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Attorney General Mike Cox
Office of the Attorney General
Charitable Trust Division
G Mennen Williams State Office Building
Lansing, MI 48909

Dear General Cox,

We write to provide additional information that you requested as part of your review of the proposed sale of the non-profit Detroit Medical Center ("DMC") to for-profit Vanguard Health Systems ("Vanguard"). In our meeting last Tuesday September 28, we offered to provide you with a copy of a recent report authored by Irving Levin, Inc., a healthcare company specializing in healthcare mergers and acquisitions.

This report, entitled "The Hospital M&A Market: Five-Year Review & Outlook," contains a review of transactions in the hospital sector from 2005-2009. We are also including a similar analysis performed by our research team in which we reviewed merger and acquisition transactions announced or completed thus far this year.

In this letter, we present highlights from each study -- you will find that data from both reports supports SEIU's main concern that Vanguard may not be paying fair value for DMC.

VANGUARD MAY NOT BE PAYING FAIR VALUE FOR DMC

PRICE-TO-REVENUE MULTIPLE. A common method of valuing a company is to divide the price paid for similar businesses by some measure of earnings such as revenue or earnings before interest, taxes, depreciation and amortization ("EBITDA") of those businesses. This "multiple" is then applied to the revenue or earnings of the company to be acquired to produce its value.

In our September 27 letter to the Attorney General's office, we discussed the price-to-revenue multiple, an example of one such valuation technique. As a reminder, Vanguard's cash offer of $417 million for Detroit Medical Center, an eight-hospital system that generated over $2 billion in revenue in 2009, represents an extremely low multiple of 20 percent of revenue (0.20x).

According to Irving Levin's report, the average price-to-revenue multiple was 0.78x in 2009 (*see Table 1 below*), which is almost four times the multiple of 0.20x in the proposed Vanguard – DMC transaction. Applying the 0.78x multiple to DMC's $2.1 billion in revenue in 2009 produces a value of $1.6 billion.

Table 1. Irving Levin Revenue Multiples by Year.[1]

	2005	2006	2007	2008	2009
Median Price / Revenue	0.79x	0.73x	0.60x	0.70x	0.77x
Average Price / Revenue	1.17x	0.75x	0.74x	0.84x	0.78x
Number of Transactions	35	33	28	31	13

Multiples are based on all announced hospital transactions within 2005-2009 where data is available. Multiples exclude transactions involving bankrupt hospitals, and we feel this is an appropriate comparison for DMC given its financial stability.

SEIU conducted a similar analysis with respect to transactions announced or closed in 2010 and we concluded that price-to-revenue multiples are also higher than what Vanguard has proposed to pay for DMC. Of the sixteen transactions this year with adequate data, the average multiple is 0.6x.[2] It should be noted that quite a few of these transactions include bankrupt or financially distressed hospitals, in contrast to 2009, which reflected "the low level of bankruptcy and distressed sales" according to Irving Levin.[3]

TWO LANDMARK DEALS IN 2010 WITH DIFFERENT OUTCOMES. There have been many reports on the recent pace of acquisitions in the hospital sector, primarily for-profit hospitals acquiring nonprofit or government owned hospitals. Two landmark deals this year as reported by analysts include the sale of Caritas Christi Health Care in Boston and that of Detroit Medical Center.

Cerberus Capital Management, a private equity firm in New York is about to close on its acquisition of Caritas Christi Health Care, a 6-hospital system in Boston that generated $1.3 billion in revenue in 2009. Cerberus will infuse $430 - $450 million in cash immediately to extinguish Caritas' debt, finance renovation, provide working capital and assume the system's pension liability.[4] This amount translates into nearly 35 percent of Caritas' 2009 revenue.

While both systems were profitable in 2009, DMC has had a longer history of solid financial performance, compared to Caritas, which generated negative operating income in 2008. Additionally, Caritas has reportedly been "struggling with serious financial problems"[5] -- two of Caritas' six hospitals are on the brink of closure unless the deal with Cerberus closes. Surely, DMC, a system that has "operated in the black since 2004"[6] according to CEO Michael Duggan, warrants a higher transaction value.

Finally, Caritas will become a tax-paying entity immediately upon being acquired by Cerberus -- Caritas CEO Ralph de la Torre estimated that over $100 million in state and local taxes would be generated in

1 Irving Levin Associates, Inc. "The Hospital M&C Market: Five-Year Review & Outlook" Second Edition, 2010. p.8.

2 Based on SEIU analysis. Sixteen of the 37 transactions announced or closed in 2010 had available pricing or revenue data that could be incorporated into the analysis.

3 Irving Levin Associates, Inc. "The Hospital M&C Market: Five-Year Review & Outlook" Second Edition, 2010. p.7.

4 Weisman, Robert. Boston Globe. "Equity firm set to buy Caritas. Catholic identity will be retained Hospitals to shift to for-profit status" March 25, 2010. Retrieved from: http://www.boston.com/business/healthcare/articles/2010/03/25/equity_firm_set_to_buy_caritas?mode=PF

5 Syre, Steven. The Boston Globe. "Making the Most of a Bad Economy" July 9, 2010.

6 Gold, Jenny. Kaiser Health News, reported in USA Today. "Mergers of for-profit, non-profit hospitals: Who does it help?" July 13, 2010. Retrieved from: http://www.usatoday.com/money/industries/health/2010-07-13-hospitalmergers13_CV_N.htm

the next five years for the state of Massachusetts.[7] In contrast, Vanguard is estimated to receive $183 million in tax breaks over 15 years as a result of a renaissance zone.[8]

EVEN BANKRUPT HOSPITALS ARE COMMANDING HIGHER MULTIPLES THAN DMC. Only one transaction in 2009 in Irving Levin's analysis involved the acquisition of a bankrupt facility. This facility fetched a multiple of 0.22x, "between one-third and one-fourth of what a non-bankrupt hospital could command" according to Irving Levin.[9]

Four transactions in 2010 involved bankrupt facilities according to data compiled by SEIU and the multiples ranged from 0.1x to 2.1x. We believe that a system as financially sound as DMC should command a much deserved higher multiple than bankrupt hospitals.

VANGUARD HAS PAID HIGHER MULTIPLES FOR OTHER TRANSACTIONS THIS YEAR

Vanguard has been steadily acquiring hospitals this year (*see Table 2 below*). Both acquisitions in Chicago and Arizona involve facilities that are financially inferior to DMC and yet, the multiple that Vanguard is offering to pay for DMC does not reflect the financial strength of DMC.

Table 2. Comparison of price-to-revenue multiples paid by Vanguard in 2010 transactions.

	Price-to-Revenue Multiple	Financial condition
Detroit Medical Center	0.2x	Positive operating income
Westlake Hospital & West Suburban Medical	0.2x	Operating losses
Arizona Heart Hospital	0.4x	Operating losses

TWO CHICAGO FACILITIES WITH OPERATING LOSSES FETCHED SAME MULTIPLES AS DMC. In August the company completed its acquisition of two hospitals in Chicago from nonprofit Resurrection Healthcare, which will become tax-paying entities once the deal is closed.[10]

"The two hospitals are in the most acute situation" according to the hospital CEO and "combined, the hospitals have lost $114 million on operations over the past three years." In fact, these facilities had to be purged "In order to save the whole of Resurrection." [11]

In stark contrast, according to Vanguard's Chief Development Officer Trip Pilgrim, DMC is an attractive acquisition candidate for a variety of reasons: [12]

(1) "In Detroit, the DMC already is a dominant player with a 13.4 percent market share"
(2) "It's remained profitable despite harsh economic conditions and the deal will give Vanguard a robust network of hospitals and doctors' offices."

[7] Weisman, Robert. Boston Globe. "Equity firm set to buy Caritas. Catholic identity will be retained Hospitals to shift to for-profit status" March 25, 2010. Retrieved from: http://www.boston.com/business/healthcare/articles/2010/03/25/equity_firm_set_to_buy_caritas?mode=PF

[8] Chambers, Jennifer. The Detroit News. "Patterson: It may be too late for Detroit" May 4, 2010.

[9] Irving Levin Associates, Inc. "The Hospital M&C Market: Five-Year Review & Outlook" Second Edition, 2010. p.9.

[10] Japsen, Bruce. Chicago Tribune. "Resurrection to sell pair of hospitals in suburbs; For-profit Vanguard to buy Westlake, West Suburban" November 25, 2009.

[11] Rogers, Christina. The Detroit News. "Vanguard's cautionary Chicago story" June 21, 2010. Retrieved from: http://detnews.com/article/20100621/BIZ/6210321

[12] Rogers, Christina. The Detroit News. "Vanguard's cautionary Chicago story" June 21, 2010. Retrieved from: http://detnews.com/article/20100621/BIZ/6210321

Mr. Pilgrim concluded by saying that "The difference between Chicago and Detroit is apples to an orange grove."[13] We find it troubling that Vanguard would offer the same price-to-revenue multiple for two acquisition candidates that the company itself considers vastly different. Accordingly, we urge the Attorney General seek an amount that recognizes the strengths that Vanguard itself clearly sees in DMC.

ARIZONA HEART HOSPITAL RECEIVED HIGHER MULTIPLE THAN DMC. This month, Vanguard purchased the Arizona Heart Hospital from for-profit operator MedCath Corporation for $32 million, representing a price-to-revenue multiple of 0.4x. This facility has experienced negative operating income for the last three years (2007, 2008, 2009).

MedCath Corporation, a physician-owned cardiac hospital chain, was also reportedly pressed to liquidate and had "explored options for selling the company in whole or in pieces" earlier in the year.[14] The company has sold its stake in its South Dakota facility as well as its Austin hospital in addition to the Arizona Heart Hospital. MedCath owns an interest in or operates nine hospitals in seven states, including these facilities.

SEIU believes that DMC should not be in as urgent a position to sell compared to MedCath, which will likely face operational challenges because healthcare reform legislation places severe restrictions on physician-owned hospitals. This, along with the lackluster financial performance leads us to question how Vanguard could offer to MedCath, a for-profit entity, twice what the company is prepared to commit to DMC.

Finally, we note that the DMC acquisition will nearly double Vanguard's acute care revenue,[15] thus potentially positioning DMC as Vanguard's flagship hospital operations. Accordingly, we argue that DMC deserves a premium for its significant impact on Vanguard's financial performance and status within Vanguard's portfolio of hospitals.

ANOTHER VALUATION TECHNIQUE ALSO INDICATES TOO LOW A VALUE FOR DMC

PRICE-TO-EBITDA MULTIPLE. Another method similar to the price-to-revenue multiple is to substitute earnings before interest, taxes, depreciation and amortization ("EBITDA") for revenue. According to Irving Levin, it is challenging to use this multiple because of "the lack of timely disclosure of financial data, mostly Medicare cost reports, and the disinclination of buyers to reveal current EBITDA of their target hospitals."[16]

Nevertheless, the median price-to-EBITDA in 2009 as calculated by Irving Levin was 8.6x, which is two and a half times the multiple Vanguard has offered for DMC. Applying the 8.6x multiple to DMC's $124.7 million in EBITDA in 2009 produces a value of $1.1 billion. In comparison, the Cerberus offer for Caritas of $430-$350 million represents 14.5x Caritas' 2009 EBIDA (as a nonprofit, Caritas is tax-exempt).

SEIU believes that Vanguard may not be offering fair market value for Detroit Medical Center, especially given the strong financial potential that DMC possesses, a fact that Vanguard officials have publicly touted. We encourage the Office of the Attorney General to employ its authority to seek a price that

[13] Rogers, Christina. The Detroit News. "Vanguard's cautionary Chicago story" June 21, 2010. Retrieved from: http://detnews.com/article/20100621/BIZ/6210321

[14] Yin, Sandra. Fierce Healthcare. "MedCath could be health reform's first victim" September 15, 2010. Retrieved from http://www.fiercehealthcare.com/story/medcath-could-be-health-reforms-first-victim/2010-09-15

[15] Vanguard Health Systems 10k filing. Fiscal-year ended June 30, 2010 patient service revenue was $2.537 billion. p.175.

[16] Irving Levin Associates, Inc. "The Hospital M&C Market: Five-Year Review & Outlook" Second Edition, 2010. p.13.

reflects the appropriate value of DMC and fairly compensates the state of Michigan and the people of Detroit for a valuable community asset.

Sincerely,

Sandra Sebastian
Research Coordinator
Service Employees International Union

CC: Tracy A. Sonneborn, Assistant Attorney General
Michigan Attorney General's Office, Consumer Protection and Charitable Trusts

Marge Faville, RN President SEIU Healthcare Michigan