

# UPMC Unaudited Quarterly Disclosure

For the Period Ended September 30, 2016



# UPMC UNAUDITED QUARTERLY DISCLOSURE

FOR THE PERIOD ENDED SEPTEMBER 30, 2016

## TABLE OF CONTENTS

<b>Introduction to Management's Discussion and Analysis</b> . . . . .	1
<b>Management's Discussion and Analysis</b>	
Financial Highlights . . . . .	2
Operating Component Information . . . . .	5
Revenue and Operating Metrics . . . . .	7
Key Financial Indicators . . . . .	10
Market Share . . . . .	11
Asset and Liability Management . . . . .	12
<b>Utilization Statistics</b> . . . . .	14
<b>Outstanding Debt</b> . . . . .	15
<b>Debt Covenant Calculations</b> . . . . .	16
<b>Interim Consolidated Financial Statements</b>	
Review Report of Independent Auditors . . . . .	18
Consolidated Balance Sheets . . . . .	19
Consolidated Statements of Operations and Changes in Net Assets . . . . .	20
Condensed Statements of Cash Flows . . . . .	21
Notes to Consolidated Financial Statements . . . . .	22

The following financial data as of and for the three month period ended September 30, 2016 and 2015 is derived from the interim consolidated financial statements of UPMC. The interim consolidated financial statements include all adjustments consisting of a normal recurring nature that UPMC considers necessary for a fair presentation of its financial position and the results of operations for these periods. The financial information as of and for the twelve month period ended June 30, 2016 is derived from UPMC's audited consolidated financial statements. Operating and financial results reported herein are not necessarily indicative of the results that may be expected for any future periods.

The information contained herein is being filed by UPMC for the purpose of complying with its obligations under Continuing Disclosure Agreements entered into in connection with the issuance of the series of bonds listed herein and disclosure and compliance obligations in connection with various banking arrangements. The information contained herein is as of September 30, 2016. Digital Assurance Certification, L.L.C., as Dissemination Agent, has not participated in the preparation of this Unaudited Quarterly Disclosure, has not examined its contents and makes no representations concerning the accuracy and completeness of the information contained herein.



# INTRODUCTION TO MANAGEMENT'S DISCUSSION AND ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

UPMC, doing business as the University of Pittsburgh Medical Center, is one of the world's leading Integrated Delivery and Financing Systems ("IDFS"). UPMC is based in Pittsburgh, Pennsylvania and primarily serves residents of western Pennsylvania. We also draw patients for highly specialized services from across the nation and around the world. With more than 20 hospitals and more than 500 clinical locations, UPMC comprises one of the largest nonprofit health systems in the United States. UPMC has three major operating components: Health Services, Insurance Services, and UPMC Enterprises.

We are committed to providing the communities that our hospitals, outpatient centers and other health care facilities serve, as well as our insurance members, with high quality, cost-effective health care while continuing to grow our business and execute on our mission to provide Life Changing Medicine. As the stewards of UPMC's community assets, we are guided by our core values of integrity, excellence, respect and teamwork. These values govern the manner in which we serve our communities and are embedded in the execution and delivery of Life Changing Medicine.

UPMC continues to make significant investments in equipment, technology, education and operational strategies designed to improve clinical quality at our hospitals and outpatient centers. As a result of our efforts, UPMC is currently ranked number 12 on the *U.S. News & World Report* Honor Roll of America's Best Hospitals. Investments in our operations and continued capital improvements are expected to become increasingly important as the competitive environment of the western Pennsylvania market and changes to health care nationally continue to progress and change the landscape of patient care and reimbursement. We build new facilities, make strategic acquisitions, and enter into joint venture arrangements or affiliations with health care businesses — in each case in communities where we believe our mission can be effectively utilized to improve the overall health of those communities.

By continually evolving and refining UPMC's world-class financial processes, we focus on achieving optimal financial results that support the continued development of our organization, as well as ongoing investment in the future of western Pennsylvania. We are committed to achieving these objectives with unyielding commitments to transparency in reporting and disclosure, enterprise-wide integration, and ongoing process improvement.

The purpose of this section, Management's Discussion and Analysis ("MD&A"), is to provide a narrative explanation of our financial statements that enhances our overall financial disclosures, to provide the context within which our financial information may be analyzed, and to provide information about the quality of, and potential variability of, our financial condition, results of operations and cash flows.

Unless otherwise indicated, all financial and statistical information included herein relates to our continuing operations, with dollar amounts expressed in thousands (except for statistical information). MD&A should be read in conjunction with the accompanying unaudited consolidated financial statements.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## CONSOLIDATED FINANCIAL HIGHLIGHTS

(Dollars in millions)

Financial Results for the Three Months Ended September 30	2016	2015
Operating revenues	\$ 3,379	\$ 3,097
Operating income	\$ 60	\$ 72
Operating margin	1.8 %	2.3%
Operating margin (including income tax and interest expense)	0.9 %	1.3%
Gain (loss) from investing and financing activities	\$ 196	\$ (291)
Excess of revenues over expenses (expenses over revenues)	\$ 254	\$ (222)
Operating EBIDA	\$ 175	\$ 186
Capital expenditures	\$ 116	\$ 80
Reinvestment ratio	1.01	0.66

Selected Other Information as of	September 30, 2016	June 30, 2016
Total cash and investments	\$ 5,820	\$ 5,096
Unrestricted cash and investments	\$ 4,843	\$ 4,325
Unrestricted cash and investments over long-term debt	\$ 1,716	\$ 1,380
Days of cash on hand	138	130
Days in net accounts receivable	38	49
Average age of plant	10.1	10.1

Operating revenues for the three months ended September 30, 2016 increased \$282 million, or 9.1%, as compared to the three months ended September 30, 2015. Operating income for the three months ended September 30, 2016 decreased \$12 million over the same period in the prior fiscal year. Operating earnings before interest, depreciation and amortization totaled \$175 million, and excess of revenues over expenses was \$254 million. As of September 30, 2016, UPMC had more than \$5.8 billion of cash and investments.

For the three months ended September 30, 2016:

- Total medical-surgical admissions and observation cases increased 5% compared to the prior year.
- Hospital outpatient revenue per workday increased 5% compared to the prior year.
- Physician service revenue per weekday increased 4% from the comparable period in the prior year, and
- Enrollment in UPMC's Insurance Services grew to more than 3.0 million members as of September 30, 2016.

UPMC's gain from investing and financing activities for the three months ended September 30, 2016 was \$196 million. UPMC made no material changes to its asset allocation policies during the quarter and continues to have a long-term perspective with regard to its investment activities.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

Following a two-year thoughtful, mission-focused process to pursue partnership options, Susquehanna Health and UPMC finalized a definitive agreement to affiliate and on October 1, 2016, Susquehanna Health became UPMC Susquehanna. Susquehanna is a four-hospital, 342-bed system based in Williamsport, Pa., with \$575 million in revenue and \$815 million in total assets as of June 30, 2016. With a \$500 million investment, UPMC has committed to advance Susquehanna's goals to expand healthcare services, maintain its patient-focused mission, invest in information technology, and introduce to the region more choice for health insurance.

In December 2015, UPMC and WCA Hospital in Jamestown, NY, announced a formal affiliation agreement to integrate WCA Hospital into the UPMC network to expand access to quality healthcare services and resources in the Jamestown region. WCA Hospital, with 317 licensed beds, is Southwestern New York's largest not-for-profit healthcare provider and is the first U.S. hospital outside of Pennsylvania to sign an affiliation agreement with UPMC. Since forming a strategic affiliation agreement in August 2012, WCA Hospital and UPMC Hamot have experienced a long-standing mutually beneficial collaboration. UPMC has committed to invest at least \$25 million over the next 10 years to continue supporting improved care coordination and delivery of services, assisting with recruitment and retention of outstanding physicians, and upgrading facilities, programs, and infrastructure, including information technology and electronic medical records capabilities. UPMC has also agreed to relieve WCA's debt and assume its pension obligations, freeing up significant additional monies for WCA development. The affiliation agreement is contingent upon the completion of regulatory approvals. UPMC and WCA anticipate finalizing the transaction before the end of 2016.

In an effort to apply data-driven insights to one of the most fundamental aspects of running a health care system, UPMC announced in July 2016 the formation of Pensiamo, an independent company that aims to help hospitals improve supply chain performance through a comprehensive source-to-pay offering, including cognitive analytics with IBM Watson Health technologies. IBM is the minority owner of Pensiamo.

In July 2016, one of the most advanced cancer centers in Colombia, developed and managed in partnership with UPMC, announced that it was preparing to open near Bucaramanga to provide care close to home for both children and adults. The new Oncology Institute is part of a recently opened 870-bed hospital owned by UPMC's long-time partner Fundacion Cardiovascular de Colombia (FCV), acclaimed for its high-quality cardiac care. The 200-bed Oncology Institute at the new Hospital Internacional de Colombia (HIC), located in the town of Piedecuesta, will provide state-of-the-art medical and radiation oncology treatments to patients who previously traveled hundreds of miles to receive such care in other regions. The opening of the Oncology Institute brings UPMC's globally renowned cancer expertise to South America for the first time.

As part of its wide-ranging efforts to better target treatments to patients while reducing unnecessary tests and procedures, UPMC announced in August 2016 that it is investing in and partnering with Cernostics, an oncology diagnostics company whose unique technology enables so-called "precision medicine." UPMC is the lead investor in a \$5 million round of funding to help Cernostics grow and accelerate its introduction of a new diagnostic test for people with an esophageal condition called Barrett's Esophagus that can lead to cancer.

## MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

In September 2016, UPMC and Cavulus, a software and services company serving the health insurance industry, announced a strategic partnership in which UPMC will invest in Cavulus and provide insights and development assistance for the growth of its cloud-based technology. Serving more than 35 health plans across the country, including UPMC Health Plan, Cavulus' solutions help insurance companies automate marketing, sales, enrollment, retention and compliance operations, primarily in the Medicare Advantage market. Boosted by Cavulus' predictive modeling and data analytics tools, the company's clients have grown membership 20 percent faster than the Medicare Advantage industry average over the past five years.

To help nursing-home patients via telemedicine, UPMC announced in September 2016 the creation of Curavi, a new UPMC-backed and Pittsburgh-based company that is bringing its comprehensive telemedicine solution and physician care to the nursing home bedside, where patients and staff need it most. Curavi offers its customers CuraviCart telemedicine equipment, specifically designed for the workflow in the challenging, nursing-home environment, and CuraviCare software that allows staff to easily request a telemedicine consult. Curavi has also developed a formal relationship with University of Pittsburgh Physicians, part of UPMC, to provide after-hours consults from fellowship-trained geriatricians.

In August 2016, UPMC Altoona announced construction of a \$20 million multi-specialty outpatient center, located near Routes 22 and 219 in Ebensburg. Built on seven acres, the 3-story, 46,500 square-foot facility is scheduled to open in the fall of 2017 to bring outpatient specialty and subspecialty services closer to Cambria County residents. Construction continues for UPMC Altoona's Logan Medical Center, along Route 36 between Hollidaysburg and Altoona. Expected to open in the spring of 2017, the approximately \$25 million, 90,000 square-foot medical complex will enhance patient access and convenience to a full range of diagnostic services in the southern part of Blair County.



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Three Months Ended September 30, 2016

(in millions)

	Health Services	Insurance Services	Eliminations	Consolidated
<b>Revenues:</b>				
Net patient service revenue less provision for bad debts	\$ 1,880	\$ -	\$ (422)	\$ 1,458
Insurance enrollment revenue	-	1,650	-	1,650
Other revenue	214	85	(28)	271
<b>Total operating revenues</b>	<b>\$ 2,094</b>	<b>\$ 1,735</b>	<b>\$ (450)</b>	<b>\$ 3,379</b>
<b>Expenses:</b>				
Salaries, professional fees and benefits	\$ 1,136	\$ 70	\$ (6)	\$ 1,200
Insurance claims expense	-	1,472	(423)	1,049
Supplies, purchased services and general	824	152	(21)	955
Depreciation and amortization	113	2	-	115
<b>Total operating expenses</b>	<b>2,073</b>	<b>1,696</b>	<b>(450)</b>	<b>3,319</b>
<b>Operating income</b>	<b>\$ 21</b>	<b>\$ 39</b>	<b>-</b>	<b>\$ 60</b>
<b>Operating margin %</b>	<b>1.0%</b>	<b>2.2%</b>	<b>-</b>	<b>1.8%</b>
<b>Operating margin % (including income tax and interest expense)</b>	<b>0.0%</b>	<b>2.2%</b>	<b>-</b>	<b>0.9%</b>
<b>Operating EBIDA</b>	<b>\$ 134</b>	<b>\$ 41</b>	<b>-</b>	<b>\$ 175</b>
<b>Operating EBIDA %</b>	<b>6.4%</b>	<b>2.4%</b>	<b>-</b>	<b>5.2%</b>

Three Months Ended September 30, 2015

(in millions)

<b>Revenues:</b>				
Net patient service revenue less provision for bad debts	\$ 1,784	\$ -	\$ (380)	\$ 1,404
Insurance enrollment revenue	-	1,446	-	1,446
Other revenue	203	72	(28)	247
<b>Total operating revenues</b>	<b>\$ 1,987</b>	<b>\$ 1,518</b>	<b>\$ (408)</b>	<b>\$ 3,097</b>
<b>Expenses:</b>				
Salaries, professional fees and benefits	\$ 1,063	\$ 65	\$ (7)	\$ 1,121
Insurance claims expense	-	1,313	(375)	938
Supplies, purchased services and general	761	117	(26)	852
Depreciation and amortization	112	2	-	114
<b>Total operating expenses</b>	<b>1,936</b>	<b>1,497</b>	<b>(408)</b>	<b>3,025</b>
<b>Operating income</b>	<b>\$ 51</b>	<b>\$ 21</b>	<b>-</b>	<b>\$ 72</b>
<b>Operating margin %</b>	<b>2.6%</b>	<b>1.4%</b>	<b>-</b>	<b>2.3%</b>
<b>Operating margin % (including income tax and interest expense)</b>	<b>1.7%</b>	<b>1.2%</b>	<b>-</b>	<b>1.3%</b>
<b>Operating EBIDA</b>	<b>\$ 163</b>	<b>\$ 23</b>	<b>-</b>	<b>\$ 186</b>
<b>Operating EBIDA %</b>	<b>8.2%</b>	<b>1.5%</b>	<b>-</b>	<b>6.0%</b>

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## Health Services

UPMC Health Services include a comprehensive array of clinical capabilities consisting of hospitals, specialty service lines (e.g., transplantation services, woman care, behavioral health, pediatrics, cancer care and rehabilitation services), contract services (emergency medicine, pharmacy and laboratory) and more than 3,600 employed physicians with associated practices. Also included within Health Services are supporting foundations and UPMC's captive insurance programs. Hospital activity is monitored in four distinct groups: (i) academic hospitals that provide a comprehensive array of clinical services that include the specialty service lines listed above and serve as the primary academic and teaching centers for UPMC and are located in Pittsburgh, Pa.; (ii) community hospitals that provide core clinical services mainly to the suburban Pittsburgh, greater Erie, and the greater Altoona populations of Pennsylvania; (iii) regional hospitals that provide core clinical services to certain other areas of western Pennsylvania; and (iv) pre- and post-acute care capabilities that include: UPMC HomeCare, a network of home health services, and UPMC Senior Communities, the facilities of which provide a complete network of senior living capabilities in greater Pittsburgh and surrounding counties. The Health Services division also includes its international ventures which aims to bring new revenue streams into western Pennsylvania. International ventures currently include ISMETT, a transplant and specialty surgery hospital in Palermo, Italy, that has performed more than 1,600 transplants since its founding in 1999, a cancer center located in Ireland, a contract to provide remote second-opinion pathology consultations for patients in China and Singapore, a national oncology treatment and research center in Kazakhstan, as well as the Advanced Radiosurgery Center of Excellence at San Pietro FBF Hospital in Rome.

Health Services revenue of \$2.1 billion increased \$107 million from prior year due primarily to payer rate increases and acquisitions. Operating income of \$21 million decreased \$30 million from prior year due to inflationary expense changes and increased physician investment.

## Insurance Services

UPMC holds various interests in health care financing initiatives and network care delivery operations that have more than 3.0 million members as of September 30, 2016. UPMC Health Plan is a health maintenance organization ("HMO") offering coverage for commercial and Medicare members. UPMC for You is also an HMO, which is engaged in providing coverage to Medical Assistance & Medicare Special Needs Plan beneficiaries. UPMC Health Network offers preferred provider organization ("PPO") plan designs to serve Medicare beneficiaries. UPMC Health Options offers PPO plan designs to serve commercial beneficiaries. UPMC for Life is a Medicare product line offered by various companies within the Insurance Services division. UPMC Work Partners provides fully insured workers' compensation, and integrated workers' compensation and disability services to employers. Community Care Behavioral Health Organization ("Community Care") is a state-licensed, risk-bearing PPO that manages the behavioral health services for Medical Assistance through mandatory managed care programs in 39 Pennsylvania counties, including Allegheny County.

Insurance Services revenues of \$1.7 billion increased \$217 million from prior year primarily as a result of increased membership. Insurance Services experienced an operating income increase of \$18 million compared to prior year primarily due to increased membership and higher underwriting margins, which more than offset higher administrative expense related to increased membership.

## UPMC Enterprises

The goal of UPMC Enterprises is to leverage UPMC's integrated delivery and financing system capabilities to generate new revenue streams. This is accomplished by fostering new ideas for improvement in the delivery of health care, pursuing commercialization opportunities of smart technologies and developing strategic partnerships with industry leaders. These ventures both support UPMC's core mission and help to stimulate the economy of western Pennsylvania.

UPMC Enterprises manages a portfolio that includes various internally-focused initiatives and numerous operating companies with commercially-available products and services directed toward the improvement of the delivery of health care. Unlike the Health Services and Insurance Services divisions, UPMC Enterprises' results are classified as investing and financing activity in the Statements of Operations and Changes in Net Assets, consistent with the long-term nature of developing and commercializing technology-enabled initiatives.



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

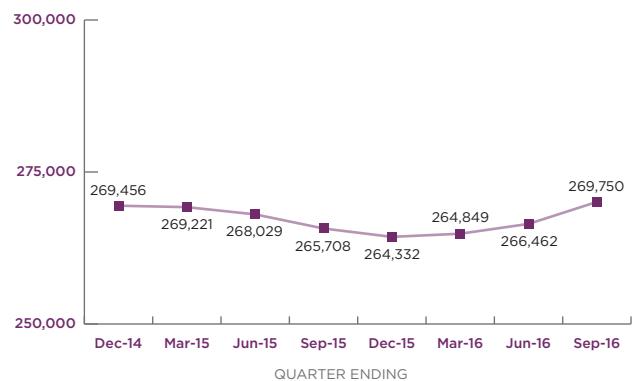
## REVENUE METRICS – HEALTH SERVICES

### Medical-Surgical Admissions and Observation Visits

Inpatient activity as measured by medical-surgical admissions and observation visits at UPMC's hospitals for the three months ended September 30, 2016 increased 5% compared to the same period in 2015.

For the Three Months Ended September 30			
(in thousands)	2016	Variance	2015
Academic	33.2	(1%)	33.4
Community	22.4	5%	21.4
Regional	13.4	22%	11.0
<b>Total</b>	<b>69.0</b>	<b>5%</b>	<b>65.8</b>

### Trailing Twelve-Months

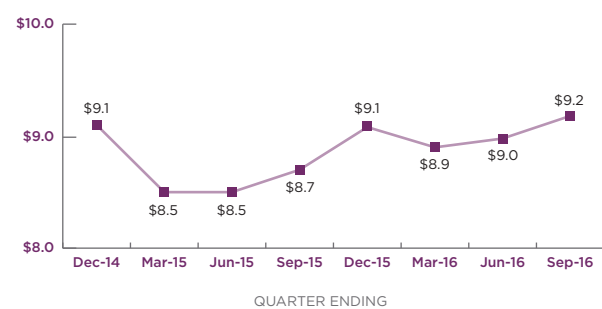


### Outpatient Revenue per Workday

UPMC's outpatient activity for the three months ended September 30, 2016 as measured by average revenue per workday increased 5% compared to the same period in 2015. Hospital outpatient activity is measured on an equivalent workday (EWD) basis to adjust for weekend and holiday hours.

For the Three Months Ended September 30			
(in thousands)	2016	Variance	2015
Academic	\$ 5,199	1%	\$ 5,150
Community	2,214	5%	2,100
Regional	1,739	20%	1,453
<b>Total</b>	<b>\$ 9,152</b>	<b>5%</b>	<b>\$ 8,703</b>

### Quarterly Average (in millions)



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

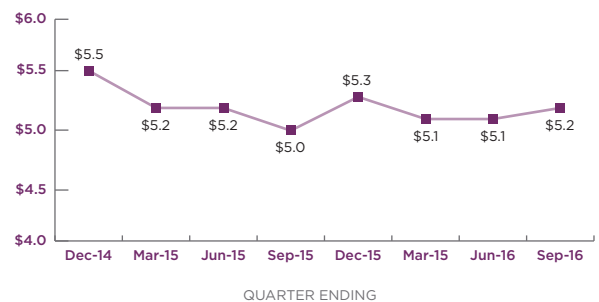
## REVENUE METRICS – HEALTH SERVICES (CONTINUED)

### Physician Service Revenue per Weekday

UPMC's physician activity for the three months ended September 30, 2016 as measured by average revenue per weekday increased 4% from the comparable period in 2015. Physician services activity is measured on a weekday basis.

For the Three Months Ended September 30			
(in thousands)	2016	Variance	2015
Academic	\$ 2,850	(3%)	\$ 2,953
Community	2,391	15%	2,071
<b>Total</b>	<b>\$ 5,241</b>	<b>4%</b>	<b>\$ 5,024</b>

Quarterly Average (in millions)



### Sources of Patient Service Revenue

The gross patient service revenues of UPMC are derived from third-party payers which reimburse or pay UPMC for the services it provides to patients covered by such payers. Third-party payers include the federal Medicare Program, the federal and state Medical Assistance Program ("Medicaid"), Highmark Blue Cross Blue Shield ("Highmark") and other third-party insurers such as health maintenance organizations and preferred provider organizations. The following table is a summary of the percentage of the subsidiary hospitals' gross patient service revenue by payer.

	Three Months Ended September 30	
	2016	2015
Medicare	45%	44%
Medicaid	18%	17%
UPMC Insurance Services	13%	12%
Highmark Commercial	9%	11%
National Insurers	9%	7%
Other	6%	9%
<b>Total</b>	<b>100%</b>	<b>100%</b>

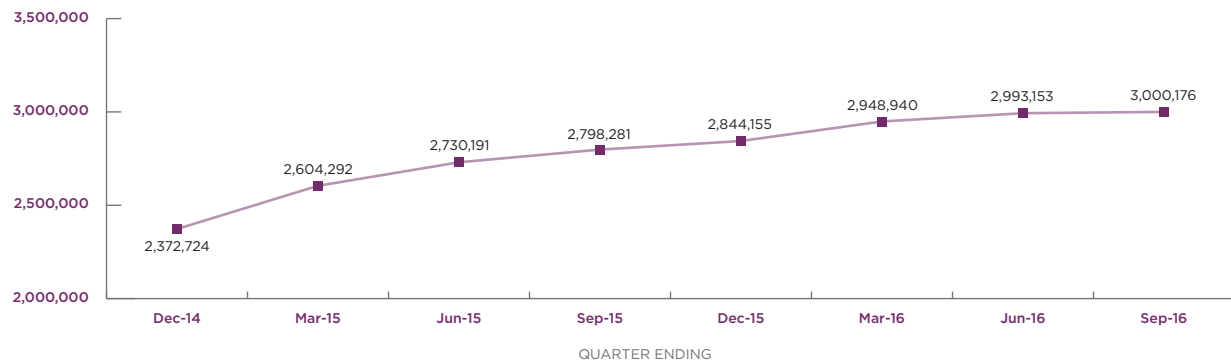
# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## OPERATING METRICS - INSURANCE SERVICES

### Membership

Membership in the UPMC Insurance Services Division increased to 3,000,176 as of September 30, 2016.

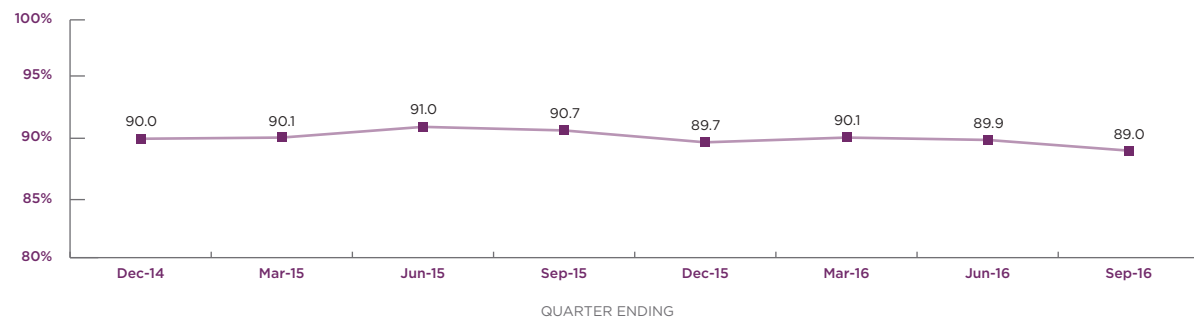


As of	Sept 30, 2016	Sept 30, 2015	June 30, 2016	June 30, 2015
Commercial Health	629,166	562,236	625,947	564,190
Medicare	156,494	145,609	155,696	143,941
Medicaid	398,797	354,232	392,281	336,340
Sub-Total Health Products	1,184,457	1,062,077	1,173,924	1,044,471
Behavioral Health	959,521	889,753	953,513	841,003
Sub-Total Health Products	2,143,978	1,951,830	2,127,437	1,885,474
Work Partners and Life Solutions	438,935	442,571	452,798	435,202
Ancillary Products	226,161	204,059	221,104	202,585
Evolent	191,102	199,821	191,814	206,930
Total Membership	3,000,176	2,798,281	2,993,153	2,730,191

### Healthcare Spending Ratio

UPMC Insurance Services Medical Expense Ratio remained stable as medical expenses trended consistently with premiums.

#### Trailing Twelve-Months



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## KEY FINANCIAL INDICATORS

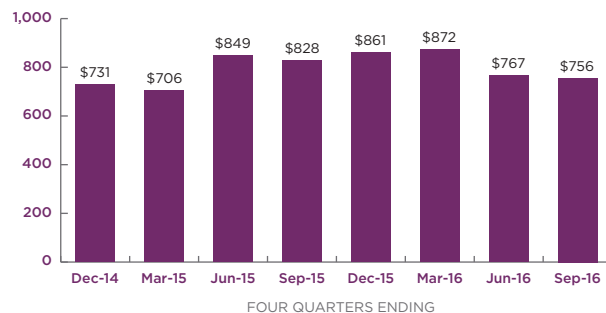
(Dollars in millions)

### Operating Earnings before Interest, Depreciation and Amortization

Operating EBIDA for the three months ended September 30, 2016 decreased as compared to the three months ended September 30, 2015.

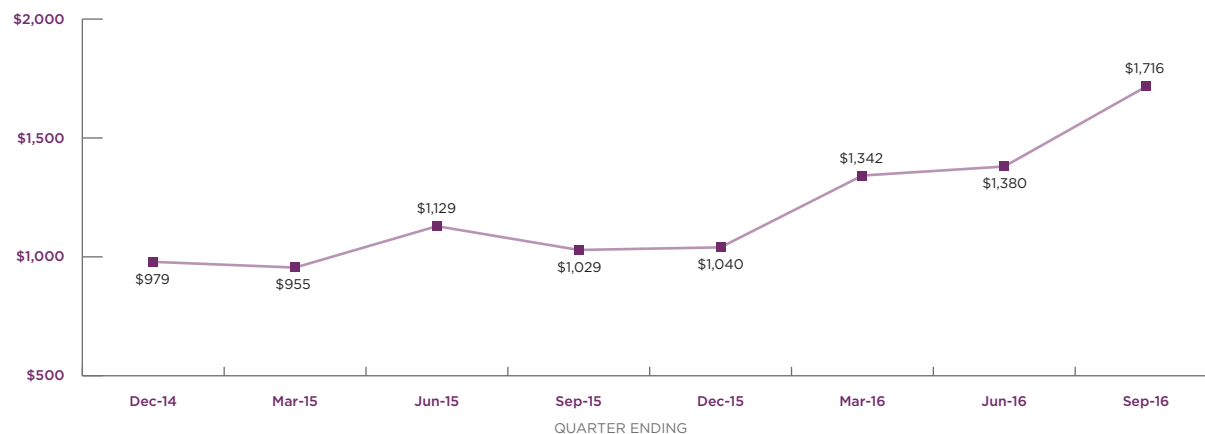
For the Three Months Ended September 30		
	2016	2015
Operating Income	\$ 60	\$ 72
Depreciation and Amortization	115	114
Operating EBIDA	\$ 175	\$ 186

### Trailing Twelve Months EBIDA



### Unrestricted Cash to Long Term Debt

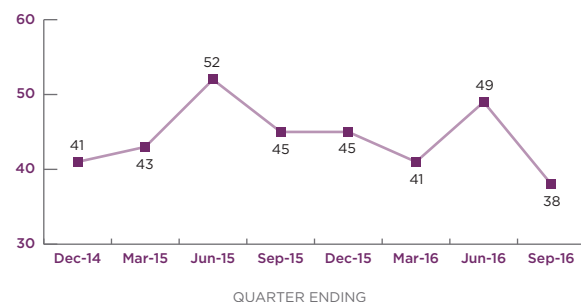
Unrestricted cash to long term debt increased by \$336 million as compared to June 2016.



### Days in Accounts Receivable

Consolidated Days in Accounts Receivable continue to be lower than industry averages due to UPMC's rigorous procedures in this area. In the first quarter of fiscal 2017, UPMC collected outstanding payments from the State of Pennsylvania's Medicaid program resulting in a decrease in Days in Accounts Receivable versus June 2016.

By Division as of September 30	2016 Balance	Days	
		2016	2015
Health Services	\$ 909	51	65
Insurance Services	456	24	26
Other	22	117	118
Consolidated	\$ 1,387	38	45



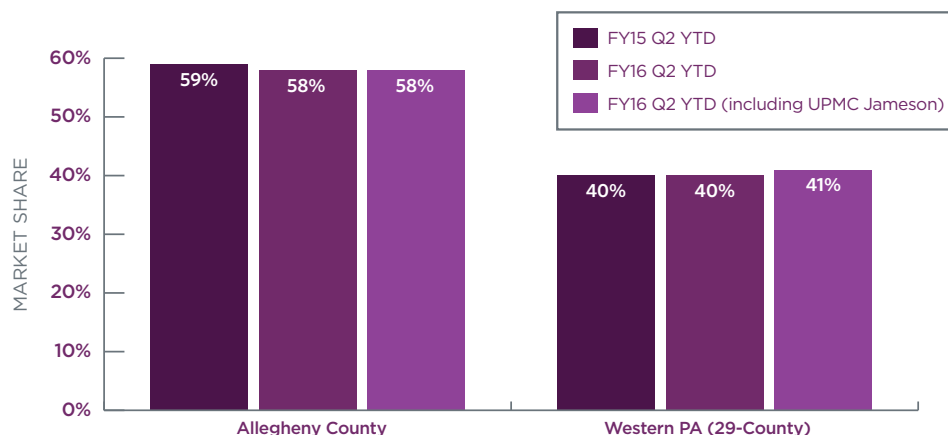
# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## Market Share

The chart below shows the change in UPMC's estimated inpatient market share for the first two quarters of fiscal years 2015 and 2016 (July 1 through December 31), by service area<sup>(1)</sup>. For fiscal year 2016, estimated market share is displayed both excluding and including discharges for UPMC Jameson<sup>(2)</sup>. This is the most recent market share data currently available.

### UPMC INPATIENT MEDICAL-SURGICAL MARKET SHARE<sup>(3)</sup> FY15 Q2 YTD vs. FY16 Q2 YTD



<sup>(1)</sup> UPMC's two service areas are (1) Allegheny County, and (2) a 29-county region which also includes Armstrong, Beaver, Bedford, Blair, Butler, Cambria, Cameron, Centre, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Huntingdon, Indiana, Jefferson, Lawrence, McKean, Mercer, Potter, Somerset, Venango, Warren, Washington and Westmoreland counties.

<sup>(2)</sup> Jameson merged with UPMC on May 1, 2016.

<sup>(3)</sup> Inpatient market share excludes psychiatry and substance abuse discharges.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## ASSET AND LIABILITY MANAGEMENT

During the three months ended September 30, 2016, UPMC's investment portfolio returned 3.8%. As of September 30, 2016, UPMC utilized 212 external investment managers, including 42 traditional managers, 21 hedge fund managers and 149 private equity managers. UPMC's investment portfolio has a long-term perspective and has generated annualized returns of 7.7%, 5.2% and 7.3% for the trailing one-, three- and five-year periods. As of September 30, 2016, 61% of UPMC's investment portfolio could be liquidated within three days.

UPMC's annualized cost of capital during the period was 3.68%. This cost of capital includes the accrual of interest payments, the amortization of financing costs and original issue discount or premium, the ongoing costs of variable rate debt and the cash flow impact of derivative contracts. As of September 30, 2016, the interest rates on UPMC's long-term debt were approximately 82% fixed and 18% variable after giving effect to derivative contracts. Annualized interest cost for the variable rate debt for the period averaged 1.20%. The annualized interest cost for the fixed rate debt was 4.20%. UPMC has a revolving credit facility which expires in July 2019 and has a borrowing limit of \$500 million. As of September 30, 2016, UPMC had approximately \$67 million letters of credit outstanding under the credit facility leaving \$433 million available to fund operating and capital needs, of which \$182 million was drawn.

The table below compares reported Investing and Financing Activity for the three months ended September 30, 2016 and 2015 by type.

### Investing and Financing Activity by Type

Three Months Ended September 30	2016	2015
<i>(in thousands)</i>		
Realized revenue (loss)	\$ 72,492	\$ (6,070)
Interest and dividends, net of fees	10,057	5,210
Realized investment revenue (loss)	\$ 82,549	\$ (860)
Unrealized losses on derivative contracts	(238)	(2,370)
Other unrealized revenue (loss)	165,834	(242,615)
Investment revenue (loss)	\$ 248,145	\$(245,845)
Interest expense	(28,590)	(27,990)
UPMC Enterprises results	(23,881)	(16,890)
<b>Revenue (loss) from investing and financing activities</b>	<b>\$ 195,674</b>	<b>\$(290,725)</b>



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED SEPTEMBER 30, 2016

## Sources and Uses of Cash

UPMC's primary source of operating cash is the collection of revenues and related accounts receivable. As of September 30, 2016, UPMC had approximately \$846 million of cash and cash equivalents on hand to fund operations and capital expenditures, and borrowing availability under the credit facility was \$433 million, of which \$182 million was drawn.

Operating EBIDA was \$175 million for the three months ended September 30, 2016, compared to \$186 million for the three months ended September 30, 2015. Net cash provided by operating activities was \$183 million in the three months ended September 30, 2016 compared to \$231 million provided by operating activities in the three months ended September 30, 2015. The decrease in the current period is driven by contributions to the defined benefit pension plans of UPMC totaling \$251 million, maintaining its funded status and avoiding paying excess premiums to the Pension Benefit Guaranty Corporation ("PBGC"), offset by cash receipts from the State of Pennsylvania's Medicaid program.

Key sources and uses of cash from investing activities for the three month period ended September 30, 2016 include capital expenditures of \$116 million. Major capital projects included construction of the Luna and Victoria garages to continue to improve patient access to UPMC facilities. Major Information Services projects included enhancements that are advancing UPMC's leading clinician-centric computing environment, technology infrastructure that supports UPMC's diversified digital environment, investments in enterprise data analytics and other technologies that are transforming the consumer experience across the spectrum of health care.

# UTILIZATION STATISTICS

PERIOD ENDED SEPTEMBER 30, 2016

The following table, presents selected consolidated statistical indicators of medical-surgical, psychiatric, sub-acute and rehabilitation patient activity for the three months ended September 30, 2016 and 2015. The period ended September 30, 2016 includes statistics for UPMC Jameson which affiliated with UPMC in April 2016. It is not included in the period ended September 30, 2015.

	Three Months Ended September 30	
	2016	2015
Licensed Beds	5,309	5,087
<b>BEDS IN SERVICE</b>		
Medical-Surgical	3,688	3,723
Psychiatric	410	418
Rehabilitation	215	198
Skilled Nursing	110	90
Total Beds in Service	4,423	4,429
<b>PATIENT DAYS</b>		
Medical-Surgical	247,248	240,032
Psychiatric	31,322	32,359
Rehabilitation	16,476	15,702
Skilled Nursing	7,010	5,773
Total Patient Days	302,056	293,866
Observation Days	25,585	23,513
Average Daily Census	3,562	3,450
<b>ADMISSIONS AND OBSERVATION CASES</b>		
Medical-Surgical	48,397	46,906
Observation Cases	20,635	18,838
Subtotal	69,032	65,744
Psychiatric	2,769	2,619
Rehabilitation	1,119	1,079
Skilled Nursing	607	500
Total Admissions and Observation Cases	73,527	69,942
Overall Occupancy	81%	78%
<b>AVERAGE LENGTH OF STAY</b>		
Medical-Surgical	5.1	5.1
Psychiatric	11.6	12.4
Rehabilitation	14.9	14.6
Skilled Nursing	12.0	11.5
Overall Average Length of Stay	5.7	5.8
Emergency Room Visits	194,614	181,908
<b>TRANSPLANTS (PITTSBURGH)</b>		
Liver	26	29
Kidney	56	68
All Other	73	100
Total	155	197
<b>TRANSPLANTS (ISMETT)</b>		
Liver	24	22
Other	15	15
Total	39	37

## OUTSTANDING DEBT

PERIOD ENDED SEPTEMBER 30, 2016

(IN THOUSANDS)

Issuer	Original Borrower	Series	Amount Outstanding
Allegheny County Hospital Development Authority	UPMC Health System	1997B	\$ 43,830
	UPMC	2007A	80,435
	UPMC	2007B	65,000
	UPMC	2008A	66,277
	UPMC	2008B	114,956
	UPMC	2008 Notes	87,115
	UPMC	2009A	335,048
	UPMC	2010A	161,348
	UPMC	2010B	100,000
	UPMC	2010C	50,000
	UPMC	2010D	150,000
	UPMC	2010F	95,000
	UPMC	2011A	91,201
Monroeville Finance Authority	UPMC	2012	354,811
	UPMC	2013B	68,106
	UPMC	2014B	51,250
	UPMC	2015A Notes	69,635
Pennsylvania Economic Development Financing Authority	UPMC	2013A	120,809
	UPMC	2014A	327,272
	UPMC	2015B	131,506
	UPMC	2016	273,627
Erie County Hospital Authority	Hamot Health Foundation	2007	30,092
	Hamot Health Foundation	2010A	13,820
	Hamot Health Foundation	2010C	1,845
Pennsylvania Higher Educational Facilities Authority	UPMC	2010E	243,599
None	UPMC	2011B	100,000
	UPMC	Swap liabilities	14,970
	Various - Capital Leases and Loans		42,871
<b>Total</b>			<b>\$ 3,284,423</b>

## DEBT ACQUIRED AS OF OCTOBER 1, 2016 DUE TO MERGER WITH SUSQUEHANNA HEALTH SYSTEM

Issuer	Original Borrower	Series	Amount Outstanding
Lycoming County Authority	Susquehanna Health System	2009	\$ 146,239
	The Williamsport Hospital	2011	18,472
Tioga County Industrial Development Authority	Laurel Health System	2010	8,318
	Laurel Health System	2011	6,646
None	Susquehanna Health Innovation Center	New Market Tax Credit	17,600
	Mortgage Note Payable	-	1,035
	Various - Capital Leases and Loans	-	3,020
<b>Total Susquehanna Outstanding Debt</b>			<b>\$ 201,330</b>

Includes original issue discount and premium and other.

Source: UPMC Records

# DEBT COVENANT CALCULATIONS

PERIOD ENDED SEPTEMBER 30, 2016

## DEBT SERVICE COVERAGE RATIO

(Dollars in Thousands)

Trailing Twelve-Month Period Ended  
September 30, 2016

Net Income	\$ 610,348
<b>ADJUSTED BY:</b>	
Net Unrealized Gains from Period <sup>1</sup>	(261,431)
Depreciation and Amortization <sup>1</sup>	457,866
Loss on Defeasance of Debt <sup>1</sup>	82
Inherent Contribution <sup>1</sup>	(2,745)
Realized Investment Impairments <sup>2</sup>	(8,869)
Interest Expense	114,440
Revenues Available for Debt Service	\$ 909,691
Historical Debt Service Requirements – 2007 MTI	\$ 261,861
Debt Service Coverage Ratio – 2007 MTI	3.47X
Historical Debt Service Requirements – All Debt and Leases	\$ 286,683
Debt Service Coverage Ratio – All Debt and Leases	3.17X

## LIQUIDITY RATIO AS OF SEPTEMBER 30, 2016

Unrestricted Cash and Investments	\$ 4,842,419
Master Trust Indenture Debt	\$ 3,114,180
<b>Unrestricted Cash to MTI Debt</b>	<b>1.55</b>

<sup>(1)</sup> Non-Cash.

<sup>(2)</sup> Reflects ultimate realization of previously impaired cost-based investments.

I hereby certify to the best of my knowledge that, as of September 30, 2016, UPMC is in compliance with the applicable covenants contained in the financing documents for the bonds listed on the cover hereof and all applicable bank lines of credit and no Event of Default (as defined in any related financing document) has occurred and is continuing.



C. Talbot Heppenstall, Jr.  
Treasurer  
UPMC

# **UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE PERIOD ENDED SEPTEMBER 30, 2016

# REVIEW REPORT OF INDEPENDENT AUDITORS

The Board of Directors  
UPMC  
Pittsburgh, Pennsylvania

We have reviewed the consolidated financial information of UPMC and subsidiaries, which comprise the consolidated balance sheet as of September 30, 2016, and the related consolidated statements of operations and changes in net assets for the three-month periods ended September 30, 2016 and 2015 and condensed cash flows for the three-month periods ended September 30, 2016 and 2015.

## Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

## Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

## Conclusion

Based on our review, we are not aware of any material modifications that should be made to the consolidated and condensed financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.

## Report on Consolidated Balance Sheet as of June 30, 2016

We have previously audited, in accordance with auditing standards of the Public Company Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of UPMC and subsidiaries as of June 30, 2016, and the related consolidated statements of operations, changes in net assets and cash flows for the year then ended (not presented herein); and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated August 25, 2016. In our opinion, the accompanying consolidated balance sheet of UPMC and subsidiaries as of June 30, 2016, is consistent, in all material respects, with the consolidated balance sheet from which it has been derived.

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style script.

Pittsburgh, Pennsylvania  
November 2, 2016



# CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(IN THOUSANDS)

	September 30 2016	As of June 30 2016
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 846,227	\$ 431,471
Patient accounts receivable, net of allowance for uncollectable accounts of \$131,788 at September 30, 2016 and \$119,943 at June 30, 2016	745,726	699,024
Other receivables	641,720	1,079,175
Other current assets	201,300	165,587
Total current assets	2,434,973	2,375,257
Board-designated, restricted, trustee and other investments	4,973,391	4,664,932
Beneficial interests in foundations	441,551	442,552
Property, buildings and equipment:		
Land and land improvements	358,121	361,679
Buildings and fixed equipment	5,062,858	5,029,854
Movable equipment	2,534,599	2,477,082
Capital Leases	104,563	104,515
Construction in progress	208,533	183,000
Property, plant and equipment	8,268,674	8,156,130
Less: allowance for depreciation	(4,648,967)	(4,542,356)
Net property, plant and equipment	3,619,707	3,613,774
Other assets	398,399	365,897
Total assets	\$ 11,868,021	\$ 11,462,412
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities		
Accounts payable and accrued expenses	\$ 467,504	\$ 473,885
Accrued salaries, wages and related benefits	551,555	627,802
Current portion of insurance reserves	491,047	522,941
Current portion of long-term debt	162,216	158,718
Other current liabilities	745,532	452,841
Total current liabilities	2,417,854	2,236,187
Long-term obligations	3,122,207	2,904,158
Pension liability	167,674	397,691
Long-term insurance reserves	278,794	284,938
Other long-term liabilities	186,852	214,676
Total liabilities	6,173,381	6,037,650
Unrestricted net assets	5,069,684	4,801,607
Restricted net assets	624,956	623,155
Total net assets	5,694,640	5,424,762
Total liabilities and net assets	\$ 11,868,021	\$ 11,462,412

See accompanying notes

# CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (UNAUDITED)

(IN THOUSANDS)

Three Months Ended September 30

	2016	2015
<b>OPERATING ACTIVITY</b>		
Net patient service revenue:		
Patient service revenue (net of contractual allowances and discounts)	\$ 1,537,363	\$ 1,483,161
Provision for bad debts	(79,091)	(79,408)
Net patient service revenue less provision for bad debts	1,458,272	1,403,753
Insurance enrollment revenue	1,650,091	1,446,318
Other revenue	270,841	246,895
Total operating revenues	3,379,204	3,096,966
Expenses:		
Salaries, professional fees and employee benefits	1,200,435	1,120,228
Insurance claims expense	1,049,312	938,208
Supplies, purchased services and general expenses	954,350	852,379
Depreciation and amortization	114,823	114,392
Total operating expenses	3,318,920	3,025,207
Operating income	60,284	71,759
Other operating income	-	85
Income tax expense	(1,716)	(2,839)
Investing and financing activities:		
Investment revenue (loss)	248,145	(245,845)
Interest expense	(28,590)	(27,990)
UPMC Enterprises activity	(23,881)	(16,890)
Revenue (loss) from investing and financing activities	195,674	(290,725)
Excess of revenues over expenses (expenses over revenues)	254,242	(221,720)
Other changes in unrestricted net assets	13,835	1,951
Increase (decrease) in unrestricted net assets	268,077	(219,769)
<b>RESTRICTED NET ASSETS</b>		
Contributions and other changes	927	(1,902)
Net realized and unrealized gains (losses) on restricted investments	2,831	(3,965)
Assets released from restriction for operations and capital purchases	(956)	(3,165)
Change in beneficial interests in foundations	(1,001)	(17,854)
Change in restricted net assets	1,801	(26,886)
Change in net assets	269,878	(246,655)
Net assets, beginning of period	5,424,762	5,441,096
Net assets, end of period	\$ 5,694,640	\$ 5,194,441

See accompanying notes

# CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

(IN THOUSANDS)

	Three Months Ended September 30	
	2016	2015
<b>OPERATING ACTIVITIES</b>		
Increase (decrease) in net assets	\$ 269,878	\$ (246,655)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	114,823	114,392
Provision for bad debts	79,091	79,408
Change in beneficial interest in foundations	1,001	17,854
Net change in pension liability	(230,017)	(70,663)
Restricted contributions and investment income	(3,758)	(5,867)
Unrealized (gains) losses on investments	(165,834)	242,615
Realized gains on investments	(72,492)	6,070
Net change in non-alternative investments	(52,955)	6,957
Changes in operating assets and liabilities:		
Accounts receivable	311,662	165,144
Other current assets	(35,713)	(26,693)
Accounts payable and accrued liabilities	(82,628)	(98,154)
Insurance reserves	(38,038)	23,370
Other current liabilities	130,847	18,031
Other noncurrent liabilities	(27,824)	1,644
Other operating changes	(15,300)	3,231
Net cash provided by operating activities	182,743	230,684
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment, net of disposals	(115,715)	(75,801)
Investments in joint ventures	(5,000)	(3,500)
Net change in investments designated as nontrading	(1,821)	9,064
Net change in alternative investments	(12,595)	(10,395)
Net change in other assets	(24,571)	(2,174)
Net cash used in investing activities	(159,702)	(82,806)
<b>FINANCING ACTIVITIES</b>		
Repayments of long-term obligations	(47,793)	(30,519)
Borrowings of long-term obligations	435,750	-
Restricted contributions and investment income	3,758	5,867
Net cash provided by (used in) financing activities	391,715	(24,652)
Net change in cash and cash equivalents	414,756	123,226
Cash and cash equivalents, beginning of period	431,471	290,291
Cash and cash equivalents, end of period	\$ 846,227	\$ 413,517
<b>SUPPLEMENTAL INFORMATION</b>		
Capital lease obligations incurred to acquire assets	\$ -	\$ -

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 1. BASIS OF PRESENTATION

UPMC is a Pennsylvania nonprofit corporation and is exempt from federal income tax pursuant to Section 501(a) of the Internal Revenue Code (the "Code") as an organization described in Section 501(c)(3) of the Code. Headquartered in Pittsburgh, Pennsylvania, UPMC is one of the world's leading integrated delivery and financing systems. UPMC comprises nonprofit and for-profit entities offering medical and health-care-related services, including health insurance products. Closely affiliated with the University of Pittsburgh ("University") and with shared academic and research objectives, UPMC partners with the University's Schools of the Health Sciences to deliver outstanding patient care, train tomorrow's health care specialists and biomedical scientists, and conduct groundbreaking research on the causes and course of disease.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal and recurring nature. The accompanying unaudited interim consolidated financial statements include the accounts of UPMC and its subsidiaries. Intercompany accounts and transactions are eliminated in consolidation. For further information, refer to the audited consolidated financial statements and notes thereto as of and for the year ended June 30, 2016.

## 2. NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, which will replace most existing revenue recognition guidance in U.S. GAAP and is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. The core principle of ASU 2014-09 is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU 2014-09 also requires additional disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. ASU 2014-09 allows for both retrospective and prospective methods of adoption and is effective for periods beginning after December 15, 2017, upon the FASB's decision to delay the effective date by one year. UPMC is currently evaluating the impact that the adoption of ASU 2014-09 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which requires lessees to recognize assets and liabilities arising from operating leases on the statement of financial position and to disclose key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Early adoption is permitted. UPMC is currently evaluating the impact that the adoption of ASU 2016-02 will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, Presentation of Financial Statements for Not-For-Profit Entities, which will require not-for-profit entities to revise financial presentation to include: net asset classifications, provide quantitative and qualitative information as to available resources and management of liquidity and liquidity risk, information on investment expenses and returns, and the presentation of operating cash flows. The standard aims to help the reader of the financial statements to better understand the financial position of the organization and enhance consistency among similar organizations. ASU 2016-02 is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. UPMC is currently evaluating the impact that the adoption of ASU 2016-14 will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which adds or clarifies guidance on eight cash flow issues. The guidance will be effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. UPMC is currently evaluating the impact that the adoption of ASU 2016-15 will have on its consolidated financial statements.

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 3. NET PATIENT SERVICE REVENUE AND ACCOUNTS RECEIVABLE

The provision for bad debts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. UPMC records a significant provision for bad debts in the period services are provided related to self-pay patients, including both uninsured patients and patients with deductible and copayment balances due for which third-party coverage exists for a portion of their balance. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible accounts. Accounts receivable are written off after collection efforts have been followed in accordance with internal policies.

Net patient service revenue is reported at estimated net realizable amounts in the period in which services are provided. The majority of UPMC's services are rendered to patients under Medicare and Medical Assistance programs. Reimbursement under these programs is based on a combination of prospectively determined rates and actual costs. Amounts received under Medicare and Medical Assistance programs are subject to review and final determination by program intermediaries or their agents.

For the three months ended September 30, 2016 and 2015, the percentage of patient service revenue, net of contractual allowances, derived from third party payers and self-pay patients is as follows:

Three Months Ended September 30	2016	2015
Third party	93%	92%
Self-pay	7%	8%
	100%	100%

Laws and regulations governing the Medicare and Medical Assistance programs are extremely complex and subject to interpretation. Compliance with such laws and regulations are subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medical Assistance programs. As a result, there is at least a reasonable possibility that the recorded estimates may change.

## 4. FAIR VALUE MEASUREMENTS

As of September 30, 2016, UPMC held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents and certain board-designated, restricted, trustee, and other investments and derivative instruments. UPMC's alternative investments are measured using either the cost or equity method of accounting and are therefore excluded from the fair value hierarchy tables presented herein. The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs are generally unsupported by market activity. The three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value, includes:

- Level 1: Quoted prices for identical assets or liabilities in active markets.
- Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Other investments measured at fair value represent funds included on the balance sheet that are reported using the net asset value practical expedient as prescribed by ASU 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share. These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the net asset value ("NAV") information provided by the general partner. Fair value is based on the proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to the balance sheet date.

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

The following tables represent UPMC's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2016 and June 30, 2016. The interest rate swaps are valued using internal models, which are primarily based on market observable inputs including interest rate curves. When quoted market prices are unobservable for fixed income securities, quotes from independent pricing vendors based on recent trading activity and other relevant information including market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable are used for valuation purposes. These investments are included in Level 2 and include corporate fixed income, government bonds, and mortgage and asset-backed securities. The net asset value has been derived using quoted market prices for the underlying securities.

## FAIR VALUE MEASUREMENTS AS OF SEPTEMBER 30, 2016

	Level 1	Level 2	Level 3	Total Carrying Amount
<b>ASSETS</b>				
Fixed income	\$ 553,413	\$ 922,310	\$ -	\$ 1,475,723
Domestic equity	458,468	1,732	-	460,200
International equity	324,935	159,553	-	484,488
Public real estate	66,147	-	-	66,147
Commodities	3,224	-	-	3,224
Long/short equity	291	128,366	-	128,657
Absolute return	31,860	61,876	-	93,736
Derivative instruments (interest rate swap)	-	2,262	-	2,262
Other investments <sup>1</sup>	-	-	-	646,351
Total assets reported at fair value	\$ 1,438,328	\$ 1,276,099	\$ -	\$ 3,360,788
<b>LIABILITIES</b>				
Derivative instruments (interest rate swap)	\$ -	\$ (14,970)	\$ -	\$ (14,970)
Total liabilities reported at fair value	\$ -	\$ (14,970)	\$ -	\$ (14,970)

## FAIR VALUE MEASUREMENTS AS OF JUNE 30, 2016

	Level 1	Level 2	Level 3	Total Carrying Amount
<b>ASSETS</b>				
Fixed income	\$ 331,140	\$ 924,678	\$ -	\$ 1,255,818
Domestic equity	547,197	2,227	-	549,424
International equity	405,410	145,101	-	550,511
Public real estate	67,537	-	-	67,537
Long/short equity	5,330	109,013	-	114,343
Absolute return	30,942	61,661	-	92,603
Commodities	3,252	-	-	3,252
Derivative instruments	-	5,647	-	5,647
Other investments <sup>1</sup>	-	-	-	455,176
Total assets	\$ 1,390,808	\$ 1,248,327	\$ -	\$ 3,094,311
<b>LIABILITIES</b>				
Derivative instruments	\$ -	\$ (18,117)	\$ -	\$ (18,117)
Total liabilities	\$ -	\$ (18,117)	\$ -	\$ (18,117)

<sup>(1)</sup> Certain investments that are measured at fair value using the NAV practical expedient have not been categorized in the fair value hierarchy tables. The fair value amounts presented in the tables are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.



# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 5. FINANCIAL INSTRUMENTS

Substantially all of UPMC's investments in debt and equity securities are classified as trading. This classification requires UPMC to recognize unrealized gains and losses on substantially all of its investments in debt and equity securities as investment income in the consolidated statements of operations and changes in net assets. UPMC's investments in debt and equity securities that are donor-restricted assets are designated as nontrading. Unrealized gains and losses on donor-restricted assets are recorded as changes in restricted net assets in the consolidated statements of operations and changes in net assets. Gains and losses on the sales of securities are determined by the average cost method. Realized gains and losses are included in investment revenue in the consolidated statements of operations and changes in net assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations. Cash and cash equivalents and investments recorded at fair value aggregate \$4,204,753 and \$3,520,135 at September 30, 2016 and June 30, 2016, respectively.

Investments in limited partnerships that invest in nonmarketable securities are primarily recorded at cost if the ownership percentage is less than 5% and are reported using the equity method of accounting if the ownership percentage is greater than 5%. These investments are periodically evaluated for impairment. At September 30, 2016 and June 30, 2016, UPMC had \$1,614,865 and \$1,576,268, respectively, of alternative investments valued at cost or equity.

The fair value of long-term debt at September 30, 2016 and June 30, 2016, was \$3,458,315 and \$3,275,982 respectively, based on market prices as estimated using model-driven valuations that would be representative of a Level 2 classification within the fair value hierarchy. In September 2016, UPMC issued fixed rate bonds in the amount of \$273,620. These bonds have been included in the total outstanding debt on UPMC's balance sheet as of September 30, 2016.

## 6. DERIVATIVE INSTRUMENTS

UPMC uses derivative financial instruments to manage exposures on its debt and investments. By using derivatives to manage these risks, UPMC exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivatives. When the fair value of a derivative is positive, the counterparty owes UPMC, which creates credit risk for UPMC. When the fair value of a derivative is negative, UPMC owes the counterparty and, therefore, it does not incur credit risk. UPMC minimizes the credit risk in derivatives by entering into transactions that require the counterparty to post collateral for the benefit of UPMC based on the credit rating of the counterparty and the fair value of the derivative. If UPMC has a derivative in a liability position, the counterparty bears UPMC's credit risk and fair market values could be adjusted downward. Market risk is the effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of their derivative positions in the context of their total blended cost of capital.

UPMC maintains interest rate swap programs on certain of its debt in order to manage its interest rate risk. To meet this objective, UPMC entered into various interest rate swap agreements. The notional amount under each interest rate swap agreement is

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

reduced over the term of the respective agreement to correspond with reductions in various outstanding bond series.

The following table summarizes UPMC's interest rate swap agreements:

Swap	Maturity Date	UPMC Pays	UPMC Receives	Notional Amount at	
				September 30, 2016	June 30, 2016
Floating to fixed	2025	3.6%	68% one-month LIBOR	\$ 105,920	\$ 105,920
Basis	2021	SIFMA Index <sup>1</sup>	67% three-month LIBOR plus .2077%	34,340	34,340
Basis	2037	SIFMA Index <sup>1</sup>	67% three-month LIBOR plus .3217%	46,095	46,095
				<b>\$ 186,355</b>	<b>\$ 186,355</b>

<sup>1</sup> The SIFMA Index is a 7-day high-grade market index comprised of tax-exempt variable rate demand obligations.

UPMC has also entered into equity-related derivative instruments to manage the asset allocation in its investment portfolio. Under the equity index swap agreements UPMC pays a fixed income-like return and receives an equity-like return. The notional amount of these swaps is based upon UPMC's target asset allocation.

The following table summarizes UPMC's equity swap agreements:

Maturity Date	UPMC Pays	UPMC Receives	Notional Amount at	
			September 30, 2016	June 30, 2016
2016	Three-month LIBOR plus .1500%	MSCI EAFE Daily Total Return <sup>2</sup>	\$ -	\$ 100,000
2017	One-month LIBOR plus .1750%	S&P 500 Total Return Index	100,000	100,000
2017	One-month LIBOR minus .0200%	MSCI All Country World Daily Total Return <sup>1</sup>	100,000	100,000
2017	Three-month LIBOR plus .1000%	MSCI EAFE Daily Total Return <sup>2</sup>	100,000	-
			<b>\$ 300,000</b>	<b>\$ 300,000</b>

<sup>1</sup> The MSCI All Country World Index is a free-float adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging markets.

<sup>2</sup> The MSCI EAFE Index is a free-float adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US and Canada.

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

Pursuant to master netting arrangements, UPMC has the right to offset the fair value of amounts recognized for derivatives, including the right to reclaim or obligation to return cash collateral from/to counterparties. The fair values of the Company's derivative financial instruments are presented below, representing the gross amounts recognized as of September 30, 2016 and June 30, 2016 which are not offset by counterparty or by type of item hedged:

	September 30, 2016	June 30, 2016
Other assets	\$ 2,262	\$ 5,647
Long-term obligations	(14,970)	(18,117)
	\$ (12,708)	\$ (12,470)

The accounting for changes in the fair value (i.e., unrealized gains or losses) of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. None of UPMC's derivatives outstanding as of September 30, 2016 and June 30, 2016 are designated as hedging instruments and as such, changes in fair value are recognized in investing and financing activities as investment loss in the consolidated statements of operations and changes in net assets.

The effects of changes in the fair value of the derivatives on the consolidated statements of operations and changes in net assets for the three months ended September 30, 2016 and 2015 are as follows:

Type of Derivative	Classification of Unrealized Revenue (loss) in Excess of Revenues over Expenses (Expenses over Revenues)	Three Months Ended September 30	
		2016	2015
Interest rate contracts	Investment revenue (loss)	\$ 962	\$ (963)
Equity index contracts	Investment revenue (loss)	(1,200)	(1,407)
		\$ (238)	\$ (2,370)

UPMC's derivatives contain provisions that require UPMC's debt to maintain an investment grade credit rating from certain major credit rating agencies. If UPMC's debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivatives could request payment or demand immediate and ongoing full overnight collateralization on derivatives in net liability positions. The aggregate fair value of all derivatives with credit-risk-related contingent features that are in a liability position at September 30, 2016 and June 30, 2016 are \$14,833 and \$16,022, respectively, for which UPMC has posted collateral of \$0. If the credit-risk-related contingent features underlying these agreements were triggered to the fullest extent on September 30, 2016, UPMC would be required to post \$15,110 of collateral to its counterparties.

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 7. PENSION PLANS

UPMC and its subsidiaries maintain defined benefit pension plans (the "Plans"), defined contribution plans and nonqualified pension plans that cover substantially all of UPMC's employees. Benefits under the Plans vary and are generally based upon the employee's earnings and years of participation.

The components of net periodic pension cost for the Plans are as follows:

		Three Months Ended September 30	
	2016	2015	
Service cost	\$ 24,939	\$ 23,769	
Interest cost	17,881	19,914	
Expected return on plan assets	(33,456)	(33,439)	
Recognized net actuarial loss	13,541	9,198	
Amortization of prior service credit	(1,260)	(1,257)	
Net periodic pension cost	\$ 21,645	\$ 18,185	

During the three months ended September 30, 2016 and 2015, UPMC made contributions to the Plans of \$251,450 and \$89,000, respectively.

## 8. CONTINGENCIES

In April 2009, two related class action lawsuits were filed against UPMC and certain of its affiliates in the Court of Common Pleas for Allegheny County, Pennsylvania. The state court actions allege violations of the Pennsylvania Minimum Wage Act, The Wage Payment and Collection Act and common law. Similar cases have already been dismissed by the federal district court. The lawsuits seek recovery of alleged unpaid wages and benefits and other monetary damages and costs. The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

In January 2012, UPMC Hamot was served with a Complaint in federal court naming it as a defendant in a qui tam action, along with a private physician practice. In July 2013, the Court denied UPMC Hamot's motion to dismiss an Amended Complaint. UPMC Hamot answered the Amended Complaint on September 18, 2013. On July 8, 2016, the parties filed competing motions for summary judgment. Opposition Briefs have been filed. The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

In July 2012, a class action suit was filed against UPMC and other defendants in the Allegheny County Court of Common Pleas alleging Pennsylvania wage and hour violations. The Complaint alleges that RN staff members with a BSN were not credited the pay differential to which they were entitled and seeks damages for that differential as well as liquidated damages and interest. UPMC filed preliminary objections that were sustained in part and overruled in part, resulting in the dismissal of all named defendants except UPMC. UPMC also filed an Answer with New Matter, denying all material allegations. Plaintiffs have filed an Amended Complaint naming each UPMC hospital as a defendant. The plaintiffs also filed a Motion to Certify the class. The Motion to Certify a UPMC-wide class of current and former BSNs from February 2006 to present was granted. Approximately 405 potential class members have been identified. Discovery is underway. On August 1, 2016, UPMC filed a motion for summary judgment on all claims and a motion to decertify the class (to the extent that any claims survive summary judgment). The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

Beginning in September 2012, multiple suits were filed against UPMC, Maxim Staffing Solutions, Inc. ("Maxim") and Medical Solutions, LLC, in the Allegheny County Court of Common Pleas ("Common Pleas Court") alleging the defendants acted negligently in failing to prevent a Maxim employee, staffed at UPMC between March 2008 and May 2008, from spreading the Hepatitis C virus ("HCV"). UPMC notified the Pennsylvania Attorney General that this employee was terminated from UPMC for violations related to attempts to switch syringes. UPMC filed preliminary objections to all of these actions based on, inter alia, the lack of a common law duty of care. The trial courts granted the preliminary objections, thereby dismissing the actions. In the ensuing appeals, the Pennsylvania Superior Court vacated the trial court's orders sustaining the preliminary objections based on lack of a common law duty of care and remanded for further proceedings. On October 21, 2016 UPMC has petitioned the Pennsylvania Supreme Court for allowance of appeal. The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

On October 9, 2012, UPMC received a Civil Investigative Demand ("CID") from the Department of Justice ("DOJ") that sought records relating to 40 surgical procedures performed between January 25, 2008 and June 24, 2010. UPMC timely responded to that CID. In November 2013, the DOJ advised UPMC that the CID had been served as part of the DOJ's investigation of allegations asserted by Relators in a federal qui tam lawsuit filed under seal. On July 27, 2016, the DOJ announced that it had reached an agreement with UPMC to settle certain allegations that UPMC had violated the False Claims Act for approximately \$2,500. UPMC admitted no liability in settling those claims, which were paid in July 2016. The DOJ declined to intervene in the remaining allegations of the Relators' lawsuit, which was also unsealed on July 27, 2016. In their Amended Complaint against UPMC and UPP, Inc., Relators allege that UPMC violated the False Claims Act violations, by overpaying physicians and encouraging physicians to perform medically unnecessary procedures. UPMC vigorously denies these allegations and intends to mount a zealous defense. On October 5, 2016 UPMC moved to dismiss all claims. Relators have opposed UPMC's motion. The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

In September 2013, a Complaint was filed with the National Labor Relations Board, Region 6 against UPMC Presbyterian Shadyside ("PUH"). The Complaint was amended in January 2014 to add UPMC as another defendant. The Amended Complaint, stemming from multiple unfair labor practice charges filed by the Service Employees International Union ("SEIU") Healthcare Pennsylvania alleges that UPMC PUH engaged in various activities that violate the National Labor Relations Act. In response, the National Labor Relations Board ("NLRB") is seeking relief in the form of: a workplace posting, to be displayed for 120 days, as determined by the proceedings; a public reading of the posting to UPMC employees; an Order granting the SEIU full access to public areas at PUH during non-working hours for the purpose of speaking to employees; an Order granting the SEIU permission to post its notices and distribute literature at PUH; the repayment of various taxes related to the termination of four employees identified in the complaint; and other undefined relief as deemed appropriate. UPMC anticipates that the "undefined relief" will include back pay and reinstatement for the four terminated employees. A five-week hearing was conducted before an administrative law judge. In the opinion, reinstatement was recommended for all of the terminated employees, plus full back pay, 120 day notice posting and a public reading of the posting. The matter is currently on appeal to the NLRB. One of the reinstated individuals has expressed an interest in resolving his claim, with no reinstatement. The ultimate outcome and effect on UPMC's consolidated financial statements cannot be determined at this time.

In February 2014, a putative class action against UPMC and UPMC McKeesport was filed in the Court of Common Pleas of Allegheny County, Pennsylvania, asserting claims for negligence, breach of privacy, and breach of implied contract in connection with a data breach at UPMC involving the personally identifiable information of certain UPMC employees. The purported class consists of former, current, and future UPMC employees. On May 28, 2015, the Court sustained UPMC's preliminary objections and dismissed Plaintiff's claims. Plaintiffs have appealed the Court's order. Since the Matter was filed, the NLRP has threatened a second complaint adding 4 more unfair labor practices changes, 1 involving Children's, 1 involving UPMC Mercy and 2 involving UPMC Presbyterian Shadyside. The ultimate outcome and effect on UPMC's consolidated financial statements cannot be determined at this time.

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

On September 3, 2014, Highmark Inc. and Keystone Health Plan West, Inc. sued UPMC and various UPMC hospitals and physician practices in the Court of Common Pleas of Allegheny County, Pennsylvania, asserting claims for breach of contract and declaratory judgment related to oncology billing. On March 24, 2015, the Court denied UPMC's preliminary objections to that Complaint. On April 2, 2015, UPMC filed a Notice of Appeal of the Court's March 24, 2015 Order. The ultimate outcome and effect on UPMC's consolidated financial statements cannot be determined at this time.

In April 2015, Premier Comp Solutions ("PCS"), a vendor used by UPMC Health Benefits, UPMC Benefit Management Services and UPMC Work Alliance to provide certain repricing services and/or panel generation and related services for certain employer groups purchasing either third-party administration and/or worker's compensation insurance products from UPMC, filed a lawsuit against UPMC Health Network, UPMC Benefit Management Services, UPMC Health Benefits, and two of PCS' competitors in the Court of Common Pleas of Allegheny County. In its Complaint, which PCS has amended three times, PCS asserts, inter alia, claims for breach of contract, tortious interference with contractual or beneficial business relations, misappropriation of trade secrets, misrepresentation and conspiracy. In PCS's First Amended Complaint in August 2015, it removed UPMC Health Network and added UPMC, a Pennsylvania nonprofit non-stock corporation, as a party. The UPMC defendants filed an Answer, New Matter and Counterclaim to PCS's Third Amended Complaint on February 16, 2016. Discovery is ongoing. The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

In May 2015, PCS also sued UPMC Health Network, UPMC Benefit Management Services, UPMC Health Benefits, and a PCS competitor in the United States District Court for the Western District of Pennsylvania, asserting four antitrust related claims. In August 2015, PCS filed an amended complaint, removing UPMC Health Network and adding UPMC, a Pennsylvania nonprofit non-stock corporation as a party. Discovery is ongoing. The outcome and ultimate effect on UPMC's consolidated financial statements cannot be determined at this time.

The Pennsylvania Insurance Commissioner has placed long-term care insurer Penn Treaty Network America Insurance Company and one of its subsidiaries (collectively, Penn Treaty) in Rehabilitation, and on July 27, 2016, filed petitions in the Commonwealth Court seeking liquidation. If Penn Treaty is liquidated, UPMC Health Benefits (and other insurers) may be required to pay a portion of Penn Treaty's policyholder claims related to their jurisdictions through guaranty association assessments. UPMC Health Benefits is currently unable to predict the ultimate outcome of, or reasonably estimate the loss or range of losses resulting from, this potential insolvency because UPMC Health Benefits cannot predict when the state court will render a decision, the amount of the insolvency, if any, the amount and timing of associated guaranty association assessments or the amount or availability of potential offsets, such as premium tax offsets. It is possible that in future reporting periods UPMC Health Benefits may record a liability and a premium tax offset receivable relating to Penn Treaty. The ultimate outcome and effect on UPMC's consolidated financial statements cannot be determined at this time.

## 9. SUBSEQUENT EVENTS

Management evaluated events occurring subsequent to September 30, 2016 through November 2, 2016, the date the unaudited interim consolidated financial statements of UPMC were issued. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements that have not been recorded except as noted below.

Following a two-year thoughtful, mission-focused process to pursue partnership options, Susquehanna Health and UPMC finalized a definitive agreement to affiliate and on October 1, 2016, Susquehanna Health became UPMC Susquehanna. Susquehanna is a four-hospital, 342-bed system based in Williamsport, Pa., with \$575,470 in revenue and \$815,478 in total assets, including \$303,625 in cash and investments, and \$324,845 in total liabilities, including \$222,215 of debt and \$8,077 of pension liabilities, as of June 30, 2016. With a \$500,000 investment, UPMC has committed to advance Susquehanna's goals to expand healthcare services, maintain its patient-focused mission, invest in information technology, assure meaningful local governance and introduce to the region more choice for health insurance.