Catholic Health Initiatives

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Quarterly Report

Dated as of March 31, 2014

Quarterly Report Concerning Catholic Health Initiatives and the CHI Reporting Group

As of March 31, 2014 and for the nine months ended March 31, 2014 and 2013

This Quarterly Report should be reviewed in conjunction with the information contained in the Annual Report dated November 27, 2013 (the *"Annual Report"*), which can be found on emma.msrb.org.

Certain of the discussions included in this Quarterly Report may include forward-looking statements. Such statements are generally identifiable by the terminology used such as *"believes," "anticipates," "intends," "scheduled," "plans," "expects," "estimates," "budget"* or other similar words. Such forward-looking statements are primarily included in *PART II* and *PART III*. These statements reflect the current views of CHI management with respect to future events based on certain assumptions, and are subject to risks and uncertainties. The Corporation undertakes no obligation to publicly update or review any forward-looking statement as a result of new information or future events.

This information contained herein has been obtained from Catholic Health Initiatives and Bethesda Hospital, Inc.

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Introduction

This Quarterly Report contains information concerning Catholic Health Initiatives, a Colorado nonprofit corporation (the *"Corporation"*), and the members of a CHI Credit Group described in more detail below. The Corporation is the parent corporation of a group of nonprofit and for profit corporations and other organizations that own and operate health care facilities and provide health care-related services in 18 states. The Corporation provides leadership and management functions for its affiliates and subsidiaries and has no material revenue producing assets of its own, other than cash and investments.

References to *"CHI"* in this Quarterly Report are to the Corporation and all of the affiliates and subsidiaries consolidated with it pursuant to generally accepted accounting principles (*"GAAP"*). References to the Corporation are references only to the parent corporation, and should not be read to include any of the Corporation's affiliates and subsidiaries.

PART I
CHI Credit Group Members

The Corporation has formed a combined financing group (the *"CHI Credit Group"*) that consists of an *"Obligated Group," "Participants"* and *"Designated Affiliates"* under a Capital Obligation Document. Only the Obligated Group is liable for payment to holders of Obligations issued under the Capital Obligation Document. Currently, the Corporation is the sole member of the Obligated Group and has no current plans to change the composition of the Obligated Group.

All entities that are consolidated with the Corporation under GAAP are *"Participants"* under the Capital Obligation Document. Participants are not parties to the Capital Obligation Document and holders of Obligations issued under the Capital Obligation Document have no recourse to the Participants or their property. *"Designated Affiliates"* are defined in the Capital Obligation Document as entities that have agreed (pursuant to agreements with the Corporation described in greater detail under Part V, Section B of the Annual Report) to comply with the provisions of the Capital Obligation Document, subject to any limitations that may be set forth in those agreements, and are enforceable solely by the Corporation. Holders of the Obligations have no recourse to the Designated Affiliates or their property. Currently, Bethesda Hospital, Inc. (*"Bethesda"*) is the sole Designated Affiliate.

Effective June 1, 2013, CHI became the sole member of the St. Luke's Episcopal Health System Corporation (now known as St. Luke's Health System), which is headquartered in Houston, Texas (*"SLHS"*). SLHS directly or indirectly owns or controls health care facilities located within the greater Houston area, which include six acute care facilities and multiple clinic facilities (collectively, *"CHI St. Luke's"*). Given its recent acquisition and size relative to the CHI Reporting Group, Part III of this Quarterly Report includes certain combined pro forma financial information of the CHI Reporting Group and CHI St. Luke's.

With the exception of certain Participants, the members of the CHI Credit Group are exempt from federal income taxation under Section 501(a) of the Internal Revenue Code.

PART II
Catholic Health Initiatives

CHI is a faith-based system operating in 18 states and includes 88 acute-care hospitals (of which 23 are designated as critical access hospitals and four of which constitute academic medical teaching centers); two community health service organizations; two accredited nursing colleges; home health agencies; and several other sites including long-term care, assisted living and residential facilities. CHI is one of the largest catholic health care systems in the nation with over $21 billion in total assets and annual total operating revenues over $12 billion as of June 30, 2013.

The table below sets forth certain total operating revenues and total operating EBIDA before restructuring, impairment and other losses (total income (loss) from operations before restructuring, impairment and other losses, plus depreciation, amortization and interest) for the Regions that represent, in aggregate, 98% of total combined operating revenues of CHI and CHI St. Luke's (unaudited) on a pro forma basis for the nine months ended March 31, 2013 and 97% for the nine months ended March 31, 2014.

Region	Pro Forma Operating Revenue as of the Nine Months ended March 31, 2013(%)[1]	Operating Revenue as of the Nine Months ended March 31, 2014(%)[2]	Pro Forma Total Operating EBIDA before restructuring impairment & other losses for the Nine Months ended March 31, 2013($ in thousands)[1]	Total Operating EBIDA before restructuring impairment & other losses for the Nine Months ended March 31, 2014($ in thousands)[2]
Kentucky	16	16	18,564	(24,400)
Nebraska	15	15	164,150	161,654
Pacific Northwest[3]	13	18	109,290	362,649
Colorado	14	13	124,963	140,979
Texas	10	9	109,209	70,547
Ohio	8	7	56,118	57,083
Iowa	8	7	32,439	31,406
Tennessee Region	5	4	30,029	32,490
Arkansas Region	4	3	(6,095)	(735)
Fargo	3	3	19,221	14,798
Pennsylvania Region	2	2	12,562	6,834

(1) Assumes for purposes of this table, that the affiliation with CHI St. Luke's had been in place for the nine month period ended March 31, 2013. The financial results of other entities that became affiliated with CHI during the fiscal year ended June 30, 2013 are not included in this combined pro forma financial information.

(2) The financial results of Harrison Medical Center are included from August 1, 2013 through March 31, 2014.

(3) The operating results of the Pacific Northwest region include a one-time contribution gain of $286.2 million reported in operating revenues as a result of the Harrison affiliation.

A. STRATEGIC ACQUISITIONS, AFFILIATIONS AND DIVESTITURES

CHI actively engages in ongoing monitoring and evaluation of potential facility expansion, mergers, acquisitions, divestitures and affiliation opportunities consistent with its strategic goals. CHI's strategic capabilities and growth initiatives are focused, in part, on creating, maintaining and/or strengthening its clinically integrated networks in key existing markets and, to the extent consistent with its growth strategy, new markets, including the transactions described below. Certain strategic acquisitions and affiliations completed within the current or preceding fiscal year, as well as certain proposed transactions, are described below. Also described in this Section A are certain pending divestitures.

I. CERTAIN STRATEGIC ACQUISITIONS AND AFFILIATIONS COMPLETED IN CURRENT OR PRECEDING FISCAL YEAR

Memorial East (Texas). On May 31, 2014, the Corporation and Memorial Health System of East Texas (*"Memorial East Texas"*) completed an affiliation transaction pursuant to which the Corporation became the sole corporate member of Memorial East Texas. Memorial East Texas owns and operates Memorial Medical Center-Lufkin, a 271 licensed bed hospital located in Lufkin, Texas, Memorial Medical Center-Livingston, a 66 licensed bed hospital located in Livingston, Texas, and Memorial Specialty Hospital, a long-term acute care hospital and leases Memorial Medical Center - San Augustine, a critical care access hospital located in San Augustine, Texas. As of and for the year ended December 31, 2013, Memorial East Texas reported approximately $243 million of total assets, $188.5 million in total unrestricted revenues, gains and other support and $106 million in outstanding long term debt (exclusive of the current maturities) as well as interest rate swap agreements with a fair value of ($5.7 million) (the *"Memorial East Texas Obligations"*). Neither the Corporation nor any of the Participants assumed the liability for or otherwise guaranteed the Memorial East Texas Obligations as part of the transaction.

QualChoice Holdings, Inc. Effective May 1, 2014, a subsidiary of the Corporation purchased all of the outstanding capital stock (both common and preferred) of QualChoice Holdings, Inc. (*"Holdings"*). Holdings, through its wholly-owned subsidiaries, QCA Health Plan, Inc. (*"QCA"*) and QualChoice Life & Health Insurance Company (*"QCLHIC"*), is an operating Arkansas commercial health insurance company with its own claims processing capabilities. QCA and QCLHIC currently offer a wide range of insurance products and services. Products include individual and family health insurance, both in and outside the Arkansas marketplace, as well as Medicare Supplement Insurance. Services include pharmacy benefit management, FSA/HRA administration and COBRA administration.

Mercy Hot Springs (Arkansas). Effective April 1, 2014, St. Vincent Infirmary Medical Center d/b/a St. Vincent Health System (*"St. Vincent"*) became the sole corporate member of Mercy Health Hot Springs Communities (*"MHHSC"*), which is the sole corporate member of Mercy Clinic Hot Springs Communities and Mercy Hospital Hot Springs (*"MHHS"*). MHHS owns and operates Mercy Hospital Hot Springs, a 309 licensed bed hospital located in Hot Springs, Arkansas. Neither MHHSC nor MHHS had any material long-term debt outstanding on the effective date of this transaction.

Harrison (Washington). Effective August 1, 2013, Franciscan Health Ventures, an affiliate of Franciscan Health System (*"FHS"*), assumed control of Harrison Medical Center (*"Harrison"*). Harrison owns and operates 297 licensed beds (260 available beds) within two acute care facilities. The facilities are located in Bremerton, Washington and in unincorporated Silverdale, Washington. Harrison also owns and operates two urgent care/primary care clinics as well as specialty clinics. No consideration was transferred for the transaction.

Joint Venture with Baylor College of Medicine (Texas). Effective January 1, 2014, SLHS and St. Luke's Medical Center (*"SLMC"*), a Texas nonprofit corporation, entered into a joint venture agreement and related agreements (collectively, the *"BCM Agreements"*) with Baylor College of Medicine, a Texas nonprofit corporation (*"BCM"*), to open a new, acute-care, open-staff hospital on BCM's McNair Campus in the central area of the Texas Medical Center, which is currently home to two outpatient facilities owned by BCM - the Baylor College of Medicine Medical Center and the Lee and Joe Jamal Specialty Care Center, and to provide for a 25-year academic affiliation between BCM and SLMC (collectively, the *"BCM Transaction"*). As a result of the transaction, BCM and SLHS became co-members of SLMC, with membership percentages of 35% and 65%, respectively. Through SLMC, BCM and SLHS will jointly operate the new hospital, which will eventually replace the current SLHS hospital in the Texas Medical Center. As contemplated in the BCM Agreements, BCM and SLHS are working to form a new joint venture by June 30, 2014, which joint venture will serve as a vehicle for efforts by BCM and SLHS to create a healthcare network in the Houston region.

St. Luke's Health System (Texas). Effective June 1, 2013, the Corporation assumed control of SLHS, which is headquartered in Houston, Texas. SLHS directly or indirectly owns or controls six acute care facilities operating in the greater Houston area, including St. Luke's Hospital in the Texas Medical Center, its 850 bed flagship hospital and five other acute care facilities: St. Luke's Sugar Land Hospital; St. Luke's Lakeside Hospital; St. Luke's Patients Medical Center; and St. Luke's Hospital at The Vintage. SLHS is affiliated with several nursing schools as well as Baylor College of Medicine, Texas Heart® Institute, Kelsey-Seybold Clinic, Texas Children's Hospital and MD Anderson Cancer Center.

As part of the transfer, the Corporation agreed to contribute $1 billion in cash and to issue a $260 million promissory note, payable over seven years, to the Episcopal Health Foundation, a newly created foundation controlled by the Episcopal Diocese of Texas. The Episcopal Health Foundation will focus on the promotion of human health, advances in medical science, improvements in community health services, and other healthcare-related activities within the 57 Texas counties that comprise the Episcopal Diocese of Texas. In addition to the contribution, the Corporation has made various post-closing commitments, including, subject to certain conditions, the expenditure of an additional $1 billion for future investments in the SLHS' properties over a 7-year period.

Highline Medical Center (Washington). Effective April 1, 2013, FHS assumed control of Highline Medical Center, which is located in Burien, Washington (*"Highline"*). Highline owns and operates a 154-bed acute care hospital and more than 20 clinics in the State of Washington.

Soundpath Health (Washington). Effective March 1, 2013, an affiliate of the Corporation purchased a majority interest in Soundpath Health, Inc. (*"Soundpath"*), which is a physician-owned health care plan headquartered in Washington. There are over 6,500 providers in the Soundpath network, which will now be managed and operated by a CHI affiliate. In addition, Soundpath provides Medicare Advantage plans to over 17,000 members in nine counties in the state of Washington.

University Medical Center (Kentucky). On March 1, 2013, KentuckyOne Health and University Medical Center (*"UMC"*) and the University of Louisville (the *"University"*) completed a joint operating agreement (the *"Kentucky JOA"*). The Kentucky JOA has a term of 20 years, whereby KentuckyOne Health controls substantially all of UMCs operations, which consist of the University of Louisville Hospital and James Graham Brown Cancer Center (ULH), a 404-licensed bed facility and the primary adult teaching hospital for the University's school of medicine. Operations under the Kentucky JOA include the operations of KentuckyOne Health and ULH; the annual operating income and losses from the combined operations will be allocated ninety percent (90%) to KentuckyOne Health and ten percent (10%) to ULH. KentuckyOne Health has agreed to provide capital investments in ULH of approximately $117 million over the first five years of the Kentucky JOA. On June 3, 2013, the Corporation loaned $39 million to ULH, the proceeds of which were used to retire certain outstanding long term debt of UMC on June 3, 2013.

II. PROPOSED STRATEGIC ACQUISITIONS AND AFFILIATIONS

Certain proposed strategic acquisitions and affiliation discussions are ongoing and are described below. In each case, unless otherwise noted, these proposed affiliation transactions are subject to the satisfactory completion of due diligence by the Corporation and the other parties to such affiliations, completion of a mutually agreeable definitive agreement, and the receipt of a variety of regulatory, governance, third party and canonical approvals. CHI can give no assurance that the proposed affiliations described below will be consummated. If these transactions are consummated, CHI may invest a total of up to $445 million in additional capital in these markets over a ten year period.

St. Alexius (North Dakota). In February 2014, the Corporation and St. Alexius Medical Center (*"St. Alexius"*), executed a non-binding letter of intent to summarize the principal terms of a proposed affiliation being considered by St. Alexius and the Corporation pursuant to which CHI would become the sole corporate member of St. Alexius. The stated goal of the proposed affiliation is to enhance the health of the communities served by St. Alexius and CHI's North Dakota Affiliates, and to strengthen and enhance the Catholic health care ministry serving central and western North Dakota. The parties are working toward completion of this transaction by fall 2014.

Sylvania Franciscan Health (Kentucky, Ohio, Texas). In May 2014, the Corporation and Sylvania Franciscan Health (*"SFH"*), headquartered in Toledo, Ohio, executed a non-binding letter of intent for SFH to join CHI. The two health care systems are working to negotiate the terms of the affiliation agreement with the expectation of reaching a final agreement by fall 2014. The parties presently expect that the Corporation would become the sole sponsor of SFH, which includes Franciscan Living Communities in Kentucky and Ohio; St. Joseph Health System in the Brazos Valley region of Texas; and the Trinity Health System Region joint venture in Eastern Ohio. In this potential transaction, the Sisters of St. Francis of Sylvania, Ohio, would continue to sponsor their other health and human services ministries as well as their education ministry, Lourdes University. In addition, the parties expect that the Sisters of St. Francis of Sylvania, Ohio would become the 13th participating congregation of CHI.

III. PENDING DIVESTITURES

St. Clare's Health System (New Jersey) In May 2013, the Corporation entered into an agreement with Prime Healthcare Services – Saint Clare's, LLC to sell the assets of Saint Clare's Health System. The transaction is expected to close by the end of fiscal year 2014, subject to customary closing conditions, including required regulatory approvals. The parties can give no assurance that the transaction will occur as proposed in the agreement. The results of operations associated with these MBOs have been reported as discontinued operations and are included in the consolidated statements of changes in net assets. Related to these discontinued operations, CHI recorded a deficiency of revenues over expenses of $(18.9) million and $(6.6) million for the nine months ended March 31, 2014 and 2013 respectively, which is reported as discontinued operations in its consolidated statements and changes in net assets.

PART III
Selected Financial Information

The Corporation's reporting obligations under the Capital Obligation Document are limited to the *"CHI Reporting Group,"* which must include the Corporation, the Participants and any Designated Affiliates whose total revenues exceed 5% of the total revenues of the CHI Credit Group. The Corporation may also choose to include any other Designated Affiliate in the financial statements of the CHI Reporting Group. Currently, the CHI Reporting Group and the CHI Credit Group consist of the same entities.

The selected financial data that follows has been prepared by management based on CHI's audited financial statements as of June 30, 2013 and unaudited financial statements for the nine months ended March 31, 2014 and 2013. The CHI Reporting Group financial information should be read in conjunction with the audited financial statements, related notes, and other financial information of CHI included in the Appendix A of this Quarterly Report.

This Part III also includes the combined pro forma financial information of the CHI Reporting Group and CHI St. Luke's as of and for the nine month period ended March 31, 2013, which is derived from the unaudited financial statements of the CHI Reporting Group for the nine month period ended March 31, 2013 and the unaudited nine-month financial statements of CHI St. Luke's for the period ended March 31, 2013.

At March 30, 2014, CHI had a 70% interest in Centura Health (Colorado) and 50% interests in TriHealth, Inc. (Ohio) and Mercy (Iowa). These JOA interests are included in investments in unconsolidated organizations. The results of operations of the services and/or facilities owned by CHI and operated pursuant to JOAs are included in the consolidated financial statements of CHI. Income-share arrangements with the JOAs are included in the respective operating or nonoperating revenue sections of the statements of operations consistent with CHI's revenue recognition policies. Certain joint venture agreements are not consolidated subsidiaries of the Corporation or the members of the CHI Credit Group. The results of those operations are reflected in the consolidated financial statements of CHI under the line item *"Changes in equity of unconsolidated organizations."*

A. SELECTED FINANCIAL DATA OF THE CHI REPORTING GROUP

The following table presents unaudited condensed combined statements of operations of the CHI Reporting Group for the nine months ended March 31, 2014[1] and 2013 and the CHI Reporting Group and CHI St. Luke's (unaudited) on a pro forma basis for the nine months ended March 31, 2013[2].

Unaudited (000s)	Statements of Operations Nine Months Ended March 31, 2014	2013	2013 Pro Forma
Revenues:			
Net patient services revenues before provision for doubtful accounts	$10,342,997	$8,406,327	$9,343,026
Provision for doubtful accounts	(814,006)	(640,832)	(696,847)
Net patient services revenues	9,528,991	7,765,495	8,646,179
Investment income used for operations	71,850	72,946	72,946
Other	959,274	447,868	490,619
Total operating revenues	10,560,115	8,286,309	9,209,744
Expenses:			
Salaries, wages and employee benefits	5,068,254	4,197,752	4,622,572
Supplies	1,810,088	1,430,778	1,621,041
Depreciation and amortization	524,528	431,520	497,841
Interest	174,614	118,451	137,525
Other	2,850,966	2,066,588	2,265,731
Total operating expenses before restructuring, impairment and other losses	10,428,450	8,245,089	9,144,710
Income from operations before restructuring, impairment and other losses	131,665	41,220	65,034
Restructuring, impairment and other losses	49,803	45,105	45,105
Income (losses) from operations	81,862	(3,885)	19,929
Nonoperating gains (losses):			
Investment income, net	597,397	564,431	634,675
Loss on defeasance of bonds	(10,018)	(17,998)	(17,998)
Realized and unrealized gains (losses) on interest rate swaps	(7,517)	10,717	40,044
Other nonoperating gains (losses)	5,883	3,268	3,268
Total nonoperating gains (losses)	585,745	560,408	659,989
Excess of revenues over expenses	667,607	556,523	679,918
Excess (deficit) of revenues over expenses attributable to noncontrolling interests	1,978	7,336	(1,452)
Excess of revenues over expenses attributable to CHI Reporting Group	$665,629	$549,187	$681,370

(1) The financial results of Harrison are included from the effective date of its acquisition (August 1, 2013) through the end of the nine month period ended March 31, 2014.

(2) The pro forma financial results of Highline Medical Center and the University of Louisville Hospital are not included in the combined pro forma financial information of the CHI Reporting Group and the St. Luke's System as of and for the nine month period ended March 31, 2014.

The following table provides unaudited condensed combined balance sheets for the CHI Reporting Group as of March 31, 2014 and June 30, 2013.

Unaudited (000s)	**Balance Sheets** March 31, 2014	June 30, 2013
Assets:		
Current assets:		
Cash and equivalents	$502,864	$614,476
Patient accounts receivable, net	2,028,614	1,793,924
Assets held for sale	207,627	215,777
Other current assets	857,625	649,634
Total current assets	3,596,730	3,273,811
Investments and assets limited as to use:		
Internally designated	6,524,986	6,291,760
Held by trustees, held for insurance purposes, and restricted by donors	1,284,985	1,134,949
Total investments and assets limited as to use	7,809,971	7,426,709
Property and equipment, net	8,778,820	8,018,488
Other assets	1,564,049	1,159,709
Total assets	$21,749,570	$19,787,717
Liabilities and net assets:		
Current liabilities:		
Commercial paper and current portion of debt	$659,301	$749,617
Variable-rate debt with self-liquidity	521,455	321,455
Liabilities held for sale	104,003	91,412
Other current liabilities	1,899,054	1,886,563
Total current liabilities	3,183,813	3,049,047
Long-term debt	7,043,666	6,359,305
Pension liability	466,132	502,372
Other liabilities	1,486,762	1,351,370
Total liabilities	12,180,373	11,262,094
Net assets:		
Net assets attributable to CHI Reporting Group	8,701,271	8,128,608
Net assets attributable to noncontrolling interests	517,040	175,663
Total Unrestricted	9,218,311	8,304,271
Temporarily restricted	258,960	225,724
Permanently restricted	91,926	86,628
Total net assets	9,569,197	8,616,623
Total liabilities and net assets	$21,749,570	$19,878,717

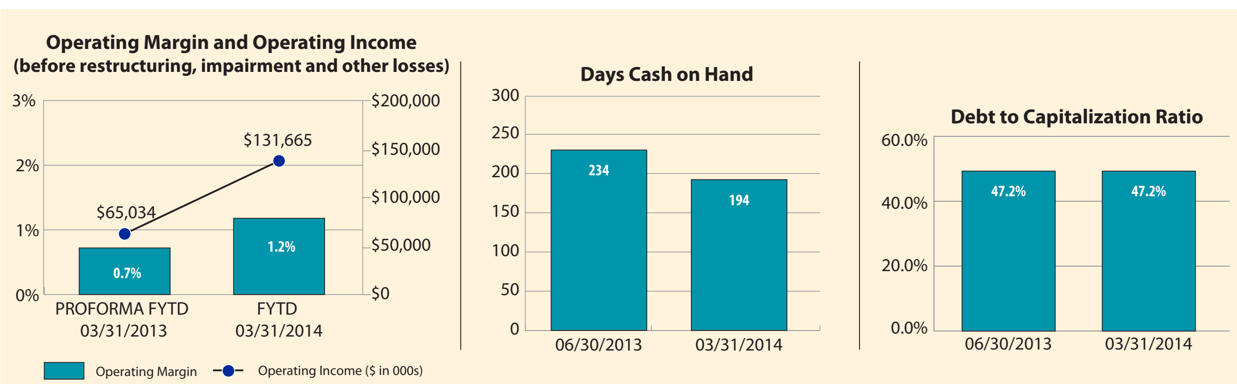
B. FINANCIAL RATIOS

The financial ratios presented below reflect the unaudited combined results of the CHI Reporting Group and CHI St. Luke's (unaudited) on a pro forma basis for the nine months ended March 31, 2013[1] and the CHI Reporting Group for the nine months ended March 31, 2013 and 2014[2].

Unaudited	Nine Months Ended March 31, 2013 Pro Forma	2013	2014
Operating Performance:			
Operating Margin Before Restructuring, Impairment and Other Losses[3]	0.7%	0.5%	1.2%
Operating Margin[4]	0.2%	(0.0)%	0.8%
Excess Margin[5]	6.9%	6.3%	6.0%
Operating EBIDA Margin Before Restructuring, Impairment & Other Losses[6]	7.6%	7.1%	7.9%
Operating EBIDA Margin[7]	7.1%	6.6%	7.4%

Unaudited	June 30, 2013	March 31, 2014
Liquidity:		
Days Cash on Hand[8]	234	194
Financial Position/Leverage Ratios:		
Debt to Capitalization[9]	47.2%	47.2%

(1) The pro forma financial results of other entities that became affiliated with CHI during fiscal year ended June 30, 2013 are not included in the combined pro forma financial information of CHI and CHI St. Luke's as of and for the nine month period ended March 31, 2013.
(2) The financial results of Harrison are included from the effective date of its acquisition (August 1, 2013) through the end of the nine month period ended March 31, 2014.
(3) Income from operations before restructuring, impairment and other losses/Total operating revenues.
(4) Income from operations/Total operating revenues.
(5) Excess of revenues over expenses/ (Total operating revenues + total non-operating gains (losses)).
(6) (Income from operations before restructuring, impairment and other losses + Depreciation and amortization + Interest)/Total operating revenues.
(7) (Income from operations + Depreciation and amortization + Interest)/Total Operating Revenues.
(8) (Cash and equivalents + Investments and assets limited as to use: Internally designated)/ ((Total operating expenses before restructuring, impairment and other losses – Depreciation and amortization)/actual number of days in a period).
(9) (Commercial paper and current portion of debt + Variable-rate debt with self-liquidity + Long-term debt)/ (Commercial paper and current portion of debt + Variable-rate debt with self-liquidity + Long-term debt + Unrestricted net assets). Included within Long-term debt are unamortized original issue premiums of $57.1 million and $59.5 million and unamortized original issue discounts of $(25.5) million and $(11.2) million at March 31, 2014 and June 30, 2013, respectively.



This document is dated as of June 20, 2014.

C. CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with GAAP requires that management make assumptions, estimates and judgments affecting the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. Management considers critical accounting policies to be those that require the more significant judgments and estimates in the preparation of its financial statements, including the following: recognition of net patient services revenues, which includes contractual allowances, bad debt and charity care reserves, and cost report settlements; impairment of goodwill, intangibles and long-lived assets; provisions for doubtful accounts; valuations of investments; and reserves for losses and expenses related to health care professional and general liability risks. In making such judgments and estimates, management relies on historical experience and on other assumptions believed to be reasonable under the circumstances. A description of CHI's accounting policies can be found in the notes to the unaudited financial statements in Appendix A. Actual results could differ materially from such estimates.

D. MANAGEMENT'S DISCUSSION AND ANALYSIS

I. NINE MONTHS ENDED MARCH 31, 2014 – CHI AND THE CHI REPORTING GROUP

A. SUMMARY OF OPERATING RESULTS – CHI AND THE CHI REPORTING GROUP

Consolidated income from operations before restructuring, impairment and other losses for CHI for the nine months ended March 31, 2014 was $122.0 million compared to $25.6 million for the corresponding period of the prior fiscal year, or, an operating margin before restructuring, impairment and other losses of 1.2% as compared to 0.3% for the corresponding period of the prior fiscal year. Management attributes such increase to acquisitions completed in the current fiscal year, including the Harrison affiliation which reported $549.5 million in operating revenues and $305.2 million of excess of revenues over expenses to the CHI consolidated results of operations, including a $286.2 million gain on the affiliation. The increase due to acquisitions was offset by declines in operating performance at the Kentucky region and the Pacific Northwest region (excluding the Harrison affiliation). Excluding the impacts of current and prior year acquisitions (same store basis), CHI's income from operations before restructuring, impairment and other losses, was a loss of $(136.4) million compared to income of $29.8 million for the corresponding period of the prior fiscal year, or an operating margin before restructuring, impairment and other losses of (1.8) % as compared to 0.4% for the corresponding period of the prior fiscal year.

The combined income from operations before restructuring, impairment and other losses of the CHI Reporting Group for the nine months ended March 31, 2014, also increased to $131.7 million from $41.2 million for the corresponding period of the prior fiscal year, or an operating margin before restructuring, impairment and other losses of 1.2% as compared to 0.5% for the corresponding period of the prior fiscal year. As noted above, this is primarily the result of the acquisitions completed by CHI in the current fiscal year. The CHI Reporting Group's excess of revenues over expenses for the nine months ended March 31, 2014 was $665.6 million compared to $549.1 million for the corresponding period of the prior fiscal year.

For the nine months ended March 31, 2014, the operating results of the regions were mixed. Most of the regions have shown improvements over the same period of the prior fiscal year as a result of successful payer negotiations, physician productivity improvements and expense management. The Kentucky region reported a loss from operations before restructuring, impairment and other losses of $(134.0) million for the nine months ended March 31, 2014 as compared to losses of $(69.9) million reported for the same period of the prior fiscal year. The Kentucky region continues to be challenged by decreasing patient volumes, physician retention issues and shifts in payer mix. The Pacific Northwest region, excluding the Harrison affiliation, reported a loss from operations before restructuring, impairment and other losses of $(3.7) million compared to income of $57.7 million for the same period of the prior fiscal year. The Pacific Northwest region's unfavorable results were due in part to the implementation of new clinical and billing systems in August 2013, which resulted in a short- term drop from historical revenue levels and a short- term increase in labor and purchased services costs due to remediation efforts.

Management is addressing the declines in operating performance through focused clinical and operational initiatives across the enterprise, targeted growth initiatives across the markets, revenue cycle improvement initiatives through its relationship with Conifer Health Solutions, which currently provides revenue cycle services for CHI's acute care operations, as well as initiating a comprehensive cost reduction strategy across all areas to identify short-term opportunities for expense reductions.

Operating Revenues. Total operating revenues of CHI increased 32.5% ($2.5 billion) for the nine months ended March 31, 2014 compared to the corresponding period of the prior fiscal year and total operating revenues of the CHI Reporting Group increased 27.4% ($2.3 billion) during that same period, primarily attributable to recently completed acquisitions. Total same store operating revenues of CHI increased 1.2% ($89.7 million) for the nine months ended March 31, 2014 compared to the corresponding period of the prior fiscal year.

Total net patient services revenues of CHI increased 27.4% ($2.0 billion) for the nine months ended March 31, 2014 compared to the corresponding period of the prior fiscal year and total net patient services revenues of the CHI Reporting Group increased 22.7% ($1.8 billion) during that same period. Factors contributing to the increase are recently completed acquisitions and the impact of rate increases, offset by patient volume shortfalls and shifts in payer mix. Same store net patient services revenues of CHI increased 1.0% ($68.8 million) for the nine months ended March 31, 2014 compared to the corresponding period of the prior fiscal year. Same store CHI patient volume declines for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year were as follows: Acute Admissions (3.0)% (8,612), Acute Inpatient Days (4.1)% (53,940), Inpatient Surgeries (3.6)% (3,281), Inpatient ER Visits (3.4)% (4,801), Outpatient ER Visits (1.8)% (18,398) and Outpatient Non-ER Visits (3.5)% (109,027). On a same store basis CHI patient volume improvements for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year were as follows: Outpatient Surgeries 5.4% (7,499) and Physician Visits 0.4% (22,247).

For the nine months ended March 31, 2014, CHI's net revenue yield, measured as the collection rate per dollar of gross patient services revenues, declined to 28.9% as compared to 30.6% for the corresponding period of the prior fiscal year, and CHI's contractual allowances as a percentage of gross revenues was 65.8%, a 2.1% increase, compared to 63.7% for the corresponding period of the prior fiscal year. This increase was primarily a result of rate increases implemented in the current fiscal year offset by less favorable impacts related to payer mix shifts in certain markets. CHI's provision for doubtful accounts increased 34.1% ($200.4 million) for the nine months ended March 31, 2014 compared to the corresponding period of the prior fiscal year, primarily due to recently completed acquisitions. CHI's provision for doubtful accounts as a percentage of gross patient services revenues remained at 2.5% for the nine months ended March 31, 2014. CHI's charity care as a percentage of gross patient services revenues decreased to 3.0% for the nine months ended March 31, 2014 compared to 3.4% for the corresponding period of the prior fiscal year.

Total Operating Expenses. CHI's total operating expenses before restructuring, impairment and other losses increased 31.3% ($2.4 billion) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year. These increases are primarily attributable to recently completed acquisitions. CHI's same store total operating expenses before restructuring, impairment and other losses increased 3.5% ($255.8 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year, primarily resulting from expansion of services in several markets, new physician growth, wage inflation increases and the cost of the key strategic initiatives undertaken by

CHI, including implementation of its information technology program known as OneCare.

Labor Costs. CHI's labor costs (salaries and benefits) accounted for the most significant component of CHI's total operating expenses before restructuring, impairment and other losses (48.7% for the nine months ended March 31, 2014 as compared to 51.3% for the corresponding period of the prior fiscal year). CHI's total labor costs increased 24.6% ($971.4 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year due to increases in FTEs from recently completed acquisitions. CHI's same store total labor costs decreased (0.2)% ($6.3 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year due to transitioning approximately $117.3 million of labor costs for certain internal billing functions to external purchased services. As a percentage of CHI's net patient services revenues, CHI's total labor costs decreased modestly to 53.7% for the nine months ended March 31, 2014 compared to 54.8% for the corresponding period of the prior fiscal year.

Supply Costs. CHI's supplies expense increased 31.1% ($414.1 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year primarily as a result of recently completed acquisitions. CHI's same store supplies expense increased 2.1% ($27.3 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year. CHI's supplies expense as a percentage of net patient services revenues increased to 19.0% for the nine months ended March 31, 2014 as compared to 18.5% for the corresponding period of the prior fiscal year. CHI's same store supplies expense as a percentage of net patient services revenues increased slightly to 18.9% compared to 18.7% in the prior year. Management has targeted this area as an improvement initiative, standardizing vendors, supply items, pricing and contracts across the organization.

Purchased Services Costs. CHI's purchased services expense increased 66.9% ($394.1 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year, due primarily to transitioning certain internal billing functions to external parties, resulting in a shift of costs from salaries, wages and benefits to purchased services expense. The majority of the transition occurred on January 1, 2013. Recently completed acquisitions also contributed to the year over year increase. CHI's same store purchased services expense increased 23.6% ($129.1 million) for the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year, primarily as a result of the billing services transition noted above.

Non-operating. CHI's nonoperating gains for the nine months ended March 31, 2014 increased to $566.3 million from $514.3 million for the corresponding period of the prior fiscal year. The major contributor to these gains in both periods was the overall strong performance of CHI's investment program. CHI's nonoperating gains for the nine months ended March 31, 2014 included investment income of $568.9 million, loss on defeasance of bonds of $(10.0) million, realized and unrealized losses on interest rate swaps of $(7.5) million and other nonoperating gains of $14.9 million. CHI's nonoperating gains for the corresponding period of the prior fiscal year included investment income of $518.0 million, loss on defeasance of bonds of $(18.0) million, realized and unrealized gains on interest rate swaps of $10.7 million and other nonoperating gains of $3.6 million. CHI's same store nonoperating gains for the nine months ended March 31, 2014 decreased to $421.6 million from $498.2 million for the corresponding period of the prior fiscal year. The CHI Reporting Group's nonoperating gains for the nine months ended March 31, 2014 increased to $585.7 million from $560.4 million for the corresponding period of the prior fiscal year.

B. SUMMARY OF BALANCE SHEET – CHI AND THE CHI REPORTING GROUP

CHI's total consolidated assets increased 9.6% ($1.9 billion) to $21.2 billion at March 31, 2014 as compared to $19.3 billion at June 30, 2013. This increase was primarily attributable to the Harrison affiliation ($504.4 million), the Baylor joint venture ($351.0 million) and net CHI debt proceeds from the fiscal year 2014 debt issuance ($620.0 million). CHI's total investments and assets limited as to use increased 5.4% ($383.5 million) to $7.5 billion during that same period as a result of the CHI net debt proceeds from the fiscal year 2014 debt issuance and due to strong investment performance for the nine months ended March 31, 2014. The CHI Reporting Group's total combined assets increased 9.4% ($1.8 billion) to $21.7 billion at March 31, 2014 as compared to $19.9 billion at June 30, 2013.

Days of Cash. CHI's days of cash on hand decreased to 192 days as of March 31, 2014 from 237 at June 30, 2013. This decrease is primarily attributable to the impact of acquisitions on the average operating expenses per day. The decrease in days of cash was also impacted by cash expenditures for CHI capital additions of $926.0 million during the nine months ended March 31, 2014, including new hospital construction and expansion primarily in the Colorado, Nebraska, Pacific Northwest, Tennessee and Texas regions as well as continued implementation costs for the OneCare program. The CHI Reporting Group's days cash on hand decreased to 194 days as of March 31, 2014 from 234 at June 30, 2013.

Accounts Receivable. CHI's net patient accounts receivable increased by 13.0% ($228.9 million) from June 30, 2013 to March 31, 2014. Of the total increase, $50.6 million was attributable to the Harrison affiliation and $178.3 million due primarily from delays in billings resulting from systems conversions in several markets (including Arkansas, Tennessee, Pennsylvania, Iowa, Kentucky, Pacific Northwest and Texas regions). These system conversions also resulted in some minor billing delays, all of which were addressed in subsequent months. Some of the increases are also due to planned changes in business office practices, including more extensive follow-up on self-pay balances and conversion of eligible patients from self-pay to Medicaid or other payer sources. The CHI Reporting Group's net patient accounts receivable increased by 13.1% ($234.7 million) from June 30, 2013 to March 31, 2014.

Debt. CHI's debt-to-capitalization ratio decreased to 48.1% at March 31, 2014 from 48.2% as of June 30, 2013. Such decrease was driven primarily by CHI's net debt proceeds from the fiscal year 2014 debt issuance ($620.0 million), which were offset by increases in unrestricted net assets as of March 31, 2014 resulting from excess of revenues over expenses of $638.5 million for the nine months ended March 31, 2014, as well as the $319.6 million increase in unrestricted net assets due to the noncontrolling interest in the Baylor joint venture. The CHI Reporting Group's debt-to-capitalization ratio was 47.2% at March 31, 2014 and June 30, 2013.

Net Assets. CHI's total net assets increased 11.3% ($929.5 million) from June 30, 2013 to March 31, 2014, primarily the result of the excess of revenues over expenses of $638.5 million for the nine months ended March 31, 2014, as well as the $319.6 million increase in unrestricted net assets due to the noncontrolling interest in the Baylor joint venture. The CHI Reporting Group's total net assets increased by 11.1% ($952.6 million) from June 30, 2013 to March 31, 2014.

PART IV
Selected Operating Information

A. PATIENT VOLUME

The table below provides selected aggregate utilization statistics for the general acute care hospitals and long-term care facilities within the CHI Reporting Group for the nine months ended March 31, 2014 and 2013 and the CHI Reporting Group and CHI St. Luke's (unaudited) on a pro forma basis for the nine months ended March 31, 2013[1].

	Nine Months ended March 31,		
	2013 Pro Forma[1]	2013	2014
Acute Admissions	362,074	325,256	379,942
Acute Inpatient Days	1,706,236	1,507,226	1,793,847
Acute Average Length of Stay (Days)	4.7	4.6	4.7
Long-term Care Days[2]	305,355	305,355	299,073

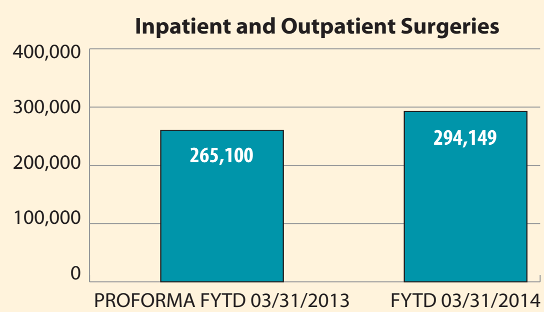
[1] Assumes, for purposes of this table, that the affiliation with CHI St. Luke's had been in place for the nine month period ended March 31, 2013. The pro forma utilization statistics of other entities that became affiliated with CHI during the fiscal year ended June 30, 2013 are not included in this combined pro forma utilization information.

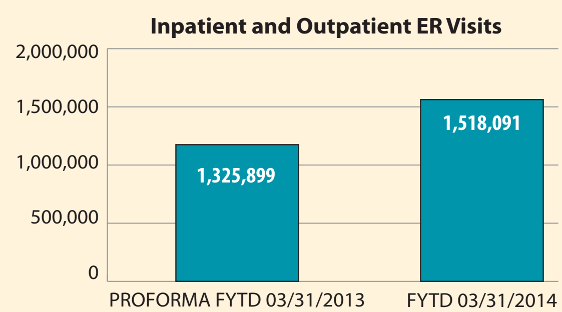
[2] Includes days in skilled nursing units and nursing homes.

The table below provides selected aggregate utilization statistics for the general acute care hospitals and long-term care facilities within CHI for the nine months ended March 31, 2014 and 2013 and CHI and CHI St. Luke's (unaudited) on a pro forma basis for the nine months ended March 31, 2013.

	Nine Months ended March 31,		
	2013 Pro Forma[1]	2013	2014
Acute Average Length of Stay (Days)	4.7	4.7	4.8
Medicare Case Mix Index	1.7	1.7	1.7
Inpatient Surgeries	105,828	94,590	115,233
Outpatient Surgeries	159,272	143,805	178,916
Inpatient ER Visits	168,946	150,007	190,040
Outpatient ER Visits	1,156,953	1,083,052	1,328,051
Outpatient Non-ER Visits	3,416,157	3,268,174	3,760,864

[1] Assumes, for purposes of this table, that the affiliation with CHI St. Luke's had been in place for the nine month period ended March 31, 2013. The pro forma utilization statistics of other entities that became affiliated with CHI during the fiscal year ended June 30, 2013 are not included in this combined pro forma utilization information.





B. INDEBTEDNESS

At March 31, 2014, CHI's outstanding indebtedness, not including approximately $459.4 million of indebtedness of certain MBOs and capital leases that are not secured by the Capital Obligation Document (the "MBO Debt"), totaled $7.7 billion, of which $5.7 billion (75%) is related to fixed rate debt (the Fixed Rate Bonds, Long-Term Rate Bonds that are subject to mandatory tender on dates occurring after March 31, 2015, the EHF Note and a portion of the St. Luke's Debt (as described below)) and $2 billion (25%) is related to variable-rate debt (including for these purposes VRDBs, Window VRDBs, Direct Purchase Bonds, Long-Term Rate Bonds that are subject to mandatory tender on dates occurring on or prior to March 31, 2015, Commercial Paper Notes, and a portion of the St. Luke's Debt).

I. INDEBTEDNESS – THE CORPORATION; COMMERCIAL PAPER NOTES AND REVENUE BONDS

A. SECURITY/SOURCE OF PAYMENT

The obligations of the Corporation to pay debt service on its commercial paper notes and revenue bonds described below are secured by Obligations issued under the Capital Obligation Document. Obligations also secure the Corporation's obligation to provide funds for the purchase of VRDBs, Window VRDBs, Direct Purchase Bonds and Long-Term Rate Bonds (each as hereinafter defined) that are tendered for purchase or subject to mandatory tender for purchase and not remarketed. At March 31, 2014, the Corporation's outstanding indebtedness secured by Obligations issued under the Capital Obligation Document totaled $7.7 billion.

The sources of liquidity for the repayment of variable rate debt are described in Section D. The obligations of the Corporation to repay advances made under the various external liquidity facilities described in Section D are also secured by Obligations issued under the Capital Obligation Document.

B. INDEBTEDNESS SECURED BY OBLIGATIONS OUTSTANDING AT MARCH 31, 2014 – THE CORPORATION

Fixed Rate Bonds *("Fixed Rate Bonds")*: At March 31, 2014, the Corporation had outstanding approximately $5.4 billion of Fixed Rate Bonds (including $31.8 million of unamortized original issue discount and original issue premium). The Fixed Rate Bonds include tax-exempt bonds issued by governmental issuers for the benefit of the CHI Credit Group and $2.0 billion of taxable bonds issued by the Corporation.

Commercial Paper Notes *("Commercial Paper Notes")*: The Corporation has in place a commercial paper program that permits the issuance of up to $881 million in aggregate principal amount of Commercial Paper Notes outstanding at any time. At March 31, 2014, the Corporation had outstanding $442.5 million of Commercial Paper Notes. J.P. Morgan Securities LLC and Morgan Stanley & Co. LLC are dealers for the Commercial Paper Notes. The Corporation has directed those dealers to tranche the maturities so that no greater than approximately one-third of the outstanding balance matures in any one month, and no more than $100 million matures per dealer within any five business-day period. The Corporation has, from time to time, directed its dealers to deviate from this structuring, and anticipates that it may do so again in the future.

Variable Rate Demand Bonds *("VRDBs")*: At March 31, 2014, the Corporation had outstanding approximately $519.1 million of VRDBs issued by governmental issuers for the benefit of the CHI Credit Group. VRDBs bear interest at variable rates (currently determined weekly) and are subject to optional tender for purchase by their holders. At March 31, 2014, $355.8 million of VRDBs were supported by dedicated liquidity facilities provided by commercial banks, and the remaining $163.3 million of VRDBs were supported by self-liquidity.

Window Variable Rate Bonds *("Window VRDBs")*: At March 31, 2014, the Corporation had outstanding approximately $358.2 million of Window VRDBs issued by governmental issuers for the benefit of the CHI Credit Group. Window

VRDBs bear interest at *"window variable interest rates"* that are set weekly based on the sum of the SIFMA Swap Index plus a window variable interest rate spread determined by a remarketing agent.

Window VRDBs are not supported by external dedicated liquidity facilities. Holders of Window VRDBs have a right to optionally tender their bonds for purchase. If the tendered Window VRDBs are not successfully remarketed within the 30 day period that follows the date that notice of such optional tender is received by the remarketing agent (the *"Remarketing Window"*), then all Window VRDBs of the same series are required to be purchased on the day that is 210 days after notice of such optional tender is received by the remarketing agent (the *"Window Mandatory Tender Date"*). The period from the end of the Remarketing Window until the Window Mandatory Tender Date (initially, 180 days) is referred to as the *"Funding Window."* During the Funding Window, Management expects that it would analyze the then current market conditions and availability and relative cost of refinancing or restructuring alternatives for those Window VRDBs that are required to be purchased on the Window Mandatory Tender Date (including, without limitation, conversion to another interest mode, refinancing or repayment).

Direct Purchase Variable Rate Bonds *("Direct Purchase Bonds"):* At March 31, 2014, the Corporation had outstanding $541.3 million of Direct Purchase Bonds issued by governmental issuers for the benefit of the CHI Credit Group and privately placed directly with holders, which currently consist of various commercial banks. Direct Purchase Bonds bear interest at variable rates determined monthly based upon a percentage of the LIBOR rate plus a spread based upon the credit rating of CHI, and are subject to mandatory tender on the dates and in the amounts described below.

Series	Principal Amount	Scheduled Mandatory Tender Date
Washington 2008A	$120.3 million	January 29, 2019
Colorado 2011C	$121.0 million	November 10, 2018
Colorado 2013C	$100.0 million	December 18, 2023
Taxable 2013E	$125.0 million	December 18, 2023
Taxable 2013F	$75.0 million	December 18, 2020

In the event any series of Direct Purchase Bonds is not remarketed (either to the existing holder or to a new holder) or refinanced on a scheduled mandatory tender date, as long as no event of default has occurred and is continuing, the Corporation is permitted by the terms of its agreements with such holders to repay those bonds over a three-year period.

Long-Term Rate Bonds (*"Long-Term Rate Bonds"*): At March 31, 2014, the Corporation had outstanding $205 million of Long-Term Rate Bonds issued by governmental issuers for the benefit of the CHI Credit Group. Each series of Long-Term Rate Bonds bears interest at a fixed rate for a specified period, and is subject to mandatory tender at the end of that period, on the date and in the principal amount described below. Long-Term Rate Bonds are not subject to optional tender for purchase.

Series	Principal Amount	Mandatory Tender Date
Colorado 2009B-3	$40.0 million	November 11, 2014
Kentucky 2009B	$60.0 million	November 11, 2014
Colorado 2008C-2	$27.5 million	November 12, 2015
Colorado 2008C-4	$27.5 million	November 12, 2015
Colorado 2008D-3	$50.0 million	November 12, 2015

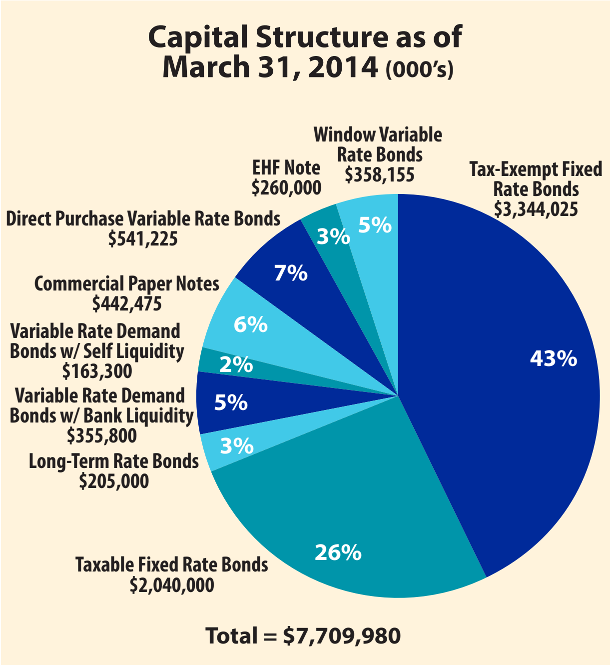
II. OTHER INDEBTEDNESS – THE CORPORATION

Episcopal Health Foundation Note *("EHF Note")*: The Corporation has issued a promissory note in the principal amount of $260 million to Episcopal Health Foundation in connection with the acquisition of the St. Luke's System. The EHF Note matures on May 31, 2020. It bears interest at a fixed rate of 4% per annum and is payable in six annual installments of principal and accrued interest, commencing May 31, 2014.

III. INDEBTEDNESS – THE ST. LUKE'S SYSTEM

CHI St. Luke's and/or certain of its affiliates are obligated on indebtedness of which, at March 31, 2014, $188.0 million was outstanding (collectively, the *"CHI St. Luke's Debt"*). The CHI St. Luke's Debt is secured by approximately $212.0 million (book value at March 31, 2014) of the CHI St. Luke's assets.

The below chart illustrates the CHI Reporting Group's capital structure at March 31, 2014:



[(1)] Does not include the approximately $188.0 million of the CHI St. Luke's Other Debt outstanding or the MBO Debt.

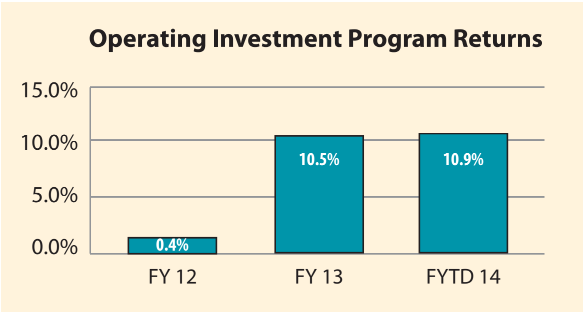
C. INVESTMENTS

The CHI Operating Investment Program (the *"Program"*) is an investment pool administered by the treasury services function of the Corporation. The Program is structured as a limited partnership with the Corporation as the managing general partner. The Corporation contracts with investment advisers to manage the investments within the Program. Substantially all CHI long-term investments are held in the Program. The Corporation requires all Participants to invest in the Program. Bethesda does not participate in the Program.

The Program consists of equity, fixed income and alternative investments (e.g., private capital, hedge funds and real estate interests). The asset allocation is established by the Finance Committee of the Board of Stewardship Trustees. At March 31, 2014, the allocation was 32% fixed income, 43% equities, 23% alternative investments and 2% cash and equivalents. The fixed income securities are invested primarily in U.S. Treasuries and agency securities and high quality mortgage backed securities (including GNMA, FNMA and FHLMC). The 43% allocation to equities is comprised of 55% domestic equities and 45% international equities. At March 31, 2014, the domestic equity segment was invested in large, mid and small cap publicly traded securities.

At June 30, 2012, 2013 and March 31, 2014, the CHI Credit Group had internally designated investments of $5.7 billion, $6.3 billion and $6.5 billion, respectively, the majority of which are invested in the Program.

The Program's investment return for the fiscal years ended June 30, 2012 and 2013 and the nine months ended March 31, 2014 is set forth in the chart below.



D. LIQUIDITY AND CAPITAL RESOURCES

I. LIQUIDITY AND OTHER FINANCIAL ARRANGEMENTS

Liquidity Facilities. As described in the chart below, the Corporation maintains several external liquidity facilities, including dedicated liquidity facilities and general liquidity facilities. External dedicated liquidity facilities are provided by commercial banks and dedicated to certain VRDBs. Each dedicated liquidity facility is subject to extension of its expiration date at the sole discretion of the provider of such liquidity facility. The Corporation's general liquidity facilities are used exclusively to support its obligations to fund tenders of VRDBs, Window VRDBs and Long-Term Rate Bonds and to pay the maturing principal of the Commercial Paper Notes in the event remarketing proceeds are unavailable for such purpose. The Corporation's dedicated liquidity facilities can currently be found at http://emma.msrb.org.

Credit Agreements by Bank as of March 31, 2014 ($000s)

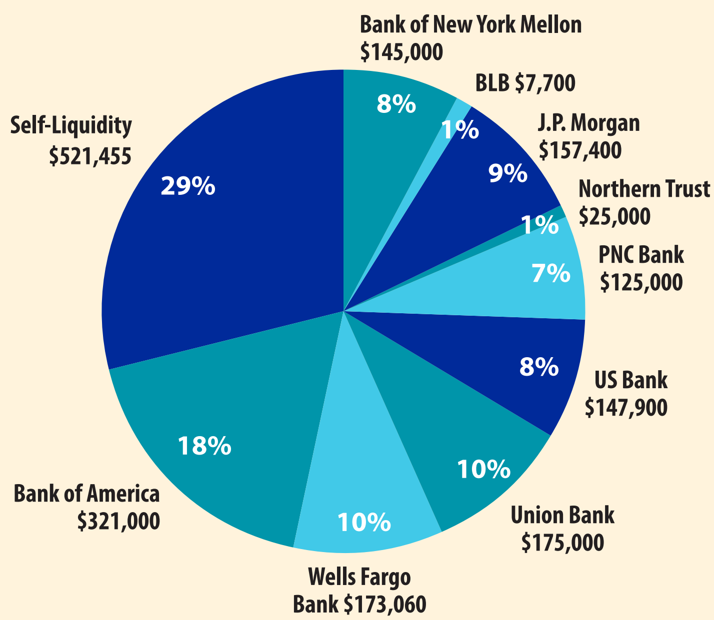
CHI Dedicated Self-Liquidity Lines

Bank	Par (000's)	Expiration
Union Bank of CA[1]	$ 75,000	06/30/2014
PNC Bank[1]	125,000	08/25/2014
Northern Trust[1]	25,000	06/30/2014
J.P. Morgan[2]	50,000	05/19/2014
Bank of New York Mellon	60,000	12/15/2014
Bank of New York Mellon	45,000	12/15/2015
Total	$380,000	

CHI SBPA/Direct Purchase

Bank	Par (000's)	Expiration
J.P. Morgan[2]	$ 54,200	06/01/2014
Wells Fargo Bank	120,260	01/29/2019
J.P. Morgan	53,200	08/19/2014
U.S. Bank	33,700	11/01/2014
U.S. Bank	50,000	11/10/2014
U.S. Bank	22,700	10/30/2015
U.S. Bank	41,500	10/30/2015
Wells Fargo Bank	52,800	10/30/2015
Union Bank	100,000	12/18/2028
BLB	7,700	11/30/2015
Bank of New York Mellon	40,000	12/15/2015
Bank of America	121,000	11/10/2018
Bank of America	125,000	12/18/2023
Bank of America	75,000	12/18/2020
Total	$897,060	

(1) *Renewal in process*
(2) *Expiration dates extended to 9/30/2014*



Master Repurchase Agreement. The Corporation has a Master Repurchase Agreement with The Bank of New York Mellon (*"BNY Mellon"*). Subject to the approval of BNY Mellon, the Corporation may enter into repurchase agreements with counterparties pursuant to which CHI may sell certain of its securities with a market value of up to $300 million and agrees to repurchase such securities at a date certain, with the repurchase amount based in part on a LIBOR-based loan rate. The ability to enter into a repurchase transaction is dependent upon a variety of conditions, including the availability of CHI to provide high quality, fixed income securities acceptable to the counterparty for purchase. Minimum collateral requirements also apply, depending upon the type of securities subject to the repurchase agreement.

II. CASH EQUIVALENTS AND INTERNALLY DESIGNATED INVESTMENTS

At March 31, 2014 and June 30, 2013, the CHI Reporting Group had cash and equivalents and internally designated investments (including net unrealized gains and losses) as described in the table below.

Unaudited (000s)	March 31, 2014	June 30, 2013
Cash and equivalents	$502,864	$614,476
Internally designated investments	6,524,986	6,291,760
Total	$7,027,850	$6,906,236

CHI holds highly liquid investments to enhance its ability to satisfy liquidity needs. Asset allocations are reviewed on a monthly basis and compared to investment allocation targets included within CHI's investment policy. The CHI summary liquidity report as of March 31, 2014 is available at http://emma.msrb.org.

E. SWAP AGREEMENTS

At March 31, 2014 and June 30, 2013, CHI was a party to seven floating-to-fixed interest rate swap agreements, and CHI St. Luke's, a wholly-owned subsidiary of CHI, was a party to four and six, respectively, floating-to-fixed interest rate swap agreements, with notional amounts totaling $1.4 billion and $1.6 billion, respectively, in the aggregate. The swap agreements require CHI and CHI St. Luke's, as applicable, to provide collateral if their respective liabilities, determined on a mark-to-market basis, exceeds a specified threshold that varies based upon the rating on CHI's long-term indebtedness. The swaps have varying maturity dates ranging from 2025 to 2047. The fair value of the swaps is estimated based on the present value sum of anticipated future net cash settlements until the swaps' maturities. At March 31, 2014 and June 30, 2013, the fair value was $229.6 million and $271.6 million, respectively. Cash collateral balances of $118.3 million and $107.5 million at March 31, 2014 and June 30, 2013, respectively, are netted against the fair value of the swaps, and the net amount is reflected in other liabilities. The change in the fair value of these agreements resulted in gains of $30.1 million and $34.4 million being recognized in the consolidated statements of operations for the nine months ended March 31, 2014 and 2013, respectively.

PART V
Legal Proceedings

A. PENDING LITIGATION/REGULATORY

The members of the CHI Credit Group, like all major health care systems, periodically may be subject to investigations or audits by federal, state and local agencies involving compliance with a variety of laws and regulations. These investigations seek to determine compliance with, among other things, laws and regulations relating to Medicare and Medicaid reimbursement, including billing practices for certain services. Violation of such laws could result in substantial monetary fines, civil and/or criminal penalties and exclusion from participation in Medicare, Medicaid or similar programs.

Nationwide Review of Certain Hospital Charges. As described in greater detail in Part VI of the Annual Report, the Civil Division of the Department of Justice contacted CHI in 2010 in connection with its nationwide review of whether, in certain cases, hospital charges to the federal government relating to implantable cardio-defibrillators met the Centers for Medicare & Medicaid services criteria. At this time, management cannot predict what effect, if any, this review or any resulting claims could have on the CHI Credit Group.

St. Joseph Medical Center, Towson, Maryland. St. Joseph Medical Center, which until December 1, 2012 owned and operated St. Joseph Medical Center in Towson, Maryland until its sale in 2012 to an unrelated party, is a defendant in certain unresolved litigation, all as described In greater detail in Part VI of the Annual Report. Management believes that adequate reserves have been established, and that the outcome of any current investigations and collateral consequences will not have a material effect on the financial position or results of operations of the CHI Credit Group.

Saint Joseph–London. Numerous lawsuits have been filed against St. Joseph Health System and the Corporation claiming damages for the allegedly unnecessary placements of cardiac stents and other cardiac procedures, all as described in greater detail in Part VI of the Annual Report. Both Saint Joseph Health System and the Corporation are vigorously defending these lawsuits. Management believes that adequate reserves have been established and that the outcome of any current litigation will not have a material effect on the financial position or results of operations of the CHI Credit Group.

Pension Plan Litigation. As described in greater detail in Part VI of the Annual Report, in May 2013, the Corporation and two employees were named as defendants in a lawsuit challenging the *"church plan"* status of certain of CHI's defined benefit plans. Medina, et al. v. Catholic Health Initiatives, et. al., Civil No 13-1249 (District of Colorado). CHI is seeking a dismissal of this action. A hearing on CHI's motion to dismiss is set for June 24, 2014. While no assurance can be given that the outcome of this litigation will be favorable to CHI, at this time, management does not believe that this matter, if decided adversely to CHI, would have a material adverse effect on the financial position or results of operations of the CHI Credit Group.

APPENDIX A

Catholic Health Initiatives Consolidated Interim Financial Statements (Unaudited)

As of March 31, 2014 and for the nine months ended March 31, 2014 and 2013

Catholic Health Initiatives

Consolidated Interim Financial Statements (Unaudited)
As of March 31, 2014 and for the Nine Months Ended
March 31, 2014 and 2013

Catholic Health Initiatives
Consolidated Interim Financial Statements (Unaudited)

Contents

Consolidated Interim Financial Statements

Catholic Health Initiatives
Consolidated Balance Sheets
(In Thousands)

	March 31, 2014	June 30, 2013
	(Unaudited)	
Assets		
Current assets:		
Cash and equivalents	**$ 502,496**	$ 609,226
Net patient accounts receivable, less allowances of $924,082 at March and $858,394 at June, respectively	**1,984,287**	1,755,348
Other accounts receivable	**323,685**	197,917
Current portion of investments and assets limited as to use	**36,594**	11,697
Inventories	**252,618**	247,720
Assets held for sale	**207,627**	215,777
Prepaid and other	**191,711**	137,776
Total current assets	**3,499,018**	3,175,461
Investments and assets limited as to use*:*		
Internally designated for capital and other funds	**5,598,744**	5,452,023
Mission and Ministry Fund	**132,652**	121,109
Capital Resource Pool	**491,365**	416,938
Held by trustees	**93,893**	16,726
Held for insurance purposes	**870,122**	825,885
Restricted by donors	**295,758**	266,325
Total investments and assets limited as to use	**7,482,534**	7,099,006
Property and equipment, net	**8,554,999**	7,786,240
Deferred financing costs	**44,323**	36,557
Investments in unconsolidated organizations	**489,050**	416,816
Intangible assets and goodwill, net	**518,053**	364,751
Notes receivable and other	**570,073**	430,888
Total assets	**$ 21,158,050**	$ 19,309,719

Continued on following page

Catholic Health Initiatives
Consolidated Balance Sheets (continued)
(In Thousands)

	March 31, 2014	June 30, 2013
	(Unaudited)	
Liabilities and net assets		
Current liabilities:		
Compensation and benefits	**$ 601,679**	$ 600,837
Third-party liabilities	**110,830**	110,571
Accounts payable and accrued expenses	**1,077,261**	1,066,930
Liabilities held for sale	**104,003**	91,412
Variable-rate debt with self liquidity	**521,455**	321,455
Commercial paper and current portion of debt	**659,301**	749,617
Total current liabilities	**3,074,529**	2,940,822
Pension liability	**436,612**	472,852
Self-insured reserves and claims	**654,031**	616,652
Other liabilities	**796,824**	698,283
Long-term debt	**7,020,402**	6,334,985
Total liabilities	**11,982,398**	11,063,594
Net assets:		
Net assets attributable to CHI	**8,320,361**	7,769,310
Net assets attributable to noncontrolling interests	**517,040**	175,663
Unrestricted	**8,837,401**	7,944,973
Temporarily restricted	**246,325**	214,524
Permanently restricted	**91,926**	86,628
Total net assets	**9,175,652**	8,246,125
Total liabilities and net assets	**$ 21,158,050**	$ 19,309,719

See accompanying notes.

Catholic Health Initiatives
Consolidated Statements of Operations
(In Thousands)

	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
	(Unaudited)	
Revenues:		
Net patient services revenues before provision for doubtful accounts	**$ 9,948,831**	$ 7,778,086
Provision for doubtful accounts	**(787,827)**	(587,445)
Net patient services revenues	**9,161,004**	7,190,641
Nonpatient:		
Donations	**24,767**	22,504
Changes in equity of unconsolidated organizations	**18,730**	15,719
Investment income used for operations	**71,850**	72,946
Other	**939,136**	408,333
Total nonpatient revenues	**1,054,483**	519,502
Total operating revenues	**10,215,487**	7,710,143
Expenses:		
Salaries and wages	**4,112,741**	3,217,305
Employee benefits	**802,466**	726,519
Purchased services, medical professional fees, consulting and legal	**1,370,780**	890,529
Supplies	**1,744,809**	1,330,748
Utilities	**146,796**	110,029
Rentals, leases, maintenance and insurance	**623,254**	457,353
Depreciation and amortization	**507,785**	400,408
Interest	**174,137**	117,828
Other	**610,733**	433,801
Total operating expenses before restructuring, impairment and other losses	**10,093,501**	7,684,520
Income from operations before restructuring, impairment and other losses	**121,986**	25,623
Restructuring, impairment and other losses	**49,803**	44,124
Income (loss) from operations	**72,183**	(18,501)
Nonoperating gains (losses):		
Investment income, net	**568,919**	518,012
Loss on defeasance of bonds	**(10,018)**	(17,998)
Realized and unrealized (losses) gains on interest rate swaps	**(7,517)**	10,707
Other nonoperating gains	**14,934**	3,594
Total nonoperating gains	**566,318**	514,315
Excess of revenues over expenses	**638,501**	495,814
Excess of revenues over expenses attributable to noncontrolling interest	**1,978**	7,336
Excess of revenues over expenses attributable to CHI	**$ 636,523**	$ 488,478

See accompanying notes.

Catholic Health Initiatives
Consolidated Statements of Cash Flows
(In Thousands)

	Nine Months Ended March 31, 2014	2013
	(Unaudited)	
Operating activities		
Increase in net assets	**$ 929,527**	$ 486,552
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	**507,785**	400,408
Provision for bad debts	**787,827**	587,445
Changes in equity of unconsolidated organizations	**(18,730)**	(15,719)
Net gains on acquisitions, and sales of facilities and investments unconsolidated organizations	**(311,437)**	(7,798)
Noncash operating expenses related to restructuring, impairment and other losses	**19,575**	4,199
Loss on defeasance of bonds	**10,018**	17,998
Increase in fair value of interest rate swaps	**(30,138)**	(34,235)
(Decrease) increase in unfunded pension liability	**(54,280)**	2,789
Net changes in current assets and liabilities:		
Net patient and other accounts receivable	**(1,055,386)**	(688,820)
Other current assets	**(43,831)**	(45,352)
Current liabilities	**(68,626)**	(261,121)
Noncontrolling equity of Baylor	**(319,500)**	–
Other changes	**28,037**	103,152
Net cash provided by operating activities, before net change in investments and assets limited as to use	**380,841**	549,498
Net increase in investments and assets limited as to use	**(209,392)**	(800,861)
Net cash provided by (used in) operating activities	**171,449**	(251,363)
Investing activities		
Purchases of property, equipment and other capital assets	**(909,653)**	(729,598)
Net cash on contributions and acquisitions	**(42,633)**	–
Purchase of Alegent Creighton Health, net of cash acquired	**–**	(504,256)
Net cash on acquisition of UMC	**–**	58,681
Net cash proceeds from asset sales	**54,304**	215,559
Distributions from investments in unconsolidated organizations	**37,178**	27,585
Notes receivable from unconsolidated affiliates, net	**9,692**	9,413
Other changes	**15,309**	15,450
Net cash used in investing activities	**(835,803)**	(907,166)
Financing activities		
Proceeds from issuance of debt and bank loans	**1,853,103**	1,611,369
Costs associated with issuance of debt	**(11,354)**	(12,170)
Repayment of debt	**(1,284,125)**	(354,372)
Net cash provided by financing activities	**557,624**	1,244,827
(Decrease) increase in cash and equivalents	**(106,730)**	86,298
Cash and equivalents at beginning of year	**609,226**	403,972
Cash and equivalents at end of year	**$ 502,496**	$ 490,270

See accompanying notes.

Catholic Health Initiatives
Consolidated Statements of Changes in Net Assets
(In Thousands)

	Unrestricted Net Assets					
	Attributable to CHI	Attributable to Noncontrolling Interests	Total	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total Net Assets
Balances, June 30, 2012	$ 6,922,466	$ 180,863	$ 7,103,329	$ 136,821	$ 68,033	$ 7,308,183
Excess of revenues over expenses	489,740	(37)	489,703	–	–	489,703
Net loss from discontinued operations	(108,594)	–	(108,594)	–	–	(108,594)
Decrease in pension funded status	483,468	2,082	485,550	–	–	485,550
Temporarily and permanently restricted contributions	–	–	–	33,056	(1,554)	31,502
Net assets released from restriction for capital	15,791	–	15,791	(15,791)	–	–
Net assets released from restriction for operations	–	–	–	(15,728)	–	(15,728)
Investment (loss) income	(45)	–	(45)	5,393	1,280	6,628
Temporarily and permanently restricted assets from acquisitons	–	–	–	74,253	19,171	93,424
Other changes in net assets	(33,516)	(7,245)	(40,761)	(3,480)	(302)	(44,543)
Net increase (decrease) in net assets	846,844	(5,200)	841,644	77,703	18,595	937,942
Balances, June 30, 2013	**7,769,310**	**175,663**	**7,944,973**	**214,524**	**86,628**	**8,246,125**
Excess of revenues over expenses	**636,523**	**1,978**	**638,501**	**–**	**–**	**638,501**
Net loss from discontinued operations	**(18,892)**	**–**	**(18,892)**	**–**	**–**	**(18,892)**
Decrease in pension funded status	**14,453**	**56**	**14,509**	**–**	**–**	**14,509**
Temporarily and permanently restricted contributions	**–**	**–**	**–**	**46,341**	**2,414**	**48,755**
Net assets released from restriction for capital	**9,958**	**–**	**9,958**	**(9,958)**	**–**	**–**
Net assets released from restriction for operations	**–**	**–**	**–**	**(13,423)**	**–**	**(13,423)**
Investment income	**2,502**	**–**	**2,502**	**9,145**	**1,684**	**13,331**
Temporarily and permanently restricted assets from acquisitons	**–**	**–**	**–**	**4,361**	**2,003**	**6,364**
Baylor JV noncontrolling interest	**–**	**319,550**	**319,550**			**319,550**
Other changes in net assets	**(93,493)**	**19,793**	**(73,700)**	**(4,665)**	**(803)**	**(79,168)**
Net increase in net assets	**551,051**	**341,377**	**892,428**	**31,801**	**5,298**	**929,527**
Balances, March 31, 2014 (unaudited)	**$ 8,320,361**	**$ 517,040**	**$ 8,837,401**	**$ 246,325**	**$ 91,926**	**$ 9,175,652**

See accompanying notes.

1. Summary of Significant Accounting Policies

Organization

Catholic Health Initiatives (CHI), established in 1996, is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI sponsors market-based organizations (MBOs) and other facilities operating in 18 states and includes 88 hospitals, including four academic medical centers, and 23 critical access facilities; community health service organizations; accredited nursing colleges; home health agencies; and other facilities that span the inpatient and outpatient continuum of care. CHI also has an offshore captive insurance company, First Initiatives Insurance, Ltd. (FIIL).

The mission of CHI is to nurture the healing ministry of the Church, supported by education and research. Fidelity to the Gospel urges CHI to emphasize human dignity and social justice as CHI creates healthier communities.

Basis of Presentation

The consolidated interim financial statements of CHI as of March 31, 2014, and for the nine months ended March 31, 2014 and 2013, reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to fairly state our financial position, results of operations and cash flows for the periods presented. The consolidated interim financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim reporting, and accordingly, do not include all of the disclosures that are required in annual financial statements. As such, these consolidated interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended June 30, 2013. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates.

Operating results for the nine months ended March 31, 2014 and 2013 are not necessarily indicative of the results that may be expected for any future period or for a full fiscal year as revenues, expenses, assets and liabilities can vary during each quarter of the year.

Principles of Consolidation

CHI consolidates all direct affiliates in which it has sole corporate membership or ownership (Direct Affiliates) and all entities in which it has greater than 50% equity interest with commensurate control. All significant intercompany accounts and transactions are eliminated in consolidation.

1. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and equivalents, patient accounts receivable, investments and assets limited as to use, notes receivable, accounts payable and long-term debt. The carrying amounts reported in the consolidated balance sheets for these items approximate fair value.

Cash and Equivalents

Cash and equivalents include all deposits with banks and investments in interest-bearing securities with maturity dates of 90 days or less from the date of purchase. In addition, cash and equivalents include deposits in short-term funds held by professional managers. The funds generally invest in high-quality, short-term debt securities, including U.S. government securities, securities issued by domestic and foreign banks, such as certificates of deposit and bankers' acceptances, repurchase agreements, asset-backed securities, high-grade commercial paper and corporate short-term obligations.

Net Patient Accounts Receivable and Net Patient Services Revenues

Net patient accounts receivable has been adjusted to the estimated amounts expected to be collected. These estimated amounts are subject to further adjustments upon review by third-party payors.

The provision for bad debts is based upon management's assessment of historical and expected net collections, taking into consideration historical business and economic conditions, trends in health care coverage and other collection indicators. Management routinely assesses the adequacy of the allowances for uncollectible accounts based upon historical write-off experience by payor category. The results of these reviews are used to modify, as necessary, the provision for bad debts and to establish appropriate allowances for uncollectible net patient accounts receivable. After satisfaction of amounts due from insurance, CHI follows established guidelines for placing certain patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by each facility. In accordance with Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Entities,* the provision for bad debts is presented on the consolidated statement of operations as a deduction from patient services revenues (net of contractual allowances and discounts) since CHI accepts and treats all patients without the regard to the ability to pay.

1. Summary of Significant Accounting Policies (continued)

Net Patient Accounts Receivable, Net Patient Revenues and Provision for Doubtful Accounts (continued)

During the first nine months of 2014 and fiscal year 2013, CHI added approximately $55 million and $400 million in net patient accounts receivable due to the acquisition of new subsidiaries – see Note 2 – *Acquisitions and Divestitures*. The total write-offs of uncollectible accounts and reserves on self-pay patient accounts have not changed significantly from year to year. CHI has not experienced significant changes in write-off trends and there have been no significant changes to its charity care policy. Details of CHI's allowance activity are as follows:

	Reserve for Contractual Allowance	Allowance for Bad Debt	Reserve for Charity	Total Accounts Receivable Allowances
	(in thousands)			
Balance at June 30, 2012	$ (1,947,750)	$ (687,631)	$ (151,348)	$ (2,786,729)
Additions	(21,690,860)	(886,571)	(1,219,555)	(23,796,986)
Reductions	20,778,640	715,808	803,787	22,298,235
Balance at June 30, 2013	(2,859,970)	(858,394)	(567,116)	(4,285,480)
Additions	(20,856,996)	(808,761)	(938,667)	(22,604,424)
Reductions	20,428,078	743,073	934,375	22,105,526
Balance at Mar 31, 2014	$ (3,288,888)	$ (924,082)	$ (571,408)	$ (4,784,378)

CHI records net patient services revenues in the period in which services are performed. CHI has agreements with third-party payors that provide for payments at amounts different from its established rates. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement and negotiated discounts from established rates and per diem payments.

1. Summary of Significant Accounting Policies (continued)

Net Patient Accounts Receivable, Net Patient Revenues and Provision for Doubtful Accounts (continued)

Net patient services revenues are reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations, and excluding estimated amounts considered uncollectible. The differences between the estimated and actual adjustments are recorded as part of net patient services revenues in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews and investigations.

Investments and Assets Limited as to Use

Investments and assets limited as to use include assets set aside by CHI for future long-term purposes, including capital improvements and self-insurance. In addition, assets limited as to use include amounts held by trustees under bond indenture agreements, amounts contributed by donors with stipulated restrictions and amounts held for Mission and Ministry programs.

CHI has designated its investment portfolio as trading. Accordingly, unrealized gains and losses on marketable securities are included within excess of revenues over expenses. In addition, cash flows from the purchases and sales of marketable securities are reported as a component of operating activities in the accompanying consolidated statements of cash flows.

Direct investments in equity securities with readily determinable fair values and all direct investments in debt securities have been measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

Investments in limited partnerships and limited liability companies are recorded using the equity method of accounting (which approximates fair value as determined by the net asset values of the related unitized interests) with the related changes in value in earnings reported as investment income in the accompanying consolidated financial statements.

1. Summary of Significant Accounting Policies (continued)

Inventories

Inventories, primarily consisting of pharmacy drugs and medical and surgical supplies, are stated at lower of cost (first-in, first-out method) or market.

Assets and Liabilities Held for Sale

A long-lived asset or disposal group of assets and liabilities that is expected to be sold within one year is classified as held for sale. For long-lived assets held for sale, an impairment charge is recorded if the carrying amount of the asset exceeds its fair value less costs to sell. Such valuations include estimates of fair values generally based upon firm offers, discounted cash flows and incremental direct costs to transact a sale (Level 2 and Level 3 inputs).

Property and Equipment

Property and equipment are stated at historical cost or, if donated or impaired, at fair value at the date of receipt or impairment. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. For property and equipment under capital lease, amortization is determined over the shorter period of the lease term or the estimated useful life of the property and equipment. Interest cost incurred during the period of construction of major capital projects is capitalized as a component of the cost of acquiring those assets. Capitalized interest of $31.5 million and $19.0 million was recorded during the nine months ended March 31, 2014 and 2013, respectively.

Costs incurred in the development and installation of internal-use software are typically expensed if they are incurred in the preliminary project stage or post-implementation stage, while certain costs are capitalized if incurred during the application development stage. Amounts capitalized are amortized over the useful life of the developed asset following project completion.

Investments in Unconsolidated Organizations

Investments in unconsolidated organizations are accounted for under the cost or equity method of accounting, as appropriate, based on the relative percentage of ownership or degree of influence over that organization. The equity income or loss on these investments is recorded in the consolidated statements of operations as changes in equity of unconsolidated organizations.

1. Summary of Significant Accounting Policies (continued)

Investments in Unconsolidated Organizations (continued)

During fiscal year 2013, CHI entered into an eleven-year agreement with Conifer Health Solutions (Conifer) to provide revenue cycle services for CHI acute care operations. The agreement allows CHI to earn shares in Conifer as transition activities are completed per the agreement. Such shares will be issued at specified future dates. As of March 31, 2014 and June 30, 2013, CHI has received 2,000 shares in Conifer with a fair market value of $19.3 million and which is reflected as an investment in unconsolidated organizations on the consolidated balance sheets. CHI has also met certain transition milestones for which CHI has earned the right to additional future shares valued at $19.1 million at March 31, 2014 and June 30, 2013, which are reflected in notes receivable and other in the accompanying consolidated balance sheets. This earned value will be amortized as an offset to revenue cycle service fees paid to Conifer over the life of the agreement.

Intangible Assets and Goodwill

Intangible assets are comprised primarily of trade names and non-compete agreements, which are amortized over the estimated useful lives ranging from 10 to 15 years using the straight-line method. Amortization expense of $5.6 million and $4.1 million was recorded for the nine months ended March 31, 2014 and 2013, respectively.

Goodwill is not amortized but is subject to annual impairment tests as well as more frequent reviews whenever circumstances indicate a possible impairment may exist. Impairment testing of goodwill is done at the MBO level by comparing the fair value of the MBO's net assets against the carrying value of the MBO's net assets, including goodwill. Each MBO is defined as a reporting unit for purposes of impairment testing. The fair value of net assets is calculated based on quantitative analysis of discounted cash flows. The fair value of goodwill is determined by assigning fair values to assets and liabilities and calculating any remaining fair value as the implied fair value of goodwill.

Notes Receivable and Other Assets

Other assets consist primarily of notes receivable, pledges receivable, deferred compensation assets, prepaid service contracts, deposits and other long-term assets. Notes receivable from related entities at March 31, 2014 include balances from Bethesda Hospital, Inc. (Bethesda), the non-CHI joint operating agreement (JOA) partner in the Cincinnati, Ohio JOA. All of the notes bear interest at rates commensurate with the CHI blended interest cost and require monthly debt service payments.

1. Summary of Significant Accounting Policies (continued)

Notes Receivable and Other Assets (continued)

A summary of notes receivable and other assets is as follows (in thousands):

	March 31, 2014	June 30, 2013
Total notes receivable from related entities	**$ 178,746**	$ 188,275
Reinsurance recoverable on unpaid losses and loss adjustment expense	**71,801**	71,801
Deferred compensation assets	**45,050**	41,014
Other long-term assets	**274,476**	129,798
Total notes receivable and other	**$ 570,073**	$ 430,888

Bethesda is a Designated Affiliate in the CHI credit group under the Capital Obligation Document (COD). As conditions of joining the CHI credit group, Bethesda has agreed to certain covenants related to corporate existence, insurance coverage, exempt use of bond-financed facilities, maintenance of certain financial ratios and compliance with limitations on the incurrence of additional debt. Based upon management's review of the creditworthiness of Bethesda and its compliance with the covenants and limitations, no allowances for uncollectible notes receivable were recorded at March 31, 2014 and June 30, 2013.

Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity, including endowment funds. Temporarily restricted net assets and earnings on permanently restricted net assets, including earnings on endowment funds, are used in accordance with the donor's wishes primarily to purchase equipment, to provide charity care and to provide other health and educational programs and services.

Unconditional promises to receive cash and other assets are reported at fair value at the date the promise is received. Conditional promises and indications of donors' intentions to give are reported at fair value at the date the conditions are met or the gifts are received. All unrestricted contributions are included in the excess of revenue over expenses as donation revenues. Other gifts are reported as either temporarily or permanently restricted if they are received with donor

1. Summary of Significant Accounting Policies (continued)

Net Assets (continued)

stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as donations revenue when restricted for operations or as unrestricted net assets when restricted for property and equipment.1. Summary of Significant Accounting Policies (continued)

Performance Indicator

The performance indicator is the excess of revenues over expenses, which includes all changes in unrestricted net assets other than changes in the pension liability funded status, net assets released from restrictions for property acquisitions, cumulative effect of changes in accounting principles, discontinued operations, and contributions of property and equipment, and other changes not required to be included within the performance indicator under generally accepted accounting principles.

Operating and Nonoperating Activities

CHI's primary mission is to meet the health care needs in its market areas through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services, long-term care and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Earnings from fixed-income investments held by FIIL are also classified within operating activities as such earnings help support FIIL operations. Other activities that result in gains or losses peripheral to CHI's primary mission are considered to be nonoperating. Nonoperating activities include all other investment earnings, gains/losses from bond defeasance, net interest cost and changes in fair value of interest rate swaps, and the nonoperating component of JOA income share adjustments.

Charity Care

As an integral part of its mission, CHI accepts and treats all patients without regard to the ability to pay. Services to patients are classified as charity care in accordance with standards established across all MBOs. Charity care represents services rendered for which partial or no payment is expected, and includes the cost of providing services to persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. CHI determines the cost of charity care on the basis of an MBO's total cost as a percentage of total charges, applied to the charges incurred by patients qualifying for charity care under CHI's policy. This amount is not included in net patient services revenue in the accompanying consolidated statements of operations and changes in net assets.

1. Summary of Significant Accounting Policies (continued)

Meaningful Use of Certified Electronic Health Record Technology Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 to certain hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. An initial Medicaid incentive payment is available to providers that adopt, implement or upgrade certified EHR technology. However, in order to receive additional Medicaid incentive payments in subsequent years, providers must demonstrate continued meaningful use of EHR technology.

CHI accounts for meaningful use incentive payments under the gain contingency model. Medicare EHR incentive payments are recognized as revenues when eligible providers demonstrate meaningful use of certified EHR technology and the cost report information for the full cost report year that will determine the full calculation of the incentive payment is available. Medicaid EHR incentive payments are recognized as revenues when an eligible provider demonstrates meaningful use of certified EHR technology. For the nine months ended March 31, 2014 and 2013, CHI recognized in its consolidated statements of operations $18.5 million and $13.7 million of Medicare meaningful use revenues, respectively, and $20.4 million and $6.4 million of Medicaid meaningful use revenues, respectively.

Other Nonpatient Revenues

Other nonpatient revenues include services sold to external health care providers, gains on the acquisitions of subsidiaries, rental income, retail pharmacy and durable medical equipment sales, auxiliary and gift shop revenues, meaningful use payments, gains and losses on the sales of assets, the operating portion of revenue-sharing income or expense associated with Direct Affiliates that are part of JOAs, and revenues from other miscellaneous sources.

Derivative and Hedging Instruments

CHI uses derivative financial instruments (interest rate swaps) in managing its capital costs. These interest rate swaps are recognized at fair value on the consolidated balance sheets. CHI has not designated its interest rate swaps related to CHI's long-term debt as hedges. The net interest cost and change in the fair value of such interest rate swaps is recognized as a component of nonoperating gains (losses) in the accompanying consolidated statements of operations. It is CHI's policy to net the value of collateral on deposit with counterparties against the fair value of its interest rate swaps in other liabilities on the consolidated balance sheets.

1. Summary of Significant Accounting Policies (continued)

Functional Expenses

CHI provides inpatient, outpatient, ambulatory, long-term care and community-based services to individuals within the various geographic areas supported by its facilities. Support services include administration, finance and accounting, information technology, public relations, human resources, legal, mission services and other functions that are supported centrally for all of CHI. Support services expenses as a percent of total operating expenses were approximately 7.4% and 5.5% for the nine months ended March 31, 2014 and 2013, respectively.

Restructuring, Impairment and Other Losses

CHI periodically evaluates property, equipment, goodwill and certain other intangible assets to determine whether assets may have been impaired. Management determined that there were certain property and equipment impairments for the nine months ended March 31, 2014 and 2013, to the extent that the fair values (estimated based upon discounted cash flows) of those assets were less than the underlying carrying values.

During the nine months ended March 31, 2014 and 2013, CHI recorded total charges of $49.8 million and $75.3 million, respectively, relating to asset impairments and changes in business operations, including reorganization and severance costs. Of this amount, $49.8 million and $44.1 million were from continuing operations and reported in the consolidated statements of operations for the nine months ended March 31, 2014 and 2013, respectively, and $31.1 million was reported as discontinued operations in the consolidated statements of changes in net assets for March 31, 2013.

Income Taxes

CHI is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI owns certain taxable subsidiaries and engages in certain activities that are unrelated to its exempt purpose and therefore subject to income tax.

Management reviews its tax positions annually and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates.

2. Acquisitions, Affiliations and Divestitures

Continuing Operations

Harrison Medical Center – Effective August 1, 2013, a subsidiary of CHI entered into an affiliation agreement with Harrison Medical Center (Harrison), whereby the CHI subsidiary now controls the operations of Harrison and reports them as part of CHI's consolidated results. No consideration was transferred for the transaction and it resulted in the recognition of a $286.2 million gain in fiscal year 2014, calculated as the fair value of assets acquired and liabilities assumed determined based upon observable (Level 2) inputs. Harrison is located in Bremerton, Washington, and operates two acute care facilities in the area as well as provides emergency services and a range of general and specialized services to adjacent areas. Including the contribution gain, Harrison reported $549.5 million in operating revenues and $305.2 million of excess of revenues over expenses to the CHI consolidated results of operations for the period August 1, 2013 through March 31, 2014.

The assets and liabilities of Harrison were allocated as follows (dollars in thousands):

	Harrison
Purchase price allocation:	
Cash and investments	212,985
Patient accounts receivable	50,556
Other current assets	11,780
Property and equipment	199,127
Intangible assets	21,028
Goodwill	-
Other assets	8,884
Current liabilities	(65,858)
Pension liability	(17,678)
Other liabilities	(14,460)
Notes payable to CHI	-
Debt	(120,122)
Gain on business combination	$ 286,242

2. Acquisitions, Affiliations and Divestitures (continued)

Regional Medical Center - Effective on January 1, 2014, Regional Hospital (Regional) entered into an affiliation agreement with Franciscan Health System (Franciscan), CHI's subsidiary in Washington state, whereby Franciscan became the sole member of Regional. Results of operations of Regional were consolidated into Franciscan upon the acquisition date. No consideration was transferred for the transaction, which resulted in the recognition of a $7.4 million gain in fiscal year 2014, calculated as the fair value of assets acquired and liabilities assumed determined based upon observable (Level 2) inputs. Located in Tukwila, Washington, Regional is a 40-bed long-term acute care hospital that offers extended critical care, including respiratory care. Including the contribution gain, Regional reported $12.5 million in operating revenues and $7.6 million of excess of revenues over expenses to the CHI consolidated results of operations for the period January 1, 2014 through March 31, 2014.

Baylor College of Medicine - Effective on January 1, 2014, St. Luke's and Baylor College of Medicine (Baylor) formed a joint venture to build and operate a new, acute-care, open-staff hospital on Baylor's McNair Campus. The venture will be owned 65% by St Luke's and 35% by Baylor. In conjunction with the joint venture, St. Luke's and Baylor also entered into an academic affiliation agreement whereby Baylor will provide certain clinical programs and services to certain of the St. Luke's hospital facilities. The valuation of contributed assets is in process and will be finalized by the end of the fiscal year.

Texas Heart Institute - Effective on January 1, 2014, CHI and Texas Heart Institute (THI) entered into a ten-year affiliation agreement to further develop research, education and patient care opportunities to reduce the toll of cardiovascular disease. Over the term of the agreement, CHI has committed to fund approximately $170 million in various programs sponsored by THI.

The following tables are a summary of the business combinations that occurred in fiscal year 2013 (dollars in thousands):

Fiscal Year 2013

	St. Luke's	Highline	UMC	Alegent	Total
Purchase consideration:					
Cash	1,000,000	-	-	553,700	**1,553,700**
Note payable	260,000	-	-	-	**260,000**
Contingent consideration	-	-	217,709	-	**217,709**
Equity interest in Alegent	-	-	-	33,934	**33,934**
Gain on business combination	-	55,436	-	20,989	**76,425**
	$ 1,260,000	$ 55,436	$ 217,709	$ 608,623	**$ 2,141,768**

2. Acquisitions, Affiliations and Divestitures (continued)

Fiscal Year 2013

	St. Luke's	Highline	UMC	Alegent	Total
Purchase price allocation:					
Cash and investments	1,153,253	57,133	94,061	496,309	**1,800,756**
Patient accounts receivable	180,106	27,268	65,723	118,833	**391,930**
Other current assets	37,413	5,081	29,601	34,884	**106,979**
Property and equipment	1,046,341	137,148	176,004	474,996	**1,834,489**
Intangible assets	41,124	1,494	-	982	**43,600**
Goodwill	-	-	53,178	92,964	**146,142**
Other assets	25,600	17,745	9,367	63,798	**116,510**
Current liabilities	(175,081)	(34,087)	(76,202)	(206,630)	**(492,000)**
Pension liability	(3,559)	(12,307)	-	(48,216)	**(64,082)**
Other liabilities	(153,436)	(5,355)	(11,202)	(81,344)	**(251,337)**
Notes payable to CHI	-	-	-	(337,953)	**(337,953)**
Debt	(891,761)	(138,684)	(122,821)	-	**(1,153,266)**
	$ 1,260,000	$ 55,436	$ 217,709	$ 608,623	**$ 2,141,768**

St. Luke's Health System - Effective June 1, 2013, CHI acquired the operations of St. Luke's Health System (St. Luke's), a six-hospital system based in Houston, TX, from Episcopal Health Foundation for cash and a note payable. For the nine months ended March 31, 2014, the operations of St. Luke's contributed $938.3 million in operating revenues, and $66.4 million of excess of revenues over expenses to the CHI consolidated results of operations.

Highline Medical Center - Effective April 1, 2013, Highline Medical Center (Highline) was acquired by CHI for no consideration, resulting in the recognition of a $55.4 million gain calculated as the fair value of assets acquired and liabilities assumed determined based upon observable (Level 2) inputs. Highline is a 154-bed acute care hospital based in Burien, WA. For the nine months ended March 31, 2014, the operations of Highline contributed $158.0 million in operating revenues, and $21.0 million of excess of revenues over expenses to the CHI consolidated results of operations.

University Medical Center and University of Louisville Hospital – Effective March 1, 2013, KentuckyOne Health, University Medical Center (UMC) and University of Louisville entered into a partnership, structured as a joint operating agreement between UMC and KentuckyOne Health, whereby KentuckyOne Health controls substantially all of UMCs operations, which consist of the University of Louisville Hospital and the James Graham Brown Cancer Center (ULH). As part of the agreement, KentuckyOne Health has committed to provide various financial support to the University of Louisville over the next 20 years, which as of the acquisition date had a fair value of $217.7 million based upon discounted cash flows and probability-weighted performance assumptions (Level 3 inputs). The value of such contingent consideration will be remeasured to fair value on a quarterly basis, and as of March 31, 2014, had a value of $202.3 million. For the nine months ended March 31, 2014, the operations of ULH contributed $383.4 million in operating revenues, and $26.5 million of excess of revenues over expenses to the CHI consolidated results of operations, prior to the impact of revenue sharing with KentuckyOne Health.

2. Acquisitions, Affiliations and Divestitures (continued)

Alegent Creighton Health and Affiliates – Effective November 1, 2012, CHI became the sole corporate sponsor of Alegent Creighton Health and Affiliates (Alegent) based in Omaha NE. In addition to the operations of Bergan Mercy Health System and Affiliates (Bergan Mercy) previously owned and consolidated by CHI, CHI now consolidates the remaining Alegent operations, which include the operations of Alegent Creighton Health Immanuel Medical Center and the operations of Creighton University Medical Center. For the nine months ended March 31, 2014, the incremental Alegent operations (excluding the Bergan Mercy component) contributed $705.9 million in operating revenues, and $14.1 million of excess of revenues over expenses to the CHI consolidated results of operations.

Soundpath Health – CHI currently holds a 62.6% majority interest in Soundpath Health, Inc., (Soundpath), a provider-owned health care plan based in Federal Way, Washington, that offers Medicare Advantage plans. In July 2013 and March 2013, CHI paid $13.2 million for shares of common stock and $12.1 million for preferred shares in Soundpath. Of the total purchase price, $16.3 million was allocated to goodwill. For the nine months ended March 31, 2014, the operations of Soundpath contributed $109.5 million in operating revenues, and $(2.3) million of deficit of revenues over expenses to the CHI consolidated results of operations.

On an unaudited pro forma basis, had CHI owned or been party to an agreement with Harrison at the beginning of fiscal year 2014, Harrison would have contributed $296.7 million of operating revenues and $21.3 million of excess of revenues over expenses for the nine months ended March 31, 2014. On an unaudited pro forma basis, had CHI owned or been party to an agreement with Harrison, St. Luke’s, Highline, University Medical Center and Alegent at the beginning of fiscal year 2013, these entities would have contributed $2.3 billion of operating revenues and $146.4 million of excess of revenues over expenses for the nine months ended March 31, 2013.

Discontinued Operations

In 2012, CHI committed to a plan to sell the MBOs in Denville, New Jersey; Towson, Maryland; and Pierre, South Dakota. The Towson MBO was sold to the University of Maryland Medical System effective on December 1, 2012. Contingent sales proceeds of $45.7 million have been placed in escrow pending final disposition of certain open items. The Pierre MBO was sold to Avera Health effective January 1, 2013. In May 2013, CHI agreed to sell the Denville MBO to Prime Healthcare Services for $100.0 million. The transaction is subject to governmental and Church approvals and is expected to close by the end of fiscal year 2014. In accordance with Accounting Standards Codification (ASC) 205-20, *Discontinued Operations*, and ASC 360-10, *Impairment and Disposal of Long-Lived Assets,* the results of operations associated with these MBOs have been reported as discontinued operations and are included in the consolidated statements of changes in net assets. Assets held for sale consist primarily of net patient accounts receivable, net property and other long-term assets. Liabilities held for sale consist primarily of accrued compensation and benefits, accounts payable and deferred revenues. For the nine months

2. Acquisitions, Affiliations and Divestitures (continued)

ended March 31, 2014 and 2013, CHI recorded a deficit of revenues over expenses of $(18.9) million and $(6.6) million respectively, for operations of the Denville market. For the nine months ended March 31, 2013, CHI recorded a deficit of revenues over expenses of $(52.5) million for all discontinued operations.

3. Net Patient Services Revenues

Net patient services revenues are derived from services provided to patients who are either directly responsible for payment or are covered by various insurance or managed care programs. CHI receives payments from the federal government on behalf of patients covered by the Medicare program, from state governments for Medicaid and other state-sponsored programs, from certain private insurance companies and managed care programs and from patients themselves. A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic and other factors. Certain CHI facilities have been designated as critical access hospitals and, accordingly, are reimbursed their cost of providing services to Medicare beneficiaries. Professional services rendered by physicians are paid based on the Medicare allowable fee schedule.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are primarily paid under the traditional Medicaid plan at prospectively determined rates per discharge. Certain outpatient services are reimbursed based on a cost reimbursement methodology, fee schedules or discounts from established charges.

Other – CHI has also entered into payment agreements with certain managed care and commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to CHI under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

3. Net Patient Services Revenues (continued)

CHI's Medicare, Medicaid and other payor utilization percentages, based upon net patient services revenues, are summarized as follows:

	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
Medicare	**32%**	32%
Medicaid	**7**	8
Managed care	**40**	40
Self-pay	**9**	8
Commercial and other	**12**	12
	100%	100%

Laws and regulations governing the Medicare and Medicaid programs 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. Estimated settlements related to Medicare and Medicaid of $95.7 million and $103.0 million at March 31, 2014 and June 30, 2013, respectively, are included in third-party liabilities. Net patient services revenues from continuing operations increased by $36.5 million and $30.5 million for the nine months ended March 31, 2014 and 2013, respectively, due to favorable changes in estimates related to prior-year settlements.

4. Investments and Assets Limited as to Use

CHI's investments and assets limited as to use are reported in the accompanying consolidated balance sheets as presented in the following table (in thousands):

	March 31, 2014	June 30, 2013
Cash and equivalents	**$ 654,593**	$ 244,077
CHI Investment Program	**5,881,994**	4,911,135
Marketable equity securities	**382,004**	858,537
Marketable fixed-income securities	**501,093**	773,069
Hedge funds and other investments	**99,444**	323,885
	7,519,128	7,110,703
Less current portion	**(36,594)**	(11,697)
	$ 7,482,534	$ 7,099,006

4. Investments and Assets Limited as to Use (continued)

Net unrealized gains at March 31, 2014 and June 30, 2013, were $574.3 million and $297.3 million, respectively.

CHI attempts to reduce its market risk by diversifying its investment portfolio using cash equivalents, marketable equity securities, fixed-income securities and alternative investments. Most of the U.S. Treasury, money market funds and corporate debt obligations as well as exchange-traded marketable securities held by CHI and the CHI Investment Program (the Program) have an actively traded market. However, CHI also invests in commercial paper, mortgage-backed or other asset-backed securities, alternative investments (such as hedge funds, private equity investments, real estate funds, funds of funds, etc.), collateralized debt obligations, municipal securities and other investments that have potential complexities in valuation based upon the current conditions in the credit markets. For some of these instruments, evidence supporting the determination of fair value may not come from trading in active primary or secondary markets. Because these investments may not be readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been

used had an active market for such investments existed. Such differences could be material. However, management reviews the CHI investment portfolio on a regular basis and seeks guidance from its professional portfolio managers related to U.S. and global market conditions to determine the fair value of its investments. CHI believes the carrying amount of these financial instruments in the consolidated financial statements is a reasonable estimate of fair value. Additionally, CHI assesses the risk of impairment related to securities held in its investment portfolio on a regular basis and noted no impairment during the nine month period ended March 31, 2014, and during the year ended June 30, 2013.

Substantially all CHI long-term investments are held in the Program. The Program is structured under a Limited Partnership Agreement with CHI as managing general partner and numerous limited partners, most sponsored by CHI. The partnership provides a vehicle whereby virtually all entities associated with CHI, as well as certain other unrelated entities, can optimize investment returns while managing investment risk. Entities participating in the Program that are not consolidated in the accompanying financial statements have the ability to direct their invested amounts and liquidate and/or withdraw their interest without penalty as soon as practicable based on market conditions but within 180 days of notification. The Limited Partnership Agreement permits a majority vote of the noncontrolled limited partners to terminate the partnership. Accordingly, CHI recognizes only the portion of Program assets attributable to CHI and its sponsored affiliates. Program assets attributable to CHI and its direct affiliates represented 91% and 90% of total Program assets at March 31, 2014 and June 30, 2013, respectively.

4. Investments and Assets Limited as to Use (continued)

The Program asset allocations were as follows:

	March 31, 2014	June 30, 2013
Marketable equity securities	**43%**	43%
Marketable fixed-income securities	**32**	32
Alternative investments	**23**	24
Cash and equivalents	**2**	1
	100%	100%

The CHI Investment Committee (the Investment Committee) of the Board of Stewardship Trustees is responsible for determining asset allocations among fixed-income, equity and alternative investments. At least annually, the Investment Committee reviews targeted allocations and, if necessary, makes adjustments to targeted asset allocations. Given the diversity of the underlying securities in which the Program invests, management does not believe there is a significant concentration of credit risk.

Investment income is comprised of the following (in thousands):

	Nine Months Ended March 31, 2014	2013
Dividend and interest income	**$ 98,004**	$ 98,663
Net realized gains	**269,625**	154,412
Net unrealized gains	**273,140**	337,883
Total investment income from continuing operations	**$ 640,769**	$ 590,958
Included in other nonpatient revenue	**$ 71,850**	$ 72,946
Included in nonoperating gains	**568,919**	518,012
Total investment income from continuing operations	**$ 640,769**	$ 590,958
Total investment income from discontinued operations	**2,229**	8,448
Total investment income	**$ 642,998**	$ 599,406

Direct expenses of the Program are less than 0.4% of total assets during the prior fiscal year and are estimated to remain below this level in the current fiscal year. Fees paid to the alternative investment managers are not included in the total expense calculation as they are not a direct expense of the Program.

5. Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1 – Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial asset or liability.

Level 3 – Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

Certain of CHI's alternative investments are made through limited liability companies (LLC) and limited liability partnerships (LLP). These LLCs and LLPs provide CHI with a proportionate share of the investment gains (losses). CHI accounts for its ownership in the LLCs and LLPs under the equity method. CHI also accounts for its ownership in the Partnership under the equity method. As such, these investments are excluded from the scope of ASC 820.

Financial assets and liabilities measured at fair value on a recurring basis were determined using the following inputs at March 31, 2014 and June 30, 2013 (in thousands):

5. Fair Value of Assets and Liabilities (continued)

	March 31, 2014 Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Fair Value as of March 31	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Assets limited as to use:				
Cash and short-term investments	$ 654,593	$ 602,993	$ 51,600	$ –
Marketable equity securities	382,004	382,004	–	–
Marketable fixed-income securities	501,093	189,971	311,122	–
Other investments	7,136	–	–	7,136
Deferred compensation assets:				
Cash and short-term investments	11,442	11,442	–	–
	$ 1,556,268	$ 1,186,410	$ 362,722	$ 7,136
Liabilities				
Interest rate swaps	$ 229,642	$ –	$ 229,642	$ –
Deferred compensation liability	11,442	11,442	–	–
	$ 241,084	$ 11,442	$ 229,642	$ –

	June 30, 2013 Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Fair Value as of June 30	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Assets limited as to use:				
Cash and short-term investments	$ 244,077	$ 197,385	$ 46,692	$ –
Marketable equity securities	858,537	858,537	–	–
Marketable fixed-income securities	773,069	123,996	649,073	–
Other investments	11,718	–	–	11,718
Deferred compensation assets:				
Cash and short-term investments	12,035	12,035	–	–
	$ 1,899,436	$ 1,191,953	$ 695,765	$ 11,718
Liabilities				
Interest rate swaps	$ 271,634	$ –	$ 271,634	$ –
Deferred compensation liability	12,035	12,035	–	–
	$ 283,669	$ 12,035	$ 271,634	$ –

5. Fair Value of Assets and Liabilities (continued)

The fair values of the securities included in Level 1 were determined through quoted market prices. Level 1 securities include money market funds, mutual funds and marketable debt and equity securities. The fair values of Level 2 securities were determined through evaluated bid prices based on recent trading activity and other relevant information, including market interest rate curves and referenced credit spreads; estimated prepayment rates, where applicable, are used for valuation purposes and are provided by third-party services where quoted market values are not available. Level 2 investments include corporate fixed–income securities, government bonds, mortgage and asset-backed securities, and interest rate swaps. The fair values of Level 3 securities are determined primarily through information obtained from the relevant counterparties for such investments. Information on which these securities' fair values are based is generally not readily available in the market.

6. Debt Obligations

The following is a summary of debt obligations (in thousands):

	Interest Rates at March 31, 2014	Balances at March 31, 2014	Balances at June 30, 2013
CHI debt issued under the COD			
Variable-rate Bonds:			
Series 1997B, maturing through 2022	0.2%	**$ 7,700**	$ 9,200
Series 2000B, maturing 2027	0.13%	**22,700**	24,000
Series 2002B, maturing 2032	0.13–0.16%	**94,700**	97,800
Series 2004B, maturing through 2044	0.05–0.16%	**180,700**	180,700
Series 2004C, maturing through 2044	0.05–0.06%	**163,300**	163,300
Series 2008A, maturing 2036	0.11%	**120,225**	120,260
Series 2008C, maturing 2041	0.13%	**50,000**	50,000
Series 2011B, maturing 2046	0.06%	**158,155**	158,155
Series 2011C, maturing 2046	0.1%	**121,000**	123,000
Series 2013B, maturing 2035	0.06%	**200,000**	–
Series 2013C, maturing 2023	0.11%	**100,000**	–
Series 2013E Taxable, maturing 2045	0.16%	**125,000**	–
Series 2013F Taxable, maturing 2045	0.16%	**75,000**	–
Fixed-rate Bonds:			
Series 2002A, maturing 2017	5.5%	**2,615**	3,400
Series 2004A, maturing through 2034	4.75–5.0%	**146,605**	146,605
Series 2006A, maturing 2041	4.0–5.0%	**270,635**	270,635
Series 2006C, maturing through 2041	3.85–5.1%	**250,000**	250,000
Series 2008C, maturing through 2041	4.0–5.0%	**105,000**	105,000
Series 2008D, maturing through 2038	5.0–6.38%	**471,450**	471,450
Series 2009A, maturing 2039	3.75–5.5%	**729,330**	748,760
Series 2009B, maturing through 2039	4.0–5.0%	**217,720**	252,360
Series 2011A, maturing 2041	3.0–5.25%	**486,090**	506,090
Series 2012A, maturing 2035	3.0–5.0%	**268,980**	271,260
Series 2012 Taxable, maturing 2042	1.6–4.35%	**1,500,000**	1,500,000
Series 2013A , maturing 2045	5.0–5.75%	**600,600**	–
Series 2013 Taxable, maturing 2023	2.6–4.2%	**540,000**	–
Commercial Paper		**442,475**	442,475
Unamortized debt premium		**57,131**	59,538
Unamortized debt discount		**(25,352)**	(11,192)
Total CHI debt issued under the COD		**7,481,759**	5,942,796

6. Debt Obligations (continued)

	Interest Rates at March 31, 2014	Balances at March 31, 2014	Balances at June 30, 2013
St. Luke's debt issued under Master Trust Indenture			
Variable-rate Bonds:			
Series 2005	n/a	**$ –**	$ 132,600
Series 2008	n/a	–	100,000
Series 2012	n/a	–	150,220
Fixed-rate Bonds: Series 2009	n/a	–	150,798
Unsecured Bank Notes		–	99,798
Total St. Luke's debt issued under Master Trust Indenture		–	633,416
Note payable issued to Episcopal Foundation		**260,000**	260,000
Capital leases		**192,064**	106,899
Other debt		**267,335**	462,946
		8,201,158	7,406,057
Less: Amounts classified as current:			
Variable-rate debt with self-liquidity		**(521,455)**	(321,455)
Commercial paper and current portion of debt		**(659,301)**	(749,617)
Long-term debt		**$ 7,020,402**	$ 6,334,985

CHI issues the majority of its debt under the COD and is the sole obligor. Bondholder security resides both in the unsecured promise by CHI to pay its obligations and in its control of its Direct and Designated Affiliates. Covenants include a minimum CHI debt service coverage ratio and certain limitations on secured debt. The Direct Affiliates of CHI, defined as Participants under the COD, have agreed to certain covenants related to corporate existence, maintenance of insurance and exempt use of bond-financed facilities.

During the second quarter of fiscal year 2014, CHI issued $900.6 million of par value tax exempt bonds and $740.0 million of par value taxable bonds. Of the total proceeds, $908.0 million was used to redeem various St. Luke's bonds and bank notes, Harrison bonds, and Highline bonds, resulting in a total loss on defeasance of $10.0 million.

As a result of redeeming the various St. Luke's obligations, the St. Luke's Health System Obligated Group and Master Trust Indenture were dissolved. Prior to December 31, 2013, St. Luke's had been a member of the St. Luke's Health System Obligated Group, and together with various of its consolidated subsidiaries, were the obligors under each of the St. Luke's bond issues. Obligated Group members were jointly and severally obligated to pay the notes issued under the Master Trust Indenture. Notes issued under the Master Trust Indenture were equally and ratably secured by a pledge of the accounts receivable of St. Luke's Medical Center and St. Luke's Woodlands Hospital.

6. Debt Obligations (continued)

CHI has two types of external liquidity facilities: those that are dedicated to specific series of variable-rate demand bonds (VRDBs) and those that are not dedicated to a particular series of VRDBs but may be used to support CHI's obligations to fund tenders of VRDBs and pay the maturing principal of commercial paper. Liquidity facilities that are dedicated to specific series of bonds were $897.0 million and $605.0 million at March 31, 2014 and June 30, 2013, respectively, of which $8.2 million and $7.9 million, respectively, are classified as current debt. The remaining $888.8 million and $597.1 million at March 31, 2014 and June 30, 2013, respectively, are reported as long-term debt due to the repayment terms on any associated drawings extending beyond the subsequent fiscal year under the terms of the specific agreements.

Liquidity facilities not dedicated for specific series of VRDBs but used to support CHI's obligations to fund tenders and to pay maturing principal of commercial paper were $380.0 million and $390.0 million at March 31, 2014 and June 30, 2013, respectively. At both March 31, 2014 and June 30, 2013, $442.5 million of commercial paper were classified as current due to maturities of less than one year. At March 31, 2014 and June 30, 2013, $521.5 million and $321.5 million, respectively, of VRDBs and Windows variable-rate bonds (Windows) were classified as current due to the holder's ability to put such VRDBs and Windows back to CHI without liquidity facilities dedicated to these bonds.

At March 31, 2014, CHI had a $55.0 million credit facility with Wells Fargo Bank. Letters of credit totaling $47.6 million have been issued for the benefit of third parties, principally in support of the self-insurance programs administered by FIIL. At March 31, 2014 and June 30, 2013, no amounts were outstanding under this credit facility.

At March 31, 2014, CHI was a party to eleven floating-to-fixed interest rate swap agreements with notional amounts totaling $1.4 billion; at June 30, 2013, CHI was a party to twelve floating-to-fixed interest rate swap agreements with notional amounts totaling $1.6 billion. Generally, it is CHI policy that all counterparties have an AA rating or better. The swap agreements require CHI to provide collateral if CHI's liability, determined on a mark-to-market basis, exceeds a specified threshold that varies based upon the rating on the corporation's long-term indebtedness. These fixed-payor swap agreements convert CHI's variable-rate debt to fixed-rate debt. The swaps have varying maturity dates ranging from 2025 to 2047. The fair value of the swaps is estimated based on the present value sum of anticipated future net cash settlements until the swaps' maturities. At March 31, 2014 and June 30, 2013, the fair value was $229.6 million and $271.6 million, respectively. Cash collateral balances of $118.3 million and $107.5 million at March 31, 2014 and June 30, 2013, respectively, are netted against the fair value of the swaps, and the net amount is reflected in other liabilities. The change in the fair value of these agreements resulted in gains of $30.1 million and $34.4 million being recognized in the consolidated statements of operations for the nine months ended March 31, 2014 and 2013, respectively.

7. Retirement Plans

CHI Pension Plan

The noncontributory, defined benefit retirement plans (Retirement Plans) sponsored by CHI and its direct affiliates were frozen as of December 31, 2013. Benefits earned by employees through December 31, 2013 will remain in the Retirement Plans, and employees will continue to receive interest credits and, if applicable, vesting credits. Beginning January 1, 2014, CHI introduced a new 401(k) Retirement Savings Plan – see CHI 401(k) Retirement Savings Plan below for additional information.

Benefits in the Retirement Plans are based on compensation, retirement age and years of service. Vesting occurs over a five-year period. Substantially all of the Plans are qualified as church plans and are exempt from certain provisions of both the Employee Retirement Income Security Act and Pension Benefit Guaranty Corporation premiums and coverage. Funding requirements are determined through consultation with independent actuaries.

CHI recognizes the funded status (that is, the difference between the fair value of plan assets and the projected benefit obligations) of its Plans in the consolidated balance sheets, with a corresponding adjustment to net assets. Actuarial gains and losses that arise and are not recognized as net periodic pension cost in the same periods are recognized as a component of net assets.

Estimated amounts for the components of net periodic pension expense are summarized in the table below. Amounts will be adjusted at year-end to reflect actual results, based on the final annual actuarial reports (in thousands):

	Nine Months Ended March 31,	
	2014	**2013**
Components of net periodic pension expense:		
Service cost	**$ 74,490**	$ 157,233
Interest cost	**125,782**	109,772
Expected return on the Plans' assets	**(174,607)**	(154,394)
Actuarial losses	**26,117**	69,345
Amortization of prior service benefit	**116**	140
Settlements	**(862)**	345
	$ 51,036	$ 182,441

7. Retirement Plans (continued)

CHI 401(k) Retirement Savings Plan

Effective on January 1, 2014, CHI introduced the CHI 401(k) Retirement Savings Plan (401(k) Savings Plan), which replaced the frozen Retirement Plan as an employee retirement benefit. Years of service under the Retirement Plan will automatically transfer to the 401(k) Savings Plan. An employee is fully vested in the plan for employer contributions after three years of service.

As part of the 401(k) Savings Plan, CHI will match 100% of the first 1% of eligible pay an employee contributes to the plan, and 50% of the next 5% of eligible pay contributed to the plan, for a maximum employer matching rate of 3.5% of eligible pay. On an annual basis and regardless of whether or not an employee participates in the 401(k) Savings Plan, CHI will also contribute 2.5% of eligible pay to an employee's 401(k) Savings Plan account. This contribution is made if an employee reaches 1,000 hours in the first year of employment or every calendar year thereafter, and is employed on the last day of the calendar year. For the period from January 1 through March 31, 2014, CHI contributed $41.0 million to the 401(k) Savings Plan.

8. Concentrations of Credit Risk

CHI grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. CHI's exposure to credit risk on patient accounts receivable is limited by the geographical diversity of its MBOs. The mix of receivables from patients and third-party payors approximated the following:

	March 31, 2014	June 30, 2013
Medicare	**29%**	28%
Medicaid	**14**	10
Managed care	**30**	31
Self-pay	**6**	7
Commercial and other	**21**	24
	100%	100%

CHI maintains long-term investments with various financial institutions and investment management firms through its investment program, and its policy is designed to limit exposure to any one institution or investment. Management does not believe there are significant concentrations of credit risk at March 31, 2014 and June 30, 2013.

9. Commitments and Contingencies

Litigation

During the normal course of business, CHI may become involved in litigation. Management assesses the probable outcome of unresolved litigation and records estimated settlements. After consultation with legal counsel, management believes that any such matters will be resolved without material adverse impact to the consolidated financial position or results of operations of CHI.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Management believes CHI is in compliance with all applicable laws and regulations of the Medicare and Medicaid programs. Compliance with such laws and regulations is complex and can be subject to future governmental interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs. Certain CHI entities have been contacted by governmental agencies regarding alleged violations of Medicare practices for certain services. In the opinion of management after consultation with legal counsel, the ultimate outcome of these matters will not have a material adverse effect on CHI's consolidated financial position.

10. Subsequent Events

Affiliation and Sponsorship Agreements

Effective on April 1, 2014, Mercy Health based in St. Louis, Missouri transferred ownership of its Arkansas facility, Mercy Hot Springs hospital and physician clinic, to an affiliate of CHI, for gross proceeds of $70 million.

During February 2014, CHI and St. Alexius Medical Center signed a non-binding letter of intent to form a new affiliation.

During January 2014, CHI and Memorial Health System of East Texas (Memorial Health) signed a non-binding letter of intent to transfer ownership of Memorial Health to CHI. A final agreement is expected in the spring of 2014.