



Annual Financial Reporting Information

For the Fiscal Year ended December 31, 2009

Sisters of Charity of Leavenworth Health System  
9801 Renner Blvd., Suite 100  
Lenexa, Kansas 66219

Disclosure information as of December 31, 2009

April 12, 2010



## Operating Information and Management Discussion For the Fiscal Year ended December 31, 2009

The Sisters of Charity of Leavenworth Health System (Corporation) is a not-for-profit Catholic healthcare system with Affiliates located in Kansas, Colorado, Montana and California. The Corporation controls two groups of related entities identified as Affiliates and Exempla entities.

The Affiliates are owned by or affiliated with the Corporation directly or indirectly through sole corporate membership. The hospital Affiliates (listed below) comprise the Restricted Affiliates.

Providence Medical Center (PMC); Kansas City, Kansas  
Saint John Hospital (SJL); Leavenworth, Kansas  
Holy Rosary Healthcare (HRH); Miles City, Montana  
St. James Healthcare (SJB); Butte, Montana  
St. Vincent Healthcare (SVB); Billings, Montana  
St. Francis Health Center (SFT); Topeka, Kansas  
Saint John's Hospital and Health Center (SJSM); Santa Monica, California  
St. Mary's Hospital & Medical Center (SMGJ); Grand Junction, Colorado  
Saint Joseph Hospital (SJD); Denver, Colorado

The Corporation is the sole member of an Obligated Group of which the Restricted Affiliates are included under the terms of a Master Trust Indenture amended and restated as of January 1, 1994. In addition to the Restricted Affiliates, SCLHS Affiliates include Foundations, Clinics, Caritas, Inc. and Subsidiaries (for-profit) and Leaven Insurance Company, Ltd. (off-shore captive insurance company.)

In December 2009, SCLHS began consolidating Exempla, Inc. and Subsidiaries (Exempla). The Exempla entities listed below are included in the accompanying consolidated financial statements. See "Basis of Presentation – Exempla" below for a discussion of the change in control and accounting treatment.

Exempla, Inc. and Subsidiaries, Denver, Colorado  
Exempla Lutheran Medical Center, Wheat Ridge, Colorado  
Exempla Lutheran Medical Center Foundation, Wheat Ridge, Colorado  
Exempla Good Samaritan Medical Center, LLC, Lafayette, Colorado  
Exempla Good Samaritan Medical Center Foundation, Lafayette, Colorado  
Exempla Partners, LLC, Denver, Colorado

The accompanying Financial Statements represent the consolidated statements of SCLHS (total System) and include a Balance Sheet, Statement of Operations, Statement of Changes in Net Assets and Statement of Cash Flows for the Fiscal Year ended December 31, 2009.

### **Basis of Presentation – Exempla**

Exempla Healthcare is a Denver, Colorado based healthcare delivery system formed on January 1, 1998 by a Joint Operating Agreement (JOA) among SCLHS, Community First Foundation (CFF), Exempla, and Saint Joseph Hospital, Inc. (SJH). Under the JOA, Exempla operates SJH and Exempla's subsidiaries.

On December 2, 2009, changes to the bylaws and articles of incorporation of Exempla gave SCLHS and CFF each the power to appoint one-half of the members of the Board of Directors of Exempla and gave SCLHS the direct power to appoint management after consultation with the Exempla Board of Directors and to implement SCLHS policies and procedures. In addition, SCLHS obtained reserved powers to approve budgets, strategic plans, debt financing, acquisition or sale of assets and dissolution of Exempla. With these changes, SCLHS has both effective control over and an economic interest in Exempla and is therefore consolidated in the SCLHS financial statements.

The change in control of Exempla was accounted for in a manner similar to that using the pooling of interest method as of the beginning of fiscal year 2009. SCLHS recorded an increase to net assets of \$308.2 million as of January 1, 2009. Due to CFF's retention of an interest in Exempla upon its dissolution, a noncontrolling interest equal to 50% of the net assets of Exempla Healthcare or \$307.7 million was also recognized as of January 1, 2009. The JOA established an equalization adjustment, whereby the profits and losses of Exempla Healthcare are shared equally by SJH and Exempla. For the year ending December 31, 2008, when Exempla was not consolidated into SCLHS financial statements, the equalization adjustment is reflected in the other operating revenue in the consolidated statements of operations was \$(11.5) million. For 2009, the equalization adjustment is eliminated in the consolidation.

### **Forward-Looking Statements**

This Quarterly Report contains disclosures which constitute "forward-looking statements." Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words like "may," "believe," "will," "expect," "project," "estimate," "anticipate," "plan," "initiative" or "continue." These forward-looking statements are based on the current plans and expectations of SCLHS and are subject to a number of known and unknown uncertainties and risks, many of which are beyond SCLHS' control, that could significantly affect current plans and expectations and SCLHS' future financial position and results of operations. These factors include, but are not limited to, (i) the highly competitive nature of the health care business, (ii) the efforts of insurers, health care providers and others to contain health care costs, (iii) possible changes in the Medicare and Medicaid programs (including changes to Medicare outlier payments) that may impact reimbursements to health care providers and insurers, (iv) the ability to achieve expected levels of patient volumes and control the costs of providing services, (v) changes in Federal, state or local regulations affecting the health care industry, (vi) the ability to attract and retain qualified management and personnel, including affiliated physicians, nurses and medical support personnel, (vii) liabilities and other claims asserted against SCLHS (viii) changes in accounting practices, (ix) changes in general economic conditions including growing numbers of uninsured and unemployed patients, (x) changes in revenue mix and the ability to enter into and renew managed care provider arrangements on acceptable terms and (xii) the collectability of uninsured accounts and deductible and co-pay amounts. As a consequence, current plans, anticipated actions and future financial position and results of operations may differ from those expressed in any forward-looking statements made by or on behalf of SCLHS. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this report, including in "Management's Discussion and Analysis of Financial Performance."

## **Governance**

In November, 2009, the board term of Sister Doris Gottemoeller, RSM ended, and Marlon Priest, M.D. was elected to the Board. There were no other changes during the year to the Board or to the Community Council of Sisters, which comprises the membership of the Corporation.

## **Management**

In January 2009, Mr. Charles Wright was appointed CEO of St. James Healthcare in Butte, Montana, replacing James Kiser, who resigned in March 2008. In December 2009, Mr. Ronald Webb was appointed CEO of Holy Rosary Healthcare in Miles City, Montana, replacing Greg Nielsen, who resigned in June 2009. In September 2009, Michael Schrader resigned as CEO of St. Francis Health Center in Topeka, KS. Grant Wicklund is serving as Interim CEO. In January 2010, William Murray announced his planned retirement as System President and CEO effective in June 2011. The 18-month transition will permit a national search process to locate his replacement and a substantial overlap for transition. Also in January 2010, Dr. Richard Lopes resigned his position as Sr. Vice President / Chief Clinical Transformation Officer of the System. In March 2010, Mr. Michael Rowe, Sr. Vice President / Chief Financial Officer announced his resignation effective June 11, 2010

## **Financial and Operating Information**

### **General**

The Statement of Operations included in the attached Financial Statements for SCLHS (Consolidated) is a summary of activity for the fiscal years ended December 31, 2007, 2008 and 2009. The Statement of Operations with respect to the fiscal years ended December 31, 2007 2008 and 2009 should be read in conjunction with the audited Financial Statements, including the notes thereto, and the reports of Ernst & Young LLP, independent auditors.

The financial and statistical tables which follow are presented for SCLHS (Consolidated) and/or for the Obligated Group under the Master Trust Indenture (Restricted Affiliates).

### **Sources of Patient Service Revenue**

<b>SCLHS (Consolidated)</b>	<b>Audit Year Ended December 31,</b>		
	<b>2007</b>	<b>2008</b>	<b>2009</b>
Medicare	35%	35%	29%
Medicaid	6%	6%	7%
Managed Care	44%	44%	47%
Commercial, Self Pay and Other	15%	15%	17%
Total	100%	100%	100%

### Historical Capitalization Ratio

Restricted Affiliates	Audit as of December 31, (in Millions)		
	2007	2008	2009
Long-Term Debt:			
Master Indenture Debt (net of Original Issue Discount)	\$ 674.6	\$ 653.3	\$ 630.9
Other Long-Term Debt	5.6	51.6	100.1
Total Long-Term Debt	680.2	704.9	731.0
Less: Current Portion of Long-Term Debt	(356.2)	(392.7)	(431.1)
Plus variable portion not scheduled	329.4	318.6	307.3
Net Long-Term Debt	653.4	630.8	607.2
Unrestricted Net Assets	2,305.0	1,991.1	2,125.6
Total Capitalization	\$ 2,958.4	\$ 2,621.9	\$ 2,732.8
Net Long-Term Debt to Capitalization	22.1%	24.1%	22.2%

\* Includes current serial maturities of debt only; excludes variable debt classified as current but not scheduled for payment. SCLHS elected self-liquidity in December, 2003, requiring classification of all variable bonds as current liabilities.

### Historical Debt Service Coverage Requirements

Restricted Affiliates	Audit as of December 31, (in Millions)		
	2007	2008	2009
Combined Income available for Debt Service:			
Revenue over Expenses*	\$ 162.5	(\$ 229.6)	\$ 79.3
Net change in unrealized (gains) losses on investments	(35.2)	245.6	(51.9)
Depreciation and Amortization	105.9	108.7	114.1
Interest and Amortization	29.3	25.3	18.6
Total Income Available for Debt Service	\$ 262.5	\$ 150.0	\$ 160.1
Combined Annual Debt Service Requirements	\$ 54.7	\$ 52.1	\$ 51.3
Debt Service Coverage Ratio	4.8x	2.9x	3.1x

\*before Extraordinary Items

## Utilization

Restricted Affiliates	Audit Year Ended December 31,		
	2007	2008	2009
Licensed Beds*	2,667	2,667	2,633
Staffed Beds	1,970	1,968	1,904
Percent of Occupancy, Staffed Beds	59%	59%	57%
Admissions	93,524	90,494	87,543
Patient Days	426,324	423,273	392,476
Average Length of Stay	4.6	4.7	4.5

\*Includes Acute Care, Psychiatric, Hospital-based Skilled Nursing and Extended Care

## **Management's Discussion and Analysis of Financial Performance**

Restricted Affiliates	Audit Year Ended December 31,		
	2007	2008	2009
Adjusted Operating Income Margin	1.1%	(0.7%)	0.7%
Operating Income Margin	9.0%	(14.9%)	4.1%
Return on Net Assets	7.0%	(11.5%)	3.7%
Debt Service Coverage Ratio	4.8x	2.9x	3.1x
Days Cash on Hand (excluding Self-Insured Risk Funds and Trustee-Held Funds)	398	276	236
Cushion Ratio	28.6x	22.9x	21.7x

SCLHS (Consolidated)	Audit Year Ended December 31,		
	2007	2008	2009
Adjusted Operating Income Margin	1.5%	(0.5%)	1.1%
Operating Income Margin	9.8%	(15.8%)	5.1%
Return on Net Assets	7.6%	(12.1%)	5.2%
Debt Service Coverage Ratio	5.2x	2.8x	3.5x
Days Cash on Hand (excluding Self-Insured Risk Funds and Trustee-Held Funds)	434	292	236
Cushion Ratio	32.2x	24.9x	29.3x

## **Management's Discussion and Analysis of Financial Performance**

### **Balance Sheet**

Cash and Investments (excluding Self-Insured Risk Funds and Trustee Held Funds) increased by \$98.7 million during fiscal year 2009. Of this increase, \$29.8 million occurred due to the consolidation of Exempla in the SCLHS financial statements on January 1, 2009. Days Cash on Hand (excluding Self-Insured Risk Funds and Trustee Held Funds) were 236 Days for SCLHS (Consolidated).

Interest payments totaling \$8.5 million were made on June 1, 2009 and interest payments totaling \$8.5 million were made on December 1, 2009 relating to the Series 1998 and 2000 Bond Issues. Principal payments of \$11.8 million were made on December 1, 2009 relating to the Series 1998 and 2000 bond issues. Monthly variable interest payments for the Series 2002 Bond Issue, the Series 2003 Bond Issue, and the Series 2006 Bond Issue totaled \$0.3 million, \$0.6 million and \$0.4 million, respectively for the year ended December 31, 2009. On December 1, 2009, principal payments were made for the Series 2002 Bond Issue, the Series 2003 Bond Issue and the Series 2006 Bond Issue which totaled \$1.8 million, \$6.1 million and \$2.9 million, respectively.

The Series 2003 Bond Issue consists of \$192 million of Variable Rate Demand Revenue Bonds. Upon the issuance of the Series 2003 Bonds, SCLHS entered into a \$60 million swap in which SCLHS agreed to pay 3.789% and receive the SIFMA rate. SCLHS also entered into a \$60 million swap in which the Corporation agreed to pay 3.18% and receive a rate equal to 68% of the monthly LIBOR rate. Both swaps will expire December 1, 2023. The fixed rate amount and the floating rate amount are netted against each other monthly and SCLHS pays additional interest only to the extent the fixed swap rate exceeds the floating rate and vice versa. Additional swap interest payments for the Series 2003 Bond Issue totaled \$2.8 million for the year ended December 31, 2009.

On March 7, 2006, SCLHS issued \$120 million of Series 2006 variable rate bonds. SCLHS also entered into a \$60 million swap to convert 50% of the Series 2006 issue from variable to fixed-rate. The Corporation agreed to pay 4.215% and receive a rate equal to SIFMA. Upon closing, \$107.9 million was reimbursed to SCLHS for past qualifying capital expenditures. The fixed rate amount and the floating rate amount are netted against each other monthly and SCLHS pays additional interest only to the extent the fixed swap rate exceeds the floating rate and vice versa. Additional swap interest payments for the Series 2006 Bond Issue totaled \$2.2 million for the year ended December 31, 2009.

On September 10, 2007, SCLHS entered into a Revolving Credit Agreement (the JP Agreement) with JPMorgan Chase Bank, National Association that matured on September 10, 2008. On September 9, 2008, the JP Agreement was replaced with a \$100 million Revolving Credit Agreement (the U.S. Bank Agreement) with U.S. Bank, National Association, which matured on September 9, 2009 and was extended through December 23, 2009. On December 23, 2009, the U.S. Bank Agreement was replaced with a \$100 million Term Loan Credit Agreement (the Morgan Stanley Agreement) with Morgan Stanley Bank, National Association which matures on September 23, 2010. As of December 31, 2009 and 2008, \$100.0 million and \$51.2 million, respectively, were outstanding and included in current maturities of long-term debt. Interest on the Morgan Stanley Agreement is calculated based on LIBOR plus 1.35% and reprices two business days prior to the end of each month.

The Series 2002, 2003, and 2006 Variable Rate Demand Bonds are backed by Standby Bond Purchase Agreements with JPMorgan Chase Bank, National Association, Morgan Stanley Bank, N.A., and The Bank of New York Mellon. The Standby Bond Purchase Agreement supporting the 2002 and 2003 bonds expires on May 26, 2010. The Standby Bond Purchase Agreement supporting the 2006 Series A bonds expires on May 26, 2013. The Standby Bond Purchase Agreements supporting the 2006 Series C and Series D bonds expire on March 25, 2012. In the event that bonds bearing interest at a weekly or daily rate are not successfully remarketed or if funds are not available for remarketing, JPMorgan Chase Bank, National Association, Morgan Stanley Bank, N.A., or The Bank of New York Mellon will pay the purchase price for debt that is tendered.

### **Statement of Operations**

For the Fiscal Year ended December 31, 2009, SCLHS (Consolidated) recorded Earnings before Interest, Depreciation and Amortization (EBIDA) of \$246.0 million compared to \$131.1 million for FY 2008. SCLHS (Consolidated) recorded Net Income of \$132.4 million for the fiscal year ended December 31, 2009 compared to Net Loss of \$250.5 million for FY 2008. Approximately \$24.6 million on the increase in Net Income is due to the consolidation of Exempla in 2009. Of the remaining increase in Net Income, \$324.1 million is attributable to investment income, as total investment income was \$83.9 million excluding Exempla (total investment income of \$98.1 including Exempla) during fiscal year 2009 compared to investment loss of \$240.2 million during the prior fiscal year.

Gross Patient Service Revenue was \$7,056.3 million, up \$2,365.2 million from fiscal year 2008, of which \$2,084.7 million was the result of the addition of Exempla as a controlled entity. Contractual Allowances and Charity were \$4,626.7 million, up \$1,678.0 million over the prior fiscal year, of which \$1,495.9 million was the result of the addition of Exempla as a controlled entity. Increases in Gross Patient Service Revenue were the result of changes in volume, service mix, acuity and rates, as well as the addition of Exempla as a controlled entity. Inpatient admissions were 120,609 in fiscal year 2009, an increase of 29,419 versus the prior fiscal year, of which 32,428 represented the addition of Exempla as a controlled entity. Admissions, (excluding Exempla) decreased by 3.3% versus the prior fiscal year. Total Operating Expenses of \$2,466.1 million as of December 31, 2009 were \$654.6 million higher than Total Operating Expenses as of December 31, 2008, primarily due to the addition of Exempla as a controlled entity (\$625.3 million) and increases in purchased services (\$61.0 million).

Investment earnings of \$98.1 million (Consolidated) in 2009 represent a 9.6% return on average invested funds. SCLHS' portfolio includes limited investments in absolute return funds, real estate and core hedge funds for which returns are reported on a calendar quarter basis and for which market values are less readily available than investments traded on the open market. SCLHS performs alternative procedures to validate existence and carrying value.

SCLHS' revenues depend upon inpatient occupancy levels, the volume of outpatient procedures and the charges and negotiated payment rates for such services. Hospital volumes and net revenues appear to be adversely impacted by several factors including general economic softness, a growing uninsured population, higher unemployment levels in certain markets, increased co-payments and deductibles and various competitive pressures. SCLHS' strategy includes providing adequate capacity through the responsible allocation of capital, improving the quality of care in order to attract patients, physicians and payers and controlling costs through increased efficiency.

### **Commitments and Contingencies**

In April 2010, the Corporation approved a financing plan that provided for the issuance of up to \$900.0 million in tax-exempt revenue bonds. The proceeds for the new bonds are expected to be used to refinance the Corporation's Series 2000 and 1998 Bonds and fund new capital improvement projects. The Corporation expects to issue these bonds in May, 2010. If such issuance is completed, the Corporation expects the principal amount of the bonds attributable to the refinancing of the Series 2000 and 1998 Bonds to be approximately \$315.0 million, the principal amount attributable to the new money projects to be \$414.3 million and the total amount of the issue to be approximately \$750.0 million.

SCLHS has adopted resolutions authorizing Exempla to become a Restricted Affiliate pursuant to the Master Trust Indenture. Exempla will consider whether to request that status in April 2010. The resolutions also require the approval of CFF, which is expected to consider the matter in April 2010. The members of Exempla intend to amend the JOA setting a new termination date on June 30, 2014 and specifying a fixed price of \$280 million for termination.

The United States Attorney's Office and the Department of Health and Human Services Office of Inspector General have made inquiries regarding certain reimbursements claimed by SCLHS. SCLHS has adopted internal organizational responsibility and compliance programs to address these concerns and seeks to proactively respond to these requests.