Palomar Health

FY 2017 Annual Operating and Capital Budget

Board of Directors Budget Workshop

June 13, 2016

Agenda

- Executive Summary
- FY 2017 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
- 2017 Annual Budget Summary / EBIDA Recap
- Three Year Capital Planning

Executive Summary

- The FY 2017 Annual Budget provides achievable goals for the coming year which are consistent and aligned with our Strategic Financial and Capital Plan (EBIDA growth of $8.8 million from FY16 Projection), and provides a renewed focus on targeted capital deployment.
- It is the result of a focused effort to absorb inflation and drive greater efficiency in all areas of the organization
- Reflects a concerted effort to hold on all non-essential expenditures
- Incorporates staffing initiatives to drive targeted improvements in utilization of labor resources
- The operating and capital budgets are aligned with our current year and long term strategic plan initiatives

FY 2017 Budget – Key Drivers & Overview

Key Plan Drivers

- Strategic Plan alignment including targeted $8.8 million EBIDA growth year over year; this growth is consistent with the long-range Financial and Capital Plan targets
- Continued reimbursement pressures driven by ACA challenges, including impacts to industry/payer relationships and changes to network patterns.
- 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
- Concerted Revenue Cycle efforts around physician documentation post ICD-10 and IT related enhancements

Patient Throughput Initiative	Supply Exp Reduction Initiative	Physician Documentation Initiative
$1,000,000	$1,000,000	$1,300,000

- PHDC closure phased in through December 31, 2016, with support services remaining throughout the fiscal year
- Assessment of service lines and contribution margin profitability

Key Plan Drivers

Palomar Health – Baseline Financial Projections ($ thousands)

K E Y D R I V E R S

Ratio/Statistic	Projection Years 2016	2017	2018	2019	2020	2021
Operating Income exc. Interest Expense	$ 8,351	$ 20,142	$ 20,418	$ 20,520	$ 20,685	$ 20,840
Cash Flow (Net Inc + Depr)	$ 46,113	$ 69,975	$ 70,771	$ 75,895	$ 80,965	$ 87,845
Capital Expenditures	$ 19,453	$ 41,500	$ 40,980	$ 43,070	$ 27,500	$ 32,500
Profitability						
Operating Margin	(3.7%)	(1.3%)	(1.2%)	(1.0%)	(0.9%)	(0.8%)
Operating Margin (Exc. Int. Exp)	1.2%	2.9%	2.8%	2.7%	2.7%	2.6%
Operating EBIDA Margin (Inc. Prop. Tax)	8.8%	10.7%	10.9%	11.0%	11.1%	11.1%
Liquidity						
Days Cash On Hand (days)	114	125	124	124	135	145
Days Cash On Hand (days) - Ex Intrerest	120	131	130	130	140	150
Other						
Capital Spending Ratio	38.0%	77.2%	70.6%	69.8%	42.1%	47.0%

Prepared by Kaufman Hall and Associates

Inflationary Assumptions

- FY2017 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

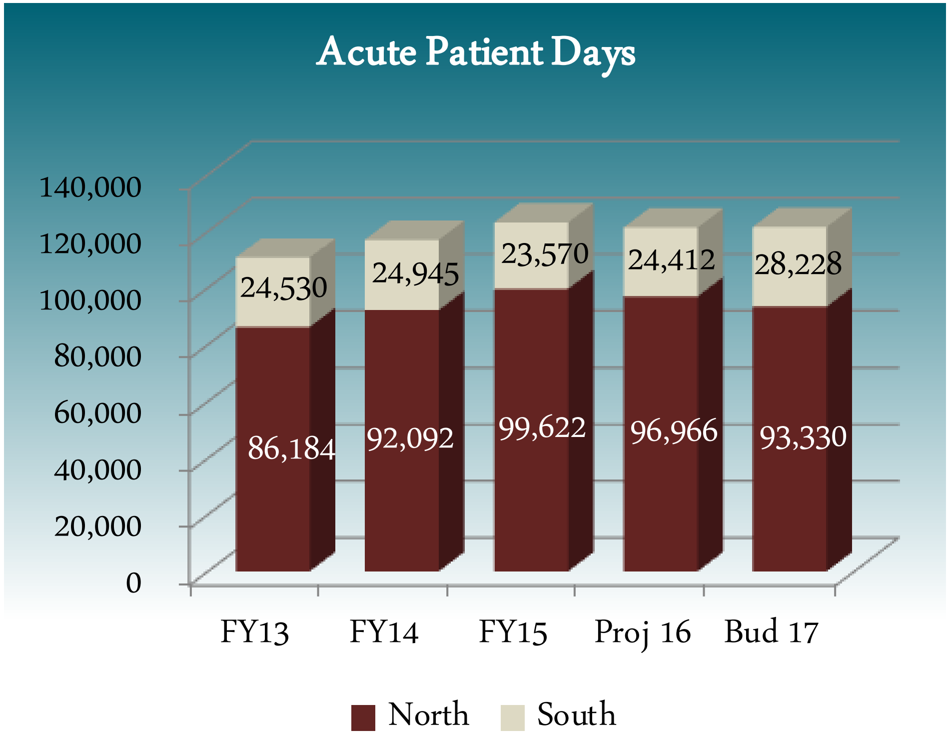
Healthcare Industry Inflation Comparison

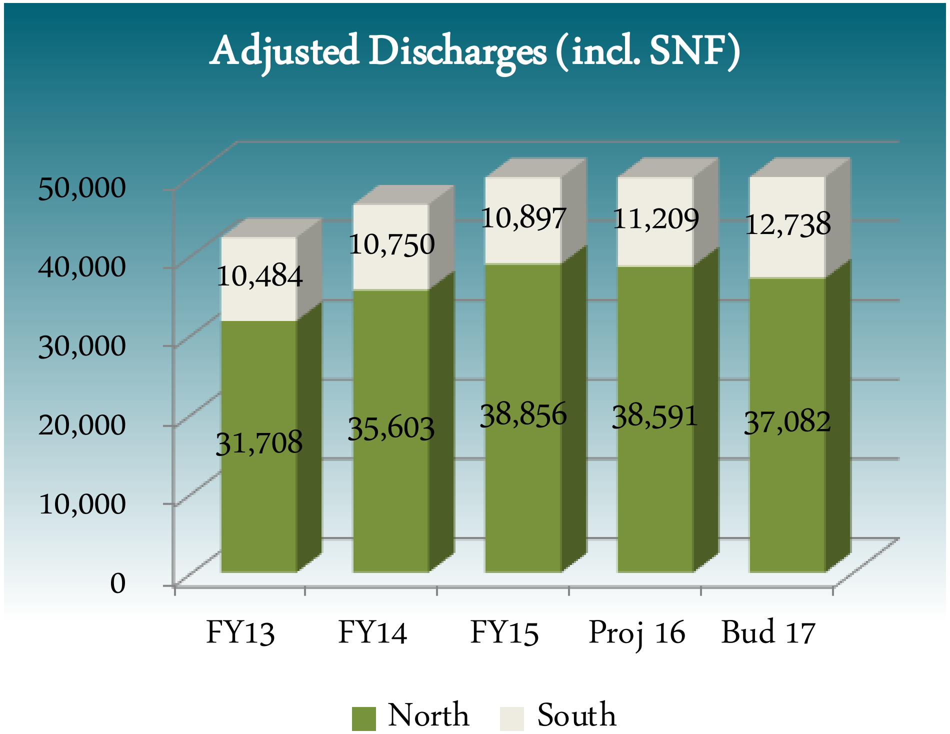
	2017 Budget	Industry Expectations
Implants	**1.0%**	**0-5%**
General Surgery Supplies	1.0%	0-5%
Surgical Needles	0.0%	1-3%
Oxygen - Gas	1.5%	1-6%
IV Solutions	14.0%	3-5%
Pharmaceuticals	**7.0%**	**10.2%**
Radioactive and X-Ray Material	0.50%	0.4-1.4%
Other Medical	0.0%	0-1.7%
Food / Meat	1.5%	1.6 – 2.8%
Linen	0.0%	0-2%
All Other: Cleaning/Forms/Office/Uniforms	0.0 – 1.0%	0–4%

Key Statistical Indicators

Key Statistical Indicators: INPATIENT

- FY 2017 Planned Acute Patient Days are essentially flat year over year
- FY 2017 Adjusted Discharges are pacing consistently with FY 2017 Projected Patient Days

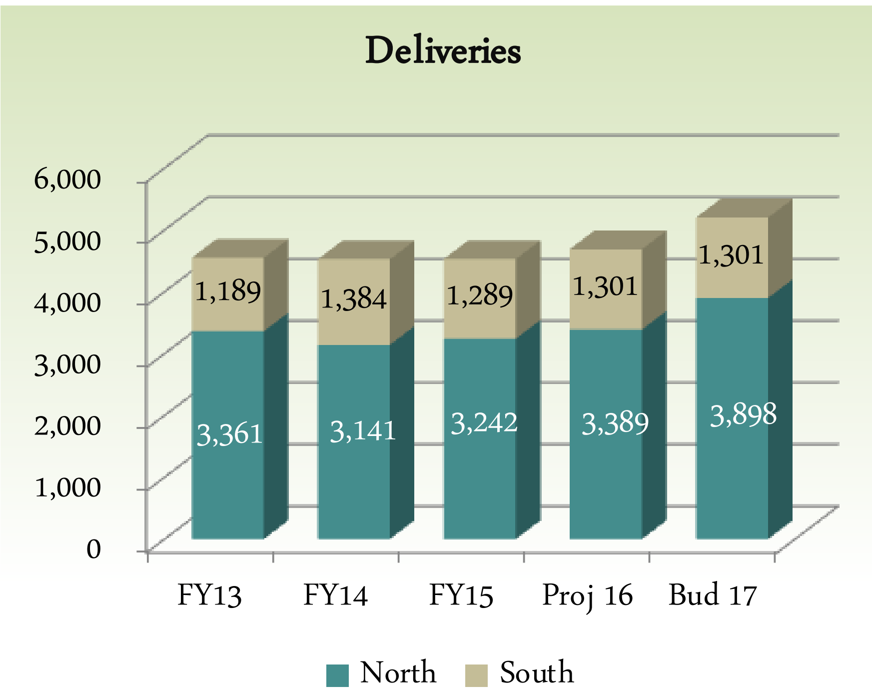


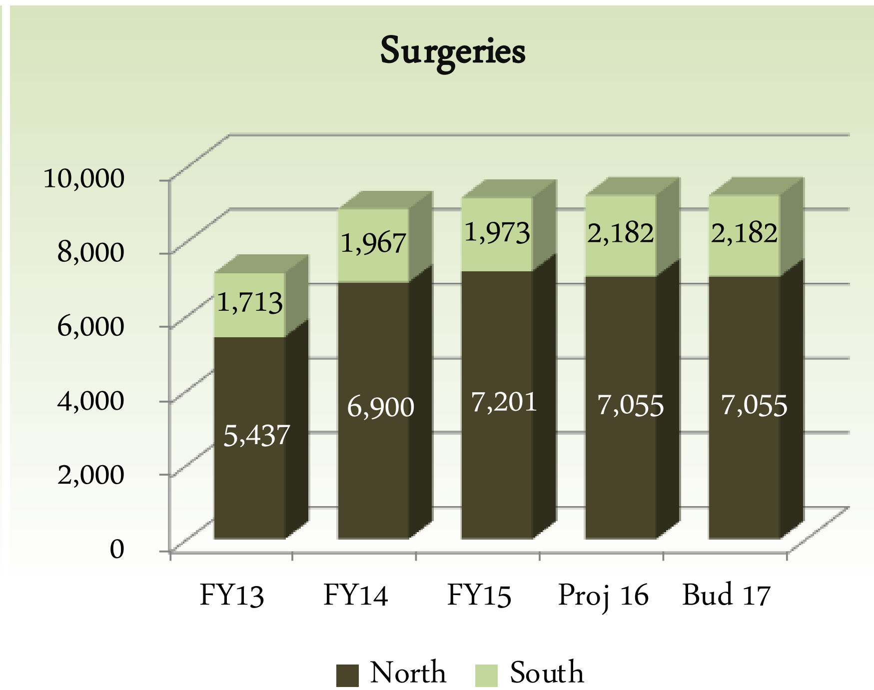


* North includes Palomar Medical Center (PMC) and Palomar Health Downtown Campus (PHDC); South includes Pomerado Hospital (POM)

Key Statistical Indicators: INPATIENT

- FY 2017 Deliveries are increasing by 509 or 10.9% year over year, largely driven by expected increased utilization of the Palomar Medical Center campus
- FY 2017 Inpatient Surgeries are flat over FY 2016 projected





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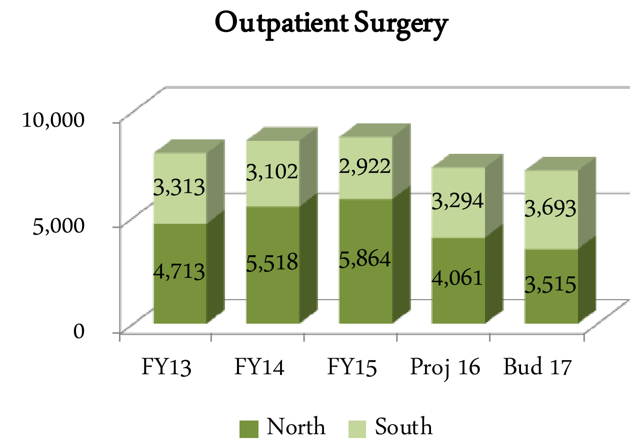
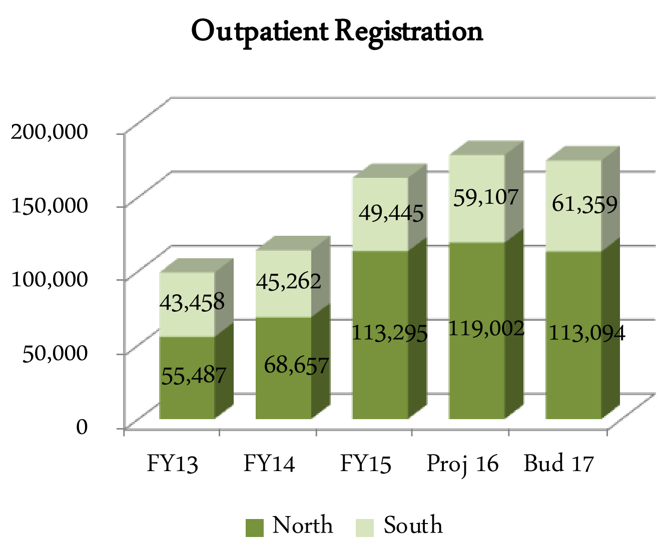
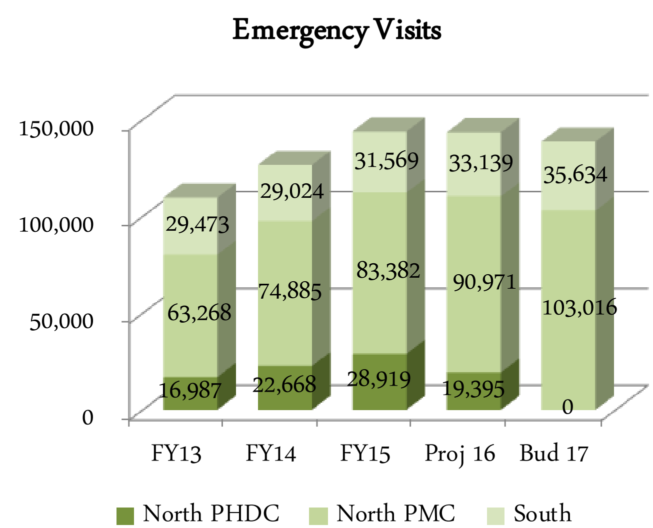
Key Statistical Indicators: OUTPATIENT

- Outpatient Surgeries are decreasing 147 or 2.0%
- Emergency Visits are decreasing by 4,855 or 3.4% as urgent care level visits continue to transition to the Community Clinics
- Outpatient Registrations are decreasing by 3,656 or 2.1%







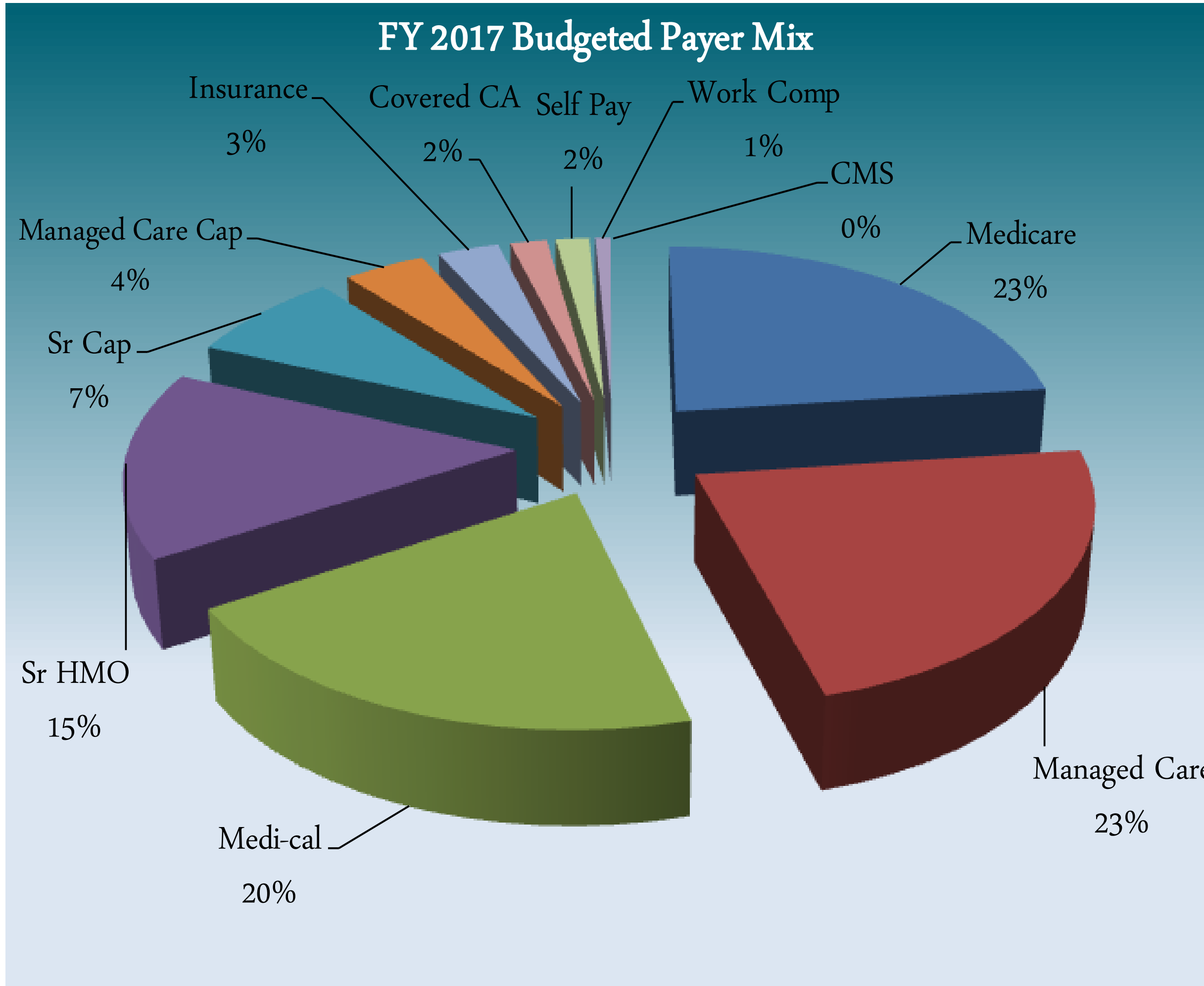
Revenue

Key Gross Revenue Considerations

Assumptions:

- 7.34% overall effective rate increase (targeted 8%)
- Bad Debt and Uncompensated Care 1.8%; FY16 Budget = 2.4%
- Managed Medi-Cal Deductions 10.2%; FY16 Budget = 9.9%

Payer Category		Total CHRGS
Medicare	$	839,965,322
Managed Care	$	827,322,412
Medi-cal	$	744,871,893
Sr HMO	$	558,077,258
Sr Cap	$	272,780,555
Managed Care Cap	$	143,088,007
Insurance	$	106,631,804
Covered CA	$	64,134,838
Self Pay	$	58,557,247
Work Comp	$	26,563,850
CMS	$	973,360
Total*	$	3,642,966,545

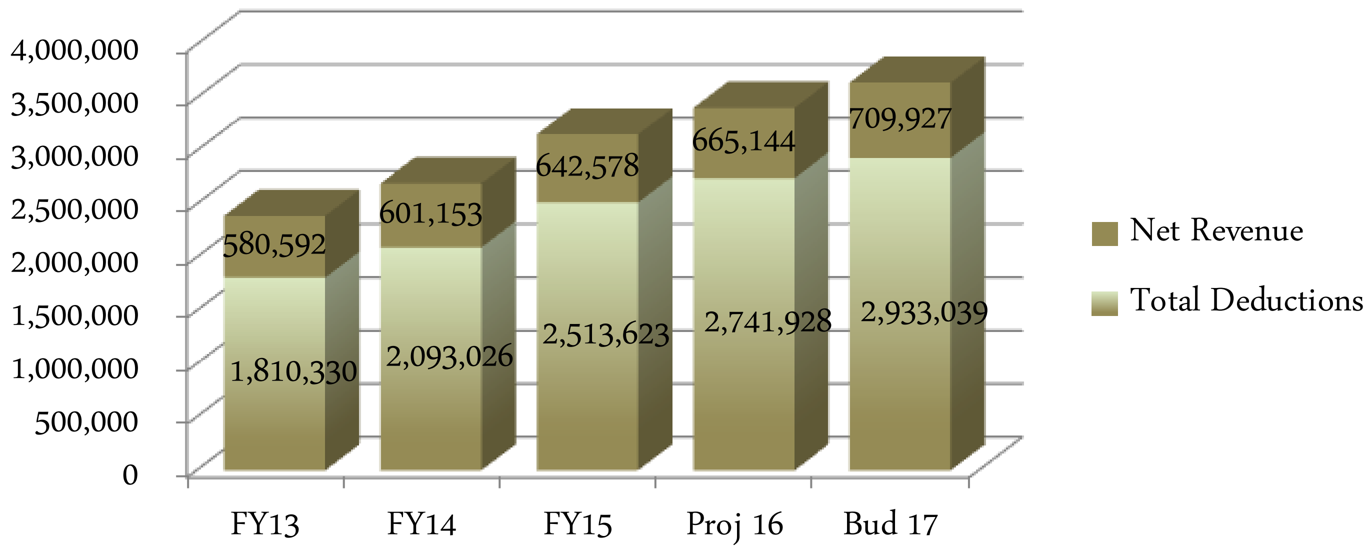


* Based on Gross Revenue and Excludes Home Health and Clinics

Revenue Trend Analysis

- FY 2017 Gross Revenue is expected to be $236M or 7% higher than FY 2016
- Net Revenue is anticipated to be $45M or 7% higher year over year

(in Thousands)



	FY13	FY14	FY15	Proj 16	Bud 17
Total Deductions *	1,810,330	2,093,026	2,513,623	2,741,928	2,933,039
Net Revenue	580,592	601,153	642,578	665,144	709,927
Total Gross Revenue	2,390,922	2,694,180	3,156,201	3,407,072	3,642,967

*Deductions include net capitation impact

Salaries, Wages, Benefits & FTEs

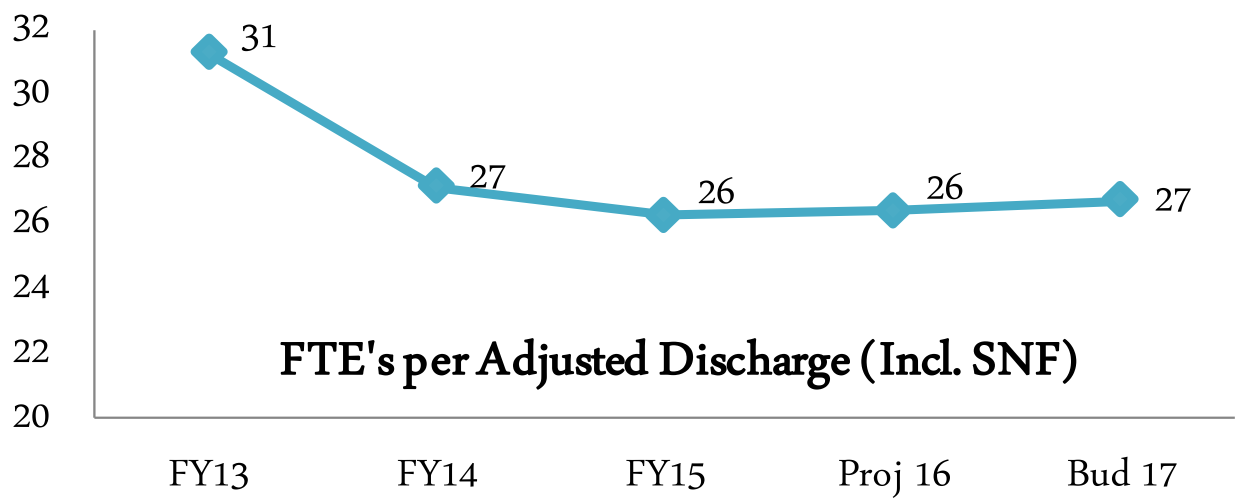
Labor Impact Summary

- The FY 2017 Operational Budget reflects a concerted effort to develop a more sustainable model for utilization of FTEs and labor dollars
- Several initiatives drive focus away from premium pay and contract labor, toward a more coordinated staffing approach
- Incorporates ninety-five positions for New Graduate or New-to-Specialty RNs
- Significant year-over-year increases in staff education are planned to support achievement of operational initiatives
- Addition of targeted FTEs in various areas
- New Information Technology tools and Human Resources strategies to drive improved scheduling and recruitment

Labor Analysis – FTE's

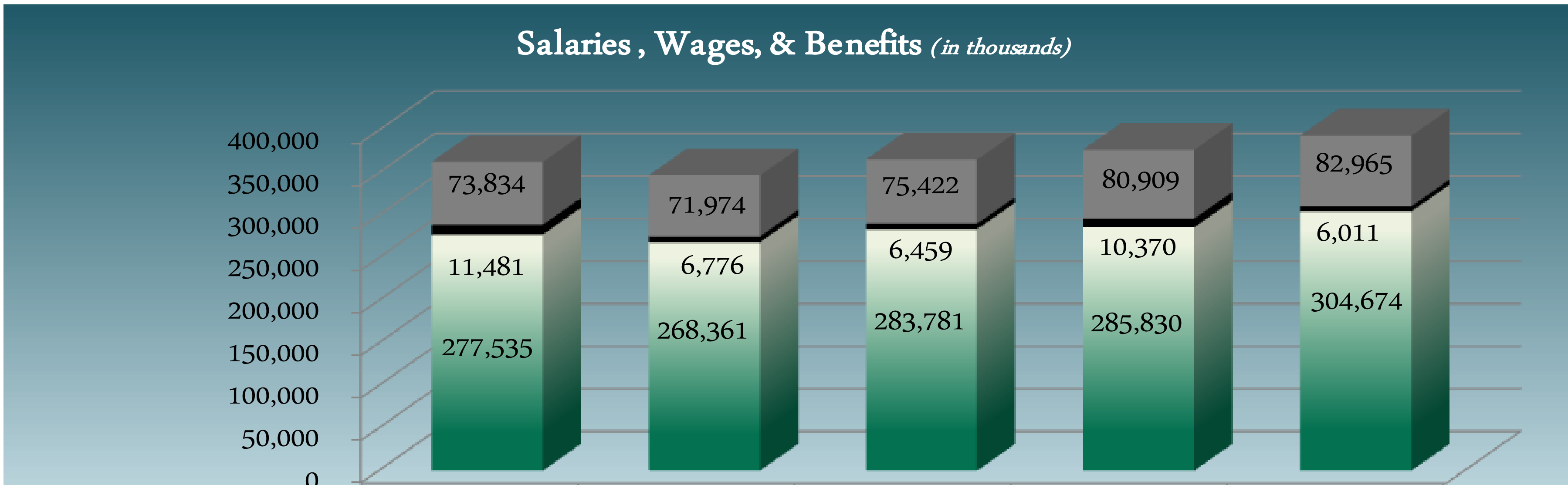
2017 Budgeted FTE Roll Forward	FTE's
FY 2016 Paid FTE's (as of 4/30/2016)	**3,604**
Volume Reductions and Operational Efficiencies	**(99)**
Consolidation Impact	**(35)**
Targeted FTE Additions	**176**
FY 2017 Paid FTE's	**3,646**

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



Labor Analysis – Salaries, Wages and Benefits

- FY 2017 Total Salaries, Wages and Benefits are increasing $16.5M or 4.4% primarily driven by a $13.8M increase for both contract and merit adjustments
- FY 2017 Agency / Registry Expense is expected to decline by $4.4M from current year

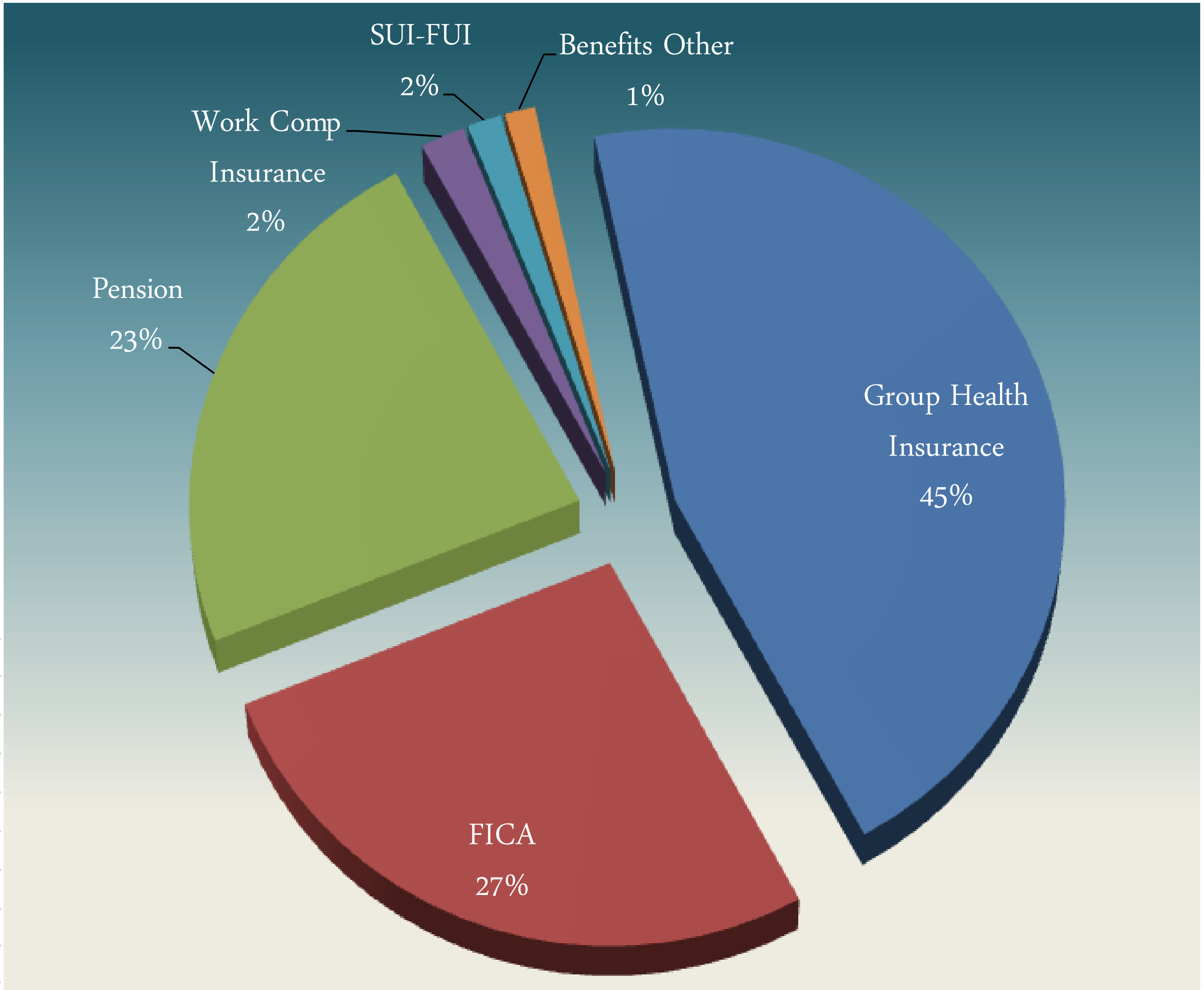


	FY13	FY14	FY15	Proj 16	Bud 17
Employee Benefits	73,834	71,974	75,422	80,909	82,965
Registry Expenses	11,481	6,776	6,459	10,370	6,011
Salaries & Wages	277,535	268,361	283,781	285,830	304,674

Labor Analysis – Benefits (excluding PTO)

- FY 2017 Employee Benefits are increasing $2.1M or 3%.
- Group Health Insurance has increased by $1.1M to provide coverage required under ACA
- Decrease of $1.7M in Worker's Compensation Insurance

Key Employee Benefits (in thousands)	**Bud 17**
Group Health Insurance	37,757
FICA	22,367
Pension	19,247
Work Comp Insurance	1,545
SUI-FUI	1,200
Benefits Other	1,065
Total Benefits	**83,181**

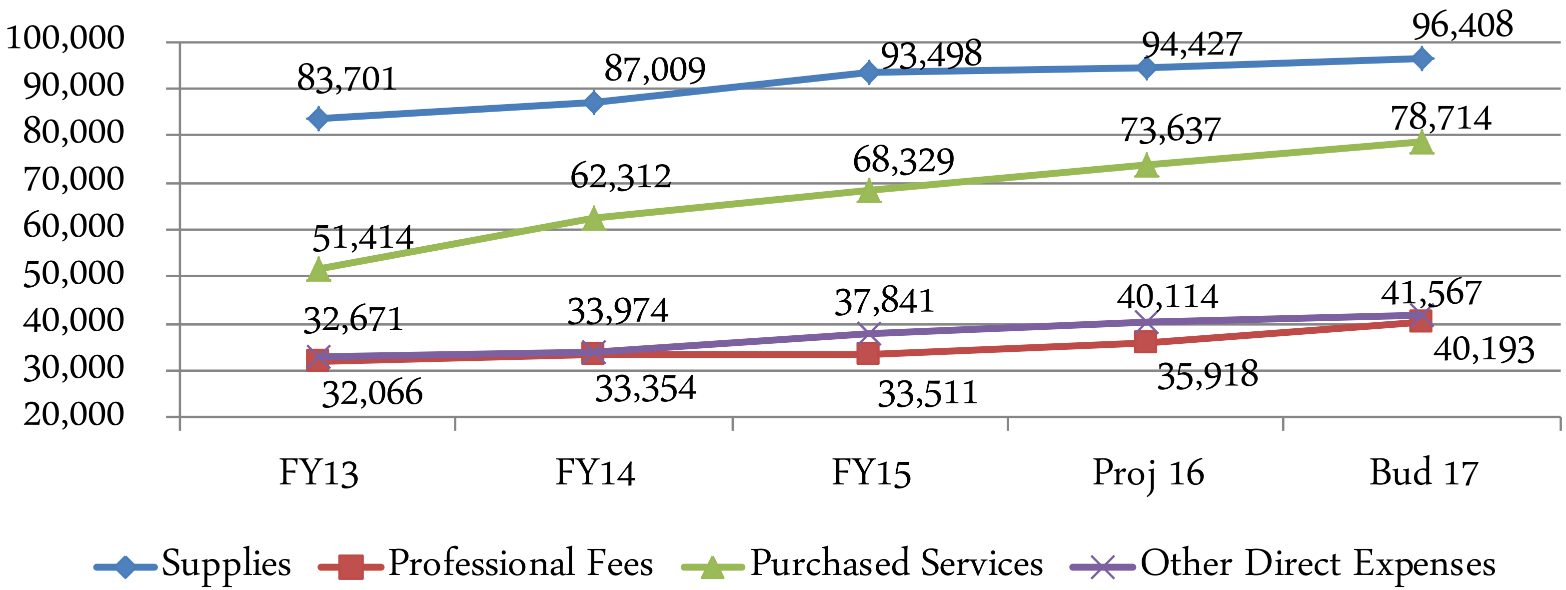


Non Labor Analysis

Non Labor Analysis - Summary

- FY 2017 Non Labor expense is increasing $15.9M or 5.4%
- Non-labor cost is increasing by $326 per adjusted discharge, primarily driven by supply inflation, the Crisis Stabilization Unit, and Information Technology advances

Trended Non Labor Expense *(In thousands)*

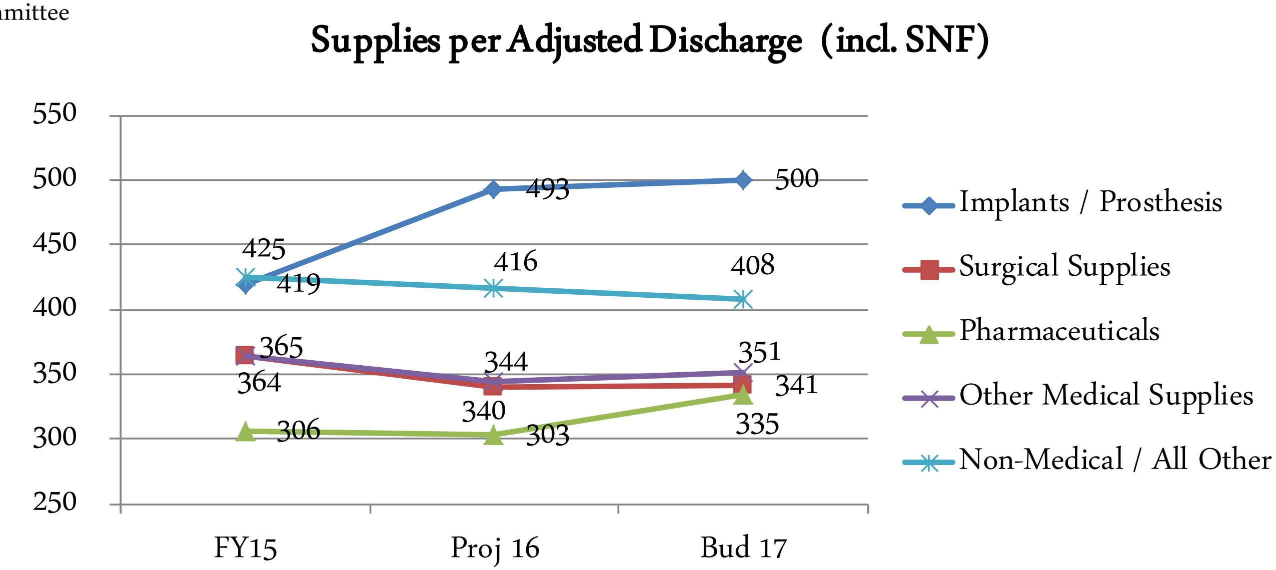


Non Labor Analysis - Supplies

FY 2017 Supply Roll Forward *(in thousands)*	
FY 2016 Supply Expense (Dec 2015 Projection)	**$94,427**
Increases due to Volume and Utilization	1,322
Inflationary Increases (Net of Absorption)	1,659
Supply Reduction Initiative (PRAC*)	(1,000)
FY 2017 Budgeted Supply Expense	**$96,408**

*Physician Resource Allocation Committee

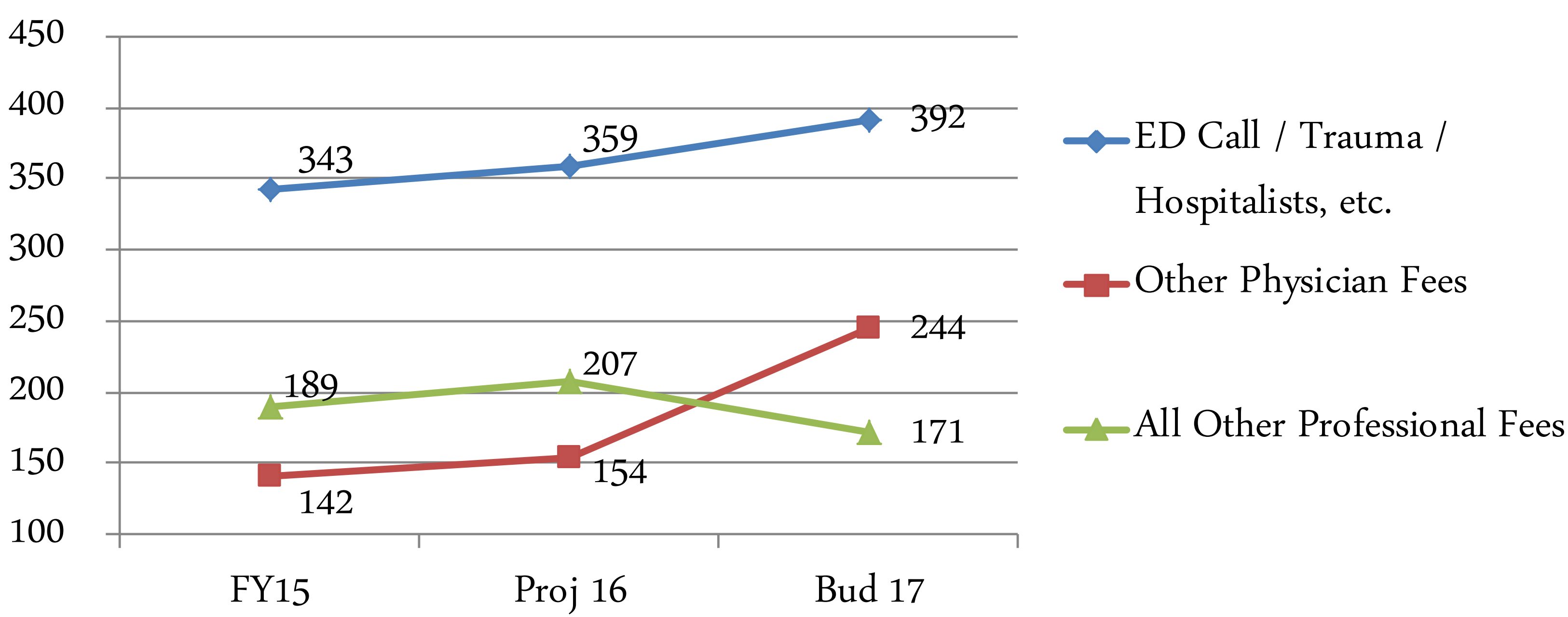
- FY17 Budgeted supply management efforts and reduction initiatives total $1M in savings; which is helping to offset significant inflation projected for the coming year



Non Labor Analysis – Professional Fees

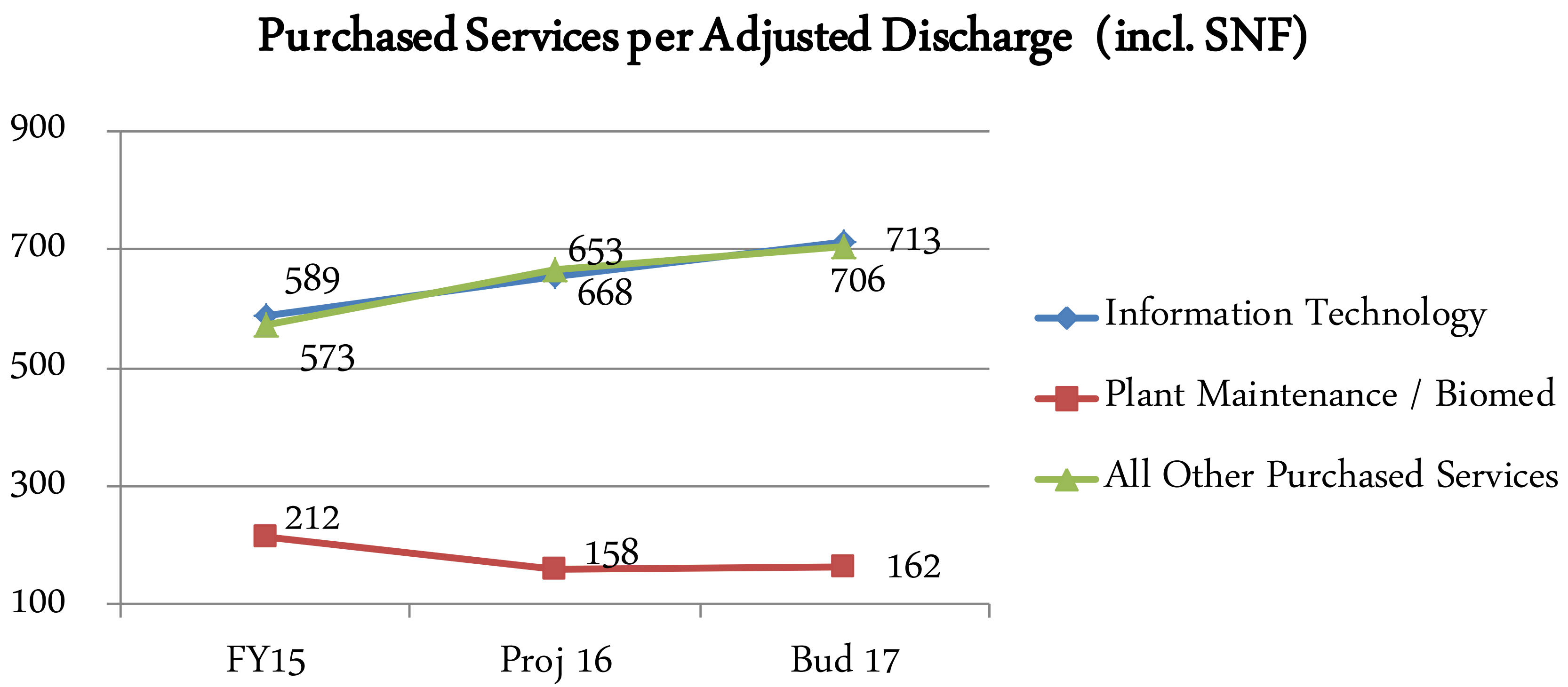
- FY 2017 Professional Fees are increasing by $4.3M or 12%
- Physician Professional Fees are primarily being driven by increased volume directed to the Hospitalists, the CSU, and a change in providers for Behavioral Health & ICU

Professional Fees per Adjusted Discharge (incl . SNF)



Non Labor Analysis – Purchased Services

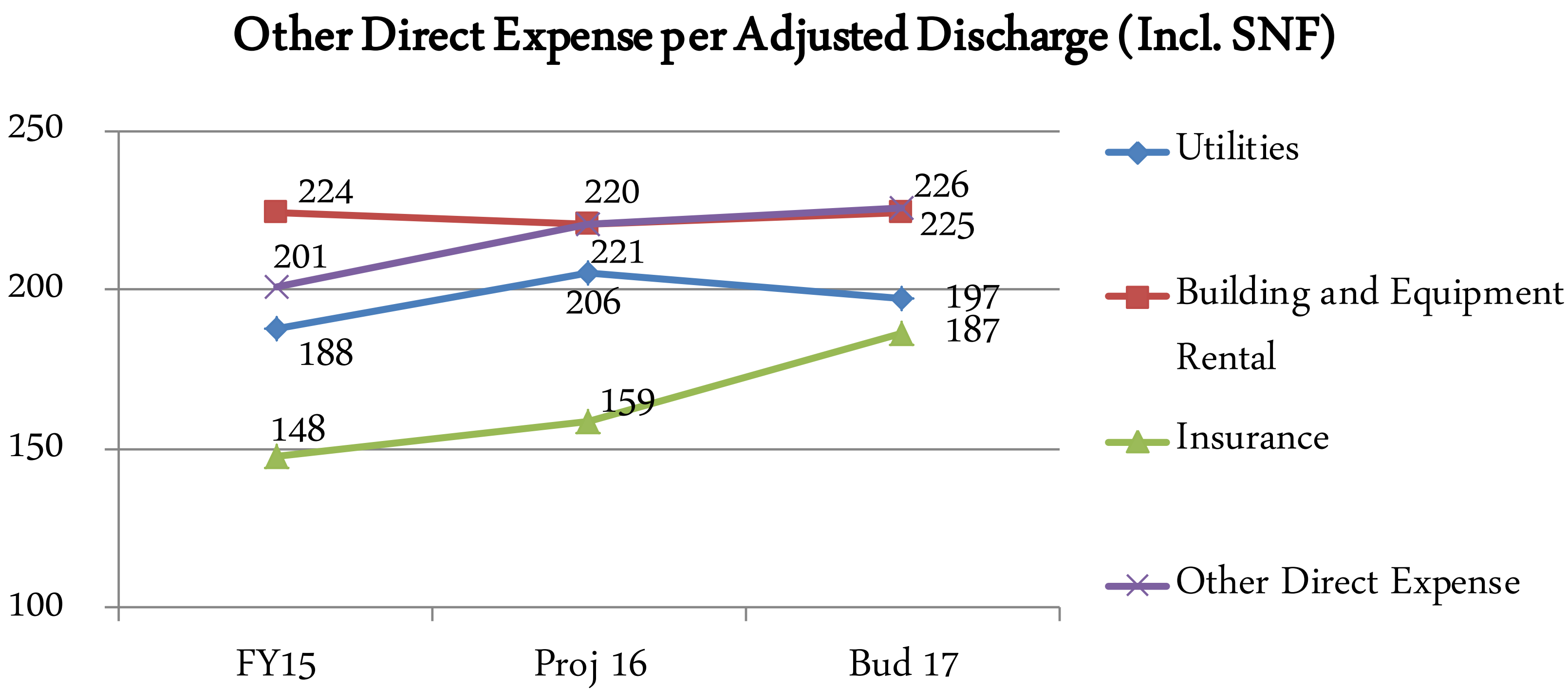
- FY 2017 Purchased Services are increasing by $5.1M or 6.9%
- Information Technology increases of $3M are the primary driver, along with increases in Reference Lab volumes and prior year transition of Coding



Non Labor Analysis – Purchased Services: IT Roadmap

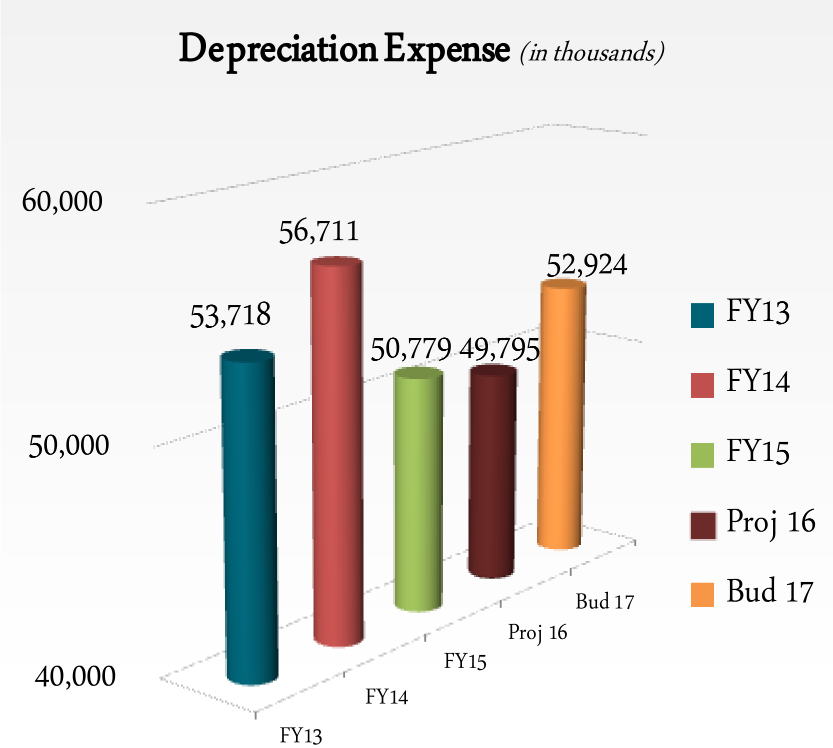
FY 2016 Accomplishments	
Agilysys Upgrade	Airstrip Upgrade and Patient Monitoring
Airwatch Mobile Device Management	Crisis Stabilization Unit (by 6/30)
Cresendo (Home Health) Project	Epilepsy Monitoring Unit
Experian OrderRite	Regional Health Information Exchange (HIE)
Immunizations Integration with County	ICD-10 Project
Lighthouse - Readmissions	Lighthouse – Infection Control
Short Stay Unit	Meaningful Use (Year 2 – Stage 1)
FY 2017 Planned Projects	
Ascend AP Invoice Imaging Project	Axiom Cost Accounting
Cerner v. 2015 Upgrade	Clarivia
Population Health Foundation Tools (Phase 1)	Long Term Care EMR
LEM Balance Scorecard	Health Catalyst – phase 1
Infor Contract Management	Cloud base Imaging Solution
Pomerado Infrastructure remediation	Lawson Automated Requisitions

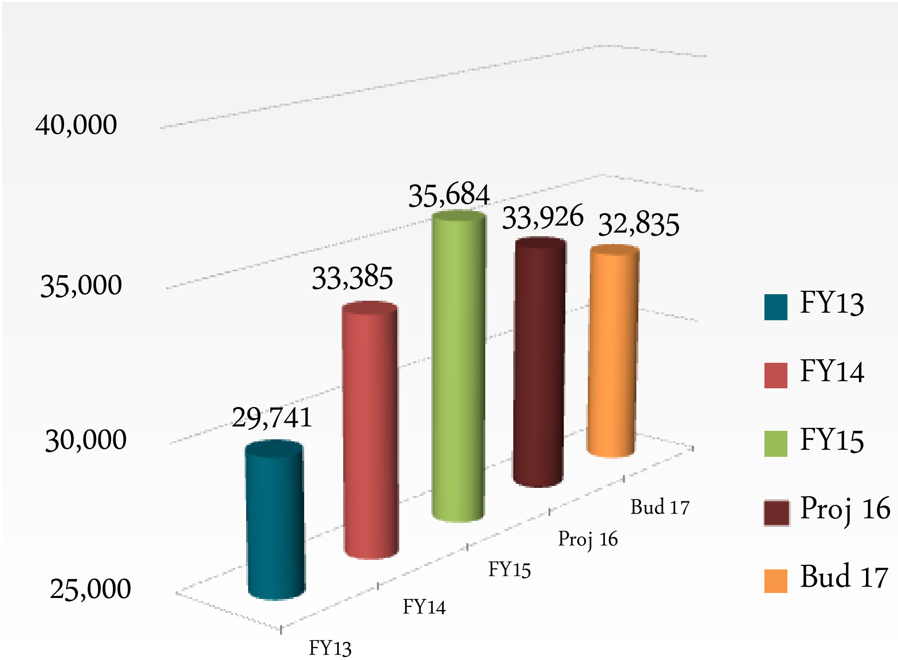
Non Labor Analysis – Other Direct Expense



- FY 2017 Budgeted Other Direct expense is increasing by $1.5M or 3.6%
- Increases in professional liability insurance costs of $1.4M and marketing costs of $1.2M

Non Labor Analysis – 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

	Budget FY17	Projected FY16	Results FY15	Results FY14
Revenue:				
Gross Revenue	3,642,966,545	3,407,071,652	3,156,201,150	2,694,179,906
Net Revenue	711,227,191	665,143,799	642,577,733	601,153,488
Other Operating Revenue	12,372,979	13,717,661	16,189,468	13,046,993
Total Operating Revenue	$ 723,600,170	$ 678,861,460	$ 658,767,201	$ 614,200,481
Expenses:				
Salaries, Wages, Registry, Benefits	393,650,506	377,109,473	365,662,152	347,110,826
Supplies	96,408,447	94,427,197	93,498,167	87,008,983
Depreciation	52,924,253	49,795,295	50,779,118	56,711,438
Other	160,474,964	149,669,210	139,681,356	129,640,252
Total Operating Expense	$ 703,458,170	$ 671,001,175	$ 649,620,793	$ 620,471,499
Operating Income	20,142,000	7,860,285	9,146,408	(6,271,018)
Non-Operating Income	(4,825,841)	2,507,119	7,775,298	9,772,515
(Interest Expense)	(32,834,866)	(33,925,799)	(35,684,422)	(33,569,486)
Property Tax Revenue	15,800,000	15,099,996	14,303,002	13,451,009
Income (Loss)	**$ (1,718,707)**	**$ (8,458,398)**	**$ (4,459,714)**	**$ (16,616,980)**
Net Margin %	-0.2%	-1.2%	-0.7%	-2.7%
OEBIDA Margin (Excl Property Tax Rev)	10.1%	8.5%	9.1%	8.2%
OEBIDA Margin (Incl Property Tax Rev)	12.3%	10.7%	11.3%	10.4%
EBIDA Margin	11.6%	11.1%	12.4%	12.0%
Total Uncompensated Care & Bad Debt	64,118,911	58,585,367	72,994,974	87,221,098
Total Uncompensated Care as % of Gross	1.76%	1.72%	2.31%	3.24%

FY 2017 EBIDA Recap (in thousands)

	Results FY 2013	Results FY 2014	Results FY 2015	Projected FY 2016	Budget FY 2017
Net Income from Ops	(22,292)	(6,217)	9,146	7,860	20,142
Depreciation Expense	53,718	56,711	50,779	49,795	52,924
OEBIDA	**$ 31,426**	**$ 50,494**	**$ 59,925**	**$ 57,655**	**$ 73,066**
OEBIDA Margin (Excl Property Tax Rev)	5.3%	8.2%	9.1%	8.5%	10.1%
OEBIDA Margin (Incl Property Tax Rev)	7.5%	10.4%	11.3%	10.7%	12.3%
EBIDA	**48,740**	**73,663**	**82,003**	**75,263**	**84,040**
EBIDA Margin	**8.2%**	**12.0%**	**12.4%**	**11.1%**	**11.6%**
Total Uncompensated Care & Bad Debt	112,188	87,221	72,995	58,585	64,119
Total Uncompensated Care as % of Gross	4.69%	3.24%	2.31%	1.72%	1.76%
Net Income/(Loss) after Non-Op Income	**$ (34,718)**	**$ (16,617)**	**$ (4,460)**	**$ (8,458)**	**$ (1,719)**

Capital Plan

Capital Plan

Three Year Capital Budget Summary *(in thousands)*

	FY 2017	FY 2018	FY 2019	Total Project Spend
Routine Capital:				
Equipment	5,500	6,500	8,500	20,500
Facility	5,000	14,480	13,570	33,050
Information Technology	5,000	6,000	7,000	18,000
Total Routine Capital Requests	**$ 15,500**	**$ 26,980**	**$ 29,070**	**$ 71,550**
Strategic Capital Reserve	16,000	14,000	14,000	44,000
Downtown Relocation	10,000	-	-	10,000
Consolidated Capital Reserve	**$ 41,500**	**$ 40,980**	**$ 43,070**	**$ 125,550**

FY17 Budget Summary
& Key Take-Aways

Summary / Key Take-Aways

FY 2017 Budget is achievable and ties to the Strategic Financial & Capital Plan. However, it requires success in the following areas:

- Stable Acute Patient Days and Inpatient Surgeries, year over year
- 10.9% growth in Deliveries
- 7% growth in Net Patient Revenue
- Successful implementation of the Crisis Stabilization Unit
- Execution of Patient Throughput, Revenue Cycle, 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
- Complete closure of the Palomar Health Downtown Campus by the end of the Fiscal Year

Successful Execution will result in:

- Net Income improvement of $6.7M year over year; Operating Income improvement of $12.3M year over year
- EBIDA of $84M