



Paladin Healthcare Capital, LLC

PRIVILEGED AND CONFIDENTIAL

May 21, 2014

Geoffrey Ligibel, Director
Houlihan Lokey
123 North Wacker Dr.
4th 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 updated 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”) and the online dataroom posted on Smartroom. For purposes herein, the acquisition by Buyer of the aforementioned Business of DCHS is hereafter referred to as the “Transaction.” This letter incorporates the text of the cover letter to which it is attached and supersedes and replaces our letter dated as of April 18, 2014 in its entirety. The purpose of this letter is to summarize the proposed Transaction, as well as to provide background information regarding Paladin and its financing sources.

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 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).

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 \$590mm (the "Purchase Price") through a series of asset purchase agreements ("APAs"). The aggregate Purchase Price will be comprised of \$270mm in cash at closing (thereby enabling DCHS to fully retire all of its outstanding bond obligations using cash proceeds from the Transaction), \$283mm of assumed pension liabilities, and \$37mm in assumed accounts payable, along with additional consideration in the form of assumed payroll obligations (the amount of which we cannot yet determine based on available information), all of which is 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 a series of special purpose entities ("SPEs"), including:

- (a) **Op-Co Group.** Op-Co Parent, a California S-corporation ("Op-Co Parent"), will assume all pension obligations of DCHS (funding deficits for which we understand to be approximately \$283mm) and form several subsidiary operating companies (each, an "Op-Co") that will serve as the operating companies of the Business.

Six Op-Cos will be formed to acquire from each of DCHS's six acute care hospitals (the "Hospitals"), the operating assets (e.g., accounts receivable, all rights to any QAF payments and other government receivables, inventory) and intangible assets (e.g., licenses) of each such Hospital. We also intend that each Op-Co will assume all other contracts (other than excluded contracts) and transferrable permits relating to their assigned Hospital (including third party payor contracts, collective bargaining agreements, Medicare and MediCal participation agreements and related provider numbers), subject to obtaining all necessary third-party approvals.

Buyer acknowledges that certain mutually agreed upon assets of DCHS will be excluded from the Transaction, including (i) the rights to the name "Daughters of Charity Health System," (ii) unrestricted cash (as reflected on the DCHS balance sheet attached to the CIM), (iii) the charitable foundations of the Hospitals and their respective assets, (iv) certain mutually agreed upon excluded contracts and (v) other customary assets relating to pre-closing periods (e.g., bank accounts, tax refunds, retained records, etc.) will be excluded from the transferred assets.

DCHS will retain but be required to utilize unrestricted cash to fund ongoing deficits relating to ordinary course operations prior to closing, and to fund transaction expenses and other operating expenses, with the balance of such unrestricted cash, if any, being placed into an escrow account at closing to satisfy mutually agreed upon indemnity obligations of DCHS relating to the Transaction.

In addition, each Op-Co will assume specified liabilities (e.g., equipment leases, accounts payable, post-closing contractual obligations, risk pool obligations, utilities, current liabilities included in working capital and other specified liabilities). All other pre-closing liabilities of DCHS and its subsidiaries (the "DCHS Group") will remain the liabilities of the DCHS Group.

It is contemplated that Op-Co Parent will create an employee stock ownership plan ("ESOP"). Each Op-Co will retain substantially all of the employees and will assume the existing collective bargaining agreements relating to their applicable Hospital on their existing terms and each employee will be given the opportunity to participate in the ESOP, subject to customary vesting conditions.

Employees will own 100% of Op-Co through the ESOP, which employees will be represented by a highly experienced and dedicated trustee who will be responsible for ensuring that the Op-Co Parent and Op-Cos subsidiaries act in the best interests of the employees and that all contractual arrangements of the Op-Co entities are fair and equitable and structured on market terms.

The Purchase Price for Op-Co Parent's portion of the Transaction is \$414mm, comprised of \$94mm in cash at closing (allocated amongst the Hospitals and Other Entities by mutual agreement of the parties), \$283mm of assumed pension obligations, and \$37mm in assumed accounts payable, plus additional consideration in the form of assumed payroll obligations. It is currently contemplated, subject to additional due diligence, that Op-Co Parent will arrange for a surety bond to be posted in an amount required to continue DCHS's multi-employer pension plan following closing to the extent necessary to consummate the Transaction.

- (b) **Prop-Co.** Prop-Co Parent, a California limited liability company ("Prop-Co Parent"), will form several subsidiary operating limited liability companies (each, a "Prop-Co") that will acquire all real and personal property assets of each Hospital, as well as other assets not acquired by the Op-Cos (e.g., restricted cash, pooled investment fund, etc.). Prop-Cos will then lease hospital-related real and personal property assets to corresponding Op-Cos.

Additional Prop-Cos would be formed to acquire DCHS's other business entities (e.g., Caritas Business Services, Marillac Insurance Company, De Paul Ventures) (collectively, "Other Entities"). The acquisitions of the Other Entities would be accomplished through asset purchases or equity purchases as determined by Paladin following further due diligence investigation. Paladin's intention is to streamline the transaction as much as possible so to the extent equity acquisitions would avoid material delays (i.e., license transfer issues), Paladin would consider using such structures to expedite the Transaction.

The Purchase Price for Prop-Co Parent’s portion of the Transaction is \$176mm in cash in the aggregate, which will be allocated amongst the various members of the DCHS group by mutual agreement and paid in cash at closing.

- (c) **1206(l) Medical Foundation.** Paladin acknowledges the request to include the DCHS medical foundation in the Transaction and continues to explore opportunities to accomplish this goal. We continue to review the due diligence materials related to the medical foundation and will make a proposal to DCHS regarding the same as soon as reasonably practicable.

Each APA will include customary representations, warranties and covenants during the pre-closing period, including the obligation to operate the Business in the ordinary course. Subject to completion of comprehensive confirmatory due diligence, Paladin is prepared to accept limited indemnification from DCHS and the Hospitals that would be satisfied exclusively through (and limited by) the escrow of remaining unrestricted cash of DCHS.

The transactions would be subject to receipt by the parties of all necessary third-party consents, including expiration of HSR waiting periods, receipt of other consents to the transfer of material licenses and contracts and other matters described in this letter under the heading “Conditions Required to Consummate the Transaction” below. All of the transactions contemplated by this letter would be consummated simultaneously.

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:

| Op-Co | | | |
|-------------------|-----------------|-----------------|-----------------|
| Sources | | Uses | |
| AR Revolver | \$ 70.3 | Purchase Price | \$ 414.0 |
| Assumed Pension | 283.0 | Working Capital | 58.3 |
| Subordinated Note | 100.0 | Pension Bond | 18.0 |
| Assumed AP | 37.0 | | |
| Total | \$ 490.3 | Total | \$ 490.3 |

| Prop-Co | | | |
|--------------|-----------------|------------------------|-----------------|
| Sources | | Uses | |
| Mortgages | \$ 114.4 | Purchase Real Property | \$ 176.0 |
| Equity | 61.6 | | |
| Total | \$ 176.0 | Total | \$ 176.0 |

| Total | | | |
|-------------------|-----------------|-----------------|-----------------|
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| Subordinated Note | 100.0 | Pension Bond | 18.0 |
| Assumed AP | 37.0 | | |
| Mortgage | 114.4 | | |
| Equity | 61.6 | | |
| Total | \$ 666.3 | Total | \$ 666.3 |

Buyer has received strong indications of interest to support the Transaction as proposed from several leading institutional capital sources. Our capital sources have committed resources to the transaction, but require additional due diligence before providing definitive term sheets. Such term sheets can be delivered quickly upon completion of additional due diligence. We have requested updated lists of outstanding items from each capital partner and will provide the same to DCHS promptly upon receipt. As reflected in letters enclosed herewith, Midcap/Apollo is committed to underwriting the entire transaction such that Paladin can close with a single source of capital. Goldman Sachs and HIG are also interested in either leading or participating in the transaction, and HFG and Monroe are prepared to support certain key elements of the capital structure. We anticipate that Midcap/Apollo will lead the transaction, and the other parties will have an opportunity to participate but not need to be relied upon with respect to the closing.

Remaining Diligence

Paladin, its capital sources and each of our respective advisors have reviewed substantially all of the materials posted to the data room, and we greatly appreciate the efforts of DCHS in producing the volumes of information posted to date. However, as previously noted, several key due diligence requests remain outstanding. We are committed to completing due diligence as quickly as possible and look forward to reviewing all requested information. To facilitate an expeditious process, it is anticipated that Seller and its advisors will continue to 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 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 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 agreements (the "Definitive Agreements"). 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.

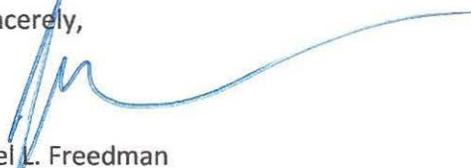
Miscellaneous

- (a) Documentation. The Definitive Agreements 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 Definitive Agreements in forms 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 Agreements.
- (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.

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We look forward to participating in the next phase of negotiations and to providing you with our marked form of 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

Attachments:
Bid Support Letters

EXHIBIT ONE

**REQUESTED INFORMATION REGARDING THE OPERATIONS OF
AVANTI HOSPITALS, LLC AND AFFILIATED HOSPITALS**

| | MHG | ELADH | CHHP | Coast | TOTAL |
|---|---|----------------------|----------------------|----------------------|-----------------------|
| 1. Quality of Care Measures | | | | | |
| Inpatient Mortality | 2.7% | 1.9% | 1.8% | 2.3% | |
| Appropriate Care Measure (Total) | 94.1% | 93.0% | 100.0% | 89.3% | |
| AMI Perfect Score | 88.9% | 89.0% | 100.0% | 83.3% | |
| CHF Perfect Patient Score | 91.3% | 77.0% | 100.0% | 66.7% | |
| Pneumonia Perfect Patient Score | 98.1% | 100.0% | 100.0% | 93.8% | |
| SCIP Perfect Patient Score | 90.6% | 100.0% | 100.0% | 100.0% | |
| Outpatient SCIP Perfect Score | 100.0% | N/A | N/A | N/A | |
| 2. Patient Satisfaction Score (Mean) | 77.0% | 81.8% | 74.1% | N/A | |
| ED Patient Satisfaction Score | 72.0% | N/A | N/A | 80.2% | |
| 3. Community Relations | | | | | |
| 4. Employee Satisfaction Surveys | N/A | N/A | N/A | N/A | |
| 5. Physician Relationships/Satisfaction Surveys | N/A | N/A | N/A | N/A | |
| 6. Details on Amounts of Charity Care Provided | | | | | |
| Charity Care (2013) | \$ 7,522,000 | \$ 6,306,000 | \$ 5,373,000 | \$ 4,217,000 | \$ 23,418,000 |
| Uncompensated Care (2013) | \$ 34,882,000 | \$ 12,991,000 | \$ 32,617,000 | \$ 12,523,000 | \$ 93,013,000 |
| TOTAL CARE PROVIDED | \$ 42,404,000 | \$ 19,297,000 | \$ 37,990,000 | \$ 16,740,000 | \$ 116,431,000 |
| 7. Payor Mix | | | | | |
| Medicare | 36.9% | 33.4% | 27.2% | 43.4% | |
| Medi-Cal | 51.9% | 51.7% | 53.4% | 35.8% | |
| Self-Pay | 4.9% | 5.3% | 11.2% | 7.6% | |
| Commercial/Capitation | 4.9% | 9.2% | 4.0% | 11.3% | |
| Other | 1.6% | 0.4% | 4.2% | 1.9% | |
| 8. Details surrounding Catholic hospitals and expectations regarding operations post-closing | We are committed to preserving the core services and community commitment of the organization | | | | |
| 9. Recent Financial Performance | | | | | |
| EBITDAR (Calendar 2013) | \$ 20,290,000 | \$ 6,952,000 | \$ 1,198,000 | \$ 4,065,000 | \$ 32,505,000 |
| 10. Expectations on continuation/cessation of operations at DCHS facilities post-closing | We are committed to preserving the core services and community commitment of the organization | | | | |

EXHIBIT TWO

PRELIMINARY TRANSITION AND DEVELOPMENT PLAN

Paladin's hospital operating model is tightly defined, highly successful, and portable to most hospitals. We believe several elements of the model can have a materially favorable impact on the DCHS hospitals. The model includes a wide range of clinical and operational improvement initiatives that can significantly improve clinical and financial performance, as well as employee and patient satisfaction, by maintaining strong disciplines in the areas of emergency department operations, care coordination, case management, clinical documentation, recruiting, staff flexing, purchasing, facilities management, contracting, revenue cycle, and capital strategies. Key initiatives include:

- Improving Emergency Department wait times and left-without-being-seen metrics;
- Improving efficiencies and documentation through sophisticated hospitalist and case management programs;
- Decreasing supply chain costs by standardizing purchasing activities and establishing stringent protocols;
- Controlling labor costs through disciplined staffing policies, while strengthening employee retention and recruitment activities;
- Increasing cash collections by implementing tighter protocols and promoting discipline across the revenue cycle;
- Developing profitable recurring revenue streams and increasing inpatient volumes by expanding and refining managed care activities;
- Realigning administrative infrastructure to better capitalize on system scale and to standardize best practices; and
- Engaging in community activities that educate, inspire, and improve quality of life and overall health outcomes.

OPERATING INITIATIVES

The DCHS hospitals have been providing comprehensive healthcare services to their respective markets for up to 140 years. It has been stated that, due to a number of factors such as shrinking reimbursements from Medicare, Medicaid, and managed care payors; inability to grow market share; a historically high volume of uninsured patients; and escalating costs, DCHS has experienced a significant deterioration in its financial condition in recent years.

Despite DCHS' ongoing efforts to improve their clinical, financial, and operational performance, the hospital continues to face operational losses. DCHS has faced a 6% decline in admissions, reduction in reimbursement from MediCare and MediCal, a steady increase in SWB, significant cost associated with the shared services model and employed physician group, and reduced volume from a very competitive secondary service area. These and other factors have contributed to EBITDA losses of more than \$15mm for FY2013, and over \$40mm for the LTM2013. The Buyer understands that due to DCHS' financial constraints, they can no longer put forth the resources necessary to revive their system and maximize its potential in the communities it serves. Buyer acknowledges and agrees to DCHS' request to not perform abortion procedures. Buyer is fully committed to engaging DCHS' management team to discuss any operational considerations important to the organization.

Optimize Emergency Department Performance

A particular strength and focus of Paladin's business model is ED management. Following its acquisition of the LA Hospitals, a conscious decision was made to view emergency medical technicians and paramedics (together, "Paramedics") as vital customers of the hospitals. A significant effort was expended to establish strong, coordinated relationships with the Paramedics; and to gain their confidence that they were safely and efficiently presenting patients at competent hospitals. A further commitment was made to keep the EDs open and accessible on a 24/7/365 basis, whereas most EDs in the market were on diversion between 40% and 50% of the time. Within a short period of time, each ED achieved industry-leading metrics for quality and efficiency, leading to increases in Paramedic volumes of more than 40% (Chart 1) and comparable increases in hospital admissions. These increases enabled the LA Hospitals to achieve scale without having to reduce staffing levels, which is counter to most turnaround strategies.



MHG refers to Memorial Hospital of Gardena, which serves Inglewood, Hawthorne, Compton, Lynwood, Gardena, and other South Los Angeles communities

SFMC's ED cares for approximately 70,000 patients annually and is Los Angeles County's busiest emergency department, while SVMC's ED received approximately 15,000 patients. SFMC's 46-bed ED is designated a Level II Trauma Center and is an Emergency Services/Paramedic Base Station facility. Given the size and current ED volumes at SFMC, Paladin is highly confident that its operations expertise can enable the SFMC ED to become among the most efficient and effective amongst tertiary hospitals in Los Angeles by:

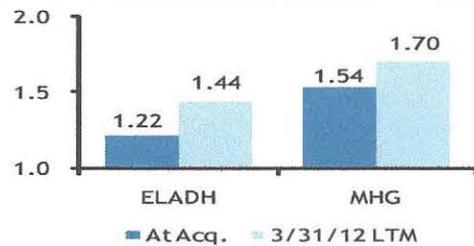
- Reducing Wall Times (time between a Paramedic's arrival to an ED and the patient being seen by a physician and the Paramedic can leave)
- Reducing ED LOS (time between a patient's arrival to the ED before being admitted or discharged)
- Reducing Left-Without-Being-Seen (percentage of patients presenting to the ED that leave prior to receiving treatment, most often due to excessive Wait Times)
- Reducing Diversion Hours (when a hospital is not accepting Paramedic runs)
- Increasing Patient Satisfaction (often a byproduct of all of the above)

Based on its business model and ability to execute, Paladin will seek to drive substantial improvements to ED operations. Paladin also believes, empirically, that there will be opportunities to recapture 911/paramedic runs that were historically presented to SFMC, but which are redirected to other area hospitals due to the saturation and diversion hours experienced by SFMC's ED.

Improve Documentation

Paladin places a significant emphasis on accurate and comprehensive documentation. Improved documentation increases charge capture, which can have an immediate and dramatic impact on the bottom line. In addition, precise documentation can increase patient safety, improve workflow, promote collaboration and improve communication among clinicians, and allow for more nurse-patient time and better utilization of physician time. More precise documentation has successfully impacted CMI at each of the LA Hospitals (Chart 2), driving increases of more than 10%.

Chart 2 – CMI Improvements at MHG & ELADH



Paladin’s documentation training and support program empowers physicians by enabling them to document with consistently improving levels of precision to more accurately reflect CMI and favorably impact clinical and financial outcomes.

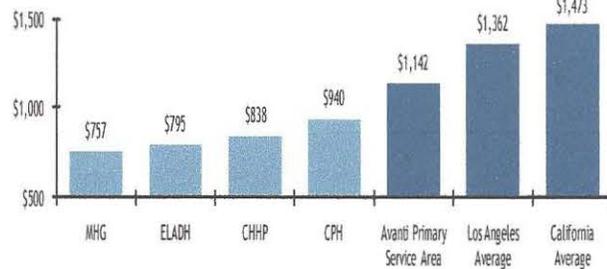
In Paladin’s experience, 911-receiving hospitals (including Level II Trauma Centers that financial underperform despite having high ED volumes), a combination of inadequate clinical documentation and suboptimal inpatient management exists. An assessment of operating metrics will enable Paladin to quantify the magnitude of any opportunities to improve documentation processes at SFMC and SVMC, which may lead to the ability to improve charge capture, thereby facilitating profit improvements.

Optimize Staffing Ratios and Implement Flex-Staffing Policies

In order to consistently provide quality care on a cost-effective basis, a key strategy is to maintain sustainable staffing ratios and enforce a flex-staffing model that varies based upon census and seasonality. The Paladin model is very effective in ensuring that the right number of personnel is in place and conducting appropriate activities at all times. Accordingly, the LA Hospitals were able to drive its cost to below-market levels (Chart 3), while simultaneously achieving dramatic improvements in quality (Chart 2).

An optimal staffing policy and management system should yield labor costs of between 50% and 60% of Net Revenue. A significantly higher labor cost structure is generally not sustainable, especially in the wake of forthcoming reimbursement adjustments. Based on a preliminary high-level review, it appears that DCHS has experienced rising total labor costs approximating 65% of Net Revenue. Paladin would seek to collaborate with the labor unions, management and staff to identify ways to reduce this percentage by establishing a sustainable staffing model that meets the needs of the Hospitals, employees, and community, with an absolute commitment to ensure that the Hospitals delivers good quality on a constant basis, while working within the framework of existing labor agreements. Further analysis is required to quantify potential savings from this initiative, which could include better management of staffing levels, overtime, and use of registry, which could lead to substantial profit improvements.

Chart 3 – SW&B per Adjusted Patient Day



Improve Efficiencies through Hospitalist and Case Management Programs

Paladin's hospital operating model is grounded in the belief that "efficiency is the friend of quality care" and vice versa. Paladin's principals developed "home-grown" hospitalist and case management programs at the LA Hospitals that have proven to be highly effective. These programs had an almost immediate and substantial impact on efficiency, while also resulting in a dramatic improvement in quality measures at each of Avanti's hospitals (Chart 4), which previously had been among the lowest quality providers in Southern California.

Paladin has found that the most effective hospitalists are those who have active practices and have earned the respect of fellow physicians. Paladin's principals have proven to be very effective at educating and empowering physicians to become exceptional hospitalists that are not only experts at acute patient care, but also true teachers and leaders among the medical staff.

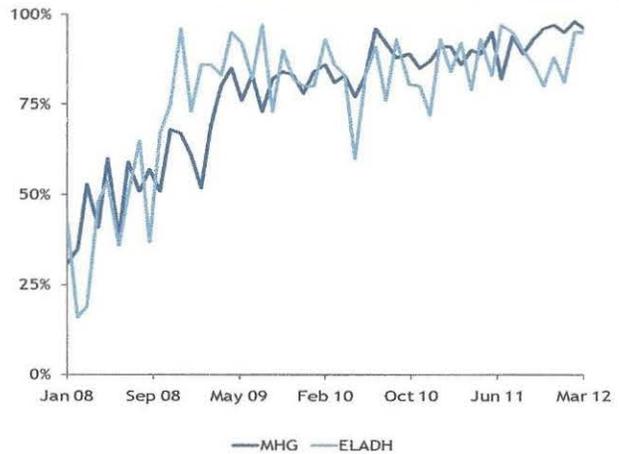
Paladin's case management program is designed to ensure that patients are admitted and transitioned to the appropriate level of care by ensuring that patient care plans are diligently executed and physicians/hospitalists are in the right place at the right time to make timely and clinically-appropriate decisions. Case managers are responsible for the implementation of patient care plans, including communication and coordination with patients, families, and third-party providers. As a result, physicians can focus on what they do best – diagnosing patients and developing appropriate care plans.

Paladin believes that the commitment to quality that has been a historical characteristic of DCHS' Hospitals, coupled with Paladin's ability to educate and empower clinicians, will lend to the development of highly effective hospitalist and case management programs at the DCHS Hospitals. As a result, Paladin believes there are opportunities to improve inpatient management such that average lengths of stay for Medicare and Medicaid patients will be reduced, yielding substantial profit improvements.

Drive Margin by Reducing Supplies Expense

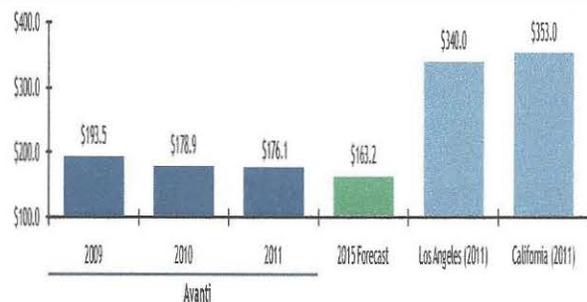
Paladin has successfully implemented numerous expense reduction strategies to lower supply chain costs at each of the LA Hospitals, often driving costs per APD to the lowest levels in the Los Angeles market (Chart 4). In addition to capitalizing on efficiencies afforded by combining purchasing power, standardizing clinical and non-clinical supplies, and centralizing decision making, Paladin has introduced new programs that have positively impacted expenses and decreased inventory levels, including SKU reduction, tight formularies and operating guidelines, reprocessing, and electronic forms management, among several others.

Chart 4 – Core Measure Improvements at MHG & ELADH



ELADH refers to East Los Angeles Doctors Hospital, which serves East LA, City of Commerce, Bell, Huntington Park, Vernon, and other East Los Angeles communities

Chart 4 – Supply Expense Per Adjusted Patient Day



Paladin has historically partnered with MedAssets to help achieve its supply chain goals, leveraging its expertise and GPO network. Further analysis of detailed historical monthly operating reports is necessary to quantify profit improvement opportunities in the supply chain; however, based on high level financial statements, and considering the likely volumes of SFMC's and SVMC's current supplies utilization, Paladin believes there is likely a significant opportunity to realize significantly lower supply costs through a combination of standardization, inventory controls, improved purchasing efficiencies through contracted GPO relationships and automated purchasing transactions; improved purchase auditing and adherence to contract pricing, and management of physician preferences, to name a few.

Review of Insurance Policies and Programs

Paladin believes that proper insurance coverage and a strong orientation toward risk management are the primary drivers of a successful insurance program. This is especially true in high-intensity environments such as hospitals. With the assistance of its strategic partner, Lockton Associates, Paladin would seek to conduct a complete review of DCHS' insurance policies and risk management programs to ensure that the Hospitals have cost-effective, comprehensive coverage to protect their patients, employees, physicians, and the mission. During the next phase of due diligence, Paladin will engage Lockton to help identify specific costs savings that may be available through renegotiation and competitive bidding with new carriers, and risk management strategies that can improve safety and reduce claims. Based upon preliminary due diligence, Paladin believes that there may be opportunities to drive value within the Hospitals' insurance programs and employee benefit plans; however, comprehensive due diligence is required before developing and quantifying a viable plan.

Leverage the Scale and Efficiencies Afforded by Avanti's Existing Infrastructure

Because of the scale afforded by the Avanti hospitals, and their close proximity to SFMC and SVMC, Paladin is uniquely positioned to reduce the cost structure of the DCHS Hospitals, and particularly SFMC and SVMC. By consolidating certain administrative and operational functions with those of Avanti's corporate management infrastructure and hospitals, Paladin sees a clear opportunity to reduce operating costs at the DCHS Hospitals, while improving the efficiency of those functions. Opportunities include consolidating central business office operations, as well as certain administrative and corporate functions. Economies of scale can also be expected in the supply chain and pharmacy, as we have been able to substantially reduce such costs at our existing facilities through the initiatives discussed above.

Further opportunities for efficiencies may also be realized by consolidating certain specialty service lines at either SFMC or SVMC, thereby minimizing intra-system competition, while allowing for coordination of referrals/transfers of specialty and higher level of care cases from Avanti's community hospitals, thereby enhancing volumes and increasing contribution margins of specialty service lines at each facility.

STRATEGIC INITIATIVES

Commitment to the Community

Paladin's mission is to build hospital systems that are innovative leaders in quality of care, operational efficiency, patient satisfaction, financial viability, and community contribution. Paladin has a deep respect for the communities it serves and has been a strong advocate of health education in South and East Los Angeles where the Avanti Hospitals have an established track record of community service and culturally-sensitive business practices, including hiring senior management that is representative of the communities it provides services to. Community involvement has become a key component of the corporate culture of the Avanti hospitals, which regularly conduct health festivals, toy drives, community fireworks shows, and event sponsorships, while also implementing a range of health education programs covering issues that are relevant in the local communities.

For the past 150 years, Daughters of Charity has been committed to best meeting the healthcare needs of its underrepresented and disadvantaged communities. This commitment is evident by several of DHCS' ongoing programs and initiatives, including its Healthy Community Initiatives (health screenings, immunizations, education and fitness classes) and Vida Sana/Health Life Community Wellness Program (education program advancing healthy lifestyle habits and awareness/prevention of chronic diseases), among others. Paladin wholly supports this commitment and hopes to complement it as Avanti's hospitals implement a Community Action Plan in their respective communities that includes an ongoing series of health education programs and services at local churches, community centers, and select health clinics. In addition to health and nutrition education, Paladin's Community Action Plan includes family planning counseling, health plan benefits and enrollment counseling, mini health festivals and AIDS/HIV education.

Paladin believes that a shift towards prevention, early diagnosis and patient education will enable individuals to make better lifestyle choices and take an active role in managing their own health, in partnership with a healthcare team, family members, and the community. By adhering to these principles, its hospitals and clinic network will be the frontline infrastructure for a better system of care for the community. Paladin, its principals and its companies are committed to educating, inspiring, and improving the quality of life and overall health outcomes among the communities it serves, while fostering a bond with the community that is uniquely impactful.

Development of Integrated Healthcare Delivery System

To better meet the needs of patients in communities that suffer from disproportionate health disparities and lack of access to basic healthcare services, Paladin intends to develop a system of ambulatory clinics and health centers in the communities surrounding each of its hospitals that, together with the Hospitals, will form the foundation of an integrated healthcare delivery system. This initiative is well underway in South and East Los Angeles. DHCS' Community Health Clinics in Lynwood, Downey and Huntington Park would complement the long-term vision of this outpatient network throughout the communities served by the Hospitals. Preliminary goals and objectives of this initiative are contemplated to include:

- Paladin will develop a number of strategically located ambulatory clinics and health centers as is deemed sufficient to facilitate an integrated delivery system offering good access, qualified clinicians, coordinated care, and education to empower community members and facilitate improved health outcomes on a cost-effective basis; while increasing the number of entry points to DHCS hospitals possibly recapturing lost volume from increased competition in primary and secondary service areas;
- A care coordination platform that will reduce the reliance on the system's emergency department and provide access to appropriate level of care for non-emergent patients;
- Reduce hospital re-admissions by coordinating post-discharge care between the Hospitals, the clinics and other ancillary service providers;
- Cohesive service delivery among physicians, nurses, and other providers who work both at the clinics and health centers and the Hospitals;
- A fully integrated IT platform with digital medical records and comprehensive data analytics that will lead to improved quality and lower costs;
- An established contracted ancillary provider network that will both lower costs and improve clinical outcomes at both the clinic and Hospital levels;

- Community outreach and health education programs focused on prevalent conditions and co-morbidities associated with heart disease, diabetes, and obesity, among other health issues; and
- An overall increase of the availability of basic and critically needed healthcare services for children, adults, seniors, and persons with disabilities.

The ambulatory clinics and health centers will serve as a central hub for administering a proactive, integrated system of care that combines preemptive health screenings, education programs, wellness, and value-based incentives when people are well; and proactive medical management, care coordination, and Care Team support when people are sick. Primary Care Physicians (“PCPs”) will function as the primary gatekeepers of care for beneficiaries who have not yet developed severe illnesses or chronic diseases; and an Extensivist (typically a physician who specializes in the particular illness) will assume the gatekeeper role for sick patients, with the support of Care Teams (e.g., nurse practitioners, case managers) that will implement a high-touch model in which the beneficiaries are regularly communicated with (often daily) by a team of experts who develop personal relationships with beneficiaries and their families, have expertise in dealing with the day to day challenges of the relevant condition, and understand when it is appropriate to refer patients for more specialized care.

As this type of system evolves, DCHS will be in a better position to establish a managed care infrastructure and enter into institutional, professional, and/or global capitation arrangements. Ultimately, it is the intention of this initiative to develop an innovative and effective healthcare model for the community surrounding the DCHS hospitals that creates a collaborative and coordinated environment for patients to receive, and physicians, nurses, clinics, and the Hospital to deliver, quality cost-effective healthcare. By combining the best values provided by the Hospital with the reach and breadth of the proposed clinical delivery system, DCHS and Paladin will be able to improve the likelihood that community members remain healthy and out of the emergency room.

Investigate Establishing an “Accountable Care Organization” in Partnership with Select Payers

Paladin is developing a business plan to design and implement a population health model tailored to the unique challenges and attributes of disadvantaged urban communities. Although relevant to numerous communities across the US, including those served by DCHS, the initial focus is to establish an integrated healthcare delivery system in South and East Los Angeles (which is in process) and to overlay a range of proprietary health plan products. The plan proposes theories and strategies that will require ongoing refinement but which offer potential to improve both clinical and financial outcomes in underrepresented markets.

Experience with New Value-Based Reimbursement Models

The Affordable Care Act promotes the transition of US healthcare from a fee-for-service reimbursement system to one based on value. Value-based reimbursement (“VBR”) models are designed to reward value instead of volume by aligning payers and providers through modified risk relationships. The objective is to use reimbursement as a lever to change the way providers deliver care. In theory, VBR programs can help to reduce costs, improve quality, and minimize waste. While the promise of VBR is significant and perhaps the best prospect to ensure the long-term sustainability of the US healthcare system, the transition to such a model is incredibly complicated and likely to place a significant financial strain on hospitals. To remain viable and vibrant in the long-term, DCHS must overcome the challenges of this transition and build an integrated healthcare delivery system that coordinates and delivers a complete spectrum of quality acute care, physician, and ancillary services on a financially-sustainable basis that may involve some underwriting risk.

Paladin brings to DCHS a deep level of knowledge, insight, and ideas to help DCHS make this transition in an optimal manner. Under the leadership of Paladin's principals, the LA Hospitals built a sizeable managed care business of more than 125,000 capitated lives. This book of business was built through the establishment of capitation agreements with five different health plans, shared-risk arrangements with 13 different Independent Practice Associations ("IPAs"), and administrative agreements with five different Management Services Organizations ("MSOs"). While the number of partners made it a difficult business to standardize and manage at the hospital level, the business was profitable, and Paladin's principals learned the mechanics of administering such a business, as well as the challenges involved, including those stemming from the unique characteristics of the patient populations (mostly MediCal) covered by such programs.

In 2012, at the strong urging of the health plans, the LA Hospitals accepted institutional risk associated with a new population of managed care beneficiaries comprised of seniors and persons with disabilities. The capitated reimbursement for members of this new population, which was consistent with data produced by the State of California (which had previously been administering this patient population), proved to be significantly inadequate in the case of the LA Hospitals, as the data (and the reimbursement) was not sensitized to reflect the health disparities between populations in different communities/geographies. With claims expenditures far greater than anticipated, the LA Hospitals termed out of this business, but experienced significant losses. The experience was very instructive, leading Paladin to adopt a very cautious posture about taking risk without tangible actuarial data to appropriately underwrite such risk. As a result, Paladin will ensure that DCHS is extremely thoughtful and diligent should it consider assuming risk in the future, and it may prove most prudent to share or cede risk to a payor partner who has the balance sheet to better absorb the potential downside associated with such an initiative. Paladin has established a dialogue with Aetna regarding the establishment of such a partnership in South and East Los Angeles.

In addition to value-based models that align providers, value-based insurance design ("V-Bid") models are designed to align patients' out-of-pocket costs such as copays and premiums with the value of health services. This approach to designing benefit plans recognizes that different health services have different levels of value. By reducing barriers to high-value treatments (through lower costs to patients) and discouraging low-value treatments (through higher costs to patients), these plans can achieve improved health outcomes at any level of health care expenditure. When such barriers are reduced, significant increases in patient compliance with recommended treatments and potential cost savings can result. To the extent that Paladin and DCHS collaborate to develop and introduce a range of proprietary health plan product to the markets served by DCHS, V-Bid technologies will become very relevant. Paladin is developing such a business plan for the South and East Los Angeles markets, which plan is anticipated to be deployed once there is sufficient data to confirm that risk-taking is a viable strategy.

Paladin is uniquely blessed to have on its advisory board two of the healthcare industry's leading experts on value-based models, and two other advisors who are leading experts at managed care, including:

- Dr. Mike Chernew is the Leonard D. Schaeffer Chair of Health Care Policy at Harvard Medical School; Vice Chair of MedPAC; and a Member of the Congressional Budget Office's Panel of Health Advisors and the National Academies' Committee on National Statistics. His research centers on value based insurance design.
- Dr. Dana Goldman is the Leonard D. Schaeffer Chair in Health Policy at the University of Southern California; Co-founder of Precision Health Economics; Health Policy Advisor to the Congressional Budget Office; and Director of the RAND/UCLA Health Services Research Postdoctoral Training Program. His research is focused on the economic impact of healthcare initiatives and governmental design of programs to curb national healthcare cost.

- Cástulo De La Rocha is President and CEO of AltaMed Health Services Corporation, the largest independent Federally qualified health center operator in the US and operator of a health plan covering more than 115,000 MediCal and Medicare beneficiaries. He is on the Governing Board of LA Care and Corporate Board of Blue Shield of California, and is also Regional Chair of the Surgeon General's Hispanic/Latino Health Initiative.
- Dr. Vinod Jivrajka is Co-founder, President and CEO of AppleCare Medical Enterprises, which is among the most successful and innovative physician-based managed care companies in the country. He is widely recognized for his expertise in healthcare management and managed care operations, including the development of medical services and care management innovations that have helped to shape the managed care industry over the past 20 years.
- Joel Freedman, Paladin's President, is a founding member of Harvard Medical School's Healthcare Policy Advisory Board and a Board Member of the Leonard Schaeffer Center at the University of Southern California, which respectively are the first and fourth ranked health policy departments in the US. He is also a National Council Co-Chair of American Enterprise Institute where he regularly engages with influential healthcare scholars. These affiliations and other long-term relationships enable collaboration with the most innovative and successful leaders in the healthcare industry, and provide access to the research capabilities of academic institutions and think tanks at the forefront of healthcare delivery innovation, a strength we believe can be of significant benefit to the communities served by DCHS.