



Aurora Health Care, Inc. and Affiliates

Unaudited Consolidated Financial Statements and Other Information
For the Period Ended March 31, 2017

AURORA HEALTH CARE, INC. AND AFFILIATES
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AURORA HEALTH CARE, INC. AND AFFILIATES
UNAUDITED CONSOLIDATED BALANCE SHEETS
(In thousands)

	March 31, 2017	December 31, 2016
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 203,963	\$ 107,664
Investments	1,551,625	1,614,843
Assets whose use is limited or restricted	4,848	5,484
Patient accounts receivable — net of allowance for doubtful accounts of \$102,858 and \$97,349 in 2017 and 2016, respectively	722,447	731,746
Other receivables	109,307	102,791
Inventory	69,649	70,031
Prepays and other current assets	50,344	48,026
Estimated third-party payor settlements	9,467	9,989
Total current assets	2,721,650	2,690,574
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:		
Board-designated and other	170,577	164,168
Contractually-restricted	167,148	154,267
Donor restricted	57,233	53,821
Debt service reserve	25,866	25,792
Total assets whose use is limited or restricted	420,824	398,048
PROPERTY, PLANT, AND EQUIPMENT — Net	2,056,105	2,066,286
OTHER ASSETS:		
Intangible assets — net	15,648	15,786
Investments in unconsolidated entities	73,570	72,313
Other	57,076	56,835
Total other assets	146,294	144,934
TOTAL	\$ 5,344,873	\$ 5,299,842

(Continued)

AURORA HEALTH CARE, INC. AND AFFILIATES
UNAUDITED CONSOLIDATED BALANCE SHEETS
(In thousands)

	March 31, 2017	December 31, 2016
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current installments of long-term debt	\$ 179,797	\$ 161,936
Accounts payable	165,788	222,528
Accrued salaries and wages	291,112	259,225
Other accrued expenses	153,983	213,684
Estimated third-party payor settlements	33,881	34,041
	<u>824,561</u>	<u>891,414</u>
Total current liabilities		
	<u>824,561</u>	<u>891,414</u>
LONG-TERM DEBT — Less current installments	1,379,916	1,403,091
	<u>1,379,916</u>	<u>1,403,091</u>
OTHER LIABILITIES:		
Pension and other employee benefit liabilities	252,888	243,574
Self-insured liabilities	58,931	61,592
Deferred gain	35,266	36,662
Other	60,749	61,822
	<u>407,834</u>	<u>403,650</u>
Total other liabilities		
	<u>407,834</u>	<u>403,650</u>
Total liabilities	2,612,311	2,698,155
	<u>2,612,311</u>	<u>2,698,155</u>
NET ASSETS:		
Unrestricted:		
Controlling interest	2,568,812	2,439,653
Noncontrolling interest in subsidiaries	98,002	100,119
	<u>2,666,814</u>	<u>2,539,772</u>
Total unrestricted net assets		
	<u>2,666,814</u>	<u>2,539,772</u>
Temporarily restricted	47,004	43,171
Permanently restricted	18,744	18,744
	<u>65,748</u>	<u>61,915</u>
Total net assets		
	<u>65,748</u>	<u>61,915</u>
TOTAL	<u>\$ 5,344,873</u>	<u>\$ 5,299,842</u>

See accompanying notes to unaudited consolidated financial statements.

(Concluded)

AURORA HEALTH CARE, INC. AND AFFILIATES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN
UNRESTRICTED NET ASSETS

(In thousands)

	Three Months Ended March 31,	
	2017	2016
REVENUE:		
Patient service revenue (net of contractual allowances and discounts)	\$ 1,230,379	\$ 1,187,802
Less provision for bad debts	39,498	38,534
Net patient service revenue less provision for bad debts	1,190,881	1,149,268
Other revenue	107,154	99,264
Total revenue	1,298,035	1,248,532
EXPENSES:		
Salaries, wages and fringe benefits	732,989	692,347
Professional fees	20,357	18,784
Supplies	234,723	227,735
Depreciation and amortization	55,204	51,519
Interest	13,719	13,907
Maintenance and service contracts	29,134	24,860
Building and equipment rental	16,700	16,610
Hospital tax assessment	24,568	24,155
Utilities	12,359	12,001
Purchased services	31,260	30,592
Other expenses	32,843	39,031
Total expenses	1,203,856	1,151,541
OPERATING INCOME	94,179	96,991
NONOPERATING INCOME:		
Investment income — net	44,030	28,095
Other nonoperating income — net	422	740
Total nonoperating income — net	44,452	28,835
EXCESS OF REVENUE OVER EXPENSES	138,631	125,826
Pension-related changes other than periodic pension cost	2,056	1,532
Net assets released from restriction for purchase of property and equipment	438	227
Distributions to noncontrolling interests	(14,079)	(15,975)
Other — net	(4)	(1)
INCREASE IN UNRESTRICTED NET ASSETS	\$ 127,042	\$ 111,609

See accompanying notes to unaudited consolidated financial statements.

AURORA HEALTH CARE, INC. AND AFFILIATES
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
THREE MONTHS ENDED MARCH 31, 2017 AND 2016
(In thousands)

	Controlling Interest Unrestricted	Noncontrolling Interest Unrestricted	Total Unrestricted	Temporarily Restricted	Permanently Restricted	Total
NET ASSETS — December 31, 2015	\$ 2,066,225	\$ 88,447	\$ 2,154,672	\$ 43,779	\$ 18,733	\$ 2,217,184
Excess of revenue over expenses	115,330	10,496	125,826	—	—	125,826
Pension-related changes other than net periodic pension costs	1,532	—	1,532	—	—	1,532
Contributions	—	—	—	1,790	—	1,790
Investment income	—	—	—	315	—	315
Net assets released from restrictions for operations	—	—	—	(1,468)	—	(1,468)
Net assets released from restrictions for purchase of property and equipment	227	—	227	(227)	—	—
Distributions to noncontrolling interest	—	(15,975)	(15,975)	—	—	(15,975)
Other — net	(1)	—	(1)	(24)	—	(25)
Increase (decrease) in net assets	117,088	(5,479)	111,609	386	—	111,995
NET ASSETS — March 31, 2016	<u>2,183,313</u>	<u>82,968</u>	<u>2,266,281</u>	<u>44,165</u>	<u>18,733</u>	<u>2,329,179</u>
NET ASSETS — December 31, 2016	<u>2,439,653</u>	<u>100,119</u>	<u>2,539,772</u>	<u>43,171</u>	<u>18,744</u>	<u>2,601,687</u>
Excess of revenue over expenses	126,669	11,962	138,631	—	—	138,631
Pension-related changes other than net periodic pension costs	2,056	—	2,056	—	—	2,056
Contributions	—	—	—	3,124	—	3,124
Investment income	—	—	—	2,486	—	2,486
Net assets released from restrictions for operations	—	—	—	(1,336)	—	(1,336)
Net assets released from restrictions for purchase of property and equipment	438	—	438	(438)	—	—
Distributions to noncontrolling interest	—	(14,079)	(14,079)	—	—	(14,079)
Other — net	(4)	—	(4)	(3)	—	(7)
Increase (decrease) in net assets	129,159	(2,117)	127,042	3,833	—	130,875
NET ASSETS — March 31, 2017	<u>\$ 2,568,812</u>	<u>\$ 98,002</u>	<u>\$ 2,666,814</u>	<u>\$ 47,004</u>	<u>\$ 18,744</u>	<u>\$ 2,732,562</u>

See accompanying notes to unaudited consolidated financial statements.

AURORA HEALTH CARE, INC. AND AFFILIATES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended	
	March 31,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 130,875	\$ 111,995
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Pension-related changes other than net periodic pension cost	(2,056)	(1,532)
Realized and unrealized gains on investments, net	(41,875)	(22,029)
Loss (gain) on sale of property, plant, and equipment	320	(574)
Amortization of intangible assets and other items	962	1,012
Amortization of deferred gains	(1,396)	(1,375)
Depreciation and amortization	55,204	51,519
Provision for bad debts	39,498	38,534
Distribution to noncontrolling interest	7,172	23,243
Increase in accounts receivable	(30,199)	(18,330)
Decrease in accounts payable and accrued expenses	(67,354)	(139,612)
Increase (decrease) in estimated third-party payor settlements	362	(312)
Increase in pension and other employee benefit liabilities	11,370	8,474
Decrease in self-insured liabilities	(2,661)	(1,472)
Other changes in assets and liabilities, net	(9,656)	23,310
Net cash provided by operating activities	<u>90,566</u>	<u>72,851</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(62,821)	(73,257)
Proceeds from sales of property, plant, and equipment	276	269
Investment in unconsolidated entities	(3,040)	(2,193)
Distributions from unconsolidated entities	761	934
Purchases of investments	(162,464)	(52,897)
Sales of investments	245,417	34,969
Net cash provided by (used in) investing activities	<u>18,129</u>	<u>(92,175)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	215	—
Repayments of long-term debt	(5,439)	(5,313)
Distribution to noncontrolling interest	(7,172)	(23,243)
Net cash used in financing activities	<u>(12,396)</u>	<u>(28,556)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	96,299	(47,880)
CASH AND CASH EQUIVALENTS:		
Beginning of period	107,664	176,626
End of period	<u>\$ 203,963</u>	<u>\$ 128,746</u>

See accompanying notes to unaudited consolidated financial statements.

AURORA HEALTH CARE, INC. AND AFFILIATES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE PERIOD ENDED MARCH 31, 2017

1. DESCRIPTION OF BUSINESS

Aurora Health Care, Inc. and its affiliates (collectively, "Aurora", "we", "our" or "us") constitute an integrated health care system providing health care services to communities throughout eastern Wisconsin, northern Illinois, and the upper peninsula of Michigan. Aurora provides a variety of health care related activities, education, philanthropic, medical research and other benefits to the communities in which it operates. Health care services include primary and specialty care, pharmacies, behavioral health care, emergency care, rehabilitation, home care, and end-of-life care.

Aurora Health Care, Inc. (the Corporation) is a Wisconsin nonstock, not-for-profit corporation. The Corporation is the parent corporation of a group of nonprofit and for profit corporations and other organizations that own and operate 14 acute-care hospital campuses, one psychiatric hospital, a network of approximately 160 physician clinic facilities, a home health services organization, over 70 retail pharmacies, and provides other health care related services.

The accompanying unaudited consolidated financial statements include the Corporation and its wholly owned or controlled affiliates. All intercompany accounts and transactions have been eliminated in the preparation of the unaudited consolidated financial statements.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The unaudited consolidated financial statements of Aurora as of March 31, 2017, and for the three months ended March 31, 2017 and 2016, include all adjustments that management considers necessary to present such information on a basis consistent with that of the audited consolidated financial statements.

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim reporting and, accordingly, do not include all of the disclosures required in annual financial statements. As such, these unaudited consolidated financial statements should be read in conjunction with the information included under Management's Discussion and Analysis of Results of Operations and Financial Position included in this quarterly report, and the audited consolidated financial statements as of and for the years ended December 31, 2016 and 2015, and the related notes. The audited consolidated financial statements are available from the Municipal Securities Rulemaking Board (MSRB) on its Electronic Municipal Market Access (EMMA) system, found at <http://emma.msrb.org>. Additional information can be obtained from the Investor Relations site on Aurora's website found at <https://www.aurorahealthcare.org/about-aurora/investor-relations-financial-information>.

The results of operations for the three months ended March 31, 2017 are not necessarily indicative of the operating results to be expected for the entire year ending December 31, 2017.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses as of the date and period of the consolidated financial statements. Actual results could differ from those estimates.

New Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry specific guidance, and requires significantly expanded disclosures about revenue recognition. The core principal of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. This ASU is effective for Aurora as of January 1, 2018. Management of Aurora is currently in the process of evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. This ASU introduces a lessee model that brings most leases on the balance sheet. The standard also aligns certain of the underlying principles of the new lessor model with those in ASU No. 2014-09, the new revenue recognition standard. This ASU is effective for Aurora as of January 1, 2019. Management of Aurora is currently in the process of evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, which is intended to simplify how a not-for-profit presents net assets and other information in the financial statements. Specifically focusing on the complexity and understandability of net asset classifications, deficiencies in information about liquidity and availability of resources, lack of consistency in the type of information provided about expenses and investment return, and misunderstandings about and opportunities to enhance the utility of the statement of cash flows. This ASU will be effective for Aurora as of January 1, 2018. Management of Aurora is currently in the process of evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, which amends guidance in Accounting Standards Codification (ASC) 230 on the classification of certain cash receipts and payments in the statement of cash flows. The primary purpose of the ASU is to reduce the diversity of practice that has resulted from the lack of consistent principles on this topic. This ASU is effective for Aurora beginning January 1, 2018. Management of Aurora is currently in the process of evaluating the impact of this guidance on its cash flows.

In March 2017, the FASB issued ASU 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. Only the service cost component of net periodic benefit cost will be eligible for capitalization in assets. This ASU is effective for Aurora beginning January 1, 2018. Management of Aurora is currently in the process of evaluating the impact of this guidance on its consolidated financial position, results of operations, and cash flows.

3. PATIENT SERVICE REVENUE AND PATIENT RECEIVABLES

Wisconsin assesses a fee or tax on gross patient service revenue. The revenues from this assessment are used to increase payments made to hospitals for services provided to Medicaid and other medically indigent patients. Aurora's patient service revenue reflects this increase in payment for services to Medicaid and other medically indigent patients, and hospital tax assessment expense reflects the fees assessed by the State. For the three months ended March 31, 2017 and 2016, patient service revenue includes \$27.7 million and \$29.9 million, respectively, related to this program, and expenses include \$24.6 million and \$24.2 million, respectively, of tax assessment fees.

The composition of patient service revenue, net of contractual allowances and discounts (before the provision for bad debts), by payor is as follows for the three months ended March 31, 2017 and 2016:

	March 31,	
	2017	2016
Managed care and all other	63%	64%
Medicare	27	26
Medicaid	9	8
Self-pay	1	2
	<u>100%</u>	<u>100%</u>

The self-pay revenue above includes only revenue from patients without insurance. The revenue related to amounts due from patients for co-insurance and deductibles is included with the related primary insurance coverage.

Laws and regulations governing government and other payment programs are complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated third-party settlements could change by a material amount. Changes in estimates relating to prior years increased patient service revenue by approximately \$1.8 million and \$1.0 million for the three months ended March 31, 2017 and 2016, respectively.

Aurora has filed formal appeals relating to the settlement of certain prior-year Medicare cost reports. The outcome of other appeals cannot be determined at this time.

The composition of patient accounts receivable, net of contractual allowances (before the allowance for doubtful accounts) is summarized as follows as of March 31, 2017 and December 31, 2016:

	March 31, 2017	December 31, 2016
Managed care and all other	47%	51%
Medicare	16	16
Medicaid	5	4
Self-pay	32	29
	<hr/>	<hr/>
	<u>100%</u>	<u>100%</u>

The self-pay patient accounts receivable above includes amounts due from patients for co-insurance, deductibles, and amounts due from patients without insurance.

Aurora's allowance for doubtful accounts increased \$5.5 million (5.7%), from 11.7% of gross accounts receivable less contractual allowances at December 31, 2016 to 12.5% at March 31, 2017. The increase in the allowance for doubtful accounts is due to an increase in amounts receivable from patients for co-insurance, deductibles and amounts due from patients without insurance.

4. FAIR VALUE

Financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, estimated third-party settlements, and long-term debt. Except for long-term debt, the fair values of these instruments approximate their carrying amounts at March 31, 2017 and December 31, 2016, due to their short-term maturities. The estimated fair value of long-term debt, based on discounted cash flows at estimated current borrowing rates, was \$1,393.0 million and \$1,394.0 million at March 31, 2017 and December 31, 2016, respectively, and is categorized as Level 2 within the fair value hierarchy.

The fair values of financial assets and liabilities that are measured by the level of significant input as of March 31, 2017 and December 31, 2016 are as follows (in thousands):

	March 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Recurring fair value measurements:				
Cash equivalents	\$ 22,373	\$ 18,900	\$ 3,473	\$ —
Fixed-income securities:				
U.S. Treasury	94,552	—	94,552	—
Corporate bonds and other debt securities	202,426	—	202,426	—
Federal agency	95,193	—	95,193	—
Fixed income mutual funds	912,572	912,572	—	—
Domestic equity securities:				
Large-cap	19,085	19,085	—	—
Mid-cap	20,390	20,390	—	—
Small-cap	22,555	22,555	—	—
Real estate	225	225	—	—
Equity mutual funds and exchange-traded funds	405,721	405,721	—	—
International equity securities	150,841	150,841	—	—
Other	7,865	7,613	—	252
Total recurring fair value measurements	<u>\$ 1,953,798</u>	<u>\$ 1,557,902</u>	<u>\$ 395,644</u>	<u>\$ 252</u>
Cash	204,551			
Assets valued at net asset value	<u>22,911</u>			
Total cash and cash equivalents, investments and assets whose use is limited	<u>\$ 2,181,260</u>			
Nonrecurring fair value measurements:				
Long-lived assets held for sale	<u>\$ 4,141</u>	<u>\$ —</u>	<u>\$ 4,141</u>	<u>\$ —</u>
Total nonrecurring fair value measurements	<u>\$ 4,141</u>	<u>\$ —</u>	<u>\$ 4,141</u>	<u>\$ —</u>

	December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Recurring fair value measurements:				
Cash equivalents	\$ 26,006	\$ 22,037	\$ 3,969	\$ —
Fixed-income securities:				
U.S. Treasury	94,596	—	94,596	—
Corporate bonds and other debt securities	194,651	—	194,651	—
Federal agency	97,665	—	97,665	—
Fixed income mutual funds	990,518	990,518	—	—
Domestic equity securities:				
Large-cap	17,961	17,961	—	—
Mid-cap	19,257	19,257	—	—
Small-cap	22,106	22,106	—	—
Real estate	470	470	—	—
Equity mutual funds and exchange-traded funds	384,410	384,410	—	—
International equity securities	142,192	142,192	—	—
Other	7,104	6,853	—	251
Total recurring fair value measurements	<u>\$ 1,996,936</u>	<u>\$ 1,605,804</u>	<u>\$ 390,881</u>	<u>\$ 251</u>
Cash	106,653			
Assets valued at net asset value	<u>22,450</u>			
Total cash and cash equivalents, investments and assets whose use is limited	<u><u>\$ 2,126,039</u></u>			
Nonrecurring fair value measurements:				
Long-lived assets held for sale	<u>\$ 5,467</u>	<u>\$ —</u>	<u>\$ 5,467</u>	<u>\$ —</u>
Total nonrecurring fair value measurements	<u><u>\$ 5,467</u></u>	<u><u>\$ —</u></u>	<u><u>\$ 5,467</u></u>	<u><u>\$ —</u></u>

Aurora categorizes assets and liabilities measured at fair value in the consolidated financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs which are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about pricing the asset or liability, based on the best information available under the circumstances.

The fair value of all assets and liabilities recognized or disclosed at fair value are classified based on the lowest level of significant inputs. Assets and liabilities that are measured at fair value are disclosed and classified in one of the three categories. Category inputs are defined as follows:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities on the reporting date. Investments in this level generally include exchange-traded equity securities, futures, pooled short-term investment funds, options, and exchange-traded mutual funds.

Level 2 — Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Investments in this level generally include fixed income securities, including fixed income government obligations; certificates of deposit, and derivatives, which are not traded on an active exchange.

Level 3 — Inputs that are unobservable for the asset or liability.

Aurora believes its valuation methods and classification in fair value levels are appropriate and consistent with other market participants based on information readily available from its service providers. Transfers between fair value levels are only done when new or additional information regarding the observability of pricing inputs is received that could result in a different classification as of the reporting date. Aurora measures the transfer between fair value levels as of the end of the reporting period, December 31. There were no significant transfers between fair value levels during the three months ended March 31, 2017.

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

Cash Equivalents — Cash equivalents are comprised primarily of money market funds, which are valued based upon a net asset value of \$1.

Fixed-Income Securities — The fair value of fixed-income securities is primarily determined with techniques consistent with the market approach. Significant observable inputs include benchmark yields, reported trades, observable broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications.

Aurora holds interests in a real estate investment trust and an international equity limited partnership where the fair value of the investment held is estimated based on the net asset value of the fund. The following table summarizes the attributes relating to the nature and risk of such investments at March 31, 2017 and December 31, 2016 (dollars in thousands):

	Fair Value		Unfunded Commitments	Redemption Frequency	Redemption Notice Period
	March 31, 2017	December 31, 2016			
Real estate investment trust	\$ 13,820	\$ 13,953	\$ —	Quarterly	90 days
International equity limited partnership	9,091	8,497	—	Monthly	15 days
Total	<u>\$ 22,911</u>	<u>\$ 22,450</u>			

The real estate investment trust is a core return, fully specified, open-end commingled equity real estate fund diversified by property type and location designed to provide stable, income-driven rate of return over the long term with potential for growth of net investment income and appreciation of value. The objective of the real estate investment trust is to achieve long term aggregate annual return on invested equity of 8% to 10%, gross of fees, by investing in real estate and real estate-related investments, broadly defined, with the majority of the return being realized from income, with modest appreciation, and using leverage when appropriate.

The fair value of the real estate investment trust is determined using the calculated net asset value provided by the fund. The fair value of the underlying real estate properties held in the trust is determined giving consideration to the income, cost and sales comparison approaches of estimating property value.

The international equity limited partnership's investment objective is long-term total return. The fund pursues its investment objective primarily by investing in equity securities of non-U.S. emerging market companies. The fair value of this fund is determined using the calculated net asset value provided by the fund.

5. INVESTMENTS IN UNCONSOLIDATED ENTITIES AND NONCONTROLLING INTEREST IN SUBSIDIARIES

In April 2016, Aurora partnered with Anthem Blue Cross and Blue Shield of Wisconsin (Anthem) to form a new joint venture, called the Wisconsin Collaborative Insurance Company (WCIC). WCIC is a health insurance company. Aurora acquired a 50% interest in the joint venture for cash consideration of \$5.0 million and accounts for this investment under the equity method of accounting within investments in unconsolidated entities in the accompanying unaudited consolidated balance sheets. Aurora's investment in WCIC as of March 31, 2017 and December 31, 2016 was \$2.9 million and \$1.8 million, respectively.

In June 2015, Aurora acquired a 6.25% interest in StartUp Health Holdings, Inc., ("StartUp Health") for cash consideration of \$5.0 million. StartUp Health is a global health innovation company with more than 100 digital health portfolio companies. Aurora's goal is to help accelerate the review and adoption of innovations aimed at transforming the delivery of care. Aurora's investment in StartUp Health was \$5.0 million as of March 31, 2017 and December 31, 2016. Aurora's investment in StartUp Health is accounted for under the equity method of accounting and is presented within investments in unconsolidated entities in the accompanying unaudited consolidated balance sheets.

Aurora has a 49% minority interest in Bay Area Medical Center ("BAMC"), a 99 bed general acute care hospital located in Marinette, Wisconsin. Aurora's investment in BAMC is accounted for under the equity method of accounting and is presented within investments in unconsolidated entities in the accompanying unaudited consolidated balance sheets. Aurora's investment in BAMC as of March 31, 2017 and December 31, 2016, was \$34.8 million and \$36.3 million, respectively. The carrying amount of Aurora's investment in BAMC was \$33.6 million and \$33.0 million less than the underlying equity in the net assets of BAMC as of March 31, 2017 and December 31, 2016, respectively. This difference represents a contingent gain which would be recognized in the event of dissolution of BAMC or if Aurora's interest in BAMC were to increase requiring BAMC to be included in the consolidated financial statements of Aurora.

In August of 2015, Aurora and BAMC combined their medical group practices in Marinette, Wisconsin and its surrounding communities to form Aurora Bay Area Medical Group (ABAMG). ABAMG provides inpatient, outpatient and other necessary professional medical services. Aurora holds a 27% ownership interest in ABAMG based on an initial cash contribution of \$1.8 million. Aurora's investment in ABAMG is accounted for under the equity method and is presented within investments in unconsolidated entities in the accompanying unaudited consolidated balance sheets.

In conjunction with the formation of ABAMG, Aurora leases employees and buildings to ABAMG and recognized \$5.4 million and \$5.7 million of other revenue for the three months ended March 31, 2017 and 2016, respectively. Aurora made additional capital contributions to ABAMG of \$1.4 million as of

March 31, 2017. Aurora's investment in ABAMG was \$0.7 million and \$0.8 million as of March 31, 2017 and December 31, 2016, respectively.

Aurora has a 50% investment in the Menomonee Falls Ambulatory Surgery Center, LLC, and a 20% investment in Froedtert Surgery Center, LLC (collectively, the "Surgery Centers"). The Surgery Centers provide various types of outpatient surgical procedures. Aurora's investment in the Surgery Centers of \$5.7 million as of March 31, 2017 and December 31, 2016, is accounted for under the equity method of accounting and is presented within investments in unconsolidated entities in the accompanying unaudited consolidated balance sheets. The carrying amount of Aurora's investment in the Surgery Centers is different from the underlying equity in the net assets of the investees due to goodwill recorded upon the initial investment in the Surgery Centers.

The summarized financial position and results of operations for the entities accounted for under the equity method as of and for the three month period ended March 31, 2017 and as of and for the year ended December 31, 2016, is as follows (in thousands):

As of and for the Three Months Ended March 31, 2017

	Bay Area Medical Center ⁽¹⁾	ABAMG	Surgery Centers	Other Investees	Total
Total assets	\$ 196,179	\$ 8,240	\$ 13,109	\$ 28,984	\$ 246,512
Total liabilities	59,294	5,590	2,143	62,475	129,502
Equity	<u>136,885</u>	<u>2,650</u>	<u>10,966</u>	<u>(33,491)</u>	<u>117,010</u>
Total revenue	23,733	7,241	15,682	68,713	115,369
Net income (loss)	2,909	(5,577)	1,764	5,963	5,059

⁽¹⁾ ABAMG is included in the consolidated financial results of Bay Area Medical Center.

As of and for the Twelve Months Ended December 31, 2016

	Bay Area Medical Center ⁽¹⁾	ABAMG	Surgery Centers	Other Investees	Total
Total assets	\$ 198,957	\$ 6,896	\$ 13,109	\$ 28,800	247,762
Total liabilities	60,441	4,004	2,143	62,461	129,049
Equity	<u>138,516</u>	<u>2,892</u>	<u>10,966</u>	<u>(33,661)</u>	<u>118,713</u>
Total revenue	86,666	30,958	15,682	73,174	206,480
Net income (loss)	(3,902)	(21,928)	1,764	5,978	(18,088)

⁽¹⁾ ABAMG is included in the consolidated financial results of Bay Area Medical Center.

6. LONG-TERM DEBT

Long-term debt at March 31, 2017 and December 31, 2016 is summarized as follows (in thousands):

	March 31, 2017	December 31, 2016
Wisconsin Health and Educational Facilities Authority (WHEFA)		
fixed-rate bonds:		
Series 2009A (5.15% weighted average coupon for 2017 and 5.12% for 2016)	\$ 22,750	\$ 22,750
Series 2009B (1.25% weighted average coupon for 2017 and 3.22% for 2016)	65,000	65,000
Series 2010A (5.45% weighted average coupon for 2017 and 5.43% for 2016)	162,375	162,375
Series 2010B (5.00% weighted average coupon for 2017 and 2016)	61,895	61,895
Series 2012A (4.77% weighted average coupon for 2017 and 2016)	208,120	208,120
Series 2013A (5.19% weighted average coupon for 2017 and 2016)	115,750	115,750
	<u>635,890</u>	<u>635,890</u>
WHEFA variable-rate bonds:		
Series 1999C (0.69% effective rate for 2017 and 0.43% for 2016)	50,000	50,000
Series 2008A (0.81% effective rate for 2017 and 0.49% for 2016)	80,000	80,000
Series 2008B (0.77% effective rate for 2017 and 0.43% for 2016)	79,470	79,470
Series 2010C (0.78% effective rate for 2017 and 0.36% for 2016)	102,690	102,690
Series 2012B (0.62% effective rate for 2017 and 0.36% for 2016)	37,700	37,700
Series 2012C (0.62% effective rate for 2017 and 0.36% for 2016)	37,700	37,700
Series 2012D (0.67% effective rate for 2017 and 0.41% for 2016)	55,930	55,930
	<u>443,490</u>	<u>443,490</u>
Unamortized original issue premium, net	11,343	11,786
Total WHEFA debt	<u>1,090,723</u>	<u>1,091,166</u>
Taxable bonds:		
Taxable Bond Series 2015A (1.18% effective rate for 2017 and 0.88% for 2016)	40,000	40,000
Taxable Bond Series 2016A (1.97% effective rate for 2017 and 2016)	125,000	125,000
Taxable Bond Series 2016B (1.99% effective rate for 2017 and 2016)	93,000	93,000
Total taxable bonds	<u>258,000</u>	<u>258,000</u>
Capital lease obligations and financing arrangements	215,530	220,829
Notes payable	6,018	5,943
Deferred financing costs - net	(10,558)	(10,911)
Total long-term debt	<u>1,559,713</u>	<u>1,565,027</u>
Less amounts classified as current:		
Current installments	(79,885)	(79,480)
Long-term debt classified as current due to contractual requirements	(34,912)	(17,456)
Long-term rate bonds classified as current	(65,000)	(65,000)
Total amounts classified as current	<u>(179,797)</u>	<u>(161,936)</u>
Long-term debt — net of current portion	<u>\$ 1,379,916</u>	<u>\$ 1,403,091</u>

Under the terms of a Master Trust Indenture (the "Aurora Indenture"), Aurora's Obligated Group has issued revenue bonds through WHEFA. All outstanding debt under the Aurora Indenture represents joint and several obligations of the members of the Obligated Group. Of the total fixed-rate WHEFA bonds, \$47.4 million is collateralized by bond insurance.

Aurora has three series of taxable bonds outstanding, which were issued directly by Aurora and placed with multiple commercial banks (the "Taxable Bonds"). The outstanding principal amount of the Taxable Bonds is \$258.0 million at March 31, 2017 and December 31, 2016. The Taxable Bonds are secured by Obligations issued under the Master Indenture, and the mandatory tender date of the 2015A Taxable Bonds is April 15, 2018.

The variable-rate demand bonds ("VRDBs") are collateralized by \$460.7 million of irrevocable direct-pay letters of credit issued by commercial banks, which provide interim financing to Aurora in the event that remarketing efforts fail for tendered bonds and are drawn upon in the period to pay scheduled debt service on the bonds. The letters of credit expire at various dates through 2019 and have various repayment terms. For \$327.4 million of the letters of credit, principal payments are due quarterly, beginning the earlier of one year from the date of the advance or two months after the expiration date of the letter of credit and amortize over a three-year period, not to exceed three years from the letter of credit's stated expiration date. For the remaining \$133.3 million letters of credit, principal payments are due quarterly, beginning the earlier of one year from the date of the advance or two months after the expiration date of the letter of credit and shall amortize over a two-year period, not to exceed two years from the letter of credit's stated expiration date. At March 31, 2017 and December 31, 2016, no draws were outstanding under the letters of credit.

At March 31, 2017 and December 31, 2016, Aurora had outstanding a \$65.0 million long-term rate bond. The long-term rate bond bears interest at a fixed rate for a specified period, and is subject to mandatory tender on August 15, 2017. There is no liquidity facility in effect with respect to the long-term rate bond to pay the purchase price on the mandatory tender date. Without a liquidity facility dedicated to this bond, the bond holder is required to put the bond to Aurora on the mandatory tender date. At March 31, 2017 and December 31, 2016, the \$65.0 million long-term bond is classified as current due to this requirement.

At March 31, 2017 and December 31, 2016, Aurora had a \$60.0 million line of credit with a commercial bank, bearing interest at either the commercial bank floating rate or LIBOR plus 1.00%, based upon the option of Aurora. As of March 31, 2017 and December 31, 2016, three letters of credit issued under the line of credit totaling \$38.8 million were outstanding. There were no outstanding draws on the line of credit or letters of credit as of March 31, 2017 or December 31, 2016.

7. EMPLOYEES' BENEFIT PLANS

Aurora has a defined benefit pension plan (the Pension Plan) covering substantially all of its employees, hired before January 1, 2013, with at least 1,000 hours of work in a calendar year. Benefits are based on years of service and the employees' final average earnings, as defined. Aurora funds the Pension Plan based on the amount calculated by the Pension Plan's actuaries to meet the minimum Employee Retirement Income Security Act (ERISA) funding requirements. During the three months ended March 31, 2017, Aurora made no contributions to the Pension Plan. The Pension Plan assets and obligations are measured at December 31.

Estimated amounts of the components of net periodic pension income for the three months ended March 31, 2017 and 2016 were as follows (in thousands):

	March 31, 2017	March 31, 2016
Interest cost on projected benefit obligation	\$ 15,968	\$ 15,784
Expected return on plan assets	(18,520)	(17,523)
Net amortization and deferral, and prior service credit	2,056	1,532
Net periodic pension income	<u>\$ (496)</u>	<u>\$ (207)</u>

The amount of net periodic pension income will be adjusted at year-end to reflect actual results, based upon the final annual actuarial valuation.

The net actuarial loss not yet recognized as a component of periodic pension income was \$441.8 million and \$443.7 million as of March 31, 2017 and December 31, 2016, and is included in unrestricted net assets in the accompanying unaudited consolidated balance sheets.

Assumptions used to determine the net periodic pension (income) cost for three months ended March 31, 2017 and 2016 were as follows:

	2017	2016
Discount rate	4.42%	4.70%
Expected long-term rate of return on assets	5.50%	5.50%

The discount rate used by Aurora is based on a hypothetical portfolio of high-quality bonds with cash flows matching the Pension Plan's expected benefit payments.

The expected long-term rate of return is based on the asset allocation of the total portfolio considering capital return assumptions from various sources. Aurora's investment objective is to achieve its targeted long-term rate of return while avoiding excessive risk. Risk is effectively managed through diversifying the asset allocation across a broad spectrum of assets including domestic and international equities and fixed income securities with varying correlations to movements in interest rates along the yield curve. These investments are readily marketable and can be sold to fund benefit payment obligations as they become payable. Overall funded status risk of the Pension Plan is managed by matching the duration of plan assets to plan liabilities to mitigate the impact of changes in interest rates on funded status.

The asset allocation of the Pension Plan assets at March 31, 2017 and December 31, 2016, was as follows:

	<u>March 31, 2017</u>		<u>December 31, 2016</u>	
	Strategic Target	Actual	Strategic Target	Actual
Equity securities	33%	34%	33%	3%
Fixed-income securities	64	61	64	6
Real estate	3	3	3	3
Cash and cash equivalents	—	2	—	2
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

Aurora and certain affiliates sponsor defined contribution and retirement savings plans (the Defined Contribution Plans), whereby Aurora contributes a percentage of participants' qualifying compensation up to certain limits as outlined in the Defined Contribution Plans or other amounts as designated by the affiliates' board of directors. Included in salaries, wages and fringe benefits expense in the accompanying unaudited consolidated statements of operations and changes in unrestricted net assets for the three months ended March 31, 2017 and 2016 is \$39.9 million and \$39.0 million, respectively, for contributions to the Defined Contribution Plans.

Aurora also sponsors a noncontributory Section 457(b) defined contribution plan (the 457(b) Plan) covering select employees, where participants may contribute a percentage of qualifying compensation up to certain limits as defined by the 457(b) Plan. The 457(b) Plan assets and liabilities, each totaling \$114.1 million and \$102.6 million at March 31, 2017 and December 31, 2016, respectively, are included in long-term assets whose use is limited or restricted and pension and other employee benefit liabilities, in the accompanying unaudited consolidated balance sheets. The assets of this 457(b) Plan are subject to the claims of the general creditors of Aurora. Net investment income from the 457(b) Plan was \$5.0 million and \$1.6 million, for the three months ended March 31, 2017 and 2016, respectively. Net investment income from the 457(b) Plan is included in other operating revenue with an equal offsetting expense in salaries, wages and fringe benefits in the accompanying unaudited consolidated statements of operations and changes in unrestricted net assets.

8. GENERAL AND PROFESSIONAL LIABILITY INSURANCE

Commercial insurance companies have issued policies covering Aurora's primary professional, general and managed care errors and omission liability risks. Aurora's professional and general liability insurance is on an occurrence basis, while managed care errors and omissions liability risks are written on a claims-made basis.

Aurora's hospitals, clinics, surgery centers, physicians, and certified registered nurse anesthetist providers that provide health care in Wisconsin are qualified health care providers as defined by Wisconsin state statute, and have separate professional liability limits of \$1.0 million per claim and \$3.0 million annual aggregate applied to each qualified provider. Losses in excess of these amounts are fully covered through mandatory participation in the State of Wisconsin Injured Patients and Families Compensation Fund (the Fund).

Aurora also has professional liability coverage for its providers and affiliates that do not qualify for the Fund coverage, as well as general liability for all of its entities. These coverages provide a number of shared professional liability limits and shared general liability limits totaling \$2.0 million per occurrence

and \$4.0 million annual aggregate for most providers. Losses in excess of these amounts are covered by Aurora's umbrella/excess insurance.

The professional, general and managed care liabilities discussed above have been ceded back to Aurora Liability Assurance, Ltd. (ALA), a wholly-owned subsidiary of Aurora, through reinsurance agreements. Independent actuaries evaluate the required provision for outstanding losses related to these risks. At March 31, 2017 and December 31, 2016, Aurora has recorded a liability for outstanding losses, including incurred but not reported, discounted at 4.0%, totaling \$32.3 million and \$35.2 million, respectively. Of this amount, a portion of the liability for outstanding losses was included in accrued expenses and a portion was included in self-insured liabilities in the accompanying unaudited consolidated balance sheets. In the opinion of management, the ultimate disposition of claims incurred to date will not have a material adverse effect on Aurora's consolidated financial position or results of operations. ALA maintains a reinsurance trust account, which in total represents security required by the reinsurance agreement between ALA and the insurance companies. At March 31, 2017 and December 31, 2016, assets held in the trust account were \$52.9 million and \$53.8 million, respectively.

9. SUBSEQUENT EVENTS

Aurora evaluated events and transactions subsequent to March 31, 2017 through May 25, 2017, the date of financial statement issuance. During this period of time, there were no subsequent events requiring recognition in or disclosure to the consolidated financial statements.

SUPPLEMENTAL CONSOLIDATING INFORMATION

AURORA HEALTH CARE, INC. AND AFFILIATES

UNAUDITED CONSOLIDATING BALANCE SHEET INFORMATION

(In thousands)

	March 31, 2017				December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments & Eliminations	Consolidated	Obligated Group	Non-Obligated Group	Consolidating Adjustments & Eliminations	Consolidated
ASSETS								
CURRENT ASSETS:								
Cash and cash equivalents	\$ (71,531)	\$ 283,656	\$ (8,162)	\$ 203,963	\$ (192,004)	\$ 308,952	\$ (9,284)	\$ 107,664
Investments	1,551,625	—	—	1,551,625	1,614,843	—	—	1,614,843
Assets whose use is limited or restricted	—	4,848	—	4,848	—	5,484	—	5,484
Patient accounts receivable — net	530,961	195,854	(4,368)	722,447	542,493	195,162	(5,909)	731,746
Due from affiliates	233	158,959	(159,192)	—	142	151,017	(151,159)	—
Other receivables	105,304	19,762	(15,759)	109,307	89,528	21,787	(8,524)	102,791
Inventory	41,252	28,397	—	69,649	42,498	27,533	—	70,031
Prepays and other current assets	52,399	9,778	(11,833)	50,344	52,650	7,234	(11,858)	48,026
Estimated third-party payor settlements	8,731	736	—	9,467	8,799	1,190	—	9,989
Total current assets	2,218,974	701,990	(199,314)	2,721,650	2,158,949	718,359	(186,734)	2,690,574
ASSETS WHOSE USE IS LIMITED OR RESTRICTED	144,278	276,546	—	420,824	131,021	267,027	—	398,048
PROPERTY, PLANT AND EQUIPMENT — Net	1,625,539	410,928	19,638	2,056,105	1,646,781	398,744	20,761	2,066,286
OTHER ASSETS:								
Intangible assets — net	5,051	12,038	(1,441)	15,648	5,079	12,148	(1,441)	15,786
Investments in unconsolidated entities	283,199	15,887	(225,516)	73,570	282,088	19,098	(228,873)	72,313
Other	332,559	50,693	(326,176)	57,076	323,314	52,345	(318,824)	56,835
Total other assets	620,809	78,618	(553,133)	146,294	610,481	83,591	(549,138)	144,934
TOTAL	\$ 4,609,600	\$ 1,468,082	\$ (732,809)	\$ 5,344,873	\$ 4,547,232	\$ 1,467,721	\$ (715,111)	\$ 5,299,842

(Continued)

AURORA HEALTH CARE, INC. AND AFFILIATES

UNAUDITED CONSOLIDATING BALANCE SHEET INFORMATION

(In thousands)

	March 31, 2017				December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments & Eliminations	Consolidated	Obligated Group	Non-Obligated Group	Consolidating Adjustments & Eliminations	Consolidated
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES:								
Current installments of long-term debt	\$ 177,034	\$ 13,606	\$ (10,843)	\$ 179,797	\$ 159,215	\$ 13,564	\$ (10,843)	\$ 161,936
Accounts payable	119,738	46,050	—	165,788	162,396	60,132	—	222,528
Accrued salaries and wages	235,065	56,047	—	291,112	209,014	50,211	—	259,225
Other accrued expenses	129,234	52,649	(27,900)	153,983	190,562	41,104	(17,982)	213,684
Due to Affiliates	158,959	233	(159,192)	—	151,018	141	(151,159)	—
Estimated third-party payor settlements	32,173	1,708	—	33,881	32,347	1,694	—	34,041
Total current liabilities	852,203	170,293	(197,935)	824,561	904,552	166,846	(179,984)	891,414
LONG-TERM DEBT — Less current installments	1,360,788	114,572	(95,444)	\$ 1,379,916	1,383,192	115,343	(95,444)	1,403,091
OTHER LIABILITIES:								
Pension and other employee benefit liabilities	231,287	21,601	—	252,888	222,257	21,317	—	243,574
Self-insured liabilities	32,062	28,113	(1,244)	58,931	32,445	30,527	(1,380)	61,592
Deferred gain	35,266	—	—	35,266	36,662	—	—	36,662
Other	34,972	21,465	4,312	60,749	38,409	23,076	337	61,822
Total other liabilities	333,587	71,179	3,068	407,834	329,773	74,920	(1,043)	403,650
Total liabilities	2,546,578	356,044	(290,311)	2,612,311	2,617,517	357,109	(276,471)	2,698,155
NET ASSETS:								
Unrestricted:								
Controlling interest	1,764,508	1,018,985	(214,681)	2,568,812	1,637,568	1,020,447	(218,362)	2,439,653
Noncontrolling interest in subsidiaries	95,833	2,169	—	98,002	98,125	1,994	—	100,119
Total unrestricted net assets	1,860,341	1,021,154	(214,681)	2,666,814	1,735,693	1,022,441	(218,362)	2,539,772
Temporarily restricted	188,963	67,114	(209,073)	47,004	180,304	64,401	(201,534)	43,171
Permanently restricted	13,718	23,770	(18,744)	18,744	13,718	23,770	(18,744)	18,744
Total net assets	2,063,022	1,112,038	(442,498)	2,732,562	1,929,715	1,110,612	(438,640)	2,601,687
TOTAL	\$ 4,609,600	\$ 1,468,082	\$ (732,809)	\$ 5,344,873	\$ 4,547,232	\$ 1,467,721	\$ (715,111)	\$ 5,299,842

(Concluded)

AURORA HEALTH CARE, INC. AND AFFILIATES
UNAUDITED CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN UNRESTRICTED NET ASSETS INFORMATION
FOR THE PERIODS ENDED MARCH 31, 2017 AND 2016
(In thousands)

	Three Months Ended March 31, 2017				Three Months Ended March 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments & Eliminations	Consolidated	Obligated Group	Non-Obligated Group	Consolidating Adjustments & Eliminations	Consolidated
REVENUES:								
Patient service revenue (net of contractual allowances and discounts)	\$ 898,977	\$ 340,568	\$ (9,166)	\$ 1,230,379	\$ 869,494	\$ 335,730	\$ (17,422)	\$ 1,187,802
Less provision for bad debts	27,855	11,643	—	39,498	28,619	9,915	—	38,534
Net patient service revenue less provision for bad debts	871,122	328,925	(9,166)	1,190,881	840,875	325,815	(17,422)	1,149,268
Other revenue	63,752	84,842	(41,440)	107,154	50,901	86,565	(38,202)	99,264
Total revenue	934,874	413,767	(50,606)	1,298,035	891,776	412,380	(55,624)	1,248,532
EXPENSES:								
Salaries, wages and fringe benefits	558,555	195,168	(20,734)	732,989	537,363	182,751	(27,767)	692,347
Professional fees	13,789	6,558	10	20,357	12,283	6,520	(19)	18,784
Supplies	145,164	89,569	(10)	234,723	138,012	89,723	—	227,735
Depreciation and amortization	45,661	9,543	—	55,204	41,501	10,018	—	51,519
Interest	16,234	(2,515)	—	13,719	10,910	2,997	—	13,907
Maintenance and service contracts	25,868	3,257	9	29,134	22,372	2,517	(29)	24,860
Building and equipment rental	10,342	8,197	(1,839)	16,700	10,318	7,943	(1,651)	16,610
Hospital tax assessment	19,825	4,743	—	24,568	19,493	4,662	—	24,155
Utilities	9,664	2,714	(19)	12,359	9,080	2,940	(19)	12,001
Purchased services	22,305	9,192	(237)	31,260	23,781	7,528	(717)	30,592
Other expenses	(11,422)	54,990	(10,725)	32,843	(8,339)	56,071	(8,701)	39,031
Total expenses	855,985	381,416	(33,545)	1,203,856	816,774	373,670	(38,903)	1,151,541
Operating income (loss)	78,889	32,351	(17,061)	94,179	75,002	38,710	(16,721)	96,991
NONOPERATING INCOME:								
Investment income — net	36,783	7,247	—	44,030	26,063	2,032	—	28,095
Other nonoperating income — net	273	149	—	422	735	5	—	740
Total nonoperating income — net	37,056	7,396	—	44,452	26,798	2,037	—	28,835
EXCESS OF REVENUES OVER EXPENSES	115,945	39,747	(17,061)	138,631	101,800	40,747	(16,721)	125,826
Pension-related changes other than net periodic pension cost	2,056	—	—	2,056	1,532	—	—	1,532
Net assets released from restrictions for purchase of property and equipment	438	—	—	438	227	—	—	227
Distributions to noncontrolling interests	(14,079)	—	—	(14,079)	(15,975)	—	—	(15,975)
Other — net	(4)	—	—	(4)	(1)	—	—	(1)
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	\$ 104,356	\$ 39,747	\$ (17,061)	\$ 127,042	\$ 87,583	\$ 40,747	\$ (16,721)	\$ 111,609

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL POSITION

This quarterly report includes the consolidated financial statements and analysis for Aurora Health Care, Inc., a Wisconsin nonstock, nonprofit corporation (the Corporation), and its affiliates. References to "Aurora", "we", "our" and "us" in this document are to the Corporation and all of the affiliates and subsidiaries consolidated with it pursuant to accounting principles generally accepted in the United States of America (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.

We recommend that you read this discussion together with our unaudited consolidated financial statements and related notes included elsewhere in this quarterly report, as well as the audited consolidated financial statements of Aurora as of and for the year ended December 31, 2016. The audited consolidated financial statements are available from the Municipal Securities Rulemaking Board (MSRB) on its Electronic Municipal Market Access (EMMA) system, found at <http://emma.msrb.org>. Additional information can be obtained from the Investor Relations site on Aurora's website found at <https://www.aurorahealthcare.org>.

Certain statements included in this quarterly report constitute forward-looking statements that involve risks and uncertainties. Actual results may differ significantly from the results discussed in the forward-looking statements as a result of known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. We do not plan to issue any updates or revisions to those forward-looking statements if or when the expectations, or events, conditions or circumstances on which such statements are based occur.

AURORA HEALTH CARE, INC. AND AFFILIATES

KEY FINANCIAL RATIOS FOR THE PERIOD ENDED MARCH 31, 2017

	Three Months Ended March 31,	
	2017	2016
Operating Performance:		
Operating margin ⁽¹⁾	7.3%	7.8%
EBIDA percent ⁽²⁾	16.0%	15.3%
	As of March 31, 2017	As of December 31, 2016
Liquidity:		
Days cash on hand ⁽³⁾	150.9	152.0
Financial Position/Leverage Ratios:		
Net AR days outstanding ⁽⁴⁾	54.6	57.0
Unrestricted cash to debt ⁽⁵⁾	124%	121%
Cash to puttable debt ⁽⁶⁾	398%	390%
Debt to capitalization ⁽⁷⁾	37%	38%
Debt to cash flow ⁽⁸⁾	2.3	2.3
Debt service coverage ratio ⁽⁹⁾	6.0x	5.9x

⁽¹⁾ Operating income/Total revenue.

⁽²⁾ (Excess of revenues over expenses + Interest expense + Depreciation and amortization expense)/Total revenue.

⁽³⁾ (Unrestricted cash and investments)/((Total expenses – Depreciation and amortization expense)/actual number of days in a period).

⁽⁴⁾ Accounts receivable, net/(Net patient service revenue/actual number of days in a period).

⁽⁵⁾ (Unrestricted cash and investments)/(Current installments of long-term debt + Long-term debt, less current installments).

⁽⁶⁾ (Unrestricted cash and investments)/Total variable rate demand bonds outstanding.

⁽⁷⁾ (Current installments of long-term debt + Long-term debt, less current installments)/(Current installments of long-term debt + Long-term debt, less current installments + Total Unrestricted net assets).

⁽⁸⁾ (Current installments of long-term debt + Long-term debt, less current installments)/(Excess of revenue over expenses + Depreciation and amortization expense) for the four consecutive quarters.

⁽⁹⁾ (Excess of revenues over expenses + Interest expense + Depreciation and amortization expense)/(Principal payments + Interest expense) for the four consecutive quarters.

AURORA HEALTH CARE, INC. AND AFFILIATES

HISTORICAL UTILIZATION

	Three Months Ended March 31,	
	2017	2016
Adult inpatient days	114,450	115,600
Adult average daily census	1,272	1,270
Adult average length of stay	4.4	4.5
Adult discharges	26,124	25,566
Emergency room visits	100,499	102,169
Observation and bedded outpatients	9,428	9,325
Surgical cases	28,377	27,485
Physician clinic, hospital outpatient and other visits (includes emergency room visits)	1,914,235	1,840,981

ANALYSIS OF RESULTS OF OPERATIONS

Results of Operations – Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Operating income was \$94.2 million for the three months ended March 31, 2017, resulting in an operating margin of 7.3%, as compared to operating income of \$97.0 million and an operating margin of 7.8% for the three months ended March 31, 2016. Nonoperating income was \$44.5 million for the three months ended March 31, 2017 compared to nonoperating income of \$28.8 million for the same period in 2016. The increase in nonoperating income from the prior period is largely due to an increase in unrealized investment gains as a result of favorable changes in the financial markets. Overall, Aurora reported an excess of revenue over expenses of \$138.6 million for the three months ended March 31, 2017 compared to \$125.8 million for the same period in the prior year.

Patient service revenue increased \$42.6 million (3.6%) in the three months ended March 31, 2017, compared to the same period in 2016. Patient service revenue increased primarily due to the annual price increase effective January 1, 2017 and an increase in volumes. Physician clinic, hospital outpatient and other visits, surgical cases, adult discharges, and observation and bedded outpatients increased 4.0%, 3.2%, 2.2%, and 1.1%, respectively, for the three months ended March 31, 2017 compared to the same period in the prior year.

Provision for bad debts increased \$1.0 million (2.5%) in the three months ended March 31, 2017, compared to the same period in the prior year due to an increase in patient service revenue during such period. The provision for bad debts as a percentage of patient service revenue (net of contractual allowances and discounts) was 3.2% for the three months ended March 31, 2017 and 2016.

Other revenue increased \$7.9 million (7.9%) in the three months ended March 31, 2017, compared to the same period in the prior year. The increase in other revenue was primarily driven by a \$4.8 million increase in revenue from risk share, quality, and administrative revenue related to managed care arrangements. Other revenue also increased \$3.5 million due to an increase in investment income on certain defined contribution funds resulting from favorable market conditions and an increase in fund balances.

Salaries, wages and fringe benefits expense increased \$40.6 million (5.9%) in the three months ended March 31, 2017, compared to the same period in the prior year. The increase in salaries, wages and fringe benefits expense was driven by a 4.2% increase in full time equivalents (FTEs) over the comparative period and the annual merit increase of 2.9% which became effective in July of 2016. The increase in FTEs is in response to an increase in patient volume from the same period in the prior year.

Supplies expense increased \$7.0 million (3.1%) in the three month period ended March 31, 2017, compared to the same period in the prior year primarily due to an increase in patient volumes over the comparative period. Supplies expense as a percent of total revenue has remained consistent at 18.1% for the three months ended March 31, 2017 compared to 18.2% for the three months ended March 31, 2016.

Depreciation and amortization increased \$3.7 million (7.2%) in the three months ended March 31, 2017, compared to the same period in the prior year. The increase is primarily driven by additional capital expenditures since the prior year, including new ambulatory surgery centers in Germantown and Burlington, Wisconsin.

Maintenance and service contracts expense increased \$4.3 million (17.2%) in the three months period ended March 31, 2017 due to service contracts associated with additional Information Technology (IT) equipment to support the new data center and other new operations.

Other expenses decreased \$6.2 million (15.9)% in the three months ended March 31, 2017, compared to the same period in the prior year, primarily due to a decrease in medical malpractice insurance expense due to favorable experience of \$2.0 million, and a decrease in the income tax provision as a result of pass through losses from companies Aurora has an ownership interest in of \$2.2 million.

The remaining expenses including; professional fees, interest, building and equipment rental, hospital tax assessment, utilities, and purchased services, remained relatively consistent for the three months ended March 31, 2017 compared to the three months ended March 31, 2016, increasing \$2.9 million (2.5%), in the aggregate.

ANALYSIS OF FINANCIAL CONDITION

Liquidity – Cash and Investments

Aurora's objectives for its investment portfolios are to target returns over the long-term within management determined reasonable and prudent levels of risk and to preserve and enhance its financial structure. The asset allocation of the portfolios, in aggregate, is broadly diversified across domestic and international equity, fixed income asset classes and cash equivalents and is designed to maximize the probability of achieving the long-term investment objectives at an appropriate level of risk while maintaining a level of liquidity to meet current business requirements. Portfolio performance is monitored throughout the year by comparing actual results to specific asset class appropriate benchmarks.

Pension plan investments are primarily maintained in a master trust fund administered using a bank as trustee. All other investments are held in bank accounts whereby the bank provides custody and safekeeping services. Management of Aurora's investments is conducted by external investment management organizations that are monitored by an investment committee of Aurora's Board of Directors, management and a third-party external advisor. Aurora has established formal investment policies that support Aurora's investment objectives.

The following table sets forth the allocation of Aurora's cash and cash equivalents, investments, and assets whose use is limited or restricted at March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017		December 31, 2016	
Cash and cash equivalents	\$ 226,925	10.4%	\$ 132,659	6.2%
Fixed-income securities	1,304,743	59.8	1,377,430	64.8
Equity securities	627,908	28.8	594,893	28.0
Real estate investments	13,820	0.6	13,953	0.7
Other	7,864	0.4	7,104	0.3
Total	2,181,260	100.0%	2,126,039	100.0%
Less restricted investments ⁽¹⁾	(255,095)		(239,364)	
Total unrestricted cash and investments	<u>\$ 1,926,165</u>		<u>\$ 1,886,675</u>	
Days cash on hand ⁽²⁾	150.9		152.0	

⁽¹⁾ Restricted investments include donor restricted funds, contractually restricted funds and funds held by a trustee.

⁽²⁾ Days cash on hand is calculated in accordance with Aurora's internal financial reporting methodology, and is not intended to conform to the Master Indenture calculation.

Aurora's unrestricted cash and investments increased by \$39.5 million or 2.1% from December 31, 2016 to March 31, 2017. The increase in unrestricted cash and investments was primarily due to \$90.6 million of cash generated from operations, offset by \$62.8 million of capital expenditures.

Total investment income for the three months ended March 31, 2017 and 2016, consisted of the following (in thousands):

	<u>2017</u>	<u>2016</u>
Interest income and dividends	\$ 10,560	\$ 8,624
Net realized losses on securities	(934)	(2,197)
Changes in unrealized gains on investments	42,809	24,226
Total	<u>\$ 52,435</u>	<u>\$ 30,653</u>

Investment income for the three months ended March 31, 2017 and 2016, is classified in the unaudited consolidated statements of operations and changes in unrestricted net assets and unaudited consolidated statement of changes in net assets as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Other revenue	\$ 5,919	\$ 2,243
Investment income	44,030	28,095
Temporarily restricted net assets	2,486	315
Total	<u>\$ 52,435</u>	<u>\$ 30,653</u>

Liquidity – Accounts Receivable

Net accounts receivable days outstanding decreased from 57.0 days as of December 31, 2016 to 54.6 days as of March 31, 2017. The decrease in net accounts receivable days outstanding is primarily due to the timing of cash collections with significant collections occurring during the month of March 2017.

Indebtedness

Master Indenture Obligations: The Corporation has certain outstanding long-term indebtedness in the form of revenue bonds issued by the Wisconsin Health and Educational Facilities Authority on its behalf (the “Revenue Bonds”). The Corporation’s obligation to pay debt service on the Revenue Bonds is secured by Obligations issued under a Second Restated Master Trust Indenture, dated January 1, 2012, between the Members of the Obligated Group created thereunder and U.S. Bank National Association, as Master Trustee (the “Master Indenture”). The obligations of the Corporation to repay advances made under the J.P. Morgan Line of Credit and the Letters of Credit described below are also secured by Obligations issued under the Master Indenture.

At March 31, 2017 and December 31, 2016, the aggregate principal amount of the Revenue Bonds outstanding was as follows (in thousands):

	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Fixed rate revenue bonds	\$ 582,233	\$ 582,676
Long-term rate revenue bond	65,000	65,000
Variable rate revenue bonds	443,490	443,490
Total	<u>\$ 1,090,723</u>	<u>\$ 1,091,166</u>

Fixed Rate Revenue Bonds: At March 31, 2017 and December 31, 2016 the Corporation had outstanding \$582.2 million (including \$11.3 million of unamortized original premium, net) and \$582.7 million (including \$11.8 million of unamortized original premium, net) of Fixed Rate Bonds, respectively. The weighted average interest rate on the Fixed Rate Revenue Bonds was 4.70% for the three months ended March 31, 2017 and 4.89% for the year ended December 31, 2016.

Long-Term Rate Bond: At March 31, 2017 and December 31, 2016, Aurora had outstanding a \$65.0 million long-term rate bond. The long-term rate bond bears interest at a fixed rate for a specified period, and is subject to mandatory tender on August 15, 2017. There is no liquidity facility in effect with respect to the long-term rate bond to pay the purchase price on the mandatory tender date. Without a liquidity facility dedicated to this bond, the bond holder is required to put the bond to Aurora on the mandatory tender date. At March 31, 2017 and December 31, 2016, the \$65.0 million long-term bond is classified as current due to this requirement.

Variable Rate Demand Bonds (VRDBs): At March 31, 2017 and December 31, 2016, the Corporation had outstanding \$443.5 million of VRDBs. The VRDBs bear interest at variable rates (currently in daily, weekly, or Unit Pricing interest rate modes) and are subject to optional tender for purchase by their holders. At March 31, 2017 and December 31, 2016, all of the VRDBs are secured by letters of credit issued by commercial banks (the Letters of Credit). Subject to certain requirements in the related Reimbursement Agreements, the Letters of Credit may be drawn on to pay the purchase price of the VRDBs in the event they are not remarketed. The Letters of Credit expire at various dates through 2019 (as set forth in the table below) and have various repayment terms. Principal payments for any advances under each of the Letters of Credit begin the earlier of one year from the date of the advance and two months after the expiration date of the Letter of Credit. The principal payments for any advance under the Letters of Credit amortize over a two or three-year period. Each Letter of Credit is subject to extension of its expiration date at the sole discretion of the related commercial bank.

<u>Bank</u>	<u>Par (in thousands)</u>	<u>Expiration</u>
J.P. Morgan	\$ 50,822	09/29/2017
J.P. Morgan	84,384	09/29/2017
J.P. Morgan	83,824	09/29/2017
Bank of Montreal	38,270	2/7/2018
Bank of Montreal	38,270	2/7/2018
Bank of Montreal	56,776	2/7/2018
Bank of America	108,317	01/31/2019
Total	<u>\$ 460,663</u>	

Line of Credit: At March 31, 2017 and December 31, 2016, the Corporation had a \$60.0 million line of credit, under which letters of credit can also be issued, with J.P. Morgan Chase Bank, N.A., bearing interest at the commercial bank floating rate or LIBOR plus a spread, based upon the option of the Corporation. As of March 31, 2017 and December 31, 2016, three letters of credit issued under the line of credit totaling \$38.8 million, were outstanding. There are currently no outstanding draws on the line of credit or letters of credit. The line of credit is currently secured by Obligations under the Master Indenture.

Taxable Bonds: At March 31, 2017 and December 31, 2016, the Corporation had outstanding \$258.0 million of fixed rate taxable bonds. The weighted average interest rate on the taxable bonds was 1.85%. At March 31, 2017, \$40.0 million of the taxable bonds are subject to a mandatory tender on April 15, 2018. Aurora issued \$218.0 million of Series 2016A and 2016B fixed rate taxable bonds which were directly placed with two commercial banks. The Taxable Bonds are secured by Obligations issued under the Master Indenture.

Other Indebtedness: Aurora is obligated under capital lease and financing arrangements entered into in connection with certain sale-leaseback transactions and capital leases of buildings which are reflected as long-term debt in the unaudited consolidated financial statements of Aurora. These arrangements, which relate to various administrative and medical support buildings, have initial lease terms of 15 to 25 years. At March 31, 2017 and December 31, 2016, the outstanding amount of capital lease obligations and financing arrangements was \$215.5 million and \$220.8 million, respectively.

Aurora's total long-term debt at March 31, 2017 and December 31, 2016 is as follows (in thousands):

	March 31,	December 31,
	2017	2016
Total revenue bonds	\$ 1,090,723	\$ 1,091,166
Taxable bonds	258,000	258,000
Capital lease obligations and financing arrangements	215,530	220,829
Various notes payable	6,018	5,943
Deferred financing costs - net	(10,558)	(10,911)
Total long-term debt	<u>\$ 1,559,713</u>	<u>\$ 1,565,027</u>

LEGAL AND REGULATORY COMPLIANCE

Aurora operates in a highly regulated and litigious industry. As a result, various lawsuits, claims and legal and regulatory proceedings are instituted or asserted against it from time to time. The results of claims, lawsuits and investigations cannot be predicted, and it is possible that the ultimate resolution of these matters, individually or in the aggregate, could have a material adverse effect on Aurora's consolidated financial position or results of operations.

Compliance and Internal Audit Programs

Aurora has a corporate compliance department and maintains a corporate compliance program intended to be consistent with laws and government guidance relating to compliance programs in health care entities. The program includes mandatory education of all employees about certain significant legal and regulatory requirements applicable to the organization, including HIPAA and other privacy regulations, and includes steps to monitor and promote compliance with these requirements. All employees are provided a copy of the Aurora Code of Ethical Conduct and sign a document acknowledging they have read it and understand it reflects Aurora's policy. A "hotline" is available to all employees and physicians to report any areas of potential

concern. In addition, Aurora has adopted policies designed to address specific risk areas and has instituted processes intended to correct problems identified through the hotline or its other compliance activities. The corporate compliance department reports functionally to the Chief Administrative Officer and administratively to the Audit Committee to the Board of Directors.

Aurora also has an internal audit department responsible for providing independent and objective assurance and consulting services designed to add value and improve Aurora's operations and control environment. The internal audit department reports functionally to the Chief Administrative Officer and administratively to the Audit and Compliance Committee to the Board of Directors. The responsibilities of the internal audit department include assessing the effectiveness of internal controls, reviewing compliance with applicable laws and regulations and assessing the reliability of financial reporting.

Debt Compliance Program

Aurora has adopted a debt compliance policy, which establishes uniform guidelines in connection with its tax-exempt bonds and other financial arrangements. The purpose of the policy is to ensure compliance with all federal tax laws relating to tax-exempt bonds including, but not limited to, rules relating to ownership and use of bond-financed property and investment of bond proceeds; compliance with all securities laws relating to Aurora and its bonds including ongoing public disclosure requirements and compliance with all financial and other covenants imposed under the Master Indenture, loan agreements and other agreements related to its bonds and financial arrangements. Preparing and maintaining documentation necessary to provide a record of compliance is an integral aspect of the policy.

INTERNAL CONTROL OVER FINANCIAL REPORTING PROGRAM

Aurora continues to strengthen and improve its internal control environment and create efficiencies in the financial reporting process. Aurora's internal controls program is based upon concepts established in the Sarbanes-Oxley Act of 2002 ("SOX"), even though Aurora is not subject to the provisions of SOX. The internal controls program is focused on ensuring the integrity and reliability of financial information, strengthening internal controls in the reporting process, reducing the risk of fraud and increasing efficiencies in the financial reporting process. The program includes the review of all aspects of the financial reporting process, identification of potential risks and ensure the risks have been mitigated utilizing a management self-assessment process.

BOND RATINGS

Aurora's outstanding bonds have been assigned ratings of A+ (stable outlook) and A2 (stable outlook) by Fitch and Moody's, respectively, as of March 31, 2017. Additional information on Aurora's bond rating can be obtained from Aurora's "Investor Relations" site found at <https://www.aurorahealthcare.org/about-aurora/investor-relations-financial-information>.