

## **EVERGREENS DEVELOPMENT GROUP – CASE STUDY**

Date Deal Closed: June 22, 2005

### **THE COMPANY**

Evergreens Development Group was a pioneer in the assisted living industry, having built its first assisted living facility in 1989. The company's goal was to provide exceptional service to elderly residents that required assistance with activities of daily living, but rather than having people live in a single, large, multi-story building with long halls that would be difficult for frail elderly residents to navigate, they would instead construct smaller single-story buildings that would be clustered on a campus. The company successfully built and operated four assisted living facilities comprised of 246 beds in Minnesota and North Dakota from 1989 until 1998, at which time they leased the facilities to Alterra, who at the time was the largest publicly traded operator of assisted living facilities in the country. Unfortunately, during the next three years of operation Alterra had significant operating problems, the facilities declined dramatically in occupancy, and the facilities experienced significant deferred maintenance. In 2001 Alterra defaulted on the leases and Evergreens Development Group took back the properties and re-instituted its management company, Centennial Care, to operate the facilities. When Centennial Care resumed operation of the facilities, it had serious public negative perceptions to overcome. The turnaround process was slow. The owner's original goal when leasing the facilities to Alterra was to get out of the elderly care business, so in 2004 when the facilities' performance was starting to get to the point where the facilities would be attractive to an acquirer, the owner wanted to start marketing the company for sale.

### **THE ASSIGNMENT**

The principal retained Codiligent to sell his small chain of assisted living facilities to one buyer in order to completely exit the elderly care industry and then use his equity to invest in more passive investments that would allow for retirement without financial concerns. Because the owner was disappointed by having thought he had exited through a long-term lease with Alterra in 1998, but then having the company default, there was no desire to lease the facilities or carry substantial financing.

### **SELLER'S GOALS**

- To sell all four facilities to one acquirer within a year.
- To maximize the price enough to cover all outstanding obligations, and provide him with at least \$1.6 million in cash (post-tax or tax-deferred).
- To be able to dismantle the management company he had formed.

## THE CHALLENGES

- Because the company's operations were still being turned around, for 2003 (the most recent full year) the company had adjusted EBITDA of only \$511,869, and for the trailing twelve months (ending August 31, 2004) it had adjusted EBITDA of \$929,604. For this type of business, it is most common to look at an income approach to value based on dividing EBITDA by an appropriate capitalization rate. A realistic capitalization rate for this business was 9%, therefore, while the value was definitely increasing, trailing twelve month numbers indicated a value of about \$10,328,993 – but in order to reach his goals the seller needed a sales price of at least \$17 million.
- Each of the facilities was in a state of improvement, but one facility was under-performing compared with the other three. If the facilities were not sold as an entire package, the seller could get stuck with one difficult to divest facility.
- Codiligent needed to locate an acquirer with the financial strength to effectuate a \$17 million deal without the seller carrying financing.
- With four distinct locations, management of the due diligence process would be more complicated.
- There were some encroachments and encumbrances on the real property title that would need to be addressed.

## PRICING STRATEGY DEVELOPMENT

Due to the perceived riskiness of many other investment vehicles at the time Codiligent started interacting with this company, there were many investors who were more comfortable with the tangible nature of real property investments, and thus through strong demand were helping maintain very aggressive commercial real estate prices.

Consequently, after performing a thorough analysis of the business, Codiligent suggested using the coming year (2005) projections to frame ideas of value rather than using current or historical numbers. Following is a chart that shows the value of the business based on 2003 historical numbers, 2004 trailing twelve month numbers (through August 31, 2004), and 2005 projected numbers.

	<b>2003</b>	<b>TTM 2004 (ending 08/31/2004)</b>	<b>2005 Projected</b>
<b>REVENUE</b>	\$6,524,545	\$7,033,078	\$8,142,125
<b>ADJUSTED EBITDA</b>	\$511,879	\$929,604	\$2,005,064
<b>CAP. RATE</b>	9%	9%	9%
<b>VALUE</b>	<b>\$5,687,544</b>	<b>\$10,328,933</b>	<b>\$22,278,488</b>

While Codiligent realized that to some, the 2005 projections may appear to be too aggressive, it also provided supporting documentation that indicated that if the current month's numbers were annualized they would exceed the projections for the coming

year. Furthermore, the past couple of years trends bode well for hitting the projection – yet nobody can predict the future, and most acquirers are not willing to pay for speculative projections. Nevertheless, Codiligent and the seller determined that the best pricing strategy would be to promote a value based on the coming year's projections and take the position that we are confident the value would be there. We knew that we could always come down on price, but that if too low of a price were set there wouldn't be the opportunity to increase it. Codiligent established the asking price for the business at \$21.4 million, but internally we felt that the realistic range would be from \$17,000,000 to \$18,750,000. While Codiligent realized that this was very aggressive pricing, it was what was needed to satisfy the seller's goals, it was an attractive option to organic expansion and lease-up associated with developing a new assisted living facility from the ground up, and there was a compelling turnaround story that supported the higher value.

## **POSITIONING AND PACKAGING**

It is much easier to position a business that is well run, than one with poor systems, bad records, and lack-luster product and service offerings. After Alterra defaulted on their leases in 2001, Evergreen Development Group's management company did an excellent job of building up a team of excellent employees (and with a high level of retention), using industry-leading systems, keeping excellent records, and providing unique and discrete levels of care (including Enhanced Care – for residents who are mentally cognitive but have ambulation issues that require a two-person assist). Furthermore, the small home-like scale of the buildings coupled with the family-like business culture provided a story for positioning the company as a small well-run chain of very high touch, high quality of care assisted living facilities.

Our analysis indicated that not only was the company having success with steadily increasing occupancy, but also it had been substantially increasing rates at the same time. Codiligent was surprised by this, because most operators of income producing real estate will not substantially increase rates while they are still improving their occupancy. Codiligent used this fact as further evidence of high quality operations that would continue to propel the company to maximum occupancy over the next two years.

A 4-page teaser package was developed that included photos, a graph of occupancy growth, a graph of employee longevity, text that focused on the positioning described in the preceding two paragraphs, properties, and information on the positive demographics of the communities in which this company operated relative to U.S. averages. This package would be sent out to prospective acquirers with the goal of generating enough interest that individuals would sign a non-disclosure agreement to gain more detailed information.

A 66-page confidential package was developed that included detailed information on the facilities including, among other things, additional photos, site plans, floor plans,

management information, staffing details, rent rolls, historical & projected financials, budgets, detailed property information, and company strengths.

Ultimately, a due-diligence CD was also created that included electronic copies of the hundreds of pages of due diligence documents requested by the acquirer. By managing the compilation of due diligence documents, it allowed Codiligent to anticipate and proactively address issues that may result from some of the information presented. Having a logically organized CD allowed for easier review of the materials by the acquirer, enabled it to more easily share the information interdepartmentally with its due diligence team, and lessened the chance for delays caused by transfer or sharing of information.

### **MARKETING METHODS**

1. Codiligent researched companies that had a high likelihood of being interested in acquiring a small chain of assisted living facilities and that had the financial capacity to successfully close on an \$18 million deal. Twenty-eight companies were identified that appeared to meet these criteria. Teaser packages were sent to the top executives of these companies.
2. Advertisements were placed on the largest online database of commercial real estate for sale and for lease.
3. Advertisements were placed on the top websites visited by active acquirers of businesses.
4. Codiligent notified other intermediaries and brokers of the company's availability, and offered to share its fee with intermediaries who were responsible for bringing a successful acquirer to the table.
5. A national Wall Street Journal print advertisement was placed under commercial real estate.

### **PROCESS AND RESULTS**

Codiligent began to actively market this company on September 20, 2004. A letter of intent, that the seller ultimately proceeded with (after modifications and further negotiation) was received on November 4, 2004, less than a month-and-a-half after marketing began. Prior to executing a final LOI, Codiligent received 54 inquiries. Out of those 54 inquiries, 22 signed non-disclosure agreements in order to obtain a 66-page package of confidential information on the business. After the letter of intent was signed, Codiligent received an additional 24 inquiries from interested parties.

The original offer was for \$17 million. Codiligent negotiated the price up to \$18.5 million, which represented a price based on a 5% capitalization rate using trailing twelve month numbers. The acquirers submitted \$50,000 in earnest money, and the deal was structured with \$17.9 million in cash at close, with the seller accepting secured bonds in the amount of \$600,000 fully amortized over ten years with 7.5%

interest per annum, and monthly payments of principal and interest. Due to certain tax issues that the seller was investigating, a purchase agreement wasn't entered into until February 4<sup>th</sup>, 2005.

Codiligent managed the due diligence process in a way that kept confusion to a minimum, maintained a central repository of documentation to track and monitor responses to due diligence requests, and gave the acquirer confidence to move forward with the process.

The sale was made easier because the seller continued to improve its financial performance during the sales process. Codiligent made it clear to the acquirer that the price negotiated was firm, and that there was the expectation that there would not be any re-negotiation of price or terms after the due diligence period.

There were significant issues that needed to be resolved prior to closing. The acquirer chose to issue bonds to raise capital to close the deal. This meant that not only did the acquirer's attorneys need to be satisfied, but so did the bond underwriter's attorneys. In addition, the seller employed two law firms due to jurisdictional issues, and the title company's attorney was involved with resolving some of the complicated title issues. Codiligent acted on behalf of the seller in interacting with the five law firms in resolving 12 pages of exceptions, including seven encroachments, two non-permitted use issues, eight encumbrances, and an estoppel certificate. Codiligent coordinated the activities of surveyors, government agencies, attorneys, the title company, utility providers, the seller's employees, and contractors to get these exceptions resolved in order to successfully close the deal.

The closing was delayed by about a month past the originally agreed upon closing date due to issues related to the acquirer's issuance of bonds to finance the deal. To prevent further delays the parties agreed that further delays would result in a significant financial penalty to the acquirer. The deal closed on June 22, 2005, at a price of \$18.5 million with all of the seller's transaction goals fulfilled.