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OUR PATIENTS

To Whom It May Concern:

Enclosed please find the audited financial report of Covenant HealthCare System and Subsidiaries for the year ended June 30, 2019. Unless otherwise noted, the information speaks only as of June 30, 2019 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.

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

Kevin S. Albosta, VP/CFO

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# Covenant HealthCare System and Subsidiaries

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**Consolidated Financial Report  
with Additional Information  
June 30, 2019**

## Covenant HealthCare System and Subsidiaries

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## Contents

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<b>Independent Auditor's Report</b>	1
<b>Consolidated Financial Statements</b>	
Balance Sheet	2-3
Statement of Operations and Changes in Net Assets	4-5
Statement of Cash Flows	6
Notes to Consolidated Financial Statements	7-31
<b>Additional Information</b>	32
<b>Independent Auditor's Report on Additional Information</b>	33
Consolidating Balance Sheet	34-35
Consolidating Statement of Operations	36
Consolidating Balance Sheet - Obligated Group	37-38
Consolidating Statement of Operations - Obligated Group	39
Consolidating Balance Sheet - Nonobligated Group	40
Consolidating Statement of Operations - Nonobligated Group	41

## 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, 2019, 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 opinion.

### **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, 2019, 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.

### **Emphasis of Matter**

As described in Note 2 to the consolidated financial statements, Covenant HealthCare System adopted the provisions of Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, using the modified retrospective adoption method as of July 1, 2018 and adopted the provisions of ASU No. 2016-14, *Not-for-Profit Entities*, using the retrospective adoption method as of June 30, 2019. Our opinion is not modified with respect to these matters.

*Plante & Moran, PLLC*

October 3, 2019

## Covenant HealthCare System and Subsidiaries

### Consolidated Balance Sheet

June 30, 2019, 2018, and 2017

(In Thousands)

	2019	2018	2017
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents (Notes 6 and 7)	\$ 35,116	\$ 30,880	\$ 27,982
Patient accounts receivable - Net (Note 3)	74,647	70,475	67,528
Inventory	16,554	16,463	14,409
Estimated third-party payor settlements (Note 4)	2,864	1,601	471
Assets limited as to use (Notes 6 and 7)	-	3,665	4,525
Prepaid expenses and other	14,736	16,724	14,853
Total current assets	143,917	139,808	129,768
<b>Assets Limited as to Use (Notes 6 and 7)</b>			
Professional liability fund	4,524	5,730	3,091
By donors for specific purposes	13,074	12,763	11,938
<b>Investments (Notes 6 and 7)</b>	423,710	403,212	373,718
<b>Property and Equipment - Net (Note 9)</b>	179,850	175,671	172,198
<b>Other Assets</b>			
Investments in unconsolidated entities (Note 15)	18,744	18,769	18,233
Other	22,215	22,714	18,984
Total other assets	40,959	41,483	37,217
Total assets	<b>\$ 806,034</b>	<b>\$ 778,667</b>	<b>\$ 727,930</b>

## Covenant HealthCare System and Subsidiaries

### Consolidated Balance Sheet (Continued)

June 30, 2019, 2018, and 2017  
(In Thousands)

	2019	2018	2017
<b>Liabilities and Net Assets</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued expenses	\$ 13,017	\$ 18,274	\$ 16,460
Current portion of long-term debt (Note 10)	6,710	6,505	3,745
Estimated third-party payor settlements (Note 4)	6,134	3,798	11,744
Accrued liabilities and other:			
Accrued compensation and related amounts	36,795	39,121	33,227
Accrued interest payable and other current liabilities	1,434	1,490	1,561
Current portion of accrued pension obligation (Note 13)	7,439	-	-
Current portion of accrued postretirement benefit obligation (Note 13)	3,757	-	-
Total current liabilities	<u>75,286</u>	<u>69,188</u>	<u>66,737</u>
<b>Long-term Debt - Net of current portion (Note 10)</b>	93,194	82,805	89,287
<b>Other Liabilities</b>			
Accrued pension obligation (Note 13)	51,193	46,305	75,417
Accrued postretirement benefit obligation (Note 13)	28,362	30,976	35,041
Reserve for professional liability claims (Note 12)	25,391	32,025	27,766
Other	18,661	16,757	13,133
Total other liabilities	<u>123,607</u>	<u>126,063</u>	<u>151,357</u>
Total liabilities	292,087	278,056	307,381
<b>Net Assets</b>			
Net assets without donor restrictions	500,873	487,849	408,611
Net assets with donor restrictions	13,074	12,762	11,938
Total net assets	<u>513,947</u>	<u>500,611</u>	<u>420,549</u>
Total liabilities and net assets	<u><u>\$ 806,034</u></u>	<u><u>\$ 778,667</u></u>	<u><u>\$ 727,930</u></u>

## Covenant HealthCare System and Subsidiaries

### Consolidated Statement of Operations and Changes in Net Assets

Years Ended June 30, 2019, 2018, and 2017  
(In Thousands)

	2019	2018	2017
<b>Unrestricted Revenue, Gains, and Other Support</b>			
Net patient service revenue before provision for bad debts		\$ 659,406	\$ 623,356
Provision for bad debts		(28,138)	(19,244)
Net patient service revenue (Note 4)	\$ 632,629	631,268	604,112
Investment income and realized gains and losses (Note 6)	546	614	315
Other revenue	30,148	40,812	34,183
Total unrestricted revenue, gains, and other support	663,323	672,694	638,610
<b>Expenses</b>			
Salaries and wages	313,488	299,618	279,017
Benefits	74,521	77,150	72,427
Supplies	135,689	132,208	129,050
Professional fees	11,578	14,524	11,011
Purchased services	60,821	63,452	59,534
Insurance	1,634	6,005	7,966
Utilities	6,200	6,415	6,208
Depreciation and amortization	29,988	29,693	30,218
Interest expense	3,504	3,658	3,815
Other	13,956	12,219	12,076
Total expenses (Note 16)	651,379	644,942	611,322
<b>Operating Income</b>	11,944	27,752	27,288
<b>Nonoperating Income</b>			
Investment income (Note 6)	9,160	7,492	6,357
Realized and unrealized net gains on investments (Note 6)	11,990	15,273	7,157
Other	464	500	39
Total nonoperating income	21,614	23,265	13,553
<b>Excess of Revenue Over Expenses</b>	<b>\$ 33,558</b>	<b>\$ 51,017</b>	<b>\$ 40,841</b>

## Covenant HealthCare System and Subsidiaries

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

	Years Ended June 30, 2019, 2018, and 2017		
	(In Thousands)		
	2019	2018	2017
<b>Net Assets without Donor Restrictions</b>			
Excess of revenue over expenses	\$ 33,558	\$ 51,017	\$ 40,841
Change in unrealized losses in fair value of investments (Note 6)	(707)	(1,291)	17,911
Other	(20)	(20)	(115)
Pension and other postretirement benefit obligation adjustment (Note 13)	(19,807)	29,532	7,091
Increase in net assets without donor restrictions	13,024	79,238	65,728
<b>Net Assets with Donor Restrictions</b>			
Contributions	1,370	1,361	1,356
Investment income (Note 6)	461	495	276
Change in unrealized (losses) gains in fair value of investments (Note 6)	(28)	(19)	377
Other	20	(9)	115
Net assets released from restriction	(1,511)	(1,004)	(1,078)
Increase in net assets with donor restrictions	312	824	1,046
<b>Increase in Net Assets</b>	13,336	80,062	66,774
<b>Net Assets - Beginning of year</b>	500,611	420,549	353,775
<b>Net Assets - End of year</b>	<b>\$ 513,947</b>	<b>\$ 500,611</b>	<b>\$ 420,549</b>

## Covenant HealthCare System and Subsidiaries

### Consolidated Statement of Cash Flows

Years Ended June 30, 2019, 2018, and 2017  
(In Thousands)

	2019	2018	2017
<b>Cash Flows from Operating Activities</b>			
Increase in net assets	\$ 13,336	\$ 80,062	\$ 66,774
Adjustments to reconcile increase in net assets to net cash and cash equivalents from operating activities:			
Depreciation and amortization	29,988	29,693	30,218
Provision for bad debts	-	28,138	19,244
Change in realized and unrealized gains in fair value of investments	(11,954)	(14,861)	(25,695)
Pension and other postretirement benefit obligation adjustment	19,807	(29,532)	(7,091)
Restricted contributions, investment income, and other	(1,851)	(1,847)	(1,632)
Gain on investment in unconsolidated entities	(665)	(1,123)	(1,435)
Changes in operating assets and liabilities that (used) provided cash and cash equivalents:			
Patient accounts receivable	(4,172)	(31,085)	(28,748)
Inventory and other current assets	1,897	(3,925)	4,935
Estimated third-party payor settlements	1,073	(9,076)	8,190
Accounts payable and accrued liabilities	(7,023)	7,943	(6,580)
Accrued pension and postretirement obligations	(6,337)	(3,645)	(7,406)
Other liabilities	(4,730)	7,883	5,447
Net cash and cash equivalents provided by operating activities	29,369	58,625	56,221
<b>Cash Flows from Investing Activities</b>			
Purchase of property and equipment	(34,783)	(33,472)	(28,003)
Purchases of investments	(146,528)	(142,634)	(94,329)
Proceeds from sales and maturities of investments	137,984	128,001	76,153
Contributions to unconsolidated entities	(271)	(741)	(620)
Distributions from unconsolidated entities	961	1,328	1,373
Decrease in assets limited as to use	3,665	860	54
Decrease (increase) in professional liability fund	1,206	(2,639)	2,525
Increase in assets limited as to use by donors	(311)	(825)	(1,046)
Decrease (increase) in other assets	499	(3,730)	(4,887)
Net cash and cash equivalents used in investing activities	(37,578)	(53,852)	(48,780)
<b>Cash Flows from Financing Activities</b>			
Proceeds from issuance of long-term debt	17,075	-	-
Repayments of long-term debt	(6,481)	(3,722)	(5,881)
Restricted contributions, investment income, and other	1,851	1,847	1,632
Net cash and cash equivalents provided by (used in) financing activities	12,445	(1,875)	(4,249)
<b>Increase in Cash and Cash Equivalents</b>	4,236	2,898	3,192
<b>Cash and Cash Equivalents - Beginning of year</b>	30,880	27,982	24,790
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 35,116</b>	<b>\$ 30,880</b>	<b>\$ 27,982</b>
<b>Supplemental Cash Flow Information - Property and equipment additions in accounts payable and accrued expenses at year end</b>	<b>\$ 83</b>	<b>\$ 699</b>	<b>\$ 1,005</b>

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(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). During 2019, VNSS was legally dissolved, and its net assets were transferred to CMC.

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 excess of revenue over 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.

**Notes to Consolidated Financial Statements**

**June 30, 2019, 2018, and 2017**  
**(In Thousands)**

**Note 2 - Significant Accounting Policies (Continued)**

***Accounts Receivable***

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges, reduced by explicit price concessions provided to third-party payors, discounts provided to qualifying individuals as part of a financial assistance policy, and implicit price concessions provided primarily to self-pay patients. Estimates for explicit price concessions are based on provider contracts, payment terms for relevant prospective payment systems, and historical experience adjusted for economic conditions and other trends affecting Covenant HealthCare's ability to collect outstanding amounts.

For receivables associated with self-pay patients (which include 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 significant implicit price concessions 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.

***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 net realizable value.

***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 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.

***Classification of Net Assets***

Net assets of Covenant HealthCare are classified based on the presence or absence of donor-imposed restrictions.

Net assets without donor restrictions: Net assets that are not subject to donor-imposed restrictions or for which the donor-imposed restrictions have expired or been fulfilled. Net assets in this category may be expended for any purpose in performing the primary objectives of Covenant HealthCare.

**Notes to Consolidated Financial Statements**

**June 30, 2019, 2018, and 2017**

**(In Thousands)**

**Note 2 - Significant Accounting Policies (Continued)**

Net assets with donor restrictions: Net assets subject to stipulations imposed by donors and grantors. Net assets with donor restrictions at Covenant HealthCare Foundation are primarily used for capital equipment and programs to support the care that CMC provides. In addition, certain funds support scholarships and educational opportunities for current and future staff alike. Some donor restrictions are temporary in nature; those restrictions will be met by actions of Covenant HealthCare or by the passage of time. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity. Restricted net assets, which may be used subsequent to the passage of time or other stipulated activities, total \$12,351, \$12,039, and \$11,243 as of June 30, 2019, 2018, and 2017, respectively. Net assets restricted in perpetuity total \$723, \$723, and \$695 as of June 30, 2019, 2018, and 2017, respectively.

Earnings, gains, and losses on donor-restricted net assets are classified as net assets without donor restrictions, unless specifically restricted by the donor or by applicable state law.

***Revenue Recognition - Net Patient Service Revenue***

Patient care service revenue is reported at the amount that reflects the consideration to which Covenant HealthCare expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, Covenant HealthCare bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by Covenant HealthCare. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Covenant HealthCare believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in our hospital receiving inpatient acute care services or patients receiving services in our outpatient centers or other clinical settings. Covenant HealthCare measures the performance obligation from admission into the hospital, or the commencement of an outpatient service or other visit, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services or other visit. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to our patients and customers in a retail setting (for example, pharmaceuticals and medical equipment), and Covenant HealthCare does not believe it is required to provide additional goods or services related to that sale.

Because all of its performance obligations relate to contracts with a duration of less than one year, Covenant HealthCare has elected to apply the optional exemption provided in FASB ASC 606 10 50 14 (a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

**Notes to Consolidated Financial Statements**

**June 30, 2019, 2018, and 2017**

**(In Thousands)**

**Note 2 - Significant Accounting Policies (Continued)**

Covenant HealthCare determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with Covenant HealthCare's policy, and implicit price concessions provided to uninsured patients. Covenant HealthCare determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. Covenant HealthCare determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. Covenant HealthCare also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. Covenant HealthCare estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change. For the years ended June 30, 2019, 2018, and 2017, changes in estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not significant. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with Covenant HealthCare's mission, care is provided to patients regardless of their ability to pay. Therefore, Covenant HealthCare has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts Covenant HealthCare expects to collect based on its collection history and those patients.

Patients who meet Covenant HealthCare's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Covenant HealthCare has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the Covenant HealthCare's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, Covenant HealthCare does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

***Excess of Revenue Over Expenses***

The consolidated statement of operations and change in net assets includes excess of revenue over expenses, which is Covenant HealthCare's performance indicator. Changes in net assets without donor restrictions, 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 purpose of acquiring such assets).

**Notes to Consolidated Financial Statements**

**June 30, 2019, 2018, and 2017**

**(In Thousands)**

**Note 2 - Significant Accounting Policies (Continued)**

***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.

***Change in Accounting Principles***

Effective July 1, 2018, Covenant HealthCare adopted Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using a modified retrospective method of application to all contracts existing on July 1, 2018. The core principle of the guidance in ASU No. 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of ASU No. 2014-09 resulted in changes to Covenant HealthCare's presentation of revenue primarily related to uninsured or underinsured patients. Prior to the adoption of ASU No. 2014-09, a significant portion of the Covenant HealthCare's provision for bad debts related to self-pay patients, as well as copays, coinsurance, and amounts and deductibles owed by patients with insurance. Under ASU No. 2014-09, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to operating revenue, with a corresponding material reduction in the amounts presented separately as provision for doubtful accounts. For the year ended June 30, 2019, Covenant HealthCare recorded approximately \$25,535 of implicit price concessions as a direct reduction of net patient service revenue that would have been recorded as provision for bad debts prior to the adoption of ASU No. 2014-09. At June 30, 2019, Covenant HealthCare recorded approximately \$18,401 as a direct reduction to accounts receivable that would have been reflected as allowance for doubtful accounts prior to the adoption of ASU No. 2014-09. The adoption of ASU No. 2014-09 also resulted in changes to Covenant HealthCare's presentation and disclosure of customer contract assets and liabilities and the assessment of variable consideration under customer contracts, which are further discussed in Note 3.

Effective June 30, 2019, Covenant HealthCare adopted ASU No. 2016-14, *Not-for-Profit Entities*. This standard requires net assets to be classified in two categories, net assets without donor restrictions and net assets with donor restrictions, rather than the three previous classifications. This standard also requires changes in the way certain information is aggregated and reported by Covenant HealthCare, including disclosures of quantitative and qualitative information about the liquidity and availability of resources and the presentation of expenses by both functional and natural classification. The standard also clarifies the definition of management and general and prohibits certain expenses from being allocated out of management and general. As a result of the adoption of this standard, the financial information for the years ended June 30, 2018 and 2017 has been restated to reclassify temporarily restricted net assets of \$12,039 and \$11,243, respectively, and permanently restricted net assets of \$723 and \$695, respectively, to net assets with donor restrictions. Additionally, for the years ended June 30, 2018 and 2017, general and administrative costs were restated to \$81,703 and \$76,468, respectively, which is an increase of \$19,373 and \$18,639, respectively, from the previously stated amounts; healthcare services were decreased by the same amounts compared to what was previously stated.

**Notes to Consolidated Financial Statements**

**June 30, 2019, 2018, and 2017**

**(In Thousands)**

**Note 2 - Significant Accounting Policies (Continued)**

***Upcoming Accounting Pronouncements***

In January 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU covers various changes to the accounting, measurement, and disclosures related to certain financial instruments, including requiring equity investments to be accounted for at fair value, with changes recorded through earnings, the use of the exit price when measuring fair value, and disaggregation of financial assets and liabilities by category for disclosure purposes. The new guidance will be effective for Covenant HealthCare's year ending June 30, 2020. Covenant HealthCare believes the requirement to record equity investments at fair value with changes recorded through earnings will have a significant impact on the consolidated financial statements, as, currently, the changes in fair value are recognized through earnings when the investment is sold or impaired, rather than when the change in value occurs.

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 currently 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 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. The anticipated impact of the adoption of the new standard is to increase earnings from operations, with a corresponding decrease in nonoperating income.

***Subsequent Events***

The consolidated financial statements and related disclosures include evaluation of events up through and including October 3, 2019, which is the date the consolidated financial statements were available to be issued.

Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

**Note 3 - Patient Accounts Receivable**

Patient accounts receivable are based on the estimated transaction price for completed contracts, which total \$74,647 at June 30, 2019. Prior to the adoption of ASU No. 2014-09, patient accounts receivable at June 30, 2018 were composed of accounts receivable of \$277,941, less allowances for uncollectible accounts of \$19,997 and allowances for contractual adjustments of \$187,469; patient accounts receivable at June 30, 2017 were composed of accounts receivable of \$253,906, less allowances for uncollectible accounts of \$16,284 and allowances for contractual adjustments of \$170,094.

At June 30, 2019, Covenant HealthCare had approximately \$4,300 of receivables related to patients who were still receiving care in our facilities. The amounts are included in patient accounts receivable in the accompanying consolidated balance sheet.

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 as of June 30:

	2019	2018	2017
Medicare	30 %	33 %	35 %
Medicaid	14	16	12
Blue Cross/Blue Shield of Michigan	10	11	12
Self-pay and other	46	40	41
Total	100 %	100 %	100 %

**Note 4 - Net Patient Service Revenue**

Covenant HealthCare has agreements with third-party payors that provide payments at amounts less than established charges. A summary of the basis of the payment arrangements with major 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. Inpatient psychiatric and substance abuse services are reimbursed at cost subject to a per case limit. 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. Capital costs relating to Medicaid patients are paid on a cost reimbursement method. 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.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs that are subject to audit by fiscal intermediaries.

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 4 - Net Patient Service Revenue (Continued)

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various healthcare entities have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in entities entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge Covenant HealthCare's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon Covenant HealthCare. In addition, the contracts Covenant HealthCare has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and Covenant HealthCare's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price were not significant in 2019, 2018, or 2017.

Covenant HealthCare has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected primarily by payor. The composition of net patient service revenue by primary payor for the years ended June 30 is as follows:

	2019	2018	2017
Medicare	\$ 263,975	\$ 271,445	\$ 259,768
Medicaid	106,699	101,003	96,658
Blue Cross	112,431	107,316	102,699
Self-pay and other	149,524	151,504	144,987
Total	<u>\$ 632,629</u>	<u>\$ 631,268</u>	<u>\$ 604,112</u>

Revenue from patient's deductibles and coinsurance is included in the categories presented above based on the primary payor.

Covenant HealthCare recognizes its net patient service revenue over time as patients simultaneously receive and consume benefits provided as care is administered.

Covenant HealthCare recognizes revenue related to retail pharmacy at a point in time. Retail pharmacy sales are recognized within other operating revenue in the accompanying consolidated statement of operations and changes in net assets and totaled \$8,509, \$8,152, and \$8,064 during the years ended June 30, 2019, 2018, and 2017, respectively.

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

#### Note 4 - Net Patient Service Revenue (Continued)

Net patient service revenue consists of the following:

	2019	2018	2017
Gross patient service revenue	\$ 2,286,482	\$ 2,256,853	\$ 2,110,357
Explicit price concessions to commercial and governmental payors	(1,628,318)	(1,597,447)	(1,487,001)
Implicit price concessions to self-pay patients	(25,535)	(28,138)	(19,244)
Net patient service revenue	<u>\$ 632,629</u>	<u>\$ 631,268</u>	<u>\$ 604,112</u>

#### 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, \$1,522, \$1,207, and \$662 of services to indigent patients during 2019, 2018, and 2017, respectively. Net patient service revenue excludes charity care adjustments of \$4,886, \$3,828, and \$2,054 during 2019, 2018, and 2017, respectively.

#### Note 6 - 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:

	2019	2018	2017
Cash and cash equivalents	\$ 38,538	\$ 34,597	\$ 41,583
Marketable equity security mutual funds	13,610	25,245	22,065
Fixed-income mutual funds	100,158	96,846	73,637
Publicly traded mutual funds	222,505	209,122	197,853
Common trust funds	39,575	27,601	27,614
Limited partnerships	10,010	10,473	11,187
Hedge funds	52,028	52,366	47,315
Total	<u>\$ 476,424</u>	<u>\$ 456,250</u>	<u>\$ 421,254</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:

	2019	2018	2017
Cash and cash equivalents	\$ 35,116	\$ 30,880	\$ 27,982
Assets limited as to use:			
Funds held under bond agreements	-	3,665	4,525
Professional liability fund	4,524	5,730	3,091
By donors for specific purposes	13,074	12,763	11,938
Total assets limited as to use	17,598	22,158	19,554
Investments	423,710	403,212	373,718
Total	<u>\$ 476,424</u>	<u>\$ 456,250</u>	<u>\$ 421,254</u>

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 6 - Investments (Continued)

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

	2019	2018	2017
Interest and dividends	\$ 9,468	\$ 7,703	\$ 6,698
Realized gains (losses) on sale of investments	8,886	13,952	(29)
Change in unrealized gains	3,068	909	25,724
<b>Total</b>	<b>\$ 21,422</b>	<b>\$ 22,564</b>	<b>\$ 32,393</b>

Investment income and realized and unrealized gains and losses on investments as follows are included in the accompanying consolidated statement of operations and changes in net assets for the years ended June 30:

	2019	2018	2017
Operating revenue	\$ 546	\$ 614	\$ 315
Nonoperating income	21,150	22,765	13,514
Change in net assets without donor restrictions	(707)	(1,291)	17,911
Restricted investment income	461	495	276
Change in net assets with donor restrictions	(28)	(19)	377
<b>Total</b>	<b>\$ 21,422</b>	<b>\$ 22,564</b>	<b>\$ 32,393</b>

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 \$38,184 and \$(5,856), respectively, at June 30, 2019; \$40,961 and \$(7,521), respectively, at June 30, 2018; and \$39,075 and \$(4,307), respectively, at June 30, 2017.

Information pertaining to available-for-sale investment securities with gross unrealized losses at June 30, 2019, 2018, and 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows:

	2019					
	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	\$ -	\$ -	\$ (1,622)	\$ 12,858	\$ (1,622)	\$ 12,858
Publicly traded mutual funds	(718)	12,409	(3,516)	47,993	(4,234)	60,402
<b>Total investments with unrealized losses</b>	<b>\$ (718)</b>	<b>\$ 12,409</b>	<b>\$ (5,138)</b>	<b>\$ 60,851</b>	<b>\$ (5,856)</b>	<b>\$ 73,260</b>

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

#### Note 6 - 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
<b>Total investments with unrealized losses</b>	<b>\$ (836)</b>	<b>\$ 20,164</b>	<b>\$ (6,685)</b>	<b>\$ 137,522</b>	<b>\$ (7,521)</b>	<b>\$ 157,686</b>
	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
<b>Total investments with unrealized losses</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (4,307)</b>	<b>\$ 115,386</b>	<b>\$ (4,307)</b>	<b>\$ 115,386</b>

#### Note 7 - 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, 2019, 2018, and 2017 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.

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 System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 7 - Fair Value Measurements (Continued)

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, 2019, 2018, and 2017, there were no transfers between levels of the fair value hierarchy.

	Assets Measured at Fair Value on a Recurring Basis at			Balance at June 30, 2019
	June 30, 2019			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>				
Cash and cash equivalents	\$ 38,538	\$ -	\$ -	\$ 38,538
Assets limited as to use and investments -				
Mutual funds:				
U.S. large-cap	119,259	-	-	119,259
Fixed income	100,158	-	-	100,158
International fixed income	12,858	-	-	12,858
International companies	77,928	-	-	77,928
Real estate	26,070	-	-	26,070
Total assets limited as to use and investments	336,273	-	-	336,273
Other assets - Benefit plan assets	15,910	-	-	15,910
Total assets	\$ 390,721	\$ -	\$ -	\$ 390,721

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 7 - Fair Value Measurements (Continued)

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
<b>Assets</b>				
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	\$ 379,218	\$ -	\$ -	\$ 379,218
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
<b>Assets</b>				
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

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

#### Note 7 - Fair Value Measurements (Continued)

Included within investments on the consolidated balance sheet are investments in common trust funds, limited partnerships, and hedge funds totaling \$101,613, \$90,440, and \$86,116 at June 30, 2019, 2018, and 2017, 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.

#### Note 8 - Liquidity and Availability of Resources

The following reflects Covenant HealthCare's financial assets as of June 30, 2019, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the consolidated balance sheet date as of June 30, 2019:

Cash and cash equivalents	\$	35,116
Patient accounts receivable		74,647
Estimated third-party payor settlements		2,864
Investments and assets limited as to use		441,308
Other financial assets		<u>26,606</u>
Financial assets - At year end		580,541
Less those unavailable for general expenditures within one year due to -		
Contractual or donor-imposed restrictions:		
Deferred compensation assets		15,910
Professional liability fund		4,524
By donors for specific purposes		<u>13,074</u>
Financial assets available to meet cash needs for general expenditures within one year	\$	<u><u>547,033</u></u>

Covenant HealthCare has certain contractual and donor-restricted assets limited as to use, which are more fully described in Notes 6 and 13. These amounts are not available for general expenditure within the next year.

Covenant HealthCare has a goal to maintain cash and investments on hand to meet 260 days of normal operating expenses, which are, on average, approximately \$1,700 per day. Covenant HealthCare has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, Covenant HealthCare invests cash in excess of daily requirements in various short-term investments, including certificates of deposit and short-term treasury instruments.

Covenant HealthCare also realizes there could be unanticipated liquidity needs.

#### Note 9 - Property and Equipment

Property and equipment are summarized at June 30 as follows:

	2019	2018	2017
Land and land improvements	\$ 17,351	\$ 16,583	\$ 15,857
Buildings	223,567	221,532	216,191
Equipment	432,418	397,833	378,177
Construction in progress	<u>1,954</u>	<u>8,909</u>	<u>3,205</u>
Total cost	675,290	644,857	613,430
Accumulated depreciation	<u>495,440</u>	<u>469,186</u>	<u>441,232</u>
Net property and equipment	<u><u>\$ 179,850</u></u>	<u><u>\$ 175,671</u></u>	<u><u>\$ 172,198</u></u>

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 9 - Property and Equipment (Continued)

As of June 30, 2019, Covenant HealthCare had outstanding commitments toward capital projects of approximately \$2,120.

### Note 10 - Long-term Debt

Long-term debt at June 30 is as follows:

	2019	2018	2017
City of Saginaw Hospital Finance Authority Hospital Revenue Refunding Bonds, Series 2010H	\$ 56,780	\$ 58,975	\$ 61,955
City of Saginaw Hospital Finance Authority Hospital Revenue and Refunding Bonds, Series 2014I	19,970	23,490	23,490
2015 term loan agreement	6,205	6,995	7,760
2019 term loan agreement	17,075	-	-
Unamortized premium	729	759	789
Unamortized debt issuance costs	(855)	(909)	(962)
<b>Total debt</b>	<b>99,904</b>	<b>89,310</b>	<b>93,032</b>
Less current portion	6,710	6,505	3,745
<b>Long-term portion</b>	<b>\$ 93,194</b>	<b>\$ 82,805</b>	<b>\$ 89,287</b>

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, 2019, the Series 2014I bonds consist of \$19,970 of fixed-rate bonds, which bear an annual interest rate of 2.09 percent. The bonds mature annually through 2024 in amounts ranging from \$3,595 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.

On October 28, 2010, Covenant HealthCare issued the Series 2010H bonds. At June 30, 2019, the Series 2010H bonds consist of \$5,810 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 \$2,300 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.

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 10 - Long-term Debt (Continued)

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, 2019, was 3.8 percent. Annual principal payments of amounts ranging from \$815 in 2020 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.

On June 25, 2019, a \$17,075 10-year term loan agreement was entered into with PNC Bank. This loan bears a variable rate of interest based on the one-month London Interbank Offered Rate plus 29 basis points, which, at June 30, 2019, was 2.7 percent. Annual principal payments of amounts ranging from \$1,675 in 2022 to \$2,135 in 2030 are required. The proceeds of this loan were used to fund various capital projects on Covenant HealthCare's campus.

Covenant HealthCare has several letters of credit available at June 30, 2019 to provide funding for certain self-insured benefits. There were no amounts outstanding on the letters of credit at June 30, 2019.

Cash paid for interest during 2019, 2018, and 2017 amounted to \$3,537, \$3,705, and \$3,858, respectively.

The balance of the above debt matures as follows:

Years Ending	Amount
2020	\$ 6,710
2021	6,910
2022	8,775
2023	9,020
2024	9,325
Thereafter	59,290
Total	<u>\$ 100,030</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, 2019, 2018, and 2017 amounted to \$6,176, \$5,662, and \$5,609, respectively.

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

Years Ending June 30	Amount
2020	\$ 1,821
2021	1,601
2022	1,355
2023	1,229
2024	893
Thereafter	1,634
Total	<u>\$ 8,533</u>

**Notes to Consolidated Financial Statements**

**June 30, 2019, 2018, and 2017**

**(In Thousands)**

**Note 12 - Professional and Other Liability Insurance**

Covenant HealthCare maintains a self-insured 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, 2019, 2018, and 2017 are \$25,391, \$32,025, and \$27,766, respectively. The loss reserves are discounted using an annual discount rate of 4.0 percent at June 30, 2019, 2018, and 2017.

Covenant HealthCare has recognized a receivable of \$2,892, \$5,892, and \$4,743 at June 30, 2019, 2018, and 2017, 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, 2019.

**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.

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

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

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, 2019, 2018, and 2017:

##### Obligations and Funded Status

	Pension Benefits			Other Postretirement Benefits		
	2019	2018	2017	2019	2018	2017
Change in benefit obligation:						
Benefit obligation at beginning of year	\$ 346,491	\$ 373,690	\$ 371,176	\$ 30,976	\$ 35,041	\$ 36,729
Service cost	261	453	575	-	-	-
Interest cost	14,665	14,336	14,236	1,238	1,267	1,340
Actuarial loss (gain)	31,062	(22,238)	2,644	2,261	(3,487)	(1,120)
Benefits paid	(17,099)	(19,750)	(14,941)	(2,356)	(1,845)	(1,908)
Benefit obligation at end of year	375,380	346,491	373,690	32,119	30,976	35,041
Change in plan assets:						
Fair value of plan assets at beginning of year	300,186	298,273	282,950	-	-	-
Actual return on plan assets	27,362	11,734	18,144	-	-	-
Employer contributions	6,299	9,929	12,120	2,356	1,845	1,908
Benefits paid	(17,099)	(19,750)	(14,941)	(2,356)	(1,845)	(1,908)
Fair value of plan assets at end of year	316,748	300,186	298,273	-	-	-
Funded status at end of year	\$ (58,632)	\$ (46,305)	\$ (75,417)	\$ (32,119)	\$ (30,976)	\$ (35,041)

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

	Pension Benefits			Other Postretirement Benefits		
	2019	2018	2017	2019	2018	2017
Net loss (gain)	\$ 129,739	\$ 112,161	\$ 137,701	\$ (2,450)	\$ (4,640)	\$ (555)
Prior service credit	-	(39)	(132)	-	-	-
Total	\$ 129,739	\$ 112,122	\$ 137,569	\$ (2,450)	\$ (4,640)	\$ (555)

The accumulated benefit obligation for all defined benefit pension plans was \$372,197, \$343,798, and \$371,684 at June 30, 2019, 2018, and 2017, respectively. The accumulated benefit obligation for all other postretirement benefit plans was \$31,256, \$30,377, and \$35,041 at June 30, 2019, 2018, and 2017, respectively.

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

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

Components of net periodic benefit cost are as follows:

	Pension Benefits			Other Postretirement Benefits		
	2019	2018	2017	2019	2018	2017
<b>Net Periodic Benefit Cost</b>						
Service cost	\$ 261	\$ 453	\$ 575	\$ -	\$ -	\$ -
Interest cost	14,665	14,336	14,236	1,238	1,267	1,340
Expected return on plan assets	(21,327)	(20,732)	(19,841)	-	-	-
Amortization of prior service cost	(38)	(94)	(94)	(193)	-	-
Amortization of actuarial loss	7,255	10,093	10,448	-	-	-
Settlement	\$ -	\$ 2,208	\$ -	\$ -	\$ -	\$ -
<b>Total recognized in net periodic benefit cost</b>	<b>\$ 816</b>	<b>\$ 6,264</b>	<b>\$ 5,324</b>	<b>\$ 1,045</b>	<b>\$ 1,267</b>	<b>\$ 1,340</b>

For measurement purposes in the other postretirement plan, a 6.60 percent initial annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2019. 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	\$ 28	\$ (26)

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

	Pension Benefits			Other Postretirement Benefits		
	2019	2018	2017	2019	2018	2017
Discount rate	3.63	4.35%	3.95%	3.63	4.35%	3.95%

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

	Pension Benefits			Other Postretirement Benefits		
	2019	2018	2017	2019	2018	2017
Discount rate	4.35%	3.95%	3.92%	4.35%	3.95%	3.92%
Expected long-term return on plan assets	7.00%	7.00%	7.00%	-	-	-
Rate of compensation increase	5.00%	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

June 30, 2019, 2018, and 2017

(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
	2019	2018	2017	2019
Cash and cash equivalents	0.60 %	1.40 %	0.50 %	1.40 %
Marketable equity securities	2.80	5.10	5.10	2.50
Fixed income	51.20	50.00	49.50	51.00
Publicly traded mutual funds	40.00	37.20	38.00	38.30
Common trust funds	4.60	4.80	4.80	4.00
Limited partnerships	0.80	1.10	1.60	2.10
Hedge funds	-	0.40	0.50	0.70

#### Fair Value Measurements at June 30, 2019

Asset Classes	Quoted Prices in			Total
	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and cash equivalents	\$ 3,482	\$ -	\$ -	\$ 3,482
Mutual funds:				
U.S. large cap	123,957	-	-	123,957
International	47,441	-	-	47,441
Fixed income	72,433	-	-	72,433
Real estate	14,666	-	-	14,666
Fixed-income contracts	-	822	-	822
<b>Total</b>	<b>\$ 261,979</b>	<b>\$ 822</b>	<b>\$ -</b>	<b>\$ 262,801</b>

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

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

Fair Value Measurements at June 30, 2018				
Asset Classes	Quoted Prices in			Total
	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
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
<b>Total</b>	<b>\$ 248,467</b>	<b>\$ 722</b>	<b>\$ -</b>	<b>\$ 249,189</b>

  

Fair Value Measurements at June 30, 2017				
Asset Classes	Quoted Prices in			Total
	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
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
<b>Total</b>	<b>\$ 244,237</b>	<b>\$ 1,316</b>	<b>\$ -</b>	<b>\$ 245,553</b>

The tables above present information about the pension plan assets measured at fair value at June 30, 2019, 2018, and 2017 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.

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

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

#### *Investments in Entities that Calculate Net Asset Value per Share*

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:

	2019	2018	2017
Fixed-income common trust funds	\$ 37,972	\$ 33,411	\$ 33,481
International common trust funds	13,509	13,153	13,244
Real asset limited partnerships	749	991	1,240
Private equity limited partnerships	1,717	2,432	3,480
Hedge funds	-	1,010	1,275
Total	<u>\$ 53,947</u>	<u>\$ 50,997</u>	<u>\$ 52,720</u>

#### *Cash Flow*

##### Contributions

Covenant HealthCare expects to contribute \$13,572 to its pension plan and \$3,825 to its other postretirement benefit plan in 2020. 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
2020	\$ 26,513	\$ 3,825
2021	21,249	3,636
2022	20,697	3,416
2023	21,202	3,250
2024	22,100	3,010
Thereafter	112,350	11,843

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 \$15,910, \$13,408, and \$10,647 at June 30, 2019, 2018, and 2017, respectively, in the consolidated financial statements as other noncurrent assets and liabilities.

## Covenant HealthCare System and Subsidiaries

# Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

### Note 14 - Defined Contribution Retirement Plan

Covenant HealthCare sponsors a defined contribution plan in which approximately 67 percent of its eligible 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 \$9,224, \$8,539, and \$7,818 during 2019, 2018, and 2017, respectively.

### Note 15 - Investments in Unconsolidated Entities

The following table summarizes Covenant HealthCare's investments in unconsolidated entities at June 30:

	2019	2018	2017
CMU Medical Education Partners	\$ 1,732	\$ 1,777	\$ 1,796
Covenant HealthCare Partners, Inc.	1,227	1,188	1,163
MMR - Mobile Medical Response	13,290	12,954	11,710
Mackinaw Surgery Center	1,571	1,650	1,714
Other	924	1,200	1,850
Total	<u>\$ 18,744</u>	<u>\$ 18,769</u>	<u>\$ 18,233</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 the financial position and results of operations for MMR and Covenant HealthCare's only significant investment accounted for under the equity method, as of and for the years ended June 30:

	June 30		
	2019	2018	2017
Assets	\$ 31,670	\$ 32,150	\$ 29,799
Liabilities	(5,090)	(6,242)	(6,379)
Equity	<u>\$ 26,580</u>	<u>\$ 25,908</u>	<u>\$ 23,420</u>
	Year Ended June 30		
	2019	2018	2017
Revenue	\$ 46,446	\$ 45,353	\$ 45,281
Expenses	(45,510)	(42,889)	(43,212)
Net income	<u>\$ 936</u>	<u>\$ 2,464</u>	<u>\$ 2,069</u>

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

#### Note 16 - Functional Expenses

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. The consolidated financial statements report certain categories of expenses that are attributable to more than one program or supporting function; these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including benefits and depreciation and amortization, are allocated based on information, such as the percentage of salaries and wages, which are classified as healthcare or general and administrative services or total expenses by category for the remaining operating expenses.

Expenses related to providing these services for the year ended June 30, 2019 are as follows:

	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 282,332	\$ 31,156	\$ 313,488
Benefits	67,115	7,406	74,521
Supplies	135,200	489	135,689
Professional fees	9,691	1,887	11,578
Purchased services	42,892	17,929	60,821
Insurance	387	1,247	1,634
Utilities	5,596	604	6,200
Depreciation and amortization	27,296	2,692	29,988
Interest expense	3,504	-	3,504
Other	5,015	8,941	13,956
Total	<u>\$ 579,028</u>	<u>\$ 72,351</u>	<u>\$ 651,379</u>

Expenses related to providing these services for the year ended June 30, 2018 are as follows:

	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 267,017	\$ 32,601	\$ 299,618
Benefits	68,754	8,396	77,150
Supplies	131,606	602	132,208
Professional fees	9,474	5,050	14,524
Purchased services	45,633	17,819	63,452
Insurance	264	5,741	6,005
Utilities	5,719	696	6,415
Depreciation and amortization	26,447	3,246	29,693
Interest expense	3,658	-	3,658
Other	4,667	7,552	12,219
Total	<u>\$ 563,239</u>	<u>\$ 81,703</u>	<u>\$ 644,942</u>

## Covenant HealthCare System and Subsidiaries

### Notes to Consolidated Financial Statements

June 30, 2019, 2018, and 2017

(In Thousands)

#### Note 16 - Functional Expenses (Continued)

Expenses related to providing these services for the year ended June 30, 2017 are as follows:

	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 247,897	\$ 31,120	\$ 279,017
Benefits	64,349	8,078	72,427
Supplies	128,475	575	129,050
Professional fees	9,840	1,171	11,011
Purchased services	43,496	16,038	59,534
Insurance	91	7,875	7,966
Utilities	5,499	709	6,208
Depreciation and amortization	26,897	3,321	30,218
Interest expense	3,815	-	3,815
Other	4,495	7,581	12,076
Total	\$ 534,854	\$ 76,468	\$ 611,322

#### 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.

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## 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, 2019 and have issued our report thereon dated October 3, 2019, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the 2019 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 2019 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2019 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 2019 consolidated financial statements as a whole.

*Plante & Moran, PLLC*

October 3, 2019

## Covenant HealthCare System and Subsidiaries

### Consolidating Balance Sheet

June 30, 2019  
(In Thousands)

	Nonobligated Group	Obligated Group	Eliminating Entries	Total
<b>Assets</b>				
<b>Current Assets</b>				
Cash and cash equivalents	\$ 2,906	\$ 32,210	\$ -	\$ 35,116
Patient accounts receivable - Net	4,959	69,688	-	74,647
Inventory	526	16,028	-	16,554
Due from affiliates	-	1,434	(1,434)	-
Estimated third-party payor settlements	-	2,864	-	2,864
Prepaid expenses and other	7	14,729	-	14,736
Total current assets	8,398	136,953	(1,434)	143,917
<b>Assets Limited as to Use</b>				
Professional liability fund	-	4,524	-	4,524
By donors for specific purposes	-	13,074	-	13,074
<b>Investments</b>	12,998	410,712	-	423,710
<b>Property and Equipment - Net</b>	387	179,463	-	179,850
<b>Other Assets</b>				
Investments in unconsolidated entities	435	18,309	-	18,744
Other	-	22,215	-	22,215
Total other assets	435	40,524	-	40,959
Total assets	<u>\$ 22,218</u>	<u>\$ 785,250</u>	<u>\$ (1,434)</u>	<u>\$ 806,034</u>

## Covenant HealthCare System and Subsidiaries

### Consolidating Balance Sheet (Continued)

June 30, 2019

(In Thousands)

	Nonobligated Group	Obligated Group	Eliminating Entries	Total
<b>Liabilities and Net Assets</b>				
<b>Current Liabilities</b>				
Accounts payable and accrued expenses	\$ 440	\$ 12,577	\$ -	\$ 13,017
Current portion of long-term debt	-	6,710	-	6,710
Estimated third-party payor settlements	-	6,134	-	6,134
Accrued liabilities and other:				
Accrued compensation and related amounts	337	36,458	-	36,795
Accrued interest payable and other current liabilities	-	1,434	-	1,434
Due to affiliates	1,434	-	(1,434)	-
Current portion of accrued pension obligation	-	7,439	-	7,439
Current portion of accrued postretirement benefit obligation	-	3,757	-	3,757
Total current liabilities	2,211	74,509	(1,434)	75,286
Long-term Debt - Net of current portion	-	93,194	-	93,194
<b>Other Liabilities</b>				
Accrued pension obligation	-	51,193	-	51,193
Accrued postretirement benefit obligation	-	28,362	-	28,362
Reserve for professional liability claims	-	25,391	-	25,391
Other	-	18,661	-	18,661
Total other liabilities	-	123,607	-	123,607
Total liabilities	2,211	291,310	(1,434)	292,087
<b>Net Assets</b>				
Net assets without donor restrictions	20,007	480,866	-	500,873
Net assets with donor restrictions	-	13,074	-	13,074
Total net assets	20,007	493,940	-	513,947
Total liabilities and net assets	<u>\$ 22,218</u>	<u>\$ 785,250</u>	<u>\$ (1,434)</u>	<u>\$ 806,034</u>

## Covenant HealthCare System and Subsidiaries

### Consolidating Statement of Operations

Year Ended June 30, 2019

(In Thousands)

	Nonobligated Group	Obligated Group	Eliminating Entries	Total
<b>Unrestricted Revenue, Gains, and Other Support</b>				
Net patient service revenue	\$ 13,859	\$ 619,185	\$ (415)	\$ 632,629
Investment income and realized gains and losses	-	546	-	546
Other revenue	(27)	30,175	-	30,148
Total unrestricted revenue, gains, and other support	13,832	649,906	(415)	663,323
<b>Expenses</b>				
Salaries and wages	7,317	306,171	-	313,488
Benefits	1,497	73,024	-	74,521
Supplies	3,120	132,569	-	135,689
Professional fees	31	11,547	-	11,578
Purchased services	1,133	60,103	(415)	60,821
Insurance	1	1,633	-	1,634
Utilities	97	6,103	-	6,200
Depreciation and amortization	53	29,935	-	29,988
Interest expense	-	3,504	-	3,504
Other	495	13,461	-	13,956
Total expenses	13,744	638,050	(415)	651,379
<b>Operating Income</b>	88	11,856	-	11,944
<b>Nonoperating Income</b>				
Investment income	362	8,798	-	9,160
Realized and unrealized net gains on investments	438	11,552	-	11,990
Other	-	464	-	464
Total nonoperating income	800	20,814	-	21,614
<b>Excess of Revenue Over Expenses</b>	888	32,670	-	33,558
<b>Transfer (to) from Affiliate</b>	(4,757)	4,757	-	-
<b>Change in Unrealized Losses in Fair Value of Investments</b>	(37)	(670)	-	(707)
<b>Other</b>	-	(20)	-	(20)
<b>Pension and Other Postretirement Benefit Obligation Adjustment</b>	-	(19,807)	-	(19,807)
<b>(Decrease) Increase in Net Assets without Donor Restrictions</b>	<u>\$ (3,906)</u>	<u>\$ 16,930</u>	<u>\$ -</u>	<u>\$ 13,024</u>

## Covenant HealthCare System and Subsidiaries

### Consolidating Balance Sheet - Obligated Group

June 30, 2019

(In Thousands)

	Covenant HealthCare Foundation	Covenant Medical Center, Inc.	Eliminating Entries	Total
<b>Assets</b>				
<b>Current Assets</b>				
Cash and cash equivalents	\$ 294	\$ 31,916	\$ -	\$ 32,210
Patient accounts receivable - Net	-	69,688	-	69,688
Inventory	-	16,028	-	16,028
Due from affiliates	-	2,224	(790)	1,434
Estimated third-party payor settlements	-	2,864	-	2,864
Prepaid expenses and other	168	14,561	-	14,729
Total current assets	462	137,281	(790)	136,953
<b>Assets Limited as to Use</b>				
Professional liability fund	-	4,524	-	4,524
By donors for specific purposes	13,074	-	-	13,074
<b>Investments</b>	10,234	400,478	-	410,712
<b>Property and Equipment - Net</b>	-	179,463	-	179,463
<b>Other Assets</b>				
Investments in unconsolidated entities	-	18,309	-	18,309
Other	-	22,215	-	22,215
Total other assets	-	40,524	-	40,524
Total assets	\$ 23,770	\$ 762,270	\$ (790)	\$ 785,250

## Covenant HealthCare System and Subsidiaries

### Consolidating Balance Sheet - Obligated Group (Continued)

June 30, 2019

(In Thousands)

	Covenant HealthCare Foundation	Covenant Medical Center, Inc.	Eliminating Entries	Total
<b>Liabilities and Net Assets</b>				
<b>Current Liabilities</b>				
Accounts payable and accrued expenses	\$ 161	\$ 12,416	\$ -	\$ 12,577
Current portion of long-term debt	-	6,710	-	6,710
Estimated third-party payor settlements	-	6,134	-	6,134
Accrued liabilities and other:				
Accrued compensation and related amounts	50	36,408	-	36,458
Accrued interest payable and other current liabilities	-	1,434	-	1,434
Due to affiliates	790	-	(790)	-
Current portion of accrued pension obligation	-	7,439	-	7,439
Current portion of accrued postretirement benefit obligation	-	3,757	-	3,757
Total current liabilities	1,001	74,298	(790)	74,509
Long-term Debt - Net of current portion	-	93,194	-	93,194
<b>Other Liabilities</b>				
Accrued pension obligation	-	51,193	-	51,193
Accrued postretirement benefit obligation	-	28,362	-	28,362
Reserve for professional liability claims	-	25,391	-	25,391
Other	-	18,661	-	18,661
Total other liabilities	-	123,607	-	123,607
Total liabilities	1,001	291,099	(790)	291,310
<b>Net Assets</b>				
Net assets without donor restrictions	9,695	471,171	-	480,866
Net assets with donor restrictions	13,074	-	-	13,074
Total net assets	22,769	471,171	-	493,940
Total liabilities and net assets	<u>\$ 23,770</u>	<u>\$ 762,270</u>	<u>\$ (790)</u>	<u>\$ 785,250</u>

## Covenant HealthCare System and Subsidiaries

### Consolidating Statement of Operations - Obligated Group

Year Ended June 30, 2019

(In Thousands)

	Covenant HealthCare Foundation	Covenant Medical Center, Inc.	Eliminating Entries	Total
<b>Unrestricted Revenue, Gains, and Other Support</b>				
Net patient service revenue	\$ -	\$ 619,185	\$ -	\$ 619,185
Investment (loss) income and realized gains and losses	-	546	-	546
Other revenue	2,352	27,823	-	30,175
<b>Total unrestricted revenue, gains, and other support</b>	<b>2,352</b>	<b>647,554</b>	<b>-</b>	<b>649,906</b>
<b>Expenses</b>				
Salaries and wages	633	305,538	-	306,171
Benefits	124	72,900	-	73,024
Supplies	841	131,728	-	132,569
Professional fees	1	11,546	-	11,547
Purchased services	25	60,078	-	60,103
Insurance	-	1,633	-	1,633
Utilities	1	6,102	-	6,103
Depreciation and amortization	-	29,935	-	29,935
Interest expense	-	3,504	-	3,504
Other	1,176	12,285	-	13,461
<b>Total expenses</b>	<b>2,801</b>	<b>635,249</b>	<b>-</b>	<b>638,050</b>
<b>Operating (Loss) Income</b>	<b>(449)</b>	<b>12,305</b>	<b>-</b>	<b>11,856</b>
<b>Nonoperating Income</b>				
Investment income	318	8,480	-	8,798
Realized and unrealized net gains on investments	467	11,085	-	11,552
Other	-	464	-	464
<b>Total nonoperating income</b>	<b>785</b>	<b>20,029</b>	<b>-</b>	<b>20,814</b>
<b>Excess of Revenue Over Expenses</b>	<b>336</b>	<b>32,334</b>	<b>-</b>	<b>32,670</b>
<b>Transfer from Affiliate</b>	<b>-</b>	<b>4,757</b>	<b>-</b>	<b>4,757</b>
<b>Change in Unrealized Losses in Fair Value of Investments</b>	<b>(48)</b>	<b>(622)</b>	<b>-</b>	<b>(670)</b>
<b>Other</b>	<b>(20)</b>	<b>-</b>	<b>-</b>	<b>(20)</b>
<b>Pension and Other Postretirement Benefit Obligation Adjustment</b>	<b>-</b>	<b>(19,807)</b>	<b>-</b>	<b>(19,807)</b>
<b>Increase in Net Assets without Donor Restrictions</b>	<b>\$ 268</b>	<b>\$ 16,662</b>	<b>\$ -</b>	<b>\$ 16,930</b>

## Covenant HealthCare System and Subsidiaries

### Consolidating Balance Sheet - Nonobligated Group

June 30, 2019

(In Thousands)

	Covenant Development Corporation	Covenant HealthCare System	Visiting Nurse Association of Saginaw	Eliminating Entries	Total
<b>Assets</b>					
<b>Current Assets</b>					
Cash and cash equivalents	\$ 2,342	\$ 31	\$ 533	\$ -	\$ 2,906
Patient accounts receivable - Net	-	-	4,959	-	4,959
Inventory	-	-	526	-	526
Prepaid expenses and other	9	2	(4)	-	7
Total current assets	2,351	33	6,014	-	8,398
<b>Investments</b>	3,734	8,020	1,244	-	12,998
<b>Property and Equipment - Net</b>	46	-	341	-	387
<b>Other Assets</b>					
Investments in unconsolidated entities	435	-	-	-	435
Long-term investments	-	6,546	-	(6,546)	-
Total other assets	435	6,546	-	(6,546)	435
Total assets	<u>\$ 6,566</u>	<u>\$ 14,599</u>	<u>\$ 7,599</u>	<u>\$ (6,546)</u>	<u>\$ 22,218</u>
<b>Liabilities and Net Assets</b>					
<b>Current Liabilities</b>					
Accounts payable and accrued expenses	\$ 22	\$ -	\$ 418	\$ -	\$ 440
Accrued liabilities and other:					
Accrued compensation and related amounts	-	-	337	-	337
Due to affiliates	-	-	1,434	-	1,434
Total current liabilities	22	-	2,189	-	2,211
<b>Net Assets - Without donor restrictions</b>	6,544	14,599	5,410	(6,546)	20,007
Total liabilities and net assets	<u>\$ 6,566</u>	<u>\$ 14,599</u>	<u>\$ 7,599</u>	<u>\$ (6,546)</u>	<u>\$ 22,218</u>

## Covenant HealthCare System and Subsidiaries

### Consolidating Statement of Operations - Nonobligated Group

Year Ended June 30, 2019

(In Thousands)

	Visiting Nurse Special Services	Covenant Development Corporation	Covenant HealthCare System	Visiting Nurse Association of Saginaw	Eliminating Entries	Total
<b>Unrestricted Revenue, Gains, and Other Support</b>						
Net patient service revenue	\$ -	\$ -	\$ -	\$ 13,859	\$ -	\$ 13,859
Other revenue	-	(45)	165	32	(179)	(27)
<b>Total unrestricted revenue, gains, and other support</b>	-	(45)	165	13,891	(179)	13,832
<b>Expenses</b>						
Salaries and wages	-	-	-	7,317	-	7,317
Benefits	-	-	-	1,497	-	1,497
Supplies	-	1	-	3,119	-	3,120
Professional fees	-	-	-	31	-	31
Purchased services	-	38	-	1,095	-	1,133
Insurance	-	-	-	1	-	1
Utilities	-	-	-	97	-	97
Depreciation and amortization	-	1	-	52	-	53
Other	-	33	-	462	-	495
<b>Total expenses</b>	-	73	-	13,671	-	13,744
<b>Operating (Loss) Income</b>	-	(118)	165	220	(179)	88
<b>Nonoperating Income</b>						
Investment income	-	169	167	26	-	362
Realized and unrealized net gains on investments	-	126	270	42	-	438
<b>Total nonoperating income</b>	\$ -	\$ 295	\$ 437	\$ 68	\$ -	\$ 800
<b>Excess of Revenue Over Expenses</b>	-	177	602	288	(179)	888
<b>Transfer to Affiliate</b>	(4,757)	-	-	-	-	(4,757)
<b>Change in Unrealized Losses in Fair Value of Investments</b>	-	(15)	(32)	(5)	15	(37)
<b>(Decrease) Increase in Net Assets without Donor Restrictions</b>	\$ (4,757)	\$ 162	\$ 570	\$ 283	\$ (164)	\$ (3,906)

## 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, 2019 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 thereon, with an unmodified opinion, dated October 3, 2019.

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*

October 3, 2019

## 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 Covenant Medical Center Obligated Group) as of June 30, 2019 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 thereon, with an unmodified opinion, dated October 3, 2019.

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*

October 3, 2019

## **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, 2019 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 thereon, with an unmodified opinion, dated October 3, 2019.

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 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*

October 3, 2019

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

**Year Ended June 30, 2019**  
**(In Thousands)**

<b>Excess of revenue over expenses</b>	<b>\$</b>	<b>32,670</b>
<b>Adjustments:</b>		
Depreciation and amortization		29,935
Interest expense		3,504
<b>Total net revenue (1)</b>	<b>\$</b>	<b>66,109</b>
<hr/>		
<b>Total Historical Principal and Interest Requirements (1)</b>	<b>\$</b>	<b>9,985</b>
<hr/>		
<b>Historical Debt Service Coverage Ratio (1)</b>		<b>6.62</b>
<hr/>		

(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-30-17	Audited Year Ended Jun-30-18	Audited Year Ended Jun-30-19		Audited Year Ended Jun-30-17	Audited Year Ended Jun-30-18	Audited Year Ended Jun-30-19	
<i>(In Thousands)</i>								
<b>Assets</b>					<b>Liabilities and net assets</b>			
<b>Current assets:</b>					<b>Current liabilities:</b>			
Cash and cash equivalents	\$27,982	\$30,880	\$35,116		Accounts payable and accrued expenses	\$16,460	\$18,274	\$13,017
Net patient accounts receivable	67,528	70,475	74,647		Estimated third-party payable	11,744	3,798	6,134
Estimated third-party settlements	471	1,601	2,864		Accrued compensation and related amounts	33,227	39,121	36,795
Current portion of funds held under bond agreements	4,525	3,665	-		Accrued interest payable and other current liabilities	1,561	1,490	1,434
Inventories	14,409	16,463	16,554		Current portion of accrued postretirement benefits	-	-	3,757
Prepaid expenses and other	14,853	16,724	14,736		Current portion accrued pension obligation	-	-	7,439
<b>Total current assets</b>	<b>129,768</b>	<b>139,808</b>	<b>143,917</b>		Current portion of long-term debt	3,745	6,505	6,710
					<b>Total current liabilities</b>	<b>66,737</b>	<b>69,188</b>	<b>75,286</b>
<b>Assets whose use is limited, less current portion:</b>					<b>Noncurrent liabilities:</b>			
Funds held under bond agreements	-	-	-		Long-term debt, less current portion	89,287	82,805	93,194
Restricted assets	11,938	12,763	13,074		Accrued post retirement benefits	35,041	30,976	28,362
Professional liability fund	3,091	5,730	4,524		Accrued pension	75,417	46,305	51,193
	<b>15,029</b>	<b>18,493</b>	<b>17,598</b>		Other noncurrent liabilities	40,899	48,782	44,052
					<b>Total noncurrent liabilities</b>	<b>240,644</b>	<b>208,868</b>	<b>216,801</b>
<b>Other assets:</b>					<b>Net assets:</b>			
Marketable securities	373,718	403,212	423,710		Unrestricted	408,611	487,849	500,873
Investments in unconsolidated affiliates	18,233	18,769	18,744		Temporarily restricted	11,243	12,039	12,351
Other	18,984	22,714	22,215		Permanently restricted	695	723	723
	<b>410,935</b>	<b>444,695</b>	<b>464,669</b>			<b>420,549</b>	<b>500,611</b>	<b>513,947</b>
<b>Property and equipment</b>	<b>172,198</b>	<b>175,671</b>	<b>179,850</b>		<b>Total liabilities and net assets</b>	<b>\$727,930</b>	<b>\$778,667</b>	<b>\$806,034</b>
<b>Total assets</b>	<b>\$727,930</b>	<b>\$778,667</b>	<b>\$806,034</b>					

**COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES**

**Consolidated Statements Of Operations**

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
	<i>(In Thousands)</i>		
<b>Revenue and support:</b>			
Net patient service revenue	\$604,112	\$631,268	\$632,629
Other revenue	34,183	40,812	30,148
Investment income	65	463	96
Realized and other than temporary losses, net	250	151	450
<b>Total revenue &amp; support</b>	<b>638,610</b>	<b>672,694</b>	<b>663,323</b>
<b>Expenses:</b>			
Salaries & wages	279,017	299,618	313,488
Benefits	72,427	77,150	74,521
Professional fees	11,011	14,524	11,578
Supplies	129,050	132,208	135,689
Other purchased services	59,534	63,452	60,821
Other	12,076	12,219	13,956
Utilities	6,208	6,415	6,200
Insurance	7,966	6,005	1,634
Depreciation and amortization	30,218	29,693	29,988
Interest	3,815	3,658	3,504
<b>Total expenses</b>	<b>611,322</b>	<b>644,942</b>	<b>651,379</b>
<b>Income (loss) from operations</b>	<b>27,288</b>	<b>27,752</b>	<b>11,944</b>
Investment income	6,357	7,492	9,160
Gain/(Loss) on refunding	-		
Realized and other than temporary gain (loss), net	7,157	15,273	11,990
Other non-operating gains (losses)	39	500	464
<b>Excess (deficit) of revenues over expenses</b>	<b>\$40,841</b>	<b>\$51,017</b>	<b>\$33,558</b>

**COVENANT MEDICAL CENTER**  
**Statistical Summary**

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
Discharges - Acute	28,682	29,340	27,653
Discharges - Rehab	904	830	866
Discharges - Skilled Nursing	466	492	452
<b>Total Discharges (Includes Newborn)</b>	<b>30,052</b>	<b>30,662</b>	<b>28,971</b>
Patient Days - Acute	135,151	141,814	132,912
Patient Days - Rehab	11,296	10,499	10,561
Patient Days - Skilled Nursing	6,307	6,226	6,543
<b>Total Patient Days (Includes Newborn)</b>	<b>152,754</b>	<b>158,539</b>	<b>150,016</b>
Equivalent Discharges (Excluding Newborn)	55,835	58,049	58,338
Equivalent Patient Days (Excluding Newborn)	291,975	308,565	309,992
Average Length of Stay - Acute (Discharges)	4.71	4.83	4.81
Average Length of Stay - Total (Discharges)	5.08	5.17	5.18
Average Daily Census	419	434	411
Newborn Discharges	2,613	2,616	2,481
Newborn Patient Days	5,117	5,107	4,939
Total ECC Admissions	23,365	23,741	24,343
Total ECC Visits	93,365	93,467	93,757
Surgical Cases - Inpatient	6,058	5,894	5,836
Surgical Cases - Outpatient	7,965	8,381	8,673
Cath Lab-EP Lab Procedures	7,517	7,979	7,384
Physician Office Visits (MSO)	276,065	312,511	344,250
MedExpress	112,024	106,624	108,610
Total FTE's	3,884.0	4,005.0	3,988.0
Payor Mix			
Medicare	46.43%	46.51%	45.76%
Blue Cross	12.50%	12.21%	12.28%
Medicaid	18.43%	18.51%	18.53%
HMO and PPO	3.84%	2.44%	2.88%
Other	<u>10.96%</u>	<u>12.39%</u>	<u>12.06%</u>
Hospital Services	92.16%	92.06%	91.51%
Physician Services	<u>7.84%</u>	<u>7.94%</u>	<u>8.48%</u>
Home Health & Other	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
Other Services	7.84%	7.94%	8.48%
Total Services	100.00%	100.00%	100.00%
Percentage of Occupancy			
Licensed Beds	65.09%	67.55%	63.92%
Available Beds-Inc. NB	70.46%	72.88%	68.96%
Case Mix			
Medicare	1.7285	1.7318	1.7572
Total	1.4971	1.5160	1.5425

**COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES**

**Consolidated Statements Of Operations**

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
	<i>(In Thousands)</i>		
<b>Revenue and support:</b>			
Net patient service revenue	\$604,112	\$631,268	\$632,629
Other revenue	34,183	40,812	30,148
Investment income	65	463	96
Realized and other than temporary losses, net	250	151	450
<b>Total revenue &amp; support</b>	<b>638,610</b>	<b>672,694</b>	<b>663,323</b>
<b>Expenses:</b>			
Operating expenses	577,289	611,591	617,887
Depreciation and amortization	30,218	29,693	29,988
Interest	3,815	3,658	3,504
<b>Total expenses</b>	<b>611,322</b>	<b>644,942</b>	<b>651,379</b>
<b>Income (loss) from operations</b>	<b>27,288</b>	<b>27,752</b>	<b>11,944</b>
Investment income	6,357	7,492	9,160
Realized and other than temporary gains (losses), net	7,157	15,273	11,990
Gain on refunding and other non-operating gains (losses)	39	500	464
<b>Excess (deficit) of revenues over expenses</b>	<b>\$40,841</b>	<b>\$51,017</b>	<b>\$33,558</b>

**COVENANT MEDICAL CENTER****Utilization Data**

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

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
Beds Licensed	643	643	643
Beds Staffed	594	596	596
<b>Admissions</b>			
Acute Care	26,069	26,724	25,172
Rehabilitation	904	830	866
Transitional Care Unit	466	492	452
	<u>27,439</u>	<u>28,046</u>	<u>26,490</u>
Newborn	2,613	2,616	2,481
Total Admissions	<u>30,052</u>	<u>30,662</u>	<u>28,971</u>
<b>Patient Days</b>			
Acute Care	130,034	136,707	127,973
Rehabilitation	11,296	10,499	10,561
Transitional Care Unit	6,307	6,226	6,543
	<u>147,637</u>	<u>153,432</u>	<u>145,077</u>
Newborn	5,117	5,107	4,939
Total Patient Days	<u>152,754</u>	<u>158,539</u>	<u>150,016</u>
<b>Percent of Occupancy</b>			
Based on Staffed Beds	70%	73%	69%
Acute Care Average Length of Stay	4.71	4.83	4.81
<b>Surgical Procedures</b>			
Inpatient	6,058	5,894	5,836
Outpatient	7,965	8,381	8,673
Outpatient Visits	489,917	503,745	510,255
Emergency Room Visits	93,365	93,467	93,757
Case Mix Index (all Medicare patients)	1.73	1.73	1.76

**COVENANT HEALTHCARE SYSTEM AND SUBSIDIARIES**

**Days Cash, Debt to Capitalization, Sources of Revenue**

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
	<i>(In Thousands)</i>		
Cash and cash equivalents	\$27,982	\$30,880	\$35,116
Investments	385,656	415,975	436,784
<b>Total Cash</b>	<b>413,638</b>	<b>446,855</b>	<b>471,900</b>
Less: Restricted Cash from Foundation	11,938	12,763	13,074
<b>Total Unrestricted Cash</b>	<b>\$401,700</b>	<b>\$434,092</b>	<b>\$458,826</b>

**Days Cash on Hand** 252                      258                      270

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
	<i>(In Thousands)</i>		
Long-term debt (including current maturities)			
Series 2010 H Bonds	\$61,955	\$58,975	\$56,780
Series 2014 I Bonds	23,490	23,490	19,970
2019 PNC Debt	-	-	17,075
JPM 2015 Loan	7,760	6,995	6,205
Unamortized Premium/Debt issuance cost	(173)	(150)	(126)
<b>Total long-term debt</b>	<b>93,032</b>	<b>89,310</b>	<b>99,904</b>
Unrestricted net assets	408,611	487,849	500,873
<b>Total Capitalization</b>	<b>\$501,643</b>	<b>\$577,159</b>	<b>\$600,777</b>

**Debt to Capitalization** 18.55%                      15.47%                      16.63%

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
<b>Sources of Revenue</b>			
Hospital Services			
Medicare	46.43%	46.51%	45.76%
Blue Cross	12.50%	12.21%	12.28%
Medicaid	18.43%	18.51%	18.53%
HMO and PPO	3.84%	2.44%	2.88%
Other	10.96%	12.39%	12.06%
<b>Hospital Services</b>	<b>92.16%</b>	<b>92.06%</b>	<b>91.51%</b>
Other Services			
Physician Services	7.84%	7.94%	8.48%
Home Health and Other	0.00%	0.00%	0.00%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

**COVENANT HEALTHCARE SYSTEM OBLIGATED GROUP**

**Maximum Annual Debt Service Coverage**

	<b>Audited Year Ended Jun-30-17</b>	<b>Audited Year Ended Jun-30-18</b>	<b>Audited Year Ended Jun-30-19</b>
	<i>(In Thousands)</i>		
Excess (deficit) of revenue over expenses	\$38,289	\$49,907	\$32,670
Depreciation and amortization	30,166	29,639	29,935
Interest	3,815	3,658	3,504
(Gain)/loss on bond refunding	-	-	-
Excess before interest, depreciation, and amortization	<u>72,270</u>	<u>83,204</u>	<u>66,109</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>\$72,270</u>	<u>\$83,204</u>	<u>\$66,109</u>
Divided by:			
Maximum annual debt service (1)	<u>\$9,966</u>	<u>\$10,010</u>	<u>\$12,090</u>
<b>Maximum Annual Debt Service Coverage (2)</b>	<u><b>7.3</b></u>	<u><b>8.3</b></u>	<u><b>5.5</b></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 PNC Term Loan which was initiated June 25, 2019. The fiscal year 2019 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 2019