



**HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2021 and 2020

(With Independent Auditors' Report Thereon)



KPMG LLP  
Suite 1400  
55 Second Street  
San Francisco, CA 94105

## **Independent Auditors' Report**

Board of Directors  
Hill Physicians Medical Group, Inc.:

### *Opinion*

We have audited the consolidated financial statements of Hill Physicians Medical Group, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

### *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 Auditors' Responsibilities for the Audit of the Consolidated 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 audits. 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 Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles, and for 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.

In preparing the consolidated 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 consolidated financial statements are available to be issued.

### *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 consolidated 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 consolidated 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 consolidated 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 consolidated 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.

*KPMG LLP*

San Francisco, California  
April 28, 2022

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

December 31, 2021 and 2020

(In thousands)

<b>Assets</b>	<b>2021</b>	<b>2020</b>
Current assets:		
Cash and cash equivalents	\$ 72,524	61,689
Marketable securities	67,461	63,186
Accounts receivable:		
Capitation and other receivables, net	23,686	19,326
Prepaid expenses and other	7,140	7,753
Total current assets	170,811	151,954
Property and equipment, net	50,228	64,842
Goodwill	1,126	1,549
Deferred taxes	1,925	1,747
Other assets	11,416	5,045
Total assets	\$ 235,506	225,137
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Claims payable	\$ 37,993	33,882
Supplemental provider payments	17,952	17,368
Accounts payable and accrued liabilities	12,197	10,321
Accrued employee benefit liabilities	12,765	12,189
Health plan advance payable	—	5,000
Premium deficiency reserve	574	—
Short-term portion of capital lease obligation	587	1,145
Short-term portion of loans payable	65	268
Total current liabilities	82,133	80,173
Deferred rent	422	756
Deferred taxes	8,680	8,886
Other long-term liabilities	2,473	2,133
Capital lease obligation	—	587
Loans payable	5,792	5,827
Total liabilities	99,500	98,362
Shareholders' equity:		
Common stock	1	1
Additional paid-in capital	151	156
Retained earnings	130,481	121,252
Total shareholders' equity attributable to Hill	130,633	121,409
Noncontrolling interest	5,373	5,366
Total shareholders' equity	136,006	126,775
Total liabilities and shareholders' equity	\$ 235,506	225,137

See accompanying notes to consolidated financial statements.

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Consolidated Statements of Operations

Years ended December 31, 2021 and 2020

(In thousands)

	<b>2021</b>	<b>2020</b>
Revenue:		
Health plan capitation revenue	\$ 476,235	464,963
Other revenue	94,656	84,233
Investment income, net	5,242	5,141
Total revenue	<u>576,133</u>	<u>554,337</u>
Expenses:		
Physician and other contracted services	421,889	402,406
Premium deficiency expense (gain)	574	(1,616)
Total physician and other contracted services	<u>422,463</u>	<u>400,790</u>
Gross margin	<u>153,670</u>	<u>153,547</u>
Administrative and other expenses:		
Salaries and benefits	88,103	85,397
Physician administrative services	1,949	1,838
Software maintenance and support	14,284	13,106
Other purchased services	11,739	13,450
Rent	5,038	5,046
Depreciation and amortization	16,170	17,923
Other	3,120	2,311
Total administrative and other expenses	<u>140,403</u>	<u>139,071</u>
Net income before provision for income taxes	13,267	14,476
Provision for income taxes	4,031	3,579
Net income attributable to noncontrolling interest	7	125
Net income	<u>\$ 9,229</u>	<u>10,772</u>

See accompanying notes to consolidated financial statements.

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Consolidated Statements of Changes in Shareholders' Equity

Years ended December 31, 2021 and 2020

(In thousands of dollars)

	Common stock		Par amount	Additional paid-in capital	Retained earnings	Noncontrolling interest	Total shareholders' equity
	Authorized	Issued					
Balance at December 31, 2019	1,000	244	\$ 1	254	110,390	5,241	115,886
Comprehensive income:							
Net income	—	—	—	—	10,772	—	10,772
Change in noncontrolling interest	—	—	—	—	—	125	125
Issuance of common stock	—	21	—	7	—	—	7
Repurchase of common stock	—	(22)	—	(15)	—	—	(15)
Other	—	—	—	(90)	90	—	—
Balance at December 31, 2020	1,000	243	1	156	121,252	5,366	126,775
Comprehensive income:							
Net income	—	—	—	—	9,229	—	9,229
Change in noncontrolling interest	—	—	—	—	—	7	7
Issuance of common stock	—	10	—	4	—	—	4
Repurchase of common stock	—	(12)	—	(9)	—	—	(9)
Balance at December 31, 2021	1,000	241	\$ 1	151	130,481	5,373	136,006

See accompanying notes to consolidated financial statements.

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

Years ended December 31, 2021 and 2020

(In thousands)

	<u>2021</u>	<u>2020</u>
Cash flows from operating activities:		
Net income	\$ 9,229	10,772
Net change in noncontrolling interest	7	125
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,170	17,923
Amortization of capitalized cloud computing arrangements	610	—
Gain on marketable securities	(3,505)	(3,855)
Deferred taxes	(384)	1,515
Deferred rent	(334)	(493)
Loan forgiveness	(175)	—
Changes in assets and liabilities:		
Accounts receivable	(4,360)	(7,753)
Prepaid expenses and other	613	(3,948)
Other assets	(3,732)	(88)
Claims payable	4,111	3,978
Supplemental provider payments	584	6,476
Accounts payable and accrued liabilities	964	(3,530)
Accrued employee benefit liabilities, advance and other	(206)	2,084
Premium deficiency reserve	574	(1,616)
Net cash provided by operating activities	<u>20,166</u>	<u>21,590</u>
Cash flows from investing activities:		
Investment in healthcare venture	(1,138)	(579)
Proceeds from sales of marketable securities	22,823	18,264
Purchases of marketable securities	(23,593)	(32,410)
Purchases of property and equipment	(2,331)	(4,844)
Net cash used in investing activities	<u>(4,239)</u>	<u>(19,569)</u>
Cash flows from financing activities:		
Health plan advance	(3,879)	3,879
Paycheck Protection Program loan proceeds	—	175
Loan principal payments	(63)	(60)
Capital lease principal payments	(1,145)	(1,107)
Issuance of common stock	4	7
Repurchase of common stock	(9)	(15)
Net cash provided by (used in) financing activities	<u>(5,092)</u>	<u>2,879</u>
Net increase in cash and cash equivalents	10,835	4,900
Cash and cash equivalents – beginning of year	61,689	56,789
Cash and cash equivalents – end of year	<u>\$ 72,524</u>	<u>61,689</u>
Supplemental cash flow information:		
Income taxes paid	\$ (2,889)	(4,841)
Change in accrued purchases of property and equipment	912	309

See accompanying notes to consolidated financial statements.

## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

#### **(1) Organization and Purpose**

Hill Physicians Medical Group, Inc. (Hill Physicians or the Company) is an independent practice association delivering medical care to health plan enrollees. Hill Physicians' mission is to control medical cost while delivering quality medical care and a high level of service through effective management and efficient operations. Hill Physicians is owned by 241 physicians and contracts with 5,297 member-physician providers.

Hill Physicians has a management services agreement with PriMed Management Consulting Services, Inc. (PriMed), which extends through 2033. Under terms of the agreement, PriMed provides strategic direction, contract negotiation, claims processing, utilization review, quality assurance, physician credentialing, accounting, and marketing services. PriMed is compensated based on its cost plus incentives related to revenue growth, operating results, and administrative efficiency.

Hill Physicians has an ownership interest in PriMed, which is considered a variable interest due to the management agreement terms. Hill Physicians has been determined to be the primary beneficiary of PriMed. Accordingly, the financial statements of PriMed are included in the accompanying consolidated financial statements.

Hill Physicians owns preferred stock in PriMed, which results in a 36% ownership interest. This ownership interest is eliminated in the accompanying consolidated financial statements. The noncontrolling interest represents 64% outside ownership interest in the common and preferred stocks of PriMed.

Hill Health, Inc. (Hill Health) is a California for-profit professional corporation, and its purpose is to employ physicians to provide medical services in Northern California.

Hill Physicians has provided loans totaling \$9,267,000 to Hill Health, which are considered a variable interest in Hill Health. Hill Physicians received \$6,000,000 of financing from health plans to fund loans for Hill Health. Hill Physicians has been determined to be the primary beneficiary of Hill Health. The financial statements of Hill Health are included in the accompanying consolidated financial statements.

Hill Physicians Care Solutions, Inc. (HPCS) was formed in September 2019 and operations began September 2020. HPCS applied and was granted a limited Knox-Keene license with the California Department of Managed Health Care (DMHC) to enter into contracts with full-service health care service plans to arrange for and manage the care of enrollees. Hill Physicians contributed \$2,500,000 to and has 100% ownership of HPCS. The financial statements of HPCS are included in the accompanying consolidated financial statements.

#### **(2) Summary of Significant Accounting Policies**

##### ***(a) Basis of Consolidation***

The consolidated financial statements include PriMed, Hill Health and HPCS. Significant intercompany accounts and transactions among consolidated entities have been eliminated.

##### ***(b) Use of Estimates***

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date



## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

#### **(c) Cash and Cash Equivalents**

Cash comprises cash in bank checking and money market accounts. Cash equivalents include all highly liquid investments with maturity of three months or less when purchased. The Company holds the majority of its cash at a single bank. Consequently, the Company's bank balances may exceed federal deposit insurance limits.

#### **(d) Marketable Securities**

Marketable securities consist principally of domestic debt and equity securities. The Company accounts for its marketable securities under the fair value method of accounting. Under this method, unrealized gains and losses are recorded in investment income in the accompanying consolidated statements of operations.

Purchases and sales of marketable securities are recorded on a trade date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

#### **(e) Property and Equipment**

Property and equipment are stated at cost, and the related depreciation is calculated using the straight-line method of depreciation using estimated useful lives ranging from three to ten years for furniture and equipment, and application software, and the shorter of the life of the lease or the assets' useful life for leasehold improvements.

#### **(f) Other Assets**

Included in other assets are capitalized cloud computing implementation costs for software used in operations. These assets are amortized over the term of the hosting arrangement.

#### **(g) Goodwill**

Goodwill represents the excess of the amount paid by Hill Physicians over the book value of the shares purchased for a portion of its ownership in PriMed. Goodwill is amortized on a straight-line basis over ten years.

#### **(h) Claims Payable**

The cost of professional and institutional medical services rendered to members through the end of the year, but not yet paid, is accrued as claims payable. A portion of the claims payable represents an estimate of claims incurred but not yet reported. Because of the degree of estimation involved in determining the claims payable liability, the actual amount paid in subsequent periods is likely to differ from the recorded liability.

#### **(i) Supplemental Provider Payments**

Supplemental provider payments represent accruals for performance compensation awards to providers that are earned by the providers during a given year but paid in the succeeding year.

## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

**(j) Premium Deficiency Reserve**

Hill Physicians performs premium deficiency reserve testing at the line of business level. Reserves and the related expenses are recognized when projected provider payments and allocated maintenance costs are expected to exceed anticipated revenues over the contract period. At December 31, 2021 and 2020, premium deficiency reserves were \$574,000 and \$0, respectively, related to the managed MediCal line of business. Investment income was not included in the premium deficiency testing. Given the inherent variability of such estimates, the actual liability could differ significantly from the calculated amount.

**(k) Health Plan Advance**

Hill Physicians received an interest-free advance from a health plan to provide assistance for providers who have experienced hardship during the COVID-19 pandemic. The advance received totaled \$5,000,000 and was repaid in 2021.

**(l) Revenue Recognition**

The Company recognizes revenue based on the estimated transaction price expected to be collected as a result of satisfying performance obligations. Revenue primarily consists of capitation, fee-for-service arrangements, care management fees, grant programs, and quality and risk sharing incentive arrangements.

**(i) Capitation**

Hill Physicians and HPCS contracts with Health Maintenance Organizations (HMO) to provide physician and other defined medical services for their enrollees. Capitation revenue is recorded in the month in which enrollees are entitled to receive medical services. Five HMOs in 2021 and 2020 comprise 82% and 79% of capitation revenue, respectively, with each HMO accounting for between 10% and 30% of capitation revenue in 2021 and between 11% and 28% of capitation revenue in 2020.

**(ii) Fee for Service**

Hill Physicians contracts with Preferred Provider Organizations (PPO) to provide physician services through a clinically integrated network. Revenue is recorded on a fee-for-service basis as services are provided.

Many HMO contracts include provisions where certain injectable drugs and other medical services are reimbursed by health plans on a fee-for-service basis. Hill Physicians recognizes revenue based on the claims submitted to health plans with an estimate for claims incurred-but-not reported.

Hill Health is paid for a majority of its contracted services on a fee-for-service basis with several payers. Contractually adjusted revenue is recorded as services are provided.

**(iii) Care Management Programs**

Hill Physicians contracts with health plans and other partners to provide care management services to enrollees attributed to various programs. Care management revenue is recorded in the month in which attributed enrollees are entitled to receive care management services.

## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

(iv) *Grant Programs*

Hill Physicians participates in grant programs with health plans to fund the costs of special programs and initiatives. Revenue is recognized as related costs are incurred.

(v) *Quality and Shared Risk Incentive Arrangements*

Under quality and shared risk incentive arrangements, Hill Physicians can earn incentives based on quality and total cost performance. Reliable performance information is not normally available until several months after the program period. Hill Physicians recognizes revenue based on third-party final performance statements.

**(m) Income Taxes**

The asset-and-liability method is used to recognize future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded if the realizability of deferred tax assets is uncertain.

The Company recognizes the benefit of uncertain tax positions only if those positions are more likely than not of being sustained. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

The Company, PriMed, and Hill Health file separate Federal and State of California income tax returns. HPCS files Federal and State of California income tax returns on a consolidated basis as a subsidiary of and inclusive with the Company.

**(n) Recently Issued Accounting Pronouncements**

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*, aimed at making leasing activities more transparent and comparable. The new standard requires substantially all leases, including operating leases, be recognized by lessees on their balance sheet as a right-of-use asset and corresponding lease liability. ASU No. 2016-02 is effective for the Company on January 1, 2022. At the time of adoption, the Company will record a right of use asset and a corresponding lease liability of approximately \$20,000,000.

**(3) Risks and Uncertainty**

On January 30, 2020, the World Health Organization declared the outbreak of COVID-19 as a “public health emergency of international concern,” and on March 13, 2020, the President of the United States declared a state of national emergency. COVID-19 has precipitated both a health crisis and economic uncertainty and has impacted the markets in which the Company operates. As of the financial statement issuance date, COVID-19 continues to be classified as a global public health emergency by the World Health Organization.

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

December 31, 2021 and 2020

COVID-19's ongoing overall impact on the Company will be driven primarily by the severity and duration of the pandemic; the pandemic's impact on the United States economy and the timing, scope, and effectiveness of federal, state, and local governmental responses to the pandemic. Those primary drivers are uncertain and beyond management's control and may adversely impact the Company's membership levels, healthcare expenses, supply chain, values of investments, and workforce, among other aspects of the Company's business.

### (4) Fair Value of Financial Instruments – Marketable Securities

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, claims payable, supplemental provider payments, accounts payable and accrued liabilities, and accrued employee benefit liabilities approximate fair value due to the short maturities of these financial instruments.

Marketable securities are reported at fair value. The fair values of marketable securities are based on quoted market prices, if available, or are estimated using quoted market prices for similar investments.

The Company utilizes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level of the fair value hierarchy for an asset class is based on the lowest-level input that is significant to the fair value measurement of the asset class.

The following table presents the fair value measurements of investments by level at December 31, 2021 and 2020 (in thousands):

	2021			2020		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Fixed-income securities:						
Municipal securities	\$ —	37,271	37,271	—	35,270	35,270
Equity securities:						
U.S. common stock	16,552	—	16,552	16,113	—	16,113
Foreign common stock	2,631	—	2,631	3,252	—	3,252
Mutual funds	7,695	—	7,695	5,649	—	5,649
Exchange traded funds	3,220	—	3,220	2,883	—	2,883
Master limited partnership	92	—	92	19	—	19
Total	\$ 30,190	37,271	67,461	27,916	35,270	63,186

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

December 31, 2021 and 2020

Transfers between fair value input levels, if any, are recorded at the end of the reporting period. During the years ended December 31, 2021 and 2020, there were no transfers between Level 1 and Level 2 investments.

Maturities of fixed-income securities are as follows at December 31, 2021 and 2020 (in thousands):

	2021		2020	
	Adjusted cost	Fair value and carrying amount	Adjusted cost	Fair value and carrying amount
Fixed-income securities:				
0 to 5 years maturity	\$ 20,373	20,880	18,246	18,487
5 to 10 years maturity	5,566	7,646	7,924	8,336
Over 10 years maturity	8,435	8,745	8,317	8,447
Total	\$ 34,374	37,271	34,487	35,270

Investment income comprises the following for the years ended December 31, 2021 and 2020 (in thousands):

	2021	2020
Interest and dividends	\$ 1,737	1,286
Realized gains	705	448
Unrealized gain	2,800	3,407
Total	\$ 5,242	5,141

### (5) Property and Equipment

Property and equipment consists of the following at December 31, 2021 and 2020 (in thousands):

	2021	2020
Leasehold improvements	\$ 900	900
Furniture and equipment	7,378	7,313
Application software	136,652	136,987
Technology projects in progress	1,652	397
Total	146,582	145,597
Less accumulated depreciation and amortization	(96,354)	(80,755)
Property and equipment – net	\$ 50,228	64,842

## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

#### (6) Loans Payable

As part of a coordinated plan to provide funding for and to support the formation and development of Hill Health, Hill Physicians entered into loan agreements with two health plans to borrow up to \$4,000,000 from each, for a total of \$8,000,000. The loans accrue interest at a rate of 3.25% per annum with respect to all amounts outstanding and unpaid. In 2019, amendments to the loan agreements were made to extend the repayment period from 10 years to 30 years. As of December 31, 2021 and 2020, the outstanding balance of the loans payable to the health plans is \$5,792,000 and \$5,920,000, respectively. Accrued interest payable as of December 31, 2021 and 2020 is \$663,000 and \$444,000, respectively.

Up to \$3,000,000 of the December 31, 2021 loan payable balance to the health plans is forgivable upon Hill Health's achievement of certain milestones and performance standards. Hill Physicians is only responsible for making payments on the loans payable to the health plans from payments received on the loan receivable from Hill Health.

In 2020, Hill Health received loan proceeds of \$175,000 under the Paycheck Protection Program (PPP). The PPP, established as part of the Coronavirus Aid, Relief and Economic Security Act (CARES Act), provides for loans to qualifying businesses for amounts up to 2.5 times of the average monthly payroll expenses of the qualifying business. The loan and accrued interest are forgivable if the loan proceeds are used for eligible purposes. The unforgiven portion of the PPP loan accrues interest at 1.00% and is payable over two years. The Company has accounted for the PPP loan as debt under Accounting Standards Codification (ASC) 470, *Debt*. The PPP loan was forgiven in 2021.

Future scheduled principal payments on the loans payable as of December 31, 2021 are as follows (in thousands):

	<b>Loans payable</b>
2022	\$ 65
2023	67
2024	94
2025	132
2026	137
Thereafter	<u>5,362</u>
Total	\$ <u><u>5,857</u></u>

#### (7) Employee Benefit Plan

PriMed and Hill Health both offer 401(k) tax deferred savings plans (the Plans) through The Principal Financial Group, under which eligible employees, subject to certain limitations, may elect to have up to 80% for PriMed and Hill Health, respectively, of their salary deferred and contributed to the Plans.

# HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

December 31, 2021 and 2020

Employees become eligible to participate in the Plans in the month or quarter, for PriMed and Hill Health, respectively, following their hire date. The amount of salary deferred is not subject to federal income tax at the time of deferral. PriMed and Hill Health matches 100% of the employees' contributions up to 6.5% and 6.0%, respectively, of their salary. PriMed contributed \$3,659,000 and \$3,517,000 to the Plan in 2021 and 2020, respectively. Hill Health contributed \$74,000 and \$65,000 to the Plans in 2021 and 2020, respectively.

### (8) Income Taxes

The provision (benefit) for income taxes consists of the following for the years ended December 31, 2021 and 2020 (in thousands):

	<u>2021</u>	<u>2020</u>
Current federal taxes	\$ 3,018	1,546
Current state taxes	1,397	518
Deferred	<u>(384)</u>	<u>1,515</u>
Total	<u>\$ 4,031</u>	<u>3,579</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are presented below at December 31, 2021 and 2020 (in thousands):

	<u>2021</u>	<u>2020</u>
Deferred tax assets (liabilities):		
Vacation accrual	\$ 954	878
Depreciation	(13,211)	(15,806)
Deferred rent	126	226
Premium deficiency reserve	171	—
State taxes	491	530
Tax effect of unrealized gains on securities	(3,140)	(2,252)
Prepaid expenses	(1,247)	(1,293)
Nonqualified deferred compensation	520	454
Long-term incentive plan	709	703
Net operating loss	7,717	8,711
Research and development credit	2,697	3,167
Distribution payable	222	337
Alternative minimum tax	35	35
Other	<u>87</u>	<u>70</u>
Total gross deferred tax liability	(3,869)	(4,240)
Less valuation allowance	<u>(2,886)</u>	<u>(2,899)</u>
Net deferred tax liability	<u>\$ (6,755)</u>	<u>(7,139)</u>

## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

As of December 31, 2021, PriMed has federal and California research and development tax credits of \$3,031,000 and \$800,000, respectively. The federal research and development credits have an expiration date of 20 years and will begin expiring in 2033. The California research and development credits have no expiration dates.

As of December 31, 2021, PriMed and Hill Health have federal and California net operating loss carryforwards of \$22,598,000 and \$33,614,000, respectively. Federal net operating losses generated prior to 2018 can be carried forward for 20 years, while net operating losses generated during 2018 and after can be carried forward indefinitely. California net operating losses generated prior to 2018 can be carried forward for 10 years, while net operating losses generated during 2018 and after can be carried forward for 20 years.

In assessing the realizability of the deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based upon the projected future operating trends and the expected reversal of deferred tax liabilities, management believes it is more likely than not that PriMed and Hill Health will be unable to realize a portion of these deductible differences. Accordingly, a valuation allowance of \$2,886,000 and \$2,899,000 is recorded as of December 31, 2021 and 2020, respectively.

Income tax expense for 2021 differed from the amount computed by applying the U.S. federal tax rate of 21% primarily due to state taxes. Income tax expense for 2020 differed from the amount computed by applying the U.S. federal tax rate of 21% primarily due to state taxes and a rate differential on a carryback.

The Company files income tax returns in the U.S. Federal and in the State of California tax jurisdictions. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for tax years 2017 and forward and under the statute of limitations by the State of California Franchise Tax Board for tax years 2016 and forward.

#### **(9) Commitments and Contingencies**

In 2019, the Company entered into a line of credit agreement with a bank in the amount of \$20,000,000, which expires August 27, 2021. In 2021, the agreement was extended through August 27, 2024. Any unpaid balance accrues interest at BSBY Daily Floating Rate plus 1.05% and is payable monthly. Under the terms of the agreement, the Company is required to maintain a debt service coverage ratio and unrestricted cash and investments to senior committed debt ratio, as defined. There have been no borrowings against this line of credit.

From time to time, the Company may be a defendant in various actions arising from its healthcare services. No such actions that may have a material adverse effect on the Company's financial position are currently pending.

The Company is required to periodically file financial statements and other information with the DMHC and is in compliance with regulatory requirements.



## HILL PHYSICIANS MEDICAL GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2021 and 2020

#### (10) Operating Leases

The Company, PriMed, and Hill Health have entered into certain operating leases for office space, hardware and software. Expenses in connection with these leases are recognized on a straight-line basis over the life of the lease. Accrued but unpaid rent is \$422,000 and \$756,000 at December 31, 2021 and 2020, respectively.

Future rental commitments, including office leases, are as follows (in thousands):

2022	\$	3,686
2023		4,736
2024		4,873
2025		5,014
2026		1,705
Thereafter		613
Total	\$	<u>20,627</u>

#### (11) Capital Lease

In 2019, Hill Physicians and PriMed entered into a capital lease arrangement to lease software totaling \$3,389,000. The leased software is depreciated on a straight-line basis over three years. Total accumulated depreciation related to the leased software is \$2,824,000 as of December 31, 2021. The interest rate was calculated using LIBOR plus 1.25%, which approximates 3.37%.

Future capital lease commitments are as follows (in thousands):

Year ending December 31:		
2022	\$	<u>592</u>
Total minimum lease payments		592
Less amount representing interest		<u>5</u>
Present value of minimum lease payments	\$	<u>587</u>

#### (12) Subsequent Events

The Company has evaluated the subsequent events from the consolidated balance sheet date through April 28, 2022, the date at which the consolidated financial statements were available to be issued, and determined there are no additional items to disclose.