

# Spectrum Health System and Affiliates Consolidated Financial Statements

September 30, 2017



# CHIEF FINANCIAL OFFICER'S REPORT

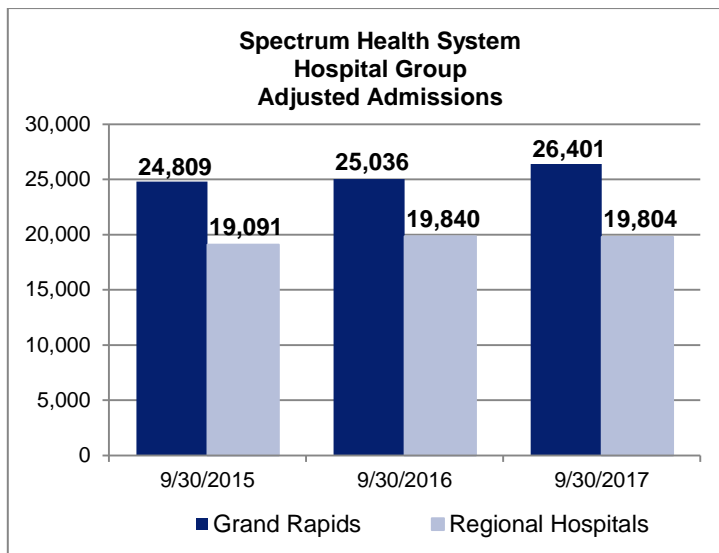
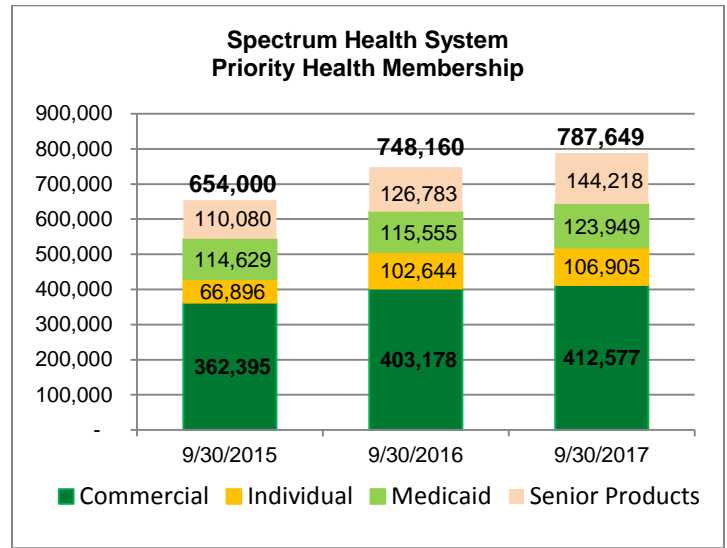
Year-to-date September 30, 2017



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 26,401 which represents an increase of 5.5% from September 2016 levels, and are ahead of planned levels by 3.0%. Regional hospitals adjusted admissions decreased 0.2% over September 2016, and are behind planned levels by 1.2%. Spectrum Health Physicians Services encounters totaled 759,678 which was an increase of 5.8% over the prior year. Health insurance membership was 787,649 as of September 30, 2017, which was a 5.3% increase compared to September 30, 2016.

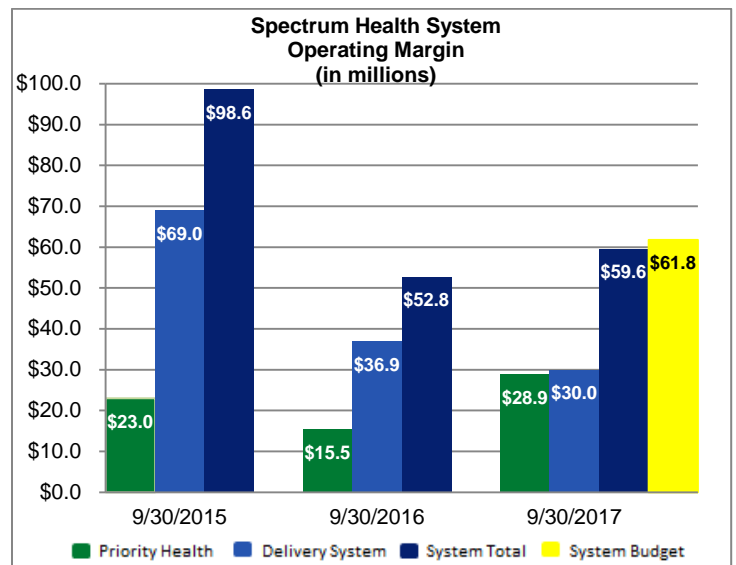
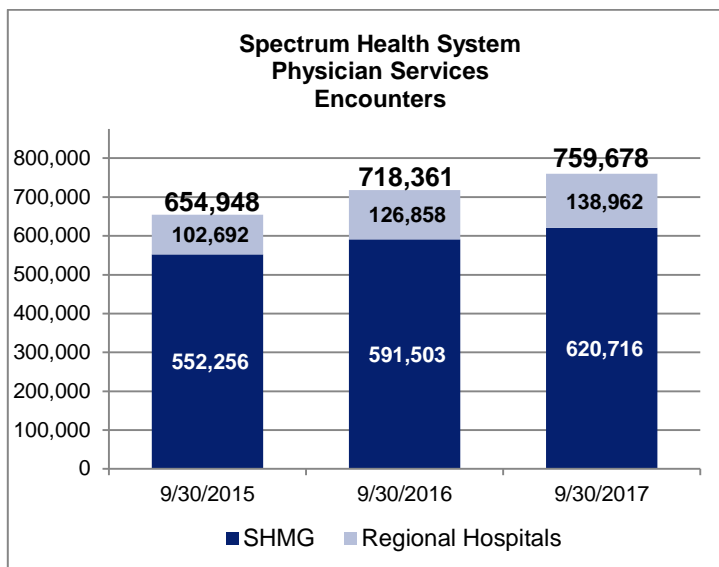


## MARGIN

The System's excess of revenue over expense year-to-date September 2017, was \$105.5 million or 7.0% of total revenue. The System's operating margin was \$59.6 million or 4.1% of net operating revenue.

The Delivery System's operating margin was \$30.0 million, or 4.0%, which was unfavorable to Plan by \$6.5 million and unfavorable to prior year by \$6.9 million. Delivery System volumes were below Plan, notably for NICU census, emergency department visits, encounters and wRVUs.

Priority Health's operating margin was \$28.9 million, or 3.2%, which was favorable to Plan by \$3.8 million and favorable to prior year by \$13.4 million. The favorable variance was a result of favorable pharmacy initiatives and positive risk adjustment performance.



# CHIEF FINANCIAL OFFICER'S REPORT

Year-to-date September 30, 2017



## OTHER REVENUE (EXPENSE)

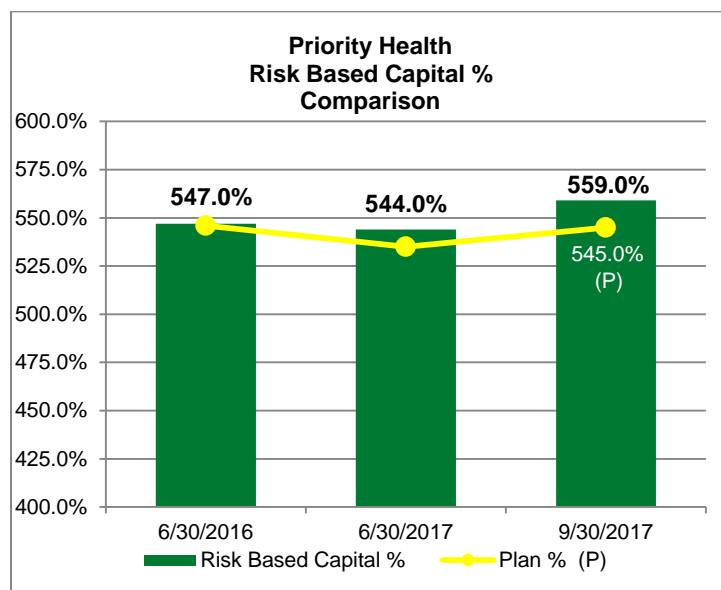
The net other revenue of \$48.3 million was comprised primarily of \$53.3 million of investment gains and \$1.4 million of swap losses. The \$53.3 million of investment gains consisted of \$38.9 million of unrealized investment gains and \$14.4 million of realized investment returns (interest, dividends and realized gains/losses), which are a function of the market. The \$48.3 million net other revenue was \$2.9 million higher than September 2016.

## LIQUIDITY AND CASH FLOW

At September 30, 2017, total cash and investments for the System were at \$2.9 billion, an increase of \$95.9 million from June 30, 2017. The increase is driven by operating cash flow margin of \$113.1 million and non-operating cash increases of \$47.3 million related to investment returns. These were offset by facility, information technology, and equipment additions totaling \$54.0 million and a decrease to working capital of \$13.1 million.

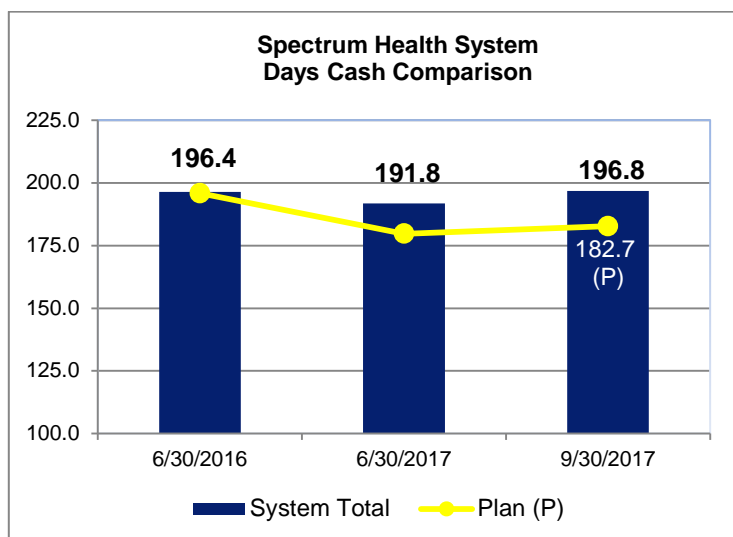
## RATIOS

Days cash on hand for the System increased by 5.0 days to 196.8 at September 30, 2017 from June 30, 2017. Priority Health's risk based capital (RBC) was 559.0%. Operating cash flow margin was 7.8%, which is below Moody's Aa3 median of 8.9% for 2016.



## EQUITY STRUCTURE

Debt was approximately \$840.3 million at the end of September and fund balance was approximately \$3.3 billion. The long-term debt to capitalization ratio for the System at September 2017 was 21.5%, which was lower than the Moody's Aa3 median of 29.5% for 2016. Total assets for the System were approximately \$5.5 billion.



Respectfully submitted,

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

## Ratio Analysis - Total System

September 30, 2017



	Actual September 30, 2017	Actual June 30, 2017	Plan June 30, 2018	Moody's Median 2016
<b>Profitability Ratios</b>				
Operating Margin	4.1%	3.4%	2.8%	3.7%
Total Margin	7.0%	6.1%	3.7%	6.6%
Return on Assets	7.6%	6.6%	4.1%	5.3%
Operating Cash Flow Margin	7.8%	7.0%	6.6%	8.9%
<b>Liquidity Indicators</b>				
Days in Patient Receivables	57.2	53.4	53.8	48.8
Days Cash (unrestricted) on Hand	196.8	191.8	182.7	234.2
Current Ratio	1.3	1.3	1.5	1.7
Cash to Debt %	343.0%	331.4%	349.3%	202.7%
<b>Capital Structure</b>				
Long Term Debt to Capitalization	21.5%	22.1%	20.6%	29.5%
Proforma Long Term Debt to Capitalization - Leases*	24.1%	25.0%	23.5%	n/a
Debt Service Coverage	14.0	12.8	9.9	6.9
Debt to Cash Flow	1.4	1.6	1.9	2.3
Risk Based Capital (PH only)	559.0%	544.0%	545.0%	449.0%
Average Age of Plant	10.3	10.1	9.5	10.1
Capital expenditures to depreciation	1.1	1.5	1.0	1.3

(a) Provider Sponsored Health Plan benchmark which consists of eight similar sized health plans.  
Benchmark data is based on June 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.

\* Estimated impact of proposed lease accounting standard in FY20.

## Key Statistics

Year-to-date September 30, 2017



	Actual	Better (Worse) than Plan	Prior Year*
<b><u>Spectrum Health Grand Rapids</u></b>			
Admissions	15,684	369	15,184
Patient Days - Acute care	73,298	(1,623)	75,091
Patient Days - Observation	3,123	243	3,021
Patient Days - Long Term Care°	19,409	(790)	19,400
Adjusted Admissions	26,401	761	25,036
Net Revenue per Adjusted Patient Admission	\$ 18,803	\$ (850)	\$ 19,517
Cost per Adjusted Patient Admission	\$ 17,915	\$ 795	\$ 18,369
<b><u>Spectrum Health Regional Hospitals</u></b>			
Admissions	3,468	(67)	3,587
Patient Days - Acute care	9,905	(309)	10,029
Patient Days - Observation	1,041	25	975
Patient Days - Long Term Care	10,134	(151)	10,036
Adjusted Admissions	19,804	(244)	19,840
Net Revenue per Adjusted Patient Admission	\$ 6,975	\$ (288)	\$ 6,915
Cost per Adjusted Patient Admission	\$ 6,596	\$ 154	\$ 6,724
<b><u>Spectrum Health Post Acute Care</u></b>			
Patient Days - Kalamazoo	16,775	(63)	14,664
Home Health Admissions	2,932	(238)	2,169
Hospice Days	28,553	3,451	24,767
Hours of Care - Neuro Homecare	79,891	(4,432)	83,036
<b><u>Spectrum Health Physician Services</u></b>			
Primary Care Covered Lives	383,403	(1,294)	346,516
Priority Health Assigned Lives	105,619	N/A	97,980
<b><u>Spectrum Health Medical Group</u></b>			
Encounters^	620,716	(17,497)	591,503
wRVU's^	1,017,275	(55,686)	981,247
wRVU's / Encounter	1.64	(0.04)	1.66
Net Patient Revenue per wRVU	\$ 87.90	\$ (1.30)	\$ 85.40
Cost per wRVU	\$ 140.49	\$ (3.43)	\$ 136.75
<b><u>Spectrum Health Regional Hospital Physician Services</u></b>			
Encounters	138,962	(9,463)	126,858
wRVU's	180,348	(13,784)	169,785
wRVU's / Encounter	1.30	(0.01)	1.34
Net Patient Revenue per wRVU	\$ 108.07	\$ (0.70)	\$ 102.67
Cost per wRVU	\$ 145.84	\$ (7.05)	\$ 146.70

^Existing operations encounters and wRVU's were 6,780 and 35,083 worse than Plan, respectively

\*Restated to conform with current year presentation

°Effective August 1, 2017, operations for Fuller RNC transferred to Spectrum Health Grand Rapids

## Key Statistics

Year-to-date September 30, 2017



	Actual	Better (Worse) than Plan	Prior Year
<b><u>Membership</u></b>			
Group	325,532	(10,629)	316,376
Individual	106,905	647	102,644
ASO Stop Loss	87,045	(298)	86,802
Total Commercial	519,482	(10,280)	505,822
Senior Products (Medicare and Medigap)	144,218	250	126,783
Medicaid	123,949	(1,855)	115,555
<b>Total Membership</b>	<b>787,649</b>	<b>(11,885)</b>	<b>748,160</b>
<b><u>Medical Cost Ratio</u></b>			
Total Commercial	87.1%	1.6%	89.9%
Senior Products (Medicare and Medigap)	87.0%	(1.9)%	86.6%
Medicaid	90.7%	0.5%	88.5%
<b>Total Medical Cost Ratio</b>	<b>87.4%</b>	<b>0.3%</b>	<b>88.6%</b>

**Spectrum Health System  
Liquidity Worksheet\*  
September 30, 2017  
(in thousands)**

<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	\$ 80,281	\$ -	\$ -	\$ 80,281
S&P Rated Money Market Funds (> Am)	78,454	-	-	78,454
U.S. Treasury Debt Obligations (> 1 year)	-	159,070	-	159,070
U.S. TIPs	-	30,742	-	30,742
U.S. Agencies (> 1 year)	-	-	116,304	116,304
Investment Grade Debt (not included above)	-	90,122	239,835	329,956
Equities	-	43,757	397,086	440,843
Non-Investment Grade Debt	-	-	754	754
Total	\$ 158,736	\$ 323,690	\$ 753,978	\$ 1,236,403

<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
	-	-	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

September 30, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
Cash and cash equivalents	\$ 167,815	\$ 376,326	\$ 26,419	\$ (35,044)	\$ 535,516
Short term investments	-	343,302	-	-	343,302
Patient accounts receivable, net	358,536	-	-	-	358,536
Other accounts receivable, net	16,484	94,139	1,261	-	111,884
Third party receivables	8	-	-	-	8
Pledges receivable	2,939	-	8,611	-	11,550
Inventory	40,729	-	-	-	40,729
Prepaid expenses and other current assets	15,809	6,562	38,249	-	60,620
<b>Total Current Assets</b>	<b>602,320</b>	<b>820,329</b>	<b>74,540</b>	<b>(35,044)</b>	<b>1,462,145</b>
Due from affiliates	137,391	87,624	142,219	(367,234)	-
Investment in system	-	-	33,004	(33,004)	-
Assets limited as to use and other LT investments	27,077	629,628	1,374,310	(22,994)	2,008,021
Donor and Restricted Assets					
Investments	-	-	165,864	-	165,864
Assets designated for affiliates (FAS 136)	148,723	-	-	(148,723)	-
Pledges receivable	26,392	-	19,032	-	45,424
	175,115	-	184,896	(148,723)	211,288
Property and equipment, net	1,473,106	22,994	97,213	-	1,593,313
Other assets:					
Investment in Joint Ventures	25,598	-	-	-	25,598
Goodwill, net	1,696	10,331	8,144	-	20,171
Other intangible assets and costs	1,948	5,348	-	-	7,296
Other long term assets	17,674	5,275	127,097	-	150,046
	46,916	20,954	135,241	-	203,111
<b>TOTAL ASSETS</b>	<b>\$ 2,461,925</b>	<b>\$ 1,581,529</b>	<b>\$ 2,041,423</b>	<b>\$ (606,999)</b>	<b>\$ 5,477,878</b>



# Consolidating Balance Sheets

September 30, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
Accounts payable and accrued expenses	\$ 171,764	\$ 293,712	\$ 58,091	\$ (35,204)	\$ 488,363
Accrued salaries, wages and related withholdings	131,884	-	58,211	-	190,095
Health plan claims payable	-	327,275	-	-	327,275
Short term debt	78,400	-	-	-	78,400
Current maturities of long term debt	17,696	1,245	1,151	-	20,092
<b>Total Current Liabilities</b>	<b>399,744</b>	<b>622,232</b>	<b>117,453</b>	<b>(35,204)</b>	<b>1,104,225</b>
Due to affiliates	87,222	151,499	151,506	(390,227)	-
Third party settlement liabilities	21,994	-	-	-	21,994
Interest rate swaps	1,435	-	99,020	-	100,455
Long term debt, less current portion	667,646	22,210	51,962	-	741,818
Professional liability accrual	-	-	47,320	-	47,320
Accrued pension obligation	2,667	-	40,901	-	43,568
Other long term liabilities	15,613	879	106,529	-	123,021
Net Assets (deficit):					
Common Stock	-	19	-	(19)	-
Additional paid-in capital	67,024	53,993	-	(121,017)	-
Unrestricted	1,017,503	730,697	1,284,616	40,684	3,073,500
Temporarily restricted	118,854	-	80,524	(87,111)	112,267
Permanently restricted	62,036	-	61,592	(61,613)	62,015
Total System Net Assets	1,265,417	784,709	1,426,732	(229,076)	3,247,782
Non-controlling interest	187	-	-	47,508	47,695
Total Net Assets	1,265,604	784,709	1,426,732	(181,568)	3,295,477
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 2,461,925</b>	<b>\$ 1,581,529</b>	<b>\$ 2,041,423</b>	<b>\$ (606,999)</b>	<b>\$ 5,477,878</b>

## Consolidating Statements of Activities

Year-to-date September 30, 2017

(in thousands)



	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
<b>OPERATING REVENUE (net of deductions)</b>					
Premium Revenue	\$ -	\$ 890,734	\$ -	\$ (46,267)	\$ 844,467
Patient service revenue (net of contractual allow & adjustments)	763,623	-	-	(153,830)	609,793
Provision for bad debt	(32,677)	-	-	-	(32,677)
Net patient service revenue less provision for bad debts	730,946	-	-	(153,830)	577,116
Other	20,009	12,178	718	(246)	32,659
<b>Total operating revenue</b>	<b>750,955</b>	<b>902,912</b>	<b>718</b>	<b>(200,343)</b>	<b>1,454,242</b>
<b>OPERATING EXPENSES</b>					
Salaries, wages and employee benefits	389,042	4	99,672	(50,022)	438,696
Supplies and other	287,407	98,181	(107,768)	70	277,890
Health plan payments to other providers	-	774,981	-	(150,391)	624,590
Depreciation and amortization	38,158	502	8,555	-	47,215
Interest	6,342	382	(282)	(184)	6,258
<b>Total operating expenses</b>	<b>720,949</b>	<b>874,050</b>	<b>177</b>	<b>(200,527)</b>	<b>1,394,649</b>
<b>Net operating income</b>	<b>30,006</b>	<b>28,862</b>	<b>541</b>	<b>184</b>	<b>59,593</b>
<b>Net operating margin %</b>	<b>4.0%</b>	<b>3.2%</b>	<b>75.4%</b>	<b>(0.1)%</b>	<b>4.1%</b>
<b>OTHER REVENUE (EXPENSE):</b>					
Investment Income, net	426	5,879	8,320	(184)	14,441
Unrealized gain (loss) on investments, net	510	5,892	32,494	-	38,896
Gain (loss) on interest rate swaps, net	(27)	-	(1,350)	-	(1,377)
Other income (expense)	(245)	(1,990)	(2,484)	1,096	(3,623)
<b>Total other revenue (expenses)</b>	<b>664</b>	<b>9,781</b>	<b>36,980</b>	<b>912</b>	<b>48,337</b>
<b>EXCESS OF REVENUE OVER (UNDER) EXPENSES</b>	<b>30,670</b>	<b>38,643</b>	<b>37,521</b>	<b>1,096</b>	<b>107,930</b>
Less: Excess of revenue over (under) expenses attributable to noncontrolling interest	(12)	-	-	(2,372)	(2,384)
<b>EXCESS OF REVENUE OVER (UNDER) EXPENSES ATTRIBUTABLE TO SYSTEM</b>	<b>\$ 30,658</b>	<b>\$ 38,643</b>	<b>\$ 37,521</b>	<b>\$ (1,276)</b>	<b>\$ 105,546</b>
<b>Total margin %</b>	<b>4.1%</b>	<b>4.2%</b>	<b>99.5%</b>	<b>0.6%</b>	<b>7.0%</b>

## Consolidating Statements of Activities (continued)

Year-to-date September 30, 2017



(in thousands)

	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>	\$ 1,176,955	\$ 692,054	\$ 1,374,402	\$ (104,869)	\$ 3,138,542	\$ 45,311	\$ 3,183,853
Excess of revenue over (under) expenses	30,658	38,643	37,521	(1,276)	105,546	2,384	107,930
Contributions	-	-	4,601	-	4,601	-	4,601
Expenditures of donor sponsored programs	(337)	-	(3,524)	-	(3,861)	-	(3,861)
Capital transfers (to affiliate) from Foundation	1,615	-	(1,615)	-	-	-	-
Investment income (loss) from restricted net assets	585	-	2,362	-	2,947	-	2,947
FAS 136 activity - current year	1,895	-	-	(1,895)	-	-	-
<b>Transfers:</b> Corporate	(12,459)	-	12,459	-	-	-	-
Foundation	(541)	-	541	-	-	-	-
Other activity	22	-	(15)	-	7	-	7
<b>Net asset balance at end of year</b>	<u>\$ 1,198,393</u>	<u>\$ 730,697</u>	<u>\$ 1,426,732</u>	<u>\$ (108,040)</u>	<u>\$ 3,247,782</u>	<u>\$ 47,695</u>	<u>\$ 3,295,477</u>

## Consolidating Statements of Cash Flows

Year-to-date September 30, 2017



(in thousands)

	Delivery System	Priority Health	Corporate & Subsidiaries	Reclass & Eliminations	Total
<b><u>OPERATING ACTIVITIES AND OTHER REVENUE</u></b>					
Change in net assets	\$ 21,450	\$ 38,643	\$ 52,330	\$ (799)	\$ 111,624
Contributions and other net asset activity	(270)	-	(3,424)	-	(3,694)
Unrealized (gain) loss in market value of interest rate swaps	(81)	-	(920)	-	(1,001)
Depreciation and amortization	38,158	502	8,555	-	47,215
Changes in operating assets and liabilities:					
Trading securities					
Assets limited as to use	(874)	(32,558)	(43,612)	640	(76,404)
Donor restricted investments	-	-	(7,048)	-	(7,048)
FAS136 changes	(1,894)	-	-	1,894	-
Decrease (increase) in net AR, inventories, prepaid expenses, third-party settlement receivables and other operating assets	(31,328)	64,272	(9,355)	-	23,589
Increase (decrease) in AP, accrued expenses, accrued salaries and related withholdings, health plan claims payable, third-party settlement liabilities and other operating liabilities	28,919	(5,313)	(19,867)	(23,900)	(20,161)
Other	76	(31)	(12)	-	33
<b>Net cash provided by (used in) operating activities and other revenue</b>	<b>54,156</b>	<b>65,515</b>	<b>(23,353)</b>	<b>(22,165)</b>	<b>74,153</b>
<b><u>INVESTING ACTIVITIES</u></b>					
Additions to property and equipment, net	(32,475)	-	(8,763)	-	(41,238)
Nexus additions	(12,715)	-	-	-	(12,715)
Investment in System	-	-	1,096	(1,096)	-
Other	(3,218)	-	-	-	(3,218)
<b>Net cash provided by (used in) investing activities</b>	<b>(48,408)</b>	<b>-</b>	<b>(7,667)</b>	<b>(1,096)</b>	<b>(57,171)</b>
<b><u>FINANCING ACTIVITIES</u></b>					
Contributions and other net asset activity	270	-	3,424	-	3,694
Proceeds from issuance of long term debt	-	-	-	-	-
Payment of long term debt	(905)	(311)	-	-	(1,216)
Inter-company - due to/due from affiliates, net	25,674	3,335	(28,370)	(639)	-
Inter-company transfers	(11,385)	-	11,385	-	-
<b>Net cash provided by (used in) financing activities</b>	<b>13,654</b>	<b>3,024</b>	<b>(13,561)</b>	<b>(639)</b>	<b>2,478</b>
<b>Increase (decrease) in cash</b>	<b>19,402</b>	<b>68,539</b>	<b>(44,581)</b>	<b>(23,900)</b>	<b>19,460</b>
<b>Cash, beginning of year</b>	<b>148,413</b>	<b>307,787</b>	<b>71,000</b>	<b>(11,144)</b>	<b>516,056</b>
<b>Cash, end of year</b>	<b>\$ 167,815</b>	<b>\$ 376,326</b>	<b>\$ 26,419</b>	<b>\$ (35,044)</b>	<b>\$ 535,516</b>