

# After the handshake

The people in the know say the most grueling work occurs between planning a merger and completing it.

BY JOHN ANDREWS

**B**lockbuster deals seem to be getting announced lately with alarming regularity: Carlyle buys Manor Care, Fortress gets Holiday, Emeritus pursues Summerville, Ventas wins the bidding for Sunrise's Canadian REIT, Formation Capital acquires Genesis ... and now Sunrise appears to be putting out "for sale" feelers.

"We have reached an unprecedented point in this industry when you look at the sheer volume of investment capital that is flowing in," said Bob Kramer, president of the National Investment Center for the Seniors Housing & Care Industry. "Look at the size of these deals – north of \$6 billion for Holiday and Manor Care. It's a great time to be a good operator with well-performing facilities because you will be rewarded."

To grasp the magnitude of current merger activity, all one has to do is look at the mushrooming volume at New York investment firm Cohen & Steers, which during the past 18 months has gone from conducting \$1 billion a year in transactions to \$1 billion a month.

"To be sure, economic conditions are probably as strong as they've ever been and that scenario creates a fertile merger-and-acquisition climate," acknowledged Arnold Whitman, CEO of Alpharetta, GA-based Formation Capital, which recently bought Genesis Healthcare.

"Things are so healthy that a little restraint combined with worldwide economics could put us on a nice run for an extended period," he said.

## Anatomy of a merger

Contrary to the public's perception, a merger announcement doesn't mean the deal is complete or that it will

even work out. It only heralds the beginning of an arduous process to come. Plenty of potential snags and pitfalls stand in the way of two separate companies successfully uniting into one.

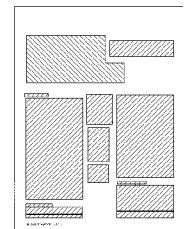
As someone who is currently undergoing this tremendous challenge, Whitman concedes that many elements could have sabotaged his acquisition of Genesis. Topping the list is human nature, he said.

"Fundamentally, the most difficult aspect is that we're dealing with human beings and emotions," Whitman said. "If everyone looked at the world the same way, it wouldn't be hard. But the difficulty with any transaction comes from having to deal with people's expectations and dealing with them as emotional creatures."

"We approach business transactions with the basic philosophy of aligning our interests with our partner so that we are shooting for the same target," he said. "The complexity of these deals is enormous and experience is our greatest asset – we learn every time what we did wrong and what we did right. It's easy to look at numbers, evaluate cap rates and multiples, but very hard to execute transactions that address the myriad complex issues, such as change of control and the pure dynamics of seeing things the same way."

## Good and bad judgment

Perhaps the best bellwether for predicting a merger's success or failure is the motivation behind it. Deals initiated for the right reasons usually go through smoothly, while those with dubious intent either fall through or break up prematurely, said Ray Lewis, executive vice president and chief investment officer for real estate investment trust Ventas Healthcare Properties.



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CapitalSource*



helps you enter a new market, gives you access to more geography or offers a product type you don't have,” he said. “A good example of that is Brookdale Senior Living taking over American Retirement Corporation, where Brookdale got the rehab and ancillary service component to develop across their portfolio.”

Lewis also pointed out situations when reasons for a merger are dubious — for defensive purposes, market domination or trying to gain economic synergies without a strategic plan.

**The brass tacks**

Jim Sherman, senior managing director for Red Capital Group in Columbus, OH, has seen many challenges creep up during deals. Among the most common:

- The assumption of employees and their contracts and the responsibility to pay existing employee benefits.
- The assumption or payoff of outstanding financing arrangements, such as debts and leases and who will be responsible for them.
- When a REIT is purchasing assets and the “current” owner is leasing the assets back, creating and negotiating a new agreement can be especially problematic.

Sherman adds that there is a lot more scrutiny and

attention paid to the minute details of a deal than was previously the case.

“It can take three to six months to get a deal that a seller and buyer will tentatively accept,” he said. “Many sellers do not understand the time it takes, the detail and analysis which takes place before a potential buyer will make an offer they can stand behind and actually close. Considering all the questions a potential buyer will ask and data they will request, a buyer will know more about the seller than the buyer knows about himself. I continually am amazed at the level of detail a potential buyer will go to before they will offer even a preliminary bid.”

One of the most important considerations merging companies need to bear in mind is how the deal will affect their respective corporate cultures, advised James “Piet” Pietrzak, president of Roanoke, VA-based Smith/ Packett Med-Com.

“It is important that the acquiring entity start slow and easy with changes to policies and procedures,” he said.

James Pieczynski, co-president of Chevy Chase, MD-based CapitalSource's Healthcare & Specialty Finance Group, cautioned against losing sight of the acquired company's mission.

“One of the key obstacles is that everyone thinks of seniors housing as a real estate business, and though it's a vital component, this is a business that is responsible for caring for people,” he said. “The provision of quality care is the key determinant of success. So when I look at those ingredients, I recommend keeping the facility operators and existing management in place in order to achieve the best outcome. Radical personnel and management changeover can be very disruptive.”

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