Opportunities in adversity

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Ernst & Young
Quality In Everything We Do

Introductions

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Agenda

- Introductions
- Observations on current M&A market
  - What we are hearing and seeing from clients
  - Understanding divestitures
- Improving operations
  - Debt covenant awareness
  - Managing working capital
  - Supply chain risk
  - Tax strategies
- Impact of Obama's proposed tax legislation
- Focus of entrepreneurs

Trends in M&A: The changing transaction landscape in a time of crisis

Driving forces

- Opportunistic market leaders
- Increasing consolidation
- Greater willingness to enter adjacencies or to redefine the business
- More serious consideration of targets overseas—especially, in developing countries

Restraining forces

- Deflationary expectations, a reason to defer
- Inelastic seller expectations
- Greater difficulty in projecting free cash flows

Possible solutions

- A rise in the use of non-cash consideration
  - Common stock
  - Convertible preferred
- Contingency payments given greater thought
- More joint ventures, partnerships, and minority investments
- Consideration of debt purchases as a means of acquiring distressed companies

Trends in M&A: The changing transaction landscape in a time of crisis (continued)

Other trends and observations

- Smaller deals
- More extended deal cycles
- Greater tracking of PE portfolio companies as targets
- Lower quality of available portfolio companies
- An increase in dispositions, including spin-offs
- More rigorous deal evaluation and execution
  - An intensified focus on target's change in net working capital
  - Sharper modeling and valuations
  - More exacting due diligence
  - Greater focus on integration – both past and future acquisitions
  - Less sanguine view of revenue synergies
- A resumption of M&A activity in the second half of 2009
- Greater M&A activity in 2010 than in 2008

Divestitures

Driving forces

- Non-performing assets
- Focus more on the core business
- Liquidity (i.e., free up cash)

Restraining forces

- Low price realization
- Too many interdependencies
- Lack of buyers

Divestiture Roadmap

Objectives: Discover Value and Determine Negotiation Range — Preserve Value

Strategic Analysis → Opportunity Analysis → Transaction Development → Negotiation Advice and Execution → Transaction Effectiveness

Offering Memorandum & Data Room

- Conduct portfolio analysis of BUs/ brands/ assets
- Upfront tax planning strategies to minimize gain and utilize NOLS (as applicable)

- Establish Transition Management Office
  - Functional leads identified
- Create business plan and stand-alone financials
  - Identify normalizing and pro forma adjustments
  - Conduct stand-alone cost analysis
  - Review accounting policies and cost allocation methodology
  - Balance sheet & working capital
- Perform sell side due diligence
  - Identify potential risks and upside from a financial/strategic buyer's perspective
- Estimate one-time & residual costs
- Determine baseline valuation
- Populate and manage data room

Management Presentation & Negotiation

- Understand needs of Buyer
- Refine valuation assumptions
  - Balance purchase price, residual cost, and TSA pricing trade-offs
- Identify and price TSAs, supply and commercial agreements
- Refine stand-alone, one-time and residual cost assumptions
- Create negotiation matrix & prepare for buyer questions
- Perform accounting and tax structuring

Divestiture Execution

- Plan and manage transaction execution
- Manage TSAs
- Plan and manage residual cost elimination
- Measure and monitor transaction effectiveness
- Adjust purchase price

Liberating Cash from Working Capital

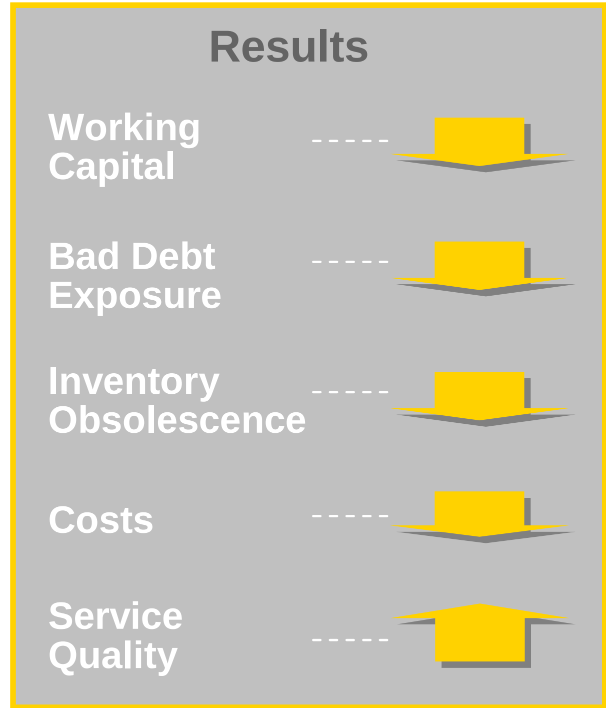
Cash from working capital is the cheapest source of additional liquidity

More cash equals more options

- Pay down debt
- Fund strategic initiatives
- Fund day-to-day operations
- Finance acquisitions

Consistently high and/or erratic working capital levels are an indicator of operational execution and quality

- Processes lacking leading practices
- Metrics driving wrong behavior
- Weak policies increasing cash consumption
- Reactive activities
- High unbilled receivables
- High inventory, yet poor customer service
- Poor supplier management disciplines



Policy and process based programs result in benefits broader than cash

Working capital improvement challenges

It's fairly simple to understand, but it's not easy to change

Performance Indicator	Meaning	People in charge	Driven by
Days of sales outstanding (DSO)	Average time a receivable remains on the balance sheet, measured as the number of days sales represented by the AR balance **How long does it takes to get paid?**	• Sales • Customer Service • Credit • Collections	• Payment terms • Timeliness of Invoice issuance • Collection effectiveness • Issues that cause late payment
+			
Days of inventory outstanding (DIO)	Inventory in terms of number of days of sales/usage **How long will it take to consume the inventory?**	• Sales / Marketing • Customer Service • Manufacturing • Supply Chain • Distribution	• Inventory policies • Poor forecast accuracy • Inflated lead-times • Low cost sourcing
-			
Days of payables outstanding (DPO)	Value of the creditor balance in terms of number of average days of purchases. **How long does it take to pay?**	• Purchasing • Finance	• Payment terms • Payment triggers • Payment clock • Payment methods
=			
Days of working capital (DWC)	Value of the NWC in terms of number of average days of sales. **How many days of sales do we carry as working capital to run the business?**	• CEO/COO &CFO	• The lower the better

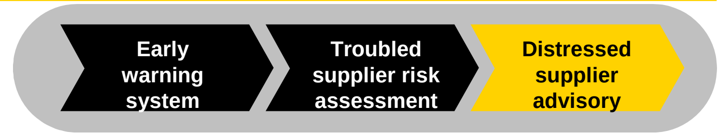
Identify and manage supplier risk

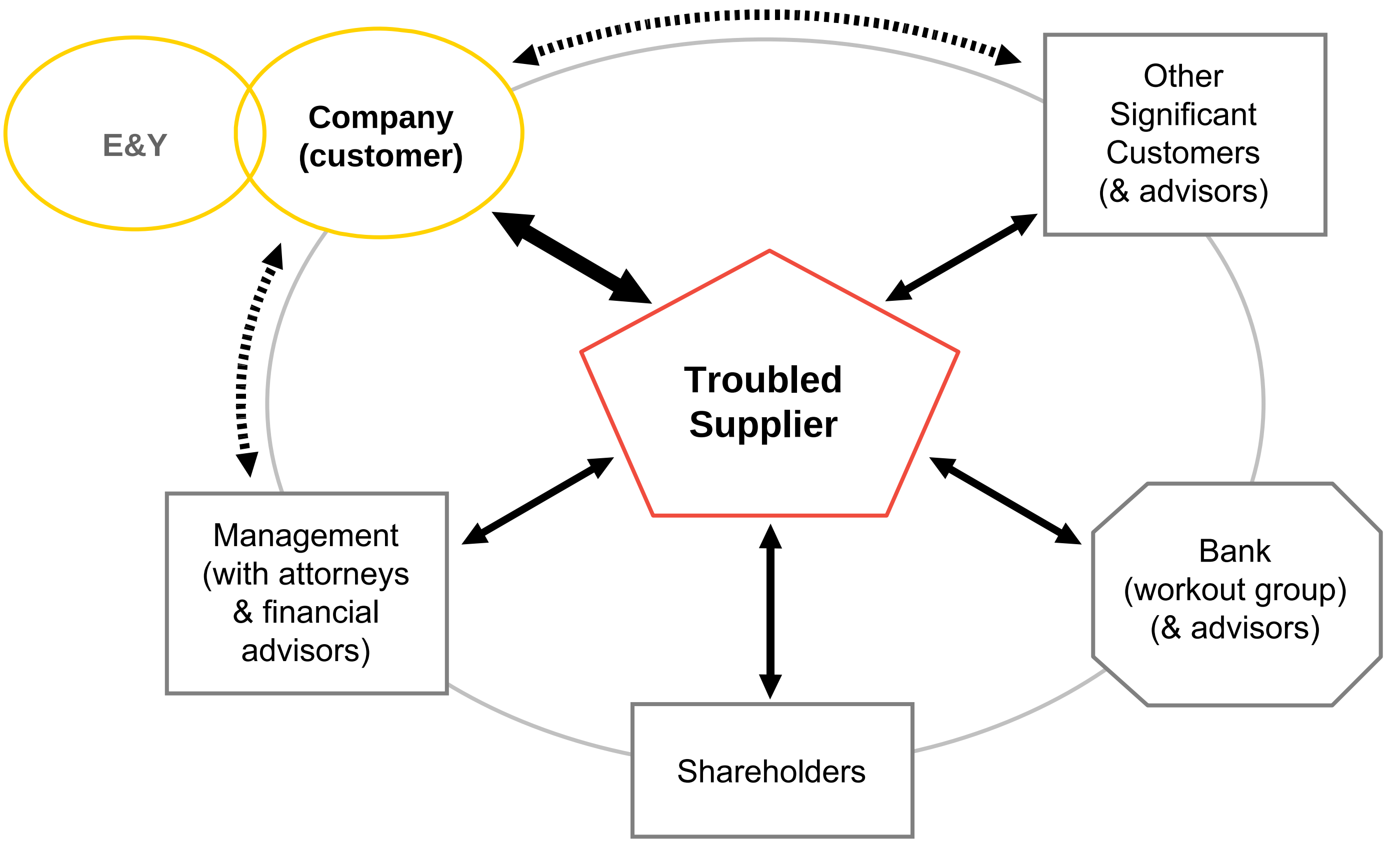
Early Warning Screening System → **Troubled Supplier Risk Assessment** → **Distressed Supplier Advisory**

Early Warning Screening System	Troubled Supplier Risk Assessment	Distressed Supplier Advisory
Operational, financial & qualitative metrics used to profile supplier pool based on risk level	Detailed risk assessment & mitigation planning for suppliers that pose significant risk	On-site evaluation and review of distressed suppliers with a view to protecting supply

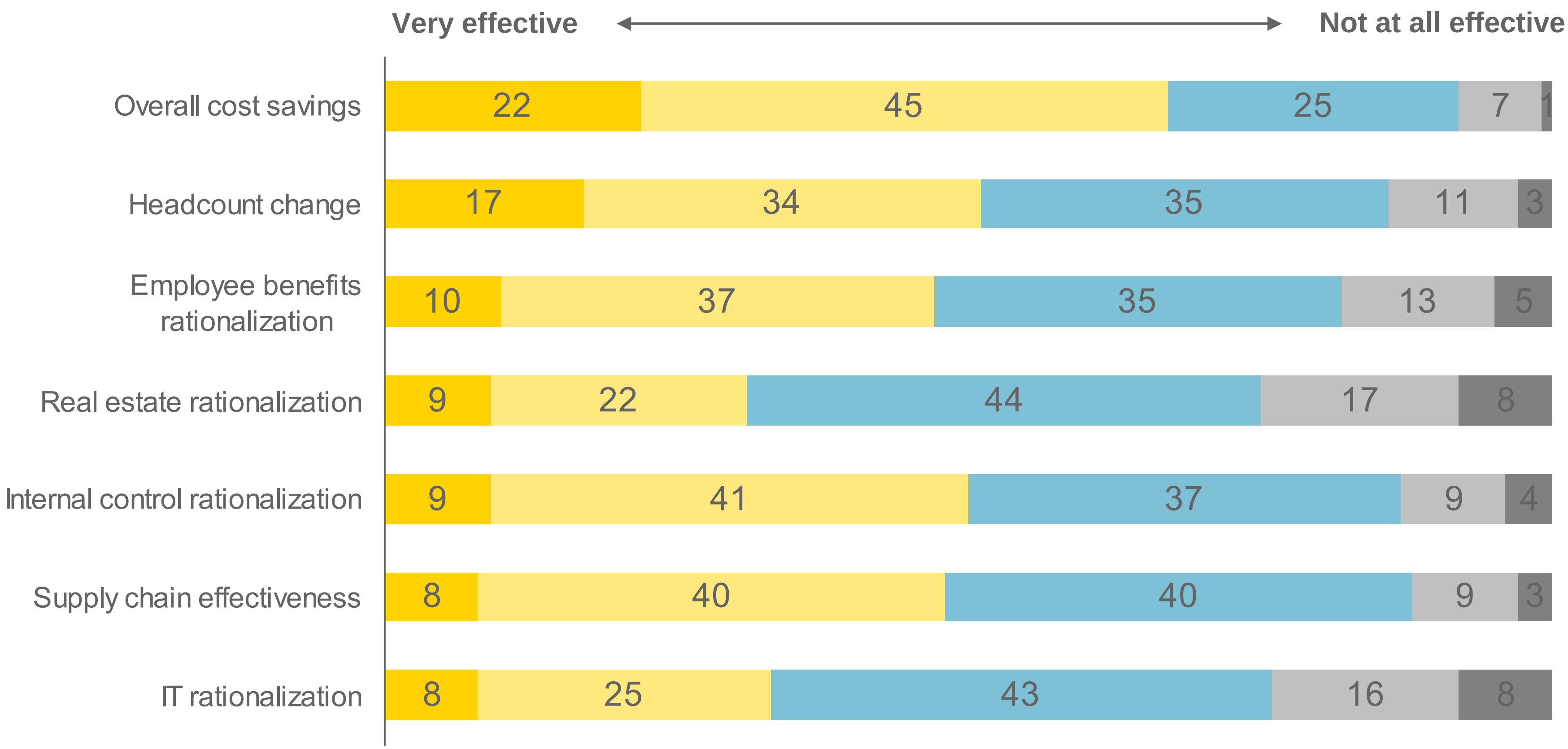
An ideal supplier risk management system generates just enough information to identify and address potential supply chain exposures

Multiple Competing Interests Are Common in Troubled Supplier Situations



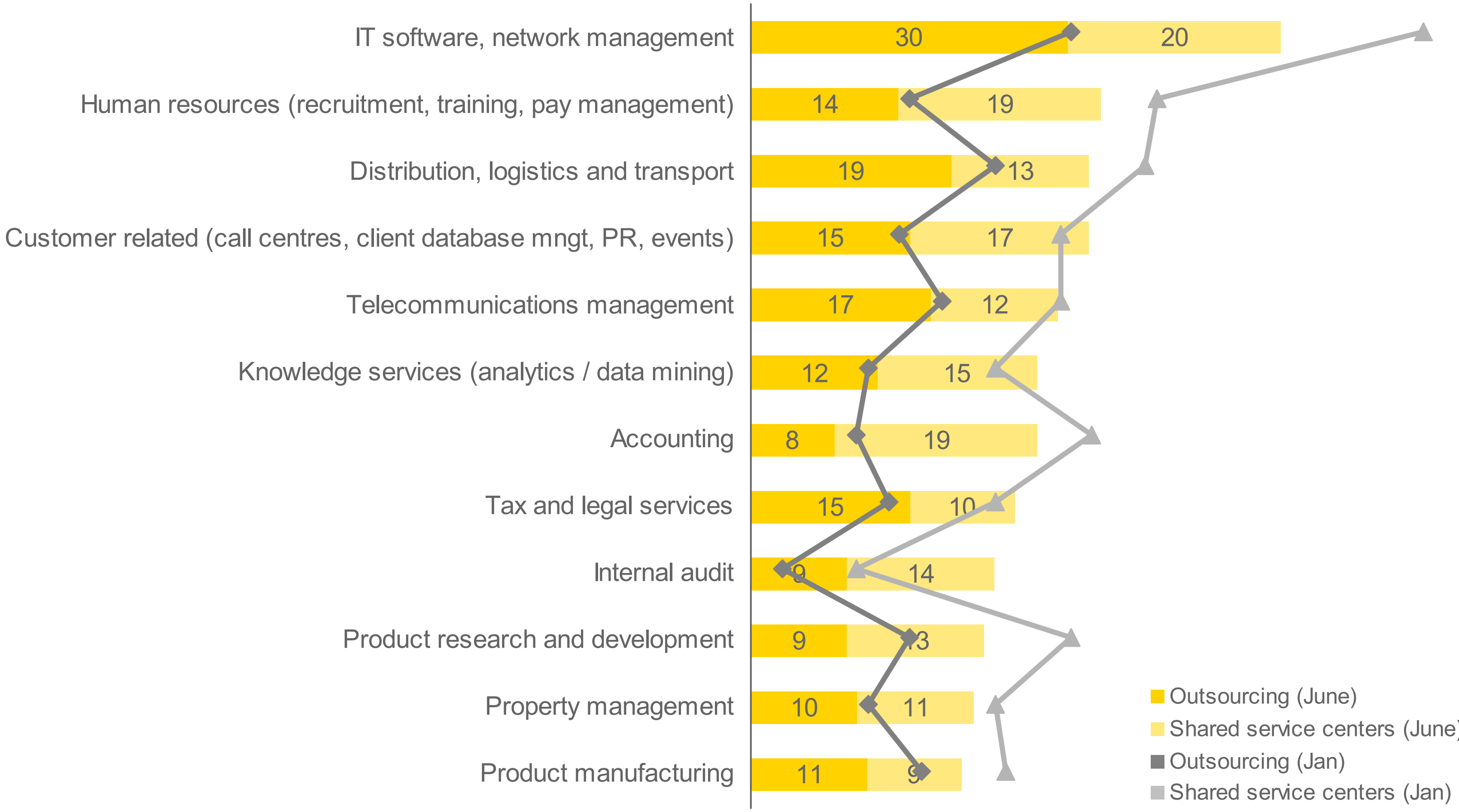


How effective have companies been in achieving cost reduction targets?



Q: **Over the past 12 months, how effective have you been in achieving your target cost reductions in the following areas?** Shown: percentage of respondents.

Considering which functions would increasingly use outsourcing or shared service centers



Q: **Over the next 12 months, for which functions are you considering an increase in the use of outsourcing or shared service centers at your company?** Shown: percentage of respondents

Discounted debt repurchases – new Section 108(i)

- Law prior to enactment of new Section 108(i)
  - The repurchase by a debtor, or a related party, of the debtor's own debt at a discount generally will give rise to cancellation of indebtedness income (COD)
  - Section 108(a) provides various exceptions to this including cases in which the debtor is insolvent or the debt is reacquired in a bankruptcy proceeding
  - These exceptions generally trigger corresponding reductions in the debtor's tax attributes (e.g., NOLs)
- New Section 108(i) deferral
  - New Section 108(i) provides for an elective deferral of COD arising from certain debt reacquisitions (e.g., the acquisition of a debt instrument by the debtor or a related party in exchange for cash, a new debt instrument or stock) in calendar years 2009 and 2010
  - For a calendar-year taxpayer, the deferred COD would be included in income ratably in calendar years 2014 through 2018 (i.e., a four or five year deferral followed by a five year inclusion period)
  - Certain events accelerate the inclusion of the deferred COD (e.g., a liquidation of the debtor, sale of substantially all of its assets or cessation of its business)
  - To the extent the reacquisition is effected by issuing a new note (or significantly modifying the existing note), OID deductions accruing with respect to the new note during the deferral period are likewise deferred (and deducted during ratably during calendar years 2014 through 2018)
    - Note that the OID *income of the holder* is not deferred
  - Note that the above results may not necessarily apply for state tax purposes

Exclusion for COD: COD recognized, but excluded from gross income

- Insolvency and bankruptcy exclusions
  - Attribute reduction
  - COD income is excluded *to the extent of* the taxpayer's insolvency immediately before the cancellation

Partnerships

  - COD determined at partnership level
  - Insolvency and attribute reduction determined at partner level on a partner-by-partner basis

S corporations

  - COD, insolvency and attribute reduction determined at S corporation level

Obama Administration's proposed international tax law changes: what's at stake for US businesses

- Obama Administration's international tax proposals:
  - Proposals announced 4 May 2009
  - Additional guidance released in Green Paper 11 May 2009
- Headline International Changes for Corporations:
  - Check the Box modifications;
  - Defer deduction for expenses related to foreign income;
  - Modify US foreign tax credit rules;
  - Codify economic substance;
  - Changes to the QI Regime;
  - Repeal 80/20 Company rules;
  - Modify Earnings Stripping rules;
  - Prevent repatriation of earnings in certain cross-border reorganizations;
  - Treatment of carried interest as ordinary income.

Modifications to the Check-The-Box Rules

- Would require US businesses that establish certain corporations overseas to report them as corporations on their US returns
  - An effective expansion of the "per se" list of foreign corporations;
  - No indication of returning to the "four factors" test;
  - Not limited to entities in tax havens;
  - Does not appear to affect entities with more than one owner;
  - Transition rules outlined in current CTB regulations;
  - No indication of grandfathering provision;
  - Denial of check-the-box entity classification for foreign corporations with a single owner was proposed by the JCT in 2005.

Reforming Deferral Rules

- Does not appear to be a wholesale end to deferral;
- Proposal for reforming deferral modeled after 2007 proposal by Rangel;
- As originally proposed, Rangel bill would require US corporations that defer income through CFCs to also defer deductions (and recognition of foreign taxes) associated with that income.
- These deductions (and foreign taxes) may be recognized when the deferred income is repatriated to the United States.

Reform Foreign Tax Credit

- Determination of FTC based on total foreign taxes actually paid using a pooling concept;
- FTC no longer allowed for foreign taxes paid on income not subject to US tax;
  - Preventing the “inappropriate” separation of income from taxes for FTC purposes.

What are the Entrepreneurs doing, compared to mature multinationals?

Top business priority over next 12 months (able to select more than one)	Mature Multinationals (global corporate executives*) Q 2 09		Strategic Growth Companies (worlds best entrepreneurs**)
	Q1 09	Q 2 09	Q1 09
Securing the present	74%	65%	30%
Protecting your assets	40%	23%	23%
Improving performance	39%	34%	41%
Reshaping your business	37%	30%	16%
Pursuing new market opportunities	19%	30%	67%

This is a unique opportunity to capture the initiative in any market.
The primary focus of these global entrepreneurs was resounding:

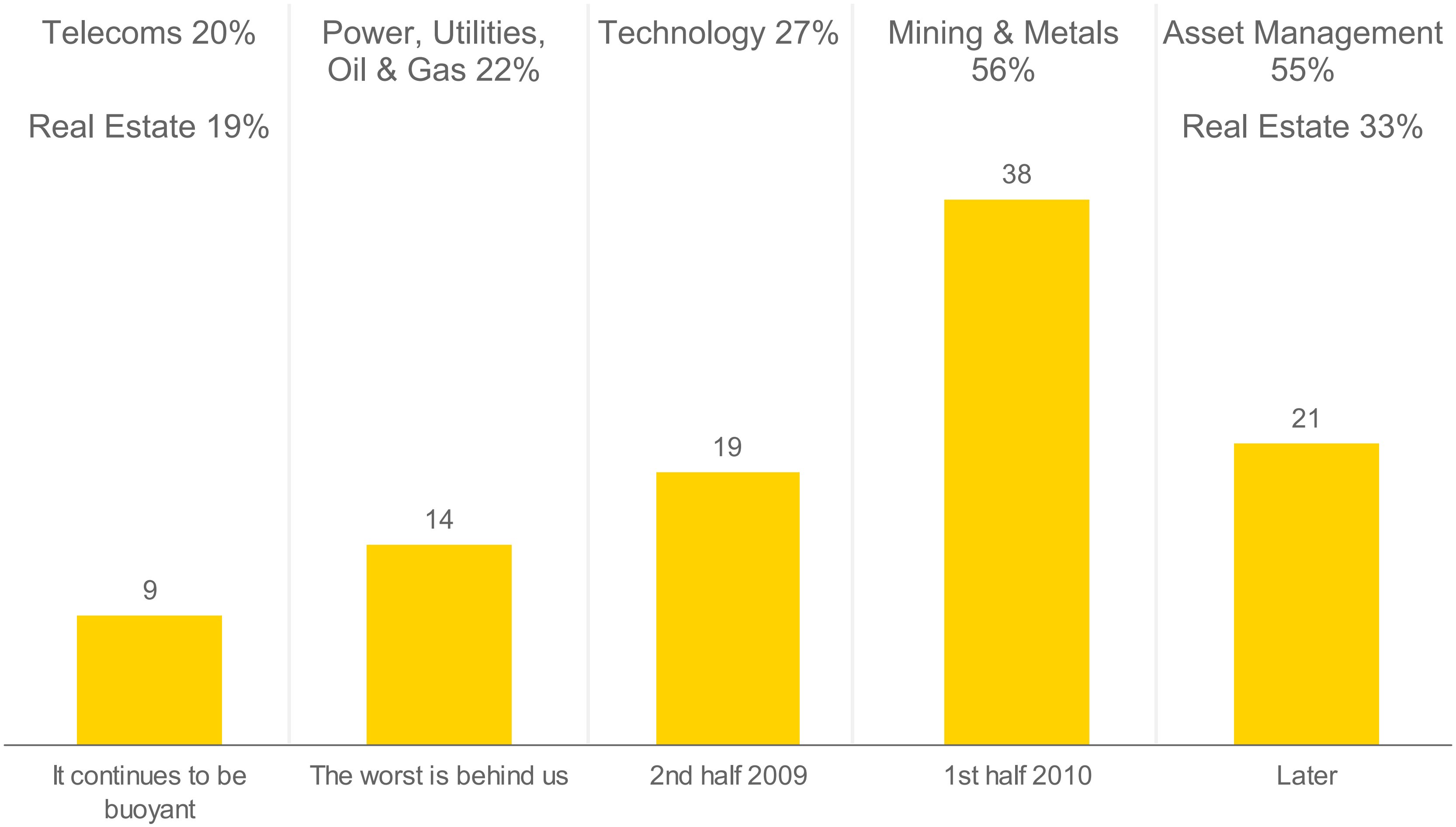
- Generate and protect your cash
- Seize new market opportunities

Entrepreneur Of The Year Survey Results

In the first half of 2009, surveyed more than 450 country level winners and finalists from the Entrepreneur Of The Year program to gather their responses to the current economic downturn.

- 93% of respondents are retaining or increasing their focus on broadening their customer base and entering new markets.
- 80% are retaining or increasing focus on re-negotiating contracts and managing customer bankruptcy.
- 80% are maintaining or increasing focus on seeking mergers and acquisitions.
- 74% are maintaining or increasing focus on divesting non-core assets.
- 68% are maintaining or increasing focus on raising further capital from shareholders or the market.
- 81% are retaining or increasing focus on accessing alternative channels of capital.
- 66% are retaining or increasing focus on raising debt to deal with the short or medium term.
- 11% are increasing focus on exits and succession planning.

When will growth return



Q: **When do you see growth returning to your sector?**
Shown: percentage of respondents

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