CoxHealth Obligated Group
Management Discussion & Analysis
June 30, 2017

On October 1, 2016, the CoxHealth Obligated Group (CHOG) was expanded to include additional CoxHealth corporations and the OG representative was changed. In addition to Cox Medical Centers (CMC) and Cox Medical Center Branson (CMCB), the following entities are now members of CHOG; CoxHealth (CH - the health system holding company), Cox Monett Hospital (CMH - a critical access hospital), Cox College (CC - a nursing and allied health institution) and Cox Medical Group Clinics (CMGC - an entity established for physician clinic operations that currently has no activity). CH is now the CHOG representative.

Balance Sheet (Unaudited)

Assets

- Total unrestricted cash and short-term investments in the current assets section of the balance sheet was $196m at 8/30/2017 versus $208m at 3/31/2017, resulting in a decrease of $12m. The $196m amount consists of $51m invested in the short-term fixed income market benchmarked against the BofA Merrill Lynch 1-3 year U.S. Treasury Index and CDs, with the remainder held at various banking institutions. Bank deposits are backed by FDIC insurance and securities of equal or greater market value pledged in the name of a CHOG entity as security for the balance. Reducing current liabilities contributed to the lower cash balance.

- Total unrestricted liquidity (cash, short-term and internally designated investments) was $642m at 6/30/2017 versus $642m at 3/31/2017, resulting in no change. With increases in the value of investments netting against the reduction in cash.

- Patient Accounts Receivable increased by nearly $3m to $173.5m at 6/30/2017. Continued increasing patient activity during the quarter accounts for the growth in accounts receivable.

- Inventory values for supply items, including pharmaceuticals, were lower by $.2m quarter over quarter.

- The remaining current assets were lower, with the current portion of assets limited as to use unchanged and prepaid expense balances reduced.

- Net Property and Equipment was higher by $2.9m. This is the result of run rate capital purchasing occurring at an amount exceeding the value of quarterly depreciation expense.

- Assets Limited as to Use – Other increased by $.8m due to growth in donor restricted, deferred compensation and self-insurance trust investments.

- Total Other Assets decreased by $.8m during the quarter. The change relates to a decline in interests in the net assets of affiliates for non-CHOG health system entities.

Liabilities and Net Assets

- Current Liabilities were $151.4m at 6/30/2017 versus $166.8m at 3/31/2017, a decrease of $15.4m resulting from the net activity of the following factors;
  - Relatively flat Current Instalments of Long-Term Debt – See additional Long-Term Debt comments noted below.
  - Decrease in Accounts Payable of $1.7m.
  - Decrease in Accrued Payroll Liabilities of $9.5m consistent with pay period end and pay dates in relation to how they fall compared to the last day of the quarter.
  - Decrease in Interest Payable of $4.3m due to scheduled annual and semi-annual interest payments on fixed rate debt occurring in May, September and November.
  - Decrease in Other Current Liabilities of .2m resulting from lower amounts due to third party payers.

- Long-Term Debt – principal cash obligations including the current portion increased by $.2m from capitalized interest on the 1992 Bonds net of regular payments on long-term debt. Non-cash premiums/discounts and deferred financing costs were reduced by $.3m due to amortization.

- Accrued Pension Liability – The long-term defined benefit pension liability increased to $85m at 6/30/2017 versus $78m at 3/31/2017, an increase of $7m. The higher liability results from pension asset returns offset by the discount rate decreasing to 3.87% at 6/30/2017 versus 4.10% at 3/31/2017.

- Other Liabilities increased by $.6m on higher deferred compensation and long-term self-insurance liabilities tied to recording of actuarially projected monthly expense amounts. Annually, at fiscal year-end (9/30), self-insured professional liabilities are measured and expenses projected out one year by an independent actuary.

- Net Assets increased by $12m during the quarter from operational earnings and investment gains, net of the pension liability increase and reduced interests in the net assets of non-CHOG health system entities.

Income Statement (Unaudited)

For the nine-months ended 6/30/2017, operating income was $29.6m, an increase of $14.3m from the same prior year period. Operating margin was 3.1% for the period as compared to an operating margin of 1.7% for the same prior year period.

Factors impacting operating margin include;

- Total operating revenues for the nine-months ended 6/30/2017 were $965m versus $889 for the prior year comparable period, an increase of $76m or 8.5%.

  Patient revenue exhibited growth of 8.4%, driven by patient activity explained below and improved payer mix characteristics that increased net revenue realization.

  Changes in patient volumes for the period are noted below;
  - Inpatient admissions increased by 5.8%, up 5.1% including observation encounters.
  - Surgical cases were up by 5.7%.
  - Emergency and urgent care patient encounters grew by 4.7%.
  - Deliveries grew by 5.8%.
  - Provider encounters increased by 8%. 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 nearly all providers transitioned to the new system. The remaining providers will adopt the change in small waves through calendar year 2017 and the encumbering effects should continue to subside over the balance of the year, as the system configuration and our experience in the new environment matures.

- Total operating expenses were $935m versus $874m for the nine-months ended 6/30/2017 and 2016, respectively, an increase of $61m or 7%.

  The change results primarily from;
  - A rise in salaries and wages of $25.2m. Factors driving the change include; patient encounter growth, planned and inflationary increases, increased headcount, premium pay practices (overtime, differentials, etc.) tied to increasing wage pressures and competition for employee recruitment.
  - An increase in employee benefit expense of $6.7m tied to greater headcount, higher healthcare prices and utilization, as well as larger retirement plan contributions and costs.
  - An increase of $25.5m in supplies and other expenses associated with patient activity levels, professional fees, purchased services/contract labor and continued pharmaceutical cost and use escalation.
  - An increase in Missouri provider tax program payments of $2.9m.
  - An increase in depreciation and amortization of $1.4m resulting from growth in depreciable assets, net of amortization of large bond premiums received in conjunction with the 2013 and 2015 bond issuances that serve to reduce amortization expense on a monthly basis.

- Interest expense was lower versus the same prior year period tied generally to lower debt levels and more specifically to pay down of higher cost debt.

For the nine-months ended 6/30/2017, excess of revenues over expenses were $57.5m, compared to $30.5m for the same prior year period. The increase is primarily the result of higher operating income and investment returns.

Item of Note

During October 2016, CoxHealth and Citizens Memorial Hospital / Citizens Memorial Healthcare (CMH) signed a letter of intent that created the framework for CMH to join CoxHealth. Within the last quarter, the two organizations jointly decided not to proceed with the affiliation at this time and no further discussions are ongoing.