

Can Real Estate Derail Your Buy-Side M&A Transaction?



*Advisors to CFOs,
Management & Boards*

When companies consider engaging in a buy-side M&A transaction, “Management often waits until a potential acquisition target is identified — or until negotiations are well under way or even completed — before analyzing the real estate considerations,” observes Andrew Zezas, Strategist & CEO of Real Estate Strategies Corporation, a New Jersey-based corporate real estate advisory and transaction services firm. “An acquirer’s interests would be better served if they addressed real estate issues even before they identify a potential acquisition.

Zezas, who has advised corporate occupants on real estate matters since 1985, says that, given the strategic role of real estate assets, “It is vital to consider, early on, not only how an acquisition will be integrated from an operating and financial perspective, but also from a real estate perspective...and how existing real estate could enhance or derail a buy-side transaction.”

EARLY STAGE STRATEGY

He says to start by assessing your company’s existing real estate — whether leased, or owned, or otherwise — and consider how real estate might positively or negatively affect an intended transaction from an operating, financial, or risk-based perspective.

“In acquisitions, it’s imperative to address how real estate is controlled and by what transaction structure — such as ownership, short- or long-term leases, or ventures. It is essential to take into account matters such as transactional flexibility; redundant and/or functionally obsolete facilities,” he notes. “Also, consider how your company may need to modify the target’s real estate, or your own, to align with your operational objectives for the transaction; or whether it may make more sense to move some or all of your operations into real estate that is owned or leased by the target company, and dispose of or monetize surplus properties.”

Zezas — who is also Host, Publisher & CEO of *CFO Intelligence* — suggests running a variety of what-if scenarios. “Such as, ‘what if’ we currently don’t have enough space? How much space we would need after an acquisition?” he says. “Or, ‘what if’ we need to acquire more or different facilities, or space in different geographies, as the result of an acquisition? Or, ‘what if’ we anticipate the need to shed some facilities after an acquisition?”

A successful buy-side M&A transaction involves more than integrating operations, he adds. “Real estate is expensive and transactions can often be inflexible. Real estate, whether considered intelligently or planned poorly, can respectively support or thwart most transactions,” Zezas explains. “When potentially impactful operating or financial issues such as real estate are identified early, your company can greatly reduce risk by developing robust advanced solutions in anticipation of potential challenges, so as to ensure the success of your intended deal.”

LOOK UNDER THE COVERS

Once a potential acquisition is identified, it’s “time to look under the covers,” says Zezas. “At this stage, your company can evaluate the target’s real estate assets and liabilities, and decide which ones should be acquired and retained and which should not. It is important to recognize that some real estate assets may not be useful from an operational perspective, but may be useful from a financial perspective. So, your company may wish to acquire select owned facilities or, in some cases, leased assets as part of the deal, and then sell or otherwise dispose of specific properties at additional profit.”

Even if your company does not want to retain certain properties, it’s still important to gain an understanding of their value as early as possible, he notes. “If you exclude certain properties from your acquisition, then the seller may retain or dispose of them, post-transaction. Such an approach may have an impact on the valuation and terms of your deal.”

Besides determining the value of the target’s real estate, it’s important to determine how your company will control them.

“If the target company owns the real estate directly — under the same entity that is being acquired — the decision to

Andrew Zezas

Strategist & CEO, Real Estate Strategies Corporation

accept or reject those properties is generally straightforward," he explains. "But what if your company wants to retain the assets and the target leases them? Is it more advantageous to try to purchase the assets, or to accept or renegotiate the existing leases, or purchase the assets and then lease them back to the operating company? Before taking any action, a variety of issues should be considered, including operations, and the effect on the balance sheet and taxes."

Zezas also addresses the issue of integrating the target's real estate assets with the acquiring company's operations. "Your company will want to determine how well the assets fit with the needs of employees and the expectations of existing customers," he says. "And adjacency of those properties to your company's inventory — raw material, work in progress, and finished goods — and the proximity of the to-be-acquired real estate to your company's existing facilities."

Additional considerations include the structure of leases. "What's important is understanding the services provided by the landlord, financial obligations of all parties, and whether there exist rights and options that contain reasonable terms, and whether hidden risks can be lurking in those transactions, advises Zezas."

Any furniture, fixtures and equipment should be reviewed and analyzed, Zezas advises. "Will the useful life of the FF&E — including heating and air conditioning that sits on

the roof — reach an end in the short term? For manufacturers, in particular, determine whether it may be more cost effective to simply secure a facility with new HVAC and other FF&E."

In some cases, he cautioned, the target company's facilities and FF&E may match up with the acquirer's needs, but the lease may not be structured in an optimum manner. "That's not necessarily a deal killer," Zezas says. "First, consider whether the lease is material to the transaction, in terms of the lease size or strategic nature. If it is, determine whether the lease can be restructured. If the lease is of minor importance, relative to the overall transaction, it may not be much of an issue. Either way, this analysis should be done well before the deal is closed."

A successful, effective acquisition strategy often hinges on successfully deploying real estate assets and liabilities, notes Zezas. "Starting your company's negotiations with a plan in place that accounts for the deployment of real estate — and how it integrates with your company's existing portfolio — before going to market in search of acquisitions is extremely important," he explains. "Engaging in an initial investigation before identifying a target acquisition will make it a lot easier to take a 'deep dive' quickly, once a viable candidate is uncovered."

Real estate transactions do not have to be a stressful component of an acquisition

INSIGHTS



transaction, he adds. "Engaging an advisor with expertise in real estate strategy, portfolio and transaction planning and execution, law, finance, site selection, labor and demographics, workplace solutions, logistics, and in other disciplines, can help companies to achieve their overall M&A objectives," Zezas counsels. "Whether it's an acquisition, corporate restructuring, avoiding bankruptcy, or navigating through bankruptcy proceedings, advanced real estate planning can enhance your company's ability to prepare for negotiations, adhere to legal and other regulations, anticipate change, and enhance your eventual outcomes."

