FY 2018 Annual Operating and Capital Plan

Board of Directors Budget Meeting

June 6, 2017

PALOMAR HEALTH

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Agenda

Executive Summary

FY 2018 Budget Overview:

- Key Budget Drivers | Inflationary Assumptions

Key Statistical / Growth Indicators

Revenue:

- Key Revenue Assumptions / Payer 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

2018 Annual Budget Summary / EBIDA Recap

Three Year Capital Planning

Executive Summary

The FY 2018 Annual Budget provides achievable goals for the coming year which are consistent and aligned with our Strategic Financial and Capital Plan. The plan includes relatively flat EBIDA margin from FY17 Projection

- Demonstrates the result of a continued effort to absorb inflation and drive greater efficiency in all areas of the organization
- Reflects a concerted effort to hold on non labor expenditures
- Incorporates staffing initiatives to drive targeted improvements in utilization of labor resources, specifically in contract labor
- Aligns the operating and capital budgets with our current year and long-term strategic plan initiatives

FY 2018 Budget – Key Drivers & Overview

Key Plan Drivers

- Strategic Plan alignment including relatively flat volume growth resulting in margins consistent with FY17
- Continued reimbursement pressures driven by ACA challenges and impacts to industry/payer relationships
- “Patient Throughput” initiative focused on revenue optimization and expense management strategies to reduce premium labor costs

Patient Throughput Initiative	Supply Expense Reduction
$5,000,000	$3,000,000

- Concerted supply management initiatives to enhance savings through utilization and rate efforts, supported by new partnership with Upper Midwest Consolidated Services Center (UMCSC)
- PMC Downtown Escondido closure phased in through June 2018
- Assessment of service lines and contribution margin profitability

Baseline Financial Projections | Key Drivers

Ratio / Statistics (000s)	Audited	Projection Years					
	2016	2017	2018	2019	2020	2021	2022
Total Operating Revenue	$ 711,287	$ 732,025	$ 743,732	$ 762,116	$ 789,020	$ 816,894	$ 845,892
Operating EBIDA	$ 73,800	$ 69,609	$ 67,184	$ 76,571	$ 78,692	$ 80,794	$ 82,987
Operating Income (Exc. Int Expense)	$ 21,192	$ 20,009	$ 20,982	$ 32,020	$ 35,658	$ 38,877	$ 41,823
Net Income	$ (3,978)	$ (2,979)	$ 6,172	$ 26,008	$ 30,995	$ 35,576	$ 43,366
Capital Expenditures	$ 7,541	$ 11,500	$ 30,000	$ 30,000	$ 30,000	$ 30,000	$ 30,000
Profitability							
Operating Margin (Exc. Int Exp)	3.0%	2.7%	2.8%	4.2%	4.5%	4.8%	4.9%
Excess Margin	-0.6%	-0.4%	0.8%	3.4%	3.9%	4.4%	5.1%
Operating EBIDA Margin (Inc. Pro. Tax)	10.4%	9.5%	9.0%	10.0%	10.0%	9.9%	9.8%
Debt Position							
Debt Service Coverage (x)	2.2x	2.0x	2.1x	2.5x	2.6x	2.6x	2.8x
Liquidity							
Days Cash On Hand (days) (Exc. Interest)	124.6	128.8	130.7	148.4	153.6	159.8	167.5
Other							
Capital Spending Ratio	14.3%	23.2%	64.9%	67.3%	69.7%	71.6%	72.9%
Average Age of Plant	8.9	10.5	12.2	11.8	13.3	14.6	15.9

Prepared by Kaufman Hall and Associates

Inflationary Assumptions

- FY 2018 Budget assumes the absorption of a significant amount of industry inflation through utilization and efficiency
- In January 2017, Palomar Health joined UMCSC to support strategic supply management efforts
- 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 Inflations Comparison

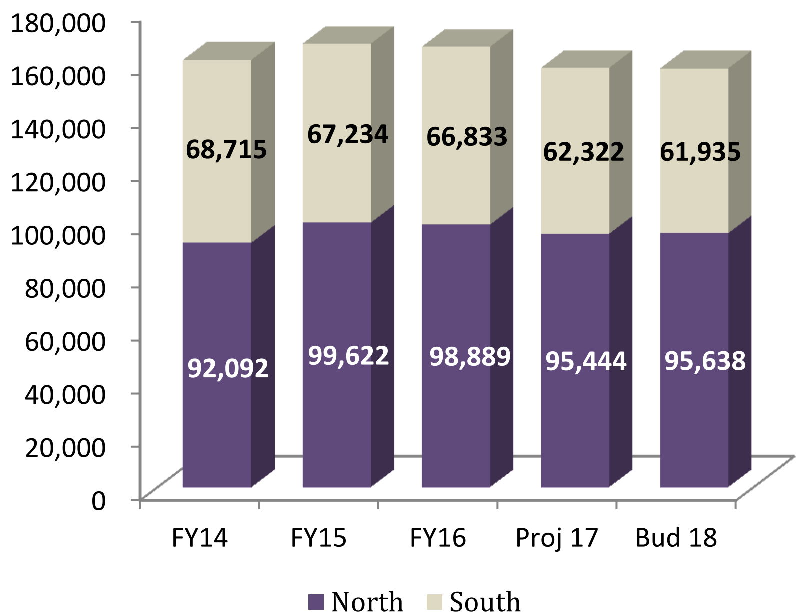
Category/Expense	2018 Budget	Industry Expectation
Implants	**2.5%**	**1-6%**
General Surgery Supplies	1%	0-6%
Surgical Needles	0%	0-2%
Oxygen – Gas	1.5%	1-7%
IV Solutions	9%	3-20%
Pharmaceuticals	**5.2%**	**7%**
Radioactive and X-Ray Material	1%	0-6%
Other Medical	0%	0-2%
Food / Meat	1.5%	3%
Linen	0%	0-1%
All Other: Cleaning, Forms, Office, Uniforms	0-1.5%	0-5%

Key Statistical Indicators

Key Statistical Indicators | Inpatient

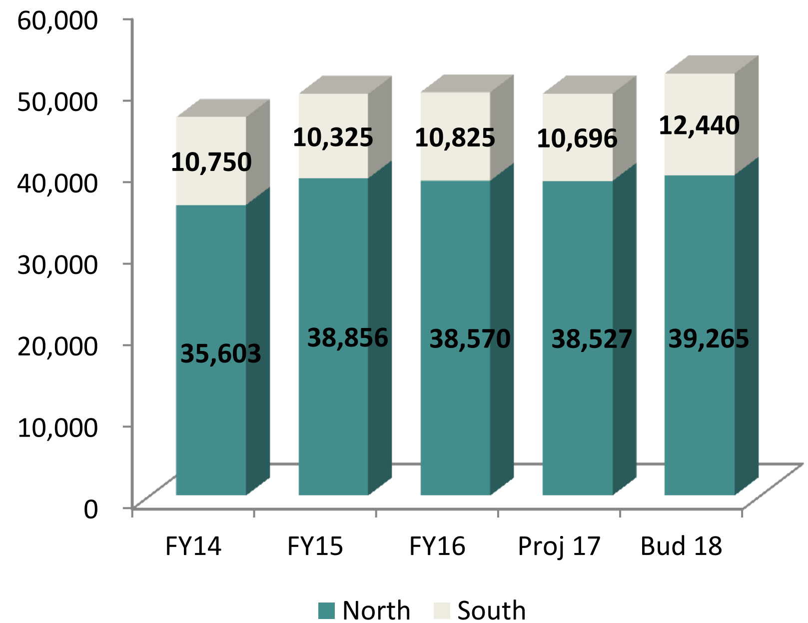
Total Patient Days

FY 2018 Planned Acute Patient Days are relatively flat year over year



Adjusted Discharges (Incl. SNF)

FY 2018 Adjusted Discharges are increasing slightly more than Patient Days due to changes in service delivery



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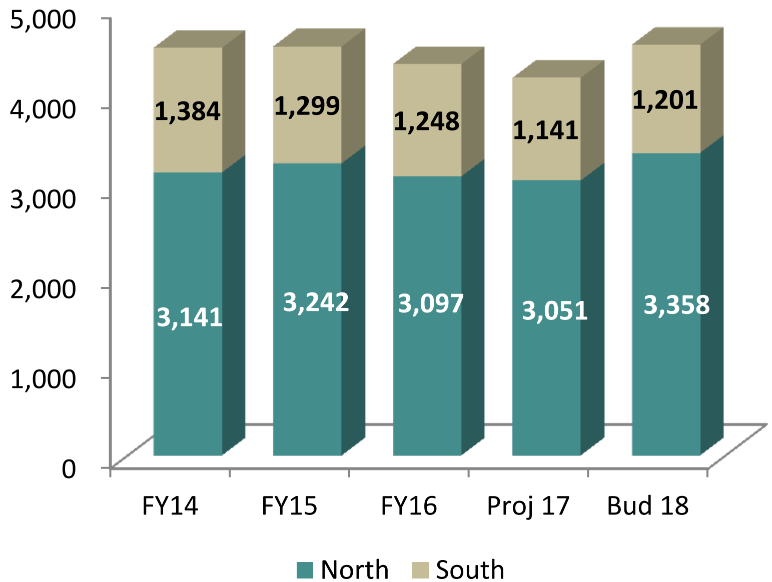
Key Statistical Indicators | Inpatient

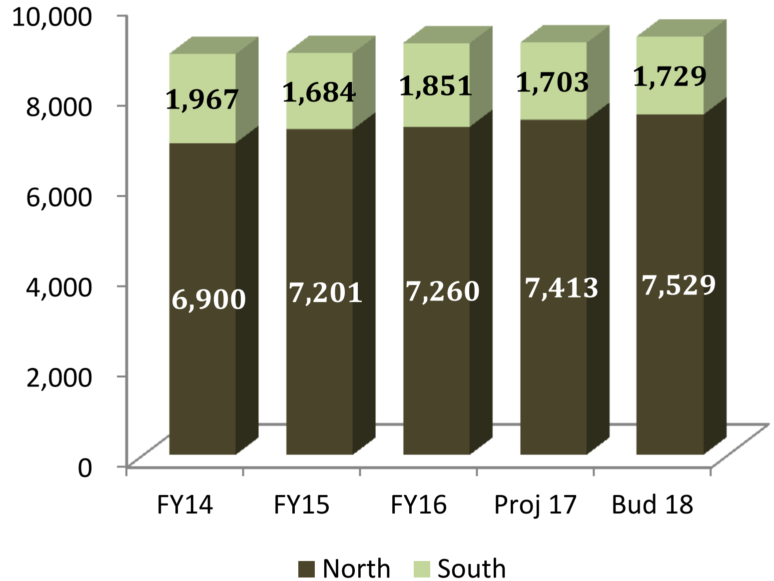
Deliveries

FY 2018 Deliveries are increasing by 367 or 8.8% year over year, largely driven by increased interest in Palomar Medical Center Escondido



Surgeries

Minimal growth expected in FY 2018 in Inpatient Surgeries compared to FY 2017 projection



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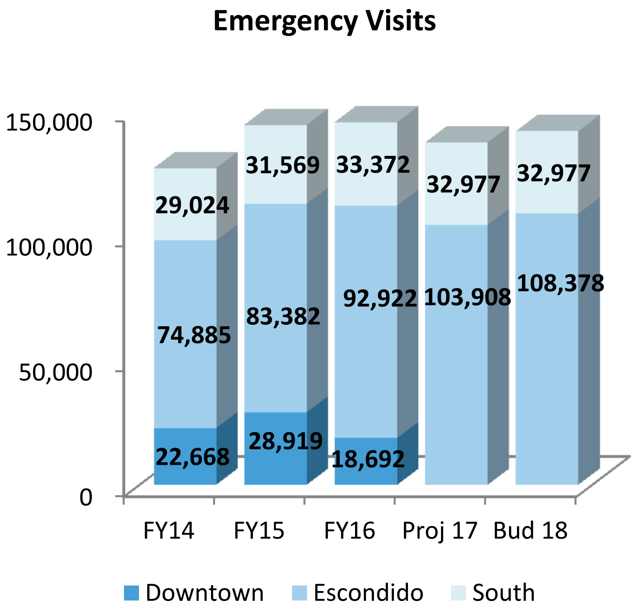
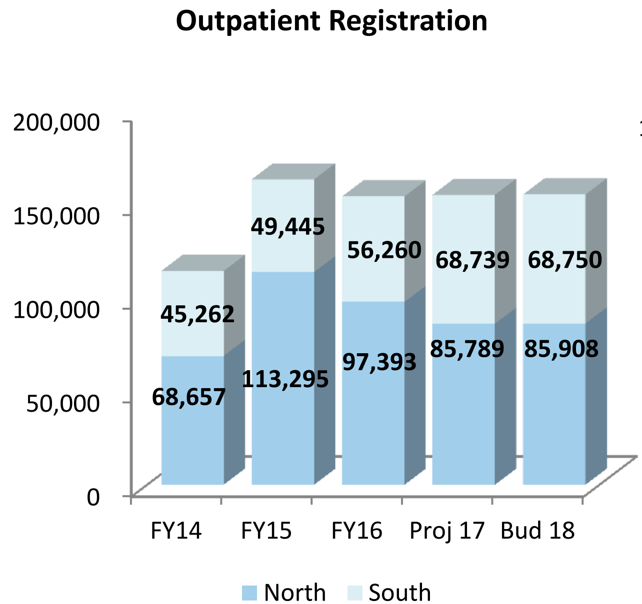
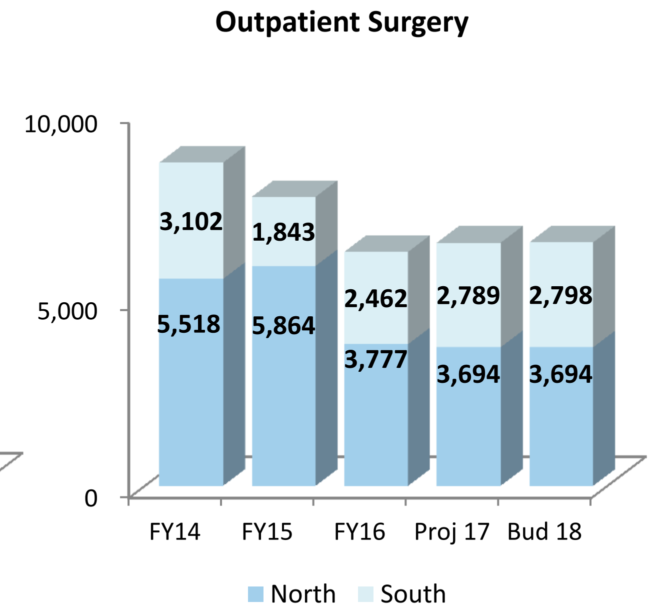
Key Statistical Indicators | Outpatient







Outpatient Services

- Emergency Visits are increasing by 4,470 or 3.3% based on anticipate increases in demand
- Outpatient Registrations and Outpatient Surgeries are expected to be relatively flat in the coming year

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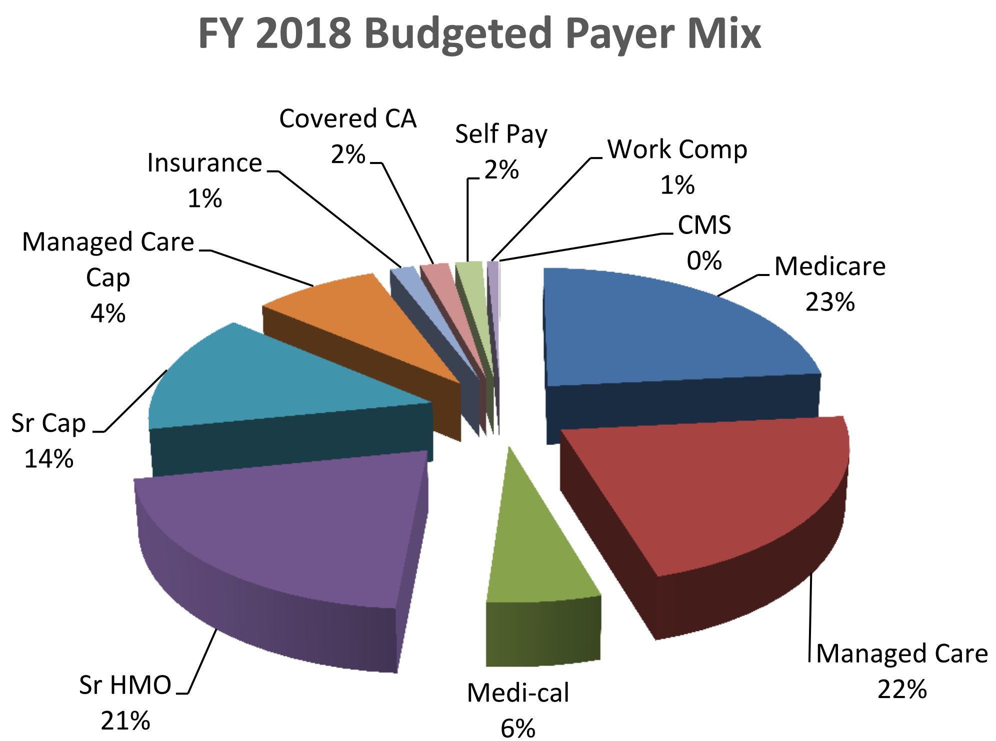
Revenue

Key Gross Revenue Considerations

Payer Category	Total Charges
Medicare	$926,627,359
Managed Care	$870,263,026
Senior HMO	$819,318,773
Senior Capitation	$564,488,220
Managed Care Capitation	$319,555,797
Medi-Cal	$228,803,273
Covered California	$70,876,185
Self Pay	$67,607,896
Insurance	$61,044,927
Workers Compensation	$28,977,253
CMS	$2,126,194
Total	**$3,959,688,903**



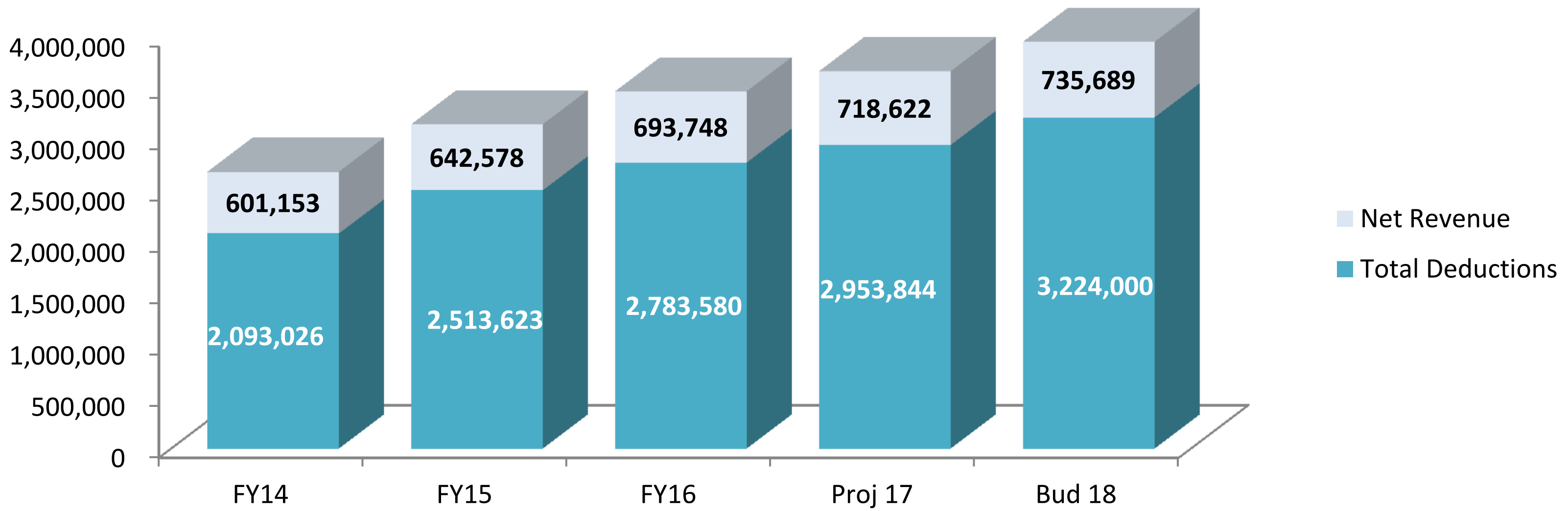
Assumptions

- 7.3% overall effective rate increase (targeted 8%)
- Bad Debt and Uncompensated Care 1.7%; FY17 Budget = 1.8%
- Payer mix has been relatively stable this year

Revenue Trend Analysis

- FY 2018 Gross Revenue is expected to be $287M or 8% higher than FY 2017
- Net Revenue is anticipated to be $17M or 2% higher year over year

(in Thousands)



	FY14	FY15	FY16	Proj 17	Bud 18
Total Deductions	2,093,026	2,513,623	2,783,580	2,953,844	3,224,000
Net Revenue	601,153	642,578	693,748	718,622	735,689
Total Gross Revenue	2,694,180	3,156,201	3,477,328	3,672,466	3,959,689

*Deductions include net capitation impact

Salaries, Wages, Benefits & FTEs

Labor Impact Summary

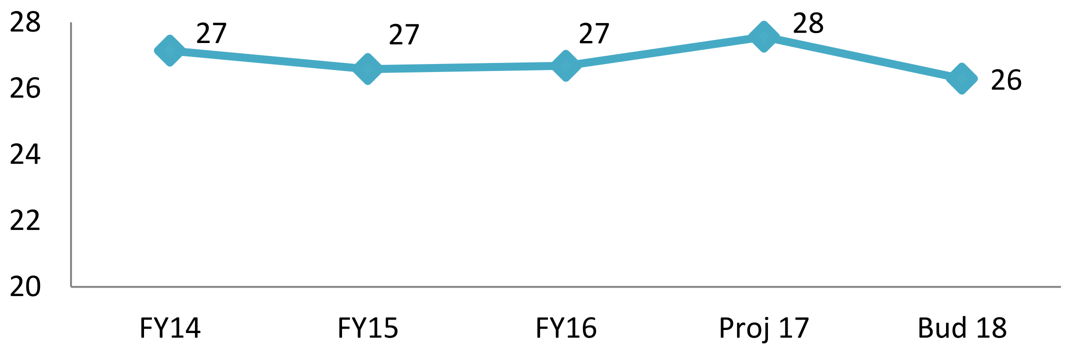
- The FY 2018 Operational Budget reflects a concerted effort to stabilize the workforce and reduce contract labor
- Several initiatives drive focus away from premium pay toward a more coordinated staffing approach
- Consistent with current year, maintains a significant focus on training positions for New Grad and/or New-to-Specialty RNs
- Significant year-over-year increases in staff education are planned to support achievement of operational initiatives
- Includes increases in FTEs in targeted areas funded by corresponding reductions in associated Purchased Services
- New Information Technology tools and Human Resources strategies to drive improved scheduling and recruitment

Labor Analysis | FTEs

2018 Budgeted FTE Roll Forward	FTEs
FY 2017 Paid FTE's (as of 12/31/2016)	**3,707**
Volume Related Changes	76
Operational Efficiencies	(126)
Targeted FTE Additions (incl. staff education hours)	68
FY 2018 Paid FTE's	**3,725**

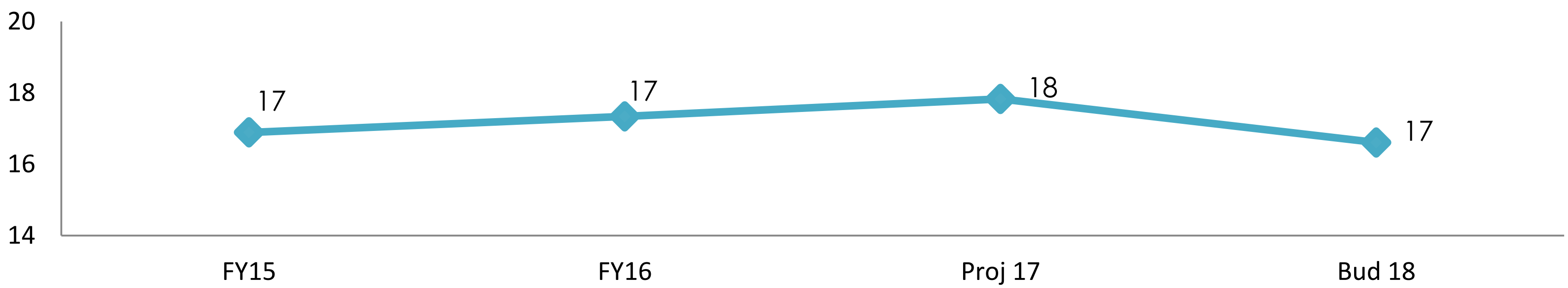
FTEs per Adjusted Discharge (Incl. SNF)

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

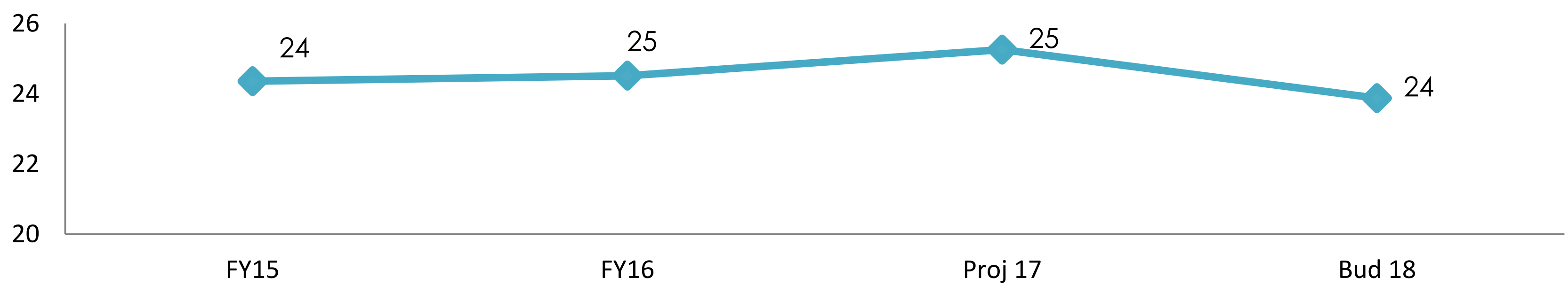


Labor Analysis | Direct Care FTEs

Direct Caregiver FTEs per Adjusted Discharges



Direct Caregiver FTEs per Adjusted Discharges (incl. support)

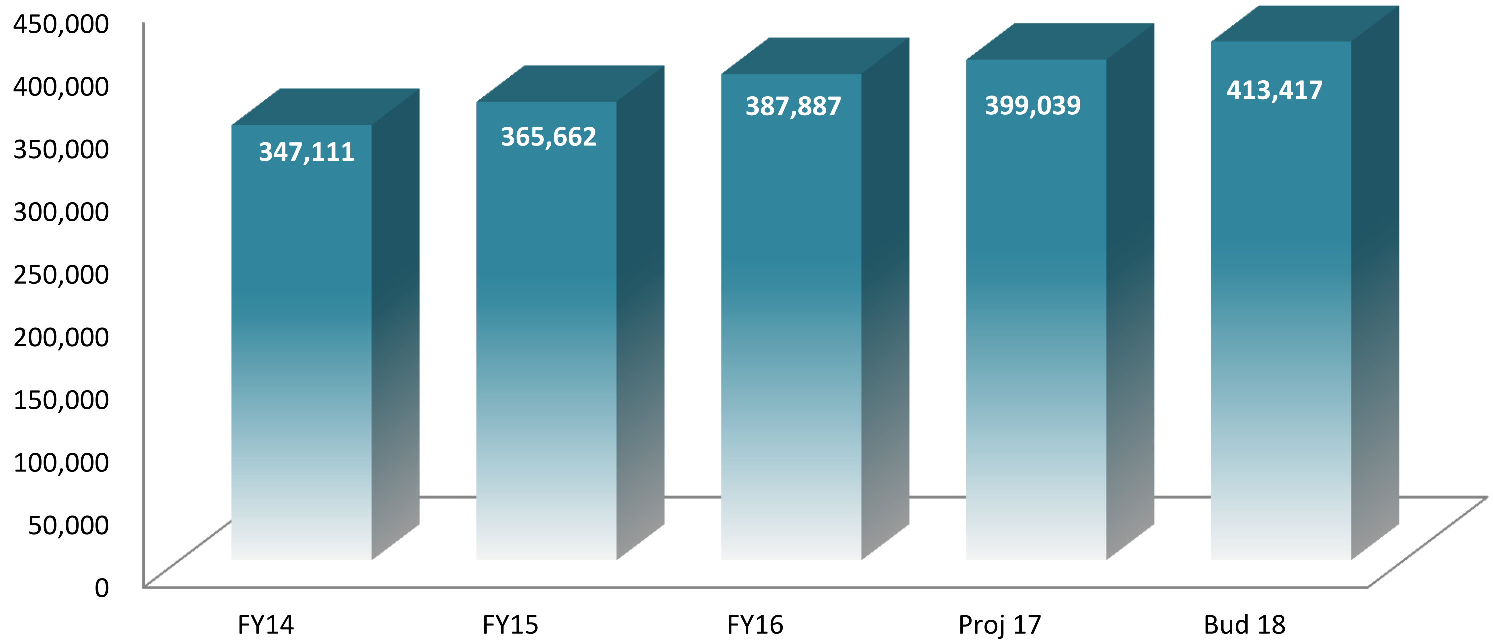


- Changes in service delivery mix, including increases in Labor & Delivery and decreases in Skilled Nursing, have impacted the length-of-stay and disproportionally increased adjusted discharges in FY18
- Planned decreases in contract labor and premium pay hours are built into the FY 2018 budget

Labor Analysis | Salaries, Wages & Benefits

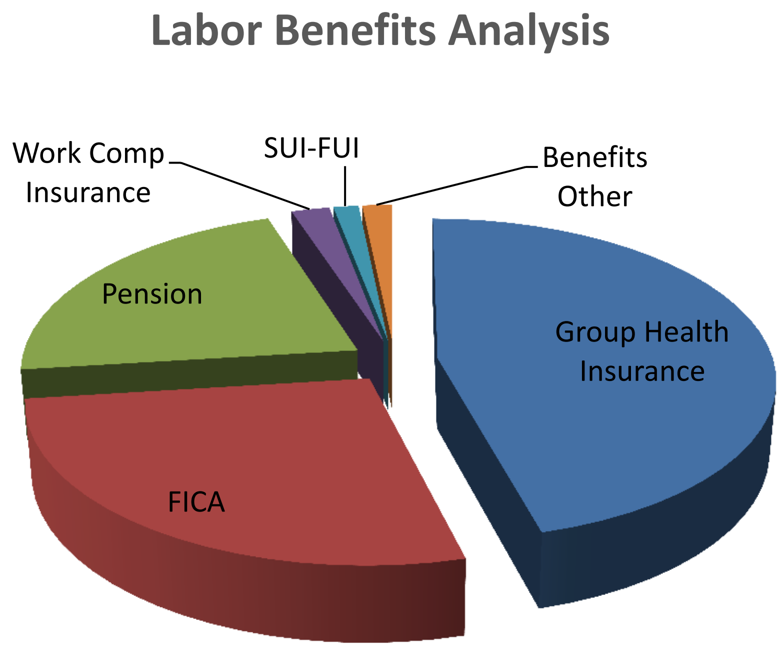
- FY 2018 Total Salaries, Wages and Benefits are increasing $14.4M or 3.6%; increases are offset by significant declines in Agency / Registry Expense over current year

Total Salaries, Wages & Benefits (in Thousands)



Labor Analysis | Benefits (excluding PTO)

Key Employee Benefits	FY18 Budget
Group Health Insurance	46%
FICA	27%
Pension	22%
Workers Compensation Insurance	2%
SUI-FUI	1%
Benefits Other	2%



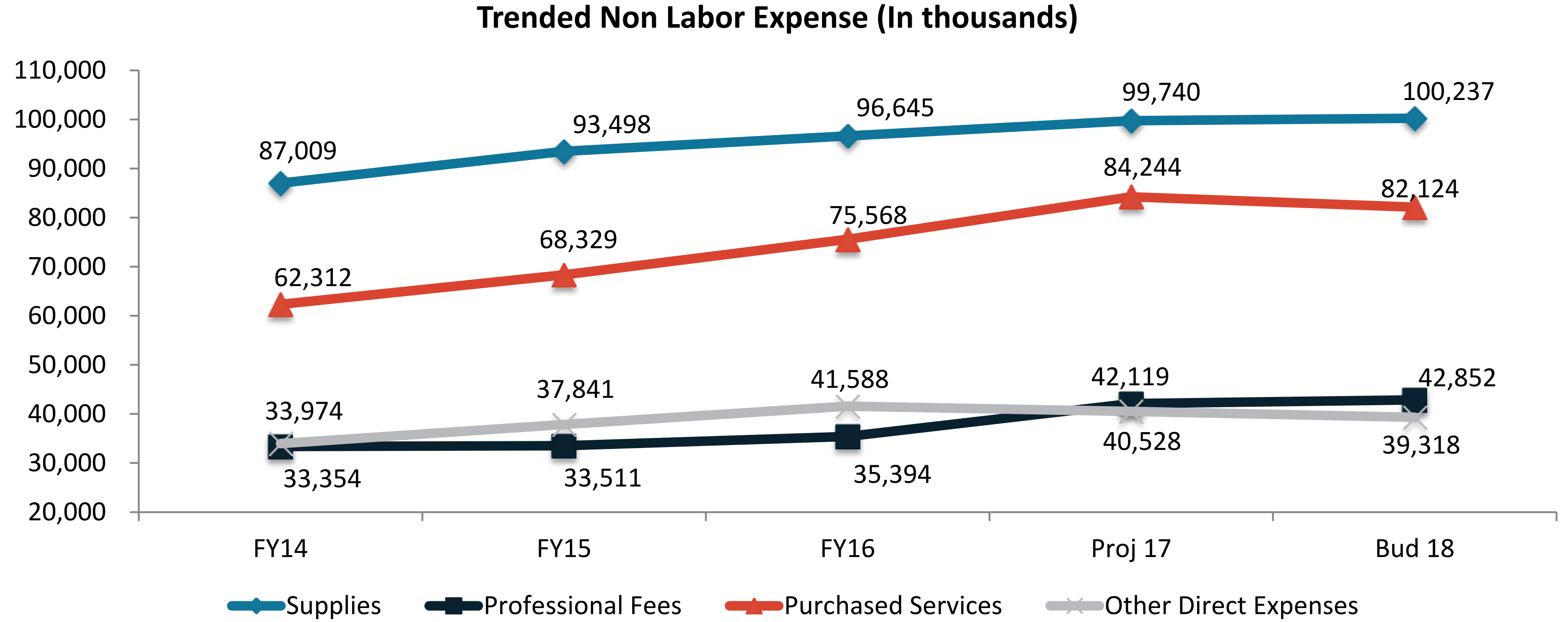
Significant Impacts

- Group Health Insurance has increased by $2.9M based on premiums increasing roughly 8%
- Decrease of $1.7M in Worker’s Compensation Insurance

Non Labor Analysis

Non Labor Analysis | Summary

- FY 2018 Non Labor expense is increasing $4.1M or 1.3%
- Non labor expense is decreasing by $301 on a per adjusted discharge basis, as a result of a concerted effort to reduce non labor expenses and hold the line on inflation



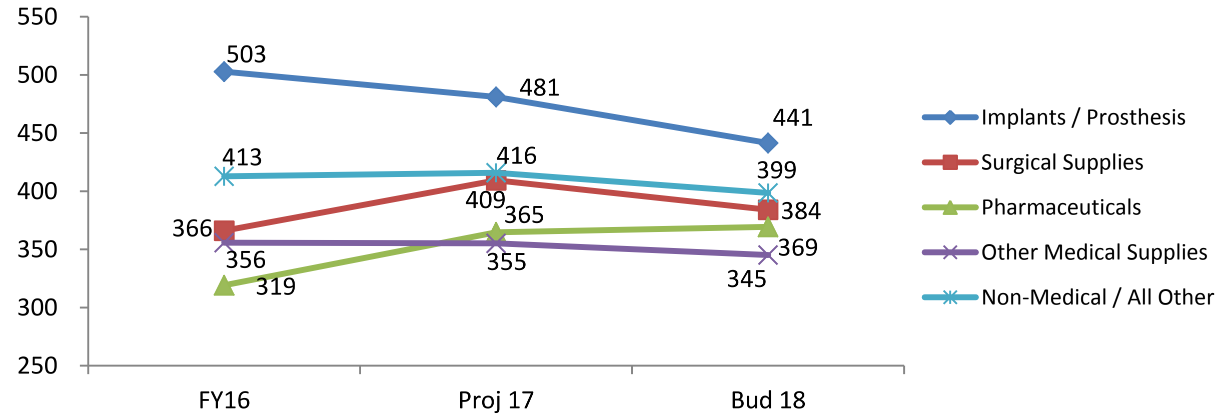
Non Labor Analysis | Supplies

FY 2018 Supply Roll Forward	Expense
FY 2017 Supply Expense (Dec 2016 Projection)	**$99,740**
Increases due to Volume and Utilization	1,507
Inflationary Increases (Net of Absorption)	1,990
Supply Reduction Initiative (UMCSC & PRAC*)	(3,000)
FY 2018 Budgeted Supply Expense	**$100,237**

*Physician Resource Allocation Committee

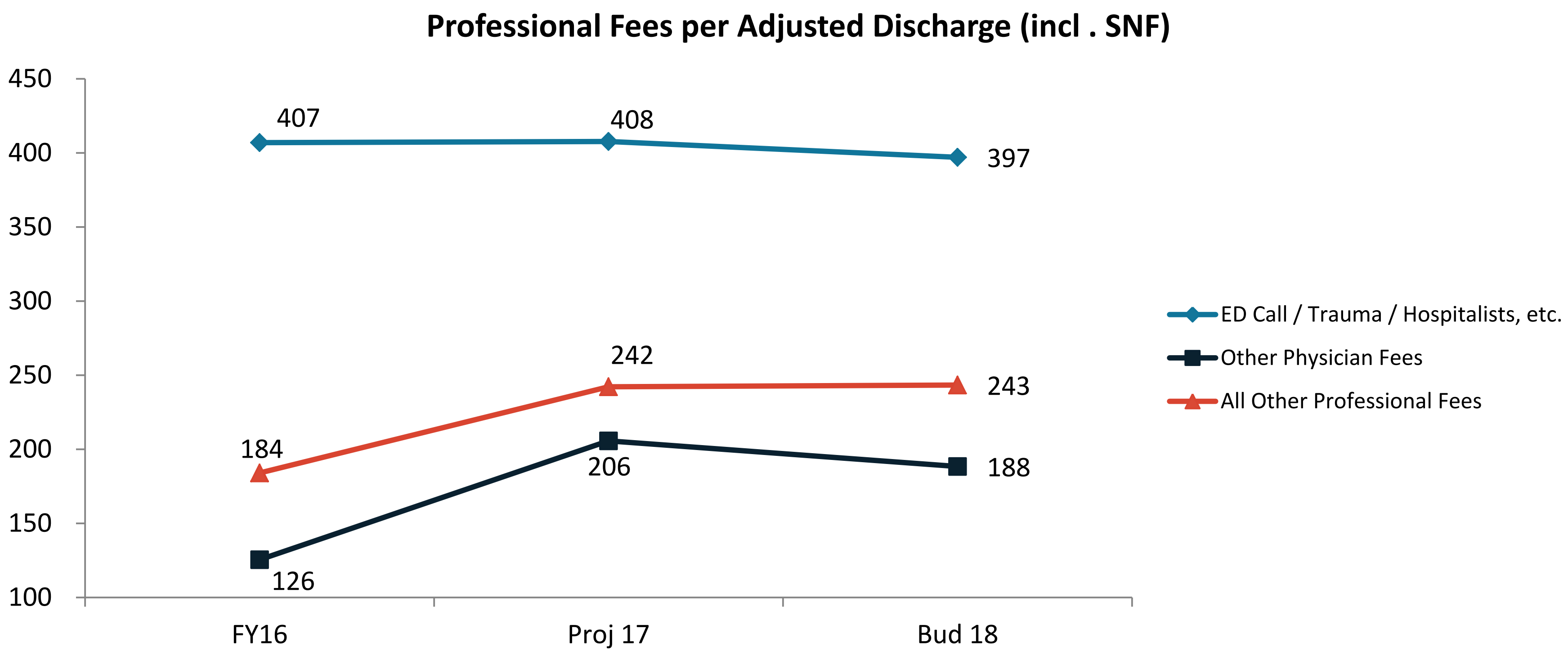
Supplies per Adjusted Discharge (Incl. SNF)

FY18 Budgeted supply management efforts and reduction initiatives total $3M in savings; which is helping to offset significant inflation projected for the coming year



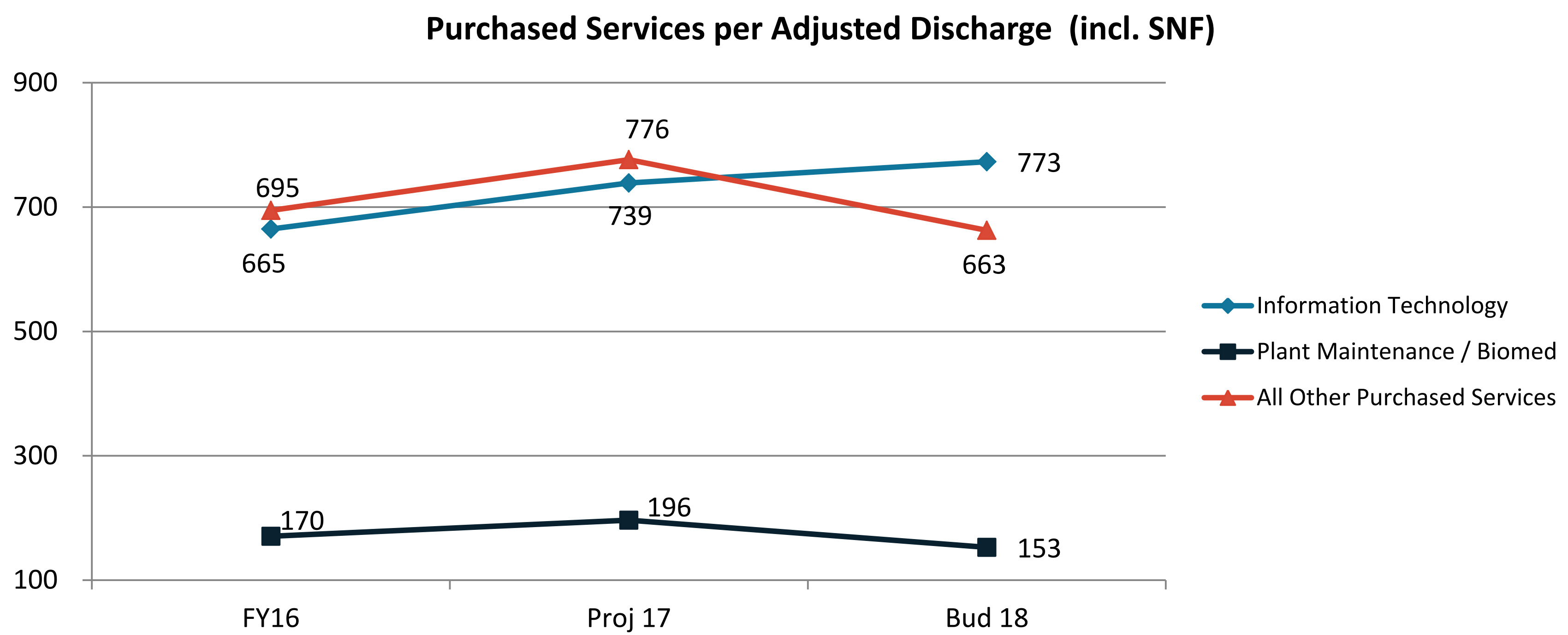
Non Labor Analysis | Professional Fees

- FY 2018 Professional Fees are increasing by $734K or 1.7%, as a result of strategic IT initiatives and increased physician fees in Acute Rehab driven by volume



Non Labor Analysis | Purchased Services

- FY 2018 Purchased Services are decreasing by $2.1M or 2.5%
- Information Technology and Parking drive the most significant increases, and are offset by savings from Patient Financial Services, Biomed, and Radiation Oncology



Purchased Services | IT Roadmap

FY 2017 Accomplishments

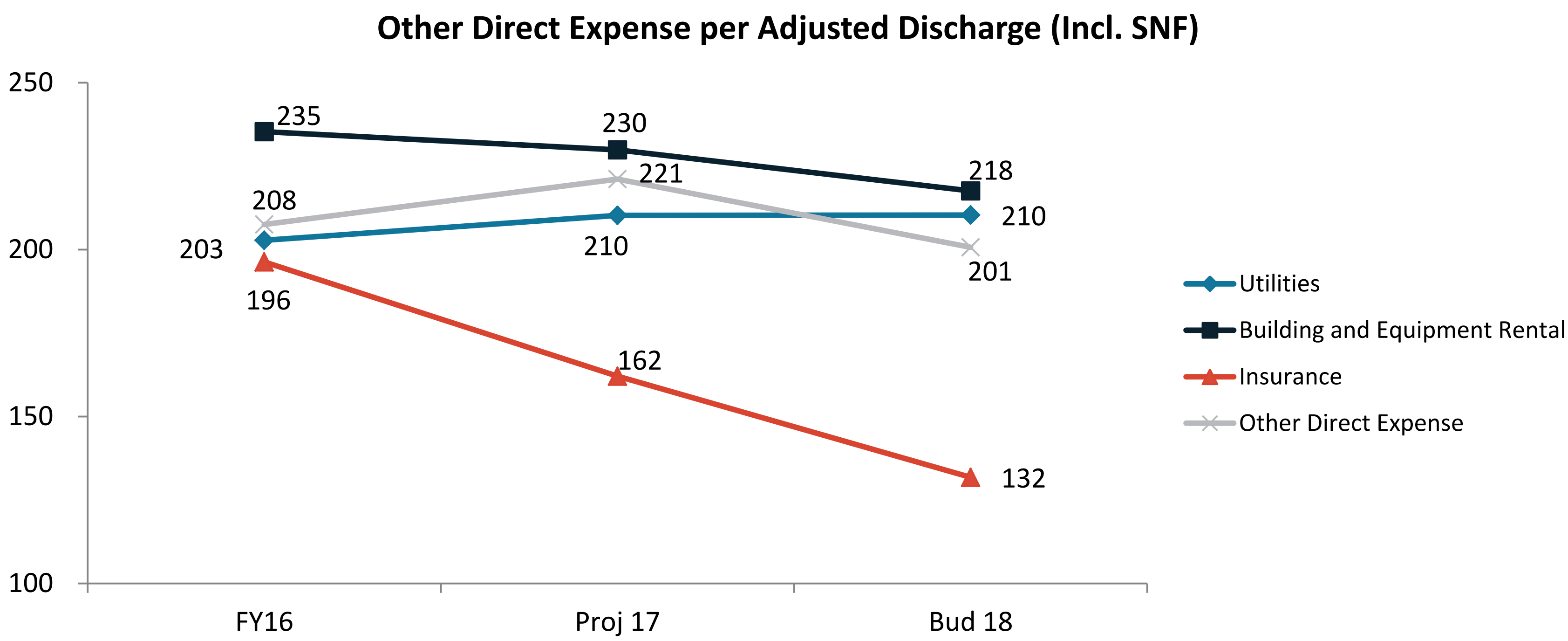
Cerner v. 2015 Upgrade	ClairVia - Scheduling
Population Health Foundation Tools (Phase 1)	PMC – Poway Wireless Remediation
Ascend AP Imaging Project	PRIME Projects
LEM Balanced Scorecard	Long Term Care EMR
Crimson Continuum of Care	Lab Auto-Verification
Lawson Automated Requisitions	Digital Storage Expansion
Axiom Capital Planning	RadConnect Cloud-based Imaging Solution

FY 2018 Planned Projects

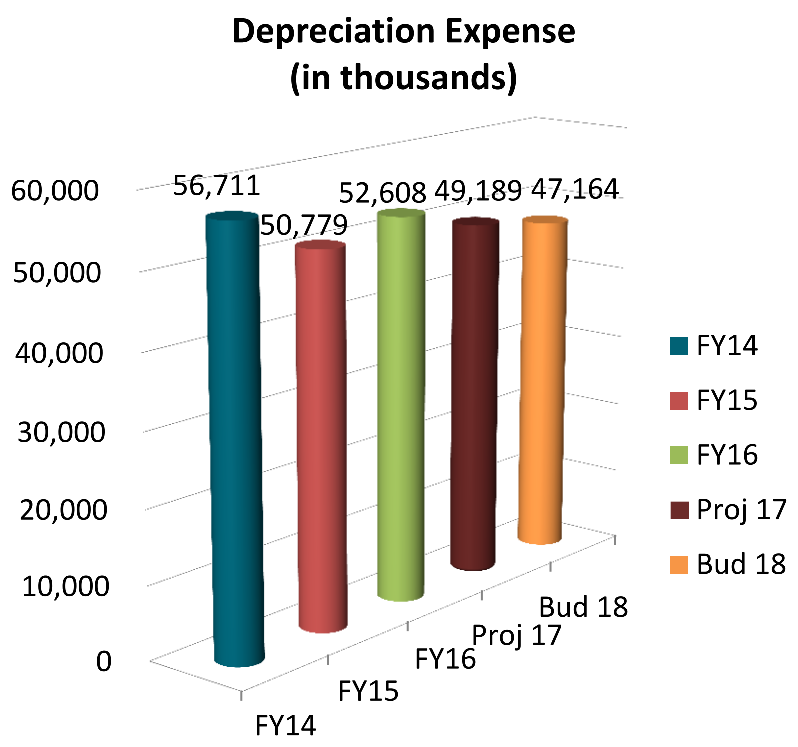
Cerner v. 2017 Upgrade	Cerner HealtheIntent - Physician Practice Integration
PMC – Poway Cellular Remediation	ClairVia - Acuity
Echo Online Application Module	Crimson Continuum of Care cont.
Radiology Decision Support	MedAssets Claims Scrubber
IT Security Systems	Surgical Instrument Tracking Solution
Axiom Capital Tracking	Teletracking & Orders Interface
Outpatient Behavioral Health EHR	McKesson PACS Upgrade

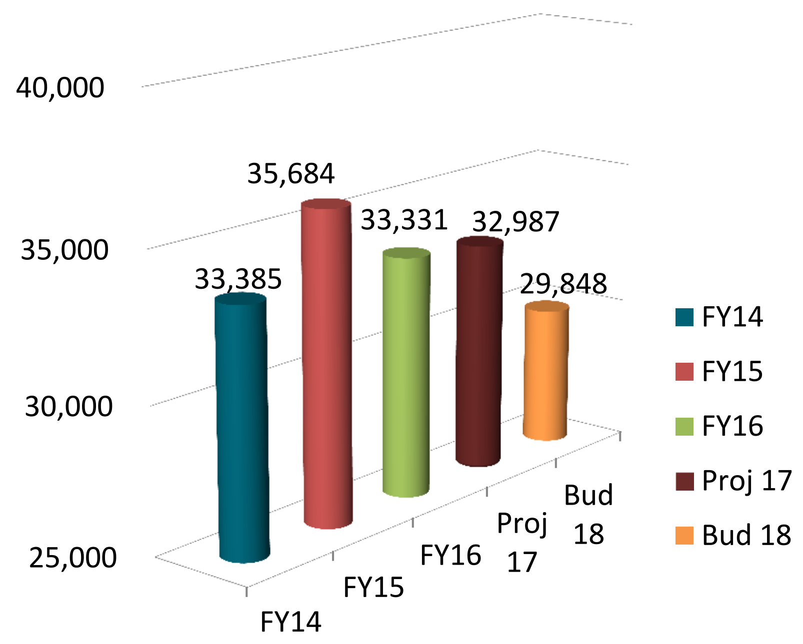
Non Labor Analysis | Other Direct Expense

- FY 2018 Budgeted Other Direct expense is decreasing by $1.2M or 3%
- Savings of $1.2M in professional liability insurance costs and $670k in electric utilities offset increases in rent, telecommunications, and other utilities



Depreciation and Interest Expense





Interest Expense*
(in thousands)

*Interest expense reflected for Revenue Bonds only

Annual Operating Budget Summary & EBIDA Recap

Annual Operating Budget Summary and Trend

	Results FY15	Results FY16	Projected FY17	Budget FY18
Revenue:				
Gross Revenue	3,156,201,150	3,477,327,647	3,672,466,002	3,959,688,903
Net Revenue	642,577,733	693,747,936	718,622,487	735,688,565
Other Operating Revenue	16,189,468	17,986,095	13,357,149	10,625,263
Total Operating Revenue	$ 658,767,201	$ 711,734,030	$ 731,979,636	$ 746,313,828
Expenses:				
Salaries, Wages, Registry, Benefits	365,662,152	387,887,342	399,039,296	413,416,518
Supplies	93,498,167	96,645,428	99,739,556	100,237,227
Depreciation	50,779,118	52,607,947	49,188,516	47,163,604
Other	139,681,356	152,550,618	166,890,238	164,294,438
Total Operating Expense	$ 649,620,793	$ 689,691,336	$ 714,857,605	$ 725,111,787
Operating Income	9,146,408	22,042,694	17,122,030	21,202,040
Non-Operating Income	7,775,298	4,871,020	(6,061,996)	(12,636,843)
(Interest Expense)	(35,684,422)	(43,407,152)	(32,986,653)	(29,847,553)
Property Tax Revenue	14,303,002	15,145,434	15,800,000	17,100,000
Income (Loss)	$ (4,459,714)	$ (1,348,003)	$ (6,126,619)	$ (4,182,356)
Net Margin %	-0.7%	-0.2%	-0.8%	-0.6%
OEBIDA Margin (Excl Property Tax Rev)	9.1%	10.5%	9.1%	9.2%
OEBIDA Margin (Incl Property Tax Rev)	11.3%	12.6%	11.2%	11.5%
EBIDA Margin	12.4%	13.3%	10.4%	9.8%
Total Uncompensated Care & Bad Debt	72,994,974	61,959,797	63,898,831	67,884,626
Total Uncompensated Care as % of Gross	2.31%	1.78%	1.74%	1.71%

FY 2018 EBIDA Recap (in thousands)

	Results FY 2015	Results FY 2016	Projected FY 2017	Budget FY 2018
Net Income from Ops (Excluding Interest Expense)	9,146	22,043	17,122	21,202
Depreciation Expense	50,779	52,608	49,189	47,164
OEBIDA	**$ 59,925**	**$ 74,651**	**$ 66,311**	**$ 68,366**
OEBIDA Margin (Excl Property Tax Rev)	9.1%	10.5%	9.1%	9.2%
OEBIDA Margin (Incl Property Tax Rev)	11.3%	12.6%	11.2%	11.5%
EBIDA	**82,003**	**94,667**	**76,049**	**72,830**
EBIDA Margin	**12.4%**	**13.3%**	**10.4%**	**9.8%**
Total Uncompensated Care & Bad Debt	72,995	61,960	63,899	67,885
Total Uncompensated Care as % of Gross	2.31%	1.78%	1.74%	1.71%
Net Income/(Loss) after Non-Op Income	$ (4,460)	$ (1,348)	$ (6,127)	$ (4,182)

Capital Plan

Capital Plan

Three Year Capital Budget Summary *(in thousands)*

	FY 2018	FY 2019	FY 2020	Total Project Spend
Routine Capital (in thousands):				
Equipment	5,000	5,000	5,000	15,000
Facility	5,000	7,000	7,000	19,000
Information Technology	5,000	5,000	5,000	15,000
Total Routine Capital Requests	**$ 15,000**	**$ 17,000**	**$ 17,000**	**$ 49,000**
Strategic Capital Reserve	15,000	13,000	13,000	41,000
Consolidated Capital Reserve	**$ 30,000**	**$ 30,000**	**$ 30,000**	**$ 90,000**

FY18 Budget Summary & Key Take-Aways

Summary

- **FY 2018 Budget is achievable and ties to the Strategic Financial & Capital Plan. However, it requires success in the following areas:**
  - 8.8% growth in Deliveries
  - 2% growth in Net Patient Revenue
  - Execution of Patient Throughput and Supply Initiatives, as well as the other planned expense management strategies included in the budget
  - Transition from reliance on premium pay and registry labor to a coordinated staffing approach
  - Transition of services from Palomar Medical Center Downtown Escondido by the end of the Fiscal Year
- **Successful Execution will result in:**
  - Net Income improvement of $2M year over year
  - EBIDA of $73M