

TO: Interested Parties

FROM: Lynn Green, Director of Financial Reporting

SUBJ: Management Discussion and Analysis
Fiscal 2016 Compared to Fiscal 2015

DATE: February 17, 2017

SUMMARY

Net income for fiscal 2016 was \$109.0 million, more than last year's net income by \$19.5 million (21.8%). The net income margin was 7.6% compared to 7.1% last year. Net income for this year and last includes unfavorable changes in the market value of the interest rate SWAP of \$13.2 million and \$17.2 million, respectively. Excluding the change in the unrealized SWAP valuations, net income was \$122.1 million this year compared to \$106.7 million last year. The net income margin would be 8.4% compared to 8.3% last year. Income from operations was \$128.0 million, less than last year by \$29.0 million (18.6%). The operating income margin was 8.9% compared to 12.0% last year.

Total operating revenue exceeded last year by \$129.5 million (9.9%), because of volume growth, favorable payor mix, managed care rate increases, increased Medicaid Waiver UC and Medicaid DSH payments recognized, expansion of the 340B drug program, and addition of a new joint ventured hospital in Southlake (\$11.4 million), offset by greater charity and bad debts and lower Medicaid Waiver DSRIP payments recognized. Charity and bad debts as a percentage of non-governmental business was more than last year (1.7%).

Patient volume was greater than last year. The number of patients in beds increased over last year; however, there was a decrease in the number of patients whose status is determined to be inpatient while there was an increase in the number assigned observation status. The status change is occurring as a result of Medicare redefining inpatient status assignment for Medicare patients resulting in greater assignment to outpatient status.

- The number of inpatients (excluding observation patients) was less than last year (1.7%).
- Inpatient days (excluding observation and newborn border days) were greater than last year (0.1%).
- Equivalent inpatients exceeded last year by 3.7%.
- Equivalent inpatient days exceeded last year by 5.6%.
- The number of observation patients exceeded last year by 54.9%.

MANAGEMENT DISCUSSION AND ANALYSIS FY16 Compared to FY15 (Continued)

- The number of observation days of care exceeded last year by 44.3%.
- Emergency Department visits increased from last year (1.7%).
- Outpatient visits increased from last year (2.8%).

Operating expenses exceeded last year by \$158.8 million (13.7%) attributable to patient volume growth, inflation, increased recognition of community benefit expense associated with the Medicaid Waiver program, increased 340b drug expense, an increased number of employees, increased depreciation on the new Mansfield bed tower (\$7.7 million) , and expenses of a new joint ventured hospital in Southlake (\$17.0 million).

Non-operating income, excluding unfavorable changes in interest rate SWAP valuations of \$13.2 million this year and \$17.2 million last year, was a gain of \$15.3 million compared to a loss of \$32.8 million last year. Non-operating income includes interest expense of \$24.7 million compared to \$22.6 million last year, and investment gains of \$38.9 million compared to losses of \$11.6 million last year.

Net income attributable to non-controlling interests is \$21.1 million this year compared to \$17.8 million last year.

METHODIST HEALTH SYSTEM
SUPPLEMENT TO THE AUDITED FINANCIAL STATEMENTS

	<u>2016</u>	<u>2015</u>
Licensed beds	1,697	1,465
Beds in service	1,165	1,104
Admissions	50,742	51,607
Patient days	257,995	257,681
Observation cases	25,614	23,226
Observation days	89,711	74,089
Average length of stay (days)	5.1	5.0
Emergency room visits	251,796	247,616
Surgeries - inpatient	13,358	13,323
Surgeries - outpatient	19,365	16,079
Gross outpatient revenue as a % of total gross patient revenue	49.5%	46.9%
Payor Mix by Gross Revenue:		
Medicare	43.0%	42.6%
Medicaid	10.1%	11.3%
Managed Care	33.9%	33.1%
Self-pay and other	13.0%	13.0%