FY2021 Annual Operating and Capital Budget

Board of Directors Budget Presentation

June 16, 2020

PALOMAR HEALTH

Passion. People. Purpose.™

Agenda

Executive Summary

FY2021 Budget Overview:

- Key Budget Drivers | Inflationary Assumptions

Key Statistical / Growth Indicators

Revenue:

- Key Revenue Assumptions / Payor Mix
- Revenue Trend Analysis

Salaries, Wages, Benefits & FTEs:

- Salaries, Wages, Benefits and FTE Trend Analysis

Non Labor Analysis:

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

FY2021 Annual Budget Summary / EBIDA Recap

Three-Year Capital Plan

Five-Year Financial Projections

Executive Summary

The FY2021 budget lays out a plan for the coming fiscal -year that has been designed to keep Palomar Health on a pathway toward achieving the five-year strategic financial and capital plan and incorporated the impact of the COVID-19 pandemic / recovery plan. The plan includes the following:

- EBIDA of $81.6 million, with growth of $6.9 million from current projected FY2020 performance
- Continued deployment of capital resources from the 2017 issuance of Certificates of Participation (revenue bonds)
- FY2021 includes the addition of 101 clinical FTEs in key areas to align with current practice, industry standards, and community needs
- Expense management initiatives designed to offset revenue losses associated with lower patient volume and revenue
- Continued focus on key organizational goals regarding clinical excellence /outcomes and patient satisfaction
- Reimbursement enhancement strategies that yield rate increases consistent with annual expense inflation
- Alignment of the operating and capital budgets with our current year and long-term strategic plan objectives

FY2021 Budget – Key Drivers & Overview

Key Budget Drivers

- Strategic Plan alignment including year-over-year EBIDA improvement, which is consistent with the long-range financial and capital plan targets
- Volume projections reflective of the current situation with a slow building back to pre-COVID-19 levels
- Closure of the Downtown Campus in Q1 drives a reduction of overhead expenses and realignment of services to other locations and sale of the real estate assets in FY2021
- Opening of the expanded Crisis Stabilization Unit and restructured staffing models in the Emergency Department are both designed to better serve the Behavioral Health population
- Opportunity to minimize supply inflation, via strategic purchasing initiatives and vendor renegotiation, is offset by increasing costs driven by PPE shortages
- Salary and wage increases in alignment with the provisions of the current labor union agreements and market dynamics
- Reimbursement pressures driven by industry / payor relationships offset by revenue capture improvement initiatives in revenue cycle and contracting strategies

Inflationary Assumptions

- FY2021 budget is based on industry-wide expectations, though the COVID-19 pandemic increases the risk of greater supply inflation for PPE
- Palomar Health will continue to focus on standardizing high cost physician preference products to offset COVID-19 related increases

Healthcare Industry Inflation Comparison

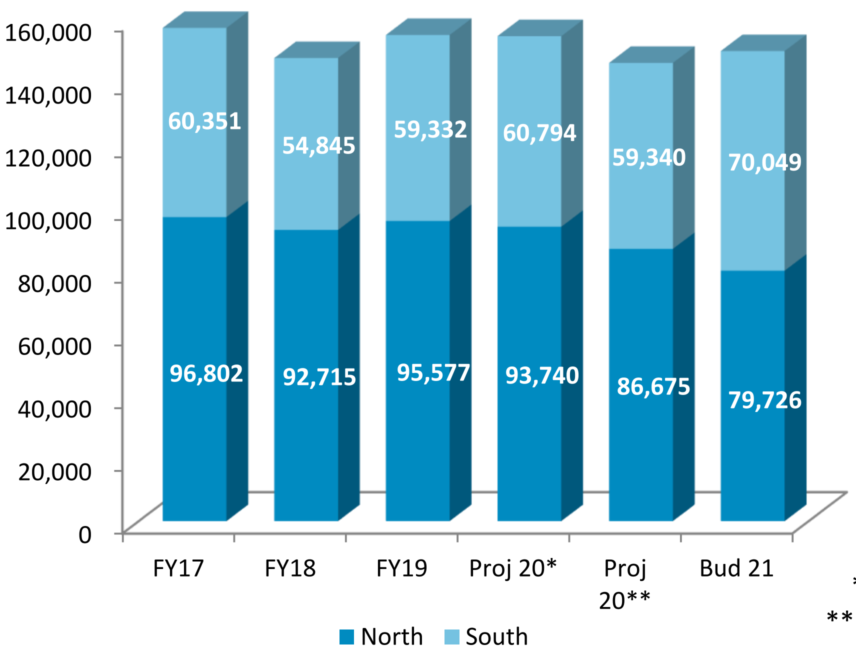
Category / Expense	FY2021 Budget	Industry Expectation
Implants	0.5%	0-1.3%
General Surgery Supplies	0.5%	0.5%
Surgical Needles	0.5%	0.5%
Oxygen – Gas	4.8%	4.8%
IV Solutions	2.5%	2.5%
Pharmaceuticals	3.6%	3.0-3.9%
Radioactive and X-Ray Material	2.0%	0-4.0%
Other Medical	0.5%	0.5%
Food	3.0%	3.0%
Linen	0.7%	0.7%
All Other: Cleaning, Forms, Office, Uniforms	0-2.6%	1.0%

Key Statistical Indicators

Key Statistical Indicators | Inpatient

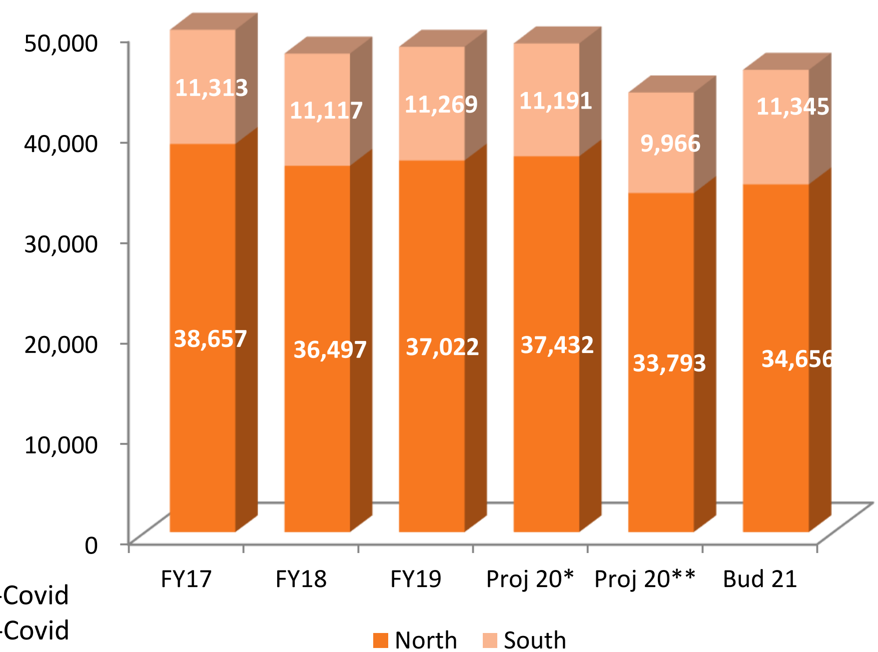
Total Patient Days

FY2021 budgeted patient days are decreasing by 3.1% over the pre-COVID-19 projection for the current year



Adjusted Discharges (Incl. SNF)

FY2021 adjusted discharges are decreasing by 2,622 discharges, or 5.4%, year-over-year

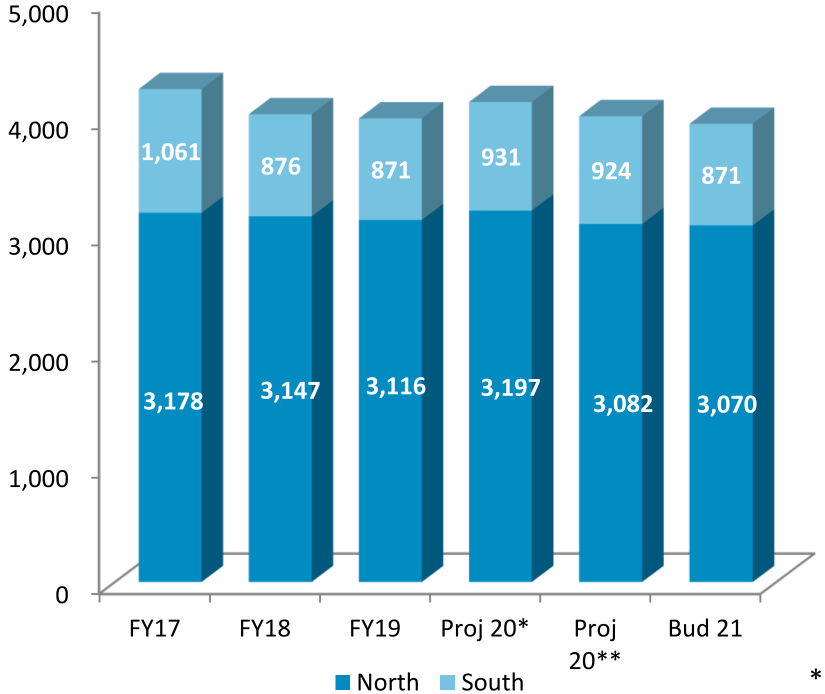


*Pre-Covid
**Post-Covid

Key Statistical Indicators | Inpatient

Deliveries

FY2021 deliveries are decreasing 4.5% based on current year trends



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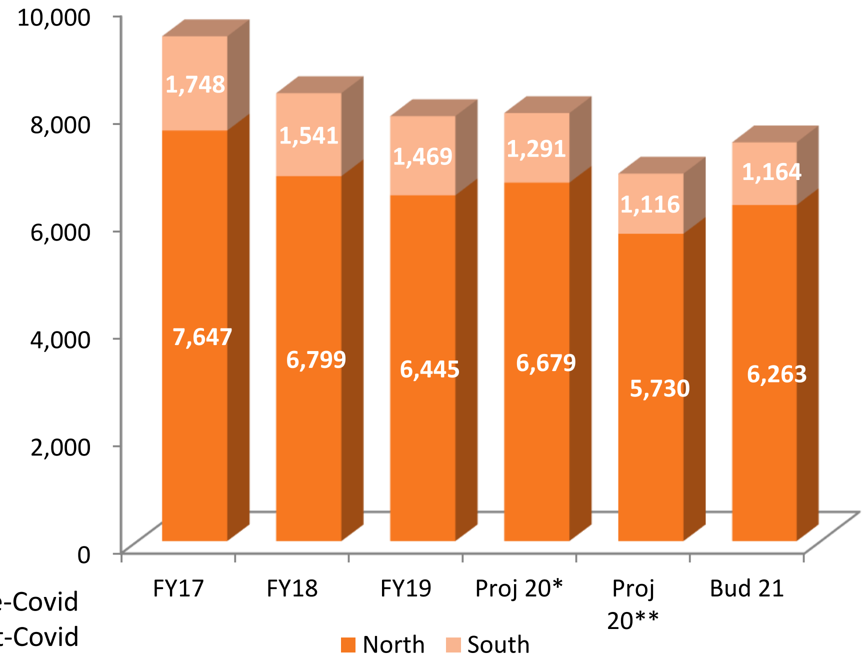
**Post-Covid

Surgeries

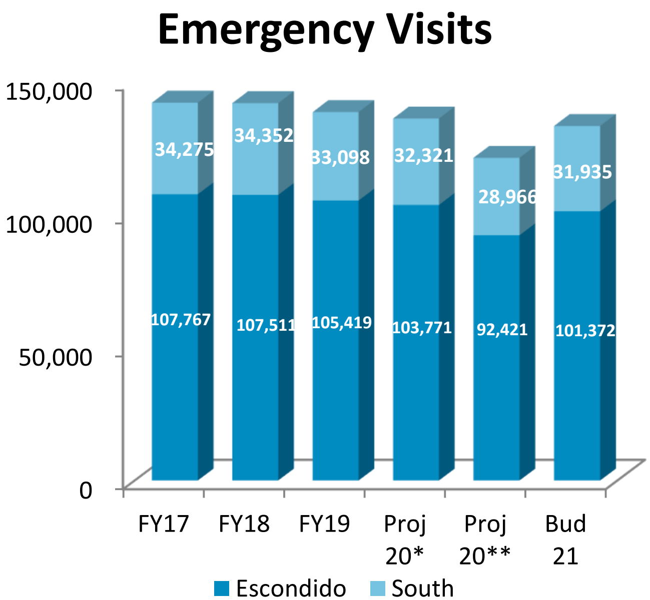
FY2021 inpatient surgeries are decreasing by 6.8%, based on the anticipated COVID-19 impact on Q1 volumes

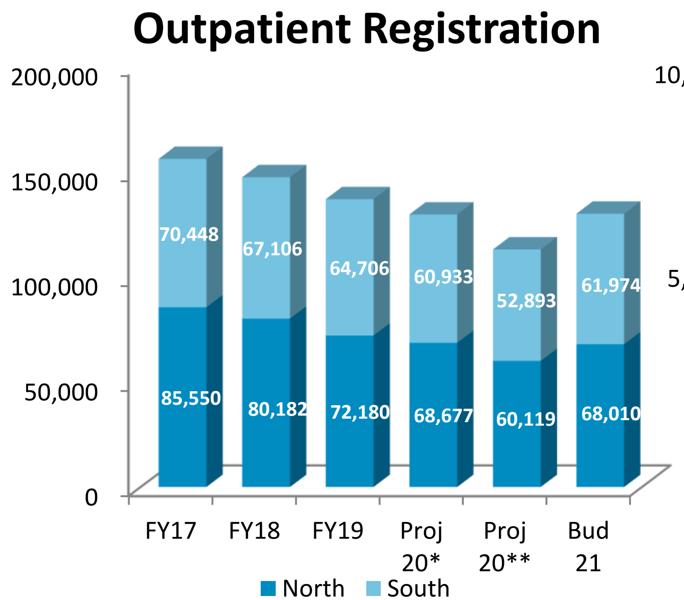


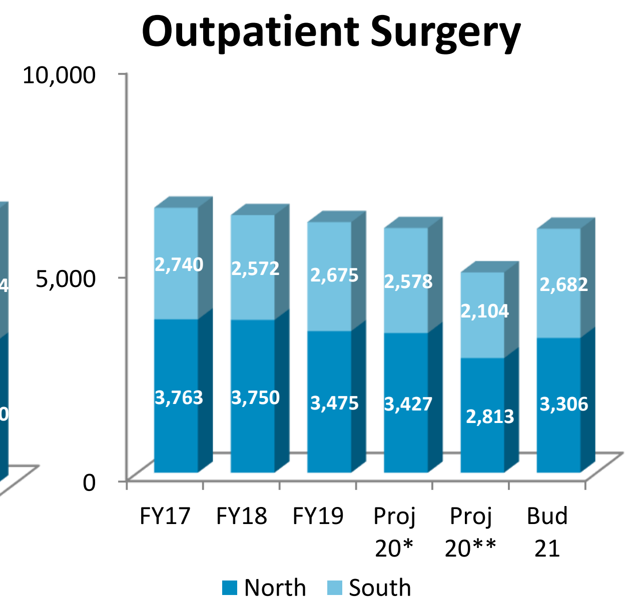
Key Statistical Indicators | Outpatient

Outpatient Services

- Emergency Department visits are decreasing by 2,785, or 2%, to align with industry expectations related to COVID-19
- Outpatient registrations are relatively flat year over year as planned growth in Infusion Services and the Crisis Stabilization Unit offsets lower volume in the first quarter
- Outpatient surgeries are relatively flat as regulatory requirements shift cases from the inpatient setting



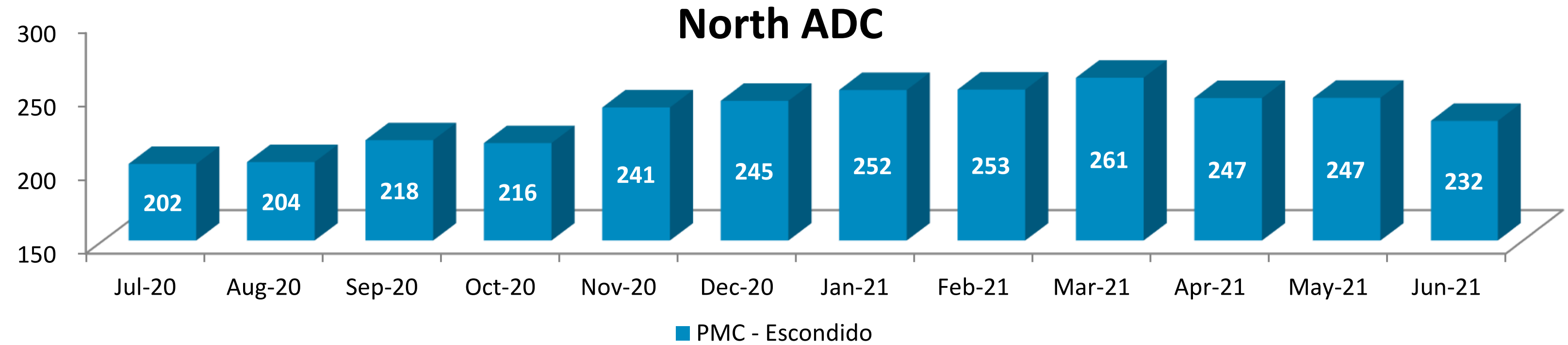


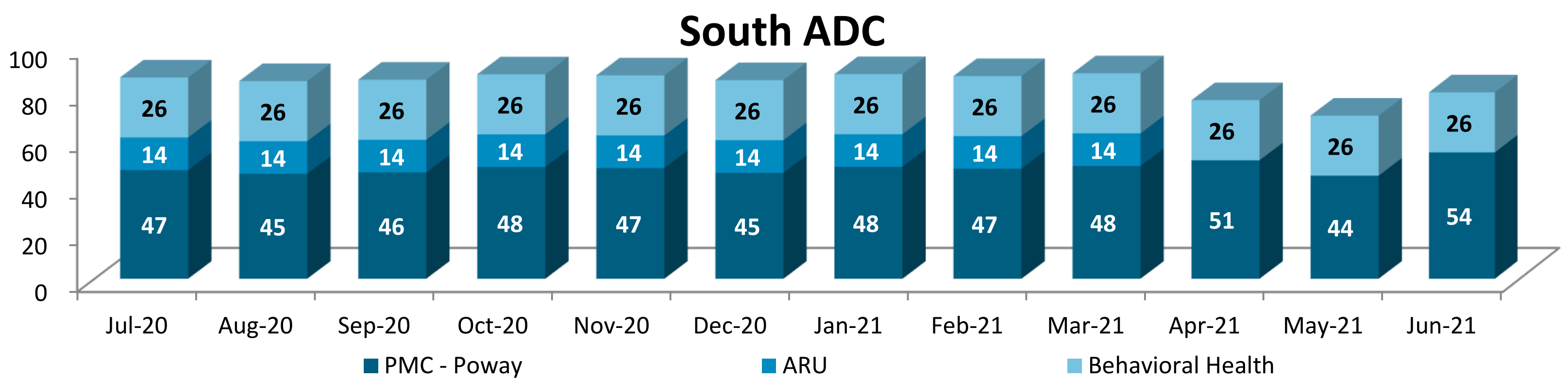


*Pre-Covid **Post-Covid

Key Statistical Indicators | ADC by Month

- Patient days are expected to begin the fiscal year low and slowly increase due to the COVID-19 pandemic
- The Average Daily Census at Poway is driven by the movement of services from the Downtown Campus

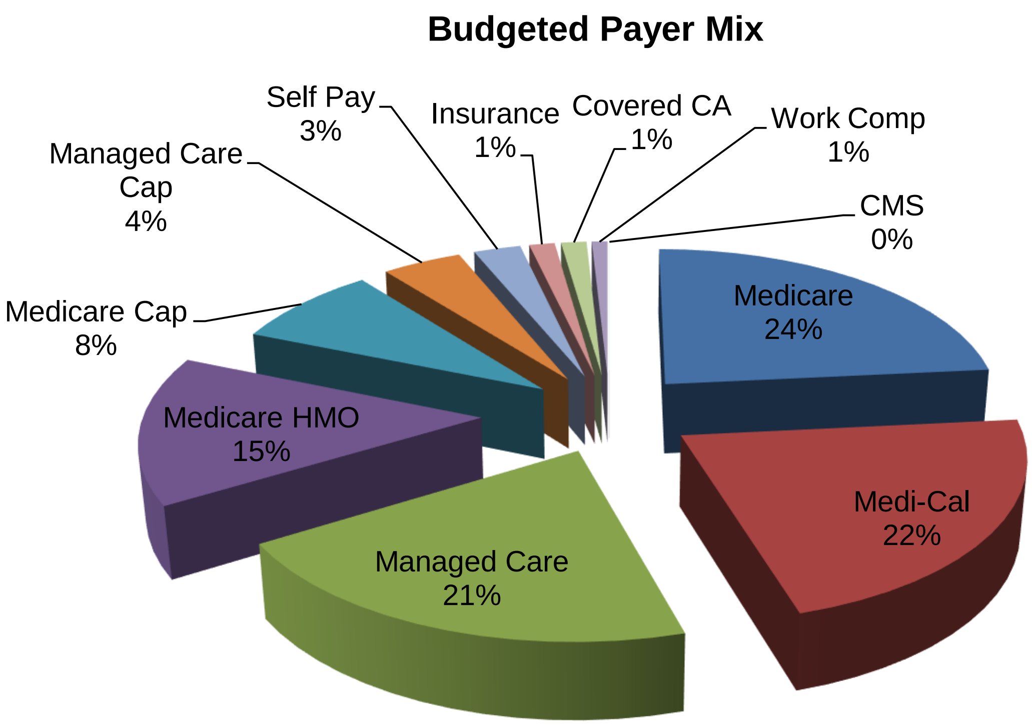




Revenue

Key Revenue Considerations

Payor Category	Total Charges *($000s)*
Medicare	$ 1,050,383
Medi-Cal	$ 986,055
Managed Care	$ 932,651
Medicare HMO	$ 668,081
Medicare Cap	$ 367,503
Managed Care Cap	$ 195,796
Self Pay	$ 115,576
Insurance	$ 62,551
Covered CA	$ 62,418
Work Comp	$ 38,528
CMS	$ 250
Total	**$ 4,479,792**

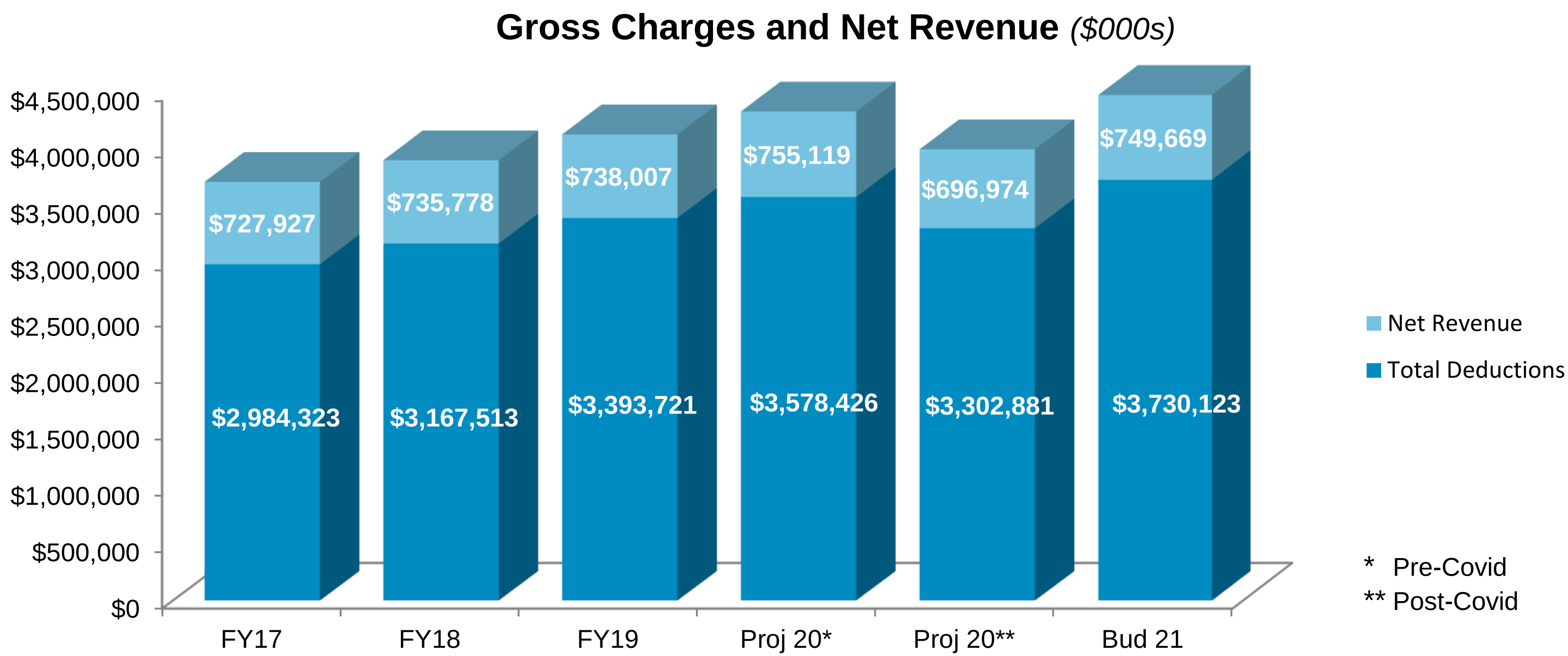


Assumptions

- 6.2% overall effective rate increase (targeted 6.75%)
- FY2021 bad debt and uncompensated care 1.9%; FY2020 Budget = 1.7%
- Climbing unemployment rates are expected to increase bad debt

Revenue Trend Analysis

Net revenue is relatively flat year-over-year



$ 2,984,323	$ 3,167,513	$ 3,393,721	$ 3,578,426	$ 3,302,881	$ 3,730,123	Total Deductions*
$ 727,927	$ 735,778	$ 738,007	$ 755,119	$ 696,974	$ 749,669	Net Revenue
$ 3,712,250	$ 3,903,290	$ 4,131,728	$ 4,333,546	$ 3,999,855	$ 4,479,792	Total Gross Revenue

*Deductions include net capitation impact

Salaries, Wages, Benefits & FTEs

Labor Assumptions

The FY2021 Operational Budget reflects a concerted effort to align labor expenses with revenue projections in a post-COVID-19 environment. Key drivers of labor assumptions:

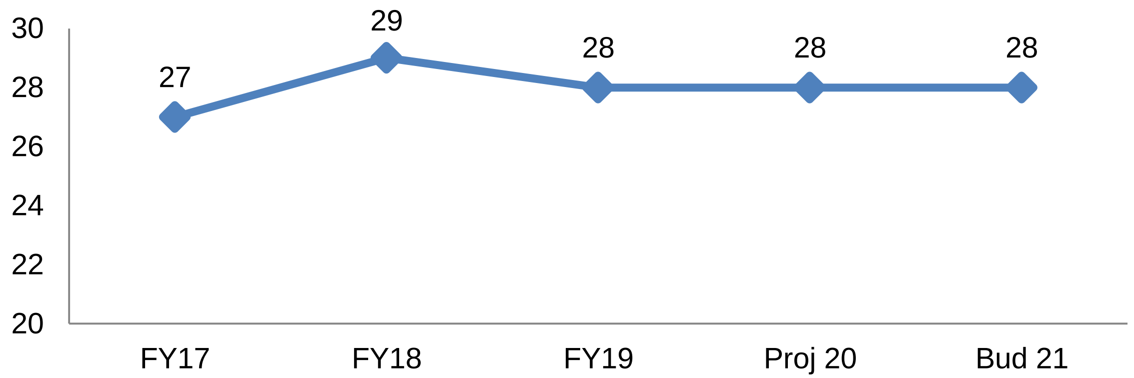
- Includes the addition of 101 clinical FTEs in key areas to align with current practice, industry standards, and community needs
- Maintains focus on staff education to support operational initiatives around quality improvement, patient satisfaction, and technology implementation
- Restructures support and ancillary services to respond to the expected local volume
- Integrates strategic initiatives to improve patient placement, throughput, and productivity
- Relocates services from the Downtown Campus to Escondido and Poway, preventing interruption of services to the community
- Increases staffing in the Crisis Stabilization Unit and Behavioral Health Units to meet the growing demand for these services in the community

Labor Analysis | FTEs

FY2021 Budgeted FTE Roll Forward	FTEs
FY2020 Paid FTEs (as of 2/29/2020)	**3,676**
RIF & Volume-Related Changes	(141)
Downtown Campus Closure	(72)
Operational Efficiencies	11
Clinical FTE Additions	101
FY2021 Paid FTE's	**3,575**

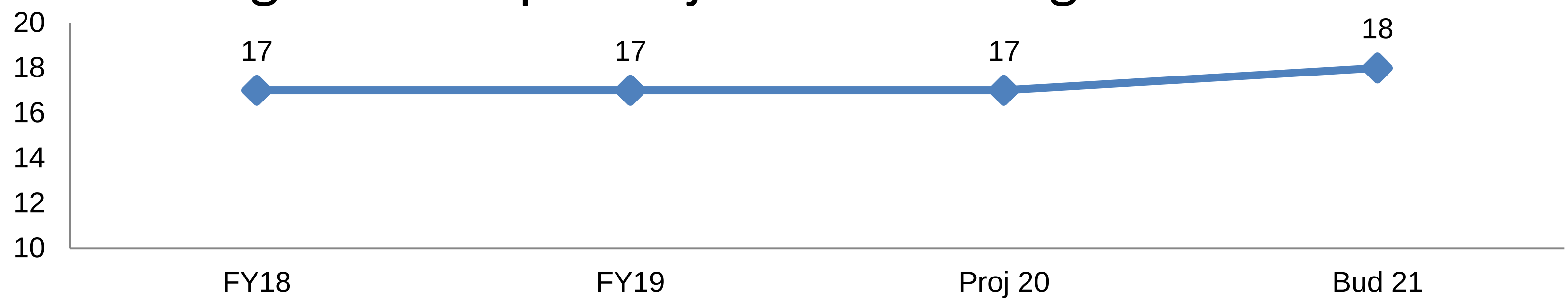
FTEs per Adjusted Discharge (Incl. SNF)

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

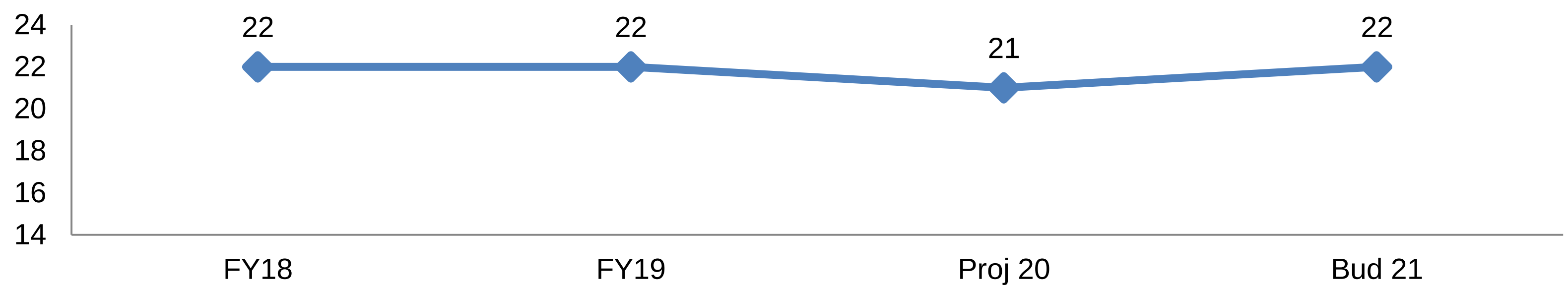


Labor Analysis | Direct Caregiver FTEs

Direct Caregiver FTEs per Adjusted Discharge



Direct Caregiver FTEs per Adjusted Discharge (Incl. support)

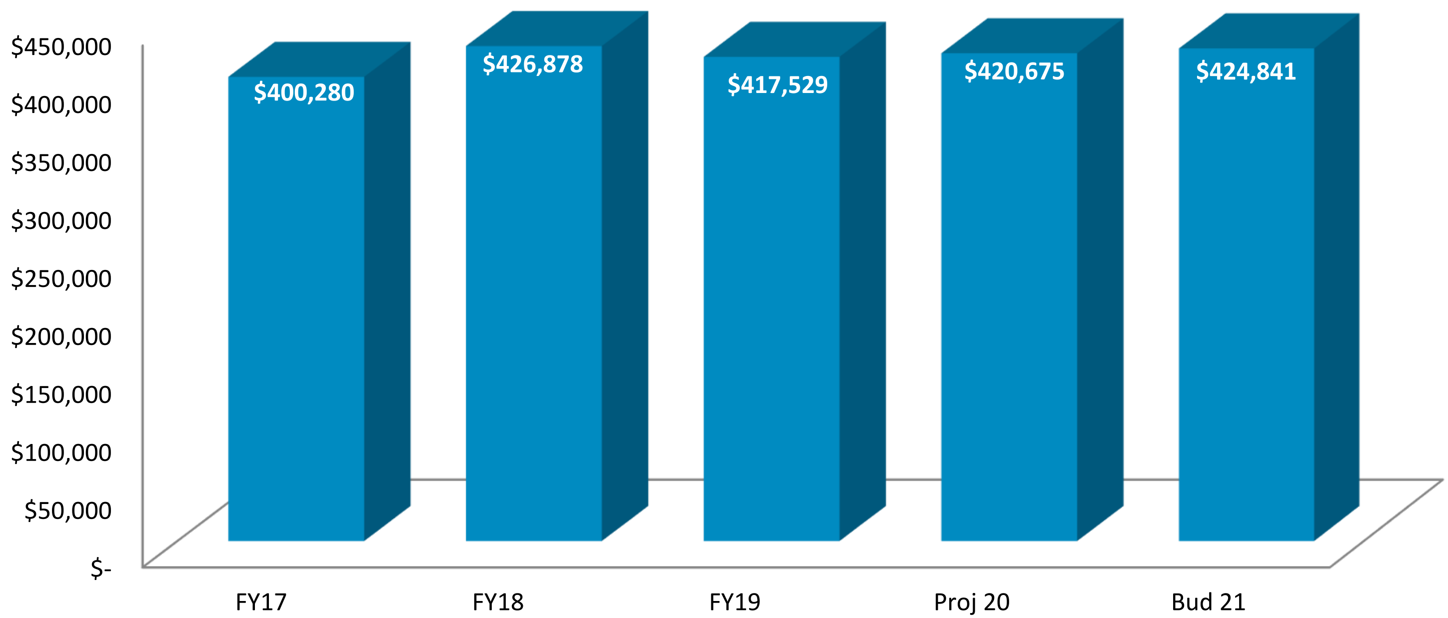


- Direct caregiver FTEs per adjusted discharge increase over current year projections
- Planned decreases in contract labor, overtime, and premium pay hours are incorporated into the FY2021 Budget

Labor Analysis | Salaries, Wages & Benefits

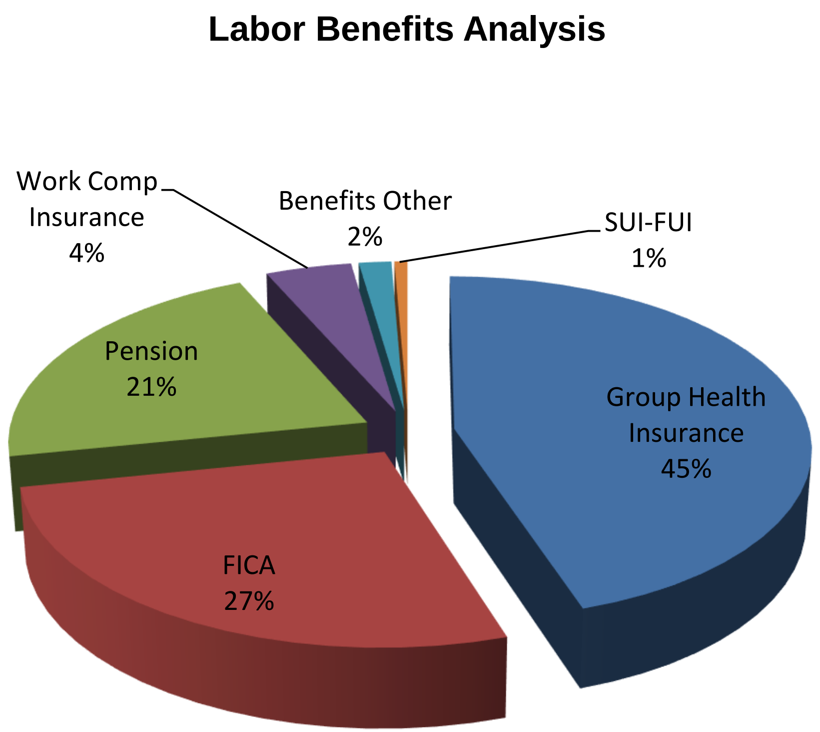
- FY2021 total Salaries, Wages, Contract Labor, and Benefits are increasing by $4.2 million or 1%
- Salary and benefit increases are offset by position reductions, as well as improvements in premium pay and contract labor over current year

Total Salaries, Wages & Benefits *($000s)*



Labor Analysis | Benefits (Excl. PTO)

Type of Benefit	% to Total Benefits
Group Health Insurance	45%
FICA	27%
Pension	21%
Workers' Compensation Insurance	4%
Benefits Other	2%
SUI-FUI	1%
Total Benefit Spend *($000s)*	**90,839**



Significant Impacts

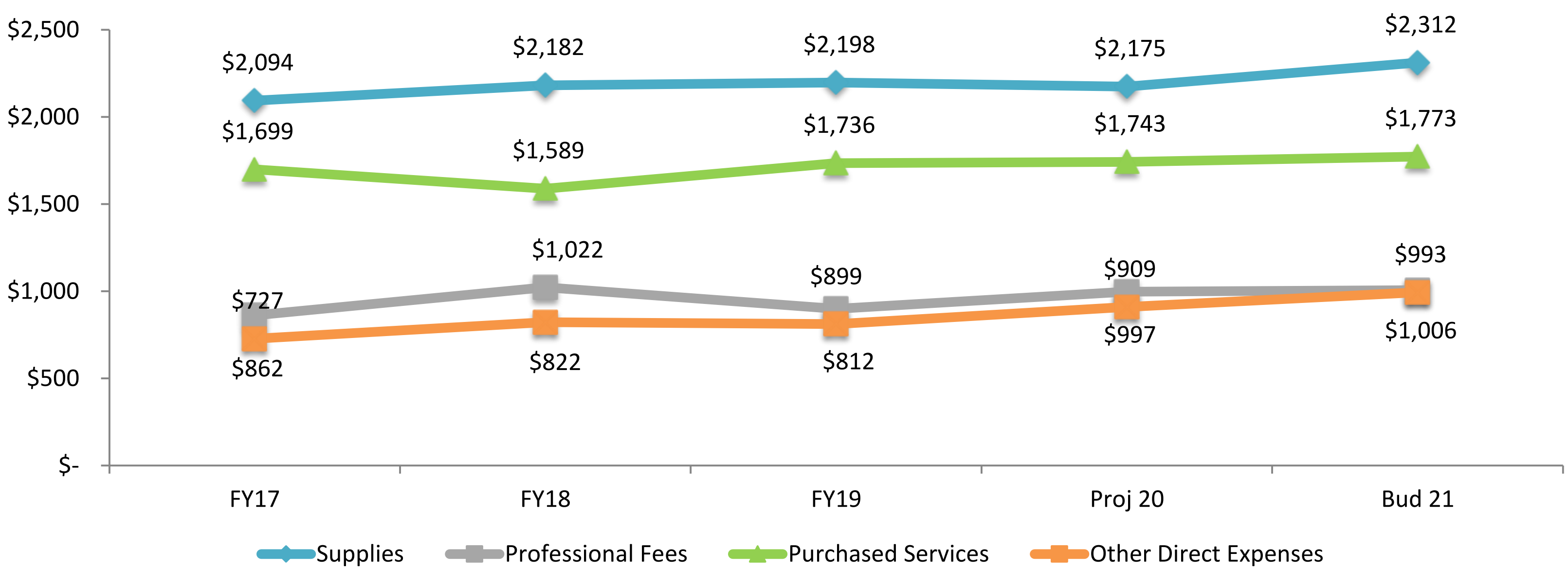
- Group health insurance expenses are flat year-over-year
- FICA, Pension, and Workers' Compensation are all increasing in proportion with salaries

Non Labor Analysis

Non Labor Analysis | Summary

- FY2021 Non Labor expense is decreasing $3.7 million or 1.1%, due to several targeted initiatives to reduce overhead expenses
- Despite an overall reduction, Non Labor expense is increasing by 3.9% on a per adjusted discharge basis compared to pre-COVID-19 projections, due to lower adjusted discharges

Trended Non Labor Expense per Adjusted Discharge *($000s)*

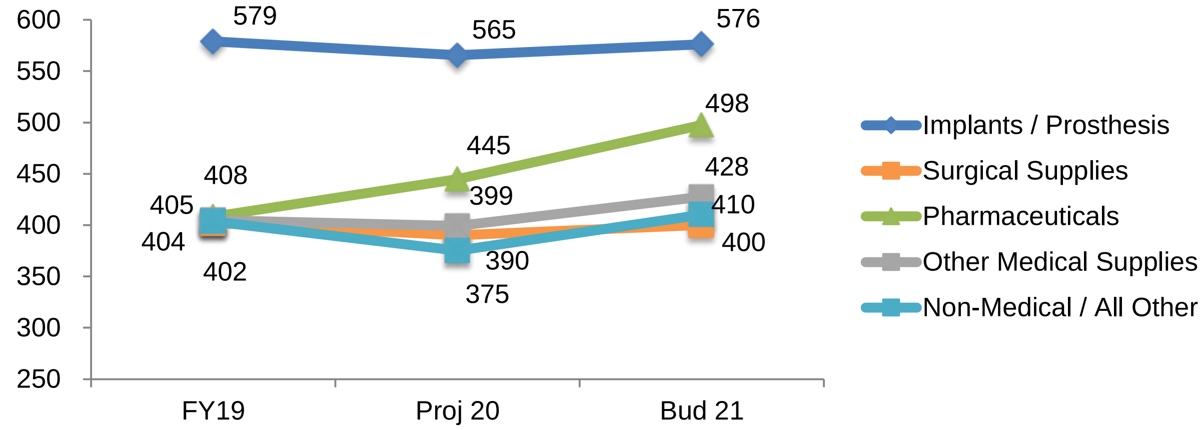


Non Labor Analysis | Supplies

FY2021 Supply Roll Forward	Expense ($000s)
FY2020 Supply Expense (Dec 2019 Projection)	**$105,751**
Changes due to Volume and Utilization	586
Inflationary increases due to COVID-19	1,400
Supply Reduction Initiatives	(1,400)
FY2021 Budgeted Supply Expense	**$106,337**

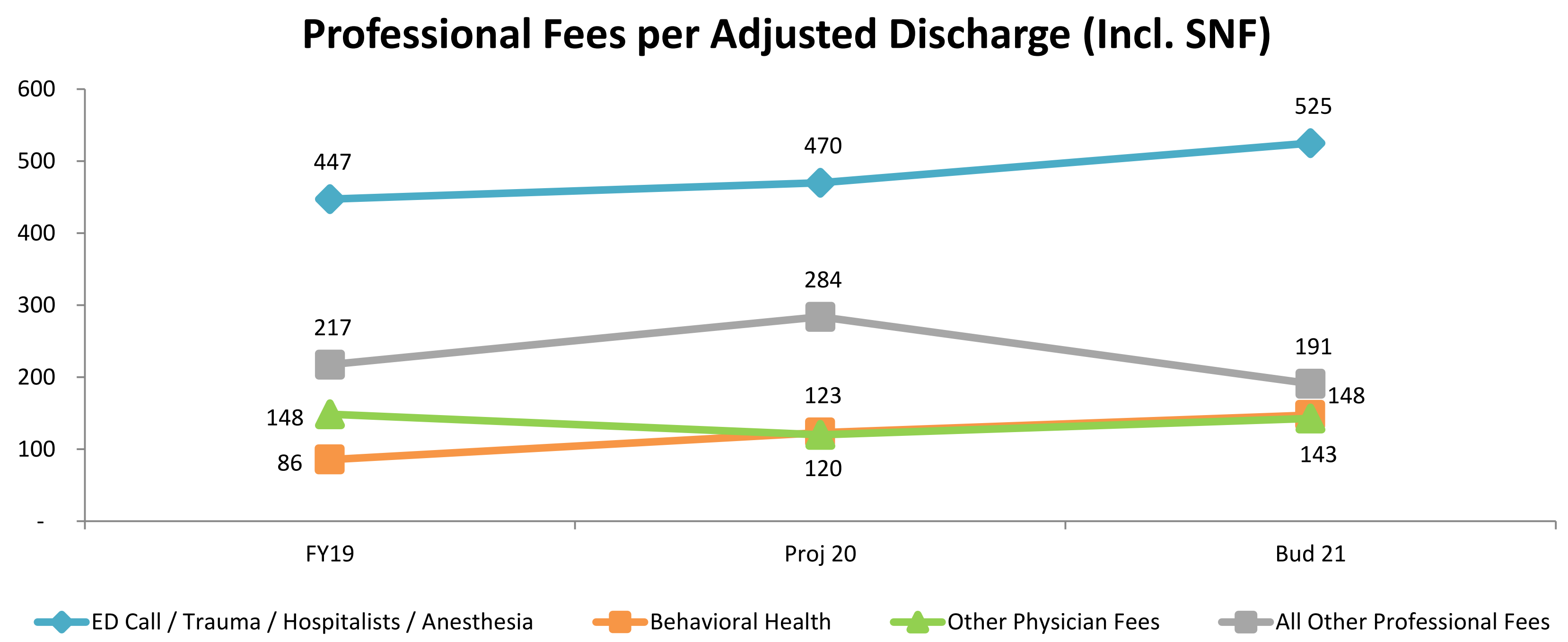
Supplies per Adjusted Discharge (Incl. SNF)

Supply management efforts and reduction initiatives totaling $1.4 million are helping to offset projected increases in cost due to COVID-19



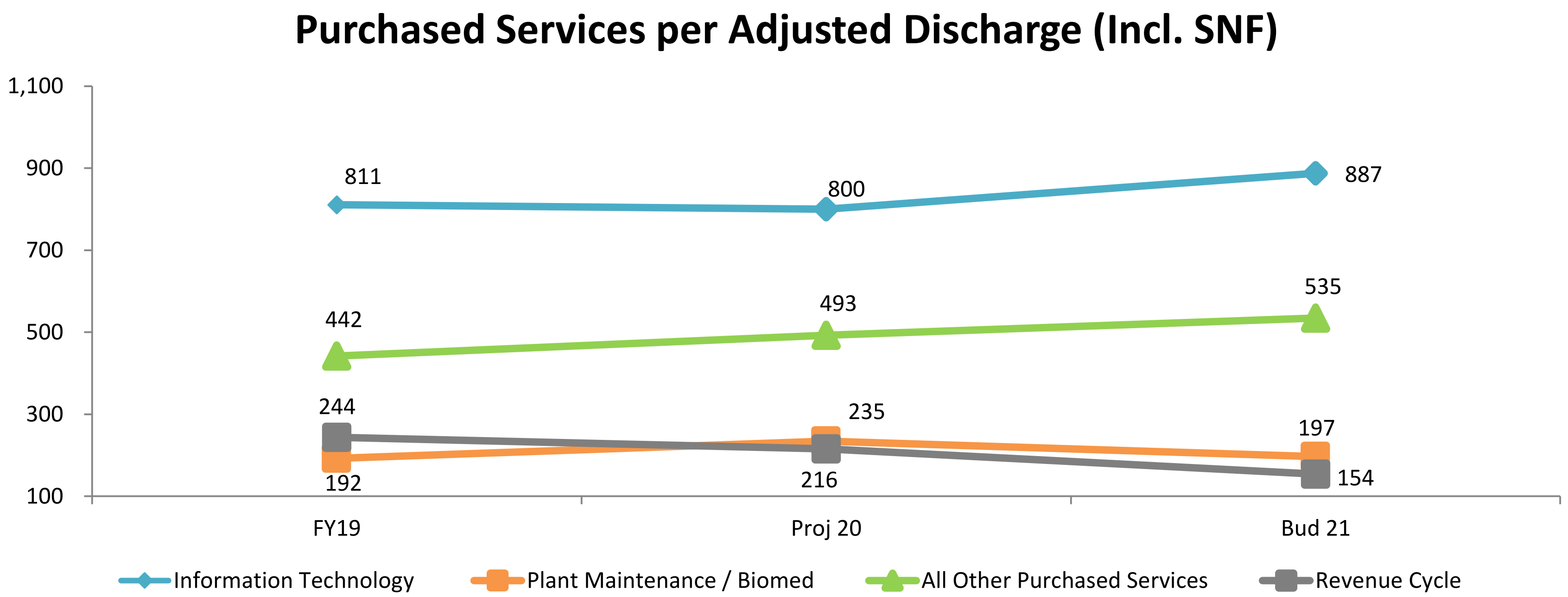
Non Labor Analysis | Professional Fees

- FY2021 Professional Fees are decreasing by $2.2 million or 4.5%
- Reductions in legal, consulting, and management fees are offsetting increasing annual increases in physician contracts



Non Labor Analysis | Purchased Services

- FY2021 Purchased Services are decreasing by $3.2 million or 3.8%, year over year
- Increases in Information Technology are offset by reductions in Revenue Cycle, Facilities, and Marketing



Purchased Services | IT Roadmap

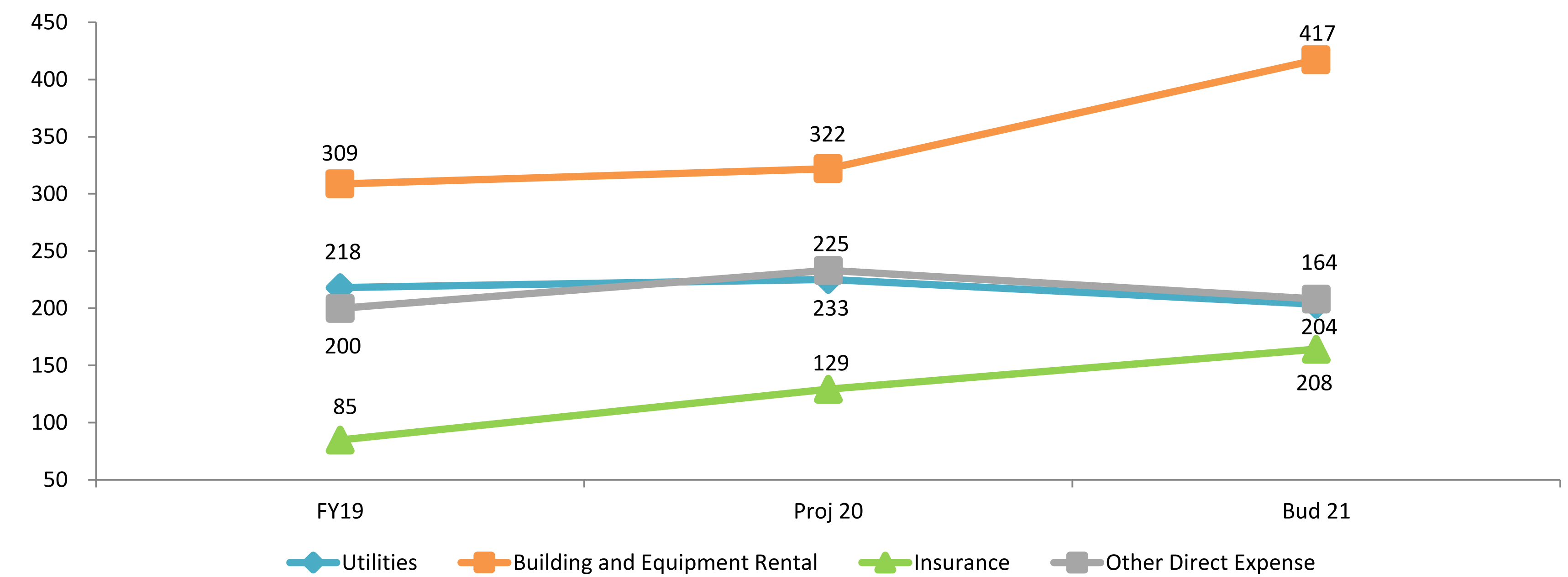
FY2020 Accomplishments	
Cerner Clarity Upgrade to 2018 Code	McKesson PACS Upgrade
Physician to Patient systems / Patient to Family tools	BD Pyxis Upgrade
ACR Select Radiology Decision Support Phase I (ED)	Muse Cardiology System Upgrade
Olive Artificial Intelligence for Revenue Cycle	Mobile Device Manager Install
Cerner Power Chart Specimen Collection Install	Telecom SIP to VOIP Phone Upgrade
Health Grades Rollout	Downtown Campus Move

FY2021 Planned Projects	
Patient Safe Implementation @ PMC Poway	Physician Results Distribution Standardization
ATT FirstNet Public Safety Call System	Viz AI Stroke Program
Enhanced Network Security	TeleTracking Upgrade
Network Infrastructure Upgrades	Anesthesia Documentation System
Alaris Infusion Smart Pump Integration	E-Prescribing of Controlled Substances
Radimetrics Infusion Dosing	SMP Sterile Processing System Install

Non Labor Analysis | Other Direct Expense

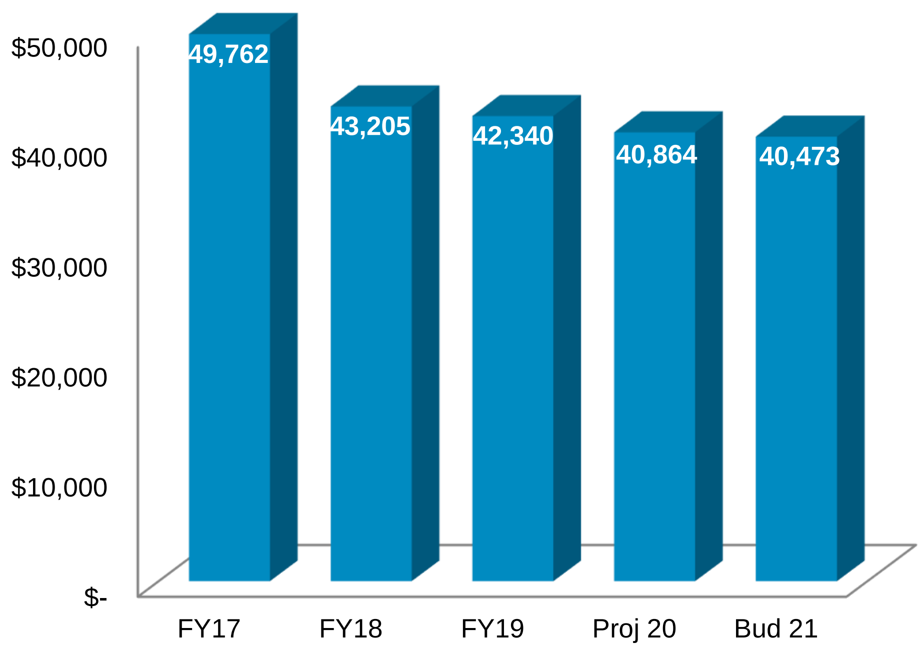
- FY2021 Budgeted Other Direct Expense is increasing by $1.5 million or 3.3%
- Increases are primarily driven by rental expenses and insurance, while utilities decrease with the closure of the Downtown Campus

Other Direct Expense per Adjusted Discharge (Incl. SNF)

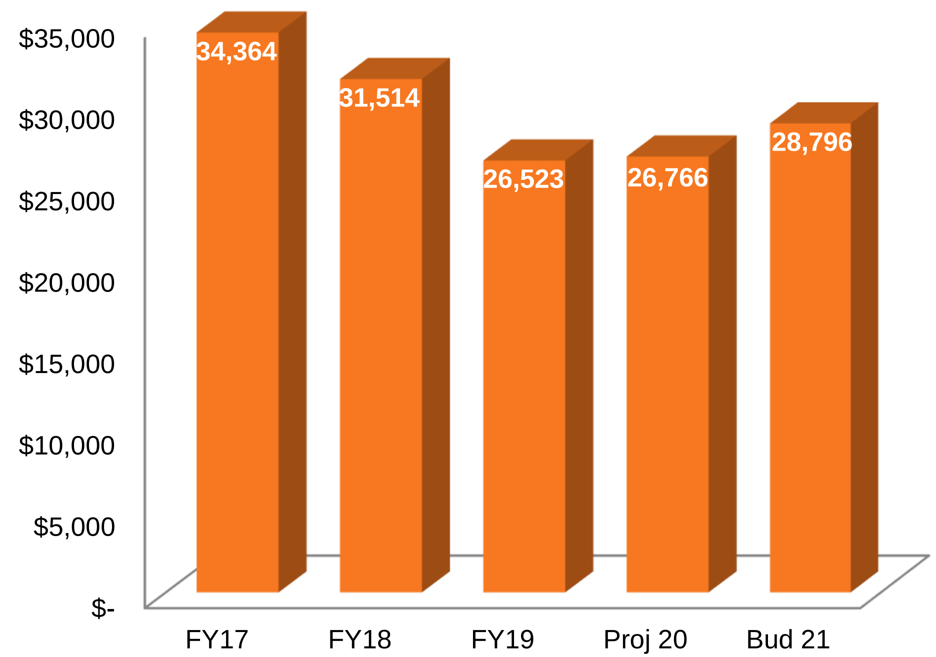


Depreciation and Interest Expense

Depreciation Expense *($000s)*



*** Interest Expense** *($000s)*



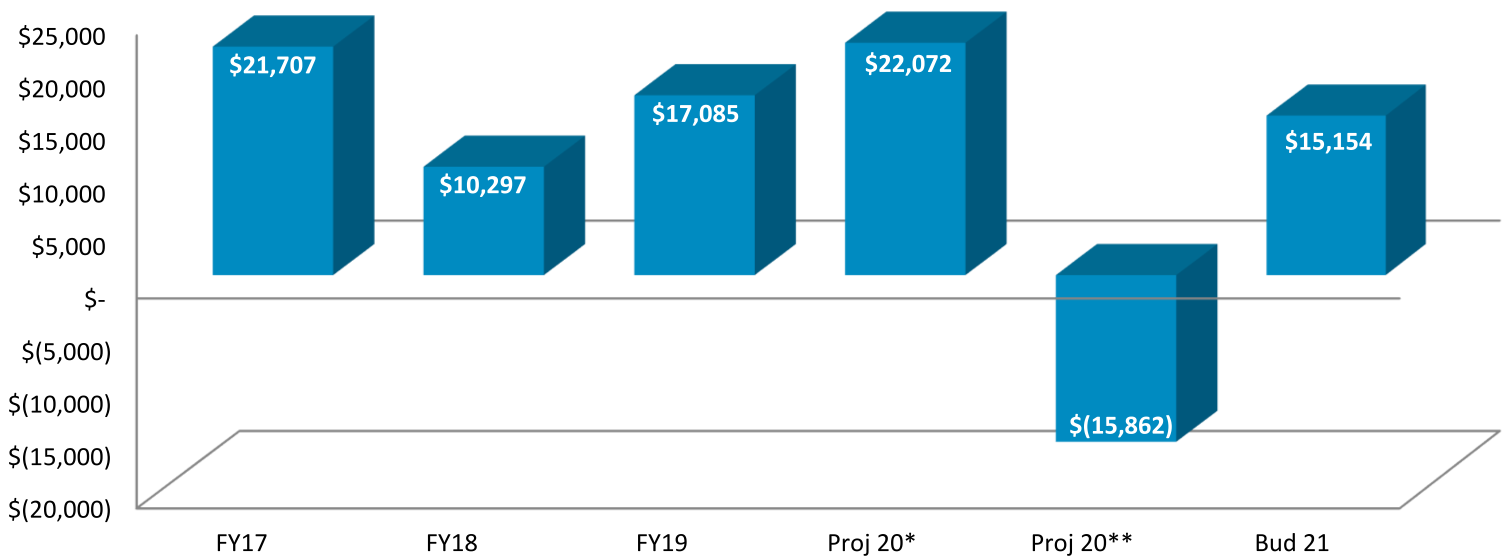
*Interest expense reflected for Revenue Bonds only

Annual Operating Budget Summary & EBIDA Recap

Income from Operations

- Though FY2021 Income from Operations is decreasing by $6.9 million from pre-COVID-19 projections, it represents a $31.0 million improvement from expected FY2020 year-end results
- The increase is driven through significant focus on aligning expenses with volume

Income from Operations *($000s)*



*Pre-Covid
**Post-Covid

Annual Operating Budget Summary and Trend

	FY2019 Results	FY2020 Projection (Pre-COVID)	FY2020 Projection (Post-COVID)	FY2021 Budget
Revenue:				
Net Revenue	738,007,078	755,119,472	696,973,873	749,668,707
Other Operating Revenue	11,477,276	11,666,144	9,980,585	10,660,164
Total Operating Revenue	**$ 749,484,354**	**$ 766,785,616**	**$ 706,954,458**	**$ 760,328,871**
Expenses:				
Salaries, Wages, Registry, Benefits	417,529,146	420,675,159	406,439,149	424,841,015
Supplies	106,120,524	105,751,361	101,643,172	106,336,558
Depreciation	42,340,412	40,864,290	41,619,579	40,473,266
Other	166,408,813	177,422,991	173,114,315	173,523,622
Total Operating Expense	**$ 732,398,895**	**$ 744,713,801**	**$ 722,816,215**	**$ 745,174,461**
Operating Income	17,085,459	22,071,815	(15,861,756)	15,154,410
Non-Operating Income (Loss)	(1,275,601)	4,045,525	31,038,763	8,117,775
(Interest Expense)	(26,523,316)	(26,766,313)	(27,614,816)	(28,795,592)
Unrealized (loss) gain on interest rate swap	(6,569,730)	-	-	-
Property Tax Revenue	17,608,947	17,802,717	17,900,001	17,900,000
Income (Loss)	**$ 325,759**	**$ 17,153,744**	**$ 5,462,193**	**$ 12,376,593**
Foundation Support	16,569,000	18,232,012	18,232,012	21,988,000
Net Margin %	0.0%	2.2%	0.8%	1.6%
OEBIDA Margin (Excl. Property Tax Rev)	7.9%	8.2%	3.6%	7.3%
OEBIDA Margin (Incl. Property Tax Rev)	10.3%	10.5%	6.2%	9.7%
EBIDA Margin	10.1%	11.1%	10.6%	10.7%
Total Uncompensated Care & Bad Debt	70,688,405	84,150,504	77,886,208	86,481,710
Total Uncompensated Care as % of Gross	1.71%	1.94%	1.94%	1.93%

FY2021 EBIDA Recap *($000s)*

	FY2019 Results	FY2020 Projection (Pre-COVID)	FY2020 Projection (Post-COVID)	FY2021 Budget
Net Income from Ops (Excl. Interest Expense)	17,085	22,072	(15,862)	15,154
Depreciation Expense	42,340	40,864	41,620	40,473
OEBIDA	**$ 59,426**	**$ 62,936**	**$ 25,758**	**$ 55,628**
OEBIDA Margin (Excl. Property Tax Rev)	7.9%	8.2%	3.6%	7.3%
OEBIDA Margin (Incl. Property Tax Rev)	10.3%	10.5%	6.2%	9.7%
EBIDA	**75,759**	**84,784**	**74,697**	**81,645**
EBIDA Margin	**10.1%**	**11.1%**	**10.6%**	**10.7%**
Total Uncompensated Care & Bad Debt	70,688	84,151	77,886	86,482
Total Uncompensated Care as % of Gross	1.71%	1.94%	1.94%	1.93%
Net Income / (Loss) after Non-Op Income	**$ 326**	**$ 17,154**	**$ 5,462**	**$ 12,377**

Capital Plan

Capital Plan | Three-Year Planning Process

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

- Equipment reaching end of useful life
- Organizational strategic initiatives and expansion of services in the community
- Enhancing the IT capabilities of the organization to improve physician, staff, and patient experience
- Deploying capital across the entire district
- Balancing the needs vs. resources of the organization

Funding sources for capital projects include:

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

Capital Plan | Three-Year Summary

Three-Year Capital Budget Summary *($000s)*

	FY2021	FY2022	FY2023	Total Project Spend
Funded by Operations:				
Equipment	1,500	2,500	3,500	7,500
Facilities	3,500	3,500	5,000	12,000
IT	3,165	4,000	4,500	11,665
Strategic Service Line	1,000	2,000	7,500	10,500
Outpatient Strategy	3,000	9,000	-	12,000
Other	1,680	-	-	1,680
Subtotal	**13,845**	**21,000**	**20,500**	**55,345**
Capital from Restricted Funds:				
Escondido 9th Floor Build-out	5,000	9,000	6,000	20,000
Poway Renovation	3,550	-	-	3,550
NICU Expansion - Escondido	1,250	-	-	1,250
Other	3,900	-	-	3,900
Subtotal	**13,700**	**9,000**	**6,000**	**28,700**
Funded by Foundation:	**2,500**	**1,000**	**-**	**3,500**
Total	**30,045**	**31,000**	**26,500**	**87,545**

FY2021 Budget Summary & Key Take-Aways

Summary

FY2021 Budget is an achievable plan, given the current assumptions related to the COVID-19 pandemic. It aligns with Palomar Health's Strategic Financial & Capital Plan and will require success in the following areas:

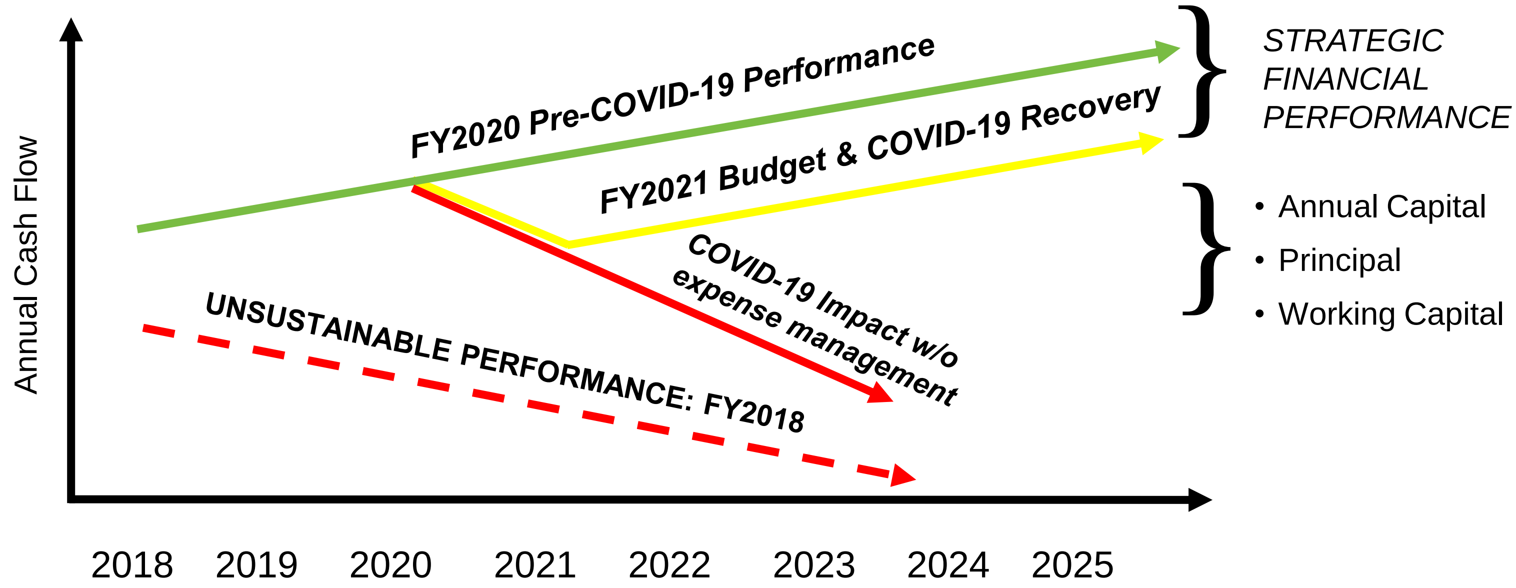
- Fully reopening the operating rooms and outpatient services to return patient volumes to pre-COVID-19 levels by Q2
- Sale and closure of Palomar Medical Center Downtown Escondido
- Continued focus and implementation of initiatives to manage variable expenses which align with fluctuating volume levels resulting from the COVID-19 pandemic
- Partnership with San Diego County to plan and provide services for the growing Behavioral Health population

Successful Execution will result in:

- Enable Palomar Health to recover from the financial impact of the COVID-19 pandemic and successfully operate in the post-COVID-19 environment
- Deployment of sufficient capital to meet the needs of the organization and continued improvement of liquidity
- Continued improvements in clinical excellence and patient satisfaction
- Net income and EBIDA improvement of $6.9 million over post-COVID-19 FY2020 projections; operating income improvement of $31.0 million; EBIDA of $81.6 million

Five-Year Financial Projections

Five-Year Financial Projections



Palomar Health needs a sound financial strategy in order to:

- Deploy sufficient capital to support the strategic plan and development / expansion of services
- Adjust capacity to serve the changing needs of the community in a post-COVID-19 environment
- Continue the development of a fully integrated health delivery system
- Fund sufficient capital to replace aging equipment and renovate facilities
- Continue to improve key liquidity ratios and achieve investment level ratings for all the rating agencies

Five-Year Financial Projections

Ratio/Statistic (in thousands)	Audit		Targeted	Projection Years				
	2018	2019	2020	2021	2022	2023	2024	2025
Total Operating Revenue	$794,167	$789,304	$753,732	$846,999	$868,736	$927,153	$942,217	$979,593
Operating EBIDA	$32,920	$38,029	$6,889	$35,294	$35,798	$74,381	$72,728	$79,463
Operating Income	($41,709)	($32,221)	($62,999)	($33,383)	($33,306)	$5,009	$3,296	$9,835
Operating Income excl. Interest Expense	($11,861)	($5,698)	($36,081)	($7,669)	($8,129)	$29,594	$27,254	$33,138
Net Income	($15,280)	($22,507)	($13,450)	($8,707)	($6,113)	$33,395	$33,148	$41,186
Unrestricted Cash	$200,404	$212,958	$245,707	$221,192	$226,006	$266,704	$307,900	$352,376
Capital Expenditures	$21,037	$18,702	$20,000	$30,045	$31,000	$26,500	$27,000	$29,500
Profitability								
Operating Margin	(5.3%)	(4.1%)	(8.4%)	(3.9%)	(3.8%)	0.5%	0.3%	1.0%
Operating Margin excl. interest expense	(1.5%)	(0.7%)	(4.8%)	(0.9%)	(0.9%)	3.2%	2.9%	3.4%
Excess Margin	(1.9%)	(2.9%)	(1.8%)	(1.0%)	(0.7%)	3.6%	3.5%	4.2%
Operating EBIDA Margin	4.1%	4.8%	0.9%	4.2%	4.1%	8.0%	7.7%	8.1%
Debt Position (Includes Arch)								
Debt Service Coverage (x)	1.3x	1.4x	1.4x	1.5x	1.6x	2.6x	2.6x	2.8x
Total Debt to Capitalization	80.0%	83.7%	85.0%	85.8%	86.3%	81.7%	77.4%	72.4%
Liquidity								
Cash to Debt	31.1%	33.9%	39.9%	36.7%	38.4%	46.5%	55.1%	64.9%
Days Cash On Hand (days)	92.5	99.9	115.9	96.4	96.1	111.0	125.8	139.3
Days Cash On Hand (days) - Ex interest	96.1	103.5	120.1	99.5	99.0	114.2	129.3	142.9
Other								
Discharges	28,441	29,434	29,423	29,531	29,640	29,011	27,927	28,435
Adjusted Discharges	47,659	48,327	47,041	47,414	47,869	46,164	44,258	45,065
Cost / Adj Discharge	$14,567	$14,279	$15,057	$15,109	$15,380	$16,345	$17,390	$17,712
Capital Spending Ratio	47.0%	42.8%	46.5%	69.9%	70.6%	59.2%	59.4%	63.7%