

## Beverly Enterprises, Inc. Perception Study: Executive Summary

*(Note: We at Capital Insight Partners do not share the results of our proprietary perception studies with anyone outside the company. However, this represents an older but still representative example of the contents of a shareholder/investor perception study, and this client was acquired and is no longer publicly traded. Investment firm names have been removed to respect their privacy.)*

### **Preface**

The purpose of this perception study was to gain insight into the current view of Beverly Enterprises among institutional investors who are either current shareholders or who have owned the stock in the past, buy-side analysts familiar with the company and sector, and sell-side analysts who are presently following BEV. We interviewed 21 individuals over the course of the last two weeks and are pleased to report that the level of cooperation among the company's followers was tremendous. This indicates that interest in Beverly as an investment is strong despite the current environment in the sector. We spoke with both current and past investors in order to obtain the most thorough feedback and to measure the perceptions among the widest audience possible.

First, you will find 12 summary conclusions that will help you focus on the most salient conclusions resulting from the study. Next, you will find a summary of investor answers to specific questions about the company and its strategy. These include a few quotes from various interview participants (the quotes are attributed in the detailed "contact log" of interviews that concludes this study).

Although we included many of the investors' individual opinions in the following summary, we strongly encourage you to read the attached interviews in order to get the best sense of how each investor or analyst views Beverly. The comments are summarized in a completely candid manner often including their direct quotes. We trust that this report will provide you with an accurate, current pulse on the prevailing opinions of your key institutional sponsors.

### **SUMMARY: CONCLUSIONS, RECOMMENDATIONS BASED ON RESPONSES**

1. Current management is respected and generally applauded for its candor and its actions to-date.
2. Investors say that a few quarters of operational execution and no more charges will solidify management credibility.
3. Current management is living with the company's past decisions and sometimes poor performance, and bears the burden of proving that it is different and can turn Beverly into a performer. The current management team has support and appreciation, but it does not have the luxury of starting with a clean slate.
4. Most investors believe that the stock is fairly valued at approximately \$7 to \$8 per share, although \$7 is at the low end of the scale and represents a "screaming buy" opportunity to some. Positives such as operational improvement and past and anticipated sales of under-performing assets are offset by uncertainty about the outcome of Medicare related issues and caution due to the company's historically spotty performance. Some investors feel BEV receives an extra discount compared to its peers due to a lower quality of properties and questions about whether the string of one-time charges are really over.
5. Several investors who have gotten out of the stock would consider getting back into it at current price levels, feeling the stock (and the sector) is currently undervalued. This indicates that even before the company starts "hitting on all eight cylinders," we have an opportunity to find other investors who are not familiar with Beverly, who might see the same investment opportunity.
6. All investors want BEV to further shrink its portfolio of nursing homes to improve returns. Several participants believe the company could be even more aggressive in this area than its announced plans indicate.
7. No one wanted the company to grow by acquiring more nursing home properties.
8. A few investors would prefer that management "stick to its knitting" and improve existing operations, rather than trying to grow the business.
9. A number of investors saw considerable promise in growing into higher margin businesses such as home care, rehab, and hospices, which was most often mentioned as a potentially good fit for BEV.

10. Investors said they currently give the company no valuation points for this growth strategy, however. Most want to see at least 20% to 25% of total revenue coming from one or more of these higher-margin businesses before they would incorporate this growth and margin-expansion strategy into an actual valuation.
11. To give Beverly's growth plan (into non-core businesses) any credence, investors say they also need more financial and market opportunity specifics than they have so far received from management. They want to know details about specific market and niche opportunities, competition, financial goals, challenges, et cetera.
12. Survey participants had no major recommendations for what management could improve in either its execution or communications, although most felt that more detailed financial information could be communicated and would be helpful in valuing the company and its opportunity. The most common comments/criticisms were:
  - ◆ More thorough management discussion of Medicare issues and how management believes various scenarios might affect the company.
  - ◆ More specifics and guidance on operational and financial targets for the coming year or two.
  - ◆ More detailed discussion of hard facts related to growth plan.

## **SUMMARY: INVESTOR PERCEPTIONS ON THE KEY ISSUES**

### ***1. Beverly followers think the uncertainty of Medicare reimbursements is far and away the main discount factor in Beverly's valuation.***

Not surprisingly, the Medicare issues are the main concern for those who follow BEV and all others in the nursing home sector. Since the majority of Beverly's revenues come from the government, many investors believe there will be an overhang in the stock until the situation is resolved in October. Most think this is a near-term issue. However, several of the company's followers expressed the view that the exposure never really goes away since this is a risk of being in the nursing home business. Most of the investors with whom we spoke think management is doing the best it can under the circumstances.

Michael Manschot from ING Furman Selz thinks the company should talk about the Medicare situation in more depth on the quarterly conference calls. He said, "I think the entire issue is overblown since the government is not going to allow these operators to go out of business. They need to diffuse some of the rumors that are out there." In addition, Rodney Hathaway from Heartland thinks that at the end of the day, the industry will get what it needs on the reimbursements but that there will be a lot of debate for the remainder of the year, causing continued volatility in nursing home stocks.

#### Related Comments:

"...Beverly is at the mercy of what is decided by the government. They are doing a good job operationally, but until there is some clarity on the current issues, there will be a significant discount on the stock." -- Anonymous

"Until this issue resolves itself, we can't get too excited about the sector. Near-term it's dead money as far as we're concerned." -- Anonymous

### ***2. The majority of the investors polled think BEV is fairly valued at current levels and believe the stock is in-line with others in the sector.***

Beverly followers think the stock is fairly valued at \$8 per share and believe all of the nursing home stocks have been equally punished due to the Medicare reimbursement issues. A few investors who are not currently involved in BEV mentioned that it is always on their radar screens and that they will consider re-establishing a position in the stock if there is a near-term catalyst.

A few of the investors with whom we spoke think BEV has been discounted slightly more than others in the sector due to the fact that the company is going through a major restructuring concurrent with the outstanding Medicare issue. Kindred and Genesis have emerged from

Chapter 11 and sector moves have already taken their lumps, allowing their stocks to actually bump up despite uncertainty about the sector. While battered by the Medicare volatility, Manor Care has continued to post earnings and has not restructured, although it has taken various charges. A few of the investors polled discussed the fact that the stock trades in a fairly predictable range and that there are some institutions that have made a lot of money simply trading the range. In addition, Susan Cross from Wilmington Trust said she thinks that the large-cap managers have been liquidating their positions while at the same time, the small cap and momentum players are taking profits whenever possible. She believes these technical factors are contributing to the downward pressure in the stock.

#### Related Comments:

"We used to be very large holders of BEV and we're just looking for the right opportunity to get back in." – Tony DeSpirito, Pzena

"If I wanted exposure to this sector again, I'd rather go with a company with a better track record." -- Anonymous

"...we made a lot of money off it and we'd be a good example of a former shareholder looking to get back in if something was going on. There really wasn't a reason we sold out of it, the stock just kept rallying and over time we reduced our position." -- Remy Trafelet, Trafelet and Company

**3. In general, Beverly followers were satisfied with the explanation on the write-offs; they are concerned about potential future charges.**

Although your followers understand the rationale behind the fourth-quarter charges, many believe this action was a "step back" for the company in terms of rebuilding management's credibility. Some of the investors with whom we spoke said that the operational progress made during 2001 was overshadowed by the recent charges and that it will take time to rebuild investor confidence. Rodney Hathaway said, "I think they'll be able to overcome this glitch." There is a concern that the "one-time" charges have become "recurring non-recurring" charges and the best way to overcome this, of course, is to have one solid year of performance without charges at the end of the fiscal year.

**4. Investors support Beverly's strategy to increase long-term shareholder value by reducing Medicare exposure and disposing of underperforming properties.**

Many of the analysts with whom we spoke about the turnaround strategy would like even more detail on how the company plans to achieve its goals. Darren Lehigh from SunTrust Robinson Humphrey would like to see the company be even more aggressive on reducing the nursing home portfolio. Many commended management for the disposition of the Florida properties, however, they think this is only the first step to strengthen the quality of the assets. One of the anonymous investors said he'd like more information on which of the properties is under the microscope. He added, "Is this just weeding out a few bad apples or a major overhaul? How are you measuring the properties that don't stand up?"

**Related Comments:**

"The problem is that the Medicare issue will never fully disappear. It's difficult to evaluate management's strategy when so much of the company's revenue stream is out of their control." -- Joe Kusnan, Highbridge Capital Management

"The company is doing the right things, trying to move away from Medicare and reduce their government exposure. Manor Care was able to reduce their dependence on Medicare reimbursements, so it should be possible for Beverly as well." -- John Schneider, PIMCO Equity Advisers

**5. Beverly followers are generally in favor of the company pursuing non-core businesses, however, most say that the company needs to provide more detail about the roadmap and the opportunities.**

Overall, Beverly followers think the decision to reduce Medicare exposure by building the non-core businesses make sense, but they are not clear on how this will be accomplished. Several commented that the roadmap to making the non-core businesses meaningful does not exist. One analyst said, "They need to be clear about how much they expect the non-core business to contribute to the overall picture" and Charlie Lynch from CIBC thinks the strategy makes sense but that the company needs to better define the opportunity. In addition, investors don't think the company is getting any credit in the market for talking about the ancillary businesses. Tony DeSpirito from Pzena said, "Until at least (25%) of revenues are from the non-core businesses, the Street is not going to pay any attention to it." Another anonymous analyst thinks 20% of revenues from non-core businesses will be necessary for investors to feel confident about this part of the growth strategy.

**Related Comments:**

"I think Beverly has demonstrated initial success in these endeavors. Some of these businesses are quite fragmented so I think there is some good opportunity there. It's not a material part of their revenue yet, but they're going in the right direction." -- Anonymous

"...they need to address their goal of having one-third of net revenues associated to ancillary businesses. I think the timeframe Bill has set forth makes this goal unachievable. There is a disconnect on what they've talked about and what the numbers are saying. The road map is missing." -- Darren Lehigh, SunTrust Robinson Humphrey

"I wouldn't want to see a lot of big acquisitions being done for the sake of growth. They need to demonstrate that they can generate free cash flow and use this to pay down some debt. Nothing fancy, just a good old-fashioned combination of strong management and a simple strategic plan." – Susan Cross, Wilmington Trust

"I think it's an appropriate strategy, however, it's not going to be easy to do. I wish them luck." -- Art Winston, Balis, Lewittes & Coleman

#### **6. Investors would like to see continued focus on strengthening the balance sheet, including further asset and debt reduction.**

A few investors discussed the fact that they'd like to hear more about debt reduction as a means to enhance shareholder value. One investor commented that, "With Medicare revenues at risk and the costs of restructuring, the first thing I worry about are the coverage ratios. Medicare or not, restructuring or not, the debt has to be paid. This affects the company's financial flexibility and access to the credit markets, both of which are needed during a major restructuring."

Several survey participants commented on the lower quality of the assets compared to the company's peers as the primary reason why they perceive the stock as a poorer value compared with Manor Care (HCR), even though Manor Care carries a higher premium. Darren Lehrich from SunTrust Robinson Humphrey said the quality of the properties in the portfolio is weaker than it should be and Charlie Lynch from CIBC World Markets agrees that the portfolio needs to be reduced to a more manageable size, weeding out the weaker assets.

#### **7. Management credibility is improving but investors are still waiting for consistent performance.**

Most of the Beverly followers with whom we spoke think the new management team is an "upgrade" from the past. Several acknowledged that the "jury is still out" in many ways since solid execution is, to them, the true test of management's ability to turn around any company. Investors think Bill Floyd presents the Beverly opportunity well and they are particularly pleased with the renewed focus on operational improvements. Not all of the investors have had exposure to Jeff yet, but initially are optimistic that he'll bring a new financial discipline to Beverly. Several of the individuals with whom we spoke are looking forward to meeting him in the near future. The company's followers are generally satisfied with the level of financial communication to investors, but are always eager to have as much transparency as possible to enable them to build their models.

#### **Related Comments:**

"Bill did a good job on the fourth quarter conference call discussing the progress they've made thus far. I think they could be more forthcoming on what the priorities are for the coming year, for example, the operational and financial targets." – Charlie Lynch, CIBC

"The new management team is a big improvement from the past." – Rodney Hathaway, Heartland

### **DETAILED COMMENTS FROM SURVEY PARTICIPANTS**

Please note that these comments are very candid. In general, such comments are given with the understanding that they will be shared with management, but not necessarily that management will directly contact them to discuss or take issue with any of the comments. In several cases, participants wished to remain anonymous from management in exchange for giving us their candid thoughts, and we respected that request. We took the higher-than normal requests for anonymity as a very positive sign. The company has good dialogue with its followers, and so it's clear that with the assurance of anonymity, a number of people took the opportunity to say things to us that they haven't feel comfortable saying to someone from the company. That's new intelligence for your use.

Do, however, take note of participants who said they would like to meet with management, or specifically noted a desire to hear from management. We strongly recommend that you contact these folks as soon as possible. We have already provided you with a list of individuals who have made requests to meet with you, be added to lists, change phone numbers, etc.

#### **Art Winston Portfolio Manager**

Art thinks the Medicare reimbursement issue is exerting the greatest influence on the stock price. He thinks the stock is currently undervalued and told us they own the stock because they like Beverly's hidden assets and strong cash flow. Art does not think BEV has been beaten down any more than others in the sector and he commented that Manor Care has also been hit pretty hard.

Art was "ok" with the explanation on the fourth-quarter charges and said, "It sounded like a lot of the analysts were pretty concerned with the write-offs. I'm not as concerned as they are and I don't think there will be many charges in the future."

Art likes the new strategy to focus on non-nursing home business but added, "I think it's an appropriate strategy, however, it's not going to be easy to do. I wish them luck." When asked what percentage of the business he thinks needs to come from non-core business in order for the Street to take notice Art said, "I don't think revenues really matter because anyone can buy

another business. I think they have to generate profits." We asked him to quantify this statement but Art was not able to put a number on it.

Art has a positive perception of the management team and is satisfied with the level of communication. He has spoken with Jeff over the phone but has not met him yet. (Art will be leaving in April with a few other members of Balis to start his own firm, Pilot Advisors. We've provided the new address and phone to BEV).

## **Anonymous Analyst**

This analyst requested that we keep the commentary anonymous. This analyst thinks the main factors causing the overhang on the stock are the Medicare and Medicaid reimbursement issues. He discussed the complexity of the situation with us and said until the October expiration date is confirmed or extended, there is not much Beverly management can do to influence the stock price. This analyst has a neutral position on the shares and added, "With fifty to sixty percent of revenues coming from Medicare/Medicaid reimbursements, Beverly is at the mercy of what is decided by the government. They are doing a good job operationally, but until there is some clarity on the current issues, there will be a significant discount on the stock."

This analyst thinks management has done an adequate job explaining the restructuring charges and does not think Beverly stock has been unjustly hit due to the level of uncertainty that exists. He does not think that any of the companies with Medicare/Medicaid exposure have been able to manage the risk simply due to the nature of the industry. The analyst further commented on the fact that Manor Care (HCR) has also seen its stock price decline significantly.

This analyst thinks Bill Floyd does a good job presenting the Beverly opportunity to the Street and added that investors need more exposure to the new CFO. It was noted: "Jeff is new to the healthcare industry. Beverly followers simply need to get more comfortable with him and he'll need to prove that he can quickly learn this business. He does not have a healthcare background but I don't think this concerns anyone. They just have to get to know him and gain confidence in his ability."

The analyst thinks the growth strategy and margin enhancement tactics are sound and he commended management for its ability to make progress on the expense-cutting initiatives. He thinks Bill and his team have been candid about pursuing non-core businesses like home-health care and hospice, however, he does not think that the Street necessarily buys it. When asked to clarify this point the analyst said, "They need to be clear about how much they expect the non-core business to contribute to the overall picture. Do they expect it to be comparable to the core business? Where do they see it going? In the fourth quarter, non-core revenues were only 8% of the total. Until the number gets closer to 20% of revenues, it is not going to get any credit from the Street. Investors don't think of the non-core businesses as an essential part of the company yet."

The analyst concluded our conversation by stating that he thinks management credibility is good, business operations are improving and that the only factor keeping a lid on the stock price is the uncertainty of the Medicare/Medicaid situation.

## **Charlie Lynch Sell-Side Analyst**

Charlie thinks the government issues are exerting the most significant portion of the negative influence on the share price. He added that the sluggish economy and the fact that Beverly is still in the midst of a fairly broad restructuring also plays an important role in the overall picture. He commented, "There have been a lot of changes over the past year and there are more to come. There has not been a lot of visibility on early positive results except for the sale of Florida operations. I've been following BEV for around five years and I've never recommended the stock. I've always been critically supportive but I've also never had a sell on the stock. I've always thought that the company needs a lot of work. It's basically a real estate company with a lot of low quality properties. They need to get the portfolio to a more manageable size so they can generate higher returns."

Charlie went on to say that he thinks Bill has taken some good steps to improving Beverly's operational performance and that it will take time for the business to demonstrate consistent performance. He thinks the Street was disappointed in the charges announced for the fourth quarter and that the ongoing lack of visibility will continue to plague shareholders' perception of the opportunity in the stock.

Charlie said that there are a good number of investors who continue to make money by trading the stock. He said the stock trades within a pretty defined range and that by trading the range, they don't necessarily need to fall in love with the business strategy.

Charlie thinks the stock price decline is consistent with other companies in the sector and he added that the exposure to Medicare/Medicaid "is what it is." He said the company's strategy to grow the non-core businesses makes sense but that the opportunity needs to be better defined.

On management, Charlie has only had one session with Jeff. He described the Street's perception of management as "the jury is still out", meaning that investors are taking a wait-and-see stance on the team's ability to turn the company around. Charlie added that, "People have to remember that they are only one year into a three-year strategic plan. Bill did a good job on the fourth-quarter conference call discussing the progress they've made thus far. There is still a lot of work to do and many investors were focussed on Florida. That was really only the first step in the process. I think they could be more forthcoming on what the priorities are for the coming year, for example the operational and financial targets. More information is always helpful."

**Rodney Hathaway**  
**Buy-Side Analyst**

Rodney acknowledged that Heartland used to be the largest shareholder of BEV owing over 11 million shares at one time. He said they are no longer involved in the stock but that it is always on their radar screen. Rodney thinks that at the end of the day, the industry will get what it needs on the reimbursement side but that there will be a lot of debate for the remainder of the current fiscal year. He expects a lot of volatility in the stock until the outcome of the Medicare reimbursement is resolved. He added, "The healthcare sector will get the funds it needs irrespective of the deficit on the federal budget. I'd say that the group as a whole is a buy."

Rodney said the fourth-quarter charges were explained to his satisfaction and that the Street had a strong sense the changes were coming. He commented that Beverly has had a checkered past and, unfortunately, this announcement set them back a step after having gained some momentum prior to the fourth quarter. "The charges definitely hurt them, but I think investors in general think of Bill favorably. The new management team is a big improvement from the past. I think they'll be able to overcome this glitch."

On the non-core business strategy, Rodney thinks management has done a good job explaining the approach. He thinks the company needs to simply focus on making money consistently. Specifically he said, "This company does not have a history of running things efficiently. They need to say they are going to make money regardless of the exposure to the government. They need to keep costs down and do an effective job on marketing."

**Anonymous Buy-Side Analyst**

This analyst has the utmost confidence in the current management team and thinks they are "a big departure from the old days." He likes the new strategy and the operational focus and is completely satisfied on the management side.

The analyst said the stock is depressed due to the Medicare reimbursement issues and does not think there will be improvement in the stock price until the Street sees some resolution on these issues. He commented further by saying, "The stock is trading on a worst-case scenario basis. The Street is assuming the reimbursements will not be extended. As investors, we are willing to hang on until they work through the macro-issues."

We discussed Beverly's progress on pursuing the non-core businesses like home-health and hospice and the analyst said, "I think Beverly has demonstrated initial success in these endeavors. Some of these businesses are quite fragmented so I think there is some good opportunity there. It's not a material part of their revenue yet, but they're going in the right direction. Until the non-core revenues become a larger influence, the Street will probably not pay a whole lot of attention to it."

**Moira Herson**  
**Sell-Side Analyst**

Moira thinks the Medicare uncertainty is causing the most negative influence on the stock, bar none. She thinks all of the nursing home and related stocks have been equally punished and does not think Beverly has been singled out. She does not believe there is anything the stocks with Medicare exposure can do to mitigate investors' concerns and added, "It's really out of the providers' control. This is causing a lot of volatility in these stocks and most investors are looking closely at the percentage of revenues from both Medicare and Medicaid. This is a big issue."

Moira thought the restructuring charges in the fourth quarter were explained satisfactorily and said Beverly followers are quite interested in the strategy to grow the other non-nursing home areas. She commented, "The hospice business is definitely of interest to me. There was a new IPO recently for a hospice company called Odyssey that a lot of investors are talking about." When asked what percentage of revenues she thinks investors would like to see from the non-nursing home businesses she said, "I can't really say. I think they need to be meaningful, I just don't know how I'd define that."

Moira said she thinks the three-year time horizon for the strategic plan is realistic and attainable. She and Ken Weakley follow other hospital companies and two to three years is a typical timeframe when talking about strategic issues in the industry. Moira has a positive perception of management but admitted that she has not yet met Jeff. As you know UBS has a hold on the stock until the Medicare issues are resolved. Until then, Moira thinks there is limited upside. She is cautiously optimistic that the increased funding will happen, but is hesitant to predict a timeframe for the decision.

**Barry Arnold**  
**Arnold Investment Counsel**

Barry told us they sold their position in BEV back in 1998-1999 and they have not really been following the story due to a shift in focus to other industries. He recalled a decline in the stock price at that time that was triggered by a government-related

decision. We updated Barry on the new management team, the new strategy and other recent events and asked what he would need to see happen before considering BEV as an investment again. Barry said any sort of catalyst or consistent financial performance might pique his interest in Beverly again. He is aware of the current cloud of uncertainty that exists related to Medicare reimbursement and will be watching developments unfold on this topic.

Barry expressed strong interest in meeting with the new management team and hearing an update on the story if a roadshow is planned for Milwaukee in the future.

**Michael Manschot**  
**Buy-Side Analyst**  
**ING Furman Selz Asset Management**

Michael said ING still owns the stock and that he believes BEV trades at a discount to its peers. He acknowledged that the entire sector is under pressure due the outstanding Medicare issues but thinks the factors specific to Beverly are the lower quality of assets and the recent charges announced during the fourth quarter results. Michael said, "They don't talk about the Medicare situation enough on the conference calls. I think the entire issue is overblown since the government is not going to allow these operators to go out of business. They need to diffuse some of the rumors that are out there. Clearly the final resolution won't be until October so it'll continue to be an overhang for the stock."

Regarding issues specific to Beverly, Michael realizes that the new management inherited the current assets in the portfolio. He thinks progress has been made but that the write-off was a big negative for the company. He commented, "It will take time for investors to get over that. People are still very concerned that there could be more charges coming. They need to have one solid year without any charges. Everything was going according to plan until the fourth quarter announcement. Once they get a year of solid execution under their belt and the Medicare issue is resolved, that will help the stock."

Michael thinks the strategy to grow the other eldercare areas makes sense but that this is overshadowed by the inconsistent results and the Medicare situation. His perception of management is that they still have to prove themselves. He would like to get to know Jeff but is generally pleased with the level of communication with investors. He thinks the three-year strategy is a reasonable timeframe and said the Florida sale demonstrated progress on the plan.

**Lisa Parisi**  
**Buy-Side Analyst**

Lisa has been at XYZ Asset Management since the summer of 2001. She used to follow BEV when she was at John A. Levin, also in New York. Lisa said she plans to get reacquainted with Beverly in the near future after being away from the story for the past year. That said, Lisa did not feel qualified to participate in the perception study. She did ask that we provide you with her new address and e-mail information as she would like to stay on the distribution lists to received all of the information on the company, which we have done.

In addition, we discussed the fact that GSAM has a position in BEV according to the December 13-F filings. Lisa was not familiar with where the position is held or who might be responsible for the holding. Lisa would like to meet the new management team and hear more about the new strategy the next time you meet with investors in New York. We assured Lisa that we would pass along her request.

**Dennis Stattman**  
**Buy-Side Analyst**

Dennis did not have time to go into detail with us on the perception study questions but said, "Our perception of Beverly is that it is a good investment. That's why we bought the stock."

**Darren Lehrich**  
**Sell-Side Analyst**

Darren thinks the biggest issue in the sector is the lack of clarity on what Congress will decide on Medicare reimbursement. He thinks this is a near-term issue that will be resolved by October but admits it will be an overhang on the stock until then.

Darren thinks the new management team has made some progress over the last year but said he has a neutral rating on the stock because he believes there are still a large number of weak assets in the portfolio. He added, "They are still faced with some tough decisions and in my opinion, they haven't been as aggressive as I would have liked. I think 20% of the nursing homes could be sold or shut down entirely."

Darren said the non-recurring, recurring charges in each of the last four year-end results have been inexcusable. He added, "It's going to be a challenge for them to attract new investors when they continue to have these huge write-downs. The other issue they need to address is their goal of having one-third of net revenues associated to ancillary businesses. I think the timeframe

Bill has set forth makes this goal unachievable. If anything, they've gone in reverse the last two quarters. They've had revenues decrease in the home health area with the divestiture of some assets and there has been no growth on the outpatient rehab business. With Aegis at a \$20 million run rate, their goals don't seem realistic. There is a disconnect on what they've talked about and what the numbers are saying. The roadmap is missing."

Darren commented that he likes Jeff and thinks he'll bring valuable financial discipline to the table. He added that he likes the fact that Bill has brought a lot of accountability to the managers, however, he'd like to see him spend more time in the field visiting the facilities, etc. He acknowledged that this was done when Bill first joined Beverly, however, he thinks it should continue to be a focus.

Darren thinks Beverly has decent potential but would like additional tangible results before changing his opinion on the stock. He discussed the importance of ROIC and hopes management will focus on driving higher returns. He concluded by saying he is disappointed that the company is not attending his firm's conference in April and said he thinks it's a bad decision for management to decline the invitation when he's been a loyal follower of Beverly over the years.

**Joe Kusnan**  
**Portfolio Manager**

Joe believes that the Medicare/Medicaid issue is the key driver of Beverly's current price for the immediate future, and management can do little "from their side" to address this issue. He does not believe that Beverly has been singled out by the market, and thinks the entire sector has come under significant pressure awaiting a final decision by Congress. Joe mentioned that he considers Beverly one of the biggest names in the space, and that the company's results are a good indicator of the overall sector. He said, "All these companies look the same from my point of view, and they all have been a disaster."

Joe thought that the disposition of the Florida properties was a good first step, but couldn't comment on management's restructuring program. Joe commented, "The problem is that the Medicare issue will never fully disappear. Sooner or later, this will come up again. It's difficult to evaluate management's strategy when so much of the Company's revenue stream (Medicare) is out of their control. For this reason it's difficult for me to comment on whether or not the strategy will pay off, or in what timeframe." Joe also mentioned that he not aware of any company in the industry that has been able to reduce their exposure to Medicare.

**Tony DeSpirito**  
**Buy-Side Analyst**

Tony thinks the industry macro trends are the key driver on the stock price. He said, "The industry itself has not had a good record because of the payment system. I worry about the state payments lagging the economy. I think the earliest we'll know the outcome is this summer. There are other parties looking for Medicare reimbursement like HMOs so I'll be interested to see what the final result is."

Specific to Beverly, Tony said he looks at the long-term operating history of the company. He thinks the decline in the stock is consistent with others in the sector and thinks the stock is fairly valued at around \$8 per share. Tony said he would be willing to buy BEV for the portfolio again if there was continued price pressure. He added, "We used to be very large holders of BEV and we're just looking for the right opportunity to get back in."

Tony said the only way other healthcare operators have been able to manage the Medicare exposure is by having a lesser percentage of revenues from Medicare. For example, he discussed that Manor Care simply has less exposure to Medicare than Beverly and that besides this, there is no way to mitigate the risk.

Tony thinks the strategy to grow the ancillary eldercare practices is reasonable but commented, "The other businesses do not contribute meaningful numbers to the bottom line. Until at least one quarter of revenues are from the non-core businesses, the Street is not going to pay any attention to it."

Tony is pleased with the current "upgrading" of management and is satisfied with the level of financial communications the company provides.

**Anonymous Investor**  
**Portfolio Manager**

This portfolio manger also asked to remain anonymous. During our conversation he discussed how Beverly is a difficult story to get comfortable with at the present time. He said, "There are some positives, as well as some negatives and the firm is having difficulty balancing these factors to get a sense of the company's prospects. On the positive side, the new management team has shown a willingness to come in and clean house, getting rid of underperforming properties and people. Getting out of Florida was a meaningful step in the right direction. The biggest negative is how the Medicare issue will play out. I really doubt that the government will abandon these companies. When was the last time Congress reduced government subsidies to shift

healthcare back to the consumer? But until this issue resolves itself, we can't get too excited about the sector. Near-term, it's dead money as far as we are concerned."

In commenting on Beverly's current valuation, this investor thinks the entire sector has been beaten down and that BEV is "appropriately valued," however, he couldn't elaborate given the difficulty in "getting our arms around the issues". He added, "It's difficult to quantify what the company is worth. All of the names in this sector are paying their dues with regard to the Medicare issue, but Beverly is also undergoing a major restructuring at the same time. If I wanted exposure to this sector again, I'd rather go with a company with a better track record. It seems like Beverly has just too much going on right now, there are safer names to go with to play a recovery in the sector."

The investor is not aware of any care providers that have been able to significantly reduce their exposure to Medicare and the government and said, "I suppose there may be a few niche companies that have, maybe in the higher-end markets, but not on a national level. Dealing with the government is just part of being in this business."

This investor believes that the best way to increase shareholder value is to reduce and manage the level of debt. Specifically he said, "With Medicare revenues at risk and the costs of restructuring, the first thing I worry about are the coverage ratios. Medicare or not, restructuring or not, the debt has to be paid. This affects the Company's financial flexibility and it's access to the credit markets, things Beverly needs during a major restructuring."

In closing, the investor commented on Beverly's restructuring plan and overall business strategy. While attainability and timeframes are difficult to call, the portfolio manager shared these thoughts, "How big is their problem? Out of all of Beverly's properties, how many are stars, how many are on the fence and how many are beyond hope? Is this just weeding out a few bad apples or a major overhaul? How is the Company measuring the properties that do not stand up? For those that are on the fence how long do they have to clean up their act? If investors had a better feel for the problems and the opportunities it would be easier to get a sense of where things are headed."

#### **Anonymous Buy-Side Analyst**

This buy-side analyst is quite familiar with Beverly and appreciated an opportunity to share some thoughts on the company. The firm currently does not own Beverly stock, but keeps up to date since they perceive Beverly as a leader in the space. This analyst mentioned that the biggest positive is the recurring nature of the revenue stream given the governments' reimbursement plan. Interestingly, this analyst also sees this as a negative. He commented, "Although revenues are recurring, there is limited visibility on the revenue stream since the company is at the mercy of Congress. As such, it is difficult to create a long-term model to arrive at an accurate valuation. I don't think these reimbursements are going to completely go away, or be reduced, but what about growth? It's an important part of the analysis that analysts cannot accurately model. I think this contributes to the volatility in this sector." Given the lack of true visibility on the top line, this analyst was unable to comment on Beverly's valuation relative to industry peers.

This analyst believes that it is possible to reduce exposure to Medicare through diversification, but it will always be an issue for healthcare providers. The analyst was impressed with HCR's ability to reduce their dependence on reimbursements by entering into new businesses.

With regards to Beverly's communication with investors, this analyst expressed frustration with past efforts by management, and specifically mentioned the charges taken in the fourth quarter. He commented, "I wish they would explain the charges in greater detail. They take these charges and we never understand what they are for, or what's really going on in the business. The reasoning should be more transparent."

In closing the analyst mentioned that he understands that the company has a difficult road ahead to rebuild credibility with investors, but is impressed with the new management team thus far.

#### **Susan Cross Buy-Side Analyst**

Susan mentioned that XYZ was a shareholder at one time, and that Beverly "looks interesting" at its present valuation. Specifically, she said, "Some of the trouble they have in the market is that the company has changed so much in a short period of time. I remember when Beverly was being a micro-cap, then went on to become large-cap, only to fall back into a small-cap. We owned it when it was a large-cap but had to sell once it fell beneath our minimum market-cap threshold. This could be something that is weighing on the stock from a technical point of view. You have large-cap value shareholders liquidating their position since the company doesn't fit that type of portfolio, and small-cap growth and momentum players taking profits where they can. You have a shareholder base of small-cap growth, large-cap value and other investment styles that are fighting it out in the market. Obviously the government reimbursement are the big issue though as far as fundamentals, especially BIPA and BBRA. Hospitals and other healthcare providers received the benefit of reimbursement rate increases, but for nursing homes it's hard to gauge the real impact to the top line."

Susan was unable to name another provider who has been able to effectively reduce its exposure to Medicare, and sees this risk as “part of the cost of doing business” in the industry. Although she believes the Bush administration is friendly to healthcare services, she said, “There always appears to be a loophole the government can use to squeeze out a few pennies out of the reimbursements, either at the federal or state level. The risk of reimbursement reduction is always out of the company’s control. Anyone who thinks they can insulate themselves completely is nuts. This isn’t necessarily a bad thing, just the cost of doing business. If investors were uncomfortable with this risk, they wouldn’t invest in this sector to begin with.”

In closing Susan mentioned what she would like to see the company do to increase shareholder value. Although she is not familiar with your strategy, she did offer some general comments. She said, “I wouldn’t want to see a lot of big acquisitions being done for the sake of growth. This is not tech where you can realistically expect to grow at 20% per year, so why try? I’d like to see them get back to the basics, more patients, period. They need to demonstrate that they can generate free cash flow and use this to pay down some debt. Nothing fancy, just a good old-fashioned combination of strong management and a simple strategic plan.”

**Ryan Downey**  
**Fixed-Income Analyst**

Although Ryan follows Beverly from the fixed-income side and could not comment on your equity valuation, he did take the opportunity to share a few thoughts on the company and the industry. Like the equity analysts, Ryan believes that the Medicare reimbursements are the “A-number one issues at this point.

He added, “There are a lot of sunset issues out there that sooner or later Congress will have to settle. Any company that has a significant source of their revenues at the whim of Congress will have to pay a premium to their creditors. There’s really not a company in Beverly’s space that can get away from this. There maybe a few out there that have priced themselves in such a way to either take on a bigger or smaller piece of the Medicare business, but it never completely disappears. I don’t have any major problems with Beverly, but I’ll admit that I’m not as close to the story as other names in the space. I first became aware of the Company about a year ago when a new issue hit the market, I see that issue has pulled back a bit in the last couple of weeks, and it caught my attention. But until October, it’s difficult to seriously look into the company since they have that cloud over the reimbursement issue.”

**Anonymous Investor**  
**Independent Money Manager/Portfolio Manager**

When contacted, this portfolio manager initially declined to participate in the perception study since he has not actively followed Beverly or the industry in “quite some time” and felt that his comments may not be relevant at this time. Although he felt he was unable to thoughtfully answer our survey, he was willing to summarize his interest in the sector, and his reasoning behind his decision to focus on other industries.

“In looking for companies in which to invest, I prefer those that have recurring revenues and fairly predictable margins and ROE. I was originally attracted to the nursing home sector because it looked similar to a REIT, with predictable and growing revenues. I figured revenue growth was almost guaranteed with the demographic shift to an older population, and people becoming increasingly focused on planning for retirement and health needs as they age. As I looked deeper into how this business works and how the company interacts with patients and the government, all I saw was risk. The big concern I had was the unknown litigation risks. In looking at the shareholder equity and retained earnings, I wondered if this money was ‘fully earned’ and available to shareholders. One or two bad lawsuits that even hint at negligence could be disastrous. I suppose there is insurance for that I guess, but if it is similar malpractice insurance, one bad claim and you face immediate and significant increases in premiums paid. I could just never get comfortable with taking on that kind of risk and convincing myself of the quality of the earnings.”

This investor was unable to comment on Beverly’s current valuation, but offered a few additional insights on how investors receive this type of company. He commented, “Companies like this often appear that they are earning abnormal returns in the market, and that can easily lead you to the conclusion that they are undervalued. However, once you take the all the risks to the earnings into account, litigation, changes in government attitude etc., the discount disappears. What’s worse is that investors cannot assign a dollar amount or probability to these events. There are just too many unknowns to deal with.”

**John Schneider**  
**Buy-Side Analyst**

John mentioned that the two largest issues that are weighing on Beverly are the renewal of Medicare reimbursements and the risk of continued lawsuits against Beverly. He feels the special charges taken in the fourth quarter were adequately explained and thought that management did a good job in walking people through the numbers. John is confident that these were true “one time items” and they will not prove to be the “recurring non-recurring” charges that many companies hide behind.

In commenting on Beverly's turnaround strategy, John believes that management is taking the company in the right direction. He commented, "The company is doing the right things, trying to move away from Medicare and reduce their government exposure. It sounds strange, but the government can be a risky payer. Manor Care was able to reduce their dependence on Medicare reimbursements, so it should be possible for Beverly as well."

In addition to reducing exposure to Medicare, John appeared concerned about ongoing litigation issues for Beverly. He mentioned that he would make exiting those states with the highest litigation risks the first priority for the company's business strategy.

**Remy Trafelet**  
**Portfolio Manager**

Remy founded this asset management company with a group of former Fidelity analysts and portfolio managers. The firm employs a classic buy and hold strategy, and prefers to privately meet with management as often as possible to round out their proprietary research.

When we spoke with Remy, he admitted that he is not as close to Beverly as he used to be, and with that said did not feel qualified to participate in the perception study. We briefed him on the changes going on at the company and summarized your turnaround strategy. During our conversation, Remy commented, "It was a great name for us a few years back when we held it in our portfolio, we made a lot of money off it and we'd be a good example of a former shareholder looking to get back in if something was going on. If I remember, there really wasn't a reason we sold out of it, the stock just kept rallying and over time we reduced our position."

Remy asked that we keep him on your distribution lists and inform him next time management is in New York, as he would appreciate an opportunity to meet with the management team and hear an update on the story.

**David Woodyatt**  
**Buy-Side Analyst**

When we spoke with David to discuss Beverly Enterprises, he cautioned us that he has not actively followed Beverly for the past few years and could not fully comment on the current status of the company. He did, however, share his current thoughts on the industry and prior experience with Beverly in particular. David commented, "There's just not much interest in these long term care stocks anymore. Investors are concerned with reimbursement and you also have the problem that several publicly traded care providers went bankrupt in a short period of time. Even though Beverly survived, I remember the company being involved in some controversy over the government reimbursements. When the government changed the reimbursement legislation for long-term care providers, Beverly in particular was somehow involved in the writing of the legislation, or consulted on the workings of the new schedules. As it worked out, Beverly was a net beneficiary on the major changes and a slew of other providers went bankrupt. It just looked like Beverly was involved somehow despite claims to the contrary." David mentioned this occurred approximately 3 years ago.

David mentioned that it is unlikely that he would consider revisiting the Beverly story since he believes that the Street has lost confidence in the company. He said, "Once a company loses the confidence and respect of investors, it's difficult for any company to win back support from the Street." We also discussed his current thoughts on the industry as a whole, and whether he would consider investing in this sector again. He commented, "I don't know. Theoretically the demographics are good and there appears to be a shortage of long-term care providers, but I'd need to feel comfortable that the government wasn't going to hit the industry over the head again by tinkering with reimbursements. Labor costs are another issue I'd consider. There appears to be a shortage of nurses that has been a problem for all healthcare providers which will increase your labor costs and eat into margins. Bottom line, this sector is not attractive to me. When I go to a conference this is not the type of company I'd want to see."

**END**