Moving Your Business Forward: Are You Taking the Right Steps?

M&A in the Boardroom

May 19, 2010
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Today’s Presenters

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Agenda

- Legal Update
- Market Overview
- Board Strategies in M&A Transactions

Legal Update
Fiduciary Duties of Corporate Directors

- Duty of Care – Requires directors to inform themselves of relevant and available facts and, so informed, to act, with due care
  - Length of time and process to evaluate a proposed transaction
  - Use of outside experts

Fiduciary Duties of Corporate Directors (cont.)

- Duty of Loyalty – Requires directors to put the best interest of the corporation and its shareholders over those of the directors
  - Vigilance in identifying conflicting interests
  - Disclosure to the board
  - Recusals by individual directors/establishment of independent board committees
Revlon duty-sale of control

- Triggered when the board evaluates a proposed transaction that will result in a sale of control or break-up of the company
- In such instances, directors have an obligation to act reasonably to seek the transaction offering the highest value reasonably available to the shareholders.

Boards Continue under Close Scrutiny

- Board decisions in public and private deals continue to be scrutinized closely
- Recent *Dow* case reaffirms principle under Delaware corporate law that business judgment rule protects boards from second-guessing, so long as board decisions are taken in good faith by disinterested directors
# Board of Directors—Selected Considerations

| Initiating a Sale Process | • Entitled to determine if, when and under what circumstances to engage in a sale process  
| | • The Board, not senior management, should act as the gatekeeper |
| Selecting an Advisor(s) | • The choice in retaining an advisor—legal or financial—is one for the Board to make and should not be shared with senior management  
| | • The formation of a special committee (and the selection of an advisor to it) are also the exclusive domain of the Board |
| Market Check/Deal Protection | • The Board must consider scope of process, ranging from a full-blown public auction to a negotiated transaction with a single bidder  
| | • A post-agreement market check or Go Shop period should also be carefully considered |
| Due Diligence | • It is important for the Board to try to minimize or monitor the risk of “management spin” by having representation (or advisor) participating in critical due diligence sessions  
| | • Preventing “management spin” is paramount when dealing with multiple parties (including strategics and financial bidders) |
| Fairness Opinions | • The Board’s objective is to exercise due care in complying with the business judgment rule  
| | • In part to fulfill its fiduciary duties, the Board often hires an investment bank to render an unbiased opinion as to the fairness of a transaction, from a financial point of view |
| Transaction Authorization | • Board is obliged to evaluate all alternatives to maximize shareholder value (i.e., sale, merger, acquisition, recapitalization, dividend, share repurchase, etc.) |

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### Market Overview

**Foley’s National Directors Institute Web Conference Series**

**Moving Your Business Forward: Are You Taking the Right Steps?**

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**Market Overview**
Market Perspectives

- M&A activity slowed significantly across all sectors of the economy in 2009
- However, strategic dialogue has begun to re-emerge in earnest
- M&A activity is returning as confidence in near-term growth prospects improve
- Private equity is not dead
- Stock is increasingly being used as acquisition currency
- Hostile activity is expected to remain high

Note:
1 In re Topps Shareholders Litigation, 2007 WL 1732586 (Del.Ch. June 14, 2007)
Private Equity Activity

- LBO volume essentially disappeared in 2009 with total volume both in the US and globally down 95% from peak levels.
- Sharp decrease in LBO activity driven primarily by upheaval in global financing markets in 2008 and 2009.
- LBO activity has begun to re-emerge with Q4 2009 + Q1 2010 volumes of roughly $40 billion.
- Transactions that are being completed now still have lower leverage and higher equity contributions than in 2006 / 2007.
- While the high yield and leveraged loan markets have recovered sufficiently to support LBO activity, appetite for mega-deals has not returned...YET.
- Massive amounts of uninvested capital remains on the sidelines and recent evidence suggests sponsors are more willing to compete and accept reduced returns to put money to work.

Note:
Key Learnings from Recent LBOs/Private Equity Sale Processes

- Desire for speed, certainty and confidentiality creating a willingness of Board’s of Directors to do one-off deals
- Increased use of “go-shop” periods as a way to ensure value maximization for shareholders
- Financial sponsors beginning to look seriously at topping deals announced by other financial sponsors
- Deal protections are highly negotiated to provide advantage to original party over go-shop bidders
- Potential competing bidders focused on leveling the playing field
- Public company stock likely to trade above announced deal price during go-shop

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Hostile M&A Activity

Hostile M&A as a percentage of total volume remains relatively active with markets generally supportive of bold moves

Source: SDC
Notes:
1 As of 3/31/2010
2 All deals with disclosed deal value, excluding minority stake purchases, repurchases or spinoffs and deals less than $50mm
Domestic Seller Mixture

Number of Transactions by Sector

Investment Management
Wealth Management
Alternatives
Real Estate

Source: Berkshire Capital Securities LLC

Domestic Buyer Mixture

Number of Transactions by Sector

Banks & Trust
Investment Management
Financial
Insurance
Wealth Management

Source: Berkshire Capital Securities LLC
Domestic M&A Trends (cont.)

Transaction Value and Number of Transactions

Source: Berkshire Capital Securities LLC
Hedge Funds as Activist / Hostile Investors

- Hedge funds are increasingly serving as catalyst investors, heightening Boards’ sensitivity to shareholder activism

### Access to Capital
- Raiders of the 1980s had to rely on third party financing, while hedge funds control their own capital
- Approximately $200 billion in assets controlled by “event driven” strategy hedge funds

### “Wolf Pack” Tactics
- Hedge funds network extensively and take similar positions in other funds’ targets
- Takeover efforts have been successful despite relatively small stakes in targets

### Changing Attitudes About Hostile M&A Activity
- Investors have a higher level of support for hedge funds as opposed to 1980s predecessors
- Perceived benefit to shareholders driven by pressure on Boards to explain why their chosen action is superior to other alternatives

### Diminishing Target Takeover Defenses
- Corporate governance activists’ voices are increasingly heeded by boards
- Evidence that growing number of governance changes are initiated by hedge funds

Common Tactics Employed by Activist Hedge Funds

- Opposition to Announced M&A
- Appraisal Rights
- Recapitalization or Deployment of Free Cash
- Proxy Contest
- Change of Control Campaigns
Key Themes in the Delaware Courts

Transaction/Process Integrity Considerations

- "Go-Shop" provision
  - In a privately negotiated transaction (or limited number of buyers contacted), provides the Board with a true market check after announcement and prior to closing
- Ability to waive standstill enforceability during a “Go-Shop” period
- Preserving fiduciary-out to respond to unsolicited proposals
- Transaction termination fees (“break-up” fee)
  - Above-market break-up fees can serve as a major hurdle in context of a topping bid
- Matching rights
  - Allow the initial acquirer the opportunity to meet or exceed a competing proposal
- Management conflicts in management-led buyouts with respect to access to information and due diligence

Emergence of the “Go-Shop” Provision

- Private equity and many privately negotiated deals are increasingly including “Go-Shop” provisions

- A “Go-Shop” provision allows the target Board to solicit alternative proposals from other potential buyers for a certain period of time between the signing of the agreement and the closing of the transaction

- Key variables impacting effectiveness of Go Shop provisions
  - Length of Go Shop period
  - Break-up fees
  - Scope of pre-signing market-check
  - Matching rights
  - Enforcement of other bidders’ standstill agreements
Overview of MAC Clauses

- Material Adverse Change (MAC) clauses have recently increased as an important deal dynamic ... however, effectively litigating a MAC is difficult and subject to a significant amount of interpretation.

| What is a MAC clause? | ✦ A contractual definition used to delineate the circumstances that, upon their occurrence, permits a buyer to withdraw from the transaction without penalty. 
|                       | ✦ MAC definitions are heavily negotiated and can be either general (e.g., “market” or “business” MAC) or a specific list of events. |
| Why is it used?       | ✦ To protect the buyer from a possible deterioration in business or market conditions between signing and closing. 
|                       | ✦ Resulting from the recent credit crisis, many buyers are using it to re-negotiate the deal to achieve more favorable terms. |
| What could be considered a MAC? | ✦ Business MAC—change in business, operations, financial performance or legal status. 
|                       | ✦ Industry MAC—change in company’s industry dynamics. 
|                       | ✦ Market MAC—ability to secure financing or close a transaction. |

Ensuring Success of Acquisitions

- **Strategic and cultural fit**
  - Are you selecting the appropriate firm for your organization? This involves a review of such areas as corporate culture, clientele and capabilities to ensure the target complements your business. 
  - It also involves developing a relationship with a target prior to any union.

- **Business metrics**
  - Structure: Are you structuring the transaction properly? What is the expected rate of return? These questions involve considerations such as equity, compensation and long-term incentives for management at the targeted firm, as well as post-acquisition management responsibility and autonomy.

- **Cost**
  - Does the deal make sense financially? Ensure an appropriate analysis of investment and return, including a model that incorporates a realistic appraisal of the target’s prospects, the likely synergies, and how those synergies will benefit both firms.

- **Planning**
  - How do we proceed after the deal? Develop a post transaction plan that your management and the target can both embrace, thereby ensuring a successful merger and business.
Boards and the Corporate Development Teams

- Acquisition growth is increasingly important
- Activity level is increased
- Corp Dev has increased in complexity
- Linkage to strategy is critical
- Board’s should consider the metrics and assessment of the team's effectiveness

How to Evaluate Potential Uses of Capital

- Programs versus acquisitions
- Organic versus M&A (buy versus build)
- Evaluating ROR
- Cross border considerations
Questions & Answers

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