

---

## **QUARTERLY REPORT**

For the quarter and six months  
ended February 28, 2017

---

### **Baptist Healthcare System, Inc. And Affiliates**

The information provided within this report  
was prepared by Baptist Healthcare System, Inc.

Report Date: April 28, 2017

# Baptist Healthcare System, Inc. And Affiliates

## Contents

### Comments

Forward looking information .....	3
System entities .....	4-9
Summary of current operations and performance improvement plan .....	10-11
Management's discussion of operating performance .....	12-20

### Obligated group

Balance sheets.....	22
Statements of operations and changes in net assets.....	23-24
Statements of cash flows.....	25
Operating statistics.....	26
Admissions and charges by payer.....	27
Net patient service revenue by payer .....	28
Patient utilization .....	29-37

### Non-Obligated Group

Membership .....	38
------------------	----

### System

Consolidated balance sheets .....	40
Consolidated statements of operations and changes in net assets .....	41-42
Consolidated statements of cash flows .....	43

### Other Information

Obligated Group and Consolidated financial and operating ratios.....	45
Obligated Group and Consolidated debt service coverage .....	46
Obligated Group and Consolidated capitalization and days cash on hand ratio .....	47
Financial indicators by division .....	48
Notes to consolidated financial statements .....	49-58

The undersigned, Stephen Oglesby, as Obligated Group Agent, hereby certifies, warrants and represents, that the financial statements attached hereto for Baptist Healthcare System, Inc. and Affiliates (BHS) (i) are the financial statements of BHS for the period stated, (ii) have been prepared in accordance with GAAP, (iii) fairly reflect the financial condition of BHS and the results of its operations as of the date and for the period stated and (iv) set forth in reasonable detail the financial information necessary to determine if BHS is in compliance with the covenants applicable to all outstanding indebtedness of BHS.

As the Obligated Group Agent I have reviewed the activities of each Member during the preceding Fiscal Year and have determined that the Members have complied with all of the terms, provisions and conditions of the Master Indenture and that each Member has kept, observed, performed and fulfilled each and every covenant, provision and condition of the Master Indenture on its part to be performed and is not in default in the performance or observance of any terms, covenants, provisions or conditions thereof.



Stephen R. Oglesby

## **Baptist Healthcare System, Inc. And Affiliates**

### **Forward looking information:**

Certain statements included or incorporated by reference in this Quarterly Report constitute “forward-looking statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 21E of the United States Securities Exchange Act of 1934, as amended, and Section 27A of the United States Securities Act of 1933, as amended. Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. Such forward-looking statements include, among others, certain of the information under the Management Discussion and Analysis included within this Quarterly Report. The achievement of certain results or other expectations included in such forward-looking statements involves known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

Given these uncertainties, bondholders and prospective bondholders are cautioned not to unduly rely on such forward-looking statements when evaluating the information in this Quarterly Report. These factors include, but are not limited to, (i) the highly competitive nature of the health care business, (ii) the efforts by insurers, health care providers and others to contain health care costs, (iii) possible changes in the Medicare and Medicaid programs that may impact reimbursements to health care providers, (iv) changes in federal, state or local regulations affecting the health care industry, (v) the possible enactment of federal or state health care reform, (vi) the ability to attract and retain qualified management and other personnel, including affiliated physicians, nurses and medical support personnel, (vii) liabilities and other claims asserted against the Obligated Group, (viii) changes in accounting standards and practices, (ix) changes in general economic conditions that affect the number of employed individuals who have health coverage, (x) future divestitures or acquisitions which may result in additional charges, (xi) changes in revenue mix and the ability to enter into and renew managed care provider arrangements on acceptable terms, (xii) the availability and terms of capital to fund future expansion plans of the Obligated Group and to provide for ongoing capital expenditure needs, (xiii) changes in business strategy or development plans, (xiv) delays in receiving payments, (xv) the ability to implement shared services and other initiatives and realize decreases in administrative, supply and infrastructure costs, (xvi) the outcome of pending and any future litigation, (xvii) the Obligated Group’s continuing efforts to monitor, maintain and comply with appropriate laws, regulations, policies and procedures relating to the status of the Members of the Obligated Group as tax-exempt organizations as well as their ability to comply with the requirements of Medicare and Medicaid programs, (xviii) the ability to achieve expected levels of patient volumes and control the cost of providing services, and (xix) the impact of new clinical techniques and technology, as well as new pharmaceutical and genetic developments and products, that may alter the course of medical diagnosis and treatment in ways that are currently unanticipated.

# Baptist Healthcare System, Inc. And Affiliates

## System Entities

### The System

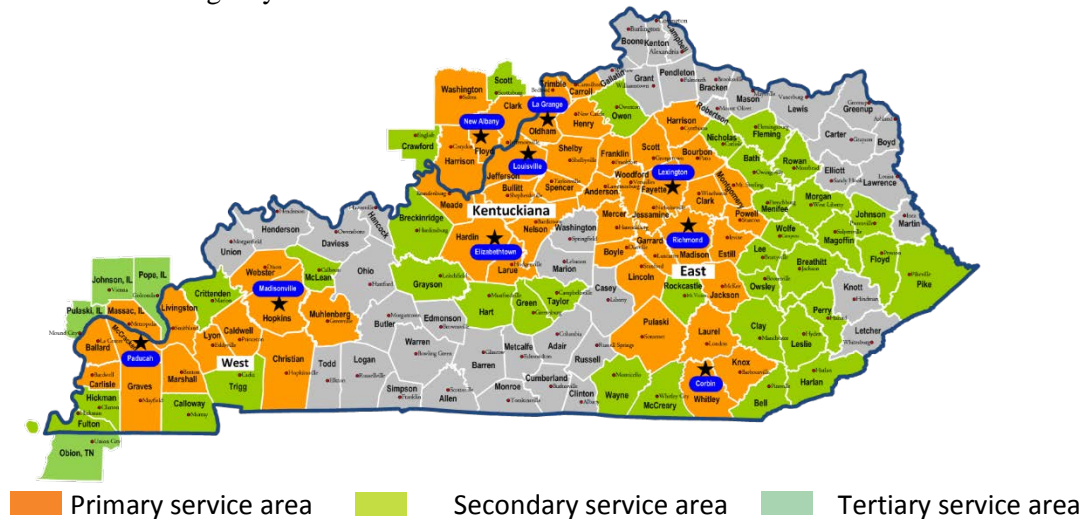
BHS and its non-obligated affiliates are hereafter referred to as the System or Baptist Health. Presented within this report are consolidated financial statements and operating results for both the System and the Obligated Group. The System consolidated financial statements represent the consolidated operations of BHS, the affiliates in which it has sole ownership or membership and the entities in which it has greater than 50% equity interest with commensurate control.

Baptist Health is one of the largest not-for-profit healthcare systems in Kentucky, with over 2,400 total beds and nearly 21,000 employees. Baptist Health includes:

- 8 owned acute care hospitals (effective October 1, 2016)
- 1 managed acute care hospital
- 3 long-term acute care hospitals (LTACHs) managed by Continuing Care Hospitals
- More than 200 community access points
- Service areas that cover 75.1% of Kentucky's population
- Health plan providing employer sponsored insurance services to more than 37,000 enrollees
- Physician network of employed and independent physicians totaling 3,000 physicians
- Over \$2.3 billion in total operating revenue (year ended August, 2016)
- Over \$2.8 billion in total assets (at August 31, 2016)

During the fiscal year August 2016, Baptist Health provided more services than any other health system in the state of Kentucky for the following services:

KEY STATISTIC	STATE RANK	VOLUME
Kentucky Births	#1	1 in 6
Outpatient/MD visits	#1	1 in 6
Admissions	#1	1 in 6
Cancer Patients	#1	1 in 4
Open Heart Surgeries	#1	1 in 5
Emergency Visits	#1	1 in 8



# **Baptist Healthcare System, Inc. And Affiliates**

## **System Entities**

### **The Obligated Group**

The Obligated Group consists of Baptist Healthcare System, Inc., Baptist Health Richmond, Inc., Baptist Health Madisonville, Inc. and Baptist Health Medical Group. Each member is a Kentucky non-profit corporation and a tax-exempt organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

#### **Baptist Healthcare System, Inc. (BHS):**

- Baptist Health Louisville (BH LOU - 519 licensed beds). BH LOU opened in 1975, is located in St. Matthews (an eastern Louisville suburb) approximately five miles from the downtown area, and is strategically located near Interstate 64, a main access to downtown, and Interstate 264, a main beltway around Louisville. BH LOU provides a continuum of care to the community, including general acute care, behavioral health, acute rehabilitation and home health services. Distinguishing services include general medical and surgical care, cardiovascular services, and women's health including obstetrics, orthopedic surgery, the Center for Behavioral Health®, the cancer center, rehabilitation, neuroscience and emergency services.
- Baptist Health Corbin (BH COR - 273 licensed beds). BH COR opened in 1986 in Corbin, Kentucky. It is located one-half mile off Interstate 75, approximately three miles from downtown Corbin and near U.S. Highway 25, which is a main access to several of the surrounding communities. BH COR is a Medicare Rural Referral Center that provides a full range of general acute care to the community. Distinguishing services include surgical services, rehabilitation, behavioral health, intensive care, obstetrics, magnetic resonance imaging (MRI) services, general medicine and emergency services. It is known in the region for its Behavioral Health, Physical Rehabilitation and Orthopedic Center of Excellence Programs.
- Baptist Health Lexington (BH LEX - 391 licensed beds). BH LEX opened in 1954 in Lexington, the second largest city in Kentucky. It is located approximately five miles from Interstate 75 and Interstate 64, which provide access for the immediate Lexington metro area patients as well as patients from other areas of central and eastern Kentucky, which the hospital serves. BH LEX is among the largest providers of cardiac care in Kentucky and offers a comprehensive program, including open heart surgery, angioplasty and full interventional procedures, electrophysiology, cardiac catheterization-guided magnetic imagery, dedicated cardiothoracic intensive care, cardiac rehabilitation, invasive and noninvasive diagnostic services, cardiac 64-slice computed tomography (CT) diagnostic capabilities, cardiac MRI services, and extensive community education, screening and wellness services. BH LEX established the first accredited chest pain center in the Lexington area, a special designation granted by the Society of Chest Pain Centers.
- Baptist Health Paducah (BH PAD - 373 licensed beds). BH PAD opened in 1953 in Paducah and is a regional medical and referral center, serving nearly 200,000 patients a year from four states. Distinguishing services include a full range of medical and surgical services, including cardiac and cancer care, orthopedics, neuroscience, women's and children's services, surgery, emergency treatment, diagnostic imaging, rehabilitation and more.

# **Baptist Healthcare System, Inc. And Affiliates**

## **System Entities**

### **The Obligated Group (continued)**

- Baptist Health LaGrange (BH LAG – 120 licensed beds). BH LAG was acquired in 1992 and was owned by Baptist Healthcare Affiliates, Inc., a wholly controlled affiliate of BHS, until September 1, 2014 when BH LAG was merged into BHS. Through the merger, BH LAG became a hospital owned and operated by BHS. BH LAG is located in LaGrange, Kentucky which is in one of the fastest growing and highest income areas within Kentucky. Located approximately 22 miles northeast of downtown Louisville off Interstate 71, BH LAG is easily accessible from communities within Oldham County as well as the four adjacent Kentucky counties. Distinguishing services include a 24-hour emergency department, intensive/coronary care, telemetry monitoring, women's health services, a full range of diagnostic imaging services including nuclear medicine, mammography, ultrasound, CT Scanning, MRI services, a full complement of rehabilitative services including physical therapy, occupational therapy and speech therapy, a Skilled Nursing Facility (SNF) and outpatient services.
- Baptist Health Floyd (BH FLO – 243 licensed beds) was acquired and became a member of BHS on October 1, 2016. BH FLO is an acute care hospital located in New Albany, Indiana. Located six miles from Louisville, BH FLO is the primary healthcare provider to patients in Floyd County. The primary service area (PSA) includes Clark, Crawford, Floyd, Harrison, Scott and Washington counties in Indiana. In addition to the hospital, BH FLO owns a comprehensive cancer center and operates multiple primary care and specialty physician practices as well as participating in three (3) joint ventures: a 48% ownership in Northgate Surgery Center, LLC (which was sold effective January 1, 2017), a 50% ownership in Northgate, Medical Imaging, LLC and a 33.3% ownership interest in Southern Indiana Rehabilitation Hospital.

Baptist Health Richmond (BH RIC – 105 licensed beds). Baptist Health Richmond, Inc. is a nonprofit, tax-exempt organization that was formed on September 1, 2012 when Baptist acquired the net assets of Pattie A. Clay Infirmary Association and Pattie A. Clay Foundation (collectively Pattie A. Clay renamed to Baptist Health Richmond). There was no consideration paid by Baptist as part of the acquisition. BH RIC offers a continuum of care such as orthopedics, obstetrics/gynecology, pediatrics, cardiology and internal medicine, sports medicine and a full array of outpatient, diagnostic and emergency services. BH RIC is located in Richmond, Kentucky approximately 2 miles off Interstate 75, adjacent to Eastern Kentucky University. It is located approximately 25 miles south of downtown Lexington, Kentucky and 28 miles from Baptist Health Lexington. BH RIC became a member of the Obligated Group effective November 1, 2016.

Baptist Health Madisonville (BH MAD – 410 licensed beds). Baptist Health Madisonville, Inc. is a nonprofit, tax-exempt organization that was formed on November 1, 2012 when Baptist acquired the net assets of The Trover Foundation (d/b/a Trover Health System and its affiliates). There was no consideration paid by Baptist as part of the acquisition. BH MAD offers 55 services and specialties including oncology, orthopedics, obstetrics/gynecology, cardiology, cardiovascular, general surgery and emergency services. BH MAD is the major medical center within its three county primary service area. BH MAD is located in Madisonville, Kentucky and is approximately one hour south of Evansville, Indiana. BH MAD became a member of the Obligated Group effective November 1, 2016.

## **Baptist Healthcare System, Inc. And Affiliates**

### **System Entities**

#### **Baptist Health Medical Group (BHMG):**

- BHMG is a non-profit 501(c)(3) tax-exempt corporation of which BHS is the sole member. BHMG was formed in 2006 to employ physicians and own and operate healthcare facilities such as physician offices, primary care centers, special health clinics, express care clinics, physical therapy, occupational medicine and urgent care centers in all Baptist Health markets and surrounding communities. Effective January 1, 2016, BHMG became a member of the Obligated Group.

#### **Non-Obligated Affiliates**

In addition to the hospitals owned and operated by BHS, BHS also controls or has an ownership interest in several affiliated non-profit and for-profit corporations. These affiliates are not members of the Obligated Group created under the Master Indenture and therefore are not obligated to make payments with respect to the Bonds.

#### **Bluegrass Family Health, Inc. (d/b/a Baptist Health Plan) (BHP)**

- BHP is a Kentucky non-profit corporation formed in 1993 to own and operate a health maintenance organization (HMO). BHP currently provides services to approximately 37,000 commercial members, Medicare Advantage Plan members, and Kentucky exchange members concentrated in the central and southeastern regions of the state and provides other services through other networks and certain subcontracts for approximately 61,000 lives throughout the Commonwealth of Kentucky. BHS is the sole member owner.

#### **Baptist Health Community Services (BCHS):**

- BCHS is a Kentucky non-profit tax-exempt 501(c)(3) corporation of which BHS is the sole member and was formed in 1987. BCHS owns a 55% interest in a limited liability company formed in 2002 called Baptist-Physicians' Surgery Center, LLC ("BPSC"). Physicians own the remaining 45% of BPSC. BPSC owns and operates an ambulatory surgery center on the campus of BH LEX. BCHS owns an 84% interest in Baptist Eastpoint Surgery Center, LLC ("BESC") which was formed in 2007. BESC operates an ambulatory surgery center located off-campus in Louisville, Kentucky, which opened in early 2009. BCHS entered into a joint venture with D1 Sports Holdings, Inc. (D1 Sports Training of Louisville, LLC) to provide sports performance and general fitness training, expert coaching and sports therapy. D1 Sports Training of Louisville, LLC opened April 25, 2016. Effective January 2, 2017, D-1 Sports Holdings, Inc. is no longer a joint venture partner and the joint venture has been renamed Baptist Health Performance Training, LLC which is a joint venture between Baptist Health Ventures, Inc. and four separate athlete investors.

# **Baptist Healthcare System, Inc. And Affiliates**

## **System Entities**

### **Non-Obligated Affiliates**

- BCHS owned Oak Tree Hospital at Baptist Health Corbin, a 32-bed long-term acute care hospital (LTACH). Effective December 1, 2013, BCHS transferred its membership interest in Corbin Long Term Acute Care, LLC d/b/a Oak Tree Hospital at Baptist Regional Medical Center (Oak Tree) to CHC Community Care, LLC (CCC), a Delaware limited liability company and a subsidiary of Community Hospital Corporation, Inc. (CHC). Through the Membership Exchange Agreement, BCHS exchanged its sole membership interest in Oak Tree for a stated membership interest in CCC that entitles BCHS to a portion of the income derived from the long-term acute care hospital (Oak Tree). Additionally, Oak Tree entered into a lease agreement with Baptist Health Corbin for a term of five years to utilize 32 beds under Baptist Health Corbin's hospital license for the term of the lease. Oak Tree also entered into an ancillary services agreement as part of the membership exchange transaction with Baptist Health Corbin for a term of five years for the provision of certain services for the operation of the LTACH. Oak Tree entered into a management agreement for a term of five years with CCC to provide key management for the LTACH and to manage the day-to-day operations thereof. The term of the management agreement would be co-extensive with the term of the lease agreement.

### **Baptist Health Ventures, Inc. (BHV):**

- BHV is a Kentucky for-profit corporation in which BHS owns 100% of the stock. BHV was formed in 1991 to own, manage, operate, maintain, lease, or joint venture with hospitals, medical facilities, or other entities which provide health care services to patients or which promote the health and well-being of the community. BHV has contracted with Hardin County Fiscal Court to manage Hardin Memorial Hospital in Elizabethtown, Kentucky. BHV owns 50% of the stock in Affiliated Nursing Services, Inc., a for-profit company formed in 1987. BHV owns 50.23% of a for-profit health and wellness center called Baptist East/Milestone, LLC, formed in 1999. Effective January 2, 2017, a new joint venture was created named Baptist Health Performance Training, LLC between BHV and four separate athlete investors.

### **Baptist Health Employer Solutions (ES LOU):**

- ES LOU is a Kentucky non-profit corporation formed in 2010 to organize, promote and develop care delivery systems such as accountable care organizations which utilize evidence-based clinical care guidelines, integrate clinical care to improve community health, collaborate among health providers to improve service and care delivery, develop chronic disease management programs, participate in pay for performance programs and to perform such activities in a manner consistent with the overall charitable purpose of BHS. BHS is the sole member owner. Effective December 31, 2016 ES LOU was dissolved and the related activities reside within BHS.



# **Baptist Healthcare System, Inc. And Affiliates**

## **System Entities**

### **Non-Obligated Affiliates**

#### **Baptist Health Network Partners, LLC (BHNP):**

- BHNP is a Kentucky limited liability company whose sole member is BHS. BHNP was formed to engage in the process of clinical integration in the commonwealth of Kentucky, which, currently means the implementation of an active and ongoing program to evaluate and modify practice patterns by the network's physician participants and create a high degree of interdependence and cooperation among physicians to control costs and ensure quality.

#### **Baptist Health Care Partners, LLC (BHCP)**

- BHCP is a Kentucky limited liability company formed in 2015 whose sole member is BHS. BHCP was formed to participate in the Centers for Medicare and Medicaid ("CMS") Medicare Shared Savings Program ("MSSP") as an Accountable Care Organization, and was approved by CMS for a three-year initial participation cycle in the MSSP beginning January 1, 2016.

#### **System Foundations:**

All foundations were formed to support the System's hospitals. The Baptist Health Cardiac Research Foundation, Inc. (dissolved effective December 31, 2016), of which BHS is the sole member, receives and administers grants, bequests and donations for cardiac related medical research. All other foundations are non-profit tax-exempt corporations that receive, invest and manage philanthropic gifts on behalf of the Hospitals.

- Baptist Health Cardiac Research Foundation, Inc.
- Baptist Health Foundation Corbin, Inc.
- Baptist Health Foundation Greater Louisville, Inc.
- Baptist Health Foundation Lexington, Inc.
- Baptist Health Foundation Madisonville, Inc.
- Baptist Health Foundation Richmond
- Baptist Health Foundation Paducah, Inc.

#### **Other Entities:**

In addition to the affiliates listed previously, BHS has a partial interest in the following entities, all of which are accounted for on the equity basis.

- Purchase Health Partners, Inc. (PHP)
- BRMC Condominium Association, Inc. (BCA)
- Baptist East Medical Pavilion Association, Inc. (BEMP)
- Cumberland Healthcare, Inc. (CHI)
- Mercy Regional Emergency Medical System, LLC (MREMS)
- Medical Associates of Middletown, LLC (MAM)
- American Excess Insurance Exchange (AEIX), Risk Retention Group

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

### *Introduction*

In late 2013, the Baptist Health Board adopted a ten-year strategic plan called the “Baptist 2<sup>nd</sup> Century Plan” which was designed to lead Baptist into its second century of operations as a leader in the transformation of health in Kentucky. Critical initiatives included in the plan are:

1. Implementation of the Epic electronic health record (“EHR”) system to provide integrated and accessible medical information at all points of care.
2. Build infrastructure and alignment with community partners and physicians to manage community and population health.
  - a. Establish an Accountable Care Organization.
  - b. Expand the Clinically Integrated Network.
  - c. Expand BH Plan.
3. Create a single statewide high performing medical group that is physician led and professionally managed.
4. Utilize robust process improvement.
5. Growth in Kentuckiana Region
6. Growth in East Region

These initiatives required significant capital and operating investments and as a result, for the fiscal year ended August 31, 2016 we reported an operating loss of \$41 million. This loss, while significant, was not too far from what we planned (\$41 million actual operating loss vs. a \$34 million budgeted operating loss). Excess of revenue over expenses finished ahead of budget for the fiscal year (\$9.1 million excess gain vs. a \$3.6 million budgeted gain).

The second quarter of fiscal year 2017 continued the investment in Epic as we implemented our 6th (Richmond) and 7th hospital (Madisonville). Growth in the medical group and population health slowed as we shifted our focus toward the completion of Epic (within the originally scheduled hospitals and medical groups) and optimizing its use to enhance both clinical and operating efficiencies. Currently, we are planning to implement Epic in the newly acquired BH FLO during the third quarter of calendar year 2018.

The operating loss for the System during the 2nd quarter ended February 28, 2017 was \$31.6 million. In response to this performance, management developed a Performance Improvement Plan (the Plan) that contains specific actionable initiatives to address the current operating performance. These initiatives provide the basis for the performance improvement necessary to remediate the loss run rate experienced in the latter half of fiscal year 2016 and the first and second quarters of fiscal year 2017.

**Specifically, the System has implemented an operating plan that is designed to achieve A-category operating margins and an A-category days cash ratio.** The Plan is designed to produce significant improvements in the second half of fiscal year 2017 and continue improvements thereafter. For long-term organizational viability, we believe this to be our minimum financial performance goal.

## **Baptist Healthcare System, Inc. and Affiliates**

### **Notes to Financial Statements**

#### ***Performance Improvement Plan***

The Plan includes certain initiatives to improve operating performance. An important element of the Plan to utilize process excellence and lean daily management techniques create a culture of accountability, continuous improvement and celebration with leaders and staff as improvements are made. Another key element of the Plan is to focus on the key areas that require improvement. The key focus areas are:

1. Productivity – Improvement initiatives throughout the System are occurring at each entity across the System. In February, 2017, the System reduced its employed and contracted labor force by 336 fulltime equivalents. Approximately \$4.9 million in severance costs related to the staff reduction was accrued in February. To ensure sustainable levels of productivity across the System and to ensure that the System maintains the type of quality care for which it is known, future staff reductions in patient care areas will be based on a new method of productivity monitoring that is based on internal benchmarks and designed to encourage hospital and physician practice managers to improve on a continuous basis.
2. BHMG – Initiatives within the medical group include, but are not limited to, the redesign of hospital-to-medical group decision making processes to foster greater alignment and coordination within each market, the evaluation of and accountability for financial performance at the market “health-system” level, enhancing in-system utilization, and practice performance improvement initiatives including practice management talent development, better practice scheduling and access workflows, office staff productivity and improved revenue cycle procedures.
3. BH Plan – Immediate initiatives are focused on reducing administrative costs. The current master services agreement was recently renegotiated at a significantly reduced cost. Improvement initiatives also include pursuing other strategic alternatives including affiliation, joint venture or sale.
4. Hospital Services—evaluate the breadth of services provided in each market by considering the competitive environment, community needs and financial return.

In addition, the System had a successful installation of Epic during the current quarter earned the “*Good Install*” award as a result. Importantly, post implementation, the System has reduced the implementation support costs incurred over the past several years and is moving immediately into optimizing the technology to drive improvements and growth. Some of the value-propositions from Epic are as follows:

1. To provide interoperability and translational capabilities throughout and outside the System so every clinician and patients can access complete information within a single, integrated electronic medical record (“EMR”) across the System’s entire provider network.
2. Provide greater patient engagement and convenience. The “MyChart” module provides functionality within Epic to offer patients personalized on-line access to portions of their medical record. It enables a patient with the capability to manage and receive information about their health via the internet. Through MyChart, patients can:
  - a. Communicate with their physician or clinician;
  - b. View test results;
  - c. Request prescription refills;
  - d. Access trusted health information resources; and
  - e. Manage appointments.

## **Baptist Healthcare System, Inc. and Affiliates**

### **Notes to Financial Statements**

3. Improve practice management. Epic provides physicians and clinicians with complete medical information which reduces unnecessary duplication and expedites diagnosis and treatment. This will also provide information to more effectively manage a patient's care as they transfer from emergency care to surgical care to recovery and routine inpatient care.
4. Improve alignment with independent physicians. The Relay Health and Epic Carelink technology interfaces information with independent physicians. This capability provides a portal into Epic for independent physicians who may not be on an Epic platform. This will extend our ability to provide patient level data across the entire network to providers beyond the "walls of Baptist".
5. Value-based health. The "*Healthy Planet*" module within Epic delivers critical data to physicians and clinicians that is needed to stratify patient conditions based on risk and severity of condition. It also provides information for physicians to review and evaluate their performance in relation to Accountable Care Organization ("ACO") quality measure requirements and cost and utilization measures.
6. Revenue-Cycle. Epic provides an extensive amount of information for better work flow, payor management and contract modeling, registration information, clinical documentation and denial management and many other areas.

A second component of the Plan is to preserve and grow cash. The goal of the Plan is to grow days cash on hand to an A-category level through a capital planning and allocation process based on operating performance. To accomplish this, the Plan also includes a disciplined capital prioritization process linking capital expenditures to key strategies, patient safety, legal or regulatory requirements, and financial return. In the event that operating performance does not meet Plan expectations, capital spending will be reduced to manage cash flow to ensure continued successful progress toward the goal for days cash on hand. To accomplish growth in cash quickly, until the end of fiscal year 2019 all investment earnings will be accretive to cash, as well as a 30% retention of the cash generated from operations.

#### ***Board Communication and Accountability***

The following accountability measures will occur:

- *Finance Committee*—monthly phone meeting to review tracking scorecard.
- *System Board*—monthly summary reports to Board Members.
- *Affiliate Board Chairs*—monthly summary reports to Affiliate Boards.
- *Administrative and Affiliate Boards*—formal report at each Baptist Board and as appropriate Affiliate Board meetings.

#### ***Conclusions***

Baptist Health currently has a strong balance sheet with a low debt to capitalization ratio, solid cash to debt ratio and acceptable although weakened days cash on hand. Management understands the implications of continued operating losses. There are significant opportunities for cost reduction and revenue enhancements in all Baptist Health entities. The Baptist Health management team has a successful track record of performance built around a culture of working together. Management is resolute and determined in the successful execution of the performance improvement plan as outlined.

# Baptist Healthcare System, Inc. and Affiliates

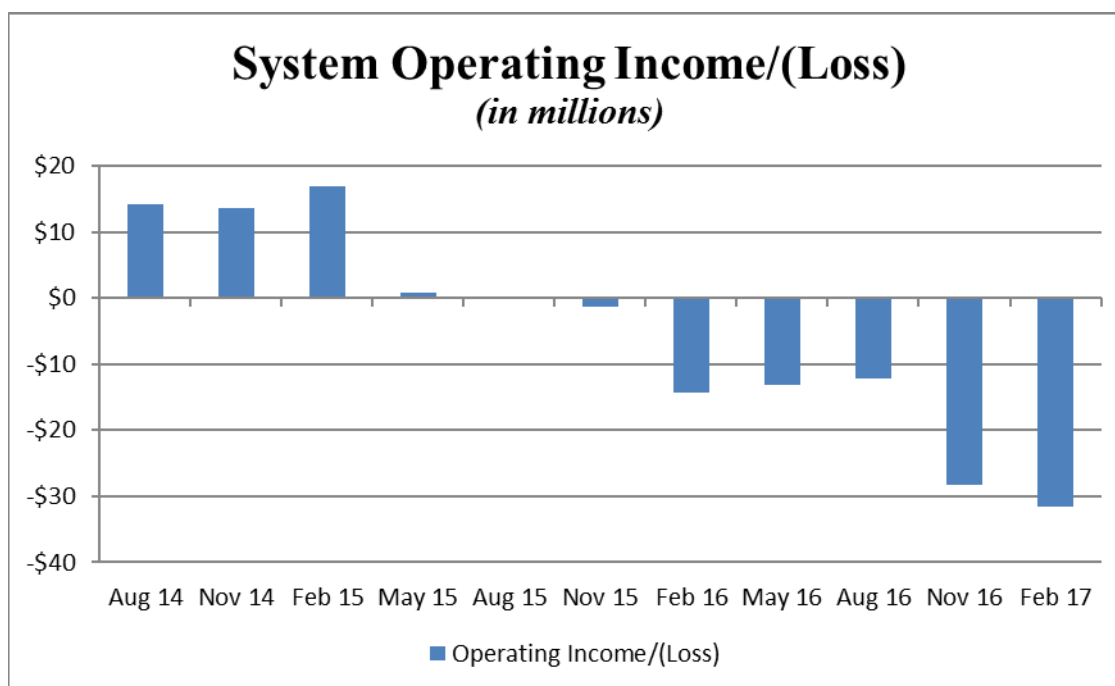
## Notes to Financial Statements

### Executive summary

The second quarter of fiscal 2017 was significantly impacted by the implementation of Epic both in terms of implementation costs as well as the disruption in operations from Epic go-lives in the Richmond and Madisonville markets. The Louisville, Lexington, Corbin and Paducah markets are stabilized from a revenue cycle perspective and beginning to see improved performance in key Epic operational metrics. System operating results for the quarter ended February 28, 2017 was a loss of \$31.7 million as compared to a loss of \$14.1 million for the previous year same quarter. The quarter performance was approximately \$17.6 million worse than the previous quarter and represented a negative margin of 4.8%.

The losses were primarily a result of:

- Epic implementation costs charged against operations while continuing to maintain the necessary legacy information systems to manage and maintain information for our hospitals not yet converted to Epic, as well as, the pre go-live information for hospitals already converted to Epic. The estimated one-time increase in operating costs was approximately \$5.0 million for the quarter ended February 28, 2017.
- A short-term reduction in patient volume related to BH RIC and BH MAD going live on Epic during the quarter plus physician practices that were converted in those markets.
- The continued investment in employed physicians' practices.
- Operating and medical claim costs related to Population Health products, losses from BHP including a net \$8.2 million premium deficiency reserve.
- Approximately \$4.9 million in severance costs related to a reduction in staff.



# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

### *System Operating Performance overview:*

#### **Patient Volume:**

As previously mentioned, despite the disruption in various markets due to Epic implementations, System hospitals still experienced solid growth in inpatient cases, surgeries and outpatient visits tempered with a modest decline in emergency visits during the quarter as compared to the prior year same quarter on a same store sales basis.

	<u>Quarter Ended February 28, 2017</u>	
	<u>Total</u>	<u>"Same Store"</u>
<u>Obligated Group patient volume % change from:</u>		
Inpatient cases	19.9%	2.4%
Surgeries	14.7%	2.1%
Deliveries	10.1%	(0.9%)
Emergency visits	16.0%	(3.4%)
Outpatient visits	28.2%	11.7%

#### **Supply Cost initiatives:**

The System continued its cost reduction initiatives in areas such as supplies and purchased services. System Supply Chain is in process of renegotiating vendor contract prices and terms to achieve savings. The System has also instituted a "Performance Excellence" program of training employees in the skills of lean management principles to better identify and rapidly implement revenue enhancement opportunities and cost savings initiatives. While we continue to experience positive results with patient supplies and purchased services, pharmaceuticals continue to be an area of focus for improvement.

The following table provides the trends of expenses to revenue:

	<u>Quarter Ended</u>					
	<u>Nov</u>	<u>Feb</u>	<u>May</u>	<u>Aug</u>	<u>Nov</u>	<u>Feb</u>
	<u>2015</u>	<u>2016</u>	<u>2016</u>	<u>2016</u>	<u>2016</u>	<u>2017</u>
<u>System Supply Efficiency Metrics:</u>						
Supplies % of total revenue	19.3%	19.3%	19.2%	20.4%	19.9%	20.4%
Purchase services % total revenue	7.3%	8.1%	7.3%	9.8%	6.7%	7.0%

#### **Investment in Physician Practices and Clinics:**

Losses in BHMG in the second quarter were approximately \$1.5 million less than the prior quarter, indicating a dramatic slowdown in the growth of the medical group, and an improvement in financial performance. Management is focused on continued improvements and has outlined specific cost reduction and revenue enhancement initiatives in a Performance Improvement Plan (discussed earlier).

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

The second quarter financial performance of BHMG as compared to the prior year same quarter reflects further investment and higher losses. Losses from our employed physician practices and clinics for the quarter ended February 28, 2017 increased by \$5.7 million over the prior year same quarter as indicated in the following chart.

*Physician Practices, Clinics and Baptist Express Care:*

	Quarter Ended		
	February 29, 2016	February 28, 2017	Change
Total revenue (in millions)	\$ 67.6	\$ 84.8	\$ 17.2
Operating loss (in millions)	\$ (46.9)	\$ (52.5)	\$ (5.7)

The number of employed physician FTEs increased by 106 and physician assistants and office staff FTEs increased by 621 from the prior year same quarter. New practices (including practices acquired through the BH FLO transaction) and growth of existing practices added over 163,000 patient encounters. Urgent care and occupational therapy visits increased by over 20,000. Selected value-added growth of employed physician practices remains one of the key strategies in the System strategic plan. The System remains committed to growing its employed physician network, but at a much slower rate than the in the past several years, and integrating System providers across the Commonwealth as it prepares for the impact of Population Health initiatives.

### Investment in Population Health: Baptist Health's shift from volume to value

In keeping with Baptist Health's mission to transform the health of the communities we serve, we have taken significant steps to incorporate population health concepts throughout our healthcare delivery system. Our population health division, Baptist Health Community Care, supports the system's population health strategies, value-based care business and wellness initiatives. These strategies also work hand-in-hand with the efforts of Baptist Health Medical Group, helping our providers to deliver the right care, at the right time, in the right place.

Baptist Health Community Care includes:

- **Baptist Health Care Partners**, a Medicare accountable care organization (ACO) made up of Baptist Health Medical Group physicians
- **Baptist Health Network Partners**, a system-wide clinically integrated network (CIN) that includes both employed and affiliated physicians
- **Baptist Health Plan**, the system's insurance arm, which provides comprehensive health benefits to individuals, families and employers
- **Outreach & Wellness**, which includes programs that create a culture of health and accountability and effectively engage participants to help them reach their health and wellness goals
- **Care Advising programs**, which allow high-risk patients to work directly with their doctors, a nurse care advisor and a care team to manage chronic health conditions or transition home after a hospital stay

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

The following are the components of the investment in Population Health:

	Quarter Ended	
	February 29, 2016	February 28, 2017
<i>(In millions)</i>		
BHCC: Baptist Health Community Care	\$ (1.8)	\$ (1.5)
ES LOU: Baptist Health Employer Solutions	(0.1)	(0.1)
BHNP: Baptist Health Network Partners	(0.1)	(0.1)
BHP: Baptist Health Plan	0.1	(14.4)
Total Population Health operating loss	<u>\$ (2.0)</u>	<u>\$ (16.1)</u>

### Obligated Group

*BHMG became a member of the Obligated Group effective January 1, 2016 and BH RIC and BH MAD became members of the Obligated Group effective November 1, 2016—all prior quarters reflect this change.*

### Patient Volume:

The Obligated Group experienced solid growth in inpatient admissions, surgeries and outpatient visits during the quarter as compared to the prior year same quarter on a same store sales basis. It is particularly important to note that these increases are despite the January, 2017 Epic go-lives at BH RIC and BH MAD along with the physician practices in those markets.

	Quarter Ended February 28, 2017	
	Total	"Same Store Sales"
<i><u>System patient volume % change from:</u></i>		
Inpatient cases	19.9%	2.4%
Surgeries	14.7%	2.1%
Deliveries	10.1%	(0.9%)
Emergency visits	16.0%	(3.4%)
Outpatient visits	26.3%	10.2%

The Obligated Group results was an operating loss of \$17.8 million for the quarter ended February 28, 2017, representing a 2.8% negative margin, an increase of \$12.9 million from the quarter ended February 29, 2016. Most of this loss was due to the Epic information systems implementation costs at BH RIC and BH MAD go-lives in January, 2017 and an unfavorable payer mix which were partially offset by higher inpatient admissions, surgical cases and outpatient visits.



**Baptist Healthcare System, Inc. and Affiliates**  
**Notes to Financial Statements**

	<b>Quarter Ended</b>	
	<b>February 29, 2016</b>	<b>February 28, 2017</b>
<i>Obligated Group:</i>		
Operating income (loss) (in millions)	\$ (4.9)	\$ (17.8)
Operating margin %	(0.9%)	(2.8%)

***System Categorical explanations:***

***Net patient service revenue:***

System net patient service revenue increased 17.8% (\$92.2 million) for the quarter ended February 28, 2017 compared to the prior year quarter ended February 29, 2016. As indicated the chart below, the increase in net patient service revenue was due to the acquisition of BH FLO (\$70.9 million), growth in inpatient cases and total surgeries at all other System hospitals as well as growth in the number of physician practices, clinics and Baptist Express Care locations. Net revenue growth was muted, however, due to a continued shift away from higher paying insurers.

	<b>Quarter Ended</b>	
	<b>February 29, 2016</b>	<b>February 28, 2017</b>
<i>Net patient service revenue (in millions):</i>		
Obligated Group	\$ 512.2	\$ 603.8
Non-Obligated Group	5.7	6.3
Total net patient service revenue	\$ 517.9	\$ 610.1

***Charity care:***

Charity care, bad debt and discounts for the uninsured, at customary charge amounts, was approximately \$35.5 million for the quarter ended February 28, 2017 compared to approximately \$33.1 million for the prior year same quarter. The increase reflected a continued shift in patients who previously had commercial coverage and now have coverage under Medicaid expansion through the Kynect program. Consequently, patients covered under these Medicaid plans have larger deductibles and coinsurance thresholds that result in an increase in charity care.

	<b>Quarter Ended</b>	
	<b>February 29, 2016</b>	<b>February 28, 2017</b>
Charity care, bad debt and discounts for uninsured	\$ 33.1	\$ 35.5

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

Prior to the Medicaid expansion, Kentucky had approximately 607,000 uninsured citizens, which represents 15% of the state's population. A comparison of February 2017 data to July-September 2013 average enrollment in Kentucky Medicaid and Kentucky Children's Health Insurance Program (KCHIP) shows an increase of 637,711 enrollees, or a 105.13% increase, compared to a national average increase of approximately 29% (Source: <http://www.medicaid.gov/Medicaid-CHIP-Program-Information/By-State/kentucky.html>). Uninsured inpatient admissions and outpatient encounters decreased 3.9% during the recent quarter compared to the prior year same quarter.

### ***Premium Revenue:***

Premium revenue for BHP was approximately \$36.9 million for the quarter ended February 28, 2017 compared to approximately \$37.1 million for the prior year same quarter. Insured membership, which includes commercial, Medicare Advantage and Kentucky exchange, increased to 37,900 at February 28, 2017, compared to 29,800 at February 29, 2016.

### ***Expenses:***

System operating expenses increased \$110.5 million (15.8%) from the quarter ended February 29, 2016 to the quarter ended February 28, 2017. BH FLO accounted for \$69.7 million or 11.8%. Salaries and benefits increased \$52.3 million (8.3%) from the prior year quarter and increased as a percentage of revenue primarily due to BH FLO of \$29.2 million (9.1%), additional physician practices acquired and the additional staff required for the implementation of Epic. Patient supplies increased \$24.6 million (22.0%) and increased as a percentage of revenue primarily due to BH FLO of \$18.0 million (16.1%). Depreciation and amortization expense increased 10.4 million (34.8%) due to the opening of the BH LEX Tower project and Epic capital deployment.

	<b>Quarter Ended</b>	
	<b>February 29, 2016</b>	<b>February 28, 2017</b>
<u>Total System Operating Expenses (in millions):</u>		
Hospital Group	\$ 422.8	\$ 497.6
Physician Practices Group	114.4	137.3
Population Health and all other	51.1	63.9
	<hr/>	<hr/>
Total System expenses	<u>\$ 588.4</u>	<u>\$ 698.8</u>
	<hr/>	
	<b>Quarter Ended</b>	
	<b>February 29, 2016</b>	<b>February 28, 2017</b>
<u>Hospital Group Operating Metrics:</u>		
Salary and benefits % of total revenue	40.8%	41.3%
Supplies % of total revenue	19.6%	21.0%
Purchased services % of total revenue	6.5%	6.9%
Full-time equivalents (FTEs)	11,410	13,533
FTE's per adjusted occupied bed - adjusted for case mix	2.6	2.7

## Baptist Healthcare System, Inc. and Affiliates

### Notes to Financial Statements

Interest expense increased \$1.5 million from \$3.2 million for the quarter ended February 29, 2016 to \$4.7 million for the quarter ended February 28, 2017. This was primarily due to a new line of credit and the additional indebtedness related to the BH FLO acquisition.

#### ***Investment gains (losses):***

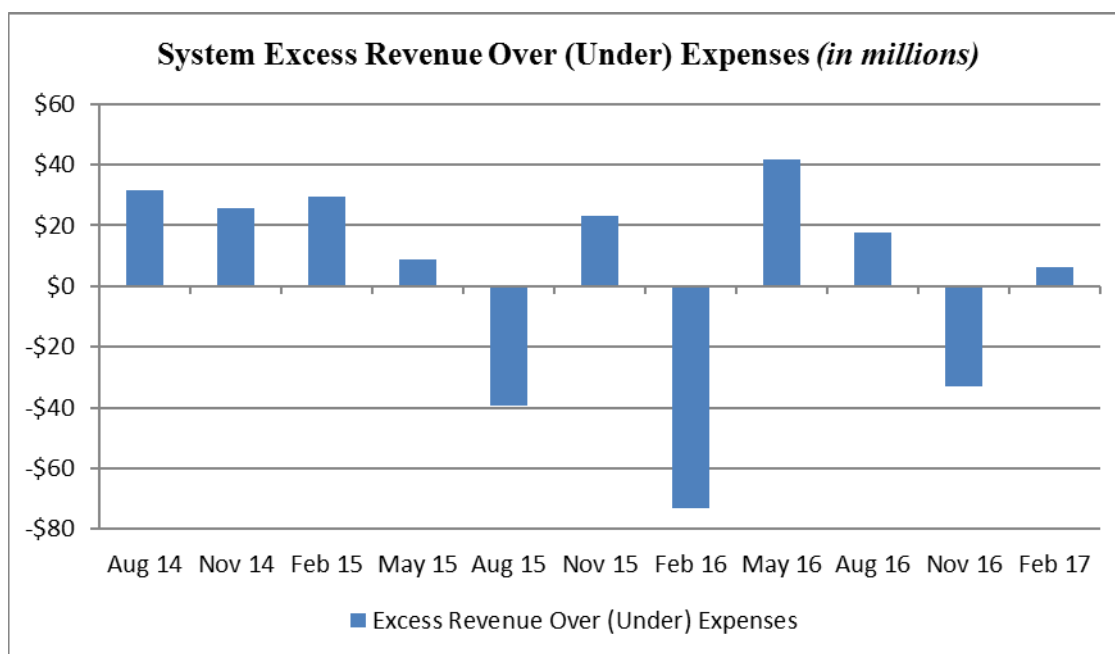
Net realized investment gains for the quarter were \$26.2 million related to interest, dividends and net realized gains. Net unrealized gains on investments were \$12.6 million for the quarter. Investment income and realized gains plus the change in market value during the quarter ended February 28, 2017 resulted in a gain of \$38.6 million compared to a loss of \$50.1 million during the prior year same quarter.

#### ***Provision for income taxes:***

The provision for income tax was \$0.3 million for the quarter ended February 28, 2017 compared to a provision of \$1.6 million in the prior year same quarter. The tax provision for the current quarter is principally related to BVI earnings while the prior year quarter provision related to both BVI earnings and a reversal of deferred tax benefits related to BHP.

#### ***Excess Revenue over Expenses:***

Improved investment performance offset the continued trend of negative operating losses for the quarter and resulted in an excess revenues over expenses of \$6.1 million for the three months ended February 28, 2017 compared \$66.3 million excess of expenses over revenues for the three months ended February 29, 2016. The following chart below indicates the trend in excess of revenues, gains and other support over (under) expenses:



## **Baptist Healthcare System, Inc. and Affiliates**

### **Notes to Financial Statements**

#### ***Balance sheet:***

At February 28, 2017, the fair value of the System's cash and total investments was \$1.025 billion, representing a decrease of \$1.6 million from the fair value at February 29, 2016.

#### ***Key Ratios:***

- Total Days Cash for the System was 141 days as of February 28, 2017, representing a decrease of 29 days from February 29, 2016.
- Days in Net Patient Accounts Receivable for the System and the Obligated Group were 61 days at February 28, 2017 representing an increase of 5 days from February 29, 2016.

#### ***Debt financing:***

BHS is contemplating the sale of what would be Series 2017 Bonds to be used to (i) pay or to reimburse the System for approximately \$115,000,000 in costs for construction, acquisition, installation, renovation and equipping of health care and health related properties and facilities of the Obligated Group, (ii) refinance a portion of the \$146,600,000 Term Loan Credit Commitment from Bank of America, N.A. to BHS (the "*Bridge Loan*"), related to the acquisition by BHS on October 1, 2016 of substantially all of the assets of the Board of Trustees of Floyd Memorial Hospital and Health Services located in New Albany, Indiana, and its affiliates (the "*Floyd Acquisition*"), and (iii) pay certain costs of issuing the Series 2017 Bonds. The anticipated date of closing is on or about May 31, 2017.

#### ***Epic implementation:***

The System began implementing a new enterprise resource planning (ERP) system effective September 1, 2015 and has completed its implementation of Epic, its new electronic health record, with the exception of BH FLO. BH LOU and BH LAG went live on Epic in early March 2016, BH LEX and BH COR went live in early June 2016, BH PAD went live in early September 2016 and BH RIC and BH MAD went live in January 2017. The related implementation, training and go-live support costs BH RIC and BH MAD are reflected in the operating results for the quarter ended February 28, 2017.

---

**OBLIGATED GROUP  
FINANCIAL STATEMENTS  
AND OPERATING STATISTICS**

For the quarter and six months ended  
February 28, 2017

---

## Consolidated Obligated Group Balance Sheets

	Unaudited February 28, 2017	Unaudited August 31, 2016
<b>Assets</b>		
<b>Current assets</b>		
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 130,975	\$ 93,901
Investments	4,281	2,734
Assets limited as to use--required for current obligations	19,741	19,866
Patient accounts receivable, net of contractual allowances and doubtful accounts: Feb '17--\$1,073,535; and Aug '16--\$979,170	405,822	353,774
Inventories	42,967	37,442
Other	84,950	82,918
Total current assets	<u>688,736</u>	<u>590,635</u>
<b>Assets limited as to use</b>		
Designated by Board for capital improvements	806,495	847,258
Held by trustee--asset purchase agreement	-	30,475
Held by trustee--donor restricted	4,898	4,733
Held by trustee--medical malpractice	69,981	72,685
Held by trustee--workers compensation	24,367	21,660
Held by trustee--perpetual trust	20,838	19,977
Less--required for current liabilities	<u>(19,741)</u>	<u>(19,866)</u>
Assets limited as to use	<u>906,838</u>	<u>976,922</u>
<b>Intercompany assets</b>	25,045	-
<b>Property and equipment, net</b>	1,303,054	1,162,655
<b>Other assets</b>	66,211	53,097
Total assets	<u><u>\$ 2,989,884</u></u>	<u><u>\$ 2,783,309</u></u>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities</b>		
Current installments of long-term debt and notes payable	\$ 217,683	\$ 63,983
Accounts payable	95,068	112,641
Accrued expenses	137,329	134,438
Estimated third party payor settlements	25,884	19,646
Accrued interest payable	953	929
Current portion of liability for medical malpractice	19,741	19,866
Other current liabilities	29,724	958
Total current liabilities	<u>526,382</u>	<u>352,461</u>
<b>Intercompany liabilities</b>		59,807
<b>Long-term debt</b>	659,887	568,493
<b>Other liabilities</b>	167,610	165,788
<b>Net assets</b>		
Unrestricted net assets attributable to Baptist	1,612,286	1,613,875
Temporarily restricted	3,251	3,266
Permanently restricted	20,468	19,619
Total net assets	<u>1,636,005</u>	<u>1,636,760</u>
Total liabilities and net assets	<u><u>\$ 2,989,884</u></u>	<u><u>\$ 2,783,309</u></u>

## Consolidated Obligated Group Statement of Operations

	Unaudited		Unaudited	
	Quarter Ended February,		Six Months Ended February,	
	2017	2016	2017	2016
	(In Thousands)		(In Thousands)	
<b>Unrestricted revenues, gains and other support</b>				
Net patient service revenue (net of contractual discounts and allowances)	\$ 628,791	\$ 537,945	\$ 1,244,471	\$ 1,068,943
Provision for uncollectible accounts	17,013	18,258	40,704	33,504
Net patient service revenue	611,778	519,687	1,203,767	1,035,439
Other	14,307	15,095	29,511	29,460
Net assets released from restrictions used for operations	125	113	265	239
Total revenues, gains and other support	626,210	534,895	1,233,543	1,065,138
<b>Expenses</b>				
Salaries and benefits	366,378	314,501	730,052	615,191
Supplies	134,084	109,620	260,791	220,626
Purchased services	54,303	46,039	104,035	92,462
Utilities	7,856	6,404	16,340	13,609
Interest	4,696	3,155	10,898	6,396
Depreciation and amortization	39,515	29,294	74,793	56,386
Administration and other	27,179	24,537	55,987	51,163
Provider tax	9,957	6,231	18,366	12,440
Total expenses	643,968	539,781	1,271,262	1,068,273
<b>Operating income (loss)</b>	(17,758)	(4,886)	(37,719)	(3,135)
<b>Other gains (losses)</b>				
Investment income	25,922	(1,473)	32,429	1,883
Unrealized gains/(losses)	12,786	(43,315)	3,324	(29,387)
Other	(37)	72	(30)	37
Total other gains (losses)	38,671	(44,716)	35,723	(27,467)
<b>Excess of revenues, gains and other support over (under) expenses before provision (benefit) for income tax</b>	20,913	(49,602)	(1,996)	(30,602)
<b>Provision (benefit) for income tax</b>	40	46	41	46
<b>Excess of revenues, gains and other support over (under) expenses</b>	<u>\$ 20,873</u>	<u>\$ (49,648)</u>	<u>\$ (2,037)</u>	<u>\$ (30,648)</u>

## Consolidated Obligated Group Statement of Changes in Net Assets

	Unaudited		Unaudited	
	Quarter Ended February,		Six Months Ended February,	
	2017	2016	2017	2016
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
<b>Unrestricted net assets:</b>				
Excess of revenues, gains and other support over (under) expenses	\$ 20,873	\$ (49,648)	\$ (2,037)	\$ (30,648)
Net assets released from restrictions for capital	1,204	-	1,204	-
Net asset transfers and other activity	(735)	(189)	(756)	(451)
Increase/(decrease) in unrestricted net assets	21,342	(49,837)	(1,589)	(31,099)
<b>Temporarily restricted net assets</b>				
Contributions and interest income	191	231	250	378
Net assets released from restrictions used for operations	(125)	(113)	(265)	(239)
Increase/(decrease) in temporarily restricted net assets	66	118	(15)	139
<b>Permanently restricted net assets</b>				
Change in beneficial interest in perpetual trust	337	(2,046)	849	(1,527)
Increase/(decrease) permanently restricted net assets	337	(2,046)	849	(1,527)
<b>Change in net assets</b>	21,745	(51,765)	(755)	(32,487)
<b>Net assets, beginning of period</b>	1,614,260	1,631,488	1,636,760	1,612,210
<b>Net assets, end of period</b>	<u>\$ 1,636,005</u>	<u>\$ 1,579,723</u>	<u>\$ 1,636,005</u>	<u>\$ 1,579,723</u>



## Consolidated Obligated Group Statement of Cash Flows

	Unaudited		Unaudited	
	Quarter Ended February 28/29,		Six Months Ended February 28/29,	
	2017	2016	2017	2016
<b>Operating activities</b>	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Changes in net assets	\$ 21,745	\$ (51,765)	\$ (755)	\$ (32,487)
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Depreciation and amortization	39,515	29,294	74,793	56,386
Net asset transfers	735	190	756	451
Restricted contributions, income and other	(191)	(230)	(250)	(378)
Net realized and unrealized losses/(gains) on investments	(35,596)	50,393	(30,225)	35,746
Equity in net earnings (losses) of joint ventures	505	(785)	(1,238)	(1,888)
Distributions from joint ventures	1,240	1,511	2,044	1,511
Loss (gain) on disposal of equipment	161	-	113	28
Change in beneficial trust	(337)	2,046	(849)	1,527
Changes in:				
Patient accounts receivable, net	(1,870)	(7,532)	(13,455)	(49,315)
Inventories and other current assets	(28,941)	(12,353)	(23,258)	(654)
Other assets	4,264	(50,402)	2,005	422
Accounts payable and accrued expenses	(48,429)	22,994	(43,020)	33,179
Estimated third-party payor settlements	(6,252)	(164)	(1,841)	144
Other current liabilities	(994)	(4,517)	406	366
Other liabilities	(4,430)	2,344	4,210	10,694
Net cash provided by operating activities	(58,875)	(18,976)	(30,564)	55,732
<b>Investing activities</b>				
Purchase of investments	(1,069,797)	(815,914)	(2,022,160)	(1,866,366)
Proceeds from disposition of investments	1,184,784	834,716	2,139,988	1,901,259
Purchase of property and equipment, net	(25,094)	(56,964)	(52,857)	(108,742)
Proceeds from sale of property and equipment	1	8	36	14
Net asset transfers	(735)	(190)	(756)	(451)
Acquisition of Floyd Memorial and other operations	49,038	-	(129,000)	(5,519)
Net cash used in investing activities	138,197	(38,344)	(64,749)	(79,805)
<b>Financing activities</b>				
Contributions from noncontrolling interest				
Distributions to noncontrolling interest				
Proceeds from issuance of debt	(46,600)	18,683	161,000	18,683
Net cost of issuance of debt	(20)	(60)	(158)	(60)
Proceeds from/(payments on) intercompany accounts	(18,410)	5,052	(20,927)	(15,975)
Capital lease and notes payable payments	(1,667)	(587)	(1,678)	(587)
Principal payments on long-term debt	(6,100)	(18,183)	(6,100)	(18,677)
Restricted contributions, income and other	191	230	250	378
Net cash from/(used in) financing activities	(72,606)	5,135	132,387	(16,238)
<b>Increase/(decrease) in cash and cash equivalents</b>	6,716	(52,185)	37,074	(40,311)
<b>Cash and cash equivalents, beginning of period</b>	124,259	167,150	93,901	155,276
<b>Cash and cash equivalents, end of period</b>	<u>\$ 130,975</u>	<u>\$ 114,965</u>	<u>\$ 130,975</u>	<u>\$ 114,965</u>

## Obligated Group Operating Statistics

Presented below is a summary of the locations, the number of licensed beds and beds in operation as of February 28, 2017, and the percentage of the Obligated Group's net patient service revenue from each of the Obligated Group hospitals for the six months ended February 28, 2017.

### Obligated Group Hospitals:

Hospital	Location	Acute Care Beds		Sub-acute and Long-Term Beds		Total Beds		Patient Service Revenue %
		Licensed	Operating	Licensed	Operating	Licensed	Operating	
BH COR	Corbin, KY	194 (a)	161	79	79	273	240	8.0
BH LEX	Lexington, KY	391	362	-	-	391	362	25.4
BH RIC	Richmond, KY	105	64	-	-	105	64	4.0
BH LAG	LaGrange, KY	90	65	30	24	120	89	5.4
BH LOU	Louisville, KY	468	449	51	51	519	500	25.3
BH FLO	New Albany, IN	243	243	-	-	243	243	11.4
BH MAD	Madisonville, KY	348 (a)	163	62	51	410	214	7.8
BH PAD	Paducah, KY	349 (a)	288	24	24	373	312	12.7
<b>Total</b>		<b>2,188</b>	<b>1,795</b>	<b>246</b>	<b>229</b>	<b>2,434</b>	<b>2,024</b>	<b>100.0</b>

(a) CHC Community Care, LLC is leasing 32 beds under the BH COR hospital license, 36 beds under the BH MAD hospital license and 37 beds under the BH PAD hospital license.

Following is the licensed bed complement by medical service for each Obligated Group hospital as of February 28, 2017.

Medical Services	BH COR	BH LEX	BH RIC	BH LAG	BH LOU	BH FLO	BH MAD	BH PAD	Total Obligated Group
General:									
Medical/surgical	136	255	76	74	391	177	244	223	1,576
Pediatric	3	8	-	8	-	10	29	18	76
Obstetrical	5	52	21	4	35	19	20	25	181
Coronary care	-	12	-	4	16	16	-	12	60
Intensive care	10	32	8	-	18	16	30	20	134
Neonatal	8	32	-	-	8	-	9	14	71
Chemical dependency	15	-	-	-	-	5	-	-	20
Psychiatric	44	-	-	-	22	-	22	-	88
Rehabilitation	20	-	-	-	29	-	-	-	49
Nursing facility	-	-	-	30	-	-	20	24	74
Long-term acute care	32	-	-	-	-	-	36	37	105
	<u>273</u>	<u>391</u>	<u>105</u>	<u>120</u>	<u>519</u>	<u>243</u>	<u>410</u>	<u>373</u>	<u>2,434</u>

Each Obligated Group entity provides compensation and a range of benefits competitive with other health care providers within the respective market. No employees are represented by a labor union. Management considers relations with employees to be positive. Presented below is a summary of employees as of February 28, 2017.

	Full-time	Part-time	Total Employees	Full-time Equivalents
BH LOU	2,166	1,304	3,470	2,787
BH LAG	343	209	552	430
BH FLO	1,839	722	2,561	1,747
BH COR	1,102	261	1,363	1,108
BH LEX	2,070	836	2,906	2,305
BH PAD	1,371	316	1,687	1,389
BH RIC	444	207	651	490
BH MAD	1,116	403	1,519	1,042
Employed Physicians and Support Staff	2,911	445	3,356	3,462
Support Services	1,926	111	2,037	2,075
Home Care	216	85	301	305
Baptist Health Community Care	34	1	35	45
<b>Obligated Group</b>	<b>15,538</b>	<b>4,900</b>	<b>20,438</b>	<b>17,185</b>
Non-obligated group entities:				
Bluegrass Family Health, Inc.	143	2	145	145
Baptist Community Health Services	105	99	204	145
Other	61	35	96	63
<b>Total</b>	<b>15,847</b>	<b>5,036</b>	<b>20,883</b>	<b>17,538</b>

## Obligated Group Admissions and Charges By Payer

	Quarter Ended February		Six months ended February	
	2017	2016	2017	2016
<b>Admissions:</b>				
Medicare	36.6 %	34.9 %	35.2 %	34.7 %
Medicare advantage	11.8	10.7	11.3	10.6
Total Medicare	48.4	45.6	46.4	45.4
Medicaid	1.3	1.2	1.4	1.3
Medicaid managed care	18.9	17.9	20.1	19.3
Total Medicaid	20.3	19.1	21.5	20.6
Blue Cross	15.2	14.7	15.8	15.7
PPO	8.6	9.7	8.8	9.4
Commercial and other	6.1	5.4	6.1	5.4
Total other insurance	29.9	29.7	30.6	30.5
Total insured	98.6	94.4	98.6	96.4
Total uninsured	1.4	5.6	1.4	3.6
Total	100.0 %	100.0 %	100.0 %	100.0 %
<b>Gross charges:</b>				
Medicare	36.1 %	36.5 %	36.0 %	36.5 %
Medicare advantage	14.0	12.6	14.1	12.9
Total Medicare	50.2	49.2	50.1	49.4
Medicaid	1.8	1.3	0.9	1.1
Medicaid managed care	12.8	13.0	14.0	13.6
Total Medicaid	14.6	14.2	14.9	14.7
Blue Cross	18.0	18.7	18.1	18.5
PPO	8.9	10.1	1.6	1.2
Commercial and other	7.1	6.8	14.2	15.1
Total other insurance	34.0	35.5	33.8	34.8
Total insured	98.7	98.9	98.8	98.9
Total uninsured	1.3	1.1	1.2	1.1
Total	100.0 %	100.0 %	100.0 %	100.0 %

# Obligated Group

## Net Patient Service Revenue By Payer

	Quarter Ended February		Six months ended February	
	2017	2016	2017	2016
<b>Net patient service revenue:</b>				
Medicare	26.8 %	27.4 %	24.9 %	26.0 %
Medicare advantage	9.7	8.1	9.1	7.9
Total Medicare	36.5	35.5	34.0	33.9
Medicaid	2.2	1.1	1.5	0.9
Medicaid managed care	9.4	11.6	9.5	11.2
Total Medicaid	11.6	12.8	11.0	12.1
Blue Cross	23.1	24.1	22.3	22.6
PPO	12.9	14.5	1.6	1.1
Commercial and other	8.7	7.7	23.9	25.6
Total other insurance	44.7	46.4	47.8	49.3
Total insured	92.8	94.6	92.8	95.3
Total patient liability	6.5	5.2	6.5	4.4
Total uninsured	0.7	0.1	0.8	0.3
Total	100.0 %	100.0 %	100.0 %	100.0 %

## Obligated Group Patient Utilization

	Quarter Ended February		Six Months Ended February	
	2017	2016	2017	2016
<b>Inpatient Acute (1):</b>				
Patient days	100,547	87,984	193,911	173,217
Admissions	22,543	18,343	43,949	37,182
Average length of stay	4.5	4.8	4.4	4.7
 Beds available	 1,816	 1,546	 1,767	 1,539
% occupancy - available	61.5%	63.2%	60.6%	62.2%
 Beds licensed	 2,188	 1,937	 2,138	 1,937
% occupancy - licensed	51.1%	50.5%	50.1%	49.4%
 <b>Inpatient sub-acute/long term:</b>				
Patient days	10,907	10,666	22,079	21,739
Admissions	1,435	1,649	2,805	2,684
Average length of stay	7.6	6.5	7.9	8.1
 Beds available	 227	 218	 229	 221
% occupancy - available	53.3%	54.4%	53.3%	54.4%
 Beds licensed	 246	 246	 246	 246
% occupancy - licensed	49.3%	48.2%	49.6%	48.8%
 <b>Inpatient total:</b>				
Patient days	111,454	98,650	215,990	194,956
Admissions	23,978	19,992	46,754	39,866
Average length of stay	4.6	4.9	4.6	4.9
 Beds available	 2,043	 1,764	 1,995	 1,759
% occupancy - available	60.6%	62.1%	59.8%	61.2%
 Beds licensed	 2,434	 2,183	 2,384	 2,183
% occupancy - licensed	50.9%	50.2%	50.1%	49.3%
 <b>Medicare &amp; Medicaid:</b>				
Medicare patient days	66,544	56,435	126,907	110,764
Medicare admissions	12,341	9,895	23,485	19,591
Average length of stay	5.4	5.7	5.4	5.7
Medicare % total - days	59.7%	57.2%	58.8%	56.8%
 Medicaid patient days	 17,189	 16,975	 34,165	 34,117
Medicaid admissions	4,258	4,060	8,548	8,053
Average length of stay	4.0	4.2	4.0	4.2
Medicaid % total - days	15.4%	17.2%	15.8%	17.5%
 <b>Other hospital-based stats:</b>				
Deliveries	2,800	2,544	5,836	5,295
Inpatient surgery cases	7,594	6,512	14,831	12,924
Outpatient surgery cases	18,108	15,894	35,498	31,160
Emergency room visits	71,548	61,700	141,196	124,888
Other outpatient registrations	382,417	302,839	751,830	613,374
 Medicare case mix index (MS-DRG)	 1.78	 1.79	 1.78	 1.79
Overall case mix index (MS-DRG)	1.65	1.64	1.63	1.61

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health Louisville (BH LOU)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	59,980	61,812	61,264
Admissions	13,680	12,769	12,672
Average length of stay	4.4	4.8	4.8
 Beds available	 449	 449	 445
% occupancy - available	73.8%	76.1%	76.1%
 Beds licensed	 468	 468	 468
% occupancy - licensed	70.8%	73.0%	72.3%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	4,431	4,642	4,512
Admissions	438	461	523
Average length of stay	10.1	10.1	8.6
 Beds available	 51	 51	 51
% occupancy - available	48.0%	50.3%	48.9%
 Beds licensed	 51	 51	 51
% occupancy - licensed	48.0%	50.3%	48.9%
 <b>Inpatient total:</b>			
Patient days	64,411	66,454	65,776
Admissions	14,118	13,230	13,195
Average length of stay	4.6	5.0	5.0
 Beds available	 500	 500	 496
% occupancy - available	71.2%	73.4%	73.3%
 Beds licensed	 519	 519	 519
% occupancy - licensed	68.6%	70.7%	70.0%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	40,610	41,199	41,487
Medicare admissions	7,344	7,176	7,284
Average length of stay	5.5	5.7	5.7
Medicare % total - days	63.0%	62.0%	63.1%
 Medicaid patient days	 6,299	 6,158	 5,432
Medicaid admissions	1,665	1,257	1,200
Average length of stay	3.8	4.9	4.5
Medicaid % total - days	9.8%	9.3%	8.3%
 <b>Other hospital-based stats:</b>			
Deliveries	1,633	1,361	1,456
Inpatient surgery cases	5,632	5,410	5,427
Outpatient surgery cases	12,778	12,274	12,592
Emergency room visits	26,112	26,706	27,366
Other outpatient registrations	174,378	145,816	147,854
 Medicare case mix index (MS-DRG)	 1.89	 1.86	 1.76
Overall case mix index (MS-DRG)	1.74	1.72	1.62

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health LaGrange (BH LAG)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	3,870	3,654	3,882
Admissions	1,103	1,008	1,112
Average length of stay	3.5	3.6	3.5
 Beds available	 65	 65	 65
% occupancy - available	32.9%	31.1%	33.0%
 Beds licensed	 90	 90	 90
% occupancy - licensed	23.8%	22.4%	23.8%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	2,624	2,708	3,136
Admissions	106	126	139
Average length of stay	24.8	21.5	22.6
 Beds available	 24	 24	 24
% occupancy - available	60.4%	62.3%	72.2%
 Beds licensed	 30	 30	 30
% occupancy - licensed	48.3%	49.9%	57.8%
 <b>Inpatient total:</b>			
Patient days	6,494	6,362	7,018
Admissions	1,209	1,134	1,251
Average length of stay	5.4	5.6	5.6
 Beds available	 89	 89	 89
% occupancy - available	40.3%	39.5%	43.6%
 Beds licensed	 120	 120	 120
% occupancy - licensed	29.9%	29.3%	32.3%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	4,686	3,812	4,533
Medicare admissions	586	466	567
Average length of stay	8.0	8.2	8.0
Medicare % total - days	72.2%	59.9%	64.6%
 Medicaid patient days	 966	 1,416	 1,333
Medicaid admissions	348	357	366
Average length of stay	2.8	4.0	3.6
Medicaid % total - days	14.9%	22.3%	19.0%
 <b>Other hospital-based stats:</b>			
Deliveries	257	253	275
Inpatient surgery cases	352	289	333
Outpatient surgery cases	1,638	1,502	1,550
Emergency room visits	6,853	7,023	7,132
Other outpatient registrations	63,034	59,090	51,914
 Medicare case mix index (MS-DRG)	 1.63	 1.59	 1.51
Overall case mix index (MS-DRG)	1.39	1.33	1.26

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health Floyd (BH FLO)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	23,850	-	-
Admissions	5,807	-	-
Average length of stay	4.1	-	-
 Beds available	 243	 -	 -
% occupancy - available	54.2%	0.0%	0.0%
 Beds licensed	 243	 -	 -
% occupancy - licensed	54.2%	0.0%	0.0%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	-	-	-
Admissions	-	-	-
Average length of stay	-	-	-
 Beds available	 -	 -	 -
% occupancy - available	0.0%	0.0%	0.0%
 Beds licensed	 -	 -	 -
% occupancy - licensed	0.0%	0.0%	0.0%
 <b>Inpatient total:</b>			
Patient days	23,850	-	-
Admissions	5,807	-	-
Average length of stay	4.1	-	-
 Beds available	 243	 -	 -
% occupancy - available	54.2%	0.0%	0.0%
 Beds licensed	 243	 -	 -
% occupancy - licensed	54.2%	0.0%	0.0%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	15,698	-	-
Medicare admissions	3,455	-	-
Average length of stay	4.5	-	-
Medicare % total - days	65.8%	0.0%	0.0%
 Medicaid patient days	 1,958	 -	 -
Medicaid admissions	372	-	-
Average length of stay	5.3	-	-
Medicaid % total - days	8.2%	0.0%	0.0%
 <b>Other hospital-based stats:</b>			
Deliveries	482	-	-
Inpatient surgery cases	1,847	-	-
Outpatient surgery cases	3,053	-	-
Emergency room visits	19,638	-	-
Other outpatient registrations	80,929	-	-
 Medicare case mix index (MS-DRG)	 1.76	 -	 -
Overall case mix index (MS-DRG)	1.65	-	-

(1) Excludes normal newborn



**Obligated Group Utilization**  
**Baptist Health Corbin (BH COR)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	14,004	14,326	13,810
Admissions	3,206	3,320	3,232
Average length of stay	4.4	4.3	4.3
 Beds available	 161	 161	 161
% occupancy - available	48.1%	49.2%	47.4%
 Beds licensed	 194	 194	 194
% occupancy - licensed	39.9%	40.8%	39.3%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	7,801	8,226	7,228
Admissions	1,400	1,517	1,165
Average length of stay	5.6	5.4	6.2
 Beds available	 79	 79	 79
% occupancy - available	54.6%	57.5%	50.5%
 Beds licensed	 79	 79	 79
% occupancy - licensed	54.6%	57.5%	50.5%
 <b>Inpatient total:</b>			
Patient days	21,805	22,552	21,038
Admissions	4,606	4,837	4,397
Average length of stay	4.7	4.7	4.8
 Beds available	 240	 240	 240
% occupancy - available	50.2%	51.9%	48.4%
 Beds licensed	 273	 273	 273
% occupancy - licensed	44.1%	45.6%	42.6%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	12,505	11,785	11,715
Medicare admissions	2,075	2,033	1,988
Average length of stay	6.0	5.8	5.9
Medicare % total - days	57.3%	52.3%	55.7%
 Medicaid patient days	 6,853	 8,302	 6,869
Medicaid admissions	1,878	2,151	1,798
Average length of stay	3.6	3.9	3.8
Medicaid % total - days	31.4%	36.8%	32.7%
 <b>Other hospital-based stats:</b>			
Deliveries	421	460	443
Inpatient surgery cases	883	848	802
Outpatient surgery cases	3,075	3,238	3,029
Emergency room visits	21,096	22,728	22,803
Other outpatient registrations	70,012	68,053	64,733
 Medicare case mix index (MS-DRG)	 1.47	 1.46	 1.35
Overall case mix index (MS-DRG)	1.30	1.25	1.17

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health Lexington (BH LEX)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	45,147	42,338	40,724
Admissions	9,629	9,186	8,838
Average length of stay	4.7	4.6	4.6
 Beds available	 362	 344	 344
% occupancy - available	68.9%	68.0%	65.4%
 Beds licensed	 391	 383	 383
% occupancy - licensed	63.8%	61.1%	58.7%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	-	-	-
Admissions	-	-	-
Average length of stay	-	-	-
 Beds available	 -	 -	 -
% occupancy - available	0.0%	0.0%	0.0%
 Beds licensed	 -	 -	 -
% occupancy - licensed	0.0%	0.0%	0.0%
 <b>Inpatient total:</b>			
Patient days	45,147	42,338	40,724
Admissions	9,629	9,186	8,838
Average length of stay	4.7	4.6	4.6
 Beds available	 362	 344	 344
% occupancy - available	68.9%	68.0%	65.4%
 Beds licensed	 391	 383	 383
% occupancy - licensed	63.8%	61.1%	58.7%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	23,449	23,004	21,389
Medicare admissions	4,375	4,271	4,053
Average length of stay	5.4	5.4	5.3
Medicare % total - days	51.9%	54.3%	52.5%
 Medicaid patient days	 8,542	 7,296	 7,209
Medicaid admissions	1,805	1,671	1,607
Average length of stay	4.7	4.4	4.5
Medicaid % total - days	18.9%	17.2%	17.7%
 <b>Other hospital-based stats:</b>			
Deliveries	1,726	1,715	1,673
Inpatient surgery cases	3,179	3,213	3,129
Outpatient surgery cases	2,625	2,717	2,549
Emergency room visits	20,322	19,761	18,815
Other outpatient registrations	158,563	145,508	127,552
 Medicare case mix index (MS-DRG)	 1.97	 1.92	 1.87
Overall case mix index (MS-DRG)	1.74	1.70	1.65

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health Paducah (BH PAD)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	23,584	27,442	27,118
Admissions	5,348	5,933	5,867
Average length of stay	4.4	4.6	4.6
 Beds available	 288	 297	 288
% occupancy - available	45.2%	51.1%	52.0%
 Beds licensed	 349	 349	 349
% occupancy - licensed	37.3%	43.4%	42.9%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	2,332	1,662	3,011
Admissions	236	151	314
Average length of stay	9.9	11.0	9.6
 Beds available	 24	 16	 24
% occupancy - available	53.7%	58.6%	69.3%
 Beds licensed	 24	 24	 24
% occupancy - licensed	53.7%	38.3%	69.3%
 <b>Inpatient total:</b>			
Patient days	25,916	29,104	30,129
Admissions	5,584	6,084	6,181
Average length of stay	4.6	4.8	4.9
 Beds available	 312	 312	 312
% occupancy - available	45.9%	51.5%	53.4%
 Beds licensed	 373	 373	 373
% occupancy - licensed	38.4%	43.1%	44.6%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	15,181	17,047	18,088
Medicare admissions	2,929	3,108	3,345
Average length of stay	5.2	5.5	5.4
Medicare % total - days	58.6%	58.6%	60.0%
 Medicaid patient days	 4,358	 5,358	 4,974
Medicaid admissions	1,057	1,247	1,114
Average length of stay	4.1	4.3	4.5
Medicaid % total - days	16.8%	18.4%	16.5%
 <b>Other hospital-based stats:</b>			
Deliveries	652	687	678
Inpatient surgery cases	1,778	2,016	1,969
Outpatient surgery cases	7,023	6,557	4,667
Emergency room visits	18,438	19,217	17,892
Other outpatient registrations	91,228	86,778	81,091
 Medicare case mix index (MS-DRG)	 1.72	 1.74	 1.66
Overall case mix index (MS-DRG)	1.59	1.63	1.57

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health Richmond (BH RIC)**  
**Six months ended February**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Inpatient Acute (1):</b>			
Patient days	5,787	5,853	6,661
Admissions	1,440	1,503	1,540
Average length of stay	4.0	3.9	4.3
 Beds available	 64	 64	 64
% occupancy - available	50.0%	50.5%	57.5%
 Beds licensed	 105	 105	 105
% occupancy - licensed	30.4%	30.8%	35.0%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	-	-	-
Admissions	-	-	-
Average length of stay	-	-	-
 Beds available	 -	 -	 -
% occupancy - available	0.0%	0.0%	0.0%
 Beds licensed	 -	 -	 -
% occupancy - licensed	0.0%	0.0%	0.0%
 <b>Inpatient total:</b>			
Patient days	5,787	5,853	6,661
Admissions	1,440	1,503	1,540
Average length of stay	4.0	3.9	4.3
 Beds available	 64	 64	 64
% occupancy - available	50.0%	50.5%	57.5%
 Beds licensed	 105	 105	 105
% occupancy - licensed	30.4%	30.8%	35.0%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	3,598	3,345	4,178
Medicare admissions	738	761	811
Average length of stay	4.9	4.4	5.2
Medicare % total - days	62.2%	57.2%	62.7%
 Medicaid patient days	 1,329	 1,540	 1,639
Medicaid admissions	429	464	456
Average length of stay	3.1	3.3	3.6
Medicaid % total - days	23.0%	26.3%	24.6%
 <b>Other hospital-based stats:</b>			
Deliveries	312	361	335
Inpatient surgery cases	469	498	530
Outpatient surgery cases	3,012	2,786	2,602
Emergency room visits	15,540	15,938	16,887
Other outpatient registrations	37,511	36,003	38,336
 Medicare case mix index (MS-DRG)	 1.56	 1.60	 1.49
Overall case mix index (MS-DRG)	1.36	1.39	1.27

(1) Excludes normal newborn

**Obligated Group Utilization**  
**Baptist Health Madisonville (BH MAD)**  
**Six months ended February**

	2017	2016	2015
<b>Inpatient Acute (1):</b>			
Patient days	17,689	17,792	17,936
Admissions	3,736	3,463	3,632
Average length of stay	4.7	5.1	4.9
 Beds available	163	159	156
% occupancy - available	60.1%	61.8%	63.5%
 Beds licensed	348	348	370
% occupancy - licensed	28.1%	28.2%	26.8%
 <b>Inpatient sub-acute/long term:</b>			
Patient days	4,891	4,501	3,820
Admissions	625	429	411
Average length of stay	7.8	10.5	9.3
 Beds available	51	51	40
% occupancy - available	53.3%	48.8%	52.8%
 Beds licensed	62	62	40
% occupancy - licensed	43.6%	40.1%	52.8%
 <b>Inpatient total:</b>			
Patient days	22,580	22,293	21,756
Admissions	4,361	3,892	4,043
Average length of stay	5.2	5.7	5.4
 Beds available	213	210	196
% occupancy - available	58.5%	58.7%	61.3%
 Beds licensed	410	410	410
% occupancy - licensed	30.4%	30.0%	29.3%
 <b>Medicare &amp; Medicaid:</b>			
Medicare patient days	11,180	10,572	10,386
Medicare admissions	1,983	1,776	1,818
Average length of stay	5.6	6.0	5.7
Medicare % total - days	49.5%	47.4%	47.7%
 Medicaid patient days	3,860	4,047	3,160
Medicaid admissions	994	906	848
Average length of stay	3.9	4.5	3.7
Medicaid % total - days	17.1%	18.2%	14.5%
 <b>Other hospital-based stats:</b>			
Deliveries	353	458	461
Inpatient surgery cases	691	650	785
Outpatient surgery cases	2,294	2,086	2,168
Emergency room visits	13,197	13,515	14,374
Other outpatient registrations	76,175	72,126	53,875
 Medicare case mix index (MS-DRG)	1.64	1.71	1.57
Overall case mix index (MS-DRG)	1.53	1.58	1.43

(1) Excludes normal newborn

**Non-Obligated Group Utilization**  
**Bluegrass Family Health dba Baptist Health Plan (BHP)**  
**Six months ended February**

	<b>2017</b>				
	<b>KY</b>	<b>IN</b>	<b>TN</b>	<b>Out of Area</b>	<b>Total</b>
<b>Members</b>					
Commercial Members	29,422	227	-	-	29,649
Individual	7,339	-	-	-	7,339
Medicare Advantage Members	915	-	-	-	915
Insured members	37,676	227	-	-	37,903
Administrative Services Only	35,032	857	1,093	469	37,451
Network Rental	22,072	334	604	-	23,010
Total Membership	95,695	1,418	1,697	469	99,279

	<b>2016</b>				
	<b>KY</b>	<b>IN</b>	<b>TN</b>	<b>Out of Area</b>	<b>Total</b>
<b>Members</b>					
Commercial Members	29,446	381	-	-	29,827
Individual	-	-	-	-	-
Medicare Advantage Members	-	-	-	-	-
Insured members	29,446	381	-	-	29,827
Administrative Services Only	18,471	97	1,264	114	19,946
Network Rental	25,146	1,971	700	-	27,817
Total Membership	73,063	2,449	1,964	114	77,590

---

## **SYSTEM FINANCIAL STATEMENTS**

For the quarter and six months ended  
February 28, 2017

---

## Consolidated System Balance Sheets

	Unaudited February 28, 2017	Audited August 31, 2016
<b>Assets</b>		
<b>Current assets</b>	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 153,118	\$ 110,645
Investments	56,574	60,985
Assets limited as to use--required for current obligations	19,741	19,866
Patient accounts receivable, net of contractual allowances and doubtful accounts: Feb '17--\$1,068,344; and Aug '16--\$974,061	402,353	349,127
Inventories	43,576	38,057
Other	94,657	63,603
Total current assets	<u>770,019</u>	<u>642,283</u>
<b>Assets limited as to use</b>		
Designated by Board for capital improvements	815,069	855,140
Designated by Board for endowment	2,777	2,661
Held by trustee--asset purchase agreement	-	30,475
Held by trustee--donor restricted	5,088	4,941
Held by trustee--medical malpractice	69,981	72,685
Held by trustee--workers compensation	24,367	21,660
Held by trustee--perpetual trust	20,906	20,052
Less--required for current liabilities	(19,741)	(19,866)
Assets limited as to use	<u>918,447</u>	<u>987,748</u>
<b>Property and equipment, net</b>	1,310,418	1,170,389
<b>Other assets</b>	74,360	58,755
Total assets	<u><u>\$ 3,073,244</u></u>	<u><u>\$ 2,859,175</u></u>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities</b>		
Current installments of long-term debt and notes payable	\$ 217,683	\$ 63,983
Accounts payable	100,390	117,985
Accrued expenses	157,438	153,232
Estimated third party payor settlements	25,884	19,646
Accrued interest payable	964	941
Current portion of liability for medical malpractice	19,741	19,866
Other current liabilities	54,538	56,658
Total current liabilities	<u>576,638</u>	<u>432,311</u>
<b>Long-term debt, net</b>	659,887	568,493
<b>Other liabilities</b>	168,003	166,113
<b>Net assets</b>		
Unrestricted net assets attributable to Baptist	1,635,376	1,661,150
Unrestricted net assets attributable to noncontrolling interest	724	696
Total unrestricted net assets	<u>1,636,100</u>	<u>1,661,846</u>
Temporarily restricted	12,142	10,793
Permanently restricted	20,474	19,619
Total net assets	<u>1,668,716</u>	<u>1,692,258</u>
Total liabilities and net assets	<u><u>\$ 3,073,244</u></u>	<u><u>\$ 2,859,175</u></u>



## Consolidated System Statement of Operations

	Unaudited		Unaudited	
	Quarter Ended February,		Six Months Ended February,	
	2017	2016	2017	2016
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
<b>Unrestricted revenues, gains and other support</b>				
Net patient service revenue (net of contractual discounts and allowances)	\$ 627,352	\$ 536,421	\$ 1,239,520	\$ 1,065,300
Provision for uncollectible accounts	17,261	18,486	41,305	33,963
Net patient service revenue	610,091	517,935	1,198,215	1,031,337
Premium revenue	36,859	37,128	76,846	69,891
Other	19,859	18,678	39,476	37,276
Net assets released from restrictions used for operations	426	476	1,175	688
Total revenues, gains and other support	667,235	574,217	1,315,712	1,139,192
<b>Expenses</b>				
Salaries and benefits	373,463	321,152	744,244	628,191
Supplies	136,295	111,675	265,490	224,374
Purchased services	56,025	47,099	107,187	94,555
Utilities	7,945	6,511	16,509	13,822
Interest	4,733	3,198	10,977	6,481
Depreciation and amortization	40,148	29,792	76,048	57,373
Administration and other	70,261	62,697	136,741	117,092
Provider tax	9,957	6,231	18,366	12,440
Total expenses	698,827	588,355	1,375,562	1,154,328
<b>Operating income (loss)</b>	(31,592)	(14,138)	(59,850)	(15,136)
<b>Other gains (losses)</b>				
Investment income	26,176	(1,413)	32,752	1,981
Unrealized gains/(losses)	12,559	(47,517)	1,558	(34,667)
Other	(770)	(241)	(998)	(452)
Total other gains (losses)	37,965	(49,171)	33,312	(33,138)
<b>Excess of revenues, gains and other support over (under) expenses before provision (benefit) for income tax</b>	6,373	(63,309)	(26,538)	(48,274)
<b>Provision (benefit) for income tax</b>	255	2,984	366	1,690
<b>Excess of revenues, gains and other support over (under) expenses</b>	<u>\$ 6,118</u>	<u>\$ (66,293)</u>	<u>\$ (26,904)</u>	<u>\$ (49,964)</u>

# Consolidated System Statement of Changes in Net Assets

	Unaudited		Unaudited	
	Quarter Ended February,		Six Months Ended February,	
	2017	2016	2017	2016
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
<b>Unrestricted net assets:</b>				
Excess of revenues, gains and other support (under) over expenses	\$ 6,118	\$ (66,293)	\$ (26,904)	\$ (49,964)
<b>Unrestricted net assets attributable to noncontrolling interests</b>				
Excess of revenue over expenses	282	173	518	543
Contributions from noncontrolling interests	42	19	62	29
Distribution to noncontrolling interests	(308)	(337)	(552)	(517)
<b>Change in unrestricted net assets due to noncontrolling interests</b>	16	(145)	28	55
Net assets released from restrictions for capital	1,204	-	1,204	-
Other	(79)	(1,317)	(74)	(333)
Increase/(decrease) in unrestricted net assets	7,259	(67,755)	(25,746)	(50,242)
<b>Temporarily restricted net assets</b>				
Contributions and interest income	2,169	1,133	3,728	1,031
Net assets released from restrictions for capital	(1,204)	-	(1,204)	-
Net assets released from restrictions used for operations	(426)	(476)	(1,175)	(688)
Increase/(decrease) in temporarily restricted net assets	539	657	1,349	343
<b>Permanently restricted net assets</b>				
Change in beneficial interest in perpetual trust	343	(2,046)	855	(1,527)
Increase/(decrease) permanently restricted net assets	343	(2,046)	855	(1,527)
<b>Change in net assets</b>	8,141	(69,144)	(23,542)	(51,426)
<b>Net assets, beginning of period</b>	1,660,575	1,708,823	1,692,258	1,691,105
<b>Net assets, end of period</b>	<u>\$1,668,716</u>	<u>\$ 1,639,679</u>	<u>\$ 1,668,716</u>	<u>\$ 1,639,679</u>

## Consolidated System Statement of Cash Flows

	Unaudited		Unaudited	
	Quarter Ended February 28/29,		Six Months Ended February 28/29,	
	2017	2016	2017	2016
<b>Operating activities</b>	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Changes in net assets	\$ 8,141	\$ (69,144)	\$ (23,542)	\$ (51,426)
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Depreciation and amortization	40,148	29,792	76,048	57,373
Restricted contributions, income and other	(2,169)	(1,133)	(3,728)	(1,031)
Net realized and unrealized losses/(gains) on investments	(36,261)	56,027	(30,273)	36,649
Equity in net earnings (losses) of joint ventures	284	(1,588)	(1,693)	(2,254)
Distributions from joint ventures	1,504	2,099	2,308	2,099
Loss (gain) on disposal of equipment	135	-	87	28
Change in noncontrolling interest	266	318	490	488
Change in beneficial trust	(343)	2,046	(855)	1,527
Changes in:				
Patient accounts receivable, net	(2,382)	(3,756)	(14,634)	(48,031)
Inventories and other current assets	(24,407)	(3,897)	(23,569)	(18,546)
Other assets	2,400	359	(296)	(638)
Accounts payable and accrued expenses	(50,830)	(21,677)	(41,726)	37,191
Estimated third-party payor settlements	(10,862)	(8,373)	(1,841)	144
Other current liabilities	1,257	(232)	4,613	5,202
Other liabilities	(574)	3,345	4,199	10,686
Net cash provided by operating activities	(73,693)	(15,814)	(54,412)	29,461
<b>Investing activities</b>				
Purchase of investments	(1,082,790)	(824,704)	(2,058,818)	(1,889,905)
Proceeds from disposition of investments	1,202,754	846,414	2,181,871	1,935,830
Purchase of property and equipment, net	(25,443)	(57,882)	(53,716)	(110,288)
Proceeds from sale of property and equipment	1	8	36	14
Acquisition of Floyd Memorial and other operations	49,038	-	(129,000)	(5,519)
Net cash used in investing activities	143,560	(36,164)	(59,627)	(69,868)
<b>Financing activities</b>				
Proceeds from issuance of debt	(46,600)	18,683	161,000	18,683
Net cost of issuance of debt	(20)	(60)	(158)	(60)
Principal payments on long-term debt	(6,100)	(17,662)	(6,100)	(18,677)
Capital lease and notes payable payments	(1,457)	(573)	(1,468)	(573)
Restricted contributions	2,169	1,133	3,728	1,031
Contributions from noncontrolling interest	42	19	62	29
Distributions to noncontrolling interest	(308)	(337)	(552)	(517)
Net cash from/(used in) financing activities	(52,274)	1,203	156,512	(84)
<b>Increase/(decrease) in cash and cash equivalents</b>	17,593	(50,775)	42,473	(40,491)
<b>Cash and cash equivalents, beginning of period</b>	135,525	178,873	110,645	168,589
<b>Cash and cash equivalents, end of period</b>	\$ 153,118	\$ 128,098	\$ 153,118	\$ 128,098

---

## **OTHER INFORMATION**

For the quarter and six months ended  
February 28, 2017

---

## Financial and Operating Ratios

	Obligated Group		Consolidated	
	Six Months Ended February,		Six Months Ended February,	
	2017	2016	2017	2016
<b>Profitability</b>	<i>(Dollars In Thousands)</i>		<i>(Dollars In Thousands)</i>	
Operating income	\$ (37,719)	\$ (3,135)	\$ (59,850)	\$ (15,136)
Operating margin	(3.1%)	(0.3%)	(4.5%)	(1.3%)
Operating cash flow	\$ 47,972	\$ 59,647	\$ 27,175	\$ 48,718
Operating cash flow margin	3.9%	5.6%	2.1%	4.3%
Excess revenue over expenses	\$ (2,037)	\$ (30,648)	\$ (26,904)	\$ (49,964)
Excess margin	(0.2%)	(2.9%)	(2.0%)	(4.4%)
<b>Liquidity</b>				
Cash on hand	\$ 941,751	\$ 945,872	\$ 1,024,761	\$ 1,026,325
Cash on hand--days	140.1	170.1	140.6	170.3
Patient accounts receivable	\$ 405,822	\$ 320,782	\$ 402,353	\$ 318,343
Patient accounts receivable--days	61.0	56.4	60.8	56.2
<b>Leverage</b>				
Historical debt service coverage	3.4	3.9	2.5	3.1
Maximum annual debt service coverage	3.4	3.3	2.4	2.6
Total debt percentage of total capitalization	35.2%	26.7%	34.9%	26.6%
Cash to total debt	1.1	1.6	1.2	1.7
Total debt to cash flow	12.1	22.4	17.9	80.3
<b>Productivity</b>				
Salary and benefit percentage of total revenue	59.2%	57.8%	56.6%	55.1%
Supplies percentage of total revenue	21.1%	20.7%	20.2%	19.7%
Purchased services percentage of total revenue	8.4%	8.7%	8.1%	8.3%
Capital expense percentage of total revenue	6.1%	5.3%	5.8%	5.0%
Full-time equivalents (FTEs)	17,015	14,270	17,379	14,610
FTEs per adjusted occupied bed	4.0	3.8	4.0	3.8
FTEs per adjusted occupied bed--case mix adjusted	2.5	2.4	2.4	2.4

## Debt Service Coverage Ratio

	Obligated Group		Consolidated	
	Six Months Ended February,		Six Months Ended February,	
	2017	2016	2017	2016
	(Dollars In Thousands)		(Dollars In Thousands)	
Excess revenue over (under) expenses	\$ (2,037)	\$ (30,648)	\$ (26,904)	\$ (49,964)
Less:				
ASC Topic 320 current unrealized losses/(gains)	(3,324)	29,387	(1,558)	34,667
Plus:				
Depreciation and amortization	74,793	56,386	76,048	57,373
Interest expense	9,948	6,396	10,026	6,481
Interest-non-obligated group (a)	13	13	-	-
Funds available for debt service	\$ 79,392	\$ 61,534	\$ 57,612	\$ 48,557
Actual debt service:				
Interest expense	9,948	6,396	10,026	6,481
Capitalized interest expense	154	2,824	154	2,824
Principal payment on long-term debt (a)	13,143	6,338	13,285	6,456
Interest-non-obligated group (a)	13	13	-	-
Principal-non-obligated group (a)	23	19	-	-
Actual debt service	\$ 23,281	\$ 15,591	\$ 23,465	\$ 15,761
Annual debt service coverage ratio	3.4	3.9	2.5	3.1
Maximum annual debt service	\$ 23,562	\$ 18,391	\$ 23,744	\$ 18,913
Maximum annual debt service coverage ratio	3.4	3.3	2.4	2.6

(a) Prorated for six months.

## Capitalization

	Obligated Group		Consolidated	
	Balance as of February,		Balance as of February,	
	2017	2016	2017	2016
	(In Thousands)		(In Thousands)	
Long-term debt				
Series 2009A Bonds	\$ 148,250	\$ 159,365	\$ 148,250	\$ 159,365
Series 2009A unamortized premium	74	192	74	192
Series 2009A unamortized discount	(966)	(1,125)	(966)	(1,125)
Series 2009B Bonds	284,435	284,435	284,435	284,435
Series 2010 Bonds	-	-	-	19,197
Series 2011 Bonds	140,000	140,000	140,000	140,000
Series 2011 unamortized discount	(3,253)	(3,377)	(3,253)	(3,377)
Series 2015A Bonds	18,683	-	18,683	-
Series 2012 Bonds	43,445	-	43,445	-
Floyd County loan	54,900	-	54,900	-
Bridge loan	146,600	-	146,600	-
Revolving line of credit	50,000	-	50,000	-
Unamortized debt issue costs	(4,598)	(3,534)	(4,598)	(3,534)
Total debt	\$ 877,570	\$ 575,956	\$ 877,570	\$ 595,153
Total debt	\$ 877,570	\$ 575,956	\$ 877,570	\$ 595,153
Unrestricted net assets				
attributable to Baptist	1,612,286	1,579,723	1,635,376	1,639,679
Total capitalization	\$ 2,489,856	\$ 2,155,679	\$ 2,512,946	\$ 2,234,832
Total debt as a percentage of total capitalization	35.2%	26.7%	34.9%	26.6%

## Days Cash on Hand Ratio

	Obligated Group		Consolidated	
	Balance as of February,		Balance as of February,	
	2017	2016	2017	2016
	(In Thousands)		(In Thousands)	
Cash:				
Cash and cash equivalents	\$ 130,975	\$ 114,965	\$ 153,118	\$ 128,098
Investments	4,281	4,411	56,574	65,667
Assets limited as to use-- designated by Board for capital improvements	806,495	826,496	815,069	832,560
Total Cash and investments	\$ 941,751	\$ 945,872	\$ 1,024,761	\$ 1,026,325
Average daily cash expense:				
Total expenses	\$ 1,293,158	\$ 1,068,273	\$ 1,397,459	\$ 1,154,328
Depreciation and amortization	(76,643)	(56,386)	(77,898)	(57,373)
Total cash expenses	\$ 1,216,515	\$ 1,011,887	\$ 1,319,562	\$ 1,096,955
Days in period	181	182	181	182
Average daily expense	\$ 6,721	\$ 5,560	\$ 7,290	\$ 6,027
Days cash on hand ratio	140.1	170.1	140.6	170.3

Note: 2017 amounts reported for days cash on hand reflect annualization of BH FLO operating expenses.

## Financial Indicators by Division

Six Months Ended February,			
	2017	2016	2015
	(In Thousands)		
<b><u>Total Revenues, Gains and Other Support:</u></b>			
Obligated Group (a)	\$1,212,975	\$1,045,777	\$972,512
Non-Obligated Group:			
Bluegrass Family Health, Inc.	84,463	77,458	79,354
Other	18,274	15,958	16,181
Total Non-Obligated Group	102,737	93,416	95,535
Total System	\$1,315,712	\$1,139,193	\$1,068,047

Six Months Ended February,			
	2017	2016	2015
	(In Thousands)		
<b><u>Operating Income (Loss):</u></b>			
Obligated Group (a)	(\$37,718)	(\$3,134)	\$29,977
Non-Obligated Group:			
Bluegrass Family Health, Inc.	(22,242)	(12,751)	488
Other	110	749	514
Total Non-Obligated Group	(22,132)	(12,002)	1,002
Total System	(\$59,850)	(\$15,136)	\$30,979

Six Months Ended February,			
	2017	2016	2015
	(In Thousands)		
<b><u>Excess/(Deficit) of Revenue Over Expenses:</u></b>			
Obligated Group (a)	(\$2,037)	(\$30,648)	\$56,120
Non-Obligated Group:			
Bluegrass Family Health, Inc.	(24,304)	(19,095)	78
Other	(563)	(221)	(1,283)
Total Non-Obligated Group	(24,867)	(19,316)	(1,205)
Total System	(\$26,904)	(\$49,964)	\$54,915

Six Months Ended February,			
	2017	2016	2015
	(In Thousands)		
<b><u>Total Assets:</u></b>			
Obligated Group (a)	\$2,945,615	\$2,637,162	\$2,612,999
Non-Obligated Group:			
Bluegrass Family Health, Inc.	77,320	77,304	104,235
Other	37,620	31,997	23,129
Total Non-Obligated Group	114,940	109,301	127,364
Total System	\$3,060,555	\$2,746,463	\$2,740,363

(a) net of eliminated inter-company accounts



# **Baptist Healthcare System, Inc. and Affiliates**

## **Notes to Financial Statements**

### **Basis of Presentation**

The accompanying consolidated financial statements represent the consolidated operations of BHS, the affiliates in which it has sole ownership or membership and the entities in which it has greater than 50% equity interest with commensurate control. All significant intercompany accounts and transactions are eliminated in consolidation.

BHS is responsible for the accompanying unaudited consolidated financial statements. These unaudited consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

### **Mission and vision statement**

Baptist's mission is to demonstrate the love of Christ by providing and coordinating care and improving health in our communities. Baptist will lead the transformation to healthier communities. Baptist's faith-based values include: Integrity, Respect, Excellence, Collaboration, Compassion and Joy.

### **Fair value of assets and liabilities**

Cash and cash equivalents, investments and assets limited as to use are valued using quoted prices in active markets for identical assets or where quoted market prices are not available, using fair values estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The System does not hold investments that are unobservable or that are supported by little or no market activity. The fair value of long term debt obligations is estimated based on the borrowing rates currently available to Baptist for bank loans with similar terms and maturities.

### **Cash equivalents**

The System considers all liquid investments, other than those limited as to use, with original maturities of six months or less to be cash equivalents. At February 28, 2017 and February 29, 2016 cash equivalents consisted primarily of money market accounts. Cash and cash equivalent balances may exceed limits insured by the FDIC from time to time.

### **Patient accounts receivable**

The System reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. In evaluating the ability to collect accounts receivable, the System analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate provisions and allowances. The System regularly reviews data regarding these major payer sources of revenue in evaluating the sufficiency of the allowances.

### **Inventories**

Inventories are stated at the lower of cost or market on a first-in, first-out basis.

### **Assets limited as to use or restricted**

Assets limited as to use are recorded at fair value and include: (1) assets set aside by the board for capital improvements over which the board retains control and may, at its discretion, subsequently use for other purposes, (2) assets set aside by the board for endowment over which the board retains control and may, at its discretion, subsequently use for other purposes, (3) assets held by trustee related to asset purchase agreement, (4) assets held for donor restricted funds, (5) assets held by trustee for the medical malpractice and workers' compensation self-insurance funding arrangements and (6) assets held by trustee in perpetual trust. Amounts required to meet current liabilities are reported as current assets in the consolidated balance sheets.

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

The System invests in various securities including money market funds, U.S. Government securities, corporate debt instruments, corporate stocks, mutual funds, commingled funds and derivative instruments. The unrealized gains and losses of these securities are recognized as net investment return in the consolidated statements of operations. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities could occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets and consolidated statements of operations.

### Property and equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of each asset. Leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. Donations of property and equipment are reported at fair value as an increase in unrestricted net assets, unless the donor restricts use of the assets. Monetary gifts that must be used to acquire property and equipment are reported as donor-restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service. The system capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing net of interest earned on investments acquired with the proceeds of the borrowing or based on the weighted-average rates paid for long-term borrowing. Total interest capitalized and incurred was:

	<b>Six Months Ended February,</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Interest expense capitalized	\$ 154	\$ 2,824
Interest income capitalized from investment of proceeds on borrowing for project	-	-
Net interest capitalized	<u>\$ 154</u>	<u>\$ 2,824</u>

	<b>Six Months Ended February,</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Net interest capitalized	\$ 154	\$ 2,824
Interest charged to expense	10,977	6,481
Total interest cost	<u>\$ 11,131</u>	<u>\$ 9,305</u>

### Other assets

Other assets include deferred financing costs incurred in connection with the issuance of long-term debt (which are amortized over the term of the respective debt using the effective-interest method), deferred taxes receivable and goodwill. For the quarter ended February 28, 2017 management has recorded a reserve against the deferred taxes receivable totaling approximately \$51.0 million. Management will continue to evaluate the recoverability of deferred taxes receivable on a quarterly basis. Goodwill is tested for impairment on an annual basis or when an event or change in circumstance indicates the value of a reporting unit may have changed. Testing is conducted at the reporting unit level. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Estimates of fair value are based on estimates of discounted future cash flows.

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

### Long-term debt

The bonds are collateralized by a pledge of revenues. The agreements also contain several covenants, the most significant of which places limitations on additional indebtedness and required levels of unrestricted cash. The System was in compliance with all debt covenants at February 28, 2017.

	<b>Obligated Group</b>		<b>Consolidated</b>	
	<b>Balance as of February,</b>		<b>Balance as of February,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
<b>Long-term debt</b>				
Series 2009A Bonds	\$ 148,250	\$ 159,365	\$ 148,250	\$ 159,365
Series 2009A unamortized premium	74	192	74	192
Series 2009A unamortized discount	(966)	(1,125)	(966)	(1,125)
Series 2009B Bonds	284,435	284,435	284,435	284,435
Series 2010 Bonds	-	-	-	19,197
Series 2011 Bonds	140,000	140,000	140,000	140,000
Series 2011 unamortized discount	(3,253)	(3,377)	(3,253)	(3,377)
Series 2015A Bonds	18,683	-	18,683	-
Series 2016A Bonds	43,445	-	43,445	-
Floyd County loan	54,900	-	54,900	-
Bridge loan	146,600	-	146,600	-
Revolving line of credit	50,000	-	50,000	-
Unamortized debt issue costs	(4,598)	(3,534)	(4,598)	(3,534)
Total debt	877,570	575,956	877,570	595,153
Less: current portion	(217,683)	(11,115)	(217,683)	(13,124)
Long-term debt	\$ 659,887	\$ 564,841	\$ 659,887	\$ 582,029

- ❖ The Series 2009A Revenue Bonds were issued on February 19, 2009, to redeem the Series 1999A Bonds and to deposit \$99,287 into the project fund used to reimburse Baptist for the costs of acquiring and constructing hospital facilities and equipment. Interest on the bonds is fixed and is payable semi-annually on each February 15 and August 15, commencing August 15, 2009. Interest rates range from 3.00% to 5.625%. Principal payments began August 2011 with a maturity date of August 2027.
- ❖ The Series 2009B Variable Rate Demand Hospital Revenue Bonds were issued on February 19, 2009. Principal payments begin August 2027 through August 2038.
- ❖ Effective July 1, 2015, Baptist entered into bond purchase agreements with U.S. Bank (Series 2009 B-1 Bonds for \$65,065), Bank of America Merrill Lynch (BAML) (2009 Series B-2 Bonds for \$65,660) and BB&T (2009 Series B-3 and Series B-4 for \$76,550 and \$76,155, respectively) in order to replace its existing bank facilities with longer tenor facilities to reduce refinancing risk, lower spreads and remove daily/weekly put risk. The Series 2009 Bonds were converted from variable rate demand bonds to a variable rate Bank Mode (direct bank purchase). The initial term for each bank is 10 years and matures effective June 30, 2025. Interest cost for the Series 2009 B Bonds is based on a percentage of the London Interbank Offered Rate (LIBOR) and a fee expressed in basis points payable to each bank. Interest rates for the 2009B Bonds ranged from 0.90% to 1.03% at August 31, 2016 and from 0.70% to 1.03% during 2016.
- ❖ The Series 2011 Fixed Rate Hospital Revenue Bonds were issued on December 15, 2011, in the amount of

## **Baptist Healthcare System, Inc. and Affiliates**

### **Notes to Financial Statements**

\$140,000 to pay or reimburse Baptist for the costs of certain hospital projects, including a portion of the costs of constructing and equipping a new seven story, approximately 400,000 square foot medical structure connected to the existing hospital building at Baptist Health Lexington. Principal payments for the 2042 term bond in the amount of \$63,060 will begin August 15, 2039, with a maturity date of August 15, 2042. The 2042 term bonds will bear an interest rate of 5.00%. Principal payments for 2046 term bond in the amount of \$76,940 will begin August 15, 2043, with a maturity date of August 15, 2046. The 2046 bonds will bear an interest rate of 5.25%. Interest on the bonds is fixed and is payable semi-annually on each February 15 and August 15.

- ❖ The Series 2015A Bonds were directly purchased by U.S. Bank on December 15, 2015, in the amount of \$18,683 to refinance the Series 2010 Variable Rate Demand Hospital Revenue Bonds issued by Baptist Health Madisonville, with a maturity date of August 15, 2024. Interest cost for the Series 2015A Bonds is based on a percentage of the London Interbank Offered Rate (LIBOR) and a fee expressed in basis points payable to U.S. Bank. The interest rate for the 2015A Bonds was 1.03% on August 31, 2016 and from 0.92% to 1.03% during 2016.
- ❖ In June 2016, the Baptist entered into a revolving credit agreement (RLOC) with US Bank. The revolving credit agreement consists of a \$50,000 credit line with a termination date of June 7, 2017. Borrowings under the credit facility are at LIBOR plus a margin of 0.55%. Borrowings are subject to various covenants consistent with other master obligations. At August 31, 2016, \$50,000 was outstanding under the revolving credit agreement.
- ❖ On October 1, 2016 Baptist Health acquired Floyd Memorial Hospital and Health Services. The following is the debt associated with the transaction:
  - \$43,445,000 Series 2016A Bonds privately placed with BB&T.
  - \$61,000,000 loan from Floyd County.
  - \$146,600,000 2016 taxable term loan with BAML.

#### **Temporarily restricted net assets**

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Investment income from restricted funds is included in temporarily restricted net assets when earned.

#### **Permanently restricted net assets**

Permanently restricted net assets are those that have been restricted by donors to be maintained in perpetuity. Permanently restricted net assets represent the System's beneficial interest in perpetual trusts. Investment income from restricted funds is included in permanently restricted net assets when earned.

#### **Charity care**

The System provides care to patients who meet certain criteria under its charity care policy, without charge or at amounts less than its established rates. The System also provides discounts from established rates to all uninsured patients. Because the System does not pursue collection of charity or uninsured discounts, such amounts are not reported as revenue.

#### **Patient service revenue**

Patient service revenues are derived from services provided to patients who are directly responsible for payment or are covered by various insurance programs including the Medicare and Medicaid programs. The System has agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge and/or per day,

# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

discounts from established charges, fee schedules and other methods.

The System recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. These payment arrangements include:

**Medicare.** Substantially all inpatient and outpatient services are paid at prospectively determined rates. These rates vary according to the patient classification system that is based on clinical, diagnostic, acuity and other factors. Certain defined medical education costs are paid based on a cost reimbursement methodology. The System is also reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare administrative contractor.

**Medicaid.** Medicaid members are enrolled through a Managed Care Organization (MCO) or are covered by “traditional” Medicaid. Inpatient services are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for other services.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

**Other Third-Party Payers**—The System also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the System under these arrangements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

**Patient liability.** The System recognizes patient deductible and co-payment revenue for patients who have third-party insurance. A provision for uncollectible accounts is recorded in the period of service on the basis of its past experience, which indicates that some patients are unwilling to pay the portion of their bill for which they are financially responsible.

The System recognizes patient service revenue associated with services provided to patients who do not have third-party payer coverage as follows:

**Uninsured patients.** The System provides a significant discount from standard charges to all uninsured patients who receive medically necessary care. An uninsured discount provision is recorded in the period of service. The amount for which the patient is responsible is recognized as patient service revenue. The System offers financial assistance programs to patients who are unable to pay the portion of their bill for which they are financially responsible and records a provision for charity in the period of service on the basis of its past experience. A provision for uncollectible accounts is recorded in the period of service on the basis of past experience for patients who are unwilling to pay the portion of their bill for which they are financially responsible.

The provision for uninsured discounts, charity care and uncollectible accounts were as follows:

Provision for	Six Months Ended February,		
	2017	2016	Change
	<i>(In Thousands)</i>		
Uninsured discounts	\$ 41,499	\$ 29,952	\$ 11,548
Charity	(8,457)	4,826	(13,284)
Uncollectible accounts	41,305	33,963	7,342
Total	<u>\$ 74,347</u>	<u>\$ 68,741</u>	<u>\$ 5,606</u>

# **Baptist Healthcare System, Inc. and Affiliates**

## **Notes to Financial Statements**

### **Premium revenue**

The System, through BHP, enters into membership contracts with employer groups. The contracts contain varying terms subject to cancellation by the employer group or BHP upon 60 days' written notice. Premiums are due at the beginning of each month and are recognized as revenue during the period in which BHP is obligated to provide services to members. Premiums billed and collected in advance recorded as unearned premiums are included in the consolidated balance sheets in other current liabilities. Estimated medical services provided but not reported to BHP are included in the consolidated balance sheets in accrued expenses. At February 28, 2017, a premium deficiency reserve of approximately \$7.4 million was recorded based on membership contracts as of January 1, 2017. Management will continue to evaluate the need for the reserve on a quarterly basis.

### **Electronic Health Records Incentive Program**

The Electronic Health Records Incentive Program (EHRIP), enacted as part of the American Recovery and Reinvestment Act of 2009, provides for incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payments under both programs are contingent upon hospitals and physicians continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

Baptist recognizes EHRIP revenue under the grant method and the contingency method, depending on the specific circumstances at each entity regarding the likelihood of meeting the requirements necessary to demonstrate meaningful use. Under the grant method, Baptist recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period. Under the contingency method, Baptist recognizes revenue when the hospital has received confirmation of meeting the meaningful use requirements.

For the hospitals being accounted under the contingency method, the System met the requirements for both Medicare and Medicaid EHRIP payments and recorded revenue in 2016 and 2015 of approximately \$2.1 million and \$7.1 million, respectively. EHRIP revenue is included in other revenue within other operating revenues in the consolidated statements of operations.

### **Contributions**

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined by using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue. Donor-restricted stipulations that limit the use of contributions are initially reported as temporarily or permanently restricted net assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of changes in net assets as net assets released from restriction.

### **Investments and investment return**

Investments in equity securities with readily determinable fair values and in all debt securities are carried at fair value in the consolidated balance sheets. Investments in an equity investee are reported on the equity method of accounting. Other investments are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value.

## **Baptist Healthcare System, Inc. and Affiliates**

### **Notes to Financial Statements**

Investment income or loss (including realized gains and losses on investments, dividends, interest and unrealized gains and losses on trading and available-for-sale investments) is included in the excess of revenues, gains and other support over expenses unless donor or law restricts the income or loss.

The System's investments are exposed to various risks, such as interest rate, market and credit. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in these risks in the near term could materially affect the amounts reported in the consolidated balance sheets and consolidated statements of operations.

#### **Beneficial interest in perpetual trusts**

The System is an income beneficiary of several perpetual trusts controlled by unrelated third-party trustees. The beneficial interests in the assets of these trusts are included in the System's consolidated financial statements as permanently restricted net assets. Income is distributed in accordance with the individual trust documents and is included in the change in beneficial interest in perpetual trust on the statement of changes in net assets.

#### **Commitments and contingencies**

The System is party to various legal matters arising in the ordinary course of business including patient-care related claims and litigation. Some of these allegations are in areas not covered by the System's self-insurance program or by commercial insurance. Based on the advice and assistance from professional and legal counsel, the System assesses the probable outcome of unresolved litigation and records an estimate of the ultimate expected loss. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term. The System believes that the resolution of such matters will not result in liability materially in excess of accounting accruals established with respect to such matters.

The System is self-insured with respect to medical malpractice risks and has established an irrevocable trust fund for the payment of medical malpractice claim settlements. Professional insurance consultants have been retained to assist the System in determining liability amounts to be recognized, as well as amounts to be deposited into the trust fund.

From September 1, 2014 through May 31, 2015, the System was self-insured for the first \$6.0 million per occurrence and not to exceed \$24.0 million for all System hospitals. Effective, June 1, 2015, the System revised its self-insured limits to the first \$4.0 million per occurrence and not to exceed \$16.0 million in the aggregate for all System hospitals. The System is self-insured for the first \$1.0 million up to \$3.0 million in the aggregate for the majority of its physician practices. The System participates in the American Excess Insurance Exchange (AEIX), Risk Retention Group, a Vermont chartered "captive" insurance company organized as a reciprocal for coverage above the self-insurance limits. The System currently has an 8.22% ownership in AEIX, the value of which is reported using the equity method of accounting and which is not material to the accompanying consolidated financial statements.

As of June 1, 2014, BH MAD and BH RIC were merged into the trust. Prior to June 1, 2014, BH MAD was self-insured for the first \$1.5 million per occurrence through January 1, 2008, and \$2.0 million per occurrence thereafter and not to exceed \$14.0 million in aggregate. BH MAD purchased commercial insurance coverage on a claims made basis over the self-insurance limits and had established an irrevocable trust fund for the payment of medical malpractice claim settlements. Losses from asserted and unasserted claims were accrued based on estimates that incorporate past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. Professional insurance consultants were retained to assist the System in determining liability amounts to be recognized, as well as amounts to be deposited into the trust fund.

Prior to June 1, 2014, BH RIC was insured for medical malpractice claims through claims made policies. This provided protection from liability in amounts not to exceed \$1.0 million per claim and \$3.0 million in the aggregate. In addition, BH RIC had purchased a \$10.0 million umbrella policy. Liabilities for incurred but not reported losses at August 31,

## **Baptist Healthcare System, Inc. and Affiliates**

### **Notes to Financial Statements**

2013, if any, will not have a material effect on the BH RIC's financial position and its malpractice and general liability insurance was adequate to cover losses, if any.

The System is self-insured with respect to workers' compensation risks and has established an irrevocable trust fund for the payment of workers' compensation claim settlements. Professional insurance consultants have been retained to assist the System in determining liability amounts to be recognized, as well as amounts to be deposited into the trust fund.

#### **Employee benefit plans**

The System employees who meet eligibility requirements are covered by a Retirement Accumulation Plan (RAP), which includes a defined contribution plan funded entirely by the System and a 401(k) plan to which the employees of BFH are the only participants permitted to make 401(k) deferrals. The finance committee of the board of directors of the System controls and manages the operation of the RAP. Participants are immediately fully vested in participant contributions and related earnings and are fully vested in the System's contributions after five years of service, or after reaching age 65, whichever occurs first.

The System offers a Thrift 403(b) Plan to which employees may defer up to 10% of their earnings on a pre-tax basis. The System matches \$.50 on each dollar for the first 6% of the employees' contributions. Employees are immediately vested in their contributions and related earnings. Employee vesting in employer contributions is graduated with full vesting after five years.

On September 5, 2014, the defined contribution plan assets from BH MAD and BH RIC were merged into the Baptist Thrift 403(b) Plan.

Prior to September 5, 2014, BH MAD provided a defined contribution pension plan covering substantially all employees. Under terms of the plan, BH MAD contributed 4.6 percent of eligible compensation up to \$150,000 for eligible employees with two years of service. Prior to June 1, 2014, BH RIC employees hired January 1, 2005, or later were eligible to participate in a defined contribution pension plan. BH RIC matched a portion of the employees' basic voluntary contributions, as determined by the provisions of the plan.

The System provides an Executive Severance and Deferred Compensation Plan; a nonqualified plan designed to provide severance benefits for select management or highly compensated employees of the System and to provide deferred compensation for those adversely affected by the required compensation limits of qualified retirement plans or Section 403(b) plans.

BH RIC has a noncontributory defined benefit pension plan covering substantially all of its employees employed prior to 2005. BH RIC's funding policy is to make the minimum annual contribution that is required by applicable regulations. Effective December 31, 2004, the defined benefit pension plan was frozen and does not allow any new participants. Effective December 31, 2007, BH RIC resolved to freeze the accrued benefits of the defined benefit plan as part of its plan to restructure employee benefits of its employees.

The System provides an Executive Severance and Deferred Compensation Plan; a nonqualified plan designed to provide severance benefits for select management or highly compensated employees of Baptist and to provide deferred compensation for those adversely affected by the required compensation limits of qualified retirement plans or Section 403(b) plans.



# Baptist Healthcare System, Inc. and Affiliates

## Notes to Financial Statements

### Acquisition of Floyd Memorial Hospital and Health Services

Effective, October 1, 2016, Baptist Health acquired Floyd Memorial Hospital and Health Services, now called Baptist Health Floyd. The acquisition agreement includes capital investment commitments by Baptist in Baptist Health Floyd of \$140,000,000 over the next seven years to expand services, invest in improved technologies and transition to Epic. The acquisition was funded through cash on the consolidated balance sheets and interim debt financing consisting of \$146,600,000 term loan from Bank of America, \$61,000,000 loan from Floyd County and the assumption of the \$43,445,000 Series 2012 Bonds which were re-designated Series 2016A and privately placed with BB&T. The following table shows the purchase price for Baptist Health Floyd:

Cash paid to Floyd County	\$ 75,000,000
Loan from Floyd County	61,000,000
Net transaction costs and closing adjustments	14,086,740
Contribution to New Albany Township Little League	2,300,000
Total purchase price	<u>\$ 152,386,740</u>

The following table shows the allocation of the purchase price for Baptist Health Floyd to the acquired identifiable assets and liabilities:

Purchase price	<u>\$ 152,386,740</u>
Cash and Cash equivalents	\$ 23,387,079
Investments	20,977,406
Accounts receivable	38,593,364
Other current assets	13,330,860
Property and equipment	162,135,412
Investments in joint ventures and other assets	7,857,500
Total identifiable assets	<u>\$ 266,281,621</u>
Accounts payable	\$ 13,301,917
Accrued liabilities and other liabilities	16,054,296
Long-term debt	90,045,000
Total identifiable liabilities	<u>\$ 119,401,213</u>
Goodwill	<u>\$ 5,506,332</u>

### Use of estimates

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include net patient service revenue, malpractice, workers' compensation, litigation matters, post-retirement benefits and medical service claims incurred but not yet reported. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates.

# **Baptist Healthcare System, Inc. and Affiliates**

## **Notes to Financial Statements**

### **Reclassifications**

Certain reclassifications have been made to the prior year quarter and year-to-date consolidated financial statements to conform to the current quarter and year-to-date consolidated financial statement presentation. These reclassifications had no effect on the change in net assets.