



MedStar Health

Fiscal 2020

Quarterly Financial Report

*Three Months and Nine months Ended
March 31, 2020*

Notice to Readers

The quarterly financial reports of MedStar Health, Inc. (MedStar) are intended to reasonably reflect the financial condition of MedStar as of the end of each quarter of the fiscal year. **THE QUARTERLY REPORTS ARE NOT BASED UPON AUDITED FINANCIAL INFORMATION.** Each quarterly report includes all known adjustments to present a fair statement of MedStar's results of operations, financial position and cash flows at the end of the quarter. While MedStar makes reasonable good faith efforts to prepare these reports to reflect the financial condition at the end of each quarter, the reader must be aware that there may be subsequent adjustments at the end of the fiscal year, including any adjustments made during MedStar's annual audit, that relate back to prior quarters. Certain of the discussions included in the Management Discussion and Analysis of Financial Condition and Results of Operations section of the quarterly report may include "forward-looking statements" which involve known and unknown risks and uncertainties inherent in the operation of healthcare facilities. In particular, statements preceded by, followed by or that include the words "expected," "anticipated," or "possible" or other similar expressions are or may constitute forward-looking statements. No information or statement in this report is intended to suggest or guarantee any future performance or results in future quarters. MedStar does not intend to update any forward-looking statements and undertakes no duty to any person to provide any such update under any circumstances. These financial statements also include a comparison to budget. The budget was prepared by management as a management tool and not as a prediction of actual performance. The budget is based on numerous assumptions which will vary from actual circumstances, developments in healthcare regulation and other applicable factors.

Any questions concerning MedStar's quarterly financial report should be addressed to: Susan K. Nelson, Executive Vice President and Chief Financial Officer, MedStar Health, Inc., 10980 Grantchester Way, Columbia, Maryland 21044.

MedStar Health, Inc.

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MedStar Health, Inc.

Consolidated Statements of Operations and Changes in Net Assets
For the Three Months and Nine Months Ended March 31, 2020 and 2019

(Dollars in millions)

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2020 Actual	2020 Budget	2019 Actual	2020 Actual	2020 Budget	2019 Actual
Operating revenues:						
Net patient service revenue	\$ 1,282.4	1,294.3	1,245.5	3,850.2	3,856.4	3,653.7
Premium revenue	128.2	125.0	119.7	365.3	369.2	403.3
Other operating revenue	62.1	58.5	56.5	176.9	166.2	160.6
Net operating revenues	1,472.7	1,477.8	1,421.7	4,392.4	4,391.8	4,217.6
Operating expenses:						
Personnel	845.4	835.8	812.1	2,529.2	2,486.5	2,392.2
Supplies	222.6	216.1	203.3	643.9	651.5	618.2
Purchased services	190.6	190.6	187.7	547.7	569.7	570.6
Other operating	120.6	129.3	119.2	368.4	393.5	358.4
Interest expense	12.5	12.1	11.5	35.0	36.3	35.0
Depreciation and amortization	48.8	54.2	46.5	150.4	164.1	149.8
Total operating expenses	1,440.5	1,438.1	1,380.3	4,274.6	4,301.6	4,124.2
Earnings from operations	32.2	39.7	41.4	117.8	90.2	93.4
Nonoperating (losses) gains:						
Investment (losses) gains, net	(274.9)	29.0	134.8	(185.4)	86.8	3.7
Income tax benefit (provision)	4.7	(0.9)	(0.6)	2.6	(2.6)	(2.4)
Other nonoperating activities, net	(8.8)	(3.5)	(3.6)	(14.9)	(10.4)	(10.2)
Total nonoperating (losses) gains	(279.0)	24.6	130.6	(197.7)	73.8	(8.9)
(Deficiency) excess of revenues over expenses	\$ (246.8)	64.3	172.0	(79.9)	164.0	84.5

(continued)

MedStar Health, Inc.

Consolidated Statements of Operations and Changes in Net Assets
For the Three Months and Nine Months Ended March 31, 2020 and 2019

(Dollars in millions)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2020	2019	2020	2019
Net assets without donor restrictions:				
(Deficiency) excess of revenues over expenses	\$ (246.8)	172.0	(79.9)	84.5
Distributions to noncontrolling interests	(0.2)	(0.1)	(2.1)	(1.6)
Net assets released from restrictions used for purchase of property and equipment and other	1.6	0.4	6.3	4.1
(Decrease) increase in net assets without donor restrictions	(245.4)	172.3	(75.7)	87.0
Net assets with donor restrictions:				
Contributions	2.7	5.8	10.8	16.4
Investment (losses) gains on restricted investments, net	(8.1)	4.0	(5.3)	0.3
(Decrease) increase in net assets of foundation	(11.1)	6.0	(8.3)	0.5
Net assets released from restrictions	(5.1)	(2.1)	(11.5)	(7.7)
(Decrease) increase in net assets with donor restrictions	(21.6)	13.7	(14.3)	9.5
(Decrease) increase in net assets	(267.0)	186.0	(90.0)	96.5
Net assets, beginning of period	2,201.7	1,905.4	2,024.7	1,994.9
Net assets, end of period	\$ 1,934.7	2,091.4	1,934.7	2,091.4

MedStar Health, Inc.

Consolidated Balance Sheets
As of March 31, 2020, June 30, 2019, and March 31, 2019

(Dollars in millions)

		March 31, 2020	June 30, 2019	March 31, 2019
Assets				
Current assets:				
Cash and cash equivalents	\$	939.6	559.6	567.1
Investments		409.2	188.7	192.9
Assets whose use is limited or restricted		65.1	65.1	64.3
Receivables:				
Patient accounts receivable, net		704.4	691.7	699.3
Other receivables		89.7	101.6	84.4
		<u>794.1</u>	<u>793.3</u>	<u>783.7</u>
Inventories		73.5	71.5	67.1
Prepays and other current assets		84.9	57.6	74.0
		<u>84.9</u>	<u>57.6</u>	<u>74.0</u>
Total current assets		2,366.4	1,735.8	1,749.1
Investments, net of current portion		1,092.2	1,209.5	1,158.3
Assets whose use is limited or restricted, net of current portion		763.6	902.2	918.3
Property and equipment, net		1,572.3	1,433.4	1,367.9
Operating lease right-of-use assets, net		287.7	-	-
Interest in net assets of foundation		56.7	65.0	63.0
Goodwill and other intangible assets, net		375.9	379.6	376.4
Other assets		136.8	130.3	135.4
		<u>136.8</u>	<u>130.3</u>	<u>135.4</u>
Total assets	\$	<u>6,651.6</u>	<u>5,855.8</u>	<u>5,768.4</u>

(continued)

MedStar Health, Inc.

Consolidated Balance Sheets
As of March 31, 2020, June 30, 2019, and March 31, 2019

(Dollars in millions)

		March 31, 2020	June 30, 2019	March 31, 2019
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued expenses	\$	449.0	493.8	472.0
Accrued salaries, benefits, and payroll taxes		397.2	394.8	370.8
Amounts due to third-party payors, net		89.5	86.3	92.7
Current portion of long-term debt (Note 1)		129.8	63.9	63.8
Current portion of self insurance liabilities		94.2	98.4	95.0
Current portion of operating lease liabilities		60.8	-	-
Other current liabilities		181.3	156.0	180.8
Total current liabilities		1,401.8	1,293.2	1,275.1
Long-term debt, net of current portion		2,123.8	1,574.4	1,575.9
Self insurance liabilities, net of current portion		276.4	272.6	284.3
Operating lease liabilities, net of current portion		248.9	-	-
Pension liabilities		422.5	436.5	284.2
Other long-term liabilities, net of current portion		243.5	254.4	257.5
Total liabilities		4,716.9	3,831.1	3,677.0
Net assets:				
Without donor restrictions		1,737.9	1,813.6	1,890.9
With donor restrictions		196.8	211.1	200.5
Total net assets		1,934.7	2,024.7	2,091.4
Total liabilities and net assets	\$	6,651.6	5,855.8	5,768.4

Note 1: Current portion of long-term debt includes amounts associated with credit agreements that expire within 12 months from the balance sheet date and principal payments related to outstanding indebtedness due within 12 months of the balance sheet date.

MedStar Health, Inc.

Consolidated Statements of Cash Flows
For the Nine Months Ended March 31, 2020 and 2019

(Dollars in millions)

	Nine Months Ended March 31,	
	2020	2019
Cash flows from operating activities:		
Change in net assets	\$ (90.0)	96.5
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	150.4	149.8
Changes in investment losses, net and derivative instrument	212.9	17.4
Changes in net assets of foundation	8.3	(0.5)
Donor restricted contributions	(10.8)	(16.4)
Changes in operating assets and liabilities:		
Net receivables	(0.8)	(43.7)
Accounts payable and accrued expenses	(2.5)	17.1
Other	(23.4)	(15.1)
Net cash provided by operations	244.1	205.1
Cash flows from investing activities:		
Purchases of property and equipment, and other	(307.0)	(204.8)
Purchases of investments and assets whose use is limited or restricted, net	(184.4)	(93.6)
Purchases of alternative investments	(4.2)	(30.0)
Proceeds from sales of alternative investments	2.4	16.6
Net settlement payment on derivative instrument	(1.2)	(1.2)
Net cash used in investing activities	(494.4)	(313.0)
Cash flows from financing activities:		
Proceeds from long-term borrowings	352.9	—
Proceeds from revolving credit agreements	345.0	—
Repayments of long-term borrowings	(79.1)	(32.4)
Donor restricted contributions	10.8	16.4
Sale of noncontrolling interests	2.8	—
Distributions to noncontrolling interests	(2.1)	(1.6)
Net cash provided by (used in) financing activities	630.3	(17.6)
Increase (decrease) in cash and cash equivalents	380.0	(125.5)
Cash and cash equivalents at beginning of year	559.6	692.6
Cash and cash equivalents at end of year	\$ 939.6	567.1
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 55.1	57.6
Noncash investing and financing activities:		
Noncash purchases of property, plant and equipment	\$ 8.5	7.3

MedStar Health, Inc.

Management Discussion and Analysis of Financial Condition and Results of Operations

Overview

MedStar Health, Inc. (MedStar or the Corporation) is a tax-exempt Maryland corporation which, through its controlled entities and other affiliates, provides and manages healthcare services in the region encompassing Maryland, Washington D.C. and Northern Virginia. The Corporation operates ten hospitals which include MedStar Franklin Square Medical Center, MedStar Good Samaritan Hospital, MedStar Harbor Hospital, MedStar Union Memorial Hospital, MedStar Georgetown University Hospital, MedStar Montgomery Medical Center, MedStar National Rehabilitation Network, MedStar Southern Maryland Hospital Center, MedStar St. Mary's Hospital and MedStar Washington Hospital Center. At March 31, 2020, the Corporation had 3,059 licensed beds.

In addition, the Corporation provides urgent care and other healthcare services, education and research through numerous affiliates including, but not limited to, MedStar Health Urgent Care, MedStar Ambulatory Services, MedStar Medical Group, LLC, MedStar Health Research Institute, MedStar Health Visiting Nurse Association and Parkway Venture Companies (Other Businesses). At March 31, 2020, MedStar Family Choice (MFC) provided Medicaid insurance services to 90,620 members within the region. See 'Other Disclosures' section below for additional information.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current period presentation, the effects of which are not material.

COVID-19

In March 2020, an outbreak of a novel strain of coronavirus (COVID-19) was declared a pandemic by the World Health Organization. To contain the spread and impact of COVID-19, and to mitigate the burden on the healthcare system, federal, state and local authorities implemented various restrictive measures, including significant limitations on business activity, travel bans, promotion of physical distancing, mandated quarantines, and shelter-in-place orders. MedStar's ongoing COVID-19 response has been guided by two primary principles:

- Providing a safe care environment for our patients and associates, and
- Ensuring operational continuity to fulfill our core mission of caring for our communities.

To that end, and in coordination with health authorities, MedStar cancelled or postponed all elective procedures and non-urgent ambulatory visits effective March 19, 2020. Simultaneously, MedStar prepared to care for a surge of COVID-19 positive patients in its communities, including, but not limited to, implementing significant new safety measures at its hospitals, creating and expanding bed capacity, acquiring personal protective equipment and other supplies, expanding testing capabilities, redeploying associates to areas of need, and investing in alternative means of care such as scaling up and offering the MedStar eVisit service free of charge. MedStar also pledged \$2.0 million to establish an 'Associate Emergency Support Fund' to aid employees who have experienced hardships as a result of the COVID-19 pandemic and instituted a work-from-home policy for certain administrative functions.

Prior to the COVID-19 pandemic, MedStar's operating performance was strong. Through the eight months ended February 29, 2020, MedStar's earnings from operations of \$120.4 million was favorable to both the budget of \$71.9 million and the prior year of \$67.9 million by \$48.5 million and \$52.5 million, respectively. The

operating margin of 3.1% was favorable to the budgeted operating margin of 1.9% and the prior year of 1.8%. The favorable operating results were primarily driven by favorable net operating revenue. Net patient service revenue of \$3,438.7 million was favorable to budget by \$28.7 million or 0.8% and increased \$212.1 million or 6.6% over the prior year. The variance from budget was primarily due to better-than-budgeted rates, favorable outpatient and physician services revenue volumes, and favorable inpatient case mix in our Washington, D.C. hospitals, partially offset by higher-than-expected implicit price concessions and unfavorable inpatient volumes. These favorable trends continued into mid-March until the spread of COVID-19 began.

The cancellation or postponement of all elective procedures and non-urgent ambulatory visits resulted in a significant reduction in patient volumes. Refer to the following table for changes in fiscal year 2020 patient volumes versus the comparable period in prior year.

	Variance vs. Prior Year Comparable Period		
	FY20 YTD February 2020	FY20 MTD March 2020	Preliminary FY20 MTD April 2020
Admissions (excluding sub-acute)	(1.8%)	(16.9%)	(27.9%)
Observations	(4.0%)	(22.8%)	(49.4%)
Emergency Room visits	(1.1%)	(19.1%)	(46.4%)
Home Health visits	10.1%	4.2%	(5.2%)
Physician Office visits	2.5%	(24.9%)	(64.2%)
All Other Outpatient visits	5.7%	(16.6%)	(50.4%)
Total Outpatient visits	3.9%	(19.2%)	(53.1%)

These reductions in volumes as a result of the COVID-19 response impacted operating results for the third quarter ended March 31, 2020 and is expected to have a significant negative impact on revenues and operating results in the fourth quarter of fiscal year 2020. In addition to lost revenue associated with lower patient volumes, MedStar is experiencing an increase in operating costs associated with the response to the COVID-19 pandemic discussed previously as well as increases in supplies expenses as a result of shortages, delays and significant price increases in medical supplies, particularly personal protective equipment and certain pharmaceuticals. Where possible, MedStar is taking measures to reduce controllable expenses to partially offset the expected negative impact.

The COVID-19 pandemic has also resulted in volatility in the financial markets, which negatively impacted MedStar's investment portfolio returns in the quarter. See 'Nonoperating Activity' section below for additional information. MedStar continues to monitor the impact of the COVID-19 pandemic on liquidity and has taken actions to bolster liquidity given the uncertainty associated with the pandemic. See 'Liquidity and Capital Resources' section below for additional information.

Effective May 18, 2020 in Maryland, and effective May 26, 2020 in the District of Columbia, elective procedures and non-urgent ambulatory visits were permitted to resume subject to certain guidelines and recommendations. As the COVID-19 pandemic continues to evolve and develop, MedStar is unable to determine the full financial impact at this time. The ultimate impact of the pandemic on MedStar's financial results will depend on, among other factors, the duration and severity of the pandemic as well as negative economic conditions arising from the pandemic and the impact of government actions and administrative regulations on the hospital industry and broader economy, including through existing and any future stimulus efforts. See 'Legislative Actions as a Result of COVID-19' under the 'Other Disclosures' section below for additional information.

Financial Performance

Three months Ended March 31, 2020

Results of Operations

Earnings from operations for the three months ended March 31, 2020 of \$32.2 million were below the budget of \$39.7 million and below the prior year of \$41.4 million. The operating margin of 2.2% was below the budgeted operating margin of 2.7% and below the prior year operating margin of 2.9%. Continued favorable trends in operating results in January and February 2020 were offset by the emergence of the COVID-19 pandemic and related responses beginning in mid-March. Operating earnings before interest, depreciation and amortization (EBIDA) for the three months ended March 31, 2020, were \$93.5 million compared to the budget of \$106.0 million and \$99.4 million for the prior year. The EBIDA margin for the three months ended March 31, 2020 was 6.3% compared to the budgeted EBIDA margin of 7.2% and the prior year EBIDA margin of 7.0%.

Total net operating revenues for the three months ended March 31, 2020 of \$1,472.7 million were unfavorable to budget by \$5.1 million or 0.3% however increased \$51.0 million or 3.6% over the prior year.

Net patient service revenue of \$1,282.4 million was unfavorable to budget by \$11.9 million or 0.9% however, increased by \$36.9 million or 3.0% over the prior year. The variance from budget was driven by significant declines in patient volumes as a result of the COVID-19 pandemic and related responses beginning in mid-March, which offset favorable net patient service revenue trends noted through February above. Hospital admissions (excluding sub-acute) for the three months ended March 31, 2020 totaled 30,634, which were 3,095 or 9.2% unfavorable to the budget of 33,729 and 2,246 or 6.8% below the prior year of 32,880. For the Maryland hospitals under the Global Budget Revenue (GBR) model, revenue is no longer recognized based on volumes alone. Outpatient visits for the quarter totaled 1,244,647, which were 42,201 or 3.3% unfavorable to the budget of 1,286,848 and 23,573 or 1.9% below the prior year of 1,268,220. See schedule on page 17 for additional outpatient data.

Premium revenue for the three months ended March 31, 2020 was \$128.2 million compared to a budget of \$125.0 million, a favorable variance of \$3.2 million or 2.6%.

Other operating revenue for the three months ended March 31, 2020 was \$62.1 million compared to a budget of \$58.5 million, favorable by \$3.6 million or 6.2% due to the timing of grants and unrestricted contributions and favorable to budget rebate income.

Personnel expenses for the three months ended March 31, 2020 were \$845.4 million compared to a budget of \$835.8 million, an unfavorable variance of \$9.6 million or 1.1%. The unfavorable variance was primarily related to nursing and other agency usage and overtime.

Supply expenses for the three months ended March 31, 2020 were \$222.6 million compared to a budget of \$216.1 million, an unfavorable variance of \$6.5 million or 3.0%. The unfavorable variance was due to favorable case mix in our Washington, D.C. hospitals, and increased expenses incurred as a result of the COVID-19 response, partially offset by unfavorable patient volumes.

Purchased services expenses for the three months ended March 31, 2020 were \$190.6 million, consistent with the budget.

Other operating expenses for the three months ended March 31, 2020 were \$120.6 million compared to a budget of \$129.3 million, a favorable variance of \$8.7 million or 6.7%. The variance from budget was primarily related to lower-than-budgeted advertising and marketing, travel and education, and other discretionary expenses.

Interest expense for the three months ended March 31, 2020 was \$12.5 million compared to a budget of \$12.1 million, an unfavorable variance of \$0.4 million or 3.3%.

Depreciation and amortization for the three months ended March 31, 2020 was \$48.8 million compared to a budget of \$54.2 million, a favorable variance of \$5.4 million or 10.0%. The favorable variance was due to the timing of the completion of certain capital projects.

Nonoperating Activity

Nonoperating losses for the three months ended March 31, 2020 totaled \$279.0 million compared to budgeted gains of \$24.6 million and prior year gains of \$130.6 million. The unfavorable variance from budget was primarily due to unfavorable investment market performance. For the three months ended March 31, 2020, net unrealized losses on investments were \$281.4 million, primarily driven by significant volatility in financial markets as a result of the COVID-19 pandemic in March 2020, partially offset by \$6.4 million of investment income and \$0.1 million of realized gains.

(Deficiency) Excess of Revenues Over Expenses

Deficiency of revenues over expenses for the three months ended March 31, 2020 was \$246.8 million, or \$311.1 million below the budgeted excess of revenues over expenses of \$64.3 million, and \$418.8 million below the prior year excess of revenues over expenses of \$172.0 million. The deficiency was primarily a result of the unfavorable investment returns discussed above.

Nine months Ended March 31, 2020

Results of Operations

Earnings from operations for the nine months ended March 31, 2020 of \$117.8 million exceeded the budget of \$90.2 million and the prior year of \$93.4 million. The operating margin of 2.7% exceeded the budgeted operating margin of 2.1% and the prior year operating margin of 2.2%. As discussed above, strong year-to-date operating results through the eight months ended February 29, 2020 were partially offset by the spread of COVID-19 and implementation of the corresponding responses beginning in mid-March. Operating earnings before interest, depreciation and amortization (EBIDA) for the nine months ended March 31, 2020 of \$303.2 million exceeded the budgeted EBIDA of \$290.6 million and the prior year EBIDA of \$278.2 million. The EBIDA margin of 6.9% exceeded the budgeted EBIDA margin and prior year EBIDA margin of 6.6%.

Total net operating revenues for the nine months ended March 31, 2020 of \$4,392.4 million were favorable to budget by \$0.6 million and increased \$174.8 million or 4.1% over the prior year.

Net patient service revenue for the nine months ended March 31, 2020 of \$3,850.2 million was unfavorable to budget by \$6.2 million or 0.2% and increased by \$196.5 million or 5.4% over the prior year. The variance from budget was driven by significant declines in patient volumes as a result of the COVID-19 pandemic and related responses beginning in mid-March, partially offset by favorable revenue trends prior to the pandemic described previously. Hospital admissions (excluding sub-acute) for the nine months ended March 31, 2020 totaled 94,987, which were 5,300 or 5.3% unfavorable to the budget of 100,287 and 3,525 or 3.6% below the prior year of 98,512. For the Maryland hospitals under the Global Budget Revenue (GBR) model, revenue is no longer recognized based on volumes alone. Outpatient visits for the nine months ended March 31, 2020 totaled 3,803,286, which were 58,812 or 1.5% unfavorable to the budget of 3,862,098 and were 44,826 or 1.2% above the prior year of 3,758,460. See schedule on page 17 for additional outpatient data.

Premium revenue for the nine months ended March 31, 2020 was \$365.3 million compared to a budget of \$369.2 million, an unfavorable variance of \$3.9 million or 1.1%, and \$38.0 million or 9.4% below the prior year of \$403.3 million. The unfavorable variance from budget was primarily due to lower-than-budgeted membership volumes and the decrease from prior year was associated with MFC's budgeted decision not to renew its contract for participation in the Medicare Advantage program effective January 1, 2019.

Other operating revenue for the nine months ended March 31, 2020 was \$176.9 million compared to a budget of \$166.2 million, a favorable variance of \$10.7 million or 6.4%. The favorable variance was primarily due to a one-time increase in realized gains on investments held in the self-insurance trust as a result of an investment strategy change in the second quarter.

Personnel expenses for the nine months ended March 31, 2020 were \$2,529.2 million compared to a budget of \$2,486.5 million, an unfavorable variance of \$42.7 million or 1.7%. The unfavorable budget variance was primarily related to nursing and other agency usage, overtime, and physician compensation, partially offset by favorable benefits expense.

Supply expenses for the nine months ended March 31, 2020 were \$643.9 million compared to a budget of \$651.5 million, a favorable variance of \$7.6 million or 1.2%. The favorable variance was primarily due to lower-than-budgeted increases in pharmaceutical and other supply costs and unfavorable inpatient volumes, partially offset by favorable case mix in our Washington, D.C. hospitals and increased expenses incurred as a result of the COVID-19 response.

Purchased services expenses for the nine months ended March 31, 2020 were \$547.7 million compared to a budget of \$569.7 million, a favorable variance of \$22.0 million or 3.9%. The favorable variance was primarily due to lower health care services costs and membership volumes associated with the insurance business and the timing of certain information technology initiatives.

Other operating expenses for the nine months ended March 31, 2020 were \$368.4 million compared to a budget of \$393.5 million, a favorable variance of \$25.1 million or 6.4%. The variance from budget was primarily related to lower-than-budgeted advertising and marketing, travel and education, consulting, and other discretionary expenses, and lower-than-budgeted malpractice expense due to better than anticipated claims experience.

Interest expense for the nine months ended March 31, 2020 was \$35.0 million compared to a budget of \$36.3 million, a favorable variance of \$1.3 million or 3.6%.

Depreciation and amortization for the nine months ended March 31, 2020 was \$150.4 million compared to a budget of \$164.1 million, a favorable variance of \$13.7 million or 8.3%. The variance from budget was due to the timing of the completion of certain capital projects.

Nonoperating Activity

Nonoperating losses for the nine months ended March 31, 2020 totaled \$197.7 million compared to budgeted gains of \$73.8 million and prior year losses of \$8.9 million. The unfavorable variance from budget was primarily due to unfavorable investment market performance. For the nine months ended March 31, 2020, net unrealized losses on investments were \$243.9 million, primarily driven by significant volatility in financial markets as a result of the COVID-19 pandemic in March 2020, partially offset by \$37.2 of net realized gains and \$21.3 million of investment income.

(Deficiency) Excess of Revenues Over Expenses

Deficiency of revenues over expenses for the nine months ended March 31, 2020 was \$79.9 million, or \$243.9 million below the budgeted excess of revenues over expenses of \$164.0 million, and \$164.4 million below the prior year excess of revenues over expenses of \$84.5 million. The deficiency was primarily a result of the unfavorable investment returns discussed above.

Liquidity and Capital Resources

In January 2020, the Corporation issued two tranches of taxable bonds: \$302.6 million of Series 2020A and \$43.4 million of Series 2020B. The Series 2020A bonds, which have a maturity date of August 15, 2049 and an interest rate of 3.626%, were issued to fund the MedStar Georgetown University Hospital surgical pavilion

project, other capital projects across the System, and costs of issuance. Proceeds from the Series 2020B bonds, which have maturity dates of August 15, 2031 and 2041, and interest rates of 2.905% and 3.626%, respectively, were issued to refund \$40.1M of outstanding Series 2011 Bonds.

While demand for healthcare services is expected to rebound in the future, MedStar has taken, and continues to take, various actions to increase liquidity and mitigate the impact of COVID-19 on the financial position and cash flows of the Corporation. These actions include:

- In March 2020, MedStar borrowed \$120.0 million under its existing \$250.0 million revolving credit agreement that has a three-year term expiring January 2022, which has been recorded in long-term debt as of March 31, 2020.
- In March 2020, MedStar closed on a new \$100.0 million revolving credit agreement that expires in March 2021, which was fully drawn and recorded in current portion of long-term debt as of March 31, 2020.
- In March 2020, MedStar closed on a new \$125.0 million revolving credit agreement that expires in April 2021, which was fully drawn and has been recorded in long-term debt as of March 31, 2020.
- In April 2020, MedStar closed on three additional revolving credit agreements totaling \$335.0 million, all of which expire in April 2021 and were fully drawn subsequent to closing.

The newly executed revolving credit agreements contain financial covenants and financial reporting requirements consistent with MedStar's existing revolving credit agreement. As of March 31, 2020, the Corporation was in compliance with all covenants under these agreements and there have been no events of default.

The Corporation's total unrestricted cash and investments (including board-designated funds) were \$2,594.7 million at March 31, 2020, \$2,123.2 million at June 30, 2019 and \$2,095.7 million at March 31, 2019. Days cash on hand were 173 days at March 31, 2020 compared to 145 days at June 30, 2019 and at March 31, 2019. Days in accounts payable were 77 days at March 31, 2020, compared to 84 days at June 30, 2019 and 81 days at March 31, 2019. Days in accounts receivable were 45 days at March 31, 2020 compared to 45 days at June 30, 2019 and 46 days at March 31, 2019.

To increase cash flow to Medicare providers impacted by the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act) expanded the Medicare Accelerated and Advance Payment Program, which allows for eligible health care facilities to request up to six months of advance Medicare payments. Such accelerated payments are interest free for 12 months for most acute care hospitals. The Centers for Medicare & Medicaid Services (CMS) will begin to apply claims for services provided to Medicare beneficiaries against the advance payments received by hospitals and other eligible health care facilities after 120 days following receipt of the advance payments. Subsequent to March 31, MedStar received approximately \$701.8 million from these advance Medicare payments. CARES Act stimulus payments received subsequent to March 31 are described in 'Legislative Actions as a Result of COVID-19' under 'Other Disclosures' below.

Lastly, the CARES Act provides for deferred payment of the employer portion of social security taxes through December 31, 2020, with 50% of the deferred amount due December 31, 2021 and the remaining 50% due December 31, 2022. Starting mid-April 2020, MedStar began deferring the employer portion of social security taxes, which is approximately \$10.0 million per month.

New Accounting Guidance

Effective July 1, 2019, the Corporation adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2016-02, *Leases* (Topic 842), the primary impact of which required lessees to recognize right-of-use assets and liabilities for most operating leases and present enhanced annual disclosures on key quantitative and qualitative information. Leases are classified as either operating or financing, with the classification determining whether the expense is recognized on a straight-line basis (for operating leases) or

based on an effective interest method (for financing leases). The Corporation elected the practical expedient package to not reassess at adoption (i) existing contracts for whether they include a lease, (ii) the lease classification of any existing leases or (iii) initial indirect costs for existing leases. The Corporation also elected the policy election that allows lessees to choose not to separate lease and non-lease components by class of underlying asset for certain asset classes. The Corporation did not elect the hindsight transitional practical expedient.

The Corporation determines if an arrangement contains a lease at inception of the contract. Right-of-use assets represent the right to use the underlying assets for the lease term and the associated operating lease liabilities represent lease payments arising from the lease, both of which are recognized at commencement date based on the present value of lease payments over the lease term. The Corporation uses the implicit rate noted within the contract, unless unknown in which case the Corporation's estimated incremental borrowing rate is used. A right-of-use asset and lease liability is not recognized for leases with an initial term of 12 months or less.

As a result of the adoption of Topic 842, the Corporation recognized operating lease right-of-use assets and liabilities of \$295.5 million and \$319.9 million, respectively, as of the transition date. Operating lease assets were less than liabilities due to the reclassification of existing liabilities for unamortized tenant improvement allowances and deferred rent balances. Comparative periods continue to be reported in accordance with Topic 840. The adoption did not have a material impact on the Corporation's results of operations or cash flows.

Effective June 30, 2019, the Corporation adopted the FASB ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, which requires not-for-profit entities to revise its financial statement presentation of net asset classifications, provide quantitative and qualitative information as to the available resources and management of liquidity and liquidity risk, and expand disclosures on functional expenses. There were no material changes to the consolidated balance sheets, statements of operations and changes in net assets or cash flows as a result of the adoption.

Other Disclosures

The healthcare industry is subject to numerous laws and regulations from federal, state and local governments, and the government has increased enforcement of Medicare and Medicaid anti-fraud and abuse laws, as well as the physician self-referral law (Stark Law). The Corporation's compliance with these laws and regulations can be subject to periodic governmental review and interpretation, which can result in regulatory action unknown or unasserted at this time. The Corporation is aware of certain asserted and unasserted legal claims and regulatory matters arising in the normal course of business but cannot reasonably predict any particular outcomes or operations or financial effects from these matters at this time. The Corporation will continue to monitor all government inquiries and respond appropriately.

For several years, government initiatives have focused on curtailing fraud, waste, and abuse in government-funded healthcare programs. To this end, the federal government and many states, have implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs. The Corporation's hospitals and providers have periodically received audit requests from Medicare and Medicaid audit contractors, as well as the Office of Inspector General of the U.S. Department of Health & Human Services (HHS). These audit requests have targeted, among other things, medical necessity of inpatient admissions and provider documentation and coding practices. The Corporation's hospitals and providers have cooperated with each of these audit requests and implemented a program to track and manage their effects.

As a result of federal healthcare reform legislation, rules and regulations, substantial changes are occurring in the United States healthcare system. These include numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to healthcare providers, the privacy and security of health information, and the legal obligations of health insurers, providers and employers.

Certain Maryland-based hospital charges are subject to review and approval by the Health Services Cost Review Commission (HSCRC). The HSCRC has jurisdiction over hospital reimbursement in Maryland by agreement with CMS. This agreement is based on a waiver from the Medicare Prospective Payment System reimbursement principles granted under Section 1814(b) of the Social Security Act. In January 2014, CMS approved Maryland's waiver for a five-year period beginning January 1, 2014 for inpatient and outpatient hospital services. The waiver tied hospital per capita revenue growth to the state's economic growth of 3.58% and required growth in Medicare spending per beneficiary in Maryland to be 0.5% below the national average. The waiver also imposed quality measures and encouraged population health management.

Under the Maryland HSCRC rate methodology, amounts payable for services to Maryland hospital patients under the Medicare and Medicaid insurance programs are computed at 92.3% of regulated charges. This discount amount does not include managed care organization (MCO) granted discounts for medical education. Hospital patients under the Blue Cross and approved HMO insurance programs are computed at 98% of regulated charges. Maryland accounts receivable from these third-party payors have been adjusted to reflect the difference between charges and the payable amounts.

In connection with the waiver, the HSCRC introduced the GBR model, which covers the Corporation's seven Maryland hospitals. This model moves payment to hospitals from each individual service to a total revenue for each hospital (or a combination of hospitals) to provide hospitals flexibility in the objectives of better care for individuals, higher levels of overall population health, and improved health care affordability. The model removes the financial incentive from increasing volume and provides incentive to work with partners to provide care in the appropriate setting. Additionally, the GBR model has the potential of including both prospective and retrospective rate adjustments. As noted above, the full impact of the COVID-19 pandemic on MedStar's financial results, including whether or not reduced patient volumes will prevent MedStar from fully charging its fiscal year 2020 GBR, cannot be quantified.

In 2018, Maryland entered into a new ten-year waiver with CMS to include total cost of care benchmarks and savings, which took effect January 1, 2019, and will be re-evaluated at the end of five years. The new waiver is intended to shift care into lower cost settings, improve care coordination, and align incentives among various healthcare providers.

Legislative Actions as a Result of COVID-19

As a result of the COVID-19 pandemic, federal, state, and the District of Columbia governments have passed legislation, promulgated regulations, and taken other administrative actions intended to assist healthcare providers in providing care to COVID-19 and other patients during the public health emergency. One of the primary sources of relief for healthcare providers is the CARES Act, which was signed into law on March 27, 2020 and aims to mitigate the economic disruption caused by the COVID-19 pandemic with up to \$2.0 trillion in authorized government spending.

The CARES Act included \$100.0 billion to establish the Public Health and Social Services Emergency Fund (PHSS Emergency Fund), commonly referred to as the CARES Act Provider Relief Fund, which is intended to support healthcare-related expenses or lost revenue attributable to the COVID-19 pandemic and to ensure uninsured Americans have access to testing and treatment for COVID-19.

HHS allotted and distributed the first \$50.0 billion of this funding based on a general allocation formula. The remaining \$50.0 billion is being distributed through targeted allocations with \$12.0 billion allocated for distribution to hospitals in areas particularly impacted by COVID-19 and \$10.0 billion allocated for rural health clinics and hospitals. A portion of the balance of the funding is being used to reimburse health care providers that submit claims requests for COVID-19-related treatment of uninsured patients at Medicare rates. HHS has not yet announced the precise method by which future payments from the PHSS Emergency Fund will be determined or allocated. In April and May 2020, MedStar received PHSS Emergency Fund payments of approximately \$156.1 million, subject to attesting to certain terms and conditions required by HHS, including limitations on balance billing and agreeing that PHSS Emergency Funds will not be used to reimburse expenses

or losses that other sources are obligated to reimburse. These funds are not required to be repaid, provided that MedStar continues to comply with the required terms and conditions, and is expected to be recognized as other operating revenue during the fourth quarter of fiscal year 2020.

An additional \$75.0 billion in emergency appropriations for COVID-19 response will be available to eligible providers under the Paycheck Protection Program and Health Care Enhancement Act (PPHCE Act), which was enacted on April 24, 2020. These funds will also be distributed through the PHSS Emergency Fund, although HHS has not yet announced the precise method by which future disbursements will be determined or allocated. Recipients are not expected to be required to repay the amounts received assuming compliance with any required terms and conditions.

The CARES Act also revised Medicare policies in order to temporarily boost Medicare reimbursement and allow for added regulatory flexibility, which included the following:

- Effective May 1, 2020, the annual 2% sequestration revenue reduction in Medicare fee-for-service and Medicare Advantage payments to hospitals, physicians and other providers was suspended for the rest of calendar year 2020. The 2% sequestration revenue reduction is scheduled to resume in calendar year 2021. In order to offset the added expense of the 2020 suspension, the CARES Act extends the sequestration revenue reduction by one year through 2030. The estimated impact on MedStar in fiscal year 2020 is not expected to be material.
- Increasing the payment that would otherwise be made to a hospital for treating a Medicare patient admitted with COVID-19 by twenty percent (20%) under the inpatient prospective payment system. The add-on payment will be available for the duration of the public health emergency as declared by the Secretary of HHS. MedStar is currently unable to estimate the financial impact of this provision.

Subsequent Events

As previously noted, the following subsequent events occurred through May 2020:

- In April 2020, MedStar closed on three additional revolving credit agreements totaling \$335.0 million, all of which expire in April 2021 and were fully drawn subsequent to closing.
- In April 2020, MedStar received approximately \$701.8 million of accelerated Medicare payments under the CARES Act. Such accelerated payments are interest free for inpatient acute care hospitals for 12 months. After 120 days following receipt of the advance payment, claims for services provided to Medicare beneficiaries will be applied against the advance payment balance.
- In April and May 2020, MedStar received PHSS Emergency Fund payments of approximately \$156.1 million that are not expected to be repaid subject to certain terms and conditions.

See 'Liquidity and Capital Resources' and 'Legislative Actions as a Result of COVID-19' under 'Other Disclosures' sections above for additional information.

MedStar Health, Inc.

Selected Other Information

	Quarter Ended March 31				
	2020 Actual	2020 Budget	% Variance	2019 Actual	% Variance
Admissions (excluding sub-acute)	30,634	33,729	(9.2%)	32,880	(6.8%)
Observations	8,542	9,270	(7.9%)	9,209	(7.2%)
Emergency Room visits	111,845	116,812	(4.3%)	118,311	(5.5%)
Home Health visits	87,037	79,879	9.0%	79,249	9.8%
Physician Office visits	535,516	558,648	(4.1%)	559,047	(4.2%)
Other Outpatient visits	501,707	522,239	(3.9%)	502,404	(0.1%)
Total Outpatient Visits	1,244,647	1,286,848	(3.3%)	1,268,220	(1.9%)
MedStar Family Choice Covered Lives	90,620	92,000	(1.5%)	92,780	(2.3%)

	Year-To-Date March 31				
	2020 Actual	2020 Budget	% Variance	2019 Actual	% Variance
Admissions (excluding sub-acute)	94,987	100,287	(5.3%)	98,512	(3.6%)
Observations	26,596	28,261	(5.9%)	28,309	(6.1%)
Emergency Room visits	345,466	353,526	(2.3%)	356,751	(3.2%)
Home Health visits	259,643	240,447	8.0%	237,261	9.4%
Physician Office visits	1,634,310	1,688,896	(3.2%)	1,645,329	(0.7%)
Other Outpatient visits	1,537,271	1,550,968	(0.9%)	1,490,810	3.1%
Total Outpatient Visits	3,803,286	3,862,098	(1.5%)	3,758,460	1.2%
MedStar Family Choice Covered Lives	90,620	92,000	(1.5%)	92,780	(2.3%)

See 'Liquidity and Capital Resources' section above for additional details.

KEY LIQUIDITY INDICATORS			
	March 2020	June 2019	March 2019
Days cash on hand * / **	173	145	145
Maximum Annual Debt Service coverage	3.66	4.21	4.23
Days revenue in accounts receivable	45	45	46
Days expense in accounts payable	77	84	81

*Under the Corporation's bank agreements, the Corporation is required to maintain certain covenants, including days cash on hand of 70 (measured semi-annually at each June 30 and December 31) and a maximum annual debt service coverage of 1.25 (measured quarterly on a rolling four quarters basis). The Corporation is in compliance with these covenants as of March 31, 2020, June 30, 2019 and December 31, 2019. Similar covenants are also included under the Corporation's Master Trust Indenture, although they are measured annually and required covenant levels are lower.

**Days cash on hand includes approximately 20 days of proceeds from MedStar's Series 2020A taxable bond financing and approximately 23 days associated with borrowings under bank lines of credit in March 2020.

CASH AND INVESTMENTS (in millions)			
	March 2020	June 2019	March 2019
Cash and cash equivalents	\$ 939.6	\$ 559.6	\$ 567.1
Investments	1,501.4	1,398.2	1,351.2
Assets whose use is limited or restricted			
Funds held by trustees	560.4	682.2	689.5
Funds restricted by donors for specific purposes and endowment	115.2	114.8	110.5
Funds designated by board and management	153.2	170.3	182.6
Total assets whose use is limited or restricted	828.8	967.3	982.6
Total cash and cash equivalents, investments and assets whose use is limited or restricted	\$ 3,269.8	\$ 2,925.1	\$ 2,900.9
Less cash and cash equivalents, and current portion of investments and assets whose use is limited or restricted	(1,413.9)	(813.4)	(824.3)
Total long-term investments and long-term assets whose use is limited or restricted	\$ 1,855.9	\$ 2,111.7	\$ 2,076.6