

Financial Health of Tarzana Treatment Center

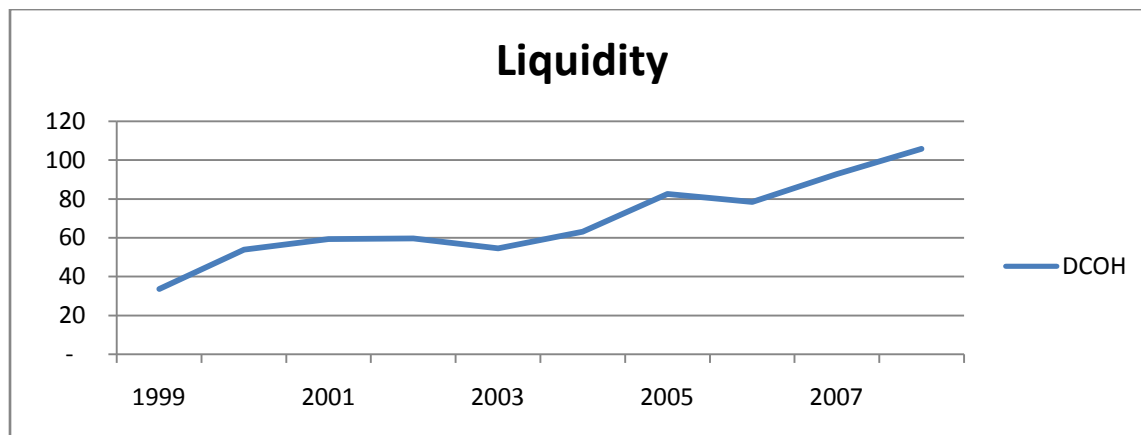
Our analysis of Tarzana’s finances over the past ten years leads us to believe that it was well positioned to buy the properties directly, as opposed to renting them. Standard & Poor’s, a leading credit rating agency, analyzes the revenue and income trends, operating margin, liquidity, and debt burden of an organization in order to assign it a credit rating, which determines access to bonds and interest rates for those bonds.¹ Based on our analysis of available data, Tarzana’s financial performance on all accounts has been solid over the past 10 years.

Operating Margin: Consistent Net Income and Revenue Growth

Tarzana has consistently generated net income every year for the past 10 years, averaging \$1.5 million per year in net income, the equivalent of profit in the non-profit sector. This translates into an average operating margin of 4.6%.² It is our experience that this level and consistency of profitability is rare for non-profits in this industry. In addition, total revenue tripled; another key factor credit rating agencies consider.

Liquidity: Growing cash on hand

Cash and Investments (the liquid portion of assets) increased by an enormous 646%, from \$1.6 million to \$12.3 million, well outpacing the increase in revenue. Days Cash on Hand (DCOH)– the common metric used to capture liquidity – tripled over the past 10 years. In 1998, the year Tarzana qualified for a low-interest bond, it had 33 DCOH. In 2006, it had over doubled that figure to 79 DCOH and for the most recent financial filing, Tarzana has over 100 DCOH.³



¹ “Criteria Governments US Public Finance: Human Service Providers.” Standard & Poor’s. June 13, 2007. P.3.

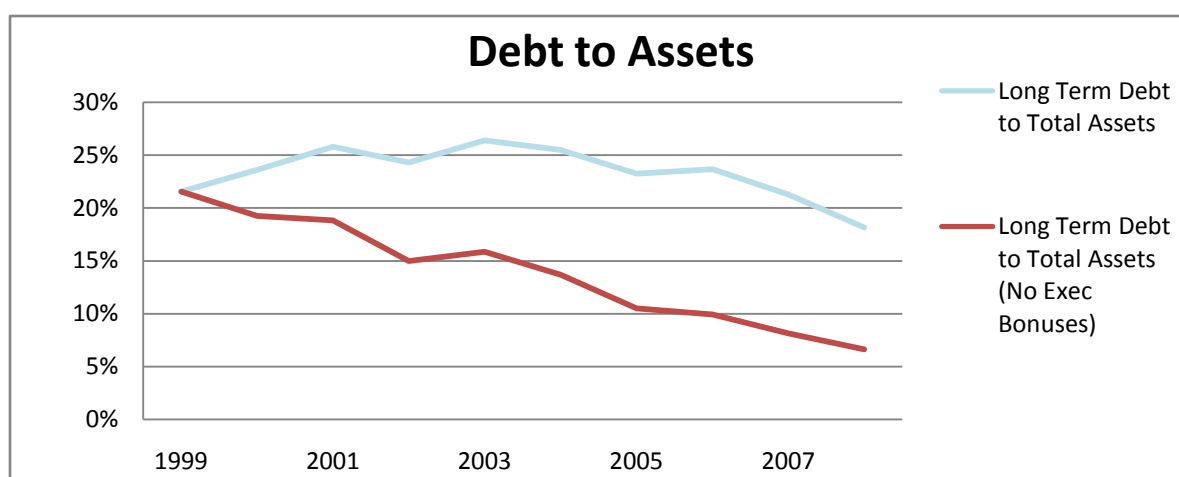
² Profit margin and operating margin are the same for this organization.

³ IRS Form 990, Tarzana Treatment Center FY1998-2008.

Debt structure: Capacity very strong despite bonuses to top executives

While revenues and assets consistently grew, long-term debt from mortgages decreased. ⁴ Total long-term debt increased only because the Board of Directors granted senior executives, in total, \$4.2 million in rights to future deferred compensation with just under \$1 million of that having been paid out in recent years. Our review of similarly sized non-profits funded largely through public dollars found that none of Tarzana's competitors has such a plan.

Even with these large and unusual grants to senior executives, long term debt as a percentage of total assets has declined over the last ten years and even more so when deferred executive bonuses are taken out of the equation. In other words, Tarzana would have been in an even better position to take on more debt if it had not negated assets to cover the deferred executive compensation, as illustrated in the chart below.



Source: IRS form 990 for Tarzana Treatment Center FY1999 through FY2008

Ideally we would like to have calculated debt service coverage ratio, but without access to all ten years of audited financial statements, this was impossible. Thus, we do not have enough information to say definitively what Tarzana's credit rating would be. But we can examine the experiences of another non-profit, slightly larger than in Tarzana, in the same market. This non-profit, The Help Group, less than a month ago was awarded an "A" credit rating by Standard and Poor's and was approved by the California Health Facilities Financing Authority for a \$6,000,000 bond.⁵

⁴ Although total long-term debt increased overall, the increase is attributable to deferred compensation for executives. In other words, an argument claiming that taking on additional long-term debt was unwise during this time period essentially says that the organization could have afforded to invest in long-term stability through property if it did not have such generous executive compensation packages.

⁵ CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY (CHFFA) BOND FINANCING PROGRAM EXECUTIVE SUMMARY, for The Help Group ("THG"). Resolution Number 345. June 25, 2009. <http://www.treasurer.ca.gov/chffa/staff/20090625/345.pdf>