

Knight Health Holdings LLC (d/b/a ScionHealth)

**Consolidated Financial Statements for the years ended December 31, 2023
and December 31, 2022**

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
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Report of Independent Auditors

The Board of Directors
Knight Health Holdings LLC (d/b/a ScionHealth)

Opinion

We have audited the consolidated financial statements of Knight Health Holdings LLC (d/b/a ScionHealth) and subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2023 and 2022, 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.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Ernst & Young LLP

April 5, 2024

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)

	<u>Year ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Revenues.....	\$ 3,591,818	\$ 3,261,253
Salaries, wages and benefits	1,975,759	1,872,012
Supplies	411,152	390,529
Building rent	146,974	139,844
Equipment rent	28,526	20,726
Other operating expenses.....	996,108	808,548
Transition services (Note 16).....	40,929	57,503
Other income	(23,879)	(20,665)
Litigation contingency expense	1,250	3,000
Restructuring charges (income) (Note 5).....	(7,360)	58,865
Depreciation and amortization.....	119,608	116,480
Sponsor fees and value capture initiatives (Note 16).....	2,052	1,017
Interest expense	121,533	74,455
Investment income.....	(2,542)	(885)
	<u>3,810,110</u>	<u>3,521,429</u>
Loss from continuing operations before income taxes	(218,292)	(260,176)
Provision for income taxes	1,601	982
Loss from continuing operations	(219,893)	(261,158)
Income (loss) from discontinued operations, net of income taxes.....	(2,025)	2,982
Net loss.....	(221,918)	(258,176)
Loss attributable to noncontrolling interests (continuing operations).....	17,396	23,875
Loss attributable to the ScionHealth	<u>\$ (204,522)</u>	<u>\$ (234,301)</u>
Amounts attributable to ScionHealth:		
Loss from continuing operations.....	\$ (202,497)	\$ (237,283)
Income (loss) from discontinued operations	(2,025)	2,982
Net loss	<u>\$ (204,522)</u>	<u>\$ (234,301)</u>

See accompanying notes to consolidated financial statements.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)

	<u>Year ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Net loss.....	\$ (221,918)	\$ (258,176)
Other comprehensive loss:		
Defined benefit post-retirement plan:		
Unrealized gain (loss) due to fair value adjustments.....	(103)	742
Other comprehensive income (loss).....	(103)	742
Comprehensive loss	(222,021)	(257,434)
Loss attributable to noncontrolling interests (continuing operations)	17,396	23,875
Comprehensive loss attributable to ScionHealth.....	<u>\$ (204,625)</u>	<u>\$ (233,559)</u>

See accompanying notes to consolidated financial statements.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
CONSOLIDATED BALANCE SHEETS
(In thousands)

ASSETS	December 31, 2023	December 31, 2022
Current assets:		
Cash and cash equivalents	\$ 76,907	\$ 31,372
Insurance subsidiary investments	573	1,669
Accounts receivable.....	782,288	755,360
Inventories.....	63,551	63,400
Other (Note 13).....	38,293	34,542
	<u>961,612</u>	<u>886,343</u>
Property and equipment:		
Land.....	125,971	114,927
Buildings	776,642	697,379
Equipment	359,942	344,347
Construction in progress.....	30,459	36,763
	<u>1,293,014</u>	<u>1,193,416</u>
Accumulated depreciation.....	<u>(424,003)</u>	<u>(313,257)</u>
	869,011	880,159
Goodwill	133,709	107,600
Intangible assets less accumulated amortization of \$1,536 – 2023 and \$2,356 – 2022	11,968	9,750
Insurance subsidiary investments.....	4,900	14,278
Operating lease right-of-use assets.....	302,102	349,597
Assets held for sale	31,035	4,500
Other (Note 13).....	190,109	227,703
Total assets (a).....	<u>\$ 2,504,446</u>	<u>\$ 2,479,930</u>
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable.....	\$ 395,573	\$ 316,038
Salaries, wages and other compensation	188,571	165,581
Operating lease liabilities – current portion	146,137	137,267
Due to third party payors	30,681	25,694
Professional liability risks.....	47,265	46,736
Other accrued liabilities (Note 13).....	96,593	100,976
Income taxes.....	918	576
Long-term debt due within one year held for sale.....	340	–
Long-term debt due within one year	5,896	4,500
Finance lease obligations due within one year.....	7,819	11,994
	<u>919,793</u>	<u>809,362</u>
Long-term debt held for sale	13,907	–
Long-term debt	896,739	672,942
Finance lease obligations	325,429	318,027
Professional liability risks.....	219,099	234,899
Operating lease liabilities – long-term	205,887	300,949
Deferred credits and other liabilities (Note 13)	84,844	89,267
Commitments and contingencies (Note 11)		
Stockholders' equity (deficit):		
Preferred stock, par value	329,000	329,000
Common stock, par value	10,000	10,000
Capital in excess of par value	(32,036)	(32,763)
Accumulated other comprehensive income	185	288
Accumulated deficit.....	<u>(463,824)</u>	<u>(259,302)</u>
	(156,675)	47,223
Noncontrolling interests – redeemable.....	(12,783)	3,938
Noncontrolling interests – nonredeemable	8,206	3,323
Total stockholders' equity (deficit).....	<u>(161,252)</u>	<u>54,484</u>
Total liabilities (a) and stockholders' equity (deficit).....	<u>\$ 2,504,446</u>	<u>\$ 2,479,930</u>

- (a) The Company's consolidated assets as of December 31, 2023 and 2022 include total assets of variable interest entities of \$194.9 million and \$154.1 million, respectively, which can only be used to settle the obligations of the variable interest entities. The Company's consolidated liabilities as of December 31, 2023 and 2022 include total liabilities of variable interest entities of \$99.1 million and \$53.6 million, respectively. See Note 1 of the notes to consolidated financial statements for additional information.

See accompanying notes to consolidated financial statements.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands)

	<u>Preferred stock, par value</u>	<u>Common stock, par value</u>	<u>Capital in excess of par value</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Accumulated deficit</u>	<u>Noncontrolling interests - redeemable</u>	<u>Noncontrolling interests - nonredeemable</u>	<u>Total</u>
Balances, December 31, 2021.....	\$ 329,000	\$ 10,000	\$ (31,386)	\$ (454)	\$ (25,001)	\$ 22,942	\$ 2,197	\$ 307,298
Comprehensive loss:								
Net loss.....					(234,301)	(18,857)	(5,018)	(258,176)
Other.....				742				742
Comprehensive loss								(257,434)
Service-vested profit units			589					589
Contributions from noncontrolling interests.....							6,000	6,000
Distributions to noncontrolling interests.....						(70)	(56)	(126)
Purchase of noncontrolling interests.....			(202)			(77)	200	(79)
Other			(1,764)					(1,764)
Balances, December 31, 2022.....	329,000	10,000	(32,763)	288	(259,302)	3,938	3,323	54,484
Comprehensive loss:								
Net loss.....					(204,522)	(16,575)	(821)	(221,918)
Other.....				(103)				(103)
Comprehensive loss								(222,021)
Service-vested profit units			727					727
Contributions from noncontrolling interests.....							7,125	7,125
Distributions to noncontrolling interests.....						(6)	(3,967)	(3,973)
Purchase of noncontrolling interests.....						(140)	11,052	10,912
Divestiture of noncontrolling interests							(8,506)	(8,506)
Balances, December 31, 2023.....	<u>\$ 329,000</u>	<u>\$ 10,000</u>	<u>\$ (32,036)</u>	<u>\$ 185</u>	<u>\$ (463,824)</u>	<u>\$ (12,783)</u>	<u>\$ 8,206</u>	<u>\$ (161,252)</u>

See accompanying notes to consolidated financial statements.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	<u>Year ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Cash flows from operating activities:		
Net loss	\$ (221,918)	\$ (258,176)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	120,998	116,480
Amortization of leasehold interest assets and liabilities, net	(29,899)	(30,327)
Amortization of deferred compensation costs	727	589
Amortization of deferred financing costs	4,715	3,772
Deferred income taxes	112	23
Gain on sale of assets	(39,846)	—
Loss on write-off of information technology asset	—	28,777
Other	4,268	(1,451)
Change in operating assets and liabilities:		
Accounts receivable	17,687	(60,684)
Inventories and other assets	42,564	34,303
Accounts payable	57,986	114,774
Income taxes	(1,356)	329
Due to third party payors	4,912	(15,325)
Other accrued liabilities	(52,818)	(70,693)
Net cash used in operating activities	<u>(91,868)</u>	<u>(137,609)</u>
Cash flows from investing activities:		
Routine capital expenditures	(32,078)	(48,511)
Development capital expenditures	(17,670)	(28,833)
Acquisition of healthcare facilities, net of cash acquired	(77,373)	—
Sale of assets under common control	34,814	—
Sale of assets	57,847	706
Deconsolidation of variable interest entity	(551)	—
Other	(2,626)	(3,895)
Net cash used in investing activities	<u>(37,637)</u>	<u>(80,533)</u>
Cash flows from financing activities:		
Proceeds from borrowings under revolving credit	218,600	334,500
Repayment of borrowings under revolving credit	(40,000)	(178,000)
Repayment of term loan and other long-term debt	(6,022)	(4,500)
Payment of finance lease obligations	(7,654)	(10,059)
Payment of deferred financing costs	(3,242)	(4,256)
Contributions from noncontrolling interests	7,125	6,000
Distributions to noncontrolling interests	(3,973)	(126)
Purchase of noncontrolling interests	(140)	(79)
Net cash provided by financing activities	<u>164,694</u>	<u>143,480</u>
Change in cash, cash equivalents, and restricted cash	35,189	(74,662)
Cash, cash equivalents, and restricted cash at beginning of period	47,333	121,995
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 82,522</u>	<u>\$ 47,333</u>
Supplemental information:		
Interest payments	\$ 109,645	\$ 69,334
Income tax payments	1,032	629
Rental payments to Ventas, Inc.	132,877	134,325

See accompanying notes to consolidated financial statements.

**KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1 – BASIS OF PRESENTATION

Reporting entity

Knight Health Holdings LLC (d/b/a ScionHealth) is a healthcare services company that through its subsidiaries operates long-term acute care (“specialty”) hospitals and short-term acute care (“community”) hospital campuses and associated health systems across the United States (collectively, the “Company” or “ScionHealth”).

Lifepoint Transaction

On December 23, 2021, Kindred Healthcare, LLC (“Kindred”) and Lifepoint Health (“Lifepoint”), and certain of their respective affiliates, entered into a reorganization (the “Lifepoint Reorganization”). Upon closing of the Lifepoint Reorganization, a new healthcare services company began operating under the name ScionHealth. ScionHealth and Lifepoint, and certain of their respective affiliates entered into a series of transactions that, among other things, provided for (i) the separation of the inpatient rehabilitation facility, behavioral health, contract rehabilitation service and certain support center businesses (collectively, the “Knight Transferred Business”) from the businesses of Kindred and its subsidiaries; (ii) the separation of the equity and assets comprising 18 short-term acute care hospitals of Lifepoint (the “Artemis Business”) from the business of Lifepoint and its subsidiaries; (iii) the transfer of the Knight Transferred Business to Lifepoint; (iv) the transfer of the Artemis Business to the Company; (v) the acquisition by Lifepoint of Class B Units of ScionHealth; and (vi) reciprocal indemnification obligations with respect to the businesses transferred, in each case of clauses (i) through (vi), pursuant to the reorganization, separation and distribution steps described therein. The Company refers to the foregoing transactions as the “Lifepoint Transaction”.

Lifepoint holds all of the Class B Units of ScionHealth, which are perpetual non-convertible non-voting units that accrue cumulative dividends at the rate of 10.00% per annum and, upon liquidation, are entitled to a return of their nominal value issue price plus accrued, unpaid dividends. The Class B Units of ScionHealth are senior to Class A Equity of ScionHealth with respect to dividends, distributions, liquidations, and dissolution. In the event of a qualifying initial public offering, Lifepoint may elect to redeem the Class B Units of ScionHealth for cash at a redemption price equal to the liquidation preference, subject to minimum multiple of invested capital of 1.5x. The Class B Units of ScionHealth were fair valued at the date of issuance using the discounted cash flow approach. The analysis resulted in the Class B Units of ScionHealth having a fair value of \$329 million, which is reflected as preferred stock in the accompanying consolidated balance sheets and consolidated statements of stockholders’ equity (deficit).

As of December 23, 2021, Apollo Global Management was the ultimate parent of both Lifepoint and ScionHealth; therefore, the Company accounted for the Lifepoint Transaction in accordance with Financial Accounting Standards Board (the “FASB”) Accounting Standards Codification (“ASC”) Subtopic 805-50, *Related Issues*, as a transaction between entities under common control.

Basis of presentation

The accompanying consolidated financial statements of the Company include all subsidiaries that the Company controls, including variable interest entities (“VIEs”) for which the Company is the primary beneficiary. All intercompany transactions have been eliminated.

The Company has completed several transactions related to the divestiture of unprofitable hospitals and nursing centers to improve its future operating results. The Company is currently in the process of completing the divestiture of seven senior living locations (as described in Note 2 and Note 4). For accounting purposes, the operating results of these businesses have been classified as discontinued operations in the accompanying consolidated statements of operations for the periods presented.

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) and include amounts based upon the estimates and judgments of management. Actual amounts may differ from those estimates.

Recently issued accounting requirements

In August 2023, the FASB issued an amendment to ASC 805, *Business Combinations*, and ASC 845, *Nonmonetary Transactions*, when accounting for contributions made to a joint venture. The objectives of the amendments are to provide decision-useful information to investors and other allocators of capital in a joint venture’s financial statements and reduce diversity in practice. The amendments in this are effective prospectively for all joint venture formations with a formation date on or after January 1, 2025. Additionally, a joint venture that was formed before January 1, 2025, may elect to apply the amendments retrospectively if it has sufficient information. Early adoption is permitted in any interim or annual period in which financial statements have not yet been issued, either prospectively or retrospectively. The Company will not elect to early adopt, and adoption of the amendment is not expected to have a material impact on the Company’s business, financial position, results of operations, or liquidity.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Revenues

Revenues are recognized as performance obligations are satisfied, which is over time as patient services are rendered throughout the length of stay, in an amount that reflects the consideration the Company expects to receive in exchange for services. A performance obligation is defined as a promise in a contract to transfer a distinct good or service to the customer. Substantially all of the Company's contracts with patients and customers have a single performance obligation as the promise to transfer services is not distinct or separately identifiable from other promises in the contract.

The transaction price for the Company's contracts represents its best estimate of the consideration the Company expects to receive and includes assumptions regarding variable consideration as applicable. These variable considerations include estimated amounts due from patients and third party payors for healthcare services provided, including anticipated settlements under reimbursement agreements with Medicare, Medicaid, Medicare Advantage, Medicaid Managed, and other third party payors. These revenues are subject to retroactive adjustments due to audits, reviews, changes in program administration and rules, and outcome of litigation. These settlements are estimated based on the agreement with the payor and correspondence, which includes an assessment to ensure it is probable that a significant reversal in the amount of cumulative revenue recognition will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available) or as years are settled or are no longer subject to audits or reviews.

Provisions for estimated third party adjustments are recorded in the period the related services are rendered to the extent it is probable that a significant reversal of cumulative revenue will occur. Any remaining differences between the amounts accrued and subsequent settlements are recorded in the periods in which the interim or final settlements are determined. Changes in estimates due to settlements of prior fiscal years' cost reports, third party settlements, and the disposition of other payor audits and settlements were not significant. Future changes in Medicare and Medicaid programs and reduction in funding levels could have an adverse effect on the Company. There were no other significant changes to the judgments used to determine the transaction price in prior periods.

A summary of revenues by payor type follows (in thousands):

	Year ended December 31,	
	2023	2022
Medicare.....	\$ 969,500	\$ 903,789
Medicaid.....	265,242	206,402
Medicare Advantage.....	692,330	623,648
Medicaid Managed.....	371,343	379,869
Commercial.....	1,144,405	1,009,331
Self-pay and other.....	148,998	138,214
	<u>\$ 3,591,818</u>	<u>\$ 3,261,253</u>

Concentration of credit risk

The Company grants credit without collateral to their patients and third party payors. The mix of receivables from patients and third party payors as of December 31 is as follows:

	2023	2022
Medicare.....	18%	19%
Medicaid.....	4%	4%
Medicare Advantage.....	23%	19%
Medicaid Managed.....	15%	16%
Commercial.....	29%	34%
Self-pay and other.....	11%	8%
	<u>100%</u>	<u>100%</u>

Cash, cash equivalents, and restricted cash

Cash and cash equivalents include highly liquid investments, including cash in excess of FDIC limits, with an original maturity of three months or less when purchased. The Company reclassifies outstanding checks in excess of funds on deposit. As of December 31, 2023, \$20.7 million was reclassified to accounts payable and \$1.0 million was reclassified to salaries, wages and other compensation. As of December 31, 2022, \$11.4 million was reclassified to accounts payable and \$0.9 million was reclassified to salaries, wages and other compensation.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Cash, cash equivalents, and restricted cash (Continued)

The Company follows ASC 230, *Statement of Cash Flows*, which simplifies the disclosure of restricted cash within the statements of cash flows. The following table provides a reconciliation of cash and cash equivalents, as reported in the accompanying consolidated balance sheets, to cash, cash equivalents, and restricted cash, as reported in the accompanying consolidated statements of cash flows (in thousands):

	December 31, 2023	December 31, 2022
Cash and cash equivalents	\$ 76,907	\$ 31,372
Restricted cash:		
Insurance subsidiary investments (current)	573	1,669
Other assets (current)	142	14
Insurance subsidiary investments (long-term)	4,900	14,278
Cash, cash equivalents, and restricted cash	<u>\$ 82,522</u>	<u>\$ 47,333</u>

Insurance subsidiary investments

The Company maintains a portfolio of insurance subsidiary investments, consisting principally of cash and cash equivalents, for the payment of claims and expenses related to professional liability and workers' compensation risks maintained by its limited purpose insurance subsidiary, Cornerstone Insurance Company ("Cornerstone Insurance"). These investments are reported at fair value. Since the Company's insurance subsidiary investments are restricted for a limited purpose, they are classified in the accompanying consolidated balance sheets based upon the expected current and long-term cash requirements of Cornerstone Insurance. See Note 8.

Accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies, hospital customers, individual patients and other customers. Estimated implicit price concessions are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectability of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of change and were not material for the years ended December 31, 2023 or 2022.

Due to third party payors

The Company's specialty hospitals and community hospitals are required to submit cost reports at least annually to various state and federal agencies administering the respective reimbursement programs. In many instances, interim cash payments to the Company are only an estimate of the amount due for services provided. Any overpayment to the Company arising from the completion of a cost report is recorded as a liability in the accompanying consolidated balance sheets.

Laws and regulations governing Medicare, Medicaid, and other governmental programs are complex, prone to changes, and subject to varying interpretation. The Company believes it is in compliance with applicable laws and regulations governing Medicare, Medicaid, and other governmental programs, as well as contracts that it has with commercial payors, and that adequate provisions have been recorded for any adjustments that may result from final settlements.

Inventories

Inventories consist primarily of pharmaceutical and medical supplies and are stated at the lower of cost (first-in, first-out) or net realizable value.

Leases

The Company leases real property and equipment under finance and operating leases. The Company determines whether an arrangement is a lease at inception. For leases with terms greater than twelve months, the Company records the right-of-use assets and lease liabilities at the present value of lease payments over the term. Leases may include rent escalation clauses and options to extend or terminate them that are factored into the determination of lease payments when appropriate. Interest rates used in computing the present value of the lease payments are based upon the lower of the Company's incremental borrowing rate or the implicit rate at the inception of the lease.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Leases (Continued)

Operating leases are included in operating lease right-of-use assets, operating lease liabilities – current portion, and operating lease liabilities – long-term on the accompanying consolidated balance sheets. Operating lease expense is recognized on a straight-line basis over the lease term and is included in building rent and equipment rent on the accompanying consolidated statements of operations. Finance leases are included in property and equipment, finance lease obligations due within one year, and finance lease obligations on the accompanying consolidated balance sheets. Property and equipment under finance lease obligations are depreciated straight-line over the lease term or the estimated useful lives.

Property and equipment

Property and equipment acquired in connection with business combinations are recorded at estimated fair value in accordance with the acquisition method of accounting as prescribed in ASC 805, *Business Combinations*, while all other property and equipment that is purchased is recorded at cost. Depreciation expense, computed by the straight-line method, was \$119.4 million and \$116.5 million for the years ended December 31, 2023 and 2022, respectively. Depreciation rates for buildings range generally from three to 40 years. Leasehold improvements are depreciated over their estimated useful lives or the remaining lease term, whichever is shorter. Estimated useful lives of equipment vary from two to 15 years. Depreciation expense is not recorded for property and equipment classified as held for sale. Repairs and maintenance are expensed as incurred.

The Company separates capital expenditures into two categories, routine and development, in the accompanying consolidated statements of cash flows. Purchases of routine property and equipment include expenditures at existing facilities that generally do not result in increased capacity or the expansion of services. Development capital expenditures include expenditures for the development of new facilities or the expansion of services or capacity at existing facilities.

Long-lived assets

The Company reviews the carrying value of certain long-lived assets and finite-lived intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest that the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

In assessing the carrying values of long-lived assets, the Company estimates future cash flows at the lowest level for which there are independent, identifiable cash flows. For this purpose, these cash flows are aggregated based upon the contractual agreements underlying the operation of the facility or group of facilities. Generally, an individual facility for hospitals is considered the lowest level for which there are independent, identifiable cash flows. However, to the extent that groups of facilities are leased under a master lease agreement in which the operations of a facility and compliance with the lease terms are interdependent upon other facilities in the agreement (including the Company's ability to renew the lease or divest a particular property), the Company defines the group of facilities under a master lease agreement, or a renewal bundle in a master lease, as the lowest level for which there are independent, identifiable cash flows. Accordingly, the estimated cash flows of all facilities within a master lease agreement, or within a renewal bundle in a master lease, are aggregated for purposes of evaluating the carrying values of long-lived assets.

Goodwill and intangible assets

Goodwill and indefinite-lived intangible assets primarily originated from business combinations accounted for as purchase transactions or from the Lifepoint Transaction.

A summary of goodwill by reporting unit follows (in thousands):

	<u>Specialty hospitals</u>	<u>Community hospitals</u>	<u>Total</u>
Balances, December 31, 2021	\$ —	\$ 107,600	\$ 107,600
Acquisitions	—	—	—
Balances, December 31, 2022	—	107,600	107,600
Acquisitions	26,109	—	26,109
Balances, December 31, 2023	<u>\$ 26,109</u>	<u>\$ 107,600</u>	<u>\$ 133,709</u>

In accordance with ASC 350, *Intangibles – Goodwill and Other*, the Company is required to perform an impairment test for goodwill and indefinite-lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. The Company performs its annual goodwill impairment test on October 1 each fiscal year for each of its reporting units.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Goodwill and intangible assets (Continued)

A reporting unit is either an operating segment or one level below the operating segment, referred to as a component. When the components within the Company's operating segments have similar economic characteristics, the Company aggregates the components of its operating segments into one reporting unit. Accordingly, the Company has determined that its reporting units are specialty hospitals and community hospitals.

Accounting guidance allows the Company to perform a qualitative assessment about the likelihood of the carrying value of a reporting unit exceeding its fair value, referred to as the step zero assessment. The step zero assessment requires the evaluation of certain qualitative factors, including macroeconomic conditions, industry and market considerations, cost factors and overall financial performance, as well as company and reporting unit factors. If the Company's step zero assessment indicates that it is more likely than not that the fair value of a reporting unit is less than the carrying value amount, then the Company would perform a quantitative impairment test. The Company applied the step zero assessment to its community hospitals as of October 1, 2023. The Company's step zero assessment concluded it is more likely than not that the fair value of the reporting unit exceeds its carrying value amount.

The Company relies on the widely accepted valuation technique of the discounted cash flow approach which captures both the future income potential of the reporting unit and actions of market participants in the industry that includes the reporting unit. This type of analyses requires the Company to make assumptions and estimates regarding future cash flows, industry-specific economic factors and the profitability of future business strategies. The discounted cash flow approach uses a projection of estimated operating results and cash flows that are discounted using a weighted average cost of capital. Under the discounted cash flow approach, the projection uses management's best estimates of economic and market conditions over the projected period including growth rates in the number of facilities, reimbursement rates, operating costs, rent expense, and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital.

Adverse changes in the operating environment and related key assumptions used to determine the fair value of the Company's reporting units and indefinite-lived intangible assets may result in future impairment charges for a portion or all of these assets. Specifically, if the rate of growth of government and commercial revenues earned by the Company's reporting units were to be less than projected, if healthcare reforms were to negatively impact the Company's business, or if recent increases in labor costs materially exceed the Company's projections in its reporting units, an impairment charge of a portion or all of these assets may be required. An impairment charge could have a material adverse effect on the Company's business, financial position and results of operations, but would not be expected to have an impact on the Company's cash flows or liquidity.

The Company's indefinite-lived intangible assets as of December 31, 2023 and 2022 consist of certificates of need and licenses. The fair values of the Company's indefinite-lived intangible assets are derived from projections at a facility, which include management's best estimates of economic and market conditions over the projected period. Significant assumptions include projected revenues, operating costs, rent expense, capital expenditures, terminal value growth rates, changes in working capital requirements, weighted average cost of capital and opportunity costs.

The Company performs its annual indefinite-lived intangible asset impairment tests on October 1 each fiscal year. Based upon the results of the annual impairment test for indefinite-lived intangible assets discussed above for the periods ended December 31, 2023 or 2022, no impairment charges were recorded.

The Company's intangible assets as of December 31, 2023 also included physician contracts and a trade name with finite lives. The Company's intangible assets as of December 31, 2022 included physician contracts with finite lives. Each of the intangible assets were amortized in accordance with the authoritative guidance for intangible assets using the straight-line method over their estimated useful lives. The amortization of trade names is recorded as a component of depreciation and amortization expense and was \$0.2 million for the year ended December 31, 2023. The amortization of physician contracts is recorded as a component of other operating expenses and was \$0.8 million for both years ended December 31, 2023 and 2022.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Goodwill and intangible assets (Continued)

A summary of intangible assets at December 31 follows (in thousands):

	2023				2022			
	Cost	Accumulated amortization	Carrying value	Weighted average remaining life	Cost	Accumulated amortization	Carrying value	Weighted average remaining life
Non-current:								
Certificates of need.....	\$ 5,349	\$ —	\$ 5,349	indefinite	\$ 5,590	\$ —	\$ 5,590	indefinite
Licenses	2,229	—	2,229	indefinite	2,229	—	2,229	indefinite
Physician contracts	3,326	(1,298)	2,028	2 years	4,287	(2,356)	1,931	2 years
Trade name	2,600	(238)	2,362	9 years	—	—	—	
	<u>\$ 13,504</u>	<u>\$ (1,536)</u>	<u>\$ 11,968</u>		<u>\$ 12,106</u>	<u>\$ (2,356)</u>	<u>\$ 9,750</u>	

Cost-method investments

The aggregate carrying amount of our cost-method investments was \$6.0 million as of both December 31, 2023 and 2022 and is recorded as a component of other long-term assets in the accompanying consolidated balance sheets. The investments were evaluated for impairment, and no impairment charges were recorded as of December 31, 2023 or 2022.

Insurance risks

Provisions for loss for professional liability and workers' compensation risks are based upon management's best available information, including actuarially determined estimates of loss. To the extent that expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited. See Note 7.

Share-based compensation

The Company recorded compensation expense of \$0.7 million and \$0.6 million for service-vesting profit units for the years ended December 31, 2023 and 2022, respectively, as reported in salaries, wages and benefits in the accompanying consolidated statements of operations.

Noncontrolling interests

Noncontrolling interests represent the portion of equity in a subsidiary not attributable, directly or indirectly, to the Company. The Company's accompanying consolidated financial statements include all assets, liabilities, revenues, and expenses at their consolidated amounts, which include the amounts attributable to the Company and the noncontrolling interests. The Company recognizes as a separate component of earnings that portion of income or loss attributable to noncontrolling interests based upon the portions of the entities not owned by the Company.

Certain of the Company's noncontrolling interests include redemption features that cause these interests not to meet the requirements for classification as equity in accordance with ASC 480-10-S99-3, *Distinguishing Liabilities from Equity*. Redemption features related to these interests could require the Company to deliver cash, if exercised. The Company uses the private company accounting standards and records redeemable equity instruments as permanent equity. Accordingly, these redeemable noncontrolling interests are classified in the Company's accompanying consolidated balance sheets as "Noncontrolling interests – redeemable". Changes in the fair value of the Company's redeemable noncontrolling interests are recognized as adjustments to consolidated stockholders' equity (deficit).

Variable interest entities

The Company follows the provisions of ASC 810, *Consolidation*, for determining whether an entity is a variable interest entity ("VIE"). In order to determine if the Company is a primary beneficiary of a VIE for financial reporting purposes, it must consider whether it has the power to direct activities of the VIE that most significantly impact the performance of the VIE and whether the Company has the obligation to absorb losses or the right to receive returns that would be significant to the VIE. The Company consolidates a VIE when it is the primary beneficiary.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Variable interest entities (Continued)

The Company had two specialty hospital and two community hospital partnerships as of December 31, 2023 and one specialty hospital and two community hospital partnerships as of December 31, 2022, that were subject to an operating and management services agreement. Under GAAP, the Company determined each of these partnerships qualify as VIEs and concluded that the Company is the primary beneficiary in all of the partnerships. The Company holds an ownership interest and acts as manager in each of the partnerships. Through the management services agreement, the Company is delegated necessary responsibilities to provide management services, administrative services, and direction of the day-to-day operations. Based upon the Company's assessment of the most significant activities of the hospitals, the manager has the ability to direct the majority of those activities in all of the partnerships.

The analysis upon which the consolidation determination rests can be complex, can involve uncertainties, and requires judgment on various matters, some of which could be subject to different interpretations.

The carrying amounts and classifications of the assets and liabilities of the consolidated VIEs are as follows (in thousands):

	<u>December 31, 2023</u>	<u>December 31, 2022</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 1,936	\$ 9,802
Accounts receivable	70,121	58,655
Inventories	11,714	12,150
Other	8,909	8,303
	<u>92,680</u>	<u>88,910</u>
Property and equipment, net	49,656	51,949
Intangible assets, net	2,567	2,716
Operating lease right-of-use assets	48,211	8,851
Other	1,758	1,625
Total assets	<u>\$ 194,872</u>	<u>\$ 154,051</u>
Liabilities:		
Current liabilities:		
Accounts payable	\$ 24,379	\$ 20,365
Salaries, wages and other compensation	14,932	15,108
Operating lease liabilities – current portion	2,191	3,063
Other accrued liabilities	3,561	3,047
Finance lease obligations due within one year	679	275
	<u>45,742</u>	<u>41,858</u>
Finance lease obligations – long-term	2,962	1,214
Operating lease liabilities – long-term	47,073	7,307
Deferred credits and other liabilities	3,333	3,270
Total liabilities	<u>\$ 99,110</u>	<u>\$ 53,649</u>

Other information

The Company performed evaluations of subsequent events through April 5, 2024, the date on which the accompanying consolidated financial statements were issued.

Reclassifications

Certain prior period amounts have been reclassified to conform with the current period presentation.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2 – ACQUISITIONS

During 2023, the Company acquired 15 specialty hospitals, eight senior living locations, and one behavioral health unit from Cornerstone Healthcare Group (“Cornerstone Healthcare”) for \$101.5 million. The fair value of this acquisition was measured primarily using discounted cash flow methodologies which are considered Level 3 inputs (as described in Note 14). One of the senior living locations was sold in 2023 as discussed in Note 3. The remaining seven senior living locations are reported in discontinued operations. See Note 4.

The following is the preliminary purchase price allocation (in thousands):

Cash and cash equivalents.....	\$ 24,087
Accounts receivable	53,501
Inventories.....	2,346
Other current assets	3,653
Property and equipment, net	118,888
Identifiable intangible assets:	
Trade name (10-year life)	2,600
Operating lease right-of-use assets.....	15,335
Other long-term assets.....	397
Accounts payable	(25,230)
Salaries, wages and other compensation	(14,695)
Operating lease liabilities – current portion	(2,771)
Other accrued liabilities	(26,488)
Long-term debt due within one year	(3,995)
Long-term debt.....	(58,926)
Operating lease liabilities – long-term	(12,564)
Deferred credits and other liabilities	(7,507)
Noncontrolling interests – nonredeemable.....	(11,052)
Total identifiable net assets	57,579
Goodwill	43,881
Net assets.....	<u>\$ 101,460</u>

Simultaneous to the close of the transaction with Cornerstone Healthcare, ScionHealth sold the behavioral health unit to Lifepoint for \$35.0 million. The following table summarizes the impact of the net assets transferred to Lifepoint for this transaction (in thousands):

Cash and cash equivalents.....	\$ (186)
Accounts receivable	(2,032)
Inventories.....	(31)
Other current assets	(126)
Property and equipment, net	(16,396)
Goodwill	(17,772)
Operating lease right-of-use assets.....	(5,458)
Accounts payable	1,321
Salaries, wages and other compensation	160
Operating lease liabilities – current portion	185
Other accrued liabilities	62
Operating lease liabilities – long-term	5,273
Net assets transferred to Lifepoint.....	<u>\$ (35,000)</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 – DIVESTITURES

Continuing operations

During 2023, the Company sold a medical office building for \$43.5 million in cash and recorded a gain, net of transaction costs, of \$37.0 million in restructuring charges in the accompanying consolidated statements of operations for the year ended December 31, 2023. See Note 5 and Note 9.

Discontinued operations

During 2023, the Company sold a senior living location for \$6.0 million in cash. No gain or loss was recognized on the transaction.

NOTE 4 – DISCONTINUED OPERATIONS

In accordance with the authoritative guidance for the impairment or disposal of long-lived assets, the divestiture of businesses has been accounted for as discontinued operations. Accordingly, the results of operations of these have been classified as discontinued operations, net of income taxes, in the accompanying consolidated statements of operations for the periods presented.

During 2023, the eight senior living locations acquired from Cornerstone Healthcare were reported in discontinued operations. One of the locations was sold in 2023 and the remaining seven locations were held for sale as of December 31, 2023.

A summary of discontinued operations follows (in thousands):

	Year ended December 31,	
	2023	2022
Revenues.....	\$ 19,980	\$ 86
Salaries, wages and benefits	10,306	(1,170)
Supplies.....	3,116	8
Building rent	12	—
Equipment rent.....	107	(8)
Other operating expenses (income).....	6,495	(1,476)
Other income	(50)	(250)
Restructuring charges	211	—
Depreciation and amortization	1,390	—
Interest expense.....	418	—
	<u>22,005</u>	<u>(2,896)</u>
Income (loss) from operations before income taxes	(2,025)	2,982
Provision for income taxes.....	—	—
Income (loss) from operations	(2,025)	2,982
Earnings attributable to noncontrolling interests	—	—
Income (loss) attributable to ScionHealth	<u>\$ (2,025)</u>	<u>\$ 2,982</u>

A summary of the net assets held for sale at December 31, 2023 follows (in thousands):

Property and equipment, net.....	\$ 31,035
Long-term debt due within one year	(340)
Long-term debt.....	<u>(13,907)</u>
	<u>\$ 16,788</u>

NOTE 5 – RESTRUCTURING CHARGES

The Company has initiated various restructuring activities whereby it has incurred costs associated with reorganizing its operations, including the acquisition, divestiture, closure of facilities, reduced headcount and realigned operations in order to improve operations, cost efficiencies and capital structure in response to changes in the healthcare industry, increasing leverage and to partially mitigate reductions in reimbursement rates from third party payors. The costs associated with these activities are reported as restructuring charges in the accompanying consolidated statements of operations and would have been recorded as salaries, wages and benefits, other operating expenses, or rent expense if not classified as restructuring charges.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – RESTRUCTURING CHARGES (Continued)

The following table sets forth the restructuring charges incurred by restructuring activities (in thousands):

	Year ended December 31,	
	2023	2022
Lifepoint Transaction	\$ 2,660	\$ 11,379
Specialty Hospital Division Reorganization.....	5,281	2,869
Specialty Hospital Portfolio Optimization Strategy 2021 Plan	4,294	4,540
Cornerstone Healthcare Transaction.....	8,285	8,440
Deconsolidation of Variable Interest Entity	2,673	—
Gain on Sale of Medical Office Building	(36,962)	—
Loss on write-off of Information Technology Asset	—	28,777
Other various	6,409	2,860
	<u>\$ (7,360)</u>	<u>\$ 58,865</u>

Restructuring Activities

Lifepoint Transaction

The costs incurred in 2023 and 2022 related to the Lifepoint Transaction included transaction, retention and severance costs, and a loss on the sale of an assisted living facility and were substantially completed in 2022.

The composition of the restructuring charges the Company has incurred for these restructuring initiatives is as follows (in thousands):

	Year ended December 31,	
	2023	2022
Transaction costs	\$ 2,100	\$ 4,676
Retention and severance costs	560	2,814
Loss on sale	—	3,889
	<u>\$ 2,660</u>	<u>\$ 11,379</u>

The following table (in thousands) summarizes the Lifepoint Transaction liability activity (included in current liabilities), which does not include \$3.9 million related to the loss on sale:

	Transaction costs	Retention and severance costs	Total
Liability balance at December 31, 2021	\$ 2,884	\$ 19,949	\$ 22,833
Expense	4,676	2,814	7,490
Payments	(7,198)	(20,823)	(28,021)
Liability balance at December 31, 2022	362	1,940	2,302
Expense	2,100	560	2,660
Payments	(2,462)	(1,919)	(4,381)
Liability balance at December 31, 2023	<u>\$ —</u>	<u>\$ 581</u>	<u>\$ 581</u>

Specialty Hospital Division Reorganization

During 2022, the Company initiated a restructuring plan to improve operations and cost efficiencies in the specialty hospital division. The activities related to the specialty hospital division reorganization were substantially completed in 2023.

The composition of the restructuring charges the Company has incurred for this reorganization is as follows (in thousands):

	Year ended December 31,	
	2023	2022
Retention and severance costs	\$ 5,175	\$ 2,817
Transaction costs	106	—
Loss on disposal	—	52
	<u>\$ 5,281</u>	<u>\$ 2,869</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – RESTRUCTURING CHARGES (Continued)

Restructuring Activities (Continued)

Specialty Hospital Division Reorganization (Continued)

The following table (in thousands) summarizes the Company's specialty hospital division reorganization liability activity (included in current liabilities):

	Retention and severance costs	Transaction costs	Total
Liability balance at December 31, 2021.....	\$ —	\$ —	\$ —
Expense.....	2,817	—	2,817
Payments.....	(260)	—	(260)
Liability balance at December 31, 2022.....	2,557	—	2,557
Expense.....	5,175	106	5,281
Payments.....	(6,233)	(106)	(6,339)
Liability balance at December 31, 2023.....	<u>\$ 1,499</u>	<u>\$ —</u>	<u>\$ 1,499</u>

Specialty Hospital Portfolio Optimization Strategy 2021 Plan

During 2021, Kindred approved the specialty hospital portfolio optimization strategy 2021 plan that incorporated the closure of certain specialty hospitals. The Company closed three specialty hospitals during 2021 and one sub-acute unit within a specialty hospital during 2022. The activities related to the specialty hospital portfolio optimization strategy 2021 plan were substantially completed in 2023.

The composition of the restructuring charges the Company incurred for these activities is as follows (in thousands):

	Year ended December 31,	
	2023	2022
Transaction costs	\$ 3,294	\$ 4,051
Asset write-off.....	1,000	—
Retention and severance costs	—	489
	<u>\$ 4,294</u>	<u>\$ 4,540</u>

The following table (in thousands) summarizes the Company's specialty hospital portfolio optimization strategy 2021 plan liability activity (included in current liabilities), which does not include \$1.0 million related to asset write-off:

	Transaction costs	Retention and severance costs	Total
Liability balance at December 31, 2021.....	\$ 178	\$ 42	\$ 220
Expense.....	4,051	489	4,540
Payments.....	(4,094)	(428)	(4,522)
Liability balance at December 31, 2022.....	135	103	238
Expense.....	3,294	—	3,294
Payments.....	(3,429)	(103)	(3,532)
Liability balance at December 31, 2023.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Cornerstone Healthcare Transaction

During 2023, the Company acquired Cornerstone Healthcare as described in Note 2. The activities related to the Cornerstone Healthcare transaction are expected to be substantially completed in 2024.

The composition of the restructuring charges the Company has incurred for the Cornerstone Healthcare transaction is as follows (in thousands):

	Year ended December 31,	
	2023	2022
Transaction costs	\$ 4,812	\$ 8,440
Severance costs.....	3,473	—
	<u>\$ 8,285</u>	<u>\$ 8,440</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – RESTRUCTURING CHARGES (Continued)

Restructuring Activities (Continued)

Cornerstone Healthcare Transaction (Continued)

The following table (in thousands) summarizes the Company's Cornerstone Healthcare transaction liability activity (included in current liabilities):

	<u>Transaction costs</u>	<u>Severance costs</u>	<u>Total</u>
Liability balance at December 31, 2021.....	\$ —	\$ —	\$ —
Expense.....	8,440	—	8,440
Payments.....	<u>(2,496)</u>	<u>—</u>	<u>(2,496)</u>
Liability balance at December 31, 2022.....	5,944	—	5,944
Expense.....	4,812	3,473	8,285
Payments.....	<u>(10,657)</u>	<u>(3,473)</u>	<u>(14,130)</u>
Liability balance at December 31, 2023.....	<u>\$ 99</u>	<u>\$ —</u>	<u>\$ 99</u>

Deconsolidation of Variable Interest Entity

During 2023, the Company sold its share of a joint venture identified as a VIE to the noncontrolling interest partner. The activities related to the deconsolidation of the VIE were substantially completed in 2023.

The composition of the restructuring charges the Company has incurred for the deconsolidation of the VIE is as follows (in thousands):

	<u>Year ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Asset write-off.....	\$ 3,705	\$ —
Transaction costs.....	51	—
Working capital settlement.....	<u>(1,083)</u>	<u>—</u>
	<u>\$ 2,673</u>	<u>\$ —</u>

Gain on Sale of Medical Office Building

During 2023, the Company sold a medical office building resulting in a gain, net of transaction costs, of \$37.0 million as described in Note 3 and Note 9. The activities related to the sale were substantially completed in 2023.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – RESTRUCTURING CHARGES (Continued)

Restructuring Activities (Continued)

Loss on write-off of Information Technology Asset

During 2022, the Company recorded a write-down of assets and runout costs related to a contract with a vendor to develop an electronic medical record (“EMR”) system. Based on an EMR evaluation with the help of a third party consulting firm, it was determined that the risk and cost to continue investing in the EMR system exceeded that of pursuing commercially available EMR products on the market. The activities related to the loss on write-off of information technology asset were substantially completed in 2023.

The composition of the restructuring charges the Company has incurred for the loss on write-off of information technology asset is as follows (in thousands):

	Year ended December 31,	
	2023	2022
Asset write-down.....	\$ —	\$ 24,964
Contract runout costs.....	—	3,813
	<u>\$ —</u>	<u>\$ 28,777</u>

The following table (in thousands) summarizes the Company’s information technology contract runout liability activity (included in current liabilities):

	Contract runout costs
Liability balance at December 31, 2021.....	\$ —
Expense.....	3,813
Payments.....	—
Liability balance at December 31, 2022.....	3,813
Expense.....	—
Payments.....	(3,813)
Liability balance at December 31, 2023.....	<u>\$ —</u>

NOTE 6 – INCOME TAXES

Provision for income taxes consists of the following (in thousands):

	Year ended December 31,	
	2023	2022
Current:		
Federal.....	\$ —	\$ —
State.....	1,489	959
	<u>1,489</u>	<u>959</u>
Deferred.....	112	23
	<u>\$ 1,601</u>	<u>\$ 982</u>

The Company’s effective income tax provision differs from the amount calculated using the statutory U.S. federal income tax rate, principally due to the following (in thousands):

	Year ended December 31,	
	2023	2022
Income tax benefit at federal rate	\$ (45,841)	\$ (54,011)
State income tax benefit, net of federal income tax benefit.....	(9,823)	(11,574)
Noncontrolling interests	4,436	6,088
Cornerstone Healthcare transaction costs.....	—	1,722
Nondeductible payments	(1,339)	(4,960)
Valuation allowance	61,256	61,294
Deferred tax adjustment	(8,225)	—
Cornerstone Healthcare acquisition.....	(5,106)	—
Disposition of nondeductible goodwill.....	5,082	—
Other items, net	1,161	2,423
	<u>\$ 1,601</u>	<u>\$ 982</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6 – INCOME TAXES (Continued)

A summary of net deferred income tax assets (liabilities) by source included in the accompanying consolidated balance sheets at December 31 follows (in thousands):

	2023		2022	
	Assets	Liabilities	Assets	Liabilities
Property and equipment.....	\$ —	\$ 96,999	\$ —	\$ 93,760
Finance leases.....	143,226	61,808	178,088	89,147
Doubtful accounts	25,255	—	14,200	—
Compensation.....	17,805	—	14,197	—
Professional liability and workers' compensation risks ...	20,381	—	9,497	—
Net operating losses	39,969	—	20,788	—
Investments	4,668	—	7,185	—
Interest limitation	34,856	—	12,057	—
Assets held for sale.....	1,095	—	—	1,148
Other items, net	7,018	—	2,363	—
Gross deferred tax assets/liabilities	294,273	<u>\$ 158,807</u>	258,375	<u>\$ 184,055</u>
Reclassification of deferred tax liabilities	<u>(158,807)</u>		<u>(184,055)</u>	
Net deferred tax before valuation allowance	135,466		74,320	
Less valuation allowance (cumulative)	<u>(135,667)</u>		<u>(74,411)</u>	
Net deferred tax	<u>\$ (201)</u>		<u>\$ (91)</u>	

Management assesses all available positive and negative evidence to determine whether a valuation allowance is needed against its deferred tax assets. The authoritative guidance requires evidence related to events that have actually happened to be weighted more significantly than evidence that is projected or expected to happen. A significant piece of negative evidence according to this weighting standard is if there are cumulative losses in the two most recent years and the current year, which was the case for the Company at both December 31, 2023 and 2022. Accordingly, a full valuation allowance was recorded during the years ended December 31, 2023 and 2022. The amount of deferred tax asset considered realizable, however, could be adjusted if the weighting of the positive and negative evidence changes.

The Company's valuation allowance was \$135.7 million and \$74.4 million at December 31, 2023 and 2022, respectively.

The Company identified deferred tax assets for federal income tax net operating losses ("NOLs") of \$31.7 million (tax effected at 21%) at December 31, 2023, with a corresponding deferred income tax valuation allowance of \$31.7 million. The Company identified deferred tax assets for federal income tax NOLs of \$17.3 million (tax effected at 21%) at December 31, 2022, with a corresponding deferred income tax valuation allowance of \$17.3 million. The federal income tax NOLs do not expire. The Company had deferred income tax assets for state income tax NOL's of \$8.3 million at December 31, 2023, with a corresponding deferred income tax valuation allowance of \$8.3 million. The Company had deferred income tax assets for state income tax NOL's of \$3.5 million at December 31, 2022, with a corresponding deferred income tax valuation allowance of \$3.5 million.

The Company does not currently have any uncertain tax liabilities.

The Company filed its first federal and state income tax returns as of December 31, 2021. The state statute of limitations generally ranges between three and five years from the time of filing.

NOTE 7 – INSURANCE RISKS

On a per-claim basis for the Company's specialty hospitals, the Company maintains a self-insured retention and Cornerstone Insurance insures all losses in excess of this retention. Cornerstone Insurance maintains commercial reinsurance through unaffiliated commercial reinsurers for these losses in excess of the Company's retention. On a per-claim basis, the Company maintains self-insured retention under commercial insurance policies for community hospitals for professional and general liability and first dollar coverage for physicians' risks and Cornerstone Insurance insures all losses in excess of those policy limits. The Company also maintains a deductible under commercial insurance policies for workers' compensation which provide coverage up to statutory limits in each state. The provisions for loss for professional and general liability and workers' compensation risks are based upon management's best available information, including actuarially determined estimates of loss.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – INSURANCE RISKS (Continued)

The allowance for professional and general liability risks includes an estimate of the expected cost to settle reported claims and an amount, based upon past experiences, for losses incurred but not reported including claims related to its former nursing center operations. These liabilities are necessarily based upon estimates and, while management believes that the provision for loss is adequate, the ultimate liability may be in excess of, or less than, the amounts recorded. To the extent that expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited.

In connection with the Lifepoint Reorganization, the Company received the historical provisions for professional and general liability and workers' compensation losses of \$40.3 million and \$2.7 million, respectively, related to the community hospitals and a related indemnity for professional and general liability and workers' compensation of \$40.3 million and \$2.7 million, respectively, from Lifepoint for those losses as of December 31, 2023. As of December 31, 2022, the historical provisions for professional and general liability and workers' compensation losses related to the community hospitals were \$60.8 million and \$4.1 million, respectively, and a related indemnity for professional and general liability and workers' compensation of \$60.8 million and \$4.1 million, respectively, from Lifepoint for those losses. Lifepoint maintains responsibility for the management and settlement of these claims and will provide adjustments to the Company at each actuarial review.

The provision for loss for insurance risks, including the cost of coverage maintained with unaffiliated commercial reinsurance and insurance carriers, follows (in thousands):

	<u>Year ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Professional liability:		
Continuing operations.....	\$ 63,767	\$ 42,919
Discontinued operations	127	(1,199)
Workers' compensation:		
Continuing operations.....	\$ 17,234	\$ 14,230
Discontinued operations	(1,641)	(1,170)

A summary of the assets and liabilities related to insurance risks included in the accompanying consolidated balance sheets at December 31 follows (in thousands):

	<u>2023</u>			<u>2022</u>		
	<u>Professional liability</u>	<u>Workers' compensation</u>	<u>Total</u>	<u>Professional liability</u>	<u>Workers' compensation</u>	<u>Total</u>
Assets:						
Current:						
Insurance subsidiary investments	\$ 34	\$ 539	\$ 573	\$ 1,000	\$ 669	\$ 1,669
Reinsurance and other recoverables ..	2,115	2,809	4,924	2,043	2,608	4,651
Other	—	608	608	—	1,331	1,331
	<u>2,149</u>	<u>3,956</u>	<u>6,105</u>	<u>3,043</u>	<u>4,608</u>	<u>7,651</u>
Non-current:						
Insurance subsidiary investments	—	4,900	4,900	6,154	8,124	14,278
Reinsurance and other recoverables ..	125,271	33,895	159,166	161,894	39,380	201,274
Deposits	—	1,593	1,593	—	1,593	1,593
	<u>125,271</u>	<u>40,388</u>	<u>165,659</u>	<u>168,048</u>	<u>49,097</u>	<u>217,145</u>
	<u>\$ 127,420</u>	<u>\$ 44,344</u>	<u>\$ 171,764</u>	<u>\$ 171,091</u>	<u>\$ 53,705</u>	<u>\$ 224,796</u>
Liabilities:						
Allowance for insurance risks:						
Current.....	\$ 47,265	\$ 12,693	\$ 59,958	\$ 46,736	\$ 14,562	\$ 61,298
Non-current.....	219,099	54,879	273,978	234,899	57,797	292,696
	<u>\$ 266,364</u>	<u>\$ 67,572</u>	<u>\$ 333,936</u>	<u>\$ 281,635</u>	<u>\$ 72,359</u>	<u>\$ 353,994</u>

The provision for loss for professional liability risks is not funded to Cornerstone Insurance. The Company does not fund the portion of professional liability risks related to estimated claims that have been incurred but not reported.

The provision for loss for workers' compensation risks is not funded to Cornerstone Insurance.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INSURANCE SUBSIDIARY INVESTMENTS

The Company maintains a portfolio of insurance subsidiary investments, consisting principally of cash and cash equivalents, for the payment of claims and expenses related to professional liability and workers' compensation risks maintained by Cornerstone Insurance. These investments are reported at fair value. Since the Company's insurance subsidiary investments are restricted for a limited purpose, they are classified in the accompanying consolidated balance sheets based upon the expected current and long-term cash requirements of Cornerstone Insurance.

The Company's insurance subsidiary's cash and cash equivalents of \$5.5 million and \$15.9 million as of December 31, 2023 and 2022, respectively, are classified as insurance subsidiary investments in the accompanying consolidated balance sheets.

Investment income earned by Cornerstone Insurance was minimal for the years ended December 31, 2023 and 2022.

NOTE 9 – LEASES

Finance leases

Finance lease obligations are comprised of real estate and equipment. A summary of finance lease obligations at December 31 follows (in thousands):

	<u>2023</u>	<u>2022</u>
Finance lease obligations	\$ 333,248	\$ 330,021
Amounts due within one year	(7,819)	(11,994)
Total finance lease obligations.....	<u>\$ 325,429</u>	<u>\$ 318,027</u>

The weighted average remaining lease term and discount rate for the Company's finance leases as of December 31 were as follows:

	<u>2023</u>	<u>2022</u>
Weighted average remaining lease term (in years)	16.8	13.3
Weighted average discount rate	10.9%	8.7%

The following table summarizes scheduled maturities of finance lease obligations (in thousands):

2024.....	\$ 7,819
2025.....	9,210
2026.....	9,271
2027.....	8,204
2028.....	6,763
Thereafter	<u>291,981</u>
	<u>\$ 333,248</u>

Operating leases

The Company has operating leases for its facilities, including specialty hospitals that generally have an initial lease term of five years, with two, five-year renewal options and community hospitals that have operating leases mostly related to medical office buildings and other ancillary properties with various terms.

The Company's building rent expense was as follows for the years ended December 31 (in thousands):

	<u>2023</u>	<u>2022</u>
Operating lease cost.....	\$ 160,920	\$ 156,519
Short-term lease cost.....	6,162	6,891
Variable lease cost	6,058	3,000
Amortization of leasehold interest assets and liabilities, net	(29,899)	(30,327)
Other	<u>3,733</u>	<u>3,761</u>
	<u>\$ 146,974</u>	<u>\$ 139,844</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – LEASES (Continued)

Operating leases (Continued)

Supplemental cash flow information related to the Company's operating leases at December 31 follows (in thousands):

	<u>2023</u>	<u>2022</u>
Cash paid for amounts included in the measurement of lease liabilities.....	\$ 169,359	\$ 168,991
Non-cash right-of-use assets obtained in exchange for lease liabilities	38,005	103,000

Supplemental balance sheet information related to the Company's operating leases with unrelated parties at December 31, follows (in thousands):

	<u>2023</u>	<u>2022</u>
Operating lease right-of-use assets (a)	\$ 340,590	\$ 419,540
Operating lease liabilities – current portion	\$ 146,137	\$ 137,267
Operating lease liabilities – long-term	205,887	300,949
Total operating lease liabilities	<u>\$ 352,024</u>	<u>\$ 438,216</u>

- (a) These amounts do not include \$3.4 million of prepaid rent, \$15.0 million of leasehold interest assets, and \$56.9 million of leasehold interest liabilities included within the operating lease right-of-use assets in the accompanying consolidated balance sheets as of December 31, 2023, and \$2.7 million of prepaid rent, \$25.0 million of leasehold interest assets, and \$97.6 million of leasehold interest liabilities included within the operating lease right-of-use assets in the accompanying consolidated balance sheets as of December 31, 2022. The leasehold interest assets and liabilities are amortized using the straight-line method over the lease term.

The weighted average remaining lease term and discount rate for the Company's operating leases as of December 31 were as follows:

	<u>2023</u>	<u>2022</u>
Weighted average remaining lease term (in years)	5.0	3.7
Weighted average discount rate	7.5%	7.1%

As of December 31, 2023, maturities of lease liabilities for the Company's operating leases were as follows (in thousands):

2024.....	\$ 168,723
2025.....	92,719
2026.....	45,959
2027.....	39,958
2028.....	20,273
Thereafter	<u>80,615</u>
Total undiscounted cash flows.....	448,247
Less imputed interest.....	<u>(96,223)</u>
Total discounted lease liabilities.....	<u>\$ 352,024</u>

As of December 31, 2023, the Company's future minimum lease obligations on long-term, non-cancelable operating leases were as follows (in thousands):

	<u>Minimum payments</u>		
	<u>Ventas, Inc.</u>	<u>Other</u>	<u>Total</u>
2024	\$ 126,446	\$ 42,277	\$ 168,723
2025	58,596	34,123	92,719
2026	24,500	21,459	45,959
2027	24,500	15,458	39,958
2028	8,166	12,107	20,273
Thereafter.....	<u>—</u>	<u>80,615</u>	<u>80,615</u>
	<u>\$ 242,208</u>	<u>\$ 206,039</u>	<u>\$ 448,247</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – LEASES (Continued)

Operating leases (Continued)

The Company has various facility leases that include contingent annual rent escalators based upon a change in the Consumer Price Index or other agreed upon terms such as a patient revenue test. These contingent rents are included in building rent expense in the time period incurred. The Company recorded contingent rent of \$5.0 million and \$2.6 million, including both continuing operations and discontinued operations, for the years ended December 31, 2023 and 2022, respectively.

Ventas Master Lease Agreement

At December 31, 2023, the Company leased from Ventas, Inc. (“Ventas”) and its affiliates 29 specialty hospitals under one master lease agreement (the “Ventas Master Lease Agreement”). The Ventas Master Lease Agreement includes land, buildings, structures, and other improvements on the land, easements, and similar appurtenances to the land and improvements, and permanently affixed equipment, machinery, and other fixtures relating to the operation of the leased properties. There are two bundles of leased properties under the Ventas Master Lease Agreement, with each bundle containing several specialty hospitals.

Rental amounts and escalators

The Ventas Master Lease Agreement is commonly known as a triple-net lease or an absolute-net lease. Accordingly, in addition to rent, the Company is required to pay the following: (1) all insurance required in connection with the leased properties and the business conducted on the leased properties; (2) certain taxes levied on or with respect to the leased properties (other than taxes on the income of Ventas); and (3) all utilities and other services necessary or appropriate for the leased properties and the business conducted on the leased properties.

The Company paid rents to Ventas of \$132.9 million and \$134.3 million for the years ended December 31, 2023 and 2022, respectively.

The Ventas Master Lease Agreement provides for rent escalations each May 1. All annual rent escalators are payable in cash. The contingent annual rent escalator for the Ventas Master Lease Agreement is based upon annual increases in the Consumer Price Index, subject to a ceiling of 4%. In 2023, the contingent annual rent escalator was 4% for the Ventas Master Lease Agreement. The annual rent escalators are excluded from the operating lease liabilities.

Medical office building sale-leaseback

During 2023, the Company sold a medical office building for \$43.5 million in cash and executed a twenty-year operating lease of the building. In accordance with ASC 842, the Company accounted for the transaction as a sale and leaseback. As a result, the Company recorded a gain, net of transaction costs, of \$37.0 million during the year ended December 31, 2023.

Equipment rent

The Company recorded equipment rent expense of \$28.5 million and \$20.7 million for the years ended December 31, 2023 and 2022, respectively.

NOTE 10 – LONG-TERM DEBT

Long-term debt

A summary of long-term debt at December 31 follows (in thousands):

	<u>2023</u>	<u>2022</u>
Term Loan Facility due 2028, net of unamortized original issue discount of \$8.0 million at December 31, 2023 and \$9.6 million at December 31, 2022.....	\$ 433,005	\$ 435,897
ABL Facility	435,100	256,500
Term Loan Facility due 2026.....	47,151	—
Other	14,247	—
Debt issuance costs, net of accumulated amortization.....	<u>(12,621)</u>	<u>(14,955)</u>
Total debt, average life of 4 years (weighted average rate 9.0% for 2023 and 8.2% for 2022)	916,882	677,442
Amounts due within one year	<u>(6,236)</u>	<u>(4,500)</u>
Long-term debt	<u>\$ 910,646</u>	<u>\$ 672,942</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – LONG-TERM DEBT (Continued)

Long-term debt (Continued)

The scheduled maturities of long-term debt (in thousands):

	Term Loan Facility due 2028	ABL Facility	Term Loan Facility due 2026	Other	Total
2024.....	\$ 4,500	\$ —	\$ 1,396	\$ 340	\$ 6,236
2025.....	4,500	—	1,467	350	6,317
2026.....	4,500	435,100	44,288	361	484,249
2027.....	4,500	—	—	372	4,872
2028.....	423,000	—	—	383	423,383
Thereafter	—	—	—	12,441	12,441
	<u>\$ 441,000</u>	<u>\$ 435,100</u>	<u>\$ 47,151</u>	<u>\$ 14,247</u>	<u>\$ 937,498</u>

See Note 9 for discussion of the Company’s finance lease obligations.

Credit Facilities

As used herein, the “Credit Facilities” refers collectively to the Term Loan Facility due 2028, the ABL Facility, the assumed Term Loan Facility due 2026, and the HUD (as defined below) mortgages in each case as defined and described below.

Term Loan Facility due 2028

The “Term Loan Facility due 2028” refers to the Company’s \$450 million term loan credit facility provided pursuant to the terms and provisions of that certain Term Loan Credit Agreement dated as of December 23, 2021 and amended June 20, 2023, among the Company, the lenders from time-to-time party thereto, and Barclays Bank PLC, as administrative agent and collateral agent. All obligations under the Term Loan Facility due 2028 are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company’s wholly owned, domestic material subsidiaries (subject to certain designated exceptions), as well as the Company’s immediate parent entity, plus any foreign or non-wholly owned domestic subsidiaries that the Company may determine from time-to-time in its sole discretion (collectively, the “Guarantors”). The obligations under the Term Loan Facility due 2028 are secured by substantially all of the assets of the Company and the Guarantors.

The Term Loan Facility due 2028 (1) matures on December 23, 2028; (2) amortizes annually at 1.00%, payable in quarterly installments, which commenced on March 31, 2022; (3) imposes a variety of restrictions including restrictions on the Company’s ability to incur debt and liens and make acquisitions, investments and payments on equity and junior debt; and (4) provides for interest rate margins of 5.25% for Term Secured Overnight Financing Rate (“Term SOFR”) borrowings and 4.25% for base rate borrowings, plus a Term SOFR adjustment, with a floor of 0.50%. The Term SOFR adjustment is 0.11448% for an interest period of one-month duration, 0.26161% for an interest period of three-months duration, and 0.42826% for an interest period of six-months duration. The Term Loan Facility due 2028 contains no financial maintenance covenants.

ABL Facility

The “ABL Facility” refers to the Company’s \$550 million asset-based loan revolving credit facility provided pursuant to the terms and provisions of that certain ABL Credit Agreement dated as of December 23, 2021 (the “ABL Credit Agreement”) and amended January 20, 2023, among the Company, the lenders party thereto from time-to-time, and Barclays Bank PLC, as administrative agent and collateral agent. All obligations under the ABL Facility are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company’s wholly owned, domestic material subsidiaries (subject to certain designated exceptions), as well as the Company’s immediate parent entity, plus any foreign or non-wholly owned domestic subsidiaries that the Company may determine from time-to-time in its sole discretion. The obligations under the ABL Facility are secured by substantially the same collateral as the obligations under the Term Loan Facility due 2028. As of December 31, 2023, \$435.1 million of loans and \$54.7 million of letters of credit were outstanding under the ABL Facility, and no amounts were drawn on the letters of credit.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – LONG-TERM DEBT (Continued)

Credit Facilities (Continued)

ABL Facility (Continued)

The ABL Facility (1) matures on December 23, 2026; (2) contains a financial maintenance covenant in the form of a springing minimum fixed charge coverage ratio; (3) imposes a variety of restrictions including restrictions on the Company's ability to incur debt and liens and make acquisitions, investments and payments on equity and junior debt, particularly if the payment condition is not satisfied; (4) provides for interest rate margins of 1.25% to 1.75% for Term SOFR borrowings and 0.25% to 0.75% for base rate borrowings (in each case depending on average daily excess availability) plus a Term SOFR adjustment of 0.10%; and (5) employs a borrowing base calculation to determine total available capacity thereunder.

In connection with the Cornerstone Healthcare acquisition, the Company entered into an amendment to the ABL Credit Agreement (Incremental Assumption and Amendment Agreement No. 1) that, among other provisions, increased the size of the ABL Facility by an aggregate principal amount of \$66.7 million, which the Company drew against at closing. In addition, the Company incurred incremental first-in-last-out ("FILO") Revolving Loans that mature on January 20, 2026 and rank junior in right of payment to the Initial Revolving Loans in an aggregate principal amount of \$33.3 million. The interest rate margin for FILO Revolving Loans is 3.75% per annum in the case of any Term Benchmark Revolving Loan and 2.75% per annum in the case of any ABR Loan.

Assumed Debt

Subsidiaries of the Company executed agreements to assume the obligations of certain existing long-term debt at Cornerstone Healthcare, including (i) a Term Loan Facility and (ii) three mortgages secured by certain real property and insured by the U.S. Department of Housing and Urban Development ("HUD").

The assumed Term Loan Facility due 2026 (1) matures on July 22, 2026; (2) amortizes in monthly installments of approximately \$0.1 million; and (3) provides for interest rate margins of 2.25% for Base Rate Loans and 3.25% for Term SOFR Loans.

The assumed HUD mortgages mature between 2048 and 2055.

The Company was in compliance with the terms of the Credit Facilities at December 31, 2023.

NOTE 11 – CONTINGENCIES

Management continually evaluates contingencies based upon the best available information. In addition, allowances for losses are provided currently for disputed items that have continuing significance, such as certain third party reimbursements and deductions that continue to be claimed in current cost reports and tax returns.

Management believes that allowances for losses have been provided to the extent necessary and that its assessment of contingencies is reasonable.

Principal contingencies are described below:

Revenues – Certain third party payments are subject to examination by agencies administering the various reimbursement programs. The Company is contesting certain issues raised in audits of prior year cost reports and the denial of payment by third parties to the Company's customers.

Professional liability risks – The Company has provided for losses for professional liability risks based upon management's best available information including actuarially determined estimates. Ultimate claims costs may differ from the provisions for loss. See Note 7.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 – CONTINGENCIES (Continued)

Legal and regulatory proceedings – The Company is a party to various legal actions and regulatory and other governmental and internal audits and investigations in the ordinary course of business (including investigations resulting from the Company’s obligation to self-report suspected violations of law). The Company cannot predict the ultimate outcome of pending litigation and regulatory and other governmental and internal audits and investigations. The U.S. Department of Justice (the “DOJ”), the Centers for Medicare and Medicaid Services (“CMS”) or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company’s businesses in the future. These matters could potentially subject the Company to sanctions, damages, recoupments, fines, and other penalties (some of which may not be covered by insurance), which may, either individually or in the aggregate, have a material adverse effect on the Company’s business, financial position, results of operations, and liquidity. See Note 15.

Other indemnifications – In the ordinary course of business, the Company enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction, such as a disposal of an operating facility. These indemnifications may cover claims related to employment-related matters, governmental regulations, environmental issues and tax matters, as well as patient, third party payor, supplier and contractual relationships. These indemnifications could potentially subject the Company to damages and other payments which may, either individually or in the aggregate, have a material adverse effect on the Company’s business, financial position, results of operations or liquidity.

Income taxes – The Company is subject to various federal and state income tax audits in the ordinary course of business. Such audits could result in increased tax payments, interest and penalties.

NOTE 12 – EMPLOYEE BENEFIT PLANS

The Company maintains defined contribution retirement plans covering employees who meet certain minimum eligibility requirements. Benefits are determined as a percentage of a participant’s contributions and generally are vested based upon length of service. Retirement plan expense for employees of the Company was \$8.2 million and \$7.4 million for the years ended December 31, 2023 and 2022, respectively. Amounts equal to retirement plan expense are funded annually.

NOTE 13 – BALANCE SHEET INFORMATION

Supplemental information related to the accompanying consolidated balance sheets at December 31 follows (in thousands):

	<u>2023</u>	<u>2022</u>
Other current assets:		
Prepaid assets	\$ 26,998	\$ 22,390
Insurance proceeds receivable	–	1,911
Rebates	–	1,551
Other	11,295	8,690
	<u>\$ 38,293</u>	<u>\$ 34,542</u>
Other long-term assets:		
Reinsurance and other recoverables	\$ 159,166	\$ 201,274
Other	30,943	26,429
	<u>\$ 190,109</u>	<u>\$ 227,703</u>
Other accrued liabilities:		
Patient accounts	\$ 46,623	\$ 47,424
Taxes other than income	21,569	23,977
Accrued interest	5,903	434
Accrued acquisition and divestiture costs	3,632	8,413
Other	18,866	20,728
	<u>\$ 96,593</u>	<u>\$ 100,976</u>
Deferred credits and other liabilities:		
Accrued workers’ compensation	\$ 54,879	\$ 57,797
Deferred revenue	15,644	17,121
Deferred compensation	5,274	5,900
Unclaimed property	4,456	3,937
Other	4,591	4,512
	<u>\$ 84,844</u>	<u>\$ 89,267</u>

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

The Company follows the provisions of ASC 820, *Fair Value Measurement*, which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance related to fair value measures establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency asset backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Recurring measurements

The Company had money market funds totaling \$30.1 million and \$13.3 million as of December 31, 2023 and 2022, respectively, consisting of cash and cash equivalents for the Company's general corporate purposes.

The Company's insurance subsidiary's cash and cash equivalents of \$5.5 million and \$15.9 million as of December 31, 2023 and 2022, respectively, classified as insurance subsidiary investments, is maintained for the payment of claims and expenses related to professional liability and workers' compensation risks.

The carrying value is equal to fair value for financial instruments that are based upon quoted market prices or current market rates, such as cash, money market funds, and insurance subsidiary investments, and is based upon Level 1 inputs.

NOTE 15 – LEGAL AND REGULATORY PROCEEDINGS

The Company provides services in a highly regulated industry and is subject to various legal actions and regulatory and other governmental and internal audits and investigations in the ordinary course of business (including investigations resulting from the Company's self-reporting of potential violations of law). These matters could (1) require the Company to pay substantial damages, fines, penalties or amounts in judgments or settlements, which individually or in the aggregate could exceed amounts, if any, that may be recovered under the Company's insurance policies where coverage applies and is available; (2) cause the Company to incur substantial expenses; (3) require significant time and attention from the Company's management; (4) subject the Company to sanctions, including possible exclusions from the Medicare and Medicaid programs; and (5) cause the Company to close or sell one or more facilities or otherwise modify the way the Company conducts business. The ultimate resolution of these matters, whether as a result of litigation or settlement, could have a material adverse effect on the Company's business, financial position, results of operations, and liquidity.

In accordance with ASC 450, *Contingencies*, the Company records an accrued liability for litigation and regulatory matters that are both probable and reasonably estimable. Additional losses in excess of amounts accrued may be reasonably possible. The Company reviews loss contingencies that are reasonably possible and determines whether an estimate of the possible loss or range of loss, individually or in aggregate, can be disclosed in the Company's consolidated financial statements. These estimates are based upon currently available information for those legal and regulatory proceedings in which the Company is involved, taking into account the Company's best estimate of losses for those matters for which such estimate can be made. The Company's estimates involve significant judgment and a variety of assumptions, given that (1) these legal and regulatory proceedings may be in early stages; (2) discovery may not be completed; (3) damages sought in these legal and regulatory proceedings can be unsubstantiated or indeterminate; (4) the matters often involve legal uncertainties or evolving areas of law; (5) there are often significant facts in dispute; and/or (6) there is a wide range of possible outcomes. Accordingly, the Company's estimated loss or range of loss may change from time-to-time, and actual losses may be more or less than the current estimate. At this time, except as otherwise specifically noted, no estimate of the possible loss or range of loss, individually or in the aggregate, in excess of the amounts accrued, if any, can be made regarding the matters described below.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15 – LEGAL AND REGULATORY PROCEEDINGS (Continued)

Set forth below are descriptions of the Company's significant legal proceedings.

Medicare and Medicaid payment reviews, audits, and investigations—As a result of the Company's participation in the Medicare and Medicaid programs, the Company faces and is currently subject to various governmental and internal reviews, audits, and investigations to verify the Company's compliance with these programs and applicable laws and regulations. The Company is routinely subject to audits under various government programs, such as the CMS Recovery Audit Contractor program, in which third party firms engaged by CMS conduct extensive reviews of claims data and medical and other records to identify potential improper payments to healthcare providers under the Medicare program. In addition, the Company, like other healthcare providers, is subject to ongoing investigations by the Office of Inspector General, the DOJ and state attorneys general into the billing of services provided to Medicare and Medicaid patients, including whether such services were properly documented and billed, whether services provided were medically necessary, and general compliance with conditions of participation in the Medicare and Medicaid programs. Private pay sources such as third party insurance and managed care entities also often reserve the right to conduct audits. The Company's costs to respond to and defend any such reviews, audits, and investigations are significant and are likely to increase in the current enforcement environment. These audits and investigations may require the Company to refund or retroactively adjust amounts that have been paid under the relevant government program or by other payors. Further, an adverse review, audit, or investigation also could result in other adverse consequences, particularly if the underlying conduct is found to be pervasive or systemic. These consequences include (1) state or federal agencies imposing fines, penalties, and other sanctions on the Company; (2) loss of the Company's right to participate in the Medicare or Medicaid programs or one or more third party payor networks; (3) indemnity claims asserted by customers and others for which the Company provides services; and (4) damage to the Company's reputation in various markets, which could adversely affect the Company's ability to attract patients, customers and employees.

Whistleblower lawsuits—The Company is also subject to *qui tam* or "whistleblower" lawsuits under the federal False Claims Act and comparable state laws for allegedly submitting fraudulent bills for services to the Medicare and Medicaid programs. These lawsuits can result in monetary damages, fines, attorneys' fees, and the award of bounties to private *qui tam* plaintiffs who successfully bring these lawsuits and to the respective government programs. The Company also could be subject to civil penalties (including the loss of the Company's licenses to operate one or more facilities or healthcare activities), criminal penalties (for violations of certain laws and regulations), and exclusion of one or more facilities or healthcare activities from participation in the Medicare, Medicaid, and other federal and state healthcare programs. The lawsuits are in various stages of adjudication or investigation and involve a wide variety of claims and potential outcomes.

Employment-related lawsuits—The Company's operations are subject to a variety of federal and state employment-related laws and regulations, including but not limited to the U.S. Fair Labor Standards Act, Equal Employment Opportunity laws, and enforcement policies of the Equal Employment Opportunity Commission, the Office of Civil Rights and state attorneys general, federal and state wage and hour laws, and a variety of laws enacted by the federal and state governments that govern these and other employment-related matters. Accordingly, the Company is currently subject to employee-related claims, class actions and other lawsuits and proceedings in connection with the Company's operations, including but not limited to those related to alleged wrongful discharge, illegal discrimination, and violations of equal employment and federal and state wage and hour laws. Because labor represents such a large portion of the Company's operating costs, noncompliance with these evolving federal and state laws and regulations could subject the Company to significant back pay awards, fines, and additional lawsuits and proceedings. These claims, lawsuits, and proceedings are in various stages of adjudication or investigation and involve a wide variety of claims and potential outcomes.

Ordinary course matters—In addition to the matters described above, the Company is subject to investigations, claims, and lawsuits in the ordinary course of business, including investigations resulting from the Company's obligation to self-report suspected violations of law and professional liability claims, particularly in the Company's hospital operations and former nursing center operations. In many of these claims, plaintiffs' attorneys are seeking significant fines and compensatory and punitive damages in addition to attorneys' fees. The Company maintains professional and general liability insurance in amounts and coverage that management believes are sufficient for the Company's operations. However, the Company's insurance may not cover all claims against the Company or the full extent of its liability.

NOTE 16 – RELATED PARTY TRANSACTIONS

Transition services agreements

As part of the Lifepoint Transaction, the Company entered into transition services agreements with Lifepoint whereas each of the Company and Lifepoint will provide various transition services such as accounting, marketing, government affairs and income taxes to the other company. In addition, Lifepoint will provide information systems, accounts payable, and payroll services to the Company. The Company recorded net charges of \$40.9 million and \$57.5 million for the years ended December 31, 2023 and 2022, respectively, in the accompanying consolidated statements of operations.

KNIGHT HEALTH HOLDINGS LLC (d/b/a SCIONHEALTH)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 16 – RELATED PARTY TRANSACTIONS (Continued)

Sponsor fees and value capture initiatives

In December 2021, the Company entered into a management services agreement with Apollo Management Holdings, LP (“Apollo”). As part of this agreement, the Company is required to pay Apollo a monthly fee. These fees totaled \$1.0 million for the Company for the years ended December 31, 2023 and 2022, in the accompanying consolidated statements of operations.

The Company is also required to pay third party consultants and vendors, and incur other expenses related to various value capture initiatives which are expected to generate future cost savings. The expense for these items totaled \$1.1 million for the year ended December 31, 2023.

Rental income

The Company recorded \$2.4 million and \$2.5 million of rental income for the years ended December 31, 2023 and 2022, respectively, in other income in the accompanying consolidated statements of operations related to the lease of office space to Lifepoint.