HOULIHAN LOKEY

September 23, 2014

Mr. Ron Bloom
Lazard Frères & Co. LLC
30 Rockefeller Plaza
New York, New York 10112

Re: Blue Wolf Capital Fund III, L.P. Restructuring, Conversion and Disaffiliation Proposal to Daughters of Charity Health System and Affiliates (DCHS)

Dear Ron:

Thank you for your letter dated September 19, 2014 responding to our discussion on September 18, 2014 regarding DCHS's most salient concerns and comments about the transaction terms contained in Blue Wolf's submission delivered on September 12.

We are striving, as you know, to present fully detailed proposals shortly to the DCHS board. Blue Wolf's proposal evidences careful preparation and efficient use of the resources available to Blue Wolf, but remains problematic or nonspecific in several keys areas. Your letter of September 19 states that Blue Wolf is willing to make "meaningful changes" in the economics of its proposal if we and DCHS's other advisors would recommend the Blue Wolf transaction to the board of DCHS. Our process thus far has afforded all interested parties with the opportunity to submit proposals on which we provided feedback in light of other proposals received. We believe that the process has benefited from this competitive approach and in light of the progress and input received to date, we seek your proposed accommodations at this time so that the advisors' recommendations can be formed. Therefore, in the interest of having the most developed proposal from Blue Wolf, this letter is intended to outline areas in which Blue Wolf's proposal can be strengthened in light of the proposals submitted by others.

1. The Daughters of Charity as a Source of Working Capital for the Post-Closing Health System; Corporate Sponsorship.

Enclosed with this letter are the following attachments which provide details of the components of certain estimated closing cash disbursements: (a) transaction costs, (b) the severance holdback and (c) the 401(a)(17) plan. Please let me know when we may discuss these numbers and how they factor into Blue Wolf's estimate of the working capital adjustment contemplated by the revised Annex VI of the Blue Wolf proposal.

A financing structure that is dependent on a multi-million dollar gift from the Daughters of Charity sets the Blue Wolf proposal apart, in a highly negative manner, from all other final bidders, each of whom has brought us a financing structure that either supports operating cash needs with the cash on the balance sheet of its existing health system or meets that need with external financing. Blue Wolf's gap is significant (maybe more than $60 million notwithstanding the revised Annex VI and Exhibit G) not to mention that the working capital contribution requested by Blue Wolf from the Daughters of Charity is uncapped and without equity participation. We recognize the proposed offset effect of the corporate sponsorship from New Found Holdings – a pledge of substantial charitable contributions over a period of years to Daughters of Charity Foundation – but it necessarily offers a pledge, not a legally binding commitment and is subject to the inherent uncertainty of the start-up nature of New Found Holdings and its limited capitalization. We encourage Blue Wolf again to propose an alternative independent source to bridge the cash gap.

2. Deposit.

I am encouraged by your letter's concluding remarks that Blue Wolf will consider a cash deposit upon execution of definitive documentation which at $50 million will put it on a par with other proposals in hand from entities that are substantial participants in the California health care market and accordingly could make persuasive arguments that their reputation and investment in the process speak for their seriousness of commitment to this transaction.

3. Corporate Sponsorship of DOC Foundation.

The offer of a ten-year corporate sponsorship of DOC Foundation is a distinctive element of Blue Wolf's proposal but for purposes of DCHS is unrelated. Nevertheless, we await a draft pledge agreement making concrete the terms you propose for the consideration of the DOC Foundation.

4. 501(c)(3) Status Bridge.

As noted above, the Daughters of Charity as a religious congregation of the Catholic Church sponsoring the Catholic identity of the health system has decided to end that relationship when control passes to a successor. Continuing sponsorship would require at a minimum continuing corporate control; the Daughters' sponsorship of the hospitals as its local health ministries has been premised on governance control.

Recognizing, though, that the 501(c)(3) exempt status of the hospital corporations, philanthropic foundations and DCHS Medical Foundation is fundamental to your proposal, I understand that DCHS is willing to collaborate with New Found Holdings in its efforts to secure new exemptions, so long as obtaining exemptions is not a closing condition and the effort is at New Found Holding's expense. Such collaboration would include DCHS submitting applications prepared by Blue Wolf's counsel that have been reviewed and approved by DCHS and its counsel. Expedited review status for the applications should be requested.

5. Management Services Agreement.

DCHS's request for more information about the management services agreement and the services and personnel costs covered by the $2 million-a-month management fee is straightforward. While we expect, as you assert, that Blue Wolf's turn-around plan has taken the burden of this expense into account, we would like to see how that works concretely. What personnel costs now embedded in the overhead of DCHS would that fee cover? How much of such overhead cost will be relieved by the outsourcing of senior management? What positions will be filled by New Found Management employees compared to DCHS's executive complement today? Are there any other leadership positions provided to the operating company beyond the three positions mentioned in your previous communications, Chairman, CEO and possibly a physician executive currently associated with a southern California health system? Additionally, we understand that this incremental expense to the operations of DCHS is in addition to the expense associated with the continuing usage of the sold medical office buildings.

6. Post-Closing Treatment of Non-Represented Employees.

You have invited our input regarding the post-closing treatment of employees who are not represented by unions. Approximately 25% of the health system's employees are not unionized, and they are also a material area of focus for DCHS. We appreciate that the size of the workforce, expense of salaries, wages and benefits of the health system must be tackled by a new owner and existing employees if the health system is to reverse its losses; this is one of many areas of initiative of a new owner. For that reason, DCHS has instructed us to seek commitments related to ongoing employment, wages, benefits and especially security of retirement plans. The Blue Wolf draft definitive agreement was unresponsive to these concerns in taking the position that, as manager, New Found Management is not able to compel an independent DCHS to make and keep such commitments. Our response will be a draft in which DCHS today makes such commitments, imposes them on the post-closing DCHS to honor them, and gives Daughters of Charity Ministry Services Corporation the right to enforce them and other post-closing commitments of the health system.

7. Capital Commitment.

Our redraft of the definitive agreement will ask New Found and post-closing DCHS to commit to spend $300 million over five years on capital needs of the health system. We believe that Blue Wolf's draft omitted this commitment based on a misunderstanding that the Attorney General's office would prescribe a capital commitment amount. Our transaction team's experience is that the conditions of the Attorney General's consent may adopt the parties' contractual commitment so that the Attorney General may enforce that obligation independently of the seller, which may no longer exist or have the financial means to enforce such promises.

8. Other Agreement Changes.

We will return to Blue Wolf a new draft of the definitive agreement that addresses other topics of your letter, including the "material adverse effect" definition that opens an exit for New Found from closing the transaction, the scope of releases, a broad standard of acceptable conditions in the Attorney General's consent (indeed, Blue Wolf's assertion that its proposal is imminently approvable raises the question why any "out" for such conditions is practically needed), the severance holdback which we have discussed (and again is featured in other proposals), among other reversions to elements we have requested in order to bring Blue Wolf's proposal into alignment with those of others.

We offer the above guidance to assist Blue Wolf in preparing its best proposal. At the root of many of our issues is a concern about the viability of the post-closing DCHS. Despite the meaningful non-economic investments Blue Wolf has made during the sale process, its proposal has limited new "equity" capital invested into DCHS (i.e., in excess of asset sale proceeds), no deleveraging, an absence of existing corporate functions to permit rationalization / operating synergies and no material corporate parent or affiliates that could become committed to the future funding of the DCHS pension plans. Nevertheless, we do appreciate the unique attributes that the Blue Wolf proposal provides, and through resolution of our concerns noted herein, an interesting alternative for consideration by the DCHS board.

Sincerely,

Andrew Turnbull
Houlihan Lokey

cc: Robert Issai, President and Chief Executive Officer
John Chesley, Ropes & Gray LLP

WORKING DRAFT

ESTIMATED TRANSACTION FEES AND CLOSING COSTS

Description	Estimated Amount	Notes
Outstanding Monthly Professional Fees at Closing	$5.2 million	Represents two months of professional fees ($2.6 million monthly run-rate assumption in the Series 2014 Bond liquidity budget)
Transaction and Success Fees	$11.0 million	Represents estimated back-end transaction and success fees payable at closing
Transfer Taxes	$1.5 million	Estimated taxes related to the transfer of Real Estate (based on book value of PP&E). *The documentary transfer tax will be $1.10 per $1,000 for all properties PLUS a city transfer tax in the following two cities:* • *Los Angeles - $4.50 per $1,000* • *San Jose - $3.30 per $1,000*
Post-Closing & Wind Down Costs	$3.6 million	
Other	$1.7 million	Other unanticipated closing transaction fees, wind down costs, etc.
Total Estimated Transaction Fees and Costs Payable at Closing	**$23.0 million**	

<u>Assumptions:</u>

- No bankruptcy
- No labor disruptions
- Receipt of Quality Assurance Fees as projected

Daughters of Charity Health System

Severance & Other Benefits Schedules Summary

HIGHLY CONFIDENTIAL - DRAFT

	# of EEs	Severance	PTO Cash Out	FICA	M-Care Tax	COBRA	Outplacement	Total
System Office:								
Administration	4	$ 1,926,397	$ 4,053	$ 17,511	$ 27,992	$ 105,165	$ 35,000	$ 2,116,118
Communications	1	219,440	-	7,440	3,182	46,740	10,000	286,802
Facilities	3	305,868	24,859	11,308	4,796	62,320	25,000	434,150
Finance	6	991,044	120,643	38,080	16,119	132,430	35,000	1,333,317
HR	5	379,288	15,421	11,820	5,723	77,900	30,000	520,152
IT	6	662,881	83,899	30,733	10,828	151,995	40,000	980,336
Legal	1	145,313	-	7,440	2,107	23,370	10,000	188,230
Managed Care	4	332,543	9,479	11,146	4,959	58,425	25,000	441,552
Materials Management	2	136,425	1,244	8,018	1,996	27,265	15,000	189,948
Risk	3	316,975	6,047	9,486	4,684	58,425	20,000	415,618
Sub-Total	35	5,416,174	265,645	152,982	82,386	744,035	245,000	6,906,223
Hospital and MF Leadership	6	3,599,895	-	82,894	52,198	241,471	60,000	4,036,458
CBS	3	272,409	-	16,599	3,950	66,215	30,000	389,173
Total	**44**	**$ 9,288,477**	**$ 265,645**	**$ 252,476**	**$ 138,535**	**$ 1,051,721**	**$ 335,000**	**$ 11,331,854**

WORKING DRAFT

NON-QUALIFIED RETIREMENT BENEFIT PLANS

Balance as of [July 31], 2014

401(a)17 Plan (a)	
System Office	$ 1,547,969
Hospital Executives	772,032
Other Employees	280,610
Sub-Total	2,600,611
Supplemental RPA (b)	
Total	528,726
TOTAL	**$ 3,129,337**

(a) $2.046 million is reflected on DCHS' balance sheet (8051-2272-22750 "Excess Plan Liab LT"). The $555k remaining liability is not reflected on the balance sheet.

(b) Cash and investments ($529k) related to the Supplemental RPA are held by Transamerica and will be distributed to participants upon closing. There is no liability from DCHS' perspective (other than potential administrative costs).