Fixed Income Insight
December 1, 2003

Early Indicators for 2003 Hospital Results Show Improved Liquidity and Debt Coverage Trends

Despite warnings by many analysts prior to the start of this year that the best news for hospital credit trends was behind us, an early sample of audit reports for fiscal year 2003 indicates a continued trend of relatively stable-to-somewhat improving results. The compilation of hospitals included in this early analysis only represents about 14% of the hospitals that furnished audits to Merritt Research Services last year. Most of the 153 hospitals whose reports have been received by Merritt Research to date have fiscal years ending on or before June 30. While the final trend for the year is far from certain, past surveys have often shown that the hospitals reporting early have tended to be predictive of the complete year's general trend. Among the most interesting trends reported so far:

- Current debt service coverage is showing a marked improvement this year. If the 3.2x coverage holds, it would represent the best current debt service coverage protection in the last five years. The improvement in coverage is probably due in part to the overall lower debt service costs related to low interest rates derived from recent borrowings, including refundings.

- Days Cash on Hand in 2003 is up significantly to 136 days, which suggests that hospitals are building cash and investments. While appreciation in investment portfolios might be a factor, faster collection of receivables and conservative reserves are probably making a difference as well. If the current trend holds, the median cash on hand for all hospitals reporting to Merritt Research will be recorded at the highest level since at least 1992.

- Operating and profit margins in 2003 are running slightly below last year, indicating relative stability. Profit margins for the hospitals reporting early are down by just 0.02% compared to 2002; however, even a slight reduction would signal the third straight year of decline. Operating margins excluding disproportionate share tax revenues are down by 0.04% but would still be superior to any year other than 2002 since 1998. A similar trend holds true for adjusted operating margins if monies received from taxes are included.

(continued on next page)

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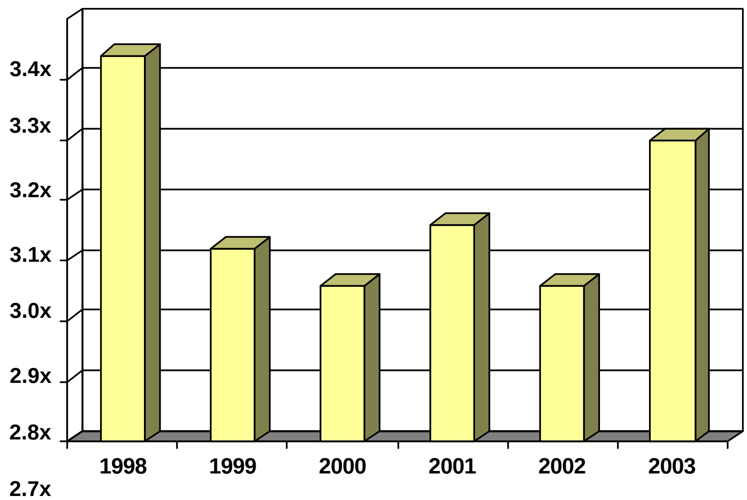
- Profit per admission is one ratio that goes against the positive perspective. The early results of hospitals reporting for fiscal year 2003 appear to be heading towards the weakest outcome in more than ten years. This contrast to better profit margin numbers would suggest that hospitals are increasing their dependency on outpatient revenues to improve their bottom lines.

Debt Service Coverage for Past Six Years



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