Daughters of Charity Health System

System Overview

October 2014

Daughters of Charity Health System

Executive Summary

- Daughters of Charity Health System's (DCHS) operating losses have increased considerably over the past several years
  - For fiscal 2014, the operating loss was $146 million (excluding the favorable accounting treatment of our 2008 bond redemption of $130 million)
- Increasing operating losses are driven by three primary operating trends:
  - Payer mix
  - Volume trends
  - Salary structure
- Liquidity (days cash on hand) has declined as a result of these significant operating pressures
  - Based on internal cash flow projections, without any intervention DCHS would have fallen below minimum operating liquidity thresholds in Q1 2015 and would run out of cash in Q2 2015

DCHS

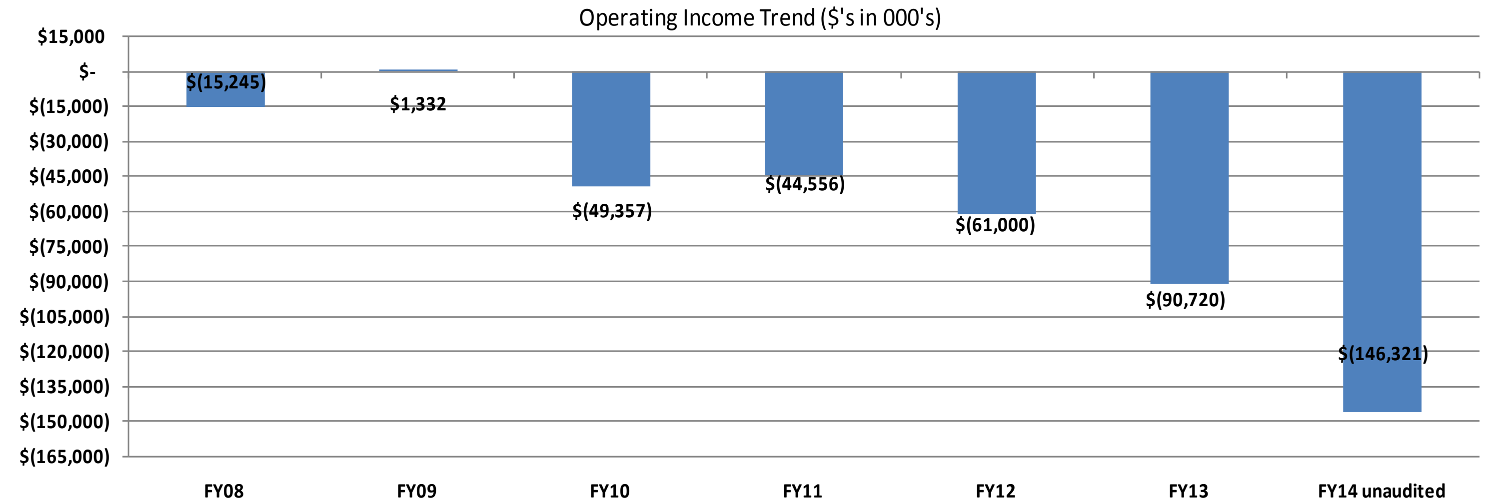
Executive Summary *(continued)*

- In order to address the liquidity shortfall, DCHS closed a $125 million short term bridge financing in August 2014
  - Based on internal cash flow projections, DCHS believes this facility will provide sufficient liquidity to support normal hospital operations through Q4 2015
  - It is important to note that the bridge facility is contingent on financial covenants and the achievement of certain sale milestones in order to ensure that the sale of all DCHS assets is completed in a timely manner
  - The bridge facility matures on July 10, 2015
- DCHS is currently meaningfully over leveraged
  - Trade payables, employee payables, long-term debt, pension and other obligations were approximately $960 million as of June 2014 (excluding the bridge facility)
  - Although DCHS is comprised of multiple legal entities, the debt and pension obligations are joint and severable obligations of all of the hospital entities
- As a result of these significant operating, liquidity and leverage pressures, continuing the status quo is not a viable option

DCHS

Operating Income Trend

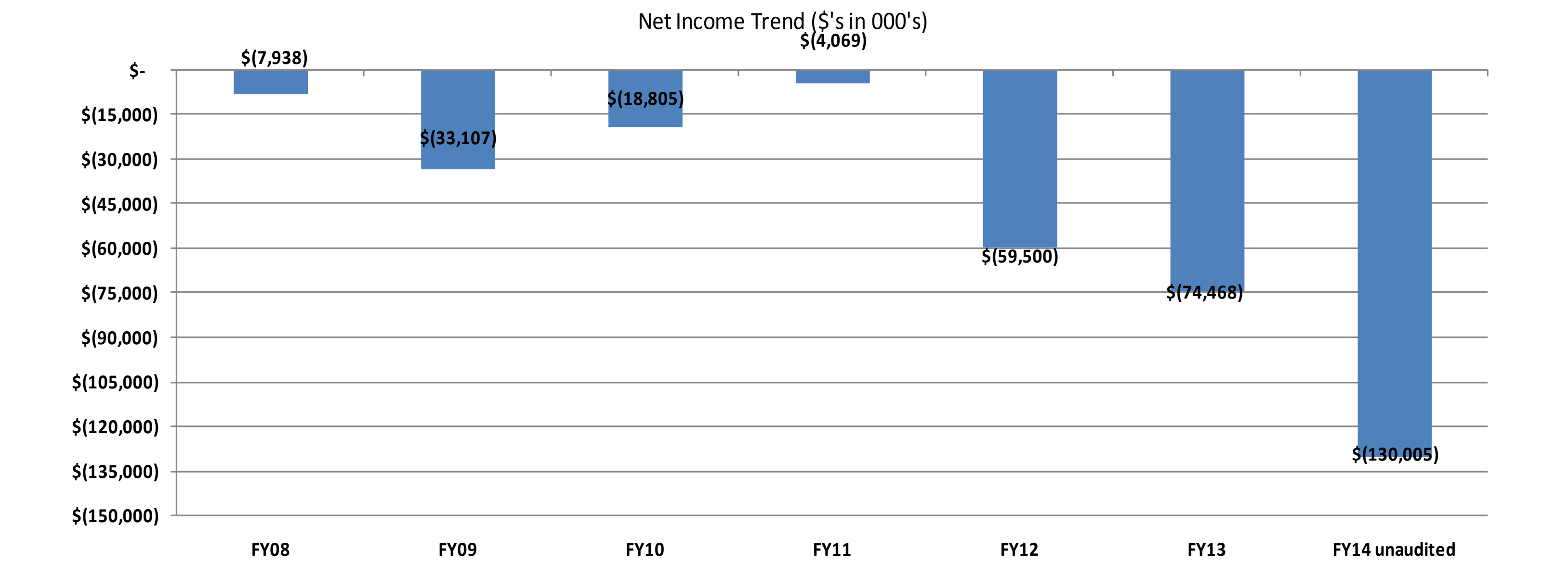
- Operating income has steadily declined over the past several years
  - Losses in fiscal 2011 improved slightly due to a $54 million net provider fee benefit
  - Fiscal years 2012, 2013 and annualized 2014 include net provider fee benefit of $55 million, $72 million and $16 million, respectively



FY14 excludes the favorable accounting treatment of the 2008 bond redemption

Net Income Trend

- Net income, which historically has been highly dependent on investment earnings, has trended lower the past several fiscal years



FY14 excludes the favorable accounting treatment of the 2008 bond redemption

DCHS

Summary of Outstanding Obligations

- DCHS has significant long-term obligations that its projected cash flow cannot support

Obligation	As of June 30, 2014 Unaudited
Total Trade, Employee, and Other Obligations	$ 185
Total Series 2005 Bonds (net of DSRF)	290
Other Long-Term Debt	6
Total Short and Long-Term Debt	481
RPHE Withdrawal Liability (multi employer plan) (a)	201
Total Unfunded Retirement Plan Liabilities	278
Total Short and Long-Term Obligations (b)	$ 960

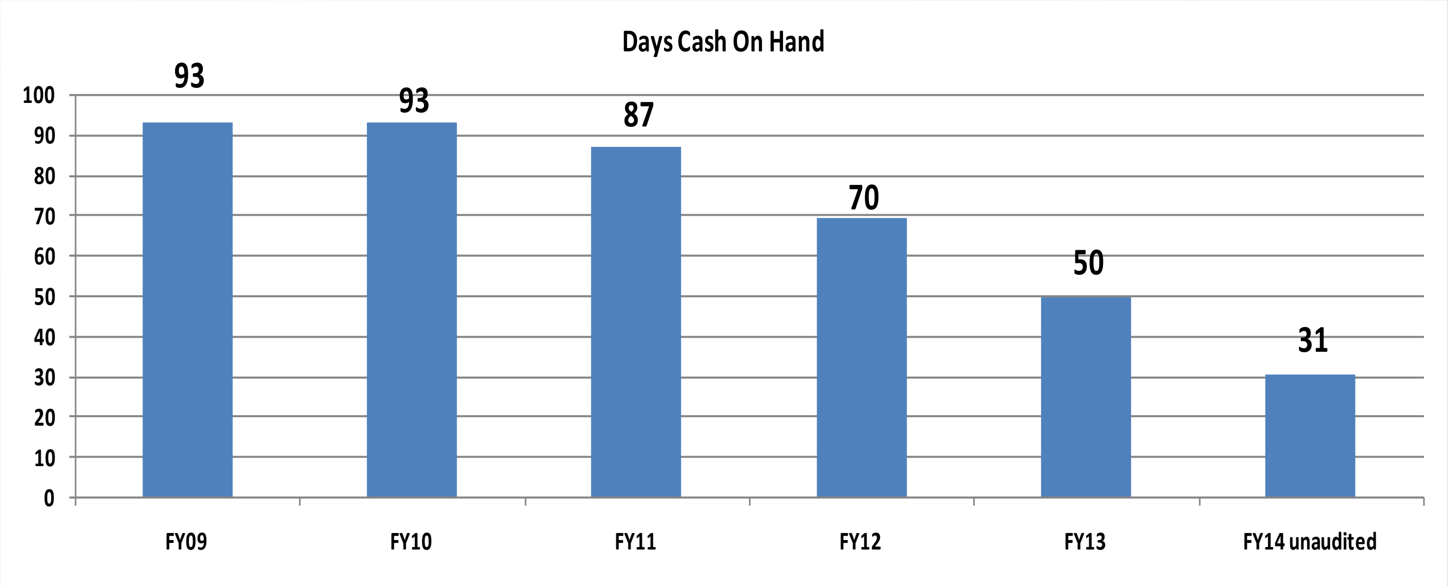
Summary of Outstanding Obligations ($ millions)

(a) The RPHE withdrawal liability would be avoided if we were to sell the System as a whole

(b) This does not include the $125 million short term bridge financing secured in August 2014

Liquidity Trend

- Days cash on hand continues to decrease
  - Liquidity levels are considerably below the Standard & Poor's Not-For-Profit Healthcare System Median of 204.6 days cash on hand



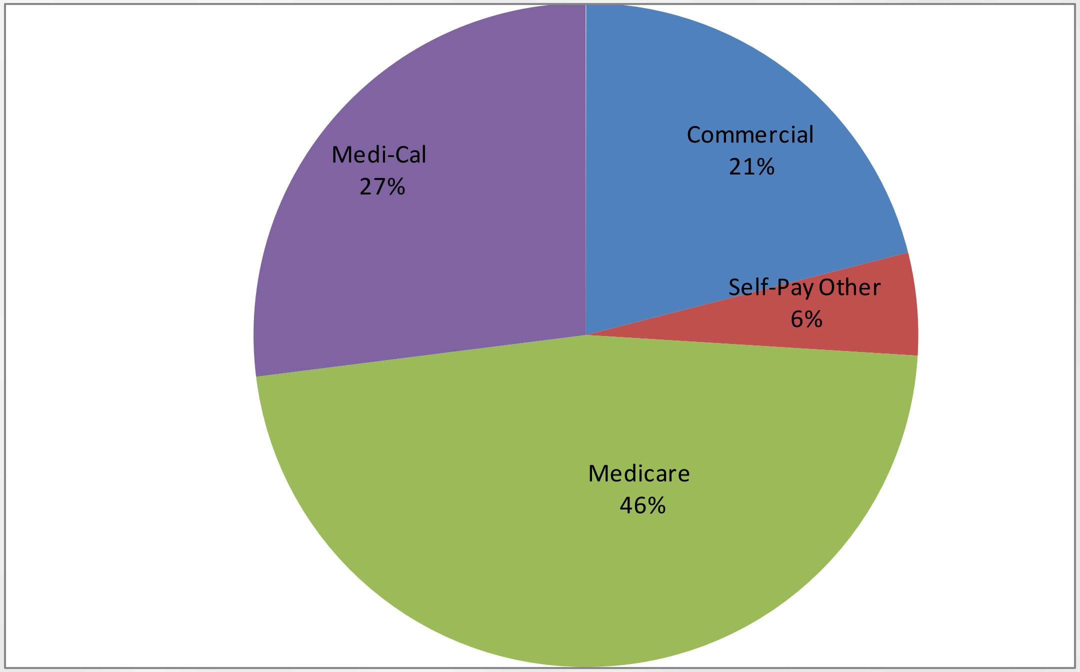
Operating Trends – Payer Mix

- Approximately 73% of total DCHS revenue is from Medicare and Medi-Cal, while only 21% of revenue comes from commercially insured patients
- Medicare reimbursement rates are currently increasing at a pace that is far less than expense increases, and Medi-Cal rate increases are even less
- As a result, in order to maintain historical operations, commercial reimbursement would need to increase at a rate that is high enough to cover operating expense inflation and the growing shortfall in Medicare and Medi-Cal
  - Over the past several fiscal years, DCHS has received only limited rate increases from commercial payers
- Additionally, in fiscal 2014 DCHS recognized additional total Medicare reductions of approximately $17.3 million (Medicare sequestration cuts of 2% and Medicare disproportionate share reductions went into effect October 1, 2013). These reductions are continuing into fiscal 2015

DCHS

Revenue Structure

- Approximately 73% of DCHS revenue is from government sources
  - The national average is approximately 57%
- DCHS' commercial mix is significantly less than the California hospital average of 32%



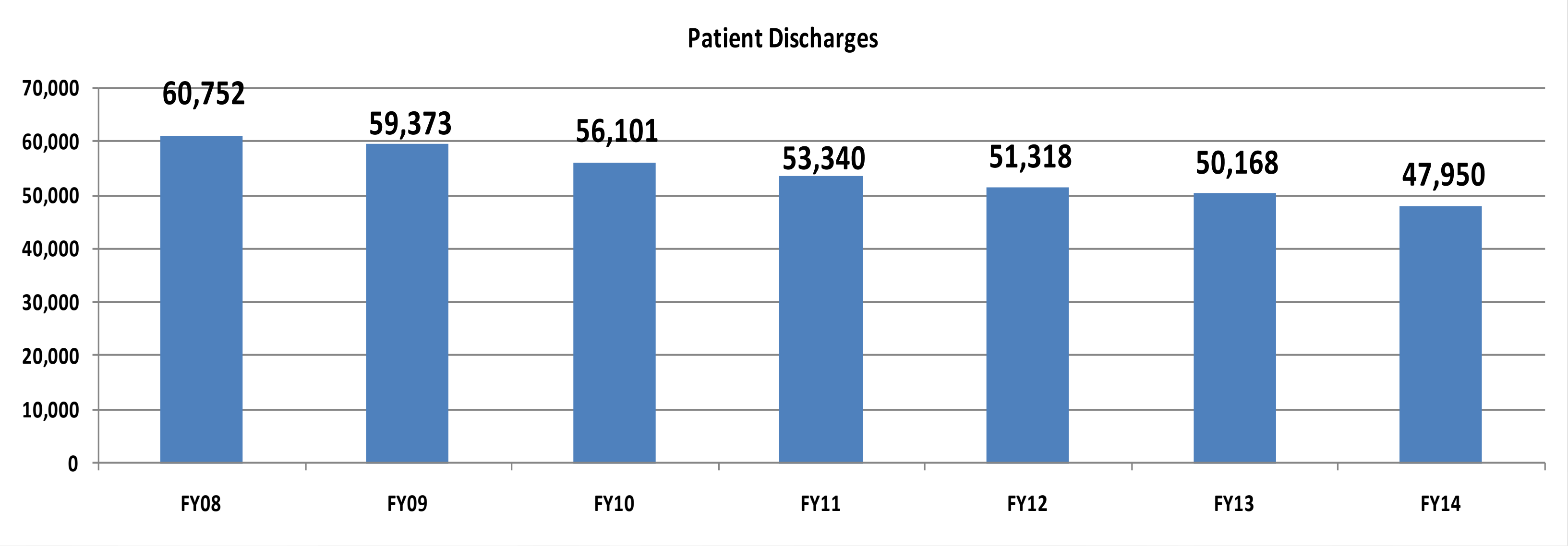
Operating Trends – Volume

- Inpatient volumes have declined over the past six years
- An accelerated rate of decline that began in fiscal year 2012 reflects an industry-wide effort to reduce hospitalizations and move care to a more efficient, lower cost outpatient setting
- More stringent criteria to qualify an inpatient admission for payment is forcing hospitals to reclassify inpatient admissions to outpatient “observation stays” to avoid non-payment
  - Observation stays are typically reimbursed at a lower rate for the same level of service and costs to provide the care

DCHS

Volume Trends

- Patient volumes have trended steadily downward the past six fiscal years



DCHS

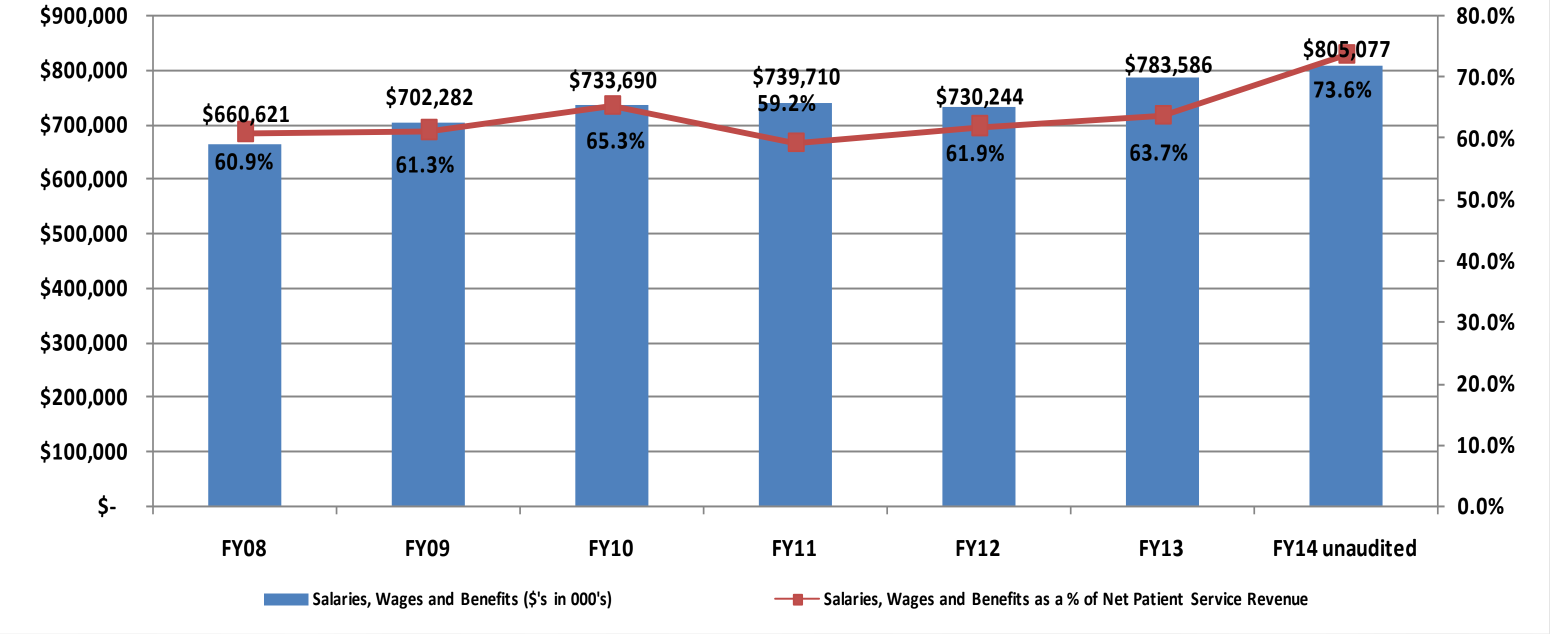
Operating Trends – Salary Structure

- Salaries, wages and benefits (SWB) as a percentage of net patient revenue is a financial metric that indicates how much is spent on SWB for every dollar of patient services revenue
- SWB as a percent of net patient revenue has increased from 59.2% for the fiscal year ended June 30, 2011 to 73.6% for the fiscal year ended June 30, 2014
- The increase in the SWB percentage is due to two factors:
    1. Annual wage increases, double digit health insurance increases as well as pension expense increases; and
    2. Little or no payer rate increases from all payers, compounded by a decline in patient volumes

DCHS

Labor Spend

- Labor costs as a percentage of net patient service revenues continue to increase
  - The Standard & Poor's Not-For-Profit Healthcare System Median is 57.7%



DCHS

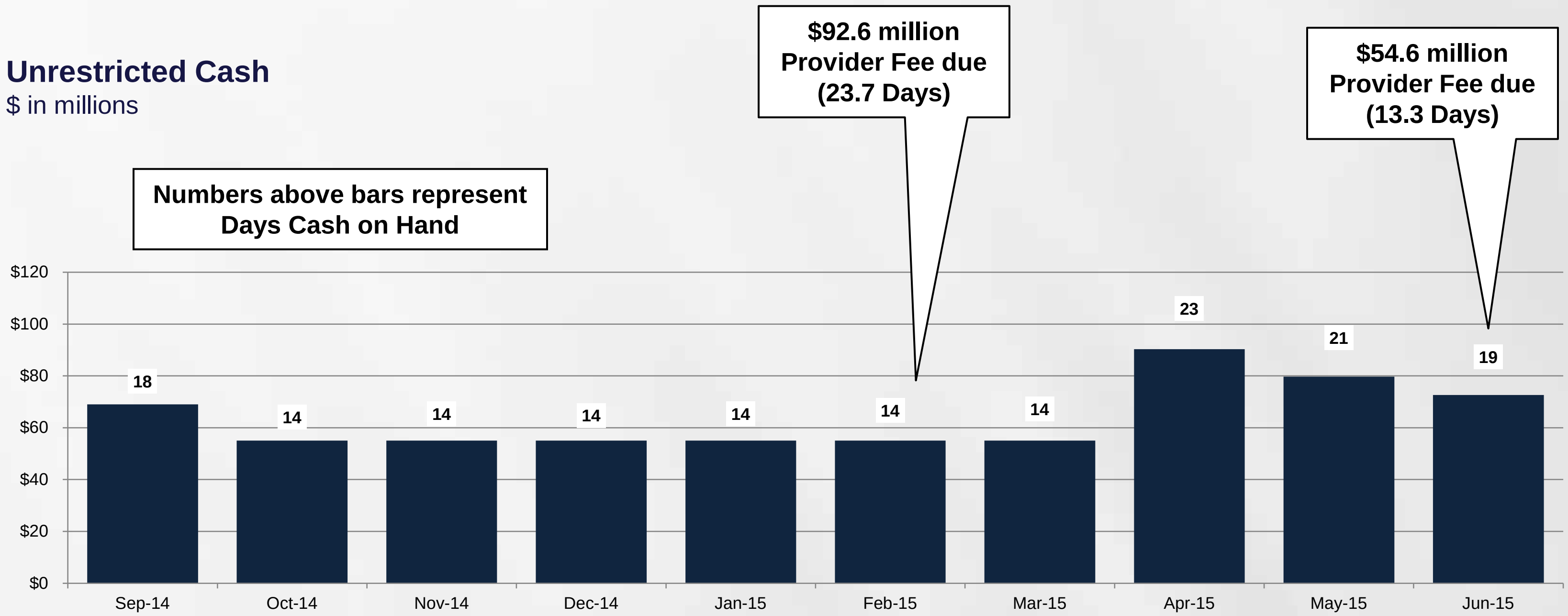
Updated Cash Flow Projections

- The monthly cash flow projections have been updated to reconcile to the actual ending August 2014 unrestricted, liquid cash balance

.

DCHS

Projected Monthly Cash



- Unrestricted Cash includes only liquid cash and equivalents
  - During September 2014, $28 million of remaining long-term investments managed by Ascension were redeemed; the result was an additional $10 million of liquid cash to DCHS, with the remaining amounts received booked as restricted funds
  - It is important to note that the liquid cash of approximately $73 million as of June 30, 2015 includes $93 million draw from our short term bridge financing. The bridge facility of $125 million matures on July 10, 2015

DCHS

Projected Monthly Sources and Uses of Funds

		A	B	C	D	E	F	G	H	I	J	K
		Projected										10 Month
		Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Total
1	Beginning Liquid Cash	$70,751	$69,040	$55,000	$55,000	$55,000	$55,000	$55,000	$55,000	$90,277	$79,726	$70,751
	Cash Inflows:											
2	Patient Revenue	$83,070	$86,445	$83,753	$86,445	$86,445	$78,371	$86,445	$83,753	$86,445	$83,753	$844,924
3	SFMC Supplemental Payments	0	2,475	7,932	3,500	4,956	0	1,900	9,031	11,242	9,843	50,879
4	Provider Fee (net)	0	0	0	6,673	11,622	(3,526)	9,568	49,917	0	9,568	83,822
5	Measure A	1,200	1,200	1,200	1,200	1,000	1,000	1,000	1,000	1,000	1,000	10,800
6	Meaningful Use	0	1,793	0	3,249	3,736	0	0	0	0	0	8,778
7	Other Operating Revenue	8,225	10,860	8,225	8,460	8,460	7,754	8,460	8,225	8,460	8,225	85,354
8	Non-Operating Revenue	893	893	893	893	893	893	893	893	893	893	8,926
9	Marillac Dividend	0	0	0	0	2,000	2,000	0	0	0	0	4,000
10	Sale of Assets	0	1,800	0	0	0	0	0	0	0	0	1,800
11	Proceeds From Borrowing	0	0	0	0	0	0	0	0	0	0	0
12	Transfers From Restricted/ Illiquid	10,070	0	0	0	0	0	0	0	0	0	10,070
13	Series 2014 Draws	8,213	20,425	14,920	7,594	2,007	28,162	11,895	0	0	0	93,215
14	Total Cash Inflows	$111,671	$125,890	$116,922	$118,013	$121,118	$114,654	$120,160	$152,818	$108,040	$113,282	$1,202,568
	Cash Outflows:											
15	Payroll	($51,655)	($52,752)	($52,849)	($52,752)	($53,529)	($47,515)	($52,752)	($51,006)	($52,752)	($51,006)	($518,566)
16	Pension	(1,220)	(1,220)	(1,220)	(1,220)	(1,220)	(5,849)	(1,220)	(1,220)	(1,220)	(5,849)	(21,454)
17	Other Benefits	(14,750)	(14,972)	(14,750)	(14,972)	(15,545)	(14,877)	(15,545)	(15,322)	(15,545)	(15,322)	(151,599)
18	Insurance	(0)	(1,822)	(0)	(0)	(1,822)	(0)	(0)	(1,822)	(0)	(0)	(5,467)
19	Property Taxes	(174)	(175)	(174)	(175)	(175)	(172)	(175)	(174)	(175)	(174)	(1,742)
20	Other AP	(40,068)	(43,612)	(42,600)	(43,610)	(43,612)	(40,719)	(43,610)	(42,602)	(43,610)	(42,740)	(426,782)
21	Risk Pool Settlements	0	0	0	0	0	0	0	0	0	0	0
22	Working Capital	(474)	(107)	(340)	(294)	(226)	(381)	(208)	(405)	(299)	(313)	(3,047)
23	PTO Cash Out	0	(280)	0	0	0	0	0	0	0	0	(280)
24	Sales Tax on Asset Sale	0	0	0	0	0	0	(1,660)	0	0	0	(1,660)
25	Mellon Bank Reserve	0	(20,000)	0	0	0	0	0	0	0	0	(20,000)
26	Debt Service	(2,704)	(2,354)	(2,354)	(2,354)	(2,354)	(2,504)	(2,354)	(2,354)	(2,354)	(2,354)	(24,035)
27	Capital	(2,337)	(2,637)	(2,637)	(2,637)	(2,637)	(2,637)	(2,637)	(2,637)	(2,637)	(2,637)	(26,073)
28	Transfers To Restricted/ Illiquid	0	0	0	0	0	0	0	0	0	0	0
29	Total Cash Outflows	($113,381)	($139,930)	($116,922)	($118,013)	($121,118)	($114,654)	($120,160)	($117,541)	($118,591)	($120,395)	($1,200,706)
30	Change in Liquid Cash	($1,711)	($14,040)	$0	$0	$0	$0	$0	$35,277	($10,552)	($7,113)	$1,862
31	Ending Liquid Cash	$69,040	$55,000	$55,000	$55,000	$55,000	$55,000	$55,000	$90,277	$79,726	$72,613	$72,613
32	Cumulative Draws	$8,213	$28,638	$43,558	$51,152	$53,159	$81,320	$93,215	$93,215	$93,215	$93,215	
	30-Month and 3-Year Provider Fee											
33	Cumulative Provider Fee Earned	$68,965	$76,855	$84,490	$92,380	$100,269	$107,395	$115,285	$122,920	$130,810	$138,445	$138,445
34	Less Provider Fee Received	0	0	0	(6,673)	(18,295)	(14,769)	(24,337)	(74,254)	(74,254)	(83,822)	(83,822)
35	Net Cumulative Due	$68,965	$76,855	$84,490	$85,707	$81,974	$92,626	$90,948	$48,666	$56,555	$54,623	$54,623
36	*Pro Forma Cash with Provider Fee*	*$138,005*	*$131,855*	*$139,490*	*$140,707*	*$136,974*	*$147,626*	*$145,948*	*$138,943*	*$136,281*	*$127,236*	*$127,236*

DCHS