

TO: Interested Parties

FROM: Lynn Green, AVP of Financial Reporting

SUBJ: Management Discussion and Analysis
Fiscal 2017 Compared to Fiscal 2016

DATE: February 20, 2018

SUMMARY

Net income for fiscal 2017 was \$132.2 million compared to \$109.0 million last year. The net income margin was 8.3% compared to 7.6% last year. Net income for this year includes favorable changes in the market value of the interest rate SWAP of \$19.3 million compared to \$13.2 million unfavorable last year. Excluding the change in the unrealized SWAP market valuation, net income was \$113.0 million this year compared to \$122.1 million last year. The net income margin, excluding SWAP, was 7.2% compared to 8.4% last year. Income from operations was \$102.8 million compared to \$127.9 million last year. The operating income margin was 6.7% compared to 8.9% last year.

Total operating revenue exceeded last year by \$95.1 million (6.6%), because of volume growth, rate increases, and a full year of operations at our joint ventured hospital in Southlake (\$41.9 million), offset by increased denials, increased charity and bad debts, lower Medicaid Waiver and Medicaid Disproportionate Share payments recognized, and reduced 340-B drug program revenue. Charity and bad debts represented approximately 34.2% of non-governmental revenue, 1.1 points greater than last year (3.2%).

Patient volume was greater than last year. The number of patients in beds increased by 2.7%. Recent process changes affected the mix of inpatient and observation cases. During the fiscal year patients classified as inpatient grew while there was a decrease in patients classified as observation.

- The number of inpatients (excluding observation patients) exceeded last year by 6.7%.
- Inpatient days (excluding observation and newborn days) exceeded last year by 4.2%.
- Equivalent inpatients exceeded last year by 2.7%.
- Equivalent inpatient days were less than last year by 0.1%.
- The number of observation patients was less than last year by 5.2%.
- The number of observation days of care exceeded last year by 2.6%.

MANAGEMENT DISCUSSION AND ANALYSIS FY17 Compared to FY16 (Continued)

- Emergency Department visits increased from last year by 1.8%.
- Outpatient visits was lower than last year by 4.0%.

Operating expenses exceeded last year by \$120.2 million (9.2%) because of volume growth, inflation and a full year of operations at our joint ventured hospital in Southlake (\$28.7 million). Salaries, wages, and benefit costs increased due to patient volume growth and additional temporary costs related to the conversion to Epic software (\$66.0 million). Patient care supply expense increases (\$34.9 million) were consistent with overall revenue growth for the year. Depreciation expense increased (\$9.1 million) as a result of capital expenditures during the year, the largest being Epic software.

Non-operating income, excluding favorable changes in interest rate SWAP valuations of \$19.3 million this year compared to \$13.2 million last year, was a gain of \$39.8 million compared to \$15.2 million last year. Non-operating income includes interest expense of \$30.2 million compared to \$25.2 million last year, and investment gains of \$73.4 million compared to \$38.9 million last year. Also included are losses on subsidiaries and unconsolidated joint ventures of \$5.0 million compared to \$2.2 million last year.

Net income attributable to non-controlling interests is \$29.7 million this year compared to \$21.1 million last year.

METHODIST HEALTH SYSTEM
SUPPLEMENT TO THE AUDITED FINANCIAL STATEMENTS

	<u>2017</u>	<u>2016</u>
Licensed beds	1,697	1,697
Beds in service	1,276	1,165
Admissions	54,132	50,742
Patient days	268,896	257,995
Observation cases	24,274	25,614
Observation days	59,434	57,922
Average length of stay (days)	5.0	5.1
Percentage occupancy (based on beds in service)	70.5%	74.3%
Emergency room visits	256,230	251,796
Surgeries - inpatient	14,355	13,358
Surgeries - outpatient	22,076	19,365
Gross outpatient revenue as a % of total gross patient revenue	47.6%	49.5%
Payor Mix by Gross Revenue:		
Medicare	42.3%	43.0%
Medicaid	10.0%	10.1%
Managed Care	34.8%	33.9%
Self-pay and other	12.9%	13.0%