Montclair Health System, LLC

Consolidated Financial Statements
December 31, 2016 and 2015

Montclair Health System, LLC
Index
December 31, 2016 and 2015

Page(s)

Report of Independent Auditors

To the Board of Directors of
Montclair Health System, LLC

We have audited the accompanying consolidated financial statements of Montclair Health System, LLC (the "Company"), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, members' equity, and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Montclair Health System, LLC, at December 31, 2016 and 2015 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
March 17, 2017

Montclair Health System, LLC
Consolidated Balance Sheets
Years Ended December 31, 2016 and 2015

(dollar amounts in thousands)

	2016	2015
Assets		
Current assets		
Cash and cash equivalents	$ 2	$ 405
Due from Corporate - cash management	2,581	4,053
Accounts receivable, less allowance for doubtful accounts of $21,683 and $12,101 at December 31, 2016 and 2015, respectively	39,740	36,573
Inventories	4,088	3,963
Other receivables, net	269	1,384
Other current assets	1,938	1,764
Total current assets	48,618	48,142
Property and equipment, at cost		
Land	957	957
Buildings and improvements	10,426	9,648
Furniture and equipment	29,725	23,463
Construction in progress	14,338	7,062
	55,446	41,130
Accumulated depreciation and amortization	(17,848)	(12,741)
Property and equipment, net	37,598	28,389
Goodwill	126,317	126,317
Intangibles	5,600	5,600
Notes receivable	276	190
Other long-term assets	-	125
Total assets	$ 218,409	$ 208,763
Liabilities and Equity		
Current liabilities		
Accounts payable	$ 13,054	$ 13,654
Accrued salaries, wages, and benefits	4,534	4,757
Other accrued expenses	1,676	1,796
Current portion of long-term debt	391	587
Current portion of capital lease obligations	893	1,258
Current portion of other deferred liabilities	44	44
Current portion of deferred gain on sale-leaseback	5,043	5,043
Total current liabilities	25,635	27,139
Long-term liabilities		
Long-term debt	-	391
Capital lease obligations	-	893
Other deferred liabilities	240	284
Deferred gain on sale-leaseback	56,735	61,778
Other long-term liabilities	1,392	1,458
Total long-term liabilities	58,367	64,804
Commitments and contingencies		
Members' equity	134,407	116,820
Total liabilities and equity	$ 218,409	$ 208,763

The accompanying notes are an integral part of these consolidated financial statements.

Montclair Health System, LLC
Consolidated Statements of Operations
Years Ended December 31, 2016 and 2015

(dollar amounts in thousands)

	2016	2015
Patient revenues before provision for doubtful accounts	$ 249,614	$ 237,895
Provision for doubtful accounts	25,795	9,235
Net patient revenues	223,819	228,660
Other revenues	989	1,516
Net revenues	224,808	230,176
Operating expenses		
Salaries and benefits	101,723	101,877
Supplies	33,992	33,175
Other operating expenses	35,024	35,467
Contract services	25,404	25,542
Depreciation and amortization	5,108	4,278
Management fees	5,085	5,032
Total operating expenses	206,336	205,371
Income from operations	18,472	24,805
Interest income, net	66	16
Net income	$ 18,538	$ 24,821

The accompanying notes are an integral part of these consolidated financial statements.

Montclair Health System, LLC
Consolidated Statements of Members' Equity
Years Ended December 31, 2016 and 2015

(dollar amounts in thousands)

	Units	Amount	Accumulated Earnings	Total
Balances at December 31, 2014	1,900	$ 67,468	$ 27,772	$ 95,240
Distributions made to				
LHP Montclair, LLC	-	(2,551)	-	(2,551)
Hackensack UMC	-	(690)	-	(690)
Net income	-	-	24,821	24,821
Balances at December 31, 2015	1,900	64,227	52,593	116,820
Distributions made to				
LHP Montclair, LLC	-	(761)	-	(761)
Hackensack UMC	-	(190)	-	(190)
Net income	-	-	18,538	18,538
Balances at December 31, 2016	1,900	$ 63,276	$ 71,131	$ 134,407

The accompanying notes are an integral part of these consolidated financial statements.

Montclair Health System, LLC
Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015

(dollar amounts in thousands)

	2016	2015
Operating activities		
Net income	$ 18,538	$ 24,821
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for doubtful accounts	25,795	9,235
Depreciation and amortization	5,108	4,278
Amortization of deferred gain on sale-leaseback	(5,043)	(5,043)
Amortization of physician income guarantees	142	252
Increase in cash from operating assets and liabilities		
Accounts receivable	(28,962)	(17,622)
Inventories and other assets	713	2,903
Accounts payable and accrued expenses	(2,448)	442
Other	(110)	(985)
Net cash provided by operating activities	13,733	18,281
Investing activities		
Purchases of property and equipment	(12,812)	(6,993)
Net cash used in investing activities	(12,812)	(6,993)
Financing activities		
Payments for borrowings	(587)	(537)
Payments on capital leases	(1,258)	(1,164)
Distributions to members	(951)	(3,241)
Decrease (increase) in due to Corporate–cash management	1,472	(6,864)
Net cash used in financing activities	(1,324)	(11,806)
Change in cash and cash equivalents	(403)	(518)
Cash and cash equivalents		
Beginning of year	405	923
End of year	$ 2	$ 405
Supplemental disclosures		
Cash paid for interest expense	$ -	$ 10
Change in fixed assets included in accounts payable	1,505	202

The accompanying notes are an integral part of these consolidated financial statements.

1. Business Overview

Organization

Montclair Health System, LLC (the Company) is a privately held New Jersey limited liability company. Membership units in the Company are owned by LHP Montclair, LLC (the Parent), an indirectly wholly owned subsidiary of LHP Hospital Group, Inc. (LHP) and Hackensack UMC (Hackensack), collectively, the Members. The Company was formed on October 18, 2011, to acquire 100% of the membership interests of Merit Mountainside, LLC, which owned and operated Mountainside Hospital. The Company commenced operations on July 1, 2012 (Acquisition Date), when the Parent contributed cash of $152,000 for an 80% interest in the Company, and Hackensack contributed cash of $38,000 in exchange for a 20.0% interest in the Company to acquire Mountainside Hospital, a 365-bed, full service, acute-care community hospital in Essex County, New Jersey.

The terms “we,” “our,” “the Company,” and “us” refer to the business of Montclair Health System, LLC and its subsidiaries, Montclair Hospital, LLC and Montclair Health Services, LLC and subsidiaries.

The Company is organized as a limited liability company and taxed as a partnership for federal and state income tax purposes under the Internal Revenue Code and various state statutes. As such, all income is taxable directly to its members, and no deferred tax assets or liabilities are recorded in the consolidated balance sheets. Management is not aware of any course of action or series of events that has occurred that might adversely affect the Company’s tax status.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and all subsidiaries and entities controlled by the Company through the Company’s direct or indirect ownership of a majority interest and exclusive right granted to the Company as the sole general partner or controlling member of such entities. All significant intercompany accounts and transactions have been eliminated upon consolidation.

Unless otherwise indicated, all numbers are in thousands, except unit and per unit amounts.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash on hand. The Company places its cash in financial institutions that are federally insured.

Revenue Recognition and Accounts Receivable

The Company recognizes revenues in the period in which services are performed. Accounts receivable primarily consist of amounts due from third-party payors and patients. The Company's ability to collect outstanding receivables is critical to its results of operations and cash flows. Amounts the Company receives for treatment of patients covered by governmental programs such as Medicare and Medicaid and other third-party payors such as health maintenance organizations, preferred provider organizations, and other private insurers are generally less than the Company's established billing rates. Additionally, to provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. Accordingly, the revenues and accounts receivable reported in the Company's consolidated financial statements are recorded at the net amount expected to be received.

The Company's approximate percentages of revenues were as follows for the years ended December 31, 2016 and 2015:

	2016	2015
Medicare/Medicaid	46.2 %	47.3 %
Other insured	60.7	55.7
Self-pay	4.6	1.1
Patient revenues before provision for doubtful accounts	111.5	104.1
Provision for doubtful accounts	(11.5)	(4.1)
Net patient revenues	100.0 %	100.0 %

Contractual Discounts and Cost Report Settlements

The Company derives a significant portion of its revenues from Medicare, Medicaid, and other payors that receive discounts from its established billing rates. The Company must estimate the total amount of these discounts to prepare its consolidated financial statements. The Medicare and Medicaid regulations and various managed care contracts under which these discounts must be calculated are complex and are subject to interpretation and adjustment. The Company estimates the allowance for contractual discounts on a payor-specific basis, given its interpretation of the applicable regulations or contract terms. These interpretations sometimes result in payments that differ from the Company's estimates. Additionally, updated regulations and contract renegotiations occur frequently, necessitating regular review and assessment of the estimation process by management. Changes in estimates related to the allowance for contractual discounts affect revenues reported in the Company's accompanying consolidated statements of operations.

Cost report settlements under reimbursement agreements with Medicare and Medicaid are estimated and recorded in the period the related services are rendered and are adjusted in future periods as final settlements are determined. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. The most recent settled cost report for Mountainside Hospital for Medicare was for the year ended December 31, 2013 and December 31, 2014 for Medicaid. The net adjustments to estimated prior years' cost report settlements resulted in an increase to revenue of $597 and $12 for the years ended December 31, 2016 and 2015, respectively. The net cost report settlement payable by the Company included in other accrued expenses in the accompanying consolidated balance sheets was approximately $36 at December 31, 2016. The net cost report settlements payable to the Company included in other receivables in the accompanying consolidated balance sheets was approximately $1,150 at December 31, 2015. The Company's management believes that adequate provisions have been made for adjustments that may result from final determination of amounts earned under these programs.

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Charity Care

Self-pay revenues are derived primarily from patients who do not have any form of healthcare coverage. The revenues associated with self-pay patients are generally reported at the Company's gross charges. The Company evaluates these patients, after the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, or other governmental assistance programs, as well as the local hospital's policy for charity care. The Company provides care without charge to certain patients who qualify under the local charity care policy. For the years ended December 31, 2016 and 2015, the Company estimates that its costs of care provided under its charity care programs approximated $1,881 and $2,158, respectively.

The Company's management estimates its costs of care provided under its charity care programs utilizing a calculated ratio of costs to gross charges multiplied by the Company's gross charity care charges provided. The Company's gross charity care charges include only services provided to patients who are unable to pay and qualify under the Company's local charity care policies. To the extent the Company receives reimbursement through the various governmental assistance programs in which it participates to subsidize its care of indigent patients, the Company does not include these patients' charges in its cost of care provided under its charity care program.

Additionally, the Company does not report a charity care patient's charges in revenues or in the provision for doubtful accounts, as it is the Company's policy not to pursue collection of amounts related to these patients.

Other Discounts

We provide discounts to uninsured patients who do not qualify for Medicare, Medicaid, or charity care. These discounts are similar to discounts provided to many local managed care plans and totaled $26,846 and $12,270 for the years ended December 31, 2016 and 2015, respectively. In implementing our discount policy, we first attempt to qualify uninsured patients for Medicare or Medicaid, other federal or state assistance, or charity care. If an uninsured patient does not qualify for these programs, the uninsured discount is applied. The increase in discounts as of December 31, 2016, as compared to December 31, 2015 is the result of providing a higher discount percentage for certain uninsured patients.

Provision and Allowance for Doubtful Accounts

To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. The primary uncertainty lies with uninsured patient receivables and deductibles, copayments, or other amounts due from individual patients.

The Company has an established process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the analytical tools that the Company utilizes include, but are not limited to, historical cash collection experience, revenue trends by payor classification, and revenue days in accounts receivable. Accounts receivable are written off after collection efforts have been followed in accordance with the Company's policies.

Changes in the allowance for doubtful accounts are as follows:

Allowance for doubtful accounts balance at December 31, 2014	$	7,682
Additions recognized as reductions to revenues		9,235
Accounts written off, net of recoveries		(4,816)
Allowance for doubtful accounts balance at December 31, 2015		12,101
Additions recognized as reductions to revenues		25,795
Accounts written off, net of recoveries		(16,213)
Allowance for doubtful accounts balance at December 31, 2016	$	21,683

The allowances for doubtful accounts as a percentage of gross accounts receivable, net of contractual discounts, were 35.3% and 24.8% as of December 31, 2016 and 2015, respectively. Receivables related to uninsured patients are reserved at 97.3% (between discount for self-pay and reserve for bad debt) and 97.2% as of December 31, 2016 and 2015, respectively. Deductibles, copayments, or other amounts due from individual patients are reserved at 73.2% and 63.3% as of December 31, 2016 and 2015, respectively.

Concentration of Revenues
As of December 31, 2016 and 2015, approximately 46.2% and 47.3% of the Company's net patient revenues related to patients participating in the Medicare and Medicaid programs, collectively. The Company's management recognizes that revenues and receivables from government agencies are significant to the Company's operations, but it does not believe that there are significant credit risks associated with these government agencies. The Company's management does not believe that there are any other significant concentrations of revenues from any particular payor that would subject the Company to any significant credit risks in the collection of its accounts receivable.

The Company's revenues are particularly sensitive to regulatory and economic changes in New Jersey, where the Company generates its revenues.

Inventories
Inventory is carried at the lower of cost or market and consists mainly of drugs and medical supplies. Cost is determined based on the weighted-average method.

Property and Equipment
Property and equipment are recorded at cost. Property and equipment acquired in connection with a business combination are recorded at their estimated fair value in accordance with the acquisition method of accounting as prescribed in FASB ASC 805-10, *Business Combinations.* Routine maintenance and repairs are charged to expense when incurred. Expenditures that increase capacities or extend useful lives of assets are capitalized. Leasehold improvements and leasehold tenant improvements are amortized over the estimated useful life of the improvement or the remaining life of the lease, whichever is shorter.

Depreciation expense is computed by applying the straight-line method over the estimated useful lives of the assets. Assets held under capital leases are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. The estimated useful life of buildings and improvements generally range from 10 to 25 years, while the estimated useful lives of furniture and equipment range from 3 to 10 years. Total depreciation and amortization for the years ended December 31, 2016 and 2015, was $5,108 and $4,278, respectively.

The Company is obligated under capital leases covering certain construction in progress. At December 31, 2016 and 2015, the amount of construction in progress obligated under capital leases was $4,332 and $4,210, respectively.

Long-Lived Assets
When events, circumstances, or operating results indicate the carrying values of certain long-lived assets (excluding goodwill and indefinite-lived intangibles) expected to be held and used might be impaired, we prepare projections of the undiscounted cash flows expected to result from the use and eventual disposition of the assets. If the projections indicate the recorded amounts are not expected to be recoverable, such amounts are reduced to estimated fair value. No impairment charge was recognized in 2016.

Internal Use Software
The Company capitalizes qualifying computer software costs incurred during the "application development stage" and other costs as permitted. Capitalized software costs included internal direct costs and internal direct labor and related employee benefits costs of developing software for internal use. Amortization of these costs begins once the product is ready for its intended use. These costs are amortized on a straight-line basis over the estimated useful life of the

product, typically 3 to 5 years. The amount of costs capitalized within any period is dependent on the nature of software development activities and projects in each period.

The Company periodically evaluates the remaining useful lives and carrying values of internal use software. If management determines that all or a portion of the asset will no longer be used, or the estimated remaining useful life differs from existing estimates, an abandonment will be recorded to reduce the carrying value or adjust the remaining useful life to reflect revised estimates. In addition, if the carrying value of the software exceeds the estimated future cash flows, an impairment will be recorded to reduce the carrying value to the expected realizable value.

The following table presents a rollforward of capitalized internal use software for the years ended December 31:

	2014	Additions	2015	Additions	2016
Capitalized internal use software	$ 998	$ 1,248	$ 2,246	$ 801	$ 3,047
Accumulated amortization	(51)	(558)	(609)	(814)	(1,423)
	$ 947	$ 690	$ 1,637	$ (13)	$ 1,624

Amortization expense related to capitalized software was $814 and $558 for the years ended December 31, 2016 and 2015, respectively.

Goodwill and Indefinite-Lived Intangible Assets
Goodwill is the excess of the purchase price over the fair value of identifiable assets acquired. Under FASB ASC 350, *Intangibles – Goodwill and Other*, goodwill and intangibles with indefinite lives are not amortized, but tested for impairment annually or more frequently if certain indications of impairment arise. The Company adopted accounting guidance that allows a qualitative assessment to determine whether the two-step goodwill impairment analysis is necessary. If a company assesses qualitative factors and concludes the two-step goodwill impairment test is necessary, the first step is performed by comparing the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered to have a potential impairment and the second step of the impairment test is not required.

However, if the carrying amount of the reporting unit exceeds its fair value, the second step is performed to determine whether goodwill is impaired and to measure the amount of impairment loss to be recognized, if any. The second step compares the implied fair value of goodwill with the carrying amount of goodwill. If the implied fair value of goodwill exceeds its carrying amount, then goodwill is not considered impaired. However, if the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is estimated based upon internal evaluations of the related long-lived assets for each reporting unit that include quantitative analyses of revenues and cash flows. No goodwill impairments were recognized during the years ended December 31, 2016 or 2015.

Other Accrued Expenses
Other accrued expenses consist of the following:

	2016	2015
Taxes other than income	$ 491	$ 328
Physician recruitment	320	238
Other	865	1,230
	$ 1,676	$ 1,796

Professional and General Liability
LHP maintains on behalf of its affiliates an insurance policy with a commercial insurer. The professional and general liability policy has combined limits of $1,000 per claim and $4,000 annual aggregate for claims. The deductible is $100 per occurrence. In addition to the primary coverage, umbrella and excess coverage is maintained with shared limits of $15,000. LHP maintains reserves for estimates of loss that will ultimately be incurred on claims that have been reported but not paid and claims that have been incurred but not reported. These reserves are established based on consultation with independent actuaries and billed as premiums to each affiliate.

At December 31, 2016 and 2015, the Company has recorded an accrued liability to LHP for professional risk liabilities of $1,882 and $1,646, respectively, which is included in the amounts due to Corporate in the consolidated balance sheets. Expenses for professional and general liability coverage allocated to the Company were approximately $326 and $122 for the years ended December 31, 2016 and 2015, respectively, and are included in other operating expenses within the consolidated statements of operations.

As part of the acquisition of the Hospital, LHP assumed responsibility for all unpaid professional and general liability claims occurring prior to July 1, 2012 (Acquisition Date). The claims-made policy has a limit of $100 per occurrence retention and aggregate retentions. Reserves are established for estimates of loss that will ultimately be incurred on claims that have been reported but not paid and claims that have been incurred but not reported. These reserves are established based on consultation with independent actuaries. Management believes the use of actuarial methods to account for these reserves provides a consistent and effective way to measure these accruals. However, recorded reserves could differ from ultimate costs relate to these claims. The Company recorded an accrued liability for professional risk liability related to the unreported claims prior to Acquisition Date of $376 as of December 31, 2016, included in other long-term obligations within the consolidated balance sheets. The Company expected reinsurance recoveries related to these liabilities of $0 as of December 31, 2016.

Self-Insured Liabilities
LHP is self-insured for substantially all of the medical benefits of its employees. LHP maintains reserves for medical benefits that reflect known claims and an estimate of incurred but not reported claims based upon an actuarial analysis as of December 31 and are billed as premiums to each affiliate. At December 31, 2016 and 2015, the Company has recorded an accrued liability to LHP for self-insured medical benefits of $902 and $879, respectively, which is included in the amounts due to Corporate in the consolidated balance sheets. Expenses for medical benefit coverage allocated to the Company were approximately $5,273 and $4,041 for the years ended December 31, 2016 and 2015, respectively, and are included in salary and benefits expense within the consolidated statements of operations.

LHP is self-insured for workers' compensation claims with a stop-loss limit of $250 per occurrence. Estimated liabilities included in due to Corporate for workers' compensation claims were $3,095 and $3,024 and anticipated recoveries of $1,014 and $1,129 were included in due to Corporate at December 31, 2016 and 2015, respectively. Expenses for workers' compensation allocated to the Company were approximately $1,375 and $1,375 for the years ended December 31, 2016 and 2015, respectively, and are included in other operating expenses on the accompanying consolidated statements of operations.

Fair Value

Fair value accounting includes a framework for measuring fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). It also includes disclosures about fair value measurements that prioritize the inputs to valuation techniques used to measure fair value into a fair value hierarchy.

The classification of a financial instrument within the valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels of the hierarchy in order of priority of inputs to the valuation technique are defined as follows:

Level 1 Observable quoted market prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.

Level 3 Unobservable inputs for the asset or liability that are significant to the fair value of the assets or liabilities.

Fair Value Disclosures

The Company currently has no financial instruments subject to fair value measurement on a recurring basis. Disclosures about fair value of financial instruments require disclosure of fair value information about those financial instruments, whether or not recognized in the balance sheets, but would be practicable to estimate that value. Management believes the carrying value of cash, due from Corporate-cash management, accounts receivable, other receivables, accounts payable and accrued expenses approximates fair value due to their short-term maturity. Management believes the fair value of long-term liabilities approximates fair value based on current interest rate assumptions and remaining term to maturity.

Recently Adopted Accounting Standards

Effective January 1, 2016, the Company adopted ASU 2015-02 *Consolidation* (ASU 2015-2) issued by the FASB. ASU 2015-02 includes amendments that are intended to improve targeted areas of consolidation for legal entities including reducing the number of consolidation models from four to two and simplifying the FASB ASC. The adoption of ASU 2015-02 had no impact on the Company's financial position, results of operation, cash flows or financial disclosures.

Effective January 1, 2016oirer to retrospectively adjust its financial statements for changes to provisional amounts that are identified during the measurement-period following the consummation of a business combination. Instead, ASU 2015-16 requires these types of adjustments to be made during the reporting period in which they are identified and would require additional disclosure or separate presentation of the portion of the adjustment that would have been recorded in the previously reported periods as if the adjustment to the provisional amounts had been recognized as of the acquisition date. The adoption of ASU 2015-16 had no impact on the Company's financial position, results of operation, cash flows or financial disclosures.

Effective December 16, 2016, the Company adopted ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* (ASU 2014-15). ASU 2014-15 requires management to assess an entity's ability to continue as a going concern. Management should evaluate whether conditions or events, considered in the aggregate, exist that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. The adoption of ASU 2014-15 had no impact on the Company's financial position, results of operation, cash flows or financial disclosures.

Accounting Standards Not Yet Adopted

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* (ASU 2017-01). ASU 2017-01 clarifies the definition of a business and affects different areas of accounting, such as business combinations. This standard will be effective for the Company for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The Company is in the process of evaluating this guidance to determine the impact it will have on the results of operations, cash flows and financial position.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 clarifies certain aspects of the statement of cash flows, including the classification of debt prepayment or debt extinguishment costs or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, distributions received from equity method investees and beneficial interests in securitization transactions. This new standard also clarifies that an entity should determine each separately identifiable source of use within the cash receipts and payments on the basis of the nature of the underlying cash flows. In situations in which cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use, the appropriate classification should depend on the activity that is likely to be the predominant source or use of cash flows for the item. This standard will be effective for the Company for annual periods beginning after December 31, 2017. The Company is in the process of evaluating this guidance to determine the impact it will have on the results of operations, cash flows and financial position.

In March 2016, the FASB issued ASU No. 2016-08, *Revenue Recognition: Clarifying the new Revenue Standard's Principal-Versus-Agent Guidance* (ASU 2016-18). The standard amends the principal-versus-agent implementation guidance and illustrations in the FASB's new revenue standard (ASU 2014-09). ASU 2016-08 clarifies that an entity should evaluate whether it is the principal or the agent for each specified good or service promised in a contract with a customer. As defined in the ASU, a specified good or service is "a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer". Therefore, for contracts involving more than one specified good or service, the Company may be the principal in one or more specified goods or services and the agent for others. The new standard has the same effective date as ASU 2014-09, as amended by the one-year deferral and early adoption provisions in ASU 2015-14. In addition, entities are required to adopt ASU 2016-08 by using the same transition method they used to adopt the new revenue standard. We are currently evaluating the impact that the adoption of this new accounting guidance will have on our results of operations, cash flows and financial position.

In March 2016, the FASB issued ASU No. 2016-07, *Investments - Equity Method and Joint Ventures* (Topic 323): *Simplifying the Transition to the Equity Method of Accounting*. ASU 2016-07 eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an adjustment must be made to the investment, results of operations and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment has been held. This standard will be effective for the Company for annual periods beginning after December 31, 2017. The Company is in the process of evaluating this guidance to determine the impact it will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* (ASU 2016-02). ASU 2016-02 establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Early adoption is permitted and modified retrospective application is required. The Company is in the process of evaluating this guidance to determine the impact it will have on the consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 amends certain aspects of accounting and disclosure requirements of financial instruments, including the requirement that equity investments with readily determinable fair values be measured at fair value with changes in fair value recognized in our results of operations. This new standard does not apply to investments accounted for under the equity method of accounting or those that result in consolidation of the investee. Equity investments that do not have readily determinable fair values may be measured at fair value or at cost minus impairment adjusted for changes in observable prices. A financial liability that is measured at fair value in accordance with the fair value option is required to be presented separately in other comprehensive income for the portion of the total change in the fair value resulting from change in the instrument-specific credit risk. In addition, a valuation allowance should be evaluated on deferred tax assets related to available-for-sale debt securities in combination with other deferred tax assets. This standard will be effective for the Company for annual periods beginning after December 31, 2017.

The Company is in the process of evaluating this guidance to determine the impact it will have on the consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory* (ASU 2015-11). ASU 2015-11 requires the measurement of inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The adoption of ASU 2015-11 is not expected to have a material impact on the Company's financial position, results of operation, cash flows or financial disclosures.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), that introduces a new five-step revenue recognition model in which an entity should recognize 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 or services. ASU 2014-09 also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. Numerous updates, including ASU 2016-08, ASU 2016-10, ASU 2016-12, ASU 2016-19 and ASU 2016-20 were issued in 2016 to provide clarification on a number of specific issues as well as requiring additional disclosures. The new standard is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company is in the process of evaluating this guidance to determine the impact it will have on the consolidated financial statements.

3. Goodwill and Other Intangible Assets

The acquired intangible assets are the Mountainside Hospital trade name, the certificate of need, and Medicare/Medicaid licenses, with carrying values of $4,600, $900, and $100, respectively. The intangible assets all have indefinite lives.

Changes in the value of goodwill are as follows:

Balance at December 31, 2014	$	126,317
Changes to goodwill		-
Balance at December 31, 2015		126,317
Changes to goodwill		-
Balance at December 31, 2016	$	126,317

4. Members' Equity

Pursuant to the Second Amended and Restated Limited Liability Company Agreement (LLC Agreement), each member's interest in the Company is denominated in membership units or fractions thereof, of which 1,900 have been issued, with each unit representing an initial capital contribution of $100,000.

5. Sale-Leaseback Transaction

On March 31, 2014, the Company sold real estate associated with Mountainside Hospital and thereafter leased the land and buildings from the acquirer. The deferred gain realized on the sale of $75,648 is being amortized on the straight-line basis over the 15-year life of the lease. The deferred gain balance was $61,778 and 66,821 for the years ended December 31, 2016 and 2015, respectively. The amortization of the gain is recorded as a reduction to rent expense. Rent expense from the sale-leaseback, net of the amortization of the deferred gain, was $4,785 and $4,618, respectively, for the years ended December 31, 2016 and 2015.

Future minimum lease payments under the operating lease, before amortization of the deferred gain or rent escalation charges, are as follows for years ending December 31:

2017	$	9,688
2018		9,834
2019		9,981
2020		10,131
2021		10,283
Thereafter		79,327
	$	129,244

6. Long-Term Debt

The Company entered into an agreement with Public Service Electric and Gas Company (PSE&G) to implement various energy cost-reduction strategies and measures to improve the hospital's energy efficiency. Pursuant to the terms of the agreement, PSE&G funds a portion of certain energy-reducing capital projects without requiring repayment from the Company (the Permanent Incentive). The portion of the funding received from PSE&G that is required to be repaid, $1,760, is repaid over three years and does not bear interest. As of December 31, 2016 and 2015, the Company received $0 from PSE&G pursuant to this agreement. The Company accounts for the permanent incentive portion of the PSE&G contract in accordance with ASC 450-30, *Contingencies – Gain Contingencies*.

For the years ended December 31, 2016 and 2015, the Company recognized $0 in permanent incentive under the PSE&G contract reflected separately in the accompanying consolidated statements of operations as energy improvement incentives within operating expenses. The remaining balance of the loan at December 31, 2016 and 2015 was $391 and $978, respectively.

7. Retirement Plan

The Company participates in LHP's contributory benefit plan that is available to employees who meet certain minimum requirements. The plan requires the Company to match 100% of a participant's contributions up to the first 3% of the participant's compensation. The Company recorded contribution expense of $1,562 and $1,660 for the years ended December 31, 2016 and 2015, respectively.

8. Transactions With Related Parties

LHP Management Services, LLC (Corporate), an indirectly wholly owned subsidiary of LHP, provides services to the Company with regard to management and administration, financial management, clinical and patient care, medical staff relations, group purchasing programs, information technology, and other services. The Company reimburses Corporate for these services based on a management fee arrangement. Additionally, HUMC provides certain advisory and marketing services to the Company based on a management fee arrangement. The annual fee under that arrangement is $100 annually. The Company recorded management fee expense of $4,985 and $4,932 to Corporate and $100 to HUMC for the years ended December 31, 2016 and 2015, respectively.

The amounts due from Corporate of $2,581 and $4,053 at December 31, 2016 and 2015, respectively, represent the net shortage of amounts paid by Corporate on behalf of the Company under the amounts transferred by the Company into the centralized cash management account. Amounts paid by Corporate on behalf of the Company generally include operating expenses and fees and services provided by Corporate to the Company.

Net operating funds provided by the Company earn interest based on the three-month London Interbank Offered Rate (LIBOR), adjusted monthly. The interest rate at December 31, 2016 was 1.00%. The Company recorded interest income of $32 and $67 for the years ended December 31, 2016 and 2015, respectively.

Net operating funds required by the Company incur interest expense based on the Prime Rate, adjusted monthly. The interest rate at December 31, 2016 was 4.25% for the $500 threshold as described in the Cash Management Agreement. For amounts due to Corporate over the $500 threshold, interest was charged at a rate of 9.00% throughout 2015 and June 2016 and 3.61% for the last six months of 2016. The Company recorded interest expense of $0 and $76 for the years ended December 31, 2016 and 2015, respectively.

9. Leases

The Company leases real estate, buildings, vehicles, and equipment under cancelable and noncancelable leases. The leases expire at various times and have various renewal options. For certain leases that meet the lease capitalization criteria in accordance with FASB ASC 840-10, *Leases-Overall,* assets have been recorded at their fair value at the date of acquisition and liabilities at the net present value of the minimum lease payments at the inception of the lease.

Rental expense on operating leases was $6,354 and $6,543, net of the amortization of the deferred gain of $5,043 for the years ended December 31, 2016 and 2015, respectively.

Future minimum lease payments, excluding those in Note 5, at December 31, 2016, are as follows:

	Operating Leases	Capital Lease Obligations	Total
2017	$ 831	$ 920	$ 1,751
2018	772	-	772
2019	760	-	760
2020	726	-	726
2021	724	-	724
Thereafter	5,060	-	5,060
	$ 8,873	920	$ 9,793
Less: Imputed interest portion		(27)	
Obligations under capital leases		$ 893	

10. Regulatory Matters

All healthcare providers are required to comply with a significant number of laws and regulations at the federal and state government levels. These laws are extremely complex, and in many instances providers do not have the benefit of significant regulatory or judicial interpretation as to how to interpret and/or apply these laws and regulations. The U.S. Department of Justice and other federal and state agencies are increasing resources dedicated to regulatory investigations and compliance audits of healthcare providers. As a healthcare provider, the Company is subject to these regulatory efforts. Healthcare providers that do not comply with these laws and regulations may be subject to civil or criminal penalties, the loss of their licenses, or restrictions on their ability to participate in various federal and state healthcare programs. We endeavor to conduct our business in compliance with applicable laws and regulations, including healthcare fraud and abuse laws.

As a result of our hospitals' state licensures and certifications under the Medicare and various Medicaid programs, we are subject to regular reviews, surveys, audits, and investigations conducted by, or on behalf of, federal and state agencies, including the CMS, which are responsible for the oversight of these programs. These agencies' reviews may include reviews or surveys of our compliance with required conditions of participation regulations. The purpose of these surveys is to ensure that healthcare providers are in compliance with governmental requirements, including requirements such as adequacy of medical care, equipment, personnel, operating policies and procedures; maintenance of adequate records; compliance with building codes and environmental protection; and healthcare fraud and abuse. These surveys may identify deficiencies with conditions of participation that require corrective actions to be made by the hospital within a given time frame.

If a hospital is not successful in addressing the deficiencies and conditions in a timely manner, CMS reserves the right to deem the hospital to be out of compliance with Medicare conditions of participation and may terminate the hospital from participation in the Medicare program. Termination of a hospital from the Medicare program would have a material adverse effect on our results of operations and cash flows.

Additionally, these agencies may review our compliance with various payment regulations and conduct audits under CMS's Recovery Audit Contractor (RAC) program. The RAC program has been made permanent and was required to be expanded broadly to healthcare providers pursuant to the Tax Relief and Healthcare Act of 2006. The results of the enhanced medical necessity reviews and the RAC program audits could have an adverse effect on our business, financial position, results of operations, and liquidity. To the extent these reviews result in an adverse finding, we may contest the adverse finding vigorously; however, these matters can result in significant legal expense and consume our resources.

11. Commitments and Contingencies

Legal

The Company is, from time to time, subject to claims and suits arising in the ordinary course of business including claims for damage for personal injuries, medical malpractice, breach of contract, wrongful restriction of or interference with physicians' staff privileges, and employment-related claims. In certain of these actions, plaintiffs request payment for damages, including punitive damages that may not be covered by insurance. The Company is currently not a party to any pending or threatened proceedings that, in management's opinion, would have a material adverse effect on the Company's business, financial condition, or results of operations.

12. Subsequent Events

In March 2017, LHP Hospital Group, Inc. completed its merger with Ardent Health Services (Ardent), pursuant to the Agreement and Plan of Merger. As a result of the transaction, LHP is now a wholly-owned subsidiary of Ardent. Under the terms of the agreement, Ardent will assume LHP's management and operational responsibilities within the Company.