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Recent Trends in the United States M&A Market Activity

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Topics

- Current U.S. M&A Market Environment
- U.S. Financial Crisis
- General Cross-Border M&A Considerations
- Q & A

Current U.S. M&A Market Environment

General U.S. M&A Market

- Effect of U.S. subprime mortgage market downturn and worsening in the 2nd half of 2007 and the first half of 2008, respectively, on the U.S. M&A Market
  1. Stifling of general U.S. economy – U.S. credit market in particular
  2. Temporary exit by private equity players from the U.S. M&A market due to difficulty obtaining third party financing.

     -At 9/30/08, buyout deals saw a 83.5% fall year-to-date, for a total of $61.8 billion out of $951.7 billion year-to-date for overall U.S. M&A deals.

     -Certain private equity players cite the current limit on bank financing for leveraged buyouts to be as high as $5 billion and as low as $2 billion.
  3. The credit crisis and the significantly weakened dollar have created bargains for foreign investors flush with strong currencies, large pools of investment capital derived from natural resources and exports and excess cash.
- In 2007, U.S. was a net M&A target whereas in 2006, U.S. was a net M&A acquirer. The 2007 trend has continued in 2008.
  1. In 2007, U.S. inbound M&A was $354 billion v. outbound M&A at $248 billion.
  2. In 2006, U.S. inbound M&A was $181 billion v. outbound M&A at $203 billion.
  3. At 9/30/08, U.S. inbound M&A was $474.2 billion v. outbound M&A at $270.5 billion.

Current U.S. Market Environment
Mergers & Acquisitions in 1st 9 months of 2008

- Weak M&A and LBO activity

  -The total number and value of M&A transactions in the U.S. have decreased dramatically – in the first three quarters of 2008, the U.S. deal volume slid 27% to $951.7 billion, as compared to the first three quarters of 2007, when the U.S. deal volume was $1,296.5 billion.

  -Record LBO volume of $433.7 billion in 2007 was followed by a steep decline as financing alternatives dried up.

- Decline in credit market liquidity

  -New CLO issuance, which aggregated nearly $200 billion in 2006-07, has essentially halted in 2008 creating a vacuum for new deals.

  -There was a Significant decline in availability of second lien tranches which had emerged as an important source of financing for issuers and acquirers who would otherwise need to raise high yield or mezzanine debt.

Current U.S. Market Environment
Mergers & Acquisitions in 1st 9 months of 2008

- Significant decline in transaction leverage with better pricing for risk

  -Leverage multiples continued to rise in 2007 marking a period of historically high leverage, but they are now decreasing with upheaval in the credit markets and global economic concerns.

  -Purchase price multiples have not yet adjusted to new market conditions, and with lower available leverage, required equity investment percentage has gone up.

U.S. Financial Crisis
Causes

- Boom and Bust in the housing market

1. A combination of low interest rates and large capital inflows from outside the U.S. created a surplus of loanable funds and easy credit for many years leading up to the crisis.

   a. Fannie Mae and Freddie Mac eased credit requirements on mortgages, leading banks to extend home mortgages to individuals whose credit is generally not good enough and offering high-risk loans such as interest-only adjustable-rate mortgages and "No Income, No Job and No Asset" loans.

2. Demand for housing fueled price increases and consumer spending, and resulted in a surplus inventory of homes due to overbuilding, and eventually caused home prices to decline.

U.S. Financial Crisis
Causes

- Inability of homeowners to pay mortgages

1. Once housing prices started depreciating in the U.S., mortgage refinancing became more difficult for many subprime borrowers, and the mortgage default rate skyrocketed.

   a. As of October 2007, approximately 16% of subprime loans with adjustable rates were 90-days delinquent or in foreclosure proceedings, approximately triple the rate in 2005. By January 2008, the delinquency rate had risen to 21% and by May 2008, 25%.

   b. During 2007, nearly 1.3 million properties were subject to foreclosure filings, up 79% versus 2006.

U.S. Financial Crisis
Causes

- Securitization allowed banks to transfer credit risk to investors

1. Securitized share of subprime mortgages (i.e., those passed to third party investors) increased from 54% in 2001, to 75% in 2006.
2. Mortgage defaults decreased the value of mortgage-backed securities, thereby adversely affecting investors in such securities.

- Too much deregulation?

1. Repeal of Glass-Steagall Act of 1933, which was devised to prevent banks from making speculative investments and which kept banking and insurance business separate, turning the debts into securities, and selling them off to investors, permitted financial supermarkets like Citigroup to operate any kind of financial business they desired.
2. Self-regulation of investment banks and decreased regulation of financial institutions led to their risky investment behavior.
   - a. No regulation of risky credit insurance contracts such as credit default swap
   - b. Led to speculative short selling in financial companies
   - c. Investment banks' increased ability to leverage their balance sheets

U.S. Financial Crisis
Impact - General

- Financial sector downturn - many financial institutions started to report collateralized debt obligation or mortgage backed securities-related loss in the form of writedowns
- Stock markets –stock indices trended downward for several months since the first panic in July/August 2007
- The crisis caused panic in financial markets and encouraged investors to take their money out of risky mortgage bonds and shaky equities and put it into commodities and Treasury Bills – contributing to food and commodities price increases
- 65,400 jobs lost in the U.S. financial sector as of September 2008

U.S. Financial Crisis
Impact – financial institutions

- Bear Stearns – acquired by JPMorgan Chase for approximately $2.2 billion
- Fannie Mae and Freddie Mac - in an effort to stabilize the U.S. housing market, the U.S. Treasury Department effectively took control of the mortgage giants for approximately $200 billion
- Merrill Lynch – acquired by Bank of America for approximately $40 billion
- Lehman Brothers – filed for Chapter 11 bankruptcy protection and sold its North American division to Barclays and its Asia-Pacific operations to Nomura Holdings three days later
- AIG – The Federal Reserve provided an emergency loan of $85 billion, which will be repaid by selling off assets of AIG and which gave the U.S. government a 79.9% equity stake, and gave another bailout in the amount of approximately $37.8 billion
- Wachovia – to be acquired by Wells Fargo for approximately $15 billion

U.S. Financial Crisis
Impact – financial institutions

- Ownership investment in banks by the government
- Washington Mutual – sold its consumer bank branch network to JPMorgan for approximately $1.9 billion after the thrift was seized in the largest U.S. bank failure in history
- Morgan Stanley and Goldman Sachs – raised additional capital from outside investors (approximately $9 billion from Mitsubishi for Morgan Stanley and approximately $5 billion from Berkshire Hathaway for Goldman Sachs), and were granted holding company status by the Federal Reserve, resulting in their obtaining greater access to federal funds and FDIC protection in exchange for more federal regulation

U.S. Financial Crisis
Main Legislative Actions

- Economic Stimulus Act of 2008 - economic stimulus package of $168 billion, mainly in the form of income tax rebates
- Housing and Economic Recovery Act of 2008 – six separate acts designed to restore confidence in the U.S. mortgage industry, which includes, among other things:

1. providing insurance for $300 billion in mortgages estimated to assist 400,000 homeowners
2. establishing a new regulator to ensure the safe and sound operation of Fannie Mae and Freddie Mac and Federal Home Loan banks
3. Raises the dollar limit of the mortgages the government sponsored enterprises can purchase

U.S. Financial Crisis
Main Legislative Actions

- Emergency Economic Stabilization Act of 2008

1. Main premise - if financial institutions could sell their troubled assets (including mortgages, mortgage-backed securities and other instruments) to the government while retaining assets that are not "troubled" on their balance sheets, these institutions would be viewed as safer transactional counterparties
2. Total amount involved - $850 billion. Up to $700 billion for the purchase of troubled assets and up to $100 billion for the extension or expansion of a variety of tax breaks
3. Troubled Asset Relief Program ("TARP") - The act authorizes the Secretary of the Treasury to purchase troubled assets from financial institutions. The Office of Financial Stability ("OFS") was created within the Treasury Department as the agency through which the Secretary of the Treasury will run TARP
4. Under TARP, the Secretary of the Treasury is authorized to purchase certain "troubled assets" from financial institutions, and in general, the act requires sellers of troubled assets to provide the Treasury with warrants exercisable for non voting stock

U.S. Financial Crisis
Main Legislative Actions

- Emergency Economic Stabilization Act of 2008

5. Any financial institution that participates will be subject to certain executive compensation restrictions – e.g., a clawback provision whereby the Secretary of the Treasury can retract bonuses paid to senior executive officers based on materially inaccurate earnings statements or other criteria, and prohibition on golden parachutes while the Treasury holds an equity or debt position in a financial institution and on golden parachutes in new employment contracts when troubled assets are purchased through an auction.

6. Temporarily increases the federal deposit insurance limit from $100,000 to $250,000 – effective until December 31, 2009.

7. Division B of the act – Energy Improvement and Extension Act of 2008

    a. Extends through 2009 tax credits for producing electricity from wind and refined coal facilities, and extends through 2010 such tax credits for other types of energy production such as solar energy and hydropower.

    b. allows a 30% investment tax credit rate for advanced coal-based generation technology projects.

U.S. Financial Crisis
Main Legislative Actions

- $250 billion stock purchase plan

1. As part of the overall plan to provide more liquidity in the financial markets, the government will initially purchase up to $125 billion of non-voting preferred stock in nine leading banks (Citigroup, Wells Fargo, JPMorgan Chase, Bank of America, Morgan Stanley, etc.)
2. After the purchase of stock in nine major banks, the remaining $125 billion are expected to be spent on the purchase of stock in many other banks by the end of 2008
3. The banks that sell stock to the government will be required to accept restrictions on executive compensation, including a ban on golden parachutes for the period during which the government holds the banks' stock
4. When financial markets stabilize and recover, the banks are expected to buy the stock back from the government

U.S. Financial Crisis
Main Legislative Actions

- ❑ Short-term debt purchase plan

1. On 10/27, The Federal Reserve will begin buying vast amounts of short-term debt, on which many companies rely to pay their workers and to buy their supplies, in an effort to break through a credit clog

- ❑ Federal Deposit Insurance Corp. ("FDIC") Program

1. FDIC will provide insurance for new "senior preferred" debt that one bank would lend to another for three years in order to unlock bank-to-bank lending
2. FDIC will remove temporarily the current $250,000 limit on FDIC insurance on bank deposits for non-interest-bearing accounts

U.S. Financial Crisis
Global Responses

- Financial markets worldwide are porous, and the U.S. financial crisis has affected the financial industries worldwide. Governments around the world have taken actions in response

1. U.S. and British regulators' temporary ban on short-selling of financial stocks
2. The British government's nationalization of Northern Rock
3. The British government's taking control of Bradford & Bingley's £50bn mortgages and loans, and selling Bradford & Bingley's savings operations and branches to Spain's Santander for approximately $1.1 billion
4. Governments of Belgium, Netherlands and Luxembourg's action in unison to effectively nationalize Fortis with a combined $15.5 billion cash injection
5. Germany and its banks pledging $30 million euros to rescue commercial property lender Hypo Real Estate

U.S. Financial Crisis
Global Responses

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6. The Australian federal government's investment of AU$4 billion in non-bank lender mortgage-backed securities in an attempt to maintain competition in the mortgage market
7. Capital injection into banking systems by Central banks in Japan and Australia
8. Russia's lowering of reserve requirements to assist its banks
9. Scottish banking group HBOS acquired by UK rival Lloyds TSB for approximately $21.9 billion, which transaction was encouraged by the British government, which agreed to waive certain UK competition rules
10. The British government's making $87 billion in direct aid available to banks along with additional guarantees

U.S. Financial Crisis
Global Responses

- European governments plan to take further actions by coordinated pledges to inject up to $2.3 trillion into Europe's struggling banks. Examples include:

1. The British government will inject $63 billion to three of Britain's largest banks, so that they could improve their balance sheets;
2. The German government has approved $136.5 billion in direct taxpayer aid if banks need it, together with $546 billion in guarantees;
3. The French government will set up two funds, one to provide $54.6 billion in state funding to capitalize needy banks by buying shares and $437 billion in the other to provide guarantees; and
4. The Italian government will make more than $27 billion available to needy banks.

U.S. Financial Crisis Forecasts

- Fall of Reaganism/Thatcherism – more regulation to come?

1. SEC's proposal of new rules on short sales – hedge funds and others might have to disclose their short positions for the time being
2. SEC's urging of Congress to pass a law to regulate credit default swaps

   a. The Governor of New York stating that New York would begin certain kinds of credit default swaps

3. Government intervention in the financial industry could be a norm in the U.S. as it is in other countries

- Worst financial crisis since the Great depression?

1. Optimistic scenario predicted by some economists – a couple of years of mild recession or painfully slow economy growth
2. In response to recent government bailout actions, stock markets seem to be rebounding

General Cross-Border M&A Considerations

General Cross-Border M&A Considerations

- Recent Developments
- Political Considerations
- Transaction Structures
- Regulatory Hurdles
- Transparency
- CFIUS
- M&A Rules of the Road
- Tax Considerations
- Disclosure Obligations
- Market Players
- Financing
- Corporate Governance and Securities Law
- Antitrust Issues

General Cross-Border M&A Considerations

- Of the $951.7 billion and $1.4 trillion of US M&A activity in 2007 and the first three quarters of 2008, approximately 50% and 25%, respectively, involved non-US buyers. In 2006 and 2005, only 13% and 12%, respectively, involved non-US buyers. We expect this percentage involving non-US buyers to continue to increase in the fourth quarter of 2008 and 2009.
- The significantly devalued dollar and the credit crisis continue to create bargains for foreign investors.
- The strategic benefits of acquiring US brands, technology and resources are attracting foreign buyers.
- U.S. investment has been high on the European agenda with the UK topping the global list, but with the ramification of the credit crunch stretching to Europe, buyers from the Middle East and pivotal Asian economies are very much in the race for U.S. assets.

General Cross-Border M&A Considerations

- The door is open for strategic buyers to acquire U.S. assets at a cheaper price due to the absence of private equity firms driving up deal values. U.S. sellers are agreeing to lower prices and focusing on the buyer's cash position and ability to obtain financing.
- Foreign companies have an advantage over U.S. companies – the exchange rate. For example, with a strong euro and pound against a weak U.S. dollar, some experts suggest that European investors can purchase U.S. companies at around 30% less than 2 years ago.
- A savvy investor that picks up a handful of good U.S. companies, and prepares for an exit in 4 to 5 years, could capitalize twice – once on a rising dollar value and again on the improved performance of the company.

General Cross-Border M&A Considerations

- Asian manufacturers see compelling reasons to make acquisitions in the U.S., desiring brand, distribution and technology.

  -At present, most of the design work happens in the U.S., and the product is then manufactured in Asia, before being passed back to the U.S. where the marking and distribution takes place. The current U.S. economic conditions give lower and middle market companies the perfect incentive to acquire the design, distribution and marketing capability which they currently lack.

General Cross-Border M&A Considerations

Political Considerations

Careful thought should be given to political ramifications in advance of any acquisition proposal, particularly if the target company is in a sensitive industry or if the acquirer is sponsored or financed by a non-U.S. government. Concerns of federal, state and local government agencies, employees, customers, suppliers, communities and other interested parties should be addressed strategically. If possible, relationships with the target company's management should be established well in advance so that political and other concerns can be addressed in a collaborative manner.

General Cross-Border M&A Considerations

Transaction Structures

Flexible acquisition structures may be necessary or expedient. Structures that may be helpful in particular circumstances include a minority position or joint venture, possibly with the right to increase to full ownership over time; making the acquisition in partnership with a U.S. firm; or utilizing a controlled or partly-controlled U.S. acquisition vehicle, possibly with a board of directors having a substantial number of U.S. citizens and a prominent American as a non-executive chairman.

General Cross-Border M&A Considerations

Regulatory Hurdles

Any weaknesses in the ability to clear regulatory hurdles could be used by reluctant targets, competing bidders or competitors of the target to frustrate the acquisition. In addition to securities and antitrust regulations, acquirers should plan for a review by the Committee on Foreign Investment in the United States (CFIUS) under the Exon-Florio Act, discussed below; and, in transactions involving regulated industries (e.g., energy, public utilities, gaming, insurance, telecommunications and media, financial institutions, and defense contracting), prepare for an additional layer of approvals.

General Cross-Border M&A Considerations

Transparency

When pursuing transactions, foreign investors have to exercise an increased level of transparency and be willing to face scrutiny from CFIUS. In addition, the recently enacted FINSA, affecting non-U.S. entities seeking to acquire, merge with, or make an investment in a U.S. business, may involve a governmental review and investigation of such transactions. AS a result of FINSA, CFIUS will likely become more active, and the reviews and investigations it undertakes more numerous. Not only will transactions in traditional defense sectors be reviewed, but FINSA makes clear that national security concerns may be implicated as well by investments in critical infrastructure, such as transportation, energy and technology.

General Cross-Border M&A Considerations

CFIUS

The U.S. Congress' passage of the Foreign Investment and National Security Act of 2007, which amends the Exon-Florio Act, highlights the continuing scrutiny of cross-border transactions. Transactions most likely to attract the greatest scrutiny by CFIUS, the multi-agency governmental body that reviews transactions in which foreign acquirers could obtain "control" of a U.S. business or assets, involve investments by foreign governments or investments in U.S. infrastructure, technology or energy assets. Two useful rules of thumb in dealing with CFIUS are, first, that in general it is prudent to make a voluntary filing with CFIUS if the likelihood of an investigation is reasonably high or if competing bidders are likely to take advantage of the uncertainty of a potential investigation, and, second, that it is often best to take the initiative and suggest methods of mitigation early in the review process in order to help shape any remedial measures and avoid delay or potential disapproval.

General Cross-Border M&A Considerations

M&A Rules of the Road

It is critical to understand the custom and practice in U.S. M&A transactions. Successful execution is more art than science, and early involvement by experienced U.S. advisors will be important. Knowing how and at what price level to enter the discussions may make or break a proposal – in some situations it is prudent to start with an offer on the low side, while in others offering a full price at the outset may be essential to achieving a negotiated deal and discouraging competitors, including those who might raise political or regulatory issues. In sensitive transactions, hostile maneuvers may be imprudent.

General Cross-Border M&A Considerations

Tax Considerations

Tax issues are critical to structuring the transaction. Non-U.S. acquirers contemplating a dividend stream flowing from the U.S. target should structure with a view toward withholding tax requirements and should consider the possibility of utilizing a subsidiary located in a country that has a favorable tax treaty network or other tax attributes that will minimize the taxes imposed on the dividends as they cross borders. The proportion of debt and equity will be important from a tax perspective, as will be obtaining U.S. interest deductions on acquisition indebtedness.

General Cross-Border M&A Considerations

Disclosure Obligations

How and when an acquirer’s interest in the target is publicly disclosed should be carefully controlled and considered, keeping in mind the various ownership thresholds that trigger mandatory disclosure on a Schedule 13D under the securities law, and regulatory agency rules such as those of the Federal Reserve Board, the Federal Energy Regulatory Commission, and the Federal Communications Commission. While the Hart-Scott-Rodino Antitrust Improvements Act does not require disclosure to the general public, the Hart-Scott rules do require disclosure to the target’s management before relatively low ownership thresholds can be crossed.

General Cross-Border M&A Considerations

Financing

The recent credit market upheaval has put even more scrutiny on the financing aspects of transactions. Critical questions to consider include where financing with the most favorable terms and conditions is available; how committed the financing is; which lenders have the best understanding of the target's business; and how comfortable the target will feel with the terms and conditions of the financing.

General Cross-Border M&A Considerations

Antitrust

To the extent that a non-U.S. acquirer directly or indirectly competes or holds an interest in a company that competes in the same industry as the target company, antitrust concerns may arise either at the federal agency or state attorneys general level. Although less typical, concerns can also occur if the foreign acquirer competes either in an upstream (e.g., major input) or downstream market of the target.