

Advanced Real Estate Planning Before Going to Market: A Sell-Side M&A Discussion



*Advisors to CFOs,
Management & Boards*

PROTECTING ENTERPRISE VALUE

The right real estate, flexibly structured to support alternative buyer deal hypotheses, can accelerate a sell-side M&A; but failure to plan in advance can delay or derail a transaction. An early real estate assessment can make a big, positive difference. Putting in place alternate real estate plans can minimize the risk of delay or derailment of the right deal.

Real estate is often one of the most significant assets on a company's balance sheet and is often overlooked in M&A until much too late. Its role in M&A transactions can vary widely, depending on the nature of the business and the specific deal hypothesis. A company with owned or leased facilities may find that these assets are either a strategic advantage or a potential obstacle, depending on the buyer's preferences and intended use of the properties.

Prior to going to market — whether the planned transaction is for a corporate-wide sale or for the divestiture of a subsidiary, division or other component — focused executives should intelligently assess how real estate might positively or negatively affect the transaction. CFOs and others should be aware of the dangers of waiting until after the LOI is executed or after closing to identify risk (which tends to get worse the longer you wait) and their ability to capture opportunity (which tends to diminish and be lost the longer you wait).

When a large, publicly traded U.S. company decided to divest of a significant subsidiary, it quickly found the right buyer and negotiated attractive terms. But negotiations hit a snag at the 11th hour when the buyer demanded a carve-out for the subsidiary's headquarters: a large West Coast office building.

Left with little choice and anxious to close the deal, the seller reluctantly agreed to exclude the office tower from the transaction — got seriously dinged on the value of the sale of the company — and ultimately executed a fire sale for the office tower, disposing of it for a figure that was more than 40% lower than the price it should have fetched. A prepared "Plan B" would have gone a long way toward preserving the seller's ability to achieve overall Enterprise Value on the business sale, and in separately selling the associated real estate at their respective highest prices, without having to resort to last-minute scrambling and a significant diminution of value.

Regardless of the specifics of a planned divestiture — whether selling the entire company, components of the organization; carve-outs, subsidiaries, business units or, for a private equity

group, disposing of portfolio companies — prudence demands that viable real estate alternatives be planned in advance of going to market. If one or more misalignments are identified, either modify the underlying real estate by making physical alterations, or restructuring transactions, or developing alternative plans and having them ready to present to potential buyers. This approach will better ensure alignment between your company's deal objectives and those of expected buyers. Planning ahead of time would minimize deal risk and enhance the ability to achieve the seller's objectives.

The goal is to intelligently plan for possible alternatives in advance as a means of supporting deal hypotheses and executing the real estate components of the intended transaction in a way that would maximize enterprise value and minimize deal-related risk. Too often, sellers go to market first, then wait until they're close to signing a deal before considering the real estate implications of their deal. This can lead to greater risk, lower sale valuations, and missed opportunities.

DRILL INTO THE DETAILS

Financial buyers, such as private equity firms, typically have an exit strategy of five to seven years, and generally seek to keep existing operations and facilities in place, while seeking to drive efficiencies.

On the other hand, strategic buyers may be more interested in aligning the acquired real estate assets, whether leased or owned, with those of their own. A strategic buyer may seek to achieve vertical integration — such as extending their operations within their supply chain, so they can reduce their reliance on outsourcing. As a result, the strategic buyer may want to acquire your company to further their own horizontal expansion, perhaps, in part, to avail itself of the real estate your company occupies.

However, a strategic buyer may be selective about not acquiring certain facilities occupied by your company due to duplication, functional obsolescence, geography, or otherwise. It is for such reasons that creating real estate alternatives before going to market are essential to the success of sell-side deals.

EARLY IDENTIFICATION OF RISKS AND OPPORTUNITIES

- **Facility Efficiency:** Assess whether current facilities are efficient or if there are opportunities for consolidation. If duplicate facilities or excess facility capacity exists, it may make sense to dispose of some facilities and consolidate before going to market.
- **Potential Issues:** Identifying and addressing potential issues early in the process can prevent them from becoming deal-breakers later on. This includes assessing any operating, regulatory, or compliance issues.
- **Lease Terms:** If a proposed sell-side deal includes properties under lease by third-party landlords, address lease terms and the possibility of renegotiating those terms or exiting those leases, in advance. Issues can include whether the buyer can take over your existing lease — if the remaining lease obligation aligns with the buyer's business plans — or if the lease terms can be renegotiated. Getting landlords on board early can prevent a last-minute scramble, deal derailment, or costly and aggressive landlord negotiating tactics.
- **Owned Properties:** If owned real estate may be part of a sale, consider whether they will likely be central to ongoing

operations for the buyer. If not, then removing them from the deal offering and creating alternate strategies could make sense. Retention, sale, leasing to third party occupants, or redevelopment of those properties excluded from the sale could create alternate paths to greater profit. But each approach should also be evaluated in the context of risk and the likelihood of success.

- **Contingency Planning:** Develop real estate plans for different sell-side scenarios to ensure the transaction will not be delayed or derailed and to avoid last minute surprises.

CAPTURING OPPORTUNITIES

- **Highlight Value-Add Opportunities:** Identify and highlight opportunities for buyers to add value. This might include potential cost savings from consolidation of their operations into the real estate they'll acquire as part of the deal, or revenue growth from below market and/or flexible lease terms, the potential for value appreciation of owned real estate, or otherwise.
- **Leverage Market Trends:** Stay informed about real estate- and deal-related market trends and leverage them to make the offering more attractive. For example, if there is a trend towards sustainability, highlighting energy-efficient facilities can be a selling point.



Preparing for a sell-side M&A transaction requires a strategic approach that minimizes risks and captures opportunities, and increases the likelihood of the deal being a success. By understanding, in advance, the business and real estate objectives of target buyers and how your company's existing real estate and associated assets may fit the potential buyer landscape, identifying risks and opportunities early, and creating alternate real estate plans, CFOs can maximize enterprise value, ensure a successful transaction, and avoid buyer preferences and last-minute negotiation scrambles that could undermine or devalue an otherwise successful M&A deal.

