



UST Executive Conference on the Future of Health Care

Capitalizing on Capital: How Dollars Impact Your Strategic Plan

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Session Schedule

- 10:45 – 11:15 a.m. Presentation
- 11:15 a.m. Divide into Discussion Rooms:
SCH 316, SCH 315
- 11:15 – 11:35 a.m. Table Discussions
- 11:35 – Noon Facilitated Group Discussion

Learning Objectives

- At the end of our time together, you will be able to discern and reflect upon:
 - The key variables impacting financial success and capital access
 - High level financial modeling tools to align strategic, operational, financial and facility plans
 - A board level understanding of risk and return on investment
 - Identifying legal strategies and opportunities to raise capital efficiently and effectively

Capital Capacity Defined

Capital Capacity

=

“Affordable” Debt Capacity

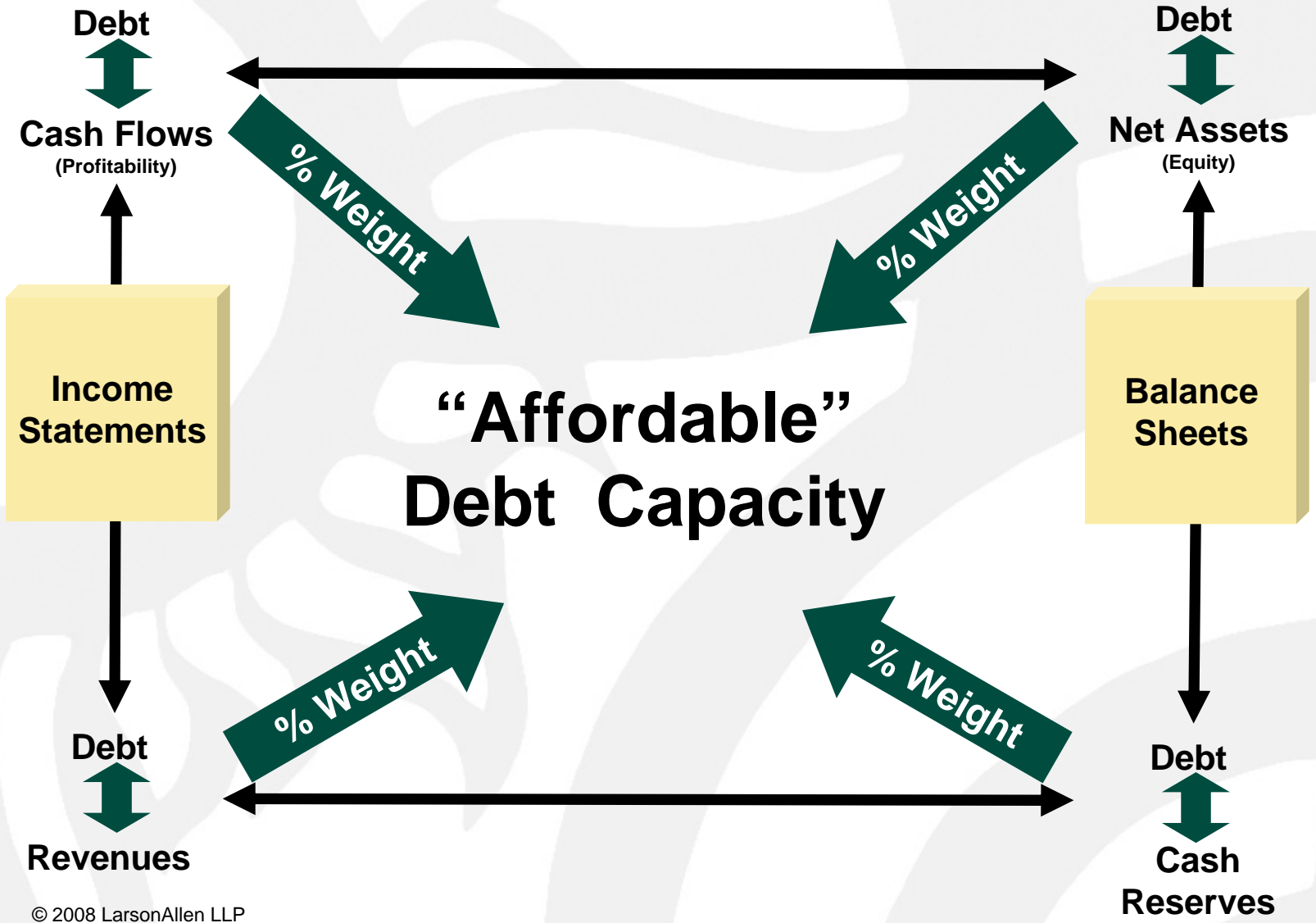
+/-

Excess (Deficit) Cash Flows

+

Philanthropy

Methodology for Sizing Affordable Debt Capacity



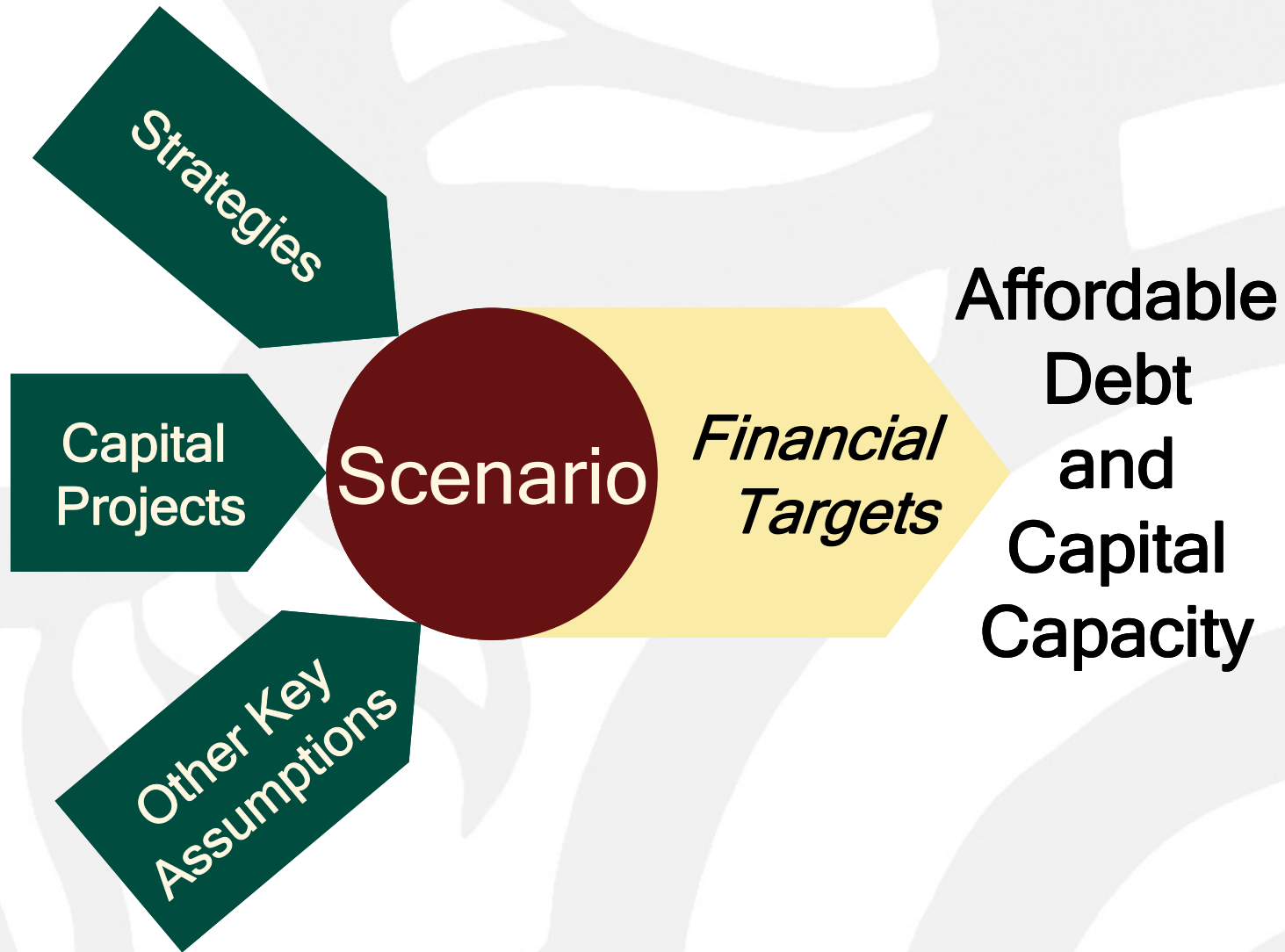
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Trends in Stand Alone Hospital Performance

	Highest Rating			S&P A+ / A-*			Minimum Investment Grade			Desired Trend
	S&P AA+ / AA- *			S&P A+ / A-*			S&P BBB+ / BBB- *			
	2003	2007	Trend	2003	2007	Trend	2003	2007	Trend	
Sample Size	33	29			182			172		
Net Patient Revenue (\$000s)	424,545	522,815	↑	162,759	248,568	↑	79,103	130,917	↑	↑
Profitability										
Debt Service Coverage (MADS)	3.3x	5.9x	↑	3.3x	4.5x	↑	2.5x	3.1x	↑	↑
MADS to Total Op Revenue (%)	3.2%	3.0%	↓	3.2%	3.1%	↓	3.9%	3.7%	↓	↓
EBIDA Margin (%)	12.7%	16.8%	↑	12.7%	13.4%	↑	9.1%	11.1%	↑	↑
Operating Margin	3.0%	4.6%	↑	3.0%	3.5%	↑	1.1%	2.3%	↑	↑
Total Margin	3.8%	9.5%	↑	3.8%	6.6%	↑	2.0%	4.4%	↑	↑
Liquidity and Capital Structure										
Cushion Ratio (x)	25.0x	29.4x	↑	10.6x	16.0x	↑	6.6x	8.8x	↑	↑
Days Cash on Hand	248	311	↑	150	196	↑	104	126	↑	↑
Cash to Debt (%)	180%	186%	↑	108%	135%	↑	64%	84%	↑	↑
Debt to Capitalization (%)	30%	26%	↓	36%	32%	↓	43%	42%	↓	↓

Source: Standard & Poors Rating Direct


Bring It All Together



Key Ratios Defined

Glossary Of Ratios	
Adjusted cash flow	Net cash from operating activities minus working capital change
Average age of plant	Accumulated depreciation / depreciation expense
Bad debt expense/ total operating revenue	(Bad debt expense / (net patient revenue + other operating revenue)) x 100
Capital expenditures / depreciation and amortization	(Purchases of property, plant, and equipment / depreciation and amortization expense) x 100
Cash	Unrestricted cash and investments + unrestricted board designated funds
Cashflow / total liabilities	(Net income + depreciation and amortization expenses) / total liabilities) x 100
Cushion ratio	Cash / maximum annual debt service
Days' cash on hand	Cash / ((operating expense minus depreciation expense) / 365)
Days in accounts receivable	(Net accounts receivable x 365) / net patient revenue
EBIDA	Net income before interest, depreciation, and amortization expenses
EBIDA margin	(EBIDA / total revenue) x 100
Excess margin	(Net income / total revenue) x 100
Interest coverage	Net available for debt service / interest expense
Long-term debt / capitalization	(Long term debt / (unrestricted net assets + long term debt)) x 100
Maximum debt service / total operating revenue	(Maximum annual debt service / (net patient revenue + other operating revenue)) x 100
Maximum debt service / total revenue	(Maximum annual debt service / total revenue x 100
Maximum debt service coverage	Net available for debt service / maximum annual debt service
Net available for debt service	Net income + depreciation and amortization expenses + interest expense
Net income	Operating income + net non-operating revenue
Net patient revenue	Gross patient revenue minus contractual allowances
Non-operating revenue	Investment earnings, contributions and other nonoperating revenue (excludes unrealized gains or losses on investments)
Non-operating revenue / total revenue	(Non operating revenue / total revenue) x 100
Operating cash flow margin	(Adjusted cash flow / total operating revenue) x 100
Operating income	Total operating revenue minus total operating expenses
Operating margin	(Operating income / total operating revenue) x 100
Payment period	(Current liabilities / (total expense minus depreciation and amortization expenses)) x 365
Salaries and benefits / net patient revenue	((Salary expense + benefit expense) / net patient revenue) x 100)
Total revenue	Net patient revenue + other operating revenue + non-operating revenue
Unrestricted cash / long-term debt	(Cash / long-term debt) x 100

Source: Standard & Poors

 Recommended **Ratios to Watch**

Case Study
Discussion

My Health System *MYHS*

Current Balance Sheet

Cash & Reserves	125,000
Long Term Debt	15,000
Net Assets	220,000
Key Ratios	
Cash to Debt	833%
Days Cash	253
DS % of Revenues	0.6%
Debt to Capitalization	6%

Current Income Statement

(\$000s)	MYHS 2007
Total Revenues	<u>200,000</u>
<i>Overall Revenue Escalation</i>	
Operating EBIDA	<u>20,825</u>
Operating EBIDA %	10.4%
Capital Depreciation & Amortization	10,000
Interest	<u>825</u>
Total	<u>10,825</u>
Operating Margin	<u>10,000</u>
Operating Margin %	5.0%
Pro Forma Op Margin w/ No Project	15.0%
Investment Income	6,250
Other Non-Operating	<u>500</u>
Total Margin	<u>16,750</u>
Total Margin %	8.1%
<i>Income Available for Debt Service</i>	27,575
<i>Debt Service Coverage (DSC)</i>	24.66

Case Study Discussion

Key Metric Comparison

My Health System

Comparison of Key Metrics to Rated S&P Credit Medians

	CURRENT MYHS	S & P A+/A-	S & P AA+/AA-	S & P BBB+/BBB-
Operating Margin % *	5.0%	3.5%	4.6%	2.3%
Operating EBIDA %	10.4%	13.4%	16.8%	11.1%
Total Margin	8.1%	6.6%	9.5%	4.4%
Debt Service Coverage	24.66 x	4.5x	5.90x	3.1x
Cash to Debt*	833%	135%	186%	84%
Days Cash on Hand*	253	196	311	126
Debt Service % of Revenues	0.6%	3.1%	3.0%	3.7%
Debt to Capitalization*	6%	32%	26%	42%

Current
MYHS Rating

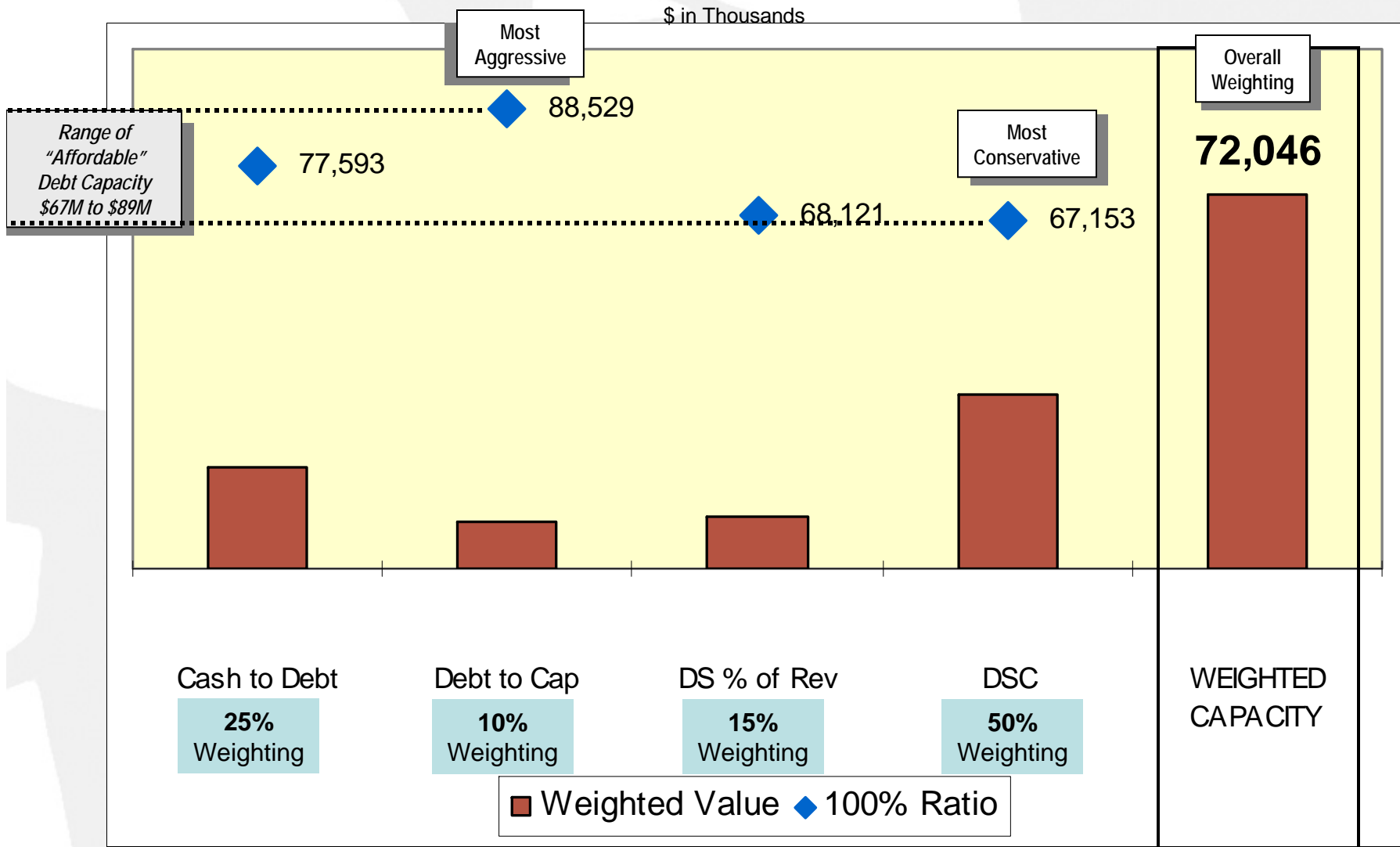
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DISCUSSION: What Should MYHS's Financial Target Profile Be?

Case Study Discussion

Sizing Additional Debt Capacity Example

Example: My Health System using S&P A+ / A- Median Targets



Case Study Discussion

Sizing Additional Debt Capacity Example

Example: My Health System using Different S & P Targets

The table below depicts the incremental current debt capacity of MYHS based on the Affordable Capital Capacity Targets of the management of My Health System and 12/31/2007 Performance

Incremental Current Debt Capacity

MYHS Management Target	\$72.0M More Debt than Current Levels
Other Targets	
<input checked="" type="checkbox"/> 2007 S&P AA+/AA-	\$53.3M More Debt than Current Levels
<input checked="" type="checkbox"/> 2007 S&P A+/A-	\$72.3M More Debt than Current Levels
<input checked="" type="checkbox"/> 2007 S&P BBB+/BBB-	\$110.7M More Debt than Current Levels
<input type="checkbox"/> 0	

[View Debt and Capital Capacity Graphs](#)

**Higher
Financial
Targets**

**Lower
Incremental
“Affordable”
Capital**

DISCUSSION

In the current credit climate, do our targets need to be...

THE SAME as they were 2 Years Ago?

HIGHER than they were 2 Years Ago?

LOWER than they were 2 Years Ago?

MYHS Defining “Financial Success”

- Maintain “**A**” Rating to Insure Future Access to Capital

Translated to
Financial “Success”



**Performance Consistent with
A+/A- Performance**

MYHS Capital “Needs”

- \$150M of Total Capital Projects in Plans

Translated to
Financial “Success”



**Performance Necessary to
Achieve Desired A+/A-
Performance**

Case Study Discussion

Early Stage Financial Planning Considerations → Sizing “Success”

Project Capital Need and Margin Target

My Project Capital Need is ...	\$150,000	← This is the Capital I Want to Invest
My Operating Margin Target is ...	5.00%	← This is the Operating Margin I Want
Years to My Target Margin ...	3	← How Many Years From Now to Achieve Target Margin

A Little Bit More About Your Capital Needs...

What % of Revenues is Needed for "Routine" Capital?	6.00%	<i>Approximately \$14,029k annually</i>
How Much "Project" Capital Will We Fund with our own Cash?	\$0	
How Much Philanthropy Do We Expect to Receive?	\$0	
Are we writing off any of our existing facility?		
IF WE ARE, how much Net Book Value are we writing off?		<i>input as a positive number</i>
IF WE ARE, how much annual Depreciation are we eliminating?		<i>input as a positive number</i>

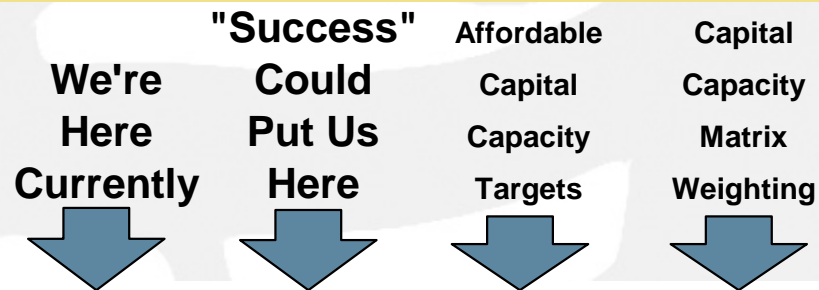
A Little Bit More About Expected Revenue Growth...

Expected Annual Growth Revenue in Operating Revenues	6.00%
Expected Annual Growth Revenue in Non-Operating Revenues	0.00%
Expected Annual Investment Earnings Rate	4.00%

Case Study Discussion

Does Our Capital Spending / Margin Target Produce Financial "Success"?

Key Financial Metrics if "Success" Achieved



KEY PERFORMANCE TARGETS

	CURRENT	FUTURE		
Operating Margin % *	5.0%	5.0%		
Operating EBIDA %	10.4%	17.6%		
Total Margin	8.1%	7.2%		
Debt Service Coverage	24.66 x	4.10 x**	4.50 x	50%
Cash to Debt*	833%	120%	135%	25%
Days Cash on Hand*	253	317	358	
Debt Service % of Revenues	0.6%	4.9%	3.1%	15%
Debt to Capitalization*	6%	35%	32%	10%

DISCUSSION
CONSIDERATION
 Is a 5% Operating Margin high enough to drive "A" performance with \$150M?

* - Target Operating Margin Achieved within 3 Years of Current Period.

** - MADS = Maximum Annual Debt Service of \$13,092 including proposed project debt

Capital “Need” Drives Required Operating Performance

Operating Performance Improvement Needed to Create "Success"

If My Health System wants to Invest

Investment

\$150.0M in Project Capital in the Next 5 Years

AND

Achieve a 5.00% Operating Margin by Year 5

It must improve its Current* EBIDA Performance by

Return

\$26.1M (95%)

(\$27.6M Current vs. \$53.7M by Year 5)

* Current = 12/31/2007

Note: Investment vs. Return with “A” Targets DRIVES the need for a 12% Cash Flow Return on Investment

A Reality Check?

- If we desired to spend \$150M on capital, do are strategies produce \$26M+ annual cash returns through...?
 - Profitable Growth
 - Operating Efficiency
 - Philanthropy Support

*We'll have to aggressive manage baseline revenue and expense growth under any circumstance
→ It's a Given!*

If the Answer is not a Confident YES....

- Reduce Capital Spending
- Focus on Strategies with Highest Returns

Sources of Capital

- Bonds (tax exempt bonds, participating bond transactions)
- Leases (e.g., new technology)
- Sale of stock or membership interest (e.g., infusion of capital in exchange for stock and/or board seats)
- Mergers and acquisitions
- Divestiture (e.g., of non-essential service lines, locations)
- Management and professional service agreements
- Joint ventures (e.g., sharing revenues/expenses for merged service line)
- Philanthropy (501(c)(3) nonprofits)

“Big Picture” Legal Considerations in Raising Capital

Is the purpose/intent of the deal a legal one?
(e.g., Medicare fraud and abuse laws prohibit payment for referrals; antitrust laws prohibit price fixing and conspiracy to monopolize)

Where is the capital coming from? (e.g., more legal requirements if capital is coming from physicians, medical device, pharma and others in a position to gain from referrals)

Are the terms “arms length” and “fair market value?” (e.g., important for 501(c)(3) nonprofits)

“Big Picture” Legal Considerations – cont’d

- What are the expectations of the parties - - and what terms will be “contractual?” (e.g., governance rights, puts/calls on ownership, termination/unwind)
- What government approvals are necessary? (e.g., Hart-Scott-Rodino filing for antitrust purposes, city/county/state)
- What other approvals are necessary? (e.g., third party payors, creditors, employees, bond trustee)

MYHS Discussion Topics

- Strengths and Weakness of MYHS's current financial situation
- Evaluate "Success" Implications of Different Levels of Financial Targets
- Discuss Ideas to "Manage" Capital Spending and Performance Expectations by Financial Management Tools / Targets
- Likely / Possible Vehicles to Access "Affordable" Capital