



FY2020 Annual Operating and Capital Plan

Board of Directors Budget Meeting

June 4, 2019



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Agenda

Executive Summary

FY2020 Budget Overview:

- Key Plan Drivers | Inflationary Assumptions

Key Statistical / Growth Indicators

Revenue:

- Key Revenue Assumptions / Payor Mix
- Revenue Trend Analysis

Salaries, Wages, Benefits & FTEs:

- Salary, Benefits, and FTE Trend Analysis

Non Labor Analysis:

- Supplies | Professional Fees | Purchased Services | Other Direct Expense

FY2020 Annual Budget Summary / EBIDA Recap

Three-Year Capital Plan

Five-Year Financial Projections

Executive Summary

Budget FY2020 lays out a plan for the coming year that puts Palomar Health on a pathway toward achieving the five-year strategic financial and capital plan (EBIDA growth of \$9.2 million from projected FY2019). The plan includes the following:

- Continues the deployment of capital resources from the 2017 issuance of Certificates of Participation (revenue bonds)
- Contains strategic service line development to optimize resource utilization and better serve the community
- Includes reimbursement enhancement strategies that yield rate increases consistent with annual expense inflation
- Maintains revenue cycle initiatives to ensure collections are consistent with expected reimbursement
- Reflects continued management efforts to absorb inflation and drive efficiency throughout the organization
- Incorporates workforce management strategies to drive targeted improvements in utilization of overtime / premium pay dollars and contract labor
- Supports key organizational goals regarding quality improvement and patient satisfaction
- Aligns the operating and capital budgets with our current year and long-term strategic plan initiatives

FY2020 Budget – Key Drivers & Overview

Key Plan Drivers

- Strategic Plan alignment including year-over-year EBIDA improvement, which is consistent with the long-range financial and capital plan targets
- Service line development in General Surgery, Thoracic Surgery, Neurosurgery, and Bariatric Surgery, driving margin improvements over the course of the fiscal year
- Reassessment of overhead costs at the downtown campus throughout FY2020 to prepare for relocation of services
- Opening of the new Crisis Stabilization Unit and restructured staffing models in the Emergency Department designed to better serve the Behavioral Health population
- Supply management initiatives to offset inflationary impacts and reduce costs through strategic purchasing and vendor renegotiations supported by industry benchmarks
- Salary and wage increases in alignment with the provisions of the current labor union agreements
- Continued reimbursement pressures driven by industry / payor relationships, offset by revenue capture improvement initiatives in revenue cycle and contracting strategies

Inflationary Assumptions

- FY2020 budget assumes the absorption of a significant amount of industry inflation through inventory and utilization improvements
- Palomar Health will continue to optimize the purchasing power of our GPO network to support strategic supply management efforts
- Implant costs continue to be a significant driver of overall supply costs, but are offset by \$2.0M in supply management initiatives in FY2020

Healthcare Industry Inflation Comparison

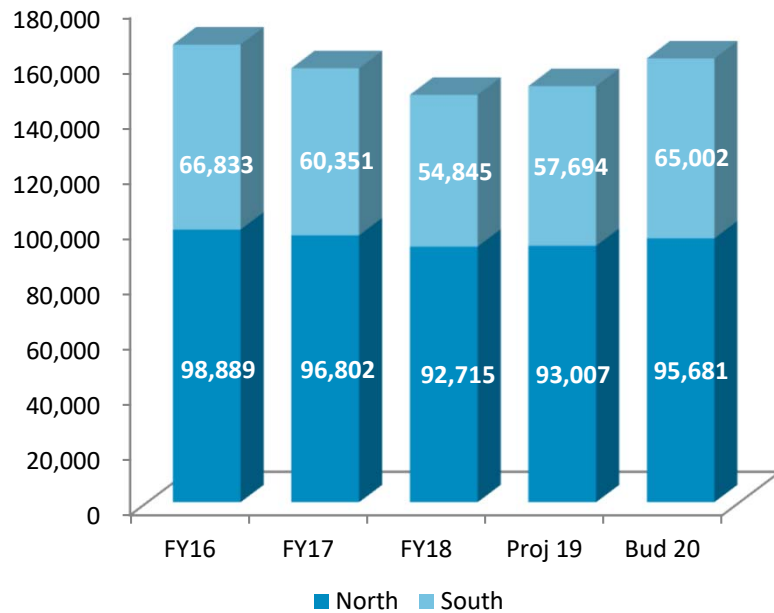
Category / Expense	FY2020 Budget	Industry Expectation
Implants	0.5%	0-2.1%
General Surgery Supplies	0.5%	0.5%
Surgical Needles	0.5%	0.5%
Oxygen – Gas	3.1%	3.1%
IV Solutions	3%	3%
Pharmaceuticals	4.3%	4.3%
Radioactive and X-Ray Material	0%	0%
Other Medical	0.5%	0.5%
Food / Meat	2.5%	2.5%
Linen	0.7%	0.7%
All Other: Cleaning, Forms, Office, Uniforms	0-2.1%	0-2.1%

Key Statistical Indicators

Key Statistical Indicators | Inpatient

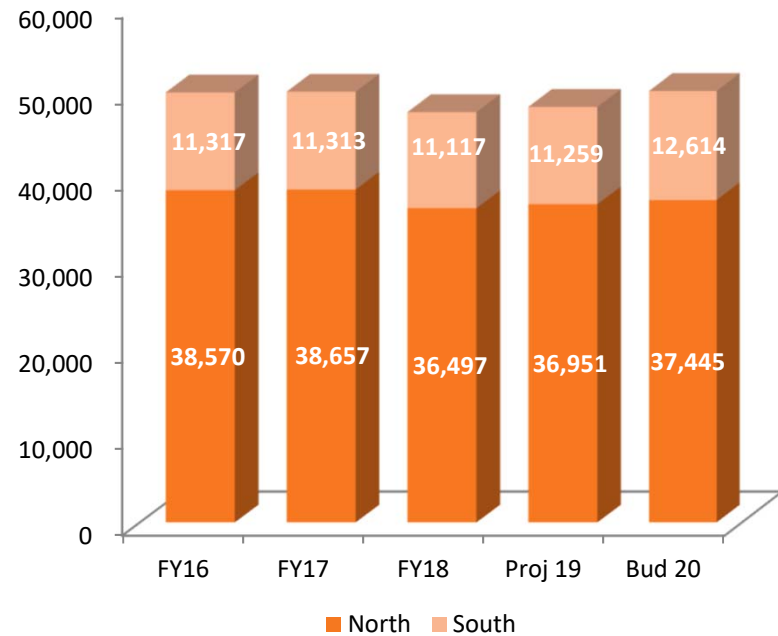
Total Patient Days

FY2020 planned patient days are increasing by 6.6%, predominantly based on growth in Behavioral Health, Acute Rehabilitation, and Skilled Nursing



Adjusted Discharges (Incl. SNF)

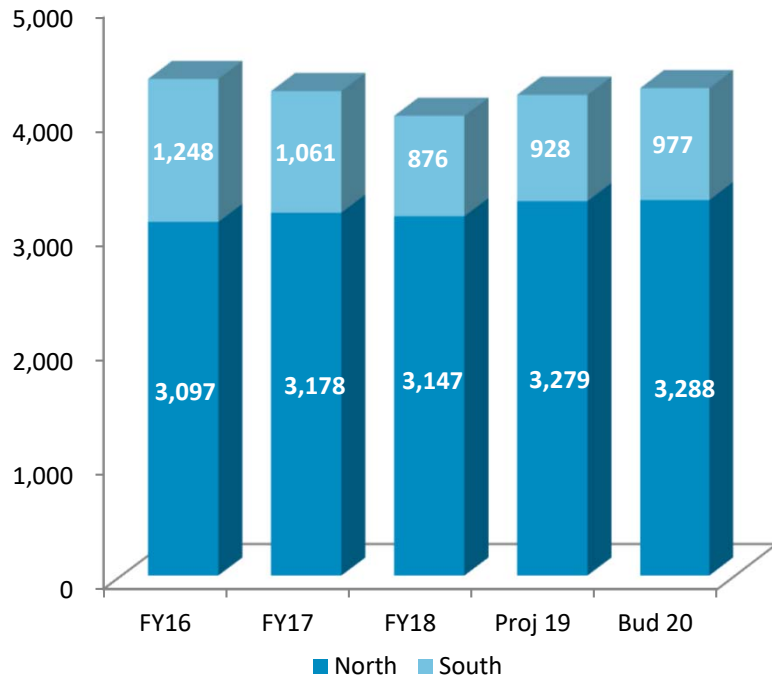
FY2020 adjusted discharges are growing by 1,849 discharges, or 3.8% year over year



Key Statistical Indicators | Inpatient

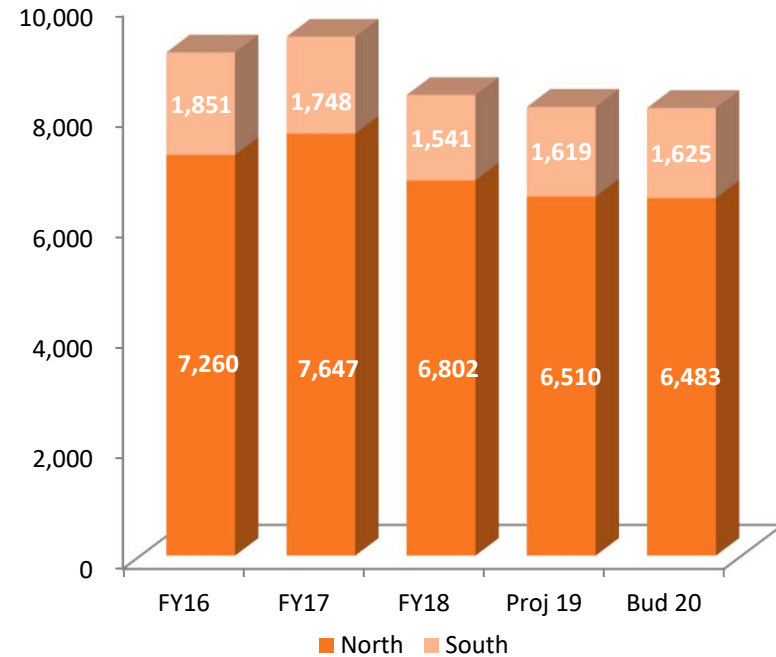
Deliveries

FY2020 deliveries are increasing 1.4% based on current year trends



Surgeries

FY2020 inpatient surgeries are relatively flat, as recruitment efforts are expected to build toward the latter half of the year

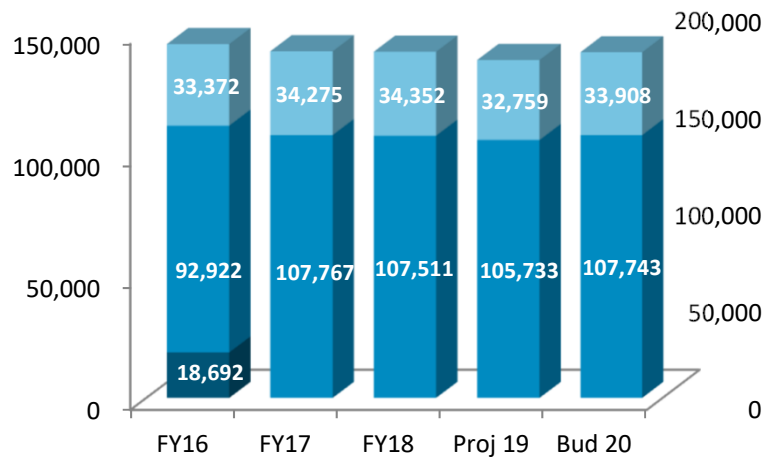


Key Statistical Indicators | Outpatient

Outpatient Services

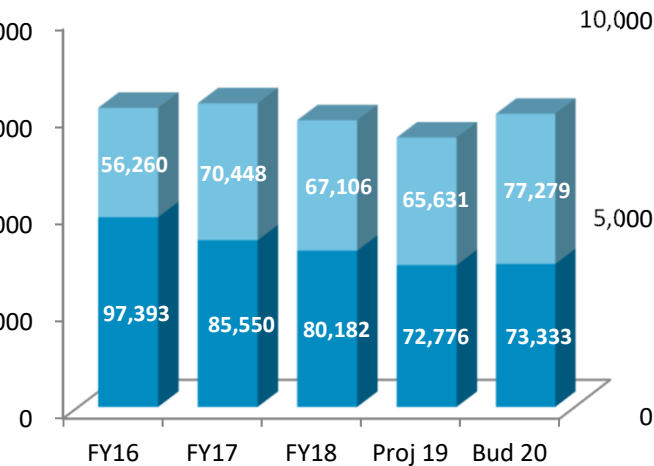
- Emergency visits are increasing by 3,159, or 2.3%, to align with seasonal trends
- Outpatient registrations are increasing by 12,205, or 8.8%, largely driven by the incorporation of additional outpatient rehabilitation clinic volume in Poway
- Outpatient surgeries are increasing by 301 cases, or 4.9%, predominantly in general surgery

Emergency Visits



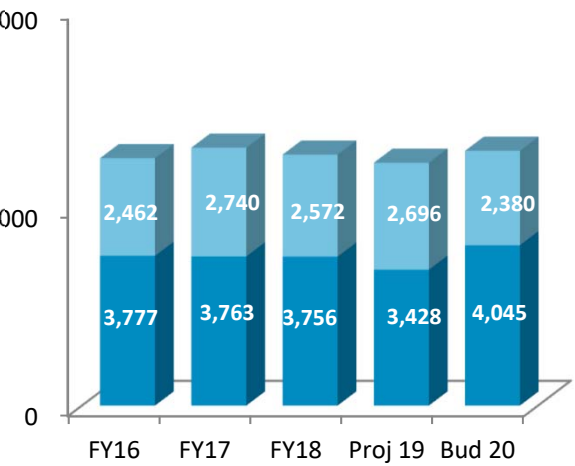
■ Downtown ■ Escondido ■ South

Outpatient Registration



■ North ■ South

Outpatient Surgery

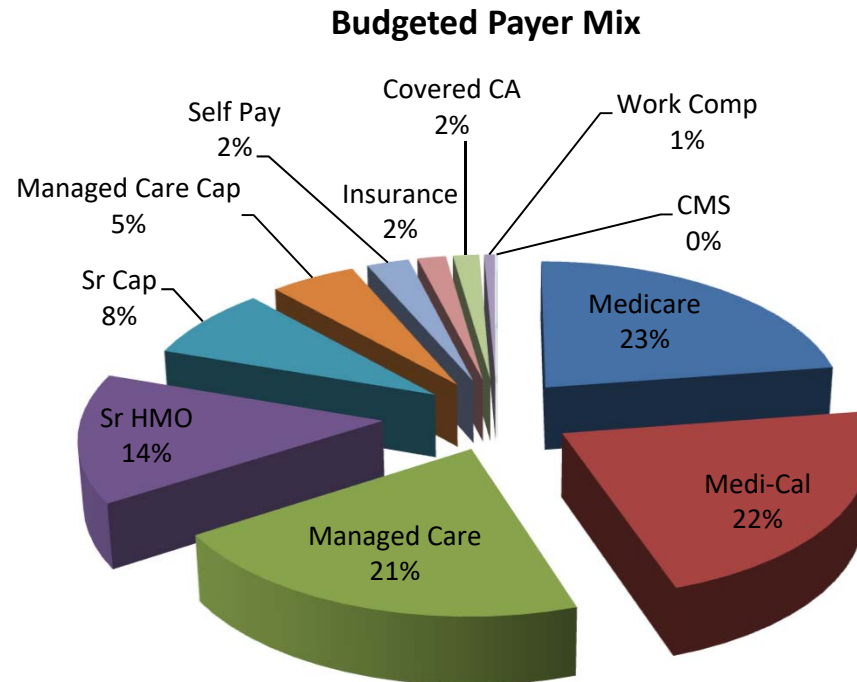


■ North ■ South

Revenue

Key Revenue Considerations

Payor Category (in thousands)	Total Charges
Medicare	\$ 996,840
Medi-Cal	\$ 978,370
Managed Care	\$ 926,709
Senior HMO	\$ 630,616
Senior Capitation	\$ 354,563
Managed Care Capitation	\$ 227,582
Self Pay	\$ 112,340
Insurance	\$ 75,656
Covered California	\$ 69,475
Workers' Compensation	\$ 29,034
CMS	\$ 1,378
Total	\$ 4,402,564

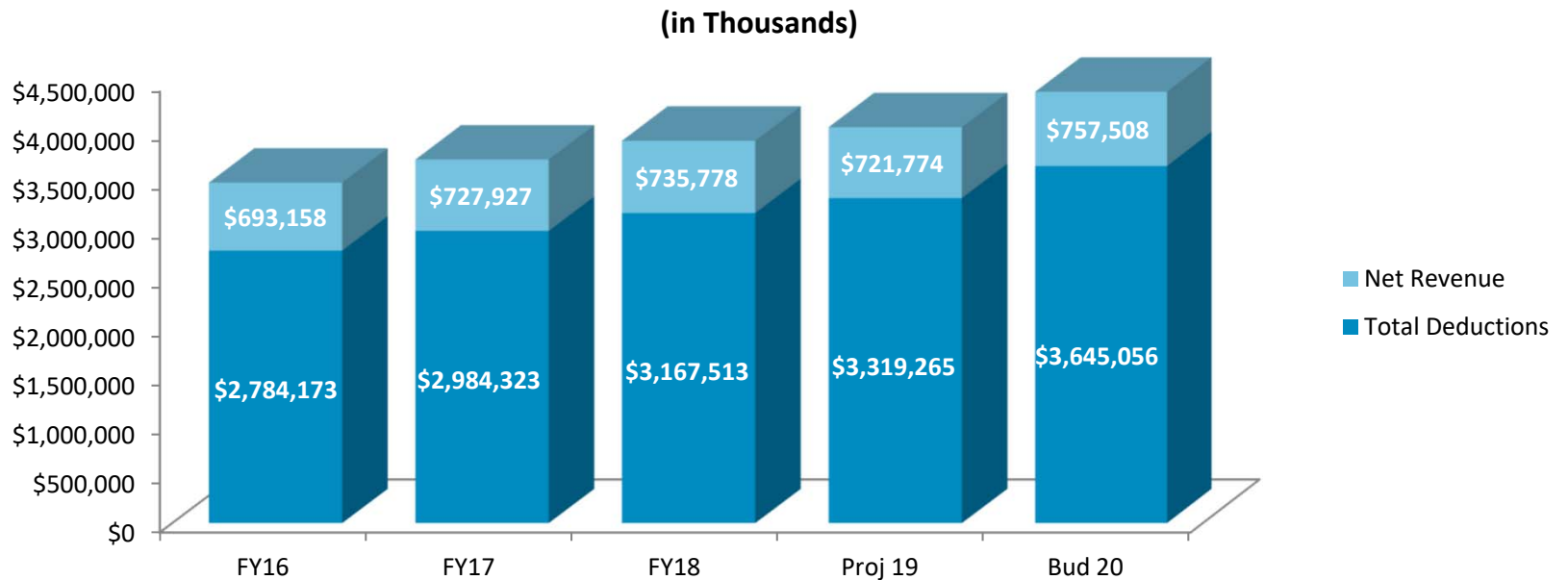


Assumptions

- 4.1% overall effective rate increase (targeted 4.5%)
- FY20 bad debt and uncompensated care 1.7%; FY19 Budget = 1.5%
- Government sources continue to be predominant

Revenue Trend Analysis

Net revenue is anticipated to increase by \$36.2M, or 4.9%, year over year



\$	2,784,173	\$	2,984,323	\$	3,167,513	\$	3,319,265	\$	3,645,056	Total Deductions*
\$	693,158	\$	727,927	\$	735,778	\$	721,774	\$	757,508	Net Revenue
\$	3,477,330	\$	3,712,250	\$	3,903,290	\$	4,041,039	\$	4,402,564	Total Gross Revenue

*Deductions include net capitation impact

Salaries, Wages, Benefits & FTEs

Labor Impact Summary

The FY2020 Operational Budget reflects a concerted effort to improve labor expense management. Across the district, the budget:

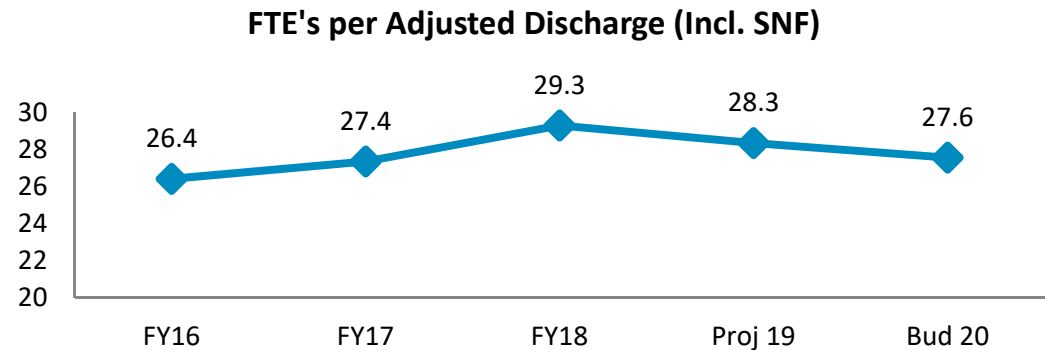
- Incorporates several workforce management initiatives designed to minimize overtime and contract labor pay, fill position vacancies, and manage leaves of absence
- Maintains a significant focus on staff education to support operational initiatives around quality improvement and technology implementation
- Sets achievable staffing benchmarks to align with organizational objectives
- Improves nursing education strategies by centralizing the nursing education team and the new graduate / new-to-specialty RN program
- Includes FTE increases in key areas to align budget and staffing models to meet volume demands
- Realigns benefit strategies, including vendor changes and a new online portal, to control increasing benefit expenses and offer better service to our employees
- Integrates a restructure of Pharmacy across the district to manage costs and increase efficiencies
- Contains new behavioral health staffing strategies across the district to better support the increasing patient population

Labor Analysis | FTEs

2020 Budgeted FTE Roll Forward	FTEs
FY2019 Paid FTEs (as of 12/22/2018)	3,734
Volume-Related Changes	81
Operational Efficiencies	(93)
Targeted FTE Changes	53
Efficiency at Downtown Campus	(10)
Additional Staff Training Time	15
FY2020 Paid FTE's	3,780

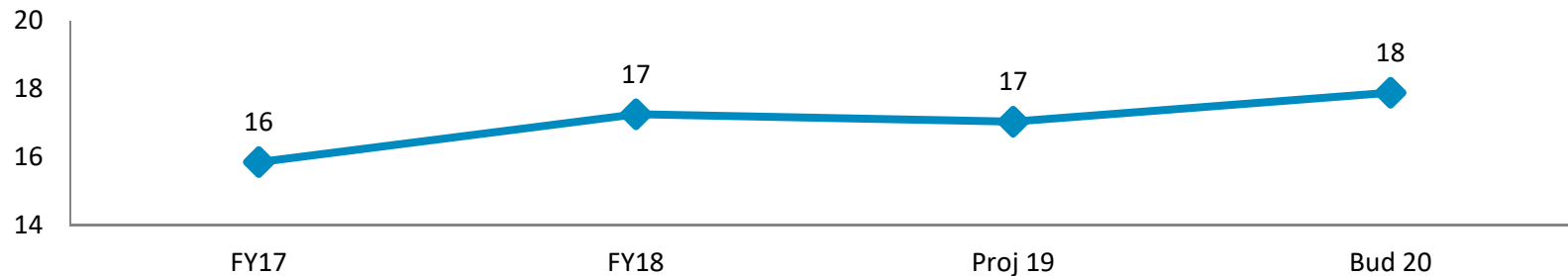
FTEs per Adjusted Discharge (incl. SNF)

Even with targeted additions, FTEs are relatively flat year over year on a per adjusted discharges basis

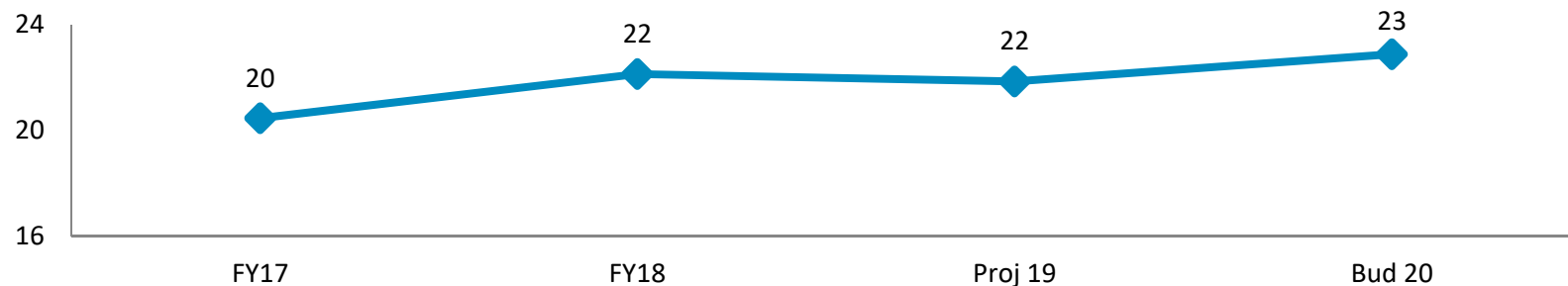


Labor Analysis | Direct Caregiver FTEs

Direct Caregiver FTEs per Adjusted Discharge



Direct Caregiver FTEs per Adjusted Discharge (incl. support)

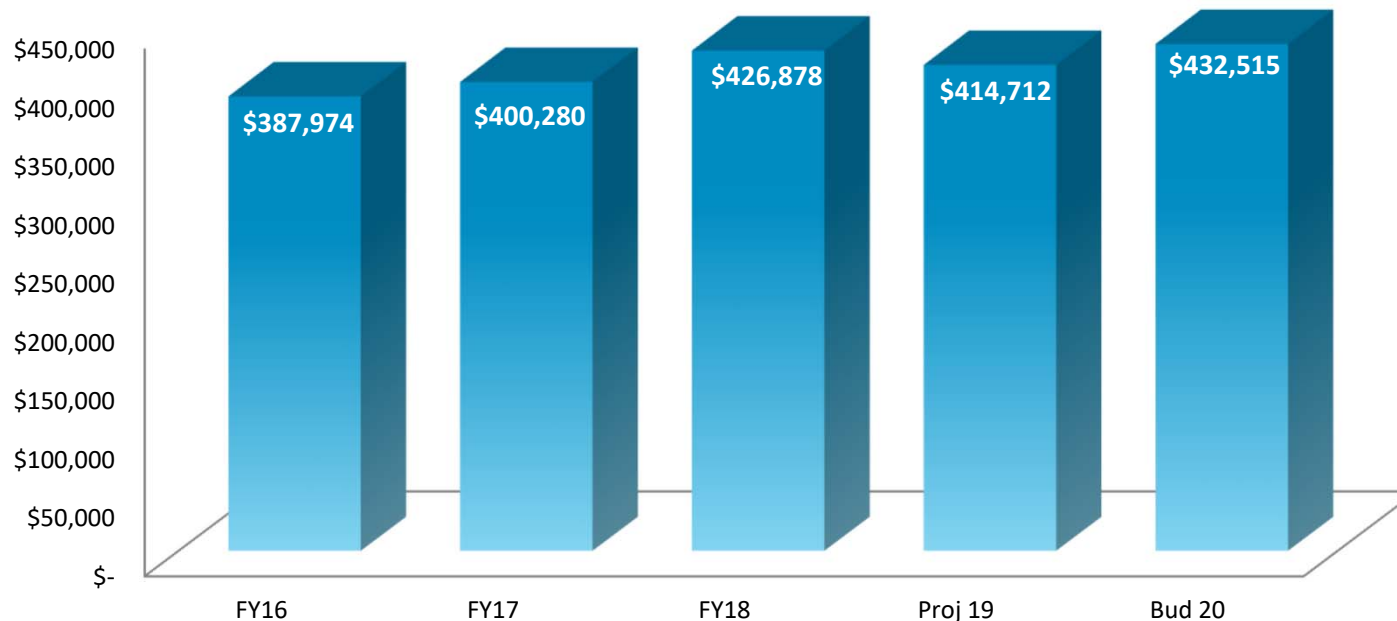


- Direct Caregiver FTEs per Adjusted Discharge increase over current year projections
- Planned decreases in contract labor, overtime, and premium pay hours are built into the FY2020 Budget

Labor Analysis | Salaries, Wages & Benefits

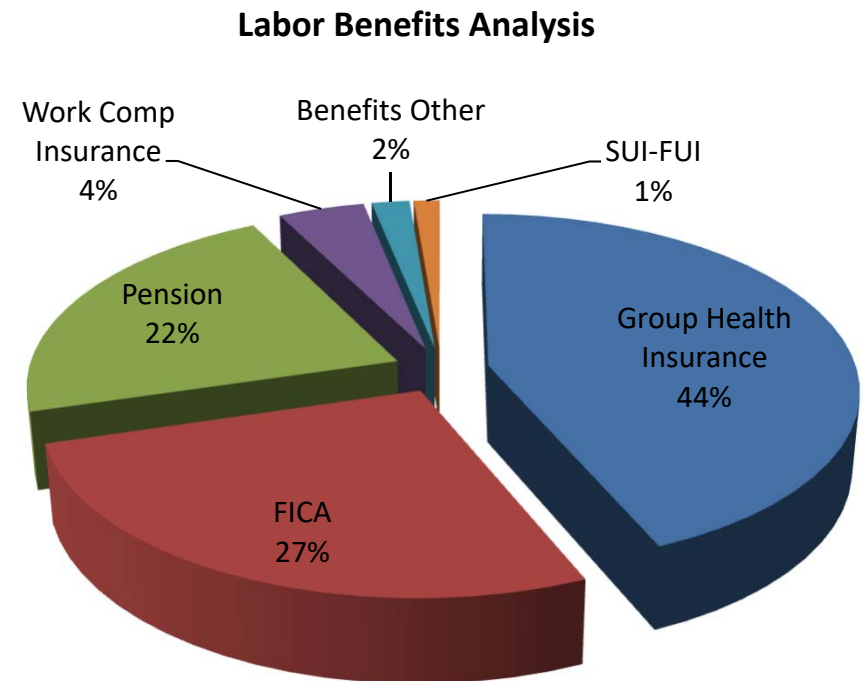
- FY2020 total Salaries, Wages, Contract Labor, and Benefits are increasing by \$17.8M, or 4.3%
- Salary and benefit increases are offset by significant declines in agency / registry, as well as improvements in premium pay expense over current year

Total Salaries, Wages & Benefits (in Thousands)



Labor Analysis | Benefits (excl. PTO)

Type of Benefit	% to Total Benefits
Group Health Insurance	44%
FICA	27%
Pension	22%
Workers' Compensation Insurance	4%
Benefits Other	2%
SUI-FUI	1%
Total Benefit Spend (in thousands)	92,683



Significant Impacts

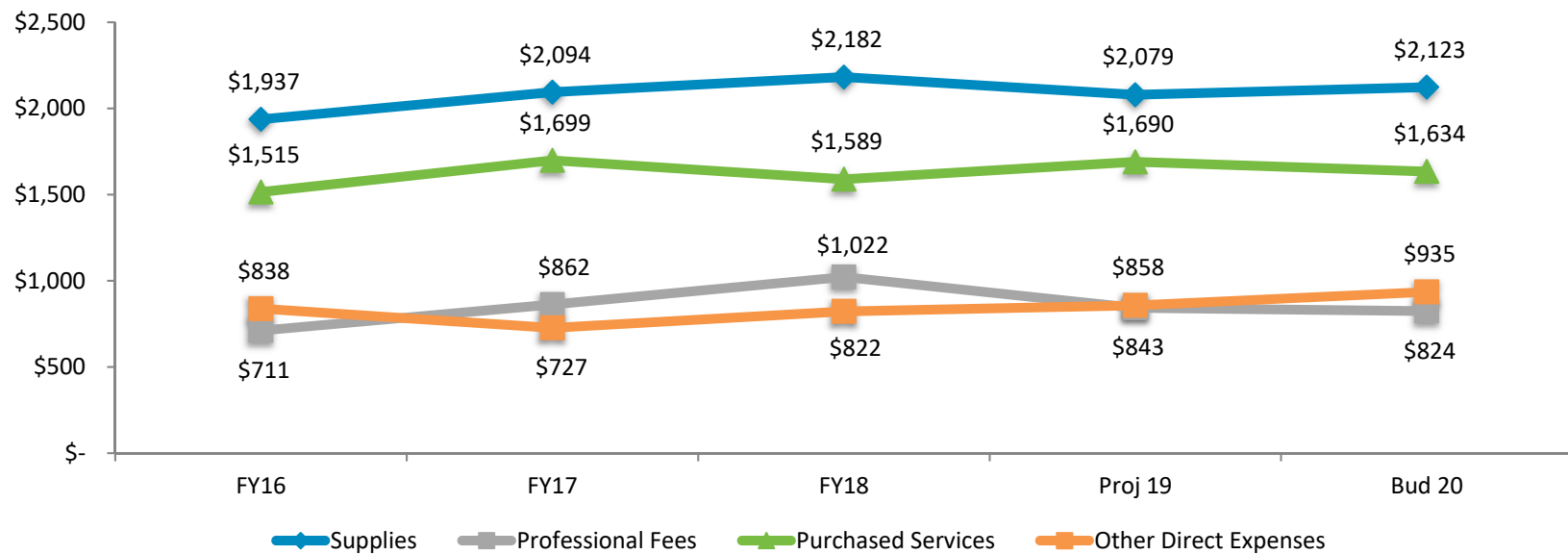
- Group Health Insurance premiums have increased by 2%, which is offset by savings from benefit management initiatives
- FICA, Pension, and Worker's Compensation are all increasing in proportion with salaries

Non Labor Analysis

Non Labor Analysis | Summary

- FY2020 Non Labor expense is increasing \$14.5M, or 5.5%
- Non labor expense is increasing by 1.6% on a per adjusted discharge basis, primarily driven by supply inflation, building rental expenses, information technology and physician professional fees

Trended Non Labor Expense per Adjusted Discharge *(In thousands)*



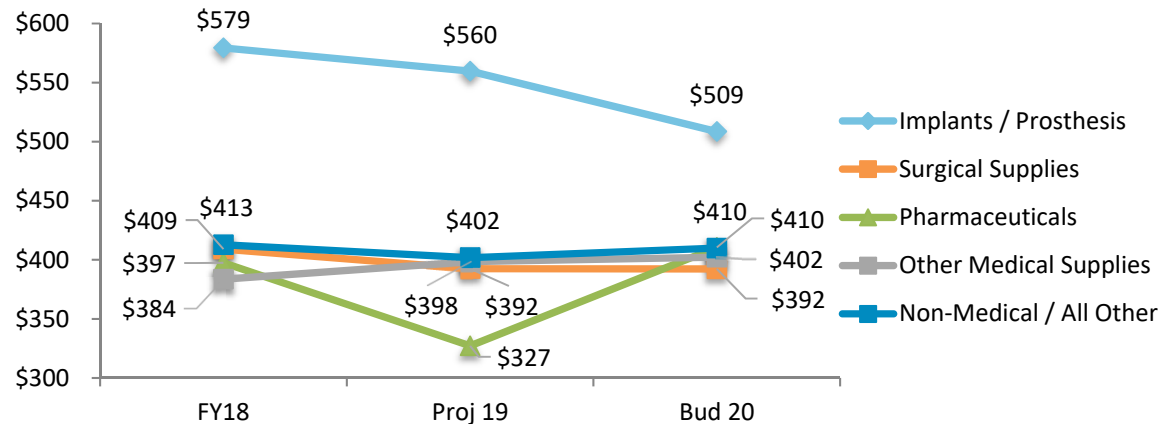
Non Labor Analysis | Supplies

FY2020 Supply Roll Forward	Expense (in thousands)
FY2019 Supply Expense (Dec 2018 Projection)	\$100,251
Increases due to Volume and Utilization	6,585
Inflationary Increases (Net of Absorption)	1,458
Supply Reduction Initiative (Captis & PRAC*)	(2,000)
FY2020 Budgeted Supply Expense	\$106,294

*Physician Resource Allocation Committee

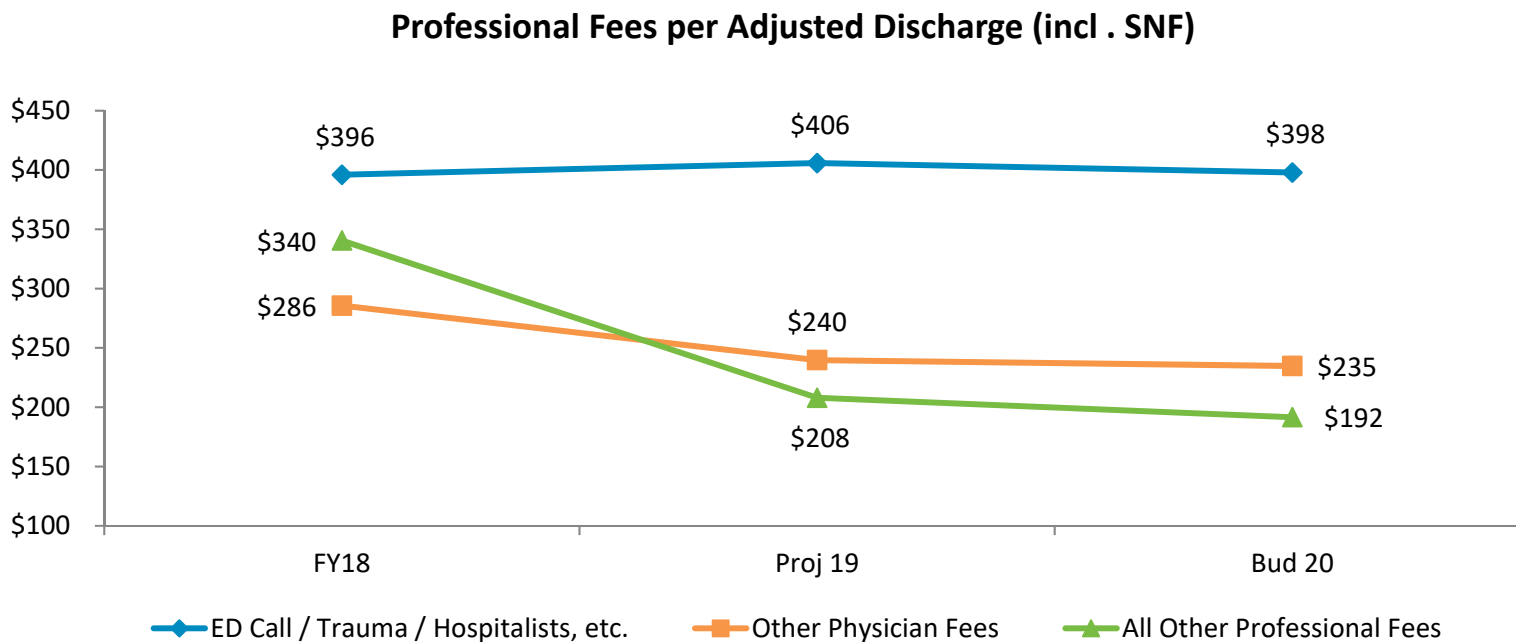
Supplies per Adjusted Discharge (Incl. SNF)

FY2020 budgeted supply management efforts and reduction initiatives total \$2.0M in savings, which is helping to offset significant inflation projected for the coming year



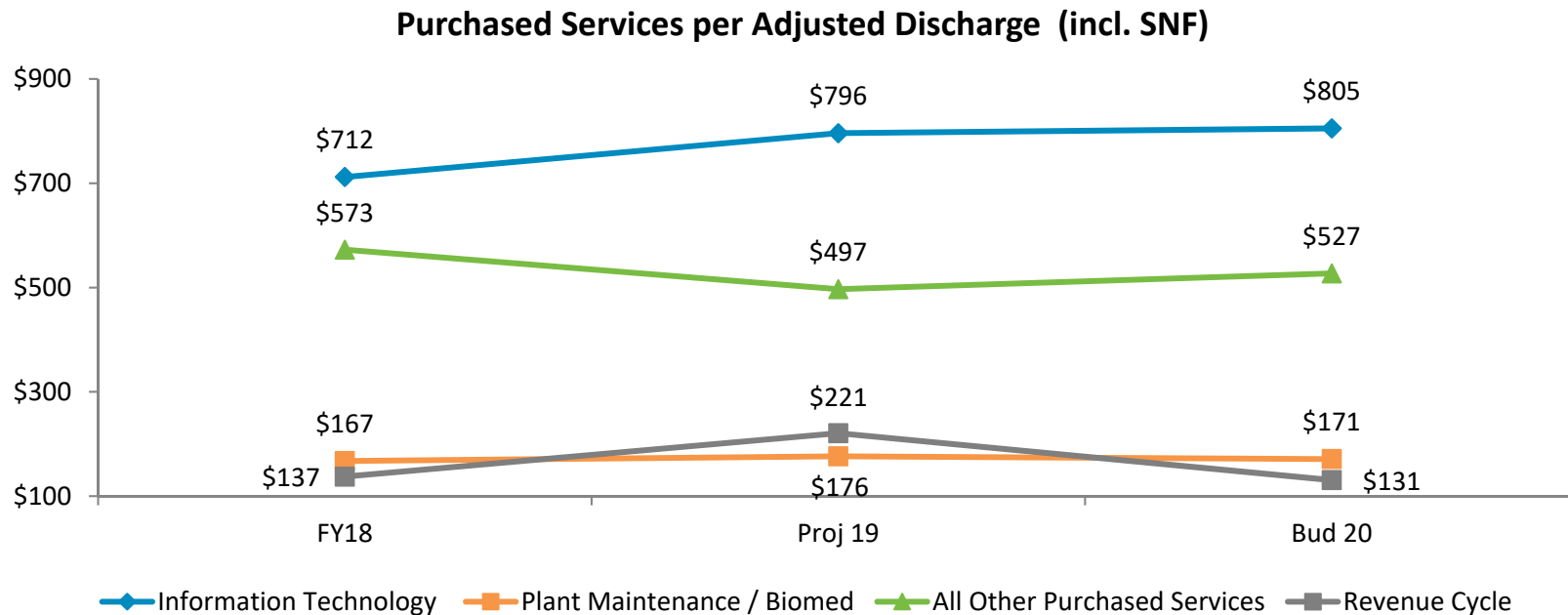
Non Labor Analysis | Professional Fees

- FY2020 Professional Fees are increasing by \$608K, or 1%, but are significantly lower than FY2018 expenses
- The continued reductions in consulting are offsetting other increases in professional fees



Non Labor Analysis | Purchased Services

- FY2020 Purchased Services are increasing by \$335K, which is less than 1% year over year
- Increases in Information Technology are partially offset by reductions in Revenue Cycle, as the Huron consulting engagement concludes



Purchased Services | IT Roadmap

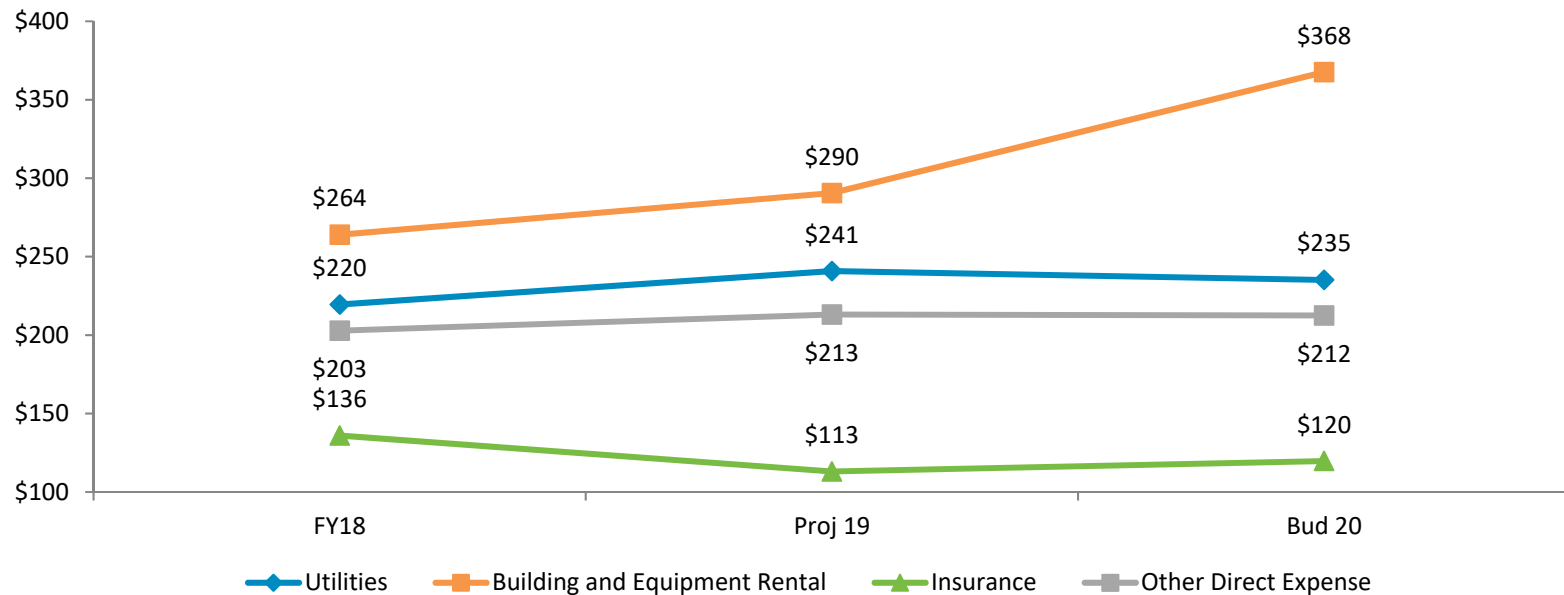
FY2019 Accomplishments	
Clarity Clinical Documentation Initiative Phase I	McKesson PACS Upgrade
Nuance Voice Recognition Radiology Upgrade	StatRad Remote Radiologist Reports into PACS
ACR Select Radiology Decision Support Phase I (ED)	Wound Advantage – Wound Care EMR
Aria Interventional Radiology Upgrade	Parkinson’s Disease Reporting to State Registry
Provation Endoscopy Solution	Midas Comply Upgrade
Cisco Call Manager VOIP Software Upgrade	Single Sign-On Proof of Concept

FY2020 Planned Projects	
Patient Safe	Cerner Clarity Upgrade to 2018 Code
Clarity Clinical Documentation Initiative Phase II	Cerner Specimen Collection
Glycemicare for Physicians and OB	Rauland Upgrade
Cardiology System Upgrades (XPER & ISCV)	Promoting Interoperability (aka Meaningful Use)
Long-term Care Survey Response EMR Requirements	E-Prescribing of Controlled Substances
iRapid Software Implementation- Stroke Certification	Alaris Smart Pump Programming & Infusion Mgmt

Non Labor Analysis | Other Direct Expense

- FY2020 Budgeted Other Direct Expense is increasing by \$5.5M, or 13%
- Increases are primarily driven by building rent, annual dues, and training expenses

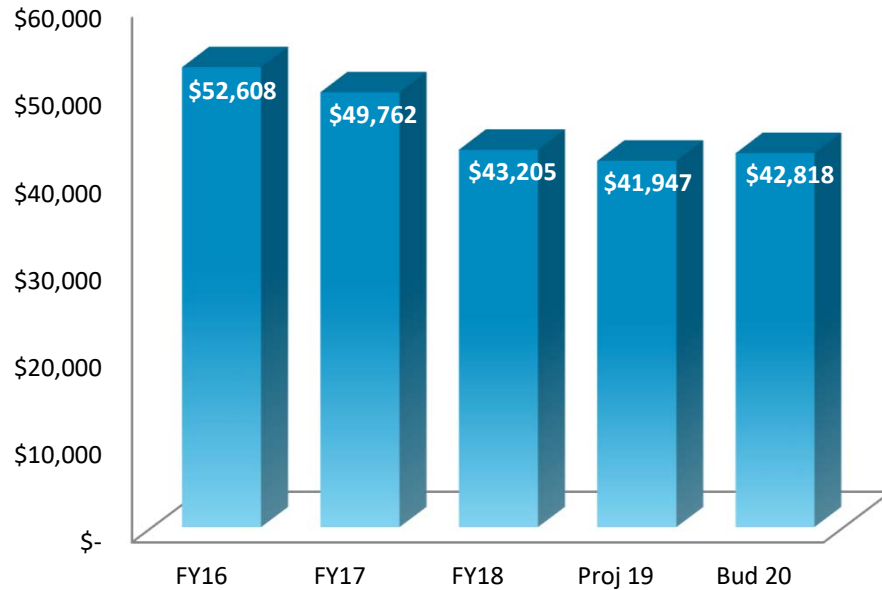
Other Direct Expense per Adjusted Discharge (Incl. SNF)



Depreciation and Interest Expense

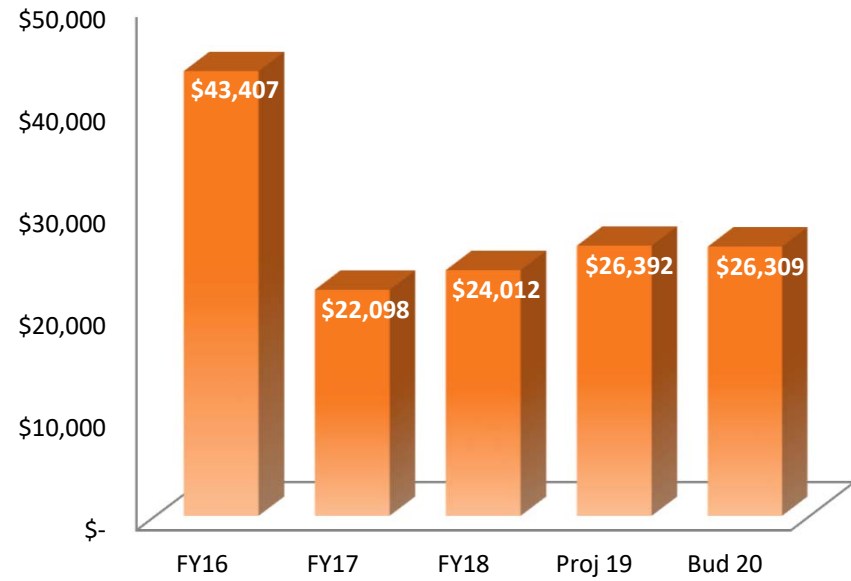
Depreciation Expense

(in thousands)



Interest Expense

(in thousands)



*Interest Expense reflected for Revenue Bonds only

Annual Operating Budget Summary & EBIDA Recap

Annual Operating Budget Summary and Trend

	FY2018 Results	FY2019 Projected	FY2020 Budget
Revenue:			
Net Revenue	735,777,685	721,774,133	757,507,803
Other Operating Revenue	11,995,538	10,648,354	11,085,786
Total Operating Revenue	\$ 747,773,223	\$ 732,422,487	\$ 768,593,588
Expenses:			
Salaries, Wages, Registry, Benefits	426,878,165	414,712,338	432,514,651
Supplies	103,901,211	100,251,006	106,294,094
Depreciation	43,204,613	41,946,907	42,818,004
Other	163,491,815	163,456,880	169,866,839
Total Operating Expense	\$ 737,475,804	\$ 720,367,131	\$ 751,493,588
Operating Income	10,297,418	12,055,356	17,100,000
Non-Operating Income (Loss)	1,222,677	1,217,309	4,862,975
(Interest Expense)	(24,012,370)	(26,391,779)	(26,309,265)
Property Tax Revenue	16,779,495	18,250,000	17,900,000
Income (Loss)	\$ 4,287,220	\$ 5,130,886	\$ 13,553,710
ARCH Subsidy	20,640,000	16,111,628	13,500,000
Net Margin %	0.6%	0.7%	1.8%
OEBIDA Margin (Excl Property Tax Rev)	7.2%	7.4%	7.8%
OEBIDA Margin (Incl Property Tax Rev)	9.4%	9.9%	10.1%
EBIDA Margin	9.6%	10.0%	10.8%
Total Uncompensated Care & Bad Debt	68,281,567	79,286,180	75,481,141
Total Uncompensated Care as % of Gross	1.75%	1.96%	1.71%

FY2020 Annual Operating and Capital Plan

FY2020 EBIDA Recap *(in thousands)*

	FY2018 Results	FY2019 Projected	FY2020 Budget
Net Income from Ops (excl. Interest Expense)	10,297	12,055	17,100
Depreciation Expense	43,205	41,947	42,818
OEBIDA	\$ 53,502	\$ 54,002	\$ 59,918
OEBIDA Margin (excl. Property Tax Rev)	7.2%	7.4%	7.8%
OEBIDA Margin (incl. Property Tax Rev)	9.4%	9.9%	10.1%
EBIDA	71,504	73,470	82,681
EBIDA Margin	9.6%	10.0%	10.8%
Total Uncompensated Care & Bad Debt	68,282	79,286	75,481
Total Uncompensated Care as % of Gross	1.75%	1.96%	1.71%
Net Income / (Loss) after Non-Op Income	\$ 4,287	\$ 5,131	\$ 13,554

Capital Plan

Capital Plan | Three-Year Planning Process

During the preparation of the three-year plan, capital priorities are based on:

- Equipment reaching end of useful life
- Organizational strategic initiatives
- Capital funding availability

Funding sources for capital projects and acquisitions include:

- Proceeds from 2017 Certificates of Participation (COP) issuance
- Cash from operations
- Foundation fundraising

Capital Plan | Three-Year Summary

Three-Year Capital Budget Summary *(in thousands)*

	FY2020	FY2021	FY2022	Total Project Spend
Funded by Operations:				
Routine - Equipment	866	1,758	2,857	5,481
Routine - Facilities	2,182	1,436	2,500	6,118
Routine - IT	2,616	2,033	3,500	8,148
Subtotal	5,663	5,227	8,857	19,747
Capital from Restricted Funds:				
Escondido 9th Floor Build-out / NICU Expansion	10,500	12,500	10,500	33,500
Poway Renovation	5,409	1,500	2,000	8,909
Other	681	1,000	3,000	4,681
Subtotal	16,590	15,000	15,500	47,090
Funded by Foundation:	988	-	-	988
Total	\$ 23,241	\$ 20,227	\$ 24,357	\$ 67,825

Capital Plan | Planned Capital Projects

Capital Project	Capital Allocation
Escondido 9 th Floor & NICU Build-out	\$ 10,500,000
Poway Renovation & Improvement	\$ 5,444,996
<i>Interior Projects</i>	<i>\$ 2,607,437</i>
<i>Exterior Projects</i>	<i>\$ 1,125,000</i>
<i>Villa Pomerado Modernization</i>	<i>\$ 1,712,559</i>
IT Infrastructure & Equipment	\$ 2,578,501
Relocation of Downtown Campus Services	\$ 2,000,000
Development of Strategic Service Lines	\$ 1,181,200
Routine Equipment Replacement	\$ 994,090
Imaging Equipment	\$ 322,972
Facility Infrastructure Improvements	\$ 219,154

FY2020 Budget Summary & Key Take-Aways

Summary

➔ **FY2020 Budget is achievable and ties to the Strategic Financial & Capital Plan. It requires success in the following areas:**

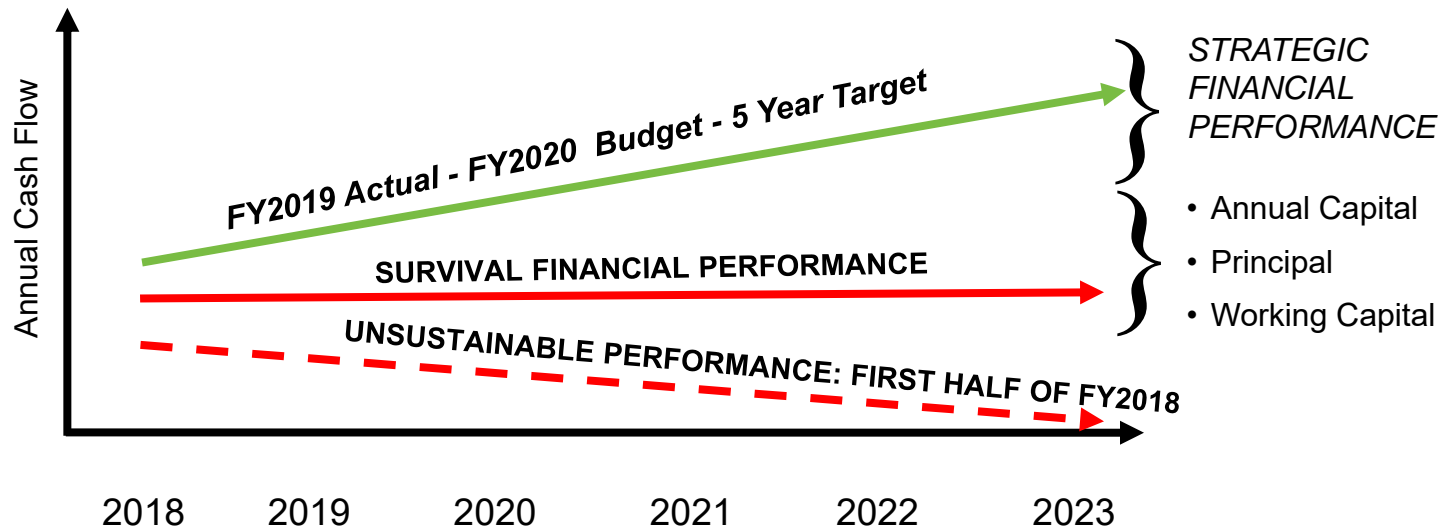
- 6.6% increase in Patient Days and 3.8% growth in Adjusted Discharges
- Successful execution of planned strategies to increase volume in key areas and better manage the behavioral health population
- Improvement of \$36.2 million in net patient revenue year over year, with continued contributions from supplemental revenue
- Normalize staffing to reduce reliance on overtime and premium pay
- Transition of all outpatient services from Palomar Medical Center Downtown Escondido by the end of the Fiscal Year

➔ **Successful Execution will result in:**

- Net income improvement of \$8.4 million year over year; operating income improvement of \$5.0 million year over year
- EBIDA of \$82.7 million

Five-Year Financial Projections

Five-Year Financial Projections



Palomar Health needs a sound financial strategy in order to:

- Replace aging equipment
- Deploy sufficient capital to support the strategic plan
- Recruit physicians
- Expand capacity to serve the changing needs of the community

FY2020 Annual Operating and Capital Plan

Five-Year Financial Projections

Ratio/Statistic (in thousands)	Audit	Targeted	Projection Years				
	2018	2019	2020	2021	2022	2023	2024
Total Operating Revenue	\$794,168	\$787,365	\$816,990	\$828,813	\$872,341	\$912,239	\$935,676
Operating EBIDA	\$32,920	\$38,938	\$44,645	\$46,228	\$50,528	\$71,586	\$72,554
Operating Income	(\$41,709)	(\$32,704)	(\$25,311)	(\$22,929)	(\$17,999)	\$3,790	\$5,697
Operating Income excl. Interest Expense	(\$11,861)	(\$6,084)	\$904	\$2,785	\$7,178	\$28,375	\$29,655
Palomar Health	\$10,297	\$13,501	\$17,100	\$18,022	\$21,958	\$42,698	\$43,524
Arch	(\$22,314)	(\$18,930)	(\$15,500)	(\$14,500)	(\$14,000)	(\$13,500)	(\$13,000)
Net Income	(\$15,280)	(\$22,140)	(\$6,311)	(\$219)	\$5,073	\$27,224	\$29,497
Unrestricted Cash	\$200,404	\$182,760	\$192,275	\$229,718	\$252,233	\$291,454	\$335,975
Capital Expenditures	\$21,037	\$15,500	\$22,500	\$23,500	\$28,500	\$15,000	\$15,000
Profitability							
Operating Margin	(5.3%)	(4.2%)	(3.1%)	(2.8%)	(2.1%)	0.4%	0.6%
Operating Margin excl. Interest Expense	(1.5%)	(0.8%)	0.1%	0.3%	0.8%	3.1%	3.2%
Excess Margin	(1.9%)	(2.8%)	(0.8%)	0.0%	0.6%	3.0%	3.2%
Operating EBIDA Margin	4.1%	4.9%	5.5%	5.6%	5.8%	7.8%	7.8%
Debt Position							
Debt Service Coverage (x)	1.3x	1.3x	1.6x	1.8x	1.9x	2.4x	2.5x
Total Debt to Capitalization	80.0%	82.1%	82.5%	82.2%	81.2%	77.6%	73.9%
Liquidity							
Cash to Debt	31.1%	29.0%	31.1%	38.1%	42.8%	50.8%	60.2%
Days Cash On Hand (days)	92.5	86.1	87.9	103.7	108.7	122.9	138.2
Days Cash On Hand (days) - excl. Interest	96.1	89.1	90.9	107.1	112.0	126.5	142.1
Other							
Discharges	32,022	30,259	30,375	29,387	30,387	29,251	28,379
Adjusted Discharges	51,705	50,374	51,075	50,789	52,601	50,968	49,870
Adj Cost / Discharge	\$13,428	\$14,214	\$14,495	\$14,754	\$14,960	\$15,773	\$16,533
Capital Spending Ratio	47.0%	34.4%	51.4%	54.1%	65.7%	34.7%	35.0%