

CONSOLIDATED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION

Saint Elizabeth Medical Center, Inc.  
For the Year Ended December 31, 2017

Saint Elizabeth Medical Center, Inc.

Consolidated Financial Statements  
and Supplementary Information

For the Year Ended December 31, 2017

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Report of Independent Auditors

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## **Independent Auditor's Report**

To the Board of Trustees  
Saint Elizabeth Medical Center, Inc.

We have audited the accompanying consolidated financial statements of Saint Elizabeth Medical Center, Inc. and its subsidiaries (the "Organization"), which comprise the consolidated balance sheet as of December 31, 2017 and 2016 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Consolidated Financial Statements***

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

### ***Auditor's Responsibility***

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

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

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Saint Elizabeth Medical Center, Inc. and its subsidiaries as of December 31, 2017 and 2016 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Trustees  
Saint Elizabeth Medical Center, Inc.

***Other Matter***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements that collectively comprise Saint Elizabeth Medical Center, Inc. and its subsidiaries' consolidated financial statements. The additional information consisting of the consolidating balance sheet and consolidating statements of operations and changes in net assets is presented for the purpose of additional analysis and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the basic consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic consolidated financial statements as a whole.

*Plante & Moran, PLLC*

April 3, 2018

Saint Elizabeth Medical Center, Inc.

Consolidated Balance Sheets

	<b>December 31</b>	<b>December 31</b>
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 37,562	\$ 30,686
Short-term investments <i>(Note 2)</i>	9,970	–
Patient accounts receivable, net of allowance for doubtful accounts (2017 – \$10,269 and 2016 – \$9,648)	133,346	124,960
Inventories and supplies	28,003	25,447
Prepaid expenses and other current assets	20,339	19,820
Total current assets	<u>229,220</u>	200,913
Cash and cash equivalents-restricted <i>(Note 1)</i>	37,820	56,046
Assets limited as to use <i>(Note 2)</i>	1,035,947	896,590
Property, plant and equipment, net <i>(Note 4)</i>	448,645	434,890
Goodwill <i>(Note 5)</i>	17,651	17,651
Intangible assets <i>(Note 5)</i>	9,045	10,846
Foundation pledge receivables	3,602	2,922
Other assets	22,766	14,774
Total assets	<u>\$ 1,804,696</u>	<u>\$ 1,634,632</u>

Saint Elizabeth Medical Center, Inc.

Consolidated Balance Sheets

	December 31 2017	December 31 2016
	<i>(In Thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 79,236	\$ 62,087
Accrued employee compensation	84,668	74,405
Accrued interest	929	904
Accrued third-party settlements	12,629	12,286
Deferred revenue	5,191	6,641
Other current liabilities	9,264	7,768
Current portion of long-term debt <i>(Note 6)</i>	6,490	5,035
Long-term debt subject to short-term remarketing arrangement <i>(Note 6)</i>	27,225	—
Total current liabilities	<u>225,632</u>	<u>169,126</u>
Long-term debt <i>(Note 6)</i>	184,231	199,287
Liability for self-insurance	58,354	63,989
Accrued pension liability <i>(Note 9)</i>	26,474	167,588
Fair value of interest rate swap <i>(Note 6)</i>	3,451	4,194
Other long-term liabilities	7,007	8,424
Total liabilities	<u>505,149</u>	<u>612,608</u>
Net assets:		
Unrestricted	1,292,097	1,016,655
Temporarily restricted	7,450	5,866
Total net assets excluding noncontrolling interest	<u>1,299,547</u>	<u>1,022,521</u>
Noncontrolling interest	—	(497)
Total net assets	<u>1,299,547</u>	<u>1,022,024</u>
Total liabilities and net assets	<u>\$ 1,804,696</u>	<u>\$ 1,634,632</u>

Saint Elizabeth Medical Center, Inc.

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended	
	December 31 2017	December 31 2016
	<i>(In Thousands)</i>	
Patient service revenue, net of contractual provisions and discounts	\$ 1,277,373	\$ 1,180,732
Provision for bad debts	(48,730)	(39,477)
Net patient service revenue less provision for bad debts	<u>1,228,643</u>	1,141,255
Net assets released from restriction for operations	672	727
Other revenue	37,537	31,657
Total revenue	<u>1,266,852</u>	<u>1,173,639</u>
Expenses:		
Salaries and wages	577,674	543,270
Employee benefits	138,270	132,248
Purchased services	81,396	72,581
Interest	5,633	5,835
Depreciation and amortization	69,338	67,644
Supplies	219,165	190,681
Other	90,280	92,459
Total expenses	<u>1,181,756</u>	<u>1,104,718</u>
Operating income	85,096	68,921
Unrestricted contributions	375	407
Other gains, net <i>(Note 2)</i>	118,865	44,862
Excess of revenue over expenses	<u>204,336</u>	114,190
Excess of revenue (expense) over expense (revenue) attributable to noncontrolling interest	497	(135)
Excess of revenue over expenses attributable to St. Elizabeth Medical Center, Inc.	<u>203,839</u>	114,325
Unrestricted net assets:		
Pension change other than net periodic costs <i>(Note 9)</i>	71,078	6,201
Other	(80)	(79)
Net assets released from restriction for capital	605	543
Increase in unrestricted net assets attributable to St. Elizabeth Medical Center, Inc.	<u>275,442</u>	120,990
Temporarily restricted net assets:		
Net (decrease) increase in cash, cash equivalents, and restricted cash	2,861	1,859
Net assets released from restriction	(1,277)	(1,270)
Increase in temporarily restricted net assets attributable to St. Elizabeth Medical Center, Inc.	<u>1,584</u>	589
Increase in net assets attributable to St. Elizabeth Medical Center, Inc.	277,026	121,579
Non-controlling interest:		
Excess of revenue (expense) over expense (revenue) attributable to noncontrolling interest	497	(135)
Increase (decrease) in net assets attributable to noncontrolling interest	<u>497</u>	(135)
Increase in net assets	277,523	121,444
Net assets at beginning of period	<u>1,022,024</u>	900,580
Net assets at end of period	<u>\$ 1,299,547</u>	<u>\$ 1,022,024</u>

*See accompanying notes.*

# Saint Elizabeth Medical Center, Inc.

## Consolidated Statements of Cash Flows

	Year Ended	
	December 31	December 31
	2017	2016
	<i>(In Thousands)</i>	
<b>Operating activities and gains</b>		
Increase in net assets	\$ 277,523	\$ 121,444
Adjustments to reconcile increase in net assets to net cash provided by operating activities and gains (losses):		
Depreciation and amortization	69,338	67,644
Amortization of bond premium/discount and issuance costs	(1,341)	(901)
Provision for bad debts	48,730	39,477
Interest and dividends received on long-term investments	(20,407)	(17,907)
Net unrealized and realized gains on long-term investments	(97,431)	(39,524)
Change in pension other than net periodic costs	(71,078)	(6,201)
Change in fair value of interest rate swap	(743)	(559)
Loss on defeasance of long-term debt	-	12,257
Changes in operating assets and liabilities:		
Patient accounts receivable	(57,116)	(49,827)
Inventory, supplies, prepaid expenses and other current assets	(3,075)	1,487
Other assets	(8,672)	5,801
Accounts payable	17,149	7,025
Other liabilities	(66,425)	(25,293)
Net cash provided by operating activities and gains	<u>86,452</u>	<u>114,923</u>
<b>Investing activities</b>		
Change in short-term investments, net	(9,970)	-
Change in assets limited to use, net	(12,654)	(23,347)
Expenditures for property, plant, and equipment	(81,277)	(78,264)
Asset purchase acquisitions	-	(17,560)
Net cash used in investing activities	<u>(103,901)</u>	<u>(119,171)</u>
<b>Financing activities</b>		
Proceeds from long-term debt	20,000	118,493
Payments on long-term debt	(5,035)	(102,146)
Net cash provided by financing activities	<u>14,965</u>	<u>16,347</u>
Net (decrease) increase in cash, cash equivalents, and restricted cash	(2,484)	12,099
Cash, cash equivalents, and restricted cash at beginning of period	93,592	81,493
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 91,108</u>	<u>\$ 93,592</u>

# Saint Elizabeth Medical Center, Inc.

## Notes to Consolidated Financial Statements

December 31, 2017 and 2016

### **1. Summary of Significant Accounting Policies**

#### **Organization and Mission**

Saint Elizabeth Medical Center, Inc. (St. Elizabeth Healthcare or SEH) is a Kentucky Corporation founded by the Franciscan Sisters of the Poor in 1861. Sponsorship of St. Elizabeth Healthcare was transferred in 1973 to the Roman Catholic Diocese of Covington, Kentucky. St. Elizabeth Healthcare is comprised of Saint Elizabeth Hospitals and Summit Medical Group, doing business as St. Elizabeth Physicians. St. Elizabeth Healthcare has major facilities in Covington, Edgewood, Florence, Fort Thomas, Falmouth, and Williamstown Kentucky. St. Elizabeth Healthcare's primary mission is to provide comprehensive and compassionate care that improves the health of the people we serve. All significant intercompany balances and transactions have been eliminated in consolidation.

St. Elizabeth Physicians (SEP) has approximately 173 full-time equivalent primary care physicians, 123 full-time equivalent specialty physicians, and 103 advanced practice providers operating in 107 offices throughout Northern Kentucky, Ohio, and Indiana. St. Elizabeth Physicians performs most of the physician billings for St. Elizabeth Healthcare's hospital facilities.

SEP Maysville Diagnostic Center (SEP MDC) is a radiological services joint venture between SEP and 15 physicians that was formed on September 4, 2012. SEP is the 51 percent majority partner of this joint venture and has a controlling interest in SEP MDC; therefore, SEP MDC is consolidated in SEP. SEP MDC was closed in 2017 and the joint venture was dissolved.

The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) as of December 31, 2017 and 2016 and for the years ended December 31, 2017 and 2016.

#### **Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

**Cash and Cash Equivalents**

Cash equivalents include investments with a maturity of three months or less when acquired or purchased, excluding amounts whose use is limited by Board designation or other arrangements under trust agreements. Cash and money market accounts are covered by the FDIC up to \$250,000, mutual funds by the SPIC up to \$500,000, and all treasury securities are automatically backed by the United States Government; however, the majority of St. Elizabeth Healthcare funds are not covered by these.

**Restricted Cash**

The bonds issued by St. Elizabeth Healthcare during the year ended December 31, 2015 require amounts to be set aside for the purpose of financing acquisition, construction, installation and equipping of facilities suitable for use by SEH as healthcare and health related facilities. These amounts have been classified as restricted cash on the consolidated balance sheets.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the statement of financial position that sum to the total of the same such amounts shown in the statement of cash flows for years ended December 31:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 37,562	\$ 30,686
Cash and cash equivalents-restricted	37,820	56,046
Cash and cash equivalents included in assets limited as to use	15,726	6,860
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	<b>\$ 91,108</b>	<b>\$ 93,592</b>

## Saint Elizabeth Medical Center, Inc.

### Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

##### **Short-term Investments**

Short term investments primarily include U.S. Government Obligations, Corporate Bonds, and Asset Backed Securities with weighted average maturities of one year or less.

##### **Inventories**

Inventories consist of medical, pharmaceutical, and other supplies; quantities are determined by physical count and priced at the lower of cost or market. Cost is determined on the first-in, first-out method.

##### **Assets Limited as to Use and Investment Income**

Assets limited as to use consist of investments in equity securities with readily determinable fair values and all investments in debt securities are carried at fair value, as determined by quoted market sources, on the consolidated balance sheets. Hedge fund of funds, real estate funds, private equity funds, infrastructure funds, and emerging markets funds are valued at the net asset value provided by the administrator of the fund. Investment income or loss (including unrealized gains and losses on trading securities and realized gains and losses on investments, interest, and dividends) is included within excess of revenue over expenses unless the income or loss is restricted by donor or law. Substantially all investments are classified as trading securities.

##### **Fair Value Measurements**

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

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

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

In instances whereby the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. St. Elizabeth Healthcare'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 asset or liability.

In order to meet the requirements of ASC 820, St. Elizabeth Healthcare utilized three basic valuation approaches to determine fair value of its assets and liabilities required to be recorded at fair value. The first approach is the cost approach. The cost approach is generally the value a market participant would expect to replace the respective asset or liability. The second approach is the market approach. The market approach looks at what a market participant would consider an exact or similar asset or liability to that of St. Elizabeth Healthcare, including those traded on exchanges, to determine value. The third approach is the income approach. The income approach uses estimation techniques to determine the estimated future cash flows of St. Elizabeth Healthcare's respective asset or liability expected by a market participant and discounts those cash flows back to present value (more typically referred to as the cash flow approach).

**Derivative Instruments**

St. Elizabeth Healthcare has entered into certain interest rate swap arrangements in connection with its debt. Under ASC 815, *Derivatives and Hedging*, St. Elizabeth Healthcare records its derivative instruments as either assets or liabilities in the accompanying consolidated balance sheets at fair value. The remaining derivative balance in net assets to be amortized on previously designated hedges excluded from the excess of revenue over expenses was \$1,068,000 and \$1,138,000 at December 31, 2017 and 2016, respectively. The accumulated derivative asset on previously designated hedges is being amortized as a reduction to interest expense through 2033, which is when the swap agreement expires. As of December 31, 2017 and 2016, St. Elizabeth

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

Healthcare reduced its interest expense by \$70,000 each period for amortization of the accumulated derivative asset on previously designated hedges.

The derivative obligation at December 31, 2017 and 2016 was \$3,451,000 and \$4,194,000, respectively. The change in the fair market value of interest rate swaps is included within other gains (losses), net within excess of revenue over expenses.

**Property, Plant, and Equipment and Depreciation**

Property, plant, and equipment is recorded at historical cost, or if donated, impaired, or acquired under a business combination, at fair market value at the date of receipt or determination. The assets are depreciated over their estimated useful lives using the straight-line method. Buildings, building services, and land improvements are depreciated over 3 to 40 years and equipment is depreciated over 3 to 20 years. Useful lives of assets are estimated by management in conjunction with the American Hospital Association's *Estimated Useful Lives of Depreciable Hospital Assets*.

**Unamortized Bond Issue Costs and Other Assets**

Debt issuance costs are recorded as a reduction in the recorded balance of outstanding debt. The costs are amortized over the term of the related debt and reported as a component of interest expense.

**Other Assets**

Other assets include investments in joint ventures and limited liability partnerships, which are accounted for on the equity method of accounting.

**Foundation Pledges Receivables**

Pledges received for unconditional promises to give are recorded as revenue in the year made by the donor. Pledges to give cash, marketable securities, and other assets are reported at fair value and discounted to present value at the date the pledge is made to the extent estimated to be collectible. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges received with donor restrictions that limit the use of the donated assets are reported as temporary restricted support until the donor restriction expires.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

**Goodwill and Intangible Assets**

Identifiable intangible assets subject to amortization consist primarily of exclusivity and non-competition agreements. Amortization of the intangible assets is calculated using the straight-line method over estimated lives of the exclusivity and non-compete agreements ranging from one to twenty years. Amortization expense was \$1,801,000 and \$1,746,000 for the years ended December 31, 2017 and 2016, respectively, and is included in depreciation and amortization expense.

St. Elizabeth Healthcare annually performs an evaluation of goodwill for impairment considering qualitative and quantitative factors. There are no indicators that an impairment loss should be recognized in 2017.

**Malpractice and General Liability Contingencies**

St. Elizabeth Healthcare maintains a policy of self-insuring its professional liability risks for individual losses up to specified amounts per claim. In addition, the self-insurance plan has specified annual aggregate limits. St. Elizabeth Healthcare carries insurance coverage for incidents that would exceed coverages specified by the self-insurance program.

Because of the nature of its operations, St. Elizabeth Healthcare is, at all times, subject to pending and threatened legal actions, which arise in the normal course of its activities.

Malpractice and general liability claims for incidents that may give rise to litigation have been asserted against St. Elizabeth Healthcare by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. There are also known incidents that have occurred through December 31, 2017 that may result in the assertion of additional claims. There may be other claims from unreported incidents arising from services provided to patients; however, because the annual excess insurance policy covers only claims that have been asserted and incidents reported to the insurance carrier, these unknown incidents are not yet covered by excess insurance. The liability for medical malpractice at December 31, 2017 and 2016 includes estimated amounts for claims and related legal expenses for these unreported incidents.

At December 31, 2017 and 2016, St. Elizabeth Healthcare's management recorded its best estimate of these contingent losses based upon recommendations of professional actuaries. Recorded malpractice and general liability self-insurance liabilities, discounted at 1.10 percent, are adequate in management's opinion. As the actuarially determined accrual for professional and general liability is an estimate, the possibility exists that the estimate could be revised by a material amount.

## Saint Elizabeth Medical Center, Inc.

### Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

St. Elizabeth Healthcare established a trust for the purpose of malpractice and general liability self-insurance liability, setting aside assets based on actuarial funding recommendations; this amount is included in assets limited as to use.

St. Elizabeth Healthcare is also self-insured for workers' compensation, unemployment compensation, and employee medical insurance coverage. At December 31, 2017 and 2016, St. Elizabeth Healthcare's management recorded its best estimates of known and incurred, but not reported claims for losses. Recorded self-insured liabilities are adequate in management's opinion.

#### **Temporarily Restricted Assets**

Temporarily restricted assets are those whose use by St. Elizabeth Healthcare has been limited by donors to a specific time period or purpose. Some of the larger restricted assets are for the Clinical Research Institute, heart and vascular care, cancer care, women's wellness, hospice, and Vision (an associate led campaign to give back to their community and fellow associates in crisis). These funds are to cover facilities, equipment, research, education, supplies, and other specified expense.

#### **Net Patient Accounts and Net Patient Service Revenue**

Net patient accounts are reduced by an allowance for doubtful receivables based upon the historical collection experience of St. Elizabeth Healthcare adjusted for current environmental risks and trends for each major payor source. Amounts recognized are subject to adjustment upon review by third-party payors. Significant provision is made for self-pay patient accounts in the period of service based on past collection experience.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Settlements are recorded on an estimated basis in the period the related services are rendered and adjusted in future periods based upon additional information, filed cost reports, interim settlements, and final settlements.

St. Elizabeth Healthcare recognizes patient service revenue at the time services are rendered even though they do not assess the patient's ability to pay. As a result, the provision for bad debts and charity care is presented as a deduction from patient service revenue (net of contractual provisions and discounts). For uninsured and underinsured patients that do not qualify for charity care, St. Elizabeth Healthcare recognizes revenue when services are provided. Based on historical experience, a significant portion of St. Elizabeth Healthcare's uninsured and

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

underinsured patients will be unable or unwilling to pay for the services provided. Thus, St. Elizabeth Healthcare records a significant provision for bad debts related to uninsured and underinsured patients in the period the services are provided.

Patient service revenue, net of contractual allowances and discounts, but before the provision for bad debts, recognized for the years ended December 31, 2017 and 2016, respectively, by major payor source, is as follows:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Medicare	<b>\$ 437,867</b>	\$ 394,261
Medicaid	<b>166,799</b>	159,768
Anthem Blue Cross	<b>303,550</b>	289,628
Humana	<b>45,622</b>	53,816
United Health Care	<b>159,331</b>	148,740
Other insurance and workers' compensation	<b>133,860</b>	103,981
Self-pay	<b>30,344</b>	30,538
Patient service revenue, net of contractual provisions and discounts	<b>1,277,373</b>	1,180,732
Provision for bad debts	<b>(48,730)</b>	(39,477)
Net patient service revenue less provision for bad debts	<b>\$ 1,228,643</b>	\$1,141,255

**Charity Care**

St. Elizabeth Healthcare provides care, without charge or at amounts less than its established rates, to patients who meet certain criteria under its charity care policy. Amounts determined to qualify as charity care are not reported as net patient service revenue. The cost to St. Elizabeth Healthcare to provide charity care was approximately \$12,365,000 and \$9,220,000 for the years ended December 31, 2017 and 2016, respectively. The cost to St. Elizabeth Healthcare to provide charity care was determined through application of the ratio of patient costs to charges, per Schedule H of Form 990 filed with the Internal Revenue Service, to current-year charity care charges included as a deduction from gross patient revenue.

The Affordable Care Act (ACA) was passed to provide Americans better access to health care coverage. A major component of increasing access to coverage was new federal funding for states to expand their Medicaid eligibility to 138 percent of the Federal Poverty Level.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

Previously these patients qualified under the Kentucky State Indigent Program and were included in St. Elizabeth Healthcare's charity care program. As a result of Kentucky choosing to participate in the Medicaid expansion program, charity care has been lower in 2017 and 2016 and the number of patients eligible for Medicaid has increased. The percent of Medicaid net revenue to total net revenue was 13 percent and 14 percent in 2017 and 2016, respectively.

Federal law requires that state Medicaid programs make Disproportionate Share Hospital (DSH) payments to qualifying hospitals that serve a large number of Medicaid and uninsured individuals. Uninsured individuals qualified under the Kentucky DSH/Indigent program are reported under hospital charity. St. Elizabeth Healthcare recognized \$11,412,000 and \$12,615,000 for the years ended December 31, 2017 and 2016, respectively, which were recognized as an offset to charity deductions. The lower 2017 DSH payment was the result of a smaller pool of DSH funds available for disbursement. St. Elizabeth Healthcare also paid provider tax to the State in the amounts of \$12,551,000 and \$12,549,000 for the years ended December 31, 2017 and 2016, respectively, and recorded these amounts to other operating expense. Kentucky uses these taxes to draw matching DSH funds from the federal government.

**Revenue and Expenses**

St. Elizabeth Healthcare's mission is to meet the health care needs of its local market area through a broad range of general and specialized health care services including inpatient acute care, outpatient 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 unrelated to St. Elizabeth Healthcare's primary mission are considered to be non-operating and are reported in other gains and losses, consisting primarily of investment income and contributions. Approximately 75 percent of St. Elizabeth Healthcare's expenses relate to health care services for both years ended December 31, 2017 and 2016, respectively.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

**Tax Status**

No provision has been made for income taxes since St. Elizabeth Healthcare is exempt from federal income taxes under Internal Revenue Code Section 501(c)(3) and is classified as other than a private foundation by the Internal Revenue Service. Management has analyzed the tax positions taken by St. Elizabeth Healthcare and has concluded that as of December 31, 2017, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. St. Elizabeth Healthcare is not currently under examination by the Internal Revenue Service or any state or local tax authorities. St. Elizabeth Healthcare's federal tax returns for the year ended prior to December 31, 2014 and prior years are no longer subject to examination as the statute of limitations has expired for those years.

**Contributions**

Contributions are recorded at fair value in the period received or pledged. Donor-restricted contributions are reported as temporarily 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 the purpose or time restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets. Donor-restricted contributions whose restrictions are met within the same year as received are accounted for as unrestricted contributions.

**Consolidated Statements of Operations and Changes in Net Assets**

For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Changes in unrestricted net assets that are excluded from the excess of revenue over expenses, consistent with industry practice, include contributions of long-lived assets, changes in plan assets and benefit obligations of the pension plans, amortization of previously hedged interest rate swaps, and the write-off of the unamortized balance on previously hedged interest rate swaps.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

**Upcoming Accounting Pronouncements**

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* in August, 2016. ASU 2016-14 requires significant changes to the financial reporting model of organizations who follow FASB not-for-profit rules, including moving from three classes of net assets down to two classes, net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by SEH, including required disclosures about the liquidity and availability of resources. The new standard is effective for SEH's year ending December 31, 2018 and thereafter and must be applied on a retrospective basis. The standard is expected to have an impact on the presentation of net assets and to result in enhanced disclosures related to liquidity and availability.

During May 2014, the FASB released ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The amendments in the ASU clarify the principles for recognizing revenue and develop a common revenue standard for U.S. GAAP that removes inconsistencies and weaknesses in revenue requirements, provides a more robust framework for addressing revenue issues, improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets, provides more useful information to users of financial statements through improved disclosure requirements, and simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. SEH will be required to adopt and implement this accounting update as of and for the year ending December 31, 2018. Management does not expect that this standard will have a significant impact on the Organization's main revenue stream.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease footnote guidance will be effective for SEH's year ending December 31, 2019 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. Management expects that this new standard will significantly increase short and long-term assets and liabilities upon adoption. The effect on the results of operations is not expected to be significant.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

**New Accounting Pronouncements**

In December 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows*. The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents; therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. In 2017, the Organization elected to early adopt this standard and applied it retrospectively.

In March 2017, the FASB released ASU 2017-07, *Compensation – Retirement Benefits (Topic 715)*. The amendments improve the presentation of net periodic pension cost and net periodic postretirement benefit cost and require that the employer report the service cost component in the same line item or items as other compensation costs. The other components of net benefit cost are required to be presented in the consolidated statement of operations and changes in net assets separately from the service cost component and included in the other gains (losses) line item of non-operating income. In 2017 St. Elizabeth elected to early adopt this new standard and retrospectively applied to the year ended December 31, 2016, utilizing the practical expedient that allows the Organization to utilize amounts previously disclosed in Note 9. As a result, approximately \$3,667,000 of expense was reclassified from employee benefits and payroll taxes to net periodic pension costs other than service cost.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**2. Assets Limited as to Use and Investments**

The following is a description of the aggregate carrying amount of assets limited as to use and investments by major type of investment carried at fair value for the different investment groupings:

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
<i>(In Thousands)</i>		
Money market funds	\$ 15,726	\$ 6,860
U.S. government obligations	40,902	47,494
Asset-backed securities	75,534	60,232
Corporate bonds	67,429	62,179
Municipal bonds	12,482	9,106
Foreign bonds	10,538	6,418
Government-backed securities	13,220	11,301
Federal agency bonds	494	493
Common stock	216,187	107,197
Mutual funds:		
Large cap value	—	68,879
Large cap core	16	17
All cap core	31,316	24,104
Mid cap core	45,025	35,622
International large cap	91,793	71,670
International small cap	31,204	23,449
International emerging markets	33,298	24,147
Fixed income	51,779	54,665
Hedge fund of funds	129,261	133,393
Real estate funds	135,354	110,135
Emerging markets fund	44,359	39,229
Total assets limited as to use and investments	<b>\$ 1,045,917</b>	<b>\$ 896,590</b>
Assets limited as to use and investments:		
Internally designated for operating needs	\$ 9,970	\$ —
Internally and board-designated for capital needs	980,545	835,889
Designated for self-insurance needs	55,402	60,701
Total assets limited as to use and investments	<b>\$ 1,045,917</b>	<b>\$ 896,590</b>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

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

Other gains (losses), net is comprised of the following for the years ended December 31:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Realized gains on sales of investments, net	\$ 16,376	\$ 541
Interest and dividend income, net	20,407	17,907
Change in unrealized gains on investments, net	81,055	38,983
Total investment income	117,838	57,431
Change in fair market value of interest rate swap	743	559
Loss on advance refunding of debt	–	(12,257)
Other periodic pension cost excluding service cost	(2,112)	(3,667)
Other	2,396	2,796
	\$ 118,865	\$ 44,862

**3. Assets and Liabilities Measured at Fair Value**

The carrying value of the hedge fund of funds, real estate funds, private equity funds, infrastructure funds, and emerging markets funds (alternative investments) is based on valuations provided by the administrators of the specific financial instruments. The underlying investments in these financial instruments may include marketable debt and equity securities, commodities, foreign currencies, derivatives, real estate and private equity investments. The underlying investments themselves are subject to various risks including market, credit, liquidity, and foreign exchange risk. St. Elizabeth Healthcare believes the carrying amount of these financial instruments in the consolidated balance sheets is a reasonable estimate of ownership interest. Since these financial instruments are not readily marketable, the estimated carrying value is subject to uncertainty and may differ from the value that would have been used had a market for such financial instruments existed. The change in the carrying value of the alternative investments is included in the other gains (losses), net within excess of revenue over expenses.

**Cash and Cash Equivalents and Assets Limited as to Use**

St. Elizabeth Healthcare's cash and cash equivalents and assets limited as to use, except for alternative investments, which are recorded at the net asset value provided by the administrator of the fund, are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

sources with reasonable levels of transparency. The types of instruments based on quoted market prices in active markets include common stock, mutual funds, and money market securities (cash and cash equivalents). Such instruments are generally classified within Level 1 of the fair value hierarchy. St. Elizabeth Healthcare does not adjust the quoted price for such instruments.

The types of instruments valued based on quoted prices that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most U.S. government obligations, preferred stock, investment-grade and high-yield corporate bonds, foreign bonds, and asset-backed securities. Fair values are primarily obtained from third-party pricing services for identical or comparable assets or liabilities. Such instruments are generally classified within Level 2 of the fair value hierarchy. Primarily all of St. Elizabeth Healthcare's marketable debt securities, including asset-backed obligations, are actively traded and the recorded fair value reflects current market conditions; however, due to the volatility in the investment market, there is at least a reasonable possibility that recorded investment values may change by a material amount in the near term.

The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level of input that is significant to the fair value measurement in its entirety.

Following is the summary of the inputs and valuation techniques as of December 31, 2017 and 2016 used for valuing Level 2 financial instruments:

<b>Financial Instrument</b>	<b>Input</b>	<b>Valuation Technique</b>
Corporate and foreign bonds	Broker/dealer	Market
Government obligations	Broker/dealer	Market
Federal agency bonds	Broker/dealer	Market
Municipal bonds	Broker/dealer	Market
Government-backed securities	Broker/dealer	Market/income
Asset-backed securities	Broker/dealer	Market/income
Common collective trust	Broker/dealer	Market

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

**Interest Rate Swap Agreements**

St. Elizabeth Healthcare participates in interest rate swap agreements to manage its exposures to fluctuations in interest rates and overall long-term debt portfolio. The interest rate swap agreements are contracts between St. Elizabeth Healthcare and third parties (counterparties) that provide for economic payments between parties based on changes in notional amounts and defined interest rates. The risk of the interest rate swap agreements is estimated and managed on an ongoing basis by St. Elizabeth Healthcare. St. Elizabeth Healthcare's interest rate swap agreements are not traded on an exchange. The valuation of the interest rate swap agreements is determined using widely accepted valuation techniques, including a discounted cash flow analysis on the expected cash flows of each interest rate swap agreement. The discounted cash flow analysis reflects the contractual terms of the interest rate swap agreements, including the period to maturity and uses observed market-based inputs, including interest rate curves and implied volatilities. Valuation adjustments are required to be considered in the determination of fair value. This includes amounts to reflect counterparty credit quality and liquidity risk. To comply with the provisions of ASC 820, St. Elizabeth Healthcare incorporated a credit valuation adjustment to appropriately reflect nonperformance risk in the fair value measurements. Although St. Elizabeth Healthcare has determined that certain of the inputs used to value its interest rate swap agreements fall within Level 2 of the fair value hierarchy, certain inputs and the credit valuation adjustment associated with the interest rate swap agreements utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by St. Elizabeth Healthcare or the counterparties. As a result, St. Elizabeth Healthcare has determined that its interest rate swap agreements in their entirety are classified in Level 3 of the fair value hierarchy.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

The following table summarizes St. Elizabeth Healthcare's assets and liabilities measured at fair value on a recurring basis as of December 31, 2017, aggregated by the level in the fair value hierarchy within which those measurements are measured:

	Fair Value at December 31, 2017	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>(In Thousands)</i>				
<b>Assets limited as to use and investments</b>				
Money market funds	\$ 15,726	\$ 15,726	\$ —	\$ —
U.S. government obligations	40,902	—	40,902	—
Asset-backed securities	75,534	—	75,534	—
Corporate bonds	67,429	—	67,429	—
Municipal bonds	12,482	—	12,482	—
Foreign bonds	10,538	—	10,538	—
Government-backed securities	13,220	—	13,220	—
Federal agency bonds	494	—	494	—
Common stock	216,187	216,187	—	—
Mutual funds:				
Large cap core	16	16	—	—
All cap core	31,316	31,316	—	—
Mid cap core	45,025	45,025	—	—
International large cap	91,793	91,793	—	—
International small cap	31,204	31,204	—	—
International emerging markets	33,298	33,298	—	—
Fixed income	51,779	51,779	—	—
Assets measured at fair value levels	<u>\$ 736,943</u>	<u>\$ 516,344</u>	<u>\$ 220,599</u>	<u>\$ —</u>
Hedge fund of funds	129,261	—	—	—
Real estate funds	135,354	—	—	—
Emerging markets fund	44,359	—	—	—
Total assets limited as to use and investments	<u>\$ 1,045,917</u>	<u>\$ 516,344</u>	<u>\$ 220,599</u>	<u>\$ —</u>
Fair value of interest rate swaps	\$ 3,451	\$ —	\$ —	\$ 3,451
Total liabilities at fair value	<u>\$ 3,451</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,451</u>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

The following table summarizes St. Elizabeth Healthcare's assets and liabilities measured at fair value on a recurring basis as of December 31, 2016, aggregated by the level in the fair value hierarchy within which those measurements are measured:

	Fair Value at December 31, 2016	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>(In Thousands)</i>				
<b>Assets limited as to use and investments</b>				
Money market funds	\$ 6,860	\$ 6,860	\$ –	\$ –
U.S. government obligations	47,494	–	47,494	–
Asset-backed securities	60,232	–	60,232	–
Corporate bonds	62,179	–	62,179	–
Municipal bonds	9,106	–	9,106	–
Foreign bonds	6,418	–	6,418	–
Government-backed securities	11,301	–	11,301	–
Federal agency bonds	493	–	493	–
Common stock	107,197	107,197	–	–
Mutual funds:				
Large cap value	68,879	68,879	–	–
Large cap core	17	17	–	–
All cap core	24,104	24,104	–	–
Mid cap core	35,622	35,622	–	–
International large cap	71,670	71,670	–	–
International small cap	23,449	23,449	–	–
International emerging markets	24,147	24,147	–	–
Fixed income	54,665	54,665	–	–
Assets measured at fair value levels	\$ 613,833	\$ 416,610	\$ 197,223	\$ –
Hedge fund of funds	133,393	–	–	–
Real estate funds	110,135	–	–	–
Emerging markets fund	39,229	–	–	–
Total assets limited as to use and investments	\$ 896,590	\$ 416,610	\$ 197,223	\$ –
Fair value of interest rate swaps	\$ 4,194	\$ –	\$ –	\$ 4,194
Total liabilities at fair value	\$ 4,194	\$ –	\$ –	\$ 4,194

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

The Organization's policy is to recognize transfers in and transfers out of Level 1, 2 and 3 fair value classifications as of the end of the reporting period. There were no significant transfers between levels for the years ended December 31, 2017 and 2016.

The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair value. Furthermore, while St. Elizabeth Healthcare believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the consolidated balance sheets date.

The following table is a roll forward of the consolidated balance sheets amounts for financial instrument liabilities classified by St. Elizabeth Healthcare within Level 3 of the fair value hierarchy defined above:

	<b>Fair Value Measurement Using Significant Unobservable Inputs (Level 3) Interest Rate Swaps</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Balance at January 1	\$ (4,194)	\$ (4,753)
Change in fair market value of interest rate swaps	743	559
Balance at December 31	<u>\$ (3,451)</u>	<u>\$ (4,194)</u>

**Investments in Entities that Calculate Net Asset Value Per Share**

The following description of funds is applicable to funds included in the assets limited as to use and/or the funds included in retirement plan assets in Note 9.

**Hedge Fund of Funds**

The hedge fund of funds investment is comprised of shares in the William Blair Marble Place TE Fund, L.P. (William Blair), the AQR GRP EL Offshore Fund, Ltd (AQR), the Magnitude International (Magnitude) Class A Shares, and the Evanston Capital Management Weatherlow

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

Fund I L.P. (Evanston) as of December 31, 2017 and 2016. The fair value of the investments in this class has been estimated using the net asset value of the investments.

*William Blair Marble Place TE*

The William Blair partnership operates as a “fund of funds,” which is a vehicle that pursues its investment objective by investing in other investment companies. Through its investment in the hedge funds, the partnership is invested, indirectly, primarily in debt obligations, preferred stock, common stocks, warrants, futures, forward and option contracts on currencies, metals, financial instruments, stock indices, energy and agricultural commodities, and other derivative securities, many of which are likely to be speculative in character. There were no unfunded commitments at December 31, 2017 or 2016.

In March 2016, the St. Elizabeth Healthcare Investment Committee voted to terminate its partnership with William Blair and redeem one hundred percent of its investment. Subsequent to this, the partnership voted to close the fund. The redemption is being disbursed to St. Elizabeth Healthcare according to terms agreed upon by all William Blair partners pursuant to the closing of the fund. The termination of the final manager within the fund did not occur until late 2017, which delayed the final closing of the fund. As a result of this, the final distribution amount will not be received until 2018. As of December 31, 2017, disbursements of 99.7 percent of St. Elizabeth Healthcare’s shares had been processed by William Blair; the remaining 0.3 percent will be disbursed in two installments in 2018, with the final installment being disbursed upon completion of William Blair’s 2017 audited financial statements and is anticipated to be received by April, 2018.

*AQR GRP EL Offshore Fund, Ltd.*

AQR operates a diversified set of global risks covering equities, government bonds, and commodities. These include exposure to global developed and emerging stocks, global inflation protected bonds, and other exposures. There were no unfunded commitments at December 31, 2017 or 2016.

Partial or complete redemptions may be voluntarily made from the shareholder’s shares in the fund, upon at least five business days’ prior written notice. The fund may delay the redemption payment if the redemption has a material adverse impact on the fund.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

*Evanston Capital Management Weatherlow Fund I L.P.*

Evanston is a multi-manager, multi-strategy “fund-of-funds” managed by Evanston Capital Management, LLC that invests predominantly in U.S. and non-U.S. investment funds managed by independent portfolio managers that employ diverse alternative investment strategies across a variety of asset classes. There were no unfunded commitments at December 31, 2017 or 2016.

Any capital contributions to Evanston must be invested in the fund for at least 36 full calendar months, effective March 1, 2015. St. Elizabeth Healthcare may withdraw the value of its capital account as of the last day of the calendar quarter that falls on or immediately after such capital contribution has been invested in Evanston for at least 36 full calendar months with at least 65 days written notice prior to the applicable redemption date.

In August 2017, the St. Elizabeth Healthcare Investment Committee voted to terminate its partnership with Evanston Capital Management and redeem one hundred percent of its investment. The redemption is being disbursed to St. Elizabeth Healthcare according to terms of the Evanston Capital Management Limited Partnership agreement. As of December 31, 2017, no disbursements had been processed by Evanston. St. Elizabeth’s assets will be disbursed in two installments in 2018, with the final installment being disbursed upon completion of Evanston’s 2017 audited financial statements and is anticipated to be received by April, 2018.

*Magnitude International*

The Magnitude fund is a global, multi-strategy “fund-of-funds” managed by Magnitude Capital, LLC. The Fund’s investment strategies can involve the purchase and sale of various financial instruments, including but not limited to stocks, bonds, options, futures contracts, derivative instruments, insurance and reinsurance-related products, and cash and cash equivalents. St. Elizabeth Healthcare has subscribed to Magnitude International’s Class A shares. There were no unfunded commitments at December 31, 2017 or 2016.

Partial or complete redemptions can be made as of the last day of any calendar quarter with at least 65 days written notice prior to the applicable redemption date.

**Real Estate Funds**

The real estate investment is comprised of shares in the Morgan Stanley Prime Property Fund (PRIME) and the Principal Enhanced Property Fund (Principal Property) as of December 31, 2017 and 2016. The fair value of the investments in this class has been estimated using the net asset value of the investments.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

*Morgan Stanley Prime Property Fund (PRIME)*

PRIME is a core fully-specified, open-end commingled equity real estate investment fund diversified by property type and geographic location across the United States. The focus is on high-quality office buildings, Class A multifamily communities, warehouse distribution and storage facilities, and top tier super regional malls and shopping centers in targeted primary markets. There were no unfunded commitments at December 31, 2017 or 2016.

PRIME does not have a lockout period for invested funds. The agreement may be terminated by either party without penalty upon 90 days' written notice. There is no withholding if a partial redemption is requested; however, a full redemption request only allows a 90 percent payout of the previous month-end balance. The remaining 10 percent will be paid out on the fifth business day following the quarter end to ensure the correct PRIME share price.

*Principal Enhanced Property Fund, L.P.*

Principal Property is an open-end, commingled fund which invests in U.S. real estate properties and portfolios. Principal Property invests only in office, retail, industrial and multifamily properties in U.S. markets with metropolitan statistical areas populations greater than one million. There were no unfunded commitments at December 31, 2017 or 2016.

After the first anniversary of an investor's initial contribution (and earlier in limited circumstances), withdrawals will be permitted on a quarterly basis with at least 90 days' notice, subject to available capital.

**Private Equity Funds**

The private equity investments are comprised of shares in the Fort Washington Fund VIII (Fund VIII) and the Fort Washington Fund IX (Fund IX) as of December 31, 2017 and 2016. The fair value of the investments in this class has been estimated using the net asset value of the investments. These investments are held in the defined benefit pension assets portfolio only.

*Fort Washington Fund VIII*

Fund VIII is a private equity fund of funds that was formed by Fort Washington Capital Partners Group. Fund VIII will endeavor to realize capital appreciation primarily by investing in a diversified portfolio of leading private equity funds including buyout, venture capital/growth equity, and special situations funds (primarily distressed, credit, and real assets), among others up to 20 percent of capital in secondary investments, structured transactions and direct

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

investments, and up to 30 percent of the private equity fund investments in international funds. Fund VIII will have a maximum limitation of 10 percent of its capital in any one investment. As of December 31, 2017 and 2016, St. Elizabeth had unfunded commitments of \$4,300,000 and \$5,700,000, respectively.

The Fund VIII does not have a redemption period or redemption frequency. Limited Partners can request an assignment of interest at the General Partner's discretion. The investment period is four years from the final closing date (October 2014). The commitment term is 10 years after the expiration of the investment period, subject to three one-year extensions with the consent of the advisory committee.

*Fort Washington Fund IX*

Fund IX is a private equity fund of funds that was formed by Fort Washington Capital Partners Group in 2016. The final closing of the fund was held in April, 2017. Similar to Fund VIII, Fund IX seeks to realize capital appreciation primarily by investing in a diversified portfolio of leading private equity funds including buyout, venture capital, growth equity, real assets and special situations; up to 20 percent of capital in secondary investments, structured transactions, and direct investments; and up to 30 percent of the private equity fund investments in international funds. Fund IX will have a maximum limitation of 10 percent of its capital in any one investment. As of December 31, 2017 and 2016, St. Elizabeth Healthcare had unfunded commitments of \$4,100,000 and \$4,612,500, respectively.

Fund IX does not have a redemption period or redemption frequency. Limited Partners can request an assignment of interest at the General Partner's discretion. The investment period is four years from the final closing date. The commitment term is 12 years after the expiration of the investment period, subject to two one-year extensions with the consent of the advisory committee.

**Infrastructure Funds**

The Infrastructure Investments Fund (IIF) is managed by J.P. Morgan Asset Management. The purpose of IIF is to invest in a broad range of infrastructure and infrastructure-related assets located in member countries of the Organization for Economic Co-Operation and Development (OECD) with a primary focus on the US, Canada, Western Europe, and Australia. These assets may include toll roads, bridges, tunnels, oil and gas pipelines, electricity transmission and distribution facilities, contracted power generation assets, communication assets, water distribution and wastewater collection and processing assets, railway lines and rapid transit links, seaports and airports. As of December 31, 2017 St. Elizabeth Healthcare had an unfunded

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**3. Assets and Liabilities Measured at Fair Value (continued)**

commitment of \$6,600,000 and no unfunded commitment as of December 31, 2016. The fair value of this investment has been estimated using the net asset value of the investment.

IIF is subject to a 4 year soft lock period. Redemptions are possible prior to the expiration of the 4 year term, but are subject to a 4 percent penalty. After the initial term has expired, funds may be redeemed with 60 days written notice. These investments are held in the defined benefit pension asset portfolio only.

**Emerging Markets Fund**

*Logan Circle Partners Emerging Markets Debt, L.P.*

The Logan Circle Partners Emerging Markets Debt, L.P. (Logan Circle) is a newly established limited partnership, which invests primarily in debt securities of issuers located in emerging market countries. Emerging market countries are countries that major international financial institutions, such as the World Bank, generally consider to be less economically mature than developed nations. Emerging market countries can include every nation in the world except the United States, Canada, Japan, Australia, New Zealand and most countries located in Western Europe. Logan Circle normally will hold fixed-income securities of government and government-related issuers and corporate issuers in emerging market countries. The investment adviser may invest in capital securities, which are hybrid securities that combine the characteristics of bonds and preferred stocks, in order to take advantage of the mispricing of subordinated risk within the marketplace. There were no unfunded commitments at December 31, 2017 or 2016. The fair value of this investment has been estimated using the net asset value of the investment.

Amounts invested in Logan Circle may only be redeemed as of the last business day of a calendar month and with at least 10 business days' prior written notice, unless otherwise consented to by the General Partner in its sole discretion.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**4. Property, Plant, and Equipment**

Property, plant, and equipment consist of the following:

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
	<i>(In Thousands)</i>	
Land	\$ 18,513	\$ 17,861
Buildings, building services, and land improvements	578,993	556,319
Equipment	408,249	399,444
Construction in process	42,728	37,738
Total cost	<u>1,048,483</u>	<u>1,011,362</u>
Less: Accumulated depreciation	599,838	576,472
Net property and equipment	<u>\$ 448,645</u>	<u>\$ 434,890</u>

Depreciation expense was \$67,521,000 and \$65,885,000 for the years ended December 31, 2017 and 2016, respectively, and is included in depreciation and amortization expense.

St. Elizabeth Healthcare is embarking on a six year Master Facility Plan aligned with its Strategic Plan. St. Elizabeth Healthcare Board of Trustees has approved the next stages of our Cancer Institute, expanding our cancer care treatment options into a state-of-the-art program equipped to provide comprehensive cancer care, with an approximate building cost of \$90,000,000 and a construction date beginning in 2018.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**5. Goodwill and Intangible Assets**

Intangible assets of St. Elizabeth Healthcare at December 31, 2017 and 2016 are summarized as follows:

	2017		2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	<i>(In thousands)</i>			
Amortized intangible assets	\$ 18,124	\$ 9,079	\$ 18,124	\$ 7,278
Unamortized intangible assets	\$ 17,651	\$ -	\$ 17,651	\$ -

Identifiable intangible assets subject to amortization consist primarily of exclusivity and non-competition agreements. Amortization of the intangible assets is calculated using the straight-line method over estimated lives of the exclusivity and non-compete agreements ranging from one to twenty years. Amortization expense was \$1,801,000 and \$1,746,000 for the years ended December 31, 2017 and 2016, respectively, and is included in depreciation and amortization expense.

Estimated Amortization expense for the years ended December 31 is as follows (in thousands):

	<b>Amount</b>
2018	\$ 1,747
2019	1,725
2020	1,697
2021	951
2022	225
Thereafter	2,700
Total estimated amortization expense	\$ 9,045

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**5. Goodwill and Intangible Assets (continued)**

St. Elizabeth Healthcare annually performs an evaluation of goodwill for impairment considering qualitative and quantitative factors. There are no indicators that impairment loss should be recognized in 2017.

The changes in the carrying amount of goodwill are as follows:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Balance at January 1	\$ 17,651	\$ 13,162
Current year activity	-	4,489
Balance at December 31	<u>\$ 17,651</u>	<u>\$ 17,651</u>

During the year ended December 31, 2016, St. Elizabeth Healthcare entered into an asset purchase agreement with Oncology/Hematology Care, Inc. (OHC) to acquire the assets of OHC's Kentucky operations, including noncompetition agreements. As part of the acquisition, St. Elizabeth recorded goodwill in the amount of \$4,489,000 and amortizable assets in the amount of \$7,260,000, which is being amortized over five years.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**6. Long-Term Debt**

Long-term debt consists of the following:

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
	<i>(In Thousands)</i>	
Kentucky Economic Development Finance Authority Adjustable Rate Hospital Facilities Revenue Refunding Bonds, Series 2009B, maturing in various amounts through 2033 with an adjustable rate set every seven days (1.27 percent and .70 percent at December 31, 2017 and 2016, respectively)	<b>\$ 28,625</b>	\$ 29,950
Kentucky Bond Development Corporation Facilities Revenue Bonds, Series 2015A, maturing in various amounts through 2045 with a fixed rate of 2.17 percent through 2027	<b>47,675</b>	48,900
Kentucky Bond Development Corporation Facilities Revenue Bonds, Series 2015B, maturing in various amounts through 2045 with an adjustable rate set every 30 days (1.47 percent and .95 percent at December 31, 2017 and 2016, respectively)	<b>50,000</b>	30,000
Kentucky Bond Development Corporation Hospital Facilities Revenue Refunding Bonds, Series 2016A, maturing in various amounts through 2039 with various fixed rates ranging from 3.00 percent through 5.00 percent	<b>82,515</b>	85,000
Total debt	<b>208,815</b>	193,850
Less current portion	<b>(6,490)</b>	(5,035)
Less unamortized debt issuance costs	<b>(1,890)</b>	(2,006)
Less long-term debt subject to short-term remarketing arrangement	<b>(27,225)</b>	-
Plus unamortized premium	<b>11,021</b>	12,478
Long-term debt	<b>\$ 184,231</b>	\$ 199,287

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**6. Long-Term Debt (continued)**

Pursuant to an Indenture of Trust dated December 1, 2009, the Kentucky Economic Development Finance Authority, on behalf of St. Elizabeth Healthcare, issued Hospital Facilities Revenue Refunding and Improvement Bonds Series 2009A totaling \$101,850,000 and the Adjustable Rate Hospital Facilities Revenue Refunding Bonds, Series 2009B totaling \$38,150,000. The Series 2009A and Series 2009B Bonds were used to refund the outstanding Series 2003A, Series 2003B and Series 2003C Bonds, pay certain costs related to the issuance of the Series 2009 Bonds, and finance improvements to St. Elizabeth Healthcare's facilities.

The Series 2009A and 2009B bonds were issued on December 9, 2009. Redemption of the 2009B bonds can occur prior to maturity, in whole or in part, at the option of St. Elizabeth Healthcare, at a redemption price of 100 percent of the principal amount plus interest. On May 12, 2016, St. Elizabeth Healthcare issued Series 2016A bonds, which expire on May 1, 2039. The proceeds from the Series 2016A bonds were used to pay off the Series 2009A bonds, which were legally defeased.

The Series 2009B bonds are also secured by a standby bond purchase agreement equal to the aggregate outstanding Series 2009B bonds plus 35 days' interest at a rate of 12 percent annually. The Bond Trustee is authorized to draw amounts from the standby bond purchase agreement sufficient to cover principal and interest payments on the Series 2009B bonds. St. Elizabeth Healthcare has an obligation to make payments to the liquidity facility provider in equal (or nearly equal) semi-annual principal installments; the first such installment is due on the first quarterly business day following the first anniversary of the draw on the facility, such that the draw is paid in full no later than the third anniversary of the draw. The standby purchase agreement was effective September 25, 2013, and has a stated expiration date of September 25, 2018. Therefore, the long-term balance on the Series 2009B bonds has been reclassified to long-term debt subject to short-term remarketing arrangements within current liabilities on the consolidated balance sheet. It is the intention of the Organization to extend the standby bond purchase agreement in 2018.

Pursuant to a Resolution of the Board of Trustees dated November 2, 2015, the Kentucky Bond Development Corporation, on behalf of St. Elizabeth Healthcare, issued Hospital Facilities Revenue Bonds Series 2015A totaling \$50,000,000 and Adjustable Rate Hospital Facilities Revenue Bonds, Series 2015B totaling \$50,000,000. St. Elizabeth Healthcare received \$10,000,000 on the 2015B series bonds at closing, received \$20,000,000 in 2016, and received \$20,000,000 in 2017. As of December 31, 2017, the amount outstanding on the 2015B series was \$50,000,000. The bonds were issued for the purpose of financing acquisition, construction, installation and equipping of facilities suitable for use by St. Elizabeth Healthcare as healthcare and health related facilities. Both series were private placement.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**6. Long-Term Debt (continued)**

The Series 2015A and 2015B bonds were issued on December 30, 2015. Redemption of the 2015A bonds can occur, in whole or in part, on and after January 2, 2018 at a redemption price of 100 percent of the principal plus accrued interest. Redemption can occur prior to January 2, 2018 at a premium. The 2015A bonds are subject to a mandatory tender and purchase by St. Elizabeth Healthcare on December 1, 2027. Redemption of the 2015B bonds can occur prior to maturity, in whole or in part, at the option of St. Elizabeth Healthcare, at a redemption price of 100 percent of the principal amount plus interest. The holder of the 2015B bonds may require St. Elizabeth Healthcare to purchase the bonds on December 1, 2025 at a redemption price of 100 percent of the principal plus accrued interest.

The Kentucky Bond Development Corporation, on behalf of St. Elizabeth Healthcare, issued Hospital Facilities Revenue Refunding Bonds Series 2016A totaling \$85,000,000. The bonds were issued for the purpose of advance refunding and defeasing all of the outstanding Kentucky Economic Development Finance Authority Hospital Facilities Revenue Refunding and Improvement Bonds, Series 2009A. The Series 2016A bonds were issued on May 12, 2016. As of December 31, 2017, the amount outstanding on the 2016A series was \$82,515,000. Redemption of the 2016A bonds can occur, in whole or in part, on and after May 1, 2026 at a redemption price of 100 percent of the principal plus accrued interest.

St. Elizabeth Healthcare has unconditionally guaranteed the payment of principal and interest on the Series 2009, Series 2015, and Series 2016 bonds that are secured by a first security interest in substantially all of St. Elizabeth Healthcare's pledged revenue. This pledged revenue includes all revenue, rents, receipts, investment income, gains and losses or other monies received by St. Elizabeth Healthcare, excluding restricted donations, proceeds from additional debt as allowed by the Master Trust Indenture, and any other revenue, where the granting of a lien is prohibited by law.

St. Elizabeth Healthcare has covenants, among other things, not to create unpermitted liens under the terms of the bond agreement, to fulfill sinking fund requirements in trustee accounts, to limit additional indebtedness, meet specific financial ratio tests, limit transfer of assets to affiliates, maintain its properties and insurance, and to maintain its corporate existence and operations.

St. Elizabeth Healthcare's debt agreements require that St. Elizabeth Healthcare report and maintain certain financial covenants under the Master Trust Indenture and the standby bond purchase agreement.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**6. Long-Term Debt (continued)**

The following is a schedule of future payments for years ending December 31 and in the aggregate, required under the debt of St. Elizabeth Healthcare (in thousands):

	<u>Amount</u>
2018	\$ 6,490
2019	6,665
2020	6,890
2021	7,070
2022	7,295
Thereafter	174,405
Total payments	<u>\$ 208,815</u>

Total interest paid was approximately \$6,798,000 and \$6,651,000 for the years ended December 31, 2017 and 2016, respectively.

St. Elizabeth Healthcare has an interest rate swap agreement on the Series 2009B variable rate bonds, with a 30-year term and a notional amount of \$28,625,000 and \$29,950,000 at December 31, 2017 and 2016, respectively. Under the terms of the interest rate swap agreement, St. Elizabeth Healthcare pays a fixed rate of 3.07 percent and receives a floating rate on the basis of 67 percent of the U.S. dollar one-month London Interbank Offered Rate (USD LIBOR BBA). The interest differential to be paid or received under the interest rate swap agreement is accrued and recognized as an adjustment to interest expense. The scheduled principal repayments of the Series 2009B bonds align with the notional amount remaining each year in the interest rate swap agreement.

As of December 30, 2015, St. Elizabeth Healthcare entered into an interest rate swap agreement on the Series 2015B variable rate bonds, with a 30-year term and a notional amount of \$50,000,000 and \$30,000,000 at December 31, 2017 and 2016, respectively. Under the terms of the interest rate swap agreement, St. Elizabeth Healthcare pays a fixed rate of 1.735 percent and receives a floating rate on the basis of 70 percent of the U.S. dollar one-month London Interbank Offered Rate (USD LIBOR BBA). The interest differential to be paid or received under the interest rate swap agreement is accrued and recognized as an adjustment to interest expense. The scheduled principal repayments of the Series 2015B bonds align with the notional amount remaining each year in the interest rate swap agreement.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**6. Long-Term Debt (continued)**

The fair market value of the interest rate swap agreements at December 31, 2017 and 2016 was a liability of \$3,451,000 and \$4,194,000, respectively, and is included in the consolidated balance sheets.

Net payments to/from counterparty of \$1,033,000 and \$1,032,000 for the years ended December 31, 2017 and 2016, respectively, are included as an increase in interest expense.

In December 2016, St. Elizabeth Healthcare amended an agreement with a bank for an operating line of credit. This agreement has a term of one year and was renewed in November 2017. The line of credit bears interest at a floating rate per annum equal to 0.40 percent in excess of the LIBOR rate, which was 1.57 percent at December 31, 2017, for a total interest rate of 1.97 percent at December 31, 2017. The line of credit has a maximum commitment of \$40,000,000 and there was no outstanding balance at December 31, 2017 or 2016. The line of credit is collateralized by a security interest in a portion of St. Elizabeth Healthcare's assets and gross revenue.

**7. Operating Lease**

St. Elizabeth Healthcare is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was \$18,373,000 and \$16,944,000 for the years ended December 31, 2017 and 2016, respectively.

The following is a schedule of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year for years ending December 31 (in thousands):

	<u>Amount</u>
2018	\$ 13,422
2019	12,816
2020	12,458
2021	11,432
2022	9,393
Thereafter	52,883
Total payments	<u>\$ 112,404</u>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**8. Third-Party Reimbursement**

St. Elizabeth Healthcare is a provider of services under contractual arrangements with the Medicare and Medicaid programs. Collectively, revenue from the Medicare and Medicaid programs accounted for approximately 47 percent of St. Elizabeth Healthcare's net patient service revenue for the years ended December 31, 2017 and 2016. In addition, St. Elizabeth Healthcare has other third-party reimbursement arrangements. Net patient service revenue includes amounts estimated by management to be reimbursable by these programs under the provisions of the various payment formulas of such arrangements. Amounts received by St. Elizabeth Healthcare for treatment of patients covered by such programs are generally less than the established rates. The difference between established billing rates and amounts received is deducted in arriving at net patient service revenue.

Amounts earned under these contractual arrangements are subject to audit by appropriate government authorities, other payors, or their agents. In the opinion of management, adequate provision has been made in the financial statements for any adjustments that may result from such audits.

In the health care industry, laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. St. Elizabeth Healthcare believes that it is in substantial compliance with all applicable laws and regulations. Compliance with health care industry laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that current recorded estimates will change by a material amount in the near term. St. Elizabeth Healthcare's net patient service revenue increased by approximately \$1,703,000 and \$4,118,000 for the years ended December 31, 2017 and 2016, respectively, as a result of changes in estimated payables/receivables to/from third-party payors.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**8. Third-Party Reimbursement (continued)**

St. Elizabeth Healthcare grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. Components of net patient accounts receivable include:

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Medicare	27%	28%
Medicaid	13	13
Anthem Blue Cross	23	24
Humana	4	5
United Healthcare	13	13
Other insurance	15	13
Self-pay	3	3
Workers' compensation	2	1
Total	<b>100%</b>	<b>100%</b>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans**

The St. Elizabeth Healthcare Employees' Pension Plan is a defined benefit plan that covers substantially all St. Elizabeth hospital and physician group employees. For hospital employees hired prior to July 1, 2009, benefits are computed based on years of service and a percentage of the employee's compensation. St. Elizabeth Hospital employees who were hired on or after July 1, 2009 accumulate benefits through a cash balance formula whereby an accumulation account is credited each year with 3 percent of the participant's eligible compensation. Effective January 1, 2012, SEP employees also accumulate benefits through this cash balance formula unless they were employed by St. Elizabeth Hospital prior to January 1, 2011 and were participants in the defined benefit plan prior to July 1, 2009, in which case their pension benefits continue to be based on years of service and a percentage of their compensation. Hospital and SEP cash balance participants are also eligible for a 50 percent employer match of the first 4 percent of each participant's compensation that is contributed by the participant in the St. Elizabeth Healthcare 403(b) Plan.

During the years ended December 31, 2017 and 2016, St. Elizabeth Healthcare recorded contribution expense of \$4,276,000 and \$3,547,000, respectively, to its defined contribution plan.

During 2017, the Organization passed a resolution offering a lump-sum window payout for eligible pension plan participants, effective September 15, 2017. As a result of this amendment, approximately \$31,063,000 was paid out in December 2017 and approximately \$3,689,000 will be paid out in 2018. The Organization also approved a hard freeze of the pension plan effective December 31, 2017, with participants' accrued benefits frozen as of that date. As a result, the pension plan recognized a decrease in the projected benefit obligation from a curtailment gain of approximately \$69,685,000. This reflects the freeze of benefit obligations as of December 31, 2017 and the reduction for previously estimated future salary levels.

As a result of the pension plan freeze, the St. Elizabeth Healthcare 403(b) Plan was amended and all future retirement benefits will be provided through this plan. Effective January 1, 2018, all active participants will be eligible for nonelective employer 403(b) contributions of 4 percent of eligible compensation or \$1,800 (prorated for part-time employees), whichever is greater. All active participants will also be eligible for an employer match of 50 percent of the first 4 percent of eligible compensation that they contribute. In addition, for the 2018, 2019, and 2020 plan years, active participants who had been in the final average pay formula of the SEMC Employees' Pension Plan will receive additional nonelective employer contributions to their 403(b) plan of between 1 percent and 6 percent, depending on their age at December 31, 2017. Eligibility for the employer match and contributions is based on service requirements specified in the 403(b) plan.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

St. Elizabeth Healthcare also maintained a Supplemental Executive Retirement Plan (SERP) to provide certain retirement benefits for its executives. Effective December 31, 2016, the SERP Plan was terminated. As part of the Plan termination, each plan participant had a choice to either (1) leave his/her existing SERP balance in its current account subject to the Plan's existing vesting schedule or (2) forfeit and revoke all of his/her rights to receive any form of deferred compensation or benefits, vested and unvested, under the Plan as of the date of revocation. Each plan participant elected to forfeit and revoke his/her rights to any form of deferred compensation or benefits, vested or unvested, under the SERP Plan. The participant balances in the SERP Plan, in the amount of \$5,601,000, reverted back to St. Elizabeth Healthcare and were recorded as a reduction to benefits expense on the consolidated statements of operations and changes in net assets in 2016.

A summary of components of net periodic costs for St. Elizabeth Healthcare's defined benefit pension plan for the year ended December 31 follows:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Service cost	<b>\$ 22,252</b>	\$ 21,807
Interest cost	<b>18,810</b>	17,424
Expected return on plan assets	<b>(24,628)</b>	(21,257)
Amortization of net loss	<b>7,930</b>	7,500
Net periodic pension cost	<b>\$ 24,364</b>	\$ 25,474

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

The following table sets forth the funded status and amounts for St. Elizabeth Healthcare's defined benefit pension plan as of December 31:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
<b>Change in projected benefit obligation</b>		
Benefit obligation at beginning of year	\$ 501,388	\$ 459,595
Service cost	22,252	21,807
Interest cost	18,810	17,424
Actuarial loss	35,884	14,372
Curtailement gain	(69,685)	-
Administrative expenses	(231)	(184)
Benefits paid	(44,230)	(11,626)
Projected benefit obligation at end of year	<u>464,188</u>	501,388
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	\$ 333,800	\$ 268,780
Actual return on plan assets	53,975	34,330
Employer contributions	94,400	42,500
Administrative expenses	(231)	(184)
Benefits paid	(44,230)	(11,626)
Fair value of plan assets at end of year	<u>437,714</u>	333,800
Funded status of the plan	<u>(26,474)</u>	(167,588)
Accrued pension liability	<u>\$ (26,474)</u>	<u>\$ (167,588)</u>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

The following weighted-average assumptions were used for the defined benefit pension plan as of December 31:

	<b>2017</b>	<b>2016</b>
<b>St. Elizabeth Medical Center Employees' Pension Plan</b>		
Discount rate – benefit obligation	<b>3.38%</b>	3.83%
Discount rate – net periodic benefit cost	<b>3.83%</b>	3.87%
Rate of compensation increase	N/A	Graded Scale
Expected return on plan assets	<b>6.80%</b>	7.00%

In selecting the expected long-term return on plan assets, St. Elizabeth Healthcare considered the average rate of earnings on the funds invested, or to be invested, to provide the benefits for these plans. This included considering the asset allocation and expected returns likely to be earned over the life of the plans. This basis is consistent with the prior year.

Prior service cost is amortized over the average remaining service period of the employees expected to receive benefits.

Amounts recognized in the consolidated balance sheets and the consolidated statements of operations and changes in net assets of the defined benefit pension plans for the year ended December 31 are as follows:

	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Change in unrestricted net assets recognized:		
Net actuarial gain (loss)	<b>\$ 63,148</b>	\$ (1,299)
Amortization of net actuarial loss	<b>7,930</b>	7,500
Total recognized in the consolidated statements of operations and changes in net assets	<b>\$ 71,078</b>	\$ 6,201

Included as a reduction in unrestricted net assets is the amount of \$70,138,000, that has not yet been recognized in net periodic pension expense as of December 31, 2017.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

The net actuarial loss included in unrestricted net assets that is expected to be recognized in net periodic pension cost during the year ending December 31, 2018 is \$2,393,000.

Defined benefit pension assets were invested in the following as of December 31:

	<b>2017</b>	<b>2016</b>
Equity mutual funds	<b>48%</b>	48%
Fixed income mutual funds	<b>29</b>	26
Hedge fund of funds	<b>6</b>	8
Real estate funds	<b>10</b>	11
Private equity funds	<b>2</b>	2
Infrastructure funds	<b>4</b>	4
Cash and cash equivalents	<b>1</b>	1
Total	<b>100%</b>	100%

St. Elizabeth Healthcare’s Investment Committee regularly reviews the investment allocation and approves changes to the investment policy as needed. In February 2017, the St. Elizabeth Healthcare Investment Committee voted to adopt a Liability Driven Investing (LDI) strategy for the St. Elizabeth Healthcare Employees’ Pension Plan. The goal of this strategy is to reduce the funded status volatility caused by asset/liability duration mismatch, ultimately lessening the need for significant contributions through a more predictable long-term funded status. A glide path was developed to define the Pension asset allocation at trigger points based on funded status. The transition of Pension assets to this strategy began in May 2017, based upon the glide path allocation policy for the Plan’s funded status as of December 31, 2016. Based upon the Plan achieving a funded status of 94 percent as of December 31, 2017, the average target allocation policy for the Plans’ investments per the glide path transitioned to 65 percent fixed income, 20 percent U.S. and non-U.S. equity, 15 percent real estate/infrastructure, and 5 percent hedge fund of funds, with cash maintained in an amount sufficient to cover benefit payments. This activity results in an actual asset allocation that does not match the target asset allocation at December 31, 2017. The Plan’s investments will be transitioned to match the December 31, 2017 allocation in early 2018. Future asset allocations are expected to match the Plan’s target allocations based upon the Plan’s funded status, which is evaluated on a quarterly basis.

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

The following table summarizes St. Elizabeth Healthcare's defined benefit pension plans assets measured at fair value on a recurring basis as of December 31, 2017, aggregated by the level in the fair value hierarchy as defined in Note 1:

	Fair Value at December 31, 2017	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		<i>(In Thousands)</i>		
Cash and cash equivalents	\$ 5,262	\$ 5,262	\$ —	\$ —
U.S. Government obligations	45,482	—	45,482	—
Asset-backed securities	257	—	257	—
Corporate bonds	73,096	—	73,096	—
Municipal bonds	1,189	—	1,189	—
Foreign bonds	8,577	—	8,577	—
Common stock	101,295	101,295	—	—
Mutual funds:				
Mid cap core	33,302	33,302	—	—
International large cap	38,545	38,545	—	—
International small cap	20,509	20,509	—	—
International emerging markets	15,720	15,720	—	—
Common collective trust:				
Money market funds	1,609	—	1,609	—
Assets measured at fair value levels	<u>\$ 344,843</u>	<u>\$ 214,633</u>	<u>\$ 130,210</u>	<u>\$ —</u>
Hedge fund of funds	24,356	—	—	—
Real estate funds	41,470	—	—	—
Private equity funds	7,988	—	—	—
Infrastructure funds	19,057	—	—	—
Assets measured at net asset value	<u>\$ 92,871</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Total assets	<u>\$ 437,714</u>	<u>\$ 214,633</u>	<u>\$ 130,210</u>	<u>\$ —</u>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

The following table summarizes St. Elizabeth Healthcare's defined benefit pension plans assets measured at fair value on a recurring basis as of December 31, 2016, aggregated by the level in the fair value hierarchy as defined in Note 1:

	Fair Value at December 31, 2016	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>(In Thousands)</i>				
Cash and cash equivalents	\$ 2,908	\$ 2,908	\$ —	\$ —
U.S. Government obligations	13,829	—	13,829	—
Asset-backed securities	14,159	—	14,159	—
Corporate bonds	16,319	—	16,319	—
Municipal bonds	142	—	142	—
Foreign bonds	860	—	860	—
Government-backed securities	13,785	—	13,785	—
Common stock	50,621	50,621	—	—
Mutual funds:				
Large cap value	33,193	33,193	—	—
Mid cap core	24,952	24,952	—	—
International large cap	26,837	26,837	—	—
International small cap	14,261	14,261	—	—
International emerging markets	10,948	10,948	—	—
Fixed income	27,602	27,602	—	—
Common collective trust:				
Money market funds	1,144	—	1,144	—
Assets measured at fair value levels	<u>\$ 251,560</u>	<u>\$ 191,322</u>	<u>\$ 60,238</u>	<u>\$ —</u>
Hedge fund of funds	25,920	—	—	—
Real estate funds	38,014	—	—	—
Private equity funds	5,154	—	—	—
Infrastructure funds	13,152	—	—	—
Assets measured at net asset value	<u>\$ 82,240</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Total assets	<u><u>\$ 333,800</u></u>	<u><u>\$ 191,322</u></u>	<u><u>\$ 60,238</u></u>	<u><u>\$ —</u></u>

Saint Elizabeth Medical Center, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2017 and 2016

**9. Pension and Other Retirement Plans (continued)**

Fair value methodologies for cash and equivalents, mutual funds, and common stock included in Level 1 and common collective trust funds, bonds, U.S. government obligations, government backed securities, and asset-backed securities included in Level 2 are consistent with the inputs described in Note 3.

The accumulated benefit obligation for St. Elizabeth Healthcare's defined benefit pension plan was \$464,188,000 and \$437,408,000 at December 31, 2017 and 2016, respectively.

St. Elizabeth Healthcare contributed \$94,400,000 to its defined benefit pension plan during 2017. The Organization does not expect to make any contributions in 2018.

The following table sets forth the expected benefit payments to be paid from the defined benefit plans during the next 10 years (in thousands):

	<u>Amount</u>
2018	\$ 23,046
2019	28,574
2020	32,679
2021	36,925
2022	34,410
2023 – 2027	147,743

**10. Commitments and Contingencies**

In order to remain a self-insured employer, St. Elizabeth Healthcare maintains a continuous bond through Travelers Casualty and Surety Company of America in the amount of \$8,539,000. The continuous bond had no outstanding balance as of December 31, 2017 and 2016.

**11. Subsequent Events**

St. Elizabeth Healthcare has evaluated and disclosed any subsequent events through April 3, 2018, which is the date the consolidated financial statements were issued.

## Supplementary Information

# Saint Elizabeth Medical Center, Inc.

## Details of Consolidating Balance Sheets

*(In Thousands)*

	Combined		Total	
	Combined Hospitals	Physician Groups	December 31 2017	December 31 2016
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 39,340	\$ (1,778)	\$ 37,562	\$ 30,686
Short-term investments	9,970	–	9,970	–
Patient accts receivable, net of allowance for doubtful accts	121,240	12,106	133,346	124,960
Inventories and supplies	27,522	481	28,003	25,447
Prepaid expenses and other assets	16,519	3,820	20,339	19,820
Total current assets	214,591	14,629	229,220	200,913
Cash and cash equivalents-restricted	37,820	–	37,820	56,046
Assets limited as to use	1,035,947	–	1,035,947	896,590
Property, plant and equipment, net	441,637	7,008	448,645	434,890
Goodwill	4,489	13,162	17,651	17,651
Intangible assets	8,907	138	9,045	10,846
Foundation pledge receivables	3,602	–	3,602	2,922
Other assets	15,167	7,599	22,766	14,774
Total assets	<u>\$ 1,762,160</u>	<u>\$ 42,536</u>	<u>\$ 1,804,696</u>	<u>\$ 1,634,632</u>
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 73,728	\$ 5,508	\$ 79,236	\$ 62,087
Accrued employee compensation	54,549	30,119	84,668	74,405
Accrued interest	929	–	929	904
Accrued third-party settlements	12,629	–	12,629	12,286
Deferred revenue	5,191	–	5,191	6,641
Other current liabilities	9,043	221	9,264	7,768
Current portion of long-term debt	6,490	–	6,490	5,035
Long-term debt subject to short-term remarketing arrangement	27,225	–	27,225	–
Total current liabilities	189,784	35,848	225,632	169,126
Long-term debt	184,231	–	184,231	199,287
Liability for self-insurance	53,786	4,568	58,354	63,989
Accrued pension liability	26,474	–	26,474	167,588
Fair value of interest rate swap	3,451	–	3,451	4,194
Other long-term liabilities	7,007	–	7,007	8,424
Total liabilities	464,733	40,416	505,149	612,608
Net assets:				
Unrestricted	1,289,977	2,120	1,292,097	1,016,655
Net (decrease) increase in cash, cash equivalents, and restricted cash	7,450	–	7,450	5,866
Total net assets excluding noncontrolling interest	1,297,427	2,120	1,299,547	1,022,521
Noncontrolling interest	–	–	–	(497)
Total net assets	1,297,427	2,120	1,299,547	1,022,024
Total liabilities and net assets	<u>\$ 1,762,160</u>	<u>\$ 42,536</u>	<u>\$ 1,804,696</u>	<u>\$ 1,634,632</u>

# Saint Elizabeth Medical Center, Inc.

## Details of Consolidating Statement of Operations and Changes in Net Assets

*(In Thousands)*

	<b>Combined Hospitals</b>	<b>Combined Physician Groups</b>	<b>Eliminations</b>	<b>Total December 31</b>	
				<b>2017</b>	<b>2016</b>
Patient service revenue, net of contractual provisions and discounts	\$ 1,087,682	\$ 189,691	\$ –	\$ 1,277,373	\$ 1,180,732
Provision for bad debts	(41,997)	(6,733)	–	(48,730)	(39,477)
Net patient service revenue less provision for bad debts	1,045,685	182,958	–	1,228,643	1,141,255
Net assets released from restriction for operations	672	–	–	672	727
Other revenue	60,108	118,169	(140,740)	37,537	31,657
<b>Total revenue</b>	<b>1,106,465</b>	<b>301,127</b>	<b>(140,740)</b>	<b>1,266,852</b>	<b>1,173,639</b>
<b>Expenses:</b>					
Salaries and wages	401,045	176,629	–	577,674	543,270
Employee benefits	105,112	33,158	–	138,270	132,248
Purchased services	185,262	34,505	(138,371)	81,396	72,581
Interest	5,620	13	–	5,633	5,835
Depreciation and amortization	66,668	2,670	–	69,338	67,644
Supplies	203,316	16,091	(242)	219,165	190,681
Other	69,611	22,796	(2,127)	90,280	92,459
<b>Total expenses</b>	<b>1,036,634</b>	<b>285,862</b>	<b>(140,740)</b>	<b>1,181,756</b>	<b>1,104,718</b>
<b>Operating income</b>	<b>69,831</b>	<b>15,265</b>	<b>–</b>	<b>85,096</b>	<b>68,921</b>
Unrestricted contributions	375	–	–	375	407
Other gains (losses), net	119,579	(714)	–	118,865	44,862
<b>Excess of revenue over expenses</b>	<b>189,785</b>	<b>14,551</b>	<b>–</b>	<b>204,336</b>	<b>114,190</b>
Excess of revenue (expense) over expense (revenue) attributable to noncontrolling interest	–	497	–	497	(135)
<b>Excess of revenue over expenses attributable to St. Elizabeth Medical Center, Inc.</b>	<b>189,785</b>	<b>14,054</b>	<b>–</b>	<b>203,839</b>	<b>114,325</b>
<b>Unrestricted net assets:</b>					
Transfer between entities	21,177	(21,177)	–	–	–
Pension change other than net periodic costs	71,078	–	–	71,078	6,201
Other	(80)	–	–	(80)	(79)
Net assets released from restriction for capital	605	–	–	605	543
<b>Increase (decrease) in unrestricted net assets attributable to St. Elizabeth Medical Center, Inc.</b>	<b>282,565</b>	<b>(7,123)</b>	<b>–</b>	<b>275,442</b>	<b>120,990</b>
<b>Temporarily restricted net assets:</b>					
Restricted contributions	2,861	–	–	2,861	1,859
Net assets released from restriction	(1,277)	–	–	(1,277)	(1,270)
<b>Increase in temporarily restricted net assets attributable to St. Elizabeth Medical Center, Inc.</b>	<b>1,584</b>	<b>–</b>	<b>–</b>	<b>1,584</b>	<b>589</b>
<b>Increase (decrease) in net assets attributable to St. Elizabeth Medical Center, Inc.</b>	<b>284,149</b>	<b>(7,123)</b>	<b>–</b>	<b>277,026</b>	<b>121,579</b>
<b>Noncontrolling interest:</b>					
Excess of revenue (expense) over expense (revenue) attributable to noncontrolling interest	–	497	–	497	(135)
<b>Increase (decrease) in net assets attributable to noncontrolling interest</b>	<b>–</b>	<b>497</b>	<b>–</b>	<b>497</b>	<b>(135)</b>
<b>Increase (decrease) in net assets</b>	<b>284,149</b>	<b>(6,626)</b>	<b>–</b>	<b>277,523</b>	<b>121,444</b>
Net assets at beginning of year	1,013,278	8,746	–	1,022,024	900,580
<b>Net assets at end of year</b>	<b>\$ 1,297,427</b>	<b>\$ 2,120</b>	<b>\$ –</b>	<b>\$ 1,299,547</b>	<b>\$ 1,022,024</b>