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PRELIMINARY DRAFT
FOR DISCUSSION PURPOSES ONLY

SEIU/UNAC BRIEFING MATERIALS – COLLECTIVE BARGAINING

Daughters of Charity Health System (DCHS)

LAZARD

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Executive Summary

($ in millions)

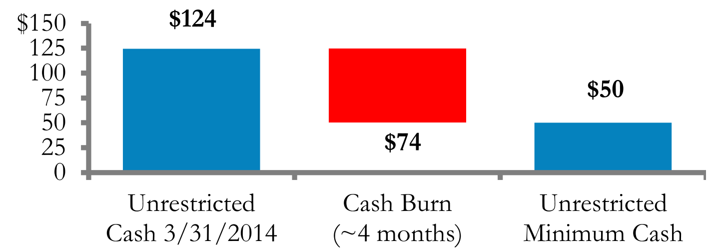
The Daughters of Charity Health System (DCHS) faces:

(1) Enormous financial and operational challenges, and (2) is rapidly running out of money

SUMMARY OF RECENT RESULTS

	Last Twelve Months (3/31/2014)
Operating Results [(a)]	**($50)**
Go Forward Interest Expense	(15)
Go Forward Needed Capital Spending [(b)]	(60)
Go Forward Pension Contributions	(30)
Net Cash Flow	**($155)**

CASH STATUS



- **Without new financing system will face severe liquidity crisis by late summer / early fall**

Based on its review to date, despite these challenges, Blue Wolf Capital Partners LLC (Blue Wolf) is prepared to submit a bid for DCHS that:

- **Maintains and continues to operate all of DCHS's acute care facilities**
- **Preserves the important role as a provider of high-quality healthcare to underserved families that DCHS serves in the communities in which it operates**
- **Maintains the retirement benefits earned to date for current and former DCHS employees**
- **Injects substantial new capital into the system to facilitate a much needed operational revitalization**

Source: Unaudited DOHS financial reports.
(a) Operating results represented as EBIDAPO. Includes $67.5 million of net QAF Provider Fee payments.2013 annual pension interest and OPEB expense used as a proxy for LTM addback to EBIDA.
(b) LTM 3/31/2014 Cap Ex of $43.6 million with additional catch-up payments based upon CIM schedules.

Strategic Overview

Blue Wolf plans on operating the DCHS system by improving central management functions to yield system-wide opportunities for revenue growth and cost savings while at the same time focusing on the local markets of San Mateo (Seton and Seton Coastal), Santa Clara (O' Connor and Saint Louise) and Los Angeles (Saint Francis and Saint Vincent)

- **Strategies for revenue enhancement**
  - Target large IPA's to drive profitable volume across the system
  - Identify and develop services that are "in-demand" including outpatient networks as well as specific tertiary and post acute services (*e.g.*, cardiology, neurology, gastroenterology, hematology/oncology, pulmonary, HIV, etc.)
  - Aggressively manage all payers, commercial and government, to identify rate enhancement and risk sharing opportunities
  - Align physicians with system objectives to improve management of referral flow from Foundation
  - Streamline the central business office to yield improvements in revenue cycle management
- **Strategies for efficiency optimization**
  - Institute a fully integrated IT system that is more simple, functional and integrated
  - Reconfigure a lean structure for central management that leverages scale and scope in regards to specific back-office functions
  - Review and rebid major vendor contracts including Group Purchasing Organization contracts
  - Identify clear physician productivity targets and opportunities for system-wide contracts
  - Work constructively with labor for alignment around cost control and work processes

Strategic Overview – Local Market Strategy

- **San Mateo (Seton and Seton Coastal)**
  - Construct new acute care tower utilizing Measure A and other funding
  - Diversify medical campus at Seton with expansion of outpatient care as well as post acute care services
  - Expand capacity for high-acuity programs in cardiovascular, orthopaedic and spine, neurology, etc.
  - Improve payer mix / develop strategic alignment with Health Plan of San Mateo / San Mateo County
- **Santa Clara (O' Connor and Saint Louise)**
  - Expand provider network through collaboration with payers and providers
  - Build relationship with O' Connor Valley Medical/Health Plan to better manage MediCal patients
  - Expand outpatient platform throughout service area
  - Expand capacity for high-acuity profitable programs including general surgery, orthopaedics, oncology, etc.
- **Los Angeles (Saint Francis and Saint Vincent)**
  - Consolidate tertiary care services between Saint Francis and Saint Vincent
  - Improve payer mix through contracting
  - Develop outpatient network including primary and urgent care
  - Develop payer relationships as low cost provider and shift to a capitated model for increasingly larger number of lives

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Summary of Key Stakeholder Issues

Accomplishing this plan will require the following initiatives:

Current Net Cash Flow ($155 million)

Initiative	Comments
Merge the DCHS Retirement Plan (the Church Plan) into the Retirement Plan for Hospital Employees (RPHE), a multiemployer defined benefit pension plan	De-risks system balance sheet and results in similar pension contribution profile
Increase revenue through initiatives to improve federal and state reimbursement rates	~$55 million
Reduce SG&A and other costs	~$50 million
Negotiate new collective bargaining agreements that permit total labor costs to be reduced by 15%	~$100 million

Net Cash Flow After Adjustments $50 million

Labor Issues

A critical part of the operational turn-around includes reducing the current $700 million cost of labor and benefits by 15%. Blue Wolf has identified possible areas with the goal of minimizing any reduction in hourly pay rates. Blue Wolf would expect that the new collective bargaining agreements would contain a meaningful opportunity for DCHS employees to share in the systems' success

	DESCRIPTION	SAVINGS TARGET
PENSION	■ Preserve pension benefits for current and future retirees ■ For RPHE this means continued participation by DCHS ■ In order to keep the Church Plan intact, it will need to be merged into the RPHE in order to best manage its current substantial underfunding	
HEALTHCARE BENEFITS	■ Current spend of $100 million covering 6,000 employees ■ It would appear that per-employee healthcare costs in Northern CA are as much as 80% higher than Southern CA	■ ~$15 - 25 million
WORK-RULES/ PRODUCTIVITY	■ Current FTE's per utilized bed at ~5.5, industry standard is ~4.5 ■ Implement work rules charges to move the FTE ratio closer to industry standard	■ ~$80 – 140 million
PREMIUM PAY / PAID TIME-OFF, ETC.	■ Modify rules to eliminate inefficient practices	■ ~$25 – 50 million

Total: ~$120 - $215 million

Target: ~$100 million

Preliminary Thoughts on Transaction Structure

The transaction will be structured to facilitate maintaining the current system, facilitating the pension merger, and maximizing Blue Wolf's ability to inject new capital to support the turn-around

- **Most of the DCHS assets will remain in place but ownership will pass to a new 501(c)(3) entity**
  - This structure will allow the current tax-exempt debt to remain outstanding and avoid the need to raise new expensive funds that could otherwise be used to support the system
- **Blue Wolf will purchase select assets (such as MOBs, dialysis centers, certain outpatient practices or business services) for $100 million, which will be used to support the system**
  - The proceeds will be kept at the system and used to fund operations and investments in capital and IT
  - Along with the purchase of certain assets, Blue Wolf will enter into both a management contract for the operations of the system as well as an option to purchase the remaining assets at a later date

Next Steps

On June 4, Blue Wolf will be submitting a letter to HLHZ outlining a proposed transaction

That letter will request that DCHS focus exclusively on the Blue Wolf transaction for a 60 day period. During this period Blue Wolf will complete its due diligence and reach all necessary agreements with stakeholders so that it can sign a definitive agreement subject only to customary closing conditions and regulatory approvals