



## VIRGINIA HOUSE OF DELEGATES

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### Strategic Health Care Trends

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November 14, 2006

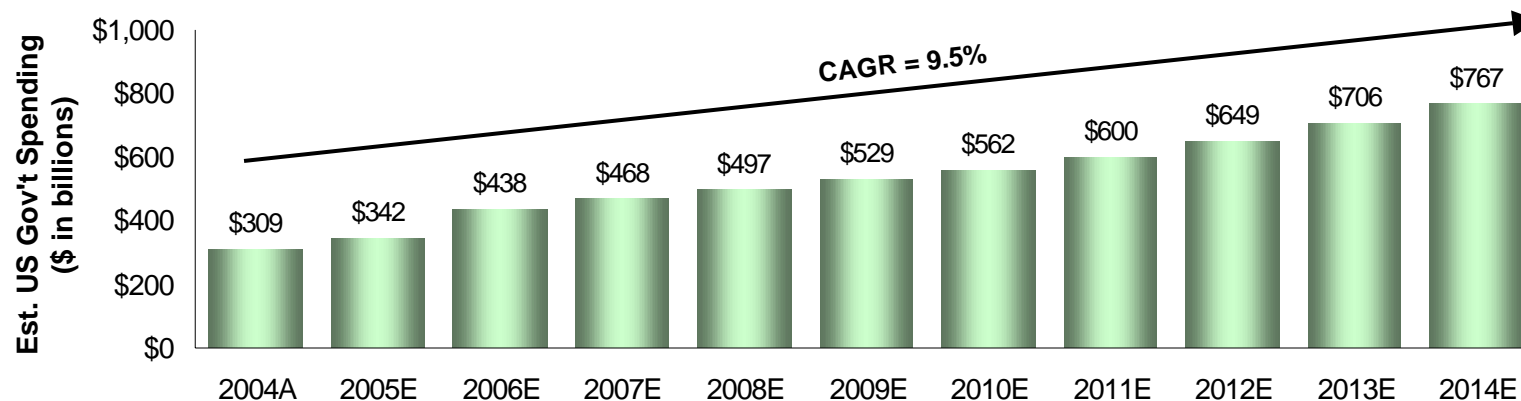
## Environmental Trends Over Next 3-5 Years

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- Payment Sources Under Pressure
- Slowing and Shifting Demand
- Quality and Patient Safety Initiatives
- Increasing Competitive Forces
- Resource Constraints—Capital and Labor
- Escalating Headline Risks

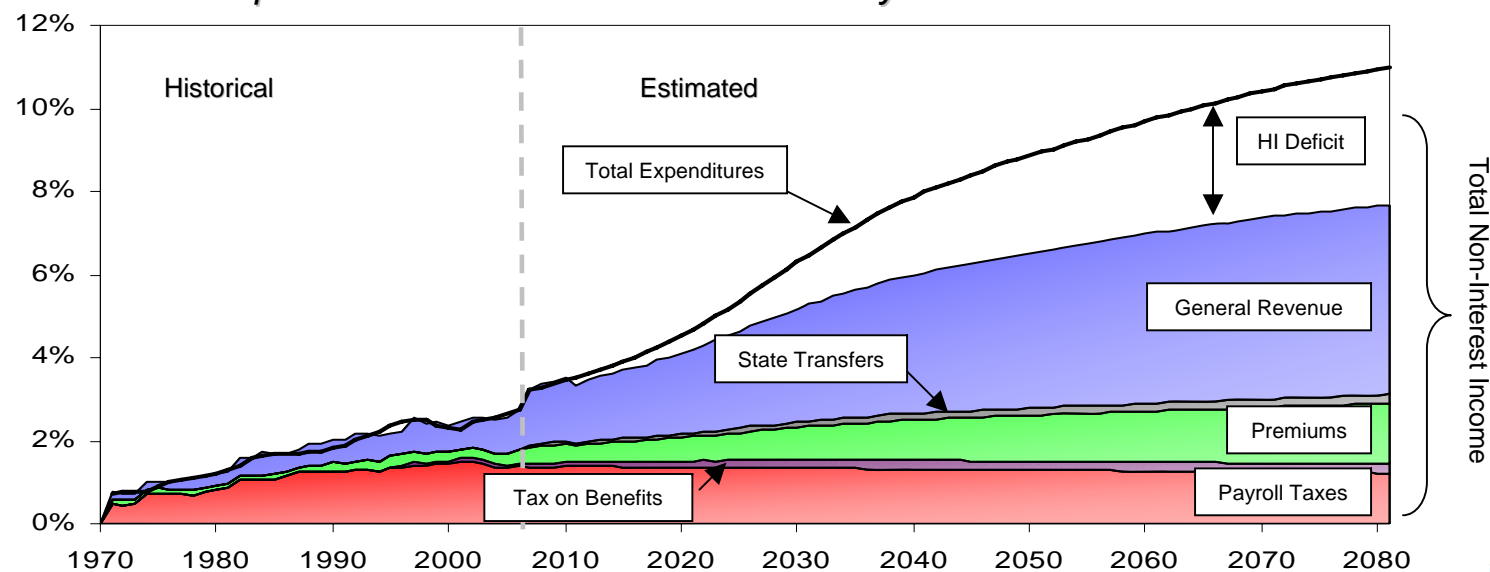
# Government Payors: Federal Payment Sources under Pressure

*Estimated Increase in US Government Medicare Spending*



Source: 2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds

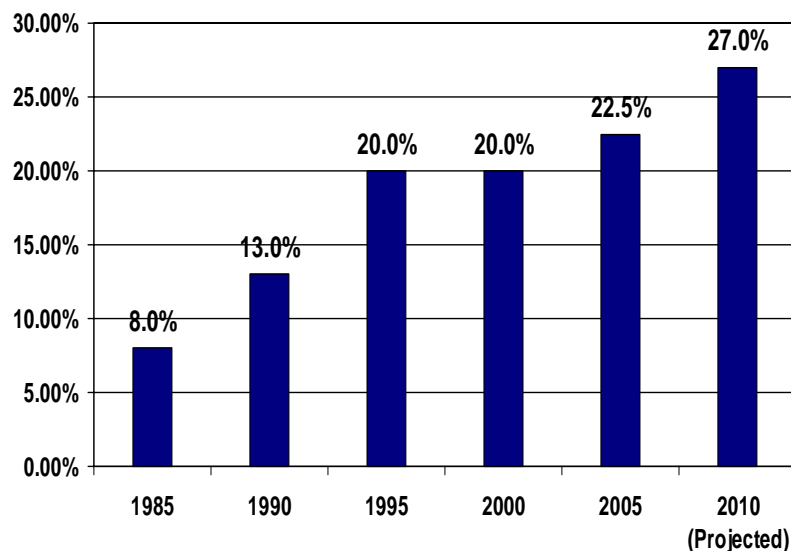
*Medicare Expenditures and Non-Interest Income by Source as % of GDP*



Source: Medicare Board of Trustees 2006 Annual Report

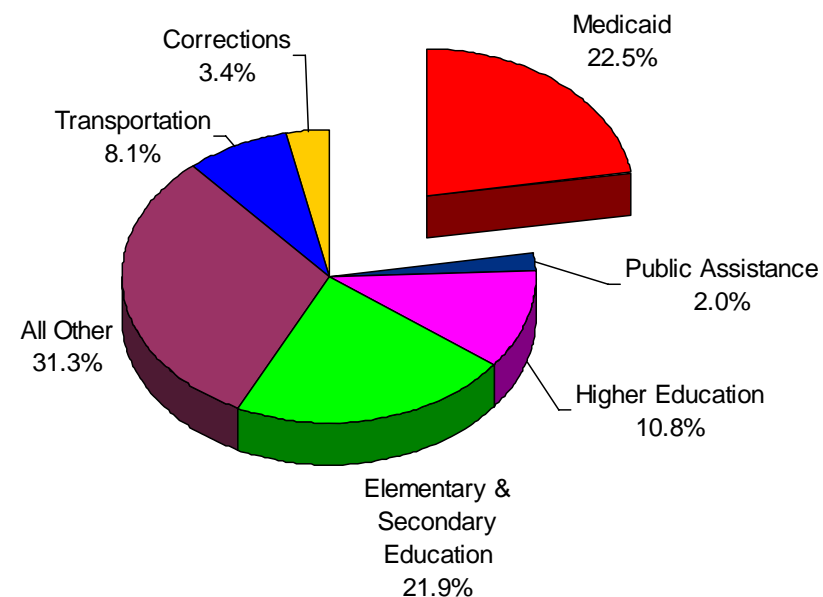
## Medicaid Expenditures: A Growing Component of States' Budgets

**Medicaid Expenditures as a Percent of Total State Spending**



Source: Vernon Smith, Health Management Associates

**Total State Expenditures by Function  
FY2005<sup>1</sup>**

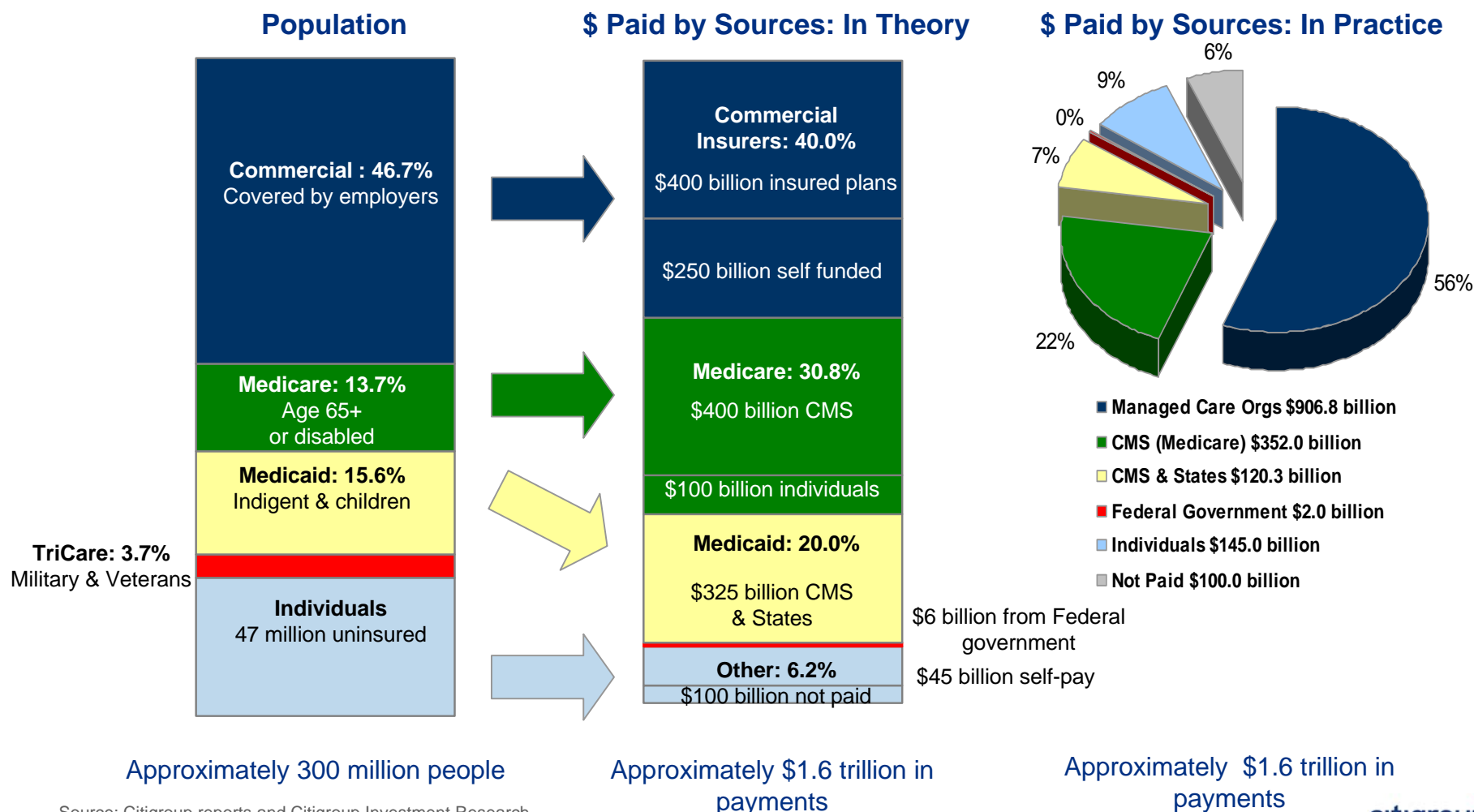


Source: NGA/NASBO Fiscal Survey, December 2005

**...States' medicaid expenditures have nearly tripled over the past 20 years and are expected to reach 27% of total state expenditures by 2010, representing one of the largest components of State spending.**

# The Emerging Reality of Provider Payments

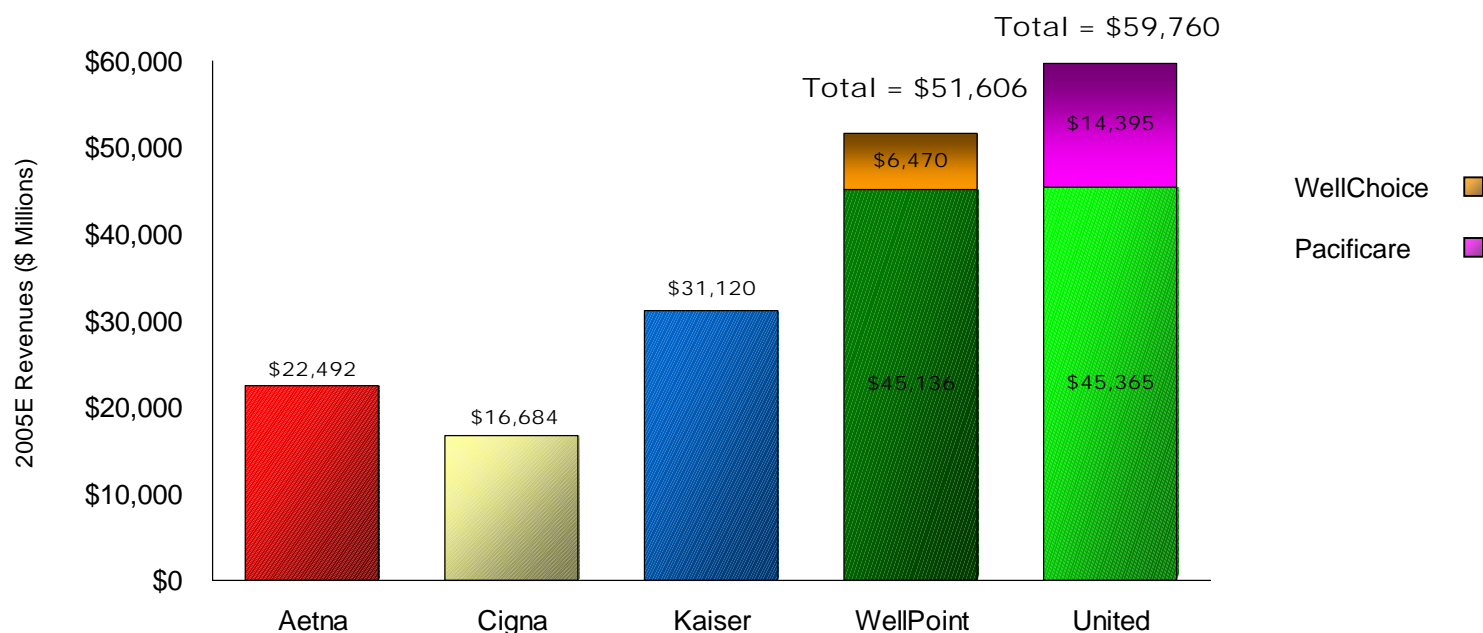
**56% of payments for health care services are channeled through private payors. Growth in this segment will accelerate with increasing penetration of Medicare Advantage.**



Source: Citigroup reports and Citigroup Investment Research  
Note: Managed Care Orgs (in pie chart) include Commercial Insured, Self-Funded Employers, Medicare Advantage and Medicaid Advantage)

# Commercial Payors: Payment Sources are Increasingly Driven at National Levels

## Commercial Insurance is Increasingly Driven by Two Super Insurers



### WellPoint (the Blue)

- Combined enrollment of 34 million members
- Operates as Blue Cross or Blue Shield license in 14 states; #1 ranked in 12 states

### United (the non-Blue)

- Combined enrollment of 23 million members
- Operates nationally as the largest health benefit provider

Source: Source: Wellchoice and Pacificare data based on Thomson First Call Consensus FY2005 estimates. Others based on FY2005 audited financials.

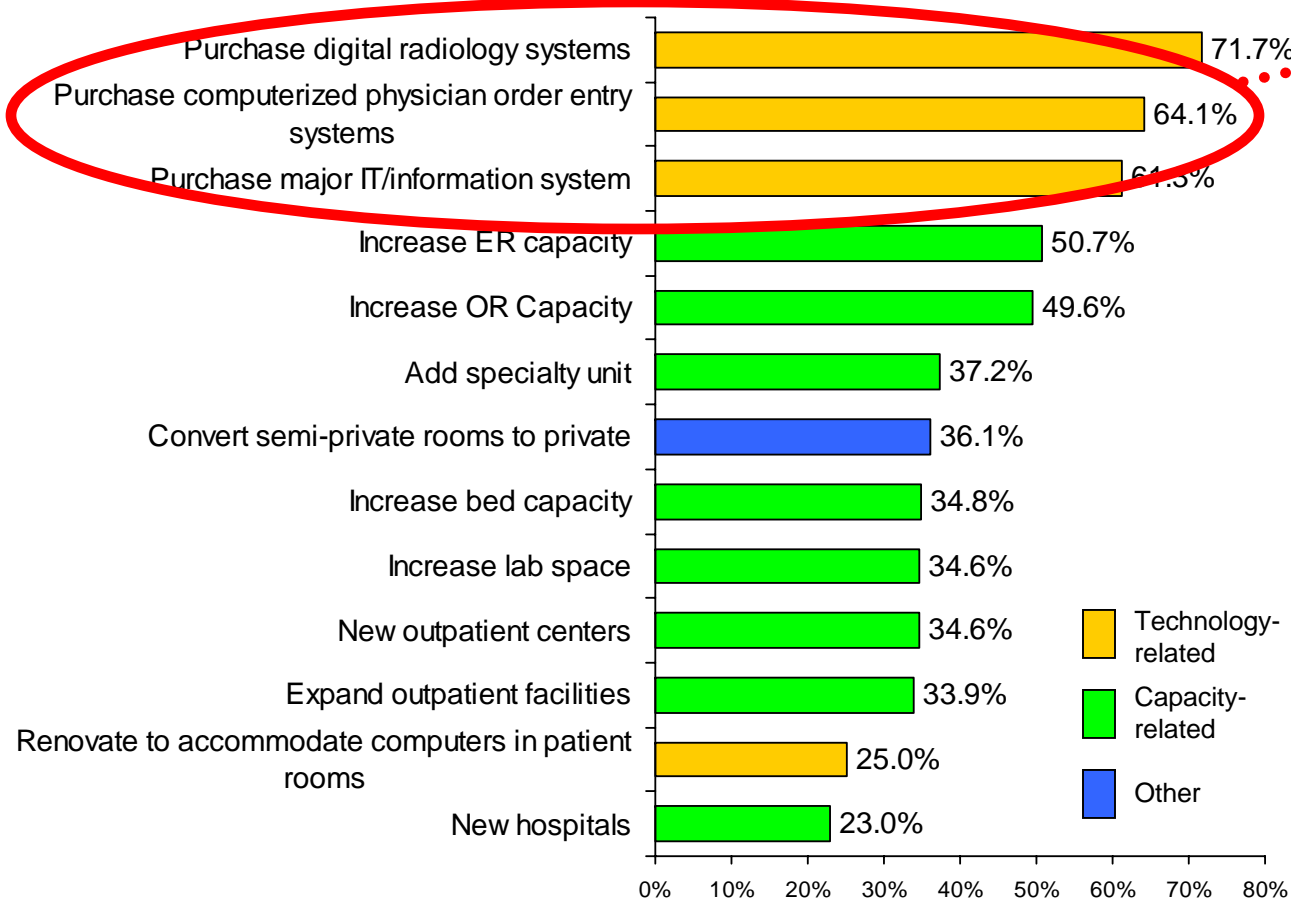
## Quality and Patient Safety Initiatives

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- Clinical and information technology investment
- Workforce development and training
- Process flow redesign
- Facilities design
- Payor focus
- Impact of transparency

## High Investment in Technology

### Planned Capital Purchases, Next Five Years



**The top 3 forecasted categories of capital purchases over the next 5 years are related to information technology.**

*"Executive management must embrace IT as a cost of doing business and a way of transforming the organization to ensure its viability. While 'return on investment' remains a critical factor for deciding some IT investments, it cannot become the sole factor in determining the value of IT on service quality or outcomes."*



## Increasing Competitive Forces: Pure Play Companies

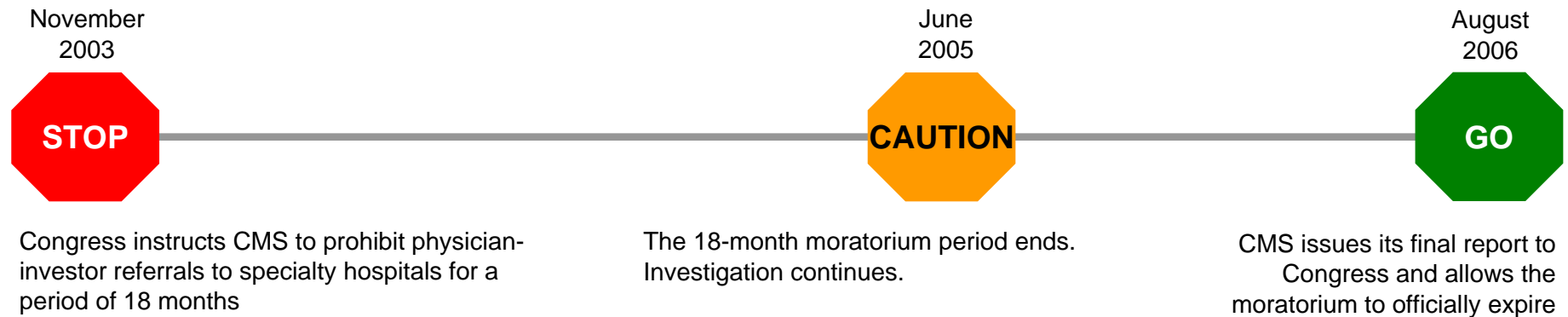
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- Pure Play Companies peel away high margin businesses



# The Lifting of the Specialty Hospital Moratorium

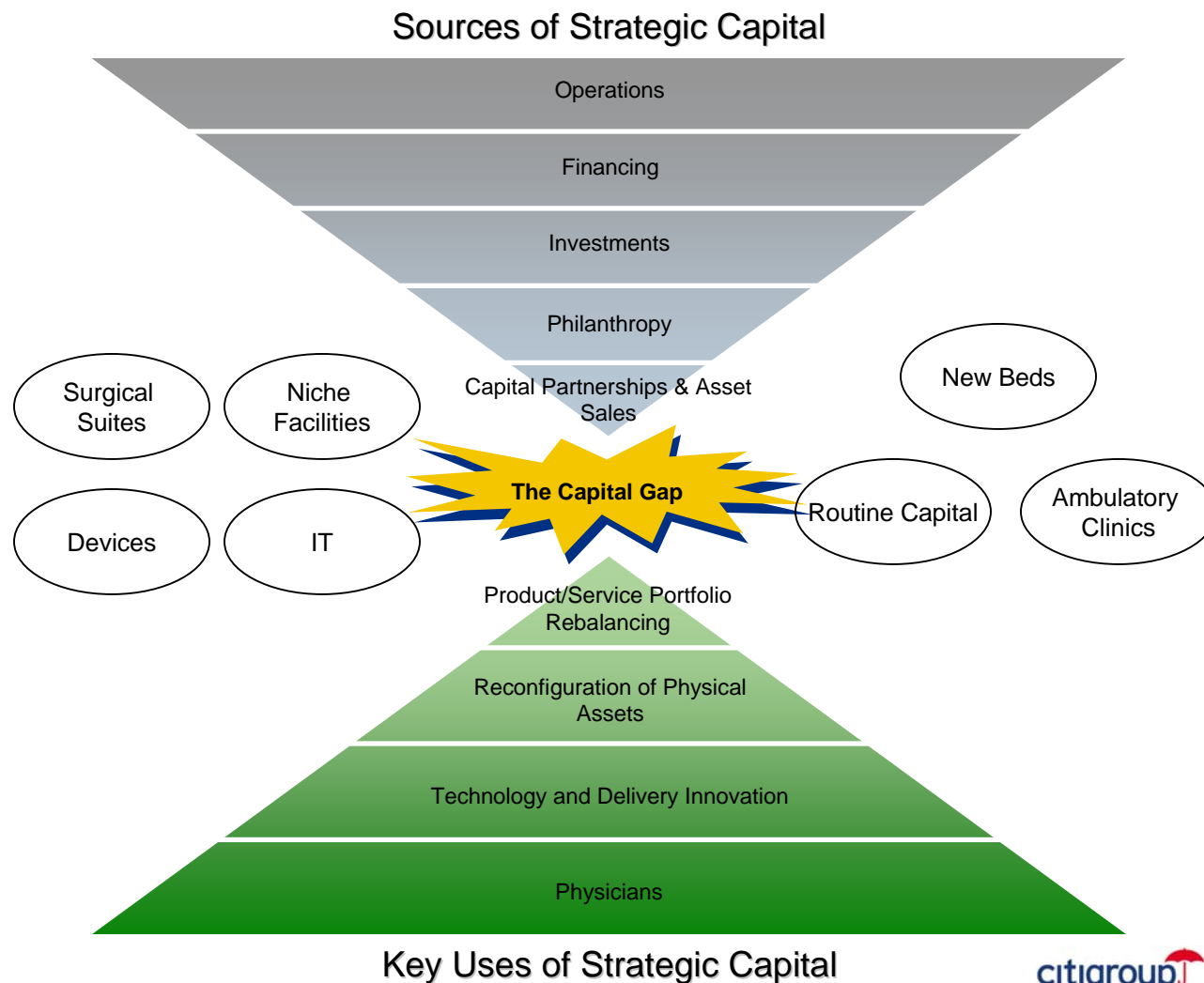
*Federal response was to change the economic incentives for specialty-hospitals, in effect “leveling the playing field” and enabling increased competition*



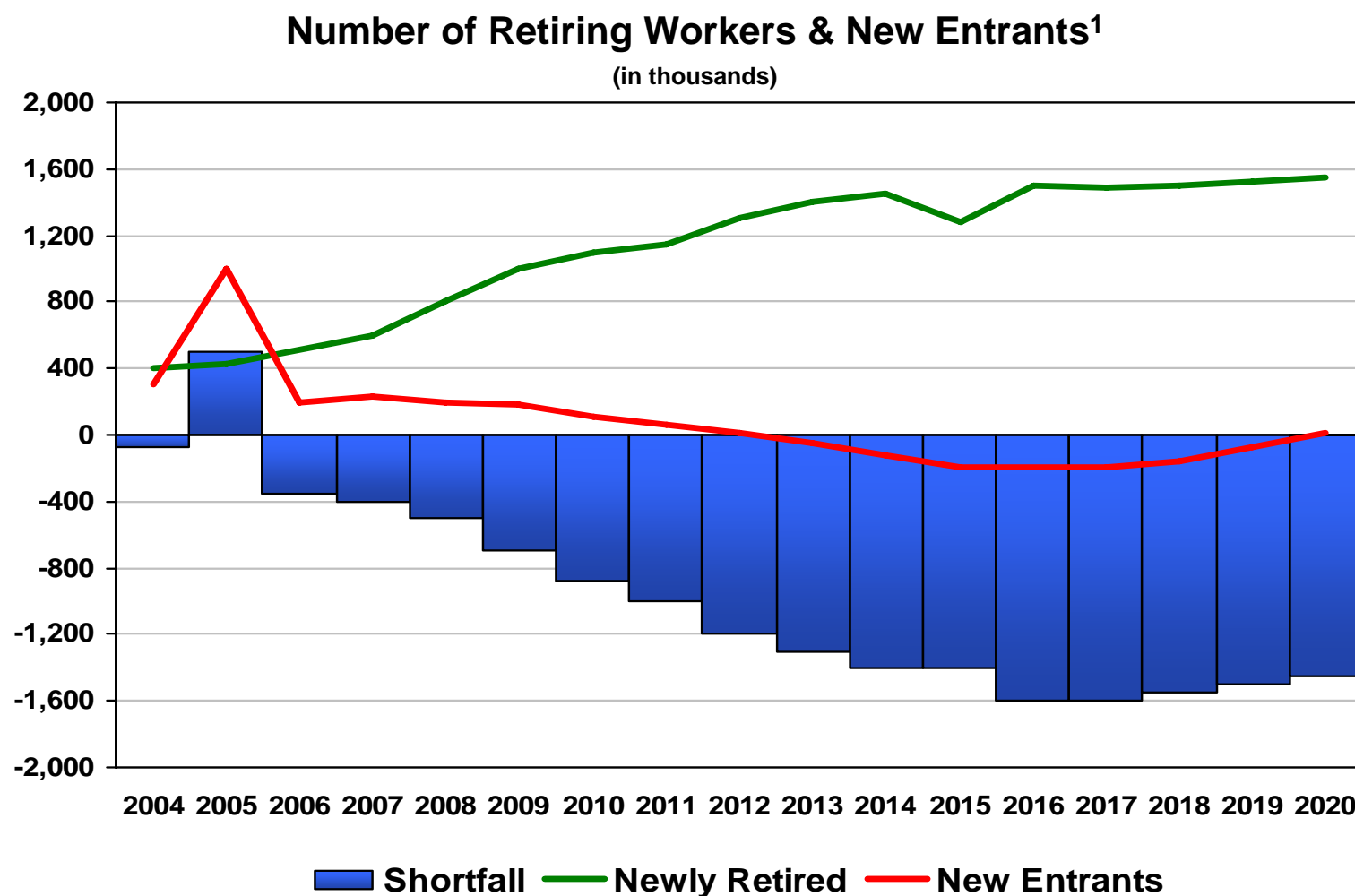
- Economic incentives re-aligned via reimbursement changes to payments
- Physician conflict of interest resolved via financial disclosure

## Resource Constraints: The “Capital Gap”

**Capital access will become tighter for all health care providers, particularly so for marginal credits.**



## Resource Constraints: Growing Labor Gap

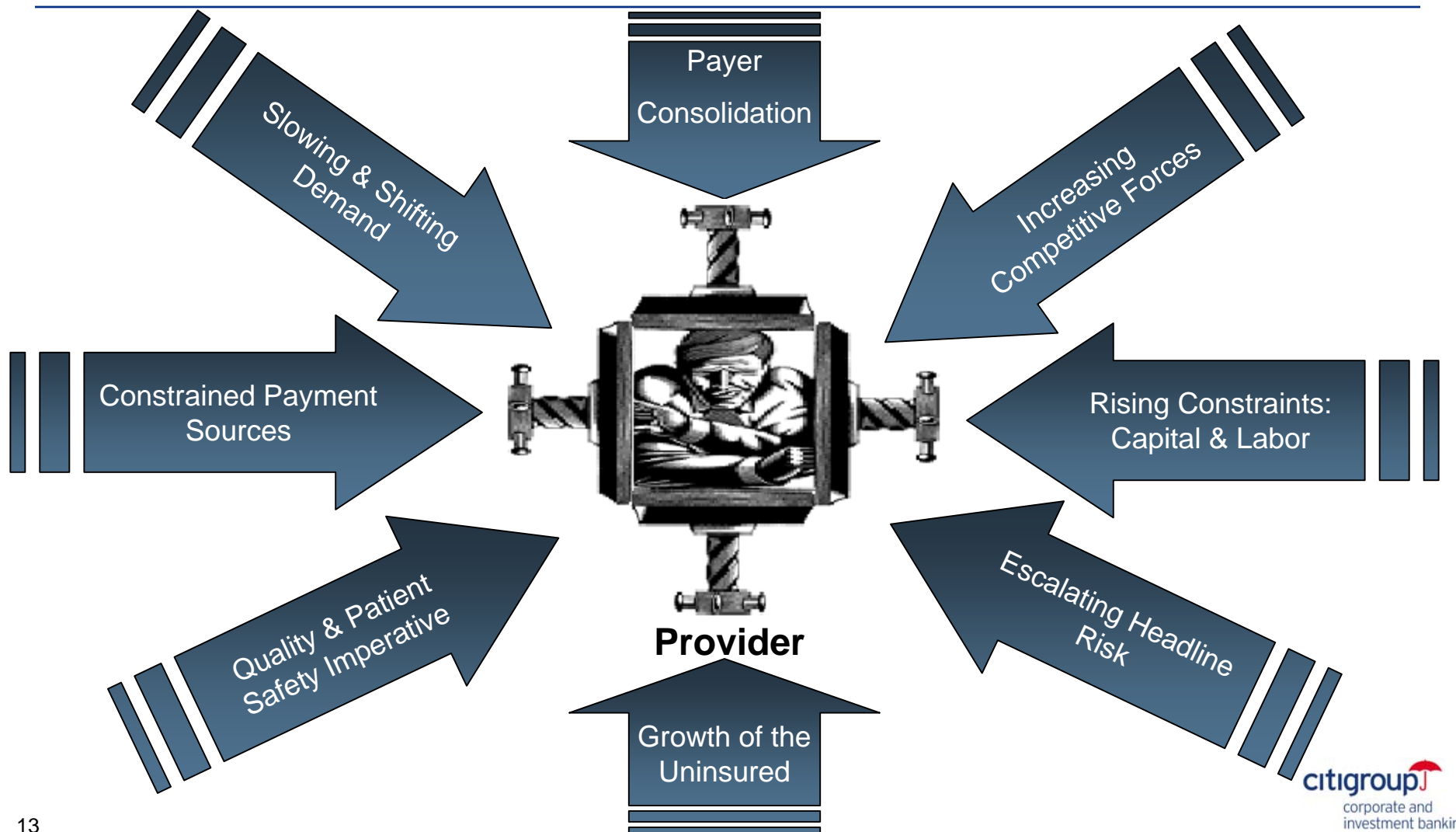


Source: Federal Reserve Bank of Atlanta, *The Health Management CEO Forum*, August 2005

<sup>1</sup> New Entrants = Newly Employed Aged 16 to 24

# Unsustainable Business Fundamentals

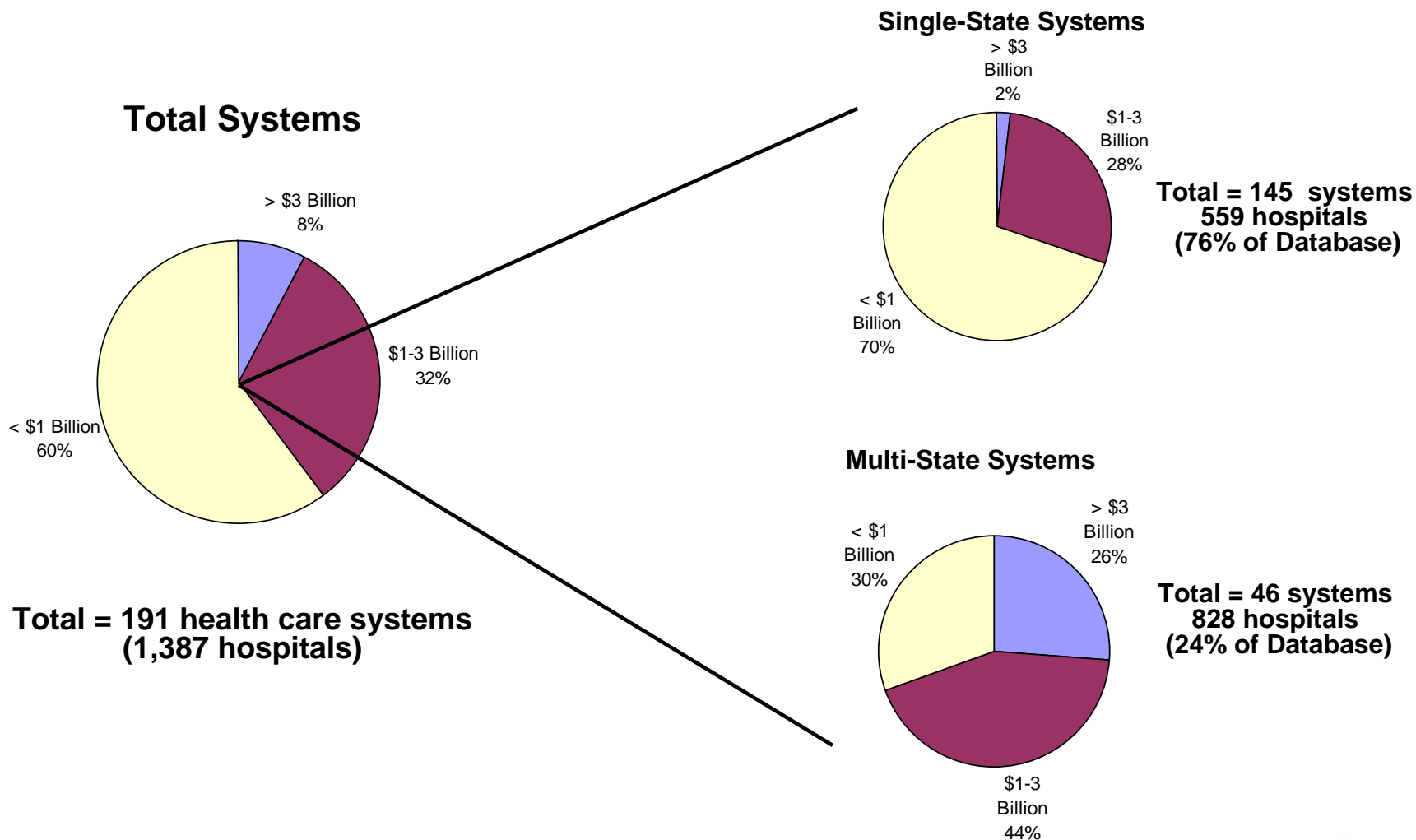
*A variety of pressures on health care providers are anticipated to “squeeze” underlying business fundamentals over the next 3-5 years*



# Evaluating Health Care Provider Performance:

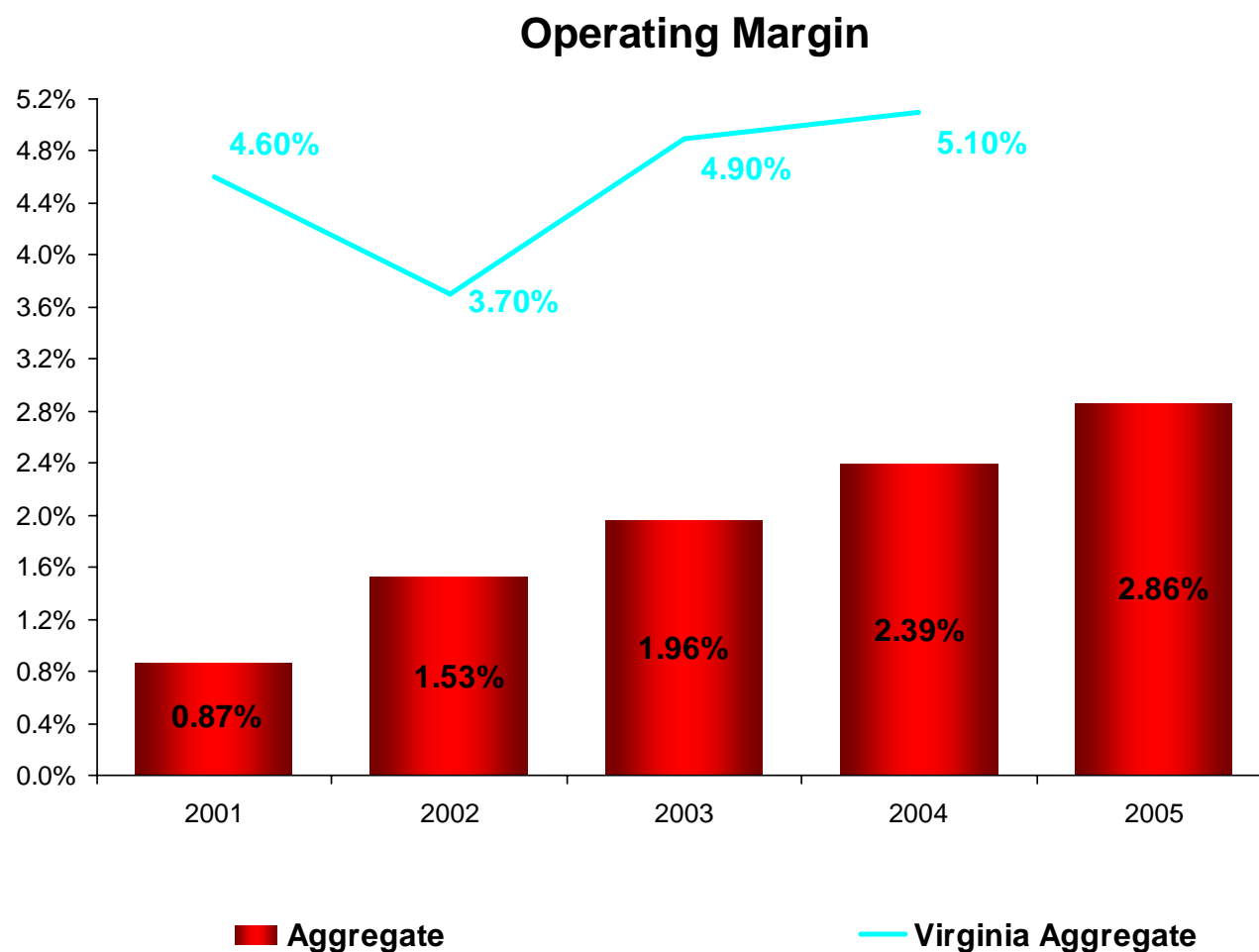
## Data Base Includes Approximately One Quarter of All U.S. Hospitals

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## Good News: Operating Margins Improving

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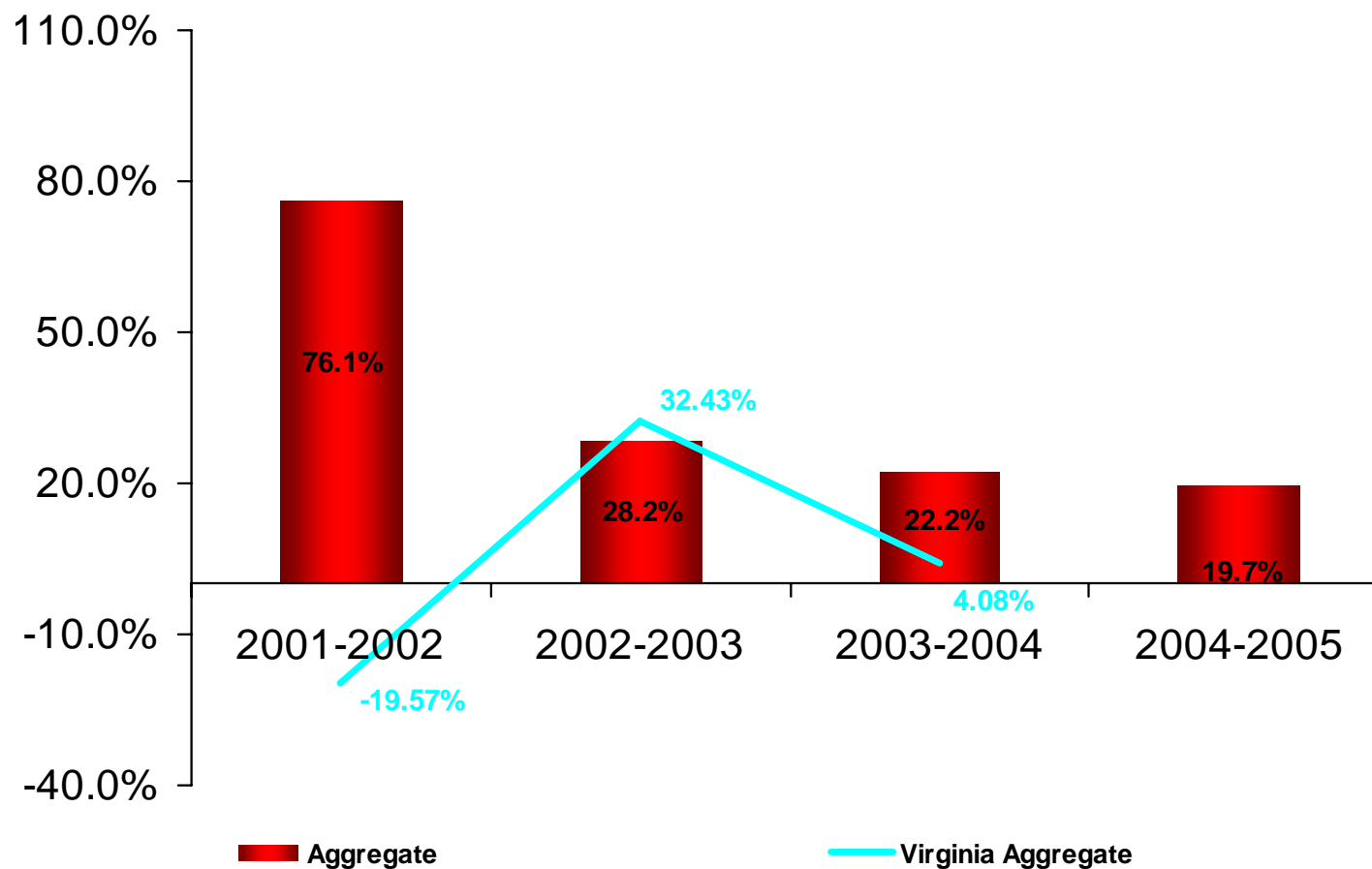


Virginia Aggregate Source: Virginia Health Information Industry Reports

## Bad News: Margin Growth Across All Size Organizations Has Been at Slowing Rates

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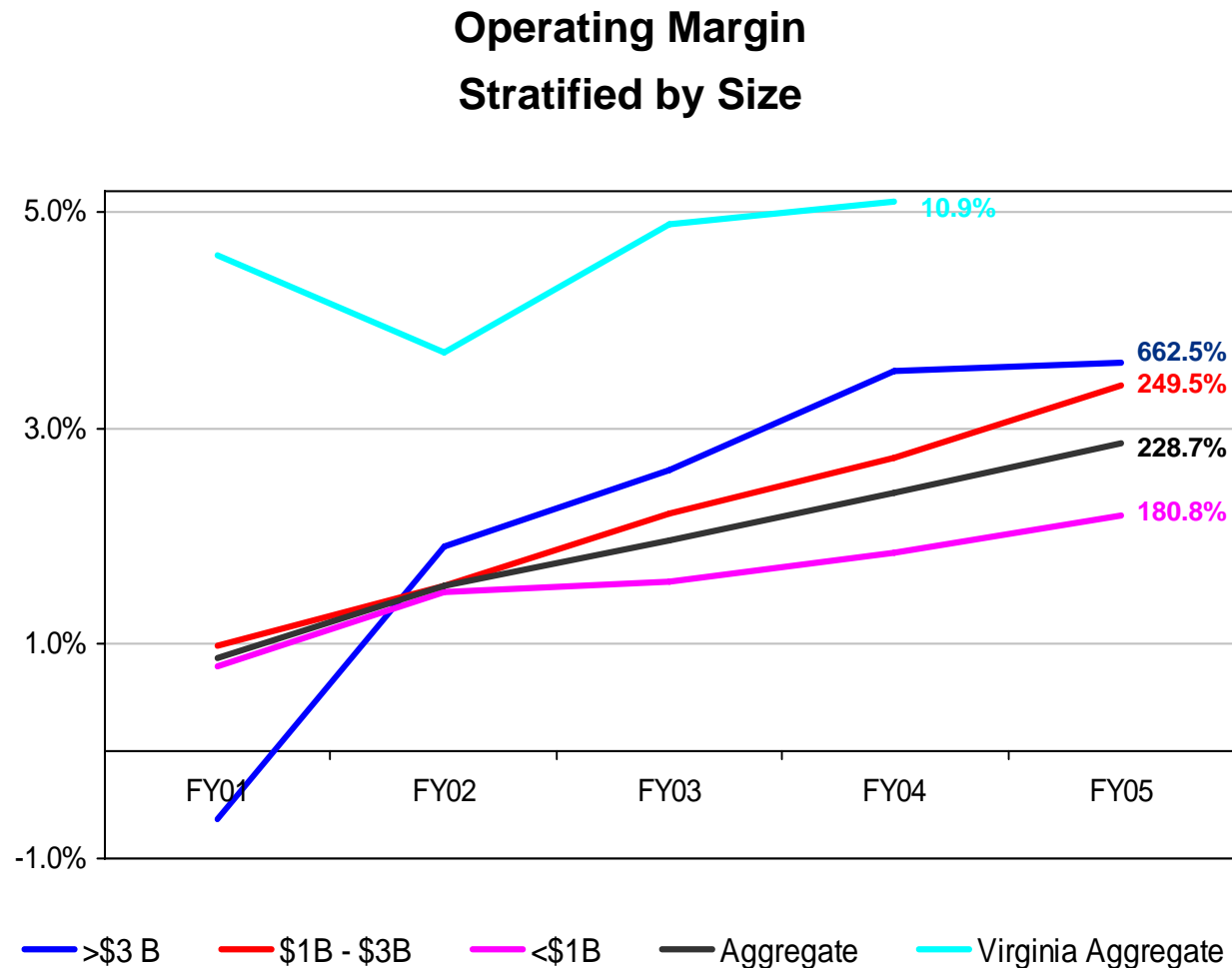
Year-over-Year Change in Operating Margin



Virginia Aggregate Source: Virginia Health Information Industry Reports



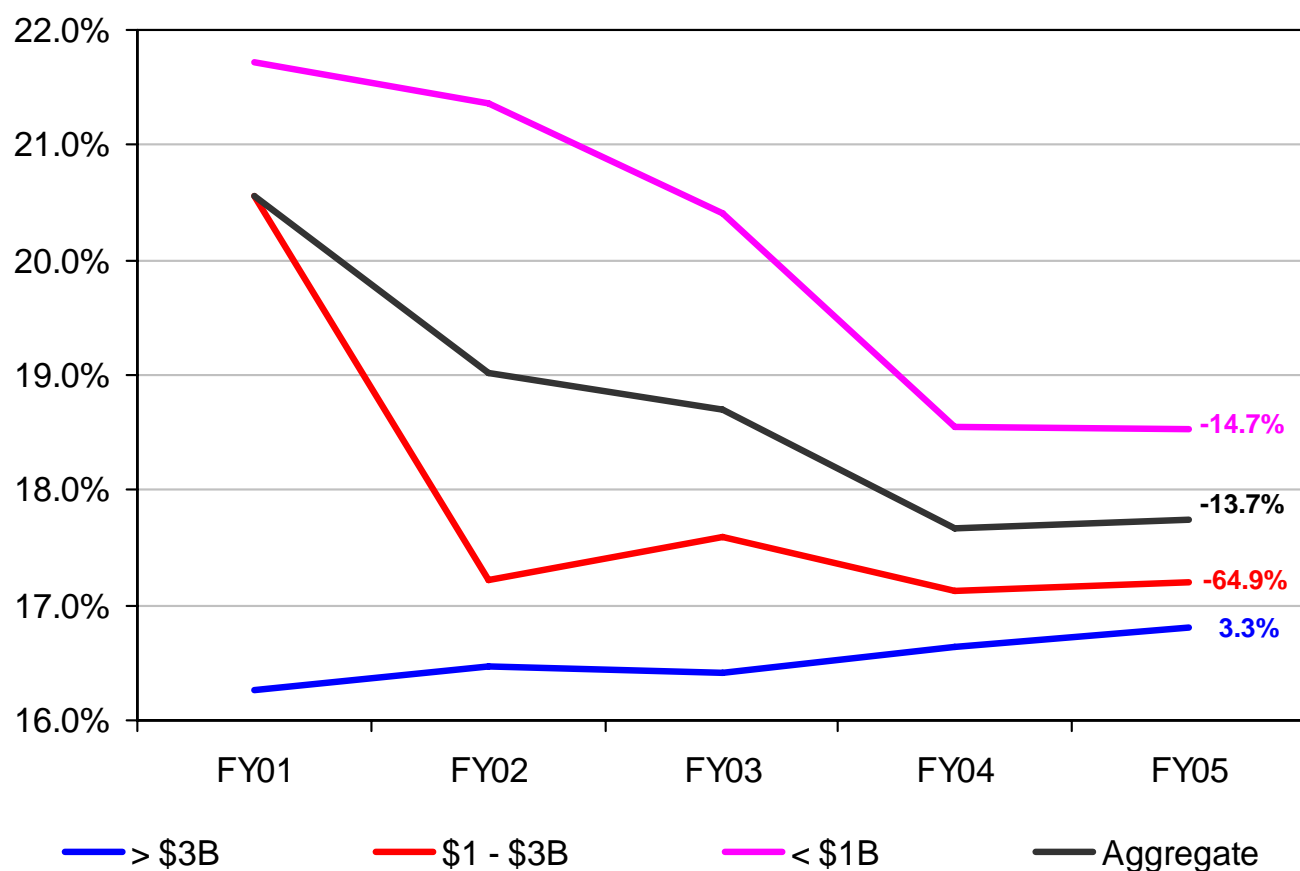
## While Operating Margins are Improving Overall, Scale of Health Care Systems is Driving the Strongest Results



Virginia Aggregate Source: Virginia Health Information Industry Reports

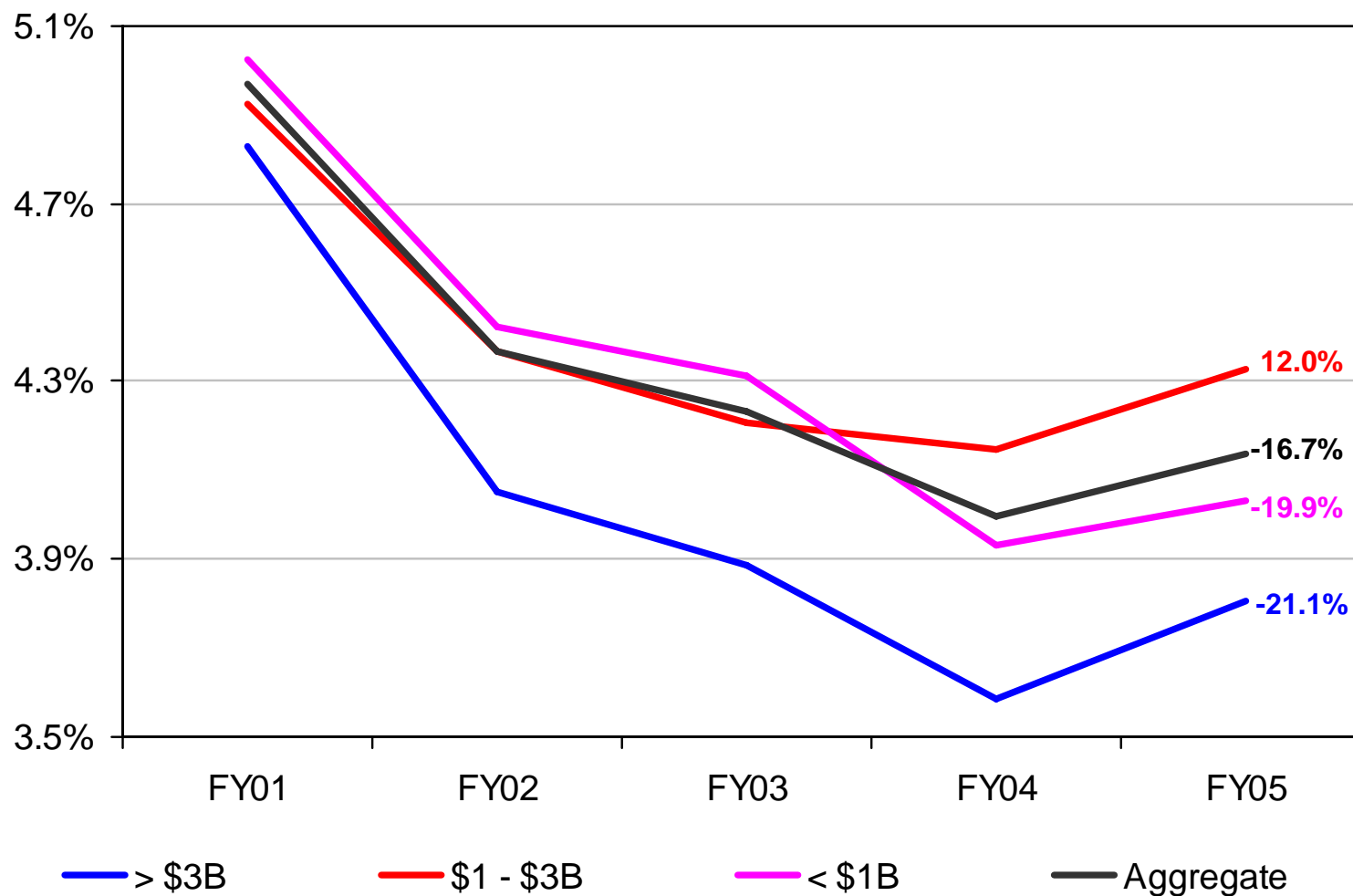
## Scale Drives Lower Supply Costs

**Supply Costs: Expense Ratio  
Stratified by Size**



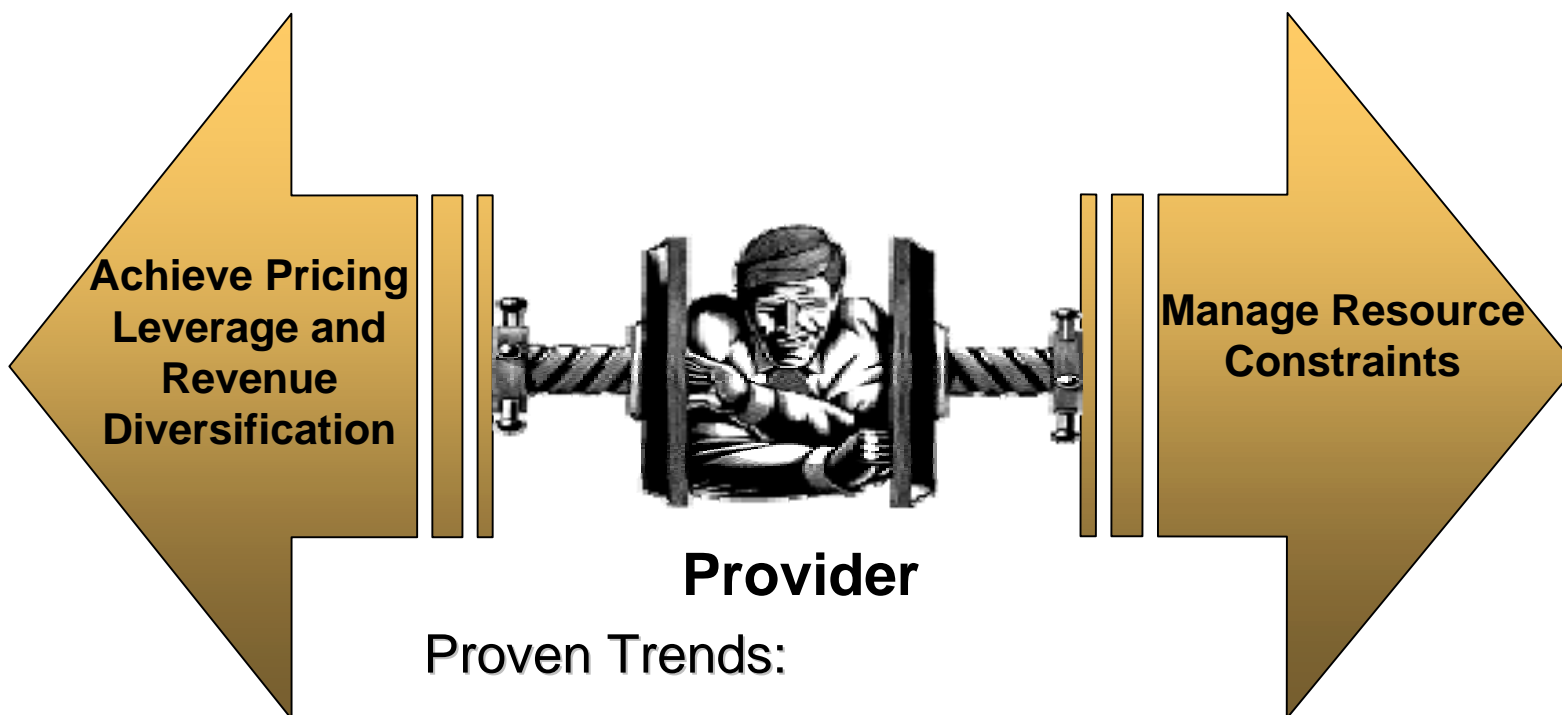
## Scale Generates a Cost of Capital Advantage

Total Cost of Debt—Stratified by Size



## Scale may Create a Sustainable Advantage for Health Care Systems

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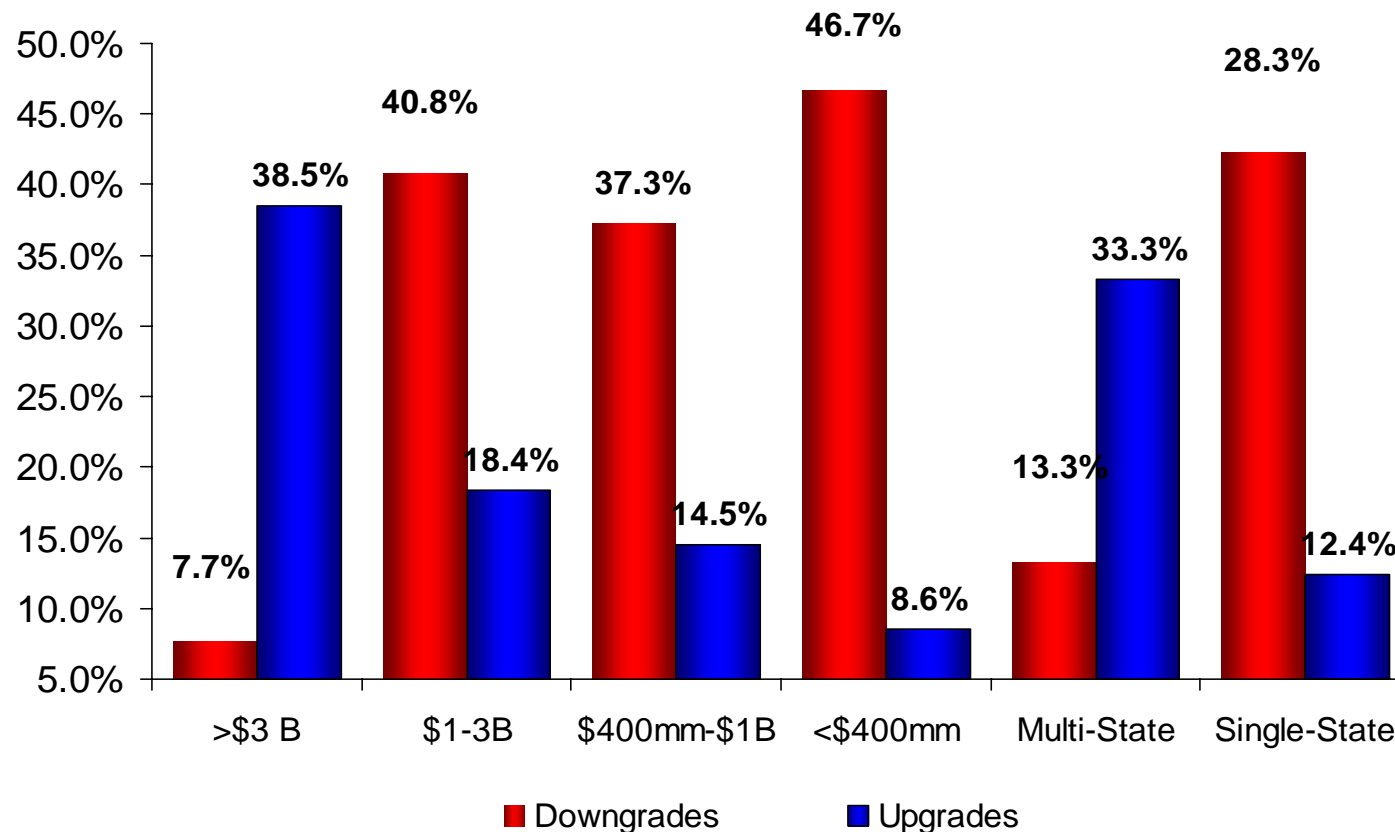


### Proven Trends:

- ✓ **Faster Revenue Growth**
- ✓ **Lower Supply Costs**
- ✓ **Ability to Pay Work Force More**
- ✓ **Lower Cost of Capital**
- ✓ **Leverage IT Spending**

## Another Data Point...Seven Years of Rating Action Show the Advantages of Scale

- Moody's Investors Service has divided 250 health systems into the following categories assessing the percentage of downgraded credits for the period of 1998 – 2005
- Large health care systems experienced far fewer downgrades



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