

Sale Leasebacks for Private Equity

Private equity firms rely on real estate sale leasebacks as a tool to maximize returns, oftentimes capturing double-digit multiples on rent, and reducing the amount of equity necessary for business acquisitions.

To be more competitive in an auction process, many firms choose to acquire the real estate along with the business, knowing they can lucratively monetize the real estate with a reliable sale leaseback capital partner.

AIC Ventures has served as one of the most active and dependable capital partners to private equity firms for more than two decades, having provided more than \$600,000,000.

The sale leaseback of corporately-owned real estate can be a valuable capital option when completing an M&A transaction for several reasons. Most important of these reasons are: maximizing capital / reducing equity needed for the company acquisition, strengthening the balance sheet, improving financial ratios, and avoiding debt covenants. It can also potentially improve a buyer's competitive position as most other buyers would generally not seek to acquire the business inclusive of the real estate. In addition, a sale leaseback can be value-added to the buyer of the business and real estate because the real estate price is generally eleven to twelve times rent (depending on the company's credit) which is higher than most EBITDA multiples. (See the simple example below.) Of course, none of the reasons to consider a sale leaseback matter if the sale leaseback provider is unreliable and does not fund the agreed upon proceeds or is not ready to fund on the transaction closing date. It is very important to consider the track record of the provider when using a sale leaseback as part of an M&A transaction.

<u>Business Sale Value</u>	8X
EBITDA	\$5,000,000
<u>BUSINESS SALE VALUE W/O SLB</u>	<u>\$40,000,000</u>
Real Estate Value	\$10,000,000
Rent	\$800,000
Adjusted EBITDA	\$4,200,000
Business Sale Value	\$33,600,000
<u>TOTAL SALE PROCEEDS W/ SLB</u>	<u>\$43,600,000</u>
Additional Value w/ SLB	9%

As a result of the sale leaseback transaction, the company's enterprise value has increased by \$3,600,000, or 9%.

A sale leaseback allows the buyer to capture the full value of the real estate. When the real estate is secured by a mortgage, or is otherwise collateral for the company's debt, the lenders generally provide capital equal to 65-75% of the land and building's value. The sale leaseback allows the buyer to capture the remaining 25-35% of value and use the proceeds as they see fit. The sale leaseback is merely a capital-raising vehicle. The company continues to operate and have long-term control over the asset through the lease, same as it did before the transaction.

A sale leaseback strengthens the balance sheet in several ways. First, it allows the company to recognize the full market value of the asset rather than the depreciated book value. Since real estate is a depreciating asset, and GAAP accounting does not provide for a mark-to-market of the asset over time, the value of the real estate continually decreases on the financial statements regardless of the actual market value of the asset. This "hidden value" is freed up by the sale leaseback. Further, under current accounting rules, the sale leaseback can be structured as an "operating" lease rather than a "capital" lease so that the rental obligations show up as a footnote to the financial statements rather than as a capitalized liability.

The sale leaseback also improves financial ratios because of the realization of the hidden value of the real estate. Since the asset side of the balance sheet increases by the amount of the hidden value, the equity increases by the same amount since there is no corresponding change to the liabilities of the company. Hence, the sale leaseback improves the shareholder's equity and, correspondingly, improves the debt to equity ratios.

A very important feature of a sale leaseback is the lack of corporate financial covenants. The sale leaseback provider makes its credit decision during the credit underwriting stage of due diligence prior to close. Once the transaction closes, the company and the sale leaseback provider operate in a typical tenant/landlord relationship. Post-closing, the sale leaseback provider does not have the ability to declare a default based upon financial performance so long as rent payments are current.

AIC Ventures has specialized in real estate sale leasebacks for more than a quarter of a century, and in the process has closed over 225 individual transactions totaling more than \$1.7 billion in value. During its long history, AIC has developed into the industry leader in sale leasebacks, always performing as promised (i.e., never re-trading agreed upon terms) and always closing, usually within 30 days. AIC is currently investing in its twelfth fund for which it will be acquiring approximately \$250 million in real estate assets.

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