

**Delta Dental of California and Subsidiaries**

Consolidated Financial Statements

December 31, 2017 and 2016



## TABLE OF CONTENTS

	<u>Page No.</u>
Independent Auditor's Report	1
Consolidated Balance Sheets	2
Consolidated Statements of Income and Expense and Comprehensive Income	3
Consolidated Statements of General Reserves	4
Consolidated Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6 - 27
Supplementary Information	
Independent Auditor's Report on Supplementary Information	29
Consolidating Balance Sheets	30
Consolidating Statements of Income and Expense and Comprehensive Income (Loss)	31
Consolidating Balance Sheets - Alphas	32
Consolidating Statements of Income and Expense - Alphas	33



## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of  
Delta Dental of California  
San Francisco, California

We have audited the accompanying consolidated financial statements of Delta Dental of California and Subsidiaries (a non-profit California corporation), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income and expense and comprehensive income, general reserves and cash flows for the years 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity'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 entity'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 Delta Dental of California and Subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads "Armanino LLP".

Armanino<sup>LLP</sup>  
San Francisco, California

April 6, 2018

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

	<b>December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 781,095	\$ 803,486
Marketable securities	1,253,981	1,083,729
	<u>2,035,076</u>	<u>1,887,215</u>
Premiums and other receivables		
Premium receivables	361,558	348,052
Other receivables	36,009	36,122
	<u>397,567</u>	<u>384,174</u>
Property and equipment, net	127,823	179,579
Deferred compensation plans investments	32,930	34,508
Notes receivable	80,200	40,000
Other assets	59,564	36,822
	<u>59,564</u>	<u>36,822</u>
<b>TOTAL ASSETS</b>	<u>\$ 2,733,160</u>	<u>\$ 2,562,298</u>
<b>LIABILITIES AND GENERAL RESERVES</b>		
<b>Liabilities</b>		
Unpaid claims and claims adjustment expenses	\$ 452,429	\$ 438,388
Accounts payable and accrued expenses	321,335	244,424
Deferred revenue	86,922	82,535
Refundable group balances	447,842	601,266
Deferred compensation plans	32,930	34,508
Accrued retirement benefits	80,967	71,283
Loan payable	10,000	-
Other liabilities	19,576	19,478
Total liabilities	<u>1,452,001</u>	<u>1,491,882</u>
<b>General reserves</b>		
General reserves	1,250,487	1,072,973
Accumulated other comprehensive gain (loss)	30,672	(2,557)
Total general reserves	<u>1,281,159</u>	<u>1,070,416</u>
<b>TOTAL LIABILITIES AND GENERAL RESERVES</b>	<u>\$ 2,733,160</u>	<u>\$ 2,562,298</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME AND EXPENSE**  
**AND COMPREHENSIVE INCOME**

(In thousands)

	<b>Years Ended December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>Premiums and other income</b>		
Commercial programs	\$ 6,155,538	\$ 5,822,874
State programs	998,415	1,004,643
Federal programs	702,297	640,113
	<u>7,856,250</u>	<u>7,467,630</u>
Administrative service contracts	(3,301,604)	(3,109,173)
	4,554,646	4,358,457
Investment income, net	35,602	17,258
Other income (expense), net	(51,424)	989
	<u>4,538,824</u>	<u>4,376,704</u>
<b>Claims and operating expenses</b>		
Claims incurred	6,851,746	6,535,514
Claims incurred on administrative service contracts	(3,301,604)	(3,109,173)
	<u>3,550,142</u>	<u>3,426,341</u>
Operating expenses	811,168	803,410
	<u>4,361,310</u>	<u>4,229,751</u>
<b>Net income</b>	<u>177,514</u>	<u>146,953</u>
Other comprehensive income		
Pension liability and post-retirement adjustments	1,356	3,566
Unrealized gains on securities	31,873	13,604
	<u>33,229</u>	<u>17,170</u>
<b>Comprehensive income</b>	<u>\$ 210,743</u>	<u>\$ 164,123</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF GENERAL RESERVES**  
(In thousands)

	<u>General Reserves</u>	<u>Accumulated Other Comprehensive Gain (Loss)</u>	<u>Total</u>
<b>BALANCE AT JANUARY 1, 2016</b>	\$ 926,020	\$ (19,727)	\$ 906,293
Net income	146,953	-	146,953
Pension liability and post-retirement adjustments	-	3,566	3,566
Net unrealized gains on securities	<u>-</u>	<u>13,604</u>	<u>13,604</u>
<b>BALANCE AT DECEMBER 31, 2016</b>	1,072,973	(2,557)	1,070,416
Net income	177,514	-	177,514
Pension liability and post-retirement adjustments	-	1,356	1,356
Net unrealized gains on securities	<u>-</u>	<u>31,873</u>	<u>31,873</u>
<b>BALANCE AT DECEMBER 31, 2017</b>	<u>\$ 1,250,487</u>	<u>\$ 30,672</u>	<u>\$ 1,281,159</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Years Ended December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 177,514	\$ 146,953
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	25,231	25,939
Impairment of long-lived assets	61,980	35,424
Impairment of marketable securities	177	14,285
Impairment of goodwill	786	6,295
Bond amortization	12,450	11,622
Realized gains on securities	(358)	(1,140)
Changes in operating assets and liabilities		
Premium receivables	(13,506)	(26,348)
Other receivables	113	(2,810)
Other assets	(23,528)	(8,765)
Unpaid claims and claims adjustment expenses	14,041	47,478
Accounts payable and accrued expenses	76,911	22,017
Deferred revenue	4,387	7,393
Refundable group balances	(153,424)	118,922
Accrued retirement benefits	11,040	2,135
Other liabilities	98	1,333
Net cash provided by operating activities	<u>193,912</u>	<u>400,733</u>
<b>Cash flows from investing activities</b>		
Purchases of marketable securities	(205,321)	(179,468)
Redemptions of marketable securities	54,673	48,904
Issuance of notes receivable	(40,200)	(30,000)
Development and purchases of computer software systems	(21,705)	(30,957)
Purchases of property and equipment	(13,750)	(8,691)
Net cash used in investing activities	<u>(226,303)</u>	<u>(200,212)</u>
<b>Cash flows from financing activities</b>		
Receipt of borrowed money	<u>10,000</u>	<u>-</u>
Net increase (decrease) in cash and cash equivalents	(22,391)	200,521
Cash and cash equivalents, beginning of year	<u>803,486</u>	<u>602,965</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 781,095</u>	<u>\$ 803,486</u>
<b>Supplemental disclosure</b>		
Interest paid	<u>\$ 1,765</u>	<u>\$ 987</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**1. Nature of Organization**

Delta Dental of California (Delta, or with its subsidiaries, referred to as the Company), is a non-profit California corporation regulated by the Department of Managed Health Care (DMHC). Delta has ownership in the following companies listed in the table below:

<u>Company Name</u>	<u>% Ownership</u>
DDC Insurance Holdings, Inc. (DDCIH)	100.0%
Delta Dental of Puerto Rico, Inc. (DDPR)	64.0%
Celebration Dental Services (CDS)	100.0%

Delta has assigned all of its interests in certain subsidiaries to DDCIH in order for the subsidiaries to properly enter into a Federal Tax Sharing agreement for the preparation of a consolidated federal tax return. Those subsidiaries include:

<u>Company Name</u>	<u>% Ownership</u>
Delta Dental Insurance Company (DDIC)	91.1%
Dentegra Insurance Company (DIC)	100.0%
Dentegra Insurance Company of New England (DICNE)	100.0%
The Alphas:	
Alpha Dental Programs, Inc.	100.0%
Alpha Dental of Alabama, Inc.	100.0%
Alpha Dental of Arizona, Inc.	100.0%
Alpha Dental of Nevada, Inc.	100.0%
Alpha Dental of New Mexico, Inc.	100.0%
Alpha Dental of Utah, Inc.	100.0%
Allied Administrators, Inc. (Allied)	100.0%

DDCIH also holds 100% of the preferred stock of DDIC.

Delta, DDIC, DDPR and the Alphas underwrite and administer prepaid, cost reimbursement, and capitation dental care programs under agreements with various subscriber groups and individuals. DIC is a single license entity authorized to offer insurance products in fifty jurisdictions. DICNE is a single license entity authorized to do business in five jurisdictions. CDS operates dental offices in Celebration, Florida.

PaCa Management, LLC (PaCa) was formed on January 1, 1998 with capital contributions from Delta Dental of Pennsylvania (DDP) and Delta. As of December 31, 2016, PaCa was dissolved. DDP was appointed as the liquidating member as of the date of dissolution. The assets of PaCa have been liquidated and the settlement of affiliate receivables and payables occurred in January 2017. The remaining members' equity balance was distributed pro-rata in accordance with their capital account balances.



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**1. Nature of Organization (continued)**

On December 31, 2016, DDC agreed to pay \$8.4 million to acquire 100% of Allied. DDC in turn assigned its interest to DDCIH. Allied provides third party administrative services for employee health and benefit plans. Allied recorded goodwill of \$8.0 million arising from the acquisition.

The Company is a member of Dentegra Group Inc., a holding company with common management and control. These entities provide services to each other and charge fees for those services, and the Company's financial position and results of operations might be different if the entities operated as stand-alone entities.

**2. Summary of Significant Accounting Policies**

**Principles of consolidation and basis of presentation**

The consolidated financial statements include the accounts of Delta and all entities in which a controlling interest is held. All significant intercompany transactions and balances have been eliminated in consolidation.

**Revenue recognition**

The Company administers a variety of dental programs, with the major programs described as follows:

Retention/guaranteed administration

Under retention and guaranteed administration programs, the excess of subscriber premiums over dental claims and administrative fees is refundable to the subscriber group, whereas any excess of dental claims and administrative fees over subscriber premiums can be recovered from future premium rates or absorbed by the Company. Premium revenue is recognized during the coverage period.

Non-retention

Under non-retention programs, the Company retains any excess or absorbs any shortages incurred between subscriber premiums and dental claims incurred and administrative fees. Premium income is recognized during the coverage period.

Administrative services contracts (ASC)

Under ASC programs, the Company receives revenues from subscriber groups on a cost reimbursement basis plus administrative fees. The cost of the dental fees for these groups is charged as incurred and administrative fees are charged to the subscriber group based on a percentage of claims paid or a specific fee per eligible subscriber.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**2. Summary of Significant Accounting Policies (continued)**

**Revenue recognition (continued)**

Capitation

Under capitation programs, the Company receives premium revenues from groups and individuals, and contracts with certain providers for agreed upon procedures for enrollees. Capitation fees are paid to providers during the contract period and are expensed as incurred. Premium income is recognized during the coverage period.

**Cash and cash equivalents**

Cash and cash equivalents include demand deposits and short-term investments with original maturities of three months or less.

**Financial instruments and concentrations of credit risk**

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, cash equivalents, marketable securities and premium receivables. Cash and cash equivalents are maintained with high-credit quality financial institutions and, at times, may exceed federally insured amounts. The Company has not incurred any losses in such accounts. All investments are managed within established guidelines that limit the amounts that may be invested with one issuer.

**Marketable securities**

The Company classifies investments in debt securities as held-to-maturity and, as such, they are carried at amortized cost. Premiums and discounts are amortized over the life of the related securities as an adjustment to yield using the scientific (constant yield) interest method. Such amortization is included in investment income. Equity securities are classified as available-for-sale and are carried at fair value. Realized gains and losses on debt and equity securities are included in investment income using the specific identification method for determining the cost of securities sold. Dividend and interest income is recognized when earned.

A decline in the fair value of held-to-maturity securities and/or common stock below cost that are deemed to be other-than-temporary results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. The Company performs regular analysis of its investments to determine the need to record an impairment. The Company recorded an impairment charge of \$0.2 million and \$14.3 million at December 31, 2017 and 2016, respectively, and is included in investment income on the consolidated statements of income and expense.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**2. Summary of Significant Accounting Policies (continued)**

**Fair value measurements**

The Company applies the provisions of ASC No. 820, *Fair Value Measurements and Disclosures (ASC 820)*, which establishes a hierarchy for inputs used in measuring fair value, as follows:

Level 1 - Valuations are based on quoted market prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are readily and regularly available, valuation of Level 1 assets and liabilities does not require a significant degree of judgment. The Company considers U.S. Treasuries and equity securities as Level 1 assets.

Level 2 - Valuations are based on quoted prices for similar assets in active markets, or quoted prices in markets that are not active for which significant inputs are observable, either directly or indirectly. The Company considers U.S. Government agencies, municipal bonds, mortgage-backed securities, collateralized mortgage obligations, asset-backed securities, and corporate bonds as Level 2 assets. The Company currently does not own any assets measured as Level 2 assets.

Level 3 - Valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. The Company considers common stock that is not actively traded as Level 3 assets. Valuation is based on cost.

The Company's investments in fixed income and equity securities are valued through the use of nationally recognized pricing services by the custodian and investment managers. If the Company does not agree with the estimated price, the identified price will be verified by an independent pricing source or through performing independent valuations of inputs and assumptions similar to those used by the pricing service in order to determine prices represent a reasonable estimate of fair value. The Company made no significant adjustments to pricing as of December 31, 2017 or 2016.

**Premiums and other receivables**

Premiums and other receivables are monitored by management on an on-going basis and are written off by the Company when it has been determined that all available collection avenues have been exhausted. The allowance for doubtful accounts at December 31, 2017 and 2016 was \$10.4 million and \$10.5 million, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**2. Summary of Significant Accounting Policies (continued)**

**Property and equipment**

Property and equipment, including computer software systems, are carried at cost and depreciated by the straight-line method over the shorter of the estimated useful lives of the assets, ranging from three to ten years, or the lease term. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred; renewals, leasehold improvements and betterments are capitalized.

**Goodwill and other intangible assets**

Included in other assets are goodwill and intangible assets of \$8.5 million and \$1.3 million as of December 31, 2017 and 2016, respectively. These assets represent goodwill on the excess of the purchase price of DIC, DICNE and Allied over the net assets acquired. Under accounting guidance, the Company does not amortize goodwill and other intangible assets with indefinite lives, however, Delta reviews the assets for impairment at least annually and more frequently if material changes in events or circumstances arise. Based on the reviews performed, the Company recorded an impairment charge of \$0.8 million and \$6.3 million to goodwill at December 31, 2017 and 2016, respectively.

**Long-lived assets**

The Company reviews long-lived assets held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The Company recorded an impairment charge of \$62.0 million and \$35.4 million at December 31, 2017 and 2016, respectively.

**Deferred compensation plans**

Delta provides deferred compensation plans, other than pension plans, for Delta dentists. Investments and liabilities related to these programs consist of participant contributions and investment income. Contributions to the dentists' plan were discontinued in 1992.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**2. Summary of Significant Accounting Policies (continued)**

**Liability for unpaid claims and claims adjustment expenses**

Liability for unpaid claims represents estimated unpaid dental services rendered and reported to the Company, as well as a provision for dental claims incurred but not reported prior to the end of the year. The provision is actuarially determined based upon claims experience. The provision for claims incurred but not reported amounted to \$322.2 million and \$342.9 million at December 31, 2017 and 2016, respectively. Claims adjustment expenses related to unpaid claims are accrued based on an estimate of expenses to adjudicate and pay such claims. Claims adjustment expenses are reflected in operating expenses.

While management believes that the liability for unpaid claims and claims adjustment expenses at December 31, 2017 and 2016 is adequate to cover the ultimate net cost of claims, the liability is based on estimates and the amount ultimately paid may be more or less than the estimates. Adjustments and changes resulting from revisions of these estimates are reported in the period in which the revisions are made.

**Deferred revenue**

Premiums received in advance for the unexpired contractual coverage periods are reflected in the accompanying consolidated balance sheets as deferred revenue.

**Refundable group balances**

Certain contracts provide that dues received in excess of claims incurred and administrative fees are either refundable to the groups at the expiration of the agreements or applied against future dues payments.

**Pension and other post-retirement benefits**

The Company provides a range of benefits to eligible and retired employees, including pensions and post-retirement healthcare. The Company records annual amounts relating to these plans based on calculations which include various actuarial assumptions such as discount rates, expected rates of return on plan assets, compensation increases, turnover rates and healthcare cost trend rates. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when appropriate. As required, the effect of the modifications is generally amortized over future periods.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**2. Summary of Significant Accounting Policies (continued)**

**Income tax status**

Delta is a tax-exempt organization organized under Section 501(c)(4) of the Internal Revenue Code and, as such, no provision for income taxes has been made in the financial statements.

Subsidiaries of DDCIH are included in a consolidated federal income tax return with DDCIH. A Federal Tax Sharing agreement sets forth the manner in which the total combined federal income tax is allocated to each entity which is party to the consolidation. Pursuant to this agreement each party has an enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes. In accordance with accounting guidance, current and deferred taxes are allocated to members of the consolidated group using the separate return allocation method. Income tax expense for the years ended December 31, 2017 and 2016 was \$18.1 million and \$19.1 million, respectively, and is included in operating expenses on the consolidated statements of income and expense.

For subsidiaries of DDCIH, deferred tax provisions and benefits are calculated for certain transactions and events because of differing treatments between generally accepted accounting principles and the currently enacted tax laws. The effects of these differences on a cumulative basis result in the recognition and measurement of the deferred tax assets and liabilities. Net deferred tax assets in the amount of \$1.7 million and \$2.2 million at December 31, 2017 and 2016, respectively, are included in other assets on the consolidated balance sheets. Deferred tax liabilities in the amount of \$2.8 million and \$2.2 million at December 31, 2017 and 2016, respectively, are included in accounts payable and accrued expenses on the consolidated balance sheets.

On December 22, 2017, the Tax Cut and Jobs Act of 2017 (the Act) was signed into law, making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a federal corporate rate decrease from 35% to 21% for tax years beginning after December 31, 2017, the transition of U.S. international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of foreign earnings. We have calculated our provision for income taxes in accordance with the Act and available guidance and have recorded \$0.5 million as additional income tax benefit as of the end of 2017 related to the remeasurement of certain deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future.

Current accounting guidance clarifies how uncertainties in tax positions are recognized in an entity's financial statements. The guidance prescribes a recognition threshold and measurement process for tax positions taken or expected to be taken in a tax return. Positions include those with respect to Delta's tax exempt status and income taxes on unrelated business income. The Company has determined that such tax positions do not result in uncertainties requiring recognition.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**2. Summary of Significant Accounting Policies (continued)**

**Estimates and assumptions**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as revenues and expenses reported for the periods presented. The Company regularly assesses these estimates and, while actual results may differ, management believes these estimates are reasonable.

**Comprehensive income (loss)**

Accumulated other comprehensive income (loss) of the Company consists of net unrealized gains or losses on equity securities and adjustments to pension and other post-retirement benefit plans.

**Subsequent events**

The Company has evaluated subsequent events through April 6, 2018, the date the consolidated financial statements were available to be issued. As of April 6, 2018, the Company did not have any subsequent events that require recognition or disclosure.

**Reclassification**

Certain reclassifications have been made to prior year balances to conform with current year presentation.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**3. Marketable Securities**

The following tables (in thousands) set forth the amortized cost, unrealized gains and losses, and fair value for debt and equity securities:

	December 31, 2017			
	Cost	Unrealized		Fair Value
		Gains	Losses	
Held-to-maturity				
Debt securities				
Corporate & municipalities	\$ 947,521	\$ 8,858	\$ 2,554	\$ 953,825
U.S. government & agencies	24,023	155	174	24,004
Mortgage backed	23,156	1,027	82	24,101
Foreign government	14,435	-	246	14,189
Certificate of deposits	1,050	-	-	1,050
	<u>1,010,185</u>	<u>10,040</u>	<u>3,056</u>	<u>1,017,169</u>
Available-for-sale				
Equity securities	145,296	79,592	2	224,886
Common stock	18,910	-	-	18,910
	<u>164,206</u>	<u>79,592</u>	<u>2</u>	<u>243,796</u>
	<u>\$ 1,174,391</u>	<u>\$ 89,632</u>	<u>\$ 3,058</u>	<u>\$ 1,260,965</u>
	December 31, 2016			
	Cost	Unrealized		Fair Value
		Gains	Losses	
Held-to-maturity				
Debt securities				
Corporate & municipalities	\$ 837,936	\$ 7,209	\$ 4,824	\$ 840,321
U.S. government & agencies	25,622	347	84	25,885
Mortgage backed	12,326	1,101	47	13,380
Foreign government	11,774	8	246	11,536
Certificate of deposits	950	-	-	950
	<u>888,608</u>	<u>8,665</u>	<u>5,201</u>	<u>892,072</u>
Available-for-sale				
Equity securities	130,905	48,004	288	178,621
Common stock	16,500	-	-	16,500
	<u>147,405</u>	<u>48,004</u>	<u>288</u>	<u>195,121</u>
	<u>\$ 1,036,013</u>	<u>\$ 56,669</u>	<u>\$ 5,489</u>	<u>\$ 1,087,193</u>



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**3. Marketable Securities (continued)**

The contractual maturities of debt securities at December 31, 2017 are summarized in the table (in thousands) below:

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due within one year	\$ 62,638	\$ 62,820
Due after one year through five years	590,271	595,490
Due after five years through ten years	<u>357,276</u>	<u>358,859</u>
	<u>\$ 1,010,185</u>	<u>\$ 1,017,169</u>

In May 2017, DDIC began a leveraged investment funding agreement with Federal Home Loan Bank of Pittsburgh (FHLB) to expand investment funding capabilities. Ownership within the FHLB provided DDIC with the ability to borrow up to \$10.0 million in additional investment funding. On May 16, 2017, DDIC finalized a \$10.0 million secured loan obligation with interest rate of 2.2% and a maturity of May 16, 2022. Investments with a book value of \$11.4 million are held as collateral on this arrangement. These collateralized investments are recorded in debt securities and cash and are not under the exclusive control of DDIC.

**4. Fair Value**

The following table (in thousands) reflects the major categories of assets measured at fair value on a recurring basis during the years ended December 31, 2017 and 2016. The Company currently does not own assets measured by significant other inputs (Level 2):

	<u>Level 1: Quoted For Identical Assets</u>	<u>Level 3: Significant Unobservable Inputs</u>	<u>Total at December 31, 2017</u>
Available-for-sale securities	<u>\$ 224,886</u>	<u>\$ 18,910</u>	<u>\$ 243,796</u>
	<u>Level 1: Quoted For Identical Assets</u>	<u>Level 3: Significant Unobservable Inputs</u>	<u>Total at December 31, 2016</u>
Available-for-sale securities	<u>\$ 178,621</u>	<u>\$ 16,500</u>	<u>\$ 195,121</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**4. Fair Value (continued)**

Realized gains included in earnings for the year ended December 31, 2017 and 2016 are reported in investment income as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Realized gains, net	\$ 358	\$ 1,140

**5. Property and Equipment**

Property and equipment as of December 31 are summarized in the table (in thousands) below:

	<u>2017</u>	<u>2016</u>
Leasehold improvements	\$ 30,875	\$ 35,736
Computer equipment and office furniture	56,941	97,260
Computer software systems	<u>234,047</u>	<u>388,863</u>
	321,863	521,859
Less accumulated depreciation and amortization	<u>(194,040)</u>	<u>(342,280)</u>
Property and equipment, net	<u>\$ 127,823</u>	<u>\$ 179,579</u>

Depreciation and amortization expense for 2017 and 2016 was \$25.2 million and \$25.9 million, respectively. In 2017, Delta disposed of and/or retired \$173.5 million of fully depreciated assets due to removal from service.

**6. Commercial, State and Federal Programs and Reinsurance**

The State of California awarded Delta the Medi-Cal dental risk contract (Denti-Cal). The Contract is a four-year contract through June 30, 2009 with multiple extensions granted in 2012, 2013, 2015 and 2016 to bring the contract date through June 30, 2017. In 2017, this contract was again extended until January 28, 2018.

The terms of the Denti-Cal contract, including extensions, limit Delta's annual underwriting gain or loss to \$4.65 million. Delta is also required to maintain a minimum tangible net equity balance, as defined in the contract, of \$148.9 million and \$143.6 million for 2017 and 2016, respectively. Delta is also required to maintain segregated investments of \$39.3 million and \$39.9 million for 2017 and 2016, respectively, and a letter of credit of \$5.0 million. Delta was in compliance with these contract requirements during 2017 and 2016. Denti-Cal revenues, included in State programs, were \$981.7 million and \$989.9 million and incurred claims were \$872.5 million and \$893.4 million for the years ended December 31, 2017 and 2016, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**6. Commercial, State and Federal Programs and Reinsurance (continued)**

On October 14, 2016, the State of California awarded Delta the Medi-Cal dental administrative services only (ASO) contract. Takeover began on December 1, 2016 with operations under the new contract starting on January 29, 2018. The ASO contract expires on November 30, 2019 with five one-year renewal options.

Delta also provides dental services to multiple county programs within the State of California with varying contract terms. The combined program revenues included in State programs were \$0.7 million and \$1.1 million and incurred claims were \$0.3 million and \$0.6 million for the years ended December 31, 2017 and 2016, respectively.

DDIC and the State of Utah Department of Health entered into a dental services contract to provide insurance under the Utah Medicaid Dental Services program through June 30, 2015, with two one-year extension options. In December 2015, the contract was extended through August 31, 2018. DDIC entered into a quota share reinsurance agreement with Delta. Under this agreement, 90% of the risk associated with the underwriting of the Utah Medicaid Dental Services contract was ceded to Delta. Utah Medicaid revenues, included in State programs, were \$16.0 million and \$13.7 million and incurred claims were \$15.1 million and \$13.8 million for the years ended December 31, 2017 and 2016, respectively.

Delta contracts with the United States Department of Defense (DOD) to provide dental benefits to retirees of the uniformed services and their dependents through a five-year contract expiring on December 31, 2018. The contract is underwritten and administered by Delta through risk sharing and administrative agreements. The Company maintains risk sharing agreements with Federal Marketing Group partners (Delta Dental Plan Association members). Under these agreements, the Company records 100% of the contract activity, retains 40.36% of the risk and provisions the remaining 59.64% of the risk to non-enterprise risk-share partners. The program revenues included in Federal programs were \$595.1 million and \$552.5 million and incurred claims were \$545.5 million and \$512.6 million for the years ended December 31, 2017 and 2016, respectively.

The Company has a multi-state dental contract with the AARP Dental Insurance Trust to provide dental insurance for AARP members. The contract covers all fifty states, Puerto Rico and the U.S. Virgin Islands and expires on December 31, 2019. Direct underwriting by selective state is assigned among DDIC, DIC and DICNE with Delta providing operational and administrative services for this contract. Delta has also entered into a 56% quota share reinsurance agreement with DDIC, DIC and DICNE. In addition, DDIC, DIC, and DICNE have each entered into a 33% and 10% quota share reinsurance agreement with Hannover Life and Reassurance Company of America (HLRC) and Renaissance Life and Health Insurance Company of America (RLHIC), respectively. As part of this agreement, Delta maintains a trust account balance for the purpose of collateralization of the reinsurance credit. The AARP program revenues included in Commercial programs were \$197.5 million and \$187.3 million and incurred claims of \$90.3 million and \$86.7 million for the years ended December 31, 2017 and 2016, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**6. Commercial, State and Federal Programs and Reinsurance (continued)**

DDIC and DIC entered into separate contracts with the United States Office of Personnel Management (OPM) to offer benefits in the Federal Employees Dental and Vision Insurance Program (FEDVIP) and with the United States Department of Veteran Affairs (VA) to provide dental benefits in the Veteran Affairs Dental Insurance Program (VADIP). The FEDVIP and VADIP contracts expire on December 31, 2020 and December 31, 2017, respectively. The VADIP contract has four one-year extension options and has exercised one of those options extending the contract through December 31, 2018. Direct underwriting by selective states and territories is assigned among DDIC and DIC. Delta provides operational and administrative services for these contracts. DDIC and DIC entered into reinsurance agreements with Delta to cede 100% of the risk associated with the underwriting for these programs. Delta entered into risk sharing agreements with Federal Marketing Group partners. Under this contract, Delta records 100% of the contract activity, retains 33.82% of the risk and provisions the remaining 66.18% of the risk to non-enterprise risk-share partners. FEDVIP program revenues, included in Federal programs, were \$75.9 million and \$56.9 million and incurred claims of \$64.3 million and \$47.7 million for the years ended December 31, 2017 and 2016, respectively. VADIP program revenues, included in Federal programs, were \$21.9 million and \$21.5 million and incurred claims of \$16.8 million and \$16.7 million, for the years ended December 31, 2017 and 2016, respectively.

On January 1, 2015, DDIC entered into a contract through December 31, 2015 with nine one-year renewal options with the Office of the Comptroller of the Currency (OCC) to offer benefits to the employees, retirees and their eligible dependents. OCC has exercised three of the one-year renewal options extending the contract through December 31, 2018. DDIC entered into a reinsurance agreement to cede 100% of premiums earned less administrative fees and claims incurred to Delta. OCC program revenues, included in Federal programs, were \$4.7 million and \$4.3 million and incurred claims of \$4.1 million and \$3.9 million years ended December 31, 2017 and 2016, respectively.

DDIC maintains a quota share reinsurance agreement with DRC of which DDIC owns a 5.93% minority share. Under the terms of this agreement, DDIC cedes 90% of all premiums earned less administrative fees and claims incurred for business written in the State of New York and the District of Columbia. Ceded premiums were \$9.9 million and \$10.9 million and ceded claims were \$9.7 million and \$10.8 million, for the years ended December 31, 2017 and 2016, respectively.

Additionally, DDIC has a reinsurance deposit in the amount of \$1.0 million from DRC for the maintenance of a statutory net credit for unauthorized reinsurance. The deposit bears interest at the lesser of the Prime Rate on the applicable date or the same rate payable on the first six-month U.S. Treasury Bill issued during each quarter. Interest paid to DRC was minimal in 2017 and 2016. The deposit amount is included in other liabilities.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**6. Commercial, State and Federal Programs and Reinsurance (continued)**

Amounts ceded by reinsurance contracts do not relieve the underwriting company from its obligations to policy holders. Failure of reinsurers to honor their obligations could result in losses to the company. Each company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities and economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

**7. Liability for Unpaid Claims and Claims Adjustment Expenses**

Activity in the liability for unpaid claims and claims adjustment expenses is summarized in the table below (in thousands):

	<u>2017</u>	<u>2016</u>
Balance, beginning of year	\$ 430,689	\$ 383,693
Incurred related to:		
Current year	6,869,105	6,533,264
Prior years	<u>(17,359)</u>	<u>2,250</u>
	<u>6,851,746</u>	<u>6,535,514</u>
Paid related to:		
Current year	6,423,504	6,102,575
Prior years	<u>413,330</u>	<u>385,943</u>
	<u>6,836,834</u>	<u>6,488,518</u>
Balance, end of year	445,601	430,689
Unpaid claims adjustment expenses	<u>6,828</u>	<u>7,699</u>
Total unpaid claims and claims adjustment expenses	452,429	438,388
Ceded claims unpaid	<u>5,278</u>	<u>5,802</u>
Gross unpaid claims and claims adjustment expenses	<u>\$ 457,707</u>	<u>\$ 444,190</u>

As a result of actual claims of prior years' experience differing from estimated amounts of insured events provided for at the beginning of the respective years, the liability for unpaid claims decreased by \$17.4 million and increased by \$2.3 million in 2017 and 2016, respectively. The Company retains the risk and received the benefit of \$3.7 million and \$7.0 million from these reserve changes for December 31, 2017 and 2016, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**8. Commitments and Contingencies**

The Company has operating leases for office facilities, equipment and computer hardware. Future minimum lease payments required under these agreements are summarized in the table below (in thousands):

<u>Year Ending December 31</u>	
2018	\$ 22,283
2019	20,669
2020	20,262
2021	13,611
2022	12,429
Thereafter	<u>51,578</u>
	<u>\$ 140,832</u>

Rental expense, including software licensing fees, was \$27.4 million and \$26.9 million in 2017 and 2016, respectively.

Lease payments for Dentegra Seguros Dentales S.A. (DSD) and Servicios Dentales Dentegra S.A. de C.V. (SDD), Mexican corporations and subsidiaries of DIC, are guaranteed by DDP. Future minimum lease payments and the term of the guarantee agreements are summarized in the table below (in thousands):

<u>Lessee</u>	<u>End of Guarantee</u>	<u>Term</u>	<u>Annual Rent</u>
DSD	7/31/2019	5 years	\$ 900
DSD	1/1/2021	5 years	\$ 228
SDD	12/31/2022	6 years	\$ 84
SDD	1/1/2026	10 years	\$ 96

These guarantees shall remain in full force and effect until the earliest date on which: (i) the term of the lease; (ii) all of the guaranteed obligations have been completely performed and paid in full, or (iii) a replacement guarantor shall have assumed all the rights and obligations of guarantor under this guaranty with prior written consent from lessor. DSD and SDD are current in all lease payments at December 31, 2017 and 2016.

Delta maintained a \$50.0 million unsecured revolving bank line of credit with applicable interest rate indexed to one month LIBOR plus 1.50% per annum. DDIC maintained a \$10.0 million unsecured revolving bank line of credit with an interest rate indexed to one month LIBOR plus 1.50% per annum. There were no outstanding balances at December 31, 2017 and 2016. Celebration maintained a \$1.0 million bank line of credit with an interest rate indexed to one month LIBOR plus 2.00% per annum. These lines of credit are used for periodic short-term cash flow requirements. The outstanding balances were \$0.6 million at December 31, 2017 and 2016.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**8. Commitments and Contingencies (continued)**

In addition to the \$5.0 million unsecured letter of credit maintained for the Denti-Cal contract (Note 6), Delta maintained credit facilities (unsecured letters of credit) of \$24.0 million with \$6.3 million and \$7.3 million outstanding at December 31, 2017 and 2016, respectively.

**9. Notes Receivable**

On November 15, 2015, Delta issued a \$20.0 million note receivable to Moda, Inc. (Moda), an affiliate of Oregon Dental Services (a Delta Dental Plan Association member) with an interest rate of 6.5% per annum payable within thirty calendar days of the close of the prior calendar year. All unpaid principal together with accrued and unpaid interest are due on November 15, 2020 unless Delta agrees to a later maturity date. Due to the uncertainty regarding the status of Moda's cash position and certain requirements placed on Moda by the Oregon Department of Insurance, a \$10.0 million allowance was established in 2015.

On May 16, 2016, Delta issued an additional \$30.0 million note receivable to Moda with an interest rate of 15.0% per annum with a maturity date of May 16, 2019 or earlier. Accrued interest shall be due and payable on the first day of each calendar month. Unpaid interest shall be added to the then-outstanding principal balance of the note and shall thereafter bear interest as noted above.

On June 29, 2017, Delta issued an additional \$30.0 million note receivable to Moda with an interest rate of 6.3% per annum payable within thirty calendar days of the anniversary date of the note. All unpaid principal together with accrued and unpaid interest are due on November 15, 2020 unless Delta agrees to a later maturity date.

On June 29, 2017, Delta issued a \$10.0 million note receivable to Dental Commerce Corporation with an interest rate of 5.0% per annum payable within thirty calendar days of the anniversary date of the note. All unpaid principal with accrued and unpaid interest are due on November 15, 2020 unless Delta agrees to a later maturity date. On February 8, 2018, principal and accrued interest of \$10.3 million was paid.

**10. Related Party Transactions**

DDP performs claims processing functions for DDC under an administrative services agreement. The Company paid DDP \$8.7 million for processing functions for both 2017 and 2016.

In accordance with an administrative services agreement for the AARP contract, Delta reimburses DDP for 100% of the pooled administrative costs incurred by DDP. The Company paid DDP \$2.8 million and \$2.9 million for 2017 and 2016, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**10. Related Party Transactions (continued)**

The amounts payable to affiliates for administrative services at December 31, 2017 and 2016 was \$1.8 million and \$2.1 million, respectively.

The Company performs certain computer and other administrative support services under the administrative services agreements with DDP and its affiliates. The Company recorded \$12.6 million and \$13.3 million in cost reimbursements in 2017 and 2016, respectively. The amounts receivable from affiliates for these administrative services at December 31, 2017 and 2016 was \$3.6 million and \$4.1 million, respectively.

Prior to the dissolution of PaCa, DDP charged administrative expenses and interest expense to PaCa, based on an allocation of actual expenses, for the performance of certain functions for PaCa, DDNY, DDDC, and the state of Maryland programs. Administrative expenses and interest expense charged by DDP, included within operating expenses, was \$33.1 million for the year ended December 31, 2016.

In addition to the allocation of expenses from DDP, PaCa covered certain direct costs incurred by DDNY and DDDC. The amounts incurred included within operating expenses, was \$0.6 million in 2016.

The amount receivable from affiliates for PaCa activity at December 31, 2016 was \$2.7 million. The amount payable to affiliates related to PaCa activity was \$2.4 million at December 31, 2016.

Receivables from affiliates are included in other receivables and payables to affiliates are included in accounts payable and accrued expenses on the consolidated balance sheets. Related party (affiliate) transactions are settled on a monthly basis through intercompany cash transfers.

**11. Minimum Tangible Net Equity and Capital and Surplus Requirements**

Under the requirements of the DMHC, Delta is required to maintain a minimum tangible net equity balance, as defined by the DMHC, of \$116.6 million and \$113.1 million at December 31, 2017 and 2016, respectively. Delta's tangible net equity balance was \$1.05 billion and \$898.4 million at December 31, 2017 and 2016, respectively, and exceeded the DMHC's requirements.

At December 31, 2017 and 2016, Delta's subsidiaries exceed minimum capital and surplus requirements under the insurance code respective to the state where they are domiciled.



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**12. Employee Benefit Plans**

The Company sponsors various plans for their employees. These plans include a qualified cash balance defined benefit pension plan and a post-retirement health benefit plan. The Company also maintains a non-qualified, defined benefit plan, Executive Supplemental Pension Plan (ESPP), for certain members of management. The ESPP is unfunded, however the Company has established a rabbi trust which protects the interest of the plan participants.

The Company's post-retirement health benefit plan is offered to eligible retired employees and their survivors. The plan is unfunded and claims are paid from Company funds.

The Company recognized other comprehensive income of \$1.4 million and \$3.6 million for the years ended December 31, 2017 and 2016, respectively, due to pension and post-retirement adjustments.

The Company participates in a 401(k) Plan (the Plan) that is available to all employees. Employees may contribute up to 50% of compensation to the Plan up to the maximum allowed by law and the Company will match 50% of the employees' contributions to the Plan up to 6% of eligible compensation, which is limited to \$270,000 and \$265,000 for the years ended December 31, 2017 and 2016, respectively. The annual expense for the Plan was \$3.8 million and \$3.4 million, respectively, for the years ended December 31, 2017 and 2016. The Company may elect to make discretionary contributions to the Plan. The Company elected to reserve for a discretionary contribution in the amount of \$0 and \$10.7 million at December 31, 2017 and 2016, respectively.

The Company participates in a qualified cash balance defined benefit plan (the Cash Balance Plan). On January 1, 2013 (for non-union employees) and January 31, 2014 (for union employees), the Cash Balance Plan was frozen to new contributions and replaced with a 7.5% and 6.0% contribution for 2017 and 2016, respectively, to the 401(k) Plan mentioned above with contributions of \$15.5 million and \$11.9 million for the years ended December 31, 2017 and 2016, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**12. Employee Benefit Plans (continued)**

The following tables (in thousands) set forth the combined plans' total projected benefit obligations, weighted average assumptions used to determine the benefit obligation, fair value of plan assets, and the funded status as of the measurement date of September 30.

	Pension		Post-Retirement Health	
	2017	2016	2017	2016
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of year	\$ 174,277	\$ 178,583	\$ 28,779	\$ 27,148
Service cost	601	760	773	813
Interest cost	5,301	5,717	1,190	1,197
Actuarial (gain)/loss	9,925	746	1,624	509
Gross benefits paid	(312)	(251)	(935)	(888)
Administrative expenses paid	(125)	(118)	-	-
Plan change	-	-	-	-
Settlements	(13,889)	(11,160)	-	-
Benefit obligation, end of year	<u>\$ 175,778</u>	<u>\$ 174,277</u>	<u>\$ 31,431</u>	<u>\$ 28,779</u>
Accumulated benefit obligation, end of year	<u>\$ 167,068</u>	<u>\$ 163,390</u>	<u>N/A</u>	<u>N/A</u>
<b>Weighted-average assumptions used to determine benefit obligation at end of year:</b>				
Qualified plan				
- Discount rate	3.22%	3.47%	3.61%	4.09%
- Rate of compensation increase	N/A	N/A	N/A	N/A
Non-qualified plan				
- Discount rate	2.66%	2.85%	N/A	N/A
- Rate of compensation increase	Various	Various	N/A	N/A
Cash balance interest credit rate	1.39%	0.58%	N/A	N/A
Health care cost trend rate				
- Initial rate	N/A	N/A	6.75%	7.00%
- Ultimate rate	N/A	N/A	5.00%	5.00%
- Years to ultimate	N/A	N/A	7	8
Effect of one-percentage point change in assumed health care cost trend rate on post retirement obligation				
- Increase	N/A	N/A	\$ 170	\$ 194
- Decrease	N/A	N/A	\$ (138)	\$ (159)
<b>Change in plan assets</b>				
Fair value of plan assets, beginning of year	\$ 131,773	\$ 133,016	\$ -	\$ -
Actual return on plan assets	18,910	10,223	-	-
Employer contributions	62	63	(935)	(888)
Gross benefits paid	(313)	(251)	935	888
Settlements	(13,889)	(11,160)	-	-
Administrative expenses paid	(125)	(118)	-	-
Fair value of plan assets, end of year	<u>\$ 136,418</u>	<u>\$ 131,773</u>	<u>\$ -</u>	<u>\$ -</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**12. Employee Benefit Plans (continued)**

The following tables (in thousands) provide the amounts recognized in the consolidated balance sheets as of December 31:

	Pension		Post-Retirement Health	
	2017	2016	2017	2016
<b>Funded status, end of year</b>				
Fair value of plan assets	\$ 136,418	\$ 131,773	\$ -	\$ -
Benefit obligations	<u>(175,778)</u>	<u>(174,277)</u>	<u>(31,431)</u>	<u>(28,779)</u>
Funded status	<u>\$ (39,360)</u>	<u>\$ (42,504)</u>	<u>\$ (31,431)</u>	<u>\$ (28,779)</u>
<b>Amounts recognized in the consolidated balance sheets:</b>				
Asset	\$ 10,176	\$ -	\$ -	\$ -
Liability	<u>(49,536)</u>	<u>(42,504)</u>	<u>(31,431)</u>	<u>(28,779)</u>
	<u>\$ (39,360)</u>	<u>\$ (42,504)</u>	<u>\$ (31,431)</u>	<u>\$ (28,779)</u>
<b>Accumulated other comprehensive loss:</b>				
Prior service cost/(credit)	\$ 2,075	\$ 1,243	\$ (841)	\$ (4,076)
Unamortized net loss	<u>38,425</u>	<u>44,999</u>	<u>9,259</u>	<u>8,107</u>
Accumulated other comprehensive loss	<u>\$ 40,500</u>	<u>\$ 46,242</u>	<u>\$ 8,418</u>	<u>\$ 4,031</u>

The following table provides the asset allocation by asset category for the years ending December 31, along with the target allocation:

The following table provides the asset allocation by asset category for the years ending December 31, along with the target allocation for 2015 and 2014:

	Target Allocation		Actual Allocation	
	2017	2016	2017	2016
Equity securities/ liability-hedging assets	70%	50%	66%	53%
Debt securities/ return-seeking assets	30%	46%	29%	43%

The investment policy for the Cash Balance Plan was revised in 2017 requiring an allocation of 70% liability-hedging assets and 30% return-seeking assets.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**12. Employee Benefit Plans (continued)**

The following tables (in thousands) provide the components of net periodic cost (benefit) and the weighted-average assumptions used to determine net periodic cost (benefit) for the years ending December 31:

|The following tables (in thousands) provide the components of net periodic costs and the

	Pension		Post-Retirement Health	
	2017	2016	2017	2016
<b>Components of net periodic cost (benefit):</b>				
Service cost	\$ 601	\$ 760	\$ 773	\$ 813
Interest cost	5,301	5,717	1,190	1,197
Expected return on plan assets	(8,809)	(9,031)	-	-
Amortization:				
Actuarial loss	4,884	5,286	473	486
Prior service credit	(831)	(831)	(3,235)	(3,234)
Settlement loss	1,514	1,925	-	-
Net periodic cost (benefit)	\$ 2,660	\$ 3,826	\$ (799)	\$ (738)

**Weighted-average assumptions used to determine net periodic cost (benefit):**

Qualified plan				
- Discount rate	3.47%	3.55%	4.09%	4.35%
- Rate of compensation increase	N/A	N/A	N/A	N/A
Non-qualified plan				
- Discount rate	2.85%	3.04%	N/A	N/A
- Rate of compensation increase	Various	4.50%	N/A	N/A
Expected long-term rate of return on plan assets	7.50%	7.50%	N/A	N/A
Cash balance interest credit rate:				
- Increases for deferred benefits	2.80%	2.86%	N/A	N/A
- Increases for in-payment benefits	1.39%	0.58%	N/A	N/A
Health care cost trend rate				
- Initial rate	N/A	N/A	7.00%	7.25%
- Ultimate rate	N/A	N/A	5.00%	5.00%
- Year of ultimate trend rate	N/A	N/A	2024	2024
Effect of one-percentage point change in assumed health care cost trend rate on aggregate service and interest cost (in thousands)				

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2017 and 2016

**12. Employee Benefit Plans (continued)**

The following table (in thousands) provides information about the expected cash flows for the years ending December 31:

	<u>Pension</u>	<u>Post-Retirement Health</u>
<b>Expected cash flows:</b>		
Expected employer contributions	\$ 180	\$ 968
Expected benefits payments		
2018	\$ 26,901	\$ 968
2019	\$ 11,934	\$ 1,041
2020	\$ 11,050	\$ 1,104
2021	\$ 10,589	\$ 1,181

**13. Mexico Operations**

In order to meet the need for cross border access to dental care, Delta has been authorized by its Board to fund the formation of a Mexican specialized health insurer in an amount not to exceed \$26.0 million less any amount funded by DDP. To date, funding of \$21.3 million has been provided. DIC holds a 100% interest in Dentegra Insurance Holdings, LLC (DIH), a Delaware limited liability corporation. DIC also holds a 99% interest in DSD with the remaining 1% held by DIH. DSD underwrites and administers dental insurance contracts in Mexico. DIC also has a 98% interest in SDD. SDD provides administrative services to DSD, as well as operates dental clinics in Mexico. DIH holds the remaining 2% of SDD.

**SUPPLEMENTARY INFORMATION**



INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Directors of  
Delta Dental of California  
San Francisco, California

We have audited the consolidated financial statements of Delta Dental of California, as of and for the years ended December 31, 2017 and 2016, and our report thereon dated April 6, 2018, which expressed an unmodified opinion on those financial statements, appears on page 1. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, and results of operations of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 consolidated financial statements as a whole.

A handwritten signature in cursive script that reads "Armanino LLP".

Armanino<sup>LLP</sup>  
San Francisco, California

April 6, 2018

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING BALANCE SHEETS**  
(In thousands)

	December 31, 2017									December 31, 2016	
	DDC	DDIC	DIC	DICNE	Alphas	DDPR	CDS	Allied	Eliminations	Consolidated	Consolidated
<b>ASSETS</b>											
Cash and cash equivalents	\$ 609,367	\$ 57,510	\$ 54,554	\$ 5,207	\$ 20,028	\$ 17,146	\$ 220	\$ 17,063	\$ -	\$ 781,095	\$ 803,486
Marketable securities	1,061,339	168,009	5,795	1,286	9,354	8,198	-	-	-	1,253,981	1,083,729
	<u>1,670,706</u>	<u>225,519</u>	<u>60,349</u>	<u>6,493</u>	<u>29,382</u>	<u>25,344</u>	<u>220</u>	<u>17,063</u>	<u>-</u>	<u>2,035,076</u>	<u>1,887,215</u>
Premiums and other receivables											
Premium receivables	250,285	104,025	13,390	6	1,031	3,037	-	-	(10,216)	361,558	348,052
Other receivables	72,050	13,966	14,378	222	2,937	272	299	39	(68,154)	36,009	36,122
	<u>322,335</u>	<u>117,991</u>	<u>27,768</u>	<u>228</u>	<u>3,968</u>	<u>3,309</u>	<u>299</u>	<u>39</u>	<u>(78,370)</u>	<u>397,567</u>	<u>384,174</u>
Property and equipment, net	123,260	1,258	2,323	-	-	205	441	336	-	127,823	179,579
Deferred compensation plans investments	32,930	-	-	-	-	-	-	-	-	32,930	34,508
Notes receivable	185,950	-	-	-	-	-	-	-	(105,750)	80,200	40,000
Other assets	194,149	9,756	2,810	445	30	416	52	8,205	(156,299)	59,564	36,822
<b>TOTAL ASSETS</b>	<u>\$ 2,529,330</u>	<u>\$ 354,524</u>	<u>\$ 93,250</u>	<u>\$ 7,166</u>	<u>\$ 33,380</u>	<u>\$ 29,274</u>	<u>\$ 1,012</u>	<u>\$ 25,643</u>	<u>\$ (340,419)</u>	<u>\$ 2,733,160</u>	<u>\$ 2,562,298</u>
<b>LIABILITIES, CAPITAL AND GENERAL RESERVES</b>											
<b>Liabilities</b>											
Unpaid claims and claims adjustment expenses	\$ 347,183	\$ 99,202	\$ 1,959	\$ 3	\$ 2,242	\$ 1,840	\$ -	\$ -	\$ -	\$ 452,429	\$ 438,388
Accounts payable and accrued expenses	247,034	81,906	30,737	585	3,070	2,715	1,035	16,793	(62,540)	321,335	244,424
Deferred revenue	79,844	4,114	848	7	2,043	66	-	-	-	86,922	82,535
Refundable group balances	447,440	372	30	-	-	-	-	-	-	447,842	601,266
Deferred compensation plans	32,930	-	-	-	-	-	-	-	-	32,930	34,508
Accrued retirement benefits	80,967	-	-	-	-	-	-	-	-	80,967	71,283
Notes payable	-	45,750	60,000	-	-	-	-	-	(105,750)	-	-
Loan payable	-	10,000	-	-	-	-	-	-	-	10,000	-
Other liabilities	12,773	3,872	-	-	-	2,350	581	-	-	19,576	19,478
Total liabilities	<u>1,248,171</u>	<u>245,216</u>	<u>93,574</u>	<u>595</u>	<u>7,355</u>	<u>6,971</u>	<u>1,616</u>	<u>16,793</u>	<u>(168,290)</u>	<u>1,452,001</u>	<u>1,491,882</u>
<b>Capital and general reserves</b>											
General reserves	1,250,487	83,601	(25,256)	121	21,667	5,052	(1,054)	470	(84,601)	1,250,487	1,072,973
Accumulated other comprehensive income (loss)	30,672	6,262	(4,595)	-	-	240	-	-	(1,907)	30,672	(2,557)
Preferred stock	-	10,500	-	-	-	-	-	-	(10,500)	-	-
Common stock	-	1,647	2,600	2,000	33	8,000	450	150	(14,880)	-	-
Additional paid-in capital	-	7,298	26,927	4,450	4,325	9,011	-	8,230	(60,241)	-	-
Total capital and general reserves	<u>1,281,159</u>	<u>109,308</u>	<u>(324)</u>	<u>6,571</u>	<u>26,025</u>	<u>22,303</u>	<u>(604)</u>	<u>8,850</u>	<u>(172,129)</u>	<u>1,281,159</u>	<u>1,070,416</u>
<b>TOTAL LIABILITIES, CAPITAL AND GENERAL RESERVES</b>	<u>\$ 2,529,330</u>	<u>\$ 354,524</u>	<u>\$ 93,250</u>	<u>\$ 7,166</u>	<u>\$ 33,380</u>	<u>\$ 29,274</u>	<u>\$ 1,012</u>	<u>\$ 25,643</u>	<u>\$ (340,419)</u>	<u>\$ 2,733,160</u>	<u>\$ 2,562,298</u>



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING STATEMENTS OF INCOME AND EXPENSE AND COMPREHENSIVE INCOME (LOSS)**  
(In thousands)

	Year Ended December 31, 2017									Year Ended December 31, 2016	
	DDC	DDIC	DIC	DICNE	Alphas	DDPR	CDS	Allied	Eliminations	Consolidated	Consolidated
<b>Premiums and other income (expense)</b>											
Commercial programs	\$ 4,419,171	\$ 1,640,997	\$ 37,857	\$ 262	\$ 40,674	\$ 32,031	\$ -	\$ -	\$ (15,454)	\$ 6,155,538	\$ 5,822,874
State programs	994,432	3,983	-	-	-	-	-	-	-	998,415	1,004,643
Federal programs	696,785	4,555	957	-	-	-	-	-	-	702,297	640,113
	6,110,388	1,649,535	38,814	262	40,674	32,031	-	-	(15,454)	7,856,250	7,467,630
Administrative service contracts	(2,364,994)	(918,396)	-	-	-	(18,214)	-	-	-	(3,301,604)	(3,109,173)
	3,745,394	731,139	38,814	262	40,674	13,817	-	-	(15,454)	4,554,646	4,358,457
Investment income, net	31,985	5,147	1,090	20	228	32	-	-	(2,900)	35,602	17,258
Other income (expense), net	(26,197)	(896)	2,323	2	(573)	156	6,446	5,551	(38,236)	(51,424)	989
	3,751,182	735,390	42,227	284	40,329	14,005	6,446	5,551	(56,590)	4,538,824	4,376,704
<b>Claims and operating expenses</b>											
Claims incurred	5,346,814	1,440,559	14,553	28	26,583	23,209	-	-	-	6,851,746	6,535,514
Claims incurred on administrative service contracts	(2,364,994)	(918,396)	-	-	-	(18,214)	-	-	-	(3,301,604)	(3,109,173)
	2,981,820	522,163	14,553	28	26,583	4,995	-	-	-	3,550,142	3,426,341
Operating expenses	591,848	183,918	29,319	266	9,752	7,588	6,718	5,081	(23,322)	811,168	803,410
	3,573,668	706,081	43,872	294	36,335	12,583	6,718	5,081	(23,322)	4,361,310	4,229,751
<b>Net income (loss)</b>	177,514	29,309	(1,645)	(10)	3,994	1,422	(272)	470	(33,268)	177,514	146,953
<b>Other comprehensive income (loss)</b>											
Pension liability and post-retirement adjustments	1,356	-	-	-	-	-	-	-	-	1,356	3,566
Unrealized gains on securities	31,873	2,725	-	-	-	172	-	-	(2,897)	31,873	13,604
Gain on foreign currency translation	-	-	636	-	-	-	-	-	(636)	-	-
	33,229	2,725	636	-	-	172	-	-	(3,533)	33,229	17,170
<b>Comprehensive income (loss)</b>	\$ 210,743	\$ 32,034	\$ (1,009)	\$ (10)	\$ 3,994	\$ 1,594	\$ (272)	\$ 470	\$ (36,801)	\$ 210,743	\$ 164,123

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING BALANCE SHEETS- ALPHAS**

(In thousands)

	December 31, 2017						December 31, 2016	
	Alpha Dental Programs, Inc.	Alpha Dental Alabama	Alpha Dental of Arizona	Alpha Dental of Nevada	Alpha Dental of New Mexico	Alpha Dental of Utah	Total	Total
<b>ASSETS</b>								
Cash and cash equivalents	\$ 15,791	\$ 431	\$ 772	\$ 1,491	\$ 212	\$ 1,331	\$ 20,028	\$ 15,776
Marketable securities	6,471	326	524	1,152	208	673	9,354	10,579
	<u>22,262</u>	<u>757</u>	<u>1,296</u>	<u>2,643</u>	<u>420</u>	<u>2,004</u>	<u>29,382</u>	<u>26,355</u>
Premiums and other receivables								
Premium receivables	943	2	31	39	1	15	1,031	991
Other receivables	2,167	11	317	285	43	114	2,937	2,315
	<u>3,110</u>	<u>13</u>	<u>348</u>	<u>324</u>	<u>44</u>	<u>129</u>	<u>3,968</u>	<u>3,306</u>
Other assets	21	-	4	2	1	2	30	71
<b>TOTAL ASSETS</b>	<u>\$ 25,393</u>	<u>\$ 770</u>	<u>\$ 1,648</u>	<u>\$ 2,969</u>	<u>\$ 465</u>	<u>\$ 2,135</u>	<u>\$ 33,380</u>	<u>\$ 29,732</u>
<b>LIABILITIES, CAPITAL AND RETAINED EARNINGS</b>								
<b>Liabilities</b>								
Unpaid claims and claims adjustment expenses	\$ 1,869	\$ 15	\$ 156	\$ 133	\$ 30	\$ 39	\$ 2,242	\$ 2,222
Accounts payable and accrued expenses	2,309	28	199	273	42	219	3,070	3,597
Deferred revenue	1,781	-	97	92	-	73	2,043	1,882
Total liabilities	<u>5,959</u>	<u>43</u>	<u>452</u>	<u>498</u>	<u>72</u>	<u>331</u>	<u>7,355</u>	<u>7,701</u>
<b>Capital and retained earnings</b>								
Retained earnings	18,740	526	899	789	39	674	21,667	17,673
Common stock	1	1	-	20	1	10	33	33
Additional paid-in capital	693	200	297	1,662	353	1,120	4,325	4,325
Total capital and retained earnings	<u>19,434</u>	<u>727</u>	<u>1,196</u>	<u>2,471</u>	<u>393</u>	<u>1,804</u>	<u>26,025</u>	<u>22,031</u>
<b>TOTAL LIABILITIES, CAPITAL AND RETAINED EARNINGS</b>	<u>\$ 25,393</u>	<u>\$ 770</u>	<u>\$ 1,648</u>	<u>\$ 2,969</u>	<u>\$ 465</u>	<u>\$ 2,135</u>	<u>\$ 33,380</u>	<u>\$ 29,732</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING STATEMENTS OF INCOME AND EXPENSE- ALPHAS**  
(In thousands)

	Year Ended December 31, 2017						Year Ended	
	Alpha Dental Programs, Inc.	Alpha Dental Alabama	Alpha Dental of Arizona	Alpha Dental of Nevada	Alpha Dental of New Mexico	Alpha Dental of Utah	December 31, 2016	
						Total	Total	
<b>Premiums and other income (expense)</b>								
Commercial programs	\$ 33,131	\$ 234	\$ 2,535	\$ 3,126	\$ 309	\$ 1,339	\$ 40,674	\$ 36,379
Investment income, net	163	9	14	21	4	17	228	223
Other expense, net	(555)	(2)	(11)	(2)	-	(3)	(573)	(261)
	<u>32,739</u>	<u>241</u>	<u>2,538</u>	<u>3,145</u>	<u>313</u>	<u>1,353</u>	<u>40,329</u>	<u>36,341</u>
<b>Claims and operating expenses</b>								
Claims incurred	21,435	130	1,903	2,193	212	710	26,583	24,036
Operating expenses	8,145	82	451	659	81	334	9,752	8,767
	<u>29,580</u>	<u>212</u>	<u>2,354</u>	<u>2,852</u>	<u>293</u>	<u>1,044</u>	<u>36,335</u>	<u>32,803</u>
<b>Net income</b>	<u>\$ 3,159</u>	<u>\$ 29</u>	<u>\$ 184</u>	<u>\$ 293</u>	<u>\$ 20</u>	<u>\$ 309</u>	<u>\$ 3,994</u>	<u>\$ 3,538</u>