



**Unaudited Consolidated  
Financial Statements and Supplementary Information**

**Banner Health and Subsidiaries**

**June 30, 2019**

**Banner Health and Subsidiaries**  
**Unaudited Consolidated Financial Statements**  
**June 30, 2019**

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## Review Report of Independent Auditors

The Board of Directors  
Banner Health

We have reviewed the consolidated financial information of Banner Health and Subsidiaries, which comprise the consolidated balance sheet as of June 30, 2019, and the related consolidated statements of income, changes in net assets and cash flows for the six-month periods ended June 30, 2019 and 2018.

### **Management's Responsibility for the Financial Information**

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

### **Auditor's Responsibility**

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

### **Conclusion**

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

### **Report on Balance Sheet as of December 31, 2018**

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Banner Health and Subsidiaries as of December 31, 2018, and the related consolidated statements of income, changes in net assets and cash flows for the year then ended (not presented herein), and we expressed an unmodified audit opinion on those consolidated financial statements in our report dated March 22, 2019. In our opinion, the accompanying consolidated balance sheet of Banner Health and Subsidiaries as of December 31, 2018, is consistent, in all material respects, with the consolidated balance sheet from which it was derived.

August 27, 2019

## Banner Health and Subsidiaries

### Consolidated Balance Sheets

(In Thousands)

	Unaudited June 30 2019	December 31 2018
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 459,496	\$ 383,096
Short-term investments	146,611	112,196
Collateral held under securities lending program	309,307	210,811
Assets limited as to use	87,166	144,170
Patient receivables, net	902,796	868,127
Inventories	215,416	206,055
Other receivables	263,448	350,731
Other current assets	121,233	86,211
Total current assets	<u>2,505,473</u>	<u>2,361,397</u>
Assets limited as to use:		
Funds designated by:		
Board of Directors	2,224,963	2,031,832
Lease agreements	1,971	1,931
Funds held by trustees under:		
Self-insurance funding arrangements	114,760	103,564
Project fund	53,650	-
Other funds	203,431	138,238
Total assets limited as to use, less current portion	<u>2,598,775</u>	<u>2,275,565</u>
Property and equipment, net	3,775,293	3,685,196
Right of use assets - operating leases	316,407	-
Right of use assets - finance leases	184,975	-
Leased hospital assets	-	207,847
Other assets:		
Long-term investments	2,490,721	2,114,408
Other	816,562	742,342
Total assets	<u>\$ 12,688,206</u>	<u>\$ 11,386,755</u>

## Banner Health and Subsidiaries

### Consolidated Balance Sheets

(In Thousands)

	Unaudited June 30 2019	December 31 2018
<b>Liabilities and net assets</b>		
Current liabilities:		
Trade accounts payable	\$ 178,722	\$ 208,932
Current portion of long-term debt	61,234	58,994
Debt subject to self liquidity	400,000	200,000
Current portion of operating lease obligations	72,605	-
Current portion of finance lease obligations	37,360	-
Current portion of hospital lease obligations	-	22,188
Payable under securities lending program	309,307	210,811
Estimated current portion of third-party payor settlements	7,285	3,465
Accrued expenses:		
Salaries and benefits	469,357	460,061
Medical claims payable	211,187	202,849
Other	263,313	238,164
Total current liabilities	<u>2,010,370</u>	<u>1,605,464</u>
Long-term debt, less current portion	3,218,624	3,064,972
Finance lease obligations, less current portion	148,149	-
Operating lease obligations, less current portion	258,336	-
Hospital lease obligations	-	211,515
Estimated self-insurance liabilities, less current portion	211,985	205,055
Estimated third-party payor settlements, less current portion	16,344	17,531
Interest rate swaps	332,599	258,762
Other	178,838	174,853
Total liabilities	<u>6,375,245</u>	<u>5,538,152</u>
Net assets:		
Net assets without donor restrictions	6,079,653	5,613,878
Non-controlling interests	46,466	43,999
Net assets without donor restrictions	<u>6,126,119</u>	<u>5,657,877</u>
Net assets with donor restrictions	186,842	190,726
Total net assets	<u>6,312,961</u>	<u>5,848,603</u>
Total liabilities and net assets	<u>\$ 12,688,206</u>	<u>\$ 11,386,755</u>

See accompanying notes.

**Banner Health and Subsidiaries**  
**Consolidated Statements of Income**

**Unaudited**

*(In Thousands)*

	<b>Six Months Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
Revenues:		
Net patient service revenue	\$ 3,510,897	\$ 3,287,170
Medical insurance premiums	957,588	703,481
Other revenue	201,551	194,013
Total revenues	4,670,036	4,184,664
Expenses:		
Salaries and benefits	2,130,275	2,003,661
Supplies	732,282	665,889
Physician and professional fees	119,445	98,623
Medical claims cost, net of Banner claims of \$177,888 and \$191,306 in 2019 and 2018, respectively	739,802	517,473
Depreciation and amortization	222,294	202,914
Interest expense	61,667	63,611
Other expenses	552,469	505,226
Total expenses	4,558,234	4,057,397
Operating income	111,802	127,267
Other income:		
Investment income - realized	62,889	76,909
Investment income (loss) - unrealized	278,932	(74,236)
Income from alternative investments	70,014	24,697
Investment income, net	411,835	27,370
Unrealized (loss) gain on interest rate swaps	(73,950)	61,691
Other (loss)	(5,116)	(4,361)
	332,769	84,700
Excess of revenues over expenses	444,571	211,967
Less excess of revenues over expenses attributable to non- controlling interests	13,650	13,776
Excess of revenues over expenses attributable to Banner Health	\$ 430,921	\$ 198,191

See accompanying notes.

## Banner Health and Subsidiaries

### Consolidated Statements of Changes in Net Assets

#### Unaudited

*(In Thousands)*

	Six Months Ended June 30	
	2019	2018
Net assets without donor restrictions:		
Excess of revenues over expenses attributable to Banner Health	\$ 430,921	\$ 198,191
Cumulative effect of change in accounting principles	24,637	(7,323)
Contributions for property and equipment acquisitions	10,105	3,871
Other changes in net assets	112	114
Increase in net assets without donor restrictions	465,775	194,853
Net assets with donor restrictions:		
Contributions	12,482	10,818
Net unrealized gain (loss) on investments	2,031	(185)
Net assets released from restriction	(18,397)	(5,910)
(Decrease) increase in net assets with donor restrictions	(3,884)	4,723
Noncontrolling interests:		
Excess of revenues over expenses attributable to noncontrolling interests	13,650	13,776
Other changes, primarily distributions of earnings to noncontrolling interests	(11,183)	(5,338)
Increase in noncontrolling interests	2,467	8,438
Increase in net assets	464,358	208,014
Net assets, beginning of period	5,848,603	5,784,480
Net assets, end of period	\$ 6,312,961	\$ 5,992,494

*See accompanying notes.*

**Banner Health and Subsidiaries**  
**Consolidated Statements of Cash Flows**

**Unaudited**

(In Thousands)

	<b>Six Months Ended June 30</b>	
	<b>2019</b>	<b>2018</b>
<b>Operating activities</b>		
Increase in net assets	\$ 464,358	\$ 208,014
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Loss on early extinguishment of debt	1,782	-
Depreciation and amortization	222,294	202,914
(Increase) decrease in investments designated as trading	(623,284)	98,805
Net unrealized loss (gain) on interest rate swaps	73,950	(61,691)
Cumulative effect of change in accounting principles	(24,637)	7,323
Gain on sale of assets	(1,217)	(42)
Contributions for property and equipment and other	(10,105)	(3,871)
Restricted contributions	(12,482)	(10,818)
Non-controlling interest	12,250	13,475
Changes in operating elements:		
Patient receivables	(34,669)	40,324
Inventories and other current assets	42,900	(15,173)
Accounts payable and accrued expenses	12,573	(54,698)
Estimated third-party settlements	2,633	(13,478)
Estimated self-insurance liabilities	6,930	16,322
Other liabilities	14,050	4,956
Net cash provided by operating activities	147,326	432,362
<b>Investing activities:</b>		
Net purchases of property and equipment	(282,909)	(265,232)
(Increase) decrease in project fund	(53,650)	44,957
Increase in other assets	(72,999)	(69,010)
Net cash used in investing activities	(409,558)	(289,285)
<b>Financing activities:</b>		
Proceeds from restricted contributions	12,482	10,818
Proceeds from issuance of debt	686,615	-
Payments of finance leases and leased hospital obligations	(15,710)	(11,302)
Payments of long-term debt	(332,505)	(61,752)
Cash distributions to non-controlling interests	(12,250)	(13,475)
Net cash provided by (used in) financing activities	338,632	(75,711)
Net increase in cash and cash equivalents	76,400	67,366
Cash and cash equivalents at beginning of year	383,096	292,911
Cash and cash equivalents at end of period	\$ 459,496	\$ 360,277
<b>Supplemental disclosure of cash flow information</b>		
Interest paid, including amounts capitalized	67,662	66,507
<b>Non-cash activities</b>		
Leased hospital assets	-	6,820
Operating and financing leases - right of use asset and liability	560,246	-

See accompanying notes.



## Banner Health and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

June 30, 2019

#### **1. Description of Business**

Banner Health is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. Banner Health and its subsidiaries (collectively, Banner) own, control, or lease hospitals, clinics, nursing homes, clinical laboratories, ambulatory surgery centers, urgent care centers, home health agencies, a captive insurance company, a foundation, an accountable health care organization, a Medicaid managed care health plan and related Medicare Advantage health plan, and other health care-related organizations in six western states. Banner also holds controlling interests in several health care-related business ventures and non-controlling interests in several other entities.

In April 2019, Banner Imaging Services, LLC, a wholly-owned subsidiary of Banner, acquired 20 freestanding outpatient imaging centers from two radiology groups in the greater Phoenix metropolitan area. Together with three existing Banner-owned imaging centers, the acquired centers will be operated as "Banner Imaging" and will provide convenient, lower-cost diagnostic imaging services. Banner recognized \$45,565,000 of goodwill as part of the acquisition.

#### **2. Significant Accounting Policies**

##### **Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial reporting, applied on a basis substantially consistent with that of the 2018 audited financial statements of Banner. They do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2019 are not necessarily indicative of the results to be expected for the year ending December 31, 2019. For more information, refer to the audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2018.

The separate details of the Obligated and Non-Obligated Group financial statements are presented for purposes of additional analysis and are not a required part of the consolidated financial statements.

##### **Basis of Consolidation**

The accompanying consolidated financial statements reflect the consolidated operations of all owned and leased operating units of Banner and its wholly owned subsidiaries. Banner also holds controlling interests in several business ventures, the financial results of which are included in Banner's consolidated financial statements. Banner records the unrelated investor's ownership share of these business ventures as non-controlling interest.

All significant intercompany accounts and transactions have been eliminated in consolidation.

##### **Short-Term Investments**

Short-term investments primarily include debt securities with maturity dates of one year or less from the balance sheet date, U.S. Treasury government obligations and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value (see Note 3).

## Banner Health and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

June 30, 2019

## 2. Significant Accounting Policies (continued)

### Investments

Banner invests in alternative investments, mainly hedge funds, through limited partnerships. Banner accounts for its ownership share in these alternative investments under the equity method based on the hedge funds' net asset value per share of the fund held by Banner. The hedge fund net asset value is provided to Banner by each of the hedge fund managers. The net asset value is determined based on the estimated fair value of each of the underlying investments held in the hedge fund. However, the hedge fund investment holdings may include investments in private investment funds whose values have been estimated by the hedge fund manager in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed. The investment income recorded is based on Banner's proportionate share of the hedge fund portfolio net asset value.

Banner uses derivative financial instruments in its investment portfolio to moderate changes in value due to fluctuations in the financial markets. Banner has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in fair value of derivatives is recognized as a component of investment income. Banner's fixed-income manager has executed a master netting arrangement for each of the derivative instruments held by the same counterparty, which are legally offset as the instrument is settled. Banner's derivative contracts in a net loss position were reported on a net basis on the accompanying consolidated balance sheets as of June 30, 2019 and December 31, 2018. As of June 30, 2019, approximately \$393,066,000 of gross derivative assets and approximately \$393,491,000 of gross derivative liabilities were netted together within investments. As of December 31, 2018, approximately \$1,429,581,000 of gross derivative assets and \$1,425,776,000 of gross derivative liabilities were netted together within investments. (see Note 3)

Banner entered into a repurchase agreement for approximately \$174,410,000 as of December 31, 2018. In connection with the repurchase agreement, Banner has loaned cash to certain financial institutions in exchange for purchased securities that serve as collateral. Collateral provided by these financial institutions was approximately \$177,973,000 as of December 31, 2018. The repurchase agreement has been accounted for as a collateralized borrowing. The collateral has not been sold or pledged to an external party and accordingly, is not recorded on the consolidated balance sheets. Banner did not enter into any repurchase agreements as of June 30, 2019.

## Banner Health and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

June 30, 2019

## 2. Significant Accounting Policies (continued)

### Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which Banner expects to be entitled 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 variable consideration (reductions to revenue) for retroactive revenue adjustments due to settlement of ongoing and future audits, reviews, and investigations. Net patient service revenue reported includes an implicit price concession which was previously reported as provision for doubtful accounts on the consolidated statements of income.

Banner uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on historical collection trends and other analyses, Banner believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

Banner's initial estimate of the transaction price for services provided to patients is determined by reducing the total standard charges related to the patient services provided by various elements of variable consideration, including contractual adjustments, discounts, implicit price concessions, and other reductions to Banner's standard charges. Banner determines the transaction price associated with services provided to patients who have third-party payor coverage based on the reimbursement terms outlined in contractual agreements, Banner's discount policies and historical experience. For uninsured and under-insured patients who do not qualify for charity care, Banner determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on Banner's historical collection experience for applicable patient portfolios. Patients who meet Banner's criteria for free care are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change.

Net patient service revenue is recognized as performance obligations are satisfied, despite the fact that Banner bills patients and third-party payors several days after the services are performed and/or the patient is discharged. Performance obligations are determined based on the nature of the services provided by Banner. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total charges. Banner believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the services needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. Banner measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided, and Banner does not believe it is required to provide additional goods or services to the patient.

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

June 30, 2019

**2. Significant Accounting Policies (continued)**

Banner has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors, the lines of business that render services to patients and the timing of when revenue is recognized and billed.

Net patient service revenue for the six months ended June 30 by line of business is as follows (*in thousands*):

	<b>2019</b>	<b>2018</b>
Hospital	<b>\$2,939,956</b>	\$2,762,039
Physician services	<b>328,135</b>	314,098
Home care	<b>39,051</b>	35,902
Laboratory	<b>147,511</b>	140,746
Other	<b>56,244</b>	34,385
	<b>\$3,510,897</b>	<b>\$3,287,170</b>

**Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements.

Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of patient accounts receivable, accruals for settlements with third-party payors, risk pool and insurance settlements, medical claim liabilities, contingent liabilities, and accrued liabilities resulting from self-insurance programs.

**New Accounting Pronouncements**

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, a new accounting standard relating to accounting for contributions received and made. This accounting standard provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. The accounting standard was adopted by Banner on January 1, 2019 using a modified prospective basis and did not have a material impact on its consolidated financial statements.

## Banner Health and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

June 30, 2019

#### **2. Significant Accounting Policies (continued)**

In January 2017, the FASB issued a new intangibles-goodwill accounting standard. The accounting standard simplified the test used to evaluate goodwill and other intangibles for impairment. Under the new accounting standard, a company will perform its annual goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value, however, the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A company will still have the option to perform the qualitative assessment for a reporting unit. This accounting standard is effective for fiscal year beginning after December 15, 2020. Management is currently evaluating the impact of adopting this accounting standard.

#### **3. Fair Value Measurements**

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, Banner utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

**Level 1.** Pricing inputs into the determination of fair value are generally observable inputs, such as quoted prices for identical instruments in active markets.

**Level 2.** Pricing inputs are based on 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.

**Level 3.** Pricing inputs are generally unobservable 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 factors that involve considerable judgment and interpretation including, but not limited to, private and public comparables, third party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities measured at fair value are generally based on the market approach, using prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. Interest rate swap liabilities are valued using the income approach, which uses techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing and excess earnings models).

Banner's alternative investments, of approximately \$1,095,474,000 and \$1,069,224,000 as of June 30, 2019 and December 31, 2018, respectively, are accounted for using the equity method of accounting. Accordingly, the alternative investments are omitted from the following schedule of financial instruments measured at fair value. There have not been any changes in any financial instruments' fair value classification between Level 1 and Level 2 since December 31, 2018. Banner has no Level 3 financial instruments.

## Banner Health and Subsidiaries

## Notes to Unaudited Consolidated Financial Statements

June 30, 2019

**3. Fair Value Measurements (continued)**

	June 30, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 290,689	\$ 283,651	\$ 7,038	\$ -
Collateral held under securities lending (primarily cash and debt securities)	309,306	93,969	215,337	
Mutual funds:				
Mutual funds – U.S. funds	1,856,042	1,856,042	-	-
Mutual funds – International	549,631	549,631	-	-
Total mutual funds	<u>2,405,673</u>	<u>2,405,673</u>	<u>-</u>	<u>-</u>
Debt securities:				
U.S. Treasury/government obligations	611,814	-	611,814	-
Corporate bonds/non-U.S. government bonds	328,283	-	328,283	-
Asset-backed securities	160,659	-	160,659	-
Commercial mortgage-backed securities	28,277	-	28,277	-
Non-government-backed collateralized mortgages	27,846	-	27,846	-
Government mortgage-backed securities	97,593	-	97,593	-
Government commercial-backed securities	5,297	-	5,297	-
Total debt securities	<u>1,259,769</u>	<u>-</u>	<u>1,259,769</u>	<u>-</u>
Equity securities:				
U.S. equity securities	579	579	-	-
International equity securities	190,042	190,042	-	-
Total equity securities	<u>190,621</u>	<u>190,621</u>	<u>-</u>	<u>-</u>
Derivative securities:				
Future contracts	232,154	232,154	-	-
Forward contracts	159,892	-	159,892	-
Interest rate swap agreements	744	-	744	-
Net credit swaps	276	-	276	-
Subtotal derivative assets	<u>393,066</u>	<u>232,154</u>	<u>160,912</u>	<u>-</u>
Future contracts	(232,154)	(232,154)	-	-
Forward contracts	(159,176)	-	(159,176)	-
Interest rate swap agreements	(1,682)	-	(1,682)	-
Option agreements	(399)	-	(399)	-
Net credit swaps	(80)	-	(80)	-
Subtotal derivative liabilities	<u>(393,491)</u>	<u>(232,154)</u>	<u>(161,337)</u>	<u>-</u>
Total investments in the fair value hierarchy	<u>\$ 4,455,633</u>	<u>\$ 2,973,914</u>	<u>\$ 1,481,719</u>	<u>\$ -</u>
Investment measured at net asset value: private commingled fund	164,553			
Total fair value investments	<u>\$ 4,620,186</u>			
Short-term investments	\$ 146,611			
Collateral held under securities lending agreements	309,307			
Assets limited as to use	2,685,941			
Long-term investments	2,490,721			
Other assets – Banner Foundation restricted funds	86,315			
Less alternative investments	1,095,474			
Less split-dollar life insurance	3,235			
Total fair value investments	<u>\$ 4,620,186</u>			
Interest rate swaps included in other long-term liabilities	<u>\$ (332,599)</u>	<u>\$ -</u>	<u>\$ (332,599)</u>	<u>\$ -</u>

## Banner Health and Subsidiaries

## Notes to Unaudited Consolidated Financial Statements

June 30, 2019

**3. Fair Value Measurements (continued)**

	December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 415,868	\$ 384,365	\$ 31,503	\$ -
Collateral held under securities lending (primarily cash and debt securities)	210,811	190,062	20,749	
Mutual funds:				
Mutual funds – U.S. funds	1,541,010	1,541,010	-	-
Mutual funds – International	522,942	522,942	-	-
Total mutual funds	2,063,952	2,063,952	-	-
Debt securities:				
U.S. Treasury/government obligations	179,202	-	179,202	-
Corporate bonds/non-U.S. government bonds	181,970	-	181,970	-
Asset-backed securities	69,195	-	69,195	-
Commercial mortgage-backed securities	8,238	-	8,238	-
Non-government-backed collateralized mortgages	6,155	-	6,155	-
Government mortgage-backed securities	158,367	-	158,367	-
Government commercial-backed securities	5,027	-	5,027	-
Total debt securities	608,154	-	608,154	-
Repurchase agreements	174,410	-	174,410	-
Equity securities:				
U.S. equity securities	78,969	78,969	-	-
International equity securities	174,006	174,006	-	-
Total equity securities	252,975	252,975	-	-
Derivative securities:				
Future contracts	842,371	842,371	-	-
Forward contracts	583,000	-	583,000	-
Interest rate swap agreements	3,489	-	3,489	-
Net credit swaps	721	-	721	-
Subtotal derivative assets	1,429,581	842,371	587,210	-
Future contracts	(842,371)	(842,371)	-	-
Forward contracts	(582,752)	-	(582,752)	-
Interest rate swap agreements	(381)	-	(381)	-
Option agreements	(92)	-	(92)	-
Net credit swaps	(180)	-	(180)	-
Subtotal derivative liabilities	(1,425,776)	(842,371)	(583,405)	-
Total investments in the fair value hierarchy	\$ 3,729,975	\$ 2,891,354	\$ 838,621	\$ -
Investment measured at net asset value: private commingled fund	142,383			
Total fair value investments	<u>\$ 3,872,358</u>			
Short-term investments	\$ 112,196			
Collateral held under securities lending agreements	210,811			
Assets limited as to use	2,419,735			
Long-term investments	2,114,408			
Other assets – Banner Foundation restricted funds	87,778			
Less alternative investments	1,069,224			
Less split-dollar life insurance	3,346			
Total fair value investments	<u>\$ 3,872,358</u>			
Interest rate swaps included in other long-term liabilities	\$ (258,762)	\$ -	\$ (258,762)	\$ -

Banner Health and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
June 30, 2019

**3. Fair Value Measurements (continued)**

Investment income consisted of the following for the six months ended June 30:

	<b>2019</b>	<b>2018</b>
	<i>(In Thousands)</i>	
Interest and dividend income	<b>\$ 35,800</b>	\$ 31,635
Net realized gain on sales of marketable securities	<b>25,966</b>	50,605
Realized and unrealized gain from alternative investments, including amount recorded in net assets with donor restriction	<b>70,489</b>	25,155
Net realized gain (loss) on derivative instruments	<b>3,957</b>	(3,470)
Net unrealized gain (loss) on marketable securities	<b>280,699</b>	(82,418)
Net unrealized (loss) gain on derivative instruments	<b>(278)</b>	7,793
	<b>416,633</b>	29,300
Less investment loss credited to other revenue, restricted equity, and capitalized bond project funds	<b>4,798</b>	1,930
Investment income, net	<b>\$ 411,835</b>	\$ 27,370

**4. Liquidity**

Financial assets available for general expenditure within one year of the balance sheet date, consist of the following as of June 30, 2019 (in thousands):

Cash and cash equivalents	\$ 459,496
Patient receivables, net	902,796
Short-term investments	146,611
Funds designated by Board of Directors	2,224,963
Long-term investments	2,490,721
	<b>\$ 6,224,587</b>

Banner has the ability to structure its financial assets to be available as its general expenditures and other obligations come due. Cash in excess of daily requirements is invested in short-term investments.

Banner currently maintains two line of credit vehicles to support interim working capital and capital financing needs: a \$75,000,000 line of credit provided by a single bank, with \$375,000 drawn and outstanding as of June 30, 2019; a \$400,000,000 line of credit initiated on April 30, 2019 as a syndicate with five banks, with no amounts drawn to date.



## Banner Health and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

June 30, 2019

#### **5. Debt**

At June 30, 2019 and December 31, 2018, the estimated fair value of Banner's debt, excluding unamortized net premiums, was \$3,746,027,000 and \$3,288,626,000, respectively. The estimated fair value is based on quoted market prices for these issues or, where such prices are not available, on current interest rates for debt with similar remaining maturities.

On June 20, 2019, Banner issued its \$125,000,000 Series 2019 fixed-rate taxable bonds, \$94,050,000 Series 2019A fixed-rate tax-exempt bonds, \$161,900,000 Series 2019B and C three and five-year, respectively, floating rate notes tax-exempt bonds, \$83,600,000 Series 2019D seven year tax-exempt put bonds and \$200,000,000 Series 2019E and F variable rate demand bonds tax-exempt. The proceeds from the sale of Series 2019B, C, and D were used to pay-off Series 2008B, C and Series 2015D.

#### **6. Interest Rate Swap Agreements**

Banner is party to multiple interest rate swaps that currently do not qualify for hedge accounting. For the six months ended June 30, 2019 and 2018, the mark-to-market adjustment resulted in an unrealized loss of \$73,950,000 and an unrealized gain of \$61,691,000 respectively, recorded in excess of revenue over expenses. The net effect of the interest rate swaps, recorded in interest expense, was to increase the overall cost of borrowing for the six months ended June 30, 2019 and 2018, by \$12,394,000 and \$15,601,000, respectively.

Each of the interest rate swap agreements has collateral posting thresholds based on the counterparties' bond ratings. At the AA- rating level, Banner and its counterparties must post collateral when the mark-to-market adjustment exceeds between \$35,000,000 and \$75,000,000 depending on the counterparty. At June 30, 2019 and December 31, 2018, Banner had \$87,822,000 and \$43,740,000 of collateral outstanding with its counterparties, respectively. The fair value of the collateral is reported as other funds under the assets limited as to use category in the accompanying consolidated balance sheets.

#### **7. Hospital Lease Obligation**

On June 10, 2019, Banner executed a Letter of Intent with NCMC Inc, a health care authority of Weld County in northern Colorado, for Banner to purchase the hospital and related assets operating since 1995 under Banner Health as North Colorado Medical Center (NCMC). The transaction includes the purchase of the medical center and equipment at a preliminary price of \$267,000,000, plus the acquisition of certain off-campus properties currently leased by Banner to support NCMC operations. This transaction will terminate the current finance lease obligation between Banner and NCMC Inc, which has an outstanding book liability of approximately \$155,000,000. Termination of the lease will also terminate any and all related covenants and rent guarantees between the parties, and will convey lien-free title of NCMC assets to Banner Health. The transaction is expected to close on or around September 30, 2019, subject to completion of required regulatory filings.

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

June 30, 2019

**8. Leases**

Banner adopted Accounting Standards Update 2016-02, *Leases* (Topic 842), on January 1, 2019. Banner elected a practical expedient to apply the new standard at the adoption date and not recast the comparative periods presented. As of January 1, 2019, Banner recorded a right-of-use asset of approximately \$491,695,000, a lease obligation of approximately \$507,599,000, and a cumulative effect adjustment to the opening balance of net assets without donor restriction of \$24,637,000. The transition adjustment relates to the reversal of the property and equipment lease obligations that were recognized as a sale leaseback as of December 31, 2018. Banner also elected a package of practical expedients to not reassess existing or expired contracts, lease classification, or initial direct costs for existing leases. Short term leases (12 months or less) will not be subject to the new standard per Banner's accounting policy. Included in the lease term are any renewal options reasonably certain of being exercised. Banner uses a risk-free discount rate commensurate with the lease term to determine the present value of lease payments used to record the right-of-use asset and related lease liability. The table below summarizes the components of lease cost by lease type for the six months ended June 30, 2019 (in thousands), followed by disclosure of weighted average remaining lease term and weighted average discount rate by type:

Finance lease cost:	
Amortization of right-of-use assets	\$15,580
Interest on lease liabilities	2,847
Operating lease cost	31,656
Short-term lease cost	5,110
Variable lease cost	2,688
Total lease cost	<u>\$57,881</u>
Weighted-average remaining lease term-finance leases (yrs)	10.1
Weighted-average remaining lease term-operating leases (yrs)	7.3
Weighted-average discount rate-finance leases	3.11%
Weighted-average discount rate-operating leases	2.57%

The following table presents supplemental cash flow information for the quarter ended June 30, 2019:

Cash paid for amounts included in the measurement of lease liabilities (in thousands):

Operating cash flows for operating leases	\$ 30,181
Operating cash flows for finance leases	\$ 2,847
Financing cash flows for finance leases	\$ 15,629

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

June 30, 2019

**8. Leases (continued)**

Maturities of Lease Liabilities

The following table reconciles the undiscounted cash flows to the finance lease liabilities and operating lease liabilities recorded on the balance sheet at June 30, 2019 (in thousands):

	<b>Operating Leases</b>	<b>Finance Leases</b>
2019	\$34,629	\$18,272
2020	67,352	33,923
2021	59,760	28,753
2022	50,583	24,669
2023	35,548	22,094
Thereafter	<u>126,384</u>	<u>83,223</u>
Total minimum lease payments	374,256	210,934
Less: amount of lease payments representing interest	<u>(43,315)</u>	<u>(25,425)</u>
Present value of future minimum lease payments	330,941	185,509
Less: current obligations under leases	<u>(72,605)</u>	<u>(37,360)</u>
Long-term lease obligations	<u>\$258,336</u>	<u>\$148,149</u>

**9. Statement of Functional Expenses**

The following statement of functional expenses reports Banner's operating expenses, as presented on the consolidated statements of income, by each of Banner's major operating functions for the six months ended June 30, 2019 and 2018. Operating expenses that are attributable to more than one operating function have been allocated using a basis representative of the operating expenditure such as patient volume, full-time equivalent or facility size.

**Operating Expenses June 30, 2019**

	<b>Delivery</b>	<b>Insurance Operations</b>	<b>Corporate Services</b>	<b>Other/ Eliminations</b>	<b>Banner Health Consolidated</b>
	<i>(In Thousands)</i>				
Expenses:					
Salaries and benefits	1,831,327	46,921	318,921	(66,894)	2,130,275
Supplies	744,177	425	(7,051)	(5,269)	732,282
Physician and professional fees	113,063	5,804	20,024	(19,446)	119,445
Medical claims costs	-	917,691	-	(177,889)	739,802
Depreciation and amortization	184,569	894	36,831	-	222,294
Interest expense	64,939	1,214	(4,426)	(60)	61,667
Other	976,978	40,198	(377,854)	(86,853)	552,469
Total expenses	<u>3,915,053</u>	<u>1,013,147</u>	<u>(13,555)</u>	<u>(356,411)</u>	<u>4,558,234</u>

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

June 30, 2019

**9. Statement of Functional Expenses (continued)**

**Operating Expenses June 30, 2018**

	<b>Delivery</b>	<b>Insurance Operations</b>	<b>Corporate Services</b>	<b>Other/ Eliminations</b>	<b>Banner Health Consolidated</b>
	<i>(In Thousands)</i>				
Expenses:					
Salaries and benefits	1,736,156	38,649	287,612	(58,756)	2,003,661
Supplies	675,817	200	(8,390)	(1,738)	665,889
Physician and professional fees	97,788	5,659	11,177	(16,001)	98,623
Medical claims costs	-	708,779	-	(191,306)	517,473
Depreciation and amortization	165,738	702	36,473	1	202,914
Interest expense	60,682	749	2,204	(24)	63,611
Other	920,839	26,772	(359,742)	(82,643)	505,226
Total expenses	<u>3,657,020</u>	<u>781,510</u>	<u>(30,666)</u>	<u>(350,467)</u>	<u>4,057,397</u>

**10. Commitments and Contingencies**

**Compliance with Laws and Regulations**

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers.

Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

**11. Subsequent Events**

Subsequent events have been evaluated through August 27, 2019, the date of issuance of the accompanying consolidated financial statements.

## Supplementary Information

## Banner Health

### Balance Sheet - Obligated and Non-Obligated Group Details of Consolidation

June 30, 2019

Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 11,555	\$ 447,941	\$ -	\$ 459,496
Short-term investments	146,577	34	-	146,611
Collateral held under securities lending program	309,307	-	-	309,307
Assets limited as to use	49,425	37,741	-	87,166
Patient receivables, net	860,551	113,255	(71,010)	902,796
Inventories	182,806	32,610	-	215,416
Other receivables	210,723	62,362	(9,637)	263,448
Other current assets	580,496	(459,263)	-	121,233
Total current assets	2,351,440	234,680	(80,647)	2,505,473
Assets limited as to use:				
Funds designated by:				
Board of Directors	2,224,963	-	-	2,224,963
Lease agreements	1,971	-	-	1,971
Funds held by trustees under:				
Self-insurance funding arrangements	(208)	114,968	-	114,760
Project fund	53,650	-	-	53,650
Other funds	202,552	879	-	203,431
Total assets limited as to use, less current portion	2,482,928	115,847	-	2,598,775
Property and equipment, net	3,637,990	137,303	-	3,775,293
Right of use assets - operating leases	96,991	219,416	-	316,407
Right of use assets - finance leases	180,368	4,607	-	184,975
Other assets:				
Long-term investments	2,460,316	30,405	-	2,490,721
Other	562,155	188,740	65,667	816,562
Total assets	\$ 11,772,188	\$ 930,998	\$ (14,980)	\$ 12,688,206

## Banner Health

### Balance Sheet - Obligated and Non-Obligated Group Details of Consolidation

June 30, 2019

Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
<b>Liabilities and net assets</b>				
Current liabilities:				
Trade accounts payable	\$ 147,000	\$ 31,722	\$ -	\$ 178,722
Current portion of long-term debt	61,234	-	-	61,234
Debt subject to self liquidity	400,000	-	-	400,000
Current portion of operating lease obligations	22,749	49,856	-	72,605
Current portion of finance lease obligations	36,504	856	-	37,360
Payable under securities lending program	309,307	-	-	309,307
Estimated current portion of third-party payor settlements	7,285	-	-	7,285
Accrued expenses:				
Salaries and benefits	364,775	118,731	(14,149)	469,357
Medical claims payable	3,877	273,482	(66,172)	211,187
Other	177,520	85,792	1	263,313
Total current liabilities	1,530,251	560,439	(80,320)	2,010,370
Long-term debt, less current portion	3,218,624	-	-	3,218,624
Finance lease obligations, less current portion	143,422	4,727	-	148,149
Operating lease obligations, less current portion	83,229	175,107	-	258,336
Estimated self-insurance liabilities, less current portion	94,229	118,082	(326)	211,985
Estimated third-party payor settlements, less current portion	16,344	-	-	16,344
Interest rate swaps	332,599	-	-	332,599
Other	175,944	2,894	-	178,838
Total liabilities	5,594,642	861,249	(80,646)	6,375,245
Net assets:				
Net assets without donor restrictions	6,102,811	(88,824)	65,666	6,079,653
Non-controlling interests	-	46,466	-	46,466
Net assets without donor restrictions	6,102,811	(42,358)	65,666	6,126,119
Net assets with donor restrictions	74,735	112,107	-	186,842
Total net assets	6,177,546	69,749	65,666	6,312,961
Total liabilities and net assets	\$ 11,772,188	\$ 930,998	\$ (14,980)	\$ 12,688,206

**Banner Health**  
**Statement of Income and Changes in Net Assets -**  
**Obligated and Non-Obligated Group Details of Consolidation**  
**Six Months Ended June 30, 2019**

**Unaudited**

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
<b>Revenues:</b>				
Net patient service revenue	\$ 3,163,581	\$ 553,125	\$ (205,809)	\$ 3,510,897
Medical insurance premiums	-	957,588	-	957,588
Other revenue	112,989	188,101	(99,539)	201,551
<b>Total revenues</b>	<b>3,276,570</b>	<b>1,698,814</b>	<b>(305,348)</b>	<b>4,670,036</b>
<b>Expenses:</b>				
Salaries and benefits	1,511,239	684,300	(65,264)	2,130,275
Supplies	603,445	134,108	(5,271)	732,282
Physician and professional fees	97,859	40,447	(18,861)	119,445
Medical claims cost, net of Banner claims of \$177,888	-	881,345	(141,543)	739,802
Depreciation and amortization	212,216	10,078	-	222,294
Interest expense	57,349	4,378	(60)	61,667
Other expenses	508,435	117,072	(73,038)	552,469
<b>Total expenses</b>	<b>2,990,543</b>	<b>1,871,728</b>	<b>(304,037)</b>	<b>4,558,234</b>
<b>Operating income</b>	<b>286,027</b>	<b>(172,914)</b>	<b>(1,311)</b>	<b>111,802</b>
<b>Other income:</b>				
Investment income - realized	58,084	4,865	(60)	62,889
Investment income - unrealized	275,611	3,321	-	278,932
Income from alternative investments	68,798	1,216	-	70,014
Investment income, net	402,493	9,402	(60)	411,835
Unrealized loss on interest rate swaps	(73,950)	-	-	(73,950)
Other (loss)	(4,809)	(1,918)	1,611	(5,116)
	323,734	7,484	1,551	332,769
<b>Excess of revenues over expenses</b>	<b>609,761</b>	<b>(165,430)</b>	<b>240</b>	<b>444,571</b>
Less excess of revenues over expenses attributable to non-controlling interests	-	13,650	-	13,650
<b>Excess of revenues over expenses attributable to Banner Health</b>	<b>609,761</b>	<b>(179,080)</b>	<b>240</b>	<b>430,921</b>
Equity transfers	(182,630)	182,593	37	-
Cumulative effect of change in accounting principles	24,637	-	-	24,637
Contributions for property and equipment acquisitions	10,380	-	(275)	10,105
Other changes in net assets	(12,025)	1,081	11,056	112
<b>Increase in net assets without donor restrictions</b>	<b>\$ 450,123</b>	<b>\$ 4,594</b>	<b>\$ 11,058</b>	<b>\$ 465,775</b>
<b>Net assets with donor restrictions:</b>				
Contributions	3,264	9,218	-	12,482
Net unrealized gain on investments	23	2,008	-	2,031
Net assets released from restriction	(2,417)	(15,980)	-	(18,397)
<b>Increase (decrease) in net assets with donor restrictions</b>	<b>\$ 870</b>	<b>\$ (4,754)</b>	<b>\$ -</b>	<b>\$ (3,884)</b>
<b>Non-controlling interests:</b>				
Less excess of revenues over expenses attributable to non-controlling interests	-	13,650	-	13,650
Other changes, primarily distributions of earnings to non-controlling interests	-	(11,183)	-	(11,183)
<b>Increase in non-controlling interests</b>	<b>-</b>	<b>2,467</b>	<b>-</b>	<b>2,467</b>
<b>Increase in net assets</b>	<b>450,993</b>	<b>2,307</b>	<b>11,058</b>	<b>464,358</b>
Net assets, beginning of period	5,726,553	67,442	54,608	5,848,603
<b>Net assets, end of period</b>	<b>\$ 6,177,546</b>	<b>\$ 69,749</b>	<b>\$ 65,666</b>	<b>\$ 6,312,961</b>



## Banner Health

### Statement of Cash Flows -

#### Obligated and Non-Obligated Group Details of Consolidation

Six Months Ended June 30, 2019

#### Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
<b>Operating activities</b>				
Increase in net assets	\$ 450,993	\$ 2,307	\$ 11,058	\$ 464,358
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:				
Loss on early extinguishment of debt	1,782	-	-	1,782
Equity transfers	182,630	(182,593)	(37)	-
Depreciation and amortization	212,216	10,078	-	222,294
Increase in investments designated as trading	(609,849)	(13,435)	-	(623,284)
Net unrealized loss on interest rate swaps	73,950	-	-	73,950
Cumulative effect of change in accounting principles	(24,637)	-	-	(24,637)
(Gain) loss on sale of assets	(1,293)	76	-	(1,217)
Contributions for property and equipment and other	(10,380)	-	275	(10,105)
Restricted contributions	(3,264)	(9,218)	-	(12,482)
Noncontrolling interest	12,250	-	-	12,250
Changes in operating elements:				
Patient receivables	(32,479)	(12,229)	10,039	(34,669)
Inventories and other current assets	(568)	49,324	(5,856)	42,900
Accounts payable and accrued expenses	(41,260)	64,213	(10,380)	12,573
Estimated third-party settlements	2,633	-	-	2,633
Estimated self-insurance liabilities	391	341	6,198	6,930
Other liabilities	17,416	(3,366)	-	14,050
Net cash provided by (used in) operating activities	230,531	(94,502)	11,297	147,326
<b>Investing activities:</b>				
Net purchases of property and equipment	(248,106)	(34,528)	(275)	(282,909)
Decrease in project fund	(53,650)	-	-	(53,650)
Decrease in other assets	(68,514)	6,574	(11,059)	(72,999)
Net cash used in investing activities	(370,270)	(27,954)	(11,334)	(409,558)
<b>Financing activities:</b>				
Proceeds from restricted contributions	3,264	9,218	-	12,482
Intercompany activity, including equity transfers	(197,341)	197,304	37	-
Proceeds from issuance of debt	686,615	-	-	686,615
Payments of finance lease obligations	(16,093)	383	-	(15,710)
Payments of long-term debt	(326,957)	(5,548)	-	(332,505)
Cash distributions to noncontrolling interests	(12,250)	-	-	(12,250)
Net cash provided by financing activities	137,238	201,357	37	338,632
Net (decrease) increase in cash and cash equivalents	(2,501)	78,901	-	76,400
Cash and cash equivalents at beginning of year	14,056	369,040	-	383,096
Cash and cash equivalents at end of period	\$ 11,555	\$ 447,941	\$ -	\$ 459,496