

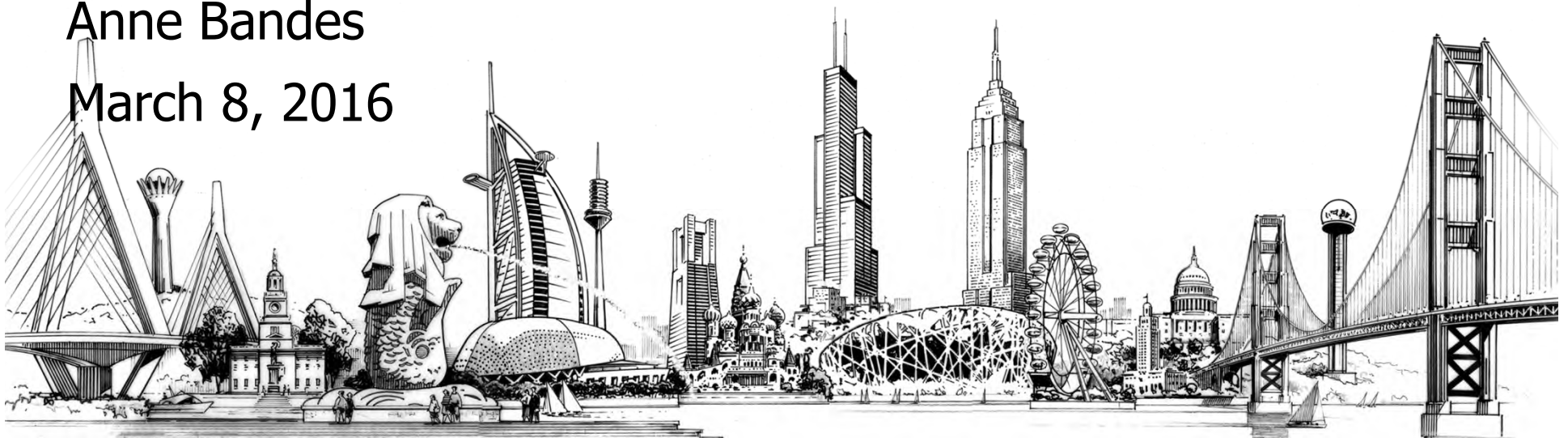
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M&A ACADEMY – FINANCING ISSUES IN M&A TRANSACTIONS

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Overview

- Purchaser-Seller Issues in Purchase and Sale Agreements
- Loan Commitments and Loan Documentation
- Lender Issues in Purchase and Sale Agreements
- Diligence and Collateral Issues
- Closing Logistics Issues
- Acquisition Financing Issues

Purchaser-Seller Issues

- Will the acquisition be financed?
 - On balance sheet, no financing
 - Most common with strategic purchasers
 - Timing of financing
 - At closing
 - Post-closing – Risk of financeability issues after closing
 - Bridge financings
- Financing contingency
 - Purchaser's obligation to close is contingent on obtaining financing.
 - Impairs perceived quality of a bid
 - Most common where assets are difficult to sell
- No financing contingency
 - Obligation to close is not contingent on financing

Purchaser-Seller Issues – No Financing Contingency

- Limitation on Purchaser's liability
 - If the financing cannot be obtained, how much downside risk will Purchaser have?
 - Reverse breakup fee, security deposit/letter of credit
 - Availability of specific performance
 - The risk of a substantial downside if the transaction fails for lack of financing puts significant pressure on certainty of financing
 - ***This is the central financing issue for Purchasers in M&A transactions***
- Certainty of financing is also a major issue for Sellers

Purchaser-Seller Issues – Cooperation with Financing

- Financing cooperation – The Purchaser will require Seller to cooperate with financing efforts
 - Attendance at bank meeting
 - Preparation of materials requested by financing arrangers
 - Financials
 - Representations and Warranties
 - Sellers do not want cooperation to broaden the representations given to Purchaser
 - Accountant consents and comfort letters (for capital markets deals)
- Diligence Q&A will need to accommodate lender questions
- Purchaser will require lender diligence to be completed before Purchaser is committed under the PSA
 - Separate data room versus single data room

Purchaser-Seller Issues – Timing of Closing

- Loan syndication process often requires a marketing period of 2 to 4 weeks, sometimes longer
 - Generally longer than the road show for a capital markets deal
 - Even if the transaction is fully committed, the lead banks usually require this marketing period in order to minimize how much they are likely to hold at closing
 - Purchase Agreement will often provide that the Closing Date cannot occur until the specified marketing period has elapsed
 - “Blackout periods”
 - The marketing period usually cannot span the couple of weeks before Labor Day and the period around Christmas, when participating syndicate banks and their credit committees may not be available.
 - Marketing period can’t begin until syndication materials are completed
- The Purchaser-Seller issue arising from this is what happens to the closing timeline if Purchaser’s lack of cooperation with bank information requirements delays the marketing period
 - Sellers want predictability on what banks will require

Purchaser-Seller Issues – Evidence of Financing

- Seller has an interest in assuring that Purchaser's financing will be completed
 - Debt and equity commitments often attached to Purchase and Sale Agreement
 - Commitment letters may be required as part of bid process on competitive deals
 - Timing of acceptance of commitment is usually simultaneous with signing PSA
 - Often have iterative versions of debt commitment between bid and signing PSA
 - Covenant by Purchaser not to adversely modify or terminate debt and equity commitment
 - Covenant by Purchaser to meet conditions in debt and equity commitments
 - Best efforts vs commercially reasonable efforts
 - Notice requirement for any adverse financing developments
- Enforcement of commitments
 - Will Purchaser covenant to sue to enforce commitments? (See "Xerox" provisions below)

Timing Issues for Capital Market Executions – Bridge Commitments

- Purchaser may want to access the high-yield bond market rather than the syndicated bank loan market to finance an acquisition long term
 - It may prove impossible to match timing of a high-yield offering precisely to the closing of an acquisition
 - Purchaser wants the ability to time the high-yield offering to match favorable market conditions
- Solution: Bridge loan to cover gap until high-yield execution post-acquisition
 - Typically short term – one year or less
 - Covenants often include obligation to do a shelf registration
 - Interest rate somewhat higher than longer term bank debt and rate often ratchets up quarterly
 - Purchaser does not want risk of default if it proves impossible to access high yield market, so often an option to convert to a long term bank loan at a high interest rate (with additional fees)

Loan Commitments and Loan Documents

- Commitment letters
 - Committed deals
 - Best efforts deals – Not suitable unless there is a financing contingency
 - Commitment letter confidentiality provisions permit it to be shared with the Seller
 - “Stapled” commitments
 - A commitment provided by the Seller’s bank to facilitate transaction
 - Somewhat out of favor since *Del Monte* case in 2011, due to risk of litigation regarding conflict of interest
- Fee letter
 - Not shared with Seller
- Definitive documentation
 - Rarely done until after the PSA is signed
 - Commitment letters are subject to completion of definitive loan documentation
 - Term sheets attached to commitment letters often contain numerous conditions precedent to closing
 - A major structural risk that could result in a financing not closing

Loan Commitments - SunGard

- If there is no financing contingency, how does Buyer protect itself against the financing not closing because the lender does not come to terms on final documentation, or conditions precedent to funding can't be met?
- "SunGard" provisions mitigate this risk
 - The conditions to closing and funding in the commitment are limited to:
 - Conditions that would permit the Purchaser not to close the purchase under the PSA
 - Solvency
 - A short list of other conditions and representations that are within the Purchaser's control or within its knowledge (due authorization, perfection of liens, OAF, Know Your Customer, etc.)
 - Critical deal-specific conditions (environmental report, no termination of critical contracts) for which Purchaser can assume some risk
 - "Material adverse effect" condition to closing in loan commitment must match condition in PSA

SunGard – Example text

- Notwithstanding anything in this Commitment Letter, the Fee Letter, the Loan Documents (as defined in Exhibit B) or any other letter agreement between you and us concerning the financing of the Transactions to the contrary, (i) **the only representations** relating to you, the Borrower, the Guarantors, the Company or your direct or indirect investors **the accuracy of which will be a condition to the availability of the Facilities on the Closing Date** will be (a) the representations made by or with respect to the Company in the Acquisition Agreement as are material to the interests of the Lenders (but only to the extent that the breach of such representations and warranties would permit you not to close the Acquisition Agreement) (the “Company Representations”) and (b) the Specified Representations (as defined below) and (ii) **the terms of the Loan Documents will be in a form such that they do not impair the availability of the Facilities on the Closing Date if all conditions set forth herein and those set forth in Exhibit B to this Commitment Letter are satisfied** (it being understood that nothing in this clause (ii) shall be construed to limit the individual conditions expressly set forth in Exhibit B). For purposes hereof, “Specified Representations” means the representations and warranties referred to in [the Term Sheet] relating to organization, requisite power and authority; due authorization, execution and delivery and enforceability, in each case, related to the entering into and performance of the Loan Documents; no conflict with organizational documents, or Material Project Documents (as defined in Exhibit C); solvency, as of the Closing Date, after giving effect to the Transactions, of the Borrower and the Guarantors on a consolidated basis; Federal Reserve margin regulations; the Investment Company Act; the Patriot Act; OAF; FCPA; status of the Facilities as senior debt; and creation, validity and perfection of the security interests in the Collateral (as defined in Exhibit A).

Loan Commitments – “SunGard” Provisions

- Limitations on SunGard protections
 - The provision overrides closing/funding conditions in the definitive loan documents and limits the representations that must be made in order to close
 - All other covenants and representations apply after closing
 - There could still be an immediate default after closing if a non-SunGard covenant is breached
 - There could still be an inability to borrow revolving loans post-closing if a representation could not be made
- Care should be taken in drafting the conditions that are required under the SunGard provisions
 - By definition, SunGard only applies when the lender doesn't want to close
 - Logistics of lien perfection should be addressed
- Note that PSA cannot be amended without lender consent

Lender Issues in PSAs

- Lenders want to avoid being pulled into disputes between Purchaser and Seller
- “Xerox” provisions
 - Lenders are third-party beneficiaries of limitations on Seller’s remedies for breach (reverse break-up fee, etc.)
 - Express restriction on Seller suing lenders
 - Exclusive venue (New York, as opposed to plaintiff-friendly jurisdiction)
 - Waiver of jury trial
- Lenders often want the Seller to acknowledge that the PSA cannot be amended without lender consent
- Carve-out to “No third-party beneficiaries” provision in PSA to give lenders benefit of the above provisions

Collateral Issues

- Most acquisition financings are secured
- Scope of collateral security is often negotiated
 - Equity pledges only?
 - Personal property only?
 - Real estate collateral?
 - Can be cumbersome and expensive to perfect
 - Pledges of receivables
 - Disruption of customer relationships through notices of assignment of receivables
 - Non-U.S. collateral
 - Difficulty/expense

Collateral Issues

- Controlled foreign corporation (“CFC”) deemed dividend issue
 - Limit of 66% of equity of foreign subsidiaries
 - No security interest in assets of CFCs
 - Impact on multi-tiered foreign subsidiary structures
 - Structural work-arounds
- Exclusion for security interest in contracts that would be breached by grant of security interest
 - Effect of 9-406, 9-407, 9-408 or 9-409
 - Overrides contractual prohibitions on granting of security interests in certain types of contracts, financial assets and licenses
 - Allows lender to be a secured party in a bankruptcy
 - Does not necessarily allow foreclosure, so if the contracts in question are critical collateral, loan structuring issues may arise
- “Intent to use” trademark filings

Collateral issues

- Example exclusion

. . . notwithstanding anything in this Credit Agreement to the contrary, the term “Collateral” shall not include any (i) “intent-to-use” trademark applications for which a statement of use has not been filed and accepted with the United States Patent and Trademark Office or any intellectual property if the grant of a security interest therein would result in the cancellation or voiding of such intellectual property by the applicable Governmental Authority, (ii) Equity Interests in any CFC owned by any Credit Parties in excess of 65% of the total combined voting power of all Equity Interests in such CFC, (iii) any assets of a CFC, or (iv) any agreement (including agreements relating to intellectual property) to which any Credit Party is a party, only to the extent and for so long as the terms of such agreement or any requirement of Applicable Law (x) validly prohibit the creation by such Credit Party of a security interest in such agreement in favor of the Administrative Agent (after giving effect to Sections 9-406(d), 9-407(a), 9-408(a) or 9-409 of the UCC (or any successor provision or provisions) or any other Applicable Law (including the Bankruptcy Code) or principles of equity) or (y) would result in a termination pursuant to the terms of any such agreement (other than to the extent that any such term would be rendered ineffective pursuant to Section 9-406, 9-407, 9-408 or 9-409 of the UCC (or any successor provision or provisions) of any relevant jurisdiction or any other Applicable Law (including the Bankruptcy Code) or principles of equity), in each case unless and until any required consents are obtained; provided further that Collateral shall include, and the security interest granted in the Collateral shall attach to, any proceeds, substitutions or replacements of any such excluded items referred to herein unless such proceeds, substitutions or replacements would constitute excluded items hereunder.

Due Diligence

- Lenders want to understand specific risks of company
 - Critical contracts
 - Regulatory issues
- Limitations on collateral?
 - Change in control provisions
 - Leases that cannot be perfected
 - These can be a significant component of value for a retailer, for example.
 - Substantial value in unperfected collateral can change the dynamic in a bankruptcy
- Timing
 - In a firm commitment, some level of diligence is necessary before commitment
 - Lenders often ask for purchaser's diligence memos
 - Non-reliance

Closing Logistic Issues

- Existing letters of credit to support third-party contracts may need to be replaced
 - New lender won't issue new LC until closing, so replacement on closing date can be an issue
 - Back to back structures
 - Post-closing timeframe for replacement
- Similar issue with original stock certificates
- Real estate collateral may require original mortgages at place of filing
- Are resolutions to approve financing adopted by pre-closing board of directors or post-closing board?
- Mapping out funds flows
 - Equity and debt funds flow in, but previous lender may require funds to hit before releasing liens

Acquisition Financing Issues

- Detailed terms of acquisition financing documentation would require a separate presentation, but a few points to note:
 - “Covenant light” versus full-fledged financial covenants
 - “Accordion” feature to facilitate upsizing
 - Tests for permitted dividends
 - Mis-match between term loan maturity and revolving credit maturity
 - Revolving credit lenders often have shorter maturities
 - In order to get benefit of longer term loan maturity, include “yank-a-bank” provision
 - Any revolving lender who doesn’t consent to extend maturity can be replaced with a new lender without refinancing the entire facility
 - Permit sponsor to hold some amount of debt, even if non-voting
 - “Soft call” versus “hard call” protection

Biography



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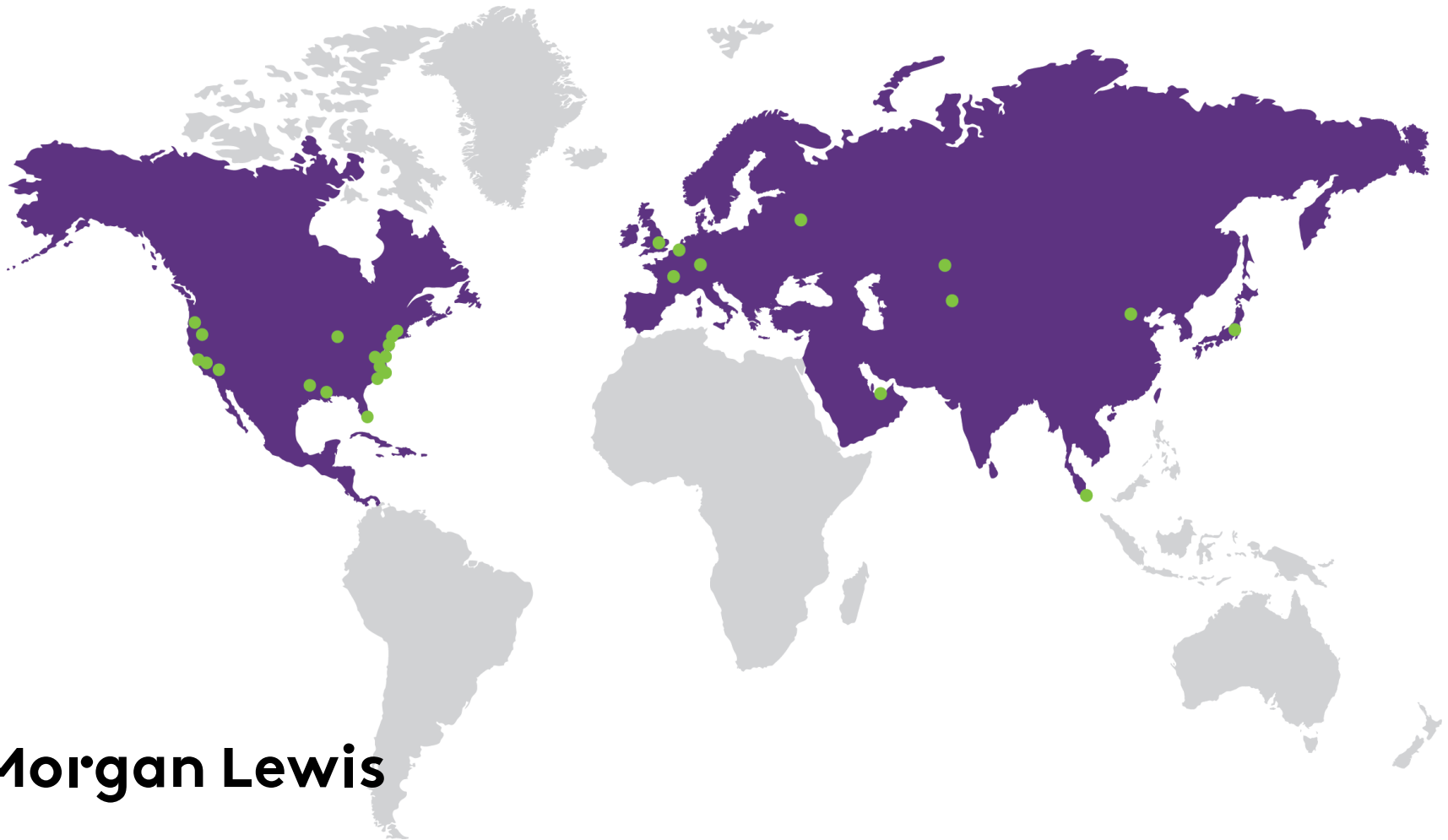
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