PREVIEW

Hospital Financial Analysis 2005

Statewide Total Margin Rises Again in FY05, Driven by an Increase in Statewide Operating Income

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. PHC4 produces a series of annual reports that measure the financial health of the Commonwealth's hospitals and surgery centers and the utilization of their services.

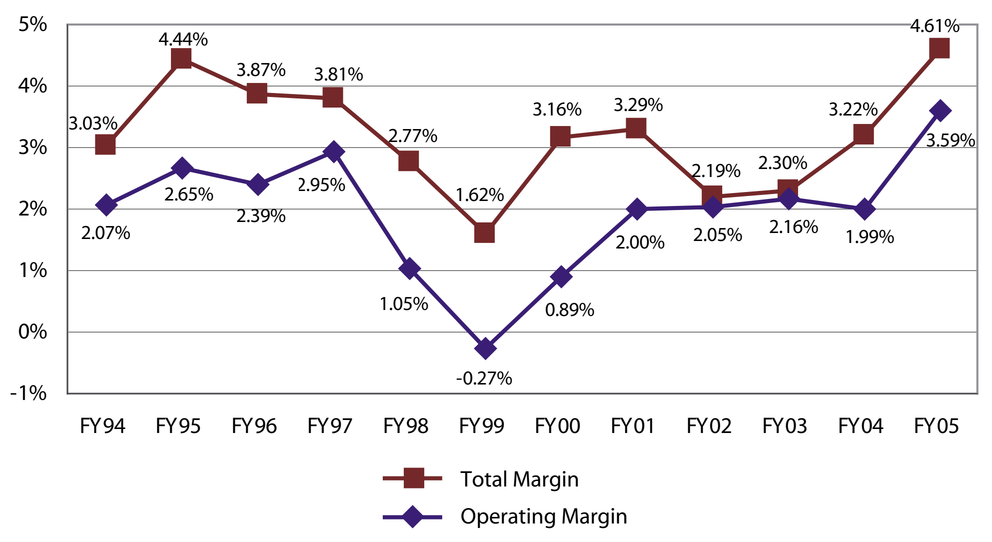
In response to the high level of interest in the financial condition of Pennsylvania's general acute care (GAC) hospitals, PHC4 is releasing this *Preview* in advance of its forthcoming *Financial Analysis for Fiscal Year 2005*, to be released in Spring 2006.

Information in this *Preview* is derived from the hospitals' audited financial statements and additional data filed directly by the hospitals. PHC4 wishes to thank the hospitals for their cooperation and timely submissions.

The overall net income or total margin realized by Pennsylvania's 176 general acute care (GAC) hospitals grew by well over a full point, rising from 3.22% in fiscal year 2004 (FY04) to 4.61% in fiscal year 2005 (FY05). Including the 0.9 point improvement in FY04, the statewide total margin has grown 2.3 points over the past two years. The total margin reflects the net income hospitals realized from all sources, including operations, investment gains and contributions.

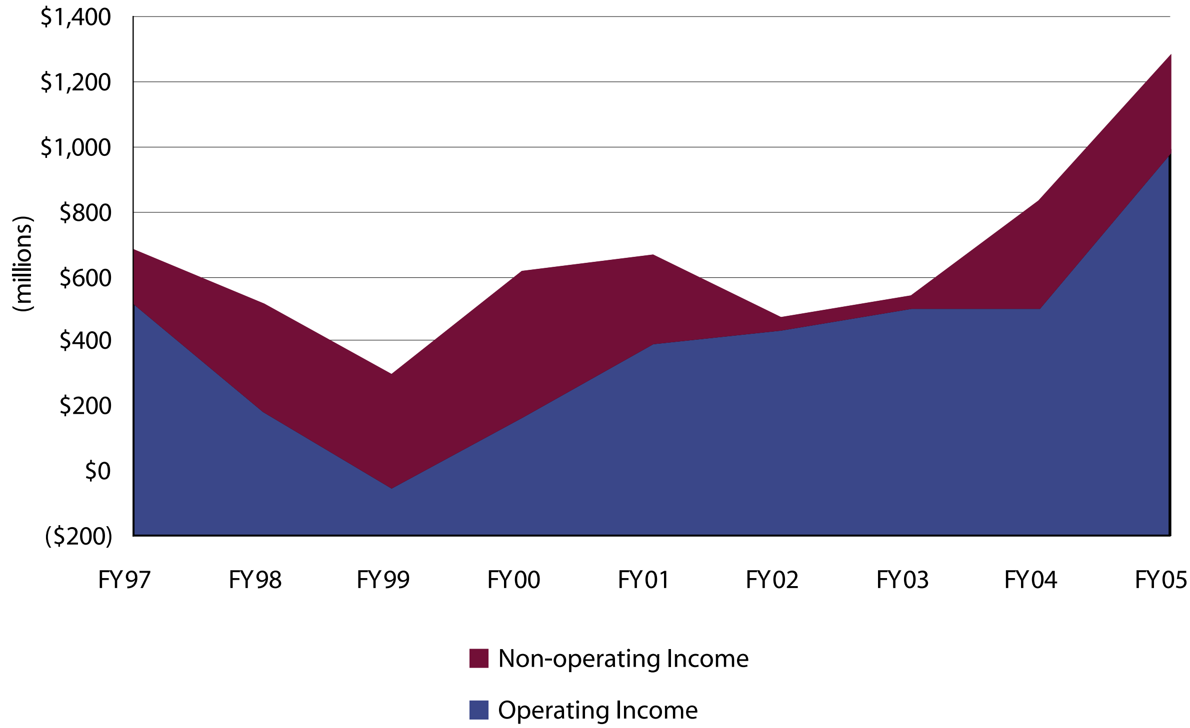
Unlike FY04, where the improvement in the total margin was primarily the result of

Statewide Average Total and Operating Margins[1]



[1] The statewide operating income and operating margin were significantly affected by "merger, impairment and other unusual charges" posted by a single health system. These changes totaled $111.3 million in FY03, $85.6 million in FY04 and $81.7 million in FY05. These adjustments had the effect of lowering the statewide operating margin from 2.64% to 2.16% in FY03, 2.32% to 1.99% in FY04 and 3.88% to 3.59% in FY05. Similarly, these adjustments had the effect of lowering the statewide total margin from 2.78% to 2.30% in FY03, 3.55% to 3.22% in FY04 and 4.90% to 4.61% in FY05.

Statewide Operating and Non-operating Margins



non-operating gains from investments, the growth in the FY05 total margin was driven by an increase in operating income. After falling slightly in FY04 to 1.99%, the statewide operating margin grew 1.6 points to 3.59% in FY05. Statewide operating income increased over 90% from a little over $500 million in FY04 to about $980 million in FY05. Statewide operating income improved because GAC hospitals collectively posted an increase in operating revenue of about 7.3% while holding the increase in operating expenses to about 5.6%. The revenue hospitals received for patient care, net patient revenue, grew at about the same rate as overall operating revenue during FY05.

After nearly a ten-fold increase in non-operating income from about $34 million in FY03 to $324 in FY04, non-operating income declined about 9.6% to slightly over $290 million in FY05. Changes in non-operating income are primarily the result of changes in the income and value of hospital investments.

With the improvement in operating income, GAC hospitals received about 77% of their total income from operations with the remaining 23% coming from non-operating sources during FY05. This is a significant shift from the previous year, when 61% of income came from operations and non-operating sources provided 39% of statewide hospital income during FY04.

Fewer Hospitals Lose Money

Thirteen (13) fewer GAC hospitals reported losses during FY05, reducing the number of hospitals posting negative total margins from 61 in FY04 to 48 in FY05. Despite this improvement, 27% of GAC hospitals still lost money during FY05. However, the scenario in FY05 is much better than just two years earlier when nearly one-half (48%) of

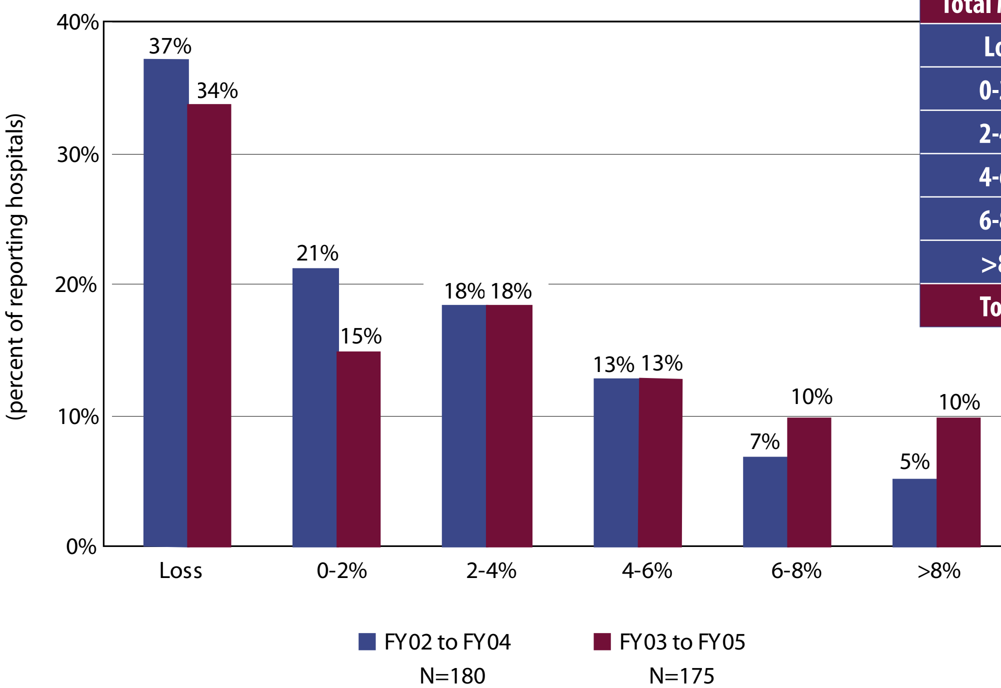
Pennsylvania's GAC hospitals posted losses and last year when 34% lost money.

Consistent with the growth in statewide operating income, 22 fewer hospitals ended FY05 with operating losses. The number of hospitals with negative operating margins fell from 75 in FY04 to 53 in FY05. At 53, 30% of GAC hospitals lost money from operations.

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 some perspective on a hospital's medium-term financial health. Seven fewer hospitals realized average losses over the three-year period ending in FY05. There were 59 hospitals with a negative three-year average total margin at the end of FY05, compared to 66 at the end of FY04.

There was a more dramatic change in the number of hospitals that posted small positive three-year average total margins in the 0% to 2% range. Eleven fewer hospitals had three-year average total margins in this range at the end of FY05 compared to FY04. At the other end of the spectrum, 14 more hospitals had three-year average total margins above 6%, bringing the total to 35 of the 175 hospitals that operated over the three-year period. There was little change in the number of hospitals with three-year average total margins between 2% and 6%.

Statewide Distribution of Three-Year Average Total Margin



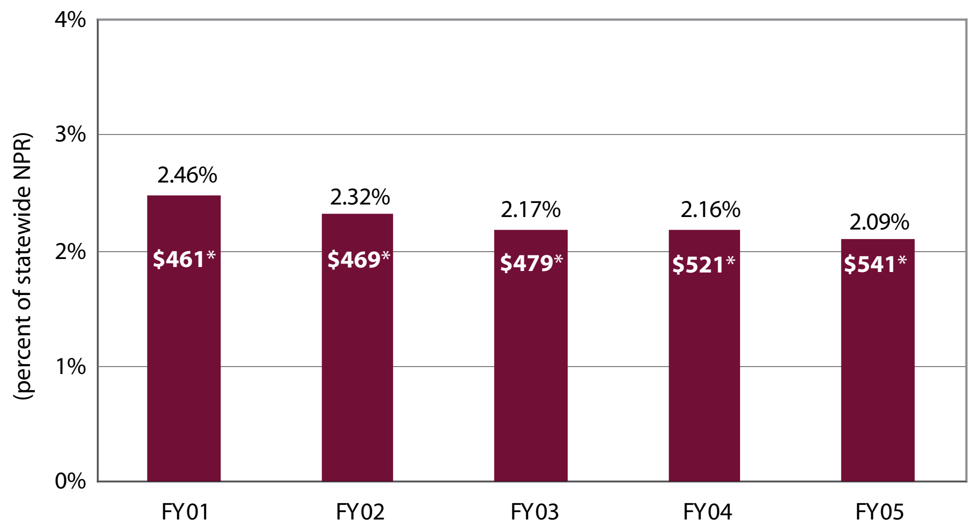
3-yr Average Total Margin	Hospitals	
	FY02-FY04	FY03-FY05
Loss	66	59
0-2%	37	26
2-4%	32	32
4-6%	24	23
6-8%	12	18
>8%	9	17
Total	180	175

Uncompensated Care Rates Remain Constant

The dollar value of uncompensated care grew by 3.7% or $20 million from $521 million during FY04 to $541 million during FY05. However, since statewide net patient revenue grew faster (7.3%), uncompensated care comprised a slightly smaller portion of total patient care during FY05. Statewide uncompensated care revenue was equal to 2.09% of total net patient revenue in FY05, down from 2.16% in FY04.

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 requirements 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. In converting the data, it was assumed that hospitals did not change their accounting procedures for bad debt between FY01 and FY03.

Pennsylvania Health Care Cost Containment Council
Marc P. Volavka, Executive Director
225 Market Street, Suite 400, Harrisburg, PA 17101
Phone: (717) 232-6787
Fax: (717) 232-3821
www.phc4.org