Information from the Division of Health Care Finance and Policy

Quarterly Acute Hospital Financial Report, FY05 Q1

Overall, the financial health of the hospital industry remained fairly stable in FY05 Q1. Total profitability improved for the middle and upper quartile hospitals, but deteriorated somewhat for the lower quartile. While close to fifty percent of the state's acute care hospitals operated at a loss, improved non-operating performance helped to mitigate these losses, with more than half of the hospitals reporting higher non-operating gains. The industry demonstrated slightly improved liquidity, with nearly all hospitals comfortably able to meet short-term obligations. In addition, solvency improved for most of the industry; however, the ability to cover long-term obligations remained a serious concern for more than a quarter of Massachusetts hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes quarterly acute hospital financial reports in response to a legislative mandate to provide an annual assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to better protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis of from FY01 through FY05 Quarter 1 (Q1).[1] Financial trends for individual hospitals are on each hospital's Fact Sheet in the DHCFP Data Catalog at www.mass.gov/dhcfp.

Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly basis and discussed in this report are profitability, liquidity, and solvency.[2]

Profitability

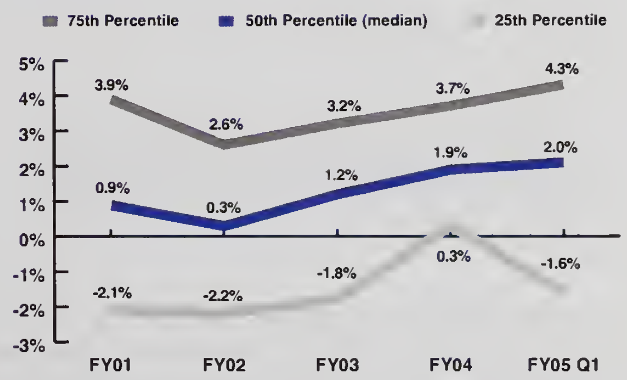
Although most Massachusetts acute care hospitals are nonprofit, they do need to generate a sufficient surplus in order to complete their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY01 through FY05 Q1 trends for 25th, 50th (median) and 75th quartile values[3] for Total Margin,[4] Operating Margin,[5] and Non-operating Margin.[6]

Total profitability increased for the middle and upper quartiles in FY05 Q1, but fell below zero (-1.6%) for the lowest quartile. Operating performance also declined across the industry in FY05 Q1, but was favorable compared to FY04 Q1 (see Figure 2). Non-operating gains increased across all quartiles (see Figure 3), mitigating some of these operating losses.

Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indication of financial stress. Three liquidity ratios are reported here:

Figure 1
Total Margin Trend, FY01-FY05 Q1



- **Overall profitability remained fairly stable for the industry in FY05 Q1; total profitability improved for the middle and upper quartiles, but deteriorated somewhat for the lower quartile hospitals.**

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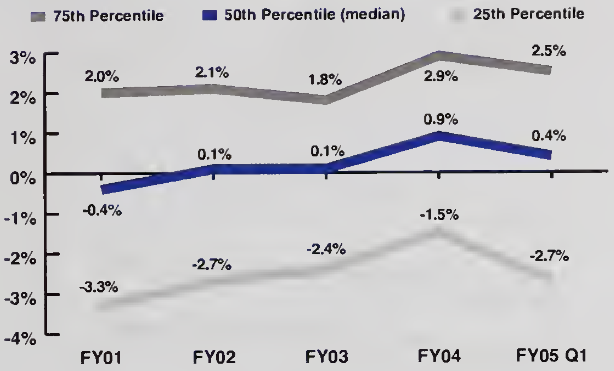
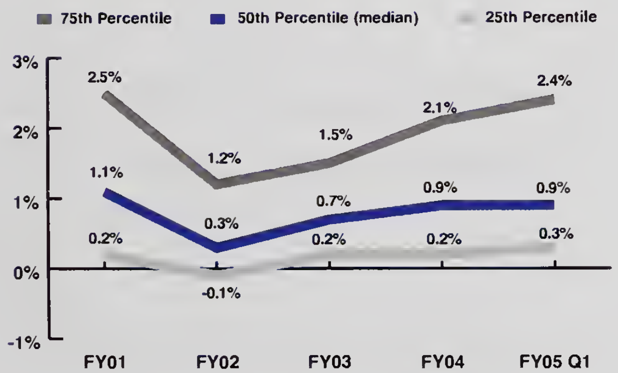
Figure 2
Operating Margin Trend, FY01-FY05 Q1



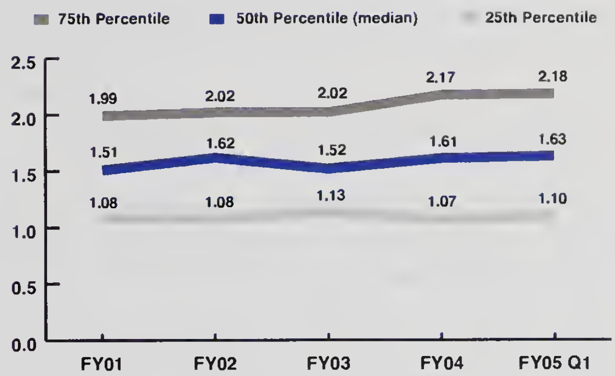
- While operating performance dipped somewhat relative to FY04 for all three quartiles, the FY05 Q1 performance was favorable compared to FY04 Q1.

Figure 3
Non-operating Margin Trend, FY01-FY05 Q1



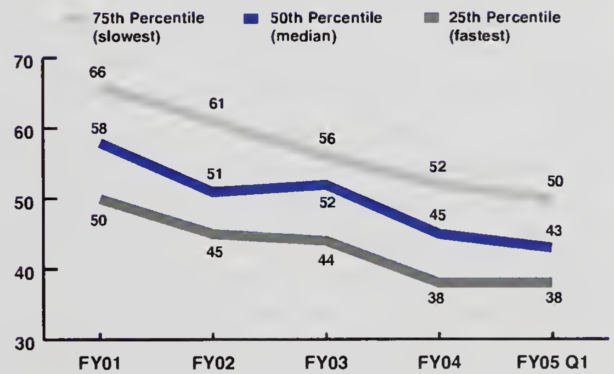
- Fueled by improved market conditions, Non-operating Margins improved across all quartiles. No hospitals reported non-operating losses in FY05 Q1.

Figure 4
Current Ratio Trend, FY01-FY05 Q1



- Current Ratio improved slightly across the industry. A majority of hospitals (79%) maintained Current Ratios above the 1.0 benchmark in FY05 Q1.

Figure 5
Days in Accounts Receivable Trend, FY01-FY05 Q1



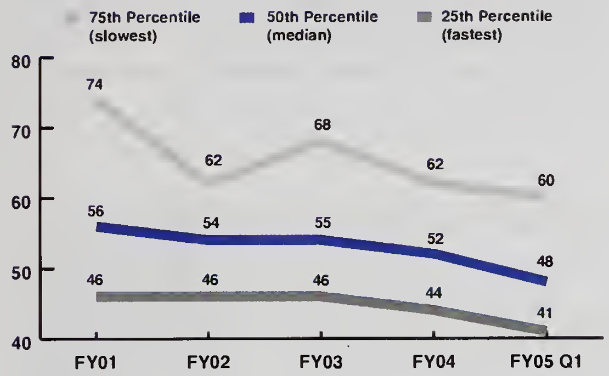
- Continuing the industry's positive trend since FY00, hospitals continued to improve collection of receivables in FY05 Q1. Median Days in A/R decreased by two days over FY04.

Current Ratio,[7] Average Days in Accounts Receivable (A/R),[8] and Average Payment Period.[9] Figures 4, 5, and 6 show trends in quartile values for these three ratios.

The majority of hospitals demonstrated more favorable short-term liquidity in FY05 Q1 over FY04 and a stronger ability to meet current obligations. Current Ratio improved for most of the industry, with the majority of hospitals (79%) performing above the 1.0 minimum benchmark and all quartiles showing increases in FY05 Q1 (see Figure 4).[10] In addition, the industry showed more efficient management of Days in A/R (see Figure 5) and improvement in the average time to pay current liabilities (Average Payment Period, see Figure 6) across all quartiles. Nearly a fifth of hospitals, however, are paying current obligations at a faster rate than they are collect-

Figure 6

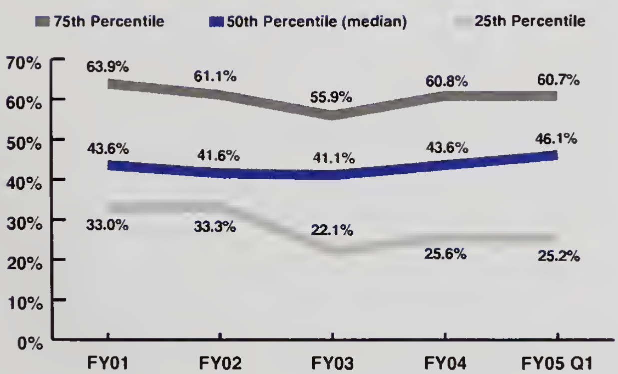
Average Payment Period Trend in Days, FY01-FY05 Q1



- **Average Payment Period decreased across all quartiles in FY05 Q1; however, nearly a fifth of hospitals paid current obligations at a faster rate than they collected receivables.**

Figure 7

Equity Financing Trend, FY01-FY05 Q1



- **Equity Financing Ratios improved slightly for most of the industry in FY05 Q1; however, over a quarter of the hospitals were below the 30% benchmark. The highly leveraged position of some hospitals may make future asset acquisition difficult for this group.**

ing payments; this could lead to cash flow constraints for this group of hospitals in the future.

Solvency

Solvency ratios provide information regarding both how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. Solvency ratios of Debt Service Coverage and Cash Flow to Total Debt are not included in this report because annualized data are necessary to accurately present these ratios. For quarterly analysis, only one solvency ratio is reported: Equity Financing.[11]

The Equity Financing ratio, measured by the proportion of total assets financed by equity, reflects the ability of a hospital to take on more debt. Low values indicate that a hospital is highly leveraged, and therefore, may have difficulty securing access to debt financing for further asset acquisition. Equity Financing improved for the majority of hospitals in FY05 Q1 compared to FY04; however this ratio was below the 30% industry benchmark for more than a quarter of the hospitals, indicating long-term solvency issues for this group.

Teaching versus Non-teaching Hospitals

The Division also examines the financial health of teaching and non-teaching hospitals using financial ratio analysis. In terms of profitability, teaching hospitals outperformed non-teaching hospitals, with a lower percentage of teaching hospitals experiencing overall losses. Non-teaching hospitals showed some improvement in non-operating performance; however, a larger percentage reported operating losses in FY05 Q1 versus FY04 (51% versus 43%).

Teaching hospitals showed a slightly stronger liquidity position compared to non-teaching hospitals. On average, Current Ratio was higher for teaching hospitals; but a higher percentage (33%) of teaching hospitals had Current Ratios below the minimum industry benchmark of 1.0 (compared to 19% of non-teaching hospitals). Both teaching and non-teaching hospitals exhibited comparable improvement in collecting receivables due and paying current obligations.

Non-teaching hospitals may have more difficulty meeting interest and principal payments in the upcoming year as nearly a third were below the 30% benchmark for Equity Financing in FY05 Q1. Although non-teaching hospitals were slightly more leveraged than teaching hospitals, no improvements in Equity Financing were found for either group in the first quarter of FY05.

Summary

Overall profitability remained fairly stable for a majority of the industry in FY05 Q1, although one-third of the hospitals experienced total losses. Dips in operating performance were mitigated by gains in non-operating performance. Overall, the industry demonstrated slightly improved liquidity, with nearly all hospitals comfortably able to meet short-term obligations. In addition, solvency improved for most of the industry; however, the ability to cover long-term obligations remained a serious concern for over a quarter of Massachusetts hospitals.

Financial ratio values for each hospital are on the Hospital Fact Sheets in the Division of Health Care Finance and Policy Data Catalog at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Hospital Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

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[1] The findings in this report are based on the financial filings of 63 acute care hospitals. Three hospitals (Mercy, MetroWest, and St. Vincent) have a fiscal year that ends on December 31, thus FY05 Q1 data were unavailable at the time of this analysis. Salem and Union hospitals are no longer reported individually since North Shore Medical Center now includes both Salem and Union Hospital information.

[2] Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

[3] Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one-quarter of the hospitals at the low end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the high end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median, or the center of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

[4] Ratio of total income to total revenue.

[5] Ratio of operating income to total revenue.

[6] Ratio of non-operating income to total revenue.

[7] Ratio of current assets to current liabilities.

[8] Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

[9] Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

[10] A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered strongly unfavorable and highlight an organization's illiquid position.

[11] Ratio of total net assets to total assets.

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