ASSOCIATION OF CORPORATE COUNSEL

TITLE: **Managing an Acquisition or Divestiture Process: An In-House Counsel's Perspective**

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PRESENTED BY: **ACC's Corporate & Securities Law Committee**

SPONSORED BY: **Lindquist & Vennum, PLLP**

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Operator: Just a reminder, today's conference is being recorded.

Amy: Welcome to the ACC Webcast. Jennifer, please go ahead.

Jennifer Wuollet: Thank you, Amy. Welcome to the webinar in managing the acquisition in divestitures process. My name is Jennifer Wuollet and I am a partner at Lindquist & Vennum and I am here with Tim Beastrom, the Associate General Counsel at the Valspar Corporation, and David Hallett, Managing Director of the investment banking firm Lazard Middle Market.

Just to start off with we would like to get a feel for who our audience is and we have a couple of polls here so if you'd be so kind to check the appropriate box and the first one we have is how many people are in your legal department? And it looks like the majority of you fall into the one to nine size.

The next question we have is how many acquisitions or divestitures does your company complete in a year? You just check the appropriate box. And it looks like the majority fall in to about one to five.

The next question is the typical size of your acquisition or divestitures transaction? Again, if you check the appropriate box. And it looks like the majority of us fall under the zero to $50 million range.

And then the final question is whether or not – or whether you generally do more acquisitions or more divestitures? And it looks like we're on the acquisition side.

And this is just a slide that has our name and information. Our presentation today is going to be broken into three parts.

The first will be preparing for a transaction which Dave will discuss. Next we will go into completing the transaction, which I will talk about, and Tim will talk about the integrating or disintegrating a business and with that I will let Dave take it away.

Dave Hallett: Thank you, Jennifer. Before I begin, I'd like to point out that given Lazard's Middle Market focus on providing investment banking services to sellers, I'll be speaking primarily from the seller's perspective, but it's a perspective that is critical for buyers to understand and to contemplate in their planning and strategy.

First, if your company is considering a sale or divestitures, it's a good idea of course to formulate an exit plan. You need to develop strategies for dealing with shareholders, boards of directors, and employees. These strategies relate to a variety of topics such as communication with the stakeholders and the extent to which they'll be involved in the process. Of course, strategies will differ depending on whether the business is closely held or public.

It's important to establish a timeline or a time table keeping in mind that sales processes, at least those that include drafting of confidential memorandums and the like, typically take in the neighborhood of six months, give or take.

Also, keep in mind the fact that buyers, especially private equity buyers, may expect management to remain on the job for two or more years post-closing. Therefore, to determine the date by which a process should be started you need to work backward from the date of senior management's expected retirement or departure.

Next slide. Among the questions that should be answered by counsel and other members of the senior management team are the following: one, does the seller want to retain equity in the business post-closing?

This is especially important to consider if private equity buyers are likely to be among the potential buyers for the business given their usual insistence that management participate in equity.

In the case of divestitures, ask the question: does the seller want to continue to supply parts or products to or distribute part or product through the business post-closing; or alternatively, does the seller want to continue to acquire parts or products from the divested business, post-closing?

Is the current management team capable of running the business? If not, better to get about the business sooner rather than later of making changes or additions that need to be made.

Does the current management want to remain with the business post-closing? This is very important, particularly to private equity buyers, given that they're in the business of backing management teams.

Does current management want to acquire the business, and, if so, do they have access to the capital necessary to do so?

Let's talk about transaction teams.

The right transaction team can significantly enhance value for both buyers and sellers. The composition of the team, of course, ultimately is dictated by whether the deal is a sale or an acquisition, and the relative size and complexity of the transaction.

You'll need to assemble internal and external teams that will work together to complete the process of buying or selling the business. The lists that we've set forth below with respect to both internal and external teams aren't intended to be exclusive, and, of course, not all of these players will need to be involved in every deal.

Audited statements are very important to buyers and to the lenders. Buyers like to see at least three years of audited financial statements. If the business doesn't have audited financials, it

should be prepared, recognizing that in some cases including certain divestitures like this may not be practical.

Create barriers to entry. Why? Because they influence quality, including predictability and consistency of earnings. Quality of earnings is one of many factors but it's a very, very important factor driving valuation.

You want to bring your top three to five managers into the process early. This will convey to them their importance and will engender the sense of loyalty and sense of ownership that can give rise to very constructive productive participation in the process. Consider implementing incentive packages for key managers. More on this topic on the next slide.

These incentive packages, commonly referred to as change of control agreements, can help to motivate top management to assist in the maximization of value to be realized from the sale, and to ensure a smooth and orderly transition or integration post-closing.

Change of control agreements typically provide for a year's compensation, and when we talk about compensation here typically we're including not only salary but bonus. And typically this would be paid to the top three or the five managers, and usually will be paid by the seller.

Packages can be structured to increase with the amount of sale proceeds. However, I should note that some sellers avoid this type of compensation structure because of their reluctance to share knowledge of the purchase price with non-shareholder members of the management team. The payments made under control agreements typically are staged with a portion, often half, being paid at closing and the balance typically being paid on the first anniversary of the closing.

Let's talk a little bit about pre-process due diligence: You may know what the due diligence issues are or at least have a sense for what they might be. A list of examples is set forth on this slide but the fact is, as they say, you don't know what you don't know, and you'd rather know the issues before the buyer does. Therefore, it's a good idea to consider certain types of preemptive diligence and we've set forth a couple of examples in the first two bullet points on this slide.

Sellers should consider engaging a transaction services provider to provide a preemptive sell-side accounting review, perhaps including a quality of earnings review, to avoid surprises that might come up in due diligence, surprises that often tend to come up post-exclusivity with a buyer and become problematic in terms of re-trades on price and terms.

The second example of preemptive due diligence I'd like to touch on is environmental due diligence. We think it's a good idea to be proactive about environmental compliance and therefore urge our clients to consider performing Phase One reviews to identify and if appropriate to address problems early. I guess the bottom line here is that you'd rather present the issue to the buyer than have the buyer present the issue to you.

Many legal matters deserve a good deal of advanced consideration. Some examples are set forth below. Of course, you need to be prepared to address transaction-related structural and tax issues. It's better to begin the preparation process sooner rather than later, recognizing that ultimately those issues or certain types of issues in these categories don't actually write them until such time as the buyer gets involved in the process.

Non-compete and non-disclosure agreements: are they necessary and, if so, are they in place?

In the case of a divestiture, as suggested earlier, you need to contemplate supplies, sales and distribution agreements to the extent that they might be necessary to meet the post-closing requirements of the seller or the business units being divested.

Let me talk a little bit about the sale process itself. It can be structured in a variety of ways, and it may be that each of you has participated in different variations on these themes or process types, but the table below describes and highlights some of the potential risks and rewards of various approaches from a process involving only a single potential buyer to a so-called auction process opened to all qualified potential buyers.

I'll just highlight some of the risks and rewards of the single buyer process and the broad market approach.

As to the single buyer process, not surprisingly, it potentially can take the least amount of time to complete and typically has the lowest chance of leaks of confidential information. The price that sellers pay is that in a process involving only one potential buyer there is a reduction – a significant reduction of negotiating leverage, and as a result the financial and non-financial terms may be significantly below market value.

In the broad market approach, on the other hand, the seller has more leverage and this may be the most critical distinction between this approach and the single buyer's approach. That competitive tension is created through the organization and management of a process that maintains for as long as possible a competitive dynamic that increases leverage and drives valuation. Thus, this approach has the highest probability of achieving a premium valuation. Obviously under the broad market approach, information flows to more parties, increasing the risk of unwanted disclosure of confidential information.

A typical sale process involving multiple potential buyers might look something like this in terms of paths to be completed and timing including preparation and distribution of the confidential memorandum, buy meetings with management including facility tours, due diligence, negotiation and closing.

As you know, and as illustrated on the graph below, negotiating leverage shifts during the course of the transaction process. As a result, decisions as to when and to whom exclusivity is granted are critical to the success of the process. Since leverage declines dramatically after the seller grants exclusivity to a buyer, all business terms including priced indemnification limitations, escrow, et cetera should be negotiated before exclusivity is granted. This means that as much due diligence as possible must be completed prior to the granting of exclusivity, and it's important to have buyer number two and buyer number three develop as backups in the event that buyer number one falters.

The best strategy from the sellers perspective is to keep as many buyers as active as is possible, for as long as possible, in the transaction process. A very effective strategy is to keep two potential buyers working through 100 percent of due diligence and the contract markup grid. This really creates a competitive dynamic that in our experience dramatically reduces the likelihood of re-trading or other late process buyer misbehavior.

When participating in a transaction process as a buyer, your client should take advantage of opportunities to distinguish itself from other buyers, including private equity groups. For example, when your company is invited to participate in the management presentation stage of the process, it's very important that you stack the meeting with the key decision makers. If your CEO ultimately is going to need to approve the deal then it's best that the CEO be at the meeting. If the CEO is not at the meeting in a situation like that it sends the wrong message to the seller.

If your company is a competitor of the seller, be sensitive to the seller's competitive concerns. Don't push too hard too early for sensitive information. One way to make the seller more comfortable is to create a more balanced dynamic by sharing important information about your own company. Sell yourself. What differentiates you from the rest of the deal? One thing might be knowledge of the business. Your knowledge of the business can give the seller comfort as to the strength of your interests and your ability to navigate through diligence effectively.

You should sell certainty of and a timing to close especially if you don't need the secure financing, debt financing to do the deal. If you are financing the transaction, we think it's important that you bring your lenders to management presentations.

Private equity buyers almost always allow management to participate in ownership so you should be prepared to compete with private equity. Offer incentive plans, stock options, bonuses, and the like.

OK, having given you an overview on how to plan for and participate in the process I'll turn it over to Jennifer who will start by talking about deal structure.

Jennifer Wuollet: Thanks, Dave. As Dave had mentioned before, in planning it's always a good idea, as a seller, to start thinking about your transaction structure and what your goals are as well as the buyer to be thinking about what they want to accomplish and what their end game is for what's being acquired.

Typically, a buyer wants to make an asset purchase and what's good about that is it's a lot cleaner. They cut off the liabilities when the assets they get a setup in basis and they can hold the assets that are passed through the entity, which makes it a lot easier for the sale and much more tax advantageous when they sell.

A seller typically wants to do an equity sale that you can send all the liabilities with subjects to the indemnification and the purchase agreement – it's more tax advantageous generally to the seller.

When you're in the asset transaction structure phase, it's really important to get tax people involved and try to come up with the most efficient way to handle things. Something else to keep in mind when you're doing a transaction structure is: what type of business are you dealing with? I have a client, for example, that is in the oil and gas consulting industry and they acquire a lot of companies in this business but they do it through equities – equity purchases as opposed to asset purchases because the businesses have over 100 material contracts of oil and gas companies where they'd have to go get consent. They have decided that this is too administratively burdensome and they want to make sure that the contracts that are actually there stay in place since they'd be dealing with some pretty big companies on the other side.

The next thing we can discuss is the due diligence process, and as Dave mentioned it's a good idea to be ahead of in the game as the seller. There's a couple of different ways to send out the diligence information. The data room – the electronic data room is a great way to do that. Merrill or Interlinx's has a really good process for that. One of the best parts about this is that if you have more than one buyer involved you can put out the same information to everybody at the same time without being concerned that somebody got missed in the game.

A great alternative to that, if you're dealing certainly with a single buyer process or something smaller, is putting your documents in a PDF and sending them on a CD. E-mail is something that happens a lot or just photocopying things and sending the paper files. I see a lot less where someone will actually go to a paper data room. It's usually: do the diligence from the comforts of your own desk. With the diligence process, that initial request that comes in is going to be overly burdensome probably and once you get that request done there's certainly going to be some follow-up.

One thing I will mention is that when you're dealing with some entrepreneurs in an acquisition they can become very overwhelmed by this process and quite frankly a little grouchy about it. One of the best ways to deal with that I have found is to tell them that although you do need everything to the diligence that you will prioritize things for them and help them and to pick out things.

For example, material contracts, organizational documents, permits. The kind of things that you need right away to see and start working through that list. Often they will find that a lot of the areas where you're making requests do not apply and once they get that list narrowed down they can feel a lot better.

As Dave had mentioned, it's important as a seller to stay on top of your diligence and be ahead of the buyer. You don't want to find out the problem from the buyer. You want to be prepared for it. Have some explanations behind it. Possible solutions if there's an issue there. You also, again, need to keep things reviewed and all the contracts reviewed to make sure that your schedules are accurate and you have all the consents necessary or are aware of all the consents necessary to complete the transaction.

From the buyers perspective you're obviously going to be reviewing all the various items to see what kind of issues are out there and what you need to do to get this transaction accomplished and potentially integrate into your existing structure. It's also the time to find out what you need – what items you need specific indemnification for, and help shape the purchase agreement.

The next item here is the transaction approvals. This is as much a timing issue as anything you need to be on top of what you need to get done. Do you need 30 days to get your board of directors together or shareholders – is their consent going to be required? Do you need lender consent or do you actually need to bring in financing?

This is something that can certainly delay your transaction if you don't have it yet. From an external perspective, if the transaction is large enough you could hit the Hart-Scott-Rodino filing requirements; I have put some of the tests here. This typically is something that you can file off the Letter of Intent but if you don't request early termination, at a minimum it would be 30 days to complete assuming that there are no questions or issues.

If you do request early termination, I've seen it as short as 12 days consent. However, that information – the information that there's a transaction going on, becomes public which is something that public companies sometimes don't want to be involved in.

Other external consents are your permits, licenses. What are you going to need if this is an asset deal? More likely than not, those kind of items will not transfer, and even in a stock deal with a change of control there could be some issues there.

Another area is the customer and supplier arrangement and this kind of hits to diligence a little bit as well that the sellers do not want the information about the transaction out there to their customers and suppliers until they know it's a done deal and obviously buyers want to get in there and figure out if these relationships are as strong as they think they are before the deal closes and before they're bound.

One middle of the road solution is if you do not do a simultaneous signing and close is that both the sellers and the buyers can go out together and get customer consent and work through that.

Next item we have here is the purchase agreement. This is your definitive document to get the transaction completed. From a process perspective, generally the buyer drafts the purchase agreement with the exception of an auction process. This is usually done by the seller and the buyer will need to mark that up.

We've put in here some of the important deal terms that we have gotten from the negotiated acquisition section of the American Bar business law section. Although they are based off transactions that happened in 2006, I think they still ring pretty true today.

You can see an escrow. It looks like they're ranging around the 10 percent value. Survivals of representations and warranties in the 12 to 18 month range. It's pretty accurate. The thing that I

typically hear from a buyer is that they want to make sure that they own the company or own the business for at least one audit cycle so that can make a difference in the timing there.

Obviously, with the representations and warranties there's going to be the exceptions for the fundamental reps, capitalization, title, authority, brokers and then those surviving indefinitely and taxes, employee benefits and environmental generally surviving for 30 days after the statute of limitations.

The baskets here with the mean, about four percent of the transaction value. A lot of those going back to the first dollar and then the cap here around 10 percent which does seem to be holding pretty true.

Another thing and maybe a little bit more is through the diligence process as people making or trying to take things outside the caps and baskets other than the basic fundamental reps that are generally excluded.

The next slide here is schedules, which is obviously part of the definitive purchase agreement. Again, this diligence on the seller's part becomes very important. The sellers want to disclose as much as they possibly they can and as much as necessary here and to make sure that they have all the people in the company who have knowledge review these to make sure that they are accurate.

The one thing that I would caution sellers on is not disclosing information that is unnecessary. By that I mean, for example, in insurance if you're only required to list the insurance and list the policy number, the policy name and potentially the name of the insurer, don't go into including deductibles and that kind of thing. That's just broadening the rep unintentionally and you don't want to make a breach on something small.

I apologize. I see a question in the back here about the baskets in this context. The basket being on the purchase agreement. The dollar amount that has to be hit prior to and claimed for indemnification to be made, and a lot of the time what I see it can be. Say if it was going to be $20,000 that it will be at $20,000 but once that $20,000 mark gets hit that it will come back to dollar one.

Back to the schedules. Buyers: the thing is here they need to absolutely review their schedules and make sure that the reps haven't been diluted by what's put on there and make sure they're aware of things. Generally, a disclosure in the schedules prevents the buyer from getting indemnification for certain losses and, at this point, if they disclose something, then maybe the purchase agreement needs to be changed to carve that out.

The next slide we have in here is dealing with surprises. In my experience, this often comes up with schedules. It never fails but you think you know everything and then you see the schedules as a buyer and you're surprised because something else has been put on there. The best thing to do here is, as soon as an issue comes up and the parties are aware of it, get all the information that you need regarding the issue. Bring it up and start dealing with it so that it's not an end of the closing kind of issue that everybody is still arguing about.

Something I do see a lot of and lately have seen a lot more of is the price re-negotiation. If this happens the buyer goes back and wants to change the price and sometimes the seller will just walk away. This is less likely to happen in an auction process where you have multiple buyers, but it can happen and the parties need to decide if the transaction is still worth moving on. If it's not, to get out before anybody else spends more money on the issue or comes up with ways to get around this.

One way I have seen happen a little bit more lately is the earnout. That obviously has more issues particular to trying to make sure that it's structured appropriately but it's certainly one solution.

And with that, I will let Tim take it over.

Tim Beastrom: Thank you Dave and Jennifer. I appreciate that. Before we start, I just want to give you a little bit of background on Valspar. I'm an in-house lawyer for the Valspar Corporation and Valspar makes and sells architectural paints, house paints, and industrial coatings. We're about a $3.5 billion company and we're, for all practical purposes, a global company. We have quite a large operation in Europe and also in Asia as well as North and South America.

I'm an ACC member so I appreciate the opportunity to talk in front of this group; I also think I fit the average profile for people that dialed into the webinar. We've got a small law department. We've got six people in our department. We typically do decide the transactions that you indicate that you do: basically small to what I would call mid-sized transactions and we're mostly on the acquisition side. So hopefully the comments that I make are typical to what you guys might see as well.

So now you've prepared for a transaction and you've completed a transaction. What next?

Typically the integration or the disintegration in the case of the divestitures, that process is not typically involved with lawyers quite as much as the other parts that have been discussed on the webcast. But like it or not, if you worked on a transaction your name is going to be associated with that transaction and whether or not it's successful may somewhat reflect on how you did the deal.

So integration or disintegration is not typically a legal role but your business people get a project on track or keep it on the right track by helping in the integration or disintegration process.

Integration matters because if you are like most companies you've setup a financial model for the transaction and the finance and accounting people who developed that model typically check to see how the transaction performed against the model.

In addition, if you went for board approval or shareholder approval they're probably very interested as well to see if you achieved the goals on which the transaction was approved.

One other thing I would note is that poor execution can lead to unexpected costs and lost opportunities. We've seen in our own business where if you make a mistake on the IP side, you make a mistake on the customer side, you make a mistake on the supplier's side, you can lose some of the benefits that you may have put into your model some of the synergies you expected in your model and that can lead to lost opportunities and it may lead to you not achieving the goals on which the transaction was based.

I've also seen some cases where if you fail to integrate a transaction properly that your future acquisition or divestitures options are limited. Your board, your senior management, your shareholders they may be a little bit spooked if you haven't shown the ability to properly integrate or disintegrate an acquisition or divestitures.

I would say that choosing an integration team is just as important to the transaction team. This is the point in the process where the business group really takes over and takes responsibility for making this acquisition part of the company or if it's a divestitures making sure that that part of the business is cleanly taken out of the company.

At this point, if the business group doesn't take responsibility, the acquisition or the divestitures becomes an orphan and that usually has bad consequences for both sides. Selecting the team

leader for an integration team is an important part of the process. This person may or may not be the same person that was the leader for the transaction team.

Typically what I see or typically in my experience in Valspar, the team leader that we pick for integration or divestitures disintegration process is somebody who's probably a rung or two down from the leader on the acquisition team. At the same time, it's still got to be somebody who's got broad influence within the organization. The ability to work with a bunch of different functional areas within the company and is at a high enough level so that they can get some things done.

For those of you who have been involved in acquisitions or divestitures before, you know that these transactions typically take on a life of their own and they take a lot of time and effort in addition to other activities and normal day-to-day business processes that you're responsible for. If you don't pick somebody at the right level, they're not going to have the right authority or influence to be able to make sure that things get done on time.

As far as functional areas being represented, I look back to Dave's initial slides about the people that are involved in the transaction team. You're going to need somebody when you do an integration on the tax side, finance accounting side, human resources, legal, purchasing, insurance, IT is one I'll make a special mention of because that always turns out to be more difficult or more complex than most people expect.

If you've got an environmental health and safety aspect of your business that can be very important. Billing and credit and sales and marketing. The CEO of Valspar is (fond) of saying that you've got to be able to take customer orders, make the products, ship the products, bill the products and collect your money and that's kind of the math that we use when we're trying to define – decide who needs to be represented, which functional areas need to be represented on the integration team.

The integration team interacts quite a lot and overlaps in many cases with the transaction team. For our transactions typically within Valspar I would say about 80 to 90 percent of the team is the same. We've got a central tax function. We've got a central HR function. We've got a central legal function. Central regulatory affairs or environmental health and safety functions so those people are the same both on the transaction team and the integration team. So it depends on how your business is structured but typically a lot of the same people will be on your integration team as who are involved in your transaction team.

Depending on the size of the transaction, though, the level of the people in the integration team you may drop down one level actually. So when you're dealing with the transaction team where you might have been dealing with the CEO, when you're on the integration team you might switch over and take one of the business group VPs or team leaders on a business group side.

Unless you do a fair number of transactions, I think people probably start developing their integration plan a little bit too late. At Valspar, we start to develop our integration plan as we're going through the transaction process itself so a lot of the things that you're learning in due diligence is what's going to form part of your integration plan.

You find out what computer system they're using. You find out what kind of 800 numbers they have. You find out who their customers are, who their suppliers are. As you start finding out this information in the due diligence, you start to prepare and develop your integration plan.

Our rule within Valspar is that you need to have your integration plan done by the time you sign the purchase agreement. Whether or not you're going to have a simultaneous signing and closing or a signing with a later closing but we typically don't take any actions on integration until the closing actually occurs. In some cases we do this for regulatory reasons not creating any kind of a problem with the Federal Trade Commission in the United States or other similar

regulatory authorities outside the United States but for us it's also a nice clean way to kind of decide when we're going to start taking integration actions.

You need to identify your strategic objectives and priorities in the integration plan in the same way you do when you approach the transaction. For us, acquisitions and divestitures are tied to and grow out of our strategy, so you have to think about when you're doing your integration plan what it is or what are the strategic reasons, priorities, objectives that you identified in doing the transaction you need to keep those front and center in your integration plan.

If they key to your transaction is making sure that you retain the customers that come along or if the key is making sure that you've properly integrated some technology that your acquisition or divestitures – you need to put those front and center in terms of your integration plan and prioritize those in your integration plan.

Typically at an integration plan you're going to want to include what I'll call both legal and business items. So for example your transaction agreement, your purchase agreement is going to describe certain things that need to be done post-closing. Perhaps there's going to be some kind of a post-closing purchase price adjustment based on working capital levels. There may be non-compete periods. You have to think a little bit about what's happening with the indemnification periods and notices and things like that.

But the more important part of the integration plan is going to be the business integration. Integrating things from a financial standpoint, from a systems standpoint, from an operational standpoint.

Finally, I'd just make a note about communicating the integration plan. Once a transaction is completed for a lot of people the – it feels like the pressure is off and typically from a lawyer's standpoint there's less work to do after a transaction is closed than prior to but for the business people, the work and the activities really just beginning.

So within Valspar we treat integrations just like any other corporate project or initiative or activity. We try to have regular communication to the participants and to the supervisors of the participants so that people are aware and updated and they understand the effects of the integration on the participants workloads.

I'd like to talk a little bit about integration meetings and milestones. I don't claim to say that Valspar has the best or the only way to do this but typically what we'll do internally is we typically have an integration kick-off meeting within one week after the closing of a transaction. A lot of things – sometimes if you've got early customer meetings, early customer announcements there's things that are going to happen prior to that kick-off meeting but we typically have our broad kick-off meeting just – just after the closing of the transaction.

For us, we typically setup a three month process for integrations so we typically will meet every week for the first month and then we'll meet every other week for the next two months. We try to take into account in the integration and it's all part of our integration plan, we try to take into account what I'll call contractual milestones. Things like post-closing adjustments for working capital. If we're talking about non-compete periods. If there are going to be any people providing some kind of transition services or supplies. Somebody paying attention to those kind of things and also some of the indemnification time periods and dollar amounts.

On the business side we usually break it up again into functional areas. So there's a report from the person who's managing insurance. How quickly has the insurance been transferred over or have we cut the one insurance and moved to the next. What have we done in terms of suppliers? Have we gone and consolidated our purchases so that we can get some reduced better pricing in some cases? What employment actions have been taken? People being let go? Have those

actions been taken and we try to do that as quickly as possible after the closing and then with financial reports on the impact of each of these things.

So, for example, what cost savings have we achieved as a result of either headcount reductions, plant closings, supplier consolidations, formula or product consolidations, and we try to keep track of that as we go through these integration meetings.

One other thing I'll mention here is a little bit about post-closing interaction with the buyer or the seller. The tenancy can be after you complete a transaction that people try to walk away or kind of wash their hands of the transaction. In my opinion and in my experience I think that keeping a good relationship with the other party to the transaction is a very important part of it. It's very common for us to have post-closing, product supply or transition services and so you need a good point of contact for that and we typically try to establish one primary contact on each side. For us, that's typically not the same person who is managing the integration or the disintegration on outside but it's somebody else who can deal with the day-to-day contacts on – day-to-day contacts with the other party.

We also like to set regular dates for meetings and calls. If there's an issue that's brewing, typically you can surface those things sooner rather than later and hopefully avoid or limit dispute that might occur after the transaction. This saves me some work in the long run if I don't have to send a dispute to arbitration or go to some kind of a legal posturing if we've got problems after the closing.

Inevitably no matter how good of job you do on preparation for a transaction or signing up a transaction, you'll run into issues that were not covered in the transaction documents. If you've established a primary contact on the other side and stayed in contact with the other side, you can often work those kinds of issues in a quicker, easier more practical way than you could if you don't maintain that contact.

The final slide addresses post-acquisition tracking and learning. This is something that Valspar in the recent past hasn't done a very good job with and we're trying to improve this. I think this is one of the most important pieces. If you're a company that's going to continue to do acquisitions, it's really important to track not only for the board, not only for management and possibly for shareholders the financial performance of some of those businesses but it really informs your decision making and your planning and your strategy as you go forward with additional transactions.

You can learn a lot from mistakes that you've made. You can reinforce your successes and you can communicate those results to people that have been on the team in the past or people that are coming on to the teams in the future and improve your success in acquisitions and divestitures going forward.

With that, I'm going to turn it back to Jennifer.

Jennifer Wuollet: And with that we're done with the presentation portion of this webinar and we will move on to questions and answers. We encourage you to submit your questions in the chat box in the lower left hand corner of your screen and we have a question here already.

A question for Tim: How involved should in-house counsel get in the integration plan and is there a risk of providing business advice as opposed to legal advice?

Tim Beastrom: I think that's a good question. I like to be involved as little as possible in the integration plan just because I don't like to do the work on that. But what I can do and what I do is I to help them try to figure out how they're going to setup their integration plan. I can help them develop a plan that prioritizes the activities during integration or disintegration based on the contract requirements so what our obligations to supply products after the closing. What are our

obligations to provide transition services after the closing and so there is legal advice that's given there. I try to limit my work there to legal advice but if you are in a small law department or you are in an organization that does not do a lot of transactions I think giving some direction or guidance in terms of generally how you plan for an integration can be very valuable to the company.

Jennifer Wuollet: The question I had is discussing the use of anti-sandbagging clauses. To be honest with you, that is something I see asked for quite often and have almost never seen in a definitive document. I think maybe Tim and Dave can weigh on in what they see in that area.

Dave Hallett: Yes. This is Dave Hallett speaking. I would agree with Jennifer. We see – we seen anti-sandbagging clauses requested from time to time by sellers but typically for a variety of reasons in addition – including the questions around who knew – or the difficulty in establishing in who knew what and when those – those clauses typically don't make their way into documents at least in – in my experience.

Tim Beastrom: I guess one thing – this is Tim Beastrom. One thing that I would add is that it's not in the interest of the buyer to withhold information. I've never known a situation where we've wanted to close over a known problem and then try to deal with it after the fact. That – that kind of circumstance or situation where you would make that decision may come up from time to time but I think it's going to be very rare. When you make that point in the discussions or the negotiations I think that typically carries the day.

Jennifer Wuollet: The question we have is what is typically handled by outside counsel versus in-house counsel and I'll let you answer that Tim.

Tim Beastrom: OK. In a small law department we typically have in addition to working on a transaction you have your normal workflow within the corporation so if you're like me you've got other areas that you're responsible for and so we rely pretty heavily on outside counsel. I would say that in terms of due diligence and in terms of preparing for a transaction it's less involvement from outside counsel than typically in the what I'll call the transaction – putting together the transaction phase where you're actually drafting documents and preparing for a closing. So in the stage that Dave Hallett was talking about the kind of planning stages typically less involvement with outside counsel.

During the transaction process itself we – we typically turn it over and a good portion to the outside counsel and then once you reach the integration or the disintegration stage you take it back in-house. It also depends a little bit on what type of transaction you're doing. Last year, Valspar did three announced transactions. We had one in Vietnam. We had one in Finland and we had one in Mexico. I probably felt the most comfortable working on the one in Mexico. The least comfortable working in Finland and Vietnam. So, in fact, it depends also on where the transaction might be whether you're familiar with the laws in that area and then also whether you're familiar with the business you're acquiring or selling.

Jennifer Wuollet: And I would echo what Tim says in that area. The other thing I would say about getting outside counsel involved is to the extent that you're finding issues that you need to have dealt with ahead of time it's a good idea to get outside involved at that point so they can help work through the process and they are certainly aware of what there when they start with the purchase agreement and items like that.

We also have another question for Tim. What are some of the mistakes your company has learned from its past integrations?

Tim Beastrom: Well now we're getting kind of personal. Some of the mistakes that we've had –- here's some of the things that we've learned from doing some of the acquisition tracking. Valspar is a manufacturing company and a large portion of our cost of goods sold is tied up in raw materials

and so we had in models when I started with the company say 10 or 12 years ago had assumed a certain rate of savings that we could probably achieve as we integrated and consolidated raw material suppliers. As we went through and tracked our transactions and looked at what our actual performance was in fact we weren't tracking to that level so one of the things we've done in models going forward is we've reduced our typical expectation for raw material savings.

Another thing that we found out in our acquisition tracking is that as far as headcount goes we had – we had assumed some percentage of savings as a result of reducing headcounts in an acquired business. And in fact what we found out that we actually got more savings in terms of our labor costs and in terms of SG&A typically from those activities then we had included in our standard model. So those were a couple of things that we had learned in the integration process.

The other thing that we have learned to prioritize in the integration process is very, very early meetings with customers and suppliers. In fact in some cases in early transactions we would maybe wait as long as a week or two weeks to get in contact with customers and we now we typically are planning is that during that first week all of the major customers are called, all the major suppliers are called and you get that communication and contact done very, very early after the closing.

Jennifer Wuollet: We've had several requests for a definition of what the anti-sandbagging clauses are.

Dave Hallett: Why don't I take that and Tim and Jennifer if you see it differently, please chime in but I've been operating under the assumption that the person who asked the first question about anti-sandbagging was referring to those provisions sometimes seen in purchase agreements preventing the seller – excuse me. Preventing the buyer from claiming indemnification if the buyer had knowledge of the breach prior to closing.

Jennifer Wuollet: And I would agree there. Another question we have is is it usual for law firms to charge their legal fees as a percentage of the transaction? My experience is I haven't seen our firm do that. I know that it seems like law firms are trying to come up with more creative ways to work with their fees but that's not something I have typically seen.

Tim Beastrom: From an in-house counsel standpoint, I would be open to that. In fact the only firm I've really seen do that regularly is (Watell-Lipton). They tell you ahead of time what the fee is that they're going charge and typically they'll either tell you the dollar amount or they'll tell you a percentage and so from my standpoint I don't see it very often but in fact would be open to it. You know other service providers charge based on size of the transaction and so I'm not sure – lawyers other – you know outside counsel other than their you know concern about the ability to kind of do a budget for a transaction I'm not sure why we don't see it more in fact.

Jennifer Wuollet: Another question is how do you manage the outside counsel's fees so that you're not surprised at the huge bill at the end which I think relates to – a little bit to the previous question.

Tim Beastrom: The way that I make sure that we're not surprised with a huge bill is I use Lindquist & Vennem here in Minneapolis, Minnesota. Fantastic law firm. Very good attorneys that are very efficient with their time. I think really that's only kind of pass and jest because what I do is I tend to pick attorneys that I've worked with before and that I understand how they're going to bill for a transaction. So what I don't like is seeing people on the bill that I didn't even know they were working on the project. That's one way is to make sure that they don't introduce anybody or have anybody work on the transaction that I don't know who that person is and I don't know what they're going to be doing. And typically a lot of the stuff that might end up being expensive kind of things like I said some of the due diligence pieces and information gathering that can be very expensive to have outside counsel do. We use some of our very capable paralegals in our law department to help gather some of that information.

Jennifer Wuollet: And that largely goes with the question we have here: is it uncommon to outsource the legal component of the due diligence to outside legal counsel? I have certainly seen it done and it's sounds like from Tim's perspective that for financial reasons it may be better to keep it in-house if you have the resources to do so.

I have a question regarding the Internal Revenue Code on the 338H elections regarding assets or treating stock purchases and asset purchased. To that person I don't have a lot of experience. It sounds to me like there was potentially an issue with the election not being timely filed. I do not have a lot of experience to that so I can't speak to that. I don't know if Dave or Tim do but I can certainly talk to a tax person around here later and hopefully get back to you.

Tim Beastrom: One other thing that I'll mention about the outsourcing legal components of due diligence process. When we do a transaction outside the United States where the typical – the due diligence information is in a language that's not English we do rely a lot on outside counsel for that and we've also in some cases relied on KPMG another transaction – other due diligence service providers on some of that stuff. But the issue with doing that is one they've got to get it in a format that you can use internally and two you've got to get that communicated to the right people within your organization so that adds little bit of time and complexity and frankly expense to a transaction that you have to plan for if you know you're going to need that.

Jennifer Wuollet: We have another question about – in representing the buyer balancing the use of materiality and other qualifiers in the agreement so it's viewed as fair from the sellers perspective. The areas that I typically see materiality qualifiers and knowledge qualifiers that seem to survive to the final document is use of materiality and the compliance with laws with an exception to that that when you're dealing with environmental that the materiality qualifier often can come out. I also see the materiality qualifier often come out in some employee benefit issues and also in dealing with employment issues. Certainly compliance with the – immigration rules lately is one area that we – that the materiality qualifier is often taken out of given the hot ((inaudible)) issues with that. As far as the knowledge qualifiers, we certainly see them survive in the context of litigation as to the knowledge of things that are threatened and that seems to survive as well in the environmental area.

And I think that we are done here. Thank you everyone for joining us today. We encourage you to fill out the evaluation and that should be on the left hand side of your screen. You should be able to get a link to that and again thank you very much for joining us and you can now disconnect.

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