Trinity Health FY18 Annual Operating Income Jumps More Than 50% Over Prior Year

Summary Highlights for the Year-Ended June 30, 2018

Trinity Health reported operating income before other items of $401.3 million and operating margin and operating cash flow margin before other items of 2.2% and 8.1%, respectively, for its fiscal year 2018. The year was marked by a $135.2 million growth in year-over-year operating income before other items, an improvement of 50.8% over fiscal year 2017 results of $266.1 million. Fiscal year 2017 operating margin and operating cash flow margin before other items were 1.5% and 7.6%, respectively.

For the year ended June 30, 2018, Trinity Health increased revenue by $0.7 billion to $18.3 billion, a 4.1% increase over the prior year. Excluding the effect of acquisitions, the increase is the result of growth in patient volumes, payment rates and case mix, and to a lesser extent, other revenue.

Expenses increased by $582.4 million, or 3.4%, to $17.9 billion. Trinity Health continues to undertake targeted efficiency initiatives to improve performance and address unfavorable industry trends. These initiatives focus primarily on labor, productivity, supply costs, and clinical and administrative operations.

Other items incurred during the year resulted in a net charge to operations of $264.4 million for non-cash asset impairment charges that are helping the system right-size inpatient physical plant utilization and reposition in some markets. The Corporation's decision to move to a single, enterprise-wide electronic health record and revenue cycle management system platform resulted in $107.8 million of the impairments. The single, fully integrated record system will enable Trinity Health to improve the experience of both its patients and physicians, supporting the system's people-centered strategy.

Highlights of results for the fiscal year ended June 30, 2018, include:

- Total assets of $26.2 billion and net assets of $13.3 billion
- Total unrestricted revenue of $18.3 billion, a 4.1% increase over fiscal year 2017 and representing a 3.1% increase prior to the impact of acquisitions
- Operating income before other items of $401.3 million, a $135.2 million increase over fiscal year 2017
- Excess of revenue over expense of $901.5 million with a net margin of 4.7%
- Unrestricted cash and investments of $8.9 billion
- Days cash on hand of 187 days

Discussion and Analysis of Financial Condition and Results of Operations for Trinity Health

June 30, 2018

Introduction to Management's Discussion & Analysis

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management of the Corporation to make assumptions, estimates and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The Corporation considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its financial statements, including the following: recognition of net patient service revenue, which includes contractual allowances, provision for bad debt and financial assistance; premium revenue; recorded values of investments, derivatives and goodwill; evaluation of long-lived assets for impairment; reserves for losses and expenses related to health care professional and general liabilities; and risks and assumptions for measurement of pension and retiree health liabilities. Management relies on historical experience and other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results could differ materially from those estimates.

The Patient Protection and Affordable Care Act (“ACA”) was enacted in March 2010. This legislation addresses almost all aspects of hospital and provider operations and health care delivery and is changing how health care services are covered, delivered, and reimbursed. These changes have resulted in millions of previously uninsured Americans gaining access to health insurance coverage, significant utilization changes, new payment models with the risk of lower hospital reimbursement from Medicare and reduced payments to providers for care. They have also increased both government enforcement of the industry and the necessity for health care providers to assess, and potentially alter, their business strategy and practices, among other consequences.

Last year, President Trump repeatedly urged Congress to repeal all or a portion of the ACA. Through executive actions, he urged federal agencies to exercise their authority to waive or delay the implementation of the Act, directed the departments of Treasury, Labor and Health and Human Services to consider proposing regulations or guidance to expand the availability of association health plans, short-term limited duration insurance and health reimbursement arrangements, and stopped payment of the Cost Sharing Reductions ("CSRs"). As a result, insurers who received federal CSRs to reduce out-of-pocket costs for low-income individuals who purchase coverage through the Health Insurance Marketplace may decide to discontinue participation in the Health Insurance Marketplace. Insurers dropping out of the Marketplace would negatively impact access to coverage in some areas. Additionally, each chamber of Congress has taken action on different versions of legislation aimed at repealing all or portions of the Act, but none passed both chambers. Congress did effectively eliminate the individual mandate penalties (the "shared responsibility payment") for years after 2018 as part of the Tax Cuts and Jobs Act of 2017. The timing and likelihood of success of additional Congressional efforts to repeal additional portions of the ACA remains unclear.

Management of the Corporation cannot predict with any reasonable degree of certainty or reliability the ultimate effects of the legislation, the potential repeal of all or a portion of the legislation, or any replacement legislation.

Trinity Health Corporation, an Indiana nonprofit corporation headquartered in Livonia, Michigan, and its subsidiaries (“Trinity Health” or the “Corporation”), controls one of the largest health care systems in the United States.

Recent Developments

Saint Mary's Health System ("SMHS")

On August 1, 2016, the Corporation became, through its Trinity Health Of New England subsidiary as part of a member substitution, the sole corporate member of SMHS, a regional health care system located in Waterbury, Connecticut. As a result of this transaction, the Corporation recognized an inherent contribution of $56.0 million for the year ended June 30, 2017 in the consolidated statement of operations and changes in net assets.

MacNeal Hospital and MacNeal Health Providers ("MacNeal"). On March 1, 2018, the Corporation's Loyola University Health System, through a wholly controlled subsidiary, purchased the assets of MacNeal Hospital, located in Berwyn, Illinois, and certain other healthcare operations affiliated with the hospital from an affiliate of Tenet Healthcare Corporation. As a result of this transaction, the Corporation recognized goodwill of $142.4 million as cash consideration paid exceeded net assets acquired.

Membership Transfer Agreement Lourdes Health System ("Lourdes") – On June 4, 2018, Maxis Health System ("Maxis"), a wholly-controlled subsidiary of Trinity Health, executed a Membership Transfer agreement with Virtua Health, Inc. ("Virtua") to transfer the membership interests of Our Lady of Lourdes Health Care Services, Inc. (the Lourdes legal entity) from Maxis to Virtua including substantially all of the healthcare operations and certain assets and working capital of Lourdes. As a result, certain assets and liabilities met the criteria to be classified as held for sale in the accompanying consolidated balance sheet as of June 30, 2018 in accordance with the guidance in the FASB's ASC 360, "*Property, Plant and Equipment*." These assets and liabilities were recorded at the lower of their carrying amount or their fair value less estimated costs to sell. The closing of the transaction remains subject to regulatory and canonical approvals, as well as other customary closing conditions, the timing of which is uncertain.

Debt Issuance

During fiscal year 2018, the Trinity Health Credit Group issued $1,117.6 million par value in tax-exempt fixed rate hospital revenue bonds at a premium of $144.2 million under its amended and restated master trust indenture. Proceeds were used to refund $560.4 million of certain tax-exempt bonds and pay down $217.5 million of then outstanding taxable commercial paper obligations in December 2017. The remaining proceeds were used to finance, refinance and reimburse a portion of the costs of acquisition, construction, and renovation and equipping of health facilities.

Results from Operations

Operating Income

Operating income before other items for fiscal year 2018 increased to $401.3 million compared to $266.1 million in fiscal year 2017. The acquisitions of MacNeal and SMHS minimally impacted operating income before other items with a combined operating loss of $7.0 million in fiscal year 2018 while the acquisition of SMHS increased operating income before other items by $3.0 million in fiscal year 2017. Operating margin and operating cash flow margin before other items were 2.2% and 8.1%, respectively, for the fiscal year 2018 compared to 1.5% and 7.6% for fiscal year 2017. The acquisitions of MacNeal and SMHS did not have a material impact on margins. Revenue growth coupled with cost controls, improvements in length of stay and productivity, as well as improved performance in the Corporation's owned managed care plans, helped to increase margins over the prior year.

(dollars in millions)	FY17	FY18	FY17*	FY18*
Operating Income**	$266.1	$401.3	$263.2	$408.3
Operating Revenue	$17,628	$18,345	$17,337	$17,877
Operating Margin**	1.5%	2.2%	1.5%	2.2%
Operating Cash Flow Margin**	7.6%	8.1%	7.6%	8.1%

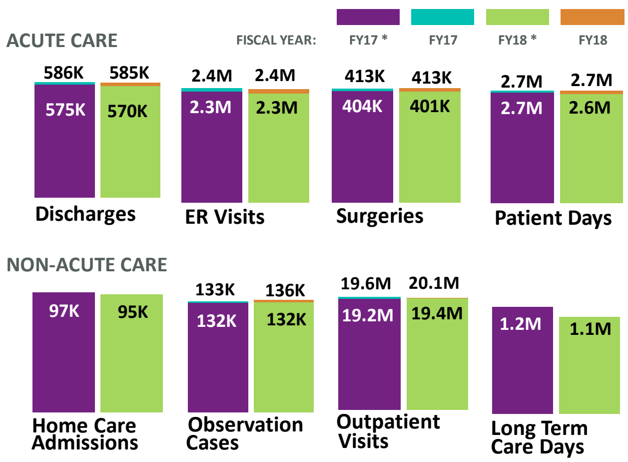
* Excluding the impact of the SMHS and MacNeal acquisitions

** Before other items

Revenue

Total unrestricted revenue of $18.3 billion increased $717.6 million, or 4.1%, for fiscal year 2018 compared to the same period in fiscal year 2017. Revenue from the MacNeal and SMHS acquisitions accounted for $176.9 million of the increase or 1.0%. Excluding the impact of acquisitions, the increase in revenue was due primarily to the following: (i) $200 million from volume growth, (ii) $150 million of payment rate increases (including impacts of provider tax programs), (iii) $125 million from improvements in case mix, and (iv) an increase of $38.6 million in other revenue, including $54.6 million of retail pharmacy revenue partially offset by lower grant revenue. These increases were also partially tempered by a continued unfavorable shift in payor mix. Same facility volumes were favorable to prior year with 12 of the 19 Regional Health Ministries experiencing increases in case mix adjusted equivalent discharges.

Volume Metrics



* Excluding the impact of the SMHS and MacNeal acquisitions

Expenses

Total operating expenses of $17.9 billion increased $582.4 million, or 3.4%, for fiscal year 2018 compared to fiscal year 2017. Expenses from the acquisitions of MacNeal and SMHS accounted for $186.9 million of the increase or 1.1%. Excluding the aforementioned acquisitions, the increase in operating expenses was due primarily to the following: (i) labor expense increase of $348.2 million (salaries and wages increase of $322.7 million primarily due to a 4.0% increase in rate and a slight increase in FTEs) and (ii) supplies increase of $81.5 million, driven by higher volumes; such increases were partially offset by lower depreciation and amortization, insurance, and health plan medical claims expenses. On a case mix and volume adjusted basis, cost per case mix adjusted equivalent discharges was flat year-over-year.

Other Items

For the year ended June 30, 2018, other items include non-cash fixed asset impairment charges of $264.4 million. $107.8 million of the impairments were due to the Corporation's decision to move to a single, enterprise-wide electronic health record and revenue cycle management system platform. The integrated system will enable the health system to improve experiences for patients and clinicians. $69.9 million of the impairments were due to the planned divestiture of the Corporation's Lourdes subsidiary. Additional asset impairments of $86.7 million were recorded primarily at three other health ministries across the Corporation. The total impairments were comprised of $15.7 million of land, $244.4 million of property and equipment, and $4.3 million of intangible and other assets. For the fiscal year ended June 30, 2017, other items included asset impairment charges of $248.1 million, recorded primarily at three health ministries across the Corporation ($216.4 million property and equipment, and $31.7 million goodwill, intangible, and other assets), and restructuring costs of $36.2 million as part of a comprehensive improvement plan to realign the Corporation's cost structure. Fiscal year 2018 operating income including other items of $136.9 million compared to an operating loss of $18.1 million in the prior year.

Nonoperating Items

The Corporation reported gains in nonoperating items of $812.2 million for fiscal year 2018 compared to gains of $1.4 billion for the same period in fiscal year 2017. The decrease was due to a decrease in investment earnings of $371.2 million, a decrease in equity in earnings of unconsolidated affiliates of $48.3 million, and a decrease in market value of interest rate swaps of $27.3 million, (all primarily driven by overall global investment market conditions) as well as a non-cash loss on extinguishment of debt of $40.6 million and a reduction in inherent contributions of $63.2 million (related primarily to the acquisition of SMHS in FY17).

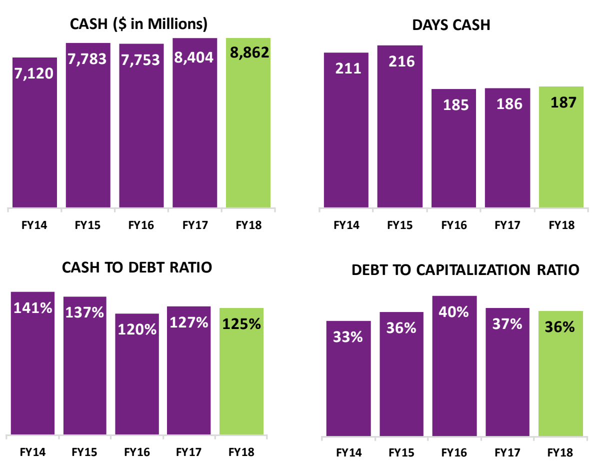
Excess of Revenue over Expenses

Excess of revenue over expenses for the fiscal year 2018 was $901.5 million compared to $1.3 billion for fiscal year 2017, primarily related to lower nonoperating investment income, which was partially offset by an increase in operating income of $155.0 million compared to fiscal year 2017.

Balance Sheet

Total assets of $26.2 billion increased $1.5 billion, or 5.9% as of June 30, 2018, compared to June 30, 2017, of which the acquisition of MacNeal accounted for $333.5 million of the increase. Excluding the acquisition, asset growth was mainly driven by investment earnings, equity earnings in unconsolidated affiliates, the issuance of debt, and increase in patient accounts receivable, due to growth in revenue as well as a slight increase in days in accounts receivable. Total assets include unrestricted cash and investments of $8.9 billion or 187 days of cash on hand.

Days cash on hand increased by one day during fiscal year 2018 due primarily to positive operating cash flow, strong investment returns, and debt issuance, offset by capital expenditures, the impact of the acquisitions, and balance sheet timing for accounts payable and accrued expenses. Net days in accounts receivable increased by 1.8 days to 44.6 days as of June 30, 2018 compared to fiscal year June 30, 2017. Total liabilities of $12.9 billion increased $98.0 million, or 0.8%, of which the acquisition of MacNeal accounted for $75.6 million. Debt increased $467.1 million, which included amounts used to fund the acquisition of MacNeal. Accounts payable and accrued expenses increased $122.9 million, primarily due to accruals for capital expenditures and deferred revenue. These increases were partially offset by a reduction in accrued pension and retiree health liabilities related to net actuarial gains of $394.8 million and cash funding of $187.0 million. The defined benefit pension plans were 91% funded as of June 30, 2018. Debt to capitalization as of June 30, 2018 and June 30, 2017 was 36.0% and 36.9%, respectively.



Statement of Cash Flows

Cash and cash equivalents decreased $36.5 million to $971.7 million during the year. Operating activities provided over $1.0 billion of cash. Investing activities used $1.5 billion of cash including $1.1 billion for purchases of property and equipment, $261.0 for acquisitions net of cash acquired and $152.3 million of net purchases of investments. Financing activities provided $458.0 million of cash due primarily to the proceeds from the issuance of debt of $1.3 billion partially offset by repayments of debt of $865.4 million.

TRINITY HEALTH
Liquidity Reporting
As of June 30, 2018

	($ in millions) (unaudited)	
ASSETS		
Daily Liquidity		
Money Market Funds (Moody's rated Aaa)	$ 776	
Checking and Deposit Accounts (at P-1 rated bank)	572	
Repurchase Agreements	-	
U.S. Treasuries & Aaa-rated Agencies	-	
Dedicated Bank Lines	931	
Subtotal Daily Liquidity (Cash & Securities)	$ 2,279	
Undrawn Portion of $600M Taxable Commercial Paper Program	500	
Subtotal Daily Liquidity Including Taxable Commercial Paper Program		$ 2,779
Weekly Liquidity		
Exchange Traded Equity	$ 2,451	
Publicly Traded Fixed Income Securities Rated at least Aa3 and Bond Funds	1,552	
Equity Funds	881	
Other	440	
Subtotal Weekly Liquidity		5,324
TOTAL DAILY AND WEEKLY LIQUIDITY		$ 8,103
Longer Term Liquidity		
Funds, vehicles, investments that allow withdrawals with less than one month notice	1,454	
Funds, vehicles, investments that allow withdrawals with one month notice or longer	1,969	
Total Longer Term Liquidity		$ 3,423
LIABILITIES (Self-liquidity Variable Rate Demand Bonds & Commercial Paper)		
Weekly Put Bonds		
VRDO Bonds (7-day)		$ 240
Long-Mode Put Bonds		
VRDO Bonds (Commerical Paper Mode)		170
Taxable Commercial Paper Outstanding		100
TOTAL SELF-LIQUIDITY DEBT AND COMMERCIAL PAPER		$ 509
Ratio of Daily and Weekly Liquidity to Self Liquidity Debt and Commercial Paper		15.92

Trinity Health
Financial Ratios and Statistics (Unaudited)

	June 30, 2018	June 30, 2017
<u>Financial Indicators</u>		
Liquidity Ratios (at June 30)		
Days Cash on Hand	187	186
Days in Accounts Receivable, Net	44.6	42.8
Leverage Ratios (at June 30)		
Debt to Capitalization	36%	37%
Cash to Debt	125%	127%
Profitability Ratios (For the Year Ended June 30)		
Operating Margin Before Other Items	2.2%	1.5%
Operating Cash Flow Margin Before Other Items	8.1%	7.6%

<u>Statistical Indicators</u> (For the Year Ended June 30)	Rounded to nearest thousand	
Discharges	585,000	586,000
Patient Days	2,700,000	2,704,000
Outpatient Visits	20,051,000	19,587,000
Emergency Room Visits	2,373,000	2,382,000
Observation Cases	136,000	133,000
<u>Continuing Care</u>		
Home Health Admissions	95,000	97,000
Long-term Care Patient Days	1,060,000	1,164,000