



**This document is dated November 18, 2019**

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**UNAUDITED PRO FORMA QUARTERLY REPORT**

For the three-month periods ended  
September 30, 2019 and 2018

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The information in this report  
has been provided by  
CommonSpirit Health

# COMMONSPIRIT HEALTH

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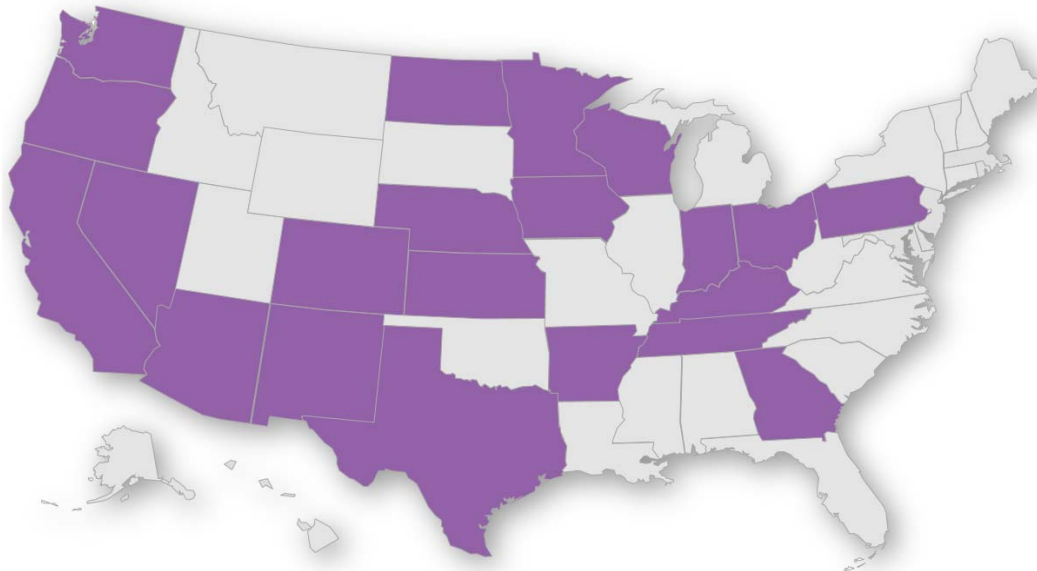
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# Management Discussion and Analysis of Financial Condition and Results of Operations

## Overview

CommonSpirit Health (the “Corporation”) is a Colorado nonprofit public benefit corporation exempt from federal and state income taxes. Effective February 1, 2019, Catholic Health Initiatives (dba “CHI”) changed its name to CommonSpirit Health and became the sole corporate member of Dignity Health, a California nonprofit public benefit corporation also exempt from federal and state income taxes. CommonSpirit Health is a Catholic healthcare system sponsored by the public juridic person, Catholic Health Care Federation (“CHCF”). Due to the circumstances of the business combination between CHI and Dignity Health, through the alignment under CHCF, the transaction qualified for acquisition accounting with CommonSpirit Health as the accounting acquirer of Dignity Health.

CommonSpirit Health owns and operates health care facilities in 21 states and is the sole corporate member (parent corporation) of other primarily nonprofit corporations that are exempt from federal and state income taxes. With its national office in Chicago, and a team of approximately 150,000 employees and 25,000 physicians and advanced practice clinicians, CommonSpirit Health is comprised of 142 hospitals, including three academic health centers, major teaching hospitals, and 31 critical access facilities; community health services organizations; accredited nursing colleges; home health agencies; living communities; a medical foundation and other affiliated medical groups; and other facilities and services that span the inpatient and outpatient continuum of care. CommonSpirit Health also has two offshore and one onshore captive insurance companies. The accompanying condensed pro forma consolidated financial statements include CommonSpirit Health and its direct affiliates and subsidiaries (together, “CommonSpirit”, or the “System”).



## Forward Looking Statements

Certain of the discussions in this document may include “forward-looking statements” which involve known and unknown risks and uncertainties inherent in the operation of health care facilities. Actual actions or results may differ materially from those discussed above, and past or current trends may not continue. Specific factors that might cause such differences include competition from other health care facilities in the service areas of CommonSpirit, federal and state regulation of health care providers, staffing shortages, organized labor initiatives and reimbursement policies of the state and federal governments and managed care organizations. In particular,

statements preceded by, followed by or that include the word “believes,” “estimates,” “expects,” “anticipates,” “plans,” “intends,” “scheduled,” or other similar expressions are or may constitute forward-looking statements.

To present the financial results herein on a consistent basis, pro forma consolidated financial information of CommonSpirit for the three-month period ended September 30, 2018, has been derived by CommonSpirit management from the results of CHI and Dignity Health assuming that operations of the two organizations were combined as of July 1, 2018.

CommonSpirit has presented its operating results for the three-month periods ending September 30, 2019 and 2018 (pro forma), in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and on a non-GAAP basis for EBITDA (earnings before interest, tax, depreciation and amortization, and nonoperating income), operating revenues and expenses reflected to include unrecorded FY20 California provider fee program revenues and expenses as the program has not yet been approved by the Centers for Medicare and Medicaid (“CMS”), and to present pro forma results for the three-month period ended September 30, 2018, as noted above. The non-GAAP financial measures are in addition to, not a substitute for, measures of financial performance prepared in accordance with GAAP.

CommonSpirit believes that its presentation of non-GAAP financial measures provides useful supplementary information to and facilitates additional analysis by investors. CommonSpirit uses certain non-GAAP financial measures to enhance an investor's overall understanding of the financial performance and prospects for the future of CommonSpirit's ongoing business activities by facilitating comparisons of results of ongoing business operations among current, past and future periods.

### **Financial Highlights and Summary**

CommonSpirit's EBITDA (earnings before interest, tax, depreciation and amortization, and nonoperating income) decreased to \$246 million during the three-month period ended September 30, 2019, from \$416 million during the same period in the prior year. The EBITDA margin percentage decreased to 3.4% from 5.9% for the same period in the prior year. Including the California provider fee income not yet approved and recorded in FY20, EBITDA during the three-month period ended September 30, 2019, would be \$354 million, or a margin of 4.8%.

For the three-month period ended September 30, 2019, CommonSpirit's volumes on an adjusted admission basis were favorable to the same period in the prior year by 2.3%. Adjusted patient days for the quarter ended September 30, 2019, were higher than the same period in the prior year by 2.2%, and the average general acute length of stay (ALOS) of 4.47 was slightly lower than the same period in the prior year of 4.48.

## Key Indicators Financial Summary

(\$ in millions)	Three-Month Periods Ended September 30,			Change
	2019	2018	(Pro Forma)	
<b>As Recorded</b>				
EBITDA	\$ 246	\$ 416	\$	(170)
Margin %	3.4%	5.9%		(2.5%)
Operating loss	\$ (227)	\$ (56)	\$	(171)
Margin %	(3.2%)	(0.8%)		(2.4%)
Excess (deficit) of revenues over expenses	\$ (259)	\$ 207	\$	(466)
Margin %	(3.6%)	2.9%		(6.5%)
<b>Including FY20 California Provider Fee Program Not Yet Recorded</b>				
EBITDA	\$ 354	\$ 416	\$	(62)
Margin %	4.8%	5.9%		(1.1%)
Operating loss	\$ (119)	\$ (56)	\$	(63)
Margin %	(1.6%)	(0.8%)		(0.8%)
Excess (deficit) of revenues over expenses	\$ (151)	\$ 207	\$	(358)
Margin %	(2.0%)	2.9%		(4.9%)

## Productivity Performance

	Three-Month Periods Ended September 30,		
	2019	2019	2018
	As recorded	Including FY20 California Provider Fee Program Not Yet Recorded	Pro Forma
Salaries, wages and benefits as a % of net patient and premium revenue	53.2%	51.5%	51.3%
Supply expense as a % of net patient and premium revenue	17.2%	16.7%	16.0%
Purchased services and other as a % of net patient and premium revenue	30.5%	31.3%	30.6%
Capital expense as a % of net patient and premium revenue	6.9%	6.7%	7.0%

## Results of Operations

### Three-Month Periods Ended September 30, 2019 and 2018 (pro forma)

For the three-month period ended September 30, 2019, CommonSpirit recorded an operating loss of \$227 million compared to a loss of \$56 million for the same period in the prior year.

CommonSpirit did not recognize any California provider fee income during the three-month period ended September 30, 2019, pending CMS approval. The State has submitted the State Plan Amendment and CMS approval is anticipated in the spring of 2020. During the same period in the prior year, \$232 million of net patient revenue and \$124 million of purchased services and other expense were recorded for this program, for net income of \$108 million. The unrecorded FY20 California provider fee net income is expected to be similar to the FY19 amount.

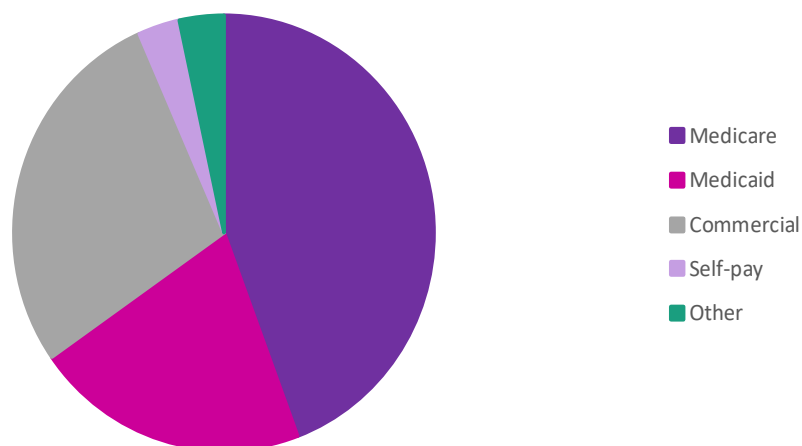
### Operating Revenues and Volume Trends

Net patient and premium revenues increased \$70 million, or 1.0%, over the same period in the prior year. Excluding provider fee program revenues, net patient and premium revenues increased \$317 million, or 4.9%, with net patient and premium revenue per adjusted admission increasing 2.5% compared to the same period in the prior year. The increase is primarily due to stable payor mix and favorable rate variances, offset by increased charity care and implicit price concessions. Adjusted admissions increased 2.3% compared to the same period in the prior year.

Volumes	Three-Month Periods Ended September 30,		Change
	2019	2018 (Pro Forma)	
Acute admissions	208,123	207,565	558
Adjusted admissions	419,329	409,726	9,603
Acute inpatient days	930,611	929,285	1,326
Adjusted patient days	1,875,008	1,834,376	40,632
Acute average length of stay	4.47	4.48	(0.01)
Outpatient visits	6,565,693	6,188,434	377,259
Gross outpatient revenue as a % of total gross patient services revenue	50.4%	49.3%	1.1%
Number of FTEs	126,480	124,933	1,547
FTEs per adjusted occupied bed	5.65	5.69	(0.04)

The following chart represents the payor gross revenue mix for consolidated operations as of September 30, 2019:

### Payor Gross Revenue Mix



Other operating revenue increased \$27 million, or 9.2%, over the same period in the prior year, primarily due to an \$11 million gain on the sale of real estate in Texas and higher rental revenues.

Operating Revenues (\$ in millions)	Three-Month Periods Ended September 30,		
	2019	2018 (Pro Forma)	Change

**As recorded**

Net patient and premium revenues	\$ 6,843	\$ 6,772	\$ 71
All other operating revenues	329	302	27
Total operating revenues	<u>\$ 7,172</u>	<u>\$ 7,074</u>	<u>\$ 98</u>

**Including FY20 California Provider Fee Program Not Yet Recorded**

Net patient and premium revenues	\$ 7,075	\$ 6,772	\$ 303
All other operating revenues	329	302	27
Total operating revenues	<u>\$ 7,404</u>	<u>\$ 7,074</u>	<u>\$ 330</u>

**Uncompensated Care**

(\$ in millions)	Three-Month Periods Ended September 30,	
	2019	2018 (Pro Forma)
Charity care, at customary charges	\$ 466	\$ 357
Charity care, at cost	\$ 116	\$ 92
Charity care, at cost, as a percentage of total expenses	1.6%	1.3%
Implicit price concessions	\$ 461	\$ 443

## Operating Expenses

Salaries and benefits increased \$166 million, or 4.8%, over the same period in the prior year, with salaries and benefits per adjusted admission increasing 2.4%, primarily due to wage increases and an increase in the cost of employee health coverage.

Supplies increased \$98 million, or 9.1%, compared to the same period in the prior year, primarily due to increased volume and higher acuity which impacted pharmaceutical and supply costs.

Purchased services and other increased \$17 million, or 0.8%, compared to the same period in the prior year. Excluding the provider fee program costs, purchased services and other increased \$155 million, or 8.4%, primarily due to increased medical fees, repairs and maintenance costs, lease expenses, pension and postretirement benefits, and higher self-insured professional liability costs.

Special charges and other costs primarily related to the affiliation between CHI and Dignity Health decreased \$13 million, or 42.2%.

Operating Expenses (\$ in millions)	Three-Month Periods Ended September 30,					Change
	2019	2019	2018			
	As Recorded	Including FY20 California Provider Fee Program Not Yet Recorded	Pro Forma	As Recorded Compared to Pro Forma	Including the Unrecorded Provider Fee Program Compared to Pro Forma	
Salaries and benefits	\$ 3,641	\$ 3,641	\$ 3,475	\$ 166	\$	166
Supplies	1,178	1,178	1,081	97		97
Purchased services and other	2,088	2,212	2,070	18		142
Depreciation and amortization	359	359	350	9		9
Interest expense, net	114	114	122	(8)		(8)
Special charges	19	19	32	(13)		(13)
Total operating expenses	<u>\$ 7,399</u>	<u>\$ 7,523</u>	<u>\$ 7,130</u>	<u>\$ 269</u>	<u>\$</u>	<u>393</u>



## Nonoperating Results

Investment income, net, was \$99 million during the three-month period ended September 30, 2019, compared to \$229 million during the same period in the prior year. Net realized gains of \$98 million in the current year were lower than net realized gains of \$156 million in the same period in the prior year. Net unrealized losses were \$55 million in the current year, compared to net unrealized gains of \$28 million during the same period in the prior year.

CommonSpirit recorded a loss on early extinguishment of debt of \$112 million during the three-month period related to the debt restructuring in August 2019.

The change in market value and cash payments of interest rate swaps was \$62 million unfavorable compared to \$22 million favorable in the same period in the prior year.

Nonoperating Results (\$ in millions)	Three-Month Periods Ended September 30,		
	2019	2018 (Pro Forma)	Change
Investment income, net	\$ 99	\$ 229	\$ (130)
Loss on early extinguishment of debt	(112)	-	(112)
Income tax expense	(4)	(7)	3
Change in fair value and cash payments of interest rate swaps	(62)	22	(84)
Contribution from business combination	19	-	19
Retirement and other deferred benefit credit	28	24	4
Other	-	(5)	5
Total nonoperating income (loss), net	<u>\$ (32)</u>	<u>\$ 263</u>	<u>\$ (295)</u>

## Operating Revenues by Division

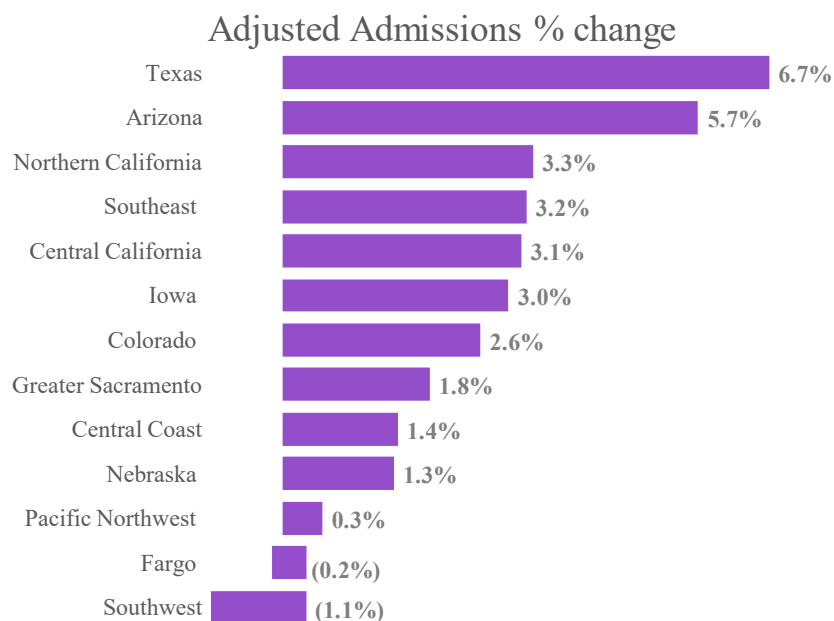
The following table presents the operating revenues by Division for the three-month periods ended September 30, 2019 and 2018 (pro forma):

Division Operating Revenue Results					
Three-Month Periods Ended					
September 30,					
(\$ in millions)	2019	2019	2018	Change	
	As Reported	Including FY20 California Provider Fee Program Not Yet Recorded	Pro Forma	As Recorded Compared to Pro Forma	Including FY20 Unrecorded Provider Fee Program Compared to Pro Forma
Southeast	\$ 860	\$ 860	\$ 828	\$ 32	\$ 32
Southwest	659	747	735	(76)	12
Pacific Northwest	739	739	700	39	39
Greater Sacramento	685	726	697	(12)	29
Colorado	619	619	613	6	6
Arizona	596	596	542	54	54
Texas	581	581	581	-	-
Central California	503	557	485	18	72
Northern California	505	531	494	11	37
Nebraska	530	530	496	34	34
Central Coast	334	357	324	10	33
Iowa	267	267	258	9	9
Fargo	183	183	177	6	6
National Business Lines*	96	96	93	3	3
Other	6	6	12	(6)	(6)
Subtotal Divisions	7,163	7,395	7,035	128	360
Corporate Services	9	9	39	(30)	(30)
CommonSpirit Health Total	\$ 7,172	\$ 7,404	\$ 7,074	\$ 98	\$ 330

\*Includes Home Care and Senior Living Business Lines.

Following are the significant division performance drivers compared to prior year:

Operating revenues for the Southeast Division increased primarily due to a 3.2% increase in adjusted admissions. The increase in the Pacific Northwest Division is driven by favorable contract rate increases and an increase in outpatient visits of 10.9%. The Greater Sacramento Division reported a favorable 1.8% increase in adjusted admissions, favorable length-of-stay, and a 2.5% increase in surgical volume. The Southwest Division reported an improved payor mix offset by a 1.1% decrease in adjusted admissions and lower surgical volume.



## Balance Sheet Metrics

The following table provides key balance sheet metrics for CommonSpirit Health:

### Key Balance Sheet Metrics

(\$ in millions)	September 30, 2019	June 30, 2019	Change
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#### Consolidated Balance Sheet Summary

Total assets	\$ 42,681	\$ 40,625	\$ 2,056
Total liabilities	\$ 27,061	\$ 24,834	\$ 2,227
Total net assets	\$ 42,681	\$ 40,625	\$ 2,056

#### Financial Position Ratios

Total cash and unrestricted investments	\$ 11,527	\$ 11,599	\$ (72)
Total debt	\$ 14,265	\$ 13,507	\$ 758
Days cash on hand	151	152	(1)
Debt to capitalization	50.0%	48.4%	(1.6%)

## Liquidity

Cash and unrestricted investments were \$11.5 billion at September 30, 2019, and \$11.6 billion at June 30, 2019.

<b>Liquidity and Capital Resources</b>			
<b>(\$ in millions)</b>	<b>September 30, 2019</b>	<b>June 30, 2019</b>	<b>Change</b>
Cash	\$ 1,515	\$ 1,569	\$ (54)
Short-term investments	2,577	2,511	66
Capital projects and other	<u>7,435</u>	<u>7,519</u>	<u>(84)</u>
Total	<u>\$ 11,527</u>	<u>\$ 11,599</u>	<u>\$ (72)</u>

## Capital Resources

Cash used in operating activities totaled \$274 million for the three-month period ended September 30, 2019, compared to \$19 million for the same period in the prior year. Significant activity for the three-month period ended September 30, 2019, includes the following:

- California provider fee-related receivables, net of payables, decreased \$28 million during the three-month period ended September 30, 2019, compared to an increase of \$1 million during the same period in the prior year.
- Accounts receivable, net, increased \$140 million during the three-month period ended September 30, 2019, compared to \$44 million during the same period in the prior year.
- Broker payables, net of receivables, decreased \$39 million during the three-month period ended September 30, 2019, compared to \$292 million during the three-month period ended September 30, 2018.
- Accrued salaries and benefits decreased \$135 million during the three-month period ended September 30, 2019, compared to \$39 million during the same period in the prior year.
- Accounts payable decreased \$35 million during the three-month period ended September 30, 2019, compared to a decrease of \$18 million during the same period in the prior year.
- Other accrued liabilities increased \$64 million during the three-month period ended September 30, 2019, compared to a decrease of \$143 million during the same period in the prior year.

Cash used in investing activities totaled \$283 million for the three-month period ended September 30, 2019, compared to \$301 million for the same period in the prior year, primarily due to the following:

- Capital expenditures were \$253 million during the three-month period ended September 30, 2019, compared to \$331 million during the same period in the prior year. Such capital expenditures primarily relate to expansion and renovation of existing facilities, equipment and systems additions and replacements, and various other capital improvements.

Cash provided by financing activities totaled \$503 million for the three-month period ended September 30, 2019, compared to cash used in financing activities of \$74 million for the same period in the prior year, primarily due to the following:

- Net debt borrowings of \$486 million during the three-month period ended September 30, 2019, compared to repayments of \$76 million during the same period in the prior year.

## Debt Consolidation

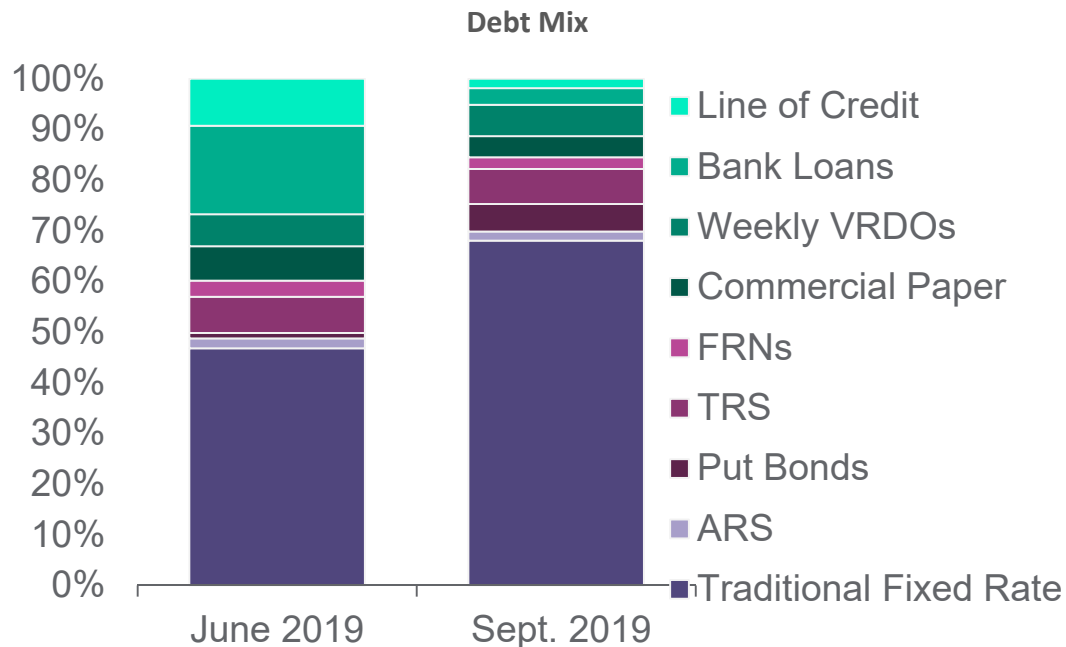
As part of a debt consolidation plan, the debt previously issued by CHI and Dignity Health was consolidated into a single unified credit group and debt structure in August 2019 in connection with the issuance and sale of the 2019 tax-exempt and taxable bonds.

With this consolidation, CHI’s Capital Obligation Document and Dignity Health’s Master Trust Indenture were amended and restated, both to be the new CommonSpirit Health Master Trust Indenture (the “CommonSpirit Health MTI”), with CHI and the Dignity Health Obligated Group each obtaining the necessary consents. The CommonSpirit Health MTI has an Obligated Group that is comprised of the former Dignity Health Obligated Group and CHI entities (collectively, the “CommonSpirit Obligated Group”). The CommonSpirit Health Obligated Group represents approximately 90% of consolidated revenues of CommonSpirit as of September 30, 2019.

Benefits from the debt restructuring include the following:

- Created a unified credit structure for CommonSpirit that will enable further streamlining of the organization, and create efficiencies in financial reporting, debt management and investor relations
- Captured net present value savings on the tax-exempt bond restructurings of approximately \$330 million
- Achieved a True Interest Cost of 3.58% on the transaction
- Generated five-year cash flow window on principal payments for the organization providing upfront cash flow savings of \$1.4 billion
- Refinanced \$3.3 billion of short-term maturities to reduce event and near-term put risk, including \$2.8 billion of bank debt
- Provided \$600 million of cash to the balance sheet for reimbursement of prior capital expenditures

The chart below depicts the debt mix of CommonSpirit before and after the debt restructuring:



## Strategic Vision

CommonSpirit's strategic vision centers around transforming health care in the United States by (i) committing to building healthier communities, (ii) advocating for those who are poor and vulnerable, and (iii) innovating how and where healing can happen in order to extend care beyond traditional settings. This strategic vision reflects and expands on CommonSpirit's founding mission by combining the strengths of CHI and Dignity Health (the "Historical Organizations") and broadening their commitment to serve the common good.

CommonSpirit is implementing its strategic vision through five transformative strategies:

**Advocate for Healthy Populations:** represent diverse populations across the United States as a leader in advancing the shift from sick care to well care.

**Coordinate and Customize Care:** take a coordinated, systemic and customizable approach to serve those with acute, chronic and complex conditions.

**Address Unique Needs of the Communities it Serves:** create a continuum of health, wellness and social services for vulnerable populations.

**Enhance Consumer Engagement:** provide more personalized care through digitalization, innovation and research in order to make care more efficient and convenient for the consumer.

**Inspire the CommonSpirit Workforce:** CommonSpirit's employees and clinicians form the core of its mission delivery. CommonSpirit intends to inspire a culture of excellence amongst all of its employees and clinicians, where people embrace service to others and experience a personal and professional fulfillment in their work.

### *Integrated Operating Company*

While still in the early stages of aligning the operations and ministries of the Historical Organizations, CommonSpirit is organized under a single operating company model that facilitates identifying, standardizing and scaling best practices across the System. The system is led by an executive leadership team, responsible for System-wide operations and long-term planning, supported by thirteen operating divisions (each, a "Division") overseen by regional executives. Centralized management and decision-making are expected to allow CommonSpirit to deploy the most effective clinical and operational practices of the Historical Organizations efficiently across the system.

At the corporate level, common services and practices include centralized financial services and purchasing, a single corporate financial planning model, budget and capital allocation processes, and centralized cash, debt and investment management. Other functions that are, or will be, coordinated centrally, with varying degrees of local implementation, include clinical quality and patient safety, managed care strategies and contracting, strategic innovation and partnerships, community health strategies, marketing management, and advocacy and communications.

As part of the integration of the Historical Organizations into a single operating company, it is anticipated that Dignity Health will merge into the Corporation, though the timing of such merger has not been determined. In addition, CommonSpirit expects to merge certain CHI affiliates into the Corporation, including CHI affiliates that are Obligated Group Members pursuant to the issuance of the 2019 Bonds. As a result of this planned internal reorganization, the number of Obligated Group Members may decrease as these entities are merged into the Corporation.

### *Synergy Goals and Realization*

Management believes that the realization of financial goals and synergies will create an improving financial platform to ensure sustainability and to generate additional capital capacity to invest in transformative strategies. Management further believes the alignment of CHI and Dignity Health presents an opportunity to realize financial synergies beyond what each organization could have achieved independently. The long-term financial goals of CommonSpirit include achievement of an eight percent operating EBITDA margin, achieving and maintaining days' cash on hand of 150 days and maintaining debt to capitalization of 45 percent or less. Management's goal is to achieve these metrics by the end of fiscal year 2023, though no assurances can be provided as to either the timing or the achievement of these goals.

CommonSpirit has identified an overall goal to realize approximately \$2 billion in synergies and performance excellence over the next four years. Management has identified approximately \$1 billion in synergy savings that are related to the types of opportunities associated with any large scale health care merger. Each functional area has a goal related to these improvements and has developed, or is in the process of developing, a detailed work plan. Some of these improvements are being implemented within one or two fiscal years, while others will require standardization of approach before the full savings can be achieved. As there is essentially no overlap in geographic footprint between CHI and Dignity Health, the majority of synergy opportunities are in support functions that do not directly address patient care and/or can be delivered virtually.

Management has also set a goal of approximately \$1 billion of savings related to performance excellence activities within the hospital and physician enterprise. CommonSpirit believes that by applying best practices, cost reductions and/or efficiency improvements can be achieved in a range of areas, including revenue cycle operations, productivity, care coordination, hospital ancillary and support services, and the physician enterprise. Each of these functions has detailed work plans supporting these efforts.

Each member of the Executive Leadership Team is responsible for several integration teams. Each team has improvement goals tied to the current calendar year, current fiscal year, and for each year through fiscal year 2023. Each team has identified specific initiatives leading to the \$2 billion goal. Finance has reviewed and evaluated each of these initiatives. An ongoing tracking mechanism has been established both for the merger-enabled synergies and the performance excellence initiatives to measure against the established goals.

Growth is also a priority for CommonSpirit in addition to achievement of synergies. Growth goals are focused across the continuum of care, from inpatient to ambulatory and virtual services. The System has identified a number of existing capabilities within each of the Historical Organizations that can be scaled rapidly across the System to accelerate performance excellence and value capture. Some examples of initiatives that are expected to drive growth or improve costs or efficiency include: scaling digital capabilities such as video visits and telehealth; expanding centralized precision sales and marketing activities that drive commercial volume; expanding home-based healthcare to manage length of stay and avoid costly readmissions; and scaling community health initiatives that address the social determinants of health. Housing, access to food, transportation and mental health and social services, when appropriately coordinated, drive efficiency through provision of services in appropriate, cost effective settings to help reduce emergency room utilization and/or preventable hospitalizations.

**COMMONSPIRIT HEALTH**

**UNAUDITED CONDENSED PRO FORMA CONSOLIDATED  
FINANCIAL STATEMENTS**

**For the Three-Month Periods Ended September 30, 2019 and 2018**



# COMMONSPIRIT HEALTH

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# COMMONSPIRIT HEALTH

## CONDENSED CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2019 AND JUNE 30, 2019 (In millions)

	As of September 30, 2019 (Unaudited)	As of June 30, 2019
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,515	\$ 1,569
Short-term investments	2,577	2,511
Assets limited as to use	1,176	2,315
Patient accounts receivable, net	3,797	3,726
Broker receivables for unsettled investment trades	238	291
Provider fee receivable	811	964
Assets held for sale	287	223
Other current assets	<u>1,637</u>	<u>1,403</u>
Total current assets	<u>12,038</u>	<u>13,002</u>
Assets limited as to use:		
Designated assets for:		
Capital projects and other	7,435	7,519
Held for self-insurance claims	1,596	1,551
Under bond indenture agreements for debt service	4	31
Donor-restricted	881	879
Other	463	397
Less amount required to meet current obligations	<u>(1,176)</u>	<u>(2,315)</u>
Assets limited as to use, net	<u>9,203</u>	<u>8,062</u>
Property and equipment, net	15,222	15,266
Right of use operating lease assets	1,885	-
Ownership interests in health-related activities	3,158	3,145
Goodwill	259	242
Intangible assets, net	713	714
Other long-term assets, net	<u>203</u>	<u>194</u>
Total assets	<u>\$ 42,681</u>	<u>\$ 40,625</u>

(Continued)

# COMMONSPIRIT HEALTH

## CONDENSED CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2019 AND JUNE 30, 2019 (In millions)

	As of September 30, 2019 (Unaudited)	As of June 30, 2019
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 923	\$ 3,475
Demand bonds subject to short-term liquidity arrangements	820	820
Accounts payable	1,406	1,362
Accrued salaries and benefits	1,169	1,348
Self-insured reserves and claims	424	423
Broker payables for unsettled investment trades	311	403
Liabilities held for sale	187	162
Provider fee payables	207	335
Right of use operating lease liabilities	264	-
Other accrued liabilities	<u>1,202</u>	<u>1,190</u>
Total current liabilities	<u>6,913</u>	<u>9,518</u>
Other liabilities - long-term:		
Self-insured reserves and claims	1,119	1,104
Pension and other postretirement liabilities	3,679	3,692
Derivative instruments	216	214
Right of use operating lease liabilities	1,790	-
Other	<u>822</u>	<u>1,094</u>
Total other liabilities - long-term	<u>7,626</u>	<u>6,104</u>
Long-term debt, net of current portion	<u>12,522</u>	<u>9,212</u>
Total liabilities	<u>27,061</u>	<u>24,834</u>
Net assets:		
Without donor restrictions - attributable to CommonSpirit Health	14,245	14,428
Without donor restrictions - noncontrolling interests	495	486
With donor restrictions	<u>880</u>	<u>877</u>
Total net assets	<u>15,620</u>	<u>15,791</u>
Total liabilities and net assets	<u>\$ 42,681</u>	<u>\$ 40,625</u>

See notes to unaudited condensed pro forma consolidated financial statements.

## COMMONSPIRIT HEALTH

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2019 AND 2018 (In millions)

	Three-Month Periods Ended September 30,	
	2019	2018 (Pro Forma)
Operating revenues:		
Net patient revenue	\$ 6,561	\$ 6,498
Premium revenue	282	274
Revenue from health-related activities, net	31	42
Other operating revenue	284	247
Contributions	14	13
Total operating revenues	<u>7,172</u>	<u>7,074</u>
Operating expenses:		
Salaries and benefits	3,641	3,475
Supplies	1,178	1,081
Purchased services and other	2,088	2,070
Depreciation and amortization	359	350
Interest expense, net	114	122
Special charges	19	32
Total operating expenses	<u>7,399</u>	<u>7,130</u>
Operating loss	(227)	(56)
Nonoperating income (loss):		
Investment income, net	99	229
Loss on early extinguishment of debt	(112)	-
Income tax expense	(4)	(7)
Change in fair value and cash payments of interest rate swaps	(62)	22
Contribution from business combination	19	-
Retirement and other deferred benefit credits, net	28	24
Other	-	(5)
Total nonoperating income (loss), net	<u>(32)</u>	<u>263</u>
Excess (deficit) of revenues over expenses	<u>\$ (259)</u>	<u>\$ 207</u>
Less excess of revenues over expenses attributable to noncontrolling interests	<u>26</u>	<u>16</u>
Excess (deficit) of revenues over expenses attributable to CommonSpirit Health	<u>\$ (285)</u>	<u>\$ 191</u>

(Continued)

## COMMONSPIRIT HEALTH

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2019 AND 2018 (In millions)

	Without Donor Restrictions		With Donor Restrictions	Total Net Assets
	Attributable to CommonSpirit Health	Noncontrolling Interests		
Balance, June 30, 2018 (pro forma)	\$ 14,146	\$ 531	\$ 857	\$ 15,534
Excess of revenues over expenses	191	16	-	207
Contributions	-	-	25	25
Net assets released from restrictions for capital	8	-	(8)	-
Net assets released from restrictions for operations and other	-	-	(10)	(10)
Loss from discontinued operations, net	(30)	-	-	(30)
Other	3	(18)	12	(3)
Increase (decrease) in net assets	172	(2)	19	189
Balance, September 30, 2018 (pro forma)	<u>\$ 14,318</u>	<u>\$ 529</u>	<u>\$ 876</u>	<u>\$ 15,723</u>
Balance, June 30, 2019	\$ 14,428	\$ 486	\$ 877	\$ 15,791
Excess (deficit) of revenues over expenses	(285)	26	-	(259)
Change in accounting principle	138	-	-	138
Contributions	-	-	13	13
Net assets released from restrictions for capital	6	-	(6)	-
Net assets released from restrictions for operations and other	-	-	(11)	(11)
Loss from discontinued operations, net	(38)	-	-	(38)
Other	(4)	(17)	7	(14)
Increase (decrease) in net assets	(183)	9	3	(171)
Balance, September 30, 2019	<u>\$ 14,245</u>	<u>\$ 495</u>	<u>\$ 880</u>	<u>\$ 15,620</u>

See notes to unaudited condensed pro forma consolidated financial statements.

# COMMONSPIRIT HEALTH

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2019 AND 2018 (In millions)

	Three-Month Periods Ended September 30,	
	2019	2018
	(Pro Forma)	
Cash flows from operating activities:		
Change in net assets	\$ (171)	\$ 189
Adjustments to reconcile change in net assets to cash used in operating activities:		
Loss on early extinguishment of debt	112	-
Depreciation and amortization	359	350
Health-related activities:		
Changes in equity of unconsolidated entities	(31)	(42)
Contribution from business combination	(19)	-
Net gain on disposal of assets	(12)	(4)
Noncash impact of change in accounting principle	(138)	-
Change in fair value of swaps	54	(32)
Change in funded status of pension and other postretirement benefit plans	1	(89)
Pension cash contributions	(17)	(2)
Changes in certain assets and liabilities:		
Accounts receivable, net	(140)	(44)
Accounts payable	(35)	(18)
Self-insured reserves and claims	9	4
Accrued salaries and benefits	(135)	(39)
Changes in broker receivables/payables for unsettled investment trades	(39)	(292)
Provider fee assets and liabilities	28	(1)
Other accrued liabilities	64	(143)
Prepaid and other current assets	(123)	(101)
Other, net	<u>(17)</u>	<u>44</u>
Cash used in operating activities before net change in investments and assets limited as to use	<u>(250)</u>	<u>(220)</u>
Net (increase) decrease in investments and assets limited as to use	<u>(24)</u>	<u>201</u>
Cash used in operating activities	<u>(274)</u>	<u>(19)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(253)	(331)
Investments in health-related activities	(69)	(46)
Business acquisitions, net of cash acquired	(4)	(8)
Proceeds from asset sales	42	9
Cash distributions from health-related activities	23	19
Other, net	<u>(22)</u>	<u>56</u>
Cash used in investing activities	<u>(283)</u>	<u>(301)</u>

(Continued)

## COMMONSPIRIT HEALTH

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2019 AND 2018

(In millions)

	<b>Three-Month Periods Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(Pro Forma)</b>	
Cash flows from financing activities:		
Borrowings	9,294	496
Repayments	(8,722)	(572)
Swaps cash collateral (posted) received	(52)	21
Distributions to noncontrolling interests	(17)	(16)
Purchase of noncontrolling interests	<u>-</u>	<u>(3)</u>
Cash provided by (used in) financing activities	<u>503</u>	<u>(74)</u>
Net decrease in cash and cash equivalents	(54)	(394)
Cash and cash equivalents at beginning of the period	<u>1,569</u>	<u>1,441</u>
Cash and cash equivalents at end of the period	<u>\$ 1,515</u>	<u>\$ 1,047</u>
Components of cash and cash equivalents and investments at end of the period:		
Cash and cash equivalents	1,515	1,047
Short-term investments	2,577	2,669
Designated assets for capital projects and other	<u>7,435</u>	<u>7,802</u>
Total	<u>\$ 11,527</u>	<u>\$ 11,518</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	<u>\$ 132</u>	<u>\$ 124</u>
Supplemental schedule of noncash investing and financing activities:		
Property and equipment acquired through capital lease or note payable	<u>\$ 54</u>	<u>\$ 1</u>
Investments in health-related activities	<u>\$ 18</u>	<u>\$ 27</u>
Accrued purchases of property and equipment	<u>\$ 101</u>	<u>\$ 98</u>

See notes to unaudited condensed pro forma consolidated financial statements.

# CommonSpirit Health

## Notes to Unaudited Condensed Pro Forma Consolidated Financial Statements

### 1. ORGANIZATION

CommonSpirit Health (the “Corporation”) is a Colorado nonprofit public benefit corporation exempt from federal and state income taxes. Effective February 1, 2019, Catholic Health Initiatives (dba “CHI”) changed its name to CommonSpirit Health and became the sole corporate member of Dignity Health, a California nonprofit public benefit corporation also exempt from federal and state income taxes. CommonSpirit Health is a Catholic healthcare system sponsored by the public juridic person, Catholic Health Care Federation (“CHCF”). Due to the circumstances of the business combination between CHI and Dignity Health, through the alignment under CHCF, the transaction qualified for acquisition accounting with CommonSpirit Health as the accounting acquirer of Dignity Health.

CommonSpirit Health owns and operates health care facilities in 21 states and is the sole corporate member (parent corporation) of other primarily nonprofit corporations that are exempt from federal and state income taxes. CommonSpirit Health is comprised of 142 hospitals, including three academic health centers, major teaching hospitals, and 31 critical access facilities; community health services organizations; accredited nursing colleges; home health agencies; living communities; a medical foundation and other affiliated medical groups; and other facilities and services that span the inpatient and outpatient continuum of care. CommonSpirit Health also has two offshore and one onshore captive insurance companies. The accompanying consolidated financial statements include CommonSpirit Health and its direct affiliates and subsidiaries (together, “CommonSpirit”).

### 2. BASIS OF PRESENTATION

The condensed pro forma consolidated financial statements of CommonSpirit as of September 30, 2019, and for the three-month periods ended September 30, 2019 and 2018, should be read in conjunction with the audited financial statements of CommonSpirit as of and for the year ended June 30, 2019. Certain footnotes and disclosures that are required in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted as they substantially duplicate the disclosures contained in the annual financial statements.

Due to the circumstances of the business combination between CHI and Dignity Health, through the alignment under CHCF, the transaction qualified for acquisition accounting with CommonSpirit Health as the accounting acquirer of Dignity Health. The affiliation was accounted for as an acquisition under Accounting Standards Codification (“ASC”) 958-805, *Not-for-Profit Entities – Business Combinations*, resulting in the recognition of a contribution of the excess of assets over liabilities of Dignity Health assumed by CommonSpirit of \$10 billion.

To present the financial results on a consistent basis, the unaudited condensed pro forma consolidated financial information of CommonSpirit for the three-month period ended September 30, 2018, has been derived by CommonSpirit management from the results of CHI and Dignity Health assuming that operations of the two organizations were combined as of July 1, 2018. Otherwise, these condensed pro forma consolidated financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of financial position and operating results in accordance with GAAP.

Certain estimates and assumptions are made that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenue and expenses for the periods presented. Actual results could differ from estimates. CommonSpirit management is responsible for the accompanying condensed pro forma consolidated financial statements.

Operating results for the three-month periods ended September 30, 2019 and 2018, are not necessarily indicative of the results that may be expected for any future period or for a full fiscal year as revenues, expenses, assets, and liabilities can vary during each quarter of the year.

Certain reclassifications and changes in presentation were made in the condensed pro forma consolidated financial statements for the three-month period ended September 30, 2018, to conform to the presentation for the three-month period ended September 30, 2019.



In preparing the accompanying condensed pro forma consolidated financial statements, management of CommonSpirit has evaluated subsequent events occurring between the end of the most recent fiscal quarter and November 18, 2019, the date the condensed pro forma consolidated financial statements were issued. See Notes 2 and 11.

### 3. ACQUISITIONS, DIVESTITURES AND SIGNIFICANT TRANSACTIONS

***Affiliation of CHI and Dignity Health*** – On February 1, 2019, CHI and Dignity Health effected a business combination as discussed in Note 1. Due to the circumstances of the business combination between CHI and Dignity Health, through the alignment under CHCF, the transaction qualified for acquisition accounting with CommonSpirit Health as the accounting acquirer of Dignity Health. No cash consideration was involved in the affiliation. As a result of the affiliation, a contribution of the excess of assets over liabilities of Dignity Health assumed by CommonSpirit of \$10 billion was recognized. Of this amount, \$9.2 billion was reported as a contribution from business combination within other income (loss) in the consolidated statements of operations and changes in net assets, and \$235 million and \$559 million was recorded as contribution from business combination for noncontrolling interest and net assets with donor restrictions, respectively, in the consolidated statements of operations and changes in net assets. There were no adjustments to the fair values of assets acquired or liabilities assumed during the three-month period ended September 30, 2019.

***Acquisitions*** – In August 2019, a consolidated subsidiary of CommonSpirit, St Joseph Health in the Texas Division, acquired the assets of College Station Medical Center (“CSMC”). CSMC includes a 167-bed hospital, is a licensed Level III Trauma center, and has accredited services which include joint replacement, chest pain, stroke and sleep specialty services. The transaction resulted in the recognition of a \$19 million gain, recorded as contribution from business combination in nonoperating income on the accompanying condensed pro forma consolidated statements of operations and changes in net assets, calculated as the fair value of the excess of identifiable assets acquired over liabilities assumed, determined based on Level 3 inputs, including estimated future cash flows and probability weighted performance assumptions.

***Dispositions*** – In April 2019, CHI sold the commercial insurance operations of QualChoice Health, Inc. (“QualChoice Health”) in the state of Arkansas for gross proceeds of \$46 million. Additionally, insurance reserves of \$61 million were released in March 2019.

In May 2017, CHI approved a plan to sell or otherwise dispose of certain entities of Jewish Hospital and St. Mary’s Healthcare, Inc. (“JHSMH”). In 2018, CHI entered into a non-binding letter of intent for the sale of JHSMH. Effective November 1, 2019, CommonSpirit completed its divestiture of the acute care operations, to the University of Louisville.

In January 2019, CHI sold QualChoice Health’s Medicare Advantage health insurance operations in the state of Washington. The purchase price is contingent upon future increases in the number of lives covered by the Medicare Advantage plans acquired, and upon maintaining a specified Centers for Medicare & Medicaid Services (“CMS”) Star Rating as published annually in October 2018 and 2019.

***Discontinued Operations and Assets and Liabilities Held for Sale*** - The operations of JHSMH and QualChoice Health are reflected as discontinued operations, with their respective assets and liabilities reflected as held for sale.

A summary of major classes of assets and liabilities of discontinued operations and held for sale is presented below (in millions):

	<b>As of September 30, 2019</b>	<b>As of June 30, 2019</b>
Patient accounts receivable, net	\$ 98	\$ 124
Held for self-insurance claims	-	47
Other current assets	22	43
Property and equipment, net	5	9
Right of use operating lease assets	144	-
Other long-term assets	<u>18</u>	<u>-</u>
Total assets held for sale	<u>\$ 287</u>	<u>\$ 223</u>
Accounts payable	\$ 25	\$ 58
Accrued salaries and benefits	25	43
Other accrued liabilities	10	19
Self-insured reserves and claims	-	7
Right of use operating lease liabilities	125	-
Other long-term liabilities	<u>2</u>	<u>35</u>
Total liabilities held for sale	<u>\$ 187</u>	<u>\$ 162</u>

Operating results of discontinued operations are reported in the accompanying condensed pro forma consolidated statements of operations and changes in net assets, and are summarized as follows (in millions):

	<b>Three-Month Periods Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
Net patient revenue	\$ 161	\$ 176
Other operating revenue	<u>14</u>	<u>147</u>
Total operating revenues	<u>175</u>	<u>323</u>
Salaries and benefits	105	106
Purchased services and other	103	235
Depreciation and amortization	1	1
Special charges	<u>5</u>	<u>12</u>
Total operating expenses	<u>214</u>	<u>354</u>
Operating loss	(39)	(31)
Nonoperating income	<u>1</u>	<u>-</u>
Deficit of revenues over expenses		
attributable to CommonSpirit Health	<u>\$ (38)</u>	<u>\$ (31)</u>

#### 4. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Sub Topic 350-40), Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (“ASU 2018-15”)*, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The guidance is effective for CommonSpirit for the annual period beginning July 1, 2021, and interim periods beginning July 1, 2022. CommonSpirit elected to early adopt this guidance beginning July 1, 2019. The adoption did not have a material impact on the accompanying condensed pro forma consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715), Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (“ASU 2017-07”)*, which requires employers to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period, and the other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside of income from operations. CommonSpirit elected to early adopt this guidance beginning July 1, 2019, applying the presentation requirements retrospectively. See Note 15.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842) (“ASU 2016-02”)*, which affects any entity that enters into a lease (as that term is defined in ASU 2016-02), with some specified scope exceptions. The main difference between the guidance in ASU 2016-02 and previous guidance is the recognition of lease assets and lease liabilities by lessees for certain leases classified as operating leases under prior guidance. CommonSpirit adopted ASU 2016-02 effective July 1, 2019, using the modified retrospective approach. Prior period financial statement amounts and disclosures have not been adjusted to reflect the provisions of the new standard. CommonSpirit has elected the transition practical expedient package to carryforward historical assessments of (1) whether contracts are or contain leases, (2) lease classification and (3) initial direct costs. CommonSpirit recognized a \$138 million cumulative effect transition adjustment increase to net assets related to the adoption of ASU 2016-02. See Note 12.

#### 5. NET PATIENT REVENUE AND PREMIUM REVENUE

Patient service revenue is reported at the amounts that reflect the consideration which CommonSpirit expects to be paid in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include consideration for retroactive revenue adjustments due to settlement of audits and reviews. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services, with revenue recognized as services are performed. Revenue for performance obligations satisfied at a point in time, which is primarily outpatient services, is recognized when services are provided. Net patient revenue is primarily comprised of hospital and physician services.

CommonSpirit determines the transaction price based on standard charges for services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with CommonSpirit’s financial assistance policy, and implicit price concessions provided to uninsured and underinsured patients. CommonSpirit determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policy, and historical experience. CommonSpirit determines its estimate of implicit price concessions based on its historical collection experience with these classes of patients using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. Subsequent changes to estimates of the transaction price are generally recorded as adjustments to net patient revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in a third-party payor’s ability to pay are recorded as bad debt expense in purchased services and other in the condensed pro forma consolidated statement of operations and changes in net assets. Bad debt expense for the three-month periods ended September 30, 2019 and 2018, was not significant.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements included in net patient revenue follows:

Medicare: Payments for inpatient services are generally made on a prospectively determined rate based on clinical diagnosis. Certain facilities receive cost-based reimbursement. Hospital outpatient services are

generally paid based on prospectively determined rates. Physician services are paid based upon established fee schedules.

Medicaid: Payments for inpatient services are generally made on a prospectively determined rate based on clinical diagnosis or on a per case or per diem basis. Hospital outpatient services and physician services are paid based upon established fee schedules, a cost basis reimbursement methodology, or discounts from established charges.

Commercial: Payments for inpatient and outpatient services provided to patients covered under commercial insurance policies are paid using a variety of payment methodologies, including per diem and per case rates.

Self-pay and Other: Payment agreements with uninsured or underinsured patients along with other responsible entities, including institutions, other hospitals and other government payors, are based on a variety of payment methodologies.

Net patient revenue by payor is comprised of the following (in millions):

	<b>Three-Months Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
		<b>(Pro Forma)</b>
Government	\$ 3,243	\$ 3,270
Contracted	\$ 2,837	2,704
Self-pay and other	<u>481</u>	<u>524</u>

Premium revenue covers amounts received on a per member per month basis for enrollees in various Medicare, Medicaid and commercial health plans. The performance obligations under these agreements are satisfied through the passage of time as CommonSpirit stands ready to provide services.

## 6. CALIFORNIA PROVIDER FEE PROGRAMS

Net patient revenue includes \$0 million and \$232 million related to supplemental Medi-Cal payments provided under the California provider fee programs during the three-month periods ended September 30, 2019 and 2018, respectively. These programs are funded by quality assurance fees paid by participating hospitals and matching federal funds. CommonSpirit recorded \$0 million and \$120 million in such fees in purchased services and other expense during the three-month periods ended September 30, 2019 and 2018, respectively. Grant expense related to the California Health Foundation and Trust was recognized in connection with the California provider fee programs resulting in \$0 million and \$4 million recorded in purchased services and other expense during the three-month periods ended September 30, 2019 and 2018, respectively. Total net income recognized was \$0 million and \$108 million during the three-month periods ended September 30, 2019 and 2018, respectively.

California's participation in provider fee programs, as authorized under federal regulations, was made permanent by the passage of Proposition 52, an initiative on the November 2016 ballot. The first iteration of the hospital provider fee program under the permanent legislation covering the period from January 1, 2017 to June 30, 2019, was approved by CMS in December 2017. The program beginning July 1, 2019, through December 31, 2021, has not yet been approved by CMS, and therefore, no amounts have been recognized for the program during the three-month period ended September 30, 2019.

## 7. INVESTMENTS AND FAIR VALUE MEASUREMENTS

CommonSpirit accounts for certain assets and liabilities at fair value or on a basis that approximates fair value. A fair value hierarchy for valuation inputs categorizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels and is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

*Level 1:* Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets in this category include money market funds, U.S. Treasury securities and listed equities.

*Level 2:* Pricing inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds, and derivative instruments.

*Level 3:* Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

The following represents assets and liabilities measured at fair value or at the NAV practical expedient on a recurring basis and certain other assets accounted for under the equity method (in millions):

	<b>September 30, 2019</b>			
	<b>Quoted Prices in Active Markets for Identical Instruments (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total Balance</b>
<b>Assets</b>				
Cash and short-term investments	\$ 474	\$ 28	\$ -	\$ 502
U.S. government securities	737	191	-	928
U.S. corporate bonds	75	537	-	612
U.S. equity securities	1,030	44	-	1,074
Foreign equity securities	722	5	-	727
Private equity	-	-	63	63
Other investments	<u>264</u>	<u>86</u>	<u>-</u>	<u>350</u>
Assets measured at fair value	<u>\$ 3,303</u>	<u>\$ 891</u>	<u>\$ 63</u>	\$ 4,257
<b>Assets at NAV:</b>				
U.S. corporate bonds				438
U.S. equity securities				210
Foreign corporate bonds				106
Foreign equity securities				648
Private equity				615
Hedge funds				1,259
Real estate				<u>243</u>
Total assets				<u>\$ 7,776</u>
<b>Liabilities</b>				
Derivative instruments	\$ -	\$ 509	\$ -	\$ 509
Other	<u>5</u>	<u>-</u>	<u>84</u>	<u>89</u>
Total liabilities	<u>\$ 5</u>	<u>\$ 509</u>	<u>\$ 84</u>	<u>\$ 598</u>

June 30, 2019

	<b>Quoted Prices in Active Markets for Identical Instruments (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total Balance</b>
<b>Assets</b>				
Cash and short-term investments	\$ 630	\$ 67	\$ -	\$ 697
U.S. government securities	727	116	-	843
U.S. corporate bonds	71	440	-	511
U.S. equity securities	1,147	12	-	1,159
Foreign equity securities	629	2	-	631
Private equity	-	-	65	65
Other investments	61	25	1	87
Assets measured at fair value	<u>\$ 3,265</u>	<u>\$ 662</u>	<u>\$ 66</u>	\$ 3,993
<b>Assets at NAV:</b>				
U.S. corporate bonds				430
U.S. equity securities				213
Foreign corporate bonds				153
Foreign equity securities				671
Private equity				578
Hedge funds				1,179
Real estate				233
Total assets				<u>\$ 7,450</u>
<b>Liabilities</b>				
Derivative instruments	\$ -	\$ 454	\$ -	\$ 454
Other	3	-	74	77
Total liabilities	<u>\$ 3</u>	<u>\$ 454</u>	<u>\$ 74</u>	<u>\$ 531</u>

Assets and liabilities measured at fair value on a recurring basis reflected in the table above are reported in short-term investments, assets limited as to use, current liabilities and other liabilities in the accompanying consolidated balance sheets.

There were no transfers among any of the levels of fair value hierarchy during the periods presented.

The Level 2 and 3 instruments listed in the fair value hierarchy tables above use the following valuation techniques and inputs:

For marketable securities, such as U.S. and foreign government securities, U.S. and foreign corporate bonds, U.S. and foreign equity securities, mortgage and asset-backed securities, and structured debt, in the instances where identical quoted market prices are not readily available, fair value is determined using quoted market prices and/or other market data for comparable instruments and transactions in establishing prices, discounted cash flow models and other pricing models. These inputs to fair value are included in industry-standard valuation techniques, such as the income or market approach. CommonSpirit classifies all such investments as Level 2.

For private equity investments where no fair value is readily available, the fair value is determined using models that take into account relevant information considered material. Due to the significant unobservable inputs present in these valuations, CommonSpirit classifies all such investments as Level 3.

The fair value of collateral held under securities lending program is classified as Level 2. The collateral held under this program is placed in commingled funds whose underlying investments are valued using techniques similar to those used for the marketable securities noted above. Amounts reported do not include non-cash collateral of \$56 million and \$54 million as of September 30, 2019, and June 30, 2019, respectively.

The fair value of assets and liabilities for derivative instruments, such as interest rate swaps classified as Level 2, is determined using an industry standard valuation model, which is based on a market approach. A credit risk spread (in basis points) is added as a flat spread to the discount curve used in the valuation model. Each leg is discounted and the difference between the present value of each leg's cash flows equals the fair value of the swap.

Investments that are measured using the NAV per share practical expedient have not been classified in the fair value hierarchy. The NAV amounts presented in the table above are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the balance sheet.

Related to investments valued using the NAV per share practical expedient, management also performs, on a regular basis when information is available, various validations and testing of NAV provided and determines that the investment managers' valuation techniques are compliant with fair value measurement accounting standards.

The following table and explanations identify attributes relating to the nature and risk of investments for which fair value is determined using a calculated NAV (in millions):

<b>As of September 30, 2019</b>					
<u>NAV Practical Expedient</u>	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period	
Private equity	(1) \$ 615	\$ -	-	-	-
Multi-strategy hedge funds	(2) 1,259	-	Weekly, Monthly, Quarterly, Semi-Annually, Annually	3 - 120 days	
Real estate fund	(3) 243	11	Quarterly	90 days	
Commingled funds - debt securities	(4) 544	40	Daily, Monthly, Quarterly	1 - 90 days	
Commingled funds - equity securities	(5) 858	-	Daily, Weekly, Monthly, Quarterly	1 - 90 days	
Total	<u>\$ 3,519</u>	<u>\$ 51</u>			

<b>As of June 30, 2019</b>					
<u>NAV Practical Expedient</u>	NAV Practical Expedient	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period	
Private equity	(1) \$ 578	\$ -	-	-	-
Multi-strategy hedge funds	(2) 1,179	-	Monthly, Quarterly, Semi-annually, Annually	5 - 120 days	
Real estate fund	(3) 233	10	Quarterly	90 days	
Commingled funds - debt securities	(4) 583	41	Daily, Monthly, Quarterly	1 - 90 days	
Commingled funds - equity securities	(5) 884	-	Daily, Monthly, Quarterly	1 - 120 days	
Total	<u>\$ 3,457</u>	<u>\$ 51</u>			

- (1) This category includes private equity funds that specialize in providing capital to a variety of investment groups, including, but not limited to, venture capital, leveraged buyout, mezzanine debt, distressed debt, and other situations. There are no provisions for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated, estimated at September 30, 2019, to be over the next 10 years.

- (2) This category includes investments in hedge funds that pursue diversification of both domestic and foreign fixed income and equity securities through multiple investment strategies. The primary objective for these funds is to seek attractive long-term, risk-adjusted absolute returns. Under certain circumstances, an otherwise redeemable investment or portion thereof could become restricted. The following table reflects the various redemption frequencies, notice periods, and any applicable lock-up periods or gates to redemption as of September 30, 2019:

Percentage of the Value of Category (2)		Redemption Frequency	Redemption Notice Period	Redemption Locked Up Until (if applicable)	Redemption Gate % of Account (if applicable)
Total	Subtotal				
13.5%	7.2%	Annually	60 days	2 years	up to 25.0% to 50.0%
	1.3%	Annually	75 days	-	-
	5.0%	Annually	90 days	2 years	-
0.6%	0.4%	Semi-Annually	60 days	2 years	-
	0.2%	Semi-Annually	75 - 90 days	-	-
46.3%	4.2%	Quarterly	30 - 45 days	2 years	up to 20.0%
	35.8%	Quarterly	60 - 65 days	1 year	up to 12.5% - 25.0%
	6.3%	Quarterly	90 days	1 year	up to 12.5% - 25.0%
37.6%	3.7%	Monthly	5 days	None	up to 20.0%
	27.8%	Monthly	30 - 45 days	-	up to 16.7%
	6.1%	Monthly	90 - 120 days	2 years	up to 20.0%
2.0%	2.0%	Weekly	3 days	None	-

- (3) This category includes investments in real estate funds that invest primarily in institutional-quality commercial and residential real estate assets within the U.S. and investments in publicly traded real estate investment trusts. Investments representing 16% of the value of investments in this category do not have provisions for redemptions during the life of these funds. Distributions will be received as the underlying investments of the funds are liquidated, estimated at September 30, 2019, to be over the next six years.
- (4) This category includes investments in commingled funds that invest primarily in domestic and foreign debt and fixed income securities, the majority of which are traded in over-the-counter markets. Also included in this category are commingled fixed income funds that provide capital in a variety of mezzanine debt, distressed debt and other special debt securities situations. Investments representing approximately 9% of the value of investments in this category do not have provisions for redemptions during the life of these funds. Distributions will be received as the underlying investments of the funds are liquidated, estimated at September 30, 2019, to be over the next six years.
- (5) This category includes investments in commingled funds that invest primarily in domestic or foreign equity securities with multiple investment strategies. A majority of the funds attempt to match or exceed the returns of specific equity indices.

The investments included above are not expected to be sold at amounts that are materially different from NAV.

CHI's investment portfolio is held directly by the CHI Operating Investment Program, L.P. (the "Program"). The Program is structured under a limited partnership agreement with CHI as managing general partner and numerous limited partners, most sponsored by CHI. The partnership provides a vehicle whereby virtually all entities associated with CHI, as well as certain other unrelated entities, can optimize investment returns while managing investment risk. Limited partners may make deposits into the Program on the first business day of each month. Withdrawals may be made from the Program on the first business day of each month upon five business days' prior notice. Fulfillment of withdrawal requests may be delayed due to market restrictions or other conditions as determined by CHI. Withdrawal requests will be fulfilled as soon as practical based upon the conditions necessitating the delay, with at least 25% of the amount requested fulfilled within 60 days, the next 25% within 90 days, and the remaining 50% within 180 days. The entire withdrawal request shall be fulfilled within 180 days of the date such request was made. The limited partnership agreement permits a simple-majority vote of the noncontrolling limited partners to



terminate the partnership. Accordingly, CHI recognizes only the utilized portion of Program assets attributable to CHI and its direct affiliates in which it has sole corporate membership or ownership, accounting for its ownership in the Program under the equity method. As such, these investments are excluded from the scope of fair value measurements reported above.

Certain of the Program's alternative investments are made through limited liability companies ("LLCs") and limited liability partnerships ("LLPs"). These LLCs and LLPs provide the Program with a proportionate share of the investment gains or losses. The Program accounts for its ownership in the LLCs and LLPs under the equity method.

The Program's alternative investments are not publicly traded and readily available market quotations are generally not available to be used for valuation purposes. Accordingly, the Program's alternative investments are measured at NAV as of the reporting date, as reported by fund managers, and are excluded from the three-level hierarchy for fair value measurements.

While the Program believes that its valuation methods are appropriate and consistent with those used by other market participants, the use of different methodologies or assumptions to estimate the fair value of Level 3 investments could result in a different estimate of fair value at the reporting date. Level 3 fair value estimates and Alternative Investments measured at NAV may differ significantly from the values that would have been determined had a readily available market for such investments existed, or had such investments been liquidated or sold to external investors, and these differences could be material to the Program's financial statements.

In situations where inputs used to determine fair value fall into different levels of the fair value hierarchy, the level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following represents assets and liabilities of the Program in its entirety, of which CHI holds 89% as of September 30, 2019, and June 30, 2019, measured at fair value or at the NAV practical expedient on a recurring basis and certain other assets accounted for under the equity method (in millions):

	<b>September 30, 2019</b>			
	<b>Quoted Prices</b>			
	<b>in Active</b>	<b>Significant</b>	<b>Significant</b>	
	<b>Markets for</b>	<b>Other</b>	<b>Unobservable</b>	
	<b>Identical</b>	<b>Observable</b>	<b>Inputs</b>	
	<b>Instruments</b>	<b>Inputs</b>	<b>Inputs</b>	
	<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>	<b>Total</b>
<b>Assets</b>				
Cash and short-term investments	\$ 284	\$ 75	\$ -	\$ 359
U.S. government securities	117	13	-	130
U.S. corporate bonds	4	325	-	329
U.S. equity securities	2,066	890	-	2,956
Foreign corporate bonds	-	62	-	62
Term loans	-	-	243	243
Foreign currency exchange contracts	-	219	-	219
Assets measured at fair value	<u>\$ 2,471</u>	<u>\$ 1,584</u>	<u>\$ 243</u>	4,298
<b>Assets at NAV:</b>				
Hedge funds				487
Real estate				395
Venture capital/private equity				<u>402</u>
<b>Total assets</b>				<u><u>\$ 5,582</u></u>
<b>Liabilities - foreign currency exchange</b>				
contracts	<u>\$ -</u>	<u>\$ 218</u>	<u>\$ -</u>	<u>\$ 218</u>

	<b>June 30, 2019</b>			
	<b>Quoted Prices in Active Markets for Identical Instruments (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total</b>
<b>Assets</b>				
Cash and short-term investments	\$ 321	\$ 79	\$ -	\$ 400
U.S. government securities	80	8	-	88
U.S. corporate bonds	5	323	-	328
U.S. equity securities	2,159	802	-	2,961
Foreign corporate bonds	-	64	-	64
Term loans	-	-	245	245
Foreign currency exchange contracts	-	220	-	220
Assets measured at fair value	<u>\$ 2,565</u>	<u>\$ 1,496</u>	<u>\$ 245</u>	4,306
<b>Assets at NAV:</b>				
Hedge funds				524
Real estate				427
Venture capital/private equity				<u>351</u>
<b>Total assets</b>				<u><u>\$ 5,608</u></u>
<b>Liabilities - foreign currency exchange contracts</b>				
	<u>\$ -</u>	<u>\$ 220</u>	<u>\$ -</u>	<u>\$ 220</u>

## 8. INTANGIBLE ASSETS, NET

Intangible assets reported in the condensed pro forma consolidated balance sheets consist primarily of amounts for managed care contracts, trade names, management agreements, noncompete agreements, and other contracts related to certain business combinations accounted for under the acquisition method. Certain intangible assets have indefinite lives, and others are amortized over estimated useful lives ranging up to 25 years using the straight-line method. The aggregate amount of amortization expense related to intangible assets subject to amortization is \$3.6 million and \$3.2 million for the three-month periods ended September 30, 2019 and 2018, respectively.

## 9. GOODWILL

Goodwill is measured as of the effective date of a business combination as the excess of the aggregate of the fair value of consideration transferred over the fair value of the tangible and intangible assets acquired and liabilities assumed.

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

	<b>As of September 30, 2019</b>	<b>As of June 30, 2019</b>
Balance at beginning of period	\$ 242	\$ 240
Addition from acquisitions	17	1
Goodwill divested during the period	<u>-</u>	<u>1</u>
Balance at end of period	<u><u>\$ 259</u></u>	<u><u>\$ 242</u></u>

## 10. DEBT

As of August 2019, the indebtedness of CHI and Dignity Health was consolidated into a single unified credit group with the issuance and sale of the 2019 tax-exempt and taxable bonds. The Capital Obligation Document (the “COD”) issued by CHI and the Dignity Health Master Trust Indenture (the “Master Trust Indenture”) were amended and restated; both are now the new CommonSpirit Master Trust Indenture (the “CommonSpirit Health MTI”).

In July 2019, Dignity Health entered into \$1.2 billion of bridge loans with three banks to advance refund certain CHI fixed rate bonds using acquisition financing treatment.

In August 2019, CommonSpirit issued \$2.5 billion of tax-exempt fixed rate bonds. Proceeds were used to refinance \$1.1 billion of the bridge loans entered into in July 2019, refund \$1.4 billion of tax-exempt fixed rate bonds that were placed in escrow and the bonds defeased, refund \$322 million of commercial paper, and provide \$106 million for general working capital purposes. The bonds were sold at a premium and mature in August 2044 and 2049.

In August 2019, CommonSpirit issued \$621 million of tax-exempt put bonds. Proceeds included \$569 million of new money and were used to refund \$161 million of tax-exempt fixed rate bonds, which were placed in escrow, and the bonds were defeased. The bonds were sold at a premium and mature in August 2049, with mandatory purchase dates in August 2024, 2025 and 2026.

In August 2019, CommonSpirit issued \$3.3 billion of taxable fixed rate bonds at par, with repayments of \$770 million, \$915 million, \$700 million (insured) and \$930 million to be made in October 2024, 2029, 2049 (insured) and 2049, respectively. A portion of the proceeds were used to refund \$1.5 billion of CHI tax-exempt fixed rate bonds, refinance \$945 million of Dignity Health bank lines of credit, refinance \$353 million of Dignity Health direct placement variable rate bank loans, refinance \$338 million of Dignity Health taxable bonds, refinance \$137 million of the bridge loans, refund \$41 million of Dignity Health tax-exempt fixed rate bonds, refinance \$5 million of commercial paper, and pay cost of issuance expenses. Refunded bonds were placed in escrow and were defeased. The bonds were sold at par and mature in October 2049.

In September 2019, CommonSpirit renewed and extended three letters of credit issued by Dignity Health in October 2015 to support VRDBs of \$76 million, \$60 million, and \$60 million, to October 2022. This did not change the terms, provisions or classification of the VRDBs.

In November 2019, CommonSpirit renewed and extended a letter of credit issued by Dignity Health in December 2015 to support VRDBs of \$57 million to December 2023. This did not change the terms, provisions or classification of the VRDBs.

In September 2018, Dignity Health renewed a \$169 million direct placement loan which was scheduled to mature in September 2018, to September 2023. The loan was refinanced with proceeds from the August 2019 bond financing.

In August 2018, CHI issued \$200 million of Series 2018B taxable bonds subject to mandatory tender in August 2019. The proceeds were subsequently used to reimburse the funding of the \$200 million Series 2016 taxable bonds, which were subject to mandatory tender in September 2018. The bonds were refinanced with proceeds from the August 2019 bond financing.

In July 2018, CHI issued \$275 million of Series 2018A taxable bonds subject to mandatory tender in August 2021. Proceeds were used to fund the \$275 million Series 2013D taxable bonds principal payment due in August 2018. The bonds were refinanced with proceeds from the August 2019 bond financing.

In July 2018, CHI extended the mandatory purchase date of the \$250 million Series 2017A taxable bonds from August 2018 to July 2021. As a result, CHI classified the Series 2013D and Series 2017A taxable bonds as long-term debt as of June 30, 2019. The bonds were refinanced with proceeds from the August 2019 bond financing.

In July 2018, Dignity Health defeased \$21 million in aggregate outstanding principal amount of the California Health Facilities Financing Authority 1988 Series C VRDBs. The defeasance was financed with a draw on the syndicated line of credit. The letter of credit supporting this series of VRDBs was cancelled in conjunction with the defeasance of the bonds. This draw on the syndicated line of credit was refinanced with proceeds from the August 2019 bond financing.

## 11. DERIVATIVE INSTRUMENTS

The following table shows the outstanding notional amount of derivative instruments measured at fair value, net of credit value adjustments, as reported in the accompanying consolidated balance sheets (in millions):

	<b>Maturity Date of Derivatives</b>	<b>Interest Rate</b>	<b>Notional Amount Outstanding</b>	<b>Fair Value</b>
<b>September 30, 2019</b>				
Derivatives not designated as hedges				
Interest rate swaps	2024 - 2047	3.2% - 4.0%	\$ 2,230	\$ (508)
Risk participation agreements	2022 - 2025	SIFMA plus spread	510	-
Total return swap	2020 - 2024	SIFMA plus spread	<u>399</u>	<u>-</u>
Total derivative instruments			3,139	(508)
Cash collateral			<u>-</u>	<u>292</u>
Derivative instruments, net			<u>\$ 3,139</u>	<u>\$ (216)</u>
<b>June 30, 2019</b>				
Derivatives not designated as hedges				
Interest rate swaps	2024 - 2047	3.2% - 4.0%	\$ 2,252	\$ (454)
Risk participation agreements	2019 - 2025, with extension options	SIFMA plus spread	510	-
Total return swaps	2020 - 2024	SIFMA plus spread	<u>408</u>	<u>-</u>
Total derivative instruments			3,170	(454)
Cash collateral			<u>-</u>	<u>240</u>
Derivative instruments, net			<u>\$ 3,170</u>	<u>\$ (214)</u>

CHI held \$1.4 billion notional amount of interest rate swaps at September 30, 2019, which have a negative fair value of \$309 million. CHI posted \$292 million of collateral against the fair value of these swaps.

The CHI interest rate swaps mature between 2024 and 2047. CHI has the right to terminate the swaps prior to maturity for any reason. The termination value would be the fair value or the replacement cost of the swaps, depending on the circumstances. All of the derivative agreements have certain early termination triggers caused by an event of default or a termination event. The events of default include failure to make payment when due, failure to give notice of a termination event, failure to comply with or perform obligations under the agreements, bankruptcy or insolvency, and defaults under other agreements (cross-default provision). The termination events include credit ratings dropping below Baa3/BBB- (Moody's/Standard & Poor's) by either party on the notional amount of \$488 million of interest rate swaps and below Baa2/BBB on a notional amount of \$561 million of interest rate swaps.

Based upon CHI's swap agreements in place as of September 30, 2019, a reduction in CHI's credit rating to BBB would obligate CHI to post additional cash collateral of \$29 million. If CHI's credit rating were to fall below BBB, the swap counterparties would have the option to require CHI to settle the swap liabilities of \$120 million as of September 30, 2019, which are recorded at fair value, net of cash collateral. Generally, it is CHI's policy that all

counterparties have an AA rating or better. The swap agreements generally require CHI to provide collateral if CHI's liability, determined on a fair value basis, exceeds a specified threshold that varies based upon the rating on CHI's long-term indebtedness.

CHI has total return swaps in the notional amount of \$129 million and a negative fair value of \$1 million at September 30, 2019.

Of the \$871 million notional amount of interest rate swaps held by Dignity Health at September 30, 2019, \$160 million are insured and have a negative fair value of \$59 million. In the event the insurer is downgraded below A2/A or A3/A- (Moody's/Standard and Poor's), the counterparties have the right to terminate the swaps if Dignity Health does not provide alternative credit support acceptable to them within 30 days of being notified of the downgrade. If the insurer is downgraded below the thresholds noted above and Dignity Health is downgraded below Baa3/BBB- (Moody's/Standard and Poor's), the counterparties have the right to terminate the swaps.

Dignity Health has \$711 million of interest rate swaps that are not insured as of September 30, 2019. While Dignity Health has the right to terminate the swaps prior to maturity for any reason, counterparties have various rights to terminate, including swaps in the outstanding notional amount of \$100 million at each five-year anniversary date commencing in March 2023 and swaps in the notional amount of \$194 million at each five-year anniversary date commencing in September 2023. Swaps in the notional amounts of \$60 million and \$68 million have mandatory puts in March 2021 and March 2023, respectively. The termination value would be the fair value or the replacement cost of the swaps, depending on the circumstances. These interest rate swaps have a negative fair value of \$87 million at September 30, 2019. The remaining uninsured interest rate swaps in the notional amount of \$289 million have a negative fair value of \$53 million as of September 30, 2019.

Dignity Health has floating rate derivatives in the notional amount of \$780 million as of September 30, 2019. Risk participation agreements in the notional amount of \$510 million have a fair value deemed immaterial as of September 30, 2019. Dignity Health has a total return swap in the notional amount of \$270 million. The total return swap has a positive fair value of \$1 million at September 30, 2019.

All of Dignity Health's derivative agreements have certain early termination triggers caused by an event of default or a termination event. The events of default include failure to make payment when due, failure to give notice of a termination event, failure to comply with or perform obligations under the agreements, bankruptcy or insolvency, and defaults under other agreements (cross-default provision). Other than the insured swaps described above, the termination events include credit ratings dropping below Baa1/BBB+ (Moody's/Standard & Poor's) by either party on the notional amount of \$699 million of swaps and below Baa2/BBB on a notional amount of \$792 million, and Dignity Health's cash on hand dropping below 85 days.

As part of the August 2019 debt consolidation, all swaps and derivative bank counterparties consented to the CommonSpirit Health MTL.

## 12. LEASES

CommonSpirit enters into operating and finance leases primarily for buildings and equipment. For leases with terms greater than 12 months, CommonSpirit records the related right-of-use asset ("ROU") and liability at the present value of lease payments over the contract term using a risk free interest rate. CommonSpirit does not separate contract lease and non-lease components except for a class of underlying assets related to supply agreements which include associated equipment. Building lease agreements generally require CommonSpirit to pay maintenance, repairs, property taxes and insurance costs, which are variable amounts based on actual costs incurred during each applicable period. Such costs are not included in the determination of the ROU asset or lease liability. Variable lease costs also include escalating rent payments that are not fixed at commencement but are based on an index that is determined in future periods over the lease term based on changes in the Consumer Price Index or other measure of cost inflation. Most leases include one or more options to renew the lease at the end of the initial term, with renewal terms that generally extend the lease at the then market rate of rental payment. Certain leases also include an option to buy the underlying asset at or a short time prior to the termination of the lease. All such options are at CommonSpirit's discretion and are evaluated at the commencement of the lease, with only those that are reasonably certain of exercise included in determining the appropriate lease term.

The components of lease cost and rent expense for the three months ended September 30, 2019, are as follows (in millions):

	<b>Three-Month Period Ended September 30, 2019</b>
Operating lease cost:	
Operating lease cost	\$ 98
Short-term rent expense	5
Variable lease cost	29
Sublease income	<u>(1)</u>
Total operating lease cost	<u>\$ 131</u>
Finance lease cost:	
Amortization of right-of-use assets	\$ 14
Interest on finance lease liabilities	<u>2</u>
Total finance lease cost	<u>\$ 16</u>

Following is supplemental balance sheet information related to leases as of September 30, 2019 (in millions):

<b>Lease Type</b>	<b>Balance Sheet Classification</b>	
<b>Operating Leases:</b>		
Operating lease ROU assets	Right of use operating lease assets	\$ 1,885
Operating lease obligations - current	Current liabilities: Right of use operating lease liabilities	264
Operating lease obligations - long-term	Other liabilities: Right of use operating lease liabilities	1,790
<b>Finance Leases:</b>		
Finance lease ROU assets	Property and equipment, net	164
Current finance lease liabilities	Current portion of long-term debt	25
Long-term finance lease liabilities	Long-term debt, net of current portion	217

Supplemental cash flow and other information related to leases as of and for the three-month periods ended September 30, 2019, are as follows:

Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases		\$ 92
Operating cash flows from finance leases		1
Financing cash flows from finance leases		24
Right-of-use assets obtained in exchange for new finance lease liabilities		\$ 15
Weighted-average remaining lease term:		
Operating leases		9 years
Finance leases		12 years
Weighted-average discount rate:		
Operating leases		2.1%
Finance leases		4.7%

Commitments related to noncancellable operating and finance lease for each of the next five years and thereafter as of September 30, 2019, are as follows:

	<b>Operating</b>	<b>Finance</b>	<b>Total</b>
2020 (remaining 9 months)	\$ 294	\$ 31	\$ 325
2021	324	43	367
2022	281	30	311
2023	251	27	278
2024	226	25	251
Thereafter	<u>1,071</u>	<u>135</u>	<u>1,206</u>
Total minimum future lease payments	2,447	291	2,738
Less: Imputed interest	<u>(268)</u>	<u>(49)</u>	<u>(317)</u>
Total lease liabilities before discontinued operations	2,179	242	2,421
Lease liabilities of discontinued operations classified as liabilities held for sale	<u>(125)</u>	<u>-</u>	<u>(125)</u>
Total lease liabilities	2,054	242	2,296
Less: Current portion	<u>(264)</u>	<u>(25)</u>	<u>(289)</u>
Long-term liabilities	<u>\$ 1,790</u>	<u>\$ 217</u>	<u>\$ 2,007</u>

Commitments related to noncancellable operating and finance lease liabilities at June 30, 2019, prior to the adoption of ASU 2016-02, were as follows:

	<b>Operating</b>	<b>Finance</b>	<b>Total</b>
2020	\$ 331	\$ 18	\$ 349
2021	278	21	299
2022	239	8	247
2023	211	8	219
2024	189	7	196
Thereafter	<u>647</u>	<u>94</u>	<u>741</u>
Total minimum future lease payments	<u>\$ 1,895</u>	<u>\$ 156</u>	<u>\$ 2,051</u>

### 13. INTEREST EXPENSE, NET

The components of interest expense, net, include the following (in millions):

	<b>Three-Month Periods Ended</b>	
	<b>September 30,</b>	
	<b>2019</b>	<b>2018</b>
		<b>(Pro Forma)</b>
Interest and fees on debt and other	\$ 122	\$ 129
Capitalized interest expense	<u>(8)</u>	<u>(6)</u>
Interest expense, net	<u>\$ 114</u>	<u>\$ 123</u>

#### 14. INVESTMENT INCOME, NET

Investment income, net, on assets limited as to use, cash equivalents, collateral held under securities lending program, notes receivable, and investments, is comprised of the following (in millions):

	September 30,	
	2019	2018
		(Pro Forma)
Interest and dividend income	\$ 61	\$ 53
Net realized gains on sales of securities	98	156
Net unrealized gains (losses) on securities	(55)	28
Other, net of capitalized investment income	<u>(5)</u>	<u>(8)</u>
Investment income, net	<u>\$ 99</u>	<u>\$ 229</u>

#### 15. RETIREMENT PROGRAMS

Total expense for all CommonSpirit retirement and postretirement plans was \$147 million and \$142 million for the three-month periods ended September 30, 2019 and 2018, respectively. The service cost component of \$175 million and \$165 million for the three-month periods ended September 30, 2019 and 2018, respectively, is included in salaries and benefits expense in the condensed pro forma consolidated statements of operations and changes in net assets. Other nonservice costs were retrospectively adjusted to present \$24 million of net benefit credits in retirement and other deferred benefit credits, net, in nonoperating income (loss), which were previously recognized in salaries and benefits in operating expenses, for the three-month period ended September 30, 2018. Such net credits for the three-month period ended September 30, 2019, were \$28 million.

#### 16. SPECIAL CHARGES

Special charges relate to consulting, legal, severance and other costs related to the following:

	Three-Month Periods Ended	
	September 30,	
	2019	2018
		(Pro Forma)
Changes in business operations	\$ 5	\$ 6
Affiliation related costs	<u>14</u>	<u>26</u>
Special charges	<u>\$ 19</u>	<u>\$ 32</u>

Charges related to changes in business operations include costs incurred periodically to implement reorganization efforts within specific operations in order to align CommonSpirit's operations in the most strategic and cost-effective manner, consisting primarily of consulting and severance costs. Affiliation costs primarily relate to legal, consulting and labor-related costs.

#### 17. COMMITMENTS AND CONTINGENT LIABILITIES

The following summary encompasses matters related to litigation, regulatory and compliance matters, and developments thereto.

**General** – The health care industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, the rules governing licensure, accreditation, controlled substances, privacy, government program participation, government reimbursement, antitrust, anti-kickback, prohibited referrals by physicians, false claims, and in the case of tax-exempt organizations, the requirements of tax exemption. Management believes CommonSpirit is materially in compliance with all applicable laws and regulations of the Medicare and Medicaid programs. Compliance with such laws and regulations is complex and can be subject to



future governmental interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs. Certain CommonSpirit entities have been contacted by governmental agencies regarding alleged violations of Medicare practices for certain services. In the opinion of management after consultation with legal counsel, the ultimate outcome of these matters will not have a material adverse effect on CommonSpirit's consolidated financial statements.

In recent years, government activity has increased with respect to investigations and allegations of wrongdoing. In addition, during the course of business, CommonSpirit becomes involved in civil litigation. Management assesses the probable outcome of unresolved litigation and investigations and records contingent liabilities reflecting estimated liability exposure. Following is a discussion of matters of note.

**U.S. Department of Justice and OIG Investigations** – CommonSpirit and/or its facilities periodically receive notices from governmental agencies, such as the U.S. Department of Justice or the Office of Inspector General (“OIG”), requesting information regarding billing, payment, or other reimbursement matters, or initiating investigations, or indicating the existence of whistleblower litigation. The health care industry in general is experiencing an increase in these activities, as the federal government increases enforcement activities and institutes new programs designed to identify potential irregularities in reimbursement or quality of patient care. Resolution of such matters can result in civil and/or criminal charges, cash payments and/or administrative measures by the entity subject to such investigations. CommonSpirit does not presently have information indicating that pending matters or their resolution will have a material effect on CommonSpirit's financial statements, taken as a whole. Nevertheless, there can be no assurance that the resolution of matters of these types will not affect the financial condition or operations of CommonSpirit, taken as a whole.

Within this category of activities, in October 2014, Dignity Health completed a civil settlement and entered into a Corporate Integrity Agreement (“CIA”) with the OIG to resolve an investigation into government reimbursement of hospital inpatient stays. The CIA requires, for a five-year period, enhanced compliance program obligations, education and training, and that Dignity Health retain an independent review organization to review the accuracy of certain claims for hospital services furnished to federal health care program beneficiaries.

**Pension Plan Litigation** – In April 2013, Dignity Health was served with a class action lawsuit filed in the United States District Court for the Northern District of California by a former employee alleging breaches of fiduciary duty and other claims under ERISA in connection with the Dignity Health Pension Plan (“DHPP”). Among other things, the complaint originally alleged that, because Dignity Health is not a church or an association of churches, the DHPP does not qualify as a “church plan”. The complaint also challenged the constitutionality of ERISA's church plan exemption. Dignity Health and the sponsoring religious orders established the DHPP and determined the DHPP was a church plan that should be exempt from ERISA, including ERISA's funding requirements, and received private letter rulings from the Internal Revenue Service that confirmed its church plan status. The plaintiff sought to represent a class comprised of participants and beneficiaries of the DHPP as of April 2013, when the complaint was filed.

In July 2014, the District Court ruled that only a church or an association of churches may establish a church plan, the DHPP did not qualify as a church plan since Dignity Health was not a church when the plan was established, and, therefore, DHPP was not exempt from ERISA. Dignity Health appealed the decision. In July 2016, the Ninth Circuit Court of Appeals issued its opinion, which affirmed the District Court's order and held that a church plan must be established by a church or by an association of churches and must be maintained either by a church or by a church-controlled or church-affiliated organization whose principal purpose or function is to provide benefits to church employees. The Ninth Circuit remanded the case to the District Court for further proceedings.

Dignity Health appealed the decision to the United States Supreme Court, which agreed to hear Dignity Health's case together with those of two other faith-based health systems facing similar challenges to church plan status.

In June 2017, the Supreme Court issued its unanimous opinion reversing the decision of the Ninth Circuit. The Court concluded that the 1980 amendment to Section 3(33)(C) of ERISA was intended by Congress to expand the types of pension plans that could qualify as church plans to include plans maintained by faith-based organizations such as Dignity Health and regardless of who first established the plans. The decision did not determine whether Dignity Health satisfied the requirements to maintain a church plan. In fact, the Court specifically noted that it was not deciding (1) whether any hospital was sufficiently associated with a church for its pension plan to qualify for the church plan exemption, or (2) whether an internal retirement committee could qualify as a “principal purpose” organization entitled to maintain a church plan. The Supreme Court remanded the case to the Ninth Circuit for further action based on its decision.

Based on the Supreme Court's decision, the Ninth Circuit returned the case to the District Court to continue the proceedings with regard to the two outstanding questions and other claims that were not decided by the Supreme Court. The plaintiff amended its original complaint in November 2017, and Dignity Health filed a motion to dismiss the case in December 2017. The motion was heard in March 2018. In September 2018, the District Court issued its ruling denying Dignity Health's motion to dismiss. The decision was primarily based upon the procedural standard that requires the Court to accept the plaintiff's allegations in the amended complaint as true and does not permit Dignity Health to refute those allegations. As a result, the Court found that the amended complaint was sufficient to withstand dismissal at this stage, but encouraged the parties to further develop the factual record as a basis to consider Dignity Health's objections in the future.

The parties have agreed in principle to resolve the litigation. Management does not believe that the proposed settlement will have a material adverse effect on the financial position or results of operations of the System.

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