Consolidated Financial Statements

As of and for the Years Ended
September 30, 2018 and 2017

Prospect Medical Holdings, Inc.

Contents

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Independent Auditor's Report

Board of Directors
Prospect Medical Holdings, Inc.
Los Angeles, California

We have audited the accompanying consolidated financial statements of Prospect Medical Holdings, Inc. (the "Company"), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations, statements of comprehensive (loss) income, statements of stockholder's (deficit) equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Prospect Medical Holdings, Inc. and its subsidiaries as of September 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

January 25, 2019

Prospect Medical Holdings, Inc.

Consolidated Balance Sheets
(in thousands, except par value and share amounts)

September 30,	**2018**	2017
Assets		
Current assets		
Cash and cash equivalents	**$ 7,694**	$ 27,109
Restricted cash	**1,742**	30,761
Restricted investments	**23,779**	15,810
Patient accounts receivable, net of allowance for doubtful accounts of $193,439 and $141,775 at September 30, 2018 and 2017, respectively	**350,789**	358,914
Due from government payers	**32,833**	51,152
Other receivables, prepaid expenses and other current assets	**128,378**	191,190
Income tax receivable	**2,737**	-
Inventories	**37,461**	36,967
Hospital fee program receivable	**211,454**	59,209
Total current assets	**796,867**	771,112
Property, improvements and equipment, net	**623,963**	576,933
Deferred income taxes, net	**1,975**	104,323
Goodwill	**305,126**	310,695
Intangible assets, net	**33,619**	40,794
Other assets	**57,083**	58,543
Total assets	**$ 1,818,633**	$ 1,862,400

See accompanying notes to the consolidated financial statements.

Prospect Medical Holdings, Inc.

Consolidated Balance Sheets
(in thousands, except par value and share amounts)

September 30,	**2018**	2017
Liabilities and Stockholder's (Deficit) Equity		
Current liabilities:		
Accrued medical claims and other healthcare costs payable	**$ 62,933**	$ 55,485
Accounts payable and other accrued liabilities	**328,431**	320,246
Accrued salaries, wages and benefits	**177,554**	144,287
Hospital fee program liability	**65,967**	1,968
Due to government payers	**30,615**	23,754
Income taxes payable	**-**	42,793
Revolving line of credit, net	**207,645**	113,061
Current portion of capital leases	**14,348**	11,315
Current portion of long-term debt	**18,429**	12,509
Other current liabilities	**27,831**	17,762
Total current liabilities	**933,753**	743,180
Long-term debt, net of current portion	**1,099,441**	625,719
Malpractice reserves	**77,280**	60,722
Capital leases, net of current portion	**35,853**	37,612
Asset retirement obligations	**6,179**	6,022
Other long-term liabilities	**34,355**	21,465
Pension obligations	**254,121**	300,364
Total liabilities	**2,440,982**	1,795,084
Commitments and contingencies		
Stockholder's (deficit) equity:		
Common stock, $0.01 par value; 100 shares authorized, issued and outstanding at September 30, 2018 and 2017	**1**	1
Additional paid-in capital	**23,961**	22,398
Accumulated other comprehensive income	**21,303**	8,148
(Accumulated deficit) retained earnings	**(676,930)**	24,165
Total stockholder's (deficit) equity attributable to Prospect Medical Holdings, Inc.	**(631,665)**	54,712
Non-controlling interests	**9,316**	12,604
Total stockholder's (deficit) equity	**(622,349)**	67,316
Total liabilities and stockholder's (deficit) equity	**$ 1,818,633**	$ 1,862,400

See accompanying notes to the consolidated financial statements.

Prospect Medical Holdings, Inc.

Consolidated Statements of Operations
(in thousands)

For the Years Ended September 30,	**2018**	2017
Revenues:		
Net Hospital Services revenues	**$ 2,766,929**	$ 2,538,695
Provision for bad debts	**(119,414)**	(91,203)
Net Hospital Services revenues less provision for bad debts	**2,647,515**	2,447,492
Medical Group revenues	**334,408**	391,120
Net Global Risk Management revenues	**33,863**	20,752
Other revenues	**53,848**	55,133
Total net revenues	**3,069,634**	2,914,497
Operating Expenses:		
Hospital operating expenses	**2,203,277**	2,003,706
Medical Group cost of revenues	**267,376**	274,639
Global Risk Management cost of revenues	**20,430**	10,396
General and administrative	**529,194**	454,576
Depreciation and amortization	**97,814**	104,348
Total operating expenses	**3,118,091**	2,847,665
Operating income from unconsolidated joint ventures	**2,599**	5,388
Operating (loss) income	**(45,858)**	72,220
Other (income) expense:		
Interest expense and amortization of deferred financing costs, net	**101,889**	73,190
Loss on early extinguishment of debt	**18,422**	-
Bargain purchase gain	**-**	(30,010)
Goodwill impairment	**18,800**	-
Other expense (income), net	**2,148**	(1,861)
Total other expense, net	**141,259**	41,319
(Loss) income before income taxes	**(187,117)**	30,901
Income tax provision	**61,497**	554
Net (loss) income from continuing operations	**(248,614)**	30,347
Income from discontinued operations:		
Income from discontinued operations	**-**	7,738
Income tax provision	**-**	2,966
Income on discontinued operations, net of taxes	**-**	4,772
Net (loss) income before allocation to non-controlling interests	**(248,614)**	35,119
Net (loss) income attributable to non-controlling interests	**(4,449)**	867
Net (loss) income attributable to Prospect Medical Holdings, Inc.	**$ (244,165)**	$ 34,252

See accompanying notes to the consolidated financial statements.

Prospect Medical Holdings, Inc.

Consolidated Statements of Comprehensive (Loss) Income
(in thousands)

For the Years Ended September 30,	**2018**	2017
Net (loss) income attributable to Prospect Medical Holdings, Inc.	**$ (244,165)**	$ 34,252
Other comprehensive income, net of tax:		
Pension obligation and other post-retirement benefits adjustment (net of $6,833 and $(1,794) tax)	**12,995**	(3,646)
Debt and equity securities, unrealized gain	**160**	456
Total other comprehensive income (loss), net of tax	**13,155**	(3,190)
Total comprehensive (loss) income	**$ (231,010)**	$ 31,062

See accompanying notes to the consolidated financial statements.

Prospect Medical Holdings, Inc.

Consolidated Statements of Stockholder's (Deficit) Equity
(in thousands, except share amounts)

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings (Accumulated Deficit)	Prospect Medical Holdings, Inc. Stockholder's Equity	Non-controlling Interests	Total Stockholder's (Deficit) Equity
Balance at October 1, 2016	100	$ 1	$ 21,277	$ 11,338	$ (10,087)	$ 22,529	$ 7,227	$ 29,756
Options exercised	-	-	3	-	-	3	-	3
Stock-based compensation	-	-	1,118	-	-	1,118	-	1,118
Non-controlling interest attributed to minority shareholders	-	-	-	-	-	-	4,510	4,510
Net income	-	-	-	-	34,252	34,252	867	35,119
Other comprehensive income, net of tax	-	-	-	(3,190)	-	(3,190)	-	(3,190)
Balance at September 30, 2017	100	1	22,398	8,148	24,165	54,712	12,604	67,316
Options exercised	-	-	853	-	-	853	-	853
Stock-based compensation	-	-	710	-	-	710	-	710
Non-controlling interest attributed to minority shareholders	-	-	-	-	-	-	1,161	1,161
Net income	-	-	-	-	(244,165)	(244,165)	(4,449)	(248,614)
Dividend paid to stockholder	-	-	-	-	(456,930)	(456,930)	-	(456,930)
Other comprehensive income, net of tax	-	-	-	13,155	-	13,155	-	13,155
Balance at September 30, 2018	100	$ 1	$ 23,961	$ 21,303	$ (676,930)	$ (631,665)	$ 9,316	$ (622,349)

See accompanying notes to the consolidated financial statements.

Prospect Medical Holdings, Inc.

Consolidated Statements of Cash Flows
(in thousands)

For the Years Ended September 30,	**2018**	2017
Operating activities		
Net (loss) income	**$ (248,614)**	$ 35,119
Adjustments to reconcile net (loss) income to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	**97,814**	104,348
Amortization of deferred financing costs, net	**2,702**	2,090
Goodwill impairment	**18,800**	-
Write-off of deferred financing costs	**11,709**	-
Amortization of original issue discount and premium, net	**2,976**	1,909
Write-off of asset retirement obligation	**-**	(272)
Write-off of original issue discount and premium	**6,713**	-
Provision for bad debts	**119,414**	91,203
Pension obligation net periodic benefit cost	**12,403**	13,688
Deferred income taxes, net	**97,782**	(50,248)
Stock-based compensation	**710**	1,118
Undistributed earnings from equity method investments	**(2,599)**	(5,552)
Loss (gain) on sale of equity method investments	**280**	(2,974)
Loss (gain) on disposal of assets	**212**	(2,870)
Bargain purchase gain	**-**	(30,010)
Changes in operating assets and liabilities, net of business combinations:		
Patient accounts receivable	**(111,289)**	(147,130)
Due to/from government payers, net	**25,180**	(14,063)
Other receivables, prepaid expenses and other current assets	**64,660**	(76,754)
Hospital fee program receivable	**(152,242)**	(16,170)
Inventories	**(494)**	(2,489)
Hospital fee program liability and deferred revenue	**63,999**	(16,716)
Income taxes payable/receivable, net	**(45,530)**	67,523
Deposits and other assets	**1,580**	19,593
Accrued medical claims and other healthcare costs payable	**7,448**	2,980
Accounts payable, other accrued liabilities and other long term liabilities	**62,091**	83,713
Pension obligation	**-**	(7,174)
Net cash and cash equivalents used in operating activities from discontinued operations	**-**	(623)
Net cash and cash equivalents provided by operating activities	**35,705**	50,239
Investing activities		
Purchases of property, improvements and equipment	**(98,580)**	(56,807)
Purchases of long-term investments	**-**	(991)
Proceeds from sale of equity method investment	**-**	2,245
Cash paid for acquisitions, net of cash received and working capital adjustments	**(5,780)**	(18,373)
Cash in escrow for acquisitions	**-**	-
Change in restricted cash for acquisitions	**-**	(21,562)
Proceeds from sale of property and improvements	**726**	7,840
Distribution received from equity method investments	**2,150**	2,089
Increase in investments	**(7,315)**	(10,786)
Net cash and cash equivalents used in investing activities from discontinued operations	**-**	5,884
Net cash and cash equivalents used in investing activities	**(108,799)**	(90,461)

Prospect Medical Holdings, Inc.

Consolidated Statements of Cash Flows (Continued)
(in thousands)

For the Years Ended September 30,	**2018**	2017
Financing activities		
Borrowings on Senior Secured Notes, net of original issue discount	**1,097,600**	-
Repayments on Senior Secured Notes	**(622,788)**	(6,250)
Borrowings on line of credit, net	**209,000**	59,515
Promissory note	**-**	3,500
Repayments on retired line of credit, net	**(115,300)**	-
Proceeds of other long-term debt	**-**	1,413
Repayments of long-term debt	**(1,380)**	(1,179)
Proceeds from financing leases, net	**-**	9,646
Repayment of financing leases	**(2,450)**	(683)
Repayments of capital leases	**(12,419)**	(12,313)
Proceeds from exercise of stock options	**853**	3
Cash paid for deferred financing costs	**(19,833)**	(2,990)
Change in restricted cash	**29,019**	(3,082)
Dividend paid to stockholder	**(456,930)**	-
Excess contribution to pension plan	**(41,667)**	-
Repayments of insurance premium financing	**(10,026)**	(9,836)
Net cash and cash equivalents provided by financing activities	**53,679**	37,744
Decrease in cash and cash equivalents	**(19,415)**	(2,478)
Cash and cash equivalents, beginning of year	**27,109**	29,587
Cash and cash equivalents, end of year	**$ 7,694**	$ 27,109
Supplemental disclosure of cash flow information		
Interest paid (including cash paid on debt extinguishment)	**$ 63,650**	$ 52,593
Income taxes (received) paid, net	**$ (3,485)**	$ 13,739
Schedule of non-cash investing and financing activities		
Equipment acquired under capital leases	**$ 19,443**	$ 12,959
Accrual of property, improvements and equipment	**$ 19,995**	$ -
Insurance premium financed	**$ 9,900**	$ 9,836
Partial satisfaction of long-term liability assumed from acquisition of PCC	**$ 1,195**	$ 1,537
Acquisition of NUMG	**$ 7,452**	$ -

See accompanying notes to the consolidated financial statements.

1. Organization

Prospect Medical Holdings, Inc. ("Prospect" or the "Company" or the "Parent Entity") is a Delaware corporation and a wholly-owned indirect subsidiary of Ivy Holdings Inc. ("Ivy Holdings").

The Company's operations are currently organized into four primary reportable segments: Hospital Services, Medical Group, Global Risk Management and Corporate, as discussed below.

Liquidity

The Company had a net working capital deficit of $136,886,000 as of September 30, 2018 compared to net working capital surplus of $27,932,000 as of September 30, 2017, respectively. Additionally, the Company had a net loss before income taxes of $187,117,000 for the year ended September 30, 2018 compared to net income before income taxes of $30,901,000 for the year ended September 30, 2017. As of September 30, 2018, the Company has a stockholder's deficit of $622,349,000 compared to stockholder's equity of $67,316,000, as of September 30, 2017. Cash and cash equivalents generated by operations declined to $35,705,000 from $50,239,000 for the years ended September 30, 2018 and 2017, respectively, and total change in cash and cash equivalents decreased year on year from a decline of $2,478,000 for the year ended September 30, 2017 to a decline of $19,415,000 for the year ended September 30, 2018. Total debt, net of discount/ premiums and deferred finance charges increased to $1,117,870,000 at September 30, 2018 compared to $638,228,000 at September 30, 2017. Such increase was primarily due to the Company's entry into New Senior Secured Credit Facilities during the year ended September 30, 2018 (Note 9). As part of the New Senior Secured Credit Facilities, the Company entered into a restated and amended revolving credit facility with a maximum revolving commitment of $250.0 million, which is expandable to $325.0 million. The balance outstanding at September 30, 2018 on the amended revolving credit facility was $207,645,000 comparable to $113,061,000 on the existing revolving credit facility at September 30, 2017. At September 30, 2018, the available balance on the line was approximately $41.0 million. Cash and cash equivalents declined from approximately $27.1 million at September 30, 2017 to approximately $7.7 million at September 30, 2018. The Company has various initiatives in place to generate positive cash flows from operations. From a revenue generating perspective, these include a focus on improving charge capture, improving the success rate on denials, and increasing reimbursements through rate negotiations with managed care payors, as well as improving volumes. From a cost cutting perspective, the initiatives include improvements to labor productivity and the reduction in overtime and use of registry, as well as better controls on supply and pharmacy contracts. Further, there are initiatives to focus on improving both productivity and volumes from the Company's physician groups. The Company is currently investigating new sources of liquidity which may include discussions with both the Company's investors and lenders in relation to additional borrowings. On January 25, 2019, Ivy Holdings made an equity contribution in the amount of $40 million (see Note 15). The Company believes that it will have sufficient cash flows from operations and available revolving facilities to provide sufficient capital resources to sustain operations, investing activities and financing for at least the next twelve months from the date these financial statements were available to be issued.

Hospital Services Segment

As of September 30, 2018, through its subsidiaries the Company owns 20 acute care and behavioral hospitals and multi-level elder care facilities in Southern California, Texas, Rhode Island, New Jersey, Pennsylvania and Connecticut with approximately 3,700 licensed beds, and a network of specialty and primary care clinics. The Hospital Services segment subsidiaries are wholly-owned by Prospect, except for the facilities in Rhode Island, in which Prospect has an 85% interest in the subsidiary that owns such facilities.

Admitting physicians are primarily practitioners in the local area. The hospitals have payment arrangements with Medicare, Medicaid and other third party payers, including commercial insurance carriers, health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs").

Medical Group Segment

The Medical Group segment is a healthcare management services organization that provides management services to affiliated physician organizations that operate as independent physician associations ("Medical Groups" or "IPAs"). The affiliated physician organizations enter into agreements with HMOs to provide HMO enrollees with a full range of medical services in exchange for fixed monthly fees ("Capitation"). The Medical Groups contract with physicians (primary care and specialist) and other healthcare providers to provide enrollees with medical services. Prospect currently manages the provision of healthcare services for its affiliated physician organizations in California, Texas, Rhode Island, Connecticut, Pennsylvania and New Jersey. The California network consists of various physician organizations that are generally wholly-owned by Prospect Medical Group, Inc. ("PMG") and managed by the two medical management company subsidiaries that are wholly-owned by Prospect. The Medical Group segment also owns clinic facilities through New Genesis Medical Association ("NGMA") that operates by employing physicians to serve its patients. PMG and NGMA are owned by a nominee physician shareholder pursuant to an assignable option agreement, under which Prospect has an assignable option, obtained for a nominal amount from PMG and the nominee shareholder, to designate the purchaser (successor physician) for all or part of PMG's issued and outstanding stock held by the nominee physician shareholder (the "Stock Option") in its sole discretion.

Most of the physician organizations have entered into Management Service Agreements ("MSA") with Prospect Medical Systems Inc., ("PMS"), and have agreed to pay a management fee to PMS, which is based in part on the costs to the management company and on a percentage of revenues. In return for payment of the management fee, PMS has agreed to provide financial management, information systems, marketing, advertising, public relations, risk management, and administrative support, including for utilization review and quality of care. At its cost, PMS has assumed the obligations for all facilities and employs physician and non-physician personnel for administrative services. The management fee is earned based on a combination of percentage of revenue and share of pre-tax income. The management fees fluctuate based on the revenue and profitability of each physician organization. The Management Agreements are not terminable by the physician organization except in the case of gross negligence, fraud or other illegal acts, or bankruptcy, of PMS.

Prospect consolidates the revenues and expenses of all the physician organizations (except for one entity that is a 50/50 joint venture, which is accounted for under the equity method) from the respective dates of execution of the Management Agreements. All significant inter-entity balances have been eliminated in consolidation. In the case of the joint venture, only that portion of the results which are contractually identified as Prospect's are recognized in the consolidated financial statements, together with the management fee that the Company charges the joint venture for managing the other owners' share of the joint venture operations.

Prospect has also entered into management services agreements with unaffiliated third parties to manage services to their HMO enrollees. These management agreements do not have characteristics that give rise to the consolidation of the entities under current accounting literature. These management services agreements are terminable in accordance with the agreements.

The affiliated physician organizations provided medical services to a combined total of approximately 442,000 and 355,000 enrollees as of September 30, 2018 and 2017, respectively. The enrollees include approximately 255,000 and 159,000 enrollees that the Company manages for the economic benefit of certain independent third parties, and for which the Company earns management fee income as of September 30, 2018 and 2017, respectively. The total paid member months including managed enrollees, for the years ended September 30, 2018 and 2017 was approximately 5,360,000 and 3,991,000, respectively.

Global Risk Management Segment

The Global Risk Management segment has entered into global capitation arrangements with certain unrelated third-party health plans. The Global Risk Management segment also manages the provision of care for members in coordination with the Hospital Services and Medical Group segments.

Corporate Segment

The Company established a captive insurance company, Prospect Medical Holding Risk Retention Group, Inc. ("RRG") on June 20, 2016 in the state of Vermont. RRG was formed to provide primary insurance coverage for hospital and physician professional and general liability risks for the Company's subsidiary health care organizations located in Pennsylvania on a claims-made basis. RRG is wholly owned by Prospect Penn, LLC, which is wholly-owned directly by the Company. All intercompany balances and transactions are eliminated upon consolidation.

Additionally, the Company has a captive insurance company based in the Cayman Islands, Connecticut Healthcare Insurance Company ("CHIC"), which provides hospital and physician professional and general liability coverage to all of the Company's hospitals and affiliated subsidiaries except for Crozer and its Pennsylvania subsidiaries (Covered by RRG above). Effective January 1, 2018, ownership of CHIC was transferred from Prospect ECHN, Inc. to make CHIC a direct wholly-owned subsidiary of the Company. CHIC is an exempted Company with limited liability under the Companies Law of the Cayman Islands and it holds a Class "B(i)" Insurer's License under Section 4(3)(b) of the Cayman Islands Insurance Law 2010. CHIC's principal activity is to issue primary policies for hospital liabilities covering Prospect, its subsidiaries and employees, on a claims-made basis. The Company procured excess healthcare professional liability and umbrella liability insurance policy on a claims-made basis covering healthcare professional liability, general liability, automobile liability, employer's liability, helipad liability and non-owned aircraft liability of the Company and its affiliates. This excess coverage is purchased entirely from unrelated commercial insurers. CHIC also provides a deductible reimbursement policy for workers compensation to the Company's California and Connecticut hospital facilities all of which have high deductible program structures or are qualified self-insureds.

On January 1, 2018, CHIC began providing an employee benefit stop-loss policy to all Company subsidiaries. Unlimited excess coverage is purchased from unrelated reinsurance companies.

The Company does not allocate interest expense related to acquisition debt or income taxes to the other reporting segments.

2. Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of all controlled subsidiaries, of which control is effectuated through ownership of voting common stock or by other means, but do not include the accounts of the parent companies, Ivy Holdings Inc. and Ivy Intermediate Holding Inc. The Company has a variable interest in various entities under the Medical Group segment due to the existence of two call options, under which the Company has the ability to require the holders of all of the voting common stock of the underlying subsidiaries to sell their shares at a fixed nominal price ($1,000) to another designated physician chosen by the Company. This call option agreement represents rights provided through a variable interest other than the equity interest itself that limits the returns that could be earned by the equity holders. In addition, the Company has management agreements with the physician organizations under the Medical Group segment which allows the Company to direct the activities of such physician organizations that most significantly impact their economic performance, retain the right to receive expected residual returns and assume the obligation to absorb losses. Accordingly, the Company is considered to be the primary beneficiary and these entities are consolidated within the accompanying consolidated financial statements.

Operating results for acquisitions are consolidated with the Company's financial statements from their acquisition dates. All significant intercompany balances and transactions have been eliminated in consolidation. Non-controlling interests in less-than-wholly-owned consolidated subsidiaries of the Company are presented as a component of total equity to distinguish between the interests of the Company and the interests of the non-controlling owners.

The consolidation of these entities does not change any legal ownership, and does not change the assets or the liabilities and equity of the Parent Entity as a stand-alone entity. These entities had total revenues of approximately $310,720,000 and $413,866,000 and total net loss of approximately $2,184,000 and net income of approximately $20,298,000 for the years ended September 30, 2018 and 2017, respectively.

The assets and liabilities of the variable interest entities are as follows (in thousands):

September 30,		**2018**		2017
Assets				
Total current assets	**$**	**89,882**	$	177,525
Total non-current assets		**90,465**		18,044
Total assets	**$**	**180,347**	$	195,569
Liabilities				
Total current liabilities	**$**	**69,097**	$	82,082
Total long-term liabilities		**730**		700
Total liabilities	**$**	**69,827**	$	82,782

Reclassifications

Certain reclassifications were made to the prior year consolidated financial statements in order to conform to the current year presentation.

Revenues

Revenues by reportable segment are comprised of the following amounts (in thousands):

For the Years Ended September 30,	**2018**	2017
Net Hospital Services		
Inpatient	**$ 1,625,187**	$ 1,423,273
Outpatient	**958,715**	955,543
Capitation	**157,622**	110,330
Other	**25,405**	49,549
Total Hospital Services revenues	**2,766,929**	2,538,695
Less: Provision for bad debts	**(119,414)**	(91,203)
Total net Hospital Services revenues less provision for bad debts	**2,647,515**	2,447,492
Medical Group		
Capitation	**307,444**	369,185
Management fees	**10,501**	7,977
Other	**16,463**	13,958
Total Medical Group revenues	**334,408**	391,120
Global Risk Management		
Capitation	**23,095**	13,097
Other	**10,768**	7,655
Total Global Risk Management revenue	**33,863**	20,752
Other revenues	**53,848**	55,133
Total net revenues	**$ 3,069,634**	$ 2,914,497

The revenues of acquisitions have been included in the accompanying consolidated financial statements for the period from their respective acquisition dates. These revenues also exclude revenues from discontinued operations.

Hospital Services Segment

Net Patient Service Revenues

Operating revenue of the Hospital Services segment consists primarily of net patient service revenue. The Company reports net patient service revenue at the estimated net realizable amounts from patients and third-party payers and others in the period in which services are rendered. The Company has agreements with third-party payers, including Medicare, Medicaid, managed care and other insurance programs that

are paid at negotiated rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments, as further described below. Estimates of contractual allowances are based upon the payment terms specified in the related contractual agreements. The Company accrues for amounts that it believes may ultimately be due to or from the third-party payers. Normal estimation differences between final settlements and amounts accrued in previous years are reported as changes in estimates in the current year. Outstanding receivables, net of allowances for contractual discounts and bad debts, are included in patient accounts receivable in the accompanying consolidated balance sheets.

The following is a summary of sources of patient service revenues (net of contractual allowances and discounts) before provision for bad debts and exclude revenues from discontinued operations (in thousands):

Years ended September 30,	**2018**	2017
Medicare	**$ 850,197**	$ 848,221
Medicaid	**905,322**	699,340
Managed Care	**631,209**	607,362
Self-Pay/Other	**197,174**	223,893
Capitation	**157,622**	110,330
Other	**25,405**	49,549
Total patient service revenue	**$ 2,766,929**	$ 2,538,695

A summary of the payment arrangements with major third-party payers follows:

Medicare: Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some persons with end-stage renal disease and certain other beneficiary categories, including eligible disabled persons. Most inpatient hospital services rendered to Medicare program beneficiaries are paid on a fee-for-service basis at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Most outpatient services also are paid on a fee-for-service basis generally using prospectively determined rates. The Company receives, as appropriate, Medicare disproportionate share hospital ("DSH") and bad debt payments at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare Administrative Contractor. The Company also receives, as appropriate, Medicare uncompensated care DSH payments, which are generally not subject to cost report audit except to determine eligibility for Medicare DSH. The Company also receives Medicare outlier payments on an ongoing basis during the year for cases that are unusually costly, and under certain circumstances these payments may be reconciled to more closely reflect the costs in excess of outlier thresholds after the submission and audit of the annual Medicare cost report. Normal estimation differences between filed settlements and amounts accrued are reflected in net patient service revenue.

The Company is reimbursed by Medicare for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare Administrative Contractor. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year that examination is substantially completed.

Although services for most Medicare beneficiaries are paid by the Federal government on a fee-for-service basis, approximately one-third of Medicare beneficiaries are enrolled in a "Medicare Advantage" plan, which is a type of health plan that contracts with the Medicare program to provide hospital and medical benefits to Medicare beneficiaries. Medicare Advantage Plans include Health Maintenance Organizations, Preferred Provider Organizations, Private Fee-For-Service Plans, Special Needs Plans, and Medicare Medical Savings Account Plans. For Medicare beneficiaries enrolled in a Medicare Advantage plan, most Medicare services are covered by the plan and are not paid for under fee-for-service Medicare. Certain Medicare Advantage plans make capitation payments to the Company using a "Risk Adjustment model," which compensates providers based on the health status (acuity) of each enrollee. Providers with higher acuity enrollees generally will receive more and those with healthier enrollees will receive less.

Medicaid: Medicaid is a joint federal-state funded healthcare benefit program that is administered by states to provide benefits to qualifying individuals who are unable to afford care. The Company receives reimbursements under the Medicaid programs in each state in which it operates at prospectively determined rates for inpatient services and a mixture of fee schedules and cost reimbursement methodologies for outpatient services depending on the specific state regulations. Cost report settlements are recorded based upon as-filed cost reports (if required by the respective facility's state) and adjusted for tentative and final settlements, if any.

The various states in which the Company operates have additional programs in which certain of the Company's facilities participate in, related to medical facilities serving a disproportionate number of low-income patients. The following table shows the revenues generated by these programs during the years ended September 30, 2018 and 2017 (in thousands), which are reflected in Net Hospital Services revenues in the accompanying consolidated statements of operations:

For the years ended September 30,	**2018**	2017
California Medi-Cal Disproportional Share ("CA DSH") *(a)*	**$ 13,761**	$ 21,460
Texas Section 1115 Waiver – UCC Pool *(b)*	**(7,324)**	10,492
Texas Section 1115 Waiver – DSRIP Pool *(b)*	**12,712**	12,712
Rhode Island DSH and UPL *(c)*	**19,035**	24,402
New Jersey Health Care Subsidy Funds *(d)*	**900**	9,040
Pennsylvania State Programs *(e)*	**40,344**	30,719
Connecticut Medicaid DSH revenue *(f)*	**33,152**	14,301
	$ 112,580	$ 123,126

(a) Revenues are accrued based on the expected total annual awards. Differences between the estimated and the actual awards are recorded in the period they become known, and are subject to retrospective revision prior to finalization, which could lead to material retractions. The Company records retrospective retractions when they are estimable and probable. Retrospective additional revenues are recorded when the amounts are received.

(b) The program has consisted of three major components: statewide Medicaid managed care, the Uncompensated Care ("UC") pool, and "Delivery System Reform Incentive Payment" (DSRIP). The UC pool contains $3.1 billion in annual funding to cover, among other things, "shortfall" between the cost of providing care to an uninsured patient and the reimbursement amount that Medicaid would pay for that service. DSRIP is an incentive pool with another $3.1 billion in annual funding that allows providers to earn payments for meeting certain CMS and HHSC-approved reporting and

performance metrics for "a wide range of innovative projects. Historically, Nix Health has received payments from both the DSRIP and UC pools. Texas' Medicaid Section 1115 Waiver that CMS approved in December 2017 (the "2017 Waiver") extended the program for an additional five years from October 2017 through September 2022 but made significant changes to the pools. The UC pool will remain at $3.1 billion until September 2019 and will subsequently be adjusted based on aggregate provider data concerning charity care cost in 2017. Widespread failure by providers to report accurate charity care data will result in a "default" pool size of $2.3 billion. The DSRIP program will be phased out during the five-year period as federal matching funds of DSRIP activities will be reduced each year until it ceases entirely in 2021. Some of these funds might be available to support other programs, or if the original DSRIP projects will be continued or incorporated into managed care. Moreover, the impact of UC pool changes, particularly in relation to charity care hospitals, while currently uncertain, will become more evident with each passing deadline over the new Waiver's five-year term.

At September 30, 2017, the Company had recorded a net receivable of approximately $17 million (net of reserves of approximately $5 million) related to State fiscal years 2015 through 2017 in respect of UC monies owed to the Company. As a result of a lawsuit by a hospital in Texas against CMS in relation to the calculation of uncompensated care, the Texas Health and Human Services Commission set aside reserves as a contingency against a reallocation of those funds, pending the outcome of the lawsuit. During the year ended September 30, 2018, the hospital won the lawsuit and it is under appeal. At September 30, 2018, given the additional uncertainty, the Company has recorded a reduction to revenue of approximately $17 million. Accordingly, the net revenues recorded under the UC program for the year ended September 30, 2018 are negative.

(c) Rhode Island hospitals receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. The State of Rhode Island also assesses a license fee to all hospitals in Rhode Island based on each hospital's net patient revenue. The Company recorded $16,925,000 and $20,137,000 of expense during the years ended September 30, 2018 and 2017, respectively, as a result of the license fee.

(d) The New Jersey Health Care Reform Act of 1992 established Health Care Subsidy Funds to provide certain hospitals in New Jersey with funds necessary to provide charity care and other forms of uncompensated care.

(e) The Company's Pennsylvania hospitals are participants in Pennsylvania statewide hospital assessment, Medicaid Modernization Assessment ("MMA"), which has been extended through June 30, 2023. The assessments have enabled the Commonwealth of Pennsylvania to maintain the updated inpatient payment system, make changes to existing disproportionate share/supplemental payments, and to create new payments where applicable. The Company has also recognized revenues from the Pennsylvania Community Access Fund ("CAF").

(f) The Company's hospitals in Connecticut participate in its Medicaid DSH program and receive additional reimbursement for treating a disproportionate share of low income patients. Connecticut assesses a provider tax based on total net revenue received by a hospital for the provision of inpatient hospital services and outpatient hospital services. The amount of the provider tax is currently the subject of litigation. The state's two-year budget adopted in late 2017 provides for an increase in the provider tax, as well as additional supplemental payments to be paid to hospitals. CMS has approved both parts of the arrangement: the increase in the provider tax, and the additional supplemental payments to be paid to certain hospitals. The state has noted

the potential that further negotiations may be needed between the hospital association and the state given that increases in a portion of the state payments may exceed federal limits.

Managed Care: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment under these agreements is in accordance with negotiated contracted rates or at the Company's standard charges for services provided. Some of these payments are capitated, meaning that the Company receives an agreed amount per patient for providing an agreed range of services.

Self-Pay: Self-pay patients represent those patients who do not have health insurance and are not covered by some other form of third party arrangement. Such patients are evaluated, at the time of services or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, as well as the Company's local hospital's indigent and charity care policy.

Laws and regulations governing the third-party payor arrangements are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Normal estimation differences between subsequent cash collections on patient accounts receivable and net patient accounts receivable estimated in the prior year are reported as adjustments to net patient service revenue in the current period.

The following is a summary of due from and due to governmental payers at September 30, 2018 and 2017 (in thousands):

September 30,	**2018**	2017
Due from government payers:		
Medicaid Disproportionate Share (DSH)	**$ 16,673**	$ 20,414
Medicare cost report settlements	**5,877**	7,707
Medicaid Section 1115 receivable	**10,283**	23,031
	$ 32,833	$ 51,152
Due to government payers:		
Medicare cost report settlements	**$ 21,616**	$ 17,712
Medicaid cost report settlements	**8,999**	6,042
	$ 30,615	$ 23,754

The Company is not aware of any material claims, disputes, or unsettled matters with any payers that would affect revenues that have not been adequately provided for and disclosed in the accompanying consolidated financial statements.

California Hospital Fee Program

The Company recognizes revenues related to supplemental Medi-Cal payments under California provider fee programs. These programs are funded by quality assurance fees paid by participating hospitals and matching federal funds.

Based on formulas contained in the legislation as well as modeling done by the California Hospital Association, the Company recognized supplemental payments, included in net patient service revenue, and quality assurance fee expense, included in general and administrative expenses in the accompanying consolidated statements of operations as follows (in thousands):

Years Ended September 30,	**2018**	2017
Hospital services revenues	**$ 284,122**	$ 70,620
General and administrative expenses	**123,996**	46,127
Net pre-tax impact	**$ 160,126**	$ 24,493

As of September 30, 2018 and 2017, the Company had receivables related to the California Hospital Fee Program of approximately $211,454,000 and $59,209,000, respectively, and had liabilities related to the California Hospital Fee Program of approximately $65,967,000 and $1,968,000, respectively, in the accompanying consolidated balance sheets.

Legislation approved by the State of California in October 2013 created the framework for the hospital fee program to continue in perpetuity without requiring further legislation from the State. In November 2016, California voters approved Proposition 52, which made the hospital fee program permanent and prohibits lawmakers from diverting Medi-Cal funds to pay for anything other than their intended purpose. In December 2017, CMS approved the fee-for-service inpatient and outpatient payments and taxes for the period from January 1, 2017 to June 30, 2019 ("QAF 5"). The increased payments to the Medi-Cal managed plans for the current California Hospital Fee Program period are anticipated to occur the first half of Calendar 2019 when it is anticipated CMS will approve the amended Health Plan contracts. During the year ended September 30, 2018, the Company recorded revenues under the QAF 5 program of $111.9 million related to periods prior to the current fiscal year. Additionally, the Company recorded revenues related to previous hospital fee programs prior to QAF 5 of $14.6 million during the year ended September 30, 2018.

Charity Care

The Company provides charity care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Company's charity care policy. This care is provided without charge or at amounts less than the Company's established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The direct and indirect costs related to this care totaled approximately $10,623,000 and $10,653,000 for the years ended September 30, 2018 and 2017, respectively. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition, the Company provides services to other medically indigent patients under various state Medicaid programs. Such programs pay amounts that are less than the cost of the services provided to the recipients. The Company has not changed its charity care or uninsured discount policies during the years ended September 30, 2018 and 2017.

Provisions for Contractual Allowances and Bad Debts

Collection of receivables from third-party payers and patients is the Company's primary source of cash and is critical to its operating performance. The Company closely monitors its historical collection rates, as well as changes in applicable laws, rules and regulations and contract terms, to assure that provisions for contractual allowances are made using the most accurate information available. However, due to the complexities involved in these estimations, actual payments from payers may be materially different from the amounts management estimates and records. The Company's primary collection risks relate to uninsured patients and the portion of the bill which is the patient's responsibility, primarily co-payments and deductibles. Payments for services may also be denied due to issues over patient eligibility for medical coverage, the Company's ability to demonstrate medical necessity for services rendered and payer authorization of hospitalization.

Accounts receivable are reduced by an allowance for doubtful accounts. Valuation of the collectability of accounts receivable and provision for bad debts is based on historical collection experience, payer mix and the age of the receivables. Management routinely reviews accounts receivable balances in conjunction with these factors and other economic conditions which might ultimately affect the collectability of the patient accounts, and makes adjustments to the Company's allowances as warranted. For receivables associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and subsequently calculates an allowance for doubtful accounts and provision for bad debts once the age of the accounts reaches a specific age category based on historical experience. For receivables associated with self-pay patients, management records a significant provision for bad debts beginning in the period services were provided based on past experience that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The allowance for doubtful accounts as a percent of gross accounts receivable was 36% and 28% at September 30, 2018 and September 30, 2017, respectively. The allowance for doubtful accounts was $193,439,000 and $141,775,000 as of September 30, 2018 and 2017, respectively.

Legislation

All of the Company's hospital facilities are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient's ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. The Company believes that it is in compliance with EMTALA and is not aware of any pending or threatened EMTALA investigations involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements.

Medical Group Segment

Medical Group Revenues

Operating revenue of the Medical Group segment consists primarily of payments for medical services procured by the Affiliates under capitated contracts with various managed care providers including HMOs. Capitation revenue under HMO contracts is prepaid monthly to the Affiliates based on the number of enrollees electing any one of the Affiliates as their health care provider. See "Concentrations of Credit Risks" below for revenues received from the five largest contracted HMOs.

Capitation revenue (net of capitation withheld to fund risk share deficits discussed below) is recognized in the month in which the physician organizations are obligated to provide services. Minor ongoing adjustments to prior months' capitation, primarily arising from contracted HMOs' finalizing of monthly patient eligibility data for additions or subtractions of enrollees, are recognized in the month they are communicated to the Company. Additionally, Medicare pays capitation using a "Risk Adjustment model," which compensates managed care organizations and providers based on the health status (acuity) of each enrollee. Health plans and providers with higher acuity enrollees will receive more and those with healthier enrollees will receive less. Under Risk Adjustment, capitation is determined based on health severity, measured using patient encounter data. Capitation is paid on an interim basis based on data submitted for the enrollee for the preceding year and is adjusted in subsequent periods (generally in the Company's fourth quarter) after the final data is compiled. Positive or negative capitation adjustments are made for Medicare enrollees with conditions requiring more or less healthcare services than assumed in the interim payments. Since the Company cannot reliably predict these adjustments, periodic changes in capitation amounts earned as a result of Risk Adjustment are recognized generally in the fourth quarter when those changes are communicated by the health plans to the Company. During the years ended September 30, 2018 and 2017, the Company returned and recognized as a reduction in revenue, approximately $3,220,000 and $13,105,000, respectively, as a result of the final Hierarchical Condition Category ("HCC") reconciliation.

HMO contracts also include provisions to share in the risk for hospitalization, whereby the physician organization can earn additional incentive revenue or incur penalties based upon the utilization of hospital services. Typically, any shared risk deficits are not payable until and unless the Company generates future risk sharing surpluses, or if the HMO withholds a portion of the capitation revenue to fund any risk share deficits. At the termination of the HMO contract, any accumulated risk share deficit is typically extinguished. Due to the lack of access to information necessary to estimate the related costs, shared-risk amounts receivable from the HMOs are only recorded when such amounts are known. Risk pools for the prior contract years are generally final settled in the third or fourth quarter of the following fiscal year. For the years ended September 30, 2018 and 2017, Medical Group revenues included approximately $7,125,000 and $73,454,000, respectively, relating to risk-sharing profit. At September 30, 2018 and 2017, contingent liabilities for carry-forward risk-pool deficits expected to be forgiven, or offset against future surpluses were approximately $92,700,000 and $30,543,000, respectively, based on the available information from the health plans.

The Company also receives incentives under "pay-for-performance" programs for quality medical care based on various criteria. These incentives, which are included in other revenues within Medical Group revenues, are generally recorded in the third and fourth quarters of the fiscal year when such amounts are known. Performance and incentive revenues recorded during the years ended September 30, 2018 and 2017 were $5,751,000 and $4,469,000, respectively.

Management fee revenue is earned in the month the services are rendered. Management fee arrangements with unaffiliated entities provide for compensation ranging from 6.5% to 10% of revenues. Management fee revenues recorded during the years ended September 30, 2018 and 2017 were $5,656,000 and $6,261,000, respectively. Management fees for revenue for entities that are consolidated are eliminated on consolidation.

Medical Group Cost of Revenues

The cost of health care services consists primarily of capitation and claims payments, pharmacy costs and incentive payments to contracted providers. These costs are recognized in the period incurred, or when the services are provided. Claims costs also include an estimate of the cost of services which have been incurred but not yet reported to the Company. The estimate for accrued medical costs is based on projections of costs using historical studies of claims paid and adjusted for seasonality, utilization and cost trends. These estimates are subject to trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management records its best estimate of the amount of medical claims incurred at each reporting period. Estimates are continually monitored and reviewed and, as settlements are made or estimates adjusted, differences are reflected in current period. See Note 13 for changes in claims estimates during the years ended September 30, 2018 and 2017.

The Company has contractual reimbursement obligations to providers and discretionary incentive payment obligations to physicians. These payments are in large part predicated on the pay-for-performance, shared risk revenues, and favorable senior capitation risk adjustment payments received by the Company from the health plans. The Company records these revenues generally in the third or fourth quarter of each fiscal year when the incentives and capitation adjustments due from the health plans are known. During this period, the Company also finalizes the physician discretionary incentive.

The Company recorded physician incentives expense of approximately $21,669,000 and $41,808,000 for the year ended September 30, 2018 and 2017, respectively. As of September 30, 2018 and 2017, physician incentive accruals of approximately $17,396,000 and $31,193,000, respectively, were included in accounts payable and other accrued liabilities in the accompanying consolidated financial statements.

The Company also periodically evaluates the need to establish premium deficiency reserves for the probability that anticipated future health care costs could exceed future capitation payments from HMOs under capitated contracts and, where appropriate, records a premium deficiency reserve. There were no such premium deficiencies recorded at September 30, 2018 and 2017, respectively.

The Company, for certain matters, maintains stop loss coverage for health care costs that are in excess of set thresholds.

Global Risk Management Segment

Global Risk Management Revenues

Operating revenue of the Global Risk Management segment consists primarily of payments for medical services procured under global capitation arrangements from third-party health plans. Capitation revenue under these global capitation contracts is prepaid monthly to the Global Risk Management segment based on the number of enrollees. Entities within the Global Risk Management segment entered into Management Services Agreements with the Hospital Services and Medical Group segments, under which 98% of capitation revenue received is transferred to these segments.

Similar to the Medical Group segment, capitation revenue is recognized in the month in which the Global Risk Management segment is obligated to provide services. Minor ongoing adjustments to prior months' capitation, primarily arising from contracted HMOs' finalizing of monthly patient eligibility data for additions or subtractions of enrollees, are recognized in the month they are communicated to the Company. Additionally, Medicare pays capitation using a "Risk Adjustment model," which compensates managed care organizations and providers based on the health status (acuity) of each enrollee. Health plans and providers with higher acuity enrollees will receive more and those with healthier enrollees will receive less. Under Risk Adjustment, capitation is determined based on health severity, measured using patient encounter data. Capitation is paid on an interim basis based on data submitted for the enrollee for the preceding year and is adjusted in subsequent periods (generally in the Company's fourth quarter) after the final data is compiled. Positive or negative capitation adjustments are made for Medicare enrollees with conditions requiring more or less healthcare services than assumed in the interim payments. Since the Company cannot reliably predict these adjustments, periodic changes in capitation amounts earned as a result of Risk Adjustment are recognized generally in the fourth quarter when those changes are communicated by the health plans to the Company. During the years ended September 30, 2018 and 2017, the Global Risk Management Segment recognized capitation risk adjustments of $5,155,000 and $3,234,000, respectively.

Global Risk Management Cost of Revenues

The cost of health care services consists primarily of the transfer of capitation revenue to the Hospital Services and Medical Group segments under the Management Services Agreements, and capitation and claims payments. These costs are recognized in the period incurred, or when the services are provided. Claims costs also include an estimate of the cost of services which have been incurred but not yet reported to the Company. The estimate for accrued medical costs is based on projections of costs using historical studies of claims paid and adjusted for seasonality, utilization and cost trends. These estimates are subject to trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management records its best estimate of the amount of medical claims incurred at each reporting period. Estimates are continually monitored and reviewed and, as settlements are made or estimates adjusted, differences are reflected in current operations.

The Company also periodically evaluates the need to establish premium deficiency reserves for the probability that anticipated future health care costs could exceed future capitation payments from HMOs under capitated contracts and, where appropriate, records a premium deficiency reserve. There were no such premium deficiencies recorded at September 30, 2018 or 2017.

The Company, for certain matters, maintains stop loss coverage for health care costs that are in excess of set thresholds.

Property, Improvements and Equipment

Property, improvements and equipment are stated on the basis of cost or, in the case of acquisitions, at their acquisition date fair values. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, and amortization of leasehold improvements is provided using the straight-line basis over the shorter of the remaining lease period or the estimated useful lives of the leasehold improvements. Leasehold improvements are generally depreciated over 5 to 40 years, buildings are depreciated over 5 to 40 years, equipment is depreciated over 2 to 15 years and furniture and fixtures are depreciated over 2 to 20 years. Equipment capitalized under capital lease obligations are amortized over the lesser of the life of the lease or the useful life of the asset.

As more fully described in Note 12, the Company is required to comply with certain seismic standards as required by the state of California by January 1, 2020 (subject to possible extension of up to 30 months to July 1, 2022, as described in Note 12). The useful life of buildings subject to seismic retrofit requirements may be limited if the Company does not make the necessary upgrades by the required compliance date.

Goodwill

Goodwill represents the excess of the consideration paid and liabilities assumed over the fair value of the net assets acquired, including identifiable intangible assets.

Goodwill is not amortized; rather it is reviewed annually for impairment for each reporting unit, or more frequently if impairment indicators arise. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value.

Through the year ended September 30, 2017, the Company tested for goodwill impairment as of September 30 each year. During the year ended September 30, 2018, the Company changed the date of the annual goodwill impairment test to July 1. The Company does not believe that the change in assessment date represents a material change in the application of applicable accounting literature. Impairment of goodwill is tested at the reporting unit level, by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of the reporting units are estimated. In evaluating whether indicators of impairment exist, the Company considers adverse changes in market value, laws and regulations, profitability, cash flows, ability to maintain enrollment and renew payer contracts at favorable terms, among other factors. The Company has adopted new literature during the year ended September 30, 2018 which changes the goodwill impairment test from a two-step process to a one-step process, which consists of estimating based on a weighted combination of (i) the guideline company method that utilizes revenue or earnings multiples for comparable publicly-traded companies, and (ii) a discounted cash flow model. If the estimated fair value of the reporting unit is less than its carrying value, this indicates that goodwill is impaired, and impairment is recorded based on the deficiency of fair value compared to the carrying value. The Company's impairment test related to goodwill during the year ended September 30, 2018 resulted in a full impairment of goodwill related to the Chartercare and East Orange facilities. There were no impairment charges during the year ended September 30, 2017.

Intangible Assets

Intangible assets include customer relationships, trade names, favorable leasehold, and physician guarantees. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if estimated undiscounted cash flows associated with those assets are less than their carrying amounts. Fair value is based upon the present value of the associated cash flows. Changes in circumstances (for example, changes in laws or regulations, technological advances or changes in strategies) may also reduce the useful lives from initial estimates. Changes in planned use of intangibles may result from changes in customer base, contractual agreements, or regulatory requirements. In such circumstances, management will revise the useful life of the long-lived asset and amortize the remaining net book value over the adjusted remaining useful life. There were no impairments recorded during the years ended September 30, 2018 and 2017.

Insurance Reserves

Medical Malpractice Liability Insurance

The individual physicians who contract with the physician organizations carry their own medical malpractice insurance, some of which may be purchased from RRG or CHIC. In the Hospital Services segment, the Company's hospitals carry professional and general liability insurance to cover medical malpractice claims under claims-made policies. Under the policies, insurance premiums cover only those claims actually reported during the policy term. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims related to occurrences during the policy term but reported subsequent to the policy's termination may be uninsured. The Company's hospitals have a consolidated policy for professional and general liability insurance with separate retentions for each entity. The Pennsylvania MCARE fund provides the $500,000 in excess of $500,000 RRG malpractice coverage for Crozer.

For the current fiscal year, RRG provided primary malpractice insurance ($500,000 per occurrence and $2,500,000 in the aggregate) and general liability ($1,000,000 per occurrence and $2,000,000 in the aggregate). In addition, the RRG provided coverage for losses of $4,000,000 in excess of $1,000,000 for each hospital professional liability claim with no aggregate limit. The RRG also provides additional layers of excess coverage over $5,000,000 up to $20,000,000, which are 100% reinsured by third party insurance carriers through multiple layers. The excess coverage provided for general liability is over $10,000,000 up to $50,000,000, which is also 100% reinsured by third party carriers.

CHIC provided malpractice ($3,000,000 per occurrence and $9,000,000 in the aggregate) and general liability ($1,000,000 per occurrence and $3,000,000 in the aggregate) coverage for ECHN for the year ended September 30, 2017. During the year ended September 30, 2018, CHIC provided malpractice and general liability ($2,000,000 per occurrence) coverage for all facilities except Crozer. CHIC also provided an excess healthcare professional liability and umbrella liability insurance policy on a claims-made basis covering healthcare professional liability, general liability, automobile liability, employers' liability, helipad liability and non-owned aircraft liability. The limit provided was $60,000,000 for each loss event and in the annual aggregate excess of the primary coverage layers described above. This coverage was fully reinsured by third party carriers.

GAAP requires that a health care organization record and disclose the estimated costs of medical malpractice claims in the period of the incident of malpractice, if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. The Company has recognized an estimated liability for incurred but not reported claims and the self-insured risks (including deductibles and potential claims in excess of policy limits) based upon an actuarial valuation of the Company's historical claims experience of its hospitals. At September 30, 2018 and 2017, the total gross claims liability, was $77,280,000 and $60,722,000 and reinsurance recoverable on unpaid losses were $12,834,000 and $9,059,000, respectively, included in other assets on the accompanying consolidated balance sheets, and were estimated using a discount factor ranging from 3.5% to 4%.

Workers' Compensation Insurance

The workers' compensation coverage provides the statutory benefits required by law with a $500,000 deductible reimbursement policy provided by CHIC for the Company's entities located in California and Connecticut. The facilities in Texas have opted out of the Texas Workers' Compensation system as non-subscribers, and provide their employees with benefits for occupational injury or disease through an ERISA plan, and have an Employer's Excess Indemnity policy with a $25,000 deductible with limits of $10,000,000 per occurrence and $25,000,000 aggregate. The facilities in Rhode Island were fully insured for workers' compensation claims with no deductible. East Orange was fully insured for workers' compensation claims with no deductible from March 1, 2017 through September 30, 2018. Crozer has a workers' compensation policy with a $500,000 deductible. At September 30, 2018 and 2017, included in accrued salaries, wages and benefits are accruals for uninsured claims and claims incurred but not reported of approximately $27,776,000 and $28,329,000 and reinsurance recoverable on unpaid losses of $8,557,000 and $7,246,000, respectively, included in other assets on the accompanying consolidated balance sheets. The amounts are estimated based upon an actuarial valuation of claims experience, using a discount factor of 4%.

Reserve Methodology

The claims reserve is based on the best data available to the Company. The estimate, however, is subject to a significant degree of inherent variability. The estimate is continually monitored and reviewed, and as the reserve is adjusted, the difference is reflected in current operations. While the ultimate amount of the medical malpractice and workers' compensation claims liability is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims. Management is not aware of any potential claims whose settlement, if any, would have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Stock Options

Ivy Holdings has a stock option plan (the "Ivy Plan"), which is administered by the Compensation Committee of the Ivy Holdings Board. The plan includes an Incentive Stock Option Agreement and a Non-Qualified Stock Option Agreement to be used in connection with the grant of options under the plan. These options granted under the Ivy Plan are exercisable into Ivy Holdings stock and vest based on a number of criteria.

Compensation costs for option awards are measured and recognized in the consolidated financial statements based on their grant date fair value, net of estimated forfeitures over the awards' service period. Options subject to variable accounting treatment are subject to revaluation at the end of each reporting period. The Company uses the Black-Scholes option pricing model and a single option award approach to estimate the fair value of stock options granted. The fair value of restricted stock grants are determined on the date of grant, based on the number of shares granted and the quoted price or estimated fair market value of the Company's common stock. Equity-based compensation is classified within the same line items as cash compensation paid to employees. Compensation costs related to stock options that vest or are exercisable when certain corporate transactions occur, including a change in control, are recognized at the time that such an event occurs.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with initial maturities of 90 days or less to be cash equivalents. Cash and cash equivalents are primarily comprised of deposits with banks. The Company maintains its cash at banks with high credit-quality ratings.

Restricted Cash

Some of the Company's cash is restricted for various purposes including research, regulatory requirements and letters of credit. The Company is also required to keep restricted deposits by certain HMOs for the payment of claims. Such restricted deposits are classified as a current asset in the accompanying consolidated balance sheets, as they are restricted for payment of current liabilities. Restricted cash also include certificates of deposit with maturity dates of more than 90 days when purchased.

Restricted Investments

Investments in marketable securities, primarily mutual funds, and are classified as available for sale and are stated at fair value. Adjustments are recorded in the statements of other comprehensive income. Investment securities are exposed to various risk, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is possible that changes in values of investment securities could occur in the near term and such changes could materially affect investment. These investments are held in the Company's captive insurance companies and are shown as restricted because the state/local regulators require their approval before dividends or return of capital to the Parent Entity.

Inventories

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

Deferred Financing Costs

Deferred financing costs are amortized over the period in which the related debt is outstanding using the effective interest method and are classified as a deduction from the carrying amount of the related debt.

Income Taxes

Deferred income tax assets and liabilities are recognized for differences between financial and income tax reporting bases of assets and liabilities based on enacted tax rates and laws. To the extent a deferred tax asset cannot be recognized under the preceding criteria, allowances must be established. The impact on deferred taxes of changes in tax rates and laws, if any, are applied to the years during which temporary differences are expected to be settled and reflected in the financial statements in the period of enactment. The Company recognizes interest and penalties associated with income tax matters and unrecognized tax benefits in the income tax expense line item of the statements of operations. For the years ended September 30, 2018 and 2017, the Company incurred $2,405,000 and $960,000 of interest and penalties related to income taxes, respectively.

An entity is required to evaluate its tax positions using a two-step process. First, the entity should evaluate the position for recognition. An entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. Next, the entity should measure the amount of benefit that should be recognized for those tax positions that meet the more-likely-than-not test.

A consolidated federal tax return is filed for Ivy Holdings, with the exception of Nuestra Familia Medical Group Inc., ("Nuestra"), which files its own federal tax returns. The Company files separate state tax returns for California, Texas, Rhode Island, Pennsylvania, Connecticut, New Jersey and Florida. The Company's filed tax returns are generally subject to examination by the IRS and state tax boards for 3 to 4 years.

Sale-Leaseback Transactions

The Company evaluates sale-leaseback transactions by determining whether the transaction meets the qualifying criteria to be recognized as a sale-leaseback, including the transfer of risk and rewards of ownership as well as the absence of continuing involvement of the Company. When the qualifying criteria for a sale-leaseback transaction are not met, the Company accounts for the transaction as a financing (see Note 9).

Comprehensive Income (Loss)

Comprehensive income consists of net income and other gains and losses affecting stockholder's equity that, under generally accepted accounting principles, are excluded from net income (loss) attributable to the Company. For the Company, such items consist primarily of unrealized gains or losses on debt and equity securities as well as changes related to pension and other postretirement liabilities that are not recognized immediately in net periodic benefit costs (see Note 11).

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and cash equivalents, restricted cash, restricted investments, patient and other accounts receivables, accrued salaries and benefits, accounts payable and accrued expenses, medical claims and related liabilities, amounts due to government agencies, notes receivable and payable, capital lease obligations, debt, and other liabilities. The carrying amounts of current assets and liabilities approximate their fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

Fair Value Measurement

Relevant accounting guidance establishes a framework for measuring fair value and clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The guidance requires disclosure about how fair value is determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of inputs as follows: Level 1 quoted prices in active markets for identical assets or liabilities; Level 2 quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or Level 3 unobservable inputs for the asset or liability, such as discounted cash flow models or valuations. The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's Level 1 assets include cash and cash equivalents and investments (certificates of deposit and money market mutual funds). The inputs for fair value of goodwill and intangible assets (including long lived assets and intangible assets subject to amortization) would be based on Level 3 inputs as data used for such fair value calculations would be based on discounted cash flows that are not observable from the market, directly or indirectly.

Financial Items Measured at Fair Value on a Recurring Basis

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis and where they are classified within the hierarchy (in thousands):

	Total	Level 1	Level 2	Level 3
As of September 30, 2018				
Mutual funds	**$ 23,779**	**$ 23,779**	**$ -**	**$ -**
Total	**$ 23,779**	**$ 23,779**	**$ -**	**$ -**
As of September 30, 2017				
Certificates of deposit	$ 850	$ 850	$ -	$ -
Mutual funds	14,960	14,960	-	-
Total	$ 15,810	$ 15,810	$ -	$ -

The Company's investments are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The Company's defined benefit pension plan assets are also measured at fair value (see Note 11).

The Company's carrying amount of long-term debt approximated fair value as of September 30, 2018 and 2017, respectively.

Nonfinancial Items Measured at Fair Value on a Nonrecurring Basis

Nonfinancial assets such as goodwill and identifiable intangible assets are measured at fair value when there is an indicator of impairment and recorded at fair value only when impairment is recognized. The Company performs an annual impairment test on the goodwill, and performs an impairment test on the intangible assets when there are indications of impairment.

During the year ended September 30, 2018, the Company recorded approximately $18.8 million of impairment relating to goodwill, which is reflected in the accompanying consolidated statements of operations.

The Company uses the discounted cash flow approach, the guideline public company approach and the guideline transactions approach to estimate the residual value of the Company's goodwill. The measurement of goodwill is a Level 3 measurement.

The following table provides quantitative information related to the significant unobservable inputs to determine fair value and impairment of goodwill as of September 30, 2018:

Residual Value of Goodwill	Valuation Technique	Unobservable Input	Rates
$ -	Discounted Cash Flow	Weighted average cost of capital	9.3%
		Revenue growth rate	(1.8)% - 11.2%
	Guideline Public Company	LTM revenue multiple	0.5x
		NTM EBITDA multiple	7.0x

There were no nonrecurring measurements as of September 30, 2017.

Concentrations of Credit Risk

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits of $250,000 per depositor of each financial institution. The Company has not experienced any losses to date related to these balances.

Financial instruments that potentially subject the Company to concentrations of credit risk consist of receivables due from Medicare, Medicaid, patients, and health plans including shared-risk arrangements.

The Company invests excess cash in liquid securities at institutions with strong credit ratings, following established guidelines relative to diversification and maturities to maintain safety and liquidity. These guidelines are periodically reviewed and modified to take into consideration trends in yields and interest rates and principal risk. Management attempts to schedule the maturities of the Company's investments to coincide with the Company's expected cash requirements. Credit risk with respect to receivables is limited since amounts are generally due from large HMOs within the Medical Group segment and from the Medicare and Medicaid programs within the Hospital Services segment. Management reviews the financial condition of these institutions on a periodic basis and does not believe the concentration of cash or receivables results in a high level of risk.

For the years ended September 30, 2018 and 2017, the Hospital Services segment received a total of 64% and 61% of its net patient revenues from Medicare and Medicaid programs, respectively, and the Medical Group segment received a total of 63% and 64% for the years ended September 30, 2018 and 2017, respectively, of their capitation revenues from its five largest HMOs, as follows (in thousands):

Years Ended September 30,	**2018**	**% of Total Revenue**		2017	% of Total Revenue
Hospital Services:					
Government Payers:					
Medicare	**$ 850,197**	**31%**		$ 848,221	33%
Medicaid	**905,322**	**33%**		699,340	28%
Total	**$ 1,755,519**	**64%**		$ 1,547,561	61%
Medical Group:					
HMO A	**$ 60,506**	**20%**	HMO A	61,624	21%
HMO B	**35,705**	**12%**	HMO F	34,950	12%
HMO F	**32,934**	**11%**	HMO B	32,923	11%
HMO D	**32,357**	**11%**	HMO D	29,617	10%
HMO C	**27,051**	**9%**	HMO C	28,585	10%
Total	**$ 188,553**	**63%**		$ 187,699	64%

The Global Risk Management segment received all of their revenues from seven health plans during the years ended September 30, 2018 and 2017.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities at the dates, and for the periods, that the consolidated financial statements are prepared. Actual results could materially differ from those estimates. Principal areas requiring the use of estimates include third party settlements, settlements under risk sharing programs, allowances for contractual discounts and doubtful accounts, accruals for medical claims, impairment of goodwill, long-lived assets and intangible assets, share-based payments, professional and general liability claims and workers' compensation claims, reserves for pension obligations and other postretirement benefit reserves, reserves for outcome of legislation and valuation allowances against deferred tax assets.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which defers the effective date of the revenue standard ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, including interim periods therein. Three basic transition methods are available — full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. October 1, 2019) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. The Company is currently evaluating the effect of this guidance on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments (Subtopic 825-10)". ASU 2016-01 requires all equity investments to be measured at fair value with changes in fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). ASU 2016-01 also requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, ASU 2016-01 eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. ASU 2016-01 is effective for annual and interim periods beginning after December 15, 2017. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)". The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard is effective for nonpublic entities for fiscal years beginning after December 15, 2019. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In March 2016, the FASB issued ASU 2016-09, "Compensation – Stock Compensation (Topic 718)". The updated standard simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 is effective for non-public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)". The updated standard addresses eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for non-public business entities for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is assessing the impact of the adoption of ASU 2016-15 on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." These amendments clarify the definition of a business. The amendments affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted under certain circumstances. The amendments should be applied prospectively as of the beginning of the period of adoption. The Company is evaluating the effect that this update will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment)". The new guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The new guidance simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. The new guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if any. The Company early adopted this standard in the current fiscal year.

In March 2017, the FASB issued ASU 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The ASU amends ASC Topic 715, Compensation — Retirement Benefits, to require employers that present a measure of operating income in their statements of income to include only the service cost component of net periodic pension costs and net periodic postretirement benefit cost in operating expenses. The ASU also stipulates that only the service cost component of net benefit cost is eligible for capitalization. This guidance is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Disclosures of the nature of and reason for the change in accounting principle are required in the first interim and annual periods of adoption. The Company is currently evaluating the provisions of ASU 2017-07 and its impact on the Company's consolidated financial position, results of operations and cash flows.

In May 2017, the FASB issued ASU 2017-09, "Modification Accounting for Share-Based Payment Arrangements (Topic 718)", which identifies and provides guidance on the types of changes to share-based payment awards that an entity would be required to apply modification accounting under ASU 2016-09, Stock Compensation (Topic 718). Specifically, an entity would not apply modification accounting if the fair value, vesting conditions and classification of the awards are the same immediately before and after the modification. ASU 2017-09 is effective for annual periods beginning after December 15, 2017 and will be applied prospectively to awards modified on or after the effective date. The Company is currently evaluating the provisions of ASU 2017-09 and its impact on the Company's consolidated financial position, results of operations and cash flows.

In February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income", which allows a reclassification from accumulated other comprehensive income to retained earnings for the standard tax effects in accumulated other comprehensive income resulting from enactment of the comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act") and corresponding accounting treatment recorded in the fourth quarter of 2017. The ASU is effective for all entities for fiscal years beginning after December 15, 2018. Early adoption of the amendments in this ASU is permitted. The Company is currently evaluating the provisions of ASU 2018-02 and its impact on the Company's consolidated financial position, results of operations and cash flows.

In August 2018, the FASB issued ASU 2018-14, "Compensation – Retirement Benefits – Defined Benefit plans – General (Topic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans", which amends ASC 715 to add, remove and clarify disclosure requirements related to defined benefit pension and other postretirement plans. This ASU is effective for fiscal years ending after December 15, 2021. Early adoption is permitted. The Company is currently evaluating the provision of ASU 2018-14 and its impact on its consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-15, "Intangibles – Goodwill and Other – Internal – Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract", which provides guidance on implementation costs incurred in a cloud computing arrangement that is a service contract. Specifically, it amends ASC 350 to include in its scope implementation costs of a cloud computing arrangement that is a service contracts and clarifies that a customer should apply ASC 350-40 to determine which implementation costs should be capitalized in such a cloud computing arrangement. The Company has early adopted this literature for the year ended September 30, 2018.

3. Property, Improvements and Equipment

Property, improvements and equipment, consisted of the following (in thousands):

September 30,	**2018**	2017
Land and land improvements	**$ 83,446**	$ 86,214
Buildings and improvements	**386,278**	352,194
Leasehold improvements	**28,971**	26,641
Equipment	**331,426**	274,577
Furniture and fixtures	**5,259**	5,184
	835,380	744,810
Less: accumulated depreciation	**(304,139)**	(219,093)
	531,241	525,717
Construction in Progress	**92,722**	51,216
Property, improvements and equipment, net	**$ 623,963**	$ 576,933

At September 30, 2018 and 2017, the Company had assets under capitalized leases of approximately $_____ and $30,986,000, respectively, and related accumulated depreciation of $26,320,000 and $22,960,000, respectively.

Depreciation expense was approximately $91,385,000 and $96,143,000 for the years ended September 30, 2018 and 2017, respectively.

4. Acquisitions

For the years ended September 30, 2018 and 2017, the Company entered into the following material acquisitions. All business combinations were consistent with the Company's strategic growth plan and were accounted for using the acquisition method of accounting. Operating results for each of the acquisitions have been included in the accompanying consolidated financial statements from the date of acquisition. Goodwill arising is primarily attributable to the synergies expected to arise after the acquisitions, and is expected to be deductible for tax purposes for entities that were asset acquisitions.

All assets acquired and liabilities assumed were at fair value with the exception of the defined benefit pension liabilities and other post retirement employee benefits, which allows for an exception to fair value accounting for business combinations in accordance with GAAP. The recognized tax bases (the amount that is attributable for tax purposes) of the assets and liabilities are compared to the financial reporting values of the acquired assets and assumed liabilities (book bases) to determine the appropriate temporary differences. The Company identified temporary differences related to assumed pension liabilities, due primarily to differences in tax law regarding when a liability is or is not assumed in an asset acquisition; this difference in the treatment of the pension liabilities resulted in the recording of deferred tax assets which are reflected in the acquisition accounting and noted in the tables below.

The Company incurred approximately $3.1 million transaction costs during the year end September 30, 2017, which are included in general and administrative expenses in the accompanying consolidated statements of operations. Transaction costs incurred during the year ended September 30, 2018 were immaterial.

2018 acquisitions

In December 2017, New University Medical Group LLC ("New UMG") entered into a Second Closing to acquire the remaining assets of University Medical Group ("UMG") that were not acquired in the initial acquisition in December 2014. As consideration for the acquisition, New UMG has assumed certain designated liabilities of the practice, which consists of various loans payable to subsidiaries of the Company, totaling approximately $7.5 million. Post-acquisition, these liabilities are eliminated on consolidation. There was no cash consideration related to the transaction. The remaining assets and liabilities acquired were immaterial and no value was assigned to them in the purchase price allocation, and accordingly goodwill of $7.5 million arises from the acquisition. New UMG's parent company, Prospect CharterCARE Physicians, LLC, dba CharterCARE Medical Associates ("CCMA"), entered into a Post Closing Administrative Services Agreement pursuant to which CCMA and its affiliates provide services to the seller of the practice in connection with its termination of all operations and the wind up its affairs and operations.

The Company completed the acquisitions of four physician practice acquisitions in Connecticut for an aggregate purchase price of approximately $2.6 million, one physician multi-specialty practice in Pennsylvania for a purchase price of $1.6 million (net of working capital adjustments), three physician medical practices in California for an aggregate purchase price of approximately $800,000, and one physician family practice in Rhode Island for $180,000. All acquisitions were asset acquisitions, except for one stock purchase acquisition in Connecticut for a purchase price of $800,000, and accordingly goodwill arising from that acquisition is not deductible for tax purposes.

2017 acquisitions

On October 1, 2016, the Company acquired substantially all of the assets, and certain liabilities, of Eastern Connecticut Health Network, Inc. and certain of its subsidiaries (collectively, "ECHN") in exchange for cash consideration of $105 million (subject to certain adjustments). The acquired assets include a network of hospitals, outpatient service centers and providers and specialists serving eastern Connecticut. The acquired hospitals are The Manchester Memorial Hospital and The Rockville General Hospital.

On October 1, 2016, the Company acquired substantially all of the assets, and certain liabilities, of Greater Waterbury Health Network, Inc. and certain of its subsidiaries (collectively, "Waterbury") in exchange for cash consideration of $31.8 million (subject to certain adjustments). The acquired assets include Waterbury Hospital, an acute-care hospital with 357 licensed beds, and a network of outpatient centers and affiliated physicians.

The following table summarizes the assets acquired and liabilities assumed in connection with each of the acquisitions in 2017 (in thousands):

	ECHN	Waterbury
Cash and cash equivalents	$ 5,292	$ 3,010
Patient accounts receivable and other receivables	31,238	23,442
Prepaid expenses and other current assets	8,893	4,100
Property, improvements and equipment	100,002	46,298
Intangible assets	3,440	2,870
Other assets	24,071	6,108
Accounts payable and other current liabilities	(39,122)	(24,639)
Capital leases and long term debt	(15,307)	(3,646)
Other long-term liabilities	(15,286)	(7,354)
Deferred tax liabilities ("DTL")	(5,474)	(13,360)
Pension obligations	(66,902)	(11,850)
Noncontrolling interests	(421)	(2,504)
Bargain gains, net of DTL of $5,474 and $13,360, respectively	(8,722)	(21,288)
Consideration	$ 21,702	$ 1,187

In connection with the acquisitions of ECHN and Waterbury, the Company recorded bargain gains (net of deferred tax liabilities) of $30,010,000 which are included in gain on bargain purchase in the accompanying consolidated statements of operations for the year ended September 30, 2017. The bargain gains arose primarily because of the future capital commitment requirements associated with the acquisitions. During the year ended September 30, 2018, the Company identified further adjustments to the purchase price allocations, which resulted in charges to the accompanying consolidated statements of operations of $3,020,000. Such adjustments related primarily to additional liabilities, offset by lower deferred tax liabilities, at Waterbury.

On May 1, 2017, the Company's wholly-owned subsidiary, Prospect Blackstone Valley Surgicare, LLC ("Prospect Blackstone"), completed an asset acquisition of a freestanding ambulatory surgery center located near the facilities in Rhode Island, in exchange for cash consideration of $1.5 million, of which $100,000 is subject to a one-year indemnification escrow hold-back.

5. Discontinued Operations

During the year ended September 30, 2016, the Company determined that it would discontinue the operations of Prospect CharterCARE Elmhurst Extended Care LLC (dba Elmhurst Extended Care), Nix Community General Hospital LLC ("Nix CGH") and Prospect ACO CA, LLC ("CA ACO"). Elmhurst Extended Care and Nix CGH are reported in the Hospital Services segment and the CA ACO is reported in the Global Risk Management segment. During the year ended September 30, 2017, the assets of Elmhurst Extended Care were sold (effective December 22, 2016) and Nix CGH ceased operations (effective October 1, 2016). The Company closed and sold the Elmhurst Extended Care business for proceeds of $13,722,000. Effective April 1, 2017, the Company made a decision to no longer discontinue operations of CA ACO and its onward activities are classified as part of the continuing operations on the consolidated financial statements. The

Company's decision to discontinue the operations of each of the entities was based on the strategy of the Company's management in their respective markets and financial results.

Summarized financial information for discontinued operations is included below (in thousands):

For the Years Ended September 30,	**2018**	2017
Net Hospital Services revenues	**$ -**	$ 10,178
Operating expenses	**-**	(6,941)
Depreciation and amortization	**-**	(80)
Interest expense	**-**	(24)
Income on discontinued operations before income taxes	**-**	3,133
Gain from sale of discontinued operations	**-**	4,605
Income tax provision	**-**	2,966
Income on discontinued operations	**$ -**	$ 4,772

6. Goodwill and Intangible Assets

The carrying value of goodwill by reporting unit is as follows (in thousands):

September 30,	**2018**	2017
Southern California Hospitals	**$ 130,912**	$ 130,912
Nix Health	**3,138**	3,138
CharterCARE	**-**	5,822
California Medical Groups	**28,222**	27,420
East Orange	**-**	4,572
Crozer	**140,216**	138,831
ECHN	**483**	-
Waterbury	**2,155**	-
Total	**$ 305,126**	$ 310,695

The changes in the carrying amount of goodwill for the years ended September 30 are as follows (amounts in thousands):

September 30,	**2018**	2017
Balance, beginning of year	**$ 310,695**	$ 341,488
Acquisitions	**13,231**	2,047
Impairment	**(18,800)**	-
Adjustments to prior year acquisitions	**-**	(32,840)
Balance, end of year	**$ 305,126**	$ 310,695

Identifiable intangible assets are comprised of the following (in thousands):

September 30,	Useful lives	**2018**	2017
HMO membership	14 years	**$ 25,200**	$ 25,200
Trade names, net of impairment	3 – 20 years	**52,583**	52,583
Physician guarantees	2 to 3 years	**-**	723
Customer relationships	7 years	**350**	350
Other	5 - 6 years	**97**	117
Gross carrying value		**78,230**	78,973
Accumulated amortization		**(44,611)**	(38,179)
Intangible assets, net		**$ 33,619**	$ 40,794

Amortization is recognized on a straight-line basis (management's best estimate of the period of economic benefit) over the respective useful lives and expense for the years ended September 30, 2018 and 2017 was $6,429,000 and $8,205,000, respectively. There are no expected residual values related to these intangible assets.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

Years ending September 30,	
2019	$ 6,523
2020	5,350
2021	5,331
2022	3,542
2023	3,022
Thereafter	9,851
	$ 33,619

The weighted-average remaining useful life for the intangible assets was approximately 7 years as of September 30, 2018.

7. Related Party Transactions

Jeereddi Prasad, M.D., a shareholder of Ivy Holdings, a director of Ivy Holdings and the Company, and an officer of the Upland Medical Group, a Professional Medical Group and Pomona Valley Medical Group, Inc (collectively "ProMed Entities"), has ownership interests in physician medical groups that provide medical services to ProMed members, including Chaparral Medical Group, Inc., (in which the Company beneficially owns a 13.2% interest). For the years ended September 30, 2018 and 2017, the ProMed Entities paid these groups approximately $19,760,000 and $17,216,000, respectively. As of September 30, 2018 and 2017, the Company had accounts payable and other accrued liabilities due to these related parties of $1,266,000 and $473,000, respectively.

Pursuant to a Management Services Agreement, dated December 15, 2010 and amended on May 3, 2012 (the "LGP Management Agreement"), between the Company and Leonard Green & Partners, L.P. ("LGP"), a private equity fund with affiliated funds that collectively constitute the majority shareholder of Ivy Holdings, LGP provides to the Company, (a) certain investment banking services, (b) management, consulting and financial planning services and (c) financial advisory and investment banking services in connection with major financial transactions from time to time. In consideration for the services provided by LGP under the LGP Management Agreement, the Company pays LGP an annual fee of $1,000,000, payable in monthly installments, and reimburses LGP for its related expenses up to $50,000 annually. If approved by the unanimous consent of the Board of Directors of the Company, additional customary fees may be due to LGP pursuant to the terms of the LGP Management Agreement for services rendered in connection with major transactions from time to time. No amounts were payable related to these related party transactions as of September 30, 2018 or 2017.

The Company is a wholly-owned indirect subsidiary of Ivy Holdings. Therefore, Ivy Holdings is the parent of an affiliated group of corporations within the meaning of Section 1504(a) of the Internal Revenue Code of 1986. On December 15, 2010, Ivy Holdings, Ivy Intermediate and the Company entered into a Tax Sharing Agreement. The Tax Sharing Agreement allows the Company to make payments to Ivy Holdings as necessary to fund their payment of any required taxes incurred due to such parent status. Under this agreement, the Company received refunds (net of payments) of $5,463,000 and $26,378,000 for the years ended September 30, 2018 and September 30, 2017, respectively.

8. Income Taxes

The components of the income tax (benefit) provision for continuing operations are as follows (in thousands):

For the years ended September 30,	**2018**	2017
Current:		
Federal	**$ (27,738)**	$ 42,836
State	**(8,547)**	8,057
	(36,285)	50,893
Deferred:		
Federal	**86,922**	(41,809)
State	**10,860**	(8,529)
	97,782	(50,338)
Total:		
Federal	**59,184**	1,026
State	**2,313**	(472)
	$ 61,497	$ 554

Temporary differences and carry forward items that result in deferred income tax balances as of September 30, are as follows (in thousands):

September 30,	**2018**	2017
Deferred tax assets:		
Accrued medical claims	**$ 4,344**	$ 11,317
Malpractice reserves	**3,727**	9,020
Accounts receivable	**24,654**	26,693
Accrued salaries & wages	**12,562**	22,920
Pension obligation	**82,697**	133,960
Net operating losses	**55,231**	6,617
Tax Credits	**2,870**	2,174
Outside basis differences	**762**	9,706
UTP & other	**12,552**	5,512
Deferred tax assets	**199,399**	227,919
Valuation allowance	**(119,544)**	(10,308)
Net deferred tax assets	**79,855**	217,611
Deferred tax liabilities:		
Property, plant & equipment	**(55,058)**	(96,490)
Intangible assets	**(8,601)**	(7,317)
Prepaid expenses	**(2,809)**	(3,543)
Other comprehensive income	**(11,412)**	(5,938)
Deferred tax liabilities	**(77,880)**	(113,288)
Net deferred tax assets	**$ 1,975**	$ 104,323

Deferred tax assets and liabilities reflect the effect of temporary differences between the assets and liabilities recognized for financial reporting purposes and the amounts recognized for income tax purposes.

Management assesses the available positive and negative evidence to estimate whether sufficient future pretax income will be generated to permit use of the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative pretax losses incurred over the three year period ended September 30, 2018. Such objective evidence limits the ability to consider other subjective evidence, such as the Company's projections for future growth. On the basis of this evaluation, at September 30, 2018, a valuation allowance of approximately $119.5 million has been recorded to recognize only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period are reduced or increased or if negative objective evidence in the form of cumulative losses is no longer present and additional weight is given to subjective evidence such as the Company's projections for growth.

During fiscal 2018, the Company completed an IRS examination for Prospect Medical Group, Inc. & Subsidiaries' fiscal year 2014 federal income tax return. The Company's IRS examination for Ivy Holdings, Inc. & Subsidiaries fiscal 2014 through 2016 federal income tax returns are also ongoing. No adjustments have been proposed thus far for any of the years under audit. We do not have any ongoing examinations

in states. We do not currently anticipate any changes to our unrecognized tax benefits for the next twelve months related to these examinations.

Generally, the Company's tax years 2014 through 2017 are open for federal and state tax examination. As of September 30, 2018, the Company has recorded a liability in the amount of $12.7 million related to uncertain tax positions ("UTP") with respect to impermissible accounting methods for federal income tax purposes, which is recorded in other long-term liabilities in the accompanying consolidated balance sheets. The Company believes that it is reasonably possible that an increase in unrecognized tax benefits may be necessary within the coming year, and these unrecognized tax benefits would primarily impact deferred taxes and taxes payable, and the expected range of potential increase in the unrecognized tax benefits is not expected to be material to the balance sheet nor the income statement.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Act") was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, limitations on various business deductions such as executive compensation under Internal Revenue Code §162(m), the transition of U.S international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017. The United States federal income tax rate reduction was effective as of January 1, 2018. Accordingly, the Company's federal statutory income tax rate for fiscal 2018 reflected a blended rate of approximately 24.5%. The Company has calculated the impact of the Act in its year end income tax provision in accordance with its understanding of the Act and guidance available as of the date of this filing. As a result, the Company has reduced net U.S. deferred tax assets by $25,660,000. As the Company does not have profitable foreign subsidiaries, it does not anticipate any impacts as a result of the mandatory deemed repatriation of cumulative foreign earnings.

On December 22, 2017, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of US GAAP in situations when an entity does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Act. Pursuant to SEC Staff Accounting Bulletin ("SAB") 118 (regarding the application of ASC740 associated with the enactment of the Tax Act), the Company believes the accounting under ASC 740 for the provisions of the Tax Act is complete.

The differences between the income tax provision at the federal statutory rate and that reflected in the accompanying consolidated statements of operations are summarized as follows:

For the years ended September 30,	**2018**	2017
Tax provision at statutory rate	**25%**	35%
State taxes, net of federal benefit	**12%**	(1)%
Impact of US Tax Reform	**(11)%**	-
Bargain purchase gain	**-**	(34)%
Valuation allowance	**(55)%**	-
UTP	**(1)%**	-
Other	**(2)%**	2%
	(32)%	2%

9. Long-Term Debt

Long-term debt consists of the following (in thousands):

	2018	2019
Senior secured credit facility (net of discount of $20,085 and $7,374, respectively)	**$ 1,094,315**	$ 609,813
Other debt *(1)*	**39,769**	38,321
Less: Deferred financing costs, net ("DFC")	**(16,214)**	(9,906)
Total Debt, net of discount, premium and DFC	**1,117,870**	638,228
Less: current maturities	**(18,429)**	(12,509)
Long-term debt, net of current maturities	**$ 1,099,441**	$ 625,719

(1) Other debt also includes financing obligations related to sales-leaseback transactions. The financing obligations related to sales-leaseback transactions were $24,614,000 and $26,027,000 for years ended September 30, 2018 and 2017, respectively.

Senior Secured Credit Facilities

On June 30, 2016, the Company entered into a six-year $625 million senior secured term loan B (the "Original Term Loan"), the proceeds of which were used to repay $425 million of PMH's existing 8.375% senior secured notes due during 2019; to repay $60 million of borrowings under the Company's existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions, including the acquisition of Crozer; and to finance transaction fees and expenses. The Original Term Loan bore interest at LIBOR (subject to a 1.0% floor) plus 6.0%. The Original Term Loan was issued with an original discount of 1.5%, or $9,375,000. Additionally, the Company refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("Original ABL Facility" and together with the Original Term Loan, the "New Senior Secured Credit Facilities"). Pursuant to various amendments from August 2016 through October 2017, the aggregate commitment amount under the Original ABL facility was increased in stages to $175 million. The maturity date for the Original ABL Facility was June 30, 2021, and the maturity date for the Term Loan was June 30, 2022.

On February 22, 2018, the Company refinanced and replaced both the Original Term Loan and the Original ABL Facility, and entered into an Amended and Restated Term Loan Credit Agreement (the "Amended TL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan Chase Bank, N.A. ("JPMorgan"), as administrative agent and collateral agent. The Amended TL Agreement replaced the Original Term Loan with a new Term B-1 Loan ("Term B-1 Loan"). The principal amount of the Term B-1 Loan is $1,120 million and such loan bears interest at LIBOR (subject to a 1.0% floor) plus 5.5%, which as of September 30, 2018 was 7.625%. The Term B-1 Loan was issued with an original discount of 2% and matures on February 22, 2024.

Additionally, on February 22, 2018, the Company entered into an Amended and Restated ABL Credit Agreement (the "Amended ABL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. The Amended ABL Agreement replaced the Original ABL Facility. Under the Amended ABL Agreement, the maximum revolving

commitment is $250.0 million with ability to expand the facility to $325.0 million, and the new ABL facility (the "New ABL Facility") bears interest at a variable base rate plus an applicable spread that is based on excess availability under the New ABL Facility, as further described in the Amended ABL Agreement, which was 3.875% as of September 30, 2018. The New ABL Facility matures on February 22, 2023. As of September 30, 2018, the available balance on the new ABL facility was $41.0 million.

The proceeds of the Term B-1 Loans and the New ABL Facility (the "New Senior Secured Credit Facilities") were used to refinance the Original Term Loan and the Original ABL Facility, to pay a dividend of $457.0 million to the Company's stockholders, to pay certain expenses associated with the refinancing, to prefund approximately $40 million of pension liabilities of the Company's subsidiaries, to make payments to certain option holders as a result of the Dividend Recapitalization, and to finance certain working capital and other operational needs of the Company and its subsidiaries.

Under applicable accounting literature, deferred financing costs of $11.7 million and outstanding debt discount of $6.7 million as of February 22, 2018 were expensed and presented within loss on debt extinguishment in the accompanying consolidated statements of operations, and new costs of approximately $18.0 million incurred in connection with the refinancing have been capitalized to offset the new long-term debt in the accompanying consolidated balance sheets, and are being amortized over the term of the related debt using the effective interest method.

The New Senior Secured Credit Facilities are guaranteed on a senior secured basis by all assets of the Company and its wholly-owned subsidiaries ("Guarantors") except PHP, CHIC, RRG, Prospect Health Access Network, Inc. and certain immaterial subsidiaries. The New ABL Facility is secured by a first priority security interest on the working capital assets of the Company and the Guarantors and a second priority security interest on their fixed assets. The Term B-1 Loan is secured by a first priority security interest on fixed assets and a second priority security interest on working capital assets. The New Senior Secured Credit Facilities are effectively senior to all of the Company's existing and future indebtedness. The New Term B-1 loan has no financial covenants. However, the consolidated total leverage ratio is required to be calculated and reported on a quarterly basis. If such ratio is above 3.5, then receipts under the QAF 5 program are required to be utilized to pay down principal on the New Term B-1 loan. The Company currently expects to receive QAF 5 payments of approximately $83 million in May 2019, and these are the only expected payments to be received in fiscal 2019 based on current information from the California Hospital Association. The Company has made an accounting election to present all receivables under QAF 5 as current, and to not reflect expected paydowns of debt related to the collection of QAF 5 monies in fiscal 2019 as current debt as the timing is an estimate. The Amended ABL Agreement does not have any financial maintenance covenants. The Amended ABL Agreement has a "springing" fixed charge ratio covenant that applies if excess availability is less than the greater of 10% of the maximum borrowing amount and $22 million. The fixed charge ratio covenant was not required to be tested for the fiscal quarter ended September 30, 2018. The Company was in compliance with all of its debt covenants at September 30, 2018 or obtained a waiver.

Demand Notes

The Company has a commitment from a bank for a $15 million equipment leasing facility to finance various equipment at the Company's hospital facilities. As of September 30, 2018 and 2017, draws under the facility are classified as capital lease arrangements. Draws represent demand notes until conversion to capital leases, and interest accrues on such draws at the bank prime rate plus 1.5% with a floor of 4.5% and payable monthly. As of September 30, 2018, approximately $15 million had been drawn under the line.

Scheduled payments under the Company's current and long-term debt as of September 30, 2018 are as follows (in thousands):

Years ending September 30,	
2019	$ 18,429
2020	16,869
2021	14,672
2022	13,097
2023	13,228
Thereafter	1,077,874
Total scheduled payments	1,154,169
Less: Senior Secured Notes discount, net	(20,085)
Less: Deferred financing costs, net	(16,214)
Less: Current maturities	(18,429)
Total long-term debt	$ 1,099,441

10. Stockholder's Equity

Equity Based Compensation Plans

Effective December 15, 2010, the Board of Directors of Ivy Holdings adopted the Ivy Plan that initially authorized the issuance of options exercisable for up to 155,110 shares of the common stock of Ivy Holdings ("Initial Options") to employees, certain consultants and independent members of the boards of directors, of Ivy Holdings and its subsidiaries (including the Company and its subsidiaries). These options are exercisable into Ivy Holdings stock and vest based on a number of criteria, including time, Company and Business Unit performance based on EBITDA targets and CEO and Compensation Committee discretion. Since the Ivy Holdings stock options were granted to Company employees for their services related to the Company, the related compensation cost has been recorded in the Company's consolidated financial statements. Effective June 30, 2015, the Board of Directors of Ivy Holdings adopted the First Amendment to the Ivy Plan. Under the First Amendment, and subsequent amendments, a further 63,704 shares of common stock of Ivy Holdings ("New Options") can be issued.

The New Options are exercisable into Ivy Holdings stock and vest based on a number of criteria, including the same criteria as the Initial Options. However, they only become exercisable on the occurrence of certain corporate transactions, including a change in control of Ivy Holdings, as defined in the Incentive Stock Option Agreements ("Corporate Transaction"). Because the occurrence and timing of a Corporate Transaction is not determinable as of September 30, 2018 and 2017 no compensation cost has been recorded in the Company's consolidated financial statements for the years then ended.

Under the terms of the Ivy Plan, the exercise price of an incentive stock option ("ISO") may not be less than 100% of the fair market value of the Company's common stock on the date of grant and, if granted to a shareholder owning more than 10% of the Company's common stock, then not less than 110%. Stock options granted under the Ivy Plan have a maximum term of 10 years from the grant date, and are exercisable at such time and upon such terms and conditions as determined by the Compensation Committee. Stock options granted to employees generally vest over four years, subject to continued service, performance, and other criteria. In the case of an ISO, the amount of the aggregate fair market

value of common stock with respect to which the ISO grant is exercisable, for the first time by an employee during any calendar year, may not exceed $100,000.

Stock Options Activity

The following table summarizes information about Ivy Holdings stock options outstanding as of September 30, 2018 and 2017 and activity during the years then ended for the Initial Options and the New Options:

	Shares Subject to Options	Weighted Average Exercise Price	Weighted Average Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term (Months)
Outstanding as of October 1, 2016	143,201	$ 92.94	$ 445.06	76.2
Granted	29,141	568.55	—	—
Exercised	(100)	30.00	—	—
Canceled/Forfeited	(3,367)	107.81	—	—
Outstanding as of September 30, 2017	168,875	174.91	663.09	73.4
Granted	26,516	418.21	—	—
Exercised	(22,608)	37.74	—	—
Canceled/Forfeited	(9,530)	322.72	—	—
Outstanding as of September 30, 2018 *(1)*	163,253	$ 140.47	$ 156.53	70.5

(1) The number of options outstanding at September 30, 2018 were modified in connection with the Adjusted Exercise Price of the options (see below).

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the estimated fair value of the Company's common stock for those awards that have an exercise price currently below the estimated fair value. As of September 30, 2018, the aggregate intrinsic value of outstanding shares was approximately $25,554,000. As of September 30, 2018, there were 104,496 options that are exercisable at a weighted average exercise price of $47.40.

A summary of Ivy Holdings non-vested options and the changes during the fiscal years ended September 30, 2018 and 2017 is presented as follows for the Initial Options and New Options:

	Shares	Weighted Average Grant Date Fair Value
Ivy Holdings Stock Options:		
Nonvested at October 1, 2016	26,424	$ 97.55
Granted	29,141	299.00
Vested	(17,834)	178.49
Canceled/Forfeited	(3,367)	107.81
Nonvested at September 30, 2017	34,364	225.09
Granted	26,516	188.98
Vested	(17,054)	269.50
Canceled/Forfeited	(9,530)	206.09
Nonvested at September 30, 2018	34,296	$ 181.07

Stock-Based Compensation Expense

Stock-based compensation expense for all share-based payments in exchange for employee services (including stock options and restricted stock) is measured at fair value on the date of grant, estimated using an option pricing model and is recognized in the consolidated financial statements, net of estimated forfeitures over the awards requisite service period.

The Company uses the Black-Scholes option pricing model and a single option award approach to estimate the fair value of options granted. Estimated forfeitures will be revised in future periods if actual forfeitures differ from the estimates and will impact compensation cost in the period in which the change in estimate occurs. The determination of fair value using the Black-Scholes option-pricing model is affected by the Company's estimated stock price as well as assumptions regarding a number of complex and subjective variables, including expected stock price volatility, risk-free interest rate, expected dividends and projected employee stock option exercise behaviors.

Fair value for options granted during the years ended September 30, 2018 and 2017 was estimated with the following assumptions for Ivy Holdings:

For the years ended September 30,	**2018**	2017
Weighted average fair value of option grants	**$ 188.98**	$ 299.00
Estimated fair market value of the Company's common stock on the date of grant	**$ 390.14**	$ 568.55
Weighted average expected life of the options	**5 years**	10 years
Risk-free interest rate	**0.85%**	1.79%
Weighted average expected volatility	**60.0%**	43.8%
Dividend yield	**0.00%**	0.00%

Expected Term - The expected term of options granted represents the period of time that they are estimated to be outstanding.

Risk-Free Interest Rate - The Company bases the risk-free interest rate on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with equivalent remaining terms.

Expected Volatility - The Company estimates the volatility of the common stock at the date of grant based on the average of the historical volatilities of a group of peer companies. The Company has identified a group of comparable companies to calculate historical volatility from publicly available data for sequential periods approximately equal to the expected terms of the option grants. In selecting comparable companies, Management considered several factors including industry, stage of development, size and market capitalization.

Forfeitures - Share-based compensation is recognized only for those awards that are ultimately expected to vest. Compensation expense is recorded net of estimated forfeitures. Those estimates are revised in subsequent periods if actual forfeitures differ from those estimates. The Company used data since December 2010 to estimate pre-vesting option forfeitures.

Stock-based compensation expense for the Ivy Holdings stock options recognized by the Company during the years ended September 30, 2018 and 2017 was $710,000 and $1,118,000, respectively. At September 30, 2018, there were no unvested options, which could potentially vest over the next nine fiscal years, subject to meeting the vesting requirements noted above. There were no remaining maximum estimated stock compensation expense to be amortized to expense in future periods. Options which are expected to vest based on CEO and Compensation Committee discretion are treated as variable stock options and are subject to revaluation at each reporting period. Management determined the fair value of the discretionary vested options using a Black Scholes calculation but determined that the change in compensation expense was not material to the consolidated financial statements for the years ended September 30, 2018 and 2017.

Dividends

The Company distributed approximately $457.0 million in connection with the issuance of “New Senior Secured Credit Facilities” during the year ended September 30, 2018, which was recorded against retained earnings, and was ultimately paid to the common stockholders of Ivy Holdings Inc (see Note 9).

On February 22, 2018, the Board of Directors of Ivy Holdings, Inc. (“the Board”) approved special cash in the amount of approximately $33 million in bonus payments were made (“the Bonuses”) to Option Holders in connection with the dividend provided that any Bonus with respect to an unvested portion of an option shall be payable upon the date such unvested portion becomes vested and exercisable, subject to the Optionee’s continued employment with Prospect through such date. At September 30, 2018 approximately $2.3 million was accrued for bonuses in connection with this. To reflect the Dividend and pursuant to the terms of the Option Plan, the Board further resolved to equitably adjust the Options by reducing the per-share exercise price of the Options to an amount determined with reference to the Bonus amount payable by Prospect Medical with respect to such Option (the “Adjusted Exercise Price”).

11. Retirement Benefits

The Company sponsors various employee non-contributory, defined benefit pension plans covering certain full-time employees of Crozer, ECHN and Waterbury.

In connection with the acquisition of Crozer, $100 million of the purchase price was put into an escrow and subsequently used by the Company, as the new sponsor of the Crozer pension plan pursuant to IRS rules and regulations, to fund in part the underfunded plan liability then outstanding. Additionally, within five years after acquisition and subject to applicable filing and authorization by the applicable government agency or entity, the Company will adopt a plan amendment to terminate the plan effective within such five year period and will liquidate, fully fund and satisfy, and pay all benefits owed to participants and beneficiaries of the plan by providing lump sum distributions to participants, purchasing annuities for participants who do not elect a lump sum distribution.

Also in connection with the Crozer acquisition, the plan was frozen with all benefit accruals ceased as of July 1, 2016. With respect to each Represented Employee who is a member of the Laborers' International Union of North America, the Monthly Compensation (as defined), the Credited Service (as defined), the Eligibility Service (as defined) and the accrued benefit was frozen and determined as of July 1, 2016. No benefits accrue since that date. Additionally, the plan was amended to provide that for purposes of determining Vesting Service (as defined) for employees who were employed with the Company before July 1, 2016, years of service shall include all periods of employment completed on and after July 1, 2016, subject to the Break in Service rules (as defined).

On September 3, 2016, the DB Plan was further amended to provide certain Qualifying Participants (as defined) the right to make a Special Benefit Election (as defined) during "2016 Lump Sum Option Window" period from October 15, 2016 through November 30, 2016 to receive or commence receiving his or her vested Accrued Benefit as of December 1, 2016 in accordance with procedures adopted by the Committee.

In conjunction with the acquisition the Company also became the sponsor and assumed CKHS postretirement benefit program (the "OPEB Plan") which is an unfunded medical care and life insurance benefit program, and a supplemental executive retirement plan (the "SERP Plan") which is an unfunded retirement plan that covers a group of current and former executives. These plans were frozen with all benefit accruals ceased as of July 1, 2016. No benefits will accrue since that date. With respect to each Represented Employee who is a member of the Laborers' International Union of North America, benefits will continue to accrue until a settlement of an ongoing union contract negotiation is reached.

ECHN has a defined benefit pension plan that covered substantially all of its employees. The benefits were based upon years of service and compensation for the five highest years during the employee's last 10 years of service. Effective December 31, 2013, ECHN froze the defined-benefit for all remaining participants. During September 2013, the Board passed a resolution to freeze all benefits related to the Defined benefit pension plan. On December 31, 2008, ECHN implemented a soft freeze on the defined benefit pension plan. All qualified employees were eligible to enter into the defined contribution plan, ECHN contributed 3% of eligible employees' salaries. This contribution was non-guaranteed for all employees, except certain union workers covered under a collective bargaining agreement.

ECHN also sponsors a postretirement benefit plan that provides health care benefits to those employees who retired. The criteria to receive this benefit is to be vested in the pension plan, attain age 55 or older and start collecting under the defined benefit plan described above once retired. The retiree must be enrolled into the medical plan on the date of retirement to be eligible for the continuation. Full-time registered nurse retirees from ECHN's Manchester facility (retired prior to October 1, 2005 and were

eligible per the collective bargaining agreement) were grandfathered and required to pay at least 50% of the total cost of the medical and dental coverage they elect for themselves under the plan.

Waterbury has a noncontributory defined benefit cash balance plan. It is Waterbury's policy to make contributions to the plan sufficient to meet the minimum funding requirements of applicable laws and regulations. The plan was frozen to non-union participants effective June 30, 2015. Participants who are part of the Connecticut Healthcare Associates Technical Unit remain active in the plan. Non-union employees no longer accrue additional employer contribution credits in the plan. These participants will continue to receive interest credits based on their account balances in accordance with the terms of the plan. They will be entitled to their account balance (the retirement benefit they have earned up to June 30, 2015) plus applicable interest credits after the Plan were frozen.

The activity of the pension plans for the years ended September 30, 2018 and 2017 is as follows (in thousands):

		2018		2017
Changes in benefit obligations				
Projected benefit obligations, beginning of period	**$**	**864,293**	$	953,983
Service cost		**194**		292
Interest cost		**27,695**		33,193
Plan participant contributions		**461**		367
Actuarial loss		**(48,654)**		(31,788)
Benefits paid		**(134,185)**		(91,045)
Lump sum benefits paid and annuity purchase		**(49,628)**		-
Plan changes		**-**		(709)
Projected benefit obligation, end of year	**$**	**660,176**	$	864,293
Changes in plan assets				
Fair value of plan assets, beginning of year	**$**	**556,590**	$	656,074
Actual return on plan assets		**(14,437)**		(15,980)
Contributions by plan sponsor		**41,667**		7,174
Plan participant contributions		**461**		367
Benefits paid		**(134,185)**		(91,045)
Lump sum benefits paid and annuity purchase		**(49,628)**		-
Fair value of plan assets, end of year	**$**	**400,468**	$	556,590
Funded status of the plan, end of year	**$**	**(259,708)**	$	(307,703)
Accumulated benefit obligation, end of year	**$**	**(259,708)**	$	(307,703)

The funded status of the pension plans as of September 30, 2018 and 2017 is as follows (in thousands), split between the pension plans and the post retirement plans:

	2018 Pensions	**2018 OPEBs**	2017 Pensions	2017 OPEBs
Amounts recognized in the consolidated balance sheets consist of:				
Current liability	**$ -**	**$ 600**	$ -	$ 820
Non-current liability	**254,121**	**4,987**	300,364	6,519
Amount recognized, end of year	**$ 254,121**	**$ 5,587**	$ 300,364	$ 7,339

The components of net periodic benefit cost for the years ended September 30, 2018 and 2017 are as follows (in thousands):

	2018	2017
Components of net periodic benefit cost:		
Service cost	**$ 194**	$ 292
Interest cost	**27,695**	33,193
Expected return on plan assets	**(16,045)**	(19,477)
Effect of settlement	**1,457**	(2,479)
Amortization of prior service credit	**(48)**	-
Total net periodic benefit cost	**$ 13,253**	$ 11,529
Other change in benefit obligations recognized in accumulated other comprehensive income:		
Gain due to assumption change	**$ (64,429)**	$ (23,922)
Liability (gain) loss due to participant experience	**14,118**	(7,865)
Asset return loss	**30,483**	35,456
Prior service cost credit	**-**	(708)
Amount recognized due to settlement	**-**	2,479
Total recognized in other comprehensive loss (income) and accumulated other comprehensive loss (income)	**$ (19,828)**	$ 5,440

The assumptions used in determining the actuarial present value of the projected benefit obligations for pension plans as of September 30, 2018 and 2017 and for the years ended September 30, 2018 and 2017 are as follows:

	2018	2017
Weighted average assumptions used to determine benefit obligations at end of period		
Discount rate	**3.23-4.48 %**	3.23-3.68 %
Rate of compensation increase	**0.00-2.00 %**	0.00-2.00 %
Weighted average assumptions used to determine net periodic benefit cost for the period ended		
Discount rate	**3.49-4.41 %**	3.18-4.01 %
Rate of compensation increase	**0.00-2.00 %**	0.00-2.00 %
Expected return on the plan assets	**0.00-4.50 %**	0.00-5.00 %

Assumed health care cost trend rates for the next period used to measure the expected cost of benefits covered by the plan are as follows:

	2018	2017
Health care trend rate assumed for next year	**7.0%**	7.0%
Rate to which the cost trend is assumed to decline (the ultimate rate)	**4.5%**	4.5%
Year that the rate reaches the ultimate trend rate	**2026**	2025

Assumed health care cost trend rates have a significant effect on amounts reported for other postretirement benefit programs. A one-percentage-point change in assumed health care cost trends would have the following effects (in thousands):

	1% Increase	**1% Decrease**
Effect on other postretirement benefit obligations	$ 5,701	$ 5,486
Effect on total of service and interest cost components	$ 239	$ 228

The asset allocation percentage by major asset class for the plans and the target allocation for 2018 follows:

	Target	**2018**
Asset class:		
Cash and cash equivalents	0% - 20%	
Fixed income	10% - 100%	**94 %**
Domestic equity	0% - 100%	
International equity	0% - 40%	
Real estate	0% - 30%	**1 %**
Alternative investments and hedge funds	0% - 30%	**5 %**
		100 %

The investment objectives of the plans are to invest consistently with the fiduciary standards of ERISA, to provide for the funding and anticipated withdrawals on an ongoing basis, conserve and enhance the capital value of the plans in real terms while maintaining a moderate risk profile, to minimize principal fluctuations over the investment cycle, and achieve a long-term level of return commensurate with contemporary economic conditions. The expected long-term rate of return with respect to the plans is based on an aggregate of expected capital market returns within each asset category.

The following tables set forth the assets in the plans measured at fair value, by input level (in thousands):

September 30, 2018	**Level 1**	**Level 2**	**Level 3**	**Net asset value**	**Total**
Fixed income securities:					
Short-Term Duration	**$ -**	**$ 35,100**	**$ -**	**$ -**	**$ 35,100**
Extended Duration	**-**	**125,562**	**-**	**-**	**125,562**
Interim Duration	**-**	**41,193**	**-**	**-**	**41,193**
Long-Term Duration	**-**	**174,162**	**-**	**-**	**174,162**
Real estate	**-**	**-**	**2,962**	**-**	**2,962**
Alternative investments	**-**	**-**	**18,593**	**-**	**18,593**
Cash and cash equivalents	**-**	**-**	**-**	**2,896**	**2,896**
Total	**$ -**	**$ 376,017**	**$ 21,555**	**$2,896**	**$ 400,468**

September 30, 2017	Level 1	Level 2	Level 3	Net asset value	Total
Fixed income securities:					
Short-Term Duration	$ -	$ 37,637	$ -	$ -	$ 37,637
Extended Duration	-	163,537	-	-	163,537
Interim Duration	-	53,703	-	-	53,703
Long-Term Duration	-	275,139	-	-	275,139
Real estate	-	-	6,288	-	6,288
Alternative investments	-	-	17,454	-	17,454
Cash and cash equivalents	-	-	-	2,832	2,832
Total	$ -	$ 530,016	$ 23,742	$ 2,832	$ 556,590

Pension plan assets classified as Level 3 in the fair value hierarchy represent investments in which the trustee has used significant unobservable inputs in the valuation model. The hedge funds consist of equity/long/short funds and multi-strategy funds in which fair values have been estimated using the net asset value per share of the investment. The alternative investments primarily consist of investments in limited partnerships that invest in the Public-Private Investment Program which fair values have been estimated using the net asset value per share of the investment.

On an annual basis, the Company assesses the valuation hierarchy for pension assets recorded at fair value. From time to time, assets will be transferred within the fair value hierarchy as a result of changes in, among other things, inputs used, liquidity, or valuation methodologies. During the years ended September 30, 2018 and 2017, there were no transfers in classification within the fair value hierarchy.

The following table is a rollforward of the plans' assets classified within Level 3 of the fair value hierarchy (in thousands):

September 30,	**2018**	2017
Balance, beginning of year	**$ 23,742**	$ 62,397
Actual return on plan assets:		
Realized loss	**-**	(445)
Unrealized (loss) gain	**(2,187)**	2,283
Purchases	**-**	5,434
Sales	**-**	(45,927)
Balance, end of year	**$ 21,555**	$ 23,742

The expected long-term future benefit payments to retirees with respect to the plans and are as follows (in thousands):

2019	$ 46,620
2020	44,230
2021	43,040
2022	43,270
2023	42,920
2024 - 2028	206,460
	$ 426,540

Waterbury participates in multi-employer pension plans that cover substantially all union employees. Contributions to the plans are based upon a percentage of each participant's total salary. The risks of participating in these multi-employer plans are different from single employer plans in the following aspects:

- Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of another participating employer.
- If a participating employer stops contributing to the plan, the unfunded obligation of the plan may be borne by the remaining participating employers.
- If Waterbury chose to stop participating in the multi-employer plans, Waterbury may be required to pay those plans an amount based on the underfunded status of the plans, referred to as a withdrawal liability.

The following table presents Waterbury's participation in these plans as of and for the years ended September 30, 2018 and 2017.

Pension Trust Fund	EIN / Pension Plan	Pension Protection Act ("PPA") Certified Zone Status (1) 2018	2017	FIP / RP Status Pending / Implemented (2)	Contributions 2018	2017	Surcharge Imposed	Exp. Date of CBA (3)
Connecticut Health Care Associates Pension Fund	06-1313462	**Red**	Green	Implemented	**$2,140,000**	$ 2,018,000	No	9/30/18
New England Health Care Employees Pension Fund	22-3071963	**Green**	Green	NA	**821,000**	939,000	No	2/28/17
Total contributions					**$2,961,000**	$ 2,957,000		

(1) The most recent PPA zone status available in 2018 is for the plan's year-ending during 2017. The zone status is based on information received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the orange zone are less than 80 percent funded and have an accumulated funding deficiency in the current year or projected in the next six years, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.

(2) The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan ("FIP") or a rehabilitation plan ("RP") is either pending or has been implemented. As it relates to the Connecticut Health Care Associates ("CHCA") Pension Plan, the trustees adopted the attached Rehabilitation Plan on May 7, 2018. The Rehabilitation Period, as defined, commences on January 1, 2019 and ends on December 31, 2028.

(3) These agreements are currently under negotiations.

During the years ended September 30, 2018 and 2017, Waterbury's contributions to the CHCA Pension Plan and the New England Health Care Employees Pension Plan represented 98.2% and 2.6% and 98.3% and 2.4% of the total contributions made to the plans by all participating employers, respectively.

Governmental regulations impose certain requirements relative to union-sponsored pension plans. In the event of plan termination or employer withdrawal, an employer may be liable for a portion of the plan's unfunded vested benefits. As of September 30, 2018, Waterbury has not recorded any liabilities for future withdrawal obligations related to the multi-employer plans.

Defined contribution plans

The Company previously sponsored five defined contribution plans covering substantially all employees who meet certain eligibility requirements. Effective May 1, 2018, the plans covering employees at ECHN, Waterbury and Crozer were merged into the plan covering employees at CharterCARE, and the two remaining plans were renamed and segregated between union and non-union employees. Under these plans, employees can contribute up to 50% of their compensation up to the IRS deferred annual maximum. There is currently no company match offered under the plans, except at certain facilities in Texas, Rhode

Island, Pennsylvania, for which the expense for the employer match was $19,723,000 and $18,088,000 for the years ended September 30, 2018 and 2017, respectively.

12. Commitments and Contingencies

Leases

The Company leases various office facilities and equipment from third parties under non-cancelable operating and capital lease arrangements expiring at various dates through 2030. Certain operating leases contain rent escalation clauses and renewal options, which have been factored into determining rent expense on a straight-line basis over the lease terms. Capital leases bear interest at rates ranging from 2.5% to 19.5% per annum.

The future minimum annual lease payments required under leases in effect at September 30, 2018, are as follows (in thousands):

For the Years ending September 30,	Capital Leases	Operating Leases
2019	$ 16,475	$ 27,031
2020	12,517	24,802
2021	7,384	21,604
2022	3,891	18,515
2023	3,670	16,361
Thereafter	23,733	57,518
Total minimum lease payments	67,670	$ 165,831
Less: amounts representing interest	(17,469)	
	50,201	
Less: current portion	(14,348)	
	$ 35,853	

Rent expense for the years ended September 30, 2018 and 2017 was approximately $47,190,000 and $49,965,000, respectively. Sublease rental income was not material to the consolidated financial statements for the years ended September 30, 2018 and 2017.

Litigation

The Company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, acquisitions, or other transactions. While the Company's management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on the Company's consolidated financial position or results of operations, the litigation and other claims that the Company faces are subject to inherent uncertainties and management's view of these matters may change in the future. Should an unfavorable final outcome occur, there exists the possibility of a material adverse impact on the Company's consolidated financial position, results of operations and cash flows for the period in which the effect becomes probable and reasonably estimable.

Seismic Standards

The Company's California Hospitals (with the exception of Bellflower, which currently only provides psychiatric services) are required to comply with laws that regulate the seismic performance of all aspects of hospital facilities in California and imposes near-term and long-term compliance deadlines for seismic safety assessment, submission of corrective plans, and retrofitting or replacement of medical facilities to comply with current seismic standards. These laws and regulations require hospitals to meet seismic performance standards to ensure that they are capable of providing medical services to the public after an earthquake.

The Company was required to conduct engineering studies at its hospitals to determine whether and to what extent modifications to the hospital facilities will be required. Two buildings at Southern California Hospital at Culver City ("SCH Culver City") and one building at Los Angeles Community Hospital ("LACH") do not currently meet the applicable seismic requirements. The three buildings are currently classified at Structural Performance Category 1 ("SPC-1") and, subject to possible deadline extensions discussed below, they must be upgraded to at least SPC-2 by January 1, 2020. That deadline date was set pursuant to an extension granted upon the Company's application submitted in accordance with California Senate Bill 90 (SB 90) and approved by the Office of Statewide Health Planning and Development ("OSHPD").

OSHPD has a voluntary program to re-evaluate the seismic risk of hospital buildings classified as SPC-1. These buildings are considered hazardous and at high risk of collapse in the event of an earthquake and they were required to be retrofitted, replaced or removed from providing acute care services by the applicable deadline. OSHPD is using Hazards U.S. ("HAZUS"), a state-of-the-art methodology, to reassess the seismic risk of SPC-1 buildings. Once the SPC-1 buildings have been seismically upgraded to SPC-2, they are no longer considered a significant risk to occupants, but they may not be repairable or functional after an earthquake. Participation in the HAZUS program is optional for hospital owners wishing to have their SPC-1 buildings evaluated.

Applications for HAZUS evaluation of seismic risk were submitted for all five of the Company's California acute care facilities: Southern California Hospital at Hollywood ("SCH Hollywood"); SCH Culver City; Los Angeles Community Hospital; Los Angeles Community Hospital at Norwalk ("LACH Norwalk"); and Foothill Regional Medical Center ("Foothill"). All buildings at these five facilities obtained SPC-2 reclassification using HAZUS, except for the aforementioned three buildings at SCH Culver City and LACH which are still classified as SPC-1. Currently, failure to obtain SPC-2 reclassification for the three remaining SPC-1 buildings by January 1, 2020 would mean that the buildings would not be allowed to provide acute care services starting on that date.

Recently enacted Assembly Bill 2190 (AB-2190) could potentially provide an additional extension of up to 30 months (July 1, 2022) to obtain SPC-2 reclassification. Such extension must be requested by April 1, 2019. If granted, any required construction must be begun by April 1, 2020 and final seismic compliance must be achieved by July 1, 2022.

The Company will also be required to make significant capital expenditures in the future to comply with 2030 seismic standards (i.e., upgrade to SPC-4D) for any buildings that will be utilized for hospital facilities beyond January 1, 2030. Such modifications to the hospital facilities could potentially result in environmental remediation liabilities which may be material to the Company.

These requirements can result in significant operational changes and capital outlays. Management is continuing to assess its options and the methods of financing the required retrofits. Based on management's evaluation, the costs of renovation needed to comply with the California seismic safety standards for its acute-care facilities, including asbestos abatement, are not estimable at this time.

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. 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.

The Health Insurance Portability and Accountability Act ("HIPAA") assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act ("HITECH Act") expanded upon HIPAA in a number of ways, including establishing notification requirements for certain breaches of protected health information. In addition to these federal rules, states have also developed their own standards for the privacy and security of health information as well as for reporting certain violations and breaches (for example, California's Confidentiality of Medical Information Act and Lanterman-Petris Short Act) which in some cases are more stringent. Other federal privacy laws may also apply to certain services provided by the Company, including 42 C.F.R. Part 2, which addresses the confidentiality of substance use disorder records. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

Affordable Care Act

The Patient Protection and Affordable Care Act ("PPACA") has made significant changes to the United States health care system. The legislation impacted multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Under this legislation, 33 states have expanded their Medicaid programs to cover previously uninsured childless adults, and four additional states voted in 2018 to expand Medicaid or to elect a governor that pledged to expand Medicaid. In addition, many uninsured individuals have had the opportunity to purchase health insurance via state-based marketplaces, state-based marketplaces using a federal platform, state-partnership marketplaces or the federally-facilitated marketplace. PPACA also implemented a number of health insurance market reforms, such as allowing children to remain on their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced the number of uninsured individuals.

It is unclear what changes may be made to PPACA with the divided Congress, current presidential administration, and pending litigation over the validity of PPACA. The Administration has promulgated rules to broaden the availability of coverage options that do not comply with the full range of PPACA requirements for individual market coverage, namely Association Health Plans and Short-Term Limited-Duration Insurance. The Administration has also provided additional guidance on state PPACA waivers. These executive actions have been or may be challenged in court. In addition, the Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate penalty under PPACA, effective January 1, 2019. The individual mandate penalty was included in PPACA to address concerns that other market reforms expanding access to coverage might produce adverse selection and higher premiums. The extent to which the repeal of the individual mandate penalty will impact the uninsured rate and 2019 premiums is unclear at this juncture. On December 14, 2018, the United States District Court for the Northern District of Texas ruled that the individual mandate without the penalty is unconstitutional and that PPACA is therefore invalid in its entirety. Litigation on this issue is ongoing, with the Administration indicating it will continue implementing PPACA pending any appeals, the court ordering expedited briefing on a potential stay and certification of an interlocutory appeal, and pending litigation in the United States District Court for the District of Maryland to ensure continued implementation of PPACA. This litigation along with any future legislative changes to PPACA or other federal and state legislation could have a material impact on the operations of the Company. The Company is continuing to monitor the legislative environment and developments in pending litigation for risks and uncertainties.

Collective Bargaining Agreements

As of September 30, 2018, the Company had approximately 18,300 employees, of whom approximately 5,500 employees or 30% are represented by various labor organizations. Of those, approximately 1,800 employees or 10% of the Company's employees are employed under union contracts that have expired or will expire before September 30, 2019.

Tangible Net Equity ("TNE") Requirement

The Company's affiliated California physician organizations and licensed healthcare service plans may be subject to one or more of the following requirements: minimum working capital, Tangible Net Equity ("TNE"), cash-to-claims ratio and claims payment requirements as prescribed by the California Department of Managed Health Care ("DMHC"). TNE is defined as net assets, less intangibles and amounts due from affiliates, plus subordinated obligations. As of September 30, 2018, the Company's affiliated California physician organizations were in compliance with these regulatory requirements. In January 2019, the Company received inquiries from DMHC related to the calculation of certain receivables for PHP and PMG. The Company is currently responding to the inquiries; however, the conclusion and potential effect on compliance with the requirements are unknown at this time.

Employee Health Plans

The Company offers self-insured EPO/HMO and PPO plans to all eligible employees.

Employee health benefits are administered by a third party claims administrator, based on plan coverage and eligibility guidelines determined by the Company, as well as by collective bargaining agreements (as reflected above). Prior to January 1, 2018, commercial insurance policies covered per occurrence losses in excess of $750,000 for Crozer, $160,000 for East Orange, $275,000 for CharterCARE, $225,000 for ECHN, $350,000 for Waterbury, $250,000 for all other hospitals and $175,000 for the Medical Group and Corporate segments. Effective January 1, 2018, all locations were covered by insurance policies with CHIC

for per occurrence losses in excess of $350,000, except for Crozer for which the limit is $750,000. CHIC maintains reinsurance coverage above $500,000 for all locations except for Crozer, for which the limit is $750,000. An actuarially and internally-estimated liability of approximately $16,566,000 and $10,985,000 for incurred but not reported claims has been included in accrued salaries, wages, and benefits as of September 30, 2018 and 2017, respectively.

Provider Contracts

Many of the Company's payer and provider contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of medical services. Such differing interpretations may not come to light until a substantial period of time has passed following contract implementation. Liabilities for claims disputes are recorded when the loss is probable and can be estimated. Any adjustments to reserves are reflected in current operations.

13. Accrued Medical Claims and Other Healthcare Costs Payable

The following table presents the roll-forward of incurred but not reported ("IBNR") claims reserves (Medical Group segment, Global Risk Management segment, and full risk contracts) as of and for each of the fiscal years ended September 30, 2018 and 2017 (in thousands):

September 30,	**2018**	2017
IBNR as of beginning of year	**$ 54,283**	$ 52,761
Claim expenses incurred during the year:		
Related to current year	**301,598**	235,207
Related to prior year	**7,969**	2,841
Total incurred	**309,567**	238,048
Claims paid during the year:		
Related to current year	**(246,369)**	(195,678)
Related to prior year	**(54,548)**	(40,848)
Total paid	**(300,917)**	(236,526)
IBNR as of end of year	**$ 62,933**	$ 54,283

Following is a table showing the details of the Medical Group and Global Risk Management segments cost of revenues per the consolidated statements of operations (in thousands):

Years Ended September 30,	**2018**	2017
Capitation expense	**$ 96,027**	$ 94,141
Fee-for-service claims expense	**171,443**	137,860
Other physician compensation	**15,097**	45,173
Other cost of revenues	**5,239**	7,861
Total cost of revenues	**$ 287,806**	$ 285,035

14. Joint Ventures and Unconsolidated Equity Investments

The Company has invested in several joint ventures with unrelated third parties, which are accounted for under the equity method of accounting. As of September 30, 2018 and 2017, CharterCARE owned: 20% of Roger Williams Radiation Therapy and 20% of Southern New England Regional Cancer Center, LLC. ECHN owned: 50% of NRRON, LLC; 50% of Aetna Ambulance Service, Inc.; 50% of Ambulance Service of Manchester, LLC; and 50% of Evergreen Endoscopy Center, LLC. Waterbury owned: 50% of Harold Leever Regional Cancer Center Inc. Crozer owned: 50% of University Technology Park, Inc.; 35% of DCMH MOB Associates; and 21.25% of Delaware Valley Sleep Management Company, LLC. Prospect Medical Group, Inc. owned: 50% of AMVI/Prospect Medical Group. These joint ventures under the equity method are included in the other assets in the accompanying consolidated balance sheets as of September 30, 2018 and 2017 are $24,627,000 and $17,371,000, respectively. For the years ended September 30, 2018 and 2017, the Company received $1,746,000 and $1,636,000, respectively, in distributions for equity method investments, and $404,000 and $453,000, respectively, for cost method investments.

Summarized combined unaudited financial information for the Company's joint ventures as of September 30, 2018 and 2017 for the years then ended is as follows (in thousands):

September 30,	**2018**	2017
Cash	**$ 17,226**	$ 16,440
Receivables	**8,060**	7,590
Other current assets	**23,654**	23,852
Total current assets	**48,940**	47,882
Property, improvements and equipment, net	**33,757**	34,843
Goodwill	**7,142**	7,142
Intangible assets	**852**	882
Other long-term assets	**3,094**	2,921
Total assets	**$ 93,785**	$ 93,670
Accounts payable and accrued liabilities	**5,563**	$ 7,180
Other long-term liabilities	**5,334**	4,275
Equity	**82,888**	82,215
Total liabilities and partner's capital	**$ 93,785**	$ 93,670

Years ended September 30,	**2018**	2017
Revenues	**$ 67,554**	$ 65,197
Net income	**$ 5,039**	$ 6,106
PMH's income from equity method investments	**$ 1,332**	$ 2,015

15. Subsequent Events (Unaudited)

The Company has evaluated subsequent events through January 25, 2019, the date the Company's consolidated financial statements were available for issuance.

On January 25, 2019, Ivy Holdings made an equity contribution in the amount of $40 million to Ivy Intermediate Holding Inc., which was then contributed as equity to the Company.

Prospect CharterCARE, LLC

Consolidated Financial Statements

As of and for the Years Ended
September 30, 2018 and 2017

Prospect CharterCARE, LLC

Consolidated Financial Statements

As of and for the Years Ended September 30, 2018 and 2017

Prospect CharterCARE, LLC

Contents

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Independent Auditor's Report

Board of Directors
Prospect CharterCARE, LLC
Los Angeles, California

We have audited the accompanying consolidated financial statements of Prospect CharterCARE, LLC, which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Prospect CharterCARE, LLC and its subsidiaries as of September 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the Company is financially dependent on its parent company which has agreed to provide the financial support necessary for the operations of the Company. The accompanying financial statements do not reflect any adjustments or disclosures that would be required should the parent company discontinue its financial support.

BDO USA, LLP

July 18, 2019

Prospect CharterCARE, LLC

Consolidated Balance Sheets
(in thousands)

September 30,	**2018**	2017
Assets		
Current assets		
Cash and cash equivalents	**$ -**	$ -
Restricted cash	**433**	3,028
Patient accounts receivable, less allowance for doubtful accounts of $11,141 and $7,245	**46,076**	42,427
Other receivables	**3,306**	12,295
Due from government payers	**5,533**	5,143
Inventories	**5,590**	5,805
Prepaid expenses and other current assets	**2,188**	3,286
Total current assets	**63,126**	71,984
Property, improvements and equipment, net	**59,780**	53,850
Goodwill	**-**	5,822
Intangible assets, net	**1,211**	2,854
Equity method investments	**4,088**	4,357
Other assets	**2,302**	1,473
Total assets	**$ 130,507**	$ 140,340

See accompanying notes to consolidated financial statements.

Prospect CharterCARE, LLC

Consolidated Balance Sheets
(in thousands)

September 30,	**2018**	2017
Liabilities and Members' Equity		
Current liabilities		
Accounts payable and other accrued liabilities	**$ 35,590**	$ 26,881
Accrued salaries, wages and benefits	**17,696**	16,589
Deferred revenue	**170**	170
Due to government payers	**4,796**	4,505
Due to affiliated companies, net	**26,377**	20,056
Current portion of capital leases	**798**	1,475
Total current liabilities	**85,427**	69,676
Capital leases, net of current portion	**92**	895
Asset retirement obligations	**2,623**	2,438
Deferred revenue, net of current portion	**2,270**	2,891
Other long-term liabilities	**12,674**	10,673
Total liabilities	**103,086**	86,573
Commitments, contingencies, and subsequent events		
Members' equity		
Member contributions	**92,108**	82,261
Accumulated deficit	**(64,687)**	(28,494)
Total members' equity	**27,421**	53,767
Total liabilities and members' equity	**$ 130,507**	$ 140,340

See accompanying notes to consolidated financial statements.

Prospect CharterCARE, LLC

Consolidated Statements of Operations
(in thousands)

For the Years Ended September 30,	**2018**	2017
Revenues		
Net patient service revenues	**$ 354,578**	$ 343,050
Provision for bad debts	**(12,598)**	(11,936)
Net patient service revenues less provision for bad debts	**341,980**	331,114
Other revenues	**8,102**	7,678
Total net revenues	**350,082**	338,792
Operating Expenses		
Salaries, wages and benefits	**196,794**	186,382
Supplies	**62,507**	60,005
Taxes and licenses	**22,309**	25,581
Purchased services	**24,125**	21,542
Depreciation and amortization	**15,096**	13,843
Professional fees	**10,988**	10,535
Other	**11,287**	7,277
Insurance	**4,620**	5,659
Management fees	**7,298**	7,033
Utilities	**4,771**	3,993
Lease and rental	**5,438**	4,792
Research grant expense	**2,503**	2,231
Repairs and maintenance	**2,675**	2,315
Registry	**887**	713
Total operating expenses	**371,298**	351,901
Operating income from unconsolidated equity method investments	**589**	605
Operating loss	**(20,627)**	(12,504)
Other expense (income):		
Interest expense	**955**	1,131
Goodwill impairment	**14,228**	-
Other expense (income), net	**282**	(98)
Net loss from continuing operations	**(36,092)**	(13,537)
(Loss) Income from discontinued operations	**(101)**	9,411
Net loss	**$ (36,193)**	$ (4,126)

See accompanying notes to consolidated financial statements.

Prospect CharterCARE, LLC

Consolidated Statements of Members' Equity
(in thousands)

	Member Contributions	Accumulated Deficit	Total Members' Equity
Balance at October 1, 2016	$ 71,645	$ (24,368)	$ 47,277
Member contributions	10,616	-	10,616
Net loss	-	(4,126)	(4,126)
Balance at September 30, 2017	82,261	(28,494)	53,767
Member contributions	9,847	-	9,847
Net loss	-	(36,193)	(36,193)
Balance at September 30, 2018	$ 92,108	$ (64,687)	$ 27,421

See accompanying notes to consolidated financial statements.

Prospect CharterCARE, LLC

Consolidated Statements of Cash Flows
(in thousands)

For the Years Ended September 30,	**2018**	2017
Operating activities		
Net loss	**$ (36,193)**	$ (4,126)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	**15,094**	13,843
Provision for bad debts	**12,598**	11,936
Accretion of interest for asset retirement obligations	**185**	158
Operating income from equity method investments, net of distributions	**(11)**	254
Gain on sale of property, improvements and equipment	**-**	(2,891)
Goodwill impairment	**14,228**	-
Write-off of investment	**280**	-
Write-off of asset retirement obligation	**-**	(272)
Changes in operating assets and liabilities, net of business combinations:		
Change in restricted cash	**2,595**	(830)
Patient accounts receivable and other receivables	**(16,247)**	(15,852)
Due to/from government payers, net	**(99)**	22
Inventories	**215**	765
Prepaid expenses and other current assets	**2,704**	(3,324)
Other assets	**(829)**	(268)
Accounts payable and other accrued liabilities	**10,381**	8,401
Net cash and cash equivalents used in operating activities from discontinued operations	**-**	(10,967)
Net cash provided by (used in) operating activities	**4,901**	(3,151)
Investing activities		
Purchases of property, improvements and equipment	**(8,973)**	(7,043)
Cash paid for acquisitions	**(736)**	(2,268)
Proceeds from sale of property, improvements and equipment	**-**	6,498
Net cash and cash equivalents provided by investing activities from discontinued operations	**-**	5,882
Net cash (used in) provided by investing activities	**(9,709)**	3,069
Financing activities		
Member contributions	**-**	4,153
Increase (decrease) in due to affiliated companies, net	**6,288**	(7,950)
Repayments of capital leases	**(1,480)**	(2,036)
Proceeds from financing hospital facility	**-**	1,824
Net cash provided by (used in) financing activities	**4,808**	(4,009)
Decrease in cash and cash equivalents	**-**	(4,091)
Cash and cash equivalents, beginning of year	**-**	4,091
Cash and cash equivalents, end of year	**$ -**	$ -
Supplemental disclosure of cash flow information		
Interest paid	**$ 955**	$ 975
Schedule of non-cash investing and financing activities		
Equipment acquired under capital leases	**$ -**	$ 366
Non-cash acquisitions	**$ 7,692**	$ -
Non-cash contributions (Note 7)	**$ 9,847**	$ 6,463

See accompanying notes to consolidated financial statements.

1. Organization

Prospect CharterCARE, LLC ("PCC" or the "Company") was formed on August 21, 2013 and is owned 85% by Prospect East Holdings, Inc. ("Prospect East"), a wholly-owned subsidiary of Prospect Medical Holdings, Inc. ("Prospect") and 15% by CharterCARE Community Board.

PCC's operating subsidiaries include Prospect CharterCARE RWMC, LLC ("RWMC", dba Roger Williams Medical Center), Prospect CharterCARE SJHSRI, LLC ("SJHSRI", dba St. Joseph Health Center and Our Lady of Fatima Hospital), Prospect CharterCARE Elmhurst, LLC ("Elmhurst Extended Care", sold in fiscal 2017, see Note 5), Prospect CharterCARE Physicians, LLC ("CharterCARE Physicians"), Prospect CharterCARE Ancillary Services, Inc., and New University Medical Group, LLC ("New UMG"), which collectively consist of hospitals, medical centers. The Company provides a comprehensive range of services at Roger Williams Medical Center, St. Joseph's Health Center, and Our Lady of Fatima Hospital. During the year ended September 30, 2018, two new entities were created, Prospect RI Home Health and Hospice, LLC ("PRIHHH"), which is owned by RWMC, and Prospect CharterCARE Home Health and Hospice, LLC ("PCCHHH"), which is owned by PRIHHH and, effective May 1, 2018, the operations of the home health business were transferred from RWMC to PCCHHH.

Admitting physicians are primarily practitioners in the local area. The hospitals have payment arrangements with Medicare, Medicaid and other third-party payers, including commercial insurance carriers, health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs").

At September 30, 2018, the Company had negative working capital in the amount $22,301,000. The Company is dependent on Prospect to fund ongoing operations. As of September 30, 2018, the Company had a liability of $26,377,000 due to Prospect and its subsidiaries, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying consolidated balance sheets. Prospect does not intend to have the Company repay the liability in a manner which would impair the Company's ability to maintain sufficient liquidity to sustain ongoing operations. Subsequent to year end, Prospect converted approximately $24,700,000 of liabilities into a capital contribution (see Note 12).

2. Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of all wholly-owned subsidiaries, but do not include the accounts of the parent companies, Prospect or CharterCARE Community Board.

Operating results for the Company's subsidiaries are consolidated with the Company's financial statements from their acquisition dates. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenues

Net Patient Service Revenues

Operating revenue consists primarily of net patient service revenues. The Company reports net patient service revenues at the estimated net realizable amounts from patients and third-party payers and others in the period in which services are rendered. The Company has agreements with third-party payers, including Medicare, Medicaid, managed care and other insurance programs that are paid at negotiated rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments, as further described below. Estimates of contractual allowances are based upon the payment terms specified in the related contractual agreements. The Company accrues for amounts that it believes may ultimately be due to or from the third-party payers. Normal estimation differences between final settlements and amounts accrued in previous years are reported as changes in estimates in the current year. Outstanding receivables, net of allowances for contractual discounts and bad debts, are included in patient accounts receivable in the accompanying consolidated balance sheets.

The following is a summary of sources of patient service revenues (net of contractual allowances and discounts) before provision for doubtful accounts and exclude revenues for discontinued operations (in thousands):

For the Years Ended September 30,	**2018**	2017
Medicare	**$ 165,882**	$ 152,240
Medicaid	**74,710**	72,948
Managed Care	**80,605**	74,920
Self-Pay/Other	**33,381**	42,942
Total	**$ 354,578**	$ 343,050

A summary of the payment arrangements with major third-party payers follows:

Medicare: Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some persons with end-stage renal disease and certain other beneficiary categories, including eligible disabled persons. Most inpatient hospital services rendered to Medicare program beneficiaries are paid on a fee-for-service basis at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Most outpatient services also are paid on a fee-for-service basis generally using prospectively determined rates. The Company receives, as appropriate, Medicare disproportionate share hospital ("DSH") and bad debt payments at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare Administrative Contractor. The Company also receives, as appropriate, Medicare uncompensated care DSH payments, which are generally not subject to cost report audit except to determine eligibility for Medicare DSH. The Company also receives Medicare outlier payments on an ongoing basis during the year for cases that are unusually costly, and under certain circumstances these payments may be reconciled to more closely reflect the costs in excess of outlier thresholds after the submission and audit of the annual Medicare cost report. Normal estimation differences between filed settlements and amounts accrued are reflected in net patient service revenue.

The Company is reimbursed by Medicare for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare Administrative Contractor. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year that examination is substantially completed.

Although services for most Medicare beneficiaries are paid by the Federal government on a fee-for-service basis, approximately one-third of Medicare beneficiaries are enrolled in a "Medicare Advantage" plan, which is a type of health plan that contracts with the Medicare program to provide hospital and medical benefits to Medicare beneficiaries. Medicare Advantage Plans include Health Maintenance Organizations, Preferred Provider Organizations, Private Fee-For-Service Plans, Special Needs Plans, and Medicare Medical Savings Account Plans. For Medicare beneficiaries enrolled in a Medicare Advantage plan, most Medicare services are covered by the plan and are not paid for under fee-for-service Medicare. Certain Medicare Advantage plans make capitation payments to the Company using a "Risk Adjustment model," which compensates providers based on the health status (acuity) of each enrollee. Providers with higher acuity enrollees generally will receive more and those with healthier enrollees will receive less.

Medicaid: Medicaid is a joint federal-state funded healthcare benefit program that is administered by states to provide benefits to qualifying individuals who are unable to afford care. The Company receives reimbursements under the Medicaid program at prospectively determined rates for both inpatient and outpatient services. Similar to Medicare, cost report settlements are recorded based upon as-filed cost reports and adjusted for tentative and final settlements, if any.

RWMC and SJHSRI are participants in the State of Rhode Island's Disproportionate Share Hospital ("DSH") program, which assists hospitals that provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including RWMC and SJHSRI, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low-income patients. RWMC and SJHSRI recognized revenue related to DSH and Upper Payment Limit ("UPL") reimbursement of $19,035,000 and $24,402,000 for the years ended September 30, 2018 and 2017, respectively. DSH and UPL payments received were $17,704,000 and $20,249,000 for the years ended September 30, 2018 and 2017, respectively. RWMC and SJHSRI recorded license fee expenses of $16,815,000 and $20,137,000 for the years ended September 30, 2018 and 2017, respectively, which is included within taxes and licenses expense within the accompanying consolidated statements of operations.

Managed Care: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment under these agreements is in accordance with negotiated contracted rates or at the Company's standard charges for services provided.

Self-Pay: Self-pay patients represent those patients who do not have health insurance and are not covered by some other form of third-party arrangement. Such patients are evaluated, at the time of services or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, as well as the Company's local hospital's indigent and charity care policy.

Laws and regulations governing the third-party payor arrangements are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Normal estimation differences between subsequent cash collections on patient accounts receivable and net patient accounts receivable estimated in the prior year are reported as adjustments to net patient service revenue in the current period.

The Company is not aware of any material claims, disputes, or unsettled matters with any payers that would affect revenues that have not been adequately provided for and disclosed in the accompanying consolidated financial statements.

Charity Care

The Company provides charity care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Company's charity care policy. This care is provided without charge or at amounts less than the Company's established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The direct and indirect costs related to this care totaled approximately $772,000 and $833,000 for the years ended September 30, 2018 and 2017, respectively. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition, the Company provides services to other medically indigent patients under various state Medicaid programs. Such programs pay amounts that are less than the cost of the services provided to the recipients. The Company has not changed its charity care or uninsured discount policies during the years ended September 30, 2018 or 2017.

Provisions for Contractual Allowances and Doubtful Accounts

Collection of receivables from third-party payers and patients is the Company's primary source of cash and is critical to its operating performance. The Company closely monitors its historical collection rates, as well as changes in applicable laws, rules and regulations and contract terms, to assure that provisions for contractual allowances are made using the most accurate information available. However, due to the complexities involved in these estimations, actual payments from payers may be materially different from the amounts management estimates and records. The Company's primary collection risks relate to uninsured patients and the portion of the bill which is the patient's responsibility, primarily co-payments and deductibles. Payments for services may also be denied due to issues over patient eligibility for medical coverage, the Company's ability to demonstrate medical necessity for services rendered and payer authorization of hospitalization.

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Accounts receivable are reduced by an allowance for doubtful accounts. Valuation of the collectability of accounts receivable and provision for bad debts is based on historical collection experience, payer mix and the age of the receivables. Management routinely reviews accounts receivable balances in conjunction with these factors and other economic conditions which might ultimately affect the collectability of the patient accounts, and makes adjustments to the Company's allowances as warranted. For receivables associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and subsequently calculates an allowance for doubtful accounts and provision for bad debts once the age of the accounts reaches a specific age category based on historical experience. For receivables associated with self-pay patients, management records a significant provision for bad debts beginning in the period services were provided based on past experience that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The allowance for doubtful accounts was 20% and 15% of gross accounts receivable as of September 30, 2018 and 2017, respectively.

Legislation

All of the Company's hospital facilities are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient's ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. The Company believes that it is in compliance with EMTALA and is not aware of any pending or threatened EMTALA investigations involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements.

Other Revenues

Other revenues totaled $8,102,000 and $7,678,000 for the years ended September 30, 2018 and 2017, respectively. A summary of the principal components of other revenues is as follows:

Tuition Revenue: Tuition revenues include student fees and outside course reimbursement and are recognized ratably during the approximately seven months of instruction provided per year. The Company recorded tuition revenues of $2,155,000 and $2,002,000 for the years ended September 30, 2018 and 2017, respectively.

Grant Revenue: The Company receives grant revenue for direct research from the federal government, other institutions and other sources for a range of research areas including oncology, cardiology, HIV and diabetes. The Company recorded grant revenue of $1,925,000 and $1,841,000 for the years ended September 30, 2018 and 2017, respectively.

Rental Revenue: Rental revenue from operating leases is recorded based on the fixed, minimum required rents (base rents) per the lease agreements. Rental revenue from base rents is recorded on the straight-line method over the terms of the related lease agreements. The Company recorded rental revenues of $494,000 and $704,000 for the years ended September 30, 2018 and 2017, respectively.

Property, Improvements and Equipment

Property, improvements and equipment are stated on the basis of cost or, in the case of acquisitions, at their acquisition date fair values. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, and amortization of leasehold improvements is provided using the straight-line basis over the shorter of the remaining lease period or the estimated useful lives of the leasehold improvements. Building improvements are generally depreciated over seven years, buildings are depreciated over 10 years, equipment is depreciated over three to seven years and furniture and fixtures are depreciated over five to seven years. Equipment capitalized under capital lease obligations are amortized over the lesser of the life of the lease or the useful life of the asset.

Goodwill

Goodwill represents the excess of the consideration paid and liabilities assumed over the fair value of the net assets acquired, including identifiable intangible assets.

Goodwill is not amortized; rather it is reviewed annually for impairment for each reporting unit, or more frequently if impairment indicators arise. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value.

Through the year ended September 30, 2017, the Company tested for goodwill impairment as of September 30 each year. During the year ended September 30, 2018, the Company changed the date of the annual goodwill impairment test to July 1. The Company does not believe that the change in assessment date represents a material change in the application of applicable accounting literature. Impairment of goodwill is tested at the reporting unit level, by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of the reporting units are estimated. In evaluating whether indicators of impairment exist, the Company considers adverse changes in market value, laws and regulations, profitability, cash flows, ability to maintain enrollment and renew payer contracts at favorable terms, among other factors. The Company has adopted new literature during the year ended September 30, 2018 which changes the goodwill impairment test from a two-step process to a one-step process, which consists of estimating based on a weighted combination of (i) the guideline company method that utilizes revenue or earnings multiples for comparable publicly-traded companies, and (ii) a discounted cash flow model. If the estimated fair value of the reporting unit is less than its carrying value, this indicates that goodwill is impaired, and impairment is recorded based on the deficiency of fair value compared to the carrying value. The Company's impairment test related to goodwill during the year ended September 30, 2018 resulted in a full impairment of goodwill. There were no impairment charges during the year ended September 30, 2017.

Intangible Assets

Intangible assets include trade names. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if estimated undiscounted cash flows associated with those assets are less than their carrying amounts. Fair value is based upon the present value of the associated cash flows. Changes in circumstances (for example, changes in laws or regulations, technological advances or changes in strategies) may also reduce the useful lives from initial estimates. Changes in planned use of intangibles may result from changes in customer base, contractual agreements, or regulatory requirements. In such circumstances, management will revise the useful life of the long-lived asset and amortize the remaining net book value over the adjusted remaining useful life. There were no impairments recorded during the years ended September 30, 2018 and 2017.

Insurance Reserves

Medical Malpractice Liability Insurance

The Company carries professional and general liability insurance to cover medical malpractice claims under claims-made policies. Under the policies, insurance premiums cover only those claims actually reported during the policy term. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims related to occurrences during the policy term but reported subsequent to the policy's termination may be uninsured. The Company was included in Prospect's consolidated medical malpractice insurance policy effective June 20, 2014 (inception). Assets and liabilities related to malpractice insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

GAAP requires that a health care organization record and disclose the estimated costs of medical malpractice claims in the period of the incident of malpractice, if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. The Company recognizes an estimated liability for incurred but not reported claims and the self-insured risks (including deductibles and potential claims in excess of policy limits) based upon an actuarial valuation of the Company's historical claims experience of the Company's hospitals. The Company's gross claims liability was $9,943,000 and $7,591,000 as of September 30, 2018 and 2017, respectively, and insurance receivables were $2,220,000 and $1,316,000 as of September 30, 2018 and 2017, respectively. The gross claims liability and insurance receivables were estimated using a discount factor of 4% and are included within long-term assets and long-term liabilities, respectively, in the accompanying consolidated balance sheets.

Workers' Compensation Insurance

The Company was fully insured for workers' compensation claims with no deductible during the years ended September 30, 2018 and 2017.

Reserve Methodology

The claims reserve is based on the best data available to the Company. The estimate, however, is subject to a significant degree of inherent variability. The estimate is continually monitored and reviewed, and as the reserve is adjusted, the difference is reflected in current operations. While the ultimate amount of medical malpractice liability is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims. Management is not aware of any potential medical malpractice claims whose settlement, if any, would have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Asset Retirement Obligations

The Company recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. Over time, the liability is accreted to its present value each period. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the statements of operations. The Company has accrued $2,623,000 and $2,438,000 related to asbestos remediation as of September 30, 2018 and 2017, respectively. The liability was estimated using a discount factor which ranged from 7% - 9%.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with initial maturities of 90 days or less to be cash equivalents. Cash and cash equivalents are primarily comprised of deposits with banks. The Company maintains its cash at banks with high credit-quality ratings.

Restricted Cash

The Company held restricted cash of $433,000 and $3,028,000 as of September 30, 2018 and 2017, respectively, which was restricted for research at the Company's hospitals as well as for School of Nursing grants.

Inventories

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

Income Taxes

For tax reporting purposes, the Company is treated as a Partnership. PCC and its wholly-owned subsidiaries are pass-through entities. Therefore, no provision is made in the accompanying consolidated financial statements for liabilities for federal, state or local income taxes since such liabilities are the responsibility of the Company's parent companies. The Company periodically evaluates its tax positions, including its status as a pass-through entity, to evaluate whether it is more likely than not that such positions would be sustained upon examination by a tax authority for all open tax years, as defined by the statute of limitations, based on its technical merits.

As of September 30, 2018 and 2017, the Company has not established a liability for uncertain tax positions. The Company files income tax returns in the U.S. federal jurisdiction and the state of Rhode Island. Generally, the Company is subject to examination by U.S. federal (or state and local) income tax authorities for three to four years from the filing of a tax return.

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and cash equivalents, restricted cash, patient and other accounts receivables, accounts payable and accrued expenses, accrued salaries and benefits, amounts due from/to government payers, capital lease obligations, and other liabilities. The carrying amounts of current assets and liabilities approximate their fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

Nonfinancial assets such as goodwill and identifiable intangible assets are measured at fair value when there is an indicator of impairment and recorded at fair value only when impairment is recognized. The Company performs an annual impairment test on the goodwill, and performs an impairment test on the intangible assets when there are indications of impairment.

During the year ended September 30, 2018, the Company recorded approximately $14.2 million of impairment relating to goodwill, which is reflected in the accompanying consolidated statements of operations.

The Company uses the discounted cash flow approach, the guideline public company approach and the guideline transactions approach to estimate the residual value of the Company's goodwill. The measurement of goodwill is a Level 3 measurement. The following table provides quantitative information related to the significant unobservable inputs to determine fair value and impairment of goodwill as of September 30, 2018:

Residual Value of Goodwill	Valuation Technique	Unobservable Input	Rates
$ -	Discounted Cash Flow	Weighted average cost of capital	9.3%
		Revenue growth rate	2.1% - 2.5%
	Guideline Public Company	LTM EBITDA multiple	7.0x

There were no nonrecurring measurements as of September 30, 2018 and 2017.

Concentrations of Credit Risk

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits of $250,000 per depositor of each financial institution. The Company has not experienced any losses to date related to these balances.

Financial instruments that potentially subject the Company to concentrations of credit risk consist of receivables due from Medicare and Medicaid. The Company received revenues from Medicare and Medicaid as follows (excluding revenues for discontinued operations, in thousands):

Years Ended September 30,	**2018**	**% of Total Revenues**	2017	% of Total Revenues
Medicare	**$ 165,882**	**47 %**	$ 152,240	44 %
Medicaid	**74,710**	**21 %**	72,948	21 %
Total	**$ 240,592**	**68 %**	$ 225,188	65 %

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities at the dates, and for the periods, that the consolidated financial statements are prepared. Actual results could materially differ from those estimates. Principal areas requiring the use of estimates include amounts due from/to government payers, allowances for contractual discounts and doubtful accounts, professional and general liability claims, long-lived assets, intangible assets and asset retirement obligations.

Subsequent Events

The Company has evaluated subsequent events through July 18, 2019, the date the Company's consolidated financial statements were available for issuance.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which defers the effective date of the revenue standard ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, including interim periods therein. Three basic transition methods are available — full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. October 1, 2019) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard is effective for nonpublic entities for fiscal years beginning after December 15, 2019. Early application of the amendment is permitted. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)." The updated standard addresses eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for non-public business entities for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." These amendments clarify the definition of a business. The amendments affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted under certain circumstances. The amendments should be applied prospectively as of the beginning of the period of adoption. The Company is evaluating the effect that this update will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment)." The new guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017, and the Company will adopt this standard effective for the year ending September 30, 2018. The new guidance simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. The new guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if any. The Company early adopted this standard in the current fiscal year.

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3. Property, Improvements and Equipment

Property, improvements and equipment, consisted of the following (in thousands):

September 30,	**2018**	2017
Property, improvements and equipment:		
Land and land improvements	**$ 7,471**	$ 7,468
Buildings and improvements	**39,359**	35,598
Leasehold improvements	**4,334**	3,394
Equipment	**39,400**	35,541
	90,564	82,001
Less: accumulated depreciation	**(44,869)**	(32,035)
	45,695	49,966
Construction in progress	**14,085**	3,884
Property, improvements and equipment, net	**$ 59,780**	$ 53,850

At September 30, 2018 and 2017, the Company had assets under capitalized leases of approximately $4,292,000 and $4,697,000, respectively, and related accumulated depreciation of $1,917,000 and $1,792,000, respectively.

Depreciation expense, excluding discontinued operations, was $13,222,000 and $12,200,000 for the years ended September 30, 2018 and 2017, respectively.

4. Acquisitions

In December 2017, New UMG entered into a Second Closing to acquire the remaining assets of University Medical Group ("UMG") that were not acquired in the initial acquisition in December 2014. As consideration for the acquisition, New UMG has assumed certain designated liabilities of the practice, which consists of various loans payable to subsidiaries of the Company, totaling approximately $7.5 million. Post-acquisition, these liabilities are eliminated on consolidation. There was no cash consideration related to the transaction. The remaining assets and liabilities acquired were immaterial and no value was assigned to them in the purchase price allocation, and accordingly goodwill of $7.5 million arises from the acquisition. The goodwill is deductible for tax purposes at Prospect, with PCC acting as a flow through entity. New UMG's parent company, Prospect CharterCARE Physicians, LLC, dba CharterCARE Medical Associates ("CCMA"), entered into a Post Closing Administrative Services Agreement pursuant to which CCMA and its affiliates provide services to the seller of the practice in connection with its termination of all operations and the wind up its affairs and operations.

Additionally during the year ended September 30, 2018, CharterCARE Physicians entered into asset purchase agreements to acquire three medical practices with primary care physicians. Total cash consideration for the medical practices was $976,000, of which $240,000 was included in accounts payable in the accompanying consolidated balance sheets and paid in October 2018.

During the year ended September 30, 2017, CharterCARE Physicians entered into asset purchase agreements to acquire two medical practices with primary care physicians. Total cash consideration for the medical practices was $1.1 million.

On May 1, 2017, the Company's wholly-owned subsidiary, Prospect Blackstone Valley Surgicare, LLC ("Prospect Blackstone"), completed an asset acquisition of a freestanding ambulatory surgery center located near the CharterCARE facilities in Rhode Island, in exchange for cash consideration of $1.6 million.

The acquisitions were accounted for as business combinations using purchase accounting. Under the purchase accounting method, assets acquired and liabilities assumed are recorded based on their estimated fair values. As asset purchases, goodwill acquired is expected to be deductible for tax purposes.

The following table summarizes the assets acquired and liabilities assumed in connection with the acquisitions (in thousands):

For the Years Ended September 30,	**2018**	2017
Inventories	**$ -**	$ 374
Improvements and equipment	**22**	813
Goodwill	**8,406**	2,048
Capital leases	**-**	(588)
Accrued purchase consideration due to seller	**(240)**	(379)
Liabilities assumed	**(7,452)**	-
Net cash consideration	**$ 736**	$ 2,268

As mentioned at Note 2, on July 1, 2018, the Company tested for goodwill impairment which resulted in a full impairment of goodwill. This includes the goodwill presented in the table above (see Note 6).

5. Discontinued Operations

During the year ended September 30, 2016, the Company determined that it would discontinue the operations of Prospect CharterCARE Elmhurst Extended Care, LLC (dba Elmhurst Extended Care). The Company's decision to discontinue the operations of each of the entities was based on the Company's management's strategy in their respective markets and financial results. The results of Elmhurst Extended Care's operations are included within loss from discontinued operations in the accompanying consolidated statements of operations.

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Summarized financial information for discontinued operations is included below (in thousands):

For the Years Ended September 30,	**2018**	2017
Major line items constituting pretax loss of discontinued operations:		
Net revenues	**$ (10)**	$ 4,324
Operating expenses	**91**	5,403
Loss on discontinued operation	**(101)**	(1,079)
Gain from sale of discontinued operations	**-**	10,490
(Loss) income on discontinued operations	**$ (101)**	$ 9,411

6. Goodwill and Intangible Assets

Goodwill and intangible assets relate to the Prospect CharterCARE and CharterCARE Physicians medical practices acquisitions. The following is a roll-forward of goodwill for the years ended September 30, 2018 and 2017, respectively (in thousands):

September 30,	**2018**	2017
Balance, beginning of year	**$ 5,822**	$ 3,774
Acquisitions	**8,406**	2,048
Impairment	**(14,228)**	-
Balance, end of year	**$ -**	$ 5,822

Identifiable intangible assets are comprised of the following (in thousands):

	Amortization Period	**September 30, 2018**	September 30, 2017
Trade names	5 years	**$ 8,130**	$ 8,130
Other	5 years	**97**	97
Total acquisition cost of intangible assets		**8,227**	8,227
Less accumulated amortization		**(7,016)**	(5,373)
Intangible assets, net		**$ 1,211**	$ 2,854

Amortization is recognized on a straight-line basis (management's best estimate of the period of economic benefit) over the respective useful lives. Amortization expense was $1,643,000 and $1,643,000 for the years ended September 30, 2018 and 2017, respectively.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

Years ended September 30,	
2019	$ 1,190
2020	19
Total	$ 1,209

The weighted-average remaining useful life for the intangible assets was approximately one year as of September 30, 2018.

7. Members' Equity

In accordance with the Amended & Restated Limited Liability Company Agreement of PCC ("LLC Agreement"), the profit or loss of PCC is to be allocated to the members based on their Adjusted Capital Contribution, as defined in the LLC Agreement. Total member contributions were $9,847,000 and $10,616,000 for the years ended September 30, 2018 and 2017, respectively. All of these contributions were made by Prospect and are accounted for as additional member contributions, however, in accordance with the LLC Agreement, the contributions were allocated 85% to Prospect and 15% to CharterCARE Community Board, consistent with their ownership percentages.

The following table breaks out total member non-cash and cash contribution:

September 30,	**2018**	2017
Cash contributions	**$ -**	$ 4,153
Non-cash contributions	**9,847**	6,463
Total	**$ 9,847**	$ 10,616

The following is a summary of the members' capital accounts (in thousands):

	Prospect	**CharterCARE Community Board**	**Total**
Balance at October 1, 2016	$ 40,185	$ 7,092	$ 47,277
Allocated contributions	9,024	1,592	10,616
Net loss	(3,507)	(619)	(4,126)
Balance at September 30, 2017	45,702	8,065	53,767
Allocated contributions	8,370	1,477	9,847
Net loss	(30,764)	(5,429)	(36,193)
Balance at September 30, 2018	$ 23,308	$ 4,113	$ 27,421

8. Related Party Transactions

The Company and Prospect East Hospital Advisory Services, LLC ("PEHAS"), a wholly-owned subsidiary of Prospect, entered into a Management Services Agreement ("MSA") as of June 20, 2014, under which PEHAS provides certain administrative and management services to PCC and its Subsidiaries. Management fees due to PEHAS under the MSA consist of 2% of net revenues monthly. The Company recognized management fees of $7,298,000 and $7,033,000 for the years ended September 30, 2018 and 2017, respectively, which is included within management fees expense in the accompanying consolidated statements of operations. As of September 30, 2018 and 2017, the Company had liabilities related to the MSA due PEHAS of $30,568,000 and $23,270,000, respectively. Subsequent to year-end, Prospect converted the unpaid management fees and certain unpaid payables to Members' Equity (see Note 12).

9. Commitments and Contingencies

Leases

The Company leases various office facilities and equipment from third parties under non-cancelable operating and capital lease arrangements expiring at various dates through 2023. Capital leases bear interest at rates ranging from 4.0% to 6.0% per annum.

The future minimum annual lease payments (net of anticipated sublease income) required under leases in effect at September 30, 2018, are as follows (in thousands):

For the Years ending September 30,	Capital Leases	Operating Leases
2019	$ 829	$ 452
2020	51	350
2021	44	288
2022	-	283
2023	-	283
Total minimum lease payments	924	$ 1,656
Less: amounts representing interest	(34)	
	890	
Less: current portion	(798)	
	$ 92	

Lease and rental expense was $5,438,000 and $4,792,000 for the years ended September 30, 2018 and 2017, respectively.

Contingent Liability for Borrowings by Prospect

The Company and its Subsidiaries are contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities as of September 30, 2018 and 2017. The obligations and related interest expense related to these credit facilities are not reflected in the Company's consolidated financial statements as of September 30, 2018 and 2017, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2018 and 2017, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

September 30,	**2018**	2017
Senior secured term notes (net of discount of $20,085 and $7,374)	**$ 1,094,315**	$ 609,813
Less: deferred financing costs	**(16,214)**	(9,906)
	$ 1,078,101	$ 599,907

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Original Term Loan"), the proceeds of which were used to repay $425 million of PMH's existing 8.375% senior secured notes due during 2019; to repay $60 million of borrowings under the Prospect's existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions, including the acquisition of a fellow subsidiary; and to finance transaction fees and expenses. The Original Term Loan bore interest at LIBOR (subject to a 1.0% floor) plus 6.0%. The Original Term Loan was issued with an original discount of 1.5%, or $9,375,000. Additionally, the Company refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("Original ABL Facility" and together with the Original Term Loan, the "New Senior Secured Credit Facilities"). Pursuant to various amendments from August 2016 through October 2017, the aggregate commitment amount under the Original ABL facility was increased in stages to $175 million. The maturity date for the Original ABL Facility was June 30, 2021, and the maturity date for the Term Loan was June 30, 2022.

On February 22, 2018, the Company refinanced and replaced both the Original Term Loan and the Original ABL Facility, and entered into an Amended and Restated Term Loan Credit Agreement (the "Amended TL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan Chase Bank, N.A. ("JPMorgan"), as administrative agent and collateral agent. The Amended TL Agreement replaced the Original Term Loan with a new Term B-1 Loan ("Term B-1 Loan"). The principal amount of the Term B-1 Loan is $1,120 million and such loan bears interest at LIBOR (subject to a 1.0% floor) plus 5.5%, which as of September 30, 2018 was 7.625%. The Term B-1 Loan was issued with an original discount of 2% and matures on February 22, 2024.

Additionally, on February 22, 2018, Prospect entered into an Amended and Restated ABL Credit Agreement (the "Amended ABL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. The Amended ABL Agreement replaced the Original ABL Facility. Under the Amended ABL Agreement, the maximum revolving commitment is $250.0 million with ability to expand the facility to $325.0 million, and the new ABL facility (the "New ABL Facility") bears interest at a variable base rate plus an applicable spread that is based on excess availability under the New ABL Facility, as further described in the Amended ABL Agreement, which was 3.875% as of September 30, 2018. The New ABL Facility matures on February 22, 2023. As of September 30, 2018, the available balance on the new ABL facility was $41.0 million.

Letter of Credit

As of September 30, 2018, Prospect secured an irrevocable letter of credit for $733,000 on behalf of the Company for its School of Nursing ("School") as required by the U.S. Department of Education. The purpose of the letter of credit is to (i) pay refunds of charges owed on behalf of current or former students, whether or not the School remains open; (ii) to provide for the "teach-out" of currently enrolled students if the School closes; and (iii) to pay any liabilities owed to the U.S. Department of Education.

Other Commitments

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

Litigation

The Company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, acquisitions, or other transactions. While the Company's management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on the Company's consolidated financial position or results of operations, the litigation and other claims that the Company faces are subject to inherent uncertainties and management's view of these matters may change in the future. Should an unfavorable final outcome occur, there exists the possibility of a material adverse impact on the Company's consolidated financial position, results of operations and cash flows for the period in which the effect becomes probable and reasonably estimable.

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. 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.

The Health Insurance Portability and Accountability Act ("HIPAA") assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act ("HITECH Act") expanded upon HIPAA in a number of ways, including establishing notification requirements for certain breaches of protected health information. In addition to these federal rules, states have also developed their own standards for the privacy and security of health information as well as for reporting certain violations and breaches which in some cases are more stringent. Other federal privacy laws may also apply to certain services provided by the Company, including 42 C.F.R. Part 2, which addresses the confidentiality of substance use disorder records. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

Affordable Care Act

The Patient Protection and Affordable Care Act ("PPACA") has made significant changes to the United States health care system. The legislation impacted multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Under this legislation, 33 states have expanded their Medicaid programs to cover previously uninsured childless adults, and four additional states voted in 2018 to expand Medicaid or to elect a governor that pledged to expand Medicaid. In addition, many uninsured individuals have had the opportunity to purchase health insurance via state-based marketplaces, state-based marketplaces using a federal platform, state-partnership marketplaces or the federally-facilitated marketplace. PPACA also implemented a number of health insurance market reforms, such as allowing children to remain on their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced the number of uninsured individuals.

It is unclear what changes may be made to PPACA with the divided Congress, current presidential administration, and pending litigation over the validity of PPACA. The Administration has promulgated rules to broaden the availability of coverage options that do not comply with the full range of PPACA requirements for individual market coverage, namely Association Health Plans and Short-Term Limited-Duration Insurance. The Administration has also provided additional guidance on state PPACA waivers. These executive actions have been or may be challenged in court. In addition, the Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate penalty under PPACA, effective January 1, 2019. The individual mandate penalty was included in PPACA to address concerns that other market reforms expanding access to coverage might produce adverse selection and higher premiums. The extent to which the repeal of the individual mandate penalty will impact the uninsured rate and 2019 premiums is unclear at this juncture. On December 14, 2018, the United States District Court for the Northern District of Texas ruled that the individual mandate without the penalty is unconstitutional and that PPACA is therefore invalid in its entirety. Litigation on this issue is ongoing, with the Administration indicating it will continue implementing PPACA pending any appeals, the court ordering expedited briefing on a potential stay and certification of an interlocutory appeal, and pending litigation in the United States District Court for the District of Maryland to ensure continued implementation of PPACA. This litigation along with any future legislative changes to

PPACA or other federal and state legislation could have a material impact on the operations of the Company. The Company is continuing to monitor the legislative environment and developments in pending litigation for risks and uncertainties.

Collective Bargaining Agreements

Approximately 316 employees at SJHSRI are subject to a collective bargaining agreement with United Nurses and Allied Professionals ("UNAP"), which was effective beginning September 2016 and expires July 2019. During April 2015, a hospital unit consisting of approximately 400 service employees of SJHSRI elected to be represented by UNAP. The parties entered into a collective bargaining agreement which expired in October 2018 and is currently in the process of renegotiations. A small number of employees are subject to a collective bargaining agreement with the Federation of Nurses and Health Professionals ("FNHP"), which expires on July 30, 2021.

Provider Contracts

Many of the Company's payer and provider contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of medical services. Such differing interpretations may not come to light until a substantial period of time has passed following contract implementation. Liabilities for claims disputes are recorded when the loss is probable and can be estimated. Any adjustments to reserves are reflected in current operations.

10. Defined Contribution Plan

The Company sponsors a defined contribution plan (the "Plan") covering substantially all employees who meet certain eligibility requirements. Under the Plan, employees can contribute up to 100% of their compensation up to the IRS deferred annual maximum. Effective May 1, 2018, the plans covering employees at ECHN, Waterbury and Crozer were merged into the plan covering employees at CharterCARE, and the two remaining plans were renamed and segregated between union and non-union employees. The Company may make discretionary matching contributions to the Plan. Employer contributions to the Plan were $1,925,000 and $839,000 for the years ended September 30, 2018 and 2017, respectively.

11. Equity Method Investments

Roger Williams Medical Center and an unrelated third party are owners of Roger Williams Radiation Therapy ("RWRT") and Southern New England Regional Cancer Center, LLC ("SNERCC"), which provide radiation therapy services. Roger Williams accounts for these investments using the equity method of accounting.

RWMC is not liable for any obligations insured by RWRT or SNERCC nor is it obligated to make any further capital contributions or lend funds to RWRT or SNERCC. As of September 30, 2018 and 2017, the Company's investments in RWRT, SNERCC, and other minor investments under the equity method were approximately $4,088,000 and $4,357,000, respectively, and are included in equity method investments in the accompanying consolidated balance sheets. For the years ended September 30, 2018 and 2017, the Company recognized approximately $589,000 and $605,000, respectively, as its share of the financial results of RWRT, SNERCC, and other minor investments and received $614,000 and $836,000, respectively, in distributions.

Summarized combined unaudited financial information for RWRT and SNERCC as of and for the years ended September 30, 2018 and 2017 is as follows (in thousands):

September 30,	**2018**	2017
Cash	**$ 2,515**	$ 1,549
Receivables and other current assets	**3,756**	2,121
Total current assets	**6,271**	3,670
Property, improvements and equipment, net	**3,502**	6,104
Goodwill	**7,142**	7,142
Intangible assets	**851**	882
Other long-term assets	**1,569**	1,603
Total assets	**$ 19,335**	$ 19,401
Accounts payable and accrued liabilities	**$ 1,052**	$ 1,201
Other long-term liabilities	**420**	400
Equity	**17,863**	17,800
Total liabilities and partner's capital	**$ 19,335**	$ 19,401

For the Years Ended September 30,	**2018**	2017
Revenues	**$ 17,278**	$ 16,387
Net income	**$ 2,953**	$ 2,941
Income from equity method investments	**$ 589**	$ 507

12. Subsequent Events (Unaudited)

On March 1, 2019, Prospect entered into Amendment No. 2 to the Amended and Restated ABL Credit Agreement, by and among Prospect (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. Under this amendment, the maximum revolving commitment is increased from $250.0 million to $280.0 million, and the maximum expansion of the facility has been reduced from $325.0 million to $285.0 million. Additionally, the amendment provides for $40.0 million of a "first in first out" revolving facility, which bears interest at either 2.5% or 3.5% per annum depending on whether they are Eurodollar loans or ABR loans.

Further, on March 25, 2019, Prospect entered into Amendment No. 3 to the Amended and Restated ABL Credit Agreement, by and among Prospect (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. Under this amendment, the maximum revolving commitment is increased from $280.0 million to $285.0 million.

In May 2019, Prospect East, which owns 85% of the Company, made a non-cash capital contribution in the amount of approximately $24.7 million, which consisted of converting unpaid management fees due to PEHAS of approximately $20.0 million and approximately $4.7 million of unpaid invoices that Prospect paid on behalf of the Company at April 30, 2019, into equity.

TAB 28A

Prospect CharterCARE RWMC, LLC

Consolidated Financial Statements

As of and for the Years Ended
September 30, 2018 and 2017

Prospect CharterCARE RWMC, LLC

Consolidated Financial Statements

As of and for the Years Ended September 30, 2018 and 2017

Prospect CharterCARE RWMC, LLC

Contents

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Independent Auditor's Report

Board of Directors
Prospect CharterCARE RWMC, LLC
Los Angeles, California

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Prospect CharterCARE RWMC, LLC (the "Company"), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations, member's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Prospect CharterCARE RWMC, LLC and its subsidiary as of September 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the Company is financially dependent on its parent companies which have agreed to provide the financial support necessary for the operations of the Company. The accompanying consolidated financial statements do not reflect any adjustments or disclosures that would be required should the parent company discontinue its financial support.

BDO USA, LLP

July 18, 2019

Consolidated Financial Statements

Prospect CharterCARE RWMC, LLC

Consolidated Balance Sheets
(in thousands)

September 30,	**2018**	2017
Assets		
Current assets		
Cash and cash equivalents	**$ -**	$ 299
Restricted cash	**267**	2,369
Patient accounts receivable, less allowance for doubtful accounts of $5,284 and $3,974, respectively	**22,400**	21,506
Other receivables	**2,171**	9,303
Due from government payers	**402**	580
Inventories	**3,332**	3,750
Prepaid expenses and other current assets	**768**	1,378
Total current assets	**29,340**	39,185
Property, improvements and equipment, net	**35,044**	30,679
Intangible assets, net	**653**	1,561
Equity method investments	**4,063**	4,052
Insurance receivable and other assets	**872**	601
Total assets	**$ 69,972**	$ 76,078

See accompanying notes to consolidated financial statements.

Prospect CharterCARE RWMC, LLC

Consolidated Balance Sheets
(in thousands)

September 30,	**2018**	2017
Liabilities and Member's Equity		
Current liabilities		
Accrued medical claims and other healthcare costs payable	**$ 491**	$ 394
Accounts payable and other accrued liabilities	**17,154**	13,946
Accrued salaries, wages and benefits	**7,152**	6,540
Due to government payers	**74**	282
Due to affiliated companies, net	**20,750**	18,357
Current portion of capital leases	**326**	596
Current portion of sale-leaseback liability	**257**	257
Total current liabilities	**46,204**	40,372
Capital leases, net of current portion	**-**	326
Malpractice reserves	**4,243**	3,273
Asset retirement obligations	**839**	750
Sale-leaseback liability, net of current portion	**3,117**	3,760
Other long-term liabilities	**315**	335
Total liabilities	**54,718**	48,816
Commitments, contingencies and subsequent events		
Member's equity		
Member contributions	**34,241**	34,241
Accumulated deficit	**(18,987)**	(6,979)
Total member's equity	**15,254**	27,262
Total liabilities and member's equity	**$ 69,972**	$ 76,078

See accompanying notes to consolidated financial statements.

Prospect CharterCARE RWMC, LLC

Consolidated Statements of Operations
(in thousands)

For the years ended September 30,	**2018**	2017
Revenues		
Net patient service revenues	**$ 181,353**	$ 177,720
Provision for bad debts	**(5,996)**	(6,190)
Net patient service revenues less provision for bad debts	**175,357**	171,530
Other revenues	**2,819**	3,001
Total net revenues	**178,176**	174,531
Operating Expenses		
Salaries, wages and benefits	**86,715**	83,968
Supplies	**39,889**	38,638
Purchased services	**12,714**	13,629
Taxes and licenses	**12,151**	11,347
Depreciation and amortization	**7,124**	6,168
Professional fees	**5,422**	6,728
Other	**5,969**	6,219
Management fees	**3,721**	3,665
Utilities	**2,400**	1,792
Research grant expense	**2,503**	120
Insurance	**1,869**	2,799
Lease and rental	**1,210**	1,434
Repairs and maintenance	**1,254**	978
Registry	**720**	623
Total operating expenses	**183,661**	178,108
Operating income from unconsolidated equity method investments	**589**	507
Operating loss	**(4,896)**	(3,070)
Other (income) expense:		
Interest income, net	**(340)**	(217)
Goodwill impairment	**7,452**	-
Other income	**-**	(89)
Total other expense (income), net	**7,112**	(306)
Net loss	**$ (12,008)**	$ (2,764)

See accompanying notes to consolidated financial statements.

Prospect CharterCARE RWMC, LLC

Consolidated Statements of Member's Equity
(in thousands)

	Member Contributions	Retained Earnings (Accumulated Deficit)	Total Member's Equity
Balance at October 1, 2016	$ 34,241	$ 330	$ 34,571
Net loss	-	(2,764)	(2,764)
Noncash distribution	-	(4,545)	(4,545)
Balance at September 30, 2017	34,241	(6,979)	27,262
Net loss	-	(12,008)	(12,008)
Balance at September 30, 2018	$ 34,241	$ (18,987)	$ 15,254

See accompanying notes to consolidated financial statements.

Prospect CharterCARE RWMC, LLC

Consolidated Statements of Cash Flows
(in thousands)

For the years ended September 30,	**2018**	2017
Operating activities		
Net loss	**$ (12,008)**	$ (2,764)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	**7,124**	6,168
Provision for bad debts	**5,996**	6,190
Undistributed earnings from equity method investments	**(589)**	(507)
Asset retirement obligations amortization (accretion), net	**89**	(5)
Accretion of sale-leaseback liability	**(386)**	(335)
Goodwill impairment	**7,452**	-
Changes in operating assets and liabilities:		
Change in restricted cash	**2,102**	(633)
Patient accounts receivable and other receivables	**(7,141)**	(8,527)
Due to/from government payers, net	**(30)**	17
Inventories	**418**	467
Prepaid expenses and other current assets	**610**	18
Insurance receivable and other assets	**(271)**	(100)
Accrued medical claims and other healthcare costs payable	**97**	394
Accounts payable and other accrued liabilities	**3,412**	(1,448)
Malpractice reserve	**970**	883
Net cash provided by (used in) operating activities	**7,845**	(182)
Investing activities		
Purchases of property, improvements and equipment	**(2,548)**	(1,872)
Cash distributions from equity investments	**578**	761
Net cash used in investing activities	**(1,970)**	(1,111)
Financing activities		
Change in due to affiliated companies	**(5,321)**	2,732
Repayments on financing liability	**(257)**	(193)
Repayments of capital leases	**(596)**	(947)
Net cash (used in) provided by financing activities	**(6,174)**	1,592
Change in cash and cash equivalents	**(299)**	299
Cash and cash equivalents, beginning of year	**299**	-
Cash and cash equivalents, end of year	**$ -**	$ 299
Supplemental disclosure of cash flow information		
Interest paid	**$ 45**	$ 1,999
Noncash distribution	**$ -**	$ 4,545
Sale-leaseback liability	**$ -**	$ 4,545
Noncash acquisition	**$ 7,452**	$ -
Noncash capital additions	**$ 7,714**	$ 3,206
Capital lease commitments transferred to affiliate	**$ -**	$ 1,669

See accompanying notes to consolidated financial statements

1. Organization

Prospect CharterCARE RWMC, LLC ("RWMC") is a wholly-owned subsidiary of Prospect CharterCARE, LLC ("PCC"). PCC is owned 85% by Prospect Medical Holdings, Inc. ("Prospect") and 15% by CharterCARE Community Board. RWMC operates a 220-bed acute care general hospital which provides healthcare services in Providence, Rhode Island and surrounding communities. New University Medical Group, LLC ("New UMG"), a wholly-owned subsidiary of RWMC (together, the "Company"), was formed during the year ended September 30, 2015. During the year ended September 30, 2018, two new entities were created, Prospect RI Home Health and Hospice, LLC ("PRIHHH"), which is owned by RWMC, and Prospect CharterCARE Home Health and Hospice, LLC ("PCCHHH"), which is owned by PRIHHH and, effective May 1, 2018, the operations of the home health business were transferred from RWMC to PCCHHH.

Admitting physicians are primarily practitioners in the local area. The hospital has payment arrangements with Medicare, Medicaid and other third-party payers, including commercial insurance carriers, health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs").

The Company is dependent on Prospect to fund ongoing operations. As of September 30, 2018, the Company had a liability of $20,750,000 due to Prospect and its subsidiaries, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying consolidated balance sheets. Prospect does not intend to have the Company repay the liability in a manner which would impair the Company's ability to maintain sufficient liquidity to sustain ongoing operations.

2. Significant Accounting Policies

Principles of Consolidation and Basis of Presentation
The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of RWMC's wholly-owned subsidiaries but do not include the accounts of PCC, Prospect or CharterCARE Community Board. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenues

Net Patient Service Revenues

Operating revenue consists primarily of net patient service revenue. The Company reports net patient service revenue at the estimated net realizable amounts from patients and third-party payers and others in the period in which services are rendered. The Company has agreements with third-party payers, including Medicare, Medicaid, managed care and other insurance programs that are paid at negotiated rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments, as further described below. Estimates of contractual allowances are based upon the payment terms specified in the related contractual agreements. The Company accrues for amounts that it believes may ultimately be due to or from the third-party payers. Normal estimation differences between final settlements and amounts accrued in previous years are reported as changes in estimates in the current year.

Outstanding receivables, net of allowances for contractual discounts and bad debts, are included in patient accounts receivable in the accompanying consolidated balance sheets.

The following is a summary of sources of net patient service revenues (net of contractual allowances and discounts) before provision for bad debts (in thousands):

For the years ended September 30,	**2018**	2017
Medicare	**$ 87,715**	$ 82,046
Medicaid	**37,616**	34,725
Managed Care/Commercial	**39,313**	39,163
Self-Pay/Other	**16,709**	21,786
Total	**$ 181,353**	$ 177,720

A summary of the payment arrangements with major third-party payers follows:

Medicare: Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some persons with end-stage renal disease and certain other beneficiary categories, including eligible disabled persons. Most inpatient hospital services rendered to Medicare program beneficiaries are paid on a fee-for-service basis at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Most outpatient services also are paid on a fee-for-service basis generally using prospectively determined rates. The Company receives, as appropriate, Medicare disproportionate share hospital ("DSH") and bad debt payments at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare Administrative Contractor. The Company also receives, as appropriate, Medicare uncompensated care DSH payments, which are generally not subject to cost report audit except to determine eligibility for Medicare DSH. The Company also receives Medicare outlier payments on an ongoing basis during the year for cases that are unusually costly, and under certain circumstances these payments may be reconciled to more closely reflect the costs in excess of outlier thresholds after the submission and audit of the annual Medicare cost report. Normal estimation differences between filed settlements and amounts accrued are reflected in net patient service revenue.

The Company is reimbursed by Medicare for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare Administrative Contractor. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year that examination is substantially completed.

Although services for most Medicare beneficiaries are paid by the Federal government on a fee-for-service basis, approximately one-third of Medicare beneficiaries are enrolled in a "Medicare Advantage" plan, which is a type of health plan that contracts with the Medicare program to provide hospital and medical benefits to Medicare beneficiaries. Medicare Advantage Plans include Health Maintenance Organizations, Preferred Provider Organizations, Private Fee-For-Service Plans, Special Needs Plans, and Medicare Medical Savings Account Plans. For Medicare beneficiaries enrolled in a Medicare Advantage plan, most Medicare services are covered by the plan and are not paid for under fee-for-service Medicare. Certain Medicare Advantage plans make capitation payments to the Company using a "Risk Adjustment model," which compensates providers based on the health status (acuity) of each enrollee. Providers with higher acuity enrollees generally will receive more and those with healthier enrollees will receive less.

Cost report settlement estimates are recorded based upon as-filed cost reports and are adjusted for tentative settlements, if any, and when a final Notice of Program Reimbursement ("NPR") is issued. *Medicaid*: Medicaid is a joint federal-state funded healthcare benefit program that is administered by states to provide benefits to qualifying individuals who are unable to afford care. The Company receives reimbursements under the Medicaid program at prospectively determined rates for both inpatient and outpatient services. Similar to Medicare, cost report settlements are recorded based upon as-filed cost reports and adjusted for tentative and final settlements, if any.

RWMC is a participant in the State of Rhode Island's Dipropionate Share Hospital ("DSH") program, which assists hospitals that provide a disproportionate amount of uncompensated care. Under the program, the Company's hospitals receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low-income patients. RWMC recognized revenue related to DSH and Upper Payment Limit ("UPL") reimbursement of 9,179,000 and $9,458,000 for the years ended September 30, 2018 and 2017, respectively. DSH and UPL payments received were $8,787,000 and $8,446,000 for the years ended September 30, 2018 and 2017, respectively. The State of Rhode Island also assesses a license fee to all hospitals in Rhode Island based on each hospital's net patient revenue. The Company recorded $9,199,000 and $8,667,000 of expense during the years ended September 30, 2018 and 2017, respectively, as a result of the license fee.

Managed Care: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment under these agreements is in accordance with negotiated contracted rates or at the Company's standard charges for services provided.

Self-Pay: Self-pay patients represent those patients who do not have health insurance and are not covered by some other form of third-party arrangement. Such patients are evaluated, at the time of services or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, as well as the Company's indigent and charity care policy.

Charity Care

The Company provides charity care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Company's charity care policy. This care is provided without charge or at amounts less than the Company's established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The direct and indirect costs related to this care totaled approximately $457,000 and $547,000 for the years ended September 30, 2018 and 2017, respectively. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition, the Company provides services to other medically indigent patients under various state Medicaid programs. Such programs pay amounts that are less than the cost of the services provided to the recipients. The Company has not changed its charity care or uninsured discount policies during the years ended September 30, 2018 or 2017.

Provisions for Contractual Allowances and Doubtful Accounts

Collection of receivables from third-party payers and patients is the Company's primary source of cash and is critical to its operating performance. The Company closely monitors its historical collection rates, as well as changes in applicable laws, rules and regulations and contract terms, to assure that provisions for contractual allowances are made using the most accurate information available. However, due to the complexities involved in these estimations, actual payments from payers may be materially different from the amounts management estimates and records. The Company's primary collection risks relate to uninsured patients and the portion of the bill which is the patient's responsibility, primarily co-payments and deductibles. Payments for services may also be denied due to issues over patient eligibility for medical coverage, the Company's ability to demonstrate medical necessity for services rendered and payer authorization of hospitalization.

Accounts receivable are reduced by an allowance for doubtful accounts. Valuation of the collectability of accounts receivable and provision for bad debts is based on historical collection experience, payer mix and the age of the receivables. Management routinely reviews accounts receivable balances in conjunction with these factors and other economic conditions which might ultimately affect the collectability of the patient accounts, and makes adjustments to the Company's allowances as warranted. For receivables associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and subsequently calculates an allowance for doubtful accounts and provision for bad debts once the age of the accounts reaches a specific age category based on historical experience. For receivables associated with self-pay patients, management records a significant provision for bad debts beginning in the period services were provided based on past experience that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The allowance for doubtful accounts was 19% and 16% of gross accounts receivable as of September 30, 2018 and 2017, respectively.

Legislation

All of the Company's hospital facilities are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient's ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. The Company believes that it is in compliance with EMTALA and is not aware of any pending or threatened EMTALA investigations involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements.

Other Revenues

Other revenues totaled $2,819,000 and $3,001,000 for the years ended September 30, 2018 and 2017, respectively. Management has evaluated the collectability of other receivables consisting primarily of other revenues and grant revenues and determined no allowance is necessary as of September 30, 2018 or 2017.

A summary of the principal components of other revenues is as follows:

Rental Revenue: Rental revenue from operating leases is recorded based on the fixed, minimum required rents (base rents) per the lease agreements. Rental revenue from base rents is recorded on the straight-line method over the terms of the related lease agreements. The Company recorded rental revenues of $264,000 and $547,000 for the years ended September 30, 2018 and 2017, respectively.

Research Grant Revenues: The Company receives grant revenue for direct research from the federal government, other institutions and other sources for a range of research areas including oncology, cardiology, HIV and diabetes. The Company recorded research grant revenue of $1,597,000 and $1,439,000 for the years ended September 30, 2018 and 2017, respectively.

Property, Improvements and Equipment

Property, improvements and equipment are stated on the basis of cost or, in the case of acquisitions, at their acquisition date fair values. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, and amortization of leasehold improvements is provided using the straight-line basis over the shorter of the remaining lease period or the estimated useful lives of the leasehold improvements. Building improvements are generally depreciated over seven years, buildings are depreciated over 10 years, equipment is depreciated over three to seven years and furniture and fixtures are depreciated over five to seven years. Equipment capitalized under capital lease obligations are amortized over the lesser of the life of the lease or the useful life of the asset.

Goodwill

Goodwill represents the excess of the consideration paid and liabilities assumed over the fair value of the net assets acquired, including identifiable intangible assets.

Goodwill is not amortized; rather it is reviewed annually for impairment for each reporting unit, or more frequently if impairment indicators arise. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value.

The Company's annual impairment testing date is July 1. Impairment of goodwill is tested at the reporting unit level, by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of the reporting units are estimated. In evaluating whether indicators of impairment exist, the Company considers adverse changes in market value, laws and regulations, profitability, cash flows, ability to maintain enrollment and renew payer contracts at favorable terms, among other factors. The Company has adopted new literature during the year ended September 30, 2018 which changes the goodwill impairment test from a two-step process to a one-step process, which consists of estimating based on a weighted combination of (i) the guideline company method that utilizes revenue or earnings multiples for comparable publicly-traded companies, and (ii) a discounted cash flow model. If the estimated fair value of the reporting unit is less than its carrying value, this indicates that goodwill is impaired, and impairment is recorded based on the deficiency of fair value compared to the carrying value. The Company's impairment test related to goodwill during the year ended September 30, 2018 resulted in a full impairment of goodwill. There were no impairment charges during the year ended September 30, 2017 because there was no goodwill on the consolidated balance sheet at September 30, 2017.

Intangible Assets

Intangible assets include trade names. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if estimated undiscounted cash flows associated with those assets are less than their carrying amounts. Fair value is based upon the present value of the associated cash flows. Changes in circumstances (for example, changes in laws or regulations, technological advances or changes in strategies) may also reduce the useful lives from initial estimates. Changes in planned use of intangibles may result from changes in customer base, contractual agreements, or regulatory requirements. In such circumstances, management will revise the useful life of the long-lived asset and amortize the remaining net book value over the adjusted remaining useful life. There were no impairments recorded during the years ended September 30, 2018 or 2017.

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Insurance Reserves

Medical Malpractice Liability Insurance

The Company carries professional and general liability insurance to cover medical malpractice claims. The General Liability coverage is occurrence coverage and the Professional Liability coverage is claims-made coverage. Under the Professional Liability policy, insurance premiums cover only those claims actually reported during the policy term. Should the Professional Liability claims-made policy not be renewed or replaced with equivalent insurance, claims related to occurrences during the policy term but reported subsequent to the policy's termination may be uninsured. The Company was included in Prospect's consolidated medical malpractice insurance policy effective June 20, 2014 (inception). Assets and liabilities related to malpractice insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

GAAP requires that a health care organization record and disclose the estimated costs of medical malpractice claims in the period of the incident of malpractice, if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. The Company recognizes an estimated liability for incurred but not reported claims and the self-insured risks (including deductibles and potential claims in excess of policy limits) based upon an actuarial valuation of the Company's historical claims experience. The Company's gross claims liability was $4,243,000 and $3,273,000 as of September 30, 2018 and 2017, respectively, and insurance receivables were $872,000 and $478,000 as of September 30, 2018 and 2017, respectively. The gross claims liability and insurance receivables were estimated using a discount factor of 4% and are included within long-term assets and long-term liabilities, respectively, in the accompanying consolidated balance sheets.

Workers' Compensation Insurance

The Company was fully insured for workers' compensation claims with no deductible during the years ended September 30, 2018 and 2017.

Reserve Methodology

The claims reserve is based on the best data available to the Company. The estimate, however, is subject to a significant degree of inherent variability. The estimate is continually monitored and reviewed, and as the reserve is adjusted, the difference is reflected in current operations. While the ultimate amount of medical malpractice liability is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims. Management is not aware of any potential medical malpractice claims whose settlement, if any, would have a material adverse effect on the Company's financial position, results of operations or cash flows.

Employee Health Plans

The Company maintains self-insured EPO/HMO and PPO plans for all eligible employees. Employee health benefits are administered by a third-party claims administrator, based on plan coverage and eligibility guidelines determined by the Company, as well as by collective bargaining agreements. Commercial insurance policies cover per occurrence losses in excess of $350,000. An actuarially estimated liability of approximately $491,000 and $367,000 for incurred but not reported claims as of September 30, 2018 and 2017, respectively.

Asset Retirement Obligations

The Company recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. Over time, the liability is accreted to its present value each period. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statement of operations. The Company has accrued $839,000 and $750,000 related to asbestos remediation as of September 30, 2018 and 2017, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with initial maturities of 90 days or less to be cash equivalents. Cash and cash equivalents are primarily comprised of deposits with banks. The Company maintains its cash at banks with high credit-quality ratings.

Restricted Cash

The Company held restricted cash of $267,000 and $2,369,000 as of September 30, 2018 and 2017, respectively, which is restricted for research.

Inventories

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or net realizable value. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

Income Taxes

For tax reporting purposes, the Company is treated as a Partnership and is a pass-through entity. Therefore, no provision is made in the accompanying financial statements for liabilities for federal, state or local income taxes since such liabilities are the responsibility of the Company's parent companies. The Company periodically evaluates its tax positions, including its status as a pass-through entity, to evaluate whether it is more likely than not that such positions would be sustained upon examination by a tax authority for all open tax years, as defined by the statute of limitations, based on its technical merits.

As of September 30, 2018 and 2017, the Company has not established a liability for uncertain tax positions. The Company files income tax returns in the U.S. federal jurisdiction and the state of Rhode Island. Generally, the Company is subject to examination by U.S. federal (or state and local) income tax authorities for three to four years from the filing of a tax return.

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and cash equivalents, restricted cash, patient and other accounts receivables, accounts payable and accrued expenses, accrued salaries and benefits, amounts due from/to government payers, capital lease obligations, and other liabilities. The carrying amounts of current assets and liabilities approximate their fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

Nonfinancial assets such as goodwill and identifiable intangible assets are measured at fair value when there is an indicator of impairment and recorded at fair value only when impairment is recognized. The Company performs an annual impairment test on the goodwill, and performs an impairment test on the intangible assets when there are indications of impairment.

During the year ended September 30, 2018, the Company recorded approximately $7.5 million of impairment relating to goodwill, which is reflected in the accompanying consolidated statements of operations.

The Company uses the discounted cash flow approach, the guideline public company approach and the guideline transactions approach to estimate the residual value of the Company's goodwill. The measurement of goodwill is a Level 3 measurement. The following table provides quantitative information related to the significant unobservable inputs to determine fair value and impairment of goodwill as of September 30, 2018:

Residual Value of Goodwill	Valuation Technique	Unobservable Input	Rates
$ -	Discounted Cash Flow	Weighted average cost of capital	9.3%
		Revenue growth rate	2.1% - 2.5%
	Guideline Public Company	LTM EBITDA multiple	7.0x

There were no nonrecurring measurements as of September 30, 2017.

Sale-Leaseback Transactions

The Company evaluates sale-leaseback transactions by determining whether the transaction meets the qualifying criteria to be recognized as a sale-leaseback, including the transfer of risk and rewards of ownership as well as the absence of continuing involvement of the Company. When the qualifying criteria for a sale-leaseback transaction are not met, the Company accounts for the transaction as a financing, see Note 6.

Concentrations of Credit Risk

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits of $250,000 per depositor of each financial institution. The Company has not experienced any losses to date related to these balances.

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Financial instruments that potentially subject the Company to concentrations of credit risk consist of receivables due from Medicare and Medicaid. The Company received revenues from Medicare and Medicaid as follows (in thousands):

	For the Year Ended September 30, 2018	% of Net Patient Services Revenues	For the Year Ended September 30, 2017	% of Net Patient Services Revenues
Medicare	$ 87,715	48%	$ 82,046	46%
Medicaid	37,616	21%	34,725	20%
Total	$ 125,331	69%	$ 116,771	66%

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities at the dates, and for the periods, that the consolidated financial statements are prepared. Actual results could materially differ from those estimates. Principal areas requiring the use of estimates include amounts due from/to government payers, allowances for contractual discounts and doubtful accounts, professional and general liability claims, impairment of long-lived assets and intangible assets, and asset retirement obligations.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which defers the effective date of the revenue standard ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, including interim periods therein. Three basic transition methods are available — full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. October 1, 2019) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard is effective for nonpublic entities for fiscal years beginning after December 15, 2019. Early application of the amendment is permitted. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)." The updated standard addresses eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for non-public business entities for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In January 2017, the FASB issued ASU 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment)." The new guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017, and the Company will adopt this standard effective for the year ending September 30, 2018. The new guidance simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. The new guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if any. The Company early adopted this standard in the current fiscal year.

Subsequent Events

The Company has evaluated subsequent events through July 18, 2019, the date the Company's consolidated financial statements were available for issuance.

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3. Property, Improvements and Equipment

Property, improvements and equipment, consisted of the following (in thousands):

September 30,	**2018**	2017
Property, improvements and equipment:		
Land and land improvements	**$ 2,946**	$ 2,946
Buildings and improvements	**25,801**	23,266
Leasehold improvements	**6,253**	6,164
Equipment	**11,948**	10,362
	46,948	42,738
Less: accumulated depreciation	**(20,517)**	(14,423)
	26,431	28,315
Construction in Progress	**8,613**	2,364
Property, improvements and equipment, net	**$ 35,044**	$ 30,679

At September 30, 2018 and 2017, the Company had assets under capitalized leases of approximately $1,928,000 and $1,928,000, respectively and related accumulated depreciation of $967,000 and $885,000, respectively.

Depreciation expense was $6,216,000 and $5,260,000 for the years ended September 30, 2018 and 2017, respectively.

4. Acquisition

In December 2017, New UMG entered into a Second Closing to acquire the remaining assets of University Medical Group ("UMG") that were not acquired in the initial acquisition in December 2014. As consideration for the acquisition, New UMG has assumed certain designated liabilities of the practice, which consists of various loans payable to subsidiaries of the Company, totaling approximately $7.5 million. Post-acquisition, these liabilities are eliminated on consolidation. There was no cash consideration related to the transaction. The remaining assets and liabilities acquired were immaterial and no value was assigned to them in the purchase price allocation, and accordingly goodwill of $7.5 million arises from the acquisition. New UMG's parent company, Prospect CharterCARE Physicians, LLC, dba CharterCARE Medical Associates ("CCMA"), entered into a Post Closing Administrative Services Agreement pursuant to which CCMA and its affiliates provide services to the seller of the practice in connection with its termination of all operations and the wind up its affairs and operations.

This acquisition was accounted for as a business combination using purchase accounting. Under the purchase accounting method, assets acquired and liabilities assumed are recorded based on their estimated fair values. As asset purchases, goodwill acquired is expected to be deductible for tax purposes.

5. Goodwill and Intangible Assets

Goodwill relates to the acquisition of UMG. The following is a roll-forward of goodwill for the years ended September 30, 2018 and 2017, respectively (in thousands):

September 30,	**2018**	2017
Balance, beginning of year	**$ -**	$ -
Acquisition	**7,452**	-
Impairment	**(7,452)**	-
Balance, end of year	**$ -**	$ -

Identifiable intangible assets are comprised of the following (in thousands):

	Amortization Period	**September 30, 2018**	September 30, 2017
Trade names	5 years	**$ 4,540**	$ 4,540
Total acquisition cost of intangible assets		**4,540**	4,540
Less accumulated amortization		**(3,887)**	(2,979)
Intangible assets, net		**$ 653**	$ 1,561

Amortization is recognized on a straight-line basis (management's best estimate of the period of economic benefit) over the respective useful lives. Amortization expense was $908,000 and $908,000 for the years ended September 30, 2018 and 2017, respectively.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

Years ended September 30,	
2019	$ 653
	$ 653

The weighted-average remaining useful life for the intangible assets was approximately 1 year as of September 30, 2018.

6. Sale of Real Estate and Sale-Leaseback

PCC previously operated Elmhurst Extended Care ("Elmhurst"), a 206 bed skilled nursing facility, and the Company owned the land and building in which Elmhurst's business was carried out. In December 2016, PCC and the Company entered into a transaction to sell the operations of Elmhurst and the land and building in which Elmhurst operated, to an unrelated third party. PCC's decision to discontinue the operations of this entity was based on the Company's strategy in its market and financial results. The transaction price was approximately $15.2 million, of which approximately $8.3 million was allocated to the land and building. After the land and building were sold, the building was then subdivided into two condominiums, one of which was deeded back to the Company. Additionally, the Company entered into a transaction to lease a portion of the other condominium back for a period of 10 years, with monthly rent of approximately $21,000. This transaction does not qualify for sale leaseback accounting because of the Company's deemed continuing involvement with the buyer-lessor, including the guarantee by PCC, which is considered a form of contingent collateral and results in the transaction being recorded under the financing method. Further, the building cannot be bifurcated, for accounting purposes, between the portion that was leased and the remainder because the transaction does not meet the definition of a minor sale-leaseback, under applicable accounting literature. PCC received and retained the cash received from the seller, and accordingly the transaction has been accounted for as a noncash distribution to PCC. In accordance with applicable accounting literature, as the Company is a wholly owned subsidiary of PCC, the value of the noncash distribution is based on the carrying value of the assets distributed at the time of sale, which was $4,545,000, and accordingly this is the value that the sale-leaseback liability has been set up at that date.

Scheduled payments under the Company's sale-leaseback liability as of September 30, 2018 are as follows (in thousands):

Years ending September 30,		
2019	$	257
2020		257
2021		257
2022		257
2023		257
Thereafter		836
		2,121
Plus: reduction in liability to be accreted to interest income		1,253
Total sale-leaseback liability	$	3,374

The total payments to be paid over the remainder of the lease are $2,121,000. The interest rate implicit in the calculation is negative 10.4%. The value of the sale-leaseback liability is based on the building that was sold, not just the part of the building that was leased back, because as noted above the transaction did not meet the definition of a minor sale-leaseback under the literature. Accordingly, the liability is greater than the sum of the future payments to be made under the lease and this gives rise to a negative interest rate.

7. Related Party Transactions

PCC and its Subsidiaries and Prospect East Hospital Advisory Services, LLC ("PEHAS"), a wholly-owned subsidiary of Prospect, entered into a Management Services Agreement ("MSA") as of June 20, 2014, under which PEHAS provides certain administrative and management services to PCC and its Subsidiaries. Management fees due to PEHAS under the MSA consist of 2% of net revenues monthly. The Company recognized management fees of $3,721,000 and $3,665,000 for the years ended September 30, 2018 and 2017, respectively, which is included within management fee expense in the accompanying statement of operations. As of September 30, 2018 and 2017, $15,478,000 and $11,758,000, respectively, due pursuant to the MSA, is included in due to affiliates, net, in the accompanying consolidated balance sheets.

The Company recognized $0 and $227,000 of rental income from Elmhurst Extended Care for the years ended September 30, 2018 and September 30, 2017 respectively, which is included in other revenues in the accompanying consolidated statements of operations.

8. Commitments and Contingencies

Leases

The Company leases various office facilities and equipment from third parties under non-cancelable operating and capital lease arrangements expiring at various dates through 2023. Capital leases bear interest at rates ranging from 5.25% to 6.0% per annum.

The future minimum annual lease payments required under leases in effect at September 30, 2018, are as follows (in thousands):

For the Years ending September 30,	Capital Leases	Operating Leases
2019	$ 334	$ 114
2020	-	96
2021	-	96
2022	-	96
2023	-	96
Total minimum lease payments	334	$ 498
Less: amounts representing interest	(8)	
	326	
Less: current portion	(326)	
	$ -	

Lease and rental expense was $1,210,000 and $1,434,000 for the years ended September 30, 2018 and 2017, respectively.

Contingent Liability for Borrowings by Prospect

The Company and its Subsidiaries are contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities as of September 30, 2018. The obligations and related interest expense related to these credit facilities are not reflected in the Company's consolidated financial statements as of September 30, 2018, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2018 and 2017, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

September 30,	**2018**	2017
Senior secured term notes (net of discount of $20,085 and $7,374)	**$ 1,094,315**	$ 609,813
Less: deferred financing costs	**(16,214)**	(9,906)
	$ 1,078,101	$ 599,907

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Original Term Loan"), the proceeds of which were used to repay $425 million of PMH's existing 8.375% senior secured notes due during 2019; to repay $60 million of borrowings under the Prospect's existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions, including the acquisition of Crozer; and to finance transaction fees and expenses. The Original Term Loan bore interest at LIBOR (subject to a 1.0% floor) plus 6.0%. The Original Term Loan was issued with an original discount of 1.5%, or $9,375,000. Additionally, the Company refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("Original ABL Facility" and together with the Original Term Loan, the "New Senior Secured Credit Facilities"). Pursuant to various amendments from August 2016 through October 2017, the aggregate commitment amount under the Original ABL facility was increased in stages to $175 million. The maturity date for the Original ABL Facility was June 30, 2021, and the maturity date for the Term Loan was June 30, 2022.

On February 22, 2018, the Company refinanced and replaced both the Original Term Loan and the Original ABL Facility, and entered into an Amended and Restated Term Loan Credit Agreement (the "Amended TL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan Chase Bank, N.A. ("JPMorgan"), as administrative agent and collateral agent. The Amended TL Agreement replaced the Original Term Loan with a new Term B-1 Loan ("Term B-1 Loan"). The principal amount of the Term B-1 Loan is $1,120 million and such loan bears interest at LIBOR (subject to a 1.0% floor) plus 5.5%, which as of September 30, 2018 was 7.625%. The Term B-1 Loan was issued with an original discount of 2% and matures on February 22, 2024.

Additionally, on February 22, 2018, Prospect entered into an Amended and Restated ABL Credit Agreement (the "Amended ABL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. The Amended ABL Agreement replaced the Original ABL Facility. Under the Amended ABL Agreement, the maximum revolving commitment is $250.0 million with ability to expand the facility to $325.0 million, and the new ABL facility (the "New ABL Facility") bears interest at a variable base rate plus an applicable spread that is based on excess availability under the New ABL Facility, as further described in the Amended ABL Agreement, which was 3.875% as of September 30, 2018. The New ABL Facility matures on February 22, 2023. As of September 30, 2018, the available balance on the new ABL facility was $41.0 million.

Other Commitments

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

Litigation

The Company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, acquisitions, or other transactions. While the Company's management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on the Company's consolidated financial position or results of operations, the litigation and other claims that the Company faces are subject to inherent uncertainties and management's view of these matters may change in the future. Should an unfavorable final outcome occur, there exists the possibility of a material adverse impact on the Company's consolidated financial position, results of operations and cash flows for the period in which the effect becomes probable and reasonably estimable.

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. 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.

The Health Insurance Portability and Accountability Act ("HIPAA") assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act ("HITECH Act") expanded upon HIPAA in a number of ways, including establishing notification requirements for certain breaches of protected health information. In addition to these federal rules, states have also developed their own standards for the privacy and security of health information as well as for reporting certain violations and breaches which in some cases are more stringent. Other federal privacy laws may also apply to certain services provided by the Company, including 42 C.F.R. Part 2, which addresses the confidentiality of substance use disorder records. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

Affordable Care Act

The Patient Protection and Affordable Care Act ("PPACA") has made significant changes to the United States health care system. The legislation impacted multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Under this legislation, 33 states have expanded their Medicaid programs to cover previously uninsured childless adults, and four additional states voted in 2018 to expand Medicaid or to elect a governor that pledged to expand Medicaid. In addition, many uninsured individuals have had the opportunity to purchase health insurance via state-based marketplaces, state-based marketplaces using a federal platform, state-partnership marketplaces or the federally-facilitated marketplace. PPACA also implemented a number of health insurance market reforms, such as allowing children to remain on their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced the number of uninsured individuals.

It is unclear what changes may be made to PPACA with the divided Congress, current presidential administration, and pending litigation over the validity of PPACA. The Administration has promulgated rules to broaden the availability of coverage options that do not comply with the full range of PPACA requirements for individual market coverage, namely Association Health Plans and Short-Term Limited-Duration Insurance. The Administration has also provided additional guidance on state PPACA waivers. These executive actions have been or may be challenged in court. In addition, the Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate penalty under PPACA, effective January 1, 2019. The individual mandate penalty was included in PPACA to address concerns that other market reforms expanding access to coverage might produce adverse selection and higher premiums. The extent to which the repeal of the individual mandate penalty will impact the uninsured rate and 2019 premiums is unclear at this juncture. On December 14, 2018, the United States District Court for the Northern District of Texas ruled that the individual mandate without the penalty is unconstitutional and that PPACA is therefore invalid in its entirety. Litigation on this issue is ongoing, with the Administration indicating it will continue implementing PPACA pending any appeals, the court ordering expedited briefing on a potential stay and certification of an interlocutory appeal, and pending litigation in the United States District Court for the District of Maryland to ensure continued implementation of PPACA. This litigation along with any future legislative changes to PPACA or other federal and state legislation could have a material impact on the operations of the Company. The Company is continuing to monitor the legislative environment and developments in pending litigation for risks and uncertainties.

Provider Contracts

Many of the Company's payer and provider contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of medical services. Such differing interpretations may not come to light until a substantial period of time has passed following contract implementation. Liabilities for claims disputes are recorded when the loss is probable and can be estimated. Any adjustments to reserves are reflected in current operations.

9. Defined Contribution Plan

Prospect previously sponsored five defined contribution plans covering substantially all employees who meet certain eligibility requirements, of which one plan was sponsored by PCC. Effective May 1, 2018, the plans covering employees at Prospect's facilities in Connecticut and Pennsylvania were merged into the plan covering employees at CharterCARE, and Prospect's two remaining plans were renamed and segregated between union and non-union employees. Under these plans, employees can contribute up to 50% of their compensation up to the IRS deferred annual maximum. The Company may make discretionary matching contributions to the Plan. The Company's contributions to the Plan were $586,000 and $0 for the years ended September 30, 2018 and 2017, respectively, and are included in Employee Benefits in the accompanying statements of operations.

10. Equity Method Investments

Roger Williams Medical Center and an unrelated third party are owners of Roger Williams Radiation Therapy ("RWRT") and Southern New England Regional Cancer Center, LLC ("SNERCC"), which provide radiation therapy services. Roger Williams accounts for these investments using the equity method of accounting.

RWMC is not liable for any obligations insured by RWRT or SNERCC nor is it obligated to make any further capital contributions or lend funds to RWRT or SNERCC. As of September 30, 2018 and 2017, the Company's investments in RWRT, SNERCC, and other minor investments under the equity method were approximately $4,063,000 and $4,052,000, respectively, and are included in equity method investments in the accompanying consolidated balance sheet. For the year ended September 30, 2018 and 2017, the Company recognized approximately $589,000 and $507,000, respectively, as its share of the financial results of RWRT, SNERCC, and other minor investments and received $578,000 and $761,000, respectively, in distributions.

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Summarized combined unaudited financial information for RWRT and SNERCC as of September 30, 2018 and September 30, 2017 is as follows (in thousands):

September 30,	**2018**	201
Cash	**$ 2,515**	$ 1,549
Receivables and other current assets	**3,756**	2,121
Total current assets	**6,271**	3,670
Property, improvements and equipment, net	**3,502**	6,104
Goodwill	**7,142**	7,142
Intangible assets	**851**	882
Other long-term assets	**1,569**	1,603
Total assets	**$ 19,335**	$ 19,401
Accounts payable and accrued liabilities	**$ 1,052**	$ 1,201
Other long-term liabilities	**420**	400
Equity	**17,863**	17,800
Total liabilities and partner's capital	**$ 19,335**	$ 19,401

For the Year Ended September 30,	**2018**	2017
Revenues	**$ 17,278**	$ 16,387
Net income	**$ 2,953**	$ 2,941
RWMC's income from equity method investments	**$ 589**	$ 507

11. Subsequent Events (Unaudited)

On March 1, 2019, Prospect entered into Amendment No. 2 to the Amended and Restated ABL Credit Agreement, by and among Prospect (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. Under this amendment, the maximum revolving commitment is increased from $250.0 million to $280.0 million, and the maximum expansion of the facility has been reduced from $325.0 million to $285.0 million. Additionally, the amendment provides for $40.0 million of a "first in first out" revolving facility, which bears interest at either 2.5% or 3.5% per annum depending on whether they are Eurodollar loans or ABR loans.

Further, on March 25, 2019, Prospect entered into Amendment No. 3 to the Amended and Restated ABL Credit Agreement, by and among Prospect (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. Under this amendment, the maximum revolving commitment is increased from $280.0 million to $285.0 million.

TAB 28B

Prospect CharterCARE SJHSRI, LLC

Financial Statements

As of and for the Years Ended
September 30, 2018 and 2017

Prospect CharterCARE SJHSRI, LLC

Financial Statements

As of and for the Years Ended September 30, 2018 and 2017

Prospect CharterCARE SJHSRI, LLC

Contents

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Independent Auditor's Report

Board of Directors
Prospect CharterCARE SJHSRI, LLC
Los Angeles, California

Report on the Financial Statements

We have audited the accompanying financial statements of Prospect CharterCARE SJHSRI, LLC (the "Company"), which comprise the balance sheets as of September 30, 2018 and 2017, and the related statements of operations, member's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of September 30, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the Company is financially dependent on its parent companies which have agreed to provide the financial support necessary for the operations of the Company. The accompanying financial statements do not reflect any adjustments or disclosures that would be required should the parent companies discontinue their financial support.

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Note 9 of the Company's calculation of its Title IV 90/10 revenue test ("Note 9 – Title IV 90/10") and Note 6 on related party transactions are required by the U.S. Department of Education and is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Note 9 – Title IV 90/10 information and Note 6 on related party transactions are fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2019 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

BDO USA, LLP

March 29, 2019

Prospect CharterCARE SJHSRI, LLC

Balance Sheets
(in thousands)

September 30,	**2018**	2017
Assets		
Current assets		
Cash and cash equivalents	**$ -**	$ -
Restricted cash	**166**	659
Patient accounts receivable, less allowance for doubtful accounts of $5,491 and $3,633	**20,224**	17,399
Other receivables	**554**	969
Due from government payers	**894**	439
Inventories	**1,889**	1,751
Prepaid expenses and other current assets	**496**	922
Total current assets	**24,223**	22,139
Property, improvements and equipment, net	**24,064**	23,152
Intangible assets, net	**517**	1,235
Other assets	**881**	576
Total assets	**$ 49,685**	$ 47,102

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Balance Sheets
(in thousands)

September 30,	**2018**	2017
Liabilities and Member's Equity		
Current liabilities		
Accrued medical claims and other healthcare costs payable	**$ 488**	$ 673
Accounts payable and other accrued liabilities	**11,438**	9,299
Accrued salaries, wages and benefits	**4,852**	4,483
Deferred revenue	**681**	971
Due to government payers	**424**	36
Due to affiliated companies, net	**5,657**	744
Current portion of capital leases	**369**	750
Total current liabilities	**23,909**	16,956
Capital leases, net of current portion	**38**	408
Deferred revenue, net of current portion	**1,514**	1,701
Asset retirement obligations	**2,092**	1,945
Other long-term liabilities	**5,771**	4,983
Total liabilities	**33,324**	25,993
Commitments, contingencies, and subsequent events		
Member's equity:		
Member's contributions	**28,535**	28,535
Accumulated deficit	**(12,174)**	(7,426)
Total member's equity	**16,361**	21,109
Total liabilities and member's equity	**$ 49,685**	$ 47,102

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Statements of Operations
(in thousands)

For the Years Ended September 30,	**2018**	2017
Revenues:		
Net patient service revenues	**$ 147,129**	$ 144,498
Provision for bad debts	**(6,096)**	(5,819)
Net patient service revenues less provision for bad debts	**141,033**	138,679
Other revenues	**1,715**	2,159
Tuition revenues	**2,155**	2,002
Total net revenues	**144,903**	142,840
Operating Expenses:		
Salaries, wages and benefits	**81,487**	80,979
Supplies	**19,662**	19,948
Taxes and licenses	**9,840**	9,355
Purchased services	**9,980**	7,476
Depreciation and amortization	**7,846**	7,248
Professional fees	**5,124**	4,075
Other	**5,374**	3,957
Management fees	**2,994**	2,981
Utilities	**1,957**	1,862
Lease and rental	**1,536**	1,577
Insurance	**1,668**	2,142
Repairs and maintenance	**1,261**	1,247
Registry	**46**	89
Total operating expenses	**148,775**	142,936
Operating income from unconsolidated equity method investments	**-**	61
Operating loss	**(3,872)**	(35)
Other (income) expense:		
Interest expense	**876**	995
Other income	**-**	(98)
Total other expense	**876**	897
Net loss	**$ (4,748)**	$ (932)

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Statements of Member's Equity
(in thousands)

	Member's Contributions	Accumulated Deficit	Total Member's Equity
Balance at October 1, 2016	$ 28,535	$ (6,494)	$ 22,041
Net loss	-	(932)	(932)
Balance at September 30, 2017	28,535	(7,426)	21,109
Net loss	-	(4,748)	(4,748)
Balance at September 30, 2018	$ 28,535	$ (12,174)	$ 16,361

See accompanying notes to financial statements.

Prospect CharterCARE SJHSRI, LLC

Statements of Cash Flows
(in thousands)

For the Years Ended September 30,	**2018**	2017
Operating activities		
Net loss	**$ (4,748)**	$ (932)
Adjustments to reconcile net loss to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	**7,846**	7,248
Provision for bad debts	**6,096**	5,819
Accretion of interest for asset retirement obligations	**156**	149
Gain on sale of property, improvements and equipment	**-**	(167)
Changes in operating assets and liabilities		
Change in restricted cash	**493**	(197)
Patient accounts receivable and other receivables	**(8,506)**	(7,045)
Due to/from government payers, net	**(67)**	(58)
Inventories	**(138)**	220
Prepaid expenses and other current assets	**426**	151
Other assets	**(305)**	7
Accrued medical claims and other healthcare costs	**(185)**	20
Accounts payable and other accrued liabilities	**2,772**	1,169
Deferred revenue	**(477)**	2,672
Net cash and cash equivalents provided by operating activities	**3,363**	9,056
Investing activities		
Purchases of property, improvements and equipment	**(7,525)**	(4,862)
Proceeds from sale of property, improvements and equipment	**-**	483
Net cash and cash equivalents used in investing activities	**(7,525)**	(4,379)
Financing activities		
Change in due to affiliated companies, net	**4,913**	(3,740)
Repayments of capital leases	**(751)**	(937)
Net cash and cash equivalents provided by (used in) financing activities	**4,162**	(4,677)
Change in cash and cash equivalents	**-**	-
Cash and cash equivalents, beginning of year	**-**	-
Cash and cash equivalents, end of year	**$ -**	$ -
Supplemental disclosure of cash flow information		
Interest paid	**$ 876**	$ 756
Schedule of non-cash investing activities		
Transfer of ARO to long-term liabilities	**$ -**	$ 2,391
Equipment acquired under capital lease	**$ -**	$ 408

See accompanying notes to financial statements.

1. Organization

Prospect CharterCARE SJHSRI, LLC ("SJHSRI" or the "Company" dba St. Joseph Health Center and our Lady of Fatima Hospital) is a wholly-owned subsidiary of Prospect CharterCARE, LLC ("PCC"). PCC is owned 85% by Prospect Medical Holdings, Inc. ("Prospect") and 15% by CharterCARE Community Board. SJHSRI operates a 359-bed acute care general hospital which provides healthcare services in North Providence, Rhode Island and surrounding communities. Additionally, SJHSRI operates the St. Joseph School of Nursing and an integrated network of primary care and specialty clinics serving an economically challenged and ethnically diverse population in Providence, Rhode Island.

Admitting physicians are primarily practitioners in the local area. The hospital has payment arrangements with Medicare, Medicaid and other third party payers, including commercial insurance carriers, health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs").

The Company is dependent on its parent companies to fund ongoing operations. As of September 30, 2018, the Company had a net liability of $5,657,000 due to Prospect and to PCC and its subsidiaries, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying balance sheets. Prospect and PCC do not intend to have the Company repay the liability in a manner which would impair the Company's ability to maintain sufficient liquidity to sustain ongoing operations.

2. Significant Accounting Policies

Basis of Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Revenues

Net Patient Service Revenues

Operating revenue consists primarily of net patient service revenues. The Company reports net patient service revenues at the estimated net realizable amounts from patients and third-party payers and others in the period in which services are rendered. The Company has agreements with third-party payers, including Medicare, Medicaid, managed care and other insurance programs that are paid at negotiated rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments, as further described below. Estimates of contractual allowances are based upon the payment terms specified in the related contractual agreements. The Company accrues for amounts that it believes may ultimately be due to or from the third-party payers. Normal estimation differences between final settlements and amounts accrued in previous years are reported as changes in estimates in the current year. Outstanding receivables, net of allowances for contractual discounts and bad debts, are included in patient accounts receivable in the accompanying balance sheets.

The following is a summary of sources of net patient service revenues (net of contractual allowances and discounts) before provision for bad debts (in thousands):

For the Years Ended September 30,	**2018**	2017
Medicare	**$ 68,242**	$ 63,629
Medicaid	**33,216**	31,842
Managed Care	**31,417**	30,132
Self-Pay/Other	**14,254**	18,895
Total	**$ 147,129**	$ 144,498

A summary of the payment arrangements with major third-party payers follows:

Medicare: Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some disabled persons with end-stage renal disease and certain other beneficiary categories. Most inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services are generally paid based on prospectively determined rates and cost-reimbursed methodologies. The Company is also reimbursed for various disproportionate share and Medicare bad debt components at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare fiscal intermediary. The Company also receives Medicare outlier payments on an ongoing basis during the year for cases that are unusually costly, and under certain circumstances these payments may be reconciled to more closely reflect the costs in excess of outlier thresholds after the submission and audit of the annual Medicare cost report. Normal estimation differences between filed settlements and amounts accrued are reflected in net patient service revenue.

Cost report settlement estimates are recorded based upon as-filed cost reports and are adjusted for tentative settlements, if any, and when a final Notice of Program Reimbursement ("NPR") is issued.

Medicaid: Medicaid is a joint federal-state funded healthcare benefit program that is administered by states to provide benefits to qualifying individuals who are unable to afford care. The Company receives reimbursements under the Medicaid program at prospectively determined rates for both inpatient and outpatient services. Similar to Medicare, cost report settlements are recorded based upon as-filed cost reports and adjusted for tentative and final settlements, if any.

SJHSRI is a participant in the State of Rhode Island's Disproportionate Share Hospital ("DSH") program, which assists hospitals that provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including SJHSRI, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. SJHSRI recognized revenue related to DSH and Upper Payment Limit ("UPL") reimbursement of $9,856,000 and $10,819,000 for the years ended September 30, 2018 and 2017, respectively. DSH and UPL payments received were $9,837,000 and $9,935,000 for the years ended September 30, 2018 and 2017, respectively. The State of Rhode Island also assesses a license fee to all hospitals in Rhode Island based on each hospital's net patient revenue. SJHSRI recorded license

fee expenses of $7,616,000 and $7,284,000, respectively, which is included within taxes and licenses expense within the accompanying statements of operations.

Managed Care: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment under these agreements is in accordance with negotiated contracted rates or at the Company's standard charges for services provided.

Self-Pay: Self-pay patients represent those patients who do not have health insurance and are not covered by some other form of third party arrangement. Such patients are evaluated, at the time of services or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, as well as the Company's indigent and charity care policy.

Laws and regulations governing the third-party payor arrangements are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Normal estimation differences between subsequent cash collections on patient accounts receivable and net patient accounts receivable estimated in the prior year are reported as adjustments to net patient service revenue in the current period.

The Company is not aware of any material claims, disputes, or unsettled matters with any payers that would affect revenues that have not been adequately provided for and disclosed in the accompanying financial statements.

Charity Care

The Company provides charity care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Company's charity care policy. This care is provided without charge or at amounts less than the Company's established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The direct and indirect costs related to this care totaled approximately $315,000 and $286,000 for the years ended September 30, 2018 and 2017, respectively. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition, the Company provides services to other medically indigent patients under various state Medicaid programs. Such programs pay amounts that are less than the cost of the services provided to the recipients. The Company has not changed its charity care or uninsured discount policies during the years ended September 30, 2018 or 2017.

Provisions for Contractual Allowances and Doubtful Accounts

Collection of receivables from third-party payers and patients is the Company's primary source of cash and is critical to its operating performance. The Company closely monitors its historical collection rates, as well as changes in applicable laws, rules and regulations and contract terms, to assure that provisions for contractual allowances are made using the most accurate information available. However, due to the complexities involved in these estimations, actual payments from payers may be materially different from the amounts management estimates and records. The Company's primary collection risks relate to uninsured patients and the portion of the bill which is the patient's responsibility, primarily co-payments and deductibles. Payments for services may also

be denied due to issues over patient eligibility for medical coverage, the Company's ability to demonstrate medical necessity for services rendered and payer authorization of hospitalization.

Accounts receivable are reduced by an allowance for doubtful accounts. Valuation of the collectability of accounts receivable and provision for bad debts is based on historical collection experience, payer mix and the age of the receivables. Management routinely reviews accounts receivable balances in conjunction with these factors and other economic conditions which might ultimately affect the collectability of the patient accounts, and makes adjustments to the Company's allowances as warranted. For receivables associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and subsequently calculates an allowance for doubtful accounts and provision for bad debts once the age of the accounts reaches a specific age category based on historical experience. For receivables associated with self-pay patients, management records a significant provision for bad debts beginning in the period services were provided based on past experience that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The allowance for doubtful accounts was 21% and 17% of gross accounts receivable as of September 30, 2018 and 2017, respectively. The decrease was due to a self-pay discount which took effect during the year ended September 30, 2018, resulting in a decrease in the bad debt allowance required as of September 30, 2018.

Legislation

All of the Company's hospital facilities are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient's ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. The Company believes that it is in compliance with EMTALA and is not aware of any pending or threatened EMTALA investigations involving allegations of potential wrongdoing that would have a material effect on the Company's financial statements.

Other Revenues

Other revenues totaled $1,715,000 and $2,159,000 for the years ended September 30, 2018 and 2017, respectively. A summary of the primary components of other revenues is as follows:

Rental Revenue: Rental revenue from operating leases is recorded based on the fixed, minimum required rents (base rents) per the lease agreements. Rental revenue from base rent is recorded on the straight-line method over the terms of the related lease agreements. The Company recorded rental revenues of $208,000 and $380,000 for the years ended September 30, 2018 and 2017, respectively.

Tuition Revenues

Tuition revenues include student fees and outside course reimbursement and are recognized ratably during the approximately 7 months of instruction provided per year. The Company recorded tuition revenues of $2,155,000 and $2,002,000 for the years ended September 30, 2018 and 2017, respectively. Amounts receivable related to tuition revenues were $67,000 and $268,000 as of September 30, 2018 and 2017, respectively, which is included within other receivables in the accompanying balance sheets. The tuition receivable is net of an allowance for uncollectible tuition of $202,000 and $226,000 as of September 30, 2018 and 2017, respectively. The receivable for tuition is included in other receivables in the accompanying balance sheets.

Property, Improvements and Equipment

Property, improvements and equipment are stated on the basis of cost or, in the case of acquisitions, at their acquisition date fair values. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, and amortization of leasehold improvements is provided using the straight-line basis over the shorter of the remaining lease period or the estimated useful lives of the leasehold improvements. Building improvements are generally depreciated over seven years, buildings are depreciated over 10 years, equipment is depreciated over three to seven years and furniture and fixtures are depreciated over five to seven years. Equipment capitalized under capital lease obligations are amortized over the lesser of the life of the lease or the useful life of the asset.

Long-Lived Assets and Amortizable Intangibles

Intangible assets include trade names. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if estimated undiscounted cash flows associated with those assets are less than their carrying amounts. Fair value is based upon the present value of the associated cash flows. Changes in circumstances (for example, changes in laws or regulations, technological advances or changes in strategies) may also reduce the useful lives from initial estimates. Changes in planned use of intangibles may result from changes in customer base, contractual agreements, or regulatory requirements. In such circumstances, management will revise the useful life of the long-lived asset and amortize the remaining net book value over the adjusted remaining useful life. There were no impairments recorded during the years ended September 30, 2018 and 2017.

Insurance Reserves

Medical Malpractice Liability Insurance

The Company carries professional and general liability insurance to cover medical malpractice claims. The General Liability coverage is occurrence coverage and the Professional Liability coverage is claims-made coverage. Under the Professional Liability policy, insurance premiums cover only those claims actually reported during the policy term. Should the Professional Liability claims-made policy not be renewed or replaced with equivalent insurance, claims related to occurrences during the policy term but reported subsequent to the policy's termination may be uninsured. The Company was included in Prospect's consolidated medical malpractice insurance policy effective June 20, 2014 (inception). Assets and liabilities related to malpractice insurance related to events prior to June 20, 2014 (inception) were not assumed by the Company.

GAAP requires that a health care organization record and disclose the estimated costs of medical malpractice claims in the period of the incident of malpractice, if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. The Company recognizes an estimated liability for incurred but not reported claims and the self-insured risks (including deductibles and potential claims in excess of policy limits) based upon an actuarial valuation of the Company's historical claims experience. The Company's gross claims liability was $3,470,000 and $2,535,000 as of September 30, 2018 and 2017, respectively, and insurance receivables were $827,000 and $522,000 as of September 30, 2018, and 2017, respectively. The gross claims liability and insurance receivables were estimated using a discount factor of 4% and are included within long-term assets and long-term liabilities, respectively, in the accompanying balance sheets.

Workers' Compensation Insurance

The Company was fully insured for workers' compensation claims with no deductible for the years ended September 30, 2018 and 2017.

Reserve Methodology

The claims reserve is based on the best data available to the Company. The estimate, however, is subject to a significant degree of inherent variability. The estimate is continually monitored and reviewed, and as the reserve is adjusted, the difference is reflected in current operations. While the ultimate amount of medical malpractice liability is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims. Management is not aware of any potential medical malpractice claims whose settlement, if any, would have a material adverse effect on the Company's financial position, results of operations or cash flows.

Employee Health Plans

The Company maintains self-insured EPO/HMO and PPO plans for all eligible employees. Employee health benefits are administered by a third party claims administrator, based on plan coverage and eligibility guidelines determined by the Company, as well as by collective bargaining agreements. Commercial insurance policies cover per occurrence losses in excess of $350,000. An actuarially estimated liability of approximately $488,000 and $673,000 for incurred but not reported claims as of September 30, 2018 and 2017, respectively.

Asset Retirement Obligations

The Company recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. Over time, the liability is accreted to its present value each period. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the statements of operations. The Company has accrued $2,092,000 and $1,945,000 related to asbestos remediation as of September 30, 2018 and 2017, respectively. The Company recorded $156,000 and $149,000 of accretion of the asset retirement obligation during the year ended September 30, 2018 and 2017, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with initial maturities of 90 days or less to be cash equivalents. Cash and cash equivalents are primarily comprised of deposits with banks. The Company maintains its cash at banks with high credit-quality ratings.

Restricted Cash

The Company held restricted cash of $166,000 and $659,000 as of September 30, 2018 and 2017, respectively, which is restricted for grants for the Company's School of Nursing.

Inventories

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

Sale-Leaseback Transactions

The Company evaluates sale-leaseback transactions by determining whether the transaction meets the qualifying criteria to be recognized as a sale-leaseback, including the transfer of risk and rewards of ownership as well as the absence of continuing involvement of the Company. When the qualifying criteria for a sale-leaseback transaction are not met, the Company accounts for the transaction as a financing.

Income Taxes

For tax reporting purposes, the Company is treated as a Partnership and is a pass-through entity. Therefore, no provision is made in the accompanying financial statements for liabilities for federal, state or local income taxes since such liabilities are the responsibility of the Company's parent companies. The Company periodically evaluates its tax positions, including its status as a pass-through entity, to evaluate whether it is more likely than not that such positions would be sustained upon examination by a tax authority for all open tax years, as defined by the statute of limitations, based on its technical merits.

As of September 30, 2018 and 2017, the Company has not established a liability for uncertain tax positions. The Company files income tax returns in the U.S. federal jurisdiction and the state of Rhode Island. Generally, the Company is subject to examination by U.S. federal (or state and local) income tax authorities for three to four years from the filing of a tax return.

Concentrations of Credit Risk

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits of $250,000 per depositor of each financial institution. The Company has not experienced any losses to date related to these balances.

Financial instruments that potentially subject the Company to concentrations of credit risk consist of receivables due from Medicare and Medicaid. The Company received revenues from Medicare and Medicaid as follows (in thousands):

	For the Year Ended September 30, 2018	% of Net Patient Services Revenues	For the Year Ended September 30, 2017	% of Net Patient Services Revenues
Medicare	$ 68,242	46%	$ 63,629	44%
Medicaid	33,216	22%	31,842	22%
Total	$ 101,458	69%	$ 95,471	66%

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities at the dates, and for the periods, that the financial statements are prepared. Actual results could materially differ from those estimates. Principal areas requiring the use of estimates include amounts due from/to government payers, allowances for contractual discounts and doubtful accounts, professional and general liability claims, employee health benefit claims, long-lived assets, intangible assets and asset retirement obligations.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which defers the effective date of the revenue standard ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, including interim periods therein. Three basic transition methods are available — full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. October 1, 2019) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. The Company is currently evaluating the effect of this guidance on its financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments (Subtopic 825-10)". ASU 2016-01 requires all equity investments to be measured at fair value with changes in fair value recognized through net income (other than those accounted for under equity method of accounting or those

that result in consolidation of the investee). ASU 2016-01 also requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, ASU 2016-01 eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. ASU 2016-01 is effective for annual and interim periods beginning after December 15, 2017. The Company is currently evaluating the standard and the impact on its financial statements and footnote disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)". The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard is effective for nonpublic entities for fiscal years beginning after December 15, 2019. The Company is currently evaluating the standard and the impact on its financial statements and footnote disclosures.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)". The updated standard addresses eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for non-public business entities for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is assessing the impact of the adoption of ASU 2016-15 on its financial statements.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." These amendments clarify the definition of a business. The amendments affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted under certain circumstances. The amendments should be applied prospectively as of the beginning of the period of adoption. The Company is evaluating the effect that this update will have on its financial statements and related disclosures.

In January 2017, the FASB issued ASU 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment)". The new guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The new guidance simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. The new guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if any. The Company early adopted this standard in the current fiscal year.

In August 2018, the FASB issued ASU 2018-15, "Intangibles – Goodwill and Other – Internal – Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract", which provides guidance on implementation costs incurred in a cloud computing arrangement that is a service contract. Specifically, it amends ASC 350 to include in its scope implementation costs of a cloud computing arrangement that is a service contracts and clarifies that a customer should apply ASC 350-40 to determine which implementation costs should be capitalized in such a cloud computing arrangement. The Company has early adopted this literature for the year ended September 30, 2018. The adoption did not have material impact to the financial statements of the Company.

Reclassifications

Certain reclassifications were made to the prior year financial statements in order to conform to the current year presentation.

Subsequent Events

The Company has evaluated subsequent events through March 29, 2019, the date the Company's financial statements were available for issuance.

3. Property, Improvements and Equipment

Property, improvements and equipment, consisted of the following (in thousands):

September 30,	**2018**	2017
Property, improvements and equipment:		
Land and land improvements	**$ 4,802**	$ 4,692
Buildings and improvements	**18,180**	16,956
Leasehold improvements	**4,048**	3,292
Equipment	**16,456**	14,817
	43,486	39,757
Less: accumulated depreciation	**(24,510)**	(17,709)
	18,976	22,048
Construction in Progress	**5,088**	1,104
Property, improvements and equipment, net	**$ 24,064**	$ 23,152

As of September 30, 2018 and 2017, the Company had assets under capitalized leases of $2,005,000 and $2,410,000, respectively, and related accumulated depreciation of $818,000 and $884,000, respectively.

Depreciation expense was $7,128,000 and $6,530,000 for the years ended September 30, 2018 and 2017, respectively.

4. Intangible Assets

Identifiable intangible assets are comprised of the following (in thousands):

	Amortization Period	**September 30, 2018**	September 30, 2017
Trade names	5 years	**$ 3,590**	$ 3,590
Total acquisition cost of intangible assets		**3,590**	3,590
Less accumulated amortization		**(3,073)**	(2,355)
Intangible assets, net		**$ 517**	$ 1,235

Amortization is recognized on a straight-line basis (management's best estimate of the period of economic benefit) over the respective useful lives. Amortization expense was $718,000 and $718,000 for the years ended September 30, 2018 and 2017, respectively.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

The weighted-average remaining useful life for the intangible assets was approximately 1 year as of September 30, 2018.

5. Sale-Leaseback Liability and Deferred Revenue

In October 2016, the Company entered into an agreement under which it granted and conveyed an exclusive easement to a water tower utilized for telecommunications purposes for a 99 year term to an unrelated third party. The agreement also assigned certain of the Company's telecommunications leases. The purchase price was approximately $2,057,000. The income derived from this transaction has been deferred and is being recognized on a straight line basis over the remaining term of the leases, through 2028.

In December 2016, the Company entered into a transaction to sell the former St. Joseph Hospital Campus for $100,000 to an unrelated third party. The purchaser has agreed to make certain required capital improvements as part of this transaction. In connection with this transaction, the Company also entered into a separate agreement to lease back a portion of the facility for 7 years, with options to renew for three 7 year periods, for an initial base rent of $80,000 per month. The lease also provides for the payment of a portion of the property taxes for the facility, consisting of $120,000 per year through 2020 and a pro rata portion of property taxes based on the Company's leased space after 2020. This transaction does not qualify for sale leaseback accounting because of the Company's deemed continuing involvement with the buyer-lessor, including the guarantee by PCC and because the term of the lease agreement is longer than the economic age of the facility. These are considered a form of contingent collateral and results in the transaction being recorded under the financing method. The sale-leaseback liability was $2,289,000 and $2,419,000 at September 30, 2018 and 2017, respectively, which consists of the purchase consideration and the transfer of the ARO balance, and is presented within other long-term liabilities in the accompanying balance sheets.

6. Related Party Transactions

PCC and its Subsidiaries and Prospect East Hospital Advisory Services, LLC ("PEHAS"), a wholly-owned subsidiary of Prospect, entered into a Management Services Agreement ("MSA") as of June 20, 2014, under which PEHAS provides certain administrative and management services to PCC and its Subsidiaries. Management fees due to PEHAS under the MSA consist of 2% of net revenues monthly. The Company recognized management fees of $2,994,000 and $2,981,000 for the years ended September 30, 2018 and 2017, respectively, which is included within management fee expense in the accompanying statements of operations. As of September 30, 2018 and 2017, $12,592,000 and $9,599,000, respectively, due pursuant to the MSA, is included in due to affiliated companies, net, in the accompanying balance sheets.

7. Commitments and Contingencies

Leases

The Company leases various office facilities and equipment from third parties under non-cancelable operating and capital lease arrangements expiring at various dates through 2022. Capital leases bear interest at rates ranging from 4% to 8% per annum.

The future minimum annual lease payments (net of anticipated sublease income) required under leases in effect at September 30, 2018, are as follows (in thousands):

For the Years ending September 30,	Capital Leases	Operating Leases
2019	$ 384	$ 338
2020	40	255
2021	-	192
2022	-	187
2023	-	187
Total minimum lease payments	424	$ 1,159
Less: amounts representing interest	(17)	
	407	
Less: current portion	(369)	
	$ 38	

Lease and rental expense was $1,536,000 and $1,577,000 for the years ended September 30, 2018 and 2017, respectively.

Contingent Liability for Borrowings by Prospect

The Company is contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities at September 30, 2018 and 2017. The obligations and related interest expense related to these credit facilities are not reflected in the Company's

financial statements as of September 30, 2018 and 2017, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2018 and 2017, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

September 30,	**2018**	2017
Senior secured term loan (net of discount of $20,085 and $7,374)	**$ 1,094,315**	$ 609,813
Less: original issue discount, net	**(16,214)**	(9,906)
	$ 1,078,101	$ 599,907

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Original Term Loan"), the proceeds of which were used to repay $425 million of PMH's existing 8.375% senior secured notes due during 2019; to repay $60 million of borrowings under the Prospect's existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions, including the acquisition of Crozer; and to finance transaction fees and expenses. The Original Term Loan bore interest at LIBOR (subject to a 1.0% floor) plus 6.0%. The Original Term Loan was issued with an original discount of 1.5%, or $9,375,000. Additionally, the Company refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("Original ABL Facility" and together with the Original Term Loan, the "New Senior Secured Credit Facilities"). Pursuant to various amendments from August 2016 through October 2017, the aggregate commitment amount under the Original ABL facility was increased in stages to $175 million. The maturity date for the Original ABL Facility was June 30, 2021, and the maturity date for the Term Loan was June 30, 2022.

On February 22, 2018, Prospect refinanced and replaced both the Original Term Loan and the Original ABL Facility, and entered into an Amended and Restated Term Loan Credit Agreement (the "Amended TL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan Chase Bank, N.A. ("JPMorgan"), as administrative agent and collateral agent. The Amended TL Agreement replaced the Original Term Loan with a new Term B-1 Loan ("Term B-1 Loan"). The principal amount of the Term B-1 Loan is $1,120.0 million and such loan bears interest at LIBOR (subject to a 1.0% floor) plus 5.5%, which as of September 30, 2018 was 7.625%. The Term B-1 Loan was issued with an original discount of 2% and matures on February 22, 2024.

Additionally, on February 22, 2018, Prospect entered into an Amended and Restated ABL Credit Agreement (the "Amended ABL Agreement"), by and among the Company (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. The Amended ABL Agreement replaced the Original ABL Facility. Under the Amended ABL Agreement, the maximum revolving commitment is $250.0 million with ability to expand the facility to $325.0 million, and the new ABL facility (the "New ABL Facility") bears interest at a variable base rate plus an applicable spread that is based on excess availability under the New ABL Facility, as further described in the Amended ABL Agreement, which was 3.875% as of September 30, 2018. The New ABL Facility matures on February 22, 2023. As of September 30, 2018, the available balance on the new ABL facility was $41.0 million. The Company was in compliance with all of its debt covenants at September 30, 2018 or obtained a waiver. The next assessment for financial statement compliance is March 31, 2019.

Letter of Credit

As of September 30, 2018, Prospect secured an irrevocable letter of credit for $733,000 on behalf of the Company for its School of Nursing ("School") as required by the U.S. Department of Education. The purpose of the letter of credit is to (i) pay refunds of charges owed on behalf of current or former students, whether or not the School remains open; (ii) to provide for the "teach-out" of currently enrolled students if the School closes; and (iii) to pay any liabilities owed to the U.S. Department of Education.

Other Commitments

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. 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.

The Health Insurance Portability and Accountability Act ("HIPAA") assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act ("HITECH Act") expanded upon HIPAA in a number of ways, including establishing notification requirements for certain breaches of protected health information. In addition to these federal rules, states have also developed their own standards for the privacy and security of health information as well as for reporting certain violations and breaches (for example, California's Confidentiality of Medical Information Act and Lanterman-Petris Short Act) which in some cases are more stringent. Other federal privacy laws may also apply to certain services provided by the Company, including 42 C.F.R. Part 2, which addresses the confidentiality of substance use disorder records. The Company may be subject to significant fines and penalties if found not to be compliant with these state or federal provisions.

Affordable Care Act

The Patient Protection and Affordable Care Act ("PPACA") has made significant changes to the United States health care system. The legislation impacted multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Under this legislation, 33 states have expanded their Medicaid programs to cover

previously uninsured childless adults, and four additional states voted in 2018 to expand Medicaid or to elect a governor that pledged to expand Medicaid. In addition, many uninsured individuals have had the opportunity to purchase health insurance via state-based marketplaces, state-based marketplaces using a federal platform, state-partnership marketplaces or the federally-facilitated marketplace. PPACA also implemented a number of health insurance market reforms, such as allowing children to remain on their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced the number of uninsured individuals.

It is unclear what changes may be made to PPACA with the divided Congress, current presidential administration, and pending litigation over the validity of PPACA. The Administration has promulgated rules to broaden the availability of coverage options that do not comply with the full range of PPACA requirements for individual market coverage, namely Association Health Plans and Short-Term Limited-Duration Insurance. The Administration has also provided additional guidance on state PPACA waivers. These executive actions have been or may be challenged in court. In addition, the Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate penalty under PPACA, effective January 1, 2019. The individual mandate penalty was included in PPACA to address concerns that other market reforms expanding access to coverage might produce adverse selection and higher premiums. The extent to which the repeal of the individual mandate penalty will impact the uninsured rate and 2019 premiums is unclear at this juncture. On December 14, 2018, the United States District Court for the Northern District of Texas ruled that the individual mandate without the penalty is unconstitutional and that PPACA is therefore invalid in its entirety. Litigation on this issue is ongoing, with the Administration indicating it will continue implementing PPACA pending any appeals, the court ordering expedited briefing on a potential stay and certification of an interlocutory appeal, and pending litigation in the United States District Court for the District of Maryland to ensure continued implementation of PPACA. This litigation along with any future legislative changes to PPACA or other federal and state legislation could have a material impact on the operations of the Company. The Company is continuing to monitor the legislative environment and developments in pending litigation for risks and uncertainties.

Collective Bargaining Agreements

The Company has 316 employees that are subject to a collective bargaining agreement with United Nurses and Allied Professionals ("UNAP"), which was effective beginning September 2016 and expires July 2019. During April 2015, a hospital unit consisting of approximately 400 service employees of Fatima elected to be represented by UNAP. The parties entered into a new collective bargaining agreement which expired in October 2018 and is currently in the process of renegotiations. A small number of employees are subject to a collective bargaining agreement with the Federation of Nurses and Health Professionals ("FNHP"), which expires on July 30, 2021.

Provider Contracts

Many of the Company's payer and provider contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of medical services. Such differing interpretations may not come to light until a substantial period of time has passed following contract implementation. Liabilities for claims disputes are recorded when the loss is probable and can be estimated. Any adjustments to reserves are reflected in current operations.

8. Defined Contribution Plan

Prospect previously sponsored five defined contribution plans covering substantially all employees who meet certain eligibility requirements, of which one plan was sponsored by PCC. Effective May 1, 2018, the plans covering employees at Prospect's facilities in Connecticut and Pennsylvania were merged into the plan covering employees at CharterCARE, and Prospect's two remaining plans were renamed and segregated between union and non-union employees. Under these plans, employees can contribute up to 50% of their compensation up to the IRS deferred annual maximum. The Company may make discretionary matching contributions to the Plan. The Company's contributions to the Plan were $1,096,000 and $1,101,000 for the years ended September 30, 2018 and 2017, respectively, and are included in Employee Benefits in the accompanying statements of operations.

9. Regulatory

General

The Company participates in Student Financial Aid ("SFA") under the Federal Title IV programs administered by the Department of Education ("ED") pursuant to the Higher Education Act of 1965, as amended ("HEA"). The Company must comply with the regulations promulgated under HEA.

Financial Responsibility

All institutions participating in the Title IV Programs must satisfy specific standards of financial responsibility as promulgated by the ED. The ED evaluates institutions for compliance with these standards each year, based on the institution's annual audited financial statements. Compliance with the financial responsibility standards are determined through the calculation of a composite score based upon certain financial ratios as defined in the regulations. Institutions receiving a composite score of 1.5 or greater are considered fully financially responsible. Institutions receiving a composite score between 1.0 and 1.4 are subject to additional monitoring and institutions receiving a composite score below 1.0 are required to submit financial guarantees in order to continue participation in the Title IV programs. As of September 30, 2018, and for the year then ended, the Company's composite score was .9.

Compliance with 90/10 Cash Basis Revenue Regulations

The Company derives a portion of its tuition revenues from SFA received by its students under the Title IV programs administered by the ED pursuant to the HEA. To continue to participate in the SFA programs the Company must comply with the regulations promulgated under HEA. The regulations restrict the proportion of cash receipts for tuition and fees from eligible programs to not more than 90 percent from the Title IV programs. In July 2008, modifications to the regulations were made with respect to amounts to be included in the 90 percent calculations including temporary provisions related to certain Title IV funds received and institutional loans made to students. The modifications also allow for the inclusion of funds received for certain qualifying non-Title IV programs. In addition, the modifications included provisions for institutions that do not comply with the 90 percent rule for a single fiscal year, whereby such institutions would be placed on provisional certification status for a period of two years. Institutions that do not comply with the 90 percent rule for two consecutive fiscal years are subject to the loss of their ability to participate in the SFA programs.

In October 2009, HEA amended the regulations with respect to the disclosure requirements to the 90 percent calculations and allowed institutions to implement the new and amended provisions. The amended provisions require an institution to disclose the dollar amount of the numerator and denominator of its 90 percent calculation as well as the individual revenue amounts by fund source received by the institution.

For the years ended September 30, 2018 and 2017, the Company's 90/10 cash basis revenue test percentages were computed as follows:

(in thousands)	**2018**	2017
Revenue by Source		
Student Title IV cash basis revenue		
Subsidized loan	**$ 344**	$ 474
Unsubsidized loan	**579**	696
Plus loan	**55**	50
Federal Pell grant	**207**	245
	$ 1,185	$ 1,465
Student Non-Title IV revenue		
Funds provided from private loans	**$ 147**	$ 182
State loans	**148**	193
Scholarships	**23**	47
Student payments	**454**	400
	$ 772	$ 822
Student Title IV cash basis revenue	**$ 1,185**	$ 1,465
Student title IV cash basis revenue + Student Non-Title IV cash basis revenue	**$ 1,957**	$ 2,287
	61%	64%

Student Default Rate

For each fiscal year, the ED calculates a rate of student defaults for each educational institution which is known as a "cohort default rate." An institution may lose its eligibility to participate in some or all Title IV programs if, for each of the three most recent federal fiscal years for which information is available, 30% or more of its students who became subject to a repayment obligation in that federal fiscal year defaulted on such obligation by the end of the following federal fiscal year. In addition, an institution may lose its eligibility to participate in some or all Title IV programs if its cohort default rate exceeds 40% in the most recent federal fiscal year for which default rates have been calculated by the ED. The Company's 3-Year cohort default rate for the 2018 federal fiscal year was 0.0%. Federal fiscal year 2018 is the most recent year for which this information is available.

10. Subsequent Event (unaudited)

On March 1, 2019, Prospect entered into Amendment No. 2 to the Amended and Restated ABL Credit Agreement, by and among Prospect (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. Under this amendment, the maximum revolving commitment is increased from $250.0 million to $280.0 million, and the maximum expansion of the facility has been reduced from $325.0 million to $285.0 million. Additionally, the amendment provides for $40.0 million of a "first in first out" revolving facility, which bears interest at either 2.5% or 3.5% per annum depending on whether they are Eurodollar loans or ABR loans.

Further, on March 25, 2019, Prospect entered into Amendment No. 3 to the Amended and Restated ABL Credit Agreement, by and among Prospect (as the borrower), the lenders party thereto and JPMorgan, as administrative agent and collateral agent. Under this amendment, the maximum revolving commitment is increased from $280.0 million to $285.0 million.

Supplemental Report and Schedule

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Directors
Prospect CharterCARE SJHSRI, LLC
Los Angeles, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Prospect CharterCARE SJHSRI, LLC (the "Company"), which comprise the balance sheet as of September 30, 2018, and the related statements of operations, member's equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 29, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Company's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses (*2018-001, 2018-002, and 2018-003*).

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Company's Response to Findings

The Company's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Company's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BDO USA, LLP

March 29, 2019

Prospect CharterCARE SJHSRI, LLC

Schedule of Findings and Disposition of Prior Year Findings

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unmodified			
Internal control over financial reporting:				
Material weaknesses identified?	X	yes		no
Significant deficiencies identified that are not considered to be material weaknesses?		yes	X	none reported
Noncompliance material to financial statements noted?		yes	X	no

Section II - Financial Statement Findings

Finding 2018-001

Condition

The Company has a material weakness in internal controls over financial reporting. The Company's control environment has not been maintained in a way to appropriately and positively influence the effectiveness of the organization's internal control. Accordingly, this material weakness is a causal factor that allowed for greater opportunity for management to override existing internal controls.

Cause

The Company did not maintain an executive and managerial tone that supported an effective internal control environment. This impacted the operating effectiveness of the Company's independent reviews, approval and authorizations, and other internal controls designed to prevent or detect material misstatements over financial reporting.

Effect

As a result of this material weakness, transfers from restricted accounts were made without sufficient reconciliation and were not subject to an appropriate level of independent review, approval, and authorization prior to being executed.

Recommendation

The Company should review its policies and procedures over cash management and treasury as well as the adequacy of its internal resources.

Views of Responsible Officials

Management acknowledges the comment and has taken the following steps to resolve: (a) implementation of the appropriate reconciliation process; and (b) the Company has separated the Treasury function from the Chief Financial Officer's role and that function now reports directly to

the CEO. Additionally those that have access to the bank accounts are aware that transfers cannot be made from restricted accounts and the Treasurer is responsible for monitoring this.

Disposition of Prior Year Findings

Finding 2017-001

Condition

The Company has a material weakness in internal controls over financial reporting. There were certain, material additional post-closing adjustments identified as a result of our audit procedures, which were not identified by the Company's internal control over the financial statement close process.

Status

Management believes that this finding has been resolved.