



Paladin Healthcare Capital, LLC

**PRIVILEGED AND CONFIDENTIAL**

April 18, 2014

Geoffrey Ligibel, Director  
Houlihan Lokey  
123 North Wacker Dr.  
4<sup>th</sup> Floor  
Chicago, IL 60606

**Re: Acquisition of Daughters of Charity Health System**

Gentlemen:

Paladin Healthcare Capital, LLC ("Paladin," or the "Buyer") is pleased to submit this non-binding proposal (the "Proposal") to acquire substantially all of the assets (the "Business") of Daughters of Charity Health System ("DCHS" or the "Seller") all as more fully described in the February, 2014 Confidential Offering Memorandum (the "CIM"). For purposes herein, the acquisition by Buyer of the aforementioned Business of DCHS is hereafter referred to as the "Transaction."

The purpose of this letter is to summarize the proposed Transaction, as well as to provide background information regarding Paladin and its financing sources. Upon request, and pursuant to the receipt of more comprehensive information regarding DCHS, Paladin will provide more complete terms and conditions in a comprehensive letter of intent.

Paladin is a special opportunity investor that makes private equity, structured debt and real estate investments in the healthcare sector. It provides capital to over-levered and/or underperforming hospitals that can be transitioned to stable and profitable enterprises, with a particular focus on urban community hospitals. Having developed a distinct business model that is uniquely suited for urban community hospitals, Paladin's principals acquired and transformed several urban hospital facilities in South and East Los Angeles (the "LA Hospitals") that were severely underperforming, both financially and clinically, into a vibrant hospital system that delivers quality, cost-effective care and 24/7/365 emergency room access to the South and East Los Angeles markets, which as DCHS is well aware, is among the most under-bedded and underserved communities in the United States. Each of the four hospitals is a wholly-owned subsidiary of Avanti Healthcare Holdings, LLC ("Avanti"), which is majority-owned and operated by Paladin's principals. Paladin's principals and advisors are recognized leaders in the healthcare industry, comprising a highly experienced and successful management team with broad collective strengths in the areas of hospital operations, emergency department operations, managed care, healthcare facilities management, insurance, finance, law, and real estate (see bios and additional information at [pldn.com](http://pldn.com)).

Paladin's team has deep experience in turnaround situations, and has successfully driven rapid improvements in performance at each of the facilities owned by Paladin's principals, including dramatic improvements in care quality, operational efficiency, and financial performance. The strength of this team has enabled Paladin to refine the business model underlying Avanti as a low-cost provider of quality healthcare services for underserved communities; and the hospital system is highly successful on both a clinical and financial basis.

Prior to 2009, Paladin's principals led an investment banking practice that focused on distressed enterprises, completing more than 175 transactions totaling more than \$3 billion. Several such transactions involved underperforming hospitals and a substantial percentage involved business reorganizations. In many instances, Paladin served as an advisor to companies that were unable to support their capital structures. This unique experience has provided us with a comprehensive toolkit to develop transitional capital strategies that provide the time to affect a tangible and defensible profit improvement plan that will ultimately result in a stable and sustainable business. The combination of restructuring, transactional, and operational expertise that Paladin brings to bear is unique in the hospital industry, and will substantially increase the probability that the proposed Transaction will close on time and on terms.

### **The Proposed Transaction Structure**

Based on the information it has received to date, Buyer is prepared to acquire the Business for an aggregate purchase price of \$546mm (the "Purchase Price"). The Purchase Price will be comprised of \$263mm in cash at closing (thereby enabling DCHS to fully retire all of its outstanding bond obligations), and \$283mm of assumed pension liabilities, subject to typical adjustments for comparable transactions such as net working capital and other upward or downward adjustments.

To effect the Transaction, Paladin has or will establish two special purpose entities ("SPEs"), including:

- (a) **Op-Co.** Op-Co, which may take the form of a community based, not-for-profit entity or other appropriate entity, will serve as the operating company and will acquire from DCHS the operating assets (e.g., accounts receivable and all rights to any QAF payments, inventory) and intangible assets (e.g., licenses). In addition, Op-Co will assume the pension obligations and other specified liabilities (e.g., equipment leases). It is further contemplated that Op-Co will retain substantially all of the employees and will assume the existing collective bargaining agreements relating to the Business on their existing terms. We also intend that Op-Co will assume all other contracts and permits relating to the Business (including third party payor contracts, Medicare and MediCal participation agreements and related provider numbers), subject to obtaining all necessary third-party approvals. Op-Co also would acquire the business of the DCHS medical foundation, either through an asset purchase or a member substitution transaction, as Op-Co shall specify. Buyer acknowledges that the rights to the name "Daughters of Charity Health System" will be excluded from the transferred assets. The Purchase Price for Op-Co's portion of the Transaction is \$370mm, comprised of \$87mm in cash at closing and \$283mm of assumed pension obligations. It is our understanding that \$283mm represents the total pension obligation of Seller.
- (b) **Prop-Co.** Prop-Co, a for-profit entity to be formed, will acquire all real and personal property assets of the Seller, as well as other assets not acquired by Op-Co. Prop-Co will then lease hospital-related real and personal property assets to Op-Co. The Purchase Price for Prop-Co's portion of the Transaction is \$176mm in cash, which will be paid at closing.

**Sources and Uses**

Paladin intends to fund the Purchase Price with equity capital, senior and subordinated debt, and mortgage/term debt based on the following Sources and Uses:

<b>Op-Co</b>			
<b>Sources</b>		<b>Uses</b>	
<b>AR Revolver</b>	\$ 64.6	<b>Purchase Price</b>	\$ 370.0
<b>Assumed Pension</b>	283.0	<b>Working Capital</b>	20.0
<b>Subordinated Note</b>	42.4		
<b>Total</b>	\$ 390.0	<b>Total</b>	\$ 390.0

<b>Prop-Co</b>			
<b>Sources</b>		<b>Uses</b>	
<b>Mortgages</b>	\$ 114.4	<b>Purchase Real Property</b>	\$ 176.0
<b>Equity</b>	61.6		
<b>Total</b>	\$ 176.0	<b>Total</b>	\$ 176.0

<b>Total</b>			
<b>Sources</b>		<b>Uses</b>	
<b>AR Revolver</b>	\$ 64.6	<b>Purchase Price</b>	\$ 546.0
<b>Assumed Pension</b>	283.0	<b>Working Capital</b>	20.0
<b>Subordinated Note</b>	42.4		
<b>Mortgage</b>	114.4		
<b>Equity</b>	61.6		
<b>Total</b>	\$ 566.0	<b>Total</b>	\$ 566.0

Buyer has received strong indications of interest to support the Transaction as proposed from several leading institutional capital sources. Paladin has received bid support letters for the funding of an A/R Revolver and mortgage debt from MidCap Financial and Healthcare Finance Group, leading asset-based lenders to the healthcare industry; and from three major hedge funds with extensive experience providing capital to the healthcare sector, including Monroe Capital for the funding of sub-debt and mortgage debt; Apollo Global Management for the funding of Sub-debt and equity; and Goldman Sachs Specialty Lending Group for all of the above (see attached funding support letters). Midcap/Apollo or Goldman has indicated its willingness and capability to fund the entire Transaction. Buyer has also had favorable discussions with three additional major institutional lenders, each of which has interest and the ability to fully fund the Transaction as proposed. The Principals of Paladin will also be making significant personal investments in support of the Transaction.

### **Remaining Diligence**

To date, Paladin's due diligence has been limited to reviewing the CIM provided by Houlihan Lokey; however, Paladin stands ready to commit a significant amount of resources for the transaction, supported by our outside advisors, including Sheppard, Mullin, Richter & Hampton LLP, Vedder Price LLP, and other professionals as necessary to conduct thorough due diligence in an expeditious manner. To facilitate an expeditious process, it is anticipated that Seller and its advisors will cooperate fully with and facilitate Buyer's due diligence review as contemplated hereby, and will afford Buyer and its agents, representatives and capital partners a reasonable opportunity to access the data room to inspect, investigate and audit the Seller's Business, including, but not limited to, assets, liabilities, financial statements, cost reports, adjusted EBIDA, legal matters and proceedings, real estate matters, environmental matters, employee benefits matters, contracts (including but not limited to payor contracts), contingent liabilities, operations, relationships with employees, suppliers and customers (including interviews of the same), physicians and prospects; and Seller will promptly and completely provide all disclosures requested by or on behalf of Buyer.

### **Regulatory Considerations**

Although Paladin has not identified any specific or material competitive or regulatory issues regarding the proposed Transaction, our proposal is conditioned upon receipt of any regulatory approvals that are necessary to effect the Transaction, and which will be more fully described in the draft definitive purchase agreement (the "Definitive Agreement"). It is currently anticipated that such conditions can be met without significant delay.

### **Conditions Required to Consummate the Transaction**

The Closing of the Transaction would be subject to:

- (a) Execution and delivery of one or more Definitive Agreement(s) and related documents and consents in a form acceptable to Seller and Buyer; and
- (b) Buyer's satisfaction (as determined in Buyer's sole discretion) with the results of its due diligence review; and
- (c) Customary conditions, including: (i) obtaining any necessary consents, approvals or releases from governmental bodies, Seller's lenders, bond agencies, lessors, major customers and suppliers and other third parties with respect to the Transaction; (ii) absence of pending or threatened material litigation, investigation or governmental proceeding regarding the Transaction; (iii) absence of any material adverse change in the business, financial condition, assets, operations or prospects of the Seller; (iv) satisfaction of all necessary title and environmental inspections related to the real property; and (v) delivery of customary legal opinions, closing certificates and other documentation.

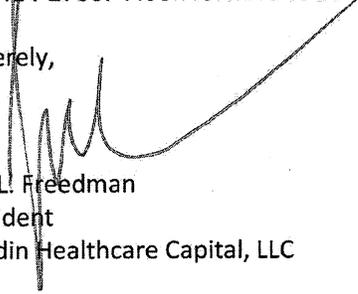
## Miscellaneous

- (a) Documentation. The Definitive Agreement will include such representations, warranties, covenants, indemnifications and conditions that are customarily included in an agreement associated with comparable transactions.
- (b) Expenses. Buyer and Seller shall bear their own expenses in negotiating and closing the Transaction.
- (c) Confidentiality and Publicity. The terms and conditions of this letter and any information received by Buyer as part of its due diligence of the Business shall be subject to the previously executed confidentiality agreement dated March 3, 2014 by and between Buyer and Seller, which shall remain in full force and effect. No party shall issue any press release or other announcement regarding the Transaction unless such release or announcement has been mutually agreed to in writing by the parties or unless required by law.
- (d) Non-Binding Commitment. Except for the provisions of paragraph (b) through paragraph (e) of this Miscellaneous section, which shall be legally binding upon Buyer, its affiliates and capital partners, and Seller, and notwithstanding anything to the contrary contained in this letter, this letter is only for the sole purpose of setting forth a basis upon which the parties may be agreeable to proceeding toward a contemplated Transaction, and is not intended to be a legally binding contract or to impose any liabilities or obligations on any party. Other than as expressly indicated in the immediately preceding sentence, the legal obligations of the parties would arise only upon the execution of a Definitive Agreement in form and substance acceptable to the parties and their respective counsel. It is understood that this letter is not intended to set forth all of the terms of such Definitive Agreement.
- (e) Governing Law. This letter shall be governed by the internal laws of the State of California, without giving regard to its principles of conflicts of laws.

**[Remainder of page intentionally left blank]**

We look forward to participating in the next phase of negotiations and collecting necessary additional data to enable us to structure a definitive offer and to allow us to quickly engage in negotiations for a Definitive Agreement. If you should have any questions, please contact me at 310-414-2700. I look forward to continuing our discussions.

Sincerely,



Joel L. Freedman  
President  
Paladin Healthcare Capital, LLC

cc: Eric Klein  
James MacPherson  
Nicholas Orzano  
Mark Bell  
Irv Edwards

Attachments:  
Bid Support Letters