

Children's Health System's combined operations (including Children's Health Foundation) achieved a banner 7.5 percent operating margin in FY '05.

Several factors contributed to the favorable results. The hospital received a \$3 million Medicaid Cost Report settlement and instituted a rate increase that, along with a favorable payer mix, resulted in a 5.5 percent increase in inpatient revenues over FY '04.

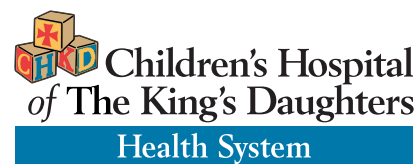
Children's Medical Group and Children's Surgical Specialty Group both recorded an increase in volume and revenue over the prior year while Children's Health Foundation improved by \$3 million over the prior year, primarily due to philanthropy.

Children's Health System Board of Directors

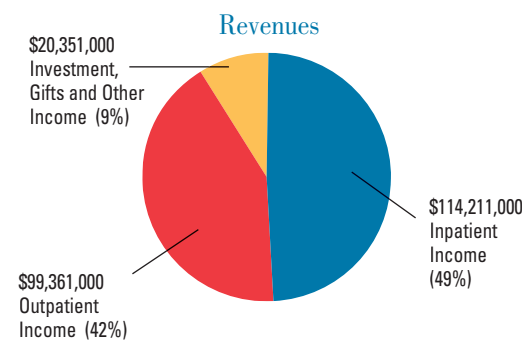
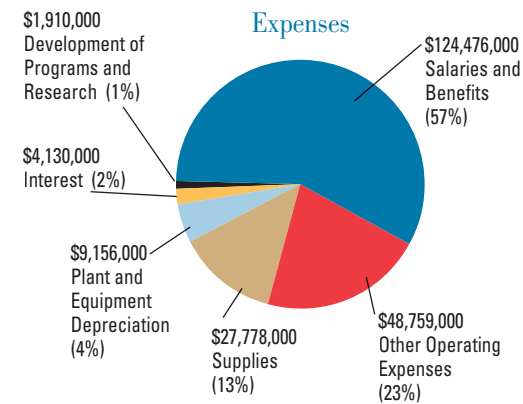
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CHKD Health System Operating Statistics
Fiscal Year ending 6/30/05

CHKD	2004	2005
Number of Beds in Service	157	157
Patient Days	46,897	46,483
Admissions	6,497	6,531
Average Daily Census	128	127
Surgeries	9,838	10,250
Outpatient Clinic Visits	103,511	106,045
Emergency Visits	42,043	41,808
CSSG		
Office Visits	25,165	27,258
Surgical Cases	3,905	4,070
CMG		
Office Visits	299,867	322,288



Report from the President

As we approach 2006, it feels in many ways as if the future has already arrived at CHKD Health System.

Today, our physicians can turn on a laptop, type in a password and have instant, secure access to essential patient data through KDXNet. They can operate laparoscopically where huge incisions were once required and repair tiny, malfunctioning heart valves in our cath lab. They can identify the slightest alteration in a child's chromosomes and develop highly specific treatment plans to help offset its impact.

Technological advances are changing the way we work throughout our organization. This year, we took the first steps toward turning all of our patient records and radiology images into electronic files – a huge project with far-reaching benefits for our patients, physicians, clinicians and office staff.

As expected, we continue to see an increase in the use of our outpatient services. In just the past three years, visits to our outpatient clinics increased more than 21 percent – from 87,297 in FY '02 to 106,045 in '05. Of the approximately 650,000 tests our lab performed last year, 50 percent were outpatient. And in its first year of operation, our health center at Oyster Point had more than 25,000 visits.

Families today are busier than ever, and we want to



CEO Jim Dahling (right) and Newport News Mayor Joe Frank cut the ribbon to the new surgery center at Oyster Point.



One of our first patients on September 7 – day one of surgery at Oyster Point

make it as easy as possible for them to reach us. So in addition to the Children's Hospital of The King's Daughters campus in Norfolk, families can now find the CHKD blocks much closer to home at our health centers in the Oyster Point, Greenbrier, Strawbridge and Kempsville

communities, at our satellite offices in Virginia Beach and on the Eastern Shore and at more than a dozen primary care pediatric practices with offices from Elizabeth City to Suffolk to Williamsburg. In all, our pediatric experts now offer their unique brand of child-focused care in 20 different sites in nine different cities.

An exciting milestone for us this year occurred when we opened our first-ever ambulatory surgery center at our Oyster Point health center. For years, the pediatric surgery program within CHKD was the only option for parents who

wanted their children's surgeries done by pediatric experts in a pediatric facility. For major pediatric surgery, few families would consider going elsewhere. But for routine outpatient surgeries, getting to our campus in Norfolk has become increasingly challenging, with traffic and parking among the chief complaints of families and visitors. At Oyster Point, Peninsula families will get the best of both worlds: the CHKD experience and the benefit of convenience.

Our next goal is to do the same thing for families in Virginia Beach. Right now, we are in the process of seeking state approval to build an outpatient surgery center in the burgeoning Princess Anne area of Virginia Beach. The new center, to be constructed beginning in 2006, will offer most of CHKD's signature outpatient services – including primary and specialty care as well as ancillary and child abuse services. An outpatient surgery center would open the following year and include such specialties as orthopedics, ophthalmology, general pediatric surgery and ear, nose and throat surgery.

For now, the CHKD Health Center at Strawbridge offers a wealth of convenient services to Virginia Beach families. The Strawbridge center provides a new home to General Booth Pediatrics and the pediatric



Lab services at our health center at Strawbridge

specialists of Children's Specialty Group. There's even a CHKD lab on site. And the former home of General Booth Pediatrics is now devoted to physical, occupational and speech therapy, saving Beach families who need those

services several trips a month to Norfolk. Within the next year, we will open additional locations in Williamsburg and northern Suffolk. Adding new locations is our way of reaching our arms wide to the children and families we serve.

We also strengthened many existing programs and services right where they are. We added the new laparoscopic surgical suites as well as lithotripsy capabilities to our operating rooms, recruited three new surgeons and brought our renal transplant surgeries in-house. Six new pediatricians joined the



New laparoscopic surgery suite at CHKD

ranks of Children's Medical Group. Our nurse recruitment efforts resulted in the hiring of more than 100 new nurses. Our child abuse program now provides long-term therapy to abused children in our community. We instituted a comprehensive diabetes program to help children manage this challenging chronic illness.

Our child life, volunteer and nursing departments expanded pet therapy into a 15-dog "Buddy Brigade," which dispenses cuddles and kisses twice weekly to raise the morale of our patients.

One of our brightest moments came in April when we dedicated our new Children's Cancer and Blood Disorders Center – a totally renovated and upgraded outpatient facility for the treatment of local children battling these deadly and debilitating diseases. The state-of-the-art center is nearly double the size of the former space and is decorated with surfboards, seascape murals, simulated waterfalls, streams, tropical trees, a lighthouse, a digital aquarium and a ship



Pet therapy with the Buddy Brigade

surrounded by a coral reef inlaid in the floor. The new patient treatment area contains a waiting room, exam rooms, procedure rooms, a children's play area and, for the first time, dedicated isolation rooms, a pharmacy and centralized space for outpatient infusion therapies such as chemotherapy, blood transfusions and intravenous antibiotics and pain management administration.

The new cancer center was made possible by a \$2 million donation from Farm Fresh. In an era when reimbursements rarely meet our cost of providing care, philanthropy provides a vital bridge between the kind of care we can afford to provide and the kind of care we want to provide.

Among those helping us bridge the gap last year were our most loyal champions, the Norfolk City Union of



Telethon 2005

The King's Daughters, whose efforts on behalf of CHKD raised \$542,169. That's above and beyond the \$2.3 million raised by their Thrift Stores. Overall, we raised \$14.6 million in 2005, with fund-raising that included the first annual Cure Kids' Cancer Radiothon as well as our annual Telethon – which raised \$3.6 million. We also initiated a new auto donation program, "CARS 4 CHKD."

At the same time, we remain focused on our \$34.5 million capital/endowment campaign. This fall, we were awarded a \$1-million grant from the prestigious Kresge Foundation

challenging us to raise the remaining \$5.4 million toward our goal before December 31, 2006.

We will need everyone's help to meet this challenge, but our community, including our family of physicians, employees, King's Daughters and board members, has long understood that meeting our commitment to children depends first on maintaining our own sound financial health.

Preserving our strength requires us to grow, to move, to prioritize and focus. Sometimes it even requires us to re-focus,

as we did this year when Eastern Virginia Medical School assumed sole responsibility for the Center for Pediatric Research. But, rest assured, as the region's premiere provider of pediatric health care, we will continue to support research, providing funds, settings, services and patients for clinical trials of new medications and therapies, as well as for clinical outcomes analyses and epidemiological studies.

Supporting research is akin to bringing our services closer to the families we serve and investing in technology that improves our efficiency: They are all giant steps we can take to improve patient care and the health of this organization today and in the future.

The condition of our organization and the well-being of the region's children are inseparable. And I am happy to report that today the future looks very good indeed for all of us.

Jim Dahling
Jim Dahling
President/Chief Executive Officer



Grand opening of the Cancer and Blood Disorders Center