



ChildrensHospitalLosAngeles

International Leader in Pediatrics

Walter W. Noce, Jr.
President and CEO

Fall 2003

Dear Friend,

You are an important partner in our mission to ensure a healthy future for children and families. As such, I am pleased to share this “report card” on Childrens Hospital Los Angeles with you.

This is a pivotal time for Childrens Hospital. Remarkable advances in the understanding of human biology, such as the mapping of the human genome, are revolutionizing medicine. As a leading pediatric facility, and one of the nation’s premier pediatric research institutions, we are seizing the moment to invest in the best talent, programs and facilities. In April 2003, we announced Living Proof: The Campaign for Childrens Hospital Los Angeles, a \$500 million fund-raising effort that will enable us to do more for children and families than ever before.

Changing the World for Children

Childrens Hospital sets the standard for pediatric medicine and offers the optimum in multidisciplinary care with 33 pediatric subspecialties. We operate the largest pediatric transport program in the nation, and are one of only two Level I Pediatric Trauma Centers in Los Angeles County accredited by the American College of Surgeons.

For the three-year period ending July 2006, Childrens Hospital has achieved the *Gold Seal of Approval* for patient care and safety from the Joint Commission on Accreditation of Healthcare Organizations (JCAHO). With a score of 98 out of 100, we are in the top seven percent of the 17,000 health care organizations and programs surveyed.

The Saban Research Institute of Childrens Hospital Los Angeles is one of the nation’s top recipients of federal funding for pediatric research at stand-alone pediatric facilities. Funding from the National Institutes of Health (NIH), the country’s largest supporter of biomedical research, has more than doubled in the last five years. Among the activities supported by the NIH are the efforts of our General Clinical Research Center, which provides doctors and scientists with the infrastructure for patients to receive novel treatments for diseases like cancer, diabetes and immunological disorders.

Respect • **Service** • **Excellence** • **Knowledge** • **Teamwork**

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Clinical research trials at Childrens Hospital show great promise for treating pediatric leukemia patients. Our researchers are evaluating clofarabine (an investigational anticancer compound) in children concurrently with researchers at other institutions who are studying the same agent in adult leukemia patients. Almost exclusively, new cancer treatments historically have been studied and approved for adults long before they are tested in children. Our trials will grant children equal access to this new anticancer therapy.

In collaboration with Children's Hospital Boston, our researchers are offering new hope for patients with muscular dystrophy. For the first time, researchers have shown that transplanted bone marrow cells can spur the development of muscle cells in human beings. Laboratory studies are now being performed to determine whether it will be possible in the future to use bone marrow transplantation to treat muscular dystrophy and other muscle diseases.

Through our Health Services and Community Health Research Program, investigators at The Saban Research Institute are working to understand how other factors impact children's health such as improving access, quality and cost effectiveness of care.

Affiliated with the Keck School of Medicine of the University of Southern California since 1932, Childrens Hospital Los Angeles is a premier teaching hospital, training the very best pediatricians in the country. Our innovative response to the nursing shortage—the highly successful R.N. Residency in Pediatrics—is being replicated by children's hospitals nationwide.

The first phase of our three-part architectural agenda was completed in May 2001, with the opening of the Marion and John E. Anderson Building and Burtie Green Bettingen Surgery Center. June 2003 marked the completion of phase two with the dedication of The Saban Research Institute building, which will allow for the expansion of leading-edge programs in developmental biology, cardiovascular research, and gene and stem cell therapy, as well as the development of research initiatives in neuroscience, imaging and infectious diseases. In Summer 2004, we will break ground on our New Hospital building, a model pediatric facility.

Our hospital and medical leaders continue to hold influential positions with national professional organizations and advocacy groups. For example:

- Francine R. Kaufman, M.D., director of the Center for Endocrinology, Diabetes and Metabolism, is the immediate past president of the American Diabetes Association.
- Donald B. Kohn, M.D., director of the Gene, Immune and Stem Cell Therapy Program and co-director of the Childrens Center for Cancer and Blood Diseases, is president of the American Society of Gene Therapy.
- Vernon T. Tolo, M.D., director of the Childrens Orthopaedic Center, is the immediate past president of the American Academy of Orthopaedic Surgeons.

In the enclosed *Los Angeles Times* supplement (July 22, 2003) you can read about our remarkable volunteer leadership, the magnificent \$40 million gift from Cheryl and Haim Saban, and our campaign priorities.

Tough Challenges from All Sides

We hold fast to our mission of caring for indigent and critically ill children, even though we continue to operate in a challenging economic and health care environment. Last fall, Congress allowed a \$1 billion cut in the nation's 20-year-old Medicaid program that provides crucial funding to hospitals that serve poor children. With health care costs continuing to soar, this cut affects approximately 70 percent of our patients.

California's \$38 billion budget deficit has led to a five percent reduction in reimbursement to Medi-Cal physicians. Medi-Cal is California's Medicaid program, which provides health care coverage for low-income children and families who lack health insurance. As Los Angeles County's health care "safety net" continues to erode, we remain one of relatively few providers still serving Medi-Cal and uninsured patients.

In addition, there is resistance on the part of managed care companies and private payers to increase payment rates to hospitals as a result of escalating health care costs and health insurance premiums.

A tight labor supply exacerbates our operating challenges and prevents us from meeting the volume of on-demand patient referrals. Not only does California rank last in the number of registered nurses per population, but also the number of academic pediatric specialists is decreasing. The increased labor costs coupled with the dramatic rise in daily expenses, requires us to constantly juggle lower reimbursement rates with higher operating expenses.

Yet, We Remain Fiscally Sound and Committed to Our Mission

We are exceedingly optimistic about the future of Childrens Hospital Los Angeles. Thanks to our volunteer investment committee's leadership, our endowment of over \$400 million continues to perform in the top quartile during difficult economic times. Our fund-raising totals, already at an historic high, reached over \$100 million in Fiscal Year 2003 (July 1, 2002 – June 30, 2003). Our total assets *exceeded \$1 billion* as of June 30, 2003. We have a strong balance sheet and continue to grow our net assets; our total net assets have increased from more than \$613 million on June 30, 2000, to over \$720 million on June 30, 2003.

Even though we had a strong fund-raising year, our operating loss was \$4.9 million. Our earnings before interest, depreciation, and amortization (EBIDA) was in excess of \$22 million in Fiscal Year 2003. With careful strategic planning, we have been able to absorb a \$9 million decline in DSH (disproportionate share hospital) funding. DSH revenue is federal/state funding for hospitals that treat a disproportionate share of Medi-Cal and uninsured patients. On a positive note, we were able to negotiate a five-percent increase in the Medi-Cal inpatient rate late in Fiscal Year 2003 and significant increases in certain managed care contracts. For Fiscal Year 2004, we have been able to narrow the budget gap and are committed to seeking additional revenue enhancements and expense reductions.

Childrens Hospital has implemented KIDS (Knowledge, Information and Decision Support), an advanced clinical information system created by the Cerner Corporation. This major technology investment will improve patient safety and operational efficiency by providing more timely and complete information to all members of the health care team at the point-of-care.

Strategies for the Short and Long Term

Childrens Hospital approaches the future with strategies that will position us to take advantage of extraordinary opportunities. In the short term, we will continue to work with the State of California to assure adequate Medi-Cal and DSH funding, and with Congress to assure continued Graduate Medical Education funding to train the finest pediatricians.

We anticipate successfully completing Living Proof: The Campaign for Childrens Hospital Los Angeles in 2006, and thereafter raising the bar on annual fund raising for hospital operations. We will explore new organizational models to help lower our costs and/or increase net revenues for outpatient care and profitable inpatient growth. We continue to evolve best practices to provide optimal patient outcomes.

Working with the National Association of Children's Hospitals and Related Institutions (NACHRI), which I will chair next year, we will explore a new dedicated financing plan for children's hospitals to replace the existing DSH program.

We will evolve The Saban Research Institute programs with an even greater entrepreneurial focus and stronger emphasis on clinical research and trials. We will target additional opportunities to license our discoveries, and use the revenue generated to invest in needed technologies.

Our New Hospital will enhance our ability to provide family-centered care and advance pediatric medicine.

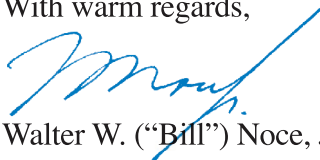
We Have What It Takes!

Talented, compassionate individuals —from investigators to physicians, nurses and other caregivers, and those who support them— make Childrens Hospital a very special place. While the economic environment is daunting, we have the financial strength, outstanding volunteer leadership, and dedicated support of our extraordinary health care professionals and the community to transform pediatric medicine for a second century.

I extend my heartfelt gratitude to each of you for what you have done and continue to do to ensure a healthy and happy future for children and families.

We remain committed to our mission to provide the best possible care available to children today, and to find the best means to diagnose, treat and prevent pediatric diseases and promote child health tomorrow. It really is all about our children. They're our most precious resource, and they're counting on us.

With warm regards,



Walter W. ("Bill") Noce, Jr.
President and CEO

Enclosure