# Consolidated Financial Statements, Management's Discussion and Analysis and Other Interim Information

## Palmetto Health and Subsidiaries

As of June 30, 2017 and September 30, 2016
and for the nine months ended
June 30, 2017 and 2016

# Palmetto Health and Subsidiaries

## Table of Contents

## RESULTS OF OPERATIONS

Palmetto Health's earnings are reported in accordance with generally accepted accounting principles (GAAP). Management believes that earnings reported under GAAP provides a meaningful representation of its fundamental earnings power and can be used in performing period-over-period financial analysis and comparison with peer group data. This measure is also used by management in making resource allocation and other budgetary and operational decisions.

### Performance Overview

Palmetto Health's revenue and gains greater (less) than expenses and losses for June 30, 2017 and 2016 is $7,809 and $6,180 for the three months, respectively, and $44,836 and $12,143 for the nine months, respectively. The net change in unrealized gains (losses) on derivatives financial instruments and trading investments for the June 30, 2017 and 2016 is $10,707 and ($3,662) for the three months, respectively, and $52,889 and ($18,309) for the nine months, respectively. The improvement for the three and nine months ended June 30, 2017 is largely attributable to the impact of market interest rates on derivative instrument valuations and trading investments. Net nonoperating revenues (expenses) for June 30, 2017 and 2016 is ($2,898) and $9,842 for the three months, respectively, and ($8,053) and $30,452 for the nine months, respectively. The net change is primarily attributable to investment performance due to market conditions.

Palmetto Health's operating (loss) income for the three months ended June 30, 2017 and 2016 is ($13,084) and $5,014, respectively; while the operating (loss) income for the nine months ended June 30, 2017 and 2016 is ($28,041) and $13,807, respectively.

The growth in total operating revenue of $105,643, and total operating expense of $147,491 for the nine months ended June 30, 2017 and 2016, respectively, is partly attributable to the addition of Palmetto Health Tuomey as of January 1, 2016, contributing an incremental over prior year for the same periods of $53,087 in total revenue and $50,435 in total expenses, while Palmetto Health Tuomey's incremental impact on the operating (loss) income was income of $2,074 for the nine months ended June 30, 2017.

The growth in total operating revenue for the three months ended June 30, 2017 was $12,101. Excluding the incremental impact of Palmetto Health Tuomey being acquired January 1, 2016, total operating revenue for the nine months ended June 30, 2017 increased $52,556 over the nine months ended June 30, 2016. Both the three and nine month changes reflect increases in negotiated managed care rates, in addition to moderate increases in volume for the nine month period.

There was a $30,199 increase in total operating expenses for the three months ended June 30, 2017. Excluding the incremental impact of Palmetto Health Tuomey, operating expenses increased $97,056 for the nine months ended June 30, 2017. This includes growth in both salaries and benefits expense of $21,856 and $61,947 for the three and nine months ended June 30, 2017, respectively, as well as growth in supplies and other expense of $33,699 for the nine months ended June 30, 2017 (there was a decrease of $4,763 for the three months ended June 30, 2017). The increase in salaries and benefits related costs are driven by an increasingly competitive labor market resulting in adjustment to pay and benefit programs, a significant increase in overtime and agency utilization, accelerated hiring in areas of strategic investment and high dollar health insurance claims. In addition, in June 2017, Palmetto Health created a voluntary transition incentive program (VTIP) to offer specific team members the choice to voluntarily leave the organization in return for financial incentives beyond basic severance pay to support their transition. An estimate of related benefits under this plan of $5,356 for 162 employees accepted under the VTIP plan were included within salaries and benefit expense on the Consolidated Statement of Operations for both the three and nine month periods ended June 30, 2017. Spending in supplies and other reflects planned investments, service mix and technology costs particularly in pharmaceuticals. Palmetto Health management is actively engaged in returning to operating profitability, emphasizing reductions in overtime and agency utilization and changes in compensation program design.

*(dollars in thousands)*

Should you have questions on this report, please contact Paul Duane, Chief Financial Officer, at 803.296.2112 or Benjamin M. Cunningham, Jr., System Vice President of Finance, at 803.296.2135.

## Operating (Loss) Income

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | June 30, | | Change | June 30, | | Change |
| | 2017 | 2016 | $ | 2017 | 2016 | $ |
| Operating (loss) income | $ (13,084) | $ 5,014 | $ (18,098) | $ (28,041) | $ 13,807 | $ (41,848) |

*Third Quarter*

Operating (loss) income decreased $18,098 from the three months ended June 30, 2016 to June 30, 2017. This was a result of the increase in operating expenses of $30,199 or 7.4%, partially offset by the increase in the unrestricted revenue, gains, and other support of $12,101, or 2.9%. See further discussion of these variances above in the Performance Overview as well as on the following pages.

*Year to Date*

Operating (loss) income decreased $41,848 from the nine months ended June 30, 2016 to June 30, 2017. This was a result of the increase in operating expenses of $147,491 or 12.7%, partially offset by the increase in the unrestricted revenue, gains, and other support of $105,643, or 9.0%. See further discussion of these variances above in the Performance Overview as well as on the following pages.

*(dollars in thousands)*

### Unrestricted Revenue, Gains and Other Support

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | June 30, | | Change | | June 30, | | Change | |
| | 2017 | 2016 | $ | % | 2017 | 2016 | $ | % |
| Revenue at established charges | $ 1,430,685 | $ 1,394,083 | $ 36,602 | 2.6% | $ 4,290,835 | $ 3,960,634 | $ 330,201 | 8.3% |
| Contractual adjustments | (904,092) | (883,064) | (21,028) | -2.4% | (2,703,410) | (2,505,326) | (198,084) | -7.9% |
| Charity care | (54,803) | (58,320) | 3,517 | 6.0% | (164,546) | (160,521) | (4,025) | -2.5% |
| Disproportionate share funding | 6,152 | 6,566 | (414) | -6.3% | 19,120 | 17,519 | 1,601 | 9.1% |
| Net patient service revenue | 477,942 | 459,265 | 18,677 | 4.1% | 1,441,999 | 1,312,306 | 129,693 | 9.9% |
| Provision for uncollectible accounts | (79,652) | (73,514) | (6,138) | 8.3% | (247,686) | (217,472) | (30,214) | 13.9% |
| Net patient service revenue less provision for uncollectible accounts | 398,290 | 385,751 | 12,539 | 3.3% | 1,194,313 | 1,094,834 | 99,479 | 9.1% |
| Other revenue | 27,499 | 27,937 | (438) | -1.6% | 86,518 | 80,354 | 6,164 | 7.7% |
| Total | $ 425,789 | $ 413,688 | $ 12,101 | 2.9% | $ 1,280,831 | $ 1,175,188 | $ 105,643 | 9.0% |

*Third Quarter*

The increase in unrestricted revenue, gains and other support was largely a result of the increases in negotiated managed care rates, partially offset by a decrease in commercial payor mix.

*Year to Date*

The increase in unrestricted revenue, gains and other support was largely a result of the January 1, 2016 addition of Palmetto Health Tuomey, which contributed $53,087 of incremental revenue in the nine months ended June 30, 2017. In addition, this increase in revenue reflects increases in negotiated managed care rates and moderately increased volume. There was also an increase in disproportionate share funding and provision for uncollectible accounts due primarily to addition of Palmetto Health Tuomey on January 1, 2016.

*(dollars in thousands)*

### Operating Expenses

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | June 30, | | Change | | June 30, | | Change | |
| | 2017 | 2016 | $ | % | 2017 | 2016 | $ | % |
| Salaries and benefits | $ 246,962 | $ 226,445 | $ 20,517 | 9.1% | $ 733,946 | $ 639,432 | $ 94,514 | 14.8% |
| Supplies and other expenses | 163,745 | 154,724 | 9,021 | 5.8% | 489,935 | 442,925 | 47,010 | 10.6% |
| Depreciation and amortization | 20,060 | 19,968 | 92 | 0.5% | 60,903 | 57,214 | 3,689 | 6.4% |
| Interest expense | 8,106 | 7,537 | 569 | 7.5% | 24,088 | 21,810 | 2,278 | 10.4% |
| Total expenses | $ 438,873 | $ 408,674 | $ 30,199 | 7.4% | $ 1,308,872 | $ 1,161,381 | $ 147,491 | 12.7% |

*Third Quarter*

Operating expenses increased primarily due to salaries and benefits and supplies and other expenses. As discussed previously, salaries and benefits increased because of an increasingly competitive labor market resulting in adjustment to pay and benefit programs, a significant increase in overtime and agency utilization, accelerated hiring in areas of strategic investment and high dollar health insurance claims. In addition, $5,356 was recorded in connection with the June 2017 VTIP plan in which 162 employees are voluntarily leaving the organization in return for financial incentives beyond basic severance pay to support their transition.

Increases in supplies and other expenses were largely a result of planned investments, service mix and technology costs particularly in pharmaceuticals. Palmetto Health management is actively engaged in returning to operating profitability, emphasizing reductions in overtime and agency utilization and changes in compensation program design.

Palmetto Health also incurred start-up costs in relation to the new 501(c)(3) entity, the Palmetto Health University of South Carolina Medical Group (PHUSCMG) formed by Palmetto Health and the University of South Carolina School of Medicine Educational Trust (USC SOM Trust) in order offer improved care and expanded research collaboration opportunities. The integration was launched in April 2016 and operations are rolling out under the new entity, with the first three practices up as of March 27, 2017. Employees moved to the new entity at the beginning in January 2017 and leased back to Palmetto Health during the nine months ended June 30, 2017. All practices are under the new management structure. The financial position and results of operations associated with this venture are immaterial to the consolidated financial statements as of and for the three and nine months ended June 30, 2017.

*Year to Date*

Operating expenses increased primarily due to salaries and benefits and supplies and other expenses. As discussed previously, salaries and benefits increased because of the addition of Palmetto Health Tuomey employees on January 1, 2016, an increasingly competitive labor market resulting in adjustment to pay and benefit programs, a significant increase in overtime and agency utilization, accelerated hiring in areas of strategic investment and high dollar health insurance claims.

*(dollars in thousands)*

Increases in supplies and other expenses were largely a result of the January 1, 2016 addition of Palmetto Health Tuomey. In addition, spending in supplies and other reflects planned investments, service mix and technology costs particularly in pharmaceuticals. Palmetto Health management is actively engaged in returning to operating profitability, emphasizing reductions in overtime and agency utilization and changes in compensation program design.

As discussed above, Palmetto Health also incurred start-up costs in relation to the new PHUSCMG.

Depreciation and amortization expense increased primarily due to purchases in routine capital and the January 1, 2016 addition of Palmetto Health Tuomey. The increase in interest expense is mostly from the issuance of the 2016 series bonds last fiscal year.

**Revenue and gains greater than expenses and losses**

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | June 30, | | Change | June 30, | | Change |
| | 2017 | 2016 | $ | 2017 | 2016 | $ |
| Revenue and gains greater than expenses and losses | $ 7,809 | $ 6,180 | $ 1,629 | $ 44,836 | $ 12,143 | $ 32,693 |

*Third Quarter*

Revenues and gains greater than expenses and losses increased primarily from the $13,293 increase in net change in unrealized gain (loss) on derivative financial instruments from a loss of $10,714 for the three months ended June 30, 2016 to a gain of $2,579 for the three months ended June 30, 2017. In addition, there was a $1,076 increase in net change in unrealized gain (loss) on trading investments from a gain of $7,052 for the three months ended June 30, 2016 to a gain of $8,128 for the three months ended June 30, 2017. In addition, there was a $3,943 increase in investment income from $5,922 for the three months ended June 30, 2016 to $9,865 for the three months ended June 30, 2017. These variances were due to changes in market conditions. There was also an offsetting decrease in operating (loss) gain of $18,098 as discussed previously.

*Year to Date*

Revenues and gains greater than expenses and losses increased primarily from the $55,209 increase in net change in unrealized gain (loss) on derivative financial instruments from a loss of $27,303 for the nine months ended June 30, 2016 to a gain of $27,906 for the nine months ended June 30, 2017. In addition, there was a $15,989 increase in net change in unrealized gain (loss) on trading investments from $8,994 for the nine months ended June 30, 2016 to $24,983 for the nine months ended June 30, 2017. There was an offsetting decrease in operating (loss) gain of $41,848 as discussed previously. In addition, there was a $935 decrease in investment income from $20,029 for the nine months ended June 30, 2016 to $19,094 for the nine months ended June 30, 2017. These variances were due to changes in market conditions.

*(dollars in thousands)*

### Increase in unrestricted net assets

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | June 30, | | Change | June 30, | | Change |
| | 2017 | 2016 | $ | 2017 | 2016 | $ |
| Increase in unrestricted net assets | $ 8,478 | $ 6,758 | $ 1,720 | $ 47,846 | $ 14,556 | $ 33,290 |

*Third Quarter and Year to Date*

The change in unrestricted net assets increased primarily from the $1,629 and $32,693 increase in revenue and gains greater than expenses and losses for the three and nine month period, respectively, described above.

### LIQUIDITY, FINANCIAL RESOURCES, AND FINANCIAL POSITION

| | June 30, | September 30, | Change | |
|---|---|---|---|---|
| | 2017 | 2016 | $ | % |
| Total cash, cash equivalents and assets limited as to use | $ 860,977 | $ 869,949 | $ (8,972) | -1.0% |
| Total assets | 2,032,545 | 2,025,833 | 6,712 | 0.3% |
| Total liabilities | 1,100,920 | 1,143,339 | (42,419) | -3.7% |
| Total net assets | 931,625 | 882,494 | 49,131 | 5.6% |

Palmetto Health's unrestricted cash and investments fair value were approximately $747,722 at June 30, 2017 and $741,884 at September 30, 2016, representing 170 and 179 days of cash operating expenses, respectively. The increase in cash is primarily due to decrease in accounts receivable from increased collections.

Palmetto Health's long-term debt balances (including current maturities) were $793,259 at June 30, 2017 and $797,556 at September 30, 2016, with the decrease due to principal payments and amortization of premiums, discounts and issuance costs. Palmetto Health's ratio of unrestricted cash and investments to long-term debt (excluding current maturities) was 94.3% at June 30, 2017 and 93.0% at September 30, 2016.

Total assets decreased $6,712 or 0.3%. This is due primarily to the $8,972, or 1.0%, decrease in total cash, cash equivalents and assets limited. The decrease coincides with the increase in daily operating expenses as described above, partially a result of the January 1, 2016, addition of Palmetto Health Tuomey acquisition, in addition to increased salaries and benefits costs and supplies and other expense. Additionally, there was a decrease in net property and equipment of $6,716 due to reduction in capital spending per management discretion. There was a $9,621 decrease in net patient accounts receivable, attributed to a favorable increase in collections. In addition, there was a $12,929 increase in other assets (current and noncurrent) attributable partially to the $5,250 initial investment in The Care Coordination Institute (CCI), a joint venture between Palmetto Health and Strategic Coordinating Organization (an affiliate of Greenville Health System) to support clinical integration and population health. Additionally, the increase in other assets occurred due to timing of prepayments and increase in interest in net assets of affiliated foundations. Other receivables increased $17,332 due primarily to DSH settlements and timing of payments, as well as changes in estimates for open years as Palmetto Health gains familiarity with new DSH redistribution methodology initiated for fiscal 2012 and forward (a receivable balance of $18,058 as of June 30, 2017 versus a payable of $3,082 at September 30, 2016).

Total liabilities decreased $42,419 or 3.7% primarily due to the $27,906 improvement in the fair value of derivatives from June 30, 2017 to September 30, 2016. In addition, in fiscal 2016 Palmetto Health entered into a multi-year agreement with a third party insurer to create a joint product offering the Health Insurance Exchange (HIX) participants in Palmetto Health's defined area. The objective of the agreement is to create an arrangement that reduces overall health care cost through more effective clinical activities, including case management and care coordination protocols, while improving the quality of outcomes to the subject HIX members. Palmetto Health has recorded an additional $1,667 liability for its estimated share of losses in the nine months ended June 30, 2017. Actual payments under the contract, if required, are due annually eight months after the end of each contract year (calendar year basis) with a final settlement 15 months after the end of the contract year. The change in accounts payable and accrued salaries is primarily due to timing.

Net assets increased $49,131 or 5.6%, which relates primarily to the $71,198 improvement in the net unrealized gain (loss) on derivative financial instruments and trading investments described previously, offset by the decrease in operating (loss) income of $41,848 described previously.

The status of Palmetto Health's various CON's follows:

> In February 2016, a $1,950 CON was submitted to DHEC for the 13 bed inpatient rehab department at the Palmetto Health Children's Hospital. This project includes equipment and space renovation. This CON application was submitted and a CON was issued July 25, 2016.
>
> In February 2017, a $1,705 CON was submitted to DHEC for an MRI located for a physician practice office in the Columbia area. This project includes equipment and space renovation. This CON application was submitted and a CON was issued July 17, 2017.

Capital expenditures are $60,000 on an average annual basis. As part of the Tuomey transaction (see Note 20), Palmetto Health committed an additional $8,000-$10,000 annually over the next three years for Palmetto Health Tuomey routine equipment and certain upgrades in facilities and information technology. Although no other major capital expenditures have either an approved CON or have been approved by the Board as of the date of this statement, the Board continually considers strategic capital expenditures and could approve such expenditures at any time in the future.

# Palmetto Health and Subsidiaries

## Consolidated Balance Sheets

### June 30, 2017 (Unaudited) and September 30, 2016 (Audited)

*(dollars in thousands)*

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| **Assets** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 15,337 | $ 41,807 |
| Assets limited as to use | 29,695 | 22,131 |
| Patient accounts receivable, net | 302,410 | 312,031 |
| Other receivables | 43,979 | 26,647 |
| Inventories | 31,029 | 29,269 |
| Other current assets | 21,146 | 20,218 |
| Total current assets | 443,596 | 452,103 |
| **Assets limited as to use** | 815,945 | 806,011 |
| **Property and equipment, net** | 676,221 | 682,937 |
| **Other assets** | 96,783 | 84,782 |
| | $ 2,032,545 | $ 2,025,833 |
| **Liabilities and Net Assets** | | |
| **Current liabilities:** | | |
| Current portion of long-term debt | $ 17,196 | $ 17,016 |
| Current portion of capital lease obligations | 903 | 872 |
| Accounts payable | 48,625 | 67,660 |
| Accrued salaries and benefits | 86,740 | 74,051 |
| Other current liabilities | 32,460 | 34,511 |
| Total current liabilities | 185,924 | 194,110 |
| **Long-term debt, net** | 776,063 | 780,540 |
| **Capital lease obligations, net** | 17,575 | 18,256 |
| **Other noncurrent liabilities** | 121,358 | 150,433 |
| Total liabilities | 1,100,920 | 1,143,339 |
| **Net assets:** | | |
| Unrestricted | 884,214 | 836,368 |
| Temporarily restricted | 31,200 | 30,112 |
| Permanently restricted | 16,211 | 16,014 |
| Total net assets | 931,625 | 882,494 |
| | $ 2,032,545 | $ 2,025,833 |

The accompanying notes are integral to these consolidated financial statements.

# Palmetto Health and Subsidiaries

## Consolidated Statements of Operations

## For the Three and Nine Months Ended June 30, 2017 and 2016 (Unaudited)

*(dollars in thousands)*

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2017 (Unaudited) | June 30, 2016 (Unaudited) | June 30, 2017 (Unaudited) | June 30, 2016 (Unaudited) |
| **Unrestricted revenue, gains and other support:** | | | | |
| Net patient service revenue | $ 477,942 | $ 459,265 | $ 1,441,999 | $ 1,312,306 |
| Provision for uncollectible accounts | (79,652) | (73,514) | (247,686) | (217,472) |
| Net patient service revenue less provision for uncollectible accounts | 398,290 | 385,751 | 1,194,313 | 1,094,834 |
| Other revenue | 27,499 | 27,937 | 86,518 | 80,354 |
| Total unrestricted revenue, gains and other support | 425,789 | 413,688 | 1,280,831 | 1,175,188 |
| **Expenses:** | | | | |
| Salaries and benefits | 246,962 | 226,445 | 733,946 | 639,432 |
| Supplies and other expenses | 163,745 | 154,724 | 489,935 | 442,925 |
| Depreciation and amortization | 20,060 | 19,968 | 60,903 | 57,214 |
| Interest expense | 8,106 | 7,537 | 24,088 | 21,810 |
| Total expenses | 438,873 | 408,674 | 1,308,872 | 1,161,381 |
| **Operating (loss) income** | (13,084) | 5,014 | (28,041) | 13,807 |
| **Nonoperating (expenses) income:** | | | | |
| Investment income, net | 9,865 | 5,922 | 19,094 | 20,029 |
| COPA – Community health improvement projects | 321 | (1,094) | 894 | (3,384) |
| Revenue and gains greater (less) than expenses and losses before net change in unrealized gain on derivative financial instruments and trading investments | (2,898) | 9,842 | (8,053) | 30,452 |
| **Net change in unrealized gain on derivative financial instruments** | 2,579 | (10,714) | 27,906 | (27,303) |
| **Net change in unrealized gain on trading investments** | 8,128 | 7,052 | 24,983 | 8,994 |
| Revenue and gains greater than expenses and losses | $ 7,809 | $ 6,180 | $ 44,836 | $ 12,143 |

The accompanying notes are integral to these consolidated financial statements.

# Palmetto Health and Subsidiaries

## Consolidated Statements of Changes in Net Assets
## For the Year Ended September 30, 2016 (Audited) and
## the Nine Months Ended June 30, 2017 (Unaudited)

*(dollars in thousands)*

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| **Balance as of September 30, 2015 (Audited)** | $ 793,293 | $ 28,794 | $ 10,392 | $ 832,479 |
| Revenue and gains greater than expenses and losses | 32,348 | - | - | 32,348 |
| Increase (decrease) in interest in Affiliated Foundations | 6,151 | (807) | 5,326 | 10,670 |
| Net adjustment for defined benefit plans | (2,794) | - | - | (2,794) |
| Excess of net assets acquired over consideration transferred | 8,983 | 2,774 | 5,337 | 17,094 |
| Contributions to Affiliated Foundations | (2,978) | - | (5,041) | (8,019) |
| Contributions and grants | - | 9,375 | - | 9,375 |
| Net assets released from restrictions used for capital | 1,365 | (1,365) | - | - |
| Net assets released from restrictions used for operations | - | (8,659) | - | (8,659) |
| Increase in net assets | 43,075 | 1,318 | 5,622 | 50,015 |
| **Balance as of September 30, 2016 (Audited)** | 836,368 | 30,112 | 16,014 | 882,494 |
| Revenue and gains greater than expenses and losses | 44,836 | - | - | 44,836 |
| Increase in interest in Affiliated Foundations | 2,795 | 2,548 | 197 | 5,540 |
| Net adjustment for defined benefit plans | 12 | - | - | 12 |
| Contributions and grants | - | 4,296 | - | 4,296 |
| Net assets released from restrictions used for capital | 203 | 203 | - | 406 |
| Net assets released from restrictions used for operations | - | (5,959) | - | (5,959) |
| Increase in net assets | 47,846 | 1,088 | 197 | 49,131 |
| **Balance as of June 30, 2017 (Unaudited)** | $ 884,214 | $ 31,200 | $ 16,211 | $ 931,625 |

The accompanying notes are integral to these consolidated financial statements.

# Palmetto Health and Subsidiaries

## Consolidated Statements of Cash Flows
## For the Nine Months ended June 30, 2017 and 2016 (Unaudited)

*(dollars in thousands)*

| | June 30, 2017 | June 30, 2016 |
|---|---|---|
| **Cash flows from operations:** | | |
| Increase in net assets | $ 49,131 | $ 25,589 |
| Adjustments to reconcile increase in net assets to net cash provided by operations: | | |
| Increase in interest in Affiliated Foundations | (5,540) | (2,072) |
| Loss on equity method investments | 424 | 107 |
| Net change in unrealized (gain) loss on derivative financial instruments | (27,906) | 27,303 |
| Depreciation and amortization | 60,903 | 57,214 |
| Provision for uncollectible accounts | 247,686 | 217,472 |
| Loss on the disposal of property and equipment | 22 | 2 |
| Net adjustment for defined benefit plans | (12) | (749) |
| Changes in operating assets and liabilities: | | |
| Patient accounts receivable | (238,065) | (257,105) |
| Other receivables | (17,332) | (7,558) |
| Accounts payable and accrued salaries and benefits | (6,346) | (4,205) |
| Other assets | (6,885) | (5,962) |
| Other liabilities | (3,208) | 1,051 |
| Other, net | (4,720) | (1,421) |
| Net cash provided by operations before trading investments | 48,152 | 49,666 |
| Trading investments | (17,498) | (55,317) |
| Net cash provided by operations before trading investments | 30,654 | (5,651) |
| **Cash flows from investing activities:** | | |
| Purchase of Tuomey, net of cash received (see Note 19) | - | (87,874) |
| Additions to property and equipment | (51,609) | (59,504) |
| Proceeds from sale of property and equipment | - | 582 |
| Net cash used in investing activities | (51,609) | (146,796) |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of long-term debt | - | 135,498 |
| Proceeds from line of credit | 46,000 | 100,000 |
| Long-term debt payments | (4,865) | (4,685) |
| Payments of line of credit | (46,000) | (100,000) |
| Capital lease obligation payments | (650) | (616) |
| Net cash (used in) provided by financing activities | (5,515) | 130,197 |
| **Net decrease in cash and cash equivalents** | (26,470) | (22,250) |
| **Cash and cash equivalents, beginning of year** | 41,807 | 47,533 |
| **Cash and cash equivalents, end of year** | $ 15,337 | $ 25,283 |

The accompanying notes are integral to these consolidated financial statements.

# Palmetto Health and Subsidiaries

## Consolidated Statements of Cash Flows
## For the Nine Months ended June 30, 2017 and 2016 (Unaudited)

*(dollars in thousands)*

| | June 30, 2017 | June 30, 2016 |
|---|---|---|
| **Supplemental information – Cash paid during the year for interest** | $ 892 | $ 1,088 |
| **Noncash investing and financing activities:** | | |
| Accrued capital expenditures | $ 3,268 | $ 3,116 |

The accompanying notes are integral to these consolidated financial statements.

## Note 1 - Description of Organization and Summary of Significant Accounting Policies

### Organization and Business

In 1998, Richland Memorial Hospital (Richland) and Baptist Healthcare System of South Carolina, Inc. (Baptist) formed Palmetto Health through the execution of a joint operating agreement. Palmetto Health is composed of substantially all of the assets and liabilities of Richland and Baptist. In 2014 Palmetto Health opened Palmetto Health Baptist Parkridge Hospital (Parkridge Hospital). On January 1, 2016, Palmetto Health acquired substantially all of the assets and assumed certain liabilities of Tuomey Healthcare System and Tuomey Medical Professionals (collectively, "Tuomey") (see Note 20) and formed a new entity known as Palmetto Health Tuomey. The operations of Palmetto Health Tuomey are included in these consolidated financial statements from the date of acquisition.

Palmetto Health is organized as a South Carolina nonprofit public benefit corporation exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC). The governance of Palmetto Health consists of a 19 member board of directors, with six directors appointed by Richland, six by Baptist, three by Palmetto Health Tuomey, three by the board of Palmetto Health, and the Palmetto Health Chief Executive Officer who serves as an ex officio voting member of the Board. Richland, Baptist and Palmetto Health Tuomey each elect at least one director each of whom is a licensed physician or dentist, and the Chair of the Board of Trustees of each is a director without term limit. The consolidated financial presentation of Palmetto Health also includes its for-profit, wholly owned subsidiaries HealthSource, Inc., and Premier Practice Management-Carolina, Inc. (PPM) and its not-for-profit, wholly owned subsidiary Palmetto Health Quality Collaborative, LLC. Palmetto Health and its Subsidiaries are referred to herein as "Palmetto Health."

### Principles of Consolidation

The consolidated financial statements include all accounts of Palmetto Health. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in affiliates that Palmetto Health does not control are accounted for either at cost or using the equity method.

### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires that management make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates and assumptions.

Significant estimates include, but are not limited to, accounts receivable allowances, third-party payer receivables and payables, useful lives assigned to capital assets, professional liability and other self-insurance accruals, and pension and other post-retirement plan assumptions.

In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates associated with these programs will change by a material amount in the near term.

### Costs of Borrowing

Deferred financing costs and bond discounts are amortized over the period related obligations are outstanding using the effective interest method. Palmetto Health follows Accounting Standards Update (ASU) 2015-03, which requires debt issuance costs to be treated as a direct deduction to the carrying amount of the related debt liability, consistent with debt discounts.

Interest costs incurred on borrowed funds during the period of construction of capital assets, net of investment earnings on related trusteed funds, are capitalized as a component of the cost of acquiring those assets when significant.

### Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

Palmetto Health maintains bank accounts at financial institutions which are insured from loss by the Federal Depository Insurance Corporation (FDIC). At June 30, 2017, $2,000 is subject to FDIC coverage, while the remaining $31,540 is in excess of the FDIC limit of $250 per institution. Management selects high-quality financial institutions for deposit maintenance and Palmetto Health has never experienced a loss in its FDIC-uninsured deposits.

### Other Receivables

Other receivables include amounts due to the Medicare and Medicaid programs for settlement of cost report filings and funding associated with the State of South Carolina disproportionate share program (the DSH program) (see Note 5). Palmetto Health recognizes revenue monthly based on the provisions of the DSH program, which follows the state fiscal year of July 1 through June 30. Therefore, included in other receivables is an accrual for the estimated funds earned from the program that have not yet been collected during the periods reported.

### Inventories

Inventories, consisting principally of medical supplies and pharmaceuticals, are determined using the first-in, first-out method and are stated at the lower of cost or market.

### Assets Limited as to Use

Assets limited as to use include assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors, primarily for future capital improvements, over which the Board retains control and may, at its discretion, use for other purposes. Amounts required to meet associated current liabilities have been classified as current assets.

Assets limited as to use are comprised of cash and investments. Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value in the accompanying consolidated balance sheets. Interest and dividend income and realized gains and losses are reported as nonoperating gains or losses in the accompanying consolidated statements of operations, except for investment income on funds held by trustee, which is included in other revenue. Investment income and realized gains or losses on investments of donor-restricted funds are also included in other revenue unless the income or loss is restricted by donors, in which case the investment income is recorded directly to temporarily or permanently restricted net assets in accordance with donor wishes.

Palmetto Health has designated and reported its entire investment portfolio as a trading portfolio – as defined by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320, "Investments – Debt and Equity Securities." All changes in unrealized gains and losses on investments are included within revenue and gains greater (less) than expenses and losses ("the performance indicator").

**Property and Equipment**

Palmetto Health capitalizes property and equipment with a cost of over $2.5 and an estimated life of two years or more. All property and equipment transferred from Richland and Baptist, either by long-term lease in the case of real property or by conveyance of title in the case of personal property, has been recorded at the historical book values of Richland and Baptist. Although the title to the real property noted above has been retained by Richland and Baptist, the operating rights of the real property and improvements thereon have been conveyed to Palmetto Health. In addition, under the leases of real property, improvements on or to leased real property are covered under the lease. Real property under the leases cannot be sold without the prior consent of Richland and Baptist.

Property and equipment acquired in the Tuomey transaction are recognized using current best estimates of fair value of those long-term assets (see Note 20).

Remaining property and equipment is stated at cost or, if donated, at fair value at time of donation. Additions and improvements are capitalized and depreciated over the estimated remaining useful lives of the related assets, primarily using the straight-line method.

A summary of estimated useful lives follows:

| | |
|---|---|
| Buildings and improvements | 5 to 40 years |
| Land improvements | 3 to 8 years |
| Equipment and furniture | 2 to 20 years |

**Other Noncurrent Liabilities**

Other noncurrent liabilities include the fair value of derivatives in a liability position with maturities due in more than one year (see Note 12), deferred revenue, certain compensation accruals, pension and postretirement obligations (Notes 15-17) and professional and general liability accruals (see Note 14). Deferred revenue represents third-party payer reimbursement received but unearned as of the consolidated balance sheet date.

### Donor-restricted Gifts

Unconditional promises to give cash and other assets are reported at estimated fair value at the date the promise is received. Conditional promises to give are recognized when the conditions are substantially met, and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restrictions. To the extent that restricted resources from multiple donors are available for the same purpose, Palmetto Health expends such gifts on a first-in, first-out basis.

### Operating (Loss) Income

The following items are excluded from operating (loss) income: nonoperating income (expense), net change in unrealized gain (loss) on derivative financial instruments, and net change in unrealized gain (loss) on trading investments. Nonoperating income (expenses) includes net investment income and the Certificate of Public Advantage (COPA) commitment. The change in unrestricted net assets includes increase (decrease) in interest in Affiliated Foundations, contributions received and expended for capital purposes, excess of net assets acquired over consideration transferred in the Tuomey transaction (see Note 20), contributions to Affiliated Foundations, and net adjustment for defined benefit plans.

### Revenue and Gains Greater (Less) Than Expenses and Losses

Changes in unrestricted net assets are excluded from the performance indicator consistent with relevant accounting principles and industry practice (see Operating (Loss) Income above for description of items excluded from the performance indicator).

### Unrestricted Revenue, Gains and Other Support

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Other revenue includes certain capitated arrangements (of which none of the related contracts are projected to be in a loss position), contributions from donors, grants, rental income, rebates, equity investee income, Baptist Easley Hospital (BEH) service contract revenue (see Notes 8 and 18), and certain investment income and other miscellaneous income.

### Charity Care

Palmetto Health provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than its established rates. Charity care is provided primarily to residents of Palmetto Health's primary service area (Richland, Lexington, Fairfield and Sumter counties) who meet asset limits and have income less than 100% of the Federal Poverty Guidelines. Because Palmetto Health does not pursue the collection of amounts determined to qualify as charity care, such amounts are not reported as net patient service revenue. Palmetto Health determines its estimated costs of providing charity care based on a calculation that applies the ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on Palmetto Health's total operating expenses (less bad debt expense) divided by gross patient service charges.

Palmetto Health maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policies.

### Income Taxes

Palmetto Health qualifies as an organization exempt from federal and state income taxes on related income under Internal Revenue Code Section 501(c)(3). Palmetto Health has two taxable subsidiaries, Healthsource, Inc. and PPM. As of September 30, 2016, Palmetto Health has determined that it does not have any material unrecognized tax benefits or obligations nor is income tax accounting significant with respect to taxable subsidiaries.

### Derivative Instruments

Palmetto Health strategically enters into interest rate protection agreements to mitigate changes in interest rates on variable rate borrowings. The notional amounts of such agreements are used to measure the interest to be paid or received and do not represent the amount of exposure to loss. None of these agreements are used for speculative or trading purposes.

Palmetto Health recognizes all derivatives as either assets or liabilities in the consolidated balance sheets and measures those instruments at their fair value.

None of Palmetto Health's derivative instruments are designated as hedging instruments, and therefore net unrealized gains and losses arising from related fair value changes are included in the performance indicator.

All of Palmetto Health's derivative instruments involve elements of credit and market risk. The counterparty to the financial instruments is a major financial institution, which was rated BBB+ by Standard & Poor's and Baa1 by Moody's Investors Service as of June 30, 2017. Palmetto Health monitors its positions with and the credit quality of the counterparty to these financial instruments. Palmetto Health does not anticipate nonperformance by the counterparty.

### Impairment of Long-lived Assets

Long-lived assets, such as property and equipment, identifiable intangibles and goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent the carrying amount of the asset exceeds the fair value of the asset. If applicable, assets to be disposed of are separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale are presented separately in the appropriate asset and liability sections of the consolidated balance sheets. Based on management's assessments, none of Palmetto Health's long-lived assets were impaired at either June 30, 2017 or September 30, 2016.

### Commitments and Contingencies

Liabilities for loss contingencies, including costs arising from claims, assessments, litigation, fines and penalties and other sources, are recorded when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

### Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Palmetto Health has been limited by donors to a specific time period or purpose. Permanently restricted net assets, generally representing specified endowments, have been restricted by donors to be maintained by Palmetto Health in perpetuity. Temporarily restricted net assets are generally available to fund designated capital expenditures and specific health care programs of Palmetto Health, which include the Children's Hospital, Cancer Programs, Hospice and Camp Kemo.

### Asset Retirement Obligations

The fair value of a liability for legal obligations associated with asset retirements is recorded in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the cost of the asset retirement obligation is capitalized by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statement of operations. Such liabilities are not significant to the consolidated financial statements at either June 30, 2017 or September 30, 2016 (Note 10).

### Fair Value of Financial Instruments

The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents, patient accounts receivable, other receivables, other current assets, accounts payable, accrued salaries and benefits, and other current liabilities, approximate fair value due to the relatively short maturity of the respective instruments or because there is no ready market for such instruments.

**Functional Expenses**

Palmetto Health does not present expense information by functional classification because its resources and activities are primarily related to providing health care services. Further, since Palmetto Health receives substantially all of its resources from providing health care services in a manner similar to a business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

**Recently Issued Accounting Standards**

ASU 2016-14 was recently issued to improve the presentation of financial statements of not-for-profit entities. This is the first major change to the nonprofit financial statement model in over 20 years, which is intended to provide more useful information to donors, grantors and other users. The standard addresses key qualitative and quantitative matters including net asset classes, investment return, expenses, liquidity and availability of resources, and presentation of operating cash flows. The amendments in ASU 2016-14 are effective for annual financial statements issued for fiscal years beginning after December 15, 2017. Early adoption is permitted. Entities presenting comparative financial statements must apply the amendments retrospectively, although certain optional practical expedients are available for periods prior to adoption. Palmetto Health has not determined any impacts on the consolidated financial statements that might result from application of this new standard.

ASU 2016-02 will require the inclusion of lease obligations, both financing and operating, on the balance sheets of companies and other organizations subject to the standard. The FASB decided that for private conduit municipal debt issuers (a definition that includes Palmetto Health), the standard will be effective for annual periods beginning after December 15, 2018. Early adoption will be permitted for all companies and organizations upon issuance of the standard. Palmetto Health has not determined any impacts on the consolidated financial statements that might result from application of this new standard.

ASU 2015-14 defers the effective date of Update 2014-09 for all entities by one year. ASU 2014-9 provides a five-step analysis of transactions to determine when and how revenue is recognized that consists of: i) identify the contract with the customer; ii) identify the performance obligations in the contract; iii) determine the transaction price; iv) allocate the transaction price to the performance obligations, and v) recognize revenue when or as each performance obligation is satisfied. The changes are intended to increase comparability, as well as simplify preparation of financial statements and provide more useful information to users through improved disclosures. The standard is effective for annual reporting periods beginning after December 15, 2017. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016. Palmetto Health has not determined any impacts on the consolidated financial statements that might result from application of this new standard.

ASU 2014-15 sets forth management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. These amendments are intended to reduce diversity in the timing and content of footnote disclosures. The standard is effective for the annual period ending after December 15, 2016 with early application permitted. Palmetto Health adopted the standard as required, with no effect on results of operations, cash flows or financial position as a result of such guidance.

## Note 2 - Joint Operating Agreement and COPA

The State of South Carolina issued a COPA in connection with the Joint Operating Agreement arising from Palmetto Health's formation. Among other conditions, the COPA requires Palmetto Health to:

- Provide an annual report to the South Carolina Department of Health and Environmental Control (DHEC).
- Generally provide 10% of revenue and gains greater than expenses and losses to fund public health initiatives and community outreach programs. These terms will be re-evaluated should revenue and gains greater than expenses and losses as a percent of gross revenue escalate or decline to a point where Palmetto Health's commitment to public health and other community benefits becomes unbalanced as it relates to Palmetto Health's profitability or to a point where there is little or no commitment.
- Report on the nature, sources and amount of operational savings and capital cost reductions from avoided capital expenditures.
- Provide a single level of care to patients without regard to ability to pay and continue to provide indigent/charity care.
- Provide patients with access to competing facilities for those services not offered by Palmetto Health facilities.
- Maintain mission statements that are substantially similar to those of Baptist and Richland.

Unexpended funds totaling $3,337 and $6,662 at June 30, 2017 and September 30, 2016, respectively, were included in other current liabilities in the accompanying consolidated balance sheets pending expenditure in accordance with COPA requirements. Compliance with COPA restrictions is the responsibility of Palmetto Health management and is subject to monitoring by DHEC. At June 30, 2017 and September 30, 2016, respectively, Board designated funds of $8,239 and $8,735 were set aside by Palmetto Health in a separate bank account equal to accrued but unexpended funds disclosed above plus an estimate of one year's future COPA obligation.

## Note 3 - Net Patient Service Revenue and Patient Accounts Receivable

Palmetto Health has agreements with third-party payers that provide for payments to Palmetto Health at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

### Medicare

Inpatient acute care and most outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic and other factors. Inpatient nonacute services, certain outpatient services, and certain defined capital and medical education costs related to Medicare beneficiaries are paid based on formula/cost reimbursement methodologies. Additionally, Medicare program reimbursement is increasingly subject to adjustment for Palmetto Health's demonstrated delivery of defined "value" across multiple domains, including experience related to certain readmissions and hospital-acquired conditions. While Palmetto Health's historical performance in this area has not subjected Palmetto Health to extraordinary penalties, it is the current intent of the Medicare program to require that future reimbursement be increasingly subject to potential penalties or other payment model change associated with delivery of value to the program, the impact of which on the consolidated financial statements is not currently determinable.

Palmetto Health is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after the submission of annual cost reports by Palmetto Health and audits thereof by the Medicare fiscal intermediary. The Medicare cost reports of Palmetto Health have been audited and final settled by the Medicare fiscal intermediary through the fiscal years ended September 30, 2011 for Palmetto Health Tuomey, through September 30, 2012 for Richland and through September 30, 2013 for Baptist. No final settlements have yet occurred for Parkridge Hospital. Net revenue from the Medicare program approximated 28% and 26% of Palmetto Health's net patient service revenue for the nine months ended June 30, 2017 and 2016.

### Medicaid

Inpatient services rendered to Medicaid program beneficiaries through September 30, 2012 were reimbursed on an interim basis at either a prospectively determined rate per discharge or specific rate for each inpatient day and then final settled at cost, while outpatient services were reimbursed on a fee schedule and then final settled at cost. For the fiscal year ended September 30, 2013 and forward all Medicaid services are reimbursed on a prospective basis. The Medicaid cost reports of Palmetto Health have been audited and final settled by Medicaid through the fiscal year ending September 30, 2011. Net revenue from the Medicaid program approximated 18% of Palmetto Health's net patient service revenue for both the nine months ended June 30, 2017 and 2016, respectively.

*(dollars in thousands)*

State Medicaid funding (and especially DSH program funding) is a vital source of revenue for Palmetto Health. Palmetto Health recognized net revenue from its participation in the DSH program totaling approximately $19,120 and $17,519 for the nine months ended June 30, 2017 and 2016, respectively. There can be no assurance that Palmetto Health will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified. Any material reduction in such funding would have a correspondingly material adverse effect on Palmetto Health's financial position and results of operations.DSH program payments are subject to audit and a final settlement process. The South Carolina Department of Health and Human Services (SCDHHS) has selected the option to redistribute all DSH program funds for fiscal year 2012 and forward to/from all hospitals based on final audit findings. Audit results and redistribution by facility for fiscal year 2012 were communicated by SCDHHS to each facility during 2016. Included in the fiscal 2016 DSH reimbursement of $6,606 disclosed above is $4,157 of incremental DSH funds arising from the 2012 redistribution. Without the receipt of final audit results of all hospitals in the state by SCDHHS for each particular year and the related calculation of facility-specific redistribution, Palmetto Health was unable to predict settlements at September 30, 2016 for any years subsequent to fiscal 2012. Recognition of DSH program audit results in the period of notification of such findings and anticipated settlements from SCDHHS may result in significant impacts to net patient service revenue in the year of recognition. As of June 30, 2017 audits have been filed and accepted through fiscal 2014, and as such, Palmetto Health estimated settlements for subsequent years.

**Other**

Palmetto Health has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, Medicaid managed care organizations and preferred provider organizations. The basis for payment to Palmetto Health under these agreements is primarily prospectively determined rates per discharge and prospectively determined daily rates.

During the nine months ended June 30, 2017 and 2016, Palmetto Health recognized changes in the prior year third party settlement estimates that resulted in an increase of approximately $20,400 and $3,596 in net patient service revenues, respectively. Such change for the three months ended June 30, 2017 and 2016 was $12,977 and $2,700, respectively.

Net patient service revenue is comprised of the following:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | **June 30, 2017** | **June 30, 2016** | **June 30, 2017** | **June 30, 2016** |
| Revenue at established charges | $ 1,430,685 | $ 1,394,083 | $ 4,290,835 | $ 3,960,634 |
| Contractual adjustments | (904,092) | (883,065) | (2,703,410) | (2,505,326) |
| Charity care | (54,803) | (58,320) | (164,546) | (160,521) |
| Disproportionate share funding (also see Note 5) | 6,152 | 6,567 | 19,120 | 17,519 |
| Net patient service revenue | $ 477,942 | $ 459,265 | $ 1,441,999 | $ 1,312,306 |

*(dollars in thousands)*

The estimated cost for Palmetto Health of providing charity services was $16,529 and $15,594 for the three months ended June 30, 2017 and 2016, respectively, and $48,962 and $45,584 for the nine months ended June 30, 2017 and 2016, respectively.

The following table summarizes Palmetto Health's net patient service revenue by payer source:

| | June 30, 2017 | June 30, 2016 |
|---|---|---|
| Medicare | 28% | 26% |
| Medicaid | 18% | 18% |
| Commercial/managed care/other third-party payers | 48% | 50% |
| Self-pay | 3% | 3% |
| All other | 3% | 3% |
| | 100% | 100% |

Palmetto Health grants credit to its patients, most of whom are local residents. Palmetto Health generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, preferred provider arrangements and commercial insurance policies). The mix of net receivables from patients and third-party payers follows:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Medicare | 25% | 28% |
| Medicaid | 16% | 19% |
| Commercial/managed care/other third-party payors | 55% | 48% |
| Self-pay | 4% | 5% |
| | 100% | 100% |

*(dollars in thousands)*

The composition of patient accounts receivable follows:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Accounts receivable | $ 601,906 | $ 654,232 |
| Less – Allowance for uncollectible accounts | (299,496) | (342,201) |
| Patient accounts receivable, net | $ 302,410 | $ 312,031 |

In evaluating the collectability of accounts receivable, Palmetto Health analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowances and provisions for uncollectible accounts, as well as performing a detail review of high dollar accounts on a case by case basis. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts.

For receivables associated with services provided to patients who have third-party coverage, Palmetto Health analyzes contractually due amounts and provides both an allowance and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments which remain unpaid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for a portion of the services provided), Palmetto Health records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients do not pay the portion of their bills for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged against the allowance for uncollectible accounts.

Palmetto Health's allowance for uncollectible accounts for self-pay patients was 83.8% and 91.5% of self-pay accounts receivable at June 30, 2017 and September 30, 2016, respectively. Palmetto Health's charity care and uninsured discount policies align with requirements of the Affordable Care Act. Charity is limited primarily to patients whose income and resources are less than 100% of Federal Poverty Guidelines, live in Palmetto Health's primary service area (Richland, Lexington or Fairfield counties), and who are not eligible for any other coverage including that offered through the Health Insurance Marketplace. Self -pay patients not eligible for charity care are provided a 20% discount from gross charges. Effective January 1, 2016, Palmetto expanded its primary service area to include Sumter County as a result of the formation of Palmetto Health Tuomey. Palmetto Health does not maintain a material allowance for uncollectible accounts from third-party payers, nor has it generally incurred significant write-offs from third-party payers.

*(dollars in thousands)*

## Note 4 - Other Revenue

Other revenue includes a capitated arrangement for Palmetto Senior Care, whereby member premiums received are based on a per-member, per-month basis, regardless of the related utilization. Revenue recorded in connection with this arrangement was $5,003 and $4,476 for the three months ended June 30, 2017 and 2016, respectively, and $13,905 and $13,627 for the nine months ended June 30, 2017 and 2016, respectively.

## Note 5 - Other Receivables

Components of other receivables follow:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Residents FICA refund receivable | $ - | $ 5,061 |
| Settlement amounts due from third-party payers | 5,836 | 2,641 |
| Flood claim receivable | - | 2,800 |
| Amounts due from the DSH program | 18,058 | - |
| Amounts due from graduate medical education arrangements | 951 | 606 |
| Interest receivable | 871 | 893 |
| Grant receivables | 792 | 1,344 |
| Due from USC SOM Educational Trust | 2,273 | - |
| Due from BEH (see Note 18) | 1,158 | 1,514 |
| Other | 14,040 | 11,788 |
| | $ 43,979 | $ 26,647 |

In August 2014, Palmetto Health filed a civil action against the United States of America seeking recovery of FICA taxes erroneously paid by Palmetto Heath for the taxable years 1996, 1998, 1999 and 2000. The suit sought refunds for contributions made on behalf of medical residents who had furnished consents. In September 2016, Palmetto Health and the government reached a final settlement on the matter of $2,384 plus interest. In November 2016 Palmetto Health received $5,061 payment for the principal and interest, which is included in current receivables at September 30, 2016. Palmetto Health had recorded $3,544 in current liabilities (see Note 10) for the portion of the settlement due to the medical residents as of September 30, 2016. Palmetto Health issued related checks to the medical residents to satisfy the liability in the nine months ended June 30, 2017.

During October 2015, a historic flood event impacted Palmetto Health's primary service area. While Palmetto Health's primary operating facilities were not materially damaged, provision of certain services was interrupted due to damage to community infrastructure. Palmetto Health resumed normal operations within ten days of this event. Palmetto Health carries substantial business interruption and physical damage insurance for such events. Palmetto Health recorded $9,800 in insurance recoveries within other revenue for the year ended September 30, 2016, of which $7,000 was received during fiscal 2016. The remaining $2,800 was recorded in other receivables as of September 30, 2016 and was received during the nine months ended June 30, 2017.

The due from USC SOM Educational Trust is in relation to the start-up of the PHUSCMG (see Note 23).

*(dollars in thousands)*

## Note 6 - Assets Limited as to Use

The composition of Palmetto Health's assets limited as to use follows:

**June 30, 2017**

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **By board primarily for capital improvements:** | | | | |
| U.S. Treasury and government agencies | $ 32,223 | $ - | $ (1,097) | $ 31,126 |
| Cash and short-term investments | 4,734 | - | - | 4,734 |
| Mutual funds | 392,997 | 43,343 | (4,092) | 432,248 |
| Common stocks and options | 26,240 | 8,971 | (1,305) | 33,906 |
| Corporate bonds, mortgage and asset-backed securities, and other | 136,835 | 3,893 | (6,815) | 133,913 |
| Alternative investments | 75,862 | 20,596 | - | 96,458 |
| | 668,891 | 76,803 | (13,309) | 732,385 |
| **By trustee primarily under indenture and collateral agreements:** | | | | |
| U.S. Treasury and government agencies | 49,053 | 394 | - | 49,447 |
| Cash and short-term investment | 47,771 | 30 | - | 47,801 |
| Corporate bonds, mortgage and asset-backed securities, and other | 16,041 | - | (34) | 16,007 |
| | 112,865 | 424 | (34) | 113,255 |
| | $ 781,756 | $ 77,227 | $ (13,343) | $ 845,640 |

**September 30, 2016**

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **By board primarily for capital improvements:** | | | | |
| U.S. Treasury and government agencies | $ 24,783 | $ 332 | $ (1,083) | $ 24,032 |
| Cash and short-term investments | 8,838 | - | - | 8,838 |
| Mutual funds | 360,801 | 22,705 | (6,027) | 377,479 |
| Common stocks and options | 48,394 | 9,810 | (2,105) | 56,099 |
| Corporate bonds, mortgage and asset-backed securities, and other | 143,488 | 3,953 | (5,454) | 141,987 |
| Alternative investments | 75,843 | 15,799 | - | 91,642 |
| | 662,147 | 52,599 | (14,669) | 700,077 |
| **By trustee primarily under indenture and collateral agreements:** | | | | |
| U.S. Treasury and government agencies | 57,430 | 1,031 | - | 58,461 |
| Cash and short-term investment | 39,465 | 25 | - | 39,490 |
| Corporate bonds, mortgage and asset-backed securities, and other | 30,199 | - | (85) | 30,114 |
| | 127,094 | 1,056 | (85) | 128,065 |
| | $ 789,241 | $ 53,655 | $ (14,754) | $ 828,142 |

*(dollars in thousands)*

The composition of net investment income is as follows:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | June 30, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 |
| **In other revenue – Interest income** | $ 135 | $ 28 | $ 229 | $ 70 |
| **In nonoperating gains and losses:** | | | | |
| Interest and dividend income | $ 3,665 | $ 2,706 | $ 13,210 | $ 16,185 |
| Realized gains (losses), net | 6,587 | 3,216 | 7,179 | 3,844 |
| Gain (loss) on nonoperating equity investees (See Note 8) | (387) | - | (1,295) | - |
| | $ 9,865 | $ 5,922 | $ 19,094 | $ 20,029 |

## Note 7 - Property and Equipment

The components of property and equipment are as follows:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Land and improvements | $ 65,730 | $ 65,239 |
| Buildings and improvements | 774,416 | 760,652 |
| Equipment and furniture | 856,462 | 820,732 |
| | 1,696,608 | 1,646,623 |
| Accumulated depreciation | (1,049,997) | (990,189) |
| Construction-in-progress | 29,610 | 26,503 |
| Property and equipment, net | $ 676,221 | $ 682,937 |

Depreciation expense was $19,868 and $19,786 for the three months ended June 30, 2017 and 2016, respectively, and $60,344 and $56,691 for the nine months ended June 30, 2017 and 2016, respectively.

At June 30, 2017, Palmetto Health had committed to expend an additional $32,865 for the construction of various projects and purchase of other miscellaneous equipment over the next several years.

*(dollars in thousands)*

## Note 8 - Other Assets

The components of other assets follow:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Interest in net assets of Affiliated Foundations (Note 18) | $ 51,031 | $ 45,490 |
| Cash surrender value, prepaids, deposits and other receivables | 28,729 | 28,343 |
| Notes receivable, net | 2,806 | 1,413 |
| Investment in affiliates | 33,127 | 26,198 |
| Other | 2,236 | 3,556 |
| | 117,929 | 105,000 |
| Less – Current portion | (21,146) | (20,218) |
| Other assets, noncurrent | $ 96,783 | $ 84,782 |

The following investments in affiliates are reported using the equity method of accounting:

| Name of Investee | Ownership Percentage | June 30, 2017 | September 30, 2016 |
|---|---|---|---|
| BEH | 50.00% | $ 24,450 | $ 24,079 |
| Carolina Home Therapeutics | 49.00% | 1,412 | 548 |
| CCI | 50.00% | 4,881 | - |
| Hospital Services, Inc. | 26.47% | 1,053 | 1,006 |
| Initiant | 20.00% | - | - |
| Radiation Oncology, LLC | 51.00% | 1,331 | 565 |
| | | $ 33,127 | $ 26,198 |

Palmetto Health's invested $5,250 during the nine months ended June 30, 2017, in CCI, a joint venture between Palmetto Health and Strategic Coordinating Organization (an affiliate of Greenville Health System) to support clinical integration and population health. Each member appoints an equal number of representatives on the Board. Palmetto Health accounts for its investment in CCI under the equity method of accounting and is included in nonoperating gains (losses), as they are not Palmetto Health's primary business purpose (See Note 6).

BEH operates as a nonprofit entity consisting of two equal members: Palmetto Health and GHC. The Board is appointed equally by Palmetto Health and Greenville Health Corporation (GHC) or an affiliate of GHC. Palmetto Health accounts for its investment in BEH under the equity method of accounting. See Note 18 for further discussion on services rendered to BEH by Palmetto Health.

Palmetto Health does not control any of the above affiliate organizations.

*(dollars in thousands)*

A summary of combined unaudited financial information of the above-mentioned affiliates as of and for the nine months ended June 30, 2017 and 2016 follows:

| | June 30, 2017 | June 30, 2016 |
|---|---|---|
| Revenues | $ 104,423 | $ 98,061 |
| Net (loss) income | (302) | 4,499 |
| Assets | 98,165 | 90,730 |
| Equity | 59,628 | 60,359 |

## Note 9 - Operating Leases

Palmetto Health leases certain business space and equipment under non-cancelable operating leases. Rental expense totaled approximately $6,985 and $7,483 for the three months ended June 30, 2017 and 2016, respectively, and $22,317 and $22,076 for the nine months ended June 30, 2017 and 2016, respectively. Future minimum rental payments, reduced by minimum sublease rentals, required under non-cancelable leases that have remaining lease terms in excess of one year as of June 30, 2017, follow:

| | |
|---|---|
| For the year ended: | |
| 2017 (remaining 3 months) | $ 5,233 |
| 2018 | 18,285 |
| 2019 | 13,312 |
| 2020 | 11,770 |
| 2021 | 10,512 |
| Thereafter | 55,834 |
| | $ 114,946 |

*(dollars in thousands)*

## Note 10 - Other Liabilities

The composition of other liabilities follows:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Fair value of derivatives (see Note 12) | $ 62,617 | $ 90,523 |
| Accrued medical malpractice losses (see Note 14) | 14,711 | 16,488 |
| Workers compensation liability (see Note 14) | 6,228 | 5,537 |
| Deferred compensation liability (see Note 15) | 3,925 | 3,727 |
| Post-retirement benefit obligations (see Note 16) | 8,353 | 9,051 |
| Pension retirement benefit obligation (see Note 17) | 34,311 | 34,975 |
| Funds restricted for COPA (see Note 2) | 3,337 | 6,662 |
| Accrued interest | 12,499 | 5,116 |
| Resident FICA refund liability (see Note 5) | - | 3,544 |
| Health Insurance Exchange collaborative liability | 4,667 | 3,000 |
| Settlement amounts due to third parties | - | 3,082 |
| Asset retirement obligation | 1,140 | 1,142 |
| Other | 2,030 | 2,097 |
| | 153,818 | 184,944 |
| Less – Current portion | (32,460) | (34,511) |
| Other liabilities, noncurrent | $ 121,358 | $ 150,433 |

In 2016 Palmetto Health entered a multi-year agreement with a third-party insurer to create a joint product offering for Health Insurance Exchange ("HIX") participants in Palmetto Health's defined service area. The objective of the agreement is to create an arrangement that reduces overall health care cost through more effective clinical activities, including case management and care coordination protocols, while improving the quality of outcomes to the subject HIX members. Palmetto Health recorded $1,667 during the nine months ended June 30, 2017 related to this liability for its estimated share of losses. The 2016-2017 contract is limited to a $4,000 for the twelve months ended December 31, 2016 and is fully recorded as part of the liability disclosed above. It is well-publicized that HIX losses are emerging for participating health plans, so Palmetto Health's intent is to support the important need for a HIX product in Palmetto Health' defined service area. Payments under the contract, if required, would be associated with Palmetto Health's 50% sharing of defined loss experience under the contract, if such emerges.

*(dollars in thousands)*

## Note 11 - Long-term Debt

Long-term debt of Palmetto Health consists of the following:

| Bonds payable: | June 30, 2017 | September 30, 2016 |
|---|---|---|
| 2016 Series current interest paying bonds, payable annually beginning in 2036 and maturing on various dates through August 1, 2042 in varying amounts, with an optional call on August 1, 2022 and mandatory tender on August 1, 2031, and with interest at 3.7% due semi-annually | $ 120,000 | $ 120,000 |
| 2014 Series current interest paying serial bonds, payable annually beginning in 2023 and maturing on various dates through August 1, 2032 in varying amounts, with a mandatory tender on December 1, 2020, and with monthly interest at 67% of LIBOR plus 0.95% (1.65% as of June 30, 2017 and 1.30% at September 30, 2016) | 18,085 | 18,085 |
| 2013 Series current interest paying serial bonds, payable annually and maturing on various dates through August 1, 2030, in varying amounts with interest due semi-annually with rates ranging from 2.50% to 5.25% | 113,130 | 113,130 |
| 2011 Series current interest paying serial bonds, payable annually and maturing on various dates through August 1, 2039, in varying amounts with interest rates ranging from 3.00% to 6.50% | 82,055 | 82,055 |
| 2010 Series A current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 67% of one month LIBOR plus 0.95% (1.65% at June 30, 2017 and 1.30% at September 30, 2016) | 61,778 | 63,288 |
| 2010 Series B current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 68% of one month LIBOR plus 0.75% (1.46% at June 30, 2017 and 1.11% at September 30, 2016) | 43,470 | 44,535 |
| 2010 Series C current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 67% of one month LIBOR plus 0.95% (1.65% at June 30, 2017 and 1.30% at September 30, 2016) | 9,150 | 9,375 |
| 2010 Series D current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 68% of one month LIBOR plus 0.75% (1.46% at June 30, 2017 and 1.11% at September 30, 2016) | 84,020 | 86,085 |
| 2009 Series current interest paying serial bonds, payable annually and maturing on various dates through August 1, 2039, in varying amounts with interest rates ranging from 3.00% to 5.90% | 89,010 | 89,010 |
| 2005 Series A current interest paying bonds, payable annually and maturing on August 1, 2035, in varying amounts with interest rates ranging from 3.25% to 5.00% | 184,775 | 184,775 |
| Less – Unamortized premiums, discounts and issuance costs | (12,214) | (12,782) |
| Total bonds payable | 793,259 | 797,556 |
| Less – Current portion | (17,196) | (17,016) |
| | $ 776,063 | $ 780,540 |

The accompanying notes are integral to these consolidated financial statements.

*(dollars in thousands)*

**Future maturities of long-term debt follow:**

| | Maturities | Net Amortization of Premiums, Discounts and Issuance Costs | Payments |
|---|---|---|---|
| 2017 (3 months remaining) | $ 12,720 | $ 185 | $ 12,905 |
| 2018 | 17,859 | 736 | 18,595 |
| 2019 | 18,802 | 688 | 19,490 |
| 2020 | 19,718 | 647 | 20,365 |
| 2021 | 20,733 | 632 | 21,365 |
| Thereafter | 703,427 | 9,326 | 712,753 |
| | $ 793,259 | $ 12,214 | $ 805,473 |

The estimated fair value of Palmetto Health's long-term debt as of June 30, 2017 and September 30, 2016 was approximately $836,794 and $864,062, respectively. Fair values are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

In April 2016, Palmetto Health issued the 2016 Series A bonds for $120,000, while simultaneously entering into a total return swap for the same amount (see Note 12). The bonds were issued to (i) refinance the $90,000 taxable bridge financing that Palmetto Health utilized in December 2015 in anticipation of the January 1, 2016 Tuomey transaction (see Note 20), (ii) finance capital additions and improvements to Palmetto Health's existing hospital facilities, and (iii) pay certain expenses incurred in connection with the issuance of the 2016 Series A bonds.

The $90,000 taxable bridge financing mentioned above was a line of credit from a bank. The line of credit requires collateralization that can take the form of cash held in safekeeping by a third-party bank or by liens on certain types of investments owned by Palmetto Health. As of September 30, 2016, there was no outstanding balance on the line of credit. After the refinancing transaction described above, Palmetto Health maintained the line of credit but reduced the available line from $90,000 to $30,000.

In December 2014, Palmetto Health issued the 2014 Series bonds for $18,085. The bonds were issued to refinance the same amount of 2009 bonds that Palmetto Health purchased in August 2014 pursuant to call in accordance with their terms.

Palmetto Health's historical bond transaction activity is generally consistent with capital financing strategies and related capital requirements evidenced by most larger not-for-profit U.S. health systems. The bonds described above were all issued under the August 1, 2003 Master Trust Indenture and related amendments and supplements issued thereafter ("the MTI"). Per the MTI definitions, Palmetto Health is the sole member of the defined Obligated Group.

Borrowings under the MTI are subject to certain financial covenants, restrictions on indebtedness, financial guarantees, and business combinations, and other terms which are usual and customary for such agreements.

Palmetto Health's bonds payable are collateralized by the Obligated Group's pledged assets and all revenues, receipts and income derived in connection with the ownership and operation of the Obligated Group's property and equipment.

## Note 12 - Derivative Financial Instruments

Palmetto Health has entered into interest rate swap agreements, some of which contain interest rate caps and call features. These instruments, which are not designated as accounting hedges, have notional amounts tied to bond issuance principal balances.

Palmetto Health is required to provide collateralization for the excess of the fair value of swaps above thresholds set per agreements. The collateralization can take the form of cash held in safekeeping by a third-party bank or by liens on investments in treasuries or government sponsored entities owned by Palmetto Health. As of June 30, 2017 and 2016, there was $43,961 and $62,702, respectively, set aside for such collateral, reported in assets limited as to use. The amount required changes on a weekly basis.

On November 19, 2015, Palmetto Health terminated its $144,000 notional basis swap while simultaneously modifying the effective date of its $142,000 notional fixed payer swap from April 1, 2016 to January 23, 2017.

On August 26, 2016, Palmetto Health terminated its $275,000 notional basis swap while simultaneously modifying the effective date of its $142,000 notional fixed payer swap from January 23, 2017 to February 20, 2020.

On April 28, 2016, Palmetto Health entered into a $120,000 notional total return swap in connection with the 2016 bond issuance. A total return swap is an agreement in which one party makes payments based on a set rate, either fixed or variable, while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains. The underlying asset in Palmetto Health's total return swap is the 2016 Series A bonds.

The $62,617 and $90,523 net fair value of all the derivative instruments at June 30, 2017 and September 30, 2016 is recorded in other liabilities (see Note 10) in the accompanying consolidated financial statements.

*(dollars in thousands)*

The following is a summary of the fair value of the instruments outstanding, excluding any net settlement differential receivable/payable, at June 30, 2017 and September 30, 2016:

**At June 30, 2017**

| Type | Notional Amount | Effective Date | Maturity Date | Rate Paid | Rate Received | Increase (decrease) in Interest Expense | Swap Fair Value Liability |
|---|---|---|---|---|---|---|---|
| Fixed payor | $ 43,675 | 8/1/13 | 7/26/35 | 3.540% | 1.072% | $ 920 | $ (8,377) |
| Total return swap | 120,000 | 4/28/16 | 4/28/21 | 1.440% | 3.700% | (2,093) | (696) |
| Fixed payor | 4,325 | 4/1/16 | 12/1/43 | 3.725% | 1.072% | 95 | (9,057) |
| Fixed payor | 142,000 | 2/20/20 | 12/1/43 | 3.477% | 0.710% | - | (44,487) |
| Totals for derivative instruments | | | | | | $ (1,078) | $ (62,617) |

**At September 30, 2016**

| Type | Notional Amount | Effective Date | Maturity Date | Rate Paid | Rate Received | Increase (decrease) in Interest Expense | Swap Fair Value Liability |
|---|---|---|---|---|---|---|---|
| Basis swap* | $ 144,000 | 8/1/03 | 5/9/18 | 0.358% | 0.834% | $ 120 | $ - |
| Basis swap** | 275,000 | 9/9/05 | 9/12/30 | 0.170% | 0.500% | 1,263 | - |
| Fixed payor | 43,675 | 8/1/13 | 7/26/35 | 3.540% | 0.632% | (648) | (11,996) |
| Total return swap | 120,000 | 4/28/16 | 4/28/21 | 1.237% | 3.700% | 1,252 | (875) |
| Fixed payor | 4,325 | 4/1/16 | 12/1/43 | 3.725% | 0.633% | (57) | (13,275) |
| Fixed payor | 142,000 | 2/20/20 | 12/1/43 | 3.477% | 0.295% | - | (64,377) |
| Totals for derivative instruments | | | | | | $ 1,930 | $ (90,523) |

* Terminated this swap in November 2015 as discussed above.
** Terminated this swap in August 2016 as discussed above.

## Note 13 - Capital Lease Obligations

### Capital Lease Obligation to Richland County

Concurrent with the transfer of substantially all Richland net assets to Palmetto Health, the operating rights of associated real property and improvements thereon were also conveyed to Palmetto Health via lease. In exchange for an annual lease payment (including a fixed portion and other expenses assumed by Palmetto Health from Richland County), Richland County and Richland leased to Palmetto Health all of the real property recorded on the Richland property records as of the date Palmetto Health was formed. Real property includes all land, buildings and the building systems. The terms of the leases include a 35-year period with three five-year options, of which all three have been exercised. Upon completion of the 35-year original lease period at December 31, 2033, the remaining lease payments will be treated as an operating lease and such payments are therefore included in the operating lease disclosure in Note 9.

*(dollars in thousands)*

The lease payment to the County includes a fixed payment of $1,693 per year. The 35 years of annual payments of $1,693 have been discounted using a 5.5% interest rate to their present value and recorded as a capital lease obligation. In addition, Palmetto Health reimburses Richland County an amount from operations equal to the County's annual responsibility for the Medically Indigent Assistance Program (MIAP) as determined by the State of South Carolina.

### Capital Lease Obligations to Third Parties

Palmetto Health also has capital lease obligations with other third parties for equipment.

Maturities on the long-term capital lease obligations for the next five years and the aggregate are as follows:

| For the year ended: | Related Party | Third Parties | Total |
|---|---|---|---|
| 2017 (3 months remaining) | $ 845 | $ 50 | $ 895 |
| 2018 | 1,693 | 153 | 1,846 |
| 2019 | 1,693 | - | 1,693 |
| 2020 | 1,693 | - | 1,693 |
| 2021 | 1,693 | - | 1,693 |
| Thereafter | 20,317 | - | 20,317 |
| Total minimum payments | 27,934 | 203 | 28,137 |
| Amount representing interest | (9,657) | (2) | (9,659) |
| Obligations under capital leases | 18,277 | 201 | 18,478 |
| Obligations due within one year | (702) | (201) | (903) |
| Long-term obligations under capital leases | $ 17,575 | $ - | $ 17,575 |

Assets under capital lease are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation and amortization in the consolidated statements of operations.

The gross amounts of assets under capital lease and accumulated amortization at June 30, 2017 and September 30, 2016 are summarized as follows:

| | June 30, 2017 | | | September 30, 2016 | | |
|---|---|---|---|---|---|---|
| | Related Party | Third Parties | Total | Related Party | Third Parties | Total |
| Gross amount of assets under capital lease | $ 26,447 | $ 964 | $ 27,411 | $ 26,447 | $ 964 | $ 27,411 |
| Less: Accumulated amortization | (8,170) | (763) | (8,933) | (7,669) | (614) | (8,283) |
| | $ 18,277 | $ 201 | $ 18,478 | $ 18,778 | $ 350 | $ 19,128 |

## Note 14 - Insurance Coverage and Litigation

### Medical Malpractice Claims

Palmetto Health purchases professional medical liability insurance coverage for medical malpractice claims. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. Palmetto Health uses independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued malpractice losses totaling $14,711 and $16,488, discounted at 3%, are included in other liabilities as of June 30, 2017 and September 30, 2016, respectively, and, in management's opinion, provide an adequate reserve for related loss contingencies.

Palmetto Health's self-insured retention is funded through a multi-provider, cell-based captive insurance arrangement. Palmetto Health participates as a voting member of the captive, but does not control the related corporation. Premiums for primary, primary excess and contingent excess coverage amounted to $1,558 and $1,383 for the years ended September 30, 2016 and 2015, respectively. Palmetto Health has a per-claim self-insured retention of $600 for the years ended September 30, 2016 and 2015. The annual aggregate self-insured retention (based on potential multiple claims at the per-claim self-insured retention) was $10,000 for the year ended September 30, 2016 and was unlimited for the year ended September 30, 2015. Additionally, Palmetto Health is contingently liable for up to 100% of cumulative premiums incurred for primary coverage, or $39,686 at September 30, 2016 (the Potential Premium Assessment). As of June 30, 2017, management believes the likelihood of any Potential Premium Assessment is not probable; hence, no related amounts have been accrued at September 30, 2016. Palmetto Health has provided two letters of credit with commercial banks in a maximum amount of approximately $5,863 (expiring January 2018) and $409 (expiring July 2017) to secure a portion of the maximum obligation for the Potential Premium Assessment. Management anticipates an updated renewal of this facility under substantially the same terms and conditions at expiration.

### Workers' Compensation and Employee Health

Palmetto Health is self-insured for workers' compensation claims and has a stop-loss insurance policy for claims in excess of $750. Palmetto Health has provided a letter of credit with a commercial bank in a maximum amount of $3,850 (expiring October 2017) related to the self-insurance of workers' compensation. Palmetto Health has recorded estimated accruals in other current liabilities and other liabilities totaling $6,228 and $5,537, at June 30, 2017 and September 30, 2016, respectively, for the self-insurance portion of workers' compensation and maintains customary excess coverages with commercial insurers for exposures above self-insured retentions. Palmetto Health is also self-insured for its employee group health insurance. Palmetto Health has recorded estimated accruals related to health insurance in other accrued salaries and benefits totaling $6,228 and $6,402, at June 30, 2017 and 2016, respectively.

### Litigation

As a not-for-profit corporation, Palmetto Health is the beneficiary of certain liability caps established under South Carolina Charitable Immunity statutes. The laws of the State limit damage recoveries for medical services rendered by the facility or the facility's employees to $300 per claim with a maximum of $600 per occurrence, with liability caps for employed physicians at $1,200 per occurrence. From time to time, Palmetto Health is involved in litigation and regulatory investigations arising in the normal course of business. Based on consultation with legal counsel and given available insurance coverages and related accruals, management believes that these matters will be resolved without a material adverse effect on Palmetto Health's financial position or results of operations

## Note 15 - Retirement Plans

Palmetto Health Retirement Savings Plan (Savings Plan) is a defined contribution retirement plan. Employees are eligible to participate in the pretax salary reduction portion of the Savings Plan beginning with the first payroll after employment. Employees are eligible for the Palmetto Health match after the completion of 12 months of service in which the employee works 1,000 hours and after reaching the age of 21. Palmetto Health matches up to 140% of employee contributions up to 3.5% of the employee's eligible compensation. The ultimate level of this employer match is based on years of service. Benefits are vested 20% annually beginning with the second year of employment with employees becoming fully vested after six years. The Savings Plan credits all previous years of vesting service with Baptist and Richland from the date of hire.

With the formation of Palmetto Health, certain Richland employees remained Richland employees and Richland entered into an arrangement with Palmetto Health whereby those employees were then leased to Palmetto Health. Those employees continue to participate in the State of South Carolina Retirement System. The plan requires contributions by employers who elect or are required to participate in the plan. Richland has funded all contributions required by the plan. Information specific to the portion of the South Carolina Retirement System's assets and vested and non-vested benefits applicable to Richland employees is not available.

Palmetto Health expensed $3,105 and $3,723 related to the above retirement plans in three months ended June 30, 2017 and 2016, respectively, and $10,021 and $11,036 for the nine months ended June 30, 2017 and 2016, respectively.

Palmetto Health has an unfunded defined benefit supplemental executive retirement plan for certain members of senior management. The participants become eligible to receive benefit payments in the month coinciding with the later of their respective 62nd or 65th birthdays, dependent upon the participant, or 36 months of participation.

*(dollars in thousands)*

The changes in the associated benefit obligation follow as of and for the years ended September 30:

| | 2016 | 2015 |
|---|---|---|
| Benefit obligation at beginning of year | $ 5,865 | $ 5,347 |
| Service cost | 318 | 296 |
| Interest cost | 243 | 222 |
| Actuarial loss | 284 | - |
| Amendments | (2,983) | - |
| Total benefit obligation, end of year | $ 3,727 | $ 5,865 |
| Amounts recognized in unrestricted net assets consist of: | | |
| Unrecognized actuarial loss | $ (477) | $ (193) |
| Unrecognized prior service cost | 2,106 | (1,274) |
| | $ 1,629 | $ (1,467) |

The components of net periodic benefit cost and other pension accounting follow as of and for the years ended September 30:

| | 2016 | 2015 |
|---|---|---|
| Service cost | $ 318 | $ 296 |
| Interest cost | 243 | 222 |
| Amortization of prior service cost | 397 | 397 |
| Net periodic postretirement benefit cost | 958 | 915 |
| Adjustment to liability recognized in unrestricted net assets consist of: | | |
| Prior service cost | (397) | (397) |
| Total benefit cost and other charges recognized in unrestricted net assets | $ 561 | $ 518 |
| Amounts expected to be recognized in net periodic benefit costs in the following year: | | |
| Unrecognized actuarial loss | $ (586) | $ 397 |

The measurement dates were as of September 30 for both fiscal 2016 and fiscal 2015. The weighted average discount rates used to determine benefit obligations were 3.5% and 4.15% for the years ended September 30, 2016 and 2015, respectively. The rate of compensation increase used to determine benefit obligations at both September 30, 2016 and 2015 was 4.0%. Participants included in the valuation were three and five for September 30, 2016 and 2015, respectively.

*(dollars in thousands)*

In December 2015, Palmetto Health also entered into split-dollar life insurance arrangements with certain members of senior management. Under the agreements, Palmetto Health will receive all premiums paid, plus a fixed rate of return, and a portion of the death benefits at the mortality events of the participating members of senior management. Palmetto Health's interests are secured by the cash values of the life insurance policies. The participating members of senior management retain all other life insurance policy benefits. Palmetto Health recorded an asset of $7,215 and $7,205 in other assets as of June 30, 2017 and September 31, 2016, respectively, equal to the premiums paid plus accrued rate of return, subject to an adjustment for cash values of the life insurance policies and other associated assets (Note 8).

## Note 16 - Postretirement Benefits Plans

Palmetto Health currently provides defined unfunded health care and drug benefits for certain retired employees. Additionally, certain active employees are eligible for future benefits. Employees who retire with Palmetto Health on and after October 1, 2004, pay the full cost of retiree medical coverage. Palmetto Health has elected to record the unrecognized transition obligation as an operating expense on a prospective basis as part of the future annual benefit cost. The changes in the associated benefit obligation follow as of and for the years ended September 30:

| | 2016 | 2015 |
|---|---|---|
| Benefit obligation at beginning of year | $ 11,397 | $ 12,387 |
| Interest cost | 325 | 449 |
| Actuarial gain | (1,890) | (262) |
| Benefits paid | (1,197) | (1,177) |
| Total benefit obligation, end of year | $ 8,635 | $ 11,397 |
| Amounts recognized in the unrestricted net assets consist of: | | |
| Unrecognized actuarial loss (gain) | 1,540 | (134) |
| Unrecognized prior service credit | 271 | 322 |
| Unrecognized net transition obligation | (1,031) | (1,684) |
| | $ 780 | $ (1,496) |

*(dollars in thousands)*

The components of net periodic postretirement benefit cost and other related accounting follow as of and for the years ended September 30:

| | 2016 | 2015 |
|---|---|---|
| Interest cost on accumulated postretirement benefit obligation | $ 325 | $ 449 |
| Amortization of transition obligation | 653 | 653 |
| Amortization of unrecognized prior service cost | (51) | (51) |
| Amortization of net gain | (216) | - |
| Net periodic postretirement benefit cost | 711 | 1,051 |
| Adjustment to liability recognized in unrestricted net assets consist of: | | |
| Net actuarial gain occurred during the year | (1,890) | (262) |
| Net actuarial gain amortized during the year | 216 | - |
| Prior service credit | 51 | 51 |
| Net transition obligation | (653) | (653) |
| | (2,276) | (864) |
| Total benefit cost and other charges recognized in unrestricted net assets | $ (1,565) | $ 187 |
| Amounts expected to be recognized in net periodic benefit costs in the following year: | | |
| Unrecognized actuarial loss | 653 | 653 |
| Unrecognized prior service cost | (51) | (51) |
| | $ 602 | $ 602 |

*(dollars in thousands)*

The measurement dates were as of September 30 for both fiscal 2016 and fiscal 2015. The weighted average discount rates used to determine benefit obligations and net cost were 3.50% for September 30, 2016 and 4.15% for September 30, 2015. Participants included in the valuation were 178 and 244 for September 30, 2016 and 2015, respectively.

Information associated with health care cost trend rate assumptions follows as of and for the years ended September 30:

| | 2016 | 2015 |
|---|---|---|
| Health care cost trend rate assumptions: | | |
| Current health care cost trend rate | 7.50% | 8.00% |
| Ultimate health care cost trend rate | 5.00% | 5.00% |
| Ultimate trend rate is reached in year | 2021 | 2021 |

| | 1% Decrease | | 1% Increase | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Sensitivity to the assumed health care cost trend rates: | | | | |
| Effect on total of service and interest cost components | $ (29) | $ (42) | $ 34 | $ 50 |
| Effect on postretirement benefit obligation | (807) | (1,086) | 949 | 1,263 |

The benefits expected to be paid, net of Medicare Part D Subsidy, in each of the years 2017 to 2021 are $708, $699, $680, $653 and $622, respectively. The aggregate benefits expected to be paid in the five years from 2022 to 2026 are $2,690. The expected benefits are based on the same assumptions used to measure Palmetto Health's benefit obligation at September 30, 2016.

In addition, as part of the Tuomey transaction (see Note 20), Palmetto Health assumed the unfunded post-retirement benefit obligations associated with Tuomey's defined benefit plan which provided postretirement medical and dental benefits to eligible employees and/or dependents. Benefits available under the plan were frozen in March 2014.

The changes in the associated benefit obligation follow as of and for the period from January 1 to September 30:

| | 2016 |
|---|---|
| Benefit obligation at beginning of year | $ 519 |
| Interest cost | 5 |
| Plan participants' contributions | 173 |
| Actuarial loss | 1 |
| Benefits paid | (282) |
| Total benefit obligation, end of year | $ 416 |

The measurement date was September 30, 2016. The weighted average discount rate used to determine benefit obligations and net cost was 1.26% for September 30, 2016. The valuation included 50 participants.

*(dollars in thousands)*

Information associated with health care cost trend rate assumptions follows as of and for the period from January 1 to September 30:

| | 2016 |
|---|---|
| Health care cost trend rate assumptions: | |
| Current health care cost trend rate | 6.50% |
| Ultimate health care cost trend rate | 5.00% |
| Ultimate trend rate is reached in year | 2022 |

| | 2016 | |
|---|---|---|
| | 1% Decrease | 1% Increase |
| Sensitivity to the assumed health care cost trend rates: | | |
| Effect on total of service and interest cost components | $ (100) | $ 100 |
| Effect on postretirement benefit obligation | (7,400) | 7,500 |

The benefits expected to be paid, net of Medicare Part D Subsidy, in each of the years 2017 to 2019 are $154, $133, and $135, respectively. The expected benefits are based on the same assumptions used to measure Palmetto Health's benefit obligation at September 30, 2016.

## Note 17 - Palmetto Health Tuomey Pension Plan

As part of the Tuomey transaction (see Note 20), Palmetto Health assumed the post-retirement benefit obligations associated with the previously-existing Tuomey pension plan.

Benefits under the plan were frozen effective December 31, 2009. The changes associated with the benefit obligation and plan assets follow as of and for the period from January 1 to September 30:

| | 2016 |
|---|---|
| Change in benefit obligation: | |
| Benefit obligation at beginning of year | $ 85,194 |
| Interest cost | 2,615 |
| Actuarial loss | 8,929 |
| Benefits paid | (2,228) |
| Total benefit obligation, end of year | 94,510 |
| Change in plan assets: | |
| Fair value of plan assets at beginning of year | 57,520 |
| Actual return on plan assets | 3,593 |
| Benefits paid | (2,228) |
| Employer contributions | 650 |
| Fair value of plan assets at end of year | 59,535 |
| Funded status of plan | $ (34,975) |

*(dollars in thousands)*

The components of net periodic benefit cost and other pension accounting follow as of and for the period from January 1 to September 30:

| | 2016 |
|---|---|
| Interest cost | $ 2,615 |
| Expected return on plan assets | (2,829) |
| Net periodic pension income | (214) |
| Total benefit cost and other charges recognized in unrestricted net assets | $ (214) |
| Expected contributions in the following year | $ 1,132 |

The measurement date is September 30, 2016. The weighted average discount rate used to determine benefit obligations at September 30, 2016 was 4.17%. The rate of compensation increase used to determine benefit obligations at September 30, 2016 was 6.75%. The valuation included 1,784 participants.

The plan's long-term rate of return assumption of 6.75% is based on expectations regarding each asset category and average long-term rate of returns for a portfolio allocated across those categories.

Pension assets are invested to provide growth of capital with a moderate level of volatility by investing in a balanced portfolio. The actual asset allocation of the overall plan assets, as well as the performance of the individual managers, is reviewed by management on a quarterly basis.

| | Percentage of Plan Assets as | |
|---|---|---|
| | Target Allocation | September 30, 2016 |
| Cash and cash equivalents | 3% | 2% |
| Fixed income securities | 35% | 30% |
| Equity securities | 62% | 68% |
| | 100% | 100% |

*(dollars in thousands)*

The following table presents the fair value of the plan's investments, along with the level within the fair value hierarchy (see Note 19) for the investments as of September 30, 2016:

| | Fair Value Measurements at September 30, 2016 using: | | | |
|---|---|---|---|---|
| | Fair value at September 30, 2016 | Quoted prices in active markets for identical assets (Level 1 inputs) | Quoted prices for similar assets (Level 2 inputs) | Significant Unobservable (Level 3 inputs) |
| Money market funds | $ 1,201 | $ 1,201 | $ - | $ - |
| Fixed income securities | | | | |
| U.S. treasury bonds | 3,393 | - | 3,393 | - |
| U.S. corporate bonds | 14,381 | - | 14,381 | - |
| Equities | | | | |
| Exchange traded | 5,826 | 5,826 | - | - |
| Indexed equity | 11,754 | 11,754 | - | - |
| U.S. large cap | 17,563 | 17,563 | - | - |
| U.S. small cap | 1,863 | 1,863 | - | - |
| International | 3,554 | 3,554 | - | - |
| Total assets at fair value | $ 59,535 | $ 41,761 | $ 17,774 | $ - |

## Note 18 - Related Parties

### Related-party Obligations with Richland County, Richland and Baptist

The total payments by Palmetto Health to Richland under the employee lease agreement described in Note 15 above totaled $1,241 and $1,489 for the three months ended June 30, 2017 and 2016, respectively, and $3,064 and $4,353 for the nine months ended June 30, 2017 and 2016, respectively. Palmetto Health deposits with Richland an amount equal to two payrolls for leased employees, which totals $446 and $479 for the nine months ended June 30, 2017 and 2016, respectively. The deposit is included in other current assets in the accompanying consolidated financial statements.

Concurrent with the transfer of substantially all net assets to Palmetto Health, the operating rights of associated real property and improvements thereon were conveyed to Palmetto Health through the leases described above in Note 13. In exchange for an annual lease payment (including a fixed portion and other expenses assumed by Palmetto Health from Richland County), Richland County and Richland leased to Palmetto Health all of the real property recorded on the Richland property records as of the date Palmetto Health was formed. Real property includes all land, buildings and the building systems.

In addition, Palmetto Health reimburses Richland County an amount from operations equal to the County's annual responsibility for the MIAP as determined by the State of South Carolina.

*(dollars in thousands)*

Palmetto Health is also committed to provide an annual payment from operations to cover certain governance costs of Richland and Baptist. The payment is calculated using a base of $250, subject to adjustment based upon the Consumer Price Index and other expenses, as defined, for an original term of 35 years with three five-year renewal options, of which two have been exercised. Expense of $186 and $182 for the three months ended June 30, 2017 and 2016, respectively, and $554 and $547 for the nine months ended June 30, 2017 and 2016, respectively, was recorded associated with these payments and is included in supplies and other expense in the accompanying consolidated statements of operations.

Palmetto Health provides certain services to BEH for a contractually-defined fee. Approximately $1,769 and $1,902 in other revenue was recognized for the three months ended June 30, 2017 and 2016, respectively, and $2,798 and $3,924 for the nine months ended June 30, 2017 and 2016, respectively, with respect to the related service contract and a sublease (see Note 5 for related receivable).

## Related-party Obligations with Affiliated Foundations

Palmetto Health is affiliated with the Palmetto Health Foundation and the Tuomey Foundation (collectively, the Affiliated Foundations). During the nine months ended June 30, 2017 and 2016, Palmetto Health received $2,674 and $2,305, respectively, in contributions from the Affiliated Foundations and Palmetto Health recorded $1,550 and $1,676 in operating expenses of the Affiliated Foundations for the nine months ended June 30, 2017 and 2016, respectively.

The Palmetto Health Foundation was established through the merger of the Baptist Medical Center Columbia Foundation into the Richland Memorial Hospital Foundation for the sole purpose of supporting the mission, purposes and activities of Palmetto Health and its related organizations. The directors of Palmetto Health Foundation include certain officers and board members of Palmetto Health, as well as other community leaders. The Palmetto Health Foundation is constituted so as to attract support and contributions directly or indirectly from persons in the community in which it operates and was not formed for pecuniary profit or financial gain.

The Tuomey Foundation's sole purpose is to support the mission, purposes and activities of Palmetto Health Tuomey activities. The directors of the Tuomey Foundation include certain officers and board members of Palmetto Health Tuomey, as well as other community leaders. The Tuomey Foundation is constituted so as to attract support and contributions directly or indirectly from persons in the community in which it operates and was not formed for pecuniary profit or financial gain. As part of the Tuomey transaction (see Note 20), Palmetto Health agreed to contribute $320 annually to the Tuomey Foundation to be used solely in furtherance of the Tuomey Foundation's charitable purpose as described above.

The following table sets forth selected unaudited financial information of the Affiliated Foundations at June 30, 2017 and September 30, 2016:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Assets | $ 54,699 | $ 49,112 |
| Liabilities | 3,669 | 3,622 |
| Unrestricted net assets | 13,908 | 11,113 |
| Temporary and permanently restricted net assets | 37,122 | 34,377 |

*(dollars in thousands)*

### Note 19 - Fair Value Measurements

ASC 820, "Fair Value Measurements and Disclosures," establishes a framework for measuring fair value. That framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. That hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

**Level 1** – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that Palmetto Health has the ability to access.

**Level 2** – Inputs to the valuation methodology include:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs other than quoted prices that are observable for the asset or liability; and

Inputs that are derived principally from, or corroborated by, observable market data by correlation other means.

**Level 3** – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

An asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Changes in economic conditions or valuation techniques may require the transfer of financial instruments from one fair value to another. In such instances, the transfer is reported at the beginning of the reporting period. For the nine months ended June 30, 2017 and 2016, there were no transfers in or out of Levels 1, 2, or 3.

The following tables set forth the level, within the fair value hierarchy, of Palmetto Health's financial instruments at fair value as of June 30, 2017 and September 30, 2016:

**At June 30, 2017**

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| U.S. Treasury and government agencies | $ 80,573 | $ - | $ - | $ 80,573 |
| Cash and short-term investments | 52,535 | - | - | 52,535 |
| Mutual funds | 432,248 | - | - | 432,248 |
| Common stocks and options | 33,906 | - | - | 33,906 |
| Corporate bonds, mortgage and asset backed securities, and other | - | 149,920 | - | 149,920 |
| Assets at fair value | 599,262 | 149,920 | - | 749,182 |
| Investments at NAV | - | - | - | 96,458 |
| Total Investments | $ 599,262 | $ 149,920 | $ - | $ 845,640 |
| Derivative financial instruments | $ - | $ (62,617) | $ - | $ (62,617) |
| Liabilities at fair value | $ - | $ (62,617) | $ - | $ (62,617) |

*(dollars in thousands)*

**At September 30, 2016**

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| U.S. Treasury and government agencies | $ 82,493 | $ - | $ - | $ 82,493 |
| Cash and short-term investments | 48,328 | - | - | 48,328 |
| Mutual funds | 377,479 | - | - | 377,479 |
| Common stocks and options | 56,099 | - | - | 56,099 |
| Corporate bonds, mortgage and asset backed securities, and other | - | 172,101 | - | 172,101 |
| Assets at fair value | 564,399 | 172,101 | - | 736,500 |
| Investments at NAV | - | - | - | 91,642 |
| Total Investments | $ 564,399 | $ 172,101 | $ - | $ 828,142 |
| | | | | |
| Derivative financial instruments | $ - | $ (90,523) | $ - | $ (90,523) |
| Liabilities at fair value | $ - | $ (90,523) | $ - | $ (90,523) |

Palmetto Health estimates the fair value of alternative investments using the reported net asset value as a practical expedient for fair value. The use of net asset value as a practical expedient for fair value is permitted under GAAP for investments in entities that meet the description of an investment company and whose underlying investments are measured at fair value. The table below is a summary of the alternative investments held by Palmetto Health as of June 30, 2017 and September 30, 2016:

| | June 30, 2017 | September 30, 2016 | Unfunded Commitments | Redemption Notice Period |
|---|---|---|---|---|
| Equity long/short hedge fund of funds | $ 19,732 | $ 18,378 | None | Written notification by 9/15 for redemption at 12/31 of each year |
| U.S. macro hedge fund of funds | - | - | None | N/A - currently liquidating |
| Diversified multi-strategy fund of funds | 76,726 | 73,264 | None | 5-90 days |
| Balance, end of year | $ 96,458 | $ 91,642 | | |

The Equity long/short hedge fund of funds oversees various managers which seek to earn attractive returns by generally focusing on investments in global equities, both long and short, but may also use other securities and instruments deemed appropriate by the investment manager to carry out the overall objective of the fund. The investment manager has broad and flexible investment authority and may trade in any type of security, issuer, or group of related issuers, country, region, etc., believed to help the fund achieve its investment objectives.

The U.S. macro hedge fund of funds oversees various managers whose investment objective is to seek risk-adjusted returns while preserving capital during difficult market periods, through exposure to the financial, metal, energy, agricultural, currency and other markets, in addition to diversify its portfolio through investment in a range of funds or managed accounts seeking to implement trading strategies in numerous U.S. and international currency, futures, options, forward and other derivative markets.

The Diversified multi-strategy fund of funds oversees various managers which seek diversification by investment strategy. Strategy sectors include, among others, Commodity Trading Advisor's (CTA)/Managed Futures, Distressed, Equity Long/Short High Hedge, Equity Long/Short Opportunistic, Event Driven, Macro, Mergers/Risk Arbitrage, Mortgage Arbitrage, Multi Strategy, Other Directional, Relative Value, and Statistical Arbitrage.

Palmetto Health estimates the fair value of debt securities based on fair values determined by independent vendors. The vendors compile prices from various sources and may apply matrix pricing for similar bonds where no price is observable in an actively traded market. If available, the vendor may also use quoted prices for recent trading activity of assets with similar characteristics to the bond being valued.

The fair values of interest rate swaps are obtained from third party advisors, overseen by management, and are based primarily on Level 2 inputs. Management also considers the creditworthiness of Palmetto Health and its counterparties in estimating the fair value of interest rate swaps, and the effect of any potential credit valuation adjustments was not significant to the fair value measurements as of June 30, 2017 or September 30, 2016.

## Note 20 - Acquisition of Subsidiary

On January 1, 2016, Palmetto Health acquired substantially all of the assets and assumed certain liabilities of Tuomey. Tuomey was a not-for-profit integrated healthcare delivery system serving Sumter, Lee, and Clarendon Counties in South Carolina, with a 301-bed medical center located in Sumter, South Carolina (approximately 45 miles from Palmetto Health's primary service locations in Columbia, South Carolina) and historically generating approximately $200,000 in annual operating revenues.

As part of the transaction, substantially all of the assets and liabilities of Tuomey were transferred to a new wholly owned subsidiary of Palmetto Health (Palmetto Health Tuomey). Palmetto Health provided the acquisition funding to Palmetto Health Tuomey through a $90,000 taxable bridge loan from a bank, which was subsequently refinanced with tax-exempt bonds (see Note 11).

In connection with a legal settlement with the Department of Justice (DOJ), Tuomey entered into a five-year Corporate Integrity Agreement (CIA) effective October 16, 2015. While Palmetto Health is not a party to the CIA, Palmetto Health did commit to the OIG, through the execution of a Side Letter, to assume certain responsibilities under the CIA as such responsibilities pertain solely to the Palmetto Health Tuomey entity. Specifically, Palmetto Health, through Palmetto Health Tuomey, agreed to extend Palmetto Health's compliance program to Palmetto Health Tuomey; provide education and training programs for staff, vendors and providers; and provide management and oversight of certain other monitoring and tracking activities as set forth in the CIA. These responsibilities and activities only affect Palmetto Health Tuomey and do not extend to Palmetto Health and its other affiliated entities.

The Tuomey transaction was accounted for as an acquisition with an effective date of January 1, 2016, and therefore the financial position and results of operations of Palmetto Health Tuomey are included in the Palmetto Health consolidated financial statements as of the effective date. The acquisition price was allocated to acquired assets and assumed liabilities based on their respective fair values, and resulted in recognition of an excess of net assets acquired over consideration transferred (a net "contribution") of $17,094 in the consolidated statement of changes in net assets for the year ended September 30, 2016. It is not atypical for not-for-profit community hospitals to be acquired where the purchase consideration is lower than the business enterprise value of the entity. With respect to the Tuomey transaction, and as generally disclosed in the notes to these consolidated financial statements, there were a number of legal and operational issues which drove Tuomey to identify a potential acquirer of its operations on an accelerated basis. The excess of net assets acquired over consideration received arises from the impact of these factors on the negotiated purchase price in the Tuomey transaction. Palmetto Health also recognized $4,000 in other revenue for funds received from the SCDHHS Hospital Transformation Plan. The program includes encouraging new long-term partnerships between rural hospitals and community, tertiary and teaching facilities to ensure seamless, timely and high quality clinical care for patients in rural areas of the state. This aided to offset Palmetto Health's estimated acquisition costs incurred of $4,485.

*(dollars in thousands)*

The following table summarizes the consideration transferred and estimated fair value of assets acquired and liabilities and net assets assumed at January 1, 2016 (the acquisition date):

| | | |
|---|---|---|
| **Consideration paid:** | | |
| Cash | $ | 89,068 |
| **Acquired assets:** | | |
| Cash and cash equivalents | $ | 932 |
| Assets limited as to use | | 14,671 |
| Patient accounts receivable, net | | 29,536 |
| Other receivables | | 4,525 |
| Inventories | | 4,037 |
| Property and equipment, net | | 83,449 |
| Other assets | | 19,209 |
| Total assets | $ | 156,359 |
| **Liabilities assumed:** | | |
| Accounts payable | $ | 7,609 |
| Accrued salaries and benefits | | 13,002 |
| Other current liabilities | | 1,216 |
| Other noncurrent liabilities | | 28,370 |
| Total liabilities | | 50,197 |
| **Net assets assumed:** | | |
| Temporarily restricted | | 2,774 |
| Permanently restricted | | 5,337 |
| Total net assets | | 8,111 |
| Total liabilities and net assets | $ | 58,308 |

*(dollars in thousands)*

The following table summarizes Palmetto Health's pro forma consolidated results from operations for the years ended September 30, 2016 and 2015 as though the acquisition occurred October 1, 2015 and October 1, 2014, respectively:

| | 2016 | 2015 |
|---|---|---|
| Total operating revenues | $ 1,626,923 | $ 1,461,596 |
| Operating income | 14,198 | 15,318 |
| Other income, net | 25,083 | (55,363) |
| Revenue and gains over expense and losses | 38,033 | (86,393) |
| | | |
| Changes in net assets: | | |
| Unrestricted | $ 839,443 | $ 792,415 |
| Temporarily restricted | 30,112 | 30,126 |
| Permanently restricted | 16,014 | 18,409 |
| Total changes in net assets | $ 885,569 | $ 840,950 |

The following table summarizes Palmetto Health Tuomey's results for the nine months ended September 30, 2016:

| | 9 months ended 2016 |
|---|---|
| Total operating revenues | $ 142,850 |
| Operating income | 6,962 |
| Other income, net | 38 |
| Revenue and gains less expenses and losses | 7,000 |
| | |
| Changes in net assets: | |
| Unrestricted | $ 8,463 |
| Temporarily restricted | 647 |
| Permanently restricted | 146 |
| Total changes in net assets | $ 9,256 |

## Note 21 – Voluntary Transition Incentive Program

In June 2017, Palmetto Health created a voluntary transition incentive program (VTIP) to offer specific team members the choice to voluntarily leave the organization in return for financial incentives beyond basic severance pay to support their transition. The program was available to full time team members at all levels, although certain team members were ineligible in order to maintain high-quality patient care and ongoing business operations such as direct patient care nurses and physicians. Applications were subject to management review and acceptance with no plans to backfill eliminated positions and team members who participate are not eligible for rehire for one year.

An estimate of related benefits under this plan of $5,356 for 162 employees accepted under the VTIP plan were included within salaries and benefit expense on the Consolidated Statement of Operations for both the three and nine month periods ended June 30, 2017. These costs qualify as special termination benefits under ASC 712 and include, but are not limited to salary continuation, supplemental unemployment benefits, severance benefits, job counseling, and continuation of benefits such as health care benefits and life insurance coverage. These costs were reasonably estimable as virtually all employee termination dates occur before the end of the fiscal year (September 30).

## Note 22 - Subsequent Events

Palmetto Health evaluated subsequent events through August 14, 2017, the date at which the consolidated financial statements were issued. Palmetto Health identified no subsequent events requiring recognition in the consolidated financial statements as of August 14, 2017.

## Note 23 - Other Matters

Palmetto Health and the USC SOM Educational Trust have formed a new 501(c)(3) entity, PHUSCMG, in order offer improved care and expanded research collaboration opportunities.

The integration was launched in April 2016 and operations are rolling out under the new entity, with the first three practices up as of March 27, 2017. Employees moved to the new entity at the beginning in January 2017 and were leased back to Palmetto Health during the nine months ended June 30, 2017. All practices are under the new management structure. The financial position and results of operations associated with this venture are immaterial to the consolidated financial statements as of and for the three and nine months ended June 30, 2017. Palmetto Health and the USC SOM will contribute assets for each practice as they are transitioned to the PHUSCMG. Ownership and governance is split equally between the two parties and, as such, Palmetto Health intends to account for the investment using the equity method of accounting.

Greenville Health System (GHS) and Palmetto Health are partnering to create a new health company (Newco) which will be the parent organization of both Greenville Health System and Palmetto Health, while both parties will remain separately incorporated not for profit entities. Patients will continue to be patients of GHS or Palmetto Health. From a governance perspective, Newco will be led by one board of directors and one executive team. This new board will consist of directors from boards currently affiliated with GHS and Palmetto Health. Newco will be co-led by the GHS and Palmetto Health Chief Executive Officers. Both organizations are currently are seeking necessary third-party approvals in this next phase of due diligence and planning. In the meantime, GHS and Palmetto Health will continue to offer care and services as two separate, independent organizations.

*(dollars in thousands)*

## MEDICAL STAFF PROFILE

Each of Palmetto Health's hospitals has a separate medical staff. Appointments are made in conjunction with the applicable staff bylaws for each hospital. The active and consulting staffs provide substantially all of the admissions at each of Palmetto Health's hospitals. The following tables represent a breakdown of active and consulting medical staffs at Palmetto Health's four hospitals:

**PALMETTO HEALTH'S ACTIVE AND CONSULTING MEDICAL STAFF PROFILE**

| | PALMETTO HEALTH | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | RICHLAND | | | BAPTIST | | | BAPTIST PARKRIDGE | | |
| Specialty | Number | (% Board Certified) | Average Age | Number | (% Board Certified) | Average Age | Number | (% Board Certified) | Average Age |
| Anesthesiology | 24 | 92% | 55 | 40 | 93% | 54 | N/A | N/A | N/A |
| Cardiology | 37 | 95% | 52 | N/A | N/A | N/A | N/A | N/A | N/A |
| Dentistry | 21 | 67% | 51 | 11 | 82% | 55 | N/A | N/A | N/A |
| Emergency Medicine | 61 | 85% | 42 | 55 | 85% | 41 | 285 | 89% | 45 |
| Family Practice | 48 | 94% | 46 | N/A | N/A | N/A | N/A | N/A | N/A |
| Internal Medicine | 152 | 88% | 46 | 163 | 89% | 47 | N/A | N/A | N/A |
| Nephrology | 22 | 95% | 46 | N/A | N/A | N/A | N/A | N/A | N/A |
| Neurology | 23 | 100% | 49 | 24 | 96% | 48 | N/A | N/A | N/A |
| Neurosurgery | 6 | 33% | 40 | 8 | 50% | 46 | N/A | N/A | N/A |
| OB/GYN | 36 | 94% | 49 | 37 | 89% | 49 | N/A | N/A | N/A |
| Ophthalmology | 15 | 93% | 47 | 22 | 95% | 49 | N/A | N/A | N/A |
| Orthopedics | 29 | 90% | 47 | 34 | 97% | 50 | N/A | N/A | N/A |
| Pathology | 17 | 100% | 48 | 17 | 100% | 48 | N/A | N/A | N/A |
| Pediatrics | 140 | 93% | 46 | 94 | 91% | 45 | N/A | N/A | N/A |
| Psychiatry | 31 | 90% | 45 | 31 | 84% | 46 | N/A | N/A | N/A |
| Radiology | 28 | 93% | 52 | 28 | 93% | 52 | N/A | N/A | N/A |
| Surgery | 58 | 93% | 49 | 43 | 95% | 53 | 155 | 90% | 51 |
| Women's Services | N/A | N/A | N/A | N/A | N/A | N/A | 52 | 88% | 47 |
| **TOTALS/ AVERAGE** | 748 | 88% | 48 | 607 | 89% | 49 | 492 | 89% | 48 |

*(dollars in thousands)*

## MEDICAL STAFF PROFILE (continued)

**PALMETTO HEALTH'S ACTIVE AND CONSULTING MEDICAL STAFF PROFILE**

| | PALMETTO HEALTH TUOMEY | | |
|---|---|---|---|
| **Specialty** | **Number** | **(% Board Certified)** | **Average Age** |
| Acute Rehabilitation | 2 | 100% | 45 |
| Allergy & Immunology | 2 | 100% | 54 |
| Anesthesia | 13 | 100% | 50 |
| Cardiac Services | 7 | 100% | 50 |
| Critical Care Telemedicine | 27 | 100% | 46 |
| Dentistry | 4 | 100% | 49 |
| Dermatology | 2 | 100% | 50 |
| Emergency Medicine | 14 | 100% | 50 |
| Endocrine | 1 | 100% | 70 |
| Family Medicine | 20 | 100% | 48 |
| Gastroenterology | 3 | 100% | 51 |
| Hemetology/Oncology | 3 | 100% | 59 |
| Infectious Disease | 1 | 100% | 35 |
| Internal Medicine | 47 | 98% | 49 |
| Nephrology | 5 | 100% | 49 |
| Neurology | 5 | 100% | 40 |
| OB/GYN | 10 | 100% | 48 |
| Ophthalmology | 2 | 100% | 52 |
| Oral and Maxillofacial Surgery | 1 | 100% | 64 |
| Orthopaedics | 6 | 100% | 54 |
| Otolaryngology | 2 | 100% | 53 |
| Pathology | 10 | 100% | 50 |
| Pediatrics | 8 | 100% | 52 |
| Plastics | 1 | 100% | 42 |
| Podiatry | 2 | 100% | 60 |
| Radiation Oncology | 5 | 100% | 53 |
| Radiology | 31 | 90% | 49 |
| Rheumatology | 1 | 100% | 50 |
| Surgery | 5 | 100% | 51 |
| Tele-Psych | 11 | 82% | 48 |
| Tele-Stroke | 22 | 100% | 48 |
| Thoracic Surgery | 2 | 100% | 60 |
| Urology | 3 | 100% | 61 |
| Vascular Surgery | 1 | 100% | 48 |
| **TOTALS/AVERAGE** | 279 | 99% | 51 |

*(dollars in thousands)*

### HISTORICAL UTILIZATION STATISTICS

The following table contains, for the fiscal periods indicated, selected historical utilization statistics for Palmetto Health:

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| Licensed Beds | 1,392 | 1,439 | 1,392 | 1,439 |
| Staffed Beds | 1,291 | 1,315 | 1,291 | 1,315 |
| Patient Days: | | | | |
| Adult/Pediatric | 76,074 | 73,806 | 229,174 | 213,242 |
| Medical Rehabilitation | 2,496 | 3,204 | 9,243 | 7,767 |
| BMU* / Substance Abuse | 6,085 | 6,012 | 17,905 | 18,252 |
| Newborn/NICU | 13,452 | 15,480 | 42,731 | 44,530 |
| Total | 98,107 | 101,772 | 299,053 | 283,791 |
| Admissions: | | | | |
| Adult/Pediatric | 13,472 | 13,031 | 40,991 | 37,170 |
| Medical Rehabilitation | 216 | 334 | 806 | 788 |
| BMU*/Substance Abuse | 321 | 387 | 1,003 | 1,175 |
| Newborn/NICU | 4,228 | 4,397 | 12,545 | 12,698 |
| Total | 18,237 | 18,149 | 55,345 | 51,831 |
| Length of Stay (Adult/Pediatric) | 5.65 | 5.66 | 5.59 | 5.74 |
| Occupancy Percentage: | | | | |
| Licensed Beds | 77.4% | 75.2% | 78.7% | 81.3% |
| Staffed Beds | 83.5% | 82.3% | 84.9% | 86.7% |
| ER Visits | 58,398 | 58,616 | 180,569 | 161,971 |

*Behavioral Medicine Unit.

# Palmetto Health and Subsidiaries

## Other Interim Information

## For the Nine Months ended June 30, 2017

*(dollars in thousands)*

### HISTORICAL COVERAGE OF MAXIMUM ANNUAL DEBT SERVICE

The following table shows, for the fiscal periods indicated, Palmetto Health's income available for debt service, calculated in accordance with the Master Indenture, and the extent to which principal and interest requirements on all long-term debt and capitalized leases outstanding at that time were covered by such revenues.

| | Twelve Months Ended June 30, 2017 | Twelve Months Ended June 30, 2016 |
|---|---|---|
| Revenues and gains greater (less) than expenses and losses | $ 65,041 | $ (23,142) |
| Plus: Depreciation and Amortization | 83,026 | 74,337 |
| Interest | 32,521 | 28,313 |
| Net change in unrealized (gain) loss on derivative financial instruments | (27,227) | 40,888 |
| Net change in unrealized (gain) loss on trading investments | (31,996) | 21,859 |
| Income available for debt service | $ 121,365 | $ 142,255 |
| Maximum Debt Service Requirement on all long-term debt [1] | $ 63,730 | $ 61,391 |
| Debt service coverage (times) | 1.9 | 2.3 |

[1] Includes debt service requirements for all bond indebtedness and the Corporation's capitalized leases.

*(dollars in thousands)*

### CAPITALIZATION

The table below sets forth, for the fiscal periods indicated, the capitalization of Palmetto Health as of:

| | June 30, 2017 | September 30, 2016 |
|---|---|---|
| Series 2016 Bonds | $ 120,000 | $ 120,000 |
| Series 2014 Bonds | 18,085 | 18,085 |
| Series 2013 Bonds | 113,130 | 113,130 |
| Series 2011 Bonds | 82,055 | 82,055 |
| Series 2010 Bonds | 198,418 | 203,183 |
| Series 2009 Bonds | 89,010 | 89,010 |
| Series 2005 Bonds | 184,775 | 184,775 |
| Other Long-Term Indebtedness | 18,477 | 19,228 |
| Total Long-Term Debt | 823,950 | 829,466 |
| Less: Current Maturities | (18,099) | (17,888) |
| Unamortized Bond Discount | (12,213) | (12,782) |
| Net Long-Term Debt | 793,638 | 798,796 |
| Total Unrestricted Net Assets | 884,214 | 836,368 |
| Total Capitalization | $ 1,677,852 | $ 1,635,164 |
| | | |
| Net Long-Term Debt as a Percentage of Total Capitalization | 47% | 49% |