

Acquisition of the Assets of St. Joseph Mercy Port Huron, a Division of Trinity Health-Michigan, by Prime Healthcare Services-Port Huron LLC

Submitted by Saint Joseph Mercy Health System, Trinity Health-Michigan and Trinity Health Corporation

March 13, 2015



INTRODUCTION

On November 19, 2014, Trinity Health-Michigan executed an Asset Purchase Agreement with Prime Healthcare Services-Port Huron LLC for the sale of substantially all of the assets of the Trinity Health-Michigan hospital known as St. Joseph Mercy Port Huron including the assets related to its operation (the "Transaction"). The Transaction is conditioned upon and subject to the review and approval of the State of Michigan Department of Attorney General ("Attorney General"). The parties anticipate closing the Transaction on or about June 1, 2015.

This narrative is being submitted to provide the Attorney General with relevant background information and the basis for this Transaction. It also is intended to substantiate Trinity Health-Michigan's conclusion that the Transaction will significantly benefit the patients, employees and communities served by St. Joseph Mercy Port Huron and that the aggregate consideration offered by Prime Healthcare Services-Port Huron LLC is both fair and reasonable.

- Section I describes the parties to the Transaction and their respective health care operations.
- Section II describes the Transaction and the process undertaken by Trinity Health-Michigan both historically and more recently to analyze and pursue strategic options to best serve and preserve health care services for the community.
- Section III describes the many benefits of the Transaction for the hospital and the community that it serves.

Trinity Health-Michigan respectfully requests that the Attorney General find that the Transaction is in the best interests of the patients, employees and community presently served by St. Joseph Mercy Port Huron and merits approval.

SECTION I. THE PARTIES

A. ST. JOSEPH MERCY PORT HURON

St. Joseph Mercy Port Huron was founded in 1954 by the Religious Sisters of Mercy and has provided health care to the residents of St. Clair County and the surrounding area for over 60 years, serving as a compassionate presence in the community, reverencing the human dignity of each person, promoting justice, peace and reconciliation, and providing respect for the poor and underserved. A recent example of how St. Joseph Mercy Port Huron has perpetuated this

mission and longstanding commitment to the provision of charity care is its provision in FY 2014 of over \$1.5 Million in charity care.

St. Joseph Mercy Port Huron is an acute care hospital currently licensed for 164 beds, 119 of which are currently operational. It is an unincorporated division of Trinity Health-Michigan and part of the Saint Joseph Mercy Health System in southeast Michigan. The St. Joseph Mercy Port Huron campus currently includes the hospital proper, medical office buildings and a renal dialysis center. St. Joseph Mercy Port Huron facilities also include:

- A senior emergency room in the hospital designed to meet the unique needs of area seniors, providing patients 65 years of age and older individualized care by specially-trained staff in dedicated, private rooms designed to meet their unique needs.
- Mercy Health Center. Mercy Health Center is a 52,000 square foot ambulatory health center located on M-25 (24th Avenue) in Fort Gratiot Township, Michigan (some 6 miles north of the St. Joseph Mercy Port Huron campus).
- Mercy Health Center opened in 2001 and is dedicated to providing convenient access to outpatient medical services, including laboratory, radiology, outpatient physical therapy, and outpatient cardiac rehabilitation. In addition, Mercy Health Center is home to Lakeshore Surgery Center, LLP, which provides outpatient surgery and endoscopy services. Several physician and medical specialist offices are located in the Mercy Health Center.
- The People's Clinic for Better Health. The People's Clinic for Better Health is an acclaimed clinic located off of the campus of St. Joseph Mercy Port Huron that provides needed care for the indigent and underserved in the community. The Peoples' Clinic is sponsored by St. Joseph Mercy Port Huron, the St. Clair County Medical Society, the community, and is funded in part by the United Way of St. Clair County.
- Several other physician offices serving the community as part of Port Huron Mercy Family Care, a nonprofit subsidiary of Trinity Health-Michigan.
- Mercy-Physician Community PHO, L.L.C, a physician/hospital organization between St. Joseph Mercy Port Huron and participating physicians in the community.
- Condominiums in medical office buildings located on the St. Joseph Mercy Port Huron campus.

St. Joseph Mercy Port Huron's commitment to the health of the communities it serves also is evidenced by the many partnerships and other affiliations developed to meet the needs of the community. These partnerships and affiliations include:

- Lakeshore Surgery Center, LLP, a joint venture between St. Joseph Mercy Port Huron and local surgeons working in concert to provide physician-managed outpatient surgical services and is one of the first of its kind in the nation.
- Port Huron Mercy Family Care, a primary care physician network that delivers primary care services and supports medical practice management for physicians.
- Advanced MRI, a joint undertaking of St. Joseph Mercy Port Huron and St. John River District Hospital. Diagnostic MRI testing services are provided via mobile services offered at Mercy Health Center and at St. John River District Hospital in East China, Michigan.
- Tri-Hospital EMS Corporation, a joint venture among St. Joseph Mercy Port Huron, St. John River District Hospital and McLaren Port Huron (formerly known as Port Huron Hospital). Tri-Hospital EMS Corporation services are offered to provide rapid emergency medical response throughout the county

B. TRINITY HEALTH-MICHIGAN, SAINT JOSEPH MERCY HEALTH SYSTEM AND TRINITY HEALTH

Trinity Health-Michigan is a Michigan non-profit, nonstock corporation exempt from federal income taxation pursuant to Section 501(c) (3) of the Internal Revenue Code of 1986 (the "Code") that operates hospital facilities in the State of Michigan and is a wholly owned subsidiary of Trinity Health, an Indiana nonprofit corporation that also is exempt from federal income taxation pursuant to Section 501(c) (3) of the Code. Trinity Health is the second largest Catholic health care system in the country. Saint Joseph Mercy Health System is one of the two regional health systems in Michigan that make up Trinity Health-Michigan and serves six counties in southeast Michigan, including Livingston, Macomb, Oakland, St. Clair, Washtenaw and Wayne. The Saint Joseph Mercy Health System regional Board is comprised of approximately one-half of the full Trinity Health-Michigan Board and has been delegated fiduciary responsibilities for overseeing the entire operations of the Saint Joseph Mercy Health System region, including the exercise of fiduciary responsibilities associated with St. Joseph Mercy Port Huron.

C. PRIME HEALTHCARE SERVICES-PORT HURON LLC AND PRIME HEALTHCARE SERVICES

Prime Healthcare Services ("PHS") is an award winning health care system based in Ontario, California. PHS has been in operation since 2001 and, by and through its subsidiaries, operates twenty-eight (28) acute care hospitals with approximately 5,000 beds throughout Alabama, California, Indiana, Kansas, Michigan, Missouri, Nevada, New Jersey, Pennsylvania, Rhode Island, and Texas. PHS is also affiliated with the Prime Healthcare Foundation, a 501(c)(3) public charity with assets of approximately \$800 million, which owns and operates seven (7) acute care hospitals in California and Texas.

PHS's hospitals have been recognized among the "100 Top Hospitals" in the nation 36 times by Truven Health Analytics (formerly Thomson Reuters). Additionally, PHS has been recognized as one of the "15 Top Health Systems" in the nation three times. Six PHS hospitals were recognized among the 100 Top Hospitals in the nation in both 2015 and 2014 by Truven Health Analytics. The following hospitals were ranked as Top 100 Hospitals by Thomson Reuters/Truven Health Analytics twenty-seven (27) times in the past six (6) years including:

- Centinela Hospital Medical Center- 4 Times including 2015
- Chino Valley Medical Center- 4 Times including 2015
- Desert Valley Hospital- 6 times including 2015
- Garden Grove Hospital Medical Center- 4 Times including 2015
- Montclair Hospital Medical Center – 2 Times
- Paradise Valley Hospital -2 Times including 2015
- San Dimas Community Hospital - 2 Times
- Shasta Regional Community Hospital- 3 Times including 2015
- West Anaheim Medical Center – 5 Times

In 2014, thirteen of PHS's hospitals were ranked as "Top Performers on Key Quality Measures" by the Joint Commission, the leading accreditation agency of health care organizations. Several PHS hospitals have been recognized in this way multiple times. In 2013, eleven PHS hospitals were similarly ranked.

PHS endeavors to provide comprehensive, quality health care in a convenient, compassionate and cost effective manner. PHS is consistently at the forefront of evolving national health care reform. PHS provides an innovative and integrated health care delivery system while remaining cognizant of patients' needs and desires for high quality, affordable health care.

Of particular interest to Trinity Health, Prime is well known and well regarded for rescuing financially distressed hospitals, saving thousands of jobs, turning the distressed hospitals into thriving community assets and providing access to quality health care for the communities it serves. To date, Prime has acquired 35 financially troubled hospitals and saved 35,000 jobs in eleven states nationwide.

SECTION II. THE TRANSACTION AND TRANSACTION PROCESS

The Transaction is the result of more than 20 years of exploration undertaken by Trinity Health and Saint Joseph Mercy Health System to strengthen St. Joseph Mercy Port Huron and secure continued high quality health care access for the community. The various and long-standing financial and operating challenges experienced by St. Joseph Mercy Port Huron have been exacerbated in more recent years as a result of the complexities, requirements and challenges of Michigan's economic situation and health care reform. In addition to these challenges, Saint Joseph Mercy Health System and Trinity Health have been developing a highly integrated regional care delivery system in southeast Michigan over the past several years. However, St. Joseph Mercy Port Huron's geographic distance from other Saint Joseph Mercy Health System hospitals and outpatient centers (a 57 mile, 75 plus minute drive to St. Joseph Mercy Oakland in Pontiac, and a 93 mile, almost 2 hour drive to St. Joseph Mercy Ann Arbor) continues to challenge the ability to integrate operations and prepare for population health management in the best interest of the community. It became apparent that St. Joseph Mercy Port Huron and those it serves would benefit from more concentrated management and support at the local level.

A. FINANCIAL AND OPERATING CHALLENGES

St. Joseph Mercy Port Huron is located in St. Clair County, Michigan with a population of approximately 192,000 and two other hospital providers in the area. One prior stand-alone hospital provider, originally known as Port Huron Hospital, was acquired by McLaren Health System in 2014. It is now known as McLaren Port Huron and is located two miles from St. Joseph Mercy Port Huron. During the first three quarters of 2014, McLaren Port Huron held a

market share of 39.2%. The second provider, St. John River District Hospital, is part of Ascension Health's St. John Providence Health System and is located thirteen miles from St. Joseph Mercy Port Huron and, during the first three quarters of 2014, held a 6.2% market share. Between 2009 and 2014, St. Joseph Mercy Port Huron's market share hovered between a low of 13.2% and a high of 14.6% and was at 13.5% during the first three quarters of 2014. Its financial and operating status has declined over the last several years with operating margins ranging from 0.3% to -3.7% from 2009 to 2014. St. Joseph Mercy Port Huron's total net assets remained relatively constant during that period, showing a slight decline from \$34.5 million to \$33.8 million. During the same period, the book value of its property, plant and equipment fell from \$34.6 million to \$25.9 million. Discharges in 2014 declined to 3,496 from 4,223 in 2013 (a 17% decrease). This declining market share, declining population and significant economic challenges have adversely impacted St. Joseph Mercy Port Huron.

During the last 10 years, Trinity Health invested nearly \$25 million of capital in St. Joseph Mercy Port Huron to support its operations and assist in meeting its financial challenges. Such investments were used for a variety of projects, including, for example, the catheterization laboratory replacement, a radiology picture archiving system, a robotic arm, a mammography digital unit, a CT scanner, patient room renovations, general ultrasound equipment replacement, anesthesia machines and a 40 bed telemetry monitoring system. A total of \$39.7 million of Trinity Health's outstanding tax-exempt bonds financed improvements at St. Joseph Mercy Port Huron.

B. REVIEW AND ANALYSIS OF STATUS AND OPPORTUNITIES

As part of its ongoing strategic planning, Trinity Health identifies, evaluates, analyzes and supports various opportunities and transactions including corporate mergers, acquisitions, affiliations and partnerships as well as divestitures and other business transactions. This work is accomplished by health care, business and financial executives well versed and experienced in these types of transactions. Their work is supported through an ongoing business relationship with Citigroup, which is a specialized, independent investment banking firm that provides merger, acquisition and other transactional and financial advice to nonprofit hospitals and health systems across the country.

Trinity Health has long recognized the challenges faced by St. Joseph Mercy Port Huron as a result of a declining population, economic downturns and local competition. Over the years,

Trinity Health invested many millions of dollars in St. Joseph Mercy Port Huron to assist it in meeting these challenges. It became increasingly apparent over recent years, however, that St. Joseph Mercy Port Huron and the community it serves would be better served by partnering with another health system. Accordingly, merger/acquisition and hospital executives of Trinity Health approached several health systems to solicit interest in an affiliation, collaboration or sale of St. Joseph Mercy Port Huron. In some cases, those approached rejected the opportunity having determined that synergies vital to a successful transaction were not achievable for reasons that mirror the impetus for this Transaction: the challenges in Port Huron noted above and the geographic distance between it and other hospitals and providers in their systems, which make regional population health initiatives unlikely to succeed.

In other cases, including with more local competitors, discussions progressed further but, ultimately, were abandoned. For example, in 1994, discussions with one local competitor were terminated as a result of the settlement of a lawsuit brought by the Federal Trade Commission ("FTC") challenging the proposed transaction, which resulted in a consent decree settlement barring a merger of the parties for 5 years and requiring notice of an intent to merge for an additional five years. Discussions with other hospitals and health systems during the years following the expiration of the consent decree were stymied in large part by concerns that the FTC would again raise antitrust concerns and by an overall lack of confidence that those concerns could be readily overcome. All the while, Trinity Health continued to support and to invest in the operations and needs of St. Joseph Mercy Port Huron.

Thus, over the past 20 years, Trinity Health-Michigan has explored various ways in which the needs of St. Joseph Mercy Port Huron's patient population could best be served on a sustained basis. Over that period, the hospital confronted a declining market and depressed economic conditions, regulatory changes, requirements and limitations, administrative challenges and the pressing need to address health reform, clinical integration, efficiencies, an improved financial performance, and the achievement of a sustainable health care delivery system. Within that period, Trinity Health divested its interest in St. Joseph Mercy Macomb, which then was the nearest Trinity Health acute care referral hospital to St. Joseph Mercy Port Huron.

In April 2014, an updated internal portfolio review of St. Joseph Mercy Port Huron was conducted by Trinity Health system-level, regional and local St. Joseph Mercy Port Huron executives and management. The subjects of this review encompassed operations, overall environment, total and senior population growth, value based purchasing metrics, utilization

rates, market volumes, performance and a bed need analysis. The outcome of this review was the recognition that St. Joseph Mercy Port Huron operates in an area that has historically struggled with a declining population and high unemployment in an over-bedded market, with operating performance below expectations and a highly challenged outlook. The physicians in the community are on staff at both McLaren Port Huron and St. Joseph Mercy Port Huron. There is a significant amount of patient outmigration with almost 50% of commercially insured patients seeking care at hospitals in the northern Macomb County area, which is very convenient to St. Clair County residents. Outmigration from the Port Huron market has been ongoing for well over a decade and the expectation is that it will increase as health systems in Southeast Michigan aggressively seek patients and as St. Clair County struggles to attract and retain specialty physicians. Additionally, changes made to various services lines in recent years (e.g., through the restructuring or termination of various joint ventures) have increased the pressures and competition facing St. Joseph Mercy Port Huron and adversely affected its performance.

As a result of the portfolio review and the factors noted above, Trinity Health considered all options available to enhance the viability of St. Joseph Mercy Port Huron, including, for example, repurposing, merger, sale, etc. As part of this review, Citigroup (Trinity Health's transaction advisor) performed an assessment of the enterprise value of St. Joseph Mercy Port Huron. Due to fiscal year 2014 projections reflecting a significant decline in revenue and operating EBITDA compared to fiscal year 2013, the indicative valuation range was between \$19 Million and \$23 Million.

Having exhausted its search for an affiliation partner in Southeastern Michigan, Trinity Health was intrigued upon being contacted by PHS and its expression of interest in acquiring St. Joseph Mercy Port Huron. That expression of interest led to preliminary discussions, due diligence, and a mission discernment process by Trinity Health to ensure that a transaction with Prime would be consistent with its mission and the needs of the community. The challenges noted above reinforced Trinity Health's decision to pursue the Transaction with Prime and, after careful consideration, Trinity Health and Saint Joseph Mercy Health System determined that the sale of the Hospital to PHS would be in the best interests of the patients, employees and communities served by St. Joseph Mercy Port Huron. They concluded that the sale would best assure alignment with the mission and strategic direction of its ministry by placing St. Joseph Mercy Port Huron and its patients in the stewardship of a strong national provider with proven

quality and an impressive success record of enabling financially distressed hospitals to thrive and meet the health care needs of the community.

C. TRINITY HEALTH-MICHIGAN AND PHS NEGOTIATE AN ASSET PURCHASE AGREEMENT FOR THE SALE OF ST. JOSEPH MERCY PORT HURON

As noted above, after PHS expressed an interest in acquiring the St. Joseph Mercy Port Huron assets, Saint Joseph Mercy Health System and PHS began discussions about the potential sale of those assets, including the transfer of Trinity Health-Michigan's interests in subsidiaries and joint venture affiliates associated with St. Joseph Mercy Port Huron. During that same time, St. Joseph Mercy Port Huron's financial position continued to deteriorate and was projected to forecast a \$4-\$5 million loss on operations in FY 2014, up from an operating loss of \$1 million in FY 2013. Management at Saint Joseph Mercy Health System concluded that the sale of the St. Joseph Mercy Port Huron assets and the transfer of the interests held by Trinity Health-Michigan in the associated subsidiaries and joint venture affiliates to PHS would align the hospital and its patients with a strong national provider, and would best address the ongoing needs of the communities served. Initial discussions were followed by negotiations between Trinity Health-Michigan and PHS, the parties reaching the agreed upon terms in the Asset Purchase Agreement and approval of the Transaction by the Saint Joseph Mercy Health System regional board.

SECTION III. THE TRANSACTION IS IN THE BEST INTEREST OF ST. JOSEPH MERCY PORT HURON AND THE CONSTITUENCIES IT SERVES

As a result of the Transaction, PHS will preserve and enhance St. Joseph Mercy Port Huron's high-quality, and efficiently delivered, health care services for the community for the foreseeable future. The quality metrics of Prime are at the forefront of the health care industry and the community served by the hospital will be the beneficiary of that quality. There is no question that the Transaction will benefit St. Joseph Mercy Port Huron, patients, the medical staff, employees, payers, local businesses and the community at large.

A. THE TRANSACTION DELIVERS FAIR VALUE FOR ST. JOSEPH MERCY PORT HURON'S ASSETS

PHS offered both economic and non-economic consideration for St. Joseph Mercy Port Huron's assets. The economic value of PHS's offer is \$37.5 Million plus payment for net working capital

in an amount to be determined as of the closing date. The \$37.5 Million includes both a cash payment of \$17.5 Million and a capital commitment of \$20 Million to be made by PHS over a three-year period. The aggregate consideration of \$37.5 Million offered by PHS, even without net working capital, fell well within the indicative valuation range (\$19 Million-\$23 Million) established by Citigroup. The economic and noneconomic value inherent in the consideration and Transaction negotiated with PHS is reflected in the following overview:

- The purchase price is \$17.5 Million plus an amount equal to St. Joseph Mercy Port Huron's net working capital as of the closing date. Saint Joseph Mercy Health System will retain cash, other assets (excluding inventory), and certain liabilities, including long-term debt and pension obligations.
- PHS will make a total capital commitment of \$20 Million to be invested in the hospital facilities and its operations over a 3 year period following the sale. Dr. Prem Reddy, the CEO of PHS, has already confirmed that the capital investments will include the purchase of a True Beam Linear Accelerator (replacing an aging existing linear accelerator) to treat cancer patients, subject to Certificate of Need (CON) approval.
- PHS will employ substantially all of the current St. Joseph Mercy Port Huron employees at similar compensation and benefit levels as currently exist, subject to each employee's satisfactory completion of PHS's customary pre-employment screenings.
- PHS will maintain the current medical staff bylaws, rules, regulations and medical staff appointments and will not make any changes to them for at least one year after the sale.
- PHS will maintain the hospital as an acute care hospital for a minimum of 5 years after the sale and continue to offer an open and accessible emergency department.
- PHS will adopt a charity care policy that is no less favorable than the current charity care policy in effect and will continue to provide treatment for indigent patients and support programs that support the community, specifically including The People's Clinic for Better Health, which is the indigent care clinic described above.
- PHS will maintain an advisory board, comprised of physicians, community members and Hospital executives to ensure substantial local and community involvement and to obtain community oversight and guidance regarding the ongoing operation of the hospital.
- Trinity Health-Michigan and PHS are working together to ensure that donor restricted funds and other restricted assets are transitioned to a nonprofit, tax-exempt affiliate of

PHS that meets all commitments and donor expectations and ensures that these funds and assets will remain in the community and be used in a manner fully consistent with the intent of the donors.

B. ADDITIONAL COMMUNITY BENEFITS

As noted above, the community will realize numerous benefits beyond the economic consideration offered by PHS. For example, PHS is nationally recognized for its exceptional quality. It has also gained notoriety for its success in improving the operations and finances of struggling, financially challenged community hospitals. PHS's growth has consisted mainly of acquiring hospitals in or near bankruptcy and turning them around. Its proven track record of strengthening hospital operations was particularly important to Trinity Health-Michigan. PHS's size and geographic coverage provide stability and access to financial, operating and capital assets to support both immediate and long term needs of the hospital.

To be sure, St. Joseph Mercy Port Huron also has a history of providing quality health care. According to the Centers for Medicare and Medicaid Services' Hospital Compare report, St. Joseph Mercy Port Huron outperforms local competitors across several metrics. Combined with PHS's proven ability to provide administrative and management support at appropriate levels for distressed community hospitals and its record of exceptional quality, Trinity Health expects not only continued quality performance in clinical outcomes but continued improvement in operations, efficiencies and the economies of scale that PHS successfully brings to its other hospitals.

The Transaction also preserves employment for the current employees of St. Joseph Mercy Port Huron and will provide economic stability to St. Clair County. In addition, the hospital will no longer be a tax-exempt entity, which may generate additional tax income for the City of Port Huron.

SECTION IV. CONCLUSION

Despite the consistent best efforts of Trinity Health, Saint Joseph Mercy Health System and management of St. Joseph Mercy Port Huron to improve performance, St. Joseph Mercy Port Huron, has operated at a significant loss and has not generated the resources necessary to fund essential capital and operating needs. Forecasts undertaken by and on behalf of Trinity Health and Saint Joseph Mercy Health System have given rise to real concerns over the ability

of St. Joseph Mercy Port Huron to continue to meet the health care needs of the community on a sustained basis within Saint Joseph Mercy Health System's regional organization. PHS brings the capital and the administrative and managerial wherewithal to recapitalize the aging facility, and to bring leaner corporate scale to operations necessary to re-position the organization to best serve the community for the years to come. Therefore, by becoming part of PHS, St. Joseph Mercy Port Huron will be better able to remain viable and serve those needs over the long term. This Transaction is in the best interest of St. Joseph Mercy Port Huron, the community, the medical staff, employees, local employers and the community at large. It offers the St. Joseph Mercy Port Huron facilities the administrative, managerial and financial support essential to ensuring that the community has continued access to a viable major health care center for the foreseeable future.