FY 2019 Annual Operating and Capital Plan

Board of Directors Budget Meeting

June 12, 2018

PALOMAR HEALTH

Passion. People. Purpose.™

Agenda

Executive Summary

Five-Year Financial Projections

FY 2019 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

2019 Annual Budget Summary / EBIDA Recap

Three-Year Capital Plan

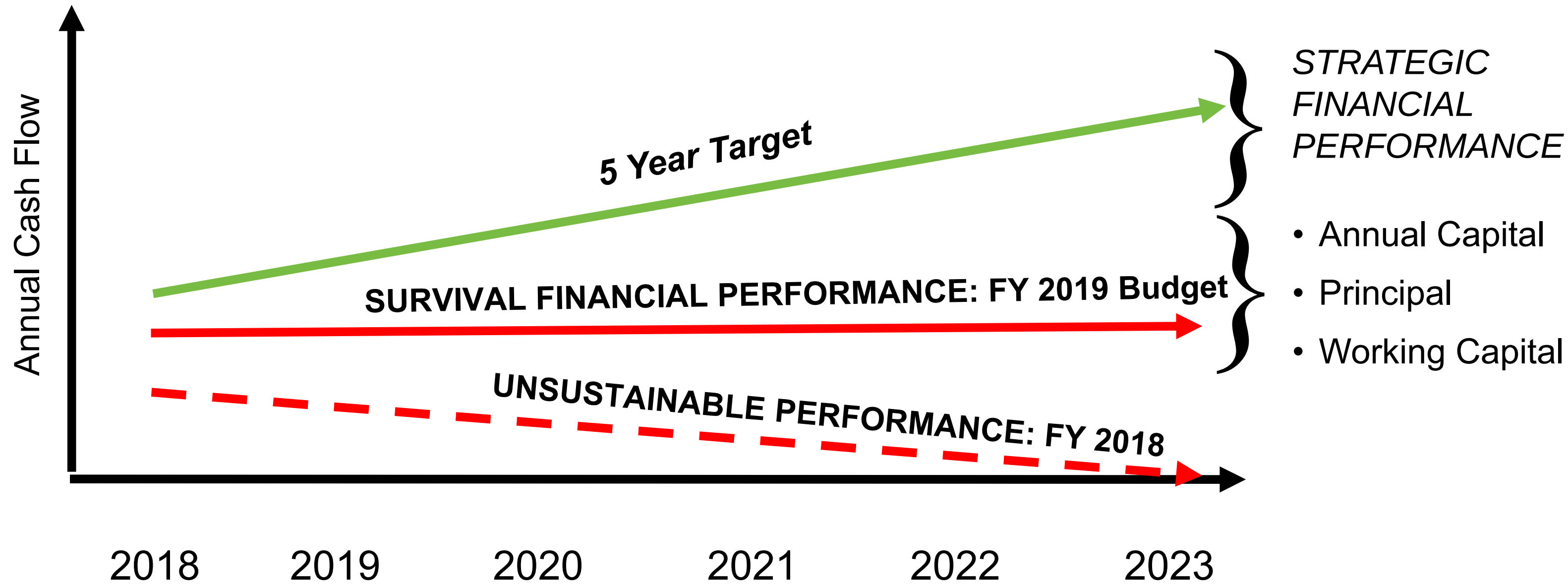
Executive Summary

The FY 2019 Annual Budget 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 $17 million from the FY18 Projection). The plan:

- Refocuses the organization on capital deployment after the 2017 issuance of Certificates of Participation (revenue bonds)
- Includes strategic Service Line development and design to optimize resource utilization and better serve the community
- Reflects a continued effort to absorb inflation and drive efficiency throughout the organization
- Incorporates hiring initiatives to drive targeted improvements in utilization of premium pay dollars
- Supports key organizational goals regarding quality improvement and regulatory compliance
- Aligns the operating and capital budgets with our current year and long-term strategic plan initiatives

Five-Year Financial Projections

Five-Year Financial Projections



Palomar Health needs a sound financial strategy in order to:

- Replace aging and obsolete equipment
- Acquire new technology
- Recruit physicians
- Buildout out floors 9, 10, and 11 and invest in outpatient services

Five-Year Financial Projections

Ratio/Statistic	Audit		Expected	Projection Years				
	2016	2017	2018	2019	2020	2021	2022	2023
Total Operating Revenue	$711,286	$740,704	$743,879	$743,047	$763,441	$787,165	$822,318	$859,272
Operating EBIDA	$73,800	$71,469	$52,160	$55,742	$70,842	$83,235	$99,876	$114,055
Operating Income	($12,139)	($12,657)	($22,512)	($16,648)	($5,130)	$5,331	$21,542	$35,359
Operating Income exc. Interest expense	$21,192	$21,707	$7,336	$10,044	$21,085	$31,045	$46,719	$59,944
Net Income	($3,658)	$14,450	($794)	($2,748)	$18,432	$30,503	$48,543	$64,533
Unrestricted Cash	$217,568	$223,256	$170,871	$207,146	$244,673	$292,360	$356,645	$437,285
Total Debt (excluding G.O)	$550,466	$593,167	$608,721	$596,431	$583,641	$570,346	$556,491	$542,066
Capital Expenditures	$7,541	$27,777	$20,000	$30,000	$40,000	$8,500	$8,500	$8,500
Profitability								
Operating Margin	(1.7%)	(1.7%)	(3.0%)	(2.2%)	(0.7%)	0.7%	2.6%	4.1%
Operating Margin excl. interest expense	3.0%	2.9%	1.0%	1.4%	2.8%	3.9%	5.7%	7.0%
Excess Margin	(0.5%)	2.0%	(0.1%)	(0.4%)	2.4%	3.9%	5.9%	7.5%
Operating EBIDA Margin	10.4%	9.6%	7.0%	7.5%	9.3%	10.6%	12.1%	13.3%
Debt Position (Includes Arch)								
Debt Service Coverage (x)	1.9x	1.8x	1.2x	1.5x	2.2x	2.5x	3.0x	3.4x
Total Debt to Capitalization	72.9%	70.2%	74.8%	75.7%	74.6%	72.4%	68.5%	63.7%
Liquidity								
Cash to Debt	39.5%	37.6%	28.1%	34.7%	41.9%	51.3%	64.1%	80.7%
Days Cash On Hand (days) - Ex interest and Includes Arch	113.4	112.0	83.0	100.9	118.0	138.5	164.6	195.6
Other								
Discharges	30,891	30,800	28,623	29,732	29,621	29,511	30,236	30,983
Adjusted Discharges	49,887	49,970	47,506	48,741	48,985	49,238	50,356	51,502
Adj Cost / Discharge	$12,779	$13,393	$14,561	$14,101	$14,139	$14,297	$14,347	$14,470
Average Age of Plant	8.9	10.2	12.4	13.1	11.4	11.9	12.7	13.4
Capital Spending Ratio	14.3%	55.8%	44.6%	65.6%	80.4%	16.3%	16.0%	15.7%

FY 2019 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 Cardiology Services (including Cardio-Thoracic Surgery), Neuro-Spine, Orthopedics, Oncology, and Bariatric Surgery driving margin improvements in the later half of the fiscal year
- Planned movement of targeted volume to Poway Campus to better balance volume and resources throughout the district
- Reassessment of overhead costs at the Downtown Campus throughout FY 2019
- Concerted supply management initiatives to off-set inflationary impacts and reduce costs through strategic purchasing and vendor re-negotiations supported by industry benchmark intelligence
- Alignment with the provisions of the new labor union agreements
- Continued reimbursement pressures driven by industry/payor relationships, offset by revenue capture improvement initiatives in Revenue Cycle

Inflationary Assumptions

- FY 2019 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 Mayo Clinic's Captis Regional Supply Network to support strategic supply management efforts
- Partnership with Cardinal Health will drive efficiencies in drug cost per case
- Implant costs continue to be a significant driver of overall supply costs with new focus on Cardio-Thoracic Surgery and Neuro-Spine. As such, inflation in this category will pose the most risk

Healthcare Industry Inflations Comparison

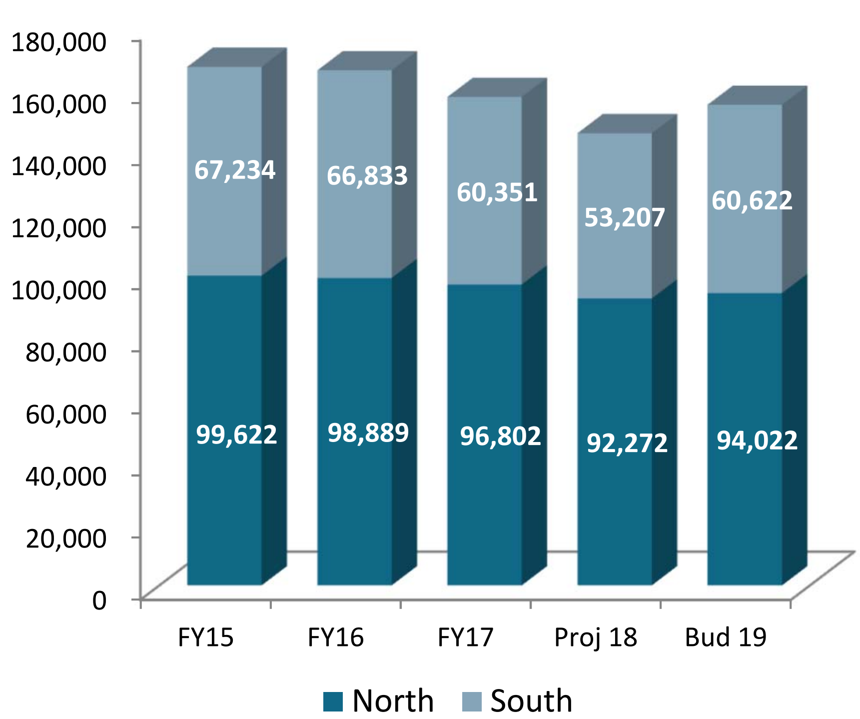
Category / Expense	2019 Budget	Industry Expectation
Implants	**1.5%**	**1-5%**
General Surgery Supplies	1%	0-1.8%
Surgical Needles	1%	1-2%
Oxygen – Gas	3%	3-5%
IV Solutions	6%	6-12%
Pharmaceuticals	**5%**	**7.35%**
Radioactive and X-Ray Material	0%	0.6-1.3%
Other Medical	0%	0-1.6%
Food / Meat	2.5%	2.5-3%
Linen	1%	1-7%
All Other: Cleaning, Forms, Office, Uniforms	1%	0-7%

Key Statistical Indicators

Key Statistical Indicators | Inpatient

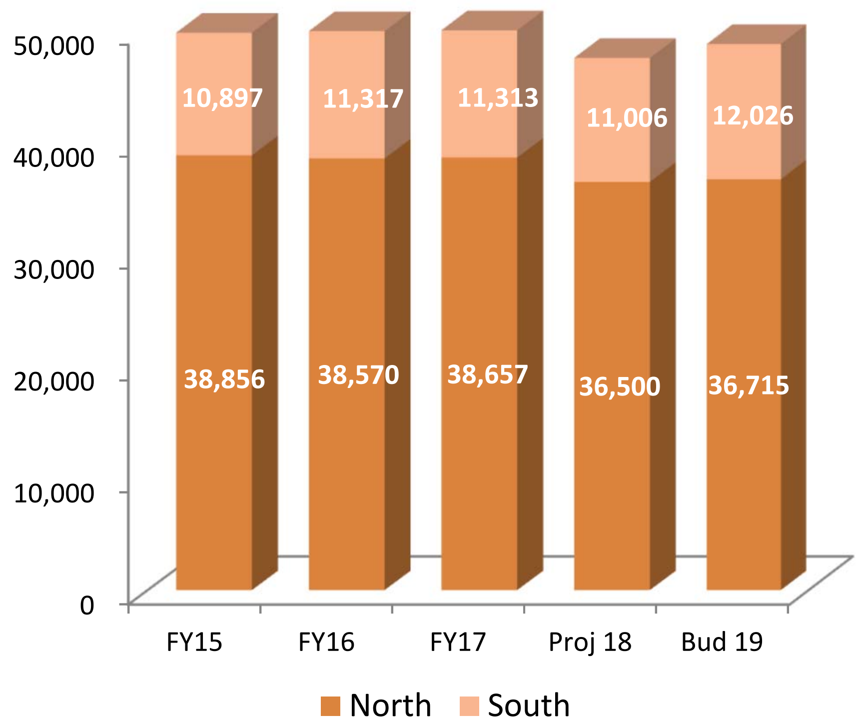
Total Patient Days

FY 2019 Planned Acute Patient Days are increasing by 6.3%, from growth in Skilled Nursing, Gero-Psychiatry, and Acute Rehabilitation



Adjusted Discharges (Incl. SNF)

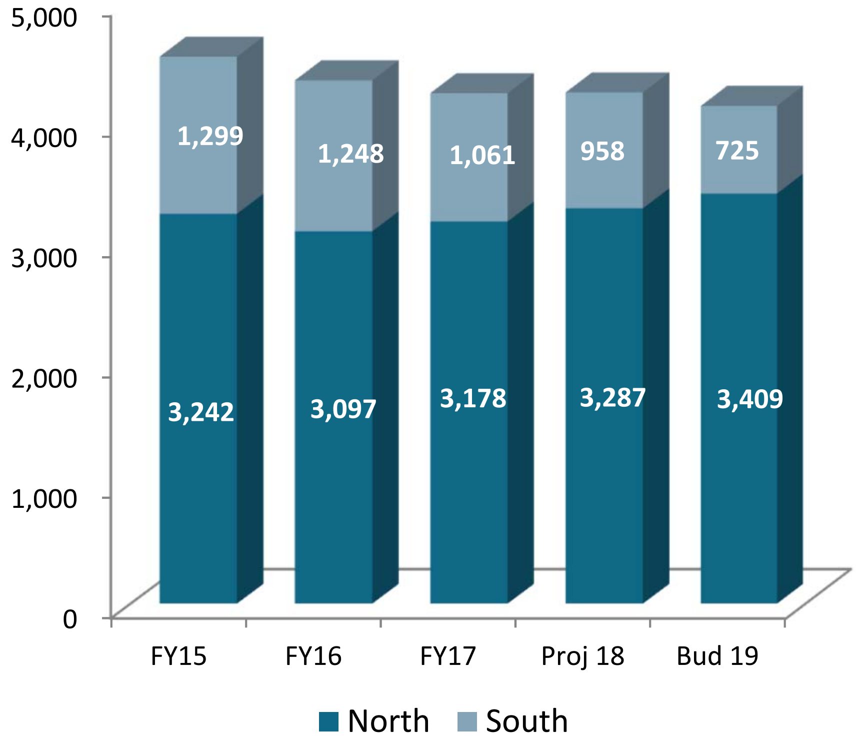
FY 2019 Adjusted Discharges are growing by 1,235 discharges or 2.6% year over year



Key Statistical Indicators | Inpatient

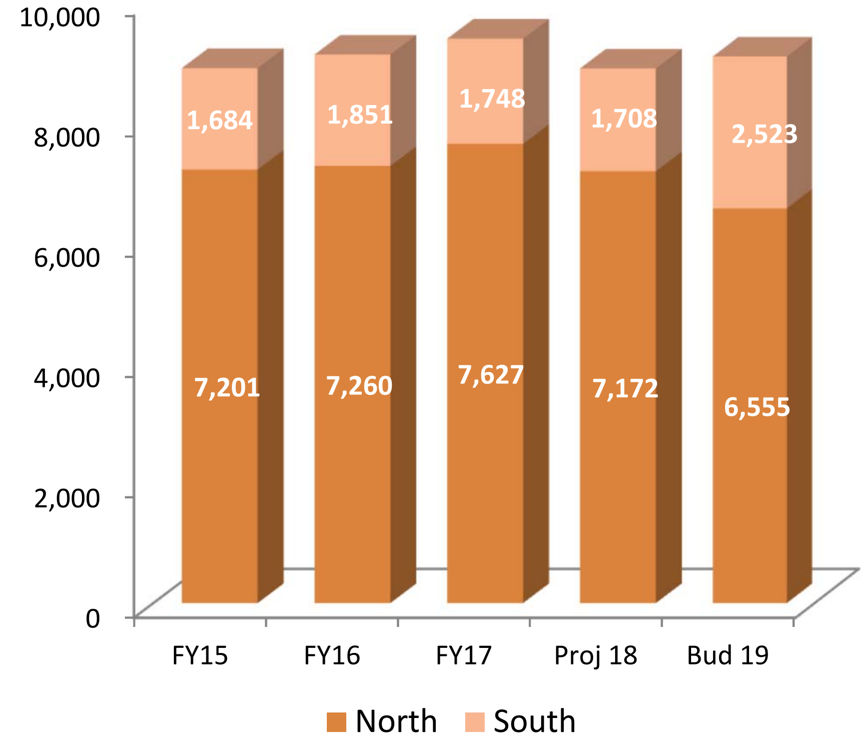
Deliveries

FY 2019 Deliveries are relatively flat, following current year trends



Surgeries

FY 2019 Inpatient Surgeries are growing by 198 cases or 2.2% based on planned Service Line development

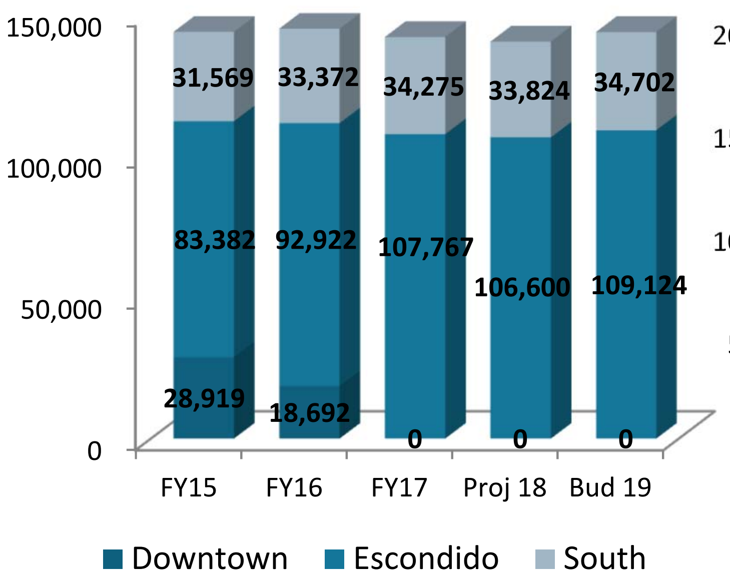


Key Statistical Indicators | Outpatient

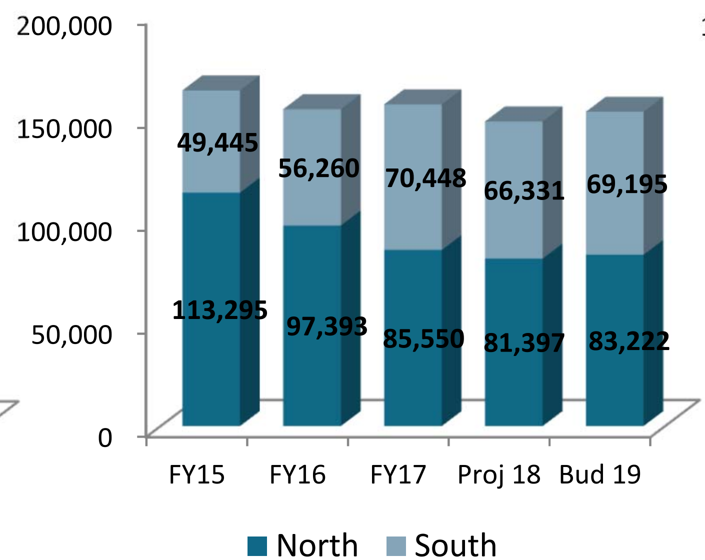
Outpatient Services

- Emergency Visits are increasing by 3,402 or 2.4% to align with seasonal trends
- Outpatient Registrations are increasing by 4,689 or 3.2%
- Outpatient surgeries are increasing by 106 cases or 1.7%

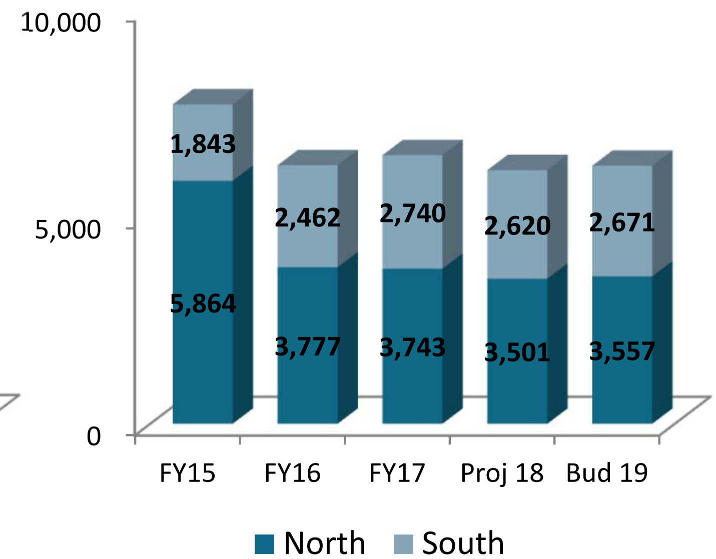
Emergency Visits



Outpatient Registration



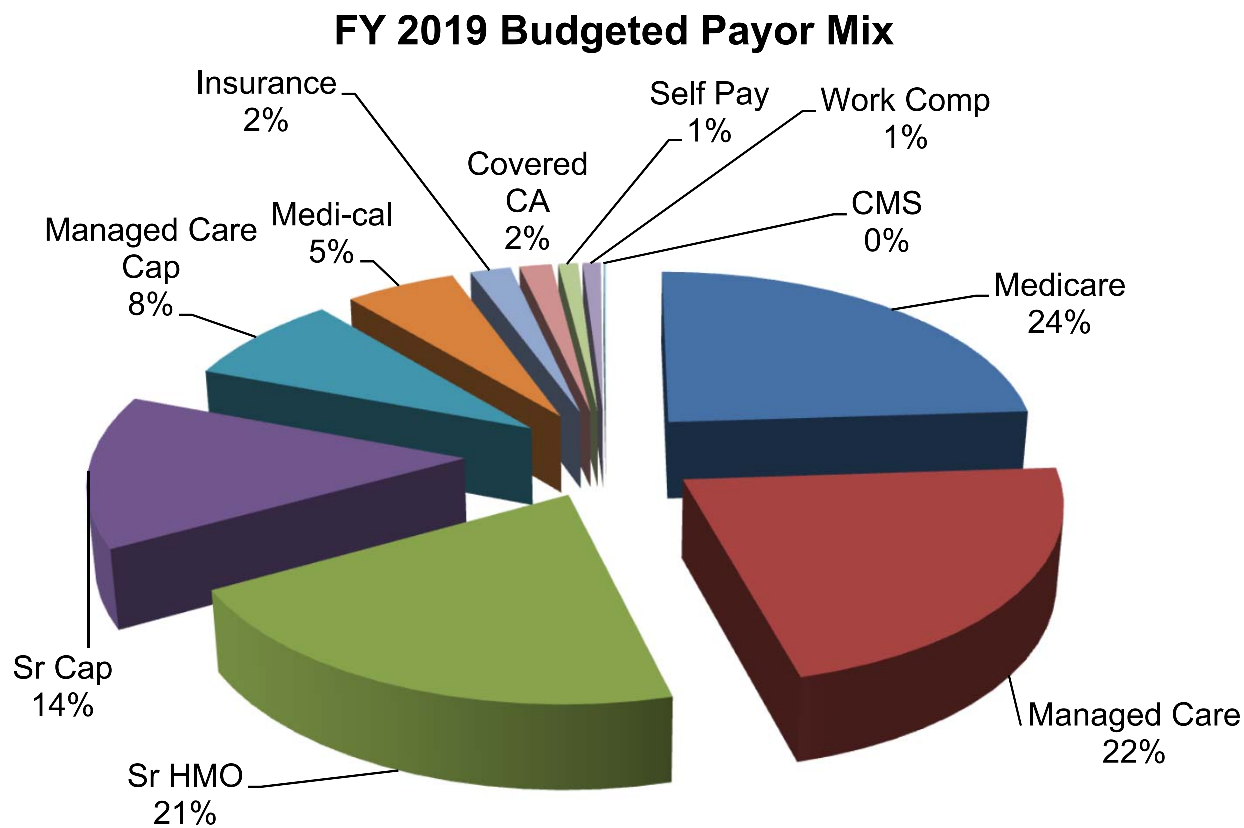
Outpatient Surgery



Revenue

Key Revenue Considerations

Payor Category (in thousands)	Total Charges
Medicare	1,016,633
Managed Care	932,989
Senior HMO	889,596
Senior Capitation	587,834
Managed Care Capitation	346,723
Medi-Cal	233,182
Insurance	85,306
Covered California	67,506
Self Pay	41,416
Workers' Compensation	37,816
CMS	4,940
Total	**4,243,943**

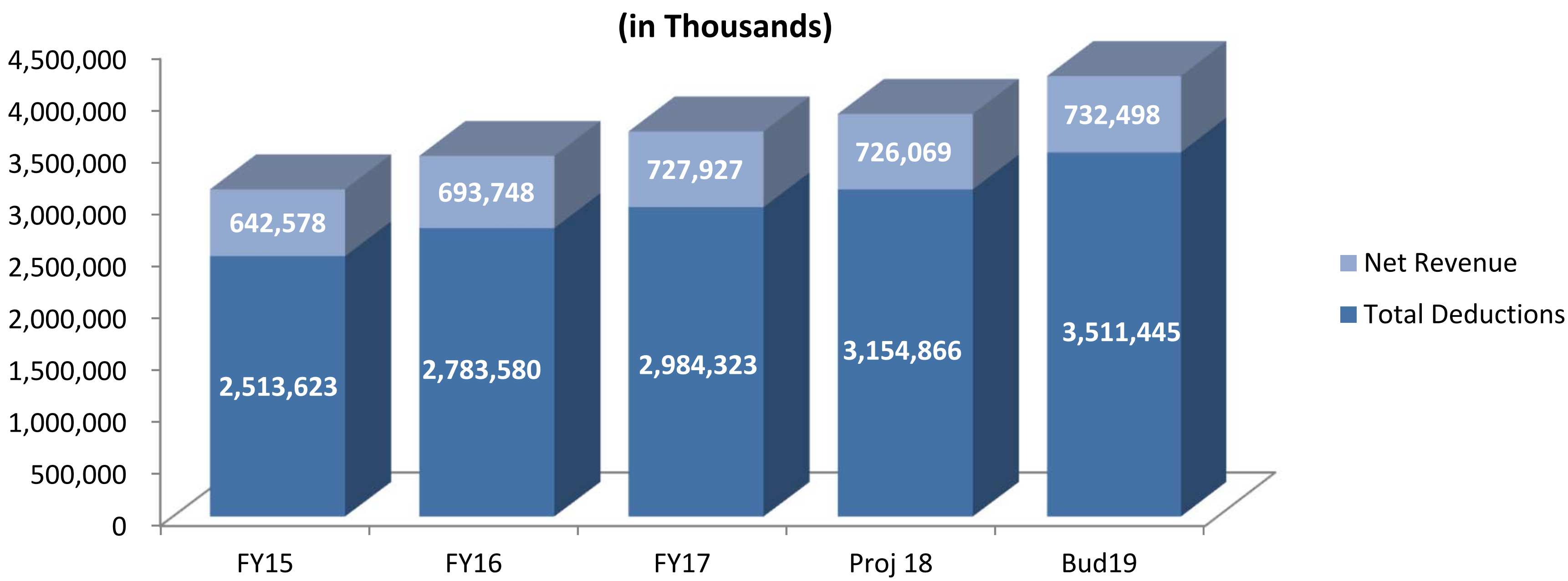


Assumptions

- 7.3% overall effective rate increase (targeted 8%)
- Bad Debt and Uncompensated Care 1.5%; FY18 Budget = 1.7%
- Government sources continue to be predominant, with self-pay decreasing year over year

Revenue Trend Analysis

- Net Revenue is anticipated to increase by $6.4M or 1% year over year
- Increased annual revenues of $20M from Huron Consulting, with $15M to be recognized within FY 2019
- Initial revenue improvement from expansion of Service Lines begins in second half of year, though majority of benefit will not be realized until FY 2020



FY15	FY16	FY17	Proj 18	Bud19	
2,513,623	2,783,580	2,984,323	3,154,866	3,511,445	Total Deductions*
642,578	693,748	727,927	726,069	732,498	Net Revenue
3,156,201	3,477,328	3,712,250	3,880,935	4,243,943	Total Gross Revenue

*Deductions include net capitation impact

Salaries, Wages, Benefits & FTEs

Labor Impact Summary

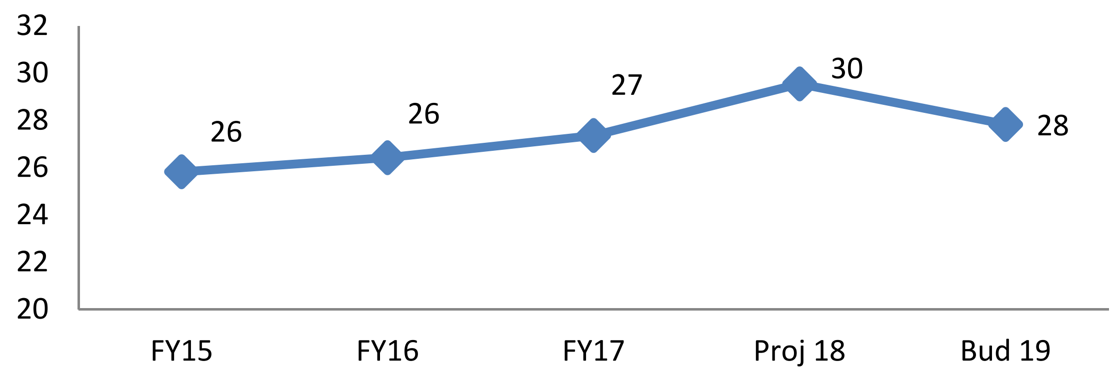
- The FY 2019 Operational Budget reflects a concerted effort to set achievable staffing benchmarks across the district, while complying with California mandatory nurse staffing requirements
- Several hiring initiatives are designed to minimize overtime pay and contract labor
- New position control will prevent unauthorized increases in staffing
- Maintains a significant focus on training positions for New Grad and/or New-to-Specialty RNs
- Targeted staff education is planned to support operational initiatives around quality improvement and technology implementation
- Includes increases in FTEs in key targeted areas to support organizational priorities including quality & regulatory management
- New sitter program is designed to optimize skill-mix while maintaining patient safety and keeping CNAs on unit
- Planned benefit realignment, including implementation of narrow network, will control annual premium increases

Labor Analysis | FTEs

2019 Budgeted FTE Roll Forward	FTEs
FY 2018 Paid FTEs (as of 12/23/2017)	**3,834**
Volume Related Changes	35
Operational Efficiencies	(115)
Targeted FTE Changes	(12)
Efficiency at Downtown Campus	(25)
FY 2019 Paid FTE's	**3,716**

FTEs per Adjusted Discharge (Incl. SNF)

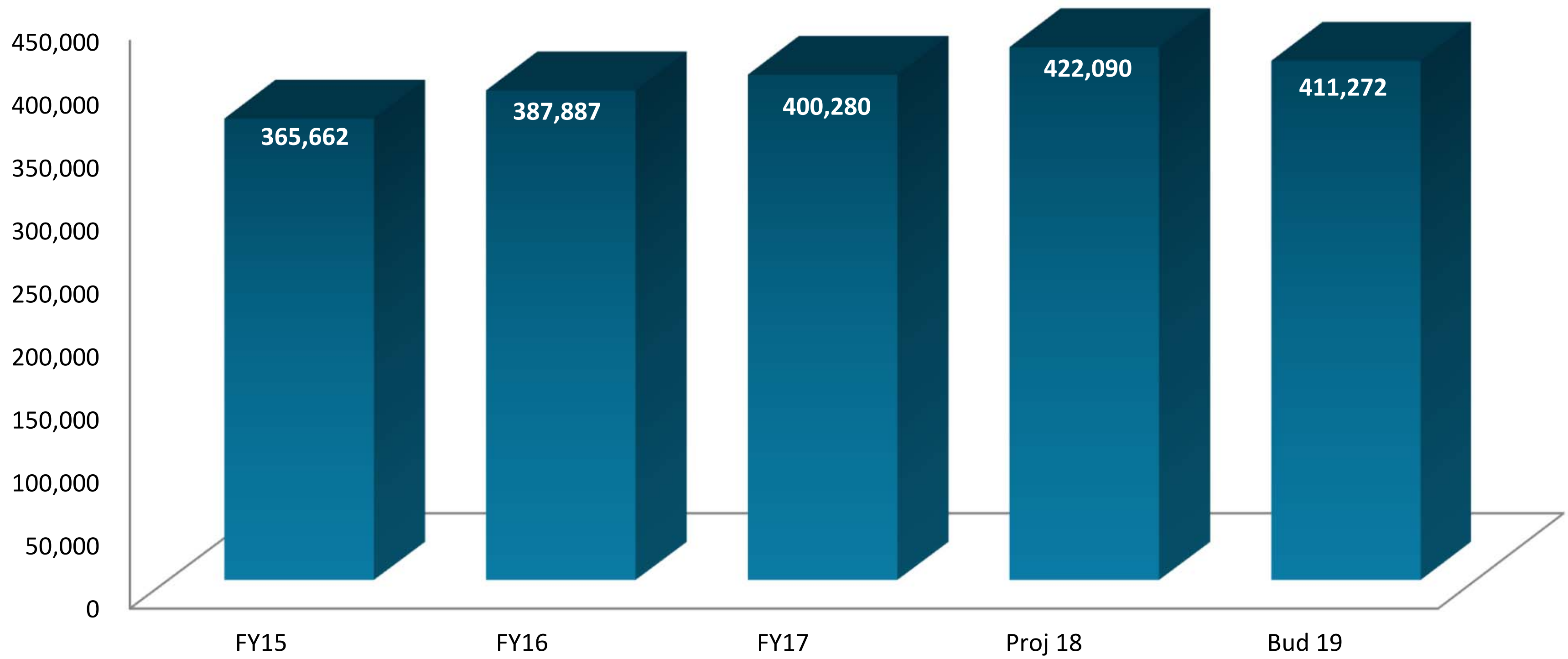
Consistent with planned changes, FY 2019 assumes a reduction in FTEs on a per Adjusted Discharge basis



Labor Analysis | Salaries, Wages & Benefits

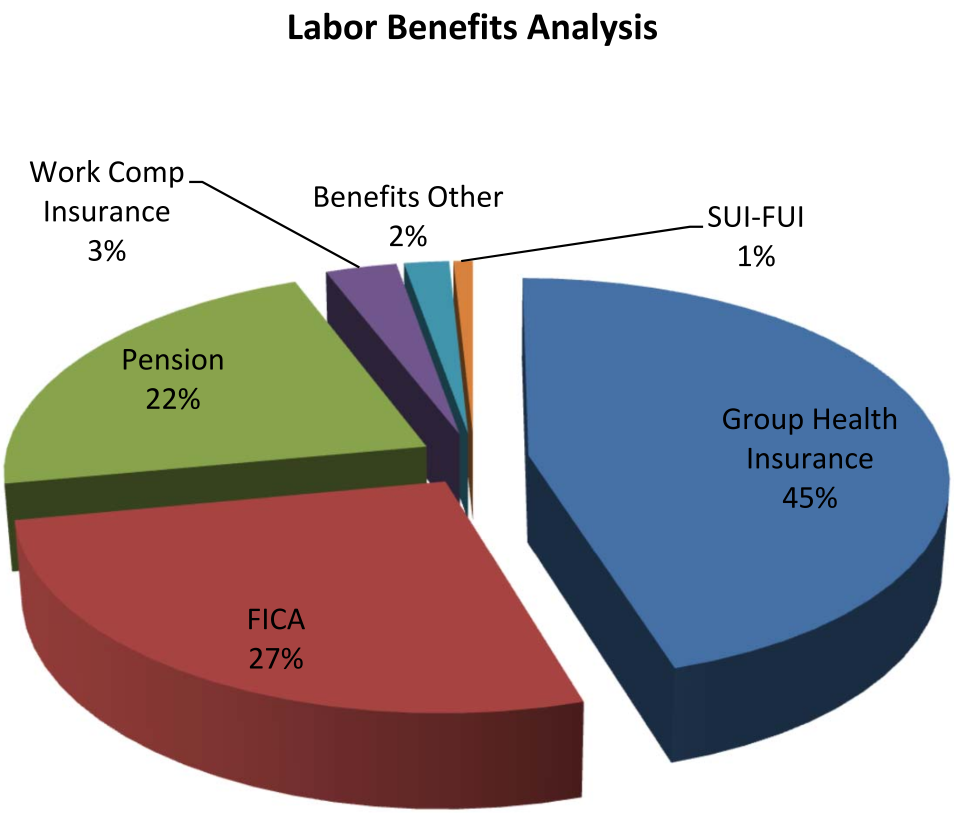
- FY 2019 Total Salaries, Wages, Contract Labor, and Benefits are decreasing by $10.8M or 3%
- Salary increases are offset by staffing reorganization and significant declines in Agency / Registry Expense over current year

Total Salaries, Wages & Benefits (in Thousands)



Labor Analysis | Benefits (excl. PTO)

Type of Benefits	% to Total Benefits
Group Health Insurance	45%
FICA	27%
Pension	22%
Workers' Compensation Insurance	3%
Benefits Other	2%
SUI-FUI	1%
Total Benefit Spend (in thousands)	**86,112**



Significant Impacts

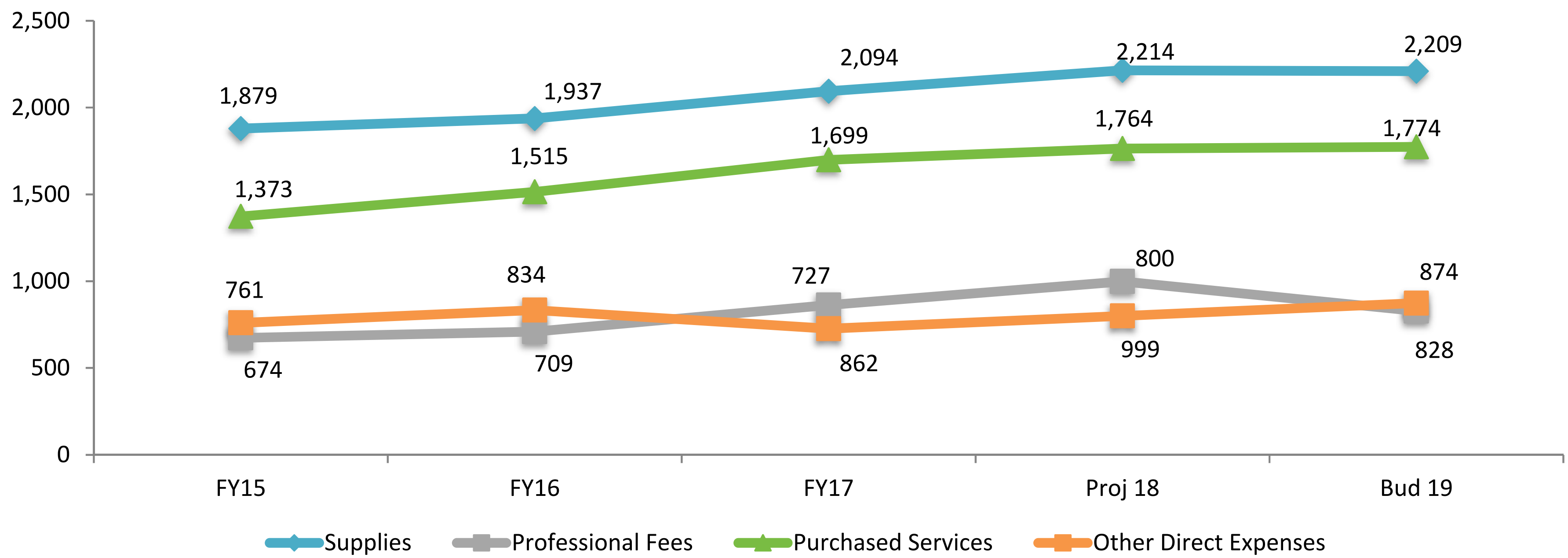
- Group Health Insurance premiums have increased by 6.5%, which is offset by savings due to the Narrow Network and other initiatives
- Unemployment Insurance is increasing $225K; while other benefit categories are relatively flat year over year

Non Labor Analysis

Non Labor Analysis | Summary

- FY 2019 Non Labor expense is increasing $2.6M or 1%
- Non labor expense is increasing by $92 on a per adjusted discharge basis, primarily driven by supply inflation, building rental expenses, and the cost of revenue collection initiatives

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



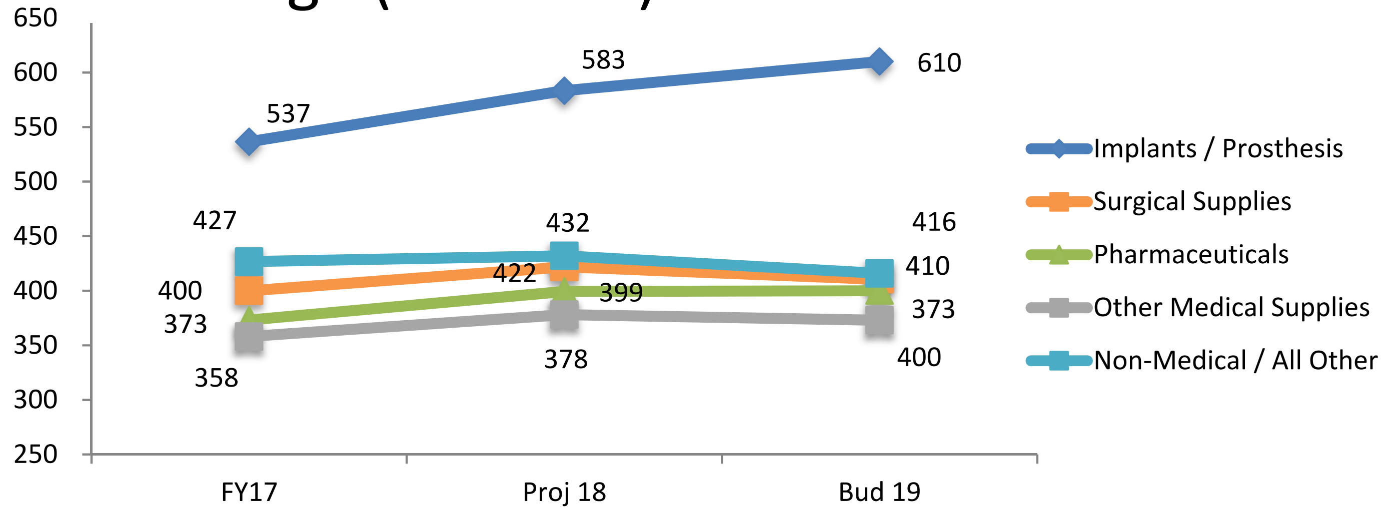
Non Labor Analysis | Supplies

FY 2019 Supply Roll Forward	Expense (in thousands)
FY 2018 Supply Expense (Dec 2017 Projection)	**$105,202**
Increases due to Volume and Utilization	2,728
Inflationary Increases (Net of Absorption)	1,755
Supply Reduction Initiative (Captis, Cardinal, & PRAC*)	(2,000)
FY 2019 Budgeted Supply Expense	**$107,685**

*Physician Resource Allocation Committee

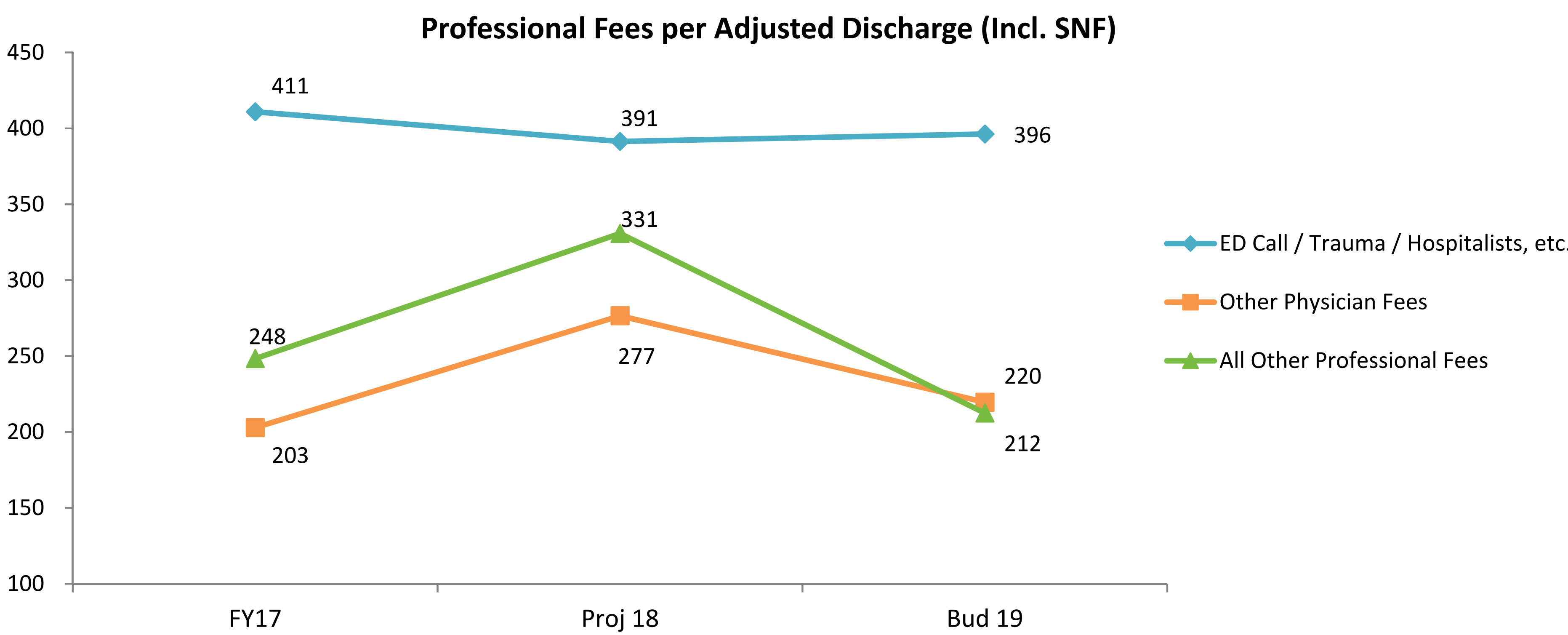
Supplies per Adjusted Discharge (Incl. SNF)

FY19 Budgeted supply management efforts and reduction initiatives total $2M in savings, which is helping to offset significant inflation projected for the coming year



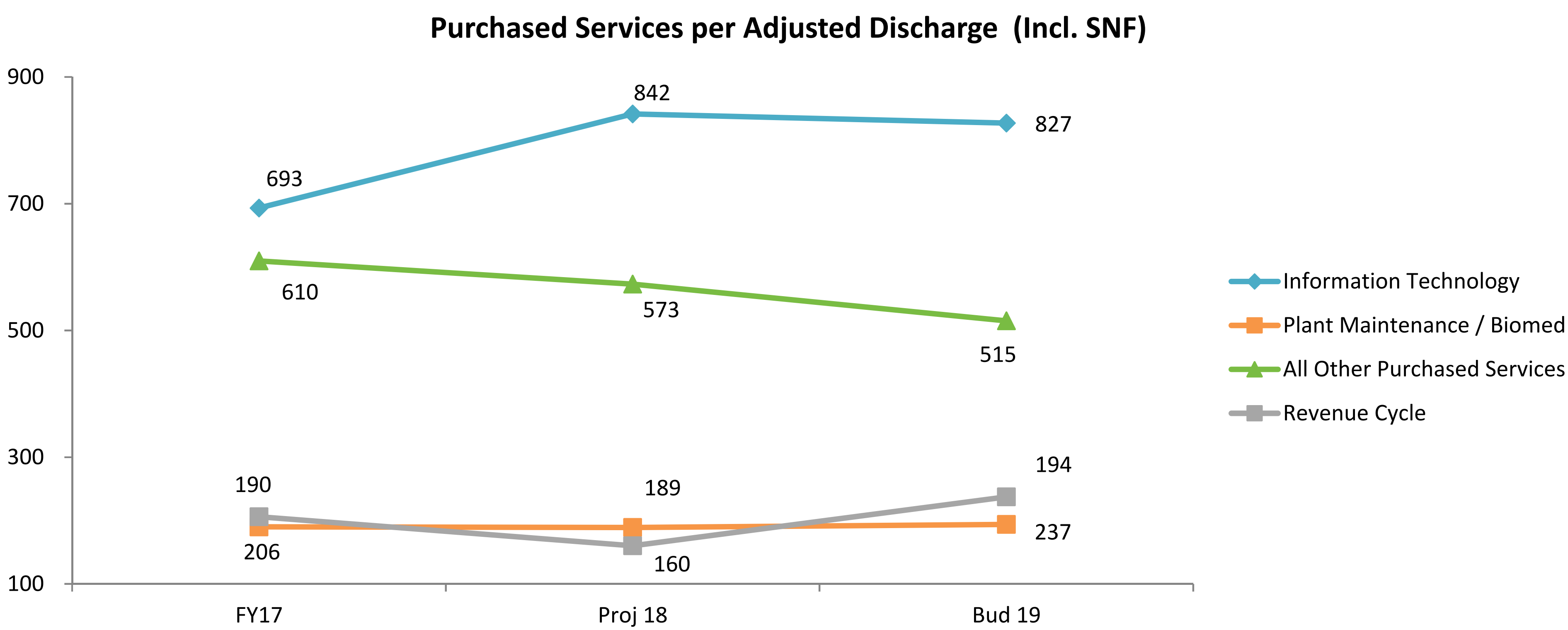
Non Labor Analysis | Professional Fees

- FY 2019 Professional Fees are decreasing by $7.1M or 15%, after growing substantially for the past two year
- The reductions are primarily driven by decreases in consulting and physician contracting



Non Labor Analysis | Purchased Services

- FY 2019 Purchased Services are increasing by $2.7M or 3.2%
- Increases in Revenue Cycle Improvement cost for Huron consultants and Facilities Maintenance drive the majority of the increases, while Information Technology is relatively flat compared to the FY 2018 Projection



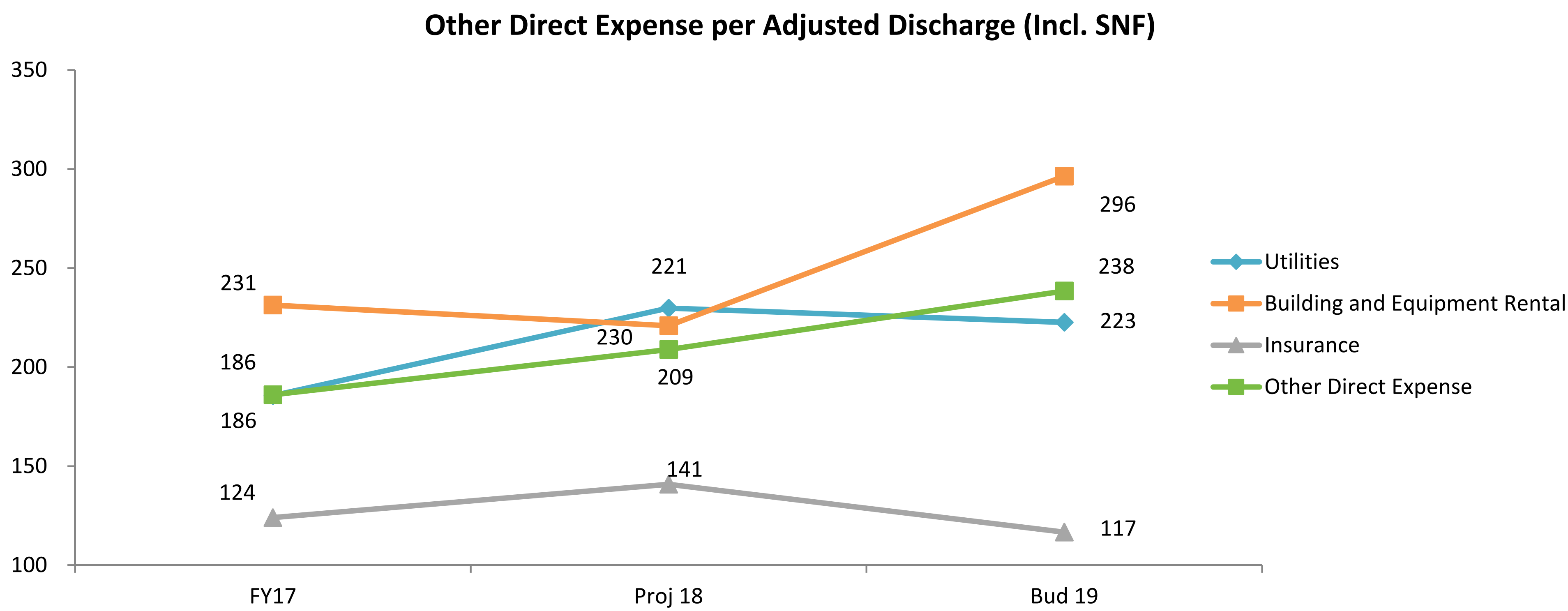
Purchased Services | IT Roadmap

FY 2018 Accomplishments	
PMC – Poway Cellular Remediation	IT Security Systems
Cerner v. 2017 Upgrade	ClairVia - Acuity
VSee OnDuty Telehealth (CSU)	PMC Escondido Pod D Applications
Echo Online Application Module	Surgical Instrument Tracking System
PRIME Projects – Year 2	TeleTracking Upgrade
Call Manager	Crimson Continuum of Care
Infusion Center in Clarity (Cerner)	MedAssets Claims Scrubber

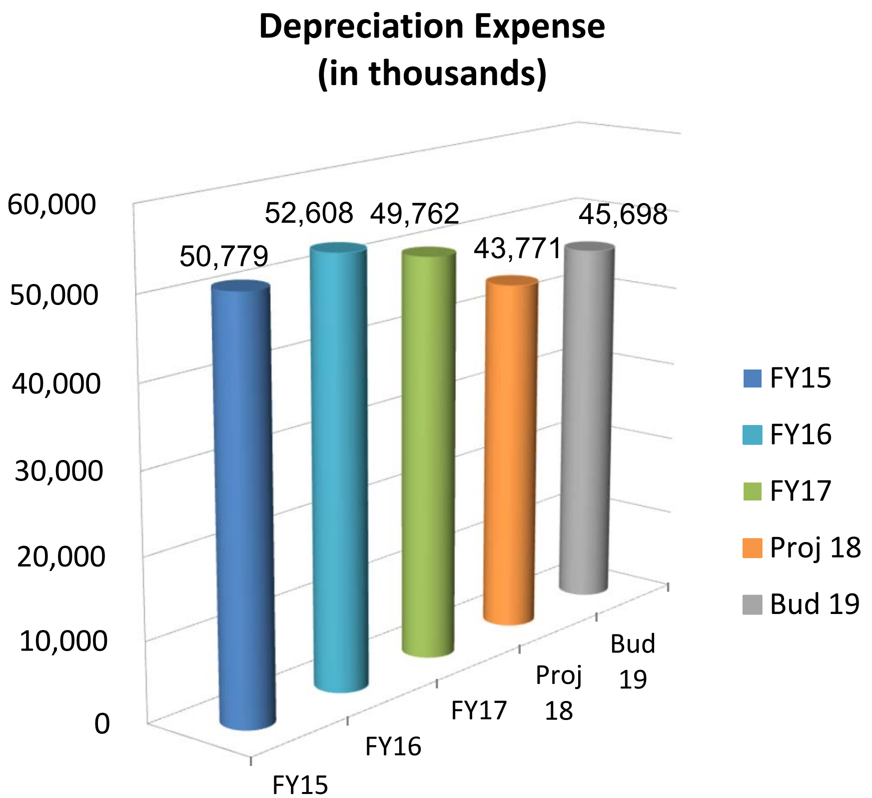
FY 2019 Planned Projects	
Cerner Anesthesia	Clinical Documentation Optimization
ACR Select	Promoting Interoperability Program (MU3)
Single Sign On	Health Information Exchange integration
Patient Safe	Wound Advantage
PACS Upgrade	SNF Integration Liaison

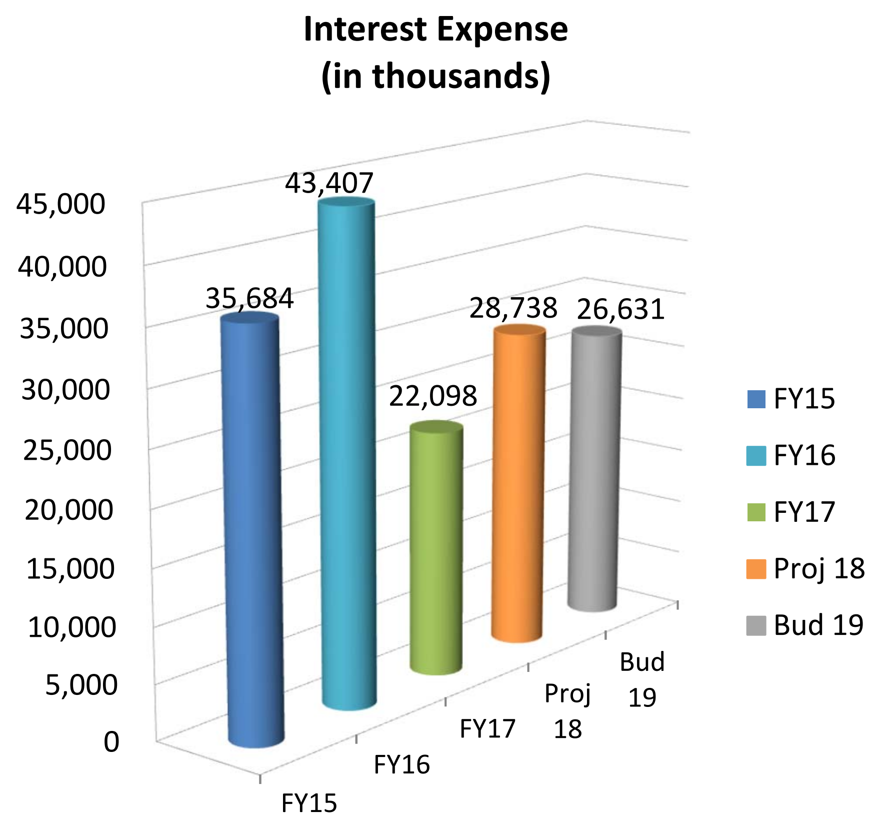
Non Labor Analysis | Other Direct Expense

- FY 2019 Budgeted Other Direct Expense is increasing by $4.6M or 12%
- Increases of $3.3M in building rental expenses and $502,000 in water utilities are the primary drivers



Depreciation and Interest Expense





*Interest expense reflected for Revenue Bonds only

Annual Operating Budget Summary & EBIDA Recap

Annual Operating Budget Summary and Trend

	Results FY16	Results FY17	Projected FY18	Budget FY19
Revenue:				
Gross Revenue	3,477,330,136	3,712,250,300	3,880,935,131	4,243,942,620
Net Revenue	693,157,590	727,926,987	726,069,021	732,498,081
Other Operating Revenue	18,128,784	12,777,222	11,112,035	11,575,557
Total Operating Revenue	$ 711,286,374	$ 740,704,209	$ 737,181,056	$ 744,073,638
Expenses:				
Salaries, Wages, Registry,	387,973,785	400,280,015	422,089,581	411,271,560
Supplies	96,645,668	104,658,357	105,201,805	107,685,308
Depreciation	52,607,947	49,761,573	43,770,969	45,698,209
Other	152,866,993	164,296,945	169,262,975	169,418,562
Total Operating Expense	$ 690,094,393	$ 718,996,890	$ 740,325,330	$ 734,073,639
Operating Income	21,191,981	21,707,319	(3,144,274)	10,000,000
Non-Operating Income (Loss	3,092,752	(1,070,667)	(2,164,688)	(4,500,531)
(Interest Expense)	(43,407,152)	(22,097,513)	(28,738,139)	(26,631,343)
Property Tax Revenue	15,145,434	15,910,055	17,100,000	18,400,000
Income (Loss)	$ (3,976,985)	$ 14,449,194	$ (16,947,101)	$ (2,731,875)
ARCH Subsidy	14,000,000	15,157,249	17,905,027	11,000,000
Net Margin %	-0.6%	2.0%	-2.3%	-0.4%
OEBIDA Margin (Excl Proper	10.4%	9.6%	5.5%	7.5%
OEBIDA Margin (Incl Propert	12.5%	11.8%	7.8%	10.0%
EBIDA Margin	12.9%	11.7%	7.5%	9.4%
Total Uncompensated Care	61,959,797	60,336,950	59,512,052	63,368,395
Total Uncompensated Care	1.78%	1.63%	1.53%	1.49%

FY 2019 EBIDA Recap *(in thousands)*

	Results FY 2015	Results FY 2016	Results FY 2017	Projected FY 2018	Budget FY 2019
Net Income from Ops (Excluding Interest Expense)	9,146	21,192	21,707	(3,144)	10,000
Depreciation Expense	50,779	52,608	49,762	43,771	45,698
OEBIDA	**$ 59,925**	**$ 73,800**	**$ 71,469**	**$ 40,627**	**$ 55,698**
OEBIDA Margin (Excl Property Tax Rev)	9.1%	10.4%	9.6%	5.5%	7.5%
OEBIDA Margin (Incl Property Tax Rev)	11.3%	12.5%	11.8%	7.8%	10.0%
EBIDA	**82,003**	**92,038**	**86,309**	**55,562**	**69,597**
EBIDA Margin	**12.4%**	**12.9%**	**11.7%**	**7.5%**	**9.4%**
Total Uncompensated Care & Bad Debt	72,995	61,960	60,337	59,512	63,368
Total Uncompensated Care as % of Gross	2.31%	1.78%	1.63%	1.53%	1.49%
Net Income/(Loss) after Non-Op Income	**$ (4,460)**	**$ (3,977)**	**$ 14,449**	**$ (16,947)**	**$ (2,732)**

Capital Plan

Capital Plan | Three-Year Planning Process

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

- Equipment reaching technical obsolescence
- Organizational strategic initiatives
- Capital funding availability

Funding sources for capital projects and acquisitions include:

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

Capital Plan | Bond Issuance

In December 2017, the Palomar Health Board approved the issuance of $60M in Certificates of Participation (Revenue Bonds). These funds will allow Palomar Health to address deferred capital needs related to:

- Routine Equipment Replacement
- Facility Infrastructure
- Information Technology
- Strategic Initiatives

Capital Plan | Three-Year Summary

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

	FY 2019	FY 2020	FY 2021	Total Project Spend
Funded by Operations:				
Equipment	815	1,400	1,500	3,715
Facilities	3,878	7,600	3,600	15,078
Information Technology	308	5,000	3,500	8,808
Subtotal	**5,000**	**14,000**	**8,600**	**27,600**
Funded by Bonds:				
Equipment	6,339	-	-	6,339
Facilities	14,154	23,200	-	37,354
Information Technology	4,911	-	-	4,911
Subtotal	**25,404**	**23,200**	-	**48,604**
Funded by Foundation:	**308**	**2,700**	-	3,008
Total	**$ 30,712**	**$ 39,900**	**$ 8,600**	**$ 79,212**

Capital Plan | Bond Issuance Summary

Bond Issuance Fiscal Year Allocation Summary

Proceeds from Bond Issuance		60,043,866
Reserved for Floors 9, 10 Infrastructure		(23,200,000)
Available Proceeds:		**36,843,866**
Funds Budgeted:	Fiscal Year 2018	(11,422,242)
	Fiscal Year 2019	(25,404,183)
	Fiscal Year 2020	-
	Fiscal Year 2021	-
Total Budgeted:		**(36,826,425)**
Unallocated Balance:		**17,441**

Capital Plan | Planned Capital Projects

Capital Project	Capital Allocation
Development of Strategic Service Lines	7,019,760
Poway Modernization	6,811,214
IT Infrastructure & Equipment	4,672,103
Relocation of Downtown Campus Services	4,300,000
Facility Infrastructure Improvements	3,378,954
Defibrillator Replacement and Standardization	1,694,889
Routine Equipment Replacement	1,634,666
Villa Pomerado Modernization	288,132
Employee and Patient Safety	140,371
SART Program	107,800

FY 2019 Budget Summary & Key Take-Aways

Summary

FY 2019 Budget is achievable and ties to the Strategic Financial & Capital Plan. However, it requires success in the following areas:

- 6.3% increase in Patient Days and 2.6% growth in Adjusted Discharges
- Successful execution of planned Service Line Development resulting in 2.2% growth in Inpatient Surgeries
- Improvement of $7 million in Net Patient Revenue year over year, with continued contributions from the PRIME Program
- Normalize staffing to reduce reliance on overtime pay and registry labor
- 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 $14.2 million year over year; Operating Income improvement of $13.1 million year over year
- EBIDA of $70 million