

Spectrum Health System and Affiliates Consolidated Financial Statements

December 31, 2017



CHIEF FINANCIAL OFFICER'S REPORT

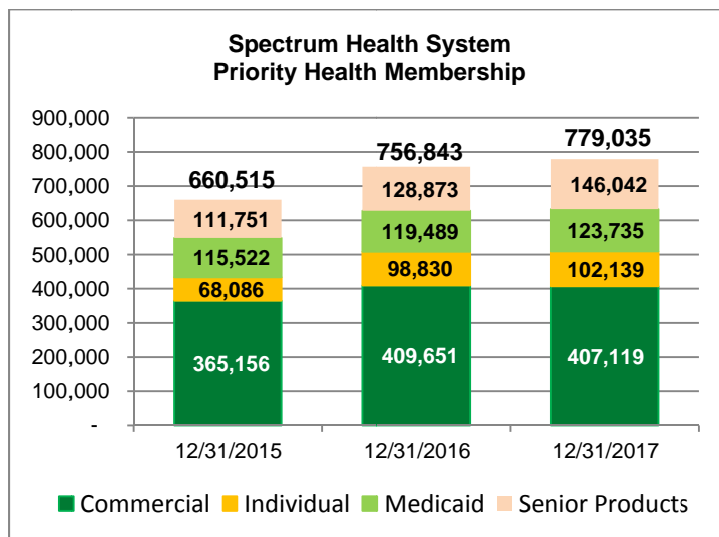
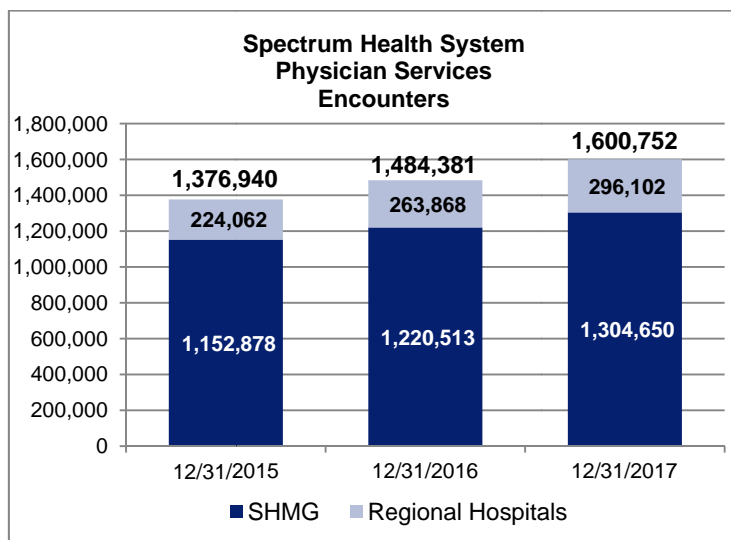
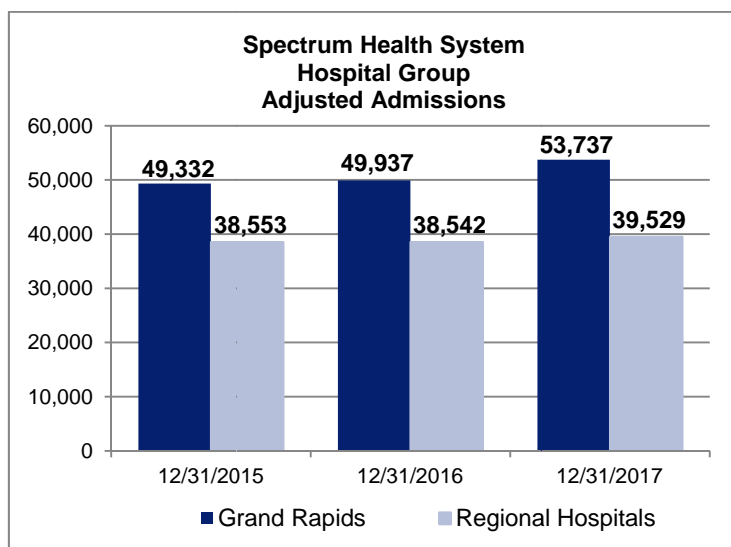
Year-to-date December 31, 2017



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 slightly from prior year. Spectrum Health Grand Rapids adjusted (for outpatient) admissions totaled 53,737 which represents an increase of 7.6% from December 2016 levels, and are ahead of planned levels by 4.2%. Regional hospitals adjusted admissions increased 2.6% over December 2016, but are behind planned levels by 1.2%. Spectrum Health Physicians Services encounters totaled 1.6 million which was an increase of 7.8% over the prior year, but was 0.5% behind Plan. Health insurance membership was 779,035 as of December 31, 2017, which was a 2.9% increase compared to December 31, 2016, but was behind Plan by 2.6%.

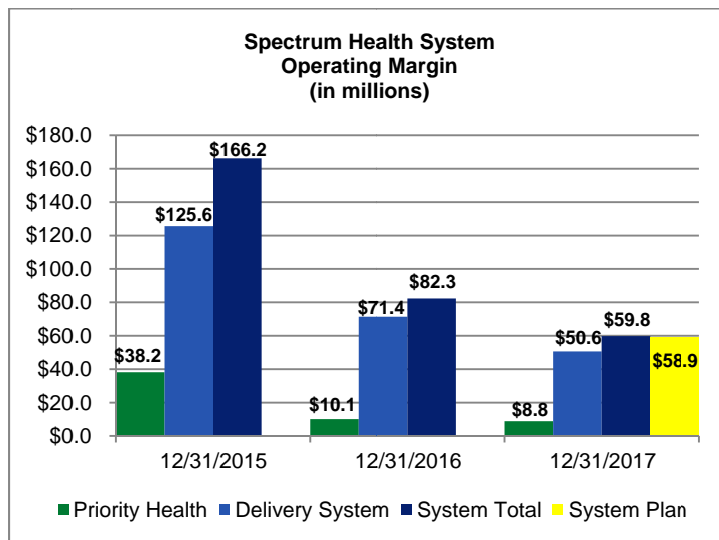


MARGIN

The System's excess of revenue over expense year-to-date December 2017, was \$161.6 million or 5.3% of total revenue. The System's operating margin was \$59.8 million or 2.0% of net operating revenue.

The Delivery System's operating margin was \$50.6 million, or 3.3%, which was unfavorable to Plan by \$7.6 million and unfavorable to prior year by \$20.8 million. Strong Delivery System volumes were offset by lower revenue per adjusted admission due to medical admissions and increased outpatient activity.

Priority Health's operating margin was \$8.8 million, or 0.5%, which was favorable to Plan by \$8.5 million and unfavorable to prior year by \$1.3 million. The favorable variance was a result of favorable pharmacy and administrative cost initiatives, as well as positive risk adjustment performance.



CHIEF FINANCIAL OFFICER'S REPORT

Year-to-date December 31, 2017



OTHER REVENUE (EXPENSE)

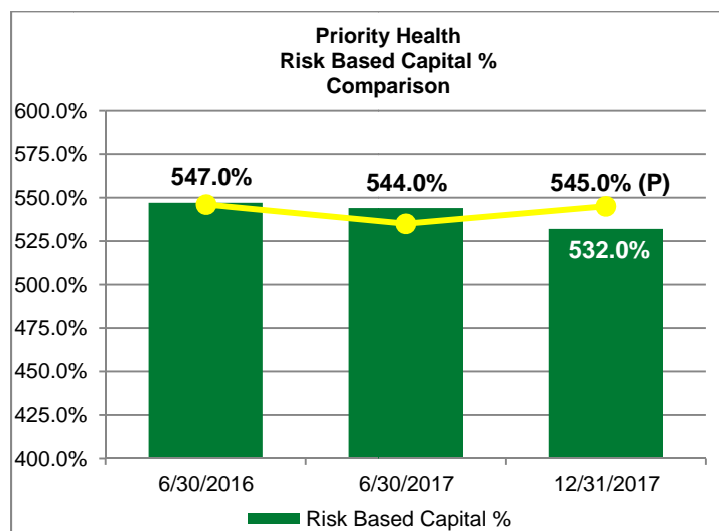
Net other revenue of \$103.5 million was comprised primarily of \$105.9 million of investment gains. The \$105.9 million of investment gains consisted of \$60.5 million of realized investment returns (interest, dividends and realized gains/losses) and \$45.4 million of unrealized investment gains, which are a function of the market. The \$103.5 million net other revenue was \$40.8 million higher than December 2016.

LIQUIDITY AND CASH FLOW

At December 31, 2017, total cash and investments for the System were at \$2.8 billion, a decrease of \$33.1 million from June 30, 2017. The decrease is driven by working capital of \$176.7 million, facility, information technology, and equipment additions totaling \$125.4 million, and net changes in long term debt of \$7.5 million. These were offset by an operating cash flow margin of \$169.1 million, non-operating cash increases of \$95.0 million related to investment returns and \$12.5 million in contributions.

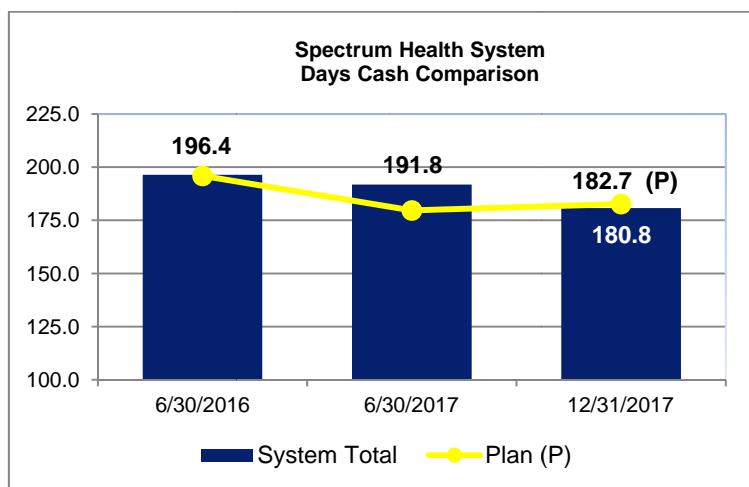
RATIOS

Days cash on hand for the System decreased by 11.0 days to 180.8 at December 31, 2017 from June 30, 2017. Priority Health's risk based capital (RBC) was 532.0%. Operating cash flow margin was 5.7%, which is below Moody's Aa3 median of 8.9% for 2016.



EQUITY STRUCTURE

Debt was approximately \$834.2 million at the end of December and fund balance was approximately \$3.4 billion. The long-term debt to capitalization ratio for the System at December 2017 was 21.0%, which was lower than the Moody's Aa3 median of 29.5% for 2016. Total assets for the System were approximately \$5.4 billion. The balance sheet is the strongest in the history of the company.



Respectfully submitted,

Matthew E. Cox
 Senior Vice President & Chief Financial Officer
 (matthew.cox@spectrumhealth.org)
 December 2017

Ratio Analysis - Total System

December 31, 2017



	Actual December 31, 2017	Actual June 30, 2017	Plan June 30, 2018	S&P Median 2016	Moody's Median 2016
Profitability Ratios					
Operating Margin	2.0%	3.4%	2.8%	2.4%	3.7%
Total Margin	5.3%	6.1%	3.7%	4.1%	6.6%
Return on Assets	5.9%	6.6%	4.1%	n/a	5.3%
Operating Cash Flow Margin	5.7%	7.0%	6.6%	n/a	8.9%
Liquidity Indicators					
Days in Patient Receivables	60.9	53.4	53.8	47.4	48.8
Days Cash (unrestricted) on Hand	180.8	191.8	182.7	210.3	234.2
Current Ratio	1.3	1.3	1.5	n/a	1.7
Cash to Debt %	330.1%	331.4%	349.3%	n/a	202.7%
Capital Structure					
Long Term Debt to Capitalization	21.0%	22.1%	20.6%	32.0%	29.5%
Proforma Long Term Debt to Capitalization [^]	23.7%	25.0%	23.5%	n/a	n/a
Debt Service Coverage	11.8	12.8	9.9	3.9	6.9
Debt to Cash Flow	1.6	1.6	1.9	n/a	2.3
Risk Based Capital (PH only)	532.0%	544.0%	545.0%	n/a	449.0% (a)
Average Age of Plant	10.2	10.1	9.5	11.0	10.1
Capital expenditures to depreciation	1.3	1.5	1.0	1.2	1.3

(a) Provider Sponsored Health Plan benchmark which consists of eight similar sized health plans. Benchmark data is based on September 30, 2017 statutory filings.

Note: Moody's figures are medians for freestanding hospitals, single-state & multi-state healthcare systems with Aa3 bond ratings for 2016. Spectrum Health's current rating from Moody's is Aa3.
S&P figures are medians for not-for-profit acute health care, which include stand-alone hospitals and health care systems, for 2016. Spectrum Health's current rating for S&P is AA.

[^] Estimated impact of proposed lease accounting standard in FY20.

Key Statistics

Year-to-date December 31, 2017



	Actual	Better (Worse) than Plan	Prior Year*
<u>Spectrum Health Grand Rapids</u>			
Admissions	31,912	1,190	30,365
Patient Days - Acute care	150,431	(179)	151,286
Patient Days - Observation	5,707	29	6,041
Patient Days - Long Term Care ^o	39,183	(796)	39,597
Adjusted Admissions	53,737	2,144	49,937
Net Revenue per Adjusted Patient Admission	\$ 18,942	\$ (827)	\$ 19,693
Cost per Adjusted Patient Admission	\$ 18,256	\$ 837	\$ 18,681
<u>Spectrum Health Regional Hospitals</u>			
Admissions	6,966	(260)	7,143
Patient Days - Acute care	20,034	(911)	20,548
Patient Days - Observation	2,137	140	1,960
Patient Days - Long Term Care	20,159	128	20,192
Adjusted Admissions	39,529	(468)	38,542
Net Revenue per Adjusted Patient Admission	\$ 7,130	\$ (124)	\$ 7,164
Cost per Adjusted Patient Admission	\$ 6,760	\$ 52	\$ 6,923
<u>Spectrum Health Post Acute Care</u>			
Patient Days - Kalamazoo	33,783	15	30,377
Home Health Admissions	5,624	(716)	5,364
Hospice Days	58,775	8,332	50,187
Hours of Care - Neuro Homecare	154,586	(14,060)	166,981
<u>Spectrum Health Physician Services</u>			
Primary Care Covered Lives	390,158	(3,004)	356,264
Priority Health Assigned Lives	104,968	N/A	100,165
<u>Spectrum Health Medical Group</u>			
Encounters	1,304,650	(7,259)	1,220,513
wRVU's	2,098,533	(94,582)	2,009,008
wRVU's / Encounter	1.61	(0.06)	1.65
Net Patient Revenue per wRVU	\$ 90.06	\$ (0.11)	\$ 89.11
Cost per wRVU	\$ 140.31	\$ (4.21)	\$ 137.79
<u>Spectrum Health Regional Hospital Physician Services</u>			
Encounters	296,102	(814)	263,868
wRVU's	372,344	(14,976)	347,634
wRVU's / Encounter	1.26	(0.05)	1.32
Net Patient Revenue per wRVU	\$ 112.06	\$ 1.95	\$ 100.48
Cost per wRVU	\$ 144.28	\$ (4.93)	\$ 146.06

*Restated to conform with current year presentation

^oEffective August 1, 2017, operations for Fuller RNC transferred to Spectrum Health Grand Rapids

Key Statistics

Year-to-date December 31, 2017



	Actual	Better (Worse) than Plan	Prior Year
<u>Membership</u>			
Group	319,674	(16,578)	322,252
Individual	102,139	(1,486)	98,830
ASO Stop Loss	87,445	(365)	87,399
Total Commercial	509,258	(18,429)	508,481
Senior Products (Medicare and Medigap)	146,042	642	128,873
Medicaid	123,735	(3,311)	119,489
Total Membership	779,035	(21,098)	756,843
<u>Medical Cost Ratio</u>			
Total Commercial	91.7%	(0.2)%	92.4%
Senior Products (Medicare and Medigap)	88.8%	(0.3)%	86.3%
Medicaid	86.8%	4.0%	90.2%
Total Medical Cost Ratio	90.1%	0.3%	90.1%

**Spectrum Health System
Liquidity Worksheet*
December 31, 2017
(in thousands)**

Assets				
	Assets With Same-Day Liquidity	Assets With Next-Day Liquidity	Assets > Next-Day Liquidity	Total
Cash & Cash Equivalents	\$ 75,976	\$ -	\$ -	\$ 75,976
S&P Rated Money Market Funds (> Am)	80,108	-	-	80,108
U.S. Treasury Debt Obligations (> 1 year)	-	161,653	-	161,653
U.S. TIPS	-	31,411	-	31,411
U.S. Agencies (> 1 year)	-	-	113,174	113,174
Investment Grade Debt (not included above)	-	105,638	242,043	347,681
Equities	-	113,047	327,034	440,081
Non-Investment Grade Debt	-	-	723	723
Total	\$ 156,084	\$ 411,749	\$ 682,973	\$ 1,250,807

Self-Liquidity Backed Debt				
	Same-Day Notice	Next-Day Notice	> Next-Day Notice	Total
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.

Consolidating Balance Sheets

December 31, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
Cash and cash equivalents	\$ 141,121	\$ 218,469	\$ 33,509	\$ (27,156)	\$ 365,943
Short term investments	-	344,652	-	-	344,652
Patient accounts receivable, net	388,988	-	-	-	388,988
Other accounts receivable, net	12,858	124,448	840	-	138,146
Third party receivables	413	-	-	-	413
Pledges receivable	3,551	-	9,236	-	12,787
Inventory	41,907	-	-	-	41,907
Prepaid expenses and other current assets	13,234	2,121	41,901	-	57,256
Total Current Assets	602,072	689,690	85,486	(27,156)	1,350,092
Due from affiliates	153,946	85,242	150,201	(389,389)	-
Investment in system	-	-	31,930	(31,930)	-
Assets limited as to use and other LT investments	27,715	650,362	1,392,910	(23,675)	2,047,312
Donor and Restricted Assets					
Investments	-	-	171,502	-	171,502
Assets designated for affiliates (FAS 136)	155,578	-	-	(155,578)	-
Pledges receivable	27,339	-	19,032	-	46,371
	182,917	-	190,534	(155,578)	217,873
Property and equipment, net	1,489,659	22,712	104,267	-	1,616,638
Other assets:					
Investment in Joint Ventures	31,376	-	-	-	31,376
Goodwill, net	1,696	10,331	8,144	-	20,171
Other intangible assets and costs	1,876	5,070	-	-	6,946
Other long term assets	14,797	4,882	138,121	-	157,800
	49,745	20,283	146,265	-	216,293
TOTAL ASSETS	\$ 2,506,054	\$ 1,468,289	\$ 2,101,593	\$ (627,728)	\$ 5,448,208

Consolidating Balance Sheets

December 31, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
Accounts payable and accrued expenses	\$ 171,935	\$ 216,867	\$ 63,912	\$ (27,264)	\$ 425,450
Accrued salaries, wages and related withholdings	126,027	-	64,782	-	190,809
Health plan claims payable	-	291,148	-	-	291,148
Short term debt	78,400	-	-	-	78,400
Current maturities of long term debt	17,779	1,245	1,151	-	20,175
Total Current Liabilities	394,141	509,260	129,845	(27,264)	1,005,982
Due to affiliates	87,738	161,154	164,172	(413,064)	-
Third party settlement liabilities	27,395	-	-	-	27,395
Interest rate swaps	1,279	-	91,585	-	92,864
Long term debt, less current portion	661,704	21,898	51,973	-	735,575
Professional liability accrual	-	-	53,213	-	53,213
Accrued pension obligation	2,581	-	36,577	-	39,158
Other long term liabilities	19,486	896	113,954	-	134,336
Net Assets (deficit):					
Common Stock	-	19	-	(19)	-
Additional paid-in capital	67,024	53,993	-	(121,017)	-
Unrestricted	1,055,921	721,069	1,311,717	42,281	3,130,988
Temporarily restricted	122,619	-	82,986	(89,982)	115,623
Permanently restricted	66,020	-	65,571	(65,596)	65,995
Total System Net Assets	1,311,584	775,081	1,460,274	(234,333)	3,312,606
Non-controlling interest	146	-	-	46,933	47,079
Total Net Assets	1,311,730	775,081	1,460,274	(187,400)	3,359,685
TOTAL LIABILITIES AND NET ASSETS	\$ 2,506,054	\$ 1,468,289	\$ 2,101,593	\$ (627,728)	\$ 5,448,208

Consolidating Statements of Activities

Year-to-date December 31, 2017

(in thousands)



	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
<u>OPERATING REVENUE (net of deductions)</u>					
Premium Revenue	\$ -	\$ 1,806,336	\$ -	\$ (91,110)	\$ 1,715,226
Patient service revenue (net of contractual allow & adjustments)	1,559,198	-	-	(324,086)	1,235,112
Provision for bad debt	(59,530)	-	-	-	(59,530)
Net patient service revenue less provision for bad debts	1,499,668	-	-	(324,086)	1,175,582
Other	40,819	26,292	1,587	(683)	68,015
Total operating revenue	1,540,487	1,832,628	1,587	(415,879)	2,958,823
<u>OPERATING EXPENSES</u>					
Salaries, wages and employee benefits	807,070	10	209,990	(98,622)	918,448
Supplies and other	590,297	199,883	(223,840)	188	566,528
Health plan payments to other providers	-	1,622,133	-	(317,392)	1,304,741
Depreciation and amortization	79,638	1,000	15,896	-	96,534
Interest	12,899	759	(551)	(364)	12,743
Total operating expenses	1,489,904	1,823,785	1,495	(416,190)	2,898,994
Net operating income	50,583	8,843	92	311	59,829
Net operating margin %	3.3%	0.5%	5.8%	(0.1)%	2.0%
<u>OTHER REVENUE (EXPENSE):</u>					
Investment Income, net	1,281	12,523	47,052	(363)	60,493
Unrealized gain (loss) on investments, net	674	9,902	34,830	-	45,406
Gain (loss) on interest rate swaps, net	31	-	3,251	-	3,282
Other income (expense)	(442)	(2,253)	(5,076)	2,139	(5,632)
Total other revenue (expenses)	1,544	20,172	80,057	1,776	103,549
EXCESS OF REVENUE OVER (UNDER) EXPENSES	52,127	29,015	80,149	2,087	163,378
Less: Excess of revenue over (under) expenses attributable to noncontrolling interest	29	-	-	(1,797)	(1,768)
EXCESS OF REVENUE OVER (UNDER) EXPENSES ATTRIBUTABLE TO SYSTEM	\$ 52,156	\$ 29,015	\$ 80,149	\$ 290	\$ 161,610
Total margin %	3.4%	1.6%	98.2%	(0.1)%	5.3%

Consolidating Statements of Activities (continued)

Year-to-date December 31, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	System Sub-Total	Controlling Interest	System Total
Net asset balance (deficit) at beginning of year	\$ 1,176,955	\$ 692,054	\$ 1,374,402	\$ (104,869)	\$ 3,138,542	\$ 45,311	\$ 3,183,853
Excess of revenue over (under) expenses	52,156	29,015	80,149	290	161,610	1,768	163,378
Contributions	-	-	14,289	-	14,289	-	14,289
Expenditures of donor sponsored programs	(680)	-	(7,942)	-	(8,622)	-	(8,622)
Capital transfers (to affiliate) from Foundation	2,684	-	(2,684)	-	-	-	-
Investment income (loss) from restricted net assets	1,875	-	5,012	-	6,887	-	6,887
FAS 136 activity - current year	8,749	-	-	(8,749)	-	-	-
Transfers: Corporate	3,589	-	(3,589)	-	-	-	-
Foundation	(635)	-	635	-	-	-	-
Other activity	(133)	-	2	31	(100)	-	(100)
Net asset balance at end of year	<u>\$ 1,244,560</u>	<u>\$ 721,069</u>	<u>\$ 1,460,274</u>	<u>\$ (113,297)</u>	<u>\$ 3,312,606</u>	<u>\$ 47,079</u>	<u>\$ 3,359,685</u>

Consolidating Statements of Cash Flows

Year-to-date December 31, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
<u>OPERATING ACTIVITIES AND OTHER REVENUE</u>					
Change in net assets	\$ 67,576	\$ 29,015	\$ 85,872	\$ (6,631)	\$ 175,832
Contributions and other net asset activity	(1,062)	-	(11,361)	(31)	(12,454)
Unrealized (gain) loss in market value of interest rate swaps	(237)	-	(8,355)	-	(8,592)
Depreciation and amortization	79,638	1,000	15,896	-	96,534
Changes in operating assets and liabilities:					
Trading securities					
Assets limited as to use	(1,512)	(54,642)	(62,212)	1,321	(117,045)
Donor restricted investments	-	-	(12,686)	-	(12,686)
FAS136 changes	(8,749)	-	-	8,749	-
Decrease (increase) in net AR, inventories, prepaid expenses, third-party settlement receivables and other operating assets	(55,844)	38,852	(24,030)	-	(41,022)
Increase (decrease) in AP, accrued expenses, accrued salaries and related withholdings, health plan claims payable, third-party settlement liabilities and other operating liabilities	32,421	(118,268)	1,519	(15,960)	(100,288)
Other	(731)	(24)	(202)	-	(957)
Net cash provided by (used in) operating activities and other revenue	111,500	(104,067)	(15,559)	(12,552)	(20,678)
<u>INVESTING ACTIVITIES</u>					
Additions to property and equipment, net	(69,875)	-	(23,162)	-	(93,037)
Nexus additions	(32,362)	-	-	-	(32,362)
Investment in System	-	-	2,170	(2,170)	-
Other	(8,996)	-	-	-	(8,996)
Net cash provided by (used in) investing activities	(111,233)	-	(20,992)	(2,170)	(134,395)
<u>FINANCING ACTIVITIES</u>					
Contributions and other net asset activity	1,062	-	11,361	31	12,454
Proceeds from issuance of long term debt	56,490	-	-	-	56,490
Payment of long term debt	(63,361)	(623)	-	-	(63,984)
Inter-company - due to/due from affiliates, net	(7,388)	15,372	(6,663)	(1,321)	-
Inter-company transfers	5,638	-	(5,638)	-	-
Net cash provided by (used in) financing activities	(7,559)	14,749	(940)	(1,290)	4,960
Increase (decrease) in cash	(7,292)	(89,318)	(37,491)	(16,012)	(150,113)
Cash, beginning of year	148,413	307,787	71,000	(11,144)	516,056
Cash, end of year	\$ 141,121	\$ 218,469	\$ 33,509	\$ (27,156)	\$ 365,943