

San Leandro Hospital

Financial Projections
Presented to
Eden Township Healthcare District

NOVEMBER 19, 2008

Complete Solutions for Healthcare Management

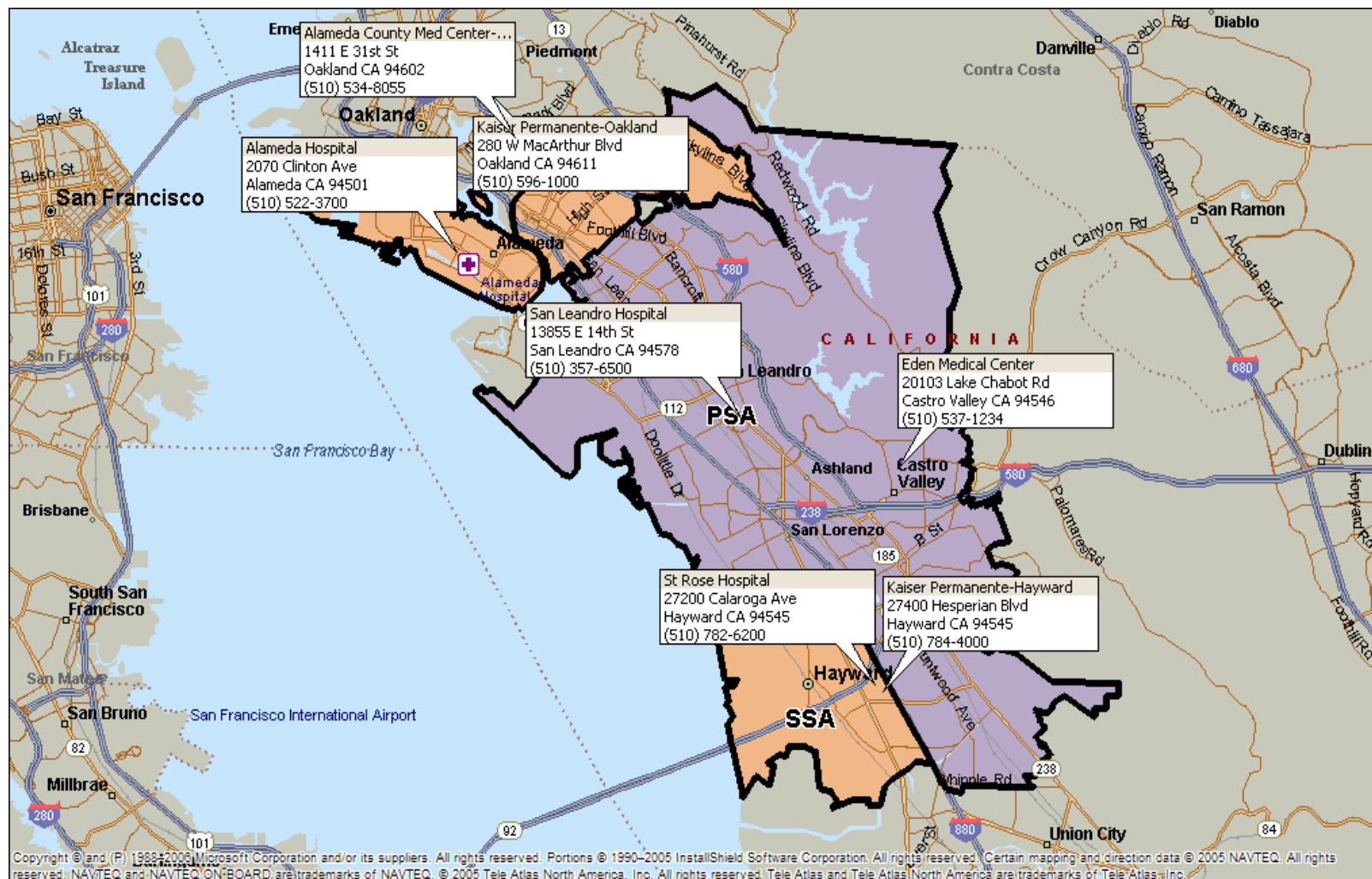


- Evaluate the financial and operational ability of San Leandro Hospital (SLH) to operate as a stand alone general acute care hospital (“GACH”)
- Prepare schedules of projected revenues and expenses, cash flow, and balance sheets for SLH as a GACH
- Prepare a summary of projected debt service coverage and other key financial ratios
- Prepare a summary of our work, assumptions and conclusions

- Defined service area using Office of Statewide Health Planning and Development (OSHPD) acute discharges and patient days by zip code
 - Primary Service Area (PSA)
 - Secondary Service Area (SSA)
- Obtained population growth projections from Claritas, Inc.
- Reviewed revenues and expenses per statistic of other California hospitals with similar size and services – based primarily on OSHPD reports
- Reviewed and applied the following SLH data:
 - Medicare cost report data 2004 to 2006 – payor mix
 - OSHPD 2004 to 2007 – utilization and market share
- Prepared 5-year financial projections

- **Primary Service Area (PSA)**
 - Represents 80% of discharges
 - Includes San Leandro, Oakland, Hayward, San Lorenzo and Castro Valley
 - Zip codes: 94577, 94578, 94603, 94579, 94605, 94621, 94541, 94580, 94546, 94544
- **Secondary Service Area (SSA)**
 - Represents 5% of discharges
 - Includes Oakland, Hayward and Alameda
 - Zip codes: 94601, 94545, 94501, 94619

Primary and Secondary Service Areas



- Stable population in service area
 - Projected growth 0.3% per year
- SLH market share in PSA and SSA has been 8 to 9% of acute patient days and discharges
- Other competitive facilities in the service area:
 - PSA
 - Eden Medical Center
 - Kaiser (new facility)
 - SSA
 - St. Rose Hospital
 - Kaiser (existing facility)
 - Alameda Hospital

Utilization – Historical

	Historical Actual Periods Ended					
	Dec. 31 2002	Dec. 31 2003	Dec. 31 2004	Dec. 31 2005	Dec. 31 2006	Dec. 31 2007
Discharges	4,748	4,672	5,296	5,242	4,662	4,208
Patient Days	20,555	19,711	23,489	23,854	21,393	19,496
ER Admissions % of Total	76.6%	79.0%	68.8%	70.7%	77.4%	84.0%
Outpatient Surgeries	522	677	864	1,328	1,252	
Emergency Room Visits	20,698	25,699	11,637	25,511	24,492	

Utilization – Projected

Projected Fiscal Years Ending

	June 30, 2011	June 30, 2012	June 30, 2013	June 30, 2014	June 30, 2015
Acute Discharges	4,256	4,270	4,284	4,300	4,316
Acute Patient Days	19,681	19,743	19,811	19,885	19,959
Outpatient Surgeries	1,269	1,273	1,277	1,282	1,287
Emergency Room Visits	25,160	25,240	25,327	25,422	25,517
Other	40,246	40,372	40,512	40,663	40,816
Total Outpatient Visits	66,675	66,885	67,116	67,367	67,620

Key Operational Assumptions

- Sutter provides ETHD a minimum of six months notice and transitions license through a change of ownership (CHOW)
- ETHD assumes operations effective July 1, 2010
- Current management and staff remain
- New executive team is recruited
- Sutter allows access to key vendor agreements and licenses (i.e. for computer system) to allow orderly transition
- \$9 million needed for NPC seismic work to be meet 2013 state compliance
 - \$15 million was included in the financial projections to account for inflation
- Hospital is fully equipped with all equipment in good working order

Estimated Transition Costs

(in thousands)



	<u>Months to</u> <u>Complete</u>	<u>Cost</u>
Transition and Start Up Costs:		
Legal fees		\$750
Licensing/change of ownership	6 to 9	70
Recruit executive team	3 to 6	330
Executive salaries during transition period	3 to 6	680
Organize and credential medical staff	0 to 6	50
Negotiate payor and physician contracts	3 to 4	50
Develop hospital wide policies and procedures	0 to 2	20
Negotiate employment and benefit agreements	3	30
Forms, signage, etc.	3	500
Negotiate vendor contracts/purchasing agreements	3	<u>20</u>
Estimated Transition and Start-Up Costs		<u>\$2,500</u>

Payor Mix Assumptions

- Payor mix is projected as follows:

• Inpatient	<u>Patient Days</u>	<u>Net Revenues</u>
Medicare	62%	65%
Medi-Cal	10%	6%
Other payors	<u>28%</u>	<u>29%</u>
Total	100%	100%
• Outpatient	<u>Visits</u>	<u>Net Revenues</u>
Medicare	76%	73%
Medi-Cal	10%	13%
Other payors	<u>14%</u>	<u>13%</u>
Total	100%	100%

Revenue Assumptions

- Net revenue per patient day assumptions were developed based on the following:
 - Inpatient:
 - Medicare – SLH historical case mix and projected DRG pricing
 - Medi-Cal – comparable facilities per diem rates
 - Other payors – comparable facilities average net revenue per patient day
 - Outpatient:
 - All payors – comparable facilities per visit rates
- Projected annual increase to reimbursement rates:

• Medicare	3%
• Medi-Cal	2%
• All other payors	3%

Expense Assumptions

- Expenses of comparable facilities was the basis for expense projections
- Expenses were deemed to be fixed or variable
 - Fixed = annual increase based on inflation only
 - Variable = annual increase based on change in utilization and inflation
- Expenses were inflated at the following annual rates:

• Salaries and wages	4%
• Benefits	6%
• Professional fees	4%
• Supplies	4%
• Purchased services	4%
• Lease and rentals	3%
• Insurance, tax and license	3%
• Other	3%

Balance Sheet Assumptions

- Projected based on industry trends
- Assumed \$36.9 million note payable from ETHD to fund transitional costs and reserve cash for capital additions and debt payments
 - Assumed interest rate = 6.5%
- Key line items:
 - Days in Accounts Receivable
 - FY2011 = 80
 - FY2012 = 70
 - FY2013-FY2015 = 60
 - Days in Accounts Payable = 60
 - Days in Inventory = 48
 - Days in Accrued Payroll = 15

Projected 5 Year Cash Needs

(in thousands)

	Pre-Opening	June 30, 2011	June 30, 2012	June 30, 2013	June 30, 2014	June 30, 2015	Total
Initial Capital Raise	\$36,900						\$36,900
EBIDA Loss less Non-Op Revenue		5,755	6,920	7,863	8,861	9,926	39,324
Debt Service (Principal+Interest)			3,316	3,314	3,312	3,309	13,251
Changes in Working Capital			(1,505)	(1,576)	160	164	(2,757)
Capital Expenditures - Seismic			6,000	6,000	3,000	0	15,000
Capital Expenditures - Ongoing			3,000	3,000	3,000	3,000	12,000
Total Capital Needs	\$36,900	\$5,755	\$17,731	\$18,601	\$18,333	\$16,399	\$113,718

Detailed Initial Capital Needs

(in thousands)

	<u>Initial Capital</u>
Start-up and transition costs	\$2,500
Capital	
Working capital - 3 months of expense	17,000
Computer system	5,000
Reimburse Sutter - capital expenditures	5,000
Capital reserve fund	3,000
Debt service - first 18 months	4,400
	<u>34,400</u>
Total initial capital needs	<u>\$36,900</u>

Projected Income Statement

(in thousands)



	Projected for the years ended June 30,				
	2011	2012	2013	2014	2015
Revenue:					
Net patient revenue	\$61,930	\$63,936	\$66,026	\$68,205	\$70,457
Other operating revenue	244	255	266	278	290
Total operating revenue	62,175	64,191	66,292	68,483	70,747
Expenses:					
Salaries, wages & benefits	40,649	42,504	44,449	46,489	48,623
Professional fees	4,613	4,754	4,942	5,138	5,343
Supplies	7,285	7,598	7,928	8,274	8,636
Purchased services	6,445	6,712	6,991	7,283	7,587
Lease/Rental	1,072	1,104	1,137	1,171	1,206
Insurance/Tax & License	848	875	903	933	963
Other	2,191	2,257	2,325	2,395	2,468
Provision for bad debts	5,140	5,307	5,480	5,661	5,848
Total Operating Expenses	68,243	71,111	74,155	77,344	80,672
EBIDA	(6,068)	(6,920)	(7,863)	(8,861)	(9,926)
Depreciation	2,726	4,422	5,708	6,565	6,994
Interest	2,373	2,304	2,236	2,164	2,087
Total Expenses	73,342	77,837	82,099	86,073	89,752
Operating income	(11,167)	(13,646)	(15,807)	(17,590)	(19,006)
Non-Operating Revenue	314	-	-	-	-
Excess of revenue over expenses	(\$10,853)	(\$13,646)	(\$15,807)	(\$17,590)	(\$19,006)

Projected Balance Sheet

(in thousands)

	June 30, 2011	June 30, 2012	June 30, 2013	June 30, 2014	June 30, 2015
Assets:					
Current Assets:					
Cash and cash equivalents	\$1,964	(\$15,767)	(\$34,368)	(\$52,701)	(\$69,100)
Patient accounts receivable, net	13,574	12,228	10,854	11,212	11,582
Inventories	947	988	1,033	1,079	1,126
Total current assets	16,485	(2,551)	(22,481)	(40,411)	(56,392)
Property, plant and equipment	42,740	51,740	60,740	66,740	69,740
Less accumulated depreciation	(14,107)	(18,529)	(24,237)	(30,802)	(37,795)
Net property, plant and equipment	28,633	33,211	36,503	35,938	31,945
Total Assets	45,118	30,660	14,023	(4,472)	(24,447)
Liabilities and Fund Balance:					
Current Liabilities:					
Current portion of long term debt	\$1,012	\$1,078	\$1,148	\$1,223	\$1,302
Accounts payable	3,691	3,820	3,982	4,142	4,307
Accrued Payroll	1,671	1,742	1,827	1,911	1,998
Total current liabilities	6,374	6,640	6,957	7,275	7,607
Long-term debt					
Note Payable to District	34,937	33,859	32,711	31,489	30,187
Total long-term debt	34,937	33,859	32,711	31,489	30,187
Fund Balance	3,807	(9,839)	(25,646)	(43,236)	(62,241)
Total Liabilities and Fund Balance	\$45,118	\$30,660	\$14,023	(\$4,472)	(\$24,447)

Projected Cash Flows

(in thousands)

	June 30, 2011	June 30, 2012	June 30, 2013	June 30, 2014	June 30, 2015
Beginning Cash and Cash Equivalents	(\$8,699)	\$1,964	(\$15,767)	(\$34,368)	(\$52,701)
Cash flows from operating and nonoperating activities:					
Net income	(10,853)	(13,646)	(15,807)	(17,590)	(19,006)
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation	2,726	4,422	5,708	6,565	6,994
Accounts receivables, net	(13,574)	1,346	1,375	(358)	(370)
Inventories and Prepaid expenses	(947)	(41)	(46)	(45)	(47)
Accounts payable	3,691	129	163	159	166
Accrued Payroll	1,671	71	85	84	88
Net cash provided by (used for) operating activities	(17,287)	(7,719)	(8,523)	(11,185)	(12,176)
Cash flow from investing activities:					
Capital expenditures-computer system	(5,000)	-	-	-	-
Capital expenditures-existing	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)
Capital Costs Reserve fund	(3,000)	-	-	-	-
Capital expenditures - seismic requirements	-	(6,000)	(6,000)	(3,000)	-
Capital Costs Reserve fund used	3,000	-	-	-	-
Net cash provided by (used for) investing activities	(8,000)	(9,000)	(9,000)	(6,000)	(3,000)
Cash flow from financing activities:					
Proceeds of debt-Note payable to District	36,900	-	-	-	-
Payment of debt-Note payable to District	(950)	(1,012)	(1,078)	(1,148)	(1,223)
Net cash provided by (used for) financing activities	35,950	(1,012)	(1,078)	(1,148)	(1,223)
Ending Cash and Cash Equivalents	\$1,964	(\$15,767)	(\$34,368)	(\$52,701)	(\$69,100)

Debt Service

	June 30, 2011	June 30, 2012	June 30, 2013	June 30, 2014	June 30, 2015
Excess of Revenues over Expenses	\$ (10,853)	\$ (13,646)	\$ (15,807)	\$ (17,590)	\$ (19,006)
Depreciation	2,726	4,422	5,708	6,565	6,994
Interest	2,373	2,304	2,236	2,164	2,087
Income Available For Debt Service	<u>\$ (5,755)</u>	<u>\$ (6,920)</u>	<u>\$ (7,863)</u>	<u>\$ (8,861)</u>	<u>\$ (9,926)</u>
Debt:					
Interest	2,373	2,304	2,236	2,164	2,087
Principal	950	1,012	1,078	1,148	1,223
Total Debt Service	<u>\$ 3,323</u>	<u>\$ 3,316</u>	<u>\$ 3,314</u>	<u>\$ 3,312</u>	<u>\$ 3,309</u>
Debt Service Coverage Ratio (EBIDA)	<u>(1.73)</u>	<u>(2.09)</u>	<u>(2.37)</u>	<u>(2.68)</u>	<u>(3.00)</u>

- Two new facilities are in development in the market:
 - Eden Medical Center – includes new OP surgery center
 - Kaiser
- Physician recruitment and retention obstacles:
 - Older physical plant
 - High cost of living in the service area
 - Established medical staff will be decreasing through attrition
 - New physicians may prefer foundation model over independent practice
- SLH lacks leverage in negotiating new payor contracts due to:
 - Hospital size
 - Close proximity of competing healthcare networks

Significant Issues

- If Sutter closes SLH, it would be difficult and costly for ETHD to reopen it as a general acute care hospital (GACH)
- Existing agreement provides for 90 days (3 months) notice for Sutter to terminate the lease
 - Not adequate notice for ETHD to transition operations
 - Eight to nine months is a more typical timeframe, six months minimum is needed
- Projected EBIDA shows \$6 million loss in year 1 of the projections, increasing to \$10 million loss in year five
- Ongoing needs to fund operating shortfalls, service debt, replace capital equipment and comply with seismic requirements by 2013
- Changing credit environment may increase the cost of capital or reduce access to it
- SLH is heavily dependent on Medicare and Medi-Cal payments for cash flow
 - This concentration of revenue increases business risk
- Outpatient revenues have increased in the current year. Any future potential increases are omitted from our projections due to insufficient data.

Conclusions

- It is not feasible for Eden Township Healthcare District to operate San Leandro Hospital (SLH) as a profitable, stand alone general acute care hospital (GACH)
- In order to continue operations as a GACH, SLH would require significant funding to:
 - Subsidize operational shortfalls
 - Purchase ongoing capital equipment needs
 - Fund future seismic compliance issues
- Funding options to continue as GACH:
 - Continued affiliation with Sutter Health
 - New affiliation with other healthcare operator
 - Public support
 - District wide parcel tax or other tax
 - Funding from federal, state, or county governments (requires special designation)
 - Private support – foundation, donations
- If inadequate support exists to fund continuing SLH losses as GACH, other options should be considered based on community needs (i.e. rehab, skilled nursing)