CoxHealth
Obligated Group
Management Discussion & Analysis
September 30, 2016

Note: On October 1, 2016 the CoxHealth Obligated Group was expanded to include additional CoxHealth entities. In tandem, the Obligated Group Representative was also changed to the health system parent corporation, or holding company, named CoxHealth. As such this 9/30/2016 report will be the final version focused on the group existing through that date. For additional information on the new Obligated Group configuration see the quarterly report filed for 12/31/2016.

Balance Sheet (Audited)

The balance sheet showed growth in assets and reduced liabilities in 2016. The following information analyzes specific changes in individual balance sheet classifications for 9/30/2016 compared to 9/30/2015;

Assets

- Total unrestricted cash and short-term investments in the current assets section of the balance sheet was $183m at 9/30/2016 versus $192m at 9/30/2015, a decrease of $9m. The decrease can be correlated with the greater decline in current liabilities during the year as well as some investment of cash into longer term investment pools. The $183m amount consists of $51m invested in the short-term fixed income market that is benchmarked against the BofA Merrill Lynch 1-3 year U.S. Treasury Index and the remainder held at various banking institutions. Bank deposits are backed by FDIC insurance and securities of equal or greater market value pledged in CoxHealth's name as security for the balance.

- Total unrestricted liquidity (cash, short-term and internally designated investments) was $595m at 9/30/2016 versus $573m at 9/30/2015, an increase of $22m. The overall increase resulted from the growth of investment pools cash combined with the decline in cash occurring during the year.

- Accounts Receivable increased by $11.5m. The change is the result of strong patient volume growth in the second half of the year, improved payer mix and a major electronic health record system implementation occurring in the Cox Medical Group operation. Additional comments on the system implementation are stated below.

- Inventories of supply items including pharmaceuticals decreased by $.2m. Year-end physical inventory procedures were carried out as in prior years.

- Assets limited as to use – current were lower by $11.8m as a result of final liquidation of Series 2013 bond issue project funds consistent with the plan of finance for major infrastructure projects.

- Other current asset items increased by $4.8m. Items making up the change include decreases in prepaid expenses, amounts due from third party payers and other miscellaneous receivables, net of an increase in amounts due from non-Obligated Group CoxHealth affiliates.

- Net Property and Equipment increased by $4.1m. This is the result of run rate capital spending net of depreciation expense.

- Assets limited as to use – other increased by $7m tied to growth in funds related to donations, deferred compensation and self-insurance trust assets.

- Interest in net assets of affiliates increased by $7.9m on growth in net assets for non-obligated group CoxHealth affiliates.

- Total other assets decreased by $2.8m tied to a decline in long-term receivables and other minor changes.

Liabilities and Net Assets

- Current liabilities were $155m at 9/30/2016 versus $169m at 9/30/2015, a decrease of $14 million driven by the following primary factors;
    - Decrease in current maturities of long term debt of $4.9m discussed with debt comments below.
    - Decrease in accounts payable of $13.8m tied to liquidation of current payables and the absence of construction project payables that existed in 2015.
    - Increase in accrued payroll liabilities of $4.7m consistent with pay period end and pay dates in relation to how they fall compared to the last day of the fiscal year.
    - Decrease in interest payable of $.4m tied to reduced long-term debt.
    - Increase in other current liabilities of $.6m

- Long term debt – principal cash obligations including the current portion decreased by $12.4m due to scheduled maturity payments on long-term debt net of capitalized interest on the 1992 Bonds. The bulk of the decrease during the year results from the initial annual principal payment on the 1992 Bonds and a $3m payment representing the last substantial payment related to acquisition of a large multi-specialty clinic in 1996. Non-cash premiums/discounts were reduced by $1.3m due to amortization.

- Accrued Pension Liability – The long-term defined pension liability increased to $108.4m at 9/30/2016 versus $87.7m at 9/30/2015, an increase of $20.7m. Higher asset values net of the impact of the discount rate decreasing from 4.28% in 2015 to 3.58% in 2016 served to increase the liability.

- Interest rate basis swap – During the summer of 2016, CoxHealth terminated the swap arrangement in order to take advantage of market conditions that supported a $7m realized gain / cash termination payment. As a result, the position is fully

closed and no further obligations exist. The gain was recorded as a component of investment return in the statement of operations for 2016.

- Other Liabilities decreased by $1.4m due to lower self-insurance liabilities against increased deferred compensation commitments from employer and employee deferrals.

- Net Assets increased by $49m during the year due to operating profit and investment returns net of increased pension liability.

Income Statement (Audited)

For the year ended 9/30/2016, operating income was $23.7m, an decrease of $12m from the prior year. Operating margin was 2.1% for the period as compared to an operating margin of 3.2% in the same prior year period. One item of note – beginning on 10/1/2015 the higher education accrediting body of Cox College (providing primarily nursing education) began to require the operations of the college be contained in a separate corporate entity from Cox Medical Centers where it had historically been held. For the year ended 9/30/2016, revenues of $9.4m and expenses of $8.7m for the college operation occurred in this new corporate entity that is not included in the obligated group for fiscal year 2016.

Factors impacting operating margin include;

- Total operating revenues for the year ended 9/30/2016 were $1,151m versus $1,121m for the prior year comparable period, an increase of $30m or 2.7%.

  Changes in patient volumes for the period are noted below;
  - Inpatient admissions declined by .3%, up .05% (or flat) including observation encounters.
  - Surgical cases were up by .75%.
  - Emergency and urgent care patient encounters grew by 1.8%.
  - Deliveries grew by 5.9%.
  - Provider encounters decreased by 2.7%. During the second half of calendar year 2015 CoxHealth embarked on a large and complex implementation of the enterprise electronic health record, extending the system throughout the ambulatory clinic / physician operations. The transition is disruptive resulting in planned and unplanned provider efficiency challenges and capacity constraints. The implementation is progressing, with approximately 90% of providers transitioned to the new system. The remaining 10% of providers will adopt the change in small waves through early calendar 2017 and the encumbering effects should subside over the balance of 2016 and the first half of fiscal year 2017, as the system configuration and our experience in the new environment matures. In addition, to better align geographically and access improved funding, a small number of rural clinics and providers have been repositioned within the CoxHealth critical access hospital corporation, which

is not currently an obligated group member. Accounting for this effect there is no reduction in total obligated group provider encounters.

Patient revenue exhibited growth of 3.7% driven by patient activity, improved payer mix characteristics that increased net revenue realization, and shared savings payments, while other operating revenue declined due to the Cox College change noted above and movement beyond the meaningful use incentive period.

- Total operating expenses were $1.127b versus $1.085b for the year ended 9/30/2016 and 2015, respectively, an increase of $42m or 3.9%.

  The change results primarily from;
  - A rise in salaries and wages of $13.0m. Factors driving the change include; planned and inflationary growth to salaries and wages, increased headcount, premium pay practices (overtime, differentials, etc.) tied to increasing wage pressures and competition for employee recruitment.
  - An increase of $6.5m in employee benefit expenses caused by four items;
    1) Higher costs associated with the frozen defined benefit pension plan tied to increased actuarially determined expense and rising PBGC premiums for the plan.
    2) Higher health insurance benefit tied to stronger utilization and increased beneficiary headcount.
    3) Increased defined contribution expense of $2.5m, of which $1m of which is the accrual of potential contributions firmly contingent on FY 2016 profitability. If margins fade over the course of the year the expense will be removed.
    4) Variable increases tied to higher employee headcount, the number of benefit plan beneficiaries and inflation.
  - An increase of $18.8m in supplies and other expenses associated with patient activity levels and continued pharmaceutical cost and use escalation, as well as, corporate shared service allocations that increased over 2015.
  - A decrease in Missouri provider tax program payments of $2.2m.
  - An increase in depreciation and amortization of $2.7m resulting from placing large capital investments into service, triggering increased depreciation, net of amortization of large bond premiums received in conjunction with the 2013 and 2015 bond issuances serve to reduce amortization expense on a monthly basis. The 2015 premium amortization began in April of 2015.
  - An increase in interest expense of $3.2m tied to placing large infrastructure projects into service and ending the capitalizing of interest that occurs during construction.

For the year ended 9/30/2016, excess of revenues over expenses was $73m compared to $7m for same prior year period. The increase is the result of higher investment returns net of lower operating income. In addition, the 2015 year included a non-cash loss from refinancing of $23.9m. Excluding this amount, the increase for 2016 over 2015 is $42m.

Item of Note

During October 2016, CoxHealth and Citizens Memorial Hospital / Citizens Memorial Healthcare (CMH) signed a letter of intent that creates the framework for CMH to join CoxHealth. The CMH operation is well regarded and based in Bolivar, Missouri which is approximately 35 miles north of Springfield where CoxHealth is based. CMH generates $180m + in annual operating revenue through an integration of hospital, physician, long-term care and other healthcare delivery. The parties are now engaged in developing a definitive agreement and have set a target to close the transaction in summer of 2017.