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The Healthcare Roundtable

M&A Activity in the Hospital Sector

March 3, 2011

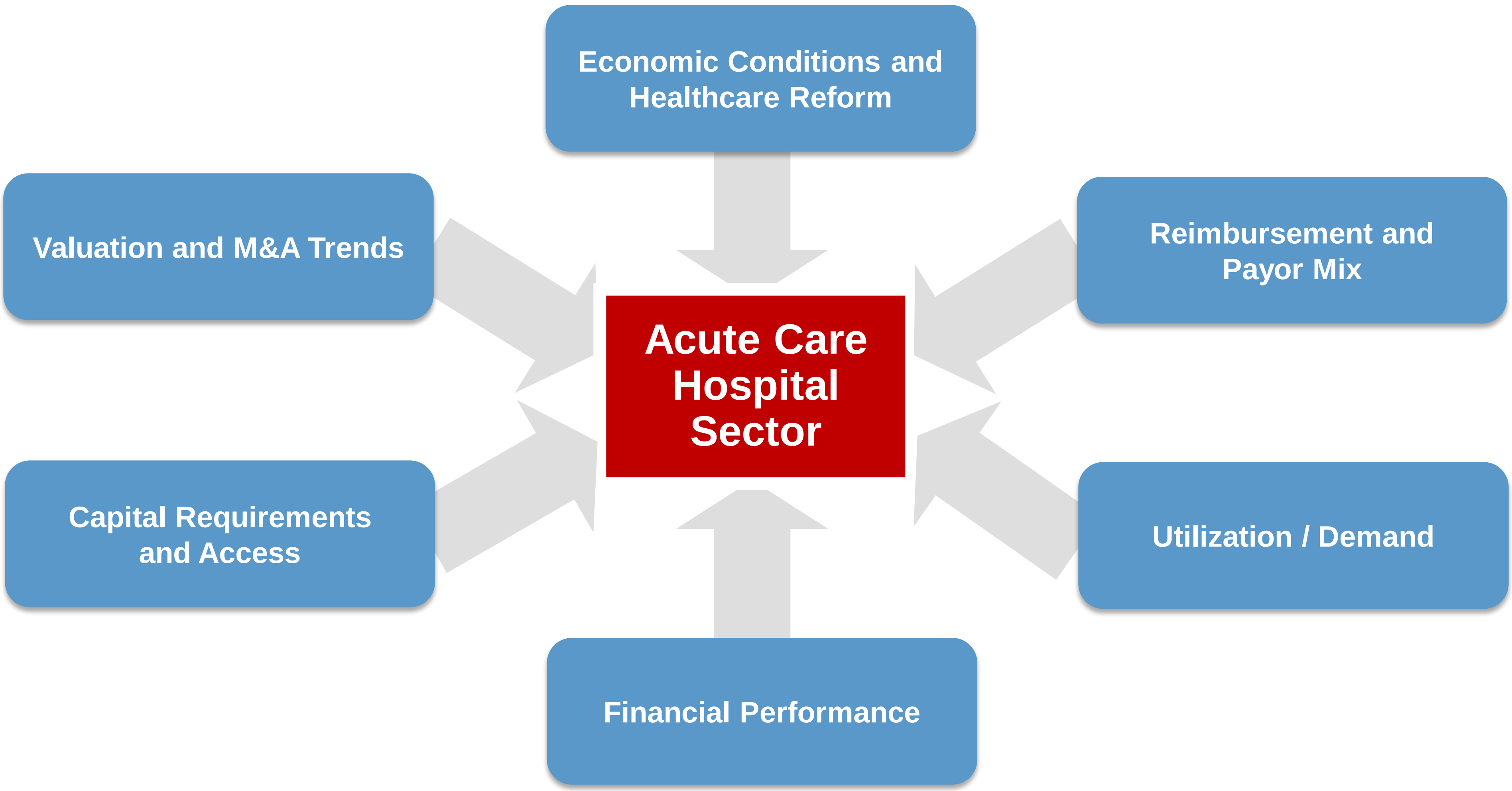
Discussion Topics

1. What's Driving M&A Activity? (Outlook for the Acute Care Hospital Sector)
   - Recent Economic/Financial Trends and Outlook
   - Healthcare Reform Implications
2. Merger & Acquisition Trends
   - Equity Market Considerations
   - For-Profit Companies and Strategies
   - Recent Activity
3. Process for Assessing Strategic Options

What’s Driving M&A Activity? (Outlook for the Acute Care Hospital Sector)

What's driving M&A Activity?

Anticipated effects of healthcare reform, added to an already complex and difficult operating environment…



Economic Conditions

"Our deficit-reduction plan is simple, but it will require a great deal of money."

Economic Conditions

Many hospitals and health systems are just recovering from the economic collapse of 2008, only to face healthcare reform mandates and an ongoing weak economic environment…

- The pressures created by the depressed economy on hospitals have been the same:
  - Lower utilization, less favorable payor mix, higher bad debt expense, margin pressure and reduced liquidity, accelerating capital needs and more difficult capital markets -- among others!
- Hospitals must expect these challenges to continue given the projected slow economic recovery and unsustainable federal and state deficits -- **significant reductions in entitlement programs will be required**
  - **Medicare** is the balancing item in the federal budget and hospitals represent ~46% of Medicare spending
    - Pressure to cut Medicare spending will be intensified as baby boomers enter the program over the next twenty years
  - Estimates suggest that by 2019, **Medicaid** will cover more than 60 million lives – making it much larger than any private health insurer in the country[1]
  - States will need to focus on reducing already inadequate provider payments long before the Medicaid expansion begins in 2014
  - To bend the healthcare cost curve, both services provided and the costs of those services will need to be reduced
- Hospitals and health systems will need to transition their business models – **to do more with less**
- Given their weakened positions, hospitals will find it particularly challenging – and for some, impossible – to accomplish this critical and costly transition

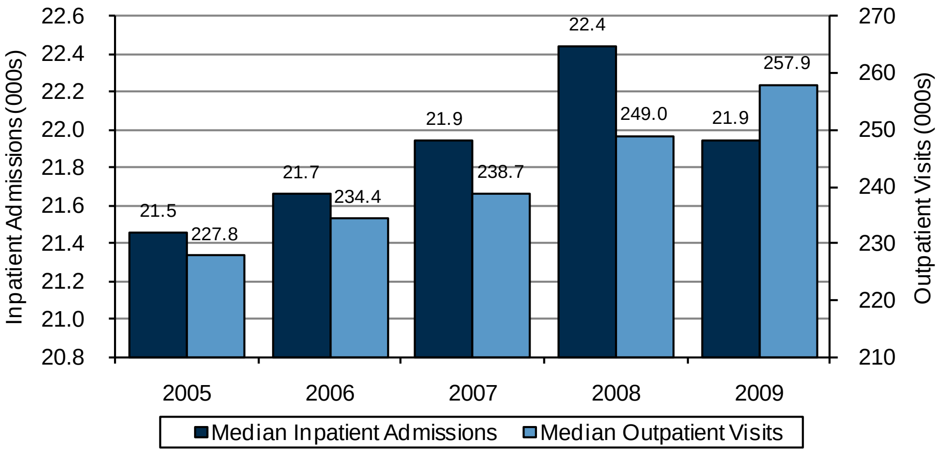
(1) Kaiser Family Foundation

Utilization / Payor Mix Trends

Since the economic downturn began, inpatient admissions have dropped precipitously at both not-for-profit and for-profit hospitals. Outpatient visits are increasing, albeit at a slower pace…

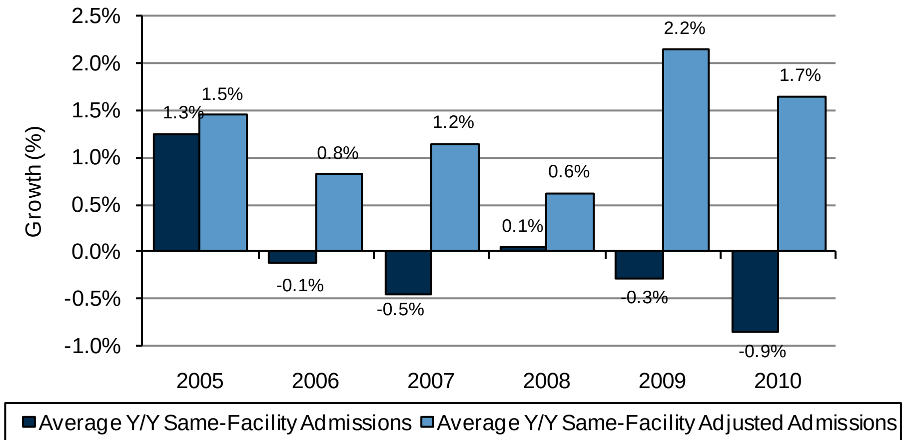
- Reductions in patient volumes continue to make it difficult for hospitals to stay ahead of expense growth
- Elective medical and surgical procedures are being deferred due to lack of insurance or an increase in the patient's contribution
- Payor mix has been adversely affected for most hospitals and health systems. From 2005 to 2009:
  - **Medicaid** revenues as a % of gross revenues increased from **10.7%** to **11.5**%
  - **Commercial and Managed Care** median revenues dropped from **6.4% and 23.0%** to **4.8% and 22.0%,** respectively

Not-for-Profit Utilization Trends(1)



(1) Moody's *Not-for-Profit Healthcare Medians for Fiscal Year 2009,* August 25, 2010.
Source: Moody's *Flat Admissions Put Pressure on Not-for-Profit Hospitals*, October 20, 2010.

For-Profit Utilization Trends



Source: Credit Suisse *Same-Facility Handbook – 3Q10*.

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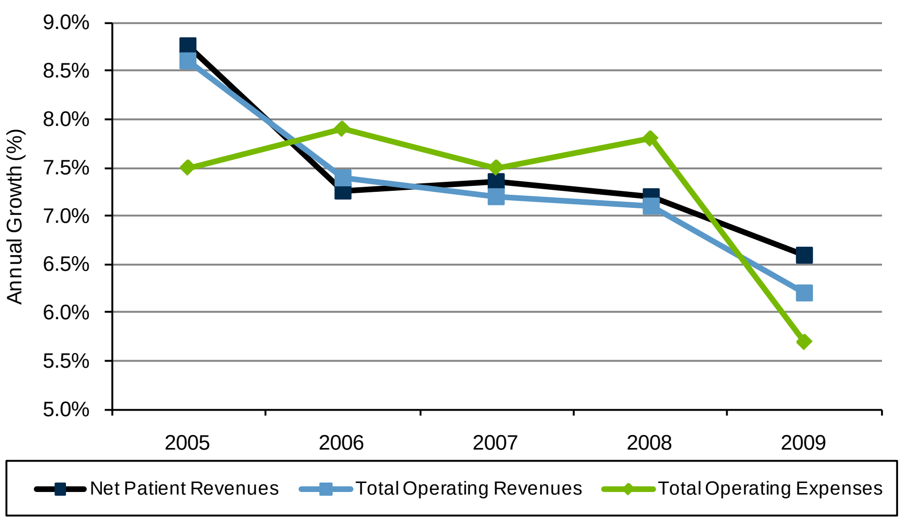
Financial Performance: NFPs

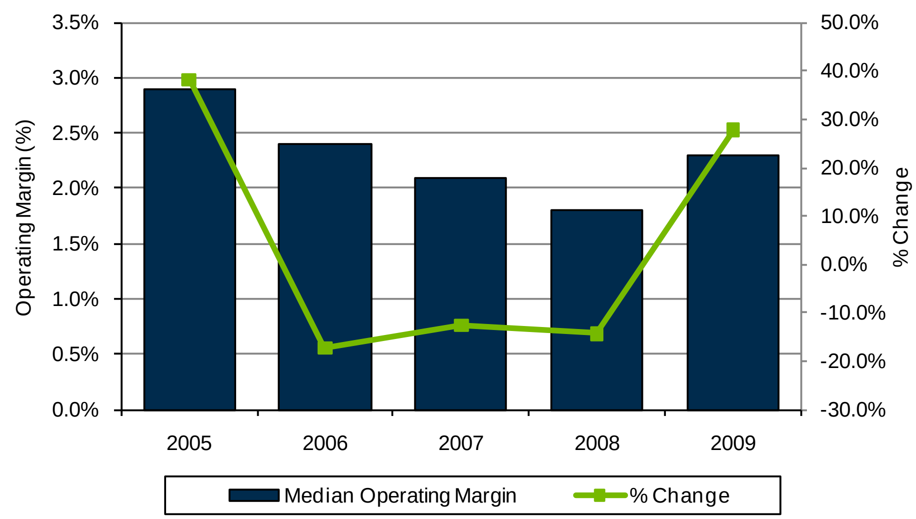
Despite declining revenues, not-for-profit hospitals generated higher operating margins in 2009…

- Margin improvement resulted from previously negotiated reimbursement levels to some degree, but substantial cost-cutting initiatives and freezes on capital expenditures were more influential
  - Expense reduction measures cannot drive profitability indefinitely
- Few health systems expect significant further improvement in profitability given continued economic pressures and cuts in reimbursement

Revenue and Expense Growth – All Rating Categories



Median Operating Margin – All Rating Categories



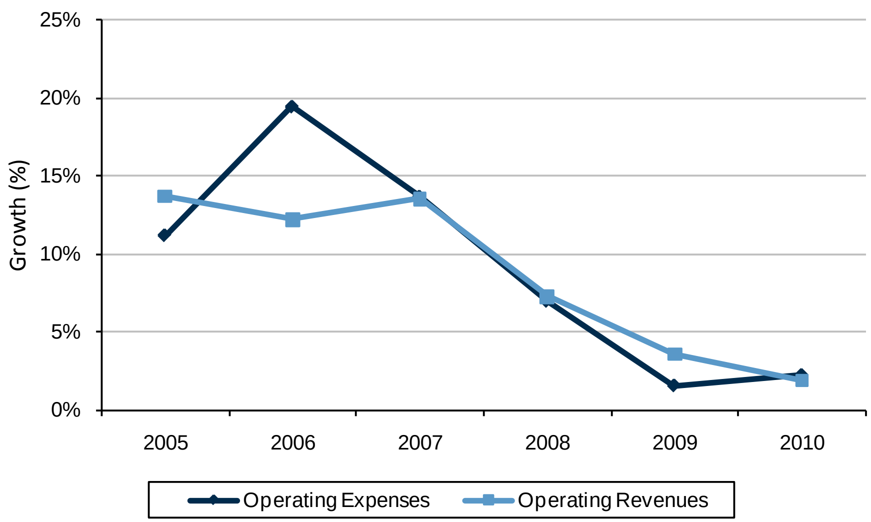
Source: Moody's Not-for-Profit Hospitals & Healthcare System Medians 2009 (July 2010)

Financial Performance: FPs

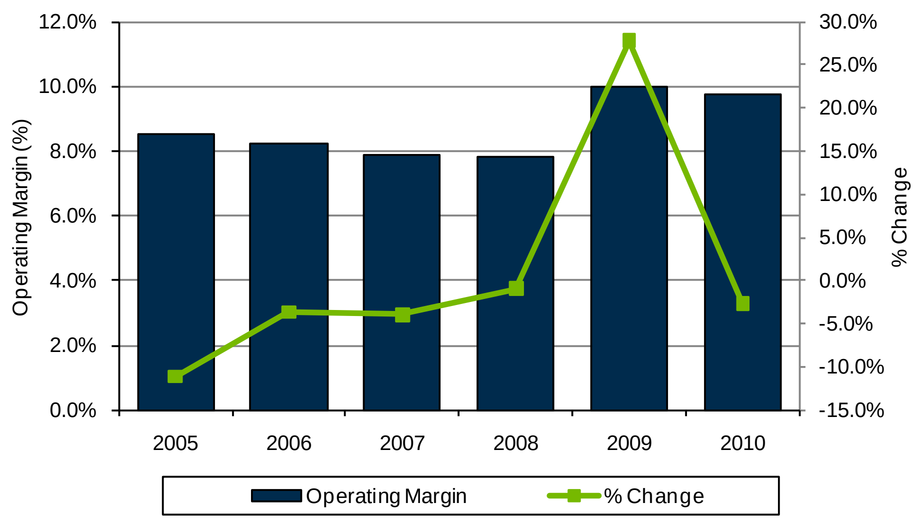
2010 brought margin pressure to the publicly-traded hospital companies due to lower revenue growth and an increase in the rate of expense inflation…

- Better-than-expected uncompensated care results and cost cutting helped drive operating margin growth at publicly-traded systems in 2009
- This trend reversed in 2010 -- expense growth outpaced growth in revenues for the first time since 2006

Publicly-Traded Health Systems
Revenue and Expense Growth (through LTM 9/30/10)



Publicly-Traded Health Systems
Median Operating Margin (through LTM 9/30/10)



Source: Company Filings; Calculations based on financials from CYH, HMA, LPNT, THC, UHS

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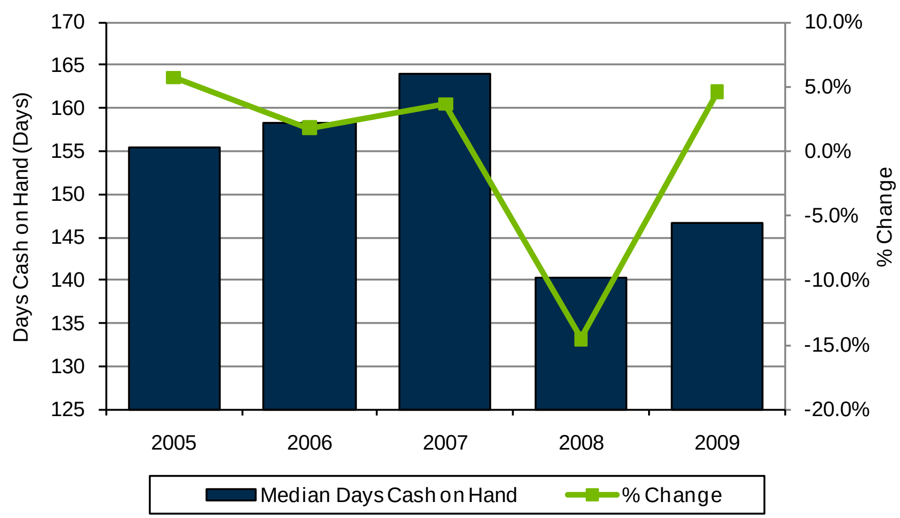
Financial Performance: NFPs

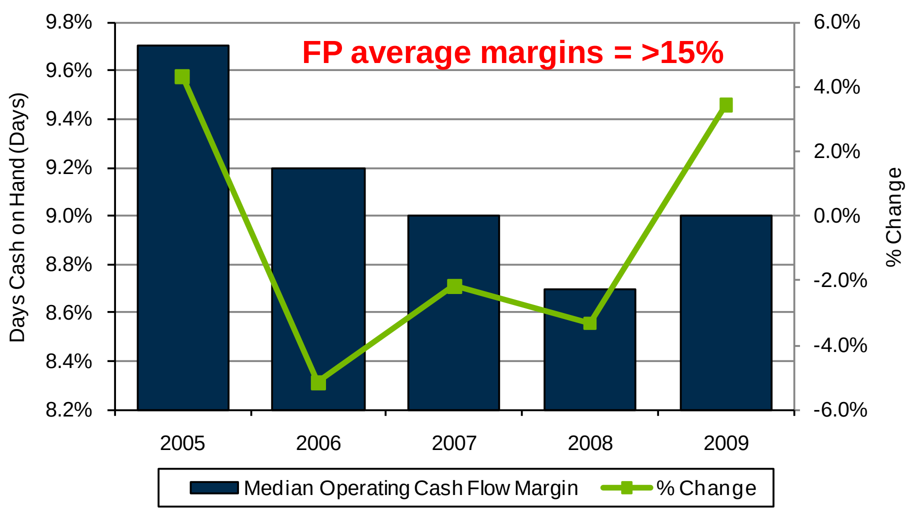
Balance sheets have been slower to recover from the market collapse…

- While rebounding somewhat from 2008, days cash on hand have not returned to their 2007 levels
  - With sizable capital needs, providers are increasingly focused on growing cash balances to fund core business operations
  - Unfunded pension liabilities created in large part by the 2008 market meltdown will continue to challenge hospital financial performance
- With ready access to capital, for-profit hospital systems are not constrained by a decline in liquidity
  - Rated for-profit hospital management companies have more than $2B in cash and access to credit lines totaling $6B.

Median Days Cash on Hand



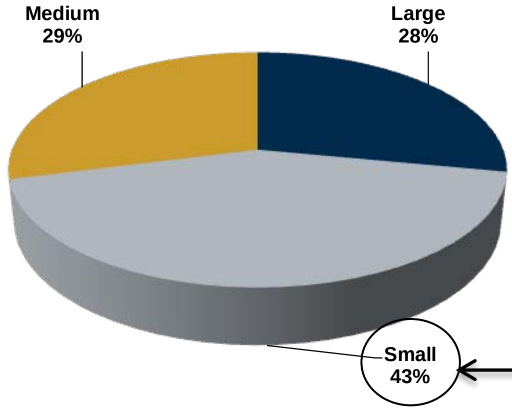
Median Operating Cash Flow Margin



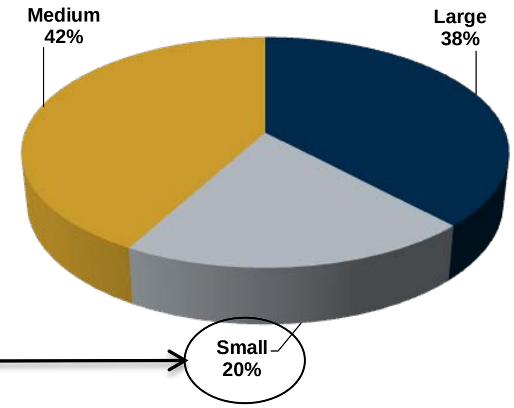
Source: Moody's Not-for-Profit Hospitals & Healthcare System Medians 2009 (July 2010)

Credit Ratings and the Benefits of Scale

Rating Activity - % of Downgrades by Total Revenue[1]



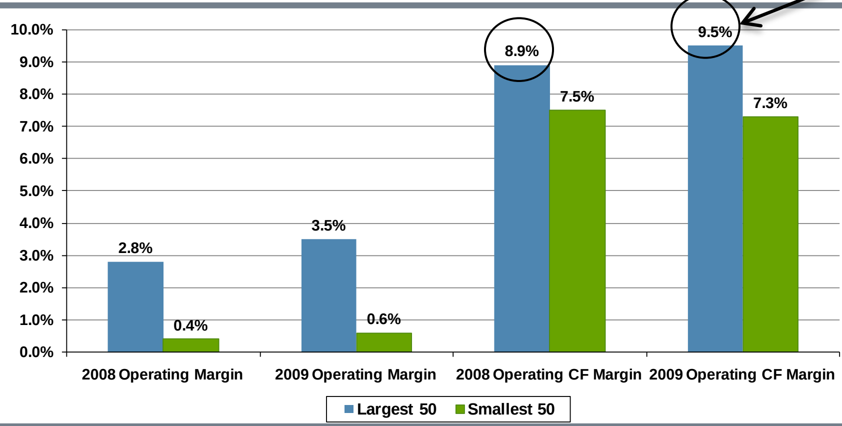
Rating Activity - % of Upgrades by Total Revenue[1]



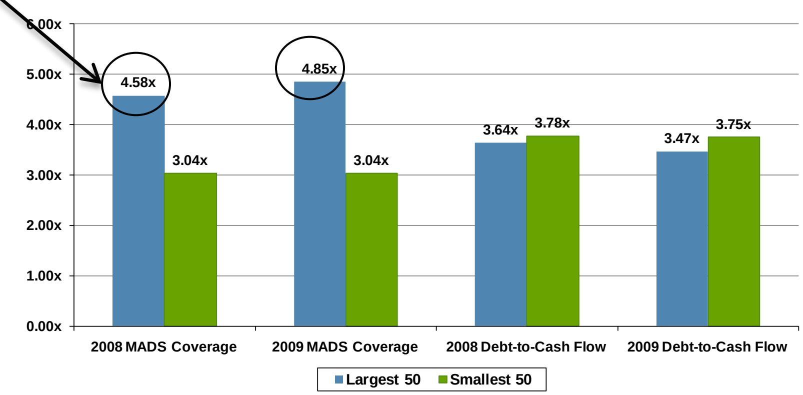
Smaller providers comprised 43% of downgrades, only 20% of upgrades.

Larger providers have achieved strong improvements in operating performance and leverage metrics. Financial performance of smaller providers lags that of larger providers.

Operating Performance – Largest 50 and Smallest 50[2]



Leverage Metrics – Largest 50 and Smallest 50[2]



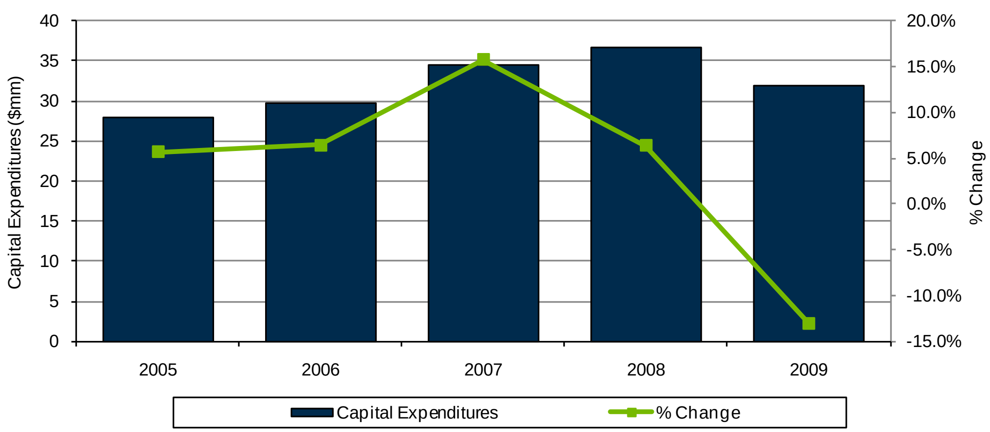
(1) Large comprised of providers with total revenue > $750 mm, medium comprised of providers with $250 mm - $750 mm in total revenue and small comprised of providers with < $250 mm in total revenue.
(2) Based on Moody's 50 largest single-state healthcare systems/freestanding hospitals and 50 smallest single-state healthcare systems/freestanding hospitals.
Source: Moody's.

Capital Requirements

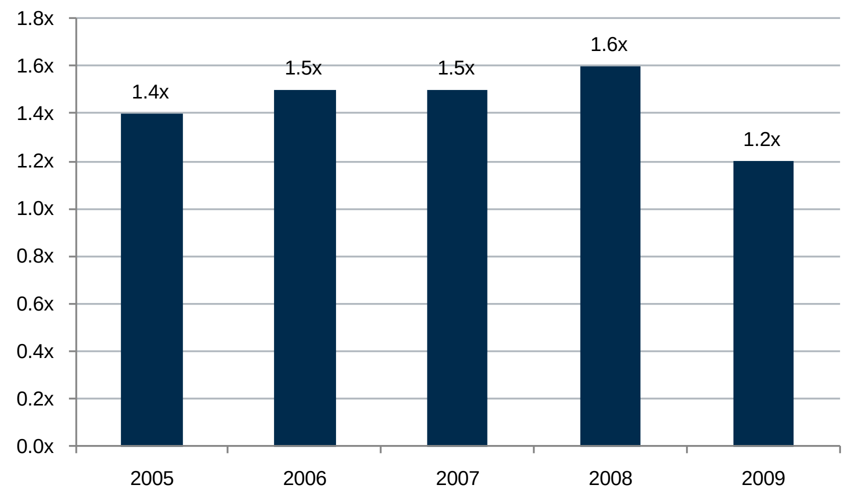
As liquidity declined, many not-for-profit providers froze capital projects and spending, creating pent up demand for capital going forward…

- Cash conservation reduces ability to create value through the traditional strategies of expansion and renovation as well as new programs, services and initiatives
- Significant portion of capital budgets represent necessary expenditures, and healthcare reform will only increase the need for investment
  - **Hospitals unable to fund necessary capital projects will fall into a downward market/credit/financial spiral from which it will be difficult to recover**

Not-for-Profit Healthcare Provider Capital Expenditures All Rating Categories



Not-for-Profit Healthcare Provider Capital Spending Ratio All Rating Categories



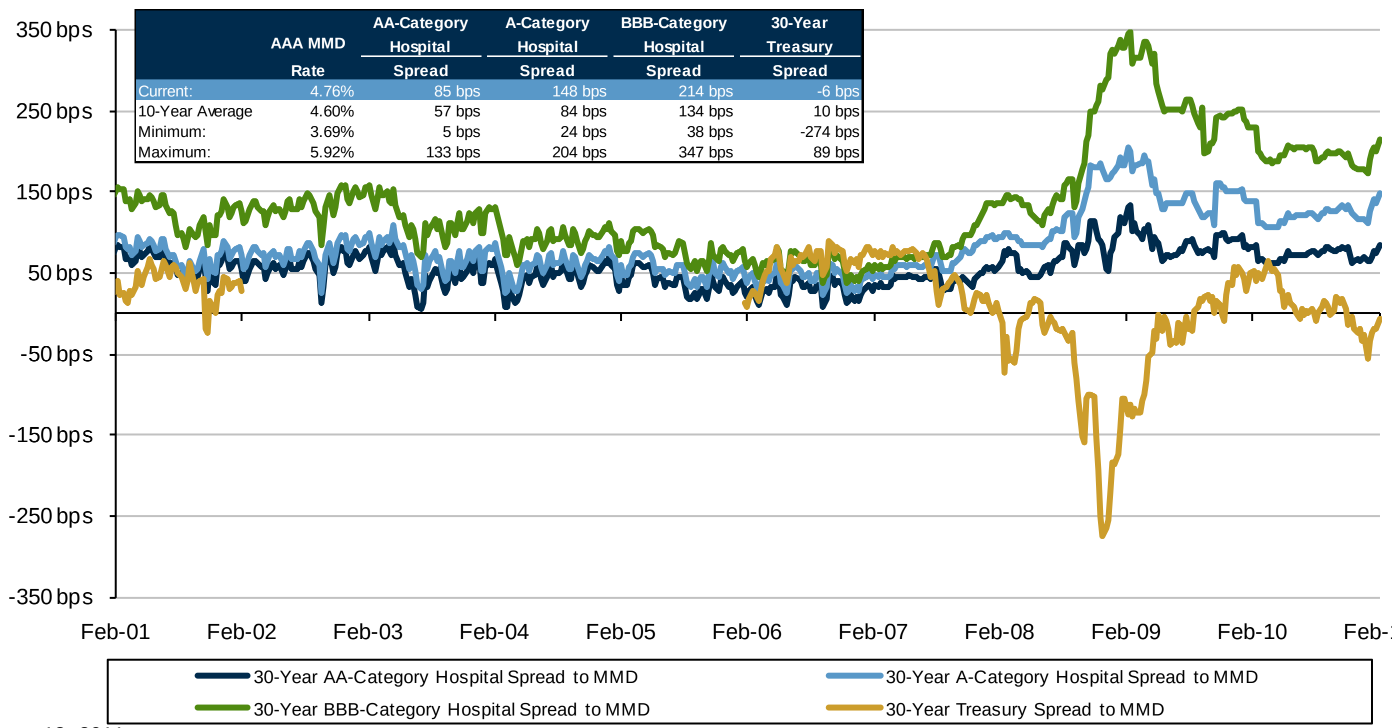
Source: Moody's Not-for-Profit Hospitals & Healthcare System Medians 2009 (July 2010)

Capital Access: NFPs

Capital access will continue to be limited, particularly for lower rated credits, and terms more restrictive for all borrowers…

- Federal and state economic conditions generating apprehension among investors and volatility in markets
- Credit spreads still relatively "wide"
- Security structures and business covenants more restrictive
- Fewer financing products available
- Fewer banks/insurers to provide credit support
- Operating pressures, reduced liquidity => credit strength and debt capacity reduced

Credit Spreads – Last 10 Years



	AAA MMD Rate	AA-Category Hospital Spread	A-Category Hospital Spread	BBB-Category Hospital Spread	30-Year Treasury Spread
Current:	4.76%	85 bps	148 bps	214 bps	-6 bps
10-Year Average	4.60%	57 bps	84 bps	134 bps	10 bps
Minimum:	3.69%	5 bps	24 bps	38 bps	-274 bps
Maximum:	5.92%	133 bps	204 bps	347 bps	89 bps

Market data as of February 18, 2011

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The benefits of healthcare reform are still unclear…

"Can a rising tide lift a boat that has a huge hole in the bottom?"

Healthcare Reform → Transformation of Care

The goals of healthcare reform are to improve access, enhance quality and reduce cost. To achieve these goals will require massive large scale change affecting all sectors of the healthcare industry…

Considerations

- Economic environment
- Aging population
- Medicaid expansion
- Physician and nurse shortages
- Increasing costs, waste in care
- Significant variation in healthcare outcomes
- Improvements in information technology

Objectives

- Greater number of insured
- Better prevention / improved outcomes
- Lower reimbursement
- Incentives for higher quality/lower cost
- Incentives for collaboration -- hospital/physician/provider /payor partnerships
- Incentives for use of IT capabilities

Legislation

- Accountable Care Organizations established – 2012
- Alternative payment methods – 2012
- Value-based purchasing for hospitals – 2013
- Reduction in readmission payments – 2013
- Medicaid and Commercial eligibility expansion – 2014
- DSH payment reductions – 2014
- Hospital-acquired conditions – 2015
- Value-based purchasing for physicians – 2015

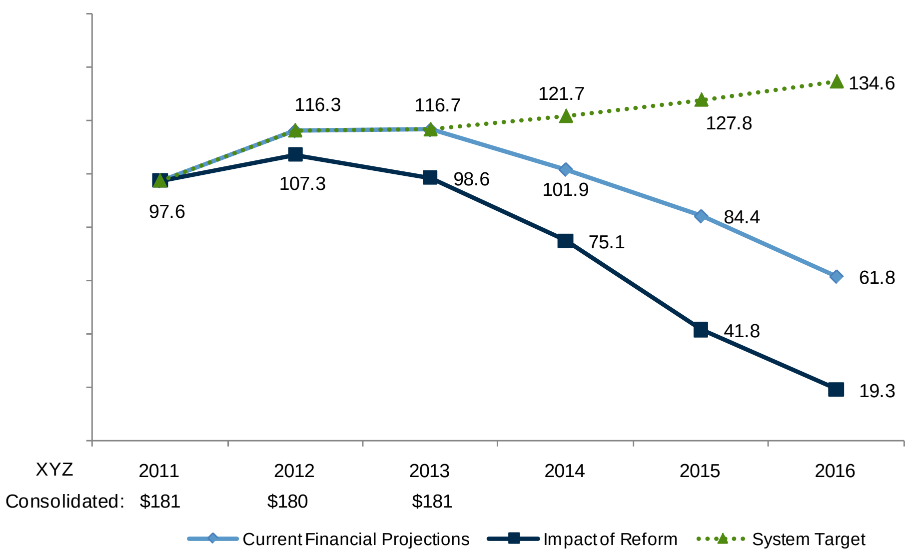
Healthcare Reform Impact on Operations

One health system's outlook as reform is implemented…

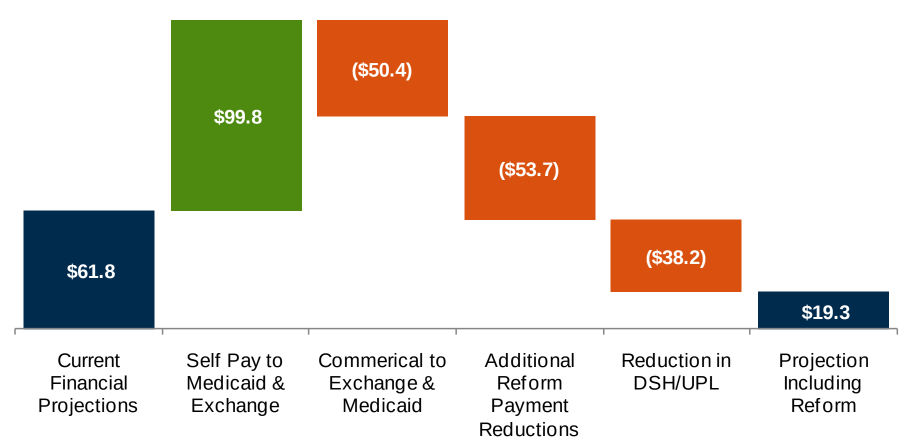
- New value-based payment mechanisms
  - Pay for performance
  - Patient-centered medical home for chronic care
  - Bundled payments
  - ACOs

- Substantial Medicare cuts affecting most providers
  - Hospitals
  - Physicians
  - Home Care
  - Labs
  - Radiation Oncology
  - Diagnostic Imaging

System XYZ Operating Income Projections ($ Millions)



System XYZ 2016 Operating Income Reconciliation ($ Millions)



How big is big enough?

"Don't worry, Ma—I'm too big to fail."

Implications for Hospitals and Health Systems

Greater integration and scale will be the key to survival in a post-healthcare-reform world… Independent hospitals and smaller health systems will be at a disadvantage.

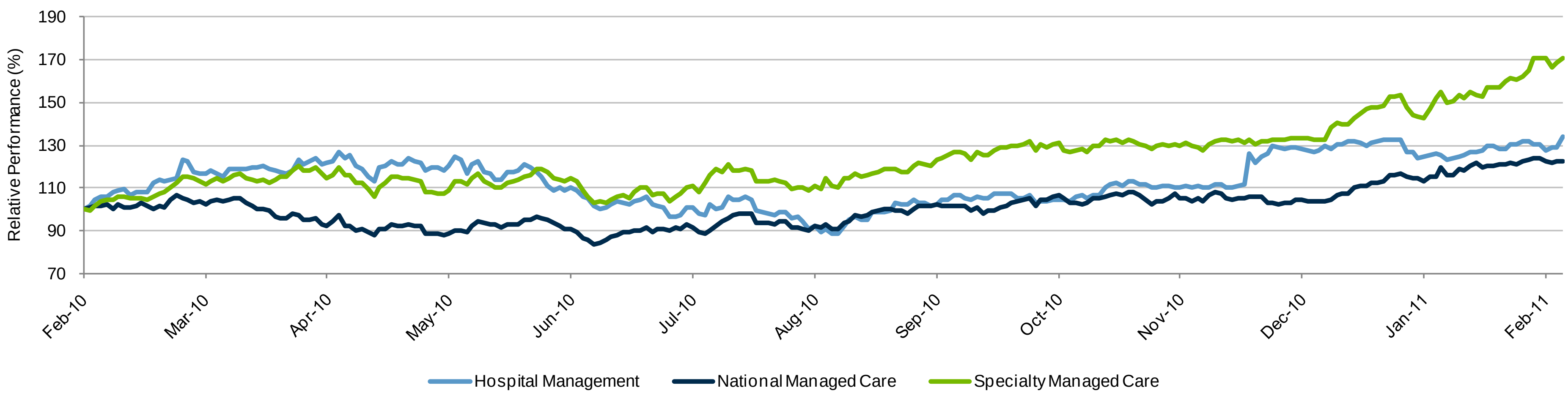
- The successful hospital/health system of the future will have to "**Do More with Less"**
  - **More:** Patients, payment risk, demonstration of quality care, collaboration across sub-sectors, supply expense, capital expenditures for IT and provider network development/ physician integration, justification of NFP status
  - **Less:** Unit reimbursement from all payors, profitability, credit strength and access to capital on favorable terms
- The emerging success model will require transformational change and impose new risks on hospitals. Successful hospitals and health systems will need to possess or develop:
  - An "essential" market position and growth strategies to drive revenues and achieve critical mass
  - Integrated physicians to support quality and cost initiatives
  - Ability to demonstrate value proposition (measurable quality and cost effectiveness) to employers and payors
  - Operations, facilities and/or alignment with other providers to enable patients to be managed seamlessly across multiple care sites
  - Sophisticated IT and care management infrastructures
  - Cost-effective operations
  - Optimization of business portfolio
  - Effective management and governance

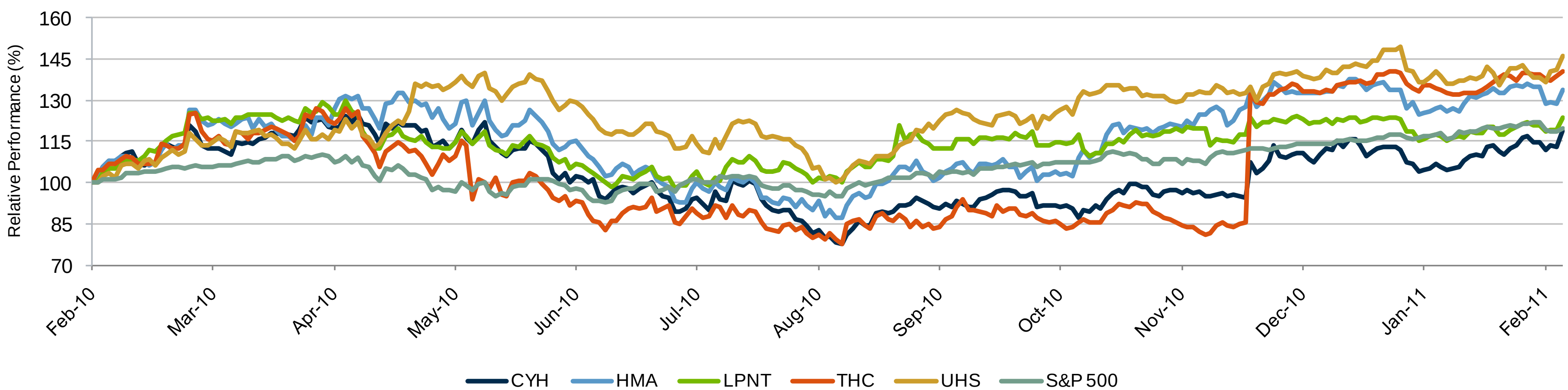
Merger & Acquisition Activity

Healthcare Services Public Equity Market Performance

The anticipated effects of healthcare reform are being construed as positive, albeit to varying degrees…

Publicly-Traded Hospital Management and Managed Care Companies Relative Price Graph (Last Twelve Months)



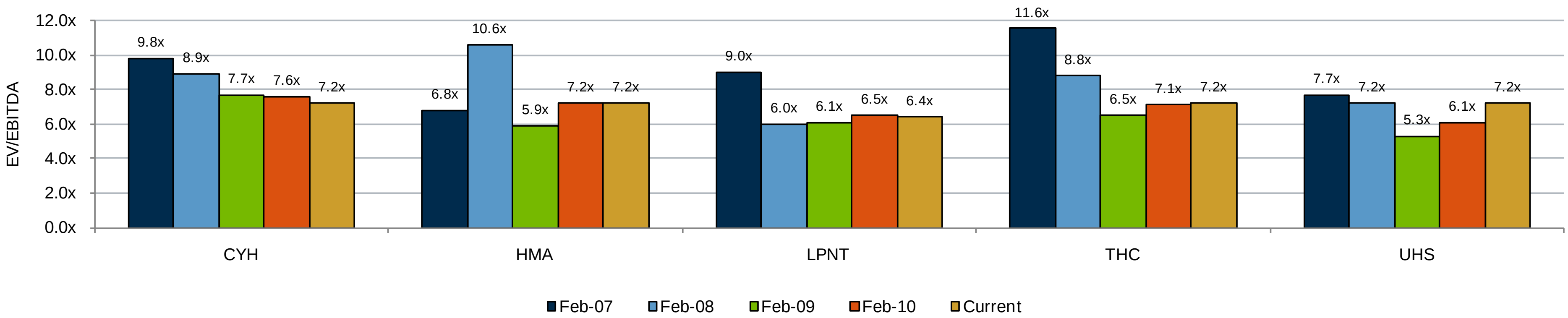


(1) LTM: Latest Twelve Months as of 9/30/10 for all companies, except MDTH & LPNT which are as of 12/31/2010.

Healthcare Services Public Equity Market Performance (cont'd)

There is little differentiation in valuation multiples of the hospital management companies, as most are currently trading around 7.0x EV/EBITDA…

Publicly-Traded Hospital Management Company Valuation Multiples[1]



- Industry analysts express optimism regarding performance of hospital management companies…
  - Headwinds in 2011 will likely be overshadowed by improving volumes and easing payer mix
  - Longer term, anticipate benefits of expanded coverage under ACA, offset somewhat by risks associated with Medicaid funding
- "Buys" assigned to most of the hospital company stocks due to reasonable valuations -- room for improvement in EBITDA multiples

(1) LTM: Latest Twelve Months as of 9/30/10 for all companies, except MDTH & LPNT which are as of 12/31/2010

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Overview of Publicly-Traded For-Profit Hospital Management Companies

Company	Overview	M&A Strategy
CHS Community Health Systems	■ One of the most diversified portfolios in the sector with nearly 2/3 of its hospitals operating as sole community providers and the remaining hospitals having strong market positions in mid-sized cities ■ Located in 29 states, its portfolio provides good geographic diversification and risk mitigation in the context of Medicaid funding ■ Also operates one of the largest 3rd party hospital management companies (QHR), which has management arrangements with more than 150 hospitals.	■ Since acquiring Triad in 2007, CYH's strategy has been largely centered on organic growth and the acquisition of NFP hospital systems ■ Has the financial capacity for additional acquisitions and will continue to target health systems
Health Management Associates	■ Portfolio is heavily concentrated in smaller, non-urban markets. ■ 59 hospitals located in 15 states and geographic concentration largely in the Southeast and Southwest – 30% in Florida ■ New leadership (2008) has brought more discipline, better execution to operations and creative growth strategies ■ Has re-emerged as a more active consolidator in the industry with a focus on underperforming NFP hospitals in states where HMA has existing operations	■ Re-entered the acquisition landscape in late 2009; throughout 2010 acquired six hospitals totaling ~$650 million ■ Future acquisitions may target community hospitals which HMA believes will be seeking to partner with a flexible, stable organization that has a proven track record and understands the nonurban hospital operations

Overview of Publicly-Traded For-Profit Hospital Management Companies (cont'd)

Company	Overview	M&A Strategy
LifePoint Hospitals, Inc.	■ Virtually all of its 52 hospitals are sole community providers in small cities located in 17 states – geographic concentration in the Southeast and Southwest ■ Recent senior management changes have enhanced physician recruiting/retention, capital deployment and expense management controls	■ Integration track record has improved in recent years, and its acquisition strategy is leading it to buy hospitals in more favorable markets
Tenet	■ 49 hospitals and 81 outpatient facilities located in 11 states, primarily in urban markets, with geographic concentration in FL, TX, CA and the Carolinas	■ Rejected CYH's bid to acquire the company at a 40% premium to its stock price, and has pursued an aggressive strategy to protect itself against a hostile takeover ■ Sees continued opportunities to buy outpatient centers within a short radius of their existing hospitals
UHS	■ Operations include 25 acute care and 196 psych hospitals in 37 states – geographic concentration in NV, TX, CA, FL ■ Acute care hospitals are located in fast-growth urban and mid-sized cities; behavioral portfolio (including recently acquired Psychiatric Solutions) is diversified across a variety of urban and non-urban markets	

Overview of Private For-Profit Hospital Management Companies

Company	Overview
Ardent Health Services	■ Private: Ridgemont Equity, Welsh, Carson, Anderson & Stowe, Clayton Associates, Ferrer Freeman & Company ■ Network includes 11 acute care hospitals, multi-specialty physician groups, a health plan and a nationally recognized medical laboratory ■ Lost bid to acquire Forum Health; acquired Oklahoma Gastroenterology Associates in May 2010
Capella Healthcare	■ Private: GTCR ■ Operates 13 hospitals in seven states ■ Targets community hospitals that are struggling to meet the growing demands of governmental regulation, complicated reimbursement requirements and the constant and capital-intensive upgrading of equipment and facilities
HCA Hospital Corporation of America®	■ Private: Bain Capital, BAML Capital Partners, Claritas Capital, KKR, Ridgemont Equity ■ Operates 164 hospitals and 106 freestanding surgery centers in 20 states and Great Britain ■ Set a preliminary price range for its initial public offering of $27 to $30 a share -- timing still uncertain
IASIS Healthcare®	■ Private: JLL Partners, MTS Health Investors, Sopris Capital, Halifax Group, TPG Capital, Trimaran Capital ■ Owner and operator of 16 general, acute-care hospitals, one behavioral hospital and three ASC in six states ■ Acquired Brim Healthcare in October 2010

Overview of Private For-Profit Hospital Management Companies (cont'd)

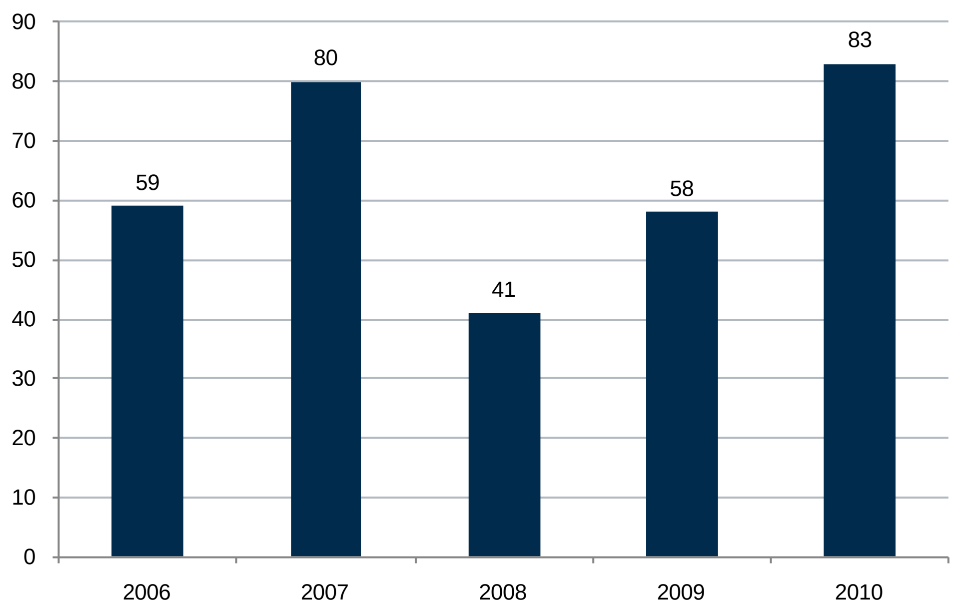
Company	Overview
LHP LHP Hospital Group, Inc.™	■ Private: CCMP Capital, CPP Investment Board ■ Former Triad executives ■ Sole mission is to establish joint venture partnerships with not-for-profit hospitals and health systems
RegionalCare HOSPITAL PARTNERS	■ Private: Warburg Pincus ■ Founded in 2009 by the former executive team of Province Healthcare ■ Currently operates 3 facilities in AL, IA and OH ■ Focused on rural / small urban markets, particularly sole community providers
VANGUARD HEALTH SYSTEMS	■ Private: APEN AG, Lexington Partners, Metalmark Capital, Pinebridge Capital, Blackstone, W Capital ■ Owns and operates over 15 acute care hospitals in five states ■ Recently acquired Detroit Medical Center and has acquired three additional hospitals in Chicago market ■ In the process of acquiring Valley Baptist Health System (TX)

Merger & Acquisition Volume

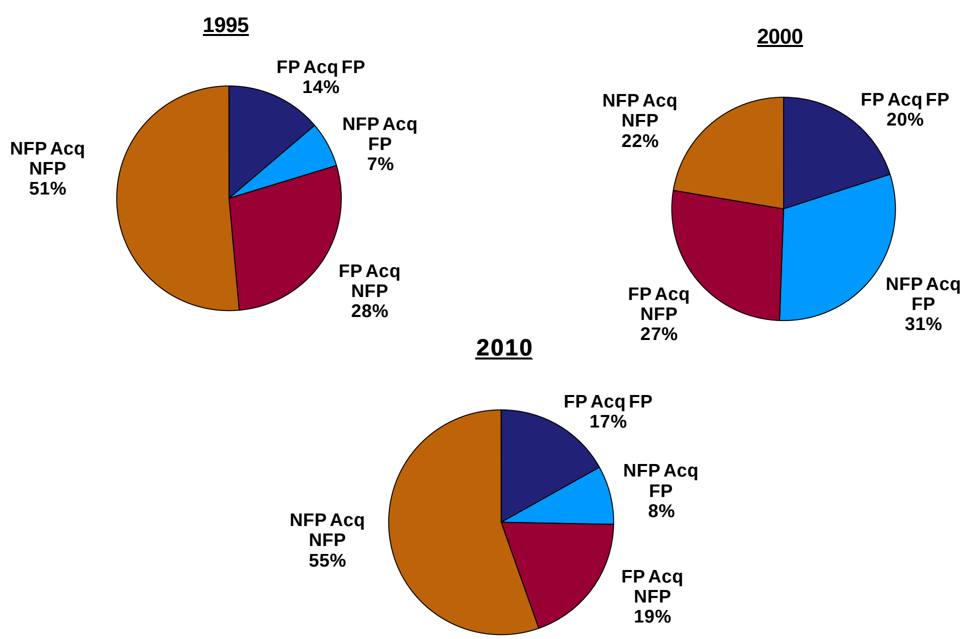
M&A activity increased significantly in 2010 – a trend that is expected to continue…

- Fueled by tremendous access to capital, for profit companies represented the lion's share of cash purchases
- However, 2010 activity reflects an increase in transactions between not-for-profit hospitals/health systems -- primarily non-cash mergers
- Overall, not-for-profits have been "net sellers" by a large margin

Announced Hospital and Health System Transactions



Distributions of Transactions by Ownership Model



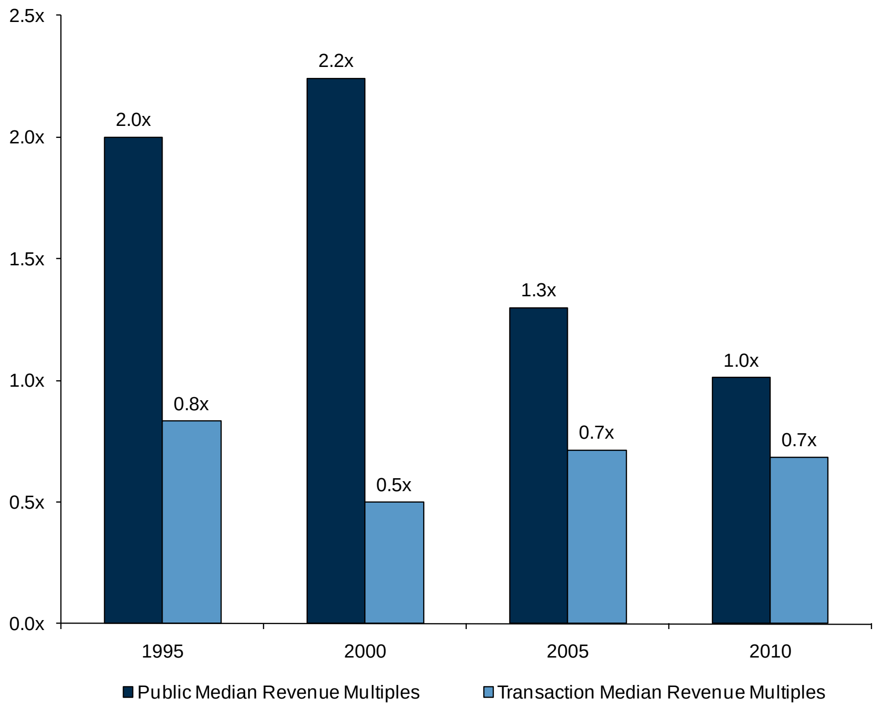
Source: Irving Levin Associates, Inc. and Shattuck Hammond Partners.

Public vs. Private Market Valuation Trends

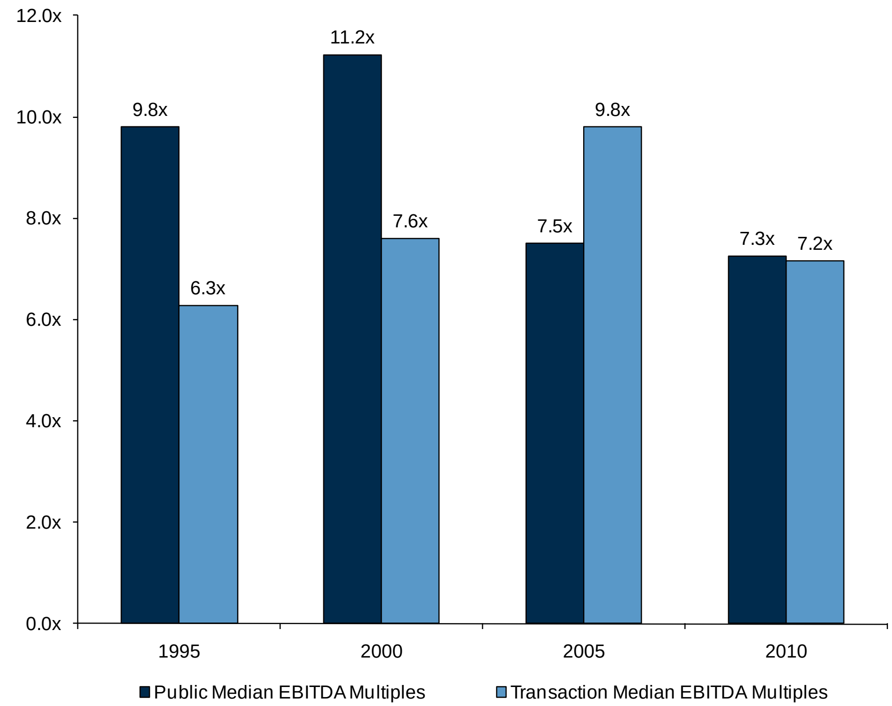
The declining trend in valuation multiples reflects caution related to the future cash flows of hospitals and health systems…

- Private market multiples often lag those in the public market, but also reflect the unique characteristics of each transaction and its participants.

Median Revenue Multiples



Median EBITDA Multiples



Source: Shattuck Hammond Partners.

Analysis of Recent Transactions: For-Profit Activity

An analysis of M&A transactions announced recently reflect a number of interesting developments…

- **For-profit hospital management companies** -- both publicly-traded and privately held -- are extremely acquisitive
  - Heightened need to increase scale, efficiency and market strength
    - Scale enhances ability to attract and retain top talent
    - Higher volumes and sharing of best practices support initiatives to improve quality
  - Healthcare reform and other payment risks driving geographic and service diversification
  - Valuations driven by pressure for continued growth
  - Substantial capital looking for investment opportunities in the healthcare sector, and financial buyers now added to the mix
    - new private-equity backed hospital management companies formed to pursue acquisitions and/or joint ventures, many with a focus on NFP facilities
    - increased funding for those already operational
    - financial buyer invested directly in distressed NFP healthcare system
  - Available capital and need for scale resulting in acquisitions of distressed or bankrupt facilities at full valuations

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Case Study: FP Entry into Urban NFP Market

On March 19, 2010, Vanguard Health Systems ("Vanguard") agreed to acquire Detroit Medical Center ("DMC"). A definitive agreement was signed on June 10, 2010 and the transaction closed on December 31, 2010.

DMC
DETROIT MEDICAL CENTER

VANGUARD
HEALTH SYSTEMS

- **Detroit Medical Center –** Not-for-profit health care system operating 8 hospitals in the metro-Detroit region with over 1,700 licensed beds. Total 2009 revenue >$2 billion.
- **Vanguard Health Systems** – For-profit owner and operator of over 20 acute care hospitals with ~5,000 licensed beds; facilities in Illinois, Arizona, Texas and Massachusetts. Total 2009 revenue >$3 billion.

Transaction Background

- Although DMC had returned to profitability over the past few years, Michigan's economic struggles significantly affected DMC's ability to raise capital and remain competitive.
- DMC pursued an investor-owned strategy that would eliminate its tax-exempt status and improve its access to capital.
- Vanguard believes there is significant opportunity in Southeast Michigan – DMC acquisition reflects its strategy to develop healthcare delivery networks in urban markets.
- Transaction will improve DMC's facilities and will likely give DMC money to acquire physician practices – critical to stem outmigration and attract suburban patients to Detroit.

Transaction Structure and Terms

- Vanguard agreed to acquire DMC for a final purchase price of $368 million and pledged to invest $850 million into DMC facilities within five years.
  - $500 million will expand and renovate DMC hospitals; the remaining $350 million will be used for maintenance capital expenditures at existing DMC facilities.
- Vanguard committed to keep all DMC hospitals open and maintain DMC's charity-care policies for 10 years.
- Final agreement included a "renaissance zone" which eliminates state, county and municipal taxes for 12 years, then provides discounts in the next 3 years before the system is fully taxed.

Case Study: Direct Investment in Health System by Private Equity Firm

Cerberus Capital Management agreed to acquire Caritas Christi Health Care, a Boston-based hospital operator, on March 25, 2010 in a transaction valued at $830 million.

- **Caritas Christi Health Care –** Operates a network of 6 not-for-profit hospitals in eastern Massachusetts, southern New Hampshire, and Rhode Island – a market dominated by large, academic medical centers.
- **Cerberus Capital Management** – Operates as a PE firm specializing in investments in undervalued companies.

Transaction Background

- Caritas Christi had been operating at negative cash flows for several years and in the CEO's words was "capital starved"
- Negotiations to merge with Ascension Health in 2007 were terminated
- The dire outlook for operations and the need for capital persuaded the system to return to the market in search of a partner
- Cerberus is known as a "turnaround specialist" – acquired Chrysler and has invested in other healthcare, but Caritas Christi will be its first hospital investment

Transaction Structure and Terms

- Cerberus will invest $430 - $450 million immediately to pay off Caritas debt, finance renovation projects, and provide working capital
  - Will also invest $400 million for building and IT improvements
- Caritas Christi will convert to a taxable entity
- Caritas Christi hospitals will retain their Catholic identities
- Cerberus will retain current hospital management, employees, medical residency and teaching programs, and respect the commitments that Caritas has made to charitable donors
- Cerberus committed not to sell the hospitals or take them public for at least three years

Case Study: NFP / FP Joint Venture

In 2009, Hackensack University Medical Center entered into a Joint Venture Agreement with Legacy Hospital Partners to acquire Pascack Valley Hospital.

- **Hackensack University Medical Center ("HUMC")** – Headquartered in Hackensack, NJ; owns a 775-bed, not-for-profit, teaching and research hospital and is the state's largest provider of inpatient and outpatient services.
- **Legacy Hospital Partners ("LHP")** – A privately-held, for-profit company that forms joint ventures to own, operate and manage acute care hospitals; headquartered in Plano, TX and owned by affiliates of CCMP Capital Advisors. Board consists of a number of NFP hospital CEOs.

Transaction Background

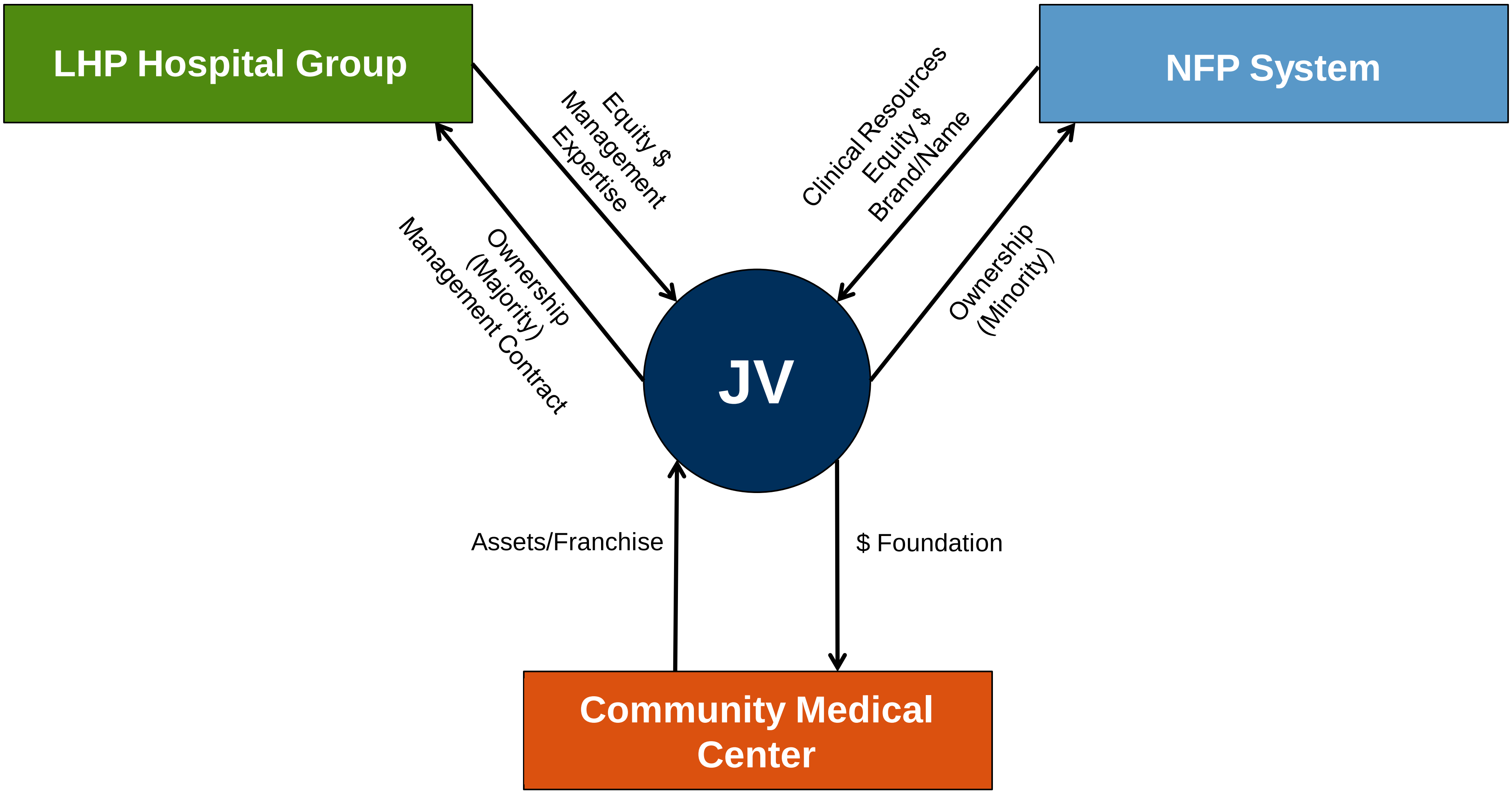
- Looking to expand into northern New Jersey in 2006, HUMC approached Pascack Valley Hospital ("PVH"), a 291-bed community hospital in Westwood, NJ.
- Entered into a preliminary letter of intent to acquire PVH, but due diligence concluded that PVH could not be "valued" at its stated or implied liabilities and the transaction was delayed.
- Months later, HUMC, in conjunction with Touro College, acquired PVH out of a bankruptcy sale for a reduced purchase price and assumed investment.

Transaction Structure and Terms

- HUMC and LHP formed a joint venture company ("JV") to own the PVH facility, which LHP will manage on an ongoing basis.
- The JV is currently evaluating the re-development of a community hospital at the PVH site to protect market share, and HUMC has opened a freestanding ER and located a mobile ICU in the market.
- A CON for the new hospital has been submitted, and negotiations for the final funding, business and structural terms of the JV with LHP are currently in progress.

Assessment of Strategic Options – Sale of Assets (cont'd)

The following diagram indicates the typical structure that LHP utilizes to acquire a facility in conjunction with a NFP partner or to establish a partnership to operate an existing hospital / health system.



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Recent Transactions: For-Profit Acquirers

Company	Description	Multiples: Revenue	Multiples: EBITDA
CHS Community Health Systems / Tenet	■ Community Health Systems announced an offer to acquire Tenet Healthcare for $6.00 per share, a 40% premium over Tenet's closing stock price on 12/9 ■ Total transaction value estimated at ~$7.3 billion, including $3.3 billion of equity and $4 billion in debt ■ Combination would be first based on number of facilities	0.8x	7.1x
CHS Community Health Systems / Forum Health	■ Community Health Systems acquired Forum Health, a Youngstown, Ohio based health system for $120 million ■ CHS acquired Forum through bankruptcy proceedings, topping a bid by Ardent	0.3x	NA
LG&P / Prospect Medical	■ Leonard Green & Partners acquired Prospect Medical Holdings for $363 million, including assumption of $158 million in debt ■ Prospect operates 5 hospitals in Southern California and offers management services to affiliated physician organizations	0.8x	6.7x
LifePoint Hospitals, Inc. / Sumner	■ LifePoint Hospitals acquired Sumner Regional Health Systems for $157 million plus $60 million in capital investments in the system's hospitals over the next 10 years ■ Sumner was acquired through a bankruptcy process that saw significant interest from several for-profit providers	1.5x	NA

Recent Transactions: For-Profit Acquirers (cont'd)

Company	Description	Multiples: Revenue	Multiples: EBITDA
LHP (LHP Hospital Group, Inc. – Culture · Collaboration · Capital) / NFP Hospitals	■ Not-for-profit partner will provide managed care contracting power and LHP will provide capital resources and management services		
	■ Acquired Portneuf Medical Center in Idaho	NA	NA
	■ Partnership with Texas Health Resources to acquire Wilson Jones Medical Center in Sherman, TX	NA	NA
	■ Partnership with Hackensack University Medical Center to replace Pascack Valley Hospital.		
UHS / PSI Psychiatric Solutions, Inc.	■ Universal Health Services acquired Psychiatric Solutions for ~$3.1 billion, including ~$1.1 billion in PSI net debt	1.7x	9.8x
	■ Highly strategic transaction that creates a premier facilities-based healthcare provider with a leading presence in the behavioral health care services sector		
	■ The transaction is expected to generate ~$35-45 million in annual cost synergies within three years, and may be significantly accretive to UHS' EPS.		
RegionalCare Hospital Partners / NFP Hospitals	■ Acquired Coffee Health Group (AL) in June 2010 for ~390 million	1.9x	NM
	■ Acquired Ottumwa Regional Health Center (IA) in May 2010 for $60 million	0.7x	10.2x
	■ Acquired Clinton Memorial Hospital (OH) in December 2010 for $82 million	NA	NA

Analysis of Recent Transactions: Not-for-Profit Activity

Not-for-profit hospitals and health systems have been more active on the merger or "sell-side," although strong, multi-hospital systems have also been acquirers…

- Need for scale and market strength driving both divestiture and acquisition activity
  - Weak market and financial positions driving independent hospitals to find partners
    - States / communities accepting for-profit healthcare through full divestitures or joint ventures with FPs
  - National multi-hospital systems with single facilities in unfavorable markets facing need to prioritize
    - Significant activity among Catholic systems, including facility "swaps"
  - Strong regional systems acquiring independent hospitals to improve market position
- Non-cash mergers have become the primary transaction structure utilized by NFPs
  - Financially sound hospitals facing substantial capital requirements and reduced access to capital
  - Governing boards' preference to retain NFP status
  - Governance rights in lieu of cash
  - Regional systems merging to create super-regionals

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Evaluation of Strategic Options

Not-for-profit hospitals are utilizing a disciplined, comprehensive approach to determine strategy…

More ***Control*** ***Less***

Less ***Potential Efficiencies*** ***More***

Independent	Affiliation			
Stay the Course	**Contractual Relationship**	**Joint Venture**	**Joint Operating Company**	**Full Asset Merger**
■ Status quo ■ Opportunistically acquire smaller operators or expand organically	■ Maintains ownership but management or specific services contracted ■ Incremental approach	■ Creation of jointly owned hospital or specific service ■ Opportunity to build upon existing strengths	■ New management structure required to operate new entity ■ Less than full commitment (e.g., assets not merged); may pose long- term challenges	■ High level of integration ■ Simplified management

Merger of Independent Hospital and Academic Medical Center

In October 2008, Lake Forest Hospital ("LFH") and Northwestern Memorial Healthcare ("NMHC") signed a letter or intent to merge. The transaction closed in February 2010.

Lake Forest Hospital

Northwestern Memorial Hospital

- **Lake Forest Hospital** -- 137-bed, independent NFP hospital located approximately 30 miles north of downtown Chicago with full range of highly ranked medical and specialty services. Total revenues were ~$220 million and LFH was rated A3/A-/A.
- **Northwestern Memorial Healthcare** – Prestigious NFP academic medical center operating a 490-bed tertiary hospital, 328-bed women's hospital and 55-bed psychiatric hospital on a single campus in downtown Chicago. NMHC also controls approximately 100 primary care physicians through Northwestern Memorial Physicians Group. Total revenues exceeded $1.3 billion; rated Aa2/AA+.

Transaction Background

- LFH considered the premier provider in its affluent and growing service area, however, LFH faced significant capital expenditure needs due to growing demand, increasing competition and outmigration, and the need to upgrade its aging and inefficient facilities.
- Determined that it needed a strategic and financial partner to realize its vision given the substantial costs to fund the strategy; evaluated several academic medical centers and integrated health systems in the market.
- NMHC's lack of geographic and facility diversification created a competitive weakness and financial challenges.

Transaction Structure and Terms

- NMHC assumed all of the assets and long-term debt of LFH.
- NMHC agreed to build a full-service replacement hospital or renovate the existing hospital within 10 years and to continue to fund the expansion projects approved and underway.
- NMHC agreed to appoint LFH board members to both the NMHC and Northwestern Memorial Hospital Boards; a separate LFH Board would continue with added representatives of NMHC.
- LFH CEO remained in place, reporting directly to the NMHC President and CEO.

Case Study – NFP / NFP Joint Venture

In December 2010, Bronson Healthcare Group ("Bronson") signed a letter of intent to acquire a 51% interest in Battle Creek Health System ("BCHS"). The transaction is expected to close in the second quarter of 2011.

- **Battle Creek Health System** – Located in Battle Creek, MI and owned equally by Trinity Health and Battle Creek Community Partners ("BCCP"). BCHS consists of a 172-bed NFP acute care hospital, a surgery center and a cancer care center. Total FY 2010 revenues were ~$230 million.
- **Bronson Healthcare Group** – A NFP health system headquartered in Kalamazoo, MI, approximately 25 miles from Battle Creek. Bronson operates 511 beds in two acute hospitals in Michigan, including Bronson Methodist, its flagship tertiary hospital. Bronson serves south central Michigan and northern Indiana, offering a full range of services from primary care to advanced critical care. Total FY 2010 revenues were ~$520 million.

Transaction Background

- In early FY10, it became apparent to BCHS's sponsors that the competitive environment was intensifying, and that BCHS would need to invest significant capital and/or align with a larger system in order to continue its mission to serve the Battle Creek community. Although BCHS gained cost synergies and other benefits as a result of its membership in Trinity, it was not geographically close enough to another Trinity member to be able to derive strategic and clinical benefits.
- Given these facts, Trinity and BCCP elected to evaluate a range of strategic alternatives that would ensure the continued availability of high quality healthcare in Battle Creek.
- A formal RFP process was initiated and multiple proposals were submitted, from both NFP and FP systems and including full asset purchase and joint venture structures.

Transaction Structure and Terms

- Chosen for its regional focus, clinical and financial strength, Trinity and BCCP selected Bronson to be BCCP's new partner; Bronson will purchase Trinity's entire 50% equity interest and 1% of BCCP's equity interest in BCHS.
- Bronson and BCCP will form a new Michigan non-profit, joint venture corporation ("Newco") to own the BCHS facility, which Bronson will manage on an ongoing basis.
- BCCP will nominate a significant number of members to both the Newco and Bronson parent boards, and will have reserved powers related to issues such as closing the hospital, electing hospital executives and a right of first refusal in the event of a future sale.

Other Notable M&A Transactions

		Multiples	
Company	Description	Revenue	EBITDA
Catholic Health East (A Transforming, Healing Presence)	■ Catholic health systems restructuring their portfolios by divesting hospitals in underperforming markets or where they have no nexus to other system facilities.		
Resurrection Health Care	■ Catholic Health East sold Mercy Hospital in south Florida to HCA and in process of selling St. Joseph's in Atlanta	NA	NA
Catholic Health Initiatives	■ Resurrection Health Care sale of Westlake and West Suburban to Vanguard Health (IL)	0.2x	NA
	■ Catholic Health Initiatives' sale of facilities in Idaho and Missouri to Trinity and Sisters of Mercy	NA	NA
Ascension Health; Oak Hill Capital Partners	■ Undertaken with the goal of consolidating Catholic healthcare systems in targeted areas	NA	NA
	■ Ascension will provide the management services and Oak Hill will provide the capital		
OSF HealthCare; Rockford Health System; Ottawa Regional Hospital & Healthcare Center	■ OSF Healthcare System looking for opportunities to strengthen its position in each of its current markets		
	■ Pending mergers with Rockford Health System and Ottawa Regional Hospital	NA	NA
Sanford Health; MeritCare	■ Sanford Health (SD) building "super-regional" system through mergers and acquisitions		
	■ Merged with MeritCare Health System (ND)	NA	NA
	■ Acquisition of North Country Health Services (MN)	0.8x	NM

Will Mergers Work?

"Only time will tell whether this merger makes sense or not."

Process for Assessing Strategic Options

Approach to Assessing Strategic Options

Shattuck Hammond's comprehensive approach is designed to reflect each organization's unique characteristics and objectives and to ensure its long-term success.

Strategic Options Assessment

Step	Task/Objective
1. Establish Objectives	Understand the organization's mission and goals, and determine evaluation criteria to select an optimal strategy and plan.
2. Market Assessment	Define the organization's market, including the evaluation of demographic and regulatory trends and competitive characteristics, and the implications for the long-term goals of the organization.
3. Institutional Assessment	Assess the organization's market position as well as its organizational and financial structure, including assessment of credit position, value and access to capital.
4. Strategic Assessment	Evaluate the current strategy and identification of alternative strategic options.
5. Evaluation	Evaluate the options against established criteria to best achieve the organization's long-term mission and objectives.
6. Recommendation	In conjunction with organization's leadership, review implications of strategic options and select the option that best achieves the organization's long-term mission and objectives.
7. Implementation	Develop and execute an implementation plan to ensure that the chosen strategic option meets the organization's objectives.

Steps 1 to 3: Situational Overview

All strategic option assessments begin with a thorough evaluation of the organization, its mission, and its likely ability to meet such mission…

Step

1. **Establish Objectives**
2. **Market Assessment**
3. **Institutional Assessment**
4. **Strategic Assessment**
5. **Evaluation**
6. **Recommendation**
7. **Implementation**

- Determine Mission, Vision and Goals
  - What does Management and the Board want to achieve for their community?
  - What does Management and the Board want the organization to be in five years? In 10 years?
- Analyze the Market / Service Area
  - What is the organization's position in the market, its strengths, its weaknesses?
  - What opportunities does the organization have to strengthen its position?
  - What threats do competitors pose?
- Evaluate the Organization's Financial Position
  - Create a "bottom up" five-year financial forecast reflecting current mission, objectives and strategic plan
    - Evaluate impact of healthcare reform on reimbursement
    - Determine opportunities for productivity improvements
    - Examine options to reduce expenses, and create efficiencies
    - Determine capital needs – including strategic investment – over the projection period
    - Explore funding sources for capital needs and determine credit impact

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Steps 4 and 5: Strategic Assessment and Evaluation of Options (cont'd)

The Situational Overview should result in a determination of what the optimal performance of the organization would be if it retains its "Independent" status, given its current mission and priorities for the community…

Step

1. **Establish Objectives**
2. **Market Assessment**
3. **Institutional Assessment**
4. **Strategic Assessment**
5. **Evaluation**
6. **Recommendation**
7. **Implementation**

- The results of the Situational analysis should assist in answering several critical questions:
  - Can the organization survive and prosper as an independent entity? If so, for how long? If not, why not?
  - How should mission implications be weighed against financial projections?
  - What needs/deficiencies did the Situational analysis identify? What objectives might encourage the evaluation of a strategic transaction?
    - Financial performance -- market position/managed care contracting/economies of scale?
    - Capital access/monetary consideration -- strategic and infrastructure investments?
    - Clinical and community service needs – specific service lines?
    - Some of each? Others?
- Ultimately, the Situational analysis serves as the baseline for determining whether an even "better job" can be done by partnering in some fashion with another/other organization(s), and helps the organization identify the criteria to be used for evaluating potential opportunities.

Steps 4 and 5: Strategic Assessment and Evaluation of Options (cont'd)

If it is not clear that the "Independent" option is the best for the organization, strategic alternatives – collaboration/affiliation/M&A -- are identified and evaluated against a set of defined criteria.

Step

1. **Establish Objectives**
2. **Market Assessment**
3. **Institutional Assessment**
4. **Strategic Assessment**
5. **Evaluation**
6. **Recommendation**
7. **Implementation**

- Are there opportunities to **collaborate** with other providers – acute care, physicians, ancillary services -- that can provide sufficient benefits to remain viable as an Independent? :
  - Sharing of clinical programs/service lines, acute and post-acute
  - Integrated medical staffs
  - Higher reimbursement opportunities
  - Revenue cycle, back office combinations
  - Supply chain management
  - Technology sharing
  - Facilities
- Would other options satisfy better the organization's long-term mission and objectives?
  - **Merger** with or **sale** to a larger regional or national health system?
  - Merger with or **acquisition** of one or more independent hospitals to create a new regional health system better positioned to compete both strategically and financially?

Steps 4 and 5: Strategic Assessment and Evaluation of Options (cont'd)

The benefits and implications of each strategic alternative are analyzed, quantified and measured against the defined decision criteria.

Step

1. **Establish Objectives**
2. **Market Assessment**
3. **Institutional Assessment**
4. **Strategic Assessment**
5. **Evaluation**
6. **Recommendation**
7. **Implementation**

- Ultimately, the organization may have to weigh the tradeoffs between remaining independent and giving up some or all of its control, in order to continue its mission of providing high quality, affordable healthcare to the community.
- Finally, questions regarding the likelihood of implementing the optimal strategy must be answered before a recommendation can be made:
  - Is the timing optimal or propitious?
  - How will capital markets and economic / political conditions challenge potential partners?
  - Will partnership discussions damage the organization's franchise / relationships with key constituents if unsuccessful?
  - What will be the reaction of key competitors?
  - Who should be involved in the final decision and its implementation?

Key Transaction Terms

If the organization determines that a strategic transaction is likely the best course of action to meet its objectives, there are several key terms of any transaction that drive the potential benefits to the seller / partner and its community / stakeholders…

Transaction Consideration – Amount and Form

- Upfront payment to establish foundation / ongoing capital investment
- Cash and / or assumption of liabilities
- Commitment to operate hospital at specific service level
- Repurchase / unwind options
- Use of proceeds in sale at later date

Governance Rights

- Local board role and control, reserved powers
- Representation on system / parent board
- Voting rights

Cultural Identity and Business Plan

- Philosophy and mission
- Role for local system
- Clinical, quality, service issues / standards

Physician Issues

- Medical staff governance
- Board committee participation
- Physician retention/recruitment

Management / Employees

- CEO and senior management appointments
- Employee retention
- Benefit levels

Criteria for Evaluating and Structuring a Partnership / Transaction

The criteria to evaluate whether a particular partnership is appropriate for an organization to pursue in serving its community are simply stated – "the 5 C's" – the evaluation of which will depend upon the structure and key terms of the transaction.

Clinical

- Will the strategy enhance the organization's ability to provide high quality health services to the community – now and in the future?
- Will physician recruitment and specialty care resources be enhanced?
- How will potential consolidation of services in the surrounding market affect the strategy?

Commitment

- Will the strategy provide the appropriate level of financial commitment, capital or resources to ensure that the organization or its successor can serve the community with high quality care and facilities and be competitive with other market participants?

Community

- Will the community at large understand and accept the strategy as being in the best interest of the organization and the community? Can the strategy be supported by its physicians, patients, government officials, payors, and the like?

Culture

- Will the strategic partnership provide the right culture or fit in line with the organization's mission, values and vision for the future?
- Is there agreement on the near term business plan to avoid out-of-the-box disputes?
- Will there be effective leadership in key management, board and physician positions going forward?

Control

- Will the strategy– on balance – afford the organization and its constituents adequate assurances or control rights that community representatives can influence or assure that the above "C's" are in place to serve the community in a responsive way going forward?

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