HOW TO GET ACQUIRED

6 pieces of the merger and acquisition puzzle.

By Teresa Burney /// Illustration by Heads of State

Patrick Neal of Neal Communities has what big home builders want to buy.

The veteran Florida builder, who painstakingly kept his business alive in the depths of the recession, has rekindled it into a bonfire that makes his business a poster child for what big builders that want to be bigger are looking for: outsized sales and orders, land in growing markets, and on-the-ground talent to turn that land into homes that sell.

Neal Communities was No. 64 on the 2012 BUILDER 100 list, delivering 487 houses and producing $143 million in revenue, which Neal has been plowing back into more land. Plus, with roughly 11,000 lots in Florida in its portfolio, the company offers potential revenue that inspires desire.

With home building reviving across the country, builders like Neal, in desirable markets and who are growing again, are getting multiple calls from potential merger or acquisition suitors. But Neal Communities is not for sale.

"We are making plenty of money and having lots of fun, so every time somebody calls I say 'No thanks,'" the owner says.

For every builder like Neal, with plenty of capital to grow on his own and who is gleefully anticipating the fun of riding the home building cycle up to the top again, there are others—queasy from memories of the steep crash—who want off the ride. Then there are those who want a better seat for the next ride up and need capital partners to get there.

FIND A MATCHMAKER

If you are serious about selling your company, contact a firm that specializes in builder mergers and acquisitions. These specialists can tell you whether your business is ripe for the taking.

Tony Avila, CEO of Builder Advisor Group—Avila Advisors, and Michael Kahn, managing partner of Michael P. Kahn & Associates, are two matchmakers. Builders looking for capital or looking to sell their businesses come to them for advice and services. Large national public home builders, under pressure from Wall Street to grow, also turn to Avila for intel, help, and introductions. Lately, both men have been busy.

Kahn, who says he has advised builders on 100 mergers since 1987, came out of retirement recently when some old friends called looking for matchmaking help. Since early 2012, he says public builders have made at least eight large acquisitions with a total estimated value of $1.5 billion. "The floodgates have opened," he says.

Avila stayed busy during the recession helping builders survive by finding sources of cash, often private equity investors. Now, with many of those short-term private investors ready to cash out, he's working to find exit strategies for them through mergers and acquisitions or by selling stock to Wall Street investors as public companies.

"We are Match.com for builders," says Avila. "Typically they are using our company as an intermediary. We have sellers coming to us saying, 'Help, guide us through the process,' and we have buyers coming to us saying 'Show us the inventory where we can grow.' We've got acquirers looking at at least 50 of the top markets in the U.S."

According to Metrostudy, the research arm of BUILDER, the top 10 markets ranked by total closings are: Houston; Dallas/Fort Worth; Phoenix; Washington, D.C. metro area; Atlanta; Austin, Texas; San Antonio; Las Vegas; Seattle; and Orlando, Fla.

SHOW OFF YOUR NUMBERS

Avila ticks off the three things that make desirable M&A targets: "Have a good inventory of land. Have a good management team. And have good future profitability."

Builders ready to be acquired need to be prepared to show their cards and prove their worth. A strong profit and margin history certainly will abet their cause. Margins currently look good because builders are constructing homes on cheap land. But as land prices increase, margins easily could decrease, especially if home prices stall.

"Some builders are making very strong profits right now, but all the land they built on they bought distressed," observes Peter Hazeloop, a vice president at Kahn's company. "Buyers need to be comfortable that [the builders they buy] can find land in the future and make a profit on it."

Having good business systems in place is important as well, including an accounting system that can easily show the company's financial situation.

HAVE LOTS OF THE RIGHT LAND

There's a higher demand than supply for land right now, so if you have lots of lots, you're in a great position. Large builders, often with stuffed larders of cash, are looking to buy builders with established footholds in new markets, in markets they exited in the downturn, or in ones where they want to beef up their presence. Builders of interest are closing at least 200—and preferably 400 to 500—per year.

"To be a good target, you really have to have at least three years of lots owned or under contract. I don't mean handshake agreements," Kahn says.

Buyers also are looking for acquisitions in areas where employment and populations are growing, with the hope that growth will translate into strong housing demand.

The highest-demand markets are those that form a "smile" on the U.S. map, curving from Seattle through California, Arizona, Texas, and the Southeast, then up to the Mid-Atlantic. Specifically, Avila sees high demand for mergers and acquisitions in the big markets of California, Arizona, Texas, Florida, and the Carolinas. But there also is demand for builders in smaller niche markets, such as Nashville.

ENSURE COMPATIBILITY

There are other less easily measured things that builder acquirers are looking for, such as compatible company cultures and good chemistry—especially if the management team is staying on.

"Chemistry is going to play a big part in it," says Kahn. "Is the culture the same or could it fit in?"

"The idea is that they are going to be focusing their local knowledge and expertise to keep feeding the machine," adds Jody Kahn, senior vice president of John Burns Real Estate Consulting. Kahn worked with her father, Michael Kahn, and his company to close more than 85 home builder transactions.

Jody Kahn says some builders want to buy local builders that have special skills they lack, such as urban infill or on-your-lot construction, or that are serving niches like active adults, first-time buyers, or affluent customers.

"The idea of running a parallel business in a market is pretty appealing," she says, because the builder can boost sales within its existing footprint.

Patrick Neal, whose company is not for sale, cautions builders to be careful about what they may have to give up. "I would not prosper in a national builder environment," he says. "I don't want to retire. I like pushing the buttons. I don't like calling to ask permission." Plus, it's a family affair: he's got a wife, two sons, and a nephew who want to keep working for Neal Communities.

#MERGE MEISTERS

Got the urge to merge? Try these five deal whisperers who can get it done.

Tony Avila
CEO
Builder Advisor Group—
Avila Advisors
San Francisco
415-561-0600

Michael P. Kahn
Managing Partner
Michael P. Kahn & Associates
Palm Coast, Fla.
904-553-2202

Ivy Zelman
CEO/Principal
Zelman and Associates
New York
212-993-5840

Richard Moriarty
Managing director
and head of home building
and building products
CITI
New York
212-816-6000

Eric Anderson
Director, Finance
Credit Suisse Securities USA
New York
212-325-2000

IF YOU CAN'T BEAT 'EM

CamWest-Toll Brothers deal combines local market know-how with public company capital.

As the recession wound down in 2010, Eric Campbell, co-founder of CamWest Development, saw opportunity—his land-constrained Seattle market was flush with distressed property at rock-bottom prices.

So Campbell, whose company survived the recession focusing on infill construction near Seattle's employment centers, took the deals to his banks, which said he'd have to put up 50 percent to get financing. For CamWest, that meant leaving land for hungry publics that considered moving into Seattle.

"We decided that if we were going to have to compete with public home builders, we would have to go out and get public money," recalls Campbell.

He spoke with Ivy Zelman of Zelman and Associates, an adviser to home builders, about taking CamWest public, and she said the firm had to be in more than one market to attract public capital. But Campbell, who has young children, wasn't keen on having to travel to build in unfamiliar markets.

Zelman introduced CamWest to Toll Brothers, a builder of high-end homes like CamWest. Toll had deep pockets; it saw opportunity in Seattle and was looking for an access point. Toll Brothers' CEO Doug Yearley visited Campbell, who took him to see a for-sale mountaintop with views of Seattle and the Olympic Peninsula and the potential for million-dollar homes.

In 2011, Toll bought CamWest for a reported $150 million. The merged company changed its name to CamWest, a Toll Brothers Co., taking advantage of CamWest's local reputation and Toll's well-branded national one. Campbell stayed on as Toll's Seattle division president.

Since the deal was consummated, CamWest has bought properties Campbell had identified, including the mountaintop community, Belvedere.

"We are on a great growth pattern. Toll did a great job executing on the land" purchases, he says, and the division added 25 employees in 18 months. Most of CamWest's management team remains and the culture between the two builders has been a good fit.

"We both have a desire to build great communities, so at the end of the day, you have a fit because of that alignment," Campbell says.

There were some things Campbell gave up in the deal, such as the ability to make a decision without consult. He's also had to learn to manage up.

Campbell acknowledges that Toll might decide he's no longer needed at the company he founded. That's why, he says, it's important to strike a deal when you sell that's big enough to take care of you and your family if you are let go.

BE REALISTIC ABOUT WORTH

Usually builders don't say how much they sold their companies for, but Avila tells BUILDER that the last six builders his organization helped to sell went for multiples of 1.5 to 2.5 times book value, their assets minus liabilities. Where in that range a company fits depends on how much inventory it has, how much land and how many lots it controls, and what its future profitability looks like.

Hazeloop of Kahn's organization advises builders to be realistic about their value and not to expect to get the full purchase price at closing. Typically sellers are paid some at closing and the rest over a period of two or three years, with the amount contingent on whether the builders' results meet predictions and other thresholds.

A backloaded deal gives buyers some security that if the business doesn't perform as well as expected, they won't overpay. So sellers are incentivized to continue making as much money as possible.

Other conditions can be built into a contract. How the buyer and seller agree to treat capital gains for tax purposes is always a point of contention, accountants say.

Likewise, the company's top executive usually signs on to stay for a two- or three-year period. Such agreements tend to include noncompete clauses that keep former owners and executives from working in that market—for themselves or for a competitor—for a certain period of time.

Because it's a possibility—and often certain—that the purchasing builder will decide it doesn't need you down the line, it behooves you to negotiate a selling price that offers a comfortable cash flow for some time to come. And based on past transactions, that's entirely possible.

"These are very, very large deals," says Michael Kahn. "These are $100 million and above transactions. That's enough for their families, their children, and their grandchildren."

Jody Kahn said it's rare for CEOs not to serve out their entire employment agreement. However, she has heard of a few who were not offered employment agreements as part of the merger or acquisition because they weren't thought to be a good fit culturally. Plus, she said a few left early because of health or family issues.

GET A TUNE UP

With the M&A trend expected to last another year or two, Michael Kahn says there is time for builders who don't catch a big builders' eye now to groom themselves into more attractive targets.

"Some are ready right now and others need a little tuneup," says Kahn. "We have some that can be ready in six to 12 months, but they need some mentoring to be in the perfect position and to sell with a premium."

He is mentoring a company that expects to sell 150 homes this year and expects to move up to 250 next year when it plans to put the for sale sign up.

"There are those who are kind of on the

MERGER IN DALLAS

BUSINESS AS USUAL

Bloomfield Homes gains a partner and keeps its corporate culture.

Don Dykstra was looking for three things when suitors came calling at his land-rich, eight-year-old Dallas/Fort Worth–based home building company:

First was "to get a little money off the table," recalls the president of Bloomfield Homes. Dykstra and his wife owned the firm they started and he thought it was time to diversify their investments.

Second was "to partner with somebody who would allow us to continue to run it, to allow Bloomfield Homes to reach its full potential," he recalls.

Third was to continue providing opportunities for its employees, the builder adds.

The founder accomplished all three objectives in July when Sumitomo Forestry Co., a giant multinational Japanese company, bought half of Bloomfield Homes from Dykstra and his wife. The deal, initiated by an introduction from Residential Strategies, had been in the works since December.

"They have left us in charge," Dykstra says. After the sale, he and Rich Ichikawa, CEO of Sumitomo Forestry, met with employees and contractors to assure them business would continue as usual.

Sumitomo Forestry bought half of Bloomfield, but didn't put cash into the business, Dykstra notes. But even part ownership by the 300-year-old company makes Bloomfield look better to banks. "The financial strength will allow us to be strategically more aggressive," he says.

That means Bloomfield, which assembled 3,500 entitled lots during the housing downturn, can develop that real fence," says Kahn. "They are not sure if now is the time to sell."

But Kahn cautions these builders about waiting too long. "The time to sell is when everybody wants to buy. I think we are right in the middle of it now and it might go on for another year or two," he says.

For builders who want to keep their management teams intact, selling sooner might be better because big builders are hungry for knowledgeable, experienced staff to run their operations in the new markets. As time goes by, these builders will have deeper benches and might be interested in only your land assets.

"So waiting is not necessarily the best thing either," Kahn says.

Senior editor John Caulfield contributed to this report.

estate more quickly.

In 2012, Bloomfield ranked No. 79 on the BUILDER 100, with 402 closings and $89 million in revenue. This year, the builder expects to close 600 houses—and that's just in Dallas.

In Sumitomo, Dykstra thinks he has found the perfect fit for his company goals, but he notes that this is an unusual arrangement.

"Most American companies are not comfortable with a 50/50 culture," he says. "For the Japanese, their desire is that you are going to work together to provide a solution for everybody, consensus-based management."

Sumitomo also has another attractive strong trait, says Dykstra: patience. "They are a huge timber company and over 300 years old. When you plant forests as part of your business, you have a long-term perspective."

SELL OFF IN CHARLOTTE

PICKING THE BATTLEGROUND

Westport Homes hands off non-core land to concentrate on home.

In 2012, Steve Dunn, then president of Indianapolis-based Timberstone and Westport Homes, was looking longingly at opportunities for land buys in the Midwest. However, like many privately held builders, his company lacked cash and lenders willing to fund acquisitions.

Meanwhile, Ryland Homes was craving a bigger presence in North Carolina. The publicly traded builder had cash, but it needed lots. Dunn, whose Timberstone Homes was building in Charlotte and Raleigh, N.C., suggested to Ryland executives that each had what the other desired, and a deal was born.

Ryland Homes bought all operations of Timberstone Homes—the ninth biggest builder in Charlotte—gaining 870 lots and homes, 154 others under contract, plus 17 models.

"This really puts us on the map; it's a popular place and where a lot of builders want to be," Drew Mackintosh, vice president of investor relations and communications for Ryland, told BUILDER at the time.

The deal also gave Dunn what he wanted: cash to buy lots and houses where competition from large public builders like Ryland was not as intense as it is in the Raleigh market.

"As a private builder, we have limited availability of capital as opposed to some of the public builders," said Dunn at the time of the Ryland deal. "We are looking long term, seeing that our ability to compete on land and lots in the Midwest is a better opportunity than in Raleigh [and Charlotte]."

The strategy has proved successful for the company. Westport Homes is expanding in Columbus, Ohio, and in Fort Wayne, Ind., and Indianapolis, where it has about 25 communities with model homes and another 15 communities where it has lots. While the builder actively is looking for lots in Columbus, it is stocked up in Fort Wayne and Indianapolis for the next two to three years.

Concentrating on the Midwest market also has made it easier for Westport to manage its personnel because the builder didn't also have to staff a location in farther-away North Carolina.

"Everything has worked out the way we anticipated and wanted it to happen," Dunn says.