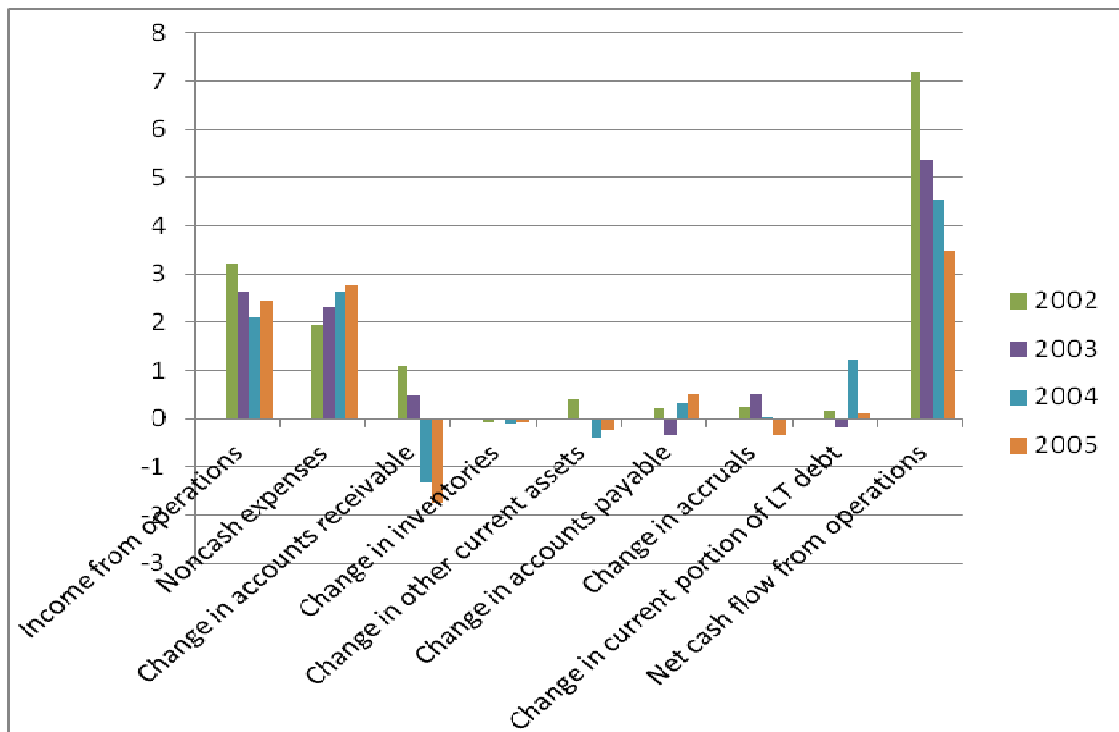


Evaluation of Creekside Clinic financial statements

By Morgan Templar, for Ohio University MHA program October 2011

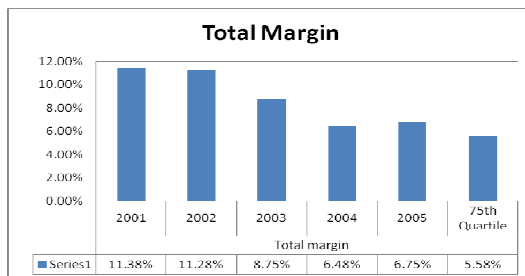
From 2002 to 2005 Creekside's Income from Operations showed a general downward trend while Non-cash Expenses went up. Accounts Receivable has dropped while Accounts Payable has risen. Of most significant note is the acquisition of a significant long-term debt in 2004. The consistent drop in net cash flow correlates with the purchase of additional fixed assets as Creekside has implemented expansion in Outpatient services.



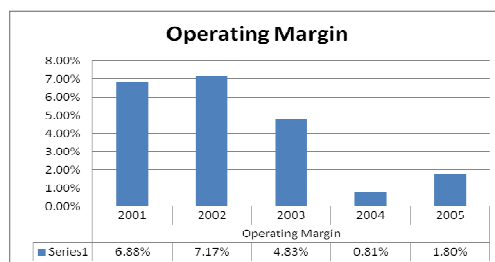
Profitability Ratios

Creekside's Total Profit Margin has fallen from 11.38% in 2001 to 6.5% in 2005.

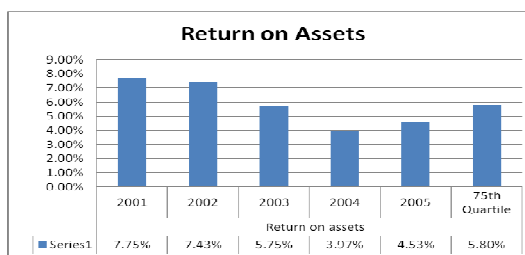
Benchmarking against the 75th Quartile at 5.58% in 2005, Creekside continues to maintain excellent profitability.



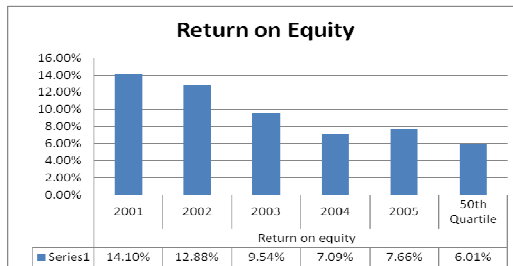
However, when considering expenses into the equation to get the Operating Margin, the numbers are significantly less favorable; they show that Creekside is incurring some large costs and has not increased revenue to compensate:



The return on Assets benchmarked at the 75th Quartile of 5.8% and 50th Quartile of 3.1% again shows that Creekside's assets are performing well in producing income:

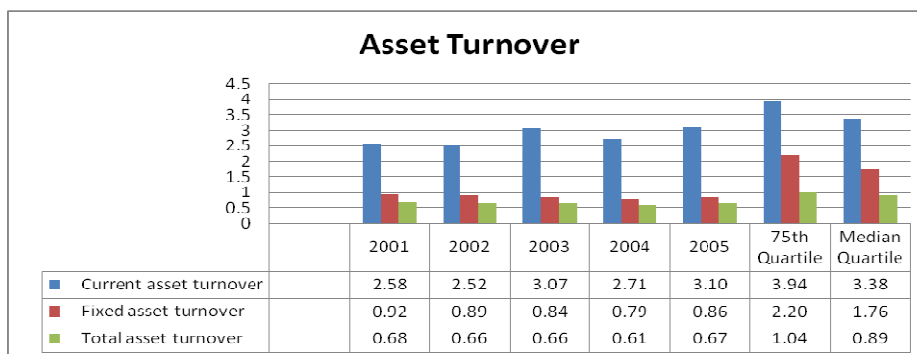


Return on Equity is also strong showing that capital is being used well benchmarking above a Median Quartile of 6.01% but below the 75th Quartile of 15.66%:



Other financial indicators show the same downward trend but do maintain levels at or above the 75th Quartile in most cases. Liquidity is good with 2.67 current ratio and 32.7 days cash on hand. Creekside has a low debt ratio of 40.9%, and the long-term-debt-to-equity ratio is also low at 55.47% compared to a median quartile of 64.7%, even with the acquisition of a large debt in 2004.

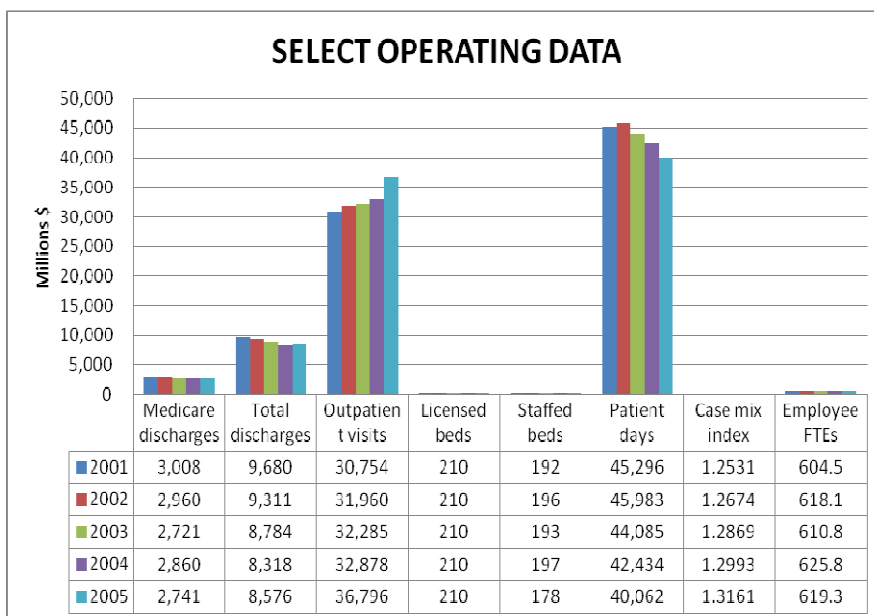
In-depth analysis shows that the area of greatest concern for Creekside's Profitability Ratios is in the return ratios from assets. Creekside is not using its assets as effectively as even the median quartile hospital:



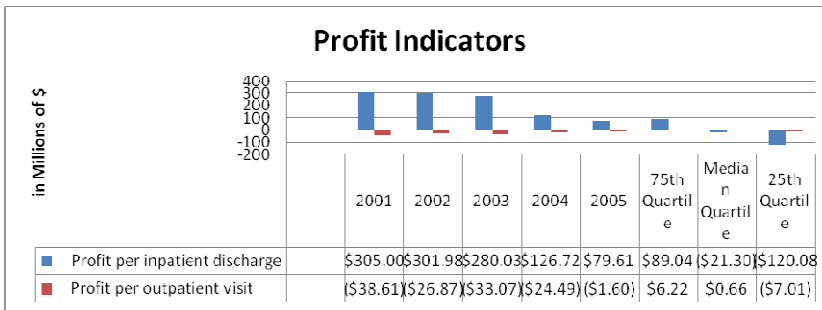
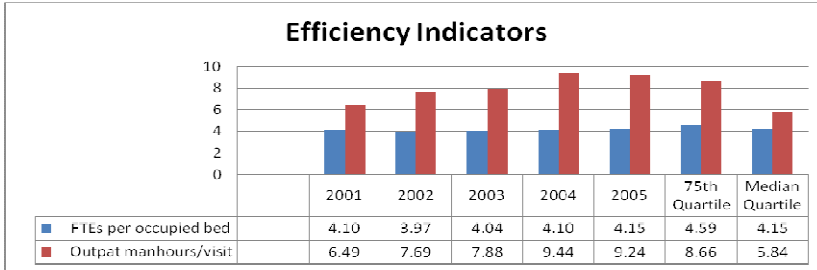
Of note, Creekside's Average Age of Plant ratio is very low indicating newer equipment purchased at higher prices, which does impact the asset turnover

rates. However, while this is contributory, this is not an ample explanation for being below the Median Quartile.

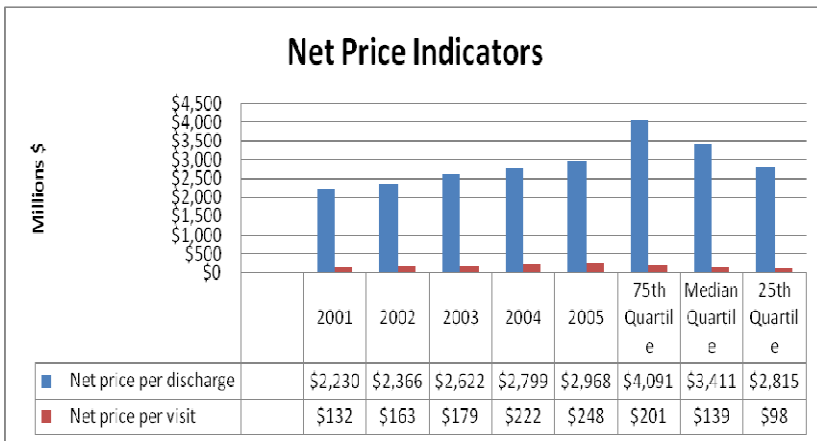
Analysis of Creekside's operations show that total inpatient discharges have been declining. Outpatient visits have increased 19.6% while inpatient days have declined by 11.56%. Inpatient income remains strong but is declining. Outpatient losses have decreased each year. Other operating data, such as Licensed Beds, Staffed Beds, Case Mix index and FTEs have remained fairly constant.



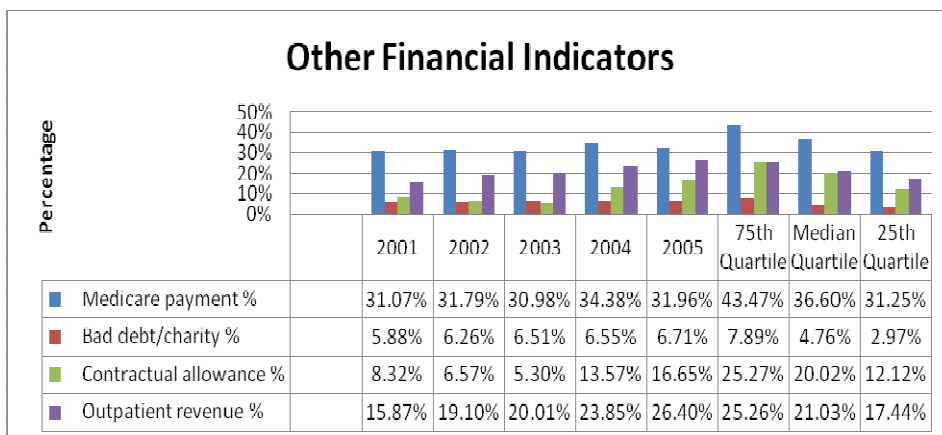
Inpatient services require fewer employees per visit to meet patient needs than outpatient visits. This directly affects the profit indicators for each type of visit. Creekside is below the 25th Quartile for outpatient profits. The outpatient services have been a significant drain on the overall profitability and financial stability of Creekside.



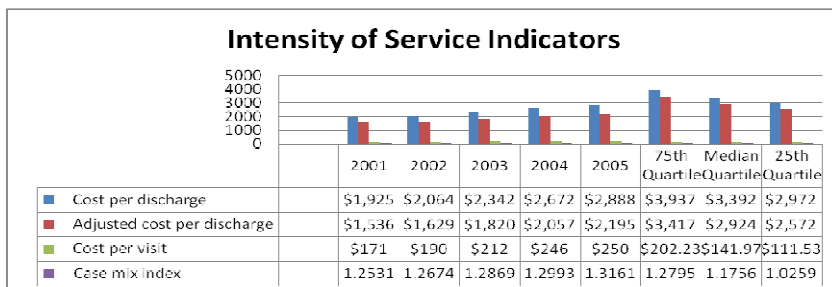
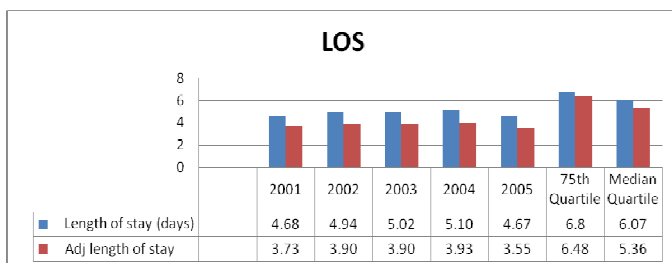
Creekside pricing is low compared to other hospitals falling just above the 25th quartile in 2005. But the cost to Creekside of providing that care is high coming in above the 75th quartile.



Other financial indicators show that Creekside is comparable to other hospitals in many performance areas.



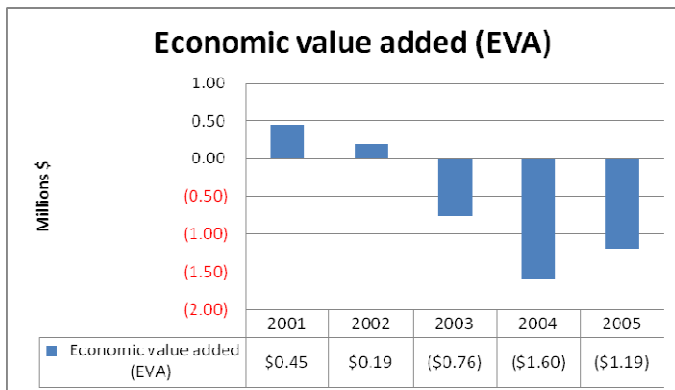
Length of Stay is well below the average. Consistent with Creekside's low prices, inpatient costs to patients/payers are also below average.



Overall, Creekside is performing very well compared to other hospitals. The many financial and operational indicators show consistent trends that profits have been declining and costs rising from 2001 to 2005. Declining margins appear to be a result of the expanded Outpatient services and the associated

higher costs of providing that care. A significant contributor to that cost is the asset costs.

A condensed picture of Creekside can be established through the calculation of Economic Value Added. According to Gapenski (2008), “EVA represents the residual income that remains after all costs, including the opportunity cost of the employed equity capital, have been recognized.” With a 10% cost of capital basis, the EVA has been in the negative for the past three years. This number is directly impacted by both income statement profitability and balance sheet assets (Gapenski, 2008). Operating efficiency must be closely scrutinized, especially in the outpatient services; the balance sheet assets must also be evaluated since Creekside is carrying a high fixed asset cost and realizing below average returns on these assets.



Performing a SWOT (Strengths, Weaknesses, Opportunities, and Threats)

Analysis on Creekside’s financial and operating data puts the financial information into operational terms.

Strengths

Creekside has strong inpatient revenue and low costs. Census has remained relatively constant and costs to provide services have declined. Other financial indicators have also remained constant indicating that Creekside's environment is stable.

Weaknesses

Creekside suffers from two main weaknesses, both of which are related. The decision was made to expand outpatient services. These services have increased the fixed asset investment and have not provided expected returns. Outpatient services cost more in human capital to provide and have increase the debt load carried by Creekside to build and maintain the facilities. Significant attention must be devoted to normalizing costs for outpatient services to benchmarked levels.

Opportunities

In spite of the challenge to the financial statement caused by the expansion of outpatient services, this is an area of tremendous opportunity. Now that Creekside has made the investment in the infrastructure, refining the processes and implementing LEAN techniques could ultimately make this service a tremendous asset. Creekside has the necessary capital to invest to expand the marketing of these services. Additional partnerships with community providers could increase utilization.

The outpatient services offered by Creekside mesh well with the coming paradigm of patient-centered medical homes required under the 2010

Accountable Care Act. More services in the future will be pushed to the outpatient and even home health arena as inpatient services are discouraged through payment discounting by Medicare/Medicaid, which will be followed closely by other managed care payers. Creekside is financially strong today and has the liquidity and opportunity to leverage that strength to expand into these service areas.

Threats

The primary threat at this time is the expansion of the for-profit competition in the area. The parent company has a reputation for impacting the neighboring hospitals in a negative way. Because they are an aggressive for-profit entity, their costs will be held as low as possible. Creekside must get the cost of the outpatient services in line with this competition. Creekside must also work to develop excellence in customer service to enhance brand loyalty among the local patient population and the community at large.

Another threat is the uncertainty of the effects of the Accountable Care Act of 2010. Cuts to reimbursement, Value Based Purchasing, Pay for Performance, Accountable Care Organization, etc. are all areas that are being pushed onto hospitals. Each will have an effect, but no one can estimate what those effects will be. Creekside must remain nimble and ready to react when changes become finalized.

Recommendations

My recommendation to the Board is to embark upon a LEAN initiative in outpatient services to bring cost into alignment with benchmarks.

Concurrent with that project, information should be gathered on the demographics and care profile of the surrounding community. A community needs survey would also be a useful exercise. This could be performed in conjunction with another non-profit hospital, the United Way, or other community program to identify areas in which Creekside could expand outpatient services to grow market share and strengthen brand loyalty among the patient base in the community.

Summary

Creekside is uniquely placed in the market at this time with a strong balance sheet, good liquidity, and profitably efficient inpatient services. Care must be taken to bring the outpatient services into line with this model. Aggressive planning for the future should also be undertaken to prepare to nimbly react to changes in the health care landscape brought about by both competition changes and the regulatory environment cause by the Accountable Care Act of 2010.

Resources:

Gapenski, L. (2006). *Cases in Healthcare Finance*. (3rd ed.). Chicago, IL:

Association of University Programs in Health Administration Press and
Health Administration Press.

Gapenski, L. (2008). *Healthcare finance, an introduction to accounting and financial management*. (4th ed.). Chicago, IL: Health Administration Press