Hospital Financial Analysis 2004

PREVIEW

The Pennsylvania Health Care Cost Containment Council (PHC4) is an independent state agency charged with addressing the cost and quality of health care in Pennsylvania.

In order to maintain a high quality, cost-effective health care delivery system, hospitals and freestanding surgery centers must be financially viable and effectively managed. To this end, the Council has produced a series of annual reports that measure the financial health of the Commonwealth's hospitals and surgery centers and the utilization of their services.

In response to the high level of interest in the financial condition of Pennsylvania's general acute care (GAC) hospitals, the Council is releasing this *Preview* in advance of its forthcoming Financial Analysis for Fiscal Year 2004, to be released in Spring 2005.

The information presented in this *Preview* is derived from the hospitals' audited financial statements and additional data filed directly by the hospitals. The Council wishes to thank the hospitals for their cooperation and timely submissions.

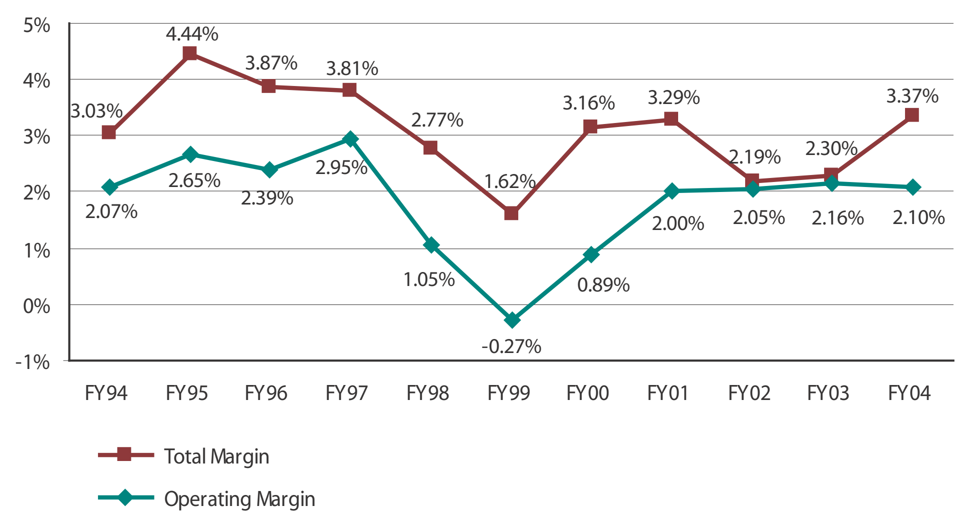
Statewide Total Margin Improves in FY04 while Statewide Operating Margin Edges Lower

The overall net income or total margin realized by Pennsylvania's general acute care (GAC) hospitals grew by more than a full point from 2.30% in Fiscal Year 2003 (FY03) to 3.37% in Fiscal Year 2004 (FY04). The total margin reflects the net income hospitals realize from all sources including operations, investment gains and contributions.

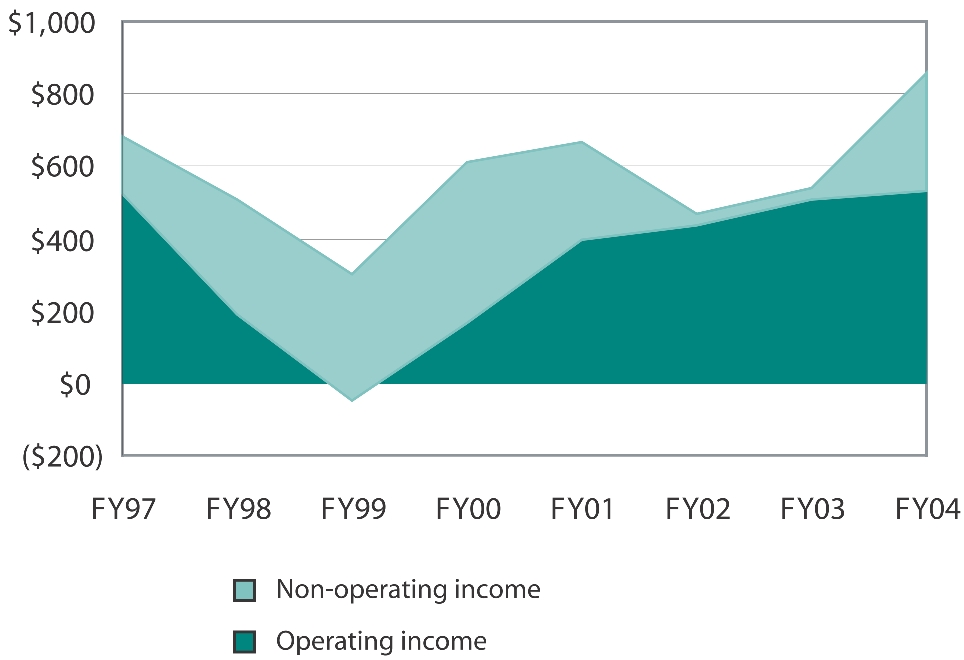
The improvement in the total margin was primarily driven by a rise in non-operating income. Many hospitals realized gains in the value of their investments during FY04 as the securities markets rebounded during FY03 after falling between 1999 and 2002. As a result, there was about a ten-fold increase in non-operating income from a little over $33 million in FY03 to about $330 million in FY04.

This growth in non-operating income has brought this source of hospital funding back to the statewide levels that were realized in FY98 and FY99 when the securities indexes were rising. The $330 million in non-operating income in FY04 is still below the FY00 peak in non-operating income of $441 million that followed the 1999 peak in the securities markets.

Statewide Average Total and Operating Margin



Statewide Operating and Non-operating Income



At $330 million, non-operating income comprises about 38% of the total income realized by GAC hospitals in FY04. One hundred sixty-two (162) of the 182 GAC hospitals operated as non-profit corporations. Consequently, Pennsylvania's GAC hospital industry relies heavily on non-operating income such as investment income and contributions to sustain its operations.

In contrast to the growth in non-operating income, hospitals reported only about a $24 million gain in operating income to $528 million. Since operating expenses grew a little faster than operating revenue during FY04, the statewide operating margin actually fell from 2.16% in FY03 to 2.10% in FY04. (However, this decline is significantly affected by a single health system. See footnote.[1]) A hospital's operations include patient care as well as a number of other related functions such as medical education, office space, parking and cafeterias. During FY04, 95% of statewide hospital revenue was generated by patient care.

[1] The statewide operating income and operating margin were significantly affected by "merger, impairment and other usual charges" posted by a single health system. These adjustments totaled $111.3 million in FY03 and $85.6 million in FY04 which were equal to 22.1% and 16.2% of statewide operating income, respectively. These adjustments had the effect of lowering the statewide operating margin from 2.64% to 2.16% in FY03 and from 2.44% to 2.10 % in FY04. Similarly, these adjustments had the effect of lowering the statewide total margin from 2.78% to 2.30% in FY03 and from 3.71% to 3.37% in FY04.

Fewer Hospitals Lose Money

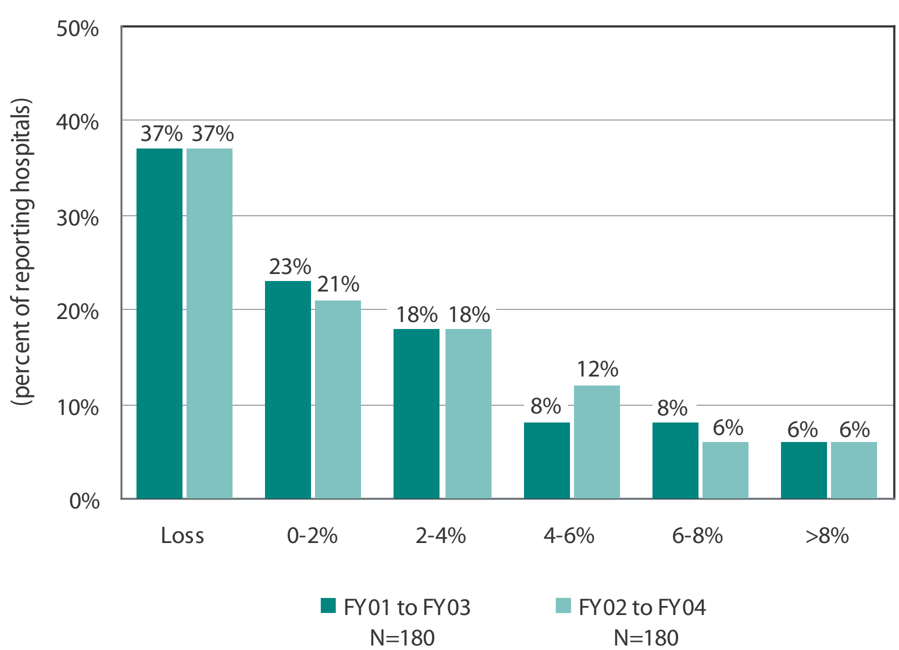
Twenty-seven (27) fewer GAC hospitals reported losses during FY04. A year earlier (FY03), nearly one-half (48%) or 88 hospitals posted losses. The number with negative total margins has fallen to 61 or about one-third (34%) of GAC hospitals by the end of FY04.

There were 38 hospitals that reported a positive total margin in FY04 after experiencing losses in FY03. In contrast to the statewide total margin that was bolstered by non-operating income, as a group, the improvement in operating income played a larger role in the recovery of these 38 hospitals. Twenty-six (26) of the 38 hospitals realized a larger growth in operating income than non-operating income, and collectively, 62% of the growth in total income came from operations.

Eleven hospitals posted losses in FY04 after reporting positive total margins in FY03. Operating income was also the primary factor that caused ten of the eleven hospitals to post losses in FY04.

Since extraordinary or short-term events can have a significant impact on a hospital's annual total margin, a three-year average total margin can provide a better perspective on a hospital's medium-term financial health. The percent of hospitals that have sustained losses over a three-year period did not change in FY04. Thirty-seven percent (37%) of the GAC hospitals had negative three-year average total margins in both FY03 and FY04. There was a four-point or eight-hospital growth in the number of hospitals that had three-year average total margins between 4% and 6% and small declines in the 0%–2% and 6%–8% ranges.

Statewide Disribution of Three-Year Average Total Margin

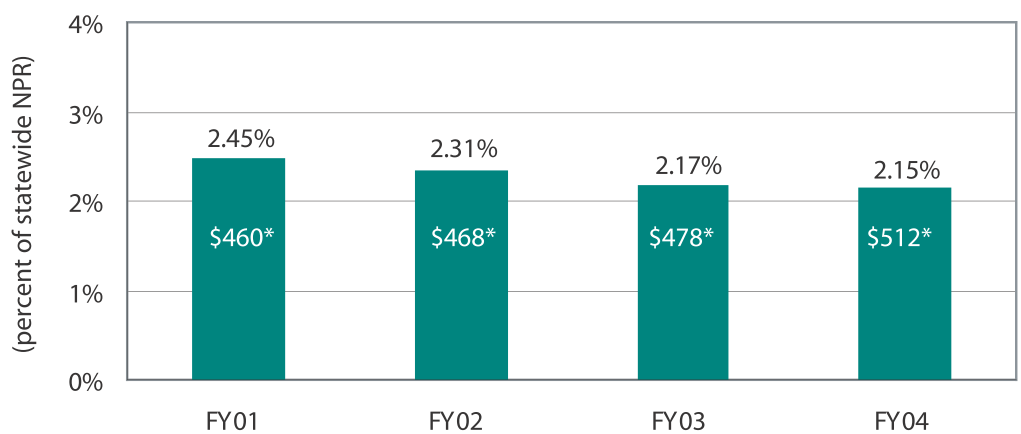


Uncompensated Care Rates Stable

The dollar value of uncompensated care grew by 7.1% or $34 million from $478 million during FY03 to $512 million during FY04. However, since statewide net patient revenue grew a little faster (8.0%), uncompensated care comprised a slightly smaller portion of total patient care during FY04. Statewide uncompensated care revenue was equal to 2.15% of total net patient revenue in FY04; down from 2.17% in FY03.

Uncompensated care revenue provides an estimate of the amount of revenue hospitals lost due to bad debt and charity care. This foregone revenue reflects what hospitals would have received if they had been reimbursed for uncompensated care. The estimate of foregone revenue is based on the average overall reimbursement hospitals received from all payors including commercial health insurers, Medicare, Medical Assistance and patients.

Statewide Uncompensated Care Revenue



* Statewide Uncompensated Care Revenue in millions.

In order to meet the requirments under Act 77 of 2001 (Tobacco Settlement Act), PHC4 modified the way in which uncompensated care is captured and reported. Beginning in FY03, hospitals submit bad debt and charity care at full charges. Uncompensated care revenue is calculated using each hospital's unique revenue-to-charge ratio. The FY01 and FY02 statewide uncompensated care revenue levels are estimates developed by converting actual FY01 and FY02 data to the new methodology.

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