

April 19, 2019

Financial Highlights for the Year Ending December 31, 2018

Enclosed are the audited financial statements of Norton Healthcare, Inc. for the year ended December 31, 2018. Please note, a post close adjustment has been recorded subsequent to the issuance of our fourth quarter 2018 unaudited financial statements. The adjustment increased net patient service revenue by \$339,000.

Revenues and Expenses

For the year ending December 31, 2018, total revenues grew \$183.7 million, or 8%, to \$2.371 billion. This increase was due to the growth of net patient service revenue of \$179.1 million, or 8%, and an increase in other revenue of \$3.9 million, or 10%, over the same period in 2017. When comparing 2018 to 2017, inpatient admissions increased 229, or less than 1%, while hospital and total outpatient volumes improved 2% and 3%, respectively, and provider office visits improved 7%.

Please note: In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09), to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. We adopted the provisions of ASU 2014-09 on January 1, 2018. The adoption of ASU 2014-09 was not material.

The increase in patient service revenue for 2018 compared to 2017 was due to:

- Increased volumes (10,849, or 7%) at Norton Cancer Institute (NCI),
- Receipt of Medicaid Intensity Operating Allowance payments for the years 2013 through 2017 at Norton Children's Hospital (NCH),
- Norton Medical Group (NMG) hired additional providers and their provider office visits have increased 7%,
- Increased admissions (520, or 3%), outpatient visits (1,331, or 2%), and inpatient surgeries (357, or 8%) at Norton Audubon Hospital (Audubon),
- Increased admissions (325, or 3%), outpatient visits (2,742, or 5%), Emergency Department visits (1,201, or 4%), and inpatient surgeries (170, or 4%) at Norton Brownsboro Hospital (NBH),
- Increased outpatient visits (6,694 or 9%), Emergency Department visits (4,245, or 7%), and outpatient surgeries (994, or 10%) at Norton Women's and Children's Hospital (NWCH), and
- Providing higher levels of service (case mix index), which is reimbursed at higher rates.

Other revenue improved \$3.9 million, or 10%, due to increased technical service revenue at CPA Lab, increased capitation revenue at NMG, and the receipt of a risk sharing contract with one of our managed care providers at NMG.

Direct expenses increased \$136.6 million, or 7%, compared to the same period in 2017. Major components of this expense growth were:

1. Labor and benefits rose by \$42.8 million, or 4%, broken down as follows:

(in millions)	2018	2017	% Change
Salary and Wages	\$ 983.2	\$ 954.2	3%
Contract Labor	8.6	10.2	(16%)
Benefits	207.3	191.9	8%
Total	\$1,199.1	\$1,156.3	4%

Salary and wages increased due to system wide pay increases and market adjustments that were given in the second and third quarters of 2017 and January 2018. NMG continued to open practice locations and

hired new providers. Hospitalists' salaries increased due to volumes in the hospitals. Also, productivity bonuses were accrued due to increased volumes. Lastly, accruals were made in 2018 for the new Managers Success Sharing Program. This program was introduced in the fourth quarter of 2017.

Benefit costs increased due to higher health insurance expense (\$12.1 million), parental leave expense (\$1.9 million), and FICA expense (\$1.9 million).

2. The increase in professional fees of \$10.7 million, or 15%, occurred at NCH (\$11.2 million) and NWCH (\$1.2 million) partially offset by a decline at Norton Hospital (Norton) (\$1.8 million). NCH established a reserve for additional pediatric academic support to the University of Louisville School of Medicine Pediatric Department. NWCH incurred increased costs with their anesthesia contract renewal. Norton paid additional startup costs for their new anesthesia contracts in 2017 that did not reoccur this year.
3. Drug and supply costs increased \$54.7 million, or 12%; \$47.3 million in drug expense and \$7.4 million in supply expense. The increase in drug expense occurred at NCI (\$34.4 million), NMG (\$3.7 million), NCH (\$3.4 million), and the Norton Healthcare Pharmacies (Pharmacies) (\$2.0 million). NCI's variance was volume related particularly in their Specialty Pharmacy and infusion centers. NMG incurred costs for Hepatitis A vaccines. With the recent Hepatitis A outbreak, each school child had to be vaccinated to attend school along with vaccine purchased to treat adult patients. NCH began using a new drug product in the second quarter of 2017 for the treatment of spinal muscular atrophy. This new drug costs \$96,000 per dose and requires two doses per treatment. Also, the usage of expensive oncology drugs has increased for treatment of pediatric patients. The Pharmacies experienced increased volumes in all four of their locations. The increase in supply expense occurred at Audubon (\$4.9 million), NBH (\$3.4 million), NMG (\$896,000), and CPA Lab (\$755,000). Audubon's increase occurred in Surgery where they incurred costs for cardiovascular implant items, orthopedic implant items, spine implant items, and chargeable supplies; NBH's was in Surgery for orthopedic implant items, chargeable supplies and nonchargeable supplies; NMG's was for chargeable supplies, and CPA Lab's was for reagents and chemicals. Lastly, based on the increase in the Premier, Inc. stock price, the hospitals recorded an increase in vendor incentive, which reduces supply expense (\$4.6 million).
4. The increase in fees and special services of \$6.6 million, or 5%, occurred at the System Office (\$9.5 million) partially offset by a decline at NMG (\$2.2 million). Information Services incurred costs related to services for EPIC and Sunquest clinical systems analysis support, IT technical support, and security operations support. Also, Patient Financial Services incurred increased expense for collection costs and other related fees. In addition, costs were incurred for a new early out receivable collection program. In 2017 the System Office and NMG incurred costs for a productivity and operational efficiency review engagement. This work was completed in early 2018 and expenses incurred this year were minimal.
5. Repairs and maintenance increased \$4.7 million, or 9%, primarily at the System Office (\$2.0 million), NCH (\$1.0 million), and Norton (\$836,000). Information Services incurred costs for software licensing and maintenance contracts. NCH's increase was caused by equipment repairs in their Sterile Processing department and general repairs in public areas of the hospital. Norton's increase was caused by general repairs to patient rooms and equipment repairs in their Cardiac Catheterization Labs, Surgery and Radiology departments.
6. Insurance expense increased \$12.6 million, or 109%, primarily for self-insurance malpractice insurance coverage. Malpractice insurance expense is determined by outside actuaries, who calculate funding levels required to cover our malpractice claims. In 2017, lower funding levels were required based on favorable claims experience, primarily with our large dollar claim settlements, and our removal from lawsuits related to Infuse spine implant litigation. These favorable adjustments did not re-occur in 2018.
7. All other direct expenses increased by \$4.5 million, or 6%. We experienced increases for rents and leases, utilities, program expenses, special event costs, dues and subscriptions, and excise taxes. The Tax Cuts and Jobs Acts passed by Congress in 2017 added a new excise tax on certain tax-exempt organizations executive compensation effective in 2018.

As a result of greater total revenue growth than direct expense growth, EBITDA improved from \$204.9 million in 2017 to \$251.9 million in 2018.

Fixed expenses, which include depreciation and amortization and interest expense, increased \$12.4 million or 10%, \$7.6 million in depreciation and amortization expense and \$4.8 million in interest expense. The increase in depreciation and amortization expense occurred primarily at Audubon (\$3.2 million), NMG (\$1.4 million) and Properties (\$1.4 million). Audubon's increase was due to new construction, energy initiatives, and other renovations; NMG's was due to mammography equipment purchases, a roof replacement at one practice location, and general refurbishment projects being completed during the year. Properties' increase was due to hospital and physician practice expansions into new building locations. The increase in interest expense was caused by higher interest on our capitalized leases and higher interest on our bonds, primarily the 2016 bond issuances, partially offset by higher capitalized interest, which lowers interest expense.

Patient service margin increased from \$74.0 million in 2017 to \$108.6 million in 2018, or an improvement of \$34.6 million. Increased net patient service revenue and other revenue were partially offset by increases in drugs, salary and wages, employee benefits, insurance, professional fees, depreciation and amortization, supplies, fees and special services, interest, and repairs and maintenance.

Investment income was \$55.0 million and \$76.9 million for the years ending December 31, 2018 and 2017, respectively. This decline was caused by unrealized losses in 2018 on the alternative investment segment of our investment portfolio compared to unrealized gains in 2017 and increased investment manager fees partially offset by higher realized gains and increased interest and dividend income.

Operating income was \$163.6 million in 2018 compared to \$150.9 million in 2017. This represents an improvement of \$12.7 million and was the result of increased patient service margin partially offset by lower investment results.

Other non-operating revenues and expenses show a loss of \$106.5 million in 2018, which is a deterioration of \$154.6 million from the same period in 2017. Unrealized losses totaled \$95.2 million in 2018 compared to unrealized gains of \$60.0 million in 2017. When comparing our total investment results (investment income plus the change in unrealized losses or gains), our results have declined from income of \$136.9 million in 2017 to losses of \$40.2 million in 2018 or a deterioration of \$177.1 million. Net periodic pension cost was \$11.5 million and \$11.9 million for the years ending December 31, 2018 and 2017, respectively.

Other equity transactions show a gain of \$4.6 million and \$14.1 million for the years ending December 31, 2018 and 2017, respectively. In 2018 and 2017, we recorded a favorable adjustments (\$933,000 and \$1.8 million, respectively) to match the pension assets to the funded status of the plan as of December 31, 2018 and 2017, respectively. In 2018, restricted contributions were used at NCH for: renovation of outdoor therapeutic space, converting support space to patient care space, an imaging system, transport equipment, and telemetry monitoring equipment and at NCI for one of their practice locations for cancer patient services. In 2017, restricted contributions were used for equipment purchases at NCH, NBH, and NWCH and for office renovations at NMG. In 2017, we received a payment from Kosair Charities Committee (KCC) for \$10.0 million. This payment was a condition of the Settlement Agreement reached between Norton Healthcare, Inc. and KCC in 2016. This money is to be used for the Imaging Center at NCH.

Net assets increased by \$61.8 million and \$213.2 million for the years ending December 31, 2018 and 2017, respectively, a decline of \$151.4 million.

Balance Sheet – December 31, 2018 compared to December 31, 2017

Working capital increased \$70.7 million compared to the prior year end primarily due to the change in cash partially offset by increases in due to third party payors. Cash from operations was favorable for the year ending December 31, 2018. Also, another item significantly improving cash was the reimbursement to our cash balance for monies previously spent for eligible capital projects funded by 2016 bond proceeds. Other activities impacting cash but not working capital were funds used to pay the employer contribution to the 403(b)/401(k) saving plans

and prepaid expenses partially offset by the reduction in patient receivables. The liability for the savings plans is recorded in accrued payroll items.

Significant items impacting cash were:

- Collections on hospital/physician practice patient receivables and other miscellaneous receipts,
- Reimbursement for capital projects funded by bond proceeds,
- Receipt of Intensity Operating Allowance payments from Passport, and
- Cost report settlements,

which were partially offset by:

- Payments made for trade payables, payroll and related taxes, and provider taxes,
- Purchase of capital assets,
- Employer contributions to the 403(b)/401(k) savings plans,
- Bond principle deposits,
- Funding the semi-annual interest payments on our debt,
- Settlement of a managed care provider overpayment issue,
- Software licensing fees, and
- Malpractice liability settlements and annual funding.

The decline in net patient receivables was caused by improved cash collections and a new early out receivable collection program that began in June 2018. Inventories increased as the hospitals purchased additional implant items. Prepaid expenses increased due to payments made for software maintenance contracts and for additional prepayments made to our pharmacy supplier. The increase in accounts payable is due to timing of the invoice processing. The decline in accrued payroll items was due to payments made to the 403(b)/401(k) savings plans, net of accruals, and federal incomes taxes withheld and FICA taxes partially offset by an increase in physician bonuses. The increase in due to third party payors was caused by reserves being established for outpatient contractual allowances for changes made to our Charge Description Master, a commercial insurer overpayment issue, and the current year Medicare and Medicaid cost report filings partially offset by the settlement of a managed care provider overpayment issue.

Cash and investments available for debt service increased \$85.8 million, as follows:

(in millions)	12/31/2018	12/31/2017	Change
Operating Cash	\$ 194.5	\$ 122.7	\$71.8
Marketable Securities	127.5	124.8	2.7
Board Designated Funds	1,151.8	1,140.8	11.0
Bond Trustee Funds	21.9	21.6	0.3
Total	\$1,495.7	\$1,409.9	\$85.8

This increase was caused by an improved cash position, discussed above, and earnings on our investments. Please note, our average daily expenses increased from \$5.5 million at December 31, 2017 to \$5.9 million at December 31, 2018. As a result, our consolidated days cash on hand declined from 254 at December 31, 2017 to 252 at December 31, 2018.

Accounts receivable days outstanding decreased from 42.8 as of December 31, 2017 to 33.5 as of December 31, 2018. This decline was attributable to improved cash collections and a new early out receivable collection program that began in the June 2018.

The increase in assets limited by Board of Trustees was due to our exchange of membership units in Premier, Inc. (Premier) (\$59.0 million) into Class A common stock of Premier and earnings on our investments partially offset by unfavorable investment results. The value of the membership units in Premier are included in the Investment in Joint Venture line. Once these membership units were exchanged for Class A common stock, the value of the common stock was transferred to the assets limited by Board of Trustees line. The Premier common stock was

subsequently sold and the proceeds were invested according to our investment policy guidelines. The decrease in assets limited by Bond Indenture Trust was the result of reimbursement of capital projects from bond proceeds. The decline in assets limited by Self Insurance Trust was caused by claims payments and unfavorable investment results. Restricted Funds decreased due to unfavorable investment results and expenditures made by the NCH Project Fund for its Imaging Center, discussed in the other equity transaction section, above.

Property and equipment increased by \$90.1 million to \$968.4 million. This was the result of capital spending, primarily for: construction at Audubon, the purchase of two medical office buildings, construction of a new medical office building, NCH design fees, NBH tower expansion design fees, window replacement at Audubon, equipment purchases at the hospitals and NCI, energy savings initiative at Audubon and downtown facilities, and digital radiology equipment at NMG practice locations partially offset by depreciation.

The decline in other assets of \$46.5 million was caused by the exchange of membership units in Premier, discussed in the assets limited section, above, partially offset by an increase in the vendor incentive with Premier, an improvement in the mark to market position on the swap agreements, and an increase in pledges receivable, net of discounts.

Other non-current liabilities declined slightly as adjustments to match the pension asset to the funded status of the plan and distributions made from the deferred compensation plan were partially offset by accruals made to the pension plan to record net periodic pension cost.

Total debt decreased \$19.6 million due to payments made on the debt partially offset by an extension on a capital lease, amortization of bond discounts, and amortization of bond issue costs.

Thank you for your ongoing interest in Norton Healthcare. We are continually evaluating alternatives to manage and optimize our outstanding debt portfolio. We may from time to time seek to retire or purchase outstanding bonds through cash purchases, through a public Tender Offer, privately negotiated transactions, or otherwise at our sole discretion. Such purchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions, and other factors. The amount of bonds purchased or exchanged may be material. If you have any questions or concerns, please contact Helena Schulz at (502) 629-8263 or by e-mail at helena.schulz@nortonhealthcare.org.

Sincerely,



Adam D. Kempf
Senior Vice President and Chief Financial Officer

COMBINED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Norton Healthcare, Inc. and Affiliates
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Norton Healthcare, Inc. and Affiliates

Combined Financial Statements and Supplementary Information

Years Ended December 31, 2018 and 2017

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Report of Independent Auditors

The Board of Trustees
Norton Healthcare, Inc. and Affiliates

We have audited the accompanying combined financial statements of Norton Healthcare, Inc. and Affiliates, which comprise the combined balance sheets as of December 31, 2018 and 2017, and the related combined statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the combined financial position of Norton Healthcare, Inc. and Affiliates at December 31, 2018 and 2017, and the combined results of their operations and changes in net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Changes in Accounting Principles

As discussed in Note 1 to the combined financial statements, Norton Healthcare, Inc. and Affiliates changed its method for revenue recognition as a result of the adoption of Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, effective January 1, 2018, and changed its method of combined financial statement presentation during the year ended December 31, 2018, as a result of the adoption of ASU 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*. Our opinion is not modified with respect to these matters.

Ernst + Young LLP

April 2, 2019

Norton Healthcare, Inc. and Affiliates

Combined Balance Sheets

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 194,516	\$ 122,746
Marketable securities and other investments	127,504	124,792
Patient accounts receivable, net of allowance for doubtful accounts of \$106,890 for 2017	235,828	263,746
Inventory	56,974	50,418
Prepaid expenses and other	49,173	36,648
Miscellaneous receivables	20,334	20,527
Current portion of assets limited as to use	21,489	23,704
Total current assets	<u>705,818</u>	<u>642,581</u>
Assets limited as to use, net of current portion	1,380,057	1,454,294
Property and equipment, net	968,413	878,268
Other assets:		
Investments in joint ventures	17,213	63,705
Pledges receivable, net	22,679	21,735
Beneficial interest in trusts held by others	22,555	23,125
Goodwill and intangible assets, net of accumulated amortization of \$3,820 and \$3,711 for 2018 and 2017, respectively	20,517	20,626
Interest rate swap asset	2,366	711
Other assets	23,630	25,550
Total other assets	<u>108,960</u>	<u>155,452</u>
Total assets	<u><u>\$ 3,163,248</u></u>	<u><u>\$ 3,130,595</u></u>

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 84,739	\$ 78,284
Accrued expenses and other	77,035	75,517
Accrued payroll and related items	129,369	159,882
Due to third-party payors, net	47,378	32,107
Accrued interest	8,553	8,587
Current portion of long-term debt	37,150	37,266
Total current liabilities	<u>384,224</u>	<u>391,643</u>
Other non-current liabilities:		
Pension liability	77,149	66,702
Insurance liability	86,649	87,018
Other	69,598	80,374
Total other non-current liabilities	<u>233,396</u>	<u>234,094</u>
Long-term debt, net of current portion	1,079,693	1,099,213
Net assets:		
Without donor restrictions	1,347,999	1,286,240
With donor restrictions	117,936	119,405
Total net assets	<u>1,465,935</u>	<u>1,405,645</u>
Total liabilities and net assets	<u><u>\$ 3,163,248</u></u>	<u><u>\$ 3,130,595</u></u>

See accompanying notes.

Norton Healthcare, Inc. and Affiliates

Combined Statements of Operations and Changes in Net Assets

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Revenue:		
Net patient service revenue before provision for doubtful accounts	\$ —	\$ 2,210,815
Provision for doubtful accounts	—	(75,897)
Net patient service revenue	2,314,044	2,134,918
Other revenue	42,739	38,811
Donations and contributions	13,168	12,610
Joint venture income	827	756
Total revenue	2,370,778	2,187,095
Operating expenses:		
Labor and benefits	1,199,135	1,156,311
Professional fees	80,051	69,349
Drugs and supplies	528,791	474,054
Fees and special services	127,195	120,637
Repairs, maintenance, and utilities	80,652	75,210
Rent and leases	38,208	35,334
Insurance	24,105	11,517
Provider tax	20,130	20,130
Other	20,579	19,686
Total operating expenses	2,118,846	1,982,228
Earnings before fixed expenses and other gains (losses)	251,932	204,867
Fixed expenses:		
Depreciation and amortization	98,482	90,890
Interest expense	46,866	42,167
Interest rate swap benefit, net	(2,009)	(2,162)
	143,339	130,895
Patient service margin	108,593	73,972

Norton Healthcare, Inc. and Affiliates

Combined Statements of Operations and Changes in Net Assets (continued)

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Patient service margin	\$ 108,593	\$ 73,972
Investment gain	55,006	76,914
Operating gain	163,599	150,886
Non-operating (losses) gains:		
Change in net unrealized (losses) gains on investments	(95,191)	60,015
Change in interest rate swaps value	1,655	466
Petersdorf Fund grants	(1,368)	(301)
Net periodic pension cost	(11,469)	(11,925)
Other non-operating losses, net	(91)	(81)
Total non-operating (losses) gains	(106,464)	48,174
Excess of revenue over expenses	57,135	199,060
Net assets without donor restrictions:		
Change in pension plan asset and obligation	933	1,769
Net assets released from restriction for equipment	3,630	2,325
Capital project settlement proceeds	–	10,000
Other	61	–
Increase in net assets without donor restrictions	61,759	213,154
Net assets with donor restrictions:		
Contributions, fees, grants, bequests, net	12,793	5,691
Investment gain	2,677	4,125
Change in beneficial interest in trusts held by others	(1,079)	2,195
Change in net unrealized (losses) gains on investments	(4,211)	2,554
Net assets released from restriction	(11,649)	(9,425)
(Decrease) increase in net assets with donor restrictions	(1,469)	5,140
Increase in net assets	60,290	218,294
Net assets at beginning of year	1,405,645	1,187,351
Net assets at end of year	\$ 1,465,935	\$ 1,405,645

See accompanying notes.

Norton Healthcare, Inc. and Affiliates

Combined Statements of Cash Flows

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Operating activities		
Increase in net assets	\$ 60,290	\$ 218,294
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	98,482	90,890
Discount accretion	3,090	3,276
Change in net unrealized losses (gains) on investments	99,402	(62,569)
Change in interest rate swap values	(1,655)	(466)
Change in pension plan asset and obligation	(933)	(1,769)
Restricted contributions and investment gain	(14,391)	(12,011)
Capital project settlement proceeds	–	(10,000)
Cash provided by (used in) operating assets and liabilities:		
Change in patient accounts receivable	27,918	(16,060)
Change in assets limited as to use, net	(22,950)	61,972
Change in amounts due to third-party payors	15,271	(1,363)
Change in marketable securities and other investments	(2,712)	(105,948)
Change in other current and non-current assets and liabilities	(38,654)	1,695
Net cash provided by operating activities	<u>223,158</u>	<u>165,941</u>
Investing activities		
Purchase of property and equipment	(188,627)	(171,731)
Incremental investment in Regional Health Network of Kentucky and Southern Indiana, LLC	–	(886)
Change in joint ventures and other	46,492	(8,260)
Net cash used in investing activities	<u>(142,135)</u>	<u>(180,877)</u>
Financing activities		
Increase in long-term debt	13,615	–
Principal payments on long-term debt	(37,259)	(36,288)
Restricted contributions and investment gain	14,391	12,011
Net cash used in financing activities	<u>(9,253)</u>	<u>(24,277)</u>
Increase (decrease) in cash and cash equivalents	71,770	(39,213)
Cash and cash equivalents at beginning of year	122,746	161,959
Cash and cash equivalents at end of year	<u>\$ 194,516</u>	<u>\$ 122,746</u>

See accompanying notes.

Norton Healthcare, Inc. and Affiliates
Notes to Combined Financial Statements

December 31, 2018 and 2017

1. Description of Organization and Summary of Significant Accounting Policies

Organization

The accompanying combined financial statements of Norton Healthcare, Inc. include the transactions and accounts of Norton Healthcare, Inc. (the controlling company) and Affiliates, including the following: Norton Hospitals, Inc.; Norton Enterprises, Inc.; Norton Properties, Inc.; The Children's Hospital Foundation, Inc.; Norton Healthcare Foundation, Inc.; and Community Medical Associates, Inc. Norton Healthcare, Inc. and Affiliates are collectively hereafter referred to as the Corporation. The Corporation operates in the Louisville, Kentucky metropolitan area, and its operations include 1,837 licensed beds, 14 Norton Immediate Care Centers, and more than 200 primary care and specialty offices.

All significant intercompany transactions and accounts have been eliminated in combination.

Use of Estimates

The preparation of the combined financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) 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 combined financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Liquidity

As a business-oriented not-for-profit that is not solely dependent on donor contributions, the capital needs of the Corporation and operating budgets are coordinated so that anticipated cash needs are provided by current cash flow from operations, supplemented from time to time by debt financing. Included within current assets on the combined balance sheets are financial assets available for general expenditure within one year of December 31, 2018, and include cash and cash equivalents, marketable securities and other investments, patient accounts receivable and the current portion of assets limited as to use. See additional information with respect to these financial assets in Note 1 and Note 4. As part of the Corporation's management of liquidity, certain cash in excess of operating requirements for general expenditures is transferred to assets limited as to use. The Corporation's long-term assets limited as to use contain various investments that can be drawn upon, if necessary, to meet the liquidity needs of the Corporation within the next fiscal year. See Note 4 for additional information as it relates to assets limited as to use.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include all cash and highly liquid investments that are neither internally nor externally restricted. The Corporation considers highly liquid investments to be cash equivalents when they are both readily convertible to cash and so near to maturity (typically within three months) that their value is not subject to risk due to changes in interest rates. The amount of cash and cash equivalents carried on the combined balance sheets represents fair value.

Marketable Securities and Other Investments

Marketable securities and other investments consist primarily of marketable debt securities which are used by the Corporation to support short-term operational and capital needs. As of December 31, 2018 and 2017, \$21.4 million and \$28.2 million, respectively, included obligations whose maturities were greater than one year from the date of the combined balance sheets. Due to the markets in which these securities are traded, the Corporation believes the securities can be liquidated at their fair value and, therefore, have included the assets as current assets.

Inventory

Inventories (predominately medical and surgical supplies and pharmaceuticals) are primarily carried at the lower of cost (first-in, first-out method) or net realizable value.

Assets Limited as to Use and Investment Return

Assets limited as to use include a portfolio of investments that are set aside by the Board of Trustees (the Board) for future services, indigent care, education, research, and community health initiatives over which the Board retains control and may, at its discretion, subsequently use for other purposes. This portfolio of investments also includes assets restricted by donors. The Corporation utilizes a pooled investment program (the Master Trust Fund) to manage this portfolio of investments. Income is allocated to each entity based on its investment balance to the total investment balance by type of investment. All entities that participate in the Master Trust Fund are included in these combined financial statements. Other investments within assets limited as to use include assets held by trustees under a self-insurance trust agreement and assets under bond indenture trust agreements. Amounts required to meet current liabilities of the Corporation have been classified as current in the combined balance sheets at December 31, 2018 and 2017.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Investment securities 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 investment securities will occur in the near term, and that such change could materially affect the amounts reported in the combined balance sheets.

All investment securities are considered trading. Included in investment gain are interest, dividends, realized gains and losses on investments, and changes in the value of investments carried at net asset value (NAV). Investment gain and the change in net unrealized (losses) gains on investments are included in the excess of revenue over expenses unless a donor or law restricts the income or loss.

Alternative investments, including hedge funds, real estate funds, and private equity funds, are recorded under the equity method of accounting using NAV. The NAV of the alternative investments is based on valuations provided by the administrators of the specific financial instrument. The underlying investments in these financial instruments may include marketable debt and equity securities, commodities, foreign currencies, derivatives, and private equity investments. The underlying investments themselves are subject to various risks, including market, credit, liquidity, and foreign exchange risk. The Corporation believes the NAV is a reasonable estimate of its ownership interest in the respective alternative investments. The Corporation's risk of alternative investments is limited to its carrying value plus amounts committed to private equity funds as disclosed in Note 4. Alternative investments can be divested only at specified times in accordance with terms of the subscription agreements. Hedge fund redemptions typically contain restrictions that allow for a portion of the withdrawal proceeds to be held back from distribution when the underlying investments are liquidated subject to final valuation following the availability of the fund's next audited financial statements. These types of redemptions are subject to lock-up provisions that are generally imposed on the initial investment in the fund for a period of time. Private equity funds and real estate funds are generally closed-end funds and have significant redemption restrictions that prohibit redemptions during the fund's life. The financial statements of all of the Corporation's alternative investments are audited annually. Because these financial instruments are not readily marketable, the estimated carrying value is subject to uncertainty, and, therefore, may differ from the value that would have been used had a market for such financial instruments existed. The change in the carrying value of the alternative investments is included in investment gain in the combined statements of operations and changes in net assets.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

The Corporation has elected to account for common and collective trust funds at fair value as allowed under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 825, *Financial Instruments*. The Corporation believes that this election is appropriate given the nature of the investments and their similarity to mutual funds.

Fair Value of Financial Instruments

The Corporation follows the provisions of ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value. ASC 820 defines a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, and, as noted above, ASC 820 defines a three-level fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity and the reporting entity's own assumptions about market participants. The fair value hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs utilize quoted market prices in active markets for identical assets or liabilities.
- Level 2 – Inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset and liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.
- Level 3 – Inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific. In order to meet the requirements of ASC 820, the Corporation utilizes three basic valuation approaches to determine the fair value of its assets and liabilities required to be recorded at fair value. The first approach is the cost approach. The cost approach is generally the value a market participant would expect to replace the respective asset or liability. The second approach is the market approach. The market approach looks at what a market participant would consider an exact or similar asset or liability to that of the Corporation, including those traded on exchanges, to determine value. The third approach is the income approach. The income approach uses estimation techniques to determine the estimated future cash flows of the Corporation's respective asset or liability expected by a market participant and discounts those cash flows back to present value (more typically referred to as a discounted cash flow approach).

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed primarily using the straight-line method. Land improvements are depreciated over a range of 2 to 30 years. Buildings and equipment are depreciated over a range of 1 to 40 years. Costs incurred in the development and installation of internal-use software are expensed if they are incurred in the preliminary project stage or post-implementation stage, while certain costs are capitalized if incurred during the application development stage. Internal-use software is amortized over its expected useful life, generally between 1 and 10 years, with amortization beginning when the project is completed and the software is placed in service.

Useful lives of assets are determined through consultation of the American Hospital Association's *Life of Depreciable Hospital Assets* and in consideration of how the Corporation intends to use the asset or has used similar assets in the past. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization expense is included in depreciation and amortization in the combined statements of operations and changes in net assets.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Gifts of long-lived assets such as land, buildings, or equipment are reported as support without donor restrictions and are excluded from the excess of revenue over expenses. Such gifts are recorded at fair value at the date of donation. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as support with donor restrictions.

The Corporation evaluates long-lived assets used in operations for impairment as events and changes in circumstances indicate that the carrying amount of such assets might not be recoverable. Assets are grouped at the lowest level for which there is identifiable cash flows that are largely independent of the cash flows of other groups of assets. Impairment write-downs are recognized in the combined statements of operations and changes in net assets at the time the impairment is identified. There was no impairment of property and equipment recognized for the year ended December 31, 2018 or 2017.

Investments in Joint Ventures

The Corporation maintains an ownership percentage of 50% or less in various joint ventures and other companies that do not require combination. These investments are accounted for using the equity method or cost method of accounting, as appropriate.

The following is a summary of the investments in joint ventures:

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Premier Healthcare Alliance, LP <i>(Note 15)</i>	\$ 3,073	\$ 47,343
The Regional Healthcare Network of Kentucky and Southern Indiana, LLC <i>(Note 16)</i>	11,831	13,468
Other	2,309	2,894
	\$ 17,213	\$ 63,705

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

The following is a summary of joint venture income:

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Premier Healthcare Alliance, LP <i>(Note 15)</i>	\$ 2,472	\$ 2,557
The Regional Healthcare Network of Kentucky and Southern Indiana, LLC <i>(Note 16)</i>	(1,637)	(2,915)
Other	(8)	1,114
	\$ 827	\$ 756

Investments in joint ventures are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of the investment might not be recoverable. No impairment was recognized for the year ended December 31, 2018 or 2017.

Goodwill and Intangible Assets

The Corporation follows the provisions of ASC 958, *Not-for-Profit Entities*, which provides guidance for a not-for-profit entity with respect to goodwill and other intangible assets subsequent to an acquisition. In accordance with ASC 958, the Corporation tests goodwill and indefinite-lived intangible assets for impairment on an annual basis (October 1) utilizing qualitative and quantitative factors and between annual tests in certain circumstances. Goodwill impairment testing is done at the reporting unit level by comparing the fair value of the reporting unit's net assets against the carrying value of the reporting unit's net assets, including goodwill. The Corporation as a whole is defined as the reporting unit for purposes of impairment testing. If a quantitative analysis is performed, the fair value of net assets is generally estimated based on an analysis of discounted cash flows. The Corporation has goodwill and indefinite-lived intangible assets recorded related to a pathology laboratory, several physician practices, diagnostic centers, and an ambulatory surgical center license totaling \$20.5 million at both December 31, 2018 and 2017.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

The annual impairment test performed in 2018 and 2017 resulted in no adjustments to recorded goodwill and indefinite-lived intangible assets. Separate identifiable intangible assets, net of accumulated amortization, of \$0.1 million at December 31, 2018 and 2017, respectively, which are not deemed to have an indefinite life, continue to be amortized over their useful lives, which range from three to five years. Future amortization expense of these identifiable intangible assets is not material to the Corporation's combined financial statements.

Medical Malpractice and General Liability Self-Insurance

The Corporation is self-insured for medical malpractice and general liability claims. The provision for estimated self-insured medical malpractice and general liability claims includes estimates of the ultimate costs of settlement for both reported claims and claims incurred but not reported. The Corporation recorded total medical malpractice and general liability self-insurance liabilities of \$108.4 million and \$111.9 million as of December 31, 2018 and 2017, respectively. Medical malpractice and general liability self-insurance liabilities of \$23.4 million and \$26.6 million are included in accrued expenses and other current liabilities at December 31, 2018 and 2017, respectively, based on the expectation of the payout of claims in the subsequent year. Additionally, the Corporation has recorded total receivables of \$12.5 million and \$13.8 million as of December 31, 2018 and 2017, respectively, for anticipated reinsurance recoveries. Of total anticipated reinsurance recoveries, \$2.8 million and \$3.4 million are classified as current at December 31, 2018 and 2017, respectively, and are recorded in miscellaneous receivables on the combined balance sheets. The non-current portions of \$9.7 million and \$10.4 million at December 31, 2018 and 2017, respectively, are recorded in other assets on the combined balance sheets. The Corporation recorded a decrease in medical malpractice and general liability self-insurance expense of approximately \$0.3 million and \$11.5 million in 2018 and 2017, respectively, related to changes in actuarial estimates reflecting lower claim activity, closed claims, improved claim resolution history, and other environmental factors. The Corporation has engaged independent actuaries to estimate the ultimate costs of the settlement of such claims. Recorded medical malpractice and general liability self-insurance liabilities, discounted at 2.75% and 2.25% at December 31, 2018 and 2017, respectively, represent management's best estimate of ultimate costs.

The Corporation has excess loss insurance coverage for claims over the self-insured limits on a claims-made basis. Through the excess loss commercial policies, the Corporation is insured for losses up to established individual and aggregate claim limits.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

The Corporation's management is of the opinion that the accompanying combined financial statements will not be materially affected by the ultimate cost related to asserted and unasserted claims, if any, at the combined balance sheet date.

Under the terms of the self-insurance trust agreements for the self-insurance funds, the Corporation makes annual deposits with its trustee based upon actuarial funding recommendations. Amounts deposited and interest thereon can only be used to pay self-insured losses and related expenses. Such trust fund assets are reported as assets limited as to use. Investment returns from trustee assets are recorded as investment gain and change in net unrealized (losses) gains on investments, as applicable.

Net Assets with Donor Restrictions

Net assets with donor restrictions are those whose use by the Corporation has been limited by donors to a specific time period or purpose or have been restricted by donors to be maintained by the Corporation in perpetuity. Net assets with donor restrictions are primarily restricted for strategic capital projects or in support of the Corporation's mission.

Net Patient Service Revenue and Patient Accounts Receivable

Net patient service revenue is reported at the amount that reflects the consideration to which the Corporation expects to be entitled for providing patient care. These amounts are due from patients, third-party payors, and others and includes variable consideration for retroactive revenue adjustments due to settlements of reviews and audits.

Net patient service revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by the Corporation. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. The Corporation believes that this method provides a reasonable 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 receiving inpatient acute care services. The Corporation measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. These services are considered to be a single performance obligation.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Outpatient services are performance obligations satisfied at a point in time, and revenue is recognized when goods or services are provided, and the Corporation does not believe it is required to provide additional goods or services.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Corporation has elected to apply the optional exemption provided in FASB ASC 606, *Revenue from Contracts with Customers*, section 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 satisfied at the combined balance sheet date. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the combined balance sheet date. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the combined balance sheet date.

The Corporation has elected to use the portfolio approach practical expedient in ASC 606 for contracts related to net patient service revenue. The Corporation accounts for the contracts within each portfolio as a collective group, rather than recognizing net patient service revenue on an individual contract basis, based on the payment pattern expected in each portfolio category and the similar nature and characteristics of the patients within each portfolio. The portfolios consist of major payor classes for inpatient net patient service revenue and outpatient net patient service revenue. Based on the historical collection trends and other analysis, the Corporation believes that net patient service revenue recognized by utilizing the portfolio approach approximates the net patient service revenue that would have been recognized if an individual contract approach were used.

The Corporation has agreements with third-party payors that provide for payment to the Corporation at amounts different than the Corporation's established charges. For uninsured patients who do not qualify for charity care, the Corporation recognizes net patient service revenue based on established charges, subject to certain discounts and implicit price concessions determined by the Corporation. The Corporation determines the transaction price based on standard charges for services provided, reduced by explicit price concessions provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with the Corporation's policy, and/or implicit price concessions provided to uninsured patients. Explicit price concessions are based on contractual agreements, discount policies, and historical experience. Implicit price concessions represent differences between amounts billed and the estimated consideration the Corporation expects to receive from patients, which are determined based on historical collection experience, current market conditions, and other factors.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Generally, patients who are covered by third-party payors are responsible for patient responsibility balances, including deductibles and coinsurance, which vary in amount. The Corporation estimates the transaction price for patients with deductibles and coinsurance based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any explicit price concessions, discounts, and/or 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 change. Adjustments arising from a change in the transaction price were not significant in 2018.

In rare instances, the Corporation receives payment in advance of the services provided and considers these amounts to represent contract liabilities. Contract liabilities at December 31, 2018 were not significant to the Corporation.

The Corporation is paid prospectively determined rates for the majority of inpatient acute care, outpatient, and ambulatory care services provided (principally Medicare, Medicaid, and certain commercial payors). This net patient service revenue is subject to retroactive adjustments due to audits, reviews, change in program administration and rules, and outcome of litigation. These settlements are estimated based on the agreement with the payor and correspondence, which includes an assessment to ensure it is probable that a significant reversal in the amount of cumulative net patient service revenue recognized will not occur when the uncertainty associated with the retroactive adjustments is subsequently resolved.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Corporation believes that it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. The Corporation has established a corporate compliance program to assist in maintaining compliance with such laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines and penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that current recorded estimates will change by material amounts in the near term.

Reported costs and/or services provided under certain arrangements are subject to retroactive adjustments due to reviews and audits. These adjustments are considered variable compensation and are included in the determination of the estimated transaction price for providing patient care in the period the related services are provided. These settlements are estimated based on the terms

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

of the payment agreement with the payor, correspondence from the payor, and the Corporation's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of net patient service 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 or as years are settled or are no longer subject to reviews or audits. The Corporation recorded an increase in net patient service revenue of approximately \$14.5 million and \$6.0 million in 2018 and 2017, respectively, as a result of changes in estimated settlements with Medicare, Medicaid, and other commercial payors.

Provision for Doubtful Accounts

The provision for doubtful accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for doubtful accounts to establish an appropriate allowance for doubtful accounts.

As a result of certain changes required by Accounting Standards Update (ASU) 2014-09, the majority of the Corporation's provision for doubtful accounts is recorded as a direct reduction to net patient service revenue instead of being presented as a separate line on the combined statements of operations and changes in net assets. The adoption of ASU 2014-09 has no impact on the Corporation's patient accounts receivable as it was historically recorded net of the allowance for uncollectible accounts and contractual adjustments on the combined balance sheets.

Charity Care

As a part of its not-for-profit mission, the Corporation provides care to patients who may be unable to pay. For those patients meeting certain criteria, the Corporation does not pursue collection of amounts determined to qualify as charity care. The Corporation follows FASB ASU 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*. ASU 2010-23 requires that cost be used as the measurement for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing charity care. ASU 2010-23 also requires entities to disclose any reimbursement received to offset the cost of providing charity care. The Corporation estimates charity care cost by calculating a ratio of cost to gross charges, and then multiplying the

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

ratio by the gross charges attributable to patients that qualify for charity care, based on the Corporation's policy. The cost associated with charity care provided was approximately \$14.0 million and \$10.0 million in 2018 and 2017, respectively. To offset the cost of charity care provided, the Corporation received state means program reimbursement and other financial assistance related receipts of \$3.9 million and \$4.8 million in 2018 and 2017, respectively.

Other Revenue

Other revenue is recognized at an amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing goods and services. The amounts recognized reflect consideration due from customers, third-party payors, and others in accordance with ASC 606. Primary categories include capitation revenue, rental income, parking revenue, research revenue, technical service fee revenue, and revenue from other miscellaneous sources.

Excess of Revenue Over Expenses

The combined statements of operations and changes in net assets include subtotals for patient service margin, operating gain, and excess of revenue over expenses. The line excess of revenue over expenses represents the operating indicator for the Corporation as defined under U.S. GAAP. Changes in net assets without donor restriction, which are excluded from excess of revenue over expenses, consistent with industry practice, include or may include contributions of long-lived assets, net assets released from restriction for equipment, investment returns on assets with donor restrictions, and changes in pension plan asset and obligation.

Gifts with Donor Restrictions

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as support with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the combined statements of operations and changes in net assets as donations and contributions if the purpose relates to operations, or as a change in net assets without donor restrictions if the purpose relates to purchase of property and equipment.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Beneficial Interest in Trusts Held by Others

The Corporation is an income beneficiary of irrevocable trust funds held by others. The Corporation has recorded the fair value of the ownership interest of the trusts in its combined balance sheet and the changes in the fair values of the ownership interests of the trusts as net assets with donor restriction.

Contributions Received and Pledges Receivable

Contributions without donor restriction are recorded as contributions and donation revenue within the combined statement of operations and changes in net assets when received. Pledges are recorded as contributions, fees, grants bequests, net as net assets with donor restriction in the year pledged. Unconditional donor pledges to give cash, marketable securities, and other assets are reported at present value, through a discounted cash flow approach, at the date the pledge is made. Pledges receivable are discounted based on the nature of the individual pledge consistent with the Corporation's policy. Discount rates ranged from 0.03% to 1.37% at December 31, 2018 and 2017. Discount rates reflect the economic conditions of the year in which the pledge was made.

Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges received with donor restrictions on the use of the donated assets are reported as net assets with donor restriction until the donor restriction expires. An allowance for uncollectible pledges is recorded for amounts the Corporation has deemed uncollectible.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Outstanding pledges receivable from various corporations, foundations, and individuals are as follows:

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Gross pledges due:		
In less than one year	\$ 11,487	\$ 10,792
In one to five years	4,610	4,533
In more than five years	31,180	29,725
	47,277	45,050
Allowance for uncollectible pledges	(1,441)	(1,455)
Discounting	(13,111)	(12,523)
Net pledges receivable	32,725	31,072
Less current portion	(10,046)	(9,337)
Net pledges receivable long-term	\$ 22,679	\$ 21,735

The current portion of pledges receivable is included in miscellaneous receivables on the combined balances sheets.

Income Taxes

Most of the income generated by the Corporation is exempt from taxation under Section 501(a) of the Internal Revenue Code. Certain of the Corporation's affiliates are taxable entities and some of the income generated by otherwise exempt entities is subject to taxation as unrelated business income. The Corporation files federal and Kentucky state income tax returns. The statute of limitations for tax years 2015 through 2017 remains open in the major U.S. taxing jurisdictions in which the Corporation is subject to taxation, and the 2018 tax year's statute of limitations will begin once returns for that year are filed. In addition, for all tax years prior to 2016 generating or utilizing a net operating loss (NOL), tax authorities can adjust the amount of NOL carryforward to subsequent years.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

As of December 31, 2018, the Corporation has NOL carryforwards of approximately \$28.0 million (\$21.4 million at December 31, 2017). These NOL carryforwards expire in years 2019 to 2038. As a result of the NOL carryforwards, the Corporation recorded a deferred income tax asset of \$7.8 million and \$5.7 million at December 31, 2018 and 2017, respectively. The Corporation evaluates the realizability of the deferred tax assets annually. Based on the cumulative losses incurred by Norton Enterprises, Inc. over the previous five-year period and future projections, the Corporation determined it is not probable that future taxable income will be available to apply against the deferred tax assets. As a result, the Corporation recorded a full valuation allowance of \$7.8 million and \$5.7 million at December 31, 2018 and 2017, respectively.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The primary impact in 2017 on the Corporation was the Act reduced the U.S. federal corporate tax rate from 35% to 21% which required a remeasurement of the Corporation's deferred taxes. For tax-exempt entities, effective beginning in the 2018 tax year, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. At December 31, 2017, the Corporation has made a reasonable estimate of the tax effects of the enactment of the Act and remeasured its deferred tax balances, which did not have a material impact on the Corporation as all deferred tax balances are offset by a full valuation allowance. The Corporation did not record any material changes to its December 31, 2017, estimates in 2018. Additionally, the Corporation did not record any material amounts during the year ended December 31, 2018, related to the new requirements under the Act.

Recent Accounting Pronouncements

Recently Adopted

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most of the current revenue recognition guidance, including industry-specific guidance, and requires expanded disclosures about revenue recognition. The core principle of the revenue model is that an entity recognizes 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 exchanges for those goods or services. The Corporation adopted ASU 2014-09 on January 1, 2018, using the cumulative catch-up transition method. The

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Corporation has performed an analysis of revenue streams and transactions under ASU 2014-09. In particular, for net patient service revenue, the Corporation performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that net patient service revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Upon adoption, the majority of what was previously classified as provision for doubtful accounts and presented as a direct reduction to net patient service revenue on the combined statements of operations and changes in net assets is treated as a price concession that reduces the transaction price, which is reported as net patient service revenue. ASU 2014-09 also required enhanced disclosures related to the disaggregation of net patient service revenue and significant judgments made in measurement and recognition. The impact of adoption of ASU 2014-09 was not material to total revenue, excess of revenue over expenses, or total net assets.

Effective December 31, 2018, the Corporation adopted FASB ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. ASU 2016-14 changes certain financial statement requirements for not-for-profit entities in an effort to make the information more meaningful to users and reduced reporting complexity. The Corporation adopted ASU 2016-14 in its combined financial statements effective December 31, 2018, applying it retrospectively to all periods presented. The impact of adoption changes the classification of net assets on the combined balance sheets and combined statements of operations and changes in net assets from three classes to two classes of net assets. The Corporation also added additional disclosure for the liquidity and availability of financial assets at the combined balance sheet date to meet cash needs for general expenditures within one year and disaggregated functional expense classifications by their natural expense classification. The impact of adoption of ASU 2016-14 had no impact to revenues, excess of revenue over expenses, or total net assets.

In August 2018, the FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20)*. This update clarifies specific requirements and adds disclosure requirements considered relevant to financial statement users of organizations that sponsor defined benefit pension plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2021, with early adoption permitted. The Corporation elected to early adopt ASU 2018-14 in its combined financial statements effective for the year ended December 31, 2018. ASU 2018-14 has been applied retrospectively as relates to enhanced disclosures to all periods presented.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

1. Description of Organization and Summary of Significant Accounting Policies (continued)

Yet to be Adopted

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheets. The ASU will require disclosures to help the financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The ASU is effective for the Company beginning January 1, 2019 and will be applied using a modified retrospective approach. The Company is currently in the process of evaluating its lease contracts as well as certain service contracts that may include embedded leases. Additionally, the Company is finalizing its analysis of certain key assumptions that will be utilized at the transition date including the incremental borrowing rate. The primary effect of the new standard will be to record right-of-use assets and obligations for current operating leases which will have a material impact on the balance sheet and significant incremental disclosures in the financial statement footnotes. The transition adjustment is not expected to have a material impact on the statement of operations and changes in net assets.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. ASU 2018-08 intends to clarify and improve current accounting guidance to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. ASU 2018-08 is effective for the Corporation for annual reporting periods beginning after June 15, 2018. The Corporation is currently assessing the impact that ASU 2018-08 will have on its combined financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820)*. ASU 2018-13 improves the disclosure requirements on fair value measurements and is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Corporation is currently evaluating the impact ASU 2018-13 will have on its combined financial statements.

Reclassification

Certain balances in the 2017 combined balance sheet, combined statement of operations and changes in net assets, and footnote disclosures have been reclassified to conform to current year presentation. The effect of such reclassifications did not change total net assets, operating gain, or excess of revenue over expenses.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

2. Community Service (Unaudited)

The Corporation continues to build on a tradition of community service established over 100 years ago by its predecessor organizations, with a mission to provide quality health care to all those served. Through Norton Children’s Hospital and Norton Children’s Medical Center tertiary, acute-level inpatient services, and emergency and outpatient specialty care, are provided to children who live throughout Kentucky and Southern Indiana, regardless of ability to pay. In addition, many patients treated at Norton Hospital, Norton Audubon Hospital, Norton Women’s and Children’s Hospital, and Norton Brownsboro Hospital receive free or discounted care. The Corporation is a major participant in the residency and medical education programs of the University of Louisville School of Medicine.

The Corporation uses the 2017 edition of the Catholic Health Association’s *Guide for Planning and Reporting Community Benefit* (CHA guidelines) to report the community benefit amounts.

In 1987, the Corporation established a fund designated for providing indigent care, education, research, and community health initiatives, now known as the James R. Petersdorf Fund (Petersdorf Fund) (see Note 4). Other programs that benefit the Corporation’s community are listed below.

The costs associated with providing community service are as follows:

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Charity care ^(A)	\$ 10,069	\$ 5,159
Educational support	41,666	39,702
Unpaid cost of Medicaid services	95,365	97,433
Sponsorships	1,865	1,700
Community cancer initiatives	5,249	4,499
Community service activities	1,043	1,291
Other community benefits	11,819	7,411
	\$ 167,076	\$ 157,195

^(A) Consistent with IRS Form 990 requirements and CHA guidelines, this amount is to be reported net of state means programs and amounts received specifically to provide financial assistance. The Corporation received state means program reimbursement and other financial assistance related receipts of \$3.9 million and \$4.8 million in 2018 and 2017, respectively.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

3. Property and Equipment

Property and equipment consists of:

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Land and land improvements	\$ 47,715	\$ 44,919
Buildings	1,073,218	926,447
Equipment	1,147,946	1,051,433
	<u>2,268,879</u>	<u>2,022,799</u>
Accumulated depreciation and amortization	<u>(1,446,653)</u>	<u>(1,349,530)</u>
	822,226	673,269
Construction-in-process	146,187	204,999
	<u>\$ 968,413</u>	<u>\$ 878,268</u>

Equipment includes computer software costs of \$96.8 million and \$82.4 million at December 31, 2018 and 2017, respectively, which are primarily related to the Corporation's clinical and revenue cycle information systems. The accumulated depreciation related to computer software recorded in accumulated depreciation and amortization is \$69.4 million and \$59.1 million at December 31, 2018 and 2017, respectively. The expense related to computer software recorded in depreciation and amortization expense on the combined statements of operations and changes in net assets was \$8.4 million and \$5.6 million for the years ended December 31, 2018 and 2017, respectively.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

4. Assets Limited as to Use and Investment Return

Asset Limited as to Use

The composition of assets limited as to use is set forth in the following table by type of Board designation or restriction. Assets limited as to use are carried at fair value, except for alternative investments (consisting of hedge funds, real estate funds, and private equity funds), which are accounted for under the equity method of accounting.

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
By Board of Trustees for indigent care, education, research, and community health initiatives (Petersdorf Fund)	\$ 130,657	\$ 136,715
By Board of Trustees	1,021,098	1,004,070
By self-insurance trust agreements	95,327	114,600
Less current portion	(20,631)	(23,208)
By self-insurance trust agreements, net	74,696	91,392
By bond indenture trust agreements	72,846	135,601
Less current portion	(19)	(21)
By bond indenture trust agreements, net	72,827	135,580
By contractual agreement (<i>Note 12</i>)	29,888	32,369
Less current portion	(839)	(476)
By contractual agreement	29,049	31,893
By donors	51,730	54,644
	\$ 1,380,057	\$ 1,454,294

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

4. Assets Limited as to Use and Investment Return (continued)

The Corporation's investment portfolio is structured in a manner that matches investment risk and return. Short-term volatility and uncertainty of investment results are recognized as real risks that are managed through specific asset allocation strategies and diversification. The assets limited as to use by the Board are excluded from current assets as they are not intended to be used within one year. The Board meets routinely throughout the year, and should an unforeseen need arise, could choose to designate those funds for current use within the assets limited as to use by the Board.

The Corporation's actual weighted-average allocations for assets limited as to use, by asset category, are as follows:

	December 31	
	2018	2017
Cash and cash equivalents	3.5%	3.4%
Marketable debt securities	18.0	21.4
Marketable equity securities	4.7	4.0
Mutual funds	38.5	38.8
Private equity funds	6.0	1.8
Hedge funds	19.3	20.7
Real estate funds	7.4	6.5
Common and collective trust funds	2.6	3.4
	100.0%	100.0%

At December 31, 2018, the Corporation has committed capital yet to be called of approximately \$23.6 million to private equity funds over the next one to three years (\$34.9 million at December 31, 2017).

Investment Return

Investment return is shown under net assets without donor restrictions and net assets with donor restrictions in the line items titled investment gain (included in operating gain for the net assets without donor restriction) and change in net unrealized (losses) gains on investments (included in non-operating (losses) gains for net assets without donor restrictions).

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

4. Assets Limited as to Use and Investment Return (continued)

The following is a summary of the key components of investment return:

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Investment gain by net asset class:		
Without donor restrictions	\$ 55,006	\$ 76,914
With donor restrictions	2,677	4,125
Total investment gain	<u>\$ 57,683</u>	<u>\$ 81,039</u>
Components of investment gain:		
Interest and dividends	\$ 29,081	\$ 23,168
Income distributions from trusts	1,107	1,128
Investment fees	(4,557)	(3,865)
Net realized gains on investments recorded at fair value	38,670	24,805
Net realized losses on investments recorded at other than fair value	-	(1,350)
Change in net unrealized (losses) gains on investments recorded at other than fair value	(6,618)	37,153
Total investment gain	<u>\$ 57,683</u>	<u>\$ 81,039</u>

The total changes in net unrealized (losses) gains on investments with and without donor restrictions was \$(99.4) million and \$62.6 million for the years ended December 31, 2018 and 2017, respectively, and is solely composed of the change in net unrealized (losses) gains on investments recorded at fair value.

5. Fair Value Measurements

The following table summarizes the recorded amount of assets and liabilities by class of asset or liability recorded at fair value on a recurring basis. Certain assets are marked as not applicable (N/A), as they are not recorded at fair value, or elected to be recorded at fair value, on a recurring basis. The valuation level of the asset or liability as defined by ASC 820 is included for assets and liabilities carried at fair value.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

	December 31		Level
	2018	2017	
	<i>(In Thousands)</i>		
Marketable securities and other investments, at fair value			
Total marketable debt securities ^(A)	\$ 127,504	\$ 124,792	2
Assets limited as to use, at fair value			
By Board of Trustees and donors:			
Cash	8,648	138	1
Mutual funds:			
Templeton Global Equity Fund ^(B)	73,281	95,802	1
PIMCO Real Return Fund ^(C)	41,104	46,170	1
Capital World Growth and Income Fund ^(D)	82,224	88,032	1
Dodge & Cox Global Stock Fund ^(E)	75,007	82,280	1
Dreyfus Global Equity Fund ^(F)	91,783	91,315	1
Wells Capital Management Core Fixed Income ^(G)	51,505	53,673	1
Vanguard Emerging Market Stock Fund ^(H)	19,582	22,913	1
MetWest Total Return Bond Fund ^(I)	51,516	51,951	1
Other publicly traded mutual funds ^(J)	39,947	41,560	1
Total mutual funds	<u>525,949</u>	<u>573,696</u>	1
Common and collective trust funds ^(K)	35,711	50,172	NAV
Separately-managed accounts:			
PNC ^(L)	—	15	2
Sterling Capital ^(M)	63,114	64,211	2
EPOCH All Cap US Equity ^(N)	50,643	37,589	1
Baron ^(O)	9	5	1
Disciplined Growth Investors ^(P)	49,355	37,892	1
Other ^(Q)	1,109	1,680	1
Total separately-managed accounts	<u>164,230</u>	<u>141,392</u>	
Total assets limited as to use by Board of Trustees and donors, at fair value	<u>\$ 734,538</u>	<u>\$ 765,398</u>	

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

	December 31		Level
	2018	2017	
	<i>(In Thousands)</i>		
By contractual agreements:			
Cash	\$ 29,888	\$ 32,369	1
Total assets limited as to use by contractual agreements, at fair value	29,888	32,369	
By self-insurance trust agreements:			
Mutual fund:			
Sterling Behavioral Small Cap Value ^(R)	3,804	5,717	1
Total mutual funds	3,804	5,717	
Separately-managed accounts:			
Cash	2,990	5,957	1
Marketable debt securities ^(S)	71,474	81,742	2
Sterling Special Opportunities Equity ^(T)	17,059	21,184	1
Total separately-managed accounts	91,523	108,883	
Total assets limited as to use by self-insurance trust agreements, at fair value	95,327	114,600	
By bond indenture trust agreements:			
Cash	19	21	1
Marketable debt securities ^(U)	72,827	135,580	2
Total assets limited as to use by bond indenture, at fair value	72,846	135,601	
Total assets limited as to use, at fair value	932,599	1,047,968	
Assets limited as to use at other than fair value:			
Hedge funds ^(V)	321,449	306,855	N/A
Real estate funds ^(W)	103,968	96,699	N/A
Private equity ^(X)	43,530	26,476	N/A
Total assets limited as to use at other than fair value	468,947	430,030	
Less current portion of self-insurance trust and bond indenture trust and assets limited as to use in escrow	(21,489)	(23,704)	
Total assets limited as to use	\$ 1,380,057	\$ 1,454,294	
Other assets at fair value:			
Beneficial interest in trusts held by others <i>(Note 1)</i>	\$ 22,555	\$ 23,125	2
Interest rate swap asset <i>(Note 7)</i>	\$ 2,366	\$ 711	2

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

- (A) Investment-grade readily marketable corporate debt securities (95%), municipal fixed-income securities (3%) and money market funds invested in high-quality fixed-income securities (2%).
- (B) Mutual fund invests in domestic and international equities to achieve long-term capital growth. Fund strives to exceed the MSCI World Index.
- (C) Mutual fund seeks to maximize real returns by investing the majority of its assets in Treasury Inflation Protected Securities (TIPS) issued by the U.S. government. The fund may also invest in U.S. Treasury securities, corporate bonds, mortgage-backed securities and emerging market bonds to add value when opportunities arise.
- (D) Mutual fund invests in domestic and international equities with a focus on companies paying regular dividends and strives to exceed the MSCI World Index.
- (E) Mutual fund invests in equity securities issued by medium-to-large-sized well-established global companies, including those domiciled in emerging markets, and strives to exceed the MSCI World Index.
- (F) Mutual fund invests in domestic and international equities and strives to exceed the MSCI World Index.
- (G) Mutual fund seeks to deliver excess return relative to the taxable fixed-income universe as measured by the Barclays U.S. Aggregate Bond Index.
- (H) Mutual fund seeks to provide long-term capital appreciation. The fund invests mainly in equity securities of companies located in emerging markets including small, mid, and large capitalization companies.
- (I) Mutual fund seeks to maximize long-term total return. At least 80% of its net assets are invested in investment grade fixed income securities or unrated securities of similar quality. Up to 20% of its net assets may be invested in securities rated below investment grade.
- (J) Various other publicly traded mutual funds invested in a variety of money market, fixed-income, domestic equity, and international equity mutual funds. The equity mutual funds are diverse in investment strategies, including both value and growth and a variety of market capitalizations.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

- (K) Common and collective trust fund whose objective is to maximize real return by investing in a variety of securities that offer strong relative performance in a rising inflation environment. This common and collective trust fund seeks to exceed the Dow Jones AIG Commodity Total Return Index.
- (L) Manager invests in marketable corporate debt securities (44%), U.S. government fixed-income securities (53%) and other fixed-income investments (3%) that strives to provide a return better than traditional cash or money market portfolios.
- (M) Manager invests primarily in marketable corporate debt securities (64%), U.S. government fixed-income securities (29%), and other fixed-income investments (7%) with the objective of maximizing total return while preserving capital. Manager strives to exceed the Barclays Capital Aggregate Index.
- (N) Manager invests in domestic equities across various industries with a value orientation and high rates of free cash flow. Manager strives to exceed the Russell 3000 Value Index.
- (O) Manager invests in domestic equities across various industries with a variety of market capitalizations with a growth orientation and strives to exceed the Russell 3000 Growth Index.
- (P) Manager seeks to invest in mid-cap companies with market caps between \$1 billion and \$10 billion that are expected to yield high returns. The portfolio will generally hold between 40-50 securities with an average turnover ratio ranging from 15% to 30%.
- (Q) Conglomeration of smaller accounts whose components are not deemed material for individual breakout. Largest holding is a money market fund (67%).
- (R) Mutual fund that seeks to capitalize on behaviorally driven market anomalies by employing a disciplined investment process that ranks small capitalization companies in the fund's universe based on a number of factors including valuation, price momentum and earnings revisions.
- (S) Externally managed portfolio holding investment grade U.S. agency and U.S. Treasury fixed-income securities whose maximum maturity does not exceed five years.
- (T) Equity portfolio that primarily invests in companies with the best perceived combination of underlying growth potential and attractive valuation in a high conviction portfolio of 25 to 40 holdings.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

- (U) Externally managed portfolio holding primarily U.S. agency and Treasury securities (approximately 73% of the portfolio) and highly rated municipal and commercial paper fixed-income securities (approximately 27% of the portfolio) structured to generate returns while protecting principal and providing liquidity to fund draws on the project fund.
- (V) The hedge funds are composed of both fund of funds and direct hedge funds that seek to provide equity-like returns over a full market cycle with reduced volatility and low correlation. The hedge fund total consists for twelve separate funds. The managers employ various strategies, including, but not limited to, long/short equity, long/short credit, distressed credit, merger/credit arbitrage, and macrotrading strategies.
- (W) The real estate funds include an actively managed private real estate investment trust (REIT) composed of participating mortgages and wholly owned real estate investments. The real estate fund total consists of two separate funds. A smaller portion of the holdings include a commingled real estate fund, which includes the purchase of REITs, real estate properties, private equity funds, public debt securities, and high-yield private debt.
- (X) The private equity funds are comprised of limited partnerships that invest in the equity and debt of privately held companies. The private equity fund total consists of eight separate funds. The objective of these strategies is to provide a return that exceeds that of public equity markets over a long-term time period. These investments will typically have a life of five to ten years depending on the strategy.

Valuation

Marketable Debt Securities, Other Investments, and Assets Limited as to Use

Level 1 securities are stated at quoted market prices. The Corporation's various investment portfolios are held by a variety of managers and these managers use external pricing services in providing the valuation for all levels of securities. The Corporation does not adjust the quoted market prices for such financial instruments.

Level 2 securities include valuations based upon direct and indirect observable market inputs that may utilize the market, income, or cost approaches in determination of their fair value. The pricing services use a variety of pricing models and inputs based upon the type of security being valued. These inputs may include, but are not limited to the following: reported trades; similar security trade data; bid/ask spreads; institutional bids; benchmark yields; broker/dealer quotes; issuer spreads; yield to maturity; and corporate, industry, and economic events.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

As nearly all of the Corporation's marketable debt securities are actively traded, the recorded fair value reflects current market conditions. However, due to the inherent volatility in the investment market, there is at least a possibility that recorded investment values may change by a material amount in the near term.

The common and collective trust funds are valued at NAV, as a practical expedient, provided by the respective fund administrators. Management has determined that the NAV is an appropriate estimate of the fair value of the common and collective trust funds at December 31, 2018 and 2017, based on the fact that the common and collective trust funds are audited and accounted for at fair value by the administrators of the respective common and collective trust funds. There are no restrictions on the ability of the Corporation to redeem any of the common and collective trust funds at December 31, 2018 or 2017.

Beneficial Interests in Trusts Held by Others

The Corporation is an income beneficiary of irrevocable trust funds held by others. The Corporation has recorded the fair value of the ownership interest of the irrevocable trust funds based on its pro rata share of the underlying assets or income. Based on the observable inputs, typically marketable debt or equity securities held in the irrevocable trust funds, the Corporation has determined its beneficial interests in outside trust funds held by others fall in Level 2 of the fair value hierarchy. This technique is consistent with the market approach.

Interest Rate Swap Asset

The fair value is calculated based on a discounted cash flow model, taking into consideration the terms of each interest rate swap and the credit rating of the Corporation or counterparty, as applicable. Based on the observable inputs, typically published interest rates and credit spreads, the Corporation has determined its interest rate swaps fall in Level 2 of the fair value hierarchy. The specific Corporation inputs are disclosed in Note 7. This technique is consistent with the income or discounted cash flow approach.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Value Measurements (continued)

Other Fair Value Measurements

The carrying value of pledges receivable is required to be disclosed at fair value under applicable accounting guidance. The fair value of the Corporation's pledges receivable, based on discounted cash flow analysis and adjusted for consideration of the donor's credit, is \$32.7 million and \$31.1 million at December 31, 2018 and 2017, respectively. These fair values are determined using a Level 2 methodology in the fair value hierarchy based on observable inputs through formal pledge agreements and other similar documents, as well as market interest rates.

Certain financial instruments are not required to be marked to fair value on a recurring basis, and, therefore, the level of disclosure is noted as not applicable.

6. Net Patient Service Revenue

Net patient service revenue by major payor source, net of price concessions is as follows:

	Year Ended	
	December 31, 2018	
	<i>(In Thousands)</i>	
Commercial	\$ 1,190,284	52%
Medicare	675,373	29%
Medicaid	396,830	17%
Self-pay and other	51,557	2%
	<u>\$ 2,314,044</u>	<u>100%</u>

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

6. Net Patient Service Revenue (continued)

Net patient service revenue by major payor source, net of contractual adjustments and discounts and before the provision for doubtful accounts is as follows:

	Year Ended	
	December 31, 2017	
	<i>(In Thousands)</i>	
Commercial	\$ 1,112,968	50%
Medicare	649,143	30%
Medicaid	427,346	19%
Self-pay and other	21,358	1%
	<u>\$ 2,210,815</u>	<u>100%</u>

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt

Long-term debt consists of the following:

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Louisville/Jefferson County Metro Government Health System Revenue Bonds, Series 2016, dated August 11, 2016 (2016 Bonds)	\$ 573,400	\$ 592,675
Louisville/Jefferson County Metro Government Health System Revenue Bonds, Series 2013, dated September 26, 2013 (2013 Bonds)	204,580	204,580
Louisville/Jefferson County Metro Government Health System Fixed Rate Revenue Refunding Bonds, dated October 31, 2012 (2012A Bonds)	6,400	7,000
Louisville/Jefferson County Metro Government Health System Variable Rate Revenue Bonds, dated August 10, 2011 (2011 Bonds)	82,725	85,545
Kentucky Economic Development Finance Authority, Health System Revenue Bonds, Series 2000, dated October 1, 2000 (2000 Bonds)	189,420	200,560
	1,056,525	1,090,360
Unamortized premiums	18,360	15,263
Less unamortized deferred financing costs	(8,938)	(9,856)
	1,065,947	1,095,767
Capital leases	50,896	40,712
Total long-term debt	1,116,843	1,136,479
Less amounts due within one year	(37,150)	(37,266)
Total long-term debt, net of current portion	\$ 1,079,693	\$ 1,099,213

The 2000 Bonds are secured by a mortgage lien on the principal hospital facilities and parking garages of Norton Hospitals, Inc. built before 2006. The net book value of these properties is \$97.9 million and \$105.2 million at December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, all bonds outstanding are tax-exempt bond issues. All bonds are secured by a security interest in certain pledged collateral, including the operating revenue of the Obligated Group (defined as Norton Healthcare, Inc. and Norton Hospitals, Inc.). Principal and interest related to the bonds are payable solely by the Obligated Group.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

Deferred financing costs are being amortized over the life of the respective bond issues using the effective interest method for fixed-rate bonds and the bonds outstanding method for variable-rate bonds.

The Corporation has agreed to certain covenants, which, among other things, limit additional indebtedness and guarantees and require the Corporation to maintain specific financial ratios. The Corporation is in compliance with these covenants at December 31, 2018 and 2017.

2016 Bonds

In 2016, the Corporation entered into loan agreements with Louisville/Jefferson County Metro Government to issue \$521.1 million of Series A uninsured fixed-rate revenue bonds (2016A Bonds), \$31.3 million of Series B uninsured variable-rate bonds (2016B Bonds), and \$68.7 million of Series C uninsured variable-rate revenue bonds (2016C Bonds). Proceeds from 2016A Bonds were used to refund all of the remaining 2006 Bonds outstanding at the time and to pay or reimburse the Corporation for the cost of acquiring, constructing, renovating, and equipping areas related to patient care and to pay certain expense in connection with the issuance of the 2016 Bonds. Proceeds from the 2016B Bonds and 2016C Bonds were used to refund all remaining 2013B Bonds and Series 2011D Bonds outstanding at the time.

At December 31, 2018 and 2017, the 2016A Bonds consist of term bonds with interest rates ranging from 3.0% to 5.5% maturing through October 1, 2037. Interest is payable semiannually on April 1 and October 1. Beginning October 1, 2026, the 2016A Bonds maturing on or after October 1, 2026, are subject to optional redemption by the Corporation prior to maturity for 100% of par.

The 2016B Bonds and 2016C Bonds are a direct placement issue and held entirely by Branch Banking and Trust Company, with final maturity in 2021 and 2023, respectively. The 2016B and 2016C Bonds are subject to optional redemption at any time prior to maturity by the Corporation for 100% of par. At both December 31, 2018 and 2017, the applicable cost of the debt for the 2016B and 2016C Bonds was approximately 2.6% and 1.5%, respectively.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

2013 Bonds

In 2013, the Corporation entered into loan agreements with Louisville/Jefferson County Metro Government to issue \$154.6 million of Series A uninsured fixed-rate revenue bonds (2013A Bonds), \$75.0 million of Series 2013B uninsured taxable variable-rate bonds (2013B Bonds), and \$50.0 million of Series C uninsured variable-rate revenue bonds (2013C Bonds). Proceeds from 2013A Bonds and 2013C Bonds were used to pay or reimburse the Corporation for the cost of acquiring, constructing, renovating, and equipping areas related to patient care and to pay certain expense in connection with the issuance of the bonds. Proceeds from the 2013B Bonds were used to refund all remaining Series 2000C Bonds outstanding at the time.

At both December 31, 2018 and 2017, the 2013A Bonds consisted of fixed-rate term bonds with interest rates ranging from 4.50% to 5.75% maturing through October 1, 2042. The 2013A Bonds have annual sinking fund deposits of various amounts due annually on October 1 beginning in 2028. Interest is payable semiannually on April 1 and October 1. Beginning October 1, 2023, the 2013A Bonds maturing on or after October 1, 2023, are subject to optional redemption by the Corporation prior to maturity for 100% of par.

The 2013C Bonds are secured by an irrevocable direct-pay letter of credit issued by PNC Bank that has a stated maturity of September 25, 2023; however, certain contractual provisions ensure that the 2013C Bonds could not be put back to the Corporation within 12 months of the combined balance sheet date. While bearing interest at a weekly interest rate, the 2013C Bonds are subject to optional redemption prior to maturity at the direction of the Corporation at a redemption price of 100% of the principal amount, plus accrued interest. The 2013C Bonds have one annual sinking fund deposit of \$17.6 million due on October 1, 2042, with final maturity in 2043. At December 31, 2018 and 2017, the applicable cost of the debt for the 2013C Bonds was approximately 2.3% and 2.4%, respectively.

2012 Bonds

In 2012, the Corporation entered into a loan agreement with Louisville/Jefferson County Metro Government to issue \$21.1 million of Series A uninsured fixed-rate revenue bonds (2012A Bonds). Proceeds from the 2012A Bonds were used to refund the remainder of the 1997 Bonds. The 2012A Bonds are a direct placement issue, with a final maturity occurring in 2021. The approximate cost of debt at both December 31, 2018 and 2017, was 2.00%. The 2012A Bonds are subject to optional redemption by the Corporation at any time prior to maturity subject to “make whole” provisions.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

2011 Bonds

In 2011, the Corporation entered into loan agreements with Louisville/Jefferson County Metro Government to issue \$35.0 million of Series A uninsured variable-rate revenue bonds (2011A Bonds), \$40.0 million of Series B uninsured variable-rate revenue bonds (2011B Bonds), \$23.8 million of Series C uninsured variable-rate bonds (2011C Bonds), and \$53.7 million of Series D uninsured taxable variable-rate bonds (2011D Bonds). Proceeds from the 2011A and 2011B Bonds were used to pay or reimburse the Corporation for the cost of acquiring, constructing, renovating, and equipping areas related to patient care and to pay certain expense in connection with the issuance of the bonds. Proceeds from the 2011C Bonds were used to refund a portion of the 1997 Bonds, and proceeds from the 2011D Bonds were used to refund all of the 2000A Bonds.

The 2011A and 2011B Bonds are secured by an irrevocable direct-pay letters of credit issued by PNC Bank that expire on July 26, 2021. The final maturities for the 2011A and 2011B Bonds occur in 2039. While bearing interest at weekly or daily interest rates, the 2011A and 2011B Bonds are subject to optional redemption prior to maturity at the direction of the Corporation at a redemption price of 100% of the principal amount, plus accrued interest. The 2011A and 2011B Bonds have annual sinking fund deposits of various amounts annually, beginning October 1, 2022, through their maturity.

At December 31, 2018 and 2017, the applicable cost of the debt for the 2011A Bonds and 2011B Bonds was approximately 2.4% and 2.5%, respectively.

The 2011C Bonds are direct placement issuances and are held entirely by PNC Bank, and their final maturity occurs in 2021. At December 31, 2018 and 2017, the applicable cost of debt for the 2011C Bonds was approximately 3.0% and 2.30%, respectively. The 2011C Bonds are subject to optional redemption at any time prior to maturity subject to make whole provisions.

2000 Bonds

In 2000, the Corporation entered into loan agreements with Kentucky Economic Development Finance Authority to issue \$148.3 million of Series A uninsured revenue bonds (2000A Bonds), \$119.2 million of Series B (2000B Bonds), and \$180.5 million of Series C insured revenue bonds (2000C Bonds), for a total of \$448.0 million (collectively, the 2000 Bonds). Proceeds from the 2000 Bonds and certain other available monies were used to legally defease the 1998 Bonds and a

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

portion of certain outstanding 1997 and 1992 Bonds issued on behalf of the Corporation through deposits to irrevocable trusts pursuant to escrow agreements, and to pay certain expenses incurred in connection with the issuance of the 2000 Bonds, as well as fund a debt service reserve account.

At December 31, 2018 and 2017, the remaining 2000 Bonds consist of the 2000B Bonds with interest rates ranging from 6.06% to 6.23%, respectively, maturing through October 1, 2028. Payment of principal and interest on the 2000B Bonds is guaranteed by National Public Finance Guarantee Corporation (formerly MBIA Insurance Corporation).

Interest on the 2000B Bonds will be compounded from the dates of delivery to their respective maturities, and will be payable only at maturity, or upon redemption prior to maturity or acceleration. 2000B Bonds mature in various amounts on October 1 through 2028. 2000B Bonds are not subject to optional redemption prior to maturity.

Required debt service on all outstanding bonds is as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
	<i>(In Thousands)</i>		
2019	\$ 26,915	\$ 45,192	\$ 72,107
2020	27,338	44,658	71,996
2021	26,506	45,898	72,404
2022	26,674	45,777	72,451
2023	26,792	45,533	72,325
Thereafter	776,595	459,303	1,235,898
	<u>\$ 910,820</u>	<u>\$ 686,361</u>	<u>\$ 1,597,181</u>

Included as part of the interest payments above is \$7.6 million of the 2000B Bonds interest payable in 2018, which is paid at the maturity of the 2000B Bonds. For 2018 through final maturity of 2000B Bonds, \$145.7 million is included in interest payments, which is paid at the various maturities of the 2000B Bonds.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

For the variable-rate bond series, which includes all of the Series 2011 Bonds, 2013C Bonds, 2016B Bonds, and 2016C Bonds, the future periods interest estimate was based on terms of the Master Trust Indenture and is calculated using an average of Securities Industry and Financial Markets Association (SIFMA), for tax-exempt issues over approximately the last 20 years plus 1.00% to estimate liquidity, credit support, and remarketing fees. Thus, for purposes of this presentation, the Corporation has utilized 2.79%.

The Corporation paid interest of \$48.2 million and \$46.1 million during 2018 and 2017, respectively. The Corporation capitalized interest costs of \$1.7 million and \$1.1 million during 2018 and 2017, respectively.

The remaining long-term debt consists of capital leases. Future payments on capital leases are as follows:

	Principal	Interest	Total
	<i>(In Thousands)</i>		
2019	\$ 2,610	\$ 3,705	\$ 6,315
2020	2,901	3,521	6,422
2021	3,454	3,305	6,759
2022	3,850	3,050	6,900
2023	4,259	2,767	7,026
Thereafter	33,856	30,852	64,738
	\$ 50,960	\$ 47,200	\$ 98,160

Assets recorded under capital lease as of December 31, 2018 and 2017 were approximately \$62.6 million and \$52.6 million, respectively. Accumulated amortization on these capital lease assets was \$22.3 million and \$17.3 million at December 31, 2018 and 2017, respectively.

Interest Rate Swaps

The Corporation uses derivative instruments to manage its cost of capital through interest rate swaps, which generate cash flow meant to reduce interest expense. The Corporation pays a rate based upon the SIFMA Municipal Swap Index, an index of seven-day, high-grade, tax-exempt variable-rate demand obligations. In return, the Corporation receives a rate based upon London Interbank Offered Rates (LIBOR).

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

The Corporation holds the following interest rate swaps:

Effective Date	Notional Amount	Maturity Date	Receive	Pay	December 31	
					2018	2017
<i>(In Thousands)</i>						
2/21/2001	\$ 100,000	10/1/2028	1.4925% of one-month LIBOR	2 times SIFMA	\$ 1,349	\$ 1,346
10/1/2004	100,000	10/1/2028	62.6% of one-month LIBOR plus 0.57%	SIFMA	241	(627)
11/3/2006	140,000	11/3/2031	61.7% of one-month LIBOR plus 0.577%	SIFMA	1,702	1,896
11/3/2008	200,000	11/3/2026	61.7% of ten-year LIBOR minus 0.016%	SIFMA	(926)	(1,904)
					\$ 2,366	\$ 711

Citigroup serves as counterparty for all of the Corporation's interest rate swaps. Consistent with industry practice, the interest rate swaps require posting of collateral should either party's cumulative contract value liability exceed certain thresholds based upon the credit rating of the counterparty. At December 31, 2018 and 2017, based upon the agreements with Citigroup, the Corporation's cumulative mark-to-market at contract value was an asset of \$2.8 million and \$0.1 million, respectively. Based upon the Corporation's lowest credit rating (A-), collateral must be posted for liabilities in excess of \$25 million. At December 31, 2018 and 2017, the Corporation had no collateral posted and was not required to post any collateral. Should the Corporation's credit rating fall below BBB, Citigroup would have the option of terminating some or all of the interest rate swaps at the market value.

All of the Corporation's interest rate swaps outstanding at December 31, 2018 and 2017, were issued pursuant to a single International Swaps and Derivatives Association, Inc. agreement with a single counterparty. Therefore, all interest rate swaps are viewed under a master netting arrangement to determine the aggregate amount of collateral to be posted or received by the Corporation. Should the Corporation hold all interest rate swaps to maturity, as it intends, no cash settlement will be necessary, and at maturity, any posted interest rate swap collateral will be returned.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

7. Long-Term Debt (continued)

None of the Corporation's interest rate swaps has been designated as a hedge for accounting purposes; therefore, the change in fair value for these interest rate swaps is included in the combined statements of operations and changes in net assets as change in interest rate swap values within non-operating gains (losses). The cash flow impact of the interest rate swaps is included in the line change in interest rate swap benefit, net in the combined statements of operations and changes in net assets. The fair value is calculated based on a discounted cash flow model taking into consideration the terms of each interest rate swap and the credit rating of the Corporation or counterparty, as applicable.

The cash flow for these interest rate swaps is settled semiannually on April 1 and October 1. During the interim periods, a receivable or payable is recorded. As of December 31, 2018 and 2017, the cash flows were in a receivable position. The receivable is included within miscellaneous receivables in the combined balance sheets.

	Miscellaneous Receivable	Interest Rate Swap Asset	Combined Balance Sheet, Net
	<i>(In Thousands)</i>		
December 31, 2016	\$ 314	\$ 245	\$ 559
Interest rate swap benefit, net	2,162	–	2,162
Swap cash settlement received	(2,035)	–	(2,035)
Change in interest rate swaps value	–	466	466
December 31, 2017	441	711	1,152
Interest rate swap benefit, net	2,009	–	2,009
Swap cash settlement received	(1,986)	–	(1,986)
Change in interest rate swaps value	–	1,655	1,655
December 31, 2018	\$ 464	\$ 2,366	\$ 2,830

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

8. Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes:

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Health care services	\$ 76,560	\$ 75,589
Investments to be held in perpetuity, the income from which is expendable to support health care services	18,821	20,691
Beneficial interest in trusts held by others, the income from which is expendable to support health care services	22,555	23,125
Total net assets with donor restrictions	\$ 117,936	\$ 119,405

9. Endowment Funds

The Corporation's endowment consists of 11 individual donor-restricted endowment funds (nine at The Children's Hospital Foundation, Inc. and two at Norton Healthcare Foundation, Inc.) established for a variety of purposes. The Children's Hospital Foundation, Inc. and Norton Healthcare Foundation, Inc. are collectively referred to as the Foundations. Net assets associated with endowment funds are included in net assets with donor restrictions.

Interpretation of Relevant Law

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) was enacted in the Commonwealth of Kentucky on March 25, 2010. The Foundations have interpreted the UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundations classify as net assets with donor restrictions (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) market appreciation and/or investment income that is restricted by the donor in the gift agreement.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

9. Endowment Funds (continued)

Investment Objectives and Policy

The Foundations follow the investment policy objectives of the Corporation. The long-term objective of the policy is to generate a return, which is sufficient to meet its current and expected future financial requirements, as defined by the Corporation's long-range financial plan. To accomplish this objective, the Corporation seeks to earn the greatest total return possible consistent with its general risk tolerance, the securities noted as eligible for purchase, and the asset allocation strategies included in the investment policy. The asset allocation includes investments in cash, marketable debt and equity securities, and alternative investments.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Foundations have adopted a 5% spending policy, which is based upon a three-year rolling average of the fair market value of the endowment fund. The current year spending policy is calculated using year-end December 31 market values.

In addition to the 5% spending policy, the Foundations consider the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the Foundations and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Foundations
7. The investment policies of the Corporation

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the original fair market value of the gift. The Foundations will not appropriate funds from the endowment for spending until the current value of the fund exceeds the fair value of the original gift, unless an appropriation is deemed prudent based upon the factors listed above.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

9. Endowment Funds (continued)

The Corporation had endowment funds with deficiencies as follows:

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Fair value of underwater endowment funds	\$ 4,093	\$ 1,943
Original endowment gifts	4,571	2,001
Amount of deficiencies	<u>\$ (478)</u>	<u>\$ (58)</u>

The deficiency of \$0.1 million as of December 31, 2017, was reported in net assets without donor restrictions. This was reclassified to net assets with donor restrictions at December 31, 2018, upon adoption of ASU 2016-14. All deficiencies are recorded in net assets with donor restrictions as of December 31, 2018.

The Corporation had endowment-related activities as follows:

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Endowment net assets, beginning of year	\$ 20,691	\$ 18,843
Investment (loss) gain	(1,414)	2,617
Contributions, less uncollectible pledges	126	31
Appropriation of endowment assets for expenditure	(884)	(800)
Reclassification of net assets	302	—
Endowment net assets, end of year	<u>\$ 18,821</u>	<u>\$ 20,691</u>

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans

Defined Benefit Plan

Certain employees of the Corporation are covered by a non-contribution defined benefit pension plan (the Plan). Benefits are generally based upon years of service and an employee's annual compensation during his or her years of service. The Corporation annually funds an amount not less than the minimum required under the Employee Retirement Income Security Act of 1974. The Plan was frozen effective January 1, 2010, and, as a result, no service cost was incurred in 2018 or 2017 and none is expected in future periods.

The Plan has been named as a defendant in a class action suit brought on behalf of certain former employees who elected to take early retirement (the Plaintiff Class), alleging that lump-sum payments made by the Plan upon their retirement were incorrectly calculated. In early 2016, the United States District Court (the Court) issued its final, appealable order, indicating that the Plan owes additional lump-sum benefits to the Plaintiff Class. The Court ordered the Plan to recalculate benefits using a court determined formula, which is different than the formula as interpreted by the Plan, and provide additional data to allow for recalculation of the benefits. As of December 31, 2018 and 2017, respectively, management has estimated potential exposure to the Plan of approximately \$60.2 million, respectively, which has been recorded by the Plan as part of the Plan's projected benefit obligation. Both the Plaintiff Class and the Plan appealed to the court order and an appeals court hearing was held in June 2017. In May 2018, the United States Court of Appeals (Appeals Court) issued a ruling that the litigation be vacated in part and remanded to the lower Court for further evaluation. The lower Court is now in the process of assessing the case and issuing a scheduling order. Based on the timing of the Appeals Court ruling and the nature of the ongoing litigation, management believes the estimated potential exposure recorded by the Plan is still the best estimate at the date of issuance of the December 31, 2018 financial statements.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

A summary of the components of net periodic benefit cost, which is included in non-operating (losses) gains in the combined statements of operations and changes in net assets, for the Plan is as follows:

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Interest cost	\$ 8,042	\$ 8,831
Expected return on plan assets	(3,629)	(4,417)
Amortization of net loss	4,282	4,372
Settlement cost	2,774	3,139
Net periodic benefit cost	<u>\$ 11,469</u>	<u>\$ 11,925</u>

Included as a component of net periodic benefit cost for 2018 and 2017 is a settlement cost of \$2.8 million and \$3.1 million, respectively. A settlement cost is required under applicable pension accounting guidance when the amount of the lump-sum benefit payments made during the fiscal year exceeds the service cost plus interest cost components of net periodic pension cost. During 2018 and 2017, the Plan paid \$10.6 million and \$12.4 million, respectively, in lump-sum benefit payments.

This exceeded the threshold of \$8.0 million and \$8.8 million in 2018 and 2017, respectively. The settlement cost is determined by taking the ratio of the lump-sum benefit payments made to the projected benefit obligation before settlement, multiplied by the unrecognized loss in the Plan.

Included in net assets without donor restrictions are \$66.2 million and \$67.1 million of unrecognized actuarial losses at December 31, 2018 and 2017, respectively, which have not been recognized in net periodic benefit cost. Changes in pension plan assets and obligations recognized in net assets without donor restrictions for the years ended December 31, 2018 and 2017, were \$0.9 million and \$1.8 million, respectively.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

A summary of the components of the changes in projected benefit obligation and fair value of plan assets for the Plan at and for the year ended December 31 is as follows:

	2018	2017
	<i>(In Thousands)</i>	
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 266,112	\$ 264,398
Interest cost	8,042	8,831
Actuarial (gain) loss	(7,862)	7,964
Benefit payments:		
Lump sum	(10,594)	(12,445)
Annuity	(2,897)	(2,636)
Projected benefit obligation at the end of year	<u>252,801</u>	<u>266,112</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	199,410	207,982
Actual (loss) return on plan assets	(10,432)	6,509
Employer contributions	165	—
Benefit payments:		
Lump sum	(10,594)	(12,445)
Annuity	(2,897)	(2,636)
Fair value of plan assets at end of year	<u>175,652</u>	<u>199,410</u>
Funded status and net pension liability	<u>\$ (77,149)</u>	<u>\$ (66,702)</u>

Since the Plan is frozen, there is no difference between the projected benefit obligation and the accumulated benefit obligation at December 31, 2018 or 2017.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

Assumptions

Weighted-average assumptions used to determine the projected benefit obligation are as follows:

	December 31	
	2018	2017
Discount rate	3.88%	3.26%
Interest crediting rate (cash balance only)	2.40%	1.95%

Weighted-average assumptions used to determine net periodic benefit cost are as follows:

	December 31	
	2018	2017
Discount rate	3.26%	3.60%
Expected long-term rate of return on assets	3.00%	3.00%

The rate of return assumption was developed by applying an expected long-term rate of return, based primarily on long-term historical returns by asset type and applying the weighted-average percent of total plan assets.

Plan Assets

The Plan seeks to assume an appropriate amount of risk to ensure enough assets are available over the life of the Plan to satisfy current and future liabilities. The Plan seeks to achieve and maintain a fully funded status while mitigating the funded status volatility. The strategy for achieving and maintaining this status may vary based on the current funded status, the duration of the Plan's liabilities, the demographics of plan participants and other factors.

At December 31, 2017, the Plan's asset allocation was invested in cash and marketable debt securities. In 2018, the asset allocation was changed to include cash, marketable debt securities, marketable equity securities, including mutual funds, and common and collective trust funds.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

Asset consideration is driven by the liability as split between traditional and cash balance formulas. Based upon funding percentage, the target allocation for the traditional benefit portion of the Plan assets were invested with the following asset strategy guidelines:

	December 31	
	2018	2017
Fixed income	65%	100%
Equity	32	–
Real assets	3	–
	100%	100%

The cash balance portion of the Plan assets were invested with the following asset strategy guidelines:

	December 31	
	2018	2017
Fixed income	70%	100%
Equity	18	–
Real assets	2	–
Cash	10	–
	100%	100%

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

Fair Value Measurements

The Plan's assets impacting the funded status of the Plan are accounted for under ASC 715, *Compensation – Retirement Benefits*. The following table presents the plan assets carried at fair value by type of investments and the fair value levels defined in Note 1:

	December 31		
	2018	2017	Level
	<i>(In Thousands)</i>		
Separately-managed accounts:			
Standish fixed income ^(A)			
Marketable debt securities:			
U.S. government	\$ –	\$ 42,460	2
Corporate	–	43,852	2
Other	–	3,317	2
Total Standish fixed income	–	89,629	
Principal fixed income ^(B)			
Marketable debt securities:			
U.S. government	–	9,233	2
Corporate	–	90,088	2
Other	–	4,309	2
Total Principal fixed income	–	103,630	
IR+M fixed income – traditional ^(C)			
Marketable debt securities:			
U.S. government	1,224	–	2
Corporate	59,524	–	2
Other	2,916	–	2
Total IR+M fixed income – traditional	63,664	–	
IR+M fixed income – cash balance ^(D)			
Marketable debt securities:			
U.S. government	1,001	–	2
Corporate	48,779	–	2
Other	1,420	–	2
Total IR+M fixed income – cash balance	51,200	–	
Total separately-managed accounts	\$ 114,864	\$ 193,259	

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

	December 31		
	2018	2017	Level
	<i>(In Thousands)</i>		
Mutual funds:			
Hotchkins & Wiley High Yield Fund ^(E)	\$ 3,942	\$ —	1
PIMCO Foreign Bond Fund ^(F)	2,050	—	1
PIMCO Emerging Market Local Bond Fund ^(G)	1,601	—	1
Vanguard Inflation Protected Securities Fund ^(H)	3,207	—	1
Wells Fargo International Bond Fund ^(I)	2,038	—	1
Dimensional Emerging Markets Fund ^(J)	2,612	—	1
American Funds Europacific Growth Fund ^(K)	7,610	—	1
Fidelity Real Estate Index Fund ^(L)	4,301	—	1
Oakmark International Fund ^(M)	7,249	—	1
Total mutual funds	<u>34,610</u>	—	
Common and collective trust funds:			
Legal and General S&P 500 Index Fund ^(N)	15,944	—	NAV
GQG Emerging Markets Fund ^(O)	2,549	—	NAV
Wellington Small Capital Opportunities Fund ^(P)	4,847	—	NAV
Total common and collective trust funds	<u>23,340</u>	—	
Pooled separate accounts:			
Edge Asset Management ^(Q)	2,586	5,919	2
Cash	252	232	1
Total pooled separate accounts	<u>2,838</u>	<u>6,151</u>	
Total plan assets, at fair value	<u>\$ 175,652</u>	<u>\$ 199,410</u>	

(A) Separately-managed account invested in fixed income securities, including U.S. government securities, corporate bonds, and other fixed-income strategy investments. The account seeks to perform at the three-year U.S. Treasury yield plus 50 basis points to match the estimated duration of the cash balance obligations.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

- (B) Separately-managed account invested in fixed-income securities, including U.S. government securities, corporate bonds, and other fixed-income strategy investments. The account seeks to perform at a custom benchmark, which is a blend of Barclays indices (including U.S. Long Credit, U.S. Treasury Strips, U.S. Intermediate Term Corporate, and U.S. Aggregate Long Government/Credit) optimized to match the estimated duration of the traditional pension benefit obligations.
- (C) Separately-managed account invested in fixed income securities, including U.S. government securities, corporate bonds, and other fixed-income strategy investments. The account seeks to perform at a blended index of 45% Barclays US Intermediate Credit and 55% Barclays US Long Credit Index to match the estimated duration of the traditional benefit obligations.
- (D) Separately-managed account invested in fixed income securities, including U.S. government securities, corporate bonds, and other fixed-income strategy investments. The account seeks to perform at the Barclays US Corporate High Yield Index to match the estimated duration of the cash balance benefit obligations.
- (E) Mutual fund whose total return strategy seeks to emphasize higher quality and lower volatility to meet the Barclays US Corporate High Yield Index.
- (F) Mutual fund investing primarily in intermediate duration non-U.S. fixed income securities from investment grade issuers in developed countries to meet the Barclays Global Aggregate Ex-US Index.
- (G) Mutual fund investing in local currency-denominated emerging markets debt instruments of intermediate duration to meet the JP Morgan Emerging Market Bond Index.
- (H) Mutual fund investing at least 80% of its assets in inflation-indexed bonds issued by the U.S. government and corporations to meet the Bloomberg Barclays US TIPS Index.
- (I) Mutual fund seeking total return by principally investing in foreign debt securities to meet the Barclays Global Aggregate Ex-US Index.
- (J) Mutual fund seeking to achieve long-term capital appreciation by investing in companies in emerging markets to meet the MSCI Emerging Markets Index.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

- (K) Mutual fund seeking to provide long-term growth of capital by investing in attractively valued companies in developed and emerging markets to meet the MSCI ACWI Ex-USA Index.
- (L) Mutual fund seeking to provide investment results that correspond to the total return of equity REITs and other real estate related investments to meet the FTSE NAREIT Equity REITs Index.
- (M) Mutual fund seeking capital appreciation by investing in mid-and large-capitalization companies located outside the U.S. to meet the MSCI ACWI Ex US Large Value Index.
- (N) Common and collective trust investing in primarily publicly traded U.S. securities to meet the S&P 500 Index.
- (O) Common and collective trust seeks long-term capital appreciation by investing in growth businesses in emerging markets to meet the MSCI Emerging Markets Index.
- (P) Common and collective trust seeks to provide long-term total return by investments in companies with small market capitalizations to meet the Russell 2000 Index.
- (Q) Actively managed fund of corporate and municipal fixed-income securities whose return is meant to mirror the Barclays U.S. 1 – 3 Year Credit Bond Index.

Fair value methodologies for Plan assets identified as Level 1, Level 2, and NAV are consistent with the inputs described in Note 5.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

Cash Flows

The Corporation does not expect to contribute to the Plan in 2019. The following table sets forth the benefit payout projections for the next ten years (in thousands):

Plan year ending December 31:	
2019	\$ 40,150
2020	19,180
2021	15,980
2022	17,190
2023	13,400
2024 – 2028	58,270

Based on the demographics of the Plan, the actuary projected a significant increase in benefit payout for the plan year ending December 31, 2019, based on the number of participants eligible for retirement.

Defined Contribution Plans

403(b)/401(k) Plan

In addition to the Plan, the Corporation also has defined contribution 403(b)/401(k) retirement plans (collectively referred to as Defined Contribution Plans). Effective January 1, 2018, the Corporation provides a matching contribution per pay period basis, up to 4% of employees' compensation. The Corporation will fund an additional non-elective contribution of 2% for employees who have at least 20 years of service as of January 1, 2018 and who do not terminate at any time during the plan year and are employed as of the last day of the plan year. Under the terms of these Defined Contribution Plans for the 2017 plan year, the Corporation provided for a 100% matching contribution of the participant's first 4% of plan deferrals for those participants employed on the last day of the plan year and if they had 1,000 hours of eligible hours.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

10. Employee Benefit Plans (continued)

While the Plan was frozen effective January 1, 2010, additional discretionary employer contributions to the Defined Contribution Plans went into effect on the same date. For the 2017 plan year, these additional discretionary employer non-elective contributions were based on years of services according to the following grid:

<u>Years of Service</u>	<u>Employer Contribution</u>
0-4	1%
5-9	2
10-14	3
15-19	4
20-24	5
25+	6

For the 2018 plan year, the additional discretionary contribution is based upon years of service and the amount an employee contributes above 4% of their eligible compensation if they are actively employed on the last day of the plan year. For employees with 0 to less than 10 years of service at the end of the plan year, the Corporation will match 50% of the next 2% of the employee's contribution while for those employees with 10 or more years of service at the end of the plan year, the Corporation will match 100% of the next 2% of the employee's contribution.

Total expense related to the Defined Contribution Plans was \$45.1 million and \$46.5 million for the years ended December 31, 2018 and 2017, respectively, and is included in labor and benefits on the combined statements of operations and changes in net assets.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

11. Functional Expenses

The Corporation, through certain affiliates (principally Norton Hospitals, Inc.), provides general health care services to residents within its geographic location.

The tables below present expenses by both their nature and function.

	Health Care Services	Support Services	Total
	<i>(In Thousands)</i>		
Year ended December 31, 2018			
Operating expenses:			
Labor and benefits	\$ 1,014,802	\$ 184,333	\$ 1,199,135
Professional fees	79,499	552	80,051
Drugs and supplies	527,833	958	528,791
Fees and special services	60,757	66,438	127,195
Repairs, maintenance, and utilities	37,074	43,578	80,652
Rent and leases	35,103	3,105	38,208
Insurance	22,143	1,962	24,105
Provider tax	20,130	–	20,130
Other	10,161	10,418	20,579
Total operating expenses	<u>1,807,502</u>	<u>311,344</u>	<u>2,118,846</u>
Fixed expenses:			
Depreciation and amortization	78,919	19,563	98,482
Interest expense	46,269	597	46,866
Interest rate swap benefit, net	–	(2,009)	(2,009)
Total fixed expenses	<u>125,188</u>	<u>18,151</u>	<u>143,339</u>
Total expenses	<u>\$ 1,932,690</u>	<u>\$ 329,495</u>	<u>\$ 2,262,185</u>

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

11. Functional Expenses (continued)

	Health Care Services	Support Services	Total
	<i>(In Thousands)</i>		
Year ended December 31, 2017			
Operating expenses:			
Labor and benefits	\$ 1,002,821	\$ 153,490	\$ 1,156,311
Professional fees	68,601	748	69,349
Drugs and supplies	473,863	191	474,054
Fees and special services	63,138	57,499	120,637
Repairs, maintenance, and utilities	33,580	41,630	75,210
Rent and leases	35,752	(418)	35,334
Insurance	11,236	281	11,517
Provider tax	20,130	–	20,130
Other	10,358	9,328	19,686
Total operating expenses	1,719,479	262,749	1,982,228
Fixed expenses:			
Depreciation and amortization	70,666	20,224	90,890
Interest expense	45,655	(3,488)	42,167
Interest rate swap benefit, net	–	(2,162)	(2,162)
Total fixed expenses	116,321	14,574	130,895
Total expenses	<u>\$ 1,835,800</u>	<u>\$ 277,323</u>	<u>\$ 2,113,123</u>

12. Commitments and Contingencies

The Corporation is in the process of improving and expanding its facilities. Future commitments related to the renovation of existing facilities or construction of new facilities totaled \$70.7 million and \$55.4 million at December 31, 2018 and 2017, respectively. This will be funded through bond proceeds and cash flows generated from operations.

The Corporation is subject to claims and suits arising in the ordinary course of business. Management assesses the probable outcome of unresolved litigation and records estimated settlements, if applicable. In the opinion of management, the ultimate resolution of pending legal proceedings will not have a material effect on the Corporation's combined financial position.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

13. Lease Commitments

Future minimum lease payments for office space and equipment, by year, under non-cancelable, operating leases with initial or remaining terms in excess of one year at December 31, 2018, are as follows (*in thousands*):

Year ending December 31:		
2019	\$	30,345
2020		29,330
2021		28,108
2022		26,993
2023		24,584
Thereafter		106,308
Total	\$	<u>245,668</u>

Rental expense, which includes amounts applicable to cancelable leases, for the years ended December 31, 2018 and 2017, was \$38.2 million and \$35.3 million, respectively.

14. Concentration of Credit Risk

The Corporation grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows:

	December 31	
	2018	2017
Medicare	9%	9%
Medicaid	18	22
Blue Cross	24	23
Other third-party payors	20	28
Self-pay	29	18
	<u>100%</u>	<u>100%</u>

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

15. Premier Healthcare Alliance, LP

The Corporation is a partner in Premier Healthcare Alliance, LP (Premier), which is a group purchasing organization (GPO). The Corporation's participation in the GPO provides purchasing contract rates and rebates the Corporation would not be able to obtain on its own. The Corporation holds membership units in Premier which have vesting rights over a seven-year period and upon vesting become eligible for exchange into the Class A publicly traded common stock of Premier, Inc. The Corporation currently accounts for its membership units in Premier using the cost method of accounting. The increase in the estimated value of the Corporation's membership units as they vest is considered a vendor incentive under applicable accounting literature, which increases the Corporation's investment in Premier, Inc. and reduces supplies expense over the seven-year vesting period ending in 2020. The Corporation recognized a vendor incentive as a reduction in supplies expense for the common stock vesting of \$14.7 million and \$10.2 million for the years ended December 31, 2018 and 2017, respectively.

On October 31, 2018, the Corporation exchanged 1,648,640 membership units into 1,648,640 shares of Class A common stock of Premier, Inc. This transaction caused a reclassification of \$59.0 million from investment in joint ventures to assets limited as to use in the combined balance sheet at the date of the transfer. The Class A common stock shares of Premier, Inc. were sold in November and December 2018, and the Corporation realized a gain of \$6.2 million, which is included in investment gain in the combined statement of operations and changes in net assets. The proceeds from sale of the Premier common stock is included in change in joint ventures and other within the combined statement of cash flows for the year ended December 31, 2018.

16. The Regional Health Network of Kentucky and Southern Indiana, LLC

In May 2012, the Corporation entered into a partnership agreement with Lifepoint Hospitals, Inc. to form The Regional Health Network of Kentucky and Southern Indiana, LLC (Regional) for the purpose of acquiring and operating hospitals in southern Indiana and Kentucky, currently Scott County Memorial Hospital and Clark Memorial Hospital.

The Corporation has an ownership interest in Regional of 25% at December 31, 2018 and 2017, respectively, and does not manage or control the operations. The investment is accounted for under the equity method of accounting wherein the Corporation's investment (recorded on a one-month lag) is recorded in investments in joint ventures in the Corporation's combined balance sheets and its share of the losses, which is disclosed in Note 1, is reflected in joint venture income in the Corporation's combined statements of operations and changes in net assets.

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

16. The Regional Health Network of Kentucky and Southern Indiana, LLC (continued)

The following is a summary of Regional's assets, liabilities, and equity (from its unaudited financial statements):

	December 31	
	2018	2017
	<i>(In Thousands)</i>	
Assets		
Cash and cash equivalents	\$ 1,356	\$ 1,155
Patient accounts receivable	22,892	25,086
Property and equipment, net	70,187	69,519
Other assets	15,502	10,966
Total assets	<u>\$ 109,937</u>	<u>\$ 106,726</u>
Liabilities and equity		
Accounts payable	\$ 9,126	\$ 7,590
Accrued payroll	7,557	6,692
Intercompany	34,845	36,530
Other liabilities	5,958	2,766
Total liabilities	<u>57,486</u>	<u>53,578</u>
Total equity	<u>52,451</u>	<u>53,148</u>
Total liabilities and equity	<u>\$ 109,937</u>	<u>\$ 106,726</u>

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

16. The Regional Health Network of Kentucky and Southern Indiana, LLC (continued)

The following is a summary of Regional's results of operations (from its unaudited financial statements):

	Year Ended December 31	
	2018	2017
	<i>(In Thousands)</i>	
Revenue	\$ 189,031	\$ 184,468
Operating expenses:		
Labor and benefits	98,217	97,486
Professional fees	4,269	4,310
Supplies	29,624	29,374
Fees and special services	12,282	12,205
Repairs, maintenance, and utilities	13,975	14,296
Rents and leases	1,416	1,469
Insurance	1,559	1,146
Non-income taxes	15,840	14,438
Other	3,616	3,366
Total operating expenses	180,798	178,090
Earnings before fixed expenses	8,233	6,378
Fixed expenses:		
Depreciation	8,928	11,633
Interest expense	1,772	1,363
Management fees	5,687	5,533
Other non-operating gains	(7,457)	—
	8,930	18,529
Loss from operations	\$ (697)	\$ (12,151)

Norton Healthcare, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

17. Subsequent Events

Companies that are considered public (e.g., have publicly traded debt) are required to disclose significant changes occurring in the fourth quarter that may impact previously reported quarterly financial statements. Management has determined there are no transactions that require disclosure for the quarter ended December 31, 2018.

The Corporation has evaluated and disclosed any subsequent events through April 2, 2019, which is the date the accompanying combined financial statements were issued. No recognized or non-recognized subsequent events were identified for recognition or disclosure in the combined financial statements.

Supplementary Information



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Report of Independent Auditors on Supplementary Information

The Board of Trustees
Norton Healthcare, Inc. and Affiliates

Our audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The following combining balance sheet and combining statement of operations and changes in net assets without donor restrictions are presented for purposes of additional analysis and are not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

Ernst & Young LLP

April 2, 2019

Norton Healthcare, Inc. and Affiliates

Combining Balance Sheet

December 31, 2018

	Norton Healthcare, Inc.	Norton Hospitals, Inc. ¹	Community Medical Associates, Inc.	Norton Properties, Inc.	Norton Enterprises, Inc.	The Children's Hospital Foundation, Inc.	Norton Healthcare Foundation, Inc.	Eliminations	Combined Totals
<i>(In Thousands)</i>									
Assets									
Current assets:									
Cash and cash equivalents	\$ 194,453	\$ 9	\$ (180)	\$ —	\$ (90)	\$ 320	\$ 4	\$ —	\$ 194,516
Marketable securities and other investments	127,504	—	—	—	—	—	—	—	127,504
Patient accounts receivable	—	210,953	18,976	—	5,899	—	—	—	235,828
Inventory	849	54,384	657	—	978	41	65	—	56,974
Prepaid expenses and other	43,190	2,422	—	3,383	35	143	—	—	49,173
Miscellaneous receivables	9,614	450	267	(43)	—	4,626	5,420	—	20,334
Current portion of assets limited as to use	21,489	—	—	—	—	—	—	—	21,489
Total current assets	397,099	268,218	19,720	3,340	6,822	5,130	5,489	—	705,818
Assets limited as to use	1,292,256	—	—	—	—	59,729	28,072	—	1,380,057
Property and equipment, net	89,306	750,527	31,006	97,169	363	42	—	—	968,413
Other assets:									
Investments in joint ventures	21,750	3,073	—	—	26,805	—	—	(34,415)	17,213
Pledges receivable, net	—	—	—	—	—	15,346	7,333	—	22,679
Beneficial interest in trusts held by others	—	—	—	—	—	15,641	6,914	—	22,555
Goodwill and intangible assets, net of accumulated amortization of \$3,820	—	7,446	3,394	—	9,677	—	—	—	20,517
Interest rate swap asset	2,366	—	—	—	—	—	—	—	2,366
Other assets	(825,848)	1,522,083	(592,307)	(61,371)	(13,870)	(4,698)	(359)	—	23,630
Total other assets	(801,732)	1,532,602	(588,913)	(61,371)	22,612	26,289	13,888	(34,415)	108,960
Total assets	\$ 976,929	\$ 2,551,347	\$ (538,187)	\$ 39,138	\$ 29,797	\$ 91,190	\$ 47,449	\$ (34,415)	\$ 3,163,248

¹Includes the balance sheet for Norton; Norton Children's; Audubon; Norton Women's and Children's; Brownsboro Hospitals; Norton Children's Medical Center; Norton Diagnostic Center—Fern Creek; Norton Diagnostic Center-DuPont; Norton Diagnostic Center-Brownsboro; Norton Cancer Institute; Norton Hospitals, Inc. owned medical office building; Cardiovascular Diagnostic Centers; and Norton Healthcare pharmacies.

Norton Healthcare, Inc. and Affiliates

Combining Balance Sheet (continued)

December 31, 2018

	Norton Healthcare, Inc.	Norton Hospitals, Inc. ¹	Community Medical Associates, Inc.	Norton Properties, Inc.	Norton Enterprises, Inc.	The Children's Hospital Foundation, Inc.	Norton Healthcare Foundation, Inc.	Eliminations	Combined Totals
	<i>(In Thousands)</i>								
Liabilities and net assets									
Current liabilities:									
Accounts payable	\$ 20,657	\$ 60,598	\$ 1,748	\$ 480	\$ 1,212	\$ 19	\$ 25	\$ –	\$ 84,739
Accrued expenses and other	36,383	35,965	3,230	184	1,081	157	35	–	77,035
Accrued payroll and related items	96,141	5,158	27,765	–	305	–	–	–	129,369
Due to third-party payors, net	–	47,378	–	–	–	–	–	–	47,378
Accrued interest	8,553	–	–	–	–	–	–	–	8,553
Current portion of long-term debt	34,500	–	–	2,650	–	–	–	–	37,150
Total current liabilities	196,234	149,099	32,743	3,314	2,598	176	60	–	384,224
Other non-current liabilities:									
Pension liability	77,149	–	–	–	–	–	–	–	77,149
Insurance liability	86,649	–	–	–	–	–	–	–	86,649
Other	52,106	7,783	–	5,326	–	2,189	2,194	–	69,598
Total other non-current liabilities	215,904	7,783	–	5,326	–	2,189	2,194	–	233,396
Long-term debt, net of current portion	1,031,447	–	–	48,246	–	–	–	–	1,079,693
Net (deficit) assets:									
Without donor restrictions	(466,911)	2,383,303	(571,361)	(17,802)	27,199	26,045	1,941	(34,415)	1,347,999
With donor restrictions	255	11,162	431	54	–	62,780	43,254	–	117,936
Total net (deficit) assets	(466,656)	2,394,465	(570,930)	(17,748)	27,199	88,825	45,195	(34,415)	1,465,935
Total liabilities and net (deficit) assets	\$ 976,929	\$ 2,551,347	\$ (538,187)	\$ 39,138	\$ 29,797	\$ 91,190	\$ 47,449	\$ (34,415)	\$ 3,163,248

¹Includes the balance sheet for Norton; Norton Children's; Audubon; Norton Women's and Children's; Brownsboro Hospitals; Norton Children's Medical Center; Norton Diagnostic Center– Fern Creek; Norton Diagnostic Center-DuPont; Norton Diagnostic Center-Brownsboro; Norton Cancer Institute; Norton Hospitals, Inc. owned medical office building; Cardiovascular Diagnostic Centers; and Norton Healthcare pharmacies.

Norton Healthcare, Inc. and Affiliates

Combining Statement of Operations and Changes in Net Assets without Donor Restrictions

Year Ended December 31, 2018

	Norton Healthcare, Inc.	Norton Hospitals, Inc. ¹	Community Medical Associates, Inc.	Norton Properties, Inc.	Norton Enterprises, Inc.	The Children's Hospital Foundation, Inc.	Norton Healthcare Foundation, Inc.	Eliminations	Combined Totals
<i>(In Thousands)</i>									
Revenue:									
Net patient service revenue	\$ (129)	\$ 1,948,330	\$ 350,321	\$ –	\$ 27,803	\$ –	\$ –	\$ (12,281)	\$ 2,314,044
Other revenue	11,208	11,994	29,665	43,921	8,781	520	855	(64,205)	42,739
Donations and contributions	890	5,086	653	–	–	14,465	5,840	(13,766)	13,168
Joint venture (loss) income	(614)	2,472	–	–	(1,031)	–	–	–	827
Total revenue	11,355	1,967,882	380,639	43,921	35,553	14,985	6,695	(90,252)	2,370,778
Operating expenses:									
Labor and benefits	182,016	634,772	360,733	1,434	17,863	1,769	548	–	1,199,135
Professional fees	488	81,919	2,051	–	–	64	–	(4,471)	80,051
Drugs and supplies	438	492,278	28,600	79	6,876	200	320	–	528,791
Fees and special services	64,929	57,837	15,159	1,193	8,701	1,225	284	(22,133)	127,195
Repairs, maintenance, and utilities	43,564	29,232	4,751	2,782	309	12	2	–	80,652
Rent and leases	12,569	21,049	22,763	30,584	585	94	31	(49,467)	38,208
Insurance	1,692	12,143	9,716	110	174	221	49	–	24,105
Provider tax	–	20,130	–	–	–	–	–	–	20,130
Other	5,810	5,202	4,202	567	606	13,128	5,245	(14,181)	20,579
Management allocation	(314,286)	262,977	43,588	4,454	3,267	–	–	–	–
Total operating expenses	(2,780)	1,617,539	491,563	41,203	38,381	16,713	6,479	(90,252)	2,118,846
Earnings (deficit) before fixed expenses and other gains (losses)	14,135	350,343	(110,924)	2,718	(2,828)	(1,728)	216	–	251,932
Fixed expenses:									
Depreciation and amortization	19,554	64,947	6,195	7,644	133	7	2	–	98,482
Interest expense	597	38,786	–	7,483	–	–	–	–	46,866
Interest rate swap benefit, net	(2,009)	–	–	–	–	–	–	–	(2,009)
	18,142	103,733	6,195	15,127	133	7	2	–	143,339

¹Includes the statement of operations and changes in unrestricted net assets for Norton; Norton Children's; Audubon; Norton Women's and Children's; Brownsboro Hospitals; Norton Children's Medical Center; Norton Diagnostic Center-Fern Creek; Norton Diagnostic Center-DuPont; Norton Diagnostic Center-Brownsboro; Norton Cancer Institute; Norton Hospitals, Inc. owned medical office building; Cardiovascular Diagnostic Centers; and Norton Healthcare pharmacies.

Norton Healthcare, Inc. and Affiliates

Combining Statement of Operations and Changes in Net Assets without Donor Restrictions (continued)

Year Ended December 31, 2018

	Norton Healthcare, Inc.	Norton Hospitals, Inc.¹	Community Medical Associates, Inc.	Norton Properties, Inc.	Norton Enterprises, Inc.	The Children's Hospital Foundation, Inc.	Norton Healthcare, Foundation, Inc.	Eliminations	Combined Totals
	<i>(In Thousands)</i>								
Patient service (deficit) margin	\$ (4,007)	\$ 246,610	\$ (117,119)	\$ (12,409)	\$ (2,961)	\$ (1,735)	\$ 214	\$ –	\$ 108,593
Investment gain	53,465	–	–	–	–	1,415	126	–	55,006
Operating gain (loss)	49,458	246,610	(117,119)	(12,409)	(2,961)	(320)	340	–	163,599
Non-operating (losses) gains:									
Change in net unrealized losses on investments	(92,226)	–	–	–	–	(2,684)	(281)	–	(95,191)
Change in interest rate swaps value	1,655	–	–	–	–	–	–	–	1,655
Petersdorf Fund grants	(1,588)	(1)	221	–	–	–	–	–	(1,368)
Net periodic pension cost	(11,469)	–	–	–	–	–	–	–	(11,469)
Other non-operating (losses) gains, net	(1)	(105)	(8)	20	6	(3)	–	–	(91)
Total non-operating (losses) gains	(103,629)	(106)	213	20	6	(2,687)	(281)	–	(106,464)
Excess of (expenses over revenue) revenue over revenue	(54,171)	246,504	(116,906)	(12,389)	(2,955)	(3,007)	59	–	57,135
Change in pension plan asset and obligation	933	–	–	–	–	–	–	–	933
Net assets released from restrictions for equipment	66	3,245	319	–	–	–	–	–	3,630
Other, net	(220)	(16)	(4)	–	–	385	(84)	–	61
(Decrease) increase in net assets without donor restrictions	\$ (53,392)	\$ 249,733	\$ (116,591)	\$ (12,389)	\$ (2,955)	\$ (2,622)	\$ (25)	\$ –	\$ 61,759

¹Includes the statement of operations and changes in unrestricted net assets for Norton; Norton Children's; Audubon; Norton Women's and Children's; Brownsboro Hospitals; Norton Children's Medical Center; Norton Diagnostic Center-Fern Creek; Norton Diagnostic Center-DuPont; Norton Diagnostic Center-Brownsboro; Norton Cancer Institute; Norton Hospitals, Inc. owned medical office building; Cardiovascular Diagnostic Centers; and Norton Healthcare pharmacies.

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Report of Independent Auditors

The Board of Trustees
Norton Healthcare, Inc. and Affiliates

We have audited the accompanying schedule of the debt service coverage ratio calculation of Norton Healthcare, Inc. and its Restricted Affiliate, Norton Hospitals, Inc. as of December 31, 2018 and for the year then ended and the related notes.

Management's Responsibility for the Schedule

Management is responsible for the preparation and fair presentation of the schedule of the debt service coverage ratio calculation on the basis of the financial reporting provisions of Section 5.7 of Article V of the Amended and Restated Master Trust Indenture dated as of September 15, 1997, as supplemented by Supplemental Indentures Nos. 1 and 2, dated as of September 15, 1997; as supplemented by Supplemental Indenture No. 3, dated as of October 1, 1998, by and between Norton Healthcare, Inc. and Bank One, Kentucky, NA; as supplemented by Supplemental Indenture No. 4 dated as of September 1, 2000; as supplemented by Supplemental Indenture No. 5, dated as of January 4, 2001; as supplemented by Supplemental Indenture No. 6, dated as of July 1, 2003, by and between Norton Healthcare, Inc., Norton Hospitals, Inc. and Bank One, Kentucky, NA; as supplemented by Supplemental Indenture No. 7, dated as of March 17, 2004; as supplemented by Supplemental Indenture No. 8, dated as of September 1, 2004; as supplemented by Supplemental Indenture No. 9, dated as of October 1, 2006; as supplemented by Supplemental Indenture No 10, dated as of November 1, 2006; as supplemented by Supplemental Indenture Nos. 11 and 12, dated as of August 1, 2011, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA; and as supplemented by Supplemental Indentures No. 13, dated as of October 1, 2012, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA; and as supplemented by Supplemental Indenture No. 14, dated as of September 1, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA; and as supplemented by Supplemental Indenture No. 15, dated as of September 1, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 16, dated as of December 1, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 17, dated as of July 1, 2016, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 18, dated as of August 1, 2016, between Norton Healthcare, Inc. and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 19, dated as of August 1,

2016, between Norton Healthcare, Inc. and The Bank of New York Mellon Trust Company NA. The calculation includes the accounts of Norton Healthcare, Inc. and its Restricted Affiliate, Norton Hospitals, Inc. Management also is responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedule of the debt service coverage ratio calculation that is free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the schedule of the debt service coverage ratio calculation based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule of the debt service coverage ratio calculation is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule of the debt service coverage ratio calculation. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the schedule of the debt service coverage ratio calculation, 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 schedule of the debt service coverage ratio calculation 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 schedule of the debt service coverage ratio calculation.

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 schedule referred to above presents fairly, in all material respects, the debt service coverage ratio calculation of Norton Healthcare, Inc. and its Restricted Affiliate, Norton Hospitals, Inc. as of December 31, 2018 and for the year then ended on the basis of the requirement referred to in the preceding paragraph.

Contractual Basis of Accounting

As described in Note 1 to the schedule, the schedule was prepared by Norton Healthcare, Inc. and Affiliates on the basis of the financial reporting provisions of Section 5.7 of Article V of the Amended and Restated Master Trust Indenture dated as of September 15, 1997, as supplemented by Supplemental Indentures Nos. 1 and 2, dated as of September 15, 1997; as supplemented by

Supplemental Indenture No. 3, dated as of October 1, 1998, by and between Norton Healthcare, Inc. and Bank One, Kentucky, NA; as supplemented by Supplemental Indenture No. 4 dated as of September 1, 2000; as supplemented by Supplemental Indenture No. 5, dated as of January 4, 2001; as supplemented by Supplemental Indenture No. 6, dated as of July 1, 2003, by and between Norton Healthcare, Inc., Norton Hospitals, Inc. and Bank One, Kentucky, NA; as supplemented by Supplemental Indenture No. 7, dated as of March 17, 2004; as supplemented by Supplemental Indenture No. 8, dated as of September 1, 2004; as supplemented by Supplemental Indenture No. 9, dated as of October 1, 2006; as supplemented by Supplemental Indenture No 10, dated as of November 1, 2006; as supplemented by Supplemental Indenture Nos. 11 and 12, dated as of August 1, 2011, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA; and as supplemented by Supplemental Indentures No. 13, dated as of October 1, 2012, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA.; and as supplemented by Supplemental Indenture No. 14, dated as of September 1, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA; and as supplemented by Supplemental Indenture No. 15, dated as of September 1, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 16, dated as of December 1, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 17, dated as of July 1, 2016, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 18, dated as of August 1, 2016, between Norton Healthcare, Inc. and The Bank of New York Mellon Trust Company NA; and as supplemented by Supplemental Indenture No. 19, dated as of August 1, 2016, between Norton Healthcare, Inc. and The Bank of New York Mellon Trust Company NA, which is a basis of accounting other than U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Restriction on Use

This report is intended solely for the information and use of management, the Board of Trustees of Norton Healthcare, Inc. and Affiliates, Bank One, Kentucky, NA, and The Bank of New York Mellon Trust Company, NA and is not intended to be and should not be used by anyone other than the specified parties.

Ernst + Young LLP

April 2, 2019

Norton Healthcare, Inc. and its Restricted Affiliate, Norton Hospitals, Inc.

Debt Service Coverage Ratio

For the Year Ended December 31, 2018

(In Thousands)

Excess of revenue over expenses		\$	192,333
Depreciation and amortization			84,501
Interest expense			39,383
Gain on disposition of assets			10
Net gain on extinguishment of debt			—
Unrealized loss on investments			98,337
Unrealized gain on swap mark-to-market			(1,655)
Income available for debt service	(A)		<u>412,909</u>
Principal and interest payments	(B)	\$	<u>73,574</u>
Debt service coverage ratio	(A)/(B)		<u>5.61</u>
Required debt service coverage ratio			<u>1.10</u>

Note 1 – The method of calculating the income available for debt service is prescribed by Section 5.7 of Article V of the Amended and Restated Master Trust Indenture dated as of September 15, 1997, as supplemented by Supplemental Indentures Nos. 1 and 2, dated as of September 15, 1997; as supplemented by Supplemental Indenture No. 3, dated as of October 1, 1998, by and between Norton Healthcare, Inc. and Bank One, Kentucky, NA; as supplemented by Supplemental Indenture No. 4 dated as of September 1, 2000; as supplemented by Supplemental Indenture No. 5, dated as of January 4, 2001; as supplemented by Supplemental Indenture No. 6, dated as of July 1, 2003, by and between Norton Healthcare, Inc., Norton Hospitals, Inc. and Bank One, Kentucky, NA; as supplemented by Supplemental Indenture No. 7, dated as of March 17, 2004; as supplemented by Supplemental Indenture No. 8, dated as of September 1, 2004; as supplemented by Supplemental Indenture No. 9, dated as of October 1, 2006; as supplemented by Supplemental Indenture No. 10, dated as of November 1, 2006; and as supplemented by Supplemental Indenture Nos. 11 and 12, dated as of August 1, 201; as supplemented by Supplemental Indenture No. 13, dated as of October 1, 2012; as supplemented by Supplemental Indenture Nos. 14 and 15, dated as of September 1, 2013, and as supplemented by Supplemental Indenture No. 16, dated as of December 31, 2013, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company, NA; as supplemented by Supplemental Indenture No. 17, dated as of July 1, 2016, between Norton Healthcare, Inc., Norton Hospitals, Inc., and The Bank of New York Mellon Trust Company NA; as supplemented by Supplemental Indenture No. 18, dated as of August 1, 2016, between Norton Healthcare, Inc. and The Bank of New York Mellon Trust Company NA; as supplemented by Supplemental Indenture No. 19, dated as of August 1, 2016, between Norton Healthcare, Inc. and The Bank of New York Mellon Trust Company NA. The calculation includes the accounts of Norton Healthcare, Inc. and its Restricted Affiliate, Norton Hospitals, Inc., which have been defined as the Obligated Group by the Amended and Restated Master Trust Indenture.

Norton Healthcare, Inc. and Affiliates
Liquidity
(dollars in thousands)

	<u>December 31,</u> <u>2018</u>
Cash & Cash Equivalents ⁽¹⁾	\$ 194,516
Marketable Securities & Other Investments ⁽²⁾	127,504
Assets Limited to use by Board	<u>1,151,755</u>
Subtotal ⁽³⁾	1,473,775
Debt Service Reserve Funds	<u>21,874</u>
	<u>\$ 1,495,650</u>
Obligated Group	
Daily Expenses ⁽⁴⁾	\$ 4,526
Days cash on hand ratio ⁽⁵⁾ :	
Excluding DSRF	326
Including DSRF	330
Consolidated	
Daily Expenses ⁽⁶⁾	\$ 5,928
Days cash on hand ratio ⁽⁵⁾ :	
Excluding DSRF	249
Including DSRF	252

(1) Cash and Cash Equivalents are composed of assets that are or may be immediately converted to cash.

(2) Marketable Securities are assets that are convertible into cash in one week or less.

(3) Assets limited to use by the Board are liquid assets (other than private equity) whose use has been restricted by the Board.

(4) Consistent with the Master Indenture definition of "Minimum Days Cash on Hand" the Daily Expenses include only those expenses of the Obligated Group.

(5) Total liquid assets (Cash and Cash Equivalents, Marketable Securities and Other Investments and Assets Limited to use by Board) divided by daily expenses (total operating expenses less depreciation and amortization divided by 366).

(6) Consolidated Daily Expenses include those of the Corporation and Affiliates.

Norton Healthcare, Inc. and Affiliates
Combined Capitalization

12/31/18

	2016A	509,340,000
	2016B	15,690,000
	2016C	48,370,000
	Total 2016 Bonds	573,400,000
	2013A	154,580,000
	2013C	50,000,000
	Total 2013 Bonds	204,580,000
	2012	6,400,000
	Total 2012 Bonds	6,400,000
	2011A	35,000,000
	2011B	40,000,000
	2011C	7,725,000
	Total 2011 Bonds	82,725,000
	2000B	189,420,000
	Total 2000B Bonds	189,420,000
	Other Debt & Capital Leases	50,896,005
	Total Other Debt & Capital Leases	50,896,005
		1,107,421,005
Less:		
Unamortized (discount)/premium		18,360,555
Unamortized bond issue costs		(8,938,389)
Current installments of long-term debt		(37,149,700)
	Total Long Term Debt	1,079,693,471
	Unrestricted net assets	1,347,941,333
	Total Capitalization	2,427,634,804
	Total long-term debt as a percentage of total capitalization	44.48%

Norton Healthcare, Inc.
For the year ended December 31, 2018

Utilization Statistics

Certain utilization statistics for the Corporation and its Affiliates are set forth below. The statistics for "Adult Hospitals" include the operations of Norton Hospital, Norton Audubon Hospital, Norton Brownsboro Hospital and Norton Women's Hospital St Matthews. "Pediatric Hospital" includes Norton Children's Hospital, Norton Children's Medical Center and Norton Children's Hospital St. Matthews.

	Year Ended
	December 31, 2018
Admissions:	
Adult Hospitals (A)	61,193
Pediatric Hospital	11,162
	<u><u>72,355</u></u>
Patient Days:	
Adult Hospitals (A)	278,694
Pediatric Hospital	85,169
	<u><u>363,863</u></u>
Average LOS (in Days):	
Adult Hospitals (A)	4.6
Pediatric Hospital	7.6
	<u><u>5.0</u></u>
Outpatient Occasions (B):	
Adult Hospitals (A)	502,107
Pediatric Hospital	58,738
	<u><u>560,845</u></u>
Emergency Visits:	
Adult Hospitals (A)	154,827
Pediatric Hospital	94,561
	<u><u>249,388</u></u>
Deliveries:	
Norton Hospital	2,331
Norton Women's/Children's Hospital St. Matthews	5,233
	<u><u>7,564</u></u>
Ambulatory Surgeries:	
Adult Hospitals (A)	44,476
Pediatric Hospital	12,222
	<u><u>56,698</u></u>
Physician Practice Visits:	
	<u><u>2,266,500</u></u>
Total Licensed Beds:	
Adult Hospitals (A)	1,479
Pediatric Hospital	358
	<u><u>1,837</u></u>
Beds in Use:	
Adult Hospitals (A)	1,174
Pediatric Hospital	337
	<u><u>1,511</u></u>

(A) - Includes acute care services only.

(B) - An outpatient occasion is a visit of a hospital outpatient to a unit/department of a hospital regardless of the number of tests or services provided to the patient. Included within this statistic are the services provided by certain stand alone outpatient centers, providing a variety of services, operated as an outpatient department of the hospitals.

Norton Healthcare, Inc.
For the year ended December 31, 2018

The Obligated Group

Norton Healthcare, Inc. (the "Corporation") and Norton Hospitals, Inc. ("Norton") are the only members of the Obligated Group as it relates to outstanding debt obligations at December 31, 2018.

The Affiliates

The term "Affiliates" refers to entities which are directly or indirectly controlled by the Corporation, by another Affiliate of the Corporation or by any person which controls the Corporation or any other Affiliate.

At December 31, 2018 the Affiliates are:

Norton Hospitals, Inc.
Community Medical Associates, Inc.
Norton Properties, Inc.
Children's Hospital Foundation, Inc.
Norton Healthcare Foundation, Inc.
Norton Enterprises, Inc.
Clinical Associates, Inc.
Norton Occupational Medicine Associates
Norton Pharmacies, PLLC

At December 31, 2018, the Obligated Group accounted for 83.5% of the total operating revenues, 76.8% of the total operating expenses and 90.3% of the total assets of the Corporation and its Affiliates which has been adjusted for Other Receivables (Payables) from Affiliates.