

Integrated Plan of Finance, marked confidential
but distributed as attached in public meeting of July 29, 2004 Finance
Committee
and approved by the Board at a Special Board Meeting August 4, 2004

FINANCIAL AND CAPITAL PLAN UPDATE
Confidential Draft Not To Be Distributed



San Diego, California

July 29, 2004

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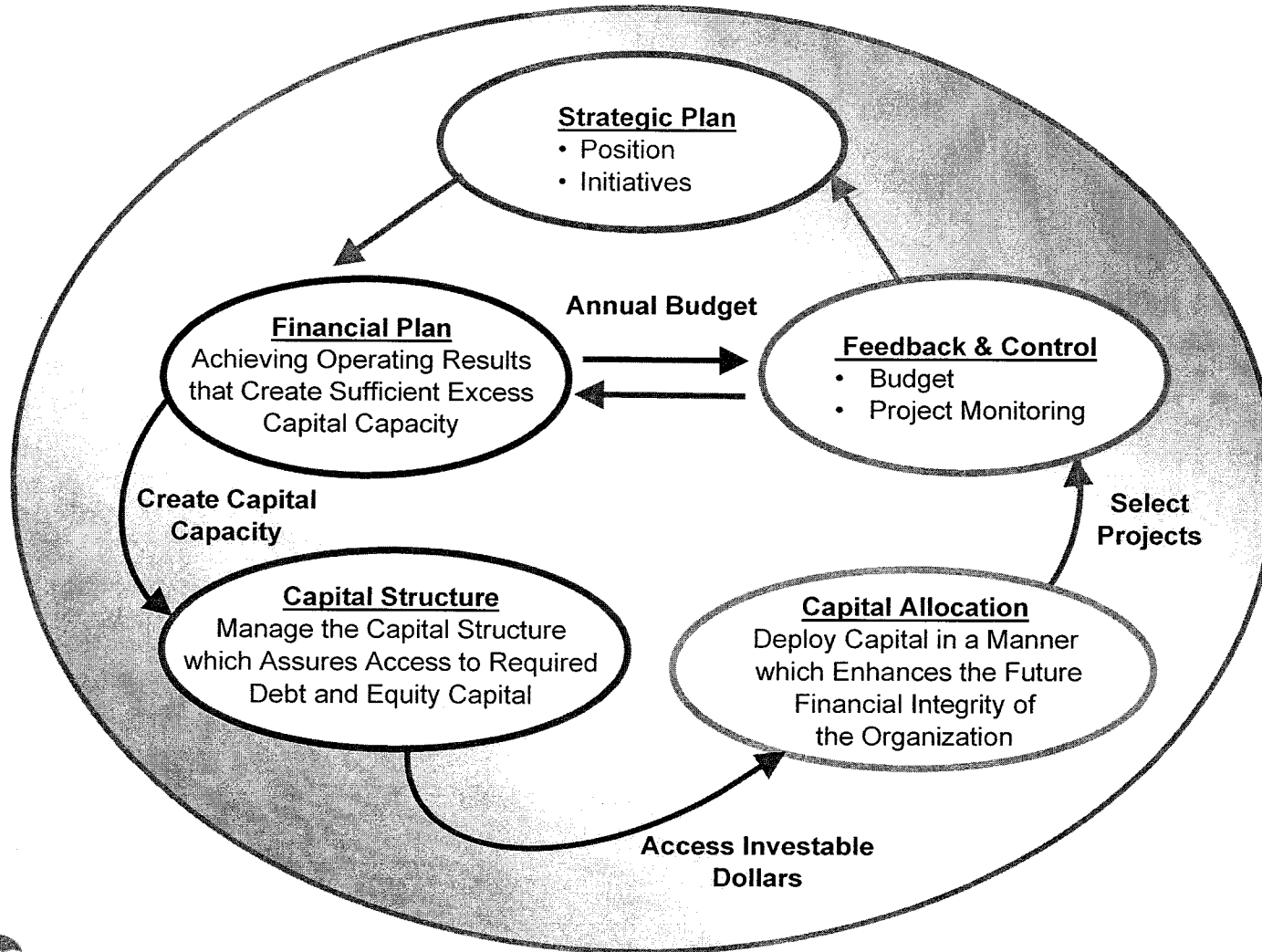
AGENDA

- 1. Overview of the Updated Strategic Financial and Capital Planning Process and Results**
- 2. Credit Analysis**
- 3. Capital Position Analyses**
- 4. Integrated Plan of Finance**
- 5. Issues/Conclusion and Next Steps**

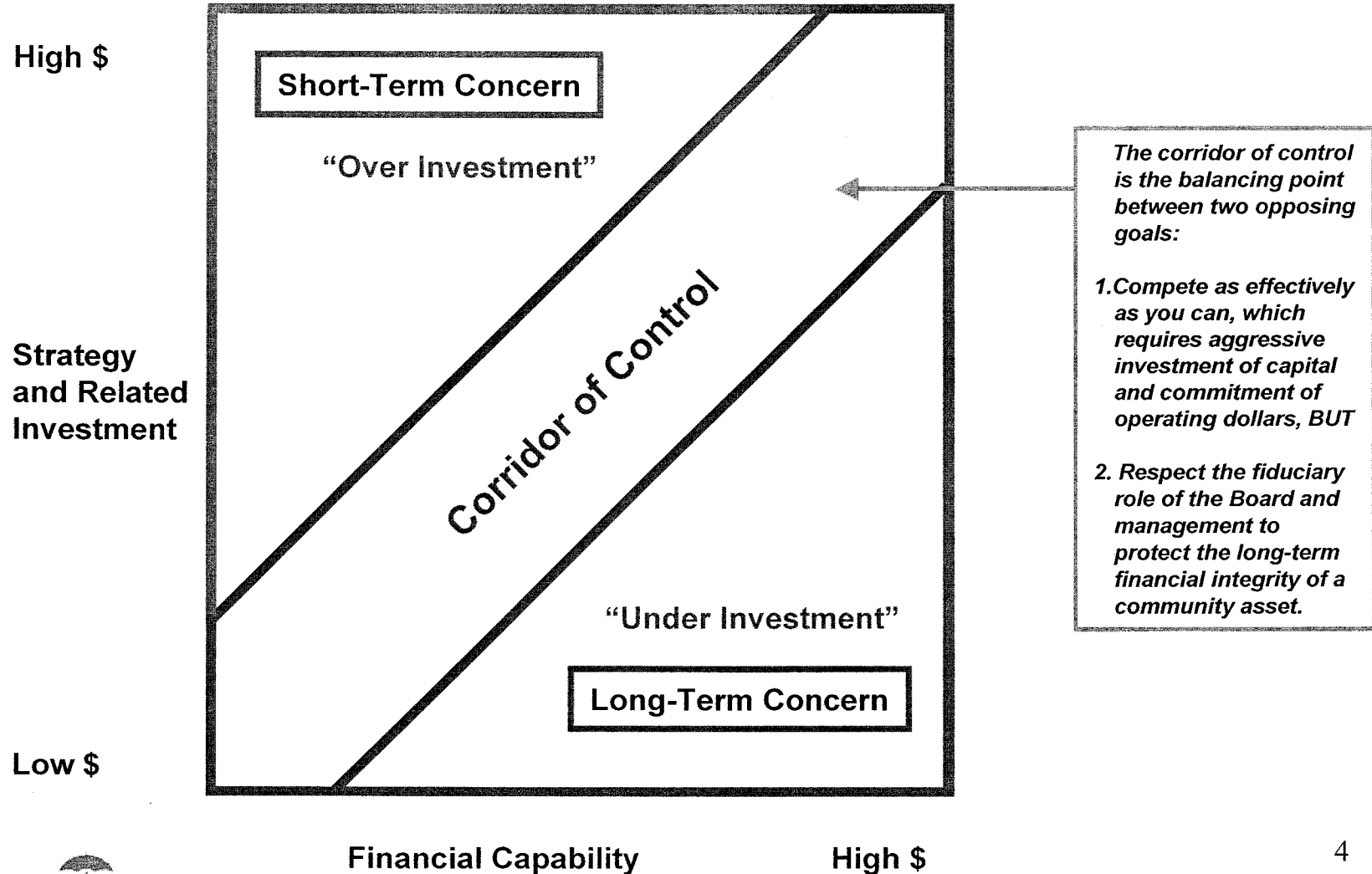
BEST PRACTICES FINANCIAL PLANNING THEMES

- Capital Management Cycle**
- Corridor of Control**
- Relationship Between the Strategic Plan and the Financial Plan**
- A Solid Financial Plan is the Backbone of a Healthcare Organization**
- Financial Road Map**

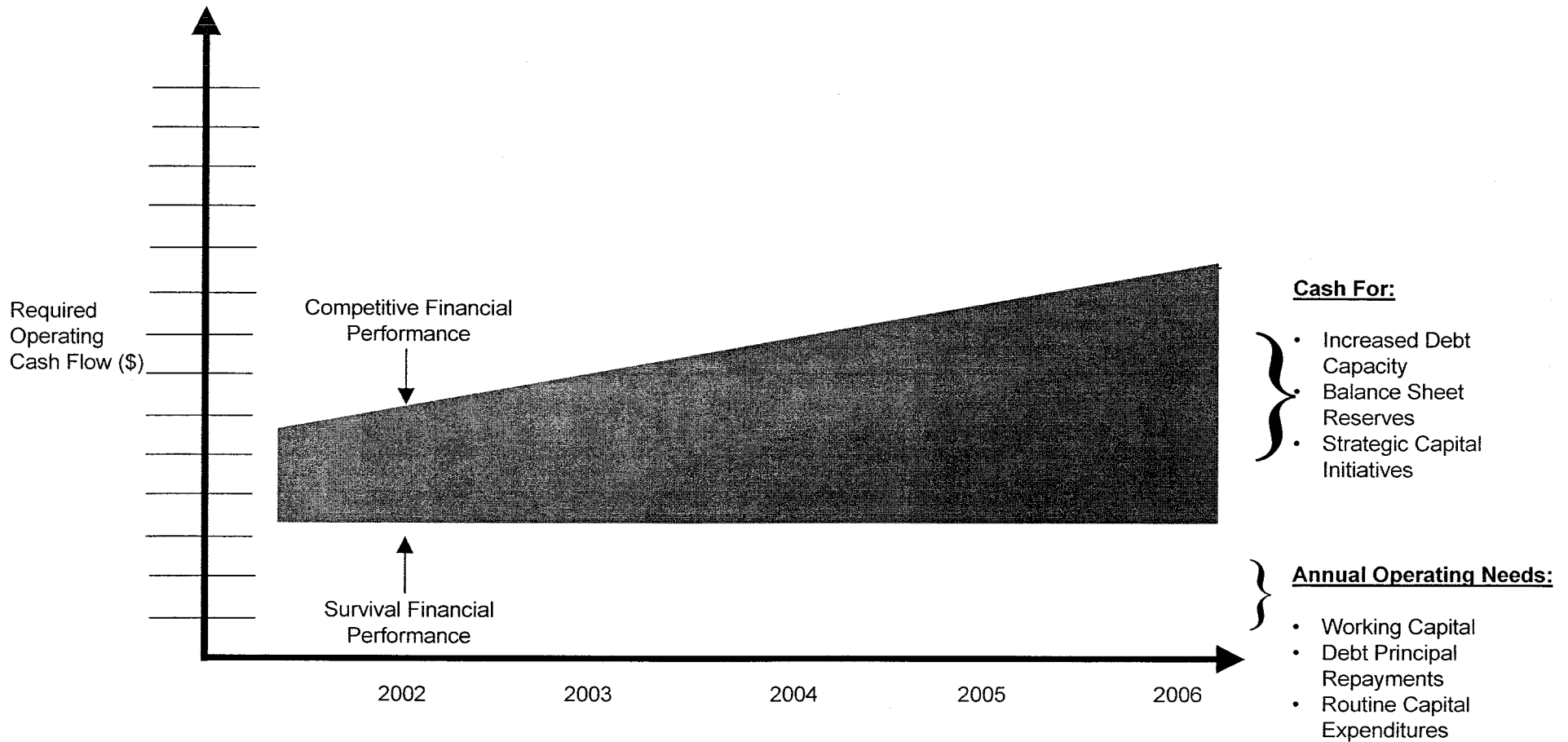
THE CAPITAL MANAGEMENT CYCLE



**THE CRITICAL RELATIONSHIPS
BETWEEN STRATEGY AND FINANCIAL CAPABILITY**



**COMPETITIVE STRATEGIES REQUIRE EXCEPTIONALLY
HIGH LEVELS OF FINANCIAL PERFORMANCE
ON A CONSISTENT BASIS**



WHY DOES PPH'S CREDIT POSITION MATTER?

- Creditworthy Organizations Have Improved Capital Market Opportunities**
 - ✓ Access to commercial banks (e.g., letters/lines of credit)
 - ✓ Access to credit enhancement (e.g., bond insurance)
 - ✓ Taxable or tax-exempt debt
 - ✓ Access to flexible financing options
 - ✓ Less restrictive bond document security provisions and operating covenants

- Creditworthy Organizations Have a Lower Cost of Capital**
 - ✓ Many institutional bond funds (typically 80%+ of the total investor market) are prohibited by their investment policies from purchasing "BBB" or lower rated debt
 - ✓ Creditworthy organization's bonds trade at lower interest rates
 - ✓ Lower issuance costs: insurance premium, letter/line of credit, underwriting/remarketing
 - ✓ Avoidance of debt service reserve fund

- Creditworthy Organizations Are Market Consolidators**
 - ✓ Nation-wide, organizations with the highest credit rating have shown the greatest ability and flexibility to react in the market

FINANCIAL CREDIT ANALYSIS HIGHLIGHTS
(\$000's)

Ratio/Statistic	Moody's "A" Rated Systems ^(A)	PPH		
		Actual 2003	Projected 2004	Budget 2005
Net Patient Revenue	\$251,290	\$292,004	\$334,909	\$370,436
Operating Income	\$5,323	\$15,210	\$14,000	\$17,498
Net Income	\$12,557	\$25,181	\$16,000	\$20,000
Net Income + Depreciation	\$29,036	\$39,712	\$30,663	\$37,604
Unrestricted Cash	\$113,899	\$161,855	\$164,488	\$178,522
Long-Term Debt	\$118,934	\$90,382	\$83,590	\$198,507
Debt Service Coverage	3.7x	3.9x	3.2 x	3.8x
Debt to Capitalization	39.5%	32.9%	29.4%	47.3%
Cushion Ratio	12.7x	13.8x	14.3x	16.0 x
Days Cash on Hand	151.9 days	209 days	196 days	194 days
Average Age of Plant	9.0 years	13.1 years	14.3 years	12.7 years
Cash-to-Debt	99.3 %	179.1 %	196.8 %	89.9 %
EBITDA Margin (operating cash flow)	9.4 %	11.4 %	10.3 %	10.9 %
Operating Margin	2.0 %	4.9 %	4.3 %	4.7%
Excess Margin	4.2 %	7.8 %	4.8 %	5.4%

Note^(A): Reflects Moody's medians for healthcare systems rated in 2003.

Note: Budget 2005 includes assumption of GO Bonds Issued consistent with MFP Construction Draws

DEFINITION OF FINANCIAL RATIOS

PROFITABILITY/CASH FLOW RATIOS:

Operating Margin:

$$\frac{\text{Operating Income}}{\text{Total Operating Revenue}}$$

Excess Margin:

$$\frac{\text{Operating Income} + \text{Non-operating Revenue}}{\text{Total Operating} + \text{Non-operating Revenue}}$$

Operating EBITDA Margin:

$$\frac{\text{Operating Income} + \text{Depreciation, Amortization and Interest}}{\text{Total Operating Revenue}}$$

DEBT RATIOS:

Historic Debt Service Coverage:

$$\frac{\text{Excess Revenue Over Expenses} + \text{Interest} + \text{Dep} + \text{Amort}}{\text{Annual Debt Service}}$$

Capitalization Ratio:

$$\frac{\text{Long-Term Debt}}{\text{Long-Term Debt} + \text{Fund Balance}}$$

LIQUIDITY RATIOS:

Days Cash on Hand:

$$\frac{\text{Cash \& Marketable Securities} + \text{Board Design. Funds}}{((\text{Total Operating Expense} - \text{Depreciation}) / 365)}$$

Cushion Ratio:

$$\frac{\text{Unrestricted Cash}}{\text{Maximum Annual Debt Service}}$$

OTHER RATIOS:

Cash to debt:

$$\frac{\text{Cash \& Marketable Securities} + \text{Board Design. Funds}}{\text{Long-Term Debt}}$$

Average Age of Plant:

$$\frac{\text{Accumulated Depreciation}}{\text{Annual Depreciation}}$$

CREDITWORTHINESS COMMENTS

Profitability and Cash Flow

Dramatic operating improvements currently over the last two years indicate a comparable rating consistent with “A” rated levels.

Debt Position

Palomar Pomerado’s leverage position is consistent with “A” rated organizations and provides ability to borrow additional debt (based on 2004 results). Restructuring debt with the plan of finance to wrap amortization in the future to achieve level debt service along with GO structure should mitigate challenges of future debt service structure.

Liquidity

The cash position (both actual dollars and days cash) is a solid credit anchor, with days cash on hand at the upper end of the range for “A” credits and continues to grow.

***THE ESSENTIAL QUESTIONS OF CORPORATE FINANCE
RELEVANT TO PALOMAR POMERADO HEALTH***

1. How much cash should Palomar Pomerado Health have?
2. How much debt can Palomar Pomerado Health afford?
3. What are Palomar Pomerado Health's capital requirements?
4. What is the magnitude of Palomar Pomerado Health's capital shortfall?
5. What short- and long-term profitability targets are necessary to resolve the capital shortfall?
6. What is the level of expense control or revenue enhancement, if any, required?
7. Where is the capital going to come from in the short-term over the next two years: debt, operations, philanthropy and/or cash reserves?

PALOMAR POMERADO PROJECT EXPENDITURES
(\$000's)

Cashflow Projection										
Palomar Pomerado Health Expansion & Replacement Project										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
QTR										
1	0	4,085,554	18,479,487	9,149,713	30,721,261	51,948,770	43,255,425	10,565,474	10,941,299	3,976,599
2	0	4,085,554	19,952,820	6,218,113	40,157,982	53,793,944	35,045,806	7,963,610	10,086,003	2,067,635
3	2,280,000	41,145,078	19,077,840	25,256,339	49,518,545	40,180,963	22,271,287	10,049,422	8,000,191	1,809,632
4	1,327,027	10,911,578	9,558,007	31,797,757	50,644,304	39,356,417	10,248,695	11,594,468	5,605,369	1,821,011
	3,607,027	60,227,763	67,068,153	72,421,921	171,042,092	185,280,095	110,821,214	40,172,973	34,632,863	9,674,876

754,948,977

Summary

Palomar Medical Center - New Campus	\$531 million
Palomar Medical Center - Existing Campus	73
Pomerado Hospital - New Construction	139
Satelite Centers	<u>12</u>
TOTAL CAPITAL EXPENDITURES	<u>\$755 million</u>

INCREMENTAL DEBT CAPACITY OVERVIEW

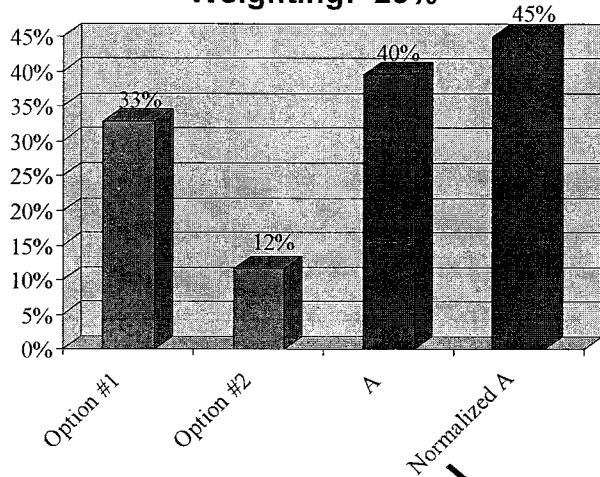
- ❑ **A Debt Capacity Analysis Compares Certain Financial Ratios to Specific Ratings Agency Median Targets**
 - ✓ Moody's 2003 "A" level Medians were used as the targets
 - ✓ The debt capacity was also performed against normalized Moody's ratios which better reflect the marketplace

- ❑ **Two Options Were Analyzed to Determine Debt Capacity**
 - 1. Option #1 – Base Case**
 - ✓ 2003 audited financial data
 - ✓ Assumed a restructuring of the existing indebtedness
 - Lowers Maximum Annual Debt Service to \$5.4 million
 - ✓ Assumes no financial benefit from the general obligation bond issue

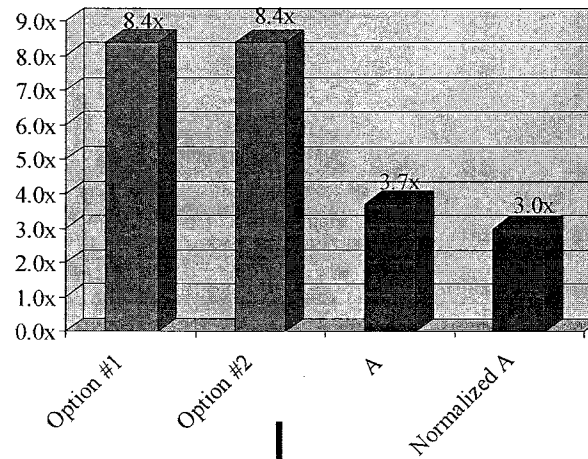
 - 2. Option #2 - Base Case + Benefit of general obligation bond issue**
 - ✓ Same assumptions as base case
 - ✓ Includes an increase of \$496 million to Unrestricted Net Assets from the proposed general obligation bond issue

IMPLIED CAPACITY IS A FUNCTION OF LEVERAGE, LIQUIDITY AND -- MOST IMPORTANTLY -- CASH FLOW RATIOS, COMPARED TO RATING AGENCY MEDIANS AT A SPECIFIC RATING LEVEL

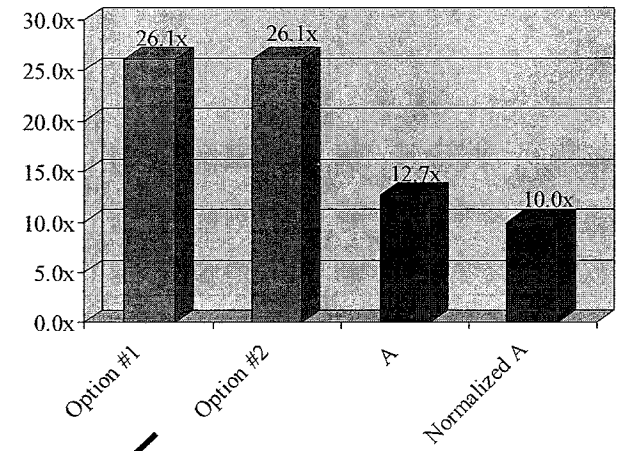
Debt-to-Capitalization
Weighting: 25%



Debt Service Coverage
Weighting: 50%



Cushion Ratio
Weighting: 25%



	<u>"A"</u>	<u>Normalized "A"</u>
Option #1	\$ 95,000,000	\$ 150,000,000
Option #2	\$ 177,000,000	\$ 252,000,000

**CALCULATION OF MINIMUM CASH RESERVE
DAYS CASH ON HAND METHODOLOGY
(\$000s)**

	Existing Approximate Days Cash	National Strong "A" Levels	National Lower "A" Levels
Estimated 2014 Cash Operating Expenses	\$573,957	\$490,837	\$490,837
per day	\$1,572.49	\$1,345	\$1,345
Days Cash on Hand Target	195	200	160
2014 Cash Target	\$306,634	\$269,000	\$215,161

2004 Preliminary Unrestricted Cash Reserve:

\$178,522 (195 days cash)

CAPITAL POSITION ANALYSIS 2005-2014
(\$ in millions)

Uses of Cash (2005 - 2014)	
Routine	\$142.0
Strategic Capital (inc. capitalized interest)	<u>780.7</u>
Total Capital Expenditures	922.7
Funding of Min. Cash Position (2014) - 195 Days	306.6
Principal Payments on Existing Debt	95.8
Working Capital	17.1
Total Capital Uses	\$1,342.2

Sources of Cash	
Unrestricted Cash (2005)	\$178.5
Revenue Bonds	210.0
General Obligation/BAN's	496.0
Total Capital Sources	\$884.5

Required 10-Year Cash Flow from Operations	(\$457.7)	\$45.8 Per Year
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2005 Budgeted Operating Cash Flow:	\$40.4
2004 Actual Operating Cash Flow:	\$34.4
2003 Actual Operating Cash Flow:	\$35.6
Avg. Annual 2005 – 2014 Operating Cash Flow	\$59.3

SUMMARY OF ALTERNATIVE FUNDING SCENARIOS TO SUPPORT THE PROJECT RELATED CAPITAL

Funding Sources Opportunities:

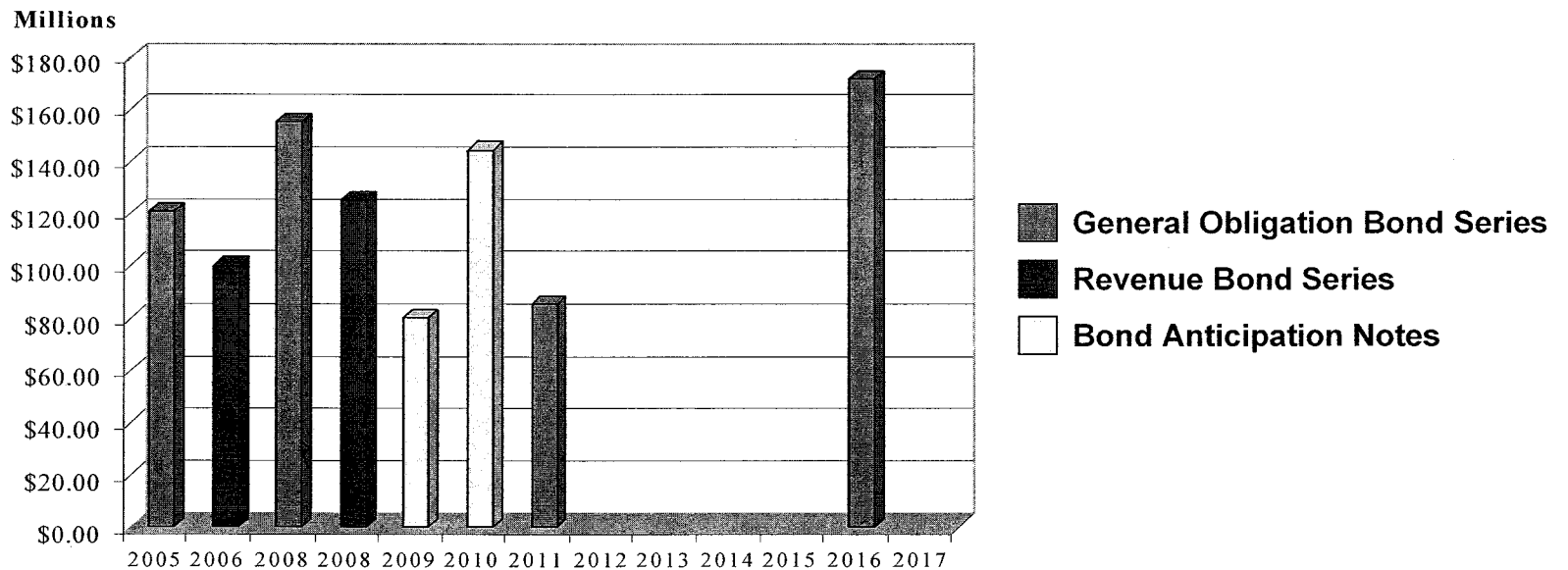
- ✓ **General Obligation Bonds**
- ✓ **Revenue Bonds**
- ✓ **Cash Reserves**
- ✓ **Philanthropy**

INTEGRATED PLAN OF FINANCE

- Passage of General Obligation Bond Measure**
- Restructure Existing Capital Structure (Debt) and Issue Revenue Bonds (Employing a Stand Alone Credit Rating)**
- Issue General Obligation Bonds, Revenue Bonds and Bond Anticipation Notes; Timed to meet Construction Draw Requirements**
- Integration of Plan components is Critical**
- AT THE END OF THE DAY....**
 - ✓ **\$496 Million of General Obligation Bonds**
 - ✓ **\$210 Million of Revenue Bonds**
 - ✓ **\$70 Million Combination of Cash From Operations/Philanthropy**
 - ✓ **\$83 Million of Restructured Existing Debt**

INTEGRATED PLAN OF FINANCE

- Issue Revenue Bonds in Conjunction with General Obligation Bonds
 - ✓ Meet projected construction draw schedule without undue delay
 - ✓ Alleviate burden on taxpayers
- Revenue Bonds issued in 2006 and 2008



INTEGRATED PLAN OF FINANCE

- Issue four tranches of General Obligation Bonds**
 - ✓ **2005, 2008, 2011 and 2016**

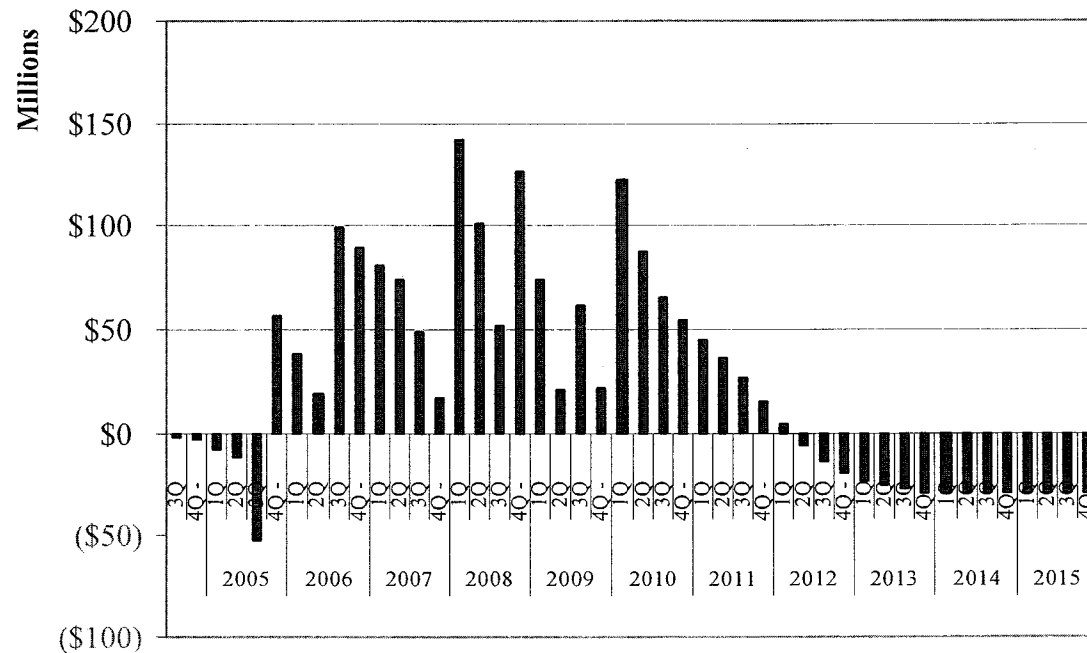
- Issue Bond Anticipation Notes**
 - ✓ **2009 BAN repaid with 2011 Bond issue**
 - ✓ **2010 BAN repaid with 2016 Bond issue**

- Total General Obligation Bond Authorization equals \$496 million**

- Projected tax equals \$17.75 per \$100,000 of assessed valuation**
 - ✓ **Assumes PPH issues thirty-year bonds for each tranche**
 - ✓ **Tax base grows at an average of 6.1% per year**
 - ✓ **Assessed Valuation for FY 2004-2005 equals \$46.031 Billion**

CAPITAL PROJECTS CASH FLOW

- Combination of General Obligation Bonds, Revenue Bonds and Bond Anticipation Notes meets the timing of PPH’s capital needs
 - ✓ Revenue Bonds and BANs are key components
 - ✓ Over \$100 million of PPH’s projects not eligible to be funded with General Obligation Bond proceeds
 - ✓ Hospital District cash flow and or philanthropy to cover remaining project funding



**FINANCIAL PLAN PROJECTION SUMMARY ASSUMING
INTEGRATED PLAN OF FINANCE FOR \$755M OF
FACILITIES MASTER PLAN CAPITAL PROJECTS
(\$000s)**

Ratio/Statistic	Moody's A	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Operating Cashflow	\$29,036	\$40,379	\$47,639	\$47,897	\$48,164	\$47,324	\$59,717	\$73,071	\$74,685	\$76,029	\$77,700
Net Income	\$12,557	\$20,000	\$39,981	\$39,388	\$39,766	\$27,657	\$26,924	\$21,413	\$21,089	\$23,534	\$27,809
Unrestricted Cash	\$113,899	\$178,522	\$213,240	\$245,226	\$276,385	\$287,681	\$308,887	\$353,444	\$396,756	\$443,722	\$494,174
Long-Term Debt	\$118,934	\$198,507	\$295,447	\$282,872	\$564,561	\$633,746	\$763,806	\$748,116	\$733,561	\$717,741	\$700,926
Excess Margin	4.2%	5.4%	9.8%	9.2%	8.8%	5.9%	5.2%	3.8%	3.6%	3.8%	4.2%
Debt Service Coverage	4.3	3.8x	4.9x	3.5x	2.9x	2.7x	3.0x	2.6x	2.5x	2.6x	2.7x
Operating EBITDA Margin	9.4%	10.9%	12.2%	11.7%	11.3%	10.5%	12.0%	13.6%	13.2%	12.8%	12.4%
Debt to Capitalization	39.5%	47.3%	53.1%	48.5%	62.4%	63.3%	65.9%	64.3%	62.7%	60.9%	58.9%
Cushion Ratio	12.7	16.0x	15.9x	13.2x	11.4x	11.1x	11.1x	9.5x	9.7x	11.4x	12.4x
Days Cash On Hand	151.9	194.3	222.1	243.2	257.8	250.7	248.0	265.6	281.3	298.6	314.5
Average Age of Plant	9.0	12.7	13.2	13.7	14.3	12.7	8.5	7.5	8.3	9.3	10.3
Cash to Debt	72.2%	86.7%	72.2%	86.7%	49.0%	45.4%	40.4%	47.2%	54.1%	61.8%	70.5%

PRELIMINARY ISSUES/CONCLUSIONS

- Funding the project with \$496 Million of General Obligation Bonds and \$210 Million of Revenue Bonds and \$70 million of Cash / Philanthropy provides the most ideal financial planning scenario;**
 - ✓ **General Obligation Bond proceeds provide approximately 2/3 of the funding. District Resources provide 1/3 of the funding.**
 - ✓ **Projected tax levy of less than \$1.50 per month per \$100,000 of assessed value**
 - ✓ **Use of Revenue Bonds protect and enhance the balance sheet, and operational assumptions support incremental depreciation.**

- Use of Cash Reserves and Philanthropy combined are necessary components to the sources of funding for completion of the capital projects identified in the Master Facility Plan.**

NEXT STEPS

- Approve Plan of Finance – July 29, 2004**
- Board Resolution to Place General Obligation Bond Measure on Election Ballot – August 4, 2004**
- General Obligation Bond Measure Election**
- Issue 1st Tranch of General Obligation Bonds - Spring 2005**
- Preparation for Issuance of Revenue Bonds**