

OFFICE OF THE ATTORNEY GENERAL

STATE OF GEORGIA

IN THE MATTER OF THE ACQUISITION OF
MEMORIAL UNIVERSITY MEDICAL CENTER
by SAVANNAH HEALTH SERVICES, LLC, an indirect wholly-owned subsidiary of HCA
HEALTHCARE, INC.

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* NO. AG 2017-4
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REPORT OF FINDINGS

BACKGROUND

MEMORIAL UNIVERSITY MEDICAL CENTER

Memorial Health University Medical Center, Inc., and Memorial Health, Inc.

(“Memorial”) lease certain real property, buildings, structures, facilities and improvements located in Chatham County, Georgia commonly known as Memorial University Medical Center (the “Hospital”) from the Chatham County Hospital Authority (“CCHA” or “Authority”) pursuant to a lease dated May 1, 2004 as amended on May 1, 2012.¹ The Hospital is a 612-bed acute care urban safety net tertiary care trauma center. It is located at 4700 Waters Avenue, Savannah, Georgia 31404, in Chatham County. The Hospital is a Level I trauma center, operates a children’s hospital and is the Savannah Campus for Mercer University School of Medicine. The Hospital is a regional referral center for cardiac care, cancer care, trauma, pediatrics, high-risk obstetrics and neonatology. The Hospital’s service area encompasses a 35-county area in Georgia and South Carolina.

¹ As part of the closing of the proposed transaction, the Lease will be amended a second time, but will ultimately terminate as the ownership interest of CCHA will be acquired by HCA under the proposed transaction.

Memorial and CCHA propose to sell substantially all of the assets associated with the Hospital to Savannah Health Services, LLC, an indirect wholly-owned subsidiary of HCA Healthcare, Inc. (“HCA”). Several other entities are affiliated with Memorial Health, Inc. and will participate in the transaction as sellers. In addition, HTI Hospital Holdings, Inc., an indirect wholly-owned subsidiary of HCA, will participate in the transaction as guarantor for Savannah Health Services, LLC. HCA, or its affiliates, own and operate a number of other hospitals in the State of Georgia including Cartersville Medical Center, Coliseum Medical Centers and Coliseum Northside Hospital in Macon, Doctors Hospital of Augusta, Eastside Medical Center in Snellville, Fairview Park Hospital in Dublin, Memorial Satilla Health in Waycross, and Redmond Regional Medical Center in Rome.

The sale includes substantially all of the assets of Memorial and CCHA, and affiliates of Memorial.

THE DISPOSITION PROCESS

For a number of years, Memorial has considered options for an affiliation with another hospital or healthcare system. In 2010, Memorial and CCHA had some discussions with potential partners, but no transaction came to fruition. In 2012, CCHA refinanced some of its bond indebtedness with assistance from Chatham County, but the refinancing transaction did not solve the financial issues faced by Memorial and CCHA. In 2015, Memorial and CCHA pursued a transaction with Novant Health, but the transaction did not close. After the termination of discussions with Novant Health, Memorial and CCHA formed a committee to pursue a relationship with another hospital or health care system. (Transcript, p. 15). As part of the process, CCHA engaged Ponder & Company and Memorial engaged Hammond Hanlon Camp, LLC. (Transcript, pp. 14-15).

As part of the process to pursue a transaction, CCHA and Memorial worked together and directed that Ponder and H2C work together. Ponder and H2C engaged with seventeen potential partners. Nine of the potential partners were non-profit entities and eight were for-profit entities. (Transcript, p. 45). Thirteen of the potential partners executed non-disclosure agreements and seven eventually submitted proposals. (Transcript, p. 45). Two companies, both for-profit, ultimately submitted letters of interest. (Transcript, p. 67). CCHA and Memorial worked together with H2C and Ponder and ultimately elected HCA. (Transcript, p. 47). The HCA offer was in line with the decision criteria developed by CCHA and Memorial and preferable on a financial basis. (Transcript, pp. 67-68).

THE PROPOSED TRANSACTION

As described above, the transaction provides for the complete sale of the Hospital pursuant to an Asset Purchase Agreement (“APA”). Pursuant to the APA, substantially all of the assets associated with the Hospital whether owned by CCHA, Memorial or an affiliate of Memorial will be sold to HCA.

VALUATION 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.”

Memorial retained Hammond Hanlon Camp, LLC (“H2C”) to provide assistance in the assessment of its proposed sale. William B. Hanlon, III with H2C testified at the hearing. (Transcript, p. 63).

The Attorney General retained Ernst & Young, LLP (“EY”) in accordance with O.C.G.A. § 31-7-405(b), as an independent financial advisory consultant to assist in the review of the proposed transaction. The Attorney General engaged EY to provide valuation advisory services,

but not to provide a separate valuation or a fairness opinion. Bridget Bourgeois, who specializes in healthcare valuations, testified at the hearing. As part of its engagement, EY held discussions with representatives of the parties involved in the proposed transaction and performed independent research and analyses to assist in the review of the conclusions contained in H2C's analysis of the proposed transaction.

H2C has assisted Memorial from the commencement of its strategic affiliation by marketing Memorial to nonprofit and investor-owned health systems, and advising Memorial management and the Negotiating Committee (a group comprised of Memorial's management, its Board of Directors and the Authority) throughout the process. After Memorial and CCHA elected to enter into the APA with HCA, H2C prepared a fair market valuation of Memorial and performed an analysis of the purchase consideration that Memorial and CCHA would receive from HCA under the proposed transaction.

In its report, H2C valued the total consideration for the proposed transaction at approximately \$433.3 million. H2C noted that the \$433.3 million figure was the sum of two components: (1) the base purchase price to be paid by HCA at closing of \$434.4 million, per the APA; and (2) closing net working capital adjustment of \$1.1 million.

H2C then conducted a valuation analysis to estimate the fair market value of the Hospital. There are three approaches to value typically considered in a valuation analysis: (1) the Income Approach; (2) the Cost Approach; and (3) the Market Approach. In its analysis, H2C considered all three approaches to value, but ultimately determined that the Market and Income Approaches were the most appropriate for valuing Memorial.² H2C noted that, as no single approach is

² H2C stated in its report that it considered the Cost Approach, but did not evaluate or appraise the current physical assets, the replacement cost of the assets, or the "highest and best use" of the assets, because they assumed that the business and operations of Memorial are valued as "going concern" enterprises.

considered conclusive and each approach offers certain advantages and disadvantages, it would rely on a combination of the methodologies in its fair market value analysis.

Under the Market Approach, H2C utilized Guideline 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 size, growth scale, and illiquidity) to derive an indicated range of value. In applying the GPC method, H2C identified and calculated valuation multiples based on financial data obtained for four (4) publicly traded guideline companies. H2C adjusted these multiples by applying a 30% discount to account for the lack of liquidity associated with private companies of 50% with an offsetting control premium of 20%. H2C applied the resulting adjusted median multiples of 0.85x of last twelve months (LTM) revenue and 0.83x of 2017 expected revenue, and developed a value range by applying a 10% premium and discount to the median LTM and 2017 revenue multiples. H2C then applied 50/50 weighting to the indicated value ranges to calculate the value range of \$443.7 million to \$542.4 million under the GPC method.

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 falling under a certain set of criteria similar to the proposed transaction. H2C selected the median multiples of 0.8x, 0.69x and 0.48x. H2C further developed a range of values by applying a 10% premium and discount to the selected median multiples. H2C calculated value indications for Memorial of \$338.3 million to \$413.5 million based on the GT method.

Under the Income Approach, H2C applied the Discounted Cash Flow (“DCF”) method. The DCF provides an indication of value based on the entity’s ability to generate net cash flow. The projected net cash flow is discounted to present value using an appropriate risk-adjusted

discount rate. H2C utilized projections that assume the Hospital would continue operating as a stand-alone hospital, with a discrete projection period from 2018 to 2020, and a terminal year value. H2C discounted the resulting cash flows to present value using a discount rate range of 10.0% to 12.0%. H2C also varied the terminal exit multiple by +/- 0.05x, or a range of 0.43x to 0.53x of revenue. H2C calculated a range of values under the DCF method ranging from \$177.9 million to \$235.3 million.

H2C took into consideration each of the value indications summarized above and placed equal weighting on the GPC, GT and DCF methods value range indications. Based on its analyses, H2C calculated a FMV range of \$320.0 to \$397.0 million. H2C concluded that HCA's offer of approximately \$433.3 million exceeds the concluded fair market value range of the Hospital as a stand-alone hospital.

In its review, EY confirmed H2C considered relevant valuation methods that one would expect to be applied in a valuation of a hospital. However, EY noted that, in reaching its fair market value conclusion, H2C did not include approximately \$6 million to \$7 million in value associated with real property assets (non-operating assets) that will transfer to HCA in the proposed transaction.

While EY did not conduct an independent valuation or fairness opinion, EY performed a number of sensitivity analyses of H2C's valuation to test the impact on H2C's concluded fair market value for Memorial and overall conclusion that HCA's offer exceeds the valuation range. EY adjusted H2C's valuation to include the approximately \$6 million to \$7 million in value for the non-operating assets. Even with the additional value, EY observed that, consistent with H2C's findings, HCA's estimated \$433.3 million offer is greater than H2C's adjusted valuation range of \$326.0 million to \$404.0 million for the assets that will transfer to HCA in the proposed transaction.

Lastly, based on EY's independent market research and sensitivity analyses, EY observed the valuation multiples based on H2C's fair market value range, and the multiples based their analysis of the transaction value is within the range of the valuation multiples paid in similar transactions. Although EY could not draw specific conclusions or findings regarding H2C's conclusions regarding the fair market value or the proposed consideration, EY noted that it appeared H2C used relevant valuation methods to value the operations and to analyze the proposed consideration that is to be received in the proposed transaction.

PUBLIC COMMENT

The public hearing was held on November 17, 2017 at 12:00 p.m. at Memorial University Medical Center in Chatham County, Georgia. Notice of the proposed transaction and the public hearing was provided as required by O.C.G.A. § 31-7-404.³

The public comments received during the public hearing were all in favor of the proposed transaction. In addition to the oral comments during the hearing, a number of written comments were also submitted. As required by O.C.G.A. § 31-7-405(b), William B. Hanlon, III of H2C testified on behalf of Memorial. As required by O.C.G.A. § 31-7-405(c), J. Curtis Lewis, III, the Chair of the Board of Memorial testified as did Dr. Frank P. Rossiter, the Chair of the Board of CCHA, Hugh Tappan, the Vice-President of the South Atlantic Division for HCA and Joseph Sowell, the Senior Vice-President and Chief Development Officer for HCA also testified.

³ The proposed transaction is the subject of two notices published in The Savannah Morning News which is the legal organ for Chatham County. The undersigned also provided notice to The Chair of the Chatham County Commission.

Following the public hearing, the record was held open until the close of business on Wednesday, November 22, 2017, for any further public comment. No comments in opposition to the transaction were received.

Counsel for the parties were requested to inform the undersigned in writing by the close of business on November 22, 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 the parties submitted letters stating that their clients wish to proceed with the transaction as proposed.⁴

FINDINGS

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(a) & 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 to be considered 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 are 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

The disposition of Memorial's assets and the interest of CCHA in the Hospital Facilities are authorized by applicable law as provided in factor number 1. Memorial and the CCHA have taken the appropriate steps to provide for the sale to HCA. O.C.G.A. §§ 14-3-206, 14-3-302, 31-7-75, 31-7-400 *et seq.* 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). Memorial and CCHA formed a joint committee and conducted a formal process for the solicitation and selection of proposals which is the preferred approach. Memorial and CCHA engaged professional assistance from Ponder and H2C respectively related to consideration of its business operations, conducting a process for a transaction and for analyzing the benefits to be conferred as a result of the transaction. The record supports a finding that the governing bodies of Memorial and CCHA "exercised due diligence 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). The record further supports a finding

⁴ The undersigned has been informed that the parties may make certain non-material adjustments to the APA prior to closing in order to address issues that have arisen based on the parties exchange of information in advance of closing.

of adequacy regarding “[t]he procedures used by the nonprofit corporation in making its decision to dispose of its assets” and that “appropriate expert assistance was used.” O.C.G.A. § 31-7-406(4).

There is no management agreement in this transaction within the meaning of O.C.G.A. § 31-7-406(8). Therefore, Factor number 8 is not implicated.⁵

Conflicts of Interest

The disclosure of any conflict of interest involving the Sellers, the Chief Executive Officer of the Hospital and their 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 boards of Memorial, CCHA and by Kerry R. Watson, the interim chief executive officer of Memorial. H2C and Ponder have also provided the required certifications. The certifications in the record are adequate and the disclosures do not rise to the level of creating an impermissible conflict of interest in the proposed transaction and are disclosed as contemplated by O.C.G.A. § 31-7-403(a) & (b) and O.C.G.A. § 31-7-405(b). Factor number 5 is satisfied.

With regard to factor number 13, the instant transaction involves the sale of assets of a public hospital authority and a nonprofit corporation to a limited liability company that is a wholly-controlled indirect subsidiary of HCA, a publicly-traded for-profit corporation. Healthcare 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. 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. Since this transaction involves the sale of a hospital owned by one nonprofit corporation and a public hospital authority to a for-profit limited liability company, Memorial and CCHA should receive fair value for the assets. *See* O.C.G.A. § 31-7-406(6). Based on the record, including the analysis conducted by H2C on behalf of Memorial and the review by EY at the request of the Attorney General as described herein, the purchase price reflects fair value as required by O.C.G.A. § 31-7-406(6).

Since Memorial and CCHA are not providing any financing for the transaction, factor number 7 is inapplicable. As to factor number 10, under the terms of the APA, the CCHA retains a right of first refusal to purchase the assets if HCA proposes to sell the assets. (APA, p. 92). The right of first refusal extends for a period of ten years from closing and requires HCA to provide CCHA with notice of any proposed sale transaction. (APA, p. 92). Within thirty days of receipt of a notice, CCHA is required to advise HCA whether it intends to exercise its right of first refusal and is then required to close the purchase within 180 days of CCHA exercising its option or the date set forth in the terms of the offer, whichever date is later. (APA, pp. 92-93). The proposed APA is consistent with the purposes of factor number 10.

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 healthcare purposes consistent with the nonprofit's original purpose. The proceeds of sale are governed by O.C.G.A. § 31-7-75.1.

⁵ The filing does disclose that the parties will execute a transition services agreement for certain services to be provided post-closing by HCA to Memorial and CCHA, but such agreement is not a management agreement within the meaning of O.C.G.A. § 31-6-406(8).

Under the proposed transaction, at closing, the approximate sum of \$25,000,000 will be paid to a trust on behalf of CCHA. After payment of amounts payable at closing including the payment to the trust on behalf of CCHA and payments to lenders, creditors and vendors of CCHA, Memorial and affiliated entities, the net proceeds will be paid to an escrow agent to fund an escrow account that will fund certain obligations of the selling parties including their indemnification obligations. Once the escrow agreement concludes, the funds remaining will be disbursed to CCHA and will be governed by O.C.G.A. § 31-7-75.1. (APA, Exhibit H).

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) healthcare to the disadvantaged, the uninsured and the underinsured and (d) benefits to the community to promote improved health care.

Under the APA, HCA is contractually obligated to cause the hospital to remain enrolled in Medicare and Medicaid for a period of ten years following the closing of the transaction. (APA, p. 93). HCA is obligated to continue the provision of defined Core Services for a period of ten years following the closing of the transaction. (APA, p. 93). Core Services include the Hospital's professions in the areas of pediatrics, neonatal care with a Level 3 nursery, a Level 1 trauma program and a residency training program. (APA, Schedule 7.14(a)(ii)). HCA is also obligated to continue the provision of defined key services for a period of five years following the closing of the transaction. (APA, p. 94). Key services include the Hospital's programs in the areas of oncology, neurosciences, orthopedics, including total joint replacement, cardiovascular, rehabilitation therapy, behavioral health, and gynecology and obstetrics. (APA, Schedule 7.14(a)(iii)). HCA is also obligated to maintain the Hospital's licensure and its emergency department for a period of fifteen years after closing of the transaction. (APA, p. 94). For a period of five years after closing, HCA is required to maintain a contractually-defined indigent

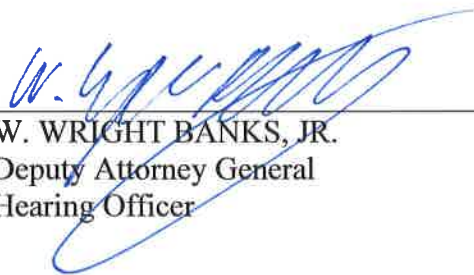
care policy. (APA, p. 97, Exhibit 0). HCA is also obligated to make certain capital investments in the Hospital over the ten-year period after closing. Such capital investments shall approximate \$280,000,000 subject to adjustments. (APA, p. 96).⁶

The obligations described herein and the record evidence that factors 11 and 12 are satisfied in this matter.

CONCLUSION

Upon review of the public record and in accordance with the Act, the undersigned Hearing Officer finds that the public record in this matter discloses that the proposed transaction is appropriate in light of the factors set forth in the Act.

This 18th day of December, 2017.



W. WRIGHT BANKS, JR.
Deputy Attorney General
Hearing Officer

⁶ The obligations of HCA described herein are not exhaustive.

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.

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