

Edgar Filing: McLeodUSA INC - Form 425

McLeodUSA INC
Form 425
September 17, 2007

Filed by PAETEC Holding Corp. Pursuant to Rule 425

Under the Securities Act of 1933

And Deemed Filed Pursuant to Rule 14a-12

Under the Securities Exchange Act of 1934

Commission File No.: 0-20763

Subject Company: McLeodUSA Incorporated

This filing relates to the proposed transaction pursuant to the terms of the Agreement and Plan of Merger, dated as of September 17, 2007, by and among PAETEC Holding Corp. (PAETEC), McLeodUSA Incorporated and PS Acquisition Corp., a wholly-owned subsidiary of PAETEC.

* * * *

PAETEC will file with the SEC a registration statement on Form S-4, which will contain a proxy statement/prospectus regarding the proposed merger transaction, as well as other relevant documents concerning the transaction. WE URGE INVESTORS AND SECURITY HOLDERS TO READ THE REGISTRATION STATEMENT AND PROXY STATEMENT/PROSPECTUS AND THESE OTHER DOCUMENTS WHEN THEY BECOME AVAILABLE, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT PAETEC, MCLEODUSA INCORPORATED AND THE PROPOSED TRANSACTION. A definitive proxy statement/prospectus will be sent to PAETEC's stockholders seeking their approval of PAETEC's issuance of shares in the transaction and to security holders of McLeodUSA Incorporated. Investors and security holders may obtain a free copy of the registration statement and proxy statement/prospectus (when available) and other documents filed by PAETEC with the SEC at the SEC's web site at www.sec.gov. Free copies of PAETEC's SEC filings are available on PAETEC's web site at www.paetec.com and also may be obtained without charge by directing a request to PAETEC Holding Corp., One PAETEC Plaza, Fairport, New York 14450, Attn: Investor Relations.

PAETEC and its directors and executive officers may be deemed, under SEC rules, to be participants in the solicitation of proxies from PAETEC's stockholders with respect to the proposed transaction. Information regarding PAETEC's directors and executive officers is included in its annual report on Form 10-K filed with the SEC on April 2, 2007. More detailed information regarding the identity of potential participants and their direct or indirect interests in the transaction, by securities holdings or otherwise, will be set forth in the registration statement and proxy statement/prospectus and other documents to be filed with the SEC in connection with the proposed transaction.

Caring Culture | Open Communication | Unmatched Service | Personalized Solutions
PAETEC to Acquire McLeodUSA
Creates One of the Largest Competitive
Communications Providers in the U.S.
September 2007

2
Forward-Looking Statements
Except for statements that present historical facts, this presentation contains forward-looking
statements
within
the
meaning

of
Section
27A
of
the
Securities
Act
of
1933
and
Section
21E

of
the
Securities Exchange Act of 1934. These statements include PAETEC's forecasts of the combined company's total revenue, adjusted EBITDA, merger-related synergies and other financial results. The forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the combined company's actual operating results, financial position, levels of activity or performance to be materially different from those expressed or implied by such forward-looking statements. Some of these risks, uncertainties and factors are discussed under the caption "Risk Factors" in PAETEC's 2006 Annual Report on Form 10-K and in PAETEC's subsequently filed SEC reports. PAETEC disclaims any obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

3
This
presentation
refers
to
Adjusted
EBITDA

and
Free
Cash
Flow,
which
are
not
measurements
of

financial performance prepared in accordance with GAAP and should not be considered as a substitute for the most comparable GAAP measures.

Adjusted EBITDA, as defined by PAETEC, represents net income before interest, provision for taxes, depreciation and amortization, change in fair value of Series A convertible redeemable preferred stock conversion rights, stock-based compensation, loss on extinguishment of debt, leveraged recapitalization costs and integration/restructuring costs. Free Cash Flow, as defined by PAETEC, consists of Adjusted EBITA less capital expenditures (purchases of property and equipment).

Adjusted EBITDA, as defined by McLeodUSA, represents net loss before interest expense, depreciation, amortization, income from discontinued operations, gain on cancellation of debt, other non-operating income or expense, restructuring charges and adjustments, reorganization items, impairment charge and non-cash compensation.

Information concerning management's reasons for including these measures and quantitative reconciliations of the differences between historical Adjusted EBITDA and historical Free Cash Flow to the most comparable GAAP measures are contained in PAETEC's and McLeodUSA's SEC filings and other publicly available information.

Non-GAAP Financial Information

4
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PAETEC

URGES
INVESTORS
AND
SECURITY
HOLDERS
TO
READ

THE REGISTRATION STATEMENT AND PROXY STATEMENT/PROSPECTUS AND THESE OTHER DOCUMENTS WHEN THEY BECOME AVAILABLE, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT PAETEC, MCLEODUSA AND THE PROPOSED TRANSACTION.

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Information

regarding

the

identity

of

potential

participants

and

their

direct

or

indirect

interests,

by

securities holdings or otherwise, will be set forth in the registration statement and proxy statement/prospectus and other documents to be filed with the SEC in connection with the proposed transaction.

Additional Information

5

Summary Highlights

Structure

PAETEC and McLeodUSA to combine in a 100% tax-free stock-for-stock merger

Exchange Ratio

McLeodUSA shareholders receive 1.30 PAETEC shares for every share of
McLeodUSA that they own

Listing / Ticker

NASDAQ / PAET

Company Name: PAETEC Holding Corp.

Ownership

75% owned by PAETEC shareholders, 25% owned by McLeodUSA Shareholders on a fully diluted basis

Headquarters

PAETEC: Rochester, NY

McLeodUSA: Dallas, TX

Board of Directors

9 seats for PAETEC

1 seat for McLeodUSA

Management

Chairman & CEO:

Arunas A. Chesonis, Current PAETEC Chairman & CEO

CFO:

Keith M. Wilson, Current PAETEC CFO

COO:

Edward J. Butler, Jr., Current PAETEC COO

Synergies

Transaction expected to generate \$20 million of synergies in Year 1 and \$30 million beginning in Year 2

Timing

Transaction expected to close 1st Quarter 2008

7

Strategic Rationale

Transaction further reinforces position as the preeminent competitive local communications services provider and expands customer base to include small as well as medium and large enterprises

Quality asset base

extensive long-haul and metro fiber footprint, valuable switching and

routing infrastructure

National footprint

expands presence into a significant portion of the Mid and Western United States

Company is better positioned financially; net leverage decreases from 3.9x to 2.9x post close

Pro forma company will be one of the largest competitive local communications service providers in the United States ranked by Revenue, Adjusted EBITDA, and Free Cash Flow
(1)

Significant size with approximately \$1.6 billion in Revenue
(2)

Substantial scale with \$290 million in Adjusted EBITDA, including \$30 million in run-rate synergies
(2)

, and \$156 million in Free Cash Flow
(1) (2)

Significant cost synergies due to increased scale, redundant network, and corporate infrastructure

\$20 million synergies expected in Year 1

\$30 million run-rate expected in Year 2
(1)

Free Cash Flow defined as Adj. EBITDA
Capex.

(2)

LQA as of June 30, 2007.

8

Strategic Rationale (Cont d)

Increased scale and scope

Approximately 3.4 million access line equivalents

Presence in 47 of the top 50 MSAs and 82 of the top 100 MSAs

(1)

Significant value from potential ability to use a portion of existing \$3 billion of McLeodUSA NOLs, subject to 382 limitations

(1)

Projected markets for 2008.

9
Transaction Details
A \$15.50 per McLeodUSA share, 100% stock deal results in PAETEC shareholders owning 121 million shares, with McLeodUSA

shareholders
receiving

41
million
shares

(1)
PAETEC shareholders will own 75% of the pro forma combined company, and McLeodUSA
shareholders will own 25%

+
121mm Shares
(Fully Diluted)

25%
75%
41mm Shares
(Fully Diluted)

162mm Shares
(Fully Diluted)

Pro Forma Valuation

Pro Forma Valuation

PAETEC + McLeodUSA Combination

PAETEC + McLeodUSA Combination

Note: Dollars in millions.

(1)
121 million current fully-diluted shares and 162 million pro forma fully-diluted shares calculated using Treasury Stock Method

(2)
Includes PAETEC / US LEC synergies on a realized-only basis plus PAETEC / McLeodUSA run-rate synergies of \$30 million

Pro Forma Fully Diluted Shares (mm)

(1)
162
PAETEC Share Price (9/14/07)

\$12.13
Equity Value

\$1,966
Net Debt

\$773
Enterprise Value

\$2,739
Adj. EBITDA with Synergies (LTM 6/30/07)

(2)
\$263

10
\$1,612
\$1,412
\$1,072
\$494
\$271
\$180

\$0

\$500

\$1,000

\$1,500

\$2,000

PF PAETEC /

McLeodUSA

XO

TWTC

ITC^DeltaCom

Cbeyond

Cogent

Significant Combined Scale

(\$ in Millions)

Note: Based on LQA as of 6/30/07.

Revenue

Revenue

11

Significant Combined Scale (Cont d)

Note: Based on LQA as of 6/30/07.

(1)

Includes anticipated synergies of \$30 million.

(1)

(\$ in Millions)

\$341
\$290
\$85
\$75
\$50
\$44
\$0
\$100
\$200
\$300
\$400
TWTC
PF PAETEC /
McLeodUSA
XO
ITC^DeltaCom
Cbeyond
Cogent
Adjusted EBITDA
Adjusted EBITDA

12

Strong Free Cash Flow

(1)

Note: Based on LQA as of 6/30/07.

(1)

Free

Cash

Flow
defined
as
Adjusted
EBITDA

Capex.

(2)

Includes anticipated synergies of \$30 million.

(2)

(\$ in Millions)

\$156

\$79

\$24

\$6

(\$1)

(\$188)

(\$200)

(\$150)

(\$100)

(\$50)

\$0

\$50

\$100

\$150

\$200

PF PAETEC /

McLeodUSA

TWTC

ITC^DeltaCom

Cogent

Cbeyond

XO

13

Business Strategy

Drive organic growth by:

Expanding geographic footprint for both sales forces

Cross-selling a broader range of products and services

Expand proven customer-focused strategy to serve smaller enterprise locations in addition to current medium and large enterprises as a premier communications provider

Differentiated service model driving superior customer retention

Better positioned to serve large enterprise branch office network

Continue

to

generate

strong

financial

results

by

focusing

on

end

customer

revenue

growth

while maintaining efficient network and back office operations

Leverage both facilities-based networks to maximize operating efficiency and network costs

Improve financial strength through de-leveraging

Scalable platform for further acquisitions

14

Synergies

PAETEC's management and operating teams have developed a detailed bottoms-up view of the estimated \$30 million in expected annual run-rate cost synergies

Expected cost synergies driven by

Network and switching

Corporate overhead

Sales & marketing

Other SG&A

Two-thirds of the anticipated synergies are network related on a run-rate basis

\$20 million of synergies are expected to be achieved in Year 1 and \$30 million in Year 2

Run-rate synergies are readily achievable

2% of PAETEC / McLeodUSA combined revenue

2% of PAETEC / McLeodUSA combined cash costs (SG&A + COGS)

11% of combined Adjusted EBITDA including synergies

No revenue synergies projected in the model

Sources and Uses

Note: Dollars

in
millions.

Balance
sheet

items

projected

as

of

12/31/07.

(1)

Based on PAETEC 6/30/07 LTM Adj. EBITDA of \$184 million. Includes PAETEC / US LEC synergies on a realized-only basis.

(2)

Based on combined 6/30/07 LTM Adj. EBITDA of \$263 million. Includes PAETEC / US LEC synergies on a realized-only basis.

\$30 million.

Sources

Stock to McLeodUSA Shareholders

\$492

PAETEC Cash on Hand

89

McLeodUSA Cash on Hand

39

Total Sources

\$620

Uses

Purchase of McLeodUSA Equity

\$492

Redeem McLeodUSA Debt

104

McLeodUSA Debt Make-Whole Premium

14

Transaction Fees and Other

10

Total Uses

\$620

Pro Forma Capitalization

Pro Forma Capitalization

Cash

\$25

Revolver (\$50mm undrawn)

Existing Secured Bank Debt

498

PAETEC 9.5% Senior Notes

300

Total Debt

\$798

Net Debt

\$773

Leverage Multiples

Pre-

Post-

Acquisition

Acquisition

Total Secured Bank Debt / LTM Adj. EBITDA

2.7x

1.9x

Total Debt / LTM Adj. EBITDA

4.3x

3.0x

Net Debt / LTM Adj. EBITDA

3.9x

2.9x

(1)

(2)

16

Financial Overview

Note: Dollars in millions. Adj. EBITDA excludes one-time items. Differs from slides 9-11 due to LTM period.

(1)

Includes PAETEC / US LEC synergies on a realized-only basis.

(2)

Includes run-rate synergies of \$30 million.

(3)

Free Cash Flow defined as Adj. EBITDA

Capex.

(4)

Calculated off of Adj. EBITDA including run-rate synergies of \$30 million.

LTM as of June 30, 2007:

Pro Forma

Revenue

\$1,057

\$514

\$1,571

% Growth (Q2 Y-o-Y)

8.8%

(7.9%)

2.8%

Gross Profit

\$548

\$231

\$779

% Margin

51.9%

44.8%

49.6%

SG&A

\$396

\$191

\$587

% Margin

37.5%

37.2%

37.4%

Adj. EBITDA

\$184

\$48

\$233

% Margin

17.5%

9.4%

14.8%

Adj. EBITDA incl. Synergies

NA

NA

\$263

% Margin

NA

NA

16.7%

Capex

\$94

\$51

\$146

% of Revenue

8.9%

10.0%

9.3%

Free Cash Flow

\$90

(\$3)

\$117

% of Revenue

8.5%

NM

7.4%

Total Debt / Adj. EBITDA

4.3x

2.2x

3.0x

Net Debt / Adj. EBITDA

3.9x

1.4x

2.9x

(1)

(2)

(3)

(4)

(4)

17

Transaction Highlights

Creates a nationwide, coast-to-coast competitive local communications service provider, with presence in 47 of the top 50 and 82 of the top 100 Metropolitan Statistical Areas

(1)

Substantial

scale,
with
\$1.6
billion
in
Revenue,
\$290
million
in
run-rate

Adjusted EBITDA, and \$156 million in Free Cash Flow

(2)

Significant cost savings, combined with increased scale and scope drives \$30 million of run-rate synergies

Improve financial strength through de-leveraging

Continues to grow network and asset base with extensive long-haul and metro fiber footprint

(1)

Projected markets for 2008.

(2)

LQA as of June 30, 2007.

Q & A

Appendix

20
Combined Top Metropolitan Statistical Area Presence (1-50)
(1)
1)
New York-Northern New Jersey-Long Island, NY-NJ-PA
26)
Sacramento-Arden-Arcade-Roseville, CA

- 2)
Los Angeles-Long Beach-Santa Ana, CA
- 27)
Orlando-Kissimmee, FL
- 3)
Chicago-Naperville-Joliet, IL-IN-WI
- 28)
Kansas City, MO-KS
- 4)
Dallas-Fort Worth-Arlington, TX
- 29)
San Antonio, TX
- 5)
Philadelphia-Camden-Wilmington, PA-NJ-DE-MD
- 30)
San Jose-Sunnyvale-Santa Clara, CA
- 6)
Houston-Sugar Land-Baytown, TX
- 31)
Las Vegas-Paradise, NV
- 7)
Miami-Fort Lauderdale-Pompano Beach, FL
- 32)
Columbus, OH
- 8)
Washington-Arlington-Alexandria, DC-VA-MD-WV
- 33)
Indianapolis-Carmel, IN
- 9)
Atlanta-Sandy Springs-Marietta, GA
- 34)
Virginia Beach-Norfolk-Newport News, VA-NC
- 10)
Detroit-Warren-Livonia, MI
- 35)
Providence-New Bedford-Fall River, RI-MA
- 11)
Boston-Cambridge-Quincy, MA-NH
- 36)
Charlotte-Gastonia-Concord, NC-SC
- 12)
San Francisco-Oakland-Fremont, CA
- 37)
Austin-Round Rock, TX
- 13)
Phoenix-Mesa-Scottsdale, AZ
- 38)
Milwaukee-Waukesha-West Allis, WI
- 14)
Riverside-San Bernardino-Ontario, CA

- 39) Nashville-Davidson-Murfreesboro-Franklin, TN
 - 15) Seattle-Tacoma-Bellevue, WA
 - 40) Jacksonville, FL
 - 16) Minneapolis-St. Paul-Bloomington, MN-WI
 - 41) Memphis, TN-MS-AR
 - 17) San Diego-Carlsbad-San Marcos, CA
 - 42) Louisville-Jefferson County, KY-IN
 - 18) St. Louis, MO-IL
 - 43) Richmond, VA
 - 19) Tampa-St. Petersburg-Clearwater, FL
 - 44) Hartford-West Hartford-East Hartford, CT
 - 20) Baltimore-Towson, MD
 - 45) Oklahoma City, OK
 - 21) Denver-Aurora, CO
 - 46) Buffalo-Niagara Falls, NY
 - 22) Pittsburgh, PA
 - 47) Birmingham-Hoover, AL
 - 23) Portland-Vancouver-Beaverton, OR-WA
 - 48) Salt Lake City, UT
 - 24) Cleveland-Elyria-Mentor, OH
 - 49) Rochester, NY
 - 25) Cincinnati-Middletown, OH-KY-IN
 - 50) New Orleans-Metairie-Kenner, LA
- Note: Markets in blue/bold type indicate PAETEC presence.
- (1)
Projected markets for 2008.

21
Combined Top Metropolitan Statistical Area Presence (51-100)
(1)
Note: Markets in blue/bold type indicate PAETEC presence.
(1)
Projected markets for 2008.
51)

Raleigh-Cary, NC
76)
Poughkeepsie-Newburgh-Middletown, NY
52)
Tucson, AZ
77)
Knoxville, TN
53)
Honolulu, HI
78)
Toledo, OH
54)
Bridgeport-Stamford-Norwalk, CT
79)
Little Rock-North Little Rock-Conway, AR
55)
Tulsa, OK
80)
Syracuse, NY
56)
Fresno, CA
81)
Charleston-North Charleston, SC
57)
Albany-Schenectady-Troy, NY
82)
Greenville-Mauldin-Easley, SC
58)
New Haven-Milford, CT
83)
Colorado Springs, CO
59)
Dayton, OH
84)
Wichita, KS
60)
Omaha-Council Bluffs, NE-IA
85)
Youngstown-Warren-Boardman, OH-PA
61)
Albuquerque, NM
86)
Cape Coral-Fort Myers, FL
62)
Allentown-Bethlehem-Easton, PA-NJ
87)
Boise City-Nampa, ID
63)
Oxnard-Thousand Oaks-Ventura, CA
88)

Lakeland, FL
64)
Worcester, MA
89)
Scranton-Wilkes-Barre, PA
65)
Bakersfield, CA
90)
Madison, WI
66)
Grand Rapids-Wyoming, MI
91)
Palm Bay-Melbourne-Titusville, FL
67)
Baton Rouge, LA
92)
Des Moines-West Des Moines, IA
68)
El Paso, TX
93)
Jackson, MS
69)
Columbia, SC
94)
Harrisburg-Carlisle, PA
70)
Akron, OH
95)
Augusta-Richmond County, GA-SC
71)
McAllen-Edinburg-Mission, TX
96)
Portland-South Portland-Biddeford, ME
72)
Springfield, MA
97)
Modesto, CA
73)
Greensboro-High Point, NC
98)
Ogden-Clearfield, UT
74)
Sarasota-Bradenton-Venice, FL
99)
Chattanooga, TN-GA
75)
Stockton, CA
100)
Deltona-Daytona Beach-Ormond Beach, FL