Prospect EOGH, Inc. and subsidiary

Consolidated Financial Statements

As of and for the Year Ended
September 30, 2017

(With Independent Auditor's Report Thereon)

Prospect EOGH, Inc.

Consolidated Financial Statements

As of and for the Year Ended September 30, 2017

Prospect EOGH, Inc.

Contents

Tel: 714-957-3200
Fax: 714-957-1080
www.bdo.com

600 Anton Blvd., Suite 500
Costa Mesa, CA 92626

Independent Auditor's Report

Board of Directors
Prospect EOGH, Inc.
East Orange, New Jersey

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Prospect EOGH, Inc. (the "Company"), which comprise the consolidated balance sheet as of September 30, 2017, and the related consolidated statements of operations, member's equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Prospect EOGH, Inc. and its subsidiary as of September 30, 2017, and the results of their operations and their cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the Company is financially dependent on its parent companies which have agreed to provide the financial support necessary for the operations of the Company. The accompanying consolidated financial statements do not reflect any adjustments or disclosures that would be required should the parent company discontinue its financial support.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of state financial assistance for the year ended September 30, 2017, as required by the State of New Jersey, Department of Treasury Circular Letter 15-08-OMB, Single Audit Policy for Recipients of Federal Grants, State Grants and State Aid is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying schedule of expenditures of state awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated June 28, 2018 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the Company's internal control over financial reporting and compliance.

BDO USA, LLP

June 28, 2018

Prospect EOGH, Inc.

Consolidated Balance Sheet
(in thousands)

September 30, 2017		
Assets		
Current assets		
Cash and cash equivalents	$	-
Patient accounts receivable, less allowance for doubtful accounts of $37,582		17,228
Other receivables		229
Due from government payers		3,710
Inventories		1,217
Prepaid expenses and other current assets		1,229
Total current assets		23,613
Property, improvements and equipment, net		42,789
Goodwill		4,572
Intangible assets, net		2,039
Deferred tax asset		3,337
Other assets		165
Total assets	$	76,515

See accompanying notes to consolidated financial statements.

Prospect EOGH, Inc.

Consolidated Balance Sheet
(in thousands)

September 30, 2017		
Liabilities and Member's Equity		
Current liabilities		
Accounts payable and other accrued liabilities	$	11,916
Accrued salaries, wages and benefits		4,224
Due to government payers		1,994
Due to affiliated companies, net		23,218
Current portion of capital leases		448
Total current liabilities		41,800
Capital leases, net of current portion		217
Malpractice reserves		2,850
Note payable		952
Other long-term liabilities		3,401
Total liabilities		49,220
Commitments and contingencies		
Member's equity:		
Member contributions		32,719
Accumulated deficit		(5,424)
Total member's equity		27,295
Total liabilities and member's equity	$	76,515

See accompanying notes to consolidated financial statements.

Prospect EOGH, Inc.

Consolidated Statement of Operations
(in thousands)

For the year ended September 30, 2017		
Revenues:		
Net patient service revenues	$	97,900
Provision for bad debts		(5,150)
Net patient service revenues less provision for bad debts		92,750
Other revenues		3,356
Total net revenues		96,106
Operating Expenses:		
Salaries, wages and benefits		52,964
Supplies		11,413
Purchased services		11,995
Taxes and licenses		1,569
Depreciation and amortization		4,817
Professional fees		4,401
Other		2,139
Management fees		4,882
Utilities		1,447
Research grant expense		2,223
Insurance		1,083
Lease and rental		388
Repairs and maintenance		4,819
Registry		634
Total operating expenses		104,774
Operating loss		(8,668)
Other expense:		
Interest expense		471
Other expense, net		83
Net loss before benefit from income taxes		(9,222)
Tax benefit		(3,651)
Net loss	$	(5,571)

See accompanying notes to consolidated financial statements.

Prospect EOGH, Inc.

Consolidated Statement of Member's Equity
(in thousands)

	Member Contributions	Retained Earnings (Accumulated Deficit)	Total Member's Equity
Balance at October 1, 2016	$ 32,719	$ 147	$ 32,866
Net loss	-	(5,571)	(5,571)
Balance at September 30, 2017	$ 32,719	$ (5,424)	$ 27,295

See accompanying notes to consolidated financial statements.

Prospect EOGH, Inc.

Consolidated Statement of Cash Flows
(in thousands)

For the year ended September 30, 2017	
Operating activities	
Net loss	$ (5,571)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	4,817
Provision for bad debts	5,150
Loss on sale of property, improvements and equipment	81
Deferred income taxes, net	(3,337)
Changes in operating assets and liabilities:	
Patient accounts receivable and other receivables	(11,505)
Due to government payers, net	(7,575)
Inventories	29
Prepaid expenses and other assets	(18)
Accounts payable and other accrued liabilities	819
Malpractice reserve	631
Net cash used in operating activities	(16,479)
Investing activities	
Purchases of property, improvements and equipment	(8,158)
Net cash used in investing activities	(8,158)
Financing activities	
Change in due to affiliated companies, net	24,265
Borrowings from notes payable	1,000
Repayments of notes payable	(48)
Repayments of capital leases	(699)
Net cash provided by financing activities	24,518
Change in cash and cash equivalents	(119)
Cash and cash equivalents, beginning of year	119
Cash and cash equivalents, end of year	$ -
Supplemental disclosure of cash flow information	
Reclassifications to finalize purchase price allocation	$ 1,041

See accompanying notes to consolidated financial statements

1. Organization

Prospect EOGH, Inc. ("EOGH" or the Company) is a wholly-owned subsidiary of Prospect NJ, Inc. ("PNJ"). PNJ is wholly owned by Prospect Medical Holdings, Inc. ("Prospect"). EOGH operates a 211-bed acute care general hospital which provides healthcare services in East Orange, New Jersey and surrounding communities.

Admitting physicians are primarily practitioners in the local area. The hospital has payment arrangements with Medicare, Medicaid and other third party payers, including commercial insurance carriers, health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs").

The Company is dependent on Prospect to fund ongoing operations. As of September 30, 2017, the Company had a liability of $23,218,000 to Prospect, which is payable on demand, does not bear interest, and is included in due to affiliated companies, net in the accompanying consolidated balance sheet. Prospect does not intend to have the Company repay the liability in a manner which would impair the Company's ability to maintain sufficient liquidity to sustain ongoing operations.

2. Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of EOGH's wholly-owned subsidiary, Prospect EOGH Hospital Properties Urban Renewal, LLC, but do not include the accounts of PNJ or Prospect. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenues

Net Patient Service Revenues

Operating revenue consists primarily of net patient service revenue. The Company reports net patient service revenue at the estimated net realizable amounts from patients and third-party payers and others in the period in which services are rendered. The Company has agreements with third-party payers, including Medicare, Medicaid, managed care and other insurance programs that are paid at negotiated rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments, as further described below. Estimates of contractual allowances are based upon the payment terms specified in the related contractual agreements. The Company accrues for amounts that it believes may ultimately be due to or from the third-party payers. Normal estimation differences between final settlements and amounts accrued in previous years are reported as changes in estimates in the current year. Outstanding receivables, net of allowances for contractual discounts and bad debts, are included in patient accounts receivable in the accompanying consolidated balance sheet.

The following is a summary of sources of net patient service revenues (net of contractual allowances and discounts) before provision for bad debts (in thousands):

For the year ended September 30, 2017		
Medicare	$	44,705
Medicaid		29,773
Managed Care		12,242
Self-Pay/Other		6,030
Total	$	92,750

A summary of the payment arrangements with major third-party payers follows:

Medicare: Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some disabled persons with end-stage renal disease and certain other beneficiary categories. Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge, according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services are paid based on a blend of prospectively determined rates and cost-reimbursed methodologies. The Company is also reimbursed for various disproportionate share and Medicare bad debt components at tentative rates, with final settlement determined after submission of the annual Medicare cost report and audit thereof by the Medicare fiscal intermediary. Normal estimation differences between filed settlements and amounts accrued are reflected in net patient service revenue.

Cost report settlement estimates are recorded based upon as-filed cost reports and are adjusted for tentative settlements, if any, and when a final Notice of Program Reimbursement ("NPR") is issued. The latest updated Supplemental Security Income ("SSI") ratios for 2014, which are used in determining disproportionate share payments, were issued on July 19, 2016. To date, the Company has not received any final NPRs since inception on March 1, 2016.

Medicaid: Medicaid is a joint federal-state funded healthcare benefit program that is administered by states to provide benefits to qualifying individuals who are unable to afford care. The Company receives reimbursements under the Medicaid program at prospectively determined rates for both inpatient and outpatient services. Similar to Medicare, cost report settlements are recorded based upon as-filed cost reports and adjusted for tentative and final settlements, if any.

The New Jersey Health Care Reform Act of 1992 established Health Care Subsidy Funds to provide certain hospitals in New Jersey with funds necessary to provide charity care and other forms of uncompensated care. EOGH recognized revenue related to this program of $4,042,409 for the year ended September 30, 2017.

Managed Care: The Company has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment under these agreements is in accordance with negotiated contracted rates or at the Company's standard charges for services provided.

Self-Pay: Self-pay patients represent those patients who do not have health insurance and are not covered by some other form of third party arrangement. Such patients are evaluated, at the time of services or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, as well as the Company's indigent and charity care policy.

Charity Care

The Company provides charity care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Company's charity care policy. This care is provided without charge or at amounts less than the Company's established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The direct and indirect costs related to this care totaled $4,010,940 for the year ended September 30, 2017. In addition, the Company provides services to other medically indigent patients under various state Medicaid programs. Such programs pay amounts that are less than the cost of the services provided to the recipients. The Company has not changed its charity care or uninsured discount policies during the year ended September 30, 2017.

Provisions for Contractual Allowances and Doubtful Accounts

Collection of receivables from third-party payers and patients is the Company's primary source of cash and is critical to its operating performance. The Company closely monitors its historical collection rates, as well as changes in applicable laws, rules and regulations and contract terms, to assure that provisions for contractual allowances are made using the most accurate information available. However, due to the complexities involved in these estimations, actual payments from payers may be materially different from the amounts management estimates and records. The Company's primary collection risks relate to uninsured patients and the portion of the bill which is the patient's responsibility, primarily co-payments and deductibles. Payments for services may also be denied due to issues over patient eligibility for medical coverage, the Company's ability to demonstrate medical necessity for services rendered and payer authorization of hospitalization.

Accounts receivable are reduced by an allowance for doubtful accounts. Valuation of the collectability of accounts receivable and provision for bad debts is based on historical collection experience, payer mix and the age of the receivables. Management routinely reviews accounts receivable balances in conjunction with these factors and other economic conditions which might ultimately affect the collectability of the patient accounts, and makes adjustments to the Company's allowances as warranted. For receivables associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and subsequently calculates an allowance for doubtful accounts and provision for bad debts once the age of the accounts reaches a specific age category based on historical experience. For receivables associated with self-pay patients, management records a significant provision for bad debts beginning in the period services were provided based on past experience that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

Legislation

All of the Company's hospital facilities are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient's ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. The Company believes that it is in compliance with EMTALA and is not aware of any pending or threatened EMTALA investigations involving allegations of potential wrongdoing that would have a material effect on the Company's consolidated financial statements.

Other Revenues

Other revenues totaled $3,356,000 for the year ended September 30, 2017, which includes grant revenues of $2,427,000 and other revenues of $929,000. Management has evaluated the collectability of other receivables consisting primarily of other revenues and grant revenues and determined no allowance is necessary as of September 30, 2017.

Property, Improvements and Equipment

Property, improvements and equipment are stated on the basis of cost or, in the case of acquisitions, at their acquisition date fair values. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, and amortization of leasehold improvements is provided using the straight-line basis over the shorter of the remaining lease period or the estimated useful lives of the leasehold improvements. Building improvements are generally depreciated over seven years, buildings are depreciated over 10 years, equipment is depreciated over three to seven years and furniture and fixtures are depreciated over five to seven years. Equipment capitalized under capital lease obligations are amortized over the lesser of the life of the lease or the useful life of the asset.

Goodwill

Goodwill represents the excess of the consideration paid and liabilities assumed over the fair value of the net assets acquired, including identifiable intangible assets.

Goodwill is not amortized; rather it is reviewed annually for impairment for each reporting unit, or more frequently if impairment indicators arise. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value.

The Company tests for goodwill impairment as of September 30 each year, at the reporting unit level, by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of the reporting units are estimated. In evaluating whether indicators of impairment exist, the Company considers adverse changes in market value, laws and regulations, profitability, cash flows, ability to maintain enrollment and renew payer contracts at favorable terms, among other factors. The goodwill impairment test is a two-step process. The first step consists of estimating based on a weighted combination of (i) the guideline company method that utilizes revenue or earnings multiples for comparable publicly-traded companies, and (ii) a discounted cash flow model. If the estimated fair value of the reporting unit is less than its carrying value, this indicates that goodwill may be impaired and a second step is performed to measure the amount of the impairment, if any. The Company's impairment test relating to goodwill during the year ended September 30, 2017, resulted in no additional impairment charges.

Long-Lived Assets and Amortizable Intangibles

Intangible assets include trade names. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The Company considers assets to be impaired and writes them down to fair value if estimated undiscounted cash flows associated with those assets are less than their carrying amounts. Fair value is based upon the present value of the associated cash flows. Changes in circumstances (for example, changes in laws or regulations, technological advances or changes in strategies) may also reduce the useful lives from initial estimates. Changes in planned use of intangibles may result from changes in customer base, contractual agreements, or regulatory requirements. In such circumstances, management will revise the useful life of the long-lived asset and amortize the remaining net book value over the adjusted remaining useful life. There were no impairments recorded during the year ended September 30, 2017.

Insurance Reserves

Medical Malpractice Liability Insurance

The Company carries professional and general liability insurance to cover medical malpractice claims. The General Liability coverage is occurrence coverage and the Professional Liability coverage is claims-made coverage. Under the Professional Liability policy, insurance premiums cover only those claims actually reported during the policy term. Should the Professional Liability claims-made policy not be renewed or replaced with equivalent insurance, claims related to occurrences during the policy term but reported subsequent to the policy's termination may be uninsured. The Company is included in Prospect's consolidated medical malpractice insurance policy effective March 1, 2016. Assets and liabilities related to malpractice insurance related to events prior to acquisition were not assumed by the Company.

GAAP requires that a health care organization record and disclose the estimated costs of medical malpractice claims in the period of the incident of malpractice, if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. The Company recognizes an estimated liability for incurred but not reported claims and the self-insured risks (including deductibles and potential claims in excess of policy limits) based upon an actuarial valuation of the Company's historical claims experience. The Company's gross claims liability was $2,850,000 as of September 30, 2017. The gross claims liability was estimated using a discount factor of 4%. Medical malpractice liability loss recoveries receivable represent the portion of the Company's reserves for medical malpractice liability losses estimated to be reimbursable under commercial insurance company policies. The entities providing medical malpractice liability coverage to the Company are creditworthy commercial insurance companies. The Company evaluates the collectability of such receivables and believes such receivables are probable of being collected and these companies will be able to fully satisfy their obligations under the insurance contracts. The gross medical malpractice and recovery receivable are included within long-term liabilities and long-term assets in the accompanying consolidated balance sheet.

Workers' Compensation Insurance

The Company was fully insured for workers' compensation claims with no deductible for the year ended September 30, 2017. Assets and liabilities related to workers' compensation insurance related to events prior to March 1, 2016 (inception) were not assumed by the Company.

Reserve Methodology

The claims reserve is based on the best data available to the Company. The estimate, however, is subject to a significant degree of inherent variability. The estimate is continually monitored and reviewed, and as the reserve is adjusted, the difference is reflected in current operations. While the ultimate amount of medical malpractice liability is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims. Management is not aware of any potential medical malpractice claims whose settlement, if any, would have a material adverse effect on the Company's financial position, results of operations or cash flows.

Employee Health Plans

The Company maintains self-insured EPO/HMO and PPO plans for all eligible employees. Employee health benefits are administered by a third party claims administrator, based on plan coverage and eligibility guidelines determined by the Company, as well as by collective bargaining agreements. Commercial insurance policies cover per occurrence losses in excess of $160,000. An actuarially estimated liability of approximately $763,000 for incurred but not reported claims due to Prospect has been included in due to affiliates, net as of September 30, 2017.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with initial maturities of 90 days or less to be cash equivalents. Cash and cash equivalents are primarily comprised of deposits with banks. The Company maintains its cash at banks with high credit-quality ratings.

Inventories

Inventories of supplies are valued at the lower of amounts that approximate the weighted average cost or market. Inventories consist primarily of medical and surgical supplies and pharmaceuticals.

Income Taxes

Deferred income tax assets and liabilities are recognized for differences between financial and income tax reporting bases of assets and liabilities based on enacted tax rates and laws. To the extent a deferred tax asset cannot be recognized under the preceding criteria, allowances must be established. The impact on deferred taxes of changes in tax rates and laws, if any, are applied to the years during which temporary differences are expected to be settled and reflected in the financial statements in the period of enactment. The Company recognizes interest and penalties associated with income tax matters and unrecognized tax benefits in the income tax expense line item of the statements of operations. For the year ended September 30, 2017, the Company did not incur any interest and penalties related to income taxes, respectively.

An entity is required to evaluate its tax positions using a two-step process. First, the entity should evaluate the position for recognition. An entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. Next, the entity should measure the amount of benefit that should be recognized for those tax positions that meet the more-likely-than-not test.

Consolidated federal tax returns are filed with Prospect. The Company files separate state tax returns for New Jersey. PMH files consolidated federal and state tax returns, which includes the Company. Relevant accounting literature requires that the consolidated amount of current and deferred tax expense for a group that files a consolidated tax return be allocated among the group members when those members issue separate financial statements. The Company is a member of a consolidated group which files combined returns for federal and state, respectively, for its ultimate parent company. The Company adopts the separate return method modified for benefits-for-loss in provisioning for current and deferred income taxes. Under this method, the subsidiary is assumed to file a separate return with the taxing authority, thereby reporting its taxable income or loss and paying the applicable tax to or receiving the appropriate refund from the parent. However, when the benefit of the net operating loss and other tax attributes is recognized in the consolidated financial statements, the subsidiary would generally reflect a benefit in its financial statements. The Company's filed tax returns are generally subject to examination by the IRS and state tax boards for 3 to 4 years.

Concentrations of Credit Risk

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits of $250,000 per depositor of each financial institution. The Company has not experienced any losses to date related to these balances.

Financial instruments that potentially subject the Company to concentrations of credit risk consist of receivables due from Medicare and Medicaid. The Company received revenues from Medicare and Medicaid as follows (in thousands):

	For the Year Ended September 30, 2017	% of Net Patient Services Revenues
Medicare	$ 44,705	48%
Medicaid	29,773	32%
Total	$ 74,478	80%

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities at the dates, and for the periods, that the consolidated financial statements are prepared. Actual results could materially differ from those estimates. Principal areas requiring the use of estimates include amounts due from/to government payers, allowances for contractual discounts and doubtful accounts, professional and general liability claims, and impairment of long-lived assets, goodwill and intangible assets.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which defers the effective date of the revenue standard ASU 2015-14. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services, and attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Nonpublic entities will apply the new standard for annual periods beginning after December 15, 2018, including interim periods therein. Three basic transition methods are available — full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. October 1, 2019) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. Early adoption is permitted for fiscal years beginning after December 15, 2016. The Company is currently evaluating the effect of this guidance on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern: Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40)" This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Specifically, this ASU provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). It also requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans and requires an express statement and other disclosures when substantial doubt is not alleviated. The new standard will be effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company has early adopted this guidance and such adoption did not have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)". The core principle of ASU 2016-02 is that a lessee should recognize the assets and liabilities that arise from leases, including operating leases. Under the new requirements, a lessee will recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing the right to the underlying asset for the lease term. For leases with a term of 12 months or less, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. The standard is effective for nonpublic entities for fiscal years beginning after December 15, 2019. Early application of the amendment is permitted. The Company is currently evaluating the standard and the impact on its consolidated financial statements and footnote disclosures.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)". The updated standard addresses eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for non-public business entities for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is assessing the impact of the adoption of ASU 2016-15 on its consolidated financial statements.

3. Property, Improvements and Equipment

Property, improvements and equipment, consisted of the following (in thousands):

September 30, 2017		
Property, improvements and equipment:		
Land and land improvements	$	3,958
Buildings and improvements		34,515
Equipment		9,279
Less: accumulated depreciation		(7,133)
Construction in Progress		2,170
Property, improvements and equipment, net	$	42,789

At September 30, 2017, the Company had assets under capitalized leases of approximately $8,146,000 and related accumulated depreciation of $149,000.

Depreciation expense was $4,575,000 for the year ended September 30, 2017.

4. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the year ended September 30 are as follows (amounts in thousands):

September 30, 2017		
Balance, beginning of year	$	3,531
Adjustments to prior year acquisition		1,041
Balance, end of year	$	4,572

Identifiable intangible assets are comprised of tradenames (in thousands):

	Amortization Period		September 30, 2017
Total acquisition cost of intangible assets	10 years	$	2,423
Less accumulated amortization			(384)
Intangible assets, net		$	2,039

Amortization is recognized on a straight-line basis (management's best estimate of the period of economic benefit) over the respective useful lives. Amortization expense was $242,000 for the year ended September 30, 2017.

Estimated amortization expense for each future fiscal year is as follows (in thousands):

Year ended September 30, 2017		
2018	$	242
2019		242
2020		242
2021		242
2022		242
Thereafter		829
Total	$	2,039

The weighted-average remaining useful life for the intangible assets was approximately 8 years as of September 30, 2017.

5. Related Party Transactions

The Company has transactions with the Parent and fellow subsidiaries of the Parent related to payments that may be made on behalf of the Company, and vice versa, and PMH pushes down various corporate expenses (largely related to salaries and wages). At September 30, 2017, the Company had a net payable due to Prospect in the amount of $23,218,000 which is reflected in due to affiliates, net on the accompanying consolidated balance sheet.

6. Income Taxes

The components of the income tax benefit are as follows (in thousands):

For the year ended September 30, 2017		
Current:		
Federal	$	(264)
State		(49)
		(314)
Deferred:		
Federal		(2,582)
State		(755)
		(3,337)
Total:		
Federal		(2,847)
State		(804)
	$	(3,651)

Temporary differences and carry forward items that result in deferred income tax balances as of September 30, 2017 are as follows (in thousands):

September 30, 2017		
Deferred tax assets:		
Allowances for bad debts	$	1,630
Prepaid		213
Malpractice Reserve		1,254
Intangibles		107
Fixed assets		961
Deferred tax assets		4,165
Deferred tax liabilities:		
State taxes		(353)
Vacation accrual		(393)
Deferred revenue		(82)
Deferred tax liabilities		(828)
Net deferred tax assets	$	3,337

The differences between the income tax provision at the federal statutory rate and that reflected in the accompanying consolidated statement of operations are related primarily to state taxes. Deferred tax assets and liabilities reflect the effect of temporary differences between the assets and liabilities recognized for financial reporting purposes and the amounts recognized for income tax purposes.

As of September 30, 2017, the Company does not have material unrecognized tax benefits. The Company believes that it is reasonably possible that an increase in unrecognized tax benefits may be necessary within the coming year, and these unrecognized tax benefits would primarily impact deferred taxes and taxes payable, and the expected range of potential increase in the unrecognized tax benefits is not expected to be material to the balance sheet nor the income statement.

On December 22, 2017, the 2017 Tax Cuts and Jobs Act (the “Tax Act”) was enacted into law and the new legislation contains several key tax provisions that will affect the Company, including a reduction of the corporate income tax rate to 21% effective January 1, 2018. The Company is required to recognize the effect of the tax law changes in the period of enactment, such as re-measuring the U.S. federal portion of deferred tax assets and liabilities as well as reassessing the net realizability of the Company’s deferred tax assets and liabilities, and accordingly will reflect such changes in the consolidated financial statements for the year ending September 30, 2018.

7. Commitments and Contingencies

Leases

The Company leases various office facilities and equipment from third parties under non-cancelable operating and capital lease arrangements expiring at various dates through September 2022. Capital leases bear interest at rates ranging from 3.65% to 8.12% per annum.

The future minimum annual lease payments required under leases in effect at September 30, 2017, are as follows (in thousands):

For the years ending September 30,	Capital Leases	Operating Leases
2018	$ 479	$ 83
2019	105	83
2020	58	83
2021	58	83
2022	10	83
Total minimum lease payments	710	$ 415
Less: amounts representing interest	(45)	
Sub-total	664	
Less: current portion	(448)	
Total	$ 217	

Lease and rental expense was $388,000 for the year ended September 30, 2017.

Contingent Liability for Borrowings by Prospect

The Company is contingently liable as a guarantor among others for amounts borrowed by Prospect on senior secured borrowings and credit facilities at September 30, 2017. The obligations and related interest expense related to these credit facilities are not reflected in the Company's financial statements as of September 30, 2017, as the borrowings are reflected in the separate consolidated financial statements of Prospect.

Total borrowings outstanding as of September 30, 2017, reflected in the consolidated financial statements of Prospect, but for which the Company is contingently liable as a guarantor, were (in thousands):

September 30, 2017		
Senior secured term loan (net of discount of $7,374)	$	609,813
Less: original issue discount, net		(9,906)
	$	599,907

On June 30, 2016, Prospect entered into a six-year $625 million senior secured term loan B (the "Term Loan"), the proceeds of which were used to repay $425 million for Prospect's existing 8.375% senior secured notes due during 2019; to repay $60 million for borrowings under Prospect's existing revolving credit facility (the "Replaced Revolver"); to fund acquisitions; and to finance transaction fees and expenses. The Term Loan bears interest at LIBOR (subject to a 1.0% floor) plus 6.0%, and the effective interest rate was 7.00% as of September 30, 2017. The Term Loan was issued with an original discount of 1.5%, or $9,375,000.

Additionally, Prospect refinanced the Replaced Revolver with a new $100 million asset-based revolving credit facility ("ABL Facility" and together with the Term Loan, the "New Senior Secured Credit Facilities"). The ABL facility was amended in August 2016 to $115 million, August 2017 to $155 million and October 2017 to $175 million. The ABL Facility bears interest at a variable base rate plus an applicable spread, contingent on Prospect's ABL Facility availability, as defined in the ABL Facility credit agreement. The ABL Facility effective interest rate was 3.25% as of September 30, 2017. The ABL Facility balance as of September 30, 2017 was $115,300,000. As of September 30, 2017, Prospect had unused letters of credit of $9,800,000, which offset Prospect's ability to borrow additional funds, and the ABL Facility had unused lender commitments of $29,900,000 as of September 30, 2017. The maturity date for the ABL facility is June 30, 2021, and the maturity date for the Term Loan is June 30, 2022. As of September 30, 2017, Prospect was in compliance with the financial covenants of the New Senior Secured Credit Facilities. Subsequent to year end, Prospect refinanced the Term Loan and amended the ABL Facility, see Note 9.

Other Commitments

The Company has additional commitments for reagents that are based on tests performed. They are non-cancelable agreements but the future dollar commitments are not quantifiable as they are volume-driven.

Litigation

The Company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, acquisitions, or other transactions. While the Company's management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on the Company's financial position or results of operations, the litigation and other claims that the Company faces are subject to inherent uncertainties and management's view of these matters may change in the future. Should an unfavorable final outcome occur, there exists the possibility of a material adverse impact on the Company's financial position, results of operations and cash flows for the period in which the effect becomes probable and reasonably estimable.

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

The Health Insurance Portability and Accountability Act ("HIPAA") assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act ("HITECH Act") expanded upon HIPAA in a number of ways, including establishing notification requirements for certain breaches of protected health information. The Company may be subject to significant fines and penalties if found not to be compliant with these federal provisions.

Affordable Care Act

The Patient Protection and Affordable Care Act ("PPACA") has made significant changes to the United States health care system. The legislation impacted multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Under this legislation, 32 states have expanded their Medicaid programs to cover previously uninsured childless adults. In addition, many uninsured individuals have had the opportunity to purchase health insurance via state-based marketplaces, state-based marketplaces using a federal platform, state-partnership marketplaces or the federally-facilitated marketplace. PPACA also implemented a number of health insurance market reforms, such as allowing children to remain an their parents' health insurance until age 26 or prohibiting certain plans from denying coverage based on pre-existing conditions. Nationally, these reforms have reduced number of uninsured.

In light of the transition to a new presidential administration, it is unclear what changes may be made to PPACA. The Tax Cuts and Jobs Act ("TCJA"), passed in December 2017, eliminates the individual mandate under PPACA, effective January 1, 2019. The individual mandate was included in PPACA to address concerns that other market reforms expanding access to coverage might produce adverse selection and higher premiums. The extent to which the repeal of the individual mandate will impact the uninsured rate and 2019 premiums is unclear at this juncture. Future changes to PPACA and in other federal and state legislation could have a material impact on the operations of the Company. The Company is continuing to monitor the legislative environment for risks and uncertainties.

Provider Contracts

Many of the Company's payer and provider contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of medical services. Such differing interpretations may not come to light until a substantial period of time has passed following contract implementation. Liabilities for claims disputes are recorded when the loss is probable and can be estimated. Any adjustments to reserves are reflected in current operations.

8. Defined Contribution Plan

Prospect sponsors a defined contribution plan (the "Plan") covering substantially all employees of Prospect who meet certain eligibility requirements, including the Company. Under the Plan, employees can contribute up to 100% of their compensation up to the IRS deferred annual maximum. The Company may make discretionary matching contributions to the Plan. The Company did not make any contributions to the Plan for the year ended September 30, 2017.

9. Subsequent Event (Unaudited)

The Company has evaluated subsequent events through June 28, 2018, the date the Company's consolidated financial statements were available for issuance.

On February 22, 2018, Prospect entered into an Amended and Restated Term Loan Credit Agreement. Under this agreement, the Term Loan is replaced by a new Term B-1 Loan and Additional Term B-1 Commitment ("Term B-1 Loans"). The total maximum borrowing under the Term B-1 Loans is $1,120 million and such loans bear interest at LIBOR (subject to a 1.0% floor) plus 5.5%, and were issued with an original discount of 2%, and mature on February 24, 2024. Additionally on February 22, 2018, Prospect entered into an Amended and Restated ABL Guarantee And Security Agreement. Under this agreement, the maximum borrowing is $250 million, and the facility bears interest at a variable base rate plus an applicable spread, contingent on the Prospect's ABL Facility availability, as defined in the agreement. The facility matures on February 22, 2023.