



The Role of Corporate Real Estate in Mergers and Acquisitions

by Ashu Kaushal

OVERVIEW

The number of mergers and acquisitions being announced is increasing, as stronger companies look to take advantage of the current economic climate by acquiring weaker rivals. No two such transactions are the same, but real estate is almost always an important part of the merger process. From pre-transaction preparation and due diligence through pricing and into post-completion integration, the corporate real estate team has a crucial role to play. This paper provides a guide to the main stages of the process and includes checklists of the key elements involved.

INTRODUCTION

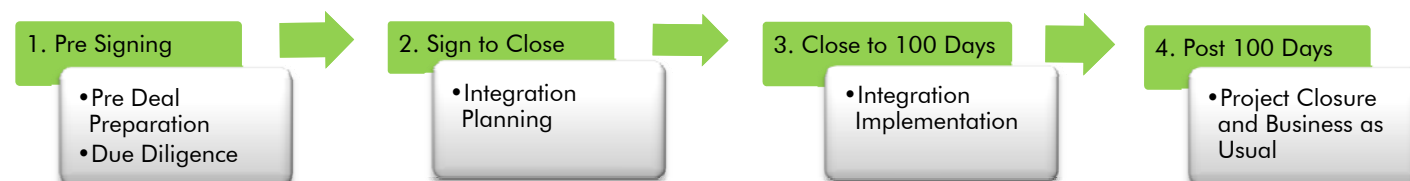
Kraft's acquisition of Cadbury, and Prudential's attempt to buy AIG's Asian business, AIA, are just two of the many merger & acquisition (M&A) transactions announced so far in 2010. This stage in the economic cycle is typically where stronger companies seek to increase market share by acquiring weaker competitors, and a further increase in M&A activity is to be expected over the next twelve to eighteen months.

Corporate real estate is often a crucial component of the transaction – as part of the operational platform, a source of cost savings or a part of the asset base of the target company. Assessing the nature, value and importance of the portfolio during the transaction phase, and then integrating the two operating companies post-completion are complex but essential to the success of the deal. Careful preparation, clear identification of objectives and responsibilities, and forensic attention to detail during implementation are vital.

No two transactions are ever the same, and each deal will have its own particular requirements. However, this paper provides a high level summary of the main issues and processes typically involved, and includes checklists of some of the key actions at each stage of the process.

THE ROLE OF CRE

From a corporate real estate (CRE) perspective, the M&A process typically comprises four phases:



The CRE team has a significant role to play in each of these phases: supporting the deal team, informing them of the potential risks and rewards of acquisition, and then delivering cost and operational synergy targets arising from the merger.

PRE-SIGNING

This “getting to know each other” stage is the first round of the M&A process in which the buyer and the seller try to understand the willingness to merge, and the relative strengths and weaknesses of each party – without necessarily having much commitment to the deal on either side. The main objective of involving the CRE teams at this stage is to assess the potential cost savings or capital that can be generated from the merger, and to identify the likely operational benefits or issues involved. M&A experts consider this the most crucial and difficult phase as lack of a comprehensive due diligence process can often result in serious problems later in the negotiations or post-completion.

The Pre signing stage has two components: Pre-Deal Preparation, and then Due Diligence.

Pre-Deal Preparation

This is the stage where the dedicated M&A Deal Team sets up the structure of the overall project, determining timing, key deadlines, resource requirements, roles and responsibilities, key deliverables, constraints and risks. Adopting a disciplined approach during this stage is important in helping the team in managing the complexities of an M&A process.

Confidentiality is crucial at this stage as often the M&A deal is still being configured internally by the “buy-side” team. A series of iterations are often tested during this stage especially in case of Target Companies with diverse and complex portfolios requiring modelling of various what if scenarios that help the valuation process and support negotiations. Following a disciplined approach and timeline is therefore critical at this stage.

Within the overall plan for the merger, the CRE team needs to have their own specific project structure. Key tasks which are often associated with this stage are:

- Setting up the Project Team
- Creating an action plan for the Due Diligence and Integration phases
- Creating a Project Plan with associated tasks, roles and responsibilities and deliverables
- Creating a Governance and Communication Plan with described stakeholders, messages, responsibilities and limitations
- Creating a reporting timeline and format
- Creating a risk register with mitigation plans for each risk identified
- Creating an M&A balanced scorecard for the team to ensure that, at any point in time, progress is on track to meet the overall timing and objectives of the transaction. This will typically involve translating the overall vision, rationale and targets for the deal into “SMART” goals for the CRE component of the team: Specific, Measurable, Achievable, Recorded and Time-bounded objectives.

Due Diligence

Closely related to the Pre-Deal phase is the due diligence process. This can generally only commence once both parties are engaged in the process; prior to this point, the target company may have been unaware of the potential deal. However, at this stage the target’s CRE team can usually be contacted – though only under the guidance of the overall M&A team who will have established a communication protocol for the two companies.

During the due diligence phase, the Deal Team will rely on the CRE team to provide an understanding of the operational and non-operational portfolio of each company, the costs and risks associated with each component and the level of synergy savings or capital generation that can be achieved as a result of the deal. An inventory of owned and leased properties needs to be compiled, together with all relevant financial rights and obligations.

“By taking a complete look at all relevant sources of value and risk, the chances of a successful acquisition increase significantly.”

John O. Nigh and Marco Boschetti

Imagine buying a second hand Ferrari. Having found what looks like the perfect model, the owner provides you with a certificate of roadworthiness from a reputable garage. Can this document provide you with the necessary comfort that the car is roadworthy? Would this “certificate” be sufficient for you to make the final buying decision? Are the procedures performed by the garage for this “certificate” defined by specific legal requirements and with a different objective in mind? Would you simply rely on the owners statements that the car has been well maintained?

“Buyer Beware: The importance of due diligence in M&A”
(Jim Woods, Norren Tai, 2005)

Each transaction will have its own special requirements depending on the nature of the portfolios and company activities concerned. For example, in sectors such as heavy manufacturing or pharmaceuticals, complex plant and machinery valuation issues can arise, and potential future liabilities associated with decommissioning and environmental impact will need to be identified and quantified.

Due diligence on the portfolio provides the CRE team with an indication of the geographic spread, the cost structure and the potential savings that could be gained through integration, as well as highlighting future risks and liabilities. It also provides an indication of the likely costs and timescales for the operational integration of the companies post-merger.

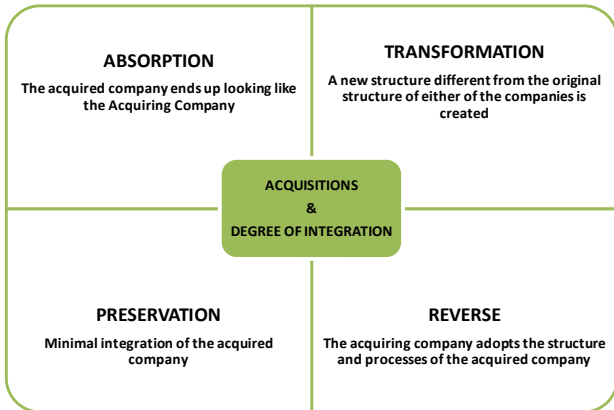
The Deal Team will have several priorities at this stage. In addition to building up a picture of ongoing cashflow and capital issues associated with the property portfolio, they will particularly want to avoid any “surprises” later in the process that could be material to the pricing of the transaction. These could be unexpected costs or liabilities, or “hidden gems” – owned property, potentially held on the books of the target client at an historic value, which can be sold to generate capital gains. In some cases, usually where substantial portfolios of owned real estate are involved, such assets may be a fundamental component of the way in which the overall deal is priced and financed.

During the due diligence phase, information on the CRE organization and processes of the target company may still be limited. However, at this stage it is also important to begin to plan for the operational integration of the companies. Mergers and acquisitions are always traumatic to an organisation to some degree, and the key is to minimise the disruption to day-to-day business during the transaction and post-completion phases. CRE and Facilities Management teams are at the heart of the practical process of integrating the new organisation. Establishing the structures and processes that will be followed, and individual roles and responsibilities, at an early stage is essential – even if these are on an “interim” basis for the duration of the transaction itself and the immediate post-completion period. Identifying the roles of suppliers and third-party serviced providers is also important, particularly where one or both parties have outsourced part of their CRE activities.

FROM DEAL SIGNING TO CLOSE

Once the due diligence phase is complete, the CRE teams then embark on full integration planning, typically referred to as the “Sign to Close” stage. During this stage the CRE teams of both companies actively engage in preparing plans to integrate the property portfolio, CRE organisations, processes, service providers/partners and systems.

The level of integration and the degree of preparation and planning required depends on the type of acquisition involved, and the degree of operational integration that will be required. Typically there are four different types of acquisitions: absorption, transformation, preservation and reverse.



The different models are likely to have varying requirements, on a spectrum ranging from full integration (where one company is fully incorporated into the physical and organisational structures and processes of the other) to minimal integration, where the acquired company will essentially remain as a standalone entity. With the exception of a true “preservation” M&A deal, all other types of acquisition are likely to require intensive involvement and co-operation between the CRE teams. Indeed, the CRE/FM teams in the two companies (along with their Human Resources counterparts) are likely to be amongst the first parts of the businesses to become operationally integrated.

Getting this integration right is essential – not only to the practical side of merging the businesses, but also in terms of setting the right tone and atmosphere of positive collaboration that will then begin to permeate through the two companies. Equally, any signs of conflict, disagreement, dissent or confusion within the CRE teams will very quickly be picked up by staff elsewhere in the business, which can have very damaging consequences to staff morale and key worker retention. Seemingly trivial issues – “where will I be based? Where will I be sitting?” – can be very important to staff who may already be concerned about their future employment. Such concerns will be made worse by rumor or apparent indecision, so effective communication and control of information flow is critical.

Since the long term success and sustainability of an M&A transaction is dependent upon the effective integration of the two companies, M&A experts place huge emphasis on diligent integration planning and preparation. According to Booz Allen’s M&A specialists, a detailed battle plan completed before deal closure can boost the chances of success to around 90%, as against a 30% success rate if planning is undertaken concurrent with deal progression.

A CRE integration plan requires bringing together the portfolio, people, processes, and partners of the combined entity. CRE teams should be prepared for the fact that putting together an integration plan is a highly complex process, requiring consideration of the people, financial and legal issues across different components of the business – often within a strict and challenging timetable. Setting up a formal integration project with specific objectives, team roles and responsibilities, budgets and timelines are essential. Identifying separate but linked integration work-streams for different components of CRE can often be more achievable than a single integration plan. Typically this could include having separate plans for each of the following:

- Operational portfolio
- CRE organization
- Transaction management
- Portfolio and lease administration
- Project management
- Facilities management
- CRE technology

Four key lessons established by the GE Capital in 1998 on how acquisitions are integrated

1. Acquisition integration is not a discrete phase of a deal and does not begin when the documents are signed. It has to be a process that begins with due diligence and runs through the ongoing management of the new business.
2. Integration management is a full-time job and needs to be recognised as a distinct business function, just like operations, marketing, or finance.
3. Decisions about management structure, key roles, reporting relationships, redundancies, restructuring and other career affecting aspects of the integration should be made, announced, and implemented as soon as possible after the deal is signed – preferably within days. Creeping changes, uncertainty and anxiety that last for months are debilitating and immediately start to drain value from an acquisition.
4. A successful integration welds not only the various technical aspects of the business but also the different cultures. The best way to do so is to get people working together quickly to solve business problems and accomplish results that could not have been achieved before.

“Making the Deal Real: How GE Capital Integrates Acquisitions” HBR, 1998

FROM CLOSE TO 100 DAYS

Once the deal has actually closed and the acquisition contract has been signed, the combined CRE team can initiate the process of implementing the plans prepared during the Sign to Close Phase.

While integration efforts often take 18 to 24 months to fully complete, it is generally true that there is a higher probability of success when integration is executed rapidly – provided it has been properly planned! Analysis of previous transactions suggests that prioritising and completing key activities within the first 100 days post close improves profitability, cash flow and organisational performance.

Although there will be a need to implement across all the various work stream action plans put together in the integration phase, it is also crucial to develop an overall priority action list for the first 100 days. In planning the resource requirements and allocations for this effort, it is important to bear in mind that the CRE team will be expected to keep its “business as usual” commitments in addition to the integration requirements. All the day-to-day issues that the team routinely has to deal with will still be there, and can even increase in volume as different parts of the business implement their own integration plans.

Typically the top priorities of this phase could include:

- Post merger streamlining of organisation structure, allocation of roles and responsibilities, and induction/training for the integrated team
- Internal and external communication
- Portfolio management
- Sourcing plan implementation
- Strategy plan implementation
- Post merger risk management and mitigation measures

POST 100 DAYS

Once the Deal has been closed and the implementation of key integration priorities has been initiated, the CRE teams need to bring the M&A project to a closure and focus activity onto “business as usual” activities.

Therefore, Post 100 days, the M&A Integration manager for CRE will need to plan and implement an exit strategy from the integration process. Typically, exit from the Integration Project takes place in stages as the processes associated with particular locations and business units are completed.

Post 100 days, the baton of responsibility is passed to the CRE senior leadership team that will be taking forward the new organisation. The new CRE leadership, which may involve members of the integration team itself, needs to ensure that the team fully understands and is aligned with the agreed processes, protocols and technology of the new CRE organisation.

How easy this is to achieve, and how long it will take, will vary depending on the level of organisational change which has taken place. Clearly, integration of two separate organisations into a new, hybrid model is likely to take longer than selective incorporation of certain individuals into a largely unchanged existing operation. The key is that the new team is able to focus on its core role of effectively supporting its internal clients as quickly as possible.

The final requirement is to ensure that the knowledge gained during the process is captured and recorded. In some cases a merger may be a one-off event, but for many companies M&A is an ongoing part of business life. Understanding what worked and why – and more importantly, what didn't – is important to ensure that potential pitfalls are avoided next time.

CONCLUSION

In most cases the M&A process is long and complex. It requires preparation, attention to detail and clear decision making processes. The larger the target company, the more complicated the due diligence and integration process will be. Even with clearly defined goals, processes, timelines and responsibilities in place throughout all stages of the process, it is impossible to remove all the risks associated with such transactions.

However, a structured approach with strong discipline and advance preparation can dramatically increase the chances of success, allowing the team to focus on dealing with unexpected problems rather than working out what needs to be done next. A “playbook” approach which sets out what needs to be done at each stage helps to provide the step by step guidance that the M&A team needs during the flurry of activity associated with the transaction.

Care should also be taken to ensure that the feedback loop of learning and pitfalls from the various deals completed through the corporate history is recorded to help improve the processes. A balanced scorecard approach is one of the ways in which the successes and failures can be recorded and communicated back to the corporate deal team.

Key things to remember:

- Plan for the M&A – develop a playbook that guides you through the process before a merger gets underway.
- Establish an experienced and available resource pool in advance of every M&A activity - deals will be time pressured and business as usual activity will not abate.
- Do thorough due diligence – establish the desired and minimum data necessary to identify risks and opportunities.
- Understand the deal objectives - determine the degree of integration that may be required and the associated issues before the deal is closed
- Quantify cost synergies that can be achieved as a result of post merger integration (PMI) to ensure successful participation of the CRE team in the PMI process
- Identify “quick wins” and focus attention on the drivers of value – consolidations, disposals, monetisation projects.
- Develop an integration plan for each of the key aspects of CRE activity involved: data management, transaction management, project management, facilities management and technology
- Align the CRE organisation behind its new objectives and assign the roles and responsibilities of the new team
- Have a clear plan, then implement quickly and efficiently to give confidence to all stakeholders that the process is under control
- Ensure the learning and pitfalls have a feedback loop into the M&A process improvement structure.
- Measure and communicate the contribution of CRE team to the merger: establish your credentials for the next effort

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