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## FY 2015 Annual Operating and Capital Budget

Board of Directors Budget Review and Adoption Workshop

June 9, 2014

## Agenda

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- Executive Summary
- FY 2015 Budget Overview:
  - Key Budget Drivers
  - Inflationary Assumptions
- Key Statistical / Growth Indicators
- Revenue
  - Key Revenue Assumptions / Payer Mix
  - Revenue Trend Analysis
- Salaries, Wages, Benefits & FTEs:
  - 5 Year Salary, Benefits and FTE Trend Analysis
- Non Labor 5 Year Analysis:
  - Supplies / Professional Fees / Purchased Services / Other Direct Expense
- 2015 Annual Budget Summary / EBIDA Recap
- Three Year Capital Planning

## Executive Summary

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- FY 2015 Annual Budget provides reasonable and achievable targets which continues to put us on a path to achieving our approved Financial and Capital Plan (EBIDA growth of \$9 million from Plan) as well as toward a Medicare cost profile
- It is the result of a concerted effort by administrative and medical staff leadership to absorb inflation and continue to look for greater efficiency in all areas of the organization - clinical and non-clinical
- The operating and capital budgets are aligned with our current year and long term strategic plan initiatives
- The budget process included significant physician leadership engagement to identify reasonable and achievable resource expenditure targets in specific areas



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# FY 2015 Budget – Key Drivers & Overview

## Key Plan Drivers



- Strategic Plan alignment including targeted \$9 million EBIDA growth year over year; this growth is consistent with the long-range Financial and Capital Plan targets and achievement of bond covenants
- Continued reimbursement pressures: governmental payer changes, trend towards capitated contracts, and Covered California transition
- Expense management strategies and initiatives include reducing labor costs through our “Patient Throughput” initiative as well as, enhancing supply costs savings through utilization and rate efforts

Patient Throughput Initiative	Supply Exp Reduction Initiative
\$1,000,000	\$1,800,000

- Examination of outsourcing opportunities and continuation of strategies already in place
- Assessment of service lines and contribution margin profitability
- Continued focus on IT related enhancements and solutions; achievement of meaningful use and revenue cycle opportunities

## Key Plan Drivers

KEY DRIVERS

### Palomar Health – Baseline Financial Projections (\$ millions)

Ratio/Statistic	Projected FYE	Budget	Projections				
	2014	2015	2016	2017	2018	2019	2020
Total Operating Revenue	\$602,892	\$634,570	\$666,759	\$701,060	\$732,391	\$768,531	\$807,174
Operating Income	(\$39,391)	(\$26,172)	(\$22,267)	(\$15,640)	(\$9,654)	(\$3,609)	\$1,871
Operating Income Including Prop. Tax Revenue	(\$26,103)	(\$12,272)	(\$8,228)	(\$1,461)	\$4,667	\$10,856	\$16,480
<b>PH Calculated Operating Income (Exc. Interest Exp.)</b>	<b>(\$5,473)</b>	<b>\$7,161</b>	<b>\$10,306</b>	<b>\$15,690</b>	<b>\$20,482</b>	<b>\$25,141</b>	<b>\$29,557</b>
Net Income	(\$22,163)	(\$9,253)	(\$4,073)	\$2,939	\$9,349	\$15,882	\$21,884
<b>Cash Flow (Net Inc + Depr)</b>	<b>\$34,729</b>	<b>\$46,564</b>	<b>\$50,565</b>	<b>\$57,136</b>	<b>\$64,027</b>	<b>\$71,948</b>	<b>\$80,596</b>
<b>Unrestricted Cash</b>	<b>\$131,738</b>	<b>\$141,469</b>	<b>\$150,431</b>	<b>\$157,619</b>	<b>\$170,919</b>	<b>\$185,867</b>	<b>\$203,027</b>
<b>Profitability</b>							
Operating Margin	(6.5%)	(4.1%)	(3.3%)	(2.2%)	(1.3%)	(0.5%)	0.2%
<b>Operating Margin (Excluding Interest Exp.)</b>	<b>(0.9%)</b>	<b>1.1%</b>	<b>1.5%</b>	<b>2.2%</b>	<b>2.8%</b>	<b>3.3%</b>	<b>3.7%</b>
Operating EBIDA Margin	8.5%	9.9%	9.7%	10.0%	10.3%	10.6%	10.9%
<b>Operating EBIDA Margin (Including Prop. Tax Revenue)</b>	<b>10.7%</b>	<b>12.1%</b>	<b>11.8%</b>	<b>12.0%</b>	<b>12.2%</b>	<b>12.4%</b>	<b>12.7%</b>
<b>Debt Position</b>							
Debt Service Coverage (x)	2.2	2.2	2.3	2.3	2.4	2.4	2.5
<b>Liquidity</b>							
<b>Days Cash On Hand (days)</b>	<b>87.2</b>	<b>90.3</b>	<b>91.2</b>	<b>91.1</b>	<b>94.9</b>	<b>98.7</b>	<b>103.1</b>
<b>Other</b>							
Average Age of Plant	6.7	7.8	9.0	10.0	10.9	11.7	12.1
Compensation Ratio	57.3%	54.9%	56.4%	56.7%	57.1%	57.2%	57.3%
Adjusted Discharges	45,489	49,103	50,190	51,300	52,436	53,596	54,782

Note: Standard and Poor's median for Days Cash on Hand for "BBB/BBB-" categories is 131 Days which is based on fiscal year 2012 results.

Prepared by Kaufman Hall and Associates

## Inflationary Assumptions

- FY2015 Budget assumes the absorption of a significant amount of industry inflation through utilization and efficiency; Several targeted supply management and strategic initiatives were identified
- Pharmaceutical and Implant costs are significant drivers of overall supply costs. As such, the inflation on these two categories will be a key area of focus and pose the most risk

### Healthcare Industry Inflation Comparison

	2015 Budget	Industry Expectations
<b>Implants</b>	<b>0.5%</b>	<b>3.2%</b>
General Surgery Supplies	0.0%	1.0%
Surgical Needles	0.0%	3.0%
Oxygen - Gas	0.0%	2.0%
IV Solutions	2.0%	2.2%
<b>Pharmaceuticals</b>	<b>3.0%</b>	<b>3.0-5.0%</b>
Radioactive and X-Ray Material	1.0%	1.1%
Other Medical	0.5%	1.0%
Food / Meat	3.0%	3.0%
Linen	0.0%	1.0%
All Other: Cleaning/Forms/Office/Uniforms	0.0%	1.0-3.0%



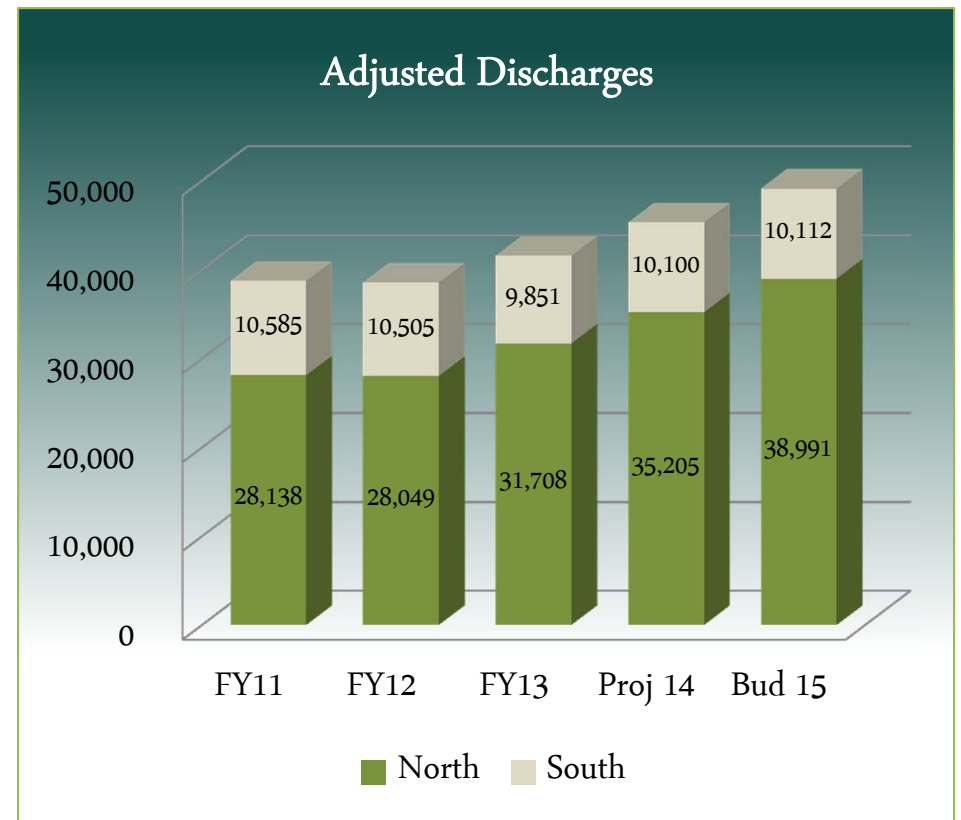
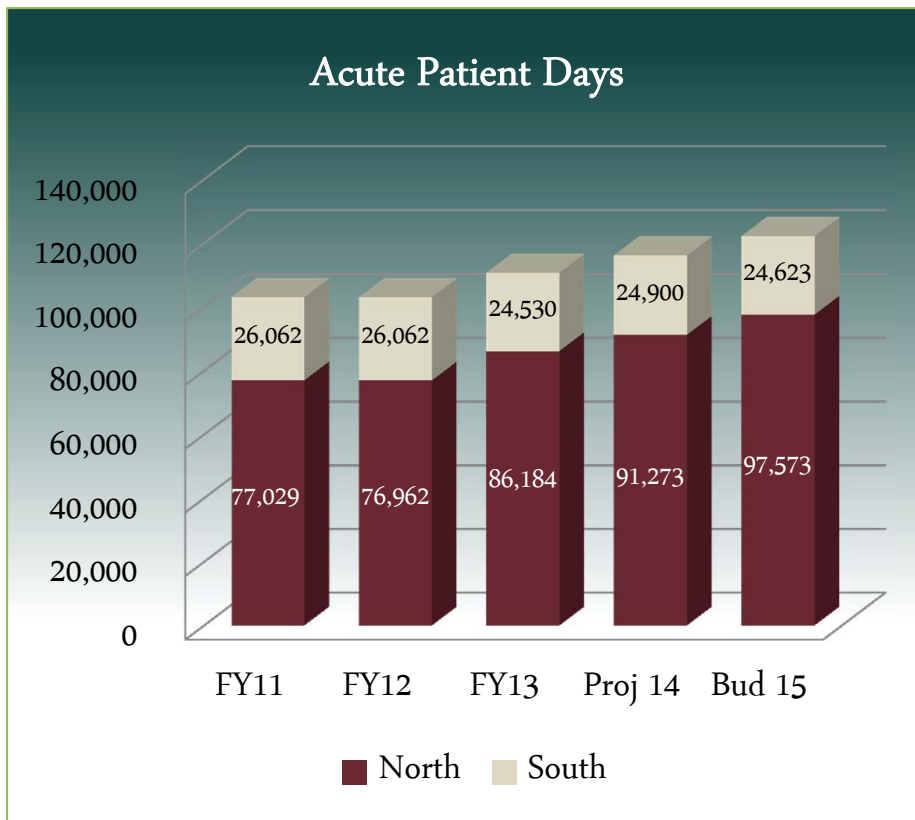
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## Key Statistical Indicators



## Key Statistical Indicators: INPATIENT

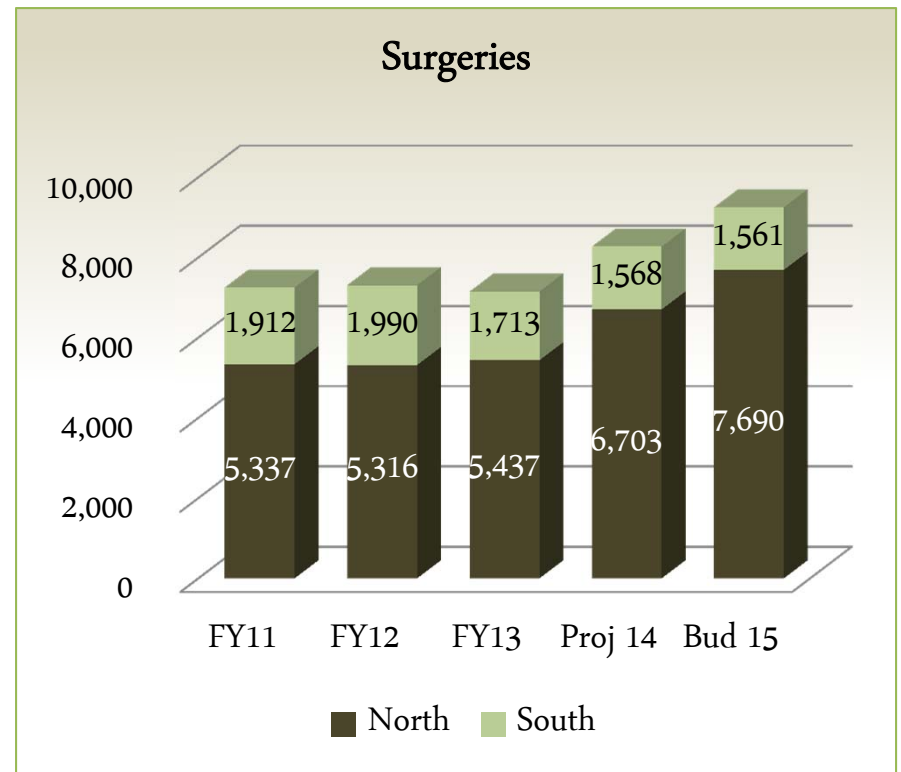
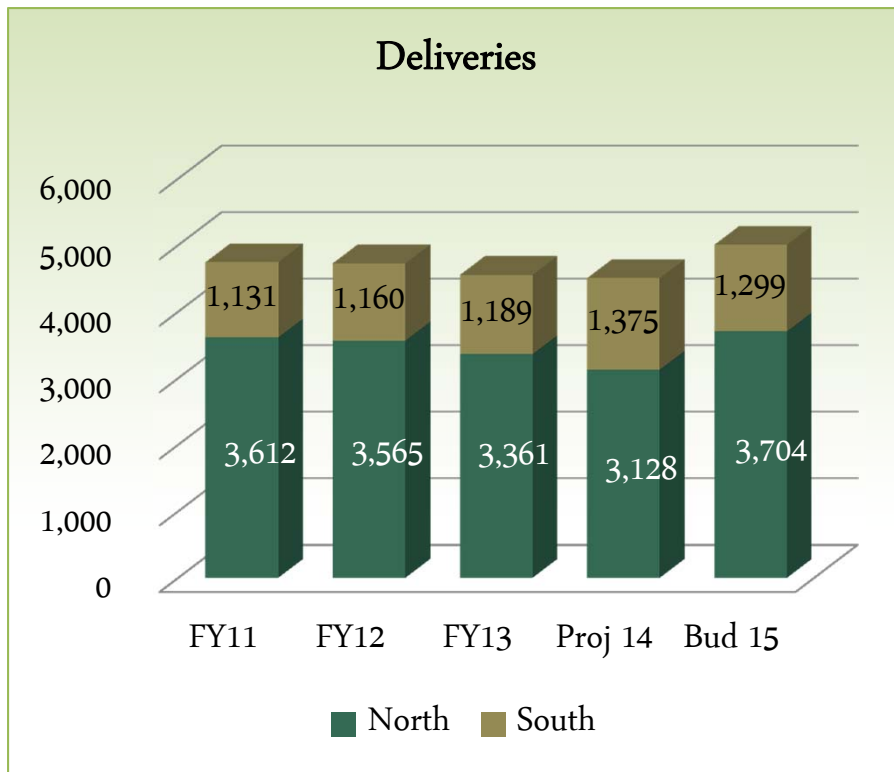
- FY 2015 Planned Acute Patient Days are an increase of 6,023 days or 5.2% year over year
- FY 2015 Adjusted Discharges are 8.4% higher or 3,798 discharges over FY 2014 projected



\* North includes Palomar Medical Center (PMC) and Palomar Health Downtown Campus (PHDC); South includes Pomerado Hospital (POM)

## Key Statistical Indicators: INPATIENT

- FY 2015 Deliveries are an increase of 500 or 11.1% year over year
- FY 2015 Surgeries are 11.8% higher or 980 over FY 2014 projected

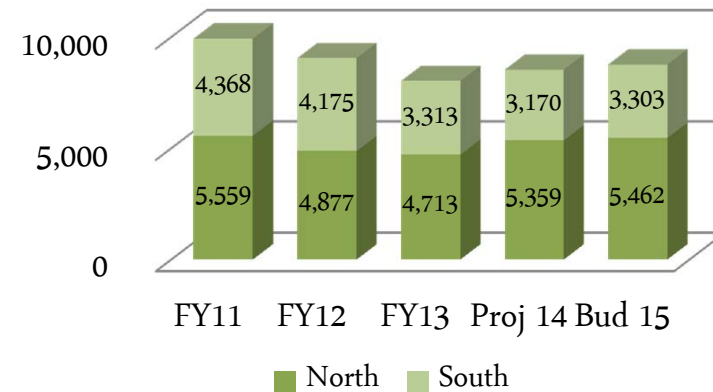


\* North includes Palomar Medical Center (PMC) and Palomar Health Downtown Campus (PHDC); South includes Pomerado Hospital (POM)

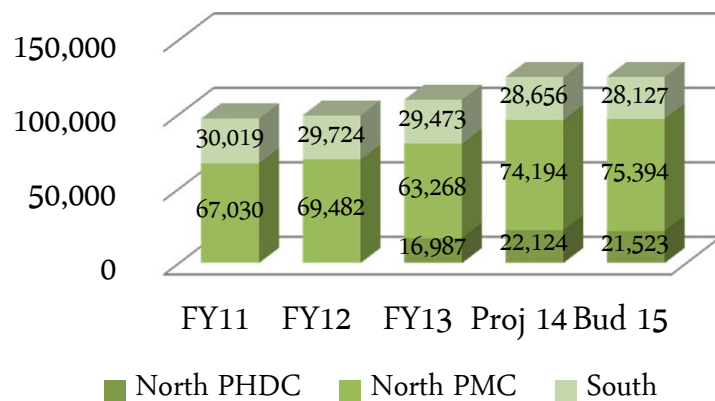
## Key Statistical Indicators: OUTPATIENT

- Outpatient Surgeries are increasing 235 or 2.8%
- Emergency Visits for the system are expected to be flat for FY15
- Outpatient Registrations are decreasing by 4.7%

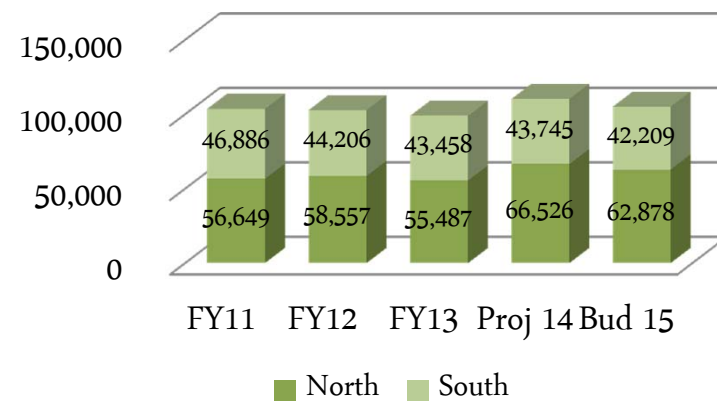
### Outpatient Surgeries



### Emergency Visits



### Outpatient Registrations





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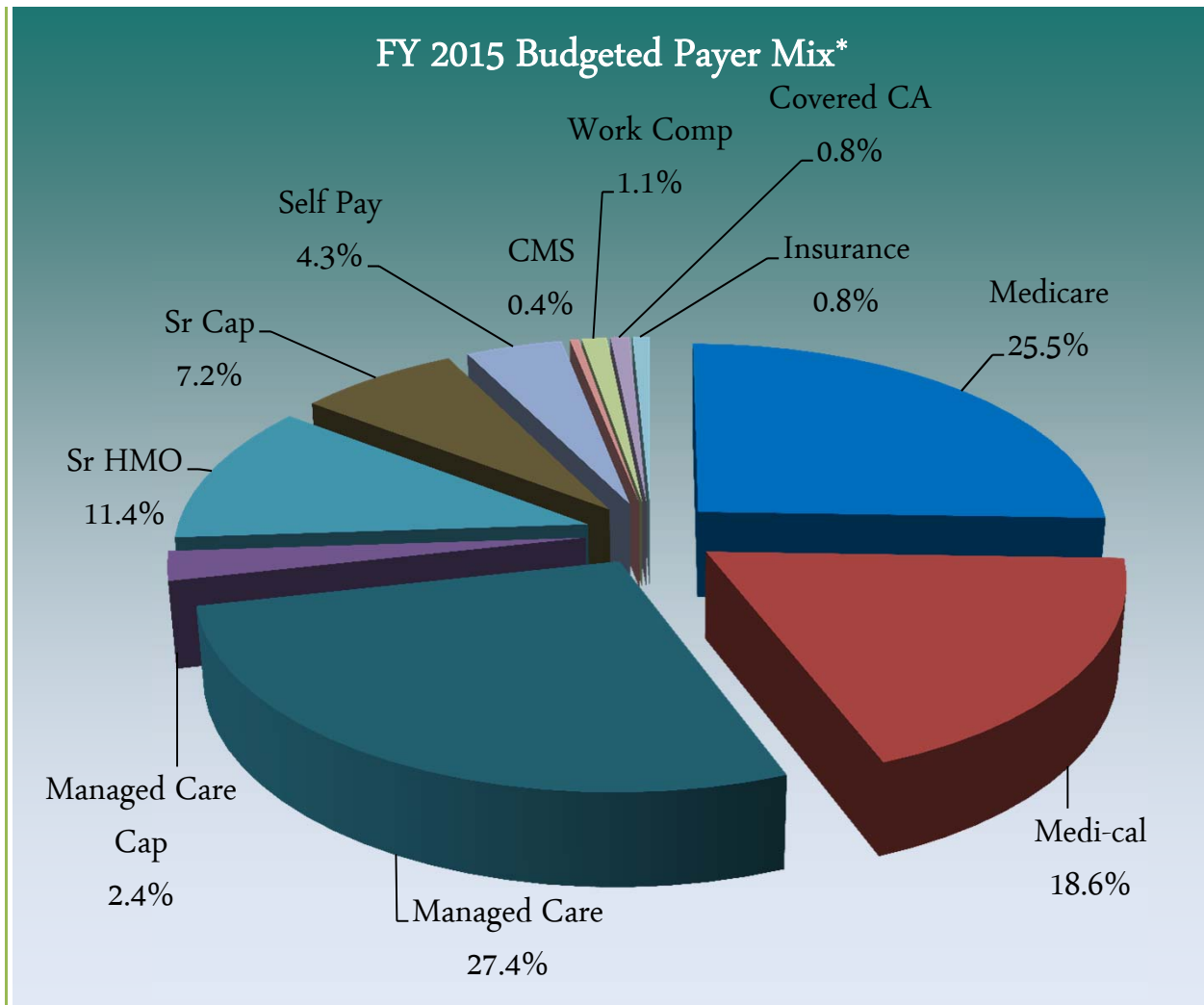
# Revenue

## Key Gross Revenue Considerations

### Assumptions:

- 7.76% overall effective rate increase (targeted 8%)
- 100% increase in At-risk Capitation contracting member lives
- Bad Debt and Uncompensated Care 4.1%; Projected FY14 = 4.7%

Payer Category	(In millions) Total Chgs
Medicare	755,904
Medi-cal	552,546
Managed Care	811,967
Managed Care Cap	70,801
Sr HMO	338,907
Sr Cap	212,403
Self Pay	127,896
CMS	11,900
Work Comp	33,374
Covered CA	25,142
Insurance	22,877
Total *	2,963,718

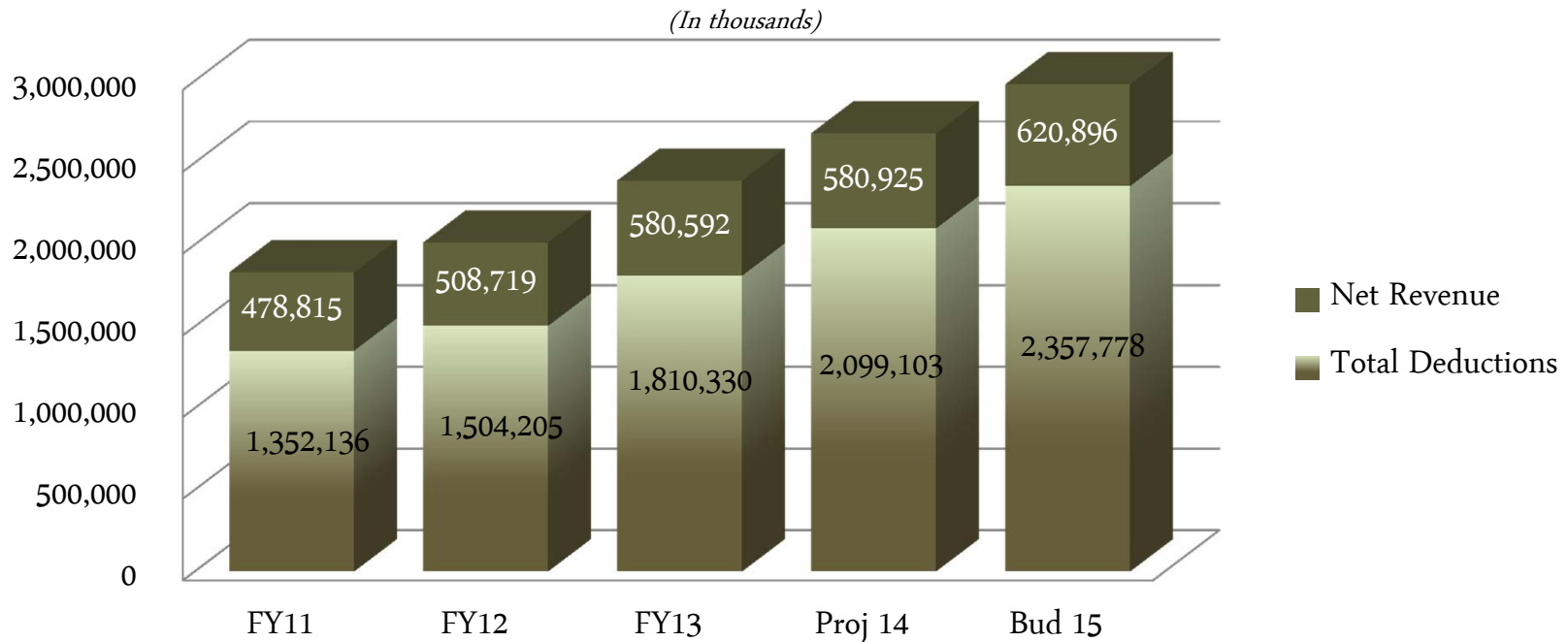


\* Based on Gross Revenue and Excludes Home Health and Clinics



## Revenue Trend Analysis

- FY 2015 Gross Revenue is expected to be \$300M or 11% higher than FY 2014
- Net Revenue is anticipated to be \$40M or 7% higher year over year



	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>Proj 14</b>	<b>Bud 15</b>
Total Deductions*	1,352,136	1,504,205	1,810,330	2,099,103	2,357,778
Net Revenue	478,815	508,719	580,592	580,925	620,896
<b>Total Gross Revenue</b>	<b>1,830,951</b>	<b>2,012,924</b>	<b>2,390,922</b>	<b>2,680,028</b>	<b>2,978,674</b>

\*Deductions include net capitation impact



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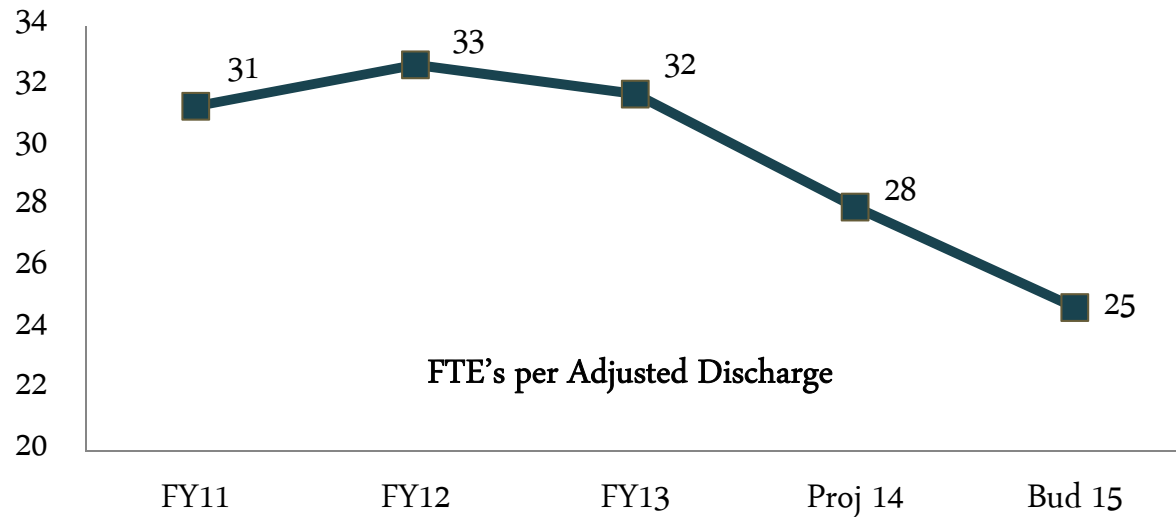
## Salaries, Wages, Benefits & FTEs

## Labor Analysis – FTE’s

2015 Budgeted FTE Roll Forward		FTE’s
	FY 2014 Paid FTE’s (as of 5/17/2014)	3,479
	Productivity Standard Adjustments*	(263)
	FTE’s Added Due to Volume Growth*	144
	FTE Reductions	(35)
	<b>FY 2015 Paid FTE’s</b>	<b>3,325</b>

\* Productive FTE’s

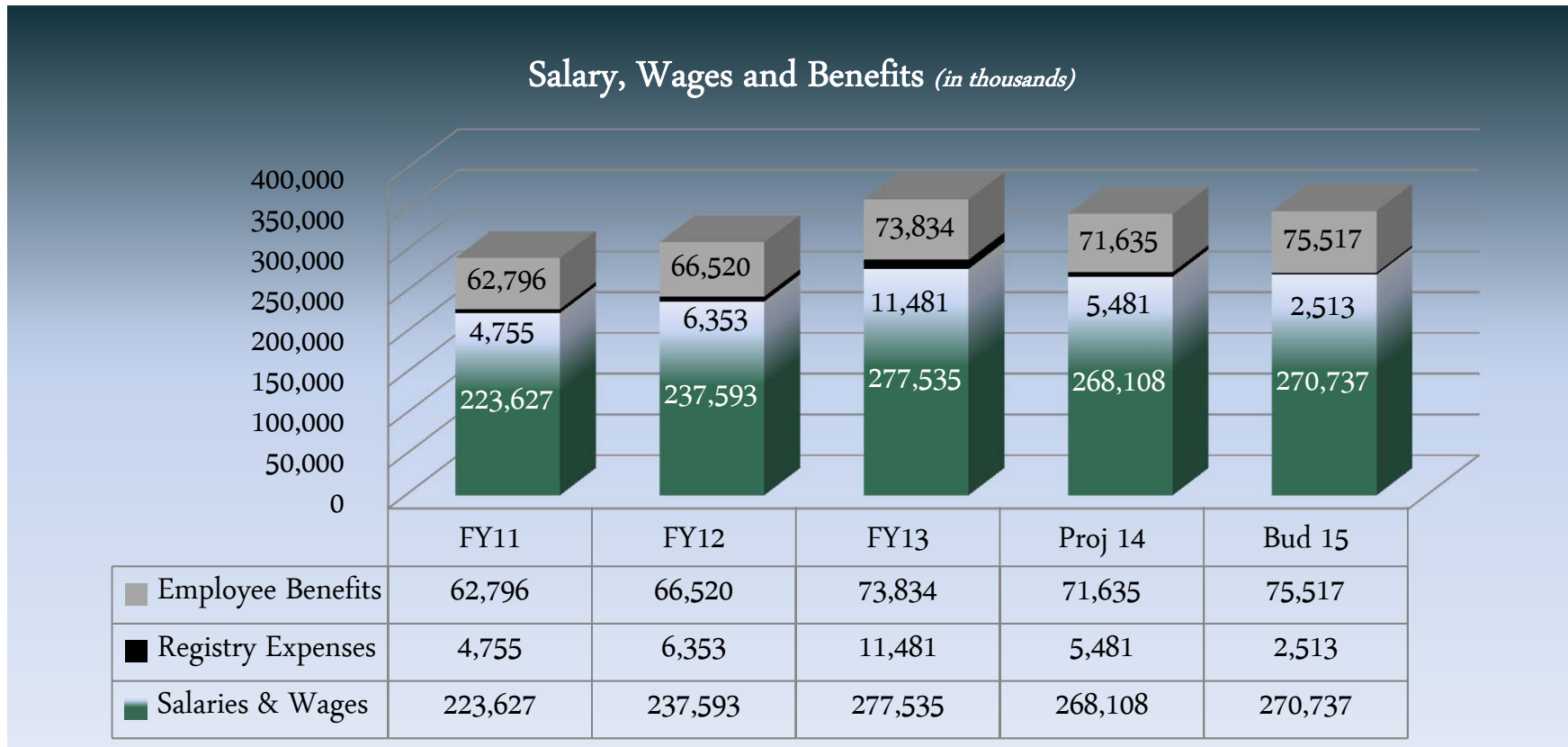
■ Consistent with FY 2014, FY 2015 Budget assumes a reduction in FTE’s on a per Adjusted Discharge basis





## Labor Analysis – Salaries, Wages and Benefits

- FY 2015 Total Salaries, Wages and Benefits are increasing \$3.4M or 1.0% primarily driven by a \$3.9M increase in Employee Benefits
- FY 2015 Agency / Registry Expense is expected to continue a 3 year decline

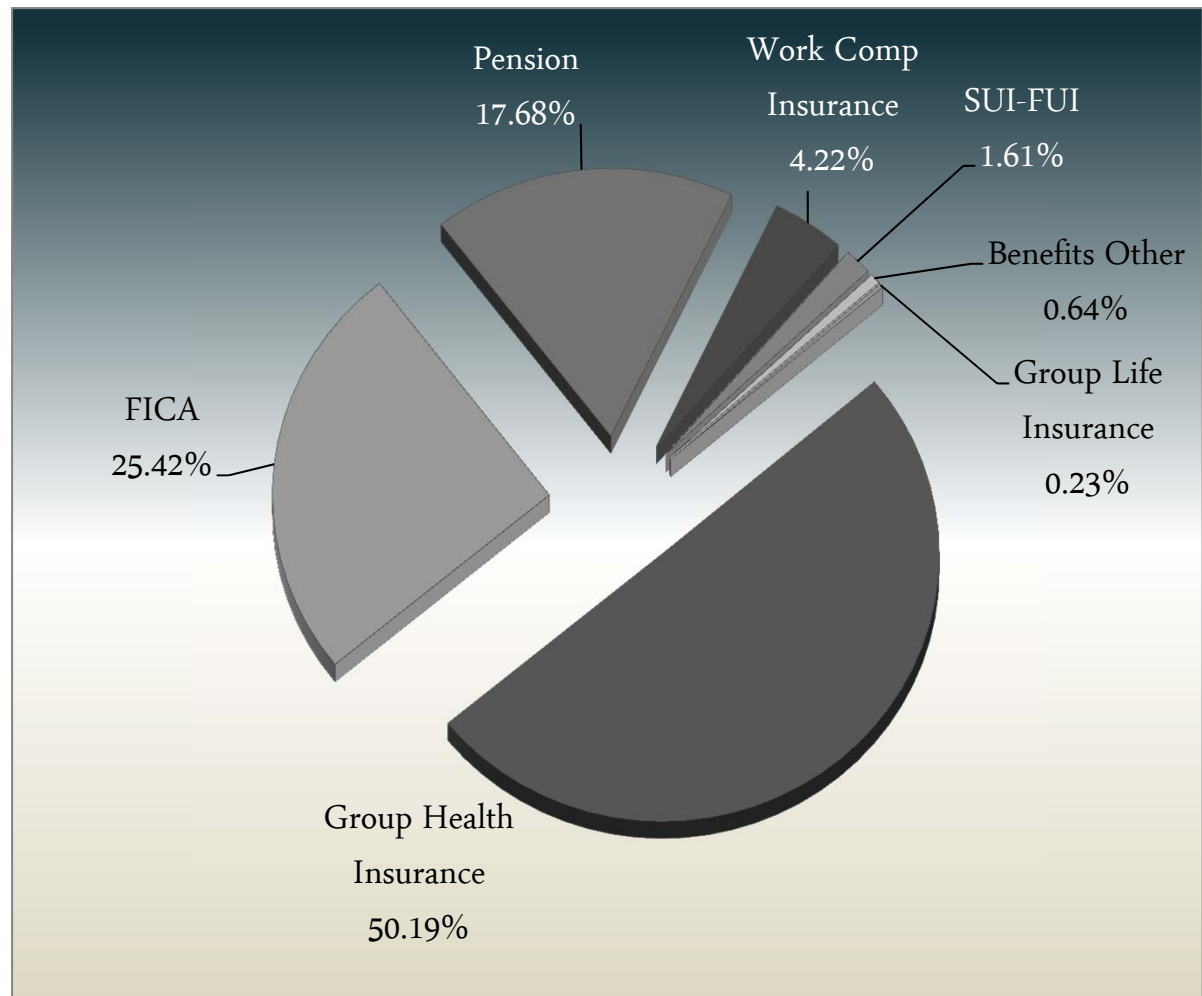


## Labor Analysis – Benefits (excluding PTO)

- FY 2015 Employee Benefits are increasing \$3.9M or 5.4% primarily driven by a \$3.6M increase in Health Insurance.

*(In thousands)*

	Bud 15
Group Health Insurance	37,903
FICA	19,193
Pension	13,352
Work Comp Insurance	3,189
SUI-FUI	1,218
Benefits Other	486
Group Life Insurance	176
<b>Total Benefits</b>	<b>75,517</b>



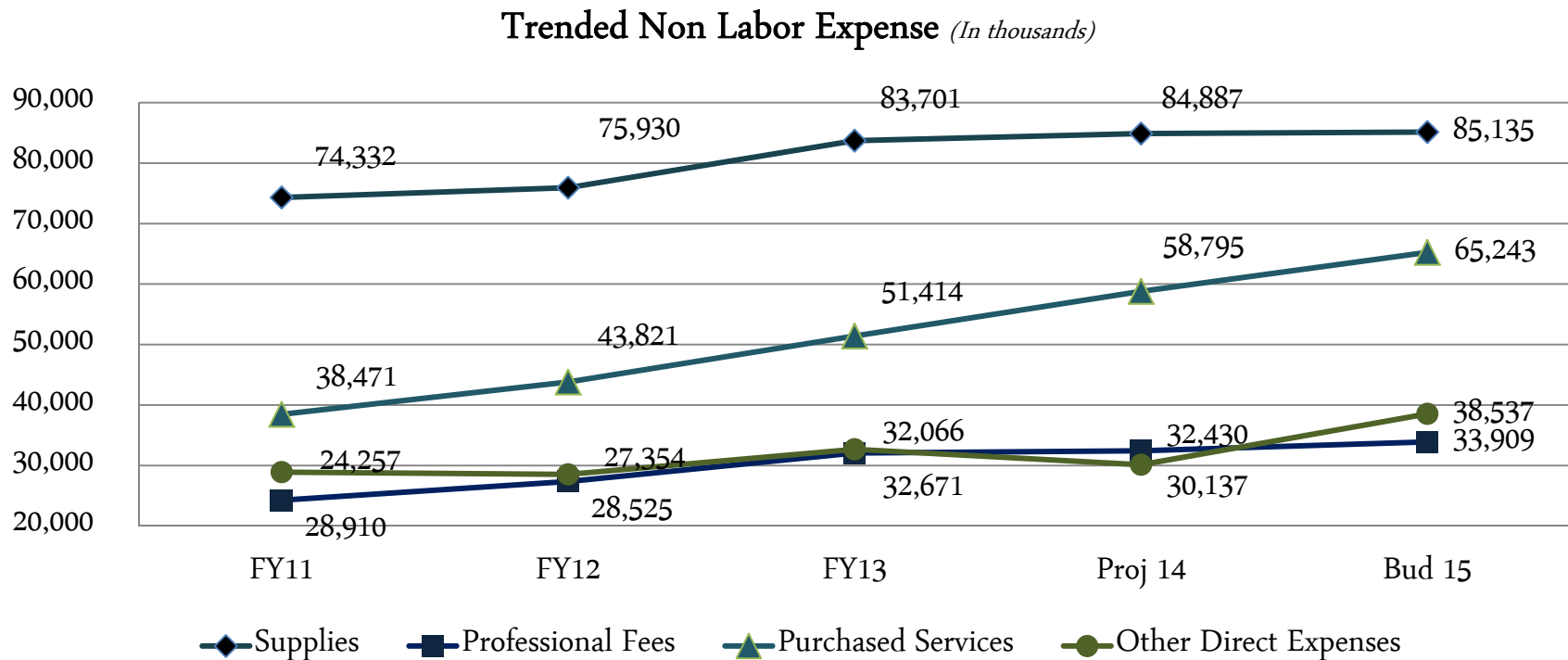


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# Non Labor Analysis

## Non Labor Analysis - Summary

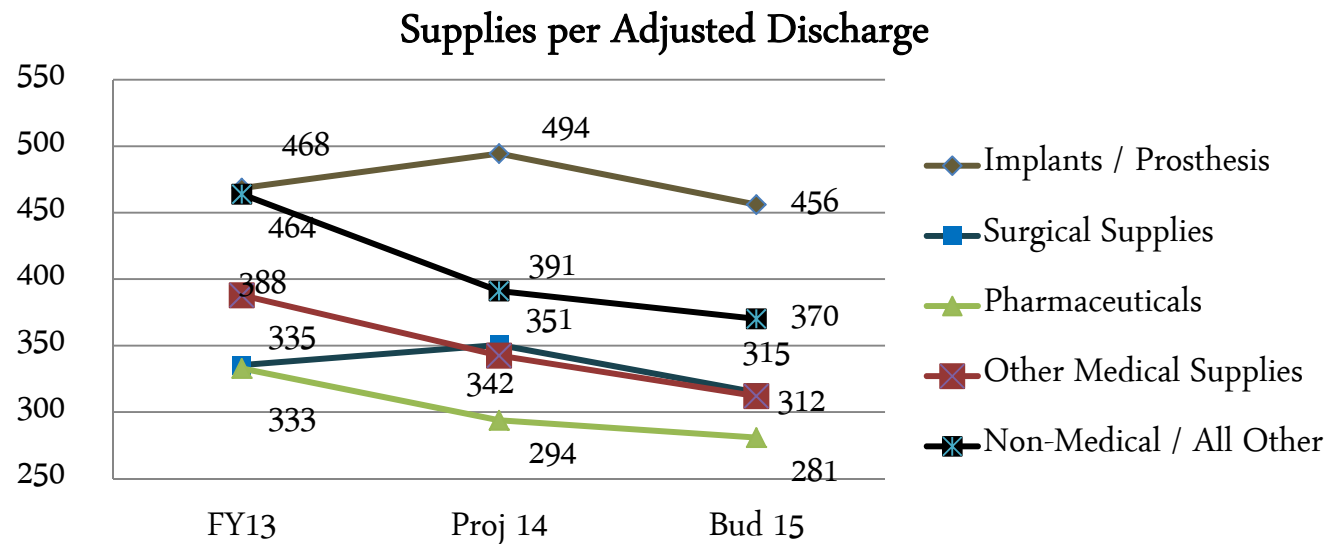
- FY 2015 Non Labor expense is increasing \$16.7M or 8.7%
- However, on a cost per adjusted discharge basis, FY 2015 Non Labor expense is remaining flat to Projected 2014



## Non Labor Analysis - Supplies

FY 2015 Supply Roll Forward <i>(in thousands)</i>	
FY 2014 Supply Expense (March 2014 Projection)	<b>\$84,887</b>
Increases due to Volume and Utilization	3,259
Inflationary Increases (Net of Absorption)	789
General Supply Management (Efficiency and rate efforts)	(2,000)
Supply Reduction Initiative	(1,800)
<b>FY 2015 Budgeted Supply Expense</b>	<b>\$85,135</b>

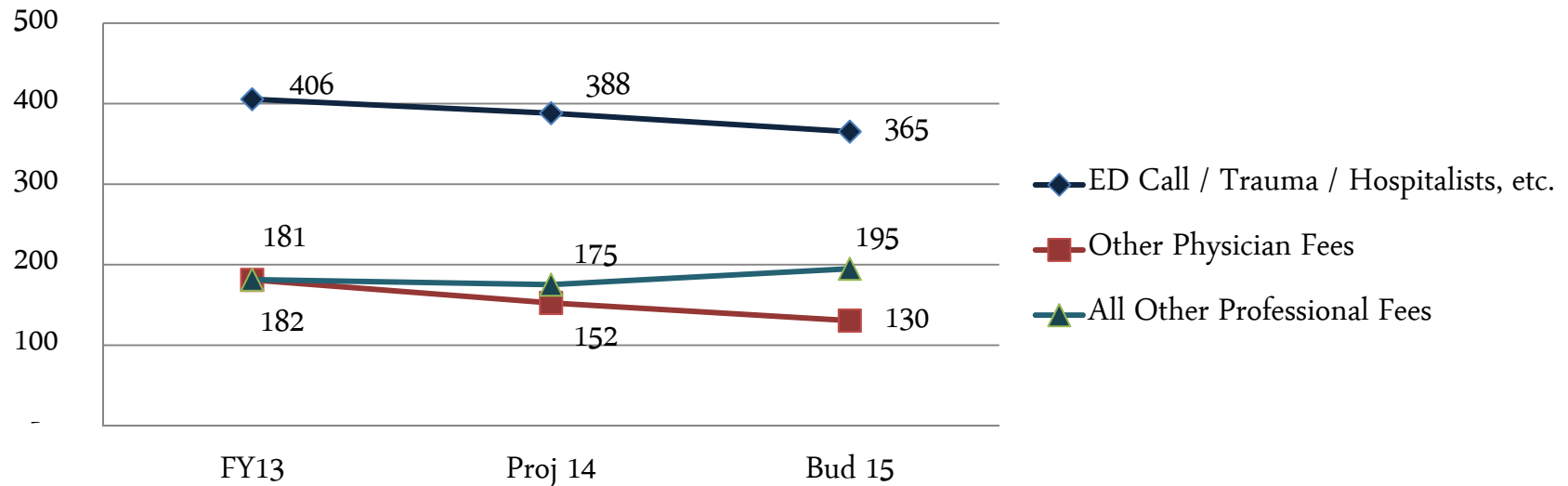
- FY15 Budgeted supply management efforts and reduction initiatives total \$3.8M in savings; holding the line on inflation and other increases



## Non Labor Analysis – Professional Fees

- FY 2015 Professional Fees are increasing by \$1.5M or 4.6%
- Professional Fees per adjusted discharge, however, are relatively flat year over year

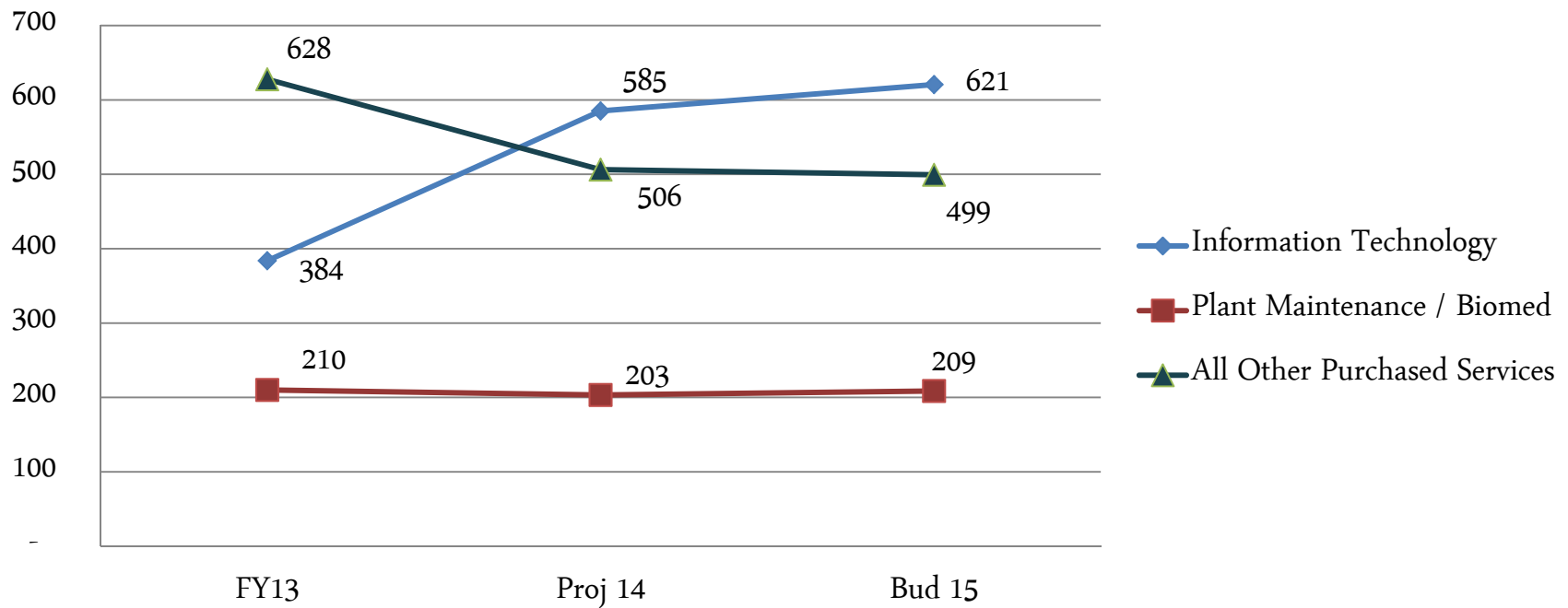
Professional Fees per Adjusted Discharge



## Non Labor Analysis – Purchased Services

- FY 2015 Purchased Services are increasing by \$6.4M or 10.9%
- Information Technology increases of \$4.0M are the primary driver due to outsourcing our IT functions

Purchased Services per Adjusted Discharge



## Non Labor Analysis – Purchased Services: IT Roadmap

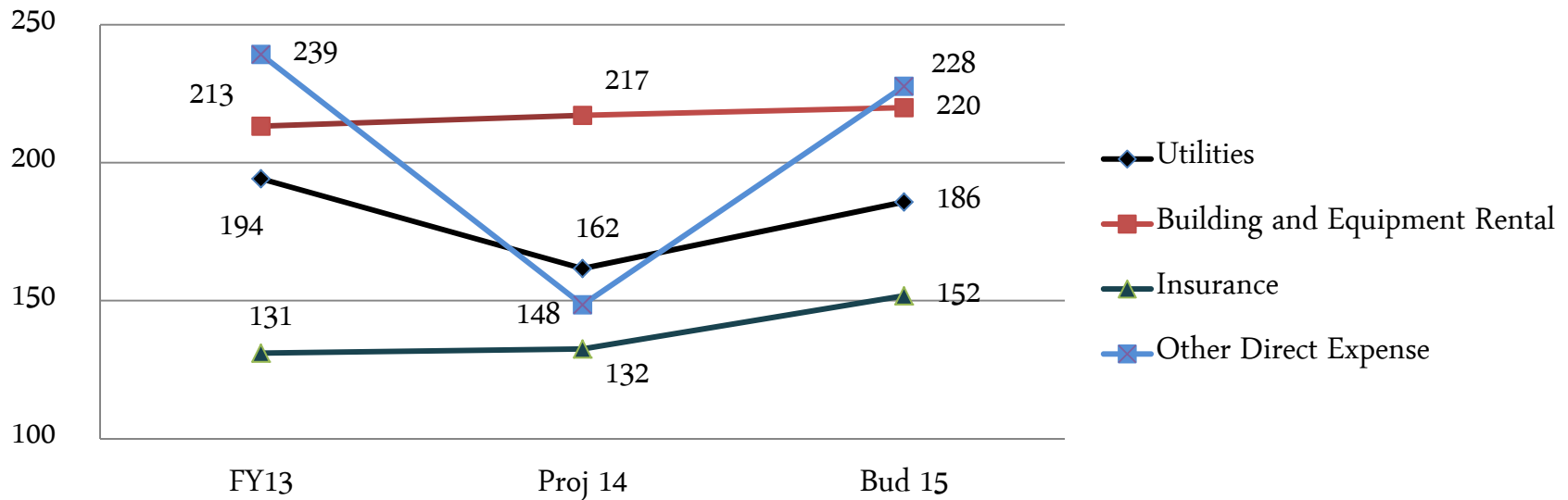
FY 2014 Accomplishments	
IT Works Transition to Cerner	AirStrip EKG Implementation
Lawson Financial System Upgrade	Extension Mobility Implementation
Clarity Platform Upgrade (Cerner Foundation)	Chart Search Implementation
Rauland Upgrade (Nurse Call System)	Care Management Implemented
Remote Hosting of Payroll System	Multiple Revenue Cycle Applications and Technology
Multiple Pharmacy Applications, incl. Electronic Prescriptions	Enterprise Data Warehouse
Remote Monitoring Room Decentralization	Patient Portal and Multiple Infrastructure Projects
FY 2015 Planned Projects	
Clairvia Patient Scheduling and Acuity System – Housewide	IT Security Optimization
Rehab Services: ARU Inpatient and Outpatient	Operating and Capital Budget System
Teletracking Upgrade	SNF EMR Enhancements
DQR – Document Quality Review for Physician Documentation	Mobile Device Management Solution
Additional Core Measures / NHIQM	Additional Rev Cycle Enhancements and Infrastructure Upgrades
Currently at HIMSS Level 6 Validation; Applying to Achieve Level 7 in FY 2015	Meaningful Use: Completed Stage 1, Year 2, October 2014 Attest to Stage 2





## Non Labor Analysis – Other Direct Expense

Other Direct Expense per Adjusted Discharge

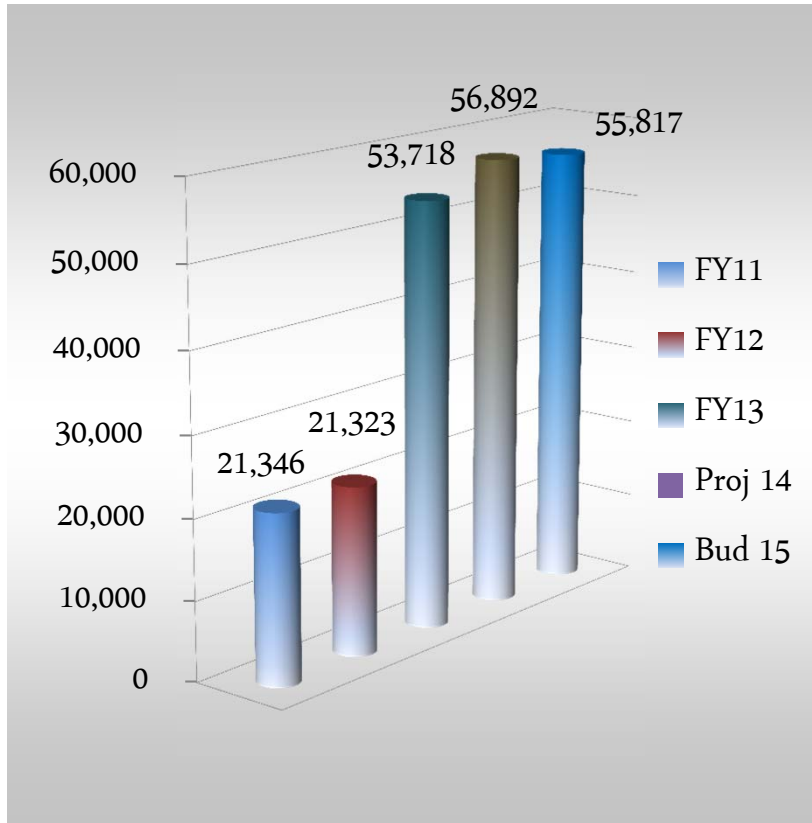


- FY 2015 Budgeted Other Direct expense is increasing by \$8.4M or 27.9%
- Increases in insurance costs of \$1.5M and utilities of \$1.8M are the primary drivers

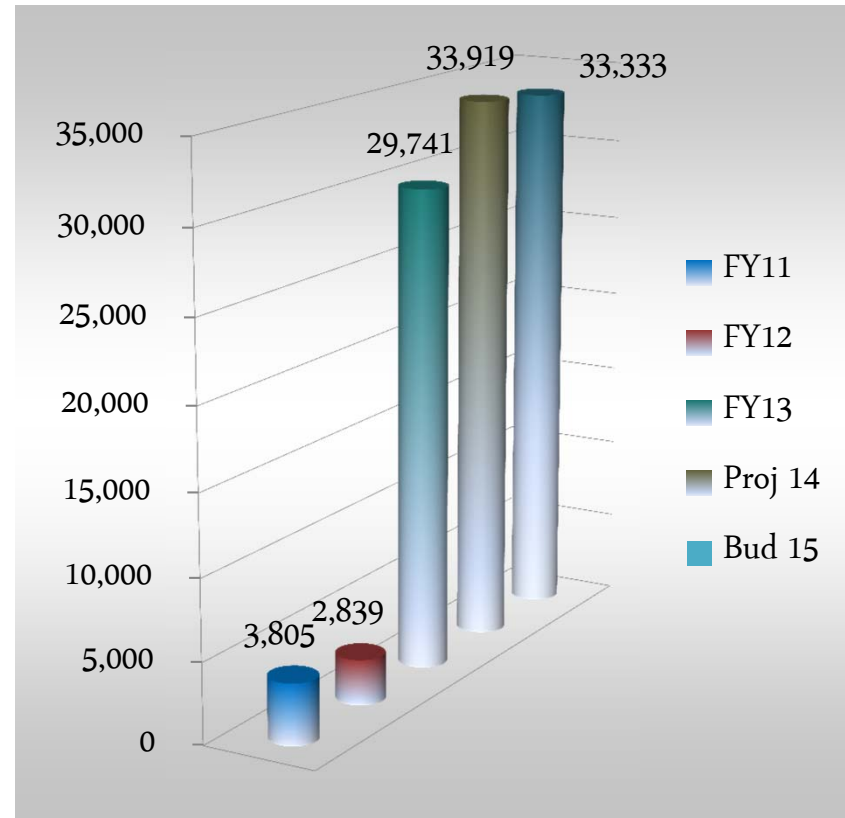
## Non Labor Analysis – Depreciation and Interest Expense

- FY 2013 reflects the opening of Palomar Medical Center

Depreciation Expense (in thousands)



6/23/2014



Interest Expense (in thousands)

- Interest expense reflected for Revenue Bonds only



# Annual Operating Budget Summary / EBIDA Recap

## Annual Operating Budget Summary and Trend

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	Budget FY15	Projected FY14	Results FY13	Results FY12
<b>Revenue:</b>				
Gross Revenue	2,978,673,586	2,680,027,774	2,390,922,045	2,012,924,172
Net Revenue	620,895,637	580,925,056	580,591,690	508,718,778
Other Operating Revenue	13,674,304	21,966,791	13,535,345	12,246,854
<b>Total Operating Revenue</b>	<b>\$ 634,569,941</b>	<b>\$ 602,891,847</b>	<b>\$ 594,127,035</b>	<b>\$ 520,965,632</b>
<b>Expenses:</b>				
Salaries, Wages, Registry, Benefits	348,608,451	345,224,452	362,849,770	304,112,667
Supplies	85,134,518	84,867,284	83,701,324	75,930,105
Depreciation	55,817,042	56,892,017	53,717,757	21,322,890
Other	137,848,119	121,381,058	116,150,300	28,525,165
<b>Total Operating Expense</b>	<b>\$ 627,408,130</b>	<b>\$ 608,364,811</b>	<b>\$ 616,419,151</b>	<b>\$ 507,417,554</b>
Operating Income	7,161,811	(5,472,964)	(22,292,116)	13,548,078
Non-Operating Income	3,018,927	3,938,978	4,400,820	3,969,772
(Interest Expense)	(33,332,613)	(33,918,682)	(29,740,802)	(2,838,979)
Property Tax Revenue	13,900,000	13,287,865	12,913,947	12,686,049
<b>Income (Loss)</b>	<b>\$ (9,251,875)</b>	<b>\$ (22,164,803)</b>	<b>\$ (34,718,151)</b>	<b>\$ 27,364,920</b>
Net Margin %	-1.5%	-3.7%	-5.8%	5.3%
OEBIDA Margin (Excl Property Tax Rev)	9.9%	8.5%	5.3%	6.7%
OEBIDA Margin (Incl Property Tax Rev)	12.1%	10.7%	7.5%	9.1%
EBIDA Margin	12.6%	11.4%	8.2%	9.9%
Total Uncompensated Care	120,789,237	127,275,121	112,188,441	97,429,796
Total Uncompensated Care as % of Gross	4.06%	4.75%	4.69%	4.84%



## FY 2015 EBIDA Recap

<i>(In thousands)</i>				Projected	Budget
	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Net Income from Ops	11,515	13,721	(22,292)	(5,473)	7,162
<i>Less:</i>					
Depreciation Expense	21,346	21,323	53,718	56,892	55,817
<b>OEBIDA</b>	<b>\$ 32,861</b>	<b>\$ 35,044</b>	<b>\$ 31,426</b>	<b>\$ 51,419</b>	<b>\$ 62,979</b>
OEBIDA Margin (Excl Property Tax Rev)	6.7%	6.7%	5.3%	8.5%	9.9%
OEBIDA Margin (Incl Property Tax Rev)	9.3%	9.1%	7.5%	10.7%	12.1%
<b>EBIDA</b>	<b>56,119</b>	<b>52,200</b>	<b>48,740</b>	<b>68,646</b>	<b>79,898</b>
<b>EBIDA Margin</b>	<b>11.5%</b>	<b>10.0%</b>	<b>8.2%</b>	<b>11.4%</b>	<b>12.6%</b>
Total Uncompensated Care	81,887	97,429	112,188	127,275	120,789
Total Uncompensated Care as % of Gross	4.47%	4.84%	4.69%	4.75%	4.06%
Net Income/(Loss) after Non-Op Income	<b>\$ 30,968</b>	<b>\$ 27,935</b>	<b>\$ (34,718)</b>	<b>\$ (22,165)</b>	<b>\$ (9,252)</b>



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# Capital Plan

## Capital Plan

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

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	FY 2015	FY 2016	FY 2017	Total Project Spend
<b><u>Routine Capital:</u></b>				
Equipment	5,000	5,000	10,000	20,000
Facility	5,000	5,000	5,000	15,000
Information Technology	5,000	5,000	5,000	15,000
<b>Total Routine Capital Requests</b>	<b>\$ 15,000</b>	<b>\$ 15,000</b>	<b>\$ 20,000</b>	<b>\$ 50,000</b>
Strategic Capital Reserve	16,000	16,000	16,000	48,000
<b>Consolidated Capital Reserve</b>	<b>\$ 31,000</b>	<b>\$ 31,000</b>	<b>\$ 36,000</b>	<b>\$ 98,000</b>



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# FY15 Budget Summary & Key Take-Aways



## Summary / Key Take-Aways

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FY 2015 Budget is achievable and ties to the Strategic Financial & Capital Plan. However, it requires success in the following areas:

- 5% growth in Acute Patient Days
- 12% growth in Inpatient Surgeries
- 11% growth in Deliveries
- 7% growth in Net Patient Revenue
- 5% Reduction in total expenses year over year on a per adjusted discharge basis
- Execution of Patient Throughput and Supply Initiatives, as well as the other planned expense management strategies included in the budget

Successful Execution will result in:

- Net Income improvement of 58% year over year
- EBIDA of \$79.9M
- Achievement of all Bond Covenants