

SHANDS JACKSONVILLE HEALTHCARE, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BASIC STATEMENT OF NET POSITION
For June 30, 2017 and June 30, 2016
(Dollars in Thousands)

	June 30, 2017	June 30, 2016
Assets		
Cash and Cash Equivalents	\$ 90,414	\$ 73,897
Short-term investments	11,425	40,967
Patient accounts receivable, net of allowance for uncollectibles of \$74,649 and \$67,528, respectively	107,422	103,657
Due from city and state agencies	-	-
Inventories	16,273	14,780
Prepaid expenses and other current assets	11,341	10,228
Assets limited as to use, current portion	2,745	1,605
Total current assets	<u>239,620</u>	<u>245,134</u>
Assets limited as to use, less current portion	32,752	92,475
Capital assets, net	265,681	208,445
Other assets	21,242	21,919
Total Assets	<u>559,295</u>	<u>567,973</u>
Deferred Outflows of resources		
Accumulated decrease in fair value of hedge derivatives	215	773
Deferred pension outflows	6,702	6,567
Total deferred outflows of resources	<u>6,917</u>	<u>7,340</u>
Liabilities and Net Position		
Current liabilities		
Long-term debt, current portion	7,869	7,555
Capital lease obligation, current portion	1,105	2,525
Accounts payable and accrued expenses	46,483	43,915
Accrued salaries and leave payable	29,843	24,473
Estimated third-party payor settlements	21,425	23,217
Total current liabilities	<u>106,726</u>	<u>101,685</u>
Long-term liabilities		
Long-term debt, non-current portion	244,142	252,142
Capital lease obligation, non-current portion	3,577	4,693
Other liabilities	13,344	13,514
Total long-term liabilities	<u>261,063</u>	<u>270,349</u>
Total liabilities	<u>367,789</u>	<u>372,034</u>
Deferred Inflows of resources		
Accumulated increase in fair value of hedge derivatives	6,135	8,822
Deferred pension inflows	532	3,101
Total deferred inflows of resources	<u>6,667</u>	<u>11,923</u>
Net position		
Net investment in capital assets	51,330	44,247
Restricted:		
Expendable	4,123	4,123
Unrestricted	136,303	142,986
Total net position	<u>\$ 191,756</u>	<u>\$ 191,356</u>

SHANDS JACKSONVILLE HEALTHCARE, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BASIC STATEMENT OF
REVENUE, EXPENSES, AND CHANGES IN NET POSITION
For June 30, 2017 and June 30, 2016
(Dollars in Thousands)

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Operating Revenues		
Net patient service revenue, net of provision for bad debts of provision for bad debts of \$78,845 and \$102,997, respectively	\$ 683,355	\$ 650,587
Other operating revenue	12,788	14,851
Total operating revenues	<u>696,143</u>	<u>665,438</u>
Operating Expenses		
Salaries and benefits	305,913	282,687
Supplies and services	319,234	310,523
Depreciation and amortization	30,776	31,832
Total operating expenses	<u>655,923</u>	<u>625,042</u>
Operating income	<u>40,220</u>	<u>40,396</u>
Nonoperating revenues (expenses)		
Interest expense	(7,328)	(9,154)
Other nonoperating losses	(134)	(2,396)
Net investment gain, including change in fair value	511	10,502
Gain on disposal of assets, net	955	17
Total nonoperating expenses, net	<u>\$ (5,996)</u>	<u>\$ (1,031)</u>
Excess of revenues over expenses before transfers and capital contributions, net	34,224	39,365
Transfers and expenditures in support of the University of Florida and its medical programs	(34,117)	(33,355)
Debt forgiveness, net	-	16,103
Capital contributions, net	293	30
Increase in net position	<u>400</u>	<u>22,143</u>
Net position		
Beginning of year	191,356	169,213
End of year	<u>\$ 191,756</u>	<u>\$ 191,356</u>

SHANDS JACKSONVILLE HEALTHCARE, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BASIC STATEMENT OF CASH FLOWS

For the Periods Ended June 30, 2017 and June 30, 2016
(Dollars in Thousands)

	June 30, 2017	June 30, 2016
Cash flows from operating Activities:		
Cash received from patients and third-party payors	\$ 677,797	\$ 643,633
Other receipts from operations	12,638	11,815
Salaries, wages and benefits paid to employees	(303,852)	(273,604)
Payments to suppliers and vendors	(322,232)	(316,148)
Net cash provided by operating activities	<u>64,351</u>	<u>65,696</u>
Cash flows from noncapital financing activities:		
Interest paid	(754)	(993)
Payments in support of the University of Florida and its medical programs	(34,118)	(33,355)
Payments of long-term debt	(855)	(1,019)
Proceeds from disposal of noncapital assets	46	4
Net used in noncapital financing activities	<u>(35,681)</u>	<u>(35,363)</u>
Cash flows from capital and related financing activities:		
Purchase of capital assets	(85,670)	(36,225)
Proceeds from disposal of capital assets	966	36
Proceeds from issuance of long-term debt	-	87,268
Payments of long-term debt and capital lease obligations	(9,391)	(8,160)
Payments on other capital borrowings	-	(6,150)
Interest paid	(6,469)	(7,148)
Capital contributions	293	30
Net cash (used in) provided by capital and related financing activities	<u>(100,271)</u>	<u>29,651</u>
Cash flows from investing activities:		
Investment income received	1,794	6,370
Redemption of short-term investments and assets whose use is limited	98,628	22,171
Purchase of short-term investments and assets limited as to use, net	(12,304)	(100,199)
Net cash provided by (used in) investing activities	<u>88,118</u>	<u>(71,658)</u>
Net increase (decrease) in Cash and Cash Equivalents	16,517	(11,674)
Cash and cash equivalents		
Beginning of year	73,897	85,571
End of period	<u>\$ 90,414</u>	<u>\$ 73,897</u>

SHANDS JACKSONVILLE HEALTHCARE, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BASIC STATEMENT OF CASH FLOWS

For the Periods Ended June 30, 2017 and June 30, 2016
(Dollars in Thousands)

	June 30, 2017	June 30, 2016
Reconciliation of change in net assets to net cash provided by operating activities:		
Operating Income	\$ 40,220	\$ 40,396
Adjustments to operating income to net cash (used in) provided by operating activities:		
Depreciation and amortization	30,776	31,832
Provision for bad debts	78,845	102,996
Changes in:		
Patient accounts receivable	(82,610)	(115,623)
Prepaid expenses, inventory and other current assets	(2,621)	(3,805)
Other assets	(3,902)	(4,034)
Accounts payable and accrued expenses	5,605	2,583
Estimated third-party payor settlements	(1,792)	5,672
Other liabilities	(170)	5,679
Total adjustments	24,131	25,300
Net cash provided by operating activities	\$ 64,351	\$ 65,696

Shands Jacksonville Healthcare, Inc.
Summary of Financial and Operational Indicators

	June 30th	
	FYTD FY17	FYTD FY16
Utilization Statistics		
Licensed beds	695	695
Beds in service (End of Period)*	585	589
Beds in service (YTD Weighted Avg)*	585	585
Admissions (excluding newborns and observation cases)	26,829	26,869
Patient days (excluding newborns and observation cases)	161,826	164,888
Average length of stay (days)	6.0	6.1
Percentage occupancy (beds in service)	75.8%	76.5%
Emergency room and trauma center visits	127,700	123,491
Outpatient visits	578,821	535,524
Calendar Days	365	366
Payor Mix - Gross Revenues		
Medicare	34.6%	33.2%
Medicaid	24.2%	25.5%
Blue Cross	12.3%	11.2%
Commercial	5.0%	5.9%
Managed Care	9.2%	9.2%
Self-pay and Medicaid Pending	14.2%	14.6%
Other	0.4%	0.5%
Total	100.0%	100.0%
Other		
Medicare case mix index for reporting period	1.712	1.704

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

Introduction

This section of the Shands Jacksonville HealthCare, Inc. and Subsidiaries' ("SJH" or the "Company") annual financial report presents the Company's analysis of its financial performance for the year ended June 30, 2017 with comparative information as of and for the years ended June 30, 2016 and 2015. This discussion has been prepared by management and should be read in conjunction with the consolidated basic financial statements and related note disclosures, which follow this section.

Organization

Shands Jacksonville HealthCare, Inc., formerly known as Jacksonville Health Group, Inc., is a Florida not-for-profit corporation with direct or indirect legal control over numerous subsidiaries.

Shands Jacksonville Medical Center, Inc. ("SJMC"), formerly known as University Medical Center, Inc. ("UMC"), is a Florida not-for-profit corporation and the principal operating subsidiary of the Company. SJMC operates a teaching hospital located in Jacksonville, Florida, through a lease with the City of Jacksonville (the "City"). During 2013, SJMC began doing business as UF Health Jacksonville.

On September 30, 1999, Methodist Medical Center, Inc., Methodist Health System, Inc. and The Methodist Hospital Foundation, Inc. (collectively, "Methodist" and now known as Shands Jacksonville Properties, Inc.), SJH, UMC and Shands Teaching Hospital and Clinics, Inc. ("Shands") completed an affiliation agreement (the "Affiliation") which allowed for the combination of the hospital operations of UMC and Methodist under SJMC. SJH became the sole member of both SJMC and Methodist.

The Affiliation was approved by the City and secured creditors of both UMC and Methodist. As a result of the Affiliation, the requisite corporate actions were taken on February 1, 2003 to designate Shands as the sole corporate member of SJH.

Effective September 8, 2010, the Board of Directors of Shands approved a motion to reorganize its corporate structure. Under the reorganization, Shands would no longer be the sole corporate member of the Company, but would continue as an affiliated entity under common control of the University of Florida. Effective September 27, 2010, the Board of Directors of the Company approved the motion for Shands to no longer be the sole corporate member of the Company. The Company continues to receive management and operational services from Shands. As a part of the reorganization, the Company delivered a promissory note to Shands in the amount of approximately \$42,276,000, payable over 20 years, in acknowledgement of historical investments in the Company.

During September 2015, after assessment of each organization's financial position, the Company's Board of Directors agreed to accept an offer from the Shands' Board of Directors for a reduction of approximately \$17,687,000 in the note due to Shands, effective July 1, 2015, which increased the Company's net position by approximately \$17,687,000 as of July 1, 2015.

On February 17, 2015, the Company opened the first of a multi-stage effort to expand to a new location north of downtown Jacksonville, Florida, where it is doing business collectively as UF Health North. This initial effort included the Company offering a ground lease to a developer that constructed a new medical office building in which the Company leases space that includes a free-standing emergency department, surgical suites and other hospital based operations (commonly referred to as "North Phase I"). On May 23, 2017, the Company completed construction on a new 92-bed tower (commonly referred to as "North Phase II"), which adjoins North Phase I. The new bed tower does not increase total licensed beds. The Company is converting rooms at its original location (known as "Downtown") from semi-private to private.

The accompanying consolidated basic financial statements include the accounts of SJH, SJMC, Methodist and other subsidiaries of SJH as of and for the years ended June 30, 2017 and 2016. The "Company" in these consolidated basic financial statements refers to the consolidated operations of these entities. Significant transactions between these entities have been eliminated.

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

Overview of the Consolidated Basic Financial Statements

Along with management's discussion and analysis, the annual financial report includes the independent certified public accountants' report and the consolidated basic financial statements of the Company. The consolidated basic financial statements also include notes that explain in more detail some of the information in the consolidated basic financial statements. By referring to the accompanying notes to the consolidated basic financial statements, a broader understanding of issues impacting financial performance can be realized.

Required Financial Statements

The required statements are the consolidated statements of net position, the consolidated statements of revenues, expenses and changes in net position and the consolidated statements of cash flows. These statements offer short and long-term financial information about the Company's activities.

The consolidated statements of net position reflect all of the Company's assets, liabilities and deferred inflows and outflows and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). Assets, liabilities and deferred activity are presented in a classified format, which distinguishes between their current and long-term time frame. The difference between the assets plus deferred outflows and liabilities plus deferred inflows is reported as "net position."

The consolidated statements of revenues, expenses and changes in net position present the change in net position resulting from revenues earned and expenses incurred. All changes in net position are reported as revenues are earned and expenses are incurred, regardless of the timing of related cash flows.

The consolidated statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, financing (capital and non-capital), and investing activities. The purpose of the statement is to reflect the key sources and uses of cash during the reporting period.

Financial Analysis of the Company

Consolidated Basic Statements of Net Position

The Company's net position is one indicator of the current financial condition of the Company. Changes in net position are an indicator of whether the overall financial condition of the organization has improved or worsened over a period of time. They also provide the basis for evaluating the capital structure, as well as assessing the liquidity and financial flexibility of the Company. However, the financial statement user should consider other nonfinancial factors, such as changes in economic conditions, population changes, regulations and government legislation affecting the health care industry. Assets, liabilities and deferred inflows and outflows are generally measured using current values, with the exception of capital assets, which are stated at historical cost less allowances for depreciation.

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

A summary of the Company's condensed consolidated basic statements of net position as of June 30 is presented below:

(in thousands of dollars)

	2017	2016	2015
Cash and cash equivalents and short-term investments	\$ 101,839	\$ 114,864	\$ 113,580
Other current assets	137,781	130,270	113,812
Capital assets, net	265,681	208,445	203,336
Other noncurrent assets	53,994	114,394	43,677
Total assets	559,295	567,973	474,405
Deferred outflows of resources	6,917	7,340	2,911
Current liabilities	106,726	101,685	96,990
Noncurrent liabilities	261,063	270,349	203,691
Total liabilities	367,789	372,034	300,681
Deferred inflows of resources	6,667	11,923	7,422
Net position			
Net investment in capital assets	51,330	44,247	52,469
Restricted:			
Expendable	4,123	4,123	4,093
Unrestricted	136,303	142,986	112,651
Total net position	\$ 191,756	\$ 191,356	\$ 169,213

During 2017, cash and cash equivalents and short-term investments decreased by approximately \$13.0 million, or 11.3%. Cash generated from operations was approximately \$64.4 million. During 2016, cash and cash equivalents and short-term investments increased by approximately \$1.3 million, or 1.1%. Cash generated from operations was approximately \$65.7 million. See "Consolidated Basic Statement of Cash Flows" section below for further information regarding cash activity.

Other current assets increased by approximately \$7.5 million, or 5.8% during 2017. The increase consists of the following: an increase in net patient accounts receivable of \$3.8 million and a combined net increase in prepaid expenses, inventories and assets whose use is limited of approximately \$3.7 million. During 2016, other current assets increased by approximately \$16.5 million, or 14.5%. The increase consists of the following: an increase in net patient accounts receivable of \$16.0 million, primarily related to the opening of North Phase I and five (5) new oncology infusion clinics since March 2015; and, a combined net increase in amounts due from city and state agencies, prepaid expenses, inventories and assets whose use is limited of approximately \$0.5 million.

Capital assets, net, increased approximately \$57.2 million, or 27.5%, in 2017, primarily related to North Phase II construction and equipment purchases, offset by an increase in accumulated depreciation. During 2016, capital assets, net, increased approximately \$5.1 million, or 2.5%, primarily related to initial North Phase II construction efforts, offset by an increase in accumulated depreciation.

Other noncurrent assets decreased approximately \$60.4 million, or 52.8%, during 2017, primarily from a \$59.4 million reduction for Series 2015 project fund balances for their intended purpose; a reduction in Series 2015 bond fair value of \$4.7 million; a \$1.0 million reduction of fair value of trustee held funds; offset by an increase deposits, investments and other receivables of \$4.0 million. During 2016, other noncurrent assets increased approximately \$70.7 million, or 161.9%, which occurred when a large portion of the proceeds of the Series 2015 \$85.0 million Healthcare Facilities Revenue Bonds, issued December 10, 2015, and discussed further below, were set aside in a trustee held project fund.

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

Deferred outflows of resources decreased by approximately \$0.4 million, or 5.8%, during 2017, primarily related to the fair value of hedged derivatives. During 2016, deferred outflows of resources increased by approximately \$4.4 million, or 152.1%, primarily due to pension contributions and related activity.

Current liabilities increased approximately \$5.0 million, or 5.0%, during 2017. Contributors include a \$5.4 million increase for accrued salaries and leave payable; a \$2.6 million increase in trade accounts payable and other accrued expenses; offset by a \$1.8 million decrease for estimated third party liabilities and a \$1.1 million net decrease for the current portion due on new long-term debt and leases, which are discussed further below. During 2016, current liabilities increased approximately \$4.7 million, or 4.8%. Contributors include a \$2.4 million increase for accrued salaries and leave payable; a \$5.7 million increase for estimated third party liabilities; a \$4.0 million decrease in trade accounts payable and other accrued expenses; and, a \$0.7 million net increase for the current portion due on new long-term debt and leases, which are discussed further below.

Noncurrent liabilities decreased approximately \$9.3 million, or 3.4%, during 2017 primarily from debt and capital lease payments as well as reclassification from long-term to current portions due. During 2016, noncurrent liabilities increased approximately \$66.7 million, or 32.7%, from the following activity: an increase of \$62.5 million for the long-term portion of the new \$85 million Series 2015 bond issue, offset by reclassifications to current liabilities and the \$17.7 million Shands 2011 promissory note debt forgiveness, discussed further below; and other liability increase of \$6.3 million, primarily for the pension liability; all of which were offset by a \$2.2 million decrease in the long-term portion of capital leases.

As of June 30, 2017, the Company has approximately \$252.0 million in long-term debt outstanding compared to approximately \$259.7 million at June 30, 2016. The decrease relates to debt payments as there was no new debt was issued during 2017. On December 10, 2015, \$85.0 million Healthcare Facilities Revenue Bonds (UF Health – Jacksonville Project), Series 2015, were issued. The proceeds of this debt were used for financing, refinancing or reimbursement for costs of certain capital improvements including the cost of the construction and equipping North Phase II, other miscellaneous improvements and paying costs associated with the issuance of the Bonds. On March 1, 2015, the Company entered into an interest only \$20 million Revolving Line of Credit Note, Series 2015A, and was advanced the entire amount, which is due and payable in full by March 6, 2020, unless extended. The proceeds of Series 2015A Note were used primarily for general corporate expenditures. On June 29, 2015, the Company closed on the \$20 million issuance of City of Jacksonville, Florida Healthcare Facilities Revenue Bonds (UF Health Jacksonville Project), Series 2015, which matures on June 30, 2025. The purpose of Series 2015 Bonds was for financing, refinancing and reimbursing the costs of capital improvements and for paying for costs of issuance. On March 2, 2015, the Company borrowed \$6.2 million under a master lease agreement. During 2013, SJMC borrowed approximately \$123.6 million with the issuance of Healthcare Facilities Revenue Bonds Series 2013A and 2013B, for approximately \$64.2 million and \$59.4 million, respectively, on November 21, 2013. The proceeds of this issuance refunded the \$100 million Series 2013 Shands Jacksonville Medical Center Taxable Notes, paid for the cost of debt issuance, provided for a debt service reserve fund and was used to reimburse or fund capital projects.

The promissory note owed to Shands in an original amount of approximately \$42.3 million, as mentioned above, was recorded by the Company during 2011. The note payable balance at June 30, 2015 was approximately \$35.8 million but is only \$17.1 million at June 30, 2016 based on debt forgiveness that was agreed to in September 2015, when the Company's Board of Directors agreed to accept the offer from the Shands Board of Directors to reduce the note due to Shands by approximately \$17,687,000, effective July 1, 2015. Beginning with the payment due on October 1, 2015, quarterly installments of principal and interest became \$402,310, with the interest rate and maturity date remaining unchanged. The impact of the Boards' actions was to increase the Company's net position by approximately \$17,687,000 as of July 1, 2015.

Also during September 2015, the Company offered, and Shands accepted, application of an interest rate of 3% to the monthly amounts outstanding back to July 2011 through June 2015 for its share of EPIC implementation costs that Shands had allowed the Company to pay over time on an interest-free basis. The impact of this action was to increase accounts payable and decrease net position for interest incurred from inception of the arrangement through June 30, 2015 by approximately \$1,584,000, when recorded in the

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

Company's 2016 financial results. During 2016, the Company paid the interest in its entirety so there is no balance due to Shands as of June 30, 2016.

The net result of September 2015 transactions was approximately \$16,103,000 and is reflected in other changes in net position in the Company's June 30, 2016 financial results.

The Company was in compliance with all financial covenants as of June 30, 2017 and 2016.

Consolidated Basic Statements of Revenues, Expenses and Changes in Net Position

The following table presents the Company's condensed consolidated basic statements of revenues, expenses and changes in net position. The table presents the extent to which the Company's overall net position increased (decreased) as a result of operations or other reasons.

(in thousands of dollars)

	2017	2016	2015
Net patient service revenue	\$ 683,355	\$ 650,587	\$ 577,554
Other operating revenue	12,788	14,851	12,523
Total operating revenues	696,143	665,438	590,077
Operating expenses	655,923	625,042	557,967
Operating Income	40,220	40,396	32,110
Nonoperating (expenses) revenue, net	(5,996)	(1,031)	11,443
Excess of revenues over expenses before transfers and capital contributions	34,224	39,365	43,553
Other changes in net assets:			
Transfers and expenditures in support of the University of Florida and its medical programs	(34,117)	(33,355)	(23,055)
Debt forgiveness, net	-	16,103	-
Capital contributions, net	293	30	10
Increase in net position	400	22,143	20,508
Net position			
Beginning of year	191,356	169,213	148,705
End of year	\$ 191,756	\$ 191,356	\$ 169,213

Patient Volumes

The following table reflects the associated volumes on a comparative basis to years ended June 30:

	2017	2016	2015
Inpatient admissions	26,829	26,869	25,850
Outpatient visits	578,821	535,524	454,001

During 2017, inpatient admissions, excluding observation cases, decreased by 40, or 0.1%, and outpatient visits increased by 43,297, or 8.1%. The inpatient decrease was negligible and relates to the transition of cases from the Downtown location to North Phase II, described above. The outpatient increase came largely from UF Health North and infusion oncology clinic and ancillary growth. UF Health North generated approximately 5,348 (3,713 acute and 1,635 observation) admissions, 2,884 surgical cases, 35,386 emergency room visits and 32,880 ancillary visits. Infusion oncology clinics, opened since March 2015, generated 33,511 outpatient clinic visits and 17,828 ancillary visits. The remainder of the outpatient visit increase is primarily from increased hematology-oncology clinic visits.

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

During 2016, inpatient admissions, excluding observation cases, increased by 1,019 or 3.9%, and outpatient visits increased 81,523, or 18.0%. These increases were primarily from opening North Phase I in February 2015, which has generated approximately 4,685 (3,223 acute and 1,462 observation) hospital admissions, 2,822 surgical cases, 32,646 emergency room visits and 24,436 ancillary visits. Five (5) infusion oncology centers have opened since March 2015, which have generated 22,131 outpatient clinic visits and 10,586 ancillary visits during 2016. The remainder of the 2016 outpatient visit increase is from additional lab services.

Operating Revenues

During 2017, patient service revenue, net of allowances for contractual discounts, charity care and bad debt expense, increased approximately \$32.8 million, or 5.0%, primarily related to the outpatient volume increases, discussed above, largely from UF Health North and infusion oncology locations, and improved payor mix growth in Medicare (+1.4%) and commercial (+0.1%). During 2016, patient service revenue, net of allowances for contractual discounts, charity care and bad debt expense, increased by approximately \$73.0 million, or 12.6%. The increase is primarily related to the new volume from North Phase I and infusion oncology operations, as noted above, and continued commercial payor mix growth (+2.5%).

Other operating revenue decreased during 2017 approximately \$2.1 million, or 13.9%, primarily related to a lack of electronic health record meaningful use grant revenue, as that program has now moved into the penalty phase, and a reduction in self-insured workers compensation stop loss insurance recoveries since prior year. During 2016, other operating revenue increased approximately \$2.3 million, or 18.6%, primarily related to revenue for patient care coordination support and a small increase in grant revenue including the electronic health record meaningful use grant.

Operating Expenses

During 2017, operating expenses increased approximately \$30.9 million, or 4.9%. Salaries and benefits increased approximately \$23.2 million, or 8.2%, which is largely the result of additional staffing for UF Health North operations as well as a 2% merit increase effective November 2016, which was earlier than originally scheduled for January 2017. Supplies and services increased by approximately \$8.7 million, or 2.8%, primarily related to pharmaceuticals and other medical supplies associated with increased volumes, as well as additional professional and purchased services for them. Depreciation expense decreased \$1.1 million, or 3.3%, primarily because of assets becoming fully depreciated. During 2016, operating expenses increased approximately \$67.1 million, or 12.0%. Salaries and benefits increased approximately \$19.9 million, or 7.6%, which is largely the result of additional staffing for a full year of North Phase I operations, and the additional openings of infusion oncology centers, as well as a scheduled 2% merit increase effective January 2016. Supplies and services increased by approximately \$43.4 million, or 16.3%, primarily related to pharmaceuticals, implants and other medical supplies associated with increased volumes from new locations, as well as additional rent and purchased services for them. Depreciation expense increased \$3.8 million, or 13.4%, primarily related to new equipment and leasehold improvements for North Phase I.

Nonoperating Revenues (Expenses), net

Nonoperating expenses, net for fiscal year 2017, were approximately \$6.0 million, which includes interest expense of approximately \$7.3 million; other nonoperating losses of approximately \$0.1 million, including a fair value increase in nonhedged derivatives of approximately \$0.6 million; offset by net investment gains of approximately \$0.5 million, including the decrease in fair value of approximately \$1.8 million; and, a \$1.0 million gain on disposals of capital equipment. Included in 2017 investment gains is a favorable true-up of SJMC's investment share of FCA proceeds from its December 2014 sale, which includes claim recoveries.

Nonoperating expenses, net for fiscal year 2016, were approximately \$1.0 million, which includes interest expense of approximately \$9.2 million; other nonoperating losses of approximately \$2.4 million, including a fair value increase in nonhedged derivatives of approximately \$0.2 million; offset by net investment gains of approximately \$10.5 million, including the increase in fair value of approximately \$1.5 million; and, a small gain on disposal of capital equipment. Included in 2016 investment gains is a favorable true-up, after claims run out, of SJMC's investment share of FCA proceeds from its December 2014 sale.

Shands Jacksonville HealthCare, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2017

Consolidated Basic Statements of Cash Flows

The consolidated basic statements of cash flows provide additional information in regards to the Company's financial results by reporting the major sources and uses of cash.

During 2017, cash and cash equivalents increased by approximately \$16.5 million, or 22.4%. Cash inflows were primarily a result of net cash provided by operating activities of \$64.4 million, redemption of assets whose use is restricted of \$98.6 million and investment income received of \$1.8 million. Redemptions of assets whose use is restricted included drawing down nearly \$59.4 million from the Series 2015 \$85 million capital project funds to construct North Phase II; liquidating nearly \$19.7 million previously held in the Florida State Treasury's Special Purpose Investment Account (SPIA); and, another \$19.5 million of board designated funds were reclassified from operating cash to SPIA. Cash outflows included purchases of short-term investments and asset whose use is restricted of \$12.3 million, which includes transfers of bank deposits to SPIA of \$10 million and posting an additional \$1.1 million for swap collateral; payments of \$34.1 million in support of UF and its medical programs, payments for acquisition of capital assets of \$85.7 million, and debt, lease, other borrowing and interest payments of \$17.5 million. The Company provided \$2.1 million to fund the defined benefit pension plan.

During 2016, cash and cash equivalents decreased by approximately \$11.7 million, or 13.6%. Cash inflows were primarily a result of net cash provided by operating activities of \$65.7 million, debt proceeds of \$87.3 million, redemption of assets whose use is restricted of \$22.2 million and investment income received of \$ 6.4 million. Cash outflows included \$87.3 million to be held in trust for project and expense funds from the debt proceeds, transfers of bank deposits to SPIA of \$12.0 million, payments of \$33.4 million in support of UF and its medical programs, payments for acquisition of capital assets of \$36.2 million, and debt, lease, other borrowing and interest payments of \$23.5 million. The Company provided \$1.2 million to fund the defined benefit pension plan.

Credit Ratings

The Company's underlying credit rating of BBB was published by Fitch Ratings in November 2016 with a stable outlook. Moody's Investor Service reaffirmed a Baa3 credit rating in November 2016, with a negative outlook.