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May 22, 2014

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**Re: Proposal for St. Francis Medical Center**

Dear Mr. Ligibel and Mr. Jackson,

Thank you for allowing us the opportunity to submit a proposal ("Proposal") for the acquisition of substantially all of the assets of St. Francis Medical Center ("SFMC") for your consideration.

Based on some additional evaluation as well as the on-site meeting, Dignity Health is pleased to submit this Proposal that we believe fully considers the Daughters of Charity Health System's ("DCHS") and SFMC's identified needs and affiliation objectives.

Please do not hesitate to contact us should you have any questions or wish to discuss in detail any aspect of our Proposal.

Respectfully,

A handwritten signature in blue ink, appearing to read "Michael Blaszyk".

Michael Blaszyk  
Sr. EVP & Chief Financial Officer

# **ACQUISITION OF SUBSTANTIALLY ALL OF THE ASSETS OF ST. FRANCIS MEDICAL CENTER BY DIGNITY HEALTH**

## **I. Purchase Agreement**

Dignity Health will deliver a marked-up version of the asset purchase agreement based on Document 1.3.1 provided in the data room on or before May 29, 2014. As further discussed below in this Proposal, for purposes of the preparation of the mark-up of the asset purchase agreement, Dignity Health has assumed that the transaction will be consummated as a 363 Transaction.

## **II. Proposal**

### **1. Purchase Price and Other Key Terms**

Based on additional due diligence as well as the financial information supplied to date, Dignity Health proposes that the purchase price for substantially all of SFMC's assets as outlined in this Proposal (the "Acquired Assets") will be \$165 million, subject to the following:

- A. The purchase price for the Acquired Assets is based on a 5.0x multiple of SFMC's adjusted FY 14 EBIDA. Dignity Health arrived at this valuation through an assumed and adjusted EBIDA performance projected for FY 14, inclusive of provider fee. The proposed purchase price is based on the assumption that all supplemental funding associated with post-closing operating revenues will accrue to SFMC and Dignity Health free and clear of any liens and without any legal encumbrances.
- B. Dignity Health will continue its due diligence to further refine its estimate of SFMC's annual recurring operating revenues and EBIDA. Dignity Health will reduce the proposed purchase price to the extent that SFMC's adjusted FY 14 EBIDA deteriorates and is lower than our current estimate. In addition, any incremental capital commitments (other than recurring maintenance capital expenditures) that are not completed or closed as of the closing date of the transaction will result in a reduction of the proposed purchase price.
- C. The purchase price for the Acquired Assets will be payable all in cash on the closing of the transaction.
- D. The Acquired Assets will be delivered to Dignity Health free and clear of all liabilities of any kind or nature, except as otherwise specified in this Proposal.
- E. To accomplish the foregoing, DCHS and SFMC will agree that (1) the proposed purchase price will be used to (i) satisfy and eliminate all outstanding long-term debt reflected on SFMC's balance sheet or otherwise secured by the Acquired Assets – including the current portion of long term debt – that is estimated at approximately \$83.3 million as of March 31, 2014, and (ii) fund, satisfy and eliminate the unfunded portion of the pension liability associated with the DCHS Retirement Plan reflected on SFMC's balance sheet that is reported at approximately \$82.5 million as of March 31, 2014; and (2) DCHS, SFMC and their respective affiliates will be solely responsible for and will fully indemnify and hold harmless Dignity Health from and against, and

Dignity Health will not be responsible, financially or otherwise, in any manner for, any and all other liabilities or obligations (contingent or certain) of SFMC or DCHS (other than current liabilities taken into account in the calculation of net working capital), including any outstanding interest bearing debt, related-party or intercompany payables, off-balance sheet contingent liabilities or liabilities associated with the DCHS Retirement Plan or any other pension, retirement or other employee benefit plan of DCHS or SFMC.

- F. As a part of the transaction, Dignity Health will acquire SFMC's current assets (excluding cash and cash equivalents, investments in pooled investment funds and related party or intercompany receivables) and will assume SFMC's current liabilities (excluding related party or intercompany payables and the current portion of long term debt) as of the closing date. In connection therewith and based upon a post-closing audit or review process to determine the amount of net working capital (i.e., current assets less current liabilities) as of the closing date, Dignity Health will compensate DCHS for any amount of net working capital on the closing date in excess of the net working capital target estimated at \$31.4 million<sup>1</sup> as of March 31, 2014 and DCHS will refund a portion of the purchase price to Dignity Health if the net working capital as of the closing date is less than the net working capital target.
- G. DCHS and SFMC will fully fund all salaries, wages, employee benefits and PTO (including any accrued portion thereof) for SFMC's employees through the closing date of the transaction. Dignity Health will assume the accrued PTO liability for SFMC's employees as of the closing date and will receive a credit against the proposed purchase price for the amount of such assumed PTO liability, which credit will be estimated on the closing date based on the PTO liability accrual as of the end of the calendar month prior to the closing date and will be reconciled post-closing to the actual PTO liability accrual as of the closing date.
- H. Dignity Health will assume those contracts and leases related to SFMC and the Acquired Assets as identified by Dignity Health during the due diligence process and listed as a part of the asset purchase agreement to be entered into by the parties.
- I. The consummation and closing of the transaction will be subject to the absence of any material adverse change in or to the financial condition, financial performance, operations, or operating condition of SFMC and the Acquired Assets prior to the closing date. Dignity Health will reserve the right, in its sole and absolute discretion, to terminate the transaction in the event of such a material adverse change.
- J. The transaction will be subject to Dignity Health's completion of additional due diligence review (as described below) with respect to SFMC and the Acquired Assets, and to Dignity Health's reasonable satisfaction with the results thereof.
- K. Dignity Health, in its sole and absolute discretion, reserves the right to change the form of the transaction from an asset acquisition to a membership substitution. In such event, Dignity Health intends that the economics of a membership substitution transaction will be substantially the same as an asset acquisition as outlined above.
- L. As a condition precedent to the closing of the transaction, Dignity Health reserves the right, in its sole and absolute discretion, to require that the transaction be approved by an order of an appropriate United States Bankruptcy Court pursuant to Section 363(b), (f) of the United States

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<sup>1</sup> Net working capital is calculated based on unaudited financial statements as of March 31, 2014 and is defined as: current assets *less* cash and cash equivalents, investment in pooled investment fund and due from related parties *minus* current liabilities *less* interest bearing debt and due to related parties.

Bankruptcy Code whereby, among other things, the assets shall be transferred free and clear of all liens and interests and all claims of successor liability (a “363 Transaction”). If this transaction does proceed as a 363 Transaction, Dignity Health reserves the right, in its sole and absolute discretion, to require certain bid protections as the proposed ‘stalking horse bidder’, which may include, without limitation, a break-up fee, expense reimbursement, minimum initial overbid, no affirmative solicitation of further bids, competing bidder qualifications, and sharing of all competing bids with Dignity Health immediately upon receipt. In addition, if this transaction does proceed as a 363 Transaction, Dignity Health reserves the right, in its sole and absolute discretion, to adjust the timing to closing notwithstanding Section 7 below.

- M. Dignity Health is willing to enter into a Transition Services Agreement with DCHS to support any pre- or post-closing services required to continue the uninterrupted operations of SFMC, including collection of outstanding accounts receivable and other business services.

**2. Sources of Capital**

Dignity Health has sufficient internal capital resources to fund the acquisition of SFMC’s assets, routine capital needs and strategic initiatives, without any financing contingency.

**3. Plans with Respect to Collective Bargaining Agreements**

Dignity Health collaborates with the following labor union organizations currently:

<b>SEIU UHW</b> 28 facilities; 13,900 employees	<b>CNA California</b> 27 facilities; 11,000 RNs	<b>AFSCME Sequoia</b> 337 employees
<b>SEIU 121 RN</b> 3 facilities; 1,500 RNs	<b>CNA Las Vegas</b> 3 facilities; 1,200 RNs	<b>SPFPA—St. John’s</b> 19 employees
<b>SEIU 1107</b> 3 facilities; 1,300 employees	<b>Teamsters Sierra Nevada</b> 403 employees	<b>IOUE—Bay Area</b> 45 employees

Dignity Health will not accept DCHS’s existing collective bargaining agreements. Dignity Health is committed to bargaining in good faith with SFMC’s current labor unions (i.e., UNAC and SEIU) for new collective bargaining agreements with respect to the represented employees at SFMC that reflect its overall operating condition and financial performance, including its existing payer mix and sources of supplemental governmental funding.

Dignity Health will offer employment to substantially all of SFMC’s employees based on reasonable salary, wage and benefit rates/levels that will sustain SFMC’s overall operating performance and financial condition over a long term taking into account its current financial performance, payer-mix and sources of supplemental governmental funding. Determination of the reasonable salary, wage and benefit rates/levels will occur during the due diligence process and will take into account the market comparability of SFMC’s existing salary, wage and benefit rates/levels, an understanding of SFMC’s benefit plans, a productivity analysis, and a review of SFMC’s service line requirements. Dignity Health will recognize the seniority of SFMC’s existing employees.

#### **4. Pension Plans**

Dignity Health will not assume any pension or other employee benefit plan that covers SFMC’s employees. As noted above, a portion of Dignity Health’s purchase price for the Acquired Assets is intended to cover the unfunded liability under the DSHC Retirement Plan for SFMC’s employees. As of the closing date of the transaction, Dignity Health contemplates that SFMC’s employees will become eligible to be participants in the Dignity Health Retirement Plan(s) in the service area.

#### **5. Further Due Diligence**

The key categories that Dignity Health considers critical for additional due diligence are listed below. We understand that some information related to these categories has already been provided via the confidential information memorandum and the data room, although additional information on a more detailed basis in the areas would be required for Dignity Health to finalize standard closing due diligence procedures and a definitive agreement. On request, Dignity Health will deliver a due diligence list reflecting the additional items required to be reviewed to complete its review process.

1.	General Information and Organization
2.	Planning and Marketing
3.	Corporate Records
4.	General Government and Regulatory Filings and Correspondence (excluding healthcare matters)
5.	Healthcare Matters (excluding those covered above)
6.	Clinical
7.	Material Agreements and Transactions
8.	Financial/Accounting
9.	Revenue Services
10.	Taxes (“Tax” refers to Income, Sales and Use, Real and Personal Property, Franchise (Net Worth), Gross Receipts)
11.	Treasury Services – Cash, Investments, Financings and Derivatives
12.	Litigation and Other Contingent Liabilities
13.	Insurance
14.	Employment and Benefit Matters
15.	Properties
16.	Information Technology
17.	Physician and Referral Relationships
18.	Hospital Outpatient Services, Clinics and Joint Ventures

#### **6. Contingencies**

The consummation of the transaction will require the approval of Dignity Health’s Board of Directors, which meets 5 times per calendar year. If necessary, Dignity Health will call a special meeting to obtain the approval of this transaction. Dignity Health will work with DCHS and SFMC to obtain all required pre-closing governmental consents or approvals to the proposed transaction, the Hart-Scott-Rodino Act Premerger Notification Program by each completing and filing a “Notification and Report Form for Certain Mergers and Acquisitions” with the Federal Trade Commission and the required consent of the California Attorney General. Dignity Health will pay its costs associated with

federal and state regulatory approvals. Dignity Health is committed to proceeding with a timely transition which includes working in good faith to:

- Negotiate and execute a definitive agreement.
- Commit to staffing the transaction with the appropriate internal and external resources
- Perform all required due diligence
- Complete the Hart-Scott-Rodino pre-merger notification process, if necessary, and the CMS and CDPH change of ownership processes. The transaction would close immediately upon receipt of all governmental regulatory approvals.
- Complete and file a Health Impact Report and an application for consent with, and receive the consent of, the California Attorney General to the transaction.

## **7. Timing to Closing**

Dignity Health will close the transaction with DCHS and SFMC in a timely manner. After signing a non-binding letter of intent setting forth the principal terms and conditions of the transaction, Dignity Health proposes the following closing timeline:

- Simultaneous due diligence and negotiation of a definitive agreement (Up to 90 days)
- Consent, licensure and change of ownership, and other regulatory approvals (Up to 135 days following execution of definitive agreements and based on Attorney General and other governmental approval processes)

## **III. Purchaser Due Diligence**

### **1. Quality of care measures**

Dignity Health's approach to quality and management of clinical performance activities to improve clinical outcomes falls along four dimensions: Patient safety, Quality (including evidence-based practices), clinical efficiency, and patient experience. As part of Dignity Health the proposed partnership would have the opportunity to leverage standardized processes, best practices, information systems, and monitoring tools to help drive continuous improvement in quality, safety and patient satisfaction. Examples of Dignity Health's commitment to improving quality outcomes and patient satisfaction are detailed below.

- Annual establishment of evidence-based metrics using a variety of resources and references including the recommendations of professional societies, the National Hospital Quality Alliance Initiatives, and published literature from peer reviewed journals (incorporating summary of evidence utilizing the evidence reference tool ZYNX®).
- Establishment of facility specific goals, time targets and processes for achieving measurable targeted improvements in key areas, including medical management, and patient safety. Goals are both department specific (e.g. OB and Emergency Department) and house-wide, and include National Patient Safety Goals, patient satisfaction, medication safety, employee safety, clinical quality such as CMS core measures, and palliative care.

- System-wide, diagnosis-specific initiatives to simultaneously improve quality and reduce cost by reducing variation in clinical practice, implementing evidence-based practice and focusing improvement on key cost drivers. Recent examples include sepsis and venous thrombosis.
- Continual assessment of lessons learned from top performing hospitals and ensures that best demonstrated practices are disseminated within the Dignity Health system regularly, including posting of detailed implementation standards on an internal best practices website.
- Engagement of each facility in a Quality and Care Management Monthly Operating Review (MOR) to assess the performance of each service area, addressing key national measures of the quality of care, HCAHPS measures, and other internal patient satisfaction measures.
- Use of measurementists to assist in implementation and monitoring the implementation of best practices.
- Provision of video and audio teleconferences, as well as in-person education, with nationally renowned speakers to discuss emerging trends, quality improvement, clinical evidence, best practices and cost improvement, and provide training on improvement processes for best practices so they "stick."
- Performance of mock Joint Commission Surveys, CMS surveys, DPHS surveys and National Patient Safety audits internally to enhance quality results.
- Contracting for criteria and software to offer hospitals significant discounts on criteria, both in the areas of quality and utilization.
- Providing internal training for Medical Necessity Criteria and use of Dignity Health Case Management Call Center for assistance with off-hours review of medical necessity for admission.
- Working closely with medical staff leadership to endorse improvements by presenting to medical staff committee meetings, stressing the relationship between utilization and quality, impacting patient care, improving efficiency of physician time at hospitals and acknowledging physicians who champion improvements.
- Utilization of an on-line system (Avatar) for monitoring and benchmarking satisfaction results, which are updated on a weekly basis to ensure that improvements are distributed to all facilities.
- Use of Studer Group best practice tools to assist in patient satisfaction. Some examples include bedside report, daily rounding, use of white boards in each patient room, discharge phone calls, and the use of "AIDET" as a tool for communication with every patient in every interaction.
- Dignity Health's focus on patient centered care, including the development of patient family councils at each facility to assist the organization in identifying opportunities for improving patient and family satisfaction.

## **2. Patient Experience Data**

To be provided in exclusivity phase.

## **3. Community Relations**

Dignity Health's community benefits reports for each hospital are available online at the following internet address:

[http://www.dignityhealth.org/Who\\_We\\_Are/Community\\_Health/STGSS044509](http://www.dignityhealth.org/Who_We_Are/Community_Health/STGSS044509)

**4. Nature Of Employee Relationships / Satisfaction Surveys**

To be provided in exclusivity phase.

**5. Physician Relationships/Satisfaction Surveys**

To be provided in exclusivity phase.

**6. Details On The Amount Of Charity Care Provided**

See community benefits reports above as well as our audited and unaudited financial statements available online at the following address:

[http://www.dignityhealth.org/Dignity\\_Health\\_Information/Financial\\_Information/index.htm](http://www.dignityhealth.org/Dignity_Health_Information/Financial_Information/index.htm)

**7. Payer Mix**

Please see our operating and financial statements available online at OSHPD.

**8. Noteworthy Details Surrounding Any Acquired Catholic Hospitals And Your Expectations Regarding Operating The DCHS Facilities Post-Closing (E.G., ERDs, Pastoral Care, Etc.)**

Dignity Health intends to maintain SFMC's Catholic identity and ministry that have been a part of SFMC throughout its history, including the legacy of those congregations of women religious who have sponsored SFMC since its inception. Dignity Health will continue to operate SFMC as a Catholic hospital that is be listed in the Official Catholic Directory (in the same manner as all other Catholic hospitals in California that are affiliated with Dignity Health). As a Catholic facility, SFMC will continue to operate in a manner consistent with Ethical and Religious Directives for Catholic Health Services, as promulgated from time to time by the United States Conference of Catholic Bishops ((in the same manner as all other Catholic hospitals in California that are affiliated with Dignity Health). Dignity Health will work with its Sponsorship Council to identify one of the current Sponsors of Dignity Health's existing Catholic Hospitals who will assume the role as the Sponsor for SFMC.

**9. Recent Financial Performance**

Please see our audited and unaudited financial statements available online at the following address:

[http://www.dignityhealth.org/Dignity\\_Health\\_Information/Financial\\_Information/index.htm](http://www.dignityhealth.org/Dignity_Health_Information/Financial_Information/index.htm)

**10. Any Expectations You Have Regarding Continuation / Cessation Of Operations At The DCHS Facility(ies) Post-Closing / Your Expectations For New Operations**

To be provided in exclusivity phase.

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