

Fixed Income Insight

May 24, 2004

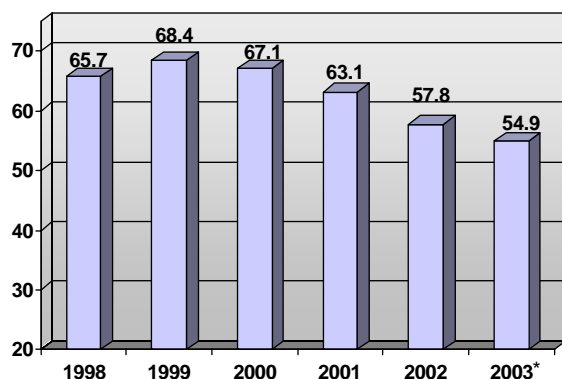
Tracking Merritt Data - Hospitals

Non-Profit Hospital Bonds Show Improving Financial Performance in Advance of Mounting Capital Outlay Plans

Operating margins of non-profit hospitals have been inching upward since 2000 when they hit a ten-year low of 0.44 of 1%. With 60% of all 2003 year audited financial reports counted by Merritt Research, the median operating margin is running at 1.30%, the best result since 1998. Most of the hospitals that have yet to report their audit had fiscal years concluding at the end of the calendar year (12/31/03). While the overall 2003 median profit margin of 2.7% showed an increase from the previous year's level of 2.3%, total profitability was still well below the 5.7% margin recorded in 1997— just before the Balanced Budget Act of 1997 cut heavily into hospital Medicare reimbursements.

Hospital managers have had to work hard to improve efficiencies and performance in recent years. A favorable factor that is helping hospital financials is the progress made to reduce outstanding receivables. So far, Days in Accounts Receivable for 2003 stands at a hospital median number of 54.9 days, which, if it holds, will be the best collection record in over ten years. In 1999, Days in Accounts Receivable was as high as 68.4 days. Another number that appears to be improving for non-profit hospitals is Bad Debt Expense-to-Total Operating Revenues. Nationwide, the non-profit hospital median for bad debt expense ratio stands at 4.94%, which is below 5% for the first time in four years. This trend is in contrast to some highly publicized individual hospitals and for-profit companies that have been burdened with higher non-collectibles. Liquidity cushions are also on the mend as the Days Cash on Hand appears on the brink of rising to the best levels since 1998, due in part to an improvement in the market values of investments.

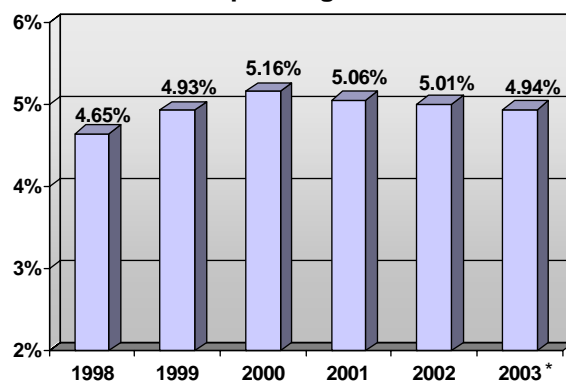
Median Days in Accounts Receivable



Source: Merritt Research Services, LLC

* 2003 median data reflects financial statements received to date.

Bad Debts Expense as Percentage of Total Operating Revenues



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MCDONNELL INVESTMENT
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Guiding Portfolio Strategies

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Despite the nationwide increase in the number of private specialty outpatient surgical centers, hospital utilization numbers continue to run ahead of previous years in key areas such as admissions, inpatient surgical operations and outpatient surgical operations. The growth in hospital activity—along with a pent-up demand for facility improvements—is spurring high projections for capital outlay spending over the next several years.

A Health Care Financial Management Association study conducted in late 2003 found that hospital infrastructure was deteriorating; in fact, one-third of the CFOs surveyed reported that their hospital infrastructure was in worse condition than ten years ago. Merritt Research's collection of 2003 financial reports appears to reinforce the steady aging trend as reflected in the average age of net fixed assets. The median average net plant age in 1993 was only 7.8 years compared to the current average age ratio of 9.5 years. During the same time span, hospitals have seen their Capital Cost-to-Operating Expenditures ratio fall from 8.4% in 1993 to 7.5% in 2003, reflecting the general erosion in infrastructure spending.

Increased capital spending and borrowing for hospitals is likely to take place throughout the rest of this decade. The stabilization of average length of stay and the continued growth of hospital utilization will likely continue to require the gradual expansion of beds in service. The need to expand and modernize hospitals will likely be an expensive proposition, which will require a combination of borrowing and higher fees—both of which may challenge recent financial gains.

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