OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE SALE OF ST. FRANCIS HOSPITAL, BY ST. FRANCIS HOSPTIAL, INC., AS SELLER, TO ST. FRANCIS HEALTH, LLC, AN INDIRECT WHOLLY OWNED SUBSIDIARY OF LIFEPOINT HEALTH INC., AS PURCHASER	* * * * * * * * *	NO. AG 2015-05

REPORT OF FINDINGS

I.

BACKGROUND

ST. FRANCIS MEDICAL CENTER

St. Francis Hospital, Inc. ("Seller" or "St. Francis"), is a Georgia nonprofit corporation which owns and operates St. Francis Hospital (the "Hospital"), a 376 bed acute care hospital, which includes an 84 bed psychiatric/behavioral health unit known as The Bradley Center. The Hospital is located at 2122 Manchester Expressway, Columbus, Georgia and The Bradley Center is located at 2000 16th Avenue, Columbus, Georgia. The Hospital, founded in 1950, provides outpatient and inpatient medical/surgical services, including 24-hour emergency department services, obstetrics and gynecology, inpatient and outpatient surgery, advanced diagnostic imaging services, critical care services, and cardiac services, including cardiovascular surgery. The Hospital's primary service area includes Chattahoochee, Harris, Marion, Meriwether, Muscogee, Stewart, Talbot, and Troup Counties in Georgia, as well as, counties in the State of Alabama.

St. Francis also owns, through wholly owned subsidiaries, Home Medical Equipment of St. Francis, a durable medical equipment provider, a retail pharmacy, multiple physician practices, and real property, including medical office building property.

THE DISPOSITION PROCESS

In October of 2014, St. Francis discovered material misstatements in its historical financial statements. As a result, St. Francis ended up writing down the net assets (equity) of the organization by $37.7 million. Adjustments posted were to net patient accounts receivable, estimated amounts due from third party payers, accounts payable, accrued liabilities, including estimated professional liability insurance, and depreciation. Based on these revisions and the Hospital's poorer than expected operational performance, St. Francis' liquidity was at critical levels by the end of 2014. With less than one month of cash on hand and lines of credit fully drawn, St. Francis could not meet its debt obligations or capital expenditure needs. Moreover, St. Francis, by the end of 2014, was in technical default on a $228 million loan undertaken to improve Hospital facilities.

Based on the financial difficulties facing the Hospital, the Board of Trustees (the "Board") began searching for a strategic partner in December 2014. Initially, the Board reached out to regional healthcare providers such as Northside Hospital, Inc., Emory Healthcare, Inc., and Piedmont Healthcare, Inc. In addition, St. Francis also reached out to Community Health Systems ("CHS") and LifePoint Health Inc., ("LifePoint") in January 2015. The Board initially targeted nonprofit health systems based on the belief that a nonprofit culture would be the best fit for the organization. The only nonprofit regional player to execute a Letter of Intent, with key terms including a loan to St. Francis for the purposes of liquidity, was Piedmont Healthcare, Inc. ("Piedmont"). The Letter of Intent with Piedmont was executed in January 2015. However, by March 2015, discussions between St. Francis and Piedmont came to an end as they could not reach an agreement on deal terms due to existing debt structure at St. Francis and could not reach an agreement on loan terms due to existing liens.

Once it became evident that St. Francis and Piedmont would not be able to reach an agreement, the Board engaged Huron Transaction Advisory, LLC ("Huron") to manage an official sale process of the Hospital. Huron made initial contact with at least eight (8) potential purchasers. However, due to St. Francis' liquidity crisis and Piedmont's withdrawal, the Board began to expedite its search for a purchaser to avoid bankruptcy. By March 16, 2015, CHS and LifePoint expressed interest in the purchase of

St. Francis and proceeded under an accelerated due diligence timeline. The Board selected CHS' proposal and executed a Letter of Intent based on CHS' willingness to promptly commit, consideration under the proposal, and an immediate deposit for liquidity purposes. [1] After conducting further due diligence, the terms and conditions set forth in the Letter of Intent were altered by CHS, which resulted in a significant reduction in the proposed purchase price.[2] As a result, CHS and St. Francis negotiations broke down.

In July 2015, the Board decided to re-engage discussions with LifePoint. As a result, LifePoint provided a Letter of Intent on July 21, 2015, the terms of which included $5 million in cash for liquidity purposes and purchase consideration of approximately $235 million. Subsequently, LifePoint continued its due diligence process and both parties began negotiating an Asset Purchase Agreement ("APA").

THE PROPOSED TRANSACTION

The APA provides that St. Francis will sell substantially all of its assets to St. Francis Health, LLC, a wholly owned subsidiary of LifePoint.[3] Furthermore, as outlined in the APA, LifePoint shall assume and pay certain liabilities of St. Francis, which will be the basis of the consideration for the proposed transaction. The aggregate consideration of the proposed transaction is approximately $271 million, which includes an immediate infusion of $5 million for liquidity purposes.

Under the APA, St. Francis' assets include the Hospital, hospital buildings, equipment, supplies and inventory used in the operation of the Hospital, all tangible personal property, real property, leases, leasehold interests, certain contractual or property rights related to the operation of the Hospital, accounts receivable, rights to payments, rights to all state, federal, special or local licenses or permits, software, software licenses, deposits, escrows, prepaid expenses, and other assets outlined in the

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[1] The proposal submitted by CHS included consideration of approximately $280 million and a $5 million loan for liquidity upon execution of a Letter of Intent.

[2] CHS has initiated a civil action against St. Francis in the United States District Court for the Middle District of Georgia asserting various claims with regard to its Letter of Intent with St. Francis.

[3] St. Francis Health, LLC, a wholly owned subsidiary of LifePoint Health Inc., is the "Buyer" under the APA, and therefore, for purposes of this report, it is referred to as LifePoint.

APA. In exchange for these assets, LifePoint agrees to pay off certain of St. Francis' liabilities as designated under the APA. Specifically, LifePoint will pay off a $228 million loan secured by a mortgage and first priority security interest on certain assets of the Hospital. The loan, undertaken by St. Francis for capital expenditures to improve Hospital facilities, is serviced by Prudential Huntoon Paige Associates, LLP and insured by the United States Department of Housing and Urban Development ("HUD"). Other liabilities to be paid off or assumed by LifePoint include payoff of a line of credit and short term debt loans with CB&T Bank of Middle Georgia, payoff debt owed under St. Francis' 457(f) Deferred Compensation Plan, assumption of current paid time off obligations to St. Francis employees, and financial satisfaction of certain known claims associated with regulatory matters.

Pursuant to the APA, LifePoint has also committed to maintain and operate the Hospital as a general acute care hospital, including the emergency department and core services, for a period of five (5) years following the transaction closing date.[4] LifePoint will also adopt the Hospital's current charity and indigent care policies. Additionally, LifePoint has agreed to offer at-will employment to all non-physician employees, subject to customary pre-employment screening procedures, who are active employees of St. Francis as of the closing date of the proposed transaction. As for physician employees, LifePoint has agreed to assume all physician contracts subject to customary screening procedures and due diligence. Furthermore, LifePoint will appoint and maintain an advisory board for the Hospital consisting of members of the medical staff of the Hospital, local community representatives, certain members of the current Board, and the Hospital's Chief Executive Officer.

VALUATION ANALYSIS

Hammond Hanlon Camp LLC ("H2C") was retained by St. Francis to provide a Fairness Opinion to the Board with respect to the proposed transaction between St. Francis and LifePoint. H2C provided a report to St. Francis with respect to the fairness, from a financial point of view, of the consideration to be provided by LifePoint, as

[4] This transaction is scheduled to close on December 31, 2015.

outlined in the APA. Mr. Richard Bayman of H2C testified at the public hearing held on November 24, 2015.

In order to determine the fairness of the proposed transaction, H2C first determined the total consideration to be received by St. Francis. In its report, H2C calculated the total consideration for the proposed transaction at approximately $271 million. The total consideration consists of the assumption of closing debt repayment, deferred compensation liability, tail insurance coverage, seller transaction costs, CHS liability, and other non-working capital liabilities by LifePoint. H2C also took into account the $5.0 million in liquidity, or earnest money, provided to St. Francis by LifePoint once the Letter of Intent was executed. As a result, H2C concluded the total consideration, and therefore enterprise value, of St. Francis to be $271 million.

Once H2C determined the total consideration of the proposed transaction, it conducted a valuation analysis to determine whether the terms of the proposed transaction are fair from a financial point of view. There are three approaches to value typically considered in a valuation analysis. The three approaches are: (1) the Income Approach, (2) the Cost Approach, and (3) the Market 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 Cost Approach, value is estimated based on the value of all of the subject business' underlying assets, both tangible and intangible, net of liabilities. With the Market Approach, value is derived through a comparison of transaction prices for similar assets trading in the marketplace. The comparison is typically of transactions involving transfers of 100% ownership interests or valuations related to publicly-traded companies in similar lines of business.

In its analysis, H2C considered all three approaches to value, but relied only upon the Market Approach in reaching its conclusion of fairness as to the total consideration in the proposed transaction.[5] Under the Market Approach, H2C utilized the Guideline

[5] H2C determined that the Income Approach was not appropriate because St. Francis did not provide a multi-year forecast, and, a discounted cash flow was not appropriate given the negative cash flows at St. Francis. H2C also declined to use the Cost Approach as the Hospital was going to continue to operate as a "going concern." As

Public Companies ("GPC") and Guideline Transactions ("GT") methods. The GPC method utilizes the revenue and earnings multiples to compare the subject hospital to publicly traded companies (adjusted for illiquidity and financial distress) to derive an indicated range of value. In applying the GPC method, H2C identified and calculated valuation multiples based on financial data obtained for five (5) publically-traded guideline companies. H2C adjusted these multiples by applying a 50% discount to account for the lack of liquidity associated with private companies and to reflect the distressed nature of St. Francis. Under the GPC method, H2C arrived at an enterprise value to revenue median multiple of 0.6x, and a median EBITDA multiple of 4.4x. H2C also calculated multiples for the proposed transaction arriving at a revenue multiple of .77x, and an EBITDA multiple of 17.9x.

Under the GT method, consideration is given to the purchase prices paid in recent comparable hospital transactions to determine transaction multiples. In applying the GT method, H2C identified and calculated valuation multiples based on transactions with similar financial circumstances to St. Francis with net revenue between $100 million and $500 million and EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) margins less than 3%. Within the 27 transactions analyzed by H2C, the price revenue multiple ranged from a median of .59x to the 75th percentile of .96x.

Ultimately, H2C, after comparing the calculated multiples for the proposed transaction to the multiples calculated under the GPC method and GT method, concluded that the total consideration to be received by St. Francis is fair from a financial point of view.

In accordance with O.C.G.A. § 31-7-405(b), Deloitte Transactions and Business Analytics LLP ("Deloitte") was retained as an independent financial advisory consultant by the Attorney General to assist in the review of the proposed transaction between St. Francis and LifePoint. The Attorney General engaged Deloitte to provide valuation advisory services, but not to provide a separate valuation or a fairness opinion. Mr. Jimmy Peterson, a Principal at Deloitte, specializing in health care valuations, testified at the hearing. As part of its engagement, Deloitte held discussions with representatives of

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such, H2C determined that it was not necessary to appraise the Hospital's physical assets, replacement cost of the assets, or their "highest and best use."

all the parties involved in the proposed transaction and performed independent research and analyses to review the conclusions contained in H2C's Fairness Opinion of the proposed transaction.

In its review, Deloitte confirmed that the Market approach used by H2C to value St. Francis is consistent with generally accepted industry standards for valuation analysis. Deloitte analyzed H2C's valuation of St. Francis using both the GPC and GT methodologies. As for the analysis under the GPC method, Deloitte determined that H2C's chosen comparable company set was appropriate and consistent with Deloitte's expectations. In addition, Deloitte opined that H2C's adjustments to the market multiples in order to apply them to St. Francis metrics did not seem inappropriate and resulted in revenue and EBITDA multiple ranges consistent with Deloitte's experience in the marketplace. Deloitte ultimately concluded that the range of values estimated by H2C using the GPC method was below or within the range of total consideration utilized by H2C.

Deloitte also analyzed H2C's valuation of St. Francis using the GT method and determined that H2C's analysis was consistent with Deloitte's expectations and typical market perspectives. During the course of Deloitte's analysis of H2C's GT method, Deloitte conducted independent research of valuation multiples for comparable hospital transactions and performed sensitivity analyses of the valuation multiples utilized in H2C's report. Deloitte found that within the twenty-seven (27) transactions used by H2C, the price / revenue multiple ranged from a median of 0.46x to the 75^{th} percentile of 0.60x, compared to H2C's multiple range of a median of 0.59x to the 75^{th} percentile of 0.96x. Based on this independent research and analysis, Deloitte indicated that the valuation multiples implied by H2C's calculations of value for St. Francis were consistent with Deloitte's observations.

In sum, Deloitte concluded that based on its independent market research of hospital transactions and sensitivity analysis, as well as its review of St. Francis' operations and balance sheet, the valuation market multiples utilized by H2C to test the fairness of the total consideration to be received by St. Francis appear appropriate and consistent with typical valuation methodologies and approaches.

PUBLIC COMMENT

The public hearing was held on November 24, 2015, at 5:00 p.m. in the Sara Ruth Carroll Auditorium at the Hospital, located at 2300 Manchester Expressway, Columbus, Georgia 31904. Pursuant to O.C.G.A. § 31-7-404, notice of the public hearing was published in the *Columbus Ledger-Enquirer* on October 13, 2015 and October 19, 2015. There were six (6) public comments made at the hearing; five (5) comments were in favor of the proposed transaction and one (1) inquiry was directed at LifePoint regarding community outreach and the rehiring of employees previously terminated by St. Francis. There were no comments in opposition to the proposed transaction.

Following the public hearing, the record was held open until the close of business on November 30, 2015, at 5:00 p.m., for any further public comment. This Office received two written public comments after the public hearing in support of the proposed transaction. Counsel for the Seller and Purchaser were requested to inform this Office in writing before the record closed, 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 *et seq.*; *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 (13) 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 (13) factors set forth in O.C.G.A. § 31-7-406 can be grouped into four (4) 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

The disposition of the Hospital is authorized by applicable law as provided in factor number 1, and St. Francis has taken the appropriate actions to sell the Hospital. O.C.G.A. §§ 14-3-302, 31-7-400 *et seq.* With respect to factor number 2, there were several donors who have contributed over $100,000. The proposed transaction appears to be consistent with the donative documents. Furthermore, LifePoint has agreed to honor all naming opportunities that resulted from past charitable contributions to St. Francis.

The due diligence factors number 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, St. Francis exercised appropriate due diligence in its selection process given the financial condition of the Hospital and its desire to avoid bankruptcy. As discussed in detail above, St. Francis reached out to numerous health systems and engaged Huron to locate potential partners. However, due to its liquidity crisis, St. Francis found it necessary to accelerate its search for a purchaser to avoid bankruptcy. St. Francis entered into executed Letters of Intent with Piedmont and CHS, however, negotiations regarding the terms and conditions of the proposed sale ultimately deteriorated. Subsequently, the Board of Trustees re-engaged in discussions with LifePoint, which resulted in an executed Letter of Intent. As such, given its financial condition, the deliberative process employed by St. Francis in locating a purchaser 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 Seller's exercise of due diligence.

Conflicts of Interest

The disclosure of any conflicts of interest involving the Sellers, the Chief Executive Officer of the Hospital and its expert consultant is 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 the Hospital and by the Interim Chief Executive Officer of the Hospital. Such certifications do not disclose any impermissible conflicting financial interest in the proposed transaction.

A conflict of interest certification was also filed by the expert consultant retained by St. Francis, C. Richard Bayman, Principal at Hammond Hanlon Camp, LLC ("H2C"). H2C disclosed that it is currently engaged by Tenet Healthcare Corporation ("Tenet") in the sale of certain assets held by Tenet to DLP Healthcare, LLC, a joint venture formed by Duke University Health System, Inc. and LifePoint. H2C's certification does not disclose any substantive or 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

The value of the Hospital and the amount of consideration to be paid in the proposed transaction must be weighed under factors number 6, 7 and 10. In a sale of hospital assets from a nonprofit corporation to a for-profit corporation, the nonprofit seller should receive "fair value" for its assets. *See* O.C.G.A. § 31-7-406(6).

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. Likewise, under factor number 13, 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 added.) The reference to "fair market value" in this separate, but related, provision of the Act 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."

Collectively, the Fairness Opinion analysis and conclusions developed by H2C, as reviewed by Deloitte, indicates that the valuation multiples implied by the proposed consideration of $270 million are within the range of valuation multiples observed for comparable hospital transactions in the marketplace. Additionally, Deloitte observed that H2C used reasonable valuation methods and techniques in its analysis of the proposed transaction to support its conclusion. Based on the record, it appears St. Francis will receive fair market value for its assets as required by the Act.

Since the Seller is not financing any portion of the proposed transaction, factor number 7 is not applicable. The proposed transaction complies with factor number 10 because the APA provides St. Francis with a right of first refusal, to be exercised within three (3) years of closing, to purchase the Hospital and its assets from LifePoint in the event LifePoint decides to consider a third-party offer to purchase the Hospital.

<u>Charitable Purpose of the Proposed Transaction</u>

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 consideration of the proposed transaction largely consists of the payment of existing secured indebtedness and assumption of liabilities by LifePoint. It does not appear that there will be any monetary proceeds generated by the proposed transaction after the indebtedness is paid off and satisfied.

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. William F. Carpenter III, Chairman and Chief Executive Officer of LifePoint, testified that the emergency room will remain open 24 hours a day, seven days a week, 365 days a year. In addition, LifePoint has agreed not to eliminate core services currently offered at the Hospital for a period of five (5) years. The Hospital will also continue to accept Medicare and Medicaid. In addition, St. Francis will adopt the charity and indigent care policies currently in place at the Hospital. 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 18th day of December, 2015.

ALKESH B. PATEL
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.