



To Whom It May Concern:

Enclosed please find the audited financial report of Covenant HealthCare System and Subsidiaries for the year ended June 30, 2018. Unless otherwise noted, the information speaks only as of June 30, 2018 and relates solely to the year then ended, and no implication is created that there has been no change in the financial position or operations of Covenant HealthCare System and its subsidiaries since that date. Neither Covenant HealthCare System nor any of its subsidiaries assume any responsibility to update any of the information contained in the financial report or any related material.

The financial report has been audited by outside, independent auditors.

The statements and data provided are for informational purposes only, and do not purport to include every item which may be of interest to holders of bonds payable from payments made by the subsidiaries of Covenant HealthCare System. Some of the statements, to the extent that they are not recitations of historical fact, may constitute "forward-looking statements." Words such as "estimate," "project," "anticipate," "expect," "intend," "believe" and similar expressions are indicative of forward-looking statements. A number of factors could cause actual results to differ materially from those stated in forward-looking statements, and as a result, readers are cautioned not to rely on forward-looking statements.

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05/04/04

A handwritten signature in black ink, appearing to read "Kevin S. Albosta", is written over a horizontal line.

Kevin S. Albosta, VP/CFO

Covenant HealthCare System and Subsidiaries

**Consolidated Financial Report
with Additional Information
June 30, 2018**

Covenant HealthCare System and Subsidiaries

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Independent Auditor's Report

To the Board of Directors
Covenant HealthCare System and Subsidiaries

We have audited the accompanying consolidated financial statements of Covenant HealthCare System and Subsidiaries (Covenant HealthCare), which comprise the consolidated balance sheet as of June 30, 2018 and 2017 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Covenant HealthCare System and Subsidiaries as of June 30, 2018 and 2017 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Prior Year Financial Statements

The financial statements of Covenant HealthCare System and Subsidiaries as of June 30, 2016 were audited by other auditors, whose report dated October 26, 2016 expressed an unqualified opinion on those statements.

Plante & Moran, PLLC

September 18, 2018

Covenant HealthCare System and Subsidiaries

Consolidated Balance Sheet

June 30, 2018, 2017, and 2016

(in Thousands)

	2018	2017	2016
Assets			
Current Assets			
Cash and cash equivalents (Notes 7 and 8)	\$ 30,880	\$ 27,982	\$ 24,790
Patient accounts receivable - Net (Note 3)	70,475	67,528	58,024
Inventory	16,463	14,409	13,996
Estimated third-party payor settlements (Note 6)	1,601	471	1,240
Assets limited as to use (Notes 7 and 8)	3,665	4,525	4,194
Prepaid expenses and other	16,724	14,853	20,201
Total current assets	139,808	129,768	122,445
Assets Limited as to Use (Notes 7 and 8)			
Funds held under bond agreements	-	-	385
Professional liability fund	5,730	3,091	5,616
By donors for specific purposes	12,763	11,938	10,892
Investments (Notes 7 and 8)	403,212	373,718	329,847
Property and Equipment - Net (Note 9)	175,671	172,198	173,276
Other Assets			
Investments in unconsolidated entities (Note 15)	18,769	18,233	17,551
Other	22,714	18,984	14,211
Total other assets	41,483	37,217	31,762
Total assets	<u>\$ 778,667</u>	<u>\$ 727,930</u>	<u>\$ 674,223</u>

Covenant HealthCare System and Subsidiaries

Consolidated Balance Sheet (Continued)

June 30, 2018, 2017, and 2016

(in Thousands)

	2018	2017	2016
Liabilities and Net Assets			
Current Liabilities			
Accounts payable and accrued expenses	\$ 18,274	\$ 16,460	\$ 14,273
Current portion of long-term debt (Note 10)	6,505	3,745	3,325
Estimated third-party payor settlements (Note 6)	3,798	11,744	4,323
Accrued liabilities and other:			
Accrued compensation and related amounts	39,121	33,227	40,928
Accrued interest payable and other current liabilities	1,490	1,561	1,622
Total current liabilities	69,188	66,737	64,471
Long-term Debt - Net of current portion (Note 10)	82,805	89,287	95,570
Other Liabilities			
Accrued pension obligation (Note 13)	46,305	75,417	88,226
Accrued postretirement benefit obligation (Note 13)	30,976	35,041	36,729
Reserve for professional liability claims (Note 12)	32,025	27,766	24,511
Other	16,757	13,133	10,941
Total other liabilities	126,063	151,357	160,407
Total liabilities	278,056	307,381	320,448
Net Assets			
Unrestricted	487,849	408,611	342,883
Temporarily restricted	12,039	11,243	10,217
Permanently restricted	723	695	675
Total net assets	500,611	420,549	353,775
Total liabilities and net assets	<u>\$ 778,667</u>	<u>\$ 727,930</u>	<u>\$ 674,223</u>

Covenant HealthCare System and Subsidiaries

Consolidated Statement of Operations and Changes in Net Assets

Years Ended June 30, 2018, 2017, and 2016
(in Thousands)

	2018	2017	2016
Unrestricted Revenue, Gains, and Other Support			
Net patient service revenue (Note 4)	\$ 659,406	\$ 623,356	\$ 605,335
Provision for bad debts	(28,138)	(19,244)	(13,717)
Net patient service revenue less provision for bad debts	631,268	604,112	591,618
Investment income and realized gains and losses	614	315	211
Other revenue	40,812	34,183	29,665
Total unrestricted revenue, gains, and other support	672,694	638,610	621,494
Expenses			
Salaries and wages	299,618	279,017	258,517
Benefits	77,150	72,427	70,379
Supplies	132,208	129,050	125,475
Professional fees	14,524	11,011	13,781
Purchased services	63,452	59,534	58,227
Insurance	6,005	7,966	7,034
Utilities	6,415	6,208	6,273
Depreciation and amortization	29,693	30,218	30,870
Interest expense	3,658	3,815	3,988
Other	12,219	12,076	12,476
Total expenses (Note 16)	644,942	611,322	587,020
Operating Income	27,752	27,288	34,474
Nonoperating Income (Loss)			
Investment income (Note 7)	7,492	6,357	6,677
Realized and unrealized net gains (losses) on investments (Note 7)	15,273	7,157	(1,105)
Other	500	39	524
Total nonoperating income	23,265	13,553	6,096
Excess of Revenue Over Expenses	\$ 51,017	\$ 40,841	\$ 40,570

Covenant HealthCare System and Subsidiaries

Consolidated Statement of Operations and Changes in Net Assets (Continued)

	Years Ended June 30, 2018, 2017, and 2016		
	(in Thousands)		
	2018	2017	2016
Unrestricted Net Assets			
Excess of revenue over expenses	\$ 51,017	\$ 40,841	\$ 40,570
Change in unrealized (losses) gains in fair value of investments (Note 7)	(1,291)	17,911	(4,371)
Other	(20)	(115)	(370)
Pension and other postretirement benefit obligation adjustment (Note 13)	29,532	7,091	(30,482)
Increase in unrestricted net assets	79,238	65,728	5,347
Temporarily Restricted Net Assets			
Contributions	1,333	1,336	1,287
Investment income	495	276	181
Change in unrealized (losses) gains in fair value of investments (Note 7)	(19)	377	76
Other	(9)	115	-
Net assets released from restriction	(1,004)	(1,078)	(916)
Increase in temporarily restricted net assets	796	1,026	628
Permanently Restricted Net Assets - Contributions and other	28	20	-
Increase in Net Assets	80,062	66,774	5,975
Net Assets - Beginning of year	420,549	353,775	347,800
Net Assets - End of year	\$ 500,611	\$ 420,549	\$ 353,775

Covenant HealthCare System and Subsidiaries

Consolidated Statement of Cash Flows

Years Ended June 30, 2018, 2017, and 2016
(in Thousands)

	2018	2017	2016
Cash Flows from Operating Activities			
Increase in net assets	\$ 80,062	\$ 66,774	\$ 5,975
Adjustments to reconcile increase in net assets to net cash and cash equivalents from operating activities:			
Depreciation and amortization	29,693	30,218	30,870
Provision for bad debts	28,138	19,244	13,717
Change in unrealized gains and losses in fair value of investments	1,310	(18,288)	4,295
Pension and other postretirement benefit obligation adjustment	(29,532)	(7,091)	30,482
Restricted contributions, investment income and other	(1,847)	(1,632)	(1,468)
Changes in operating assets and liabilities which (used) provided cash and cash equivalents:			
Patient accounts receivable	(31,085)	(28,748)	(12,205)
Inventory and other current assets	(3,925)	4,935	(6,667)
Estimated third-party payor settlements	(9,076)	8,190	(2,917)
Accounts payable and accrued liabilities	7,943	(6,580)	(1,235)
Accrued pension and postretirement obligations	(3,645)	(7,406)	(8,864)
Other liabilities	7,883	5,447	(4,987)
Net cash and cash equivalents provided by operating activities	75,919	65,063	46,996
Cash Flows from Investing Activities			
Purchase of property and equipment	(33,472)	(28,003)	(22,770)
Purchases of investments - Net	(30,804)	(25,583)	(26,291)
Decrease (increase) in assets limited as to use	860	54	(58)
(Increase) decrease in professional liability fund	(2,639)	2,525	2,008
Change in assets limited as to use by donors	(825)	(1,046)	(628)
(Increase) decrease in other assets	(4,266)	(5,569)	3,548
Net cash and cash equivalents used in investing activities	(71,146)	(57,622)	(44,191)
Cash Flows from Financing Activities			
Repayments of long-term debt	(3,722)	(5,881)	(5,259)
Restricted contributions, investment income, and other	1,847	1,632	1,468
Net cash and cash equivalents used in financing activities	(1,875)	(4,249)	(3,791)
Net Increase (Decrease) in Cash and Cash Equivalents	2,898	3,192	(986)
Cash and Cash Equivalents - Beginning of year	27,982	24,790	25,776
Cash and Cash Equivalents - End of year	<u>\$ 30,880</u>	<u>\$ 27,982</u>	<u>\$ 24,790</u>
Supplemental Cash Flow Information - Property and equipment additions in accounts payable and accrued expenses at year end	\$ 699	\$ 1,005	-

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 1 - Nature of Business

Covenant HealthCare System (Covenant HealthCare) is the sole corporate member of Covenant Medical Center, Inc. (Medical Center or CMC); Covenant HealthCare Foundation (CHF); Covenant Development Corporation (CDC); Visiting Nurse Association of Saginaw (VNA); and Visiting Nurse Special Services (VNSS).

Covenant HealthCare is organized exclusively for charitable, scientific, and educational purposes. CDC is a for-profit corporation organized to further the healthcare services and needs of Covenant HealthCare. Covenant HealthCare provides healthcare services to Saginaw County (Michigan) and surrounding areas, and its mission is to provide extraordinary care for every generation. To achieve this mission, Covenant HealthCare meets the needs of individuals and the communities in its service area through a complement of general and specialized healthcare services, including inpatient acute care, outpatient services, home health care, and other healthcare services.

Note 2 - Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Covenant HealthCare and all of its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation. Investments in entities where Covenant HealthCare owns 50 percent or less of an entity but has significant influence over the operating and financial policies are recorded under the equity method of accounting.

Cash and Cash Equivalents

Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use. Cash balances held in the bank exceed the federal depository insurance limit. Covenant HealthCare's cash is only insured up to the federal depository insurance limit.

Investments

Investments in equity securities with readily determinable fair values, investments in common trust funds that invest in marketable equity securities, and all investments in debt securities are measured at fair value using quoted market prices. The realized gains and losses on investments are the difference between the proceeds received and the cost determined using the average method of investment valuation.

Unrealized gains and losses on unrestricted investments considered available for sale and determined to be temporary are recorded below the excess of revenue over (under) expenses.

Covenant HealthCare's management continually evaluates the available-for-sale investment portfolio and evaluates whether declines in fair values should be considered other than temporary. Factored into this evaluation are general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendations of advisors, and the length of time and extent to which the market value has been at less than cost.

Covenant HealthCare has investments in certain limited partnerships, including private equity investments, real estate investments, common trust funds, and hedge funds, which are reported using the equity method of accounting.

Investments in unconsolidated entities where Covenant HealthCare does not have operating control are recorded using the equity or cost method of accounting.

Accounts Receivable

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 2 - Significant Accounting Policies (Continued)

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors. Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, Covenant HealthCare analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, Covenant HealthCare analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), Covenant HealthCare records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts in the period they are determined to be uncollectible.

Third-party Settlements

Contractual adjustments under third-party reimbursement programs represent the difference between Covenant HealthCare's established rates for services and amounts reimbursed by third-party payors. Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs.

Inventory

Inventory, which consists of medical and office supplies and pharmaceutical products, is stated at cost, determined on a first-in, first-out basis or market.

Property and Equipment

Property and equipment, including internal use software, are recorded at cost. The straight-line method is used for computing depreciation and amortization. Assets are depreciated over their estimated useful lives. Estimated useful lives by asset category are as follows: land improvements - 2 to 25 years; buildings - 20 to 40 years; equipment - 3 to 20 years; and internal use software - 10 years. Costs of maintenance and repairs are charged to expense when incurred.

Donated property and equipment are reported as unrestricted support and are excluded from the excess of revenue over expenses, unless explicit donor stipulations specify how the donated asset must be used. Donated property and equipment are recorded at estimated fair value at the time of donation.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific purpose, such as capital additions or research. When a donor restriction expires, such as through expenditure for the restricted purpose, temporarily restricted net assets are reclassified as net assets released from restrictions for operating purposes and are included in operating revenue, whereas net assets released from restrictions for long-lived assets are reported as an increase in unrestricted net assets. Pledges are recorded as increases in net assets when the pledge is made.

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 2 - Significant Accounting Policies (Continued)

Permanently restricted net assets are assets for which the donor has stipulated that the principal remains intact.

Net Patient Service Revenue

Covenant HealthCare recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, Covenant HealthCare recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of Covenant HealthCare's uninsured patients will be unable or unwilling to pay for the services provided. Thus, Covenant HealthCare records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action, including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Excess of Revenue Over Expenses

The consolidated statement of operations and change in net assets includes excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments classified as available-for-sale securities, pension and other postretirement-related changes other than net periodic benefit cost, and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purposes of acquiring such assets).

Charity Care

Covenant HealthCare provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Covenant HealthCare does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

Covenant HealthCare and its subsidiaries, except for CDC, are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. No provision for income taxes has been included in the consolidated financial statements for the exempt entities. CDC is a Michigan for-profit corporation; income tax provisions for CDC are not material to the consolidated financial statements.

Subsequent Events

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 2 - Significant Accounting Policies (Continued)

The consolidated financial statements and related disclosures include evaluation of events up through and including September 18, 2018, which is the date the consolidated financial statements were available to be issued.

Upcoming Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The ASU is based on the principle that revenue is recognized to depict the transfer of 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 or services. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The new guidance will be effective for Covenant HealthCare's year ending June 30, 2019. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. Covenant HealthCare has not yet determined which application method it will use. Covenant HealthCare does not expect there to be a significant impact on the amounts recognized as revenue based on the effect of the new standard on the consolidated financial statements; however, Covenant HealthCare has not completed its analysis on all revenue streams.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for Covenant HealthCare's year ending June 30, 2020. The new lease standard is expected to have a significant effect on Covenant HealthCare's consolidated financial statements as a result of the leases for real estate and equipment classified as operating leases. The effect of applying the new lease guidance on the consolidated financial statements will be to increase long-term assets and lease liabilities. The effects on the results of operations are not expected to be significant, as recognition and measurement of expenses and cash flows for leases will be substantially the same under the new standard.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 requires significant changes to the financial reporting model of organizations that follow FASB not-for-profit rules, including changing from three classes of net assets to two classes: net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by Covenant HealthCare, including required disclosures about the liquidity and availability of resources. The new standard is effective for Covenant HealthCare's year ending June 30, 2019 and must be applied on a retrospective basis. Covenant HealthCare is currently evaluating the impact this standard will have on the financial statements.

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 2 - Significant Accounting Policies (Continued)

In March 2017, the FASB issued ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard requires the presentation of the service cost component of net benefit cost to be in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. All other components of net benefit cost should be presented separately from the service cost component and outside of income from operations. The standard is effective for Covenant HealthCare's year ending June 30, 2020 and must be adopted retrospectively. Adoption of the new standard is not expected to have a material impact on Covenant HealthCare's financial statements.

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2018	2017	2016
Patient accounts receivable	\$ 277,941	\$ 253,906	\$ 241,427
Less:			
Allowance for uncollectible accounts	19,997	16,284	18,981
Allowance for contractual adjustments	187,469	170,094	164,422
Net patient accounts receivable	<u>\$ 70,475</u>	<u>\$ 67,528</u>	<u>\$ 58,024</u>

Covenant HealthCare grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from these major payor sources was as follows:

	2018	2017	2016
Medicare	33 %	35 %	34 %
Medicaid	16	12	16
Blue Cross/Blue Shield of Michigan	11	12	10
Self-pay and other	40	41	40

Note 4 - Net Patient Service Revenue

Patient service revenue, net of contractual allowances and discounts, recognized in the years ended June 30, 2018, 2017, and 2016 from these major payor sources, is as follows:

	2018	2017	2016
Medicare	43.00 %	43.00 %	43.00 %
Medicaid	16.00	16.00	17.00
Blue Cross	17.00	17.00	18.00
Self-pay and other	24.00	24.00	22.00

Net patient service revenue consists of the following:

	2018	2017	2016
Gross patient service revenue	\$ 2,256,853	\$ 2,110,357	\$ 1,987,353
Contractual provisions and adjustments	(1,597,447)	(1,487,001)	(1,382,018)
Net patient service revenue	<u>\$ 659,406</u>	<u>\$ 623,356</u>	<u>\$ 605,335</u>

During the years ended June 30, 2018, 2017, and 2016, increases to net patient service revenue related to prior year third-party settlements amount to \$820, \$760, and \$1,700, respectively.

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 5 - Charity Care

Covenant HealthCare provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Covenant HealthCare does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The estimated cost of providing charity services is based on a calculation that applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. Covenant HealthCare estimates that it provided, at cost, \$1,207, \$662, and \$1,145 of services to indigent patients during 2018, 2017, and 2016, respectively. Net patient service revenue excludes charity care adjustments of \$3,828, \$2,054, and \$3,468 during 2018, 2017, and 2016, respectively.

Note 6 - Cost Report Settlements

Covenant HealthCare has agreements with third-party payors that provide for payments to Covenant HealthCare at amounts different from its established rates. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient, acute-care, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient and homecare services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Outpatient and physician services are reimbursed on an established fee-for-service methodology.
- **Blue Cross/Blue Shield of Michigan** - Inpatient, acute-care services are reimbursed at prospectively determined rates per discharge. Outpatient services are reimbursed on a fee-for-service and percentage-of-charge basis.

Laws and regulations governing the Medicare, Medicaid, and Blue Cross/Blue Shield 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.

Note 7 - Investments

The details of Covenant HealthCare's investments, including cash and cash equivalents and assets limited as to use, at June 30 are as follows:

	2018	2017	2016
Cash and cash equivalents	\$ 34,597	\$ 41,583	\$ 34,425
Marketable equity security mutual funds	25,245	22,065	23,233
Fixed-income mutual funds	96,846	73,637	72,096
Publicly traded mutual funds	209,122	197,853	172,687
Common trust funds	27,601	27,614	25,585
Limited partnerships	10,473	11,187	12,526
Hedge funds	52,366	47,315	35,172
Total	<u>\$ 456,250</u>	<u>\$ 421,254</u>	<u>\$ 375,724</u>

A reconciliation of investments, assets limited as to use, and cash and cash equivalents from the above table to the consolidated balance sheet is presented below as of June 30:

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 7 - Investments (Continued)

	2018	2017	2016
Cash and cash equivalents	\$ 30,880	\$ 27,982	\$ 24,790
Assets limited as to use:			
Funds held under bond agreements - Current	3,665	4,525	4,194
Funds held under bond agreements - Long term	-	-	385
Professional liability fund	5,730	3,091	5,616
By donors for specific purposes	12,763	11,938	10,892
Total assets limited as to use	22,158	19,554	21,087
Investments	403,212	373,718	329,847
Total	<u>\$ 456,250</u>	<u>\$ 421,254</u>	<u>\$ 375,724</u>

Investment income and realized and unrealized gains and losses on investments are reported as follows for the years ended June 30:

	2018	2017	2016
Interest and dividends	\$ 7,703	\$ 6,698	\$ 7,011
Realized gains (losses) on sale of investments	13,952	(29)	(633)
Change in unrealized gains (losses)	909	25,724	(4,709)
Total	<u>\$ 22,564</u>	<u>\$ 32,393</u>	<u>\$ 1,669</u>

Investment income and realized and unrealized gains and losses on investments are included in the following for the years ended June 30:

	2018	2017	2016
Operating revenue	\$ 614	\$ 315	\$ 211
Nonoperating income	22,765	13,514	5,572
Change in unrestricted net assets	(1,291)	17,911	(4,371)
Temporarily restricted investment income	495	276	181
Change in temporarily restricted net assets	(19)	377	76
Total	<u>\$ 22,564</u>	<u>\$ 32,393</u>	<u>\$ 1,669</u>

Covenant HealthCare invests in various financial instruments that are publicly and privately traded. Financial instruments are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated statement of operations and changes in net assets.

The gross unrealized gains (losses) since acquisition on marketable equity securities were \$40,961 and \$(7,521), respectively, at June 30, 2018; \$39,075 and \$(4,307), respectively, at June 30, 2017; and \$22,425 and \$(5,835), respectively, at June 30, 2016.

Information pertaining to available-for-sale investment securities with gross unrealized losses at June 30, 2018, 2017, and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows:

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 7 - Investments (Continued)

	2018					
	Less than 12 Months		12 Months or Greater		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Investments with unrealized losses:						
Fixed-income mutual funds	\$ -	\$ -	\$ (3,977)	\$ 93,181	\$ (3,977)	\$ 93,181
Publicly traded mutual funds	(836)	20,164	(2,708)	44,341	(3,544)	64,505
Total investments with unrealized losses	<u>\$ (836)</u>	<u>\$ 20,164</u>	<u>\$ (6,685)</u>	<u>\$ 137,522</u>	<u>\$ (7,521)</u>	<u>\$ 157,686</u>
	2017					
	Less than 12 Months		12 Months or Greater		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Investments with unrealized losses:						
Fixed-income mutual funds	\$ -	\$ -	\$ (1,268)	\$ 69,113	\$ (1,268)	\$ 69,113
Publicly traded mutual funds	-	-	(3,039)	46,273	(3,039)	46,273
Total investments with unrealized losses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (4,307)</u>	<u>\$ 115,386</u>	<u>\$ (4,307)</u>	<u>\$ 115,386</u>
	2016					
	Less than 12 Months		12 Months or Greater		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Investments with unrealized losses:						
Fixed-income mutual funds	\$ -	\$ -	\$ (848)	\$ 7,637	\$ (848)	\$ 7,637
Publicly traded mutual funds	-	-	(4,987)	41,844	(4,987)	41,844
Total investments with unrealized losses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (5,835)</u>	<u>\$ 49,481</u>	<u>\$ (5,835)</u>	<u>\$ 49,481</u>

Note 8 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the consolidated financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about Covenant HealthCare's assets measured at fair value on a recurring basis at June 30, 2018, 2017, and 2016 and the valuation techniques used by Covenant HealthCare to determine those fair values.

Fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that Covenant HealthCare has the ability to access.

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 8 - Fair Value Measurements (Continued)

Fair values determined by Level 2 inputs use other inputs that are observable either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. Covenant HealthCare's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

Covenant HealthCare's policy is to recognize transfers into and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. During the years ended June 30, 2018, 2017, and 2016, there were no transfers between levels of the fair value hierarchy.

	Assets Measured at Fair Value on a Recurring Basis at June 30, 2018			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2018
Assets				
Cash and cash equivalents	\$ 34,597	\$ -	\$ -	\$ 34,597
Assets limited as to use and investments:				
Mutual funds:				
U.S. large-cap	122,413	-	-	122,413
Fixed income	96,846	-	-	96,846
International fixed income	12,166	-	-	12,166
International companies	71,879	-	-	71,879
Real estate	27,909	-	-	27,909
Total assets limited as to use and investments	331,213	-	-	331,213
Other assets - Benefit plan assets	13,408	-	-	13,408
Total assets	<u>\$ 379,218</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 379,218</u>

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 8 - Fair Value Measurements (Continued)

	Assets Measured at Fair Value on a Recurring Basis at June 30, 2017			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2017
Assets				
Cash and cash equivalents	\$ 41,583	\$ -	\$ -	\$ 41,583
Assets limited as to use and investments:				
Mutual funds:				
U.S. large cap	112,868	-	-	112,868
Fixed income	73,637	-	-	73,637
International fixed income	11,387	-	-	11,387
International companies	71,380	-	-	71,380
Real estate	24,283	-	-	24,283
Total assets limited as to use and investments	293,555	-	-	293,555
Other assets - Benefit plan assets	10,647	-	-	10,647
Total assets	\$ 345,785	\$ -	\$ -	\$ 345,785
	Assets Measured at Fair Value on a Recurring Basis at June 30, 2016			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2016
Assets				
Cash and cash equivalents	\$ 34,425	\$ -	\$ -	\$ 34,425
Assets limited as to use and investments:				
Mutual funds:				
U.S. large cap	97,202	-	-	97,202
Fixed income	72,096	-	-	72,096
International fixed income	12,112	-	-	12,112
International companies	60,063	-	-	60,063
Real estate	26,543	-	-	26,543
Total assets limited as to use and investments	268,016	-	-	268,016
Other assets - Benefit plan assets	8,200	-	-	8,200
Total assets	\$ 310,641	\$ -	\$ -	\$ 310,641

Included within investments on the consolidated balance sheet are investments in common trust funds, limited partnerships, and hedge funds totaling \$90,440, \$86,116, and \$73,283 at June 30, 2018, 2017, and 2016, respectively. These investments are accounted for under the equity method. Equity method investments are not measured at fair value on a recurring basis and, therefore, are not included in the table above.

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 9 - Property and Equipment

Property and equipment are summarized as follows:

	2018	2017	2016
Land and land improvements	\$ 16,583	\$ 15,857	\$ 15,611
Buildings	221,532	216,191	216,872
Equipment	397,833	378,177	387,244
Construction in progress	8,909	3,205	1,193
Total cost	644,857	613,430	620,920
Accumulated depreciation	469,186	441,232	447,644
Net property and equipment	<u>\$ 175,671</u>	<u>\$ 172,198</u>	<u>\$ 173,276</u>

As of June 30, 2018, Covenant HealthCare has no significant outstanding commitments toward capital projects. As of June 30, 2018, construction in progress primarily consisted of projects to expand the radiation center and beaker lab system.

Note 10 - Long-term Debt

Long-term debt at June 30 is as follows:

	2018	2017	2016
City of Saginaw Hospital Finance Authority Hospital Revenue Refunding Bonds, Series 2010H	\$ 58,975	\$ 61,955	\$ 64,540
City of Saginaw Hospital Finance Authority Hospital Revenue and Refunding Bonds, Series 2014I	23,490	23,490	26,045
Term loan agreement	6,995	7,760	8,500
Unamortized premium	759	789	829
Unamortized debt issuance costs	(909)	(962)	(1,019)
Long-term debt	89,310	93,032	98,895
Less current portion	6,505	3,745	3,325
Long-term portion	<u>\$ 82,805</u>	<u>\$ 89,287</u>	<u>\$ 95,570</u>

Covenant HealthCare entered into long-term debt agreements with the City of Saginaw Hospital Finance Authority. The debt agreements require payments sufficient to pay principal and interest on the bonds. Among other things, the debt agreements contain covenants that place restrictions on the amount of new debt that Covenant HealthCare can incur and the maintenance of a minimum debt service coverage ratio. The debt is secured by the accounts receivable and general intangibles of the obligated group members pursuant to the Master Indenture. The obligated group is responsible for making all principal and interest payments on the bonds as they become due. The Obligated Group consists of CMC and CHF.

On April 25, 2014, Covenant HealthCare issued the Series 2014I bonds, which were purchased by JPMorgan Chase Bank, National Association. At June 30, 2018, the Series 2014I bonds consist of \$23,490 of fixed-rate bonds, which bear an annual interest rate of 2.09 percent. The bonds mature annually through 2024 in amounts ranging from \$3,520 to \$5,130. The bonds are secured by a pledge of gross revenue of the members of the Obligated Group. The proceeds from the Series 2014I bonds were used to pay for certain capital projects, refund the Series 2004G bonds, and pay for the expenses incurred in connection with the issuance of the 2014I bonds.

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 10 - Long-term Debt (Continued)

On October 28, 2010, Covenant HealthCare issued the Series 2010H bonds. At June 30, 2018, the Series 2010H bonds consist of \$8,005 of serial bonds, which bear annual interest at 4.25 to 5.00 percent, and \$50,970 of term bonds, which bear annual interest at 5.00 percent. The serial bonds are subject to annual redemption through 2022 in amounts ranging from \$2,195 to \$2,400. The term bonds are subject to annual redemption starting in 2023 through 2031 in amounts ranging from \$2,665 to \$7,895. The bonds are secured by a pledge of gross revenue of the members of the Obligated Group. The proceeds from the Series 2010H bonds were used to refund the Series 1999E and Series 2000F bonds and to pay the expenses incurred in connection with the issuance of the Series 2010H bonds.

On May 27, 2015, an \$8,500 10-year term loan agreement was entered into with JPMorgan Chase Bank. This loan bears a variable rate of interest based on the one-month London Interbank Offered Rate (LIBOR) plus 135 basis points, which, at June 30, 2018, was 3.3 percent. Annual principal payments of amounts ranging from \$790 in 2019 to \$965 in 2025 are required. The proceeds of this loan were used to fund the purchase of the remaining two-thirds interest in Saginaw Radiation Oncology Center as well as certain real property.

Covenant HealthCare has several letters of credit available at June 30, 2018 to provide funding for certain self-insured benefits. There were no amounts outstanding on the letters of credit at June 30, 2018.

Cash paid for interest during 2018, 2017, and 2016 amounted to \$3,705, \$3,858, and \$4,047, respectively.

The balance of the above debt matures as follows:

<u>Years Ending</u>	<u>Amount</u>
2019	\$ 6,505
2020	6,710
2021	6,910
2022	7,100
2023	7,290
Thereafter	<u>54,945</u>
Total	<u>\$ 89,460</u>

Note 11 - Operating Leases

Covenant HealthCare has various operating leases for buildings and equipment. Rental expense under these leases during the years ended June 30, 2018, 2017, and 2016 amounted to \$5,662, \$5,609, and \$5,138, respectively.

Future minimum annual commitments under these operating leases are as follows:

<u>Years Ending June 30</u>	<u>Amount</u>
2019	\$ 2,843
2020	2,353
2021	2,035
2022	1,603
2023	1,486
Thereafter	<u>3,784</u>
Total	<u>\$ 14,104</u>

Note 12 - Professional and Other Liability Insurance

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 12 - Professional and Other Liability Insurance (Continued)

Covenant HealthCare maintains a self-insurance irrevocable trust fund for medical malpractice claims. Under terms of the trust agreements, trust assets may be used for payment of professional liability losses, related expenses, and the cost of administering the trusts, subject to certain retention limits. Excess professional liability insurance coverage has been obtained in amounts deemed adequate by Covenant HealthCare to cover claims in excess of self-insured retention limits.

Covenant HealthCare records its estimated liabilities for damages and costs that may be awarded on claims and unreported liabilities. Covenant HealthCare's estimates are based on historical experience, the evaluations of all known claims and certain incidents, and the evaluation of claims of substance. Estimated liabilities for known incidents that may result in the assertion of additional claims and other claims that may be asserted arising from services provided to patients during the period are based upon projections by a consulting actuary. The recorded loss reserves as of June 30, 2018, 2017, and 2016 are \$32,025, \$27,766, and \$24,511, respectively. The loss reserves are discounted using an annual discount rate of 4.0 percent at June 30, 2018, 2017, and 2016.

Covenant HealthCare has recognized a receivable of \$5,892, \$4,743, and \$2,121 at June 30, 2018, 2017, and 2016, respectively, for amounts to be recovered from various insurance carriers and captive insurance companies within other long-term assets in the consolidated balance sheet. While it is possible that settlement of asserted claims and claims that may be asserted in the future could result in liabilities in excess of amounts for which Covenant HealthCare has provided, management believes that the additional liabilities, if any, would not materially affect the consolidated financial position at June 30, 2018.

Note 13 - Pension and Other Postretirement Benefit Plans

Covenant HealthCare has funded noncontributory defined benefit pension plans. The plans provide defined benefits based on years of service and the employee's compensation during the last five years of employment. In February 2011, Covenant HealthCare elected to freeze the pension benefits at the levels in place as of that date.

Covenant HealthCare also has other postretirement benefit plans for retirees who meet eligibility requirements. This plan is frozen and has had no new participants since January 2000. The plan participants also stopped accumulating years of service as of December 31, 2007.

The following tables set forth the funded status and amounts recognized in the consolidated balance sheet for the defined benefit pension and other postretirement benefit plans as of June 30, 2018, 2017, and 2016:

Obligations and Funded Status

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 13 - Pension and Other Postretirement Benefit Plans (Continued)

	Pension Benefits			Other Postretirement Benefits		
	2018	2017	2016	2018	2017	2016
Change in benefit obligation:						
Benefit obligation at beginning of year	\$ 373,690	\$ 371,176	\$ 335,394	\$ 35,041	\$ 36,729	\$ 35,901
Service cost	453	575	443	-	-	-
Interest cost	14,336	14,236	15,147	1,267	1,340	1,560
Actuarial (gain) loss	(22,238)	2,644	35,983	(3,487)	(1,120)	1,007
Benefits paid	(19,750)	(14,941)	(15,791)	(1,845)	(1,908)	(1,739)
Benefit obligation at end of year	346,491	373,690	371,176	30,976	35,041	36,729
Change in plan assets:						
Fair value of plan assets at beginning of year	298,273	282,950	267,958	-	-	-
Actual return on plan assets	11,734	18,144	16,776	-	-	-
Employer contributions	9,929	12,120	14,007	1,845	1,908	1,739
Benefits paid	(19,750)	(14,941)	(15,791)	(1,845)	(1,908)	(1,739)
Fair value of plan assets at end of year	300,186	298,273	282,950	-	-	-
Funded status at end of year	\$ (46,305)	\$ (75,417)	\$ (88,226)	\$ (30,976)	\$ (35,041)	\$ (36,729)

Amounts recognized in changes in net assets consist of the following:

	Pension Benefits			Other Postretirement Benefits		
	2018	2017	2016	2018	2017	2016
Net loss (gain)	\$ 112,161	\$ 137,701	\$ 143,766	\$ (4,640)	\$ (555)	\$ 565
Prior service credit	(39)	(132)	(226)	-	-	-
Total	\$ 112,122	\$ 137,569	\$ 143,540	\$ (4,640)	\$ (555)	\$ 565

The accumulated benefit obligation for all defined benefit pension plans was \$343,798, \$371,684, and \$369,340 at June 30, 2018, 2017, and 2016, respectively. The accumulated benefit obligation for all other postretirement benefit plans was \$30,377, \$35,041, and \$36,729 at June 30, 2018, 2017, and 2016, respectively.

Components of net periodic benefit cost are as follows:

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 13 - Pension and Other Postretirement Benefit Plans (Continued)

	Pension Benefits			Other Postretirement Benefits		
	2018	2017	2016	2018	2017	2016
Net Periodic Benefit Cost						
Service cost	453	575	443	-	-	-
Interest cost	14,336	14,236	15,147	1,267	1,340	1,560
Expected return on plan assets	(20,732)	(19,841)	(19,024)	-	-	-
Amortization of prior service cost	(94)	(94)	(94)	-	-	-
Amortization of actuarial loss	10,093	10,448	7,693	-	-	-
Settlement	2,208	-	1,160	-	-	-
Total recognized in net periodic benefit cost	<u>\$ 6,264</u>	<u>\$ 5,324</u>	<u>\$ 5,325</u>	<u>\$ 1,267</u>	<u>\$ 1,340</u>	<u>\$ 1,560</u>

For measurement purposes in the other postretirement plan, a 6.80 percent initial annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2018. The rate was assumed to decrease gradually annually to 4.50 percent in 2029 and remain at that level thereafter.

The healthcare cost trend rate assumptions have a significant effect on the amounts reported for the healthcare plans. To illustrate, a 1 percentage point change in assumed healthcare cost trend rates would have the following effects:

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost components	\$ 34	\$ (31)

Weighted-average assumptions used to determine benefit obligations at June 30 are as follows:

	Pension Benefits			Other Postretirement Benefits		
	2018	2017	2016	2018	2017	2016
Discount rate	4.35%	3.95%	3.92%	4.35%	3.95%	3.92%

Weighted-average assumptions used to determine net periodic benefit cost for the years ended June 30 are as follows:

	Pension Benefits			Other Postretirement Benefits		
	2018	2017	2016	2018	2017	2016
Discount rate	3.95%	3.92%	4.63%	3.95%	3.92%	4.63%
Expected long-term return on plan assets	7.00%	7.00%	7.10%	-	-	-
Rate of compensation increase	3.25%	3.25%	3.25%	-	-	-

Pension Plan Assets

The investments of the plans are held by a trustee and managed in accordance with guidelines established by Covenant HealthCare. The plan assets are invested in a well-diversified portfolio designed to maximize returns without assuming undue risk. The plans use investment managers specializing in each asset class. Plan assets largely consist of domestic and international equity holdings, domestic and international fixed-income holdings, common trust funds, limited partnerships, and hedge funds. The performance of all managers and the aggregate asset allocation are formally reviewed quarterly.

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

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(in Thousands)

Note 13 - Pension and Other Postretirement Benefit Plans (Continued)

The expected long-term rate of return of plan assets is based on historical and projected rates of return for current and planned asset categories in the plans' investment portfolio. Assumed projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category using benchmark rates. Based on the target asset allocation among the asset categories, the overall expected rate of return for the portfolio was developed and adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from plan assets.

The weighted-average asset allocation and the target allocation, by asset category, are as follows:

Asset category:	Percentage of Plan Assets at June 30			Target Allocation
	2018	2017	2016	2018
Cash and cash equivalents	1.40 %	0.50 %	1.40 %	1.90 %
Marketable equity securities	5.10	5.10	2.50	2.50
Fixed income	50.00	49.50	51.00	48.60
Publicly traded mutual funds	37.20	38.00	38.30	39.40
Common trust funds	4.80	4.80	4.00	3.70
Limited partnerships	1.10	1.60	2.10	2.90
Hedge funds	0.40	0.50	0.70	1.00

As of June 30, 2017, Covenant HealthCare implemented new guidance that changes the required disclosures for investments valued at net asset value (NAV) per share (or its equivalent) as a practical expedient. Previously, investments measured at fair value using the NAV practical expedient were classified in the fair value hierarchy based on the redemption features associated with the investment. Under the new guidance, investments measured at fair value using NAV per share (or its equivalent) as a practical expedient are no longer classified in the fair value hierarchy. The information for 2016 has been adjusted to conform to the new disclosure requirements.

Asset Classes	Fair Value Measurements at June 30, 2018			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and cash equivalents	\$ 5,808	\$ -	\$ -	\$ 5,808
Mutual funds:				
U.S. large cap	117,829	-	-	117,829
International	37,255	-	-	37,255
Fixed income	72,963	-	-	72,963
Real estate	14,612	-	-	14,612
Fixed-income contracts	-	722	-	722
Total	\$ 248,467	\$ 722	\$ -	\$ 249,189

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 13 - Pension and Other Postretirement Benefit Plans (Continued)

Fair Value Measurements at June 30, 2017				
Asset Classes	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and cash equivalents	\$ 2,354	\$ -	\$ -	\$ 2,354
Mutual funds:				
U.S. large cap	128,306	-	-	128,306
International	42,401	-	-	42,401
Fixed income	57,563	-	-	57,563
Real estate	13,613	-	-	13,613
Fixed-income contracts	-	1,316	-	1,316
Total	\$ 244,237	\$ 1,316	\$ -	\$ 245,553

Fair Value Measurements at June 30, 2016				
Asset Classes	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and cash equivalents	\$ 4,572	\$ -	\$ -	\$ 4,572
Mutual funds:				
U.S. large cap	64,223	-	-	64,223
International	37,496	-	-	37,496
Fixed income	115,850	-	-	115,850
Real estate	13,561	-	-	13,561
Fixed-income contracts	-	1,428	-	1,428
Total	\$ 235,702	\$ 1,428	\$ -	\$ 237,130

The tables above present information about the pension plan assets measured at fair value at June 30, 2018, 2017, and 2016 and the valuation techniques used by Covenant HealthCare to determine those fair values.

Fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Plan has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. Covenant HealthCare's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each plan asset.

Investments in Entities that Calculate Net Asset Value per Share

Covenant HealthCare System and Subsidiaries

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(in Thousands)

Note 13 - Pension and Other Postretirement Benefit Plans (Continued)

The pension plan holds shares or interests in investment companies whereby the fair value of the investment held is estimated based on the net asset value per share (or its equivalent) of the investment company.

At June 30, the fair values of those investments are as follows:

	2018	2017	2016
Fixed-income mutual funds	\$ 33,411	\$ 33,481	\$ 26,428
International common trust funds	13,153	13,244	11,456
Real asset limited partnerships	991	1,240	1,767
Private equity limited partnerships	2,432	3,480	4,725
Hedge funds	1,010	1,275	1,444
Total	<u>\$ 50,997</u>	<u>\$ 52,720</u>	<u>\$ 45,820</u>

Cash Flow

Contributions

Covenant HealthCare expects to contribute \$6,445 to its pension plan and \$3,851 to its other postretirement benefit plan in 2019. The contribution amount for the pension plan includes the amount paid to the pension trust, and the contribution amount for the other postretirement plan includes amounts expected to be paid by Covenant HealthCare.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years Ending	Pension Benefits	Other Postretirement Benefits
2019	\$ 18,821	\$ 3,851
2020	21,923	3,647
2021	20,132	3,337
2022	20,353	3,098
2023	20,964	2,904
Thereafter	112,095	12,108

The pension plan benefit payment amounts above also reflect the total benefits expected to be paid from the pension trust. The other postretirement plan benefit payment amounts above also reflect the total benefits expected to be paid from Covenant HealthCare's assets. As part of Covenant HealthCare's retiree health plan, \$1,500 per year is provided to eligible participants, based on years of service, to be used for health-related expenses after retirement.

In addition, Covenant HealthCare sponsors a deferred compensation plan for certain employees. Covenant HealthCare has recorded an asset and corresponding liability of \$13,408, \$10,647, and \$8,200 at June 30, 2018, 2017, and 2016, respectively, in the consolidated financial statements.

Note 14 - Defined Contribution Retirement Plan

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 14 - Defined Contribution Retirement Plan (Continued)

Covenant HealthCare sponsors a defined contribution plan in which approximately 62 percent of its employees participate. Employees who meet eligibility requirements specified by the plan may contribute to the plan. The plan provides for Covenant HealthCare to make a required matching contribution. Covenant HealthCare also may make additional contributions to the plan at its discretion. Expense under the defined contribution plan was \$8,395, \$7,674, and \$7,655 during 2018, 2017, and 2016, respectively.

Note 15 - Investments in Unconsolidated Entities

The following table summarizes Covenant HealthCare's investments in unconsolidated entities:

	2018	2017	2016
CMU Medical Education Partners	\$ 1,777	\$ 1,796	\$ 1,784
Covenant HealthCare Partners, Inc.	1,188	1,163	1,204
MMR - Mobile Medical Response	12,954	11,710	10,675
Mackinaw Surgery Center	1,650	1,714	1,804
Other	1,200	1,850	2,084
Total	<u>\$ 18,769</u>	<u>\$ 18,233</u>	<u>\$ 17,551</u>

CMU Medical Education Partners, formerly known as Synergy Medical Education, is a joint venture owned 5 percent by Covenant HealthCare that provides medical education to medical residents in the area.

Covenant HealthCare Partners, Inc. is a joint venture owned 50 percent by Covenant HealthCare that provides healthcare services to the area.

Mobile Medical Response (MMR) is a joint venture owned 50 percent by Covenant HealthCare that provides emergency medical services to the area.

Mackinaw Surgery Center is a joint venture owned 46.2 percent by Covenant HealthCare that provides surgical facility services to the area.

The following is a summary of financial position and results of operations of Covenant HealthCare's investments accounted for under the equity method as of and for the years ended June 30:

	June 30		
	2018	2017	2016
Assets	\$ 67,180	\$ 62,746	\$ 55,836
Liabilities	(25,695)	(21,133)	(18,191)
Equity	<u>\$ 41,485</u>	<u>\$ 41,613</u>	<u>\$ 37,645</u>
	Year Ended June 30		
	2018	2017	2016
Revenue	\$ 102,340	\$ 91,701	\$ 89,359
Expenses	(102,913)	(89,897)	(83,578)
Net income	<u>\$ (573)</u>	<u>\$ 1,804</u>	<u>\$ 5,781</u>

Note 16 - Functional Expenses

Covenant HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018, 2017, and 2016

(in Thousands)

Note 16 - Functional Expenses (Continued)

Covenant HealthCare fulfills the health requirements of residents within the communities it serves by providing, as its principal function, a complete array of health services. Expenses related to providing these services for the years ended June 30, 2018, 2017, and 2016 are as follows:

	2018	2017	2016
Healthcare services	\$ 582,612	\$ 553,493	\$ 531,048
General and administrative	62,330	57,829	55,972
Total	<u>\$ 644,942</u>	<u>\$ 611,322</u>	<u>\$ 587,020</u>

Note 17 - Contingencies

In addition to managing its professional liability claims, Covenant HealthCare is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without material adverse effect on Covenant HealthCare's consolidated balance sheet.

Note 18 - Collaborative Arrangement

During 2018, Covenant HealthCare entered into a joint operating agreement with an unrelated healthcare provider in order to provide inpatient rehabilitation services on CMC's campus and has accounted for the agreement as a collaborative arrangement. Both parties are active participants in the arrangement and share evenly in the excess cash flow of the rehabilitation business. Under the terms of the agreement, Covenant HealthCare was paid for its share of the fair market value of its inpatient rehabilitation business as of the closing date, which was April 1, 2018, in the amount of \$8,677. This amount was recorded within other operating revenue in the consolidated statement of operations and changes in net assets.

Additional Information



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Independent Auditor's Report on Additional Information

To the Board of Directors
Covenant HealthCare System and Subsidiaries

We have audited the consolidated financial statements of Covenant HealthCare System and Subsidiaries as of and for the year ended June 30, 2018 and have issued our report thereon dated September 18, 2018, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the 2018 consolidated financial statements as a whole. The consolidating information in the accompanying schedules, as listed in the table of contents, is presented for the purpose of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the 2018 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2018 consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the 2018 consolidated financial statements as a whole.

Plante & Moran, PLLC

September 18, 2018

Covenant HealthCare System and Subsidiaries

Consolidating Balance Sheet

June 30, 2018
(in Thousands)

	Nonobligated Group	Obligated Group	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	\$ 3,482	\$ 27,398	\$ -	\$ 30,880
Patient accounts receivable - Net	4,947	65,528	-	70,475
Inventory	513	15,950	-	16,463
Due from affiliates	-	1,922	(1,922)	-
Estimated third-party payor settlements	-	1,601	-	1,601
Assets limited as to use	-	3,665	-	3,665
Prepaid expenses and other	131	16,593	-	16,724
Total current assets	9,073	132,657	(1,922)	139,808
Assets Limited as to Use				
Professional liability fund	-	5,730	-	5,730
By donors for specific purposes	-	12,763	-	12,763
Investments	16,595	386,617	-	403,212
Property and Equipment - Net	411	175,260	-	175,671
Other Assets				
Investments in unconsolidated entities	848	17,921	-	18,769
Other	-	22,714	-	22,714
Total other assets	848	40,635	-	41,483
Total assets	\$ 26,927	\$ 753,662	\$ (1,922)	\$ 778,667

Covenant HealthCare System and Subsidiaries

Consolidating Balance Sheet (Continued)

June 30, 2018
(in Thousands)

	Nonobligated Group	Obligated Group	Eliminating Entries	Total
Liabilities and Net Assets				
Current Liabilities				
Accounts payable and accrued expenses	\$ 377	\$ 17,897	\$ -	\$ 18,274
Current portion of long-term debt	-	6,505	-	6,505
Estimated third-party payor settlements	-	3,798	-	3,798
Accrued liabilities and other:				
Accrued compensation and related amounts	715	38,406	-	39,121
Accrued interest payable and other current liabilities	-	1,490	-	1,490
Due to affiliates	1,922	-	(1,922)	-
Total current liabilities	3,014	68,096	(1,922)	69,188
Long-term Debt - Net of current portion	-	82,805	-	82,805
Other Liabilities				
Accrued pension obligation	-	46,305	-	46,305
Accrued postretirement benefit obligation	-	30,976	-	30,976
Reserve for professional liability claims	-	32,025	-	32,025
Other	-	16,757	-	16,757
Total other liabilities	-	126,063	-	126,063
Total liabilities	3,014	276,964	(1,922)	278,056
Net Assets				
Unrestricted	23,913	463,936	-	487,849
Temporarily restricted	-	12,039	-	12,039
Permanently restricted	-	723	-	723
Total net assets	23,913	476,698	-	500,611
Total liabilities and net assets	\$ 26,927	\$ 753,662	\$ (1,922)	\$ 778,667

Covenant HealthCare System and Subsidiaries

Consolidating Statement of Operations

Year Ended June 30, 2018

(in Thousands)

	Nonobligated Group	Obligated Group	Eliminating Entries	Total
Unrestricted Revenue, Gains, and Other Support				
Net patient service revenue	\$ 13,472	\$ 646,807	\$ (873)	\$ 659,406
Provision for bad debts	-	(28,138)	-	(28,138)
Net patient service revenue less provision for bad debts	13,472	618,669	(873)	631,268
Investment income and realized gains and losses	-	614	-	614
Other revenue	773	40,039	-	40,812
Total unrestricted revenue, gains, and other support	14,245	659,322	(873)	672,694
Expenses				
Salaries and wages	8,383	291,235	-	299,618
Benefits	1,576	75,574	-	77,150
Supplies	2,565	129,643	-	132,208
Professional fees	33	14,491	-	14,524
Purchased services	862	63,463	(873)	63,452
Insurance	4	6,001	-	6,005
Utilities	136	6,279	-	6,415
Depreciation and amortization	54	29,639	-	29,693
Interest expense	-	3,658	-	3,658
Other	488	11,731	-	12,219
Total expenses	14,101	631,714	(873)	644,942
Operating Income	144	27,608	-	27,752
Nonoperating Income				
Investment income	334	7,158	-	7,492
Realized and unrealized net gains on investments	632	14,641	-	15,273
Other	-	500	-	500
Total nonoperating income	966	22,299	-	23,265
Excess of Revenue Over Expenses	1,110	49,907	-	51,017
Change in Unrealized Losses in Fair Value of Investments	(14)	(1,277)	-	(1,291)
Other	-	(20)	-	(20)
Pension and Other Postretirement Benefit Obligation Adjustment	-	29,532	-	29,532
Increase in Unrestricted Net Assets	\$ 1,096	\$ 78,142	\$ -	\$ 79,238

Covenant HealthCare System and Subsidiaries

Consolidating Balance Sheet - Obligated Group

June 30, 2018
(in Thousands)

	Covenant HealthCare Foundation	Covenant Medical Center, Inc.	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	\$ 727	\$ 26,671	\$ -	\$ 27,398
Patient accounts receivable - Net	-	65,528	-	65,528
Inventory	-	15,950	-	15,950
Due from affiliates	-	2,689	(767)	1,922
Estimated third-party payor settlements	-	1,601	-	1,601
Assets limited as to use	-	3,665	-	3,665
Prepaid expenses and other	167	16,426	-	16,593
Total current assets	894	132,530	(767)	132,657
Assets Limited as to Use				
Professional liability fund	-	5,730	-	5,730
By donors for specific purposes	12,763	-	-	12,763
Investments	9,395	377,222	-	386,617
Property and Equipment - Net	-	175,260	-	175,260
Other Assets				
Investments in unconsolidated entities	-	17,921	-	17,921
Other	-	22,714	-	22,714
Total other assets	-	40,635	-	40,635
Total assets	\$ 23,052	\$ 731,377	\$ (767)	\$ 753,662

Covenant HealthCare System and Subsidiaries

Consolidating Balance Sheet - Obligated Group (Continued)

June 30, 2018
(in Thousands)

	Covenant HealthCare Foundation	Covenant Medical Center, Inc.	Eliminating Entries	Total
Liabilities and Net Assets				
Current Liabilities				
Accounts payable and accrued expenses	\$ 42	\$ 17,855	\$ -	\$ 17,897
Current portion of long-term debt	-	6,505	-	6,505
Estimated third-party payor settlements	-	3,798	-	3,798
Accrued liabilities and other:				
Accrued compensation and related amounts	54	38,352	-	38,406
Accrued interest payable and other current liabilities	-	1,490	-	1,490
Due to affiliates	767	-	(767)	-
Total current liabilities	863	68,000	(767)	68,096
Long-term Debt - Net of current portion	-	82,805	-	82,805
Other Liabilities				
Accrued pension obligation	-	46,305	-	46,305
Accrued postretirement benefit obligation	-	30,976	-	30,976
Other	-	16,757	-	16,757
Reserve for professional liability claims	-	32,025	-	32,025
Total other liabilities	-	126,063	-	126,063
Total liabilities	863	276,868	(767)	276,964
Net Assets				
Unrestricted	9,427	454,509	-	463,936
Temporarily restricted	12,039	-	-	12,039
Permanently restricted	723	-	-	723
Total net assets	22,189	454,509	-	476,698
Total liabilities and net assets	\$ 23,052	\$ 731,377	\$ (767)	\$ 753,662

Covenant HealthCare System and Subsidiaries

Consolidating Statement of Operations - Obligated Group

Year Ended June 30, 2018

(in Thousands)

	Covenant HealthCare Foundation	Covenant Medical Center, Inc.	Eliminating Entries	Total
Unrestricted Revenue, Gains, and Other Support				
Net patient service revenue	\$ -	\$ 646,807	\$ -	\$ 646,807
Provision for bad debts	-	(28,138)	-	(28,138)
Net patient service revenue less provision for bad debts	-	618,669	-	618,669
Investment income and realized gains and losses	-	614	-	614
Other revenue	1,777	38,262	-	40,039
Total unrestricted revenue, gains, and other support	1,777	657,545	-	659,322
Expenses				
Salaries and wages	610	290,625	-	291,235
Benefits	122	75,452	-	75,574
Supplies	766	128,877	-	129,643
Professional fees	2	14,489	-	14,491
Purchased services	82	63,381	-	63,463
Insurance	-	6,001	-	6,001
Utilities	2	6,277	-	6,279
Depreciation and amortization	-	29,639	-	29,639
Interest expense	-	3,658	-	3,658
Other	1,221	10,510	-	11,731
Total expenses	2,805	628,909	-	631,714
Operating (Loss) Income	(1,028)	28,636	-	27,608
Nonoperating income				
Investment income	272	6,886	-	7,158
Realized and unrealized net gains on investments	593	14,048	-	14,641
Other	-	500	-	500
Total nonoperating income	865	21,434	-	22,299
Excess of Revenue (Under) Over Expenses	(163)	50,070	-	49,907
Change in Unrealized Losses in Fair Value of Investments	(33)	(1,244)	-	(1,277)
Other	(20)	-	-	(20)
Pension and Other Postretirement Benefit Obligation Adjustment	-	29,532	-	29,532
(Decrease) Increase in Unrestricted Net Assets	\$ (216)	\$ 78,358	\$ -	\$ 78,142

Covenant HealthCare System and Subsidiaries

Consolidating Balance Sheet - Nonobligated Group

June 30, 2018
(in Thousands)

	Visiting Nurse Special Services	Covenant Development Corporation, Inc.	Covenant HealthCare System	Visiting Nurse Association	Eliminating Entries	Total
Assets						
Current Assets						
Cash and cash equivalents	\$ 574	\$ 1,838	\$ 31	\$ 1,039	\$ -	\$ 3,482
Patient accounts receivable - Net	1	-	-	4,946	-	4,947
Inventory	-	-	-	513	-	513
Prepaid expenses and other	(2)	137	1	(5)	-	131
Total current assets	573	1,975	32	6,493	-	9,073
Investments	4,253	3,546	7,615	1,181	-	16,595
Property and Equipment - Net	-	47	-	364	-	411
Other Assets						
Investments in unconsolidated entities	-	848	-	-	-	848
Long-term investments	-	-	6,382	-	(6,382)	-
Total other assets	-	848	6,382	-	(6,382)	848
Total assets	<u>\$ 4,826</u>	<u>\$ 6,416</u>	<u>\$ 14,029</u>	<u>\$ 8,038</u>	<u>\$ (6,382)</u>	<u>\$ 26,927</u>
Liabilities and Net Assets						
Current Liabilities						
Accounts payable and accrued expenses	\$ 6	\$ 22	\$ -	\$ 349	\$ -	\$ 377
Accrued liabilities and other:						
Accrued compensation and related amounts	63	-	-	652	-	715
Due to affiliates	-	12	-	1,910	-	1,922
Total current liabilities	69	34	-	2,911	-	3,014
Net Assets - Unrestricted	4,757	6,382	14,029	5,127	(6,382)	23,913
Total liabilities and net assets	<u>\$ 4,826</u>	<u>\$ 6,416</u>	<u>\$ 14,029</u>	<u>\$ 8,038</u>	<u>\$ (6,382)</u>	<u>\$ 26,927</u>

Covenant HealthCare System and Subsidiaries

Consolidating Statement of Operations - Nonobligated Group

Year Ended June 30, 2018

(in Thousands)

	Visiting Nurse Special Services	Covenant Development Corporation	Covenant HealthCare System	Visiting Nurse Association of Saginaw	Eliminating Entries	Total
Unrestricted Revenue, Gains, and Other Support						
Net patient service revenue	\$ 538	\$ -	\$ -	\$ 12,934	\$ -	\$ 13,472
Other revenue	43	640	824	94	(828)	773
Total unrestricted revenue, gains, and other support	581	640	824	13,028	(828)	14,245
Expenses						
Salaries and wages	422	-	-	7,961	-	8,383
Benefits	70	-	-	1,506	-	1,576
Supplies	2	-	-	2,563	-	2,565
Professional fees	-	-	-	33	-	33
Purchased services	48	37	-	777	-	862
Insurance	3	-	-	1	-	4
Utilities	12	-	-	124	-	136
Depreciation and amortization	-	1	-	53	-	54
Other	36	7	-	445	-	488
Total expenses	593	45	-	13,463	-	14,101
Operating (Loss) Income	(12)	595	824	(435)	(828)	144
Nonoperating Income						
Investment income	77	98	138	21	-	334
Realized and unrealized net gains on investments	162	135	290	45	-	632
Total nonoperating income	239	233	428	66	-	966
Excess of Revenue Over (Under) Expenses	227	828	1,252	(369)	(828)	1,110
Change in Unrealized Losses in Fair Value of Investments	(5)	(4)	(8)	(1)	4	(14)
Increase (Decrease) in Unrestricted Net Assets	\$ 222	\$ 824	\$ 1,244	\$ (370)	\$ (824)	\$ 1,096



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Independent Auditor's Report

To the Board of Directors and Management
Covenant HealthCare System and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Covenant HealthCare System and Subsidiaries (including Covenant Medical Center, Inc. and Covenant HealthCare Foundation, which comprise the Covenant Medical Center Obligated Group) as of June 30, 2018 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report, with an unmodified opinion thereon, dated September 18, 2018.

In connection with our audit of the consolidated financial statements referred to above, nothing came to our attention that caused us to believe that Covenant Medical Center Obligated Group failed to comply with the terms, covenants, provisions, or conditions of Sections 6.27 through 6.33 of the Continuing Covenant Agreement dated April 1, 2014 between JPMorgan Chase Bank, National Association and Covenant Medical Center, Inc., as Obligated Group Agent, insofar as they relate to accounting matters. However, our audit of the consolidated financial statements was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Covenant Medical Center Obligated Group's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Continuing Covenant Agreement dated April 1, 2014, insofar as they relate to accounting matters.

This report is intended solely for the information and use of management and the board of directors of Covenant HealthCare System and Subsidiaries and JPMorgan Chase Bank, National Association, and is not intended to be and should not be used by anyone other than these specified parties.

Plante & Moran, PLLC

September 18, 2018



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Independent Auditor's Report

To the Board of Directors and Management
Covenant HealthCare System and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Covenant HealthCare System and Subsidiaries (including Covenant Medical Center, Inc. and the Covenant HealthCare Foundation, which comprise the Covenant Medical Center Obligated Group) as of June 30, 2018, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report, with an unmodified opinion thereon, dated September 18, 2018.

In connection with our audit of the consolidated financial statements referred to above, nothing came to our attention that caused us to believe that Covenant Medical Center Obligated Group failed to comply with the terms, covenants, provisions, or conditions of Sections 506 through 510 of the Master Indenture dated July 15, 1991 between U.S. Bank National Association (successor to Comerica Bank) and Covenant Medical Center, Inc. (successor to St. Luke's Hospital), insofar as they relate to accounting matters. However, our audit of the consolidated financial statements was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding Covenant Medical Center Obligated Group's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Master Indenture dated July 15, 1991, insofar as they relate to accounting matters.

This report is intended solely for the information and use of management and the board of directors of Covenant HealthCare System and Subsidiaries and U.S. Bank National Association and is not intended to be, and should not be, used by anyone other than these specified parties.

Plante & Moran, PLLC

September 18, 2018

Independent Auditor's Report

The Board of Directors and Management
Covenant HealthCare System and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States of America, the accompanying consolidated financial statements of Covenant HealthCare System and Subsidiaries (including Covenant Medical Center, Inc. and Covenant HealthCare Foundation, which comprise Covenant Medical Center Obligated Group), which comprise the consolidated balance sheet as of June 30, 2018 and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report, with an unmodified opinion thereon, dated September 18, 2018.

In connection with our audit of the consolidated financial statements referred to above, nothing came to our attention that caused us to believe that Covenant Medical Center Obligated Group failed to comply with the Historical Debt Service Coverage Ratio, as prescribed by Section 512(2) of the Master Indenture dated July 15, 1991 between U.S. Bank National Association (successor to Comerica Bank) and Covenant Medical Center, Inc. (successor to St. Luke's Hospital), insofar as they relate to accounting matters. However, our audit of the consolidated financial statements was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Covenant Medical Center Obligated Group's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Master Indenture dated July 15, 1991, insofar as they relate to accounting matters.

This report is intended solely for the information and use of management and the board of directors of Covenant HealthCare System and Subsidiaries and U.S. Bank National Association and is not intended to be, and should not be, used by anyone other than these specified parties.

Plante & Moran, PLLC

September 18, 2018

Covenant HealthCare System and Subsidiaries
Historical Debt Service Coverage Ratio of the Covenant Medical Center Obligated Group

Year Ended June 30, 2018
(In Thousands)

Excess of revenue over expenses	\$	49,907
Adjustments:		
Depreciation and amortization		29,639
Interest expense		3,658
Total net revenue (1)	\$	<u>83,204</u>
Total Historical Principal and Interest Requirements (1)	\$	<u>7,380</u>
Historical Debt Service Coverage Ratio (1)		<u>11.27</u>

(1) - This term is defined in the "Master Indenture" dated as of July 15, 1991 between U.S. Bank National Association (successor to Comerica Bank) and Covenant Medical Center, Inc. (successor to St. Luke's Hospital). The methodology for computing the Historical Debt Service Coverage Ratio is prescribed by Section 101 of the Master Indenture.

COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18		Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18	
	<i>(In Thousands)</i>				<i>(In Thousands)</i>			
Assets					Liabilities and net assets			
Current assets:					Current liabilities:			
Cash and cash equivalents	\$24,790	\$27,982	\$30,880		Accounts payable and accrued expenses	\$14,273	\$16,460	\$18,274
Net patient accounts receivable	58,024	67,528	70,475		Estimated third-party payable	4,323	11,744	3,798
Estimated third-party settlements	1,240	471	1,601		Accrued compensation and related amounts	40,928	33,227	39,121
Current portion of funds held under bond agreements	4,194	4,525	3,665		Accrued interest payable and other current liabilities	1,622	1,561	1,490
Inventories	13,996	14,409	16,463		Current portion of long-term debt	3,325	3,745	6,505
Prepaid expenses and other	20,201	14,853	16,724					
Total current assets	122,445	129,768	139,808		Total current liabilities	64,471	66,737	69,188
Assets whose use is limited, less current portion:					Noncurrent liabilities:			
Funds held under bond agreements	385	-	-		Long-term debt, less current portion	95,570	89,287	82,805
Restricted assets	10,892	11,938	12,763		Accrued post retirement benefits	36,729	35,041	30,976
Professional liability fund	5,616	3,091	5,730		Accrued pension	88,226	75,417	46,305
	16,893	15,029	18,493		Other noncurrent liabilities	35,452	40,899	48,782
					Total noncurrent liabilities	255,977	240,644	208,868
Other assets:					Net assets:			
Marketable securities	329,847	373,718	403,212		Unrestricted	342,883	408,611	487,849
Investments in unconsolidated affiliates	17,551	18,233	18,769		Temporarily restricted	10,217	11,243	12,039
Other	14,211	18,984	22,714		Permanently restricted	675	695	723
	361,609	410,935	444,695			353,775	420,549	500,611
Property and equipment	173,276	172,198	175,671		Total liabilities and net assets	\$674,223	\$727,930	\$778,667
Total assets	\$674,223	\$727,930	\$778,667					

COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES
Consolidated Statements Of Operations

	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
<i>(In Thousands)</i>			
Revenue and support:			
Net patient service revenue	\$591,618	\$604,112	\$631,268
Other revenue	29,665	34,183	40,812
Investment income	153	65	463
Realized and other than temporary losses, net	58	250	151
Total revenue & support	621,494	638,610	672,694
Expenses:			
Salaries & wages	258,517	279,017	299,618
Benefits	70,379	72,427	77,150
Professional fees	13,781	11,011	14,524
Supplies	125,475	129,050	132,208
Other purchased services	58,227	59,534	63,452
Other	12,476	12,076	12,219
Utilities	6,273	6,208	6,415
Insurance	7,034	7,966	6,005
Depreciation and amortization	30,870	30,218	29,693
Interest	3,988	3,815	3,658
Total expenses	587,020	611,322	644,942
Income (loss) from operations	34,474	27,288	27,752
Investment income	6,677	6,357	7,492
Gain/(Loss) on refunding	-	-	
Realized and other than temporary gain (loss), net	(1,105)	7,157	15,273
Other non-operating gains (losses)	524	39	500
Excess (deficit) of revenues over expenses	\$40,570	\$40,841	\$51,017

COVENANT MEDICAL CENTER
Statistical Summary

	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
Discharges - Acute	29,003	28,682	29,340
Discharges - Rehab	878	904	830
Discharges - Skilled Nursing	537	466	492
Total Discharges (Includes Newborn)	30,418	30,052	30,662
Patient Days - Acute	134,752	135,151	141,814
Patient Days - Rehab	11,042	11,296	10,499
Patient Days - Skilled Nursing	6,126	6,307	6,226
Total Patient Days (Includes Newborn)	151,920	152,754	158,539
Equivalent Discharges (Excluding Newborn)	56,358	55,835	58,049
Equivalent Patient Days (Excluding Newborn)	289,341	291,975	308,565
Average Length of Stay - Acute (Discharges)	4.65	4.71	4.83
Average Length of Stay - Total (Discharges)	4.99	5.08	5.17
Average Daily Census	416	419	434
Newborn Discharges	2,636	2,613	2,616
Newborn Patient Days	5,297	5,117	5,107
Total ECC Admissions	23,674	23,365	23,741
Total ECC Visits	93,039	93,365	93,467
Surgical Cases - Inpatient	6,222	6,058	5,894
Surgical Cases - Outpatient	7,576	7,965	8,381
Cath Lab-EP Lab Procedures	7,130	7,517	7,979
Physician Office Visits (MSO)	263,428	276,065	312,511
MedExpress	109,210	112,024	106,624
Total FTE's	3,798.0	3,884.0	4,005.0
Payor Mix			
Medicare	45.56%	46.43%	46.51%
Blue Cross	12.92%	12.50%	12.21%
Medicaid	18.67%	18.43%	18.51%
HMO and PPO	5.58%	3.84%	2.44%
Other	<u>9.31%</u>	<u>10.96%</u>	<u>12.39%</u>
Hospital Services	92.04%	92.16%	92.06%
Physician Services	<u>7.96%</u>	<u>7.84%</u>	<u>7.94%</u>
Home Health & Other	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
Other Services	7.96%	7.84%	7.94%
Total Services	100.00%	100.00%	100.00%
Percentage of Occupancy			
Licensed Beds	64.73%	65.09%	67.55%
Available Beds-Inc. NB	69.37%	70.46%	72.88%
Case Mix			
Medicare	1.7151	1.7285	1.7318
Total	1.4702	1.4971	1.5160

COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES

Consolidated Statements Of Operations

	Audited	Audited	Audited
	Year Ended	Year Ended	Year Ended
	Jun-30-16	Jun-30-17	Jun-30-18
	<i>(In Thousands)</i>		
Revenue and support:			
Net patient service revenue	\$591,618	\$604,112	\$631,268
Other revenue	29,665	34,183	40,812
Investment income	153	65	463
Realized and other than temporary losses, net	58	250	151
Total revenue & support	621,494	638,610	672,694
Expenses:			
Operating expenses	552,162	577,289	611,591
Depreciation and amortization	30,870	30,218	29,693
Interest	3,988	3,815	3,658
Allowance for uncollectible accounts	-	-	-
Total expenses	587,020	611,322	644,942
Income (loss) from operations	34,474	27,288	27,752
Investment income	6,677	6,357	7,492
Realized and other than temporary gains (losses), net	(1,105)	7,157	15,273
Gain on refunding and other non-operating gains (losses)	524	39	500
Excess (deficit) of revenues over expenses	\$40,570	\$40,841	\$51,017

COVENANT MEDICAL CENTER**Utilization Data**

The data is derived from the Medical Center's internal reports.

	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
Beds Licensed	643	643	643
Beds Staffed	600	594	596
Admissions			
Acute Care	26,367	26,069	26,724
Rehabilitation	878	904	830
Transitional Care Unit	537	466	492
	<hr/> 27,782	<hr/> 27,439	<hr/> 28,046
Newborn	2,636	2,613	2,616
Total Admissions	<hr/> 30,418	<hr/> 30,052	<hr/> 30,662
Patient Days			
Acute Care	129,455	130,034	136,707
Rehabilitation	11,042	11,296	10,499
Transitional Care Unit	6,126	6,307	6,226
	<hr/> 146,623	<hr/> 147,637	<hr/> 153,432
Newborn	5,297	5,117	5,107
Total Patient Days	<hr/> 151,920	<hr/> 152,754	<hr/> 158,539
Percent of Occupancy			
Based on Staffed Beds	69%	70%	73%
Acute Care Average Length of Stay	4.65	4.71	4.83
Surgical Procedures			
Inpatient	6,222	6,058	5,894
Outpatient	7,576	7,965	8,381
Outpatient Visits	485,993	489,917	503,745
Emergency Room Visits	93,039	93,365	93,467
Case Mix Index (all Medicare patients)	1.72	1.73	1.73

COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES

Days Cash, Debt to Capitalization, Sources of Revenue

	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
	<i>(In Thousands)</i>		
Cash and cash equivalents	\$24,790	\$27,982	\$30,880
Investments	340,739	385,656	415,975
Total Cash	365,529	413,638	446,855
Less: Restricted Cash from Foundation	10,892	11,938	12,763
Total Unrestricted Cash	\$354,637	\$401,700	\$434,092

Days Cash on Hand	233	253	258
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	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
	<i>(In Thousands)</i>		
Long-term debt (including current maturities)			
Series 2010 H Bonds	\$64,540	\$61,955	\$58,975
Series 2014 I Bonds	26,045	23,490	23,490
JPM 2015 Loan	8,500	7,760	6,995
Unamortized Premium/Debt issuance cost	(190)	(173)	(150)
Total long-term debt	98,895	93,032	89,310
Unrestricted net assets	342,883	408,611	487,849
Total Capitalization	\$441,778	\$501,643	\$577,159

Debt to Capitalization	22.39%	18.55%	15.47%
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	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
Sources of Revenue			
Hospital Services			
Medicare	45.56%	46.43%	46.51%
Blue Cross	12.92%	12.50%	12.21%
Medicaid	18.67%	18.43%	18.51%
HMO and PPO	5.58%	3.84%	2.44%
Other	9.31%	10.96%	12.39%
Hospital Services	92.04%	92.16%	92.06%
Other Services			
Physician Services	7.96%	7.84%	7.94%
Home Health and Other	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%

COVENANT HEALTHCARE SYSTEM OBLIGATED GROUP

Maximum Annual Debt Service Coverage

	Audited Year Ended Jun-30-16	Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18
	<i>(In Thousands)</i>		
Excess (deficit) of revenue over expenses	\$39,650	\$38,289	\$49,907
Depreciation and amortization	30,793	30,166	29,639
Interest	3,984	3,815	3,658
(Gain)/loss on bond refunding	-	-	-
Excess before interest, depreciation, and amortization	<u>74,427</u>	<u>72,270</u>	<u>83,204</u>
Realized (losses) on investment transactions related to other than temporary investments	<u>-</u>	<u>-</u>	<u>-</u>
Earnings before interest, depreciation, amortization, refunding loss, and adjustments for other than temporary losses on investments	<u>\$74,427</u>	<u>\$72,270</u>	<u>\$83,204</u>
Divided by:			
Maximum annual debt service (1)	<u>\$9,966</u>	<u>\$9,966</u>	<u>\$10,010</u>
Maximum Annual Debt Service Coverage (2)	<u>7.5</u>	<u>7.3</u>	<u>8.3</u>

(1) The maximum annual debt service includes debt service on the Series 2010 H Bonds, Series 2014 I Bonds, JPMorgan taxable loan initiated in May 2015 and the entire balance of the US Bank line of credit which was initiated in FY 2010. The fiscal year 2018 maximum debt service amount represents twelve months of the annual debt service total.

(2) Based on annualized earnings before interest, depreciation, amortization and adjustments for other than temporary losses on investments for fiscal year ending June 2018