

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY
VALLEY MEDICAL CENTER
Management's Discussion and Analysis
March 31, 2013 and 2012
(unaudited)

Public Hospital District No. 1 of King County, Washington (the District), doing business as Valley Medical Center (VMC), is a full-service, public hospital serving over 400,000 District residents. Licensed for 303 beds, VMC has approximately 2,800 employees, including approximately 130 employed physicians, and is the largest nonprofit healthcare provider between Seattle and Tacoma. In addition to the hospital, VMC operates a network of more than two dozen primary care, urgent care, and specialty clinics throughout Southeast King County.

On July 1, 2011, VMC became the eighth member of UW Medicine through an approved strategic alliance agreement executed between the District and UW Medicine. The District continues to own the hospital, the clinic network, and all other assets and liabilities, and all employees are employees of VMC/the District. VMC is managed as a component unit of the University of Washington, subject to the oversight of the Board of Trustees (the Valley Board). The Valley Board oversees the healthcare operations of the District, while a publicly elected Board of Commissioners (the District Board) oversees the District's property taxes and certain non-healthcare related functions.

Summary of Revenue and Expense

The financial statements for the nine months ended March 31, 2013 compared to the nine months ended March 31, 2012, respectively, have been prepared by VMC's management. The unaudited financial information includes all adjustments that VMC's management considers necessary for a fair presentation of the financial position and results of operations for these periods.

The District changed its fiscal year from a December 31 year-end to a June 30 year-end, effective with the year ending June 30, 2012. Consequently, this Management's Discussion and Analysis discusses the nine months spanning July 1, 2012 through March 31, 2013.

Operating Income and Margin; Total Income and Margin

VMC's net operating loss through March 31, 2013 was (\$17.0 million), and an operating margin of (5.1%) year-to-date. The primary reasons for the loss were approximately \$20.0 million in operating expenses related to the implementation of the EPIC electronic health record information technology system throughout the organization, as well as weaker than anticipated patient volumes through much of the third quarter.

Prior year's year-to-date performance was net operating loss of approximately \$(2.5 million), or a (.8%) operating margin. The District's total loss was just under (\$16.0 million), with a total margin of (4.8%), compared to prior year's total income of \$1.1 million and .3% total margin.

Revenues

VMC's total operating revenues increased by 4.4% from approximately \$316.6 million for the nine months ended March 31, 2012 to \$330.5 million for the nine months ended March 31, 2013.

Net patient revenues increased 3.4% from \$299.5 million for the nine months ended March 31, 2012 to \$309.6 million for the nine months ended March 31, 2013. Total patient days increased 5.6%. Surgeries decreased just under 1%. Emergency department visits were essentially even with prior year. Births increased 14.4%, respectively, over prior year. Clinic network visits (primary, urgent, and specialty care) increased 8.2% between years.

Other operating revenue increased 22.3% from \$17.1 million for the nine months ended March 31, 2012 to \$20.9 million for the nine months ended March 31, 2013, due primarily to increased revenue from the outpatient and contracted pharmacies.

Expenses

Total operating expenses increased 8.9% from \$319.1 million for the nine months ended March 31, 2012 to \$347.5 million for the nine months ended March 31, 2013. The increase in salary and wages between years is primarily related to the patient volume increases, as well as the implementation of EPIC. Employee benefits are correlated to salaries and wages; therefore, a portion of the employee benefit increase is related to the increased labor required by increased volumes and utilization.

Salaries and wages increased 6.3% from \$143.7 million for the nine months ended March 31, 2012 to \$152.7 million for the nine months ended March 31, 2013. The increase is primarily related to patient volume increases, as well as additional staffing required for the implementation of EPIC, which went live in two phases: July 1, 2012 for the clinic network and October 1, 2012 for the hospital.

Employee benefits increased 15.5% between years. Employee benefits are correlated to salaries and wages; therefore, a significant portion of the increase is related to the increased labor required by increased volumes. There has also been an increase in enrollees over prior year, and utilization, particularly medical, has increased year over year.

Supply and related expenses, such as purchased services, increased 11.9% from \$107.9 million to \$120.7 million between respective March 31 years-to-date figures. Much of the increase (approximately \$10.0 million) is due to consulting and purchased services expense related to the EPIC implementation, as well as increases in medical and pharmaceutical supply expense due to increased volumes during the first six months of the year.

Depreciation expense is essentially flat between respective March 31 time periods.

Non-Operating Income and Expense

On a year-to-date basis, tax revenues decreased 11.8%, from \$13.9 million in fiscal year 2012 to \$12.3 million in fiscal year 2013. The District was notified in late January 2013 by the King County Assessor's Office that the District-approved tax levied amount of approximately \$18.5 million would be statutorily reduced in calendar year 2013 to approximately \$16.1 million, due primarily to reductions in assessed property valuations within the District.

Interest and amortization expense increased 1.5% from \$13.3 million at March 31, 2012 to \$13.5 million at March 31, 2013 and directly corresponds to scheduled long term debt/bond payments.

Balance Sheet/Financial Position

Total current assets increased by 1.9% from \$157.8 million at March 31, 2012 to \$160.7 million at March 31, 2013.

As of March 31, 2013, the District's unrestricted cash and investments, excluding unspent bond proceeds, were \$121.2 million compared with \$131.6 million as of March 31, 2012. Days cash on hand was 102 at March 31, 2013 compared to 121 at March 31, 2012.

Restricted unspent bond proceeds shown under non-current assets decreased 99.8% between year-to-date figures, representing the spend-down of the bonds on capital projects.

As of March 31, 2013, capital assets were \$391.0 million compared to \$371.1 million at March 31, 2012. Construction in progress decreased 41.8% from \$62.1 million to \$36.2 million. The change is due to the capitalization of the EPIC implementation, as well as the ongoing construction of the Covington medical building and the completion of the 6th and 7th floors of the Emergency Services Tower. Depreciable capital assets, net of accumulated depreciation, increased 15.5%, primarily related to the capitalization of EPIC.

Goodwill, intangible assets, and other assets, net, decreased by 9.6%, between years. The decrease was related to accumulated amortization related to goodwill.

Total current liabilities increased by 32.2%, from \$65.1 million at March 31, 2012 to \$86.0 million at March 31, 2013. The change is primarily related to deferred property tax revenue, which is now reflected in the financial statements under current liabilities.

Long-term debt decreased by 2.5%, from \$333.5 million at March 31, 2012 to \$325.2 million at March 31, 2013. The \$8.3 million decrease is due to repayment of principal.

Valley Medical Center
BALANCE SHEET
For the Nine Months Ending March 31, 2013

	March 03/31/13	March 03/31/12
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$29,976,109	\$19,647,680
Short-term investments	18,303,878	17,238,230
Restricted unspent bond proceeds	2,555,925	6,952,015
Accounts receivable, less allowance for uncollectible accounts	55,207,157	55,372,308
Property tax receivable	15,836,299	16,683,620
Noncurrent assets, required for current obligations	25,887,855	27,130,260
Supplies inventory	4,350,553	4,952,287
Prepaid expenses and other assets	8,624,988	9,809,939
	160,742,765	157,786,338
LONG-TERM INVESTMENTS	23,959,370	26,747,004
NONCURRENT ASSETS		
Unrestricted for general capital improvements and operations	49,128,964	67,948,871
Restricted for self-insurance reserve funds	6,732,509	2,656,488
Restricted unspent bond proceeds	67,859	27,350,681
Restricted under deferred compensation arrangements	3,583,415	3,594,334
Restricted under revenue bond indenture agreements	7,484,022	7,347,091
	66,996,768	108,897,464
Less amounts required for current obligations	(25,887,855)	(27,130,260)
	41,108,913	81,767,204
CAPITAL ASSETS		
Land	13,299,496	13,299,496
Construction in progress	36,200,474	62,149,206
Depreciable capital assets, net of accumulated depreciation	341,503,543	295,624,645
	391,003,512	371,073,347
DEFERRED FINANCING COSTS	3,527,432	4,472,811
GOODWILL, INTANGIBLE ASSETS & OTHER	4,534,508	5,014,725
	\$624,876,500	\$646,861,430
	\$624,876,500	\$646,861,430

Valley Medical Center
BALANCE SHEET
For the Nine Months Ending March 31, 2013

	March 03/31/13	March 03/31/12
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	\$9,606,920	\$9,837,938
Accrued salaries, wages and benefits	35,371,357	32,038,462
Other accrued liabilities, including estimated third-party payor settlements	3,057,060	4,157,307
Interest, patient refunds and other	17,730,047	11,012,286
Deferred property tax revenue	12,034,964	0
Current portion of long-term debt and capital lease obligations	8,199,646	8,005,239
	85,999,994	65,051,231
DEFERRED COMPENSATION	3,420,144	3,150,621
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, net of current portion		
	325,155,697	333,513,179
	414,575,834	401,715,031
NET ASSETS		
Invested in capital assets net of related debt	59,595,536	64,238,411
Restricted		
For debt service	7,484,022	7,347,091
Expendable for specific operating activities	358,248	348,602
Unrestricted	142,862,861	173,212,295
	210,300,666	245,146,399
Total liabilities and net assets	\$624,876,500	\$646,861,430

Valley Medical Center
STATEMENT OF REVENUE AND EXPENSE AND CHANGES IN NET ASSETS
For the Nine Months Ending March 31, 2013

	March 03/31/13	March 03/31/12
OPERATING REVENUES		
Net patient service revenue (net of Provision for bad debts)	\$309,596,970	\$299,549,620
Other operating revenue	20,901,957	17,091,827
	330,498,927	316,641,447
OPERATING EXPENSES		
Salaries and wages	152,749,927	143,730,400
Employee benefits	49,456,237	42,823,778
Supplies and other expenses	120,668,274	107,868,630
Depreciation	24,643,444	24,710,776
	347,517,882	319,133,585
OPERATING INCOME	(17,018,955)	(2,492,138)
NONOPERATING INCOME (EXPENSE)		
Revenue from taxation	12,287,045	13,933,450
Interest income	2,323,682	2,405,317
Interest and amortization expense	(13,462,834)	(13,267,931)
Net increase (decrease) in FV of investments	251,129	1,030,202
Other, net	(330,397)	(510,258)
	1,068,625	3,590,781
INCREASE IN NET ASSETS	(15,950,330)	1,098,643
NET ASSETS, beginning of year	226,250,996	234,865,822
	\$210,300,666	\$232,556,830
NET ASSETS, end of year	\$210,300,666	\$232,556,830

Valley Medical Center
Statement of Cash Flows
For the Nine Months Ending March 31, 2013

Increase (Decrease) in Cash and Cash Equivalents

	UNAUDITED PERIOD ENDED	
	March 31, 2013	June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from and on behalf of patients	\$ 306,942,355	\$ 401,653,878
Payments to suppliers and contractors	(116,555,664)	(149,832,926)
Payments to employees	(199,742,927)	(254,536,668)
Other cash receipts	19,064,721	18,298,958
Net cash from operating activities	<u>9,708,485</u>	<u>15,583,242</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash received from tax levy	8,574,358	17,831,507
Other	(277)	27,294
Net cash from noncapital financing activities	<u>8,574,081</u>	<u>17,858,801</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from issuance of refunding bonds	-	35,636,412
Payment to refunding bond escrow agent	-	(34,630,000)
Cash paid for bond issuance	-	(115,637)
Principal payments on long-term debt and capital lease obligations	(5,595,899)	(7,575,868)
Interest paid, net of amounts capitalized	(8,138,379)	(17,424,855)
Purchases of capital assets	(38,467,976)	(66,436,800)
Purchase of VM Oncology	(480,100)	(1,370,000)
Purchase of Valley Women's Healthcare Clinic	-	(865,000)
Other	11,038	(919,410)
Net cash from capital and related financing activities	<u>(52,671,316)</u>	<u>(93,701,158)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Distributions from joint venture	2,284,187	4,227,979
Sale of investments and noncurrent assets	56,808,557	88,049,091
Purchases of investments and noncurrent assets	(21,635,779)	(48,473,001)
Investment and interest income, net of amounts capitalized	2,323,682	3,900,299
Net cash from investing activities	<u>39,780,647</u>	<u>47,704,368</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	5,391,897	(12,554,747)
CASH AND CASH EQUIVALENTS, beginning of year	<u>24,584,212</u>	<u>37,138,959</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 29,976,109</u>	<u>\$ 24,584,212</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET ASSETS		
Cash and cash equivalents	<u>\$ 29,976,109</u>	<u>\$ 24,584,212</u>

Valley Medical Center
Statement of Cash Flows
For the Nine Months Ending March 31, 2013

Increase (Decrease) in Cash and Cash Equivalents

	UNAUDITED PERIOD ENDED	AUDITED
	<u>March 31,</u>	<u>June 30,</u>
	<u>2013</u>	<u>2012</u>
RECONCILIATION OF OPERATING INCOME TO NET		
CASH FROM OPERATING ACTIVITIES		
Operating income	\$ (17,018,955)	\$ (8,677,598)
Adjustments to reconcile operating income to net cash from operating activities		
Interest expense considered a capital financing activity		
Revenue from tax levies considered a noncapital financing activity		
Interest income considered an investing activity		
Depreciation	24,643,444	32,528,941
Amortization		
Provision for bad debts	29,429,683	33,915,355
Income recognized from joint venture	(1,837,236)	(4,635,286)
Amount expensed from purchase of VM Healthcare Clinic		184,000
Changes in assets and liabilities		
Accounts receivable	(31,503,798)	(37,987,367)
Supplies inventory	(103,842)	314,528
Prepaid expenses and other assets	1,548,225	(3,662,486)
Accounts payable	(1,609,253)	690,912
Accrued salaries, wages, and benefits	2,298,792	141,874
Estimated third-party payor settlements	(580,500)	109,821
Other liabilities	4,277,480	2,440,940
Deferred compensation	164,445	219,609
NET CASH FROM OPERATING ACTIVITIES	<u>\$ 9,708,485</u>	<u>\$ 15,583,243</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Increase (decrease) in capital assets included in accounts payable	<u>\$ (8,090,241)</u>	<u>\$ 7,922,116</u>
Equipment financed with capital lease obligations	<u>\$ -</u>	<u>\$ -</u>

Valley Medical Center

FY 13 through Quarter 3 (July 2012 - March 2013)

Key Statistics

	<u>July - March</u> <u>FY13</u>	<u>July - March</u> <u>FY12</u>	<u>FY13 to FY12</u> <u>Variance</u>
Discharges	13,198	12,473	5.8%
Patient Days	49,260	46,666	5.6%
Average Daily Census	180	170	5.9%
Length of Stay	3.73	3.74	-0.3%
Occupancy	67%	65%	3.1%
Case Mix Index	1.31	1.28	2.3%
OR Inpatient/Outpatient Cases	8,389	8,468	-0.9%
Emergency Room Visits	56,073	56,376	-0.5%
Births	3,270	2,859	14.4%
Hospital Outpatient Visits	137,518	148,498	-7.4%
VMG Primary and Urgent Care visits	159,708	151,149	5.7%
VMG Specialty Care visits	112,013	99,989	12.0%
FTEs	2,468	2,452	0.7%