

2009 Global Taxand Conference

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LEADERSHIP • PROBLEM SOLVING • VALUE CREATION

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ALVAREZ & MARSAL

Themes for Today's Discussion

- I. Welcome
- II. About Alvarez & Marsal
- III. Today's Economic Reality
- IV. What Industries Will be Affected?
- V. What Makes this Recession Different?
- VI. Doing Business in the Current Environment
- VII. My Views on the Proposed US Stimulus Plans
- VIII. Implications to Tax Practitioners
- IX. Key Take-Away



II. About A&M: Snapshot of Alvarez & Marsal Today

North America

New York (Global HQ)

- Atlanta
- Birmingham
- Boston
- Charlotte
- Chicago
- Dallas
- Denver
- Detroit
- Houston
- Kansas City
- Los Angeles
- Miami
- Nashville
- Philadelphia
- Phoenix
- San Antonio
- San Francisco
- Seattle
- Tampa
- Toronto
- Vienna, VA
- Washington, D.C.

Europe and the Middle East

London (Europe HQ)

- Amsterdam
- Cairo
- Dubai
- Frankfurt
- Madrid
- Milan
- Moscow
- Mumbai
- Munich
- New Delhi
- Paris

Latin America Location

- São Paulo (Latin American HQ)
- Bogotá

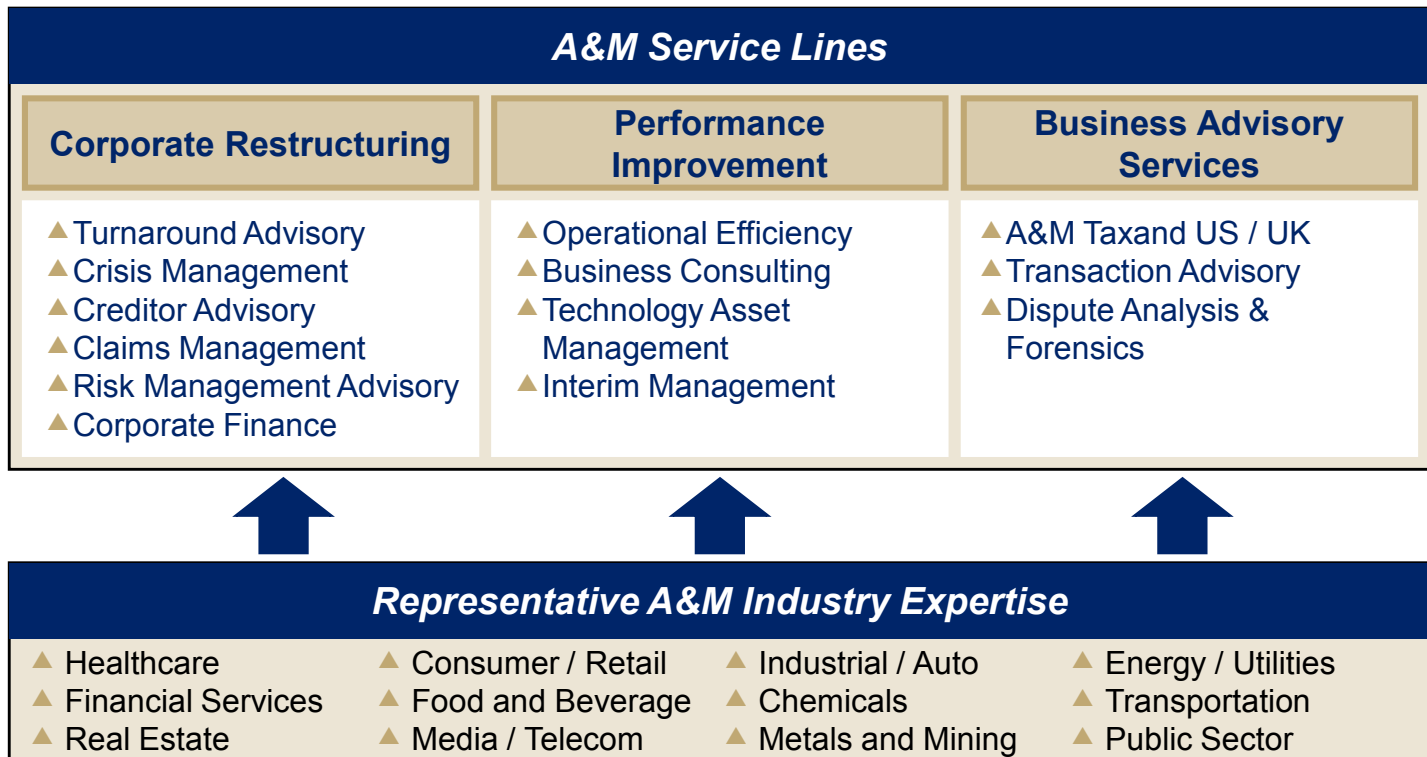
Asia

- Hong Kong (Asia HQ)
- Shanghai



ALVAREZ & MARSAL

- ▲ Founded in 1983
- ▲ 1,400+ professionals
- ▲ 200+ Managing Directors
- ▲ One of the fastest growing privately-owned professional service firms.
- ▲ Four continents; 15 countries; 39 cities



II. About A&M: Who are Our Clients?



II. About A&M: Gaining Global Market Leadership

▲ A&M has Achieved Market Leadership in Corporate Restructuring:

- Routinely invited to pitch as restructuring advisors / crisis managers in major restructuring cases across industries
- Continues to earn industry recognition for successful outcomes of high profile clients



▲ When Lehman filed, A&M took a front row seat in financial history



▲ A&M's Operational Performance Improvement Capabilities are on a Global Path to Growth:

- Organic growth (selective hiring) of consulting talent specializing in less troubled situations is now gaining market share among clients and employees in global markets



▲ A&M Business Advisory Services are achieving “early” market recognition against mature, entrenched competitors:

- A&M Taxand is competing as the “Fifth Choice to the Big Four” as part of Taxand Global Network
- A&M tax practitioners are finding synergies to work on major A&M clients like Lehman and WaMu



Best Newcomer, 2008



III. Today's Economic Reality

How We Got Here:

- ▲ **Failure on the part of banks to properly assess risk in an environment of easy and inexpensive access to credit**
- ▲ Failure of credit agencies to properly rate sophisticated debt instruments (e.g., subprime mortgages)
 - Credit agencies ratings relied on unrealistic appreciation of future real estate values
 - Banks relied excessively on credit agencies and did little independent assessment
 - Multiplier effect of “bundled” and “toxic” subprime loans (“MBS” and “CDO”)
- ▲ The trigger point that commenced the economic downturn was the melt-down of subprime mortgages
- ▲ The subprime meltdown led to the plummeting decline in real estate prices and impacted credit markets
- ▲ Stock market losses accelerated on the heels of the subprime crisis
- ▲ The demise of Lehman Brothers in September 2008 deepened the downward spiral already in play.

Exposed interconnectivity and fragility of the global financial system



III. Today's Economic Reality

Where We Are Today?

- ▲ **The credit default rate has jumped to 4.5%** with double-digit predictions now expected into 2010.
- ▲ **US bankruptcy filings have jumped 74%** to 136 public companies.
- ▲ **European insolvencies have jumped 51%** with one in every 150 actively traded companies going into liquidation in the UK.
- ▲ **US jobless rate stands at 7.6%** with 3.6 million Americans who have lost jobs since the recession began in 2008.
- ▲ **Residential real estate values have dropped 28%** on average nationally from the peak through December 2008, and are likely to drop further in the coming year.
- ▲ **Consumer spending is down** due to fear of job losses and declines in 401(k)s and home values.
- ▲ **Stock market declines** have accelerated.
- ▲ **Commercial real estate values have declined** and show signs of further deterioration.
- ▲ **PE investments done** in 2004-2007 are generally **in trouble**.
- ▲ **Banks have been weakened**, especially “mega” banks, under new government “ownership”
- ▲ **Increasing shortfall in tax receipts** from loss of jobs, sale of fewer goods and services and real estate devaluation.



III. Today's Economic Reality: Implications

▲ **Liquidity is King:**

- Cash is the “life-blood” of corporate survival
- Liquidity will determine the amount of time and options companies have to effectively restructure and improve operating performance

▲ **Extremely challenging environment due to lack of credit availability**

- DIP financing has gone from easy to difficult to arrange due to frozen credit markets
- The rate of involuntary liquidations will increase dramatically as companies – across the industry spectrum – are unable to find capital for reorganizations.
- Liquidation offers poor recovery

▲ **The majority of M&A deals taking place currently are strategic:**

- PE firms – financial buyers – are keeping their power dry
- PE firms have one main focus: **PORTFOLIO-PORTFOLIO-PORTFOLIO**
- Few financial buyers are doing deals except for strategic “add-ons”
- PE firms are hunkering down and playing defense; strong management teams will be key
- The little M&A PE business today is in mid-cap PE Firms – large cap deals are dead
- Expectation when credit frees up is that PE deals will be closer to 50% financed – so large deals will be more difficult to do alone



III. Today's Economic Reality: Implications

Beware of Unintended Consequences

- With government getting into the banking business, how will banks manage risk going forward?
- ▲ **Buying opportunities will abound for PE and corporate buyers that have the cash to invest.**
 - The next two years will be a terrific “vintage” for M&A deals
- ▲ **Financial Engineering will NOT be the answer for tomorrow:**
 - Primary focus is liquidity
 - Increased need for operational performance improvement
 - Back to basics: implement improvements in working capital management, SG&A and market share growth
 - Financial “wizardry” will NOT cut it.



IV. What Industries Will Be Affected?

Few industries will be spared in this recession, except non-discretionary sectors such as healthcare, food, restructuring, etc.

▲ **Hard Hit Industries:**

- Financial Institutions
- Residential Real Estate (and related construction/homebuilder sectors)
- Automotive (and suppliers)
- Media and Advertising
- Retail
- Consumer Electronics
- Hospitality (Hotel vacancies are at their worst since Sept. 11th)

▲ **The Next Wave:**

- Retail: Deepening Impact
- Commercial Real Estate (also tied to retail downturn)
- Consumer Products



V. What Makes this Recession Different?

This Recession Cycle is Different and Unprecedented:

- ▲ The absence of credit has caused unprecedented conditions not seen since the Great Depression.
- ▲ Bank-led crises can lead to recessions that are painful and protracted.
- ▲ What history tells us:
 - Professors Reinhart (University of Maryland) and Rogoff (Harvard) recently released a research paper on the aftermath of bank crises-driven recessions.
 - Their findings of historic patterns revealed that real estate values had declined on average 35% over a 5 year period.
 - Equity prices declined on average, 50% over a 3.5 year period.
 - Profound declines in output occurred lasting about 2 years.
 - Unemployment rises by 7% over a 4 year period.

This unprecedented recession will continue beyond 2009.



VI. Doing Business in the Current Environment

Remember the **GOLDEN RULE**:

“He who has the gold, makes the rules!”

**Never was that truer than in this environment.
And it will get worse before it gets better.**



VI. Doing Business in the Current Environment

- ▲ **Those With the Gold:** Buying opportunities could be the greatest that we have ever seen. The situation will only get better in 2009. It should be a great “vintage” year for some.
 - Real estate, loans and company acquisitions should be leverageable with EXISTING debt combined with a modest cash equity infusion.
- ▲ **Those Without the Gold:** It could be the worst of times for you: covenant lite, slow death as liquidity runs lower and the equity sponsor waits for a miracle.
 - Financial engineering solutions are not available
 - Operational solutions are needed to buy time and generate cash:
 - Working capital improvement = cash earnings
 - G&A cost reduction = cash earnings
 - Supplier cost reduction = cash earnings
 - Employee wage reduction = cash earnings
 - Capital expenditure deferral = cash earnings
 - **Tax Refunds = cash earnings**

“HUNKER DOWN LIKE A RABBIT IN A HAIL STORM!!”

– Eddie Childs, Western Co. of North America



VII. My Views on the Proposed US Stimulus Plan

▲ Things I LIKE About the Proposed Stimulus Plan

- Agree with “macro points” of Obama Administration:
 - Seeks to create an environment for consumer spending to take place
 - Seeks to reduce unemployment and create jobs (i.e., infrastructure spending)
 - Seeks to increase GDP
 - Seeks to free up lending to take place – especially real estate lending, a leading economic indicator
 - Seeks to restore confidence (lenders/borrowers)
 - Takes into account that this unprecedented recession demands a multi-dimensional solution that recognizes the magnitude of the problem
 - Big and bold enough to make a difference
 - Understands that tax cuts will likely spur increased savings and not help consumption in the near term



VII. My Views on the Proposed US Stimulus Plan

▲ Things I DON'T LIKE About the Proposed Stimulus Plan

- Absence of detail on how to implement the proposed plan, for example:
 - Valuing toxic assets
 - No details provided on what procedures will be put in place to ensure banks lend money to corporations and small businesses
 - No specifics on plan to be implemented that will free up real estate lending to individual borrowers
 - No specifics on new regulatory roles
 - **The Devil is in the Details!**
- No distinction being made between good managers and not-so-good managers (too focused on size: “Too Big To Fail”)
- Fearful of the line government may cross in the process of nationalizing banks for “social” reasons: need greater regulation, not nationalization



VIII. Implications to Tax Practitioners

- ▲ Tax law changes are likely to be written – this is usually good for tax practitioners
- ▲ “Traditional” tax consulting, like other traditional “Business Consulting” work, will be under stress
- ▲ Tax Practitioners have a real role to play as part of the solution in this economic downturn.
- ▲ There are complex tax implications and intricacies in every restructuring.
- ▲ Clients will need experienced tax and restructuring advice as they reorganize to weather the storm.
- ▲ It is key that tax work be viewed as helping liquidity: lower taxes, getting refunds, etc.
- ▲ Companies with multi-country operations will need experienced advisors to handle cross border complexity – that is a strength of the Taxand and A&M platforms.
- ▲ These can be the best of times and the worst of times. We must work together to serve our clients and help them survive to see a better day.

**The Taxand network needs to leverage its cross-border capabilities:
More opportunities to team together and generate value for clients.**



IX. Key Take Away

KEY TAKE AWAY:

- ▲ Both A&M and Taxand are positioned to provide value during these difficult times – but we need to connect the dots to liquidity / earning power.
- ▲ We are all guessing *when* the bottom will hit – *but there will be a bottom*
- ▲ Buying opportunities will exist and the economic cycle will eventually move to good times

