OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF SALE OF MAYO CLINIC HEALTH SYSTEM IN WAYCROSS	* * * * * *	NO. AG 2017-01

REPORT OF FINDINGS

I.

BACKGROUND

MAYO CLINIC HEALTH SYSTEM IN WAYCROSS

Mayo Clinic Health System in Waycross (hereinafter the "Hospital"), is a 231 bed acute care hospital, located at 1900 Tebeau Street, Waycross, Georgia 31501. The Hospital is operated by Mayo Clinic Health System in Waycross, Inc., ("MCHSW"), a Georgia nonprofit corporation.[1] The Hospital facility consists of an approximately 362,330 square foot building. In addition to the Hospital facility, MCHSW's facilities include: (i) The Heart Center, focused on diagnosis and treatment of cardiovascular disease; (ii) the Senior Behavioral Unit, a 15-bed geriatric psychiatric unit; (iii) Express Care, an urgent care center; and (iv) the Rehabilitation Institute, a free standing 20-bed rehabilitation unit. Additionally, MCHSW operates physician practices through twenty-nine (29) employed physicians.

The main Hospital building and two parcels of land, which includes one 9.98 acre parcel and the adjacent 4.29 acre parcel, on which the Hospital is located is owned by the Hospital Authority of Ware County (the "Authority"). The Authority also owns the land

[1] Pursuant to an Integration Agreement dated January 30, 2012, Mayo Clinic Jacksonville, Inc. a Florida nonprofit corporation, became the sole member of Satilla Health Services, Inc., which operated Satilla Regional Medical Center. Satilla Health Services, Inc. changed its name to Mayo Clinic Health Services in Waycross, Inc. Pursuant to the Integration Agreement, Satilla integrated with The Mayo Clinic Jacksonville.

and building of the Rehabilitation Center located at 2500 Satilla Parkway, Waycross. The Hospital, Rehabilitation Center and all of the related land is leased by the Authority to MCHSW pursuant to a recently renewed lease for a forty-year (40) term.

In the past five (5) years, MCHSW has invested approximately $38 million in new equipment and facilities at the Hospital. The services provided at the Hospital include medical and surgical inpatient acute care, outpatient surgery, emergency, intensive care, cardiology, psychiatry, imaging, laboratory, labor and delivery, radiation oncology and cardiopulmonary rehabilitation. The Hospital's primary service areas include areas of Ware, Pierce, Appling, Atkinson, Bacon, Brantley, Charlton, Clinch and Coffee Counties.

THE DISPOSITION PROCESS

Currently, the sole member of the Hospital is Mayo Clinic Jacksonville, Inc., a Florida nonprofit corporation (hereinafter "Mayo Jacksonville"). In November 2015, after several years of operating losses, Mayo Jacksonville notified the Board of Directors[2] of MCHSW that it intended to withdraw as the sole member of MCHSW. The community members of the Board of Directors were subsequently appointed by the MCHSW Board to serve on the Strategic Transition Committee (the "Committee)[3] to assist with the Hospital's transition. On December 19, 2015, the Committee retained the services of Stroudwater and Associates ("Stroudwater") to identify a potential new partner, lessee or purchaser. Stroudwater and the Committee determined, after study, that independent operation after Mayo's withdrawal was too risky given the challenging financial and operational position of the Hospital. As such, Stroudwater identified thirty-seven (37) potential partners/buyers.

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[2] The MCHSW Board of Directors is composed of five (5) Mayo appointees and four (4) community appointees.

[3] The Committee was reconstituted to include one Mayo appointed director, one community director, and the Hospital administrator.

Stroudwater successfully notified thirty-four (34) of the identified potential partners/buyers with a brief description of the Hospital and health system and of the opportunity for affiliation on some basis. Twenty-five (25) of those contacted expressed initial interest and were sent confidentiality agreements; all twenty-five (25) returned signed confidentiality agreements and received confidential descriptive memoranda containing financial and business data on the Hospital and health system. Of those receiving a confidential descriptive memorandum, six (6) potential offerors submitted bid proposals, to wit: Hospital Corporation of America ("HCA"), Prime Healthcare Services, ERH Healthcare, St. Vincent's Healthcare, Coffee Regional Hospital and Community Hospital Corporation.

The MCHSW Board of Directors selected four (4) bidders as finalists: HCA, Prime Healthcare Services, ERH Healthcare and St. Vincent's Healthcare. In June 2016, the four (4) bidders toured the facilities with management and were given access to extensive economic and operating data, from which each bidder presented final proposals to MCHSW's Board of Directors. The Board of Directors met separately with each finalist and ultimately selected HCA as the winning bidder. The Board of Directors negotiated a non-binding Memorandum of Understanding with HCA Management Services, L.P., an indirect wholly-owned subsidiary of HCA Holdings, Inc.

THE PROPOSED TRANSACTION

Upon the closing of this transaction, the Hospital will be leaving the larger Mayo Clinic network of hospitals. All of the hospital assets associated with the operation of MCHSW, including those currently leased from the Authority by MCHSW, will be sold to Southeast Georgia Health Services, LLC, a Delaware for-profit limited liability company (hereinafter "HCA Sub") and an indirect wholly-owned subsidiary of HCA Holdings, Inc. (a/k/a "Hospital Corporation of America" or "HCA").

This transaction will close in two simultaneous transfers. In the first transfer, Mayo Jacksonville will withdraw as the sole member of MCHSW pursuant to a Separation Agreement. The Separation Agreement will provide that (i) all Mayo appointed directors and officers of MCHSW and affiliated entities will resign; (ii) Mayo Jacksonville will receive a lump sum payment in full satisfaction of all financial obligations considered to be owed by MCHSW to Mayo Jacksonville; (iii) Mayo

Jacksonville will return the net reserves on hand to MCHSW; (iv) Mayo Jacksonville will retain all liabilities associated with the operation of the Hospital and related facilities prior to the closing of the transaction that are not otherwise assumed by HCA Sub; and (v) each party to the Separation Agreement will release the others from specific claims and liabilities as described in the agreement.

In the second transfer, pursuant to the Asset Purchase Agreement ("APA"), Mayo Jacksonville, MCHSW, and the Authority will convey substantially all property associated with the operations of the Hospital to HCA Sub. HCA Sub will assume certain current liabilities of MCHSW. In addition, HCA Sub will commit $21.6 million to capital improvements at the Hospital and the health system over the next five (5) years. The APA includes a ten (10) year right of first refusal in favor of MCHSW, a fifteen (15) year commitment to continue to operate an acute care Hospital and to provide emergency room services, a ten (10) year commitment to continue as a Medicare/Medicaid provider, a five (5) year commitment to continue core services, a five (5) year commitment to MCHSW's charity care policy, and a ten (10) year commitment to fund a community benefit fund at levels historically maintained by MCHSW. HCA Sub has committed to hiring substantially all of MCHSW's employees.

The price for the acquisition of the Hospital's assets is $51.1 million. The acquisition price will be paid in cash with capital investments over a period of five (5) years.

VALUATION ANALYSIS

Principle Valuation, LLC ("Principle") was retained by MCHSW to perform a financial analysis to determine the fair market value of the Hospital on a going-concern basis for the proposed purchase of the Hospital by HCA Sub. The scope of Principle's engagement was a calculation of the fair market value for the Hospital. In its report, Principle determined that the fair market value of the Hospital's assets was between a range of $45 million to $51.1 million. Mr. Patrick J. Simers of Principle testified at the public hearing held on February 28, 2017.

In its calculation of the fair market value for the Hospital, Principle calculated the value of the Hospital assets and operations. There are three traditional approaches considered to determine value. The three approaches are: (1) the Income Approach, (2) the Market Approach, and (3) the Cost (net asset value) Approach. The Income Approach is based on the concept that the value of a business is the present worth of the expected future economic benefits to be derived by the owners of the business. Under the Market Approach, value is derived through a comparison of the transaction prices of similar assets and business interests trading in the marketplace. In the Cost (net asset value) Approach, value is estimated based on the value of all of the subject business's underlying assets, both tangible and intangible.

Principle considered all three approaches, then reconciled and synthesized the indicated values according to industry standards to reach a final estimate of value. Under the Income Approach, Principle applied a Discounted Cash Flow ("DCF") method, which provides an indication of value based on the entity's ability to generate net cash flow. This projected net cash flow is then discounted to present value using an appropriate risk-adjusted discount rate. The Hospital did not provide a multi-year forecast; instead, projections were prepared by Principle based on historical trends, national operating ratios, and Principle's proprietary databases. The magnitude of the discount rate applied to the projected cash flows is related to the perceived risk of the investment and current capital costs. The discount rate used by Principle in their analysis is an estimate of the Hospital's weighted-average cost of capital ("WACC"), which, when applied, converts the free cash flow to present value. Using this methodology, Principle valued the Hospital at $47.7 million.

Under the Market Approach, Principle applied two methods to estimate the Hospital's fair market value: the Guideline Public Company Method and the Guideline Transaction Method. The Guideline Public Company Method considers the reported values and implied market multiples of minority interests in publicly-traded companies in comparable or similar lines of business. Under the Guideline Public Company Method, Principle identified and calculated valuation multiples based on the financial data for minority interests in comparable companies. Principle utilized an adjusted business enterprise value in order to incorporate a control premium, which reflects the difference between a minority interest value of the comparable public companies and an estimated value of a controlling interest. Principle then calculated Revenue multiples, which ranged from 0.91x to 1.81x with an average of 1.26x, and also calculated the Earnings

Before Interest, Taxes, Depreciation, and Amortization ("EBITDA") multiples, which ranged from 8.42x to 30.32x with an average of 13.19x. Principle subsequently applied an adjustment of -50.0% due to the Hospital's smaller size, lack of diversity, and fluctuating margins. Principle also adjusted the Revenue multiple by another -20% due to the Hospital's inferior profitability relative to the comparables. These multiples were then applied to the projected year one revenue and the EBITDA of the Hospital in order to arrive at a value conclusion of $47.6 million.

The Guideline Transaction Method is an approach that considers the valuation metric relationships of recent acquisitions of similar companies and applies them to the company being valued. Under the Guideline Transaction Method, Principle identified and calculated valuation multiples based on financial data from 26 publicly reported transactions. For each of those transactions, Principle calculated a price-per-bed and revenue-per-bed regression analysis. This approach implied the value of the Hospital to be $46.7 million, but this number is assumed to not include the net working capital figure of $14,273,000. The net working capital was added to the value calculated by the Guideline Transaction Method and resulted in a valuation of $60,973,000. Principle followed the same analysis for three (3) recent transactions in Georgia with a result of the hospital being valued at $56 million. Principle then weighted the Guideline Transaction Method and the Guideline Public Company Method, which yielded a value conclusion of $51.8 million.

Under the Cost (net asset value) Approach, Principle identified three groups of assets to value: (1) the real estate, (2) the equipment assets, and (3) the agreed-upon debt-free net working capital balance. To value the real estate, Principle used both the replacement cost method and the income capitalization approach. To value the equipment assets, Principle began with the book value of the equipment, but reduced the book value by 40% to account for depreciation. Lastly, the agreed-upon debt-free net working capital balance was determined by Principle to be $14,273,000.[4] The cost approach yielded a valuation of $52,500,000, which is 18.5% higher than the income approach and 4.8% higher than the market approach. After valuing the Hospital using all

[4] This number was reduced from $17,179,000 by a January 17, 2017 Valuation Report Addendum.

three approaches, Principle reconciled and synthesized the values, resulting in a final fair market value range of $45 Million to $51.1 Million.

Deloitte Transactions and Business Analytics, LLP ("Deloitte"), in accordance with O.C.G.A. § 31-7-405(b), was retained as an independent financial advisory consultant by the Attorney General to assist in the review of the proposed sale of the Hospital to HCA Sub. The Attorney General engaged Deloitte to provide valuation advisory services, but not to provide a separate valuation or a fairness opinion. Mr. Jimmy Peterson testified at the hearing on behalf of Deloitte. As part of its engagement, Deloitte held discussions with representatives of all the parties involved in the proposed transaction and performed independent research and analyses to review the conclusions contained in Principle's independent assessment of the fair market value of the Hospital.

In the course of its engagement, Deloitte analyzed Principle's underlying valuation methodologies and assumptions, and performed a number of sensitivity analyses on Principle's assessment of Fair Market Value. Deloitte also performed an independent Guideline Public Company valuation method analysis. Deloitte concluded that Principle's calculation of the multiples was consistent with industry standards. Deloitte also performed an independent study of guideline transactions from which to calculate multiples, and again concluded that Principle's calculations were consistent with industry standards. In addition, Deloitte performed an independent check of Principle's WACC calculation using its own analysis of market data. Deloitte's WACC calculations corroborated Principle's conclusion for this discount rate.

Mr. Peterson testified that the economics of the transaction were consistent with the fair market value of the Hospital's assets. Deloitte confirmed that the Income, Market, and Cost approaches to value considered by Principle are consistent with generally accepted industry standards for valuation analyses. Deloitte further concluded that Principle's reconciliation and synthesis of the three valuation approaches were also consistent with industry norms.

PUBLIC COMMENT

The public hearing was held on February 28, 2017, at 1:00 p.m. in the Cafetorium at the Hospital. Nine (9) persons made comments at the public hearing and a vast majority of the comments were in favor of the proposed transaction. There were no comments made in opposition to the transaction.

Following the public hearing, the record was held open until the close of business on Friday, March 3, 2017, for any further public comment. This Office did not receive any written public comments. Counsel for the Hospital Authority of Ware County, Mayo Clinic Jacksonville, MCHSW and HCA Holdings, were requested to inform this office in writing by Friday, March 10, 2017, as to whether their respective clients intended to proceed with the proposed transaction as structured or modify the proposed transaction in some respect. Counsel for both parties have written a joint letter stating that their clients wish to proceed with the transaction as proposed.

II.

FINDINGS

The Hospital Acquisition Act (the "Act") involves a public interest determination in the Attorney General's review of a proposed disposition and acquisition of hospital assets. *See* O.C.G.A. §§ 31-7-400 through 31-7-412; *Sparks v. Hospital Authority of City of Bremen and County of Haralson*, 241 Ga. App. 485 (1999) (physical precedent only). The Act requires a written notice filing and a public hearing "regarding the proposed transaction in the county in which the main campus of the hospital is located." O.C.G.A. §§ 31-7-401, 31-7-405(a). The purpose of the public hearing is "to ensure that the public's interest is protected when the assets of a nonprofit hospital are acquired by an acquiring entity by requiring full disclosure of the purpose and terms of the transaction and providing an opportunity for local public input." O.C.G.A. § 31-7-406.

Under the Act, disclosure is linked to whether "appropriate steps have been taken to ensure that the transaction is authorized, to safeguard the value of charitable assets, and to ensure that any proceeds of the transaction are used for appropriate charitable health care purposes." O.C.G.A. § 31-7-406. The Act identifies thirteen factors that are key considerations in determining whether the appropriate steps have been taken by the parties. *Id.* The thirteen factors are listed in Appendix A to this report.

The thirteen factors set forth in O.C.G.A. § 31-7-406 can be grouped into four categories relating to (a) the exercise of due diligence by the seller (factors number 1, 2, 3, 4 and 8), (b) conflicts of interest (factors number 5 and 13), (c) valuation of the hospital assets (factors number 6, 7 and 10), and (d) the charitable purpose of the proposed transaction (factors number 9, 11 and 12).

The Exercise of Due Diligence by the Seller

Factor number 1 is satisfied. The disposition is authorized by applicable law and the respective boards of the Sellers have taken the appropriate corporate action to authorize the transfer of assets to HCA Sub. *See* O.C.G.A. §§ 14-3-302, 14-3-1202. With respect to factor number 2, there are no major donors who have contributed over $100,000 to MCHSW.

The due diligence factor numbers 3 and 4 necessitate review of the process and procedures employed by the Seller "in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition." O.C.G.A. § 31-7-406(3). In this instance, the Seller exercised appropriate due diligence in its selection process because the evidence shows that a formal, comprehensive Request for Proposals ("RFP") was conducted by the Seller with the assistance of professional consultants. Offers were solicited from thirty-four (34) local and regional healthcare organizations. Of those thirty-four (34) potential purchasers, twenty-five (25) expressed interest and six (6) submitted formal proposals. The Board met separately with four (4) of the bidders as finalists. The deliberative process employed by the Board in selecting the proposal of HCA Holdings demonstrates the exercise of due diligence, consistent with factors number 3 and 4.

Since there is no separate management or services contract negotiated in conjunction with the proposed transaction, factor number 8 is not applicable to the determination of the Seller's exercise of due diligence.

Conflicts of Interest

The disclosure of any conflict of interest involving the Sellers, their chief executive officers and their expert consultants are required to be considered under factor number 5. Conflict of interest certifications, as required by the Act and the notice filing requirements of the Attorney General, have been filed by members of the governing board of MCHSW, by the chief executive officer of MCHSW and by MCHSW's expert consultant. In addition, certifications have been filed by the board members of Mayo Jacksonville and its chief executive officer. Certifications have also been filed by the board members of the Authority. Such certifications do not disclose any impermissible conflicting financial interest in the proposed transaction.

With regard to factor number 13, health care providers will not be offered an opportunity to invest or own an interest in the Hospital. Therefore, factor number 13 is not applicable.

Valuation of the Hospital Assets

Factors number 6, 7 and 10 involve a determination of the value of the Hospital and the consideration to be paid in the proposed transaction. For the purposes of factor number 6, the sale of the Hospital to HCA Sub, a for-profit purchaser, implicates a "fair value" determination. Factor number 6 requires consideration of:

> Whether the seller or lessor will receive fair value for its assets, including an appropriate control premium for any relinquishment of control or, in the case of a proposed disposition to a not-for-profit entity, will receive an enforceable commitment for fair and reasonable community benefits for its assets

O.C.G.A. § 31-7-406(6).

The use of the disjunctive "or" in factor number 6 distinguishes the valuation determination relating to the sale of hospital assets to a *for-profit* purchaser from the valuation determination relating to the sale of hospital assets to a *not-for-profit* purchaser. The question of "whether a seller or lessor will receive fair value for its assets" by necessity must apply to the sale of hospital assets to a for-profit purchaser, since this qualification precedes the clause *"or,* in the case of a proposed disposition to a *not-for-profit entity,* [the seller or lessor] will receive an enforceable commitment for fair and reasonable community benefits for its assets." (Italics and parenthetical supplied.)

While the term "fair value" is not defined in the Act, it is reasonable to conclude that fair value means "fair *market* value," since the Act is concerned with the sale or lease of real, personal and intangible property. Moreover, under a separate provision of the Act, board members and the chief executive officer of the nonprofit seller corporation must provide a certification "stating that the nonprofit corporation has received fair *market* value for its assets or, in the case of a proposed disposition to a not-for-profit entity or hospital authority, stating that the nonprofit corporation has received an enforceable commitment of fair and reasonable community benefits for its assets." O.C.G.A. § 31-7-403(b)(3). (Emphasis supplied.) The reference to "fair market value" in this separate, but related, provision of the Act with otherwise substantively similar language to the language of factor number 6 suggests that the term "fair value" in factor number 6 should be read as "fair market value," in order to apply the Act's provisions consistently, especially since "fair market value" is the more descriptive and specific term. Thus, when the provisions of the Act are read in *pari materia* and in context, the term "fair value" should be construed to mean "fair market value."

As provided in more detail above, the price for the acquisition of the Hospital's assets is $51.1 million. In its valuation analysis, Principle determined that the fair market value of the Hospital's assets was between $45 million and $51.1 million. Deloitte performed a number of sensitivity analyses related to Principle's assessment of fair market value and concluded that the analyses used by Principle were reasonable and consistent with industry standards.

Factor 7 examines whether charitable assets are placed at "unreasonable risk" if the transaction is financed in part by Sellers. Since the Seller is not financing any part of this transaction, factor 7 is inapplicable. The proposed transaction complies with factor number 10 because the APA provides MCHSW with a right of first refusal for ten (10) years from the effective date of the closing of the transaction. MCHSW has committed, through a newly created nonprofit organization, to maintain adequate reserves for the purpose of exercising its right of first refusal and enforcing HCA Sub's community obligations, if necessary.

Charitable Purpose of the Proposed Transaction

With respect to the charitable purpose of the proposed transaction, factor number 9 requires that the disposition of proceeds be used for charitable health care purposes consistent with the nonprofit's original purpose. The testimony and documents filed disclose that the Sellers will form a new charitable organization which will maintain and apply MCHSW's sales proceeds and restricted reserves to: (i) ensure the continuity of a community hospital and nursing home services in the community; (ii) provide scholarships to students throughout the community who intend to pursue careers in healthcare; (iii) support other social welfare and charitable programs to improve health and wellness in the community, including healthcare transportation initiatives for patients in the community, educational seminars, cancer screenings, and initiatives directed to indigent and uninsured populations; and (iv) enforce MCHSW's right of first refusal, if necessary.

The other two charitable purpose factors, factor numbers 11 and 12, concern the purchaser's commitment to provide (a) continued access to affordable care, (b) the range of services historically provided by the seller, (c) health care to the disadvantaged, the uninsured and the underinsured and (d) benefits to the community to promote improved health care. The Purchaser has made a fifteen (15) year commitment to operate an acute care hospital and to provide emergency room services. Gregg Gerken, the Vice President of Development with HCA in Nashville, testified that the emergency room will remain open 24 hours a day, seven days a week. In addition, the Purchaser has made a ten (10) year commitment to continue to provide Medicare and Medicaid and to contribute funds toward a community benefit fund. The Purchaser has also made a five (5) year commitment to continue core services and to continue the existing charity care policies of MCHSW. Thereafter, the charity care policies of HCA Holdings' affiliated hospitals will be adopted as long as those policies comply with the existing requirements of Georgia law. In addition to the consideration purchase price of $51.1 million, the Purchaser has also made an additional five (5) year commitment of $21.6 million in capital expenditures. The Hospital will continue to serve uninsured, underinsured and indigent patients without regard to ability to pay. The evidence, taken as a whole, demonstrates an enforceable commitment to improve health care in the community and to assure continued access to affordable care.

III.

CONCLUSION

Upon review of the public record and in accordance with the Hospital Acquisition Act, the Hearing Officer finds that the public record in this matter discloses that the parties have taken appropriate steps to ensure (a) that the transaction is authorized, (b) that the value of the charitable assets is safeguarded and (c) that any proceeds of the transaction are used for appropriate charitable health purposes.

This 24TH day of March, 2017.

Julie Adams Jacobs

JULIE ADAMS JACOBS
Senior Assistant Attorney General
Hearing Officer

APPENDIX A

(1) Whether the disposition is permitted under Chapter 3 of Title 14, the Georgia Nonprofit Corporation Code,' and other laws of Georgia governing nonprofit entities, trusts, or charities;

(2) Whether the disposition is consistent with the directives of major donors who have contributed over $100,000.00;

(3) Whether the governing body of the nonprofit corporation exercised due diligence in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition;

(4) The procedures used by the nonprofit corporation in making its decision to dispose of its assets, including whether appropriate expert assistance was used;

(5) Whether any conflict of interest was disclosed, including, but not limited to, conflicts of interest related to directors or officers of the nonprofit corporation and experts retained by the parties to the transaction;

(6) Whether the seller or lessor will receive fair value for its assets, including an appropriate control premium for any relinquishment of control or, in the case of a proposed disposition to a not-for-profit entity, will receive an enforceable commitment for fair and reasonable community benefits for its assets;

(7) Whether charitable assets are placed at unreasonable risk if the transaction is financed in part by the seller or lessor;

(8) Whether the terms of any management or services contract negotiated in conjunction with the transaction are reasonable;

(9) Whether any disposition proceeds will be used for appropriate charitable health care purposes consistent with the nonprofit corporation's original purpose or for the support and promotion of health care in the affected community;

(10) Whether a meaningful right of first refusal to repurchase the assets by a successor nonprofit corporation or foundation has been retained if the acquiring entity subsequently proposes to sell, lease, or transfer the hospital to yet another entity;

(11) Whether sufficient safeguards are included to assure the affected community continued access to affordable care and to the range of services historically provided by the nonprofit corporation;

(12) Whether the acquiring entity has made an enforceable commitment to provide health care to the disadvantaged, the uninsured, and the underinsured and to provide benefits to the affected community to promote improved health care; and

(13) Whether health care providers will be offered the opportunity to invest or own an interest in the acquiring entity or a related party, and whether procedures or safeguards are in place to avoid conflicts of interest in patient referrals.