



Scripps

**Obligated Group
Financial Statements**

**2nd Quarter
March 31, 2020**



Scripps Health Obligated Group

Table of Contents
For the Quarter and Six Months Ended March 31, 2020

Obligated Group Financial Statements	1a – 1f
Notes to Financial Statements	2a – 2l
Management Discussion and Analysis	3a – 3e



SCRIPPS HEALTH
OBLIGATED GROUP
STATEMENTS OF FINANCIAL POSITION
March 31, 2020
(\$000s)

	March 2020	March 2019	September 2019
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 391,293	\$ 202,725	\$ 366,595
Accounts Receivable, Net	401,842	421,986	413,011
Assets Limited As To Use	10	9	9
Other Current Assets	165,176	208,545	174,477
Total Current Assets	958,320	833,265	954,092
Investments:			
Assets Limited As To Use	310,535	211,394	248,402
Unrestricted	2,186,126	2,338,348	2,367,235
Property, Plant and Equipment	3,869,607	3,658,435	3,754,870
Less Accumulated Depreciation	(1,956,363)	(1,842,474)	(1,885,743)
Property, Plant and Equipment, Net	1,913,245	1,815,961	1,869,127
Right of Use Assets	114,399	-	-
Other Assets	272,427	197,545	184,061
Total Assets	\$ 5,755,051	\$ 5,396,512	\$ 5,622,917
LIABILITIES AND EQUITY			
Current Liabilities:			
Current Portion of Long-term Debt	\$ 229,352	\$ 235,299	\$ 121,283
Accounts Payable	155,922	136,774	148,360
Accrued Liabilities	232,500	228,616	248,134
Current Portion of Lease Liability	26,683	-	-
Total Current Liabilities	644,457	600,689	517,777
Long Term Debt	749,297	672,049	785,908
Other Liabilities	170,782	108,478	109,811
Long Term Lease Liability	97,045	-	-
Total Liabilities	1,661,581	1,381,216	1,413,496
Net Assets:			
Without Donor Restrictions			
Controlling Interest	3,807,928	3,807,718	3,960,342
	3,807,928	3,807,718	3,960,342
With Donor Restrictions	285,540	207,578	249,079
Total Net Assets	4,093,468	4,015,296	4,209,421
Total Liabilities and Net Assets	\$ 5,755,051	\$ 5,396,512	\$ 5,622,917



**SCRIPPS HEALTH
OBLIGATED GROUP
STATEMENT OF OPERATIONS**
(\$000s)

	FOR THE QUARTER ENDED MARCH 31,	
	2020	2019
Revenues, gains, and other support without donor restrictions:		
Patient service revenue	\$ 673,368	\$ 678,105
Provider tax revenue	110,264	30,178
Total patient service revenue	783,632	708,283
Capitation premium	56,878	36,094
Other	23,518	43,153
Meaningful use	93	-
Net assets released from restrictions used for operations	35,439	5,939
Total operating revenues	899,561	793,469
Operating expenses:		
Wages and benefits	354,397	331,312
Supplies	146,421	142,719
Physician services	138,586	127,296
Other services	85,913	81,017
Provider fee	77,158	24,684
Capitation services	1,154	1,000
Depreciation and amortization	41,247	40,460
Interest	4,918	5,741
Restructuring	2,991	-
Total operating expenses	852,786	754,230
Operating income before corporate overhead allocation & income tax	46,775	39,239
Corporate overhead allocation	397	400
Provision for income tax expense	(106)	509
Operating income after corporate overhead allocation & income tax	47,066	40,148
Nonoperating gains (losses):		
Interest and dividends	9,004	9,197
Realized gains	5,459	230
Unrealized (losses) gains on trading portfolio	(350,259)	161,374
Contributions	350	433
Market adjustment on Interest rate swaps	(7,660)	(1,956)
Excess of revenues over expenses	\$ (296,040)	\$ 209,426



**SCRIPPS HEALTH
OBLIGATED GROUP
STATEMENTS OF CHANGES IN NET ASSETS
(\$000s)**

	FOR THE QUARTER ENDED MARCH 31,	
	2020	2019
Other change in net assets without donor restrictions:		
Excess of revenues over expenses attributable to controlling interests	\$ (296,040)	\$ 209,426
Net assets released from restrictions used for purchase of property & equipment	546	796
Other	-	367
(Decrease) / Increase in net assets without donor restrictions	(295,493)	210,589
Change in net assets with donor restrictions:		
Contributions	61,006	2,980
Interest and dividends	430	582
Realized gains	516	469
Unrealized (losses) gains on trading portfolio	(12,071)	8,121
Net assets released from restrictions used for operations	(35,437)	(5,941)
Net assets released from restrictions used for purchases of property & equipment	(546)	(796)
Change in value of deferred gifts	1,685	130
Increase in net assets with donor restrictions	15,583	5,545
Total (decrease) / increase in net assets	\$ (279,910)	\$ 216,134



**SCRIPPS HEALTH
OBLIGATED GROUP
STATEMENT OF OPERATIONS**
(\$000s)

	FOR THE SIX MONTHS ENDED MARCH 31,	
	2020	2019
Revenues, gains, and other support without donor restrictions:		
Patient service revenue	\$ 1,386,281	\$ 1,331,496
Provider tax revenue	110,264	60,356
Total patient service revenue	1,496,545	1,391,852
Capitation premium	88,538	68,028
Other	49,636	70,617
Meaningful use	130	-
Net assets released from restrictions used for operations	44,910	10,201
Total operating revenues	1,679,760	1,540,697
Operating expenses:		
Wages and benefits	704,399	658,262
Supplies	303,431	280,241
Physician services	274,076	248,283
Other services	173,262	170,690
Provider fee	77,049	48,982
Capitation services	2,267	1,953
Depreciation and amortization	82,442	80,494
Interest	10,350	11,970
Restructuring	4,172	-
Total operating expenses	1,631,448	1,500,875
Operating income before corporate overhead allocation & income tax	48,312	39,822
Corporate overhead allocation	774	720
Provision for income tax expense	(147)	212
Operating income after corporate overhead allocation & income tax	48,939	40,754
Nonoperating gains (losses):		
Interest and dividends	37,450	56,771
Realized gains	16,634	7,386
Unrealized losses on trading portfolio	(252,327)	(63,944)
Contributions	1,232	1,969
Market adjustment on Interest rate swaps	(5,701)	(4,636)
(Losses) / Gain on early extinguishment of debt	(739)	45
Excess of revenues over expenses	\$ (154,512)	\$ 38,345



**SCRIPPS HEALTH
OBLIGATED GROUP
STATEMENTS OF CHANGES IN NET ASSETS
(\$000s)**

	FOR THE SIX MONTHS ENDED MARCH 31,	
	2020	2019
Other change in net assets without donor restrictions:		
Excess of revenues over expenses attributable to controlling interests	\$ (154,512)	\$ 38,345
Net assets released from restrictions used for purchase of property & equipment	1,394	3,619
Other	-	405
(Decrease) / Increase in net assets without donor restrictions	(153,118)	42,369
Change in net assets with donor restrictions:		
Contributions	84,200	21,332
Interest and dividends	1,836	2,881
Realized gains	1,071	935
Unrealized losses on trading portfolio	(6,966)	(2,244)
Net assets released from restrictions used for operations	(44,908)	(10,202)
Net assets released from restrictions used for purchases of property & equipment	(1,394)	(3,619)
Change in value of deferred gifts	2,615	328
Other	9	(32)
Increase in net assets with donor restrictions	36,461	9,379
Total (decrease) / increase in net assets	\$ (116,657)	\$ 51,748



**SCRIPPS HEALTH
OBLIGATED GROUP
STATEMENT OF CASH FLOWS**

(\$000)

	For the Six Months Ended	
	March 31, 2020	March 31, 2019
Operating activities and nonoperating gains		
Total (decrease) / increase in net assets	(\$116,657)	\$51,748
Reconciliation of total change in net assets to cash flows provided by operating activities and nonoperating gains and losses:		
Depreciation and amortization	82,442	80,494
Amortization of debt issuance costs	139	154
Amortization of original issue premium / discount	23	(269)
Loss / (Gain) on early extinguishment of debt	739	(45)
Realized and unrealized losses on investments	241,587	57,867
Purchases of investments designated as trading	(582,383)	(242,600)
Proceeds from sale of investments designated as trading	521,904	213,803
Interest rate swaps	4,489	3,687
Gain on disposal of property	(5)	(5,664)
Restricted contributions and investment income	(87,108)	(25,148)
Change in assets and liabilities:		
Accounts receivables - net	11,169	(583)
Right of use operating lease assets	(3,070)	-
Right of use operating lease liabilities	(13,592)	-
Other current assets	22,129	(36,731)
Other assets	(88,635)	10,131
Accounts payable and accrued liabilities	(1,260)	(44,123)
Other liabilities	70,411	(14,230)
Net cash provided by operating activities:	62,325	48,491
Investing activities:		
Purchases of property, plant and equipment	(132,288)	(96,254)
Purchases of investments designated as assets limited as to use	(4,406)	-
Sales of investments designated as assets limited as to use	185	57,819
Net cash used in investing activities:	(136,509)	(38,435)
Financing activities:		
Proceeds from restricted contributions and investment income	27,993	30,884
Proceeds from line of credit	141,000	-
Payments from line of credit	(35,976)	-
Payment of bond issuance costs	(353)	-
Right of use financing lease payment	(1,452)	(1,579)
Proceeds from long-term debt	99,360	-
Payments on long-term debt	(131,730)	(88,255)
Proceeds from sale of donated financial assets	40	127
Net cash provided by / (used in) financing activities:	98,882	(58,823)
Increase / (decrease) in cash and cash equivalents	24,697	(48,767)
Cash and cash equivalents at beginning of period	366,595	251,491
Cash and cash equivalents at end of period	\$391,293	\$202,725
Supplemental non-cash disclosure:		
Operating Lease	\$475	-
Financing Lease	-	-

SCRIPPS HEALTH
OBLIGATED GROUP
NOTES TO THE OBLIGATED GROUP FINANCIAL STATEMENTS
(UNAUDITED)

NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

Basis of Presentation

In the opinion of management, all adjustments, consisting of normal recurring adjustments necessary for the fair presentation of the statements of financial position and results of operations as of and for the quarter ended March 31, 2020 and 2019 as well as for the year-to-date September 30, 2019 have been made.

On October 1, 2019, the Organization adopted ASU 2016-02, *Leases (Topic 842)* initially issued by Financial Accounting Standards Board ("FASB") in February 2016. ASU 2016-02 amended the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. These changes to the lease accounting model require operating leases be recorded on the balance sheet through recognition of a liability for the discounted present value of future fixed lease payments and a corresponding right-of-use ("ROU") asset. The Organization's accounting for finance leases remained substantially unchanged from its prior accounting for capital leases. The ROU asset recorded at commencement of the lease represents the right to use the underlying asset over the lease term in exchange for the lease payments. Leases with an initial term of 12 months or less that do not have an option to purchase the underlying asset that is deemed reasonably certain to be exercised are not recorded on the balance sheet; rather, rent expense for these leases is recognized on a straight-line basis over the lease term, or when incurred if a month-to-month lease.

The Organization elected the amended transition requirements allowed for by the FASB in Accounting Standards Update ("ASU") 2018-11, which provide entities relief by allowing them not to recast prior comparative periods from the adoption of ASC 842. As a result, the prior year comparative financial statements have not been restated to reflect the adoption of ASC 842. Additionally, the Organization elected the package of practical expedients available in ASC 842 upon adoption whereby an entity need not reassess expired contracts for lease identification or classification as a finance or operating lease, or for the reassessment of initial direct costs. The Organization has not elected the practical expedient to use hindsight to determine the lease term for its leases at transition.

The primary effect of the new standard was to record right-of-use assets and obligations for current operating leases, which had a material impact on the obligating balance sheets and significant incremental disclosures in the notes to the financial statements of the obligated group. The impact to the Statement of Financial Position was to record new right of use assets and lease liabilities for Scripps Health's operating lease portfolio totaling \$136,800,000. The implementation of this guidance resulted in a reclassification of the existing deferred rent liability of \$13,200,000 against the right of use assets. The standard did not have a material impact on the Organization's obligated group results of operations or statement of cash flows.

NOTE (2) FAIR VALUE MEASUREMENTS

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

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets and liabilities in Level 1 include U.S. and foreign equity securities.

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 asset or liabilities. Financial assets and liabilities in this category generally include U.S. and foreign government securities, asset-backed securities, U.S. and foreign corporate bonds and loans, municipal bonds, commingled funds, interest rate swaps, real estate, real estate held for sale, and annuity/unitrust liabilities.

Level 3: Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates. There are no Level 3 financial assets or liabilities at March 31, 2020 and September 30, 2019.

Assets and liabilities measured at fair value are based on one or more of the three valuation techniques. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

- a) Market approach. Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- b) Income approach. Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing, and excess earnings models).

Cost approach. Measurement alternative for equity securities without readily determinable fair values and are not eligible to use Net Asset Value (NAV) of accounting. Cost minus impairment, if any, changes resulting from observable changes in orderly transactions from an identical or similar investment of the same issuer.

NOTE (2) FAIR VALUE MEASUREMENTS (CONTINUED)

The following represents financial assets and liabilities measured at fair value on a recurring and nonrecurring basis as of March 31, 2020 (in thousands). Most alternative investments are accounted for using net asset value (NAV) of accounting, which is not a fair value measurement.

	Active Markets for Identical Assets		Significant Other Observable Inputs		Unobservable Inputs			Valuation Technique
	(Level 1)		(Level 2)		(Level 3)		NAV	(a,b,c)
Investments								
Liquid investments:								
Cash equivalents	\$ 527	\$ 527	\$ -	\$ -	\$ -			a
Equity securities:								
U.S. equity	463,556	463,556	-	-	-	-		a
Foreign equity	338,889	338,899	-	-	-	-		a
Foreign equity (commingled)	257,765	-	257,765	-	-	-		a
	1,060,210	805,445	257,765	-	-	-		
Fixed income securities:								
U.S. government	52,089	-	52,089	-	-	-		a
U.S. government agencies	10,545	-	10,545	-	-	-		a
U.S. federal agency mortgage-backed	101,669	-	101,669	-	-	-		a
U.S. corporate	398,550	-	398,550	-	-	-		a
U.S. corporate (commingled)	375,304	-	375,304	-	-	-		a
Foreign corporate	19,378	-	19,378	-	-	-		a
	957,535	-	957,535	-	-	-		
Other investments:								
Multi-strategy hedge funds	309,227	-	-	-	-	309,217		
Private capital funds	59,659	-	-	-	-	59,659		
Defensive equity funds (commingled)	45,686	-	45,686	-	-	-		a
Real estate	5,914	-	5,914	-	-	-		a
Limited partnership (nonrecurring)	57,911	-	-	57,911	-	-		c
	478,397	-	51,600	57,911	368,886			
Total investments	2,496,669	802,972	1,266,900	57,911	368,886			
Other assets:								
Real estate held for sale	710	-	710	-	-	-		a
Total assets	\$ 2,497,379	\$ 802,972	\$ 1,267,610	\$ 57,911	\$ 368,886			
Other liabilities:								
Swap hedge	\$ 26,153	\$ -	\$ 26,153	\$ -	\$ -	-		b
Annuity/unitrust liabilities	8,149	-	8,149	-	-	-		b
Total liabilities	\$ 34,302	\$ -	\$ 34,302	\$ -	\$ -	-		

NOTE (2) FAIR VALUE MEASUREMENTS (CONTINUED)

The following represents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2019 (in thousands). Alternative investments are accounted for using net asset value (NAV) of accounting, which is not a fair value measurement.

	Active Markets for Identical Assets		Significant Other Observable Inputs			Valuation Technique (a,b)			
	(Level 1)		(Level 2)		NAV				
Investments									
Liquid investments:									
Cash equivalents	\$	565	\$	565	\$	–	a		
Equity securities:									
U.S. equity		599,646		599,646		–	a		
Foreign equity		428,899		428,899		–	a		
Foreign equity (commingled)		290,875		–		290,875	a		
		1,319,420		1,028,545		290,875	–		
Fixed income securities:									
U.S. government		69,995		–		69,995	–	a	
U.S. government agencies		9,251		–		9,251	–	a	
U.S. federal agency mortgage-backed		84,203		–		84,203	–	a	
U.S. corporate		447,193		–		447,193	–	a	
U.S. corporate (commingled)		272,017		–		272,017	–	a	
Foreign corporate		15,989		–		15,989	–	a	
		898,648		–		898,648	–		
Other investments:									
Multi-strategy hedge funds		294,288		–		–	294,288		
Private capital funds		50,290		–		–	50,290		
Defensive equity funds (commingled)		46,520		–		46,520	–	a	
Real estate		5,914		–		5,914	–	a	
		397,012		–		52,434	344,578		
Total investments		2,615,645		1,029,110		1,241,957	344,578		
Other assets:									
Real estate held for sale		710		–		710	–	a	
Total assets	\$	2,616,355	\$	1,029,110	\$	1,242,667	\$	344,578	
Current liabilities:									
Swap hedge	\$	21,664	\$	–	\$	21,664	\$	–	b
Other liabilities:									
Annuity/unitrust liabilities		10,272		–		10,272	–	b	
Total liabilities	\$	31,936	\$	–	\$	31,936	\$	–	

NOTE (2) FAIR VALUE MEASUREMENTS (CONTINUED)

Transfers to/from Levels 1 and 2 are recognized at the end of the reporting period. There were no transfers for the years ended March 31, 2020 and September 30, 2019.

As of March 31, 2020 and September 30, 2019, the Level 2 and 3 instruments listed in the fair value hierarchy table above use the following valuation techniques and inputs:

U.S. Government Securities

The fair value of investments in U.S. government securities, classified as Level 2, was primarily determined using techniques consistent with the market approach. Significant observable inputs to the income approach include data points for benchmark constant maturity curves and spreads.

U.S. and Foreign Corporate Bonds

The fair value of the investments in U.S. and foreign corporate bonds, including mutual and commingled funds that invest primarily in such bonds, classified as Level 2 was primarily determined using techniques that are consistent with the market approach. Significant observable inputs include benchmark yields, reported trades, observable broker/dealer quotes, issuer spreads, and security specific characteristics (such as early redemption options).

Real Estate – Investments and Held for Sale

The fair values of the real estate investments and real estate held for sale were classified as Level 2 and were primarily determined using techniques that are consistent with the market approach. Significant observable inputs include sales of comparable properties, market rents, and market rent growth trends.

Annuity/Unitrust Liabilities

The fair value of the annuity/unitrust liabilities as Level 2 was primarily determined using techniques that are consistent with the income approach. Significant observable inputs to the income approach include data points for benchmark constant maturity curves and spreads.

Commingled Funds

The fair value of commingled fund investments classified as Level 2 was determined using fair value. The values for underlying investments are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. Due to the significant unobservable inputs present in these valuations, Scripps Health classifies all such investments as Level 2.

NOTE (2) FAIR VALUE MEASUREMENTS (CONTINUED)

Swap Hedge

The fair value of the swap hedge liability classified as Level 2 is based on independent valuations obtained and is determined by calculating the fair value of the discounted cash flows of the differences between the fixed interest rate of the interest rate swaps and the counterparty's forward LIBOR curve, which is the input used in the valuation, taking also into account any nonperformance risk.

Included within the assets above are investments in certain entities that report fair value. The following table (dollar figures in thousands) and explanations identify attributes relating to the nature and risk of such investments:

	March 31, 2020	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Commingled:				
Equity securities ⁽¹⁾	\$ 257,765	\$ -	Monthly	10 days
Fixed income securities ⁽²⁾	375,304	-	Daily	15 days
	<u>\$ 633,069</u>	<u>\$ -</u>		
Alternative investments:				
Multi-strategy hedge funds ⁽³⁾	\$ 309,227	\$ -	Monthly to Biennially	45 to 120 days
Private capital ⁽⁴⁾	59,659	158,592	N/A	N/A
Defensive equity (commingled) ⁽⁵⁾	45,686	-	Monthly	5 days
	<u>\$ 414,572</u>	<u>\$ 158,592</u>		

(1) Commingled funds: Equity – This category includes investments in commingled funds with underlying investments that are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. The investments are diversified by geography, sector, and organization. Liquidity is provided on a monthly basis.

(2) Commingled funds: Fixed income – This category includes investments in one commingled fund with underlying investments that are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. The investments are diversified by geography, sector, maturity, and issue. Liquidity is provided on a daily basis. As of March 31, 2020, the category consisted of 100% daily liquidity.

NOTE (2) FAIR VALUE MEASUREMENTS (CONTINUED)

- (3) Hedge funds – This category includes investments in thirteen multi-strategy funds with underlying investments that are fair value estimates determined by a third-party administrator based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. The investments are diversified by geography, sector, and organization. Liquidity is provided on a monthly, quarterly, annual, and biennial basis. As of March 31, 2020, the category consisted of 30.8% monthly liquidity, 53.8% quarterly liquidity, 7.7% annual liquidity, and 7.7% biennial liquidity.
- (4) Private capital – This category includes investments in fifteen private capital funds with underlying investments that are fair value estimates determined either internally or by a third-party administrator based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. The investments are diversified by geography, sector, maturity, and issue. All funds have liquidity in excess of one year.
- (5) Defensive equity – This category includes an investment in a commingled defensive equity fund with underlying investments that are fair value estimates determined by a third-party administrator as of the end of each calendar month (or more frequently in the event that Interests are purchased or withdrawn intra-month), determined by its assets less its liabilities. The underlying investments consist primarily of money market funds and/or Cash; short term investments, including U.S. Treasuries and other high-quality government or corporate bonds; and written options. Liquidity is provided on a monthly basis.

During March 2020, Scripps Health recognized receipt of a donated nonmarketable equity security in a limited partnership measured at fair value based on a third-party analysis using discounted cash flow and adjusted book value method. The limited partnership is measured on a nonrecurring basis and classified as Level 3 within the fair value hierarchy. Management elected the measurement alternative as the investment does not have readily determinable fair value. At March 31, 2020, Scripps Health performed a qualitative assessment to consider impairment indicators to evaluate whether the investment is impaired. No impairment was recognized.

NOTE (3) ENDOWMENTS

The Organization's endowments consist of 88 individual funds as of March 31, 2020 and 2019, established for a variety of purposes. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

California Senate Bill No. 1329 enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) for California. The Organization is subject to UPMIFA and, thus, classifies amounts in its donor-restricted endowment funds as net assets with donor restrictions because those net assets are time restricted until the Board of Trustees appropriates such amounts for expenditures. Most of those net assets also are subject to purpose restrictions that must be met before reclassifying those net assets to net assets without donor restrictions. The Board of Trustees of the Organization has interpreted as not requiring the maintenance of purchasing power of the original gift amount contributed to an endowment fund, unless a donor stipulates to the contrary. As a result of this interpretation, when reviewing its donor-restricted endowment funds, the Organization considers a fund to be underwater if the fair value of the fund

NOTE (3) ENDOWMENTS (CONTINUED)

is less than the sum of (a) the original value of initial and subsequent gift amounts donated to the fund and (b) any accumulations to the fund that are required to be maintained in perpetuity in accordance with the direction of the applicable donor gift instrument.

The Organization has interpreted UPMIFA to permit spending from underwater funds in accordance with the prudent measures required under law. In accordance with UPMIFA, the Organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) duration and preservation of the fund, (2) purposes of the Organization and the donor-restricted endowment fund, (3) general economic conditions, (4) possible effect of inflation or deflation, (5) expected total return from income and the appreciation of investments, (6) other resources of the Organization, and (7) investment policies of the Organization.

From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration.

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results while assuming a moderate level of investment risk. The Organization expects its endowment funds, over time, to provide an average rate of return of approximately 5% over the rate of inflation annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places an emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The Organization has a policy of appropriating for distribution 4% (with an additional 1% administrative fee) of its endowment fund's average fair value over the prior three-year rolling average market values. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of 3% to 4% annually above inflation. This is consistent with the Organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return. The Organization has a policy that prohibits spending from underwater endowment funds.

NOTE (3) ENDOWMENTS (CONTINUED)

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or UPMIFA requires Scripps Health to retain as a fund of perpetual duration. Deficiencies of this nature exist in 3 donor-restricted endowment funds, which together have an original gift value of \$7,272,000, a current fair value of \$6,932,000, and a deficiency of \$340,000 as of March 31, 2020. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new contributions for donor-restricted endowment funds and continued appropriation for certain programs that was deemed prudent by the Board of Trustees.

Changes in donor restricted endowment funds for the six months ended March 31, 2020, and 2019 are as follows (in thousands):

	2020	2019
Donor restricted endowment funds as of beginning of year	\$ 120,326	\$ 118,216
Investment return, net	(4,424)	1,706
Contributions	81	(321)
Appropriation of endowment assets for expenditure	(2,260)	(2,067)
Other changes	(1,675)	(597)
Donor restricted endowment funds as of end of period	<u>\$ 112,048</u>	<u>\$ 116,937</u>

NOTE (4) GOODWILL

Impairment assessments of the carrying amount of goodwill are completed annually, or whenever impairment indicators are present for SMF, which includes Scripps Clinic and Scripps Coastal Medical Centers. At March 31, 2020 and September 30, 2019 the amount of goodwill totaled approximately \$58,310,000. No impairment or additions to goodwill were recorded for the six months ended March 31, 2020.

NOTE (5) LEASES

Scripps' leases certain medical equipment and medical office properties under various operating and finance leases. These leases have remaining lease terms ranging from one to twenty-three years. Many of Scripps' leases have rental escalation clauses which have been factored into the determination of lease payments. Generally, Scripps does not include renewal options in the lease terms for calculating the lease liability as Scripps' maintains operational flexibility and is not reasonably certain that renewal options will be exercised. The leases do not provide a readily determinable implicit rate in the contract; therefore, the incremental borrowing rate is estimated to discount the lease payments based on information available at lease commencement. Upon adoption of the lease standard, discount rates for existing operating leases were established as of October 1, 2019.

NOTE (5) LEASES (CONTINUED)

Scripps elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the historical lease classification not to be reassessed. Scripps made an accounting policy election to not apply the recognition requirements of the guidance to short-term leases with a term of 12 months or less. Scripps also made an accounting policy election to not separate non-lease components from lease components for equipment and real estate.

The components of the right-of-use assets and lease liabilities consist of the following at March 31, 2020 (000s):

Property, Plant and Equipment, net	
Finance leases, net	\$ <u>3,702</u>
Right-of-use assets	
Operating leases	\$ <u>114,399</u>
Finance Leases Liabilities	
Current portion of long-term debt	\$ 1,708
Long-term debt	<u>2,115</u>
	\$ <u>3,823</u>
Operating Lease Liabilities	
Current portion of lease liability	\$ 26,683
Long-term lease liability	<u>97,045</u>
	\$ <u>123,728</u>

The components of lease expense reported within Other Services of Obligated Statement of Operations are for the six months ended March 31, 2020, as follows (000s):

Lease/rental cost:	
Amortization of right-of-use assets	\$ 1,417
Interest on lease liabilities	<u>73</u>
Total finance lease cost	1,490
Operating lease cost	14,604
Short-term rental/lease cost	<u>2,992</u>
Total lease/rental cost	\$ 19,086
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from finance leases	\$ 73
Operating cash flows from operating leases	15,368
Financing cash flows from finance leases	<u>1,448</u>
Total	\$ 16,889

NOTE (5) LEASES (CONTINUED)

Right-of-use assets obtained in exchange for new operating lease liabilities	\$	475
Weighted average remaining lease term - finance leases		2.9 years
Weighted average remaining lease term - operating leases		7.4 years
Weighted average discount rate - finance leases		3.19%
Weighted average discount rate - operating leases		2.80%

Scheduled maturities of lease liabilities were as follows:

	Operating Leases	Finance Leases
2020 (excluding the six months ended March 31, 2020)	\$ 15,073	\$ 1,276
2021	26,446	987
2022	19,555	809
2023	16,729	649
2024	14,018	290
Thereafter	45,727	-
Total lease payments	137,548	4,011
Less imputed interest	13,820	188
Total principal payments	\$ 123,728	\$ 3,823

NOTE (6) OTHER EVENTS

The current worldwide COVID 19 pandemic has adversely impacted the Organization's operations by causing a deferral of elective surgeries, other medical treatments and temporary closure of some outpatient clinics. There has been disruption in the supply chain for personal protective equipment (PPE) resulting in supply shortages and higher supply and equipment acquisition costs. There was an adverse impact on the Organization's long-term investment portfolio in the month of March, which has since been recovering. The Organization has a COVID command center in place, led by the system CEO, overseeing all aspects of our COVID response, and currently planning for a phased return of services.

Management continues to closely monitor the operational and financial impact of COVID-19 and is pursuing opportunities for federal and state funding that is or will become available. In response to the COVID-19 pandemic, The Coronavirus Aid, Relief, and Economic Security (CARES) Act, was signed into law on March 27, 2020. The Act provides an estimated \$2.2 trillion to fight the COVID-19 pandemic, stimulate the U.S. economy and provide assistance to affected industries. The Act clarifies that all COVID-19 testing, preventive services and vaccines are to be provided by private insurance plans without cost sharing. The Act also delays certain Medicare and Medicaid cuts (e.g., Medicare sequestration, disproportionate share hospital reductions) and extends certain other government programs. The Organization is evaluating the provisions to determine the effect on revenue recognized from contracts with customers.

NOTE (6) OTHER EVENTS (CONTINUED)

In April 2020, the Organization received a \$45.4 million grant as part of the emergency funding for healthcare expenses or lost revenues not otherwise reimbursed for treating COVID-19 patients. The Organization is currently evaluating the tracking, reporting and accounting requirements for this funding as new information becomes available.

In April 2020, the Organization also received advanced payments from Medicare of \$204 million, which has been recorded as a liability.

NOTE (7) SUBSEQUENT EVENTS

The Organization has evaluated events and transactions occurring subsequent to March 31, 2020 through April 29, 2020, the date the financial statements were issued. During this period, there were no subsequent events requiring recognition in the financial statements.



SCRIPPS HEALTH
OBLIGATED GROUP FINANCIAL STATEMENTS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE QUARTER AND SIX MONTHS ENDED MARCH 31, 2020

	For the Quarter Ended	
	(\$000s)	
	March 31, 2020	March 31, 2019
	Actual	Actual
Operating Revenue	\$899,561	\$793,469
Operating Income	\$47,066	\$40,148
Operating Margin	5.2%	5.1%
Operating EBITDA	\$93,337	\$85,841
Operating EBITDA Margin	10.4%	10.8%
Excess Margin	(\$296,040)	\$209,426
Excess Margin %	-53.2%	21.8%

Operating revenue for the quarter ended March 31, 2020 was \$106,092,000 or 13.4% higher than the quarter ended March 31, 2019. This was primarily attributable to \$80,086,000 higher Provider Tax revenue for the CY2019-CY2021 program, \$29,500,000 increase in net assets released from restriction to Green Hospital and the Clinics from a large estate gift, and \$20,784,000 higher Capitation Premium revenue at the Clinics, offset by \$17,500,000 decrease in other operating revenue for a one time confidential settlement received in March 2019.

Operating expenses for the quarter ended March 31, 2020 were \$98,556,000 or 13.1% higher than the quarter ended March 31, 2019 primarily attributable to a \$52,474,000 increase in Provider Fees for the CY2019-CY2021 program, \$23,083,000 increase in wages and benefits primarily due to an increase in Paid FTEs and temporary labor as a result of higher volumes at the hospitals and clinics, \$11,290,000 increase in physician services expense due to higher ambulatory services, and \$4,860,000 increase in pharmaceutical expense primarily for infusion therapy at Scripps Clinic and Mercy Hospital.

Excess margin for the quarter ended March 31, 2020 compared to the quarter ended March 31, 2019 was \$505,465,000 lower than prior year.

	For the Six Months Ended	
	(\$000s)	
	March 31, 2020	March 31, 2019
	Actual	Actual
Operating Revenue	\$1,679,760	\$1,540,697
Operating Income	\$48,939	\$40,754
Operating Margin	2.9%	2.6%
Operating EBITDA	\$141,878	\$133,005
Operating EBITDA Margin	8.4%	8.6%
Excess Margin	(\$154,512)	\$38,345
Excess Margin %	-10.5%	2.5%

Operating revenue for the six months ended March 31, 2020 was \$139,063,000 or 9.0% higher than six months ended March 31, 2019. This was primarily attributable to \$54,785,000 net patient revenue due to higher Hospital patient revenue from increased volume of Hospital emergency room visits, outpatient visits, and patient days, higher clinic outpatient revenue from increased volume of clinic fee for service visits, \$49,909,000 higher in Provider Tax revenue for the CY2019-CY2021 program and \$34,710,000 higher in net assets released from restrictions primarily at Green Hospital and Scripps Clinic from a large estate gift.

Operating expenses for the six months ended March 31, 2020 were \$130,572,000 or 8.7% higher than the six months ended March 31, 2019 primarily attributable to a \$46,137,000 increase in wages and benefits primarily due to annual merit increases and an increase in Paid FTEs as a result of higher volumes at the hospitals and clinics, \$28,067,000 increase in Provider Fees for the CY2019-CY2021 program, \$25,792,000 increase in physician services expense due to higher ambulatory services, and \$23,191,000 increase in supplies (\$14.7M is related to pharmaceutical expense primarily for infusion therapy at Scripps Clinic and Mercy Hospital and \$5.7M for medical supplies - other).

Excess margin for the six months ended March 31, 2020 compared to the six months ended March 31, 2019 was \$192,857,000 lower than prior year.

	March 31, 2020	March 31, 2019	September 30, 2019
Unrestricted Cash & Investments (\$000s)	\$ 2,577,419	\$ 2,541,072	\$ 2,733,830
Days Unrestricted Cash on Hand *	326.7	346.8	358.1
Days in AR, Net *	53.0	57.7	55.8
Accounts Payable & Accrued Liabilities (\$000s)*	\$ 369,978	\$ 343,055	\$ 371,898
Days in AP & Accrued Liabilities *	46.0	45.6	48.7
Unrestricted Cash & Investments to Total Debt	263.4%	280.1%	301.4%
Long Term Debt (\$000s)	\$ 749,297	\$ 672,049	\$ 785,909
Current Portion of Long-Term Debt (\$000s)	\$ 229,352	\$ 235,299	\$ 121,282
Total Debt (\$000s)	\$ 978,649	\$ 907,348	\$ 907,189
Long-Term Debt to Capitalization	20.4%	19.2%	18.6%

* Amounts and ratios exclude the impact of provider tax revenues and expenses.

SIGNIFICANT TRANSACTIONS

COVID-19 Response

Scripps Health has evaluated subsequent events and transactions that occurred after the balance sheet date up to April 27, 2020 that the financial statements were issued. Management is currently evaluating the impact of COVID-19 pandemic on the industry and has concluded that while it is reasonably possible that the virus could have a negative impact on the Organization's financial position and results of its operations, the specific financial impact is not readily determinable as of the date of these financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Scripps Health received \$45.4 million from the CARES Act Provider Relief Fund and will recognize this as revenue in the April financials. All attestation requirements have been complied with.

Scripps Health received \$204 million in April from Medicare's COVID-19 advance payment program for the Hospitals that needs to be repaid over the next 12 months without interest.

Scripps Health will take advantage of the CARES Act Social Security Tax Deferral program for May 1, 2020 through December 31, 2020 that will be repaid without interest in CY21 and CY22 estimated to be \$55 million.

Tax Exempt Bonds

In October 2019, Scripps Health made scheduled bond principal payments amounting to \$29,140,000, which included \$1,600,000 scheduled principal payment on the 2001A bond, \$475,000 on 2008G tax-exempt bond series, \$18,325,000 scheduled principal payment on the 2016A and 2016B tax-exempt bond series, and \$8,740,000 on term loan.

2010A Bond Refunding

In June 2019, Scripps Board of Trustees adopted a resolution authorizing the issuance of fixed rate, tax exempt bonds (the "2019A Refunding Bonds") through the California Health Facilities Financing Authority ("CHFFA") in an amount sufficient to refund the 2010A Bonds. As authorized by the resolution, Scripps entered into a commitment to sell the Refunding Bonds to J.P. Morgan through a private placement transaction at a later date. A rate lock agreement was executed concurrently with the bank to fix the bond interest rate at 2.38% in advance of the bond issue date.

On November 15, 2019, Scripps issued the 2019A Refunding Bonds in the amount of \$99,360,000 to J.P. Morgan. Proceeds of the new issue were used to fully refund the 2010A Bonds, which were called on the same date. The Refunding Bonds have the same final maturity date and substantially the same amortization schedule as the 2010A Bonds. Scripps will realize interest savings of \$39,200,000 over the 17 year life of the bonds as a result of this refinancing.

Line of Credit

In March 2020, Scripps Health drew down \$105 million with existing Bank of America revolving line of credit for operational needs to support the COVID-19 response. In April 2020, Scripps Health established a

second line of credit with Bank of America for \$100 million with a 364 day facility. In addition, in April 2020, Scripps Health established a \$100 million line of credit with US Bank with a 364 day facility. The Union Bank line of credit that was in place terminated on April 30, 2020.

Right of Use Assets

In October 2019, Scripps Health implemented new accounting lease guidance under ASC 842. The new guidance had no significant impact on the consolidated statement of operations for the year to date FY2020. The impact to the Consolidated Statement of Financial Position was to record new right of use assets and lease liabilities for Scripps Health and Subsidiaries' operating lease portfolio totaling \$146,100,000. The lease implementation reclassified the existing deferred rent liability of \$13,500,000 against the right of use assets.

Provider Fee Program

The CY2017-CY2019 program ended on June 30, 2019. In February 2020, CMS approved the July 1, 2019 through December 31, 2021 program. The estimated total net benefit for Scripps Health for the entire program is \$110.9 million. In FY 2020, a net benefit of \$31.6 million was recorded based on CHA model for the program period 07/2019 – 03/2020. In February 2020, an additional net benefit accrual of \$1.5 million was recorded for managed care program period 07/2017 – 06/2018 based on expected direct managed care payments. In FY2020, a \$109,000 CHFT excess fund repayment refund was received from Scripps Health- 30 month program 7/1/2011-12/31/2013.

Medi-Cal Supplemental Provider Fee Schedule for 2017-2019 Program				
(\$000s)				
Hospitals	Supplemental Revenue	Provider Fee	CHFT Fee	Net Operating Income (Loss)
La Jolla	\$ 611	\$ -	\$ -	\$ 611
Green	143	-	-	143
Encinitas	770	-	-	770
Mercy	3	-	-	3
Total	\$ 1,527	\$ -	\$ -	\$ 1,527

Medi-Cal Supplemental Provider Fee Schedule for 2019-2021 Program				
For the Six Months Ended 3/31/20				
(\$000s)				
Hospitals	Supplemental Revenue	Provider Fee	CHFT Fee	Net Operating Income (Loss)
La Jolla	\$ 15,377	\$ (19,569)	\$ -	\$ (4,192)
Green	-	-	-	-
Encinitas	10,052	(12,684)	-	(2,632)
Mercy	83,309	(44,643)	(261)	38,405
Total	\$ 108,738	\$ (76,896)	\$ (261)	\$ 31,581
Target	\$ 60,354	\$ (48,780)	\$ -	\$ 11,574
Variance	\$ 48,384	\$ (28,116)	\$ (261)	\$ 20,007

Encinitas Acute Rehab

Scripps has converted the acute rehab unit at Encinitas, effective January 2020, and converted that part of the hospital into an additional medical surgical unit that can better meet our patients' needs.

Geisel Gift

Scripps Health received notification from Geisel Trust of their intention to transfer of shares in Dr. Seuss Enterprises, L.P. including royalty rights for Dr. Seuss book rights effective December 31, 2019. A third party performed a preliminary measurement which calculated Scripps Health's partnership interest in the L.P. at December 19, 2018 totaling approximately \$57,900,000. As of March 31, 2020, Scripps Health has recorded the gift as Restricted Contributions and Assets Limited as to Use in the accompanying consolidated financial statements. Additionally, approximately \$28,900,000 was released from donor restrictions into operations based on eligible expenses for Green Hospital and Scripps Clinic.