## To Acquire or Be Acquired:

# KPK CHOSE THE FORMER

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• OVER THE last few years, successful real estate development firms have been prime targets for acquisition by larger corporations. The acquisitions which have taken place are usually by related companies who can directly or indirectly benefit from the services of an in-house development firm.

Typical of these acquisitions would be a steel company purchasing an industrial developer to help promote a pre-engineered structural system; or a forest products manufacturer purchasing a home builder to provide a locked-in outlet for its wood products.

The benefits can work the other way too, as when a lumber firm acquires a developer to convert cut-over timber land into a "recreational second-home wonderland"; or when a land-rich railroad acquires a developer to promote land sales and development — usually a much more lucrative business than the operation of a railroad.

**Aerial view of downtown Seattle, Wash., which is heated by Chicago developer KPK Corporation.**

The acquisitions described above appear to be good marriages because there is a product-user, or a land owner-land developer relationship in each case making the firms *complimentary.*

The more common type of acquisition/merger in recent years has been the *supplementary* accumulation of real estate service companies by financially oriented companies. Thus, a major insurance company might acquire a mortgage banker who might acquire a land developer, a construction company, a real estate brokerage firm, real estate consulting firm, and a real estate management firm. Each acquired firm down the ladder would provide a service to *supplement* the services of the other firms and their combined services would provide a one-stop supermarket (but certainly no discount store) for all real estate needs. The ultimate product from this type of conglomerate appears to be the R.E.I.T., a sophisticated real estate investment tool designed to benefit everyone involved.

Each supplementary company within the real estate conglomerate both services and feeds off the others. Therefore, it sometimes becomes difficult to provide adequate checks and balances between fees and services, creating possible conflicts at the consumer end. All one has to do is read a typical R.E.I.T. prospectus to learn the bewildering array on conflicts-of-interest that are possible in a real estate development-sale transaction.

Another possible defect to be avoided in the *supplementary* conglomerate is total interdependence of each service offered on the other services in the group. With total interdependence, the overall effectiveness of the conglomerate becomes dependent on the performance of the weakest service link, reducing quality of service. Also, it is conceivable that the self-sufficient real estate conglomerate will slowly lose effectiveness as it drifts away from competing service organizations in favor of the acquired *supplemental* service companies. For example, a land development firm with its own real estate brokerage subsidiary may tend to discourage outside brokers from showing prospects.

For this reason, KPK Corp. has chosen not to go into the real estate brokerage business, and instead depends on the excellent professional brokerage community in Chicagoland.

Likewise, KPK Corp. chose not to pursue acquisitions of/or by *supplementary* real estate service firms. Instead, KPK entertained overtures from a number of large national corporations who needed complimentary real estate development expertise and could lend financial strength to the development operation.

Subsequent negotiations pointed out several serious problems in finding a compatible and *complimentary* acquirer. The usual goal of a publicly owned stock company is to produce high taxable earnings as measured by the IRS. This is because the public, who buys stocks, measures performance and, therefore, stock price by "taxable earnings", a practice fostered by stock brokers in promoting companies on the basis of their price-earnings ratio. This may be a valid way of evaluating the investment desirability of some companies, but the P-E ratio is hardly the best way to measure the worth of a real estate development company. KPK's goals as a privately held developer and owner are low taxable income (earnings), high cash flow, and appreciation of properties held.

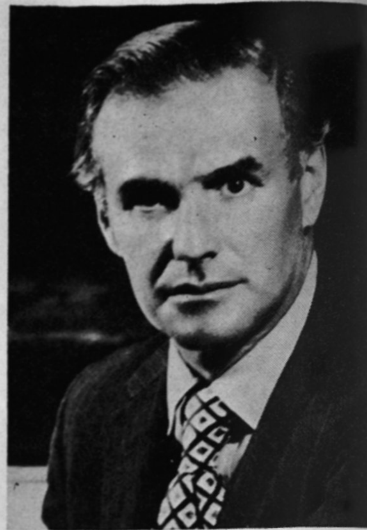
For example, a new general purpose industrial warehouse appreciates in value at about 3% per year based on the current inflationary cost trends in warehouse rental rates. While the property may have real appreciation of 3% per year, the developer is taking depreciation at 3% to 5% per year which has the effect of lowering the net worth and "book value" of the developer. Therefore, the difference between real value and book value may increase by 6% to 8% per year to the value of the real estate held. The negative effect on the value of the developer's stock is even more dramatic.

Since the rental properties are generally highly mortgaged the effect on equity may be five times the overall appreciation factor.

Another compatibility problem may arise in personalities when a public company buys a developer. The successful developer is necessarily an entrepeneur willing to speculate with large sums of money and take responsibility for major decisions made in many cases intuitively.

After this view of the merger/acquisition market place, KPK Corp. decided that a complimentary acquisition would be beneficial to both parties, but KPK Corp. had to become the acquirer. In conjunction with their accountants, Touche Ross & Co., the principals of KPK set down criteria for an acquisition of a company with a long history of steady taxable earnings, in a business not dependent on sales effort, and

# Demand Steps-Up for Multiple Occupancy Industrials



Mr. Friedman

• ARCHITECT Robert L. Friedman notes that the construction of single-occupancy industrial inventory buildings has picked up considerably this year over 1971 and 1972 when construction slowed due to the large amount of existing vacant structures. Demand for multiple-occupancy industrial buildings is still high, continuing the growth market needs of 1971 and 1972, he says.

Mr. Friedman is president of Robert L. Friedman & Associates, Ltd, AIA, Architects, specialists in the design of industrial building projects of the multiple-occupancy type. The firm has designed projects of this type in industrial complexes from Hammond to Waukegan, including Franklin Park, Deerfield, Elmhurst, Lombard, Arlington Heights, Oak Lawn and the Indiana city and the northern Illinois comunity.

The typical multiple-occupancy building being designed by the firm provides six to 20 office-warehouse units with individual sizes ranging from 3,000 to 10,000 square feet.

Face brick and metal curtain walls have predominated with warehouse ceiling heights 14 feet and better, Mr. Friedman explains in commenting on the current popularity of this multiple occupancy classification and the increasing assignments to design industrial buildings being given his company.

Multiple-occupancy buildings are sometimes referred to as incubator buildings. This term derived from the fact that many new and smaller type businesses find them especially suitable for their purposes. A firm can move into a small unit of 3,000 square feet, for example, and then can conveniently move into larger units as they experience growth.

The Friedman organization, located at 10 S. Riverside Plaza, has also designed many of the larger industrial plants to be found in the area, such as structures for Allied Tube & Conduit Corp., Cherry Electrical Products, Cincinnati Corp., Pronto Food Corp., Teletype, Western Electric, Sullair Corp., United States Tobacco Co. and Ludwig Industries.

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(Continued from page 95)

with existing management able to continue the operation.

A francised public utility company, Seattle Steam Corporation, turned out to meet KPK's criteria. Seattle Steam is a district steam company, which through its 20 plus miles of looped steam pipes, distributes heat at 300 psi to some 500 properties in the central downtown Seattle area including major office buildings, hotels, hospitals, and even a large University and Junior College. Acquisition was accomplished last year through a successful tender offer to the widely dispersed stockholders.

Seattle Steam Corporation has now gone through its first winter heating season operated as a wholly owned subsidiary of KPK Corp. Steam generation, revenues and profits have all reached new highs and the acquisition has given KPK Corp. an unusually large and stable cash flow base on which to expand its development and ownership of industrial properties in the midwest area of the United States.