

# **SPECTRUM HEALTH SYSTEM AND AFFILIATES**

## **CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2017**



# SPECTRUM HEALTH SYSTEM AND AFFILIATES

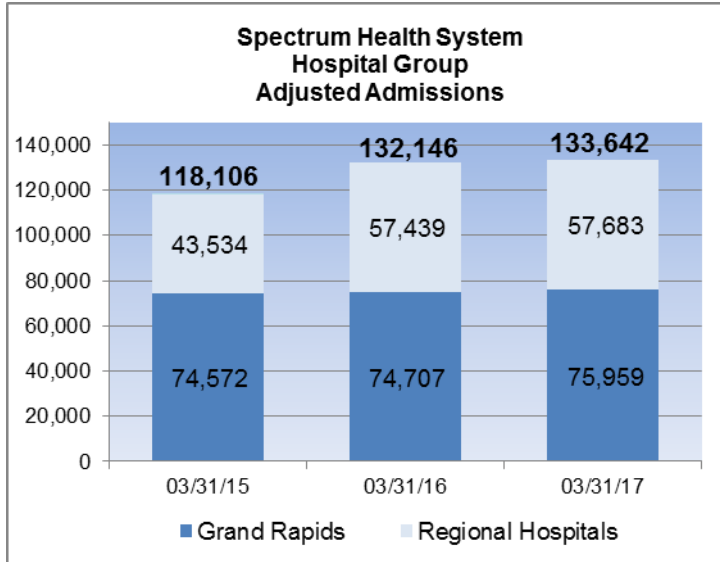
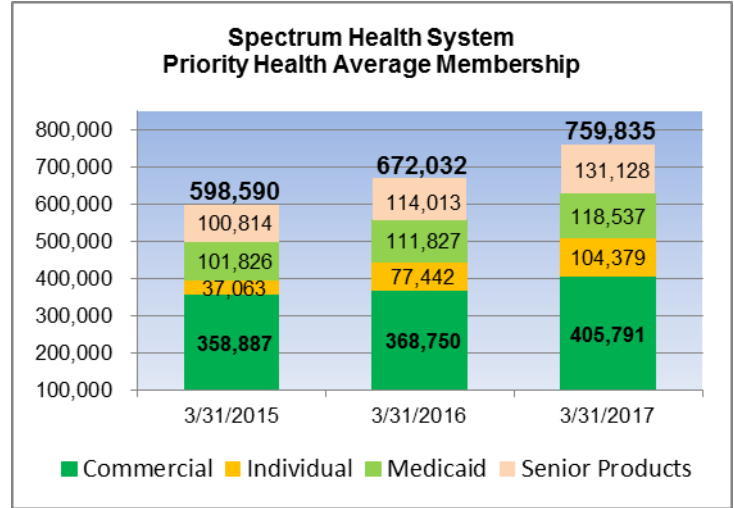
## Chief Financial Officer's Report

FOR THE NINE MONTHS ENDED MARCH 31, 2017

The enclosed package represents the consolidated financial statements for Spectrum Health System and Affiliates (the System). The financial statements have been summarized by the System's delivery, insurance and other operations.

### Volume

Overall admissions for the Hospital Group are up 1,141 from the prior year. Spectrum Health Grand Rapids adjusted (for outpatient) admissions totaled 75,959 which represents an increase of 1.7% from March 2016 levels, and is ahead of planned levels by 1.4%. Regional hospitals adjusted admissions increased 0.4% over 2016, but were behind planned levels by 0.2%. Spectrum Health Physicians Services encounters totaled 2.3 million which was an increase of 7.8% over the prior year. Health insurance average membership increased to 759,835, which was a 13.1% increase compared to March 2016. Actual membership was 794,599.

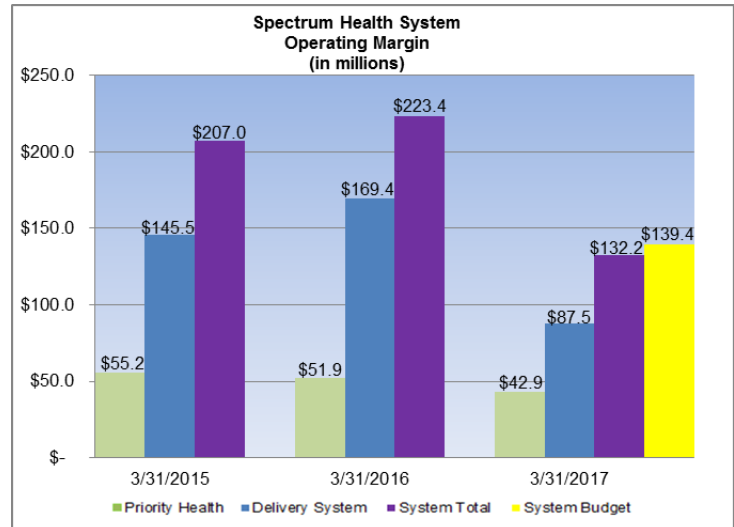
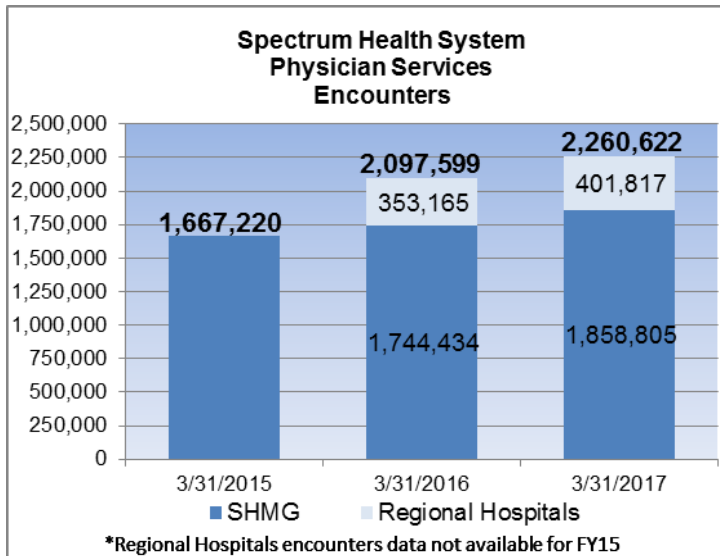


### Margin

The System's excess of revenue over expense for the nine months ended March 2017, was \$258.7 million or 6.0% of total revenue. The System's operating margin was \$132.2 million or 3.1% of net operating revenue.

The Delivery System's operating margin was \$87.5 million, or 3.9%, which was unfavorable to Plan by \$8.8 million and unfavorable to prior year by \$81.8 million. Operating results for Grand Rapids, Pennock and Ludington were the primary contributors to the Plan variance. Spectrum Health Medical Group encounters were approximately 5.0% behind Plan for existing operations, due to provider vacancies.

Priority Health's operating margin was \$42.9 million, or 1.7%, which was favorable to Plan by \$0.7 million and unfavorable to prior year by \$9.0 million. Variance to prior year is driven by unfavorable medical expense and ACA individual performance.



# SPECTRUM HEALTH SYSTEM AND AFFILIATES

## Chief Financial Officer's Report

FOR THE NINE MONTHS ENDED MARCH 31, 2017

### Other Revenue (Expense)

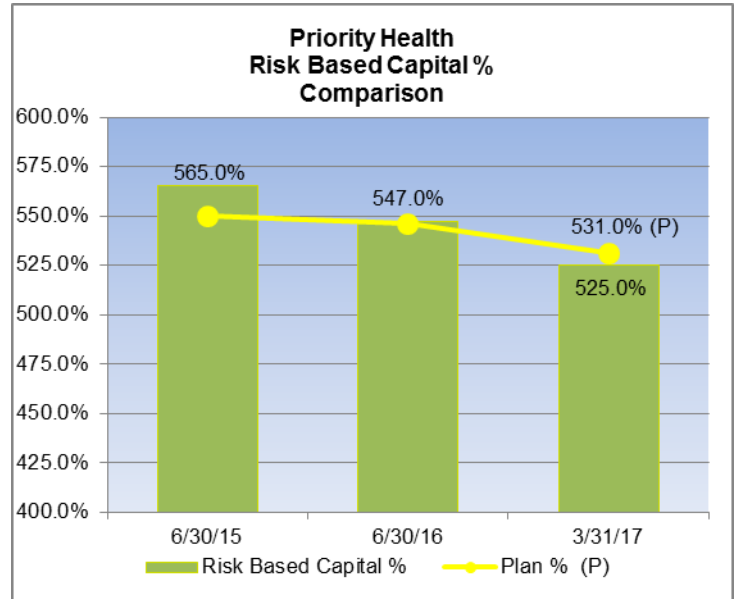
The net other revenue of \$129.8 million was comprised primarily of \$99.6 million of investment gains and \$33.7 million of swap gains. The \$99.6 million of investment gains consisted of \$61.7 million of realized investment returns (interest, dividends and realized gains/losses) and \$37.9 million of unrealized investment gains, which are a function of the market. The \$129.8 million net other revenue was \$202.4 million better than March 2016.

### Liquidity and Cash Flow

At March 31, 2017, total cash and investments for the System were at \$2.8 billion, an increase of \$194.9 million from June 30, 2016. The increase is driven by operating cash flow margin of \$287.9 million, non-operating cash increases of \$86.4 million related to investment returns, and an increase to working capital of \$10.3 million. These were offset by facility, information technology, and equipment additions totaling \$191.0 million and a net decrease to long term debt of \$11.8 million, on a year-to-date basis.

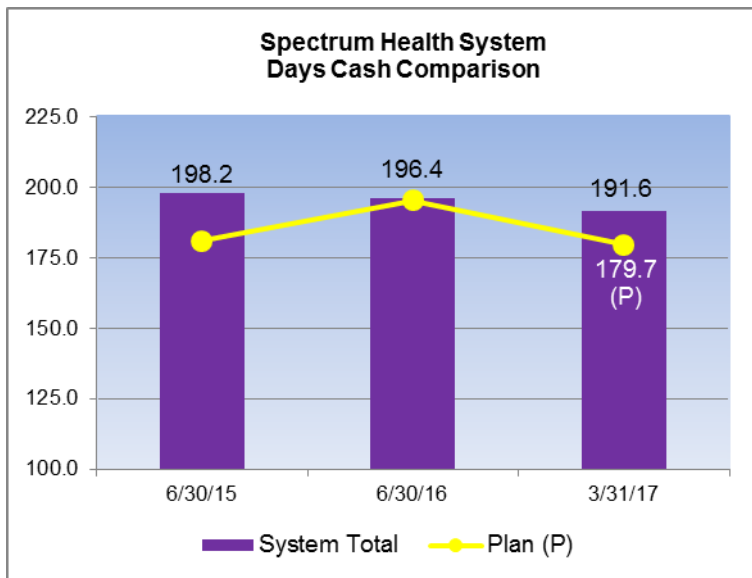
### Ratios

Days cash on hand for the System decreased to 191.6 at March 31, 2017. Priority Health's risk based capital (RBC) was 525.0%. Operating cash flow margin was 6.8%, which is below Moody's Aa3 median of 10.3% for 2015.



### Equity Structure

Debt was approximately \$842.7 million at the end of March and fund balance was approximately \$3.0 billion. The long-term debt to capitalization ratio for the System at March 31, 2017 was 22.9%, which was lower than the Moody's Aa3 median of 29.4% for 2015. Total assets for the System were approximately \$5.3 billion.



Respectfully submitted,

Ronald J. Knaus  
 Senior Vice President & Chief Financial Officer  
 (ron.knaus@spectrumhealth.org)  
 March, 2017

**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Ratio Analysis - Total System**

March 31, 2017

<b><u>Profitability Ratios</u></b>	<b>March 31, 2017</b>	<b>Total System June 30, 2016</b>	<b>Total System Plan June 30, 2017</b>	<b>2015 Moody's Median</b>
Operating Margin	3.1%	5.2%	3.3%	4.6%
Total Margin	6.0%	4.1%	4.4%	7.9%
Return on Assets	6.5%	4.2%	4.8%	5.8%
Operating Cash Flow Margin	6.8%	9.0%	7.2%	10.3%
<b><u>Liquidity Indicators</u></b>				
Days in Patient Receivables	54.1	50.5	51.0	48.4
Days Cash (unrestricted) on Hand	191.6	196.4	179.7	266.2
Current Ratio	1.4	1.3	1.4	1.7
Cash to Debt %	327.2%	298.4%	308.2%	201.1%
<b><u>Capital Structure</u></b>				
Long Term Debt to Capitalization	22.9%	24.9%	23.0%	29.4%
Proforma Long Term Debt to Capitalization - Leases*	25.9%	28.3%	26.2%	n/a
Debt Service Coverage	12.8	9.9	10.7	7.9
Debt to Cash Flow	1.6	2.2	1.9	2.3
Risk Based Capital (PH only)	525.0%	547.0%	535.0%	409.0% (a)
Average Age of Plant	10.1	9.6	9.6	10.2
Capital expenditures to depreciation	1.4	1.1	1.6	1.2

(a) Provider Sponsored Health Plan benchmark which consists of six similar sized health plans.  
Benchmark data is based on September 30, 2016 statutory filings.

Note: Moody's figures are medians for freestanding hospitals, single-state & multi-state healthcare systems with Aa3 bond ratings for 2015.  
Spectrum Health's current rating from Moody's is Aa3.

\* Estimated impact of proposed lease accounting standard in FY19.

**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Key Statistics**

Nine months ended March 31, 2017

**DELIVERY SYSTEM**

	<u>Actual</u>	<u>Better (Worse) than Plan</u>	<u>Prior Year<sup>□</sup></u>
<b><u>Spectrum Health Grand Rapids</u></b>			
Admissions	46,139	932	44,591
Patient Days	228,548	5,689	219,431
Patient Days - Observation	8,951	511	9,116
Adjusted Admissions	75,959	1,051	74,707
Net Revenue per Adjusted Patient Admission	\$ 19,310	\$ (665)	\$ 19,899
Cost per Adjusted Patient Admission	\$ 18,364	\$ 530	\$ 17,781
<b><u>Spectrum Health Regional Hospitals</u></b>			
Admissions	10,852	(506)	11,259
Patient Days - Acute care	31,965	(1,893)	34,210
Patient Days - Observation	3,025	(112)	3,326
Patient Days - Long Term Care	30,066	(1,149)	30,567
Adjusted Admissions	57,683	(121)	57,439
Net Revenue per Adjusted Patient Admission	\$ 7,166	\$ (294)	\$ 6,984
Cost per Adjusted Patient Admission	\$ 6,948	\$ 236	\$ 6,633
<b><u>Spectrum Health Post Acute Care</u></b>			
Patient Days - Fuller	60,575	(1,458)	61,928
Patient Days - Kalamazoo	46,725	(3,591)	47,263
Home Health Admissions	8,437	1,702	6,273
Hospice Days	74,772	5,980	65,426
Hours of Care - Neuro Homecare	249,053	(33,018)	283,179
<b><u>Spectrum Health Physician Services</u></b>			
Ambulatory Practice Panel Size*	364,319	(4,156)	317,320
<b><u>Spectrum Health Medical Group</u></b>			
Encounters <sup>^</sup>	1,858,805	(209,421)	1,744,434
wRVU's <sup>^</sup>	3,072,146	(379,519)	2,849,300
wRVU's / Encounter	1.65	(0.02)	1.63
Net Revenue per wRVU	\$ 140.21	\$ 1.97	\$ 139.64
Cost per wRVU	\$ 137.74	\$ (0.26)	\$ 140.99
<b><u>Spectrum Health Regional Hospital Physician Services</u></b>			
Encounters	401,817	(56,244)	353,165
wRVU's	533,526	(102,531)	463,798
wRVU's / Encounter	1.33	(0.06)	1.31
Net Revenue per wRVU	\$ 97.93	\$ 0.84	\$ 95.96
Cost per wRVU	\$ 143.39	\$ (16.06)	\$ 121.95

\*including Regional Hospital Physician Services

<sup>^</sup>Existing operations encounters and wRVU's were 97,097 and 163,392 worse than Plan, respectively

<sup>□</sup>Restated to conform with current year presentation

**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Key Statistics**

Nine months ended March 31, 2017

**PRIORITY HEALTH**

	<u>Actual</u>	<u>Better (Worse) than Plan</u>	<u>Prior Year</u>
Number of Member Months			
- Group	2,876,926	166,010	2,573,627
- ASO Stop Loss	775,188	(10,969)	745,129
<b><i>Total Group</i></b>	<u>3,652,114</u>	<u>155,041</u>	<u>3,318,756</u>
<b><i>Individual</i></b>	939,412	(27,295)	696,978
- Senior Products	1,180,156	18,971	1,026,119
- Medicaid	1,066,837	75,037	1,006,446
<b><i>Total Governmental Programs</i></b>	<u>2,246,993</u>	<u>94,008</u>	<u>2,032,565</u>
<b><i>Total Member Months</i></b>	<u><u>6,838,519</u></u>	<u><u>221,754</u></u>	<u><u>6,048,299</u></u>
Membership for the month ended March 2017	<u><u>794,599</u></u>	<u><u>43,159</u></u>	<u><u>720,601</u></u>

**Spectrum Health System  
Liquidity Worksheet\*  
March 31, 2017  
(Dollars in 000s)**

<b>Assets</b>				
	<b>Assets With Same-Day Liquidity</b>	<b>Assets With Next-Day Liquidity</b>	<b>Assets &gt; Next-Day Liquidity</b>	<b>Total</b>
Cash & Cash Equivalents	\$116,202	-	-	\$116,202
S&P Rated Money Market Funds (> Am)	126,760	-	-	126,760
U.S. Treasury Debt Obligations (> 1 year)	-	140,946	-	140,946
U.S. TIPs	-	30,302	-	30,302
U.S. Agencies (> 1 year)	-	-	121,339	121,339
Investment Grade Debt (not included above)	-	75,653	246,515	322,168
Equities	-	-	407,825	407,825
Non-Investment Grade Debt	-	-	847	847
<b>Total</b>	<b>\$242,962</b>	<b>\$246,901</b>	<b>\$776,525</b>	<b>\$1,266,388</b>

<b>Self-Liquidity Backed Debt</b>				
	<b>Same-Day Notice</b>	<b>Next-Day Notice</b>	<b>&gt; Next-Day Notice</b>	<b>Total</b>
Series 2015A Variable Rate Demand Obligation (Windows)	\$ -	\$ -	\$78,400	\$78,400

\*The table represents assets that would be reasonably available to Spectrum Health System to satisfy a liquidity event. The table does not include assets held by affiliates that would not be reasonably available to satisfy a liquidity event, including assets held by Spectrum Health Foundation and Priority Health, among others.

**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Consolidating Balance Sheets**

March 31, 2017

	<b>Delivery System</b>	<b>Priority Health</b>	<b>Corporate &amp; Subsidiaries</b>	<b>Reclass &amp; Eliminations</b>	<b>Total</b>
Cash and cash equivalents	\$ 215,448	\$ 296,791	\$ 49,751	\$ (28,013)	\$ 533,977
Short-term investments	-	341,110	-	-	341,110
Patient accounts receivable, net	339,342	-	-	-	339,342
Other accounts receivable, net	16,532	138,023	974	-	155,529
Third party receivables	512	-	-	-	512
Pledges receivable	4,359	-	5,995	-	10,354
Inventory	40,639	-	-	-	40,639
Prepaid expenses and other current assets	17,046	11,296	29,370	-	57,712
<b>Total Current Assets</b>	<b>633,878</b>	<b>787,220</b>	<b>86,090</b>	<b>(28,013)</b>	<b>1,479,175</b>
Due from affiliates	237,656	80,918	172,229	(490,803)	-
Investment in system	-	-	35,473	(35,473)	-
Assets limited as to use & other LT investments	25,644	571,759	1,310,958	(21,792)	1,886,569
<b>Donor and Restricted Assets</b>					
Investments	-	-	154,919	-	154,919
Assets designated for affiliates (FAS 136)	145,835	-	-	(145,835)	-
Pledges receivable	25,653	-	21,231	-	46,884
	171,488	-	176,150	(145,835)	201,803
Property and equipment, net	1,433,209	23,444	90,145	-	1,546,798
<b>Other assets:</b>					
Investment in Joint Ventures	18,598	-	-	-	18,598
Goodwill, net	1,696	10,331	8,144	-	20,171
Other intangible assets and costs	2,090	5,906	-	-	7,996
Other long-term assets	9,887	4,499	115,910	-	130,296
	32,271	20,736	124,054	-	177,061
<b>TOTAL ASSETS</b>	<b>\$ 2,534,146</b>	<b>\$ 1,484,077</b>	<b>\$ 1,995,099</b>	<b>\$ (721,916)</b>	<b>\$ 5,291,406</b>



**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Consolidating Balance Sheets**

March 31, 2017

	<b>Delivery System</b>	<b>Priority Health</b>	<b>Corporate &amp; Subsidiaries</b>	<b>Reclass &amp; Eliminations</b>	<b>Total</b>
Accounts payable and accrued expenses	\$ 163,206	\$ 286,710	\$ 51,113	\$ (28,175)	\$ 472,854
Accrued salaries, wages and related withholdings	133,549	-	67,473	-	201,022
Health plan claims payable	-	319,279	-	-	319,279
Short term debt	78,400	-	-	-	78,400
Current maturities of long-term debt	17,586	1,245	1,151	-	19,982
<b>Total Current Liabilities</b>	<b>392,741</b>	<b>607,234</b>	<b>119,737</b>	<b>(28,175)</b>	<b>1,091,537</b>
Due to affiliates	190,480	153,328	168,786	(512,594)	-
Third party settlement liabilities	23,662	-	-	-	23,662
Interest rate swaps	1,619	-	96,775	-	98,394
Long-term debt, less current portion	669,558	22,832	51,944	-	744,334
Professional liability accrual	-	-	46,498	-	46,498
Accrued pension obligation	4,275	-	118,627	-	122,902
Other long term liabilities	16,201	901	99,463	-	116,565
Net Assets (deficit):					
Common Stock	-	19	-	(19)	-
Additional paid-in capital	67,024	53,993	-	(121,017)	-
Unrestricted (deficit)	999,585	645,770	1,154,638	43,498	2,843,491
Temporarily restricted	110,184	-	80,747	(87,661)	103,270
Permanently restricted	58,598	-	57,884	(58,175)	58,307
Total System Net Assets	1,235,391	699,782	1,293,269	(223,374)	3,005,068
Non-controlling interest	219	-	-	42,227	42,446
Total Net Assets	1,235,610	699,782	1,293,269	(181,147)	3,047,514
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 2,534,146</b>	<b>\$ 1,484,077</b>	<b>\$ 1,995,099</b>	<b>\$ (721,916)</b>	<b>\$ 5,291,406</b>

**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Consolidating Statements of Activities**

Nine months ended March 31, 2017

	<b>Delivery System</b>	<b>Priority Health</b>	<b>Corporate and Subs</b>	<b>Reclass &amp; Elim</b>	<b>Total</b>
<b><u>OPERATING REVENUE (net of deductions)</u></b>					
Health plan	\$ -	\$ 2,575,496	\$ -	\$ (164,452)	\$ 2,411,044
Patient service revenue (net of contractual allow & adjustments)	2,251,228	-	-	(460,247)	1,790,981
Provision for bad debt	(72,926)	-	-	-	(72,926)
Net patient service revenue less provision for bad debts	2,178,302	-	-	(460,247)	1,718,055
Other	64,723	22,140	494,946	(497,205)	84,604
<b>Total operating revenue</b>	<b>2,243,025</b>	<b>2,597,636</b>	<b>494,946</b>	<b>(1,121,904)</b>	<b>4,213,703</b>
<b><u>OPERATING EXPENSES</u></b>					
Salaries, wages and employee benefits	1,145,157	35	306,699	(174,955)	1,276,936
Supplies and other	878,161	289,729	166,059	(499,123)	834,826
Health plan payments to other providers	-	2,261,902	-	(447,825)	1,814,077
Depreciation and amortization	114,141	1,800	22,208	-	138,149
Interest	18,017	1,233	(861)	(920)	17,469
<b>Total operating expenses</b>	<b>2,155,476</b>	<b>2,554,699</b>	<b>494,105</b>	<b>(1,122,823)</b>	<b>4,081,457</b>
<b>Net operating income</b>	<b>87,549</b>	<b>42,937</b>	<b>841</b>	<b>919</b>	<b>132,246</b>
<i>Net operating margin %</i>	<i>3.9%</i>	<i>1.7%</i>	<i>0.2%</i>	<i>(0.1)%</i>	<i>3.1%</i>
<b><u>OTHER REVENUE (EXPENSE):</u></b>					
Investment Income, net	1,233	16,564	44,761	(920)	61,638
Unrealized gain (loss) on investments, net	771	(5,808)	42,954	-	37,917
Gain (loss) on interest rate swaps, net	399	-	33,303	-	33,702
Other income (expense)	(1,437)	1,608	(5,266)	1,594	(3,501)
<b>Total other revenue (expenses)</b>	<b>966</b>	<b>12,364</b>	<b>115,752</b>	<b>674</b>	<b>129,756</b>
<b>EXCESS OF REVENUE OVER (UNDER) EXPENSES</b>	<b>88,515</b>	<b>55,301</b>	<b>116,593</b>	<b>1,593</b>	<b>262,002</b>
Less: Excess of revenue over (under) expenses attributable to noncontrolling interest	(76)	-	-	(3,247)	(3,323)
<b>EXCESS OF REVENUE OVER (UNDER) EXPENSES ATTRIBUTABLE TO SYSTEM</b>	<b>\$ 88,439</b>	<b>\$ 55,301</b>	<b>\$ 116,593</b>	<b>\$ (1,654)</b>	<b>\$ 258,679</b>
<b>Total margin %</b>	<b>3.9%</b>	<b>2.1%</b>	<b>19.1%</b>	<b>0.1%</b>	<b>6.0%</b>

SPECTRUM HEALTH SYSTEM AND AFFILIATES

Consolidating Statements of Activities (continued)

Nine months ended March 31, 2017

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	System Sub-Total	Controlling Interest	System Total
<b>Net asset balance (deficit) at beginning of year</b>	\$ 1,056,675	\$ 590,469	\$ 1,178,102	\$ (91,963)	\$ 2,733,283	\$ 39,123	\$ 2,772,406
Excess of revenue over (under) expenses	88,439	55,301	116,593	(1,654)	258,679	3,323	262,002
Contributions	-	-	18,250	-	18,250	-	18,250
Expenditures of donor sponsored programs	(1,014)	-	(11,707)	-	(12,721)	-	(12,721)
Capital transfers (to affiliate) from Foundation	1,649	-	(1,649)	-	-	-	-
Investment income (loss) from restricted net assets	1,976	-	5,654	-	7,630	-	7,630
FAS 136 activity - current year	11,138	-	-	(11,138)	-	-	-
Pension related changes other than net periodic pension costs	(2,417)	-	-	2,417	-	-	-
<b>Transfers:</b> Corporate	13,766	-	(13,766)	-	-	-	-
Foundation	(1,801)	-	1,801	-	-	-	-
Other activity	(44)	-	(9)	-	(53)	-	(53)
	\$ 1,168,367	\$ 645,770	\$ 1,293,269	\$ (102,338)	\$ 3,005,068	\$ 42,446	\$ 3,047,514

**SPECTRUM HEALTH SYSTEM AND AFFILIATES**

**Consolidating Statements of Cash Flows**

Nine months ended March 31, 2017

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
<b><u>OPERATING ACTIVITIES AND OTHER REVENUE</u></b>					
Change in net assets	\$ 111,768	\$ 55,301	\$ 115,167	\$ (7,128)	\$ 275,108
Contributions and other net asset activity	(918)	-	(12,188)	-	(13,106)
Unrealized (gain) loss in market value of interest rate swaps	(757)	-	(42,596)	-	(43,353)
Depreciation and amortization	114,141	1,800	22,208	-	138,149
Pension-related changes other than net periodic pension costs	2,417	-	-	(2,417)	-
Changes in operating assets and liabilities:					
Trading securities					
- Assets limited as to use	(1,379)	(110,717)	(46,301)	1,404	(156,993)
- Donor restricted investments	-	-	(17,371)	-	(17,371)
FAS136 changes	(11,138)	-	-	11,138	-
Decrease (increase) in net AR, inventories, prepaid expenses, third-party settlement receivables and other operating assets	(13,318)	(4,762)	(5,512)	(15)	(23,607)
Increase (decrease) in AP, accrued expenses, accrued salaries and related withholdings, health plan claims payable, third-party settlement liabilities and other operating liabilities	(31,795)	116,496	11,839	(13,342)	83,198
Other	247	192	(5,910)	64	(5,407)
<b>Net cash provided by (used in) operating activities and other revenue</b>	<b>169,268</b>	<b>58,310</b>	<b>19,336</b>	<b>(10,296)</b>	<b>236,618</b>
<b><u>INVESTING ACTIVITIES</u></b>					
Additions to property and equipment, net	(115,664)	-	(28,472)	-	(144,136)
Nexus additions	(46,864)	-	-	-	(46,864)
Investment in System	-	-	1,590	(1,590)	-
Other	(9,020)	-	-	-	(9,020)
<b>Net cash provided by (used in) investing activities</b>	<b>(171,548)</b>	<b>-</b>	<b>(26,882)</b>	<b>(1,590)</b>	<b>(200,020)</b>
<b><u>FINANCING ACTIVITIES</u></b>					
Contributions and other net asset activity	918	-	12,188	-	13,106
Proceeds from issuance of long-term debt	-	-	6,500	-	6,500
Payment of long-term debt	(16,277)	(926)	(1,112)	(20)	(18,335)
Inter-company - due to/due from affiliates, net	(45,651)	27,547	19,541	(1,437)	-
Inter-company transfers	13,614	-	(13,614)	-	-
<b>Net cash provided by (used in) financing activities</b>	<b>(47,396)</b>	<b>26,621</b>	<b>23,503</b>	<b>(1,457)</b>	<b>1,271</b>
<b>Increase (decrease) in cash</b>	<b>(49,676)</b>	<b>84,931</b>	<b>15,957</b>	<b>(13,343)</b>	<b>37,869</b>
<b>Cash, beginning of year</b>	<b>265,124</b>	<b>211,860</b>	<b>33,794</b>	<b>(14,670)</b>	<b>496,108</b>
<b>Cash, end of year</b>	<b>\$ 215,448</b>	<b>\$ 296,791</b>	<b>\$ 49,751</b>	<b>\$ (28,013)</b>	<b>\$ 533,977</b>