Strategic Capital Planning Embracing the What If?

Western Region HFMA Conference

14 January 2019

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HEALTH CARE PRACTICE


HAPPY NEW YEAR
2019

Answers to Questions

- What is Strategic Capital Planning?
- How does the process work?
- What are the important considerations?
- How do we account for uncertainty?
- Should we do this internally or should we get help?

What’s on Your List?

What is Strategic Capital Planning?

- Quantifies how much money, regardless of source, your organization needs to achieve strategic objectives
- Allows for various scenarios to help prioritize capital investments

Process: Develop A Baseline

- **Utilize historical trends in revenues and expenses & adjusts for extraordinary items not repeated in future**
- **Establish assumptions in a "status quo" world**
- **Incorporate planned or "known" projects**
- **Output = 5-10 year financial statements and ratios to estimate credit strength**

RESULTS ARE FOR PLANNING PURPOSES ONLY
and not necessarily reflective of future performance

Baseline Income Statement Assumptions

- Price increases
- Changes in payor mix
- Contractual allowance
- Bad Debt/Charity Care
- Salary increases
- Benefits as %age of salaries
- Professional fees
- Supplies
- Utilities

Other

- Tax Support
- Grants
- Donations

Baseline Balance Sheet Assumptions

- Days in Accounts Receivable
- Days in Accounts Payable
- Routine Capital Expenditures (flow to depreciation)
- Investment returns

General Rules of Thumb on Baseline

- Be conservative, very conservative
- Include what you know today of upcoming policy impacts – even if its negative
- Include known (i.e., signed) provider impacts

- Assume accelerated revenue growth in perpetuity
- Use exact numbers for estimates of removal of non-re-occurring expenses – ROUND

Important Considerations

- Physical Resources
- Human Resources
- Operational Changes
- Unintended Costs
- Financial Resources
- Financing Options

Key Financial Ratios: Determining "Financability"

	Minimum Standard
Operating Margin (%) Reflects your profitability from active patient care less operational expenses	**varies**
Total Margin (%) Reflects your profitability from all sources of funds	**0%**
Earnings Before Interest Depreciation & Amortization Margin (%) How much cash you made before accounting for non-cash item capital expenses (depreciation) divided by revenues (from all sources)	**6%**
Days Cash on Hand – All Sources (Number) Measuring the number of days of cash operating expenses you could support if your revenue stream were reduced or eliminated	**100 - 150+** **(dependent on upcoming cash needs)**
Debt-to-Capitalization What you owe (long term) versus what you own	**<80%**
Debt Service Coverage (Ratio) Measures your ability to cover the maximum debt payment of the debt (interest and principal payment)	**1.40**

Rules of Thumb on Financing Structure

- Assume a future interest rate that is .25% or more than current
- Assume at least 2% for costs of financing
- Consult with bankers on rates

- Use exact numbers for project costs – ROUND UP
- Forget to include construction inflation
- Forget to include interest during construction as part of the Project costs

Sensitive Assumptions

INTERNAL - STRATEGIC

EXTERNAL- UNPREDICTABLE

- Provider Recruitment
- Growth Initiatives
- EHR or other system conversion/update
- Affiliation / Partnerships

$$$

$$$

- Borrowing costs
- Reimbursement
- Disruption of business
- Construction costs
- Policy changes

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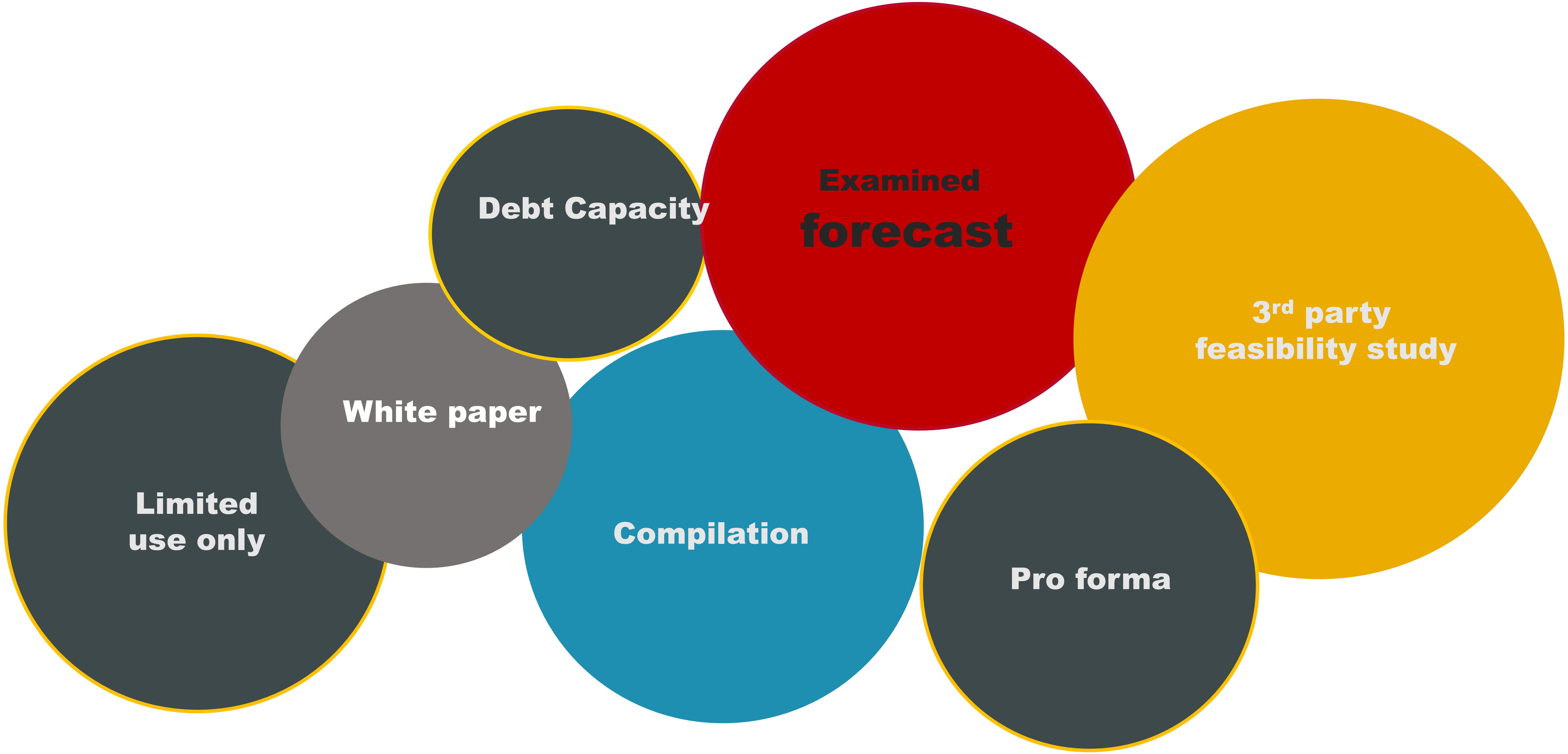
Make
?
Buy

How Will We Use This Work?



Conclusions

In this process you will …

- **Never be exactly right**
- **Have a quantitative foundation for decision making**
- **Strengthen buy in for a beneficial but difficult to implement initiative**
- **Potentially avoid a costly investment that never had a chance of being realized**
- **Be ahead of the game on next year's budget process**

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Thank you!