

**Phoenix Children’s Hospital
Financial and Operating Report**

**For the Quarter Ended December 31, 2018
(Unaudited)**

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Contents

Corporate Structure	2
Statistical and Financial Information	4
Consolidating Balance Sheets (Unaudited)	5
Consolidating Statements of Operations (Unaudited)	6
Consolidating Statements of Cash Flows (Unaudited)	7
Management’s Discussion and Analysis of Consolidated Operations and Financial Performance	8

Phoenix Children's Hospital Financial and Operating Report

**For the Quarter Ended December 31, 2018
(Unaudited)**

Cautionary Statement Regarding Forward-Looking Statement

We may have made forward-looking statements in this presentation that are not historical facts but rather reflect current expectations concerning future results and events. These forward-looking statements are subject to risks, uncertainties and other factors, some of which are beyond our control that could cause actual results and events to differ materially from those forecasted or anticipated in the forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which reflect management's view only as of the date of this presentation or as of such earlier date as indicated. All forward-looking statements included in this presentation and all subsequent forward-looking statements attributable to Phoenix Children's Hospital, Inc. or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We do not intend to update or revise these statements to reflect events or circumstances existing after the date of this presentation or to reflect the occurrence of unanticipated events, except as required by law.

Phoenix Children's Hospital Corporate Structure

Phoenix Children's Hospital (the Hospital) is Arizona's only licensed nonprofit children's hospital providing care in more than 70 pediatric subspecialties to the state's pediatric patients. Six Centers of Excellence at the Hospital offer interdisciplinary care, including the Center for Cancer and Blood Disorders, the Phoenix Children's Heart Center, the Barrow Neurological Institute at Phoenix Children's Hospital, the Center for Pediatric Orthopedics, Level One Pediatric Trauma Center, and the Neonatal Intensive Care Unit. The Hospital is one of the ten largest freestanding children's hospitals in the United States based on number of beds.

In addition to the Hospital's main campus near downtown Phoenix, Arizona, the Hospital opened a 22-bed pediatric unit at Mercy Gilbert Medical Center (a Dignity Health hospital) in Gilbert, Arizona in October 2014. The Hospital also operates freestanding pediatric clinics in Mesa, Scottsdale, Glendale, Avondale, Yuma, and Flagstaff, Arizona that offer specialty care and advanced urgent care.

In 2017, the Hospital entered into an agreement with Dignity Health for the construction of a women's and children's hospital on the Dignity Health Mercy Gilbert campus. Under the current plans, pediatric services include 48 pediatric beds, 6 pediatric operating rooms, 60 level III NICU beds and a pediatric emergency room with 24 bays with adult services that include 24 labor and delivery rooms and 48 post-partum beds. Dignity Health will fund the construction and the Hospital will lease its portion of the space. In return for Dignity Health's relative contribution of its historic pediatric volume, Dignity Health has the rights to 33.3% interest in the project available free cash flow.

Phoenix Children's Hospital Corporate Structure (continued)

The Phoenix Children's Hospital Foundation (the Foundation) was established to solicit gifts and grants, manage fundraising, and provide other philanthropic support for the Hospital, which is the sole statutory member of the Foundation. Funds raised by the Foundation are used for clinical programs, support services, charitable care coverage, research initiatives, capital programs, facility upgrades, and community outreach.

Cambridge Arizona Insurance Company (the Captive), a wholly owned subsidiary of the Hospital, provides captive insurance coverage to Phoenix Children's Hospital and related affiliates. The Captive specifically provides professional and general liability insurance pursuant to the provisions of Arizona Revised Statutes 20-1098, and has been approved by the State of Arizona Department of Insurance.

The Hospital is a member-based Arizona nonprofit corporation. In 2011, the Hospital approved a strategic affiliation with Dignity Health (Dignity). At December 31, 2017, the Hospital's members were Children's Healthcare of Arizona, Inc. (the Parent), an Arizona nonprofit holding corporation exempt from income taxes under Internal Revenue Code (the Code) Section 501(c)(3), and Dignity.

Phoenix Children's Care Network (PCCN), a wholly owned networking contracting company, was created by the Hospital to facilitate future efforts to jointly contract, along with other area providers, with payors.

In order to consolidate and expand its cardiology service line, the Hospital and Obstetrix Medical Group of Phoenix, P.C. (OBX) formed an integrated pediatric cardiology practice named Arizona Pediatric Cardiology, LLC (APC). Simultaneously, the Hospital and APC Holdings, LLC, a wholly owned subsidiary of OBX, formed Phoenix Children's Cardiology Diagnostics LLC (PCCD) to manage the cardiology product line for the Hospital. The Hospital originally owned 25% of APC; however, in March 2017, the Hospital purchased the remaining 75% from OBX and integrated the entity into operations. The Hospital owns 62.5% of PCCD, and the financial statements of PCCD are included in the accompanying consolidated financial statements of the Hospital.

Phoenix Children's Property Development, LLC (PCPD) is owned 90% by the Hospital and 10% by the Foundation. The financial statements of PCPD are included in the accompanying consolidated financial statements. PCPD was formed to develop and own the assets associated with the build-out of the ninth floor of the Hospital tower financed pursuant to a New Markets Tax Credit financing, which closed in December 2014.

In January 2017, the Hospital entered into an agreement to purchase 100% of the stock in a multi-physician general surgery practice located on the main campus of the Hospital. During 2017, the Hospital integrated the operations of the practice into the Hospital's medical group and subsequently liquidated the legal entity.

Statistical and Financial Information

The statistical and financial information provided on the page below and pages that follow was prepared from records maintained by the Hospital. All statistical data and financial statements for the quarter ended December 31, 2018 are unaudited.

Performance Summary

	Quarter Ended	
	December 31, 2018	December 31, 2017
Discharges	3,326	3,497
Average Length of Stay	6.1	5.5
Case Mix Index	1.73	1.69
Patient Days	20,196	19,384
Adjusted Patient Days	39,707	41,311
Surgeries	5,913	5,644
Emergency Visits	23,888	24,670
Outpatient Visits	84,685	82,396
Provider RVUs	394,724	375,929

Phoenix Children's Hospital
Consolidating Balance Sheets
at December 31, 2018
UNAUDITED
(In Thousands)

	December 31, 2018						
	PCH	Foundation	Captive	PCPD	PCCD	Elimination	Total
Assets							
Current assets:							
Cash and cash equivalents	\$ 40,332	\$ 1,869	\$ 1,429	\$ 1,550	\$ 148	\$ -	\$ 45,328
Short-term investments	507,458	557	-	-	-	-	508,015
Accounts receivable, net	143,976	-	-	131	-	-	144,107
Contributions receivable, net	-	6,583	-	-	-	-	6,583
Inventory	12,868	-	-	-	-	-	12,868
Other current assets	21,545	599	3,508	-	30	-	25,682
Due (to) from affiliate	(101,833)	60,677	29,473	(139)	11,822	-	-
Total current assets	624,346	70,285	34,410	1,542	12,000	-	742,583
Assets limited as to use:							
Assets held by trustee	40,461	-	-	-	-	-	40,461
Other restricted cash	43,989	-	-	-	-	-	43,989
Investments	28,867	28,367	-	-	-	-	57,234
Charitable remainder trust investments	-	391	-	-	-	-	391
Endowment investments	-	12,608	-	-	-	-	12,608
Total assets limited as to use	113,317	41,366	-	-	-	-	154,683
Contributions receivable, net	-	3,740	-	-	-	-	3,740
Property and equipment, net	526,337	-	-	10,363	248	-	536,948
Other long term assets	43,407	149	-	-	-	(3,521)	40,035
Total assets	\$ 1,307,407	\$ 115,541	\$ 34,410	\$ 11,905	\$ 12,248	\$ (3,521)	\$ 1,477,989
Liabilities and net assets							
Current liabilities:							
Accounts payable and accrued liabilities	\$ 90,180	\$ 693	\$ 4,418	\$ 13	\$ 891	\$ -	\$ 96,195
Current portion of long-term debt	11,341	-	-	-	-	-	11,341
Total current liabilities	101,521	693	4,418	13	891	-	107,536
Other liabilities	64,082	-	19,351	326	-	-	83,759
Annuities payable, less current portion	-	125	-	-	-	-	125
Interest rate swap obligations	59,406	-	-	-	-	-	59,406
Long-term debt, net	528,404	-	-	11,934	-	-	540,338
Total liabilities	753,413	818	23,769	12,273	891	-	791,164
Net assets							
Unrestricted	537,394	64,617	10,641	(367)	7,151	(3,521)	615,915
Temporarily restricted	16,600	35,908	-	-	-	-	52,508
Permanently restricted	-	14,198	-	-	-	-	14,198
Total PCH net assets	553,994	114,723	10,641	(367)	7,151	(3,521)	682,621
Unrestricted - non-controlling interest	-	-	-	-	4,206	-	4,206
Total net assets	553,994	114,723	10,641	(367)	11,357	(3,521)	686,827
Total liabilities and net assets	\$ 1,307,407	\$ 115,541	\$ 34,410	\$ 11,905	\$ 12,248	\$ (3,521)	\$ 1,477,989

Phoenix Children's Hospital
Consolidating Statements of Operations
4th Quarter 2018
UNAUDITED
(In Thousands)

	Three Months Ended December 31, 2018						
	PCH	Foundation	Captive	PCPD	PCCD	Elimination	Total
Unrestricted revenues:							
Net patient service revenue before bad debt	\$ 204,180	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 204,180
Less: provision for bad debt	839	-	-	-	-	-	839
Net patient service revenue	203,341	-	-	-	-	-	203,341
Other operating revenue	8,411	-	1,623	392	(81)	(1,285)	9,060
Donations, gifts and contributions	-	4,207	-	-	-	-	4,207
Net assets released from restrictions used for operations	2,093	-	-	-	-	-	2,093
Total unrestricted revenue	213,845	4,207	1,623	392	(81)	(1,285)	218,701
Expenses:							
Employee compensation and benefits	121,318	1,555	-	-	642	-	123,515
Supplies, purchased services and professional fees	58,273	868	26	-	18	887	60,072
Operating and other expenses	12,338	1,123	1,845	169	5	(2,172)	13,308
Depreciation and amortization	12,459	-	-	245	38	-	12,742
Interest, net of amounts capitalized	6,532	-	-	57	-	-	6,589
Total expenses	210,920	3,546	1,871	471	703	(1,285)	216,226
Income (loss) from operations	2,924	661	(248)	(79)	(784)	-	2,474
Other loss:							
Net investment loss	(34,099)	(148)	-	-	-	-	(34,247)
Change in fair value of interest rate swaps	(7,228)	-	-	-	-	-	(7,228)
Total other loss	(41,327)	(148)	-	-	-	-	(41,475)
(Deficiency) excess of revenues over expenses	(38,403)	513	(248)	(79)	(784)	-	(39,001)
Less noncontrolling interest	-	-	-	-	(294)	-	(294)
PCH (deficiency) excess of revenue over expenses	(38,403)	513	(248)	(79)	(490)	-	(38,707)
Net assets released from restrictions used for purchase of property and equipment	638	-	-	-	-	-	638
(Decrease) increase in unrestricted net assets	\$ (37,765)	\$ 513	\$ (248)	\$ (79)	\$ (490)	\$ -	\$ (38,069)

Phoenix Children's Hospital
Consolidating Statements of Cash Flows
4th Quarter 2018
UNAUDITED
(In Thousands)

	Three Months Ended December 31, 2018						
	PCH	Foundation	Captive	PCPD	PCCD	Elimination	Total
Operating activities							
Change in net assets	\$ (37,324)	\$ 2,730	\$ (248)	\$ (78)	\$ (785)	\$ -	\$ (35,705)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:							
Provision for bad debts	6,020	-	-	-	-	-	6,020
Investments classified as trading and other restricted cash	31,151	(1,302)	-	-	-	-	29,849
Change in fair value of interest rate swaps	7,228	-	-	-	-	-	7,228
Depreciation and amortization	12,459	-	-	245	38	-	12,742
(Increase) in accounts receivable	(17,287)	-	-	(131)	-	-	(17,418)
(Increase) in contributions receivable	-	(526)	-	-	-	-	(526)
(Increase) in inventory	(471)	-	-	-	-	-	(471)
Decrease (increase) in other current assets	17,668	(2,004)	924	(157)	785	-	17,216
(Increase) in other long term assets	(182)	-	-	-	-	-	(182)
(Decrease) increase in accounts payable and accrued liabilities	(2,963)	663	(2,583)	-	(33)	-	(4,916)
(Decrease) increase in other liabilities	(11,702)	26	1,907	143	-	-	(9,626)
Net cash provided by (used in) operating activities	\$ 4,597	\$ (413)	\$ -	\$ 22	\$ 5	\$ -	\$ 4,211
Investing activities							
Purchase of property, plant and equipment	\$ (9,760)	\$ -	\$ -	\$ (3)	\$ -	\$ -	\$ (9,763)
Proceeds from assets held by trustee	(1,034)	-	-	-	-	-	(1,034)
Net cash (used in) investing activities	\$ (10,794)	\$ -	\$ -	\$ (3)	\$ -	\$ -	\$ (10,797)
Financing activities							
Proceeds of financing costs	\$ -	\$ -	\$ -	\$ 3	\$ -	\$ -	\$ 3
Payments on long-term debt	(216)	-	-	-	-	-	(216)
Net cash (used in) provided by financing activities	\$ (206)	\$ -	\$ -	\$ 3	\$ -	\$ -	\$ (203)
Net (decrease) increase in cash and cash equivalents	\$ (6,403)	\$ (413)	\$ -	\$ 22	\$ 5	\$ -	\$ (6,789)
Cash and cash equivalents, beginning of period	46,735	2,283	1,429	1,528	142	-	52,117
Cash and cash equivalents, end of period	\$ 40,332	\$ 1,870	\$ 1,429	\$ 1,550	\$ 147	\$ -	\$ 45,328

Phoenix Children's Hospital Management's Discussion and Analysis of Consolidated Operations and Financial Performance

Quarter ended December 31, 2018 (Unaudited)

New Accounting Pronouncement

Effective January 1, 2018, the Company adopted the provisions of Accounting Standards Codification ("ASC") 606-10, "Revenue from Contracts with Customers" ("ASC 606-10"), which supersedes most existing revenue recognition guidance, including industry-specific healthcare guidance, by applying the modified retrospective method for the current period presented. ASC 606-10 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The adoption of the provisions of ASC 606-10 had no impact on the Company's current or historical financial position, results of operations or cash flows. Additionally, management does not anticipate that the provisions of ASC 606-10 will have an impact on the amount or timing of when the Company recognizes revenue prospectively. However, in accordance with ASC 606-10, the Company now recognizes the majority of its previously reported provision for doubtful accounts, primarily related to its self-pay patient population, as a direct reduction to revenues as an implicit pricing concession, instead of separately as a discrete deduction to arrive at net revenue.

Analysis of Performance Summary

Discharges for the quarter ended December 31, 2018 were 3,326, 4.9% lower than the same quarter of the previous year. Average length of stay for the quarter was 6.1 days, 0.5 days higher than fourth quarter prior year average length of stay primarily due to a higher acuity of care provided in the fourth quarter of 2018. The case mix index was 1.73 for the quarter ended December 31, 2018, higher than the prior year at 1.69. Patient days for the quarter were 20,196, which was an increase to the same period a year ago at 19,384, while adjusted patient days were 39,707, down 3.9% from the fourth quarter 2017.

Total outpatient visits were 84,685 for the fourth quarter of 2018, up approximately 2.8% from the prior year's outpatient visits. Emergency visits (a component of the total outpatient visits) of 23,888 decreased approximately 3.2% from the same quarter of the prior year. Provider RVUs increased 5.0% from the prior year's fourth quarter RVU levels to 394,724. Total surgeries in the fourth quarter 2018 were 5,913, an increase of 4.8% from the same quarter in 2017.

Management's Discussion and Analysis (continued)

Net Patient Service Revenue

Net patient service revenue for the quarter ended December 31, 2018, after the provision for bad debt, was \$203.3 million, a decrease of 8.9% compared to the same quarter of the previous year due to a reduction in recorded graduate medical education funding. Management expects to receive funding during 2019.

Patient service revenue, net of contractual allowances and discounts and the provision for bad debts, recognized from major payor sources for the quarters ended December 31 is as follows (in thousands):

	2018		December 31, 2017	
		%		%
AHCCCS	\$ 81,084	39.9%	\$ 116,216	52.1%
Contracted health care agreements	98,041	48.1%	83,999	37.6%
Other commercial payors	5,203	2.7%	3,177	1.4%
Patients and other	19,013	9.4%	19,818	8.9%
	<u>\$ 203,341</u>	<u>100.0%</u>	<u>\$ 223,210</u>	<u>100.0%</u>

Patient service revenue, net of contractual allowances and discounts and the provision for bad debts, recorded by patient type for the quarters ended December 31 is as follows (in thousands):

	2018		December 31, 2017	
		%		%
Inpatient	\$ 97,522	48.0%	\$ 122,348	54.8%
Outpatient	75,566	37.2%	73,205	32.8%
Professional Fee	30,254	14.9%	27,657	12.4%
	<u>\$ 203,341</u>	<u>100.0%</u>	<u>\$ 223,210</u>	<u>100.0%</u>

The AHCCCS payment reductions from 2011 and continuing into 2018 were substantially offset during 2018 by the recording of AHCCCS supplementary revenues ;however, a reduction of \$6.3 million was recorded during the fourth quarter to adjust the revenue recorded to the amount received in 2018.

CMS originally approved the AHCCCS Safety Net Care Pool in 2012 to provide support for uncompensated costs incurred by three safety net health systems, including the Hospital. The University of Arizona provided intergovernmental transfers to fund these payments for the Hospital, pursuant to Senate Bill 1357, First Regular Session 2011.

Management's Discussion and Analysis (continued)

CMS terminated AHCCCS' authority to make Safety Net Care Pool payments to most providers as of December 31, 2013, but the Arizona legislature authorized the extension of the Safety Net Care Pool for the Hospital. Subsequently, CMS approved multiple extensions of the Safety Net Care Pool for the Hospital, ultimately through December 31, 2017.

In 2014, the city of Phoenix (the City) adopted the Pediatric Health Care Initiative through which it established a special fund to accept donations (other than non-bona fide provider-related donations) intended to benefit care at freestanding children's hospitals in the City. Donated funds are transferred by the City to AHCCCS to be used as the non-federal share of Safety Net Care Pool payments to the Hospital. No funding was received during the fourth quarter 2018 or 2017 through this fund.

In total, the Hospital recorded Safety Net Care Pool funding of \$92,478,000 and \$125,331,000 during the years ended December 31, 2017 and 2016, respectively, including payments funded through the City of Phoenix Pediatric Health Care Initiative, as well as through intergovernmental transfers from the University of Arizona and Maricopa Integrated Health System. All of the 2017 funding was received before December 31, 2017. A receivable of \$18,700,000 was recorded at December 31, 2016 related to 2016 funding, which was received in January 2017.

The policy of the Hospital is to reflect disproportionate share funds, graduate medical education funding, and other AHCCCS supplemental payments as offsets to contractual adjustments. Accordingly, these amounts have been included in net patient service revenue. The estimation of funding levels to be received through intergovernmental transfers is uncertain and subject to change until such time as CMS and AHCCCS have reviewed required filings for completeness and propriety of expenditures. Management has made estimates and assumptions based on its past experience in these programs to determine the recorded funding levels, but actual results may differ from the estimates.

Other Operating Revenue

Other operating revenue for the quarter ended December 31, 2018 was \$9.1 million, a 50.1% increase from the same quarter of the prior year. The favorable increase over prior year fourth quarter is primarily due to the contract pharmacy that was started mid-year in 2017 and is now operating full time.

Net Assets Released from Restrictions

Net assets released from restrictions used for operations in the quarter ended December 31, 2018 were \$2.1 million, down from \$2.7 million in the same quarter of 2017; funds are released when donor restrictions are met, when funds are available.

Operating Expenses

Consolidated operating expenses decreased from the same quarter of the prior year from \$224.2 million to \$216.2 million, due primarily to decreases in supplies, purchased services and professional fees.

Management's Discussion and Analysis (continued)

Employee compensation and benefits was approximately 60.7% of net patient revenues for the fourth quarter 2018, an increase from 51.1% for the same period of the prior year. Supplies, purchased services and professional fees expenses decreased to \$60.1 million in the fourth quarter of 2018 from \$79.6 million in the same quarter of 2017. Depreciation and amortization expense increased to \$12.7 million in the fourth quarter of 2018 from \$12.1 million in the same quarter of 2017 primarily due to the new ED/Trauma Center.

Consolidated operating expenses as a percent of total unrestricted revenue increased by 3.7% from the same quarter of the prior year, from 95.2% of total unrestricted revenue in the fourth quarter of 2017 to 98.9% in the same quarter of 2018.

Income from Operations

Consolidated income from operations for the three months ended December 31, 2018 was \$2.5 million, compared to \$11.3 million for the same quarter of 2017. Consolidated earnings before interest, depreciation and amortization (EBIDA) including non-controlling interest for the quarter ended December 31, 2018, was \$21.8 million or 10.0% of total net operating revenue as compared to \$29.8 million or 12.7% of total net operating revenue in the same quarter of 2017.

Excess of Revenue over Expenses

Consolidated deficiency of revenues over expenses was \$38.7 million for the quarter ended December 31, 2018. Market performance during the fourth quarter of 2018 resulted in net investment losses of \$34.2 million and an unfavorable change in the fair value of interest rate swaps of \$7.2 million for a combined non-operating loss of \$41.4 million.

Change in Unrestricted Net Assets

Unrestricted net assets increased from \$580.5 million at December 31, 2017 to \$615.9, net of the non-controlling interest in a joint venture consolidated in the Hospital's financial statements at the end of the same quarter in 2018, reflecting positive annual operating performance.

Cash, Accounts Receivable and Other Current Assets

Consolidated cash and investments at December 31, 2018 was \$553.3 million, a decrease of \$12.6 million from the December 31, 2017 balances. A major contributor to the decrease in cash balances was the previously mentioned market performance experienced in the fourth quarter of 2018. At December 31, 2018, the Hospital's collateral posting was \$36.5 million, a decrease of \$10.0 million from the same date in 2017.

The consolidated net accounts receivable balance was \$144.1 million at December 31, 2018, up from \$121.1 million at December 2017, as a result of higher charges recorded throughout 2018. Days in A/R decreased from 58.2 at the end of the fourth quarter of 2017 to 57.2 at the end of the fourth quarter of 2018.

Management's Discussion and Analysis (continued)

Liabilities

Consolidated current liabilities at December 31, 2018 totaled \$107.5 million, down from \$115.2 million at the end of the same quarter of the prior year. The decrease in current liabilities is primarily due to the decrease in accrued mission support expenses offset by increases in accrued payroll liabilities and capital expenditure liabilities. Long-term debt and interest rate swap obligations also decreased compared to the fourth quarter of 2017 for an overall decrease in total liabilities from \$825.1 million at December 31, 2017 to \$791.2 million at December 31, 2018.

Net Assets

Total consolidated net assets were \$686.8 million at December 31, 2018, an increase of \$48.2 million from the same quarter of 2017 due mainly to an increase in unrestricted net assets of approximately \$35.4 million, an increase of \$9.8 million in temporarily restricted net assets, and \$1.4 million in permanently restricted net assets. The increases come primarily from favorable operating results and new contributions throughout 2018.

Capital Expenditures/Strategic Purchases

Construction in progress at December 31, 2018 decreased \$10.7 million from the same quarter ended December 31, 2017 primarily as a result of the completion of the new ED/Trauma Center. Net property, plant and equipment decreased \$5.5 million from the prior year balance at December 31, 2017, reflecting a slower addition of assets as compared to the depreciation charged during the period after the transfer of remaining CIP balance related to the ED/Trauma Center building which was placed into service during the fourth quarter of 2017.

Cash Flows

Consolidated cash provided by operating activities for the three months ended December 31, 2018 was \$4.2 million, primarily the result of favorable operating results offset by decreases in certain current liabilities.

Cash used in investing activities totaled \$10.8 million, due to cash outlays for property, plant and equipment at the Hospital and PCPD.