

FOLEY'S NATIONAL DIRECTORS INSTITUTE

2009 WEB CONFERENCE SERIES



AON

Boardroom Bound

Deloitte.

Chicagoland Chamber of Commerce

D. I. King

Chicagoland Entrepreneurial Center



EVERSHEDS

Corporate Secretary

RR DONNELLEY

NASDAQ

NYSE

08.4975

FOLEY
FOLEY & LARDNER LLP

FOLEY'S EIGHTH ANNUAL NATIONAL DIRECTORS INSTITUTE 2009 WEB CONFERENCE SERIES



M&A in the Board Room

Steve Hilfinger, *Foley & Lardner LLP*, Moderator
Pete Underwood, *Foley & Lardner LLP*, Moderator
Bud Aspatore, *Amherst Partners*
Will Frame, *Deloitte & Touche LLP*
Robin Johnson, *Eversheds LLP*

08.4975

FOLEY
FOLEY & LARDNER LLP



Topics

- Current State of M&A Markets
- Current State of Financing Markets
- Legal Strategies
- Board Strategies

08.4975

FOLEY
FOLEY & LARDNER LLP

3



Current State of M&A Markets

08.4975

FOLEY
FOLEY & LARDNER LLP

4



Where We've Come From

- Last few years (until late 2007) sellers generally had the upper hand
 - Highly competitive auction processes
 - Limited buyer protections
 - Accommodating financing environment
- So where are we now?

08.4975

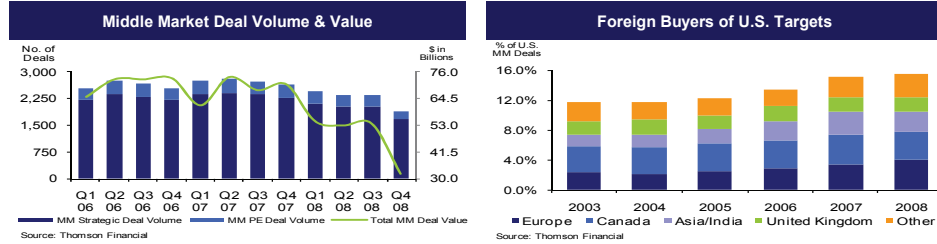


Where We Are Now

- Global economic recession
- Reduction in the general availability of credit
 - Dramatic negative impact on M&A activity
 - Lack of credit; difficulty with paper – “Cash is King”
- Increase in the number of companies in financial difficulty
 - Even “good companies” having difficulties
 - Distressed sales on the increase (in/out of bankruptcy)
- Deal volumes have plummeted
 - Overall volume down 28% from Q3 '08 and 43% from Q4 '07
 - General reduction in leveraged buyout activity
 - Private equity sponsored buyouts down 74% from 2007

08.4975


Where We Are Now (cont'd)



- 2008 middle market M&A activity declined by 17.3% from the previous year
- Activity decline was accelerated in Q4 as deal volume declined by 29.0% from Q4 '07
- Deal volume is expected to remain at depressed levels through 2009 as the economic environment remains challenging
- The acquisition of U.S.-based targets by foreign buyers increased from 11.7% of all buyers in 2003 to 15.4% in 2008
- Buyers located in Asia and India showed strong growth from 2003 to 2008
- Cross border M&A activity should continue to grow as foreign buyers seek access to U.S. consumers and take advantage of market conditions

Buyer's Market

- Shift to a buyer's market
 - Fewer auctions sales
 - Multiples and valuations are reduced
- Cautious buyers – increased focus on due diligence
- Financing/due diligence outs are back
- Higher break-up fees
- Contingent or deferred consideration (e.g. earnouts)
 - Buyer wants to be sure not overpaying
 - Way to finance difference in buyer and seller expectations




Current State of Financing Markets

08.4975

FOLEY
FOLEY & LARDNER LLP

9



Where We Are Now

- Decreased liquidity
- Availability of credit is the issue – not rates
 - Fewer lenders
 - Failure and consolidation of banks
 - Fewer hedge funds/others “in the market” now
 - Decreased lending
 - Banks continue to be less willing to extend credit
 - Senior financing contracts
 - Subordinated debt availability remains tight
- Higher borrowing costs despite low base rate

08.4975

FOLEY
FOLEY & LARDNER LLP

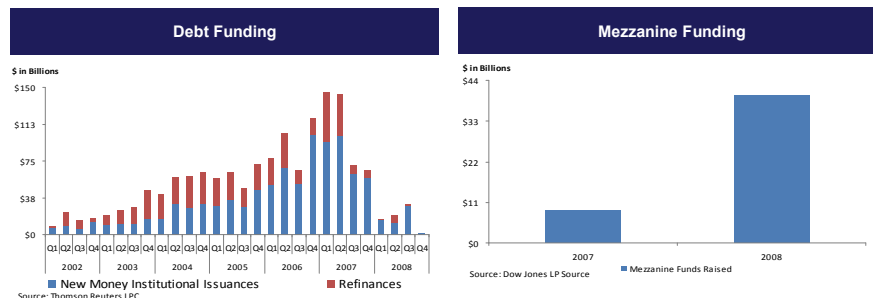
10

Where We Are Now (cont'd)

- Fear over lender willingness to lend
 - Covenant defaults exist/are imminent Q1 2009
 - Premature draw downs on revolvers
- Access to capital constraining lending
 - Loan write-offs and provisions exacerbate problem
 - One response to reduced capital: reduced lending
- LBO transactions require greater equity contributions (often approaching 50%)
- Cash flow financing contracts

08.4975

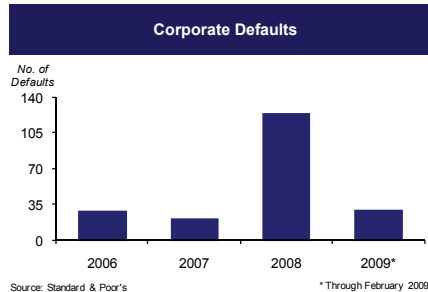
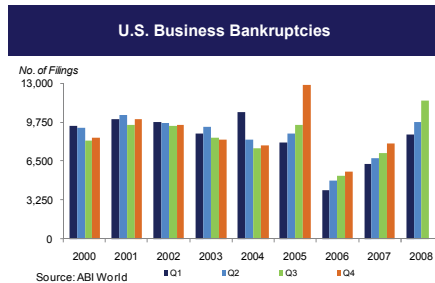
Where We Are Now (cont'd)



- Significant decrease in senior debt funding availability and multiples during 2008
- Current levels of senior funding are expected to continue through much of 2009
- Decrease in senior debt funding has led to an increase in revolvers and other capital sources as sources of funding
- Increase in alternative capital sources, such as mezzanine financing (\$40 billion raised in 2008)
- Goldman Sachs (GS Mezzanine Partners V LP) raised a \$20 billion mega fund in 2008
- Excluding the Goldman Sachs fund, there was a 100% increase in mezzanine fund raising

08.4975

Where We Are Now (cont'd)



- Q3 2008 Business bankruptcies increased 48.7% from Q3 2007
- Companies are finding it more challenging to obtain DIP financing
- Not all bankruptcies involve poor assets

- Defaults through February 2009 outpace 2008 total
- Credit rating downgrades continue to accelerate and outpace upgrades by almost 10 to one
- Defaults are expected to continue to rise through 2009

08.4975

Impact on Existing Facilities

- Strict compliance with covenants being enforced by banks
 - Banks will use this as opportunity to renegotiate “covenant light” agreements
 - Impose tighter restrictions and covenants
 - Higher prices and fees
 - MAC and “going concern” qualification defaults may be triggered

08.4975



Impact on Existing Facilities (cont'd)

- Banks looking to re-price loans
 - Some banks have limited access to LIBOR-based funds
 - Up pricing for added risk
 - Putting floors on rates
- How can companies deal with defaulting lenders?
 - Enforcing “yank a bank” clauses
 - Set off arrangements

08.4975



Impact on New Facilities

- Increase in financial and other covenants
 - Interest coverage ratios
 - Debt-to-EBITDA ratios
- Guarantees are more prevalent
- Increased due diligence and scrutiny by banks
- Higher prices and fees
- Market MAC provisions becoming standard?
- Banks insisting on greater equity contributions as condition to acquisition financings
 - 50% of capitalization is becoming standard
 - Second lien loan market has evaporated

08.4975



Legal Strategies

08.4975



Takeover Defenses

- New opportunities for cash-rich companies to aggressively pursue targets
 - Hostile transactions significantly increased in 2008
- Traditional takeover defenses were in the recent past abandoned due to pressure from shareholder advisory groups
- Expect increased public to private?

08.4975



Takeover Defenses (cont'd)

- Poison pill developments
 - Adoption of poison pills increased substantially in 2008
 - Year-over-year increase in poison pill adoptions for the first time in five years
 - Inclusion of derivative positions in definition of beneficial ownership
 - Recently, first rights plan trigger ever in the U.S.

08.4975



Takeover Defenses (cont'd)

- Challenges to advance notice bylaw provisions
 - Series of decisions in 2008 make clear that Delaware courts will construe advance notice provisions in bylaws in favor of shareholders seeking to submit nominations/proposals
 - Need to consider changes to bylaws to clarify advance notice provisions

08.4975



Takeover Defenses (cont'd)

- Defense Strategies
 - Have response strategy and team in place
 - Monitor shareholder issues and trading in shares
 - Know your shareholders – who can the directors count on for support?
 - “Just say no”
 - White knights and white squires
 - Advance notice bylaw provisions, poison pills, others
- BUT:
 - Regulatory and other restrictions
 - Directors’ duties

08.4975



Material Adverse Change Clauses

- Not all MAC clauses are created equal; a matter of contract interpretation
- Most include MAC to business, operations, financial condition, ability to close; what about carveouts?
- Pendulum has swung back to more buyer friendly MAC clauses
- Invoking leads to renegotiation/lawsuit

08.4975



Legal Issues in Distressed Sales

- To whom does Board owe duties?
- Fraudulent conveyance risk
 - Not merely actual fraud; “constructive” fraud if inadequate consideration and seller insolvent/rendered insolvent
 - Long statutes of limitation (up to 6 years)
 - Address risk with fairness opinions and balance sheets/cash flow projections

08.4975



Legal Issues in Distressed Sales (cont'd)

- Section 363 Sales in Bankruptcy
 - Buying assets “free and clear”
 - May still have contingent liability issues
 - Lack of DIP financing; need to move fast
- Article 9 Sales outside of Bankruptcy
 - Appropriate for smaller/simpler deals
 - Give notice to all known lienholders
 - Still pose fraudulent conveyance risks

08.4975



Board Strategies

08.4975



Increased Scrutiny on Boards

- Focus on board's role – both public and private transactions
 - Directors duties
 - Directors liabilities
 - Shareholder scrutiny
- Buy side vs. sell side
 - Key considerations for boards

08.4975



Board Strategies

- Diversify-Diversify-Diversify
 - Lessen concentrations
 - Customers
 - Product
 - Geographic
- Diversification through M&A market
 - Buyers market
 - Distressed sellers
 - Lower cash payments or contingent kickers
- Use cash for acquisitions or “hunker down” to ride out downturn?
- Bank board issues

08.4975