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## **Preliminary Proposal for the Daughters of Charity Health System**

### **Section I Preliminary Proposal Introduction**

This preliminary proposal is the indication of interest of Integrity Health Care, Inc. (IHI) in acquiring the Daughters of Charity Health System (DCHS). IHI interest is in the entire system and all of its components. It is our desire and intent to retain employees at all levels with the organization and to continue the system's philosophy and practices with regard to healthcare.

The Integrity Healthcare's genesis towards becoming a corporate entity with financial resources led by executives from the nation's leading hospital organizations began several years ago. It was organized with the belief that coupling the healthcare industry's best practices and with significant turnaround know how can revitalize community hospitals. We are evaluating a number of opportunities around the country but feel that acquiring the DCHS is particularly well suited for us and our funding source. Our familiarity with Catholic Healthcare in general and with the DCHS in particular and the environment in which it operates makes this an ideal opportunity. The size and scope of the operation fits the parameters of projects that our funders favor. We have chosen to respond to the preliminary proposal requirements by providing information for each of the required elements below in the exact order listed in the Houlihan Lokey solicitation sent to us on behalf of the Daughters of Charity Health System.

### **Section II Preliminary Proposal Required Elements**

#### **1. Description of Potential Bidder**

A. Integrity Healthcare, Inc. (IHI) was established to successfully operate healthcare organizations of the future. Our executives have held leadership roles at the operating and corporate levels in multi-hospital systems for 20 to 35 years each. IHI's core purpose is to revitalize community hospitals by implementing best practice strategies that match current challenges and prepare them to thrive in a rapidly changing healthcare environment. What follows is a description of the acquisition team who are also some of the principal executives of IHI.

All of the members of the acquisition team, with their decades of experience in the nation's premier health systems presided over dramatic hospital turnarounds and participated in leading edge management innovations. They combine the discipline of investor owned hospitals with the mission focus of faith based healthcare. The team brings accumulated learning from years in leadership roles at Hospital Corporation of America, Tenet Healthcare, Kindred Healthcare, Providence Health and Services and Dignity Health. This includes up to date knowledge of information technology, sophisticated group purchasing practices, rapid cycle change, physician integration and health care reform. After our many years in mission driven organizations, we recognize that significant changes to improve operations and strategies can be made in a way that can honor the ideals of Catholic Healthcare as reflected by the traditions of the Daughters of Charity Health system.

Leading the acquisition effort is Jeffrey P. Winter, who held a similar role at Hospital Corporation of America. He was responsible for mergers and acquisitions and was involved in leading the team that acquired the Health Dimensions system in San Jose and Riverside Community Hospital in Riverside among others. Supporting the acquisition is the legal team at Manatt Phelps headed by Francis La Pallo who has extensive experience in hospital buy/sell transactions. The balance of the acquisition team includes Mark Meyers, Mark Overeem, and David Mauss and all are described in the career briefs below. Each member of the team has been part of multiple due diligence efforts enabling them to perform this task efficiently and timely.

Our core beliefs are expressed in the following Four Pillars of Integrity Health:

1. Community hospitals must be prepared to assume a more central role due to health care reform's evolving incentives that will move patient care into lower cost and more accessible settings.
2. Quality of care and employee retention are paramount priorities that must be addressed through balanced leadership that focuses on superior stewardship and commitment to clinical partnerships.
3. The ultimate measures of success are patient ratings and clinical outcomes. These are achieved by maximizing physician and employee satisfaction which collectively drives organizational outcomes.
4. Deploying the most advanced technology and most advanced management practices are very important tools for the success of the health care organization of the future.

The team is further described in the career briefs that follow. Some of the most important functions of Integrity Health Care's management including physicians, leadership and IT leadership will be performed by individuals who are currently employed and will give permission to disclose their names after a firm offer to join the company is made.

Career briefs:

Jeffrey P. Winter, F.A.C.H.E.

Thirty six years of demonstrated management and executive experience in senior leadership positions in Hospitals and Health Systems. Demonstrated track record in multi-facility management, market-based strategic leadership, Hospital and Health System turnarounds and performance improvement. Leadership experience has included Faith-based, Non-profit and For-profit systems. Success in a variety of markets including rural, urban, highly managed care markets and sole provider markets.

Recent experience has focused on re-designing corporate culture, strategic and performance improvement in Faith-based healthcare systems. Specific expertise in business development, merger and acquisition activities. Finally, strong skills in governance systems, physician alignment and leadership development and employee organizational development have enabled a balanced and effective executive style.

Mr. Winter served as a key regional executive for Catholic Health Care West (Dignity Health Care) and was instrumental in leading its operational turnaround from 1999-2010. In addition, Mr. Winter has recently served as Executive Vice President and President of Kindred HealthCare's Hospitals Division in which he lead 125 long term acute care hospitals and Rehabilitation hospitals in 26 states.

### Mark Meyers

Thirty seven years in healthcare leadership roles with 22 years as a hospital chief executive officer and 9 additional years supervising multiple hospitals in a corporate role. His career focus has been on reversing distressed hospitals and his turnarounds starting in 1980 include Catholic non-profit as well as investor owned hospitals. His most notable turnaround was at a large downtown Los Angeles hospital reversing two decades of decline with the addition of a trauma program and a volume increase of nearly 80%.

He was more recently Senior Vice President, Operations for Dignity Health for the Los Angeles area hospitals. His primary tool for hospital turnarounds is strategy development that incorporates a full range of growth strategies. While at ApolloMed Holdings, a large physician organization, his efforts were in the areas of population management where he guided the formation of an Accountable Care Organization that now has 750 physician members.

### Mark Overeem, C.P.A.

Thirty years of financial management experience with 19 years as a financial officer in health care. Most of his senior executive experience was with Tenet Healthcare corporation where he was, for several years, Vice President California Financial Operations with accountability for 11 hospitals, 14 freestanding outpatient facilities, a health plan, and a non-profit medical foundation. His region was able to achieve earnings growth in the difficult California environment and it led Tenet Healthcare in the Balanced Scorecard that measures performance in cost, growth, quality, service, and people. He has also participated at a senior level in Tenet's acquisition projects.

### David Mauss

Over 40 years of experience in various aspects of health care with eight of those years as Vice President Business Development for Tenet's California Region and more recently 10 years in a similar role at Catholic hospitals including responsibility for the four Dignity Health Los Angeles hospitals. After receiving his degree in Finance, David started his career as a financial analyst in the treasury department of Carnation Company where he was involved in pension and health benefit analysis over a period of four years. This foundation led David to become administrator of a large Taft-Hartley trust fund covering 20,000 employees for health and pension benefits. It was during this tenure that Health Maintenance Organizations (HMOs) enabling legislation was passed and David moved over to the HMO health care segment serving as a senior executive with Maxicare/California, PacifiCare and Equicore/Western Division Health Plans. Following his career with the HMO segment, David transitioned over to the hospital segment serving senior level positions in business development for over 25 years to date.

## B. Integrity Health Financial Wherewithal

Integrity Healthcare in its developing stages had two years of discussions with various funding sources interested in investing in US healthcare. Each source specified their criteria in terms of size, purpose, and scope of investment. The opportunity to acquire Daughters of Charity Health System (DCHS) was a good fit with one of the funding sources, LEPL Projects Limited. It is an investment fund located in India. This multi-billion dollar fund, in the past, invested almost exclusively in-country in several economic sectors including healthcare and hospitals. In an effort to diversify and thereby temper investment risk, the fund has been considering investments that are outside of its traditional geographies and investment categories. LEPL accepted our recommendation to support and partner in the acquisition of the Daughters of Charity Health System. They will want more information and with our analysis of the due diligence materials will efficiently confirm their conclusion that this project fits their organizational objectives.

## **2. Assets to be acquired:**

Integrity HealthCare Inc. intends to purchase all of the Daughters of Charity Hospital system including:

- Seton Medical Center
  - Seton Medical Center – Coast-side
  - O’Conner Hospital
  - St. Louise Regional Hospital
  - St. Francis Medical Center
  - St. Vincent Medical Center
- and all properties related to these facilities.

Our bid will also include other system components including but not limited to the Caritas central business office and other corporate shared services, medical office buildings, land and certain joint ventured Medical office interests, the DCHS Medical Foundation and interests in certain ancillary and outpatient ventures.

The acquisition of the provider numbers and licenses and current assets and liabilities that are transferable will be guided by legal counsel in accordance with current best practices and seller’s preferences.

## **3. Treatment of the Medical Foundation**

The intent of IHI is to keep the Medical Foundation intact by transferring ownership in a manner that is most suitable and is in compliance with legal and regulatory requirements. We believe that the medical foundation helps achieve the core strategies of physician integration along with other strategic objectives. IHI will give every consideration to expanding the Medical Foundation to other geographies. Though it will be our intention to maintain operational independence of the medical foundation we believe the Medical Foundation and the Hospital system should always strive to have aligned incentives. We have experience in Medi-Care payment innovations that provide financial incentives for hospitals and physicians to work together to achieve quality and cost improvement. These payment innovations include Accountable Care Organizations (ACO), bundled payments, episodic care and ‘medical homes’ and understanding how to implement them will help integrate the Foundation with hospital efforts. The efforts to achieve efficiency in operations, maximizing professional revenue, and to create risk pool surpluses that flow to the foundation are very important. Integrity Healthcare will make these efforts a priority and will find ways to contribute to their success.

## **4. Amount and Form of Consideration**

Integrity Health care, Inc. is considering a value between \$350-\$400MM for the Daughters of Charity Health System. This amount of consideration contemplates the transfer of all provider numbers and related licenses, the physical buildings and land assets, the Medical Foundation and certain other investments in medical office buildings and ancillary and outpatient ventures. This consideration also includes the transfer of current assets, current liabilities and some other transferable accounts. We also plan to accept the current collective bargaining agreements. Our approach is designed to create an effective transition by being employee friendly, cooperating with the Unions, and doing what is necessary to facilitate the decision of the California Attorney General’s office. Furthermore, by accepting current assets and liabilities as well as the government due to/from accounts, we feel we are maintaining the opportunity for the

highest rate of collection as the same infrastructure will continue to collect and manage these funds. This will also relieve the Daughters of Charity from prior period reimbursement risk and

responsibility. In the above stated transaction, we contemplate the Daughters retaining the following balance sheet asset accounts:

- Cash
  - Interest from short term investment fund
  - Interest from long term investment fund
  - Other Investments
  - Unrestricted assets
  - Temporarily restricted assets
  - Permanently restricted assets
  - Reserve under bond indenture
- The Daughters would also retain and extinguish the following balance sheet liability accounts:
    - Long term debt
    - Funding of Workers Compensation/General and Professional Liability
    - Funding of the Defined Benefit Pension plans
    - Other liabilities

We designed this offer so that the assets retained by the Daughters plus the purchase price will be sufficient and adequate to extinguish and fully fund all current and long term liabilities and completely de-fease all bond indebtedness.

## **5. Working Capital Assumption**

Our plan for working capital is to assume patient accounts receivable and other current assets and also assume accounts payable and accrued liabilities. Since additional working capital will be necessary, we plan to have a line of credit equivalent to 50 additional days of cash on hand.

## **6. CBA Agreements and Non-Union Employee retention**

Collective bargaining agreements are governed by law and by the contracts that define them. Integrity Health Care will respect all contractual obligations that are contained in Daughter of Charity Health System union agreements. If, after review, IHI finds elements of the agreements that are not bound by successor language and desires to change them, then discussions with the union representation will be held regarding potential amendments. Any staffing changes that affect union employees will be subject to processes specified in the CBA's. IHI's preference is to retain both union and non-union employees and will seek to transfer employees at every level of the organization.

An example of this preference is IHI's intent to keep corporate functions and any centralized services intact and to retain existing personnel to do so. There is no end date to this commitment. There are several reasons for this preference to keep rather than replace. Many of these functions and services are known to be effective and operating smoothly and to recreate or transfer them to another entity may cause delay and disruption. In the event that we find a need to improve the performance of some of these functions, we prefer to use existing personnel. This approach should enhance our ability to achieve a smooth transition and effective future operations.

## **7. Post-Retirement Obligations**

The proposed purchase price was calculated so that sufficient proceeds will be available to fund the pension obligation. If there is a reason for IHI to assume these obligations and fund them on an agreed upon go forward basis then the purchase price would be adjusted accordingly. This change would be discussed with the unions if the parties agree that this is a preferred approach.

## **8. Treatment of Other Agreements**

All other agreements will be reviewed on a case by case basis and treated appropriately.

## **9. Sources of Capital**

Capital for the purchase of DCHS will come from a combination of sources that include funding by LEPL projects, Ltd, the principal founders of IHI, and other minority interests that may be accepted for participation. The IHI is open to other alternative sources including asset based financing such as mortgages or REITs but does not have plans to utilize them at this time. The only debt financing being considered is a revolving line of credit to supplement the working capital.

## **10. Anticipated Operating Plan and capital commitment**

The Integrity Healthcare business plan for DCHS is based on the information available in the CIM and on general knowledge of the DCHS and the environment in which it functions. The plan encompasses the areas of Capital Investment, Governance, Faith- based Hospitals, and Strategic Priorities.

### Capital Investment

Integrity Healthcare is committed to high quality patient care provided in a safe and technologically advanced environment. Capital investments in expanding a service, adding technology, replacing facilities or equipment, or meeting code requirements will be funded from cash flow. In any period where investment needs exceed funds generated from operations, other sources will be considered including debt financing and/or leasing. The funder has indicated a willingness to consider additional investment provided that it is needed to maintain or augment the success of the organization.

Integrity Healthcare, Inc. and its funders are investing for the long term and will not be making any cash distribution to shareholders for at least five years. All earnings from operations will be retained for capital investments or other cash needs within IHI that may occur from time to time.

### Governance

The governance structure will invite current DCHS corporate board members or someone chosen to represent them to participate in corporate governance which will provide opportunity for input in financial decisions and corporate strategy. At the facility level the plan is to keep the local boards intact, inviting all existing members to continue their participation.

### Faith based Hospitals

Integrity Health embraces an approach to health care delivery that is compatible with Catholic Health care including the Ethical and Religious Directives. We feel that it would be worth while to make every effort to honor the long standing values of the Daughters of Charity. Three of the founders of Integrity Health have spent much of their career in Catholic Healthcare and have received two years of education in the Leadership Formation, a joint program of several leading Catholic Healthcare systems. Though the system will no longer be Catholic in the official sense, input will be sought from the Daughters of Charity leadership and Bishops or other clergy that have considered any Daughters of Charity Hospital to be within their clerical purview. Even if not a condition placed by the seller, the commitment to spiritual care will continue by offering to retain personnel involved in chaplaincy services as well as local mission leadership roles.

## Strategic Priorities

The strategic priorities for DCHS that Integrity Health Care, Inc. would implement are extensions of those already adopted by the system as described in the CIM. IHI will maintain the mix of services that the hospitals provide while accelerating the implementation of strategies that will position the system for success under health care reform. The traditions for providing maternity, newborn care will continue but will be in the context of population management. The commitment to provide care for the elderly will also evolve as Medicare programs continue the movement towards managed care. The California program that transitions the dual eligibles, called Medi-Medis, into managed care requires that DCHS be engaged in county organized Medi-Cal managed care and be willing to expand participation in Medicare risk programs in general. IHI believes that DCHS should be fully engaged in every aspect of Covered California and the expansion of the Medi-Cal programs. This new era in CA healthcare will require expanded focus on patient through put and the transition from acute to post acute care, home health, long term acute care and nursing home care. The system will need to adopt care management models aimed at lowering costs by keeping people with chronic and serious conditions out of the hospitals, thereby reducing readmissions.

The immediate strategic priority is to engage each hospital's management team and medical staff and governing board in reaffirming or recalibrating annual operating plans. This will assure that after the transition to new ownership there will be a common understanding and commitment at the corporate and local levels of the strategic directions. This process will include a complete review and prioritization of capital needs at each facility within the first 60 days. Every effort will be made so that corporate leaders and local leadership of each operating unit agree on a plan to meet system financial goals and meet or exceed all quality and service metrics.

### **11. Community Service and Charity Care**

IHI will review DCHS community benefit policies and quantify DCHS historic levels of community benefit funded by the hospitals and charity care and will commit to maintain or exceed these levels. This commitment will include the continuation of emergency services at each location. If charity care needs are reduced by the expansion of coverage under the Affordable Care Act, then equivalent resources will be redirected to other unmet healthcare needs in the facility service areas.

We recognize the importance of the hospital foundation and since they will no longer raise funds for capital expenditures they can concentrate more focus on programs that directly benefit the community. IHI will seek ways to support this and we hope the foundations will welcome our willingness to continue to partner and collaborate.

### **12. Process and Timing**

IHI will engage in a period of due diligence with the duration depending on the availability of information and on other issues that may need additional understanding. During this time, facility visits will be scheduled. If the IHI non-binding offer is accepted then we will make every effort to facilitate the development of definitive documents. Upon approval of the California Attorney General then IHI will be prepared to fund the acquisition within 30 days.

### **13. Due Diligence**

We expect due diligence to take between four and eight weeks. It is not possible to commit to a precise time frame but the IHI acquisition team experience allows us to conduct due diligence efficiently. We have assembled the due diligence resources to digest all of the information needed to make the non-binding offer. This includes expertise in specific areas as well as general legal and financial expertise.

### **14. Specific Contingencies to Closure**

There are no known contingencies that will have an impact on ability to close the transactions.

### **15. Other Parties**

IHI intends to collaborate with many different parties who can bring value to the organization in the future but who will not play a role in the acquisition transaction.

### **16. Contact Information**

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Integrity Health Care, Inc. website is in development and new email addresses will be forwarded shortly.