



# WEST PENN ALLEGHENY HEALTH SYSTEM

## **Management Discussion and Analysis** (Based on unaudited financial information)

**For the Nine Months Ended March 31, 2012**

# Table of Contents

	<u>Pages</u>
<b>I. MANAGEMENT'S DISCUSSION OF THE UNAUDITED FINANCIAL RESULTS FOR THE NINE MONTHS ENDED MARCH 31, 2012</b>	<b>2-5</b>
<b>II. UNAUDITED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED MARCH 31, 2012</b>	<b>6-10</b>
<b>III. COMPARATIVE SELECTED UTILIZATION STATISTICS FOR THE NINE MONTHS ENDED MARCH 31, 2008 – 2012</b>	<b>11-12</b>

**I. MANAGEMENT'S DISCUSSION OF THE UNAUDITED FINANCIAL RESULTS FOR THE NINE MONTHS ENDED MARCH 31, 2012**

# WEST PENN ALLEGHENY HEALTH SYSTEM

## CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

(dollars in thousands)

	QUARTER ENDED		NINE MONTHS ENDED	
	MARCH 31,		MARCH 31,	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Net patient service revenue	\$ 389,961	\$ 382,344	\$ 1,127,270	\$ 1,152,573
Other revenue	18,357	14,879	53,983	66,954
Net assets released from restrictions	<u>793</u>	<u>1,288</u>	<u>2,658</u>	<u>3,708</u>
Total unrestricted revenues and other support	<u>409,111</u>	<u>398,511</u>	<u>1,183,911</u>	<u>1,223,235</u>
Salaries, wages, and fringe benefits	228,303	218,229	672,428	662,695
Patient care supplies	73,628	66,970	208,492	208,597
Professional fees and purchased services	40,886	37,262	120,477	117,388
General and administrative	40,679	52,951	124,440	126,884
Provision for bad debts	21,059	17,796	60,050	53,928
Depreciation and amortization	17,149	15,335	48,202	44,736
Interest	<u>10,045</u>	<u>8,319</u>	<u>29,731</u>	<u>28,400</u>
Expenses, excluding restructuring	<u>431,749</u>	<u>416,862</u>	<u>1,263,820</u>	<u>1,242,628</u>
<b>Operating loss before restructuring</b>	<b>(22,638)</b>	<b>(18,351)</b>	<b>(79,909)</b>	<b>(19,393)</b>
Restructuring	<u>(1,242)</u>	<u>(3,678)</u>	<u>(7,860)</u>	<u>(15,717)</u>
<b>Operating loss</b>	<b>(23,880)</b>	<b>(22,029)</b>	<b>(87,769)</b>	<b>(35,110)</b>
Investment income	2,547	4,569	10,851	13,711
Gifts and donations	142	106	314	444
Gain from divestiture	-	-	-	9,606
Gain (loss) in joint venture investment	<u>1,419</u>	<u>(5,030)</u>	<u>933</u>	<u>(8,919)</u>
<b>Deficiency of revenues over expenses</b>	<b>\$ <u>(19,772)</u></b>	<b>\$ <u>(22,384)</u></b>	<b>\$ <u>(75,671)</u></b>	<b>\$ <u>(20,268)</u></b>

## **Operating Results**

The System produced a deficiency of revenues over expenses of \$75.7 million for the nine months ended March 31, 2012. Net patient service revenue for the nine months ended March 31, 2012 decreased \$25.3 million, or 2.2%, as compared to the nine months ended March 31, 2011. This is primarily attributable to a 7.7% decline in acute inpatient discharges, mainly at Western Pennsylvania Hospital (WPH). The results reported through March 31, 2011 include a fully operational WPH for six months, whereas the results reported through March 31, 2012 only include a fully operational WPH for one and a half months (out of the nine month period). The emergency department at WPH was closed on December 31, 2010 as part of the "Urban Consolidation" initiative. The emergency department reopened on February 14, 2012 and inpatient volumes at WPH have begun to increase.

For the nine months ended March 31, 2011, other revenue included \$23.3 million relating to the termination of a joint venture with a commercial payor. No such event occurred for the nine months ended March 31, 2012.

Expenses, excluding restructuring, through March 31, 2012 increased 1.7% as compared to March 31, 2011. The increase is attributable to an increase in salaries, wages, and fringe benefits (1.5%) and the provision for bad debts (11.4%). See the following page for further discussion of expense trends.

Restructuring costs of \$7.9 million were incurred through March 31, 2012 which are primarily related to severance costs associated with changes in system leadership. Restructuring charges for the nine months ended March 31, 2011 related mainly to the "Urban Consolidation" initiative.

Also included in the operating results are revenues and expenses relating to Pennsylvania's Medicaid Modernization Act (MMA), which was passed by the legislature in September 2010, and approved by the Centers for Medicare and Medicaid Services in January 2011. Total revenue recognized for the MMA was \$19.4 million and \$23.1 million for the nine months ended March 31, 2012 and 2011, respectively. That amount was offset by a related assessment (expense) of \$17.6 million and \$16.3 million for the nine months ended March 31, 2012 and 2011, respectively.

The System received \$100.0 million from Highmark, Inc. on October 31, 2011. Of this amount, \$50.0 million was in the form of a loan and has been accounted for as long-term debt and the remaining \$50.0 million was an unrestricted payment and is currently accounted for as deferred revenue. The latter amount is expected to be recognized as contribution income before year-end.

A comparison of expense categories as a percentage of total revenue for the nine months ended March 31, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Salaries, wages, and fringe benefits	56.8 %	54.2 %
Patient care supplies	17.6	17.1
Professional fees and purchased services	10.2	9.6
General and administrative	10.5	10.4
Provision for bad debts	5.1	4.4
Depreciation and amortization	4.1	3.7
Interest	2.5	2.3
Expenses, excluding restructuring	<u>106.8 %</u>	<u>101.7 %</u>
Restructuring	<u>0.7</u>	<u>1.3</u>
Total	<u><u>107.5 %</u></u>	<u><u>103.0 %</u></u>

Expenses, excluding restructuring, as a percentage of total revenue for the nine months ended March 31, 2012 increased in comparison to the nine months ended March 31, 2011. Driving the increase in expense percentage is a decrease in total revenue of (3.2%) - see previous page.

Salaries, wages, and fringe benefits as a percentage of total revenue increased 2.6% for the nine months ended March 31, 2012 when compared to March 31, 2011. This is due to an increase in agency fees, accompanied by annual salary increases, offset by a decrease in salaries at WPH due to the emergency department closure discussed previously.

Professional fees and purchased services as a percentage of total revenues increased 0.6% for the nine months ended March 31, 2012 when compared to March 31, 2011. This increase is attributable to outsourced consulting services for the improvement of operations and additional legal expenses incurred related to ongoing matters.

### **Liquidity and Capital Position**

As of March 31, 2012, day's cash-on-hand as defined in the Master Indenture of Trust (MIT) was 50 days. Of the \$220.6 million included in this calculation, \$17.2 million consists of proceeds remaining from the Series 2007 Project Fund which are invested in U.S. Government fixed income securities with a maturity of less than one year. Of the remaining \$203.4 million, approximately 32.7% is subject to daily market value fluctuations, with approximately 27.7% invested in fixed income and 5.0% in equities and equity funds.

Contributions of \$24.0 million were made to the cash balance retirement plans during the nine months ended March 31, 2012, as required by the Internal Revenue Code and Employee Retirement Income Security Act and relevant regulations and guidance issued there under.

Capital expenditures during the nine months ended March 31, 2012 were \$60.3 million, of which \$9.9 million related to Urban Consolidation.

Debt repayments during the nine months ended March 31, 2012 were \$14.3 million.

The average number of days in net accounts receivable was 33.8 at March 31, 2012. Vendor accounts are being paid in accordance with terms.

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**II. UNAUDITED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED MARCH 31, 2012**

**WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES**

Consolidating Balance Sheet Information - Unaudited

March 31, 2012

(Amounts in thousands)

<b>Assets</b>	<b>Total Obligated</b>	<b>Total Non-Obligated</b>	<b>Eliminations</b>	<b>Total Consolidated</b>
Current assets:				
Cash and cash equivalents	\$ 123,788	1,145	—	124,933
Short-term investments	5,100	—	—	5,100
Assets limited or restricted as to use	12,281	—	—	12,281
Receivables:				
Patient accounts, less allowance for uncollectible accounts of \$40,906	145,111	—	—	145,111
Other	36,826	315	262	37,403
Estimated third-party payor settlements	566	—	—	566
Inventories, net	22,774	—	—	22,774
Prepaid expenses	18,202	7	—	18,209
Total current assets	364,648	1,467	262	366,377
Assets limited or restricted as to use	416,004	2,182	—	418,186
Property and equipment, net	355,366	26,635	—	382,001
Other assets, net	56,859	1,545	(1,621)	56,783
Total assets	\$ <u>1,192,877</u>	<u>31,829</u>	<u>(1,359)</u>	<u>1,223,347</u>



**WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES**

Consolidating Balance Sheet Information - Unaudited

March 31, 2012

(Amounts in thousands)

<b>Liabilities and Net Assets</b>	<b>Total Obligated</b>	<b>Total Non-Obligated</b>	<b>Eliminations</b>	<b>Total Consolidated</b>
Current liabilities:				
Current portion of long-term debt	\$ 2,840	2,077	—	4,917
Accounts payable	80,620	45	—	80,665
Accrued expenses	19,442	4	—	19,446
Accrued interest	14,888	102	—	14,990
Accrued salaries and vacation	52,518	7	—	52,525
Current portion of deferred revenue	14,590	—	—	14,590
Current portion of self-insurance liabilities	2,954	—	—	2,954
Current portion of other long-term liabilities	3,965	387	—	4,352
Due to affiliate, net	—	(262)	262	—
<b>Total current liabilities</b>	<b>191,817</b>	<b>2,360</b>	<b>262</b>	<b>194,439</b>
Deferred revenue	89,695	—	—	89,695
Self-insurance liabilities	57,760	1,392	—	59,152
Long-term debt	819,759	21,760	—	841,519
Accrued pension obligation	192,897	—	—	192,897
Other noncurrent liabilities	21,450	2,056	—	23,506
<b>Total liabilities</b>	<b>1,373,378</b>	<b>27,568</b>	<b>262</b>	<b>1,401,208</b>
Net assets (deficit):				
Unrestricted	(433,724)	3,431	(1,621)	(431,914)
Temporarily restricted	22,629	485	—	23,114
Permanently restricted	230,594	345	—	230,939
<b>Total net assets (deficit)</b>	<b>(180,501)</b>	<b>4,261</b>	<b>(1,621)</b>	<b>(177,861)</b>
<b>Total liabilities and net assets (deficit)</b>	<b>\$ 1,192,877</b>	<b>31,829</b>	<b>(1,359)</b>	<b>1,223,347</b>

**WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES**

Consolidating Statement of Operations Information - Unaudited

Nine Months Ended March 31, 2012

(Amounts in thousands)

	<u><b>Total Obligated</b></u>	<u><b>Total Non-Obligated</b></u>	<u><b>Eliminations</b></u>	<u><b>Total Consolidated</b></u>
Unrestricted revenues and other support:				
Net patient service revenue	\$ 1,127,270	—	—	1,127,270
Other revenue	53,964	2,955	(2,936)	53,983
Net assets released from restrictions	<u>2,649</u>	<u>9</u>	<u>—</u>	<u>2,658</u>
Total unrestricted revenues other support	1,183,883	2,964	(2,936)	1,183,911
Expenses:				
Salaries, wages, and fringe benefits	672,289	139	—	672,428
Patient care supplies	208,492	—	—	208,492
Professional fees and purchased services	120,461	16	—	120,477
General and administrative	127,321	55	(2,936)	124,440
Provision for bad debts	60,050	—	—	60,050
Depreciation and amortization	46,890	1,312	—	48,202
Interest	<u>28,716</u>	<u>1,015</u>	<u>—</u>	<u>29,731</u>
Total expenses, excluding restructuring	<u>1,264,219</u>	<u>2,537</u>	<u>(2,936)</u>	<u>1,263,820</u>
Operating income (loss) before restructuring	(80,336)	427	—	(79,909)
Restructuring	<u>(7,860)</u>	<u>—</u>	<u>—</u>	<u>(7,860)</u>
Operating income (loss)	(88,196)	427	—	(87,769)
Investment income	10,851	—	—	10,851
Gifts and donations	210	104	—	314
Gain in joint venture investment	<u>933</u>	<u>—</u>	<u>—</u>	<u>933</u>
Excess (deficiency) of revenues over expenses	\$ <u><u>(76,202)</u></u>	<u><u>531</u></u>	<u><u>—</u></u>	<u><u>(75,671)</u></u>

**WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES**

Consolidating Statement of Changes in Net Assets - Unaudited

Nine Months Ended March 31, 2012

(Amounts in thousands)

	<b>Total Obligated</b>	<b>Total Non-Obligated</b>	<b>Eliminations</b>	<b>Total Consolidated</b>
Unrestricted net assets:				
Excess (deficiency) of revenues over expenses	\$ (76,202)	531	—	(75,671)
Net assets released for property acquisitions and donated capital	399	224	—	623
Other transfers	(13)	(222)	—	(235)
	<u>(75,816)</u>	<u>533</u>	<u>—</u>	<u>(75,283)</u>
Temporarily restricted net assets:				
Contributions	1,887	127	—	2,014
Investment income	698	1	—	699
Net assets released from restrictions used for:				
Operations	(2,649)	(9)	—	(2,658)
Acquisition of equipment	(399)	(224)	—	(623)
Change in net unrealized losses on other than trading securities	(26)	—	—	(26)
Other transfers	282	1	—	283
	<u>(207)</u>	<u>(104)</u>	<u>—</u>	<u>(311)</u>
Permanently restricted net assets:				
Contributions	4	—	—	4
Investment income	5,159	—	—	5,159
Change in net unrealized gains on other than trading securities	(1,587)	—	—	(1,587)
Transfers out of endowments/participating trust to investment income and operations	(6,768)	—	—	(6,768)
Other transfers	20	(2)	—	18
	<u>(3,172)</u>	<u>(2)</u>	<u>—</u>	<u>(3,174)</u>
Increase (decrease) in net assets	(79,195)	427	—	(78,768)
Net assets-beginning of period	<u>(101,306)</u>	<u>3,834</u>	<u>(1,621)</u>	<u>(99,093)</u>
Net assets-end of period	\$ <u><u>(180,501)</u></u>	<u><u>4,261</u></u>	<u><u>(1,621)</u></u>	<u><u>(177,861)</u></u>

**III. COMPARATIVE SELECTED UTILIZATION STATISTICS FOR  
THE NINE MONTHS ENDED MARCH 31, 2008 - 2012**

**West Penn Allegheny Health System  
Health System Totals  
Statistics and Volumes**

	<b>Nine Months Ended March 31,</b>				
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Discharges</b>					
Acute*	57,903	57,849	53,496	45,604	42,075
Rehab	835	890	1,192	1,160	938
Hospice	329	382	359	317	290
<b>Patient Days (excludes newborns)</b>					
Acute*	297,456	293,289	279,116	240,772	222,146
Rehab	9,721	10,078	14,114	13,872	11,283
Hospice	2,293	2,429	2,299	1,870	2,069
<b>Staffed Beds</b>					
Acute*	1,662	1,657	1,612	1,274	1,367
Rehab	61	61	99	88	61
Hospice	12	12	12	12	12
<b>Occupancy Rate</b>					
Acute*	65.1%	64.6%	63.2%	69.0%	59.1%
Rehab	57.9%	60.3%	52.0%	57.5%	67.3%
Hospice	69.5%	73.9%	69.9%	56.9%	62.7%
<b>Length-of-Stay (based on discharges)</b>					
Acute*	5.11	5.06	5.23	5.31	5.28
Rehab	11.66	11.32	11.80	12.14	12.04
Hospice	6.97	6.36	6.40	5.89	7.13
<b>Observation Cases</b>	9,143	9,568	10,725	11,449	12,133
<b>Births</b>	3,592	3,631	3,400	3,003	2,913
<b>Emergency Visits</b>					
Inpatient	33,028	33,840	32,809	28,296	24,958
Outpatient	111,854	112,635	113,120	102,142	94,777
<b>Operating Room Cases</b>					
Inpatient	17,762	17,738	17,118	15,274	13,915
Outpatient	26,041	25,002	24,529	23,716	22,713
<b>Transplants</b>					
Heart	13	11	9	32	17
Kidney	59	50	50	47	52
Bone Marrow	58	60	55	51	44
Liver	5	6	9	12	17
Pancreas	-	-	-	3	-
Lung	-	-	-	1	-

\* Includes Psychiatric