The Value Imperative: Landscape Reflects Acceleration in Transformation
Introductory Remarks

- Earlier this year, Citi’s Global Healthcare Team hosted senior managers from 130 companies

- Focus on the “value imperative”
  - Increasing urgency for providers to demonstrate value
  - Considerable disagreement on:
    ▪ Pace of change
    ▪ Best redesign of the current model
    ▪ Future model in 2020 and beyond

- Selected conclusions
  - Risk payment models are on the rise
  - Healthcare dynamics remain local, with no national model yet
  - Status quo is an increasingly risky strategy
Strategic Positioning Under Reform

Efficient Producer
- Scale
- High Quality
- High Service
- Very Efficient

Fully Integrated System
- Network
- Care Coordination
- Risk Management
- Quality Outcomes

Centers of Excellence
- Expertise
- Exceptional Quality
- Proven Outcomes
- Research / Innovation

Market Maker
- Geography
- Market Leader
- High Quality
- Essential in Community
Growing Evidence of Future Success Factors

The emerging success model requires:

- Scale and integration
- Market essentiality
- Leading quality and patient safety
- Aligned physicians
- Sophisticated IT with high adoption rates
- Highly efficient cost structures
- Population health focus
- New payment model competencies
- Reasonable capital access
- Progressive governance and leadership

Maintain Organizational Strength
Citi Study…Examining the Impact of Scale and Integration

All NFP Systems

- < $1 Billion, 41%
- $1-3 Billion, 43%
- $3-5 Billion, 11%
- > $5 Billion, 5%

Total = 246* health care systems with $460 billion in revenue

Top 100 Integrated NFP Health Systems

- < $1 Billion, 22%
- $1-3 Billion, 55%
- $3-5 Billion, 19%
- > $5 Billion, 4%

Total = 78 health care systems with $165 billion in revenue

Based on Citi overlap with 2008-2012 IMS IHS 100 Surveys

Top Quartile: Top quartile (20 systems) overlapping the Citi study

Other Integrated: 2nd-4th quartiles (58 systems) overlapping the Citi study

Largest NFP Systems Experience Highest Operating Margin

Operating Margin

Note: Historical Data based on approximately 255 reporting systems. Comparative data from Citi Growth Study. Health system data reflects average value of category.
The Higher the Level of Integration, the Greater the Profitability

**Operating Margin**

The Top Quartile has average FY12 operating revenue of $3.0 billion

Other Quartiles have average FY12 operating revenue of $1.9 billion

Note: Historical Data based on approximately 255 reporting systems. Comparative data from Citi Growth Study. Health system data reflects average value of category. "Other Integrated" includes the remaining three quarters of health systems overlapping the Citi study.
Quantifying The Expected Benefits: Scale and Integration

Scale has led to operating leverage:

- Since 2006, the operating margin differential between the >$5 billion health systems and <$1 billion health systems has averaged approximately 200 basis points.

Higher level of integration has also led to greater operating leverage:

- Since 2006, the operating margin differential between the Top Quartile and the Other Integrated group has averaged approximately 160 basis points.

Note: Historical Data based on 255 reporting systems. Comparative data from Citi Growth Study. Health system data reflects average value of category. “Other Integrated” includes the remaining three quarters of health systems overlapping the Citi study.
Factors Contributing to Differences in Performance

5 Year Average Annual Benefit vs. Aggregate Average

- Operating Margin Increase
- Cost of Debt Savings
- Supply Expense Savings
- Bad Debt Expense Savings
- Compensation Expense Savings

<1 B  $1 - 3 B  Other Integrated
$1 - 3 B  Top Quartile
$3 - 5 B
>$5 B

Note: Historical Data based on 255 reporting systems. Comparative data from Citi Growth Study. Health system data reflects average value of category. "Other Integrated" includes the remaining three quarters of health systems overlapping the Citi study.
Recent Tenet / Vanguard Deal Confirms Imperatives

Well-Positioned for the New Healthcare Environment

**Increased Scale**
- 79 hospitals and 157 outpatient centers
- Applies proven cost management, quality improvement, care integration and network development strategies across a broader platform
- Enhances portfolio management opportunities

**Enhanced Geographic Breadth**
- Expands market leader position – #1 or #2 position in 19 important markets
- Adds geographic diversification with expansion into additional states
- Adds important markets in Texas – San Antonio and South Texas

**Integrated Service Offering**
- Leverages Conifer Health Solutions across broader portfolio
- Adding Vanguard health plan expertise expands Conifer value-based care and population health management capabilities

**Broader Physician Platform**
- Physician alignment, recruitment and employment strategies applied across broader network
- Leverages Vanguard’s health plan experience developing successful clinical integration and ACO models

**Complementary Management Teams**
- Combines two organizations with similar values, priorities and demonstrated cultures of ethics and compliance
- Tenet’s proven management capabilities augmented by Vanguard turnaround expertise and experience in health plan operations

Tenet / Vanguard Merger Enhances Position in Key Markets

Established Positions in Key Markets

Greater Breadth Provides Opportunities for Revenue Growth


[Map showing various states and hospital locations marked with Tenet and Vanguard logos.]


*Excludes 2 Connecticut hospitals currently under LOI.
Horizontal Strategies Also Reflected in Recent NFP Transactions

Geographic expansion and deeper market penetration.

**In-Market**
- Hoag
- St. Joseph Health System
- Providence Health & Services
- Swedish
- Baylor Health Care System
- Scott & White

**Geographic Expansion**
- Ascension Health
- Marian Health System
- Trinity Health
- Catholic Health East
- Catholic Health Initiatives
- St. Luke’s Episcopal Health System

A spirit of innovation, a legacy of care.
Dignity Health Overview

- Dignity Health, headquartered in San Francisco, CA and formerly Catholic Healthcare West, provides integrated, patient and family centered care
  - Fifth largest health system in the country with 10,000 physicians and 55,000 employees across Arizona, California, and Nevada
  - Through its network of more than 150 ancillary care sites and 40 acute care hospitals, Dignity Health is committed to delivering compassionate, high-quality, affordable health care services with special attention to the poor and underserved

U.S. HealthWorks Overview

- U.S. HealthWorks, headquartered in Valencia, CA, was founded in 1995 and is the largest independent operator of occupational health care centers in the nation
  - Has 172 clinics and worksites in 15 states and more than 2,700 employees including approximately 800 medical providers
  - Serves more than 11,000 patients each day throughout the country
  - Helps employers control work-related injury costs through quality medical care and effective management of claims and lost work time

Transaction Overview

- On July 2, 2012, Dignity Health and U.S. HealthWorks Medical Group (“U.S. HealthWorks”) announced that they have entered into a definitive agreement under which Dignity Health will acquire U.S. HealthWorks
- U.S. HealthWorks will continue to operate as a for-profit provider through a wholly-owned subsidiary of Dignity Health
- Dignity Health has agreed to retain substantially all U.S. HealthWorks management and employees, and plans to expand operations across its ambulatory care settings
- Transaction is subject to certain regulatory approvals

Strategic Rationale

- Expands its geographic reach to 16 states and brings Dignity Health one step closer to becoming a fully integrated delivery network
- Diversifies the care it offers as part of a broader strategy to integrate care across the spectrum of services
- Expands its existing partnerships with other organizations to operate ambulatory surgery and imaging centers
  - Dignity Health has a joint-venture partnership with United Surgical Partners International for 17 ambulatory surgery centers and surgical hospitals across California, Arizona and Nevada
  - The organization has 35 imaging centers in partnership with SimonMed Imaging

Source: Press release.
Non-traditional partnerships have emerged as a response to environmental forces.
Majority of Top Quartile IHS’s Have Health Plans

**Top 100 Integrated NFP Health Systems**

- **Health Plan**, 62%
- **No Health Plan**, 38%

Total = 78 health care systems with $165 billion in revenue

Based on Citi overlap with 2008-2012 IMS IHS 100 Surveys.

**Top Quartile**

- **Health Plan**, 70%
- **No Health Plan**, 30%

Total = 20 health care systems with $58 billion in Revenue

**Other Integrated**

- **Health Plan**, 28%
- **No Health Plan**, 72%

Total = 58 health care systems with $107 billion in Revenue

Provider Insurance Strategies Vary

- **Own it, build, and/or buy:** Now or in the future

- **Contract for infrastructure:** Evolent (UPMC), xG Health Solutions (Geisinger)

- **Partner:** Aetna and other ACO initiatives
Case Study: Health System Leverages What Works

Transaction Rationale
- On April 16, 2013 SSM Health Care (“SSM”) and Dean Health System (“Dean”) entered into a definitive agreement under which Dean will become part of SSM Health Care, pending the approval of Dean physician shareholders and regulatory agencies.
  - Dean physician shareholders will sell their majority ownership in each business unit and SSM will increase its ownership to 100%.
  - Financial terms of the transaction were not disclosed.

About Dean Health System
- Dean, based in Madison, Wisconsin, is one of the largest physician owned integrated healthcare delivery systems in the United States with over $1.3 billion in annual revenue. The System is privately held and physician-governed.
  - Dean provides services through 4 main business units:
    • Physician Services (Dean Clinic)
    • Managed Care (Dean Health Plan)
    • Pharmacy Benefit Management (Navitus Health Solutions)
    • Surgery Centers and Clinics (St. Mary’s Dean Ventures)

About SSM Health Care
- SSM, a multi-regional system based in St. Louis, Missouri, is one of the largest health care providers throughout the United States. SSM owns seventeen hospitals, has a minority interest in five hospitals, manages one hospital, has affiliations with several rural hospitals, owns two nursing homes, and has a variety of partnerships with physicians.
  - The transaction will grow SSM’s annual revenues to over $4.5 billion.
  - The transaction will facilitate the formation of Integrated Delivery Networks across all of SSM’s markets.

“This is our opportunity to take the high quality/low cost model that SSM and Dean have developed in south central Wisconsin and expand it throughout the Midwest.”
William P. Thompson, President and CEO of SSM Health Care

“This transaction is being considered because it would help us become fully integrated and continue delivering value-based care.”
Craig Samitt, President and CEO of Dean Health System
Evolent Health is backed by capital, assets and intellectual property contributions from UPMC Health Plan and the Advisory Board.

Evolent Health markets services and software to help large systems develop the wherewithal to manage financial risk under accountable care and other emerging payment models.

The company delivers the infrastructure necessary for health systems to accept value-based payments from all payers.

The key components of Evolent Health's offering include an integrated population health management technology platform, extensive operational care management support, integrated payer functions, and holistic change management support.

UPMC’s primary contribution is its Identifi care management workflow software platform, a robust library of proven population management interventions embedded in the platform, and integrated health plan capabilities.

Source: Company website, press releases and other public disclosure.
Case Study: Regional Provider Agreements Promote Clinical Integration

**Transaction Overview**

- Aetna, the second-largest insurer in the Phoenix area, has implemented a risk-sharing agreement with Banner Health for its Aetna Whole Health.
- Aetna Whole Health, a commercial healthcare product provides members access to coordinated care from providers in the Banner Health Network, the health system’s ACO.
- Aetna Whole Health is available to Phoenix-area employers with two to 100 employees.
- Banner was recently the first health system accepted by the Centers for Medicare & Medicaid Services to participate in the ACO Pioneer Program; it has yet to accept the offer.

> “ACOs and similar collaborative models are moving forward whether healthcare reform is implemented or not.”
> Peter Fine
> Banner Health President and CEO

**Transaction Overview**

- On June 22, 2012, Inova Health System and Aetna announced an exclusive partnership to establish Innovation Health Plans, a jointly owned health plan serving Northern Virginia.
- The partnership will help to promote clinical integration of the health care community.
- New commercial and Medicare Advantage HMO and PPO products will be offered in Northern Virginia as part of the joint venture expected to begin January 1, 2013.

> “This joint venture with the region’s largest health system signals a new level of Aetna’s commitment to payment reform and stronger provider collaboration. It is a significant step forward for our customers and members. Through our joint arrangement we will deliver a better, more affordable health care experience.”
> Mark T. Bertolini
> Aetna Chairman, President and CEO

Source: Moody’s, S&P, Health Leaders Inter Study.
Convergence is a Two-Way Street
Back to the Future – Physician Practice Management Reborn?

- The rise and fall of the PPM sector in the 1990’s
  - Fatal flaws in the earlier model
  - Characteristics of surviving PPMs
- New risk payment models
- Recent acquisitions of physician groups
- Outlook for PPMs
  - “This time is different”? 
  - “The more things change, the more they stay the same”
Capital Implications of Transformation

- Citi’s annual capex survey shows changes
  - Expenditure growth slows
  - Change in focus
- Bond issuance reflects changes as well
  - Tax-exempt issuance remains modest
  - Taxable issuance up dramatically
- Rating agency sector outlooks are guarded
- Access to capital (or lack thereof) is a key factor driving M&A activity
Citi’s Annual Hospital Capex Survey Shows Slower Growth

Source: 2013 US Hospital Capex Survey.
Citi’s Annual Hospital Capex Survey Shows Change in Focus

Primary Use of Capital Expenditures in 2013

- Normal maintenance capital spending: 74%
- Upgrade clinical information systems: 64%
- Add/upgrade diagnostic equipment: 54%
- Upgrade financial information systems: 31%
- Expand outpatient square footage: 28%
- Add new outpatient services: 27%
- Other: 16%
- Construct a medical office building: 14%
- Add inpatient bed capacity: 11%
- Construct an ambulatory surgery center: 6%
- Add new inpatient services: 6%
- Construct a replacement hospital: 5%

Source: 2013 US Hospital Capex Survey.
Tax-Exempt Healthcare Issuance Has Remained Modest

Source: SDC by Thompson Reuters
Excludes AMT and taxable transactions and private placements
Recent and Upcoming Not-For-Profit Health Care Taxable Financings

<table>
<thead>
<tr>
<th>Institution</th>
<th>Amount</th>
<th>Date</th>
<th>Maturity</th>
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<td>Ascension Health Alliance</td>
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T – Term Maturity with Amortization
B – Bullet Maturity
P – Put Maturity

Corporate – 3a4  Muni Conduit
## Taxable Issuance More Attractive in Today’s Market

Taxable bonds provide a unique opportunity to lock in low costs while maintaining spending flexibility.

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Considerations</th>
</tr>
</thead>
</table>
| • Captures historically low interest rates  
  – Spread between a taxable and tax-exempt transaction is at an all-time low  
• No limitations on use of bond proceeds  
  – Opportunity to fund pensions  
  – Shorter-lived assets (IT and equipment)  
  – “Private use” of financed space is not an issue  
  – No asset tracking is required  
• Bonds may be issued directly on an expedited basis; do not require Authority, State, or other approvals  
• Bond proceeds may be immediately added to investment portfolio to enhance liquidity  
• Average life restrictions do not apply  
  – There is robust demand for longer-dated maturities  | • Depending on market conditions, potential for higher cost of capital than a tax-exempt transaction  
• Less structuring flexibility, as taxable investors prefer bullet maturities  
  – Liquidity matters to taxable investors, so index-eligible size ($250 million per maturity) will achieve the best execution  
  – Non-index-eligible bonds may incur a pricing penalty  
  – Amortizing structures are uncommon but available  
• Make-whole call provisions will likely make refinancing of taxable debt not economical  |
Municipal Bond Rates Have Moved Higher than Treasuries

Municipals severely underperformed Treasuries this summer

Key Events
1) 05/03/13: April Jobs Report
2) 05/10/13: Largest Budget Surplus since 2008 Reported
3) 05/22/13: Fed Minutes Released from April 30-May 1 Meeting
4) 05/28/13: Consumer Confidence Rises to 5-year High
5) 06/07/13: May Jobs Report
6) 06/19/13: FOMC Policy Statement Released / Bernanke Press Conference
7) 07/05/2013: June Jobs Report
8) 07/18/2013: Detroit Files for Chapter 9 Bankruptcy Protection
9) 09/06/2013: August Job Report

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<td>5-Year</td>
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<td>10-Year</td>
<td>1.66%</td>
<td>2.76%</td>
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<td>30-Year</td>
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<td><strong>3.80%</strong></td>
<td>2.79%</td>
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Rates as of September 19, 2013.
For illustration purposes only; actual results will depend on future market conditions and may differ.
## Not-For-Profit Healthcare Sector Industry Outlook

<table>
<thead>
<tr>
<th><strong>Moody’s</strong></th>
<th><strong>Standard &amp; Poor’s</strong></th>
<th><strong>Fitch Ratings</strong></th>
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<tr>
<td><strong>Outlook: Negative</strong></td>
<td><strong>Outlook: Stable</strong></td>
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<tr>
<td>▲ Stable operating performance resulting from management ability to successfully transition to a new paradigm</td>
<td>▲ Positive credit metrics due to management’s resilience in an increasingly difficult operating environment</td>
<td>▲ Management initiatives expected to sustain stable operating performance</td>
</tr>
<tr>
<td>▲ Expansion of insurance coverage resulting from the PPACA</td>
<td>▲ Increased investment in information technology and other infrastructure to support value-based delivery</td>
<td>▲ Expanded coverage for the uninsured through the creation of health insurance exchanges</td>
</tr>
<tr>
<td>▲ Aging of the population</td>
<td>▼ Shrinking reimbursement rates for Medicare, Medicaid and commercial payors</td>
<td>▲ Expected increases in capital spending over the next five years, notably in information technology</td>
</tr>
<tr>
<td>▼ Slow economic recovery resulting in flat patient volume and a decrease in commercial coverage</td>
<td>▼ Looming reductions in federal reimbursement rates</td>
<td>▼ Decrease in the number of future cost-cutting opportunities</td>
</tr>
<tr>
<td>▼ Introduction of new and untested insurance products</td>
<td>▼ Increase in risks resulting from a transition to new payment models</td>
<td>▼ Risk of further cuts to reimbursement rates and entitlement reform</td>
</tr>
<tr>
<td>▼ Continued deterioration of operating conditions resulting from revenue constraints and challenging utilization trends</td>
<td>▼ Widening of the credit gap due to changes in the operating environment and increased consolidation</td>
<td></td>
</tr>
</tbody>
</table>

Source: Moody’s, Standard & Poor’s and Fitch 2013 not-for-profit healthcare industry outlook.
Conclusion

• Several factors critical to thrive in the new value paradigm
• Strong financial performance and transaction activity underscore importance of scale
• Top quartile integrated health systems often operate health plans
• Blurred lines among traditional players stress importance of thinking differently
• For-profit partners can provide expertise in addition to capital
• Innovative managed care organizations and physicians pose increasing competitive threat
• Capital needs have changed, however remain substantial
For questions or comments, please contact:

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Citi works with its clients in greenhouse gas intensive industries to evaluate emerging risks from climate change and, where appropriate, to mitigate those risks.

efficiency, renewable energy and mitigation