

ARV ASSISTED LIVING INC  
Form DEFM14A  
March 28, 2003  
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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## SCHEDULE 14A

### (Rule 14a-101)

#### Information Required in Proxy Statement

Pursuant to Section 14(a) of the  
Securities Exchange Act of 1934

Filed by the Registrant ☒

Filed by a Party other than the Registrant ☐

Check the appropriate box:

<input type="checkbox"/>	Preliminary Proxy Statement	<input type="checkbox"/>	Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
<input checked="" type="checkbox"/>	Definitive Proxy Statement		
<input type="checkbox"/>	Definitive Additional Materials		
<input type="checkbox"/>	Soliciting Material Pursuant to Rule 14a-12		

## ARV ASSISTED LIVING, INC.

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(Name of Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

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☐ No fee required.

☒ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

common stock, par value \$0.01 per share

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(2) Aggregate number of securities to which transaction applies:

9,864,620 shares of, and options to acquire 2,386,500 shares of, common stock

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

The filing fee of \$4,034 was calculated pursuant to Exchange Act Rule 0-11(c)(1) and is based on the 9,864,620 shares of ARV Assisted Living, Inc. common stock outstanding that are not owned by Prometheus and its affiliates, multiplied by the \$3.90 per share merger consideration, plus the difference between \$3.90 and the strike price of options to acquire 2,386,500 shares of ARV Assisted Living, Inc. common stock. The filing fee was then calculated by multiplying the resulting transaction cash value of \$43,841,643 by 0.000092.

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(4) Proposed maximum aggregate value of transaction:

\$43,841,643

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(5) Total fee paid:

\$4,034

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x Fee paid previously with preliminary materials.

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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**ARV ASSISTED LIVING, INC.**

**245 FISCHER AVENUE, SUITE D-1**

**COSTA MESA, CALIFORNIA 92626**

**March 27, 2003**

To our Stockholders:

We cordially invite you to attend a special meeting of stockholders of ARV Assisted Living, Inc. ( ARV ), to be held on April 23, 2003 at 9:00 a.m., local time, at the Airport Hilton, 18800 MacArthur Boulevard, Irvine, California 92715.

As described in the enclosed proxy statement, at the special meeting, we will ask you to consider and vote upon a proposal to adopt a merger agreement that provides for the merger of ARV with Jenny Merger Corp. ( Merger Sub ), a wholly owned subsidiary of Prometheus Assisted Living LLC ( Prometheus ), and to approve the merger contemplated by the merger agreement. If the merger is completed, you will receive \$3.90 in cash, without interest, for each share of common stock of ARV that you own. After the merger, ARV will be a wholly owned subsidiary of Prometheus.

A special committee of ARV's board of directors, consisting of directors who are not officers or employees of ARV or Prometheus, evaluated and negotiated the terms of the merger agreement and the proposed merger and unanimously recommended the approval of the merger agreement and the proposed merger to ARV's board of directors. The entire board of directors of ARV has unanimously approved the merger agreement and the merger. The special committee and the board of directors unanimously recommend that all stockholders vote FOR the adoption of the merger agreement and approval of the merger. Cohen & Steers Capital Advisors LLC ( Cohen & Steers ), the special committee's independent financial advisor, rendered an opinion to the special committee on January 3, 2003 that as of such date, the \$3.90 per share cash consideration to be received by the ARV stockholders (other than Prometheus, Merger Sub and their respective affiliates) pursuant to the terms and subject to the conditions set forth in merger agreement, was fair from a financial point of view to those stockholders.

Under Delaware law, for the proposed merger to be completed, the merger agreement must be adopted by the holders of a majority of the shares of ARV common stock outstanding as of the close of business on March 27, 2003, which is the record date for purposes of the special meeting. Prometheus owned approximately 43.5% of the outstanding shares of ARV common stock, as of the record date.

The accompanying notice of special meeting of stockholders and proxy statement explain the proposed transactions and provide specific information concerning the special meeting. Please give this information your careful attention.

Your vote is important. Whether or not you plan to attend the special meeting, please sign, date and return the enclosed proxy card in the postage-paid envelope as soon as possible. Returning a signed proxy card will not prevent you from voting your shares in person if you subsequently choose to attend the special meeting. You may also revoke your proxy at any time before it is voted at the special meeting by submitting a written revocation or a proxy bearing a later date. If you fail to vote by proxy or in person, or fail to instruct your broker on how to

vote, it will have the same effect as a vote against adoption of the merger agreement and approval of the merger.

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In considering the recommendation of the special committee and ARV's board of directors, you should be aware that Prometheus, members of the ARV board of directors and certain key members of ARV's management have interests in the merger that may be different from your interests as an ARV stockholder. These interests are summarized in the accompanying proxy statement in the section entitled "SPECIAL FACTORS - Interests of Certain Persons in the Merger."

On behalf of the board of directors, I thank you for your support and urge you to vote **FOR** the adoption of the merger agreement and the approval of the merger.

Sincerely yours,

Douglas M. Pasquale

*Chairman and Chief Executive Officer*

The date of this proxy statement is March 27, 2003. It is first being mailed to ARV stockholders on or about April 1, 2003.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these transactions, passed upon the fairness or merits of these transactions, or passed upon the accuracy or adequacy of the information contained in this document. Any representation to the contrary is a criminal offense.**

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**ARV ASSISTED LIVING, INC.**

**245 FISCHER AVENUE, SUITE D-1**

**COSTA MESA, CALIFORNIA 92626**

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**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS**

**TO BE HELD ON APRIL 23, 2003**

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TO THE STOCKHOLDERS OF ARV ASSISTED LIVING, INC.:

NOTICE IS HEREBY GIVEN that a special meeting of stockholders of ARV Assisted Living, Inc., a Delaware corporation ( ARV ), will be held at the Airport Hilton, 18800 MacArthur Boulevard, Irvine, California 92715 on April 23, 2003, at 9:00 a.m., local time, for the following purposes:

1. To consider and vote on a proposal to adopt the Agreement and Plan of Merger, dated as of January 3, 2003, by and among Prometheus Assisted Living LLC ( Prometheus ), Jenny Merger Corp., a Delaware corporation and wholly owned subsidiary of Prometheus ( Merger Sub ), and ARV, a copy of which is attached to the accompanying proxy statement as Appendix A, and to approve the merger contemplated by the merger agreement. Under the merger agreement, Merger Sub will be merged with and into ARV and ARV will become a wholly owned subsidiary of Prometheus. If the merger is completed, each outstanding share of ARV common stock (except for shares held by Prometheus or its affiliates, ARV or any subsidiary of ARV and except for shares as to which the holders perfect their dissenters' rights under Delaware law) will be converted into the right to receive \$3.90 in cash, without interest, and each holder of a stock option granted by ARV to purchase shares of ARV's common stock will receive in cash, without interest, for each share of common stock subject to such option, the excess, if any, of the merger consideration of \$3.90 per share over the exercise price per share of such option, less any applicable withholding taxes. Prometheus owned approximately 43.5% of the outstanding shares of ARV common stock on March 27, 2003, the record date of the special meeting.
2. To consider and vote upon such other matters as may properly come before the special meeting or any adjournment or postponement thereof.

The foregoing items of business are more fully described in the proxy statement accompanying this notice.

ARV's stockholders of record as of the close of business on March 27, 2003 are entitled to receive notice of and to vote at the special meeting, and any adjournment or postponement of the special meeting.

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The ARV board of directors, based in part on the unanimous recommendation of a special committee, has unanimously determined that the merger agreement and the merger are advisable and approved the merger agreement and the proposed merger. The board of directors and the special committee recommend that you vote **FOR** the adoption of the merger agreement and approval of the merger. Please review in detail the attached proxy statement for a more complete statement regarding the matter to be acted upon at the special meeting, including a description of the merger agreement, the background of the merger and the factors that the special committee considered in recommending that the board of directors adopt and approve the merger and the merger agreement.



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Stockholders of ARV who do not vote in favor of the adoption of the merger agreement and approval of the merger will have the right to seek appraisal of the fair value of their shares of ARV common stock if the merger is completed, but only if they submit a written demand for an appraisal before the vote is taken on the merger agreement and the merger and they comply with Delaware law as explained in the accompanying proxy statement.

Whether or not you expect to attend the meeting, please complete, date and sign the enclosed proxy card and mail it promptly in the enclosed envelope in order to ensure representation of your shares.

**Please do not send your stock certificate at this time. If the proposed merger is completed, you will be sent instructions regarding the surrender of your certificates.**

If you properly execute and submit a proxy and no instructions are given, the shares of ARV common stock represented by that proxy will be voted **FOR** the adoption of the merger agreement and approval of the merger.

By Order of the Board of Directors

Douglas Armstrong

*Secretary*

Costa Mesa, California

March 27, 2003

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APPENDIX B	Opinion of Cohen & Steers Capital Advisors LLC, dated January 3, 2003
APPENDIX C	Section 262 of the Delaware General Corporation Law; Appraisal Rights
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**SUMMARY TERM SHEET**

*This summary term sheet highlights selected information contained in the proxy statement and may not contain all of the information that is important to you. To understand the transactions fully and for a more complete description of the legal terms of the transactions, you should carefully read this entire document and the additional documents to which we refer you, including the Agreement and Plan of Merger attached as Appendix A. This proxy statement is first being mailed on or about April 1, 2003, to ARV's stockholders of record as of the close of business on March 27, 2003.*

**The Parties (see page 63)**

**ARV Assisted Living, Inc.** (ARV, the Company, we or us) is a fully integrated provider of assisted living accommodations and services in the United States. We operate, acquire and develop assisted living communities (ALCs) that offer a combination of housing, personalized support services and healthcare in a non-institutional setting. Our ALCs are designed to respond to the individual needs of elderly residents who require assistance with certain activities of daily living, but who do not require the intensive nursing care provided in a skilled nursing facility. ARV is a Delaware corporation, and its executive offices are located at 245 Fischer Avenue, Suite D-1, Costa Mesa, California 92626 (Telephone: (714) 751-7400).

**Prometheus Assisted Living LLC** (Prometheus) is a Delaware limited liability company formed to acquire common stock of, and other investments in, ARV. Prometheus currently owns approximately 43.5% of our outstanding common stock. Prometheus' executive offices are located at c/o Lazard Frères Real Estate Investors L.L.C., Attn: General Counsel, 30 Rockefeller Plaza, New York, New York 10020 (Telephone: (212) 632-6000).

**Jenny Merger Corp.** (Merger Sub) was incorporated in Delaware in November 2002 by Prometheus for the purpose of effecting the merger. Merger Sub has not been engaged in any business activities other than those in connection with its formation and the merger. All of the outstanding capital stock of Merger Sub is owned by Prometheus. Merger Sub will be merged with and into ARV, and ARV will be a wholly owned subsidiary of Prometheus following the merger. Merger Sub's executive offices are located at c/o Lazard Frères Real Estate Investors L.L.C., Attn: General Counsel, 30 Rockefeller Plaza, New York, New York 10020 (Telephone: (212) 632-6000).

Appendix D sets forth information regarding Prometheus, Merger Sub and certain of their affiliates (namely LF Strategic Realty Investors II L.P., LFSRI II Alternative Partnership L.P., LFSRI II CADIM Alternative Partnership L.P., and Lazard Frères Real Estate Investors L.L.C.) who, under the rules of the Securities and Exchange Commission (the Commission), may be deemed to be engaged in the merger. Prometheus, Merger Sub and these affiliates are collectively referred to as the Prometheus Parties in this proxy statement.

**Information Concerning the Special Meeting (see page 55)**

*Date, Time and Place.* ARV will hold a special meeting of stockholders on April 23, 2003 at 9:00 a.m., local time, at the Airport Hilton, 18800 MacArthur Boulevard, Irvine, California 92715.

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*Purpose of the Special Meeting.* At the special meeting, you will be asked to adopt the Agreement and Plan of Merger, dated as of January 3, 2003, by and among Prometheus, Merger Sub and ARV, and to approve the merger contemplated by the merger agreement. You will also be asked to vote on other matters that properly come before the special meeting, although we are not aware that any such other matters will be brought before the special meeting. Pursuant to the merger agreement, Merger Sub will merge with and into ARV, and ARV will become a wholly owned subsidiary of Prometheus. If the merger agreement is adopted, the merger is approved and the merger is completed, your shares of ARV common stock will be converted into the right to receive \$3.90 per share, in cash, without interest, unless you perfect appraisal rights in accordance with Delaware law, in which case you will be entitled to receive the appraised value, as determined by the Delaware Court of Chancery, of your shares. (See THE MERGER Dissenters and Appraisal Rights below.) Holders of stock options granted by ARV to purchase shares of ARV's common stock, whether or not otherwise exercisable, will receive in cash, without interest, for each share of common stock subject to such option, the excess, if any, of the merger consideration of \$3.90 per share over the exercise price per share of such option less any applicable withholding taxes.

*Record Date; Voting at the Special Meeting.* You will only be entitled to vote at the special meeting if you are a stockholder of record as of the close of business on March 27, 2003, which is the record date for the special meeting. You will be entitled to one vote per share.

*Quorum.* The holders of a majority of the shares of ARV common stock outstanding as of the close of business on March 27, 2003, and entitled to vote on a matter at the special meeting must be present in person or by proxy in order for a quorum to exist at the special meeting. Abstentions and broker non-votes will be counted as present for purposes of determining a quorum.

*Vote Required.* Under Delaware law, the merger agreement and the proposed merger must be adopted by the holders of a majority of shares of ARV common stock issued and outstanding as of March 27, 2003, which is the record date for the special meeting. On the record date, ARV had 17,459,689 shares of common stock issued and outstanding. Prometheus owned 7,595,069 shares of our common stock, representing approximately 43.5% of the shares of ARV common stock outstanding as of the record date. Separate approval by the holders of a majority of shares of ARV common stock who are not affiliated with Prometheus is not required to complete the merger.

Brokers will not have the right to vote on adoption of the merger agreement and approval of the merger unless the beneficial owners of the shares held in street name give the broker specific instructions authorizing the vote. If you fail to return an executed proxy card or to vote in person at the special meeting, or if you abstain from voting, it will constitute, in effect, a vote against adoption of the merger agreement and approval of the merger. Similarly, broker non-votes will have the same effect as a vote against adoption of the merger agreement and approval of the merger.

*Engagement of Proxy Solicitation Firm.* ARV has retained the firm of Georgeson Shareholder Communications, Inc. to assist in the solicitation of proxies, for which Georgeson Shareholder Communications will be paid a fee of approximately \$7,500 and reimbursed for its expenses.

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### **Trading Markets and Market Price of ARV Common Stock (see page 61)**

ARV common stock is traded on the American Stock Exchange under the symbol SRS. The closing price per share for ARV common stock on September 23, 2002, the last full trading day prior to the public announcement of Prometheus' initial proposal, was \$2.55 per share. The closing price per share for ARV common stock on January 3, 2003, the last full trading day prior to the public announcement of the proposed merger, was \$3.75 per share. On March 26, 2003, the last full trading day prior to the date of this proxy statement, the closing price for ARV common stock was \$3.85.

### **Special Factors (see page 14)**

*Purpose of the Merger (see page 44).* ARV's purpose for the merger is to provide ARV's stockholders who are not affiliated with Prometheus immediate liquidity from their investment in ARV. The merger price of \$3.90 per share represents a premium of approximately 53% over the \$2.55 closing price of ARV common stock on September 23, 2002, the last full trading day prior to ARV's announcement that it had received a preliminary transaction proposal from Prometheus. See SPECIAL FACTORS Reasons, Purpose and Structure of the Merger.

*Effects of the Merger (see page 46).* The merger is a going private transaction for ARV. Upon completion of the merger, Prometheus will beneficially own all of the equity securities of ARV and ARV will be a wholly owned, privately held subsidiary of Prometheus. Immediately following the merger, no other stockholders will have any interest in ARV, including in any future earnings and growth of ARV, and similarly will not bear the risk of any decrease in the value of ARV after the merger. ARV common stock will no longer be publicly traded after the merger. In addition, the registration of ARV common stock and ARV's reporting obligations under the Securities Exchange Act of 1934, as amended (the Exchange Act), will be terminated upon application to the Commission. See SPECIAL FACTORS Certain Effects of the Merger and Plans for ARV.

*Special Committee (see page 35).* ARV's board of directors formed a special committee of directors consisting of two independent directors (the Special Committee) to evaluate Prometheus' proposal and to consider options that may be available to ARV. The Special Committee consists of David Collins and Maurice DeWald, neither of whom is an officer of ARV or an affiliate of Prometheus. The Special Committee, with the advice and assistance of its independent legal and financial advisors, evaluated and negotiated the merger proposal, including the terms of the merger agreement, with Prometheus.

*ARV's Reasons for the Merger and Board of Directors' Recommendation; Fairness of the Merger (see pages 36 and 40).* The Special Committee of ARV's board of directors determined that the merger agreement and the proposed merger are fair to, from a financial and procedural point of view, and in the best interests of ARV's stockholders who are not affiliated with Prometheus. The Special Committee considered a number of substantive and procedural factors in its determination of whether the proposed merger was fair to the stockholders of ARV who are not affiliated with Prometheus. These included, without limitation, the fact that the Special Committee had not received a proposal in excess of \$3.90 per share that, in the Special Committee's view, was also reasonably likely to be consummated in light of Prometheus' significant ownership interest in ARV, Prometheus' indication that it was not interested in selling its shares and Prometheus' ability potentially to purchase up to 50% of

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ARV's common stock, without ARV's prior approval. During the course of negotiations between ARV and Prometheus, other parties expressed interest in entering into a strategic transaction with ARV, and two of such parties offered, subject to due diligence, to purchase ARV's outstanding common stock for \$4.00 per share. However one party withdrew its offer before furnishing the Special Committee with any type of definitive agreement and the other party could not provide a reasonable basis for the Special Committee to conclude that such a transaction could be consummated due to the factors set forth above. Therefore, after careful consideration of all of the offers, the Special Committee concluded that the interests of the public stockholders of ARV (other than Prometheus and its affiliates) would be best served by entering into the merger agreement with Prometheus. Accordingly, the Special Committee unanimously recommended to ARV's board of directors that it approve the merger and the merger agreement. ARV's board of directors, based in part on the positive recommendation of the Special Committee, determined that the merger agreement and the merger are advisable and approved the merger agreement and the merger.

The Special Committee and the board of directors recommend that you vote **FOR** the proposal to adopt the merger agreement and approve the merger. To our knowledge, each of our executive officers and directors intends to vote all of the shares of our common stock they directly own in favor of the merger. For a discussion of the material factors considered by the Special Committee and the board of directors, see **SPECIAL FACTORS** Special Committee's and Board of Directors' Recommendation; Fairness of the Merger. All of the members of ARV's board of directors unanimously approved the merger and recommended adoption of the merger agreement and approval of the merger. See **SPECIAL FACTORS** Background of the Merger.

*Opinion of Cohen & Steers with respect to the fairness to ARV's stockholders who are not affiliated with Prometheus (see page 23).* In connection with the merger, the Special Committee and ARV's board of directors considered the opinion of Cohen & Steers, the independent financial advisor to the Special Committee, dated January 3, 2003, that as of such date, the \$3.90 per share cash consideration to be received by the holders of ARV's common stock (other than Prometheus, Merger Sub and their respective affiliates) pursuant to the terms and subject to the conditions set forth in the merger agreement, was fair, from a financial point of view, to such holders. A copy of the fairness opinion of the Special Committee's financial advisor is attached to this proxy statement as Appendix B. ARV urges you to read the fairness opinion for a complete understanding of the assumptions, limitations and qualifications set forth in it.

*Position of Prometheus and Merger Sub as to the Fairness of the Merger (see page 41).* The rules of the Commission require each of the Prometheus Parties to express a belief regarding the fairness of the merger to ARV's stockholders who are not affiliated with Prometheus. After careful consideration and based on various factors, the Prometheus Parties have formed the belief that the merger is procedurally and substantively fair to ARV's stockholders who are not affiliated with Prometheus. However, you should not construe this belief as a recommendation as to how you should vote on the merger. For a discussion of the material factors considered by the Prometheus Parties, see **SPECIAL FACTORS** Prometheus Parties' Position as to the Fairness of the Merger.

*Interests of Certain Persons in the Merger (see page 48).* Certain members of ARV's board of directors and ARV's executive officers have interests in the merger that are different from those



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that you have as an ARV stockholder. These relationships and interests are or could be viewed to create conflicts of interest that would affect the ARV board of directors' recommendations.

Interests that you should consider include:

Two members of ARV's board of directors were nominated by and are affiliated with Prometheus.

Some of ARV's executive officers and directors, including the members of the Special Committee, own our common stock and have options to purchase ARV common stock. The merger agreement provides that, at the effective time of the merger, all outstanding options to purchase common stock of ARV will be cancelled in exchange for the right to receive, for each such option, a cash payment equal to the amount, if any, by which the \$3.90 per share merger consideration exceeds the per share exercise price of the option, referred to as the spread, without interest, less any applicable withholding taxes. Approximately \$2.1 million will be paid to the members of the Special Committee in connection with the merger with respect to their ARV shares and options. The members of the Special Committee received no ARV shares or options in connection with their role as members of that committee.

In recognition of their service on the Special Committee, ARV has agreed to pay to Maurice DeWald and David Collins, the members of the Special Committee, additional compensation of \$1,000 per material meeting. As Chairman of the Special Committee, Mr. DeWald also receives \$750 per quarter. The amount is not conditioned on whether the merger is consummated. To date, Mr. DeWald and Mr. Collins have each received \$29,000 in fees for their service on the Special Committee.

ARV will continue the indemnification arrangements and directors' and officers' liability insurance for ARV's past, present and future directors and officers following the merger, including members of the Special Committee.

Prometheus is having discussions with Douglas Pasquale, ARV's Chairman and Chief Executive Officer, regarding his potential employment in a senior management position with ARV and a combined company composed of ARV and two assisted living companies affiliated with Prometheus after the merger. There is no assurance that Prometheus and Mr. Pasquale will reach an agreement. Prometheus is evaluating the role ARV's current management will play in ARV and the combined company after the merger. Neither member of the Special Committee will be employed by ARV or the combined company after the merger.

Mr. Pasquale and certain other executive officers of ARV have agreements that provide them with severance payments in the event that their employment is terminated after the merger.

*Conditions to Completion of the Merger (see page 84).* Completion of the merger is subject to various conditions, including, but not limited to, ARV receiving all necessary regulatory approvals. The conditions to completion of the merger are summarized under "THE MERGER AGREEMENT - Conditions to the Merger." As a result of various conditions to the completion of the merger, ARV cannot assure you that the merger will be completed even if the requisite stockholder approval is obtained. It is expected that if ARV's stockholders do not adopt the merger agreement and approve the merger or if the merger is not completed for any other reason, the current management of ARV, under the direction of the board of directors, will continue to manage ARV as an ongoing business.

*Financing of the Merger (see page 65).* Prometheus has informed us that it currently estimates the aggregate merger consideration and other transaction costs, including fees and expenses relating to the merger to be approximately \$60 million. It expects these funds to come from a

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combination of a capital contribution from one of its affiliates and the working capital of ARV. For additional information regarding the financing of the merger, see THE MERGER Financing of the Merger.

### **Accounting Treatment (see page 70)**

The merger will be accounted for under the purchase method of accounting.

### **Material U.S. Federal Income Tax Consequences (see page 67)**

Generally, the merger will be taxable for U.S. federal income tax purposes to ARV's stockholders. You will recognize taxable gain or loss in the amount of the difference between \$3.90 and your adjusted tax basis for each share of ARV common stock that you own. Tax matters are very complex, and the tax consequences of the merger to you will depend on the facts of your own situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you.

### **Exchange of Stock Certificates for the Merger Consideration (see page 64)**

You should not send in stock certificates until you receive a letter and instructions from the paying agent on how to surrender your ARV stock certificates, which should be sent to you soon after the effective date of the merger. You can expect to receive a check in the amount of your cash payment soon after ARV's paying agent has received your stock certificates, along with your properly completed documentation.

### **Dissenters' and Appraisal Rights (see page 70)**

If you do not vote in favor of the adoption of the merger agreement and the approval of the merger and you take all steps required to perfect your appraisal rights under Delaware law, you will be entitled to dissent from the merger and to have the fair value of your shares of ARV common stock judicially determined and paid to you in cash, together with a fair rate of interest. The text of Section 262 of the Delaware General Corporation Law (DGCL), which sets forth the specific steps you must take to perfect your dissenters' rights, is attached to this proxy statement as Appendix C. Any stockholder of record who wishes to exercise his or her right to dissent from the merger and demand appraisal under Delaware law must:

deliver to ARV a written demand for appraisal of your shares of ARV common stock before the vote on the proposal to adopt the merger agreement and approve the merger is taken at the special meeting, which demand must reasonably inform ARV of your identity and that you intend to demand the appraisal of your shares; and

not vote in favor of the adoption of the merger agreement and approval of the merger (which means that you must vote against adopting the merger agreement and approving the merger or abstain from voting on the adoption of the merger agreement and approval of the merger because a proxy executed in blank that does not contain voting instructions will, unless revoked, be voted in favor of adopting the merger agreement and approving the merger).

Any holder who wishes to exercise his or her right to dissent from the merger and demand appraisal rights or who wishes to preserve his or her right to do so should review the discussion in the section captioned THE MERGER Dissenters' and Appraisal Rights carefully (see

page 70 and Appendix C). Failure to timely and properly comply with the requirements and procedures specified will result in the loss of appraisal rights under Delaware law.

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### **Terms of the Merger Agreement (see page 75)**

*Payments to Stockholders and Holders of Stock Options (see page 76).* Upon completion of the merger, you will be entitled to receive \$3.90 in cash, without interest, for each share of ARV common stock that you own, unless you perfect your appraisal rights in accordance with Delaware law. You will not own any shares of ARV common stock or any other equity interest in ARV after completion of the merger. Each outstanding option to purchase shares of ARV common stock (whether or not presently vested) will be cancelled at the effective time of the merger, and each option holder will be entitled to receive a cash payment, without interest, equal to the excess, if any, of the \$3.90 per share merger consideration over the exercise price of the option, multiplied by the number of shares subject to the option, less any applicable withholding taxes. The total merger consideration to be paid to all ARV stockholders and option holders will be approximately \$43.9 million, with the total amount to be paid to the holders of options being approximately \$5.4 million.

*Effective Date of the Merger (see page 75).* The merger will be effective when a certificate of merger is filed with the Delaware Secretary of State and becomes effective. ARV expects to make this filing no later than two business days following the satisfaction or waiver of all of the conditions to the merger contained in the merger agreement, including the adoption of the merger agreement and approval of the merger at the special meeting. ARV cannot assure you that all conditions to the merger contained in the merger agreement will be satisfied or waived. In addition, if as of the date the merger would otherwise be consummated, Prometheus does not have sufficient cash funds available to pay the merger consideration, Prometheus will have the right (subject to the provisions in the merger agreement relating to termination rights and payment by Prometheus of a termination fee) to elect either of the following:

not to consummate the merger; or

delay consummation of the merger to a date no later than the earlier of (a) the date 90 days after the satisfaction or waiver of all of the conditions to the merger and (b) July 1, 2003.

*Conditions to the Obligations of the Parties to Close the Merger (see page 84).* The closing of the merger is subject to the condition, as required under Delaware law, that the merger agreement be adopted and the merger be approved by the holders of a majority of the outstanding shares of ARV common stock. In addition, the completion of the transaction contemplated by the merger agreement is subject to the absence of an order or injunction prohibiting the merger from a court or other governmental entity.

*Conditions to the Obligations of Prometheus and Merger Sub to Close the Merger (see page 84).* The obligations of Prometheus and Merger Sub to complete the merger are subject to satisfaction or waiver of additional conditions, including, but not limited to, the following:

ARV's representations and warranties being true and correct as of the closing date, except to the extent that any failure of the representations and warranties to be so true and correct would not have a material adverse effect on ARV;

ARV must have performed and complied in all material respects with all of its covenants and agreements contained in the merger agreement;

no occurrence after the date of the merger agreement of any event reasonably likely to have a material adverse effect on ARV;

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ARV obtaining all necessary consents and approvals from governmental authorities without the imposition of any terms or conditions, except for consents and approvals, other than specified consents and approvals, whose failure to have been obtained is not material to ARV and its subsidiaries and except for the imposition of any terms or conditions that are not material to ARV or its subsidiaries;

no event occurring after January 3, 2003 that has resulted in or would reasonably be expected to result in, as a result of the transactions contemplated by the merger agreement, the loss of ARV's and its subsidiaries' ability to operate more than 10% of the assisted living and skilled nursing facility units currently operated by ARV and its subsidiaries, other than units operated at specified facilities;

ARV's settlement of Medicare related governmental claims arising out of its former GeriCare business must not have been modified or amended and must be in full force and effect; and

no pending action, proceeding or investigation by a governmental authority or action by any other person challenging, seeking to prohibit, prevent or delay or seeking material damages in connection with the merger.

*Conditions to the Obligations of ARV to Close the Merger (see page 85).* The obligation of ARV to complete the merger is subject to satisfaction or waiver of the following additional conditions:

Prometheus's representations and warranties being true and correct as of the closing date, except to the extent that any failure of the representations and warranties to be so true and correct, would not have a material adverse effect on Prometheus; and

Prometheus and Merger Sub must have performed and complied in all material respects with all of their material covenants and agreements contained in the merger agreement.

*Limitations on Considering Other Takeover Proposals (see page 79).* We have agreed not to solicit or enter into discussions with any third party regarding an acquisition proposal while the merger is pending. However, at any time prior to the special meeting, our Special Committee or other representatives may furnish information to or enter into discussions with a third party in response to an unsolicited takeover proposal if:

the Special Committee determines that the proposal is reasonably likely to result in a superior proposal, as defined in the merger agreement;

ARV furnishes Prometheus with reasonable advance notice of its decision to take such action;

the Special Committee determines in good faith, after consultation with its legal counsel, that failure to do so would result in a breach of its fiduciary duties; and

the third party enters into a confidentiality agreement with us.

Furthermore, prior to the Special Committee, the board of directors or ARV accepting another takeover proposal or, in a manner adverse to Prometheus, withdrawing or modifying the recommendation of the merger agreement by the board of directors, ARV must give Prometheus five business days notice of such parties' intention to take such action. During this five day period, Prometheus may

propose modifications to the terms of the merger agreement.

In addition, the board of directors may not approve or recommend a takeover proposal unless the above requirements with respect to takeover proposals are complied with and, after

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receiving advice from outside legal counsel, the board of directors and the Special Committee determine that failure to do so would be inconsistent with their fiduciary duties.

*Termination (see page 85).* ARV and Prometheus may agree by mutual written consent to terminate the merger agreement at any time prior to completion of the merger. In addition, either party may terminate the merger agreement if:

the merger is not completed by the end date, which is May 1, 2003. However, if all the conditions to the merger (except the conditions relating to governmental approvals and litigation in connection with the transaction and those conditions that by their nature are to be fulfilled at closing) are satisfied or waived as of April 30, 2003, the end date would be extended to June 1, 2003. The end date may also be extended as described above under *Effective Date of the Merger*. Furthermore, no party whose breach of the merger agreement was a significant cause of the failure to complete the merger by the end date will be permitted to terminate the merger agreement by reason of the occurrence of the end date;

a court or other governmental entity issues a final order prohibiting the merger;

our stockholders do not adopt the merger agreement and approve the merger;

the other party breaches its representations, warranties or covenants contained in the merger agreement, such that the condition to closing relating to their compliance would not be satisfied, subject to cure periods; or

Prometheus elects not to consummate the merger as a result of its not having available sufficient cash funds to pay the aggregate merger consideration as described above.

In addition, Prometheus may terminate the merger agreement if our board of directors or the Special Committee recommends another takeover proposal, or withdraws or modifies its recommendation of the merger agreement and the merger in a manner adverse to Prometheus.

We may terminate the merger agreement if, prior to the special meeting, our board of directors approves an unsolicited superior proposal as set forth in the merger agreement. However, before we can terminate the merger agreement under these circumstances and accept any such superior proposal, ARV, the board of directors and the Special Committee are required to comply with provisions in the merger agreement that relate to takeover proposals and recommendations by the board of directors (see *Limitations on Considering Other Takeover Proposals* above) and that relate to termination fees and expense reimbursement (see *Termination Fee and Expense Reimbursement* below).

*Termination Fee and Expense Reimbursement (see page 87).* The merger agreement provides that if it is terminated, all fees and expenses relating to the proposed merger will be paid by the party incurring them, except as described below.

We are required to pay Prometheus an aggregate amount equal to \$2,224,064 plus up to an aggregate of \$1,500,000 of Prometheus' reasonable expenses if:

we terminate the merger agreement when the transactions contemplated by the merger agreement have not been consummated before the end date (described above under *Termination* ) and at any time after the date of the merger agreement and prior to the date of this termination another takeover proposal shall have been made or reaffirmed to us or publicly announced and, within nine months of this termination of the merger agreement, we enter into a definitive agreement with respect to any acquisition transaction meeting certain requirements;





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either party terminates the merger agreement when the merger fails to receive the necessary stockholder approval at the special stockholders meeting and at any time after the date of the merger agreement and on or prior to the date of the stockholders meeting another takeover proposal shall have been made or reaffirmed to us or publicly announced and, within nine months of this termination of the merger agreement, we enter into a definitive agreement with respect to any acquisition transaction meeting certain requirements;

Prometheus terminates the merger agreement when there has been a breach by us of a closing condition with respect to representations, warranties, covenants or agreements (other than those in the recommendation of the board or non-solicitation sections) and at any time after the date of the merger agreement and on or prior to the date of this termination another takeover proposal shall have been made or reaffirmed to us or publicly announced and, within nine months of this termination of the merger agreement, we enter into a definitive agreement with respect to any acquisition transaction meeting certain requirements;

Prometheus terminates the merger agreement when our special committee or board of directors withdraws or changes their approval or recommendation of the merger or recommends another takeover proposal and at any time after the date of the merger agreement and on or prior to the date of this termination another takeover proposal shall have been made or reaffirmed to us or publicly announced and, within nine months of this termination of the merger agreement, we enter into a definitive agreement with respect to any acquisition transaction meeting certain requirements;

Prometheus terminates the merger agreement when there has been a breach by us of any covenants or agreements relating to the board of directors and ARV's obligations with respect to making a recommendation in favor of the merger or soliciting takeover proposals. (See Limitations on Considering Other Takeover Proposals. ); or

we exercise our right under the merger agreement to terminate the merger agreement (prior to the stockholders meeting), in connection with a proposal that is superior to the proposed merger agreement. (See Termination. )

In addition, Prometheus will be required to pay to us our reasonable expenses plus \$4,448,128, if:

either party terminates the merger agreement due to the failure to receive the requisite stockholder approval of the merger after Prometheus has voted against the merger at the special stockholders meeting (if Prometheus' vote in favor of the merger would have resulted in the merger being approved); or

either party terminates the merger agreement because Prometheus exercises its right under the merger agreement to elect not to complete the merger because it does not have available sufficient cash funds to pay the aggregate merger consideration and at the time of this termination all conditions to Prometheus' and Merger Sub's obligation to consummate the merger (disregarding after February 17, 2003 the condition with respect to material market disruptions) shall have been satisfied or waived (or with respect to conditions that by their nature are to be fulfilled at the closing, shall then be capable of being satisfied at a closing).

For a more detailed summary of the provisions in the merger agreement that relate to the termination fee and other effects of termination of the merger agreement, see the section entitled THE MERGER AGREEMENT Effect of Termination.

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**QUESTIONS AND ANSWERS**

*Q. Why did I receive this proxy statement?*

A. You are being asked to vote upon a proposal to adopt the merger agreement and approve the merger of a wholly owned subsidiary of Prometheus with and into ARV. As a result of the merger, ARV will become a wholly owned subsidiary of Prometheus.

*Q. Where and when is the special meeting?*

A. The special meeting will be held on April 23, 2003 at 9:00 a.m., local time at the Airport Hilton, 18800 MacArthur Boulevard, Irvine, California 92715.

*Q. What will I receive if the merger is completed?*

A. If the merger is completed and if you do not perfect your dissenters' rights, you will receive \$3.90 in cash, without interest, for each share of ARV common stock that you own. Upon the closing of the merger, each share of ARV common stock held by you will become the right to receive \$3.90 per share.

*Q. When should I expect to receive the merger consideration if the merger is completed?*

A. Promptly after the completion of the merger, you will receive detailed instructions regarding the surrender of your stock certificates. You should not send your stock certificates to us or anyone else until you receive these instructions. Promptly after surrendering your stock certificates and such other documents identified in the instructions, you will receive payment in an amount equal to the \$3.90 per share merger consideration multiplied by the number of shares represented by your stock certificates.

*Q. When is the merger expected to be completed?*

A. The merger cannot be completed until a number of conditions are satisfied, including the adoption of the merger agreement by ARV's stockholders at the special meeting. ARV currently expects the merger to be completed during the second quarter of 2003, if the merger agreement is adopted at the special meeting.

*Q. Will I owe taxes as a result of the merger?*

A. Generally, the merger will be a taxable transaction for all holders of ARV common stock. As a result, any gain you recognize as a result of the cash you receive in the merger or the cash you could receive from exercising your dissenters' rights will be subject to United States income tax and, in certain circumstances, a portion of the cash may be required to be withheld. You may also be taxed under applicable state, local, and other tax laws. In general, you will recognize a taxable gain or loss equal to the difference between (1) the amount of cash you receive and (2) the tax basis of your shares of ARV common stock.

Tax matters are very complex, and the tax consequences of the merger to you will depend on the facts of your own situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you.



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*Q. How do I cast my vote?*

A. If you are a holder of record, you may vote in person at the special meeting or by submitting a proxy for the special meeting. You can submit your proxy by completing, signing, dating, and returning the enclosed proxy card in the accompanying pre-addressed postage paid envelope. If you hold your shares in street name, which means your shares are held of record by a broker, bank, or nominee, you must provide the record holder of your shares with instructions on how to vote your shares. You must return your proxy card before the special meeting or attend the special meeting in person in order for your votes to be counted at the special meeting.

*Q. What happens if I do not instruct a broker holding my shares as to how to vote them or I abstain from voting?*

A. If your shares are held by a broker as a nominee, your broker will not be able to vote your shares without instructions from you. You should instruct your broker on how to vote your shares, using the instructions that will be provided to you by your broker prior to the special meeting. If your broker is unable to vote your shares or if you abstain, it will have the effect of voting against adoption of the merger agreement and approval of the merger.

*Q. Can I attend the special meeting and vote my shares if my shares are held by a nominee?*

A. If you would like to attend the special meeting and your shares are held by a broker, bank, or other nominee, you must bring to the special meeting a recent brokerage statement or letter from the nominee confirming your beneficial ownership of the shares of ARV common stock. You must also bring a form of personal identification. In order to vote your shares at the special meeting, you must obtain from each nominee a proxy issued in your name.

*Q. Can I change my vote after I have mailed my proxy card?*

A. Yes. You can change your vote at any time before your proxy is voted at the special meeting by: delivering to ARV's Secretary a signed notice of revocation; granting a new, later-dated proxy, that must be signed and delivered to ARV's Secretary; or attending the special meeting and voting in person; however, your attendance alone will not revoke your proxy.

If you have instructed a broker to vote your shares, you must follow the instructions received from your broker to change your vote.

*Q. What happens if I sell my shares before the special meeting?*

A. If you were a stockholder on March 27, 2003, the record date for the special meeting, you will be entitled to vote at the special meeting. If you sell your stock after the record date but before the date of the special meeting, you will be able to vote at the special meeting, but you will not have a right to receive the \$3.90 per share merger consideration. The right to receive the \$3.90 per share will pass to the person who owns your stock when the merger becomes effective.

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*Q. Who can help answer my questions?*

A. If you have questions about the special meeting or the merger after reading this proxy statement, you should contact:

Georgeson Shareholder Communications, Inc.

(800) 818-0721

or

ARV Assisted Living, Inc.  
245 Fischer Avenue, Suite D-1  
Costa Mesa, CA 92626  
Attention: Douglas Armstrong  
Phone: (714) 435-4327

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### **SPECIAL FACTORS**

#### **Background of the Merger**

In light of adverse financial and competitive conditions in the assisted living industry and ARV's difficulty in obtaining the financing necessary to maintain and expand its business on favorable terms, in early 2001, ARV management initiated, with the approval of the board of directors, the exploration of potential strategic alternatives available to ARV and to conduct preliminary discussions with potential strategic transaction partners. ARV's difficulty obtaining financing on favorable terms was a result of the limited financing generally available to participants in the assisted living industry, the level of ARV's existing indebtedness and its current inability to generate sufficient cash from operations to fund recurring working capital and capital expenditure requirements. Management believed that, as part of a larger company, ARV would have improved access to financing and the ability to allocate overhead expenses over a larger number of assisted living communities (ALCs). In considering the possibility of a business combination with a third-party, management of ARV recognized that it was unlikely that any transaction could be successfully completed without the approval of Prometheus, given its share ownership in ARV. During the first quarter of 2001, management of ARV held preliminary discussions separately with Emeritus Corporation (Emeritus), a publicly traded assisted living company, and two other entities to evaluate the likelihood of a business combination between ARV and any of the three entities. In connection with these discussions, ARV entered into separate confidentiality agreements and exchanged initial due diligence materials with these entities. No substantive negotiations were subsequently conducted between the management of ARV and these entities.

During the summer of 2001, management of Summerville Assisted Living, Inc. (Summerville), a wholly owned subsidiary of Apollo Real Estate Advisors LP (Apollo), and management of ARV held preliminary discussions to assess the likelihood of a business combination between Summerville and ARV. In connection with these discussions, Summerville and ARV entered into a confidentiality agreement and exchanged initial due diligence materials. No specific transactions or agreements were discussed at this time and no further discussions took place until September 27, 2002, as described below.

Prometheus has been a significant stockholder of ARV since its initial investment in 1997. In 1997, ARV was subject to an unsolicited acquisition proposal from a third-party. As an alternative to the unsolicited acquisition proposal in 1997, ARV sold to Prometheus a total of 6.2 million, or approximately 40%, of the shares of ARV at a price of approximately \$14.00 per share. This investment was the first investment in the assisted living industry by Prometheus and its affiliates. Prometheus currently holds approximately 43.5% of our outstanding shares. In addition, one of its affiliates holds a warrant to acquire additional ARV shares which, if exercised, would result in Prometheus and its affiliate holding approximately 45.8% of our outstanding shares. In 1999, ARV, Prometheus, and certain of Prometheus' affiliates entered into a settlement agreement to settle litigation among them. Under this agreement, Prometheus is entitled to nominate at least two members of our board of directors. Currently, Robert C. Larson and John A. Moore, each of whom was nominated by Prometheus, are two of the five directors of ARV. Under this agreement, except under limited circumstances, Prometheus may not purchase additional shares of ARV's common stock unless ARV first receives a fairness opinion. This agreement would not apply to acquisitions of ARV shares by Prometheus at any time after, among other things, ARV, its board of directors or any committee of its board of directors authorizes the solicitation of offers or indications of interest with respect to a business combination transaction or a bidder submits a written proposal of indication of interest with

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respect to an acquisition of, or business combination with, ARV, unless ARV's board of directors rejects the proposal as soon as practicable.

In the course of reviewing its investment in ARV, Prometheus has occasionally explored, and discussed with ARV, the feasibility and desirability of a range of strategic transactions involving ARV and each of Atria, Inc. ( "Atria" ) and Kapson Senior Quarters Corp. ( "Kapson" ), assisted living companies affiliated with Prometheus. No presentations or proposals by Prometheus to ARV resulted from these reviews, nor did they give rise to any negotiations or material communications regarding any transactions except as discussed below.

In 2001, Prometheus began again to evaluate and discuss with ARV the possibility of a strategic transaction involving ARV, Atria and/or Kapson. ARV and Prometheus determined that the three companies should exchange information regarding their respective businesses in order to more effectively explore possible transactions. On November 15, 2001, Atria, Kapson and ARV entered into a confidentiality/non-disclosure agreement and began an initial exchange of confidential information regarding their respective businesses. Review of confidential information continued on a periodic basis over the next few months.

Because of the ongoing exploratory discussions between ARV management and potential transaction parties, on April 10, 2002, ARV's board of directors established a Strategic Transactions Review Committee consisting of Maurice DeWald, Chairman, Douglas M. Pasquale and David Collins to evaluate potential strategic alternatives available to ARV. In that connection, ARV engaged Cohen & Steers as financial advisor, reporting to the Strategic Transactions Review Committee, to review ARV's business and assist in evaluating potential strategic alternatives.

On July 19, 2002, the Strategic Transactions Review Committee met with Cohen & Steers to discuss possible strategic merger, acquisition or capital raising transactions. In addition, Cohen & Steers provided the Strategic Transactions Review Committee with an overview and update on financial and other developments in the assisted and senior living industry. Following the meeting, the Strategic Transactions Review Committee instructed Cohen & Steers to monitor the marketplace and identify prospective candidates that might be interested in a strategic transaction with ARV.

During late 2001 and the first three quarters of 2002, Prometheus continued its evaluation of the possibility of a potential transaction involving ARV, Atria and Kapson. As a result of this evaluation, Prometheus concluded that a combination could be achieved at this time because of recent changes in the capital structure and improvements to the financial results of Atria and Kapson as well as the anticipated availability to Prometheus of financing for a transaction. In addition, Prometheus believed that a larger combined company could achieve benefits of scale. Prometheus further believed that a combined company would be likely to operate more efficiently and would be more likely to be able to obtain the financing necessary to operate and expand its business on favorable terms, than could Atria, Kapson and ARV operating separately.

Prometheus determined to propose to ARV a transaction that would result in Prometheus owning all of ARV's outstanding shares, with the intention of subsequently combining ARV, Atria and Kapson. Although Prometheus indicated that it had considered the possibility of proposing that Atria, Kapson and ARV combine in a transaction in which ARV's public stockholders would receive stock in a combined company, Prometheus stated its belief that, in the current market environment, the combined company could be operated more efficiently and have more flexibility obtaining financing if

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it were a privately-held company. In addition, the combined company would avoid the administrative, legal, accounting and other costs associated with being a public company.

On September 23, 2002, Prometheus delivered a letter to the board of directors, proposing a merger transaction in which all of the outstanding shares of ARV that Prometheus did not already own would be converted into the right to receive cash, and ARV would become a wholly owned subsidiary of Prometheus. In its letter, Prometheus stated that it expected the consideration it would pay in the transaction to be in the range of \$3.25 to \$3.60 per share in cash, subject to completion of confirmatory due diligence and the negotiation of a mutually acceptable merger agreement. Prometheus selected this range for its initial offer because its midpoint represented a premium of 35% over ARV's closing share price of \$2.55 on September 22, 2002. Prometheus believed that offering a premium at this level demonstrated its commitment to negotiating a transaction that is fair to unaffiliated stockholders. Prometheus further indicated that, although it intended following completion of a transaction to combine ARV with Atria and Kapson, its proposal would not be dependent on any subsequent transaction with Atria or Kapson, and that it hoped to retain Mr. Pasquale in a senior position with the combined companies. Prometheus also indicated that it was not interested in selling its shares of ARV stock.

On September 23, 2002, after its receipt of the Prometheus proposal, the board established a new special committee (the "Special Committee") comprised of Messrs. DeWald and Collins, the two directors of ARV who are neither employees of ARV nor affiliates of Prometheus, to evaluate Prometheus' proposal and any other proposals that may be received from other interested parties. The Special Committee engaged the law firm of O'Melveny & Myers LLP ("O'Melveny & Myers") as its legal counsel and Cohen & Steers as its financial advisor. In connection with its retention by the Special Committee, Cohen & Steers' engagement with ARV in respect of the Strategic Transactions Review Committee was discontinued.

On September 23, 2002, ARV issued a press release announcing receipt of Prometheus' proposal.

Between September 24 and September 27, 2002, four putative class action lawsuits were filed in the Court of Chancery in the State of Delaware, and on October 1, 2002, another putative class action lawsuit was filed in the Orange County Superior Court in the State of California. The lawsuits alleged, among other things, self dealing and breach of fiduciary duty by ARV, its directors and Prometheus in connection with Prometheus' proposal.

On or about September 27, 2002, Cohen & Steers received a call from a representative of Apollo, Summerville's sole shareholder, expressing Summerville's continued interest in a potential business combination with ARV.

From September 30, 2002 through October 10, 2002, the Special Committee had numerous discussions with its financial and legal advisors concerning Prometheus' proposal. Cohen & Steers reported to the Special Committee that other persons had indicated interest in possible transactions with ARV.

On October 1, 2002, representatives of Cohen & Steers and representatives of Prometheus met to discuss Prometheus' proposed due diligence process. Thereafter, Prometheus began conducting its due diligence of ARV. In addition, O'Melveny & Myers received from Fried, Frank, Harris, Shriver & Jacobson ("Fried Frank"), counsel to Prometheus, a draft of a proposed merger agreement.





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On or about October 3, 2002, a representative of Apollo telephoned Cohen & Steers to indicate that he believed that Summerville could pay a substantially higher price than that set forth in Prometheus' proposal. Subsequently, the Special Committee instructed Cohen & Steers to contact Apollo and to offer to enter into a confidentiality agreement with Apollo/Summerville so that they could be provided with additional due diligence material relating to ARV.

On or about October 4, 2002, Mr. Moore received a telephone call from Apollo. Mr. Moore referred Apollo to the Special Committee.

On or about October 7, 2002, Cohen & Steers received a telephone call from a party indicating that an affiliate of that party might have an interest in acquiring ARV. At the Special Committee's direction, Cohen & Steers advised the party that it would be provided with a confidentiality agreement, with ARV's due diligence material to follow after execution of the agreement. This party executed a confidentiality agreement and received due diligence materials on or about October 22, 2002.

Also on October 7, 2002, Atria and Kapson, and ARV entered into a letter agreement extending the term of the November 2001 confidentiality/non-disclosure agreement until March 31, 2003. In addition, on that day Prometheus executed a confidentiality agreement with ARV. This confidentiality agreement prohibits Prometheus from, among other things, acquiring shares of ARV common stock for one year, without approval from ARV, unless ARV enters into an agreement with respect to, or another party announces an intention to effect, a business combination transaction, including any tender offer for ARV shares, with ARV or acquires 15% or more of ARV's shares. If the restrictions under the confidentiality agreement and the settlement agreement on purchasing additional shares no longer applied, then Prometheus could purchase, without first obtaining ARV's approval, additional ARV shares and become the beneficial owner of up to 50% of ARV's outstanding common stock without triggering ARV's stockholder rights plan.

On or about October 9, 2002, Cohen & Steers received a telephone call from the Chief Executive Officer of Emeritus and the Vice Chairman of Holiday Retirement Corp., a large privately held owner-operator of retirement communities (HRC), indicating that HRC would be interested in acquiring 51% of ARV at a price in the range of \$3.65 to \$3.75. At the Special Committee's direction, Cohen & Steers informed him that HRC would be provided with a confidentiality agreement and would receive due diligence material from ARV after execution of the agreement.

On October 10, 2002, representatives of Prometheus met with the Special Committee and the Special Committee's legal and financial advisors to discuss Prometheus' proposal. At the meeting, Prometheus made a formal presentation to the Special Committee describing how Prometheus arrived at its proposed price range of \$3.25 to \$3.60. Prometheus also discussed the general structure of the financing arrangements it expected to utilize to fund the transaction. The participants also discussed in general terms the structure and terms of a proposed merger agreement that Fried Frank had previously provided to O'Melveny & Myers.

Also on October 10, 2002, the Special Committee received a letter from HRC in which it proposed making an offer to the ARV stockholders other than Prometheus for a minimum of 51% of the shares of ARV at a price of \$3.70 per share in cash. On that day the Special Committee also received a letter from Summerville in which Summerville communicated its interest in either acquiring or entering into a business combination with ARV. Summerville indicated that, based on the information it had received to date, it believed it could pay substantially more than what was proposed in the Prometheus' proposal. The Summerville proposal did not indicate a specific purchase price.

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After receiving the letters from HRC and Summerville, the Special Committee instructed Cohen & Steers to seek clarification from both bidders regarding their offers, including their anticipated financing sources, their contemplated transaction structure and the impact of Prometheus ownership position on their proposed offer. The Committee also authorized Cohen & Steers to contact other parties in order to determine if there was any interest on the part of other parties in pursuing a transaction with ARV.

Thereafter, the Special Committee established a formal bid process allowing interested parties to execute a confidentiality agreement and conduct legal and financial due diligence on ARV, including establishing a due diligence data room and holding due diligence meetings with ARV management. The Special Committee reserved the period from October 21, 2002 to November 15, 2002 to allow interested parties to conduct due diligence on ARV and prepare any proposal they wished to deliver to the Special Committee. Final proposals were to be submitted by Friday, November 15, 2002.

During the period from October 21 through October 28, 2002, HRC, Apollo and another party executed confidentiality agreements and subsequently received due diligence information regarding ARV, including ARV's projections. These parties also were provided access to ARV's management, and were informed of the timetable for the bid process established by the Special Committee. At the instruction of the Special Committee, ARV issued a press release on October 28, 2002, announcing that it had received two unsolicited letters from third parties indicating interest in a transaction involving the outstanding shares of common stock of ARV. ARV also announced that each of the potential bidders had proposed alternative transactions to that proposed by Prometheus on terms that the letters suggested could be more favorable to ARV's stockholders.

On October 23, 2002, O'Melveny & Myers and Fried Frank participated in a telephone conference during which the respective counsel further discussed the terms and conditions of the proposed merger agreement with Prometheus.

During late October and early November 2002, the Special Committee continued to discuss with its legal and financial advisors Prometheus proposal and the status of the other offers. During this time, O'Melveny & Myers and Fried Frank further negotiated the terms of the proposed merger agreement.

On November 5, 2002, at a meeting of the Special Committee, Cohen & Steers reviewed the history of the negotiations and updated the committee on the status of the discussions with each of the prospective bidders.

Also on November 5, 2002, the Special Committee and its advisors met with representatives of Prometheus to discuss Prometheus' due diligence process and the open issues on the proposed merger agreement. The Special Committee's advisors informed Prometheus that the committee was considering proposals from other parties and that, even if an agreement on a transaction with Prometheus could be negotiated, the Special Committee would not be in a position to move forward with any transaction with Prometheus until after reviewing and evaluating proposals submitted by other parties. Prometheus reiterated its prior position that it was not interested in selling its ARV shares.

In early November 2002, representatives of Cohen & Steers delivered to Summerville additional due diligence information. On or about November 11, 2002, Summerville informed Cohen & Steers that it planned to visit ARV on November 13 and review the legal diligence materials available at ARV's headquarters. Summerville indicated to Cohen & Steers that Summerville might not be able to meet the November 15 deadline for submission of proposals. Cohen & Steers encouraged Summerville



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to submit its bid by the November 15 deadline. On or about November 12, 2002, Summerville advised Cohen & Steers that it had cancelled its planned November 13 visit to ARV.

On or about November 14, 2002, Cohen & Steers again encouraged Summerville to submit its bid by Friday, November 15, as the Special Committee intended to begin early in the following week to review and evaluate all other proposals that it had received by such time. On November 14, Summerville sent a letter to O Melveny & Myers and Cohen & Steers asking the Special Committee for an extension of the deadline to submit a proposal so that Summerville could have additional time in which to review and evaluate the due diligence material.

On or about November 15, 2002, at the Special Committee's direction, Cohen & Steers replied to Summerville's November 14 letter, indicating that the Special Committee intended to adhere to the November 15 deadline and otherwise abide by the process that had previously been implemented for receiving and evaluating proposals from all interested parties. Cohen & Steers communicated that, in the Special Committee's view, Summerville had been provided with all relevant due diligence materials on a timely basis, and that Summerville had had an adequate opportunity to evaluate the information and formulate a definitive proposal. Cohen & Steers advised Summerville that if Summerville wished to submit a proposal for consideration by the Special Committee, Summerville should do so as soon as possible.

On or about November 15, 2002, Cohen & Steers received a letter from HRC stating that HRC would offer \$4.00 per share for all the outstanding stock of ARV, subject to a definitive agreement and completion of corporate and real estate due diligence.

On November 18, 2002, the Special Committee met in the offices of O Melveny & Myers to discuss Prometheus' proposal and the other correspondence received from HRC and Summerville. The other party that executed a confidentiality agreement with ARV in late October did not make a proposal to the Special Committee. At this meeting, the Special Committee considered all of the proposals in light of Prometheus' indication that it was not interested in selling its shares of ARV common stock. The Special Committee considered other possible alternatives, specifically, maintaining the status quo as a separate public company and internal growth through the selling of additional equity. The Special Committee concluded that neither of these alternatives provided the ARV unaffiliated stockholders with as much value for the shares as did Prometheus' proposal.

On November 19, 2002 and November 20, 2002, the Special Committee and its advisors met with Prometheus to attempt to negotiate improved terms of Prometheus' proposal. In connection with these discussions, Prometheus indicated that it would consider increasing its offer above the range reflected in its initial proposal provided that the putative class action law suits could be settled in connection with the execution of a merger agreement on terms satisfactory to Prometheus. The parties were unable to reach an agreement at these meetings but agreed to continue discussions and pursue settlement discussions with the class action plaintiffs.

On November 21, 2002, the Special Committee received a letter from Summerville outlining a formal proposal for the acquisition of ARV in a transaction in which ARV's stockholders would receive \$4.00 per share in cash. The offer was subject to the negotiation of definitive documentation.

The Special Committee instructed its legal and financial advisors to contact HRC and Summerville to attempt to negotiate improved terms on a parallel path with negotiating improved terms with Prometheus.



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In a subsequent conversation with HRC, HRC's Chairman indicated that HRC did not believe it could successfully complete a transaction in view of Prometheus' ownership. He also indicated that as a significant stockholder of ARV, he would be supportive of a transaction between ARV and Prometheus at or around the level of HRC's offer. He indicated that HRC would leave its offer open in the event Prometheus determined not to proceed with a transaction.

On or about November 22, 2002, at the direction of the Special Committee, Cohen & Steers responded to Summerville's proposal by requesting that Summerville provide ARV, by November 25, 2002, a definitive agreement, additional information regarding how Summerville proposed to complete its proposed transaction in light of Prometheus' ownership stake in ARV and confirmation that \$4.00 per share represented Summerville's best and final price.

On November 25, 2002, Summerville's counsel delivered to the Special Committee a draft form of merger agreement providing for an acquisition of all of ARV's outstanding shares. The draft agreement contemplated the grant by ARV to Summerville of an option to purchase approximately 19.9% of ARV shares at \$4.00 per share payable in the form of a promissory note from Summerville. If exercised, this option would have the effect of diluting Prometheus' ownership interest in ARV to approximately 37%, or 38.5% after giving effect to the exercise of the warrant held by Prometheus' affiliate.

On or about November 26, 2002, the Special Committee and its financial and legal advisors discussed Summerville's offer with Summerville and its legal advisors. During these discussions, the Special Committee and its advisors attempted to negotiate an increased price and improved terms from Summerville and sought clarification on the impact of Prometheus' ownership interest on Summerville's offer. The Special Committee and its advisors indicated that, according to the advice of legal counsel to the Special Committee, Summerville's proposal regarding a dilutive option could be unenforceable and subject to challenge under applicable Delaware law. The Special Committee explained to Summerville that it was open to continuing discussions with Summerville, but because the Special Committee and its advisors were unaware of a feasible legal structure for implementing Summerville's proposal, asked if Summerville had an alternative proposal that was more likely to be capable of being consummated. Summerville did not propose an alternative structure for a possible transaction. Summerville and its counsel also responded by indicating that Summerville would be unwilling to increase its price without further diligence, and that Summerville would be unwilling to pursue further due diligence without a commitment from ARV to pay Summerville's legal, accounting and other professional fees and expenses.

On or about November 27, 2002, a new bidder delivered a letter to the Special Committee indicating its general interest in a possible transaction with ARV. At the Special Committee's request, Cohen & Steers offered to allow this bidder to enter into a confidentiality agreement with ARV and be provided with due diligence materials. The bidder was encouraged to make its proposal as quickly as possible.

On or about December 1, 2002, at the direction of the Special Committee, Cohen & Steers indicated to Prometheus that any increased offer from Prometheus must be at least \$4.00 per share in cash.

On or about December 4, 2002, ARV was informed that the Office of Inspector General (OIG) of the United States Department of Health and Human Services was investigating Medicare cost reports previously submitted by GeriCare, and other affiliated parties, a now dissolved Medicare certified outpatient rehabilitation provider that was a wholly owned subsidiary of ARV (the GeriCare Matter).

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On or about December 6, 2002, the bidder that had delivered the November 27 letter to the Special Committee informed Cohen & Steers that it would not be submitting a proposal for a transaction with ARV.

On December 9, 2002, Cohen & Steers and O Melveny & Myers updated the Special Committee on the status of discussion with Prometheus. The Special Committee instructed its advisors to continue to seek an increased offer of at least \$4.00 per share from Prometheus.

On or about December 12, 2002, Prometheus indicated to Cohen & Steers that it would consider the Special Committee's requested price of at least \$4.00 per share if the putative class action litigation would be settled in connection with any such offer. Prometheus also indicated that the closing of any transaction would have to be conditioned on a satisfactory resolution of the GeriCare Matter, and that the requested \$4.00 price would be subject to subsequent reduction to reflect the aggregate amount of any liabilities and costs incurred by ARV to settle the GeriCare Matter.

On or about December 17, 2002, at the instruction of the Special Committee, Cohen & Steers informed Prometheus that the Special Committee would not accept a transaction in which the price would be subject to any subsequent reduction based on the outcome of the GeriCare Matter. Cohen & Steers indicated that, in view of the GeriCare Matter, the Special Committee would consider a transaction at \$3.90 per share, without any reduction for GeriCare settlement costs or any condition associated with the ultimate amount of a GeriCare settlement.

On or about December 19, 2002, Prometheus indicated to Cohen & Steers that Prometheus would consider a transaction at \$3.90 per share, with no further adjustment relating to any settlement or other outcome of the GeriCare Matter, if the GeriCare Matter and the putative class action lawsuits could be settled prior to or in connection with the execution of a merger agreement.

During the period from December 19, 2002 through January 2, 2003, ARV's legal advisors proceeded to negotiate with the federal government to settle the GeriCare Matter. Additionally, O Melveny & Myers and Fried Frank continued to negotiate the terms of the merger agreement and discussions with the plaintiffs in the putative class actions also continued.

On January 2, 2002, ARV and the U.S. government entered into a settlement agreement, relating to the GeriCare Matter. Under this settlement agreement, and without admitting liability, ARV agreed to pay \$1,625,000 to the U.S. government in exchange for the United States releasing, and agreeing to refrain from any administrative claim or any action against, ARV and its current or former affiliates for all Medicare claims for all periods during the existence of the GeriCare business. In connection with the settlement, ARV incurred approximately \$74,000 in legal fees and other expenses. Based on there being 17,459,689 shares of common stock of ARV outstanding, the amount paid in settlement of the GeriCare Matter and the associated legal fees and other expenses represented approximately \$.10 per share.

After ARV executed the settlement agreement relating to the GeriCare Matter, Prometheus agreed to proceed with a transaction in which ARV stockholders not affiliated with Prometheus would receive \$3.90 per share, subject to the execution of memoranda of understanding with respect to a settlement of the putative class actions.

At a meeting held on January 3, 2003, Cohen & Steers provided the Special Committee with a financial analysis of the proposed transaction. Cohen & Steers summarized the history of the different





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proposals that had come before the Special Committee and explained the different valuation methodologies, including a market trading analysis, a market multiple analysis, a comparable transaction analysis and a discounted cash flow analysis, employed by Cohen & Steers, in reaching their opinion. Cohen & Steers then rendered its oral and written opinion to the Special Committee to the effect that, as of the date of such opinion, and on the basis of its analyses and subject to the qualifications, assumptions and limitations set forth in its opinion, the merger consideration per share to be received by the holders of the common shares of ARV (other than Prometheus, Merger Sub and their respective affiliates) pursuant to the terms and subject to the conditions set forth in the merger agreement was fair to such holders from a financial point of view. The Special Committee also discussed with O Melveny & Myers and Cohen & Steers the conditions to the merger and Prometheus proposed financing of the transaction. Following discussion among the members of the Special Committee, the Special Committee unanimously (i) determined that the merger and merger agreement are fair to, and in the best interests of, the stockholders of ARV who are not affiliated with Prometheus, (ii) recommended to the board of directors that the merger and merger agreement be authorized, approved and adopted by the board of directors, and (iii) recommended that the stockholders of ARV vote to adopt the merger agreement and approve the merger.

ARV's board of directors met after the meeting of the Special Committee on January 3, 2003. At ARV's board of directors meeting, the Special Committee recommended that ARV's board of directors authorize and approve the merger agreement and the transactions contemplated thereby. Following discussion with the Special Committee members and their financial and legal advisors, ARV's board of directors accepted the Special Committee's recommendations and unanimously (i) determined that the merger and the merger agreement are advisable, (ii) approved the merger and the merger agreement, and (iii) recommended that the stockholders of ARV vote to adopt the merger agreement and approve the merger.

On January 3, 2003, after the approval of ARV's board of directors, the parties signed the merger agreement. At the same time, plaintiffs in the putative class action lawsuits and ARV, Prometheus and the other defendants executed memoranda of understanding reflecting an agreement in principal to settle both the California and Delaware actions, subject to, among other things, confirmatory discovery and approval by the courts in each state. Pursuant to the memoranda of understanding, Prometheus and ARV have agreed not to oppose the payment of an aggregate of \$550,000 in fees of plaintiffs' counsel.

A joint press release announcing the signing of the merger agreement was issued on January 3, 2003.

On January 9, 2003, the Special Committee received a letter from Summerville reaffirming Summerville's prior offer of \$4.00 per share. On January 10, 2003, the Special Committee met with its legal and financial advisors to discuss and evaluate Summerville's letter. On January 10, 2003, the Special Committee, through Cohen & Steers, replied to Summerville that the Special Committee had carefully considered Summerville's prior indications of interest, but that in the Special Committee's view, Summerville had failed to provide a reasonable basis for the Special Committee to conclude that Summerville could consummate its proposed merger transaction in light of Prometheus' significant ownership interest in ARV, Prometheus' indication that it was not interested in selling its shares and Prometheus' ability potentially to purchase up to 50% of ARV's common stock, without ARV's prior approval. Accordingly, the Special Committee had concluded that the interests of the public stockholders of ARV (other than Prometheus, Merger Sub and their affiliates) would be best served by entering into the merger agreement with Prometheus.

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### **Opinion of the Special Committee's Financial Advisor**

The Special Committee retained Cohen & Steers to act as its financial advisor. In that capacity, the Special Committee requested Cohen & Steers to render an opinion as to whether the \$3.90 per share merger consideration to be received by holders of ARV's common shares (other than Prometheus, Merger Sub and their respective affiliates) in the merger, as contemplated in the merger agreement, was fair to such holders from a financial point of view. The fairness opinion was prepared to assist the Special Committee in evaluating the terms of the merger.

Cohen & Steers presented its analysis as described below at a meeting of the Special Committee on January 3, 2003, in connection with the Special Committee's consideration of Prometheus' proposal of \$3.90 per share. At that meeting, Cohen & Steers rendered to the Special Committee its oral opinion (subsequently confirmed in writing) that, as of such date, and subject to the matters described in the fairness opinion, the price per share of \$3.90 to be received by the holders of ARV's common shares (other than Prometheus, Merger Sub and their respective affiliates) was fair from a financial point of view to such stockholders. The amount and form of the merger consideration were determined by the Special Committee's negotiations with Prometheus.

The summary of the fairness opinion set forth below is qualified in its entirety by reference to the full text of the fairness opinion delivered by Cohen & Steers, which sets forth the procedures followed, assumptions made, valuation techniques, matters considered and limitations on the scope of review undertaken by Cohen & Steers and is attached as Appendix B to this document. You are urged to read the fairness opinion in its entirety. A copy of this fairness opinion will be made available for inspection and copying at the principal executive offices of ARV during regular business hours by any interested stockholder or other person designated in writing as a representative of such stockholder.

Cohen & Steers' opinion is directed only to the fairness of the merger consideration, from a financial point of view to the holders of the common shares (other than the Prometheus, Merger Sub and their respective affiliates).

Cohen & Steers' opinion was provided at the request and for the information of the Special Committee in evaluating the merger consideration, and did not, and does not constitute a recommendation to any stockholder to vote in favor of the merger and should not be relied upon as such.

The summary of Cohen & Steers' opinion set forth in this document describes the procedures followed, assumptions made, valuation techniques applied, matters considered and limitations on the scope of review undertaken by Cohen & Steers, but does not purport to be complete and is qualified in its entirety by reference to the full text of Cohen & Steers' opinion attached as Appendix B to this proxy statement.

Stockholders of ARV should read Cohen & Steers' opinion carefully and in its entirety for information with respect to the procedures followed, assumptions made, matters considered and limitations on the review undertaken by Cohen & Steers in rendering its opinion.

Cohen & Steers consents to the references to its name and opinion in this proxy statement and to the attachment of its opinion to this document as Appendix B.

In arriving at its opinion, Cohen & Steers:

(i)

reviewed certain publicly-available financial statements and other publicly-available business and financial information relating to ARV;

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- (ii) reviewed certain internal financial and operating data, including financial forecasts, furnished to Cohen & Steers by ARV relating to the business, earnings, cash flow and assets of ARV;
- (iii) conducted discussions with ARV and its representatives and consultants concerning the matters described in clauses (i) and (ii) above, as well as the business and prospects of ARV, before and after giving effect to the merger;
- (iv) reviewed the merger agreement and certain related documents, and held discussions with certain senior officers, directors and other representatives and advisors of ARV concerning the business, operations and prospects of ARV;
- (v) performed various financial analyses as Cohen & Steers deemed appropriate, using generally accepted valuation methodologies, including (a) a discounted cash flow analysis; (b) a theoretical stock price analysis; (c) a net asset value analysis; (d) an analysis of premiums paid in select transactions involving publicly traded assisted living and senior housing companies; (e) an analysis of comparable trading multiples of select assisted living and senior housing companies; (f) an analysis of comparable transactions involving select assisted living and senior housing companies; and (g) an analysis of historical stock prices and trading volumes of ARV; and
- (vi) conducted such other financial studies, analyses and financial investigations, and considered such other financial, economic and market data and other information as Cohen & Steers deemed necessary or appropriate.

In its review and analysis and in formulating its opinion, Cohen & Steers:

assumed and relied upon the accuracy and completeness of all information supplied or otherwise made available to it by ARV or obtained by Cohen & Steers from other sources, and upon the assurance of ARV that it was not aware of any information or facts that would make the information provided by it to Cohen & Steers materially incomplete or misleading;

did not attempt to independently verify any of such information;

did not undertake an independent appraisal of the assets or liabilities (contingent or otherwise) of ARV or Prometheus, nor was Cohen & Steers furnished with any such appraisals;

with respect to the financial and operating projections of ARV reviewed by Cohen & Steers, Cohen & Steers assumed that they were reasonably prepared on a basis reflecting the best current estimates and good faith judgments of management as to ARV's anticipated future financial condition and operating results;

assumed the political, economic, regulatory, monetary and U.S. capital market conditions affecting the assisted living industry would remain generally stable; and

expressed no opinion with respect to such projected financial statements.

Cohen & Steers opinion relates to the merger, taken as a whole. Cohen & Steers' opinion was necessarily based upon financial, economic, market and other conditions as they existed and that could be evaluated by Cohen & Steers on the date of its opinion. Cohen & Steers disclaimed any undertaking or obligation to advise any person of any change in any fact or matter affecting its opinion that may come or be brought to its attention after the date of its opinion.

**Cohen & Steers' opinion does not constitute a recommendation as to any action any stockholder of ARV should take in connection with the merger agreement, the merger or any aspect thereof, including whether to vote in favor of the merger or to purchase, sell or hold**

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**ARV's common stock or take or refrain from taking any other action, and should not be relied upon as such.** Although Cohen & Steers discussed, at ARV's and the Special Committee's request, strategic financial alternatives, it expressed no opinion or recommendation with respect to the desirability of pursuing any such alternatives.

Cohen & Steers' opinion states that it was provided at ARV's request for the use and benefit of the Special Committee of the board of directors of ARV in connection with evaluating the merger, and for no other purpose. Cohen & Steers has not been engaged as an agent or fiduciary of ARV's stockholders or any other persons. Its opinion was addressed to the Special Committee and only addresses the fairness, from a financial point of view, to the holders of ARV's common shares (other than the Prometheus, Merger Sub and their respective affiliates) of the merger consideration to be received by such holders in the merger. Accordingly, the fairness opinion states that it was provided at the Special Committee's request and for its use in connection with evaluating the merger consideration.

Because there is no state or federal law or regulation which expressly requires that a fairness opinion be issued or obtained in connection with this transaction, it is the view of Cohen & Steers that the determination as to who may rely on the fairness opinion and to whom Cohen & Steers may be liable in connection with the opinion is determined by the January 3, 2003 engagement letter to provide the fairness opinion between Cohen & Steers and the Special Committee. Cohen & Steers intends to assert this disclaimer and the limitations in the engagement letter pertaining to the use of, and the liability arising in connection with, the fairness opinion as an affirmative defense to any claim brought by any stockholder against Cohen & Steers under applicable state law. Cohen & Steers believes that the law of the state of Delaware governs this transaction. To the best of its knowledge, Cohen & Steers believes that Delaware law has not addressed the availability of this affirmative defense and therefore a court of competent jurisdiction in Delaware would have to resolve the availability of this affirmative defense. In any event, such a defense, whether or not available to Cohen & Steers, would not affect the rights and responsibilities of the board of directors under governing state law or the federal securities laws or the rights and responsibilities of Cohen & Steers under the federal securities laws.

Cohen & Steers and the Special Committee entered into a letter agreement dated January 3, 2003 that confirmed the fee arrangement with and engagement of Cohen & Steers to render the fairness opinion to the Special Committee as to the fairness, from a financial point of view, to the holders of ARV's common stock (other than Prometheus, Merger Sub and their respective affiliates) of the merger consideration to be received by such holders pursuant to the merger agreement.

The following is a summary of all of the material financial analyses performed by Cohen & Steers in arriving at its opinion and was provided by Cohen & Steers for inclusion in this proxy statement. In support of several of its analyses, Cohen & Steers used financial projections that were prepared by ARV's management and reviewed and approved by the Special Committee. The financial projections were subsequently updated from time to time to reflect actual results and other unanticipated events. As noted above, Cohen & Steers assumed that the financial projections were reasonably prepared on a basis reflecting the best current estimates and good faith judgments of management as to ARV's anticipated future financial condition and operating results.

*Discounted Cash Flow Analysis.* Cohen & Steers performed a discounted cash flow analysis of the projected free cash flows of ARV for the calendar years 2003 through 2007 based on the financial projections. Free cash flows were defined as after-tax earnings before interest and taxes plus depreciation and amortization, less capital expenditures, less future operating deficit funding, plus changes in working capital.

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The discounted cash flow analysis of ARV was determined by:

adding:

the present value of the projected free cash flows of ARV over the five-year period from 2003 to 2007; and

the present value of the estimated terminal value of the business at the end of 2007; and then

subtracting:

the debt, net of cash and cash equivalents outstanding of ARV at September 30, 2002, subject to certain adjustments further described below.

In order to perform this analysis, Cohen & Steers, at the direction of the Special Committee, made certain assumptions, including:

The use of ARV's net operating loss carry-forward to offset a significant portion of taxable earnings during the projection period. Cohen & Steers noted that ARV's ability to use its net operating loss carry-forward in the future might be adversely impacted following a change of control transaction, among other factors.

The repurchase of the minority interest in certain consolidated partnerships that own one or more assisted living properties. The purchase price assumed to acquire the minority partners' interests was calculated using an 11% capitalization rate on the net operating income of the relevant properties. In the case of unprofitable properties, a minimum purchase price of \$50,000 per unit was assumed. The impact of such assumption for purposes of this analysis was (i) an increase in ARV's net debt by the amount required to fund the repurchase of such minority interests and (ii) an increase in projected free cash flows resulting from the corresponding add-back of distributions to minority partners during the projection period.

The exercise of all outstanding options and warrants and the addition of the resulting cash proceeds to ARV's cash balance.

The payment of the settlement (and related expenses) relating to the GeriCare Matter and the resulting reduction in ARV's cash balance.

Certain additional adjustments to reflect certain expenditures expected during the quarter ended December 31, 2002 including an estimate of unpaid operating deficit funding, certain capital expenditures and distributions to minority interest partners.

The range of estimated terminal values at the end of the five-year period was calculated by applying terminal multiples ranging from 7.0x to 10.0x to the projected calendar year 2007 earnings before interest, taxes, depreciation and amortization (EBITDA). The range of terminal multiples was derived based on several factors including the EBITDA multiples of the ARV Comparable Companies (as defined in - Selected Comparable Public Assisted Living Companies Analysis below). Estimated cash flows and terminal values were then discounted to December



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31, 2002 using discount rates ranging from 13.0% to 17.0%, a range representative of the weighted average cost of capital, excluding the effect of leases, for ARV and the ARV Comparable Companies. Based on such terminal value multiples and discount rates, the derived mean, median, high and low diluted equity value for ARV was \$3.87, \$3.85, \$5.91 and \$2.08, respectively. Cohen & Steers observed that the \$3.90 per share to be paid in the merger to ARV's stockholders fell within the reference range and was in excess of both the mean and median implied equity value per share based on the discounted cash flow analysis per share.

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*Theoretical Stock Price Analysis.* Cohen & Steers performed a theoretical stock price analysis for each of the years ended December 31, 2002, 2003, 2004, 2005 and 2006, respectively using the financial projections. The analysis was performed by applying a range of valuation multiples of 7.0x to 10.0x to ARV's projected EBITDA for each measurement year to calculate a future enterprise valuation and deducting therefrom indebtedness net of available cash outstanding at the end of such measurement year to derive an implied future gross equity value for such period. Thereafter, the implied future gross equity value was further reduced by the minority interest portion of joint ventures, which were valued using the same multiples applied to ARV as a whole, to calculate the future net equity value for such period. The implied future net equity value was then discounted to the present using a range of discount rates of 20.0% to 40.0%, reflecting theoretical required rates of return for comparable companies with comparable debt leverage. For purposes of this analysis, the range of terminal multiples used was derived based on several factors, including the EBITDA multiples of the ARV Comparable Companies. Furthermore, Cohen & Steers further assumed at the direction of the Special Committee that (i) ARV's net operating loss carry-forward would be available to offset a significant portion of taxable earnings during the projection period, and (ii) that all outstanding options and warrants are exercised at the end of each respective measurement year.

The following table sets forth the implied mean, adjusted mean (excludes high and low values) and median values per share of ARV common stock based upon the foregoing analysis:

	<b>Implied Mean Value Per Share</b>	<b>Adjusted Mean Value Per Share</b>	<b>Median Value Per Share</b>
Calendar Year 2002	\$ 2.05	\$ 2.06	\$ 2.08
Calendar Year 2003	\$ 1.89	\$ 1.89	\$ 1.90
Calendar Year 2004	\$ 2.53	\$ 2.52	\$ 2.52
Calendar Year 2005	\$ 3.05	\$ 3.02	\$ 2.97
Calendar Year 2006	\$ 3.32	\$ 3.29	\$ 3.20

In arriving at its opinion, Cohen & Steers noted that the \$3.90 per share to be paid in the merger to ARV's stockholders exceeds the implied mean, adjusted mean (excludes high and low values) and median values per share based on the theoretical stock price analyses for calendar years 2002, 2003, 2004, 2005 and 2006.

*Net Asset Value ( NAV ) Analysis.* Cohen & Steers performed a NAV Analysis using the residence level cash flows of each of the owned and leased residences of ARV for the four months ended October 31, 2002 on an annualized basis. The analysis assumed that ARV is a going-concern and does not provide for deductions for sales taxes, commissions and other related transaction costs. Furthermore, each residence was valued on a stand-alone basis, notwithstanding the existence of certain master lease or cross collateral arrangements.

#### *Owned Residences NAV*

The net asset values of the owned residences of ARV were determined by:

dividing:

the current cash flows from each of the owned residences of ARV; by

capitalization rates ranging from 10.0% to 12.0%; and then

subtracting

the current net debt outstanding of the owned residences;

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In the case of the owned residences, current cash flows from the residents is calculated as residence level revenues less residence level operating expenses, less an assumed management fee of 5% of revenues and less a \$350 per unit capital expenditure reserve, consistent with customary industry practice. In the case of unprofitable owned properties, a minimum purchase price of \$50,000 per unit was assumed. To the extent an owned residence with negative residence level cash flows was subject to mortgage debt in excess of \$50,000 per unit, such residence was assumed to have no residual net asset value. The range of capitalization rates used in this analysis is based on, among other factors, the range of capitalization rates observed in transactions involving properties similar to ARV's owned residences.

### *Leased Residences NAV*

The net asset values of the leased residences were determined by:

multiplying:

the current cash flows from each leased residence of ARV by

EBITDA (after rent expense) multiples ranging from 4.0x to 8.0x.

In the case of the leased residences, the current cash flows from residents is calculated as residence level revenues less residence level operating expenses, less an assumed management fee of 5% of revenues, less a \$350 per unit capital expenditure reserve, and less lease expense. All leased residences with negative residence level cash flows, after rent expense, were assumed to have no residual net asset value. The range of EBITDA multiples used for purposes of this analysis is based on, among other factors, the range of multiples observed in transactions involving properties similar to ARV's leased residences.

### *Total NAV*

The implied equity values per share of ARV were then determined by:

adding:

the net asset values of each of the owned residences;

the net asset values of each of the leased residences;

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cash and cash equivalents of \$14.5 million as of September 30, 2002, adjusted for the liability and cost of the settlement of the GeriCare Matter; and

the proceeds received upon the assumed exercise of all options and warrants outstanding.

and subtracting:

the following corporate obligations of ARV: (i) \$7.2 million of public convertible debentures, (ii) \$10.0 million of debt to an affiliate of Prometheus, (iii) a range of estimated future unpaid operating deficit funding requirements, and (iv) a range of assumed purchase prices for the minority partners' interests in certain joint ventures using the same valuation methodology and capitalization rates described above.

and dividing:

the aggregate result by the total number of shares outstanding, including all options and warrants.

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Based on the NAV analysis, the implied mean, median, high and low equity values per share for ARV were \$3.81, \$3.78, \$4.95 and \$2.71, respectively. In arriving at its opinion, Cohen & Steers noted that the \$3.90 per share to be paid in the merger to ARV's stockholders was within the range and exceeded both the mean and median equity value per share based on the NAV valuation analysis per share of ARV.

*Premiums Paid Analysis.* Cohen & Steers compared the premiums paid per share over the trading share price of ARV one day, one week and four weeks prior to ARV's first announcement on September 23, 2002 of Prometheus' initial offer to similar transactions in the senior care industry. Given the limited number of public company transactions in the assisted living/senior housing industry the universe of transactions reviewed was broadened to include other senior care company transactions. Cohen & Steers compared the premiums paid in both cash only and stock transactions.

The following transactions (with announcement dates & forms of consideration) were included in the Premiums Paid Analysis:

Fortress Brookdale Acquisition LLC / Brookdale Living Communities, Inc. (July 2000, cash)

Pincus LLC / Centennial Healthcare Corp. (February 2000, cash)

Sunrise Assisted Living, Inc. / Karrington Health Inc. (October 1998, stock)

Health Care & Retirement Corp. / Manor Care, Inc. (June 1998, stock)

Kapson Senior Quarters Corp. / Atria Communities, Inc. (April 1998, cash)

Investcorp / Harborside Healthcare Corp. (April 1998, cash)

Paragon Health Network, Inc. / Mariner Health Group, Inc. (April 1998, stock)

Fountain View Inc. / Summit Care Corp. (February 1998, cash)

Prometheus Senior Quarters LLC / Kapson Senior Quarters Corp. (October 1997, cash)

Extendicare Health Services Inc. / Arbor Health Care Company (Sept. 1997, cash)

Alternative Living Services, Inc. / Sterling House Corp. (July 1997, stock)

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Sun Healthcare Group Inc. / Regency Health Services Inc. (July 1997, cash)

Genesis Health Ventures, Inc./ Multicare Companies, Inc. (June 1997, cash)

Whitehall Street Real Estate LP VII / Integrated Living Communities, Inc. (May 1997, cash)

Paragon Health Network, Inc. / GranCare, Inc. (May 1997, stock)

Paragon Health Network, Inc. / Living Centers of America, Inc. (May 1997, cash)

HealthSouth Corp. / Horizon / CMS Healthcare Corp. (February 1997, stock)

Vencor Inc. / Thera TX Inc. (February 1997, cash)

Cohen & Steers calculated premiums paid in the above transactions and compared it to the ARV merger transaction.

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The following table sets forth the implied mean, adjusted mean (excludes high and low values) and median values per share of ARV common stock based upon the foregoing analysis:

	Comparable Multiples			Implied Mean Value  Per Share	Discount/ (Premium)	Implied  Adj. Mean Value Per Share	Discount/ (Premium)	Implied Median Value Per Share	Discount/ (Premium)
	Mean	Adj. Mean	Median		to Merger		to Merger		
					Consideration		Consideration		
Cash Transactions									
1 Day	24.7%	21.1%	21.6%	\$3.18	\$0.72	\$3.09	\$0.81	\$3.10	\$0.80
1 Week	28.6%	25.1%	21.7%	3.27	0.63	3.18	0.72	3.09	0.81
4 Weeks	31.4%	29.7%	29.0%	3.19	0.71	3.15	0.75	3.13	0.77
Mean				\$3.21		\$3.14		\$3.11	
Median				3.19		3.15		3.10	
All Transactions									
1 Day	25.6%	23.3%	22.6%	\$3.20	\$0.70	\$3.14	\$0.76	\$3.13	\$0.77
1 Week	29.6%	27.3%	23.2%	3.29	0.61	3.23	0.67	3.13	0.77
4 Weeks	35.6%	32.8%	26.8%	3.30	0.60	3.23	0.67	3.08	0.82
Mean				\$3.26		\$3.20		\$3.11	
Median				3.29		3.23		3.13	

In arriving at its opinion, Cohen & Steers noted that the \$3.90 per share to be paid in the merger to ARV's stockholders exceeds the implied mean, adjusted mean (excludes high and low values) and median values per share based on the premiums paid over the trading price of the 1 Day, 1 Week, and 4 Weeks prior to the announcement date trading price for both cash and all comparable transactions. The range of Implied Mean Equity Values per ARV share derived from the cash transactions analysis ranged from a high of \$3.27 to a low of \$3.18 with a mean of \$3.21 and a median of \$3.19 compared with the \$3.90 per share merger consideration. The range of Implied Mean Equity Values per ARV share derived from all transactions analysis ranged from a high of \$3.30 to a low of \$3.20 with a mean of \$3.26 and a median of \$3.29 compared with the \$3.90 per share merger consideration. The range of Implied Adjusted Mean Equity Values per ARV share derived from the cash transactions analysis ranged from a high of \$3.18 to a low of \$3.09 with a mean of \$3.14 and a median of \$3.15 compared with the \$3.90 per share merger consideration. The range of Implied Adjusted Mean Equity Values per ARV share derived from the all transactions analysis ranged from a high of \$3.23 to a low of \$3.14 with a mean of \$3.20 and a median of \$3.23 compared with the \$3.90 per share merger consideration. The range of Implied Median Equity Values per ARV share derived from the cash transactions analysis ranged from a high of \$3.13 to a low of \$3.09 with a mean of \$3.11 and median of \$3.10 compared with the \$3.90 to be paid in the merger to ARV's stockholders. The range of Implied Median Equity Values per ARV share derived from the all transactions analysis ranged from a high of \$3.13 to a low of \$3.08 with a mean of \$3.11 and median of \$3.13 compared with the \$3.90 to be paid in the merger to ARV's stockholders.

*Selected Comparable Public Assisted Living Companies Analysis.* Cohen & Steers compared selected projected financial and operating data of ARV to the corresponding data of a group of publicly traded companies that it deemed to be reasonably comparable to ARV. In determining the appropriate comparable companies, Cohen & Steers considered a variety of factors, including market capitalization, business focus, revenues, cash flow and resident capacity. These six companies (the ARV Comparable Companies) consisted of:

Alterra Healthcare Corporation;



American Retirement Corporation;

Assisted Living Concepts, Inc.;

Capital Senior Living Corporation;

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Emeritus Corporation;

Sunrise Assisted Living, Inc.

Cohen & Steers calculated multiples of Adjusted Enterprise Value (defined as market value of equity plus the sum of total debt and capitalized rent payments (i.e., ten times rent expense), less cash and cash equivalents adjusted, in the case of the proposed merger, for the payment of the settlement relating to the GeriCare Matter) to resident capacity (defined as total owned and leased operating units), to latest quarter annualized revenues and latest quarter annualized earnings before interest, taxes, depreciation, amortization and rent expense (EBITDAR). Cohen & Steers also calculated multiples of Enterprise Value (defined as market value of equity plus the sum of total debt, less cash and cash equivalents adjusted for the payment of the settlement relating to the GeriCare Matter) to latest quarter annualized EBITDA. Cohen & Steers also calculated multiples of the equity value to book value.

The following table sets forth the implied mean, adjusted mean (excludes high and low values) and median values per share of ARV common stock based upon the foregoing analysis:

	Comparable Multiples			Implied Mean Value Per Share	Discount/ (Premium) to Merger Consideration	Implied Adj. Mean Value Per Share	Discount/ (Premium) to Merger Consideration	Implied Median Value Per Share	Discount/ (Premium) to Merger Consideration
	Mean	Adj. Mean	Median						
Adjusted Enterprise Value to:									
Resident Capacity	\$ 81.4	\$ 80.0	\$ 84.3	\$ 4.12	\$ (0.22)	\$ 3.61	\$ 0.29	\$ 5.11	\$ (1.21)
LQA Revenues	3.0x	3.1x	3.1x	3.06	0.84	3.63	0.27	3.68	0.22
LQA EBITDAR	10.8	9.7	9.7	7.02	(3.12)	3.68	0.22	3.68	0.22
Enterprise Value to:									
LQA EBITDA	10.6x	9.4x	9.4x	\$ 5.26	\$ (1.36)	\$ 3.89	\$ 0.01	\$ 3.89	\$ 0.01
Market Price of Equity to:									
Book Value	1.0x	1.1x	1.2x	\$ 2.62	\$ 1.28	\$ 2.81	\$ 1.09	\$ 3.25	\$ 0.65
Mean			\$4.41	\$ 3.52			\$ 3.92		
Median			4.12	3.63			3.68		

In arriving at its opinion, Cohen & Steers noted that the \$3.90 per share to be paid in the merger to ARV's stockholders exceeds the implied mean values per share based on multiples of latest quarter annualized Revenues and Book Value, the implied adjusted mean values per share based on multiples of Resident Capacity, latest quarter annualized revenues, latest quarter annualized EBITDAR, latest quarter annualized EBITDA and Book Value and the implied median values per share based on latest quarter annualized revenues, latest quarter annualized EBITDAR, latest quarter annualized EBITDA and Book Value. The implied mean value per share based on Resident Capacity, latest quarter annualized EBITDAR and latest quarter annualized EBITDA and the implied median value per share based on Resident Capacity exceeds the \$3.90 per share merger consideration. The range of Implied Mean Equity Values per ARV share derived from this analysis ranged from a high of \$7.02 to a low of \$2.62 with a mean of \$4.41 and a median of \$4.12 compared with the \$3.90 per share merger consideration. The range of Implied Adjusted Mean Equity Values per ARV share derived from this analysis ranged from a high of \$3.89 to a low of \$2.81 with a mean of \$3.52 and

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median of \$3.63 compared with the \$3.90 per share merger consideration. The range of Implied Median Equity Values per ARV share derived from this calculation ranged from a high of \$5.11 to a low of \$3.25 with a mean of \$3.92 and median of \$3.68 compared with the \$3.90 to be paid in the merger to ARV's stockholders.

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Cohen & Steers also noted that a number of the companies, including Alterra Healthcare Corporation, American Retirement Corporation, Assisted Living Concepts, Inc. and Emeritus Corporation, among others, have either undergone recent, or are currently undergoing, material financial restructurings. As a result, certain financial data used in the analysis may not be relevant and consequently, Cohen & Steers did not consider the Comparable Trading Companies Analysis to be meaningful in the context of its overall evaluation.

*Selected Comparable Transactions Analysis.* Cohen & Steers considered the terms, to the extent publicly available, of selected cash and stock transactions that it deemed reasonably comparable to the merger (the Comparable ARV Transactions ) and sought to compare the \$3.90 per share to be paid by Prometheus with the consideration involved in such transactions. The eighteen Comparable ARV Transactions and their pertinent dates were as follows:

Senior Housing Properties Trust / Constellation Health Services, Inc. (completed in October 2002)

IPC Advisors S.a.r.l. / Balanced Care Corporation (completed in August 2002)

Five Star Quality Care Inc. / ILM II Senior Living, Inc. (completed in April 2002)

Senior Housing Properties Trust / Crestline Capital Corp. (completed in January 2002)

Fortress Brookdale Acquisition LLC / Brookdale Living Communities, Inc. (two steps -completed in May and September 2000)

Capital Senior Living Corp. / ILM Senior Living, Inc. (completed in August 2000)

Alterra Healthcare Corp. / Manor Care, Inc. (completed in July 1999)

Sunrise Assisted Living, Inc. / Karrington Health Inc. (completed in May 1999)

Kapson Senior Quarters Corp. / Atria Communities, Inc. (completed in September 1998)

American Retirement Corp. / Freedom Group Inc. (completed in July 1998)

Prometheus Senior Quarters LLC / Kapson Senior Quarters Corp. (completed April 1998)

Alternative Living Services, Inc. / Sterling House Corp. (completed October 1997)

Whitehall Street Real Estate LP VII / Integrated Living Communities, Inc. (completed July 1997)

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Host Marriott Corporation / Marriott International, Inc. (completed June 1997)

Greenbriar Corp. / American Care Communities Inc. (completed December 1996)

Alternative Living Services, Inc. / New Crossings International Corp. (completed in May 1996)

Greenbriar Corp. / Wedgwood Retirement Inn Corp. (completed in April 1996)

Marriott International, Inc. / Forum Group, Inc. (completed in March 1996)

In considering the preceding transactions, Cohen & Steers selected the assisted living and senior housing transactions on the basis of several variables including, but not limited to, the nature of the business of the targets involved.

Cohen & Steers calculated multiples of Adjusted Transaction Value (defined as equity value of the transaction plus the sum of total assumed debt and capitalized rent payments (i.e., ten times rent

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expense), less cash and cash equivalents adjusted, in the case of the proposed merger, for the payment of the settlement relating to the GeriCare Matter) to resident capacity (defined as total owned and leased units), to latest quarter annualized revenues and latest quarter annualized earnings before interest, taxes, depreciation, amortization and rent expense. Cohen & Steers also calculated multiples of Transaction Value (defined as equity value of the transaction plus the sum of total debt, less cash and cash equivalents adjusted for the payment of the settlement relating to the GeriCare Matter) to latest quarter annualized earnings before interest, taxes, depreciation and amortization. Cohen & Steers also calculated multiples of the equity value to book value.

The following table sets forth the implied mean, adjusted mean (excluding high and low values) and median values per share of ARV common stock based upon the foregoing analysis:

	Comparable Multiples			Implied Mean Value Per Share	Discount/ (Premium) to Merger Consideration	Implied Adj. Mean Value Per Share	Discount/ (Premium) to Merger Consideration	Implied Median Value Per Share	Discount/ (Premium) to Merger Consideration	
	Mean	Adj. Mean	Median							
Adjusted Transaction Value to:										
Resident Capacity	\$ 84.4	\$ 83.2	\$ 78.4	\$ 4.69	\$ (0.79)	\$ 4.31	\$ (0.41)	\$ 2.89	\$ 1.01	
LQA Revenues	3.4x	3.4x	3.5x	5.48	(1.58)	5.67	(1.77)	6.21	(2.31)	
LQA EBITDAR	9.5	9.1	8.3	2.90	1.00	1.92	1.98	0.08	3.82	
Transaction Value to:										
LQA EBITDA	8.9x	8.3x	8.3x	\$ 3.16	\$ 0.74	\$ 2.65	\$ 1.25	\$ 2.64	\$ 1.26	
Market Price of Equity to:										
Book Value	2.0x	2.1x	2.4x	\$ 4.54	\$ (0.64)	\$ 4.61	\$ (0.71)	\$ 5.39	\$ (1.49)	
Mean			\$ 3.83			\$ 3.44				
Median			4.31			2.89				

In arriving at its opinion, Cohen & Steers noted that the \$3.90 per share to be paid in the merger to ARV's stockholders exceeds the implied mean value per share on the multiples of latest quarter annualized EBITDAR and latest quarter annualized EBITDA, the implied adjusted mean value per share on multiples of latest quarter annualized EBITDAR and latest quarter annualized EBITDA and the implied median value per share on multiples of Resident Capacity, latest quarter annualized EBITDAR, and latest quarter annualized EBITDA. The implied mean value per share based on multiples of Resident Capacity, latest quarter annualized revenues and Book Value, the implied adjusted mean value per share on multiples of Resident Capacity, latest quarter annualized revenues and Book Value, and the implied median value per share on multiples of latest quarter annualized revenues and Book Value exceeds the \$3.90 per share merger consideration. The range of Implied Mean Equity Values per ARV share derived from this analysis ranged from a high of \$5.48 to a low of \$2.90 with a mean of \$4.16 and a median of \$4.54 compared with the \$3.90 per share merger consideration. The range of Implied Adjusted Mean Equity Values per ARV share derived from this analysis ranged from a high of \$5.67 to a low of \$1.92 with a mean of \$3.83 and a median of \$4.31 compared with the \$3.90 per share merger consideration. The range of Implied Median Equity Values per ARV share derived from this analysis ranged from a high of \$6.21 to a low of \$0.08 with a mean of \$3.44 and a median of \$2.89 compared with the \$3.90 per share to be paid in the merger to ARV stockholders.

Cohen & Steers also noted that all of the transactions occurred in materially different economic and industry market conditions than the ARV transaction. As a result, certain financial data used in the analysis may not be relevant and consequently, Cohen & Steers did not consider the Comparable Transactions Analysis to be meaningful in the context of its overall evaluation.



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*Stock Trading History Analysis.* Cohen & Steers reviewed the history of the trading prices and trading volume of ARV's common stock since its initial public offering on October 18, 1995 and the relative trading price of ARV's common stock over the prior twelve months, six months, three months, two months and one month ended September 23, 2002, the date of ARV's receipt and announcement of Prometheus' initial proposal). Cohen & Steers compared the trend in ARV's stock price to certain market indices including the Standard & Poor's 500 Index (the S&P 500), the Dow Jones Industrial Average Index (the DJIA) and an index of assisted living companies (the Assisted Living Index). The Assisted Living Index included Alterra Healthcare Corporation, American Retirement Corporation, ARV Assisted Living, Inc., Capital Senior Living Corporation, Emeritus Corporation and Sunrise Assisted Living, Inc.

Such review indicated that for the twelve months, six months, three months and one month ended September 23, 2002, ARV's common stock significantly outperformed the S&P 500, the DJIA and the Assisted Living Index. In addition, Cohen & Steers noted the stock had not traded above the proposed \$3.90 per share to be paid in cash in the merger since July 20, 1999.

*Conclusion.* The preparation of a fairness opinion is a complex process involving various determinations as to the most appropriate and relevant quantitative and qualitative methods of financial analysis and the application of those methods to the particular circumstances and, therefore, is not readily susceptible to partial analysis or summary description. In arriving at its opinion, Cohen & Steers considered the results of all its analyses as a whole.

Subject to the matters set forth in its opinion, the judgments made by Cohen & Steers as to its analyses and the factors considered by it caused Cohen & Steers to be of the opinion, that, as of the date of its opinion, the \$3.90 per share to be paid in cash in the merger was fair, from a financial point of view, to the holders of ARV's common shares (other than the Prometheus, Merger Sub and their respective affiliates). Cohen & Steers' analyses must be considered as a whole and considering any portion of such analyses or of the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying Cohen & Steers' opinion.

Any estimates contained in Cohen & Steers' analyses are not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than those contained in such analyses. Estimated values do not purport to be appraisals or to reflect the prices at which businesses or companies may be sold in the future, and such estimates are inherently subject to uncertainty.

Cohen & Steers is an investment banking firm regularly engaged in the valuation of businesses and their securities in connection with:

mergers;

acquisitions;

private placements; and

valuations for corporate and other purposes.



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The extensive experience of Cohen & Steers investment bankers in providing corporate finance and financial advisory services to companies in the senior housing and assisted living industry was a significant factor in the decision of the Special Committee to select Cohen & Steers to be its financial

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advisor in connection with the merger and subsequently the decision of the board of directors and the Special Committee to engage Cohen & Steers to provide a fairness opinion.

Cohen & Steers has previously performed, and may in the future perform, financial advisory and financing services for ARV and/or its affiliates and has received and, may in the future receive fees for such services. In April 2002, ARV engaged Cohen & Steers as financial advisor, reporting to the Strategic Transactions Review Committee of the board of directors. This engagement was discontinued at the time the Special Committee retained Cohen & Steers to act as its financial advisor. In the ordinary course of business, Cohen & Steers and its affiliates may actively trade the securities of ARV for the accounts of their clients and, accordingly, may at any time hold a long or short position in such securities.

ARV agreed to pay Cohen & Steers a fairness opinion fee of \$500,000 for its services in connection with the fairness opinion, plus reasonable out-of-pocket expenses, including legal expenses, up to a maximum of \$20,000. No portion of Cohen & Steers fairness opinion fee is contingent upon the conclusions reached in its opinion nor upon the ultimate consummation of the merger. ARV has paid Cohen & Steers the \$500,000 fee. ARV has agreed to indemnify and hold harmless Cohen & Steers or any subsidiary, affiliate, director, officer, employee, agent or any person who controls Cohen & Steers, against and from all losses arising out of or in connection with its engagement by the Special Committee. ARV has also agreed to pay Cohen & Steers an additional \$1,750,000 fee if the merger is completed and to reimburse Cohen & Steers for certain expenses and liabilities in connection with its engagement not to exceed \$25,000. Except as expressly set forth above, no limitation was imposed by ARV or the Special Committee on the nature or scope of, or methodologies and procedures used in, Cohen & Steers' financial analyses.

## **Special Committee's and Board of Directors' Recommendation; Fairness of the Merger**

### *Special Committee*

On September 23, 2002, ARV's board of directors established a Special Committee, comprised of the two ARV directors who are neither employees of ARV nor affiliates of Prometheus, to evaluate Prometheus' transaction proposal, determine whether to seek transactions with other parties, negotiate with Prometheus or any other potential acquirer of ARV, consider whether any proposed transaction was in the best interest of ARV's stockholders, and, if appropriate, recommend a proposed transaction to ARV's full board of directors.

The board appointed Messrs. Maurice DeWald and David Collins, non-employee members of our board of directors who are not affiliates of Prometheus, to serve as the two members of the Special Committee. Because neither of Messrs. DeWald or Collins are affiliated with Prometheus or its affiliates, the Special Committee did not deem it necessary to, and did not, hire any additional representatives to act on behalf of our stockholders who were not affiliated with Prometheus.

The board delegated to the Special Committee the power and authority to:

determine whether the sale of ARV or another strategic transaction was in the best interest of our stockholders;

review and evaluate the terms, conditions, and advisability of any proposed transaction involving Prometheus and its affiliates;



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determine whether or not to seek or commence discussions with other potential acquirers;

negotiate with Prometheus or any other potential purchaser of ARV; and

recommend action(s) to the full board to maximize stockholder value through one or more strategic transactions.

The Special Committee was also authorized and empowered to retain such legal and financial advisors as it deemed necessary and appropriate to execute its responsibilities, and enter into any retention or engagement relationships with such parties to effect its charter. The Special Committee engaged Cohen & Steers to act as its financial advisors and O'Melveny & Myers as legal counsel to assist it in discharging its mandate.

In consideration of the expected time requirements and other commitments required from the Special Committee members, our board of directors also determined that each member of the Special Committee should be paid an additional fee of \$1,000 for each material meeting of the Special Committee. As Chairman of the Special Committee, Mr. DeWald also receives \$750 per quarter. The board further determined that the Special Committee members should be reimbursed for their reasonable documented expenses incurred in the discharge of their duties.

### *Reasons for the Special Committee's Determination; Fairness of the Merger*

The Special Committee, which is composed solely of directors who are neither employees of ARV nor affiliates of Prometheus, has unanimously determined that the merger is fair, from a financial and procedural point of view, to and in the best interests of ARV and ARV's stockholders who are not affiliated with Prometheus, and recommended that the full board of directors of ARV approve the merger agreement and that stockholders of ARV vote for the adoption of the merger agreement and the approval of the merger contemplated thereby. The following are the material factors the Special Committee considered in reaching their conclusion that the merger is substantively fair to ARV's stockholders who are not affiliated with Prometheus:

The efforts of the Special Committee, assisted by Cohen & Steers, commencing in September 2002 and continuing over the subsequent four months, to explore and pursue strategic alternatives for us, including continuing to operate as a stand-alone company.

That during a four-month period the Special Committee (through its financial advisor) had contact with at least seven parties, entered into confidentiality agreements with four parties and received preliminary bids or proposals from three parties.

The cash price of \$3.90 per share to be paid in the merger, including the fact that such amount represents a premium of 53% over the market price for ARV shares on September 23, 2002 (the day of ARV's announcement of Prometheus' interest in acquiring the shares of ARV common stock not already owned by Prometheus). In addition, the \$3.90 per share price represents a premium of:

68% over the average closing market price of ARV shares over the six-month period ending on September 23, 2002;

98% over the average closing market price of ARV shares over the one-year period ending on September 23, 2002;

153% over the average closing market price of ARV shares over the three-year period ending on September 23, 2002;

4% over the average closing market price of ARV shares on January 3, 2003, the date of the announcement of the execution of the merger agreement;

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The relatively low trading volume of the ARV shares – an average daily trading volume over the two year period ending December 31, 2002 of 15,726 shares. The merger will provide ARV’s unaffiliated stockholders with immediate liquidity for their shares without the usual transaction costs associated with open market sales.

The delivery to the Special Committee of the opinion of Cohen & Steers, dated January 3, 2003, its independent financial advisor, to the effect that as of that date the cash merger consideration of \$3.90 per share of ARV common stock is fair, from a financial point of view, to ARV’s stockholders (other than Prometheus, Merger Sub or their respective affiliates). The Special Committee and the ARV board of directors reviewed the analysis of Cohen & Steers and expressly adopted that analysis, which is summarized above under the caption, SPECIAL FACTORS Opinion of the Special Committee’s Financial Advisor.

That the merger agreement, after giving consideration to the requirements and limitations contained therein, allows us a reasonable opportunity to respond to certain third party alternative acquisition proposals, and, if a superior proposal were made, to terminate the merger agreement and accept the superior proposal up until the time of the stockholder vote on the merger, subject to certain limitations including the payment of a termination fee and expense reimbursement. (See THE MERGER AGREEMENT No Solicitation and THE MERGER AGREEMENT Termination ).

The determination by the Special Committee that any liquidation valuation of ARV would be less than ARV’s net book value. The Special Committee believed that both the net book value and the liquidation value of ARV are significantly less than the range of values determined by Cohen & Steers.

That the going concern value of ARV was consistent with the enterprise valuation range determined by Cohen & Steers.

That the negotiations with Prometheus resulted in the elimination of numerous conditions and contingencies originally proposed by Prometheus, including revisions to the representations, warranties, covenants, and closing conditions; substantial modifications in favor of ARV to the originally proposed limitations on the ability of our board of directors to consider superior proposals; and a reduction in the payment of break-up fees if the merger agreement is terminated under special circumstances.

The current and prospective business environment in which ARV operates, including: economic, market, regulatory and competitive conditions; the benefits, costs and risks inherent in ARV’s strategic plan, which contemplates growth through increasing the number of its facilities; the risk that ARV is dependent on a concentrated market and region from which to draw customers; existing and potential increased competition from other similar companies and the prospect of substantially larger, better financed companies entering ARV’s markets; the difficulty that ARV has experienced in raising capital and the risks of changes to the regulations governing ARV.

ARV’s strategic alternatives, including remaining a separate company while continuing to explore a merger or joint venture transaction with another party, and the significant challenges that ARV would face as an independent company if it did not proceed with the proposed merger, including the effect of unpredictable and volatile equity and debt markets on its ability to raise capital.

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Although ARV received offers at a price of \$4.00 per share, both offers were subject to due diligence. Moreover, Summerville indicated that it would not be willing to pursue further due diligence without a commitment from ARV to pay Summerville's expenses. As such, the Special Committee believes that there is considerable uncertainty as to whether those proposed transactions could have been entered into on the terms proposed within a reasonable time frame, if at all. Moreover, the merger consideration of \$3.90 per share reflects a \$4.00 per share price, reduced by \$.10 in light of the costs and expenses of the settlement of the GeriCare Matter.

The fact that the Special Committee had not received a proposal in excess of \$3.90 per share that, in the Special Committee's view, was also reasonably likely to be consummated, in light of Prometheus' ownership of 43.5% of ARV's common stock, its stated intention that it was not interested in selling those shares and, as described above under "Background of the Merger," its ability potentially to acquire shares representing up to 50% of ARV's total outstanding shares, without ARV's prior approval.

The business reputation of Prometheus and its past investment in ARV as well as its and its affiliates' strong track record in completing transactions similar to the merger, including transactions in the assisted living industry, supported the Special Committee's determination that Prometheus has the ability to complete the merger in a timely manner.

The other terms of the merger agreement, including the parties' representations, warranties, and covenants, and the conditions to their respective obligations. The Special Committee concluded that these terms provide a high degree of certainty that the merger can be completed, particularly in light of Prometheus' ability to terminate the merger agreement only in limited circumstances.

The fact that ARV has never paid any dividends in respect of its common stock and the Special Committee's belief that, in light of ARV's level of existing indebtedness, its current inability to generate sufficient cash from operations to fund recurring working capital and capital expenditure requirements and a prohibition on dividend payments contained in an existing term loan agreement between ARV and an affiliate of Prometheus described below under "Interests of Certain Persons in the Merger" Interests of Prometheus and its Affiliates, ARV would be unlikely to pay dividends in the foreseeable future, including from the approximately \$11 million of ARV's working capital Prometheus expects to use to pay a portion of the merger consideration. The merger will afford ARV stockholders who are unaffiliated with Prometheus an opportunity to receive this cash in the form of merger consideration.

The fact that the GeriCare Matter was settled and the impact of the settlement amount on the cash balances of ARV.

The Special Committee also considered the following factors, among others, relating to the procedures involved in the negotiation of the merger:

ARV's board of directors established a Special Committee, comprised of the two ARV directors who are neither employees of ARV nor affiliates of Prometheus, to evaluate Prometheus' transaction proposal, determine whether to seek transactions with other parties, negotiate with Prometheus or any other potential acquirer of ARV, consider whether any proposed transaction was in the best interest of ARV's stockholders, and, if appropriate, recommend a proposed transaction to ARV's full board of directors. Moreover, the Special Committee had the authority to reject a transaction with Prometheus, notwithstanding Prometheus' significant ownership interest in ARV and its statement that it was not interested in selling its shares in ARV;

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The Special Committee retained Cohen & Steers and O Melveny & Myers, both of which are unaffiliated with Prometheus, as the Special Committee's outside financial and legal advisors, and these advisors reported directly to, and took direction from, the Special Committee;

Since early 2001, representatives of ARV, including management of ARV and Cohen & Steers as financial advisor first to the Strategic Transactions Review Committee of the ARV board and then to the Special Committee, have periodically explored various potential strategic transactions, contacted and held discussions with a number of potential transaction partners. In addition, notwithstanding Prometheus' significant share ownership and its statement that it was not interested in selling its shares, the Special Committee received a number of indications of interest and two offers for transactions with third parties, Summerville and HRC, at \$4.00 per share, although these proposals were subject to due diligence. HRC subsequently withdrew its offer and Summerville required that ARV commit to pay its due diligence costs in order for it to conduct further due diligence. Moreover, after Prometheus' initial proposal was announced on September 23, 2002, the Special Committee established a formal bidding process for third parties to conduct due diligence of ARV and submit proposals with respect to transactions with ARV;

The Special Committee, assisted by its outside advisors, negotiated the terms of the transaction with Prometheus. These negotiations resulted in, among other things, a transaction price of \$3.90 per share, which reflected a \$4.00 per share price reduced by \$.10 per share in light of the amount paid under the settlement agreement, and related legal fees and other costs, relating to the GeriCare Matter. The \$3.90 per share merger consideration represents a premium of approximately 14% over the midpoint of the \$3.25-\$3.60 price range contained in Prometheus' initial proposal;

ARV stockholders who do not vote in favor of the adoption of the merger agreement and approval of the merger will have the right to seek an appraisal of their shares in accordance with Delaware law.

The Special Committee also considered a variety of risks and other potentially negative factors concerning the merger but determined that these factors were outweighed by the benefits of the factors supporting the merger. These negative factors included the following:

The Special Committee and ARV's board approved the merger agreement despite the fact that Prometheus insisted upon an approximately \$2.2 million fee plus expenses to be paid by ARV to Prometheus if the merger did not close for certain reasons and ARV entered into another, similar transaction within nine months.

Certain terms and conditions set forth in the merger agreement, required by Prometheus as a prerequisite to entering into the merger agreement, prohibit ARV and its representatives from soliciting third-party bids and from accepting third-party bids except in specified circumstances. See THE MERGER AGREEMENT No Solicitation.

Certain members of ARV's board of directors have interests in the merger that are different from those of the ARV stockholders. The Special Committee and the ARV board considered these interests and gave careful consideration to the following potential conflicts of interests:

two members of the ARV board of directors were nominated by Prometheus, and that those directors are officers or directors of various affiliates of Prometheus; and

Prometheus owns 43.5% of the outstanding shares of ARV common stock, and if a warrant held by an affiliate of Prometheus were exercised, Prometheus, together with its affiliate, would own 45.8% of the outstanding shares of ARV common stock.





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For greater detail of these and other potential conflicts of interest, see SPECIAL FACTORS Interests of Certain Persons in the Merger.

Under Delaware law, Prometheus' ownership of approximately 43.5% of the outstanding shares of ARV common stock, as of the record date, is nearly sufficient to adopt the merger agreement and approve the merger with limited additional approval by stockholders who are unaffiliated with Prometheus. Moreover, as described under Background of the Merger, Prometheus could potentially acquire up to 50% of ARV's common stock, without ARV's prior approval.

The fact that Prometheus holds 43.5%, and could potentially acquire up to 50%, of our voting stock may have discouraged other parties from becoming bidders.

Following the merger, ARV will be a privately held company, and its current stockholders will cease to participate in any future earnings, losses, growth or decline in value of ARV.

After considering these factors, the Special Committee concluded that the positive factors relating to the merger outweighed the negative factors. Because of the variety of factors considered, the Special Committee did not find it practicable to quantify or otherwise assign relative weights to, and did not make specific assessments of, the specific factors considered in reaching its determination. However, individual members of the Special Committee may have assigned different weights to various factors. The determination of the Special Committee was made after consideration of all of the factors together.

*Reasons for the Board of Directors' Determination*

Our board of directors consists of five directors: Messrs. Maurice J. DeWald and David P. Collins, who serve on the Special Committee, Messrs. Robert C. Larson and John A. Moore, who were nominated by Prometheus under an agreement with ARV, and Mr. Douglas M. Pasquale, our Chairman and Chief Executive Officer. In reporting to our board of directors regarding its determination and recommendation, the Special Committee, with its legal and financial advisors participating, advised the other members of our board of directors of the process that the Special Committee underwent in the course of seeking alternatives for us, the course of its negotiations with third parties, in particular with Prometheus and its advisors, its review of the merger agreement and the factors the Special Committee considered in reaching its determination that the terms of the merger agreement, including the offer price of \$3.90 per share, and the merger are advisable, fair to and are in the best interests of, our stockholders who are not affiliated with Prometheus.

The board of directors, based in part upon the determination and recommendation of the Special Committee, unanimously determined that the terms of the merger agreement and the proposed merger are advisable, approved the merger agreement and the merger and unanimously recommends that our stockholders vote FOR the adoption of the merger agreement and approval of the merger. Moreover, the board of directors believes that the merger is procedurally and substantively fair to the stockholders of ARV not affiliated with Prometheus. The different board members reached these determinations, including the determination as to fairness of the merger and this recommendation based on different factors. Messrs. DeWald and Collins, members of the Special Committee, and Mr. Pasquale, based their determinations and recommendations as part of the board of directors on the facts set forth above under Reasons for the Special Committee Determination; Fairness of the Merger and expressly adopted the Special Committee's analyses and conclusions. Messrs. Larson and Moore based their determinations and recommendations as part of the board of directors on the factors set forth below under Prometheus Parties' Position as to the Fairness of the Merger, and expressly adopted the analyses and conclusions of the Prometheus Parties. In view of the wide variety of factors considered in its evaluation of the proposed merger, the members of our board of directors did not find it

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practicable to quantify or otherwise assign relative weights to, and did not make specific assessments of, the specific factors considered in reaching their determination. Rather, our board of directors based its position on the totality of the information presented and considered. To our knowledge, each of our executive officers and directors intends to vote all of the shares of our common stock he or she directly owns in favor of the merger.

### *Position of Our Chairman and Chief Executive Officer as to the Fairness of the Merger*

Under a potential interpretation of the Exchange Act rules governing going private transactions, continuing officers may be deemed to be our affiliates. Prometheus is having discussions with Mr. Douglas Pasquale, our Chairman and Chief Executive Officer, regarding his potential employment in a senior position with ARV and a combined company including ARV, Kapson and Atria after the merger. There is no assurance that Prometheus and Mr. Pasquale will reach an agreement. Prometheus is evaluating the role ARV's current management will play in ARV and a combined company after the merger. Prometheus has not yet made any offer to Mr. Pasquale. Mr. Pasquale is making the statements included in this subsection solely for the purpose of complying with the requirements of Rule 13e-3 and related rules under the Exchange Act. Although Mr. Pasquale may have interests in the merger that are different from the interests of our stockholders generally, Mr. Pasquale believes that the terms of the merger agreement and the proposed merger are substantively and procedurally fair to the stockholders who are not affiliated with Prometheus based on the facts and information available to him. See *Interests of Certain Persons in the Merger*.

Mr. Pasquale was not a member of, and did not participate in the deliberations of, the Special Committee; however as a director of ARV, he participated in the deliberations of the board of directors described above. Mr. Pasquale concurs with, and expressly adopts, the analyses and conclusions of the Special Committee relating to whether the consideration offered to unaffiliated stockholders is fair from a substantive and financial point of view and whether procedures existed that were designed to enhance the protection of unaffiliated stockholders in the transaction. In making this determination, Mr. Pasquale considered the same factors examined by the Special Committee described above under

Special Committee's and Board of Directors' Recommendation; Fairness of the Merger and has adopted the conclusion, and the analysis underlying the conclusion, of the Special Committee, based upon his view as to the reasonableness of that analysis. Mr. Pasquale believes that the terms of the merger agreement and the proposed merger are substantively and procedurally fair to our stockholders who are not affiliated with Prometheus. He has formed this belief with respect to substantive and procedural fairness even though no disinterested representative, other than the Special Committee and its advisors, was retained to act solely on behalf of the stockholders who are not affiliated with Prometheus.

Mr. Pasquale believes these analyses and factors provide a reasonable basis upon which to form his belief that the merger is fair to our stockholders who are not affiliated with Prometheus. To our knowledge, each of our executive officers intends to vote all of the shares of our common stock he or she directly owns in favor of adopting the merger agreement and approving the merger.

### **Prometheus Parties' Position as to the Fairness of the Merger**

Under the rules of the Commission, the Prometheus Parties are required to express their belief as to the fairness of the proposed merger to the stockholders of ARV who are unaffiliated with the Prometheus Parties. Each of the Prometheus Parties believes the merger is procedurally and substantively fair to the stockholders of ARV that are unaffiliated with the Prometheus Parties.

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The Prometheus Parties formed their belief that the merger is procedurally fair to the unaffiliated ARV stockholders based on the following material factors:

*Establishment of Special Committee to Evaluate Prometheus Proposal and Other Transaction Proposals.* ARV's board of directors established a Special Committee, comprised of the two ARV directors who are neither employees of ARV nor affiliates of Prometheus, to evaluate Prometheus' transaction proposal, determine whether to seek transactions with other parties, negotiate with Prometheus or any other potential acquirer of ARV, consider whether any proposed transaction was in the best interest of ARV's stockholders, and, if appropriate, recommend a proposed transaction to ARV's full board of directors. Moreover, the Special Committee had the authority to reject a transaction with Prometheus, notwithstanding Prometheus' significant ownership interest in ARV and its statement that it was not interested in selling its shares in ARV;

*Outside Advisors.* The Special Committee retained Cohen & Steers and O'Melveny & Myers, both of which are unaffiliated with Prometheus, as the Special Committee's outside financial and legal advisors, and these advisors reported directly to, and took direction from, the Special Committee;

*Efforts to Seek Alternative Transactions.* Since July 2002, representatives of ARV, including Cohen & Steers as financial advisor first to the Strategic Transactions Review Committee of the ARV board and then to the Special Committee, explored various potential strategic transactions and contacted and held discussions with a number of potential transaction partners. In addition, notwithstanding Prometheus' significant share ownership and its statement that it was not interested in selling its shares, the Special Committee received a number of indications of interest and two offers for transactions with third parties, Summerville and HRC, at \$4.00 per share, although these proposals were subject to due diligence, and Summerville required that ARV commit to pay its due diligence costs in order for it to conduct further due diligence. Moreover, after Prometheus' initial proposal was announced on September 23, 2002, the Special Committee established a formal bidding process for third parties to conduct due diligence of ARV and submit proposals with respect to transactions with ARV. In addition, prior to July 2002, members of ARV's management engaged in exploratory discussions with several potential strategic transaction partners;

*Negotiations with Prometheus.* The Special Committee, assisted by its outside advisors, negotiated the terms of the transaction with Prometheus. These negotiations resulted in, among other things, a transaction price of \$3.90 per share, which reflected a \$4.00 per share price reduced by \$.10 per share in light of the amount paid under the settlement agreement, and associated legal fees and other costs, relating to the GeriCare Matter. The \$3.90 per share merger consideration represents a premium of approximately 14% over the midpoint of the \$3.25-\$3.60 price range contained in Prometheus' initial proposal;

*Cohen & Steers Opinion.* Cohen & Steers delivered to the Special Committee its written opinion, dated January 3, 2003, to the effect that, as of that date, the cash merger consideration of \$3.90 per share was fair, from a financial point of view, to holders of ARV's common shares (other than Prometheus, Merger Sub or their respective affiliates);

*Special Committee Recommendation.* After evaluating Prometheus' transaction proposal, negotiating the terms of that proposal with Prometheus and conducting a formal bidding process for submission of alternative proposals, the Special Committee unanimously determined that the merger agreement and the merger with Prometheus are advisable, fair to

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and in the best interests of ARV's stockholders who are not affiliated with Prometheus and recommended to the full board of directors that they approve the merger agreement and the merger. The Special Committee also recommends that ARV stockholders vote in favor of the adoption of the merger agreement and approval of the merger; and

*Appraisal Rights.* ARV stockholders who do not vote in favor of the adoption of the merger agreement will have the right to seek an appraisal of their shares in accordance with Delaware law.

Although the merger was not structured to require approval of at least a majority of ARV stockholders unaffiliated with the Prometheus Parties, the Prometheus Parties nonetheless believe that the merger is procedurally fair to those stockholders, based on the material factors described above.

The Prometheus Parties formed their belief that the merger is substantively fair to the unaffiliated stockholders based upon the following material factors:

*Premium to Current and Historic Market Price.* The merger consideration of \$3.90 per share reflects a premium of approximately 53% over the \$2.55 closing price of ARV common stock on September 23, 2002, the day of ARV's announcement that it had received a preliminary transaction proposal from Prometheus. In addition, the \$3.90 per share price represents a premium of:

68% over the average closing market price of the ARV shares over the six-month period ending on September 23, 2002;

98% over the average closing market price of the ARV shares over the one-year period ending on September 23, 2002;

153% over the average closing market price of the ARV shares for the three-year period ending on September 23, 2002; and

4% over the closing market price of the ARV shares on January 3, 2002, the date of the announcement of the execution of the merger agreement;

*Possible Decline in the Market Prices of the ARV Shares if the Merger is not Completed.* The possibility that, if the merger is not completed, the market price of ARV common stock could decline. The closing price per share of ARV common stock on September 23, 2002, the day of the announcement of Prometheus' initial offer, was \$2.55.

*Limited Liquidity of ARV Shares, Absence of Transaction Costs.* The relatively low trading volume of the ARV shares—an average daily trading volume over the two-year period ending December 31, 2002 of 15,726 shares. The merger will provide ARV's unaffiliated stockholders with immediate liquidity for their shares without the usual transaction costs associated with open market sales.

*Summerville and HRC Proposals.* Although Summerville and HRC offered transactions at \$4.00 per share, both offers were subject to due diligence. Moreover, Summerville indicated that it would be unwilling to pursue further due diligence without a commitment by ARV to pay Summerville's due diligence expenses. As such, the Prometheus Parties believe there is considerable uncertainty as to whether those proposed transactions could have been entered into on the terms proposed within a reasonable time frame, if at all, even if Prometheus agreed to support those transactions. Moreover, the merger consideration of \$3.90 per share reflects a price of \$4.00 per share, reduced by \$.10 in light of the costs and expenses of the settlement of the GeriCare Matter.



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*No Dividends.* The fact that ARV has never paid any dividends in respect of its common stock and the Prometheus Parties' belief that, in light of ARV's level of existing indebtedness, its current inability to generate sufficient cash from operations to fund recurring working capital and capital expenditure requirements and a prohibition on dividend payments contained in an existing term loan agreement between ARV and an affiliate of Prometheus described below under *Interests of Certain Persons in the Merger* *Interests of Prometheus and its Affiliates*, ARV would be unlikely to pay dividends in the foreseeable future, including from the approximately \$11 million of ARV's working capital Prometheus expects to use to pay a portion of the merger consideration. The merger will afford ARV stockholders unaffiliated with Prometheus an opportunity to receive this cash in the form of merger consideration.

The Prometheus Parties believe that a significant portion of ARV's value is derived from factors which, under generally accepted accounting principles, or GAAP, are not reflected as assets on ARV's balance sheet and therefore are not reflected in ARV's net book value. These include leasehold interests and regulatory licenses held by ARV, ARV's experience operating assisted living communities, the skill and dedication of its personnel and the strong reputation of its ALCs. In addition, the Prometheus Parties believe a substantial portion of the value of these leasehold interests, licenses and other resources is realizable only in connection with the continued operation of ARV's business rather than in a liquidation. Moreover, consent requirements triggered by a transfer of the leases and licenses further limit their value in a liquidation. For these reasons, the Prometheus Parties did not consider the net book value or liquidation value of ARV to be a material factor in evaluating the fairness of the merger. The Prometheus Parties noted, however, that the net book value per share of ARV of \$2.75 per share as of September 30, 2002 is less than the \$3.90 per share price that ARV stockholders will receive in the merger. The Prometheus Parties did not determine a liquidation value for ARV. The Prometheus Parties also did not prepare a valuation of ARV on a going concern basis, in light of their intention to combine ARV with their other assisted living investments in Atria and Kapson.

The Prometheus Parties believe that the analyses and factors discussed above provide a reasonable basis upon which they formed their belief that the merger is procedurally and substantively fair to ARV's stockholders not affiliated with the Prometheus Parties. In view of the wide variety of factors considered, the Prometheus Parties did not find it practicable, and did not attempt, to quantify, rank or otherwise assign relative weight to the specific factors they considered in forming this belief. The discussion above of the analyses and factors considered and given weight by the Prometheus Parties is not intended to be exhaustive but is believed to include all material factors considered. In addition, the Prometheus Parties' belief should not be construed as a recommendation by the Prometheus Parties to ARV stockholders as to the manner in which they should vote with respect to the merger.

Prometheus intends to vote all of the ARV shares held by it as of the record date in favor of the merger.

## **Reasons, Purpose and Structure of the Merger**

ARV's purpose for the merger is to provide its stockholders who are not affiliated with Prometheus with immediate liquidity for their investment in ARV. ARV's shares of common stock have been trading at a relatively low trading volume. ARV believes that this is due to its relatively low market capitalization and share price and certain institutions' reluctance to invest in companies with low market capitalization or shares trading at low stock prices, the fact that Prometheus holds a large portion of the outstanding shares and ARV has not attracted meaningful analyst coverage. Additionally, trading

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volume of companies in the assisted living industry has been relatively low. The merger will provide ARV's unaffiliated stockholders with immediate liquidity at a specified price for their shares without the usual transaction costs associated with open market sales.

ARV considered strategic alternatives, including remaining a separate company while continuing to explore a merger or joint venture transaction with another party, and the significant challenges that ARV would face as an independent company if it did not proceed with the proposed merger. Because of the effect of adverse financial and competitive conditions in the assisted living industry and ARV's difficulty in obtaining favorable financing necessary to maintain and expand its business, ARV believes that the merger consideration of \$3.90 per share represents the highest likely value that our unaffiliated common stockholders could realize under any scenario available to us at this time based on our exploration of strategic alternatives as set forth in **SPECIAL FACTORS** Background of the Merger.

ARV is undertaking the transaction now primarily because it presents the most viable alternative for ARV at this time, the benefits of which may not be available to our unaffiliated stockholders in the future, and for the reasons set forth in **SPECIAL FACTORS** Background of the Merger and **Special Committee's and Board of Directors' Recommendation; Fairness of the Merger**.

ARV believes that obtaining \$3.90 per share in cash for its stockholders in the merger is preferable to attempting to achieve a future price in excess of that amount as an independent publicly traded company. ARV also believes that it is unlikely that a third party would be able to consummate a superior offer. The \$3.90 per share merger consideration represents a premium of approximately 53% over the \$2.55 closing price per share of its common stock on September 20, 2002, the last full trading day before the public announcement of Prometheus' initial proposal.

As part of the foregoing analysis, the Special Committee and board of directors considered other possible alternatives to engaging in a going-private transaction at this point in ARV's operating history. In addition, Cohen & Steers reviewed alternatives that were generally related either to continuing current operations or to seeking a merger or sale transaction with a strategic or industry partner. The Special Committee determined that each of the alternatives presented was subject to significant risks and uncertainties, and that none offered greater value to the stockholders who are not affiliated with Prometheus than the \$3.90 per share merger consideration.

The merger has been structured as a merger of Merger Sub with and into ARV in order to permit the acquisition of ARV in a single step and the preservation of ARV's identity. The merger was structured as a cash transaction because that was the consideration offered by Prometheus in its proposal.

Mr. Pasquale's reasons and purposes for the merger and the transaction structure are the same as those for ARV as described above.

Prometheus' purpose and reason for the merger is to enable it to combine ARV with its affiliates, Atria and Kapson. Prometheus believes that a larger combined company could achieve benefits of scale and would be likely to operate more efficiently and obtain the financing necessary to operate and expand its business on more favorable terms than could Atria, Kapson and ARV operating separately. Prometheus believes that this transaction can be achieved at this time because of recent changes in the capital structure and improvements to the financial results of Atria and Kapson as well as the anticipated availability to Prometheus of financing for a transaction.



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Although Prometheus considered the possibility of proposing that Atria, Kapson and ARV combine in a transaction in which ARV's public stockholders would receive stock in a combined company, Prometheus believes that, in the current market environment, the combined company could be operated more efficiently and have more flexibility obtaining financing if it were a privately held company. In addition, the combined company would avoid the administrative, legal, accounting and other costs associated with being a public company. Although Prometheus considered the possibility of selling its shares, it believes that, in light of its affiliates' investments in Atria and Kapson, the best interests of Prometheus and its affiliates would be served by Prometheus retaining its investment in ARV as part of their assisted living investment strategy. Moreover, as noted above, the Prometheus Parties believe that, in the current market, this strategy could be best pursued by combining ARV, Atria and Kapson.

### **Certain Effects of the Merger**

If the merger agreement is adopted and the merger is approved by ARV's stockholders and the merger is completed, ARV will be a privately held corporation and Prometheus will own 100% of ARV's outstanding common stock. Accordingly, no current ARV stockholders other than Prometheus will have any interest in, or be stockholders of, ARV, and no current ARV stockholders other than Prometheus will have the right to vote on corporate matters affecting the surviving corporation. In addition, no current stockholders other than Prometheus will benefit from any future earnings or growth of ARV or benefit from any increase in the value of ARV. However, other than Prometheus, no current stockholders will bear the risk of any decrease in value of ARV. Instead, upon completion of the merger, those stockholders will have the right to receive a payment of \$3.90 in cash, without interest, for each share of ARV common stock they hold (unless they perfect appraisal rights under Delaware law). See THE MERGER Dissenters' and Appraisal Rights for a description of the effect of perfecting appraisal rights.

If the merger is completed, Prometheus will own all of the equity interests in ARV and will benefit from any future earnings or growth of ARV and any increase in value of ARV; however, Prometheus will also bear the risk of any decrease in value of ARV.

ARV's common stock is currently registered under the Exchange Act. Upon the closing of the merger, ARV common stock will no longer be publicly traded or quoted on the American Stock Exchange and the registration of ARV common stock under the Exchange Act will be terminated upon application to the Commission. ARV will also be relieved of the obligation to comply with the proxy rules of Regulation 14A under Section 14 of the Exchange Act and, as described under Plans for ARV, the periodic reporting requirements of the Exchange Act and will cease filing information with the Commission. As a result, it is estimated that the surviving company will decrease its recurring annual costs by an amount of approximately \$250,000 because it will save the costs currently incurred in complying with its obligations as a public company including, but not limited to, investor relations and printing, legal, and accounting costs relating to quarterly and annual reports, proxy solicitations, and annual meetings and other expenses relating to compliance with the rules of the Commission.

Prometheus is having discussions with Mr. Pasquale regarding his potential employment in a senior position with ARV and a combined company including ARV, Kapson and Atria after the merger. There is no assurance that Prometheus and Mr. Pasquale will reach an agreement. Prometheus is evaluating the role ARV's current management will play in ARV and a combined company after the merger. Pursuant to the merger agreement, the directors of Merger Sub immediately prior to the merger

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will be the directors of the surviving corporation immediately after the merger. No determination has been made as to whether additional persons will be invited to join the board of directors of the surviving corporation following the merger. At the effective time, the certificate of incorporation and bylaws of ARV will be the certificate of incorporation and bylaws of the surviving corporation, with certain amendments to the certificate of incorporation.

The receipt of cash pursuant to the merger will constitute a taxable transaction for U.S. federal income tax purposes under the Internal Revenue Code of 1986, as amended, and may also constitute a taxable transaction under applicable state, local, foreign and other tax laws. For U.S. federal income tax purposes, a stockholder would generally recognize gain or loss in an amount equal to the difference between the amount of cash received by the stockholder pursuant to the merger and the stockholder's tax basis in the shares surrendered. If shares are held by a stockholder as capital assets, that gain or loss will be capital gain or loss. Any such capital gain or loss will be long-term if, as of the date of the disposition of its shares, the stockholder held such shares for more than one year or will be short term if, as of such date, the stockholder held such shares for one year or less.

## **Plans for ARV**

Prometheus intends, following the completion of the merger, to combine ARV with Atria, Inc. and Kapson Senior Quarters Corp. (also assisted living companies), subject to receipt of all necessary approvals and consents. The merger is not conditioned on this combination. Prometheus is having discussions with Mr. Pasquale, ARV's Chairman and Chief Executive Officer, regarding his potential employment in a senior position with the combined company. There is no assurance that Prometheus and Mr. Pasquale will reach an agreement.

Except as described above, Prometheus expects that the business and operations of the surviving corporation will be continued substantially as they are currently being conducted by ARV. Prometheus does not currently intend to dispose of any assets or operations of the surviving corporation other than in the ordinary course of business. Prometheus will continue to evaluate all aspects of the business, operations, capitalization and management of ARV prior to and following consummation of the merger and will take such further actions, if any, as it deems appropriate under the circumstances then existing.

Under the merger agreement, ARV's current certificate of incorporation will be amended so as to (i) not provide for a classified board of directors, (ii) decrease the number of authorized shares, (iii) provide that there will be no fewer than three and no more than five directors on the board of directors, (iv) not to prohibit stockholder action by written consent and (v) provide for other changes to reflect that ARV will not be a public company. Prometheus also expects to cause ARV's bylaws to be amended after the closing of the merger to reflect that ARV will not be a public company. ARV's directors and officers may be replaced in connection with, or at any time after, the merger.

Under the terms of the ARV's 6<sup>3</sup>/<sub>4</sub>% convertible subordinated notes due 2006, after the completion of the merger, the 6<sup>3</sup>/<sub>4</sub>% notes will no longer be convertible into shares of ARV. Instead, upon conversion of any 6<sup>3</sup>/<sub>4</sub>% note, the holders will receive an amount equal to \$3.90, the merger consideration being paid for each ARV share, multiplied by the number of ARV shares into which the 6<sup>3</sup>/<sub>4</sub>% note was convertible prior to the merger, without interest.

The terms of the 6<sup>3</sup>/<sub>4</sub>% notes would require ARV, within 30 days after completion of the merger, to mail to each 6<sup>3</sup>/<sub>4</sub>% noteholder an offer (a Change of Control Offer) to repurchase all or any



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portion of the holder's  $\frac{8}{4}\%$  notes at a purchase price equal to 101% of the principal amount of the holder's  $\frac{8}{4}\%$  notes plus accrued and unpaid interest. However, ARV has the right, at any time to redeem all or a portion of the  $6\frac{3}{4}\%$  notes then outstanding at the following redemption prices (expressed as percentages of the principal amount), together with accrued interest to the redemption date, if redeemed during the twelve month period beginning April 1:

<u>Year</u>	<u>Redemption Price</u>
2002	102.700%
2003	102.025%
2004	101.350%
2005	100.675%

Prometheus presently intends to cause ARV to redeem at the applicable redemption price set forth above all of the outstanding  $6\frac{3}{4}\%$  notes promptly after the completion date of the merger instead of making a Change of Control Offer.

As soon as practicable after completion of the merger, Prometheus will seek to cause the surviving corporation to delist its common stock from the American Stock Exchange and terminate registration of its stock under the Exchange Act.

In addition, prior to completion of the merger, Prometheus or one of its affiliates may, with the approval of the Special Committee and the board of directors, purchase outstanding  $6\frac{3}{4}\%$  notes in open market or privately negotiated transactions.

As of December 31, 2002, the last day of ARV's prior fiscal year, there were less than 300 registered holders of the  $\frac{8}{4}\%$  notes. Accordingly, after the termination of the registration of ARV's common stock, ARV would have the right, under the Commission's rules, to terminate its obligations to file reports with the Commission. However, under the terms of the  $6\frac{3}{4}\%$  notes, so long as any of the  $6\frac{3}{4}\%$  notes are outstanding, ARV is required to file with the Commission all quarterly and annual financial information required to be contained in a filing with the Commission on Forms 10-Q and 10-K. Accordingly, if and when the  $6\frac{3}{4}\%$  notes cease to be outstanding, ARV will no longer be required to file periodic reports with the Commission.

**Interests of Certain Persons in the Merger**

In considering the recommendation of the Special Committee to the ARV board of directors and the recommendation of the ARV board of directors to you, you should be aware that certain members of the ARV board of directors and some members of ARV's management have interests that are different from your interests as an ARV stockholder generally. This section of the proxy statement discusses all of the interests of ARV board members and ARV officers that are different from your interests as a stockholder generally and other than what is discussed below, there are no other agreements that relate to the voting of shares in this transaction. The ARV board of directors appointed the Special Committee, consisting solely of non-employee directors who are not officers, directors, or employees of Prometheus or its affiliates, to evaluate, negotiate and recommend the merger agreement and to evaluate whether the merger is in the best interests of ARV's stockholders who are unaffiliated with Prometheus. The Special Committee was aware of these differing interests and considered them, among other matters, in evaluating and negotiating the merger agreement and the merger and in recommending to the ARV board of directors that the merger agreement be adopted and the merger be approved. In addition, each of the members of ARV's board of directors was aware of these interests and considered them, among other matters, in approving the merger agreement and the merger.



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### *Special Committee*

The ARV board of directors determined that each member of the Special Committee would receive a fee of \$1,000 per material meeting as additional consideration for his service on the Special Committee, regardless of whether any proposed transaction was entered into or completed. As Chairman of the Special Committee, Mr. DeWald also receives \$750 per quarter. To date, Mr. DeWald and Mr. Collins have each received \$29,000 in fees for their services on the Special Committee. Neither member of the Special Committee will be employed by ARV or the combined company of ARV, Atria and Kapson after the merger.

### *Management of ARV Following the Merger*

Prometheus is currently having discussions with Mr. Pasquale, currently the Chairman and Chief Executive Officer of ARV, regarding his potential employment in a senior position with ARV and a combined company including ARV, Atria and Kapson after the completion of the merger. There is no assurance that Prometheus and Mr. Pasquale will reach an agreement. Prometheus is evaluating the role ARV's current management will play in ARV and a combined company after the merger. Mr. Pasquale, Abdo H. Khoury, ARV's President and Chief Financial Officer, and other members of our management are parties to employment agreements that will remain in effect following the merger.

Mr. Pasquale's employment agreement was amended in December 2002. The December 2002 amendment to Mr. Pasquale's employment agreement required ARV, before December 31, 2002, to pay Mr. Pasquale: (i) a cash amount representing all previously accrued and unused vacation paid at Mr. Pasquale's current base salary rate; and (ii) an Amendment Payment of \$440,000. Following these payments, Mr. Pasquale's vacation accrual began from a zero balance as provided in the agreement, and other payments potentially owed Mr. Pasquale as described below will be reduced by the amount of the Amendment Payment.

Mr. Pasquale's employment agreement provides that ARV may terminate Mr. Pasquale with cause (as defined in the employment agreement) without notice at any time. The employment agreement also provides that in the event ARV terminates Mr. Pasquale without cause (or Mr. Pasquale terminates the agreement for good reason including a substantial diminution of Mr. Pasquale's duties or title or relocation outside of Orange County) with fifteen (15) days prior written notice by making a payment to him equal to:

accrued base salary and vacation pay;

reimbursement of expenses through termination date;

accrued bonus for calendar year ending prior to termination date (if not yet paid);

an amount equal to his minimum bonus accrued since preceding July 1;

a lump-sum amount equal to three times the sum of current annual base salary plus target bonus;

a \$75,000 relocation payment; and

automatic vesting of all unvested stock options.

In connection with the December 2002 amendment, Mr. Pasquale received a \$440,000 Amendment Payment. Under the December 2002 amendment, a payment of the above items to Mr. Pasquale if ARV terminates him without cause (or Mr. Pasquale terminates the agreement for good reason ) is to be reduced by the amount of the Amendment Payment.

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The employment agreement further provides that if Mr. Pasquale voluntarily terminates his employment without good reason, he will receive his accrued and unpaid salary, vacation, minimum bonus and reimbursable expenses, plus a lump-sum payment equal to three months' base salary. The employment agreement provides that during its term and for one year thereafter, Mr. Pasquale cannot directly or indirectly engage in or render services to any business or activity that is competitive in any manner with ARV or any of its affiliates in the business of assisted living or long-term health care. This covenant not to compete is not applicable in the event of a termination without cause or a change in control, or in the event Mr. Pasquale voluntarily terminates his employment without good reason and first waives in writing his right to all severance pay other than accrued and unpaid salary, vacation, minimum bonus and reimbursable expenses.

### *Change in Control Arrangements*

To better assure that Mr. Pasquale and Mr. Khoury would continue to provide independent leadership consistent with ARV's best interests in the event of an actual or threatened change of control of ARV, the employment agreement of each provides certain protections in the event of a change in control.

Mr. Pasquale's employment agreement also provides for certain protections in the event of a change of control. Mr. Pasquale's employment agreement defines a change of control as any of the following:

*Change in Ownership of ARV:* either (a) the date any person or group acquires the beneficial ownership of 50% or more of the combined voting power of ARV's outstanding voting securities; or (b) the date that any person or group other than Prometheus Assisted Living LLC, an affiliate of Lazard Frères Real Estate Investors L.L.C., acquires 20% or more of the voting power of ARV's outstanding voting securities; or

*Change in Effective Control of ARV:* either (a) the date any person or group acquires the beneficial ownership of capital stock of ARV possessing 50% or more of the total voting power of ARV's capital stock; or (b) the replacement of a majority of the members of the Board during any 12 month period by directors whose appointment or election was not endorsed by a majority of the members of the Board prior to the date of such appointment or election; or

*Change in Ownership of Substantial Portion of ARV's Assets:* the date on which any person or group acquired assets from ARV that have a total fair market value equal to or more than 33 1/3% of the total fair market value of all of ARV's assets immediately prior to the acquisition.

Following a change of control, If Mr. Pasquale terminates his employment for any reason within the period beginning six (6) months after the change of control and ending twelve (12) months after the change of control, or if his employment is terminated by ARV (with or without cause) at any time during the twelve-month period following the change of control, then ARV is required to pay him the excess, if any, of (A) the sum of (i) three times the sum of his current annual base salary plus target bonus; (ii) his accrued and unpaid base salary, vacation pay, and reimbursable expenses; (iii) his bonus, if any, for the calendar year ended prior to the date of termination (if not yet paid); (iv) an amount equal to his minimum bonus accrued since the previous July 1; (v) a relocation payment of \$75,000; and (vi) reimbursement for the cost of outplacement services, up to a maximum of \$50,000, or a payment of \$50,000, at the election of Mr. Pasquale over (B) \$440,000. In addition, as of the date of the change in control, all of Mr. Pasquale's stock options become fully vested, regardless of whether he remains employed by ARV.



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Mr. Pasquale's employment agreement provides that, if a change in control occurs either (i) prior to June 30, 2003 or (ii) pursuant to an agreement entered into prior to March 31, 2003, the change in control payments described above will be reduced, if necessary, so that no portion of such payments will be deemed to be an excess parachute payment under Section 280G of the Code.

For Mr. Khoury, a change of control is defined to include the following events:

*Change in Ownership of ARV:* the date that any person or group acquires the beneficial ownership of 50% or more of the voting power of ARV's outstanding voting securities; or

*Change in Effective Control of ARV:* either (a) a person or group acquires the beneficial ownership of capital stock of ARV possessing 50% or more of the total voting power of ARV's capital stock or (b) a majority of the members of the Board are replaced during any 12-month period by directors whose appointment or election was not endorsed by a majority of the members of the Board prior to the date of such appointment or election; or

*Change in Ownership of a Substantial Portion of ARV's Assets:* the date on which any person or group acquires assets from ARV that have a total fair market value equal to or greater than 33 1/3% of the total fair market value of all of ARV's assets immediately prior to such acquisition.

Following a change of control, if Mr. Khoury terminates his employment with ARV for any reason within the period beginning six months after the change in control and ending nine months after the change of control, or if his employment is terminated by ARV (with or without cause) within nine months after the change in control, ARV is required to pay the sum of the following amounts:

his accrued and unpaid base salary;

his accrued and unpaid vacation pay;

his bonus, if any, for the calendar year ending prior to the date of termination (if not yet paid);

a salary payment equal to one and one-half times his annual base salary if he terminates his employment, or two times his annual base salary if ARV terminates his employment; and

his unreimbursed expenses incurred through the date of the change of control.

Mr. Khoury's employment agreement provides that the change in control payments described above will be reduced, if necessary, so that no portion of such payments will be deemed to be an excess parachute payment under Section 280G of the Code.

In addition, as of the date of the change of control, all of Mr. Khoury's stock options become fully vested, regardless of whether he remains employed by ARV.

ARV has no outstanding loans to any of its executive officers.

*Allocation of Consideration Among Executive Officers and Directors of ARV; Treatment of Stock Options*

As of the record date for the special meeting, ARV's directors and executive officers, excluding Messrs. Larson and Moore who are affiliates of Prometheus, owned 665,974 shares of ARV common stock, or approximately 3.8% of the outstanding shares. Additionally, they collectively have options to purchase 2,075,000 shares of ARV common stock at a weighted average exercise price per share of \$1.6484. The directors and executive officers will receive the same consideration for their shares of ARV common stock as the other stockholders of ARV. See SECURITY OWNERSHIP OF

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CERTAIN PERSONS for information regarding the current executive officers and directors and their stock ownership in ARV. Prometheus and its affiliates, including Messrs. Larson and Moore who may be deemed to beneficially own the shares of ARV stock owned by Prometheus, will not receive the \$3.90 per share merger consideration.

Immediately prior to the effective time of the merger, all unexpired and unexercised options or similar rights to purchase shares of ARV common stock, whether or not then exercisable, will be cancelled. In exchange for such cancellation, each former holder will be entitled to receive a cash payment, without interest, equal to the excess, if any, of the \$3.90 per share cash consideration over the exercise price per share of the cancelled options, multiplied by the number of shares of ARV common stock subject to the options, less any applicable withholding taxes.

The aggregate amount to be paid to ARV's directors and executive officers for their outstanding stock options is expected to be approximately \$4,622,190, before taxes and other withholding. The following table sets forth the cash amounts, before taxes and any withholding, that the executive officers and directors of ARV are expected to receive in respect of their stock options upon completion of the merger:

Name	Shares Subject to Options	Exercise Price	Proceeds to be Received in Merger From	
			Options(1)	
Douglas M. Pasquale	1,250,000	\$ 1.6706	\$	2,786,750
Abdo H. Khoury	575,000	\$ 1.6836	\$	1,274,430
William R. Eason	65,000	\$ 1.0269	\$	186,750
John A. Moore	0	\$ 0	\$	0
Robert C. Larson	0	\$ 0	\$	0
David P. Collins	30,000	\$ 1.5233	\$	45,699
Maurice J. DeWald	30,000	\$ 1.5233	\$	45,699
Douglas Armstrong	62,500	\$ 1.7680	\$	133,250
Christine A. Kasulka	62,500	\$ 1.5062	\$	149,612
Total			\$	4,622,190

- (1) Calculated by multiplying the number of shares subject to option by the excess, if any, of the \$3.90 per share cash consideration over the exercise price of the options.

*Interests of Prometheus and Its Affiliates**Prometheus Settlement Agreement*

On September 29, 1999 Prometheus and certain of its affiliates and ARV agreed to settle all outstanding actions between the parties and to provide mutual releases of certain claims that the parties had against each other. Prometheus and certain of its affiliates accepted a promissory note for \$1.5 million in connection with the settlement of its claims. As part of the settlement agreement, the board of directors was reduced to

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five persons, with Prometheus having the right to nominate two directors. Under the terms of the settlement agreement, Prometheus is entitled to participate for an amount up to 35.8% of any sale by ARV of equity or equity linked securities. Under this agreement, except under limited circumstances, Prometheus may not purchase additional shares of ARV's common stock unless ARV first receives a fairness opinion. This agreement would not apply to acquisitions of ARV shares by Prometheus, at any time after, among other things, ARV, its board of

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directors or any committee of its board of directors authorizes the solicitation of offers or indications of interest with respect to a business combination transaction or a bidder submits a written proposal of indication of interest with respect to an acquisition of, or business combination with, ARV, unless ARV's board of directors rejects the proposal as soon as practicable.

### *Loan by Prometheus Affiliate to ARV and Warrant Granted to Prometheus Affiliate*

On April 24, 2000, ARV entered into a Term Loan Agreement with LFSRI II Assisted Living LLC ( LFSRI II AL ), an affiliate of Prometheus. Pursuant to the Term Loan Agreement, ARV was permitted to borrow up to \$10 million from LFSRI II AL. The loan had a maturity date of April 24, 2002, which, subject to certain conditions, could be extended by one year if no default had occurred. The loan bears interest at a rate equal to the LIBOR rate for each interest period plus 10%, and among other things, prohibits ARV from paying dividends. In connection with the Term Loan Agreement, ARV issued to LFSRI II AL a warrant to purchase up to 750,000 share of ARV common stock at a price of \$3.00 per share, subject to various adjustments, exercisable until April 24, 2005. ARV borrowed the full \$10 million under the Term Loan Agreement. On April 24, 2002, for a fee of \$250,000, the parties amended the existing \$10.0 million term loan to: (i) increase the principal amount by \$1.5 million to \$11.5 million, (ii) decrease the interest rate to LIBOR plus 9.54% payable monthly and (iii) extend the maturity date to July 1, 2004, with principal payments of \$1.5 million due on each July 1 until maturity. The proceeds of \$1.5 million were used to pay off the note payable to Prometheus of \$1.5 million that was issued in connection with the Prometheus settlement agreement.

### *Pledge of Securities*

Prometheus has pledged all of its ARV shares as security for the repayment of borrowings under the Loan Agreement referred to below under THE MERGER Financing of the Merger. In addition, LFSRI II AL has pledged its interest in the warrant and loan to ARV referred to above as security for the repayment of borrowings under the Loan Agreement referred to below.

### *Confidentiality Agreement*

On October 7, 2003, Prometheus executed a confidentiality agreement with ARV. This agreement prohibits Prometheus from, among other things, acquiring shares of ARV common stock for one year, without approval from ARV, unless ARV enters into an agreement with respect to, or another party announces an intention to effect, a business combination transaction, including any tender offer for ARV shares, with ARV or acquires 15% or more of ARV's shares. If the restrictions under the confidentiality agreement and the settlement agreement on purchasing additional shares no longer applied, then Prometheus could purchase, without first obtaining ARV's approval, additional ARV shares and become the beneficial owner of up to 50% of ARV's outstanding common stock without triggering ARV's stockholder rights plan.

### *Stockholders Rights Plan*

In May 1998, we adopted a Rights Agreement that established a stockholders rights plan under which we have declared a dividend distribution of one Preferred Share Purchase Right on each outstanding share of our common stock. Subject to limited exceptions, the Rights will be exercisable if a person or group acquires 10% or, in the case of Lazard Frères Real Estate Investors L.L.C. or its affiliates, including Prometheus, 50% or more of our common stock or announces a tender offer for



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10% or, in the case of Lazard Frères Real Estate Investors L.L.C. or its affiliates, 50% or more of the common stock, and such merger or other business combination transaction has not been approved by our board of directors.

On April 24, 2000, we amended the Rights Agreement to prevent shares that Prometheus may be deemed to beneficially own by reason of Lazard Frères Real Estate Investors L.L.C.'s rights under the warrant from causing Prometheus to become an Acquiring Person and thus causing a triggering event under the Rights Agreement.

In accordance with the merger agreement, we amended the Rights Agreement to provide that prior to the termination of the merger agreement, Prometheus, or any of its affiliates, would not be deemed to beneficially own the common shares beneficially owned by any of the officers, directors or employees of ARV or its subsidiaries, and the officers, directors and employees of ARV and its subsidiaries would not be deemed to beneficially own the common shares owned by any other officer, director or employee of ARV or any of its subsidiaries or by Prometheus or any of its affiliates.

Additionally, in order so as not to cause a triggering event under the Rights Agreement, our board of directors approved the merger of ARV with Merger Sub.

### *Insurance; Directors' and Officers' Indemnification*

ARV presently maintains a directors' and officers' liability insurance policy. For six years after the closing of the merger, the merger agreement requires the surviving company to provide for each current and former director and officer of ARV a directors' and officers' liability insurance and indemnification policy that provides coverage for events occurring prior to the merger. This policy shall be no less favorable than ARV's existing policy, provided that the average annual premium for such policy does not exceed 200% of ARV's current annual premium or the total cost for that coverage for the six year period does not exceed \$1,505,100.

In addition, all right to indemnification existing in favor of the directors and officers of ARV as provided in ARV's certificate of incorporation as of the date of the merger agreement will survive the merger. Such indemnification will continue in full force and effect and not be amended, appealed, or otherwise modified in any manner that would adversely affect the rights of anyone entitled to indemnification thereunder (unless such amendment or modification is required by law) for a period of six years after the merger, all in accordance with, and subject to, applicable law.

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**SPECIAL MEETING OF STOCKHOLDERS**

**General**

ARV's board of directors is furnishing you with this proxy statement to solicit your proxy to be voted at the special meeting of stockholders to be held on April 23, 2003 and at any adjournments or postponements thereof.

**Matters to be Considered at the Special Meeting**

At the special meeting, holders of ARV common stock will be asked to vote upon a proposal to adopt the merger agreement attached to this proxy statement as Appendix A and approve the merger contemplated in the merger agreement and to vote on any other matter that properly comes before the special meeting. Pursuant to the merger agreement, Merger Sub will merge with and into ARV, and ARV will become a wholly owned subsidiary of Prometheus. Each outstanding share of ARV common stock held by stockholders other than Prometheus, ARV, ARV's subsidiaries, and those who have perfected appraisal rights pursuant to and in accordance with Delaware law will be converted into the right to receive \$3.90 in cash, without interest. Each outstanding option to purchase ARV common stock will be cancelled and converted into the right to receive the excess, if any, of the \$3.90 per share merger consideration over the exercise price per share of such option, multiplied by the number of shares subject to such option, less any applicable withholding taxes.

**Date, Place and Time**

The special meeting will be held on April 23, 2003 at the Airport Hilton, 18800 MacArthur Boulevard, Irvine, California 92715 at 9:00 a.m., local time.

**Record Date, Voting Rights, Quorum and Revocability of Proxies**

If you owned ARV common stock at the close of business on March 27, 2003, the record date for the special meeting, you are entitled to notice of and to vote at the special meeting. On the record date, there were 17,459,069 shares of ARV common stock issued and outstanding held by approximately 1,636 holders of record. At the special meeting, each ARV stockholder will be entitled to one vote for each share of ARV common stock owned by such stockholder on the record date. The holders of a majority of the shares of ARV common stock outstanding as of the record date must be present in person or by proxy in order for a quorum to exist at the special meeting.

Brokers who hold shares in "street name" for customers who are the beneficial owners of such shares may not give a proxy to vote those shares to adopt the merger agreement and approve the merger without specific instructions from their customers.



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Properly executed proxies that ARV receives before the vote at the special meeting that are not revoked will be voted in accordance with the instructions indicated on the proxies. If no instructions are indicated, such proxies will be voted FOR the proposal to adopt the merger agreement and approve the merger, and the proxy holder may vote in his discretion as to any other matter that may come properly before the special meeting.

Any stockholder who has given a proxy solicited by the board of directors may revoke it at any time prior to its exercise at the special meeting by:

giving written notice of revocation to the secretary of ARV;

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properly submitting by mail to ARV's secretary a duly executed proxy bearing a later date; or

attending the special meeting and voting in person.

All written notices of revocation and other communications with respect to revocation of proxies should be sent to:

ARV Assisted Living, Inc.

245 Fischer Avenue, Suite D-1

Costa Mesa, CA 92626

Attention: Douglas Armstrong, Secretary

On the record date, Prometheus owned 7,595,069 shares, or 43.5%, of the outstanding shares of ARV common stock. ARV's directors and executive officers who are not affiliated with Prometheus, including their immediate family members and affiliated entities, owned 665,974 shares, or approximately 3.8%, of the outstanding shares of ARV common stock, or approximately 6.8% of the non-Prometheus shares entitled to vote on the proposal to adopt the merger agreement and approve the merger. This number does not include unexercised options to purchase ARV common stock.

A list of stockholders entitled to vote at the special meeting will be available for inspection at ARV's main office during regular business hours at least 10 days before the special meeting, as well as at the special meeting.

## **Required Vote, Abstentions and Broker Non-Votes**

Under Delaware law, adoption of the merger agreement and approval of the merger requires the affirmative vote of the holders of a majority of all shares of ARV common stock outstanding on the record date. Prometheus owns approximately 43.5% of the outstanding shares of ARV common stock, as of the record date, and has indicated that it intends to vote in favor of the adoption of the merger agreement and approval of the merger. Your vote is important to the adoption of the merger agreement and approval of the merger, which are conditions to the completion of the merger.

Any abstention or broker non-vote will have the same effect as a vote against adoption of the merger agreement and approval of the merger under this condition to closing of the merger.

## **Solicitation of Proxies and Expenses**

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ARV will solicit proxies through the mails and has requested brokerage firms, nominees, custodians, and fiduciaries to forward proxy materials to the beneficial owners of shares held of record by them. In addition to the solicitation of proxies by mail, ARV's directors, officers, and regular employees may solicit proxies in person, by telephone, or facsimile, but ARV will not pay them any additional compensation for doing this, except for reimbursement of reasonable out-of-pocket costs.

ARV has retained Georgeson Shareholder Communications, Inc. to assist in the solicitation of proxies, for which Georgeson Shareholder Communications will be paid a fee of approximately \$7,500 and reimbursed for their expenses.

ARV will bear all costs and expenditures related to the solicitation of proxies for the special meeting. Such costs and expenditures shall include fees for attorneys, accountants, public relations or financial advisors, solicitors, advertising, printing, transportation, and other costs incidental to the solicitation.

**Table of Contents****SUMMARY FINANCIAL DATA**

The following summary financial data has been extracted from, and should be read in conjunction with, our audited consolidated financial statements and other financial information contained in ARV's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, including the notes thereto. The comparability of the following summary financial data to the financial information contained in such annual report is impacted by the fact that such report reflects in more detail the acquisition of public partnership interests, the early extinguishment of debt and other unusual items. More comprehensive financial information (including management's discussion and analysis of financial condition and results of operation) is included in such annual report, and the following summary is qualified in its entirety by reference to such report and all of the financial information and notes contained therein. Our Annual Report on Form 10-K for the fiscal year ended December 31, 2002 is being delivered to stockholders together with this proxy statement and is incorporated by reference in this proxy statement. See **AVAILABLE INFORMATION**. Copies of such report may be inspected or obtained at the website of the Commission, [www.sec.gov](http://www.sec.gov).

	For Year Ended December 31,				
	2002	2001	2000	1999	1998
	(In thousands, except per share data)				
Income Statement Data:					
Total revenue	\$ 158,378	\$ 145,395	\$ 138,865	\$ 138,179	\$ 128,425
Total operating expenses	148,282	139,387	147,560	159,768	167,985
Income (loss) from operations	10,096	6,008	(8,695)	(21,589)	(39,560)
Income (loss) before extraordinary items, discontinued operations and change in accounting principle	(3,263)	(1,090)	(14,101)	(33,425)	(46,811)
Net income (loss)	\$ (3,263)	\$ 972	\$ 6,512	\$ (27,665)	\$ (45,981)
Basic and diluted earnings (loss) per common share:					
Income (loss) before extraordinary items, discontinued operations and change in accounting principles	\$ (0.19)	\$ (0.06)	\$ (0.81)	\$ (2.09)	\$ (2.95)
Net income (loss)	\$ (0.19)	\$ 0.06	\$ 0.38	\$ (1.73)	\$ (2.90)
Weighted average common shares outstanding	17,460	17,460	17,357	15,968	15,866
Ratio of earnings to fixed charges	0.83	0.93			