

**This document is dated May 15, 2012**

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UNAUDITED QUARTERLY REPORT

For the quarterly period ended  
March 31, 2012

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Dignity Health  
(formerly Catholic Healthcare West)  
and Subordinate Corporations

The information in this report  
has been provided by  
Dignity Health

# DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

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# DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

## CONDENSED CONSOLIDATED BALANCE SHEETS AS OF MARCH 31, 2012 AND JUNE 30, 2011 (In thousands)

	As of March 31, 2012	As of June 30, 2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 281,069	\$ 704,044
Short-term investments	914,862	825,849
Collateral held under securities lending program	228,736	290,526
Assets limited as to use	1,006,449	828,632
Patient accounts receivable, net of allowance for doubtful accounts of \$376,433 and \$297,294 at March 31, 2012 and June 30, 2011, respectively	1,396,311	1,257,296
Other current assets	<u>576,111</u>	<u>743,086</u>
Total current assets	<u>4,403,538</u>	<u>4,649,433</u>
Assets limited as to use:		
Board-designated assets (including \$254,326 and \$308,202 of assets loaned under securities lending program at March 31, 2012 and June 30, 2011, respectively) for:		
Capital projects	3,323,076	3,139,101
Workers' compensation	450,315	367,554
Hospital professional and general liability	202,650	162,091
Under bond indenture agreements for:		
Capital projects	240,443	51,679
Debt service	5,702	190,975
Bond reserves	20,631	26,387
Donor-restricted	438,063	439,932
Other	65,404	68,213
Less amount required to meet current obligations	<u>(1,006,449)</u>	<u>(828,632)</u>
Net assets limited as to use	<u>3,739,835</u>	<u>3,617,300</u>
Property and equipment, net	4,106,886	4,102,551
Ownership interests in health-related activities	563,895	558,178
Assets held for sale	50,094	-
Other long-term assets, net	<u>238,705</u>	<u>196,163</u>
Total assets	<u>\$ 13,102,953</u>	<u>\$ 13,123,625</u>

(Continued)

# DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

## CONDENSED CONSOLIDATED BALANCE SHEETS AS OF MARCH 31, 2012 AND JUNE 30, 2011 (In thousands)

	As of March 31, 2012	As of June 30, 2011
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 323,275	\$ 107,381
Demand bonds subject to short-term liquidity arrangements	574,000	574,000
Accounts payable	415,909	418,155
Payable under securities lending program	229,158	291,148
Accrued salaries and benefits	473,800	507,915
Accrued workers' compensation	41,647	31,647
Accrued hospital professional and general liability	61,304	61,304
Pension and other postretirement liabilities	278,599	278,369
Other accrued liabilities	<u>435,295</u>	<u>871,042</u>
Total current liabilities	<u>2,832,987</u>	<u>3,140,961</u>
Other liabilities:		
Workers' compensation	341,556	234,938
Hospital professional and general liability	231,542	228,559
Pension and other postretirement liabilities	564,261	598,697
Other	<u>106,830</u>	<u>115,823</u>
Total other liabilities	<u>1,244,189</u>	<u>1,178,017</u>
Long-term debt, net of current portion	<u>3,639,188</u>	<u>3,556,817</u>
Total liabilities	<u>7,716,364</u>	<u>7,875,795</u>
Net assets:		
Unrestricted - controlling interest	4,819,593	4,715,076
Unrestricted - noncontrolling interest	132,560	98,304
Temporarily restricted	326,526	326,503
Permanently restricted	<u>107,910</u>	<u>107,947</u>
Total net assets	<u>5,386,589</u>	<u>5,247,830</u>
Total liabilities and net assets	<u>\$ 13,102,953</u>	<u>\$ 13,123,625</u>

(Concluded)

See notes to unaudited condensed consolidated financial statements.

## DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE THREE AND NINE-MONTH PERIODS ENDED MARCH 31, 2012 AND 2011 (In thousands)

	Three-Month Periods Ended		Nine-Month Periods Ended	
	March 31,		March 31,	
	2012	2011	2012	2011
Unrestricted revenues and other support:				
Net patient revenue	\$ 2,325,054	\$ 2,194,783	\$ 6,947,122	\$ 7,110,501
Premium revenue	150,181	144,349	443,536	415,447
Revenue from health-related activities, net	32,937	45,118	50,955	106,523
Other operating revenue	57,580	50,410	190,726	144,538
Contributions	4,543	3,393	11,642	10,255
Total unrestricted revenues and other support	<u>2,570,295</u>	<u>2,438,053</u>	<u>7,643,981</u>	<u>7,787,264</u>
Expenses:				
Salaries and benefits	1,270,390	1,225,605	3,806,403	3,677,682
Supplies	354,381	344,729	1,028,514	1,024,649
Provision for bad debts	226,027	195,635	669,399	601,578
Purchased services and other	495,162	499,669	1,551,443	1,776,223
Depreciation	108,178	103,936	317,547	311,479
Interest expense, net (Note 12)	20,405	29,506	210,836	95,350
Loss on early extinguishment of debt	-	-	48	-
Special charges (Note 6)	11,697	-	30,789	-
Total expenses	<u>2,486,240</u>	<u>2,399,080</u>	<u>7,614,979</u>	<u>7,486,961</u>
Operating income	84,055	38,973	29,002	300,303
Other income:				
Investment income, net	<u>330,829</u>	<u>146,879</u>	<u>175,396</u>	<u>669,040</u>
Excess of revenues over expenses	<u>\$ 414,884</u>	<u>\$ 185,852</u>	<u>\$ 204,398</u>	<u>\$ 969,343</u>

(Continued)

## DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE THREE AND NINE-MONTH PERIODS ENDED MARCH 31, 2012 AND 2011 (In thousands)

	Three-Month Periods Ended March 31,		Nine-Month Periods Ended March 31,	
	2012	2011	2012	2011
Unrestricted net assets:				
Excess of revenues over expenses	\$ 414,884	\$ 185,852	\$ 204,398	\$ 969,343
Change in net unrealized gains on available-for-sale investments	4,597	227	258	7,113
Net assets released from restrictions used for purchase of property and equipment	7,850	3,664	14,314	8,458
Loss from discontinued operations, net (including estimated property value losses of \$34 million and \$94 million for the three and nine-month periods ended March 31, 2012)	(40,751)	(8,240)	(123,216)	(29,905)
Change in noncontrolling interests	10,049	6,482	34,256	8,139
Change in ownership interests held by controlled subsidiaries	5,949	4,813	815	7,391
Change in accumulated unrealized derivative gains, net	671	671	2,012	8,386
Donated property and equipment	3,552	3,238	6,041	7,127
Other	72	255	(105)	608
Increase in unrestricted net assets	406,873	196,962	138,773	986,660
Temporarily restricted net assets:				
Contributions	8,600	8,419	28,801	30,370
Net realized and unrealized gains on investments	2,894	1,581	862	7,095
Net assets released from restrictions	(13,689)	(10,172)	(28,620)	(24,739)
Change in interest in net assets of unconsolidated foundations	11,436	4,432	(1,168)	26,931
Other	(86)	(1,090)	148	(1,943)
Increase in temporarily restricted net assets	9,155	3,170	23	37,714
Permanently restricted net assets:				
Contributions	(1)	101	(17)	282
Net realized and unrealized gains on investments	21	15	53	56
Change in interest in net assets of unconsolidated foundations	31	747	(73)	5,451
Other	-	697	-	560
Increase (decrease) in permanently restricted net assets	51	1,560	(37)	6,349
Increase in net assets	416,079	201,692	138,759	1,030,723
Net assets, beginning of period	4,970,510	4,734,838	5,247,830	3,905,807
Net assets, end of period	\$ 5,386,589	\$ 4,936,530	\$ 5,386,589	\$ 4,936,530

(Concluded)

See notes to unaudited condensed consolidated financial statements.

## DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

### CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE-MONTH PERIODS ENDED MARCH 31, 2012 AND 2011

(In thousands)

	Nine-Month Periods Ended	
	March 31,	
	2012	2011
Cash flows from operating activities:		
Change in net assets	\$ 138,759	\$ 1,030,723
Adjustments to reconcile change in net assets to cash provided by operating activities:		
Loss on early extinguishment of debt	48	-
Depreciation, including discontinued operations	322,335	322,648
Amortization	(60)	1,250
Equity in earnings of health-related activities	(22,886)	(71,649)
Loss, net, on disposal of assets	192	1,299
Software development abandonment	19,091	-
Property value adjustments, including discontinued operations	94,000	-
Restricted contributions and investment income	(30,822)	(33,446)
Change in net realized and unrealized gains on investments	(115,733)	(609,732)
Undistributed portion of change in net assets of unconsolidated foundations	1,241	(32,382)
Change in fair value of swaps	76,010	(64,816)
Changes in certain assets and liabilities:		
Accounts receivable, net	(128,768)	(173,627)
Accounts payable	3,906	(6,875)
Workers' compensation and hospital professional and general liabilities	18,283	64,230
Accrued salaries and benefits	(35,038)	(29,800)
Pension and other postretirement liabilities	(34,206)	10,324
Other accrued liabilities	(58,750)	(47,472)
Other, net	(234,719)	(82,628)
Cash provided by operating activities	<u>12,883</u>	<u>278,047</u>

(Continued)

## DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

### CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE-MONTH PERIODS ENDED MARCH 31, 2012 AND 2011

(In thousands)

	Nine-Month Periods Ended	
	March 31,	
	2012	2011
Cash flows from investing activities:		
Net proceeds from sale (purchases) of investments	(302,412)	112,728
Cash proceeds on disposal of assets	828	428
Investment in health-related activities	-	(7,074)
Cash distributions from health-related activities	18,361	-
Additions to operating property and equipment	(438,427)	(455,219)
(Increase) decrease in securities lending collateral	61,990	(54,119)
Other, net	(4,190)	250
Cash used in investing activities	<u>(663,850)</u>	<u>(403,006)</u>
Cash flows from financing activities:		
Borrowings	1,195,361	133,390
Repayments	(929,224)	(201,809)
Increase (decrease) in payable under securities lending program	(61,990)	54,119
Restricted contributions and investment income	30,822	33,446
Deferred financing costs	(6,977)	(2,851)
Cash provided by financing activities	<u>227,992</u>	<u>16,295</u>
Net decrease in cash and cash equivalents	(422,975)	(108,664)
Cash and cash equivalents at beginning of period	<u>704,044</u>	<u>796,034</u>
Cash and cash equivalents at end of period	<u>\$ 281,069</u>	<u>\$ 687,370</u>
Components of cash and cash equivalents and investments at end of period:		
Cash and cash equivalents	\$ 281,069	\$ 687,370
Short-term investments	914,862	697,917
Board-designated assets for capital projects	<u>3,323,076</u>	<u>3,264,189</u>
Total	<u>\$ 4,519,007</u>	<u>\$ 4,649,476</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	<u>\$ 175,848</u>	<u>\$ 201,796</u>
Supplemental schedule of noncash investing and financing activities:		
Assets acquired through capital lease or note payable	<u>\$ 16,494</u>	<u>\$ 35,682</u>
Donated property and equipment	<u>\$ 6,041</u>	<u>\$ 7,127</u>
Accrued purchases of property and equipment	<u>\$ 46,747</u>	<u>\$ 44,501</u>
Net due from/(to) brokers for unsettled investment trades	<u>\$ 32,307</u>	<u>\$ (129,821)</u>
		(Concluded)

See notes to unaudited condensed consolidated financial statements.

**Dignity Health and Subordinate Corporations**  
**Notes to Condensed Consolidated Financial Statements**  
**(Unaudited)**

**1. ORGANIZATION**

In January 2012, Catholic Healthcare West announced its name change to Dignity Health and a governance restructuring. This governance restructuring has been implemented through revisions to Catholic Healthcare West's corporate documents, including Restated Articles of Incorporation and Restated Bylaws. Dignity Health has transitioned to a self-perpetuating Board of Directors structure from the prior structure where the Board of Directors was appointed by the Corporate Members, which had been comprised of women religious appointed by the sponsoring religious orders. There was no change to the ownership, use of the corporation's assets or federal tax identification number, nor did the governance restructuring impact the corporation's management structure or nonprofit status. Dignity Health has applied to the IRS to maintain its 501(c)(3) tax-exempt status, retroactive to the application date in December 2011.

**2. BASIS OF PRESENTATION**

The condensed consolidated financial statements of Dignity Health and Subordinate Corporations ("the Company") as of March 31, 2012, and for the three and nine-month periods ended March 31, 2012 and 2011, should be read in conjunction with the audited financial statements as of and for the year ended June 30, 2011. Certain footnotes and disclosures that are required in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted as they substantially duplicate the disclosures contained in the annual financial statements.

Dignity Health management is responsible for the accompanying unaudited condensed consolidated financial statements. These condensed consolidated financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of financial position and operating results in accordance with GAAP. Certain estimates and assumptions are made that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenue and expenses for the periods presented. Actual results could differ from estimates.

Operating results for the three and nine-month periods ended March 31, 2012, are not necessarily indicative of the results that may be expected for any future period or for a full fiscal year as revenues, expenses, assets, and liabilities can vary during each quarter of the year.

Certain reclassifications and changes in presentation were made in the condensed consolidated financial statements for the three and nine-month periods ended March 31, 2011, to conform to the presentation for the three and nine-month periods ended March 31, 2012.

In preparing the accompanying unaudited condensed consolidated financial statements, management of Dignity Health has evaluated subsequent events occurring between the end of the most recent fiscal quarter and May 15, 2012, the date the condensed consolidated financial statements were issued.

### 3. ACQUISITIONS AND DIVESTITURES

In October 2011, Dignity Health's Board of Directors approved management's plan to sell the assets of Saint Mary's Regional Medical Center ("SMRMC"), a 380-bed facility located in Reno, Nevada, and certain related entities, and, effective March 30, 2012, an Asset Purchase Agreement was entered into between Dignity Health, Saint Mary's Multi-Specialty Clinic, Inc. (dba, Saint Mary's Medical Group) and an unrelated party for the sale of substantially all of the land, buildings, equipment, inventory and certain other property of SMRMC and the operations of Saint Mary's Medical Group. Accordingly, the assets with a carrying value of \$50.1 million have been classified as held for sale on the accompanying balance sheet as of March 31, 2012, and the operations of the facility are reflected as discontinued in the accompanying statements of operations and changes in net assets for all periods presented, including operating revenues of \$229.2 million and \$213.1 million for the nine-month periods ended March 31, 2012 and 2011, respectively. Approximately \$94.0 million in outstanding tax-exempt debt will require remediation within 90 days of the closure of the sale in accordance with federal tax law. Management is evaluating the options for remedial action, which might include the establishment of a defeasance escrow for such bonds, the payment of a settlement amount to the Internal Revenue Service to compensate for the change in ownership of the SMRMC assets, or such other actions that would satisfy the Internal Revenue Service.

### 4. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-08, *Testing Goodwill for Impairment* ("ASU 2011-08"). The objective of ASU 2011-08 is to simplify how entities test goodwill for impairment. The update permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The provisions of ASU 2011-08, which are to be applied prospectively, are effective for the Company as of July 1, 2012. The adoption of ASU 2011-08 is not expected to have a material impact on the consolidated financial statements of the Company.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities* ("ASU 2011-11"). The amendments in ASU 2011-11 require entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The disclosure requirements of ASU 2011-11, which are to be applied retrospectively, are effective for the Company as of July 1, 2014. The adoption of ASU 2011-11 is not expected to have a material impact on the consolidated financial statements of the Company.

### 5. REVENUE FROM GOVERNMENT PROGRAMS

**California Provider Fee Programs** – Net patient revenue includes \$231.6 million and \$583.7 million related to supplemental Medi-Cal payments provided under the California provider fee programs during the nine-month periods ended March 31, 2012 and 2011, respectively. These programs are funded by quality assurance fees paid by participating hospitals and matching federal funds. Dignity Health recorded \$121.2 million and \$359.1 million in such fees in purchased services and other expense during the nine-month periods ended March 31, 2012 and 2011, respectively. Grant payments to the California Health Foundation and Trust ("CHFT") were recognized in connection with the provider fee programs resulting in \$8.9 million and \$25.8 million recorded in purchased services and other expense during the nine-month periods ended March 31, 2012 and 2011, respectively. Total net income recognized during the nine-month periods ended March 31, 2012 and 2011 related to the provider fee programs was \$101.5 million and \$198.8 million, respectively. Amounts reported in 2011 reflect the recognition of a 21-month program

while amounts reported in 2012 reflect a 6-month program and adjustments to the 21-month program.

Payments related to Medicaid provider fee programs are matched through the Federal Medical Assistance Program. More than twenty-two states, including California, have a provider fee program that is specific to hospitals. In September 2011, the State of California enacted an additional 30-month program that, upon final approval by the Centers for Medicare & Medicaid Services (“CMS”), will cover the period from July 1, 2011 through December 31, 2013. No amounts have been recorded for this 30-month program as of the date of these financial statements.

**“Meaningful Use” Incentives** – The American Recovery and Reinvestment Act of 2009 (“ARRA”) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (“EHR”) technology. The Medicare incentive payments are paid out to qualifying hospitals over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physicians must meet EHR “meaningful use” criteria that become more stringent over three stages as determined by CMS.

Medicaid programs and payment schedules vary from state to state. The Medicaid programs in California and Arizona require hospitals to register for the program prior to 2016, to engage in efforts to adopt, implement or upgrade certified EHR technology in order to qualify for the initial year of participation, and to demonstrate meaningful use of certified EHR technology in order to qualify for payment for up to three additional years through 2019 for Arizona and 2021 for California. Nevada has not yet adopted a Medicaid program.

During the nine-month period ended March 31, 2012, the Company recorded \$19.0 million related to the Medicare program and \$18.5 million related to Medicaid programs in other operating revenue for meaningful use incentives. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria. Eight hospitals demonstrated meaningful use and attested to the compliance requirements for Year 1 (federal fiscal year ending September 30, 2011) for the Medicare and Medicaid programs. As these hospitals have continued to use EHR technology in a meaningful way under the Medicare program criteria, management has concluded there is reasonable assurance that the hospitals will successfully demonstrate meaningful use for the full reporting period and earn a Year 2 incentive payment as well. As such, these hospitals recognized grant income as of December 31, 2011, for the Medicare program and will continue to recognize grant income ratably over the remainder of the 12-month reporting period, which began on October 1, 2011. The reporting period for Year 2 of the Medicaid program is a 90-day period, which has been fully met by the eight hospitals. As such, full Year 2 Medicaid program incentive payments have been recognized in other operating revenue for these eight hospitals. A ninth hospital has met the Medicaid criteria for Year 1 and recorded other operating revenue accordingly.

Amounts recognized represent management’s best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

**Cost Reports and Other Settlements** – Net patient revenue includes \$79.8 million related to favorable prior years’ reimbursement settlements from Medicare, Medicaid and other programs during the nine-month period ended March 31, 2012, and \$19.0 million related to favorable prior years’ reimbursement settlements from Medicare, Medicaid and other programs during the nine-

month period ended March 31, 2011. Prior years' settlements include \$69.3 million recorded in March 2012 for settlement of an appeal with CMS related to underpayments that occurred between 1998 and 2011 as a result of errors in the Medicare inpatient wage index calculation.

## 6. SPECIAL CHARGES

Special charges consist of the following for the nine-month period ending March 31, 2012:

Software development costs abandoned	\$	19,091
Restructuring costs for patient financial services		6,343
Restructuring costs for name and governance changes		5,355
Total special charges	\$	<u>30,789</u>

Abandoned software development costs relate to the write-off of certain costs in connection with a change in strategic direction and vendor for clinical systems.

Restructuring costs for patient financial services consisting of severance and lease termination costs have been recorded in connection with the announcement in March 2012 that the Company will consolidate four of its patient financial service centers into a single service center.

Expenses related to the name change to Dignity Health and governance restructuring described in Note 1 include legal and implementation costs.

## 7. SELF-INSURANCE PLANS

The Company maintains self-insurance programs for workers' compensation benefits for employees and for hospital professional and general liability risks. Self-insurance expense decreased \$13.3 million and increased \$46.1 million during the nine-month periods ended March 31, 2012 and 2011, respectively, related to revisions to prior years' actuarially estimated liabilities.

In July 2011, the Company discontinued the application of a discount factor and confidence level in determining its actuarially estimated liabilities and changed to present the liabilities on an expected, undiscounted basis, which caused a \$3.5 million increase in self-insurance expense during the nine-month period ended March 31, 2012. In addition, the Company adopted the provisions of ASU 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries*, beginning July 2011. This resulted in the reclassification of \$101.3 million in anticipated insurance recoveries from excess workers' compensation insurers, which were previously netted against liabilities for self-insurance programs, to a receivable within board-designated assets limited as to use for workers' compensation. All subsequent changes to such anticipated insurance recoveries are recorded to the receivable in the same manner. This change had no effect on expenses or net assets.

## 8. FAIR VALUE MEASUREMENTS

The Company accounts for certain assets and liabilities at fair value or on a basis that approximates fair value. A fair value hierarchy for valuation inputs prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels and is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

*Level 1:* Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets and liabilities in Level 1 include U.S. Treasury securities and listed equities.

*Level 2:* Pricing inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds and derivative instruments.

*Level 3:* Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. Financial assets and liabilities in this category include alternative investments and derivative instruments.

The following represents assets and liabilities measured at fair value on a recurring basis and certain assets accounted for under the equity method as of March 31, 2012 and June 30, 2011 (in thousands):

	<b>Fair Value Measurements at March 31, 2012 Using</b>			
	<b>Quoted Prices</b>			
	<b>in Active</b>	<b>Significant</b>	<b>Significant</b>	<b>Total</b>
	<b>Markets for</b>	<b>Other</b>	<b>Unobservable</b>	<b>Balance at</b>
	<b>Identical</b>	<b>Observable</b>	<b>Inputs</b>	<b>March 31,</b>
	<b>Instruments</b>	<b>Inputs</b>	<b>Inputs</b>	<b>2012</b>
	<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>	
<b>Assets</b>				
Cash and cash equivalents	\$ 756,862	\$ -	\$ -	\$ 756,862
U.S. government securities	509,041	45,402	-	554,443
U.S. corporate bonds	57,858	584,391	6,301	648,550
U.S. equity securities	1,289,032	359,709	-	1,648,741
Foreign government securities	-	168,156	-	168,156
Foreign corporate bonds	5,482	29,063	-	34,545
Foreign equity securities	414,693	23	-	414,716
Asset-backed securities	-	23,781	-	23,781
Structured debt	-	209,312	-	209,312
Private equity investments	-	-	122,433	122,433
Multi-strategy hedge fund investments	-	-	466,075	466,075
Real estate	10,400	-	173,234	183,634
Collateral held under securities lending program	-	228,736	-	228,736
Other fund investments	8,537	-	-	8,537
<b>Total assets</b>	<b>\$ 3,051,905</b>	<b>\$ 1,648,573</b>	<b>\$ 768,043</b>	<b>\$ 5,468,521</b>
<b>Liabilities</b>				
Interest rate swap instruments	\$ -	\$ 186,704	\$ -	\$ 186,704

**Fair Value Measurements at June 30, 2011 Using  
Quoted Prices**

	<b>in Active Markets for Identical Instruments (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total Balance at June 30, 2011</b>
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<b>Assets</b>				
Cash and cash equivalents	\$ 579,206	\$ -	\$ -	\$ 579,206
U.S. government securities	392,981	510,507	-	903,488
U.S. corporate bonds	62,061	573,974	-	636,035
U.S. equity securities	1,461,940	204,750	-	1,666,690
Foreign government securities	5,896	237,433	-	243,329
Foreign corporate bonds	-	7,369	-	7,369
Foreign equity securities	400,339	-	-	400,339
Asset-backed securities	-	36,938	-	36,938
Structured debt	-	105,106	-	105,106
Private equity investments	-	-	102,944	102,944
Multi-strategy hedge fund investments	-	-	107,889	107,889
Real estate	6,805	-	155,819	162,624
Collateral held under securities lending program	-	290,526	-	290,526
Other fund investments	8,724	-	-	8,724
<b>Total assets</b>	<b><u>\$ 2,917,952</u></b>	<b><u>\$ 1,966,603</u></b>	<b><u>\$ 366,652</u></b>	<b><u>\$ 5,251,207</u></b>
<b>Liabilities</b>				
Interest rate swap instruments	<u>\$ -</u>	<u>\$ 110,694</u>	<u>\$ -</u>	<u>\$ 110,694</u>

Assets and liabilities measured at fair value on a recurring basis and certain assets accounted for under the equity method are reported in short-term investments, assets limited as to use, and other accrued liabilities in the consolidated balance sheet. Such amounts do not include donor-restricted funds or interests in unconsolidated foundations.

There were no significant transfers to or from Levels 1 or 2 during the periods presented.

The Level 2 and 3 instruments listed in the fair value hierarchy tables above use the following valuation techniques and inputs:

For marketable securities such as U.S. and foreign government securities, U.S. and foreign corporate bonds, U.S. and foreign equity securities, asset-backed securities, and structured debt, in the instances where identical quoted market prices are not readily available, fair value is determined using quoted market prices and/or other market data for comparable instruments and transactions in establishing prices, discounted cash flow models and other pricing models. These inputs to fair value are included in industry-standard valuation techniques such as the income or market approach. The Company classifies all such investments as Level 2.

For investments such as private equity funds, multi-strategy hedge funds, real estate funds, and other limited partnership investments, fair value is determined using the calculated net asset value (“NAV”) provided by the fund. The value of underlying investments in private equity funds are estimated based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. Real estate investments are priced using valuation techniques that include income, sales comparison (market), and cost approaches.

Significant inputs include contract and market rents, operating expenses, capitalization rates, discount rates, sales of comparable properties, and market rent growth trends, as well as the use of the value of the property plus the cost of building a similar structure of equal utility. Hedge funds and other limited partnership investments typically value underlying securities traded on a national securities exchange or reported on a national market at the last reported sales price on the day of the valuation. Underlying securities traded in the over-the-counter market and listed securities for which no sale was reported on the valuation date are typically valued at the mean between representative bid and ask quotes obtained. Where no fair value is readily available, the fund or investment manager may determine, in good faith, the fair value using models that take into account relevant information considered material. Due to the significant unobservable inputs present in these valuations, the Company classifies all such investments as Level 3. Dignity Health's management regularly monitors and evaluates the accounting and valuation methodologies of the investment managers. Management also performs, on a regular basis when information is made available, various validations and testing of the NAV provided and determines that the investment managers' valuation techniques are compliant with fair value measurement accounting standards. Significant increases (decreases) in any unobservable inputs used for Level 3 holdings, in isolation, would result in a significantly lower (higher) fair value measurement.

The fair value of collateral held under securities lending program classified as Level 2 is determined using the calculated NAV. The collateral held under this program is placed in commingled funds whose underlying investments are valued using techniques similar to those used for the marketable securities noted above. Amounts reported do not include non-cash collateral of \$33.6 million and \$23.7 million as of March 31, 2012 and June 30, 2011, respectively.

The fair value of liabilities for derivative instruments such as interest rate swaps classified as Level 2 is determined using an industry standard valuation model, which is based on a market approach. A credit risk spread (in basis points) is added as a flat spread to the discount curve used in the valuation model. Each leg is discounted and the difference between the present value of each leg's cash flows equals the market value of the swap.

The following table presents the change in the balance of financial assets and liabilities using significant unobservable inputs (Level 3) measured on a recurring basis and certain assets accounted for under the equity method for the nine-month periods ended March 31, 2012 and 2011 (in thousands):

	Nine-Month Period Ended March 31, 2012				
	Private Equity Investments	Multi-Strategy Hedge Fund Investments	Real Estate	Debt Securities	Total
Balance at June 30, 2011	\$ 102,944	\$ 107,889	\$ 155,819	\$ -	\$ 366,652
Total realized gains, net, included in excess of revenues over expenses	1,039	401	-	-	1,440
Total unrealized gains, net, included in excess of revenues over expenses	1,779	138,194	12,456	199	152,628
Purchases, issuances, sales and settlements					
Purchases	26,475	270,664	4,959	6,684	308,782
Sales	(9,804)	(51,073)	-	(582)	(61,459)
Balance at March 31, 2012	<u>\$ 122,433</u>	<u>\$ 466,075</u>	<u>\$ 173,234</u>	<u>\$ 6,301</u>	<u>\$ 768,043</u>

**Nine-Month Period Ended March 31, 2011**

**Multi-Strategy**

	<b>Private Equity Investments</b>	<b>Hedge Fund Investments</b>	<b>Real Estate</b>	<b>Debt Securities</b>	<b>Total</b>
Balance at June 30, 2010	\$ 83,344	\$ 152,272	\$ 128,509	\$ -	\$ 364,125
Total realized gains, net, included in excess of revenues over expenses	667	2,537	-	-	3,204
Total unrealized gains, net, included in excess of revenues over expenses	8,180	9,828	22,867	-	40,875
Purchases, issuances, sales and settlements					
Purchases	13,072	59,847	-	-	72,919
Sales	(8,232)	(67,377)	-	-	(75,609)
Transfers out of Level 3	-	(221)	-	-	(221)
Balance at March 31, 2011	<u>\$ 97,031</u>	<u>\$ 156,886</u>	<u>\$ 151,376</u>	<u>\$ -</u>	<u>\$ 405,293</u>

Included within the assets above are investments in certain entities that report fair value using a calculated NAV or its equivalent. The following tables and explanations identify attributes relating to the nature and risk of such investments as of March 31, 2012 and June 30, 2011 (in thousands):

**As of March 31, 2012**

	<b>Fair Value</b>	<b>Unfunded Commitments</b>	<b>Redemption Frequency (If Currently Eligible)</b>	<b>Redemption Notice Period</b>
<b><u>Level 2</u></b>				
Debt securities	(1) \$ 262,427	\$ -	Daily, Semi-Monthly	1 - 5 days
Equity securities	(2) 358,443	-	Daily, Semi-Monthly, Monthly	1 - 30 days
Collateral held under securities lending	(3) <u>228,736</u>	-	Daily	10 days
Total Level 2	<u>\$ 849,606</u>	<u>\$ -</u>		
<b><u>Level 3</u></b>				
Multi-strategy hedge funds	(4) \$ 466,075	\$ -	Monthly, Quarterly, Semi-Annually, Annually	5 - 370 days
Private equity	(5) 122,433	125,432	-	-
Real estate	(6) 173,234	-	Quarterly	90 days
Debt securities	(7) <u>6,301</u>	<u>18,065</u>	Daily	1 - 5 days
Total Level 3	<u>\$ 768,043</u>	<u>\$ 143,497</u>		
Total Level 2 and Level 3	<u>\$ 1,617,649</u>	<u>\$ 143,497</u>		

**As of June 30, 2011**

		<b>Fair Value</b>	<b>Unfunded Commitments</b>	<b>Redemption Frequency (If Currently Eligible)</b>	<b>Redemption Notice Period</b>
<b><u>Level 2</u></b>					
Debt securities	(1)	\$ 202,794	\$ -	Daily, Semi-Monthly	1 - 5 days
Equity securities	(2)	203,352	-	Daily, Semi-Monthly, Monthly	1 - 30 days
Collateral held under securities lending	(3)	<u>290,526</u>	<u>-</u>	Daily	10 days
Total Level 2		<u>\$ 696,672</u>	<u>\$ -</u>		
<b><u>Level 3</u></b>					
Multi-strategy hedge funds	(4)	\$ 107,889	\$ -	Quarterly, Semi-Annually, Annually	60 - 370 days
Private equity	(5)	102,944	116,595	-	-
Real estate	(6)	<u>155,819</u>	<u>-</u>	Quarterly	90 days
Total Level 3		<u>\$ 366,652</u>	<u>\$ 116,595</u>		
Total Level 2 and Level 3		<u>\$ 1,063,324</u>	<u>\$ 116,595</u>		

- (1) This category includes investments in commingled funds that invest primarily in domestic and foreign debt and fixed income securities, the majority of which are traded in over-the-counter markets.
- (2) This category includes investments in commingled funds that invest primarily in domestic or foreign equity securities with multiple investment strategies. A majority of the funds attempt to match the returns of specific equity indices.
- (3) This category includes investments of collateral held under securities lending program. Dignity Health participates in a securities lending program administered by its custodian as a means to augment income from its portfolio. Securities are loaned to select brokerage firms who in turn post collateral. The collateral is placed in commingled funds that invest primarily in cash and cash equivalents, and domestic and foreign debt securities. The collateral pool is allocated into two separate pools. While Dignity Health can fully withdraw from the program with its custodian at any time, the redemption conditions differ. For the “duration pool”, which represents approximately 5.7% of the value of this category, Dignity Health can fully withdraw from the program with its custodian, and in return receive proportional distributions of the investments held by the collateral lending fund. For the “liquidity pool”, which represents approximately 94.3% of the value of this category, no such redemption restrictions apply. The cash flow maturity schedule provided by the custodian anticipates that the cash collateral in the duration pool will fully mature and become available through December 2012, with a de minimus amount remaining in the duration pool thereafter. Earlier redemption from the duration pool would result in Dignity Health receiving a proportional share of the in-kind cash collateral.

- (4) This category includes investments in hedge funds that pursue diversification of both domestic and foreign fixed income and equity securities through multiple investment strategies. The primary objective for these funds is to seek attractive long-term risk-adjusted absolute returns. The following table represents the various redemption frequencies, notice periods required, and any applicable lock-up periods or gates to redemption as of March 31, 2012. Under certain circumstances, an otherwise redeemable investment or portion thereof could become restricted. Such restrictions were not applicable at March 31, 2012.

<b>Percentage of the Value of Category (4)</b>		<b>Redemption Frequency</b>	<b>Redemption Notice Period</b>	<b>Redemption Locked Up Until (if applicable)</b>	<b>Redemption Gate % of Account (if applicable)</b>
<b>Total</b>	<b>Subtotal</b>				
29.1%	10.3%	Annually	45 - 90 days	-	-
	10.0%	Annually	45 - 75 days	3/31/2013 to 12/31/2014	-
	8.8%	Annually	60 - 65 days		up to 33.3% - 50.0%
5.5%	5.5%	Semi-Annually	75 - 90 days	-	-
40.8%	21.0%	Quarterly	30 - 370 days	-	-
	8.2%	Quarterly	90 days	7/1/2012 to 7/1/2013	-
	11.6%	Quarterly	45 - 90 days	-	up to 25.0% - 33.3%
24.6%	14.4%	Monthly	5 - 60 days	-	-
	5.0%	Monthly	120 days	until 8/31/2012	-
	5.2%	Monthly	45 days	-	up to 16.7%

- (5) This category includes several private equity funds that specialize in providing capital to a variety of investment groups, including but not limited to venture capital, leveraged buyout, mezzanine debt, distressed debt, and other situations. There are no provisions for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated, estimated at March 31, 2012, to be over the next 2-12 years.
- (6) This category includes an open-ended real estate fund that invests primarily in institutional quality commercial and residential real estate assets within the United States.
- (7) This category includes a commingled fund that invests primarily in a fixed income fund that provides capital in a variety of mezzanine debt, distressed debt, and other special debt securities situations.

The investments included above are not expected to be sold at amounts that are different from NAV.

## 9. DEBT

In July 2011, Dignity Health issued \$106.5 million of tax-exempt fixed rate bonds with a premium of \$8.5 million to repay \$115.0 million of previously outstanding bonds. Dignity Health also repaid \$30.5 million of outstanding bonds and a \$45.9 million put bond with a draw on its syndicated line of credit. No loss on early extinguishment of debt was recorded related to these transactions.

In July 2011, in light of the debt ceiling crisis, Dignity Health drew \$250.0 million on its syndicated line of credit facility in order to ensure adequate liquidity in the event of a capital market disruption. In August 2011, subsequent to the successful resolution of the debt ceiling, this amount was repaid.

In November 2011, Dignity Health issued, under the Master Trust Indenture, \$478.3 million of tax-exempt fixed rate bonds to refund \$249.3 million of previously outstanding bonds and accrued interest and \$40.9 million of draws on the line of credit, and to provide funds for capital projects. The bonds were sold at a net premium, bear interest at 3.0% to 5.25%, and mature in installments through March 2041. The proceeds used to refund previously outstanding bonds were placed in an irrevocable trust and the bonds were legally defeased.

In November 2011, Dignity Health issued, under the Master Trust Indenture, \$150.0 million of variable rate demand bonds supported by new letters of credit from a single bank, which expire in November 2016. The bond proceeds will be used for capital projects.

In November 2011, Dignity Health entered into a forward delivery private placement agreement. Subject to the terms, Dignity Health expects to issue \$215.0 million of bonds in June 2012 under the Master Trust Indenture and the proceeds will be used to repay the maturity of put bonds due in July 2012. The obligations of Dignity Health and the placement agent are conditioned on the terms contained in the forward delivery agreement.

No material gain or loss on early extinguishment of debt was recorded related to the November 2011 transactions.

In February 2012, Dignity Health drew \$100.0 million on its syndicated line of credit facility for general working capital purposes. The amount was repaid in March 2012.

## **10. DERIVATIVE INSTRUMENTS**

In August 2011, Dignity Health novated swaps with a notional amount of \$343.1 million from Citigroup to Deutsche Bank. One of the swaps with a notional amount of \$80.0 million was insured by Assured Guaranty (formerly known as FSA); the insurance was removed at the request of Dignity Health and Deutsche Bank upon the novation. Swaps with a notional amount of \$263.1 million were uninsured and the counterparty's right to terminate the swaps at each five-year anniversary was removed on these swaps with the novation. These swaps, as well as the one with the \$80.0 million notional amount, retain certain early termination triggers caused by an event of default or termination event as described below.

In December 2011, Dignity Health entered into risk participation agreements with a notional amount of \$215.0 million with Deutsche Bank and Bank of Montreal. Under the risk participation agreements, payments made by the counterparties and Dignity Health will commence upon the delivery of the bonds in June 2012 as described in Note 9. These risk participation agreements have certain early termination triggers caused by an event of default or termination event as described below. These risk participation agreements have not been designated as hedges. Dignity Health may owe a payment to the counterparty upon termination and such payment is to be based on the then mark-to-market value of the underlying bonds. The bonds are not expected to be issued until June 2012.

As of March 31, 2012, derivative instruments include 16 floating-to-fixed interest rate swaps and four fixed-to-floating risk participation agreements. Dignity Health uses floating-to-fixed interest rate swaps to manage interest rate risk associated with outstanding variable rate debt. Under these swaps, Dignity Health receives a percentage of LIBOR ranging from 57.00% to 58.96% plus a spread ranging from 0.13% to 0.32% and pays a fixed rate. Counterparties to these swaps are JPMorgan, Citigroup and Deutsche Bank for \$369.8 million, \$227.7 million and \$343.1 million, respectively, of the notional amounts outstanding. Dignity Health uses fixed-to-floating risk participation agreements to reduce interest expense associated with fixed rate debt. Under these risk participation agreements, Dignity Health will receive a fixed rate and pay a variable rate

percentage of SIFMA plus a spread. Counterparties to the fixed-to-floating risk participation agreements are Deutsche Bank and Bank of Montreal for \$215.0 million and \$0 million, respectively, of the notional amounts outstanding. Bank of Montreal exercised its option to assume a portion of the notional amounts and assumed \$75 million of the notional amount on April 13, 2012.

The following table shows the outstanding notional amount of derivative instruments measured at fair value as reported in other accrued liabilities in the condensed consolidated balance sheets as of March 31, 2012 and June 30, 2011 (in thousands):

	<b>Maturity Date of Derivatives</b>	<b>Fixed Rate</b>	<b>Notional Amount Outstanding</b>	<b>Fair Value</b>
<b>March 31, 2012</b>				
Derivatives not designated as hedges				
Interest rate swaps	2026 - 2042	3.2% - 3.4%	<u>\$ 940,600</u>	<u>\$ (186,704)</u>
<b>June 30, 2011</b>				
Derivatives not designated as hedges				
Interest rate swaps	2026 - 2042	3.2% - 3.4%	<u>\$ 944,525</u>	<u>\$ (110,694)</u>

Changes in fair value of derivative instruments have been recorded for the nine-month periods ended March 31, 2012 and 2011, as follows (in thousands):

	<b>Nine-Month Periods Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Loss reclassified from unrestricted net assets into interest expense, net, related to derivatives in cash flow hedging relationships:		
Interest rate swaps - amortization	<u>\$ (2,012)</u>	<u>\$ (8,386)</u>
Gain (loss) recognized in interest expense, net:		
Changes in fair value:		
Non-hedged derivatives - interest rate swaps	<u>\$ (76,010)</u>	<u>\$ 64,816</u>
Total changes in fair value	(76,010)	64,816
Amortization of amounts in unrestricted net assets - interest rate swaps	<u>(2,012)</u>	<u>(8,386)</u>
Total	<u>\$ (78,022)</u>	<u>\$ 56,430</u>

Of the amounts classified in unrestricted net assets as of March 31, 2012, Dignity Health anticipates reclassifying approximately \$2.7 million of additional non-cash losses from unrestricted net assets into interest expense, net, in the next twelve months. Amounts in unrestricted net assets will be amortized into earnings as the interest payments being economically hedged are made.

Of the \$940.6 million notional amount of interest rate swaps held by Dignity Health, \$160.0 million are insured and have a negative fair value of \$37.5 million at March 31, 2012. In the event the insurer, Assured Guaranty, is downgraded below A2/A or A3/A- (Moody's/Standard & Poor's), the counterparties have the right to terminate the swaps if Dignity Health does not provide alternative credit support acceptable to them within 30 days of being notified of the downgrade. If the insurer is downgraded below the thresholds noted above and Dignity Health is downgraded below Baa3/BBB- (Moody's/Standard & Poor's), the counterparties have the right to terminate the swaps.

Dignity Health has \$780.6 million of interest rate swaps that are not insured. While Dignity Health has the right to terminate the swaps prior to maturity for any reason, certain counterparties have the right to terminate swaps in the outstanding notional amount of \$437.5 million at each five-year anniversary date commencing in May 2013. The termination value would be the fair market value or the replacement cost of the swaps, depending on the circumstances. These interest rate swaps have a negative fair value of \$85.2 million at March 31, 2012. The remaining uninsured swaps in the notional amount of \$343.1 million have a negative fair value of \$64.0 million. The fair value of the risk participation agreements is deemed immaterial as of March 31, 2012. All of the uninsured swaps and risk participation agreements have certain early termination triggers caused by an event of default or a termination event. The events of default include failure to make payments when due, failure to give notice of a termination event, failure to comply with or perform obligations under the agreements, bankruptcy or insolvency, and defaults under other agreements (cross-default provision). The termination events include credit ratings dropping below Baa1/BBB+ (Moody's/Standard & Poor's) by either party and Dignity Health's cash on hand dropping below 85 days.

Dignity Health, under the terms of its Master Trust Indenture, is prohibited from posting collateral on derivative instruments.

#### 11. NONCONTROLLING INTEREST

Changes in the noncontrolling interests related to revenues, expenses, gains, and losses of consolidated investments in health-related activities of \$13.6 million and \$18.1 million are included in purchased services and other in the condensed consolidated statements of operations and changes in net assets for the nine-month periods ended March 31, 2012 and 2011, respectively.

#### 12. INTEREST EXPENSE, NET

The components of interest expense, net, include the following (in thousands):

	<b>Nine-Month Periods Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Interest and fees on debt and swap cash settlements	\$ 152,193	\$ 167,283
Market adjustment on swaps and amortization of amounts in unrestricted net assets	<u>78,022</u>	<u>(56,430)</u>
Total interest expense	230,215	110,853
Capitalized interest expense	<u>(19,379)</u>	<u>(15,503)</u>
Interest expense, net	<u>\$ 210,836</u>	<u>\$ 95,350</u>

### 13. INVESTMENT INCOME, NET

Investment income, net, on assets limited as to use, cash equivalents, collateral held under securities lending program, notes receivable, and investments are comprised of the following (in thousands):

	Nine-Month Periods Ended March 31,	
	2012	2011
Interest and dividend income	\$ 82,780	\$ 84,493
Realized gains on sales of securities	225,194	119,494
Net unrealized gains (losses) on securities	(110,376)	481,304
Other, net of capitalized investment income	(22,202)	(16,251)
Investment income, net	<u>\$ 175,396</u>	<u>\$ 669,040</u>

### 14. COMMITMENTS, CONTINGENT LIABILITIES AND OTHER

The following summary encompasses matters previously disclosed in the Company's audited financial statements, as well as additional developments since the date of those financial statements.

***Litigation, Regulatory and Compliance Matters - General*** – The healthcare industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions, and in the case of tax-exempt hospitals, the requirements of tax exemption. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations by healthcare providers of reimbursement, false claims, anti-kickback and anti-referral statutes and regulations, and quality of care provided to patients. In addition, during the course of business, the Company becomes involved in litigation. Management assesses the probable outcome of unresolved litigation and investigations and records contingent liabilities reflecting estimated liability exposure. Following is a discussion of matters of note.

**Department of Justice and OIG Investigations** – Dignity Health and/or its facilities periodically receive notices from governmental agencies, such as the Department of Justice or the OIG, requesting information regarding billing, payment, or other reimbursement matters, or formally or informally initiating investigations, or indicating the existence of qui tam litigation. The healthcare industry in general is experiencing an increase in these activities, as the federal government increases enforcement activity and institutes new programs designed to identify areas of potential reimbursement or quality irregularities. Based on the information received to date from the government, Dignity Health does not presently have information indicating that any of these current matters or their resolution will have a material effect on the Company, taken as a whole. Nevertheless, investigations of this type and scope could lead to civil and/or criminal charges and material penalties or settlements. Consequently, there can be no assurance that the resolution of these matters will not affect the financial condition or operations of the Company, taken as a whole.

**Wage and Hour Class Actions and Litigation** – Federal law and many states, including California, impose standards related to worker classification, eligibility and payment for overtime, liability for providing rest periods and similar requirements. Large employers with complex workforces, such as hospitals, are susceptible to actual and alleged violations of these standards. In recent years, there has been a proliferation of lawsuits over these “wage and hour” issues, often in the form of large, sometimes multi-state, class actions. For large employers such as hospitals and

health systems, such class actions can involve multi-million dollar claims, judgments and/or settlements.

In February 2008, a lawsuit was filed against Dignity Health alleging violations of California state wage and hour laws and regulations. The lawsuit is fashioned as a class action on behalf of nurses and medical technicians employed at the Company's California facilities during the previous four years. Dignity Health is evaluating the lawsuit and its implications. Extensive discovery has been taken by plaintiff's counsel, and it is too early to assess any liability exposure from the lawsuit, but lawsuits of this nature have the potential for a material impact on the financial condition or operations of the Company, taken as a whole.

**Medicare Certification** – From time to time, Dignity Health and/or its facilities receive notices from CMS that steps to terminate provider agreements will be taken unless certain corrective actions related to qualification for Medicare participation are undertaken. The process of responding to these notices involves plan(s) of correction by the facility and resurvey by CMS or its designee. Although termination is rare there is no guarantee that CMS or its designee will be satisfied with a facility's corrective action. Currently, Mercy Hospital (Bakersfield), St. Rose Dominican Hospital – Siena Campus, St. John's Regional Medical Center, and St. Mary's Medical Center are in the process of addressing such notices.

**Employment Law Litigation** – In February 2012, a jury in federal court awarded damages and lost wages to a former employee of Mercy General Hospital in response to various employment law claims. The jury award of approximately \$168.0 million appears to include duplication of award amounts and is subject to elimination of duplication, as well as certain statutory damages caps. On April 30, 2012, the trial judge entered judgment in the case, reducing the jury verdict to approximately \$82.3 million. Management is of the opinion that the facts do not support the verdict or the damages. Management currently plans to file post-trial motions to vacate the verdict in its entirety and, if necessary, appeal any judgment for plaintiff. Dignity Health has multiple layers of insurance coverage the extent of which will depend in part on the final disposition of the matter. Insurers for a portion of these layers have filed suit in federal court seeking declaratory relief that they have no coverage obligation for damages incurred by Dignity Health in this litigation. Consequently, there can be no assurance that the resolution of this matter will not adversely affect the financial condition or results of operations of Dignity Health.

# **Dignity Health and Subordinate Corporations**

## **Management Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

Dignity Health is a California not-for-profit corporation exempt from federal and state income taxes. The Company operates 40 hospitals in California, Arizona and Nevada and provides a variety of healthcare, education and other benefits to the communities in which it operates. Healthcare services include inpatient, outpatient, sub-acute and home health care services, as well as physician services through a medical foundation and affiliated medical groups.

### **Results of Operations**

For the nine months ended March 31, 2012, operating income was \$29.0 million compared to \$300.3 million for the same period in the prior year. These results exclude the operations of Saint Mary's Regional Medical Center, which is held for sale and whose operations are reported as discontinued. The results of operations for the nine-month period ended March 31, 2012, are primarily related to the following:

- The Company recognized \$101.5 million of net income related to the California provider fee program, which was \$97.3 million lower than net income of \$198.8 million recognized for the provider fee program during the same period in the prior year.
- Excluding the impact of the provider fee programs, net patient and premium revenues increased \$216.8 million, or 3.1%, over the same period in the prior year, primarily due to payment rate increases and a \$69.3 million CMS settlement for underpayments that occurred between 1998 and 2011 as a result of errors in the Medicare inpatient wage index calculation.
- Adjusted admissions decreased 1.9% compared to the same period in the prior year. Excluding the impact of the provider fee programs, net patient and premium revenue per adjusted admission increased 5.1% compared to the same period in the prior year, primarily a function of payment rate increases and the CMS settlement, partially offset by unfavorable shifts in payor mix.
- Other operating revenue increased \$46.2 million, primarily due to \$37.5 million in meaningful use incentives recognized during the nine months ended March 31, 2012.
- Non-cash market adjustments on derivative instruments, recorded in interest expense, net, were \$78.0 million unfavorable compared to favorable adjustments of \$56.4 million recorded in the same period in the prior year.
- The Company recorded \$30.8 million in special charges consisting of \$19.1 million of abandoned software development costs related to a change in strategic direction and vendor for clinical systems, \$6.3 million of costs associated with the centralization of patient financial services and \$5.4 million in expenses related to the organization's governance restructuring and name change.
- Revenue from health-related activities decreased \$55.6 million primarily due to lower earnings related to Dignity Health's investment in the net assets of Scripps Health of \$28.7 million year over year, and unfavorable non-cash market adjustments on derivative instruments and investment earnings of \$13.5 million impacting the performance of Dignity Health's investment in Phoenix Children's Hospital.

- Salaries and benefits increased \$128.7 million, or 3.5%, with salaries and benefits per adjusted admission increasing 5.5%, primarily due to increased staffing levels and wage and benefit costs.
- Provision for bad debts on uncollectible accounts increased \$67.8 million, or 11.3%, with provision for bad debts on uncollectible accounts as a percentage of gross revenues increasing to 2.4% from 2.2% in the prior year.
- Excluding the impact of the provider fee programs, purchased services and other increased \$30.1 million, or 2.2%, primarily related to increased medical fees, professional services, repairs and maintenance, and collection agency fees, offset by lower professional liability costs.
- Investment income, net, decreased \$493.6 million to \$175.4 million, from \$669.0 million, primarily due to net unrealized losses of \$110.4 million in the current year as a result of less favorable market conditions, compared to unrealized gains of \$481.3 million in the same period of the prior year. Current year unrealized losses were offset by realized gains of \$225.2 million resulting in part from a high volume of security sales activity related to the realignment of the asset allocation within portfolios at the beginning of the year.

### **Capital Resources**

Cash provided by operating activities totaled \$12.9 million for the nine months ended March 31, 2012, compared to cash provided by operating activities of \$278.0 million for the same period in the prior year. Significant activity for the nine months ended March 31, 2012, includes the following:

- The provider fee programs contributed \$22.6 million of cash during the nine months ended March 31, 2012, compared to \$196.6 million during the same period in the prior year.
- Operating results were not as strong during the period as they were during the same period in the prior year, primarily due to volume decreases and unfavorable shifts in payor mix.

Cash used in investing activities totaled \$663.9 million for the nine months ended March 31, 2012, compared to \$403.0 million for the same period in the prior year, primarily due to the following:

- Net purchases of investments during the period were \$302.4 million compared to net proceeds from sales of investments of \$112.7 million during the same period in the prior year, primarily related to investment of the November 2011 bond proceeds in construction funds.
- Capital expenditures were \$438.4 million during the nine months ended March 31, 2012 compared to \$455.2 million during the same period in the prior year. Such capital expenditures primarily relate to expansion and renovation of existing facilities, equipment and systems additions and replacements, and various other capital improvements.
- Securities lending collateral decreased \$62.0 million during the period compared to an increase of \$54.1 million during the same period in the prior year.

Cash provided by financing activities totaled \$228.0 million for the nine months ended March 31, 2012, compared to cash provided by financing activities of \$16.3 million for the same period in the prior year, primarily due to the following:

- New borrowings of \$1.2 billion during the nine months ended March 31, 2012, compared to \$133.4 million during the same period in the prior year.
- Repayments of debt of \$929.2 million during the nine months ended March 31, 2012, compared to \$201.8 million during the same period in the prior year.
- Payables under the securities lending program decreased \$62.0 million during the period compared to an increase of \$54.1 million during the same period in the prior year.

The Company's debt-to-capitalization ratio increased to 48.5% as of March 31, 2012, from 47.3% as of June 30, 2011, primarily due to investment and operating results and new debt issued in November 2011.

The Company's EBIDA (earnings before interest expense, net, depreciation, loss on early extinguishment of debt, investment earnings (losses) and special charges) decreased \$118.9 million to \$588.2 million during the period from \$707.1 million for the same period in the prior year, primarily due to \$97.3 million of lower provider fee program income and lower patient volumes. The EBIDA margin percentage decreased to 7.7% from 9.1%.

### **Forward Looking Statements**

Certain of the discussions in this document may include "forward-looking statements" which involve known and unknown risks and uncertainties inherent in the operation of healthcare facilities. Actual actions or results may differ materially from those discussed above, and past or current trends may not continue. Specific factors that might cause such differences include competition from other healthcare facilities in the service areas of the Company, federal and state regulation of healthcare providers, staffing shortages, organized labor initiatives and reimbursement policies of the state and federal governments and managed care organizations. In particular, statements preceded by, followed by or that include the word "believes," "estimates," "expects," "anticipates," "plans," "intends," "scheduled," or other similar expressions are or may constitute forward-looking statements.

## Dignity Health and Subordinate Corporations Consolidated Operating Statistics

	<b>Three-Month Periods</b>		<b>Nine-Month Periods</b>	
	<b>Ended March 31,</b>		<b>Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Financial Performance:</b>				
Operating income (before investment earnings)	\$ 84,055	\$ 38,973	\$ 29,002	\$ 300,303
Margin %	3.3%	1.6%	0.4%	3.9%
EBIDA (earnings before interest expense, net, depreciation, loss on early extinguishment of debt, investment earnings and special charges)	\$ 224,335	\$ 172,415	\$ 588,222	\$ 707,132
Margin %	8.7%	7.1%	7.7%	9.1%
Excess of revenues over expenses	\$ 414,884	\$ 185,852	\$ 204,398	\$ 969,343
Margin %	14.3%	7.2%	2.6%	11.5%
<b>Uncompensated Care:</b>				
Charity care, at customary charges	\$ 237,110	\$ 180,410	\$ 674,620	\$ 508,791
Charity care, at cost	\$ 60,963	\$ 46,127	\$ 181,509	\$ 138,790
Charity care, at cost, as a percentage of total expenses	2.5%	1.9%	2.4%	1.9%
Bad debt expense at customary charges	\$ 226,027	\$ 195,635	\$ 669,399	\$ 601,578
<b>Productivity:</b>				
Salaries, wages and benefits as a % of net patient and premium revenue	51.3%	52.4%	51.5%	48.9%
Supply expense as a % of net patient and premium revenue	14.3%	14.7%	13.9%	13.6%
Purchased services as a % of net patient premium revenue	20.0%	21.4%	21.0%	23.6%
Capital expense as a % of net patient and premium revenue	5.2%	5.7%	7.1%	5.4%
<b>Operations (Hospital Only):</b>				
Acute admissions	98,662	102,158	290,616	302,352
Adjusted admissions	151,734	152,980	446,519	455,034
Acute inpatient days	422,428	450,628	1,235,956	1,311,725
Adjusted patient days	699,183	721,875	2,043,012	2,120,426
Acute average length of stay	4.28	4.41	4.25	4.34
Outpatient revenue as a % of total patient services revenue	36.0%	33.7%	35.5%	33.8%
Number of FTEs	45,620	46,145	45,792	45,856
FTEs per adjusted occupied bed	5.34	5.22	5.56	5.38