MARQUETTE GENERAL HEALTH SYSTEM

STRATEGY AND PROCESS

ACQUISITION OF MARQUETTE GENERAL HOSPITAL, INC.

BY DLP HEALTHCARE, LLC.

Submitted by Marquette General Hospital

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I. INTRODUCTION

Marquette General Hospital, Inc. ("MGH") is a Michigan nonprofit corporation formed in 1897 and located in Marquette, Michigan. MGH operates a 307 licensed bed acute care hospital serving the Upper Peninsula of Michigan. The hospital is the flagship for a regional referral center, that includes ambulatory clinics, home health, a reference lab, telehealth, hospice, and an ambulance service. In addition, MGH has interests in several joint ventures in areas such as diagnostic testing, information management, managed care, and health education. The Marquette General Foundation is a Michigan nonprofit corporation exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986 which is controlled by MGH.

MGH is led by a community representative Board of Trustees and a well experienced and qualified executive team. Bradley Cory is the current Chairman of the Board of Trustees. A. Gary Muller is the President and Chief Executive Officer of MGH and is joined on his executive team by Jerry Worden, Senior Vice President and Chief Financial Officer, Thomas Noren, M.D., Senior Vice President and Chief Medical Officer, Dave Graser, Senior Vice President and Chief Information Officer/Chief Operating Officer, and Jan Hillman, Vice President, Chief Integration Officer.

II. MGH FOLLOWED A DELIBERATE, INFORMED DECISION MAKING PROCESS INVOLVING HOSPITAL AND COMMUNITY STAKEHOLDERS

A. Strategic Planning

As part of its strategic planning, MGH began a process in January, 2010 to evaluate the overall status of the organization, its financial condition, and its ability to meet the future health care needs of the communities it serves. Attached as Attachment 1 and Attachment 2 are an explanation of that process and a timeline that illustrates the steps taken by the Board of Trustees of MGH and management to ensure that the decisions made by the Board were informed and in the best interest of MGH and the citizens of Marquette and surrounding communities. To initiate the analysis, management of MGH (a) collected and evaluated both qualitative and quantitative data about MGH, the health care environment in Marquette and the Upper Peninsula and the future of the health care industry, and (b) solicited input from representatives of the Board, management, physician leadership, regional leaders from across the Upper Peninsula, employees and volunteers. MGH's objective in this process was to identify and prioritize the strengths, weaknesses, opportunities, threats, and obstacles of MGH in its future development.

In April, 2010, Board members, executive staff, medical staff leadership, and others met to review the data collected and to develop a strategic plan. The Board adopted the strategic plan in June, 2010.

B. Board Education

In June, 2010, based on the data evaluation, information provided by management, and other Board education described in Attachment 1, the Board of Trustees discussed the options of remaining an independent hospital or aligning with another health care system. The Board considered several factors including, without limitation, the financial performance of the hospital, the condition of the facility, bond covenant compliance, pension liabilities and continued employment for MGH employees.

As described in Attachments 1 and 2, the Board education has been ongoing throughout the strategic planning processes and the steps that followed to select a potential suitor that best suited the needs of MGH and the Upper Peninsula. At least one hour of each monthly meeting of the Board has been devoted to Board education. Board members were provided with written materials and attended conferences and webinars pertaining to the options of remaining independent, mergers and acquisitions, and hospital affiliations. The education process was open and comprehensive with extensive involvement by Board members at every step. Board members did not enter the process with any pre-conceived expectations of how or where the process would conclude.

C. Superior Health Partners

Superior Health Partners ("SHP") is a Michigan nonprofit corporation exempt from tax as a 501(c)(3) organization. In June, 2010, MGH entered into a Joint Operating Agreement with Bell Memorial Hospital and SHP to establish a network of health care providers in the Upper Peninsula. The purpose of SHP and this network is to provide a vehicle for a comprehensive and collaborative effort to promote access to quality health care in a cost-effective manner for the citizens of the Upper Peninsula. Since the date of inception, seven Upper Peninsula hospitals (including MGH) have affiliated with SHP via support service agreements.

The Board and leadership of SHP have been involved with MGH at various stages of the planning process related to the proposed transaction.

D. Board Retreat

In April 2011, Jan Hillman, the Vice Present/Chief Integration Officer, continued the process of strategizing for a future MGH that would achieve, among other things, continued high quality care, an improved operating margin, an infusion of capital into the facility, and a higher bond rating making borrowing more accessible and cost effective. To that end, Ms. Hillman organized a retreat between MGH and SHP to address the health care issues and challenges facing MGH and providers in surrounding communities. The Board Retreat was held in June, 2011 and the participants identified priorities for MGH and for any potential arrangement with another health care system. (See Attachment 1) Those priorities have been key in all decisions made by the Board since that time.

E. Special Committee

The MGH Board appointed a Special Committee in September 2011, consisting of four Board members: Brad Cory, Gary LaPlant, Rick Schaeffer, Judy Watson Olson, and Gary Muller (ex-officio). The Board charged the Special Committee with choosing an advisor for the affiliation process and providing leadership, guidance and recommendations regarding an upstream affiliation to the MGH Board. The Special Committee met frequently as indicated on Attachment 2.

III. FACTORS CONSIDERED KEY IN MGH DECISION TO MOVE FORWARD WITH AFFILIATION

A. Future of Health Care

The MGH Board took a proactive approach to its strategic planning process. As the sole tertiary care provider in the Upper Peninsula, MGH wanted to ensure its survivability and the continued access to care for its patients. To that end, MGH believed it appropriate to begin evaluating alternatives to address the challenges it was facing and that it expected to worsen into the future. MGH did not want to be in a position of financial distress or even closure of its facility.

MGH recognized that changes to health care regulation and reimbursement would impact its financial situation. The economic downturn in Michigan impacted all hospitals and particularly those serving Medicaid populations. The full impact of health reform is unknown but expectations are that reimbursement for hospital and physician services will decrease in the future and that regulations, imposing additional costs on hospitals, will increase.

B. Financial Circumstances

In 2007, MGH retained the consulting firm, Wellspring, to assess the financial condition of the hospital and make recommendations for financial improvement. Although the hospital implemented many of the Wellspring recommendations, changes in its financial position were not as positive as hoped.

Jerry Worden, the Senior Vice President and Chief Financial Officer of MGH, and others of his financial team, continuously assess the financial performance of the organization. Mr. Worden has actively informed the Board, employees and other interested parties about the financial condition of the hospital and its concerns for the future. Attached as Attachment 3 are presentations made by Mr. Worden to the Michigan Nurses Association in May, 2010 and August, 2010. Attached as Attachment 4 is a presentation by Mr. Worden to the MGH and SHP Boards at the Board Retreat in June, 2011. As noted in Attachments 3 and 4, MGH was facing and continues to face challenges in the following areas: (a) compliance with its bond covenants, (b) a decline in inpatient admissions for fiscal year 2010 and the first six months of fiscal year 2011, (c) an underfunded pension plan, and (d) an average age of facility of 18.9 years in fiscal year 2010 and currently, 19.9 years.

C. Bond Covenants

In December, 2008, MGH did not meet certain bond covenants under outstanding bonds issued in 2005 and 2006, including required days cash on hand. Wells Fargo Bank, N.A., the Bond Trustee and Assured Guaranty Corporation, the Bond Insurer, agreed to forebear their respective rights under the bond documents. However, as a result, MGH was subjected to penalties and required to agree to changes in existing covenants and additional covenants, including a 2% Adjusted Operating Margin target and a prohibition on additional indebtedness without Bond Insurer consent. MGH incurred significant expense to remedy the situation. In

June, 2010 MGH failed to meet the new Adjusted Operating Margin covenant. See Attachment 6. Again, MGH agreed to modification of its bond covenants, including a covenant to refinance its variable rate debt and terminate the interest rate swap that was part of the 2006 bond financing. In December, 2011, MGH refinanced its debt through a commercial bank to eliminate the variable rate debt and the interest rate swap. The cost of retiring these obligations was significant. MGH continues to face challenges in meeting the covenants relating to its outstanding debt.

Like many hospitals around the country, MGH has faced difficulty in accessing capital on reasonable terms and at reasonable costs. This trend was particularly acute following the auction-rate security market failures and broader financial system turmoil beginning in 2007. On April 9, 2012, MGH received a stable outlook and affirmation of its Baa3 long-term revenue bond ratings from Moody's Investors Service. Key to both the rating and the outlook was the proposed transaction with Duke LifePoint. Specifically, Moody's noted (i) that "MGHS's adjusted operating performance was weak in FY 2011 and that failure to improve operating margins considerably could pressure the rating," and (ii) that "[c]ontinued weaker operating results and maintenance of weaker debt ratios; deterioration of balance sheet ratios; additional new borrowing without commensurate increase in cash flow" could make the rating go down.

D. Pension Liability

Following enactment of the Pension Protection Act in 2006, MGH, like other employers with defined benefit plans, was subject to changes in funding requirements. These new requirements hit at a time when the Michigan and national economy were at a low point resulting in lower investment return. Over time, the plan has required significant cash to meet minimum funding levels. MGH decided to freeze its defined benefit plan in October 31, 2010 to achieve cost savings. Attached as Attachment 5 is correspondence from Aon Hewitt providing an estimate of liability associated with a termination of the MGH Retirement Plan. MGH is committed to ensuring that all MGH employees receive full retirement benefits for their service to MGH.

E. Condition of Facility

The MGH facility consists of several buildings, some of which date back to the early to mid twentieth century. At the current time, the average age of the plant is 19.9 years. This compares to an average of 10 years for similar facilities and an average in single digits for companies with "A" ratings. MGH estimated that an investment of over $30 million would be needed to bring MGH in line with its peers. MGH currently has approximately $5 million in capital requests that it is unable to fund.

As noted in the Memorandum of Understanding with Duke Life Point ("MOU"), Duke LifePoint will invest significant resources in the transaction, including significant capital expenditures to improve the MGH facilities. MGH has proposed certain capital projects and a timeline for completion of the projects to Duke LifePoint.

F. Access to Care

MGH recognized that residents of the Upper Peninsula were seeking care at health care facilities in Wisconsin and Minnesota that could be provided by MGH. In some instances, these out of state facilities are actually closer in distance to the resident's home. In other instances, however, residents were traveling long distances for care because they wanted updated facilities and equipment or the particular physician specialty needed was not available. The Board and management have identified physician recruitment and physician relocation to Marquette and surrounding areas as a key ingredient in preserving access to care for the residents of the Upper Peninsula.

In searching for the appropriate partner, MGH looked for a commitment to recruit additional physicians to the area. As noted in the MOU, Duke LifePoint has agreed to commit significant resources for physician recruitment.

IV. MGH AND JUNIPER ADVISORY IMPLEMENTED A COMPETITIVE, COMMERCIALLY REASONABLE PROCEDURE TO ENSURE THAT MGH IDENTIFIED THE PARTNER THAT COULD BEST MEET ITS NEEDS AND THE NEEDS OF THE COMMUNITY

A. Juniper Advisory

In September 2011, the MGH Board retained Juniper Advisory ("Juniper") following a selection process that involved six potential candidates. Juniper is an independent, privately-held investment banking firm based in Chicago that focuses exclusively on nonprofit hospital mergers and acquisitions. Juniper and its principals, James Burgdorfer and David Gordon, have specialized in providing strategic financial advice, including mergers, acquisitions, divestitures, lease structuring and other elements of corporate finance, to hospital systems for over 25 years. Juniper principals have advised on over 100 nonprofit hospital and health system transactions in numerous states across the country.

B. Market Clearing Process

On MGH's behalf, Juniper designed and implemented a "controlled competitive" process to solicit proposals from potential partners that reflected the key priorities identified in the June 2011 Board Retreat. In addition, Juniper asked each respondent to address its business and medical expertise and its ability (i) to thrive in the future, (ii) to maintain and expand MGH's medical capabilities, (iii) to provide the highest quality medical care for Marquette and the Upper Peninsula, and (v) to further the Upper Peninsula healthcare delivery network.

Juniper approached a total of twenty-six health care organizations, fourteen of which were nonprofit and twelve of which were for profit. Of the twenty-six, eight nonprofits and ten for profits executed Confidentiality Agreements, were provided with an Information Memorandum about MGH and were afforded access to a secure electronic data room. Ten of the organizations submitted proposals, including two from nonprofit organizations and eight from for profit organizations. This level of response exceeds the average for this type of market clearing process and included some of the best and most highly regarded companies in the industry. Of the initial twenty-six, nine of the organizations own and operate one or more hospitals in the State of Michigan.

Juniper presented a summary of the proposals to the Board of MGH on December 19, 2011. (See Attachment 7) The Board selected five finalists and requested that the finalists make site visits to MGH and present to the Board. These site visits occurred in January, 2012. The full MGH Board, members of the Special Committee, and three representatives from the MGH Physician Focus Group ("PFG") heard several hour presentations from each of the finalists. PFG is comprised of 23 independent and MGH employed physicians. These individuals evaluated the five finalists' presentations and Duke LifePoint was evaluated as the leading finalist.

At the direction of the MGH Board, in late January, a group, including the Special Committee members, physician Board members, Gary Muller and Jan Hillman conducted "reverse due diligence" with site visits to three hospitals from around the country operated by the three leading finalists.

Juniper solicited second proposals from the five finalists to address more specific issues, including balance sheet allocation, confirmation of buyer commitments, and greater specificity on transaction issues. At the Board's direction, Juniper also made efforts to develop joint arrangements between the five finalists and other regional nonprofit health care systems, such as Henry Ford Health System, University of Michigan, Marshfield Clinic, Cleveland Clinic, and Mayo Clinic. LifePoint was the only company that was successful in arranging a joint venture proposal and made its second offer in conjunction with Duke University Medical Center, a nonprofit, exempt organization.

The MGH Board members that made the "reverse due diligence" site visits were asked to evaluate the prospective suitors. Each of the individuals independently ranked Duke LifePoint as their first choice.

C. <u>The Decision</u>

On February 16, 2012, the MGH Board of Trustees met and received presentations from Juniper and from McGuire Woods and Dykema Gossett, two law firms with specialties in health care and transactions of this sort. The presentations included information on the finalists and on corporate and regulatory issues involved in a transaction of this kind, including Attorney General review, licensure and CON, and the due diligence and agreement drafting process. Juniper's presentation included the evaluations of the individuals who conducted the "reverse due diligence" site visits, financial profiles of the finalists, comparisons of the acquisition structure, and other non-economic factors. Juniper's presentation also included an analysis of the economic features and transaction valuation as established through the market clearing process. See Attachment 8.

The Board of Trustees voted <u>unanimously</u> to select Duke LifePoint as the best choice to move MGH and the Upper Peninsula into the future and to meet the challenges they will face. The community Board determined, after thorough deliberation and careful consideration of all offers, and in good faith that the transaction with Duke LifePoint presented the best possible outcome.

The Board presentations by Juniper on September 19, 2011, December 16, 2011 and February 16, 2012 are attached as Attachments 6, 7 and 8, respectively.

V. THE MGH AND JUNIPER PROCESS REPRESENTS A COMPETITIVE FAIR MARKET VALUE ANALYSIS

MGH, with the assistance of Juniper, followed an open, competitive, fair and non-discriminatory "bidding" process with the objective of selecting a suitor that could enhance the quality of care provided by MGH, fit within the culture of Marquette and the Upper Peninsula, and achieve a fair market value purchase price. MGH opened the process for nonprofit and for-profit organizations and to Michigan health care providers.

The total consideration offered by the five finalists ranged from \$295 million to \$521 million. Duke LifePoint offered aggregate consideration that represented the second highest transaction value. In addition, as part of the second proposal in the competitive process, Duke LifePoint increased its offer by \$50 million.

A competitive market clearing process has long been recognized by professionals in the corporate world as the best and most effective method for establishing fair market value in a change-of-control transaction. This type of process has become the norm for large publicly-traded companies, subject to oversight by federal and state government agencies, including the SEC.

VI. **CONCLUSION**

MGH believes that the strategic process that the Board of Trustees followed to reach the conclusion that an affiliation was necessary for the future of health care in the Upper Peninsula, was a sound, informed and fair process. At the end of the process described in this summary and the attachments, the Board of Trustees concluded unanimously that the transaction proposed by Duke LifePoint would have a positive impact on the hospital, the citizens of Marquette and surrounding communities, and on the overall delivery of health care in the Upper Peninsula. Duke LifePoint's commitment to invest in MGH to build new facilities, recruit additional physicians, increase the number of employees, and grow medical services will boost the economic vitality of the entire region. In addition, the transaction with Duke LifePoint, an organization with significant capital, operating expertise, and medical prestige, will reduce the outmigration of Upper Peninsula residents for care and permit MGH to continue as one of the leading health care centers in Michigan.

MGH believes that (i) the reasons MGH sought a strategic partner were very sound and in the best interests of the hospital and the residents of the Upper Peninsula, (ii) the process MGH followed was disciplined and thorough, and (iii) the controlled competitive bidding process conducted by Juniper yielded a result that can easily be defended as fair market value. The process resulted in an outcome that exceeded MGH's objectives for the future of health care for the residents of the Upper Peninsula.