

This document is dated as of November 5, 2009.

SPECIAL NOTE CONCERNING FORWARD-LOOKING STATEMENTS. Certain of the discussions included in the Management's Discussion and Analysis sections of the following document may include certain "forward-looking statements" which involve known and unknown risks and uncertainties inherent in the operation of healthcare facilities. Actual actions or results may differ materially from those discussed below. Specific factors that might cause such differences include competition from other healthcare facilities in the service areas of Catholic Health Initiatives' Participant and Designated Affiliate facilities, federal and state regulation of healthcare providers, and reimbursement policies of the state and federal governments and managed care organizations. In particular, statements preceded by, followed by or that include the words "believes," "estimates," "expects," "anticipates," "plans," "intends," "scheduled" or other similar expressions are or may constitute forward-looking statements.

ANNUAL REPORT

Concerning

**CATHOLIC HEALTH INITIATIVES
REPORTING GROUP¹**

The information in this report
has been provided by

Catholic Health Initiatives,
Bethesda Hospital,
Alegent Health and
Alegent Health-Immanuel Medical Center

¹ Reporting Group is defined as CHI and the Participants (which includes those entities whose financial statements are required to be consolidated with those of CHI as per GAAP) and Material Designated Affiliates (currently Bethesda and Alegent) and any other Designated Affiliate CHI chooses to include.

**CHI REPORTING GROUP
AS OF AND FOR THE FISCAL YEAR ENDED
June 30, 2009**

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Catholic Health Initiatives Reporting Group
Analysis of Financial Statements
For the Fiscal Year Ended June 30, 2009

Introduction

Combined financial statements for the Catholic Health Initiatives Reporting Group (Reporting Group) for the year ended June 30, 2009 have been completed and are attached for your review. The Reporting Group is defined as Catholic Health Initiatives (CHI) which includes those entities whose financial statements are required to be consolidated per generally accepted accounting principles (GAAP), Material Designated Affiliates (currently Alegent Health and Alegent Health-Immanuel Medical Center, hereafter referred to as Alegent, and Bethesda Hospital, Inc., hereafter referred to as Bethesda) and any other Designated Affiliate CHI chooses to include.

Within this analysis, the reader will encounter financial, operational or other references to the Reporting Group and/or to the individual entities comprising the Reporting Group, especially CHI. To better inform the reader, commentary may be provided for CHI alone when information is not available for the Reporting Group as a whole. When commentary refers to CHI, it includes consolidated CHI, as noted above. Certain changes have been made to the financial statements that impact the way information and ratios are presented. These changes are highlighted below.

Changes in Presentation of the Statement of Operations

During FY 2009, CHI management reviewed and refined categorization of components of income related to core functions versus those activities peripheral to core operations. In addition, certain items were specifically displayed on the face of the statement of operations (previously included in other operating revenues) so that they were readily observable. The following changes are reflected in the June 30, 2009 statement of operations:

- **First Initiatives Insurance Ltd. (FIIL) investment income** – Investment income/(loss) from FIIL is now reported as a separate line in the operating revenues section of the statement of operations (investment gain/loss from self-insured trust funds). These earnings continue to support operations of CHI and, as such, are included in operating revenues.
- **Nonoperating component of Joint Operating Agreement (JOA) income share arrangements** – CHI participates in an income share arrangement with three of its JOAs. This income share includes income derived from core operating activities of the JOA as well as nonoperating activities (investment earnings, bond defeasance activity and transactions around interest rate swaps). Previously, the combined income share was included in other operating revenues. In the June 30, 2009 financials, the portion of the income share related to nonoperating activities is now reflected in other nonoperating gains/(losses) in the statement of operations. The portion of the income share related to operating activities continues to be included in other operating revenues.

Changes in ratio calculations

Certain margins and ratios have also been modified to be more consistent with industry standards. These changes are noted below.

- **Days of total cash, including bad debt expense** -- this ratio previously excluded bad debt expense from the calculation of days of total cash. Consistent with industry standard, this ratio now includes bad debt expense.
- **Debt-to-capitalization** – This ratio previously included only variable-rate debt with self liquidity, bank loans and long-term debt in the calculation of debt-to-capitalization, exclusive of the current portion of long-term debt. However, the calculation has been changed to include all debt, which is a more common industry measure. Additionally, total net assets were previously included in the denominator of this calculation. This has been changed to include only unrestricted net assets in order to be more consistent with rating agency presentations.

The changes noted above have been incorporated into the Reporting Group financial statements effective June 30, 2009. Historical ratios have also been adjusted for comparative purposes. We believe this new presentation will allow for more transparency in the statement of operations and more clearly identify components of the business that are driving operating performance.

Recent Developments (CHI Financial Results - Two Months Ended August 31, 2009)

CHI reported positive results from operations for the two months ended August 31, 2009. Income from operations was a positive \$98.3 million (6.2% margin) compared to \$12.1 million (0.8% margin) for the same prior-year period. A significant portion of the increase was due to favorable investment results at FIIL, which increased \$43.1 million over prior year. Net patient services revenues increased by 5.8%, while total operating expenses, excluding restructuring, impairment and other losses, increased by 3.3%. This continued the trend from fiscal year 2009, where revenue growth outpaced expense growth. The patient margin, which measures the difference between net patient services revenues and total expenses as a percentage of total net patient services revenues, was a negative (1.1)%, although an improvement over the negative (3.6)% in the prior year. Investment performance was a positive \$230.3 million including both operating and non-operating items, which was a \$270.6 million improvement over prior-year investment results. Volume indicators were mixed compared to prior year, with outpatient and physician volumes showing significant improvement.

Reporting Group Summary of Operating Results

The consolidated financial performance of the Reporting Group for the year ended June 30, 2009 declined from operating results achieved in fiscal year 2008. Income from operations was \$190.4 million or an operating margin of 2.0% compared to the prior year results of \$229.7 million or 2.6%. Income from operations based on a new internal metric, however, was \$330.0 million (3.4% margin) in 2009 compared to prior year results of \$253.9 million (2.9% margin). The new internal metric is defined as income from operations excluding restructuring, impairment and other losses, investment gain/loss from self-insured trust funds (i.e. FIIL investment income) and the nonoperating portion of a CHI equity method investment in Jewish Hospital and St. Mary's Healthcare. Excluding these items provides a better indication of controllable operations of the Reporting Group.

The majority of the volume indicators for the Reporting Group showed growth over the prior year, when taking into consideration a full year of operations of a CHI Market Based Organization (MBO) in Denville NJ (acquired April 1, 2008) in fiscal year 2009 as well as the opening of a new facility (St. Anthony's Hospital) at an MBO in Tacoma WA (opened March 17,

2009). Net patient services revenues increased 9.2% over the prior year, while operating expenses increased 8.3% year over year, excluding restructuring, impairment and other losses. The patient margin, however, which measures the relationship of operating expenses before restructuring, impairment and other losses to net patient services revenues was a negative (1.3%) for the year ended June 30, 2009, an improvement from the (2.2%) patient margin for fiscal year 2008, but still indicating a need for better management of resources to net patient services revenues. Total investment losses from self-insured trust funds were significantly higher in 2009 (negative \$88.1 million) compared to 2008 (negative \$4.9 million), offsetting an increase in total operating revenues of 7.8%.

Overall investment performance was significantly off from the prior year as a result of the continued downturn in the economy and instability in the investment and credit markets. Total investment losses, including net unrealized losses, were \$(709.0) million for the year compared to the prior year loss of \$(21.3) million (amounts include losses from self-insured trust funds). The total deficiency of revenues over expenses for fiscal year 2009 was \$(508.1) million, primarily due to negative investment performance, compared to excess of revenues over expenses of \$119.8 million in fiscal year 2008.

Significant Transactions

There were several significant and/or non-recurring transactions recorded in fiscal years 2009 and 2008 (including the adoption of various accounting pronouncements) that affect consistent comparisons in the financial results between the fiscal years.

The following significant transactions were recorded in fiscal year 2009:

- **Discontinued Operations** -- In April 2009, CHI's management signed a letter of intent to transfer sponsorship and related operations of its Missouri facilities to an unrelated third party. The operations associated with these lines of business have been reported as discontinued operations and are excluded from the combined statements of operations. Assets and liabilities related to the transaction are reported as assets/liabilities held for sale in the accompanying combined balance sheets. At June 30, 2009 and 2008, assets held for sale consist primarily of inventories, property and equipment, donor-restricted assets and investments in unconsolidated organizations. Liabilities held for sale consist of certain compensation and benefits expenses. This designation effectively removed the operating results of the MBO in Joplin MO from the income from operations for 2009 and 2008.
- **Unfunded Pension Liability** – At the June 30, 2009 measurement date, the projected benefit obligation in excess of the fair value of plan assets for all CHI plans was approximately \$621.7 million. This resulted from several factors, but was most significantly impacted by investment performance through June 30, 2009 as well as the change in actuarial losses, and the decrease in the discount rate from 6.75% to 6.44% year over year. This charge to net assets, as well as the investment losses reported through earnings in fiscal year 2009, had a negative impact on the debt to capitalization ratio for the Reporting Group.

- **Restructuring and Impairment Losses** – During the year ended June 30, 2009, CHI recorded nonrecurring expenses in the statement of operations of \$34.7 million relating to asset impairments and changes in business operations, including reorganization and severance costs. CHI recorded an additional \$50.0 million of nonrecurring expenses related to the Joplin MO MBO, which were included as discontinued operations (and not included in the statement of operations). Impairment charges included in the statement of operations totaled \$10.4 million, the majority of which was a \$7 million charge at an MBO in Great Bend KS, related to hospital performance and recoverability of long-lived assets.
- **Release of FIIL Loss Reserves** – The release of FIIL loss reserves in fiscal year 2009 was approximately \$61 million, as compared to the \$62 million benefit in the prior year. This was attributable to continued favorable loss trends and other factors as evaluated by outside actuaries. Additional reserve estimates were booked at year end related to potential claims at one of the CHI MBOs.
- **Debt Proceeds and Restructurings** -- In November 2008, CHI issued \$477.1 million of fixed rate and put bonds in the states of Colorado, Ohio, Tennessee and Washington. Proceeds were used to refinance \$177.1 million in variable-rate bonds and to reimburse CHI approximately \$300 million for capital expenditures. This refinancing resulted in a loss on defeasance of \$2.9 million. In February 2009, CHI recognized a gain of \$13.7 million from the restructuring of escrowed securities held by trustees. CHI retained the \$300 million in reimbursement for capital expenditures in cash and cash equivalents to build liquidity and minimize further impact of volatile market conditions on investment performance. Cash and cash equivalents are up significantly year over year as a result of this short-term strategy to hold cash.
- **Debt Classification on Balance Sheet** – Commercial paper previously classified as long term debt was reclassified to current debt in May 2009 based on maturity dates of less than one year. The variable rate demand bonds that do not have dedicated credit facilities are also included as current obligations, consistent with prior year treatment. There are no requirements to repay the commercial paper in fiscal year 2010.
- **Statement of Financial Accounting Standards (SFAS) 157, Fair Value Measurements (SFAS No. 157)** -- In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, which provides a new definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Reporting Group members adopted the provisions of SFAS No. 157 as of July 1, 2008. The adoption of SFAS No. 157 did not have a material effect on the Reporting Group's combined financial position as of July 1, 2008 or June 30, 2009 or on the combined statement of operations for the year ended June 30, 2009.
- **Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS No. 161)** -- In March 2008, the FASB issued SFAS No. 161, which builds upon the existing disclosure requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133) by requiring enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect

an entity's financial position, financial performance, and cash flows. CHI adopted the provisions of SFAS No. 161 as of July 1, 2008. In connection with the adoption of SFAS No. 161, CHI classified the net interest cost on its interest rate swaps for the year ended June 30, 2009 of \$26.5 million, previously reported in interest expense, into realized and unrealized losses on interest rate swaps in the accompanying consolidated statements of operations and changes in net assets. The net interest cost for the year ended June 30, 2008 was \$5.8 million and was included in interest expense.

The following significant and/or non-recurring transactions recorded in fiscal year 2008 include the following:

- **Bond Restructuring and Loss on Defeasance of Debt** – During April and May 2008, CHI successfully completed the restructuring of \$896 million of its auction-rate securities. As a result of this restructuring, CHI wrote off \$9.0 million of previously capitalized deferred financing costs, including bond insurance premiums and unamortized costs of issuance. Approximately half of this was related to bond insurance premiums for Financial Guaranty Insurance Company (FGIC).

CHI drew \$150 million on a line of credit with Wachovia Bank to defease a portion of the outstanding bonds at Denville NJ, which were acquired as part of the Saint Clare's transaction in Denville NJ. Approximately \$93.2 million of the bonds were defeased, resulting in a loss on defeasance of \$6.5 million. The \$150 million line of credit was paid off in May 2009.

- **Statement of Financial Accounting Standards (SFAS) 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158)** -- On July 1, 2007, CHI adopted the provisions of SFAS No. 158 regarding elimination of an early measurement date for plan assets and obligations, such that plan assets were re-measured as of CHI's year-end. The change in measurement date also permitted a change in the discount rate used by CHI to value plan obligations from 6.0% to 6.25%. These changes resulted in a reduction in the pension liability and an adjustment to net assets of \$65.3 million. The measurement of plan assets and liabilities at June 30, 2008 resulted in an underfunded status of \$25 million.
- **Restructuring and Impairment Losses** – CHI recorded \$13 million in losses related to restructuring costs associated with reorganization of information services functions and senior leadership functions at CHI. An additional \$23 million was recorded in restructuring and impairment losses in 2008, which was a charge at the Joplin MO MBO related to hospital performance and recoverability of long-lived assets. The additional \$23 million has been reclassified to discontinued operations for 2008 from the statement of operations where it was reported in the prior year.

Changes in Organization

The following organizational changes occurred in fiscal year 2009, which had varying impact on the year-over-year comparative financial performance.

- **St. Anthony's Hospital** -- On March 17, 2009, St. Anthony's Hospital opened for business as the newest addition to the Tacoma WA MBO. St. Anthony's is a 112-bed acute care hospital located in Gig Harbor, WA. The newly-built hospital resulted in an increase to Tacoma's total assets of approximately \$213.2 million. The impact on the Reporting Group's consolidated income from operations was a negative (\$13.6) million for the year primarily related to start-up costs for this entity.
- **Denville NJ** – The operations of Denville NJ are included in the fiscal year 2009 results of operations for the entire year compared to three months of operations in fiscal year 2008. The impact on the Reporting Group's consolidated income from operations was a negative (\$23.2) million in 2009 compared to a negative (\$2.4) million in 2008.
- **Joplin MO** – As discussed above, the operations of the Joplin MO MBO were effectively removed from the statement of operations for fiscal years 2009 and 2008 as a result of its status as a "held for sale" entity. This had the impact of removing \$9.1 million and \$19.7 million in operating losses (exclusive of restructuring, impairment and other losses) in 2009 and 2008, respectively, from the statements of operations. These amounts are reflected as discontinued operations.
- **Letter of Intent Regarding Divestiture of Three MBOs** – In early September 2009, CHI entered into an agreement with Trinity Health to consolidate several of their hospitals into a new regional health system based in Boise, Idaho and owned by Trinity Health. Under this non-binding arrangement, CHI would sell three of its market based organizations (Nampa ID, Ontario OR and Baker City OR) to Trinity Health, the terms of which have not yet been finalized. The transaction is expected to close in early 2010.

Reporting Group – Discussion of Operating Results

The Reporting Group has been challenged to deliver more favorable operating results. During the year, an extensive performance improvement effort was implemented at CHI, with significant savings opportunities identified. This coordinated effort has helped deliver an operating margin of 3.4% for the Reporting Group based on the new internal metric, as noted earlier in this discussion. The discussion below is based on the components of the Reporting Group (CHI, Alegent and Bethesda).

CHI Results of Operations

Total net patient services revenues increased 9.9% (\$741.6 million) in fiscal year 2009 when compared to the prior year. Excluding the Denville NJ MBO, the increase in net patient services revenues was 6.8%. Volume and rate increases were the primary factors contributing to the increase, in addition to the new St. Anthony's Hospital at the MBO in Tacoma WA. Master facility plan improvements also contributed to volume increases at several of the MBOs. **Contractual allowances** as a percentage of gross revenues were 59.6% in the current year compared to 57.2% in the prior year, while **case-mix index** remained relatively flat compared to the prior year (1.40 in 2009 compared to 1.39 in 2008). **Charity care**, an offset to net patient services revenues, was consistent between 2009 and 2008 as a percentage of gross revenues (3.4% and 3.3%, respectively).

Investment losses from self-insured trust funds were \$(88.1) million in 2009 compared to \$(4.9) million in 2008. This was a significant increase in losses year over year due to the continued downturn in the economy and instability in the investment and credit markets during fiscal year 2009.

Total **operating expenses** were \$8.4 billion in fiscal year 2009, excluding restructuring, impairment and other losses, an increase of 8.6% over 2008. Excluding the Denville NJ MBO, the increase was 5.1%. Significant efforts were made in 2009 to manage overall expenses for the organization, which contributed to the improved patient margin of negative (2.0)% in 2009 compared to (3.2)% in 2008. Significant expense variances are discussed below.

Labor costs (salaries and benefits) accounted for the most significant component of total operating expenses and represented 47.5% of total operating costs in 2009, excluding restructuring, impairment and other losses, compared to 47.8% in 2008. As a percentage of net patient services revenues, total labor costs were 48.5% in 2009 compared to 49.4% in 2008, an expected improvement given the cost savings initiatives that have been put into place. Although total labor dollars increased \$293.3 million (7.9%) compared to 2008, most of this increase was due to the MBO in Denville NJ which contributed \$141.1 million to the increase. Additional labor increases were expected due to wage rate increases over the prior year along with the addition of the new St. Anthony Hospital at the MBO in Tacoma WA. During 2009 and 2008, a SFAS 87 pension credit was also booked for \$62.4 million and \$37.8 million, respectively, to reduce total pension expense to the actuarially determined amount for each year. These credits reduced total labor costs in each of the respective years, although the amount in 2009 was \$24.6 million higher than 2008. Excluding the impact of the SFAS 87 pension credit, total labor costs increased \$317.9 million (8.5%) year-over-year.

Supplies increased 7.7% (\$107.1 million) in fiscal year 2009, below the 9.9% growth in net patient services revenues. Excluding the MBO in Denville NJ, the increase was 5.4% (\$75.3 million). However, as a percentage of net patient services revenues, supplies decreased to 18.2% in 2009 compared to 18.6% in 2008. CHI has begun to realize savings from supply contracting and other process improvements as well as other efforts around supply chain management initiatives.

Bad debt expenses increased 9.3% (\$52.9 million) in fiscal year 2009. Excluding the MBO in Denville NJ, the increase was 7.5%. As a percentage of net patient services revenues, however, bad debt expenses were a consistent 7.5% in both 2009 and 2008. Again, as noted in the past, there has been a continuing transfer of healthcare costs to the patients through growing co-pays and deductibles, and many patients find they have little or no coverage. At the same time, there has been some slow down in the rate of increase for bad debt due to better classification of balances as charity care.

Bad debt and charity care, combined as a percentage of net patient services revenues, increased to 16.7% in fiscal year 2009, compared to 16.0% in 2008. Most of this increase was due to an increase in charity given improved standards of qualifying patients as unable to pay.

Interest expense decreased 20.9% (\$26.5 million) in fiscal year 2009. The overall decrease was because interest rates on variable rate demand bonds and commercial paper were significantly lower than in the prior year, resulting in lower expense on a higher debt load year over year. Additionally, \$26.5 million in interest expense on the interest rate swaps was moved to nonoperating expense consistent with new accounting regulations (SFAS No. 161) as compared to \$5.8 million in the prior year.

Other expenses increased 46.3% (\$179.5 million) over the prior year. Excluding the MBO in Denville NJ, the increase was 30.8%. The increase was due to increases in purchased services and insurance expenses. Purchased services expenses increased due to a change in relationship for lab services at an MBO, where lab services previously owned by the MBO are now purchased through an unconsolidated entity. Additionally, insurance expense increased due to expected losses related to a healthcare regulatory issue at one of CHI's MBOs, discussed previously.

Restructuring, impairment and other losses were \$84.7 million in fiscal year 2009 compared to \$35.7 million in the prior year. The MBO in Joplin MO represented \$50.0 million and \$23.0 million of these charges in fiscal year 2009 and 2008, respectively. The primary components for 2009 included impairments of \$52.2 million related to cash flow deficits and concern about recoverability of long-lived assets at several MBOs, in addition to other restructuring charges of \$26.5 million due to reorganization and severance costs at both the MBO and Corporate levels. As discussed previously, charges related to the Joplin MBO were classified as discontinued operations and are not included in the statement of operations.

Alegent Results of Operations

The consolidated financial performance of Alegent Health includes all entities required to be consolidated per GAAP for this entity, some of which are not included in the Reporting Group financial statements. The consolidated performance for Alegent Health and related entities for the year ended June 30, 2009 declined from operating results achieved in fiscal year 2008. The operating margin was 3.6% in fiscal year 2009 compared to 5.7% in the prior year. Total net patient services revenues increased 2.2% compared to the prior year, while total operating expenses increased 4.4%. The patient margin was a negative (1.1)% in 2009 compared to a positive 1.1% in the prior year. Total operating revenues for Alegent only represent approximately 5.8% of the total Reporting Group.

Bethesda Results of Operations

The consolidated financial performance of Bethesda Hospital, Inc. and Subsidiaries includes all entities required to be consolidated per GAAP for this entity, some of which are not included in the Reporting Group financial statements. The consolidated performance for Bethesda Hospital, Inc. and Subsidiaries for the year ended June 30, 2009 declined from operating results achieved in fiscal year 2008. The operating margin was 4.4% in fiscal year 2009 compared to 5.4% in the prior year. Total net patient services revenues increased 6.9% compared to the prior year, while total operating expenses increased 8.2%. The patient margin was a positive 3.7% in 2009 compared to a positive 4.9% in the prior year. Total operating revenues for Bethesda only represent approximately 4.4% of the total Reporting Group.

Reporting Group Utilization

Most utilization metrics showed moderate increases over fiscal year 2008 levels, largely due to the full year impact of the addition of the MBO in Denville NJ. **Acute inpatient admissions** were 2.6% above 2008 levels, while **acute inpatient days** were 1.9% above prior year. **Long-term care days**, however, declined 17.6% from 2008. Excluding the MBO in Denville NJ, acute inpatient admissions, acute inpatient days and long-term care days declined (0.9)%, (2.1)% and (21.0)%, respectively, compared to levels achieved in 2008.

Reporting Group Balance Sheet

Total consolidated assets decreased 4.3% to \$12.4 billion at June 30, 2009, a decrease of \$552.8 million from fiscal year 2008. The Reporting Group maintained a strong balance sheet, but it has been strained considerably during fiscal year 2009 due to market conditions that have impacted investment earnings and year-end investment balances, as well as the challenges in the debt markets with accessing capital and maintaining the appropriate levels of liquidity to manage the current debt structure. Capital spend was limited in fiscal year 2009 as a result of declining capital capacity and management's intent to hold cash until operating and investment performance improve.

Days of total cash was 169 days at the end of June 30, 2009, significantly down from the prior year level of 205 days. For CHI, days of total cash was 164 days at the end of June 30, 2009 compared to the prior year level of 199 days. Operating and investment performance had a significant impact on the cash position as of June 30, 2009. Factors contributing to the decrease in days cash at CHI included: capital additions (33.5 days), the calculation of one day's cash including an increase in expenses (14.9 days), a net decrease in unrealized gains (20.2 days), regular payments on long-term debt (15.9 days) and an increase in payments of notes payable (6.0 days). These decreases were partially offset by cash provided by income from operations (26.0 days), issuance of long-term debt (21.1 days) and the release of trustee-held assets into cash (9.0 days).

Net patient accounts receivable increased slightly to \$1.3 billion at June 30, 2009. Most of this growth was attributable to the opening of the new St. Anthony's Hospital in Tacoma WA. **Days in accounts receivable** improved to 49.3 days compared to 53.7 days at June 30, 2008. Several key revenue cycle initiatives have been implemented over the past few years which have resulted in improvements in the self-pay collection efforts, as well as better identification of charity versus self-pay balances.

Total debt, including current portion, variable-rate debt with self liquidity and bank loans, was \$3.7 billion and \$3.6 billion as of June 30, 2009 and 2008, respectively. The transactions impacting debt during the year were described earlier in the narrative.

The **current portion of debt** obligations was \$1.3 billion at June 30, 2009, which included approximately \$525.3 million of variable rate debt with self-liquidity. The self-liquidity debt was classified as current due to the fact that CHI provides the financial backing for these obligations in the event the bonds are not successfully remarketed. Commercial paper of \$550.6 million was also classified as current due to the terms of less than one year. The commercial paper is not scheduled for payment in 2010.

The current ratio improved significantly over the prior year from 0.8 at June 30, 2008 to 1.0 at June 30, 2009. The biggest impact on this ratio was the buildup of cash and equivalents as a result of CHI's short-term strategy to hold cash to cover liquidity requirements based on the current debt structure.

The **debt-to-capitalization ratio** was not as strong compared to the prior year. The ratio increased to 38.1% from 33.4% in the prior year. The impact of the unfunded pension liability and investment performance had a significant impact on the debt-to-capitalization ratio as noted earlier.

Other liabilities increased \$732.7 million over June 30, 2008. This was the result of the unfunded pension liability adjustment at June 30, 2009 as well as the negative position on interest rate swaps, net of collateral, of approximately \$92.1 million, an increase of \$56.9 million over the prior year negative balance of \$35.2 million.

Total net assets decreased 17.9% from June 30, 2008 to June 30, 2009, primarily the result of lower than expected operating performance and portfolio losses for fiscal year 2009 and the adjustment to net assets for the unfunded pension liability.

Conclusion

Fiscal year 2009 represented a challenging year with the first six months falling significantly below performance expectations, and the last six months reaching and/or exceeding budget. The turnaround in operating performance was achieved through a very deliberate focus on key operating performance metrics as well as improvement plans for specific initiatives, which involved the efforts of the entire organization. Many of these initiatives were identified towards the end of the last fiscal year and began to yield results as implementation plans gained traction through the fall months.

The investment and credit markets were extremely volatile all year and required significant management and monitoring to ensure adequate liquidity for the Reporting Group's current debt structure, obtaining credit facilities to back variable rate debt, and managing competing cash needs. Investment performance placed a significant strain on available capital spending; however, this highlighted the need to drive better operating performance to become less dependent on investment earnings to support both operating and capital investment activities.

The members of the Reporting Group will need to continue the momentum of the last several months with a focus on clinical initiatives and cost of care to provide sustainable results for the future. An improvement in the operation margin of 1% for fiscal year 2010 would contribute approximately \$96 million in potential additional capital capacity for fiscal year 2011, which is imperative to meeting growing capital investment requirements. Monitoring activities and reports as well as a focus on performance and strategic metrics will provide the information to respond timely to both challenges and opportunities in the markets.

Items of Disclosure

Recent Developments

Proposed Transfer of St. John's Regional Medical Center, Joplin, Missouri

CHI has finalized the transfer of sponsorship of St. John's Regional Medical Center, Joplin, Missouri (382 acute beds), including Brady Rehabilitation Center and St. John's Maude Norton Memorial Hospital (25 acute beds), to the Sisters of Mercy Health System of St. Louis, Missouri. The transfer of sponsorship occurred on November 1, 2009. The affiliation with the Sisters of Mercy, an integrated health care system based in Missouri, with acute-care hospitals in seven states, is intended to ensure a strong, coordinated network for communities now served by St. John's Regional Medical Center. Total operating revenues from St. John's Regional Medical Center's operations for the fiscal year ended June 30, 2009 were \$313.0 million and represented 3.5% of total operating revenues of consolidated CHI. Such amounts were included in discontinued operations in the statement of changes in net assets for the 2009 financial statements.

Proposed Transfer of One CHI Facility in Idaho and Two CHI Facilities in Oregon to Trinity Health

CHI signed a letter of intent with Trinity Health, a national health system based in Novi, Michigan, in early September 2009 for the proposed transfer to Trinity Health of three CHI facilities: Mercy Medical Center, Nampa, Idaho (152 acute bed); Holy Rosary Medical Center, Ontario, Oregon (49 acute beds); and St. Elizabeth Health Services, Baker City, Oregon (36 acute beds). The transfer of these facilities may occur during the 2010 fiscal year. Total operating revenues from the three CHI facilities' operations for the fiscal year ended June 30, 2009 were \$188.7 million. The three MBOs represented approximately 1.6% of the total assets of consolidated CHI, 2.2% of total operating revenues of consolidated CHI and 0.5% of the deficiency of revenues over expenses as of June 30, 2009.

St. Joseph Medical Center, Towson, Maryland reaches an "Agreement in Principle" with U.S. Attorney Office for the District of Maryland

St. Joseph Medical Center (Towson, Maryland) ("SJMC") received two subpoenas from the Office of Inspector General of the U.S. Department of Health and Human Services ("OIG"), requiring the production of certain documents relating to issues including, but not limited to, SJMC's relationship with a physician group. These subpoenas were issued in connection with a civil investigation being conducted by the U.S. Attorney's Office for the District of Maryland. SJMC is cooperating with this investigation, has produced numerous documents in response to the subpoenas, and has held numerous meetings with the U.S. Attorney's Office in an effort to resolve this matter. SJMC entered into an "Agreement in Principle" with the U.S. Attorney's Office to resolve all potential civil claims arising out of SJMC's relationship with the physician group, including claims under the federal False Claims Act, the Civil Monetary Penalties Law, and all common

law theories relating to the filing of claims for reimbursement with the Medicare program, Tricare program, the Federal Employees Health Benefits Program, and Maryland Medicaid for all services referred to SJMC by the physician group from January 1, 1999 to the present. The “Agreement in Principle” must be approved by the U.S. Department of Justice, the OIG, the Office of Personnel Management, and the State of Maryland. In addition, SJMC is working with the Internal Revenue Service to resolve potential excess benefit and other tax issues implicated by the potential settlement. To the best knowledge of CHI, the status of SJMC as an organization described in Section 501(c)(3) of the Internal Revenue Code is not at risk. Further, SJMC is in negotiations with the OIG over whether a corporate integrity agreement will be imposed upon SJMC and, if so, what terms will be required. Due to the inherent uncertainties in matters of this type, CHI is not in a position to predict any potential outcome. Notwithstanding that uncertainty, CHI believes that any resolution, including any potential monetary penalties or actions that must be taken under a corporate integrity agreement, will not have material adverse consequences to the CHI Credit Group. In this regard, a liability of \$22 million has been recorded at June 30, 2009.

While no assurance can be given that the outcome of any current investigation will be favorable, management of CHI believes that adequate reserves have been established and the outcome of any current investigations and collateral consequences, including possible media coverage, will not have a material effect on the financial position or results of operations of the CHI Credit Group.

Closure of St. Joseph Memorial Hospital, Larned, Kansas

In June 2009, CHI announced plans to close St. Joseph Memorial Hospital, Larned, Kansas, a critical-access hospital (25 acute beds). Following action taken by the State of Kansas against the closure and concerns about access to healthcare services expressed by local community groups, CHI is exploring alternatives to closure with the Attorney General of the State of Kansas and those local community groups. Among the alternatives being considered is the transfer of the hospital facilities and license. The hospital remains open while this and other alternatives are being considered and discussed.

Acquisitions

Saint Clare’s Health System, Denville, New Jersey

CHI acquired Saint Clare’s Health System, (“Saint Clare’s), based in Denville, New Jersey, on April 1, 2008. Saint Clare’s and its affiliates are now an MBO, and each affiliate is a Participant and a Member of the CHI Credit Group. Saint Clare’s controls nonprofit corporations that own and operate four acute care hospitals and a long-term care (behavioral health) facility, located in Boonton Township, Denville, Dover and Sussex, New Jersey, with an aggregate of 541 acute licensed beds that employ over 3,100 employees. Additionally, one of Saint Clare’s affiliates, St. Francis Lifecare Corporation d/b/a Franciscan Oaks, operates a continuing care retirement center, located in Denville,

New Jersey, comprised of 79 skilled nursing beds, 34 assisted living beds and 286 independent living units.

The transaction was accounted for as a donation of net assets and contributed approximately \$389 million in total assets to the consolidated financial position of CHI for the fiscal year ended June 30, 2008. Liabilities in the amount of \$294 million were assumed by CHI.

Dayton Heart Hospital

On May 18, 2008, Good Samaritan Hospital, Dayton, Ohio completed the acquisition of the assets of the Dayton Heart Hospital (now named Dayton Heart and Vascular Hospital) in a purchase valued at \$55 million. This facility is operated as a division of Good Samaritan Hospital.

New Greenfield/Replacement Hospitals

In March 2009, Franciscan Health System, Tacoma, Washington, a Participant, opened St. Anthony Hospital, Gig Harbor, Washington. The 112 acute-bed facility is the first full-service, acute-care community hospital in Gig Harbor, a maritime village in Puget Sound. Construction on the hospital, the fifth Franciscan Health System facility and 78th in the CHI system, began in April 2007.

In September 2009, Mercy Medical Center, Des Moines, Iowa, a Participant, opened Mercy Medical Center-West Lakes. It is the first new community hospital in West Des Moines and the first in the Des Moines area in almost 50 years. The seven-story, 230,000 square-foot facility, which is licensed for 146 beds, is also Iowa's first Leadership in Energy and Environmental Design (LEED) hospital. At the same time it opened its new facility, Mercy Health Network closed Mercy Capital Hospital, a 103-year-old hospital in downtown Des Moines.

Liquidity Arrangements for Put Obligations, Including Commercial Paper

CHI has two types of external liquidity facilities; those which are dedicated to specific series of variable rate demand bonds ("VRDBs") and those which are not dedicated to a particular series of VRDBs but which may be used to support CHI's obligations to fund tenders of VRDBs and Put Bonds and to pay the maturing principal of the Commercial Paper Notes.

As of September 30, 2009, CHI had \$567.0 million of VRDBs backed by dedicated facilities. \$174.5 million and \$148.4 million of these dedicated facilities are supported by Bayerische Landesbank (Bayern LB) and Landesbank Hessen-Thuringen Girozentrale (Heleba), respectively. S&P has confirmed that the Bayern LB and Heleba facilities remain rated A-1+.

CHI has issued Taxable Commercial Paper Notes, Series A and Series B (the “Commercial Paper Notes”), which may be issued from time to time pursuant to a Commercial Paper Issuing and Paying Agency Agreement, dated December 20, 2006, between CHI and Wells Fargo Bank, National Association. The Series A and B Notes are currently sold by JPMorgan Chase Bank, N.A. and Morgan Stanley, as broker-dealers, each using a separate “Commercial Paper Offering Memorandum”. The obligation to make payments on the Commercial Paper Notes is the general obligation of CH, secured by an obligation issued under the Capital Obligation Document. Funds for such payments are provided by CHI from its operations and from the operations of the members of the CHI Credit Group, from unrestricted funds of CHI and the CHI Credit Group and, to the extent necessary, from funds available under external liquidity facilities described below. The Commercial Paper Notes are not secured by any assets, nor are any specific assets set aside or otherwise dedicated to such payments. CHI has directed the broker-dealers of the Commercial Paper Notes to tranche the maturities so that no greater than approximately one-third of the outstanding balance matures in any one month and no more than \$150 million matures within any five business day period. As of the date of this report, the noted tranching was in effect. No assurances can be given that this tranching can always be accomplished.

As of June 30, 2009 and September 30, 2009, the outstanding aggregate principal balance of Commercial Paper Notes was \$550.6 million and the aggregate principal balance of variable rate bonds with an optional tender right that are not supported by a dedicated liquidity facility was \$525.3 million.

At June 30, 2007, June 30, 2008 and June 30, 2009, the Reporting Group (which includes Designated Affiliates) had cash and equivalents and unrestricted investments (includes net unrealized gains and losses) as described in the table below.

(000's)	June 30, <u>2007</u>	June 30, <u>2008</u>	June 30, <u>2009</u>
Cash and Equivalents	\$428,390	\$283,628	\$808,036
Unrestricted Investments	<u>4,449,287</u>	<u>4,468,223</u>	<u>3,418,668</u>
TOTAL	<u>\$4,877,667</u>	<u>\$4,751,851</u>	<u>\$4,226,704</u>

As mentioned above, CHI has external liquidity facilities that are not dedicated to specific series of bonds. One such facility, the 2008 Credit Agreement, was provided by a group of banks in the amount of \$350 million with JPMorgan Chase Bank, National Association, as Administrative Agent. The 2008 Credit Agreement terminated on May 14, 2009. CHI has a number of other general liquidity facilities provided by various commercial banks with a total commitment level of \$670.0 million. The Commercial Paper Notes of \$550.6 million and the variable rate bonds not supported by a dedicated liquidity facility of \$525.3 million are supported by these bank lines and the investments of the CHI Reporting Group, noted above. Although there are no amounts drawn under the Credit Agreements, CHI has covenanted to apply any funds drawn under the Agreements exclusively to support its obligations to fund tenders of variable rate bonds

issued for the benefit of CHI and the CHI Credit Group and to pay the Commercial Paper Notes.

Recent Management Changes

Several changes have taken place over the last year in CHI management. These include the resignation, effective October 2, 2009, of Colleen M. Blye, Executive Vice President, Finance and Integrated Services; and four executive appointments: Mitch Melfi, Senior Vice President, Legal Services and General Counsel (former Senior Vice President and Chief Risk Officer); Stephen Moore, M.D., Senior Vice President and Chief Medical Officer; Paul Edgett, Senior Vice President, National Business Lines (former Vice President, Strategy); and Michael O'Rourke, from interim to the permanent position of Senior Vice President and Chief Information Officer. Management of CHI has commenced a national search to replace Ms. Blye, who will remain in a limited role until January 2, 2010. Susanna Laundry, Vice President, Financial Management has been appointed Interim Senior Vice President and Chief Financial Officer.

Transition to DACBond.com

In addition to filing financial information on CHI's website, CHI moved to DAC for financial information dissemination concurrent with the March 31, 2009 quarterly report. To access CHI's financial information on the DAC system, interested parties may visit www.dacbond.com. If new to the DAC system, please click on the **Register** link, complete the registration form and submit.

You may search by CUSIP number, obligor, issuer, issue description, bond type, city and state, county and state or by state only.

Please contact Shana Bridge at DAC at 888.824.2663 or by email at shanab@dacbond.com if you have any questions or need assistance with obtaining access to CHI's information.

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**Catholic Health Initiatives Reporting Group
Balance Sheets**

	June 30 2009 (Unaudited)	June 30 2008 (Unaudited)
<i>(In Thousands)</i>		
Assets		
Current assets:		
Cash and equivalents	\$ 808,036	\$ 283,628
Patient accounts receivable, net	1,287,708	1,285,330
Assets held for sale	4,120	63,527
Other current assets	441,884	445,971
Total current assets	2,541,748	2,078,456
Investments and assets limited as to use:		
Internally designated	3,418,668	4,468,223
Held by trustees, held for insurance purposes, and restricted by donors	804,469	1,111,211
Total investments and assets limited as to use	4,223,137	5,579,434
Property and equipment, net	5,173,141	4,811,444
Other assets	471,809	493,310
Total assets	\$ 12,409,835	\$ 12,962,644
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	\$ 692,025	\$ 557,919
Variable-rate debt with self liquidity	525,260	696,985
Bank loans	50,631	150,000
Liabilities held for sale	4,513	5,040
Other current liabilities	1,181,073	1,153,687
Total current liabilities	2,453,502	2,563,631
Long-term debt	2,398,602	2,235,545
Other liabilities	1,430,074	697,420
Total liabilities	6,282,178	5,496,596
Net assets	6,127,657	7,466,048
Total liabilities and net assets	\$ 12,409,835	\$ 12,962,644

**Catholic Health Initiatives Reporting Group
Statements of Operations**

	Twelve Months Ended June 30	
	2009	2008
	(Unaudited)	(Unaudited)
	<i>(In Thousands)</i>	
Revenues		
Net patient services	\$ 9,230,281	\$ 8,454,694
Investment loss from from self-insured trust funds	(88,093)	(4,937)
Other	434,980	431,232
Total operating revenues	<u>9,577,168</u>	<u>8,880,989</u>
Expenses		
Salaries, wages, and employee benefits	4,426,348	4,116,913
Supplies	1,676,199	1,560,368
Bad debts	681,653	614,563
Depreciation and amortization	524,707	462,873
Interest	97,109	124,909
Other	1,946,094	1,759,017
Total operating expenses before restructuring, impairment and other losses	<u>9,352,110</u>	<u>8,638,643</u>
Income from operations before restructuring, impairment and other losses	225,058	242,346
Restructuring, impairment and other losses	34,690	12,650
Income from operations	<u>190,368</u>	<u>229,696</u>
Nonoperating (losses) gains:		
Investment losses	(620,925)	(16,363)
Gain (loss) on escrow restructuring and defeasance of bonds	10,845	(15,491)
Change in fair value of interest rate swaps	(88,350)	(64,694)
Other nonoperating losses	(32)	(13,345)
Total nonoperating losses	<u>(698,462)</u>	<u>(109,893)</u>
(Deficit) excess of revenues over expenses	<u>\$ (508,094)</u>	<u>\$ 119,803</u>

**Catholic Health Initiatives Reporting Group
Operating Statistics**

	Twelve Months Ended June 30	
	2009	2008
	(Unaudited)	(Unaudited)
Financial Performance:		
(Deficit) excess of revenues over expenses margin	(5.7)%	1.4%
Operating margin	2.0%	2.6%
EBIDA margin	1.3%	8.1%
Operating EBIDA margin	8.5%	9.2%
Liquidity:		
Bad debt expense as a percentage of net patient services revenues	7.4%	7.3%
Operations:		
Acute admissions	481,576	469,456
Acute inpatient days	2,137,452	2,097,050
Acute average length of stay, in days	4.4	4.5
Long-term care days	554,904	673,758

Note: As of June 30, 2009 and June 30, 2008, days of total cash on hand were 169 and 205, respectively. At the same dates, the debt-to-capitalization ratio was 38.1% and 33.4%, respectively, and the number of days of net patient services revenues in net patient accounts receivable was 49.3 and 53.7 respectively.