



**CONVERGENCE**  
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I. Who We Are

II. Sale Leasebacks Explained

III. Case Studies

IV. Tax and Legal Issues

V. Current State of the Market

VI. About Convergence



## Who We Are

- ◊ Founded in June 2006 by Alexander B. Kasdan
- ◊ Private real estate merchant banking firm
- ◊ National provider of real estate sale-leaseback and structured real estate financing
- ◊ Opportunistic investments in “storied” real estate opportunities: bridge lending, creative advance structures, secondary markets
- ◊ Collective expertise: corporate finance, mergers and acquisitions, law, real estate,
- ◊ Distressed companies
- ◊ Growth companies
- ◊ Private equity acquisitions and divestitures



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## Benefits of a Sale-Leaseback

- ◇ Generate immediate liquidity
- ◇ Free up 100%+ equity vs. 75% or less with a conventional loan
- ◇ Enhance financial ratios (debt/equity, ROA, ROE, current ratio)
  - ◇ Enhance borrowing capacity
  - ◇ Most efficient use of capital
- ◇ Retain control over operating costs through the net lease structure
- ◇ Option to repurchase property in select circumstances



## Advantages of a Sale Leaseback to the Seller

- ◊ Replaces a “passive,” non-revenue generating asset with additional working capital, acquisition or growth capital
- ◊ Management retains control and use of the property in a sale leaseback
- ◊ Removes a capital asset from the balance sheet at book value and replaces it with cash realized from the sale
- ◊ Improves liquidity, freeing up cash for other revenue generating investments or a stockholder dividend
- ◊ Creates an attractive exit strategy for a user that may not otherwise be able to sell the real estate readily
- ◊ Immediate liquidity event potentially in excess of enterprise value of the business



## Disadvantages of a Sale Leaseback to the Seller

- ◇ Potential capital gains tax implications
- ◇ Foregone potential future appreciation
- ◇ Loss of flexibility to renovate or rehab the property
- ◇ “Locked” into long-term lease
- ◇ May lose the property at end of lease term or have to renegotiate the lease rate and term



## Disadvantages of Real Estate Ownership

- ◇ Asset shown at book value on balance sheet; any debt shown as a liability
- ◇ Occupancy/finance cost is high; equity contribution of at least 20-30% is usually required
- ◇ Opportunity cost (forego product development/capital improvement and allocation of capital to core operations and other uses of funds)
- ◇ Frozen liquidity, amortization costs of real estate loans
- ◇ Tax benefits limited to depreciation of buildings and improvements; any debt service payments applied to principal are not deductible
- ◇ Specialized use or operation of the property may diminish marketability



## Summary:

Purpose:	To divest of non revenue generating long-term assets, thus improving the balance sheet ratios while retaining control of the property
Tenant:	Typically, middle-market unrated credit tenant. Lease is triple net (lessee pays all costs associated with operation and maintenance of the property)
Rental Rates:	Calculated as a percentage of the purchase price, usually with embedded escalations throughout the lease term
Term:	15 to 20-year lease terms, with options to include up to four 5-year renewal periods
Advance:	100% + of appraised value, \$2.0 million and above
Property:	Conveyed via Warranty Deed; must have fee simple ownership interest in property; ground leases as exception only
Property Types:	Industrial (distribution, warehouse, manufacturing and R&D), medical, office, retail, and hospitality



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# Case Study 1

A \$25 million sale-leaseback transaction at a 10.0% cap rate, or \$2.5 million annual rent. Assume the following valuation and leverage statistics pre-sale leaseback transaction:

(\$ in millions)

EBITDA	\$50.0		
Valuation Multiple	6.0x		
Enterprise Value	\$300.0		
		% of Total Cap	Debt/EBITDA
Debt	\$150.0	50%	3.0x
Equity	\$150.0	50%	



Assume the company uses the sale-leaseback proceeds to pay down debt. The table below shows the same valuation and leverage statistics pro forma for the sale-leaseback transaction:

(\$ in millions)

EBITDA	\$47.5		
Valuation Multiple	6.0x		
Enterprise Value	\$285.0		
		% of Total Cap	Debt/EBITDA
Debt	\$125.0	44%	2.6x
Equity	\$160.0	56%	

Case Study 1 Cont.



## Case Study 2

Sale leaseback of industrial warehouse properties in conjunction with acquisition of a steel logistics company by a financial buyer

### Pre-Sale Leaseback

**Company:**

Sales: \$120mm

EBITDA: \$14

FMV Real Estate: \$50mm

**Company Valuation Metrics:**

75% of Sales

6.5x EBITDA



\$90mm

**Acquisition Structure:**

\$20mm Equity

\$70mm Indebtedness

### Post-Sale Leaseback

**Structure:**

\$50mm @ 12%cap

Annual Rent: \$6mm

**Subsequent Capitalization:**

\$0 Equity

\$40mm Indebtedness

**Proceeds:**

\$50mm

(\$39mm) corresponding  
reduction on valuation

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**\$11mm immediate gain**



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## Legal & Tax Issues Involving Sale-Leaseback Transactions

- ◇ Treatment as a financing transaction for accounting purposes can generally be avoided
- ◇ Financial Accounting Standards Board (FASB) rules give extensive guidance on sale-leaseback transactions, and an accountant should be asked to review the proposed lease document to reduce the risk of re-characterization.
- ◇ Potential risk factors include:



## ◇ **The intent of the parties.**

For tax purposes, the intent of the parties is a factor in determining how the lease should be treated. The parties should intend that the transaction be a lease, and the seller/tenant should understand that it will likely lose control and possession of the property at the end of the lease term. The transaction should not be undertaken between parties if the seller/tenant initially requested a loan from the buyer/landlord. Both parties should agree to treat the transaction as an **operating lease** pursuant to FASB 13 and for tax purposes.



## ◇ **The length of the term.**

Analyzing a sale-leaseback lease for tax and accounting purposes requires two separate steps:

- ◇ First, will the “sale” in a sale-leaseback transaction be treated for tax and accounting purposes as an actual sale, or only as a financing transaction? For example, some sale-leaseback transactions with fixed rent during the base term and with fixed-rent renewal terms could be treated as financing transactions (and not really “sales” at all) because of the provisions in FASB 98 that prohibit a tenant in a sale-leaseback arrangement from participating in the appreciation of the property. If the remaining economic life of the improvements is less than 90% of the initial term and any fixed-rent option periods, then the tenant could be found to be participating in the appreciation of the property, precluding treatment of the transaction as a sale (and leaseback).
- ◇ Second, if the transaction is a “sale,” will it be treated as an operating lease? FASB 13 provides that if the base term and any option periods that are “reasonably assured of exercise” exceed 75% of the estimated remaining economic life of the leased premises, then operating lease treatment is not appropriate.



## ◇ **The amount of the rent.**

FASB rules do not require that the rent be tied to the fair rental value in the vicinity, but they do require that the present value of the base rent be less than or equal to 90% of the fair market value of the property to the landlord (typically the purchase price paid) to receive operating lease treatment.



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# Macro Economic Conditions Affecting The Middle Market

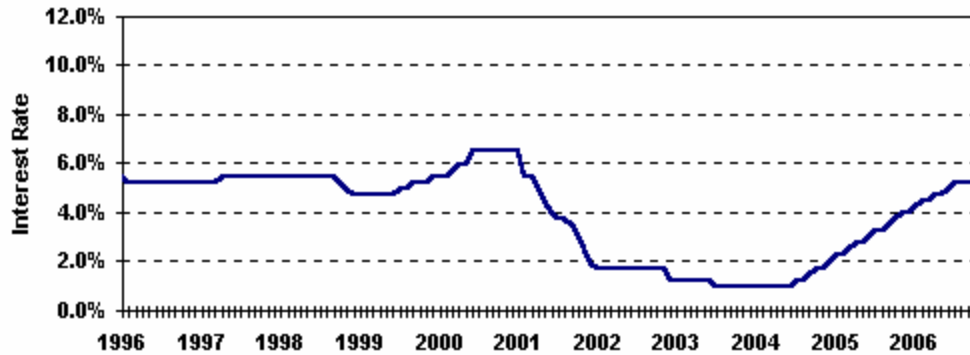
	2004	2005	2006F	2007F
Real GDP Growth	4.2%	3.5%	3.2%	3.0%
Personal Spending Growth	3.9%	3.6%	3.2%	2.8%
Business Investment Growth	9.4%	8.7%	8.3%	6.8%
Gov't Spending Growth	2.2%	1.8%	2.0%	1.9%
Pre-Tax Corp. Profit Growth	12.6%	14.2%	9.7%	4.7%
Inflation	2.7%	3.4%	2.9%	2.3%
10 Year Treasury Yield	4.2%	4.4%	4.9%	5.1%
Employment Growth	1.6%	1.5%	1.4%	1.3%

Source: Consensus Economic Forecasts, Bloomberg, Federal Reserve Board, Bureau of Economic Analysis

- ◇ Stable job growth drives strong tenant demand
- ◇ Hot RE markets cooling down
- ◇ Economic slowdown inevitable over the short-term horizon
- ◇ Real GDP growth to slowdown
- ◇ Corporate liquidity squeeze expected in '07

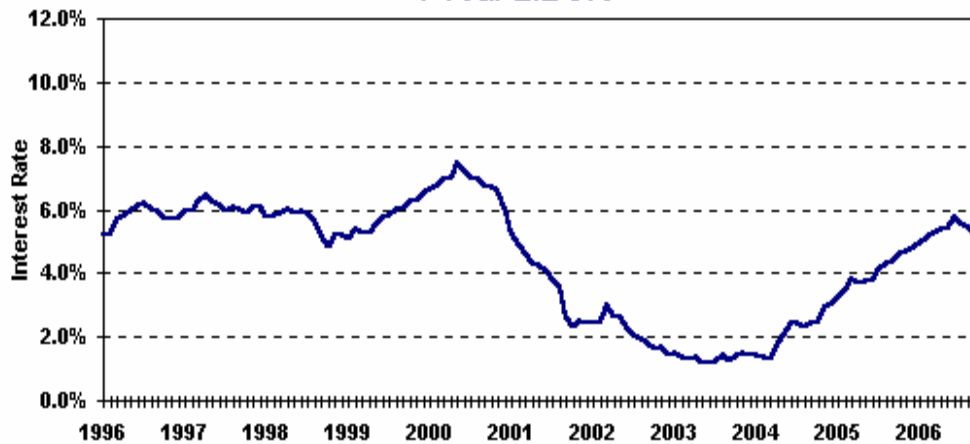


**Federal Funds Target Rate**



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Flexible credit markets



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# When to Call Convergence

- ◇ Mergers and Acquisitions
- ◇ Leveraged Buyouts
- ◇ Financial Restructuring or Recapitalization
- ◇ Bankruptcy Proceedings
- ◇ Growth Capital



# The Convergence Advantage

- ◇ Substantial capital and liquidity
- ◇ Creative Real Estate Solutions
- ◇ Fast response and no drawn-out institutional approval process
- ◇ Strategic alliance with Braun, Inc., a nationally recognized valuation, auction and brokerage services company
- ◇ Expertise in real estate, corporate finance and law
- ◇ Certainty of closing- 45-60 days



# Relationship Building

We are actively seeking to develop relationships with select:

- ◇ Law Firms
- ◇ Lending Institutions
- ◇ Accounting Firms
- ◇ Investment Banks
- ◇ Private Equity Sponsors
- ◇ Turnaround Professionals



**Alexander B. Kasdan** is Founder and President of Convergence Capital Partners, LLC. He has more than sixteen years of investment banking, real estate, corporate law and corporate strategy experience. Since 1988, Mr. Kasdan has executed over 100 domestic and cross-border transactions totaling more than \$10 billion in overall volume in a variety of industries. Prior to founding Convergence, Mr. Kasdan was Founder and President of Alexander B. Kasdan Company Limited, an investment bank focused on the middle market, an investment banker at Barrington Associates in Los Angeles, where he headed the restructuring group, Peter J. Solomon Company, Credit Suisse First Boston and Merrill Lynch.

Mr. Kasdan practiced law with O'Melveny & Myers LLP (formerly O'Sullivan Graev & Karabell LLP) and Paul, Hastings, Janofsky & Walker LLP (formerly Battle Fowler LLP), where he specialized in mergers and acquisitions, private equity and corporate finance transactions. In addition, Mr. Kasdan served as Corporate Counsel in charge of business development at Schlumberger Ltd., a global oilfield and information services company.

Mr. Kasdan graduated magna cum laude from Middlebury College with a B.A. degree in Economics and Italian and was elected to Phi Beta Kappa during his junior year. In addition, he holds a J.D. degree from Columbia University Law School and has studied at the University of Florence in Italy. Mr. Kasdan is admitted to the Bar in the State of New York.

Mr. Kasdan is active in community affairs and serves on the Board of ICAN Associates, a non-profit concerned with the prevention of child abuse. Mr. Kasdan is a frequent speaker on the subject of mergers and acquisitions, corporate finance and restructuring, including as organizer of the Conference at the Anderson School at UCLA on "Buying and Selling a Company in a Tough Economy - How to Optimize Price and Liquidity in a Buyer's Market." Mr. Kasdan has published articles on the subjects of mergers and acquisitions and corporate finance.



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