2012 M&A HOLDBACK ESCROW REPORT

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Agenda

J.P. Morgan 2012 M&A Holdback Escrow Report

Introduction

The first annual *J.P. Morgan M&A Holdback Escrow Report* was released in September 2009 with the intent of providing insight into the typical components of M&A holdback escrows. The initial report provided broad analysis of basic structure seen in domestic J.P. Morgan holdbacks with a focus on size, length and the indemnification claim payout process. As a leader in the global escrow space, this look into our business was meant to boost market clarity concerning standards for holdback escrows.

Subsequent Studies

Since the initial report, the study has transformed into a comprehensive, end-to-end summary of escrow metrics sourced from review of hundreds of transactions. Expansion of our business, development of analytical breakdown and suggestions from M&A market participants has fueled this ongoing progression. The 2012 Report, which marks the 4th annual iteration, drives our analysis to new heights through inclusion of year-over-year trends and previously unexplored transaction components.

The Future

Through our interactions with clients and members of the legal community, we are constantly striving to improve upon the foundation established by previous studies and fully intend to provide an ongoing resource for those engaged in the M&A market. We appreciate your continued support and feedback in this effort.

Executive Summary

Summary of Key Findings

Deal Statistics

- The average transaction size was $236MM, down 7% from last year's study; the median was $70MM
- The average escrow deposit was $8.2MM, down 11% from last year's study; the median was $3.4MM
- The median percentage of purchase price placed into the escrow was 9%, which is consistent with previous studies
- The average expected deal duration is 19 months, consistent with previous studies
  - 72% of deals have expected duration between 7 and 18 months

Financial vs Strategic Buyer Behavior

- The average underlying M&A transaction size for deals involving financial buyers is 2.27 times larger than the average for deals with strategic buyers
- The median percentage of purchase price put in escrow for financial buyers was 6%, compared with 9% for strategic buyers
- Escrows involving financial buyers were more concentrated in the standard 13 – 18 month duration range (55%) than those involving strategic buyers (42%)
  - Financial buyer duration range: 9 – 48 months
  - Strategic buyer duration range: 5 – 74 months

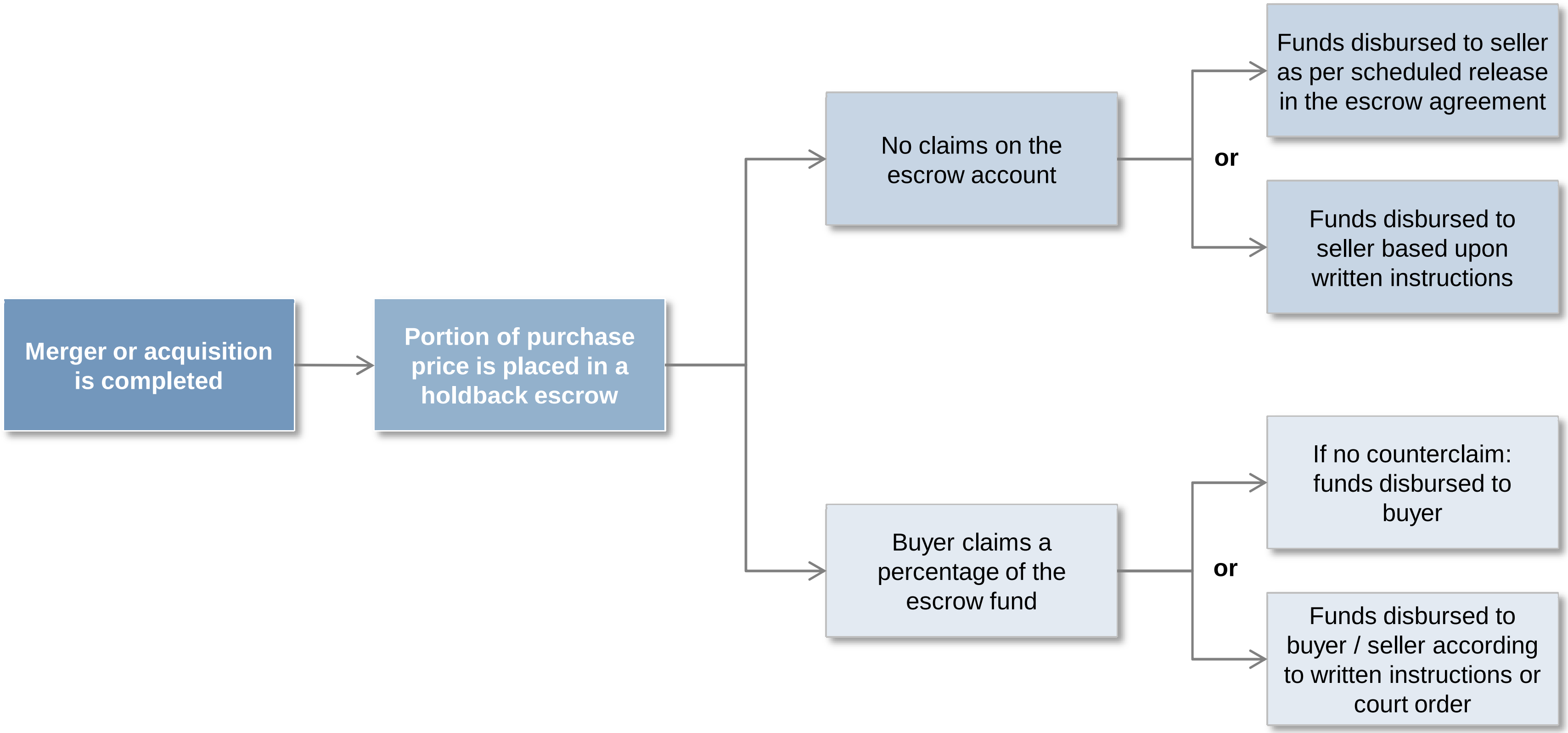
Claims & Adjustments

- 33% of terminated deals had at least one claim or adjustment
  - Excluding deals with *only* purchase price adjustments, this number falls to 28%
  - 48% of claims came within one month prior to deal termination
- On average, buyers were able to recover 59% of their initial claim amount
- Deals in the *Industrials* sector were most likely to receive a claim
  - Occurrence of claims in the *Financials*, *Healthcare* and *Energy* sectors nearly doubled since the 2011 Study
- Claims often impact escrow duration by shortening (34% frequency) or lengthening (23% frequency) the deal

Overview of the Holdback Process

Holdback Escrow Definition

- At the closing of a merger or acquisition, a portion of the purchase price is placed in an escrow account and held until the terms of the escrow agreement have been satisfied
- Holdback escrows serve as a risk mitigation tool: the claims process provides the buyer with an opportunity to retrieve the funds in escrow in the event that the seller fails to meet specific terms of the sale and purchase agreement



What's New?

Expanded Population

- The report analyzes 385 transactions with escrow agreements dated in 2011 compared to 250 transactions in the previous study
- The claims and adjustments section looks at 195 terminated transactions with escrow agreements dated between July 2009 and June 2011 compared to 115 terminated transactions in the previous study
- Increases the strength of observations by more clearly defining individual data points and trends while creating the opportunity for analysis of additional metrics not seen in previous studies

Year-Over-Year Analysis

- Comparisons to recent studies allow for trend identification incorporating holdback escrows spanning from July 2008 through December 2011
- Allows for high level forecasting discussions concerning the direction of the M&A holdback escrow market

Examination of Account Bifurcation

- An assessment of account bifurcation, or the division of escrowed funds for specific purposes, offers additional transparency concerning escrow purpose and deposit distribution
- Analysis on the frequency of bifurcation by auxiliary account reason and the corresponding breakdown of fund allocation between general indemnification and specific purpose accounts

Agenda

Population Characteristics & Definition

Overview

- **Background**
  - J.P. Morgan Escrow Services’ 4th annual study of holdback escrow accounts used in merger and acquisition transactions
- **Purpose**
  - To identify trends and characteristics for holdback escrows
  - To determine behavioral differences amongst financial and strategic counterparties
  - To provide insight into purchase price adjustments and dispute resolution in the holdback escrow marketplace
- **Population[1]**
  - 2012 statistics are based off of **385** J.P. Morgan escrow transactions with publicly available acquisition information[2] that closed in the United States in 2011
  - The “2011 Study” refers to the study released in 2011 covering **250** U.S. escrow transactions that closed in 2010
  - The “2010 Study” refers to the study released in 2010 covering **142** U.S. escrow transactions that closed between July 2008 and December 2009

1300+ deals closed[3] in 2011 in the U.S.

More than half were M&A related

600+ structured as M&A holdback escrows

385 have publicly available acquisition information[2]

[1] Note that population sizes may vary for particular data points due to availability or applicability of information
[2] “Publicly available acquisition information” is defined as the availability of transaction details in the Capital IQ database: https://www.capitaliq.com
[3] “Closed” here refers to the date on which the escrow agreement was signed

Underlying M&A[1] Market Summary

Market Observations

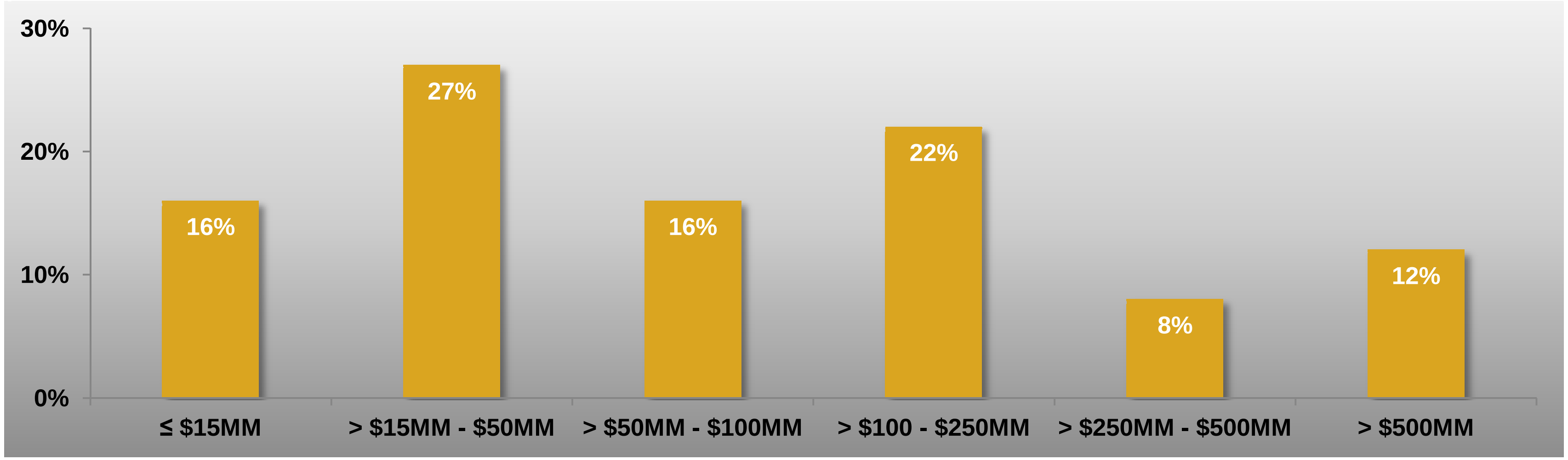
Underlying Transaction Statistics

- Transaction Size[2]
  - Average: $236MM
  - Median: $70MM
  - Range: $0.6MM – $3,056MM
- Deal Funding
  - 91% of deals were funded through cash only; 9% through multiple sources (i.e. stock, debt, etc.)
  - Cash only funding was also 91% in the 2011 Study

Counterparty Information

- Counterparty Type
  - Buyers were 51% private and 49% public
    - Consistent with previous study split of ~50/50
  - 98% of targets were private companies
- Cross-Border Statistics
  - 20% of all transactions were cross border, up from 15% in 2011's Study and 13% in 2010's Study
  - Cross-border transactions involve a buyer and target that are located in different countries, ***with escrows managed in the U.S.***

Distribution of Deals by Transaction Size



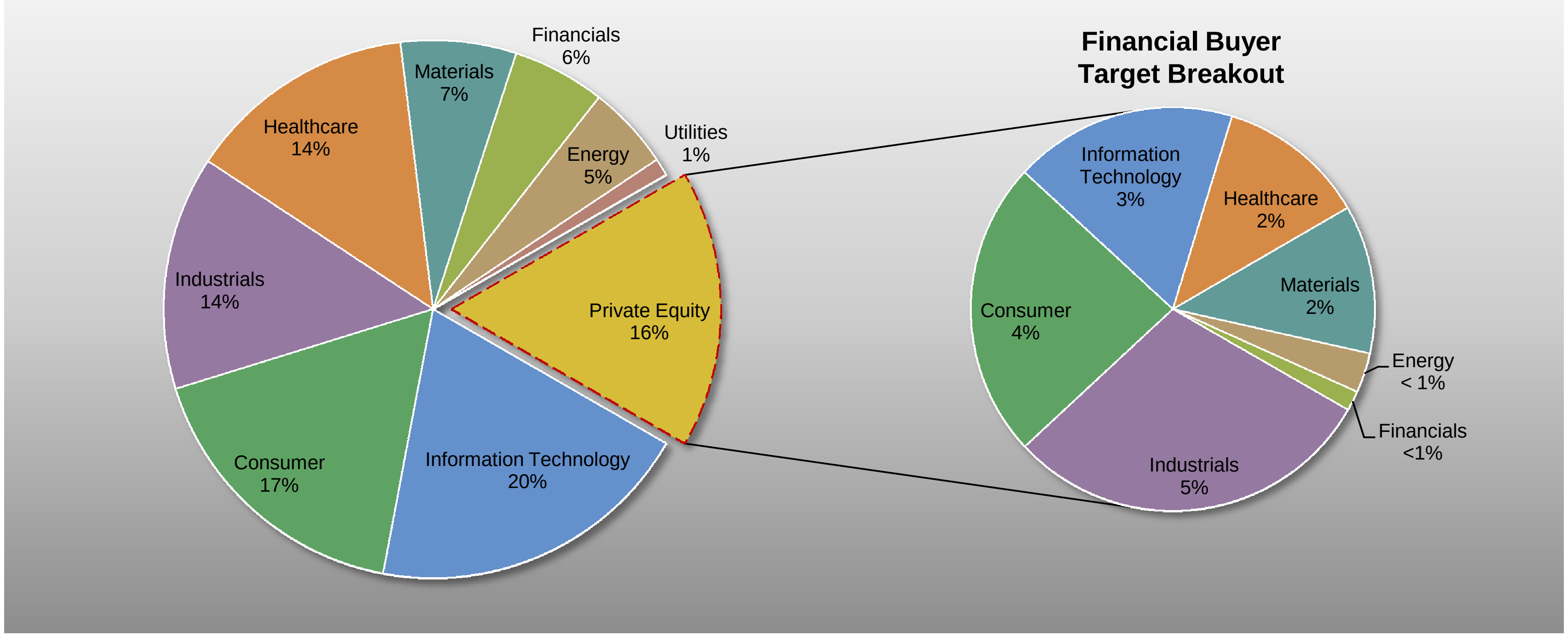
[1] Sourced exclusively from available information in Capital IQ
[2] Transaction size is defined as the "Total Gross Transaction Value," less earnouts (per Capital IQ definition)

Underlying M&A Sector Breakdown

Observations

- *Private Equity* made up 16% of the overall buy-side population compared with 17% in the 2011 Study
- *Information Technology* was the largest buy-side sector, making up 20% of population
- *Industrials* were the targets for almost a third of transactions involving financial buyers (5% out of 16%), while only accounting for 14% of the population

Buy-Side Sector Breakdown for Underlying M&A Transactions

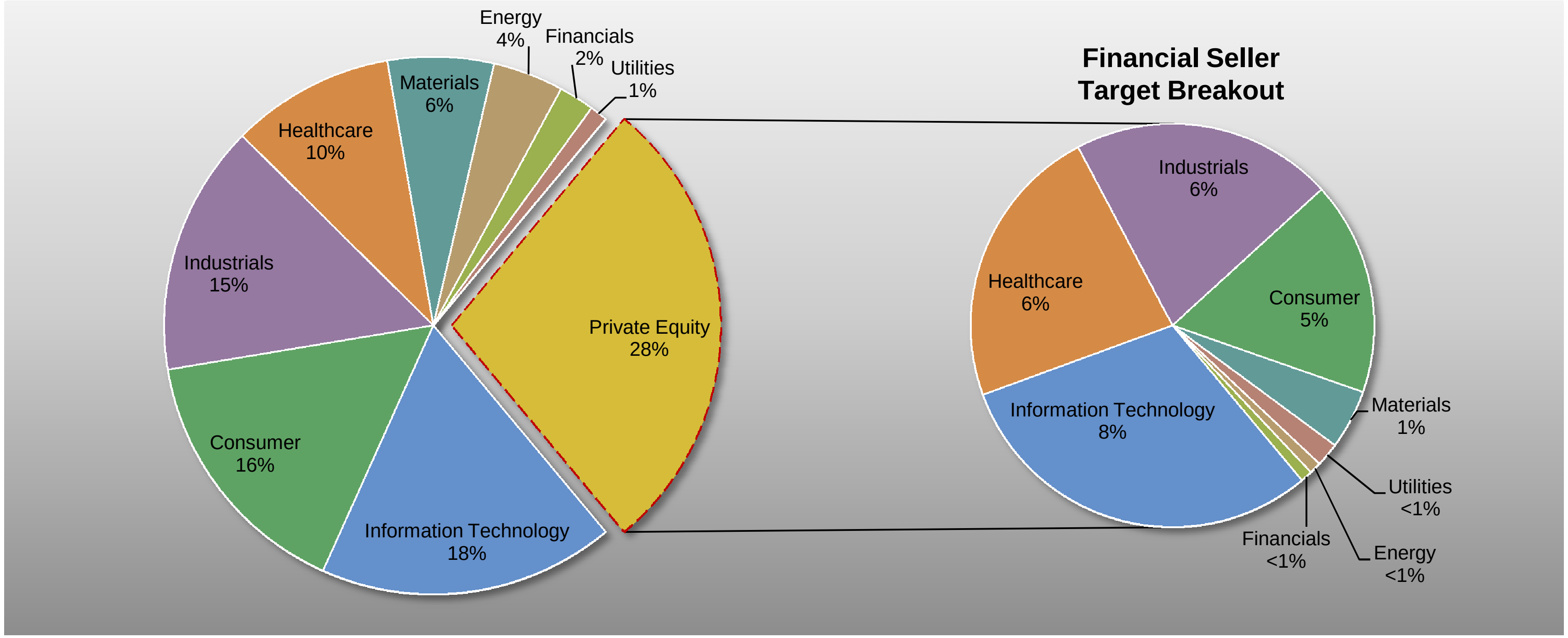


Underlying M&A Sector Breakdown (Continued)

Observations

- *Private Equity* made up 28% of the overall sell-side population
- *Information Technology* was the largest non-financial sell-side sector, as it was for buyers, making up 18% of underlying sellers

Sell-Side Sector Breakdown for Underlying M&A Transactions



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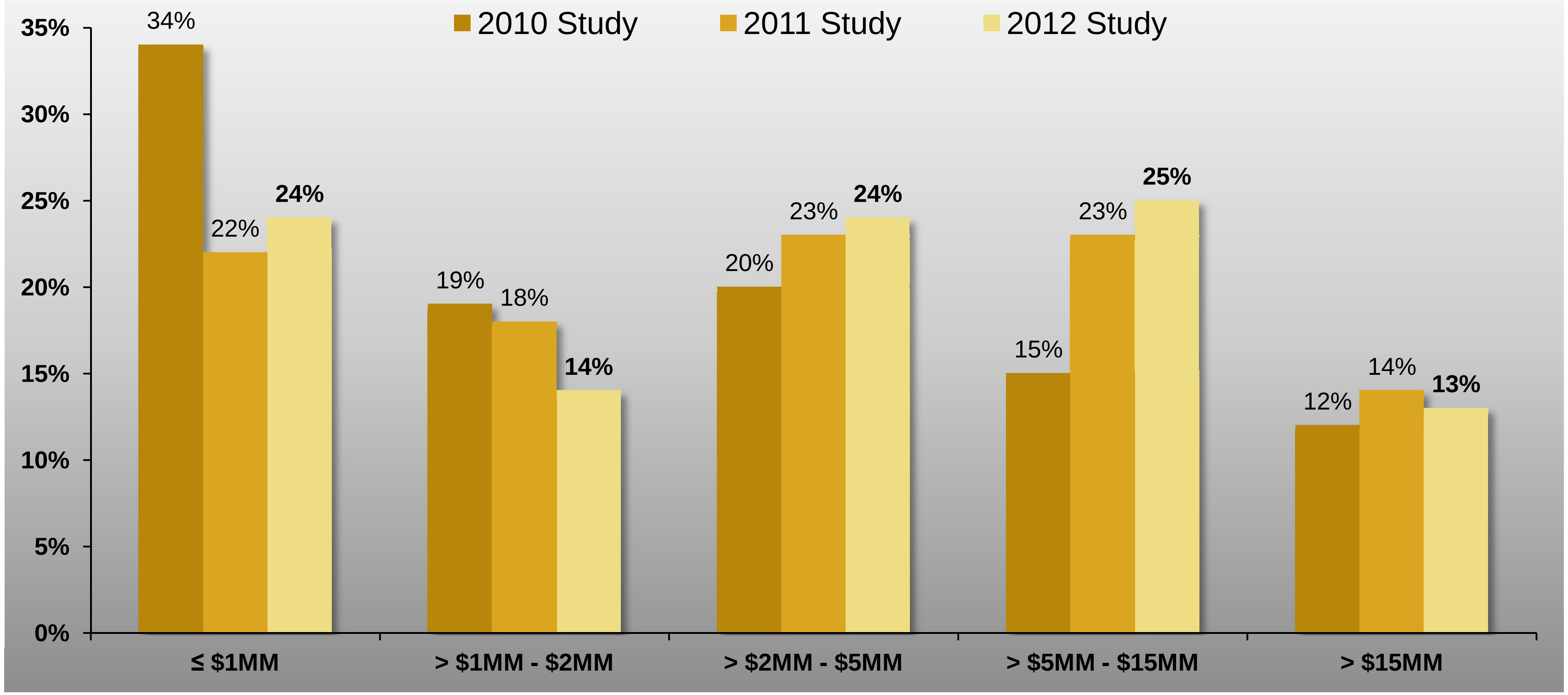
Escrow Deposit Size

Distribution of Deals by Escrow Deposit Size



Deposit Size

- Average deposit size: $8.2MM
- Median deposit size: $3.4MM
- Deposit size range: $0.1MM - $240MM

Investments

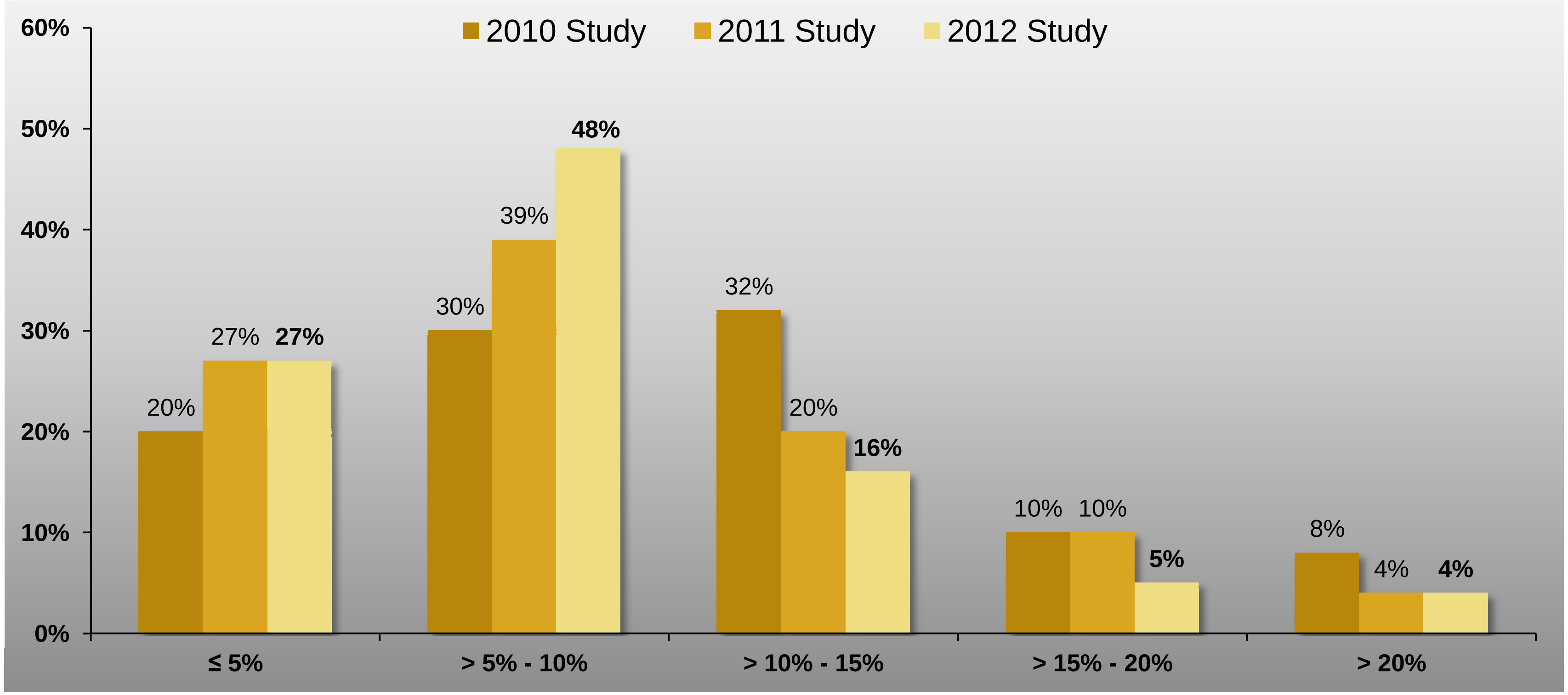
- 96% of deposits are cash only
- 84% of deposits are put in money market deposit accounts

Trends in the Market

- The $5MM - $15MM deposit tranche has jumped to 25%, up from 15% in the 2010 Study
- The ≤ $1MM bucket rebounded 2 percentage points, to 24%, from last year's low
- Frequency of $1MM - $2MM deposits continues to fall, with a drop from 18% in last year's study to 14% this year

Escrow Deposit Size (Continued)

Distribution of Deals by Escrow Deposit as a % of Purchase Price[1]



2012 Study

- 48% of sampled deals are for >5%-10% of the purchase price
- Only 9% of holdback escrows involve more than 15% of the purchase price

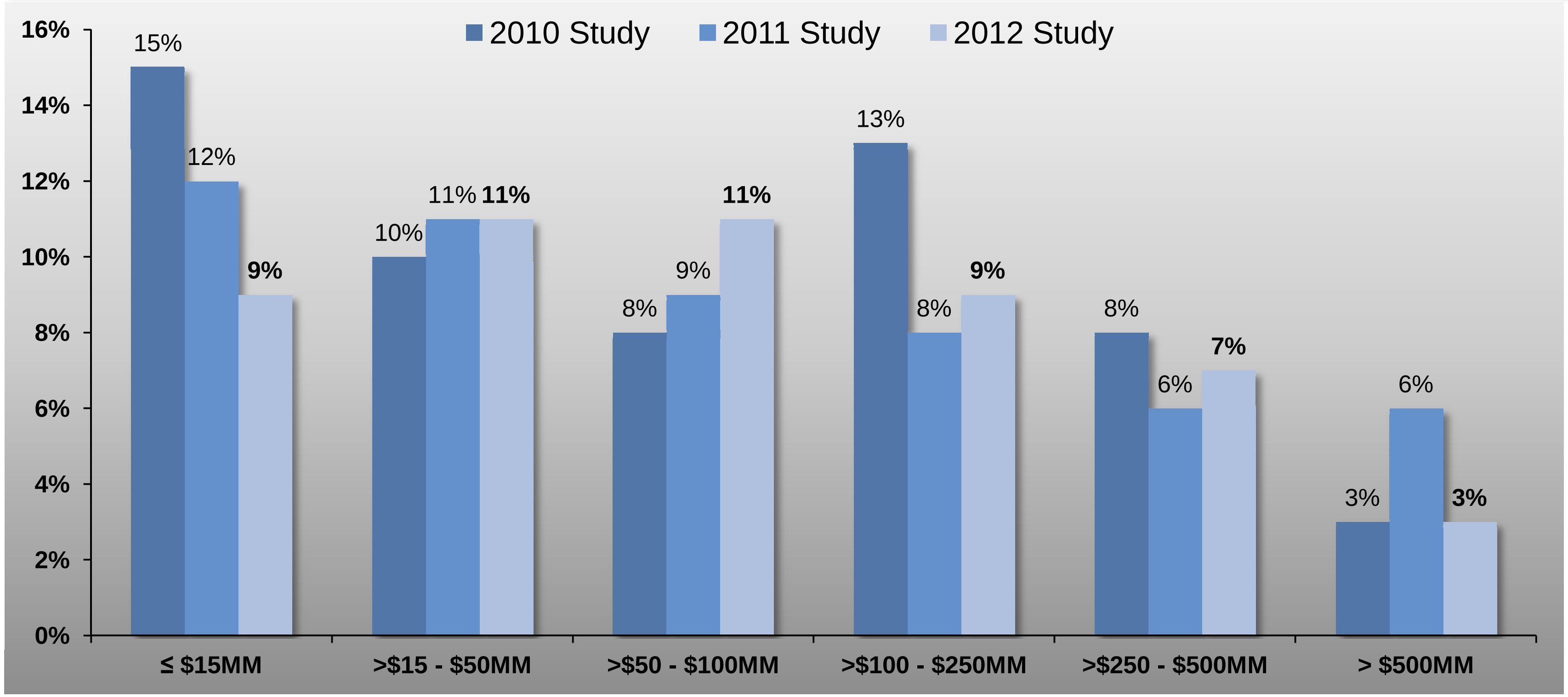
Trends in the Market

- The >5%-10% bucket has seen the largest overall growth, rising from 30% in the 2010 Study to 48% in the 2012 Study
- The >10%-15% tranche continued to decline, from 32% to 20% between the 2010 and 2011 Studies to a new low of 16% in the 2012 Study

[1] 2012 Study Purchase Prices include transaction earnouts

Escrow Deposit Size (Continued)

Average % of Purchase Price Placed in Escrow by Transaction Size



2012 Study

- Average percent of purchase price placed in escrow: 9%
- Median percent of purchase price placed in escrow: 9%
- Range: 0.3% - 38%

Trends in the Market

- Transactions ≤ $15MM have dropped from an average of 15% of purchase price in escrow in the 2010 study to 9% this year
  - This was driven by a number of transactions in the $0-$15MM range with small (< 3%) deposits

Account Bifurcation

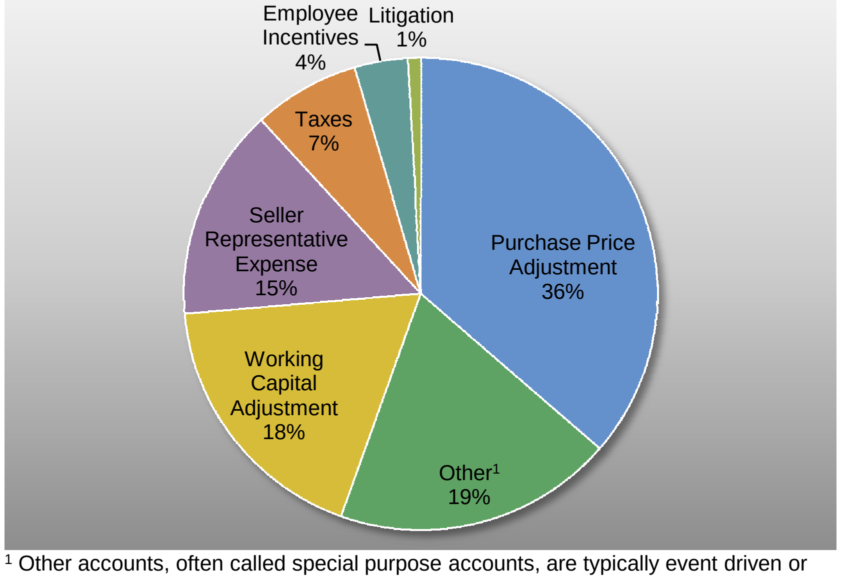
Bifurcation Overview & Definition

- Account bifurcation refers to the explicit segregation of escrowed funds for distinct purposes
- 23% of transactions outlined account bifurcation
- Deals with account bifurcation typically specify a **primary account**, for uses of *General Indemnification*, along with one or more **secondary accounts**
  - Common secondary account purposes include *Purchase Price Adjustments*, *Working Capital Adjustments*, and *Seller Representative Expense* accounts
- Primary indemnification accounts typically account for 78% of the total deposit
  - The remaining 22%, on average, is therefore split across one or more secondary accounts

Bifurcation by Account Purpose

- *Purchase Price Adjustment* was the most commonly seen account purpose, making up 36% of all secondary accounts
- *Working Capital* and *Seller Representative Expense* accounts, which made up 18% and 15% of the population respectively, were also common reasons to split escrowed funds
- *Other* accounts, which made up 19% of the population of secondary accounts, were often tied to events/milestones or provided additional indemnification for specific situations

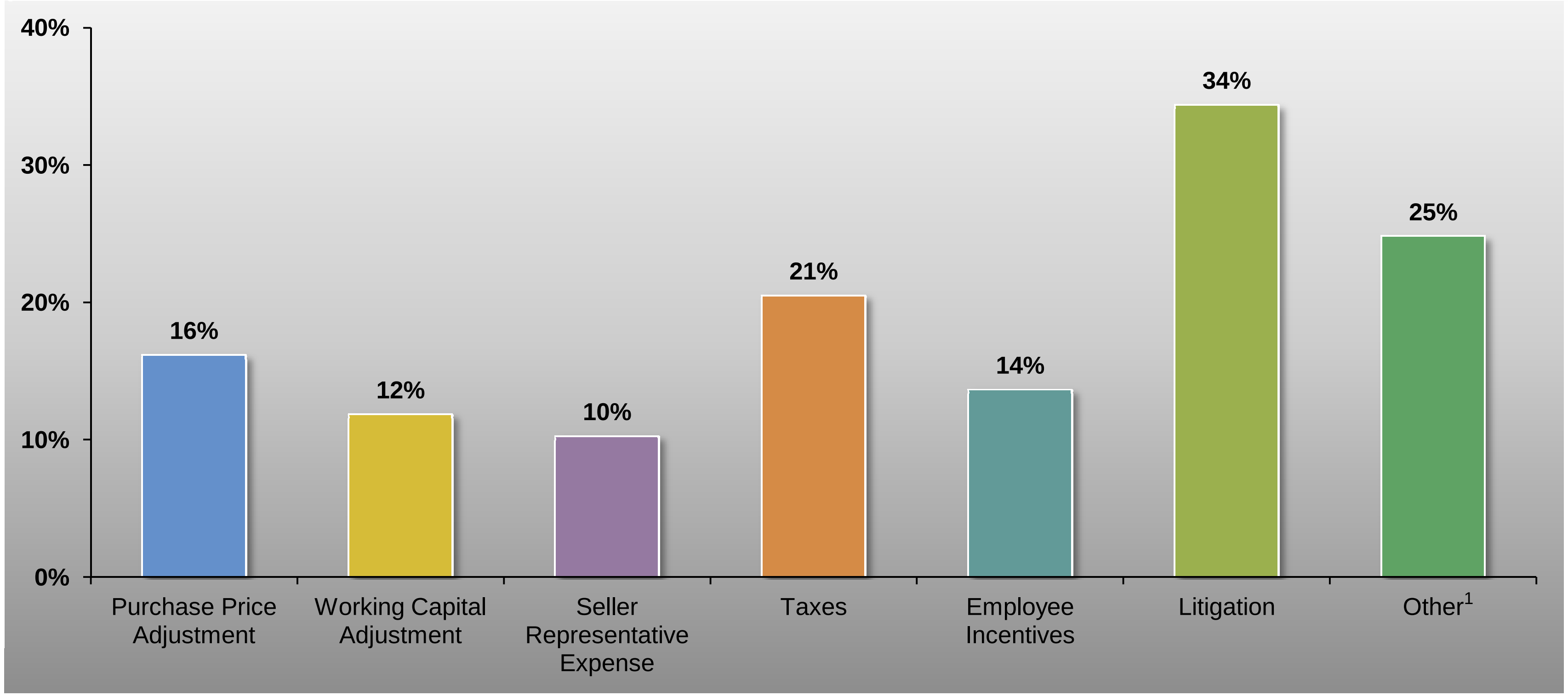
Secondary Account Distribution by Purpose



[1] Other accounts, often called special purpose accounts, are typically event driven or provide additional indemnification

Account Bifurcation (Continued)

Average Secondary Account Size as a % of Entire Deposit



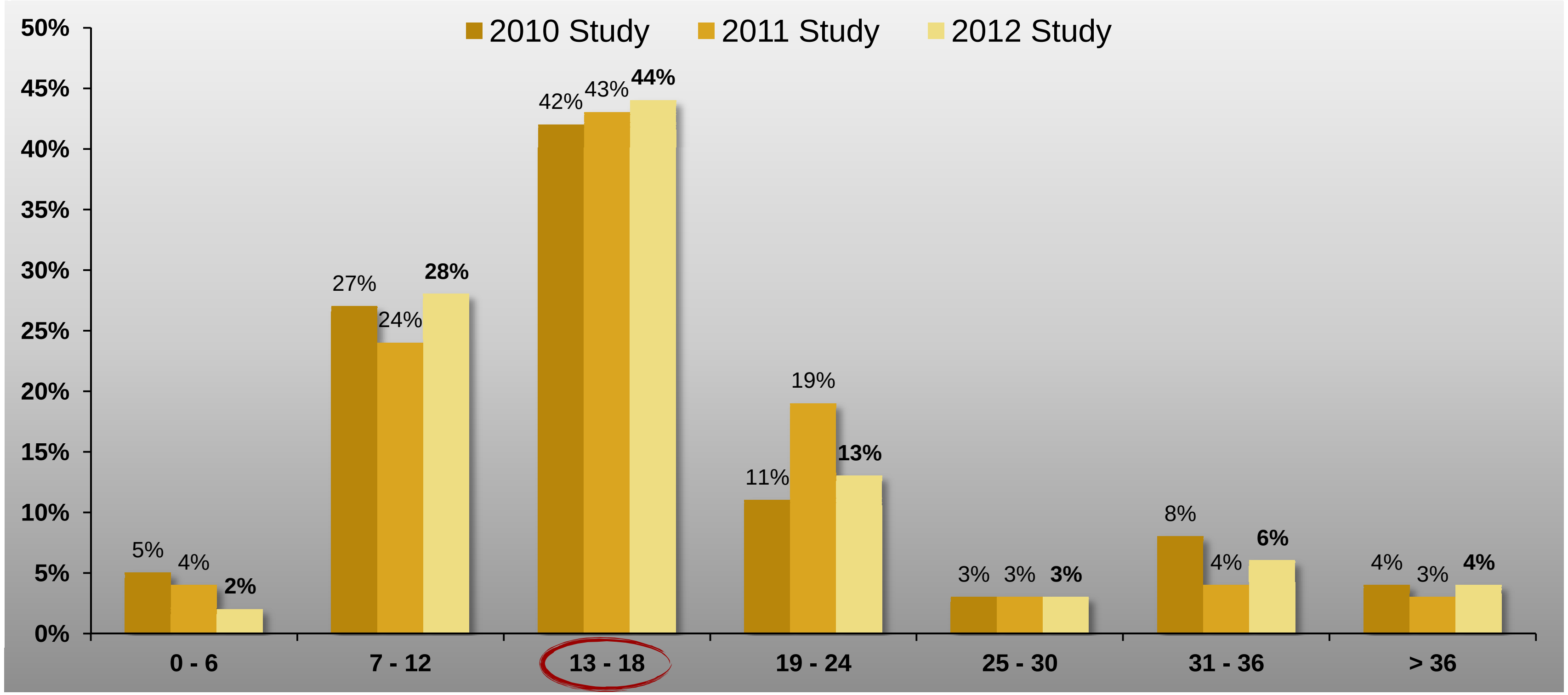
Funding Distribution

- *Purchase Price Adjustment* and *Working Capital Adjustment* accounts made up 16% and 12%, respectively, of the total escrow deposit when present
- *Seller Representative Expense* accounts make up 10% of the escrow deposit when used to bifurcate funds
- *Litigation* and *Tax* accounts only made up 8% (combined) of the overall bifurcation population, but made up 34% and 21% of their respective total escrow deposits when present

[1] Other accounts, often called special purpose accounts, are typically event driven or provide additional indemnification

Escrow Account Duration

Expected Duration Distribution (in months)



2012 Study

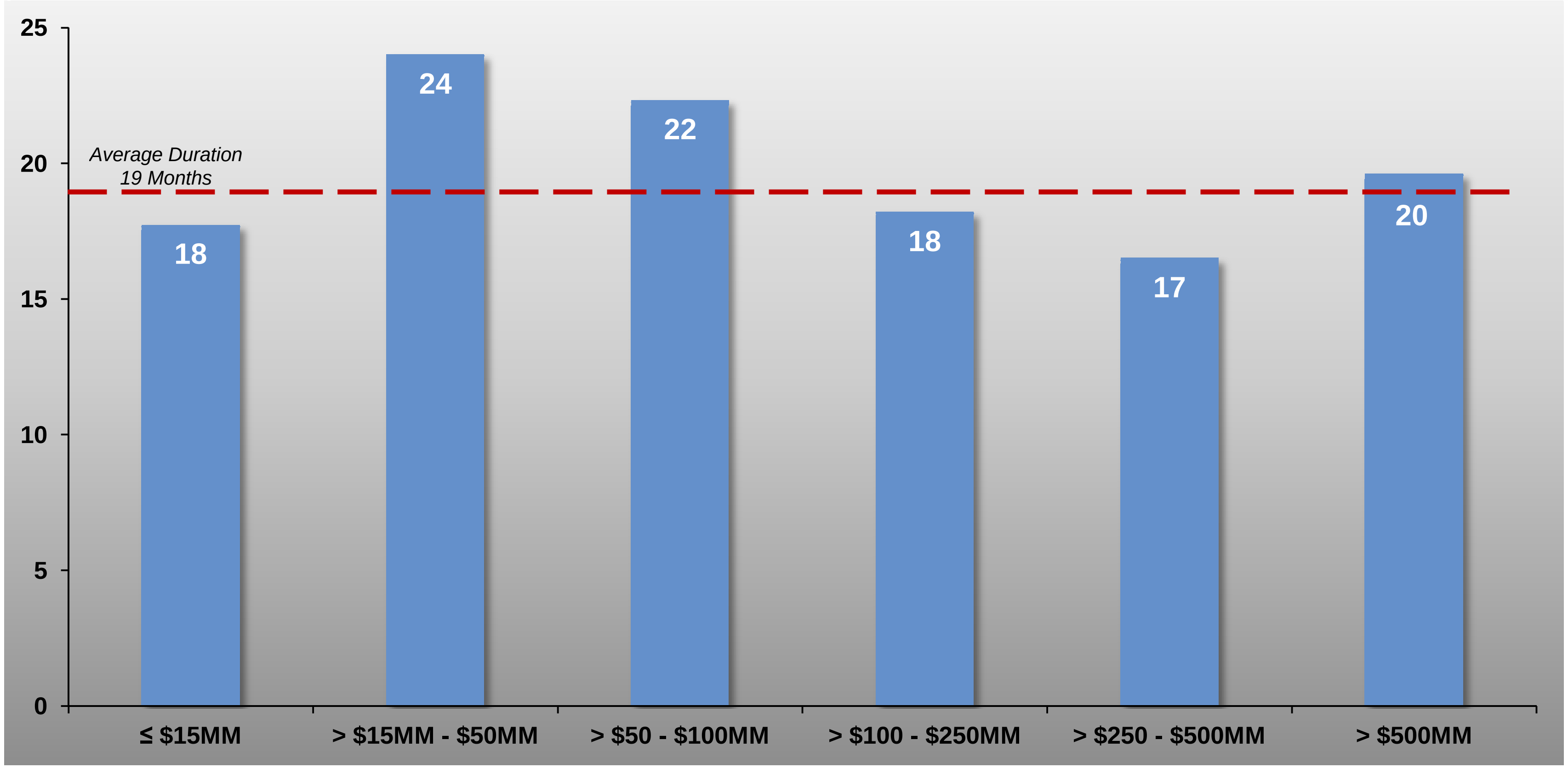
- Average expected duration: 19 months
- Median expected duration: 18 months
- Duration range: 5 – 74 months
- 79% of escrow agreements specify a termination date

Observations

- 18 months is still the most prevalent duration (30% of deals with termination dates specified)
- 12 and 24 months are the next most common, representing 27% and 10% respectively
- 85% of transactions fall within the 7-24 month timeframe

Escrow Account Duration (Continued)

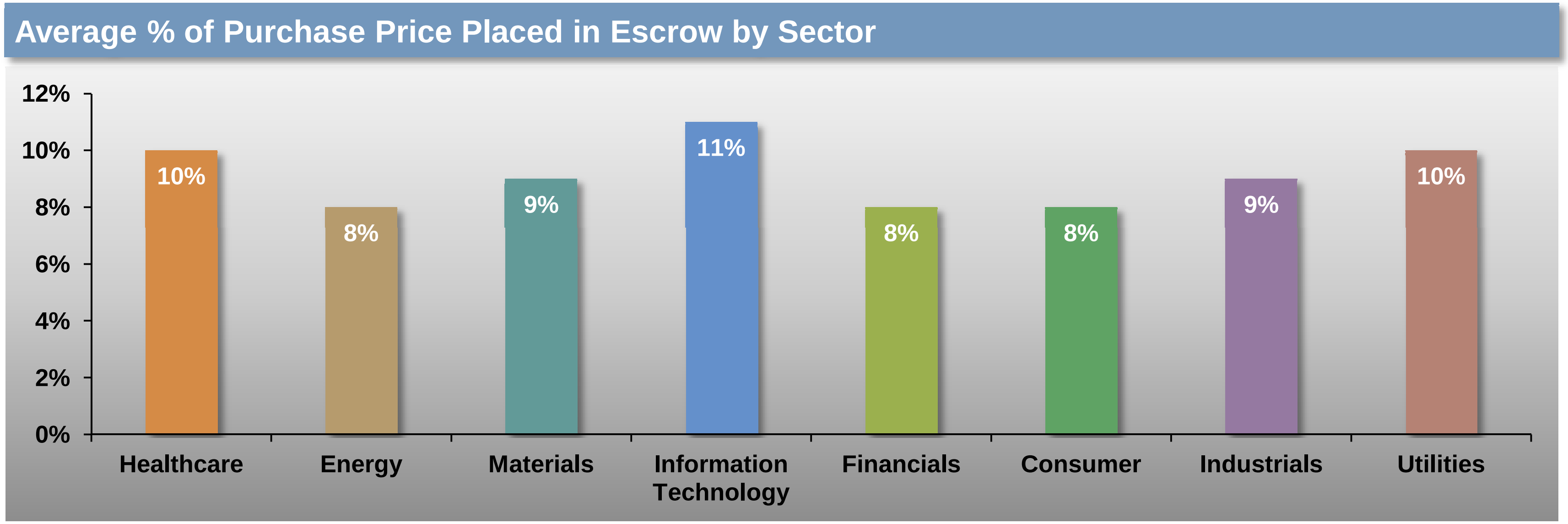
Average Expected Duration (in months) by Transaction Size

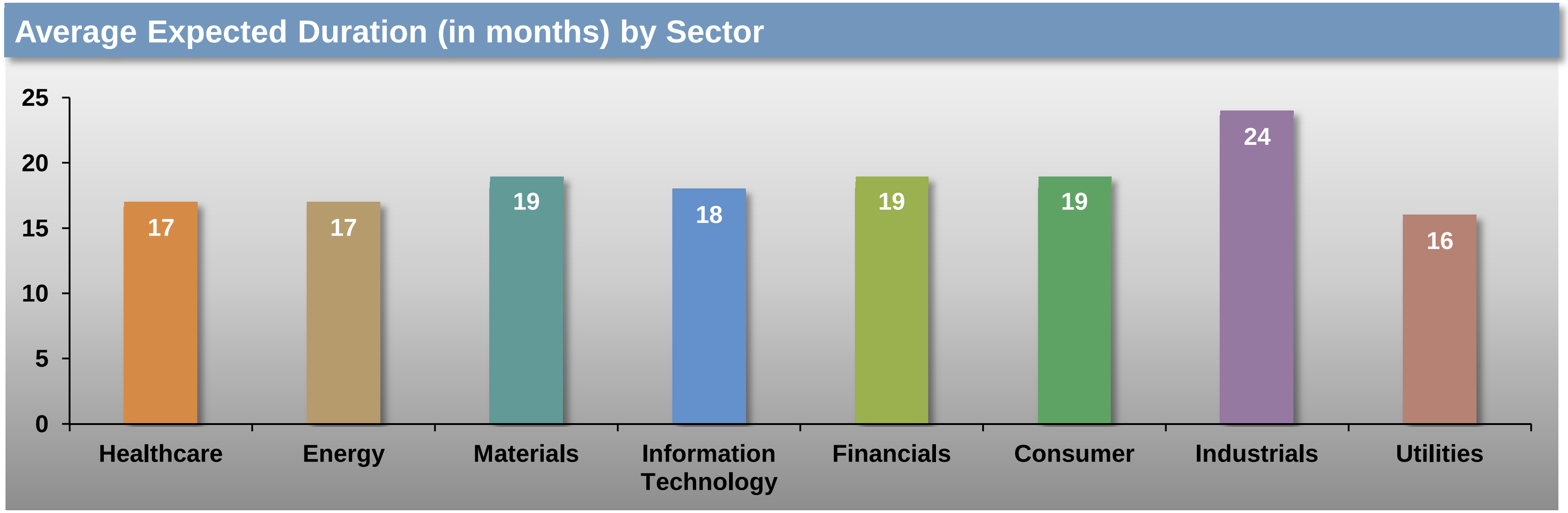


Observations

- Transaction size is not directly correlated to escrow deal duration
- Deals in the >$15MM – $50MM and >$50MM – $100MM ranges are longest in expected duration at 24 and 22 months, respectively
- Deals in the >$250MM – $500MM range typically had the shortest duration, at 17 months

Industry Analysis



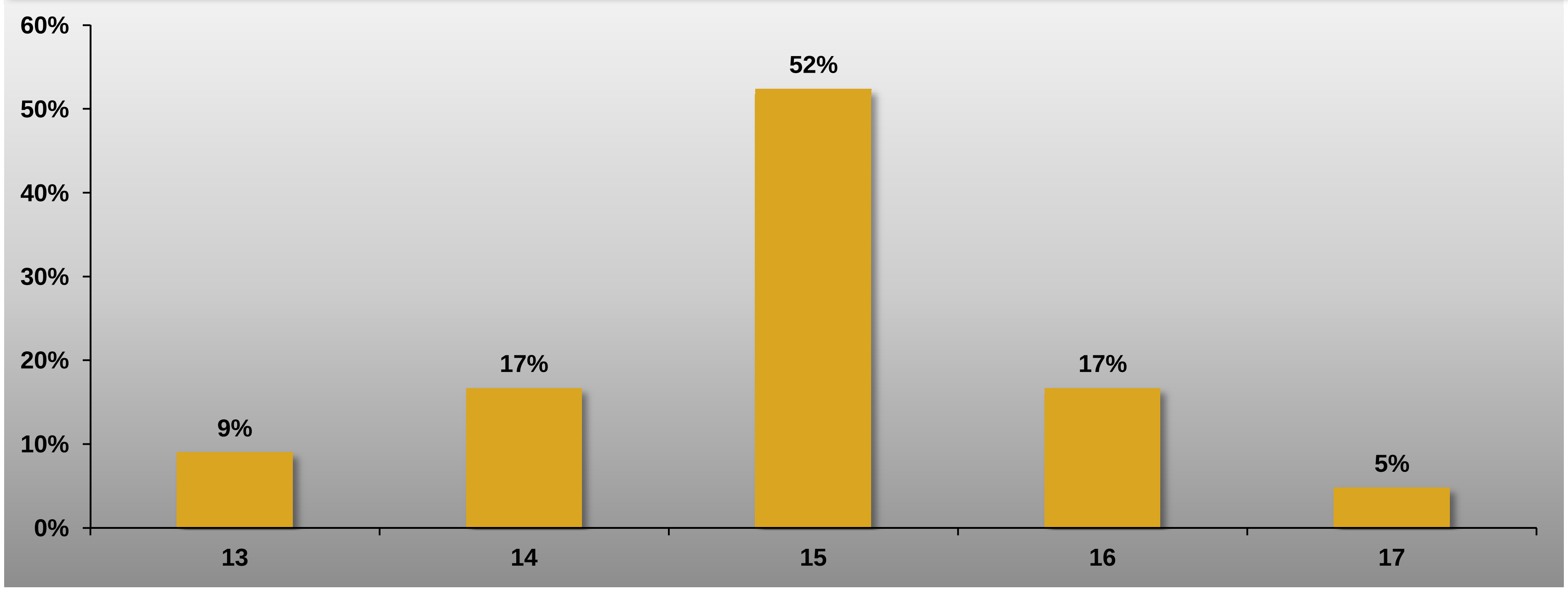


The Audit Cycle Tendency

Audit Cycle Deals

- 14% accounts specify duration between 13 and 17 months
  - 52% of these deals had a 15-month duration, making this the 4th most common explicit duration
- 38% of these deals involved a financial seller; 10 percentage points more than the 28% seen in the general population
  - 63% of these deals had a 15-month duration
- "Audit Cycle" type of deals had scheduled disbursements 19% of the time; 5 percentage points less than the 24% seen in the general population

Distribution of Deals with Audit Cycle Duration (in months)



Scheduled Disbursements

Characteristics of Deals with Scheduled Disbursements

Frequency

- 24% of all transactions had at least 1 scheduled disbursement to the seller prior to termination
- Only 14% of deals with scheduled disbursements had more than 1 disbursement before expected termination

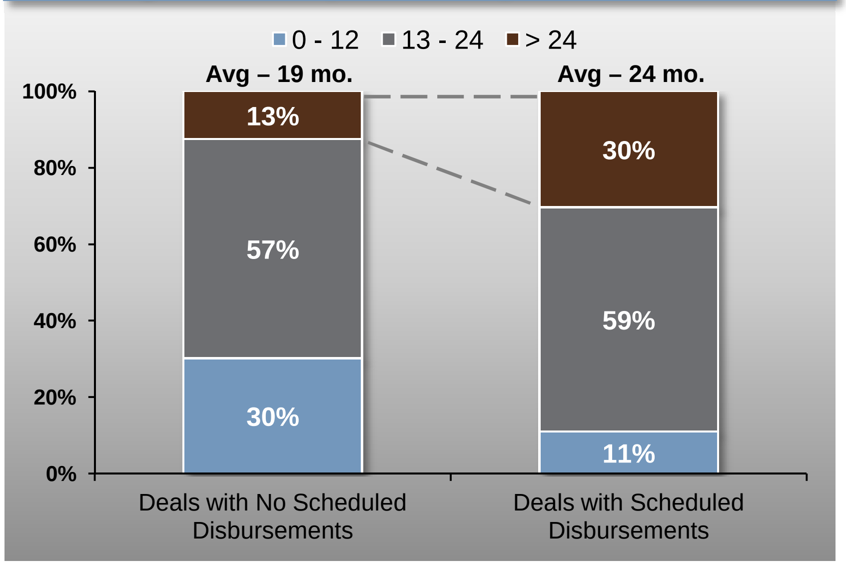
Duration & Size

- The average duration of deals with scheduled disbursements is 24 months; 5 months longer than the general population
  - Results from increase in the proportion of deals with > 24 month duration (13% to 30% for scheduled disbursements)
- The average deposit size for escrows with scheduled disbursements is $9.5MM, 16% larger than the general average
  - Primarily due to a smaller proportion of deals falling in the $0-$2MM range (38% to 24% for scheduled disbursements)

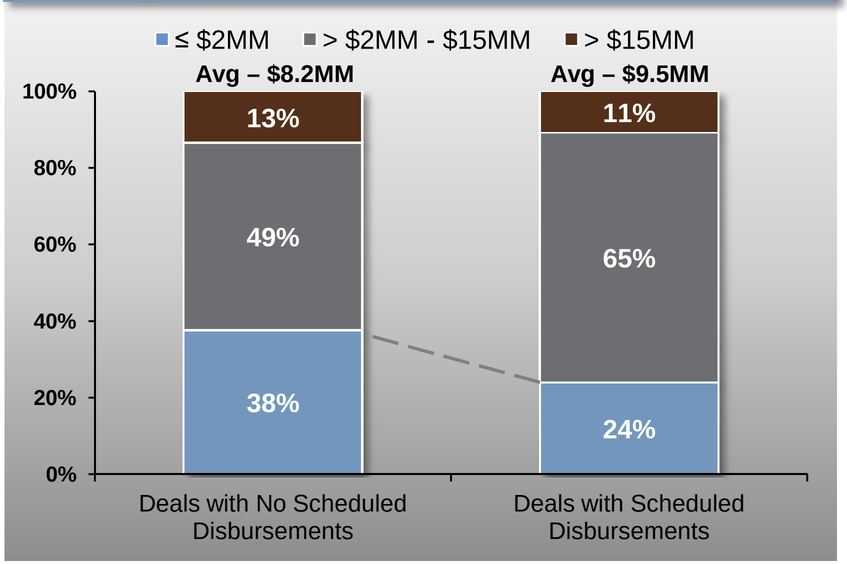
Initial Disbursement

- 50% of first scheduled disbursements occurred exactly 12 months after the funds were put in escrow
- 46% of first scheduled disbursements require exactly one-half of the escrow deposit to be disbursed to the seller

Deals by Duration (in months)



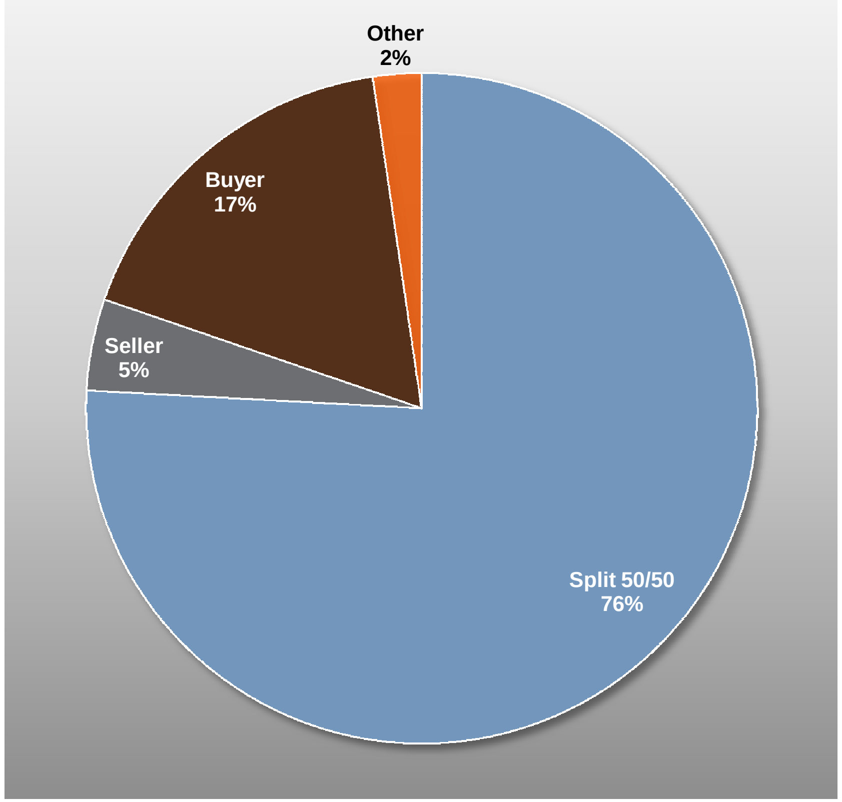
Deals by Deposit Size



Fee Payments & Interest Distribution

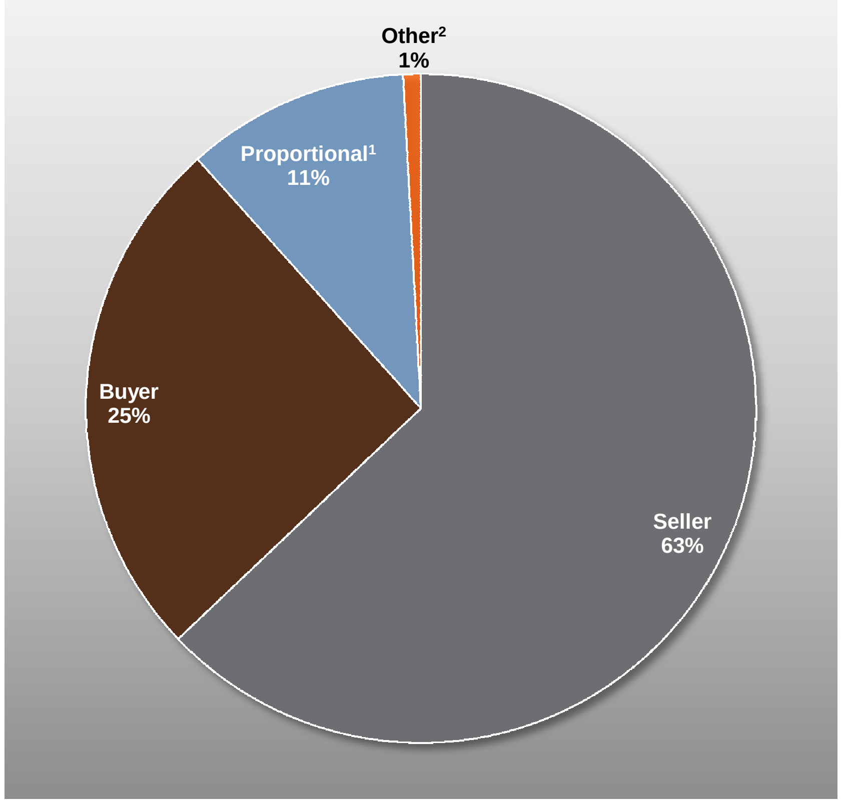
Fee Payment

- 76% of counterparties share the escrow agent fee equally
- The buyer is more likely to pay the fee (17%) than the seller (5%)
- *Other* may include the situation in which fees are paid out of the Escrow fund



Interest Distribution

- Interest is distributed to the seller 63% of the time
- 25% of deals indicate interest should go to the buyer
- 11% of deals distribute interest in equal proportion to general principal disbursements

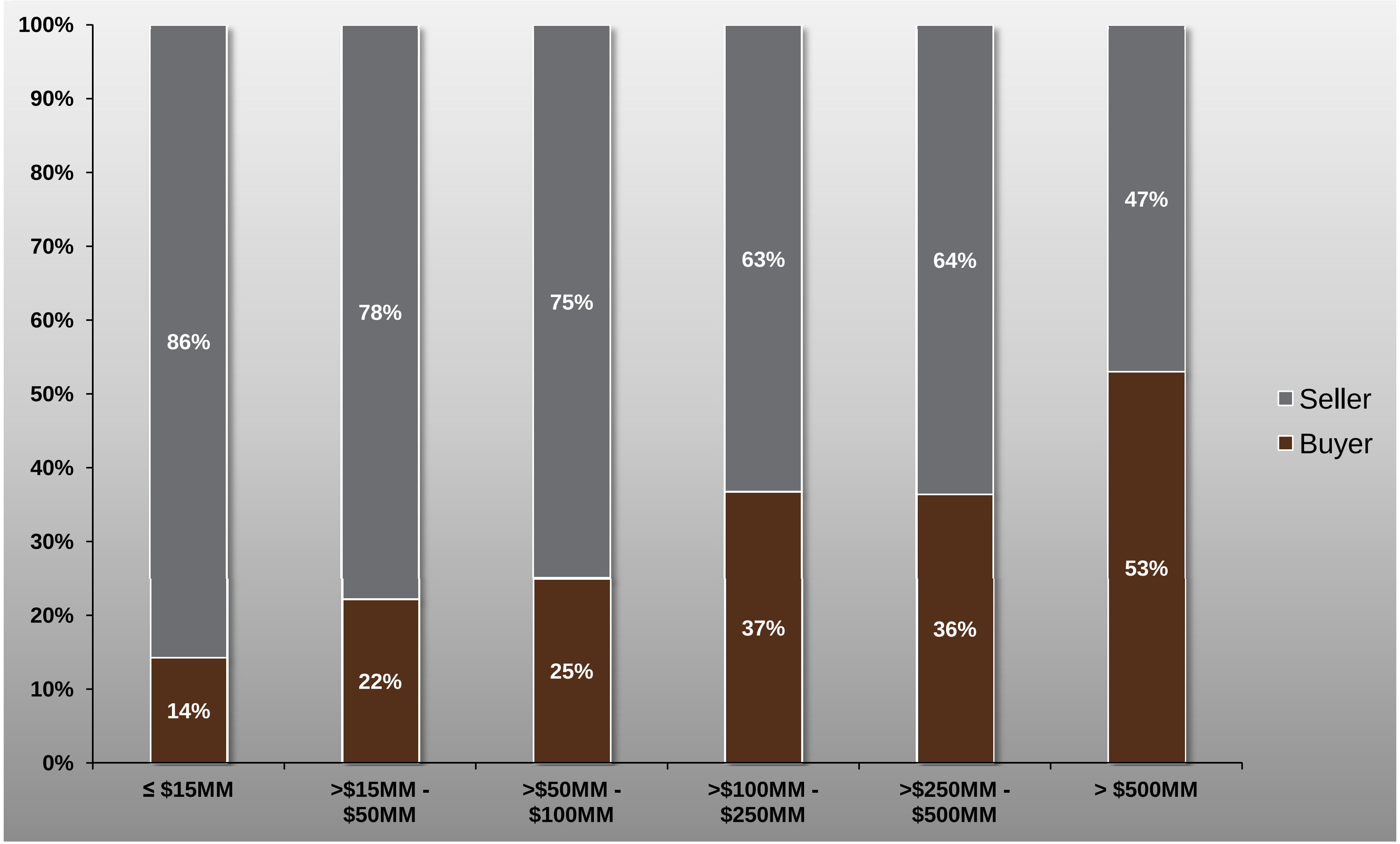


[1] Indicates that interest is distributed in the same proportion as principal

[2] May include the situation where each party is entitled to an exact % of interest

Interest Distribution

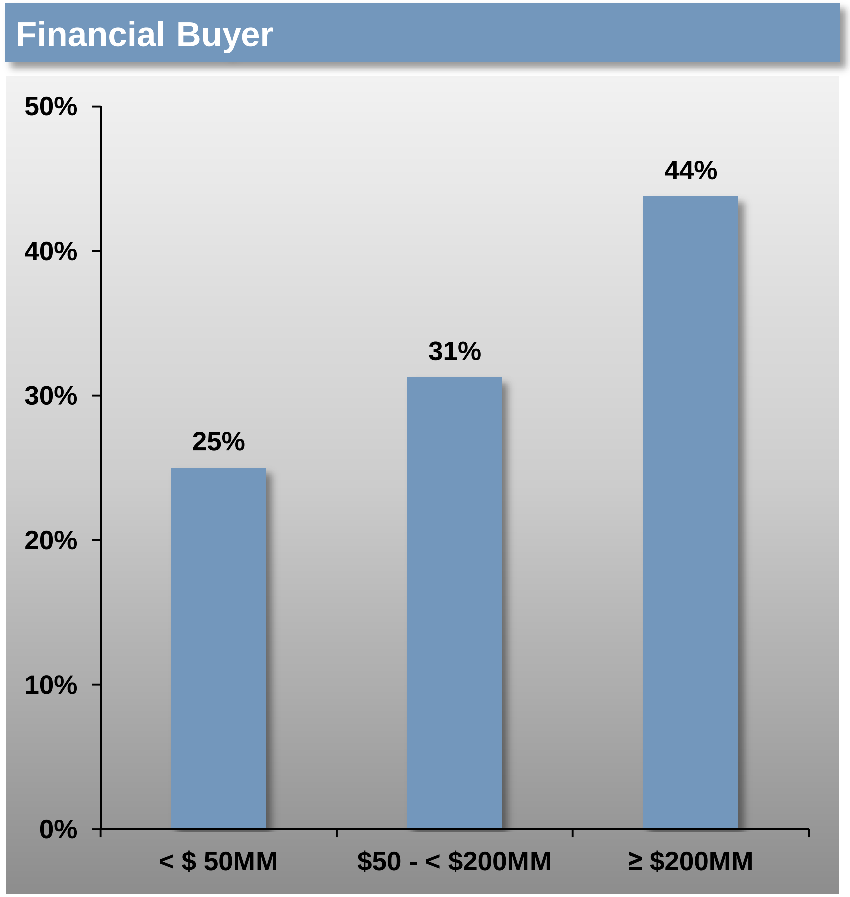
Interest Distribution[1] by Transaction Size

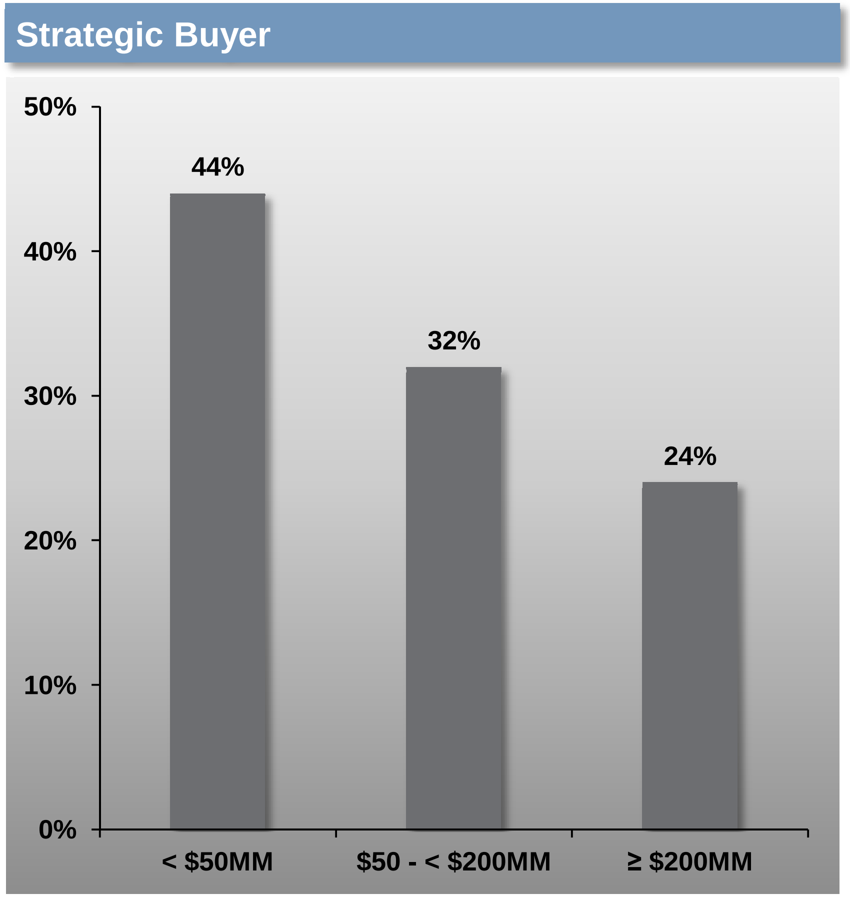


[1] Population only includes deals in which interest is going to either Seller or Buyer

Agenda

Distribution of Underlying M&A Transaction Size



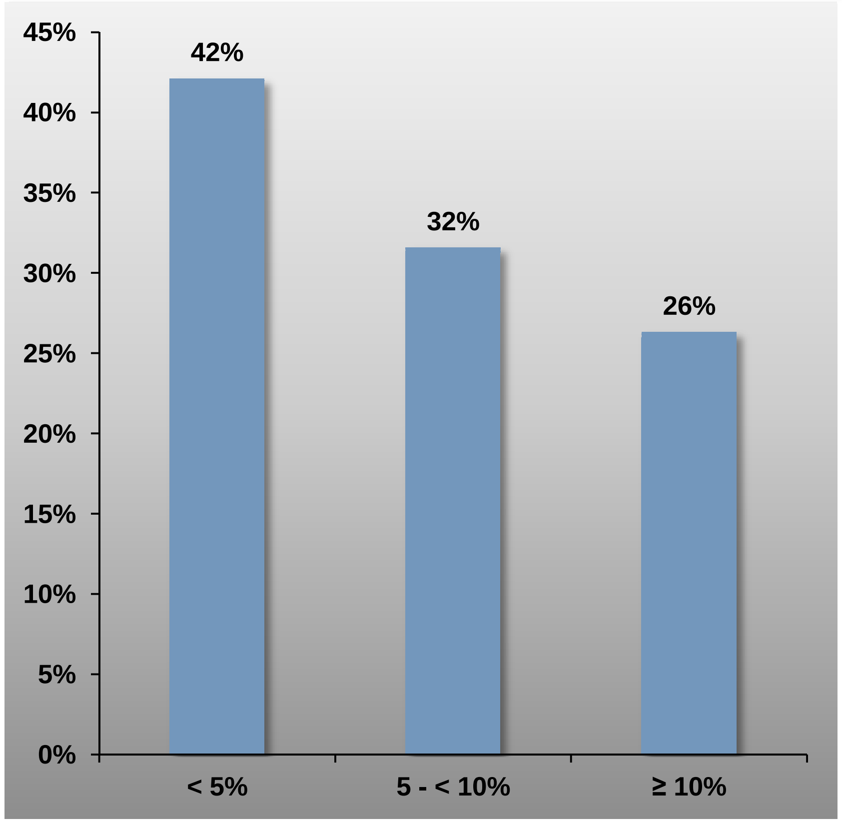


Observations

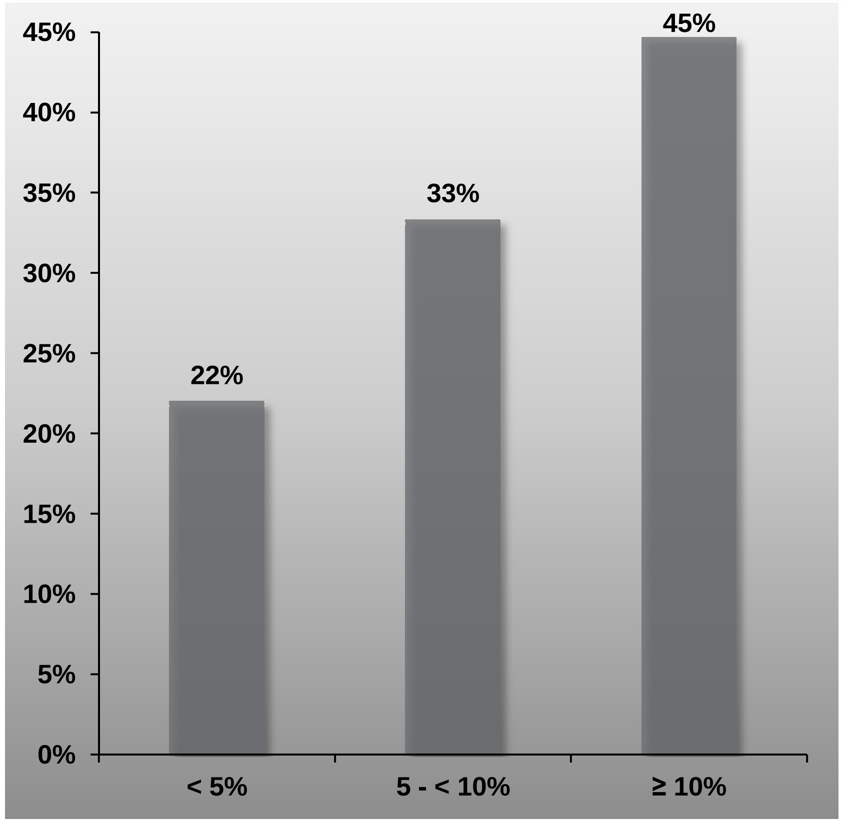
- Occurrence of deals with financial buyers rises from 25% for deals under $50MM to 44% for deals ≥ $200MM, while deals with strategic buyers falls from 44% to 24% for the same transaction sizes
- Transactions involving financial buyers are typically larger than those involving strategic buyers
  - Financial buyer transaction size (average/median/range): $459MM / $115MM / $18MM – $2.1B
  - Strategic buyer transaction size (average/median/range): $202MM / $65MM / $0.6MM – $3.1B

Distribution of % of Purchase Price Placed in Escrow

Financial Buyer



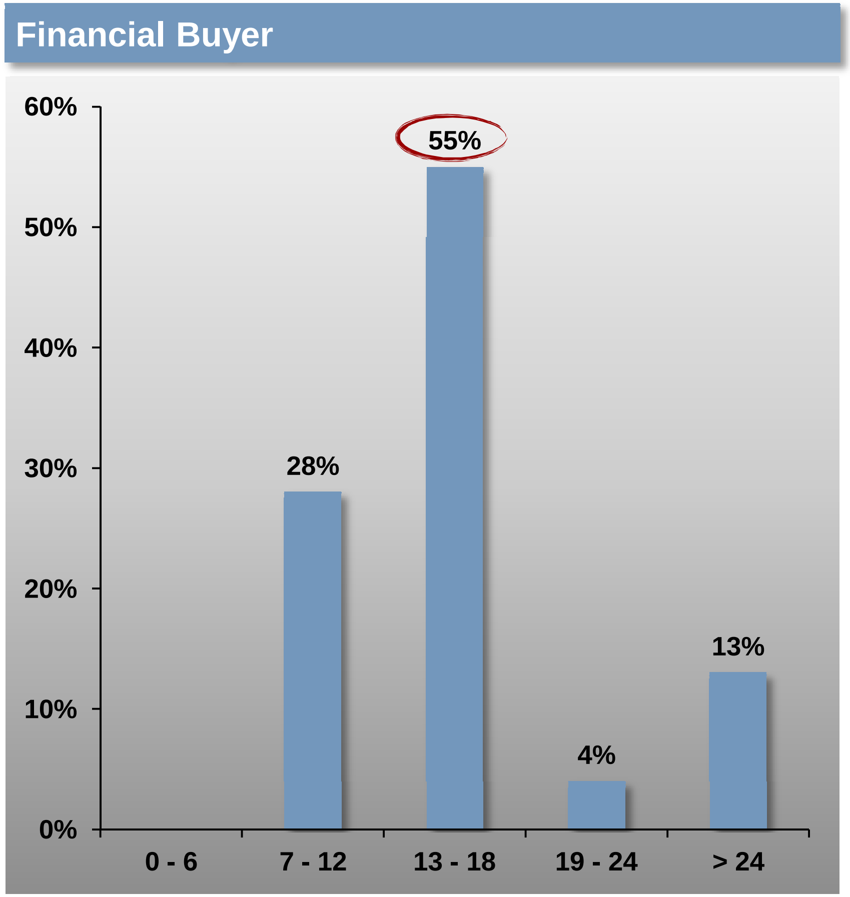
Strategic Buyer

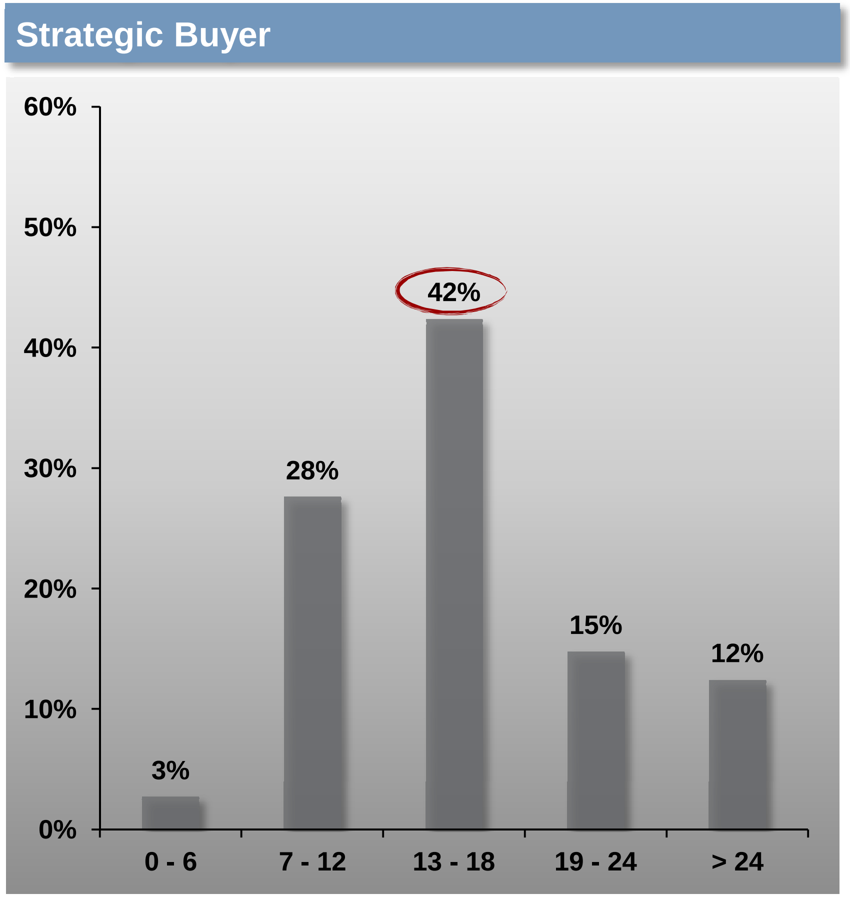


Observations

- Financial buyers typically place a lesser percentage of purchase price in escrow
  - 42% of financial buyer deals held < 5% of purchase price in escrow, compared with only 22% of strategic buyer deals
- Financial buyer % of purchase price in escrow (average/median/range): 8.4% / 5.7% / 0.6 – 33%
- Strategic buyer % of purchase price in escrow (average/median/range): 9.2%/ 9.1% / 0.3 – 38%

Distribution of Expected Deal Duration





Observations

- 55% of transactions involving financial buyers indicate duration between 13 and 18 months, compared with 42% for strategic buyers
- Only 17% of deals involving financial buyers were greater than 18 months
- Financial buyer duration range: 9 – 48 months
- Strategic buyer duration range: 5 – 74 months
- Average expected duration was 19 months for both Financial as well as Strategic buyers

Agenda

Claim & Adjustment Population

Population Characteristics

Claim & Adjustment Population

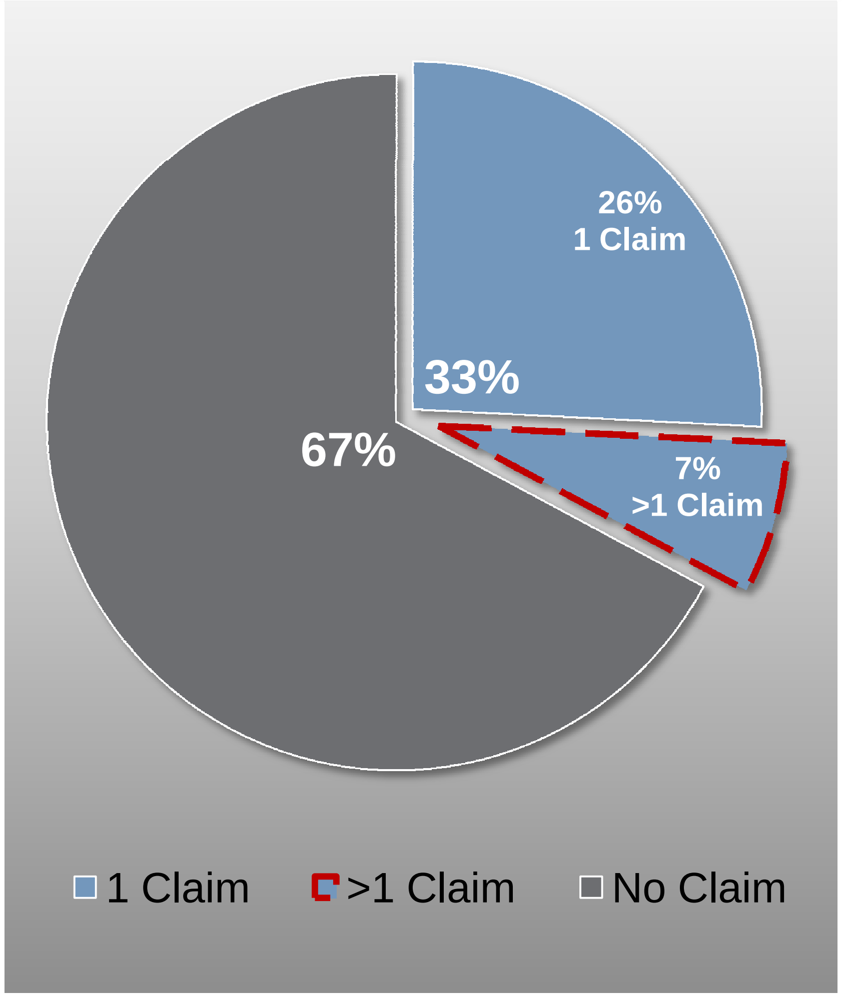
- Claims can occur at any time during the escrow
- This section only looks at J.P. Morgan **terminated deals** with publicly available acquisition information[1] with escrow agreements in the U.S. and dated from July '09 to June '11
- This section analyzes 195 of these transactions[2]

Claim Definition

- For purposes of our study, a claim is a disbursement of funds to the buyer that was not delineated in the escrow agreement[3]
- Claims can be presented through either Joint Order or Claim Notice, the process for which is often delineated in the escrow agreement

Population Characteristics

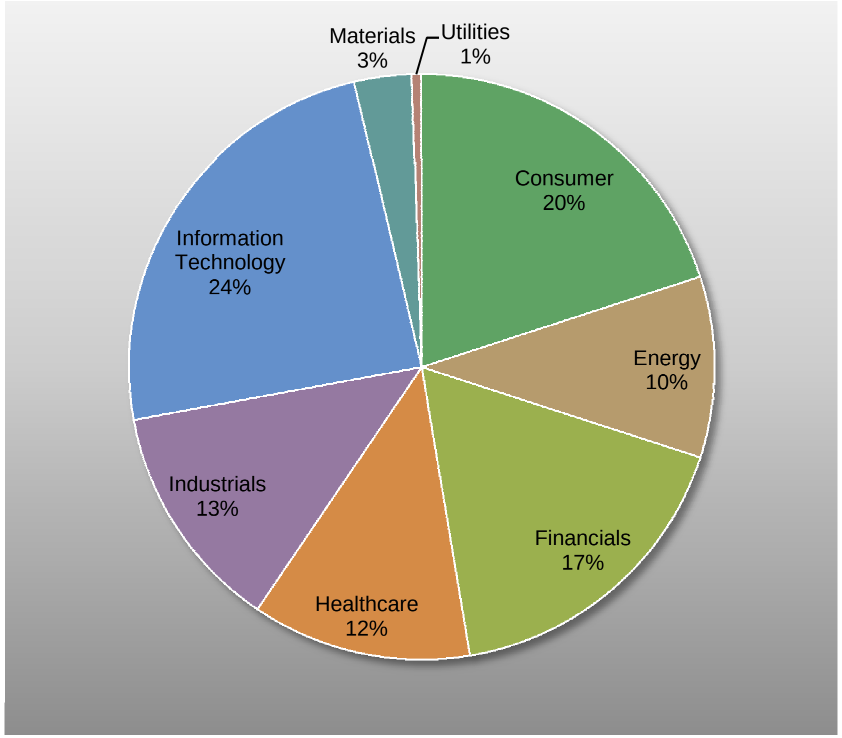
- 33% of deals have at least one claim
- 7% of deals have multiple claims
- 15% of claims involved financial buyers; this is consistent with the proportion of the total population



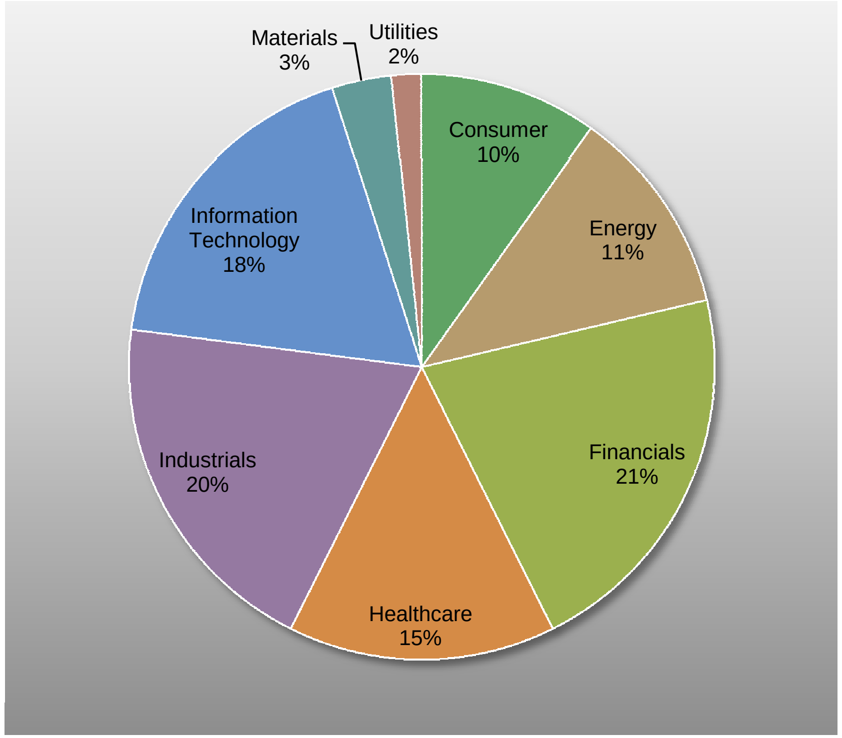
[1] "Publicly available acquisition information" is defined as the availability of transaction details in the Capital IQ database: https://www.capitaliq.com
[2] Population sizes vary for particular data points due to availability or applicability of information
[3] Excludes interest payments and income tax disbursements to the buyer; claims identification is supported by survey results and internal deal knowledge

Claim Distribution by Sector

Completed Deals Population



Claims Population

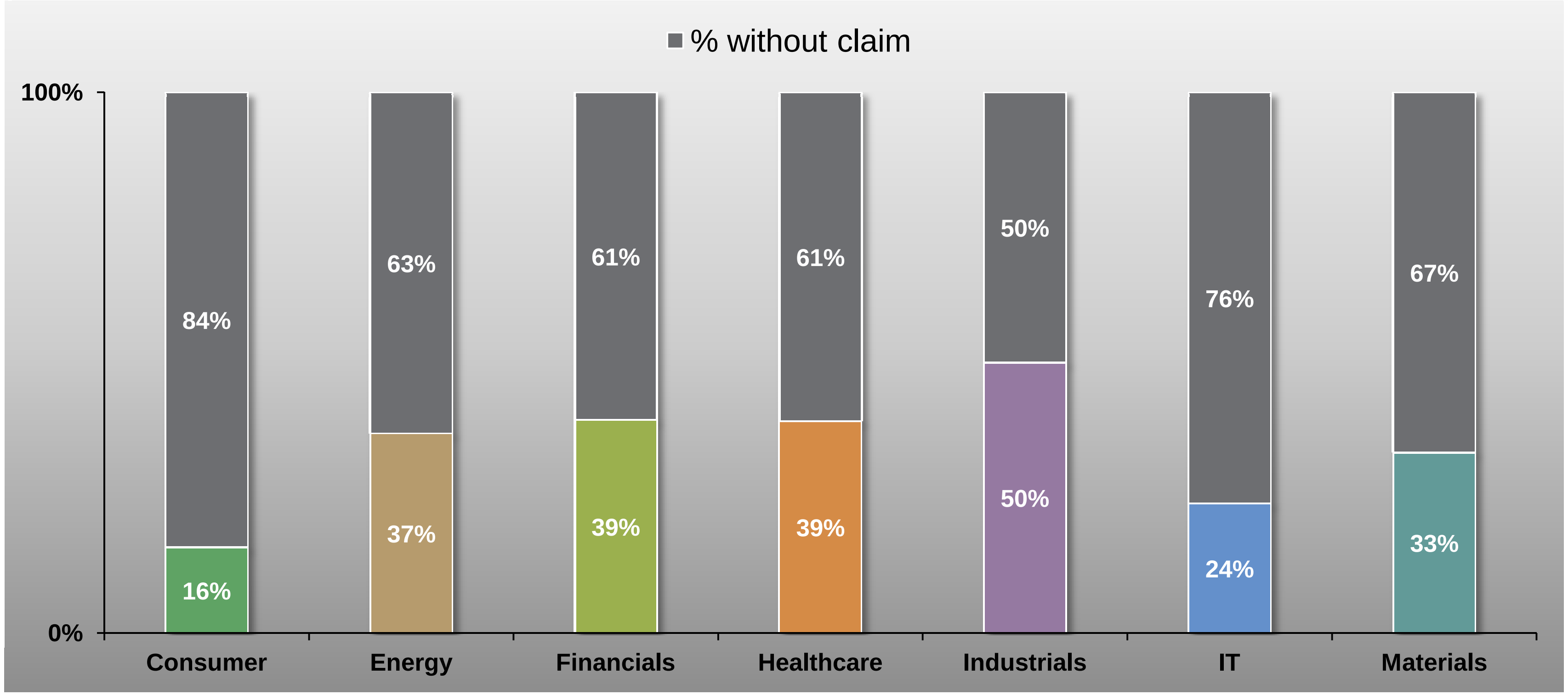


2012 Claims by Sector

- While *Consumer* was the 2nd largest sector for terminated deals, it accounted for only 10% of observed claims
- *Industrials* made up only 13% of terminated deals, but accounted for 20% of claims

Frequency of Claims by Sector

% of Deals with Claims by Sector

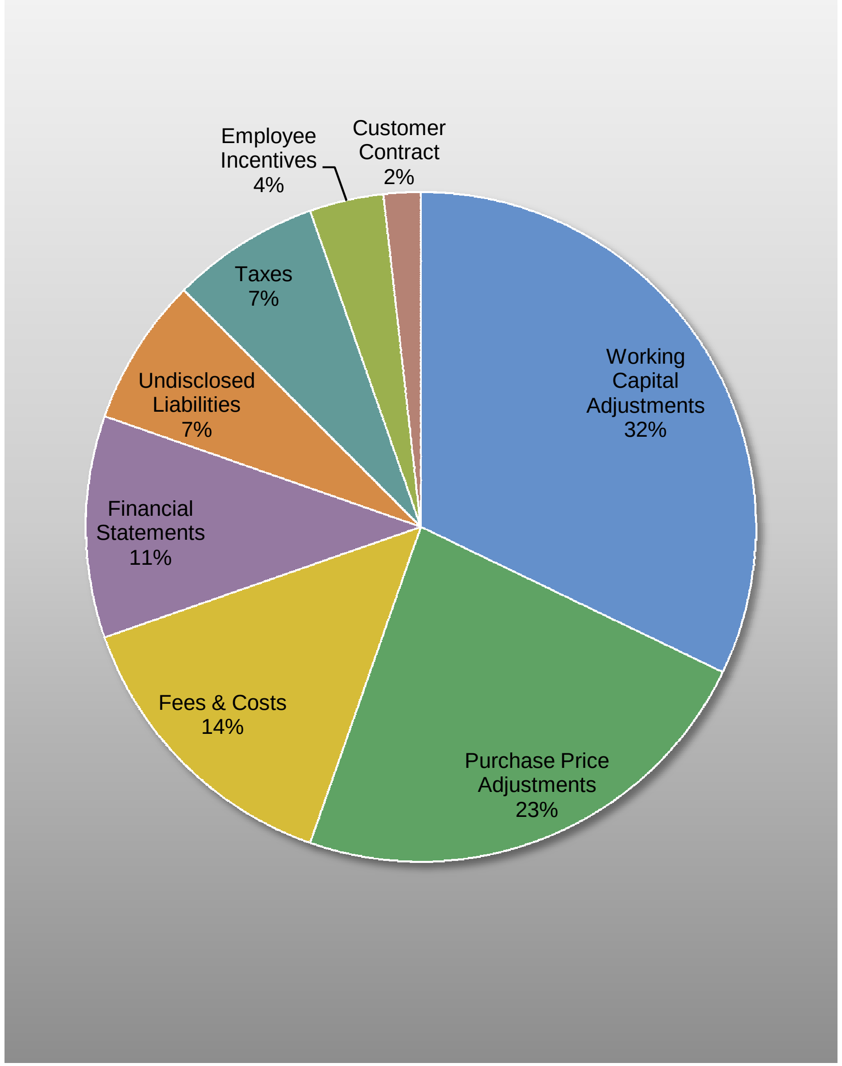


Observations

- *Deals in the Industrials* sector were most likely to receive a claim (50%)
  - *Industrials* were also the most likely to submit a claim in last year's study at 42%
- *Consumer* was the sector that was least likely to receive a claim (16%)
  - 35% of *Consumer* sector deals received a claim in the 2011 Study
- The occurrence of claims in the *Financials* and *Healthcare* sectors have nearly doubled since last year's study; *Energy* has nearly tripled

Claim Reasons

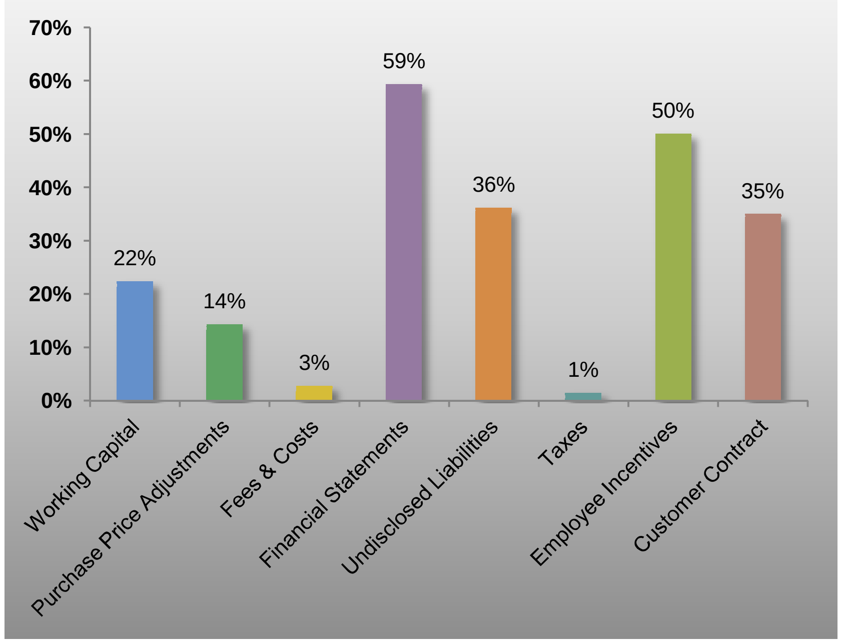
Distribution of Claims by Reason



Distribution & Fund Recovery by Claim Reason

- Claims are most commonly made for *Working Capital* (32%) or *Purchase Price Adjustments* (23%)
- *Financial Statement* claims have fallen from 19% of the population in the 2011 Study to 11% this year
- *Financial Statement* claims were disputed the most frequently out of all claims, but received 59% of the escrow on average

Average % of Escrow Paid to Buyer by Claim Reason

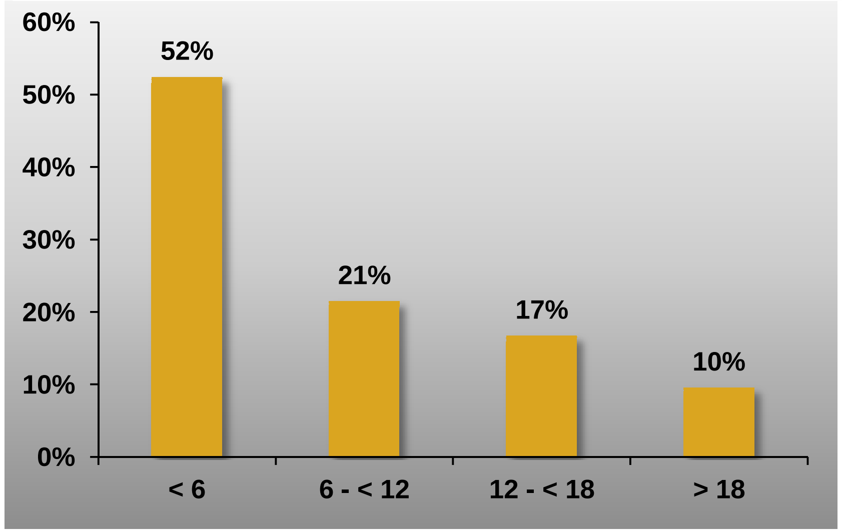


Claim Timing

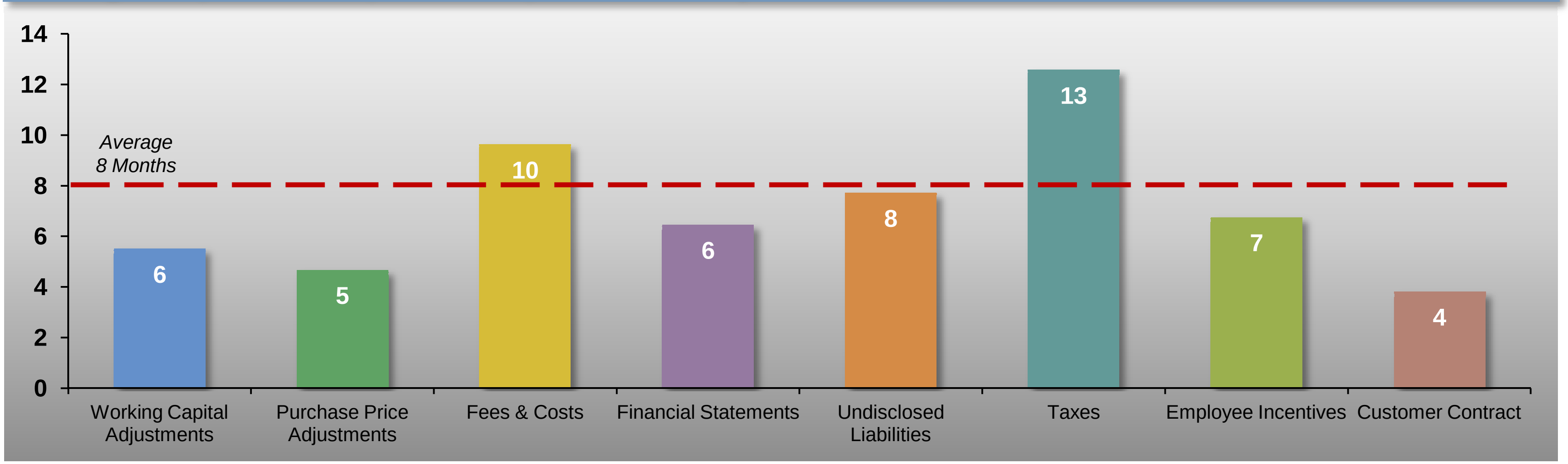
Claim Timing

- 52% of claims and adjustments are received within six months of deal inception
- 10% of claims were received more than 18 months after deal inception
- The average financial buyer claim came in the 5th month; strategic buyer claims were in the 8th month of the escrow on average
- *Customer Contract* had the lowest average elapsed time; less than 4 months after agreement date
- Claims related to *Taxes* typically came much later, in the 13th month of the escrow

Distribution of Elapsed Time until Claim[1]

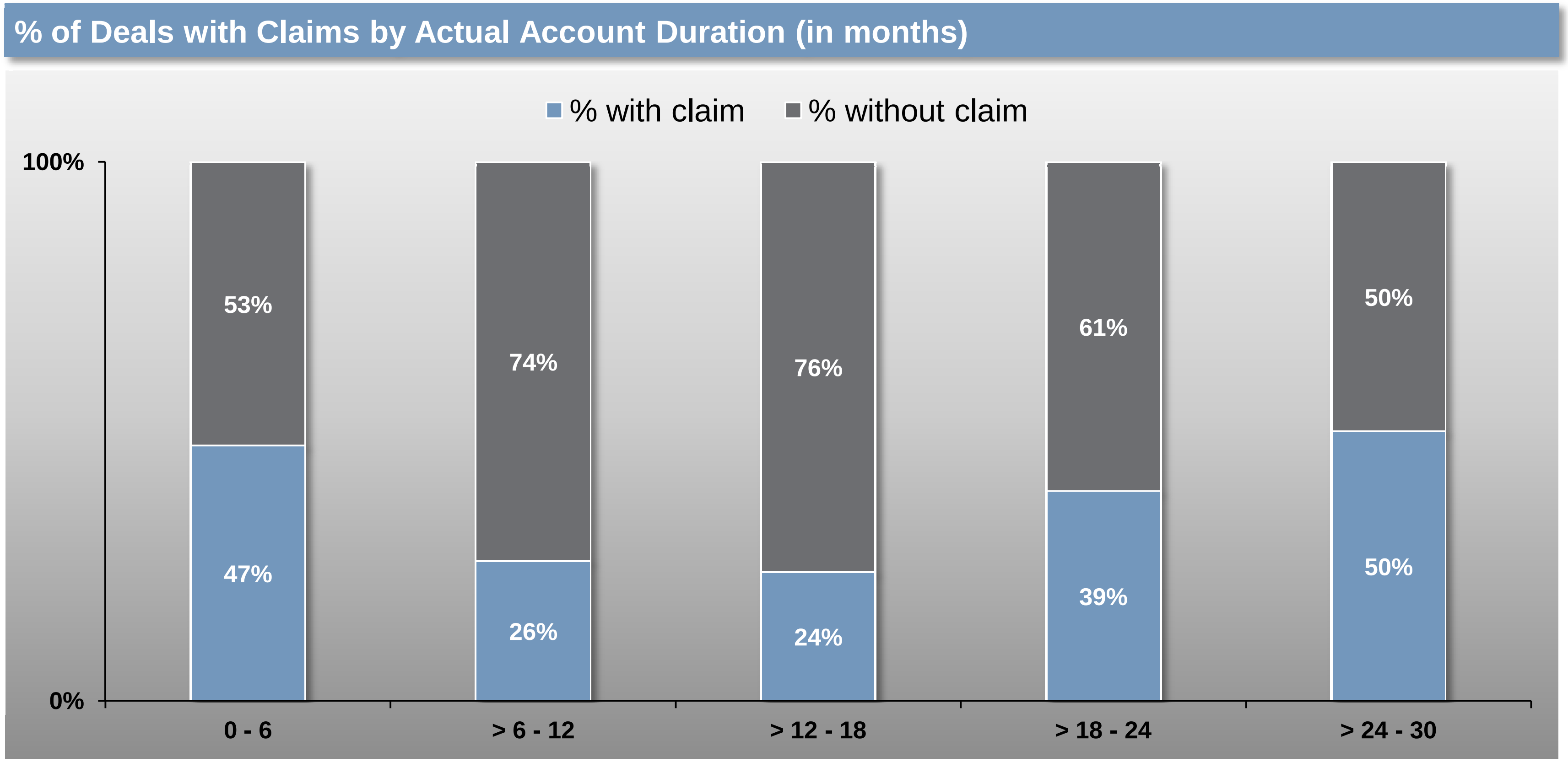


Average Elapsed Time (in months) until Claim by Reason



[1] Claim notification may differ from claim resolution and disbursement

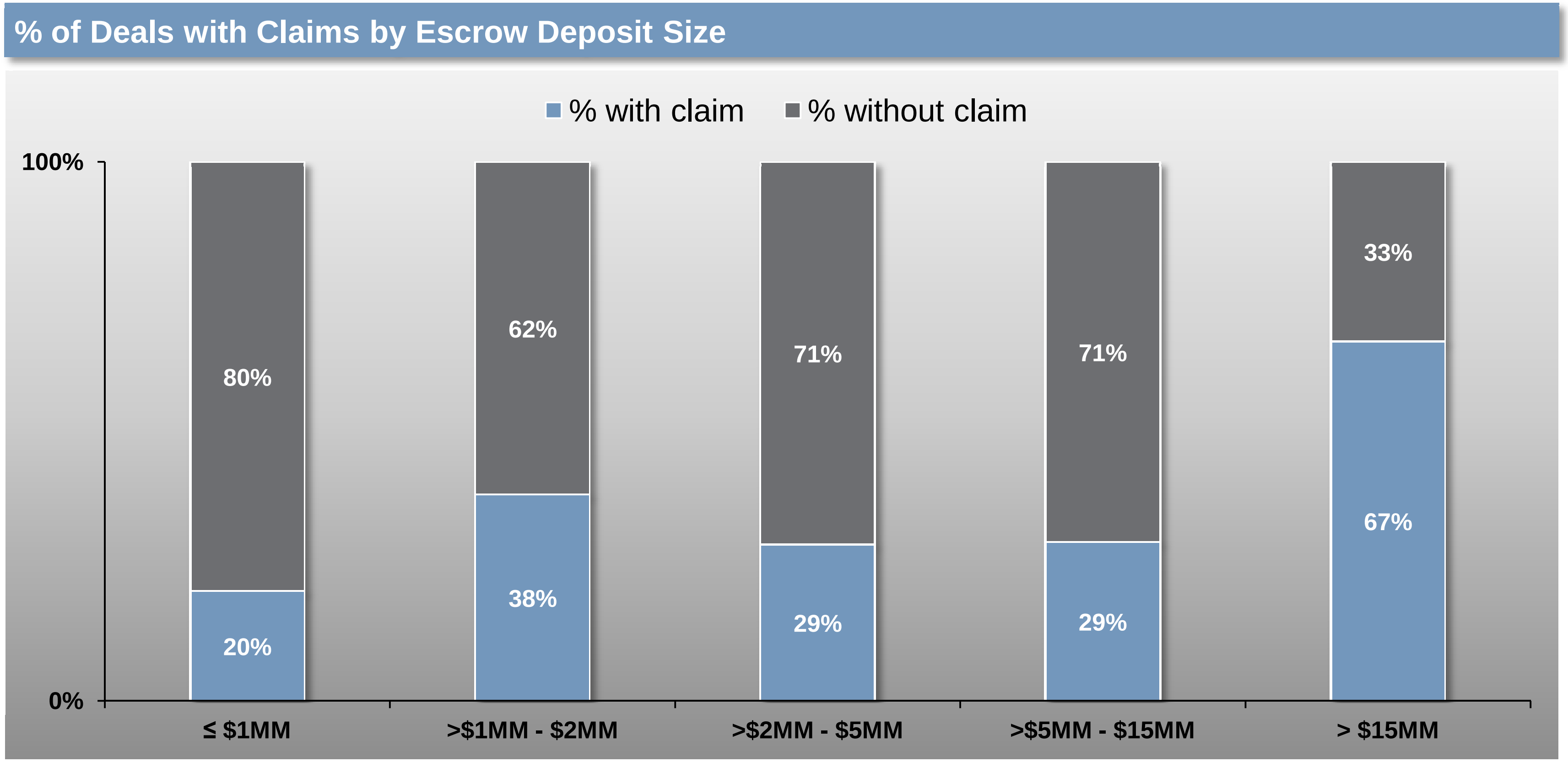
Frequency of Claims by Duration



Observations

- Deals 0-6 months in duration received claims 47% of the time
- Deals with duration > 18 months also had a relative likelihood of receiving claims
  - 39% of deals with duration > 18-24 months received a claim
  - 50% of deals with duration > 24-30 months received a claim

Frequency of Claims by Deposit Size



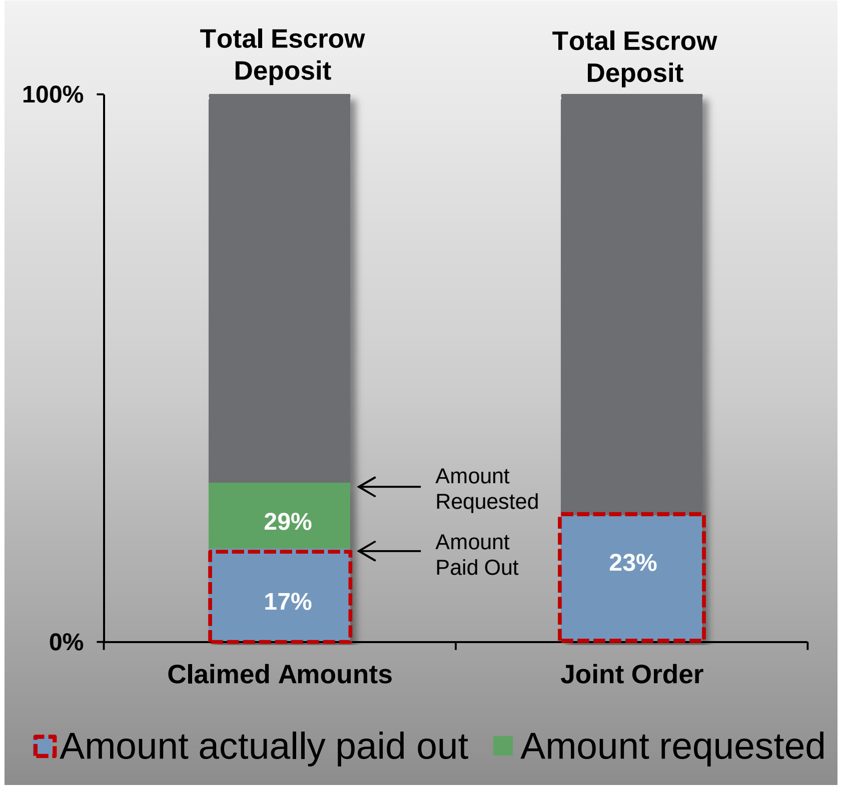
Observations

- Deals with larger deposits are more likely to receive a claim than those with a small deposit size
  - Deals with deposit size > $15MM received claims 67% of the time, compared with 20% for deals with deposit ≤ $1MM
- In the 2011 Study, deals with deposits > $15MM were most likely to receive claims (43%)

Percent of Escrow Claimed & Recovered

Claim Recovery Analysis

- When in the form of a claim notice, 29% of the escrow was requested
  - Buyers were able to recover an average of 59% of the amount originally claimed for, or 17% of total escrow deposit
- Financial buyers were able to recover 24% of the deposit on average; strategic buyers recovered 22%



Forms of Claims Presentation

- Claim Notice (19% of all claims were in this form)
  - Letter filed by buyer with the escrow agent that certifies an indemnification claim and requests disbursal of funds; subject to counterclaims by seller
- Joint Order (81%)
  - Buyer and seller negotiate a settlement price prior to contacting the escrow agent

Claims and Account Termination

- 48% of claims were filed within one month prior to actual termination
  - 30% of these claims were for over half of the escrow amount; 18% were for the entire amount
  - 78% of these claims were filed within one week prior to actual termination
- Escrows with claims sometimes terminate early due to client instructions
  - 34% did so more than one month before their scheduled termination date
- Claims can also force the length of the escrow past their scheduled termination date
  - 23% of deals with claims went more than one month beyond their expected termination date

Agenda

Discourse on the Value Proposition of Holdback Escrows

Benefits to seller[1]

Increases valuation of private targets

- Holdback escrows help to overcome asymmetric information in the markets

Limits liability

- When there are multiple shareholders of the Selling company, escrows provide for Seller security by clearly outlining liability and claims processes in the escrow agreement

Provides a form of reverse insurance in the form of "caps"

- Seller liability is often limited in amount to the value of the escrow deposit earmarked for damages (i.e. "cap") and also in time by the life of the escrow

Reduces immediate tax burden

- The contingent portion of the purchase price (the escrow amount) may be tax deferred, thereby reducing the seller's immediate tax burden

Provides for payment of earnouts via offset provisions

- Among deals with earnouts and determinable offset provisions, approximately 85% were found to allow for the right of set-off[2]
- This provides security to the seller against non-payment by the buyer

Benefits to buyer

Protects the buyer against breach of representations and warranties and / or the dishonoring of covenants by the seller

- Achieved through indemnification provisions
- Among transactions in which representations and warranties survived closing, 83% were supported by a holdback escrow as it mitigates buyer risk[3]

Mitigates volatility risk

- Purchase price adjustments protect the buyer against economic downturns
  - Holdback escrows capture changes in value—which are most prevalent in uncertain economic times—that occur between the negotiation stage and closing

Minimizes the risk of post-closing target devaluation

- Holdback escrows often support the retention of key employees who are pivotal to the future success of the business

Confirm that the seller pays its agreed upon share of advisers' fees

- Protects the buyer against non-payment by the seller
- This concern is most relevant when purchasing distressed assets

[1] Dr. Lubomir P. Litov, Asst. Professor of Finance, John M. Olin School of Business Washington University in St. Louis, May 2010
[2] American Bar Association (ABA). (2009). 2009 Private Target M&A Deal Points Study [White Paper]
[3] Houlihan Lokey. (2010). Q1 2010 M&A & Financing Market Overview [White Paper]

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Claim Definitions

Claim Type	Description
Customer Contract	Third-party or direct claim type. Claims are placed in this category where the buyer's claim is based on a customer contract of the target. Common examples include claims that the target failed to provide a contracted service or product to the customer. Does not include claims involving contracts with vendors or suppliers of the target.
Employee Incentives	Third-party claim type. Examples of claims in this category include claims by former employees involving non-equity based compensation and lawsuits by former employees for discrimination or harassment.
Fees & Costs	Can be either a direct or third-party claim. These claims may be based on terms such as seller's obligation to pay outstanding transaction costs, or costs relating to audits or litigation disclosed prior to closing
Financial Statements	Direct claim type. These claims are based on alleged breach of representations and warranties regarding the accuracy of the target's financial statements. This may also include claims for a net working capital adjustment included in the indemnification section rather than as a dedicated, short-term post-closing adjustment mechanism.
Purchase Price Adjustment	These claims result from an explicit adjustment to the purchase price of an underlying M&A transaction. Purchase price adjustments may result from the final determination of a number of financial metrics related to the target company after closing.
Working Capital	A common deal feature where the transaction consideration is adjusted shortly after closing in accordance with a specified financial metric. While there are a number of metrics used to determine the adjustment, the most common is some variation of a net working capital formula. As a result, claims in this category are commonly referred to as "Net Working Capital claims." The adjustment can be in favor of either the buyer or selling shareholders.
Taxes	Tax claims are based on the target's alleged failure to pay applicable state or federal taxes. Includes, among others, income, sales, and use taxes.
Undisclosed Liabilities	These claims are based on the target's alleged failure to disclose a liability in the disclosure schedules. The undisclosed liabilities representation is sometimes used as a catch-all by buyers for unexpected third party claims that do not fit under the financial statements or material contracts representations. The most common example is a buyer's claim that the target did not disclose outstanding obligations to a vendor, supplier or other partner.

Questions / Contact

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