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Acquisition Financing: Strategies for Deal Counsel

Evaluating Financing Options, Structuring the Deal, Addressing Loan Documentation and Intercreditor Issues

TUESDAY, APRIL 12, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Lawrence F. Flick, II, Partner, **Blank Rome**, New York

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S. Randy Lampert, President, **Lampert Debt Advisors**, New York

Brian Schofield, Director, **Lampert Debt Advisors**, New York

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Strategies for Deal Counsel

April 12, 2011

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LAMPERT DEBT ADVISORS

Lampert Debt Advisors is a boutique investment bank specializing in arranging debt financing for privately-owned, sponsor-backed and publicly-traded companies

S. Randy Lampert – President

- 30 years of experience in completing debt financings
- Co-founder of Debt Capital Markets Group and Head of Business Development at Morgan Joseph
- Founder and Head of Leveraged Finance at Nomura Securities
- Assistant Head of Communications and Technology at Salomon Brothers
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Brian Schofield – Director

- Vice President – ICON Capital Corp., engaged in originating and structuring asset based transactions in numerous industries
- Founder of Schofield Realty Group, a real estate development company
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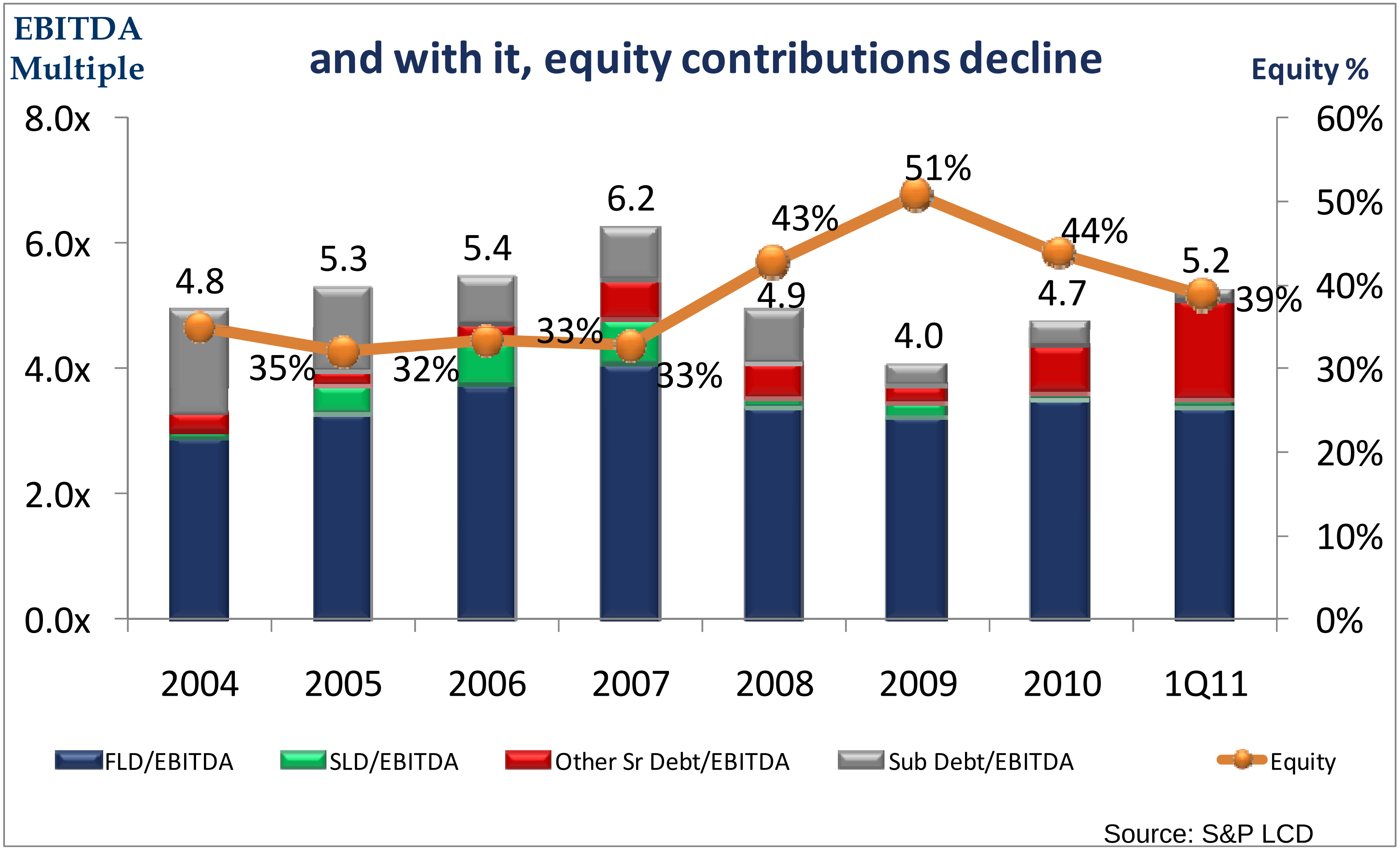
LEVERAGE FOR LBO'S CONTINUES TO RISE..



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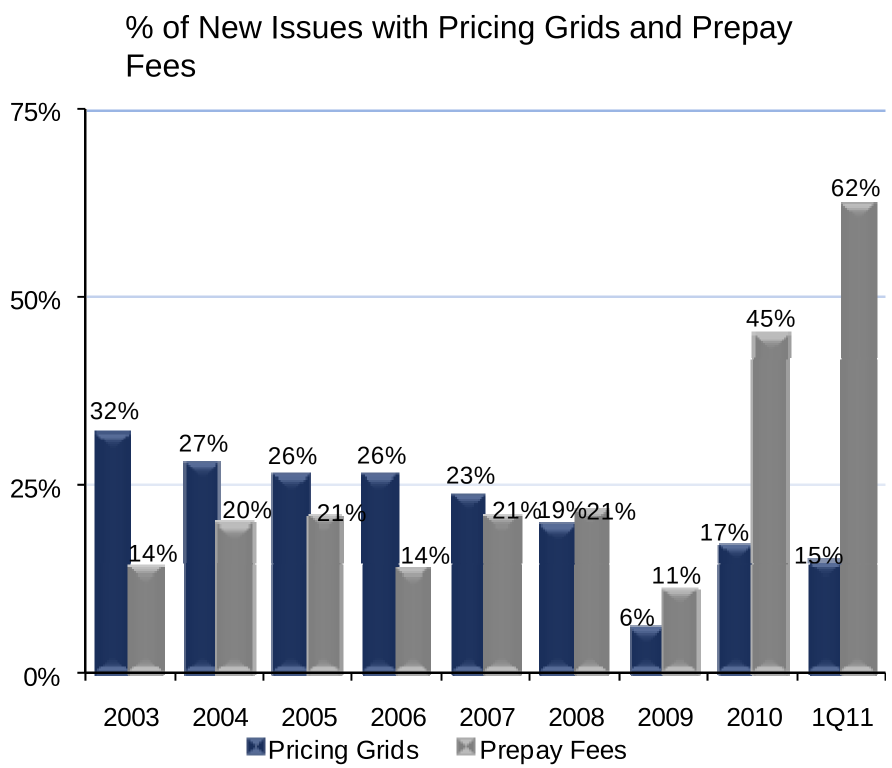
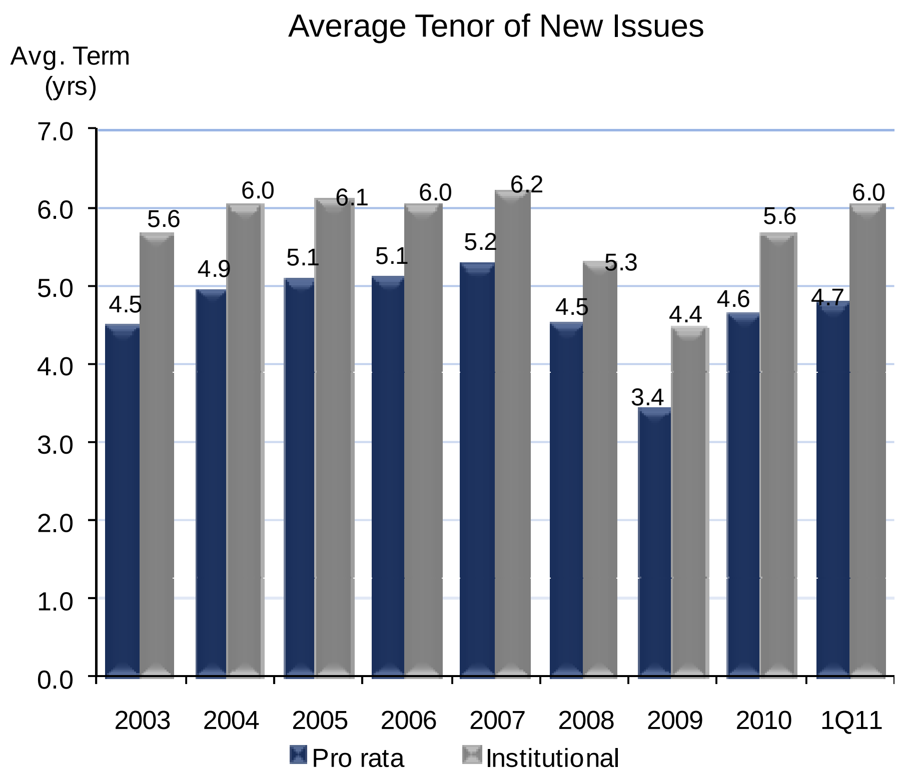
STRUCTURAL CONSIDERATIONS





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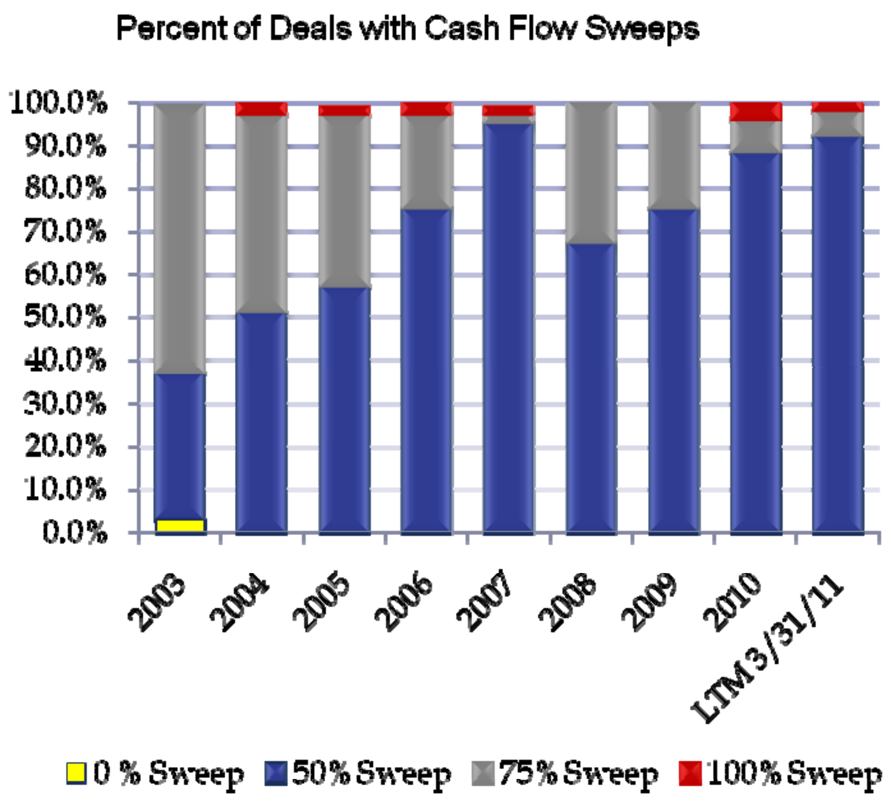
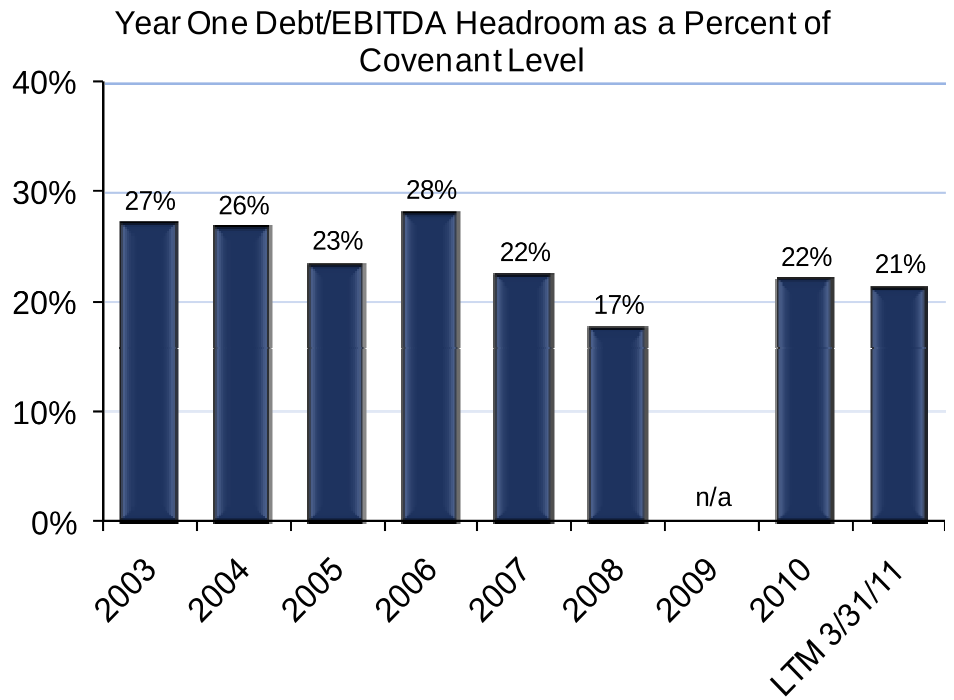
COVENANTS





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KEY CONSIDERATIONS

Cash Flow Considerations

- Improvement Realizations
- Availability to Service Debt
- Reinvestment Requirements
  - Maintenance Capital Expenditures
  - Working Capital Needs
  - Growth Requirements
- Gross vs. Free Cash Flow
- Seasonality
- Vulnerabilities

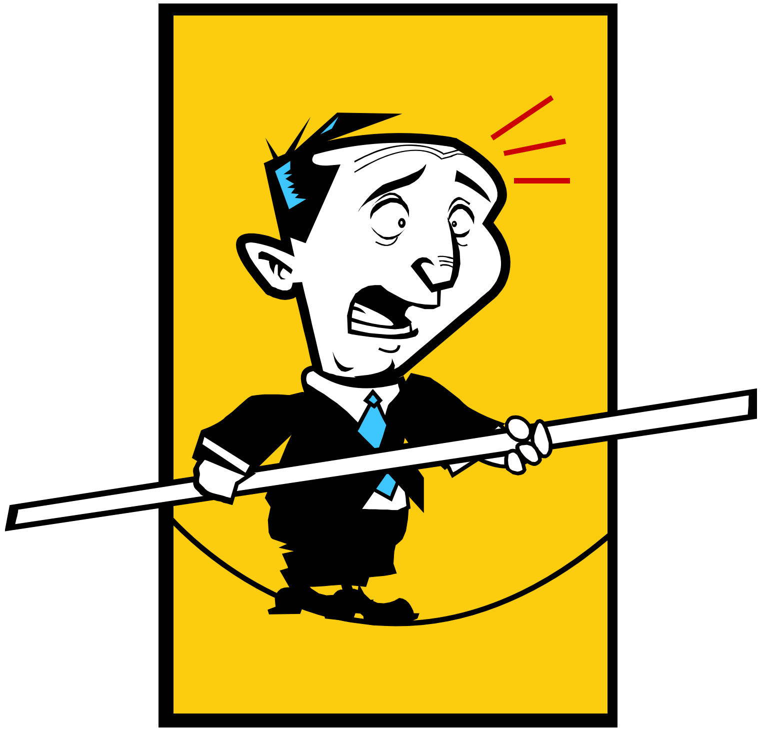
Key Concentrations

- Customer / Industry
- Raw materials
- Markets served
- Ownership /leadership
- Products

Risk Profile

Given the trials and tribulations of the past 3 years, lenders are placing heavy emphasis on risk and how it can be mitigated.

- Volatility exposure
- Competitive exposure
- Input costs
- Output prices
- Asset deterioration
- Technological risk



In soliciting lenders, it is critically important for borrowers (and their representatives) to mollify investor concerns early in the process

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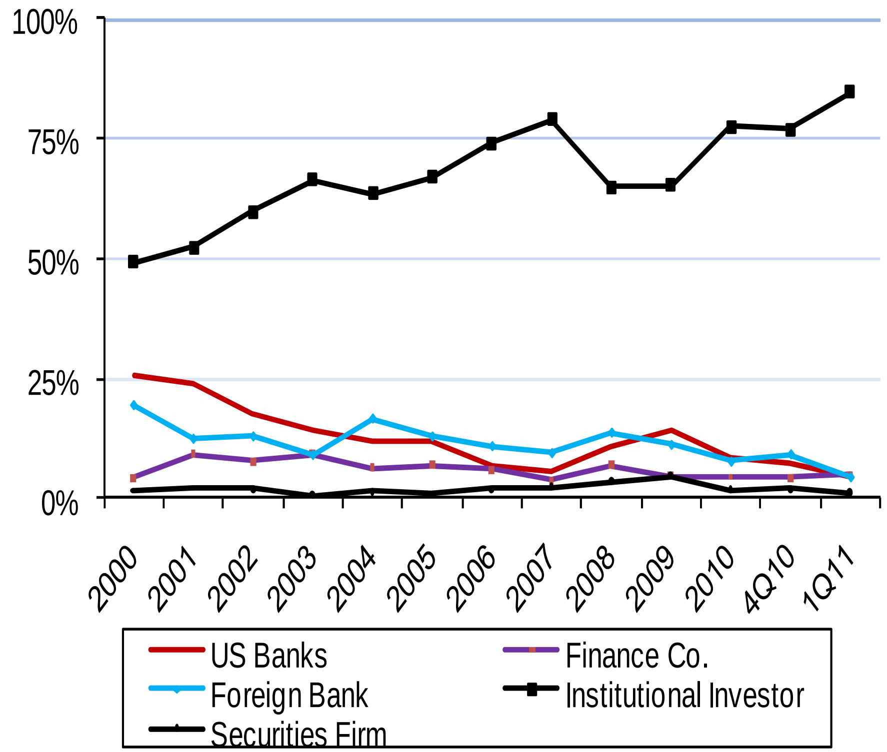
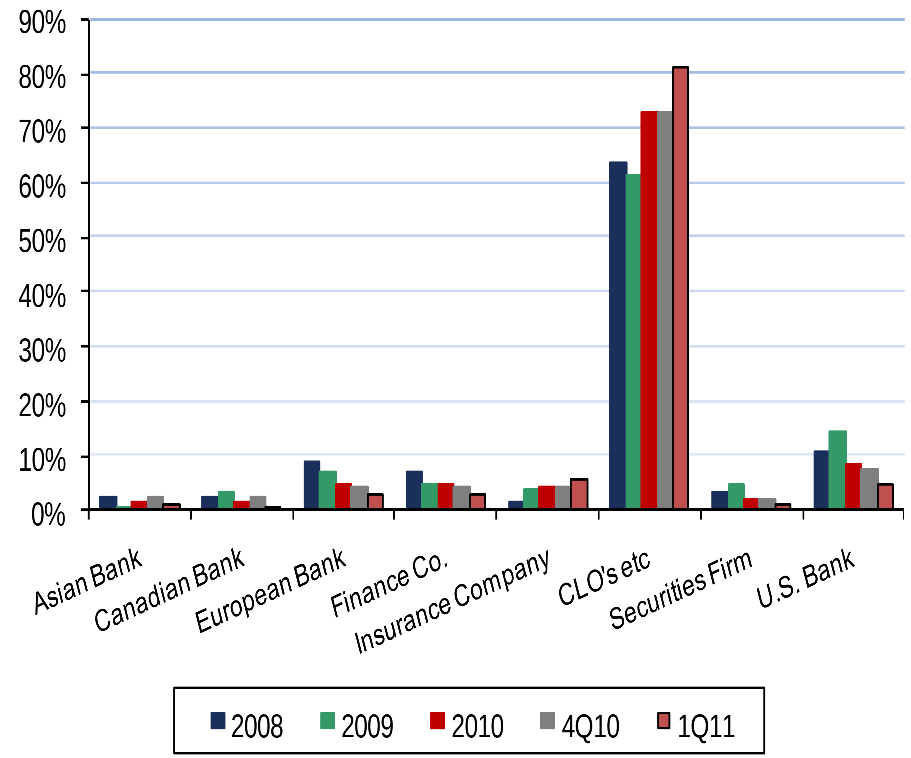
CAPITALIZATION STRATEGY

- Gear amortization to the specific cash flow characteristics of the borrower
- Coordinate financing layers to fully benefit from various classes of assets
- Establish levels of leverage consistent with ownership's risk tolerance
  - Ownership
    - Public vs. Private
    - Future Financial Support Capability
    - Track Record
- Use wide, Auction Financing Process to drive:
  - Lowest cost of capital – rates, fees
  - Optimal terms and improved flexibility
  - Looser covenants

INVESTOR LANDSCAPE





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OUR INVESTOR NETWORK

- Banks
- Finance Co's
- CLO's
- BDC's
- Hedge Funds
- Insurance Co's
- Private Debt Funds
- Mezzanine Funds
- Credit Oppty. Funds
- Private Equity

LDA possesses a network of over 500 investors across multiple classes of debt and equity securities. Our active dialogue with these sources of capital provides us with real-time market knowledge with respect to key investment criteria such as return, appetite and structure requirements

- Revolver
- Term Loan
- Last Out Senior
- TLB
- Second Lien TL
- Sub Debt
- Bridge Financing
- Structured Equity
- Common Equity

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Debt Financing Auction Process

Structure

- Real time knowledge of current market terms
- Optimal structure based on market requirements and company needs
- Identification of and solution to credit and transaction risks
- Specific covenants and inter-creditor terms established upfront

Solicitation

- Rapid deployment and comprehensive solicitation of investors for each financing layer
- Concentrated management meetings minimize distraction
- Successfully secure multiple proposals and commitments
- Secure “back-pocket” bids

Closing

- Seamless transition from commitment to closing
- Reduction in closing surprises and elimination of “drift” in terms
- Increased likelihood of successful closing

CONCLUSION

- Most market participants expect to see M&A activity increase in the 2nd quarter
- The supply/demand imbalance, particularly in the loan market, has given rise to tightened spreads and looser terms in the first 3 months of 2011; however, March saw investors push back on a number of very aggressive transactions
- Geopolitical events occurring throughout the world and the natural disaster in Japan have created a degree of uncertainty in the long-term view of the economic recovery
- Acquisition financing should remain readily available in 2011; however, proper alignment of deal characteristics and the financing being sought will be the main underpinning of successfully financed acquisitions

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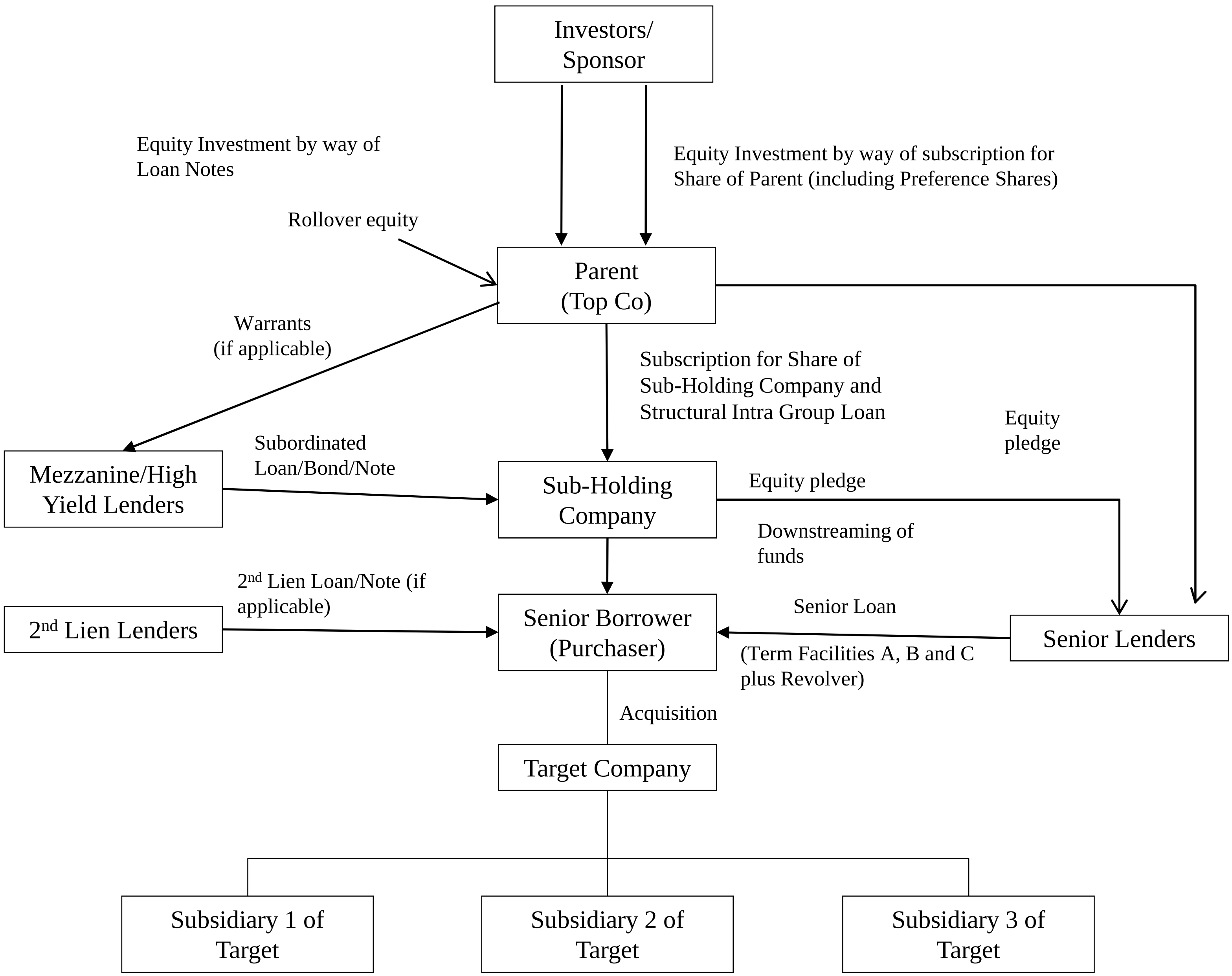
Structuring the Transaction

- Cash Flow vs. ABL; Layers of Financing
  - During downturn, cash flow loans largely disappeared and traditional cash flow lenders became ABL lenders.
  - Amend/extends often accompanied by conversion to ABL structure and/or additional covenants. Strongest borrowers were able to extend existing loans, reduce covenant hurdles, and upsize facilities to continue growth.
  - More cash flow deals getting done, but ABL deals still very common, especially in lower middle market.
  - Important to understand real availability in ABL structures. Increasing lender discretion in borrowing base criteria versus borrower's desires for certain of access to capital.
  - Split collateral package loans.
  - Increase in sponsors providing mezz/sub debt or even senior debt in order to more quickly deploy capital; to be determined whether there will be an adequate supply of traditional lender loans to refinance sponsor financing.
- Use of holding companies
  - Important to understand lender's requirements around org chart early in process.
  - Most lenders require pledge of equity in borrower/operating company to facilitate transfer of control in default situation (exercise of pledge rights vs. foreclosure on operating assets)

- Fraudulent transfer issues
  - Traditional lenders increasingly focused on issue, particularly as leverage levels increase.
  - Many approaches: Target as borrower, acquisition entity as borrower with target assuming obligations immediately upon closing, new strategies to limit loans made to operating subsidiaries, stronger solvency representations.
  - Does not seem to be a standard approach at this time.
- Intercreditor issues
  - Many possible intercreditor issues, affecting subordinate and second lien lenders, sponsors (relating to management fees), holders of seller notes and earnout recipients.

- Focus on when and to what extent subordinated lenders can exercise enforcement rights and the extent of the senior lender's ability to make decisions binding on subordinated lenders in enforcement proceedings.
- Subordinated lenders focused on an exit strategy, a seat at the table during enforcement proceedings, and objective asset valuations.
- Seller notes and earnouts are often deeply subordinated, which is a key issue to be handled; different approaches on timing of these discussions.
- Seller notes and earnouts often subject to refinancing indebtedness, further prolonging the lifecycle.


Investors/ Sponsor
Equity Investment by way of Loan Notes
Equity Investment by way of subscription for Share of Parent (including Preference Shares)
Rollover equity
Parent (Top Co)
Warrants (if applicable)
Subscription for Share of Sub-Holding Company and Structural Intra Group Loan
Equity pledge
Mezzanine/High Yield Lenders
Subordinated Loan/Bond/Note
Sub-Holding Company
Equity pledge
Downstreaming of funds
2nd Lien Loan/Note (if applicable)
2nd Lien Lenders
Senior Borrower (Purchaser)
Senior Loan
Senior Lenders
(Term Facilities A, B and C plus Revolver)
Acquisition
Target Company
Subsidiary 1 of Target
Subsidiary 2 of Target
Subsidiary 3 of Target

Commitment Letter Issues

- "SunGard" provisions
- Market flex provisions
  - Increased sponsor resistance given increased competition among lenders.
  - Certainty of deal terms and shifting some or all of the syndication risk to lenders is critical for many sponsors.

Documentation Issues

- Financial covenant definitions
  - Increased sponsor focus on covenant compliance and cash-flow sweep provisions (extensive negotiations on EBITDA add-backs and other inputs driving covenant compliance and cash-flow sweep numbers).
  - Sponsor demands for flexibility to contribute additional capital without mandatory pre-pays, undertake equipment and other operational financing options, and to execute growth strategy through add-on acquisitions.
  - Trend towards negotiating definitions at term sheet/commitment letter stage.
- Permitted acquisitions
  - Often a critical negotiating point for sponsors, but rarely will lenders provide self-executing carveouts from negative covenants for material transactions.
  - Focus on issues other than the basket: can process be streamlined, amendment fees agreed to up front or waived, etc.
  - For negative covenants generally, sponsor focus on avoiding yet another costly amendment: certainty on covenant compliance, flexibility for growth/ordinary course event, tying together negative covenants so that an exception to one is an exception to all, predetermined amendment fees for non-default amendments.
- Permitted distributions
  - Rarely will pure dividends be permitted, but important to negotiate rights to make tax distributions.
  - Need to look up the org chart to understand the complete picture around tax distributions.
  - Consider need for carveouts in respect of dividend accruals on preferred stock, management fees, earnouts, and equity repurchases from departing employees.

- Equity cure rights
  - Sponsors have different strategies.
  - If included, negotiations around amount of cure permitted, number of cures permitted, and time frame over which cure amounts included in covenant calculations.
- Solvency representations

- Defaulting lender provisions
  - Typical remedies.
  - Lead lender(s) commitment to make loans for defaulting lenders.
  - Impact on availability of swingline loans.
- Consents to assignments
  - Sponsor focus on the "relationship" and have approval right on new agent or material change in inter-lender provisions.
  - Limitations on syndication.
  - Assignments during default.

- Foreign subsidiaries
- Lender remedies – rights to credit bid