

OFFICE OF THE ATTORNEY GENERAL  
STATE OF GEORGIA

IN THE MATTER OF THE SALE OF \*  
WALTON REHABILITATION HOSPITAL \* NO. AG-2012-2  
TO HEALTHSOUTH WALTON \*  
REHABILITATION HOSPITAL, LLC \*  
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**REPORT OF FINDINGS**

**I.**

**BACKGROUND**

**WALTON REHABILITATION HOSPITAL**

Walton Rehabilitation Hospital (the "Hospital") is a fifty-eight bed rehabilitation hospital located in Augusta, Richmond County, Georgia. The Hospital is operated by Georgia Rehabilitation Institute, Inc. ("GRI"). The Hospital's primary service area is Columbia, Richmond, Burke, Warren, McDuffie and Glascock counties in Georgia; and Aiken and Edgefield counties in South Carolina. Under the proposed transaction, HealthSouth Walton Rehabilitation Hospital, LLC ("HealthSouth"), a Delaware for-profit limited liability company, will purchase the Hospital for \$33,000,000.00 in cash subject to certain adjustments discussed herein.

**THE DISPOSITION PROCESS**

GRI utilized a request for proposal process to obtain proposals from interested parties. GRI issued a request for proposals to a list of recipients that it, in conjunction with its consultant, determined might have interest in a purchase of the Hospital. Of the parties that submitted responses, GRI then narrowed the list of interested parties and engaged in negotiations with three of the parties. GRI ultimately reached an agreement with HealthSouth as presented in this matter.

**THE PROPOSED TRANSACTION**

Under the terms of the transaction, GRI will sell the Hospital to HealthSouth for \$33,000,000.00. Pursuant to a proposed First Amendment to Asset Sale Agreement, the purchase price of \$33,000,000 is subject to certain adjustments including a reduction based on

the amount of annual leave of hired employees and the value of certain accounts receivable retained by GRI. There is also an amount that is set aside from the purchase price for a Survey Expense Fund related to the payment of expenses associated with HealthSouth obtaining a Medicare provider number. The Survey Expense Fund is to be paid to GRI once the appropriate expenses are paid from that Fund.

### **FINANCIAL ANALYSIS**

Under O.C.G.A. § 31-7-406(6), a transaction involving the acquisition or disposition of the assets of a nonprofit hospital to a for-profit entity requires the Attorney General to make a determination as to whether the seller “will receive fair value for its assets . . . .” GRI engaged the firm of Pershing Yoakley & Associates, P.C. (“PYA”) to perform a valuation analysis of the Hospital and to assess the value resulting from the transaction. PYA reviewed the transaction under O.C.G.A. § 31-7-406(6), which requires that the seller or lessor in a disposition of a nonprofit hospital to “receive fair value for its assets.”

Pershing Yoakley & Associates, P.C. (“PYA”) was jointly engaged by GRI and HealthSouth to perform an independent fair market value analysis of the Hospital as of October 31, 2012. PYA employed a standard of fair market value, defined as:

[T]he price at which the property or service would change hands between a willing buyer and a willing seller, neither being under compulsion to buy or sell and both having reasonable knowledge of the relevant facts.

There are typically three approaches considered in valuation: the income approach, the market approach, and the asset (cost) approach. The income approach is based on the concept that 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 trading in the marketplace. In the asset (cost) based approach, value is estimated based on the value of all of the subject business’s underlying assets, both tangible and intangible.

In its valuation, PYA considered the income, market and asset (cost) methods, with a primary concentration on the income and market approaches, to estimate the fair market value of

the Hospital.<sup>1</sup> David McMillan, principal of PYA, testified at the public hearing. Under the income approach, PYA used the discounted cash flow method, which “provides an indication of value based on the entity’s ability to generate economic benefits (i.e., net cash flow) for its owners.” The projected net cash flow is discounted to a present value using an appropriate risk-adjusted discount rate. Under the discounted cash flow method, PYA utilized various forecast assumptions and a discount rate of 12.54% which resulted in its conclusion that the Hospital’s fair market value is approximately \$14.7 million.

Under the market approach, PYA considered both the guideline transaction method and the guideline public companies method to arrive at additional indications of value for the Hospital.<sup>2</sup> In connection with the guideline transaction method, PYA located three comparable transactions involving inpatient rehabilitation facilities and arrived at an indicated value of approximately \$15.9 million for the Hospital.<sup>3</sup> Pursuant to the guideline public companies method, PYA considered three publicly traded US companies and, after adjusting for the differences between public companies and privately owned companies such as the Hospital, arrived at an indicated value of approximately \$9.3 million for the Hospital.

After arriving at three different indications of value for the Hospital ranging from \$9.3 million to \$15.9 million, PYA opined that the \$14.7 million value resulting from the discounted cash flow method under the income approach provides the “most reliable indication of value in this particular case because it is based on the economic benefits that a hypothetical buyer would expect to receive.” Ultimately, PYA concluded that the fair market value of the Hospital, based on a 100% interest, is approximately \$14.0 million to \$15.4 million, which after excluding cash anticipated to be retained by the seller, results in a fair market value range of \$13.2 million to \$14.6 million.

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<sup>1</sup> In its report, PYA stated it did not apply the asset (cost) approach because this method is “generally not appropriate for operating entities with positive cash flow, such as [GRI], since the intangible value of the business is not captured.”

<sup>2</sup> The guideline transactions method relies on data derived from transactions of companies that have recently been acquired, either by a tender offer or in a private transaction, whereas the guideline public companies method relies on data from transactions in the stock of publicly-traded companies.

<sup>3</sup> PYA located transactions in the Pratt’s Stats® Private Transaction Database and Irving Levin’s Healthcare Services Acquisitions Reports.

The Attorney General was assisted by the firm of Ernst and Young, LLP (“EY”) in the review of PYA’s determination of market value. The Attorney General engaged EY to provide valuation advisory services, but not to provide a separate valuation or a fairness opinion. Bridget Bourgeois, a partner at EY, testified at the public hearing. In its review, EY confirmed that the income, market, and asset (cost) approaches to value applied by PYA are consistent with generally accepted industry standards for valuation analysis. EY also agreed with PYA’s decision not to apply the asset (cost) approach as it is typically not relied upon in valuing a hospital as a going concern. In the course of its engagement, EY analyzed PYA’s underlying valuation methodologies and assumptions, performed a number of sensitivity analyses, and tested the impact to value of PYA’s conclusions by changing certain assumptions employed by PYA in its analysis.

In order to analyze PYA’s valuation of the Hospital under the income approach, EY performed a sensitivity analysis under which EY changed some of the assumptions PYA had employed in its discounted cash flow method. After the adjustments, EY found a range of value for the Hospital of approximately \$25.0 million to \$33.0 million excluding cash and accounts receivable, as opposed to PYA’s approximate value of \$13.2 million to \$14.6 million including accounts receivable.

In its review of PYA’s analysis under the market approach, EY researched the enterprise value multiples of transactions involving similarly situated specialty hospitals and other healthcare providers outside the acute care specialty, as well as the valuation multiples for selected guideline publicly traded companies. As a result of this analysis, EY concluded that the valuation multiples implied by the proposed purchase price are significantly higher than the multiples implied by PYA’s value for the Hospital.

EY concluded that PYA utilized valuation methodologies and techniques that are commonly employed to support its valuation of the Hospital. Based on its independent analysis and research, EY further indicated that the valuation multiples implied by the proposed purchase price are significantly higher than the multiples implied by PYA’s value for the Hospital, which appears to support the conclusion that the consideration GRI will receive under this transaction significantly exceeds the fair market value of the Hospital as determined by PYA.

## PUBLIC COMMENT

The public hearing was held on February 19, 2013, at 1:00 p.m. in Richmond County, Georgia, at the Augusta Richmond County Justice Center. No public comments were received during the hearing.

Following the public hearing, the record was held open until the close of business on Friday, February 22, 2013. No comments were received.<sup>4</sup> Counsel for GRI and HealthSouth were requested to inform the undersigned in writing by the close of business on Friday, February 22, 2013, as to whether their respective clients intended to proceed with the proposed transaction as structured or modify the proposed transaction in some respect. On February 22, 2013, counsel for both parties submitted 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).<sup>5</sup> 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

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<sup>4</sup> The undersigned has received a few questions from one person by telephone since the close of the record. The undersigned advised the caller that she could submit a written comment even after the close of the record, but no comment has been received.

<sup>5</sup> The hearing in this matter was held in Richmond County where the Hospital is located.

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, as the disposition of the Hospital is authorized by applicable law. O.C.G.A. § 14-3-302. With regard to factor number 2, it does not appear that the proposed disposition is inconsistent with the directives of any major donors who have contributed over \$100,000.00. Exhibit P to the Notice to the Attorney General in this matter sets forth detailed information regarding donations to benefit the Hospital. The information provided does not reveal any directives or restrictions related to contributions that are inconsistent with the proposed disposition.<sup>6</sup>

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). GRI did conduct a formal process for the solicitation of proposals. The Notice filed by GRI provides a detailed description of the decision to sell and the process utilized to reach the proposed transaction. GRI also provided detailed testimony regarding the decision to sell and the process utilized. (Transcript, pp. 6-17).

Beginning in January of 2011, the Board of GRI created a sub-committee regarding the market dynamics impacting the utilization of the Hospital’s programs and services. The sub-committee evaluated various information and identified six priorities for immediate action. During February, March and April of 2011, GRI took various actions to address the six priorities. In May of 2011, the Board of GRI discussed strategies regarding the long-term viability of the

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<sup>6</sup> It is notable that Section 5.12 of the Asset Purchase Agreement requires HealthSouth to maintain certain names of parts of the Hospital and to maintain certain plaques or other signs that recognize donations to the Hospital or other dedications.

Hospital. The Board considered various options including establishing a strategic partnership with a local provider or providers, establishing a joint venture, or selling the Hospital to a local or national provider. At that time, the Board determined to continue operating the Hospital in the then-current manner and to re-evaluate in October of 2011 to determine if additional options should be considered.

In October of 2011, the Board determined to move forward with exploring a strategic partner and requested that a draft invitation letter be composed and a recommendation listing of invitees be prepared. In November of 2011, the Board approved a letter of invitation to be sent to a number of providers. The Board also initiated follow-up contacts with local providers that received the letter. In January of 2012, the Board received information regarding the providers that had responded to the letter. A number of providers, including HealthSouth, indicated a high degree of interest.

In February of 2012, the Board heard a presentation regarding a possible virtual collaborative relationship strategy on behalf of Georgia Health Sciences University. The Board also received information regarding providers that had expressed no interest. The Board determined to delay the release of a request for proposals until all members were fully informed and a communication plan was reviewed. In March of 2012, the Board discussed the release of the request for proposals as well as the related process and requirements. In April of 2012, the Board recapped legal discussion and the progress of matters to date. The Board also reviewed proposals from certain merger and acquisition consultants. The Board determined to have an interview with one consultant and determined to hold a meeting with representatives of Georgia Health Sciences University and University Health System to discuss plans for the Hospital and ensure that efforts at collaboration had been exhausted.

In May of 2012, GRI engaged FTI Consulting. In June of 2012, the Board reviewed and approved a prospect list for the purpose of sending out the request for proposals. Forty-two providers were identified to receive the request for proposals. Ten of the forty-two recipients of the request for proposals responded and entered into confidentiality agreements for the purpose of completing a due diligence process. Of the ten respondents, nine were for-profit and one was non-profit.

In August of 2012, the Board reviewed proposals from six respondents. The other four withdrew their interest. After reviewing the six proposals, the Board narrowed the list to

HealthSouth, Select Medical and Ernest Health and determined to invite those entities to participate in presentation, discussion and final negotiation on August 31, 2012. On August 31, 2012, the three selected respondents made presentations and participated in question and answer sessions with the Board. After consideration of the proposals, all three were invited to submit final bids. Before receiving the final bids, the Board voted award the bid to HealthSouth subject to the contingency that if any final bid from any of the other bidders was within 5% of the top bidder, the Board would reconvene for further discussion. No bid met the threshold. Therefore, the bidders were notified that HealthSouth had been selected as the winning bidder. On September 10, 2012, GRI entered into a letter of intent and exclusivity with HealthSouth.

Based on the facts in the record, I conclude that the Board utilized adequate procedures in making its decision to dispose of its assets including using the services of appropriate experts. Therefore, factor number 4 is satisfied. I further conclude that the Board exercised due diligence in deciding to dispose of the Hospital assets, selecting the acquiring entity and negotiating the terms and conditions of the disposition. Therefore, factor number 3 is satisfied.

With regard to factor number 8, there is no management services agreement in place related to the Hospital or contemplated as part of the sale. Therefore, factor number 8 is not implicated.

#### **Conflicts of Interest**

The disclosure of any conflict of interest involving the Seller, 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 Authority, by the chief executive officer of the Authority and by David McMillan for PYA. The certifications are all without exceptions.

With regard to factor number 13, the proposed transaction involves the transfer of control of a nonprofit hospital to a for-profit entity. Health care providers will not be offered an opportunity to invest or own an interest in the Hospital as part of the transaction or after the transaction. (Transcript, pp. 56-57). Therefore, factor number 13 is not applicable.

#### **Valuation of the Hospital Assets**

The factors numbered 6, 7 and 10 involve a determination of the value of the hospital assets. GRI has to receive fair value for the assets of the Hospital. *See* O.C.G.A. § 31-7-406(6).



Based on the record, including the analysis conducted by PYA on behalf of GRI and HealthSouth and the review by Ernst & Young at the request of the Attorney General as described herein, GRI will receive fair value for the assets of the Hospital, as required by the Act.

The transaction is a cash transaction. GRI is not providing any financing. Therefore, I conclude that factor number 7 is inapplicable. As to factor number 10, the Asset Sale Agreement provides in Section 9.4 that GRI has a right of first refusal to acquire the assets from HealthSouth under certain conditions within five years after the effectiveness of the Asset Sale Agreement. This is “a meaningful right of first refusal” within the meaning of O.C.G.A. § 31-7-406(10). Thus, factor 10 is satisfied.

#### **Charitable Purpose of the Proposed Transaction**

With respect to the charitable purpose of the proposed transaction, factor number 9 requires that the disposition proceeds be used for charitable health care purposes consistent with the nonprofit’s original purpose. GRI provided testimony regarding the continuing activities in which it will engage after the transaction which will be supported by the proceeds from the transaction. (Transcript, p. 25). Factor number 9 is satisfied.

The other two charitable purpose factors, 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. HealthSouth has committed to provide at least the level of charity care that has been provided in the past. (Transcript, pp. 50, 55). Section 5.9 of the Asset Sale Agreement includes a requirement that HealthSouth implement a policy for treatment of indigent patients at the Hospital that is generally consistent with the policy in place immediately prior to the effective time of the Agreement. Section 5.11 requires HealthSouth to continue to provide services sufficient to serve the community need as reasonably determined by HealthSouth. I conclude that factors 11 and 12 are satisfied.

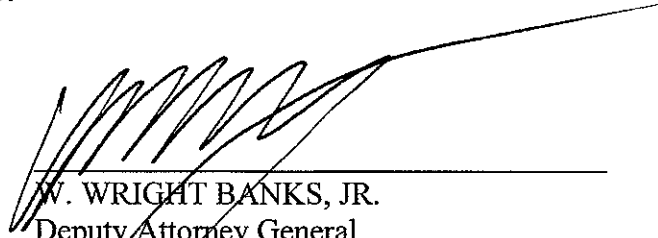
### **III.**

#### **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 that the transaction is authorized and that the value of the charitable assets is safeguarded.

This 21st day of March, 2013.



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W. WRIGHT BANKS, JR.  
Deputy 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.