The following information should be read in conjunction with Ascension’s consolidated financial statements and related notes to the consolidated financial statements.
Introduction to Management’s Discussion and Analysis

The purpose of Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A), is to provide a narrative explanation of the financial statements of Ascension Health Alliance, d/b/a Ascension (the System), that enables users of the System’s financial statements to better understand the System’s operations, to enhance the System’s overall financial disclosures, to provide the context within which the System’s financial information may be analyzed, and to provide the System’s financial condition, results of operations and cash flows. Unless otherwise indicated, all financial and statistical information included herein relates to continuing operations. MD&A, which should be read in conjunction with the accompanying Consolidated Financial Statements and Supplementary Information, includes the following sections:

- Strategic Direction
- Organizational Developments
- Results of Operations - Consolidated
- Liquidity and Capital Resources

Strategic Direction

The System continues to provide high-quality, low-cost, person-centered care for all and is focused on centralization, standardization, optimization and collaboration efforts in order to work together as one integrated ministry. The System is focused on creating regional clinically integrated systems of care in its markets that deliver value-based healthcare to individuals served, with special attention to those who are poor and vulnerable.

Across the System, Health Ministries are engaging in value-based healthcare delivery through a variety of vehicles including accountable care organizations (ACOs), bundled payment products and wholly- or partially-owned health plans as well as narrow network and state health exchange products. Some of these initiatives are being pursued in partnership with the Centers for Medicare and Medicaid Services (CMS) as part of the Medicare Shared Savings Program or the Partnership for Patients program, as well as with the Center for Medicare & Medicaid Innovation.

Organizational Developments

The System continues to broaden its healthcare delivery platform and diversify its care continuum beyond inpatient acute care services as well as drive greater efficiencies through consolidation of services, creation of joint venture partnerships where appropriate, and divestiture of certain operations as discussed further below.

Together Health Network

Ascension Health (a direct subsidiary of Ascension), CHE Trinity Health, and physician partners across the state of Michigan have collaborated to form a joint venture named Together Health Network. Together Health Network is a Michigan LLC that provides for joint participation in population health-based contracts and delivery of seamless, coordinated care. Together Health Network will also work in concert with payers to develop health plan products for public and private health exchanges, as well as direct-to-employer offerings.

Alexian Brothers Health System (Arlington Heights, IL)

Alexian Brothers Health System (ABHS), a subsidiary of Ascension Health, and Adventist Midwest Health signed a definitive agreement to form a joint operating company (JOC). The JOC will result in a notably diverse physician provider network, bringing together more than 3,000 physicians to offer better-coordinated, more-comprehensive care for patients in the Chicago area. This transaction is expected to close in fiscal 2015, following review by appropriate regulatory bodies.
Organizational Developments (continued)

Ascension Health Senior Care

Effective July 1, 2014, Ascension united the majority of its senior-focused programs into one national organization. Ascension Health Senior Care includes independent living and skilled nursing facilities, as well as Program of All-inclusive Care for the Elderly (PACE) programs that are a part of Ascension Health. Together, the 34 senior care facilities across the country will have better access to resources to enhance patient care, programs and services, as well as share best practices and processes, and establish consistent standards.

Joint Venture for Home Care Services

Ascension Health entered into an agreement with Evolution Health, a division of Envision Healthcare, to form a joint venture to provide home care, hospice care and infusion therapy to individuals in communities served by Ascension Health.

Ascension Clinical Holdings

Ascension Clinical Holdings (Clinical Holdings) provides a standard suite of capabilities and services to enable physician practices to operate more efficiently, and to facilitate the transition to emerging fee-for-value payment models and risk-based contracting arrangements. Clinical Holdings near term efforts are primarily focused on deploying a core set of capabilities and a common practice management software platform to the System’s Health Ministries’ employed physician base. This common platform was successfully implemented for approximately 2,500 providers, representing 43% of total System providers as of September 30, 2014 and is expected to be fully deployed across the System by the end of fiscal year 2016.

Symphony and Ministry Service Center

Symphony is an enterprise resource planning initiative of Ascension. Symphony is designed to facilitate efficiency, focus resources, and provide analytic capabilities that will improve operational and clinical decisions, both at the local Health Ministry and System-wide levels. Symphony will provide a single, centralized source of information with a shared database, allowing for immediate information access and retrieval and reducing or eliminating data inaccuracy and duplication.

Through Symphony, the System is implementing new operational practices in finance, human resources, and supply chain, enabled by information technology. As of September 30, 2014, this initiative has been successfully deployed at twenty Health Ministries with more than 108,000 users. In addition, Symphony was successfully deployed at three additional Health Ministries on November 1, 2014. Symphony is expected to be fully implemented in fiscal year 2017.

The Ministry Service Center (MSC), a critical and permanent component of Symphony, provides shared services in the areas of finance, human resources, and supply chain to the Health Ministries of the System. Through process transformation, the MSC delivers value by providing services more efficiently, enabling new insights, and facilitating Health Ministry consistency in day to day practices.

Carondelet Health (Kansas City, Missouri)

Carondelet Health in Kansas City, Missouri, a subsidiary of Ascension Health, signed a sale agreement with Prime Healthcare Services Inc. (Prime) for the acquisition of the majority of the facilities of Carondelet Health. The transaction includes St. Joseph Medical Center in Kansas City and St. Mary’s Medical Center in Blue Springs, Missouri, and most of their subsidiaries and affiliated facilities. This transaction is expected to close in fiscal 2015.

The three Carondelet Health long-term care facilities - Carondelet Manor, Villa Saint Joseph and St. Mary’s Manor - and the two hospitals’ charitable foundations will remain part of Ascension.
Organizational Developments (continued)

Mount St. Mary’s Hospital and Health Center (Lewiston, New York)

Catholic Health of Buffalo (“Catholic Health”), a health system serving western New York, and Mount St. Mary’s Hospital and Health Center, a subsidiary of Ascension Health, agreed in principle to formalize a comprehensive agreement to have Mount St. Mary’s become a full member of Catholic Health. Mount St. Mary’s will join Catholic Health’s other regional hospitals; however, Our Lady of Peace Nursing Care Residence will remain part of Ascension Health. The transition will require corporate, religious and governmental approvals. This transaction is expected to close in fiscal 2015.

Carondelet Health Network (Tucson, Arizona)

Carondelet Health Network (Carondelet), a subsidiary of Ascension Health, entered into a Letter of Intent to create a joint venture with Tenet Healthcare Corp. (“Tenet”) and Dignity Health to own and operate the operating assets of Carondelet in Tucson, Arizona. This transaction is expected to close in fiscal 2015.

Under the anticipated agreement, Tenet would be the majority partner in the joint venture and have management responsibility for the operations of Carondelet’s health system assets, including St. Joseph’s and St. Mary’s Hospitals in Tucson, Arizona, Holy Cross Hospital in Nogales, Arizona, Carondelet Medical Group, Carondelet Specialist Group, as well as substantially all of Carondelet’s ancillary businesses.

Results of Operations – Consolidated

On a consolidated basis, recurring operating margin, excluding self-insurance trust fund (SITF) investment return, was 3.3% for the three months ended September 30, 2014, as compared to 3.1% for the three months ended September 30, 2013. The primary drivers for the increase in the recurring operating margin, excluding SITF investment return, for the three months ended September 30, 2014, as compared to the same period in the prior year include:

- An increase in the intensity of services provided as evidenced by the increase in case mix index of 1.50 for the three months ended September 30, 2013 to 1.53 for the three months ended September 30, 2014, or an increase of 2.0%.
- Focused efforts to increase productivity as evidenced by the decrease in FTE’s per adjusted occupied bed from 4.57 for the three months ended September 30, 2013 compared to 4.33 for the three months ended September 30, 2014, a decrease of 5.3%.
- Decreased employee healthcare costs and modifications to employee benefit programs, including the addition of care management and wellness programs along with the transition to defined contribution retirement plans.

Volume Trends and Net Patient Service Revenue

There has been a national trend toward declining utilization rates in healthcare delivery, however, for the three months ended September 30, 2014, equivalent discharges increased 0.3% as compared to prior year. While inpatient admissions and inpatient surgeries decreased 2.2% and 1.3%, respectively, observation days and emergency room visits increased 22.2% and 4.9%, respectively, as compared to the same period in the prior year. The increase in observation days is primarily due to increasing limitations on the admission of Medicare and Medicaid patients, due primarily to Medicare’s “2-Midnight Rule.”

Contrary to the trend in inpatient volumes, outpatient volumes continue to grow. Outpatient visits increased 3.5% for the three months ended September 30, 2014 as compared to the same period in the prior year due primarily to a 6.5% increase in physician office visits consistent with the transition to deliver healthcare services in the outpatient setting.
Results of Operations – Consolidated (continued)

Net patient service revenue per equivalent discharge increased 4.9% compared to the same period in the prior year due to mix of services provided and favorable rate negotiations in certain markets. Medicaid expansion in Michigan, Illinois, Washington, and the District of Columbia helped reduce both the self-pay mix and uncompensated care. Additionally, case mix increased to 1.53 for the three months ended September 30, 2014 as compared to 1.50 for the same period in the prior year, with more substantial increases in case mix index at certain facilities.

Uncompensated Care

Charity care costs decreased $19.6 million, or 12.7%, for the three months ended September 30, 2014 as compared to the same period in the prior year. This decrease is primarily attributable to the expansion of Medicaid in certain states and improved processes for identifying patients qualifying for financial assistance. As compared to the same period in the prior year, bad debt expense decreased 14.9% due to successful collection efforts at certain health ministries, expansion of coverage under the Patient Protection and Affordable Care Act and the previously mentioned improved processes for identifying patients qualifying for financial assistance.

The following table reflects certain patient volume information and key performance indicators, on a consolidated basis, for the three months ended September 30, 2014 and 2013.

<table>
<thead>
<tr>
<th>Volume Trends and Key Performance Indicators</th>
<th>Three Months Ended September 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
</tr>
<tr>
<td><strong>Volume Trends</strong></td>
<td></td>
</tr>
<tr>
<td>Equivalent Discharges</td>
<td>386,227</td>
</tr>
<tr>
<td>Total Admissions</td>
<td>189,663</td>
</tr>
<tr>
<td>Case Mix Index</td>
<td>1.53</td>
</tr>
<tr>
<td>Acute Average Length of Stay (days)</td>
<td>4.52</td>
</tr>
<tr>
<td>Observation Days</td>
<td>83,015</td>
</tr>
<tr>
<td>Emergency Room Visits</td>
<td>749,971</td>
</tr>
<tr>
<td>Surgical Visits (IP &amp; OP)</td>
<td>152,519</td>
</tr>
<tr>
<td>Physician Office Visits</td>
<td>2,413,769</td>
</tr>
<tr>
<td><strong>Key Performance Indicators</strong></td>
<td></td>
</tr>
<tr>
<td>Recurring Operating Margin</td>
<td>3.0%</td>
</tr>
<tr>
<td>Recurring Operating Margin, excluding SITF investment return</td>
<td>3.3%</td>
</tr>
<tr>
<td>Recurring Operating EBITDA Margin</td>
<td>8.5%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>2.3%</td>
</tr>
<tr>
<td>Operating EBITDA Margin</td>
<td>7.8%</td>
</tr>
</tbody>
</table>
Results of Operations – Consolidated (continued)

Recurring Operations

For the three months ended September 30, 2014:

Net patient service revenue, less provision for doubtful accounts, increased $228.0 million, or 5.2% as compared to the same period in the prior year. As previously noted, the System experienced a 4.9% increase in net revenue per equivalent discharge as compared to the same period in the prior year.

Total operating expenses increased $247.7 million, or 5.2%, as compared to the same period in the prior year primarily due to the following:

- Salaries, wages and employee benefits increased $81.6 million, or 3.3%, compared to the three months ended September 30, 2013, due primarily to wage increases offset by increased productivity and decreased employee healthcare costs and modifications to employee retirement programs.

- Purchased services expense increased $30.1 million, or 10.4%, as compared to the same period in the prior year due primarily to the implementation of the common practice management software platform for physician practices as previously discussed and the implementation of new billing systems at certain health ministries.

- Professional fees increased $24.8 million, or 8.2%, as compared to the same period in the prior year primarily due to a change in accounting for claims expenses associated with capitated plans. Previously, a portion of out-of-network claims expense was reported in other operating revenue; effective July 1, 2014, these out-of-network claims are included in other professional fees. Other increases in professional fees are due to management’s continued efforts to identify process improvements and further streamline operational processes across the System.

- Supplies expense increased $46.3 million, or 6.8%, as compared to the same period in the prior year due primarily to increased pharmacy costs due in part to recent modifications made to the discounts available under the Federal government’s 340B Drug Pricing Program, as well as a higher intensity service mix as demonstrated by the increase in case mix index.

- Other expenses increased $56.4 million, or 8.1%, as compared to the same period in the prior year due primarily to an increase in maintenance and repairs expense of $12.5 million, primarily due to the growth in new customers in the System’s biomedical engineering company. Additionally, an increase of $11.7 million in claims expense at the System’s health insurance entities, and an increase of $7.3 million in state sponsored provider tax expenses primarily in Illinois and Indiana. The increase in provider tax expenses is substantially offset by an increase in provider tax revenues included in total operating revenue.

Impairment, Restructuring and Nonrecurring Losses

Net impairment, restructuring and nonrecurring losses were $35.5 million for the three months ended September 30, 2014 as compared to a loss of $39.8 million during the three months ended September 30, 2013. Losses for the three months ended September 30, 2014, were primarily due to $31.5 million in Symphony expenses, one-time termination and other restructuring expenses of $2.5 million, and other nonrecurring expenses of $1.5 million. Losses for the three months ended September 30, 2013 were primarily due to $35.8 million in Symphony expenses, one-time termination and other restructuring expenses of $2.8 million, and other nonrecurring expenses of $1.2 million.
Results of Operations – Consolidated (continued)

Investment Return

For the three months ended September 30, 2014, the long-term investments held in the Alpha Fund, excluding non-controlling interests and long-term investments held by the self-insurance programs, experienced a loss of 1.4%, compared to a return of 2.9% for the three months ended September 30, 2013. The System’s cash and investments are invested in a broadly diversified portfolio that is managed by Ascension Investment Management, a wholly owned subsidiary of Ascension.

Nonoperating Gains, Net

For the three months ended September 30, 2014, nonoperating losses, net were $220.1 million compared to nonoperating gains, net were $360.6 million for the three months ended September 30, 2013. The decrease is due primarily to changes in the investment environment during the two periods.

Liquidity and Capital Resources

The System had net unrestricted cash and investments of $12.8 billion at September 30, 2014, compared to $13.0 billion at June 30, 2014. This decrease is primarily due to investment losses for the three months ended September 30, 2014.

Days cash on hand decreased 10 days from June 30, 2014 to September 30, 2014 primarily due to investment losses offset by strong expense management with daily operating expenses increasing only 2.4% from the prior fiscal year. Net days in accounts receivable increased from 48 to 49 from June 30, 2014 to September 30, 2014, primarily due to implementation of new billing systems in certain health ministries.

Cash-to-senior debt and cash-to-debt continue to remain strong at 221.9% and 199.3%, respectively, at September 30, 2014. Debt to capitalization remained steady at 27.6% at June 30, 2014 and September 30, 2014.

<table>
<thead>
<tr>
<th>Balance Sheet Ratios</th>
<th>September 30, 2014</th>
<th>June 30, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days Cash on Hand</td>
<td>246</td>
<td>256</td>
</tr>
<tr>
<td>Net Days in Accounts Receivable</td>
<td>49</td>
<td>48</td>
</tr>
<tr>
<td>Cash-to-Senior Debt</td>
<td>221.9%</td>
<td>224.6%</td>
</tr>
<tr>
<td>Cash-to-Debt (Senior and Subordinated)</td>
<td>199.3%</td>
<td>201.5%</td>
</tr>
<tr>
<td>Senior Debt to Capitalization</td>
<td>25.5%</td>
<td>25.5%</td>
</tr>
<tr>
<td>Total Debt to Capitalization</td>
<td>27.6%</td>
<td>27.6%</td>
</tr>
</tbody>
</table>