

From: Kirk, Alex (FID) [akirk@lehman.com]
Sent: Friday, May 11, 2007 12:50 PM (GMT)
To: 4955214@archwireless.net [8774955214@archwireless.com]
Subject: FW: Thomson Executive Committee Memo

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> From: Nagioff, Roger
> Sent: Friday, May 11, 2007 8:49:41 AM
> To: Orlan, Fred S; Kirk, Alex (FID)
> Subject: RE: Thomson Executive Committee Memo
> Auto forwarded by a Rule
>
> Goldfarb hates it too..expect a meeting

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> From: Orlan, Fred S
> Sent: Friday, May 11, 2007 1:13 PM
> To: Nagioff, Roger; Kirk, Alex (FID)
> Cc: Toal, Peter J; Orlan, Fred S
> Subject: FW: Thomson Executive Committee Memo
>
> 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
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>
> 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.
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> 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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> _____
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>
> << File: Thomson Learning KKR Exec Comm Memo 5-8-07 vF.pdf >>