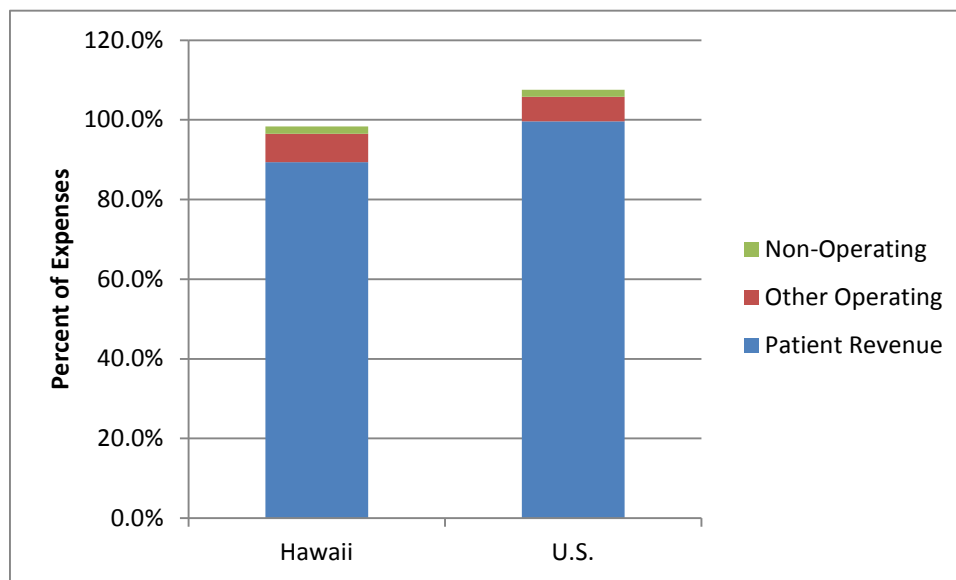


Financial Climate for Hospitals in Hawaii

The financial performance of Hawaii hospitals lags that of the industry on a national level. Revenue earned from providing patient care covered only 90% of total expenses for Hawaii hospitals versus 99% for the industry as a whole. Hawaii hospitals are dependent on forms of non-patient revenues and donations to break even, as opposed to the industry which uses their positive margins to reinvest in new technology and quality improvement initiatives.

Figure 1: Hospital Revenues to Expenses, 2011



Source: American Hospital Association Hospital Statistics, 2013 edition

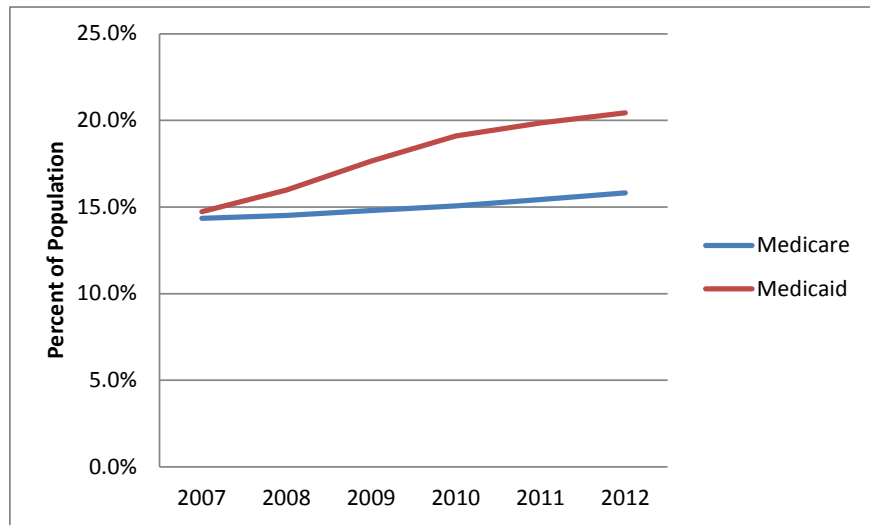
The disparity in revenues and financial performance arise from a conundrum of payer mix and national reimbursement methodologies which do not take into account the higher costs associated with Hawaii's geographic isolation. In general, public insurance programs (Medicare and Medicaid) do not reimburse providers adequately for the cost of services performed. This underpayment is subsidized by commercial/private insurance companies and is commonly referred to as a cost shift.

This phenomenon is not hospital-specific and applies to all provider types. In general, Medicare, the public insurance program covering seniors, reimburses Hawaii providers at roughly 115% of the national average through a wage adjustment factor. However, this adjustment is still insufficient as it is applied to a national base rate, which does not take into account costs like shipping fees and high electricity rates that Hawaii providers face.

This is particularly problematic for hospitals which are reimbursed by an all-inclusive per-case basis. Longer hospital stays due to a lack of skilled nursing beds results in Hawaii hospitals having a \$100 million per year shortfall (cost minus payments) for Medicare patients alone. Shortfalls for the Medicaid and uninsured populations create an additional \$125 million in losses which hospitals must overcome.

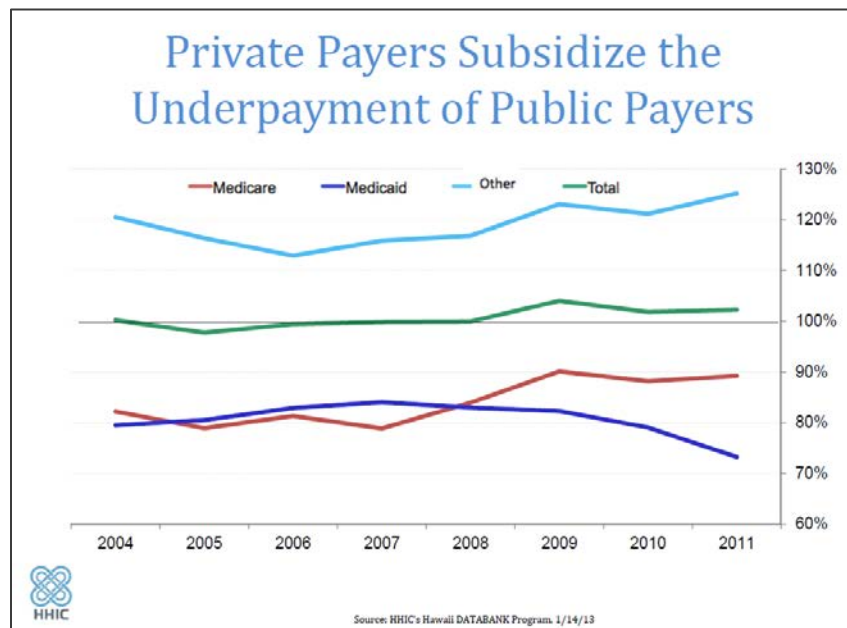
These shortfalls continue to grow due to increasing enrollment in these programs. Medicare growth is fueled by Baby Boomers exiting the workforce and QUEST counts have risen sharply since the economic recession.

Figure 2: Medicare and Medicaid Enrollments as a Percent of Hawaii Resident Population



Source: CMS, MedQUEST Division, US Census Bureau

Figure 3: Payment to Cost Ratios by Payer Type



Source: Hawaii Health Information Corporation

APPENDIX

Hospital Financial Summary, Hawaii vs. U.S., 2007 - 2011

Hawaii	2011	2010	2009	2008	2007
Net Patient Revenue	2,137,819,877	2,426,222,007	2,323,124,743	2,210,192,467	1,986,444,647
Other Operating	170,282,864	171,665,631	174,637,723	150,555,239	137,045,681
Non-Operating	43,411,366	48,234,523	40,300,553	21,263,753	67,676,101
Total Net Revenue	2,351,514,107	2,646,122,161	2,538,063,019	2,382,011,459	2,191,166,429
Total Expense	2,391,952,134	2,611,062,195	2,576,059,889	2,321,587,503	2,144,699,750
Patient Service Margin	-10.6%	-7.1%	-9.8%	-4.8%	-7.4%
Operating Margin	-3.5%	-0.5%	-3.0%	1.7%	-1.0%
Net Margin	-1.7%	1.3%	-1.5%	2.6%	2.2%
United States	2011	2010	2009	2008	2007
Net Patient Revenue	699,719,097,711	676,383,280,857	647,062,726,820	610,900,885,267	573,581,118,858
Other Operating	43,297,884,991	41,269,017,419	38,997,453,520	37,136,577,114	35,765,948,073
Non-Operating	12,267,965,061	13,251,393,842	4,467,480,534	(4,453,107,631)	17,000,138,209
Total Net Revenue	755,284,947,763	730,903,692,118	690,527,660,874	643,584,354,750	626,347,205,140
Total Expense	702,091,033,815	677,968,038,012	656,156,258,314	626,576,957,912	583,252,287,933
Patient Service Margin	-0.3%	-0.2%	-1.4%	-2.5%	-1.7%
Operating Margin	5.8%	5.9%	4.6%	3.4%	4.5%
Net Margin	7.6%	7.8%	5.2%	2.7%	7.4%

Source: American Hospital Association

Hospital Utilization Summary, Hawaii vs. U.S., 2007 - 2011

Hawaii	2011	2010	2009	2008	2007
Beds per 1,000 Population	1.9	2.4	2.3	2.4	2.3
Admissions per 1,000	76.4	85.1	86.2	86.5	86.8
Inpatient Days per 1,000	524.2	636.9	596.4	657.7	624.1
Average Length of Stay	5.8	6.1	6.0	6.1	6.6
Emergency Visits per 1,000	266.4	281.4	296.3	280.4	265.5
United States					
Beds per 1,000 Population	2.6	2.6	2.6	2.7	2.7
Admissions per 1,000	111.8	113.7	115.7	117.5	117.2
Inpatient Days per 1,000	600.4	613.5	627.5	644.2	645.1
Average Length of Stay	5.0	5.0	5.0	5.0	5.0
Emergency Visits per 1,000	415.5	411.7	414.6	404.2	400.6

Source: American Hospital Association