

Financial results • **Financial results** • Financial re

## Management's discussion and analysis

*Columnar amounts in millions*

*The objective of this section is to help American Medical Association (AMA) members and other readers of our financial reports understand management's views on the AMA's financial condition and results of operations. This discussion should be read in conjunction with the audited financial statements and notes to the financial statements.*

In 2003, the AMA achieved its fourth consecutive year of operating profit. Operating results, which exclude non-recurring or non-operating items such as market gains or losses on investments, improved by \$8.4 million in 2003 compared to 2002, resulting in a \$20.1 million operating profit.

The \$20.1 million operating profit achieved in 2003 was substantially better than the projected operating profit of \$8.5 million. The following paragraphs outline major changes from the 2003 forecast.

Revenues from business operations were \$1 million higher than forecast. Overall business expenses, including cost of products sold, selling expenses and general and administrative expenses, were \$2.8 million less than forecast. This was mainly due to lower than expected promotional spending and a reversal of bad debt reserves not required, as collection of outstanding receivables improved at year end. As a result, business contribution margins were \$3.8 million higher than forecast.

Membership revenues were \$2.6 million better than forecast, while expenses were \$0.4 million higher than forecast, largely due to higher consulting expenses for the membership initiative. The resulting contribution margin was \$2.2 million higher than forecast. Investment income was also higher than forecast, by \$0.4 million.

In the remaining areas, net spending for Core Operations, Governance and Administration was \$0.8 million less than forecast. The \$1.2 million reserve for risk, which is a budget mechanism whereby the AMA reduces forecast revenues, accounts for the remaining increase from forecast in pre-tax operating results.

Income taxes for 2003 reflect increases stemming from the improvement in taxable publishing results. This increase was offset by a release of a tax reserve previously established for an outstanding claim with the IRS that was settled in 2003, and an adjustment of prior years' deferred taxes. As a result, taxes were \$3.1 million less than projected.

Non-operating and non-recurring items totaled a \$23.3 million gain, \$12.5 million better than the 2003 forecast. The main factor in the change from forecast was the gain in the market value of investment securities. This gain totaled \$20.8 million for 2003, as compared to an \$8.5 million gain in the forecast.

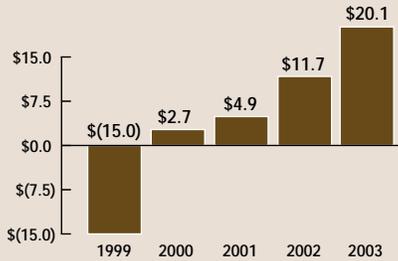
AMA's revenues exceeded expenses by \$43.4 million for 2003, consisting of \$20.1 million in operating profits and \$23.3 million in non-operating income. In 2002, the AMA was required to record a \$17.1 million non-cash charge against equity for a minimum pension liability adjustment. Since the market value of plan assets and contributions increased to cover accumulated plan obligations in 2003, that adjustment is no longer required. The entire \$17.1 million adjustment was therefore reversed in 2003, and after including that reversal, association equity increased by \$60.5 million.

In both 2003 and 2002, the AMA achieved its goal of maintaining an operating surplus substantial enough to withstand adverse changes in economic conditions without requiring major cost reduction efforts in programmatic activities. An operating surplus also allows the AMA to continue to invest in initiatives to improve membership dues revenues.

The 2003 results continue to demonstrate the AMA's efforts to improve efficiency and productivity. The AMA is committed to continuing these efforts in the future, as it is our responsibility to ensure that the organization focuses its finite resources on its core mission and improving AMA membership. Our members' presence and voice is central to the overall success of our AMA.

## Consolidated financial results

### Results from operations (in millions)



### Results from activities

The following provides an overview of the 2003 results of operations compared to 2002. Additional detailed discussion of operating unit results is provided in the section titled "Group operating results."

#### Revenues

In 2003, total revenues increased \$5.8 million from 2002.

Business revenues improved by \$6.4 million with substantial increases in book and product sales, as well as royalty and credentialing product sales. Equity in earnings or losses of affiliates was \$0.8 million better than 2002, due to the dissolution of Preference Solutions, the joint venture between the AMA and Acxiom Corporation.

Membership dues revenue decreased substantially less than expected in 2003, down only \$1.2 million or 2.4 percent. Investment income was \$0.8 million less than 2002, largely due to continued low interest rates.

Grant and other revenues increased \$1.4 million in 2003, as compared to the prior year.

#### Cost of products sold and selling expenses

All variable expenses related to the production, distribution and sale of periodicals, books, reimbursement products and licensed products are included in the cost of products sold and selling expense categories. Examples include paper, advertising commissions, promotional activities, distribution costs and third-party editorial costs. The \$2.3 million decrease in cost of products sold and selling expenses can be largely attributed to improvements in several areas, such as reduced paper and print costs, and reduced promotional and bad debt expenses in both Publishing and Book and Products.

#### Contribution to general and administrative expenses

Cost of products sold and selling expenses are deducted from revenues to determine the amount of money available for the general and administrative expenses of the organization. Contribution to general and administrative expenses measures the gross margin derived from revenue-producing activities.

The contribution to general and administrative expenses increased by \$8.1 million in 2003, totaling \$208.2 million.

The contribution to general and administrative expenses from business operations increased \$8.7 million, of which \$6.4 million was due to higher revenues and \$2.3 million was due to the reductions in cost of products sold and selling expenses discussed previously. The membership and investments units' contribution to general and administrative expenses dropped by \$1.3 million and \$0.7 million, respectively, as a result of revenue decreases. The remaining \$1.4 million increase in contribution results from increased revenues from grants and other fee income.

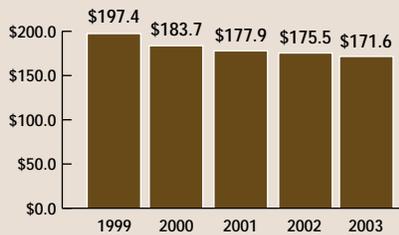
#### General and administrative expenses

General and administrative expenses increased \$2.4 million in 2003, or 1.3 percent. Higher grant expenses accounted for \$0.9 million of the increase.

The AMA also incurred substantial one-time expenses in 2003 for consulting related to membership and operating efficiencies, the Committee on Organization of Organizations, and the tort reform campaign. These expenses totaled \$6.5 million. In 2002, the AMA incurred \$1.1 million in one-time expenses for the Organization of Organizations project. Excluding grant and one-time expenses, ongoing general and administrative expenses actually decreased \$3.9 million in 2003, or 2.2 percent. The decrease in ongoing expenses was largely a result of

reduced computer costs and pension-related expenses, offset by higher postretirement health care benefit expenses for current employees.

**General and administrative expenses, excluding grants and one-time expenditures** (in millions)



**Operating results before income taxes**

The AMA achieved a \$23.1 million pre-tax operating profit in 2003, compared to \$17.4 million in 2002, mainly due to increased revenues in business operations and cost decreases in selling-related expenses. All units continued expense management efforts and operating results improved substantially for the year.

**Income taxes**

Income taxes decreased \$2.7 million in 2003. Taxable activities in the AMA showed higher profits, but the tax increase was offset by two adjustments that reduced 2003 income taxes. The AMA reversed a \$1.2 million tax reserve previously established for an outstanding claim with the IRS that was settled in AMA's favor in 2003. In addition, adjustments to prior years' deferred taxes resulted in a \$2.3 million tax benefit.

**Net operating results**

Operating income was \$20.1 million in 2003, an \$8.4 million improvement over 2002. The main factors driving this improvement were higher revenues in business operations and the \$3.5 million in tax benefits noted previously.

**Non-operating and non-recurring items**

Non-operating and non-recurring items totaled a \$23.3 million gain, compared to \$11.6 million in losses for 2002.

The 2003 non-operating items include a \$20.8 million gain in market value on the investment portfolio, \$1.4 million in interest on a tax settlement and \$1.1 million in other non-operating income.

In 2002, non-operating items included \$12.9 million in investment portfolio losses, a \$0.5 million pension curtailment loss and \$1.8 million in other non-operating income.

**Revenue in excess of expenses**

Revenues exceeded expenses by \$43.4 million in 2003, a combination of the \$20.1 million operating profit and the \$23.3 million in non-recurring and non-operating gains. In 2002, revenues exceeded expenses by \$0.1 million.

**Change in association equity**

The AMA increased its association equity by \$60.5 million during 2003.

This includes \$43.4 million of revenues in excess of expenses and a reversal of the \$17.1 million non-cash minimum pension liability adjustment established in 2002. Pension plan assets exceeded accumulated pension benefit obligations at December 31, 2003, and the minimum liability is no longer required.

In 2002, the accumulated pension benefit obligation exceeded pension plan assets and the AMA was required to record a minimum pension liability charge of \$17.1 million. The 2002 decrease in equity of \$17.0 million was primarily due to that minimum pension liability adjustment.

*Financial condition*

The AMA's assets include cash, cash equivalents and investments; operating assets such as accounts receivable, inventory and prepaid expenses; fixed capital such as equipment, computer hardware and software, and other assets. AMA assets are supported by association equity, operating liabilities and deferred revenue. Operating liabilities include accounts payable, accrued expenses and long-term liabilities such as pension and postretirement health care liabilities.

## Assets

	2003	2002	% change
Cash and cash equivalents	\$ 68.3	\$ 68.5	(0.3)%
Investments	190.2	143.2	32.8
Total cash and investments	258.5	211.7	22.1
Operating assets	26.0	30.2	(13.9)
Property and equipment	26.1	31.7	(17.7)
Prepaid pension	24.8	—	—
Other assets	3.6	3.2	12.5
	\$339.0	\$ 276.8	22.5%

The AMA's total assets increased \$62.2 million in 2003, of which \$46.8 million represents increases in cash and investments. Gains in the market value of investment securities increased cash and investments by \$20.8 million, with the remaining \$26 million increase generated by cash from operations.

Operating assets decreased \$4.2 million in 2003, mainly due to lower receivables from year-end book and product sales. The change in operating assets from year to year is largely a result of timing of cash receipts and payments.

Property and equipment net book value decreased \$5.6 million, as depreciation and amortization of prior years' capital expenditures is not replaced by new capital spending.

The continued decrease in property and equipment reflects the effect of the capital spending policy adopted in 2000. The policy requires that

capital spending not exceed current year depreciation and amortization, and is designed to ensure that future capital spending is funded from operations, not reserves.

Contributions to the AMA pension plan, coupled with eliminating the minimum pension liability balance, resulted in a \$24.8 million prepaid pension contribution.

## Liabilities and equity

	2003	2002	% change
Operating liabilities	\$ 98.7	\$ 97.5	1.2%
Deferred revenue	49.3	48.8	1.0
Association equity	191.0	130.5	46.4
	\$339.0	\$ 276.8	22.5%

Operating liabilities increased \$1.2 million in 2003, with all categories largely unchanged from 2002.

Deferred revenue represents money received during the year that will not be recognized as income until the following year or thereafter. These amounts, as well as accounts payable and accrued expenses, change annually depending on the timing of cash receipts and payments.

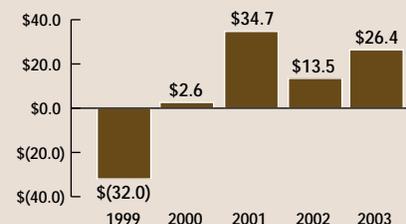
Association equity increased \$60.5 million in 2003, or 46.4 percent, due to operating income, non-operating gains and the reversal of the 2002 non-cash minimum pension liability adjustment.

## Cash flow

Cash and cash equivalents decreased \$0.2 million in 2003, compared to a \$10.4 million decrease in 2002. This comparison can be misleading, since the change in cash and cash equivalents includes reductions for amounts invested in marketable securities, as well as cash inflows from non-operating activities. For example, the 2003 cash usage includes \$27.9 million "used" to purchase investment securities.

## Adjusted cash from operations

(in millions)



Adjusted cash from operations measures the AMA's ability to fund operations, capital spending and programmatic initiatives from funds generated from operations. This measure excludes one-time or non-operating gains and losses. Negative cash from operations indicate depletion of reserve funds. The above graph highlights the five-year comparison of adjusted cash from operations.

The increase in adjusted cash from operations in 2003, as compared to 2002, was primarily caused by a reduced pension contribution in

2003 of \$13.2 million, compared to \$25.1 million in 2002. The AMA funds its pension plan in accordance with a stated funding policy that required substantial contributions in both 2003 and 2002. Although the pension plan has been frozen and participants do not accrue new benefits, continued funding for the plan will be required until all current participants receive their retirement benefits.

### Reserves (AMA-only)

**Reserves (in millions)**



As of year-end 2003, permanent reserves were \$161.2 million, compared to \$138.4 million in 2002, an increase of \$22.8 million, mainly due to gains in the market value of the portfolio.

Operating funds totaled \$73.1 million in 2003, up from \$51.3 million in 2002. The \$21.8 million increase was generated by operations.

The AMA has established target reserve levels in its reserve policy that require that permanent reserves should be adequate to cover 50 percent of annual general and adminis-

trative expenses (excluding grant expenses) plus an amount sufficient to pay long-term pension and postretirement liabilities. Operating funds, coupled with operating assets, are to be maintained at a level that allows payment of all operating liabilities.

### 2003 permanent reserves and target (in millions)

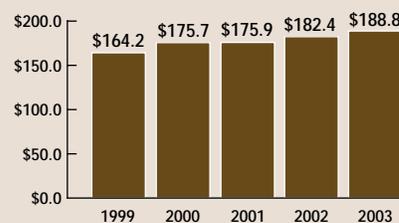


### Group operating results

The AMA is organized into various groups: business operations, core operations, administration and operations, affiliated organizations and unallocated overhead. Revenues and expenses directly attributed to those units are included in the group operating results. A financial summary of group operating results is presented at the end of this section.

### Revenues

**Business operations (in millions)**



The following table highlights the net change in revenues by major business operating unit:

	2003	2002	% change
Publications	\$ 70.8	\$ 71.4	(0.8)%
Internet and Database	36.8	34.2	7.6
Book and Products	56.6	53.3	6.2
Preference Solutions	(0.8)	(1.6)	50.0
Insurance Agency	25.4	25.1	1.2
	<b>\$188.8</b>	<b>\$182.4</b>	<b>3.5%</b>

Publications include *The Journal of the American Medical Association*, the *Archives* journals and *American Medical News*. Publication revenues are derived from advertising, subscriptions, reprint revenues, electronic licensing and royalties. Publishing revenues decreased \$0.6 million in 2003, largely due to lower reprint and electronic licensing revenues.

Internet and Database Operations includes sales of data and credentialing products and licensing royalties. Internet and Database Operations continued to increase revenues during 2003, up \$2.6 million over 2002.

AMA Press, AMA Solutions and the reimbursement products make up the Book and Products unit. Book and Products revenues improved by \$3.3 million, largely due to improved sales in reimbursement products and sales of new HIPAA products.

Preference Solutions was a joint venture between the AMA and Acxiom Corporation that was started in 2000 and is accounted for using the equity method. AMA records its share of profits or losses as a single line item of revenue. The joint venture was dissolved in 2003 by agreement of both parties and the AMA merged the line of business into its Internet and Database Operations unit.

The AMA has one active subsidiary, the AMA Insurance Agency. The Insurance Agency revenues increased slightly in 2003, mainly as a result of insurance premium increases. The Agency, as broker, receives a percent of these premiums.

### Membership

The Membership group's total revenues were down \$1.3 million in 2003, a 2.6 percent decrease from 2002. Gross dues revenue was down only \$0.8 million, or 1.6 percent. This represents a substantial improvement over prior years' membership revenue trends. The remaining decrease is a result of two items, a \$0.4 million increase in commissions paid to state societies for federation memberships, and \$0.1 million in increased interest costs associated with lifetime memberships.

Direct membership dues revenue increased \$3.9 million, or 21 percent. Some of that increase can be attributed to recovering losses from the 2002 delay in the direct membership

marketing program. Federation dues revenues were down \$4.7 million in 2003, or 14.5 percent, despite the higher commissions paid.

### Investments (AMA-only)

Investment income was down \$0.7 million in 2003, when compared to 2002. Lease income from the one remaining real estate investment was \$0.8 million in 2003 compared to \$0.6 million in 2002. Dividends and interest from the investment portfolio totaled \$4.8 million in 2003, a decrease of \$0.9 million over the prior year. This decrease reflects the impact of continued low interest rates.

### Other revenues

Other revenues are derived from grants and other fee income. Core operations revenues include mainly grant income for Professional Standards and Communications.

### Contribution margin (net expenses)

Contribution margin equals unit revenues minus cost of products sold, selling expenses and direct general and administrative expenses such as compensation, occupancy, travel and meetings, computer costs and professional services. Net expenses equals total spending, net of any revenue produced by that unit, such as grants or other fee income. Total contribution margin and net expenses is equal to consolidated operating results before income taxes.

### Contribution margin

	2003	2002	% increase/ (decrease)
Business operations	\$ 79.1	\$ 71.3	10.9%
Membership Investments (AMA-only)	40.2	43.9	(8.4)
	5.3	6.0	(11.7)
	<b>\$124.6</b>	\$121.2	2.8%

As outlined above, financial support of AMA's core operations and administration are derived mainly from business activities and membership, with the latter providing approximately one-third of AMA's funding needs.

### Business operations

Business operations improved results by \$7.8 million in 2003, on revenue increases of \$6.4 million. Contribution margin increased in most units, approaching or above a double-digit percentage rate of growth. In addition to improved revenues, successful productivity projects initiated in 2003 drove margin improvement in several business activities. Publishing and Book and Products collection of accounts receivable also improved, resulting in a \$0.9 million reversal of previously established reserves for bad debts.

### Membership

Membership contribution margins dropped \$3.7 million, on a \$1.3 million revenue decrease, as expenses increased \$2.4 million. Consulting for the new membership initiative was the main reason for the expense increase.

**Investments (AMA-only)**

AMA-only Investments relates to earnings on the AMA's portfolio. Investment income in AMA subsidiaries is included in business operations. The change in AMA-only Investments contribution margin was solely due to revenue decreases caused by continued low interest rates.

**Net expenses**

	2003	2002	% increase/ (decrease)
Core operations	\$ (36.9)	\$ (34.5)	7.0%
Governance	(10.8)	(10.1)	6.9
Administration and operations	(47.3)	(50.2)	(5.8)
Affiliated organizations	(1.6)	(1.6)	—
Unallocated overhead	(4.9)	(7.4)	(33.8)
	<b>\$(101.5)</b>	<b>\$(103.8)</b>	<b>(2.2)%</b>

Units with expenses that exceed revenues include AMA's core operations, governance, administration and operations, affiliated organizations and unallocated overhead.

**Core operations**

Core operations includes three groups: Professional Standards, Advocacy and Federation Relations, and Communications and Core Identity.

Professional Standards includes Science, Medical Education, Ethics and Grants. The various groups are involved in developing AMA policies on scientific issues for the House of Delegates; defining or influencing standards for undergrad-

uate, graduate and continuing medical education; establishing and disseminating ethical standards for the profession; providing support for the Councils on Ethical and Judicial Affairs, Scientific Affairs and Medical Education; and influencing the public on health problems caused by tobacco and alcohol.

Advocacy and Federation Relations includes federal and state-level advocacy operations; private sector advocacy; economic, statistical and market research to support advocacy efforts; political education for physicians; and maintaining relations with the Federation of medicine.

Communications and Core Identity focuses its efforts on informing the public about AMA's positions and policies; supporting the advocacy efforts; maintaining member communications; and organizing conferences on scientific issues.

Core operations increased net expenses by \$2.4 million, with Professional Standards up by 7 percent and Advocacy spending up by 9 percent. Most of the increase in net spending in Advocacy was for tort reform and lobbying expenses.

**Governance**

Governance includes the Board of Trustees and Officer Services and the House of Delegates and Professional Relations units. The Board of Trustees expenses include

costs related to governance activities as well as expenses associated with support of Advocacy, Professional Standards and Communications. The House of Delegates and Professional Relations unit includes costs associated with annual and interim meetings, groups and sections and other House of Delegates activities.

In 2003, Governance net spending increased \$0.7 million, mainly in net spending for the House of Delegates and Professional Relations. The increase was largely due to \$0.3 million in expenses for the Committee on Organization of Organizations meetings. The remaining cost increases related to the House of Delegates meetings.

**Administration and operations**

These units provide administrative and operational support for business, membership and core operations. Administration achieved a net reduction in spending of \$2.9 million in 2003, largely due to reduced depreciation and amortization expenses in Information Technology. All units were affected by increased fringe benefit expenses due to health care benefits.

**Affiliated organizations**

Affiliated organizations represent either grant or in-kind service support provided by AMA to other foundations and societies. In many cases, the other foundations and societies reimburse AMA for services

provided. The reimbursement is not allocated to the units providing the service, but remains in this group as unallocated contribution margin.

### Unallocated overhead

The net expenses for unallocated overhead include expenses not allocated back to operating units such as corporate insurance and actuarial services, AMA incentive compensation, valuation or other reserves and other one-time write downs of impaired asset values.

AMA incentive compensation was \$2.6 million in 2003, down \$0.1 million from 2002. Bonuses were maintained at the increased level of 2002 to offset the impact of lower merit increases. There were no reserves for benefit-related expenses in 2003, compared to \$2.1 million in 2002. Insurance expense was \$0.9 million, compared to \$0.7 million in 2002, mainly due to directors and officers coverage premium increases. Consulting expenses for a purchasing review totaled \$1 million in 2003 while consulting for the Organization of Organizations project totaled \$0.3 million and \$1.1 million in 2003 and 2002, respectively. There were no impaired asset valuation allowances in 2003, compared to \$0.5 million in 2002. The remaining unallocated expenses totaled \$0.1 million and \$0.3 million in 2003 and 2002, respectively.

## Group operating results

	Revenues		Contribution margin (net expenses)	
	2003	2002	2003	2002
<b>Business operations</b>				
Publications	\$ 70.8	\$ 71.4	\$ 12.3	\$ 10.5
Internet and Database Operations	36.8	34.2	27.3	25.0
Book and Products	56.6	53.3	30.7	26.8
Preference Solutions	(0.8)	(1.6)	(0.8)	(1.6)
Insurance Agency	25.4	25.1	10.8	11.2
Other business operations	—	—	(1.2)	(0.6)
	<b>188.8</b>	<b>182.4</b>	<b>79.1</b>	<b>71.3</b>
<b>Membership</b>	<b>48.7</b>	<b>50.0</b>	<b>40.2</b>	<b>43.9</b>
<b>Investments (AMA-only)</b>	<b>5.6</b>	<b>6.3</b>	<b>5.3</b>	<b>6.0</b>
<b>Core operations</b>				
Professional Standards	8.8	7.8	(10.6)	(9.9)
Advocacy and Federation Relations	1.0	0.9	(20.6)	(18.9)
Communications and Core Identity	1.2	1.2	(5.7)	(5.7)
	<b>11.0</b>	<b>9.9</b>	<b>(36.9)</b>	<b>(34.5)</b>
<b>Governance</b>				
Board of Trustees and Officer Services	—	—	(4.9)	(4.7)
House of Delegates and Professional Relations	0.2	0.2	(5.9)	(5.4)
	<b>0.2</b>	<b>0.2</b>	<b>(10.8)</b>	<b>(10.1)</b>
<b>Administration and operations</b>				
Information Technology	—	—	(21.6)	(24.3)
Corporate Services	0.5	0.5	(6.0)	(6.2)
Senior Executive Management	—	—	(4.7)	(4.4)
General Counsel	0.3	0.2	(4.4)	(4.8)
Finance	—	—	(4.6)	(4.4)
Human Resources	—	—	(3.6)	(3.6)
Planning	0.1	0.1	(1.0)	(1.3)
Other	0.4	0.1	(1.4)	(1.2)
	<b>1.3</b>	<b>0.9</b>	<b>(47.3)</b>	<b>(50.2)</b>
<b>Affiliated organizations</b>	<b>0.3</b>	<b>0.6</b>	<b>(1.6)</b>	<b>(1.6)</b>
<b>Unallocated overhead</b>	<b>0.4</b>	<b>0.2</b>	<b>(4.9)</b>	<b>(7.4)</b>
<b>Consolidated</b>	<b>\$256.3</b>	<b>\$250.5</b>	<b>\$ 23.1</b>	<b>\$17.4</b>