

SUNLINK HEALTH SYSTEMS INC
Form DEF 14A
September 26, 2005
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934
(Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

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| <input type="checkbox"/> Preliminary Proxy Statement | <input type="checkbox"/> Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2)) |
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SunLink Health Systems, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

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SUNLINK HEALTH SYSTEMS, INC.

900 Circle 75 Parkway, Suite 1120

Atlanta, Georgia 30339

September 23, 2005

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders which will be held at 10:00 a.m., local time, on Monday, November 7, 2005, at the Renaissance Waverly Hotel, 2450 Galleria Parkway, Atlanta, Georgia 30339.

The accompanying Notice of the Annual Meeting and Proxy Statement contain detailed information concerning the matters to be considered and acted upon at the meeting. The Company's 2005 Annual Report to Shareholders is also enclosed.

We hope you will be able to attend the meeting.

Whether or not you plan to attend the meeting, please execute and return the enclosed proxy card at your earliest convenience to ensure representation at the meeting or vote via telephone or the Internet. If you later find you can attend the meeting, you may then withdraw your proxy and vote in person. If you have questions or need assistance regarding your shares, please call our proxy solicitor, Georgeson Shareholder Communications, Inc., at (866) 203-9401.

Sincerely,

/s/ ROBERT M. THORNTON, JR.
ROBERT M. THORNTON, JR.

President and Chief Executive Officer

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SUNLINK HEALTH SYSTEMS, INC.

900 Circle 75 Parkway, Suite 1120

Atlanta, Georgia 30339

NOTICE OF 2005 ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD ON NOVEMBER 7, 2005

To the Shareholders of

SUNLINK HEALTH SYSTEMS, INC.:

The Annual Meeting of Shareholders of SUNLINK HEALTH SYSTEMS, INC. will be held at 10:00 a.m., local time, on Monday, November 7, 2005, at the Renaissance Waverly Hotel, 2450 Galleria Parkway, Atlanta, Georgia 30339, for the purpose of considering and voting upon:

1. The election of four directors for a term of two years;
2. The Company's proposed 2005 Equity Incentive Plan; and
3. Such other business as may properly come before the meeting or any adjournment thereof.

Holders of the common shares of SunLink of record at the close of business on September 14, 2005, will be entitled to notice of and to vote at the meeting. You may vote by mail, telephone or the Internet from and to the extent described in the Company's proxy statement. Internet and telephone voting will conclude on the Friday prior to the meeting.

Whether or not you expect to be present, please mark, sign, date and return the enclosed proxy promptly in the envelope provided or vote via telephone or the Internet. Giving the proxy will not affect your right to vote in person if you attend the meeting.

By order of the Board of Directors of

SunLink Health Systems, Inc.

/s/ JAMES J. MULLIGAN

James J. Mulligan

Secretary

September 23, 2005

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SUNLINK HEALTH SYSTEMS, INC.

900 Circle 75 Parkway, Suite 1120

Atlanta, Georgia 30339

PROXY STATEMENT

FOR 2005 ANNUAL MEETING OF SHAREHOLDERS

GENERAL INFORMATION

We are providing these proxy materials to you in connection with the solicitation of proxies by the Board of Directors of SunLink Health Systems, Inc. for the 2005 Annual Meeting of Shareholders and for any adjournment or postponement of the Annual Meeting. In this Proxy Statement, we refer to SunLink Health Systems, Inc. as SunLink, the Company, we or us.

We are holding the Annual Meeting at 10:00 a.m. local time, on Monday, November 7, 2005, at the Renaissance Waverly Hotel, 2450 Galleria Parkway, Atlanta, Georgia 30339, and invite you to attend in person.

We intend to mail this Proxy Statement and a proxy card to shareholders starting on or about September 29, 2005.

VOTING INFORMATION

All shares represented by properly executed proxies received by the Board of Directors pursuant to this solicitation will be voted in accordance with the shareholder's directions specified on the proxy. If no directions have been specified by marking the appropriate places on the accompanying proxy card, the shares will be voted in accordance with the Board's recommendations which are:

FOR the election of Robert M. Thornton, Jr., Chairman, Stephen J. Baileys, D.D.S., Gene E. Burleson and Michael W. Hall, as directors of the Company for a term of two years; and

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FOR the adoption of the 2005 Equity Incentive Plan;

A shareholder signing and returning the accompanying proxy has power to revoke it at any time prior to its exercise by delivering to the Company a later dated proxy or by giving notice to the Company in writing or at the meeting, but without affecting any vote previously taken.

Record Date

You may vote all shares that you owned as of September 14, 2005, which is the record date for the Annual Meeting. On September 14, 2005, we had 7,203,703 common shares outstanding. Each common share is entitled to one (1) vote on each matter properly brought before the Meeting.

Ownership Of Shares

If your shares are registered directly in your name, you are the holder of record of these shares and we are sending these proxy materials directly to you. As the holder of record, you have the right to give your proxy

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directly to us, give your voting instructions by telephone or by the Internet, or vote in person at the Annual Meeting. If you hold your shares in a brokerage account or through a bank or other holder of record, you hold the shares in street name, and your broker, bank or other holder of record is sending these proxy materials to you. As a holder in street name, you have the right to direct your broker, bank or other holder of record how to vote by filling out a voting instruction form that accompanies your proxy materials. Regardless of how you hold your shares, we invite you to attend the Annual Meeting.

How To Vote

Your Vote Is Important. We encourage you to vote promptly. Internet and telephone voting is available through 5:00 p.m. Eastern time on Friday, November 4, 2005 for all shares. You may vote in one of the following ways:

By Telephone: If you are located in the U.S., you can vote your shares by calling the toll-free telephone number on your proxy card or, if you are an owner in street name, in the instructions that accompany your proxy materials. You may vote by telephone 24 hours a day. The telephone voting system has easy-to-follow instructions and allows you to confirm that the system has properly recorded your votes. If you vote by telephone, you do not need to return your proxy card.

By Internet: You can also vote your shares by the Internet. Your proxy card indicates the website you may access for internet voting. You may vote by the Internet 24 hours a day. As with telephone voting, you will be able to confirm that the system has properly recorded your votes. If you are an owner in street name, please follow the Internet voting instructions that accompany your proxy materials. You may incur telephone and internet access charges if you vote by the Internet.

By Mail: If you are a holder of record, you can vote by marking, dating, and signing your proxy card and returning it by mail in the enclosed postage-paid envelope. If you hold your shares in street name, please complete and mail the voting instruction card.

At The Annual Meeting: If you vote your shares now it will not limit your right to change your vote at the Annual Meeting if you attend in person. If you hold your shares in street name, you must obtain a proxy, executed in your favor, from the holder of record if you wish to vote your shares at the Meeting.

All shares that have been properly voted and not revoked will be voted at the Meeting. If you sign and return your proxy card without any voting instructions, your shares will be voted as the Board of Directors recommends.

Revocation Of Proxies: You can revoke your proxy at any time before your shares are voted if you (1) submit a written revocation to our Secretary; (2) submit a later-dated proxy (or voting instructions if you hold shares in street name), (3) provide subsequent telephone or internet voting instructions or (4) vote in person at the Meeting.

Quorum And Required Vote

Quorum: We will have a quorum and will be able to conduct the business of the Annual Meeting if the holders of a majority of the shares that shareholders are entitled to vote are present at the Meeting, either in person or by proxy.

Votes Required For Proposals: To elect directors and adopt the other proposals, the following proportion of votes is required:

To elect the Directors, a plurality of the votes cast.

To adopt the 2005 Equity Incentive Plan, a majority of the votes cast.

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Routine And Non-Routine Proposals: American Stock Exchange rules determine whether proposals presented at the shareholder meetings are routine or not routine. If a proposal is routine, a broker or other entity holding shares for an owner in street name may vote for the proposal without voting instructions from the owner.

If a proposal is not routine, the broker or other entity may vote on the proposal only if the owner has provided voting instructions. A broker non-vote occurs when the broker or other entity is unable to vote on a proposal because the proposal is not routine and the owner does not provide any instructions.

The American Stock Exchange has informed us that the election of directors is a routine item. The American Stock Exchange has also informed us that the proposal to adopt the 2005 Equity Incentive Plan is a non-routine item which requires a majority of votes cast.

How We Count Votes: In determining whether we have a quorum, we count abstentions and broker non-votes as present and entitled to vote.

In counting votes on the proposals:

We do not count abstentions or broker non-votes, if any, as votes cast for the election of Directors, but we do count votes withheld for one or more nominees as votes cast.

Under our Code of Regulations, all matters, other than the election of directors, are determined by the holders of a majority of the voting shares held by shareholders present in person or by proxy at the time of the meeting, except where a different proportion is required by law. Accordingly, we count abstentions as votes cast on our proposal to approve the new equity incentive plan. We do not count broker non-votes, if any, as votes cast on this proposal. Because the proposal to adopt the 2005 Equity Incentive Plan requires the approval of a majority of the votes cast, abstentions will have the effect of a no vote, but broker non-votes will not have any impact on the outcome of this proposal.

CORPORATE GOVERNANCE

Our business is managed by the Company's employees under the direction and oversight of the Board of Directors. Except for Mr. Thornton, none of our Board members is an employee of the Company. The Board limits membership on the Audit Committee and Executive Compensation Committee (referred to in this proxy statement as the *Compensation Committee*) to independent non-management directors. We keep Board members informed of our business through discussions with management, materials we provide to them, visits to our offices and hospitals and their participation in Board and Board committee meetings.

The Board of Directors has adopted charters for the Board committees, resolutions governing the process for identification and nomination of candidates for the Board, and the Company's code of ethics (the SunLink Health Systems, Inc. Code of Conduct) for employees, including our principal executive officer, principal financial officer and principal accounting officer. These documents, together with the Company's Articles of Incorporation and Code of Regulations, provide the framework for the governance of the Company.

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A complete copy of the charters of the Board committees, the resolutions governing the process for identification and nomination of candidates for the Board, and the Code of Conduct for employees may be found on the Company's website at <http://www.sunlinkhealth.com>. Copies of these materials also are available to shareholders without charge upon written request to the Secretary of the Company.

Summary of the Corporate Governance Principles

Independence

A majority of the Board of Directors is required to consist of independent, non-management directors who meet the criteria for independence required by the American Stock Exchange. Under such rules, a director is independent if he or she does not have a material relationship with the Company.

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The Board of Directors has determined that as of September 14, 2005, six (6) of the Company's seven (7) incumbent directors are independent under these guidelines: Ms. Brenner and Messrs. Baileys, Burleson, Ford, Hall and Turner. Mr. Thornton, as a management director, also participates in the Board's activities and provides valuable insights and advice.

The non-management directors meet periodically in executive session without the Chief Executive Officer present.

The executive sessions of non-management directors are presided over by the director who is the chairman of the committee responsible for the issue being discussed. General discussions, such as the review of the Company's overall performance, are presided over by a director elected by a majority of the non-management directors.

Non-management directors have access to individual members of management or to other employees of the Company on a confidential basis. Directors also have access to Company records and files, and directors may contact other directors without informing Company management of the purpose or even the fact of such contact.

Business Combinations

In the event SunLink receives any formal written offer(s) to purchase more than 20% of SunLink's outstanding common stock, such proposal is required to be evaluated by the Board of Directors, who may delegate the evaluation of such offer to a committee of the Board of Directors (which may be its Executive Committee), so long as such committee is comprised of a majority of independent directors. Such committee will be empowered to retain such legal and financial advisors as it may deem necessary to advise it and the Board in respect of such offer(s).

In the event of any proposed business combination involving SunLink, the Compensation Committee is authorized to retain an independent financial advisor to evaluate and make recommendations to the Compensation Committee concerning any severance package proposed for any of SunLink's officers or Board members in connection with any proposed business combination and the financial effect thereof.

Director Share Ownership

The Company believes that each director should have a personal investment in the Company. Each outside director (or future outside director, as the case may be) is required to own at least one thousand (1,000) shares of SunLink common stock. Each outside director (or future outside director, as the case may be) must maintain ownership of such number of common shares until such outside director ceases to serve as a member of the Board.

Annual Meeting Attendance

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The Board of Directors encourages all its members to attend the Annual Meeting of Shareholders. In November 2004, all director nominees and all continuing directors were present at the Annual Meeting of Shareholders.

Communicating with Directors

The Board of Directors has provided a means by which shareholders may send communications to the Board or to individual members of the Board. Such communications, whether by letter, e-mail or telephone, should be directed to the Secretary of the Company who will forward them to the intended recipients. However, unsolicited advertisements or invitations to conferences or promotional material, in the discretion of the Secretary or his designee, may not be forwarded to the directors.

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If a shareholder wishes to communicate to the Chairman of the Audit Committee about a concern relating to the Company's financial statements, accounting practices or internal controls, the concern should be submitted in writing to the Chairman of the Audit Committee in care of the Company's Secretary at the Company's headquarters address. If the concern relates to the Company's governance practices, business ethics or corporate conduct, the concern likewise should be submitted in writing to the Chairman of the Audit Committee in care of the Company's Secretary at the Company's headquarters address. If the shareholder is unsure as to which category his or her concern relates, he or she may communicate it to any one of the independent directors in care of the Company's Secretary.

The Company's whistleblower policy prohibits the Company or any of its employees from retaliating or taking any adverse action against anyone for raising a concern. If a shareholder or employee nonetheless prefers to raise his or her concern in a confidential or anonymous manner, the concern may be directed to the Office of the Technical and Compliance Services at the Company's headquarters or by telephone at 1-866-244-5952. The Vice President for such services or his designee will refer the concern to the Compliance Committee (a committee composed of Board and non-Board members and chaired by Ms. Brenner), or if appropriate, the Chairman of the Audit Committee who will assure that the matter is properly investigated.

ITEMS TO BE VOTED ON BY SHAREHOLDERS**Item 1 Election of Directors**

The Company's Board of Directors is presently comprised of seven members. One class of Directors is normally elected at each Annual Meeting of Shareholders for a term of two years. At the 2005 Annual Meeting, shareholders will elect four directors who will hold office until the Annual Meeting of Shareholders in 2007. The Board of Directors has nominated Robert M. Thornton, Jr., Chairman, Dr. Steven J. Baileys, Michael W. Hall and Gene E. Bursleson, who are presently directors of the Company, for election to terms of office of two years.

It is the intention of the proxy agents named in the proxy, unless otherwise directed, to vote such proxy for the election of Robert M. Thornton, Jr., Chairman, Dr. Steven J. Baileys, Michael W. Hall and Gene E. Bursleson. Should any of such nominees be unable to accept the office of director, an eventuality which is not anticipated, proxies may be voted with discretionary authority for a substitute nominee or nominees designated by the Board of Directors.

The following table sets forth certain information about the nominees for election and the directors whose terms of office will continue after the meeting.

Current Nominees:	Name and Offices Presently Held with Company	Director Since
Robert M. Thornton, Jr.	Director, Chairman, President, and Chief Executive Officer	1996
Dr. Steven J. Baileys	Director	2000
Michael W. Hall	Director	2001
Gene E. Bursleson	Director	2003

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Directors Whose Term of Office Expires in 2006:

Karen B. Brenner	Director	1996
C. Michael Ford	Director	1999
Howard E. Turner	Director	1999

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Certain information concerning each person listed in the above table, including his or her principal occupation for at least the last five years, is set forth below.

Robert M. Thornton, Jr., 56, has been Chairman and Chief Executive Officer of the Company since September 10, 1998, President since July 16, 1996 and was the Chief Financial Officer from July 18, 1997 through August 31, 2002. From October 1994 to the present, Mr. Thornton has been a private investor and, since March 1995, Chairman and Chief Executive Officer of CareVest Capital, LLC, a private investment and management services firm. Mr. Thornton was a director of and held various executive offices with Hallmark Healthcare Corporation from October 1989 until Hallmark's merger with Community Health Systems, Inc. in October 1994.

Dr. Steven J. Baileys, 51, is a private investor and was Chairman of the Board of Directors of SafeGuard Health Enterprises, Inc., a public dental care benefits company, from July 1995 to June 2004. Dr. Baileys was Chief Executive Officer of SafeGuard from April 1995 to February 2000, its President from December 1981 until May 1997, and its Chief Operating Officer from December 1981 until April 1995. Dr. Baileys is licensed to practice dentistry in the State of California.

Michael W. Hall, 56, is a private investor and was Chairman and Chief Executive Officer of Pyramed Health System, Inc., a healthcare consulting firm, from August 1996 through March 31, 2001. From April 1991 to August 1996, Mr. Hall was Chief Operating Officer and Executive Vice President of Southern Health Management Corporation, a healthcare management company specializing in rural healthcare. Prior to its sale to NetCare Health Systems, Inc., in 1996, Southern Health Management Corporation owned three of SunLink's seven hospitals.

Gene E. Burleson, 64, is a private investor and was a director of HealthMont Inc., a Tennessee corporation, from its inception in September 2000 until its acquisition by SunLink in October 2003. Mr. Burleson served as the Chairman of the Board of Directors of Mariner Post-Acute Network, Inc., a diversified provider of long-term and specialty health care services, from February 2000 to June 2002. Mr. Burleson served as the Chief Executive Officer and as a director of Vitalink Pharmacy Services, Inc. from February 1997 to August 1997. He served as Chairman of the Board of Directors of GranCare, Inc., a provider of long-term and specialty health care services, which subsequently became a part of Mariner Post-Acute Network, Inc., from January 1994 to November 1997, and as its Chief Executive Officer from December 1990 to February 1997. His previous experience also includes serving as the President and Chief Operating Officer of American Medical International, Inc., an acute-care hospital company and a predecessor to Tenet Healthcare Corporation. Mr. Burleson also currently serves on the Board of Directors of Prospect Medical Holdings, Inc., a provider of management services to independent physician associations, Deckers Outdoor Corporation, a shoe manufacturer, and various other privately-held companies.

Karen B. Brenner, 53, has been President of Fortuna Asset Management, LLC, an investment advisory firm located in Newport Beach, California, since 2000. Fortuna Asset Management, LLC succeeded to the business of Fortuna Advisors, Inc., which Ms. Brenner formed and operated from 1993 to 2000. Ms. Brenner is also a director of Creative Bakeries, Inc.

C. Michael Ford, 66, has been the owner and Chairman of the Board of Directors of Montpelier Corporation, a venture capital and real estate holding company, since October 1990. Mr. Ford has served as Chief Executive Officer since November 2003 and Chief Financial Officer of Newtown Macon, Inc. from October 2002 to November 2003. Mr. Ford was Chairman of the Board of In Home Health, Inc. from February 2000 to December 2000, and the Interim Chief Executive Officer from February 2000 to December 2000, except for the period June 27 through July 7, 2000. Mr. Ford served as Vice President of Development of Columbia/HCA Healthcare Corporation from September 1994 to September 1997, and was Vice President of Marketing of Meditrust Corp. from October 1993 to September 1994.

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Howard E. Turner, 63, has been a partner in the law firm of Smith, Gambrell & Russell, LLP, since 1971, where he is a member of the firm's executive committee. Mr. Turner has served as a director of Avlease, Ltd., a

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lessor of large commercial aircraft, and currently serves as an officer and director of Historic Motorsports Holdings, Ltd. Mr. Turner provides legal services to the Company through the law firm, Smith, Gambrell & Russell, LLP, as requested by the Company.

INFORMATION CONCERNING THE BOARD OF DIRECTORS

Board Meetings

The Board of Directors held eight meetings and took two actions by unanimous written consent during fiscal 2005. The Board has an Executive Committee, an Audit Committee and a Compensation Committee. All directors attended 75% or more of the meetings of the Board and Board committees on which they served in our fiscal year ended June 30, 2005.

Membership On Board Committees

This table lists our three committees, the directors who currently serve on them, and the number of committee meetings held in the fiscal year ended June 30, 2005:

<u>Name</u>	<u>Audit</u>	<u>Compensation</u>	<u>Executive</u>
Dr. Baileys		•	
Ms. Brenner	•	C	•
Mr. Burleson		•	
Mr. Ford	C		
Mr. Hall	•		
Mr. Thornton			C
Mr. Turner			•
2005 Meetings	9	4	2

C = Chair

• = Member

Audit Committee

The Audit Committee's primary function is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing:

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The integrity of the financial statements and other financial information provided by the Company to the Company's shareholders, the general public and the Securities and Exchange Commission (SEC);

The Company's systems of internal controls regarding finance, accounting, legal and compliance that management and the Board have established;

The Company's auditing, accounting and financial reporting processes generally; and

The independence and performance of the Company's external auditors.

Annually review and reassess the adequacy of the Audit Committee Charter and recommend any proposed changes to the Board for approval; and

Perform any other activities consistent with the Audit Committee Charter, the Company's Code of Regulations and governing law as the Committee or the Board deem appropriate.

All three members of the Audit Committee are independent as defined in Section 121(A) of the American Stock Exchange's listing standards and Rule 10A-3 of the Securities Exchange Act of 1934. The Board has also determined that Mr. Ford meets the requirements for being an audit committee financial expert as defined by SEC regulations adopted in January 2003.

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Compensation Committee

The Compensation Committee has the power and authority of the Board to perform and shall perform the following duties and responsibilities:

Develop guidelines and, on an annual basis, review the compensation and performance of the Company's senior executive officers, review and approve corporate goals relevant to the compensation of the Chief Executive Officer, evaluate the Chief Executive Officer's performance in light of these goals and objectives, set the Chief Executive Officer's compensation based on this evaluation, evaluate the performance of the Company's senior executive officers and approve their annual compensation, and produce an annual report on executive compensation for inclusion in the Company's annual proxy statement, in accordance with all applicable rules and regulations;

Make recommendations to the Board with respect to incentive compensation plans and equity-based plans, and administer such plans by establishing criteria for the granting of awards to the Company's officers and other employees and reviewing and approving the granting of awards in accordance with such criteria;

Review and approve plans for managerial succession of the Company;

Review director compensation levels and practices, and recommend to the Board, from time to time, changes in such compensation levels and practices (including retainers, meetings fees, committee fees, stock options and other similar items as appropriate);

Annually review and reassess the adequacy of the Compensation Committee Charter and recommend any proposed changes to the Board for approval; and

Perform any other activities consistent with the Compensation Committee Charter, the Company's Code of Regulations and governing law as the Committee or the Board deem appropriate.

All three members of the Compensation Committee are independent, as defined in Section 121(A) of the American Stock Exchange's listed company guide.

Executive Committee

The Executive Committee is empowered to exercise all of the authority of the Board of Directors except as to matters not delegable to a committee under the General Corporation Law of Ohio.

Nomination Procedures

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The Board does not have a nominating committee but has adopted a nominating resolution which provides that the Company believes it to be in its best interest and the best interest of its shareholders to authorize the entire Board to identify and nominate directors to serve on the Company's Board so long as, pursuant to American Stock Exchange rules, director nominees so selected are approved by a majority of the independent directors and, when vacancies occur on the Board, the Board shall actively seek individuals qualified to become Board members based on business experience, professional expertise, industry experience, and geographic representation. Shareholders who wish to submit nominees for election at an annual or special meeting of shareholders should follow the procedure generally described beginning on page 32 and more particularly, in the Company's Code of Regulations. The Board of Directors applies the same standards in considering candidates submitted by shareholders as it does in evaluating candidates submitted by members of the Board of Directors. The Board does not have a separate policy with regard to the consideration of candidates recommended by shareholders other than the process provided in the nominating resolution.

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Cash Compensation. The Company Board typically evaluates director compensation on an annual basis with charges typically implemented on a twelve month cycle. The following table shows the effective or proposed effective date for director's compensation for the periods indicated, including monthly fees for services as a director, fees for attendance at a meeting of the Board of Directors, fees for attending an Audit Committee, Compensation Committee or Executive Committee meeting, fees for participating in telephone meetings, additional monthly fees for service on the Audit Committee, and the additional monthly fees paid to committee chairmen. We also reimburse customary expenses for attending Board, committee, and shareholder meetings.

Year	Retainers (\$ per month)					Meeting Fees (\$ per meeting)		
	Board	Committee Membership		Committee Chairmanship		For Attendance At:		
		Audit	Other	Chair	Compensation Chair	In Person		By Telephone
						Board Meetings	Committee Meetings	Board & Committee Meetings ⁵
2005 ¹	1,500	750	0	750	500	1,500	1,000	1,000
2004 ²	1,500	750	0	750	0	1,000	750	750
2003 ³	1,250	600	0	600	0	1,000	600	600
2002 ⁴	1,000	500	0	500	0	1,000	500	500

¹ To be effective December 1, 2005

² Effective December 1, 2004 to November 30, 2005

³ Effective December 1, 2003 to November 30, 2004

⁴ Effective September 1, 2002 to November 30, 2003

⁵ Where attendance is via a telephonic meeting rather than in person, Board meeting fees are paid at a reduced rate.

Non-Cash Compensation. Each non-employee director currently is eligible to participate in the Company's 2001 Outside Directors' Stock Ownership and Stock Option Plan and will be eligible to participate in the 2005 Equity Incentive Plan, if such plan is approved by the Company's shareholders. In December 2003, each of the Company's non-employee directors was granted options to purchase 6,250 shares of SunLink's common stock at an exercise price of \$2.90 per share. One-third of such options vest each year, beginning with the date of the grant. Upon the adoption of the new Equity Incentive Plan, we anticipate that we will award equity compensation to non-employee directors with an estimated value for 2005 of \$20,000 per year. If such award is made in the form of stock options, the Board expects the number of options to be derived from a Black-Scholes or other similar valuation. Based on a preliminary Black-Scholes valuation assuming a \$9 per share market price and a 10 year option term, the Board anticipates that non-employee directors will receive a grant of options to purchase approximately 5,200 shares.

Management Directors. We do not pay directors who are also our employees any additional compensation for serving as a director other than customary reimbursement of expenses.

Other Arrangements. Mr. Turner is a partner of the law firm of Smith, Gambrell & Russell, LLP. Mr. Mulligan, a director emeritus and our Secretary, is a partner of the law firm of Mulligan & Mulligan. These firms provided legal services to the Company in the fiscal year ended June 30, 2005 at customary rates and they continue to provide such services to the Company in the fiscal year ending June 30, 2006.

Item 2 Approval of 2005 Equity Incentive Plan

General.

The Company's stockholders are being asked to approve the adoption of the SunLink 2005 Equity Incentive Plan (the *Plan*), which will be adopted if approved by the shareholders. The Board of Directors, through its Compensation Committee composed entirely of independent, outside directors, unanimously has recommended the adoption of the proposed Plan.

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The Company believes equity compensation aligns the interests of employees, non-employee directors and service providers with the interests of its other shareholders. The Company currently provides for the award of stock options to key employees through the Company's 2001 Stock Option Plan (the *2001 Employee Plan*) and for the award of stock options to non-employee directors through its 2001 Outside Directors' Stock Option and Stock Ownership Plan (the *2001 Directors' Plan*). We refer to the 2001 Employee Plan and the 2001 Directors Plan collectively as the *2001 Plans* in this Proxy Statement. Other forms of equity compensation cannot be granted under the 2001 Plans. The Company believes that the continuation and expansion of its equity compensation program is essential in attracting, retaining and motivating employees and non-employee directors, and will give it additional flexibility to motivate consultants and advisors to the Company. The Plan will allow for such expanded use of equity compensation. The Plan will be administered by a committee which initially will be the Compensation Committee unless the Board of Directors otherwise provides.

Board Analysis of the Plan and Basis For Shares Authorized Thereunder and Recommendation For Approval

The Board of Directors believes that it is in the best interest of the Company's shareholders to adopt the Plan in order to continue to provide eligible participants with an opportunity to acquire an equity interest in the Company.

The Plan is intended to accomplish five major objectives:

- (1) attracting and retaining officers and employees of the Company and its Subsidiaries;
- (2) motivating such individuals by means of time and performance-related incentives to achieve Company performance goals and increased shareholder value;
- (3) enabling such individuals to participate in the growth and financial success of the Company;
- (4) encouraging ownership of stock in the Company by such individuals; and
- (5) linking compensation to the interests of shareholders.

The Plan also is intended to accomplish similar goals with respect to the Company's non-employee directors.

As of June 30, 2005, SunLink only had 35,550 shares available for future grants under its 2001 Plans. Accordingly, the Compensation Committee concluded it would be advisable to seek shareholder approval of a new, more flexible, Plan to succeed the 2001 Plans. If the 2005 Plan is approved the authority to grant new awards under the 2001 Plans will be terminated and any unused shares thereunder will also be available for issuance under the new Plan.

The Compensation Committee then considered the appropriate size for a new plan.

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In evaluating a potential new plan, the Compensation Committee considered the Company's *overhang* (shares issued and reserved for future issuance as a percent of common shares outstanding) and *run rates* (annual shares granted as a percent of common shares outstanding). However, it did not consider any quantitative data with respect thereto because it believed there were no directly comparable companies of both similar size and industry to the Company. The Compensation Committee noted that other publicly traded community hospital companies are substantially larger than SunLink. Similarly, the Compensation Committee concluded that SunLink's historical run rate was not material to its analysis because the Company has made equity awards to only three of the five Named Executive Officers in the past three fiscal years; no awards to the Company's Chief Executive Officer or its Chief Financial Officer in the past three fiscal years and awards to only one of its Named Executive Officers in the past two fiscal years.

The Compensation Committee was aware that a number of institutional investors and their advisors suggest that companies request authority under their equity plans which is sufficient only enough to fund up to three years of grants. Based in part on management's recommendations, the Compensation Committee concluded that

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SunLink would require approximately 200,000 shares (based on restricted stock awards) to 700,000 shares (based on option awards) over the next three years for its employees and approximately 20,000 (based on restricted stock awards) to 100,000 shares (based on option grants) for non-employee directors over the same period. The majority of the Company's outstanding options were awarded prior to June 30, 2001 and 232,500 options have been awarded in the last three fiscal years, of which only 36,000 were awarded to the Company's Named Executive Officers.

The Compensation Committee concluded that a request for up to an aggregate of 800,000 new shares under the Plan would be reasonable and should be acceptable to the Company's shareholders. Approval of the Plan would result in an overhang of approximately 11.1% based solely on new shares authorized under the Plan. Based on the new shares to be authorized under the Plan, together outstanding options issued in the last three fiscal years plus approximately 35,550 remaining shares available under the 2001 Employee Plan for new awards (for which authority would carry over to the Plan) would result in an overhang of approximately 14.8%. The maximum overhang based on the 800,000 new shares to be authorized under the Plan and the approximately 35,550 remaining shares available under the 2001 Employee Plan for new awards plus the shares which are issuable upon the exercise of the Company's outstanding stock options, regardless of when such options were awarded, would be approximately 20.1%. Of the Company's 836,900 outstanding stock options, 500,000 are held by the Company's Named Executive Officers.

Employee participants under the Plan may include not only the named executive officers of the Company but also may include other officers or employees of the Company or any of its subsidiaries who meet the definition of an eligible employee and who are, in the judgment of the Compensation Committee, contributing significantly to the success and growth of the Company.

Under the Plan, SunLink would reserve 800,000 shares of the Company's no par value common shares. We anticipate that the Plan will provide sufficient shares to fund awards for at least three years and will provide multiple award vehicles including incentive and non-qualified option awards, performance contingent restricted stock, and time-vesting-based restricted stock. The Plan provides the ability to have a strong pay and performance linkage. Future incentive awards for employees may be tied to performance-contingent vesting and/or performance-accelerated vesting. Awards may vest ratably over time or all or substantially all at once pursuant to cliff vesting provisions.

The Board and the Compensation Committee are committed to employee stock ownership by the Company's executive officers and non-employee directors. The Chief Executive Officer and the other named executive officers have significant equity ownership and the Plan continues the stock ownership requirements of the 2001 Directors' Plan which requires non-employee directors to own at least 1,000 shares of the Company's common stock. The time-vesting-based restricted stock awards authorized under the Plan further emphasize long-term equity ownership. The Board and the Compensation Committee will continue to monitor ownership levels and may consider additional ownership guidelines or mandatory holding periods in the future if deemed necessary.

Under the Company's 2001 Employee Plan, as of June 30, 2005, approximately 774,450 outstanding stock options have been awarded to employees, of which 486,000 outstanding stock options have been awarded to the Company's Named Executive Officers. The Compensation Committee presently intends to also award stock options in 2005 under the Plan and is evaluating whether to award restricted shares (which may be performance-based restricted shares) in lieu of, or in combination with, an award of stock options to employee participants. If restricted shares are awarded, one restricted share is expected to be issued for each four stock options that otherwise would be issued to Participants in the Plan. The Board of Directors also intends to grant to each non-employee director annual awards in the form of options to purchase shares of the Company's common stock. Such awards are expected to vest at the end of the fiscal year in which they are awarded although the Board may require minimum terms of service for any awards to new non-employee directors. See "Compensation of Directors" for a discussion of the option awards expected to be made for 2005.

The Board of Directors adopted the Plan, subject to the approval of the Company's shareholders. The Board of Directors believes that it is desirable to continue the Company's equity compensation program and increase the Compensation Committee's choices under the Plan, and

recommends that shareholders vote FOR approval of the Plan. The Plan will become effective upon approval by the Company's shareholders.

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The following is a brief summary of the material provisions of the Plan, which summary is qualified in its entirety by reference to the copy of the Plan, attached to this Proxy Statement as Appendix A.

Summary of the Plan

The Plan provides for equity compensation awards in the form of stock options, restricted stock, dividend equivalent rights, and performance awards (collectively, *Awards*) to eligible employees, non-employee directors, consultants or advisors of the Company or a subsidiary thereof. As of August 31, 2005, there are five executive officers, thirty management personnel, approximately 1,171 other employees and six non-employee directors who are eligible to receive Awards under the Plan.

Common Shares Available under the Plan

The Plan authorizes up to 800,000 common shares for grants of Awards, 700,000 of which shares may be actually issued or transferred upon the exercise of Incentive Stock Options, but only 200,000 of which may be issued as restricted stock. The common shares offered under the Plan may be issued from authorized, but unissued shares, treasury shares or any combination thereof. To the extent that any Award based on common shares expires or terminates without having been exercised in full, is forfeited or is settled in cash, the common shares subject to that Award will be available for other Awards. Also, to the extent that an option is exercised by tendering common shares as payment of the exercise price and/or required tax withholding, the maximum number of shares available under the Plan will be increased by the number of shares so tendered.

The Plan provides that the maximum number of common shares with respect to which Options or performance-based Awards may be granted to any single participant in any calendar year may not exceed 200,000 shares. The amount that any single participant may receive in any calendar year for performance units settled in cash may not exceed \$1,000,000.

Fair market value under the Plan is generally equal to the closing sales price at which common shares of the Company were traded on the American Stock Exchange (or other principal exchange on which the common shares are listed) on the relevant date (or if there were no reported sales on that date, on the most recent date on which sales were reported). As of September 21, 2005, the closing sales price of a common share of the Company on the American Stock Exchange was \$8.13.

Plan Administration

The Plan will be administered by the Compensation Committee or other committee specified by the Board, which will consist solely of not less than two Non-Employee Directors, all of whom shall (1) satisfy the requirements of Rule 16b-3(b)(3) of the Exchange Act; (2) be outside directors within the meaning of Section 162(m) of the Internal Revenue Code (the *Code*); and (3) otherwise meet any independence requirements promulgated by any stock exchange on which the shares are listed except that in the case of awards to non-employee directors the Plan generally will be administered by the full Board. The members of the Compensation Committee are appointed by and serve at the pleasure of the Board. Furthermore, the Board retains the right to make Awards under the Plan.

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The Compensation Committee has the authority, among other things, to select the individuals, to whom, and the time or times at which, Awards will be granted, the type of Awards to be granted, the number of common shares to be subject to each grant, the terms and conditions of each Award, and the duration of leaves of absence which may be granted to participants without constituting a termination of their employment for purposes of the Plan.

The Compensation Committee cannot make any adjustment or amendment (other than in connection with a stock dividend, recapitalization or other transaction where an adjustment is permitted or required under the terms of the Plan) where the adjustment or amendment would reduce or have the effect of reducing the exercise price of an option previously granted under the Plan, whether through amendment, cancellation, replacement grants or other means, unless the Company's shareholders have approved the adjustment or amendment.