# Management's Discussion and Analysis of Financial Condition and Results of Operations for Ascension

As of and for the nine months ended March 31, 2019 and 2018

Ascension

The following information should be read in conjunction with Ascension's consolidated financial statements and related notes to the consolidated financial statements.

# Introduction to Management's Discussion and Analysis

The purpose of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is to provide a narrative explanation of the financial position and operations of Ascension (the System).

Unless otherwise indicated, all financial and statistical information included herein relates to continuing operations. MD&A includes the following sections:

- Strategic Direction
- Portfolio Changes
- Results of Operations — Consolidated
- Liquidity and Capital Resources

## Strategic Direction

Ascension is driven by the changing consumer landscape to put our patients and their needs first. Providing care for all persons where, how and when they need it – that is the organization's strategic purpose.

With a commitment to the Mission, Vision and Values of Ascension, the organization is working to optimize and transform core healthcare operations while also creating new models of care that help meet the needs of the communities we serve.

Ascension continues to make strategic and purposeful investments to improve the health of individuals and communities served, engage with consumers in new ways and evaluate geographic presence. To best position itself for the future, the organization is connecting with consumers when and where they need care.

Having completed its transition from a holding company to an operating company, Ascension is embarking on a new Mission-inspired Transformation initiative to accelerate new and innovated approaches to various operational areas. In alignment with the Advanced Strategic Direction, the Mission-inspired Transformation creates a roadmap for how Ascension will work to implement new strategies while reimagining health and wellness for the sustainability of our organization and to have an even greater impact on all those we serve.

## Portfolio Changes

Effective March 14, 2019, Ascension Sacred Heart Health System (Sacred Heart), a wholly owned subsidiary of Ascension Healthcare in Florida, acquired Ardent Health Services' 80% interest in Bay Medical Center (Bay Medical). Upon closing of the transaction, Bay Medical, in Panama City, Florida, became wholly owned by and consolidated under the operations of Sacred Heart.

## Results of Operations – Consolidated

The following table reflects summary financial information, on a consolidated basis.

### Select Financial Data (in millions)

| | 3/31/2019 | 6/30/2018 | | 3/31/2019 | 6/30/2018 |
|---|---|---|---|---|---|
| Current Assets | $ 6,344 | $ 5,514 | Current Liabilities | $ 5,782 | $ 5,389 |
| Long-Term Investments | 19,245 | 19,405 | Long-Term Liabilities | 9,650 | 10,021 |
| Property and Equipment | 10,588 | 10,598 | Total Liabilities | 15,432 | 15,410 |
| Other Assets | 3,039 | 3,011 | Net Assets | 23,784 | 23,118 |
| Total Assets | $ 39,216 | $ 38,528 | Total Liabilities and Net Assets | $ 39,216 | $ 38,528 |

### Select Financial Data (in millions)

| Nine months ended March 31, | 2019 | 2018 |
|---|---|---|
| Net Cost of Providing Care of Persons Living in Poverty and Other Community Benefit Programs | $ 1,478 | $ 1,600 |
| Total Operating Revenue | 18,904 | 17,085 |
| Income from Recurring Operations | 435 | 282 |

Consistent with trends seen through the second quarter of the fiscal year, changes in the healthcare landscape and planned changes in the way that we provide services to our communities have resulted in expected shifts in volumes within our System. Over the past several years, Ascension has systematically been building capacity to manage the care of those we serve in a different manner, as we migrate from fee for service to fee for value and from inpatient to outpatient care. Ascension care delivery is evolving from treating people when they are sick to being a partner in the well-being of individuals – measuring the care we provide by the quality outcomes and experience to patients.

Income from recurring operations has increased year over year by approximately 55% primarily due to operational improvement initiatives and focus on standardization, increased income from joint ventures, and gains from sales of assets.

On a consolidated basis, recurring operating margin was 2.3% for the nine months ended March 31, 2019 compared to 1.6% for the same period in the prior year. The drivers impacting net patient service revenue are further discussed below. The net income as of March 31, 2019 also reflects favorable investment market performance.

The following table reflects certain patient volume information and key performance indicators, on a consolidated basis, for the nine months ended March 31, 2019 and 2018.

## Volume Trends and Key Performance Indicators

| Nine months ended March 31, | 2019 | 2018 |
|---|---|---|
| **Volume Trends** | | |
| Equivalent Discharges | 1,280,479 | 1,197,349 |
| Total Admissions | 609,361 | 572,624 |
| Case Mix Index | 1.69 | 1.67 |
| Acute Average Length of Stay (days) | 4.52 | 4.52 |
| Emergency Room Visits | 2,484,928 | 2,371,324 |
| Surgery Visits (IP & OP) | 479,944 | 455,321 |
| Physician Office and Clinic Visits | 11,160,146 | 10,356,609 |
| | | |
| **Revenue (in millions)** | | |
| Total Operating Revenue | $ 18,904 | $ 17,085 |
| Net Patient Service Revenue | 17,647 | 15,988 |
| | | |
| **Key Performance Indicators** | | |
| Recurring Operating Margin | 2.3% | 1.6% |
| Recurring Operating EBITDA Margin | 8.2% | 7.5% |
| Operating EBITDA Margin | 7.9% | 6.8% |

### Total Operating Revenue

Total operating revenue increased $1.8 billion, or 10.6%, for the nine months ended March 31, 2019, as compared to the same period in prior year primarily due to revenue recorded by Presence facilities acquired March 1, 2018. On a same facility basis, total operating revenue increased $293.0 million, or 1.7%.

### Net Patient Service Revenue and Volume Trends

For the nine months ended March 31, 2019, net patient service revenue, increased $1.7 billion or 10.4%. On a same facility basis, net patient service revenue increased $226.7 million, or 1.4%, compared to the same period in the prior year. Also on a same facility basis, net patient service revenue per equivalent discharge increased 3.2% compared to the same period in the prior year, dampened by changes in payor mix and transition of services to outpatient settings.

For the nine months ended March 31, 2019, equivalent discharges, inpatient admissions, emergency room visits, and inpatient surgeries increased 6.9%, 6.4%, 4.8%, and 2.7%, respectively, as compared to the same period in the prior year primarily due to the previously mentioned acquisition of Presence. On a same facility basis, equivalent discharges, inpatient admissions, emergency room visits, and inpatient surgeries decreased 1.8%, 3.6%, 3.8%, and 3.4%, respectively.

For the nine months ended March 31, 2019, outpatient services as a percentage of total services provided increased 1.7% on a same facility basis compared to the same period in the prior year. Outpatient volumes increased 9.4% compared to the same period in the prior year primarily driven by an increase in physician office and clinic visits of 7.8%. On a same facility basis, outpatient visits increased 0.4%. Outpatient surgeries increased 6.7% compared to the same period in the prior year and increased 0.1% on a same facility basis.

### Uncompensated Care

Ascension provided $1.48 billion in Care of Persons Living in Poverty and Other Community Benefit Programs for the nine months ended March 31, 2019. Through programs, donations, health education, free care, and more, the organization's uncompensated care and other community benefit fulfills unmet needs in communities across 21 states and the District of Columbia.

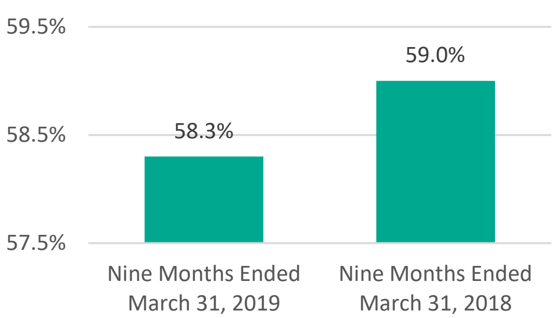
## Total Operating Expenses

Total operating expenses increased $1.6 billion, or 9.8%, as compared to the same period in the prior year primarily due to the previously mentioned acquisition of Presence.

As volumes continue to shift to outpatient services, Ascension is managing its cost structure to align with revenues. On a same facility basis, total operating expenses increased $115.5 million, or 0.7%, and cost per equivalent discharge increased only 2.5% compared to the previously mentioned increase in net patient service revenue per equivalent discharge of 3.2%.

- Total salaries, wages and benefits increased slightly by $12.4 million, or 0.1%, compared to the same period in the prior year. Employed and contract labor per adjusted occupied bed has improved to 3.8 compared to 3.9 FTEs for the same period in the prior year. These decreases have been partially offset by moderate merit and cost of living adjustments and the employment of additional physicians. Salaries, wages, and benefits, including the purchased services labor component, as a percentage of net patient service revenue, has improved from 59.0% as of March 31, 2018 to 58.3% as of March 31, 2019.

Salaries and Benefits[1]
as % of Net Patient Service Revenue - Same Facility




[1] Includes the purchased services labor component and physician fees

- Despite rapidly increasing specialty and generic drug pricing and a higher intensity service mix supplies expense increased by a modest 1.7%, as compared to the same period in the prior year due to ongoing focused supply contract management efforts. Supplies expense, as a percentage of net patient service revenue remained flat at 16.2% for the nine months ended March 31, 2018 and 2019.

- Purchased services and professional fees increased $128.0 million, or 4.9%, as compared to the same period in the prior year primarily due to the transition of revenue services to a preferred provider partner organization and an increase in repair and maintenance expenses. There were offsetting decreases in salaries and wages, benefits, collection agency fees and other related operating costs for the transition of these services.

## Impairment, Restructuring and Nonrecurring Losses

Net impairment, restructuring and nonrecurring losses were $68.9 million for the nine months ended March 31, 2019, as compared to losses of $124.6 million during the nine months ended March 31, 2018.

## Investment Return

Ascension's long-term investments, excluding noncontrolling interests and long-term investments held by self-insurance programs, experienced a gain of 1.6%, or $299.2 million, for the nine months ended March 31, 2019. Substantially all the System's cash and investments are invested in a broadly diversified portfolio that is managed by Ascension Investment Management (AIM), a wholly owned subsidiary of Ascension. The System has maintained a consistent investment strategy during the current fiscal year.

Total net investments under management by AIM are $40 billion at March 31, 2019.

## Liquidity and Capital Resources

Net unrestricted cash and investments for the System were $16.9 billion at March 31, 2019 compared to $17.1 billion at June 30, 2018. The slight decrease is primarily due to capital purchases offset by cash generated by operations and investment income for the nine months ended March 31, 2019. Days cash on hand of 264 days decreased 4 days from June 30, 2018 to March 31, 2019 primarily due to items previously mentioned. Net days in accounts receivable improved 1 day from 51 days at June 30, 2018 to 50 days at March 31, 2019.

## Balance Sheet Ratios

| | 3/31/2019 | 6/30/2018 |
|---|---|---|
| Days Cash on Hand | 264 | 268 |
| Net Days in Accounts Receivable | 50 | 51 |
| Cash-to-Senior Debt | 218.4% | 217.2% |
| Senior Debt to Capitalization | 26.9% | 27.8% |
| Total Debt to Capitalization | 27.3% | 28.0% |