

ANNUAL REPORT

ORLANDO HEALTH, INC.

For the Fiscal Year ended September 30, 2017

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Sources of Patient Revenues and Utilization of Patient Services

The table below lists the approximate percentage of gross patient charges for hospital services by payor category and patient services utilization statistics.

	Year ended September 30	
	2017	2016
<i>Payor Mix</i>		
Medicare (includes HMO's)	35.0%	34.4%
Medicaid (includes HMO's)	17.9%	18.3%
Managed Care	34.5%	34.2%
Commercial	3.4%	3.6%
Self Pay	7.1%	7.2%
Other	2.1%	2.3%
	100.0%	100.0%
<i>Average Licensed Beds</i>		
	2,032	1,881
<i>Average Beds in Service</i>		
	1,902	1,823
<i>Average Daily Census</i>		
Adult	1,080	1,072
Newborn and neonatal	184	190
	1,264	1,262
<i>Admissions</i>		
Adult	86,965	85,194
Newborn and neonatal	14,781	15,376
	101,746	100,570
<i>Observation Cases</i>		
Adult and neonatal	30,810	29,168
<i>Patient Days</i>		
Adult	394,247	392,369
Newborn and neonatal	67,076	69,553
	461,323	461,922
<i>Average Length of Stay (days)</i>		
Adult	4.5	4.6
Newborn and neonatal	4.5	4.5
<i>Percent Occupancy (beds in service)</i>		
Adult	66.6	68.5
Newborn and neonatal	65.4	73.4
<i>Outpatient Visits</i>		
Outpatient Visits	670,265	657,294
Outpatient Surgery Cases	27,543	26,216
Total Outpatient Visits	697,808	683,510
<i>Emergency Dept. Patients Treated</i>		
	319,072	319,864
<i>Case Mix Index</i>		
Medicare only	1.86	1.80
All payors	1.69	1.61

Source: Records of the Corporation

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Consolidated Financial Statements

The following consolidated financial statements are excerpted from the audited consolidated financial statements of Orlando Health, Inc. and Controlled Affiliates for the years ended September 30, 2017 and 2016, which comprise the Consolidated Balance Sheet and the related Consolidated Statement of Operations and Changes in Net Assets and Cash Flows. The audited consolidated financial statements of Orlando Health, Inc. and Controlled Affiliates for the years ended September 30, 2017 and 2016 were posted to EMMA on February 2, 2018.

Consolidated Statements of Operations and Changes in Net Assets (in 000's)

	Year Ended September 30,	
	2017	2016
Unrestricted revenues and other support		
Net patient service revenue (net of contractual allowances and discounts)	\$ 2,687,080	\$ 2,507,482
Provision for bad debts	(144,060)	(181,450)
Net patient service revenue, less provision for bad debts	2,543,020	2,326,032
Other revenue	130,085	124,794
Net assets released from restrictions	5,784	5,096
Total unrestricted revenues and other support	2,678,889	2,455,922
Expenses		
Salaries and benefits	1,407,648	1,276,382
Supplies and other	846,087	802,197
Professional fees	38,830	39,318
Depreciation and amortization	125,821	119,734
Interest	43,094	45,565
Total expenses	2,461,480	2,283,196
Income from operations	217,409	172,726
Non-operating gains and (losses)		
Investment income	83,563	63,602
Change in fair value of interest rate swap agreements	15,294	(9,932)
Loss on early extinguishment of debt	—	(16,442)
Non-operating gain	13,576	—
Non-operating gains (losses), net	112,433	37,228
Excess of revenues, other support, and gains over expenses and losses	329,842	209,954
Deficit (excess) of revenues, other support, and gains over expenses and losses attributed to non-controlling interests in Controlled Affiliates	1,849	(448)
Excess of revenues, other support, and gains over expenses and losses attributed to Orlando Health, Inc. and Controlled Affiliates	331,691	209,506

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Consolidated Statements of Operations and Changes in Net Assets (in 000's)(continued)

	Year Ended September 30,	
	2017	2016
Unrestricted net assets		
Excess of revenues, other support, and gains over expenses and losses	\$ 329,842	\$ 209,954
Other changes in unrestricted net assets:		
Net assets released from restriction for property and equipment	15,449	22,895
Deconsolidation of controlling interest in OH/USP Surgery Centers	—	(3,679)
Other	(288)	290
Increase in unrestricted net assets	345,003	229,460
Temporarily restricted net assets		
Contributions	13,345	93,948
Net assets released from restrictions	(21,233)	(27,991)
Net realized and unrealized gains on investments	2,716	1,401
Other	(246)	(191)
(Decrease) increase in temporarily restricted net assets	(5,418)	67,167
Permanently restricted net assets		
Contributions	—	2
Other	(1,116)	—
Net realized and unrealized gains on investments	2	1
(Decrease) increase in permanently restricted net assets	(1,114)	3
Increase in net assets	338,471	296,630
Net assets at beginning of year	1,854,901	1,558,271
Net assets at end of year	<u>\$ 2,193,372</u>	<u>\$ 1,854,901</u>

See accompanying notes.

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Consolidated Balance Sheets (in 000's)

	September 30	
	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 358,845	\$ 270,712
Short-term investments	—	100
Assets limited as to use	38,701	36,805
Accounts receivable, less allowances for uncollectible accounts of \$160,404 in 2017, \$142,734 in 2016, and \$162,928 in 2015	297,845	298,939
Other receivables	40,033	49,132
Inventories	51,355	28,704
Other current assets	36,690	37,349
Total current assets	<u>823,469</u>	<u>721,741</u>
Assets limited as to use:		
Debt service and reserve funds held by bond trustee	43,932	41,668
Interest rate swap contract collateral	14,258	29,395
Malpractice self-insurance	13,428	12,417
	<u>71,618</u>	<u>83,480</u>
Less amount required to meet current obligations	<u>(38,701)</u>	<u>(36,805)</u>
	32,917	46,675
Assets Held for Sale	—	8,596
Long-term investments – unrestricted	1,185,747	971,900
Long-term investments – restricted	107,651	83,957
Investments in related parties	37,499	25,274
Other assets	268,259	237,580
Property and equipment, net	<u>1,301,899</u>	<u>1,261,100</u>
Total assets	<u>\$ 3,757,441</u>	<u>\$ 3,356,823</u>
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 256,546	\$ 234,460
Other current liabilities	122,718	108,594
Current portion of long-term debt	23,288	20,860
Total current liabilities	<u>402,552</u>	<u>363,914</u>
Long-term debt, less current portion	959,404	959,618
Accrued malpractice claims	105,178	97,977
Other noncurrent liabilities	96,935	80,413
Total liabilities	<u>1,564,069</u>	<u>1,501,922</u>
Net assets:		
Unrestricted		
Orlando Health, Inc. and Controlled Affiliates	2,018,745	1,671,804
Non-controlling interests in Controlled Affiliates	(878)	1,060
Total unrestricted	<u>2,017,867</u>	<u>1,672,864</u>
Temporarily restricted	174,122	179,540
Permanently restricted	1,383	2,497
Total net assets	<u>2,193,372</u>	<u>1,854,901</u>
Total liabilities and net assets	<u>\$ 3,757,441</u>	<u>\$ 3,356,823</u>

The accompanying notes are an integral part of these consolidated financial statements.

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Consolidated Statements of Cash Flows (in 000's)

	Year Ended September 30	
	2017	2016
Operating activities		
Increase in net assets	\$ 338,471	\$ 296,630
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	125,821	119,734
Change in value of interest rate swap agreements	(15,294)	9,932
Net unrealized gains on investments	(50,228)	(33,089)
Loss on early extinguishment of debt	—	16,442
Gain on Sale of Lucerne	(1,900)	—
Restricted grant from the District	—	(75,200)
Deconsolidation of OH/USP Surgery Centers	—	3,679
Restricted contributions and investment income	(14,701)	(19,961)
Sales of short-term trading securities, net	—	241,800
Changes in operating assets and liabilities:		
Accounts receivable, net	1,094	(7,165)
Other operating assets	(8,853)	(2,559)
Accounts payable and accrued expenses	22,086	15,203
Other operating liabilities	28,654	35,761
Net cash provided by operating activities	<u>425,150</u>	<u>601,207</u>
Investing activities		
Purchases of property, equipment, and other noncurrent assets	(135,124)	(154,344)
Acquisition of OHRI imaging centers	—	—
Acquisition of physician practice	—	—
Proceeds from sale of group purchasing organization	11,676	—
Decrease (increase) in assets limited as to use	11,675	(16,207)
Purchase of trading securities, net of sales	(187,203)	(281,146)
Other investing activities	(29,916)	(1,371)
Net cash used in investing activities	<u>(328,892)</u>	<u>(453,068)</u>
Financing activities		
Proceeds from issuance of long-term debt	—	350,661
Refunding and repayments of long-term debt	(22,826)	(396,157)
Proceeds from debt service reserve fund liquidation	—	17,424
Bond proceeds used for loan costs	—	(2,731)
Restricted contributions and investment income	14,701	19,961
Net cash used in financing activities	<u>(8,125)</u>	<u>(10,842)</u>
Increase in cash and cash equivalents	88,133	137,297
Cash and cash equivalents at beginning of year	270,712	133,415
Cash and cash equivalents at end of year	<u>\$ 358,845</u>	<u>\$ 270,712</u>
Non-cash investing and financing transactions		
Capital lease obligation incurred for property	<u>\$ 21,000</u>	<u>\$ —</u>

See accompanying notes.

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Notes to Consolidated Financial Statements

1. Basis of Presentation

The accompanying consolidated financial statements include the accounts and activity of the Corporation and its Controlled Affiliates. All significant intercompany transactions have been eliminated in consolidation for all periods presented.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for financial information. However, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal and recurring nature. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the years ended September 30, 2017 and 2016, which were posted to EMMA on February 2, 2018.

2. Organization

Orlando Health, Inc. (Orlando Health) and Orlando Health Central, Inc. (Health Central) comprise the Obligated Group. Orlando Health is a tax-exempt organization pursuant to Section 501(c)(3) of the Internal Revenue Code, which controls a diversified healthcare delivery system headquartered in Orlando, Florida. Orlando Health includes the following hospitals operating in Central Florida: Orlando Regional Medical Center (ORMC), Dr. P. Phillips Hospital, Arnold Palmer Hospital for Children (APH), Winnie Palmer Hospital for Women and Babies (WPH), South Seminole Hospital and Health Central Hospital. APH and WPH are jointly referred to as the Arnold Palmer Medical Center (APMC). Health Central includes a hospital and Health Central Park, a skilled nursing facility. Orlando Health also has a home health services division and eight medical residency programs.

Controlled Affiliates are those entities Orlando Health controls as the sole or majority member, sole shareholder, or through board appointment and approval of all major transactions. Controlled Affiliates operate a variety of healthcare-related services, including physician practice groups (Orlando Health Physician Group, Inc., Orlando Physician Network, Inc., Orlando Cancer Center, Inc., Physician Associates, LLC (PAL), ORHI, LLC (ORHI), which operates five imaging centers, a fund-raising organization (Orlando Health Foundation, Inc.) and other healthcare-related services. Healthnet Services, Inc. and its subsidiaries are taxable corporations and are a part of the Controlled Affiliates. The Obligated Group, together with its Controlled Affiliates, is collectively referred to herein as the "System." These consolidated financial statements include the consolidated accounts of Orlando Health, Orlando Health Central, and their Controlled Affiliates. Significant transactions between entities have been eliminated.

Orlando Health has a 50% membership in South Lake Hospital, Inc. (South Lake), a not-for-profit acute care hospital. As Orlando Health does not hold a controlling interest in the accounts of South Lake, those accounts are excluded from the consolidated financial statements.

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Management's Discussion and Analysis

Year ended September 30, 2017 Compared to 2016

Excess of revenues, other support and gains over expenses and losses was \$329.8 million for the year ended September 30, 2017, a \$119.9 million or 57.1% increase from the prior year. Income from operations of \$217.4 million for the year was \$44.7 million or 25.9% more than the prior year. Non-operating gains, net increased \$75.2 million from the prior year.

Revenue, Utilization, and Payor Mix

Net patient service revenue, less the provision for bad debts for the year ended September 30, 2017 increased \$217 million or 9.3% compared to the prior year. The increase is due to increased volumes, rate increases, higher acuity, and fewer patients without insurance.

Combined admissions and observation cases increased 2.2%, case mix index from increased from 1.61 to 1.69, and adult length of stay improved from 4.6 days to 4.5 days. Outpatient visits increased 2.1%, including a 5.1% increase in outpatient surgery cases. The payor mix changed with decreases in Medicaid, commercial and self-pay patients, offset with increases in Medicare and managed care patients.

Expenses

Total expenses for the year ended September 30, 2017 increased \$178.3 million or 7.8% compared to the prior year. The increase is due to increased volumes and related increase in employees, employee pay rate increases, and supply inflation.

Changes in Cash, Investments, Accounts Receivable, and Working Capital

From September 30, 2016 to September 30, 2017, unrestricted cash and investments increased \$301.9 million or 24.3% due to operating cash flow and investment returns.

Accounts receivable decreased \$1.1 million or 0.4%. Days of revenue in accounts receivable is based on one year of net patient service revenue. There were 43 days revenue in accounts receivable at September 30, 2017, compared to 47 days at September 30, 2016.

Current assets increased \$101.7 million or 14.1 % due to the increase in cash and cash equivalents. Current liabilities increased \$38.6 million or 10.6%.

Capital Expenditures and Construction Projects

Capital expenditures decreased from \$154.3 million in 2016 to \$135.1 million in 2017.

Construction-in-progress represents numerous construction and renovation projects. Estimated costs to complete these projects as of September 30, 2017, are approximately \$156.2 million which includes \$12.6 million for DPH Oncology Regional Care Center, \$5.4 million for Health Central's Sunrise Clinical Manager System, \$37.7 million for Horizons West campus development, \$22.8 million for an on campus Cancer Center at Health Central, and \$33 million for an on campus Skilled Nursing Facility at Health Central.

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Obligated Group and Controlled Affiliates

Excess (deficiency) of revenues, other support, and gains over expenses and losses by the Obligated Group and Controlled Affiliates for the years ended September 30, 2017 and 2016 is presented below:

<i>Excess (deficiency) of revenue, other support, and gains over expenses and losses</i>	Year Ended September 30	
	2017	2016
	<i>(in millions)</i>	
Orlando Health Obligated Group	\$443.7	\$313.1
Controlled Affiliates	(107.5)	(95.2)
Inter-company Eliminations	6.4	(7.9)
Consolidated	\$329.8	\$210.0