

From: Kirk, Alex (FID) [akirk@lehman.com]
Sent: Friday, May 11, 2007 12:13 PM (GMT)
To: 4955214@archwireless.net [8774955214@archwireless.com]
Subject: FW: Thomson Executive Committee Memo
Attach: Thomson Learning KKR Exec Comm Memo 5-8-07 vF.pdf

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> From: Orlan, Fred S
> Sent: Friday, May 11, 2007 8:12:56 AM
> To: Nagioff, Roger; Kirk, Alex (FID)
> Cc: Toal, Peter J; Orlan, Fred S
> Subject: FW: Thomson Executive Committee Memo
> Auto forwarded by a Rule
>

Roger- Regarding Thompson Learning, Steve Berkenfeld has done a good job of summarizing many of the risks in his analysis below. I would like to further highlight the following points:

- 1) In transactions where we have minimal Free Cash Flow in the first year, there is typically a growth story that will cause the credit to quickly delever shortly thereafter. In KKR's model, the company doesn't cover its fixed charges 1x 'til the end of 2008, then only covers them 1.1x 'til 2011. (see the model on page 8)
- 2) The fact that they have to PIK 50% of the toggle notes out of the gate, implies that the capital structure is deficient and requires bond holders to "bridge" the company 'til it can more comfortably cover its total interest expense. This "PIK'ing" out of the box concept has not been tested in the market. (First Data Corp may have to do it as well). We don't believe that the Bridge Caps price this risk appropriately.
- 3) KKR has included covenants that are very aggressive and could scuttle the syndication. (Highly likely) Ros Stephenson did address this with the sponsor who said in an email that they wouldn't let the specific "asset sale" covenant scuttle the deal syndication. However, since we are funding this bridge prior to syndication, Lehman may be stuck with this covenant.
- 4) Our Loan Syndication professionals are extremely nervous about the market capacity for B3/B- covenant lite term loans.

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> From: Berkenfeld, Steven
> Sent: Friday, May 11, 2007 1:19 AM
> To: LBEC Member; LBEC Assistants; O'Meara, Chris M (NY); Lowitt, Ian
> T; Freidheim, Scott J; Antoncic, Madelyn
> Cc: Kirk, Alex (FID); Orlan, Fred S; Konigsberg, Michael;
> Stephenson, Ros; Cohen, William; Wieseneck, Larry
> Subject: FW: Thomson Executive Committee Memo
>
>
> Attached is a memorandum for the Executive Committee regarding
> Lehman's participation in the financing for KKR's bid for Thomson

> Learning, a leading publisher of higher education textbooks and
> library reference materials and a subsidiary of Thomson Corp. We
> believe that KKR is one of seven remaining bidders.
>
> We were requested to provide a commitment letter for 100% of the total
> financing of \$5.25 billion (\$4.85 billion funded), but have been
> assured by KKR that we will be obligated for no more than 25% (approx.
> \$1.3 billion). In addition, there will be a separate financing in a
> total amount of Can \$575 million for the acquisition of Thomson's
> Canadian publishing business.
>
> It is the general consensus of the members of the committee that this
> transaction, in many ways, is a new high watermark in terms of
> aggressive demands from our financial sponsor clients. As expected in
> the current market, it is very highly levered at 8.7x LTM 6/30/07
> EBITDA (11.3x post book plate cap ex). And it is being structured to
> a B3/B- corporate rating without covenants. As a new feature, the
> senior toggle notes will pay interest in kind for 50% of the interest
> right from the outset, rather than an option to PIK in the future in
> the event the company has a cashflow shortfall, as is customary.
> Also, in contrast to most other LBOs currently getting done, the
> equity contribution by KKR is anticipated to be under 20%. However,
> the biggest issue is that the debt is priced so tightly that even with
> full flex we believe that we may need to use a significant portion of
> our fees (including our M&A fee) to syndicate it. In addition, as a
> result of the desire of the seller to have a quick closing, we believe
> we will need to fund the bridge facility (LB's share - \$412.5 million)
> prior to syndication and will not receive any incremental fees for
> doing so - more specifically, the funding fee will be fully rebated if
> the bridge is repaid within 60 days.
>
> Our current analysis, as shown in the memo, is that in a downside
> scenario we will retain only \$3.5 million of our total fees of \$29.3
> million (including a \$7.5 million M&A fee) post-syndication. This net
> amount will be even lower if we decide to syndicate a portion of the
> funded bridge loan. And of course this analysis assumes that the
> market does not materially deteriorate.
>
> Even though this is a high quality company with solid credit
> fundamentals, due to the aggressiveness of the capital structure and
> the mispricing of the debt, on a stand alone basis we would decide not
> to participate in this financing. However, we are concerned that a
> decision to pass on this transaction would adversely affect the very
> positive momentum we have developed with KKR over the last few months
> and hurt our chances to have a leading role in other transactions we
> are currently working on with them. In addition, the media bankers
> believe that our participation in this transaction would be very
> significant for our media franchise.
>
> Bottom line - although not without some dissent, we believe that this
> transaction deserves to be considered as one that is important enough
> to our leveraged finance business, our media franchise and our
> financial sponsor relationships that we should accept the possibility
> of some net losses in syndication and move forward with a 25%
> commitment - again drawing on the Sponsor FRL budget like we did a
> couple of months ago for Dollar General, another KKR transaction.

>
> In this note I've tried to give you a sense of how we evaluated this
> transaction. More details on the deal are provided in the memo. I
> will check around in the morning to see if there is an interest in
> getting together to discuss. In any event, if you have any questions
> please call me, Ros, Mike or Fred. Thanks.
>
> _____
> From: Hayes, Brendan V
> Sent: Tuesday, May 08, 2007 10:47 AM
> To: Berkenfeld, Steven
> Cc: Konigsberg, Michael; Hughes, William J; Toal, Peter J;
> Maniscalco, Anthony; Becker, David A; Levy, Scott R; Agarwal, Anup;
> Van Arsdale, John-Paul; Schepps, Evan C
> Subject: Thomson Executive Committee Memo
>
> Pending other discussions, attached is the latest executive committee
> memo for Thomson. Let us know if you have any questions or comments.
>
> -Brendan
> _____
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