801.10 Agree – MV concurs

Walsh, Kathryn

From: [redacted]

Sent: Tuesday, June 19, 2007 4:03 PM
To: Walsh, Kathryn
Cc: [redacted]
Subject: HSR Question on Valuation - Size of Transaction

Kate - Thanks for fielding our recent calls and for your guidance.
Here is a statement of the facts we discussed with you.
In broad brush, the ultimate objective of the overall transaction is to distribute cash out of an existing business to its current owners and to sell an interest in the business to a new investor group (the "Investors").

As currently proposed, the elements of the greater transaction and the manner in which it would unfold are as follows:

1. The business is now owned and operated by a corporation (the "Corporation").
2. The Corporation will form a limited liability company (the "LLC"). All of the member interests of the LLC will be owned initially by the Corporation.
3. After the formation of the LLC, the Corporation will transfer all of its assets, subject to all of its liabilities, to the LLC. In addition, the LLC will sell enough of its member interests to the existing shareholders of the Corporation (the "Shareholders") so that the Shareholders will hold 1% of the LLC's member interests. The Corporation will hold the other 99%.
4. The LLC will then borrow $41.3 million from a third-party (presumably a bank or other financial institution) that is not affiliated with the Shareholders, the Corporation, the LLC or the Investors (the "Lender"). The proceeds of the loan will be distributed by the LLC to the Corporation and the Shareholders in proportion to their member interests in the LLC. It is expected that the Corporation and the Shareholders will not be permitted to distribute or use those funds unless the Investors make their intended investment described below. It is also expected that the loan will initially be secured by a pledge of the distributed funds. The loan will not be guarantied by the Investors, nor secured by assets of the Investors. The Investors will take the lead in identifying and interviewing potential lenders for the LLC, developing a term sheet and negotiating proposed terms. The LLC, however, will have sole responsibility for approving the Lender and the loan and settling upon loan terms. (Note that instead of an interim loan followed by a replacement loan, it is now more probable the two loans will be combined into one set of loan documentation from one lender with the loan initially having a short maturity (the interim component) which will then convert into a long maturity (the replacement component) if the Investors, in fact, purchase the Class A Shares as planned -- although two separate loans (an interim loan followed by a replacement loan), perhaps from two different lenders, is still a possibility.)
5. The operating agreement of the LLC will be restated to create three classes of "shares" with varying voting and economic rights. Initially, all of the Class A shares will be held by the Corporation. Those Class A shares will entitle the Corporation to greater than 50% of the profits of the LLC or greater than 50% of the assets of the LLC upon dissolution.
6. At the ultimate closing, (a) the Investors will purchase all of the Class A Shares from the Corporation for (i) approximately $23 million paid currently and (ii) the future obligation to pay the members of the LLC their pro rata portions of an additional payment geared to the financial performance of the LLC over the year following the closing (the "Earnout") and (b) thereupon the recipients of the LLC's prior $41.3 distribution (from the loan proceeds) will be free to use those moneys.
7. The Earnout will not exceed $21.5 million. The Investors will be obligated to pay over to the Corporation the portion of the Earnout they are entitled to receive as a consequence of holding the Class A shares.
8. In one way or another, each element of the overall transaction will be subject to or contingent upon the others.
9. We have assumed for purposes of the analysis that the size-of-the-parties test will be met.

We would be grateful if you would confirm for us your conclusion that under the foregoing facts the $41.3 million borrowing and distribution by the LLC would not be included in the consideration being paid for the Investors' acquisition of the Class A Shares and that, accordingly, the size-of-the-transaction threshold would not be met since the total consideration could not exceed $44.5 million (the $23 million paid at closing plus a maximum possible earnout of $21.5 million).

Kind regards,
[redacted]

16

federal tax law.

****

[redacted]

****