Duke Response to the NHRMC Request for Proposal

Clarifying Questions
April 10, 2020

This response to NHRMC's clarifying questions is intended to be reviewed together with Duke's comprehensive proposal submitted to NHRMC on March 16, 2020. As outlined in Duke's proposal and herein, all aspects of Duke's proposal remain subject to change based on additional due diligence, further understanding of the impacts of the COVID-19 pandemic, and other applicable considerations.

1. Describe what impact, if any, Respondent's Proposed Strategic Partnership would have on NHRMC's ability to further develop and/or reconfigure existing inpatient facilities in the Service Area? Please comment on the Respondent's support for and alignment with the inpatient facility planning included NHRMC's Master Plan provided in the Data Room.

Based on Duke's review of the high-level strategic planning information made available by NHRMC to-date, Duke is supportive of NHRMC's inpatient facility plan. Under the proposed NHRMC and Duke strategic partnership, NHRMC's ability to further develop and/or reconfigure existing inpatient facilities in the service area will be enhanced. This includes comprehensive support from the Duke enterprise and the proposed capital commitment, and is consistent with Duke's underlying vision for the strategic partnership – to continue enhancing NHRMC's role as a regional destination medical center that serves an even broader geographic footprint. This includes, but is not limited to the following, as specifically identified in the NHRMC materials Duke has reviewed:

(1) Further develop advanced services/tertiary care on main campus;

(2) Cancer center upgrades; and

(3) Service distribution initiative to relocate services (including lower acuity services) from the main campus to throughout the geographic area including other acute care facilities and outpatient locations, and/or leverage digital solutions where possible.

2. Please define capital expenditures per your proposal (i.e., what specific types of expenditures would be counted as part of the capital commitment), as well as provide a clarification for (i) the expected source of funding for non-routine capital expenditures associated with the capital commitment, and (ii) any factors or contingencies that would affect the total capital commitment.

Duke is committed to supporting the ongoing maintenance and strategic capital requirements of NHRMC in order to facilitate the continued growth and development of the organization. As such, Duke has proposed a minimum financial investment in NHRMC of $1.9 billion to execute on NHRMC's strategic plan and fund estimated routine capital. The capital commitment will be applied to facility, program, and service improvements, and to otherwise maintain and further increase NHRMC's capabilities, efficiency, infrastructure, and reach across its current service area and beyond.

Under the proposed asset purchase transaction structure, the capital commitment may be funded through system cash flows, reserves, and/or borrowed funds. Funding of the capital commitment will not be subject to contingencies; however, Duke acknowledges that over time the optimal use of the capital commitment may evolve from what is initially envisioned. As a result, Duke suggests the parties maintain appropriate flexibility on how funds are ultimately deployed within the NHRMC service area.

3. In the attached Excel worksheets, please indicate:

a. The financial consideration proposed as part of a partnership with NHRMC. Please provide a version for each structure proposed.

b. The treatment of NHRMC's balance sheet and working capital for a Day 1 cutover. Please indicate which assets and liabilities will be retained by the successor organization or retained by New Hanover County. Please provide a version for each structure proposed.

The two requested templates have been populated by Duke and provided below based on available information received to-date and subject to additional due diligence. As detailed in Duke's proposal submitted on March 16, 2020, Duke shares NHRMC's desire for its strategic partner to invest in NHRMC and in those communities it serves. To that end, Duke proposes an asset purchase transaction structure with economic consideration to include a significant capital commitment, meaningful cash "purchase price" paid at closing, and New Hanover County retaining NHRMC's net cash, as detailed below. However, Duke remains open to discussing this allocation (across capital commitment and cash at closing) with New Hanover County and NHRMC to ensure the parties' mutual objectives of accelerating NHRMC's growth as a regional destination medical center and keeping care local can be accomplished. If preferred by NHRMC and New Hanover County, this includes Duke's openness to considering an all cash at closing offer (i.e., without a capital commitment), subject to additional discussion to ensure alignment with NHRMC's goals and objectives and the organizations' shared vision for the strategic partnership.

The completed templates below contemplate Duke's preferred asset purchase transaction structure and the parties' mutual desire for Duke to invest significantly in NHRMC and those communities it serves. Duke remains open to a range of integrated and less integrated partnership structures including joint ownership, lease, and other less integrated partnership structures, as detailed in its March 16, 2020 proposal. While not detailed below, if preferred by NHRMC and New Hanover County, Duke will be pleased to collaborate to determine economic terms for alternative structures preferred by NHRMC that take into account structural variations when compared to the proposed asset purchase transaction.

As outlined further in Question 5 of this document, as NHRMC makes available additional information and data regarding actual or expected impacts on the organization due to the COVID-19 pandemic, it is possible that Duke would modify various aspects of its proposal including these economic matters.

The following two pages contain information from Duke Health submitted in response to Question 3(a) and 3(b) above.

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	Asset Purchase Structure ($ in thousands)
CONSIDERATION	
Purchase Price / Upfront Cash	$ 500,000.00
Other Components of Cash Consideration	$ -
County Retention of NHRMC Assets Less Liabilities (1,2,3)	$ 440,491.00
Incremental Impact to Purchase Price / Upfront Cash - Balance Sheet Analysis (2,3)	$ 440,491.00
TOTAL CASH PROCEEDS TO COUNTY	
Cash to County/Community Foundation allocation subject to County preference →	*$ 940,491.00*
CASH TO COMMUNITY FOUNDATION	
OTHER NON-CASH CONSIDERATION	*$ -*
TOTAL PROCEEDS RECEIVED	***$ 940,491.00***
TOTAL CAPITAL COMMITMENT	**$ 1,903,400.00**
Number of Years	12
Implied Annual Capital Commitment	$ 158,616.67
OTHER CONSIDERATION	**$ -**

(1) Excludes defeasance and winddown costs.
(2) See balance Sheet Analysis in separate template.
(3) Impact, if any, of deferred inflows/outflows of resources remains subject to additional due diligence.

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Assets	($ in thousands)	Retained by Successor Organization	Retained by County	Incremental impact to purchase price/upfront cash
Cash and cash equivalents	$ 220,636		$ 220,636	$ 220,636
Patient accounts receivable	$ 150,333	$ 150,333		
Prepaids and inventory	$ 53,779	$ 53,779		
Investments	$ 9,011		$ 9,011	$ 9,011
Other current assets	$ 42,710	$ 19,888	$ 22,822	$ 22,822
Total current assets	**$ 476,469**	**$ 224,000**	**$ 252,469**	**$ 252,469**
Board designated funds	$ 634,239		$ 634,239	$ 634,239
Restricted funds and pledges (1)	$ 20,252	$ 20,252		
Investment in affiliates	$ 5,222	$ 5,222		
Other long-term assets	$ 5,483	$ 5,414	$ 69	$ 69
Total non current assets	**$ 665,196**	**$ 30,888**	**$ 634,308**	**$ 634,308**
PP&E	$ 590,887	$ 590,887		
Total assets	**$ 1,732,552**	**$ 845,775**	**$ 886,777**	**$ 886,777**
Liabilities				
Accounts payable	$ 83,246	$ 83,246		
Accrued salaries and wages	$ 55,350	$ 55,350		
Accrued interest payable	$ 7,669		$ (7,669)	$ (7,669)
Current portion of debt, capital leases	$ 17,123		$ (17,123)	$ (17,123)
Other current liabilities	$ 44,095	$ 44,095		
Total current liabilities	**$ 207,483**	**$ 182,691**	**$ (24,792)**	**$ (24,792)**
Net pension liability	$ 49,090		$ (49,090)	$ (49,090)
Supplemental retirement programs	$ 2,201		$ (2,201)	$ (2,201)
Interest rate swap agreements	$ 3,020		$ (3,020)	$ (3,020)
Notes and bonds payable, less current	$ 367,183		$ (367,183)	$ (367,183)
Total long-term liabilities	**$ 421,494**	**$ -**	**$ (421,494)**	**$ (421,494)**
Total liabilities	**$ 628,977**	**$ 182,691**	**$ (446,286)**	**$ (446,286)**
Incremental Impact to Purchase Price / Upfront Cash (2)			**$ 440,491**	**$ 440,491**

(1) The intended purpose for any restricted gifts and donations will be honored.
(2) Impact, if any, of deferred inflows/outflows of resources remains subject to additional due diligence.

4. If not already provided, please provide a brief statement on the Respondent's support for affiliated health systems in response to COVID-19?

Please refer to the Clarifying Questions document submitted by Duke to NHRMC on April 1, 2020 for related activities up to that date.

5. In light of the demands the COVID-19 crisis will place on all healthcare systems, please confirm your organization's commitment to this process. Specifically, confirm the Respondent has the capacity and resources to continue this process over the coming months and clarify if the expected ramifications from the crisis change any aspects of Respondent's Proposal.

Duke continues to view a partnership with NHRMC as strategically important to achieving its mission and vision as a nonprofit healthcare enterprise, and remains committed to pursuing this opportunity and to participating in NHRMC's partnership process. That said, although Duke has committed significant internal and third-party advisor resources to the pursuit of a strategic partnership with NHRMC, as is the case with healthcare organizations across the country, Duke's organizational bandwidth is focused on addressing the COVID-19 pandemic. While the pursuit of a strategic partnership with NHRMC is a high priority, like NHRMC, Duke is focused on patient care as its single highest priority and, as a result, the capacity of Duke's team will be impacted for the duration of the pandemic.

As the long-term impacts of the COVID-19 pandemic (if any) continue to unfold over the coming weeks and months, they may have implications on various aspects of Duke's proposal. As additional information and data become known and are shared by NHRMC regarding actual or expected impacts on its operations, financials, and partnership goals and objectives, Duke will make NHRMC aware of any modifications to its proposal based on the new information and understanding.

6. Respondent's preferred transaction structure is an asset purchase indicating a preference for a fully integrated relationship with NHRMC. Please provide additional information on why Respondent believes a fully integrated model is the best partnership model between NHRMC and the Respondent. Additionally, if the Respondent has less than fully integrated relationships with other health systems today, please include how those relationships have informed your decision to propose a fully integrated partnership as the preferred model with NHRMC.

In developing its proposal, Duke's focus was on how best to advance NHRMC's partnership goals and objectives and the organizations' mutual vision of continuing to advance and expand NHRMC's role as a regional destination medical center. Duke considered the full spectrum of partnership arrangements when identifying its preferred approach. While Duke believes alternative approaches can be effectively deployed if structured appropriately, full integration via an asset purchase transaction positions both organizations to collectively realize the maximum potential of the strategic partnership. In addition to optimizing clinical and economic opportunities and efficiencies, as Duke looks into the future, it is clear that a higher level of integration will best position the combined system in the new healthcare era impacted by population health and a value-based care reimbursement model. As detailed in its March 16, 2020 proposal, Duke is open to alternative structures, but believes it has proposed a strategic partnership that effectively balances these benefits with the critical element of local perspective and autonomy, including local management and governance, as well as meaningful New Hanover representation on the Duke University Health System board of directors.

In 1998, Duke Regional Hospital (owned by Durham County) joined Duke under a lease that originally had an initial 20-year term. While Duke maintained all of its commitments and made a number of significant investments at the hospital, the organizations were challenged to operate as a true system since incentives were not fully aligned. Three core examples are provided below, each resulting from the original lease structure's finite term.

(1) The lack of "permanency" made it more difficult to overcome the "us and them" in the local hospital's governance, negatively impacting the ability to operate as one and truly advance Duke Regional Hospital's capabilities and performance.

(2) The lease term also led to decreased strategic and mission-oriented investments, despite Duke's desire to invest more materially in Duke Regional Hospital and its communities, since the mutual benefit of those investments would be partially or fully realized after the 20-year lease term.

(3) Long-term clinical and operational integration activities were also impacted. As one example, how electronic medical record (EMR) systems would be "decoupled" if the partnership ended required significant consideration.

In 2009, Duke and Durham County worked together to transition the lease structure to more tightly align operations and incentives, effectively achieving full integration of Duke Regional Hospital through a 40-year "evergreen" lease. Under the evergreen structure, the lease automatically renews for an additional year, every year, until notice of an election to terminate is given by one of the two parties, at which time the 40-year term would begin to decrease. Since 2009, the true potential of the partnership has been unleashed, and Duke Regional Hospital and the Duke enterprise have transformed into true complements as detailed further in the case study included in Duke's March 16, 2020 proposal.

NHRMC is vital to the communities it serves, and Duke is committed to enhancing NHRMC's role as a regional destination medical center that sustainably delivers high quality, efficient, and accessible care locally. To be clear, it is Duke's intention not merely to sustain NHRMC, but to work together to rapidly grow NHRMC's service area and capabilities to continue to meet the expanding needs of its communities. Meeting this goal will require the deployment of significant resources and investment, to be supported by a strategic partnership model that appropriately promotes a high level of structural and functional alignment. Duke stands ready to partner with NHRMC to meet such goal.

Duke Response to the NHRMC Request for Proposal

Clarifying Questions
April 15, 2020

This response to NHRMC's clarifying questions is intended to be reviewed together with Duke's comprehensive proposal submitted to NHRMC on March 16, 2020 and its responses to NHRMC's separate clarifying questions. As outlined in Duke's proposal and in its responses to NHRMC's clarifying questions, all aspects of Duke's proposal remain subject to change based on additional due diligence, further understanding of the impacts of the COVID-19 pandemic, and other applicable considerations.

1. Does the $440.491 million in County Retention of NHRMC Assets Less Liabilities identified in your response to clarification questions dated April 10, 2020, apply to both the preferred and the all-cash at closing options? For the all-cash at closing option, is the $440.491 million in net cash retained by the County for a total cash consideration for the County of $1,815.491 million?

2. For the all-cash at closing option, your clarifying response indicates this comes without a capital commitment. Please confirm. In the absence of a capital commitment, please describe your approach to spending capital as it relates to the strategic plan as outlined by NHRMC.

As contemplated in its March 16, 2020 proposal, the all-cash at closing approach would be on a cash-free/debt-free basis and any capital deployed at NHRMC would be subject to Duke's regular capital allocation process. When compared to the proposed combination of cash at closing and capital commitment, the all-cash at closing approach naturally does not align as well with Duke's desires to invest significant capital at NHRMC and to advance the common vision of expanding NHRMC's role as a regional destination medical center that provides even more services to an even broader geography. This premise has been further compounded by recent events and the COVID-19 pandemic which has reinforced the importance of NHRMC's strategic partner investing significantly in initiatives within the NHRMC service area to execute on NHRMC's master capital plan and achieve the strategic partnership objectives. As a result, while Duke remains open to considering an all-cash at closing offer, additional discussion and understanding are required as to how that approach optimally advances NHRMC's goals and objectives and the organizations' shared vision for the strategic partnership.