHI Franciscan Health and TDC constitutes *per se* illegal price-fixing, holding that that question cannot be resolved without a full factual record. Fact discovery has ended, and expert discovery is in process. A tentative trial date of March 19, 2019, has been set. No assurance can be given as to the timing or outcome of this litigation matter.

In the second action, on September 5, 2017, the WA AG filed a civil lawsuit in Pierce County Superior Court, Washington, against St. Joseph Medical Center ("SJMC") alleging that SJMC violated the Washington Consumer Protection Act by failing to comply with Washington State's charity care laws and regulations from 2012 to the present, allegedly resulting in a failure to provide charity care to patients who would have qualified for charity care assistance under state law and FHS's charity care policy. The lawsuit seeks civil money penalties, restitution to patients, attorneys' fees and other injunctive relief. Discovery is in process. CHI Franciscan Health has filed an answer to this lawsuit and discovery is proceeding. Both sides anticipate filing motions for summary judgment in November 2018 with oral argument occurring in December 2018 or January 2019. A tentative trial date of February 25, 2019, has been set. The State has requested a 60-day postponement of the trial date in order for the parties to engage in mediation of the dispute. SJMC is amenable to the request, but the details have not yet been discussed. No date has been set for the mediation. No assurance can be given as to the timing or outcome of this litigation matter.

Additionally, on June 22, 2018, an alleged former patient filed a purported class-action lawsuit against CHI Franciscan Health and SJMC in the U.S. District Court for the Western District of Washington, alleging that SJMC violated the Washington Consumer Protection Act, breached the covenant of good faith and fair dealing, and were unjustly enriched, by failing to affirmatively screen her and other similarly situated patients who sought emergency care at SJMC for charity care before engaging in collection efforts, in violation of Washington's charity care laws and regulations. The lawsuit seeks treble damages, restitution, costs, attorneys' fees and injunctive relief. CHI Franciscan Health and SJMC answered the complaint on July 19, 2018. No other deadlines have been set at this time. If SJMC and the State engage in mediation of the charity care dispute between them, it is SJMC's intention to invite the private litigants and their counsel to participate in the mediation in order to negotiate a global settlement of disputes involving SJMC's historical charity care practices. No assurance can be given as to the timing or outcome of this litigation matter.

**J.R. v. Blue Cross & Blue Shield of Illinois, et al., No. 2:18-cv-1191 (W.D. Wash.)** The lead plaintiff in the referenced action is a minor child diagnosed with autism spectrum disorder (ASD) who is a beneficiary under the Catholic Health Initiatives (CHI) medical plan (the Plan). In a federal court complaint filed on August 14, 2018, plaintiff (by and through his parents) alleges that coverage for certain physician recommended ASD treatment was denied by the Plan's third-party administrator, Blue Cross & Blue Shield of Illinois, on the basis that the Plan excluded coverage for same. CHI and the Plan, along with the third-party administrator are named defendants in the litigation. Plaintiff alleges that exclusion of the therapy sought for ASD treatment is not at parity with the Plan's coverage of medical and surgical services and, as a result, fails to comply with the Federal Mental Health Parity and Addiction Equity Act (Parity Act). Plaintiff brings the action based on alleged violation of the Parity Act on behalf of himself and a putative class of similarly situated individuals/beneficiaries. The class has not yet been certified. Plaintiff seeks damages in an unspecified amount, injunctive relief, and other relief. Due to inherent uncertainties in matters of this type, no opinion as to the outcome can be provided at this time.

# APPENDIX A

## *CATHOLIC HEALTH INITIATIVES*

## *CONSOLIDATED FINANCIAL STATEMENTS*

## *AND SUPPLEMENTAL INFORMATION*

***As of September 30, 2018 and for the three months ended September 30, 2018 and 2017***



This document is dated as of November 29, 2018.

# CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Catholic Health Initiatives
As of September 30, 2018, and for the
Three Months Ended September 30, 2018 and 2017
With Review Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

# Catholic Health Initiatives

## Consolidated Interim Financial Statements (Unaudited)

As of September 30, 2018, and for the Three
Months Ended September 30, 2018 and 2017

## Contents

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Building a better working world

# Review Report of Independent Auditors

The Board of Stewardship Trustees
Catholic Health Initiatives

We have reviewed the consolidated financial information of Catholic Health Initiatives, which comprise the consolidated balance sheet as of September 30, 2018, and the related consolidated statements of operations, changes in net assets and cash flows for the three-month period ended September 30, 2018 and 2017, and the related notes to the financial statements.

## Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

## Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

## Conclusion

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

November 29, 2018

Catholic Health Initiatives

## Consolidated Balance Sheets

*(In Thousands)*

| | September 30, 2018 *(Unaudited)* | June 30, 2018 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and equivalents | **$ 287,951** | $ 510,456 |
| Net patient accounts receivable, less allowances for bad debts of $827,130 at June 30, 2018 | **2,157,692** | 2,121,582 |
| Other accounts receivable | **282,615** | 257,285 |
| Current portion of investments and assets limited as to use | **94,009** | 64,348 |
| Inventories | **309,677** | 298,636 |
| Assets held for sale | **206,379** | 195,698 |
| Prepaid and other | **177,331** | 144,003 |
| Total current assets | **3,515,654** | 3,592,008 |
| | | |
| Investments and assets limited as to use: | | |
| Internally designated for capital and other funds | **5,221,604** | 5,308,868 |
| Held by trustees | **79,079** | 76,080 |
| Held for insurance purposes | **837,535** | 829,402 |
| Restricted by donors | **260,570** | 258,513 |
| Total investments and assets limited as to use | **6,398,788** | 6,472,863 |
| | | |
| Property and equipment, net | **8,040,187** | 8,110,767 |
| Investments in unconsolidated organizations | **1,751,482** | 1,732,840 |
| Intangible assets and goodwill, net | **419,310** | 421,388 |
| Notes receivable and other | **259,528** | 265,441 |
| Total assets | **$ 20,384,949** | $ 20,595,307 |

*Continued on following page*

Catholic Health Initiatives

Consolidated Balance Sheets (continued)
*(In Thousands)*

| | September 30, 2018 (Unaudited) | June 30, 2018 |
|---|---|---|
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Compensation and benefits | **$ 560,337** | $ 568,986 |
| Third-party liabilities, net | **104,312** | 131,670 |
| Accounts payable and accrued expenses | **1,319,651** | 1,480,365 |
| Liabilities held for sale | **233,735** | 251,710 |
| Variable-rate debt with self-liquidity | **96,700** | 96,700 |
| Commercial paper and current portion of debt | **2,087,380** | 2,087,406 |
| Total current liabilities | **4,402,115** | 4,616,837 |
| | | |
| Pension liability | **843,791** | 854,427 |
| Self-insured reserves and claims | **622,638** | 623,267 |
| Other liabilities | **1,039,806** | 1,027,091 |
| Long-term debt | **6,311,519** | 6,341,931 |
| Total liabilities | **13,219,869** | 13,463,553 |
| | | |
| Net assets: | | |
| Net assets attributable to CHI | **6,563,201** | 6,528,635 |
| Net assets attributable to noncontrolling interests | **295,091** | 300,428 |
| Unrestricted | **6,858,292** | 6,829,063 |
| Temporarily restricted | **207,545** | 207,695 |
| Permanently restricted | **99,243** | 94,996 |
| Total net assets | **7,165,080** | 7,131,754 |
| Total liabilities and net assets | **$ 20,384,949** | $ 20,595,307 |

*See accompanying notes.*

# Catholic Health Initiatives

## Consolidated Statements of Operations

*(In Thousands)*
*(Unaudited)*

| | Three Months Ended September 30, 2018 | 2017 |
|---|---|---|
| **Revenues:** | | |
| Net patient services revenues before provision for doubtful accounts | | $ 3,690,808 |
| Provision for doubtful accounts | | (195,998) |
| Net patient services revenues | **$ 3,527,754** | 3,494,810 |
| Other operating revenues: | | |
| Donations | **9,015** | 8,353 |
| Changes in equity of unconsolidated organizations | **3,524** | 4,105 |
| Hospital ancillary revenues | **84,305** | 84,291 |
| Other | **103,792** | 104,210 |
| Total other operating revenues | **200,636** | 200,959 |
| Total operating revenues | **3,728,390** | 3,695,769 |
| **Expenses:** | | |
| Salaries and wages | **1,483,578** | 1,489,732 |
| Employee benefits | **277,535** | 276,255 |
| Purchased services, medical professional fees and consulting | **584,046** | 561,510 |
| Supplies | **612,262** | 596,437 |
| Utilities | **49,169** | 51,775 |
| Rentals, leases, maintenance and insurance | **222,953** | 222,524 |
| Depreciation and amortization | **207,322** | 225,588 |
| Interest | **80,942** | 75,110 |
| Other | **262,826** | 260,554 |
| Total operating expenses before restructuring, impairment and other losses | **3,780,633** | 3,759,485 |
| Loss from operations before restructuring, impairment and other losses | **(52,243)** | (63,716) |
| Restructuring, impairment and other losses | **21,201** | 14,170 |
| **Loss from operations** | **(73,444)** | (77,886) |
| **Nonoperating gains (losses):** | | |
| Investment gains, net | **138,331** | 214,937 |
| Gains on early extinguishment of debt | **–** | 208 |
| Realized and unrealized gains (losses) on interest rate swaps | **13,953** | (3,982) |
| Other nonoperating (losses) gains | **(3,874)** | 2,068 |
| Total nonoperating gains | **148,410** | 213,231 |
| **Excess of revenues over expenses** | **74,966** | 135,345 |
| **Excess of revenues over expenses attributable to noncontrolling interests** | **4,204** | 4,220 |
| **Excess of revenues over expenses attributable to CHI** | **$ 70,762** | $ 131,125 |

*See accompanying notes.*

# Catholic Health Initiatives

## Consolidated Statements of Changes in Net Assets
*(In Thousands)*

| | Unrestricted Net Assets: Attributable to CHI | Unrestricted Net Assets: Attributable to Noncontrolling Interests | Unrestricted Net Assets: Total | Temporarily Restricted Net Assets | Permanently Restricted Net Assets | Total Net Assets |
|---|---|---|---|---|---|---|
| **Balances, July 1, 2017** | $ 7,047,905 | $ 367,483 | $ 7,415,388 | $ 214,250 | $ 97,096 | $ 7,726,734 |
| Excess of revenues over expenses | 193,652 | 28,449 | 222,101 | – | – | 222,101 |
| Net loss from discontinued operations | (790,493) | (3,261) | (793,754) | – | – | (793,754) |
| Change in pension funded status | 139,204 | 4,360 | 143,564 | – | – | 143,564 |
| Temporarily and permanently restricted contributions | – | – | – | 41,883 | 563 | 42,446 |
| Net assets released from restriction for capital | 20,584 | – | 20,584 | (20,584) | – | – |
| Net assets released from restriction for operations | – | – | – | (26,552) | – | (26,552) |
| Investment income | – | – | – | 4,760 | 697 | 5,457 |
| Distributions to noncontrolling owners | – | (33,384) | (33,384) | – | – | (33,384) |
| Noncontrolling ownership purchase | (91,483) | (63,968) | (155,451) | – | – | (155,451) |
| Other changes in net assets | 9,266 | 749 | 10,015 | (6,062) | (3,360) | 593 |
| Net decrease in net assets | (519,270) | (67,055) | (586,325) | (6,555) | (2,100) | (594,980) |
| **Balances, June 30, 2018** | 6,528,635 | 300,428 | 6,829,063 | 207,695 | 94,996 | 7,131,754 |
| Excess of revenues over expenses | 70,762 | 4,204 | 74,966 | – | – | 74,966 |
| Net loss from discontinued operations | (31,188) | – | (31,188) | – | – | (31,188) |
| Temporarily and permanently restricted contributions | – | – | – | 7,574 | 3,626 | 11,200 |
| Net assets released from restriction for capital | 45 | – | 45 | (45) | – | – |
| Net assets released from restriction for operations | – | – | – | (10,218) | – | (10,218) |
| Investment income | 45 | – | 45 | 1,994 | 600 | 2,639 |
| Distributions to noncontrolling owners | – | (9,528) | (9,528) | – | – | (9,528) |
| Other changes in net assets | (5,098) | (13) | (5,111) | 545 | 21 | (4,545) |
| Net increase (decrease) in net assets | 34,566 | (5,337) | 29,229 | (150) | 4,247 | 33,326 |
| **Balances, September 30, 2018 (unaudited)** | **$ 6,563,201** | **$ 295,091** | **$ 6,858,292** | **$ 207,545** | **$ 99,243** | **$ 7,165,080** |

*See accompanying notes.*

## Catholic Health Initiatives

## Consolidated Statements of Cash Flows

*(In Thousands)*
*(Unaudited)*

| | Three Months Ended September 30, 2018 | Three Months Ended September 30, 2017 |
|---|---|---|
| **Operating activities** | | |
| Increase (decrease) in net assets | **$ 33,326** | $ (366,518) |
| Adjustments to reconcile increase (decrease) in net assets to net cash (used in) provided by operating activities: | | |
| Loss on deconsolidation of subsidiary | **–** | 319,167 |
| Purchase of noncontrolling interest | **–** | 150,000 |
| Depreciation and amortization | **207,322** | 225,588 |
| Provision for doubtful accounts | **–** | 195,998 |
| Changes in equity of unconsolidated organizations | **(3,524)** | (4,105) |
| Net gains on sales of facilities and investments in unconsolidated organizations | **(3,694)** | (6,496) |
| Noncash operating expenses related to restructuring, impairment and other losses | **680** | 206 |
| Gains on early extinguishment of debt | **–** | (208) |
| Change in fair value of interest rate swaps | **(19,601)** | (3,524) |
| Noncash pension adjustments | **(8,299)** | (14,603) |
| Pension cash contributions | **(2,337)** | (12,686) |
| Net changes in current assets and liabilities: | | |
| Net patient and other accounts receivable | **(77,719)** | (247,968) |
| Other current assets | **(40,184)** | (15,257) |
| Current liabilities | **(173,155)** | (279,021) |
| Other changes | **40,901** | (837) |
| Net cash used in operating activities, before net change in investments and assets limited as to use | **(46,284)** | (60,264) |
| Net decrease in investments and assets limited as to use | **34,951** | 270,633 |
| Net cash (used in) provided by operating activities | **(11,333)** | 210,369 |
| **Investing activities** | | |
| Purchases of property, equipment, and other capital assets | **(151,103)** | (119,025) |
| Investments in unconsolidated organizations | **(45,661)** | (35,692) |
| Business acquisitions, net of cash acquired | **(8,298)** | – |
| Proceeds from asset sales | **8,552** | 22,913 |
| Distributions from investments in unconsolidated organizations | **18,425** | 18,974 |
| Repayments (issuance) of notes receivable, net | **1,429** | (30,107) |
| Other changes | **(15,184)** | 9,974 |
| Net cash used in investing activities | **(191,840)** | (132,963) |
| **Financing activities** | | |
| Proceeds from issuance of debt and bank loans | **475,000** | 254,695 |
| Repayment of debt and bank loans | **(505,799)** | (317,746) |
| Swap cash collateral received | **20,995** | 4,284 |
| Distributions to noncontrolling owners | **(9,528)** | (9,246) |
| Purchase of noncontrolling interest | **–** | (150,000) |
| Net cash used in financing activities | **(19,332)** | (218,013) |
| Decrease in cash and equivalents | **(222,505)** | (140,607) |
| Cash and equivalents at beginning of period | **510,456** | 810,235 |
| Cash and equivalents at end of period | **$ 287,951** | $ 669,628 |

*See accompanying notes.*

## 1. Summary of Significant Accounting Policies

### Organization

Catholic Health Initiatives (CHI), established in 1996, is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI sponsors market-based organizations (MBO) and other facilities operating in 18 states, comprised of facilities and services that span the inpatient and outpatient continuum of care, including hospitals and clinics, academic health centers, major teaching hospitals, and critical access facilities; as well as community health service organizations, accredited nursing colleges, home health agencies, and living communities. CHI also has an offshore captive insurance company, First Initiatives Insurance, Ltd. (FIIL).

The mission of CHI is to nurture the healing ministry of the Church, supported by education and research. Fidelity to the Gospel urges CHI to emphasize human dignity and social justice as CHI creates healthier communities.

### Basis of Presentation

The consolidated interim financial statements of CHI as of September 30, 2018, and for the three months ended September 30, 2018 and 2017, reflect normal recurring adjustments, which in the opinion of management are necessary to fairly state its financial position, results of operations and cash flows for the periods presented. The consolidated interim financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim reporting, and accordingly, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to U.S. GAAP. However, CHI believes that the disclosures are adequate to make the information presented not misleading. These consolidated interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended June 30, 2018.

The preparation of financial statements in conformity with U. S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates. Operating results for the three months ended September 30, 2018 and 2017, are not necessarily indicative of the results that may be expected for any future period or for a full fiscal year as revenues, expenses, assets and liabilities can vary during each quarter of the year.

**1. Summary of Significant Accounting Policies (continued)**

**Principles of Consolidation**

CHI consolidates all direct affiliates in which it has sole corporate membership or ownership (Direct Affiliates) and all entities in which it has greater than 50% equity interest with commensurate control. All significant intercompany accounts and transactions are eliminated in consolidation.

**Fair Value of Financial Instruments**

Financial instruments consist primarily of cash and equivalents, patient accounts receivable, investments and assets limited as to use, notes receivable and accounts payable. The carrying amounts reported in the consolidated balance sheets for these items, other than investments and assets limited as to use, approximate fair value. See Note 7, *Fair Value of Assets and Liabilities*, for a discussion of the fair value of investments and assets limited as to use.

**Cash and Equivalents**

Cash and equivalents include all deposits with banks and investments in interest-bearing securities with maturity dates of 90 days or less from the date of purchase. In addition, cash and equivalents include deposits in short-term funds held by professional managers. The funds generally invest in high-quality, short-term debt securities, including U.S. government securities, securities issued by domestic and foreign banks, such as certificates of deposit and bankers' acceptances, repurchase agreements, asset-backed securities, high-grade commercial paper, and corporate short-term obligations.

## 1. Summary of Significant Accounting Policies (continued)

### Net Patient Accounts Receivable and Net Patient Services Revenues

On July 1, 2018, CHI adopted Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and subsequent amendments thereto (collectively referred to herein as Accounting Standards Codification (ASC) 606). The core principle of the new revenue recognition model is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASC 606 also requires expanded disclosures regarding an entity's revenue recognition policies and significant judgments employed in the determination of revenue – see Note 5, *Net Patient Services Revenues*.

CHI adopted ASC 606 using a modified retrospective method of application to all contracts existing on July 1, 2018. CHI applied the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that net patient services revenues for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis.

The adoption of ASC 606 resulted in changes to the presentation for revenue related to uninsured or underinsured patients. Prior to the adoption of ASC 606, a significant portion of CHI's provision for doubtful accounts related to self-pay patients as well as co-payments and deductibles owed by patients with insurance. Under ASC 606, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions, which are recorded as a direct reduction of net patient services revenues rather than as a provision for doubtful accounts. For the three months ended September 30, 2018, CHI recorded $233.9 million of implicit price concessions as a direct reduction of net patient services revenues that would have been recorded as provision for doubtful accounts prior to the adoption of ASC 606. For periods prior to the adoption of ASC 606, the provision for doubtful accounts was presented separately as a component of patient services revenues, consistent with the previous revenue recognition guidance. Additionally, at September 30, 2018, CHI recorded $845.1 million as a direct reduction of net patient accounts receivable that would have been reflected as allowance for bad debts prior to the adoption of ASC 606. Other than these changes in presentation, the adoption of ASC 606 did not have a material impact on the consolidated balance sheet as of September 30, 2018, or the consolidated statement of operations and the consolidated statement of changes in net assets for the three months ended September 30, 2018.

Net patient accounts receivable has been adjusted to the estimated amounts expected to be collected. These estimated amounts are subject to further adjustments upon review by third-party payors – see Note 5, *Net Patient Services Revenues*.

## 1. Summary of Significant Accounting Policies (continued)

### Investments and Assets Limited as to Use

Investments and assets limited as to use include assets set aside by CHI for future long-term purposes, including capital improvements and self-insurance. In addition, assets limited as to use include amounts held by trustees under bond indenture agreements, amounts contributed by donors with stipulated restrictions and amounts held for Mission and Ministry programs.

CHI has designated its investment portfolio as trading as the portfolio is actively managed to achieve investment returns. Accordingly, unrealized gains and losses on marketable securities are reported within excess of revenues over expenses. In addition, cash flows from the purchases and sales of marketable securities are reported as a component of operating activities in the accompanying consolidated statements of cash flows.

Direct investments in equity securities with readily determinable fair values and all direct investments in debt securities have been measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

Investments in limited partnerships and limited liability companies are recorded using the equity method of accounting (which approximates fair value as determined by the net asset values of the related unitized interests) with the related changes in value in earnings reported as investment income or loss in the accompanying consolidated financial statements.

### Inventories

Inventories, primarily consisting of pharmacy drugs, and medical and surgical supplies, are stated at lower of cost (first-in, first-out method) or net realizable value.

### Assets and Liabilities Held for Sale

Assets and liabilities held for sale represent assets and liabilities that are expected to be sold within one year. A group of assets and liabilities expected to be sold within one year is classified as held for sale if it meets certain criteria. The assets and liabilities held for sale are measured at the lower of carrying value or fair value less costs to sell. Such valuations include estimates of fair values generally based upon firm offers, discounted cash flows and incremental direct costs to transact a sale (Level 2 and Level 3 inputs).

## 1. Summary of Significant Accounting Policies (continued)

### Property and Equipment

Property and equipment are stated at historical cost or, if donated or impaired, at fair value at the date of receipt or impairment. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Buildings and improvements are depreciated over estimated useful lives of 5 to 84 years, equipment over 3 to 30 years, and land improvements over 2 to 25 years. For property and equipment under capital lease, amortization is determined over the shorter period of the lease term or the estimated useful life of the property and equipment.

Interest cost incurred during the period of construction of major capital projects is capitalized as a component of the cost of acquiring those assets. Capitalized interest of $2.8 million and $2.2 million was recorded in the three months ended September 30, 2018 and 2017, respectively.

Costs incurred in the development and installation of internal-use software are expensed if they are incurred in the preliminary project stage or post-implementation stage, while certain costs are capitalized if incurred during the application development stage. Internal-use software is amortized over its expected useful life, generally between 2 and 15 years, with amortization beginning when the project is completed and the software is placed in service.

### Investments in Unconsolidated Organizations

Investments in unconsolidated organizations are accounted for under the cost or equity method of accounting, as appropriate, based on the relative percentage of ownership or degree of influence over that organization. The income or loss on the equity method investments is recorded in the consolidated statements of operations as changes in equity of unconsolidated organizations.

### Intangible Assets and Goodwill

Intangible assets are comprised primarily of trade names, which are amortized over the estimated useful lives ranging from 10 to 25 years using the straight-line method. The weighted average useful life of the trade names is 16 years. Amortization expense of $2.3 million was recorded in each of the three months ended September 30, 2018 and 2017.

## 1. Summary of Significant Accounting Policies (continued)

Goodwill is not amortized but is subject to annual impairment tests during the third quarter of the fiscal year, as well as more frequent reviews whenever circumstances indicate a possible impairment may exist; no such circumstances were identified at September 30, 2018. Impairment testing of goodwill is performed at the reporting unit level by comparing the fair value of the reporting unit's net assets against the carrying value of the reporting unit's net assets, including goodwill. Each MBO is defined as a reporting unit for purposes of impairment testing. The fair value of the reporting unit's net assets is generally estimated based on quantitative analysis of discounted cash flows (Level 3 measurement). The fair value of goodwill is determined by assigning fair values to assets and liabilities, with the remaining fair value reported as the implied fair value of goodwill.

The changes in the carrying amount of goodwill and intangibles is as follows as of the beginning of each fiscal period presented (in thousands):

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Intangible assets, beginning of period | **$ 233,285** | $ 236,034 |
| Acquisitions | **-** | 1,084 |
| Sales and other adjustments | **(705)** | (3,833) |
| Intangible assets, end of period | **232,580** | 233,285 |
| Accumulated amortization, beginning of period | **(51,588)** | (47,370) |
| Intangible amortization expense | **(2,292)** | (9,477) |
| Sales and other adjustments | **214** | 5,259 |
| Accumulated amortization, end of period | **(53,666)** | (51,588) |
| Intangible assets, net | **178,914** | 181,697 |
| Goodwill, beginning of period | **239,691** | 231,995 |
| Acquisitions | **705** | 11,459 |
| Impairments and other adjustments | **-** | (3,763) |
| Goodwill, end of period | **240,396** | 239,691 |
| Total intangible assets and goodwill, net | **$ 419,310** | $ 421,388 |

## 1. Summary of Significant Accounting Policies (continued)

### Notes Receivable and Other Assets

Other assets consist primarily of notes receivable, pledges receivable, deferred compensation assets, long-term prepaid service contracts, deposits and other long-term assets. A summary of notes receivable and other assets is as follows (in thousands):

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Notes receivable: | | |
| From related entities | **$ 15,789** | $ 16,842 |
| Other | **34,421** | 35,566 |
| Long-term pledge receivables | **36,551** | 36,387 |
| Reinsurance recoverable on unpaid losses and loss adjustment expense | **39,772** | 39,772 |
| Deferred compensation assets | **73,883** | 75,199 |
| Other long-term assets | **59,112** | 61,675 |
| Total notes receivable and other | **$ 259,528** | $ 265,441 |

### Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity, including endowment funds. Temporarily restricted net assets and earnings on permanently restricted net assets, including earnings on endowment funds, are used in accordance with the donor's wishes primarily to purchase equipment, to provide charity care, and to provide other health and educational programs and services.

Unconditional promises to receive cash and other assets are defined as voluntary, nonreciprocal transactions between CHI and external parties, which are reported at fair value at the date the promise is received. Conditional promises and indications of donors' conditional intentions to give are defined as agreements where a barrier exists that must be overcome before CHI is entitled to the assets transferred or promised, or where a right of return of the transferred asset or a right of release of the promisor from its obligation to transfer the asset to CHI exists. Indicators of a gift containing a barrier are as follows: a requirement that a recipient's entitlement to transferred assets is contingent upon the achievement of a certain level of service, an identified number of units of output, or a specific outcome; the extent to which a stipulation limits discretion by the recipient on

**1. Summary of Significant Accounting Policies (continued)**

the conduct of an activity; and whether a stipulation is related to the purpose of the agreement. The funds are reported at fair value at the date the barriers are overcome. All unrestricted contributions are reported as donation revenues in the accompanying consolidated statements of operations. All other gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as donations revenue when restricted for operations or as unrestricted net assets when restricted for property and equipment.

**Performance Indicator**

The performance indicator is the excess of revenues over expenses, which includes all changes in unrestricted net assets other than changes in the pension liability funded status, net assets released from restrictions for property acquisitions, cumulative effect of changes in accounting principles, discontinued operations, contributions of property and equipment, and other changes not required to be included within the performance indicator under U.S. GAAP.

**Operating and Nonoperating Activities**

CHI's primary mission is to meet the health care needs in its market areas through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services, long-term care, and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to CHI's primary mission are considered to be nonoperating. Nonoperating activities include investment earnings, gains/losses from extinguishment of debt, net interest cost and changes in fair value of interest rate swaps, and the nonoperating component of Joint Operating Agreement (JOA) income share adjustments. Any infrequent and nonreciprocal contribution that CHI makes to enter a new market community or to expand upon existing affiliations is also classified as nonoperating.

**1. Summary of Significant Accounting Policies (continued)**

**Other Operating Revenues**

Other operating revenues include services sold to external health care providers, gains on acquisitions of subsidiaries, cafeteria sales, rental income, retail pharmacy and durable medical equipment sales, auxiliary and gift shop revenues, gains and losses on asset disposals, the operating component of JOA revenue share adjustments, premium revenues, and revenues from other miscellaneous sources.

**Derivative and Hedging Instruments**

CHI uses derivative financial instruments (interest rate swaps) in managing its capital costs. These interest rate swaps are recognized at fair value on the consolidated balance sheets. CHI has not designated its interest rate swaps related to CHI's long-term debt as hedges. The net interest cost and change in the fair value of such interest rate swaps is recognized as a component of nonoperating gains (losses) in the accompanying consolidated statements of operations. It is CHI's policy to net the value of collateral on deposit with counterparties against the fair value of its interest rate swaps in other liabilities on the consolidated balance sheets.

**Functional Expenses**

CHI provides healthcare services, including inpatient, outpatient, ambulatory, long-term care and community-based services to individuals within the various geographic areas supported by its facilities. Support services include administration, finance and accounting, information technology, public relations, human resources, legal, mission services, and other functions that are supported centrally for all of CHI. Support services expenses as a percentage of total operating expenses were approximately 5.6% and 5.3% for the three months ended September 30, 2018 and 2017, respectively.

**Restructuring, Impairment, and Other Losses**

Restructuring, impairment, and other losses include charges relating to changes in business operations, severance costs, EPIC go-live support costs, goodwill and long-lived asset impairments, acquisition-related costs, and pension settlement activity. Changes in business operations include costs incurred periodically to implement reorganization efforts within specific operations, in order to align CHI's operations in the most strategic and cost-effective manner.

**1. Summary of Significant Accounting Policies (continued)**

Details of CHI's restructuring, impairment and other losses is as follows (in thousands):

| | Three Months Ended September 30, 2018 | 2017 |
|---|---|---|
| Changes in business operations | **$ 16,929** | $ 7,939 |
| Severance costs | **3,592** | 6,025 |
| Impairment charges | **680** | 206 |
| Restructuring, impairment and other losses from continuing operations | **$ 21,201** | $ 14,170 |
| Restructuring, impairment and other losses from discontinued operations | **$ 12,266** | $ 321,859 |

Noncash impairment charges included in the consolidated statements of operations totaled $0.7 million and $0.2 million for the three months ended September 30, 2018 and 2017, respectively. Discontinued operations are reported in the consolidated statements of changes in net assets. For the three months ended September 30, 2017, the discontinued operations include the loss on deconsolidation of University Medical Center (UMC), a subsidiary of CHI – see Note 4, *Discontinued Operations, and Assets and Liabilities Held for Sale.*

**Income Taxes**

CHI is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI owns certain taxable subsidiaries and engages in certain activities that are unrelated to its exempt purpose and therefore subject to income tax.

On December 22, 2017, the Tax Cuts and Jobs Act (the Tax Act) was enacted. The Tax Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, creates new taxes on certain foreign sourced earnings, provides for a new excise tax on certain compensation of exempt organizations over $1 million, and requires the separate calculation of unrelated business taxable income for each trade or business carried on.

**1. Summary of Significant Accounting Policies (continued)**

As of September 30, 2018, CHI made provisional estimates of the tax effects of the Tax Act, including remeasuring its deferred tax balances at the new tax rate. CHI will continue to revise and refine its calculations as it receives additional guidance from the Internal Revenue Service on how the new provisions apply to exempt organizations and taxable subsidiaries.

Management reviews its tax positions annually and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated financial statements.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates.

**2. Joint Operating Agreements and Investments in Unconsolidated Organizations**

**Joint Operating Agreements**

CHI participates in JOAs with hospital-based organizations in three separate market areas. The agreements generally provide for, among other things, joint management of the combined operations of the local facilities included in the JOAs through Joint Operating Companies (JOC). CHI retains ownership of the assets, liabilities, equity, revenues and expenses of the CHI facilities that participate in the JOAs. The financial statements of the CHI facilities managed under all JOAs are included in the CHI consolidated financial statements. Transfers of assets from facilities owned by the JOA participants generally are restricted under the terms of the agreements.

As of September 30, 2018, and June 30, 2018, CHI has investment interests of 65%, 50%, and 50% in JOCs based in Colorado, Iowa, and Ohio, respectively. CHI's interests in the JOCs are included in investments in unconsolidated organizations and totaled $444.6 million and $435.8 million at September 30, 2018, and June 30, 2018, respectively. CHI recognizes its investment in all JOCs under the equity method of accounting. The JOCs provide varying levels of services to the related JOA sponsors, and operating expenses of the JOCs are allocated to each sponsoring organization.

## 2. Joint Operating Agreements and Investments in Unconsolidated Organizations (continued)

### Investments in Unconsolidated Organizations

CHI holds noncontrolling interests in various organizations, accounted for under the cost or equity method of accounting, as appropriate. Significant investments are described below.

**Conifer Health Solutions (Conifer) –** As of September 30, 2018, and June 30, 2018, CHI holds a 23.8% equity method investment in Conifer totaling $681.8 million and $670.6 million, respectively. The investment in Conifer was acquired as part of a multi-year agreement with Conifer where Conifer provides revenue cycle services and health information management solutions for CHI acute care operations. Since CHI was granted incremental shares in Conifer in conjunction with the multi-year agreement with Conifer, CHI also has a deferred income balance related to the Conifer agreement of $396.3 million and $403.2 million as of September 30, 2018, and June 30, 2018, respectively, reported in other liabilities on the accompanying consolidated balance sheets. The deferred income balance is being amortized straight line over the remaining agreement term expiring in January 2033, offsetting revenue cycle services fees paid to Conifer, which are reported in purchased services expense in the accompanying consolidated statements of operations.

As a result of CHI recording its incremental equity ownership in Conifer at fair value, the carrying value of its equity method investment in Conifer was $241.6 million and $243.9 million greater than CHI's equity interest in the underlying net assets of Conifer as of September 30, 2018 and June 30, 2018, respectively, due to basis differences in the carrying amounts of the tangible and intangible assets of $174.9 million and $177.2 million, respectively, and of goodwill of $66.7 million in both periods. Goodwill is not amortized but is subject to annual impairment tests during the third quarter of the fiscal year, as well as more frequent reviews whenever circumstances indicate a possible impairment may exist. No impairment of goodwill was identified as of September 30, 2018 and June 30, 2018. The basis differences of the tangible and intangible assets are being amortized over the average useful lives of the underlying assets, ranging from 8 to 25 years, as a reduction of CHI's equity earnings in Conifer.

**2. Joint Operating Agreements and Investments in Unconsolidated Organizations (continued)**

**Premier Health Partners (Premier) –** Effective on January 1, 2018, CHI entered into an agreement with Premier, an Ohio nonprofit corporation operating various hospitals in southwest Ohio, to reorganize and restructure the existing JOA with Premier. The agreement provided that CHI transfer ownership of the Good Samaritan-Dayton MBO to Premier in exchange for a 22% interest in Premier. CHI's 22% equity method investment in Premier totaled $308.6 million and $310.8 million at September 30, 2018, and June 30, 2018, respectively.

**3. Acquisitions, Affiliations, and Divestitures**

There were no significant business combinations and affiliations, individually or in the aggregate, during the three months ended September 30, 2018 and 2017.

**KentuckyOne Health Noncontrolling Interest –** Effective September 1, 2017, CHI became the sole owner of KentuckyOne Health through the purchase of the noncontrolling interest from the remaining partner for $150.0 million in cash consideration.

**Dignity Health –** On December 7, 2017, CHI and Dignity Health signed a definitive agreement to combine their ministries. The combined ministries will build a stronger operational and financial foundation to expand access to quality care, build upon complementary resources and capabilities, and reinvest in critical areas to accelerate improvements in care delivery across 28 states.

The combined ministries will include more than 700 care sites and 139 hospitals, offering people and communities access to quality care delivered by approximately 159,000 employees and more than 25,000 physicians and other advanced practice clinicians. The ministries are geographically complementary with no overlap across hospital service areas.

In November 2018, the remaining state approvals to the combined ministries were received. The agreement is anticipated to close in the second half of calendar year 2018. The name of the new organization will be Common Spirit Health.

**4. Discontinued Operations, and Assets and Liabilities Held for Sale**

The operations of Jewish Hospital and St. Mary's Healthcare, Inc. System (JHSMH) and QualChoice Health, Inc. (QualChoice Health) are reflected as discontinued operations, with their respective assets and liabilities reflected as held for sale, in accordance with ASC 205-20, *Presentation of Financial Statements – Discontinued Operations.*

**JHSMH Held for Sale –** In May 2017, CHI approved a plan to sell or otherwise dispose of certain entities of JHSMH. In fiscal year 2018, CHI entered into a letter of intent for the purchase of JHSMH and anticipates closing on a sale during fiscal year 2019. The assets and liabilities of JHSMH are valued at the lower of their carrying value or their fair value less cost to sell.

**QualChoice Health Held for Sale –** In September 2018, CHI entered into an asset purchase agreement for the sale of its Medicare Advantage health insurance operations in the state of Washington, effective in January 2019. The purchase price is contingent upon future increases in the number of lives covered by the Medicare Advantage plans acquired, and upon maintaining a specified Centers for Medicare & Medicaid Services (CMS) Star Rating as published annually in October 2018 and 2019.

In May 2018, CHI also entered into a letter of intent for the sale of its commercial insurance operations. Negotiations are currently under way, and CHI anticipates closing on the sale during fiscal year 2019.

**UMC Deconsolidation -** Effective on July 1, 2017, and in accordance with the agreement entered into in December 2016 between KentuckyOne Health and UMC, UMC took over the management of its assets and CHI ceased consolidating the UMC operations. The transaction resulted in a loss on deconsolidation of $319.2 million for the three months ended September 30, 2017, reflected in discontinued operations in the consolidated statement of changes in net assets.

**4. Discontinued Operations, and Assets and Liabilities Held for Sale (continued)**

A reconciliation of major classes of assets and liabilities held for sale is presented below (in thousands):

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Other accounts receivable | **$ 27,852** | $ 23,672 |
| Inventory | **16,344** | 16,797 |
| Investments held for insurance purposes | **136,362** | 126,899 |
| Property and equipment, net | **5,991** | 6,918 |
| Other assets | **14,635** | 14,523 |
| Total major classes of assets of the discontinued operations held for sale | **201,184** | 188,809 |
| Other assets held for sale | **5,195** | 6,889 |
| Total assets held for sale | **$ 206,379** | $ 195,698 |
| | | |
| Compensation and benefits | **$ 41,492** | $ 42,167 |
| Accounts payable and accrued expenses | **46,227** | 66,260 |
| Debt | **8,496** | 8,856 |
| Self-insured reserves and claims | **95,918** | 91,094 |
| Other liabilities | **35,568** | 36,918 |
| Total major classes of liabilities of the discontinued operations held for sale | **227,701** | 245,295 |
| Other liabilities held for sale | **6,034** | 6,415 |
| Total liabilities held for sale | **$ 233,735** | $ 251,710 |

The $5.2 million and $6.9 million of other assets classified as held for sale as of September 30, 2018, and June 30, 2018, respectively, represent real estate and other assets that are scheduled to be sold in fiscal year 2019, measured at the lower of their carrying amount or fair value less cost to sell.

**4. Discontinued Operations, and Assets and Liabilities of Held for Sale (continued)**

Operating results of discontinued operations are reported in the accompanying consolidated statements of changes in net assets, and are summarized as follows (in thousands):

| | Three Months Ended September 30, 2018 | 2017 |
|---|---|---|
| Net patient services revenues | **$ 176,225** | $ 179,432 |
| Other operating revenues | **147,353** | 134,824 |
| Total operating revenues | **323,578** | 314,256 |
| Salaries, wages and employee benefits | **106,407** | 113,943 |
| Purchased services and medical claims | **157,384** | 155,763 |
| Depreciation and amortization | **906** | 877 |
| Other expenses | **76,715** | 73,279 |
| Total operating expenses before restructuring, impairment and other losses | **341,412** | 343,862 |
| Loss from operations before restructuring, impairment and other losses | **(17,834)** | (29,606) |
| Restructuring, impairment and other losses | **(12,266)** | (321,859) |
| Loss from operations | **(30,100)** | (351,465) |
| Nonoperating (losses) gains | **(1,088)** | 88 |
| Deficit of revenues over expenses | **(31,188)** | (351,377) |
| Deficit of revenues over expenses attributable to noncontrolling interest | **(4,532)** | (3,261) |
| Deficit of revenues over expenses attributable to CHI | **$ (26,656)** | $ (348,116) |

For the three months ended September 30, 2017, restructuring, impairment and other losses from discontinued operations include the $319.2 million loss on deconsolidation of UMC.

The discontinued operations reported $0.9 million and $1.3 million in capital expenditures for the three months ended September 30, 2018 and 2017, respectively.

## 5. Net Patient Services Revenues

The performance obligation in CHI's patient contracts is to provide care to its patients and is generally satisfied over time for healthcare services in both the inpatient and outpatient setting, as patients simultaneously receive and consume the benefits provided as services are performed.

The performance obligation for inpatient acute care services is generally satisfied over an average of 4 to 5 days. CHI measures the period of time through which the performance obligation is satisfied from the time of the patient's admission into the hospital to the point when the patient no longer requires services, which is generally the time of discharge. Revenue for those patients receiving inpatient acute care services is recognized based on actual charges incurred in relation to total expected or actual charges. CHI believes this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs and outputs needed to satisfy the obligation.

The performance obligation for outpatient and physician services is generally satisfied over a period of less than one day.

Net patient services revenues are reported at the estimated transaction price from patients, third-party payors and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. CHI's estimate of contractual adjustments and discounts was based on contractual agreements, discount policies and historical experience. The estimate of implicit price concessions was based on CHI's historical collection experience with these classes of patients using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. There were no significant revenue reversals or impairment losses to report for the three months ended September 30, 2018.

*Contractual Discounts and Third-Party Reimbursement* – Net patient services revenues are derived from services provided to patients who are either directly responsible for payment or are covered by various insurance or managed care programs. CHI receives payments from the federal government on behalf of patients covered by the Medicare program, from state governments for Medicaid and other state-sponsored programs, from certain private insurance companies and managed care programs, and from patients themselves. A summary of payment arrangements with major third-party payors follows:

**5. Net Patient Services Revenues (continued)**

**Medicare –** Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic and other factors. Certain CHI facilities have been designated as critical access hospitals and, accordingly, are reimbursed their cost of providing services to Medicare beneficiaries. Professional services rendered by physicians are paid based on the Medicare allowable fee schedule.

**Medicaid –** Inpatient services rendered to Medicaid program beneficiaries are primarily paid under the traditional Medicaid plan at prospectively determined rates per discharge. Certain outpatient services are reimbursed based on a cost reimbursement methodology, fee schedules or discounts from established charges.

**Other –** CHI has also entered into payment agreements with certain managed care and commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to CHI under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

*Self-Pay* – Consistent with CHI's mission, care is provided to patients regardless of their ability to pay. Therefore, CHI has determined that it has provided implicit price concessions to uninsured patients and patients with other uninsured balances such as co-payments and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts CHI expects to collect based on its collection history with those patients.

CHI estimates the transaction price for the patient portion and uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, implicit price concessions and charity.

*Charity Care* – As an integral part of its mission, CHI accepts and provides medically necessary health care to all patients without regard to the patient's financial ability to pay. Services to patients are classified as charity care in accordance with standards established across all MBOs. This amount is not included in net patient services revenue in the accompanying consolidated statements of operations and changes in net assets.

**5. Net Patient Services Revenues (continued)**

Charity care represents services rendered for which partial or no payment is expected and includes the cost of providing services to persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. CHI determines the cost of charity care on the basis of an MBO's total cost as a percentage of total charges applied to the charges incurred by patients qualifying for charity care under CHI's policy. The estimated cost of charity care provided was $57.4 million and $55.7 million for the three months ended September 30, 2018 and 2017, respectively, for continuing operations.

The composition of net patient services revenues by primary payor is summarized as follows (in thousands):

| | Three Months Ended September 30, | |
|---|---|---|
| | **2018** | **2017** |
| Medicare | $ 1,275,107 | $ 1,249,218 |
| Medicaid | 401,216 | 407,065 |
| Managed care | 1,441,720 | 1,429,334 |
| Self-pay | 52,592 | 32,193 |
| Commercial and other | 357,119 | 377,000 |
| Total | $ 3,527,754 | $ 3,494,810 |

*Estimated Settlements* - Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Included in third-party liabilities are estimated settlements related to Medicare and Medicaid of $68.9 million and $110.4 million at September 30, 2018, and June 30, 2018, respectively. Net patient services revenues from continuing operations increased by $8.0 million and $1.5 million for the three months ended September 30, 2018 and 2017, respectively, due to favorable changes in estimates related to prior-year settlements.

## 6. Investments and Assets Limited as to Use

CHI's investments and assets limited as to use reported in the accompanying consolidated balance sheets are comprised of the following (in thousands):

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Cash and equivalents | **$ 168,077** | $ 106,053 |
| CHI Investment Program | **5,447,654** | 5,534,127 |
| Marketable equity securities | **266,559** | 267,390 |
| Marketable fixed-income securities | **604,823** | 623,789 |
| Hedge funds and other alternative investments | **5,684** | 5,852 |
| | **6,492,797** | 6,537,211 |
| Less current portion | **(94,009)** | (64,348) |
| | **$ 6,398,788** | $ 6,472,863 |

CHI attempts to reduce its market risk by diversifying its investment portfolio using cash equivalents, fixed-income securities, marketable equity securities and alternative investments. Most of the U.S. Treasury, money market funds and corporate debt obligations as well as exchange-traded marketable securities held directly by CHI and by the CHI Investment Program (the Program) have an actively traded market. However, CHI also invests in commercial paper, mortgage-backed or other asset-backed securities, alternative investments (hedge funds, private equity investments, real estate funds, funds of funds, etc.), collateralized debt obligations, municipal securities and other investments that have potential complexities in valuation based upon the current conditions in the credit markets. For some of these instruments, evidence supporting the determination of fair value may not come from trading in active primary or secondary markets. Because these investments may not be readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had an active market for such investments existed. Such differences could be material. However, management reviews the CHI investment portfolio on a regular basis and seeks guidance from its professional portfolio managers related to U.S. and global market conditions to determine the fair value of its investments. CHI believes the carrying amount of these financial instruments in the accompanying consolidated financial statements is a reasonable estimate of fair value.

**6. Investments and Assets Limited as to Use (continued)**

The majority of all CHI long-term investments are held in the Program. The Program is structured under a Limited Partnership Agreement with CHI as managing general partner and numerous limited partners, most sponsored by CHI. The partnership provides a vehicle whereby virtually all entities associated with CHI, as well as certain other unrelated entities, can optimize investment returns while managing investment risk. Entities participating in the Program that are not consolidated in the accompanying financial statements have the ability to direct their invested amounts and liquidate and/or withdraw their interest without penalty as soon as practicable based on market conditions but within 180 days of notification. The Limited Partnership Agreement permits a simple-majority vote of the noncontrolling limited partners to terminate the partnership. Accordingly, CHI recognizes only the unitized portion of Program assets attributable to CHI and its Direct Affiliates. Program assets attributable to CHI and its Direct Affiliates represented 89% of total Program assets at September 30, 2018 and June 30, 2018.

The Program asset allocation is as follows:

| | **September 30, 2018** | **June 30, 2018** |
|---|---|---|
| Equity securities | **43%** | 43% |
| Fixed-income securities | **36** | 36 |
| Alternative investments | **21** | 20 |
| Cash and equivalents | **–** | 1 |
| | **100%** | 100% |

The CHI Finance Committee (the Committee) of the Board of Stewardship Trustees is responsible for determining target asset allocations among fixed-income, equity, and alternative investments. At least annually, the Committee reviews targeted allocations and, if necessary, makes adjustments to targeted asset allocations. Given the diversity of the underlying securities in which the Program invests, management does not believe there is a significant concentration of credit risk.

The Program allocation to alternative investments is based upon contractual commitment levels to various funds. These commitments are drawn by the fund managers as opportunities arise to invest the capital. As of September 30, 2018, the Program had committed to invest $1.0 billion in 45 funds, of which $850.7 million had been invested. The remaining $153.3 million will be invested when, and if, requested by the funds. Alternative investments within the Program have limited liquidity. As of September 30, 2018, illiquid investments not available for redemption totaled $410.9 million, and investments available for redemption within 180 days at the request of the Program totaled $869.3 million.

**6. Investments and Assets Limited as to Use (continued)**

Investment gains, net are comprised of the following (in thousands):

| | Three Months Ended September 30, 2018 | 2017 |
|---|---|---|
| Dividend and interest income | **$ 33,007** | $ 32,719 |
| Net realized gains | **94,320** | 59,786 |
| Net unrealized gains | **11,004** | 122,432 |
| Total investment gains, net from continuing operations | **138,331** | 214,937 |
| Total investment (losses) gains from discontinued operations | **(1,088)** | 88 |
| Total investment gains, net | **$ 137,243** | $ 215,025 |

Direct expenses of the Program attributable to CHI and its Direct Affiliates for the prior fiscal year were approximately $18.5 million, or 0.33% of total assets, for the entire fiscal year, reflected in investment gains. Direct expenses are estimated to remain at this level in the current fiscal year. Fees paid to certain alternative investment managers are not included in the Program's total expense calculation as they are not a direct expense of the Program, but the fees are deducted from the alternative investment's performance and reflected in investment gains.

## 7. Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

> Level 1 – Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.
>
> Level 2 – Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial asset or liability.
>
> Level 3 – Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

Certain of CHI's alternative investments are made through limited liability companies (LLC) and limited liability partnerships (LLP). These LLCs and LLPs provide CHI with a proportionate share of the investment gains (losses). CHI accounts for its ownership in the LLCs and LLPs under the equity method. CHI also accounts for its ownership in the Program under the equity method. As such, these investments are excluded from the scope of ASC 820.

Financial assets and liabilities measured at fair value on a recurring basis were determined using the market approach based upon the following inputs at September 30, 2018, and June 30, 2018 (in thousands):

## 7. Fair Value of Assets and Liabilities (continued)

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Fair Value Measurements at Reporting Date Using | | | |
| | | (Level 1) | (Level 2) | (Level 3) |
| | Total | Quoted Prices in Active Markets | Other Observable Inputs | Unobservable Inputs |
| **Assets** | | | | |
| Assets limited as to use: | | | | |
| Cash and short-term investments | $ 168,077 | $ 168,077 | $ – | $ – |
| Equity securities | 266,559 | 266,559 | – | – |
| Fixed-income securities | 604,823 | 179,679 | 425,144 | – |
| Other investments | 2,429 | – | – | 2,429 |
| Deferred compensation assets: | | | | |
| Cash and short-term investments | 5,147 | 5,147 | – | – |
| | $ 1,047,035 | $ 619,462 | $ 425,144 | $ 2,429 |
| **Liabilities** | | | | |
| Interest rate swaps | $ 188,810 | $ – | $ 188,810 | $ – |
| Contingent consideration | 81,070 | – | – | 81,070 |
| Deferred compensation liability | 5,147 | 5,147 | – | – |
| | $ 275,027 | $ 5,147 | $ 188,810 | $ 81,070 |

## 7. Fair Value of Assets and Liabilities (continued)

| | June 30, 2018 | | | |
|---|---|---|---|---|
| | Fair Value Measurements at Reporting Date Using | | | |
| | | (Level 1) | (Level 2) | (Level 3) |
| | Total | Quoted Prices in Active Markets | Other Observable Inputs | Unobservable Inputs |
| **Assets** | | | | |
| Assets limited as to use: | | | | |
| Cash and short-term investments | $ 106,053 | $ 96,316 | $ 9,737 | $ – |
| Equity securities | 267,390 | 267,390 | – | – |
| Fixed-income securities | 623,789 | 185,307 | 438,482 | – |
| Other investments | 2,585 | – | – | 2,585 |
| Deferred compensation assets: | | | | |
| Cash and short-term investments | 5,249 | 5,249 | – | – |
| | $ 1,005,066 | $ 554,262 | $ 448,219 | $ 2,585 |
| **Liabilities** | | | | |
| Interest rate swaps | $ 208,462 | $ – | $ 208,462 | $ – |
| Contingent consideration | 80,891 | – | – | 80,891 |
| Deferred compensation liability | 5,249 | 5,249 | – | – |
| | $ 294,602 | $ 5,249 | $ 208,462 | $ 80,891 |

The fair values of the securities included in Level 1 were determined through quoted market prices. Level 1 instruments include money market funds, mutual funds, and marketable debt and equity securities. The fair values of Level 2 instruments were determined through evaluated bid prices based on recent trading activity and other relevant information, including market interest rate curves and referenced credit spreads; estimated prepayment rates, where applicable, are used for valuation purposes and are provided by third-party services where quoted market values are not available. Level 2 instruments include corporate fixed-income securities, government bonds, mortgage and asset-backed securities, and interest rate swaps. The fair values of Level 3 securities are determined primarily through information obtained from the relevant counterparties for such investments. Information on which these securities' fair values are based is generally not readily available in the market. The fair value of the contingent consideration liability was determined based on estimated future cash flows and probability-weighted performance assumptions, discounted to net present value. The contingent consideration liability balance was adjusted to reflect $2.0 million of payments made since June 30, 2018, and to reflect a $2.2 million increase for changes in payment assumptions, reported in other expenses in the consolidated statements of operations.

## 8. Debt Obligations

The following is a summary of debt obligations (in thousands):

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| **Debt secured under the CHI COD** | | |
| Fixed-rate debt: | | |
| Fixed-rate serial and term exempt bonds payable in installments from 2018 through 2045; interest at 2.84% to 7.0% | **$ 2,763,612** | $ 2,784,522 |
| Fixed-rate serial and term taxable bonds payable in installments from 2022 through 2042; interest at 2.6% to 4.35% | **1,515,000** | 1,790,000 |
| Long-term rate exempt bonds subject to mandatory tender from 2019 through 2021; interest at 1.88% to 5.0% | **141,870** | 141,870 |
| Total fixed-rate debt | **4,420,482** | 4,716,392 |
| Variable-rate debt | | |
| Floating rate notes subject to mandatory tender from 2020 through 2025; interest set at prevailing market rates (2.33% to 2.96% at September 30, 2018) | **411,145** | 411,145 |
| Variable-rate demand bonds subject to optional 7-day tender terms and mandatory tender from 2032 through 2035; interest set at prevailing market rates (1.7% to 1.83% at September 30, 2018) | **96,700** | 96,700 |
| Variable-rate direct purchase exempt bonds subject to mandatory tender from 2019 through 2024; interest set at prevailing market rates (2.45% to 3.92% at September 30, 2018) | **928,287** | 928,287 |
| Variable-rate direct purchase taxable bonds subject to mandatory tender from 2019 through 2021; interest set at prevailing market rates (3.48% to 3.86% at September 30, 2018) | **925,000** | 650,000 |
| Bank line of credit maturing July 2019; interest set at prevailing market rates (2.95% at September 30, 2018) | **250,000** | 250,000 |
| Commercial paper notes with maturities ranging 14 to 128 days from September 30, 2018; interest set at prevailing market rates (2.7% at September 30, 2018) | **881,000** | 881,000 |
| Total variable-rate debt | **3,492,132** | 3,217,132 |
| **Total debt secured under the CHI COD** | **7,912,614** | 7,933,524 |
| St. Leonard Master Trust Indenture fixed-rate exempt bonds payable in installments through 2040; interest at 6.0% to 6.63% | **39,641** | 39,707 |
| Other debt: | | |
| Capital lease obligations | **109,525** | 112,889 |
| Note payable issued to Episcopal Health Foundation payable in installments through 2020; interest at 4.0% | **98,726** | 98,726 |
| Other notes payable and debt obligations | **339,599** | 345,467 |
| Total debt obligations before unamortized debt issuance costs, debt premium and debt discount, net | **8,500,105** | 8,530,313 |
| Unamortized debt issuance costs, debt premium and debt discount, net | **(4,506)** | (4,276) |
| Total debt obligations | **8,495,599** | 8,526,037 |
| Less amounts classified as current: | | |
| Variable-rate debt with self-liquidity | **(96,700)** | (96,700) |
| Commercial paper and current portion of debt | **(2,087,380)** | (2,087,406) |
| **Long-term debt** | **$ 6,311,519** | $ 6,341,931 |

**8. Debt Obligations (continued)**

CHI issues the majority of its debt under the Capital Obligation Document (COD) and is the sole obligor. Bondholder security resides both in the unsecured promise by CHI to pay its obligations and in its control of its Direct Affiliates. Covenants include a minimum CHI debt service coverage ratio and certain limitations on secured debt. The Direct Affiliates of CHI, defined as Participants under the COD, have agreed to certain covenants related to corporate existence, maintenance of insurance and exempt use of bond-financed facilities.

Debt issued under the St. Leonard Master Trust Indenture is secured by the property of St. Leonard in Centerville, Ohio, and a pledge of gross revenues.

**Debt Redemptions and Reissuances**

In August 2017, CHI redeemed $34.5 million of bonds originally acquired in fiscal year 2016 as part of the acquisition of Trinity Health System. The bond redemption was funded from cash and investments, resulting in a gain on redemption of $0.2 million reflected in the accompanying consolidated statements of operations.

In July 2018, CHI issued $275.0 million of Series 2018A taxable bonds subject to mandatory tender in August 2021. Proceeds were used to fund the $275.0 million Series 2013D taxable bonds principal payment due in August 2018. Additionally, in July 2018, CHI extended the mandatory purchase date of the $250.0 million Series 2017A taxable bonds from August 2018 to July 2021. As a result, CHI classified the Series 2013D and Series 2017A taxable bonds as long-term debt as of June 30, 2018.

In August 2018, CHI issued $200.0 million of Series 2018B taxable bonds subject to mandatory tender in August 2019. The proceeds were subsequently used to reimburse the funding of the $200.0 million Series 2016 taxable bonds, which were subject to mandatory tender in September 2018.

**Liquidity Facilities, Credit Facilities, and Lines of Credit**

CHI has external liquidity facilities available totaling $365.0 million at September 30, 2018, and June 30, 2018, which can be used to support CHI's obligations to fund tenders of variable rate demand bonds and to pay maturing principal of commercial paper.

**8. Debt Obligations (continued)**

At September 30, 2018, and June 30, 2018, CHI classified as current $881.0 million of commercial paper due to maturities of less than one year and $96.7 million of variable rate demand bonds (VRDBs) due to the holder's ability to put such VRDBs back to CHI on a daily basis, after providing a seven-day notice to tender.

At September 30, 2018, and June 30, 2018, CHI had a credit facility with a third-party bank totaling $69.0 million, of which letters of credit totaling $59.4 million and $59.3 million at September 30, 2018 and June 30, 2018, respectively, have been designated for the benefit of third parties, principally in support of the self-insurance programs administered by FIIL. No amounts were outstanding under this credit facility at September 30, 2018 and June 30, 2018.

At September 30, 2018, and June 30, 2018, CHI had a $250.0 million outstanding bank line of credit, which was fully drawn, and matures in July 2019.

**Interest Rate Swap Agreements**

CHI utilizes various interest rate swap contracts to manage the risk of increased interest rates payable of certain variable-rate bonds. The fixed-payer swap agreements convert CHI's variable-rate debt to fixed-rate debt. Generally, it is CHI's policy that all counterparties have an AA rating or better. The swap agreements generally require CHI to provide collateral if CHI's liability, determined on a mark-to-market basis, exceeds a specified threshold that varies based upon the rating on CHI's long-term indebtedness.

The fair value of the swaps is estimated based on the present value sum of anticipated future net cash settlements until the swaps' maturities. Cash collateral balances are netted against the fair value of the swaps, and the net amount is reflected in other liabilities in the accompanying consolidated balance sheets. At September 30, 2018, and June 30, 2018, the net swap liability reflected in other liabilities was $34.9 million and $33.6 million, respectively, net of swap collateral posted of $153.9 million and $174.9 million, respectively. The change in the fair value of swap agreements resulted in a net gain of $19.6 million and $3.5 million for the three months ended September 30, 2018 and 2017, respectively, reflected in realized and unrealized gains (losses) on interest rate swaps in the accompanying consolidated statements of operations.

## 8. Debt Obligations (continued)

Based upon the swap agreements in place as of September 30, 2018, a reduction in CHI's credit rating to BBB would obligate CHI to post additional cash collateral of $29.0 million. If CHI's credit rating were to fall below BBB, the swap counterparties would have the option to require CHI to settle the swap liabilities at the recorded fair value, which was $34.9 million as of September 30, 2018.

Following is a summary of interest rate swap contracts (in thousands):

| | | Swap Contracts Outstanding | | Fair Value Liability (Asset) | | Notional Amount | |
|---|---|---|---|---|---|---|---|
| | Maturity Date | September 30, 2018 | June 30, 2018 | September 30, 2018 | June 30, 2018 | September 30, 2018 | June 30, 2018 |
| Basis swaps | 3/2028 | **1** | 1 | **$ (507)** | $ (474) | **$ 30,000** | $ 30,000 |
| Fixed payer swaps | 2024–2047 | **15** | 15 | **187,827** | 207,446 | **1,369,680** | 1,373,096 |
| Total return swaps | 2019–2020 | **18** | 19 | **1,490** | 1,490 | **148,857** | 154,462 |
| | | **34** | 35 | **$ 188,810** | $ 208,462 | **$ 1,548,537** | $1,557,558 |

## 9. Retirement Plans

### CHI Pension Plan

CHI and its Direct Affiliates maintain a variety of noncontributory, defined benefit retirement plans (Retirement Plans) for their employees. Certain of these plans were frozen in previous fiscal years, and benefits earned by employees through that time period remain in the Retirement Plans, where employees continue to receive interest credits and vesting credits, if applicable. Benefits in the Retirement Plans are based on compensation, retirement age, and years of service. Substantially all of the Retirement Plans are qualified as church plans and are exempt from certain provisions of both the Employee Retirement Income Security Act of 1974 and Pension Benefit Guaranty Corporation premiums and coverage. Funding requirements are determined through consultation with independent actuaries.

CHI recognizes the funded status (that is, the difference between the fair value of plan assets and the projected benefit obligations) of its Plans in the consolidated balance sheets, with a corresponding adjustment to net assets. Actuarial gains and losses that arise and are not recognized as net periodic pension cost in the same periods are recognized as a component of changes in net assets.

**9. Retirement Plans (continued)**

Estimated amounts for the components of net periodic pension (income) expense are summarized in the table below. Amounts will be adjusted at year-end to reflect actual results, based on the final annual actuarial reports (in thousands):

| | Three Months Ended September 30, | |
|---|---|---|
| | **2018** | **2017** |
| Components of net periodic pension (income) expense: | | |
| Service cost | **$ 3,038** | $ 3,446 |
| Interest cost | **46,246** | 41,072 |
| Expected return on the Plans' assets | **(68,989)** | (70,877) |
| Actuarial losses | **11,378** | 11,593 |
| | **$ (8,327)** | $ (14,766) |

The service cost, interest cost, expected return on the Plans' assets, actuarial losses, and amortization of prior service benefit components of net periodic pension (income) expense are recognized in the accompanying consolidated statements of operations within employee benefits expense.

**CHI 401(k) Retirement Savings Plan**

CHI sponsors the CHI 401(k) Retirement Savings Plan (401(k) Savings Plan) for its employees whereby CHI matches 100.0% of the first 1.0% of eligible pay an employee contributes to the plan, and 50.0% of the next 5.0% of eligible pay contributed to the plan, for a maximum employer matching rate of 3.5% of eligible pay. On an annual basis and regardless of whether or not an employee participates in the 401(k) Savings Plan, CHI will also contribute 2.5% of eligible pay to an employee's 401(k) Savings Plan account. This contribution is made if an employee reaches 1,000 hours in the first year of employment or every calendar year thereafter, and is employed on the last day of the calendar year. An employee is fully vested in the plan for employer contributions after three years of service. CHI recorded 401(k) Savings Plan expense of $57.3 million and $55.2 million for the three months ended September 30, 2018 and 2017, respectively, which is reflected in employee benefits expenses in the accompanying consolidated statements of operations.

## 10. Concentrations of Credit Risk

CHI grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. CHI's exposure to credit risk on patient accounts receivable is limited by the geographical diversity of its MBOs.

The mix of net patient accounts receivable approximated the following:

| | **September 30, 2018** | **June 30, 2018** |
|---|---|---|
| Medicare | **28%** | 26% |
| Medicaid | **11** | 10 |
| Managed care | **35** | 34 |
| Self-pay | **9** | 11 |
| Commercial and other | **17** | 19 |
| | **100%** | 100% |

CHI maintains long-term investments with various financial institutions and investment management firms through its investment program, and its policy is designed to limit exposure to any one institution or investment. Management does not believe there are significant concentrations of credit risk at September 30, 2018 and June 30, 2018.

## 11. Commitments and Contingencies

### Litigation

During the normal course of business, CHI may become involved in litigation. Management assesses the probable outcome of unresolved litigation and records estimated settlements. After consultation with legal counsel, management believes that any such matters will be resolved without material adverse impact to the consolidated financial position or results of operations of CHI.

## 11. Commitments and Contingencies (continued)

### Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Management believes CHI is in compliance with all applicable laws and regulations of the Medicare and Medicaid programs. Compliance with such laws and regulations is complex and can be subject to future governmental interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs. Certain CHI entities have been contacted by governmental agencies regarding alleged violations of Medicare practices for certain services. In the opinion of management after consultation with legal counsel, the ultimate outcome of these matters will not have a material adverse effect on CHI's consolidated financial statements.

## 12. Subsequent Events

CHI's management has evaluated events subsequent to September 30, 2018 through November 29, 2018, which is the date these consolidated financial statements were issued. There have been no material events noted during this period that would either impact the results reflected herein or CHI's results going forward.

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