A&M

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HEALTH FACILITIES &
SERVICES REVIEW BOARD

May 28, 2014

Mr. Ajay Pathak
Director, Strategic Business Development
OSF HealthCare System
800 N.E. Glen Oak Avenue
Peoria, Illinois 61603

Dear Mr. Pathak,

As requested, Alvarez & Marsal Valuation Services, LLC ("A&M VS") has performed a valuation of St. Anthony's Health System ("SAHS") and certain assets (the "Subject Assets") associated with SAHS as of December 31, 2013 (the "Valuation Date"). It is our understanding that OSF HealthCare System ("OSF") and SAHS are contemplating an affiliation (the "Transaction"). Management of OSF ("Management") has requested that A&M VS assist with an assessment of the fair market value[1] and fair value of (i) the four business units of SAHS, an Illinois not for profit corporation, including: Saint Anthony's Health Center ("Health Center"), Saint Anthony's Health System - Parent Company ("Parent"), Saint Anthony's Physician Group ("SAPG") and Saint Anthony's Foundation ("Foundation"), (ii) the real and personal property owned by the businesses at three locations in Alton, Illinois including Saint Anthony's Health Center, Saint Clare's Hospital and Saint Anthony's Health Center Medical Mall and (iii) identified intangible assets associated with the operation of the businesses, if any, all as of a current date (the "Valuation Date"). It is our understanding that our work will be used for the purposes of reporting requirements with respect to financial and regulatory reporting regarding the Transaction. The scope of our work was limited to the analyses we deemed appropriate and necessary to prepare our assessment of the fair values ("Opinion") as stated herein.

Our analyses and report are intended solely for your use as described in our engagement letter dated May 16, 2014. The report may be used only for the purposes described above. Neither the report nor its contents may be referred to or quoted in any registration statement, prospectus, loan or other agreement or document without prior written consent of A&M VS.

[1] Fair Market Value is defined as: "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." (Treas. Reg. 20.2031-1(b); Rev. Ruling 59-60, 1959 C.B. 237).

Executive Summary

We have considered the prevailing economic and industry environments, the history and nature of SAHS and the expected performance of SAHS as reflected in the prospective financial information ("PFI") and described by Management.

Scope of the Engagement

The scope of our work consisted of the identification, analysis and valuation of each of the four business enterprises of SAHS and the Subject Assets which included the following:

- Real Property and Related Assets;
- Personal Property and Related Assets;
- Intangible Assets.

Assets and liabilities not identified above were excluded from the scope of our engagement.

Sources of Information

For the purpose of our analysis, the primary written documents and records provided by Management were as follows:

- Projected financial information;
- Audited and internally prepared historical financial information; and
- Other miscellaneous documents.

The information provided by Management has been assumed, without further independent verification, to correctly represent the results of the actual and/or estimated operations and the financial condition of SAHS and each of its businesses.

Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.

The PFI was provided by Management and prepared by SAHS. Management utilized a third party healthcare industry consulting firm to assist them in identifying and making adjustments to the PFI provided by SAHS. A&M VS had several discussions with Management regarding the PFI including discussions regarding the basis for expectations of future financial performance. The PFI was also compared to historical trends of SAHS and the performance of selected publicly-traded guideline companies and private guideline transactions.

We have made certain adjustments to the historical information and PFI provided by Management considering the standard of value, the nature of the business and discussions with Management. In particular, we included the payment of corporate income taxes despite the tax exempt status of OSF and SAHS as required by the standard of fair market value. Based on all of the above, we confirmed that the PFI reflects Management's best estimate of the assumptions a hypothetical buyer and seller would use in pricing SAHS and was appropriate for use in our analysis. Our work does not constitute an examination, compilation or an agreed-upon procedures assignment as described in the American Institute of Certified Public Accountants ("AICPA") Professional Standards, Attestation Standards Section 200, Financial Forecasts and Projections.

Standard of Value

Fair value is defined in FASB ASC Section 820-10-35 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

ASC 820 provides several key principles of fair value measurement:

- Fair value should reflect an exit price, the price that would be accepted to sell the asset.
- The hypothetical transaction is assumed to be an orderly transaction, not a forced sale.
- The asset (liability) is transferred in an exchange between market participants.
- Fair value should reflect the perspective of a market participant that holds the asset or owes the liability; thus, it would reflect its highest and best use.
- The hypothetical transaction is assumed to occur in the principal or most advantageous market.
- Fair value should not reflect any adjustment for transaction costs, but it may include transportation costs in certain circumstances.
- The highest and best use determines the premise of value, either in-use (in combination with other assets as installed or otherwise configured) or in-exchange (stand-alone).

Fair market value is defined by Internal Revenue Services as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Many of the underlying concepts and principles of fair market value are similar to those of fair value but there can be differences under certain circumstances. The differences are usually insignificant and unless otherwise noted, our conclusions are the same under both standards herein and are referred to as fair values.

Premise of Value

Fair value is established based on premise of value and underlying analytical approaches appropriate to the facts and circumstances pertaining to the various classes of assets valued. Our valuation assumes that, unless identified otherwise in this report, the highest and best use of the assets will continue to be as a group in the ongoing business of providing healthcare services. Therefore, we recognized the highest and best use of the assets to be as installed and as used, and we valued the assets under an in-use premise. In the case of the personal property assets, the premise of value in-use includes the additional value related to the freight, tax, installation and other costs that were incurred when the personal property assets were placed into service.

Valuation Approaches

In developing our opinions, we considered three approaches to value for the businesses of SAHS and the Subject Assets and chose the most appropriate approach or approaches for each. Our conclusions rely on the approaches judged to be most appropriate for the purpose and scope of our analysis, as well as the nature and reliability of the available data. The three approaches to value are summarized as follows:

- **Income Approach**

  The income approach is a way of developing a value indication for a business, tangible or intangible asset or liability using one or more methods that convert anticipated economic benefits or obligations into a present single amount.[2] The discounted cash flow method is a method whereby the present value of future expected net cash flows is calculated using a discount rate.[3]

- **Market Approach**

  The market or sales comparison approach is a general way of estimating the value of a business, security, tangible, or intangible asset using one or more methods that compare the subject to similar investments or assets that have been sold or offered for sale.[4] Sales and offering prices for the comparable investments or assets are adjusted to reflect the difference between the investment or asset being valued and the comparable investments or assets, such as historical financial condition and performance, expected economic benefits, time and terms of sale, utility, and physical characteristics. The adjusted prices of the comparable assets provide an indication of value for the subject asset.

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[2] AICPA Statement on Standards for Valuation Services No. 1, *Appendix B: International Glossary of Business Valuation Terms*, 45.
[3] Ibid. 43.
[4] *International Glossary of Business Valuation Terms*, 45.

- **Cost Approach**

  The cost or asset approach may be viewed as a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capacity of that asset.[5]

Application and Methodology

Business Enterprise Value of SAHS

SAHS is comprised of four business units:

- St. Anthony's Health Center ("Health Center')
- St. Anthony's Health System – Parent Company ("Parent")
- St. Anthony's Physician's Group ("SAPG")
- St. Antony's Foundation ("Foundation").

Health Center

Both income and market approaches were applied to determine the fair value of the Total Invested Capital ("TIC") for the Health Center. In particular, we used a discounted cash flow analysis ("DCF") and market-derived multiples of revenue, earnings before interest taxes depreciation and amortization ("EBITDA"). The discounted cash flow analysis was used to determine the enterprise value of the Health Center based on the PFI. In addition to the PFI, the discounted cash flow method relies upon a discount rate and a long term growth rate. The discount rate is the rate used to convert the annual cash flows as represented in the PFI into a present value. The appropriate discount rate to estimate enterprise value is the weighted average cost of capital ("WACC") that reflects the required rates of return on debt and equity by the investors in the business.

Our market approach included derivation of market multiples from publicly-traded guideline companies in the hospital management business as well as market multiples observed in private transactions where individual hospitals were acquired.

In addition, we prepared a valuation based on the net underlying assets method ("asset method") of the cost approach for the Health Center. The asset method entailed a valuation of the real property and related assets and the personal property and related assets based on a consideration of all three approaches.

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[5] Ibid, 43.

Parent, SAPG, and Foundation

Parent, SAPG, and Foundation were each valued separately based on the asset method. The asset method is more appropriate for asset holding companies, investment holding companies and other businesses whose cumulative value of its underlying assets on a piecemeal basis is likely to be greater than the value of the expected earnings or stream of future benefits that can be generated from the assets as a going concern business.

By adding the value of liabilities not considered to be components of invested capital, typically the liabilities being included in Net Working Capital, to our estimate of the TIC, we arrive at an estimate of the aggregate fair value of the cumulative Total Assets.

Real Property

In order to estimate the value of land, we used the sales comparison approach by gathering recent sales transactions of land sales with similar characteristics as the subject land parcels. We then used adjustment grids to make qualitative and quantitative adjustments to arrive to our land value.

The cost approach was used to calculate the fair value for building and site improvements. The replacement cost new less depreciation ("RCN-LD") was determined by subtracting accrued depreciation resulting from physical depreciation, functional and external obsolescence from the replacement cost new. Building and site improvement estimates were based on information provided by Management, information acquired during site inspections, discussions with SAHS personnel, and estimates using GIS software. Our cost estimates are based on guidelines provided by *Marshall Valuation Service*. Due to the specialized nature of the subject property, the sales comparison and income approaches were not utilized in estimating the fair value of the subject buildings as vacant and site improvements.

Personal Property and Related Assets

We applied the cost and market approaches to value the personal property and related assets. The income approach was not considered due to the inefficiency of calculating an income stream to each individual personal property and related asset considered in the analysis. Within the cost approach analysis, several techniques are commonly used to facilitate the process of estimating the current replacement or reproduction cost new of the assets. The following methods of the cost approach have been applied within this analysis: trending and direct costing analysis. The historic costs were indexed (using trend factors) to determine the reproduction costs new of the assets. In some situations, additional procedures are appropriate to confirm or adjust the reproduction cost estimates to better reflect replacement costs. The direct replacement costs were researched and quantified by contacting Original Equipment Manufacturers ("OEM") and/or their representatives to determine the cost new today, and from standard pricing media and our data files.

Since the Subject Assets are currently in use and of various age, some deficiency, or loss in value, needs to be deducted in the form of accrued deprecation to arrive at their value. The elements of deprecation to be considered are Physical Deterioration, Functional Obsolescence, and Economic Obsolescence, when applicable. The three forms of deprecation are further described below:

- Physical is a form of depreciation where loss in value or usefulness of a property is due to the using up or expiration of its useful life caused by wear and tear, deterioration, exposure to various elements, physical stresses, and similar factors.
- Functional Obsolescence is a form of depreciation in which the loss in value or usefulness of a property is caused by inefficiencies or inadequacies of the property itself, when compared to a more efficient or less costly replacement property that new technology has developed. Symptoms suggesting the presence of functional obsolescence are excess operating cost, excess construction (excess capital cost), over-capacity, inadequacy, lack of utility, or similar conditions.
- Economic Obsolescence (sometimes called "external obsolescence") is a form of depreciation where the loss in value of a property is caused by factors external to the property. These may include such things as the economics of the industry; availability of financing; loss of material and/or labor sources; passage of new legislation; changes in ordinances; increased cost of raw materials, labor, or utilities (without an offsetting increase in product price); reduced demand for the product; increased competition; inflation or high interest rates; or similar factors.

Summary and Conclusions

The cumulative fair values of the underlying assets of the Health Center resulted in an indicative value approximately equal to the estimated value of the Health Center based on the results of the income and market approaches. These results reflect the absence of any significant value for intangible assets or goodwill for the Health Center. The value conclusion for each of the remaining three business units was based on the application of the asset method due to the nature of the businesses as described above. Based upon the information provided, discussions with Management and our independent research, as well as the analyses performed and described herein, we have concluded that the fair market value and fair value of the Total Assets of SAHS as of the Valuation Date is approximately $64.554 million. Our conclusions of value by asset class and business unit as well as the consolidated value of SAHS are provided on the attached schedule.

The conclusions and opinions expressed herein are subject to the *Assumptions and Limiting Conditions* included in the full valuation report. Additional relevant information and analyses considered in our opinions will be retained in our work files and will be available for review upon request. The depth of discussion contained herein is specific to your needs as the client and for the intended use as stated.

If you have any questions regarding the results of the analysis, please contact me at (312) 288-4065.

Very truly yours,

Gary T. Frantzen

Gary T. Frantzen, CFA
Managing Director
Alvarez & Marsal Valuation Services, LLC

OSF HealthCare System

Schedule

Valuation of Certain Assets of St. Anthony's Health System

Summary of Values

Valuation Date: December 31, 2013

US$ in 000s

	Saint Anthony's Health Center	Saint Anthony's Health System	Saint Anthony's Physician Group	Saint Anthony's Foundation	Consolidated Appraised Values
Assets					
Working Capital, Net of Cash	$ 2,039	$ (101)	$ 76	$ -	2,013
Property, Plant & Equipment					
Building & Improvements	17,380	4,920	-	-	22,300
Land	1,390	-	-	-	1,390
Land Improvements	1,370	-	-	-	1,370
Total Real Property	20,140	4,920	-	-	25,060
Personal Property	10,191	10	90	-	10,290
Construction in Progress	1,127	-	-	-	1,127
Total Property, Plant & Equipment	31,458	4,930	90	-	36,477
Intangible Assets	-	-	-	-	-
Non-Operating Assets					
Other Assets	4,000	-	4	-	4,004
Assets Limited As To Use	-	-	-	61	61
Total Non-Operating Assets	4,000	-	4	61	4,065
Cash and Cash Equivalents	11,305	0	26	28	11,360
Total Invested Capital	**48,802**	**4,828**	**196**	**89**	**53,915**
Current Liabilities, Net of Debt	9,846	101	691	-	10,639
Total Assets	**58,648**	**4,930**	**887**	**89**	**64,554**

Ed Parkhurst

From: Ed Parkhurst
Sent: Tuesday, June 17, 2014 9:11 AM
To: 'Roate, George'
Subject: RE: FMV Report for Projects E-009-14 and E-010-14

George, will do. Ed

From: Roate, George [mailto:George.Roate@Illinois.gov]
Sent: Tuesday, June 17, 2014 8:47 AM
To: Ed Parkhurst
Subject: RE: FMV Report for Projects E-009-14 and E-010-14

Thank you, Ed.
Please send a paper copy to Bonnie. No need to overnight it (unless you really want to).

From: Ed Parkhurst [mailto:eparkhurst@consultprism.com]
Sent: Tuesday, June 17, 2014 6:58 AM
To: Roate, George
Cc: Constantino, Mike
Subject: FMV Report for Projects E-009-14 and E-010-14

George,

Attached is the required FMV report for both the above referenced COE's. Mike requested the report for the record. It supports the valuation as stated.

I am sending it to you in that we understand Mike is out on medical leave.

Will this form of submission be acceptable or do you need the report to be sent overnight, return receipt requested?

Thanks for your assistance.

Ed