Overview of the Financial Health of Ten New Hampshire Community Mental Health Centers

Submitted to the New Hampshire Department of Health and Human Services
by Kane Consulting Group.

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Introduction

This report updates the January 2010 report to the Endowment For Health, "Overview of the Financial Health of Ten New Hampshire Community Mental Health Centers, 2004-2009."

The ten mental health centers include: CLM Center for Life Management (Southern New Hampshire), Community Council of Nashua, Inc., Community Partners (Strafford County), Genesis Behavioral Health (Lakes Region),The Mental Health Center of Greater Manchester, Monadnock Family Services, Northern Human Services, Inc., Riverbend Community Mental Health, Inc., Seacoast Mental Health Center, Inc, and West Central Behavioral Health.

All are nonprofit organizations providing mental health services to specific geographic areas under contract with the New Hampshire Department of Health and Human Services. Most have one or more affiliates that are associated with activities related to the mental health centers, such as foundations/fundraising, real estate, and information technology services. Two (Community Partners and Northern Human Services, Inc.) also provide services to the developmentally disabled.

Aggregate Financial Performance: Revenues and Expenses

Table 1 below summarizes the aggregate annual income statements of the ten centers. Total operating revenues and total operating expenses grew at average annual rate 2.30% and 2.25% respectively, which is considerably slower than the growth rates of 4.7% and 3.3%, respectively, for the period 2004-2009. Aggregate patient volume declined at an average annual rate of 2.9% over the period, going from 51,305 patients in 2010 to 45,992 patients in 2014.

Aggregate operating margins hovered between breakeven and 1.5% between 2010 and 2014, while aggregate total margins ranged between 1% and 2.6%. However, in 2014, six CMHC's received Meaningful Use Payments from the state totaling $1.2 million, which accounted for 46% of the aggregate operating income in that year. Without those special and non-recurring payments, aggregate operating income would have been only $1.4 million, a much smaller improvement over 2013, and the operating margin would have dropped to .8%, roughly the same as the year before.

Table 1: Aggregate Income Statements
for the 10 CHMC's 2010 - 2014

Year	**2010**	**2011**	**2012**	**2013**	**2014**	Average Annual Change
Operating Revenues:						
Net Patient Serv Revenue	142007	142902	143003	145385	149603	1.34%
DonatedGoods and Services/Contributions	274	507	266	660	392	
Grants	8959	8311	8482	10860	11288	
Assets Released From Restrictions for Opns	580	95	321	50	1824	
Other Operating Revenue	7171	7920	8475	9524	10519	
Total Other Operating Revenues	14975	14607	15423	18343	20369	9.01%
Total Operating Revenue	158991	159381	160547	166479	173592	2.30%
Operating Expenses:						
Salaries , Payroll Taxes, Fringes	113373	115807	95783	119091	123606	2.26%
Depreciation	2383	2439	2455	2517	2540	1.65%
Interest expense	1175	1039	806	805	788	-8.23%
Other operating expenses	40049	56066	76585	38870	41802	1.09%
Total operating expenses	156863	159849	160128	165183	170978	2.25%
Net Operating Income	2128	-468	419	1296	2614*	
Nonoperating Revenues:						
Interest and dividends	235	386	368	443	520	
Realized gains(losses)	147	646	-7	205	688	
Other Income (expense)	1060	882	978	1440	792	
Total nonoperating revenue	1472	2049	1244	2088	2000	
Excess of revenue over expenses	3600	1581	1663	3384	4614	
Aggregate Operating Margin	1.34%	-0.29%	0.26%	0.78%	1.51%	
Aggregate Total Margin	2.24%	0.98%	1.03%	2.01%	2.63%	
Aggregate Number of Clients Seen	51261	50798	49529	47819	45992	-2.89%

*Includes $1.4 million of one-time meaningful use payments from the state to six health centers; 2014 operating margin drops to .70 % if these are removed from revenues

Aggregate Financial Performance: Cash Flows

The five year aggregate cash flow (sources and uses) is shown in Table 2 below. As in the prior report, the overall pattern represents a relatively "healthy" performance in aggregate, in that the sources are largely from operations, and the uses are primarily for investments in the future - property, plant and equipment expenditures, as well as a build-up in liquid assets (cash and marketable securities).

Ninety percent of fund sources were generated by operating activities, which is a healthy pattern as long as the amount is adequate to maintain fixed assets (plant and equipment, information systems) and working capital. The remaining 10% came from the sale of fixed assets (5%), decreases in other noncurrent assets (2.6), and increases in other noncurrent liabilities (2%). A negligible source was transfers from other entities (less than 1%).

Uses of cash included an aggregate increase in working capital (22%), due to a large increase in patient accounts receivable (revenue growth plus slowdown in collections) coupled with a decrease in other current liabilities.

The largest use of cash, as would be expected, was investment in property, plant and equipment, using 35% of funds generated in this period. As in the past, this investment ($9.45 million) was slightly higher than the aggregate amount of depreciation expense ($9.2 million) over the period. While for medical facilities a capital expenditure to depreciation ratio of 1.03 is inadequate to maintain the full replacement cost of buildings and equipment, it may suffice for much less capital-intensive mental health services. In 2014, six of the ten CMHC's received roughly $1.4 million in Medicaid Meaningful Use (MMU) payments, and in 2013, one received a MMU payment of $106 thousand, indicating that most of the CMHC's are investing in electronic medical record systems. It is not possible to determine how much of the capital expenditure in 2014 was for meaningful-use –related investments in information systems.

Net repayment of debt absorbed another 21% of total funds, while increases in working capital cash plus board-designated funds used another 22% of funds.

The relatively healthy overall cash flow and moderate profitability of the sector is not representative of the 10 centers individually, however. Substantial variation in financial stability remained, as the following section describes.

Table 2	Sources and Uses of Cash, 2010-2014				
	$ '000	**% Total**	**$ '000**	**% Total**	
	Sources	**Sources**	**Uses**	**Uses**	
Excess of revenue over expenses	14,900	56%			
Noncash expenses (revenues)	9,181	34%			
Decr(Incr) working capital			-5810	22%	
Decr (Incr) in investments			-3610	13%	
Sale of Fixed Assets and					
Change in Other Noncurrent		10%			
Decr (incr) PP&E gross			-9446	35%	
Net repayment Long Term Debt			-5,500	21%	
Net change in Cash			-2,475	9%	
Total Sources (Uses)	26,741		-26,741		

Community Mental Health Center Ratio Analysis by Groups of Relative Strength

Following the format of our earlier report, the health centers were ranked into three groups: the "Low" performing group represented three CHMC's with the lowest, and generally negative, operating and total margins over the period 2010 - 2014; the "Middle" performing group represented three CMHC's with margins in the middle of the range, with operating margins averaging around breakeven; and the 'High" performing group represented the four CMHC's with generally positive operating and total margins. Since none of the profit margins were particularly high, these grouping names indicated each group's position relative to the others, rather than as an indication of overall financial health.

Since the 2010 report, five of the ten centers changed groups. The greatest changes were two centers: one went from low to high (with the inclusion of an affiliated real estate entity that had not been included in 2010 analysis), and one went from high to low (no change in entities included). The other three experienced less dramatic changes: low to middle, middle to low, and middle to high. Of these five, then, only two went into a lower group; three went into higher groups, and the original three centers in the High group in 2010 remained there in 2014.

Figure 1 shows total margins by the 2014 CMHC financial groups. Total margins included both operating income and nonoperating revenue (generally investment income). Figure 1 shows that, while the High group medians stayed within a viable range of 2-6%, the Low group medians were generally below zero. The Middle group median ranged between -3% and 2%. In most health sectors, consistently breakeven to negative margins do not ensure a sustainable financial operation, especially if there is debt service, capital assets to maintain, or working capital needs that must be financed. The aggregate cash flow analysis indicated that the sector as a whole generated cash flow (profit with noncash expenses added back) adequate for working capital, debt service, and plant investment, but this was not true for every agency within the sector, particularly for those in the "Low" profitability group.

Figure 1: Median Total Margins by CMHC 2014 Financial Group

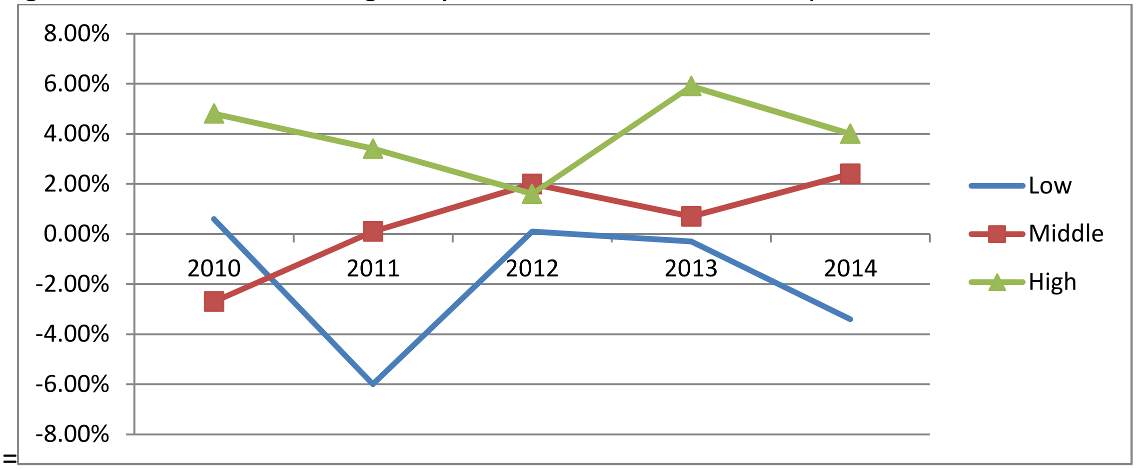


Figure 2 shows Median Operating Margins by CMHC Financial Group. These exclude the nonoperating revenues from the ratio, so it summarizes the results of providing patient services only. The Low group remained unprofitable the entire period, with medians ranging from -1% to -7.7%. The Middle group medians showed steady improvement over time, going from -3% in 2010 to 1.8% in 2014. The High group maintained positive median operating margins throughout the period, ranging between 1 and 4% over the period. Figures 1 and 2 show very similar patterns by group, as the total margin was driven by operating margins in this sector .

Figure 2: Operating Margins by CMHC Financial Group

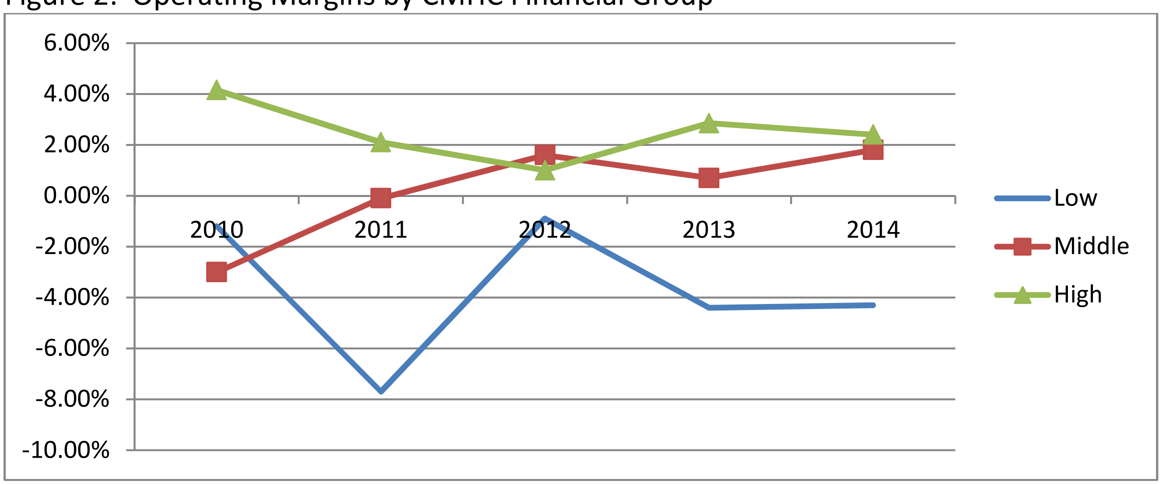


Table 3 describes the total number of patients served each year by the centers in each financial grouping. Overall, patient volume dropped 10% between 2010 and 2014, with the greatest drop occurring in the Middle Financial group. Six centers lost volume over the five years, with a five-year range of -5% to -49%. Four gained volume, with a five-year range of 1% to 18%.

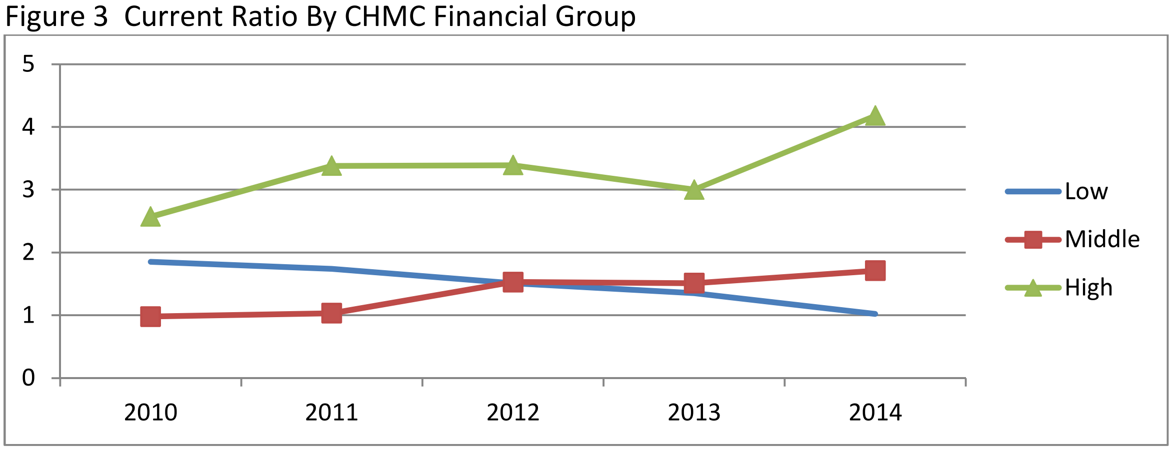
The High group's average patient volume was more than twice as great as that of the other two groups in all five years. The correlation coefficient between number of patients and operating margins, .3372, is statistically significant with a P value of .0166. However volume is quite similar between the Medium and Low Financial Groups, and the Medium Group profitability is rising despite the decline in volume, so other factors were clearly at work in affecting operating margins as well.

Table 3: Number of Patients By CHMC Financial Group

Year:	**2010**	**2011**	**2012**	**2013**	**2014**	Avg Ann Rate of Change
High (4 Centers)	26334	27449	26757	25299	24289	-.0194
Middle (3 Centers)	12840	11362	10631	10400	9857	-.0581
Low (3 Centers)	12087	11987	12140	12120	11846	-.005

Figure 3 shows the current ratio (current assets/current liabilities), a measure of the ability of the centers to make payroll and pay vendors on a timely basis. A ratio above 1.5 is considered adequate; below that, centers may experience difficulties paying their bills on time, which can lead to vendor dissatisfaction, or increase their need for bank lines of credit, if they can qualify for them.

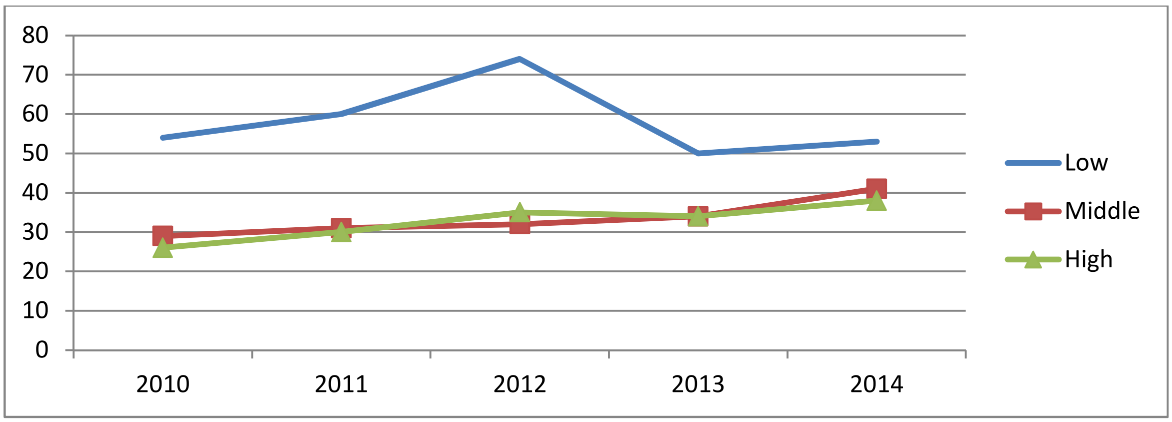
Figure 3 Current Ratio By CHMC Financial Group



As can be seen in Figure 3, the Low group deteriorated from a median of 1.85 in 2010 to a median of 1.02 in 2014, indicating the likelihood of significant difficulties meeting payroll and paying vendors on a timely basis. The Middle group did the reverse, going from a 2010 median of .98 to a more financially comfortable 1.71 in 2014. The High group median current ratio range of between 2.5 and 4.2 indicated a healthy liquidity position.

Figure 4 shows the collection period for accounts receivable, expressed in the number of days of revenue that has been billed but not yet collected.

Figure 4: Median Days in Accounts Receivable by CMHC Financial Group

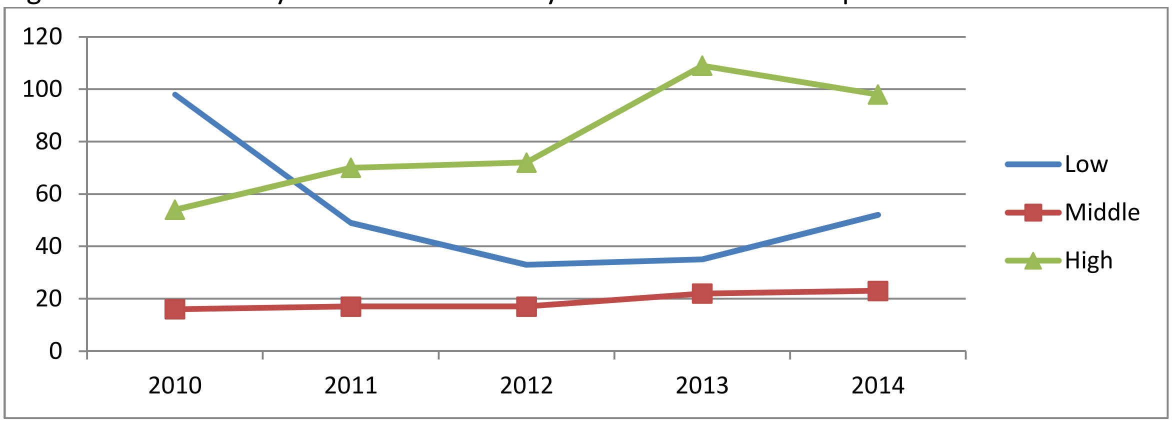


While the median days in accounts receivable is rising overall, the Low group has the slowest collection period. The Low group also had current ratios that fell below 1.5 in 2013 and 2014; the combination means that the Low group's current assets , which include accounts receivable, were slower to convert to cash than for the other two groups, even though their collection period improved over the last couple of years.

Figure 5 describes the median values for each group for the number of days of operating expense they can pay with available cash on hand (here we are including their noncurrent marketable securities when available). This provides a sense of how long a center can continue to operate in the event that their days in receivables is longer than expected due to a slow payer or a payer that can't pay its bills.

The wide variation in days cash on hand among the three financial groups is apparent from Figure 5. The High group median ranged between 54 and 109 days cash on hand, which provided them a healthy cushion against payment slowdowns. In 2014, the center with the lowest value in the High group had 66 days cash on hand. The Low group median dropped from a high of 98 in 2010 to a low of 35 in 2013, improving to 51 days in 2014. In 2014, the center with the lowest value in the Low group had 21 days cash on hand. The Middle group had the lowest median days cash on hand, which improved from 16 to 23 days over the period, but was still quite low, indicating that some may struggle to pay bills on time , especially in 2014 when the days in accounts receivables bumped up to 41. The lowest in the Middle group as of 2014 had only 16 days cash on hand.

Figure 5: Median Days of Cash on Hand by CMHC Financial Group



Moving to solvency ratios, Figure 6 presents the median values for the equity financing ratio by CMHC Financial Group. An equity financing ratio represents the proportion of total assets financed with equity, as opposed to debt. A higher ratio is indicates less financial risk, and is thus more favorable.

Figure 6 shows a very healthy (high) equity financing ratio for the High group, with medians rising from 69% in 2010 to 76% by 2014. While it is improving, the Middle group median ranges were quite low, remaining below 40% in all years. The Low group median ratios are declining over time, and are almost as low as the Middle group by 2013- 2014. Thus the Low and Middle groups are carrying a heavy debt burden that must be repaid from a fairly thin cash flow from operations (income plus depreciation). The debt burden represented a mix of current liabilities, notes payable, and long-term debt.

Figure 6: Median Equity Financing Ratio by CMHC Financial Group

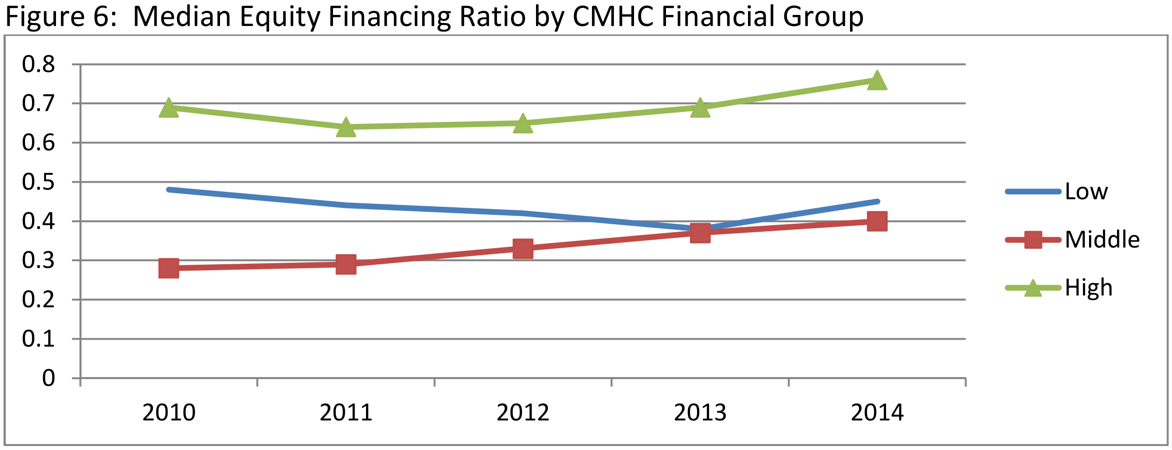
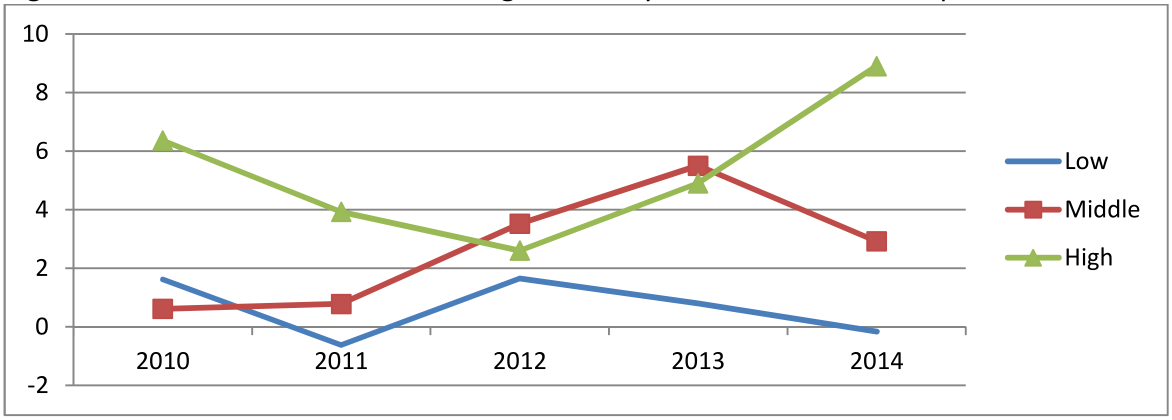


Figure 7 presents the Debt Service Coverage Ratio median values by financial group. If the ratio was below 1, the center was not meeting its debt service requirements from operating cash flow.

Figure 7: Median Debt Service Coverage Ratios by CMHC Financial Group



As the Equity Financing discussion suggested, the Low group appears to be struggling to meet its debt service requirements, with a median debt service coverage ratio below 1 in three of the five years. In 2014, two of the three centers in the Low group had debt service coverage ratios below 1.   They may have had to negotiate with their banks to allow them to pay only what they can afford, which can mean that they exist at the pleasure of their creditors. This is clearly not a viable financial strategy for the long-term. The Middle group median coverage ratios rose over the period to well above 2, because despite their relatively high debt burden, they were somewhat more profitable. These profits provided the Middle group with a greater ability to pay debt service operating cash flow. The High group medians were well above 2 in all years, indicating ample ability to meet their debt service requirements from operating cash flow. Two of the four in the High group had no or negligible long term debt (although two others had substantial levels of long term debt). But their operating cash flow was more than sufficient to cover their debt service requirements.

The final ratio in this report is the Average Plant Age, which approximates the extent to which the centers are maintaining their plant and equipment assets. A rising plant age suggests some asset erosion, while a lower plant age suggests adequate maintenance of capital assets. Figure 8 provides the median values for each financial group over time.

Figure 8: Average Age of Plant : Medians by CMHC Financial Group

This shows that the Middle group achieved a younger plant age than the two other groups, which may have contributed to their lower equity financing ratios (greater debt burdens). The correlation between average plant age and level of long-term debt is -.4285 (inversely correlated, eg more long term debt is associated with younger plant age) with a highly statistically significant p value of .0024.

Conclusion

This report suggests a somewhat healthy overall picture of the CHMC sector, which cannot be generalized to the entire sector as there is significant variation in performance among the centers. The three centers in the "Low" group were short on profitability, liquidity, and solvency, and have relatively older buildings/equipment. The "Middle" group of three centers improved profitability in recent years to adequate levels, although relying to some extent on nonrecurring Meaningful Use payments in 2013 or 2014. The improved profitability also improved solvency (ability to meet long term debt requirements) despite carrying the heaviest debt burden of the three groups. However the "Middle" group had very weak liquidity, particularly days cash on hand, and experienced the greatest drop in patient volume. On the positive side, the Middle group had a relatively young plant age. The "High" group of four centers was reasonably profitable, liquid, and solvent, but did not appear to be investing in property plant and equipment at the rate of the Middle group. Capital investment may not be a priority in mental health services, so older capital assets may not impair the ability of the centers in the "High" group to continue to provide services in the future.

Other than some of the centers in the "High" group, none of these centers had the financial resources to significantly expand their services, especially any services that would require up-front investment in buildings, equipment or working capital. It is of particular concern that volume is 10 percent below 2010 levels at a time when there is such high demand for community based mental health services.