

PIH Health, Inc. and Subsidiaries

Consolidated Financial Statements
September 30, 2018 and 2017

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Independent Auditor's Report

Board of Directors
PIH Health, Inc.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of PIH Health, Inc. and its subsidiaries, which comprise the consolidated balance sheets as of September 30, 2018 and 2017, the related consolidated statements of income, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 financial position of PIH Health, Inc. and its subsidiaries as of September 30, 2018 and 2017, and the results of their operations, changes in net assets, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Consolidating Schedules

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the 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 financial statements. The consolidating information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

RSM US LLP

Los Angeles, California
January 17, 2019

PIH Health, Inc. and Subsidiaries

**Consolidated Balance Sheets
September 30, 2018 and 2017
(In Thousands)**

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,688	\$ 14,791
Investments, short term (Note 4)	3,692	2,895
Patient accounts receivable, net of allowance for doubtful accounts of \$14,798 and \$14,961 in 2018 and 2017, respectively (Notes 3 and 12)	96,806	91,022
Inventory	8,347	8,613
Other receivables	5,926	9,237
Prepaid expenses and other assets	10,523	13,850
Other current assets, Hospital Fee Program (Note 14)	44,400	72,983
Total current assets	176,382	213,391
Investments in mutual funds and other investments (Note 4)	46,219	41,480
Investments, assets limited as to use (Note 4)	453,847	438,745
Property and equipment, net (Note 5)	644,952	645,755
Other assets	1,235	1,909
Total assets	\$ 1,322,635	\$ 1,341,280

See notes to consolidated financial statements.

	2018	2017
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 93,361	\$ 95,234
Estimated third-party payor settlements	204	-
Accrued interest	2,241	2,175
Current portion of long-term debt (Note 6)	10,753	10,210
Current portion of obligations under capital leases (Note 11)	201	685
Current portion of prepetition liabilities (Note 7)	1,191	2,591
Short-term loan borrowing (Note 6)	28,000	48,000
Other current liability, Hospital Fee Program (Note 14)	30,943	43,018
Retention—self-insurance programs, current portion (Note 11)	10,461	13,331
Total current liabilities	177,355	215,244
Deferred compensation	16,441	15,511
Interest rate swaps (Note 6)	25,961	38,751
Prepetition liabilities, net of current portion (Note 7)	-	1,191
Long-term debt, net of current portion (Note 6)	367,002	377,189
Obligations under capital leases, net of current portion (Note 11)	8	192
Pension liability (Note 9)	49,218	77,435
Retention—self-insurance programs, net of current portion (Note 11)	20,807	20,766
Total liabilities	656,792	746,279
Commitments and contingencies (Note 11)		
Net Assets		
Unrestricted	659,448	588,903
Temporarily restricted (Note 8)	5,424	5,127
Permanently restricted (Note 8)	971	971
Total net assets	665,843	595,001
Total liabilities and net assets	\$ 1,322,635	\$ 1,341,280

PIH Health, Inc. and Subsidiaries

**Consolidated Statements of Income
Years Ended September 30, 2018 and 2017
(In Thousands)**

	2018	2017
Revenues:		
Net patient service revenue, including Hospital Fee Program revenue of \$53,650 for 2018 and \$52,835 for 2017 (Notes 3 and 14)	\$ 769,662	\$ 732,598
Less provision for bad debts	14,970	12,413
Net patient service revenue less provision for bad debts	754,692	720,185
Capitation revenue (Note 3)	111,431	107,485
Other operating revenue	19,456	18,303
Net assets released from restrictions used for operations	1,351	1,489
Total revenues	886,930	847,462
Expenses (Note 13):		
Salaries and wages	300,913	282,701
Purchased services	104,497	104,225
Medical supplies and drugs	108,970	101,446
Employee benefits	108,348	104,669
Professional fees	119,329	111,600
Depreciation and amortization (Note 5)	40,253	39,544
Other expenses	26,991	27,468
Interest	12,645	11,881
Insurance	6,559	6,106
Rent expense	2,290	2,862
Hospital Fee Program (Note 14)	38,886	40,052
Total expenses	869,681	832,554
Excess of revenues over expenses	17,249	14,908
Other gains (losses):		
Net investment income (Note 4)	11,728	9,896
Net realized gains on investments (Note 4)	7,736	3,533
Change in fair value of interest rate swap and net interest expense (Note 6)	8,080	10,962
Gain (loss) on disposal of property and equipment	144	(107)
Other gains, net	9	1,629
Pension-related changes - net periodic pension cost (Note 9)	(3,032)	(6,470)
Total other gains, net	24,665	19,443
Excess of revenues over expenses and other gains	\$ 41,914	\$ 34,351

See notes to consolidated financial statements.

PIH Health, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2018 and 2017
(In Thousands)

	2018	2017
Unrestricted net assets:		
Excess of revenues over expenses and other gains	\$ 41,914	\$ 34,351
Unrealized gains on investments, net	5,424	30,522
Pension-related changes other than net periodic pension cost (Note 9)	22,945	11,354
Net assets released from restrictions used for long-lived assets	262	3,051
Change in unrestricted net assets	70,545	79,278
Temporarily restricted net assets:		
Contributions revenue	1,910	3,538
Net assets released from restrictions	(1,613)	(4,540)
Change in temporarily restricted net assets	297	(1,002)
Change in net assets	70,842	78,276
Net assets, beginning of year	595,001	516,725
Net assets, end of year	\$ 665,843	\$ 595,001

See notes to consolidated financial statements.

PIH Health, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
Years Ended September 30, 2018 and 2017
(In Thousands)

	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ 70,842	\$ 78,276
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	40,253	39,544
Provision for bad debts	14,970	12,413
Amortization of deferred financing costs	185	192
Accretion of bond premium	(86)	(89)
Amortization of bond discount	24	24
(Gain) loss on disposal of property and equipment	(144)	107
Net realized gains on investments	(7,736)	(3,533)
Unrealized gains on investments	(5,424)	(30,522)
Gain on interest rate swap	(12,790)	(16,796)
Pension-related changes other than net periodic pension cost	(22,945)	(11,354)
Contributions restricted for purchase of long-lived assets	-	(212)
Noncash contributions received	(282)	-
Proceeds from sale of donated securities	282	-
Other miscellaneous losses	-	1,400
Changes in assets and liabilities:		
Patient accounts receivable	(20,754)	(9,386)
Inventory	266	(1,061)
Other receivables	3,311	(2,638)
Prepaid expenses and other assets	3,327	(1,895)
Other current assets, Hospital Fee Program	28,583	(19,233)
Other assets	552	2,488
Accounts payable and accrued expenses	(6,506)	9,007
Estimated third-party payor settlements	204	(779)
Accrued interest	66	(145)
Other current liability, Hospital Fee Program	(12,075)	4,982
Retention, self-insurance programs	(2,829)	(3,040)
Pension liability	(5,272)	4,047
Deferred compensation	930	1,160
Net cash provided by operating activities	66,952	52,957
Cash flows from investing activities:		
Purchase of assets limited as to use	(120,990)	(81,864)
Proceeds from sale of assets limited as to use	118,313	87,496
Purchase of investments in mutual funds and other investments	(11,979)	(9,529)
Proceeds from sales of investments in mutual funds and other investments	7,176	7,050
Proceeds from sale of property and equipment	144	13
Purchase of property and equipment	(34,693)	(54,941)
Net cash used in investing activities	(42,029)	(51,775)

(Continued)

PIH Health, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (Continued)
Years Ended September 30, 2018 and 2017
(In Thousands)

	2018	2017
Cash flows from financing activities:		
Repayment of long-term debt	\$ (9,555)	\$ (9,692)
Proceeds from borrowing	37,000	15,000
Repayment of short-term debt	(57,000)	(20,000)
Payments of capital lease obligations	(668)	(674)
Payments of Downey's prepetition liabilities	(2,591)	(2,591)
Payment of security agreement	(212)	(327)
Contributions restricted for purchase of long-lived assets	-	212
Net cash used in financing activities	(33,026)	(18,072)
Net decrease in cash and cash equivalents	(8,103)	(16,890)
Cash and cash equivalents, beginning of year	14,791	31,681
Cash and cash equivalents, end of year	<u>\$ 6,688</u>	<u>\$ 14,791</u>
Supplementary disclosure of cash flow information:		
Cash paid for interest	<u>\$ 16,285</u>	<u>\$ 16,709</u>

Supplementary information relating to noncash operating and investing activities:

As of September 30, 2018 and 2017, accounts payable and accrued expenses include \$4,633 and \$4,207, respectively, related to purchases of property and equipment.

See notes to consolidated financial statements.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 1. Organization

PIH Health, Inc. (PIH) is a nonprofit California corporation located in Whittier, California. PIH is the sole member (as the term “member” is defined in California Corporations Code, Section 5056) of the following 15 nonprofit, limited liability or captive insurance corporations, and two for-profit subsidiaries:

- PIH Health Hospital - Whittier (PIH - Whittier)—tax-exempt organization
- PIH Health Hospital - Downey (PIH - Downey)—tax-exempt organization
- PIH Health Physicians (PHP)—tax-exempt organization
- PIH Health Real Estate Services, LLC—limited liability corporation
- PIH Health Management Corp. (PIHMC)—tax-exempt organization
- PIH Health Foundation (PIHF)—tax-exempt organization
- PIH Health Adult Day Healthcare—tax-exempt organization
- PIH Health Community Pharmacy—limited liability corporation
- PIH Health Insurance Company, a reciprocal risk retention group—captive insurance company
- PIH Health RE, a reciprocal captive insurance company
- PIH Health Care Solutions (PHCS)—taxable nonprofit
- Putnam Properties, LLC—limited liability corporation
- KDW Real Estate Investments, LLC—limited liability corporation
- PIH Health Home Healthcare—tax-exempt organization
- Downey Regional Medical Center Properties, Inc. (DRMCP)—for-profit
- Memorial Trust Foundation (MTF)—tax-exempt organization
- HealthMed Services, Inc.—for-profit

These entities are collectively referred to as the Company.

The Company has an integrated delivery network that provides health care services to southeastern Los Angeles County, Orange County, portions of the San Gabriel Valley and the City of Downey. PIH - Whittier is a 523-bed regional hospital that provide a full range of health services, including transitional care services, home health and hospice services. PIH - Downey is a 199-bed acute care hospital servicing the Downey community. PIH - Whittier and PIH - Downey are referred herein as the Hospitals.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 1. Organization (Continued)

In February 2008, PHP was formed and acts as a physician organization offering a network of primary care physicians and specialists as well as a number of special benefit services to the community, including community education, urgent care and after-hour clinics, community health screenings, multispecialty care centers and mobile screening clinics.

In December 2008, PIH Health Insurance Company was created as a reciprocal insurance exchange and incorporated under the laws of the state of Hawaii. Effective January 1, 2009, this entity began to provide professional liability, commercial general liability, and managed care errors and omissions liabilities insurance to PIH - Whittier, PIH - Downey, physicians and medical groups.

On November 20, 2012, PHCS was incorporated as a California nonprofit mutual benefit corporation. On April 15, 2014, PHCS' application for a limited Knox Keene license was approved by the California Department of Managed Health Care. PHCS' operations were de minimis in fiscal years 2018 and 2017. As of September 30, 2018, PHCS still holds a valid limited Knox-Keene license with zero membership.

On January 15, 2014, PIH Health Real Estate Services, LLC was established to serve as a single-purpose entity in relation to the acquisition of a medical office building in Downey, California. PIH is the sole member of the single-member limited liability company.

On August 27, 2014, two limited liability corporations were established, Putnam Real Estate Properties, LLC and KDW Real Estate Investments, LLC. PIH is the sole member of the single-member limited liability companies. These entities will be utilized to acquire strategic parcels of land. No activities occurred during fiscal years 2018 or 2017.

On December 17, 2014, PIH Health RE received approval to operate as a captive insurance company and is domiciled in the state of Hawaii. Effective January 1, 2015, this entity began to provide medical stop-loss insurance coverage to the employee health plan.

Note 2. Summary of Significant Accounting Policies

Principles of consolidation and basis for presentation: The accompanying consolidated financial statements include the accounts of the above member corporations and affiliates. All intercompany transactions have been eliminated in consolidation. The consolidated financial statements are prepared on the accrual basis of accounting. See the recent accounting pronouncements section below.

Use of estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (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 consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of the consolidated financial statements, including the following: patient accounts receivable and net patient service revenue, which includes contractual allowances and provision for doubtful accounts; estimated useful lives of property and equipment; investment valuation, self-insured workers' compensation and professional and general liabilities; incurred but not reported liabilities; employee group health and dental plan; estimated third-party payor estimates; valuation of interest rate swaps; and risk assumptions for measurement of pension obligations. Management bases its estimates on historical experience and various other assumptions that it believes are reasonable under the particular circumstances. Actual results could differ significantly from those estimates.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Cash and cash equivalents: Cash and cash equivalents are short-term, highly liquid investments with maturities of three months or less at the time of purchase. Cash and cash equivalents exclude amounts whose use is limited by Board of Directors' (the Board) designation, other arrangements under trust agreements and certain overnight short-term investments that participate in a reinvestment program.

The Company maintains cash and cash equivalents in accounts held by major banks and financial institutions which, at times, exceed the amounts insured by the U.S. government. The Company has not experienced any losses related to these balances.

Patient accounts receivable: The Company has agreements with third-party payors that provide for payments at established rates. Payment arrangements with third-party payors include prospectively determined rates per discharge, per diem payments, discounted charges and reimbursed costs. Patient accounts receivable and net patient service revenue are reported at the net realizable amounts from patients, third-party payors and others for services rendered.

As part of the Company's mission to serve the community, the Company provides care to patients even though they may lack adequate insurance or may participate in programs with negotiated or regulated payment amounts. The Company makes every effort to determine if a patient qualifies for charity care upon admission, though determination may also be made at a later time. After satisfaction of amounts due from insurance, the application of any financial, uninsured or other discounts or payments received on the account, and reasonable efforts to collect from the patient have been exhausted, the Company follows established guidelines for placing certain past-due patient balances with collection agencies, subject to certain restrictions on collection efforts as determined by the Company. The Company manages its collection risk by regularly reviewing its accounts and contracts, and by providing appropriate allowances that are netted against patient accounts receivable in the consolidated balance sheets.

The provision for bad debts is based upon management's assessment of historical and expected net collections, taking into consideration historical business and economic conditions, trends in health care coverage and other collection indicators. Management routinely assesses the adequacy of the allowances for uncollectible accounts based upon historical write-off experience by payor category. The Company follows established guidelines for placing certain patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by each facility. The provision for bad debts is presented on the consolidated statements of income as a deduction from patient services revenues (net of contractual allowances and discounts), since the Company generally accepts and treats all patients without regard to the ability to pay.

Investments: The Company establishes guidelines for investment decisions. Within those guidelines, the Company invests in equity securities with readily determinable fair values and in debt securities, which are measured at fair value and are classified as trading or other-than-trading securities. Investment income or loss, net of expenses, is included in other gains and losses, unless the income or loss is restricted by donor or legally imposed restrictions. Unrealized gains and losses on investments, if any, are excluded from excess of revenues over expenses and other gains (losses), unless the loss is considered to be other-than-temporarily impaired.

Management assesses its intent to sell all debt and equity investments. If such intent exists, and an unrealized loss is present, securities may be considered other-than-temporarily impaired.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Management also assesses if the Company may be required to sell the debt investments (due to the financial health and credit deterioration of the issuer), which may also trigger such a charge. No impairment amount was recognized during the years ended September 30, 2018 and 2017.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially differ from the amounts in the accompanying consolidated balance sheets.

Assets limited as to use: Investments classified as assets limited as to use are stated at fair value. Assets limited as to use include primarily (a) assets set aside by the Board for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes and (b) investments held by trustees under indenture agreements.

Fair value measurements: The Company measures and reports the fair value of its investments and certain liabilities in accordance with Accounting Standards Codification (ASC) 820, *Fair Value Measurement and Disclosures*. The Company records and classifies the investments and liabilities based on the level of judgment associated with the inputs used to measure their fair value and the level of market price observability. The Company also estimates fair value when the volume and level of activity for the assets have significantly decreased or in those circumstances that indicate when a transaction is not orderly.

Investments and liabilities measured and reported at fair value using level inputs are classified and disclosed in one of the following categories:

Level 1: Quoted prices are available in active markets for identical investments as of the reporting date. The types of investments included in Level 1 include listed equities and publicly-traded mutual funds whose value is determined based on quoted market prices for such investments. As required by ASC 820, the Company does not adjust the quoted price for these investments even in situations where it holds a large position and a sale could reasonably affect the quoted price.

Level 2: Pricing inputs are other-than-quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies, which are based on an income approach. Specific pricing inputs include quoted prices for similar securities in both active and nonactive markets and other observable inputs, such as interest rates, yield curve volatilities, default rates, and inputs that are derived principally from or corroborated by other observable market data. Investments that are generally included in this category include U.S. Treasury securities, asset-backed securities, corporate bonds, municipal bonds and interest rate swaps.

Level 3: Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

The fair values of investments, assets limited as to use, and investments in mutual funds and other investments are based on quoted market prices, if available, or estimated using quoted market prices for similar securities on the last business day of the fiscal year.

Joint Venture: In September 2014, the Company entered into a joint venture arrangement (Vivity) with Anthem Blue Cross and six other health systems in Southern California. As of September 30, 2018, the Company has a 12.5 percent interest and its contribution amounted to \$800, which has been recorded under the cost method of accounting as the Company is not deemed to exert significant influence over Vivity.

Inventory: Inventory is stated at the lower of cost or market, determined using the weighted-average cost method on a first-in, first-out basis.

Other receivables: Other receivables consist primarily of third-party physician billings, annual cost report settlements and various other receivables.

Prepaid expenses and other assets: Prepaid expenses and other assets consist primarily of various prepaid clinical and administrative expenses, insurance claim recoveries and other miscellaneous current assets.

Property and equipment: Property and equipment are recorded at cost. Depreciation on property and equipment is computed using the straight-line method over the estimated useful life of each class of depreciable assets. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful lives of the improvements or the term of the related lease. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. No interest costs were capitalized for the years ended September 30, 2018 or 2017.

Estimated useful lives by asset type are generally as follows:

	<u>Years</u>
Land improvements	8-30
Buildings and improvements	5-50
Equipment, fixed and major movable	5-15
Leasehold improvements	Shorter of the estimated useful lives or term of lease
Information technology equipment and software	2-18

When property is sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting net gain or loss is included in the excess of revenues over expenses and other gains (losses) in the accompanying consolidated statements of income. The costs of normal maintenance, repairs and minor replacements are charged to expense when incurred.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Asset impairment: The Company routinely evaluates the carrying value of its long-lived assets for impairment and assessment of useful lives. The Company performs an impairment test annually or more frequently if there are changes in events or circumstances that indicate that the carrying value of the asset, or related group of assets, may not be recoverable from estimated future undiscounted cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds the estimated recoverability, an asset impairment charge is recognized. The impairment tests are based on financial projections prepared by management that incorporate anticipated results from programs and initiatives being implemented and market value assessments of the assets. If projections are not met, or if negative trends occur that impact the future outlook, the value of the long-lived assets may be impaired.

Fair value of financial instruments: The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents and other financial instruments, such as receivables, payables and short-term loan borrowing approximates fair value due to short-term maturities. The fair value of investments is disclosed in Note 4.

The fair values of long-term debt (bonds, capital leases, commercial mortgages and security agreements) are estimated based on the current rates offered for debts of similar issues and same remaining maturities (Level 2). As of September 30, 2018 and 2017, the fair value of the Company's long-term debt was \$382,928 and \$396,333, respectively.

Deferred financing costs: Deferred financing costs consist primarily of costs incurred in connection with the issuance of the 2014, 2012, 2011 and 2009 revenue bonds, which are amortized based on the interest method over the life of the bonds. Deferred financing costs are included as a direct deduction from the carrying amount of the related debt liability on these consolidated financial statements.

Bond premiums and discounts: Bond premiums and discounts are deferred and amortized based on the interest method over the life of the bonds.

Self-insurance plans: The Company maintains self-insurance programs for workers' compensation benefits for employees, professional and general liability risks, group health and dental plans. Annual self-insurance expense under these programs is based on past claims experience and projected losses. Actuarial estimates of uninsured losses for workers' compensation and professional and general liability at September 30, 2018 and 2017, have been accrued as liabilities and include an actuarial estimate for claims incurred but not reported. Management's estimate of uninsured losses for the group health and dental plans as of September 30, 2018 and 2017, have been accrued as liabilities and include an estimate for claims incurred but not reported.

The Company has insurance coverage in place for amounts in excess of the self-insured retention workers' compensation, professional and general liabilities, group health and dental plans. The Company records recoveries against cost.

Interest rate swap: The Company accounts for derivative instruments in the consolidated balance sheets as either assets or liabilities measured at estimated fair value, and recognizes any unrealized gains or losses in the consolidated statements of income. In certain defined conditions, a derivative may be specifically designated as a hedge for a particular exposure. The accounting for derivatives depends on the intended use of the derivatives and the resulting designation. Management has not designated the interest rate swaps as hedges in accordance with ASC 815, *Derivatives and Hedging*.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

The Company uses derivative financial instruments to manage its exposure to interest rate risk and to balance its variable rate long-term debt portfolio. Credit risk related to derivative financial instruments is considered minimal and is managed by requiring high credit standards for its counterparties.

Net patient service revenue: The Company has agreements with third-party payors that provide for payments to the Company at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is recognized in the period the related services are rendered and is reported at the estimated net realizable amounts due from patients, third-party payors and others, including estimated retroactive adjustments under reimbursement agreements with third-party payors. These retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

The Company recognizes patient revenue associated with the services provided to patients who have third-party payor coverages on the basis of the contractual rates for the services rendered and estimated collectibility of deductibles and co-insurance. For uninsured patients that do not qualify for charity care, the Company recognizes revenue on the basis of discounted rates.

340B program: PIH – Whittier participates in the 340B drug discount program, which enables qualifying health care providers to purchase drugs from pharmaceutical suppliers at a discount prescribed by the government. The 340B program is managed by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs. PIH – Whittier benefits under this program by purchasing pharmaceuticals at a reduced cost. As one of the conditions for participating in the 340B program, PIH – Whittier is subject to audits by the government. Government audit activity involving the 340B program has increased and may further increase in the foreseeable future. Reimbursements to the 340B program by CMS is periodically evaluated and such activity may have an impact on the program participants.

Capitation revenue: The Company has agreements with various health maintenance organizations (HMO) to provide medical services to subscribing participants. Under these arrangements, the Company receives monthly capitation payments based on the number of each HMO's participants assigned to the Company, regardless of services performed by the Company. Capitation revenue is recognized based on the period the Company is obligated to provide services. In addition, the HMOs make fee-for-service payments to the Company for certain covered services based upon discounted fee schedules, per diem rates and case rates.

Capitation claims expense: The cost of health services provided by other health care providers to participants, including administrative costs, out-of-area or emergency services, and services contracted for but not provided by the Company, are included in capitation claims expense. Such amounts are accrued in the period in which the services are provided based in part on estimates, including an accrual for services provided by others but not reported to the Company. The accruals amounted to \$7,622 and \$8,656 at September 30, 2018 and 2017, respectively, and are included in accounts payable and accrued expenses.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Traditional charity care: The Company provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Company maintains records to identify and monitor the level of charity care it provides. Because the Company does not pursue collection of amounts determined to qualify as charity care, these charges are not reported as revenue. The amount of services written off as charity quantified at customary charges was approximately \$57,000 and \$45,000 for the years ended September 30, 2018 and 2017, respectively. The estimated costs of providing charity services are based on a calculation, which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of costs to charges is calculated based on the Hospitals' total expenses divided by gross patient service revenue. The cost of these benefits and services was approximately \$6,900 and \$4,228 for the years ended September 30, 2018 and 2017, respectively.

Community benefits: As part of its mission, the Company provides services to the poor and benefits for the broader community. The costs incurred to provide such services are included in excess of revenues over expenses and other gains (losses) in the consolidated statements of income. The Company prepares a summary of unsponsored community benefit expenses in accordance with Internal Revenue Service Form 990, Schedule H, and the California Health Association of the United States publication, *A Guide for Planning and Reporting Community Benefit*.

A separate Community Benefit Report is issued by the Company and the current unaudited report is available on the Company's website: <https://www.pihhealth.org/app/files/public/3402/cb-annual-report-2017-v2.pdf>.

Contributed services: Volunteers have donated significant amounts of time and services to the Hospitals' operations. Contributed services are recognized if the services received, which create or enhance long-lived assets or require specialized skills, would have typically been purchased if not provided by donation. None of the services donated met these criteria, and accordingly, no volunteer time has been reflected in the accompanying consolidated financial statements.

Other operating revenue: Other operating revenue mainly includes certain third-party physician billing, drugs sold to non-patients and rental income.

Operating and nonoperating activities: The Company's primary mission is to meet the health care needs in its market areas through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to the Company's primary mission are considered to be nonoperating. Nonoperating activities include investment income, net realized gains on investments, change in fair value of interest rate swap and net interest expense, gain (loss) on disposal of property and equipment, other gains (losses), net, unrealized gains (losses) on investments, pension-related changes other than net periodic pension cost, and net assets released from restrictions used for long-lived assets.

Excess of revenues over expenses and other gains: Management has identified the excess of revenues over expenses and other gains as the performance indicator. The consolidated statements of income include the excess of revenues over expenses and other gains. Changes in unrestricted net assets, which are excluded from this total, include unrealized gains (losses) on investments, contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets), and pension-related changes other than net periodic pension cost.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Donor-restricted gifts: Unconditional promises to give cash and other assets 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 or when the conditions expire, whichever occurs first. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of income as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the consolidated statements of income.

Temporarily and permanently restricted net assets: Temporarily restricted net assets are those whose use by the Company has been limited by donors to a specific time period or purpose. Permanently restricted net assets are those with donor-imposed restrictions that are to be maintained by the Company in perpetuity.

Investment income on temporarily or permanently restricted net assets is classified pursuant to the intent or requirement of the donor.

Endowment assets include donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. The Company preserves the fair value of these gifts as of the date of the donation unless otherwise stipulated by the donor. Portions of donor-restricted endowment funds that are not classified in permanently restricted net assets are classified as temporarily restricted net assets until those amounts are appropriated for expenditure. The Company considers 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 purpose of the organization 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 appreciation of investments, (6) other resources of the organization, and (7) the investment policies of the Company.

The Company has investment and spending policies for endowment assets designated to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets.

Endowment assets are invested in a manner that is intended to produce results that achieve the respective benchmark while assuming an appropriate level of investment risk. Actual returns in any given year may vary from this amount. To satisfy its long-term rate-of-return objectives, the Company relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Company has a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level the Company is required to retain as a fund of perpetual duration. Deficits of this nature are reported in unrestricted net assets, unless otherwise specified by the donor.

Interest expense: The components of interest expense, net, include interest and fees on debt. Net interest expense associated with the swaps and change in fair value of the swaps is included in change in fair value of interest rate swap and net interest expense in the accompanying consolidated statements of income.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Pension plan: The Company applies the provisions of ASC 715, *Compensation—Retirement Benefits*, which requires a not-for-profit organization to recognize the overfunded or underfunded status of a defined benefit postretirement plan (measured as the difference between the fair value of plan assets and the projected benefit obligation as of the date of the fiscal year-end) as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets.

Income taxes: The Company has established its status as an organization exempt from income taxes under the Internal Revenue Code (IRC) Section 501(c)(3) and the laws of the states in which it operates, and as such, is generally not subject to federal or state income taxes. However, the Company is subject to income taxes on net income derived from a trade or business regularly carried on, which does not further the organization's exempt purpose. No significant income tax provision has been recorded in the accompanying consolidated financial statements for net income derived from unrelated trade or business.

The Company measures liabilities for unrecognized tax uncertainties in accordance with ASC 740, *Income Taxes*, which prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on a tax return. The guidance is applicable to profit-oriented entities, pass-through entities and tax-exempt organizations. Management believes it has no significant uncertain tax positions, and as such no tax liability, benefits, interest or penalties were accrued at September 30, 2018 or 2017. The Company is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Company believes it is no longer subject to income tax examinations for years prior to 2014 for federal purposes and 2012 for California purposes.

Recent accounting pronouncements: In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue From Contracts With Customers*, which provides a robust framework for addressing revenue recognition and replaces most of the existing revenue recognition guidance, including industry-specific guidance, in current U.S. GAAP. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 for all entities by one year. The standard and subsequent amendments (ASU Nos. 2016-08, 2016-10, 2016-12 and 2016-20) are effective for the Company's fiscal year beginning October 1, 2018. Management is currently evaluating the impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall*, which requires all investments in equity securities (other than those that qualify for equity method accounting or that are consolidated) to be reported at fair value, with changes in fair value reported through income. Also, it removes, for entities other than public business entities, the required disclosures of fair value of financial instruments measured at amortized costs (e.g., debt). The guidance is effective for the Company as of October 1, 2019. Management is in the process of determining the potential impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 amends the accounting for leases, requiring lessees to recognize most leases on their balance sheet with a right-of-use asset and a lease liability. Leases will be classified as either finance or operating leases, which will impact the expense recognition of such leases over the lease term. The ASU also modifies the lease classification criteria for lessors and eliminates some of the real estate leasing guidance previously applied for certain leasing transactions. The guidance is effective for the Company as of October 1, 2019. Management is in the process of determining the potential impact on its consolidated financial statements.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities, Presentation of Financial Statements of Not-for-Profit Entities*, which requires improved presentation and disclosures to help not-for-profit entities provide more relevant information about their resources to donors, grantors, creditors and other issues, including net asset classifications, investment returns, expenses, liquidity and availability of resources and presentation of operating cash flows. The guidance is effective for the Company beginning October 1, 2018.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*, which provides consistent principles for evaluating the classification of cash payments and receipts in the statement of cash flows. The guidance is effective for the Company beginning October 1, 2018.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows: Restricted Cash*. The guidance clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The guidance requires entities to present the change in restricted cash and restricted cash equivalents with cash and cash equivalents to reconcile amounts on the balance sheet to the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. Entities will be required to disclose the nature of the restrictions, as well as reconcile the totals in the statement of cash flows to cash, cash equivalents, restricted cash and restricted cash equivalents on the balance sheet when these are shown in more than one line item. The guidance is effective for the Company beginning October 1, 2018.

In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement or cancellation of liabilities) is a contribution or an exchange transaction. The amendments also require that an entity determine whether a contribution is conditional on the basis of whether an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. The presence of both a barrier and a right of return or a right of release indicates that a recipient is not entitled to the transferred assets or a future transfer of assets until it has overcome the barrier(s) in the agreement. The guidance is effective for the Company beginning October 1, 2018.

Management is currently evaluating the impact of these new accounting standards on its consolidated financial statements.

Reclassifications: Certain prior-year amounts have been reclassified to conform to current-year presentation with no impact on the reported net assets.

Note 3. Net Patient Service Revenue

The Company recognizes patient service revenue on the basis of contractual rates for the services rendered for those patients who have third-party coverage. For the uninsured patients who do not qualify for charity care, the Company recognizes revenue on the basis of its standard rates (or on the basis of discounted rates if negotiated or provided by policy). Patients covered by insurance, but required to pay deductibles or co-payments, are considered to be uninsured for those portions. Based on historical experience, the Company believes that a significant portion of its self-pay patient accounts will be uncollectible. Thus, it records a significant provision for bad debts related to self-pay patient accounts in the period the services are provided.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 3. Net Patient Service Revenue (Continued)

The Company's allowance for doubtful accounts was \$14,798 as of September 30, 2018, compared to \$14,961 as of September 30, 2017, or 15.3 percent and 16.8 percent of patient accounts receivable as of September 30, 2018 and 2017, respectively.

The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. The Company accrues for amounts that it believes may ultimately be due from Medicare and other third-party payors and reports such amounts in the accompanying consolidated financial statements. A summary of the payment arrangements with major third-party payors is as follows:

Medicare: Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain outpatient services provided to Medicare beneficiaries are paid based on prospectively determined rates for covered outpatient hospital services using ambulatory payment classification groups (APCs). APCs compose a system covering outpatient services consisting of groups arranged so that services within each group are comparable clinically and with respect to the use of resources. PIH is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by PIH and audits thereof by the Medicare administrative contractor. PIH - Whittier's Medicare cost reports have been audited by the Medicare fiscal intermediary through September 30, 2015. PIH - Downey's Medicare cost reports have been audited by the Medicare fiscal intermediary through September 30, 2014.

Medi-Cal: Beginning on July 1, 2013, the California Medi-Cal program transitioned away from negotiated, per diem contracts to a fee schedule based on the patient's final, determined diagnosis (known as diagnosis-related groupings or APR-DRGs). Under APR-DRGs, reimbursement is scaled to patient acuity and complexity.

Capitation revenue: PHP contracts with various HMOs to provide health care services to HMO enrollees. Under the various contracts, PHP receives monthly capitation payments based on the number of enrollees, regardless of physician services actually performed by PHP.

Effective March 1, 2016, the Company entered into a capitation agreement with United Health Care, which provides health care services to senior HMO enrollees. Under this contract, PIH - Whittier receives monthly capitation payments based on the number of enrollees, regardless of services actually provided by PIH - Whittier and other outside facilities. As of September 30, 2018 and 2017, estimated liabilities of \$1,252 and \$1,321, respectively, for services provided to these enrollees by providers other than the Company, are included in accounts payable and accrued expenses in the accompanying consolidated financial statements.

Other: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations (PPO). The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 3. Net Patient Service Revenue (Continued)

Patient service revenues, net of contractual and other allowances (but before the provision for bad debts), recognized during the years ended September 30 are as follows:

	2018	2017
Medicare	\$ 234,164	\$ 230,671
Medi-Cal	108,514	101,175
HMO	128,447	115,422
PPO	210,479	200,635
Other third-party and self-payors	88,058	84,695
	<u>\$ 769,662</u>	<u>\$ 732,598</u>

A summary of net patient service revenue before provision for bad debts for the years ended September 30 is as follows:

	2018	2017
Gross charges:		
Inpatient	\$ 2,420,006	\$ 2,278,817
Outpatient and other	2,448,914	2,415,756
Total gross patient service revenue	<u>4,868,920</u>	<u>4,694,573</u>
Less:		
Contractual and other allowances	(4,087,652)	(3,957,119)
Charity care	(11,606)	(4,856)
Net patient service revenue before provision for bad debts	<u>\$ 769,662</u>	<u>\$ 732,598</u>

Note 4. Investments and Assets Limited as to Use

Investments: Short-term investments are stated at fair value and amounted to \$3,692 and \$2,895 as of September 30, 2018 and 2017, respectively. Such investments are composed of cash for reinvestment, commercial paper, debt securities and U.S. Treasury bills.

Investments in mutual funds and other investments: The Company has investments held by PIH Health Insurance Company, a reciprocal risk retention group, and nonqualified deferred compensation plans that provide for deferred compensation at various minimum levels, based on employment status. The plans are available to certain physician, supervisory and executive personnel. The Company has invested the deferred amounts in mutual funds and other investments that are stated at fair value. Such amounts, while segregated in the accompanying consolidated financial statements, are available to satisfy the Company's obligations to the general creditors, if necessary. The deferred amount includes investments in a fixed-income annuity of \$7,015 and \$7,008 as of September 30, 2018 and 2017, respectively, which is categorized as Level 3 of the fair value categories. Additionally, the Company has a flexible benefit plan that provides for life insurance coverage for certain executive personnel.

Investments in mutual funds and other investments were \$46,219 and \$41,480, of which \$4,828 and \$4,566 were related to the flexible benefit plan for executives, as of September 30, 2018 and 2017, respectively.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 4. Investments and Assets Limited as to Use (Continued)

Assets limited as to use: The composition of assets limited as to use at fair value as of September 30 is as follows:

	2018	2017
Cash and cash equivalents	\$ 11,719	\$ 5,730
Fixed-income securities	98,092	98,531
Equity securities	171,756	157,732
Mutual funds	172,280	176,752
Investments, assets limited as to use	<u>\$ 453,847</u>	<u>\$ 438,745</u>

Assets limited as to use at fair value as of September 30 consist of amounts designated as follows:

	2018	2017
Board-designated for building and equipment	\$ 452,587	\$ 438,444
Held by lender escrow fund (Note 6)	958	-
Restricted by government agency	302	301
Investments, assets limited as to use	<u>\$ 453,847</u>	<u>\$ 438,745</u>

The unrealized losses and fair value of the Company's investments and assets limited as to use with unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30 are as follows:

	2018					
	Unrealized Losses				Total	
	Less Than 12 Months		12 Months or Greater			
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
Equity securities includes						
mutual funds	\$ 72,335	\$ (4,631)	\$ 31,617	\$ (1,168)	\$ 103,952	\$ (5,799)
Fixed income	53,688	(2,552)	38,548	(854)	92,236	(3,406)
Total	<u>\$ 126,023</u>	<u>\$ (7,183)</u>	<u>\$ 70,165</u>	<u>\$ (2,022)</u>	<u>\$ 196,188</u>	<u>\$ (9,205)</u>

	2017					
	Unrealized Losses				Total	
	Less Than 12 Months		12 Months or Greater			
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
Equity securities, includes						
mutual funds	\$ 17,963	\$ (859)	\$ 30,002	\$ (2,712)	\$ 47,965	\$ (3,571)
Fixed income	31,477	(511)	16,784	(482)	48,261	(993)
Total	<u>\$ 49,440</u>	<u>\$ (1,370)</u>	<u>\$ 46,786</u>	<u>\$ (3,194)</u>	<u>\$ 96,226</u>	<u>\$ (4,564)</u>

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 4. Investments and Assets Limited as to Use (Continued)

The unrealized losses on the Company's investments in debt and equity securities were caused by interest rate increases and current market volatility. The Company has the ability and intent to hold these debt and equity securities until a recovery of fair value (which may be maturity).

Fair value measurements: Investments are measured and reported at fair value using level inputs, as defined by ASC 820. A description of valuation inputs and techniques that the Company utilizes to fair value each major category of assets is as follows:

Cash and cash equivalents: Cash and cash equivalents are primarily short-term money market funds that are categorized as Level 1.

Fixed-income securities (U.S. government, corporate debt instruments, state and municipal, and mortgage and asset backed): Fixed-income securities are categorized as either Level 1 or Level 2 depending on the volume of market activity. They are valued using third-party pricing services. These services may use, for example, model-based pricing methods that utilize observable market data as inputs. Broker-dealer bids or quotes of securities with similar characteristics may also be used.

Mutual funds (balanced funds, bond funds and equity funds): Registered with the Securities and Exchange Commission as mutual funds under the Investment Company Act of 1940. To the extent valuation adjustments are not applied, mutual funds are categorized as Level 1.

Equity securities (common stock): Equity securities that are actively traded on a securities exchange are valued based on quoted prices from the applicable exchange, and to the extent valuation adjustments are not applied to these securities, they are categorized as Level 1.

Investments in fixed-income annuities: The fair value of the fixed-income annuity contracts was estimated based on the provisions of the contract and classified as Level 3.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 4. Investments and Assets Limited as to Use (Continued)

The information about the Company's assets and liabilities measured at fair value on a recurring basis and the fair value hierarchy of the valuation techniques utilized by management to determine such fair values as of September 30 are as follows:

	2018			Total
	Level 1	Level 2	Level 3	
Assets:				
Investments, short term:				
Cash and cash equivalents	\$ 2,015	\$ -	\$ -	\$ 2,015
Fixed-income securities:				
Corporate debt instruments	224	1,433	-	1,657
Mortgages and asset backed	20	-	-	20
Total investments, short term	<u>\$ 2,259</u>	<u>\$ 1,433</u>	<u>\$ -</u>	<u>\$ 3,692</u>
Cash and cash equivalents	<u>\$ 74</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 74</u>
Fixed-income securities:				
U.S. government and agency	3,271	-	-	3,271
Corporate debt instruments	2,981	1,612	-	4,593
Mortgages and asset backed	3,088	-	-	3,088
Total fixed-income securities	<u>9,340</u>	<u>1,612</u>	<u>-</u>	<u>10,952</u>
Mutual funds:				
Balanced funds	118	-	-	118
Bond funds	563	-	-	563
Equity funds	27,369	-	-	27,369
Real estate	128	-	-	128
Total mutual funds	<u>28,178</u>	<u>-</u>	<u>-</u>	<u>28,178</u>
Investments in fixed-income annuity	-	-	7,015	7,015
Total investments in mutual funds and other investments	<u>\$37,592</u>	<u>\$ 1,612</u>	<u>\$ 7,015</u>	<u>\$46,219</u>

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 4. Investments and Assets Limited as to Use (Continued)

	2018			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 11,719	\$ -	\$ -	\$ 11,719
Fixed-income securities:				
U.S. government and agency	31,900	3,864	-	35,764
Corporate debt instruments	-	40,324	-	40,324
Mortgages and asset backed	-	17,574	-	17,574
State and municipal	-	4,430	-	4,430
Total fixed-income securities	31,900	66,192	-	98,092
Equity securities:				
Communication services	19,126	-	-	19,126
Consumer discretionary	17,939	-	-	17,939
Consumer staples	6,159	-	-	6,159
Energy	4,092	-	-	4,092
Equity funds	27,482	-	-	27,482
Financials	22,589	-	-	22,589
Health care	12,923	-	-	12,923
Industrials	11,787	-	-	11,787
Information technology	28,603	-	-	28,603
Materials	3,462	-	-	3,462
Real estate	17,267	-	-	17,267
Utilities	327	-	-	327
Total equity securities	171,756	-	-	171,756
Mutual and commingled funds:				
Balanced funds	21,555	-	-	21,555
Bond funds	45,589	-	-	45,589
Equity funds	105,136	-	-	105,136
Total mutual and commingled funds	172,280	-	-	172,280
Total investments, assets limited as to use	\$ 387,655	\$ 66,192	\$ -	\$ 453,847

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 4. Investments and Assets Limited as to Use (Continued)

	2017			Total
	Level 1	Level 2	Level 3	
Assets:				
Investments, short term:				
Cash and cash equivalents	\$ 2,011	\$ -	\$ -	\$ 2,011
Fixed-income securities:				
U.S. government and agency	-	85	-	85
Corporate debt instruments	97	702	-	799
Total investments, short term	<u>\$ 2,108</u>	<u>\$ 787</u>	<u>\$ -</u>	<u>\$ 2,895</u>
Cash and cash equivalents	<u>\$ 91</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 91</u>
Fixed-income securities:				
U.S. government and agency	953	2,794	-	3,747
Corporate debt instruments	217	3,170	-	3,387
Mortgages and asset backed	173	348	-	521
Total fixed-income securities	<u>1,343</u>	<u>6,312</u>	<u>-</u>	<u>7,655</u>
Mutual funds:				
Balanced funds	127	-	-	127
Bond funds	1,760	-	-	1,760
Equity funds	24,746	-	-	24,746
Real estate	93	-	-	93
Total mutual funds	<u>26,726</u>	<u>-</u>	<u>-</u>	<u>26,726</u>
Investments in fixed-income annuity	<u>-</u>	<u>-</u>	<u>7,008</u>	<u>7,008</u>
Total investments in mutual funds and other investments	<u>\$28,160</u>	<u>\$ 6,312</u>	<u>\$ 7,008</u>	<u>\$41,480</u>

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 4. Investments and Assets Limited as to Use (Continued)

	2017			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 5,730	\$ -	\$ -	\$ 5,730
Fixed-income securities:				
U.S. government and agency	25,262	5,982	-	31,244
Corporate debt instruments	-	35,979	-	35,979
Mortgages and asset backed	-	26,486	-	26,486
State and municipal	-	4,822	-	4,822
Total fixed-income securities	25,262	73,269	-	98,531
Equity securities:				
Consumer discretionary	17,092	-	-	17,092
Consumer staples	6,922	-	-	6,922
Energy	2,415	-	-	2,415
Equity funds	24,582	-	-	24,582
Financials	23,257	-	-	23,257
Health care	12,025	-	-	12,025
Industrials	9,971	-	-	9,971
Information technology	35,585	-	-	35,585
Materials	4,561	-	-	4,561
Real estate	20,490	-	-	20,490
Utilities	832	-	-	832
Total equity securities	157,732	-	-	157,732
Mutual and commingled funds:				
Balanced funds	22,038	-	-	22,038
Bond funds	49,649	-	-	49,649
Equity funds	105,065	-	-	105,065
Total mutual and commingled funds	176,752	-	-	176,752
Total investments, assets limited as to use	\$ 365,476	\$ 73,269	\$ -	\$ 438,745

There were no significant transfers between levels during the years ended September 30, 2018 or 2017.

Investment income and gains: Income and gains related to investments for the years ended September 30 are comprised of the following:

	2018	2017
Net investment income	\$ 11,728	\$ 9,896
Net realized gains on investments, net of fees of \$1,744 and \$1,426 for 2018 and 2017, respectively	7,736	3,533
Net unrealized gains on investments	5,424	30,522
Total	\$ 24,888	\$ 43,951

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 5. Property and Equipment

Property and equipment as of September 30 consist of the following:

	2018	2017
Buildings and equipment	\$ 754,109	\$ 713,855
Land and land improvements	75,083	44,456
Leasehold improvements	148,779	130,988
Construction in progress	14,829	66,597
Total property and equipment	992,800	955,896
Less accumulated depreciation	(347,848)	(310,141)
Total property and equipment, net	\$ 644,952	\$ 645,755

Depreciation and amortization expense for the years ended September 30, 2018 and 2017, amounted to \$40,253 and \$39,544, respectively.

Note 6. Debt

A summary of long-term debt as of September 30 is as follows:

	2018	2017
Health Facility Revenue Bonds—Series 2014	\$ 66,300	\$ 66,300
Health Facility Revenue Notes—Series 2014	35,700	35,700
Health Facility Revenue Bonds—Series 2012	141,950	147,650
Health Facility Revenue Bonds—Series 2011	35,930	37,210
Health Facility Revenue Bonds—Series 2009	70,975	73,825
Unamortized bond premium—Series 2014	4,285	4,371
Unamortized bond discount—Series 2011	(307)	(331)
Commercial mortgage	6,368	6,498
Term loan	19,500	19,750
Security agreement with supplier	444	-
Less deferred financing cost, net	(3,390)	(3,574)
Less current portion	(10,753)	(10,210)
Total long-term debt, net	\$ 367,002	\$ 377,189

Series 2014 Health Facility Revenue Bonds and Notes: On August 1, 2014, PIH, PIHMC and PIH - Downey (collectively, the Obligated Group), jointly issued \$66,300 aggregate principal amount of City of Whittier Health Facility Revenue fixed-rate bonds (Series 2014 Bonds) at a premium of \$4,612 and \$35,700 aggregate principal amount of City of Whittier Health Facility Revenue notes (Series 2014 Notes), in total of \$106,612. The proceeds of these bonds and notes were used to (1) repay certain indebtedness (Bank Loan) incurred by PIH in connection with the affiliation with PIH - Downey, (2) to finance or reimburse the prior payment of costs of renovating and equipping the hospital facilities operated by PIH - Downey, and (3) to pay costs of issuance related to the Series 2014 Bonds and Series 2014 Notes.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Debt (Continued)

The Series 2014 Bonds bear a fixed-interest rate at 5 percent and have maturities beginning in 2040 and ending in 2044. The Series 2014 Notes are held by a financial institution and bear interest at 2.75 percent, and mature in 2024.

Series 2012 Health Facility Revenue Bonds: On December 31, 2012, the Obligated Group replaced its Series 2009 B and Series 2009 C City of Whittier Health Facility Revenue Bonds (aggregate of \$148,000 principal amount) with direct private placement bonds with varying term periods. The Series 2012 City of Whittier Health Facility Bonds (Series 2012 Bonds) initially consisted of three series: Series 2012 A with a notional amount of \$48,000 with initial five-year term (initial purchase date December 29, 2017), Series 2012 B with a notional amount of \$50,000 with initial six-year term (initial purchase date December 31, 2018) and Series 2012 C with a notional amount of \$50,000 with initial seven-year term (initial purchase date December 31, 2019). In July 2017, the Obligated Group remarketed the \$48 million Series 2012 A direct-purchase bonds with the existing financial institution, pursuant to the modified Indenture and Continuing Covenant Agreement. The purchase date was extended to June 1, 2022.

The Series 2012 Bonds are held by three large financial institutions and bear interest at approximately 65 percent to 68 percent of one-month LIBOR, plus 70 to 95 basis points. The Series 2012 Bonds have Sinking Fund Installments beginning in 2017 and final maturity in 2036. In November 2018, Series 2012 B was refinanced, as discussed in Note 15.

Series 2011 Health Facility Revenue Bonds: On March 31, 2011, the Obligated Group jointly issued \$41,305 aggregate principal amount of City of Whittier Health Facility Revenue fixed-rate bonds (Series 2011 Bonds) at a discount of \$477. The proceeds of these bonds were used to finance certain facilities for the benefit of the Hospitals and pay certain costs of issuance of the Series 2011 Bonds.

The Series 2011 Bonds bear fixed-interest rates ranging from 4 percent to 6.25 percent and have maturities beginning in 2012 and ending in 2036.

Series 2009 Health Facility Revenue Bonds: On May 14, 2009, the Obligated Group jointly issued \$222,000 aggregate principal amount of City of Whittier Health Facility Revenue variable rate bonds, Series 2009 A, Series 2009 B and Series 2009 C bonds (the Variable Rate Bonds), at par. Concurrently, the Obligated Group jointly issued \$58,000 aggregate principal amount of City of Whittier Health Facility Revenue fixed-rate bonds, Series D (the Fixed Rate Bonds) at a premium of \$329. The Fixed Rate Bonds, together with the Variable Rate Bonds, are referred to as the Series 2009 Bonds. The proceeds of these bonds were used to (1) finance certain facilities for the benefit of PIH, (2) advance refund the Series 2007 City of Whittier Health Facility Revenue Bonds (Series 2007 Bonds), (3) fund a reserve fund for the Series 2009 D Bonds, and (4) pay certain costs of issuance of the Series 2009 Bonds. The Series 2007 Bonds were originally issued with a principal balance of \$292,000 at par on January 31, 2007.

The Variable Rate Bonds bear interest at a weekly interest rate determined by the remarketing agents. During the year ended September 30, 2018, the weekly interest rate ranged from 0.91 percent to 1.75 percent and its weighted average was 1.15 percent. During the year ended September 30, 2017, the weekly interest rate ranged from 0.52 percent to 0.91 percent and its weighted average was 0.72 percent. If certain conditions are met, the Company may elect to convert the weekly interest rate period to either a daily or a long-term period. The Variable Rate Bonds have sinking fund requirements beginning in 2018 and ending in 2036. The Fixed Rate Bonds bear fixed-interest rates ranging from 4 percent to 5 percent and have maturities, which began in 2012 and final payment was made in June 2017.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Debt (Continued)

On September 27, 2016, the Letter of Credit Facility was amended with the existing bank for the Series 2012 Bonds. The Letter of Credit fee rate was reduced from 0.75 percent to 0.50 percent based on the Company's S&P rating. In addition, the term of the Letter of Credit term was extended to July 30, 2021.

There were no draws against the Letter of Credit Facility in the years ended September 30, 2018 or 2017.

In the case of a liquidity drawing made under the Letter of Credit Facility, the unpaid portion of this drawing shall constitute a term loan. The Company is required to repay the principal amount of each term loan in eight (8) equal quarterly installments of principal, plus interest at the bank rate, commencing on the first quarterly date following the 367th day following the drawing and continuing on each quarterly date thereafter through and including the seventh quarterly date, and on the third anniversary of the date of the applicable drawing, at which time all unpaid principal and accrued interest shall be due and payable in full.

Commercial mortgage: The Company had one commercial mortgage outstanding as of September 30, 2018 and 2017.

On April 25, 2014, PIH assumed a \$6,886 existing mortgage upon purchase of a medical office building. The mortgage is secured by the underlying real property, with a book value of \$11,888 as of September 30, 2018, and assignment of leases and rent relating to the medical office building. The mortgage bears interest at a fixed rate of 5.68 percent and is collateralized by the property. Monthly principal and interest payments are \$42 through November 1, 2020, with the remaining principal balance due on December 1, 2020. The terms of the mortgage also require monthly payments amounting to \$14 to fund property taxes, insurance, maintenance and improvements related to the secured property. These amounts, which are held in escrow by the lender, amounted to \$1,108 and \$710 as of September 30, 2018 and 2017, respectively. Principal payments totaled \$130 and \$122 for the fiscal years 2018 and 2017, respectively. As of September 30, 2018 and 2017, the balance due was \$6,368 and \$6,498, respectively.

Term loan: On April 1, 2016, the Company entered into a \$20,000 term loan agreement with a financial institution to provide capital to pay the remainder of a PIH - Downey fixed-rate note, obtain the rights to the purchase option to DRMCP for \$5,200, and for other general corporate purposes. The maturity date is June 1, 2021, and the interest rate is a fixed 2.35 percent. Covenants and security provisions are similar to the Company's other bank borrowings. Principal payments of \$250 are due annually in June with the final principal payment of \$19,000 due in June 2021. Interest payments of \$39 are payable monthly. As of September 30, 2018, the balance due was \$19,500.

Security agreement with supplier: On March 26, 2014, the Company entered into a \$1,300 security agreement to purchase medical equipment. The agreement is secured by the equipment and the amount due does not bear interest. Scheduled annual payments of were \$327, and the final payment of \$327 was made in November 2016.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Debt (Continued)

Scheduled principal repayments on long-term debt as of September 30, 2018, are provided in the table below. The table below illustrates principal payments at their stated maturities and assumes no early redemptions of Series 2012 direct placement bonds. If the Series 2012 A, 2012 B or 2012 C direct placement bonds are not remarketed or extended, additional principal in the amounts of \$40,135 (Series 2012 A), \$47,955 (Series 2012 B) and \$45,965 (Series 2012 C) would be due in fiscal years 2022, 2019 and 2020, respectively. See Note 15 for the subsequent refinancing of the Series 2012 B bonds.

Years ending September 30:

2019	\$	10,753
2020		11,157
2021		35,971
2022		11,260
2023		11,645
Thereafter		296,380
	\$	<u>377,166</u>

Total amount includes \$589 in debt discounts and premiums, and deferred financing cost.

Pursuant to a Master Indenture, the Company has pledged its gross revenues as security for all of its long-term debt. The Master Indenture provides for limitations on the increase of additional indebtedness, unless certain conditions are met, and requires the Company to maintain certain financial ratios, including a debt service coverage ratio. Management believes it has complied with all debt covenants pursuant to the Master Indenture as of September 30, 2018 and 2017.

Short-term loan borrowing: The Company has a \$55,000 revolving credit agreement with a financial institution. The annual interest rate spread to LIBOR is 0.70 percent and the commitment fee is 0.13 percent, based on the Company's S&P rating. The termination date of the revolving credit agreement is September 27, 2019. Revolving credit draws are for the purpose of working capital needs and general corporate purposes. Interest periods can be for one-, three- or six-month periods, at which point the Company may pay the balance, if any. During the fiscal year 2018, the Company borrowed \$37,000 against the revolving credit line and repaid \$57,000. During the fiscal year 2017, the Company borrowed \$15,000 against the revolving credit line and repaid \$20,000. As of September 30, 2018 and 2017, the aggregate outstanding balance on the Company's revolving credit line was \$28,000 and \$48,000, respectively.

Interest rate swaps: In connection with the issuance of the Series 2007 Bonds and in an effort to reduce its interest costs, PIH entered into three separate interest rate swap agreements with a total notional amount of \$212,925. Under the terms of the agreements, PIH agreed to pay to the counterparty a fixed rate of interest on the notional amount in exchange for receiving a payment from the counterparty based on a floating rate tied to the one-month LIBOR. From time to time, the Company may be required to post collateral with its swap counterparties. The amount of the collateral is based on (1) the daily valuation of the swaps, (2) the Company's S&P rating, and (3) the excess valuation over predetermined collateral thresholds.

As of September 30, 2018 and 2017, the cash collateral was \$0. Based on the Company's current A rating from S&P, the collateral thresholds are \$25,000 for one counterparty and \$10,000 for the other counterparty.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 6. Debt (Continued)

The swap agreements terminate approximately on the same date that the related bonds are scheduled to mature. As of September 30, 2018 and 2017, the swaps were recorded as a liability of \$25,961 and \$38,751, respectively. The change in value of the swaps totaling \$12,790 and \$16,796 in the years ended September 30, 2018 and 2017, respectively, is recorded in the consolidated statements of income as change in fair value of interest rate swaps, in addition to interest expense and interest income related to the swaps. As of September 30, 2018 and 2017, management has not designated the swaps as a hedge in accordance with ASC 815.

The Company had the following derivatives as of September 30:

Series	2018 Nominal Amount	Expiration Date	Fixed Rate	2018 Fair Value	2017 Fair Value
2009 A	\$ 70,975	June 2, 2036	3.208%	\$ (8,226)	\$ (12,433)
2012 A	35,480	June 2, 2036	3.196%	(4,151)	(6,182)
2012 A	10,555	June 1, 2036	3.320%	(1,350)	(2,001)
2012 B	24,940	June 1, 2036	3.320%	(3,187)	(4,725)
2012 B	23,015	June 1, 2036	3.402%	(2,934)	(4,349)
2012 C	47,960	June 1, 2036	3.402%	(6,113)	(9,061)
				<u>\$ (25,961)</u>	<u>\$ (38,751)</u>

The fair value of the interest rate swaps is estimated utilizing the terms of the swaps and publicly available market yield curves along with the Company's nonperformance risk as observed through the credit default swap market and bond market and based on prices for recent trades. These swap agreements are classified as Level 2 within the fair value hierarchy.

Note 7. Prepetition Liabilities

On September 14, 2009, PIH - Downey (the Debtor) filed voluntary petitions for bankruptcy protection under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Code in the United States Bankruptcy Court for the Central District of California (the Bankruptcy Court). As of September 30, 2018 and 2017, PIH - Downey had prepetition liabilities of \$1,191 and \$3,782, respectively. The balance at September 30, 2018, is due to be paid in fiscal year 2019.

Note 8. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets as of September 30 are available for the following purposes or periods:

	2018	2017
Contributions received and restricted for patient care	\$ 2,347	\$ 2,602
Contributions restricted for construction projects	1,302	3
Contributions restricted for specific programs	1,775	2,522
	<u>\$ 5,424</u>	<u>\$ 5,127</u>

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 8. Temporarily and Permanently Restricted Net Assets (Continued)

There were no time-restricted contributions during the fiscal years 2018 or 2017. Net assets released from restrictions in the accompanying consolidated statements of income represent purpose-restricted contributions utilized for their restricted purpose during the years ended September 30 summarized as follows:

	2018	2017
Program	\$ 1,351	\$ 1,489
Capital	262	3,051
	<u>\$ 1,613</u>	<u>\$ 4,540</u>

Permanently restricted net assets as of September 30, 2018 and 2017, in the amount of \$971, are held in perpetuity, the income from which is expended to support the Company's resident Chaplain office.

Note 9. Pension Plan

The Company has a defined benefit pension plan (the Plan) covering substantially all employees. It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Under the terms of the Plan, participants are eligible for monthly benefit payments upon reaching age 65, as defined in the Plan document. Vesting occurs after completion of five years of cumulative service. Participants are eligible for reduced benefits upon early retirement under certain circumstances. Monthly benefit payments are determined by application of a benefit formula to a participant's annual wages for all years of eligibility in the Plan before retirement. Under the terms of the Plan, participants are not required or permitted to make contributions to the Plan.

The Company's policy is to fund its pension cost in accordance with the provisions of ERISA. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

Effective October 31, 2014, the Board approved a plan amendment to freeze all accrued benefits for the Plan. The impact of this plan amendment was projected to reduce the benefit obligation by \$21,186.

Net periodic benefit cost for the years ended September 30 include the following components:

	2018	2017
Interest cost	\$ 8,334	\$ 8,463
Expected return on Plan assets	(6,914)	(6,793)
Recognized actuarial loss	1,472	1,727
Recognized settlement loss	-	2,968
	<u>\$ 2,892</u>	<u>\$ 6,365</u>

Total amounts do not include administrative expenses associated with Plan operations, which were \$140 and \$105 for the years ended September 30, 2018 and 2017, respectively.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 9. Pension Plan (Continued)

In fiscal year 2017, the Company paid cash settlements of \$8,649 to terminated employees who elected to take lump-sum cash payments or annuities. Since the total settlement costs exceeded the sum of the service costs and interest cost components, a pro rata portion of the unrecognized maximum pension loss, or \$2,968, is recognized in net periodic benefit costs for the year ended September 30, 2017. For fiscal year 2018, the improvement in funded status is primarily due to a decrease in benefit obligation largely due to the implementation of the forfeiture assumption for deferred vested participants over age 70.

A summary of the components of net pension cost as of the date of the latest actuarial valuation as of September 30 is as follows:

	2018	2017
Changes in benefit obligations:		
Benefit obligation, beginning of year	\$ 209,043	\$ 217,544
Interest cost	8,334	8,463
Benefits paid	(10,161)	(4,109)
Plan settlements paid	-	(8,649)
Actuarial gain	(24,990)	(4,206)
Benefit obligation, end of year	<u>182,226</u>	<u>209,043</u>
Changes in Plan assets:		
Fair value of Plan assets, beginning of year	131,608	132,802
Actual return on Plan assets	3,396	9,246
Employer contributions	8,165	2,318
Benefits paid	(10,161)	(4,109)
Plan settlements paid	-	(8,649)
Fair value of Plan assets, end of year	<u>133,008</u>	<u>131,608</u>
Funded status, pension liability	<u>\$ (49,218)</u>	<u>\$ (77,435)</u>

Amounts recognized in the change in unrestricted net assets consist of:

	2018	2017
Accumulated change from pension in unrestricted net assets - actuarial loss	\$ (48,784)	\$ (71,728)
Cumulative employer contributions less than net periodic benefit cost	(434)	(5,707)
Obligation recognized	<u>\$ (49,218)</u>	<u>\$ (77,435)</u>

The amount expected to be recognized as a component of net periodic benefit cost over the next fiscal year includes the following:

Net actuarial loss	<u>\$ 1,472</u>
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The accumulated benefit obligation for the Plan was \$182,226 and \$209,043 as of September 30, 2018 and 2017, respectively.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 9. Pension Plan (Continued)

Weighted-average assumptions used to determine benefit obligations as of September 30 are as follows:

	<u>2018</u>	<u>2017</u>
Discount rate	4.55%	4.10%

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

	<u>2018</u>	<u>2017</u>
Discount rate	4.10%	4.00%
Expected long-term rate of return on assets	7.40%	7.10%

To develop the expected long-term rate of return on assets assumption, the Company considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

The primary asset classifications utilized to achieve both appreciation and diversification are domestic large-cap equity, domestic mid-cap equity, domestic small-cap equity, domestic medium-cap equity, international equity, domestic investment-grade fixed income, high-yield fixed income and inflation-indexed fixed income. The investment policy reflects the expected allocation between these different asset classes in order to best achieve the objectives of the Plan. Investments are rebalanced, as appropriate, to maintain the desired asset allocation.

Asset allocations by asset category as of September 30 are as follows:

	<u>2018</u>	<u>2017</u>
Equity securities	45.6%	48.1%
Debt securities	41.3%	38.8%
Real estate	3.8%	3.8%
Other	9.3%	9.3%
	<u>100.0%</u>	<u>100.0%</u>

The investment policy has been designed to utilize asset/liability matching strategies to match Plan assets and obligations over the expected life of the Plan. The primary asset classes utilized to attain these objectives are equity securities, debt securities, real estate and all other with target allocations at September 30, 2018, of 48 percent, 38 percent, 4 percent and 10 percent, respectively.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
(Dollars in Thousands)

Note 9. Pension Plan (Continued)

The fair value hierarchy of investments held by the Plan by Level as of September 30 is as follows:

	2018			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 3,614	\$ -	\$ -	\$ 3,614
Fixed-income securities:				
U.S. government and agency	-	14,437	-	14,437
Corporate debt instruments	-	34,133	-	34,133
Total fixed-income securities	-	48,570	-	48,570
Common stock:				
Consumer discretionary	4,517	-	-	4,517
Consumer staples	1,510	-	-	1,510
Energy	1,036	-	-	1,036
Equity fund	5,982	-	-	5,982
Financials	5,691	-	-	5,691
Health care	3,495	-	-	3,495
Industrials	3,172	-	-	3,172
Information technology	8,197	-	-	8,197
Materials	909	-	-	909
Real estate	6,077	-	-	6,077
Telecommunication	4,755	-	-	4,755
Utilities	85	-	-	85
Total common stock	45,426	-	-	45,426
Mutual funds:				
Balanced funds	12,409	-	-	12,409
Bond funds	3,618	-	-	3,618
Equity funds	19,371	-	-	19,371
Total mutual funds	35,398	-	-	35,398
	<u>\$ 84,438</u>	<u>\$ 48,570</u>	<u>\$ -</u>	<u>\$ 133,008</u>

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 9. Pension Plan (Continued)

	2017			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 2,060	\$ -	\$ -	\$ 2,060
Fixed-income securities:				
U.S. government and agency	4,560	9,010	-	13,570
Corporate debt instruments	-	32,481	-	32,481
Total fixed-income securities	4,560	41,491	-	46,051
Common stock:				
Consumer discretionary	4,717	-	-	4,717
Consumer staples	2,025	-	-	2,025
Energy	722	-	-	722
Equity fund	6,802	-	-	6,802
Financials	6,381	-	-	6,381
Health care	3,689	-	-	3,689
Industrials	2,873	-	-	2,873
Information technology	10,672	-	-	10,672
Materials	1,319	-	-	1,319
Real estate	6,073	-	-	6,073
Utilities	229	-	-	229
Total common stock	45,502	-	-	45,502
Mutual funds:				
Balanced funds	12,406	-	-	12,406
Bond funds	3,720	-	-	3,720
Equity funds	21,869	-	-	21,869
Total mutual funds	37,995	-	-	37,995
	\$ 90,117	\$ 41,491	\$ -	\$ 131,608

There were no significant transfers between Level 1 and Level 2 during the years ended September 30, 2018, and there were no Level 3 securities held by the Plan during the years ended September 30, 2018 or 2017.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 9. Pension Plan (Continued)

The Company expects to contribute \$7,352 to the Plan for the year ending September 30, 2019. Benefit payments, which reflect expected future service, as appropriate, as of September 30, 2018, are expected to be paid as follows:

Years ending September 30:

2019	\$	11,863
2020		10,681
2021		10,766
2022		11,152
2023		11,165
2024-2026		53,581

Note 10. Employee Retirement Plans and Benefits

The InterHealth Corp. 403(b) Plan (the 403(b) plan) is a defined contribution plan covering substantially all employees of the Company. Each year, participants may elect to contribute a portion of their pretax annual compensation, as defined by the 403(b) plan, subject to certain IRC limitations. Employer contributions related to the 403(b) plan are made to the Interhealth Corp. 401(a) Plan. For the years ended September 30, 2018 and 2017, employer contributions related to the 403(b) plan, which are included in the employee benefits expenses in the accompanying consolidated financial statements, were \$2,770 and \$2,690, respectively.

The InterHealth 401(a) Plan (the 401(a) Plan) is a defined contribution plan that allows contributions to be made by the Company and allocated to individual participant accounts within the 401(a) Plan. The Company is required to make nondiscretionary contributions equal to 50 percent of a participant's eligible contributions made into the 403(b) plan during the plan year, but shall not exceed 2 percent of a participant's eligible compensation. The Company may make nonelective contributions based on employee years of service subject to certain IRC limitations. For the years ended September 30, 2018 and 2017, nonelective contributions to the 401(a) Plan, which are included in the employee benefits expenses in the accompanying consolidated financial statements, were \$11,785 and \$11,990, respectively.

Note 11. Commitments and Contingencies

Litigation, Regulatory and Compliance Matters—General: The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, the rules governing licensures, accreditation, controlled substances, privacy, government program participation, government reimbursement, antitrust, anti-kickback, prohibited referrals by physicians, dales claims and in the case of tax-exempt organizations, the requirement of tax exemption. Compliance with such laws and regulations can be subject to the future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. In recent years, government activity has increased with respect to investigations and allegations of wrongdoing. Management believes it is in compliance with fraud and abuse as well as other applicable government laws and regulations.

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Commitments and Contingencies (Continued)

The health care regulatory environment is constantly changing. It is difficult to predict what final rules may be adopted and implemented by federal and state, and if any final rule would result in any material adverse effect on the Company's business, financial condition, cash flows or results of operations.

Insurance programs: The Company partially insures or self-insures against professional and general liability claims, workers' compensation claims, and certain employee group health and dental benefits. Under the professional and general liability program, effective January 1, 2009, the Company is self-insured for up to \$750 consolidated indemnity and expense per occurrence, with maximum annual coverage of \$24,000 per occurrence annual aggregate. With regard to workers' compensation claims, the Company has reinsurance coverage for individual claim expenses in excess of \$1,000 per occurrence, with maximum annual coverage of \$250,000 per occurrence. Self-insurance liabilities as of September 30, 2018 and 2017, are as follows: professional and general liability claims of \$11,128 and \$12,679, workers' compensation claims of \$15,824 and \$16,915, employee health insurance claims of \$4,003 and \$3,606, employee dental benefits claims of \$199 and \$885, and medical stop-loss claims of \$115 and \$12, respectively. For health claims under the self-insured plan that are provided through PIH-controlled hospitals and clinics, PIH recognizes net patient service revenue in the consolidated statements of income. At September 30, 2018 and 2017, the Company had recorded professional and general liability insurance receivables of \$3,400 and \$4,293, respectively.

Revenue recovery audit: The Company is subject to audit through the use of Revenue Recovery Audit Contractors (RAC) under the Medicare Modernization Act of 2003. The resolution of the outstanding RAC audits is not expected to have a material adverse effect on the Company's consolidated balance sheets, the results of its operations or cash flows.

Litigation: From time to time, the Company is subject to claims arising in the ordinary course of business. In the opinion of management, the ultimate resolution to these legal proceedings will not have a material adverse effect on the consolidated balance sheets of the Company, the results of its operations or cash flows.

Guarantees: In accordance with the requirements of California Health and Safety Code Section 1375.4(b)(1)(B) in December 2005, PIH and PHP signed a guaranty agreement (the Guaranty). Under the terms of the Guaranty, PIH has unconditionally guaranteed all liabilities of PHP not to exceed \$30,000. PIH made an equity transfer of \$30,000 to PHP in 2017. There were no equity transfers from PIH to PHP in fiscal year 2018. The transactions between PHP and PIH are eliminated in consolidation.

Capital expenditures: The Company is required to comply with earthquake retrofit requirements for its health care facilities in accordance with the laws of state of California. Certain of its health care facilities are currently compliant or have received extensions, while certain others would require capital expenditures to attain seismic compliance. The Company continuously evaluates its facilities for compliance with applicable laws and regulations.

Leases: The Company leases certain buildings and equipment under noncancelable operating and capital leases. Rent expense relating to operating leases was \$2,836 and \$3,428 for the years ended September 30, 2018 and 2017, respectively. The cost and accumulated amortization of assets under capital leases is included in the consolidated balance sheets as net property and equipment. The cost and accumulated amortization of leased assets were \$3,305 and \$1,830 as of September 30, 2018. The cost and accumulated amortization of leased assets were \$3,305 and \$1,587 as of September 30, 2017. Amortization of assets under capital leases is included in depreciation expense.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 11. Commitments and Contingencies (Continued)

Future minimum lease payments required under operating and capital leases as of September 30, 2018, are summarized in the following table:

	Capital Leases	Operating Leases
Years ending September 30:		
2019	\$ 201	\$ 1,612
2020	8	1,592
2021	-	1,339
2022	-	1,338
2023	-	1,353
Thereafter	-	-
Total minimum payments	209	\$ 7,234
Less amounts representing interest	(1)	
	208	
Less current portion	(200)	
Long-term capital lease obligations	\$ 8	

Note 12. Concentration of Credit Risk

The Company grants credit without collateral to their patients, most of whom are local residents, and are insured under third-party payor agreements. The mix of net patient accounts receivable from patients and third-party payors as of September 30 was as follows:

	2018	2017
Medicare	35%	35%
Medi-Cal	11%	12%
HMO	17%	16%
PPO	29%	29%
Other third-party and self-payors	8%	8%
	100%	100%

Note 13. Functional Expenses

The Company provides general health care services to residents within its geographical location. Expenses related to providing these services for the years ended September 30 are as follows:

	2018	2017
Health care services	\$ 767,307	\$ 728,332
Management and general	101,387	103,233
Fundraising	987	989
	\$ 869,681	\$ 832,554

PIH Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 14. Hospital Fee Program

In January 2010, the state of California enacted legislation that provides for supplemental Medi-Cal payments to certain hospitals funded by a quality assurance fee paid by participating hospitals, as well as matching federal funds (the Hospital Fee Program). In September 2010, this legislation was amended at the request of Centers for Medicare and Medicaid Services (CMS). In October 2010, CMS substantially approved the program and the state of California began its implementation. The supplemental payments encompass fee-for-service payments directly from the California Department of Health Care Services, as well as payments routed through managed care plans.

Legislation approved by the state of California in October 2013 created the framework for the provider fee to continue in perpetuity without requiring further legislation by the state. In addition, in November 2016, Proposition 52 passed, which made the current provider fee program permanent and places limits on the ability of the state of California to reallocate funds for non-health care expenses.

The Hospital Fee Program is subject to CMS review and approval and recognition in the consolidated financial statements of each segment (or "round") of the program is determined upon respective CMS program approval thereof. In December 2017, CMS approved the new 2017-2019 Hospital Fee Program, which is effective January 1, 2017, and covers the 30-month period from January 1, 2017, through June 30, 2019.

During the year ended September 30, 2018, the Hospitals received \$82,232 and paid \$50,960 in supplemental payments and fees, respectively, related to the fourth-round, 36-month Hospital Fee Program and 2017-2019 Hospital Fee Program. For the year ended September 30, 2018, the Hospitals recognized \$53,650 in related net patient service revenues and \$38,886 in related expenses, representing estimated amounts due and payable for the service period from October 1, 2017, through September 30, 2018.

During the year ended September 30, 2017, the Hospitals received \$33,660 and paid \$35,126 in supplemental payments and fees, respectively, related to the fourth-round, 36-month Hospital Fee Program. For the year ended September 30, 2017, the Hospitals recognized \$52,835 in related net patient service revenues and \$40,052 in related expenses, representing estimated amounts due and payable for the service period from October 1, 2016, through September 30, 2017.

The funding for the Hospital Fee Program is processed through the hospital fee model. The hospital fee model calculates the fees and payments for each participating hospital by utilizing each hospital's daily data to determine the Medicaid utilization rate, federal upper limit and various other data elements. Accordingly, the estimated fees and timing of payments are dependent on these factors and may subsequently change. The financial impact of any change is not known at this time. As of September 30, 2018 and 2017, the Company had receivables of \$44,400 and \$72,983, respectively, and payables of \$30,943 and \$43,018, respectively.

Note 15. Subsequent Events

The Company has evaluated subsequent events through January 17, 2019, the date the consolidated financial statements were issued.

In November 2018, the Obligated Group refinanced its Series 2012 B. In this refinancing, the Obligated group issued \$48.5 million 2018 A City of Whittier Health Facility Revenue Bonds to refinance Series 2012 B and to pay costs of issuance in connection with the issuance. These fixed-rate tax-exempt bonds were purchased by a financial institution. In conjunction with issuance of Series 2018 A, PIH entered into a total return swap to effectively convert the fixed-rate bonds to a variable rate.

PIH Health, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Dollars in Thousands)**

Note 15. Subsequent Events (Continued)

The Company is currently in discussions with a Southern California physician organization for a potential acquisition of the entity. As of the date of this report, the terms of the transaction are being evaluated.

Effective January 1, 2019, the Company's health insurance coverage for essentially all of its employees residing in approved zip codes will be provided through the Vivity HMO Plan, a comprehensive medical coverage plan offered by Vivity.

Supplementary Information

Consolidating Schedule—Balance Sheet
September 30, 2018
(In Thousands)

	PIH Health, Inc. *	PIH Health Management Corp.	PIH Health Hospital - Whittier*	PIH Health Foundation	PIH Health Physicians	PIH Health Adult Day Healthcare	PIH Health Community Pharmacy, LLC	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Assets												
Current assets:												
Cash and cash equivalents	\$ 128	\$ 987	\$ 266	\$ 55	\$ 58	\$ -	\$ 3	\$ 4,502	\$ 643	\$ 46	\$ -	\$ 6,688
Investments, short term	-	-	-	-	-	-	-	1,678	2,014	-	-	3,692
Patient accounts receivable, net	-	-	71,042	-	7,728	-	-	-	-	18,036	-	96,806
Inventory	-	-	4,962	-	852	-	459	-	-	2,074	-	8,347
Other receivables	140	-	3,708	-	162	-	-	1,580	-	2,283	(1,947)	5,926
Prepaid expenses and other assets	9	-	6,103	371	104	-	-	3,842	-	440	(346)	10,523
Other current assets, Hospital Fee Program	-	-	25,180	-	-	-	-	-	-	19,220	-	44,400
Total current assets	277	987	111,261	426	8,904	-	462	11,602	2,657	42,099	(2,293)	176,382
Investments in mutual funds and other investments	-	-	21,269	5,466	-	-	-	19,484	-	-	-	46,219
Investments, assets limited as to use	958	-	452,587	-	-	-	-	-	302	-	-	453,847
Property and equipment, net	152,896	-	348,490	2	10,843	-	64	-	-	132,657	-	644,952
Intercompany receivables	-	2,795	357,860	1,909	-	-	-	-	-	-	(362,564)	-
Investments in affiliates	-	-	1,555	-	17	-	-	-	-	1	(1,573)	-
Other assets	-	-	800	155	-	-	-	-	-	280	-	1,235
Total assets	\$ 154,131	\$ 3,782	\$ 1,293,822	\$ 7,958	\$ 19,764	\$ -	\$ 526	\$ 31,086	\$ 2,959	\$ 175,037	\$ (366,430)	\$ 1,322,635

* PIH Health, Inc. includes activity of PIH Health Real Estate Services, LLC.
PIH Health Hospital - Whittier includes activity of PIH Health Home Health Care.
PIH Health Insurance Company includes activity of PIH Health RE.
PIH Health Hospital - Downey includes activity of DRMCP and MTF.

(Continued)

Consolidating Schedule—Balance Sheet (Continued)
September 30, 2018
(In Thousands)

	PIH Health, Inc.*	PIH Health Management Corp.	PIH Health Hospital - Whittier*	PIH Health Foundation	PIH Health Physicians	PIH Health Adult Day Healthcare	PIH Health Community Pharmacy, LLC	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Liabilities and Net Assets (Deficits)												
Current liabilities:												
Accounts payable and accrued expenses	\$ 1,439	\$ 924	\$ 51,178	\$ 465	\$ 17,184	\$ -	\$ 203	\$ 2,137	\$ -	\$ 21,619	\$ (1,788)	\$ 93,361
Estimated third-party payor settlement	-	-	204	-	-	-	-	-	-	-	-	204
Accrued interest	-	-	2,241	-	-	-	-	-	-	-	-	2,241
Current portion of long-term debt	137	-	10,395	-	-	-	-	-	-	221	-	10,753
Current portion of obligations under capital leases	-	-	192	-	-	-	-	-	-	9	-	201
Current portion of prepetition liabilities	-	-	-	-	-	-	-	-	-	1,191	-	1,191
Short-term loan borrowing	-	-	28,000	-	-	-	-	-	-	-	-	28,000
Other current liability, Hospital Fee Program	-	-	18,597	-	-	-	-	-	-	12,346	-	30,943
Retention—self-insurance programs, current portion	-	-	4,776	-	835	-	-	2,986	-	1,864	-	10,461
Total current liabilities	1,576	924	115,583	465	18,019	-	203	5,123	-	37,250	(1,788)	177,355
Deferred compensation	-	-	16,441	-	-	-	-	-	-	-	-	16,441
Interest rate swaps	-	-	25,961	-	-	-	-	-	-	-	-	25,961
Prepetition liabilities, net of current portion	-	-	-	-	-	-	-	-	-	-	-	-
Long-term debt, net of current portion	6,231	-	360,549	-	-	-	-	-	-	222	-	367,002
Obligations under capital leases, net of current portion	-	-	-	-	-	-	-	-	-	8	-	8
Pension liability	-	-	49,218	-	-	-	-	-	-	-	-	49,218
Retention—self-insurance programs, net of current portion	-	-	10,392	-	1,896	-	-	4,800	-	4,224	(505)	20,807
Intercompany payables	114,420	2,774	-	-	27,953	2,793	1,354	-	-	213,269	(362,563)	-
Total liabilities	122,227	3,698	578,144	465	47,868	2,793	1,557	9,923	-	254,973	(364,856)	656,792
Net Assets (Deficits)												
Unrestricted	31,904	84	715,678	1,098	(28,104)	(2,793)	(1,031)	21,163	2,959	(79,936)	(1,574)	659,448
Temporarily restricted	-	-	-	5,424	-	-	-	-	-	-	-	5,424
Permanently restricted	-	-	-	971	-	-	-	-	-	-	-	971
Total net assets (deficits)	31,904	84	715,678	7,493	(28,104)	(2,793)	(1,031)	21,163	2,959	(79,936)	(1,574)	665,843
Total liabilities and net assets	\$ 154,131	\$ 3,782	\$ 1,293,822	\$ 7,958	\$ 19,764	\$ -	\$ 526	\$ 31,086	\$ 2,959	\$ 175,037	\$ (366,430)	\$ 1,322,635

* PIH Health, Inc. includes activity of PIH Health Real Estate Services, LLC.
PIH Health Hospital - Whittier includes activity of PIH Health Home Health Care.
PIH Health Insurance Company includes activity of PIH Health RE.
PIH Health Hospital - Downey includes activity of DRMCP and MTF.

See notes to supplementary information.

Consolidating Schedule—Balance Sheet
September 30, 2017
(In Thousands)

	PIH Health, Inc.*	PIH Health Management Company	PIH Health Hospital - Whittier	PIH Health Foundation	PIH Health Physicians	PIH Health Home Healthcare	PIH Health Community Pharmacy	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Assets												
Current assets:												
Cash and cash equivalents	\$ 113	\$ 8,311	\$ 272	\$ 91	\$ 364	\$ -	\$ -	\$ 4,073	\$ 656	\$ 911	\$ -	\$ 14,791
Investments, short term	-	-	-	-	-	-	-	884	2,011	-	-	2,895
Patient accounts receivable, net	-	-	69,367	-	5,544	-	-	-	-	16,111	-	91,022
Inventory	-	-	5,117	-	973	-	450	-	-	2,073	-	8,613
Other receivables	12	-	5,370	-	1,055	-	-	1,588	-	2,761	(1,549)	9,237
Prepaid expenses and other assets	552	-	8,558	374	696	-	-	4,814	-	742	(1,886)	13,850
Other current assets, Hospital Fee Program	-	-	46,106	-	-	-	-	-	-	26,877	-	72,983
Total current assets	677	8,311	134,790	465	8,632	-	450	11,359	2,667	49,475	(3,435)	213,391
Investments in mutual funds and other investments	-	-	20,078	4,439	-	-	-	16,963	-	-	-	41,480
Investments, assets limited as to use	710	-	437,734	-	-	-	-	-	301	-	-	438,745
Property and equipment, net	145,387	-	367,390	3	12,608	-	62	-	-	120,305	-	645,755
Intercompany receivables	-	-	315,687	2,301	-	-	-	-	-	-	(317,988)	-
Investments in affiliates	-	-	1,555	-	14	-	-	-	-	-	(1,569)	-
Other assets	3	-	813	155	17	-	-	-	-	921	-	1,909
Total assets	\$ 146,777	\$ 8,311	\$ 1,278,047	\$ 7,363	\$ 21,271	\$ -	\$ 512	\$ 28,322	\$ 2,968	\$ 170,701	\$ (322,992)	\$ 1,341,280

* PIH includes activity of PIH Health Real Estate Services, LLC.
Presbyterian Intercommunity Hospital, Inc. includes activity of InterHealth Home Health Care.
PIH Health Insurance Company includes activity of PIH Health RE.
DRMC includes DRMC, DRMCP and MTF.

(Continued)

Consolidating Schedule—Balance Sheet (Continued)
September 30, 2017
(In Thousands)

	PIH Health, Inc.*	PIH Health Management Company	PIH Health Hospital - Whittier	PIH Health Foundation	PIH Health Physicians	PIH Health Home Healthcare	PIH Health Community Pharmacy	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Liabilities and Net Assets (Deficits)												
Current liabilities:												
Accounts payable and accrued expenses	\$ 2,953	\$ 1,442	\$ 53,961	\$ 353	\$ 18,008	\$ -	\$ 203	\$ 2,261	\$ -	\$ 19,433	\$ (3,380)	\$ 95,234
Estimated third-party payor settlements	-	-	-	-	-	-	-	-	-	-	-	-
Accrued interest	-	-	2,175	-	-	-	-	-	-	-	-	2,175
Current portion of long-term debt	130	-	10,080	-	-	-	-	-	-	-	-	10,210
Current portion of obligations under capital leases	-	-	685	-	-	-	-	-	-	-	-	685
Current portion of prepetition liabilities	-	-	-	-	-	-	-	-	-	2,591	-	2,591
Short-term loan borrowing	-	-	48,000	-	-	-	-	-	-	-	-	48,000
Other current liability, Hospital Fee Program	-	-	26,003	-	-	-	-	-	-	17,015	-	43,018
Retention—self-insurance programs, current portion	-	-	5,570	-	713	-	-	4,637	-	2,411	-	13,331
Total current liabilities	3,083	1,442	146,474	353	18,721	-	203	6,898	-	41,450	(3,380)	215,244
Deferred compensation	-	-	15,511	-	-	-	-	-	-	-	-	15,511
Interest rate swaps	-	-	38,751	-	-	-	-	-	-	-	-	38,751
Prepetition liabilities, net of current portion	-	-	-	-	-	-	-	-	-	1,191	-	1,191
Long-term debt, net of current portion	6,368	-	370,821	-	-	-	-	-	-	-	-	377,189
Obligations under capital leases, net of current portion	-	-	192	-	-	-	-	-	-	-	-	192
Pension liability	-	-	77,435	-	-	-	-	-	-	-	-	77,435
Retention—self-insurance programs, net of current portion	-	-	10,860	-	2,115	-	-	3,683	-	4,163	(55)	20,766
Intercompany payables	110,259	6,891	-	-	3,336	2,793	847	-	-	193,862	(317,988)	-
Total liabilities	119,710	8,333	660,044	353	24,172	2,793	1,050	10,581	-	240,666	(321,423)	746,279
Net Assets (Deficits)												
Unrestricted	27,067	(22)	618,003	967	(2,901)	(2,793)	(538)	17,741	2,968	(70,020)	(1,569)	588,903
Temporarily restricted	-	-	-	5,072	-	-	-	-	-	55	-	5,127
Permanently restricted	-	-	-	971	-	-	-	-	-	-	-	971
Total net assets (deficits)	27,067	(22)	618,003	7,010	(2,901)	(2,793)	(538)	17,741	2,968	(69,965)	(1,569)	595,001
Total liabilities and net assets	\$ 146,777	\$ 8,311	\$ 1,278,047	\$ 7,363	\$ 21,271	\$ -	\$ 512	\$ 28,322	\$ 2,968	\$ 170,701	\$ (322,992)	\$ 1,341,280

* PIH includes activity of PIH Health Real Estate Services, LLC.
Presbyterian Intercommunity Hospital, Inc. includes activity of InterHealth Home Health Care.
PIH Health Insurance Company includes activity of PIH Health RE.
DRMC includes DRMC, DRMCP and MTF.

Consolidating Schedule—Statement of Operations
Year Ended September 30, 2018
(In Thousands)

	PIH Health, Inc.*	PIH Health Management Corp.	PIH Health Hospital - Whittier*	PIH Health Foundation	PIH Health Physicians	PIH Health Adult Day Healthcare	PIH Health Community Pharmacy, LLC	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Revenues:												
Net patient service revenue, including Hospital Fee Program revenue	\$ -	\$ -	\$ 549,688	\$ -	\$ 62,706	\$ -	\$ -	\$ -	\$ -	\$ 157,268	\$ -	\$ 769,662
Less provision for bad debts	-	-	10,503	-	678	-	-	-	-	3,789	-	14,970
Net patient service revenue less provision for bad debts	-	-	539,185	-	62,028	-	-	-	-	153,479	-	754,692
Capitation revenue	-	-	26,054	-	85,377	-	-	-	-	-	-	111,431
Other operating revenue	18,189	833	11,270	860	5,282	-	6,128	5,847	-	2,614	(31,567)	19,466
Net assets released from restrictions used for operations	-	-	806	27	-	-	-	-	-	518	-	1,351
Total revenues	18,189	833	577,315	887	152,687	-	6,128	5,847	-	156,611	(31,567)	886,930
Expenses:												
Salaries and wages	1,413	-	194,974	583	31,320	-	950	191	-	71,482	-	300,913
Purchased services	1,906	-	56,716	61	41,417	-	10	45	-	9,300	(4,958)	104,497
Medical supplies and drugs	221	-	79,875	8	8,214	-	5,288	-	-	19,370	(4,006)	108,970
Employee benefits	249	-	73,625	139	11,985	-	162	-	-	22,958	(750)	108,348
Professional fees	377	-	35,987	76	71,778	-	-	578	1	10,532	-	119,329
Depreciation and amortization	5,600	-	24,347	1	3,362	-	11	-	-	6,932	-	40,253
Other expenses	3,204	833	22,327	41	(3,086)	-	58	83	12	3,987	(468)	26,991
Interest	371	-	7,600	-	-	-	-	-	-	4,674	-	12,645
Insurance	15	-	5,602	-	1,910	-	-	2,635	-	1,424	(5,027)	6,559
Rent expense	160	-	4,933	78	10,630	-	142	-	-	524	(14,177)	2,290
Management services expense	-	-	2,157	-	-	-	-	-	-	24	(2,181)	-
Hospital Fee Program	-	-	23,508	-	-	-	-	-	-	15,378	-	38,886
Total expenses	13,516	833	531,651	987	177,510	-	6,621	3,532	13	166,585	(31,567)	869,681
Excess (deficit) of revenues over expenses	4,673	-	45,664	(100)	(24,823)	-	(493)	2,315	(13)	(9,974)	-	17,249
Other gains (losses):												
Net investment income	-	106	11,015	113	-	-	-	490	4	-	-	11,728
Realized gains (losses) on investments, net	-	-	7,578	347	-	-	-	(189)	-	-	-	7,736
Change in fair value of interest rate swap and net interest expense	-	-	8,080	-	-	-	-	-	-	-	-	8,080
Gain on disposal of property and equipment	-	-	138	-	-	-	-	-	-	6	-	144
Other gains (losses), net	164	-	(157)	-	(19)	-	-	-	-	26	(5)	9
Pension-related changes, net periodic pension cost	-	-	(2,671)	-	(361)	-	-	-	-	-	-	(3,032)
Total other gains (losses), net	164	106	23,983	460	(380)	-	-	301	4	32	(5)	24,665
Excess (deficit) of revenues over expenses and other gains (losses)	4,837	106	69,647	360	(25,203)	-	(493)	2,616	(9)	(9,942)	(5)	41,914
Unrealized gains (losses) on investments, net	-	-	4,847	(229)	-	-	-	806	-	-	-	5,424
Pension-related changes other than net periodic pension cost	-	-	22,945	-	-	-	-	-	-	-	-	22,945
Net assets released from restrictions used for long-lived assets	-	-	236	-	-	-	-	-	-	26	-	262
Total increase (decrease) in unrestricted net assets (deficits)	\$ 4,837	\$ 106	\$ 97,675	\$ 131	\$ (25,203)	\$ -	\$ (493)	\$ 3,422	\$ (9)	\$ (9,916)	\$ (5)	\$ 70,545

* PIH Health, Inc. includes activity of PIH Health Real Estate Services, LLC.
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PIH Health Insurance Company includes activity of PIH Health RE.
PIH Health Hospital - Downey includes activity of DRMCP and MTF.

See notes to supplementary information.

Consolidating Schedule—Statement of Operations
Year Ended September 30, 2017
(In Thousands)

	PIH Health, Inc.*	PIH Health Management Company	PIH Health Hospital - Whittier	PIH Health Foundation	PIH Health Physicians	PIH Health Home Healthcare	PIH Health Community Pharmacy	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Revenues:												
Net patient service revenue, including Hospital Fee Program revenue	\$ -	\$ -	\$ 528,075	\$ -	\$ 54,027	\$ -	\$ -	\$ -	\$ -	\$ 150,496	\$ -	\$ 732,598
Less provision for bad debts	-	-	8,618	-	955	-	-	-	-	2,840	-	12,413
Net patient service revenue less provision for bad debts	-	-	519,457	-	53,072	-	-	-	-	147,656	-	720,185
Capitation revenue	-	-	24,886	-	82,595	-	-	-	4	-	-	107,485
Other operating revenue	16,445	790	8,571	353	5,845	-	5,716	5,853	-	4,629	(29,899)	18,303
Net assets released from restrictions used for operations	-	-	1,379	-	-	-	-	-	-	110	-	1,489
Total revenues	16,445	790	554,293	353	141,512	-	5,716	5,853	4	152,395	(29,899)	847,462
Expenses:												
Salaries and wages	1,432	-	186,307	586	26,817	-	548	-	-	67,011	-	282,701
Purchased services	1,912	-	57,351	118	40,344	-	2	56	-	9,034	(4,592)	104,225
Medical supplies and drugs	179	-	74,462	6	7,731	-	5,255	-	-	17,770	(3,957)	101,446
Employee benefits	260	-	73,846	153	11,552	10	118	-	-	19,293	(563)	104,669
Professional fees	576	-	35,886	84	64,831	-	-	637	15	9,571	-	111,600
Depreciation and amortization	4,937	-	24,981	1	3,406	-	9	-	-	6,210	-	39,544
Other expenses	3,013	794	23,212	40	(3,298)	-	48	33	10	4,648	(1,032)	27,468
Interest	378	-	6,820	-	-	-	-	-	-	4,683	-	11,881
Insurance	16	-	5,793	-	2,445	-	-	1,476	-	1,369	(4,993)	6,106
Rent expense	160	-	5,960	45	9,210	-	75	-	-	119	(12,707)	2,862
Management services expense	-	-	2,031	-	-	-	-	-	-	24	(2,055)	-
Hospital Fee Program	-	-	24,179	-	-	-	-	-	-	15,873	-	40,052
Total expenses	12,863	794	520,828	1,033	163,038	10	6,055	2,202	25	155,605	(29,899)	832,554
Excess (deficit) of revenues over expenses	3,582	(4)	33,465	(680)	(21,526)	(10)	(339)	3,651	(21)	(3,210)	-	14,908
Other gains (losses):												
Net investment income	-	35	9,499	84	-	-	-	273	5	-	-	9,896
Realized gains on investments, net	-	-	3,394	84	-	-	-	55	-	-	-	3,533
Change in fair value of interest rate swap and net interest expense	-	-	10,962	-	-	-	-	-	-	-	-	10,962
(Loss) gain on disposal of property and equipment	-	-	(118)	-	-	-	-	-	-	11	-	(107)
Other (losses) gains, net	(128)	2	(292)	-	(362)	-	-	327	-	2,082	-	1,629
Pension-related changes, net periodic pension cost	-	-	(6,147)	-	(323)	-	-	-	-	-	-	(6,470)
Total other (losses) gains, net	(128)	37	17,298	168	(685)	-	-	655	5	2,093	-	19,443
Excess (deficit) of revenues over expenses and other gains (losses)	3,454	33	50,763	(512)	(22,211)	(10)	(339)	4,306	(16)	(1,117)	-	34,351
Unrealized gains on investments, net	-	-	29,168	217	-	-	-	1,137	-	-	-	30,522
Pension-related changes other than net periodic pension cost	-	-	11,354	-	-	-	-	-	-	-	-	11,354
Net assets released from restrictions used for long-lived assets	-	-	2,241	-	-	-	-	-	-	810	-	3,051
Total increase (decrease) in unrestricted net assets (deficits)	\$ 3,454	\$ 33	\$ 93,526	\$ (295)	\$ (22,211)	\$ (10)	\$ (339)	\$ 5,443	\$ (16)	\$ (307)	\$ -	\$ 79,278

* PIH includes activity of PIH Health Real Estate Services, LLC.
Presbyterian Intercommunity Hospital, Inc. includes activity of InterHealth Home Health Care.
PIH Health Insurance Company includes activity of PIH Health RE.
DRMC includes DRMC, DRMCP and MTF.

See notes to supplementary information.

Consolidating Schedule—Statement of Changes in Net Assets
Year Ended September 30, 2018
(In Thousands)

	PIH Health, Inc.*	PIH Health Management Corp.	PIH Health Hospital - Whittier*	PIH Health Foundation	PIH Health Physicians	PIH Health Adult Day Healthcare	PIH Health Community Pharmacy, LLC	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Unrestricted net assets:												
Excess (deficit) of revenues over expenses and other gains (losses)	\$ 4,837	\$ 106	\$ 69,647	\$ 360	\$ (25,203)	\$ -	\$ (493)	\$ 2,616	\$ (9)	\$ (9,942)	\$ (5)	\$ 41,914
Unrealized gains (losses) on investments, net	-	-	4,847	(229)	-	-	-	806	-	-	-	5,424
Pension-related changes other than net periodic pension cost	-	-	22,945	-	-	-	-	-	-	-	-	22,945
Net assets released from restrictions used for long-lived assets	-	-	236	-	-	-	-	-	-	26	-	262
Change in unrestricted net assets	4,837	106	97,675	131	(25,203)	-	(493)	3,422	(9)	(9,916)	(5)	70,545
Temporarily restricted net assets:												
Contributions and grants received	-	-	-	1,910	-	-	-	-	-	-	-	1,910
Net assets released from restrictions	-	-	-	(1,558)	-	-	-	-	-	(55)	-	(1,613)
Change in temporarily restricted net assets	-	-	-	352	-	-	-	-	-	(55)	-	297
Investment in affiliates	-	-	-	-	-	-	-	-	-	-	-	-
Equity transfer	-	-	-	-	-	-	-	-	-	-	-	-
Change in net assets (deficits)	4,837	106	97,675	483	(25,203)	-	(493)	3,422	(9)	(9,971)	(5)	70,842
Net assets (deficits), beginning of year	27,067	(22)	618,003	7,010	(2,901)	(2,793)	(538)	17,741	2,968	(69,965)	(1,569)	595,001
Net assets (deficits), end of year	\$ 31,904	\$ 84	\$ 715,678	\$ 7,493	\$ (28,104)	\$ (2,793)	\$ (1,031)	\$ 21,163	\$ 2,959	\$ (79,936)	\$ (1,574)	\$ 665,843

* PIH Health, Inc. includes activity of PIH Health Real Estate Services, LLC.
 PIH Health Hospital - Whittier includes activity of PIH Health Home Health Care.
 PIH Health Insurance Company includes activity of PIH Health RE.
 PIH Health Hospital - Downey includes activity of DRMCP and MTF.

See notes to supplementary information.

**Consolidating Schedule—Statement of Changes in Net Assets
Year Ended September 30, 2017
(In Thousands)**

	PIH Health, Inc.*	PIH Health Management Corp.	PIH Health Hospital - Whittier*	PIH Health Foundation	PIH Health Physicians	PIH Health Adult Day Healthcare	PIH Health Community Pharmacy, LLC	PIH Health Insurance Company*	PIH Health Care Solutions	PIH Health Hospital - Downey*	Eliminations	Total
Unrestricted net assets:												
Excess (deficit) of revenues over expenses and other gains (losses)	\$ 3,454	\$ 33	\$ 50,763	\$ (512)	\$ (22,211)	\$ (10)	\$ (339)	\$ 4,306	\$ (16)	\$ (1,117)	\$ -	\$ 34,351
Unrealized gains on investments, net	-	-	29,168	217	-	-	-	1,137	-	-	-	30,522
Pension-related changes other than net periodic pension cost	-	-	11,354	-	-	-	-	-	-	-	-	11,354
Net assets released from restrictions used for long-lived assets	-	-	2,241	-	-	-	-	-	-	810	-	3,051
Change in unrestricted net assets	3,454	33	93,526	(295)	(22,211)	(10)	(339)	5,443	(16)	(307)	-	79,278
Temporarily restricted net assets:												
Contributions and grants received	-	-	-	3,538	-	-	-	-	-	-	-	3,538
Net assets released from restrictions	-	-	-	(4,540)	-	-	-	-	-	-	-	(4,540)
Change in temporarily restricted net assets	-	-	-	(1,002)	-	-	-	-	-	-	-	(1,002)
Investment in affiliates	-	-	-	-	-	-	-	3	-	-	(3)	-
Equity transfer	-	-	(30,000)	801	30,000	-	-	-	-	(801)	-	-
Change in net assets (deficits)	3,454	33	63,526	(496)	7,789	(10)	(339)	5,446	(16)	(1,108)	(3)	78,276
Net assets (deficits), beginning of year	23,613	(55)	554,477	7,506	(10,690)	(2,783)	(199)	12,295	2,984	(68,857)	(1,566)	516,725
Net assets (deficits), end of year	\$ 27,067	\$ (22)	\$ 618,003	\$ 7,010	\$ (2,901)	\$ (2,793)	\$ (538)	\$ 17,741	\$ 2,968	\$ (69,965)	\$ (1,569)	\$ 595,001

* PIH Health, Inc. includes activity of PIH Health Real Estate Services, LLC.
 PIH Health Hospital - Whittier includes activity of PIH Health Home Health Care.
 PIH Health Insurance Company includes activity of PIH Health RE.
 PIH Health Hospital - Downey includes activity of DRMCP and MTF.

See notes to supplementary information.

PIH Health, Inc. and Subsidiaries

Notes to Supplementary Information

Note 1. Basis of Presentation

The accompanying consolidating balance sheets, statements of income and statements of changes in net assets (collectively, the consolidating schedules) are prepared on the accrual basis of accounting. The preparation of the consolidating schedules in conformity with 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 consolidating schedules and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

PIH Health, Inc. and affiliates eliminate intercompany transactions, such as investments in affiliates and the related net assets and results of operations, and records its investments in affiliates at a cost basis. Net assets released from restrictions are transferred immediately to recipient affiliates.

Note 2. Allocations

Assets, liabilities, expenses and revenues have been allocated to the affiliates based on the number of employees, patients seen or other relevant benchmarks, except as outlined below:

Items maintained at PIH - Whittier: Line of credit, deferred compensation and the pension liability are held and maintained by PIH - Whittier and not allocated to the individual affiliates because these items would be maintained by PIH - Whittier regardless of the operations of the affiliates. The net periodic benefit cost of the pension plan is allocated to the affiliates based on the number of employees eligible for the benefit. Other administrative costs are not allocated to affiliates and are recorded by PIH - Whittier.

Items maintained within certain members of the Obligated Group: Pooled investments, bonds, deferred financing costs, interest rate swap, accrued interest and interest expense related to such are held at PIH - Whittier and PIH, which are members of the Obligated Group, and have not been allocated to other Obligated Group members due to feasibility.

Items maintained within the Hospitals and PIH Health Insurance Company: Receivables for insurance recoveries are recorded at the Hospitals and PIH Health Insurance Company, and have not been allocated to the affiliates.

Note 3. Accounting Policies

The accompanying consolidating schedules include net assets and beneficial interests between related parties that have not been allocated to individual entities in accordance with U.S. GAAP.