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10 Key Metrics as Components to Measuring Financial Health

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Hospital CFOs are continually tracking and measuring financial performance using key metrics and indicators for reporting to their boards, rating agencies, and their executive management teams. Profitability, cash flow, liquidity, capital structure, and the age of the physical plant are all monitored and reported. However, the individual metrics often become the focus, and the composite picture of the hospital's overall financial strength is lost.

Rather than analyzing endless individual metrics, hospital CFOs can focus on just ten key indicators and the Financial Strength Index™¹ ("FSI") to simply and effectively measure overall financial health. FSI encompasses metrics for profit, liquidity, capital structure, and physical plant, and "normalizes" them around an average for that metric. Routine use of these metrics can track the overall financial performance of an organization and identify areas of concern far enough in advance to implement corrective action.

Listed below are the ten key metrics, their definitions as applied to FSI, and the Financial Strength Index formula.

- 1. Operating Margin (%).** Total operating revenues minus total operating expenses, divided by total operating revenues.
- 2. Excess Margin (%).** Total operating revenues plus non-operating revenues minus total operating expenses, divided by total operating revenues plus non-operating revenues.
- 3. Cash Flow Margin (%).** Cash flow from operations, divided by total operating revenues plus non-operating revenues.
- 4. Debt Service Coverage Ratio (x).** Net increase in unrestricted net assets plus depreciation and interest expense, divided by interest expense (net of deferred financing) plus principal payments.
- 5. Days Cash on Hand (days).** Unrestricted cash and investments, divided by daily cash operating expenses (total operating expenses less depreciation/amortization expenses).
- 6. Cushion Ratio (x).** Unrestricted cash and investments, divided by maximum future annual debt service.
- 7. Debt Financing (%).** Total assets minus unrestricted net assets, divided by total assets.
- 8. Long-Term Debt to Capitalization (%).** Long-term debt, divided by long-term debt plus unrestricted net assets.
- 9. Accumulated Depreciation (%).** Accumulated depreciation, divided by gross property, plant, and equipment.
- 10. Capital Expenditures as Percent of Depreciation Expense (%).** Annual expenditures on property, plant, and equipment, divided by depreciation expense.

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¹Cleverley, W. and Cameron, A., "Financial Strength Index™: A Measure of Overall Financial Health," *Executive Insights*, January 2003.

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$$\text{Financial Strength Index}^{\text{TM}} = \frac{\text{Excess Margin} - 0.04}{0.04} + \frac{\text{Days Cash on Hand} - 50}{50} - \frac{\text{Debt Financing} - 0.50}{0.50} - \frac{\text{Accum. Depreciation} - 0.50}{0.50}$$

The FSI seeks to reflect the impact of changes within an organization, and the tradeoffs between each of the component metrics. The suggested guide to FSI rating is as follows:

FSI Score	Financial Health
> 3.0	Excellent
0 to 3.0	Good
-2.0 to 0	Fair
< -2.0	Poor

While CFOs use a variety of methods to assess the financial performance of their hospitals, focusing on these ten key metrics and the FSI score is a simple and effective way of measuring overall financial health. For more information, please contact Michael Miyagi at (310) 320-3990 or by email at mmyagi@thecamden.com.