

VALHI INC /DE/
Form 10-Q
November 08, 2018

Not later than

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended September 30, 2018

Commission file number 1-5467

VALHI, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

87-0110150
(IRS Employer
Identification No.)

5430 LBJ Freeway, Suite 1700, Dallas, Texas
(Address of principal executive offices)

75240-2620
(Zip Code)

Registrant's telephone number, including area code: (972) 233-1700

Indicate by check mark:

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing

Edgar Filing: VALHI INC /DE/ - Form 10-Q

requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by checkmark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, smaller reporting company or emerging growth company. See definitions of “large accelerated filer”, “accelerated filer,” smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Number of shares of the Registrant’s common stock outstanding on November 2, 2018: 339,185,449

VALHI, INC. AND SUBSIDIARIES

INDEX

	Page number
Part I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets – December 31, 2017 and September 30, 2018 (unaudited)</u>	3
<u>Condensed Consolidated Statements of Income (unaudited) – Three and nine months ended September 30, 2017 and 2018</u>	5
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited) – Three and nine months ended September 30, 2017 and 2018</u>	6
<u>Condensed Consolidated Statements of Cash Flows (unaudited) – Nine months ended September 30, 2017 and 2018</u>	7
<u>Condensed Consolidated Statement of Equity (unaudited) – Nine months ended September 30, 2018</u>	8
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	9
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	35
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	56
Item 4. <u>Controls and Procedures</u>	56
Part II. <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	58
Item 1A. <u>Risk Factors</u>	58
Item 6. <u>Exhibits</u>	59
Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report.	

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

	December 31, 2017	September 30, 2018 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 435.7	\$ 571.5
Restricted cash equivalents	16.1	15.6
Marketable securities	3.0	2.2
Accounts and other receivables, net	365.8	381.7
Land held for development	16.5	9.9
Inventories, net	398.4	464.2
Other current assets	15.5	24.9
Current assets of discontinued operations	11.2	—
Total current assets	1,262.2	1,470.0
Other assets:		
Marketable securities	255.7	5.1
Investment in TiO ₂ manufacturing joint venture	86.5	79.7
Goodwill	379.7	379.7
Deferred income taxes	119.8	94.8
Other assets	174.1	170.0
Noncurrent assets of discontinued operations	40.8	—
Total other assets	1,056.6	729.3
Property and equipment:		
Land	47.0	46.8
Buildings	261.6	256.1
Equipment	1,150.8	1,171.2
Mining properties	35.0	31.9
Construction in progress	58.3	41.1
	1,552.7	1,547.1
Less accumulated depreciation	964.0	977.0
Net property and equipment	588.7	570.1
Total assets	\$ 2,907.5	\$ 2,769.4

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In millions)

	December 31, 2017	September 30, 2018 (unaudited)
LIABILITIES AND EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 1.6	\$ 1.6
Accounts payable and accrual liabilities	257.1	343.6
Income taxes	25.1	36.7
Current liabilities of discontinued operations	47.3	—
Total current liabilities	331.1	381.9
Noncurrent liabilities:		
Long-term debt	1,041.5	809.7
Deferred income taxes	183.2	44.9
Payable to affiliates – income taxes	70.1	57.8
Accrued pension costs	266.4	256.7
Accrued environmental remediation and related costs	110.7	97.7
Accrued postretirement benefits costs	11.3	10.8
Other liabilities	73.6	94.9
Noncurrent liabilities of discontinued operations	52.9	—
Total noncurrent liabilities	1,809.7	1,372.5
Equity:		
Valhi stockholders' equity:		
Preferred stock	667.3	667.3
Common stock	3.6	3.6
Additional paid-in capital	—	—
Retained earnings (deficit)	(17.9)	209.3
Accumulated other comprehensive loss	(179.0)	(180.6)
Treasury stock, at cost	(49.6)	(49.6)
Total Valhi stockholders' equity	424.4	650.0
Noncontrolling interest in subsidiaries	342.3	365.0
Total equity	766.7	1,015.0
Total liabilities and equity	\$ 2,907.5	\$ 2,769.4

Commitments and contingencies (Notes 14 and 17)

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share data)

	Three months ended September 30, 2017		2018		Nine months ended September 30, 2017		2018	
	(unaudited)							
Revenues and other income:								
Net sales	\$496.5	\$455.2	\$,383.6	\$	1,431.4			
Other income, net	4.3	20.1	15.7		59.8			
Total revenues and other income	500.8	475.3	1,399.3		1,491.2			
Costs and expenses:								
Cost of sales	332.1	322.5	958.8		929.4			
Selling, general and administrative	65.2	78.2	194.8		237.9			
Litigation settlement expense, net	—	—	—		62.0			
Loss on prepayment of debt	7.1	—	7.1		—			
Other components of net periodic pension and OPEB expense								
	4.5	3.7	12.9		11.2			
Interest	15.0	14.0	44.2		45.4			
Total costs and expenses	423.9	418.4	1,217.8		1,285.9			
Income from continuing operations before income taxes								
	76.9	56.9	181.5		205.3			
Income tax expense (benefit)	14.7	(91.4)	(67.5))	(33.2)			
Net income from continuing operations	62.2	148.3	249.0		238.5			
Income (loss) from discontinued operations	1.7	.7	(108.2))	38.7			
Net income	63.9	149.0	140.8		277.2			
Noncontrolling interest in net income of subsidiaries	18.0	5.5	73.4		32.7			
Net income attributable to Valhi stockholders	\$45.9	\$143.5	\$7.4		\$ 244.5			
Amount attributable to Valhi stockholders:								
Income from continuing operations	\$44.2	\$142.8	\$75.6		\$ 205.8			
Income (loss) from discontinued operations	1.7	.7	(108.2))	38.7			
Net income attributable to Valhi stockholders	\$45.9	143.5	\$7.4		\$ 244.5			
Basic and diluted net income per share:								
Income from continuing operations	\$.13	\$.42	\$1		\$.60			
Income (loss) from discontinued operations	—	—	(.31))	.11			
Net income attributable to Valhi stockholders	\$.13	\$.42	\$0		\$.71			
Cash dividends per share	\$.02	\$.02	\$06		\$.06			

Basic and diluted weighted average shares outstanding	342.0	342.1	342.0	342.0
---	-------	-------	-------	-------

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

	Three months ended September 30, 2017 2018 (unaudited)		Nine months ended September 30, 2017 2018	
Net income	\$63.9	\$149.0	\$140.8	\$277.2
Other comprehensive income (loss), net of tax:				
Currency translation	26.1	4.2	46.2	(8.9)
Marketable securities	(1.1)	—	(1.9)	(.1)
Interest rate swap	1.6	—	1.7	—
Defined benefit pension plans	2.4	2.5	6.0	7.6
Other postretirement benefit plans	(.3)	(.2)	(.7)	(.7)
Total other comprehensive income (loss), net	28.7	6.5	51.3	(2.1)
Comprehensive income	92.6	155.5	192.1	275.1
Comprehensive income attributable to noncontrolling interest	24.7	7.3	85.7	32.2
Comprehensive income attributable to Valhi stockholders	\$67.9	\$148.2	\$106.4	\$242.9

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Nine months ended September 30, 2017 2018 (unaudited)	
Cash flows from operating activities:		
Net income	\$140.8	\$277.2
Depreciation and amortization	46.1	43.5
Benefit plan expense greater than cash funding	7.9	3.7
Deferred income taxes	(171.6)	(72.8)
Gain on sale of WCS	—	(58.4)
Gain on land sales	—	(12.5)
Securities transactions, net	(.1)	(12.6)
Distributions from TiO ₂ manufacturing joint venture, net	3.8	5.5
Long-lived asset impairment	170.6	—
Loss on prepayment of debt	7.1	—
Payment for termination of interest rate swap	(3.3)	—
Other, net	2.2	14.3
Change in assets and liabilities:		
Accounts and other receivables, net	(75.7)	(45.3)
Inventories, net	39.6	(72.2)
Land held for development, net	(.2)	2.8
Accounts payable and accrued liabilities	47.0	73.0
Accounts with affiliates	(14.6)	27.8
Income taxes	13.7	9.6
Other, net	(9.0)	7.9
Net cash provided by operating activities	204.3	191.5
Cash flows from investing activities:		
Capital expenditures	(45.9)	(39.1)
Cash, cash equivalents and restricted cash and cash equivalents of discontinued operations		
at time of sale	—	(28.8)
Capitalized permit costs	(2.2)	—
Proceeds from sale of land	—	19.5
Purchases of marketable securities	(7.7)	(3.8)
Disposals of marketable securities	8.2	17.6
Other, net	(.2)	.1
Net cash used in investing activities	(47.8)	(34.5)
Cash flows from financing activities:		
Indebtedness:		
Borrowings	748.1	—
Principal payments	(597.8)	(10.2)
Deferred financing costs paid	(8.4)	—

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Valhi cash dividends paid	(20.4)	(20.4)
Distributions to noncontrolling interest in subsidiaries	(10.5)	(11.8)
Net cash provided by (used in) financing activities	111.0	(42.4)
Cash, cash equivalents and restricted cash and cash equivalents - net change from:		
Operating, investing and financing activities	267.5	114.6
Effect of exchange rates on cash	11.3	(7.9)
Balance at beginning of period	196.5	489.4
Balance at end of period	\$475.3	\$596.1
Supplemental disclosures:		
Cash paid for:		
Interest, net of capitalized interest	\$43.9	\$48.2
Income taxes, net	36.6	31.2
Noncash investing activities:		
Change in accruals for capital expenditures	4.1	2.5
Sale of investment in Amalgamated Sugar Company LLC	—	250.0
Noncash financing activities:		
Trade payable to affiliate converted to indebtedness	—	36.3
Deemed repayment of Snake River Sugar Company indebtedness	—	(250.0)
Indebtedness borrowings paid directly to lender to settle refinanced indebtedness	9.3	—
Indebtedness principal payments paid directly by lender	(8.4)	—
Indebtedness borrowings paid directly to lender for debt issuance costs	(.9)	—
See accompanying Notes to Condensed Consolidated Financial Statements.		

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF EQUITY

Nine months ended September 30, 2018

(In millions)

(unaudited)

	Valhi Stockholders' Equity				Accumulated		Non- controlling interest	Total equity
	Preferred stock	Common stock	Additional paid-in capital	Retained earnings (deficit)	other comprehensive loss	Treasury stock		
Balance at December 31, 2017	\$667.3	\$ 3.6	\$ --	\$ (17.9)	\$ (179.0)	\$ (49.6)	\$ 342.3	\$ 766.7
Change in accounting principle – ASU 2014-09	--	--	--	2.7	--	--	2.3	5.0
Balance at January 1, 2018, as adjusted	667.3	3.6	--	(15.2)	(179.0)	(49.6)	344.6	771.7
Net income	--	--	--	244.5	--	--	32.7	277.2
Other comprehensive loss, net	--	--	--	--	(1.6)	--	(.5)	(2.1)
Cash dividends	--	--	(.4)	(20.0)	--	--	(11.8)	(32.2)
Other, net	--	--	.4	--	--	--	--	.4
Balance at September 30, 2018	\$667.3	\$ 3.6	\$ --	\$ 209.3	\$ (180.6)	\$ (49.6)	\$ 365.0	\$ 1,015.0

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(unaudited)

Note 1—Organization and basis of presentation:

Organization— We are majority owned by a wholly-owned subsidiary of Contran Corporation (“Contran”), which owns approximately 92% of our outstanding common stock at September 30, 2018. All of Contran's outstanding voting stock is held by a family trust established for the benefit of Lisa K. Simmons and Serena Simmons Connelly and their children, for which Ms. Simmons and Ms. Connelly are co-trustees, or is held directly by Ms. Simmons and Ms. Connelly or entities related to them. Consequently, Ms. Simmons and Ms. Connelly may be deemed to control Contran and us.

Basis of Presentation—Consolidated in this Quarterly Report are the results of our majority-owned and wholly-owned subsidiaries, including NL Industries, Inc., Kronos Worldwide, Inc., CompX International Inc., Tremont LLC, Basic Management, Inc. (“BMI”) and The LandWell Company (“LandWell”). Kronos (NYSE: KRO), NL (NYSE: NL), and CompX (NYSE American: CIX) each file periodic reports with the Securities and Exchange Commission (“SEC”). In January 2018, we sold Waste Control Specialists LLC (“WCS”). See Note 3.

The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 that we filed with the SEC on March 15, 2018 (the “2017 Annual Report”). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments, other than the gain on the sale of WCS recognized in the first quarter of 2018 as discussed in Note 3), in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet at December 31, 2017 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2017) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Our results of operations for the interim periods ended September 30, 2018 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2017 Consolidated Financial Statements contained in our 2017 Annual Report.

Unless otherwise indicated, references in this report to “we,” “us” or “our” refer to Valhi, Inc. and its subsidiaries (NYSE: VHI), taken as a whole.

Note 2—Business segment information:

Business segment	Entity	% controlled at September 30, 2018	
Chemicals	Kronos	80	%
Component products	CompX	87	%
Real estate management and development	BMI and LandWell	63% - 77	%

- 9 -

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Our control of Kronos includes 50% we hold directly and 30% held directly by NL. We own 83% of NL. Our control of CompX is through NL. We own 63% of BMI. Our control of LandWell includes the 27% we hold directly and 50% held by BMI.

	Three months ended September 30, 2017 2018 (unaudited) (In millions)		Nine months ended September 30, 2017 2018	
Net sales:				
Chemicals	\$464.5	\$410.3	\$1,275.7	\$1,312.5
Component products	26.9	30.0	86.9	90.8
Real estate management and development	5.1	14.9	21.0	28.1
Total net sales	\$496.5	\$455.2	\$1,383.6	\$1,431.4
Cost of sales:				
Chemicals	\$309.9	\$291.7	\$883.7	\$848.3
Component products	18.8	20.4	59.6	60.5
Real estate management and development	3.4	10.4	15.5	20.6
Total cost of sales	\$332.1	\$322.5	\$958.8	\$929.4
Gross margin:				
Chemicals	\$154.6	\$118.6	\$392.0	\$464.2
Component products	8.1	9.6	27.3	30.3
Real estate management and development	1.7	4.5	5.5	7.5
Total gross margin	\$164.4	\$132.7	\$424.8	\$502.0
Operating income:				
Chemicals	\$98.4	\$61.0	\$234.7	\$295.2
Component products	3.4	4.5	12.5	14.9
Real estate management and development	1.3	3.7	3.1	7.9
Total operating income	103.1	69.2	250.3	318.0
General corporate items:				
Securities earnings	7.5	19.3	21.6	36.1
Insurance recoveries	.1	.5	.2	.9
Gain on land sales	—	—	—	12.5
Other components of net periodic pension and OPEB expense	(4.5)	(3.7)	(12.9)	(11.2)
Litigation expense	—	—	—	(62.0)
Loss on prepayment of debt	(7.1)	—	(7.1)	—
General expenses, net	(7.2)	(14.4)	(26.4)	(43.6)
Interest expense	(15.0)	(14.0)	(44.2)	(45.4)
Income from continuing operations before income taxes	\$76.9	\$56.9	\$181.5	\$205.3

Segment results we report may differ from amounts separately reported by our various subsidiaries due to purchase accounting adjustments and related amortization or differences in the way we define operating income. Intersegment sales are not material.

- 10 -

Note 3—Business disposition — Waste Control Specialists LLC:

Pursuant to an agreement we entered into in December 2017, on January 26, 2018 we completed the sale of our Waste Management Segment to JFL-WCS Partners, LLC ("JFL Partners"), an entity sponsored by certain investment affiliates of J.F. Lehman & Company, for consideration consisting of the assumption of all of WCS' third-party indebtedness and other liabilities. Our Waste Management Segment, which operated in the low-level radioactive, hazardous, toxic and other waste disposal industry historically struggled to generate sufficient recurring disposal volumes to generate positive operating results or cash flows. We believe the sale will enable us to focus more effort on continuing to develop our remaining segments which we believe have greater opportunity for higher returns than our Waste Management segment.

In accordance with GAAP, the Waste Management Segment has been classified as discontinued operations in our Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Income for all periods presented. Also in accordance with GAAP, we have not reclassified our Condensed Consolidated Statement of Cash Flows to reflect the Waste Management Segment as discontinued operations. We recognized a pre-tax gain of approximately \$58 million primarily in the first quarter of 2018 on the transaction (\$39.3 million, or \$.11 per diluted share, net of tax) because the carrying value of the liabilities of the business assumed by the purchaser exceeded the carrying value of the assets sold at the time of the sale in large part due to the previously-reported long-lived asset impairment of \$170.6 million recognized in the second quarter of 2017, as discussed in the 2017 Annual Report. The net assets of the disposed Waste Management Segment at the time we completed the sale on January 26, 2018 were not materially different as compared to December 31, 2017. The income tax benefit associated with discontinued operations recognized in the second and third quarters of 2018 relates principally to a change in the amount of the deferred income tax asset valuation allowance recognized during 2018 allocated to discontinued operations under the intra-period guidance of ASC 740 associated with the business interest expense deduction limitation discussed in Note 13. Selected financial data for the operations of the disposed Waste Management Segment for periods prior to completing the sale is presented below. Current assets at December 31, 2017 consist principally of trade accounts receivable.

	December 31, 2017 (In millions)
ASSETS	
Current assets	\$ 11.2
Restricted cash	27.2
Property and equipment, net	6.0
Other noncurrent assets	7.6
Total noncurrent assets	40.8
Total assets	\$ 52.0
LIABILITIES	
Current portion of long-term debt	\$ 3.0
Payable to Contran	36.1
Other current liabilities	8.2
Total current liabilities	47.3

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Long-term debt	65.0
Deferred income taxes	(43.8)
Accrued noncurrent closure and post closure costs	31.7
Total noncurrent liabilities	52.9
Total liabilities	\$ 100.2

- 11 -

	Three months ended			
	September 30, 2017		September 30, 2018 ⁽¹⁾	
	2017	2018	2017	2018 ⁽¹⁾
	(In millions)			
Net sales	\$18.4	\$—	\$60.4	\$ 4.6
Operating income (loss) ⁽²⁾	\$4.0	\$—	(167.0)	(.4)
Termination fee	—	—	4.0	—
Other expense, net	(.5)	—	(8.2)	—
Interest expense, net	(1.2)	—	(3.6)	(.3)
Loss before taxes	2.3	—	(174.8)	(.7)
Income tax expense (benefit)	.6	—	(66.6)	(.1)
Net income (loss)	1.7	—	(108.2)	(.6)
Pre-tax gain on disposal	—	—	—	58.4
Income tax expense (benefit)	—	(.7)	—	19.1
After-tax gain on disposal	—	.7	—	39.3
Total	\$1.7	\$.7	\$(108.2)	\$ 38.7
Net cash provided by operating activities			\$15.7	\$ 2.3
Net cash used in investing activities			\$(2.9)	\$(.1)

(1) Includes results of the Waste Management Segment through January 26, 2018, the date of the sale.

(2) Operating results in the first nine months of 2017 includes a \$170.6 million long-lived asset impairment. In connection with the January 2018 sale, JFL Partners did not assume WCS' trade payable owed to Contran, which consisted primarily of intercorporate service fees charged to WCS by Contran which WCS did not pay to Contran for several years. Immediately prior to the closing of the sale of WCS, Contran transferred its associated receivable of \$36.3 million from WCS to Valhi, in return for a deemed \$36.3 million borrowing by Valhi under its revolving credit facility with Contran, see Note 8. Valhi subsequently contributed such receivable from WCS to WCS's equity, and the trade payable obligation of WCS was deemed paid in full.

Note 4—Accounts and other receivables, net:

	September	
	December 31, 2017	2018
	(In millions)	
Trade accounts receivable:		
Kronos	\$301.4	\$ 318.5
CompX	10.5	13.4

Edgar Filing: VALHI INC /DE/ - Form 10-Q

BMI and LandWell	1.6	1.8
VAT and other receivables	20.7	27.5
Insurance recovery receivable – NL	—	15.0
Refundable income taxes	.5	2.7
Receivable from affiliates:		
Contran – trade items	1.0	.8
Contran – income taxes	19.4	—
LPC – trade items	8.9	—
Other – trade items	3.3	3.3
Allowance for doubtful accounts	(1.5)	(1.3)
Total	\$365.8	\$ 381.7

The insurance recovery receivable due to NL is discussed in Note 17.

- 12 -

Note 5—Inventories, net:

	December 31, 2017	September 2018
(In millions)		
Raw materials:		
Chemicals	\$106.9	\$ 106.1
Component products	2.7	3.0
Total raw materials	109.6	109.1
Work in process:		
Chemicals	20.8	26.6
Component products	9.8	10.9
Total in-process products	30.6	37.5
Finished products:		
Chemicals	192.2	249.6
Component products	2.8	3.3
Total finished products	195.0	252.9
Supplies (chemicals)	63.2	64.7
Total	\$398.4	\$ 464.2

Note 6—Marketable securities:

Our marketable securities consist of marketable equity and debt securities. Prior to 2018, any unrealized gains or losses on equity securities were recognized through other comprehensive income, net of deferred income taxes. Beginning on January 1, 2018 with the adoption of Accounting Standards Update (“ASU”) 2016-01, our marketable equity securities will continue to be carried at fair value as noted above, but any unrealized gains or losses on the securities are now recognized as a component of other income included in the securities transactions, net on our Condensed Consolidated Statements of Income. See Note 19.

	Market value	Cost basis	Unrealized losses, net
(In millions)			
December 31, 2017:			
Current assets	\$3.0	3.0	—
Noncurrent assets:			
The Amalgamated Sugar Company LLC	\$250.0	250.0	—
Other	5.7	5.9	(.2)
Total	\$255.7	255.9	(.2)
September 30, 2018:			
Current assets	\$2.2	2.2	—
Noncurrent assets	\$5.1	\$5.4	\$ (.3)

All of our marketable securities are accounted for as available-for-sale, which are carried at fair value using quoted market prices, primarily Level 1 inputs as defined by ASC Topic 820, Fair Value Measurements and Disclosures, except for our investment in The Amalgamated Sugar Company LLC (“Amalgamated”). Our other marketable securities, which consist of marketable equity and debt securities, are not material. See Note 18. Our investment in Amalgamated was measured using significant unobservable inputs, which are Level 3 inputs. Please refer to Note 6 in our 2017 Annual Report for a complete description of the valuation methodology used for our investment in Amalgamated.

On May 30, 2018, we entered into an agreement with Snake River Sugar Company, an Oregon agricultural cooperative corporation that controls Amalgamated ("Snake River"), in which we agreed to sell our interest in Amalgamated for consideration consisting of \$12.5 million in cash and the deemed payment in full of our \$250 million in loans we owe Snake River (see Note 8). The sale was completed on August 31, 2018 and as a result in the third quarter of 2018 we recognized a securities transaction gain of \$12.5 million related to the sale and our \$250 million in loans were deemed repaid in full.

Note 7—Other noncurrent assets:

	September	
	December 31,	2018
	2017	2018
	(In millions)	
Other noncurrent assets:		
Land held for development	\$ 126.6	\$ 124.2
Restricted cash	9.9	9.0
Land contract receivables	—	7.9
IBNR receivables	6.8	7.0
Pension asset	4.2	6.1
Notes receivable - OPA	—	2.4
Other	26.6	13.4
Total	\$ 174.1	\$ 170.0

Land contract receivables classified as a noncurrent asset relate to our Real Estate Management and Development Segment. Such receivables relate to certain fees we collect from builders when the builder sells a home to a customer, as discussed in Note 19.

As disclosed in Note 18 to our 2017 Annual Report under an Owner Participation Agreement (“OPA”) entered into by LandWell with the Redevelopment Agency of the City of Henderson, Nevada, if LandWell develops certain real property for commercial and residential purposes in a master planned community in Henderson, Nevada, the cost of certain public infrastructure may be reimbursed to us through tax increment. The maximum reimbursement under the OPA is \$209 million, and is subject to, among other things, completing construction of approved qualifying public infrastructure, transferring title of such infrastructure to the City of Henderson, receiving approval from the Redevelopment Agency of the funds expended to be eligible for tax increment reimbursement and the existence of a sufficient property tax valuation base and property tax rates in order to generate tax increment reimbursement funds. We are entitled to receive 75% of the tax increment generated by the master planned community through 2036, subject to the qualifications and limitations indicated above. Public infrastructure costs previously incurred for which the Redevelopment Agency had provided its approval for tax increment reimbursement but we had not yet received such reimbursement through tax increment receipts aggregated \$3.1 million at December 31, 2017. Such amount is evidenced by a promissory note issued to LandWell by the City of Henderson.

Prior to 2018, due to the significant uncertainty of the timing and amount of any of such potential tax increment reimbursements, we recognized any such tax increment reimbursements only when received. However, due to growth in the master planned community and the increase in tax increment funds to which we are entitled, we determined in the first quarter of 2018 we expected the tax increment reimbursements to be collected in the future would at least be sufficient to support recognizing the \$3.1 million note payable issued by the City of Henderson to us. The note payable bears interest at 6% annually and the note expires in 2036. Any unpaid balances in 2036 are forfeited. See Note 13.

Note 8—Long-term debt:

	September	
	December 30,	2018
	2017	2018
	(In millions)	
Valhi:		
Snake River Sugar Company	\$250.0	\$ —
Contran credit facility	284.3	314.3
Total Valhi debt	534.3	314.3
Subsidiary debt:		
Kronos:		
Senior Secured Notes	471.1	463.0
Tremont:		
Promissory note payable	13.1	10.9
BMI:		
Bank loan – Western Alliance Bank	18.8	18.0
LandWell:		
Note payable to the City of Henderson	2.5	2.3
Other	3.3	2.8
Total subsidiary debt	508.8	497.0
Total debt	1,043.1	811.3
Less current maturities	1.6	1.6
Total long-term debt	\$1,041.5	\$ 809.7

Valhi – Snake River Sugar Company – In connection with the sale of our ownership interest in Amalgamated on August 31, 2018, our \$250 million outstanding debt obligations owed to Snake River Sugar Company were deemed paid in full. See Note 6.

Contran credit facility – In connection with the sale of WCS discussed in Note 3, immediately prior to the closing of the sale, Contran transferred its associated receivable of \$36.3 million from WCS to Valhi, in return for a deemed \$36.3 million borrowing by Valhi under its revolving credit facility with Contran. In addition, during the first nine months of 2018 we repaid \$6.3 million under this facility. The average interest rate on the existing balance as of and for the nine months ended September 30, 2018 was 6.25% and 5.77%, respectively. At September 30, 2018, the equivalent of \$45.7 million was available for borrowing under this facility.

Kronos – Senior Secured Notes - At September 30, 2018, the carrying value of Kronos' 3.75% Senior Secured Notes due September 15, 2025 (€400 million aggregate principal amount outstanding) is stated net of unamortized debt issuance costs of \$6.7 million.

North American and European revolving credit facilities– During the first nine months of 2018, Kronos had no borrowings or repayments under its North American revolving credit facility and its European revolving credit facility. At September 30, 2018, approximately \$106.2 million was available for additional borrowing under the North American Revolving credit facility. Kronos' European revolving credit facility requires the maintenance of certain financial ratios, and one of such requirements is based on the ratio of net debt to last twelve months earnings before income tax, interest, depreciation and amortization expense (EBITDA) of the borrowers. Based upon the borrowers' last twelve months EBITDA as of September 30, 2018 and the net debt to EBITDA financial test, the full €90.0 million of the credit facility (\$105.7 million) is available for borrowing availability at such date.

Tremont – Promissory note payable – In January 2018, and following Tremont’s sale of certain land held for investment, discussed in Note 13, Tremont prepaid (without penalty) \$2.2 million principal amount on the note as required under the terms of the note agreement.

Restrictions and other – Certain of the credit facilities with unrelated, third-party lenders described above require the respective borrowers to maintain minimum levels of equity, require the maintenance of certain financial ratios, limit dividends and additional indebtedness and contain other provisions and restrictive covenants customary in lending transactions of this type. We are in compliance with all of our debt covenants at September 30, 2018.

Note 9—Accounts payable and accrued liabilities:

	December 31, 2017	September 30, 2018
(In millions)		
Accounts payable:		
Kronos	\$107.9	\$ 105.8
CompX	2.3	3.3
BMI and LandWell	3.7	3.8
NL	1.8	2.6
Other	.4	.4
Payable to affiliates:		
Contran – taxes	—	11.6
LPC – trade items	16.2	12.7
Litigation settlement	—	60.0
Employee benefits	36.3	38.5
Deferred income	28.3	23.3
Accrued sales discounts and rebates	14.3	25.4
Environmental remediation and related costs	6.8	19.0
Interest	5.5	1.4
Other	33.6	35.8
Total	\$257.1	\$ 343.6

The litigation settlement accrual is discussed in Note 17.

Note 10—Other noncurrent liabilities:

	December 31, 2017	September 30, 2018
(In millions)		
Reserve for uncertain tax positions	\$16.5	\$ 17.5
Litigation settlement	—	17.0
Deferred income	15.7	15.0
Employee benefits	8.4	8.1
Insurance claims and expenses	9.1	9.9
Deferred payment obligation	9.3	9.5
Accrued development costs	6.1	8.8
Other	8.5	9.1
Total	\$73.6	\$ 94.9

The litigation settlement accrual is discussed in Note 17.

Note 11 – Revenue Recognition

Chemicals and Component Products Segments - Our sales involve single performance obligations to ship our products pursuant to customer purchase orders. In some cases, the purchase order is supported by an underlying master sales agreement, but our purchase order acceptance generally evidences the contract with our customer by specifying the key terms of product and quantity ordered, price and delivery and payment terms. Effective January 1, 2018 with the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), see Note 19, we record revenue when we satisfy our performance obligations to our customers by transferring control of our products to them, which generally occurs at point of shipment or upon delivery. Such transfer of control is also evidenced by transfer of legal title and other risks and rewards of ownership (giving the customer the ability to direct the use of, and obtain substantially all of the benefits of, the product), and our customers becoming obligated to pay us and such payment being probable of occurring. In certain arrangements we provide shipping and handling activities after the transfer of control to our customer (e.g. when control transfers prior to delivery). In such arrangements shipping and handling are considered fulfillment activities, and accordingly, such costs are accrued when the related revenue is recognized.

Revenue is recorded in an amount that reflects the net consideration we expect to receive in exchange for our products. Prices for our products are based on terms specified in published list prices and purchase orders, which generally do not include financing components, noncash consideration or consideration paid to our customers. As our standard payment terms are less than one year, we have elected the practical expedient under ASC 606 and we have not assessed whether a contract has a significant financing

- 16 -

component. We state sales net of price, early payment and distributor discounts as well as volume rebates (collectively, variable consideration). Variable consideration, to the extent present, is recognized as the amount to which we are most-likely to be entitled, using all information (historical, current and forecasted) that is reasonably available to us, and only to the extent that a significant reversal in the amount of the cumulative revenue recognized is not probable of occurring in a future period. Differences, if any, between estimates of the amount of variable consideration to which we will be entitled and the actual amount of such variable consideration have not been material in the past. We report any tax assessed by a governmental authority that we collect from our customers that is both imposed on and concurrent with our revenue-producing activities (such as sales, use, value added and excise taxes) on a net basis (meaning we do not recognize these taxes either in our revenues or in our costs and expenses).

Frequently, we receive orders for products to be delivered over dates that may extend across reporting periods. We invoice for each delivery upon shipment and recognize revenue for each distinct shipment when all sales recognition criteria for that shipment have been satisfied. As scheduled delivery dates for these orders are within a one year period, under the optional exemption provided by ASC 606, we do not disclose sales allocated to future shipments of partially completed contracts.

Real Estate Management and Development Segment – Our sales involve providing utility services, among other things, to an industrial park located in Henderson, Nevada and we are responsible for the delivery of water to the city of Henderson and various other users through a water distribution system we own. These sales involve single performance obligations and we record revenue when we satisfy our performance obligations to our customers generally after the service is performed and our customers become obligated to pay us and such payment being probable of occurring. Revenue is recorded in an amount that reflects the net consideration we expect to receive in exchange for our services. Prices for our products are based on contracted rates and do not include financing components, noncash consideration or consideration paid to our customers. As our standard payment terms are less than one year, we have elected the practical expedient under ASC 606 and we have not assessed whether a contract has a significant financing component.

Our revenues also are related to efforts to develop certain real estate in Henderson, Nevada, including approximately 2,100 acres zoned for residential/planned community purposes and approximately 400 acres zoned for commercial and light industrial use. Contracts for land sales are negotiated on an individual basis, involve single performance obligations, and generally require us to complete property development and improvements after title passes to the buyer and we have received all or a substantial portion of the selling price. We recognize land sales revenue associated with the residential/planned community over time using cost based input methods. Land sales associated with the residential/planned community have variable consideration components which are based on a percentage of the builder's ultimate selling price of residential housing unit to their customer (generally 3.5% of such sales price). The amount we recognize when a parcel is sold to a home builder is the amount to which we are most-likely to be entitled, using all information (historical, current and forecasted) that is reasonably available to us, and only to the extent that a significant reversal in the amount of the cumulative revenue recognized is not probable of occurring in a future period. By recognizing revenue over time using cost based input methods, revenues (including variable consideration) and profits are recognized in the same proportion of our progress towards completion of our contractual obligations, with our progress measured by costs incurred as a percentage of total costs estimated to be incurred relative to the parcels sold. Estimates of total costs expected to be incurred require significant management judgment, and the amount of revenue and profits that have been recognized to date are subject to revisions throughout the

development period. The impact on the amount of revenue recognized resulting from any future change in the estimate of total costs estimated to be incurred would be accounted for prospectively in accordance with GAAP. We also receive variable consideration of 1% tied to the builders ultimate selling price to their customers which is intended to recover our expenses for marketing the entire residential/planned community. Because we control and direct the marketing campaign we recognize both the revenues and expenses on a gross basis. We record estimated deferred revenue on the amount to which we are most-likely to be entitled and deferred revenue is recognized into revenue as the housing units are sold.

Disaggregation of sales—The following table disaggregates the net sales of our Chemicals Segment by place of manufacture (point of origin) and the location of the customer (point of destination), which are the categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors (as required by ASC 606).

- 17 -

	Three months ended		Nine months ended	
	September 30, 2017	2018	September 30, 2017	2018
(In millions)				
Net sales – point of origin::				
Germany	\$256.6	\$211.9	\$672.1	\$704.1
United States	209.3	234.5	623.6	640.2
Canada	70.4	82.3	228.2	236.1
Belgium	75.6	66.4	205.7	205.0
Norway	58.2	49.8	156.8	159.4
Eliminations	(205.6)	(234.6)	(610.7)	(632.3)
Total	\$464.5	\$410.3	\$1,275.7	\$1,312.5
Net sales – point of destination:				
Europe	\$246.0	\$191.8	\$652.3	\$664.2
North America	131.4	142.0	393.5	412.6
Other	87.1	76.5	229.9	235.7
Total	\$464.5	\$410.3	\$1,275.7	\$1,312.5

The following table disaggregates the net sales of our Component Products and Real Estate Management and Development Segments by major product line.

	Three months ended		Nine months ended	
	September 30, 2017	2018	September 30, 2017	2018
(In millions)				
Component Products:				
Net sales:				
Security products	\$22.8	\$24.5	\$74.9	\$75.8
Marine components	4.1	5.5	12.0	15.0
Total	\$26.9	\$30.0	86.9	90.8
Real Estate Management and Development:				
Net sales:				
Land sales	\$2.7	\$13.4	14.8	23.0
Water delivery	1.8	.9	4.5	3.7
Utility and other	.6	.6	1.7	1.4
Total	\$5.1	\$14.9	\$21.0	\$28.1

Note 12—Employee benefit plans:

The components of our net periodic defined benefit pension cost are presented in the table below.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

	Three months ended			
	September		months ended	
	30,	30,	September 30,	September 30,
	2017	2018	2017	2018
	(In millions)			
Service cost	\$3.0	\$2.9	\$8.5	\$8.8
Interest cost	4.1	3.8	11.8	11.8
Expected return on plan assets	(3.3)	(3.9)	(9.7)	(11.7)
Amortization of unrecognized prior service cost	—	.1	.2	.2
Recognized actuarial losses	3.9	3.7	11.2	11.4
Total	\$7.7	\$6.6	\$22.0	\$20.5

The components of our net periodic other postretirement benefit cost are presented in the table below.

	Three months ended		Nine months ended	
	September 30, 2017	September 30, 2018	September 30, 2017	September 30, 2018
	(In millions)			
Service cost	\$—	\$—	\$.1	\$.1
Interest cost	.1	.2	.3	.3
Amortization of prior service credit	(.3)	(.3)	(.8)	(.8)
Recognized actuarial gains	(.1)	—	(.2)	(.1)
Total	\$(.3)	\$(.1)	\$(.6)	\$(.5)

Upon the adoption of ASU 2017-07, Compensation— Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, our net periodic defined benefit pension cost and other postretirement benefit cost, other than the service cost component, is presented as a separate line item (“Other components of net periodic pension and OPEB expense”) in our Condensed Consolidated Statements of Income for all periods presented. See Note 19. We expect to contribute the equivalent of approximately \$19.8 million and \$1.0 million, respectively, to all of our defined benefit pension plans and other postretirement benefit plans during 2018.

Note 13—Other income, net:

	Nine months ended	
	September 30, 2017	September 30, 2018
	(In millions)	
Securities earnings:		
Dividends and interest	\$21.5	\$23.5
Securities transactions, net	.1	12.6
Total	21.6	36.1
Currency transactions, net	(8.0)	4.2
Insurance recoveries	.2	.9
Infrastructure reimbursement	.7	4.3
Gain on land sales	—	12.5
Other, net	1.2	1.8
Total	\$15.7	\$59.8

Securities transactions, net in the first nine months of 2018 includes a \$12.5 million gain on the sale of our investment in The Amalgamated Sugar Company LLC, see Note 6.

Insurance recoveries reflect, in part, amounts NL received from certain of its former insurance carriers and relate to the recovery of prior lead pigment and asbestos litigation defense costs incurred by NL. See Note 17.

Infrastructure reimbursement costs relate principally to tax increment reimbursements of our Real Estate Management and Development Segment discussed in Note 7.

In the first quarter of 2018 we sold two parcels of land not used in our operating activities. We sold the first parcel for net proceeds of \$18.9 million, and recognized a pre-tax gain on the sale of \$11.9 million. We were required under our debt agreement with NERT to use a portion of the net proceeds received for the property to pay down our note balance and accordingly we made \$2.2 million in principal payments on our debt, see Note 8. In addition, NL sold excess property with a nominal book value for proceeds of \$.6 million.

Note 14—Income taxes:

	Three months ended		Nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2017	2018	2017	2018
	(In millions)			
Expected tax expense, at U.S. federal statutory income tax rate of 35% in 2017 and 21% in 2018	\$26.9	\$11.9	\$63.5	\$43.1
Incremental net tax on earnings and losses of non-U.S., U.S. and non-tax group companies	8.9	(160.3)	57.2	(151.3)
Non-U.S. tax rates	(3.5)	3.5	(8.2)	18.4
Valuation allowance	(7.8)	(2.0)	(170.4)	—
Adjustment to the reserve for uncertain tax positions, net	(7.7)	.3	(6.6)	2.2
Transition tax	—	(2.1)	—	(2.1)
Change in federal tax rate	—	59.7	—	59.7
Change in state tax rate	—	(3.4)	—	(3.4)
Canada – Germany APA	(3.2)	—	(3.2)	(1.4)
Nondeductible expenses	.8	.8	1.5	1.5
U.S. state income taxes and other, net	.3	.2	(1.3)	.1
Income tax expense (benefit)	\$14.7	\$(91.4)	\$(67.5)	\$(33.2)
Comprehensive provision for income taxes (benefit) allocable to:				
Income from continuing operations	\$14.7	\$(91.4)	\$(67.5)	\$(33.2)
Discontinued operations	.5	(.8)	(66.7)	19.0
Retained earnings – change in accounting principle	—	—	—	1.1
Other comprehensive income (loss):				
Currency translation	10.6	.7	28.7	(1.2)
Pension plans	1.6	1.4	4.7	4.4
OPEB plans	(.2)	(.1)	(.4)	(.3)
Marketable securities	(.5)	—	(1.0)	—
Interest rate swap	1.3	—	1.4	—
Total	\$28.0	\$(90.2)	\$(100.8)	\$(10.2)

The amount shown in the above table of our income tax rate reconciliation for non-U.S. tax rates represents the result determined by multiplying the pre-tax earnings or losses of each of our non-U.S. subsidiaries by the difference between the applicable statutory income tax rate for each non-U.S. jurisdiction and the U.S. federal statutory tax rate of 35% in 2017 and 21% in 2018. The amount shown on such table for incremental net tax (benefit) on earnings and losses on non-U.S. and non-tax group companies includes, as applicable, (i) deferred income taxes (or deferred income tax benefits) associated with the current-year change in the aggregate amount of undistributed earnings of our Chemicals Segment's Canadian subsidiary and, beginning in 2018, the post-1986 undistributed earnings of our Chemicals Segment's European subsidiaries (such post-1986 undistributed earnings were subject to a permanent reinvestment plan until December 31, 2017), (ii) current U.S. income taxes (or current income tax benefit), including U.S. personal holding company tax, as applicable, attributable to current-year income (losses) of one of Kronos' non-U.S. subsidiaries, which subsidiary is treated as a dual resident for U.S. income tax purposes, to the extent the current-year income (losses) of such subsidiary is subject to U.S. income tax under the U.S. dual-resident provisions

of the Internal Revenue Code, (iv) deferred income taxes associated with our direct investment in Kronos and (v) current and deferred income taxes associated with distributions and earnings from our investment in LandWell and BMI.

Our Chemicals Segment has substantial net operating loss (NOL) carryforwards in Germany (the equivalent of \$652 million for German corporate purposes and \$.5 million for German trade tax purposes at December 31, 2017) and in Belgium (the equivalent of \$50 million for Belgian corporate tax purposes at December 31, 2017), all of which have an indefinite carryforward period. As a result, we have net deferred income tax assets with respect to these two jurisdictions, primarily related to these NOL carryforwards. The German corporate tax is similar to the U.S. federal income tax, and the German trade tax is similar to the U.S. state income tax. As discussed in the 2017 Annual Report, commencing June 30, 2015, we concluded that we were required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to our Chemicals Segment's German and Belgian net deferred income tax assets at such date. During the first six months of 2017, Kronos recognized an aggregate non-cash deferred income tax benefit of \$12.7 million as a result of a net decrease in such deferred income tax asset valuation allowance, due to utilizing a portion of both the German and Belgian NOL during the period, including \$7.7 million in the second quarter of 2017. As also discussed in the 2017 Annual Report, at June 30, 2017, we concluded we had sufficient positive evidence under the more-likely-than-not recognition criteria to support reversal of the entire valuation allowance related to our

- 20 -

Chemicals Segment's German and Belgian operations. In accordance with the ASC 740-270 guidance regarding accounting for income taxes at interim dates, the amount of the valuation allowance reversed at June 30, 2017 (\$149.9 million, of which \$141.9 million related to Germany and \$8.0 million related to Belgium) relates to our change in judgment at that date regarding the realizability of the related deferred income tax asset as it relates to future years (i.e., 2018 and after). A change in judgment regarding the realizability of deferred tax assets as it relates to the current year is considered in determining the estimated annual effective tax rate for the year and is recognized throughout the year, including interim periods subsequent to the date of the change in judgment. Accordingly, our income tax benefit in calendar 2017 includes an aggregate non-cash deferred income tax benefit of \$186.7 million related to the reversal of the German and Belgian valuation allowance, comprised of \$12.7 million recognized in the first half of 2017 (noted above) related to the utilization of a portion of both the German and Belgian NOLs during such period, \$149.9 million related to the portion of the valuation allowance reversed as of June 30, 2017 and \$24.1 million recognized in the second half of 2017 (including \$7.8 million reversed in the third quarter) related to the utilization of a portion of both the German and Belgian NOLs during such period. Our deferred income tax asset valuation allowance increased \$13.7 million in 2017 as a result of changes in currency exchange rates, which increase was recognized as part of other comprehensive income (loss).

As discussed in the 2017 Annual Report, on December 22, 2017, the 2017 Tax Act was enacted into law. This new tax legislation, among other changes, (i) reduced the U.S. Federal corporate income tax rate from 35% to 21% effective January 1, 2018; (ii) implemented a territorial tax system and imposed a one-time repatriation tax ("Transition Tax") on the deemed repatriation of the post-1986 undistributed earnings of non-U.S. subsidiaries accumulated up through December 31, 2017, regardless of whether such earnings are repatriated; (iii) eliminated U.S. tax on future non-U.S. earnings (subject to certain exceptions); (iv) eliminated the domestic production activities deduction beginning in 2018; (v) eliminated the net operating loss carryback and provides for an indefinite carryforward period subject to an 80% annual usage limitation; (vi) allows for the expensing of certain capital expenditures; (vii) imposed a tax on global intangible low-tax income ("GILTI") beginning in 2018; (viii) imposed a base erosion anti-abuse tax ("BEAT") beginning in 2018; and (ix) amended the rules limiting the deduction for business interest expense beginning in 2018. Following the enactment of the 2017 Tax Act, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") 118 to provide guidance on the accounting and reporting impacts of the 2017 Tax Act. SAB 118 states that companies should account for changes related to the 2017 Tax Act in the period of enactment if all information is available and the accounting can be completed. In situations where companies do not have enough information to complete the accounting in the period of enactment, a company must either 1) record an estimated provisional amount if the impact of the change can be reasonably estimated; or 2) continue to apply the accounting guidance that was in effect immediately prior to the 2017 Tax Act if the impact of the change cannot be reasonably estimated. If estimated provisional amounts are recorded, SAB 118 provides a measurement period of no longer than one year during which companies should adjust those amounts as additional information becomes available in the reporting period within the measurement period in which such adjustment is determined.

Under GAAP, we were required to revalue our net deferred tax liability associated with our U.S. net deductible temporary differences in the period in which the new tax legislation is enacted based on deferred tax balances as of the enactment date, to reflect the effect of such reduction in the corporate income tax rate. Our temporary differences as of December 31, 2017 were not materially different from our temporary differences as of the enactment date; accordingly revaluation of our net taxable temporary differences was based on our net deferred tax as of December 31, 2017. Such revaluation resulted in a provisional non-cash deferred income tax benefit of \$77.1 million recognized as of December 31, 2017 in continuing operations, reducing our net deferred income tax liability. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represented estimates based on information currently available. We did not make any additional measurement-period adjustments to the provisional amounts recorded for this item during the first six months of 2018. During the third quarter of 2018, in conjunction with finalizing our federal income tax return we were able to obtain, prepare and analyze the necessary information to complete the accounting under ASC 740 related to the revaluation of our net deferred tax liability associated with our U.S. net

taxable temporary differences as of December 31, 2017, which resulted in a measurement period adjustment and recognition of a non-cash deferred income tax expense of \$59.7 million, decreasing the provisional amount recognized at December 31, 2017. Such adjustment is almost entirely attributable to the re-measurement of our deferred income taxes with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock discussed below. Accordingly, we have completed our analysis related to such revaluation as of September 30, 2018.

Prior to the enactment of the 2017 Tax Act, the undistributed earnings of our European subsidiaries were deemed to be permanently reinvested (we had not made a similar determination with respect to the undistributed earnings of our Canadian subsidiary). Pursuant to the Transition Tax provisions imposing a one-time repatriation tax on post-1986 undistributed earnings, we recognized a provisional current income tax expense of \$76.2 million in the fourth quarter of 2017. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We elected to pay such tax over an eight year period beginning in 2018, including approximately \$6.1 million which was paid in April 2018 (for the 2017 tax year) and approximately \$4.5 million which has been paid in the second and third quarters of 2018 (for the 2018 tax year). We did not make any measurement-period adjustments to the provisional amounts recorded for this item during the first six months of 2018 because no new information became available during the period that required an adjustment. During the third quarter of 2018, in conjunction with finalizing our federal income tax return and based on additional information that became available (including

proposed regulations issued by the IRS in August 2018 with respect to the Transition Tax), we recognized a provisional income tax benefit of \$2.1 million which amount is recorded as a measurement-period adjustment in continuing operations, reducing the provisional income tax expense of \$76.2 million recognized in the fourth quarter of 2017. As a result, at September 30, 2018, taking into account the prior Transition Tax installments payments of \$10.6 million (noted above), the balance of our unpaid Transition Tax aggregates \$63.5 million, which will be paid in quarterly installments over the remainder of the eight year period. Of such \$63.5 million, \$57.8 million is recorded as a noncurrent payable to affiliate (income taxes payable to Contran) classified as a noncurrent liability in our Condensed Consolidated Balance Sheet, and \$5.7 million is included with our current payable to affiliate (income taxes payable to Contran) classified as a current liability (a portion of our noncurrent income tax payable to affiliate was reclassified to our current payable to affiliate for the portion of our 2019 Transition Tax installment due within the next twelve months). The issuance of final regulations and/or additional guidance with respect to the Transition Tax may impact the amount of the Transition Tax recognized in the fourth quarter of 2017, as adjusted in the third quarter of 2018. We are also continuing to gather information and await further guidance from the state jurisdictions in which we operate with respect to the Transition Tax. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amounts recognized at December 31, 2017 and September 30, 2018 is required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Prior to the enactment of the 2017 Tax Act the undistributed earnings of our European subsidiaries were deemed to be permanently reinvested (we had not made a similar determination with respect to the undistributed earnings of our Canadian subsidiary). As a result of the implementation of a territorial tax system under the 2017 Tax Act, effective January 1, 2018, and the Transition Tax which in effect taxes the post-1986 undistributed earnings of our non-U.S. subsidiaries accumulated up through December 31, 2017, we determined effective December 31, 2017 that all of the post-1986 undistributed earnings of our European subsidiaries are not permanently reinvested. Accordingly, in the fourth quarter of 2017 we recognized an aggregate provisional non-cash deferred income tax expense of \$5.3 million based on our reasonable estimates of the U.S. state and non-U.S. income tax and withholding tax liability attributable to all of such previously-considered permanently reinvested undistributed earnings through December 31, 2017. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We have not made any measurement-period adjustments to the provisional amounts recorded at December 31, 2017 for this item during the first nine months of 2018. However, we recorded a provisional non-cash deferred income tax expense of \$3.2 million for the estimated U.S. state and non-U.S. income tax and withholding tax liability attributable to the 2018 undistributed earnings of our non-U.S. subsidiaries in the first nine months of 2018, including withholding taxes related to the undistributed earnings of our Canadian subsidiary. We are continuing our review of certain other provisions under the 2017 Tax Act and waiting on further guidance primarily from the state jurisdictions in which we operate that may impact our determination of the aggregate temporary differences attributable to our investments in our non-U.S. subsidiaries. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 and September 30, 2018 are required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Under U.S. GAAP, as it relates to the new GILTI tax rules, we are allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the “period cost method”) or (2) factoring such amounts into the measurement of our deferred taxes (the “deferred method”). Our selection of an accounting policy related to the GILTI tax provisions will depend, in part, on analyzing our global income to determine whether we expect to have future U.S. inclusions in taxable income related

to GILTI and, if so, what the impact is expected to be. While our future global operations depend on a number of different factors, we do expect to have future U.S. inclusions in taxable income related to GILTI. As such, we performed an analysis of GILTI's impact on our provision and determined the impact is not material. Because the impact is not material to our tax provision, we have not recorded any adjustments related to potential GILTI tax in our financial statements in the first nine months of 2018. Further, we have not made a policy decision regarding whether to record deferred taxes on GILTI or record GILTI tax as a current-period expense when incurred. We will complete our policy election for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118 and if we determine such policy election impacts our provision, we will recognize an adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined. Similarly, we have evaluated the tax impact of BEAT on our tax provision in the first six months of 2018 and determined that the tax law has no material impact on our tax provision as we have historically not entered into international payments between related parties that are unrelated to cost of goods sold.

The 2017 Tax Act amended the rules limiting the deduction for business interest expense beginning in 2018. The limitation applies to all taxpayers and our annual deduction for business interest expense is limited to the sum of our business interest income and 30% of our adjusted taxable income as defined under the 2017 Tax Act. Any business interest expense not allowed as a deduction as a result of the limitation may be carryforward indefinitely and is treated as interest paid in the carryforward year subject to the respective year's limitation. We have determined that our interest expense for 2018 is limited under these provisions, in part because of the loss we recognized on the sale of WCS for income tax purposes. We have concluded that we are required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to a portion of our

deferred tax asset attributable to the nondeductible amount of business interest expense carryforward. Consequently, our provision for income taxes in the first nine months of 2018 includes a non-cash deferred income tax expense of \$3.0 million for the amount of such deferred income tax asset that we have determined does not meet the more-likely-than-not recognition criteria (the nondeductible portion of our business interest expense in the third quarter of 2018 is lower than the amount recognized in the second quarter of 2018 primarily due to the sale of our interest in Amalgamated during the third quarter which resulted in the recognition of a gain for tax purposes and related increase in our adjusted taxable income). In accordance with the ASC 740 guidance regarding intra-period allocation of income taxes, the full amount of non-cash deferred income tax expense is classified as part of the income taxes associated with the pre-tax gain we recognized for financial reporting purposes on the sale of WCS which is classified as part of discontinued operations as discussed in Note 3. Our estimate of the amount of such non-cash deferred income tax asset valuation allowance we are required to recognize, and the allocation of such valuation allowance between continuing and discontinued operations under the intra-period guidance of ASC 740, can change during the year due to, among other things, changes in our estimate of the amount of business interest expense, business interest income and adjusted taxable income for the current year.

We recognized a non-cash deferred income tax benefit of \$3.4 million in the third quarter of 2018 related to a decrease in our effective state income tax rate; this decrease is a direct result of the sale of our interest in the Amalgamated Sugar Company LLC which will reduce the number of state jurisdictions in which we are required to file.

We recognize deferred income taxes with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock because the exemption under GAAP to avoid such recognition of deferred income taxes is not available to us. At December 31, 2017, we had recognized a deferred income tax liability with respect to our direct investment in Kronos of \$157.6 million. There is a maximum amount (or cap) of such deferred income taxes we are required to recognize with respect to our direct investment in Kronos. The maximum amount of such deferred income tax liability we would be required to have recognized (the cap) is \$155.4 million (the cap was reduced as a result of the decrease in our effective state tax rate in the third quarter of 2018 discussed above). During the first nine months of 2018, we recognized a non-cash deferred income tax expense with respect to our direct investment in Kronos of \$19.2 million for the increase in the deferred income taxes required to be recognized with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock, to the extent such increase related to our equity in Kronos' net income during such period. We recognized a similar non-cash deferred income tax expense of \$49.3 million in the first nine months of 2017. A portion of the net change with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock during such periods related to our equity in Kronos' other comprehensive income (loss) items, and the amounts shown in the table above for income tax expense (benefit) allocated to other comprehensive income (loss) items includes amounts related to our equity in Kronos' other comprehensive income (loss) items. Due to uncertainties and complexities of the new legislation, we were still evaluating the impact of the one-time deemed repatriation of the post-1986 undistributed earnings of our non-U.S. subsidiaries up through December 31, 2017 as it relates to the income tax basis of our direct investment in Kronos at December 31, 2017 and June 30, 2018. Our deferred income tax liability with respect to our direct investment in Kronos and the deferred income taxes recognized at December 31, 2017 and June 30, 2018 represented our reasonable estimate and, in accordance with the guidance in SAB 118, such amounts were provisional and subject to adjustment as we obtain additional information and complete our analysis of the impact of the new legislation as it relates to the income tax basis of our direct investment in Kronos. We made no adjustments to the provisional amounts recorded at December 31, 2017 as it relates to the income tax basis of our direct investment in Kronos at such date in the first six months of 2018 because no new information was available. During the third quarter of 2018, in conjunction with

finalizing our federal income tax return and based on additional information that became available (including proposed regulations issued by the IRS in August 2018 with respect to the Transition Tax), we recognized an adjustment, which is treated as a measurement period adjustment, to the deferred income taxes we recognized at December 31, 2017 associated with our direct investment in Kronos common stock (before revaluation of our deferred tax liability related to the decrease in the corporate income tax rate). Such adjustment resulted in an investment basis adjustment under the income tax regulations which increased the income tax basis of our direct investment in Kronos attributable to the income recognition related to the deemed repatriation of the post-1986 undistributed earnings of our non-U.S. subsidiaries in 2017. Such adjustment resulted in a non-cash deferred tax measurement period adjustment decreasing the deferred income taxes we recognize with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock. Including the impact of the non-cash deferred tax revaluation adjustment discussed above, we recognized a net non-cash deferred income tax benefit of \$113 million in the third quarter of 2018 related to the incremental tax on Kronos. As of September 30, 2018, we have completed our analysis related to the impact of the new legislation as it related to the income tax basis of our direct investment in Kronos. Excluding the impact of such adjustment, our effective income tax rate from continuing operations in the third quarter and nine months ending September 30, 2018 was 38% and 38.9%, respectively.

- 23 -

We will complete our accounting for the taxes recognized under the Transition Tax provisions, deferred taxes recognized with respect to the undistributed earnings of our foreign subsidiaries and our policy decision as it relates to the new GILTI tax rules within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118 and if such estimates change, we will recognize an adjustment in the reporting period within the measurement period in which such adjustment is determined.

None of our U.S. and non-U.S. tax returns are currently under examination. As a result of prior audits in certain jurisdictions, which are now settled, in 2008 Kronos filed Advance Pricing Agreement Requests with the tax authorities in the U.S., Canada and Germany. These requests have been under review with the respective tax authorities since 2008 and prior to 2016, it was uncertain whether an agreement would be reached between the tax authorities and whether Kronos would agree to execute and finalize such agreements.

During the third quarter of 2017, Kronos' Canadian subsidiary executed and finalized an Advance Pricing Agreement with the Competent Authority for Canada (the "Canada-Germany APA") effective for tax years 2005 - 2017. Pursuant to the terms of the Canada-Germany APA, the Canadian and German tax authorities agreed to certain prior year changes to taxable income of our Canadian and German subsidiaries. As a result of such agreed-upon changes, we reversed a significant portion of our reserve for uncertain tax positions and recognized a non-cash income tax benefit of \$8.1 million related to such reversal in the third quarter of 2017. In addition, we recognized a \$2.6 million non-cash income tax benefit related to an increase in our German NOLs and a \$.6 million German cash tax refund related to the Canada-Germany APA in the third quarter of 2017.

During the first quarter of 2018, Kronos' German subsidiary executed and finalized the related Advance Pricing Agreement with the Competent Authority for Germany (the "Germany-Canada APA") effective for tax years 2005 - 2017. In the first quarter of 2018, we recognized a net \$1.4 million non-cash income tax benefit related to an APA tax settlement payment between Kronos' German and Canadian subsidiaries.

We believe we have adequate accruals for additional taxes and related interest expense which could ultimately result from tax examinations. We believe the ultimate disposition of tax examinations should not have a material adverse effect on our consolidated financial position, results of operations or liquidity. We currently estimate that our unrecognized tax benefits will decrease by approximately \$1.8 million during the next twelve months primarily due to certain adjustments to our prior year returns and the expiration of certain statutes of limitations.

Note 15—Noncontrolling interest in subsidiaries:

	December 31, 2017	September 30, 2018
	(In millions)	
Noncontrolling interest in net assets:		
Kronos Worldwide	\$204.9	\$ 228.1
NL Industries	71.1	63.7
CompX International	17.8	19.2
BMI	26.0	28.0
LandWell	22.5	26.0
Total	\$342.3	\$ 365.0

	Nine months ended September 30, 2017 2018 (In millions)	
Noncontrolling interest in net income (loss) of subsidiaries:		
Kronos Worldwide	\$60.0	\$35.3
NL Industries	11.4	(7.4)
CompX International	1.2	1.6
BMI	.3	1.1
LandWell	.5	2.1
Total	\$73.4	\$32.7

Note 16—Accumulated other comprehensive loss:

Changes in accumulated other comprehensive income (loss) attributable to Valhi stockholders for the three and nine months ended September 30, 2017 and 2018 are presented in the table below.

	Three months ended		Nine	
	September 30,		months ended	
	2017	2018	2017	2018
	(In millions)			
Accumulated other comprehensive income (loss), net of tax				
and noncontrolling interest:				
Marketable securities:				
Balance at beginning of period	\$1.7	\$1.6	\$1.7	\$1.7
Other comprehensive loss – unrealized losses arising during the period	—	—	—	(.1)
Balance at end of period	\$1.7	\$1.6	\$1.7	\$1.6
Interest rate swap:				
Balance at beginning of period	\$(1.1)	\$—	\$(1.2)	\$—
Other comprehensive income (loss):				
Unrealized losses arising during the year	(.7)	—	(1.2)	—
Less reclassification adjustment for amounts included in interest expense	1.8	—	2.4	—
Balance at end of period	\$—	\$—	\$—	\$—
Currency translation adjustment:				
Balance at beginning of period	\$(73.8)	\$(63.6)	\$(88.5)	\$(54.1)
Other comprehensive income (loss)	19.3	2.9	34.0	(6.6)
Balance at end of period	\$(54.5)	\$(60.7)	\$(54.5)	\$(60.7)
Defined benefit pension plans:				
Balance at beginning of period	\$(134.4)	\$(125.2)	\$(137.0)	\$(129.0)
Other comprehensive income— amortization of prior service cost and net losses included in net periodic pension cost	1.8	1.9	4.4	5.7
Balance at end of period	\$(132.6)	\$(123.3)	\$(132.6)	\$(123.3)
OPEB plans:				
Balance at beginning of period	\$2.7	\$2.0	\$3.1	\$2.4
Other comprehensive loss – amortization of prior service credit	(.2)	(.2)	(.6)	(.6)
Balance at end of period	\$2.5	\$1.8	\$2.5	\$1.8
Total accumulated other comprehensive income (loss):				
Balance at beginning of period	\$(204.9)	\$(185.2)	\$(221.9)	\$(179.0)
Other comprehensive income (loss)	22.0	4.6	39.0	(1.6)
Balance at end of period	\$(182.9)	\$(180.6)	\$(182.9)	\$(180.6)

See Note 12 for amounts related to our defined benefit pension plans and OPEB plans.

Note 17 – Commitments and contingencies:

Lead pigment litigation – NL

General

We are involved in various environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our current and former businesses. At least quarterly our management discusses and evaluates the status of any pending litigation or claim to which we are a party or which has been asserted against us. The factors considered in such evaluation include, among other things, the nature of such pending cases and claims, the status of such pending cases and claims, the advice of legal counsel and our experience in similar cases and claims (if any). Based on such evaluation, we make a determination as to whether we believe (i) it is probable a loss has been incurred, and if so if the amount of such loss (or a range of loss) is reasonably

- 25 -

estimable, or (ii) it is reasonably possible but not probable a loss has been incurred, and if so if the amount of such loss (or a range of loss) is reasonably estimable, or (iii) the probability a loss has been incurred is remote.

Lead pigment litigation

Our former operations included the manufacture of lead pigments for use in paint and lead-based paint. We, other former manufacturers of lead pigments for use in paint and lead-based paint (together, the “former pigment manufacturers”), and the Lead Industries Association (LIA), which discontinued business operations in 2002, have been named as defendants in various legal proceedings seeking damages for personal injury, property damage and governmental expenditures allegedly caused by the use of lead-based paints. Certain of these actions have been filed by or on behalf of states, counties, cities or their public housing authorities and school districts, and certain others have been asserted as class actions. These lawsuits seek recovery under a variety of theories, including public and private nuisance, negligent product design, negligent failure to warn, strict liability, breach of warranty, conspiracy/concert of action, aiding and abetting, enterprise liability, market share or risk contribution liability, intentional tort, fraud and misrepresentation, violations of state consumer protection statutes, supplier negligence and similar claims.

The plaintiffs in these actions generally seek to impose on the defendants responsibility for lead paint abatement and health concerns associated with the use of lead-based paints, including damages for personal injury, contribution and/or indemnification for medical expenses, medical monitoring expenses and costs for educational programs. To the extent the plaintiffs seek compensatory or punitive damages in these actions, such damages are generally unspecified. In some cases, the damages are unspecified pursuant to the requirements of applicable state law. A number of cases are inactive or have been dismissed or withdrawn. Most of the remaining cases are in various pre-trial stages. Some are on appeal following dismissal or summary judgment rulings or a trial verdict in favor of either the defendants or the plaintiffs.

We believe that these actions are without merit, and we intend to continue to deny all allegations of wrongdoing and liability and to defend against all actions vigorously. Other than with respect to the Santa Clara case discussed below, we do not believe it is probable that we have incurred any liability with respect to all of the lead pigment litigation cases to which we are a party, and with respect to all such lead pigment litigation cases to which we are a party, other than with respect to the Santa Clara case discussed below, we believe liability to us that may result, if any, in this regard cannot be reasonably estimated, because:

- we have never settled any of the market share, intentional tort, fraud, nuisance, supplier negligence, breach of warranty, conspiracy, misrepresentation, aiding and abetting, enterprise liability, or statutory cases (subject to the final outcome of the Santa Clara case discussed below),
- no final, non-appealable adverse verdicts have ever been entered against NL (subject to the final outcome of the Santa Clara case discussed below), and
- we have never ultimately been found liable with respect to any such litigation matters, including over 100 cases over a twenty-year period for which we were previously a party and for which we have been dismissed without any finding of liability (subject to the final outcome of the Santa Clara case discussed below).

Accordingly, other than with respect to the Santa Clara case discussed below, we have not accrued any amounts for any of the pending lead pigment and lead-based paint litigation cases filed by or on behalf of states, counties, cities or their public housing authorities and school districts, or those asserted as class actions other than the Santa Clara case noted below. In addition, we have determined that liability to us which may result, if any, cannot be reasonably estimated at this time because there is no prior history of a loss of this nature on which an estimate could be made and there is no substantive information available upon which an estimate could be based.

In one of these lead pigment cases, in April 2000 we were served with a complaint in County of Santa Clara v. Atlantic Richfield Company, et al. (Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657) brought by a number of California government entities against the former pigment manufacturers, the LIA and certain paint manufacturers. The County of Santa Clara sought to recover compensatory damages for funds the plaintiffs have expended or would in the future expend for medical treatment, educational expenses, abatement or other costs due to exposure to, or potential exposure to, lead paint, disgorgement of profit, and punitive damages. In July 2003, the trial judge granted defendants' motion to dismiss all remaining claims. Plaintiffs appealed and the intermediate appellate court reinstated public nuisance, negligence, strict liability, and fraud claims in March 2006. A fourth amended complaint was filed in March 2011 on behalf of The People of California by the County Attorneys of Alameda, Ventura, Solano, San Mateo, Los Angeles and Santa Clara, and the City Attorneys of San Francisco, San Diego and Oakland. That complaint alleged that the presence of lead paint created a public nuisance in each of the prosecuting jurisdictions and sought its abatement. In July and August 2013, the case was tried. In January 2014, the Judge issued a judgment finding us, The Sherwin Williams Company and ConAgra Grocery Products Company jointly and severally liable for the abatement of lead paint in pre-1980 homes, and ordered the defendants to pay an aggregate \$1.15 billion to the people of the State of California to fund such abatement. The trial court's judgment also found that to the extent any abatement funds remained unspent after four years, such funds were to be returned to the defendants. In February 2014, we filed a motion for a new trial, and in March 2014 the trial court denied

the motion. Subsequently in March 2014, we filed a notice of appeal with the Sixth District Court of Appeal for the State of California. On November 14, 2017, the Sixth District Court of Appeal issued its opinion, upholding the trial court's judgment, except that it reversed the portion of the judgment requiring abatement of homes built between 1951 and 1980 which significantly reduced the number of homes subject to the abatement order. In addition, the appellate court ordered the case be remanded to the trial court to recalculate the amount of the abatement fund, to limit it to the amount necessary to cover the cost of investigating and remediating pre-1951 homes, and to hold an evidentiary hearing to appoint a suitable receiver. In addition, the appellate court found that we and the other defendants had the right to seek recovery from liable parties that contributed to a hazardous condition at a particular property. Subsequently, we and the other defendants filed a Petition with the California Supreme Court seeking its review of a number of issues. On February 14, 2018, the California Supreme Court denied such petition. In July 2018, we and the other defendants filed appeals with the U.S. Supreme Court, seeking its review of two federal issues in the trial court's original judgment. Review by the U.S. Supreme Court is discretionary, and in October 2018 the U.S. Supreme Court denied the petitions for the Court to hear such appeals.

Under such remand ordered by the appellate court, the trial court would, among other things, (i) recalculate the amount of the abatement fund, excluding remediation of homes built between 1951 and 1980, (ii) hold an evidentiary hearing to appoint a suitable receiver for the abatement fund and (iii) enter an order setting forth its rulings on these issues. We believe any party will have a right to appeal any of these new decisions to be made by the trial court from the remand of the case. Several uncertainties exist with respect to the new decisions to be made by the trial court from the remand of the case, including the following:

•The appellate court remanded the case back to the trial court to recalculate the total amount of the abatement, limiting the abatement to pre-1951 homes. In this regard, NL and the other defendants filed a brief with the trial court proposing a recalculated maximum abatement fund amount of no more than \$409 million and plaintiffs filed a brief proposing an abatement fund amount of \$730 million. In September 2018, following a case-management hearing regarding the recalculated abatement fund amount held in August 2018, the trial court issued an order setting the recalculated amount of the abatement fund at \$409 million;

•The appellate court upheld NL's and the other defendants' right to seek contribution from other liable parties (e.g. property owners who have violated the applicable housing code) on a house-by-house basis. The method by which the trial court would undertake to determine such house-by-house responsibility, and the outcome of such a house-by-house determination, is not presently known;

•Participation in any abatement program by each homeowner is voluntary, and each homeowner would need to consent to allowing someone to come into the home to undertake any inspection and abatement, as well as consent to the nature, timing and extent of any abatement. The original trial court's judgment unrealistically assumed 100% participation by the affected homeowners. Actual participation rates are likely to be less than 100% (the ultimate extent of participation is not presently known);

•The remedy ordered by the trial court is an abatement fund. The trial court ordered that any funds unspent after four years are to be returned to the defendants (this provision of the trial court's original judgment was not overturned by the appellate court). As noted above, the actual number of homes which would participate in any abatement, and the nature, timing and extent of any such abatement, is not presently known; and

•We and the other two defendants are jointly and severally liable for the abatement, we do not believe any individual defendant would be 100% responsible for the cost of any abatement, and the allocation of the recalculated amount of the abatement fund (\$409 million) among the three defendants has not yet been determined.

In May 2018, we and the plaintiffs entered into a settlement agreement pursuant to which, as supplemented, the plaintiffs would be paid an aggregate of \$80 million, in return for which we would be dismissed from the case with

prejudice and all pending and future claims, causes of action, cross-complaints, actions or proceedings against us and our affiliates for indemnity, contribution, reimbursement or declaratory relief in respect to the case would be barred, discharged and enjoined as a matter of applicable law. Of such \$80 million, \$65 million would be paid by us and \$15 million would be provided by one of our former insurance carriers that has previously placed such amount on deposit with the trial court in satisfaction of potential liability such former carrier might have with respect to the case under certain insurance policies we had with such former carrier. Of such \$65 million which would be paid by us, \$45 million would be paid upon approval of the terms of the settlement, and the remaining \$20 million would be paid in five annual installments beginning four years from such approval (\$6 million for the first installment, \$5 million for the second installment and \$3 million for each of the third, fourth and fifth installments). The settlement agreement is subject to a number of conditions including the trial court's approval of the terms of the settlement (which trial court approval includes a determination that such settlement agreement meets the standards for a "good faith" settlement under applicable California law). The other defendants filed motions with the trial court objecting to the terms of the settlement. In September 2018, the trial court denied approval of the settlement agreement, finding among other things that the settlement agreement did not meet the standards for a "good faith" settlement under applicable California law. Subsequently in October 2018, we filed an appeal of the trial court's denial of approval of the settlement agreement with the Sixth District Court of Appeal for the State of California, asserting among other things that in denying such approval the trial court made several legal errors in applying applicable California law to the terms of the settlement agreement. The appellate court has discretion whether to hear such appeal, and the time for the appellate court to determine if it will hear such appeal has not yet run. There can be no assurance that the appellate court will agree to hear such appeal, or if it agrees to hear such appeal, that it would rule

in favor of us and approve the settlement agreement. We continue to believe the settlement agreement satisfies the standards for a “good faith” settlement under applicable California law.

The Santa Clara case is unusual in that this is the second time that an adverse verdict in the lead pigment litigation has been entered against us (the first adverse verdict against us was ultimately overturned on appeal). Given the appellate court’s November 2017 ruling, and the denial of an appeal by the California Supreme Court, we have concluded that the likelihood of a loss in this case has reached a standard of “probable” as contemplated by ASC 450. With all of the uncertainties that exist with respect to the new decisions to be made by the trial court from the remand of the case, as noted above, we had previously concluded that the amount of such loss could not be reasonably estimated (nor could a range of loss be reasonably estimated). However, the terms of the settlement agreement entered into by us and the plaintiffs in May 2018, as supplemented, provides evidence that the amount of the loss to us could be reasonably estimated (and provides evidence of the low end of a range of loss to us). For financial reporting purposes, we discounted the five payments aggregating \$20 million to be paid in installments to their estimated net present value, using a discount rate of 3.0% per annum. Such net present value is \$17 million, and we would begin to accrete such present value amount upon approval of the settlement agreement. Accordingly, in the second quarter of 2018 we recognized a net \$62 million pre-tax charge with respect to this matter (\$45 million for the amount to be paid by us upon approval of the terms of the settlement and \$17 million for the net present value of the five payments aggregating \$20 million to be paid by us in installments beginning four years from such approval), representing the net amount we would pay in full settlement of our liability under the terms of the proposed settlement agreement. For purposes of our condensed consolidated balance sheet, we have presented the aggregate \$45 million that would be paid to the plaintiffs upon approval of the terms of the settlement and the \$15 million that would be paid to the plaintiffs from the amount placed as deposit with the trial court by one of our former insurance carriers as a current liability, \$17 million for the net present value of the five payments aggregating \$20 million to be paid by us in installments beginning four years from such approval as a noncurrent liability and the \$15 million portion of such aggregate \$80 million undiscounted amount which would be funded from the amount placed on deposit with the trial court by one of our former insurance carriers as a current insurance recovery receivable. See Notes 2, 7 and 10.

Although, we and the plaintiffs believed the settlement met all requirements of applicable California law, the trial court denied our motive for approval of a good faith settlement, and there can be no assurance that the appellate court will reverse that decision and approve the terms of this or any other settlement agreement between us and the plaintiffs. If the appellate court does not reverse the trial court decision and approve the terms of this or any other settlement agreement between us and the plaintiffs, the proceedings in the trial court under the remand, as discussed above, would continue. In such event, NL’s share of the recalculated amount of the abatement fund is not presently known, and other uncertainties exist with respect to the new decisions to be made by the trial court from the remand of the case, as discussed above. As with any legal proceeding, there is no assurance that any appeal would be successful, and it is reasonably possible, based on the outcome of the appeals process and the remand proceedings in the trial court, that NL may in the future incur some liability resulting in the recognition of an additional loss contingency accrual that could have a material adverse impact on our results of operations, financial position and liquidity.

New cases may continue to be filed against us. We cannot assure you that we will not incur liability in the future in respect of any of the pending or possible litigation in view of the inherent uncertainties involved in court and jury rulings. In the future, if new information regarding such matters becomes available to us (such as a final, non-appealable adverse verdict against us or otherwise ultimately being found liable with respect to such matters), at that time we would consider such information in evaluating any remaining cases then-pending against us as to whether it might then have become probable we have incurred liability with respect to these matters, and whether such liability, if any, could have become reasonably estimable. The resolution of any of these cases could result in the recognition of a loss contingency accrual that could have a material adverse impact on our net income for the interim or annual period during which such liability is recognized and a material adverse impact on our consolidated financial condition and liquidity.

Environmental matters and litigation

Our operations are governed by various environmental laws and regulations. Certain of our businesses are and have been engaged in the handling, manufacture or use of substances or compounds that may be considered toxic or hazardous within the meaning of applicable environmental laws and regulations. As with other companies engaged in similar businesses, certain of our past and current operations and products have the potential to cause environmental or other damage. We have implemented and continue to implement various policies and programs in an effort to minimize these risks. Our policy is to maintain compliance with applicable environmental laws and regulations at all of our plants and to strive to improve environmental performance. From time to time, we may be subject to environmental regulatory enforcement under U.S. and non-U.S. statutes, the resolution of which typically involves the establishment of compliance programs. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies, could adversely affect our production, handling, use, storage, transportation, sale or disposal of such substances. We believe that all of our facilities are in substantial compliance with applicable environmental laws.

- 28 -

Certain properties and facilities used in NL's former operations, including divested primary and secondary lead smelters and former mining locations, are the subject of civil litigation, administrative proceedings or investigations arising under federal and state environmental laws and common law. Additionally, in connection with past operating practices, we are currently involved as a defendant, potentially responsible party ("PRP") or both, pursuant to the Comprehensive Environmental Response, Compensation and Liability Act, as amended by the Superfund Amendments and Reauthorization Act ("CERCLA"), and similar state laws in various governmental and private actions associated with waste disposal sites, mining locations, and facilities that we or our predecessors, our subsidiaries or their predecessors currently or previously owned, operated or used, certain of which are on the United States Environmental Protection Agency's ("EPA") Superfund National Priorities List or similar state lists. These proceedings seek cleanup costs, damages for personal injury or property damage and/or damages for injury to natural resources. Certain of these proceedings involve claims for substantial amounts. Although we may be jointly and severally liable for these costs, in most cases we are only one of a number of PRPs who may also be jointly and severally liable, and among whom costs may be shared or allocated. In addition, we are occasionally named as a party in a number of personal injury lawsuits filed in various jurisdictions alleging claims related to environmental conditions alleged to have resulted from our operations.

Obligations associated with environmental remediation and related matters are difficult to assess and estimate for numerous reasons including the:

- complexity and differing interpretations of governmental regulations,
- number of PRPs and their ability or willingness to fund such allocation of costs,
- financial capabilities of the PRPs and the allocation of costs among them,
- solvency of other PRPs,
- multiplicity of possible solutions,
 - number of years of investigatory, remedial and monitoring activity required,
- uncertainty over the extent, if any, to which our former operations might have contributed to the conditions allegedly giving rise to such personal injury, property damage, natural resource and related claims, and
- number of years between former operations and notice of claims and lack of information and documents about the former operations.

In addition, the imposition of more stringent standards or requirements under environmental laws or regulations, new developments or changes regarding site cleanup costs or the allocation of costs among PRPs, solvency of other PRPs, the results of future testing and analysis undertaken with respect to certain sites or a determination that we are potentially responsible for the release of hazardous substances at other sites, could cause our expenditures to exceed our current estimates. We cannot assure you that actual costs will not exceed accrued amounts or the upper end of the range for sites for which estimates have been made, and we cannot assure you that costs will not be incurred for sites where no estimates presently can be made. Further, additional environmental and related matters may arise in the future. If we were to incur any future liability, this could have a material adverse effect on our consolidated financial statements, results of operations and liquidity.

We record liabilities related to environmental remediation and related matters (including costs associated with damages for personal injury or property damage and/or damages for injury to natural resources) when estimated future expenditures are probable and reasonably estimable. We adjust such accruals as further information becomes available to us or as circumstances change. Unless the amounts and timing of such estimated future expenditures are fixed and reasonably determinable, we generally do not discount estimated future expenditures to their present value due to the uncertainty of the timing of the payout. We recognize recoveries of costs from other parties, if any, as assets when their receipt is deemed probable. At December 31, 2017, we had not recognized any material receivables and at September 30, 2018, we have recognized \$15.0 million of receivables for recoveries related to the California case discussed above.

We do not know and cannot estimate the exact time frame over which we will make payments for our accrued environmental and related costs. The timing of payments depends upon a number of factors, including but not limited to the timing of the actual remediation process; which in turn depends on factors outside of our control. At each balance sheet date, we estimate the amount of our accrued environmental and related costs which we expect to pay within the next twelve months, and we classify this estimate as a current liability. We classify the remaining accrued environmental costs as a noncurrent liability.

- 29 -

The table below presents a summary of the activity in our accrued environmental costs during the first nine months of 2018.

	Amount (In millions)
Balance at the beginning of the year	\$ 117.5
Additions charged to expense, net	2.9
Payments, net	(3.7)
Balance at the end of period	\$ 116.7
Amounts recognized in our Condensed Consolidated Balance Sheet at the	
end of the period:	
Current liabilities	\$ 19.0
Noncurrent liabilities	97.7
Total	\$ 116.7

NL – On a quarterly basis, NL evaluates the potential range of its liability for environmental remediation and related costs at sites where it has been named as a PRP or defendant. At September 30, 2018, NL had accrued approximately \$111 million related to approximately 37 sites associated with remediation and related matters that it believes are at the present time and/or in their current phase reasonably estimable. The upper end of the range of reasonably possible costs to NL for remediation and related matters for which we believe it is possible to estimate costs is approximately \$130 million, including the amount currently accrued.

NL believes that it is not reasonably possible to estimate the range of costs for certain sites. At September 30, 2018, there were approximately 5 sites for which NL is not currently able to estimate a range of costs. For these sites, generally the investigation is in the early stages, and NL is unable to determine whether or not NL actually had any association with the site, the nature of its responsibility, if any, for the contamination at the site and the extent of contamination at and cost to remediate the site. The timing and availability of information on these sites is dependent on events outside of our control, such as when the party alleging liability provides information to us. At certain of these previously inactive sites, NL has received general and special notices of liability from the EPA and/or state agencies alleging that NL, sometimes with other PRPs, are liable for past and future costs of remediating environmental contamination allegedly caused by former operations. These notifications may assert that NL, along with any other alleged PRPs, are liable for past and/or future clean-up costs. As further information becomes available to us for any of these sites which would allow us to estimate a range of costs, we would at that time adjust our accruals. Any such adjustment could result in the recognition of an accrual that would have a material effect on our consolidated financial statements, results of operations and liquidity.

Other – We have also accrued approximately \$5.7 million at September 30, 2018 for other environmental cleanup matters.

Insurance coverage claims

We are involved in certain legal proceedings with a number of our former insurance carriers regarding the nature and extent of the carriers' obligations to us under insurance policies with respect to certain lead pigment and asbestos lawsuits. The issue of whether insurance coverage for defense costs or indemnity or both will be found to exist for our

lead pigment and asbestos litigation depends upon a variety of factors and we cannot assure you that such insurance coverage will be available.

We have agreements with certain of our former insurance carriers pursuant to which the carriers reimburse us for a portion of our future lead pigment litigation defense costs, and one such carrier reimburses us for a portion of our future asbestos litigation defense costs. We are not able to determine how much we will ultimately recover from these carriers for defense costs incurred by us because of certain issues that arise regarding which defense costs qualify for reimbursement. While we continue to seek additional insurance recoveries, we do not know if we will be successful in obtaining reimbursement for either defense costs or indemnity. Accordingly, we recognize insurance recoveries in income only when receipt of the recovery is probable and we are able to reasonably estimate the amount of the recovery.

For additional discussion of certain litigation involving NL and certain of its former insurance carriers, please refer to our 2017 Annual Report.

- 30 -

Other litigation

NL— NL has been named as a defendant in various lawsuits in several jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by our former operations containing asbestos, silica and/or mixed dust. In addition, some plaintiffs allege exposure to asbestos from working in various facilities previously owned and/or operated by NL. There are 109 of these types of cases pending, involving a total of approximately 582 plaintiffs. In addition, the claims of approximately 8,676 plaintiffs have been administratively dismissed or placed on the inactive docket in Ohio courts. We do not expect these claims will be re-opened unless the plaintiffs meet the courts' medical criteria for asbestos-related claims. We have not accrued any amounts for this litigation because of the uncertainty of liability and inability to reasonably estimate the liability, if any. To date, we have not been adjudicated liable in any of these matters. Based on information available to us, including:

- facts concerning historical operations,
- the rate of new claims,
- the number of claims from which we have been dismissed, and
- our prior experience in the defense of these matters,

we believe that the range of reasonably possible outcomes of these matters will be consistent with our historical costs (which are not material). Furthermore, we do not expect any reasonably possible outcome would involve amounts material to our consolidated financial position, results of operations or liquidity. We have sought and will continue to vigorously seek dismissal and/or a finding of no liability from each claim. In addition, from time to time, we have received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries, including notices provided to insurers with which we have entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from us.

Kronos— In March 2013, Kronos was served with the complaint, *Los Gatos Mercantile, Inc. d/b/a Los Gatos Ace Hardware, et al v. E.I. Du Pont de Nemours and Company, et al.* (United States District Court, for the Northern District of California, Case No. 3:13-cv-01180-SI). The defendants include us, E.I. Du Pont de Nemours & Company, Huntsman International LLC and Millennium Inorganic Chemicals, Inc. As amended by plaintiffs' third amended complaint (*Harrison, Jan, et al v. E.I. Du Pont de Nemours and Company, et al*), plaintiffs seek to represent a class consisting of indirect purchasers of titanium dioxide in the states of Arizona, Arkansas, California, the District of Columbia, Florida, Iowa, Kansas, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New Mexico, New York, North Carolina, Oregon and Tennessee that indirectly purchased titanium dioxide from one or more of the defendants on or after March 1, 2002. The complaint alleges that the defendants conspired and combined to fix, raise, maintain, and stabilize the price at which titanium dioxide was sold in the United States and engaged in other anticompetitive conduct. In December 2017, the Court preliminarily approved a settlement agreement with the class plaintiffs. In January 2018, without admitting any fault or wrongdoing, Kronos paid an immaterial amount in full settlement of this matter, and in August 2018 the Court issued a final approval of the settlement.

Other—In addition to the litigation described above, we and our affiliates are involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our present and former businesses. In certain cases, we have insurance coverage for these items, although we do not expect any additional material insurance coverage for our environmental claims. We currently believe that the disposition of all of these various other claims and disputes (including asbestos-related claims), individually or in the aggregate, should not have a material adverse effect on our consolidated financial position, results of operations or liquidity beyond the accruals already provided.

Note 18—Fair value measurements and financial instruments:

The following table summarizes the valuation of our marketable securities, financial instruments and other items recorded on a fair value basis as of:

	Fair Value Measurements			
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Total				
(In millions)				
Asset				
December 31, 2017:				
Marketable securities:				
Current	\$3.0	\$ —	\$ 3.0	\$ —
Noncurrent	255.7	1.3	4.4	250.0
September 30, 2018:				
Marketable securities:				
Current	\$2.2	\$ —	\$ 2.2	\$ —
Noncurrent	5.1	1.7	3.4	—

See Note 6 for information on how we determine fair value of our noncurrent marketable securities.

Certain of our sales generated by Chemicals Segment's non-U.S. operations are denominated in U.S. dollars. Our Chemicals Segment periodically uses currency forward contracts to manage a very nominal portion of currency exchange rate risk associated with trade receivables denominated in a currency other than the holder's functional currency or similar exchange rate risk associated with future sales. Derivatives that we use are primarily currency forward contracts and interest rate swaps. We have not entered into these contracts for trading or speculative purposes in the past, nor do we currently anticipate entering into such contracts for trading or speculative purposes in the future. Derivatives used to hedge forecasted transactions and specific cash flows associated with financial assets and liabilities denominated in currencies other than the U.S. dollar and which meet the criteria for hedge accounting are designated as cash flow hedges. Consequently, the effective portion of gains and losses is deferred as a component of accumulated other comprehensive income (loss) and is recognized in earnings at the time the hedged item affects earnings. Contracts that do not meet the criteria for hedge accounting are marked-to-market at each balance sheet date with any resulting gain or loss recognized in income currently as part of net currency transactions. The fair value of the currency forward contracts is determined using Level 1 inputs based on the currency spot forward rates quoted by banks or currency dealers. During 2017 and the first nine months of 2018, Kronos had no currency forward contracts outstanding.

Interest rate swap contract - See the 2017 Annual Report for a discussion of the interest rate swap Kronos had entered into in August 2015, and which was voluntarily terminated in September 2017.

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure:

	December 31, 2017		September 30, 2018	
	Carrying amount	Fair value	Carrying amount	Fair value
	(In millions)			
Cash, cash equivalents and restricted cash equivalents	\$461.7	\$461.7	\$596.1	\$596.1
Deferred payment obligation	9.3	9.3	9.5	9.5
Long-term debt (excluding capitalized leases):				
Kronos Senior Notes	471.1	495.1	463.0	455.1
Snake River Sugar Company fixed rate loans	250.0	250.0	—	—
Valhi credit facility with Contran	284.3	284.3	314.3	314.3
Tremont promissory note payable	13.1	13.1	10.9	10.9
BMI bank note payable	18.8	19.7	18.0	18.8
LandWell note payable to the City of Henderson	2.5	2.5	2.3	2.3

At September 30, 2018, the estimated market price of Kronos' Senior Notes was €969 per €1,000 principal amount. The fair value of Kronos' Senior Notes was based on quoted market prices; however, these quoted market prices represent Level 2 inputs because the markets in which the term loan trades were not active. The fair value of our fixed-rate nonrecourse loans from Snake River Sugar Company was based upon the \$250 million redemption price of our investment in Amalgamated, which collateralized the

nonrecourse loans (this is a Level 3 input). The fair value of variable interest rate debt and other fixed-rate debt, which represents Level 2 inputs, is deemed to approximate carrying values. See Note 8. Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value. See Notes 4 and 9.

Note 19—Recent accounting pronouncements:

Adopted

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) for all contracts which were not completed as of January 1, 2018 using the modified retrospective method. Prior to adoption of this standard, we recorded sales of our Chemicals and Component Products Segments when our products were shipped and title and other risks and rewards of ownership had passed to our customer, which was generally at the time of shipment (although in some instances shipping terms were FOB destination point, for which we did not recognize revenue until the product was received by our customer). Following adoption of this standard, we will record sales of our Chemicals and Component Products Segments when we satisfy our performance obligation to our customers by transferring control of our products to them, which we have determined is at the same point in time as when we would have recognized revenue prior to adoption of this new standard. Accordingly, the adoption of Topic 606 as of January 1, 2018 did not have a material impact on our consolidated financial statements as it relates to sales of our Chemicals and Component Products Segments, and we believe adoption of this standard will have a minimal effect on our revenues of our Chemicals and Component Products Segments on an ongoing basis. See Note 11.

Revenues from our Real Estate Management and Development Segment are generally under long-term contracts. We collect certain fees from builders when the builder sells a home to a customer which we previously recognized when received and now beginning on January 1, 2018 we recognize these fees as revenue at the time we sell the parcels to the builder versus our previous practice which did not recognize revenue until the homes were sold. Accordingly, upon adoption of ASU 2014-09, such fees we collect from builders when the builder sells a home to a customer are now estimated at the time we sell a parcel to a builder, and such fees are part of the revenue we recognize over time using cost based input methods for our retail land sales in the case of the home participation fee or over the time the homes in the parcel are sold in the case of the marketing fee. Under the transition requirements for adopting this ASU, we recognized the cumulative amount of such revenue that we would have recognized through December 31, 2017, had we recognized such builder fees under this new accounting method (\$6.1 million, or \$2.7 million, net of applicable income taxes and noncontrolling interest), as a direct increase in our retained earnings as of January 1, 2018. A portion of such builder fees are expected to be collected more than twelve months from the balance sheet date, and such amounts are classified as a noncurrent asset (Land contract receivables), see Note 7. In addition to recognizing such \$6.1 million receivable, we recognized a contract asset of \$8.8 million and an offsetting liability for deferred revenue of \$8.8 million upon the adoption of this ASU for the estimated amount of such builder fees which we expect to receive from future home sales by the builders, which builder fees are not yet recognizable as revenue (and a portion of such contract asset is also classified as a noncurrent receivable along with an equal amount of noncurrent deferred revenue). Had we recognized revenue in 2018 on the same basis we did in 2017, our land sales revenue would have been higher by \$.5 million and lower by \$.7 million in the third quarter and first nine months of 2018, respectively.

On January 1, 2018, we adopted ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects related to the recognition,

measurement, presentation and disclosure of financial instruments. The ASU requires equity investments (except for those accounted for under the equity method of accounting or those that result in the consolidation of the investee) to generally be measured at fair value with changes in fair value recognized in net income (previously, changes in fair value of such securities were recognized in other comprehensive income). The amendment also requires a number of other changes, including among others: simplifying the impairment assessment for equity instruments without readily determinable fair values; eliminating the requirement for public business entities to disclose methods and assumptions used to determine fair value for financial instruments measured at amortized cost; requiring an exit price notion when measuring the fair value of financial instruments for disclosure purposes; and requiring separate presentation of financial assets and liabilities by measurement category and form of asset. We adopted the new standard prospectively. The most significant aspect of adopting this ASU is the requirement to recognize changes in fair value of our available-for-sale marketable equity securities in net income. At December 31, 2017, our portfolio of marketable equity securities was not material.

In March 2017, the FASB issued ASU 2017-07, Compensation— Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that the service cost component of net periodic defined benefit pension and OPEB cost be reported in the same line item as other compensation costs for applicable employees incurred during the period. Other components of such net benefit cost are required to be presented in the income statement separately from the service cost component, and below income from operations (if such a subtotal is presented). These other net benefit cost components must be disclosed either on the face of the financial statements or in the notes to the financial statements. In addition only the service cost component is eligible for capitalization in assets where applicable (inventory or internally constructed fixed assets for example). We adopted the amendments in ASU 2017-06 beginning in the first quarter of 2018, with retrospective

presentation in our Condensed Consolidated Statements of Income. We began applying ASU 2017-07 prospectively beginning on January 1, 2018 as it relates to the capitalization of the service cost component of net benefit cost into assets (primarily inventory). We are availing ourselves of the practical expedient that permits us to use amounts we previously disclosed as components of our net periodic defined benefit pension and OPEB cost for periods prior to the adoption of this ASU as the estimation basis for applying the retrospective presentation requirements. As a result we have reclassified \$2.8 million and \$1.7 million previously classified as part of cost of sales and selling, general and administrative expenses, respectively, for the third quarter 2017 and \$8.0 million and \$4.9 million for the first nine months of 2017, to “Other components of net periodic pension and OPEB cost” in our Condensed Consolidated Statement of Income. See Note 12.

Pending Adoption

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which is a comprehensive rewriting of the lease accounting guidance which aims to increase comparability and transparency with regard to lease transactions. The primary change will be the recognition of lease assets for the right-of-use of the underlying asset and lease liabilities for the obligation to make payments by lessees on the balance sheet for leases currently classified as operating leases. The ASU, as amended, also requires increased qualitative disclosure about leases in addition to quantitative disclosures currently required. Upon adoption, companies are required to either apply a modified retrospective transition approach, or recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption with no restatement of prior period financial statement. We expect to elect the cumulative-effect adjustment method of transition. The ASU also provides a practical expedient which will allow companies to continue to account for existing leases under the prior guidance unless a lease is modified, other than the requirement to recognize the right-of-use asset and lease liability for all operating leases. The changes indicated above will be effective for us beginning in the first quarter of 2019, with early adoption permitted. We expect to adopt ASU 2016-02 beginning in the first quarter of 2019. We are in the process of assessing all of our current leases. We are in the process of evaluating the effect this ASU will have on our Consolidated Financial Statements, but given the material amount of our future minimum payments under non-cancellable operating leases at December 31, 2017 discussed in Note 17 to our 2017 Annual Report, we expect to recognize a material right-of-use lease asset and lease liability upon adoption of the ASU. This ASU permits companies to elect certain practical expedients upon adoption, and at adoption we expect to elect such practical expedients related to, among other things, lease classification (in which existing leases classified as operating leases under current GAAP would be classified as an operating lease under the new ASU, and existing leases classified as a capital lease under current GAAP would be classified as a finance lease under the new ASU), nonlease components (in which nonlease components associated with a lease and paid by us to the lessor, such as property taxes, insurance and maintenance, would be treated as a lease component and considered part of minimum lease rent payments), and short-term leases (in which leases with an original term of 12 months or less would be excluded from the recognition requirements of the new ASU).

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Business Overview

We are primarily a holding company. We operate through our wholly-owned and majority-owned subsidiaries, including NL Industries, Inc., Kronos Worldwide, Inc., CompX International Inc., Tremont LLC, Basic Management, Inc. ("BMI") and the LandWell Company ("LandWell"). Kronos (NYSE: KRO), NL (NYSE: NL) and CompX (NYSE American: CIX) each file periodic reports with the SEC.

On January 26, 2018 we completed the sale of our Waste Management Segment to JFL-WCS Partners, LLC ("JFL Partners"), an entity sponsored by certain investment affiliates of J.F. Lehman & Company, for consideration consisting of the assumption of all of WCS' third-party indebtedness and other liabilities. Accordingly the results of operations of our Waste Management Segment is reflected as discontinued operations in our Consolidated Statements of Operations for all periods presented. We recognized a pre-tax gain of approximately \$58 million on the transaction in the first quarter of 2018 because the carrying value of the liabilities of the business assumed by the purchaser exceeded the carrying value of the assets sold at the time of sale in large part due to a long-lived asset impairment of \$170.6 million recognized with respect to the Waste Management Segment in the second quarter of 2017. Such pre-tax gain is classified as part of discontinued operations. Our Waste Management Segment, which operated in the low-level radioactive, hazardous, toxic and other waste disposal industry historically struggled to generate sufficient recurring disposal volumes to generate positive operating results or cash flows. We believe the sale will enable us to focus more effort on continuing to develop our remaining segments which we believe have greater opportunity for higher returns. See Note 3 to our Condensed Consolidated Financial Statements.

We have three consolidated reportable operating segments:

☛ **Chemicals**—Our chemicals segment is operated through our majority control of Kronos. Kronos is a leading global producer and marketer of value-added titanium dioxide pigments ("TiQ"). TiQ is used to impart whiteness, brightness, opacity and durability to a wide variety of products, including paints, plastics, paper, fibers and ceramics. Additionally, TiO₂ is a critical component of everyday applications, such as coatings, plastics and paper, as well as many specialty products such as inks, foods and cosmetics.

☛ **Component Products**—We operate in the component products industry through our majority control of CompX. CompX is a leading manufacturer of security products used in the recreational transportation, postal, office and institutional furniture, cabinetry, tool storage, healthcare and a variety of other industries. CompX is also a leading manufacturer of stainless steel exhaust systems, gauges, throttle controls and trim tabs for the recreational marine industry.

☛ **Real Estate Management and Development**—We operate in real estate management and development through our majority control of BMI and LandWell. BMI provides utility services to certain industrial and municipal customers and owns real property in Henderson, Nevada. LandWell is engaged in efforts to develop certain land holdings for commercial, industrial and residential purposes in Henderson, Nevada.

General

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Quarterly Report that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. In some cases, you can identify forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expects" or comparable terminology, or by discussions of strategies or trends.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, we do not know if these expectations will be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results. Actual future results could differ materially from those predicted. The factors that could cause actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Quarterly Report and those described from time to time in our other filings with the SEC include, but are not limited to, the following:

- Future supply and demand for our products;
- The extent of the dependence of certain of our businesses on certain market sectors;
- The cyclicity of certain of our businesses (such as Kronos' TiQ operations);
- Customer and producer inventory levels;

- 35 -

- Unexpected or earlier-than-expected industry capacity expansion (such as the TiO₂ industry);
- Changes in raw material and other operating costs (such as ore, zinc, brass, aluminum, steel and energy costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs;
- Changes in the availability of raw materials (such as ore);
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for, among other things, TiO₂ and component products);
- Competitive products and prices and substitute products, including increased competition from low-cost manufacturing sources (such as China);
- Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts;
- Customer and competitor strategies;
- Potential difficulties in integrating future acquisitions;
- Potential difficulties in upgrading or implementing new accounting and manufacturing software systems (such as the Chemicals Segment's new enterprise resource planning system);
- Potential consolidation of our competitors;
- Potential consolidation of our customers;
- The impact of pricing and production decisions;
- Competitive technology positions;
- The introduction of trade barriers;
- The ability of our subsidiaries to pay us dividends;
- The impact of current or future government regulations (including employee healthcare benefit related regulations);
- Uncertainties associated with new product development and the development of new product features;
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian krone and the Canadian dollar) or possible disruptions to our business resulting from potential instability resulting from uncertainties associated with the euro or other currencies;
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime, transportation interruptions and cyber-attacks);
- Decisions to sell operating assets other than in the ordinary course of business;
- The timing and amounts of insurance recoveries;
- Our ability to renew, amend, refinance or establish credit facilities;
- Our ability to maintain sufficient liquidity;
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters, including future tax reform;
- Our ultimate ability to utilize income tax attributes, the benefits of which may or may not presently have been recognized under the more-likely-than-not recognition criteria;
- Environmental matters (such as those requiring compliance with emission and discharge standards for existing and new facilities, or new developments regarding environmental remediation at sites related to our former operations);
- Government laws and regulations and possible changes therein (such as changes in government regulations which might impose various obligations on former manufacturers of lead pigment and lead-based paint, including NL, with respect to asserted health concerns associated with the use of such products);
- The ultimate resolution of pending litigation (such as NL's lead pigment litigation, environmental and other litigation and Kronos' class action litigation);
- Our ability to comply with covenants contained in our revolving bank credit facilities;
- Our ability to complete and comply with the conditions of our licenses and permits;

- Changes in real estate values and construction costs in Henderson, Nevada;
- Water levels in Lake Mead; and
- Possible future litigation.

Should one or more of these risks materialize (or the consequences of such development worsen), or should the underlying assumptions prove incorrect, actual results could differ materially from those currently forecasted or expected. We disclaim any intention or obligation to update or revise any forward-looking statement whether as a result of changes in information, future events or otherwise.

Operations Overview

Quarter Ended September 30, 2018 Compared to the Quarter Ended September 30, 2017 —

We reported net income from continuing operations attributable to Valhi stockholders of \$142.8 million or \$.42 per diluted share in the third quarter of 2018 compared to \$44.2 million or \$.13 per diluted share in the third quarter of 2017. As discussed more fully below, our net income from continuing operations attributable to Valhi stockholders increased from 2017 to 2018 primarily due to the net effects of:

- the third quarter 2018 recognition of an aggregate income tax benefit of \$113 million related to a change in the deferred income tax liability related to our investment in Kronos as a result of the 2017 Tax Act;
- an aggregate charge of \$7.1 million recognized in the third quarter of 2017 related to a loss on prepayment of debt;
 - lower operating income from our Chemicals Segment in 2018 compared to 2017;
- a securities transaction gain of \$12.5 million recognized in the third quarter of 2018 related to the sale of our interest in The Amalgamated Sugar Company LLC (“Amalgamated”);
- the third quarter 2017 recognition of an aggregate income tax benefit of \$11.3 million related to the execution and finalization of an Advance Pricing Agreement between Canada and Germany associated with our Chemicals Segment; and
 - a non-cash deferred income tax benefit of \$7.8 million in 2017 as a result of a decrease in our deferred income tax asset valuation allowance related to our Chemicals Segment’s German and Belgian operations.

Our diluted net income from continuing operations per share in 2018 includes:

- a non-cash deferred income tax benefit of \$.33 per diluted share related to a change in the deferred income tax liability related to our investment in Kronos as a result of the 2017 Tax Act; and
- a gain of \$.03 per diluted share related to a securities transaction gain recognized in the third quarter related to the sale of our interest in Amalgamated Sugar Company LLC.

Our diluted net income from continuing operations per share in 2017 includes:

- a non-cash deferred income tax benefit of \$.02 per diluted share related to the execution and finalization of an Advance Pricing Agreement between Canada and Germany associated with our Chemicals Segment;
- a non-cash deferred income tax benefit of \$.01 per diluted share as a result of a decrease in our deferred income tax asset valuation allowance related to our Chemicals Segment’s German and Belgian operations; and
- an aggregate charge of \$.01 per diluted share recognized in the third quarter related to the loss on prepayment of debt.

Nine Months Ended September 30, 2018 Compared to the Nine Months Ended September 30, 2017 —

We reported net income from continuing operations attributable to Valhi stockholders of \$205.8 million or \$.60 per diluted share in the first nine months of 2018 compared to \$175.6 million or \$.51 per diluted share in the first nine months of 2017. As discussed more fully below, our net income from continuing operations attributable to Valhi stockholders increased from 2017 to 2018 primarily due to the net effects of:

the third quarter 2018 recognition of an aggregate income tax benefit of \$113 million related to a change in the deferred income tax liability related to our investment in Kronos as a result of the 2017 Tax Act;

- 37 -

• a non-cash deferred income tax benefit of \$170.4 million in 2017 as a result of a decrease in our deferred income tax asset valuation allowance related to our Chemicals Segment's German and Belgian operations;

• a pre-tax litigation settlement expense of \$62.0 million recognized in the second quarter of 2018;

- higher operating income from our Chemicals Segment in 2018 compared to 2017;

• a securities transaction gain of \$12.5 million recognized in the third quarter of 2018 related to the sale of our interest in Amalgamated;

• recognition of a gain on sale of land of \$12.5 million in the first quarter of 2018;

• the third quarter 2017 recognition of an aggregate income tax benefit of \$11.3 million related to the execution and finalization of an Advance Pricing Agreement between Canada and Germany associated with our Chemicals Segment; and

• an aggregate charge of \$7.1 million recognized in the third quarter of 2017 related to the loss on prepayment of debt.

Our diluted net income per share in 2018 includes:

• a non-cash deferred income tax benefit of \$.33 per diluted share in the third quarter related to a change in the deferred income tax liability related to our investment in Kronos as a result of the 2017 Tax Act;

• a gain of \$.03 per diluted share related to a securities transaction gain recognized in the third quarter related to the sale of our interest in Amalgamated Sugar Company LLC;

• a gain of \$.03 per diluted share related to the sale of land not used in our operations; and

• a charge of \$.12 per diluted share related to the litigation settlement expense recognized in the second quarter.

Our diluted net income from continuing operations per share in 2017 includes:

• a non-cash deferred income tax benefit of \$.29 per diluted share as a result of a decrease in our deferred income tax asset valuation allowance related to our Chemicals Segment's German and Belgian operations;

• a non-cash deferred income tax benefit of \$.02 per diluted share related to the execution and finalization of an Advance Pricing Agreement between Canada and Germany associated with our Chemicals Segment; and

• an aggregate charge of \$.01 per diluted share recognized in the third quarter related to the loss on prepayment of debt; and

Current Forecast for 2018—

We currently expect our consolidated operating income for 2018 will be slightly higher as compared to 2017 primarily due to the net effects of:

• higher operating income from our Real Estate Management and Development Segment in 2018 as we anticipate increased land development activities;

• higher operating income from our Component Products Segment in 2018, principally as a result of expected higher sales in 2018; and

• slightly lower operating income from our Chemicals Segment as a result of higher operation costs and lower sales volumes in 2018 compared to 2017.

However, we currently expect to report lower net income from continuing operations attributable to Valhi stockholders for 2018 as compared to 2017, primarily because the favorable impact of slightly higher expected operating income in 2018 and the aggregate income tax benefit recognized in the third quarter of 2018 related to our investment in Kronos would be more than offset by the litigation settlement expense recognized in the second quarter of 2018 and the aggregate net income tax benefit we recognized in 2017 (mostly in the second, third and fourth quarters of 2017, as discussed in the 2017 Annual Report).

Segment Operating Results—2017 Compared to 2018 –

Chemicals –

We consider TiO₂ to be a “quality of life” product, with demand affected by gross domestic product, or GDP, and overall economic conditions in our markets located in various regions of the world. Over the long-term, we expect demand for TiO₂ will grow by 2% to 3% per year, consistent with our expectations for the long-term growth in GDP. However, even if we and our competitors maintain consistent shares of the worldwide market, demand for TiO₂ in any interim or annual period may not change in the same proportion as the change in GDP, in part due to relative changes in the TiO₂ inventory levels of our customers. We believe that our customers’ inventory levels are influenced in part by their expectations for future changes in market TiO₂ selling prices as well as their expectations for future availability of product. Although certain of our TiO₂ grades are considered specialty pigments, the majority of our grades and substantially all of our production are considered commodity pigment products, with price and availability being the most significant competitive factors along with quality and customer service.

The factors having the most impact on our reported operating results are:

- our TiO₂ sales and production volumes,
- TiO₂ selling prices,
- manufacturing costs, particularly raw materials such as third-party feedstock ore, maintenance and energy-related expenses, and
- currency exchange rates (particularly the exchange rate for the U.S. dollar relative to the euro, the Norwegian krone and the Canadian dollar).

Our Chemicals Segment’s key performance indicators are our TiO₂ average selling prices, our level of TiO₂ sales and production volumes, and the cost of our third-party feedstock ore. TiO₂ selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures.

	Three months ended September 30,			Nine months ended September 30,		
	2017	2018	% Change	2017	2018	% Change
Net sales	\$464.5	\$410.3	(12)%	\$1,275.7	\$1,312.5	3 %
Cost of sales	309.9	291.7	(6)	883.7	848.3	(4)
Gross margin	\$154.6	\$118.6	(23)	\$392.0	\$464.2	18
Operating income	\$98.4	\$61.0	(38)	\$234.7	\$295.2	26
Percent of net sales:						
Cost of sales	67 %	71 %		69 %	65	
Gross margin	33	29		31	35	
Operating income	21	15		18	22	
TiO ₂ operating statistics:						
Sales volumes*	150	123	(19)	450	385	(15)%
Production volumes*	141	131	(7)	427	400	(6)
Percent change in net sales:						
TiO ₂ product pricing			9 %			18 %
TiO ₂ sales volumes			(19)			(15)
TiO ₂ product mix			(2)			(4)

Changes in currency exchange rates	—	4
Total	(12)%	3 %

*Thousands of metric tons

Industry conditions and 2018 overview – Due to the successful implementation of previously-announced price increases, average selling prices rose throughout 2017 and the first six months of 2018. Our Chemicals Segment’s average TiO₂ selling prices at the end of 2017 were 27% higher than at the end of 2016, and our average selling prices at the end of the second quarter of 2018 were 3% higher than at the end of 2017, with most of the increase occurring during the first quarter. Our Chemicals Segment’s average selling prices declined during the third quarter of 2018. Our Chemicals Segment’s average selling prices at the end of the third quarter of 2018 were 2% lower than at the end of the second quarter of 2018, and were 1% higher than at the end of 2017. Higher prices in the European and North American markets were partially offset by lower prices in the Latin American and export markets (attributable to changes in customer mix) at the end of the third quarter of 2018 as compared to the end of 2017. Our Chemicals

- 39 -

Segment experienced lower sales volumes in all major markets in the first nine months of 2018 as compared to the record sales volumes achieved in the same period of 2017.

We operated Our Chemicals Segment's production facilities at overall average capacity utilization rates of 95% in the first nine months of 2018 compared to full practical capacity utilization rates in the first nine months of 2017. Our Chemicals Segment's production rates in the third quarter of 2018 were impacted by maintenance activities at certain facilities. The table below lists our comparative quarterly capacity utilization rates.

	Production Capacity Utilization Rates	
	2017	2018
First quarter	100%	95%
Second quarter	100%	97%
Third quarter	100%	92%

Due to a moderate rise in the cost of third-party feedstock ore we procured in 2017 and the first nine months of 2018, our Chemicals Segment's cost of sales per metric ton of TiO₂ sold in the first nine months of 2018 was higher as compared to the first nine months of 2017 (excluding the effect of changes in currency exchange rates).

Net sales – Our Chemicals Segment's net sales in the third quarter of 2018 decreased 12%, or \$54.2 million, compared to the third quarter of 2017 primarily due to the net effect of a 9% increase in average TiO₂ selling prices (which increased net sales by approximately \$42 million) and a 19% decrease in sales volumes (which decreased net sales by approximately \$88 million). TiO₂ selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Our Chemicals Segment's sales volumes decreased 19% in the third quarter of 2018 as compared to the record third quarter sales volumes of 2017 primarily due to lower sales in the European and export markets reflecting the effects of reduced shipments as customer inventory levels returned to more normal levels. In addition to the impact of changes in average TiO₂ selling prices and sales volumes, we estimate that changes in currency exchange rates (primarily the euro) had a nominal effect on our net sales as compared to the third quarter of 2017.

Our Chemicals Segment's net sales in the first nine months of 2018 increased 3%, or \$36.8 million, compared to the first nine months of 2017 primarily due to the net effect of an 18% increase in average TiO₂ selling prices (which increased net sales by approximately \$230 million) and a 15% decrease in sales volumes (which decreased net sales by approximately \$191 million). TiO₂ selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Our Chemicals Segment's sales volumes decreased 15% in the first nine months of 2018 as compared to the record first nine months of 2017 primarily due to a combination of factors including (i) lower sales in all major markets resulting from a controlled ramp-up in January 2018 as we brought the second phase of our new global enterprise resource planning system online; (ii) inventory management to assure adequate supply to our customers during the spring and summer necessitated by the lower production volumes in the first three months of the year (as discussed below); (iii) product availability in the second quarter; and (iv) customer inventory level changes in the second and third quarters as discussed above. In addition to the impact of changes in average TiO₂ selling prices and sales volumes, we estimate that changes in currency exchange rates increased our net sales by approximately \$53 million as compared to the first nine months of 2017.

Cost of Sales and Gross Margin—Our Chemicals Segment’s cost of sales decreased 6% in the third quarter of 2018 compared to the third quarter of 2017 due to the net effect of a 19% decrease in sales volumes, a 7% decrease in TiO₂ production volumes, higher raw materials and other production costs of approximately \$40 million and currency fluctuations (primarily the euro). The decrease in TiO₂ production volumes in the third quarter of 2018 compared to the production volumes in the third quarter of 2017 was primarily due to maintenance activities at certain facilities in 2018. Our Chemicals Segment’s cost of sales as a percentage of net sales increased to 71% in the third quarter of 2018 compared to 67% in the same period of 2017 as the unfavorable effects related to lower production volumes and higher raw materials and other production costs more than offset the favorable impact of higher average selling prices, as discussed above.

Gross margin as a percentage of net sales decreased to 29% in the third quarter of 2018 compared to 33% in the third quarter of 2017. As discussed and quantified above, our gross margin decreased primarily due to the net effect of higher average selling prices, lower sales and production volumes and higher raw materials and other production costs.

Our Chemicals Segment’s cost of sales decreased 4% in the first nine months of 2018 compared to the same period in 2017 primarily due to the net impact of a 15% decrease in sales volumes, 6% decrease in TiO₂ production volumes, higher raw materials and

other production costs of approximately \$75 million (primarily caused by higher third-party feedstock ore costs) and currency fluctuations (primarily the euro). The decrease in TiO₂ production volumes in the first nine months of 2018 compared to the production volumes in the first nine months of 2017 was primarily due to maintenance activities at certain facilities in 2018, and the implementation of a productivity-enhancing improvement project at our Belgian facility in the first quarter of 2018. Our Chemicals Segment's cost of sales as a percentage of net sales decreased to 65% in the first nine months of 2018 compared to 69% in the same period of 2017 as the favorable impact of higher average selling prices more than offset the unfavorable effects related to lower production volumes and higher raw materials and other production costs, as discussed above.

Gross margin as a percentage of net sales increased to 35% in the first nine months of 2018 compared to 31% in the first nine months of 2017. As discussed and quantified above, our gross margin increased primarily due to the net effect of higher average selling prices, lower sales and production volumes and higher raw materials and other production costs.

Operating Income—Our Chemicals Segment's operating income decreased 38% in the third quarter of 2018 compared to the third quarter of 2017, and operating income as a percentage of net sales decreased to 15% in 2018 from 21% in 2017. This decrease was driven by the decrease in gross margin for the quarter, discussed above. Our Chemicals Segment's operating income increased 26% in the first nine months of 2018 compared to the first nine months of 2017, and operating income as a percentage of net sales increased to 22% in 2018 from 18% in 2017. The increase was driven by the increase in gross margin for the first nine months of 2018, discussed above. We estimate that changes in currency exchange rates increased income from operations by approximately \$7 million in the third quarter of 2018 and \$26 million in the first nine months of 2018 as compared to the same periods in 2017, as discussed below. Our Chemicals Segment's operating income was also effected by increased higher general and administrative costs related to the implementation of a new accounting and manufacturing software system and higher sales support.

Our Chemicals Segment's operating income is net of amortization of purchase accounting adjustments made in conjunction with our acquisitions of interests in NL and Kronos. As a result, we recognize additional depreciation expense above the amounts Kronos reports separately, substantially all of which is included within cost of sales. We recognized additional depreciation expense of \$1.7 million in the first nine months of 2018 and \$1.6 million in the same period of 2017, which reduced our reported Chemicals Segment's operating income as compared to amounts reported by Kronos.

Currency Exchange Rates— Our Chemicals Segment has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). The majority of our Chemicals Segment's sales from non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the euro, other major European currencies and the Canadian dollar. A portion of our sales generated from our non-U.S. operations is denominated in the U.S. dollar (and consequently our non-U.S. operations will generally hold U.S. dollars from time to time). Certain raw materials used worldwide, primarily titanium-containing feedstocks, are purchased primarily in U.S. dollars, while labor and other production costs are purchased primarily in local currencies. Consequently, the translated U.S. dollar value of our non-U.S. sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect the comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, our non-U.S. operations also generate currency transaction gains and losses which primarily relate to (i) the difference between the currency exchange rates in effect when non-local currency sales or operating costs (primarily U.S. dollar denominated) are initially accrued and when such amounts are settled with the non-local currency, (ii) changes in currency exchange rates during time periods when our non-U.S. operations are holding non-local currency (primarily U.S. dollars), and (iii) relative changes in the aggregate fair value of currency forward contracts held from time to time. As discussed in Note 18 to our Condensed Consolidated Financial Statements, we periodically use currency forward contracts to manage a portion of our currency exchange risk, and relative changes in the aggregate fair value

of any currency forward contracts we hold from time to time serves in part to mitigate the currency transaction gains or losses we would otherwise recognize from the first two items described above.

Overall, we estimate that fluctuations in currency exchange rates had the following effects on the reported amounts of our Chemicals Segment's sales and operating income for the periods indicated.

Impact of changes in currency exchange rates

Three months ended September 30, 2018 vs September 30, 2017

	Transaction gains/(losses) recognized		Translation gains – impact of	Total currency impact
	2017	2018	Change	rate changes
	(In millions)			
Impact on:				
Net sales	\$-	\$-	\$ -	\$ -
Operating income	(4)	(1)	3	4
				2018 vs 2017
				7

- 41 -

Changes in currency exchange rates (primarily the euro) had a nominal effect on our Chemicals Segment's net sales as compared to the third quarter of 2017.

The \$7 million increase in income from operations was comprised of the following:

- Approximately \$3 million from net currency transaction gains primarily caused by relative changes in currency exchange rates at each applicable balance sheet date between the U.S. dollar and the euro, Canadian dollar and the Norwegian krone, which causes increases or decreases, as applicable, in U.S. dollar-denominated receivables and payables and U.S. dollar currency held by our non-U.S. operations, and
- Approximately \$4 million from net currency translation gains primarily caused by the strengthening of the U.S. dollar relative to the Canadian dollar, as its local currency-denominated operating costs were translated into less U.S. dollars in 2018 as compared to 2017 and such translation, as it related to the U.S. dollar relative to the euro, had a nominal effect on income from operations in 2018 as compared to 2017.

Impact of changes in currency exchange rates

Nine months ended September 30, 2018 vs September 30 2017

	Transaction gains/(losses) recognized		Change rate changes	Translation gains – impact of	Total currency impact
	2017	2018			
(In millions)					
Impact on:					
Net sales	\$-	\$ -	\$ -	\$ 53	\$ 53
Operating income	(8)	4	12	14	26

The \$53 million increase in net sales (translation gain) was caused primarily by a weakening of the U.S. dollar relative to the euro, as our euro-denominated sales were translated into more U.S. dollars in 2018 as compared to 2017. The weakening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2018 did not have a significant effect on the reported amount of our net sales, as a substantial portion of the sales generated by our Chemicals Segment's Canadian and Norwegian operations are denominated in the U.S. dollar.

The \$26 million increase in operating income was comprised of the following:

- Approximately \$12 million from net currency transaction gains primarily caused by relative changes in currency exchange rates at each applicable balance sheet date between the U.S. dollar and the euro, Canadian dollar and the Norwegian krone, which causes increases or decreases, as applicable, in U.S. dollar-denominated receivables and payables and U.S. dollar currency held by our non-U.S. operations, and
 - Approximately \$14 million from net currency translation gains primarily caused by a weakening of the U.S. dollar relative to the euro as the positive effects of the weaker U.S. dollar on euro-denominated sales more than offset the unfavorable effects of euro-denominated operating costs being translated into more U.S. dollars in 2018 as compared to 2017, partially offset by the weakening of the U.S. dollar relative to the Canadian dollar, as its local currency-denominated operating costs were translated into more U.S. dollars in 2018 as compared to 2017.
- Outlook— We expect our Chemicals Segment's production volumes in 2018 to be lower as compared to the record 2017 production volumes. Assuming current global economic conditions continue and based on anticipated production levels, we expect our Chemicals Segment's 2018 sales volumes to be lower as compared to record 2017 sales volumes. As expected, customer inventory level changes we experienced in the second quarter of 2018 continued into the third quarter. However, we believe customer inventory level changes were short term and worldwide demand

remains solid. We will continue to monitor current and anticipated near-term customer demand levels and align our production and inventories accordingly.

The cost of third-party feedstock ore we purchased in the first nine months of 2018 was higher as compared to the fourth quarter of 2017, and such higher cost feedstock ore was reflected in our results of operations beginning in the second quarter of 2018. We expect our Chemicals Segment's cost of sales per metric ton of TiO₂ sold in 2018 will be moderately higher than our per-metric ton cost in 2017 primarily due to higher third-party feedstock ore costs along with the unfavorable effects of lower production volumes.

Our Chemicals Segment started 2018 with average selling prices 27% higher than the beginning of 2017, and average selling prices increased by an additional 3% in the first six months of 2018 (most of which occurred in the first quarter). Average selling prices declined by 2% during the third quarter of 2018. Industry data indicates that overall TiO₂ inventory held by producers stood at

- 42 -

adequate-to-low levels in the third quarter of 2018. We expect changes in customer inventory levels to continue to decrease through the fourth quarter of 2018 which could lead to some selling price decreases during the fourth quarter of 2018.

Overall, we expect our Chemicals Segment's sales in 2018 will be comparable to 2017, as the favorable impact of expected higher average selling prices in 2018 would be offset by the unfavorable impact of expected lower sales volumes. In addition, we expect our Chemicals Segment's operating income in 2018 will be comparable to 2017, as the favorable impact of expected higher average selling prices in 2018 would be offset by the unfavorable impact of expected lower sales and production volumes and higher raw material and other production costs (principally feedstock ore).

Due to the constraints of high capital costs and extended lead time associated with adding significant new TiO₂ production capacity, especially for premium grades of TiO₂ products produced from the chloride process, we believe increased and sustained profit margins will be necessary to financially justify major expansions of western producers' TiO₂ production capacity required to meet expected future growth in demand. Any such major expansion of TiO₂ production capacity, if announced, would take a number of years before such production would become available to meet future growth in demand. Certain Chinese producers have recently announced expansion plans, but the extent to which such expansion plans will be implemented, or if implemented the resulting additional capacity and the timing thereof is uncertain.

Our expectations for our future operating results are based upon a number of factors beyond our control, including worldwide growth of gross domestic product, competition in the marketplace, continued operation of competitors, unexpected or earlier-than-expected capacity additions or reductions and technological advances. If actual developments differ from our expectations, our results of operations could be unfavorably affected.

Component Products –

Our Component Products Segment's product offerings consist of a significantly large number of products that have a wide variation in selling price and manufacturing cost, which results in certain practical limitations on our ability to quantify the impact of changes in individual product sales quantities and selling prices on our net sales, cost of sales and gross margin. In addition, small variations in period-to-period net sales, cost of sales and gross margin can result from changes in the relative mix of our products sold. The key performance indicator for our Component Products Segment is operating income margins.

	Three months ended September 30,		% Change	Nine months ended September 30,		% Change
	2017	2018		2017	2018	
Net sales	\$26.9	\$ 30.0	11 %	\$86.9	\$ 90.8	4 %
Cost of sales	18.8	20.4	9	59.6	60.5	2
Gross margin	\$8.1	\$ 9.6	17	\$27.3		

Location	Use	Approximate Square Footage	Lease Expiration
----------	-----	----------------------------------	---------------------

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Beverly Hills, CA	Corporate Headquarters	16,000	12/31/2016
Austin, TX	Regional Office; Disaster Recovery Office	6,864	3/31/2012

Legal Proceedings

Kennedy-Wilson may be involved in various legal proceedings arising in the ordinary course of business, none of which is material to its business. From time to time, Kennedy-Wilson's real estate management division is named in "slip and fall" type litigation relating to buildings it manages. Kennedy-Wilson's standard management agreement contains an indemnity provision whereby the building owner indemnifies and agrees to defend its real estate management division against such claims. In such cases, Kennedy-Wilson is defended by the building owner's liability insurer.

Table of Contents**Management**

The current directors and executive officers of Kennedy-Wilson are as follows:

Name	Age	Position
William J. McMorrow	62	Chairman and Chief Executive Officer
Mary Ricks	45	Co-CEO of KW Commercial Investment Group
Freeman A. Lyle	54	Executive Vice President and Chief Financial Officer
Barry S. Schlesinger	68	Co-CEO of KW Commercial Investment Group
James A. Rosten	51	President of Kennedy-Wilson Properties
Robert E. Hart	51	President of KW Multi-Family Management Group
Donald J. Herrema	57	Executive Vice Chairman and CEO of KW Capital Markets
Kent Mouton	55	Director
Jerry R. Solomon	58	Director
Norm Creighton	74	Director
Thomas Sorell	54	Director
Jeff Hudson*	57	Director
Cathy Hendrickson	62	Director

*

Jeff Hudson will resign upon consummation of the merger. It is proposed that David A. Minella will be elected to fill the vacancy caused by Mr. Hudson's resignation.

See the section entitled "*The Director Election Proposal Information About the Nominees and Executive Officers*" on page 187 for a brief description of the business experience of each Kennedy-Wilson executive officer and director that is expected to be appointed or elected as an executive officer or director of the post-merger company.

Table of Contents

**KENNEDY-WILSON'S MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with the financial statements and related notes and the other financial information appearing elsewhere in this proxy statement/prospectus. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. See the section entitled "Forward-Looking Statements" on page 15 for more information. Actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including those discussed in "Risk Factors" on page 46 and elsewhere in this proxy statement/prospectus.

In the interest of providing a more complete presentation of Kennedy-Wilson's financial performance since its inception in 1977, this discussion and analysis includes comparisons of: Kennedy-Wilson's consolidated financial results for the six months ended June 30, 2009 as well as Kennedy-Wilson's results for the period from 2006 through 2008.

Overview

Founded in 1977, Kennedy-Wilson is a diversified, international real estate company that provides investment and real estate services. Kennedy-Wilson has grown from an auction business in one office into a vertically-integrated operating company with over 300 professionals in 21 offices throughout the U.S. and Japan. Kennedy-Wilson is an industry leader, currently owning real estate (through its closed-end funds and joint ventures) and managing over 40 million square feet of residential, multifamily and commercial real estate, including 10,000 apartment units, throughout the U.S. and Japan. Kennedy-Wilson's operations are defined by two core business units: KW Investments and KW Services.

When reading Kennedy-Wilson's financial statements and the information included in this section, it should be considered that Kennedy-Wilson has experienced, and continues to experience, the same material trends that have affected the nation, and therefore, Kennedy-Wilson's operations and financial condition. It is, therefore, a challenge to predict Kennedy-Wilson's future performance based on its historical results, but Kennedy-Wilson believes that the following material trends assist in understanding the variability of its historical earnings and cash flows and the potential for the future:

Macroeconomic Conditions

Kennedy-Wilson's business is closely tied to general economic conditions and the real estate industry. As a result, Kennedy-Wilson's economic performance, the value of its real estate and real estate secured notes, and its ability to implement its business strategies may be affected by changes in national and local economic conditions. The condition of the real estate markets in which Kennedy-Wilson operates tends to be cyclical and related to the condition of the economy in the U.S. and Japan as a whole and to the perceptions of investors of the overall economic outlook. Rising interest rates, declining demand for real estate or periods of general economic slowdown or recession have had a direct negative impact on the real estate market in the past and a recurrence of these conditions in the U.S. or a deeper recession in Japan could result in a reduction in Kennedy-Wilson's revenues. In addition, the economic condition of each local market where Kennedy-Wilson operates may be dependent on one or more industries.

Kennedy-Wilson has experienced in past years, is currently experiencing, and expects in the future to be negatively impacted by, periods of economic slowdown or recession, and corresponding declines in the demand for real estate and related services, within the markets in which it operates. The current economic recession has been extraordinary for its worldwide scope, its severity and its impact on major financial institutions, among other aspects. The current recession and the downturn in the real estate market have resulted in and/or may continue to result in: a general decline in rents due to defaulting

Table of Contents

tenants or less favorable terms for renewed or new leases; fewer purchases and sales of properties by clients, resulting in a decrease in property management fees and brokerage commissions; a decline in actual and projected sale prices of Kennedy-Wilson's properties resulting in lower returns on the properties in which it has invested; higher interest rates, higher loan costs, less desirable loan terms and a reduction in the availability of mortgage loans and mezzanine financing, all of which could increase costs and could limit Kennedy-Wilson's ability to acquire additional real estate assets; and a decrease in the availability of lines of credit and other sources of capital used to purchase real estate investments and distressed notes.

Beginning in 2003, economic conditions in the United States rebounded from the economic downturn in 2001 and 2002. The recovery, which positively impacted the commercial and residential real estate markets generally, continued through the second quarter of 2007, helping to improve the revenue in the Kennedy-Wilson services segment, particularly leasing and brokerage revenue. Improved economic conditions also resulted in a general increase in transaction activity, higher occupancy levels, rental rates, and property values, helping to increase the income in the Kennedy-Wilson investments segment as several of its real estate investments were sold.

Since the third quarter of 2007, U.S. economic activity has progressively weakened due initially to stresses in the residential housing and financial sectors and the impact of sharply higher energy costs. The weakening economic activity developed into a recession, affecting all segments of the economy, in early 2008, as both consumer and business spending dropped. This weakening economic activity, coupled with capital market stresses, led to a global financial disruption in the third quarter of 2008, the consequences of which have continued through the first half of 2009. This disruption caused credit markets to freeze up, investors to become more risk averse and assets of all types, from the riskiest to the most secure, to lose value. These conditions also caused the economy to contract further and job losses to accelerate throughout 2008 and continuing through the first half of 2009. This has resulted in a decline in leasing activity and space absorption, rising vacancy rates and decreasing rents across the United States, which in turn, has reduced Kennedy-Wilson's services revenue, particularly leasing and brokerage revenue. Investment sales activity in the United States has been falling sharply from peak levels in 2007 and has continued to decline through the second quarter of 2009. This decline is the result of an absence of debt financing, weakening property fundamentals, and the re-pricing of risk in the face of economic and market uncertainty. The deteriorating conditions adversely affected Kennedy-Wilson's investments segment throughout 2008 as property values decreased sharply and disposition opportunities were markedly reduced.

The current economic downturn has also significantly affected countries throughout Asia, including Japan. The worldwide recession has led to falling stock prices and asset values in Asia and reduced economic growth prospects in Asia. Several property markets in Asia have been affected by real estate developments that resulted in an oversupply of completed or partially completed space. Property prices have fallen along with prices of other investments and asset values. These conditions have resulted in a decline in Kennedy-Wilson's investment sales and investment activities in Japan beginning in late 2008 and continuing throughout the first half of 2009.

A rebound of Kennedy-Wilson's services and investments segments is expected, but contingent on, among other things, the U.S. and Japanese economies resuming their growth and credit markets attaining stability and predictability over a sustained period. Kennedy-Wilson is sensitive to the challenges of the current economic climate and as a vertically integrated company, Kennedy-Wilson has the in-house expertise and skill sets to navigate through these challenging times by taking advantage of opportunities in real estate and the capital markets. Kennedy-Wilson has been implementing and continues to implement cost-savings measures across its business lines to maximize its competitive position.

Table of Contents

International Operations

Kennedy-Wilson has made investments in Asia, particularly in Japan, and plans to expand its operations and investments in Japan and selected markets throughout Asia in the future. If Kennedy-Wilson is successful in implementing this strategy, the increased scope of its international operations may lead to more volatile financial results and difficulties in managing its businesses. This volatility and difficulty could be caused by, among other things, the following: currency fluctuations, restrictions and problems relating to the repatriation of profits; difficulties and costs of staffing and managing international operations; the burden of complying with multiple and potentially conflicting laws; laws restricting foreign companies from conducting business and unexpected changes in regulatory requirements; the impact of different business cycles and economic instability; political instability and civil unrest; greater difficulty in perfecting its security interests, collecting accounts receivable, foreclosing on security and protecting its interests as a creditor in bankruptcies in certain geographic regions; potentially adverse tax consequences; share ownership restrictions on foreign operations; Japanese property and income taxes, tax withholdings and tariffs; and geographic, time zone, language and cultural differences between personnel in different areas of the world.

Kennedy-Wilson's revenues from non-U.S. operations have been primarily denominated in the local currency where the associated revenues were earned. Thus, Kennedy-Wilson may experience significant fluctuations in revenues and earnings because of corresponding fluctuations in foreign currency exchange rates. To date, Kennedy-Wilson's foreign currency exposure has been limited to the Japanese Yen. Due to the constantly changing currency exposures to which Kennedy-Wilson will be subject and the volatility of currency exchange rates, there can be no assurance that Kennedy-Wilson will not experience currency losses in the future, nor can Kennedy-Wilson predict the effect of exchange rate fluctuations upon future operating results. Kennedy-Wilson's management may decide to use currency hedging instruments from time to time including foreign currency forward contracts, purchased currency options (where applicable) and foreign currency borrowings. The economic risks associated with these hedging instruments include unexpected fluctuations in inflation rates, which could impact cash flow relative to paying down debt, and unexpected changes in Kennedy-Wilson's underlying net asset position. There can be no assurance that any hedging will be effective.

Acquisitions, Dispositions, and Financings

Acquisitions

During the six months ended June 30, 2009, Kennedy-Wilson completed the following acquisition transactions:

In June 2009, Kennedy-Wilson acquired 149 condominiums for \$33.5 million in a renovated condominium tower in Los Angeles, California.

In May 2009, Kennedy-Wilson purchased 38 acres of land in Shreveport, Louisiana for \$2.25 million. This property will be part of a 50 acre mixed use, multi-purpose development project.

Dispositions

During the six months ended June 30, 2009, Kennedy-Wilson completed the following disposition transactions:

In May 2009, Kennedy-Wilson sold a multifamily property in Napa, California to KW Property Fund III for a contract price of \$6.8 million. The property was originally owned in a joint venture partnership between Kennedy-Wilson and Hanover Financial. In December 2008, Kennedy-Wilson acquired Hanover's interest in the property.

Table of Contents

In March 2009, Kennedy-Wilson sold 136 vacant, finished lots in Lancaster, California for \$6.3 million to KW Property Fund III. The lots are planned for single family detached homes.

Financings

During 2008, Kennedy-Wilson issued 53,000 shares of Series A Preferred Stock. The holders of the Series A Preferred Stock are entitled to receive dividends quarterly at a per annum rate equal to 7% of the liquidation value of \$1,000 per share. The Series A Preferred Stock is senior to all other existing classes and series of shares of stock of Kennedy-Wilson upon dissolution, liquidation, or winding up, to the extent of the aggregate liquidation value and all accrued but unpaid dividends. The Series A Preferred Stock must be converted into shares of Kennedy-Wilson's common stock at any time on or prior to the third annual anniversary, May 2011 through September 2011, of the latest date of the original issuance of any Series A Preferred Stock at a conversion price of \$42 per share of common stock. The proceeds from the issuance of the Series A Preferred Stock were \$52,354,000, net of expenses related to the offering totaling \$646,000.

Kennedy-Wilson has entered into a loan agreement with US Bank and East-West Bank that provides Kennedy-Wilson with an unsecured revolving credit facility for use in acquisitions and for working capital purposes in the amount of \$30 million. The loan bears interest at a range of rates from prime to prime plus 0.50%, or, at the borrower's option, LIBOR plus 2.50% to LIBOR plus 3.00%. During the six months ended June 30, 2009, the average outstanding borrowings under the line of credit were \$20,903,000 with the high and low outstanding balances being \$26 million and \$12 million, respectively. The borrowings under this loan had interest rates ranging from 3.31% to 3.75% and 3.75% to 5.50% at June 30, 2009, and December 31, 2008, respectively. The principal amount outstanding under this loan was \$26,000,000 at June 30, 2009 and \$13,500,000 at December 31, 2008. The loan matures in June 2011.

In November 2008, Kennedy-Wilson issued a convertible subordinated note with a principal amount of \$30 million to Guardian. The note bears interest at a fixed rate of 7%. Interest is payable quarterly with the outstanding principal due in November 2018. The holder of the note may convert the note, in whole or in part, into common stock of Kennedy-Wilson at a conversion price of \$40 per share of common stock at any time prior to the tenth anniversary of the original issue date of the note. On October 8, 2009, Kennedy-Wilson and Guardian entered into a letter agreement pursuant to which the parties agreed to amend the Guardian Note, effective only if the merger consummated, to change the conversion price to \$37.50 per share and the expiration date for the conversion period to May 3, 2017. At any time on or after the ninth anniversary of the original issue date of the note and prior to the due date, Kennedy-Wilson may demand that the holder of the note convert the note in accordance with the terms of the note.

In 2007, Kennedy-Wilson issued junior subordinated debentures with an aggregate principal amount of \$40 million. The debentures were issued to a trust established by Kennedy-Wilson, which contemporaneously issued \$40 million of trust preferred securities to Merrill Lynch International. The interest rate on the debentures is fixed for the first ten years at 9.06%, and variable thereafter at LIBOR plus 3.70%. Interest is payable quarterly with the principal due in 2037.

Critical Accounting Policies

Basis of Presentation The consolidated financial statements include the accounts of Kennedy-Wilson and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. In addition, Kennedy-Wilson evaluates its relationships with other

Table of Contents

entities to identify whether they are variable interest entities as defined by FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities, or FIN 46R, and to assess whether it is the primary beneficiary of such entities. If the determination is made that Kennedy-Wilson is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46R.

Revenue Recognition Management and leases fees and commissions revenues are accounted for in accordance with the provisions of SEC Staff Accounting Bulletin 104. Management fees for property and asset management are recognized over time as earned based upon the terms of the management agreement.

Leasing fees that are payable upon tenant occupancy, payment of rent or other events beyond Kennedy-Wilson's control are recognized upon the occurrence of such events. In the case of real estate sales commissions, this generally occurs when escrow closes. In accordance with EITF 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, Kennedy- Wilson records commission revenues and expenses on a gross basis. Of the criteria listed in the EITF, Kennedy-Wilson is the primary obligor in the transaction, does not have inventory risk, performs all, or part, of the service, has credit risk, and has wide latitude in establishing the price of services rendered and discretion in selection of agents and determination of service specifications.

Sales of real estate are recognized at the close of escrow when title to the real property passes to the buyer. Kennedy-Wilson follows the requirements for profit recognition as set forth by Statement of Financial Accounting Standards No. 66, Accounting for Sales of Real Estate.

In accordance with SEC Staff Accounting Bulletin No. 51, or SAB 51, Kennedy-Wilson records gains as a result of equity transactions by its subsidiaries in the consolidated statements of operations.

Investments in Joint Ventures Kennedy-Wilson has a number of joint venture interests, generally ranging from 5% to 50%, that were formed to acquire, manage, develop and/or sell real estate. Investments in joint ventures which Kennedy-Wilson does not control are accounted for under the equity method of accounting as Kennedy-Wilson can exercise significant influence, but does not have the ability to control the joint venture. An investment in joint ventures is recorded at its initial investment plus or minus Kennedy-Wilson's share of undistributed net income or loss and less distributions. Declines in value of Kennedy-Wilson's investment in joint ventures that are other than temporary are recognized when evidence indicates that such a decline has occurred.

Profit on the sales of real estate held by joint ventures that have continuing involvement are deferred until such time that the continuing involvement has been resolved and all the risks and rewards of ownership have passed to the buyer. Profit on sales to joint ventures in which Kennedy-Wilson retains an equity ownership interest results in partial sales treatment in accordance with the provisions of SFAS 66 and Statement of Position 78-9, thus deferring a portion of the gain on Kennedy-Wilson's continuing ownership percentage in the joint ventures.

One of Kennedy-Wilson's investments in joint ventures, KW Property Fund III, L.P. is, for GAAP purposes, an investment company under the AICPA Audit and Accounting Guide Investment Companies. Thus, the fund reflects its investments at fair value, with unrealized gains and losses resulting from changes in fair value reflected in earnings. Kennedy-Wilson has retained the specialized accounting for the fund pursuant to EITF Issue No. 85-12, Retention of Specialized Accounting for Investments in Consolidation in recording its equity in joint venture income from the fund.

Fair Value Measurements On January 1, 2008, Kennedy-Wilson adopted the provisions of FASB Statement No. 157, Fair Value Measurements, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. Statement 157 defines fair value

Table of Contents

as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement 157 also establishes a framework for measuring fair value and expands disclosures about fair value measurements.

Goodwill Goodwill results from the difference between the purchase price and the fair value of net assets acquired based upon the purchase method of accounting for business combinations. In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, or SFAS 142, goodwill is no longer amortized, but instead is reviewed for impairment at least annually by Kennedy-Wilson management. In testing for impairment in accordance with SFAS 142, goodwill is assigned to the reporting unit based upon the amount of goodwill generated at the time of acquisition of the businesses by the reporting unit. An earnings multiple appropriate to the respective reporting unit was applied to the cash basis net operating income of the reporting unit. This process enables a fair approximation of the reporting unit's value, which is then compared to the net book value of the reporting unit. As a result of the evaluation performed of its goodwill as described above, Kennedy-Wilson has determined that there was no goodwill impairment as of December 31, 2008.

Long-Lived Assets Kennedy-Wilson reviews its long-lived assets (excluding goodwill) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards No. 144 Accounting for Impairment or Disposal of Long-Lived Assets. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Discontinued Operations Kennedy-Wilson presents components as discontinued operations if the operations and cash flows of the component have been or will be eliminated from the ongoing operations in a disposal transaction where Kennedy-Wilson will not have any significant continuing involvement in the operations of the component after the disposal transaction. A component comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of Kennedy-Wilson. Because each of its real estate assets generally constitutes a discrete subsidiary, many assets that Kennedy-Wilson holds for sale in the ordinary course of business must be reported as a discontinued operation unless it has significant continuing involvement in the operations of the asset after its disposition. Furthermore, operating profits and losses on such assets are required to be recognized and reported as operating profits and losses on discontinued operations in the periods in which they occur. Interest expense is only allocated to discontinued operations to the extent that the interest is specific to the component.

Share-Based Payment Arrangements Kennedy-Wilson accounts for its share-based payment arrangements under the provisions of FASB Statement No. 123(R), Share-Based Payments. The statement requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the share-based award. The cost of employee services is recognized over the period during which an employee provides service in exchange for the share-based payment award.

Fair Value Option Effective January 1, 2008, Kennedy-Wilson adopted the provisions of FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, or Statement 159. Statement 159 gives Kennedy-Wilson the irrevocable option to report most financial assets and financial liabilities at fair value on an instrument-by-instrument basis, with changes in fair value.

Table of Contents

Income Taxes Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Beginning with the adoption of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, as of January 1, 2007, Kennedy-Wilson recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Prior to the adoption of FIN 48, Kennedy-Wilson recognized the effect of income tax positions only if such positions were probable of being sustained. There was no impact upon adoption. Kennedy-Wilson records interest related to unrecognized tax benefits in interest expense and penalties in selling, general, and administrative expenses.

Results of Operations

The following compares results of operations for the periods ending June 30, 2009 and June 30, 2008, as well as the years ended 2008, 2007, and 2006.

Kennedy-Wilson Consolidated Financial Results and Comparison of six months ended June 30, 2009 and six months ended June 30, 2008

Kennedy-Wilson's revenues for the six months ended June 30, 2009 and six months ended June 30, 2008 were \$19.3 million and \$16.5 million, respectively. Total operating expenses for the same periods were \$20.6 million and \$14.7 million, respectively. Net loss attributable to the Kennedy-Wilson common stockholders was \$6.4 million for the six months ended June 30, 2009 compared to net loss of \$0.2 million attributable to the Kennedy-Wilson common stockholders for the six months ended June 30, 2008.

*Revenues*Services Segment Revenues

In the six months ended June 30, 2009, management and leasing generated revenues of \$9.3 million (including related party fees of \$2.7 million), representing 48% of Kennedy-Wilson's total revenue, compared to approximately \$8.3 million (including approximately \$3.9 million in related party fees) and 48% of total revenue in the six months ended June 30, 2008. Comparing the two six-month periods, management and leasing fees increased 11% primarily due to increased asset management fees associated with KW Property Funds II and III. Management and leasing fees include asset management, construction management, leasing services, engineering and other services to property owners.

Commissions revenues in the six months ended June 30, 2009 decreased to \$2.5 million (including approximately \$0.3 million in related party fees), representing 13% of total revenues compared to commission revenues in the six months ended June 30, 2008 of \$7.1 million (including related party fees of approximately \$2.9 million). Acquisition fees decreased \$3.6 million in the six months ended June 30, 2009 as compared to the six months ended June 30, 2008. The decrease can be attributed primarily to the current disarray in the debt and equity markets, which has caused a reduction in the acquisition of commercial and apartment properties and the related acquisition fees. Kennedy-Wilson's

Table of Contents

brokerage activities provide clients and Kennedy-Wilson with development and implementation of marketing plans, sealed bid auctions and open bid auctions.

Investments Segment Revenues

Rental income increased 22% to \$1.3 million in the six months ended June 30, 2009 from \$1.0 million in the six months ended June 30, 2008. Rental income includes rental and other income from properties in which Kennedy-Wilson holds a controlling interest. The acquisition of an office property in Japan in 2008 was the main cause for the increase in rental income.

Sale of real estate for the six months ended June 30, 2009 produced gross revenue of \$6.3 million related to the sale of land in southern California to KW Property Fund III. Kennedy-Wilson has a 5% investment in KW Property Fund III.

Operating Expenses

Operating expenses in the six months ended June 30, 2009 were approximately \$20.6 million, representing a 40% increase over \$14.7 million in the six months ended June 30, 2008. This increase was due to the cost of real estate sold associated with the sale of land in southern California.

Services Segment Operating Expenses

Commissions and marketing expenses increased to \$1.4 million in the six months ended June 30, 2009 from \$1.1 million in the six months ended June 30, 2008. The increase in commission expense corresponds to the higher percentage of auction fees in commission revenues in the first six months of 2009 compared to 2008, which incur the majority of commission expenses. As noted above, commission revenue for the first six months of 2008 included a greater component of acquisition fees, which incur a relatively minor portion of expenses.

Compensation and related expenses were approximately \$7.9 million in the six months ended June 30, 2009, down 9% from \$8.6 million in the six months ended June 30, 2008. The change was due primarily to the decrease in bonuses due to the decline in operating results as well as the reduction of staff during the first half of 2009.

General and administrative expenses were \$1.6 million in the six months ended June 30, 2009, representing a 20% decrease from expenses of \$2.0 million in the six months ended June 30, 2008. The change was primarily attributable to the implementation of cost cutting measures. Additionally, the acquisition of four commercial properties in the Los Angeles area increased the payroll reimbursements for property management services.

Investments Segment Operating Expenses

Rental operating expenses in the six months ended June 30, 2009 and 2008 were approximately \$0.7 million and \$0.3 million, respectively. Rental operating expense includes operating expenses from properties, in which Kennedy-Wilson holds a controlling interest. The increase of 114% can be attributed to the operating expense from a condominium project that was acquired in June 2009 and a large apartment project acquisition in February 2008. The apartment project was included for six months in 2009 in comparison to four and a half months in 2008.

Cost of real estate sold was \$5.8 million for the six months ended June 30, 2009 and relates to the disposition of land in southern California and the sale of an apartment building in northern California. Cost of real estate sold was zero for the six months ended June 30, 2008 as Kennedy-Wilson did not recognize any sales outside of joint venture partnerships.

Table of Contents

Other Operating Expenses

Other operating expenses were \$2.5 million in the six months ended June 30, 2009, up 43% from \$1.8 million in the six months ended June 30, 2008. The increase resulted primarily from an expense of \$0.6 million related to stock options granted during 2009.

Depreciation and amortization expense decreased to \$0.4 million in the six months ended June 30, 2009, a 12% decrease from \$0.5 million in the six months ended June 30, 2008. The change was primarily due to the sale of an office building in southern California in 2008.

Investments Segment Equity in Joint Venture Income

Investments in joint ventures generated a loss of \$0.5 million during the six months ended June 30, 2009, a decrease of 130% from income of \$1.5 million recorded in the six months ended June 30, 2009. Kennedy-Wilson sold two assets during the first six months of 2008 as compared to one sale during the same period of 2009.

Non-Operating Items

Interest and other income was \$0.2 million in the six months ended June 30, 2009, compared to \$0.5 million in the six months ended June 30, 2008. The change was due to lower interest income on bank and escrow deposits, which resulted from decrease in interest rates. In addition, a note receivable was paid off in the first half of 2008.

Interest expense was \$5.1 million in the six months ended June 30, 2009, an increase of 49% compared to \$3.4 million in the six months ended June 30, 2008. The increase was due, in part, to the debt service of approximately \$1.0 million on a \$30 million subordinate convertible loan originated in November 2008. Additionally, the interest expense increased by approximately \$0.4 million 2009 for two assets, in which Kennedy-Wilson holds a controlling interest.

Other than temporary impairment on available-for-sale security of \$0.3 million represents the write-down of the value of a stock investment during the six months ended June 30, 2009. There was no write-down during the six months ended June 30, 2008.

The benefit from income taxes was approximately \$2.2 million for the six months ended June 30, 2009, compared to the income tax provision of approximately \$0.2 million for the six months ended June 30, 2008. The change was due to change in income before provision for income taxes.

Income of approximately \$0.3 million attributable to a non-controlling interest in three properties was recognized for the six months ended June 30, 2009.

Kennedy-Wilson Consolidated Financial Results and Comparison of years ended December 31, 2008 and 2007

Notwithstanding the current disarray in the capital markets, especially the debt and equity markets that most significantly affect real estate, Kennedy-Wilson is uniquely positioned because it is a full service real estate operating company to take advantage of the opportunities arising from the current economic difficulties that affect real estate. In 2008, the general shortage of available equity and debt, was overcome through Kennedy-Wilson's extensive relationships in the capital markets that allowed Kennedy-Wilson to place debt for those properties that met Kennedy-Wilson's criteria as appropriate and potentially profit producing investments. This ability to properly provide for the capitalization of investments made available to Kennedy-Wilson, through its extensive relationships in the real estate markets, enables Kennedy-Wilson to acquire well located, income producing properties that are not distressed from owners that have distressed financial positions. Current economic conditions have not only made available to Kennedy-Wilson excellent buying opportunities but also have provided additional opportunities for our real estate service groups such as our auction group and our asset and property management divisions where experience and professional excellence is being sought by

Table of Contents

distressed real estate owners. Kennedy-Wilson is sensitive to the challenges of the current economic climate and as a vertically intergraded company, Kennedy-Wilson has the in-house expertise and skill sets to navigate through these challenging times by taking advantage of opportunities in real estate and the capital markets. Kennedy-Wilson has been implementing and continues to implement cost-savings measures across its business lines to maximize its competitive position.

Kennedy-Wilson's revenues for the year ended December 31, 2008 and the year ended December 31, 2007 were \$32.2 million and \$33.4 million, respectively. Total operating expenses for the same periods were \$32.6 million and \$43.2 million, respectively. Operating income included equity in income of joint ventures of \$10.1 million for 2008 and \$27.4 million for 2007. Net loss attributable to the Kennedy-Wilson common stockholders in 2008 was \$1.7 million compared to net income attributable to the Kennedy-Wilson common stockholders of \$9.4 million in 2007.

Revenue

Services Segment Revenues

In 2008, management and leasing generated revenue of \$19.1 million (including related party fees of \$8.4 million), representing 59% of Kennedy-Wilson's total revenue, compared to approximately \$20.1 million (including related party fees of approximately \$10.3 million) and 60% of total revenue in 2007. Management and leasing fees include asset management, construction management, leasing services, engineering and other services to property operators. Management fees and leasing fees in aggregate decreased by approximately 5% primarily due to the decrease in the total number of multifamily properties under management. Lower interest rates and favorable loan terms resulted in increased number of building sale transactions in 2007, including some of the buildings managed by Kennedy-Wilson. Construction management fees declined primarily due to completion of major renovation projects.

Commission revenues in 2008 decreased 22% to \$10.2 million (including approximately \$4.3 million in related party fees), representing 32% of total revenues compared to commission revenues in 2007 of \$13.2 million (including related party fees of approximately \$8.9 million). Kennedy-Wilson's brokerage activities provide clients and Kennedy-Wilson with development and implementation of marketing plans, sealed bid auctions and open bid auctions. The increase in auction activity resulted in an increase of residential commissions of approximately \$1.5 million in 2008. The decrease in transaction activity across all commercial asset classes led to a decrease of approximately \$4.4 million in acquisition, disposition, and financing fees.

Investments Segment Revenues

Rental income increased to \$2.4 million in 2008 from \$100,000 in 2007. Rental income was 8% of total revenue in 2008. Rental income includes rental and other revenue from properties, in which Kennedy-Wilson has a controlling interest. The acquisition of several assets, including an office building in Japan and an apartment project in California, was the main cause for the increase in rental income.

Interest and other income totaled \$0.6 million in 2008, compared to no income in 2007. The change can be attributed to the gain on sale of Kennedy-Wilson's membership interest in an office building in southern California. Kennedy-Wilson has continued to provide property management service to the property after the sale and is, therefore, not included in discontinued operations.

Operating Expenses

Operating expenses in 2008 were approximately \$32.6 million, representing a decrease of 25% from \$43.2 million in 2007. The decrease in operating expenses was primarily due to decrease in compensation and related expenses.

Table of Contents

Services Segment Operating Expenses

Commissions and marketing expenses increased to \$2.8 million in 2008 from \$2.1 million in 2007. While most commission and marketing expenses decreased due to decreased commercial transactions, the auction commission and business development expenses combined increased by approximately \$1 million.

Compensation and related expenses were approximately \$16.9 million in 2008, up 8% from \$15.6 million in 2007. The change was primarily a result of increase in staff to meet the needs of the increased residential auction and fund management activities.

General and administrative expenses were \$4.0 million in 2008, representing a 19% decrease from 2007 expenses of \$4.9 million. The change was primarily due to the implementation of cost cutting measures in 2008.

Investments Segment Operating Expenses

Rental operating expense increased to \$1.5 million in 2008 from \$34,000 in 2007. Rental operating expense includes operating expenses from properties, in which Kennedy-Wilson has controlling interest. The acquisition of several assets, including an office building in Japan and an apartment project in California, was the main cause for the increase in rental operating expense.

Depreciation and amortization expense was \$0.7 million in 2008, compared to \$22,000 in 2007. The change was due to the acquisition of an apartment project in California.

Other Operating Expenses

Other operating expenses were approximately \$5.7 million in 2008, down 71% from \$19.7 million in 2007. The change was primarily due to the decrease in bonuses, which resulted from the decline in operating results in 2008.

Investments Segment Equity in Joint Venture Income

Equity in joint venture income totaled approximately \$10.1 million in 2008, a decrease of 63% compared to \$27.4 million recognized in 2007. The revenue from joint venture investments includes income from the operation and sale of numerous real estate investments in the U.S. which are owned primarily in joint ventures with institutional investor partners. Six residential investments and one commercial investment were sold in 2008 as compared to ten residential investments, two commercial investments, and one land investment sold in 2007.

Investments Segment Non-Operating Items

Interest expense was \$2.0 million in 2008 compared to \$0.3 million in 2007. The increase was primarily due to the acquisition of several assets, including an office building Japan and apartment project in California in 2008.

Other Non-Operating Items

Other non-operating items were \$6.1 million in 2008, an increase of 56% compared to \$3.9 million in 2007. The change was primarily due to \$0.3 million in additional debt service under a junior subordinated note and debt service of \$1.3 million for a new \$15 million loan.

Other-than-temporary impairment on available-for-sale security, loss was \$0.4 million and relates to Kennedy-Wilson's recognition of an impairment loss on a stock investment in 2008. There was no impairment loss or income recognized in 2007.

The provision for income taxes was approximately \$0.6 million for 2008 compared to \$4.4 million in 2007 as a result of the change in income before provision for income taxes.

Table of Contents

Outside of joint ventures, there were no sales of real estate in 2008. In 2007, Kennedy-Wilson executed the sale of a commercial project in southern California for \$39.4 million. Income from discontinued operations included the net gain of \$2.8 million from this sale.

Net income attributable to the noncontrolling interests was approximately \$54,000 in 2008, a decrease of approximately 98% compared to approximately \$2.4 million in 2007. The decrease was related to a non-controlling interest in a commercial project in southern California, which was sold in 2007.

Kennedy-Wilson Consolidated Financial Results and Comparison of years ended December 31, 2007 and 2006

Kennedy-Wilson's revenues for the year ended December 31, 2007 and the year ended December 31, 2006 were \$33.4 million and \$26.5 million, respectively. Total operating expenses for the same periods were \$43.2 million and \$34.6 million, respectively. Operating income included equity in income of joint ventures of \$27.4 million for 2007 and \$14.7 million for 2006. Net income attributable to the Kennedy-Wilson common stockholders for the same periods was \$9.4 million and \$6.0 million, respectively.

Revenues

Services Segment Revenues

In 2007, management and leasing generated revenue of \$20.1 million (including related party fees of \$10.2 million), representing 60% of Kennedy-Wilson's total revenue, compared to \$16.6 million (including related party fees of \$8.2 million) and 63% of total revenue in 2006. Management and leasing fees include asset management, construction management, leasing services, engineering and other services to property operators. Management and leasing fees increased approximately 21% in 2007 due to increased fees earned by the property management group of \$1.5 million, the asset management fees from a newly formed real estate fund and a disposition fee in 2007 of \$1.4 million on the sale of a commercial property in southern California.

Commission revenues in 2007 increased 33% to \$13.2 million (including related party fees of \$8.9 million), representing 39% of total revenues compared to commission revenues in 2006 of \$9.9 million (including related party fees of approximately \$7.9 million). Kennedy-Wilson's brokerage activities provide clients and Kennedy-Wilson with development and implementation of marketing plans, sealed bid auctions and open bid auctions. Increased residential auction activity raised residential commission revenues by approximately \$2.4 million in 2007. Commercial commissions also increased by nearly \$0.5 million in 2007 due to acquisition and financing fees for several large transactions.

Investments Segment Revenues

Rental income increased to \$100,000 in 2007 from zero in 2006. Rental income includes rental and other income from properties, in which Kennedy-Wilson held a controlling interest. The acquisition of a commercial property in southern California contributed to the increase in rental income.

There was no interest and other income in 2007, compared to \$0.5 million in 2006. The change was primarily due to the decrease in the discounted note pool interest income as the investment activity slowed.

Operating Expenses

Operating expenses in 2007 were approximately \$43.2 million, representing an increase of 25% from \$34.6 million in 2006. The increase was primarily due to an increase of compensation and related expenses by approximately \$9.3 million.

Table of Contents

Services Segment Operating Expenses

Commissions and marketing expenses increased to \$2.1 million in 2007 from \$1.8 million in 2006. While the property management group commission and marketing expenses fell by approximately \$0.3 million in 2007, the overall increase is primarily due to an increase of auction commission and marketing expenses of \$0.6 million in 2007.

Compensation and related expenses were approximately \$15.6 million in 2007, up 16% from \$13.5 million in 2006. The increase was primarily due to higher bonus accrual, which resulted from the increase in operating results in 2007.

General and administrative expenses were \$4.9 million in 2007 representing a 50% increase from 2006 expenses of \$3.3 million. The change was primarily due to increase in marketing and travel costs.

Investments Segment Operating Expenses

Rental operating expense totaled \$34,000 in 2007 as compared to zero in 2006. Rental operating expense includes operating expenses from properties, in which Kennedy-Wilson holds a controlling interest. The increase was due to the acquisition of a commercial project in southern California.

General and administrative expenses were \$0.2 million in 2007 representing a 64% decrease from 2006 expenses of \$0.9 million. The change was primarily due to decrease in expenses related to winding down the discounted note pools operations.

Other Operating Expenses

Other operating expenses were approximately \$19.5 million in 2007, up 41% from \$13.3 million in 2006. The change was primarily due to increase in staff and bonuses, which resulted from increase in operating results in 2007.

Depreciation and amortization expense decreased to \$0.5 million in 2007, a 27% decrease from \$0.7 million in 2006. The decrease was primarily due to amortization of acquired property management contracts, which were fully amortized in 2006.

Investments Segment Equity in Joint Venture Income

Equity in joint venture income totaled approximately \$27.4 million in 2007, an increase of 87% compared to \$14.7 million realized in 2006. The revenue from joint venture investments includes income from the operation and sale of numerous real estate investments in the U.S. which are owned primarily in joint venture funds with institutional investor partners. Ten residential investments, two commercial investments, and one land investment were sold in 2007 as compared to two commercial buildings, and five apartment projects sold in 2006.

Non-Operating Items

In January 2006, Kennedy-Wilson sold a 20% interest in its wholly-owned apartment management division to Kenedix, Inc., a Japanese real estate company, for \$9 million. A gain on the sale in the amount of \$7.1 million was recognized after deduction of related expenses.

Investments Segment Non-Operating Items

Interest expense was \$0.3 million in 2007, a decrease of 41% compared to \$0.6 million in 2006. The change was mainly due to the repayment of a credit facility in 2007.

There was no interest and other income in 2007 as compared to income of \$0.5 million in 2006. The change resulted from winding down the discounted note pool operations.

Table of Contents

Other Non-Operating Items

Other non-operating items were \$3.9 million in 2007, an increase of 58% compared to \$2.5 million in 2006 due, in part, to additional corporate debt of \$40 million issued in 2007.

The provision for income taxes was approximately \$4.4 million for 2007 compared to \$4.6 million in 2006 due to the impact of deferred income taxes.

Kennedy-Wilson executed the sale of a commercial project in southern California for \$39.4 million. Income from discontinued operations included the net gain of \$2.8 million from this sale. Outside of joint ventures, there were no sales of real estate in 2006.

Net income attributable to the non-controlling interests was approximately \$2.4 million in 2007, an increase of 317% compared to approximately \$0.6 million in 2006. The increase was related to a non-controlling interest in a commercial project in southern California.

Liquidity and Capital Resources

Kennedy-Wilson's liquidity and capital resources requirements include expenditures for joint venture investments, real estate held for sale, distressed debt and working capital needs. Historically, Kennedy-Wilson has not required significant capital resources to support Kennedy-Wilson's brokerage and property management operations. Kennedy-Wilson finances its operations with internally generated funds and borrowings under Kennedy-Wilson's revolving lines of credit. Kennedy-Wilson's investments in real estate are typically financed by mortgage loans secured primarily by that real estate. These mortgage loans are generally nonrecourse in that, in the event of default, recourse will be limited to the mortgaged property serving as collateral. In some cases, Kennedy-Wilson guarantees a portion of the loan related to a joint venture investment, usually until some condition, such as completion of construction or leasing or certain net operating income criteria, has been met. Kennedy-Wilson does not expect these guarantees to materially affect liquidity or capital resources.

Historical Cash Flows

Net cash used in operating activities totaled \$3.0 million for the six months ended June 30, 2009, a decrease of \$10.0 million as compared to the six months ended June 30, 2008. The change was primarily due to the decrease in equity in joint venture income and the increase in deferred and accrued income taxes as well as accruals for expenses and other liabilities during the six months ended June 30, 2009.

Net cash used in operating activities totaled \$14.7 million for the year ended December 31, 2008, a decrease of \$0.1 million as compared to the year ended December 31, 2007. The change was primarily due to the decrease in net income and accruals for bonuses and income taxes, offset by lower equity in joint venture income and no gain on sale of commercial real estate during the year ended December 31, 2008.

Net cash used in operating activities totaled about \$14.8 million for the year ended December 31, 2007, an increase of \$7.8 million as compared to the year ended December 31, 2006. The change was primarily due to the increase in net income and accruals for bonuses and income taxes, offset by higher equity in joint venture income and gain from sale of commercial real estate, during the year ended December 31, 2007.

Net cash used in investing activities totaled approximately \$38.5 million for the six months ended June 30, 2009, a decrease of \$36.5 million as compared to the six months ended June 30, 2008. The decrease was primarily due to decreased investment activity during the six months ended June 30, 2009.

Net cash used in investing activities totaled about \$96.4 million for the year ended December 31, 2008, an increase of \$102.2 million as compared to the year ended December 31, 2007. The increase was primarily driven by the use of cash for new investments, which included additional investment in

Table of Contents

the Japanese joint venture and acquisition of an apartment building, a condominium project, and land in California as well as an office building in Japan during the year ended December 31, 2008.

Net cash provided by investing activities totaled approximately \$5.8 million for the year ended December 31, 2007, compared to net cash of about \$3.6 million used in investing activities for the year ended December 31, 2006. The change was primarily due to the sale of an office building and other investments in California during the year ended December 31, 2007.

Net cash provided by financing activities totaled approximately \$31.9 million for the six months ended June 30, 2009, a decrease of \$45.4 million as compared to the six months ended June 30, 2008. The decrease was primarily due to no preferred stock issued during the six months ended June 30, 2009. The change includes the payments of dividends to preferred stockholders, which were funded by the combination of cash from operations, borrowings from lines of credit, and proceeds from sale of investments.

Net cash provided by financing activities totaled about \$112.6 million for the year ended December 31, 2008, an increase of \$94.7 million as compared to the year ended December 31, 2007. The increase was primarily due to issuance of preferred stock, additional borrowings under lines of credit, and fewer mortgage loan repayments from the sale of real estate during the year ended December 31, 2008. The increase was offset by the payments of dividends to preferred shareholders, which were funded by the combination of cash from operations, borrowings from lines of credit, and proceeds from sale of investments.

Net cash provided by financing activities totaled about \$17.9 million for the year ended December 31, 2007, an increase of \$11.3 million as compared to the year ended December 31, 2006. The increase was primarily due to issuance of subordinated debentures, partially offset by higher repayments of lines of credit and repurchase of common stock during the year ended December 31, 2007.

To the extent that Kennedy-Wilson engages in additional strategic investments, including real estate, note portfolio, or acquisitions of other property management companies, it may need to obtain third-party financing which could include bank financing or the public sale or private placement of debt or equity securities. Kennedy-Wilson believes that existing cash, plus capital generated from property management and leasing, brokerage, sales of real estate owned, collections from notes receivable, as well as its current lines of credit, will provide Kennedy-Wilson with sufficient capital requirements for the foreseeable future.

Under its current joint venture strategy, Kennedy-Wilson generally contributes property, expertise, and typically a fully funded initial cash contribution (without commitment to additional funding by Kennedy-Wilson). Capital required for additional improvements and supporting operations during lease-up and stabilization periods is generally obtained at the time of acquisition via debt financing or third party investors. Accordingly, Kennedy-Wilson generally does not have significant capital commitments with unconsolidated entities. Infrequently, there may be some circumstances when Kennedy-Wilson, usually with the other members of the joint venture entity, may be required to contribute additional capital for a limited period of time. Kennedy-Wilson believes that it has the capital resources, generated from its business activities and borrowing capacity, to finance any such capital requirements, and does not believe that any additional capital contributions to joint ventures will materially affect liquidity.

Kennedy-Wilson's need, if any, to raise additional funds to meet its capital requirements will depend on many factors, including the success and pace of the implementation of its strategy for growth. Kennedy-Wilson regularly monitors capital raising alternatives to be able to take advantage of other available avenues to support its working capital and investment needs, including strategic partnerships and other alliances, bank borrowings, and the sale of equity or debt securities. Kennedy-Wilson expects to meet the repayment obligations of notes payable and borrowings under lines of credit

Table of Contents

from cash generated by its business activities, including the sale of assets and the refinancing of debt. Kennedy-Wilson intends to retain earnings to finance its growth and, therefore, does not anticipate paying dividends.

Contractual Obligations and Commercial Commitments

At June 30, 2009, Kennedy-Wilson's contractual cash obligations, including debt, lines of credit, capital lease obligations and operating leases include the following:

	Total	Payments due by period			After 5 years
		Less than 1 year	1 - 3 years	4 - 5 years	
Contractual obligations					
Borrowings:					
Notes payable	\$ 14,000,000	\$ 14,000,000	\$	\$	\$
Borrowings under lines of credit	26,000,000		26,000,000		
Mortgage loans payable	53,071,000	26,956,000	26,115,000		
Subordinated debt	70,000,000				70,000,000
Total borrowings	163,071,000	40,956,000	52,115,000		70,000,000
Capital lease obligations					
Operating leases	8,863,000	1,753,000	2,602,000	1,424,000	3,084,000
Total contractual cash obligations	\$ 171,996,000	\$ 42,730,000	\$ 54,758,000	\$ 1,424,000	\$ 73,084,000

At December 31, 2008, Kennedy-Wilson's contractual cash obligations, including debt, lines of credit, capital lease obligations and operating leases include the following:

	Total	Payments due by period			After 5 years
		Less than 1 year	1 - 3 years	4 - 5 years	
Contractual obligations					
Borrowings:					
Notes payable	\$ 21,188,000	\$ 21,188,000	\$	\$	\$
Borrowings under lines of credit	13,500,000		13,500,000		
Mortgage loans payable	29,548,000	8,808,000	20,740,000		
Subordinated debt	70,000,000				70,000,000
Total borrowings	134,236,000	29,996,000	34,240,000		70,000,000
Capital lease obligations					
Operating leases	2,549,000	1,340,000	1,161,000	48,000	
Total contractual cash obligations	\$ 136,785,000	\$ 31,336,000	\$ 35,401,000	\$ 48,000	\$ 70,000,000

Off-Balance Sheet Arrangements

Kennedy-Wilson has provided guarantees associated with loans secured by assets held in various joint venture partnerships. The maximum potential amount of future payments (undiscounted) Kennedy-Wilson could be required to make under the guarantees was approximately \$68.5 million and \$46.0 million at June 30, 2009 and December 31, 2008, respectively. Subsequent to June 30, 2009, several loans have been paid down, which reduced the guarantees to approximately \$41.5 million. The guarantees expire by the year end of 2011 and Kennedy-Wilson's performance under the guarantees would be required to the extent there is a shortfall in liquidation between the principal amount of the

Table of Contents

loan and the net sales proceeds of the property. If Kennedy-Wilson were to become obligated to perform on these guarantees, it could have an adverse affect on its financial condition.

Impact of Inflation and Changing Prices

Inflation has not had a significant impact on the results of operations of Kennedy-Wilson in recent years and is not anticipated to have a significant impact in the foreseeable future. Kennedy-Wilson's exposure to market risk from changing prices consists primarily of fluctuations in rental rates of commercial and residential properties, market interest rates on residential mortgages and debt obligations and real estate property values. The revenues associated with the commercial services businesses are impacted by fluctuations in interest rates, lease rates, real property values and the availability of space and competition in the market place. Commercial service revenues are derived from a broad range of services that are primarily transaction driven and are therefore volatile in nature and highly competitive. The revenues of the property management operations with respect to rental properties are highly dependent upon the aggregate rents of the properties managed, which are affected by rental rates and building occupancy rates. Rental rate increases are dependent upon market conditions and the competitive environments in the respective locations of the properties. Employee compensation is the principal cost element of property management. Economic trends in 2009 were characterized by general decrease in commercial leasing volume in the U.S.

Qualitative and Quantitative Disclosures about Market Risk

The primary market risk exposure of Kennedy-Wilson relates to changes in interest rates in connection with its short-term borrowings, some of which bear interest at variable rates based on lender's base rate, prime rate, and LIBOR plus an applicable borrowing margin. These borrowings do not give rise to a significant interest rate risk because they have short maturities. Historically, Kennedy-Wilson has not experienced material gains or losses due to interest rate changes.

Interest Rate Risk

Kennedy-Wilson has established an interest rate management policy, which attempts to minimize its overall cost of debt, while taking into consideration the earnings implications associated with the volatility of short-term interest rates. As part of this policy, Kennedy-Wilson has elected to maintain a combination of variable and fixed rate debt.

The tables below represent contractual balances of Kennedy-Wilson's financial instruments at the expected maturity dates as well as the fair value at June 30, 2009, and December 31, 2008. The expected maturity categories take into consideration actual amortization of principal and do not take into consideration reinvestment of cash. The weighted average interest rate for the various assets and liabilities presented are actual as of June 30, 2009, and December 31, 2008. Kennedy-Wilson closely monitors the fluctuation in interest rates, and if rates were to increase significantly, Kennedy-Wilson

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

believes that it would be able to either hedge the change in the interest rate or to refinance the loans with fixed interest rate debt. All instruments included in this analysis are non-trading.

(in thousands)	Principal maturing in:						Total	Fair Value June 30, 2009
	2009	2010	2011	2012	2013	Thereafter		
Interest rate sensitive assets								
Cash equivalents	\$ 3,196						\$ 3,196	\$ 3,196
Average interest rate	0.79%						0.79%	
Variable rate receivables								
Average interest rate								
Fixed rate receivables	2,704	500	3,455				6,659	6,659
Average interest rate	8.76%	10.00%	7.50%				8.20%	
Total	\$ 5,900	\$ 500	\$ 3,455				\$ 9,855	\$ 9,855
Weighted average interest rate	4.44%	10.00%	7.50%				5.80%	
Interest rate sensitive liabilities								
Variable rate borrowings	\$ 14,000	\$ 450	\$ 26,000				\$ 40,450	\$ 40,450
Average interest rate	4.00%	4.00%	3.58%				3.73%	
Fixed rate borrowings	5,766	20,740	26,115			70,000	122,621	122,621
Average interest rate	2.18%	6.16%	10.65%			8.18%	8.08%	
Total	\$ 19,766	\$ 21,190	\$ 52,115			\$ 70,000	\$ 163,071	\$ 163,071
Weighted average interest rate	3.47%	6.11%	7.12%			8.18%	7.00%	

(in thousands)	Principal maturing in:						Total	Fair Value December 31, 2008
	2009	2010	2011	2012	2013	Thereafter		
Interest rate sensitive assets								
Cash equivalents	\$ 9,742						\$ 9,742	\$ 9,742
Average interest rate	2.09%						2.09%	
Variable rate receivables								
Average interest rate								
Fixed rate receivables	343		3,455				3,798	3,798
Average interest rate	6.87%		7.50%				7.44%	
Total	\$ 10,085		\$ 3,455				\$ 13,540	\$ 13,540
Weighted average interest rate	2.25%		7.50%				3.59%	
Interest rate sensitive liabilities								
Variable rate borrowings	\$ 5,450		\$ 13,500				\$ 18,950	\$ 18,950
Average interest rate	4.00%		3.75%				3.82%	
Fixed rate borrowings	24,546	20,740				70,000	115,286	115,286
Average interest rate	8.96%	6.16%				8.18%	7.98%	
Total	\$ 29,996	\$ 20,740	\$ 13,500			\$ 70,000	\$ 134,236	\$ 134,236
Weighted average interest rate	8.06%	6.16%	3.75%			8.18%	7.39%	

Recently Issued Accounting Pronouncements

In December 2007, the FASB issued FASB Statement No. 141(R), *Business Combinations*. Statement 141(R) requires most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at "full fair value" and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Statement 141(R) is effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited.

In April 2008, the FASB issued FASB Staff Position FAS 142-3, "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors that should be considered in developing

Table of Contents

renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement 142. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Kennedy-Wilson is currently evaluating the impact, if any, of adopting FSP FAS 142-3 on its financial position and results of operations.

In November 2008, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations." EITF 08-6 continues to follow the accounting for the initial carrying value of equity method investments in APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, which is based on a cost accumulation model and generally excludes contingent consideration. EITF 08-6 also specifies that other-than-temporary impairment testing by the investor should be performed at the investment level and that a separate impairment assessment of the underlying assets is not required. An impairment charge by the investee should result in an adjustment of the investor's basis of the impaired asset for the investor's pro-rata share of such impairment. In addition, EITF 08-6 reached a consensus on how to account for an issuance of shares by an investee that reduces the investor's ownership share of the investee. An investor should account for such transactions as if it had sold a proportionate share of its investment with any gains or losses recorded through earnings. EITF 08-6 also addresses the accounting for a change in an investment from the equity method to the cost method after adoption of Statement 160. EITF 08-6 affirms the existing guidance in APB 18, which requires cessation of the equity method of accounting and application of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, or the cost method under APB 18, as appropriate. EITF 08-6 is effective for transactions occurring on or after December 15, 2008. Kennedy-Wilson does not anticipate that the adoption of EITF 08-6 will materially impact its financial position or results of operations.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Table of Contents

EXECUTIVE COMPENSATION

Prospect Executive Compensation

Compensation Discussion and Analysis

None of Prospect's executive officers has received any cash or other compensation for services rendered to it in any capacity. Commencing on November 14, 2007, the date of Prospect's prospectus related to its IPO, through the consummation of the initial business combination or its liquidation, pursuant to a letter agreement, Prospect has paid and will continue to pay Teleos Management, L.L.C., an entity affiliated with Daniel Gressel, one of Prospect's directors, and LLM Capital Partners LLC, an entity affiliated with Patrick J. Landers, Prospect's President and a director, LLM Structured Equity Fund L.P. and LLM Investors L.P., a fee of \$4,500 and \$3,000, respectively, per month for office space and administrative services, including secretarial support (amended December 31, 2008 to \$4,083.15 and \$2,722.10, respectively). This arrangement has been agreed to by Teleos Management, L.L.C. and LLM Capital Partners LLC for Prospect's benefit and is not intended to provide Mr. Gressel or Mr. Landers compensation in lieu of a salary. Prospect believes that such fees are at least as favorable as it could have obtained from an unaffiliated third-party. Other than the fees payable to Teleos Management, L.L.C. and LLM Capital Partners LLC, no compensation of any kind, whether from Prospect or any entity affiliated with it, including finder's fees, consulting fees or other similar compensation, will be paid to, awarded to, or earned by any of Prospect's initial stockholders, sponsors, officers or directors, in each case in any capacity, or to any of its respective affiliates, for any services rendered prior to or in connection with the consummation of Prospect's initial business combination. However, such individuals and entities will be reimbursed for any out-of-pocket expenses incurred in connection with activities on Prospect's behalf such as identifying potential target businesses and performing due diligence on suitable business combinations. There is no limit on the amount of these out-of-pocket expenses; provided, however, that to the extent such out-of-pocket expenses exceed the available proceeds not deposited in the trust account and interest income of up to \$2.75 million on the balance in the trust account (subject to the holdback of a sufficient amount of interest income to pay any due and unpaid taxes on such \$2.75 million), such out-of-pocket expenses would not be reimbursed by Prospect unless Prospect consummates an initial business combination. Prospect's audit committee will review and approve all payments made to its founders, sponsors, officers and directors, and any payments made to members of Prospect's audit committee will be reviewed and approved by Prospect's board of directors, with the interested director or directors abstaining from such review and approval.

Compensation Committee Report

Without a compensation committee, Prospect's board of directors has reviewed and discussed the Compensation Discussion and Analysis with management, and based on such review and discussion, the board of directors determined that the Compensation, Discussion and Analysis be included in this proxy statement/prospectus.

Kennedy-Wilson Executive Compensation

Compensation Discussion and Analysis

Executive Compensation Philosophy and Objectives

Kennedy-Wilson's core compensation philosophy has been to pay its executive officers a competitive level of compensation that best reflects:

individual performance,

overall responsibility to Kennedy-Wilson, and

performance of Kennedy-Wilson and its business units.

Table of Contents

This philosophy was implemented for the executive officers, or the named executive officers, who are named in the summary compensation table in 2008, through a combination of base salary, the opportunity to earn significant bonuses and executive benefits. As will be described below, except in the case of the Chief Executive Officer, whose bonus is determined by Kennedy-Wilson's compensation committee of its board of directors, the Chief Executive Officer generally determines the bonuses to be paid to the other named executive officers.

Elements of Compensation

Kennedy-Wilson generally utilizes three components of compensation: base salary, annual bonuses and benefits (in 2009, as discussed below, stock options were also issued). Due to Kennedy-Wilson's overall philosophy of maintaining a pay mix that results fundamentally in a pay-for-performance orientation for executives, in years prior to 2008 the most significant element of compensation for the named executive officers was bonuses. While, as reflected in the summary compensation table, bonuses for 2008 were much less than salary for 2008, this reflects the fact that the decline in Kennedy-Wilson's financial performance in 2008, as compared to prior years, made it appropriate to award much lower bonuses or no bonuses to the named executive officers for that year.

Base Salary Base salary is determined by the level of the position within Kennedy-Wilson and the individual's current and sustained performance results. Except in the case of the Chief Executive Officer, whose base pay is set by Kennedy-Wilson's compensation committee, the base salary for the other named executive officers is set by the Chief Executive Officer, in some cases after consultation with Kennedy-Wilson's compensation committee.

With respect to 2008, base salary for each of the named executive officers was increased in the amounts set forth below. These modifications stemmed from the decision of Kennedy-Wilson's compensation committee (in the case of the Chief Executive Officer) and the decision of the Chief Executive Officer (in the case of the other named executive officers) that such increases were appropriate in light of the responsibilities of the executives and their job performance. The following were primary factors taken into account in measuring the contributions of named executive officers to Kennedy-Wilson in the process of setting their base salaries:

the number of employees supervised by the officer;

the effort expended by the officer in soliciting and bringing new business or capital investments to his or her business unit;

the extent to which the officer's business unit generated new business or new capital;

the travel demands placed upon the officer; and

the extent to which the officer engaged in investor relation activities.

While these factors are critical to the success of Kennedy-Wilson, many of them cannot be evaluated quantitatively, so a portion of the evaluations by both Kennedy-Wilson's compensation committee and the Chief Executive Officer were necessarily subjective. Kennedy-Wilson's compensation committee's decision to increase Mr. McMorrow's salary reflected its evaluation of Mr. McMorrow's contributions to the company (taking into account the criteria listed above) and the desire to pay an amount of base salary to Mr. McMorrow that Kennedy-Wilson's compensation committee and Mr. McMorrow considered appropriate in light of his efforts on behalf of Kennedy-Wilson. Mr. McMorrow's salary decisions with respect to the other named executive officers took into account the specific factors listed above, his determination that comparable salaries should be paid to officers with comparable levels of contributions to Kennedy-Wilson, and the need to pay levels of salary that, in the judgment of the Chief Executive Officer would continue to motivate them to maintain sustained levels of high performance and provide a retention incentive. Neither the compensation committee nor Mr. McMorrow utilized specific peer group or survey data in the process of setting salaries.

Table of Contents

Kennedy-Wilson's compensation committee determined toward the end of 2007 that Mr. McMorrow's base salary should be raised from \$800,000 to \$950,000, effective January 1, 2008. In reaching this determination, key factors taken into account were Mr. McMorrow's contributions to Kennedy-Wilson's exceptional financial results and developments in 2007 through his leadership and supervisory efforts and his primary role in developing several critical new business relationships during 2007. These exceptional results included the acquisition of 37 real estate properties, the disposition of 10 real estate properties, the generation of \$66 million of joint venture income for Kennedy-Wilson and its partners (compared to \$49 million in 2006), and becoming the west coast partner and service provider for a multibillion dollar east coast family office.

With respect to Ms. Ricks, Mr. Hart, and Mr. Schlesinger, the Chief Executive Officer determined that each of their base salaries should be raised to \$600,000, effective January 1, 2008. With respect to Ms. Ricks, key factors taken into account in reaching this determination were her role in the development and implementation of overall corporate strategy (in which capacity she functioned as the number two executive officer) with respect to all Kennedy-Wilson's business units, her critical role with respect to the development of general sources of capital (including the sourcing of over \$225 million of equity for acquisitions) and the disposition of several key properties, and the extraordinary travel demands placed upon her schedule because of her key role in connection with the development of Kennedy-Wilson's Japan real estate activities, including five trips to Japan and supervision of Kennedy-Wilson's Tokyo office. With respect to Mr. Hart, key factors taken into account in reaching this determination were the number of employees that Mr. Hart was responsible for supervising either directly (supervision of approximately 40 Kennedy-Wilson employees) or indirectly (oversight and strategic guidance with respect to approximately 300 employees of the independent contractor that provided property management services to KW Multi-Family Management Group, Ltd.), the efforts and success of his capital raising efforts for his business unit as evidenced by the investment of approximately \$300 million in new transactions (representing approximately a 30% increase over the prior year), and the quantity and success of his investor relation activities, as evidenced by the significant number of investors in 2007 who had previously invested in company-sponsored transactions. With respect to Mr. Schlesinger, key factors taken into account in reaching this determination were his role in raising new capital for his business unit including \$85 million in new fund commitments and the launch of the Bay Area Smart Growth Fund II and the Northwest Community Development Fund I, his supervision of over 20 fund properties located throughout the United States, and his extensive travel schedule (including more than 25 trips throughout the United States) in support of these capital raising and supervisory efforts.

The Chief Executive Officer determined that Mr. Rosten's base salary should be increased from \$500,000 to \$550,000, effective January 1, 2008. With respect to Mr. Rosten, key factors taken into account in reaching this determination were the number of employees that he was responsible for supervising (over 220 employees) and his extensive investor relations efforts, including the development and maintenance of investor relations with a number of major regional and national banks and a major public sector employer.

The Chief Executive Officer determined that Mr. Lyle's base salary should be increased from \$355,000 to \$450,000, effective January 1, 2008. With respect to Mr. Lyle, key factors taken into account in reaching this determination were the significance and complexity of the financial functions that he was responsible for supervising and the very extensive efforts required to coordinate the financial reporting and related aspects of investor relationships, including preparation of monthly, quarterly, and annual reports for over 100 properties and management of the financial aspects of Kennedy-Wilson's unsecured and secured borrowings (including the successful completion of a \$40 million secured financing transaction in 2007).

Table of Contents

Annual Bonus In general, the determination of the annual bonus payable to a named executive officer is a discretionary determination. Because generally Kennedy-Wilson has historically not used forms of long-term incentive compensation as incentives for executive performance, annual bonuses have functioned as the primary component of variable compensation for most executive officers. Kennedy-Wilson's compensation committee and its Chief Executive Officer believe that annual bonuses should play a primary role in motivating executives to undertake efforts that provide increases in company value and that executive officers should be potentially eligible for bonuses that are a very significant percentage of base pay and, in the case of the most senior officers, may be a significant multiple of base pay. While the named executive officer's individual performance is taken into account, a primary determinant of the bonus to be paid is the financial performance of the business unit over which the named executive officer has responsibility (in the case of the Chief Executive Officer and the Chief Financial Officer, the primary determinant is the financial performance of Kennedy-Wilson as a whole). Kennedy-Wilson's compensation committee determines the Chief Executive Officer's bonus based on its evaluation of both his and Kennedy-Wilson's performance. While Kennedy-Wilson's compensation committee does not determine the bonus for the other named executive officers, it is consulted as part of the process by which the Chief Executive Officer determines or participates in the determination of bonuses for the other named executive officers. Except as noted below, the bonus determination process does not take into account specific targets or metrics; instead, it is based on a discretionary evaluation by Kennedy-Wilson's compensation committee (in the case of the Chief Executive Officer) or the Chief Executive Officer (in the case of the other named executive officers) of the performance of the executive and the business unit for which he or she has responsibility. Because Kennedy-Wilson's financial performance for 2008 was significantly below that achieved for 2007 due, in large part, to the general economy and depressed real estate market, the bonuses payable in 2008 were significantly less than those paid for 2007. In light of this, in order to both retain and incentivize senior management, Kennedy-Wilson's compensation committee determined to grant stock options to selected employees as described below under the heading "*Executive Compensation Kennedy-Wilson Executive Compensation 2009 Stock Option Grants*" on page 249. The following bonus determinations were made for 2008:

Kennedy-Wilson's compensation committee determined that no bonus should be payable to the Chief Executive Officer for 2008 in light of Kennedy-Wilson's overall financial performance.

In light of Kennedy-Wilson's overall financial performance, it was determined that no bonus should be payable for 2008 to Mr. Lyle, the Chief Financial Officer, or to Ms. Ricks, who was President of Kennedy-Wilson Investment Sales Group during 2008. In addition to basing Ms. Ricks' potential bonus on an evaluation of the overall financial performance of Kennedy-Wilson, she was eligible to receive payment from a bonus pool available for employees of the Kennedy-Wilson Investment Sales Group that was based on 20% of adjusted net operating income of that business unit. This bonus formula did not result in a 2008 bonus pool for the Kennedy-Wilson Investment Sales Group.

Mr. Schlesinger, who headed the Kennedy-Wilson Fund Management Group during 2008, received a bonus of \$205,616 for 2008. Historically, the bonus pool determination for employees of the Kennedy-Wilson Fund Management Group has been computed as an amount equal to 20% of the business unit's adjusted net operating income, from which the business unit leader may elect to receive up to 50% of the bonus pool. Mr. Schlesinger elected to receive 50% of the bonus pool, which resulted in an award of \$205,616.

Mr. Hart's employment agreement with KW Multi-Family Management Group, Ltd., or KW Multi-Family Management Group, provides for the creation of an annual bonus pool equal to 20% of the net operating income of KW Multi-Family Management Group for the applicable calendar year, which is defined as the gross revenue of KW Multi-Family Management Group less costs and overhead expenses (as defined in the agreement) incurred up to \$2.3 million. This

Table of Contents

pool can be distributed among KW Multi-Family Management Group employees. Because this formula resulted in the creation of no bonus pool for 2008, no bonus was payable to Mr. Hart.

Mr. Rosten's employment agreement with Kennedy-Wilson Properties, Ltd., or Kennedy-Wilson Properties, provides for the creation of an annual bonus pool generally equal to 20% of operating income of Kennedy-Wilson Properties, less (1) a 12% cost of capital charge, and (2) an annual overhead charge (both charges reflecting capital and services provided to Kennedy-Wilson Properties by Kennedy-Wilson or its affiliates). The agreement provides that Mr. Rosten shall receive a portion of the bonus pool, as determined by the Chief Executive Officer, Mr. Schlesinger, and Kennedy-Wilson's Senior Managing Director of Human Resources. Historically, the bonus pool has been administered by providing that the business unit leader may elect to receive 50% of the bonus pool. Mr. Rosten elected to receive 50% of the pool, which resulted in a bonus of \$69,265 for 2008.

Other Executive Benefits Named executive officers are entitled to employee benefits generally available to all full time employees (subject to fulfilling any minimum service period). These employee benefits include, among other things, vacation and health and welfare benefits generally available to all employees. Kennedy-Wilson believes these benefits are generally competitive with those offered by similar companies in the markets in which Kennedy-Wilson operates.

Kennedy-Wilson employees, including the named executive officers (except for Mr. Schlesinger, who is an independent contractor) participate in a tax-qualified 401(k) plan, pursuant to which Kennedy-Wilson may match a certain portion of employee contributions. Kennedy-Wilson may annually match 50% of employee contributions to the plan, limited to employee contributions equal to 4% of compensation, but not to exceed \$1,500 for any participant.

The Chief Executive Officer receives certain additional benefits, which includes a car allowance of \$18,000 and the use of certain club memberships that are maintained by Kennedy-Wilson for business purposes only. Further details regarding these benefits are contained in the summary compensation table and accompanying footnotes. These benefits are provided because Kennedy-Wilson's compensation committee has concluded that they are generally competitive with those provided to comparable executives or provide benefits to Kennedy-Wilson which are appropriate in light of their cost.

Employment Agreements

Kennedy-Wilson is a party to employment agreements with five of its six named executive officers. Mr. Schlesinger provides his executive services as an independent contractor to the KW Commercial Investment Group and there is currently no contract in effect between him and Kennedy-Wilson.

Mr. McMorrow The employment agreement in effect with Mr. McMorrow generally provides for base salary of \$950,000, a bonus at the sole discretion of Kennedy-Wilson's compensation committee, and insurance coverages and other benefits generally available to officers. In addition, it provides for entrance fees and monthly dues for two country clubs. Mr. McMorrow's agreement was amended effective February 1, 2009. The amended agreement extends through December 31, 2019. It further provides that, in the event of a "Change in Control," as defined in the agreement, Mr. McMorrow would receive a payment equal to two times his average annual compensation over the preceding three years (the agreement previously provided for a payment in a similar amount if Mr. McMorrow was terminated after a change in control or his agreement was not renewed upon its expiration). It also generally provides that Mr. McMorrow will receive continued benefit coverage (as well as continued salary) for the remainder of the term of his employment agreement in the event of a qualifying termination of employment, which will occur if Mr. McMorrow dies, becomes disabled, is terminated without cause, or terminates after a Change in Control on account of a change in location or a material reduction in his duties. In connection with this amendment, Mr. McMorrow received a signing

Table of Contents

bonus of \$2 million, which must be returned on a pro rata basis if he voluntarily terminates employment prior to the expiration of the term. Kennedy-Wilson's compensation committee determined that the 2009 amendments and signing bonus were appropriate additional elements of compensation to Mr. McMorrow in light of the critical role of Mr. McMorrow in the future success of Kennedy-Wilson.

Ms. Ricks Ms. Ricks entered into an employment agreement with Kennedy-Wilson effective February 1, 2009. The agreement extends through January 31, 2014. The employment agreement provides for base salary of \$600,000, a bonus at the sole discretion of Kennedy-Wilson's compensation committee, and other benefits generally available to employees of Kennedy-Wilson. The employment agreement further provides that, in the event of a "Change in Control," as defined in the agreement, Ms. Ricks is entitled to receive a payment equal to two times her average annual compensation over the preceding three years. In the case of death or disability, Ms. Ricks is entitled to base salary, discretionary bonus and benefits to the date of termination. In the event Ms. Ricks is terminated by Kennedy-Wilson without cause, or terminates after a Change in Control on account of a change in location or a material reduction in her duties, she is entitled to the payment of base salary and benefits through the end of the term. If employment with Kennedy-Wilson is terminated by Ms. Ricks without cause, she is entitled to base salary and discretionary bonus (not benefits) to the date of termination. In connection with the execution of the agreement, Ms. Ricks received a signing bonus of \$1 million, which is subject to return on a pro rata basis if she voluntarily terminates employment prior to the expiration of the term. The Chief Executive Officer determined (after consultation with Kennedy-Wilson's compensation committee) that the 2009 amendments and signing bonus were appropriate additional elements of compensation to Ms. Ricks in light of her important role in the future success of Kennedy-Wilson.

Mr. Hart Mr. Hart entered into an employment agreement with KW Multi-Family Management Group dated January 1, 2006, which has been subsequently amended and extended on a year-to-year basis. The employment agreement was most recently amended as of January 1, 2009 to extend the term through December 31, 2009. In addition to base salary of \$600,000, the agreement provides for Mr. Hart's participation in the annual bonus pool equal to 20% of the net operating income of KW Multi-Family Management Group for the applicable calendar year, plus benefits generally available to employees of KW Multi-Family Management Group. In the event Mr. Hart's employment is terminated by KW Multi-Family Management Group without cause, Mr. Hart is entitled to receive base salary, participation in the bonus pool and benefits through the end of the term.

Mr. Rosten Mr. Rosten entered into an employment agreement with Kennedy-Wilson Properties dated January 1, 2001, which has been subsequently amended and extended on a year-to-year basis. The employment agreement was most recently amended as of January 1, 2009 to extend the term through December 31, 2009. The employment agreement provides for a base salary of \$550,000 plus benefits generally available to employees of Kennedy-Wilson Properties. In addition, the agreement provides for Mr. Rosten's participation in a bonus pool equal to 20% of the net operating income of Kennedy-Wilson Properties, less (1) a 12% cost of capital charge, and (2) an annual overhead charge (both charges reflecting capital and services provided to Kennedy-Wilson Properties by Kennedy-Wilson or its affiliates). The agreement provides that Mr. Rosten shall receive a portion of the bonus pool, as determined by the bonus pool committee. In the event Mr. Rosten's employment is terminated by Kennedy-Wilson Properties without cause, Mr. Rosten is entitled to receive base salary, participation in the bonus pool and benefits through the end of the term (less the aggregate value of compensation and benefits received by him during the remainder of the term from any source and without regard to characterization).

Mr. Lyle Mr. Lyle entered into an employment agreement with Kennedy-Wilson on April 1, 1996, which has been subsequently amended and extended on a year-to-year basis. The employment agreement was most recently amended to extend the term through December 31, 2009. In addition to base salary of \$450,000, the agreement provides for a discretionary bonus of up to 100% of base salary

Table of Contents

and benefits generally available to employees of Kennedy-Wilson. In the event Mr. Lyle's employment is terminated by Kennedy-Wilson without cause, Mr. Lyle is entitled to receive base salary, discretionary bonus, and benefits through the end of the term.

2009 Stock Option Grants

Kennedy-Wilson's compensation committee determined to issue stock options in early 2009 to senior executives and members of the board of directors.

Two types of options were granted by Kennedy-Wilson's compensation committee: (1) options with vesting only contingent on continued service for a specified amount of time, which were intended to reward contributions to Kennedy-Wilson and act as a retention incentive; and (2) options with vesting contingent upon both continued service for a specified amount of time and upon meeting specific EBITDA performance goals set forth in the option agreement (if the EBITDA target for a previous year is not met, the options may still be earned if a "catch up hurdle" is met in a later year). Additional stock option grants going forward are not currently contemplated.

A total of 750,000 stock options were issued, of which the following amounts were issued to the named executive officers (the number in parentheses represent options with vesting contingent upon meeting EBITDA performance goals): 150,000 options to each of Mr. McMorrow and Ms. Ricks; 100,000 options to Mr. Hart (77,400); 41,500 options to Mr. Schlesinger (32,594); and 20,000 options to each of Mr. Rosten and Mr. Lyle (15,708 performance options for each of them). Kennedy-Wilson's compensation committee's determination of the amount of options granted to each named executive officer took into account that optionee's contribution to Kennedy-Wilson and the amount of options that was being awarded to other officers with comparable levels of responsibility. The options vest over seven years in equal annual installments and have a strike price of \$30. A condition to the closing of the merger is that the holders of these options agree to cancel them prior to the closing.

Executive Compensation Actions in Connection with the Merger

In connection with the merger, Kennedy-Wilson's compensation committee has approved several additional executive compensation arrangements:

Restricted Stock To reward and incentivize Kennedy-Wilson's key employees and management after the merger, up to 2,475,000 shares of Prospect common stock will be reserved for issuance under the 2009 Plan. If the merger is consummated, certain Kennedy-Wilson officers, directors and key employees will be issued an aggregate of 2,376,000 restricted shares of Prospect common stock under the 2009 Plan upon the closing of the merger. NEOs will be issued the following amounts of restricted shares: 556,875 restricted shares to each of Mr. McMorrow and Ms. Ricks; 77,344 restricted shares to each of Messrs. Hart, Rosten, Schlesinger and Lyle. In the event that the recipient of the restricted shares remains employed by (or continues to perform services as a director for) the post-merger company through the relevant vesting date, $\frac{1}{5}$ of the restricted shares will vest on each of the first five anniversaries of the date of issuance, provided that the Performance Target is met as of the September 30 immediately preceding the applicable anniversary date (in the case of the installments vesting on the fourth and fifth anniversary dates, the Performance Target must be met as of the September 30 immediately preceding the third anniversary date). The Performance Target was established by an independent committee of Prospect and is subject to the approval of the compensation committee of the post-merger company following the consummation of the merger. Notwithstanding the foregoing, in the event the employment with the post-merger company of an employee who has been granted restricted shares is terminated without cause or if the employee resigns from his employment with the post-merger company for good reason, the restricted shares will continue to vest on the applicable anniversary dates (subject to the satisfaction of the Performance Target), subject to certain limitations. In addition, in the event of a "Change of Control" as defined in the 2009

Table of Contents

Plan (see *"The Equity Participation Plan Proposal "Change of Control"* on page 180), any unvested restricted shares of Prospect common stock that have not previously been forfeited will become vested, subject to certain limitations. See section *"The Equity Participation Plan Proposal Awards to Particular Officers, Directors and Employees"* on page 184 for additional information.

Cash Bonuses If the merger is consummated, William J. McMorrow and Mary L. Ricks will be potentially entitled to receive certain cash bonus payments of up to \$11.7 million and \$4.0 million, respectively. The cash bonus payments will be payable as follows:

Mr. McMorrow and Ms. Ricks will be entitled to receive \$4.85 million and \$2.0 million, respectively, on October 15, 2009, provided, however, that such payments will be repaid to Kennedy-Wilson in the event the merger is not consummated by November 15, 2009 or the executive is not employed by Kennedy-Wilson on the effective date of the merger (these employment requirements will not apply, however, in the case of a termination of employment due to death or disability);

Mr. McMorrow and Ms. Ricks will receive "performance unit awards" under the 2009 Plan which will entitle them to receive \$2.425 million and \$1.0 million, respectively, on April 1, 2010, provided that the Performance Target is met as of March 31, 2010 (in the event that the Performance Target is not met as of March 31, 2010, the bonus otherwise due April 1, 2010 shall, nevertheless, be paid on July 1, 2010, October 1, 2010, or January 1, 2011, respectively, if the Performance Target is satisfied as of the earliest of June 30, 2010, September 30, 2010, or December 31, 2010, respectively), and the executive remains employed through the date on which the Performance Target is satisfied; and

Mr. McMorrow and Ms. Ricks will receive additional "performance unit awards" under the 2009 Plan which will entitle them to receive cash payments in the amounts of \$4.425 and \$1.0 million, respectively, on January 1, 2011, provided that the Performance Target is met as of December 31, 2010 and he or she, as applicable, remains employed by the post-merger company through January 1, 2011.

Notwithstanding the foregoing, in the event that the merger is consummated and the employment of Mr. McMorrow or Ms. Ricks is terminated by the post-merger company without cause or he or she, as applicable, resigns from his or her, as applicable, employment with the post-merger company for good reason, the payments referred to in clauses (ii) and (iii) above will still be payable on the applicable payment dates if the Performance Target is met. The Performance Target was established by an independent committee of Prospect and is subject to the approval of the compensation committee of the post-merger company following the consummation of the merger. The compensation committee of Kennedy-Wilson's board of directors made the determination to pay cash bonuses to only Mr. McMorrow and Ms. Ricks upon consummation of the merger after taking into account several factors, including the primary roles Mr. McMorrow and Ms. Ricks played in negotiating the terms of the merger and the merger agreement and the amendments to Mr. McMorrow's and Ms. Ricks' employment agreements eliminating their rights to receive cash lump sum payments otherwise due upon a change in control.

Note Forgiveness On April 10, 2006, William J. McMorrow borrowed \$3,543,127 from Kennedy-Wilson evidenced by a promissory note bearing simple interest at a rate of 7.5% per annum and scheduled to mature on April 9, 2011. Mr. McMorrow's employment agreement has been amended to provide that the McMorrow Note will be forgiven if the merger is consummated. The determination of Kennedy-Wilson's compensation committee to forgive the note upon the consummation of the merger stemmed from its consideration of Mr. McMorrow's contributions to Kennedy-Wilson, Mr. McMorrow's primary role in negotiating the terms of the merger and

Table of Contents

the merger agreement, and the terms of the note which provides for its forgiveness in the event of certain changes in control.

Employment Agreements In connection with the merger, Mr. McMorrow and Ms. Ricks have entered into amendments to their employment agreements which provide for, among other things,

the removal of certain benefits in the event of a change in control;

the addition of certain severance benefits if the executive resigns on account of a change in location or a material reduction in duties;

the grant to each executive of 556,875 shares of restricted stock of Prospect pursuant to the 2009 Plan and upon the terms and conditions set forth above;

the cash bonus payments set forth above; and

in the case of Mr. McMorrow, the McMorrow Note forgiveness described above.

Mr. Herrema has also entered into an amendment to his employment agreement which provides for the extension of his employment term from December 31, 2010 to January 31, 2014 as well as the second and third bullets above.

In addition, the employment agreements for Messrs. McMorrow and Herrema and Ms. Ricks have been amended to include language intended

to provide for a reduction in the amount of payments or benefits payable or provided to them under their respective employment agreements or otherwise to ensure that no payment or benefit is subject to the excise tax imposed by Section 4999 of the Code (certain golden parachute payments) which reduction may, in certain circumstances, result in the repayment of certain previously paid amounts (plus earnings) to the post-merger company, and

to achieve compliance with Section 409A of the Code.

Compensation Committee Report

We have reviewed and discussed the foregoing Compensation Discussion and Analysis with management. Based on our review and discussion with management, we have recommended to the board of directors that the Compensation Discussion and Analysis be included in this proxy statement/prospectus.

Submitted by: Kent Mouton, Chairman
Cathy Hendrickson
Norm Creighton
Members of the Kennedy-Wilson Compensation Committee

Notwithstanding anything to the contrary set forth in any Kennedy-Wilson filings under the Securities Act or the Exchange Act that incorporate other filings, including this proxy statement/prospectus, in whole or in part, the foregoing Compensation Committee Report shall not be incorporated by reference into any such filings.

Table of Contents**2008 Executive Compensation Information****2008 Summary Compensation Table**

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
William J. McMorrow Chairman & Chief Executive Officer	2008	\$950,000	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 19,500(1)	\$969,500
Freeman A. Lyle Executive Vice President & Chief Financial Officer	2008	\$410,417	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,500(2)	\$411,917
Barry S. Schlesinger(3) President, Kennedy-Wilson Fund Management Group	2008	\$600,000	\$205,616	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$805,616
Mary Ricks(4) President, Kennedy-Wilson Commercial Investments	2008	\$600,000	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,500(2)	\$601,500
James A. Rosten President, Kennedy-Wilson Properties	2008	\$550,000	\$ 69,265	\$ 0	\$ 0	\$ 0	\$ 0	\$ 769(2)	\$620,034
Robert E. Hart President, Kennedy-Wilson Multi-Family Management Group	2008	\$600,000	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,500(2)	\$601,500

- (1) Includes \$18,000 in car allowance payments and \$1,500 in Kennedy-Wilson contributions to Mr. McMorrow's account in Kennedy-Wilson's tax qualified 401(k) savings plan. Kennedy-Wilson maintains two corporate club memberships that are made available to the Chief Executive Officer. Since all use during 2008 was business-use, accordingly no amount is recorded as "All Other Compensation" with respect to these memberships.
- (2) Consists of Kennedy-Wilson contributions to the executive's account in the Kennedy-Wilson's tax qualified 401(k) Savings Plan.
- (3) During 2008, Mr. Schlesinger served as President of Kennedy-Wilson Fund Management Group.
- (4) During 2008, Ms. Ricks served as President of Kennedy-Wilson Investment Sales Group.

Kennedy-Wilson did not make any grants of plan-based awards to its named executive officers in 2008; at December 31, 2008, the named executive officers did not hold any outstanding equity awards; and in 2008, none of the named executive officers exercised stock options or vested in stock awards.

Termination of Employment and Change-in-Control Agreements for Named Executive Officers*Chief Executive Officer*

As of December 31, 2008, Mr. McMorrow's employment agreement provided that, in the event of his termination of employment by Kennedy-Wilson without cause (not in connection with a change in control of Kennedy-Wilson) or due to death or disability, he would receive salary continuation throughout the remaining term of the agreement. At December 31, 2008, Mr. McMorrow's employment agreement extended to December 31, 2014. In the event Mr. McMorrow's employment was terminated without cause in connection with a Change in Control of Kennedy-Wilson, he would be entitled to a lump sum payment equal to two times the sum of his average base salary and bonus for the most recently completed three fiscal years. Please also see above under "*Executive Compensation Employment Agreements Mr. McMorrow*" on page 247 for a description of the changes to the

Table of Contents

termination of employment provisions of Mr. McMorrow's employment agreement that were made effective February 1, 2009.

Termination Event	Severance Payments
Voluntary or Involuntary for Cause	\$ 0
Involuntary without Cause (non-Change in Control)	\$ 5,700,000
Death or Disability	\$ 5,700,000
Involuntary without Cause with Change-in-Control	\$ 14,133,333

Remaining Executives

Pursuant to their employment agreements, if Messrs. Lyle, Rosten, or Hart were terminated without cause on December 31, 2008, each executive would have been entitled to base salary, bonus and benefit continuation through the remainder of term of his respective agreement (December 31, 2009 for each executive). Accordingly, Messrs. Lyle, Rosten, and Hart would have received salary continuation payments of \$450,000, \$550,000, and \$600,000, respectively, and bonus and benefit continuation payments of \$6,815 each.

At December 31, 2008, neither Ms. Ricks nor Mr. Schlesinger would have been entitled to any benefits following a termination without cause or a change in control of Kennedy-Wilson. However, please see above under "*Executive Compensation Employment Agreements Ms. Ricks*" on page 248 for a description of the continued salary and benefits payable to Ms. Ricks upon certain qualifying terminations of her employment pursuant to the terms of her employment agreement entered into on February 1, 2009.

Kennedy-Wilson Director Compensation

Each non-employee director, other than Thomas Sorell, receives a fee of \$25,000 per year, \$1,000 for each board of directors meeting attended and \$500 for each committee meeting attended. The following table provides compensation information for the fiscal year ended December 31, 2008 for each non-employee member of Kennedy-Wilson's board of directors(1):

Name(2)	Fees Earned or Paid in	
	Cash (\$)	Total (\$)
Cathy Hendrickson	28,000	28,000
Norm Creighton	29,500	29,500
Jeffrey Hudson	29,000	29,000
Gary Kasper(3)	20,750	20,750
Kent Mouton	29,500	29,500
Jerry Solomon	28,000	28,000
Thomas Sorell(4)	0	0

- (1) The columns titled "Stock Awards," "Option Awards," "Non-Equity Incentive Plan Compensation," "Change in Pension Value and Nonqualified Deferred Compensation Earnings" and "All Other Compensation" have been omitted because no amounts would have been included in such columns.
- (2) Mr. McMorrow receives no compensation for his service as a director of Kennedy-Wilson.
- (3) Gary Kasper resigned from the board of directors of Kennedy-Wilson on November 1, 2008.

Table of Contents

(4)

Thomas Sorell was appointed as a member of the board of directors of Kennedy-Wilson on November 1, 2008. Mr. Sorell receives no compensation for his services as a director of Kennedy-Wilson.

Compensation Discussion and Analysis of Kennedy-Wilson Following the Merger / Post-Merger Employment Agreements and Benefits

Subsequent to the merger, it is expected that compensation decisions with respect to the named executive officers of the post-merger company will be made by the post-merger company's compensation committee. No decisions have been made at this time with respect to post-merger compensation decisions, other than as set forth above in section "*Executive Compensation Executive Compensation Actions in Connection with the Merger*" on page 249.

Table of Contents

COMPARISON OF RIGHTS OF PROSPECT AND KENNEDY-WILSON HOLDERS

Prospect and Kennedy-Wilson are both incorporated under the laws of the State of Delaware. Both companies are governed by the DGCL. If the merger is completed, Kennedy-Wilson Holders, whose rights are currently governed by Kennedy-Wilson's amended and restated certificate of incorporation and the Kennedy-Wilson's bylaws, will become stockholders of Prospect, and their rights as such will be governed by Prospect's amended and restated certificate of incorporation and Prospect's amended and restated bylaws. Prospect's stockholders, if the merger is completed, will remain stockholders of Prospect. The material differences between the rights of Kennedy-Wilson Holders and the rights of Prospect's stockholders are summarized below. Kennedy-Wilson as a direct wholly-owned subsidiary of Prospect will have its amended and restated certificate of incorporation and bylaws amended in connection with the merger.

This summary does not purport to be a complete statement of the rights of Prospect stockholders under Prospect's amended and restated certificate of incorporation following the consummation of the merger or its amended and restated bylaws or Kennedy-Wilson Holders under Prospect's amended and restated certificate of incorporation or its amended and restated bylaws. In addition, this summary does not purport to be a complete description of the specific provisions referred to herein and is qualified in its entirety by reference to the governing corporate documents and the DGCL. You are urged to read those documents carefully in their entirety. A copy of Prospect's second amended and restated certificate of incorporation as will be in effect if each of the charter amendment proposals are approved is attached as Annex D to this proxy statement/prospectus and a copy of Prospect's amended and restated bylaws is included with Prospect's Form S-1 Registration Statement filed with the SEC (SEC File No. (333-145110) on November 14, 2007.)

Rights under the DGCL	Capitalization:	
	Rights of Prospect's Stockholders	Rights of Kennedy-Wilson's Stockholders
	Prospect's amended and restated certificate of incorporation authorizes it to issue 81,000,000 shares, of which 80,000,000 are common stock, par value \$0.0001 per share, and 1,000,000 are preferred stock, par value \$0.0001. Prospect's board of directors is expressly granted the power to issue shares of the preferred stock in one or more series and to fix the rights and preferences, including voting powers, of each series of preferred stock.	KW's certificate of incorporation, as amended authorizes it to issue 62,000,000 shares, each with par value of \$0.01 per share, of which 50,000,000 shares are common stock, 5,000,000 shares are partial-voting common stock, 2,000,000 are shares of non-voting common stock and 5,000,000 are shares of preferred stock, of which 60,000 shares are designated as series A preferred stock. KW's board of directors is expressly granted the power to authorize the issuance of any or all shares of common stock, partial-voting common stock, non-voting common stock and one or more series of preferred stock.

Voting Rights:		
Rights under the DGCL	Rights of Prospect's Stockholders	Rights of Kennedy-Wilson's Stockholders
The DGCL permits that the holders of common stock are entitled to one vote per shares on all matters to be voted on by stockholders.	Except as otherwise required by law or as otherwise provided in the terms of any class or series of stock having a preference over the common stock, the holders of Prospect's common stock shall exclusively possess all voting power and each share of common stock shall have one vote.	Except as otherwise required by law, with respect to all matters upon which stockholders are entitled to vote, the holders of the outstanding shares of common stock shall vote together with the holders of any other outstanding shares of capital stock entitled to vote and each share of common stock shall have one vote.

Table of Contents

Voting Rights:

Rights under the DGCL

Rights of Prospect's Stockholders

Rights of Kennedy-Wilson's Stockholders

Except as required by law, outstanding shares of partial-voting common stock shall vote together with the holders of any other outstanding shares of capital stock and each share of partial-voting common stock shall have one-half (1/2) vote.

Except as otherwise required by law, non-voting common stock shall not be entitled to vote.

Except as otherwise required by law, series A preferred stock shall not be entitled to vote.

Dividends:

Rights under the DGCL

The DGCL permits a corporation to declare and pay dividends out of "surplus" or, if there is no "surplus," out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. "Surplus" is defined as the excess of the net assets of the corporation over the amount determined to be the capital of the corporation by the board of directors. The capital of the corporation is typically calculated to be (and cannot be less than) the aggregate par value of all issued shares of capital stock. Net assets equals the fair value of the total assets minus total liabilities. The DGCL also provides that dividends may not be paid out of net profits if, after the payment of the dividend, capital is less than the capital represented by the outstanding stock of all classes having a preference upon the distribution of assets.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws provide that the board of directors may declare dividends at a regular or special meeting and dividends may be paid in cash, property or shares of Prospect's capital stock, subject to the provisions of the amended and restated certificate of incorporation.

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, provides that the board of directors may declare dividends out of funds legally available to them and that the holders of common stock, partial-voting common stock and non-voting common stock shall be entitled to receipt such dividends ratably, subject to the rights and preferences of any preferred stock. Dividends on the series A preferred stock shall accrued and be cumulative from the issuance date. For each outstanding share of series A preferred stock, dividends shall be paid quarterly beginning June 30, 2008 and continue until such shares are converted. The payment of dividends shall be in cash.

The board of directors may also declare a dividend of securities to distribute to the holders of common stock, partial-voting common stock and non-voting common stock.

Table of Contents

Appraisal Rights:

Rights under the DGCL

Under the DGCL, Section 262, where a merger is to be submitted for approval at a meeting of stockholders, not less than 20 days prior to the meeting, a constituent corporation must notify each of the holders of its stock for whom appraisal rights are available that such appraisal rights are available and include in each such notice a copy of Section 262. A record holder of shares who has made the demand with respect to such shares, who continuously is the record holder of such shares through the effective time of the merger, and who otherwise complies with the statutory requirements of Section 262 will be entitled to an appraisal by the Delaware Court of Chancery of the fair value of his, her or its shares in lieu of the consideration that such stockholder would otherwise be entitled to receive pursuant to the merger.

Rights of Prospect's Stockholders

Rights of Kennedy-Wilson's Stockholders

Holders of Kennedy-Wilson common stock and preferred stock are entitled to exercise appraisal rights in connection with the merger under Section 262.

Holders of Kennedy-Wilson common stock and preferred stock may also be entitled to exercise appraisal rights in connection with the merger under the CGCL.

Number of Directors:

Rights under the DGCL

Under the DGCL, the board of directors shall consist of 1 or more members, all of who are a natural person and such number of directors shall be fixed in a corporation's bylaws unless the certificate of incorporation fixes the number of directors.

Rights of Prospect's Stockholders

Pursuant to Prospect's amended and restated certificate of incorporation and amended and restated bylaws, the board of directors shall consist of three classes and each such class shall consist, as nearly as may be possible, of one-third of the total number of directors constituting the entire board of directors. The number of directors shall be fixed from time to time by a vote of a majority of the entire board of directors and shall be not less than one director and no more than nine directors.

Rights of Kennedy-Wilson's Stockholders

Pursuant to KW's certificate of incorporation, as amended, and bylaws, the board of directors shall consist of three classes and each class shall consist, as nearly as may be possible, of one-third of the total number of directors constituting the entire board of directors. The number of directors shall be seven, subject to change by the board of directors.

Removal of Directors:

Rights under the DGCL

Under the DGCL, unless where the board of directors is classified or the certificate of incorporation provides for cumulative voting, a director may be removed with or without cause by a majority of the shares entitled to vote at an election of directors.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws provide that any director may be removed, from office with or without cause by a majority vote of the holders of the outstanding shares entitled to vote at an election of directors.

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, and bylaws are silent as to the stockholder's right to remove directors.

Table of Contents

Filling Vacancies on the Board of Directors:

Rights under the DGCL

Under the DGCL, unless otherwise provided in the certificate of incorporation, a majority of the directors in office can fill any vacancy or newly created directorship.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws provide that any newly created directorships resulting from an increase in the number of directors or vacancies occurring in the board of directors or from any other cause may be filled by a majority of the directors then in office.

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, and bylaws provide that any vacancy in the board, whether because of death, resignation or an increase in the number of directors, may be filled by a vote of the majority of the remaining directors, even if less than a quorum.

Prospect's amended and restated certificate of incorporation provides that the election of directors need not be by ballot unless provided by the bylaws.

Amendments to Certificate of Incorporation:

Rights under the DGCL

Under the DGCL, an amendment to the certificate of incorporation requires that the board of directors approve the amendment, declare it advisable and submit it to stockholders for adoption. Such amendment must be adopted by a majority in voting power of all issued and outstanding shares and any greater vote required by the certificate of incorporation. Except in limited circumstances, any proposed amendment to the certificate of incorporation that would increase or decrease the authorized shares of a class of stock, increase or decrease the par value of the shares of a class of stock, or alter or change the powers, preferences or special rights of the shares of a class of stock (so as to affect them adversely) requires approval of the holders of a majority of the outstanding shares of the affected class, voting as a separate class, in addition to the approval of a majority of the shares entitled to vote on that proposed amendment. If any proposed amendment would alter or change the powers, preferences or special rights of any series of a class of stock so as to affect them adversely, but does not affect the entire class, then only the shares of the series affected by the proposed amendment is considered a separate class for purposes of the immediately preceding sentence.

Rights of Prospect's Stockholders

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, provides that KW reserves the right to amend, alter, change or repeal any provision contained in the certificate of incorporation in the manner prescribed by law.

Table of Contents

Amendments to Bylaws:

Rights under the DGCL

Under the DGCL, the power to adopt, amend or repeal bylaws is conferred upon the stockholders. A corporation may, however, in its certificate of incorporation also confer upon the board of directors the power to adopt, amend or repeal its bylaws.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws and amended and restated certificate of incorporation provide that the bylaws may be adopted, amended or repealed by the stockholders entitled to vote thereon at any regular or special meeting. The board of directors also has the power, without the assent or vote of the stockholders to make, alter, amend, change, add or repeal the bylaws, subject to the stockholder's right to alter or repeal any bylaw.

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, and bylaws provide that the bylaws may be altered, amended or repealed by the board of directors or by an affirmative vote of the stockholders holding a majority in voting power of the outstanding capital stock entitled to vote at an election of directors.

Special Meetings of the Board of Directors:

Rights under the DGCL

Under the DGCL, the board of directors can meet telephonically or through other communications and any action can be taken by consent, subject to restrictions set by the certificate of incorporation or bylaws.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws provide that special meetings of the board of directors may be called by the chief executive officer, the president or a majority of the entire board of directors. Notice of the meeting shall state the place, date and hour of the meeting and shall be given to each director either by mail not less than forty-eight (48) hours before the date of the meeting, by telephone, facsimile, telegram or email on twenty-four (24) hours notice, or on such shorter notice as the person or persons calling such meeting may deem necessary or appropriate in the circumstances.

Rights of Kennedy-Wilson's Stockholders

KW's bylaws provide that special meetings of the board of directors may be called by the chairman of the board or, if the chairman is absent or unable or refuses to act, by the chief executive officer or the president. Written notice of the time and place of the special meetings shall be delivered personally or by facsimile to each director, or sent to each director by mail or by other form of written communication. Except where otherwise required by law or they bylaws, notice of the purpose of the special meeting need not be given.

Special Stockholders Meetings:

Rights under the DGCL

Under the DGCL, a special meeting of a corporation's stockholders may be called by the board or by any other person authorized by the corporation's articles or certificate of incorporation or bylaws. Generally, all stockholders of record entitled to vote must receive notice of stockholder meetings not less than 10 nor more than 60 days before the date of the stockholder meeting.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws provide that special meetings of the stockholders, for any purpose or purposes, may only be called by a majority of the entire board of directors, or the chief executive officer, the chairman or the secretary. Written notice of such meeting shall state the time, place and purpose or purposes of the special meeting and shall be given to each stockholder entitled to vote at such meeting, not less than ten (10) or more than sixty (60) days before the date fixed for the meeting. Business transacted at any special meeting of stockholders shall be limited to the purpose or purposes stated in the notice.

Rights of Kennedy-Wilson's Stockholders

KW's bylaws provide except as otherwise required by law, notice of each meeting of stockholders shall be given not less than ten (10) days nor more than sixty (60) days before the date of the meeting to each stockholder of record entitled to vote at such meeting by delivering a type written or printed notice personally or by mailing such notice. Every notice of a special meeting of stockholders shall state the place, date, hour and purpose for which the meeting is called.

Table of Contents

Requirements for Timely Stockholder Notification:

Rights under the DGCL

Under the DGCL, notice of a special or annual meeting of a corporation's stockholders must be received not less than 10 nor more than 60 days before the date of the stockholder meeting.

Rights of Prospect's Stockholders

Prospect's amended and restated bylaws provide that, to be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of the company not less than ninety (90) days nor more than one hundred and twenty (120) days prior to the annual meeting; provided, however, that in the event that less than ninety (90) days notice or public disclosure of the date of the annual meeting is given or made to stockholders, notice by a stockholder, to be timely, must be received no later than the close of business on the tenth (10th) day following the day on which such notice of the date of the annual meeting was mailed or such public disclosure was made, whichever first occurs. A stockholder's notice to the secretary shall set forth (a) as to each matter the stockholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, and (ii) any material interest of the stockholder in such business, and (b) as to the stockholder giving the notice (i) the name and record address of the stockholder and (ii) the class, series and number of shares of Prospect capital stock which are beneficially owned by the stockholder.

Rights of Kennedy-Wilson's Stockholders

KW's bylaws provide that notice of each meeting of stockholders shall be given not less than ten (10) days nor more than sixty (60) days before the date of the meeting to each stockholder of record entitled to vote at such meeting by delivering a type written or printed notice personally or by mailing such notice.

Table of Contents

Mergers, Consolidations and Other Transactions:

Rights under the DGCL

Under the DGCL, the board of directors and the holders of a majority of the outstanding shares entitled to vote must approve a merger, consolidation or sale of all or substantially all of a corporation's assets. However, unless the corporation provides otherwise in its certificate of incorporation, no stockholder vote of a constituent corporation surviving a merger is required if: (i) the merger agreement does not amend the constituent corporation's articles or certificate of incorporation; (ii) each share of stock of the constituent corporation outstanding immediately before the merger is to be an identical outstanding or treasury share of the surviving corporation after the merger; and; (iii) either no shares of common stock of the surviving corporation and no shares, securities or obligations convertible into such stock are to be issued or delivered under the plan of merger, or the authorized unissued shares or the treasury shares of common stock of the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed 20% of the shares of common stock of such constituent corporation outstanding immediately prior to the effective date of the merger.

Rights of Prospect's Stockholders

Neither Prospect's amended and restated certificate of incorporation nor bylaws contains any super-majority voting requirements governing mergers, consolidations, sales of substantially all of the assets, liquidations, reclassifications or recapitalizations.

Rights of Kennedy-Wilson's Stockholders

Neither the Kennedy-Wilson's certificate of incorporation, as amended, nor bylaws contain any super-majority or class voting requirements governing mergers, consolidations, sales of substantially all of the assets, liquidations, reclassifications or recapitalizations.

Limitation of Personal Liability of Directors:

Rights under the DGCL

Section 102(b)(7) of the DGCL permits a corporation, in its certificate of incorporation, to limit or eliminate, subject to certain statutory limitations, the liability of directors to the corporation or its stockholders for monetary damages for breaches of fiduciary duty, except for liability (i) for any breach of the director's duty of loyalty to the company or its stockholders; (ii) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of labor acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; (iii) in respect of certain unlawful dividend payments or stock redemptions or repurchases; and (iv) for any transaction from which the director derives an improper personal benefit.

Rights of Prospect's Stockholders

Prospect's amended and restated certificate of incorporation provides that no director shall be personally liable to the company or its stockholders for monetary damages for breach of a fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the company or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the DGCL, or (iv) for any transaction from which the director derived an improper personal benefit. If the DGCL is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the company shall be eliminated or so limited to the fullest extent permitted by the DGCL, as so amended.

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, provides that no director shall be liable to the company or its stockholders for monetary damages for breach of fiduciary duty as a director, to the fullest extent permitted by the DGCL.

Table of Contents

Limitation of Personal Liability of Directors:

Rights under the DGCL

Rights of Prospect's Stockholders

Rights of Kennedy-Wilson's Stockholders

In accordance with Section 102(b)(7) of the DGCL, Section 8.1 of the Company's charter provides that no director shall be personally liable to the Company or any of its stockholders for monetary damages resulting from breaches of their fiduciary duty as directors, except to the extent such limitation on or exemption from liability is not permitted under the DGCL. The effect of this provision of the Company's charter is to eliminate the Company's rights and those of its stockholders (through stockholders' derivative suits on the Company's behalf) to recover monetary damages against a director for breach of the fiduciary duty of care as a director, including breaches resulting from negligent or grossly negligent behavior, except, as restricted by Section 102(b)(7) of the DGCL. However, this provision does not limit or eliminate the Company's rights or the rights of any stockholder to seek non-monetary relief, such as an injunction or rescission, in the event of a breach of a director's duty of care.

If the DGCL is amended to authorize corporate action further eliminating or limiting the liability of directors, then, in accordance with the Company's charter, the liability of the Company's directors to the Company or its stockholders will be eliminated or limited to the fullest extent authorized by the DGCL, as so amended. Any repeal or amendment of provisions of the Company's charter limiting or eliminating the liability of directors, whether by the Company's stockholders or by changes in law, or the adoption of any other provisions inconsistent therewith, will (unless otherwise required by law) be prospective only, except to the extent such amendment or change in law permits the Company to further limit or eliminate the liability of directors on a retroactive basis.

Table of Contents

Indemnification of Directors and Officers:

Rights under the DGCL

Section 145(a) of the DGCL empowers a corporation to indemnify any director, officer, employee or agent, or former director, officer, employee or agent, who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of his service as a director, officer, employee or agent of the corporation, or his service, at the corporation's request, as a director, officer, employee or agent of another corporation or enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding provided that such director or officer acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, provided that such director or officer had no reasonable cause to believe his conduct was unlawful.

Section 145(b) of the DGCL empowers a corporation to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that such person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another enterprise, against expenses (including attorneys' fees) actually and reasonably incurred in connection with the defense or settlement of such action or suit provided that such director or officer acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, except that no indemnification may be made in respect of any claim, issue or matter as to which such director or officer shall have been adjudged to be liable to the corporation unless and only to the extent that the Delaware Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such director or officer is fairly and reasonably entitled to indemnity for such expenses which the court shall deem proper.

Rights of Prospect's Stockholders

Prospect's amended and restated certificate of incorporation provides that Prospect shall indemnify, to the fullest extent permitted by Section 145 of the DGCL, all persons whom it may indemnify pursuant thereto. Expenses, including attorneys' fees, incurred by an officer or director in defending any civil, criminal, administrative, or investigative action, suit or proceeding for which such officer or director may be entitled to indemnification hereunder shall be paid by the company in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the company as authorized hereby.

Rights of Kennedy-Wilson's Stockholders

KW's certificate of incorporation, as amended, provides that it shall indemnify any director or officer who is a party, or threatened to be made a party, to any threatened, pending or completed action, suit or proceeding, whether or not by or in the right of the company, and whether civil, criminal administrative, investigative or otherwise, by reason of the fact that such person is or was a director or officer of the company, or is or was serving at the request of the company as a director or officer of another corporation, partnership, joint venture, trust or other enterprise, to the fullest extent permitted by the DGCL. To the fullest extent permitted by the DGCL, the indemnification provided for in KW's certificate of incorporation, as amended, includes expenses (including attorneys' fees), judgments, fines and amounts paid in settlement and, in the manner provided by the DGCL, any such expenses may be paid by the company in advance of the final disposition of such action, suit or proceeding.

Table of Contents

Indemnification of Directors and Officers:

Rights under the DGCL

Rights of Prospect's Stockholders

Rights of Kennedy-Wilson's Stockholders

Section 145 of the DGCL further provides that to the extent a director or officer of a corporation has been successful in the defense of any action, suit or proceeding referred to in Section 145(a) or Section 145(b) of the DGCL or in the defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith, provided that indemnification provided for by Section 145 of the DGCL or granted pursuant thereto shall not be deemed exclusive of any other rights to which the indemnified party may be entitled, and empowers the corporation to purchase and maintain insurance on behalf of a director or officer of the corporation against any liability asserted against him or incurred by him in any such capacity or arising out of his status as such whether or not the corporation would have the power to indemnify him against such liabilities under Section 145 of the DGCL.

Commission Position on Indemnification for Securities Act Liabilities

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling Prospect or Kennedy-Wilson pursuant to the foregoing provisions, Prospect and Kennedy-Wilson have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

Table of Contents

BENEFICIAL OWNERSHIP OF SECURITIES

The following table sets forth information regarding the beneficial ownership of the common stock of Prospect as of October 21, 2009 and the beneficial ownership of the common stock of the post-merger company by:

each person known by Prospect to be the beneficial owner of more than 5% of its outstanding shares of common stock either on October 21, 2009 or after the consummation of the merger, assuming the merger occurred on October 21, 2009;

each of Prospect's current executive officers and directors;

each of the executive officers and directors upon consummation of the merger;

all of Prospect's current executive officers and directors as a group; and

all of Prospect's executive officers and directors as a group after the consummation of the merger.

This table is based on an exchange ratio in the merger of 3.8031 shares of Prospect common stock per share of Kennedy-Wilson common stock and 105.6412 shares of Prospect common stock per share of Kennedy-Wilson preferred stock. This table:

assumes that no holder of public shares converts such shares into cash and that no Kennedy-Wilson holder of common stock exercises its appraisal rights,

assumes that 26.0 million shares are issued to Kennedy-Wilson Holders in the merger,

assumes that 2,376,000 shares of restricted common stock will be issued to Kennedy-Wilson executive officers and management pursuant to the 2009 Plan,

assumes that 250,000 shares will be issued to De Guardiola Holdings, Inc. upon consummation of the merger, and

gives effect to the forfeiture and cancellation of 4,750,000 shares of founders shares. Information (pre-merger) does not reflect beneficial ownership of Prospect's outstanding warrants as these warrants are not currently exercisable. Information (post-merger) assumes that all warrants are exercisable immediately after the merger. Except as set forth in the footnotes to this table, the

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

persons named in the table have sole voting and dispositive power with respect to all shares shown as beneficially owned by them.

Name of Beneficial Owner	Prospect Pre-Merger		Prospect Post-Merger	
	Amount and Nature of Beneficial Ownership	Approximate Percentage of Outstanding Common Stock(1)	Amount and Nature of Beneficial Ownership	Approximate Percentage of Outstanding Common Stock(2)
Flat Ridge Investments LLC(3)	3,271,753	10.5%	3,907,721(4)	6.7%
HBK Investments L.P.(5)	3,069,191	9.8%	3,069,191	5.6%
Aldebaran Investments LLC(6)	1,916,820	6.1%	1,916,820	3.5%
QVT Financial LP(7)	1,800,450	5.8%	1,800,450	3.3%
Hartz Capital, Inc.(8)	1,590,016	5.1%	1,590,016	2.9%
David A. Minella(9)	3,271,753	10.5%	3,907,721(4)	6.7%
Patrick J. Landers(10)	1,505,514	4.8%	2,041,323(11)	3.6%
James J. Cahill	406,250	1.3%	125,000	*%
Michael P. Castine	138,021	.4%	33,125	*%
William Cvengros(12)	138,021	.4%	33,125	*%
Michael Downey	138,021	.4%	33,125	*%
Daniel Gressel	138,021	.4%	233,125(13)	*%
William Landman(14)	376,378	1.2%	510,331(15)	*%
John Merchant	138,021	.4%	33,125	*%
All Prospect executive officers and directors as a group	6,250,000	20.0%	6,950,000	11.5%
William J. McMorrow(17)	0	0%	14,371,938(16)	26.1%
Mary Ricks(17)	0	0%	1,012,579	1.8%
Freeman A. Lyle(17)	0	0%	728,622	1.3%
Barry S. Schlesinger(17)	0	0%	114,209	*%
James A. Rosten(17)	0	0%	261,540	*%
Robert E. Hart(17)	0	0%	116,854	*%
Donald J. Herrema(17)	0	0%	556,875	1.0%
Kent Mouton(17)	0	0%	128,630	*%
Jerry R. Solomon(17)	0	0%	57,837	*%
Norm Creighton(17)	0	0%	225,574	*%
Thomas Sorell(17)	0	0%	0	*%
Cathy Hendrickson(17)	0	0%	3,094	*%
All executive officers and directors as a group post-merger	0	0%	21,485,473	36.9%

*

Less than 1%

- (1) Amount and applicable percentage of ownership is based on 31,250,000 shares of Prospect's common stock outstanding on October 21, 2009, which in some instances results in a different percentage than reported by the beneficial owners on their respective 13G filings.
- (2) Amount and applicable percentage of ownership is based on 55,126,000 shares of Prospect's common stock outstanding on October 21, 2009, assuming the merger occurred on October 21, 2009 and no public shares are converted upon consummation of the merger, which in some instances results in a different percentage than reported by the beneficial owners on their respective 13G filings.
- (3) David A. Minella is the Managing Member of Flat Ridge Investments LLC, and may be deemed to beneficially own the same number of shares of common stock reported by Flat Ridge Investments LLC. Mr. Minella disclaims beneficial ownership of any shares in which he does not

Table of Contents

have a pecuniary interest. Mr. Minella and Flat Ridge Investments LLC have shared voting and dispositive power with respect to all of the reported shares of common stock. The business address of Mr. Minella and Flat Ridge Investments LLC is 814 Hollow Tree Ridge Road, Darien, Connecticut 06820. The foregoing information was derived from a Schedule 13G filed with the SEC on February 14, 2008.

- (4) Includes 3,150,000 sponsors warrants beneficially owned by Flat Ridge Investments LLC.
- (5) The amount shown is the aggregate number of shares of common stock beneficially owned by HBK Investments L.P., HBK Services LLC, HBK New York LLC, HBK Partners II L.P., HBK Management LLC, HBK Master Fund L.P. and HBK Special Opportunities Fund I L.P., or the HBK Entities. The HBK Entities have shared voting and dispositive power with respect to all of the reported shares of common stock. The business address of each of the HBK Entities except HBK New York LLC is 2101 Cedar Springs Road, Suite 700, Dallas, Texas 75201. The business address of HBK New York LLC is 350 Park Avenue, 20th Floor, New York, New York 10022. The foregoing information was derived from a Schedule 13G filed with the SEC on February 3, 2009.
- (6) Aldebaran Investments LLC, or Aldebaran, is the investment manager of a separate account which owns 1,916,820 shares of common stock. Aldebaran is deemed to be the beneficial owner of these shares. The business address of Aldebaran is 500 Park Avenue, 5th Floor, New York, NY 10022. The foregoing information was derived from a Schedule 13G filed with the SEC on February 17, 2009.
- (7) QVT Financial LP, or QVT Financial, is the investment manager for QVT Fund LP, or the Fund, Quintessence Fund L.P., or Quintessence, and a separate discretionary account managed for Deutsche Bank AG, or the Separate Account. The Fund beneficially owns 1,504,500 shares of common stock, Quintessence beneficially owns 150,052 shares of common stock and the Separate Account holds 145,898 shares of common stock. QVT Financial has the power to direct the vote and disposition of the common stock held by the Fund, Quintessence and the Separate Account. Accordingly, QVT Financial may be deemed to be the beneficial owner of an aggregate of 1,800,450 shares of common stock, consisting of shares owned by the Fund and Quintessence and the shares held in the Separate Account. QVT Financial GP LLC, as General Partner of QVT Financial, may be deemed to beneficially own the same number of shares of common stock reported by QVT Financial. QVT Associates GP LLC, as General Partner of the Fund and Quintessence, may be deemed to beneficially own the aggregate number of shares of common stock owned by the Fund and Quintessence, and accordingly, QVT Associates GP LLC may be deemed to be the beneficial owner of an aggregate of 1,654,552 shares of common stock. Each of QVT Financial and QVT Financial GP LLC disclaims beneficial ownership of all shares of common stock owned by the Fund, Quintessence and the Separate Account. QVT Associates GP LLC disclaims beneficial ownership of all shares of common stock owned by the Fund and Quintessence, except to the extent of its pecuniary interest therein. QVT Financial, QVT Financial GP LLC, the Fund and QVT Associates GP LLC have shared voting and dispositive power with respect to those shares of common stock beneficially owned by each of the respective entities as set forth herein. The business address of each of QVT Financial, QVT Financial GP LLC and QVT Associates GP LLC is 1177 Avenue of the Americas, 9th Floor, New York, New York 10036. The business address of the Fund is Walkers SPV, Walkers House, Mary Street, George Town, Grand Cayman KY1-9002, Cayman Islands. The foregoing information was derived from a Schedule 13G filed with the SEC on February 3, 2009.
- (8) Hartz Capital, Inc., or Hartz Capital, is the investment manager of Hartz Capital Investments, LLC, or the Fund. The Fund beneficially owns 1,590,016 shares of common stock. Hartz Capital is also deemed to have beneficial ownership of these shares. The business address of both Hartz Capital and the Fund is 400 Plaza Drive, Secaucus, NJ 07094. The foregoing information was derived from a Schedule 13G filed with the SEC on August 27, 2008.

Table of Contents

- (9) David A. Minella is the Managing Member of Flat Ridge Investments LLC, and may be deemed to beneficially own the 3,271,753 shares of common stock beneficially owned by Flat Ridge Investments LLC as of the record date, the 757,721 shares of common stock beneficially owned by Flat Ridge Investments LLC after taking into account the forfeiture and cancellation of the founders shares in connection with the merger, and the 3,150,000 sponsor warrants beneficially owned by Flat Ridge Investments LLC. Mr. Minella disclaims beneficial ownership of any shares in which he does not have a pecuniary interest.
- (10) Patrick J. Landers does not own any shares of common stock directly, but may be deemed to beneficially own the 1,475,404 shares of common stock beneficially owned by LLM Structured Equity Fund L.P. and the 30,110 shares of common stock beneficially owned by LLM Investors L.P. as of the record date, 354,097 shares of common stock beneficially owned by LLM Structured Equity Fund L.P. and 7,226 shares of common stock beneficially owned by LLM Investors L.P. after taking into account the forfeiture and cancellation of the founders shares in connection with the merger and 1,646,400 sponsor warrants beneficially owned by LLM Structured Equity Fund L.P. and 33,600 sponsor warrants beneficially owned by LLM Investors L.P. Mr. Landers owns a 50% membership interest in LLM Capital Group LLC, which owns a 75% membership interest in LLM Capital Partners LLC. LLM Capital Partners LLC is the Sole Member of LLM Advisors LLC, which is the General Partner of LLM Advisors L.P. LLM Advisors LLC makes investment decisions through an investment committee on behalf of LLM Advisors L.P., which is the General Partner of each of LLM Structured Equity Fund L.P. and LLM Investors L.P. Mr. Landers is a member of the investment committee of LLM Advisors LLC. Mr. Landers disclaims beneficial ownership of any shares in which he does not have a pecuniary interest.
- (11) Includes 1,646,400 sponsor warrants beneficially owned by LLM Structured Equity Fund L.P. and 33,600 sponsor warrants beneficially owned by LLM Investors L.P.
- (12) William Cvengros is the Managing Member of SJC Capital LLC, and may be deemed to beneficially own the 138,021 shares of common stock beneficially owned by SJC Capital LLC as of the record date and 33,125 shares of common stock beneficially owned by SJC Capital LLC after taking into account the forfeiture and cancellation of the founders shares in connection with the merger. Mr. Cvengros disclaims beneficial ownership of any shares in which he does not have a pecuniary interest.
- (13) Includes 200,000 public warrants purchased by Daniel Gressel on the open market.
- (14) William Landman is the Managing Member of CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), and may be deemed to beneficially own the 376,378 shares of common stock beneficially owned by CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.) as of the record date, 90,331 shares of common stock beneficially owned by CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.) after taking into account the forfeiture and cancellation of the founders shares in connection with the merger and 420,000 sponsor warrants beneficially owned by CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.). Mr. Landman disclaims beneficial ownership of any shares in which he does not have a pecuniary interest.
- (15) Includes 420,000 sponsor warrants beneficially owned by CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.).
- (16) Includes 90,851 shares of common stock beneficially owned by Leslie McMorrow, Mr. McMorrow's wife, and 52,821 shares of common stock beneficially owned by Tyler McMorrow, Mr. McMorrow's son. Mr. McMorrow disclaims beneficial ownership of the shares owned by his wife and son.
- (17) The address for such individual is c/o Kennedy-Wilson, Inc., 9701 Wilshire Boulevard, Suite 700, Beverly Hills, California 90212. Except as otherwise indicated, each individual holds sole voting and dispositive power with respect to all reported shares of common stock.

Table of Contents

CERTAIN RELATIONSHIPS AND TRANSACTIONS WITH RELATED PERSONS

Prospect Transactions with Related Persons

On July 18, 2007, Prospect issued an aggregate of 4,312,500 shares of common stock to Flat Ridge Investments LLC, LLM Structured Equity Fund L.P. and LLM Investors L.P., an entity affiliated with David A. Minella, Prospect's Chairman and Chief Executive Officer, in exchange for an aggregate purchase price of \$25,000 in cash. Subsequent to the purchase of these shares, each of:

Flat Ridge Investments LLC transferred at cost an aggregate of 431,252 of these shares to SJC Capital LLC, an entity affiliated with William Cvengros, one of Prospect's directors, and Michael P. Castine, Michael Downey and Daniel Gressel, each of whom is a director,

LLM Structured Equity Fund L.P. and LLM Investors L.P. transferred at cost an aggregate of 345,000 of these shares to CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), a corporation affiliated with William Landman, a Prospect director,

LLM Structured Equity Fund L.P., LLM Investors L.P. and CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.) transferred at cost an aggregate of 215,625 of these shares to James J. Cahill, Prospect's Chief Financial Officer and Secretary,

LLM Structured Equity Fund L.P. transferred at cost an aggregate of 64,688 of these shares to James J. Cahill and

SJC Capital LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., Michael P. Castine, Michael Downey, Daniel Gressel and CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.) transferred at cost an aggregate of 161,721 of these shares to Flat Ridge Investments LLC.

In October 2007, the aggregate outstanding 4,312,500 shares of common stock were increased to 7,187,500 shares of common stock as a result of a 5-for-3 stock split declared by Prospect's board of directors. Subsequent to the stock split, Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P. and CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.) transferred at cost an aggregate of 158,724 of these shares to John Merchant, one of Prospect's directors.

On December 21, 2007, upon the expiration of the underwriters' over-allotment option granted in connection with Prospect's IPO, Prospect repurchased an aggregate of 937,500 founder shares from its initial stockholders at a price equal to \$0.0001 per share. In connection with such repurchase, Prospect recorded the aggregate fair value of the shares purchased to treasury stock and a corresponding credit to additional paid-in capital based on the difference between the fair market value of the shares of common stock repurchased and the price equal to \$0.0001 per share (which was an aggregate total of \$93.75 for all 937,500 shares). Upon receipt, the repurchased shares were immediately cancelled, which resulted in the retirement of the treasury stock and a corresponding charge to additional paid-in capital.

The initial stockholders holding a majority of such shares are entitled to make up to three demands that Prospect register these shares pursuant to an agreement signed on November 14, 2007. The holders of the majority of these shares may elect to exercise these registration rights at any time generally commencing nine months after the consummation of Prospect's initial business combination. In addition, these stockholders have certain "piggy-back" registration rights with respect to registration statements filed by Prospect subsequent to the date on which these shares of common stock are released from escrow. Prospect will bear the expenses of registering these securities.

On November 14, 2007, Prospect issued 5,250,000 sponsors warrants (exercisable at \$7.50 per warrant), to Flat Ridge Investments LLC, an entity affiliated with David A. Minella, Prospect's

Table of Contents

Chairman and Chief Executive Officer, LLM Structured Equity Fund L.P. and LLM Investors L.P., entities affiliated with Patrick J. Landers, Prospect's President and a director, and CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), a corporation affiliated with William Landman, one of Prospect's directors, for an aggregate purchase price of \$5,250,000. All of the proceeds Prospect received from these purchases were placed in the trust account. The sponsors warrants are identical to the public warrants underlying the units sold in Prospect's IPO except that:

the sponsors warrants are non-redeemable so long as of they are held by any of the sponsors or their permitted transferees,

they are non-transferable, other than to permitted transferees, until the date that is 30 days after the date on which Prospect consummates the initial business combination,

for so long as the sponsors warrants are subject to the transfer restrictions described in the second bullet above, the sponsors warrants are not exercisable and

the sponsors warrants are exercisable on a cashless basis at the holders' option so long as the sponsors warrants are held by the sponsors or their affiliates.

Prospect has agreed to register the shares underlying the sponsors warrants at any time after Prospect has consummated its initial business combination, but the purchasers of the sponsors warrants have agreed that the sponsors warrants will not be sold or, subject to certain limited exceptions, transferred by them and they may not exercise the sponsors warrants until 30 days after Prospect has completed a business combination. Accordingly, the sponsors warrants have been placed in escrow and will not be released until 30 days after the completion of a business combination. Such sponsors warrants are not publicly traded and have an exercise price of \$7.50 per warrant. All of the sponsors warrants will become worthless if the merger is not consummated by November 14, 2009 (as will the remainder of the public warrants).

The holders of the majority of these sponsors warrants (or underlying shares) are entitled to make up to three demands that Prospect register these securities pursuant to the registration rights agreement referred to above. The holders of the majority of these securities may elect to exercise these registration rights with respect to such securities at any time after Prospect consummates the initial business combination. In addition, these holders will have certain "piggy-back" registration rights with respect to registration statements filed subsequent to such date. Prospect will bear the expenses incurred in connection with the filing of any such registration statement.

Each of Teleos Management, L.L.C., an entity affiliated with Daniel Gressel, one of Prospect's directors, and LLM Capital Partners LLC, an entity affiliated with Patrick J. Landers, Prospect's President and a director, LLM Structured Equity Fund L.P. and LLM Investors L.P., has agreed that, commencing on November 14, 2007 through the acquisition of Kennedy-Wilson, it will make available to Prospect office space and certain office and secretarial services, as Prospect may require from time to time. Prospect has agreed to pay Teleos Management, L.L.C., \$4,500 per month and LLM Capital Partners LLC, \$3,000 per month for these services (amended December 31, 2008 to \$4,083.15 and \$2,722.10, respectively). This arrangement is solely for Prospect's benefit and is not intended to provide Mr. Gressel or Mr. Landers compensation in lieu of a salary. Prospect believes, based on rents and fees for similar services in the Naples, Florida and Boston, Massachusetts metropolitan areas, that the fee charged by each of Teleos Management, L.L.C. and LLM Capital Partners LLC, is at least as favorable as Prospect could have obtained from an unaffiliated person.

To fund pre-offering expenses associated with Prospect's IPO, Flat Ridge Investments LLC, LLM Structured Equity Fund L.P. and LLM Investors L.P. advanced an aggregate of \$200,000 to Prospect in exchange for a promissory note, without interest, which was repaid from the proceeds of Prospect's IPO.

Table of Contents

Prospect will reimburse its officers and directors for any reasonable out-of-pocket business expenses incurred by them in connection with certain activities on its behalf such as identifying and investigating possible target businesses and business combinations. There is no limit on the amount of out-of-pocket expenses that could be incurred; provided, however, that to the extent such out-of-pocket expenses exceed the available proceeds not deposited in the trust account and interest income of up to \$2.75 million on the balance in the trust account (subject to the holdback of a sufficient amount of interest income to pay any due and unpaid taxes on such \$2.75 million), such out-of-pocket expenses would not be reimbursed by Prospect unless Prospect consummates the initial business combination. Prospect's audit committee will review and approve all payments made to its initial stockholders, sponsors, officers and directors, and any payments made to members of Prospect's audit committee will be reviewed and approved by its board of directors, with the interested director or directors abstaining from such review and approval.

Prospect has entered into a business opportunity right of first review agreement with David A. Minella, its Chairman and Chief Executive Officer, who is affiliated with Flat Ridge Investments LLC, one of Prospect's sponsors, Patrick J. Landers, Prospect's President and a director, who is affiliated with LLM Structured Equity Fund L.P. and LLM Investors L.P., two of Prospect's sponsors, James J. Cahill, Prospect's Chief Financial Officer and Secretary, William Landman, a Prospect directors, who is affiliated with CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), one of Prospect's sponsors, and Michael P. Castine, William Cvengros, Michael Downey, Daniel Gressel and John Merchant, each of whom is a director, and each a Prospect sponsor, which provides that from November 14, 2007 until the earlier of the consummation of the initial business combination or Prospect's liquidation, Prospect will have a right of first review with respect to business combination opportunities of which Messrs. Minella, Landers, Cahill, Landman, Castine, Cvengros, Downey, Gressel, Merchant and each of its sponsors, and companies or other entities that they manage or control become aware, in the financial services industry with an enterprise value of \$195 million or more.

Other than the \$7,500 per month administrative fee (amended December 31, 2008 to \$6,805.25 per month) and reimbursable out-of-pocket expenses payable to its officers and directors, no compensation or fees of any kind, including finder's fees, consulting fees or other similar compensation, will be paid to awarded to or earned by any of Prospect's initial stockholders, sponsors, officers or directors, or to any of their respective affiliates, prior to or with respect to the initial business combination (regardless of the type of transaction that it is).

After the merger, members of Prospect's management team who remain may be paid consulting, management or other fees from the post-merger company with any and all amounts being fully disclosed to stockholders. As information about executive and director compensation post-merger becomes known it will be publicly disclosed at the time of its determination in a Current Report on Form 8-K, as required by the SEC.

All ongoing and future transactions between Prospect and any director or member of its management team, initial stockholders, sponsors, or their respective affiliates, including financing, will be on terms believed by Prospect at that time, based upon other similar arrangements known to it, to be no less favorable than are available from unaffiliated third parties. Such transactions will require prior approval in each instance by its audit committee. Prospect will not enter into the initial business combination with an entity that is affiliated with any of its officers, directors, sponsors or initial stockholders. All affiliated transactions will be on terms no less favorable to it than could be obtained from independent parties. All affiliated transactions must be approved by a majority of its independent and disinterested directors.

In connection with the merger, Prospect entered into a forfeiture agreement with De Guardiola Advisors, Inc., De Guardiola Holdings, Inc., Kennedy-Wilson, Flat Ridge Investments LLC, LLM

Table of Contents

Structured Equity Fund L.P., LLM Investors L.P., CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), SJC Capital LLC, Michael P. Castine, Michael Downey, Daniel Gressel, James J. Cahill and John Merchant, as amended by a first amendment dated October 22, 2009, whereby immediately prior to and subject to consummation of the merger, 4,750,000 founder shares will be cancelled and forfeited. As a result of this forfeiture, at the consummation of the merger, the founders will own 1,500,000 shares of Prospect common stock.

Code of Ethics and Related Person Policy

Prospect has adopted a code of ethics, which establishes standards of ethical conduct applicable to all of its officers, directors and employees. You will be able to review Prospect's code of ethics by accessing its public filings at the SEC's web site at <http://www.sec.gov> or visiting Prospect's website at <http://www.prospectac.com>, under the caption "Investors Relations/Corporate Governance." In addition, a copy of the code of ethics will be provided without charge upon request. Prospect intends to disclose any amendments to or waivers of certain provisions of Prospect's code of ethics in a Current Report on Form 8-K.

Conflicts of Interest

Prospect's stockholders should also be aware of the following other potential conflicts of interest:

None of Prospect's officers and directors is required to commit his full time to Prospect's affairs and, accordingly, he may have conflicts of interest in allocating his time among various business activities.

Prospect's directors and members of its management team may become aware of business opportunities that may be appropriate for presentation to Prospect as well as the other entities with which they are or may be affiliated. Some of Prospect's officers and directors are now and may in the future become affiliated with entities, including other blank check companies, engaged in business activities similar to those intended to be conducted by Prospect, although each of Prospect's officers, directors and sponsors has agreed not to participate in the formation of, or become an officer or director of, any blank check company that may complete an initial business combination with an entity in the financial services industry until the earlier of (i) the date on which Prospect has entered into a definitive agreement regarding the initial business combination or (ii) November 14, 2009.

The founders shares and sponsors warrants are subject to transfer restrictions (and in the case of the sponsors warrants, restrictions on exercise) and will not be released from escrow until specified dates after consummation of Prospect's initial business combination. In addition, the sponsors warrants purchased by the sponsors and any public warrants which Prospect's founders, sponsors, officers and directors purchased in Prospect's IPO or may purchase in the aftermarket will expire and become worthless if an initial business combination is not consummated. Additionally, Prospect's initial stockholders, including its directors, will not receive liquidation distributions with respect to any of the founders shares. For the foregoing reasons, Prospect's board of directors may have a conflict of interest in determining whether a particular target business is appropriate to effect the initial business combination with.

Prospect's officers and directors may have a conflict of interest with respect to evaluating a particular business combination if the retention or resignation of any such officers and directors were included by a target business as a condition to any agreement with respect to an initial business combination.

Table of Contents

In general, officers and directors of a corporation incorporated under the laws of the State of Delaware are required to present business opportunities to a corporation if:

the corporation could financially undertake the opportunity;

the opportunity is within the corporation's line of business; and

it would not be fair to the corporation and its stockholders for the opportunity not to be brought to the attention of the corporation.

Accordingly, as a result of multiple business affiliations, Prospect's officers and directors may have similar legal obligations relating to presenting business opportunities meeting the above-listed criteria to multiple entities. In addition, conflicts of interest may arise when Prospect's board of directors evaluate a particular business opportunity with respect to the above-listed criteria. Prospect cannot assure you that any of the above mentioned conflicts will be resolved in its favor.

In order to minimize potential conflicts of interest which may arise from multiple corporate affiliations, Prospect has entered into a business opportunity right of first review agreement with David A. Minella, its Chairman and Chief Executive Officer, who is affiliated with Flat Ridge Investments LLC, a Prospect sponsor, Patrick J. Landers, its President and a director, who is affiliated with LLM Structured Equity Fund L.P. and LLM Investors L.P., two of Prospect's sponsors, James J. Cahill, its Chief Financial Officer and Secretary, William Landman, a Prospect director, who is affiliated with CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), a Prospect sponsors, and Michael P. Castine, William Cvengros, Michael Downey, Daniel Gressel and John Merchant, each of whom is a director, and each a sponsor, which provides that from November 14, 2007 until the earlier of the consummation of the initial business combination or Prospect's liquidation in the event its does not consummate the initial business combination, Prospect has a right of first review with respect to business combination opportunities of which Messrs. Minella, Landers, Cahill, Landman, Castine, Cvengros, Downey, Gressel, Merchant and each of its sponsors, and companies or other entities that they manage or control become aware, in the financial services industry with an enterprise value of \$195 million or more.

In connection with the vote required for the initial business combination, all of the initial stockholders, have agreed to vote the founders shares in accordance with the vote of the public stockholders owning a majority of the shares of Prospect's common stock sold in its IPO. In addition, they have agreed to waive their respective rights to participate in any liquidation distribution with respect to the founders shares. If they purchased shares of common stock as part of Prospect's IPO or if they purchase shares in the open market, however, they would be entitled to vote such shares as they choose on a proposal to approve an initial business combination, however, in no event could they exercise conversion rights and convert their shares into a portion of the trust account.

To further minimize potential conflicts of interest, Prospect has agreed not to consummate an initial business combination with an entity that is affiliated with any of its officers, directors, sponsors or initial stockholders, including any businesses that are either portfolio companies of its initial stockholders or sponsors or any entity affiliated with its officers, directors, initial stockholders or sponsors. Furthermore, in no event will any of Prospect's initial stockholders, sponsors, officers or directors, or any of their respective affiliates, be paid any finder's fee, consulting fee or other compensation prior to, or for any services they render in order to effectuate the consummation of the initial business combination.

Promoters

Each of Flat Ridge Investments LLC and David A. Minella may be deemed Prospect's "promoters" as that term is defined under United States federal securities laws.

Table of Contents

Kennedy-Wilson Transactions With Related Persons

You should be aware that certain members of the Kennedy-Wilson board and certain executive officers of Kennedy-Wilson have agreements or arrangements with Kennedy-Wilson and with Prospect after the merger.

If the merger is consummated, William J. McMorrow and Mary Ricks will be potentially entitled to receive certain cash bonus payments of up to \$11.7 million and \$4.0 million, respectively. The cash bonus payments will be payable as follows:

Mr. McMorrow and Ms. Ricks will be entitled to receive \$4.85 million and \$2.0 million, respectively, on October 15, 2009, provided, however, that such payments will be repaid to Kennedy-Wilson in the event the merger is not consummated by November 15, 2009 or the executive is not employed by Kennedy-Wilson on the effective date of the merger (these employment requirements will not apply, however, in the case of a termination of employment due to death or disability);

Mr. McMorrow and Ms. Ricks will receive "performance unit awards" under the 2009 Plan which will entitle them to receive \$2.425 million and \$1.0 million, respectively, on April 1, 2010, provided that the Performance Target is met as of March 31, 2010 (in the event that the Performance Target is not met as of March 31, 2010, the bonus otherwise due April 1, 2010 shall, nevertheless, be paid on July 1, 2010, October 1, 2010, or January 1, 2011, respectively, if the Performance Target is satisfied as of the earliest of June 30, 2010, September 30, 2010, or December 31, 2010, respectively), and the executive remains employed through the date on which the Performance Target is satisfied; and

Mr. McMorrow and Ms. Ricks will receive additional "performance unit awards" under the 2009 Plan which will entitle them to receive cash payments in the amounts of \$4.425 and \$1.0 million, respectively, on January 1, 2011, provided that the Performance Target is met as of December 31, 2010 and he or she, as applicable, remains employed by the post-merger company through January 1, 2011.

Notwithstanding the foregoing, in the event that the merger is consummated and the employment of Mr. McMorrow or Ms. Ricks is terminated by the post-merger company without cause or he or she, as applicable, resigns from his or her, as applicable, employment with the post-merger company for good reason, the payments referred to in the second and third bullets above will still be payable on the applicable payment dates if the Performance Target is met. The Performance Target was established by an independent committee of Prospect and is subject to the approval of the compensation committee of the post-merger company following the consummation of the merger. The compensation committee of Kennedy-Wilson's board of directors made the determination to pay cash bonuses to only Mr. McMorrow and Ms. Ricks upon consummation of the merger after taking into account several factors, including the primary roles Mr. McMorrow and Ms. Ricks played in negotiating the terms of the merger and the merger agreement and the amendments to Mr. McMorrow's and Ms. Ricks' employment agreements eliminating their rights to receive cash lump sum payments otherwise due upon a change in control.

On April 10, 2006, William J. McMorrow borrowed \$3,543,127 from Kennedy-Wilson evidenced by a promissory note bearing simple interest at a rate of 7.5% per annum and scheduled to mature on April 9, 2011. Mr. McMorrow's employment agreement has been amended to provide that the McMorrow Note will be forgiven if the merger is consummated. The determination of Kennedy-Wilson's compensation committee to forgive the note upon the consummation of the merger stemmed from its consideration of Mr. McMorrow's contributions to Kennedy-Wilson, Mr. McMorrow's primary role in negotiating the terms of the merger and the merger agreement, and the terms of the note which provides for its forgiveness in the event of certain changes in control.

Table of Contents

If the merger is consummated, certain of Kennedy-Wilson's executive officers will continue to be employed with the post-merger company, including William J. McMorrow, Freeman A. Lyle, Barry S. Schlesinger, Mary Ricks, James A. Rosten, Robert E. Hart and Donald J. Herrema. In addition, it is proposed that six members of the board of directors of Kennedy-Wilson will be elected to serve as directors of the post-merger company. To reward and incentivize Kennedy-Wilson's key employees and management after the merger, up to 2,475,000 shares of Prospect common stock will be reserved for issuance under the 2009 Plan. If the merger is consummated, certain Kennedy-Wilson officers, directors and key employees will be issued an aggregate of 2,376,000 restricted shares of Prospect common stock under the 2009 Plan upon the closing of the merger as set forth in the table below:

Name of Group	Dollar (\$)	Number of Shares of Restricted Stock
William McMorrow, Chief Executive Officer	\$ 5,513,062.50	556,875
Freeman Lyle, Chief Financial Officer	\$ 765,705.60	77,344
Mary Ricks, Co-CEO of KW Commercial Investment Group	\$ 5,513,062.50	556,875
Barry Schlesinger, Co-CEO of KW Commercial Investment Group	\$ 765,705.60	77,344
Robert Hart, President of KW Multi-Family Management Group	\$ 765,705.60	77,344
James Rosten, President of Kennedy-Wilson Properties	\$ 765,705.60	77,344
All executive officers, as a group	\$22,021,619.40	2,224,406
All directors who are not executive officers, as a group	\$ 153,143.10	15,469
All employees, including all current officers who are not executive officers, as a group	\$ 1,347,637.50	136,125

In the event that the recipient of the restricted shares remains employed by (or continues to perform services as a director for) the post-merger company through the relevant vesting date, $\frac{1}{5}$ of the restricted shares will vest on each of the first five anniversaries of the date of issuance, provided that the Performance Target is met as of the September 30 immediately preceding the applicable anniversary date (in the case of the installments vesting on the fourth and fifth anniversary dates, the Performance Target must be met as of the September 30 immediately preceding the third anniversary date). The Performance Target was established by an independent committee of Prospect and is subject to the approval of the compensation committee of the post-merger company following the consummation of the merger. Notwithstanding the foregoing, in the event the employment with the post-merger company of an employee who has been granted restricted shares is terminated without cause or if the employee resigns from his employment with the post-merger company for good reason, the restricted shares will continue to vest on the applicable anniversary dates (subject to the satisfaction of the Performance Target), subject to certain limitations. In addition, in the event of a "Change of Control" as defined in the 2009 Plan (see *"The Equity Participation Plan Proposal "Change of Control"* on page 180), any unvested restricted shares of Prospect common stock that have not previously been forfeited will become vested, subject to certain limitations. See section *"The Equity Participation Plan Proposal Awards to Particular Officers, Directors and Employees"* on page 184 for additional information.

In connection with the merger, Mr. McMorrow and Ms. Ricks have entered into amendments to their employment agreements which provide for, among other things:

the removal of certain benefits in the event of a change in control;

the addition of certain severance benefits if the executive resigns on account of a change in location or a material reduction in duties;

the grant to each executive of 556,875 shares of restricted stock of Prospect pursuant to the 2009 Plan and upon the terms and conditions set forth above;

the cash bonus payments set forth above and

Table of Contents

in the case of Mr. McMorrow, the McMorrow Note forgiveness described above.

Mr. Herrema has also entered into an amendment to his employment agreement which provides for the extension of his employment term from December 31, 2010 to January 31, 2014 as well as the second and third bullets above. In addition, the employment agreements for Messrs. McMorrow and Herrema and Ms. Ricks have been amended to include language intended:

to provide for a reduction in the amount of payments or benefits payable or provided to them under their respective employment agreements or otherwise to ensure that no payment or benefit is subject to the excise tax imposed by Section 4999 of the Code (certain golden parachute payments) which reduction may, in certain circumstances, result in the repayment of certain previously paid amounts (plus earnings) to the post-merger company, and

to achieve compliance with Section 409A of the Code.

In November 2008, Kennedy-Wilson issued a convertible subordinated note with a principal amount of \$30 million to Guardian. Thomas Sorell, a director of Kennedy-Wilson, is the Executive Vice President and Chief Investment Officer of Guardian. The Guardian Note bears interest at a fixed rate of 7%, payable quarterly, and the outstanding principal is due on November 3, 2018. Guardian may convert the Guardian Note, in whole or in part, into common stock of Kennedy-Wilson at a conversion price of \$40.00 per share of common stock at any time prior to the tenth anniversary of the original issue date of the note. On October 8, 2009, Kennedy-Wilson and Guardian entered into a letter agreement pursuant to which the parties agreed to amend the Guardian Note, effective only if the merger is consummated, to change the conversion price to \$37.50 per share and the expiration date for the conversion period to May 3, 2017. At any time on or after the ninth anniversary of the original issue date of the note and prior to the due date, Kennedy-Wilson may demand that the holder of the note convert the note in accordance with the terms of the note. In addition, Guardian has from time to time entered into various loan and investment transactions involving Kennedy-Wilson and its subsidiaries and affiliates relating to real estate investments.

In connection with the issuance of the Guardian Note, Guardian entered into a shareholders agreement with Kennedy-Wilson, William McMorrow, Mary Ricks and Lyle Freeman pursuant to which the parties agreed to appoint one person designated by Guardian as a member of the board of directors of Kennedy-Wilson. Thomas Sorell currently serves as the director designee of Guardian. On October 8, 2009, Kennedy-Wilson and Guardian entered into a letter agreement pursuant to which the parties agreed, effective only if the merger is consummated, to terminate the shareholders agreement subject to entering into a voting agreement to provide Guardian with the right to designate a director to the board of directors of Prospect.

Kulik, Gottesman, Mouton & Siegel LLP serves as general legal counsel to Kennedy-Wilson and received approximately \$832,000 in legal fees for the year ended December 31, 2008 and \$_____ in legal fees as of the record date in connection with this transaction. Kent Mouton, a director of Kennedy-Wilson, is a partner with Kulik, Gottesman, Mouton & Siegel LLP and holds an approximately 25% interest in the firm.

Solomon, Winnett & Rosenfield, Certified Public Accountants, Inc. provides certain tax consulting, preparation and general advice to Kennedy-Wilson and received approximately \$300,000 in fees for the year ended December 31, 2008 and \$_____ in fees as of the record date in connection with this transaction. Jerry Solomon, a director of Kennedy-Wilson, is a principal of Solomon, Winnett & Rosenfield, Certified Public Accountants, Inc. and holds an approximately 25% interest in the firm.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires Prospect's officers, directors and persons who own more than 10% of a registered class of its equity securities to file reports of ownership and changes in

Table of Contents

ownership with the SEC. Officers, directors and 10% stockholders are required by regulation to furnish Prospect with copies of all Section 16(a) forms they file. Based solely on copies of such forms received, Prospect believes that, during the fiscal year ended December 31, 2008, all Section 16(a) filing requirements applicable to Prospect's officers, directors and greater than 10% beneficial owners were met in a timely manner, except that on December 19, 2007, Prospect's board of directors authorized Prospect to repurchase an aggregate 937,500 shares of its common stock for a price of \$0.0001 per share from the founders in accordance with the terms of the IPO and the inside letters executed by each of the founders. The following founders inadvertently failed to file such repurchases on a Form 4 or Form 5: Flat Ridge Investments LLC, of which David A. Minella may be deemed a beneficial owner; Michael Castine; Daniel Gressel; SJC Capital LLC, of which William Cvengros may be deemed a beneficial owner; Michael Downey; John Merchant; James Cahill; LLM Structured Equity Fund LP, of which Patrick J. Landers may be deemed a beneficial owner; LLM Investors LP, of which Patrick J. Landers may be deemed a beneficial owner; and Capital Management Systems, Inc., of which William Landman may be deemed a beneficial owner. Further, the Form 3 filed by William Landman on November 13, 2007 inadvertently did not include his beneficial ownership of certain shares held by Capital Management Systems, Inc. The Company expects such inadvertent failures to file to be promptly corrected.

Table of Contents

DESCRIPTION OF PROSPECT SECURITIES

The following discussion summarizes the material terms of Prospect's securities. This discussion does not purport to be complete and is qualified in its entirety by reference to Prospect's amended and restated certificate of incorporation and Prospect's amended and restated bylaws, that will be in effect as of the closing of the merger. The form of Prospect's second amended and restated certificate of incorporation that will be in effect at the consummation of the merger is attached to this proxy statement/prospectus as Annex D. Prospect's amended and restated bylaws can be obtained by following the instructions under "Where You Can Find More Information" on page 296.

General

On November 20, 2007, Prospect issued and sold 25,000,000 units in its IPO. Each of Prospect's units consist of one share of common stock, \$0.0001 par value per share, and one warrant. Each warrant sold in the IPO entitles the holder to purchase one share of common stock at an exercise price of \$7.50. Prospect's units began publicly trading on November 15, 2007. Prospect's warrants and common stock have traded separately since December 3, 2007. The public offering price of each unit was \$10.00, and the IPO raised gross proceeds of \$250,000,000. Of the gross proceeds:

Prospect deposited \$241,750,000 into a trust account at JP Morgan Chase Bank, NA, maintained by Continental Stock Transfer & Trust Company, as trustee, which included \$10,000,000 of contingent underwriting discount (the underwriters have agreed to forgo \$4,000,000 of deferred underwriting compensation otherwise payable to them in connection with, and in accordance with the terms of, the underwriting agreement for the IPO);

the underwriters received \$7,500,000 as underwriting discount (excluding the contingent underwriting discount); and

Prospect retained \$700,000 for offering expenses, plus \$50,000 for working capital.

In addition, Prospect deposited into the trust account \$5,250,000 that it received from the private placement of 5,250,000 sponsors warrants to Flat Ridge Investments LLC, an entity affiliated with David A. Minella, Prospect's Chairman and Chief Executive Officer, LLM Structured Equity Fund L.P. and LLM Investors L.P., entities affiliated, with Patrick J. Landers, Prospect's President and a director, and CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), a corporation affiliated with William Landman, one of Prospect's directors.

The amended and restated certificate of incorporation of Prospect authorizes the issuance 72,000,000 shares of common stock, par value \$.0001, and 1,000,000 shares of preferred stock, par value \$.0001. As of the record date, shares of common stock are outstanding, held by stockholders of record and no shares of preferred stock were outstanding. The number of authorized shares of common stock will be increased to 80,000,000 upon approval of the merger proposal, the charter amendment share increase proposal and the filing of an amended and restated certificate of incorporation with the Secretary of State of the State of Delaware.

Units

Each Unit consists of one share of common stock and one warrant. Each warrant entitles the holder to purchase one share of common stock. The Units began trading on AMEX on November 15, 2007 and the common stock and public warrants comprising the units began separate trading on December 3, 2007.

Table of Contents

Common Stock

As of the date of this proxy statement/prospectus, there were 31,250,000 shares of Prospect common stock outstanding. Holders of common stock have exclusive voting rights for the election of Prospect's directors and all other matters requiring stockholder action, except with respect to amendments to its amended and restated certificate of incorporation that alter or change the powers, preferences, rights or other terms of any outstanding preferred stock if the holders of such affected series of preferred stock are entitled to vote on such an amendment. Holders of common stock are entitled to one vote per share on matters to be voted on by stockholders and also are entitled to receive such dividends, if any, as may be declared from time to time by Prospect's board of directors in its discretion out of funds legally available therefor.

Prospect's board of directors is divided into three classes, each of which are generally serve for a term of three years with only one class of directors being elected in each year. There is no cumulative voting with respect to the election of directors, with the result that the holders of more than 50% of the shares voted for the election of directors can elect all of the directors.

In connection with the vote required for Prospect's initial business combination, all Prospect's founders have agreed to vote the founders shares in accordance with the majority of the public shares. This voting arrangement does not apply to shares included in Units purchased in the IPO or shares purchased following the IPO in the open market. However, Prospect's founders, sponsors, officers and directors have waived any conversion rights with respect to such shares. Additionally, Prospect's founders will vote all of their shares in any manner they determine, in their sole discretion, with respect to any other items that come before a vote of Prospect's stockholders.

Prospect will proceed with its initial business combination only if:

a majority of the public shares voted by the public stockholders present in person or by proxy at a duly held stockholders meeting are voted in favor of the merger proposal,

a majority of the public shares are voted in favor of each of the charter amendment share increase proposal and the charter amendment existence proposal, and

public stockholders holding no more than 30% of the public shares (minus one public share) exercise their conversion rights. Voting against the merger proposal alone will not result in conversion of a stockholder's shares into a pro rata share of the trust account. A stockholder must have also exercised the conversion rights described below for a conversion to be effective. The actual per-share conversion price will be equal to the aggregate amount then on deposit in the trust account, before payment of deferred underwriting discounts and commissions and including accrued interest, net of any income taxes on such interest, and net of interest income of \$2.75 million previously released to fund Prospect's working capital requirements (calculated as of two business days prior to the consummation of the proposed initial business combination), divided by the number of shares sold in this offering. The initial per-share conversion price would be approximately \$9.88.

Pursuant to Prospect's amended and restated certificate of incorporation, if Prospect does not consummate an initial business combination within 24 months after the date the prospectus, corporate existence will cease except for the purposes of winding up its affairs and liquidating. If Prospect is related to its IPO, or November 14, 2009, its forced to liquidate prior to its initial business combination, its public stockholders are entitled to share ratably in the trust account, inclusive of any interest not previously released to Prospect to fund working capital requirements and net of any income taxes due on such interest, which income taxes, if any, shall be paid from the trust account, and any assets remaining available for distribution to them. If Prospect does not complete its initial business

Table of Contents

combination and the trustee must distribute the balance of the trust account, the underwriters have agreed that:

they will forfeit any rights or claims to their deferred underwriting discounts and commissions, including any accrued interest thereon, then in the trust account, and

the deferred underwriters' discounts and commission will be distributed on a pro rata basis among the public stockholders, together with any accrued interest thereon, net of income taxes payable on such interest. Prospect's founders have agreed to waive their respective rights to participate in any liquidation distribution occurring upon Prospect's failure to consummate an initial business combination with respect to the founders shares.

Prospect' founders will therefore not participate in any liquidation distribution with respect to such founders shares. They will, however, participate in any liquidation distribution with respect to any shares of common stock acquired in connection with or following this offering.

Prospect stockholders have no conversion, preemptive or other subscription rights and there are no sinking fund or redemption provisions applicable to the common stock, except that public stockholders have the right to have their shares of common stock converted to cash equal to their pro rata share of the trust account plus any interest earned thereon, net of income taxes payable on such interest and net of interest income of \$2.75 million on the trust account balance previously released to Prospect to fund its working capital requirements (subject to the tax holdback), if they vote against the initial business combination and the initial business combination is approved and completed. Public stockholders who convert their common stock into their pro rata share of the trust account will retain any public warrants they own if they previously purchased units or public warrants.

The payment of dividends, if ever, on the common stock will be subject to the prior payment of dividends on any outstanding shares of preferred stock, of which there presently are none.

Founders Shares

In transactions occurring in July, August, September and October 2007, Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), a corporation affiliated with William Landman, a Prospect director, James J. Cahill, Prospect's Chief Financial Officer and Secretary, SJC Capital LLC, an entity affiliated with William Cvengros, one of Prospect's directors, and Michael P. Castine, Michael Downey and Daniel Gressel, each of whom is a director, purchased 4,312,500 shares of Prospect's common stock for an aggregate purchase price of \$25,000. In October 2007, the aggregate outstanding 4,312,500 shares of common stock were increased to 7,187,500 shares of common stock as a result of a 5-for-3 stock split declared by Prospect's board of directors. Subsequent to the stock split, Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P. and CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.) transferred at cost an aggregate of 158,724 of these shares to John Merchant, one of Prospect's directors. On December 21, 2007 Prospect repurchased 937,500 shares of common stock at a price equal to \$0.0001 per share from the founders. The founders shares are identical to the public shares, except that:

the founders shares are subject to the transfer restrictions described below; the founders have agreed to vote the founders shares in the same manner as a majority of the public stockholders who vote at the special or annual meeting called for the purpose of approving Prospect's initial business combination; and as a result, Prospect's founders will not be able to exercise conversion rights (as described below) with respect to the founders shares;

the founders have agreed to vote the founders shares in favor of the amendment to Prospect's amended and restated certificate of incorporation to provide for Prospect's perpetual existence; and

Table of Contents

the founders have agreed to waive their rights to participate in any liquidation distribution with respect to the founders shares if Prospect fails to consummate an initial business combination.

The founders have agreed not to transfer, assign or sell any of the founders shares should until one year after the date of the completion of Prospect's initial business combination or earlier if, subsequent to Prospect's initial business combination:

the closing price of Prospect's common stock equals or exceeds \$14.50 per share for any 20 trading days within any 30 trading day period; or

Prospect consummates a subsequent liquidation, merger, stock exchange or other similar transaction which results in all of Prospect's stockholders having the right to exchange their shares of common stock for cash, securities or other property;

provided, however, that transfers can be made to permitted transferees who agree in writing to be bound to the foregoing transfer restrictions, agree to vote in the same manner as a majority of the public stockholders who vote at the special or annual meeting called for the purpose of approving Prospect's initial business combination and to vote in favor of the amendment to Prospect's amended and restated certificate of incorporation providing for Prospect's perpetual existence and waive any rights to participate in any liquidation distribution if Prospect fails to consummate its initial business combination.

For so long as the sponsors warrants are subject to such transfer restrictions they will be held in an escrow account maintained by Continental Stock Transfer & Trust Company.

In addition, the founders or their permitted transferees are entitled to registration rights with respect to founders shares under an agreement to be signed on or before the date of this proxy statement/prospectus.

In connection with the merger, Prospect entered into a forfeiture agreement with Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., CMS Platinum Fund, L.P. (formerly Capital Management Systems, Inc.), SJC Capital LLC, Michael P. Castine, Michael Downey, Daniel Gressel, James J. Cahill and John Merchant, as amended by a first amendment dated October 22, 2009, whereby immediately prior to and subject to consummation of the merger, 4,750,000 founder shares will be cancelled and forfeited. As a result of this forfeiture, at the consummation of the merger, the founders will own 1,500,000 shares of Prospect common stock.

Preferred Stock

Prospect's amended and restated certificate of incorporation, provides that shares of preferred stock may be issued from time to time in one or more series. Prospect's board of directors is authorized to fix the voting rights, if any, the designations, powers, and preferences, the relative, participating, optional or other special rights and any qualifications, limitations and restrictions, applicable to the shares of each series of preferred stock. Prospect's board of directors is able to, without stockholder approval, issue preferred stock with voting and other rights that could adversely affect the voting power and other rights of the holders of the common stock and could have anti-takeover effects. The ability of Prospect's board of directors to issue preferred stock without stockholder approval could have the effect of delaying, deferring or preventing a change of control or the removal of existing management by diluting the stock ownership or voting rights of a person seeking to obtain control of the company or remove existing management. Prospect's amended and restated certificate of incorporation, prohibits Prospect, prior to its initial business combination, from issuing Prospect capital stock, including preferred stock, which participates in any manner in the proceeds of the trust account, or which votes as a class with the common stock on an initial business combination. Prospect may issue some or all of the preferred stock to effect an initial business combination. Prospect has no preferred stock outstanding at the date hereof. Although Prospect does

Table of Contents

not currently intend to issue any shares of preferred stock, Prospect cannot assure you that it will not do so in the future. No shares of preferred stock are being issued or registered in this offering.

Warrants

Public Warrants

Each public warrant entitles the registered holder to purchase one share of Prospect's common stock at a price of \$12.50 per share, subject to adjustment as discussed below, at any time before November 14, 2013.

However, the public warrants are exercisable only if a registration statement relating to the common stock issuable upon exercise of the public warrants is effective and current. The public warrants will expire on November 14, 2013 or earlier upon redemption.

At any time while the public warrants are exercisable and there is an effective registration statement covering the shares of common stock issuable upon exercise of the public warrants available and current throughout the 30 day redemption period, Prospect may call the outstanding public warrants (except as described below with respect to the sponsors warrants) for redemption:

in whole and not in part at a price of \$.01 per warrant if the sale price of Prospect common stock equals or exceeds \$19.50 per share for any 20 trading days within a 30 trading day period ending on the third business day prior to the notice of redemption to warrant holders; and

upon not less than 30 days' prior written notice of redemption to each warrant holder.

The public warrants are issued in registered form under a warrant agreement, as amended by the warrant amendment, between Continental Stock Transfer & Trust Company, as warrant agent, and Prospect. You should review a copy of the warrant agreement, which has been filed as an exhibit to the registration statement relating to Prospect's IPO, for a complete description of the terms and conditions of the public warrants and a copy of the warrant amendment attached to this proxy statement/prospectus as Annex B. The form of amended warrant agreement, which will be in effect upon consummation of the merger, is attached to this proxy statement/prospectus as Annex C.

Prospect established these redemption criteria to provide warrant holders with a significant premium to the initial warrant exercise price as well as a sufficient degree of liquidity to cushion the market reaction, if any, to Prospect's redemption call. If the foregoing conditions are satisfied and Prospect issues notice of redemption of the public warrants, each warrant holder shall be entitled to exercise his or her warrant prior to the scheduled redemption date. However, there can be no assurance that the price of common stock will exceed the redemption trigger price or the warrant exercise price after the redemption notice is issued.

If Prospect calls the public warrants for redemption as described above, Prospect's management will have the option to require any holder that wishes to exercise his, her or its warrant (including the sponsors warrants) to do so on a "cashless basis." If Prospect's management takes advantage of this option, all holders of public warrants would pay the exercise price by surrendering his, her or its public warrants for that number of shares of common stock equal to the quotient obtained by dividing (x) the product of the number of shares of common stock underlying the public warrants, multiplied by the difference between the exercise price of the public warrants and the "fair market value" (defined below) by (y) the fair market value. The "fair market value" shall mean the average reported last sale price of the common stock for the ten trading days ending on the third trading day prior to the date on which the notice of redemption is sent to the holders of public warrants. If Prospect's management takes advantage of this option, the notice of redemption will contain the information necessary to calculate the number of shares of common stock to be received upon exercise of the public warrants, including the "fair market value" in such case. Requiring a cashless exercise in this manner will reduce

Table of Contents

the number of shares to be issued and thereby lessen the dilutive effect of a warrant redemption. If Prospect calls its public warrants for redemption and Prospect's management does not take advantage of this option, Prospect's sponsors and their respective transferees would still be entitled to exercise their sponsor warrants for cash or on a cashless basis using the same formula described above that other warrant holders would have been required to use had all warrant holders been required to exercise their public warrants on a cashless basis.

The exercise price and number of shares of common stock issuable on exercise of the public warrants may be adjusted in certain circumstances including in the event of a stock dividend, or Prospect's recapitalization, reorganization, merger or consolidation. However, the exercise price and number of shares of common stock issuable on exercise of the public warrants will not be adjusted for issuances of common stock at a price below the warrant exercise price except in certain circumstances.

The public warrants may be exercised upon surrender of the warrant certificate on or prior to the expiration date at the offices of the warrant agent, with the exercise form on the reverse side of the warrant certificate completed and executed as indicated, accompanied by full payment of the exercise price, by certified check payable to Prospect, for the number of public warrants being exercised. On the exercise of any warrant, the warrant exercise price will be paid directly to Prospect and not placed in the trust account. In no event may the public warrants be net cash settled. Warrant holders do not have the rights or privileges of holders of common stock, including voting rights, until they exercise their public warrants and receive shares of common stock. After the issuance of shares of common stock upon exercise of the public warrants, each holder will be entitled to one vote for each share held of record on all matters to be voted on by stockholders.

No public warrants will be exercisable and Prospect will not be obligated to issue shares of common stock unless at the time a holder seeks to exercise such warrant, a prospectus relating to the common stock issuable upon exercise of the public warrants is current and the common stock has been registered or qualified or deemed to be exempt under the securities laws of the state of residence of the holder of the public warrants. Under the terms of the warrant agreement, as amended, Prospect has agreed to use its best efforts to meet these conditions and to maintain a current prospectus relating to the common stock issuable upon exercise of the public warrants until the expiration of the public warrants. However, Prospect cannot assure you that it will be able to do so and, if it does not maintain a current prospectus relating to these shares of common stock issuable upon exercise of the public warrants, holders will be unable to exercise their public warrants and Prospect will not be required to settle any such warrant exercise. If the prospectus relating to these shares of common stock issuable upon the exercise of the public warrants is not current or if the common stock is not qualified or exempt from qualification in the jurisdictions in which the holders of the public warrants reside, the public warrants may have no value, the market for the public warrants may be limited and the public warrants may expire worthless.

No fractional shares will be issued upon exercise of the public warrants. If a holder exercises public warrants and would be entitled to receive a fractional interest of a share, Prospect will round up the number of shares of common stock to be issued to the warrant holder to the nearest whole number of shares.

Sponsors Warrants

The sponsors warrants are identical to the public warrants, except that the sponsors warrants:

are non-redeemable so long as they are held by any of the sponsors or their permitted transferees;

are subject to the transfer restrictions described below;

will not be exercisable while they are subject to the transfer restrictions described below; and

Table of Contents

may be exercised for cash or on a cashless basis as described below.

Although the shares of common stock issuable pursuant to the sponsors warrants will not be issued pursuant to a registration statement so long as they are held by the sponsors and their permitted transferees, the warrant agreement, as amended, provides that the sponsors warrants may not be exercised unless Prospect has an effective registration statement relating to the common stock issuable upon exercise of the sponsors warrants and a related current prospectus is available.

If holders of the sponsors warrants elect to exercise them on a cashless basis, they would pay the exercise price by surrendering his, her or its sponsor warrants for that number of shares of common stock equal to the quotient obtained by dividing (x) the product of the number of shares of common stock underlying the sponsor warrants, multiplied by the difference between the exercise price of the sponsor warrants and the "fair market value" (defined below) by (y) the fair market value. The "fair market value" shall mean the average reported last sale price of the common stock for the ten trading days ending on the third trading day prior to the date on which the notice of redemption is sent to the holders of sponsor warrants. The reason that Prospect agreed that these sponsor warrants will be exercisable on a cashless basis so long as they are held by the sponsors and their affiliates and permitted transferees is because it is not known at this time whether they will be affiliated with Prospect following a business combination. If they remain affiliated with Prospects, their ability to sell securities in the open market will be significantly limited.

The sponsors have agreed not to transfer, assign or sell any of the sponsors warrants until the date that is 30 days after the date Prospect completes its initial business combination; provided, however, that transfers can be made to permitted transferees who agree in writing to be bound by such transfer restrictions. For so long as the sponsors warrants are subject to such transfer restrictions they will be held in an escrow account maintained by Continental Stock Transfer & Trust Company.

In addition, the sponsors or their permitted transferees are entitled to registration rights with respect to the sponsors warrants under an agreement signed with Prospect.

Transfer Agent, Warrant Agent and Registrar

The transfer agent for Prospect's securities and the warrant agent for Prospect warrants is Continental Stock Transfer & Trust Company, 17 Battery Place, New York, New York 10004; telephone (212) 509-4000.

Table of Contents**PRICE RANGE OF SECURITIES AND DIVIDENDS****Prospect**

NYSE Euronext completed its acquisition of AMEX on October 1, 2008. Prospect's units, which consist of one share of its common stock, par value \$0.0001 per share, and one warrant to purchase one share of its common stock, trade on AMEX under the symbol "PAX.U." Prospect's warrants and common stock have traded separately on AMEX under the symbols "PAX.WS" and "PAX," respectively, since December 3, 2007. Assuming approval of the warrant amendment proposal, each warrant entitles the holder to purchase one share of its common stock at an exercise price of \$12.50 commencing on the later of the consummation of the initial business combination or November 14, 2009. Prospect's warrants will expire at 5:00 p.m., New York City time, on November 14, 2013, or earlier upon redemption.

Price Range of Securities

The following table sets forth, for the calendar quarter indicated, the high and low closing sales prices per unit, warrant and share of common stock, respectively, as reported on AMEX. The quotations listed below reflect interdealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.

Quarter ended	Units		Warrants		Common Stock	
	High	Low	High	Low	High	Low
2009						
First Quarter	\$9.55	\$9.07	\$0.07	\$0.03	\$9.46	\$9.20
Second Quarter	\$9.74	\$9.45	\$0.17	\$0.03	\$9.67	\$9.49
2008						
First Quarter	\$9.91	\$9.44	\$0.85	\$0.38	\$9.20	\$8.97
Second Quarter	\$9.75	\$9.20	\$0.45	\$0.30	\$9.31	\$9.05
Third Quarter	\$9.80	\$9.11	\$0.41	\$0.20	\$9.50	\$9.01
Fourth Quarter	\$9.30	\$8.40	\$0.25	\$0.05	\$9.15	\$8.56
2007						
First Quarter*						
Second Quarter*						
Third Quarter *						
Fourth Quarter (November 15, 2007 to December 31, 2007)	\$9.95(1)	\$9.67(1)	\$0.90(2)	\$0.65(2)	\$9.10(3)	\$8.91(3)

(1) Represents the high and low closing sales prices from Prospect's first day of trading on November 15, 2007 through December 31, 2007.

(2) Represents the high and low closing sales prices from December 3, 2007, the date that Prospect's warrants first became separately tradable, through December 31, 2007.

(3) Represents the high and low closing sales prices from December 3, 2007, the date that Prospect's common stock first became separately tradable, through December 31, 2007.

*

No amounts are included as none of Prospect's securities commenced trading on AMEX until November 15, 2007.

The closing price for each share of common stock, public warrant and unit of Prospect on September 8, 2009, the last trading day before announcement of the execution of the merger agreement, was \$9.79, \$0.28 and \$9.82, respectively. As of October 26, 2009, the last practicable date

Table of Contents

before the date of this proxy statement/prospectus, the closing price for each share of common stock, public warrant and unit of Prospect was \$9.90, \$0.55 and \$10.39, respectively.

Holders of Prospect common stock, public warrants and units should obtain current market quotations for their securities. The market price of Prospect common stock, public warrants and units could vary at any time before the merger.

 Holders

As of October 26, 2009 (the record date), Prospect had 1 holder of record of its units, 11 holders of record of its common stock and 1 holder of record of its public warrants.

 Dividends

Prospect has not paid any dividends on its common stock to date and does not intend to pay dividends prior to the completion of the merger. The payment of dividends in the future will be contingent upon revenues and earnings, if any, capital requirements and general financial condition subsequent to completion of the initial business combination. The payment of any dividends subsequent to the initial business combination will be within the discretion of Prospect's board of directors. It is the present intention of its board of directors to retain all earnings, if any, for use in its business operations and, accordingly, Prospect's board of directors does not anticipate declaring any dividends in the foreseeable future. If, after Prospect consummates the merger, it becomes a holding company with a risk-bearing operating company subsidiary, the ability of that subsidiary to pay dividends to stockholders, either directly or through Prospect may be limited by statute or regulation.

 Kennedy-Wilson

Kennedy-Wilson's common stock is quoted on the Pink Sheets under the symbol "KWIC.PK"

 Price Range of Securities

The following table sets forth, for the calendar quarter indicated, the high and low closing sales prices per share of common stock of Kennedy-Wilson as reported on the Pink Sheets Electronic OTC. The quotations listed below reflect interdealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.

Quarter Ended	Common Stock	
	High	Low
2009		
First Quarter	\$36.50	\$25.00
Second Quarter	\$40.00	\$30.00
2008		
First Quarter	\$42.50	\$37.48
Second Quarter	\$46.50	\$38.50
Third Quarter	\$43.50	\$36.00
Fourth Quarter	\$44.00	\$25.00
2007		
First Quarter	\$30.00	\$24.00
Second Quarter	\$38.00	\$30.50
Third Quarter	\$44.00	\$36.00
Fourth Quarter	\$47.93	\$39.40

Table of Contents

The closing price for each share of Kennedy-Wilson common stock on September 8, 2009, the last trading day before announcement of the execution of the merger agreement, was \$33.50. As of October 26, 2009, the last practicable date before the date of this proxy statement/prospectus, the closing price for each share of Kennedy-Wilson common stock was \$38.00.

Holders

As of October 26, 2009 (the record date), there were 21 holders of record of Kennedy-Wilson common stock and 35 holders of record of Kennedy-Wilson preferred stock.

Dividends

Kennedy-Wilson has not paid any dividends on its common stock to date. Kennedy-Wilson paid the following dividends on its preferred stock:

Date of Payment	Aggregate Amount
06/30/08	\$ 393,501
09/30/08	\$ 930,222
12/30/08	\$ 940,340
03/31/09	\$ 927,480
06/22/09	\$ 118,475
07/01/09	\$ 809,025

Kennedy-Wilson does not currently intend to pay any cash dividends in the foreseeable future. Kennedy-Wilson's board of directors will determine the payment of future cash dividends, if any.

Table of Contents

APPRAISAL RIGHTS

Prospect

Prospect stockholders do not have appraisal rights under the DGCL in connection with the merger.

Kennedy-Wilson

In connection with the merger, holders of record of Kennedy-Wilson common stock and preferred stock who do not vote in favor of adopting the merger are entitled to appraisal rights under Section 262 provided that they comply with the conditions established by Section 262. Prospect is not required to effect the merger in the event that either:

holders of more than 10% of the outstanding shares of Kennedy-Wilson common stock or

the holders of more than 10% of the outstanding shares of Kennedy-Wilson preferred stock exercise their appraisal rights.

Prospect shall not waive this condition if the number of outstanding shares of Kennedy-Wilson common stock or preferred stock for which holders exercise appraisal rights is such that, pursuant to the transactions contemplated by the merger agreement, Prospect will not be acquiring "control" of Kennedy-Wilson as defined in Section 368(c) of the Code, solely in exchange for Prospect common stock.

Kennedy-Wilson's holders of common stock may also have appraisal rights under Chapter 13 of the CGCL. Any stockholder who does not vote in favor of the merger and remains a holder of Kennedy-Wilson common stock at the effective time of the merger may, by complying with the procedures set forth in Chapter 13 of the CGCL and sending Kennedy-Wilson a written demand for appraisal, be entitled to seek appraisal of the fair value of their shares as determined by the proper California superior court. These appraisal rights are contingent upon consummation of the merger.

Except as set forth herein, stockholders of Kennedy-Wilson will not be entitled to appraisal rights in connection with the merger.

Appraisal Rights under the DGCL

The discussion below is not a complete summary regarding an Kennedy-Wilson stockholder's appraisal rights under the DGCL and is qualified in its entirety by reference to the text of the relevant provisions of the DGCL, which are attached to this proxy statement/prospectus as Annex G. Stockholders intending to exercise appraisal rights should carefully review Annex G. Failure to follow precisely any of the statutory procedures set forth in Annex G may result in a termination or waiver of these rights. All references in this summary of appraisal rights to a "stockholder" or "holders of shares of Kennedy-Wilson's common stock" are to the record holder or holders of shares of Kennedy-Wilson's common stock and preferred stock.

A record holder of shares of Kennedy-Wilson's common stock and preferred stock who has made the demand described below with respect to such shares, who continuously is the record holder of such shares through the effective time of the merger, who otherwise complies with the statutory requirements of Section 262 and who neither voted in favor of the merger nor consented thereto in writing will be entitled to an appraisal by the Delaware Court of Chancery (the "Delaware Court") of the fair value of his, her or its shares of Kennedy-Wilson's common stock in lieu of the consideration that such stockholder would otherwise be entitled to receive pursuant to the merger agreement.

Under Section 262, where a merger is to be submitted for approval at a meeting of stockholders, not less than 20 days prior to the meeting, a constituent corporation must notify each of the holders of

Table of Contents

its stock for whom appraisal rights are available that such appraisal rights are available and include in each such notice a copy of Section 262.

Stockholders who desire to exercise their appraisal rights must satisfy all of the conditions of Section 262. Those conditions include the following:

Stockholders electing to exercise appraisal rights must not have voted for the adoption of the merger agreement. Voting for the adoption of the merger agreement will result in the waiver of appraisal rights.

A written demand for appraisal of shares must have been filed with Kennedy-Wilson before the taking of the vote on the merger agreement. The written demand for appraisal should have specified the stockholder's name and mailing address, and that the stockholder was thereby demanding appraisal of his, her or its Kennedy-Wilson common stock. The written demand for appraisal of shares is in addition to and separate from a vote against the merger agreement or an abstention from such vote.

A demand for appraisal must have been executed by or for the stockholder of record, fully and correctly, as such stockholder's name appears on the stock certificate. If the shares are owned of record in a fiduciary capacity, such as by a trustee, guardian or custodian, this demand must have been executed by or for the fiduciary. If the shares are owned by or for more than one person, as in a joint tenancy or tenancy in common, such demand must have been executed by or for all joint owners. An authorized agent, including an agent for two or more joint owners, may execute the demand for appraisal for a stockholder of record. However, the agent must have identified the record owner and expressly disclosed the fact that, in exercising the demand, he was acting as agent for the record owner. A person having a beneficial interest in Kennedy-Wilson's common stock held of record in the name of another person, such as a broker, bank or nominee, must act promptly to cause the record holder to follow the steps summarized below in a timely manner to perfect whatever appraisal rights the beneficial owners may have.

Within ten days after the effective time of the merger, Kennedy-Wilson must provide notice of the effective time of the merger to all Kennedy-Wilson stockholders who have complied with Section 262 and have not voted in favor of the adoption of the merger agreement.

Within 120 days after the effective time of the merger, either Kennedy-Wilson or any stockholder who has complied with the required conditions of Section 262 may commence an appraisal proceeding by filing a petition in the Delaware Court, with a copy served on Kennedy-Wilson in the case of a petition filed by a stockholder, demanding a determination of the fair value of the shares of all dissenting stockholders. There is no present intent on the part of Kennedy-Wilson to file an appraisal petition and stockholders seeking to exercise appraisal rights should not assume that Kennedy-Wilson will file such a petition or that Kennedy-Wilson will initiate any negotiations with respect to the fair value of such shares. Accordingly, holders of Kennedy-Wilson's common stock who desire to have their shares appraised should initiate any petitions necessary for the perfection of their appraisal rights within the time periods and in the manner prescribed in Section 262.

Within 120 days after the effective time of the merger, any stockholder who has satisfied the requirements of Section 262 will be entitled, upon written request, to receive from Kennedy-Wilson a statement setting forth the aggregate number of shares of Kennedy-Wilson's common stock not voting in favor of the adoption of the merger agreement and with respect to which demands for appraisal were received by Kennedy-Wilson and the aggregate number of holders of such shares. Such statement must be mailed within 10 days after the stockholder's request has been received by Kennedy-Wilson or within 10 days after the expiration of the period for the delivery of demands as described above, whichever is later. Notwithstanding the foregoing, a person who is the beneficial owner of shares of Kennedy-Wilson's common stock held either in a voting trust or by a nominee on behalf of such person

Table of Contents

may, in such person's own name, file a petition or request from the surviving corporation the statement described in this paragraph.

If a petition for an appraisal is timely filed and a copy thereof is served upon Kennedy-Wilson, Kennedy-Wilson will then be obligated, within 20 days after service, to file with the Register in Chancery a duly verified list containing the names and addresses of all stockholders who have demanded an appraisal of their shares and with whom agreements as to the value of their shares have not been reached. After notice to stockholders, as required by the Delaware Court, at the hearing on such petition, the Delaware Court will determine which stockholders are entitled to appraisal rights. The appraisal proceeding shall be conducted in accordance with the rules of the Delaware Court, including any rules specifically governing appraisal proceedings. The Delaware Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Delaware Court may dismiss the proceedings as to such stockholder. Where proceedings are not dismissed, the Delaware Court will appraise the shares of Kennedy-Wilson's common stock owned by such stockholders, determining the fair value of such shares exclusive of any element of value arising from the accomplishment or expectation of the merger, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. Unless the Delaware Court in its discretion determines otherwise for good cause shown, interest from the effective date of the merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment.

Although the board of directors of Kennedy-Wilson believes that the merger consideration is fair, no representation is made as to the outcome of the appraisal of fair value as determined by the Delaware Court and stockholders should recognize that such an appraisal could result in a determination of a value higher or lower than, or the same as, the consideration they would receive pursuant to the merger agreement. Moreover, Kennedy-Wilson does not anticipate offering more than the merger consideration to any stockholder exercising appraisal rights and reserves the right to assert, in any appraisal proceeding, that, for purposes of Section 262, the "fair value" of a share of Kennedy-Wilson's common stock is less than the merger consideration. In determining "fair value", the Delaware Court is required to take into account all relevant factors. The cost of the appraisal proceeding, which does not include attorneys' or experts' fees, may be determined by the Delaware Court and taxed against the dissenting stockholder and/or Kennedy-Wilson as the Delaware Court deems equitable in the circumstances. Each dissenting stockholder is responsible for his, her or its attorneys' and expert witness expenses, although, upon application of a dissenting stockholder, the Delaware Court may order that all or a portion of the expenses incurred by any dissenting stockholder in connection with the appraisal proceeding, including without limitation, reasonable attorneys' fees and the fees and expenses of experts, be charged pro rata against the value of all shares of stock entitled to appraisal.

Any stockholder who has duly demanded appraisal in compliance with Section 262 will not, after the effective time of the merger, be entitled to vote for any purpose any shares subject to such demand or to receive payment of dividends or other distributions on such shares, except for dividends or distributions payable to stockholders of record at a date prior to the effective time of the merger.

At any time within 60 days after the effective time of the merger, any stockholder who has not commenced an appraisal proceeding or joined that proceeding as a named party will have the right to withdraw his, her or its demand for appraisal and to accept the terms offered in the merger agreement. After this period, a stockholder may withdraw his, her or its demand for appraisal and receive payment for his, her or its shares as provided in the merger agreement only with the consent of Kennedy-Wilson. If no petition for appraisal is filed with the court within 120 days after the effective time of the merger,

Table of Contents

stockholders' rights to appraisal, if available, will cease. Inasmuch as Kennedy-Wilson has no obligation to file such a petition, any stockholder who desires a petition to be filed is advised to file it on a timely basis. Any stockholder may withdraw such stockholder's demand for appraisal by delivering to Kennedy-Wilson a written withdrawal of his, her or its demand for appraisal and acceptance of the merger consideration, except:

that any such attempt to withdraw made more than 60 days after the effective time of the merger will require written approval of Kennedy-Wilson and

that no appraisal proceeding in the Delaware Court shall be dismissed as to any stockholder without the approval of the Delaware Court, and such approval may be conditioned upon such terms as the Delaware Court deems just; provided, however, that any stockholder who has not commenced an appraisal proceeding or joined that proceeding as a named party may withdraw his, her or its demand for appraisal and accept the merger consideration offered pursuant to the merger agreement within 60 days after the effective date of the merger.

Failure by any Kennedy-Wilson stockholder to comply fully with the procedures described above and set forth in Section 262 on Annex G to this proxy statement/prospectus may result in termination of such stockholder's appraisal rights. In view of the complexity of exercising appraisal rights under the DGCL, any Kennedy-Wilson stockholder considering exercising these rights should consult with legal counsel.

Appraisal Rights under the CGCL

Kennedy-Wilson's stockholders may also have appraisal rights under Chapter 13 of the CGCL. The discussion below is not a complete summary regarding an Kennedy-Wilson stockholder's appraisal rights under the CGCL and is qualified in its entirety by reference to the text of the relevant provisions of the CGCL, which are attached to this proxy statement/prospectus as Annex H. Stockholders intending to exercise appraisal rights should carefully review Annex H, which sets forth the procedures for Kennedy-Wilson's stockholders to dissent from the merger and to demand statutory dissenters' rights under the CGCL. Failure to follow precisely any of the statutory procedures set forth in Annex H may result in a termination or waiver of these rights. Shares of Kennedy-Wilson common stock held by stockholders who have perfected their dissenters' rights in accordance with Chapter 13 of the CGCL and have not withdrawn their demands or otherwise lost their rights are referred to in this summary as "Dissenting Shares."

Under Sections 181 and 1201 of the CGCL, the merger constitutes a "reorganization." Chapter 13 of the CGCL provides dissenters' rights for stockholders dissenting from reorganizations in certain circumstances. For a Kennedy-Wilson stockholder to exercise dissenters' rights as to any shares of Kennedy-Wilson' common stock in connection with the merger, the stockholder must not vote in favor of the merger and must make a written demand to Kennedy-Wilson that it purchase the shares at their fair market value. Thus, if a stockholder wishes to dissent, the stockholder must vote "AGAINST" the merger or "ABSTAIN" from voting. If the stockholder votes "FOR" the merger, he will lose his dissenters' rights.

The stockholder's written demand must:

be made by the record holder of the shares; thus, a beneficial owner of our stock that is registered in the record ownership of another person (such as a broker or nominee) should instruct the record holder to follow the procedures for perfecting dissenters' rights if the beneficial owner wants to dissent with respect to any or all of those shares;

be mailed or otherwise directed to Kennedy-Wilson, Inc., attention Chief Financial Officer, 9701 Wilshire Blvd., Suite 700, Beverly Hills, CA 90212;

Table of Contents

be received not later than 30 days after notice of the approval of the merger is mailed to stockholders who did not vote in favor of the merger (as described below);

specify the stockholder's name and mailing address and the number and class of shares held of record that the stockholder demands that Kennedy-Wilson purchase;

state that the stockholder is demanding purchase of the shares and payment of their fair market value (Chapter 13 of the CGCL states that the fair market value, for this purpose, is determined "as of the day before the announcement" of the proposed merger); and

state the price that the stockholder claims to be the fair market value of the shares (this statement will constitute an offer by the stockholder to sell the shares to Kennedy-Wilson at that price).

In addition, within 30 days after notice of the approval of the merger is mailed to stockholders, the stockholder must also submit to Kennedy-Wilson, for endorsement as dissenting shares, the stock certificates representing the Kennedy-Wilson shares as to which the stockholder is exercising dissenters' rights. A holder of dissenting shares may not withdraw a demand for payment unless Kennedy-Wilson consents to the withdrawal.

Simply failing to vote for or against, or voting against, the proposed merger will not be sufficient to constitute the demand described above.

If the merger is approved by Kennedy-Wilson's stockholders, Kennedy-Wilson will have 10 days after the approval to send to those stockholders who did not vote in favor of the merger and who could potentially exercise dissenters' rights in accordance with the CGCL, a written notice of such approval accompanied by:

a copy of Chapter 13 of the CGCL;

a statement of the price Kennedy-Wilson determines to represent the fair market value of the dissenting shares (this statement will constitute an offer by Kennedy-Wilson to purchase any dissenting shares at the stated amount if the merger closes and unless the shares lose their status as dissenting shares); and

a brief description of the procedures to be followed if a stockholder desires to exercise dissenters' rights.

If Kennedy-Wilson and a dissenting stockholder agree that the shares are dissenting shares and agree on the price of the shares, the dissenting stockholder is entitled to receive the agreed-upon price with interest from the date of such agreement. The applicable interest rate will be the rate then set by law for the accrual of interest on judgments for money. Payment for the dissenting shares must be made within 30 days after the later of the date of that agreement or the date on which all statutory and contractual conditions to the merger are satisfied. Payments are also conditioned on the surrender to Kennedy-Wilson of the certificates representing the dissenting shares.

If Kennedy-Wilson denies that shares are dissenting shares or the stockholder fails to agree with Kennedy-Wilson as to the fair market value of the shares, then, within six months after the notice of approval is mailed, any stockholder demanding purchase of such shares as dissenting shares or any interested corporation may file a complaint in the superior court in the proper California county requesting a determination as to whether the shares are dissenting shares or as to the fair market value of the holder's shares, or both, or may intervene in any action pending on such a complaint. If the complaint is not filed or intervention in a pending action is not made within the specified six-month period, the dissenters' rights are lost. If the status of the shares as dissenting shares is at issue, the court will first determine that issue. If the fair market value of the dissenting shares is at issue, the court will determine, or will appoint one or more impartial appraisers to determine, such fair market value.

Table of Contents

If the court appoints an appraiser or appraisers, they will proceed to determine the fair market value per share. Within the time fixed by the court, the appraisers, or a majority of the appraisers, will make and file a report in the office of the clerk of the court. Thereafter, on the motion of any party, the report is submitted to the court and considered on such evidence as the court considers relevant. If the court finds the report reasonable, the court may confirm it.

If a majority of the appraisers fails to make and file a report within 10 days after the date of their appointment or within such further time as the court allows, or if the court does not confirm the report, the court will determine the fair market value of the dissenting shares. Subject to Section 1306 of Chapter 13 of the CGCL, judgment is rendered against Kennedy-Wilson for payment of an amount equal to the fair market value of each dissenting share multiplied by the number of dissenting shares that any dissenting stockholder who is a party, or who has intervened, is entitled to require Kennedy-Wilson to purchase, with interest at the legal rate from the date on which the judgment is entered.

The costs of the action, including reasonable compensation to the appraisers to be fixed by the court, is assessed or apportioned as the court considers equitable. However, if the price determined by the court is more than the price offered by Kennedy-Wilson, it will pay the costs (including, in the discretion of the court, attorneys' fees, fees of expert witnesses and interest at the legal rate on judgments from the date of compliance with Sections 1300, 1301 and 1302 of the CGCL if the price determined by the court is more than 125% of the price offered by Kennedy-Wilson).

Except as expressly limited by Chapter 13, holders of dissenting shares continue to have all of the rights and privileges incident to their shares until the fair market value of their shares is agreed upon or determined.

Dissenting shares lose their status as dissenting shares, and dissenting stockholders cease to be entitled to require Kennedy-Wilson to purchase their shares, if:

the merger is abandoned;

the shares are transferred before they are submitted to Kennedy-Wilson for the required endorsement;

the dissenting stockholder and Kennedy-Wilson do not agree on the status of the shares as dissenting shares or do not agree on the purchase price, but neither Kennedy-Wilson nor the stockholder files a complaint or intervenes in a pending action within six months after Kennedy-Wilson mails a notice that its stockholders have approved the merger; or

with Kennedy-Wilson's consent, the holder delivers to Kennedy-Wilson a written withdrawal of such holder's demand for purchase of the shares.

To the extent that the provisions of Chapter 5 of the CGCL (which places conditions on the power of a California corporation to make distributions to its stockholders) prevent the payment to any holders of dissenting shares of the fair market value of the dissenting shares, the dissenting stockholders will become creditors of Kennedy-Wilson for the amount that they otherwise would have received in the repurchase of their dissenting shares, plus interest at the legal rate on judgments until the date of payment, but subordinate to all other creditors of Kennedy-Wilson in any liquidation proceeding, with the debt to be payable when permissible under the provisions of Chapter 5 of the CGCL.

For U.S. federal income tax purposes, stockholders who receive cash for their shares of Kennedy-Wilson's stock pursuant to the exercise of dissenters' rights will generally recognize taxable gain or loss. Each holder should consult its own tax advisor as to the particular tax consequences of the exercise of dissenters' rights to such holder.

Table of Contents

CHAPTER 13 OF THE CGCL PROVIDES THAT THE VALUE OF KENNEDY-WILSON COMMON STOCK FOR PURPOSES OF THE EXERCISE OF DISSENTERS' RIGHTS IS THE "FAIR MARKET VALUE" ON THE DAY PRIOR TO ANNOUNCEMENT OF THE TRANSACTION. AS A RESULT, THE KENNEDY-WILSON BOARD INTENDS TO FIX THE VALUE FOR PURPOSES OF ANY STOCKHOLDER EXERCISING DISSENTERS' RIGHTS AT \$33.50 PER SHARE, THE PRICE OF OUR COMMON STOCK ON SEPTEMBER 8, 2009, AND AN AMOUNT SUBSTANTIALLY LESS THAN THE MERGER CONSIDERATION.

Table of Contents

STOCKHOLDER PROPOSALS

If the merger is consummated, Kennedy-Wilson will be a wholly-owned subsidiary of Prospect. If the merger is not consummated prior to November 14, 2009, Prospect will be required to dissolve and liquidate and will conduct no annual meetings thereafter. Prospect's next annual meeting of stockholders will be held on or about June 15, 2010 unless the date is changed by Prospect's board of directors. Proposals to be included in the proxy statement for the 2010 annual meeting must be provided to Prospect in a reasonable time before it begins to print and deliver proxy materials. You should direct any proposals to Prospect's secretary at Prospect's principal executive offices. Applicable SEC rules and regulations govern the submission of stockholder proposals and Prospect's consideration of them for inclusion in next year's proxy statement for the 2010 annual meeting.

LEGAL MATTERS

Bingham McCutchen LLP will pass upon the validity of the common stock issued in connection with the merger and certain other legal matters related to this proxy statement/prospectus. Bingham McCutchen LLP, as counsel to Prospect, has provided an opinion to Prospect related to the statements made in the sections of this proxy statement/prospectus captioned "*Material United States Federal Income Tax Consequences Tax Consequences of the Merger to Prospect and United States Holders of Prospect Common Stock*" on page 137 and "*Material United States Federal Income Tax Consequences Tax Consequences of the Warrant Amendment to United States Holders of Prospect Warrants*" on page 137. Loeb & Loeb LLP, as counsel to Kennedy-Wilson, has provided an opinion to Kennedy-Wilson related to the statements made in the section of this proxy statement/prospectus captioned "*Material United States Federal Income Tax Consequences Tax Consequences of the Merger to United States Holders of Kennedy-Wilson Stock*" on page 136.

EXPERTS

The consolidated financial statements of Kennedy-Wilson as of December 31, 2008 and 2007, and for each of the years in the three-year period ended December 31, 2008, have been included herein in reliance upon the report of KPMG LLP, independent registered public accounting firm appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing. The audit report covering the December 31, 2008 financial statements refers to the adoption of Statement of Financial Accounting Standards No. 160, *Noncontrolling Interest in Consolidated Financial Statements an Amendment of ARB No. 51*.

The financial statements of Prospect as of December 31, 2008 and 2007 and for the year ended December 31, 2008 and the periods from July 9, 2007 (inception) to December 31, 2007 and July 9, 2007 (inception) to December 31, 2008 included in this proxy statement/prospectus have been so included in the reliance on a report of McGladrey & Pullen LLP, an independent registered public accounting firm, appearing elsewhere herein given on the authority of said firm, as experts in auditing and accounting.

DELIVERY OF DOCUMENTS TO STOCKHOLDERS

Pursuant to the rules of the SEC, Prospect and services that it employs to deliver communications to its stockholders are permitted to deliver to two or more stockholders sharing the same address a single copy of this proxy statement/prospectus. Upon written or oral request, Prospect will deliver a separate copy of this proxy statement/prospectus to any stockholder at a shared address to which a single copy of this proxy statement/prospectus was delivered and who wishes to receive separate copies of such documents in the future. Stockholders receiving multiple copies of this proxy statement/prospectus may likewise request that Prospect deliver single copies of such documents in the future.

Table of Contents

Stockholders may notify Prospect of their requests by calling or writing Prospect at its principal executive offices at 9130 Galleria Court, Suite 318, Naples, FL 34109, telephone (239) 254-4481.

WHERE YOU CAN FIND MORE INFORMATION

Prospect files reports, proxy statements and other information with the SEC as required by the Exchange Act.

You may read and copy reports, proxy statements and other information filed by Prospect with the SEC at its public reference room located at 100 F Street, N.E., Washington, D.C. 20549-1004.

You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also obtain copies of the materials described above at prescribed rates by writing to the SEC, Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-1004.

Prospect files its reports, proxy statements and other information electronically with the SEC. You may access information on Prospect at the SEC web site containing reports, proxy statements and other information at <http://www.sec.gov>.

This proxy statement/prospectus describes the material elements of relevant contracts, exhibits and other information described in this proxy statement/prospectus.

All information contained or incorporated by reference in this proxy statement/prospectus relating to Prospect has been supplied by Prospect.

If you would like additional copies of this proxy statement/prospectus you should contact:

James J. Cahill
Chief Financial Officer and Secretary, Prospect Acquisition Corp.
9130 Galleria Court, Suite 318
Naples, Florida 34109
(239) 254-4481

DIRECTIONS TO THE SPECIAL MEETING OF STOCKHOLDERS AND THE SPECIAL MEETING OF WARRANTHOLDERS

You can obtain directions to the special meeting of Prospect stockholders and the special meeting of Prospect warrantholders by visiting <http://www.professionalsuitesnaples.com> and clicking on the "location" tab.

Table of Contents

INDEX TO FINANCIAL STATEMENTS

Prospect Acquisition Corp.

*Audited***Report of Independent Registered Public Accounting Firm**Balance Sheets as of December 31, 2008 and 2007

F-3

Statements of Operations For the year ended December 31, 2008, for the period from July 9, 2007 (date of inception) through December 31, 2007 and for the cumulative period from July 9, 2007 (date of inception) through December 31, 2008

F-4

Statements of Stockholders' Equity For the year ended December 31, 2008, for the period from July 9, 2007 (date of inception) through December 31, 2007 and for the cumulative period from July 9, 2007 (date of inception) through December 31, 2008

F-5

Statements of Cash Flows For the year ended December 31, 2008, for the period from July 9, 2007 (date of inception) through December 31, 2007 and for the cumulative period from July 9, 2007 (date of inception) through December 31, 2008

F-6

Notes to Financial Statements

F-7

F-8

*Unaudited*Condensed Balance Sheets At December 31, 2008 and June 30, 2009

F-18

Condensed Statements of Operations For the six months ended June 30, 2009 and June 30, 2008, and for the period from July 9, 2007 (date of inception) through June 30, 2009

F-19

Condensed Statements of Stockholders' Equity At December 31, 2008 and 2007 and June 30, 2009

F-20

Condensed Statements of Cash Flows For the six months ended June 30, 2009 and June 30, 2008 and for the period from July 9, 2007 (date of inception) through June 30, 2009

F-21

Notes to Unaudited Condensed Financial Statements

F-22

Kennedy-Wilson, Inc. and Subsidiaries*Audited***Report of Independent Registered Public Accounting Firm**Consolidated Balance Sheets December 31, 2008 and December 31, 2007

F-31

F-32

Consolidated Statements of Income and Comprehensive Income Years ended December 31, 2008, December 31, 2007 and December 31, 2006

F-33

Consolidated Statements of Equity Year ended December 31, 2008, December 31, 2007 and December 31, 2006

F-34

Consolidated Statements of Cash Flows Year ended December 31, 2008, December 31, 2007 and December 31, 2006

F-35

Notes to Consolidated Financial Statements Years ended December 31, 2008, December 31, 2007 and December 31, 2006

F-37

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Unaudited

<u>Unaudited Consolidated Balance Sheets June 30, 2009 and December 31, 2008</u>	<u>F-62</u>
<u>Unaudited Consolidated Statements of Operations and Comprehensive Loss Six months ended June 30, 2009 and June 30, 2008</u>	<u>F-63</u>
<u>Unaudited Consolidated Statement of Equity Year ended December 31, 2008, and the Six Months Ended June 30, 2009</u>	<u>F-64</u>
<u>Unaudited Consolidated Statements of Cash Flows Six months ended June 30, 2009 and June 30, 2008</u>	<u>F-65</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>F-66</u>

F-2

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Prospect Acquisition Corp.

We have audited the accompanying balance sheets of Prospect Acquisition Corp. (a development stage company) as of December 31, 2008 and 2007, and the related statements of operations, stockholders' equity, and cash flows for the year ended December 31, 2008, the period from July 9, 2007 (date of inception) through December 31, 2007, and the cumulative period from July 9, 2007 (date of inception) through December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Prospect Acquisition Corp. as of December 31, 2008 and 2007 and the results of its operations and its cash flows for the year ended December 31, 2008, the period from July 9, 2007 (date of inception) through December 31, 2007, and the cumulative period from July 9, 2007 (date of inception) through December 31, 2008, in conformity with U.S. generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that Prospect Acquisition Corp. will continue as a going concern. As discussed in Note 1 to the financial statements, the Company will face mandatory liquidation on November 14, 2009 if a business combination is not consummated, which raises substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ McGladrey & Pullen, LLP

McGLADREY & PULLEN, LLP
New York, New York
March 13, 2009

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Balance Sheets**

	December 31,	
	2008	2007
Assets		
Current assets:		
Cash	\$ 28,678	\$ 58,075
Investments held in trust account	248,924,201	247,340,887
Accrued interest income on trust account	59,219	739,654
Prepaid expenses	60,716	22,605
Prepaid taxes	203,588	
Total current assets	249,276,402	248,161,221
Deferred tax asset	173,158	
Total assets	\$ 249,449,560	\$ 248,161,221
Liabilities and Stockholders' Equity		
Current liabilities:		
Accrued expenses	\$ 186,097	\$ 45,407
Accrued offering costs		38,216
Income taxes payable		392,498
Deferred interest income	67,148	
Deferred underwriting commission	10,000,000	10,000,000
Total liabilities	10,253,245	10,476,121
Common stock, subject to possible conversion, 7,499,999 shares	74,099,990	74,099,990
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$0.0001 par value; 1,000,000 shares authorized; none issued and outstanding		
Common stock, \$0.0001 par value; 72,000,000 shares authorized; 31,250,000 shares (including 7,499,999 subject to possible conversion) issued and outstanding	3,125	3,125
Additional paid-in capital	162,966,787	162,966,787
Earnings accumulated during the development stage	2,126,413	615,198
Total stockholders' equity	165,096,325	163,585,110
Total liabilities and stockholders' equity	\$ 249,449,560	\$ 248,161,221

See notes to financial statements.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Statements of Operations**

	For the year ended December 31, 2008	For the period from July 9, 2007 (date of inception) through December 31, 2007	For the period from July 9, 2007 (date of inception) through December 31, 2008
Interest income	\$ 3,875,836	\$ 1,080,541	\$ 4,956,377
Deferred interest income	67,148		67,148
Net interest income	3,808,688	1,080,541	4,889,229
Operating expenses:			
Capital & franchise taxes	886,646	94,763	981,409
Professional fees	250,457	24,996	275,453
Formation and operating costs	193,232	16,913	210,145
Rent and office expenses	90,050	11,750	101,800
	1,420,385	148,422	1,568,807
Net income before provision for income taxes	2,388,303	932,119	3,320,422
Provision for income taxes	877,088	316,921	1,194,009
Net income	\$ 1,511,215	\$ 615,198	\$ 2,126,413
Weighted average number of common shares outstanding:			
Basic and diluted	31,250,000	13,155,357	25,396,835
Net income per share:			
Basic and diluted	\$ 0.05	\$ 0.05	\$ 0.08

See notes to financial statements.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Statements of Stockholders' Equity**

	Common Stock		Additional	Retained	Total
	Shares	Amount	Paid-in	Earnings	Stockholders'
			Capital	Accumulated	Equity
				During the	
				Development	
				Stage	
Common shares issued to initial stockholders on July 18, 2007 at approximately \$.003 per share	7,187,500	\$ 719	\$ 24,281	\$	\$ 25,000
Sale of 25,000,000 units, net of underwriters' discount and offering expenses of \$18,205,004 (includes 7,499,999 shares subject to possible conversion)	25,000,000	2,500	231,792,496		231,794,996
Proceeds subject to possible conversion of 7,499,999 shares			(74,099,990)		(74,099,990)
Proceeds from issuance of sponsors' warrants			5,250,000		5,250,000
Repurchase of 937,500 common shares issued to initial stockholders	(937,500)	(94)			(94)
Net income				615,198	615,198
Balance at December 31, 2007	31,250,000	3,125	162,966,787	615,198	163,585,110
Net income				1,511,215	1,511,215
Balance at December 31, 2008	31,250,000	\$ 3,125	\$ 162,966,787	\$ 2,126,413	\$ 165,096,325

See notes to financial statements.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Statements of Cash Flows**

	For the year ended December 31, 2008	For the period from July 9, 2007 (date of inception) through December 31, 2007	For the period from July 9, 2007 (date of inception) through December 31, 2008
Cash flows from operating activities			
Net income	\$ 1,511,215	\$ 615,198	\$ 2,126,413
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Interest income earned on trust account	(3,875,836)	(1,080,541)	(4,956,377)
Changes in assets and liabilities:			
Increase in prepaid expenses	(241,699)	(22,605)	(264,304)
Increase in deferred tax asset	(173,158)		(173,158)
Increase in accrued expenses	140,690	45,407	186,097
Increase in deferred interest income	67,148		67,148
(Decrease) increase in income taxes payable	(392,498)	392,498	
Net cash used in operating activities	(2,964,138)	(50,043)	(3,014,181)
Cash flows from investing activities			
Cash placed in trust account		(247,000,000)	(247,000,000)
Cash withdrawn from trust account	2,972,957		2,972,957
Net cash provided by (used in) investing activities	2,972,957	(247,000,000)	(244,027,043)
Cash flows from financing activities			
Gross proceeds from initial public offering		250,000,000	250,000,000
Proceeds from issuance of sponsors' warrants		5,250,000	5,250,000
Proceeds from sale of shares of common stock to initial stockholders		25,000	25,000
Proceeds from notes payable to stockholders		200,000	200,000
Repayment of notes payable to stockholders		(200,000)	(200,000)
Repurchase of common shares from initial stockholders		(94)	(94)
Payment of deferred offering costs			
Payment of offering costs	(38,216)	(8,166,788)	(8,205,004)
Net cash (used in) provided by financing activities	(38,216)	247,108,118	247,069,902
Net (decrease) increase in cash	(29,397)	58,075	28,678
Cash at beginning of period	58,075		
Cash at end of period	\$ 28,678	\$ 58,075	\$ 28,678
Supplemental disclosure of non-cash financing activities			
Accrual of deferred offering costs		\$ 38,216	
Deferred underwriting commission		\$ 10,000,000	\$ 10,000,000

Supplemental disclosure of cash flow information

Cash paid during the period for income taxes	\$ 1,646,332	\$	\$ 1,646,332
--	--------------	----	--------------

See notes to financial statements.

F-7

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Financial Statements

1. Organization, Business Operations and Significant Accounting Policies

Prospect Acquisition Corp. (the "Company") was incorporated in Delaware on July 9, 2007 as a blank check company formed for the purpose of acquiring control of, through a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or other similar business combination, one or more operating businesses or assets in the financial services industry (a "Business Combination").

At December 31, 2008, the Company's operations related to the Company's formation and the initial public offering described below.

The registration statement for the Company's initial public offering (the "Offering") was declared effective November 14, 2007. The Company consummated the Offering on November 20, 2007 and received gross proceeds of \$250,000,000 and \$5,250,000 from the sale of sponsors' warrants on a private placement basis (see Note 2). The Company's management has broad discretion with respect to the specific application of the net proceeds of the Offering, although substantially all of the net proceeds of the Offering are intended to be generally applied toward consummating a Business Combination. Furthermore, there is no assurance that the Company will be able to successfully effect a Business Combination. An amount of \$247,000,000 (or approximately \$9.88 per unit) of the net proceeds of the Offering and the sale of the sponsors' warrants (see Note 2) was deposited in a trust account (the "trust account") and invested in United States "government securities" within the meaning of Section 2(a)(16) of the Investment Company Act of 1940 having a maturity of 180 days or less, or in money market funds meeting certain conditions under Rule 2a-7 promulgated under the Investment Company Act of 1940 until the earlier of (i) the consummation of its initial Business Combination or (ii) liquidation of the Company. At December 31, 2008, the trust account was invested in United States government securities and has been accounted for as a trading security. The placing of funds in the trust account may not protect those funds from third-party claims against the Company. Although the Company has sought and will seek to have all vendors, prospective target businesses or other entities it engages, execute agreements with the Company waiving any right, title, interest or claim of any kind in or to any monies held in the trust account, there is no guarantee that they will execute such agreements. A Company officer and two initial stockholders have agreed that they will be personally liable under certain circumstances to ensure that the proceeds in the trust account are not reduced by the claims of target businesses or vendors or other entities that are owed money by the Company for services rendered, contracted for or products sold to the Company, subject to limited exceptions. However, there can be no assurance that they will be able to satisfy those obligations. The remaining net proceeds (not held in the trust account) are being used to pay for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses. Until the consummation of the initial Business Combination or the liquidation of the Company, proceeds held in the trust account will not be available for the Company's use for any purpose, except there can be released to the Company from the trust account (i) interest income earned on the trust account balance to pay any taxes on such interest and (ii) interest income earned of up to \$2.75 million on the trust account balance to fund the Company's working capital requirements, provided that after such

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Notes to Financial Statements (Continued)****1. Organization, Business Operations and Significant Accounting Policies (Continued)**

release there remains in the trust account a sufficient amount of interest income previously earned on the trust account balance to pay any due and unpaid taxes on income generated by the trust account.

Amounts placed in trust account	\$ 247,000,000
Interest income received	4,897,158
Amounts withdrawn for payment of federal & state taxes	(2,387,057)
Amounts withdrawn for working capital	(585,900)
Total	\$ 248,924,201

The Company, after signing a definitive agreement for a Business Combination with a target business or businesses, is required to submit such transaction for stockholder approval. In the event that those persons that purchase securities in the Offering or thereafter ("Public Stockholders") owning 30% or more of the shares sold in the Offering vote against the Business Combination and exercise their conversion rights described below, the Business Combination will not be consummated. All of the Company's stockholders prior to the Offering, including all of the directors of the Company (the "Initial Stockholders"), have agreed to vote all of their founding shares of common stock in accordance with the majority of the shares of common stock voted by the Public Stockholders with respect to any Business Combination.

After consummation of a Business Combination, these voting safeguards will no longer apply.

With respect to a Business Combination which is approved and consummated, any Public Stockholder who voted against the Business Combination may demand that the Company convert his or her shares into cash from the trust account. The per share conversion price will equal the aggregate amount then on deposit in the trust account, before payment of deferred underwriting discounts and commissions and including accrued interest, net of income taxes on such interest and net of interest income on the trust account balance released to the Company as described above, calculated as of two business days prior to the proposed consummation of the initial Business Combination, divided by the number of shares of common stock sold in the Offering. Accordingly, Public Stockholders holding not more than 30% of the shares (minus one share) sold in the Offering may seek conversion of their shares in the event of a Business Combination. Such Public Stockholders are entitled to receive their per share interest in the trust account (net of the tax and working capital items described above) computed without regard to the shares held by Initial Stockholders.

Accordingly, a portion of the net proceeds from the Offering (29.99% of the amount placed in the trust account) has been classified as common stock subject to possible conversion and a portion (29.99%) of the interest earned on the trust account, after deducting the amounts permitted to be utilized for tax obligations and working capital purposes, has been recorded as deferred interest in the accompanying financial statements.

The Company's Certificate of Incorporation was amended on November 14, 2007 to provide that the Company will continue in existence only until 24 months from the effective date of the registration statement relating to the Offering (the "Effective Date"), or November 14, 2009. If the Company has not completed a Business Combination by such date, its corporate existence will cease except for the purposes of liquidating and winding up its affairs. In the event of liquidation, it is possible that the per

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Financial Statements (Continued)

1. Organization, Business Operations and Significant Accounting Policies (Continued)

share value of the residual assets remaining available for distribution (including assets in the trust account) will be less than the initial public offering price per Unit in the Offering (assuming no value is attributed to the Warrants contained in the Units offered in the Offering discussed in Note 2) because of the expenses of the Offering, the Company's general and administrative expenses and the anticipated costs of seeking an initial Business Combination. This raises substantial doubt about the Company's ability to continue as a going concern beyond November 14, 2009. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Deferred Income Taxes:

Deferred income tax assets and liabilities are computed for differences between the financial statements and tax basis of assets and liabilities that will result in future taxable or deductible amounts and are based on enacted tax laws and rates applicable to the periods in which the differences are expected to effect taxable income. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized.

Net Income per Share:

The Company complies with Statement of Financial Accounting Standards ("SFAS") No. 128, "*Earnings Per Share*," which requires dual presentation of basic and diluted earnings per share on the face of the statement of operations. Basic net income per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income per share gives effect to dilutive options, warrants, and other potential common stock outstanding during the period. The effect of the 30,250,000 outstanding Warrants issued in connection with the Offering and the private placement described in Note 2 has not been considered in the diluted earnings per share calculation since the Warrants are contingent upon the occurrence of future events, and therefore, is not includable in the calculation of diluted earnings per share in accordance with SFAS 128.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications:

Certain prior year balances have been reclassified to conform with the current year presentation.

Cash and Cash Equivalents:

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Financial Statements (Continued)

1. Organization, Business Operations and Significant Accounting Policies (Continued)

Concentration of Credit Risk:

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments with Concentration of Credit Risk," requires disclosure of significant concentrations of credit risk regardless of the degree of risk. At December 31, 2007, financial instruments that potentially expose the Company to credit risk consist of cash and investments held in the trust account. The Company maintains its cash balances in various financial institutions. The Federal Deposit Insurance Corporation insures balances in bank accounts up to \$100,000 and the Securities Investor Protection Corporation insures balances up to \$500,000 in brokerage accounts. The Company maintains cash in accounts which, at times, exceeds such limits. The Company has not experienced any losses on this account and management believes the risk of loss to be minimal since it invests through major financial institutions.

Fair value of financial instruments:

The fair values of the Company's assets and liabilities that are defined as financial instruments under Statement of Financial Accounting Standards ("SFAS") No. 107, *Disclosures about Fair Value of Financial Instrument*, approximate their carrying amounts presented in the balance sheets at December 31, 2008 and December 31, 2007.

New Accounting Pronouncements:

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosures about fair value measurements. SFAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157*, which permits a one-year deferral for the implementation of SFAS 157 with regard to non-financial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Company adopted SFAS 157 for the fiscal year beginning January 1, 2008, except for the non-financial assets and non-financial liabilities for which delayed application is permitted until our fiscal year beginning January 1, 2009. The adoption of the remaining provisions of SFAS 157 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB No. 115* ("SFAS 159"). SFAS 159 allows a company to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and will be applied prospectively. The adoption of SFAS 159 did not have a significant impact on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ("SFAS 141R") which establishes principles and requirements for how the acquirer of a business recognizes and

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Financial Statements (Continued)

1. Organization, Business Operations and Significant Accounting Policies (Continued)

measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R will have an impact to the Company for any acquisitions consummated on or after January 1, 2009.

In December 2007, the FASB released SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* ("SFAS 160"), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent and for the deconsolidation of a subsidiary. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interest of the parent and the interests of the non-controlling owners. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. SFAS 160 may have a material impact to the Company with respect to any acquisitions consummated on or after January 1, 2009.

Management does not believe that any other recently issued, but not yet effective, accounting standards, if currently adopted, would have a material effect on the accompanying financial statements.

2. Initial Public Offering

On November 20, 2007, the Company sold 25,000,000 units (the "Units") at an offering price of \$10.00 per Unit. The Company granted the underwriters an option to purchase up to an additional 3,750,000 Units solely to cover over-allotments. Said option could have been exercised in whole or in part at any time before the 30th day after the Effective Date, and has expired without having been exercised by the underwriters.

Each Unit consists of one share of the Company's common stock and one warrant exercisable for one share of common stock at an exercise price of \$7.50 per share (a "Warrant"). Each Warrant will be exercisable on the later of the completion of the initial Business Combination and fifteen months from the Effective Date, provided in each case that the Company has an effective registration statement covering the shares of common stock issuable upon exercise of the warrants and a current prospectus relating to them is available. The Warrants will expire five years from the Effective Date, unless earlier redeemed. The Company may call the Warrants for redemption, in whole and not in part, at any time after the Warrants become exercisable and there is an effective registration statement covering the shares of common stock issuable upon exercise of the warrants available and current throughout the 30-day Redemption Period defined hereafter, upon a minimum of 30 days' prior written notice of redemption (the "30-day Redemption Period") at a price of \$0.01 per Warrant, only in the event that the last sale price of the common stock equals or exceeds \$14.50 per share for any 20 trading days within a 30-trading day period ending on the third business day prior to the date on which the notice of redemption is sent to the warrant holder. In accordance with the warrant agreement relating to the Warrants sold and issued in the Offering, the Company is only required to use its best efforts to maintain the effectiveness of the registration statement covering the Warrants from the date the warrants become exercisable until the warrants expire or are redeemed. The Company will not be obligated to deliver securities, and there are no contractual penalties for failure to deliver securities, if a registration statement is not effective at the time of exercise. Additionally, in the event that a

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Financial Statements (Continued)

2. Initial Public Offering (Continued)

registration statement is not effective at the time of exercise, the holder of such Warrant shall not be entitled to exercise such Warrant and in no event (whether in the case of a registration statement not being effective or otherwise) will the Company be required to settle the warrant exercise, whether by net cash settlement or otherwise. Consequently, the Warrants may expire unexercised and unredeemed (and therefore worthless), and, as a result, an investor in the Offering may effectively pay the full Unit price solely for the shares of common stock included in the Units.

The Company entered into an agreement with the underwriters of the Offering (the "Underwriting Agreement"). The Underwriting Agreement requires the Company to pay 3% of the gross proceeds of the Offering as an underwriting discount plus an additional 4% of the gross proceeds of the Offering only upon consummation of a Business Combination. The Company paid an underwriting discount of 3% of the gross proceeds of the Offering (\$7.5 million) in connection with the consummation of the Offering and has placed 4% of the gross proceeds of the Offering (\$10 million) in the trust account. The \$10 million amount due to the underwriters has been classified as deferred underwriting commission on the accompanying balance sheets. The Company did not have to pay any discount related to the sponsors' warrants sold on a private placement basis. The underwriters have waived their right to receive payment of the 4% of the gross proceeds for the Offering upon the Company's liquidation if the Company is unable to complete a Business Combination.

Pursuant to purchase agreements dated November 14, 2007, certain of the Initial Stockholders have purchased from the Company, in the aggregate, 5,250,000 warrants for \$5,250,000 (the "sponsors' warrants"). The purchase and issuance of the sponsors' warrants occurred simultaneously with the consummation of the Offering on a private placement basis. All of the proceeds the Company received from these purchases were placed in the trust account. The sponsors' warrants are identical to the Warrants included in the Units offered in the Offering except that the sponsors' warrants (i) are non-redeemable so long as they are held by the original purchasers or their permitted transferees, (ii) are subject to certain transfer restrictions and will not be exercisable while they are subject to these transfer restrictions and (iii) may be exercised for cash or on a cashless basis. The purchase price of the sponsors' warrants has been determined to be the fair value of such warrants as of the purchase date.

The Initial Stockholders have waived their right to receive a liquidation distribution with respect to their founding shares upon the Company's liquidation if it is unable to complete a Business Combination.

3. Fair Value Measurement

As discussed in Note 1, effective January 1, 2008 the Company adopted the required portions of SFAS 157. SFAS 157 requires new disclosure that establishes a framework for measuring fair value in GAAP, and expands disclosure about fair value measurements. This statement enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The

Table of Contents**Prospect Acquisition Corp.**

(a development stage company)

Notes to Financial Statements (Continued)**3. Fair Value Measurement (Continued)**

statement requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to SFAS 157. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

	Fair Value As of December 31, 2008	Quoted Prices in Active Markets (Level 1)	Significant other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments held in trust account plus Accrued Interest Income on trust account	\$248,983,420	\$248,983,420		
Total	\$248,983,420	\$248,983,420		

4. Accrued Offering Costs

Accrued offering costs consisted of road show and printing fees related to the Offering that were incurred through the balance sheet date and were charged to additional paid-in capital upon the consummation of the Offering.

5. Notes Payable to Stockholders

The Company issued three unsecured promissory notes for \$120,000, \$78,400 and \$1,600 (a total of \$200,000) to three Initial Stockholders. The notes were non-interest bearing and were repaid upon the consummation of the Offering.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Notes to Financial Statements (Continued)****6. Income Taxes**

Income tax expense in the accompanying statements of operations consists of the current and deferred provisions as follows:

	2008	2007
Current:		
Federal	\$ 1,050,246	\$ 316,921
State		
	1,050,246	316,921
Deferred:		
Federal	(173,158)	
State		
	(173,158)	
Total income tax expense	\$ 877,088	\$ 316,921

The components of the deferred tax asset are as follows:

	December 31, 2008	December 31, 2007
Expenses deferred for income tax purposes	\$ 198,368	\$
Interest income deferred for book purposes	26,154	
Valuation allowance	(51,364)	
	\$ 173,158	\$

The effective tax rate differs from the statutory rate of 34% due to the following:

	2008	2007
Statutory rate	34.0%	34.0%
State income taxes, net of current federal benefit	(1.2)	
Change in valuation allowance	2.2	
Other	1.7	
	36.7%	34.0%

7. Related Party Transactions

The Company presently occupies office space provided by affiliates of certain of the Company's officers and directors. Such affiliates have agreed that until the Company consummates a Business Combination, they will make such office space, as well as certain general and administrative services including utilities and administrative support, available to the Company, as may be required by the Company from time to time. The Company has agreed to pay such affiliates a total of \$7,500 per month for such services commencing on the Effective Date (amended December 31, 2008 to \$6,805.25 per month). For the periods ended December 31, 2008 and 2007, the Company has incurred \$90,050

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Financial Statements (Continued)

7. Related Party Transactions (Continued)

and \$11,750, respectively, of expense relating to these agreements, which is reflected in rent and office expenses in the accompanying statements of operations.

8. Commitments

The Initial Stockholders and holders of the sponsors' warrants (or underlying securities) will be entitled to registration rights with respect to their founding shares or sponsors' warrants (or underlying securities), as the case may be, pursuant to an agreement dated November 14, 2007. In addition, the Initial Stockholders have certain "piggy-back" registration rights with respect to registration statements filed by the Company generally commencing nine months after the consummation of the Company's initial Business Combination, and the holders of the sponsors' warrants (or underlying securities) have certain "piggy-back" registration rights on registration statements filed after the Company's consummation of a Business Combination.

9. Capital Stock

The Company's original Certificate of Incorporation authorized the Company to issue 6,000,000 shares of common stock with a par value of \$0.0001 per share. In October, 2007, the Company's certificate of incorporation was amended to increase the authorized shares of common stock from 6,000,000 shares to 8,000,000 shares. The Company's Certificate of Incorporation was amended on November 14, 2007 to increase the number of authorized shares of common stock to 72,000,000. In addition, the Company is authorized to issue 1,000,000 shares of preferred stock.

On July 18, 2007, the Company issued 4,312,500 shares of common stock to the founders for an aggregate of \$25,000 in cash, at a purchase price of approximately \$0.006 per share. In October, 2007, the aggregate outstanding 4,312,500 shares of common stock were increased to 7,187,500 shares of common stock as a result of a 5-for-3 stock split declared by our board of directors. All references in the accompanying financial statements to the number of shares of stock have been retroactively restated to reflect these transactions.

In accordance with the terms of the Offering, with the expiration of the underwriters' option to purchase up to an additional 3,750,000 Units solely to cover over-allotments, the Company repurchased 937,500 shares of common stock from the Initial Stockholders at a price of \$0.0001 per share.

10. Legal

There is no material litigation currently pending against the Company of any member of its management team in their capacity as such.

Table of Contents**Prospect Acquisition Corp.**

(a development stage company)

Notes to Financial Statements (Continued)**11. Quarterly Results of Operations (Unaudited)**

The following table presents summarized unaudited quarterly results of operations for the Company for fiscal years ended December 31, 2008 and 2007. We believe all necessary adjustments have been included in the amounts stated below to present fairly the following selected information when read in conjunction with the Financial Statements and Notes thereto included elsewhere herein. Future quarterly operating results may fluctuate depending on a number of factors.

	Fiscal Year Ended December 31, 2008				Fiscal Year Ended December 31, 2007	
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	For the Period from July 9, 2007 (date of inception) through September 30, 2007	4th Quarter
Net Interest Income	\$ 1,621,880	\$ 906,706	\$ 951,016	\$ 329,086	\$	\$ 1,080,541
Operating Expenses	\$ 215,488	\$ 167,647	\$ 437,378	\$ 599,872	\$ 1,213	\$ 147,209
Provision for Income Taxes	\$ 581,931	\$ 295,335	\$ 235,427	\$ (235,605)	\$	\$ 316,921
Net Income (Loss)	\$ 824,461	\$ 443,724	\$ 278,211	\$ (35,181)	\$ (1,213)	\$ 616,411
Basic and diluted earnings per share	\$ 0.03	\$ 0.01	\$ 0.01	\$ (0.00)	\$ (0.00)	\$ 0.03

F-17

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Condensed Balance Sheets**

	June 30, 2009	December 31,
	(Unaudited)	2008
Assets		
Current assets:		
Cash	\$ 9,425	\$ 28,678
Investments held in trust account	248,535,987	248,924,201
Accrued interest income on trust account	2,616	59,219
Prepaid expenses	40,122	60,716
Prepaid taxes	212,270	203,588
Total current assets	248,800,420	249,276,402
Deferred tax asset	315,649	173,158
Total assets	\$ 249,116,069	\$ 249,449,560
Liabilities and Stockholders' Equity		
Current liabilities:		
Accrued expenses	\$ 100,957	\$ 186,097
Deferred interest income	76,181	67,148
Deferred underwriting commission	10,000,000	10,000,000
Total liabilities	10,177,138	10,253,245
Common stock, subject to possible conversion, 7,499,999 shares	74,099,990	74,099,990
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$0.0001 par value; 1,000,000 shares authorized; none issued and outstanding		
Common stock, \$0.0001 par value; 72,000,000 shares authorized; 31,250,000 shares (including 7,499,999 subject to possible conversion) issued and outstanding	3,125	3,125
Additional paid-in capital	162,966,787	162,966,787
Retained earnings accumulated during the development stage	1,869,029	2,126,413
Total stockholders' equity	164,838,941	165,096,325
Total liabilities and stockholders' equity	\$ 249,116,069	\$ 249,449,560

See notes to unaudited condensed financial statements.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Condensed Statements of Operations****(Unaudited)**

	For the six months ended June 30, 2009	For the six months ended June 30, 2008	For the period from July 9, 2007 (date of inception) through June 30, 2009
Interest income	\$ 50,183	\$ 2,528,586	\$ 5,006,560
Deferred interest income	9,033		76,181
Net interest income	41,150	2,528,586	4,930,379
Operating expenses:			
Capital & franchise taxes	73,254	257,329	1,054,663
Professional fees	242,409	161,039	517,862
Formation and operating costs	89,428	103,923	299,573
Rent and office expenses	44,616	45,000	146,416
	449,707	567,291	2,018,514
Net (loss) income before income taxes	(408,557)	1,961,295	2,911,865
Income tax (benefit) provision	(151,173)	693,110	1,042,836
Net (loss) income	\$ (257,384)	\$ 1,268,185	\$ 1,869,029
Weighted average number of common shares outstanding:			
Basic and diluted	31,250,000	31,250,000	26,864,179
Net income per share:			
Basic and diluted	\$ (0.01)	\$ 0.04	\$ 0.07

See notes to unaudited condensed financial statements.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Condensed Statements of Stockholders' Equity**

	Common Stock		Additional	Retained	Total
	Shares	Amount	Paid-in	Earnings	Stockholders'
			Capital	Accumulated	Equity
				During the	
				Development	
				Stage	
Common shares issued to initial stockholders on July 18, 2007 at approximately \$.003 per share	7,187,500	\$ 719	\$ 24,281	\$	\$ 25,000
Sale of 25,000,000 units, net of underwriters' discount and offering expenses of \$18,205,004 (includes 7,499,999 shares subject to possible conversion)	25,000,000	2,500	231,792,496		231,794,996
Proceeds subject to possible conversion of 7,499,999 shares			(74,099,990)		(74,099,990)
Proceeds from issuance of sponsors' warrants			5,250,000		5,250,000
Repurchase of 937,500 common shares issued to initial stockholders	(937,500)	(94)			(94)
Net income				615,198	615,198
Balance at December 31, 2007	31,250,000	3,125	162,966,787	615,198	163,585,110
Net income				1,511,215	1,511,215
Balance at December 31, 2008	31,250,000	3,125	162,966,787	2,126,413	165,096,325
Unaudited:					
Net loss				(257,384)	(257,384)
Balance at June 30, 2009	31,250,000	\$ 3,125	\$ 162,966,787	\$ 1,869,029	\$ 164,838,941

See notes to unaudited condensed financial statements.

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Condensed Statements of Cash Flows****(Unaudited)**

	For the six months ended June 30, 2009	For the six months ended June 30, 2008	For the period from July 9, 2007 (date of inception) through June 30, 2009
Cash flows from operating activities			
Net (loss) income	\$ (257,384)	\$ 1,268,185	\$ 1,869,029
Adjustments to reconcile net (loss) income to net cash used in operating activities:			
Interest income earned on trust account	(50,183)	(2,528,586)	(5,006,560)
Changes in assets and liabilities:			
Decrease (increase) in prepaid expenses	11,912	(228,560)	(252,392)
Increase in deferred tax asset	(142,491)	(100,200)	(315,649)
(Decrease) increase in accrued expenses	(85,140)	2,535	100,957
Increase in deferred interest income	9,033		76,181
Increase in income taxes payable		(392,498)	
Net cash used in operating activities	(514,253)	(1,979,124)	(3,528,434)
Cash flows from investing activities			
Cash placed in trust account			(247,000,000)
Cash withdrawn from trust account	495,000	1,964,265	3,467,957
Net cash provided by (used in) investing activities	495,000	1,964,265	(243,532,043)
Cash flows from financing activities			
Gross proceeds from initial public offering			250,000,000
Proceeds from issuance of sponsors' warrants			5,250,000
Proceeds from sale of shares of common stock to initial stockholders			25,000
Proceeds from notes payable to stockholders			200,000
Repayment of notes payable to stockholders			(200,000)
Repurchase of common shares from initial stockholders			(94)
Payment of offering costs		(38,216)	(8,205,004)
Net cash (used in) provided by financing activities		(38,216)	247,069,902
Net (decrease) increase in cash	(19,253)	(53,075)	9,425
Cash at beginning of period	28,678	58,075	
Cash at end of period	\$ 9,425	\$ 5,000	\$ 9,425
Supplemental disclosure of non-cash financing activities			
Deferred underwriting commission			\$ 10,000,000

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Supplemental disclosure of cash flow information

Cash paid during the period for income taxes	\$	\$ 1,508,580	\$ 1,646,332
--	----	--------------	--------------

See notes to unaudited condensed financial statements.

F-21

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements

1. Interim Financial Information

Prospect Acquisition Corp.'s (the "Company") unaudited condensed interim financial statements as of June 30, 2009, for the six month periods ended June 30, 2009 and 2008, and for the period from July 9, 2007 (date of inception) through June 30, 2009, have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the interim period presented are not necessarily indicative of the results to be expected for any other interim period or for the full year. The Company has evaluated subsequent events through the filing date, August 7, 2009 and updated its evaluation through October 28, 2009.

These unaudited condensed interim financial statements should be read in conjunction with the audited financial statements and notes thereto for the period ended December 31, 2008 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission on March 16, 2009. The December 31, 2008 balance sheet and the changes in stockholders' equity through December 31, 2008 have been derived from those audited financial statements. The accounting policies used in preparing these unaudited financial statements are consistent with those described in the December 31, 2008 audited financial statements. Certain prior year balances have been reclassified to conform with the current year presentation.

If we are unable to complete a business combination by November 14, 2009 we will be forced to liquidate. Currently, we are rigorously evaluating several opportunities for potential targets, however have not yet entered into any definitive agreements toward a transaction. There is no assurance that we will successfully complete a Business Combination by November 14, 2009. These factors, among others, raise substantial doubt about the Company's ability to continue operations as a going concern. The accompanying financial statements do not include any adjustments that may result from the outcome of this uncertainty.

2. Organization, Business Operations and Significant Accounting Policies

The Company was incorporated in Delaware on July 9, 2007, and is a blank check company formed for the purpose of acquiring control of, through a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or other similar business combination, one or more operating businesses or assets in the financial services industry (a "Business Combination"). At June 30, 2009, the Company's operations related to the Company's formation and the initial public offering described below.

The registration statement for the Company's initial public offering (the "Offering") was declared effective November 14, 2007. The Company consummated the Offering on November 20, 2007 and received gross proceeds of \$250,000,000 and \$5,250,000 from the sale of sponsors' warrants on a private placement basis (see Note 3). The Company's management has broad discretion with respect to the specific application of the net proceeds of the Offering, although substantially all of the net proceeds of the Offering are intended to be generally applied toward consummating a Business Combination. Furthermore, there is no assurance that the Company will be able to successfully effect a Business

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Notes to Unaudited Condensed Financial Statements (Continued)****2. Organization, Business Operations and Significant Accounting Policies (Continued)**

Combination. An amount of \$247,000,000 (or approximately \$9.88 per unit) of the net proceeds of the Offering and the sale of the sponsors' warrants (see Note 3) was deposited in a trust account (the "trust account") and invested in United States "government securities" within the meaning of Section 2(a)(16) of the Investment Company Act of 1940 having a maturity of 180 days or less, or in money market funds meeting certain conditions under Rule 2a-7 promulgated under the Investment Company Act of 1940 until the earlier of (i) the consummation of its initial Business Combination or (ii) liquidation of the Company. At June 30, 2009, the trust account was invested in United States government securities and has been accounted for as a trading security. The placing of funds in the trust account may not protect those funds from third party claims against the Company. Although the Company has sought and will seek to have all vendors, prospective target businesses or other entities it engages, execute agreements with the Company waiving any right, title, interest or claim of any kind in or to any monies held in the trust account, there is no guarantee that they will execute such agreements. A Company officer and two initial stockholders have agreed that they will be personally liable under certain circumstances to ensure that the proceeds in the trust account are not reduced by the claims of target businesses or vendors or other entities that are owed money by the Company for services rendered, contracted for or products sold to the Company, subject to limited exceptions. However, there can be no assurance that they will be able to satisfy those obligations. The remaining net proceeds (not held in the trust account) have been and will continue to be used to pay for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses. Until the consummation of the initial Business Combination or the liquidation of the Company, proceeds held in the trust account will not be available for the Company's use for any purpose, except there can be released to the Company from the trust account (i) interest income earned on the trust account balance to pay any taxes on such interest and (ii) interest income earned of up to \$2.75 million on the trust account balance to fund the Company's working capital requirements, provided that after such release there remains in the trust account a sufficient amount of interest income previously earned on the trust account balance to pay any due and unpaid taxes on income generated by the trust account.

Amounts placed in Trust	\$ 247,000,000
Interest income received	5,003,944
Amounts withdrawn for payment of federal & state taxes	(2,387,057)
Amounts withdrawn for working capital	(1,080,900)
Total	\$ 248,535,987

The Company, after signing a definitive agreement for a Business Combination with a target business or businesses, is required to submit such transaction for stockholder approval. In the event that those persons that purchase securities in the Offering or thereafter ("Public Stockholders") owning 30% or more of the shares sold in the Offering vote against the Business Combination and exercise their conversion rights described below, the Business Combination will not be consummated. All of the Company's stockholders prior to the Offering, including all of the directors of the Company (the "Initial Stockholders"), have agreed to vote all of their founding shares of common stock in accordance with the majority of the shares of common stock voted by the Public Stockholders with respect to any Business Combination.

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements (Continued)

2. Organization, Business Operations and Significant Accounting Policies (Continued)

After consummation of a Business Combination, these voting safeguards will no longer apply.

With respect to a Business Combination which is approved and consummated, any Public Stockholder who voted against the Business Combination may demand that the Company convert his or her shares into cash from the trust account. The per share conversion price will equal the aggregate amount then on deposit in the trust account, before payment of deferred underwriting discounts and commissions and including accrued interest, net of taxes on such interest and net of interest income on the trust account balance released to the Company as described above, calculated as of two business days prior to the proposed consummation of the initial Business Combination, divided by the number of shares of common stock sold in the Offering. Accordingly, Public Stockholders holding not more than 30% of the shares (minus one share) sold in the Offering may seek conversion of their shares in the event of a Business Combination. Such Public Stockholders are entitled to receive their per share interest in the trust account (net of the tax and working capital items described above) computed without regard to the shares held by Initial Stockholders.

Accordingly, a portion of the net proceeds from the Offering (29.99% of the amount placed in the trust account) has been classified as common stock subject to possible conversion and a portion of the interest earned on the trust account (29.99%), after deducting the amounts permitted to be utilized for tax obligations and working capital purposes, has been recorded as deferred interest in the accompanying financial statements.

The Company's Certificate of Incorporation was amended on November 14, 2007 to provide that the Company will continue in existence only until 24 months from the effective date of the registration statement relating to the Offering (the "Effective Date"), or November 14, 2009. If the Company has not completed a Business Combination by such date, its corporate existence will cease except for the purposes of liquidating and winding up its affairs. In the event of liquidation, it is possible that the per share value of the residual assets remaining available for distribution (including assets in the trust account) will be less than the initial public offering price per Unit in the Offering (assuming no value is attributed to the Warrants contained in the Units offered in the Offering discussed in Note 3) because of the expenses of the Offering, the Company's general and administrative expenses and the anticipated costs of seeking an initial Business Combination.

Fair Value of Financial Instruments:

The fair values of the Company's assets and liabilities that qualify as financial instruments under Statement of Financial Accounting Standard ("SFAS") No. 107, *Disclosures about Fair Value of Financial Instrument*, approximate their carrying amounts presented in the balance sheet based upon the short-term nature of the account at June 30, 2009.

New Accounting Pronouncements:

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosures about fair value measurements. SFAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements (Continued)

2. Organization, Business Operations and Significant Accounting Policies (Continued)

priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB issued FASB Staff Position ("FSP") No. 157-2, *Effective Date of FASB Statement No. 157*, which permits a one-year deferral for the implementation of SFAS 157 with regard to non-financial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Company adopted SFAS 157 for the fiscal year beginning January 1, 2008, except for the non-financial assets and non-financial liabilities, which was adopted effective January 1, 2009. The adoption of the provisions of SFAS 157 did not have a material impact on the Company's financial position or results of operations.

In April 2009, the FASB issued three FSP's to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities. FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidelines for making fair value measurements more consistent with the principles presented in SFAS 157. FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, enhances consistency in financial reporting by increasing the frequency of fair value disclosures. FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. These three FSP's are effective for interim and annual periods ending after June 15, 2009. The adoption of the provisions of these FSP's did not have a material impact on the Company's financial position or results of operations

In June 2008, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* ("EITF 07-5"). EITF 07-5 provides a new two-step model to be applied in determining whether an equity-linked financial instrument, or embedded feature, is indexed to an entity's own stock. EITF 07-5 was effective for the quarter ended March 31, 2009. There was no impact on the financial position or results of operations as a result of the adoption of this new guidance.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ("SFAS 141R") which establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R will have an impact to the Company for any acquisitions consummated by the Company.

In December 2007, the FASB released SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* ("SFAS 160"), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent and for the deconsolidation of a subsidiary. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interest of the parent and the interests of the non-controlling owners. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. SFAS 160 may have a material impact to the Company with respect to any acquisitions consummated by the Company.

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements (Continued)

2. Organization, Business Operations and Significant Accounting Policies (Continued)

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ("SFAS 165"). SFAS 165 is intended to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, and is effective for interim and annual periods ending after June 15, 2009. The adoption of SFAS No. 165 has not materially impacted the Company's financial position or results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* SFAS 162. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in preparation of the financial statements of non governmental entities that are presented in conformity with U.S. GAAP (the GAAP hierarchy). In July 2009, the FASB issued SFAS No. 168, *The FASB Accounting Codification and the Hierarchy of Generally Accepted Accounting Principles* ("SFAS 168"). SFAS 168 supersedes SFAS 162. SFAS 168 will become the source of authoritative U.S. generally accepted accounting principles ("GAAP") recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of SFAS 168, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of SFAS 168 is not expected to materially impact the Company's financial position or results of operations.

Management does not believe that any other recently issued, but not yet effective, accounting standards, if currently adopted, would have a material effect on the accompanying financial statements.

3. Initial Public Offering

On November 20, 2007, the Company sold 25,000,000 units (the "Units") at an offering price of \$10.00 per Unit. The Company granted the underwriters an option to purchase up to an additional 3,750,000 Units solely to cover over-allotments. Said option could have been exercised in whole or in part at any time before the 30th day after the Effective Date, and has expired without having been exercised by the underwriters.

Each Unit consists of one share of the Company's common stock and one warrant exercisable for one share of common stock at an exercise price of \$7.50 per share (a "Warrant"). Each Warrant will be exercisable on the later of the completion of the initial Business Combination and fifteen months from the Effective Date, provided in each case that the Company has an effective registration statement covering the shares of common stock issuable upon exercise of the warrants and a current prospectus relating to them is available. The Warrants will expire five years from the Effective Date, unless earlier redeemed. The Company may call the Warrants for redemption, in whole and not in part, at any time after the Warrants become exercisable and there is an effective registration statement covering the shares of common stock issuable upon exercise of the warrants available and current throughout the 30-day Redemption Period defined hereafter, upon a minimum of 30 days' prior written notice of redemption (the "30-day Redemption Period") at a price of \$0.01 per Warrant, only in the event that the last sale price of the common stock equals or exceeds \$14.50 per share for any 20 trading days

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements (Continued)

3. Initial Public Offering (Continued)

within a 30-trading day period ending on the third business day prior to the date on which the notice of redemption is sent to the warrant holder. In accordance with the warrant agreement relating to the Warrants sold and issued in the Offering, the Company is only required to use its best efforts to maintain the effectiveness of the registration statement covering the Warrants from the date the warrants become exercisable until the warrants expire or are redeemed. The Company will not be obligated to deliver securities, and there are no contractual penalties for failure to deliver securities, if a registration statement is not effective at the time of exercise. Additionally, in the event that a registration statement is not effective at the time of exercise, the holder of such Warrant shall not be entitled to exercise such Warrant and in no event (whether in the case of a registration statement not being effective or otherwise) will the Company be required to settle the warrant exercise, whether by net cash settlement or otherwise. Consequently, the Warrants may expire unexercised and unredeemed (and therefore worthless), and, as a result, an investor in the Offering may effectively pay the full Unit price solely for the shares of common stock included in the Units.

The Company entered into an agreement with the underwriters of the Offering (the "Underwriting Agreement"). The Underwriting Agreement requires the Company to pay 3% of the gross proceeds of the Offering as an underwriting discount plus an additional 4% of the gross proceeds of the Offering only upon consummation of a Business Combination. The Company paid an underwriting discount of 3% of the gross proceeds of the Offering (\$7.5 million) in connection with the consummation of the Offering and has placed 4% of the gross proceeds of the Offering (\$10 million) in the trust account. The \$10 million amount due to the underwriters has been classified as deferred underwriting commission on the accompanying balance sheets. The Company did not have to pay any discount related to the sponsors' warrants sold on a private placement basis. The underwriters have waived their right to receive payment of the 4% of the gross proceeds of the Offering upon the Company's liquidation if the Company is unable to complete a Business Combination.

Pursuant to purchase agreements dated November 14, 2007, certain of the Initial Stockholders have purchased from the Company, in the aggregate, 5,250,000 warrants for \$5,250,000 (the "sponsors' warrants"). The purchase and issuance of the sponsors' warrants occurred simultaneously with the consummation of the Offering on a private placement basis. All of the proceeds the Company received from these purchases were placed in the trust account. The sponsors' warrants are identical to the Warrants included in the Units offered in the Offering except that the sponsors' warrants (i) are non-redeemable so long as they are held by the original purchasers or their permitted transferees, (ii) are subject to certain transfer restrictions and will not be exercisable while they are subject to these transfer restrictions and (iii) may be exercised for cash or on a cashless basis. The purchase price of the sponsors' warrants has been determined to be the fair value of such warrants as of the purchase date.

The Initial Stockholders have waived their right to receive a liquidation distribution with respect to their founding shares upon the Company's liquidation if it is unable to complete a Business Combination.

4. Fair Value Measurement

As discussed in Note 2, the Company adopted SFAS 157. SFAS 157 requires new disclosure that establishes a framework for measuring fair value in GAAP, and expands disclosure about fair value measurements. SFAS 157 enables the reader of the financial statements to assess the inputs used to

Table of Contents**Prospect Acquisition Corp.****(a development stage company)****Notes to Unaudited Condensed Financial Statements (Continued)****4. Fair Value Measurement (Continued)**

develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values.

SFAS 157 also requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
- Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.
- Level 3: Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels in which to categorize its assets and liabilities, the Company performs a detailed analysis of the assets and liabilities that are subject to SFAS 157. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

	Fair Value As of June 30, 2009	Quoted Prices In Active Markets (Level 1)	Significant other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments held in trust account plus Accrued Interest Income on trust account	\$ 248,538,603	\$ 248,538,603		
Total	\$ 248,538,603	\$ 248,538,603		

The Company currently does not have non-financial assets and non-financial liabilities that are required to be measured at fair value on a recurring basis.

5. Related Party Transactions

On December 31, 2008, the Company entered into an amendment to its Administrative Services Agreement (the "Amendment") with LLM Capital Partners (an entity affiliated with Patrick Landers, the Company's President and one of its directors) and Teleos Management, L.L.C. (an entity affiliated with Daniel Gressel, one of the Company's directors). Pursuant to the terms of the Amendment, the Company will continue to receive certain general and administrative services from LLM Capital Partners and Teleos Management, L.L.C., until November 14, 2009. The Amendment also provides that the Company will no longer require (i) the use of the office space situated at 695 East Main Street, Stamford, Connecticut or (ii) certain of the general and administrative services previously provided to the Company pursuant to the terms of the Administrative Services Agreement. As a result of the Amendment, the Company's total monthly payment was reduced from \$7,500 to \$6,805 (\$4,083.15 per month for Teleos Management, L.L.C. and \$2,722.10 per month for LLM Capital Partners). The accompanying statements of operations for the six months ended June 30, 2009, the six months ended June 30, 2008 and for the period from July 9, 2007 (date of inception) through June 30, 2009 includes

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements (Continued)

5. Related Party Transactions (Continued)

\$40,832, \$45,000 and \$142,582, respectively, of expense relating to the Amendment and the Administrative Services Agreement.

6. Commitments

The Initial Stockholders and holders of the sponsors' warrants (or underlying securities) will be entitled to registration rights with respect to their founding shares or sponsors' warrants (or underlying securities), as the case may be, pursuant to an agreement dated November 14, 2007. In addition, the Initial Stockholders have certain "piggy-back" registration rights with respect to registration statements filed by the Company generally commencing nine months after the consummation of the Company's initial Business Combination, and the holders of the sponsors' warrants (or underlying securities) have certain "piggy-back" registration rights on registration statements filed after the Company's consummation of a Business Combination.

7. Capital Stock

The Company's original Certificate of Incorporation authorized the Company to issue 6,000,000 shares of common stock with a par value of \$0.0001 per share. In October, 2007, the Company's certificate of incorporation was amended to increase the authorized shares of common stock from 6,000,000 shares to 8,000,000 shares. The Company's Certificate of Incorporation was amended on November 14, 2007 to increase the number of authorized shares of common stock to 72,000,000. In addition, the Company is authorized to issue 1,000,000 shares of preferred stock.

On July 18, 2007, the Company issued 4,312,500 shares of common stock to the founders for an aggregate of \$25,000 in cash, at a purchase price of approximately \$0.006 per share. In October, 2007, the aggregate outstanding 4,312,500 shares of common stock were increased to 7,187,500 shares of common stock as a result of a 5-for-3 stock split declared by our board of directors. All references in the accompanying financial statements to the number of shares of stock have been retroactively restated to reflect these transactions.

In accordance with the terms of the Offering, with the expiration of the underwriters' option to purchase up to an additional 3,750,000 Units solely to cover over-allotments, in December 2007, the Company repurchased 937,500 shares of common stock from the Initial Stockholders at a price of \$0.0001 per share.

8. Legal

There is no material litigation currently pending against the Company or any member of its management team in their capacity as such.

9. Subsequent Events

On September 8, 2009, Prospect entered into an Agreement and Plan of merger (the "merger agreement") by and among Prospect, KW Merger Sub Corp., a newly formed and wholly-owned subsidiary of Prospect ("Merger Sub") and Kennedy-Wilson, Inc. ("Kennedy-Wilson"), pursuant to which Merger Sub will merge (the "merger") with and into Kennedy-Wilson, with Kennedy-Wilson continuing as the surviving corporation and a wholly-owned subsidiary of Prospect.

Table of Contents

Prospect Acquisition Corp.

(a development stage company)

Notes to Unaudited Condensed Financial Statements (Continued)

9. Subsequent Events (Continued)

Pursuant to the merger agreement, common stockholders of Kennedy-Wilson will receive as consideration 3.8031 shares of Prospect common stock for each share of Kennedy-Wilson common stock outstanding and preferred stockholders of Kennedy-Wilson will receive as consideration 105.6412 shares of Prospect's common stock for each share of preferred outstanding, for an aggregate consideration of 26 million shares of Prospect common stock. In addition, 2.475 million shares of Prospect common stock will be reserved for issuance to employees, nonemployees and management of Kennedy-Wilson pursuant to an equity compensation plan adopted by Prospect's board of directors and submitted to Prospect's stockholders for approval.

Upon consummation of the merger, the Initial Stockholders will forfeit 4,750,000 of their founders shares. Following the transaction, assuming 29.99% in interest of Prospect stockholders exercise their conversion rights, the current stockholders of Prospect will own approximately 39.9% of the outstanding common stock of Prospect, the Kennedy-Wilson Holders will own approximately 54.6% and the other new Prospect stockholders (including recipients of awards under the 2009 Plan) will own approximately 5.5% of the outstanding common stock of Prospect.

As a condition to the closing of the merger, holders of warrants must approve an amendment (the "Warrant Amendment") to the current warrant agreement that governs all of the warrants, each of which is exercisable for one share of Prospect common stock. The Warrant Amendment will provide that, at the closing of the merger, each holder of a warrant sold and issued in the IPO (the "public warrants") must elect either: (i) to receive upon the closing of the merger \$0.55 in cash per warrant, or (ii) to continue to hold his, her or its public warrant which will be amended to extend the warrant termination date to November 14, 2013, increase the exercise price to \$12.50 from \$7.50 and increase the redemption trigger price to \$19.50 from \$14.50. At least 12,500,000 warrants, (consisting of the public warrants and sponsor warrants, as necessary) must be redeemed for cash. In addition, the Warrant Amendment will amend the terms of the sponsors' warrants to extend the warrant termination date to November 14, 2013, increase the exercise price to \$12.50 from \$7.50 and increase the redemption trigger price to \$19.50 from \$14.50. If the merger is consummated, any holder of public warrants who votes against the approval of the Warrant Amendment or who makes no election, will receive \$0.55 for each of its public warrants.

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Kennedy-Wilson, Inc.:

We have audited the accompanying consolidated balance sheets of Kennedy-Wilson, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income and comprehensive income, equity, and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kennedy-Wilson, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 4 to the consolidated financial statements, the Company adopted the presentation and disclosure requirements of Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51* for all periods presented.

/s/ KPMG LLP

Los Angeles, California
March 20, 2009, except for notes 4, 22, and 23, as to which the date is September 24, 2009.

[Table of Contents](#)**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Balance Sheets**

	December 31,	
	2008	2007
Assets		
Cash and cash equivalents	\$ 25,831,000	\$ 24,248,000
Accounts receivable	1,091,000	4,235,000
Accounts receivable from related parties	4,659,000	1,138,000
Income tax receivable	1,414,000	
Notes receivable	43,000	69,000
Notes receivable from related parties	3,755,000	8,866,000
Investments in real estate, net	48,727,000	13,112,000
Investments in joint ventures (\$15,088,000 carried at fair value as of December 31, 2008)	142,188,000	66,914,000
Other assets	4,210,000	3,267,000
Goodwill	23,965,000	23,965,000
Total assets	\$ 255,883,000	\$ 145,814,000
Liabilities and equity		
Liabilities		
Accounts payable	\$ 359,000	\$ 733,000
Accrued expenses and other liabilities	7,008,000	5,192,000
Accrued salaries and benefits	2,775,000	7,225,000
Income tax payable		4,406,000
Deferred tax liability	8,516,000	6,098,000
Notes payable	21,188,000	10,000,000
Borrowings under line of credit	13,500,000	5,000,000
Mortgage loans payable	29,548,000	10,084,000
Convertible subordinated debt	27,187,000	
Junior subordinated debentures	40,000,000	40,000,000
Total liabilities	150,081,000	88,738,000
Equity		
Convertible preferred stock, \$0.01 par value: 5,000,000 shares authorized, 53,000 shares issued and outstanding as of December 31, 2008. The preferred stock is mandatorily convertible to common stock on the third anniversary from issue date of September 2008.	1,000	
Common stock, \$0.01 par value: 50,000,000 shares authorized; 5,466,150 and 5,619,224 shares issued as of December 31, 2008 and 2007, respectively	55,000	56,000
Additional paid-in capital	60,026,000	9,921,000
Retained earnings	45,467,000	47,118,000
Accumulated other comprehensive income (loss)	2,000	(238,000)
Total Kennedy-Wilson, Inc. stockholders' equity	105,551,000	56,857,000
Noncontrolling interests	251,000	219,000
Total equity	105,802,000	57,076,000
Total liabilities and equity	\$ 255,883,000	\$ 145,814,000

See accompanying notes to consolidated financial statements.

F-32

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statements of Income and
Comprehensive Income**

	Year ended December 31,		
	2008	2007	2006
Revenue			
Management and leasing fees	\$ 10,671,000	\$ 9,836,000	\$ 8,415,000
Management and leasing fees related party	8,380,000	10,306,000	8,163,000
Commissions	5,906,000	4,257,000	2,037,000
Commissions related party	4,295,000	8,896,000	7,883,000
Rental income	2,409,000	98,000	
Other income	564,000		
Total revenue	32,225,000	33,393,000	26,498,000
Operating Expenses			
Commission and marketing expenses	2,827,000	2,097,000	1,824,000
Rental operating expense	1,458,000	34,000	
Compensation and related expenses	21,292,000	34,151,000	24,892,000
General and administrative	6,074,000	6,393,000	7,202,000
Depreciation and amortization	920,000	505,000	688,000
Total operating expense	32,571,000	43,180,000	34,606,000
Equity in joint venture income	10,097,000	27,433,000	14,689,000
Total operating income	9,751,000	17,646,000	6,581,000
Non-operating income (expense)			
Interest income	221,000	487,000	561,000
Interest income-related party	341,000	378,000	85,000
Gain on sale of asset			7,060,000
Interest expense	(8,596,000)	(5,090,000)	(3,183,000)
Other than temporary impairment on available-for-sale security	(445,000)		
Income before provision for income taxes	1,272,000	13,421,000	11,104,000
Provision for income taxes	(605,000)	(4,384,000)	(4,563,000)
Income from continuing operations	667,000	9,037,000	6,541,000
Income from discontinued operations, net of tax		2,797,000	
Net income	667,000	11,834,000	6,541,000
Net income attributable to the noncontrolling interests	(54,000)	(2,441,000)	(586,000)
Preferred stock dividends	(2,264,000)		
Net (loss) income attributable to Kennedy-Wilson common stockholders	(1,651,000)	9,393,000	5,955,000
Other comprehensive income (loss), net of tax	240,000	(238,000)	
Total comprehensive (loss) income attributable to Kennedy-Wilson common stockholders	\$ (1,411,000)	\$ 9,155,000	\$ 5,955,000
Basic (loss) earnings per share:			
(Loss) income from continuing operations	\$ (0.32)	\$ 1.30	\$ 1.23
Income from discontinued operations		0.55	
Net (loss) income attributable to Kennedy-Wilson common stockholders	\$ (0.32)	\$ 1.85	\$ 1.23

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Weighted average number of common shares outstanding basic	5,119,684	5,063,949	4,840,963
Diluted (loss) earnings per share:			
(Loss) income from continuing operations	\$ (0.32)	\$ 1.17	\$ 1.07
Income from discontinued operations		0.50	
Net income (loss) attributable to Kennedy-Wilson common stockholders	\$ (0.32)	\$ 1.67	\$ 1.07
Weighted average number of common shares outstanding diluted	5,119,684	5,621,802	5,558,087

See accompanying notes to consolidated financial statements.

F-33

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statement of Equity**

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive		Noncontrolling Interests	Total	
	Shares	Amount	Shares	Amount			Loss				
Balance, January 1, 2006		\$	5,477,706	\$ 55,000	\$ 10,295,000	\$ 31,770,000	\$	\$	\$	\$ 42,120,000	
Issuance of common stock exercise of stock options			245,040	2,000	1,006,000					1,008,000	
Repurchase of common stock			(37,641)		(651,000)					(651,000)	
Amortization of equity compensation					1,015,000					1,015,000	
Net income						5,955,000		586,000		6,541,000	
Distribution to noncontrolling interest								(430,000)		(430,000)	
Balance, December 31, 2006			5,685,105	57,000	11,665,000	37,725,000		156,000		49,603,000	
Issuance of common stock exercise of stock options			55,000	1,000	235,000					236,000	
Repurchase of common stock			(120,881)	(2,000)	(2,994,000)					(2,996,000)	
Amortization of equity compensation					1,015,000					1,015,000	
Other comprehensive loss:											
Foreign currency translation								(44,000)		(44,000)	
Unrealized loss on marketable security, net of tax								(194,000)		(194,000)	
Net income						9,393,000		2,441,000		11,834,000	
Contribution from noncontrolling interest								1,615,000		1,615,000	
Distribution to noncontrolling interest								(3,993,000)		(3,993,000)	
Balance, December 31, 2007			5,619,224	56,000	9,921,000	47,118,000		(238,000)	219,000	57,076,000	
Issuance of preferred stock	53,000	1,000			52,353,000					52,354,000	
Issuance of common stock exercise of stock options			11,250	1,000	92,000					93,000	
Repurchase of common stock			(164,324)	(2,000)	(6,168,000)					(6,170,000)	
Amortization of equity compensation					1,015,000					1,015,000	
Discount on convertible subordinated debt					2,813,000					2,813,000	
Other comprehensive loss:											
Foreign currency translation								240,000		240,000	
Dividend paid preferred stock						(2,264,000)				(2,264,000)	
Net income						613,000		54,000		667,000	
Contribution from noncontrolling interest								482,000		482,000	
Distribution to noncontrolling interest								(504,000)		(504,000)	
Balance, December 31, 2008	53,000	\$ 1,000	5,466,150	\$ 55,000	\$ 60,026,000	\$ 45,467,000	\$	2,000	\$	251,000	\$ 105,802,000

See accompanying notes to consolidated financial statements.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

	Year ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income	\$ 667,000	\$ 11,834,000	\$ 6,541,000
Adjustments to reconcile net income to net cash used in operating activities:			
Gain from sale of commercial real estate		(5,269,000)	
Depreciation and amortization	920,000	1,242,000	688,000
Provision for deferred income taxes	2,418,000	918,000	2,284,000
Amortization of deferred loan costs	658,000	296,000	237,000
Equity in joint venture income	(10,097,000)	(27,433,000)	(14,689,000)
Provision for notes receivable		159,000	210,000
Amortization of deferred compensation	1,015,000	1,015,000	1,015,000
Change in assets and liabilities:			
Accounts receivable	3,144,000	(2,335,000)	(235,000)
Accounts receivable related party	(3,521,000)	1,442,000	(683,000)
Income tax receivable	(1,414,000)		
Operating distributions from joint ventures	294,000	885,000	45,000
Other assets	(1,339,000)	(979,000)	(186,000)
Accounts payable	(374,000)	337,000	64,000
Accrued expenses and other liabilities	1,816,000	344,000	2,065,000
Accrued salaries and benefits	(4,450,000)	2,830,000	126,000
Income taxes payable	(4,406,000)	(95,000)	(4,508,000)
Net cash flow from operating activities	(14,669,000)	(14,809,000)	(7,026,000)
Cash flows from investing activities:			
Settlements of notes receivable	26,000	2,667,000	6,369,000
Additions to notes receivable		(144,000)	(1,992,000)
Settlements of notes receivable related party	6,000		
Additions to notes receivable related party	(300,000)	(7,128,000)	(1,738,000)
Net proceeds from sale of real estate	5,181,000	37,705,000	
Purchases of and additions to real estate	(41,460,000)	(38,458,000)	(7,637,000)
Return of capital distributions from joint ventures	12,903,000	39,390,000	32,359,000
Contributions to joint ventures	(72,729,000)	(28,193,000)	(30,975,000)
Net cash flow from investing activities	(96,373,000)	5,839,000	(3,614,000)
Cash flow from financing activities:			
Borrowings under notes payable	20,161,000	10,000,000	11,131,000
Repayment of notes payable	(8,973,000)	(12,810,000)	(11,453,000)
Borrowings under lines of credit	47,957,000	27,582,000	11,758,000
Repayment of lines of credit	(39,457,000)	(44,289,000)	(8,998,000)
Borrowings under mortgage loans payable	30,316,000	36,934,000	6,000,000
Repayment of mortgage loans payable	(10,852,000)	(32,850,000)	
Issuance of convertible subordinated debt	30,000,000		
Issuance of junior subordinated debentures		40,000,000	
Repayment of senior unsecured notes			(1,667,000)
Debt issue costs	(518,000)	(1,543,000)	(150,000)
Issuance of preferred stock	52,354,000		
Issuance of common stock	93,000	236,000	1,008,000
Repurchase of common stock	(6,170,000)	(2,996,000)	(651,000)
Dividend paid preferred stock	(2,264,000)		
Contributions from noncontrolling interests	482,000	1,615,000	
Distributions to noncontrolling interests	(504,000)	(3,993,000)	(430,000)
Net cash flow from financing activities	112,625,000	17,886,000	6,548,000

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Net change in cash and cash equivalents	1,583,000	8,916,000	(4,092,000)
Cash and cash equivalents, beginning of year	24,248,000	15,332,000	19,424,000
Cash and cash equivalents, end of year	\$ 25,831,000	\$ 24,248,000	\$ 15,332,000
Supplemental disclosure of non-cash investing activities:			
Unrealized loss on marketable security, net of tax	\$	\$ (194,000)	\$
Foreign currency translation	240,000	(44,000)	
Beneficial conversion of convertible subordinated debt	2,813,000		

F-35

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statements of Cash Flows (Continued)**

In 2008, Kennedy-Wilson converted a note receivable from a joint venture investment into equity in the joint venture resulting in an increase of investments in joint ventures of \$1,008,000 and a decrease in notes receivable of \$1,008,000.

In 2008, Kennedy-Wilson converted notes receivable from various executives and directors of Kennedy-Wilson related to KW Residential, LLC into equity in that joint venture resulting in an increase in investments in joint ventures of \$4,397,000 and a decrease in notes receivable of \$4,397,000.

	Year ended December 31,		
	2008	2007	2006
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	\$6,945,000	\$6,067,000	\$2,733,000
Interest capitalized	999,000	519,000	509,000
Income taxes	4,000,000	5,310,000	6,787,000

See accompanying notes to consolidated financial statements.

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

NOTE 1 ORGANIZATION

Kennedy-Wilson, Inc., a Delaware corporation, and its subsidiaries provide various commercial and residential real estate services including property management, asset management, brokerage and marketing in the U.S. and Japan primarily to institutional investors, financial institutions, pension funds, and developers. Kennedy-Wilson, principally through joint venture investments, also acquires, renovates and resells commercial and residential real estate, and invests in discounted loan portfolios.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION The consolidated financial statements include the accounts of Kennedy-Wilson and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. In addition, Kennedy-Wilson evaluates its relationships with other entities to identify whether they are variable interest entities as defined by FASB Interpretation No. 46 (revised December 2003) *Consolidation of Variable Interest Entities* ("FIN 46R") and to assess whether it is the primary beneficiary of such entities. If the determination is made that Kennedy-Wilson is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46R.

USE OF ESTIMATES The preparation of the accompanying consolidated financial statements in conformity with U. S. generally accepted accounting principles requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosure about contingent assets and liabilities, and reported amounts of revenues and expenses. Such estimates include the value of accounts and notes receivable, long-lived assets, debt, goodwill, investment in joint ventures, and legal contingencies. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Kennedy-Wilson adjusts such estimates and assumptions when facts and circumstances dictate. Illiquid credit markets, volatile energy markets, and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

REVENUE RECOGNITION Management and leasing fees and commissions revenues are accounted for in accordance with the provisions of SEC Staff Accounting Bulletin 104. Management fees for property and asset management are recognized over time as earned based upon the terms of the management agreement. Leasing fees that are payable upon tenant occupancy, payment of rent or other events beyond Kennedy-Wilson's control are recognized upon the occurrence of such events. In the case of real estate sales commissions, this generally occurs when escrow closes. In accordance with EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, Kennedy-Wilson records commission revenues and expenses on a gross basis. Of the criteria listed in the EITF, Kennedy-Wilson is the primary obligor in the transaction, does not have inventory risk, performs all, or part, of the service, has credit risk, and has wide latitude in establishing the price of services rendered and discretion in selection of agents and determination of service specifications.

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Sales of real estate are recognized at the close of escrow when title to the real property passes to the buyer. Kennedy-Wilson follows the requirements for profit recognition as set forth by Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*.

In accordance with SEC Staff Accounting Bulletin No. 51 ("SAB 51"), Kennedy-Wilson records gains as a result of equity transactions by its subsidiaries in the consolidated statements of operations.

INVESTMENTS IN JOINT VENTURES Kennedy-Wilson has a number of joint venture interests, generally ranging from 5% to 50%, that were formed to acquire, manage, develop and/or sell real estate. Investments in joint ventures which Kennedy-Wilson does not control are accounted for under the equity method of accounting as Kennedy-Wilson can exercise significant influence, but does not have the ability to control the joint venture. An investment in joint ventures is recorded at its initial investment plus or minus Kennedy-Wilson's share of undistributed net income or loss and less distributions. Declines in value of Kennedy-Wilson's investment in joint ventures that are other than temporary are recognized when evidence indicates that such a decline has occurred.

Profit on the sales of real estate held by joint ventures that have continuing involvement are deferred until such time that the continuing involvement has been resolved and all the risks and rewards of ownership have passed to the buyer. Profit on sales to joint ventures in which Kennedy-Wilson retains an equity ownership interest results in partial sales treatment in accordance with the provisions of SFAS 66 and Statement of Position 78-9, thus deferring a portion of the gain on Kennedy-Wilson's continuing ownership percentage in the joint ventures.

One of Kennedy-Wilson's investments in joint ventures, KW Property Fund III, L.P. (the "Fund") is, for GAAP purposes, an investment company under the AICPA Audit and Accounting Guide *Investment Companies*. Thus, the Fund reflects its investments at fair value, with unrealized gains and losses resulting from changes in fair value reflected in earnings. Kennedy-Wilson has retained the specialized accounting for the Fund pursuant to EITF Issue No. 85-12, *Retention of Specialized Accounting for Investments in Consolidation* in recording its equity in joint venture income from the Fund.

FAIR VALUE MEASUREMENTS On January 1, 2008, Kennedy-Wilson adopted the provisions FASB Statement No. 157 *Fair Value Measurements*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. Statement 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement 157 also establishes a framework for measuring fair value and expands disclosures about fair value measurements.

GOODWILL Goodwill results from the difference between the purchase price and the fair value of net assets acquired based upon the purchase method of accounting for business combinations. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), goodwill is no longer amortized, but instead is reviewed for impairment at least annually by Company management.

In testing for impairment in accordance with SFAS 142, goodwill is assigned to the reporting unit based upon the amount of goodwill generated at the time of acquisition of the businesses by the

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

reporting unit. An earnings multiple appropriate to the respective reporting unit was applied to the cash basis net operating income of the reporting unit. This process enables a fair approximation of the reporting unit's value, which is then compared to the net book value of the reporting unit. As a result of the evaluation performed of its goodwill as described above, Kennedy-Wilson has determined that there was no goodwill impairment as of December 31, 2008.

CASH AND CASH EQUIVALENTS Cash and cash equivalents consist of cash and all highly liquid investments purchased with maturities of three months or less.

LONG-LIVED ASSETS Kennedy-Wilson reviews its long-lived assets (excluding goodwill) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards No. 144 *Accounting for Impairment or Disposal of Long-Lived Assets*. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

DISCONTINUED OPERATIONS Kennedy-Wilson presents components as discontinued operations if the operations and cash flows of the component have been or will be eliminated from the ongoing operations in a disposal transaction where Kennedy-Wilson will not have any significant continuing involvement in the operations of the component after the disposal transaction. A component comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of Kennedy-Wilson. Because each of our real estate assets generally constitutes a discrete subsidiary, many assets that we hold for sale in the ordinary course of business must be reported as a discontinued operation unless we have significant continuing involvement in the operations of the asset after its disposition. Furthermore, operating profits and losses on such assets are required to be recognized and reported as operating profits and losses on discontinued operations in the periods in which they occur. Interest expense is only allocated to discontinued operations to the extent that the interest is specific to the component.

NOTES RECEIVABLE Kennedy-Wilson accounts for any impairment to the basis of notes receivable in accordance with Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by Statement of Financial Accounting Standards No. 118, *Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures*. Accordingly, an impaired loan is measured based upon the present value of expected future cash flows, discounted at the loan's effective interest rate or, if readily determinable, the loan's observable market price or the fair value of the collateral if the loan is collateral dependant.

FAIR VALUE OF FINANCIAL INSTRUMENTS The estimated fair value of Kennedy-Wilson's financial instruments is determined using available market information and appropriate valuation methodologies. Considerable judgement, however, is necessary to interpret market data and develop the related estimates of fair value. Accordingly, the estimates presented herein are not necessarily

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

indicative of the amounts that could be realized upon disposition of the financial instruments. The use of different market assumptions or estimation methodologies may have a material impact on the estimated fair value amounts. The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other liabilities, accrued salaries and benefits, and deferred and accrued income taxes approximate fair value due to their short-term maturities. The carrying value of notes receivable (excluding related party notes receivable as it is presumed not to be an arm's length transaction) approximate fair value as they are negotiated based upon the fair value of loans with similar characteristics. Bank lines of credit and debt approximate fair value as the terms are comparable to the terms currently being offered to Kennedy-Wilson.

CAPITALIZED INTEREST Kennedy-Wilson capitalizes interest in accordance with Statement of Financial Accounting Standards No. 34, *Capitalization of Interest Cost* for assets that are undergoing development or entitlement activities in preparation for their planned principal operations. For qualifying equity investments, interest is capitalized in accordance with Statement of Financial Accounting Standards No. 58, *Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for Under the Equity Method (an amendment of FASB Statement No. 34)*. An appropriate interest rate is applied to Kennedy-Wilson's cash investment in the qualifying asset. The interest is credited against interest expense and added to the basis in the investment. Interest is capitalized when the development or entitlement activity commences and ceases when the investment has begun its planned principal operations.

GUARANTEES Kennedy-Wilson has certain guarantees associated with loans secured by assets held in various joint venture partnerships. The maximum potential amount of future payments (undiscounted) Kennedy-Wilson could be required to make under the guarantees was approximately \$46 million and \$44 million at December 31, 2008 and 2007, respectively. The guarantees expire through 2011 and Kennedy-Wilson's performance under the guarantees would be required to the extent there is a shortfall in liquidation between the principal amount of the loan and the net sales proceeds of the property. Based upon Kennedy-Wilson's evaluation of guarantees under FIN 45, the estimated fair value of guarantees made as of December 31, 2008 is immaterial.

CONCENTRATION OF CREDIT RISK Financial instruments that subject Kennedy-Wilson to credit risk consist primarily of accounts and notes receivable and cash equivalents. Credit risk is generally diversified due to the large number of entities composing Kennedy-Wilson's customer base and their geographic dispersion throughout the U.S. Kennedy-Wilson performs ongoing credit evaluations of its customers and debtors. Cash and cash equivalents are invested in institutions insured by government agencies. Certain accounts contain balances in excess of the insured limits.

EARNINGS PER SHARE Basic earnings per share is computed based upon the weighted average number of shares of common stock outstanding during the periods presented. Diluted earnings per share is computed based upon the weighted average number of shares of common stock and potentially dilutive securities outstanding during the periods presented. The weighted average number of shares outstanding for the diluted earnings per share computation also includes the dilutive impact of options to purchase common stock which were outstanding during the period calculated by the "treasury stock" method.

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SHARE-BASED PAYMENT ARRANGEMENTS Kennedy-Wilson accounts for its share-based payment arrangements under the provisions of FASB Statement No. 123(R), *Share-Based Payments*. The statement requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the share-based award. The cost of employee services is recognized over the period during which an employee provides service in exchange for the share-based payment award.

FAIR VALUE OPTION Effective January 1, 2008, Kennedy-Wilson adopted the provisions of FASB Statement No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*. Statement 159 gives Kennedy-Wilson the irrevocable option to report most financial assets and financial liabilities at fair value on an instrument-by-instrument basis, with changes in fair value reported in earnings. See Note 6 for the impact of adopting Statement 159 on Kennedy-Wilson's financial position and results of operations.

INCOME TAXES Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Beginning with the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* as of January 1, 2007, Kennedy-Wilson recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Prior to the adoption of FIN 48, Kennedy-Wilson recognized the effect of income tax positions only if such positions were probable of being sustained. There was no impact upon adoption.

RECLASSIFICATIONS Interest income and interest income-related party have been reclassified from revenue to non-operating income (expense) in the accompanying statements of income and comprehensive income for the year ended December 31, 2008, 2007, and 2006.

Kennedy-Wilson records interest related to unrecognized tax benefits in interest expense and penalties in selling, general, and administrative expenses.

RECENT ACCOUNTING PRONOUNCEMENTS In December 2007, the FASB issued FASB Statement No. 141(R) *Business Combinations*. Statement 141(R) requires most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at "full fair value" and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Statement 141(R) is effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited.

In April 2008, the FASB issued FASB Staff Position FAS 142-3, "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement 142. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Kennedy-Wilson is currently evaluating the impact, if any, of adopting FSP FAS 142-3 on its financial position and results of operations.

In November 2008, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations." EITF 08-6 continues to follow the accounting for the initial carrying value of equity method investments in APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, which is based on a cost accumulation model and generally excludes contingent consideration. EITF 08-6 also specifies that other-than-temporary impairment testing by the investor should be performed at the investment level and that a separate impairment assessment of the underlying assets is not required. An impairment charge by the investee should result in an adjustment of the investor's basis of the impaired asset for the investor's pro-rata share of such impairment. In addition, EITF 08-6 reached a consensus on how to account for an issuance of shares by an investee that reduces the investor's ownership share of the investee. An investor should account for such transactions as if it had sold a proportionate share of its investment with any gains or losses recorded through earnings. EITF 08-6 also addresses the accounting for a change in an investment from the equity method to the cost method after adoption of Statement 160. EITF 08-6 affirms the existing guidance in APB 18, which requires cessation of the equity method of accounting and application of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, or the cost method under APB 18, as appropriate. EITF 08-6 is effective for transactions occurring on or after December 15, 2008. Kennedy-Wilson does not anticipate that the adoption of EITF 08-6 will materially impact Kennedy-Wilson's financial position or results of operations.

NOTE 3 NOTES RECEIVABLE

Notes receivable consists of the following:

	December 31,	
	2008	2007
Note receivable pools with various interest rates and maturity dates, secured by real estate, personal property or guarantees	\$ 43,000	\$ 69,000
Total notes receivable from third parties	43,000	69,000
Note receivable from the CEO of Kennedy-Wilson, fixed interest rate of 7.5% per annum, principal and accrued interest due April 2011, unsecured	3,455,000	3,455,000
Note receivable, fixed interest rate of 7%, interest only, repaid in 2009, secured by preferred stock shares that were acquired from Kennedy-Wilson	300,000	
Note receivable from a joint venture investment, fixed interest rate of 18%, principal and accrued interest due October 2012, unsecured, converted to equity in the joint venture investment		1,008,000
Notes receivable from various executives and directors of Kennedy-Wilson, variable interest rate based on the 30-day LIBOR plus 3.70%, secured by their ownership interest in a joint venture investment in Japan		4,403,000
Total notes receivable from related parties	3,755,000	8,866,000
	\$3,798,000	\$8,935,000

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 4 NONCONTROLLING INTERESTS**

In December 2007, the FASB issued FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51*. Statement 160 establishes accounting and reporting standards for a parent company's noncontrolling interest in a subsidiary. Statement 160 is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. Kennedy-Wilson adopted Statement 160 effective January 1, 2009. The financial statements and related notes contained herein reflect the retrospective application of Statement 160 as though it was adopted as of January 1, 2006. Kennedy-Wilson has presented noncontrolling interests of \$251,000 and \$219,000 at December 31, 2008 and 2007, respectively, as equity in the accompanying consolidated balance sheets. Additionally, in the accompanying consolidated statements of income and comprehensive, Kennedy-Wilson separately presented net income attributable to noncontrolling interests of \$54,000, \$2,441,000, and \$586,000 for the years ended December 31, 2008, 2007, and 2006, respectively. Other than these presentation changes, the adoption of Statement 160 had no impact on our consolidated financial position or results of operations.

NOTE 5 INVESTMENT IN REAL ESTATE

Kennedy-Wilson's investment in real estate includes the following:

	December 31,	
	2008	2007
Residential lot, Kona, Hawaii	\$	\$ 8,061,000
Office building, Glendora, California		5,069,000
Office building in Japan	8,428,000	
Residential land in Landcaster and Victorville, California	7,724,000	
House in Kona, Hawaii	8,361,000	
204-unit residential apartment complex in Lompoc, California	25,637,000	
Residential land in Kent, Washington	733,000	
	50,883,000	13,130,000
Less: Accumulated depreciation	(2,156,000)	(18,000)
Total	\$48,727,000	\$ 13,112,000

During 2008, Kennedy-Wilson sold its interest in an entity that owned an office building located in Glendora, California for \$1,488,000. The sale resulted in a gain of \$564,000, which is included in other income in the accompanying consolidated statements of income and comprehensive income. Kennedy-Wilson continues to provide management services to the property and therefore it is not included in discontinued operations.

Kennedy-Wilson capitalized \$219,000 and \$519,000 of interest for the years ended December 31, 2008 and 2007, respectively, related to the residential lot located in Kona, Hawaii while the lot was being developed for its intended use. In addition to land costs of \$6,667,000, capitalized costs, excluding capitalized interest, were \$89,000 and \$169,000 for 2008 and 2007, respectively.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 5 INVESTMENT IN REAL ESTATE (Continued)**

During 2007, Kennedy-Wilson purchased and sold an office building located in Los Angeles, California, realizing income from discontinued operations of \$2,797,000. This was the only property sold in 2007. Discontinued operations for the year ended December 31, 2007:

Rental revenue	\$ 2,931,000
Rental operating expense	(980,000)
Depreciation and amortization	(737,000)
Interest expense	(1,826,000)
Gain on sale	5,269,000
Income tax expense	(1,860,000)
Total	\$ 2,797,000

NOTE 6 INVESTMENTS IN JOINT VENTURES

Kennedy-Wilson has a number of joint venture interests, generally ranging from 5% to 50%, which were formed to acquire, manage, develop and/or sell real estate. Kennedy-Wilson has significant influence over these entities, but not voting or other control and accordingly, these investments are accounted for under the equity method.

Summarized financial data of the joint ventures are as follows:

	December 31,					
	2008			2007		
	KW Residential LLC	Other	Total	KW Residential LLC	Other	Total
Balance sheets for equity method investees:						
Assets						
Cash	\$ 26,658,000	\$ 25,665,000	\$ 52,323,000	\$ 10,053,000	\$ 19,796,000	\$ 29,849,000
Real estate	544,033,000	1,582,148,000	2,126,181,000	453,138,000	1,233,183,000	1,686,321,000
Other	50,008,000	251,099,000	301,107,000	41,994,000	105,652,000	147,646,000
Total assets	\$ 620,699,000	\$ 1,858,912,000	\$ 2,479,611,000	\$ 505,185,000	\$ 1,358,631,000	\$ 1,863,816,000
Liabilities						
Debt	\$ 377,280,000	\$ 1,046,514,000	\$ 1,423,794,000	\$ 453,739,000	\$ 763,447,000	\$ 1,217,186,000
Other	39,347,000	24,377,000	63,724,000	11,277,000	36,852,000	48,129,000
Total liabilities	416,627,000	1,070,891,000	1,487,518,000	465,016,000	800,299,000	1,265,315,000
Partners' capital						
Kennedy-Wilson	62,379,000	73,644,000	136,023,000	12,781,000	53,361,000	66,142,000
Other partners	141,693,000	714,377,000	856,070,000	27,388,000	504,971,000	532,359,000
Total partners' capital	204,072,000	788,021,000	992,093,000	40,169,000	558,332,000	598,501,000
Total liabilities and partners' capital	\$ 620,699,000	\$ 1,858,912,000	\$ 2,479,611,000	\$ 505,185,000	\$ 1,358,631,000	\$ 1,863,816,000

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 6 INVESTMENTS IN JOINT VENTURES (Continued)**

Total investments are comprised of the following:

	December 31, 2008			December 31, 2007		
	KW Residential LLC	Other	Total	KW Residential LLC	Other	Total
Equity method	\$62,379,000	\$73,644,000	\$136,023,000	\$12,781,000	\$53,361,000	\$66,142,000
Unrealized gain on fair value option		5,856,000	5,856,000			
	62,379,000	79,500,000	141,879,000	12,781,000	53,361,000	66,142,000
Cost method		309,000	309,000		772,000	772,000
Total Investments	\$62,379,000	\$79,809,000	\$142,188,000	\$12,781,000	\$54,133,000	\$66,914,000

	Year ended December 31,					
	2008			2007		
	KW Residential LLC	Other	Total	KW Residential LLC	Other	Total
Statements of income for equity method investees:						
Revenues	\$36,721,000	\$164,748,000	\$201,469,000	\$15,830,000	\$211,520,000	\$227,350,000
Depreciation	10,029,000	35,539,000	45,568,000	1,823,000	38,713,000	40,536,000
Interest	14,112,000	50,513,000	64,625,000	5,907,000	49,083,000	54,990,000
Other expenses	16,949,000	59,064,000	76,013,000	5,976,000	59,596,000	65,572,000
Total expenses	41,090,000	145,116,000	186,206,000	13,706,000	147,392,000	161,098,000
Net (loss) income	\$ (4,369,000)	\$ 19,632,000	\$ 15,263,000	\$ 2,124,000	\$ 64,128,000	\$ 66,252,000
Net (loss) income allocation:						
Kennedy-Wilson	\$ (694,000)	\$ 642,000	\$ (52,000)	\$ 646,000	\$ 26,787,000	\$ 27,433,000
Other partners	(3,675,000)	18,990,000	15,315,000	1,478,000	37,341,000	38,819,000
Net (loss) income	\$ (4,369,000)	\$ 19,632,000	\$ 15,263,000	\$ 2,124,000	\$ 64,128,000	\$ 66,252,000

	Year ended December 31, 2006		
	KW Residential LLC	Other	Total
Statements of operations:			
Revenues	\$3,197,000	\$152,925,000	\$156,122,000
Depreciation	368,000	26,743,000	27,111,000
Interest	1,193,000	12,732,000	13,925,000
Other expenses	2,157,000	63,779,000	65,936,000

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Total expenses	3,718,000	103,254,000	106,972,000
Net (loss) income	\$ (521,000)	\$ 49,671,000	\$ 49,150,000
Net income allocation:			
Kennedy-Wilson	(106,000)	14,795,000	14,689,000
Other partners	(415,000)	34,876,000	34,461,000
Net (loss) income	\$ (521,000)	\$ 49,671,000	\$ 49,150,000

F-45

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 6 INVESTMENTS IN JOINT VENTURES (Continued)**

Equity in joint venture income for the year ended December 31, 2008:

Net income allocation	\$ (52,000)
Unrealized gain on fair value option	5,856,000
	\$ 5,804,000

Kennedy-Wilson has determined that as of December 31, 2008 and 2007, it has investments in two variable interest entities and based on its evaluation under FIN 46R has concluded that Kennedy-Wilson is not the primary beneficiary. As of December 31, 2008 and 2007, the variable interest entities had assets totaling \$132 million and \$125 million, respectively. As of December 31, 2008 and 2007, Kennedy-Wilson's exposure to loss as a result of its interests in these variable interest entities was \$7.8 million and \$5.4 million, respectively, related to its equity contributions. In addition, Kennedy-Wilson has \$16 million in the form of loan guarantees that represent 20% of the mortgage loans of the underlying variable interest entities.

Investments in which Kennedy-Wilson does not have significant influence are accounted for under the cost method of accounting. At December 31, 2008 and 2007, Kennedy-Wilson had three investments accounted for under the cost method with a carrying value totaling \$309,000 and \$772,000, respectively.

Distributions in excess of the Kennedy-Wilson's basis in investments in joint ventures totaling \$56,000, \$1,694,000, and \$230,000 were deferred for the years ended December 31, 2008, 2007, and 2006, respectively, due to continuing involvement in the real estate sold by the joint venture. Total deferred revenues and gains on sale of investments in joint ventures included in accrued expenses and other liabilities were \$3,450,000 and \$1,856,000 at December 31, 2008 and 2007, respectively.

NOTE 7 FAIR VALUE MEASUREMENTS AND THE FAIR VALUE OPTION

FAIR VALUE MEASUREMENTS Statement 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 Valuations based on unadjusted quoted market prices in active markets for identical securities.

Level 2 Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets and quoted prices in markets that are not active.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement, and involve management judgment.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 7 FAIR VALUE MEASUREMENTS AND THE FAIR VALUE OPTION (Continued)**

The following table presents fair value measurements (including items that are required to be measured at fair value and items for which the fair value option has been elected) as of December 31, 2008 classified according to the Statement 157 valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Available-for-sale security	\$28,000	\$	\$	\$ 28,000
Investment in joint ventures			15,088,000	15,088,000
	\$28,000	\$	\$ 15,088,000	\$ 15,116,000

The following table presents changes in Level 3 investments for the year ended December 31, 2008:

	December 31, 2007	Net Purchases or sales	Realized gains or losses	Unrealized appreciation or (depreciation)	Net transfers in or out of Level 3	Total
Investment in joint ventures	\$ 22,000	\$8,019,000	\$	\$ 7,047,000	\$	\$ 15,088,000

Kennedy-Wilson's records its investment in the Fund based on the amount of net assets that would be allocated to its interests in the Fund assuming the Fund was to liquidate its investments at fair value. The Fund reports its investments in real estate at fair value based on valuations of the underlying real estate holdings and indebtedness securing the real estate. The valuations of real estate were, in part, based on third party appraisals of the real estate assets using an income approach. The indebtedness securing the real estate and the investments in debt securities were valued, in part, by a third party valuation firm also using an income approach. Kennedy-Wilson's investment balance in the Fund was \$2,332,000 at December 31, 2008.

FAIR VALUE OPTION Kennedy-Wilson has elected the fair value option for two investments in joint venture entities that were acquired during 2008. The first investment in joint venture has a partial interest in a condominium development located in Richmond, California that was acquired from the developer in June of 2008. The developer retained an ownership interest in the condominium project that is subordinated to all of the other ownership interests in the entity that holds the fee simple interest in the real estate. The second investment in joint venture has a partial ownership interest in an entity that has two investments. The first investment is a partial interest in the same condominium development as the first investment in joint venture and the second is an interest in an office building located in San Francisco, California. Kennedy-Wilson elected to record these investments at fair value to more accurately reflect the timing of the value created in the underlying investments and report those results in current operations. The change in fair value for these investments of \$5,856,000 is recorded in equity in joint venture income in the consolidated statements of income and comprehensive income. Kennedy-Wilson determines the fair value of these investments based upon the income approach, utilizing estimates of future cash flows, discount rates and liquidity risks.

NOTE 8 OTHER ASSETS

Office furniture and equipment and leaseholds improvements are carried at cost. The office furniture and equipment are depreciated over a period of three to ten years and the leasehold

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 8 OTHER ASSETS (Continued)**

improvements are amortized over their estimated useful lives or the lease term, whichever is shorter. Other assets consists of the following:

	December 31,	
	2008	2007
Office furniture and equipment	\$ 1,439,000	\$ 1,316,000
Leasehold improvements	57,000	57,000
	1,496,000	1,373,000
Less: Accumulated depreciation and amortization	(1,049,000)	(822,000)
	447,000	551,000
Prepaid expenses	1,740,000	970,000
Loan fees, net of accumulated amortization of \$1,522,000 and \$501,000 at December 31, 2008 and 2007, respectively	1,367,000	1,506,000
Deposits and other, net of accumulated amortization of \$7,000 and \$274,000 at December 31, 2008 and 2007, respectively	656,000	240,000
	\$ 4,210,000	\$ 3,267,000

Depreciation and amortization expense related to the above depreciable assets was \$256,000, \$695,000 and \$470,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 9 NOTES PAYABLE**

Notes payable were incurred primarily in connection with the acquisition of joint venture investments and stock repurchases, and includes the following:

	December 31,	
	2008	2007
Note payable, variable interest rate based on prime, 4% and 7.25% at December 31, 2008 and 2007, respectively, due August 2009, which the Company expects to refinance with similar terms and conditions prior to maturity	\$ 5,000,000	\$ 10,000,000
Note payable, variable interest rate of 8% plus the greater of 4% or the 1-month LIBOR rate, 12% at December 31, 2008, interest payable monthly, secured by the company's ownership interest in two joint ventures, repaid in 2009	12,000,000	
Loan payable to related party for \$4,255,000, \$3,700,000 funded at close, \$555,000 held back as interest reserve, \$221,000 available to fund interest payments at December 31, 2008, fixed interest rate of 14%, 10% payable monthly and 4% deferred until repayment of the loan or maturity, \$154,000 deferred at December 31, 2008, secured by the company's ownership interest in a multi-family property, repaid in 2009	4,188,000	
	\$ 21,188,000	\$ 10,000,000

NOTE 10 BORROWINGS UNDER LINES OF CREDIT

Kennedy-Wilson has entered into a loan agreement with US Bank and East-West Bank that provides Kennedy-Wilson with an unsecured revolving credit facility for use in acquisitions and for working capital purposes in the amount of \$30 million. The loan bears interest at a range of rates from prime to prime plus 0.50%, or, at the borrower's option, LIBOR plus 2.50% to LIBOR plus 3.00%. During 2008, the average outstanding borrowings under the line of credit was \$3,413,000 with the high and low outstanding balances being \$18,457,000 and \$0, respectively. The borrowings under this loan had interest rates ranging from 3.75% to 5.50% and 7.74% to 8.819% at December 31, 2008 and 2007, respectively. The principal amount outstanding under this loan was \$13,500,000 at December 31, 2008 and \$5,000,000 at December 31, 2007. The loan matures in June 2011.

Kennedy-Wilson's ability to borrow under this facility is subject to compliance with certain financial covenants, including maximum balance sheet leverage and fixed charge coverage ratios. As of December 31, 2008 and 2007, Kennedy-Wilson was in compliance with the covenants.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 11 MORTGAGE LOANS PAYABLE**

	December 31,	
	2008	2007
Mortgage loan payable, variable interest rate based on 1-month LIBOR plus 1.50%, 6.47% at December 31, 2007, interest only payable monthly, repaid in 2008	\$	\$ 4,084,000
Mortgage loan payable, variable interest rate of prime plus 0.50%, 7.75% at December 31, 2007, interest only payable monthly, repaid in 2008		6,000,000
Mortgage loan payable, fixed interest rate on initial advance (\$18,600,000), 6.16% at December 31, 2008, variable interest rate on subsequent advances of 1-month LIBOR plus 1.25% (2.6875% at December 31, 2008), due January 2010, secured by multi-family property	20,740,000	
Mortgage loan payable, fixed interest rate of 10%, interest paid quarterly with periodic principal repayments, secured by residential land, repaid in 2009	2,025,000	
Mortgage loan payable, fixed interest rate of 2.175%, interest only with partial principal repayment, \$262,000 repaid in 2008, \$275,000 due April 2009, balance due July 2009, secured by office building	6,333,000	
Mortgage loan payable, variable interest rate of prime, 4.00% at December 31, 2008, interest paid monthly, balance due June 2009, secured by property	450,000	
	\$29,548,000	\$10,084,000

During 2007, Kennedy-Wilson entered into two mortgage loans payable for the purchase of an office building located in Los Angeles, California. The first loan was in the amount of \$29,200,000 and carried a fixed interest rate of 6.03%, interest only payable monthly. The second loan was in the amount of \$3,650,000 and carried a fixed interest rate of 10.26%, interest only payable monthly. Both notes were collateralized by the office building and were repaid in 2007 upon the sale of the property.

Also during 2007, Kennedy-Wilson entered into a mortgage loan agreement for a total commitment of \$4,512,000 for the purchase of an industrial property located in Glendora, California. The loan had a variable interest rate based on the 1-month LIBOR plus 1.50% (6.47% at December 31, 2007), with interest only payable monthly. The loan is collateralized by the property and matures in September 2010. At closing, \$3,976,000 was advanced with \$536,000 available to fund capital improvements. As of December 31, 2007, \$108,000 had been drawn for capital improvements. The loan was assumed by the buyer of the related property.

The aggregate maturities of mortgage loans payable subsequent to December 31, 2008 are: \$8,808,000 in 2009 and \$20,740,000 in 2010.

NOTE 12 JUNIOR SUBORDINATED DEBENTURES

In 2007, Kennedy-Wilson issued junior subordinated debentures in the amount of \$40 million. The debentures were issued to a trust established by Kennedy-Wilson, which contemporaneously issued \$40 million of trust preferred securities to Merrill Lynch International. The interest rate on the

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 12 JUNIOR SUBORDINATED DEBENTURES (Continued)**

debentures is fixed for the first ten years at 9.06%, and variable thereafter at LIBOR plus 3.70%. Interest is payable quarterly with the principal due in 2037.

Prior to April 30, 2012, Kennedy-Wilson may redeem the debentures, upon a Special Event, as defined, at a redemption price equal to 107.5% of the outstanding principal amount. After April 30, 2012, Kennedy-Wilson may redeem the debentures, in whole or in part, on any interest payment date at par.

Kennedy-Wilson is subject to be in compliance with certain financial covenants, including maximum balance sheet leverage and fixed charge coverage ratios. As of December 31, 2008, Kennedy-Wilson was in compliance with the covenants.

NOTE 13 CONVERTIBLE SUBORDINATED NOTE

In November 2008, Kennedy-Wilson issued a convertible subordinated note in the amount of \$30 million. The note bears interest at a fixed rate of 7%. Interest is payable quarterly with the outstanding principal due in November 2018. The holder of the note may convert the note, in whole or in part, into common stock of Kennedy-Wilson at a conversion price of \$40 per share of common stock at any time prior to the 10th anniversary of the note. At any time on or after the ninth anniversary of the date of the note and prior to the due date, Kennedy-Wilson may demand that the holder of the note convert the note in accordance with the terms of the note.

The convertible subordinated note was issued with a beneficial conversion feature as the share price on the commitment date was \$43.75. The beneficial conversion feature totaled \$2,813,000 and is being amortized over ten years from issue date using the effective interest method.

NOTE 14 RELATED PARTY TRANSACTIONS

In 2008, the firm of Kulik, Gottesman & Mouton Ltd. was paid \$286,000 for legal services provided by the firm and \$30,000 for director's fees for Kent Mouton, a partner in the firm and a member of Kennedy-Wilson's board of directors, respectively. For 2007 the amounts were \$138,000 and \$28,000, respectively. For 2006 the amounts were \$220,000 and \$28,000, respectively.

The firm of Solomon, Winnett & Rosenfield was paid \$194,000, \$174,000, and \$195,000 for income tax services provided by the firm during the years ended December 31, 2008, 2007, and 2006, respectively. Jerry Solomon is a partner in the firm and a member of Kennedy-Wilson's board of directors. For the years ended December 31, 2008, 2007, and 2006, Mr. Solomon was paid director's fees in the amounts of \$29,000, \$29,000, and \$29,000, respectively. Kennedy-Wilson received fees and other income from affiliates and entities in which Kennedy-Wilson holds ownership interests in the following amounts:

	Year ended December 31,		
	2008	2007	2006
Property management and leasing fees	\$ 8,380,000	\$ 10,306,000	\$ 8,163,000
Commissions	4,295,000	8,896,000	7,883,000
Total related party revenue	\$ 12,675,000	\$ 19,202,000	\$ 16,046,000

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 14 RELATED PARTY TRANSACTIONS (Continued)**

In 2008, Kennedy-Wilson sold its ownership interest in three joint venture investments to three funds in which it also has ownership interests ranging from 4.40% - 5.00%. The gains recognized on the sale of these three ownership interests totaled \$1,409,000 and are included in equity in income of joint ventures in the accompanying consolidated statements of income and comprehensive income. Gains on the sale of the joint venture interests were deferred in the amount of \$56,000 and are included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

In 2008, Kennedy-Wilson entered into a note payable in the amount of \$4,255,000 with a joint venture in which it owns a 4.42% interest. The terms of the note are discussed in Note 9.

NOTE 15 INCOME TAXES

The provision for income taxes consists of the following:

	Year ended December 31,		
	2008	2007	2006
Current			
Federal	\$(1,583,000)	\$4,637,000	\$2,037,000
State	(230,000)	689,000	242,000
	(1,813,000)	5,326,000	2,279,000
Deferred			
Federal	2,083,000	759,000	2,041,000
State	335,000	159,000	243,000
	2,418,000	918,000	2,284,000
Total	\$ 605,000	\$6,244,000	\$4,563,000

The provision for income taxes is allocated as follows:

	Year ended December 31,		
	2008	2007	2006
Continuing operations	\$605,000	\$4,384,000	\$4,563,000
Discontinued operations		1,860,000	
	\$605,000	\$6,244,000	\$4,563,000

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 15 INCOME TAXES (Continued)**

A reconciliation of the statutory federal income tax rate with Kennedy-Wilson's effective income tax rate is as follows:

	Year ended December 31,		
	2008	2007	2006
Tax computed at statutory rate	\$ 414,000	\$ 5,473,000	\$ 3,682,000
State income taxes, net of federal benefit	69,000	551,000	273,000
Non-vested stock expense	375,000	384,000	362,000
Other	(253,000)	(164,000)	246,000
Provision for income taxes	\$ 605,000	\$ 6,244,000	\$ 4,563,000

The following summarizes the effect of deferred income tax items and the impact of "temporary differences" between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. Temporary differences and carryforwards which give rise to deferred tax assets and liabilities are as follows:

	Year ended December 31,	
	2008	2007
Deferred tax assets:		
Accrued reserves	\$ 223,000	\$ 243,000
Investment basis	175,000	
Marketable securities	291,000	129,000
Total deferred tax assets	689,000	372,000
Deferred tax liabilities:		
Depreciation and amortization	(4,738,000)	(3,934,000)
Prepaid expenses and other	(254,000)	(284,000)
Investment basis and reserve differences		(385,000)
Accrued payroll	(138,000)	(217,000)
Unrealized gain on fair value option	(2,364,000)	
Capitalized interest	(1,711,000)	(1,650,000)
Total deferred tax liabilities	(9,205,000)	(6,470,000)
Net deferred tax liability	\$ (8,516,000)	\$ (6,098,000)

Based upon the level of historical taxable income and projections for future taxable income over the periods which Kennedy-Wilson's gross deferred tax assets are deductible, management believes it is more likely than not Kennedy-Wilson will realize the benefits of these deductible differences at December 31, 2008.

Management has considered the likelihood and significance of possible penalties associated with its current and intended filing positions and has determined, based on their assessment, that such penalties, if any, would not be expected to be material.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 15 INCOME TAXES (Continued)**

Kennedy-Wilson's federal income tax returns remain open to examination for the tax years 2006 through 2008.

NOTE 16 COMMITMENTS AND CONTINGENCIES

Future minimum lease payments under scheduled operating leases, net of minor subleases, that have initial or remaining noncancelable terms in excess of one year are as follows:

Year	Operating Leases
2009	\$ 1,340,000
2010	885,000
2011	276,000
2012	48,000
Total minimum payments	\$ 2,549,000

Net rental expense amounted to \$1,586,000, \$1,517,000, and \$1,510,000 for the years ended December 31, 2008, 2007, and 2006, respectively, and is included in general and administrative expense in the accompanying consolidated statements of income and comprehensive income.

EMPLOYMENT AGREEMENTS Kennedy-Wilson has entered into an employment agreement with one of its principal officers, which provides for annual base compensation in the aggregate amount of \$950,000 and expires in December 2014. The employment agreement provides for the payment of an annual discretionary bonus in an amount determined in the sole and absolute discretion of the Compensation and Stock Option Committees of the board of directors. Kennedy-Wilson also has employment agreements with other non-officer employees which provide for aggregate minimum annual compensation of \$3,405,000 and expire in 2009.

LITIGATION Kennedy-Wilson is currently a defendant in certain routine litigation arising in the ordinary course of business. It is the opinion of management and legal counsel that the outcome of these actions will not have a material effect on the financial position or results of operations of Kennedy-Wilson.

NOTE 17 STOCK OPTION PLANS

Kennedy-Wilson currently has the 1992 Incentive and Non-statutory Stock Option Plan, which includes a Plan A and a Plan B and the 1992 Non-Employee Director Stock Option Plan ("Plan C"). An aggregate of 1,700,000 shares of common stock are reserved for issuance under Plan A and B. The Company has 81,000 shares of common stock reserved for issuance under Plan C.

Plan A permits the granting of Incentive Stock Options to employees, including employee-directors. Plan B permits the granting of nonstatutory stock options to employees, including employee-directors and consultants. Plan C permits the granting of options to non-employee-directors. Options granted under the Plans have an option price of 100% of the fair value of the common stock on the date of grant.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 17 STOCK OPTION PLANS (Continued)**

Options granted under Plan A vest over a period of three years and may be exercised for a period of up to five years from the grant date; options granted under Plan B vest over a period of three years and may be exercised for a period of up to 10 years from the grant date. Options granted under Plan C vest and become exercisable on the first anniversary of the date of the initial grant provided that the optionee continues to serve as a director for at least one year from the date of such initial grant. Under Plan C, options expire on the earlier of the tenth anniversary of the date of grant and 90 days after the individual ceases to be a director of Kennedy-Wilson.

The following table sets forth activity under the plans:

	Options	Range of Exercise Prices	Weighted Average Exercise Price
Outstanding, January 1, 2006	325,870	\$0.93 - \$8.81	\$ 4.29
Exercised	(245,040)	\$0.93 - \$7.00	\$ 4.12
Balance, December 31, 2006	80,830	\$3.81 - \$8.81	\$ 4.80
Exercised	(55,000)	\$4.23 - \$4.35	\$ 4.30
Balance, December 31, 2007	25,830	\$3.81 - \$8.81	\$ 5.88
Exercised	(11,250)	\$8.25	\$ 8.25
Balance, December 31, 2008	14,580	\$3.81 - \$8.81	\$ 4.06

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/08	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable at 12/31/08	Weighted Average Exercise Price
\$3.81	13,500	2.24	\$ 3.81	13,500	\$ 3.81
\$5.45	540	3.45	\$ 5.45	540	\$ 5.45
\$8.81	540	0.48	\$ 8.81	540	\$ 8.81

The number of options exercisable at December 31, 2008, 2007, and 2006, were 14,580, 25,830, and 80,830, respectively.

NOTE 18 CAPITAL STOCK TRANSACTIONS

During 2008, Kennedy-Wilson issued 53,000 shares of Series A Preferred Stock (the "preferred stock"). The holders of the preferred stock are entitled to receive dividends quarterly at a per annum rate equal to 7% of the liquidation value of \$1,000 per share. The preferred stock will be senior to all other existing classes and series of shares of stock of the company upon dissolution, liquidation, or winding up, to the extent of the aggregate liquidation value and all accrued but unpaid dividends. The preferred stock must be converted into shares of Kennedy-Wilson's

Edgar Filing: VALHI INC /DE/ - Form 10-Q

common stock at any time on or prior to the third annual anniversary, May 2011 through September 2011, of the latest date of the original issuance of any preferred stock at a conversion price of \$42 per share of common stock for a total of approximately 1,262,000 shares of common stock. Additionally, the preferred stock

F-55

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 18 CAPITAL STOCK TRANSACTIONS (Continued)**

automatically shall be converted into shares of common stock no later than 10 days after Kennedy-Wilson delivers notice to the holders of the preferred stock advising such holder that Kennedy-Wilson shall sell all or substantially all of its assets or shall be acquired by or reorganized into or with another entity. The proceeds from the issuance of the preferred stock was \$52,354,000, net of expenses related to the offering totaling \$646,000.

During 2008, 2007, and 2006, Kennedy-Wilson acquired approximately 164,000, 121,000, and 38,000 shares, respectively, of its common stock for total consideration of \$6,170,000, \$2,996,000, and \$651,000, respectively.

During 2001 and 2002, Kennedy-Wilson's Chairman was granted a total of 1,700,000 shares of non-vested stock that vest over a period of eight to ten years. For the years ended December 31, 2008, 2007, and 2006, compensation expense for the non-vested stock grants was \$1,015,000, \$1,015,000, and \$1,015,000, respectively, and is included in compensation and related expenses in the accompanying consolidated statements of income and comprehensive income. At December 31, 2008, 2007, and 2006, the amount of non-vested shares deducted from additional paid-in capital was \$1,543,000, \$2,558,000, and \$3,573,000, respectively. The vesting of the remaining non-vested shares and the related compensation expense is as follows:

	Non-Vested Shares	Compensation Expense
2009	195,000	\$ 1,015,000
2010	109,000	528,000
	304,000	\$ 1,543,000

NOTE 19 EMPLOYEE BENEFIT ARRANGEMENTS

Kennedy-Wilson has a qualified plan under the provisions of Section 401(k) of the Internal Revenue Code. Under this plan, participants are able to make salary deferral contributions of up to 15% of their total compensation, up to a specified maximum. The 401(k) plan also includes provisions which authorize Kennedy-Wilson to make discretionary contributions. During 2008, 2007, and 2006, Kennedy-Wilson made matching contributions of \$6,000, \$100,000, and \$71,000, respectively, to this plan and is included in compensation and related expenses in the accompanying consolidated statements of income and comprehensive income.

NOTE 20 SALE OF MINORITY INTEREST

In 2006, Kennedy-Wilson sold a 20% interest in its wholly-owned apartment management division to Kenedix, Inc., a Japanese real estate company, for \$9 million. A gain on the sale in the amount of \$7,060,000 was recognized after deduction of related expenses.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 21 EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share:

	Year ended December 31,		
	2008	2007	2006
Income from continuing operations	\$ 613,000	\$ 6,596,000	\$ 5,955,000
Income from discontinued operations, net of tax		2,797,000	
Less: Preferred stock dividend	(2,264,000)		
Net (loss) income available to common stockholders	\$(1,651,000)	\$ 9,393,000	\$ 5,955,000
Basic (loss) earnings per share:			
(Loss) income from continuing operations	\$ (0.32)	\$ 1.30	\$ 1.23
Income from discontinued operations, net of tax		0.55	
	\$ (0.32)	\$ 1.85	\$ 1.23
Weighted average common shares			
	5,119,684	5,063,949	4,840,963
Diluted earnings per share:			
(Loss) income from continuing operations	\$ (0.32)	\$ 1.17	\$ 1.07
Income from discontinued operations, net of tax		0.50	
	\$ (0.32)	\$ 1.67	\$ 1.07
Weighted average common shares			
	5,119,684	5,063,949	4,840,963
Options and warrants		10,243	100,333
Non-vested stock		547,610	616,791
Total diluted shares	5,119,684	5,621,802	5,558,087

The dilutive shares from convertible preferred stock, convertible subordinated debt, options and non-vested stock have not been included in the diluted weighted average shares as Kennedy-Wilson has a net loss available to common stockholders. There were a total of 1,281,070 dilutive securities as of December 31, 2008.

NOTE 22 SEGMENT INFORMATION

Kennedy-Wilson's business activities currently consist of services and various types of real estate investments. Kennedy-Wilson's segment disclosure with respect to the determination of segment profit or loss and segment assets is based on these services and its various investments.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

SERVICES Kennedy-Wilson provides a full range of commercial and residential real estate services. These services include property management, leasing, brokerage, asset management, and various other specialized commercial and residential real estate services.

F-57

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 22 SEGMENT INFORMATION (Continued)**

INVESTMENTS With joint venture partners and on its own, Kennedy-Wilson invests in commercial and residential real estate which Kennedy-Wilson believes value may be added through Kennedy-Wilson's expertise or opportunistic investing. Kennedy-Wilson's current real estate portfolio focuses on commercial buildings and multiple-family residences.

Substantially all of the management fees and commissions related party revenues were generated via intersegment activity for the years ended December 31, 2008, 2007 and 2006. The amounts representing investments with related parties and non-affiliates are included in the investment segment. No single external customer provided Kennedy-Wilson with 10% or more of its revenues during any period presented in these financial statements.

The following tables summarize the income and expense activity by segment for the year ended December 31, 2008 and total assets as of December 31, 2008.

	Services	Investments	Corporate	Consolidated
Management fees and commissions	\$ 16,577,000	\$	\$	\$ 16,577,000
Management fees and commissions related party	12,675,000			12,675,000
Rental and sales revenue		2,409,000		2,409,000
Other income		564,000		564,000
Total revenue	29,252,000	2,973,000		32,225,000
Depreciation and amortization	(83,000)	(683,000)	(154,000)	(920,000)
Operating expenses	(23,910,000)	(2,195,000)	(5,546,000)	(31,651,000)
Total operating expenses	(23,993,000)	(2,878,000)	(5,700,000)	(32,571,000)
Equity in joint venture income		10,097,000		10,097,000
Total operating income (loss)	5,259,000	10,192,000	(5,700,000)	9,751,000
Interest income			221,000	221,000
Interest income related party			341,000	341,000
Interest expense		(1,974,000)	(6,622,000)	(8,596,000)
Other than temporary impairment on available for sale security			(445,000)	(445,000)
Income (loss) before provision for income taxes	\$ 5,259,000	\$ 8,218,000	(12,205,000)	1,272,000
Provision for income taxes			(605,000)	(605,000)
Net income			\$(12,810,000)	\$ 667,000
Total assets	\$ 39,791,000	\$ 175,368,000	\$ 40,724,000	\$ 255,883,000
Expenditures for long lived assets	\$	\$ 41,460,000	\$	\$ 41,460,000

Edgar Filing: VALHI INC /DE/ - Form 10-Q

All of the revenues included in the table above are attributable to the United States, except for \$198,000 in rental and sales revenue that is attributable to Japan. This rental and sales revenue was

F-58

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 22 SEGMENT INFORMATION (Continued)**

generated from the office building in Japan that had a carrying value of \$8,428,000 as of December 31, 2008. The only other activity outside the United States is conducted through Kennedy-Wilson's equity method investment KW Residential LLC (See Note 6).

The following tables summarize the income and expense activity by segment for the year ended December 31, 2007 and total assets as of December 31, 2007.

	Services	Investments	Corporate	Consolidated
Management fees and commissions	\$ 14,093,000	\$	\$	\$ 14,093,000
Management fees and commissions related party	19,202,000			19,202,000
Rental and sales revenue		98,000		98,000
Total revenue	33,295,000	98,000		33,393,000
Depreciation and amortization	(351,000)	(22,000)	(132,000)	(505,000)
Operating expenses	(22,663,000)	(481,000)	(19,531,000)	(42,675,000)
Total operating expenses	(23,014,000)	(503,000)	(19,663,000)	(43,180,000)
Equity in joint venture income		27,433,000		27,433,000
Total operating income (loss)	10,281,000	27,028,000	(19,663,000)	17,646,000
Interest income			487,000	487,000
Interest income related party			378,000	378,000
Interest expense		(333,000)	(4,757,000)	(5,090,000)
Income (loss) before provision for income taxes	\$ 10,281,000	26,695,000	(23,555,000)	13,421,000
Provision for income taxes			(4,384,000)	(4,384,000)
Income (loss) from continuing operations			(27,939,000)	9,037,000
Income from discontinued operations, net of tax		2,797,000		2,797,000
Net income		\$ 29,492,000	\$ (27,939,000)	\$ 11,834,000
Total assets	\$ 45,053,000	\$ 66,552,000	\$ 34,209,000	\$ 145,814,000
Expenditures for long lived assets	\$	\$ 38,458,000	\$	\$ 38,458,000

The only activity outside the United States is conducted through Kennedy-Wilson's equity method investment KW Residential LLC (See Note 6).

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 22 SEGMENT INFORMATION (Continued)**

The following tables summarize the income and expense activity by segment for the year ended December 31, 2006 and total assets as of December 31, 2006.

	Services	Investments	Corporate	Consolidated
Management fees and commissions	\$ 10,452,000	\$	\$	\$ 10,452,000
Management fees and commissions related party	16,046,000			16,046,000
Total revenue	26,498,000			26,498,000
Depreciation and amortization	(327,000)		(361,000)	(688,000)
Operating expenses	(18,604,000)	(1,482,000)	(13,832,000)	(33,918,000)
Total Operating Expenses	(18,931,000)	(1,482,000)	(14,193,000)	(34,606,000)
Equity in joint venture income		14,689,000		14,689,000
Total operating income (loss)	7,567,000	13,207,000	(14,193,000)	6,581,000
Interest income		503,000	58,000	561,000
Interest income related parties			85,000	85,000
Gain on sale of asset			7,060,000	7,060,000
Interest expense		(569,000)	(2,614,000)	(3,183,000)
Income (loss) before provision for income taxes	\$ 7,567,000	\$ 13,141,000	(9,604,000)	11,104,000
Provision for income taxes			(4,563,000)	(4,563,000)
Net income			\$ (14,167,000)	\$ 6,541,000
Total assets	\$ 37,748,000	\$ 51,825,000	\$ 18,173,000	\$ 107,746,000
Expenditures for long lived assets	\$	\$ 7,637,000	\$	\$ 7,637,000

The only activity outside the United States is conducted through Kennedy-Wilson's equity method investment KW Residential LLC (See Note 6).

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****December 31, 2008, 2007 and 2006****NOTE 23 UNAUDITED QUARTERLY INFORMATION**

Year ended December 31, 2008	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$ 6,601,000	\$ 9,906,000	\$ 8,158,000	\$ 7,560,000
Operating expenses	6,357,000	8,366,000	7,995,000	9,853,000
Equity in joint venture income (loss)	1,317,000	216,000	4,130,000	4,434,000
Operating income	1,561,000	1,756,000	4,293,000	2,141,000
Non-operating income (expense)	(1,163,000)	(1,732,000)	(2,254,000)	(3,330,000)
Income (loss) before provision for income taxes	398,000	24,000	2,039,000	(1,189,000)
(Provision for) benefit from income taxes	(177,000)	(11,000)	(738,000)	321,000
Net income (loss)	\$ 221,000	\$ 13,000	\$ 1,301,000	\$ (868,000)
Basic earnings (loss) per share	\$ 0.04	\$ (0.07)	\$ 0.07	\$ (0.15)
Diluted earnings (loss) per share	\$ 0.04	\$ (0.07)	\$ 0.07	\$ (0.15)
Year ended December 31, 2007	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$ 6,479,000	\$ 10,772,000	\$ 8,383,000	\$ 7,759,000
Operating expenses	6,612,000	8,147,000	8,156,000	20,265,000
Equity in joint venture (loss) income	(86,000)	3,575,000	2,256,000	21,688,000
Operating (loss) income	(219,000)	6,200,000	2,483,000	9,182,000
Non-operating expense	(853,000)	(1,056,000)	(1,090,000)	(1,226,000)
(Loss) income before provision for income taxes	(1,072,000)	5,144,000	1,393,000	7,956,000
(Provision for) benefit from income taxes	560,000	(2,028,000)	(479,000)	(2,437,000)
(Loss) income from continuing operations	(512,000)	3,116,000	914,000	5,519,000
(Loss) income from discontinued operations, net of tax	(86,000)	(180,000)	1,000	3,062,000
Net (loss) income	\$ (598,000)	\$ 2,936,000	\$ 915,000	\$ 8,581,000
Basic (loss) earnings per share:				
(Loss) income from continuing operations	\$ (0.15)	\$ 0.64	\$ 0.14	\$ 0.67
(Loss) income from discontinued operations	(0.02)	(0.04)		0.60
	\$ (0.17)	\$ 0.60	\$ 0.14	\$ 1.27

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Diluted (loss) earnings per share:								
(Loss) income from continuing operations	\$	(0.15)	\$	0.57	\$	0.13	\$	0.61
(Loss) income from discontinued operations		(0.02)		(0.03)				0.55
	\$	(0.17)	\$	0.54	\$	0.13	\$	1.16

F-61

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Balance Sheets**

	June 30, 2009	December 31, 2008
	(Unaudited)	
Assets		
Cash and cash equivalents	\$ 16,206,000	\$ 25,831,000
Accounts and notes receivable	14,358,000	9,548,000
Income tax receivable		1,414,000
Investment in real estate available for sale	34,260,000	
Investments in real estate, net	40,618,000	48,727,000
Investments in joint ventures (\$15,263,000 and \$15,088,000 carried at fair value as of June 30, 2009 and December 31, 2008, respectively)	147,581,000	142,188,000
Goodwill and other assets	30,393,000	28,175,000
Total assets	\$283,416,000	\$255,883,000
Liabilities and equity		
Liabilities		
Accounts payable and other liabilities	\$ 19,050,000	\$ 18,658,000
Mortgage loans payable on real estate held for sale	26,115,000	
Line of credit, notes payable, mortgages and other long-term debt	134,285,000	131,423,000
Total liabilities	179,450,000	150,081,000
Equity		
Convertible preferred stock, \$0.01 par value: 5,000,000 shares authorized, 53,000 shares issued and outstanding as of December 31, 2008. The preferred stock is mandatorily convertible to common stock on the third anniversary from issue date of September 2008	1,000	1,000
Common stock, \$0.01 par value: 50,000,000 shares authorized; 5,387,997 and 5,466,150 shares issued as of June 30, 2009 and December 31, 2008, respectively	54,000	55,000
Other stockholders' equity	98,042,000	105,495,000
Total Kennedy-Wilson stockholders' equity	98,097,000	105,551,000
Noncontrolling interests	5,869,000	251,000
Total equity	103,966,000	105,802,000
Total liabilities and equity	\$283,416,000	\$255,883,000

See accompanying notes to consolidated financial statements.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statements of Operations and
Comprehensive Loss****(Unaudited)**

	Six months ended June 30,	
	2009	2008
Revenue		
Gross revenues	\$ 19,300,000	\$ 16,473,000
Operating expenses		
Costs and expenses related to revenue	17,918,000	11,096,000
General, administrative, depreciation and amortization	2,684,000	3,627,000
Total operating expense	20,602,000	14,723,000
Equity in joint venture (loss) income	(461,000)	1,533,000
Total operating income	(1,763,000)	3,283,000
Non-operating income (expense)		
Interest income	182,000	542,000
Interest expense	(5,061,000)	(3,403,000)
Other than temporary impairment on available-for-sale security	(323,000)	
(Loss) income before provision for income taxes	(6,965,000)	422,000
Benefit from (provision for) income taxes	2,215,000	(188,000)
Net (loss) income	(4,750,000)	234,000
Net loss (income) attributable to the noncontrolling interest	267,000	(50,000)
Preferred stock dividends and accretion of beneficial conversion feature	(1,964,000)	(394,000)
Net loss attributable to Kennedy-Wilson common stockholders	(6,447,000)	(210,000)
Other comprehensive income, net of tax	117,000	
Total comprehensive loss attributable to Kennedy-Wilson common stockholders	\$ (6,330,000)	\$ (210,000)
Basic (loss) earnings per share:		
Net (loss) income attributable to Kennedy-Wilson common stockholders	\$ (1.24)	\$ (0.04)
Weighted average number of common shares outstanding basic	5,195,273	5,098,855
Diluted (loss) earnings per share:		
Net (loss) income attributable to Kennedy-Wilson common stockholders	\$ (1.24)	\$ (0.04)
Weighted average number of common shares outstanding diluted	5,195,273	5,098,855

See accompanying notes to consolidated financial statements.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statement of Equity****(Unaudited)**

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other	Noncontrolling Interests	Total
	Shares	Amount	Shares	Amount			Comprehensive Loss		
Balance, January 1, 2008		\$	5,619,224	\$ 56,000	\$ 9,921,000	\$ 47,118,000	\$ (238,000)	\$ 219,000	\$ 57,076,000
Issuance of preferred stock	53,000	1,000			52,353,000				52,354,000
Issuance of common stock exercise of stock options			11,250	1,000	92,000				93,000
Repurchase of common stock			(164,324)	(2,000)	(6,168,000)				(6,170,000)
Amortization of equity compensation					1,015,000				1,015,000
Discount on convertible subordinated debt					2,813,000				2,813,000
Other comprehensive loss:									
Foreign currency translation							240,000		240,000
Dividends paid preferred stock						(2,264,000)			(2,264,000)
Net income						613,000		54,000	667,000
Contributions from noncontrolling interests								482,000	482,000
Distributions to noncontrolling interests								(504,000)	(504,000)
Balance, December 31, 2008	53,000	1,000	5,466,150	55,000	60,026,000	45,467,000	2,000	251,000	105,802,000
Issuance of common stock exercise of stock options			540		5,000				5,000
Repurchase of common stock			(78,693)	(1,000)	(2,393,000)				(2,394,000)
Amortization of equity compensation					507,000				507,000
Stock compensation expense					650,000				650,000
Other comprehensive loss:									
Foreign currency translation							(77,000)		(77,000)
Unrealized loss on marketable security, net of tax							194,000		194,000
Dividends paid and accrued preferred stock						(1,856,000)			(1,856,000)
Accretion of preferred stock beneficial conversion					108,000	(108,000)			
Net income (loss)						(4,483,000)		(267,000)	(4,750,000)
Contributions from noncontrolling interests								5,885,000	5,885,000
Distributions to noncontrolling interests									
Balance, June 30, 2009 (unaudited)	53,000	\$ 1,000	5,387,997	\$ 54,000	\$ 58,903,000	\$ 39,020,000	\$ 119,000	\$ 5,869,000	\$ 103,966,000

See accompanying notes to consolidated financial statements.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****Six months ended June 30, 2009 and 2008****(Unaudited)**

	Six months ended June 30,	
	2009	2008
Net cash used in operating activities	\$ (3,009,000)	\$ (13,021,000)
Cash flows from investing activities:		
Additions to notes receivable related party	(2,663,000)	
Net proceeds from sale of real estate	6,368,000	
Purchases of and additions to real estate	(34,869,000)	(27,976,000)
Capital distributions from joint ventures	404,000	8,136,000
Contributions to joint ventures	(7,533,000)	(55,187,000)
Other	(198,000)	28,000
Net cash used in investing activities	(38,491,000)	(74,999,000)
Cash flow from financing activities:		
Borrowings under notes payable	9,000,000	20,450,000
Repayment of notes payable	(16,188,000)	(5,973,000)
Borrowings under lines of credit	12,500,000	13,000,000
Repayment of lines of credit		(18,000,000)
Borrowings under mortgage loans payable	30,286,000	23,290,000
Repayment of mortgage loans payable	(4,738,000)	(2,911,000)
Debt issue costs	(625,000)	(1,009,000)
Issuance of preferred stock		51,951,000
Issuance of common stock	5,000	
Repurchase of common stock	(2,394,000)	(2,909,000)
Dividends paid preferred stock	(1,856,000)	(394,000)
Contributions from (distributions to) noncontrolling interests	5,885,000	(200,000)
Net cash provided by financing activities	31,875,000	77,295,000
Net decrease in cash and cash equivalents	(9,625,000)	(10,725,000)
Cash and cash equivalents, beginning of year	25,831,000	24,248,000
Cash and cash equivalents, end of year	\$ 16,206,000	\$ 13,523,000

Non-Cash Items

In 2008, Kennedy-Wilson converted notes receivable from various executives and directors of Kennedy-Wilson related to a joint venture investment in Japan into equity in the Japanese joint venture resulting in an increase in investments in joint ventures of \$4,397,000 and a decrease in notes receivable of \$4,397,000.

In 2009, the debt on a piece of land that was sold was assumed by the buyer resulting in a decrease of proceeds from the sale of real estate of \$2,025,000 and reduction of repayment of mortgage loans payable of \$2,025,000.

At June 30, 2009, \$809,000 of preferred dividends were declared and not paid resulting in an increase in accrued expenses and other liabilities.

See accompanying notes to consolidated financial statements.

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2009 and 2008

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

Kennedy-Wilson's unaudited interim consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles used in the preparation of its annual financial statements. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of Kennedy-Wilson, all adjustments, consisting of only normal and recurring items, necessary for a fair presentation of the results of operations for the six-month periods ended June 30, 2009 and 2008 have been included. The results of operations for six months ended June 30, 2009 are not necessarily indicative of results that might be expected for the full year ended December 31, 2009. For further information, your attention is directed to the footnote disclosures found in Kennedy-Wilson's 2008 Financial Statements.

The consolidated financial statements include the accounts of Kennedy-Wilson and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. In addition, Kennedy-Wilson evaluates its relationships with other entities to identify whether they are variable interest entities as defined by FASB Interpretation No. 46 (revised December 2003) *Consolidation of Variable Interest Entities* ("FIN 46R") and to assess whether it is the primary beneficiary of such entities. If the determination is made that Kennedy-Wilson is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46R.

The ownership of the other interest holders of consolidated subsidiaries is reflected as noncontrolling interests. The preparation of the accompanying consolidated financial statements in conformity with U. S. generally accepted accounting principles requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosure about contingent assets and liabilities, and reported amounts of revenues and expenses. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates.

Kennedy-Wilson acquired a condominium project located in Los Angeles, California. The Project was purchased for the purposes of resale and was classified as held for sale at the date of acquisition. Management having the authority has committed to a plan of disposal and is actively marketing the property and expects to dispose of all of the condominium units within one year.

Kennedy-Wilson has evaluated all subsequent events through the date of the filing of this form S-4.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued FASB Statement No. 141(R), *Business Combinations*. Statement 141(R) requires most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at "full fair value" and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Statement 141(R) is effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited. FASB No. 141(R) was adopted on January 1, 2009, and there was no material impact to the accompanying consolidated financial statements.

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

June 30, 2009 and 2008

(Unaudited)

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

In April 2008, the FASB issued FASB Staff Position FAS 142-3, "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement 142. FSP FAS 142-3 was adopted on January 1, 2009, and there is no material impact to the accompanying consolidated financial statements.

In November 2008, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations". EITF 08-6 continues to follow the accounting for the initial carrying value of equity method investments in APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, which is based on a cost accumulation model and generally excludes contingent consideration. EITF 08-6 also specifies that other-than-temporary impairment testing by the investor should be performed at the investment level and that a separate impairment assessment of the underlying assets is not required. An impairment charge by the investee should result in an adjustment of the investor's basis of the impaired asset for the investor's pro-rata share of such impairment. In addition, EITF 08-6 reached a consensus on how to account for an issuance of shares by an investee that reduces the investor's ownership share of the investee. An investor should account for such transactions as if it had sold a proportionate share of its investment with any gains or losses recorded through earnings. EITF 08-6 also addresses the accounting for a change in an investment from the equity method to the cost method after adoption of Statement 160. EITF 08-6 affirms the existing guidance in APB 18, which requires cessation of the equity method of accounting and application of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, or the cost method under APB 18, as appropriate. EITF 08-6 was adopted on January 1, 2009, and did not materially impact Kennedy-Wilson's financial position or results of operations.

NOTE 3 GUARANTEES

Kennedy-Wilson has certain guarantees associated with loans secured by assets held in various joint venture partnerships. The maximum potential amount of future payments (undiscounted) Kennedy-Wilson could be required to make under the guarantees was approximately \$69 million and \$46 million at June 30, 2009 and December 31, 2008, respectively. The guarantees expire through 2011 and Kennedy-Wilson's performance under the guarantees would be required to the extent there is a shortfall in liquidation between the principal amount of the loan and the net sales proceeds of the property. Based upon Kennedy-Wilson's evaluation of guarantees under FIN 45, the estimated fair value of guarantees made as of June 30, 2009 is immaterial.

NOTE 4 INVESTMENT IN REAL ESTATE

Kennedy-Wilson disposed of residential land with a historical cost basis of \$5.7 million during the six month period ended June 30, 2009 for a gain of \$0.5 million. Kennedy-Wilson has continuing involvement with the property and as a result has not included this transaction in discontinued operations. Additionally, a condominium project was acquired for \$33 million and is presented as real estate held for sale.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****June 30, 2009 and 2008****(Unaudited)****NOTE 5 INVESTMENTS IN JOINT VENTURES**

Kennedy-Wilson has a number of joint venture interests, with ownership generally ranging from 5% to 50%, which were formed to acquire, manage, develop and/or sell real estate. Kennedy-Wilson has significant influence over these entities, but not voting or other control and accordingly, these investments are accounted for under the equity method.

During the six months ended June 30, 2009, Kennedy-Wilson made contributions to joint ventures totalling \$6.7 million, received distributions from joint ventures of \$0.9 million, and recorded equity in joint ventures losses of \$0.5 million.

NOTE 6 FAIR VALUE MEASUREMENTS AND THE FAIR VALUE OPTION**FAIR VALUE MEASUREMENTS**

The following table presents fair value measurements (including items that are required to be measured at fair value and items for which the fair value option has been elected) as of June 30, 2009 classified according to the Statement 157 valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Available-for-sale security	\$28,000	\$	\$	\$ 28,000
Investment in joint ventures			15,235,000	15,235,000
	\$28,000	\$	\$ 15,235,000	\$ 15,263,000

The following table presents changes in Level 3 investments for the six months ended June 30, 2009:

	December 31, 2008	Net Purchases or sales	Realized gains or losses	Unrealized appreciation or (depreciation)	Net transfers in or out of Level 3	Total
Investment in joint ventures	\$ 15,088,00	\$ 75,000	\$	\$ 72,000	\$	\$ 15,235,000

Kennedy-Wilson has an investment in an investment company (the "Fund") and records its investment based on the amount of net assets that would be allocated to its interests in the Fund assuming the Fund was to liquidate its investments at fair value. The investment company reports its investments in real estate at fair value based on valuations of the underlying real estate holdings and indebtedness securing the real estate. The indebtedness securing the real estate and the investments in debt securities were valued, in part, by a third party valuation firm also using an income approach. During the six months ended June 30, 2009, Kennedy-Wilson made contributions to the joint venture of \$0.2 million, received distributions from the joint venture of \$0.1 million, and recorded equity in the joint venture's income of \$0.1 million. Kennedy-Wilson's investment balance in the Fund was \$2,569,000 at June 30, 2009.

FAIR VALUE OPTION Kennedy-Wilson has elected the fair value option for two investments in joint venture entities that were acquired during 2008. The first investment in joint venture has a partial interest in a condominium development located in Richmond, California that was acquired from the developer in June of 2008. The developer retained an ownership interest in the condominium project that is subordinated to all of the other ownership interests in the entity that holds the fee simple interest in the real estate. The second investment in joint venture has a partial ownership interest in an

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

June 30, 2009 and 2008

(Unaudited)

NOTE 6 FAIR VALUE MEASUREMENTS AND THE FAIR VALUE OPTION (Continued)

entity that has two investments. The first investment is a partial interest in the same condominium development as the first investment in joint venture and the second is an interest in an office building located in San Francisco, California. Kennedy-Wilson elected to record these investments at fair value to more accurately reflect the timing of the value created in the underlying investments and report those results in current operations. Kennedy-Wilson does not believe the other investments in joint ventures will demonstrate these characteristics. Kennedy-Wilson determines the fair value of these investments based upon the income approach, utilizing estimates of future cash flows, discount rates and liquidity risks. As of June 30, 2009, investments for which fair value treatment was elected under SFAS 159 totaled \$12,665,000.

NOTE 7 MORTGAGE LOANS PAYABLE ON REAL ESTATE HELD FOR SALE

During the six month period ended June 30, 2009 Kennedy-Wilson entered into two mortgage loans payable totaling \$26.1 million that bear interest at 9% and 15%. The mortgage loans are secured by 149 condominium units. Kennedy-Wilson also repaid two mortgage loans totaling \$6.0 million.

NOTE 8 LINE OF CREDIT, MORTGAGE AND OTHER LONG-TERM DEBT

During the six month period ended June 30, 2009 Kennedy-Wilson borrowed an additional \$12.5 million from its line of credit which bears interest from prime to prime plus 0.50% or, at the borrower's option, LIBOR plus 2.50% to LIBOR plus 3.00%, bringing the outstanding balance to \$26.0 million as of June 30, 2009.

During the six month period ended June 30, 2009, two loans totaling \$16.2 million, which bore interest at 12% and 14% as of December 31, 2008 were repaid. Kennedy-Wilson entered into two new loans totaling \$9.0 million with Pacific Western bank and both bear interest at the lender's base lending rate, which was 4% at June 30, 2009.

NOTE 9 RELATED PARTY TRANSACTIONS

For the six months ended June 30, 2009, the firm of Kulik, Gottesman & Mouton Ltd. was paid \$112,000 for legal services provided by the firm and \$9,000 for director's fees for Kent Mouton, a partner in the firm and a member of Kennedy-Wilson's board of directors, respectively. For the six months ended June 30, 2008 the amounts were \$143,000 and \$15,000, respectively.

The firm of Solomon, Winnett & Rosenfield was paid \$52,000 and \$97,000 for income tax services provided by the firm during the six months ended June 30, 2009 and 2008, respectively. Jerry Solomon is a partner in the firm and a member of Kennedy-Wilson's board of directors. For the six months ended June 30, 2009 and 2008, Mr. Solomon was paid director's fees in the amounts of \$7,000 and \$14,500, respectively.

NOTE 10 CAPITAL STOCK TRANSACTIONS

During the six month period ended June 30, 2009 Kennedy-Wilson repurchased approximately 79,000 of its common shares for total consideration of approximately \$2.4 million.

Table of Contents

Kennedy-Wilson, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

June 30, 2009 and 2008

(Unaudited)

NOTE 11 EMPLOYEE BENEFIT ARRANGEMENTS

During 2009, Kennedy-Wilson adopted the 2009 Equity Participation Plan (the "Plan") which allows for the grant of up to 750,000 shares of common stock. On March 25, 2009, Kennedy-Wilson granted 375,000 performance awards and 375,000 service awards with an exercise price of \$30 that was equal to the fair value on the date of grant. The performance and service awards vest ratably over a seven year period and are settled in shares of common stock of Kennedy-Wilson. The option awards expire at the end of ten year. The Plan allows participants to settle vested awards with cash, a full recourse note, or net share settlement. Kennedy-Wilson has determined the compensation expense to be recorded under the Plan using the Black-Scholes-Merton option pricing model. The option pricing model inputs used to determine grant date fair value were, expected stock option term of 7 years, expected volatility of 43.5%, expected risk free rate of 2.5%, and no expected dividends.

Kennedy-Wilson has elected to recognize the compensation expense for the service awards on a straight-line basis over the vesting period and is grade vesting the performance awards over the vesting period. The total compensation expense recorded for the six months ended June 30, 2009 was \$650,000.

NOTE 12 EARNINGS PER SHARE

The dilutive shares from convertible preferred stock, convertible subordinated debt, options and non-vested stock have not been included in the diluted weighted average shares as Kennedy-Wilson has a net loss available to common stockholders. There were a total of 2,634,033 and 696,019 dilutive securities as of June 30, 2009 and 2008, respectively. See accompanying consolidated statement of income and comprehensive income.

NOTE 13 COMPREHENSIVE INCOME

Comprehensive income consists of net income and other comprehensive income. Accumulated other comprehensive income consists of foreign currency translation adjustments.

NOTE 14 SEGMENT INFORMATION

Kennedy-Wilson's business activities currently consist of services and various types of real estate investments. Kennedy-Wilson's segment disclosure with respect to the determination of segment profit or loss and segment assets is based on these services and its various investments.

SERVICES Kennedy-Wilson provides a full range of commercial and residential real estate services. These services include property management, leasing, brokerage, asset management, and various other specialized commercial and residential real estate services.

INVESTMENTS With joint venture partners and on its own, Kennedy-Wilson invests in commercial and residential real estate which Kennedy-Wilson believes value may be added through Company expertise or opportunistic investing. Kennedy-Wilson's current real estate portfolio focuses on commercial buildings and multiple-family residences.

Substantially all of the gross revenue related party revenues were generated via intersegment activity for the six months ended June 30, 2009 and 2008. The amounts representing investments with related parties and non-affiliates are included in the investment segment. No single external customer provided Kennedy-Wilson with 10% or more of its revenues during any period presented in these financial statements.

Table of Contents**Kennedy-Wilson, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****June 30, 2009 and 2008****(Unaudited)****NOTE 14 SEGMENT INFORMATION (Continued)**

There have been no changes in the basis of segmentation or in the basis of measurement of segment profit or loss since the December 31, 2008 financial statements.

The following tables summarize Kennedy-Wilson's income activity by segment for the six-month period ended June 30, 2009 and balance sheet data as of June 30, 2009:

	Services	Investments	Corporate	Consolidated
Gross revenue	\$ 8,756,000	\$ 7,546,000	\$ 26,000	\$ 16,328,000
Gross revenue related party	2,972,000			2,972,000
Total revenue	\$ 11,728,000	\$ 7,546,000	\$ 26,000	\$ 19,300,000
Net Loss	\$ 741,000	\$ (1,040,000)	\$ (4,451,000)	\$ (4,750,000)
Total assets	\$ 29,831,000	\$ 210,659,000	\$ 42,926,000	\$ 283,416,000

The following tables summarize Kennedy-Wilson's income activity by segment for the six-month period ended June 30, 2008 and balance sheet data as of December 31, 2008.

	Services	Investments	Corporate	Consolidated
Gross revenue	\$ 8,634,000	\$ 1,012,000	\$	\$ 9,646,000
Gross revenue related party	6,827,000			6,827,000
Total revenue	\$ 15,461,000	\$ 1,012,000	\$	\$ 16,473,000
Net Income	\$ 3,725,000	\$ 829,000	\$ (4,320,000)	\$ 234,000
Total assets	\$ 39,791,000	\$ 175,368,000	\$ 40,724,000	\$ 255,883,000

NOTE 15 INCOME TAXES

Kennedy-Wilson's effective tax rates for the six months ended June 30, 2009 and 2008 were 31.8% and 44.5%, respectively. Permanent items that impacted Kennedy-Wilson's effective tax rates as compared to the U.S. federal statutory rate of 35% were not materially different in amount during both periods.

NOTE 16 SUBSEQUENT EVENTS

On September 8, 2009, Kennedy-Wilson entered into an Agreement and Plan of merger (the "merger agreement") by and among Kennedy-Wilson, Prospect and merger Sub, a newly formed and wholly-owned subsidiary of Prospect, pursuant to which merger Sub will merge with and into Kennedy-Wilson, with Kennedy-Wilson continuing as the surviving corporation and a wholly-owned subsidiary of Prospect.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Pursuant to the merger agreement, common stockholders of Kennedy-Wilson will receive as consideration 3.8031 shares of Prospect common stock for each share of Kennedy-Wilson's common stock outstanding and preferred stockholders will receive as consideration 105.6412 shares of Prospect's common stock for each share of preferred stock outstanding, for an aggregate consideration of 26 million shares of Prospect common stock. In addition, 2.475 million shares of Prospect common stock will be reserved for issuance to employees, nonemployees and management of Kennedy-Wilson pursuant to an equity compensation plan adopted by Prospect's board of directors and submitted to Prospect's stockholders for approval.

F-71

AGREEMENT AND PLAN OF MERGER

BY AND AMONG

PROSPECT ACQUISITION CORP.,

KW MERGER SUB CORP.

AND

KENNEDY-WILSON, INC.

Dated as of September 8, 2009

Table of Contents

AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER dated as of September 8, 2009 (this "**Agreement**"), by and among PROSPECT ACQUISITION CORP., a company incorporated under the laws of Delaware ("**Prospect**"), KW MERGER SUB CORP., a company incorporated under the laws of Delaware and a wholly owned subsidiary of Prospect ("**Merger Sub**") and KENNEDY-WILSON, INC., a company incorporated under the laws of Delaware ("**KW**"). Each of the Parties to this Agreement is individually referred to herein as a "**Party**" and collectively as the "**Parties**." Capitalized terms used herein that are not otherwise defined herein shall have the meanings ascribed to them in Annex A hereto.

BACKGROUND

Prospect has formed a wholly owned subsidiary, Merger Sub, solely for the purposes of the merger of Merger Sub with and into KW pursuant to Section 251 of the General Corporation Law of the State of Delaware (the "**DGCL**"), in which KW will be the surviving corporation (the "**Merger**").

The board of directors of KW has declared this Agreement advisable and fair to, and in the best interests of, KW.

The Merger requires the affirmative vote of the holders of a majority of the issued and outstanding shares of common stock, par value \$0.01 per share of KW (the "**KW Common Stock**") and (ii) the affirmative vote of the holders of a majority of the shares of common stock of Prospect, par value \$0.0001 per share (the "**Prospect Common Stock**") sold in the Prospect Public Offering voted at the Prospect Stockholders' Meeting, *provided*, that the Merger will only proceed if holders of fewer than 30% of the shares of the Prospect Common Stock sold in the Prospect Public Offering exercise their conversion rights. Prior to the Closing, the holders of the convertible preferred stock of KW (the "**KW Preferred Stock**") and collectively with the KW Common Stock, the "**KW Securities**"), will agree to amend the Certificate of Designation of the KW Preferred Stock to provide that, upon the Closing, each share of KW Preferred Stock will be converted into the right to receive shares of Prospect Common Stock at the Preferred Stock Exchange Ratio.

Concurrently with the execution of this Agreement, Prospect, the Prospect Founders, De Guardiola Advisors, Inc. ("**DGA**"), De Guardiola Advisors Holdings, Inc. ("**DGAH**") and KW are entering into a letter agreement, of even date herewith (the "**Forfeiture Agreement**"), in the form attached hereto as *Exhibit A*, pursuant to which, subject to the terms and conditions set forth therein (i) the Prospect Founders have agreed to the forfeiture and cancellation of 2.575 million shares of Prospect Common Stock and (ii) Prospect has agreed to issue to DGAH an aggregate of 375,000 shares of Prospect Common Stock upon the closing of the transactions contemplated by this Agreement in satisfaction of an obligation of Prospect under its engagement letter with DGA.

The parties intend that the Merger contemplated herein constitute a tax-free reorganization with the meaning of Section 368(a) of the Code and hereby adopt this Agreement as a plan of reorganization within the meaning of the Code.

NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants and agreements set forth herein, and intending to be legally bound hereby, the Parties agree as follows:

ARTICLE I

The Merger

Section 1.1 *The Merger.* At the Merger Effective Time (as defined in Section 1.2), Merger Sub will be merged with and into KW in accordance with Section 251 of the DGCL and this Agreement, and the separate corporate existence of Merger Sub will thereupon cease. KW (sometimes hereinafter

Table of Contents

referred to as the "**Surviving Corporation**") will be the surviving corporation in the Merger. The Merger will have the effects specified in the DGCL. The name of the Surviving Corporation will be Kennedy-Wilson, Inc.

Section 1.2 *Merger Effective Time.* As soon as practicable following the satisfaction or, to the extent permitted by applicable Law, waiver of the conditions to the Closing set forth in Article VIII, if this Agreement shall not have been terminated prior thereto as provided in Article X, the parties hereto shall cause the Merger to be consummated by filing a certificate of merger (the "**Certificate of Merger**") meeting the requirements of Section 251 of the DGCL to be properly executed and filed in accordance with the applicable requirements of the DGCL. The Merger shall become effective at the time designated in the Certificate of Merger as the effective time of the Merger that the Parties shall have agreed upon and designated, or if no such time has been designated, on filing (the "**Merger Effective Time**").

Section 1.3 *Effect of the Merger.* At the Merger Effective Time, the effect of the Merger shall be as provided in the applicable provisions of the DGCL. Without limiting the generality of the foregoing, and subject thereto, at the Merger Effective Time, except as otherwise provided herein, all the property, rights, privileges, powers and franchises of Merger Sub and KW shall become the debts, liabilities and duties of the Surviving Corporation.

Section 1.4 *Certificate of Incorporation; By-Laws.* The Certificate of Incorporation of KW in effect immediately prior to the Merger Effective Time shall be the Certificate of Incorporation of the Surviving Corporation, until duly amended in accordance with applicable Law. The bylaws of KW in effect immediately prior to the Merger Effective Time shall be the bylaws of the Surviving Corporation, until duly amended in accordance with applicable Law.

Section 1.5 *Directors of Surviving Corporation.* Immediately prior to the Merger Effective Time, one of the directors of KW shall resign. The remaining directors of KW immediately prior to the Merger Effective Time shall be the directors of the Surviving Corporation along with one additional director to be appointed by Prospect, until the earlier of their death, resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

Section 1.6 *Officers of Surviving Corporation.* The officers of KW immediately prior to the Merger Effective Time shall be the officers of the Surviving Corporation, until the earlier of their death, resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

Section 1.7 *Conversion of Stock in the Merger.* At the Merger Effective Time, by virtue of the Merger and without any action on the part of the holder of any shares:

(a) *Conversion of KW Securities.* Subject to Section 1.7(f), each share of KW Common Stock issued and outstanding immediately prior to the Merger Effective Time shall be automatically converted into the right to receive 3.8031 shares of Prospect Common Stock ("**Common Stock Exchange Ratio**"). Each share of KW Preferred Stock issued and outstanding immediately prior to the Merger Effective Time shall be automatically converted into the right to receive 105.6412 shares of Prospect Common Stock ("**Preferred Stock Exchange Ratio**," and together with the Common Stock Exchange Ratio, the "**Exchange Ratio**"). The total number of shares of Prospect Common Stock issued in the Merger as a result of the conversion of the KW Securities into shares of Prospect Common Stock ("**Conversion Shares**") shall equal 26 million shares, *minus* any shares of Prospect Common Stock that would otherwise have been issuable to holders of Dissenting Shares had such holders not exercised Dissent Rights, *plus* the aggregate number of additional shares paid pursuant to Section 1.7(g).

Table of Contents

(b) *Conversion of Merger Sub Shares.* Each issued and outstanding share of the capital stock of Merger Sub shall be converted into and become one fully-paid and nonassessable common share, no par value, of the Surviving Corporation.

(c) *KW Stock Rights Become Prospect Stock Rights.* All KW Stock Rights then outstanding shall remain outstanding and shall be assumed by Prospect and thereafter become Prospect Stock Rights. Each KW Stock Right by virtue of becoming a Prospect Stock Right shall be exercisable upon the same terms and conditions as in effect immediately prior to the Merger, except that upon the exercise of such Prospect Stock Rights, shares of Prospect Common Stock shall be issuable in lieu of KW Common Stock. The number of shares of Prospect Common Stock issuable upon the exercise of a Prospect Stock Right immediately after the Merger Effective Time and the exercise price of each such Prospect Stock Right shall be equal to the number of shares and price as in effect immediately prior to the Merger Effective Time multiplied by the Common Stock Exchange Ratio (in the case of the number of shares) and the inverse of the Common Stock Exchange Ratio (in the case of the exercise price).

(d) *KW Securities Become Rights for Prospect Common Stock.* From and after the Merger Effective Time, all of the certificates which immediately prior to that time represented outstanding KW Securities (the "**KW Certificates**") shall be deemed for all purposes to evidence ownership of, and to represent, the shares of Prospect Common Stock into which such KW Securities have been converted as herein provided. The registered owner on the books and records of the Surviving Corporation or its transfer agent of any such KW Certificate shall have and be entitled to exercise any voting and other rights with respect to and to receive any dividend and other distributions upon the shares of Prospect Common Stock evidenced by such KW Certificate as above provided.

(e) *No Transfers of Pre-Merger KW Securities.* At or after the Merger Effective Time, there shall be no transfers on the stock transfer books of KW of the KW Securities which were outstanding immediately prior to the Merger Effective Time. If, after the Merger Effective Time, KW Certificates are presented to Prospect, the Surviving Corporation or their respective transfer agent or the Exchange Agent (defined in Section 1.8), the presented KW Certificates shall be cancelled and exchanged for certificates for shares of Prospect Common Stock deliverable in respect thereof pursuant to this Agreement in accordance with the procedures set forth herein.

(f) *KW Dissenting Shares.* Notwithstanding any other provisions of this Agreement to the contrary, KW Securities that are outstanding immediately prior to the Merger Effective Time and that are held by stockholders who shall not have voted in favor of the Merger or consented thereto in writing and who shall have demanded properly in writing appraisal ("**Dissent Rights**") for such shares (collectively, the "**Dissenting Shares**") in accordance with Section 262 of the DGCL or, if applicable, pursuant to Chapter 13 of the California General Corporation Law (the ("**CGCL**"), shall not be converted into or represent the right to receive shares of Prospect Common Stock. Such stockholders shall be entitled to receive payment of the appraised value of the Dissenting Shares held by them in accordance with the provisions of said Section 262 or, if applicable, said Chapter 13, except that all Dissenting Shares held by stockholders who shall have failed to perfect or who effectively shall have withdrawn or lost their rights to appraisal of such Dissenting Shares under such Section 262 or, if applicable, such Chapter 13, shall thereupon be deemed to have been converted into and to have become exchangeable, as of the Merger Effective Time, for the right to receive, without any interest thereon, the shares of Prospect Common Stock in the manner provided in subparagraph (a) above.

(g) *Fractional Shares.* No certificates or scrip representing fractional shares of Prospect Common Stock will be issued in the Merger, but in lieu thereof, the number of shares of Prospect Common Stock to be delivered to each holder of shares of KW Securities shall be rounded up to the nearest whole share.

Table of Contents

(h) *Lost, Stolen or Destroyed Certificates.* In the event any KW Certificates shall have been lost, stolen or destroyed, the Exchange Agent shall issue in exchange for such lost, stolen or destroyed certificates upon the making of an affidavit of that fact by the holder thereof, the shares of Prospect Common Stock contemplated to be paid and transferred to the holder of KW Securities represented by such KW Certificates; provided, however, that Prospect may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificates to deliver a bond in such sum as it may reasonably direct as indemnity against any claim that may be made against Prospect with respect to the certificates alleged to have been lost, stolen or destroyed.

(i) *Withholding Rights.* Each of Prospect, the Surviving Corporation and the Exchange Agent shall be entitled to deduct and withhold from the number of shares of Prospect Common Stock otherwise deliverable under this Agreement (or any payments made in respect of any Dissenting Shares), such amounts as Prospect, the Surviving Corporation and the Exchange Agent may reasonably determine are required to be deducted and withheld with respect to such delivery and payment under the Code or any provision of state, local, provincial or foreign tax law. To the extent that any amounts are so withheld all appropriate evidence of such deduction and withholding, including any receipts or forms required in order for the Person with respect to whom such deduction and withholding occurred to establish the deduction and withholding and payment to the appropriate authority as being for its account with the appropriate authorities, shall be delivered to the Person with respect to whom such deduction and withholding has occurred, and such withheld amounts shall be treated for all purposes as having been delivered and paid to the Person otherwise entitled to the consideration in respect of which such deduction and withholding was made. Notwithstanding the foregoing, Prospect or the Exchange Agent, at its option, may require any such amounts required to be deducted and withheld from any Prospect Common Stock or payments made in respect of any Dissenting Shares deliverable hereunder to be reimbursed in cash to Prospect or the Exchange Agent, as the case may be, prior to the issuance of such Prospect Common Stock hereunder.

Section 1.8 *Exchange Agent.* As of the Merger Effective Time, Prospect shall enter into an agreement with the transfer agent of Prospect Common Stock (the "**Exchange Agent**") authorizing such Exchange Agent to act as exchange agent in connection with the Merger. The Exchange Agent shall, pursuant to irrevocable instructions, deliver the Prospect Common Stock contemplated to be paid and transferred to the holders of KW Securities hereunder upon surrender of a KW Certificate. Each KW Certificate representing shares of KW Common Stock or KW Preferred Stock shall be deemed at any time after the Merger Effective Time to evidence only the right to receive upon such surrender the consideration described in Section 1.7(a).

Section 1.9 *Closing.* The Closing (the "**Closing**") of the Merger and the other transactions contemplated hereby shall take place on or prior to November 13, 2009 at the offices of Loeb & Loeb LLP in New York, New York commencing at 9:00 a.m. local time on the third business day following the satisfaction or waiver of all conditions and obligations of the Parties to consummate the transactions contemplated hereby (other than conditions and obligations with respect to the actions that the respective Parties will take at Closing) on such date and at such time as the Parties may mutually determine (the "**Closing Date**").

Section 1.10 *Further Assurances.* Subject to the terms and conditions of this Agreement, at any time or from time to time after the Closing, each of the Parties shall execute and deliver such other documents and instruments, provide such materials and information and take such other actions as may be commercially reasonable, to the extent permitted by law, to fulfill its obligations under this Agreement and to effectuate and consummate the transactions contemplated hereby.

Table of Contents

ARTICLE II

Representations and Warranties of KW

Subject to the exceptions set forth in the Disclosure Schedule of KW attached hereto as *Schedule II* (the "**KW Disclosure Schedule**"), KW represents and warrants to Prospect as of the date hereof and as of the Closing as follows:

Section 2.1 *Corporate Existence and Power.*

(a) *Corporate Existence and Power.* Each of KW and its Subsidiaries is duly organized, validly existing and in good standing (or such analogous concept as shall be applicable in the relevant jurisdiction) under the laws of its jurisdiction of incorporation. Each of KW and its Subsidiaries is duly qualified to do business in each of the jurisdictions in which property owned, leased or operated by it or the nature of the business which it conducts requires qualification, except where the failure to so qualify would not reasonably be expected, individually or in the aggregate, to result in a Material Adverse Effect. Each of KW and its Subsidiaries has all requisite power and authority to own, lease and operate its assets and properties and to carry on its business as now being conducted and, subject to necessary approvals of the relevant Governmental Authorities, as presently contemplated to be conducted. KW has delivered to Prospect true and complete copies of KW Constituent Instruments.

(b) *Capital Structure.* The registered capital of KW and the total number of shares and type of all authorized, issued and outstanding capital stock of KW and all shares of capital stock of KW reserved for issuance under KW's various option and incentive plans, are set forth in Section 2.1(b) of the KW Disclosure Schedule and included therein is a list of the record holders of the outstanding shares of capital stock of KW prepared by Mellon Investor Services, LLC, transfer agent for KW, which list indicates the number of KW Securities held by each such record holder. Except as set forth in Section 2.1(b) of the KW Disclosure Schedule: (i) no shares of capital stock or other voting securities of KW are issued, reserved for issuance or outstanding; (ii) all outstanding shares of the capital stock of KW are duly authorized, validly issued, fully paid and nonassessable and are not subject to or issued in violation of any purchase option, call option, right of first refusal, preemptive right, subscription right or any similar right under any provision of KW Constituent Instruments or any Contract to which KW is a party or otherwise bound; (iii) there are no bonds, debentures, notes or other indebtedness of KW having the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which holders of the shares of capital stock of KW may vote ("**Voting KW Debt**"); (iv) there are no options, warrants, rights, convertible or exchangeable securities, "phantom" stock rights, stock appreciation rights, stock-based performance units, commitments, Contracts, arrangements or undertakings of any kind to which KW is a party or is bound (A) obligating KW to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock or other equity interests in, or any security convertible or exercisable for or exchangeable into any capital stock of or other equity interest in, KW or any Voting KW Debt, (B) obligating KW to issue, grant, extend or enter into any such option, warrant, call, right, security, commitment, Contract, arrangement or undertaking or (C) giving any Person the right to receive any economic benefit or right similar to or derived from the economic benefits and rights occurring to holders of the capital stock of KW; (v) as of the date of this Agreement, there are no outstanding contractual obligations of KW to repurchase, redeem or otherwise acquire any shares of KW capital stock; and (vi) there are no arbitrations or litigation proceedings involving KW with respect to the share capital of KW or its Subsidiaries.

Section 2.2 *Authority; Execution and Delivery; Enforceability.* KW has all requisite corporate power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a party and to consummate the transactions contemplated hereby and thereby. The execution and

Table of Contents

delivery by KW of this Agreement and the consummation by it of the transactions contemplated hereby have been duly authorized and approved by the board of directors of KW and no other corporate proceedings on the part of it are necessary to authorize this Agreement and the transactions contemplated hereby (other than the approval of the KW stockholders). All action, corporate and otherwise, necessary to be taken by KW to authorize the execution, delivery and performance of this Agreement, the Transaction Documents and all other agreements and instruments delivered by KW in connection with the transactions contemplated hereby has been duly and validly taken. Each of this Agreement and the Transaction Documents to which KW is a party has been duly executed and delivered by it and constitutes the valid, binding, and enforceable obligation of it, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or similar laws of general application now or hereafter in effect affecting the rights and remedies of creditors and by general principles of equity (regardless of whether enforcement is sought in a proceeding at law or in equity).

Section 2.3 *Subsidiaries.* Section 2.3 of the KW Disclosure Schedule lists, as of the date hereof, all Subsidiaries of KW and indicates as to each the type of entity, its jurisdiction of organization and, its stockholders or other equity holders. Except as set forth in Section 2.3 of the KW Disclosure Schedule, KW does not directly or indirectly own any other equity or similar interest in, or any interest convertible or exchangeable or exercisable for, any equity or similar interest in, any corporation, partnership, joint venture or other business association or entity. Except as set forth in Section 2.3 of the KW Disclosure Schedule, KW is the direct or indirect owner of all outstanding shares of capital stock of its Subsidiaries, and all such shares are duly authorized, validly issued, fully paid and nonassessable and are owned by KW free and clear of all Liens (except for Permitted Liens). There are no outstanding subscriptions, options, warrants, puts, calls, rights, exchangeable or convertible securities or other commitments or agreements of any character relating to the issued or unissued capital stock or other securities of any Subsidiaries of KW or otherwise obligating any Subsidiaries of KW to issue, transfer, sell, purchase, redeem or otherwise acquire any such securities.

Section 2.4 *No Conflicts.* The execution and delivery of this Agreement or any of the Transaction Documents by KW and the consummation of the transactions contemplated hereby and compliance with the terms hereof and thereof will not, (a) except as set forth in Section 2.4(a) of the KW Disclosure Schedule, conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien (other than a Permitted Lien) upon any of the assets and properties of KW and its Subsidiaries under, any provision of: (i) any KW Constituent Instrument; or (ii) any Material Contract to which KW or any of its Subsidiaries is a party or to or by which it (or any of its assets and properties) is subject or bound; (b) subject to the filings and other matters referred to in Section 2.5, conflict with any material Judgment or Law applicable to KW and its Subsidiaries, or their respective properties or assets, (c) result in any suspension, revocation, impairment, forfeiture or nonrenewal of any Permit applicable to KW or its Subsidiaries; (d) terminate or modify, or give any third party the right to terminate or modify, the provisions or terms of any Contract to which KW or any of its Subsidiaries is a party; (e) cause KW or any of its Subsidiaries to become subject to, or to become liable for the payment of, any Tax; or (f) to KW's knowledge, cause any of the assets owned by KW or any of its Subsidiaries to be reassessed or revalued by any Governmental Authority, except, in the case of clauses (a)(ii), (b), (c), (d), (e) and (f) above, any such items that, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on KW.

Section 2.5 *Consents and Approvals.* Except as set forth in Section 2.5 of the KW Disclosure Schedule and except for the KW Stockholder Approval, no consent, approval, license, permit, order or authorization of, or registration, declaration or filing with (each, a "**Consent**"), or permit from any third party or any Governmental Authority is required to be obtained or made by or with respect to KW, in

Table of Contents

connection with the execution, delivery and performance of this Agreement or the consummation of the transactions contemplated hereby, including pursuant to any Material Contract, except for (a) such Consents as may be required under applicable state securities laws and the securities laws of any foreign country; and (b) such other Consents which, if not obtained or made, would not have a Material Adverse Effect on KW and would not prevent, or materially alter or delay, the consummation of any of the transactions contemplated hereby.

Section 2.6 *Financial Statements.*

(a) KW has delivered to Prospect its audited consolidated financial statements as of and for the fiscal years ended December 31, 2006, 2007 and 2008 and its unaudited consolidated financial statements for the six-month period ended June 30, 2009 (collectively, the "**KW Financial Statements**") prepared in accordance with U.S. GAAP applied on a consistent basis throughout the periods indicated, *provided* that the financial statements as of and for the six months ended June 30, 2009 are subject to normal year end audit adjustments that are not expected to have a Material Adverse Effect on KW and such statements do not contain notes. The KW Financial Statements fairly present in all material respects the financial condition and operating results, change in stockholders' equity and cash flow of KW and its Subsidiaries, as of the dates, and for the periods, indicated therein, and are accompanied by an unqualified opinion of an internationally recognized and U.S. registered independent public accounting firm qualified to practice before the Public Company Accounting Oversight Board. KW does not have any material liabilities or obligations, contingent or otherwise, other than (a) liabilities incurred in the ordinary course of business subsequent to June 30, 2009, and (b) obligations under contracts and commitments incurred in the ordinary course of business and not required under U.S. GAAP to be reflected in KW Financial Statements, which, in both cases, individually or in the aggregate, would not be reasonably expected to result in a Material Adverse Effect on KW.

(b) KW does not have any Off-Balance Sheet Arrangements.

Section 2.7 *Internal Accounting Controls.* KW has implemented and maintains a system of internal accounting controls sufficient to provide reasonable assurance that (a) transactions are executed in accordance with management's general or specific authorizations, (b) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain asset accountability, (c) access to assets is permitted only in accordance with management's general or specific authorization, and (d) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Section 2.8 *Absence of Certain Changes or Events.* Except as disclosed in the KW Financial Statements and except for changes as a result of actions taken in the ordinary course of business or pursuant to the terms of this Agreement or the Transaction Documents and the transactions contemplated hereby or thereby, from June 30, 2009 to the date of this Agreement, KW and its Subsidiaries have not taken any action which would result in:

(a) any change in the assets, liabilities, financial condition or operating results of KW or any of its Subsidiaries, except changes in the ordinary course of business that have not caused, in the aggregate, a Material Adverse Effect on KW;

(b) any material change in any compensation arrangement or agreement with any employee, officer, director or stockholder;

(c) other than the cancellation of the loan in the aggregate principal amount of \$3,543,127, plus accrued interest, to William McMorrow, any waiver or compromise by KW or any of its Subsidiaries of a valuable right or of a material debt owed to it;

Table of Contents

(d) any material loan, promissory note, mortgage, pledge, transfer of a security interest in, or Lien, created by KW or any of its Subsidiaries, with respect to any of their respective material properties or assets, except for Permitted Liens;

(e) any loans or guarantees made by KW or any of its Subsidiaries to or for the benefit of its employees, officers or directors, or any members of their immediate families, in each case, other than travel advances and other advances made in the ordinary course of its business;

(f) any declaration, accrual, set aside or payment of dividend or any other distribution of cash or other property or redemption, in respect of any shares of capital stock of KW or any of its Subsidiaries, other than up to \$3 million in connection with KW's stock buyback program and any dividend payments on the KW Preferred Stock required by KW's Certificate of Designation for the KW Preferred Stock;

(g) any issuance of equity securities to any officer, director or Affiliate, except pursuant to existing KW option plans;

(h) any amendment to any KW Constituent Instruments, or any merger, consolidation, share exchange, business combination, recapitalization, reclassification of shares, stock split, reverse stock split or similar transaction involving KW or any of its Subsidiaries; or

(i) any negotiations, arrangement or commitment by KW or any of its Subsidiaries to do any of the things described in this Section 2.8.

Section 2.9 *No Undisclosed Liabilities.* Except as set forth in Section 2.9 of the KW Disclosure Schedule, neither KW nor any of its Subsidiaries has any material obligations or liabilities of any nature (matured or unmatured, fixed or contingent, including any obligations to issue capital stock or other securities of KW) due after the date hereof, other than (a) those set forth or adequately provided for in the KW Balance Sheet, (b) those incurred in the ordinary course of business and not required to be set forth in the KW Balance Sheet under U.S. GAAP, (c) those incurred in the ordinary course of business since the KW Balance Sheet date and not reasonably likely to result in a Material Adverse Effect to KW, and (d) those incurred in connection with the execution of this Agreement.

Section 2.10 *Litigation.* There is no private or governmental action, suit, inquiry, notice of violation, claim, arbitration, audit, proceeding (including any partial proceeding such as a deposition) or investigation ("**Action**") pending or to the Knowledge of KW, threatened in writing against or affecting KW, any of its officers or directors (in their capacities as such), any of its Subsidiaries or any of their properties, before or by any Governmental Authority which (a) adversely affects or challenges the legality, validity or enforceability of this Agreement or (b) could, if there were an unfavorable decision, individually or in the aggregate, have or reasonably be expected to result in a Material Adverse Effect on KW. There is no Judgment imposed upon KW, or to the Knowledge of KW, any of its officers or directors (in their capacities as such), any of its Subsidiaries or any of their respective properties, that would prevent, enjoin, alter or materially delay any of the transactions contemplated by this Agreement, or that would reasonably be expected to have a Material Adverse Effect on KW. Neither KW nor any of its Subsidiaries nor, to the Knowledge of KW, any director or officer thereof (in his or her capacity as such), is or has been the subject of any Action involving a material claim or material violation of or material liability under the securities laws of any Governmental Authority or a material claim of breach of fiduciary duty.

Section 2.11 *Licenses, Permits, Etc.* KW and its Subsidiaries possess or will possess prior to the Closing all Material Permits. Such Material Permits are described or set forth on Section 2.11 of the KW Disclosure Schedule. True, complete and correct copies of the Material Permits issued to KW and its Subsidiaries have previously been delivered to Prospect. As of the date of this Agreement, all such Material Permits are in full force and effect. Unless otherwise stipulated herein, KW, its Subsidiaries and each of their respective officers, directors, employees, representatives and agents have complied

Table of Contents

with all terms of such Material Permits, except where instances of such noncompliance, individually or in the aggregate, have not had and would not reasonably be expected to have, a Material Adverse Effect on KW.

Section 2.12 *Title to Properties.*

(a) *Real Property.* Section 2.12(a) of the KW Disclosure Schedule contains an accurate and complete list and description of all real properties with respect to which KW directly or indirectly holds a 50% or greater interest (collectively, the "**Real Property**"). Neither KW nor any of its Subsidiaries is in default under any of the Real Estate Leases and the officers of KW are not aware of any default by any of the lessors thereunder, except any such default that, individually or in the aggregate, have not had and would not be reasonably expected to have, a Material Adverse Effect on KW. Section 2.12(a) of the KW Disclosure Schedule also sets forth a complete list of each Real Estate Lease which involves an annual rental payment of \$750,000 or more.

(b) *Tangible Personal Property.* Except as would not reasonably be expected to have a Material Adverse Effect on KW, KW and its Subsidiaries are in possession of and have good title to, or have valid leasehold interests in or valid contractual rights to use all material tangible personal property used in the conduct of their business, including the tangible personal property reflected in the KW Financial Statements and material tangible personal property acquired since June 30, 2009 (collectively, the "**Tangible Personal Property**"). All Tangible Personal Property is free and clear of all Liens, other than Permitted Liens, and is in good order and condition, ordinary wear and tear excepted, and its use complies in all material respects with all applicable Laws.

(c) *Accounts Receivable.* The accounts receivable of KW and each of its Subsidiaries reflected on the KW Financial Statements and created after June 30, 2009 but prior to the Closing Date are bona fide accounts receivable created in the ordinary course of business.

Section 2.13 *Intellectual Property.* KW and its Subsidiaries own or are validly licensing or otherwise have the right to use any patents, trademarks, trade names, service marks, domain names, copyrights, and any applications therefore, trade secrets, computer software programs, and tangible or intangible proprietary information or material which are material to the conduct of their business taken as a whole (the "**Intellectual Property Rights**"). No claims are pending or, to the Knowledge of KW, threatened in writing that KW or any of its Subsidiaries is infringing or otherwise adversely affecting the rights of any Person with regard to any Intellectual Property Right. To the Knowledge of KW, no Person is infringing the rights of KW or any of its Subsidiaries with respect to any Intellectual Property Right. None of KW or its Subsidiaries has received any notice regarding the infringement, misappropriation or other violation by KW or any of its Subsidiaries of any intellectual property rights of any third party. To the knowledge of KW, neither the conduct of the business of KW or any Subsidiary, nor the provision of services by KW or any Subsidiary has infringed, misappropriated or otherwise violated, or infringes, misappropriates or otherwise violates, any intellectual property rights of any third party.

Section 2.14 *Taxes.* Except as disclosed in Section 2.14 of the KW Disclosure Schedule:

(a) KW and its Subsidiaries have timely filed, or have caused to be timely filed on their behalf, all Tax Returns that are or were required to be filed by or with respect to any of them, either separately or as a member of a group of corporations, pursuant to applicable Legal Requirements, except to the extent any failure to timely file any Tax Returns, either individually or in the aggregate, have not and would not reasonably be expected to have a Material Adverse Effect on KW. All Tax Returns filed by (or that include on a consolidated basis) KW and its Subsidiaries are (and, as to a Tax Return not filed as of the date hereof, and filed on or before the Closing Date, will be) in all respects true, complete and accurate, except to the extent any inaccuracies in any filed Tax Returns, individually or in the aggregate, have not and would not

Table of Contents

reasonably be expected to have a Material Adverse Effect on KW. To the Knowledge of KW, there are no unpaid Taxes claimed to be due by any Governmental Authority in charge of taxation of any jurisdiction, nor any claim for additional Taxes for any period for which Tax Returns have been filed, except to the extent any failure to file or any inaccuracies in any filed Tax returns, individually or in the aggregate, have not and would not reasonably be expected to have a Material Adverse Effect on KW.

(b) Neither KW nor any of its Subsidiaries has received any written notice that any Governmental Authority will audit or examine (except for any general audits or examinations routinely performed by such Governmental Authorities), seek information with respect to, or make material claims or assessments with respect to any Taxes for any period since January 1, 2004.

(c) The KW Financial Statements reflect an adequate reserve, established in accordance with U.S. GAAP, for all Taxes known to be payable by KW and its Subsidiaries (in addition to any reserve for deferred Taxes to reflect timing differences between book and Tax items) for all taxable periods and portions thereof through the date of such financial statements. None of KW or its Subsidiaries is a party to or bound by any Tax indemnity, Tax sharing or similar agreement and KW and its Subsidiaries currently have no material liability, and will not have any material liabilities, for any Taxes of any other Person under any agreement or by the operation of any Law. No deficiency with respect to any Taxes has been proposed, asserted or assessed against KW or its Subsidiaries, except to the extent any such deficiency, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect on KW.

(d) Neither KW nor any of its Subsidiaries has executed any outstanding waivers or comparable consents regarding the application of the statute of limitations with respect to any Taxes or Tax Returns.

(e) There are no Tax Liens upon any of the assets or properties of KW or any of its Subsidiaries, other than with respect to Taxes not yet due and payable.

(f) All Taxes required to be withheld, collected or deposited by or with respect to KW and each of its Subsidiaries have been timely withheld, collected or deposited, as the case may be, and to the extent required, have been paid to the relevant taxing authority.

Section 2.15 *Employment and Employee Benefits Matters.*

(a) Section 2.15 of the KW Disclosure Schedule sets forth a complete and accurate list of each bonus, pension, profit sharing, deferred compensation, incentive compensation, stock ownership, stock purchase, stock option, phantom stock, retirement, vacation, severance, disability, death benefit, hospitalization, medical or other material plan, arrangement or understanding, including, but not limited to, each employee benefit plan as defined in ERISA Section 3(3), whether or not subject to ERISA, which is maintained by KW or any of its Subsidiaries, which is intended to provide benefits to current or former employees, directors, officers or independent contractors of KW or any of its Subsidiaries and/or their beneficiaries, or for which KW or any of its Subsidiaries has any liability, whether actual or contingent (collectively, the "**KW Benefit Plans**").

(b) KW has delivered to Prospect a true and complete copy of the following documents, to the extent that they are applicable, with respect to each KW Benefit Plan:

(i) the current plan document, any related funding agreements (e.g., trust agreements or insurance contracts), and any custodial, administrative, recordkeeping, investment management and other service agreements, including all amendments thereto;

(ii) the current summary plan description and all subsequent summaries of material modifications;

Table of Contents

(iii) the most recent Internal Revenue Service determination letter for each KW Benefit Plan that is intended to qualify for favorable income tax treatment under Code Section 401(a) or 501(c)(9);

(iv) the three (3) most recent Form 5500s (including all applicable schedules and the opinions of the independent accountants) that were filed on behalf of the KW Benefit Plan and the three most recent actuarial reports; and

(v) any governmental advisory opinions, rulings, compliance statements, closing agreements and similar materials.

(c) Except to the extent that any failure to comply would not reasonably be expected to result in material liability to KW, each KW Benefit Plan has at all times been operated in accordance with its terms, and complies currently, and has complied in the past, both in form and in operation, and whether as a matter of substantive law or in order to maintain any intended tax qualification, with all applicable Legal Requirements, including COBRA, ERISA and the Code (including, but not limited to, Section 409A of the Code). All material contributions required to be made to each KW Benefit Plan under the terms of the plan, ERISA, the Code, or any other applicable Legal Requirements have been timely made.

(d) The Internal Revenue Service has issued a favorable determination letter with respect to each KW Benefit Plan that is intended to qualify under Section 401(a) of the Code and each trust intended to qualify under Section 501(a) of the Code (or, where such KW Benefit Plan is based upon a master and prototype or volume submitter form, the sponsor of such form has received a current opinion or advisory letter as to the form upon which KW is entitled to rely under applicable Internal Revenue Service procedures). No event has occurred and no condition has existed which could reasonably be expected to result in any KW Benefit Plan that is intended to qualify under Code Section 401(a) or Section 501(c)(9) to fail to so qualify or which requires or could reasonably be expected to require action under the compliance resolution program of the Internal Revenue Service to preserve its qualification.

(e) Other than routine claims for benefits under the KW Benefit Plans and those relating to qualified domestic relations orders, there are no (i) pending or (ii) threatened lawsuits, governmental investigations or other claims against or involving any KW Benefit Plan or any fiduciary (within the meaning of Section 3(21)(A) of ERISA) or service provider of any KW Benefit Plan, in any such case which could reasonably be expected to result in material liability of KW, nor is KW aware of any reasonable basis for any such lawsuit, investigation or claim.

(f) No KW Benefit Plan provides (or will provide) medical or other welfare benefits to one or more former employees or independent contractors (including retirees), other than benefits that are required to be provided pursuant to COBRA.

(g) No KW Benefit Plan holds any assets that include securities issued by KW or any of its Subsidiaries.

(h) KW and its Subsidiaries have not undertaken to maintain any KW Benefit Plan for any period of time and each such plan is terminable at the sole discretion of the sponsor thereof, subject only to such constraints as may imposed by applicable law.

(i) No KW Benefit Plan is, and none of KW or any of its Subsidiaries or ERISA Affiliates maintains or contributes to, or has within the last six years maintained or contributed to, or has any liability, whether actual or contingent, under, a plan subject to Title IV of ERISA or to the minimum funding requirements of Section 302 of ERISA or Section 412 of the Code. No KW Benefit Plan is or was within the last six years a multiemployer plan, as defined in Section 3(37) of ERISA, or a multiple employer plan, as described in Code Section 413(c) or ERISA Sections 4063

Table of Contents

or 4064, and neither KW nor any of its Subsidiaries or ERISA Affiliates have within the last six years contributed to or had an obligation to contribute to any such plan. None of the KW Benefit Plans are part of, or have at any time been part of, a multiple employer welfare arrangement, as that term is defined in ERISA Section 3(40).

(j) Except as disclosed in Section 2.15(j) of the KW Disclosure Schedule, the consummation of the transactions contemplated by this Agreement will not alone trigger any severance or termination agreements or arrangements between KW or any of its Subsidiaries and any of their respective current or former employees, officers or directors. Except as disclosed in Section 2.15(j) of the KW Disclosure Schedule, neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated by this Agreement will alone result in, cause the funding, accelerated vesting or delivery of, or increase the amount or value of, any payment or benefit to any employee of KW or any of its Subsidiaries. Except as disclosed in Section 2.15(j) of the KW Disclosure Schedule, neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated by this Agreement will alone result in excess parachute payments (within the meaning of Code Section 280G). Since June 30, 2009, there has not been any adoption or amendment in any material respect of any KW Benefit Plan.

(k) There are no collective bargaining or other labor union agreements to which KW or any of its Subsidiaries is a party or by which it is bound; (ii) no labor dispute exists or, to the Knowledge of KW, is imminent with respect to the employees of KW or any of its Subsidiaries; (iii) there is no strike, work stoppage or other labor dispute involving KW or any of its Subsidiaries pending or, to the Knowledge of KW, threatened; (iv) no complaint, charge or Actions by or before any Governmental Authority brought by or on behalf of any employee, prospective employee, former employee, retiree, labor organization or other representative of its employees is pending or threatened in writing against KW or any of its Subsidiaries; (v) no material grievance is pending or threatened in writing against KW or any of its Subsidiaries; (vi) neither KW nor any of its Subsidiaries is a party to, or otherwise bound by, any consent decree with, or citation by, any Governmental Authorities relating to employees or employment practices; and (vii) except to the extent that any such failure to comply would not reasonably be expected to result in material liability of KW, KW and its Subsidiaries have complied in all material respects with all applicable Legal Requirements relating to employment, employment termination, equal employment opportunity, nondiscrimination, nonharassment, nonretaliation, immigration, wages and other compensation, penalties, hours, benefits, workers' compensation, collective bargaining, the payment of social security and similar taxes, occupational safety and health, lay offs, and plant closings.

Section 2.16 *Transactions with Affiliates and Employees.* Except as disclosed in the KW Financial Statements or in Section 2.16 of the KW Disclosure Schedule, none of the officers, directors or employees of KW is presently a party, directly or indirectly, to any transaction with KW or any of its Subsidiaries that is required to be disclosed under Rule 404(a) of Regulation S-K (other than for services as employees, officers and directors), including any Contract providing for the furnishing of services to or by, providing for rental of real or personal property to or from, or otherwise requiring payments to or from any such officer, director or employee or, to the Knowledge of KW, any entity in which any such officer, director, or employee has a substantial interest or is an officer, director, trustee or partner.

Table of Contents

Section 2.17 *Insurance.* KW has previously made available to Prospect, prior to the date of this Agreement, true and correct schedules summarizing the terms of all contracts of insurance or indemnification to which KW or any of its Subsidiaries is a party, each of which is listed in Section 2.17 of the KW Disclosure Schedule. All such insurance policies are in full force and effect, all premiums due thereon have been paid and, to the Knowledge of KW, KW and each Subsidiary has complied with the material provisions of such policies. Neither KW nor any such Subsidiary has been advised of any defense to coverage in connection with any claim to coverage asserted or noticed by KW or any such Subsidiary under or in connection with any of their extant insurance policies. KW and its Subsidiaries are insured by insurers of recognized financial responsibility against such losses and risks and in such amounts as are prudent and customary in the businesses in which they are engaged and in the geographic areas where any of them engages in such businesses. KW and its Subsidiaries have no reason to believe that KW or its Subsidiaries will not be able to renew their existing insurance coverage as and when such coverage expires or to obtain similar coverage from similar insurers as may be necessary to continue their business on terms consistent with market for KW's or any of its Subsidiaries' respective lines of business.

Section 2.18 *Material Contracts.*

(a) KW is not in material violation of or in material default under (nor does there exist any condition which upon the passage of time or the giving of notice would cause such a violation of or default under) any Material Contract to which it or any of its Subsidiaries is a party or by which they or any of their respective properties or assets is bound, except for violations or defaults that would not, individually or in the aggregate, reasonably be expected to result in a Material Adverse Effect on KW; and, to the Knowledge of KW, no other Person has violated or breached, or committed any default under, any Material Contract, except for violations, breaches and defaults that, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on KW.

(b) Each Material Contract is listed in Section 2.18 of the KW Disclosure Schedule and was previously provided to Prospect (provided that Prospect acknowledges that KW has listed debt instruments for only five of the properties in which it has an interest) and has provided all of the guarantees by KW of debt relating to properties in which it has an interest. Assuming due authorization and execution by the other parties thereto, each Material Contract is a legal, valid and binding agreement, and is in full force and effect, and (i) neither KW nor any of its Subsidiaries is in breach or default of any Material Contract to which it is a party in any material respect; (ii) to the Knowledge of KW, no event has occurred or circumstance has existed that (with or without notice or lapse of time), will or would reasonably be expected to, (A) contravene, conflict with or result in a violation or breach of, or become a default or event of default under, any provision of any Material Contract; (B) permit KW or any other Person the right to declare a default or exercise any remedy under, or to accelerate the maturity or performance of, or to cancel, terminate or modify any Material Contract; (iii) neither KW nor any of its Subsidiaries has received written notice of any proposed cancellation, revocation or termination of any Material Contract to which it is a party; and (iv) there are no renegotiations of, or attempts to renegotiate, any material terms of any Material Contract. Since June 30, 2009, neither KW nor any of its Subsidiaries has received any written notice regarding any actual or possible violation or breach of, or default under, any Material Contract, except in each such case for defaults, acceleration rights, termination rights and other rights that have not had and would not reasonably be expected to have a Material Adverse Effect on KW.

Section 2.19 *Compliance with Applicable Laws.* To the Knowledge of KW, KW and its Subsidiaries are in compliance with all applicable Laws, including those relating to occupational health and safety and the environment, except for instances of noncompliance that, individually and in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on

Table of Contents

KW. Neither KW nor any of its Subsidiaries has received any written communication during the past two (2) years from a Governmental Authority alleging that KW or any such Subsidiary is not in compliance in any material respect with any applicable Law. This Section 2.19 does not relate to matters with respect to Taxes, which are the subject of Section 2.14.

Section 2.20 *Foreign Corrupt Practices.* None of KW or any of its Subsidiaries, nor any of their respective Representatives, has, in the course of its actions for, or on behalf of, KW or any of its Subsidiaries, directly or indirectly, (a) used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expenses relating to political activity; (b) made any direct or indirect unlawful payment to any Governmental Authority or any foreign or domestic government official or employee from corporate funds; (c) violated or is in violation of any provision of the U.S. Foreign Corrupt Practices Act of 1977, as amended, and the rules and regulations thereunder (the "**FCPA**"); or (d) made any unlawful bribe, rebate, payoff, influence payment, kickback or other unlawful payment in connection with the operations of KW or any such Subsidiary to any foreign or domestic government official or employee, except, in the case of clauses (a) and (b) above, any such items that, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on KW.

Section 2.21 *Money Laundering Laws.* KW and its Subsidiaries have conducted their business at all times in compliance with money laundering statutes in all applicable jurisdictions, the rules and regulations thereunder and any related or similar rules, regulations or guidelines, issued, administered or enforced by any Governmental Authority (collectively, the "**Money Laundering Laws**") and no proceeding involving KW with respect to the Money Laundering Laws is pending or, to the Knowledge of KW, was threatened in writing.

Section 2.22 *Governmental Inquiry.* Neither KW nor any of its Subsidiaries has received any material written inspection report, questionnaire, inquiry, demand or request for information from a Governmental Authority.

Section 2.23 *Records.* The books of account, minute books and shareholder records of KW and its Subsidiaries made available to Prospect are complete and accurate in all material respects, and there have been no material transactions involving KW or any of its Subsidiaries which are required to be set forth therein and which have not been so set forth.

Section 2.24 *Brokers; Schedule of Fees and Expenses.* Except as set forth in Section 2.24 of the KW Disclosure Schedule, no broker, investment banker, financial advisor or other Person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with this Agreement or the transactions based upon arrangements made by or on behalf of KW or any of its Subsidiaries.

Section 2.25 *OFAC.* None of KW, any director or officer of KW, or, to the Knowledge of KW, any agent, employee, affiliate or Person acting on behalf of KW is currently identified on the specially designated nationals or other blocked person list or otherwise currently subject to any U.S. sanctions administered by the Office of Foreign Assets Control of the U.S. Treasury Department ("**OFAC**"); and KW has not, directly or indirectly, used any funds, or loaned, contributed or otherwise made available such funds to any Subsidiary, joint venture partner or other Person, in connection with any sales or operations in Cuba, Iran, Syria, Sudan, Myanmar or any other country sanctioned by OFAC or for the purpose of financing the activities of any Person currently subject to, or otherwise in violation of, any U.S. sanctions administered by OFAC in the last five (5) fiscal years.

Section 2.26 *Environmental Matters.* To the Knowledge of KW, each of KW and its Subsidiaries is, and at all times has been, in substantial compliance with, and has not been and is not in material violation of or subject to any material liability under, any Environmental Law, and no proceeding involving KW or its Subsidiaries with respect to any Environmental Law is pending or, to the

Table of Contents

Knowledge of KW, has been threatened in writing. Except as listed on Schedule 2.26, KW has not (i) entered into any indemnification arrangements relating to Environmental Laws, or (ii) reserved any amounts on its balance sheet for violations of Environmental Laws. KW and its Subsidiaries are in compliance with the material terms of any settlements or other accommodations relating to Environmental Laws entered into with respect to any real property owned directly or indirectly by KW or its Subsidiaries.

Section 2.27 *Board Approval.* The Board of Directors of KW (including any required committee or subgroup of the KW Board of Directors) has, as of the date of this Agreement, (i) adopted resolutions approving the Merger and setting forth the terms and conditions thereof, and declared the advisability of and approved this Agreement and the transactions contemplated hereby and (ii) determined that the transactions contemplated hereby are in the best interests of the stockholders of KW.

Section 2.28 *Proxy Statement/Prospectus.* The information to be supplied in writing by KW for inclusion in Prospect's proxy statement/prospectus (such proxy statement/prospectus as amended or supplemented is referred to herein as the "**Proxy Statement/Prospectus**"), which shall be included in Prospect's Registration Statement on Form S-4 (the "**Registration Statement**") shall not at the time the Proxy Statement/Prospectus is first mailed, at the time of the Prospect Stockholders' Meeting and at the time of the filing with the SEC, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading. If at any time prior to the Closing, any event relating to KW, any of its Subsidiaries or their respective officers or directors should be discovered by KW which should be set forth in a supplement to the Proxy Statement/Prospectus, KW shall promptly inform Prospect. Notwithstanding the foregoing, KW makes no representation or warranty with respect to any information supplied by Prospect or any Person other than KW which is contained in the Proxy Statement/Prospectus.

Section 2.29 *Tax Representations Regarding Tax-Free Reorganization.*

(a) Immediately following the Merger, KW will hold at least seventy percent (70%) of the fair market value of its net assets and at least ninety percent (90%) of the fair market value of its gross assets that it held immediately prior to the Merger. For purposes of this representation, amounts paid by KW to dissenters, amounts paid by KW to stockholders who receive cash or other property, amounts used by KW to pay expenses incurred in connection with the Merger, and all redemptions and distributions (other than regular, normal dividends) made by KW are included as assets of KW immediately prior to the Merger.

(b) KW has no plan or intention to issue additional shares of its stock that would result in Prospect losing control of KW within the meaning of Section 368(c) of the Code. At the time of the Merger, KW will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in KW that, if exercised or converted, would affect Prospect's acquisition of control of KW as defined in Section 368(c) of the Code.

(c) KW is not an investment company as defined in Section 368(a)(2)(F)(iii) and (iv) of the Code.

(d) KW is not under the jurisdiction of the court in a Title 11 or similar case within the meaning of Section 368(a)(3)(A) of the Code.

Table of Contents

ARTICLE III

Representations and Warranties of Prospect

Except as set forth in the Disclosure Schedule of Prospect attached hereto as *Schedule III* (the "**Prospect Disclosure Schedule**"), Prospect represents and warrants to KW as follows:

Section 3.1 *Capital Structure.*

(a) Section 3.1(a) of the Prospect Disclosure Schedule sets forth, as of the date hereof, the share capitalization of Prospect and Merger Sub and all the outstanding options, warrants or rights to acquire any share capital of Prospect and Merger Sub. Other than as set forth in Section 3.1(a) of the Prospect Disclosure Schedule: (i) there are no options, warrants or other rights outstanding which give any Person the right to acquire any share capital of Prospect or Merger Sub or to subscribe to any increase of any share capital of Prospect or Merger Sub; and (ii) there are no disputes, arbitrations or litigation proceedings involving Prospect or Merger Sub with respect to the share capital of Prospect or Merger Sub.

(b) Except as set forth in Section 3.1(b) of the Prospect Disclosure Schedule: (i) no shares of capital stock or other voting securities of Prospect or Merger Sub were issued, reserved for issuance or outstanding and there have not been any issuances of capital securities or options, warrants or rights to acquire the capital securities of Prospect or Merger Sub; (ii) all outstanding shares of the capital stock of Prospect and Merger Sub are, and all such shares that may be issued prior to the date hereof will be when issued, duly authorized, validly issued, fully paid and nonassessable and not subject to or issued in violation of any purchase option, call option, right of first refusal, preemptive right, subscription right or any similar right under any provision of the DGCL, Prospect Constituent Instruments (as defined in Section 3.2) or any Contract to which Prospect or Merger Sub is a party or otherwise bound; and (iii) there are no outstanding contractual obligations of Prospect or Merger Sub to repurchase, redeem or otherwise acquire any shares of capital stock of Prospect or Merger Sub.

(c) Except as set forth in Section 3.1(c) of the Prospect Disclosure Schedule, as of the date of this Agreement: (i) there are no bonds, debentures, notes or other indebtedness of Prospect or Merger Sub having the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which holders of Prospect Common Stock may vote ("**Voting Prospect Debt**"); and (ii) there are no options, warrants, rights, convertible or exchangeable securities, "phantom" stock rights, stock appreciation rights, stock-based performance units, commitments, Contracts, arrangements or undertakings of any kind to which Prospect or Merger Sub is a party or by which it is bound (A) obligating Prospect or Merger Sub to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock or other equity interests in, or any security convertible or exercisable for or exchangeable into any capital stock of or other equity interest in, Prospect or Merger Sub or any Voting Prospect Debt, or (B) obligating Prospect or Merger Sub to issue, grant, extend or enter into any such option, warrant, call, right, security, commitment, Contract, arrangement or undertaking.

Section 3.2 *Organization and Standing.* Each of Prospect and Merger Sub is duly organized, validly existing and in good standing under the laws of the State of Delaware. Each of Prospect and Merger Sub is duly qualified to do business in each of the jurisdictions in which the property owned, leased or operated by Prospect or Merger Sub or the nature of the business which it conducts requires qualification, except where the failure to so qualify would not reasonably be expected to have a Material Adverse Effect on Prospect. Each of Prospect and Merger Sub has the requisite power and authority to own, lease and operate its tangible assets and properties and to carry on its business as now being conducted and, subject to necessary approvals of the relevant Governmental Authorities, as presently contemplated to be conducted. Prospect has delivered to KW true and complete copies of the

Table of Contents

certificate of incorporation of Prospect and Merger Sub, as amended to the date of this Agreement and the bylaws of Prospect and Merger Sub, as amended to the date of this Agreement (the "*Prospect Constituent Instruments*").

Section 3.3 *Authority; Execution and Delivery; Enforceability.* Each of Prospect and Merger Sub has all requisite corporate power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a Party and to consummate the transactions contemplated hereby. The execution and delivery by Prospect of this Agreement and the consummation by Prospect and Merger Sub of the transactions contemplated hereby have been duly authorized and approved by the Prospect Board and no other corporate proceedings on the part of Prospect and Merger Sub are necessary to authorize this Agreement and the transactions contemplated hereby. Other than the Prospect Stockholder Approval, all action, corporate and otherwise, necessary to be taken by Prospect and Merger Sub to authorize the execution, delivery and performance of this Agreement, the Transaction Documents and all other agreements and instruments delivered by Prospect and Merger Sub in connection with the transactions contemplated hereby has been duly and validly taken. Each of this Agreement and the Transaction Documents to which Prospect and Merger Sub is a Party has been duly executed and delivered by Prospect and Merger Sub and constitutes the valid, binding, and enforceable obligation of Prospect and Merger Sub, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or similar laws of general application now or hereafter in effect affecting the rights and remedies of creditors and by general principles of equity (regardless of whether enforcement is sought in a proceeding at law or in equity).

Section 3.4 *No Subsidiaries or Equity Interests.* Neither Prospect nor Merger Sub owns, directly or indirectly, any capital stock, membership interest, partnership interest, joint venture interest or other equity interest in any Person other than Prospect's ownership interest in Merger Sub prior to the Merger Effective Time.

Section 3.5 *No Conflicts.* Except as set forth in Section 3.5 of the Prospect Disclosure Schedule, the execution and delivery of this Agreement or any of the Transaction Documents by Prospect and Merger Sub and the consummation of the transactions and compliance with the terms hereof and thereof will not, (a) conflict with, or result in any violation of or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien (other than a Permitted Lien) upon any of the assets and properties of Prospect and Merger Sub under, any provision of: (i) any Prospect Constituent Instrument; (ii) any Prospect Material Contract (as defined in Section 3.21 hereof) to which Prospect or Merger Sub is a party or to or by which it (or any of its assets and properties) is subject or bound; or (iii) any Material Permit; (b) subject to the filings and other matters referred to in Section 3.6, conflict with any material Judgment or Law applicable to Prospect or Merger Sub, or its properties or assets; (c) result in any suspension, revocation, impairment, forfeiture or nonrenewal of any Permit applicable to Prospect or Merger Sub; (d) terminate or modify, or give any third party the right to terminate or modify, the provisions or terms of any Prospect Material Contract; or (e) cause any of the assets owned by Prospect or Merger Sub to be reassessed or revalued by any Governmental Authority, except, in the case of clauses (a)(ii), (a)(iii), (b), (c), (d) and (e) above, any such items that, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on Prospect.

Section 3.6 *Consents and Approvals.* Except as set forth in Section 3.6 of the Prospect Disclosure Schedule, no consent of, or registration, declaration or filing with, or permit from, any Governmental Authority is required to be obtained or made by or with respect to Prospect or Merger Sub in connection with the execution, delivery and performance of this Agreement or the consummation of the transactions contemplated hereby, other than (i) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware as provided in Section 1.2; (ii) the filing with, clearance and

Table of Contents

declaration of effectiveness by the SEC of the Registration Statement and the Prospect Stockholder Approvals and the approval of the Prospect Warrant Agreement Amendment at the Prospect Warrant holders Meeting; (iii) consents, waivers, approvals, orders, authorizations, registrations, declarations, notices and filings required under the HSR Act and other applicable antitrust or competition Laws, if any; (iv) the filing of a Form 8-K with the SEC within four (4) business days after the execution of this Agreement and of the Closing Date; (v) any filings as required under applicable securities laws of the United States and the securities laws of any foreign country; (vi) any filing required by the AMEX; and (vii) the procurement of such other consents, authorizations, filings, approvals and registrations which, if not obtained or made, would not have a Material Adverse Effect on Prospect and would not prevent, or materially alter or delay, consummation of any of the transactions contemplated hereby.

Section 3.7 *SEC Documents.* Prospect has filed all reports, schedules, forms, statements and other documents required to be filed by Prospect with the SEC since November 13, 2007, pursuant to Sections 13(a), 14(a) and 15(d) of the Exchange Act (the "**Prospect SEC Documents**"). As of its respective filing date, each Prospect SEC Document complied in all material respects with the requirements of the Exchange Act and the rules and regulations of the SEC promulgated thereunder applicable to such Prospect SEC Document, and did not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. Except to the extent that information contained in any Prospect SEC Document has been revised or superseded by a later filed Prospect SEC Document, none of the Prospect SEC Documents contains any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The consolidated financial statements of Prospect included in the Prospect SEC Documents (the "**Prospect Financial Statements**") comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with U.S. GAAP (except, in the case of unaudited statements, as permitted by the rules and regulations of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present the financial position of Prospect as of the dates thereof and the results of its operations and cash flows as at the respective dates of and for the periods referred to in such financial statements (subject, in the case of unaudited financial statements, to normal year-end audit adjustments and the omission of notes to the extent permitted by Regulation S-X of the SEC).

Section 3.8 *Internal Accounting Controls.* Prospect maintains a system of internal accounting controls sufficient to provide reasonable assurance that (a) transactions are executed in accordance with management's general or specific authorizations, (b) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain asset accountability, (c) access to assets is permitted only in accordance with management's general or specific authorization, and (d) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. Prospect's officers have established disclosure controls and procedures for Prospect and designed such disclosure controls and procedures to ensure that material information relating to Prospect is made known to the officers by others within those entities. Prospect's officers have evaluated the effectiveness of Prospect's controls and procedures and there is no material weakness, significant deficiency or control deficiency, in each case as such term is defined in Public Company Accounting Oversight Board Auditing Std. No. 2. Since June 30, 2009, there have been no significant changes in Prospect's internal controls or, to Prospect's Knowledge, in other factors that could significantly affect Prospect's internal controls.

Table of Contents

Section 3.9 *Absence of Certain Changes or Events.* Except as disclosed in Section 3.9 of the Prospect Disclosure Schedule, from the date of the most recent audited financial statements included in the filed Prospect SEC Documents to the date of this Agreement, there has not been:

- (a) any change in the assets, liabilities, financial condition or operating results of Prospect, except changes in the ordinary course of business that have not caused, in the aggregate, a Material Adverse Effect on Prospect;
- (b) any material change in any compensation arrangement or agreement with any employee, officer, director or stockholder;
- (c) any resignation or termination of employment of the Chief Executive Officer, Chief Financial Officer, President or the Secretary of Prospect;
- (d) any waiver or compromise by Prospect or Merger Sub of a valuable right or material debt owed to it;
- (e) any loan, promissory note, mortgage, pledge, transfer of a security interest in, or Lien, created by Prospect or Merger Sub, with respect to any of its material properties or assets, except for Permitted Liens;
- (f) any loans or guarantees made by Prospect or Merger Sub to or for the benefit of its employees, officers or directors, or any members of their immediate families, or any material loans or guarantees made by Prospect or Merger Sub to or for the benefit of any of its employees or any members of their immediate families, in each case, other than travel advances and other advances made in the ordinary course of its business;
- (g) any declaration, setting aside or payment of a dividend or other distribution in respect of any of Prospect or Merger Sub's capital stock, or any direct or indirect redemption, purchase, or other acquisition of any of such stock by Prospect or Merger Sub;
- (h) any issuance of equity securities to any officer, director or affiliate, except pursuant to existing Prospect option plans;
- (i) any amendment to the Prospect Constituent Instruments, or any merger, consolidation, share exchange, business combination, recapitalization, reclassification of shares, stock split, reverse stock split or similar transaction involving Prospect or Merger Sub; or
- (j) any negotiations, arrangement or commitment by Prospect to take any of the actions described in this Section 3.9.

Section 3.10 *Undisclosed Liabilities.* Except as set forth in Section 3.10 of the Prospect Disclosure Schedule, Prospect has no material liabilities or obligations of any nature matured or unmatured, fixed or contingent, including any obligations to issue capital stock or other securities of Prospect) due after the date hereof, other than (a) those set forth or adequately provided for in the most recent balance sheet included in the Prospect Financial Statements or (b) those not required to be set forth on a balance sheet of Prospect or in the notes thereto under U.S. GAAP.

Section 3.11 *Litigation.* As of the date hereof, there is no Action which (a) adversely affects or challenges the legality, validity or enforceability of this Agreement or (b) could, if there were an unfavorable decision, individually or in the aggregate, have or reasonably be expected to result in a Material Adverse Effect on Prospect. Neither Prospect, Merger Sub, nor any director or officer thereof (in his or her capacity as such) is or has been the subject of any Action involving a claim or violation of or liability under federal or state securities laws or a claim of breach of fiduciary duty.

Table of Contents

Section 3.12 *Compliance with Applicable Laws.* Except as set forth in Section 3.12 of the Prospect Disclosure Schedule, each of Prospect and Merger Sub is in compliance with all applicable Laws, including those relating to occupational health and safety and the environment, except for instances of noncompliance that, individually and in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on Prospect. Except as set forth in Section 3.12 of the Prospect Disclosure Schedule, Prospect has not received any written communication during the past two (2) years from a Governmental Authority alleging that Prospect is not in compliance in any material respect with any applicable Law.

Section 3.13 *Sarbanes-Oxley Act of 2002.* Prospect is in material compliance with all provisions of the Sarbanes-Oxley Act of 2002 (the "*Sarbanes-Oxley Act*") applicable to it as of the date hereof and as of the Closing. There has been no change in Prospect's accounting policies since inception except as described in the notes to the Prospect Financial Statements. Each required form, report and document containing financial statements that has been filed with or submitted to the SEC since inception, was accompanied by the certifications required to be filed or submitted by Prospect's chief executive officer and chief financial officer pursuant to the Sarbanes-Oxley Act, and at the time of filing or submission of each such certification, such certification was true and accurate and materially complied with the Sarbanes-Oxley Act and the rules and regulations promulgated thereunder. Neither Prospect, nor, to the Knowledge of Prospect, any Representative of Prospect, has received or otherwise had or obtained knowledge of any complaint, allegation, assertion or claim, whether written or oral, regarding the accounting or auditing practices, procedures, methodologies or methods of Prospect or its internal accounting controls, including any complaint, allegation, assertion or claim that Prospect has engaged in questionable accounting or auditing practices, except for (a) any complaint, allegation, assertion or claim as has been resolved without any resulting change to Prospect's accounting or auditing practices, procedures methodologies or methods of Prospect or its internal accounting controls, and (b) questions regarding such matters raised and resolved in the ordinary course of business in connection with the preparation and review of Prospect's financial statements and periodic reports. To the Knowledge of Prospect, no attorney representing Prospect, whether or not employed by Prospect, has reported evidence of a material violation of securities laws, breach of fiduciary duty or similar violation by Prospect or any of its officers, directors, employees or agents to the Prospect Board or any committee thereof or to any director or officer of Prospect. To the Knowledge of Prospect, no employee of Prospect has provided or is providing information to any law enforcement agency regarding the commission or possible commission of any crime or the violation or possible violation of any applicable law.

Section 3.14 *Certain Registration Matters.* Except as specified in Section 3.14 of the Prospect Disclosure Schedule, and except for registration rights granted in connection with the Prospect Public Offering, Prospect has not granted or agreed to grant to any Person any rights (including "piggy-back" registration rights) to have any securities of Prospect registered with the SEC or any other Governmental Authority that have not been satisfied.

Section 3.15 *Brokers' and Finders' Fees.* Except as specified in Section 3.15 of the Prospect Disclosure Schedule, neither Prospect nor Merger Sub has incurred, nor will it incur, directly or indirectly, any liability for brokerage or finders' fees or agents' commissions or investment bankers' fees or any similar charges in connection with this Agreement or any Transaction.

Section 3.16 *Records.* The books of account, minute books and shareholder records of Prospect and Merger Sub are complete and accurate in all material respects, and there have been no material transactions involving Prospect or Merger Sub which are required to be set forth therein and which have not been so set forth.

Section 3.17 *Board Approval.* The Prospect Board (including any required committee or subgroup of the Prospect Board) has, as of the date of this Agreement, (i) adopted resolutions

Table of Contents

approving the Merger and setting forth the terms and conditions thereof, and declared the advisability of and approved this Agreement and the transactions contemplated hereby, (ii) determined that the transactions contemplated hereby are in the best interests of the stockholders of Prospect, and (iii) determined that the fair market value of KW is equal to at least 80% of the balance in the Trust Fund (excluding deferred underwriting discounts and commissions).

Section 3.18 *AMEX*. The Prospect Common Stock and Warrants are quoted on the AMEX. There is no Action pending or, to the Knowledge of Prospect, threatened against Prospect by AMEX with respect to any intention by such entities to prohibit or terminate the quotation of such securities on the AMEX. The Prospect Common Stock and Prospect Warrants are registered pursuant to Section 12(b) of the Exchange Act, and Prospect has taken no action designed to, or which is likely to have the effect of, terminating the registration of such securities under the Exchange Act nor has Prospect received any notification that the SEC is contemplating terminating such registration.

Section 3.19 *Trust Fund*. Section 3.19 of the Prospect Disclosure Schedule sets forth as of June 30, 2009 the dollar amount (including an accrual for the earned but uncollected interest thereon) held in the trust account established in connection with Prospect's Public Offering for the benefit of its public shareholders (the "*Trust Fund*") for use by Prospect in connection with a business combination as set forth in the Prospect Constituent Instruments. Section 3.19 of the Prospect Disclosure Schedule sets forth as of June 30, 2009 the dollar amount of the Trust Fund that represents deferred underwriting commissions which will be paid to the underwriters of the Prospect Public Offering at the Closing.

Section 3.20 *Transactions with Affiliates and Employees*. Except as set forth in Section 3.20 of the Prospect Disclosure Schedule, none of the officers or directors of Prospect and, to the Knowledge of Prospect, none of the employees of Prospect is presently a party to any transaction with Prospect that is required to be disclosed under Rule 404(a) of Regulation S-K (other than for services as employees, officers and directors), including any contract, agreement or other arrangement providing for the furnishing of services to or by, providing for rental of real or personal property to or from, or otherwise requiring payments to or from any officer, director or such employee or, to the Knowledge of Prospect, any entity in which any officer, director, or any such employee has a substantial interest or is an officer, director, trustee or partner.

Section 3.21 *Material Contracts*.

(a) Prospect has made available to KW, prior to the date of this Agreement, true, correct and complete copies of each material contract which would be considered a material contract pursuant to Item 601(b)(10) of Regulation S-K or pursuant to which Prospect receives or pays amounts in excess of \$100,000 (each a "*Prospect Material Contract*"). A list of each such Prospect Material Contract is set forth on Section 3.21 of the Prospect Disclosure Schedule. As of the date of this Agreement, Prospect is not in violation of or in default under (nor does there exist any condition which upon the passage of time, the giving of notice or both would cause such a violation of or default under) any Prospect Material Contract to which it is a party or by which it or any of its properties or assets is bound, except for violations or defaults that would not, individually or in the aggregate, reasonably be expected to result in a Material Adverse Effect on Prospect; and, to the Knowledge of Prospect, as of the date of this Agreement, no other Person has violated or breached, or committed any default under, any Prospect Material Contract, except for violations, breaches and defaults that, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on Prospect.

(b) Except as would not reasonably be expected to have a Material Adverse Effect on Prospect, each Prospect Material Contract is a legal, valid and binding agreement, and is in full force and effect, and (i) Prospect is not in breach or default of any Prospect Material Contract in any material respect; (ii) no event has occurred or circumstance has existed that (with or without

Table of Contents

notice or lapse of time), will or would reasonably be expected to, (A) contravene, conflict with or result in a violation or breach of, or become a default or event of default under, any provision of any Prospect Material Contract; (B) permit Prospect or any other Person the right to declare a default or exercise any remedy under, or to accelerate the maturity or performance of, or to cancel, terminate or modify any Prospect Material Contract; or (iii) Prospect has not received notice of the pending or threatened cancellation, revocation or termination of any Prospect Material Contract to which it is a party. Since June 30, 2009, Prospect has not received any notice or other communication regarding any actual or possible violation or breach of, or default under, any Prospect Material Contract, except in each such case for defaults, acceleration rights, termination rights and other rights that have not had and would not reasonably be expected to have a Material Adverse Effect on Prospect.

Section 3.22 *Taxes.* Except as disclosed in Schedule 3.22 of the Prospect Disclosure Schedule:

(a) Prospect has timely filed, or has caused to be timely filed on its behalf, all Tax Returns that are or were required to be filed by it pursuant to applicable Legal Requirements, except to the extent any failure to timely file any Tax Returns, either individually or in the aggregate, have not and would not reasonably be expected to have a Material Adverse Effect on Prospect. All such Tax Returns are (and, as to a Tax Return not filed as of the date hereof, and filed on or before the Closing Date, will be) in all respects true, complete and accurate, except to the extent any inaccuracies in any filed Tax Returns, individually or in the aggregate, have not and would not reasonably be expected to have a Material Adverse Effect on Prospect. To the Knowledge of Prospect, there are no unpaid Taxes claimed to be due by any Governmental Authority in charge of taxation of any jurisdiction, nor any claim for additional Taxes for any period for which Tax Returns have been filed, except to the extent any failure to file or any inaccuracies in any filed Tax returns, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect on Prospect.

(b) Prospect has not received any written notice that any Governmental Authority will audit or examine (except for any general audits or examinations routinely performed by such Governmental Authorities), seek information with respect to, or make material claims or assessments with respect to any Taxes for any period. Prospect has made available to KW copies of all Tax Returns, examination reports, and statements of deficiencies filed by, assessed against or agreed to by Prospect since its inception.

(c) The Prospect Financial Statements reflect an adequate reserve, established in accordance with U.S. GAAP, for all Taxes known to be payable by Prospect (in addition to any reserve for deferred Taxes to reflect timing differences between book and Tax items) for all taxable periods and portions thereof through the date of such financial statements. Prospect is neither a party to nor is it bound by any Tax indemnity, Tax sharing or similar agreement and Prospect currently has no material liability, and will not have any material liabilities for any Taxes of any other Person under any agreement or by the operation of any Law. No deficiency with respect to any Taxes has been proposed, asserted or assessed against Prospect, except to the extent any such deficiency, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect on Prospect.

(d) Prospect has not executed any outstanding waivers or comparable consents regarding the application of the statute of limitations with respect to any Taxes or Tax Returns.

(e) There are no Tax Liens upon any of the assets or properties of Prospect, other than with respect to Taxes not yet due and payable.

Table of Contents

(f) All Taxes required to be withheld, collected or deposited by or with respect to Prospect have been timely withheld, collected or deposited as the case may be, and to the extent required, have been paid to the relevant taxing authority.

(g) Prospect has not been a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code during the applicable period specified in Section 897(c)(1)(A)(ii) of the Code.

Section 3.23 *Foreign Corrupt Practices.* Neither Prospect nor Merger Sub, nor, to Prospect's Knowledge, any Representative of Prospect or Merger Sub has, in the course of its actions for, or on behalf of, Prospect (a) used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expenses relating to political activity; (b) made any direct or indirect unlawful payment to any foreign or domestic government official or employee from corporate funds; (c) violated or is in violation of any provision of the FCPA; or (d) made any unlawful bribe, rebate, payoff, influence payment, kickback or other unlawful payment to any foreign or domestic government official or employee, except, in the case of clauses (a) and (b) above, any such items that, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect on Prospect.

Section 3.24 *Money Laundering Laws.* The operations of Prospect are and have been conducted at all times in compliance with Money Laundering Laws and no proceeding involving Prospect with respect to the Money Laundering Laws is pending or, to the Knowledge of the officers of Prospect, is threatened.

Section 3.25 *OFAC.* None of Prospect, Merger Sub, any director or officer of Prospect or Merger Sub, or, to the Knowledge of Prospect or Merger Sub, any agent, employee, affiliate or Person acting on behalf of Prospect or Merger Sub is currently identified on the specially designated nationals or other blocked person list or otherwise currently subject to any U.S. sanctions administered by OFAC; and neither Prospect nor Merger Sub has not, directly or indirectly, used any funds, or loaned, contributed or otherwise made available such funds to any joint venture partner or other Person, in connection with any sales or operations in Cuba, Iran, Syria, Sudan, Myanmar or any other country sanctioned by OFAC or for the purpose of financing the activities of any Person currently subject to, or otherwise in violation of, any U.S. sanctions administered by OFAC in the last five (5) fiscal years.

Section 3.26 *Proxy Statement/Prospectus.* None of the information in the Proxy Statement/Prospectus or incorporated by reference therein will, at the time the Proxy Statement/Prospectus is filed with the SEC or at the time it becomes effective under the Securities Act, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading (provided that Prospect shall not be responsible for the accuracy or completeness of any information relating to KW or its Subsidiaries or any information furnished by them in writing for inclusion in the Proxy Statement/Prospectus). If any information is discovered or any event occurs, or any change occurs with respect to the other information included in the Proxy Statement/Prospectus which is required to be described in an amendment of, or a supplement to, the Proxy Statement/Prospectus so that such document does not include any misstatement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, Prospect shall notify KW promptly of such event.

Section 3.27 *Tax Representations Regarding Tax-Free Reorganization.*

(a) Merger Sub was organized solely for purposes of the Merger. Merger Sub has no assets or liabilities and has not conducted any business.

(b) Merger Sub is wholly owned by Prospect and will continue to be wholly owned by Prospect through the Merger Effective Time.

Table of Contents

- (c) Prospect does not own any stock in KW and has not owned any stock in KW in the last five (5) years.
- (d) Neither Prospect nor any person related to Prospect within the meaning of Treasury Regulation Section 1.368-1(e) has any plan or intention to redeem or acquire any of the Prospect Common Stock issued to KW stockholders in the Merger.
- (e) Prospect has no plan or intention to liquidate KW, to merge KW with or into another corporation, to sell or otherwise dispose of the stock of KW except for transfers of stock described in Treasury Regulation Section 1.368-2(k), or to cause KW to sell or otherwise dispose of any of its assets except for dispositions made in the ordinary course of business or transfers of assets to a qualified group or qualified partnership within the meaning of and in accordance with Treasury Regulation Section 1.368-1(d)(4).
- (f) Following the Merger, KW will continue its historic business or continue to use a significant portion of its historic business assets in a business within the meaning of Treasury Regulation Section 1.368-1(d).
- (g) Prospect is not an investment company as defined in Section 368(a)(2)(F)(iii) and (iv) of the Code.

ARTICLE IV

Conduct Prior To The Closing

Section 4.1 *Covenants of KW.* During the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Closing Date, KW agrees that KW and its Subsidiaries shall (i) use commercially reasonable efforts to (except to the extent expressly contemplated by this Agreement or as consented to in writing by Prospect) carry on their businesses in the ordinary course in substantially the same manner as heretofore conducted, to pay debts and Taxes when due (subject to good faith disputes over such debts or Taxes), to pay or perform other obligations when due, and to use all reasonable efforts consistent with past practice and policies to preserve intact their present business organizations, and (ii) use their commercially reasonable efforts consistent with past practice to keep available the services of their present executive officers and directors to preserve their relationships with customers, suppliers, distributors, licensors, licensees, and others having business dealings with them, in each case, to the end that there shall not be a Material Adverse Effect in their ongoing businesses as of the Closing Date. KW agrees to promptly notify Prospect of any material event or occurrence not in the ordinary course of business that would have or reasonably be expected to have a Material Adverse Effect on KW. Without limiting the generality of the foregoing, during the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Closing Date, except as otherwise expressly permitted by or provided for in this Agreement, KW shall not take, allow, cause or permit any of the following actions to occur with respect to KW without the prior written consent of Prospect, which consent shall not be unreasonably delayed or withheld:

- (a) *Charter Documents.* Cause or permit any amendments to any of the KW Constituent Instruments or any other equivalent organizational documents, except for such amendments made pursuant to a Legal Requirement or as contemplated by this Agreement;
- (b) *Accounting Policies and Procedures.* Change any material method of accounting or accounting principles or practices by KW, except for any such change made pursuant to a Legal Requirement or by a change in U.S. GAAP;
- (c) *Dividends; Changes in Capital Stock.* Except for the payment of quarterly dividends on the KW Preferred Stock in an amount and a manner consistent with past practices, declare or pay

Table of Contents

any dividends on or make any other distributions (whether in cash, stock or property) in respect of any of its capital stock, or split, combine or reclassify any of its capital stock or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of its capital stock;

(d) *Material Contracts.* Enter into any new Material Contract, or violate, amend or otherwise modify or waive any of the terms of any existing Material Contract, other than in the ordinary course of business consistent with past practice;

(e) *Issuance of Securities.* Issue, deliver or sell or authorize or propose the issuance, delivery or sale of, or purchase or propose the purchase of, any shares of its capital stock or securities convertible into, or subscriptions, rights, warrants or options to acquire, or other agreements or commitments of any character obligating it to issue any such shares or other convertible securities;

(f) *Indebtedness.* Except in its ordinary course of business, issue or sell any debt securities or guarantee any debt securities of others in excess of \$10,000,000;

(g) *Dispositions.* Sell, lease, license or otherwise dispose of or encumber any of its properties or assets which are material, individually or in the aggregate, to its business, taken as a whole, except in the ordinary course of business consistent with past practice;

(h) *Taxes.* Make or change any Tax election, change an annual accounting period, adopt or change any accounting method with respect to Taxes, file any amended Tax Return, enter into any closing agreement, settle or compromise any proceeding with respect to any Tax claim or assessment relating to KW or any of its Subsidiaries, surrender any right to claim a refund of Taxes, consent to any extension or waiver of the limitation period applicable to any Tax claim or assessment relating to KW or any of its Subsidiaries, or take any other similar action relating to the filing of any Tax Return or the payment of any Tax;

(i) *New Line of Business.* Enter into any new line of business;

(j) *Liquidation.* Adopt a plan or effect any complete or partial liquidation or adopt resolutions providing for or authorizing such liquidation or adopt a plan of or effect any dissolution, merger, consolidation, restructuring, recapitalization or reorganization;

(k) *Officers and Employees.* (1) Increase the wages, salaries, bonus, compensation or other benefits of any of its officers or employees (other than non-material increases granted to retain employees, other than officers, who have been offered employment by another Person) or enter into, establish, amend or terminate any KW Benefit Plan or, except as contemplated by this Agreement, enter into any other employment, consulting, retention, change in control, collective bargaining, bonus or incentive compensation, profit sharing, health, welfare, stock option, equity, pension, retirement, vacation, severance, termination, deferred compensation or other compensation or benefit plan, policy, agreement, trust, fund or other arrangement with, for or in respect of any officer, director or employee other than as required by applicable Law or pursuant to the terms of agreements in effect on the date of this Agreement or in the ordinary course of business consistent with past practice with its employees (other than officers), (2) hire any employees except in the ordinary course of business consistent with past practice or (3) fail to make contributions to any KW Benefit Plan in accordance with the terms thereof or with past practice;

(l) *Material Adverse Effect.* Take or omit to take any action, the taking or omission of which could reasonably be expected to have a Material Adverse Effect on KW; and

(m) *Other.* Agree in writing or otherwise to take any of the actions described in Section 4.1(a) through (l) above.

Table of Contents

Section 4.2 *Covenants of Prospect.* During the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Closing Date, Prospect agrees that Prospect shall (i) use commercially reasonable efforts, and cause Merger Sub to use commercially reasonable efforts, to (except to the extent expressly contemplated by this Agreement or as consented to in writing by KW), carry on its business in the ordinary course in substantially the same manner as heretofore conducted, to pay debts and Taxes when due (subject to good faith disputes over such debts or taxes), to pay or perform other obligations when due, and to use all reasonable efforts consistent with past practice and policies to preserve intact its present business organizations and (ii) use its commercially reasonable efforts consistent with past practice to keep available the services of its present officers, directors and employees and to preserve its relationships with customers, suppliers, distributors, licensors, licensees, and others having business dealings with it, in each case to the end that there shall not be a Material Adverse Effect in its ongoing business as of the Closing Date. Prospect agrees to promptly notify KW of any material event or occurrence not in the ordinary course of its business and of any event that would have a Material Adverse Effect on Prospect. Without limiting the generality of the foregoing, during the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Closing Date, except as listed on Section 4.2 of the Prospect Disclosure Schedule or as otherwise expressly permitted by or provided for in this Agreement, Prospect shall not do, allow, cause or permit any of the following actions to occur without the prior written consent of KW, which consent shall not be unreasonably delayed or withheld:

(a) *Charter Documents.* Cause or permit any amendments in any of their constituent instruments except for such amendments required by any Legal Requirement or the rules and regulations of the SEC or AMEX or as are contemplated by this Agreement (or such other applicable national securities exchange);

(b) *Accounting Policies and Procedures.* Change any method of accounting or accounting principles or practices by Prospect, except for any such change made pursuant to a Legal Requirement or by a change in U.S. GAAP;

(c) *Dividends; Changes in Capital Stock.* Declare or pay any dividends on or make any other distributions (whether in cash, stock or property) in respect of any of its capital stock, or split, combine or reclassify any of its capital stock or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of its capital stock, cancel or agree to cancel shares of its capital stock or repurchase, agree to repurchase or otherwise acquire or agree to acquire, directly or indirectly, any of its securities;

(d) *Material Contracts.* Enter into any new Prospect Material Contract, or violate, amend or otherwise modify or waive any of the terms of any existing Prospect Material Contract, other than in the ordinary course of business consistent with past practice;

(e) *Issuance of Securities.* Issue, deliver or sell or authorize or propose the issuance, delivery or sale of, or purchase or propose the purchase of, any shares of its capital stock or securities convertible into, or subscriptions, rights, warrants or options to acquire, or other agreements or commitments of any character obligating it to issue any such shares or other convertible securities;

(f) *Indebtedness.* Issue or sell any debt securities or guarantee any debt securities of others;

(g) *Dispositions.* Sell, lease, license or otherwise dispose of or encumber any of its properties or assets which are material, individually or in the aggregate, to its business, taken as a whole, except in the ordinary course of business consistent with past practice;

(h) *Taxes.* Make or change any Tax election, change an annual accounting period, adopt or change any accounting method with respect to Taxes, file any amended Tax Return, enter into any closing agreement, settle or compromise any proceeding with respect to any Tax claim or

Table of Contents

assessment relating to Prospect, surrender any right to claim a refund of Taxes, consent to any extension or waiver of the limitation period applicable to any Tax claim or assessment relating to Prospect, or take any other similar action relating to the filing of any Tax Return or the payment of any Tax.

(i) *New Line of Business.* Enter into any new line of business;

(j) *Liquidation.* Adopt a plan or effect any complete or partial liquidation or adopt resolutions providing for or authorizing such liquidation or adopt a plan of or effect any dissolution, merger, consolidation, restructuring, recapitalization or reorganization;

(k) *SEC Reports.* Fail to timely file or furnish to or with the SEC all reports, schedules, forms, statements and other documents required to be filed or furnished (except those filings by affiliates of Prospect required under Section 13(d) or 16(a) of the Exchange Act provided their failure to file such documents does not have a Material Adverse Effect on Prospect or the ability of Prospect to consummate the transactions contemplated hereby); and

(l) *Other.* Agree in writing or otherwise to take any of the actions described in Sections 4.2(a) through (k) above.

Section 4.3 *No Shop; Non-Solicit.*

(a) From and after the date hereof until the earlier of the (i) termination of this Agreement in accordance with its terms or (ii) the Merger Effective Time ("**Exclusivity Period**"): (A) Prospect shall not, and shall cause its stockholders and Representatives (collectively, with Prospect, the "**Prospect Group**") not to enter into any written agreement with any other person or entity (whether or not such written agreement is absolute, contingent or conditional) regarding a Prospect Third Party Acquisition other than the transactions contemplated by this Agreement, (B) Prospect shall not and shall cause the other members of the Prospect Group not to solicit, offer, initiate, knowingly encourage, conduct or seek to engage in any discussions, investigations or negotiations or enter into any agreement with any other person or entity (whether or not such agreement or understanding is absolute, revocable, contingent or conditional) regarding a Prospect Third Party Acquisition and (C) Prospect agrees that during the Exclusivity Period it shall promptly, after obtaining knowledge thereof, advise KW of any inquiry or proposal regarding a Prospect Third Party Acquisition that is received by any member of the Prospect Group, including the terms of the proposal and the identity of the inquirer or offeror; and

(b) During the Exclusivity Period: (A) KW shall not, and shall cause its stockholders and Representatives (collectively, with KW, the "**KW Group**") not to enter into any written agreement with any other person or entity (whether or not such written agreement is absolute, contingent or conditional) regarding a KW Third Party Acquisition other than the transactions contemplated by this Agreement, (B) KW shall not and shall cause the other members of the KW Group not to solicit, offer, initiate, knowingly encourage, conduct or seek to engage in any discussions, investigations or negotiations or enter into any agreement or understanding with any other person or entity (whether or not such agreement or understanding is absolute, revocable, contingent or conditional) regarding a KW Third Party Acquisition, other than the transactions contemplated in this Agreement; and (C) KW agrees that during the Exclusivity Period it shall promptly, after obtaining knowledge thereof, advise Prospect of any inquiry or proposal regarding a KW Third Party Acquisition that is received by any member of the KW Group, including the terms of the proposal and the identity of the inquirer or offeror.

Table of Contents

ARTICLE V

Additional Covenants of KW

Section 5.1 *Access to Information.* Except as required pursuant to any confidentiality agreement or similar agreement or arrangement to which KW is subject, between the date of this Agreement and the Closing Date, subject to Prospect's undertaking to use its commercially reasonable efforts to keep confidential and protect the Trade Secrets of KW and its Subsidiaries against any disclosure, KW and its Subsidiaries shall permit, upon reasonable request, Prospect and its Representatives access at dates and times agreed upon by the applicable entity and Prospect, to all of the books and records of KW and its Subsidiaries which Prospect determines are necessary for the preparation and amendment of the Proxy Statement/Prospectus and such other filings or submissions in accordance with SEC rules and regulations as are necessary to consummate the transactions contemplated hereby and as are necessary to respond to requests of the SEC staff, Prospect's accountants and relevant Governmental Authorities; *provided, however*, that Prospect may make a disclosure otherwise prohibited by this Section 5.1 if required by applicable law or regulation or regulatory, administrative or legal process (including, without limitation, by oral questions, interrogatories, requests for information, subpoena of documents, civil investigative demand or similar process) or the rules and regulations of the SEC or any stock exchange having jurisdiction over Prospect. In the event that Prospect or any of its Representatives is requested or required to disclose any Trade Secrets of KW or its Subsidiaries as provided in the proviso in the immediately preceding sentence, Prospect shall provide KW and its Subsidiaries with immediate written notice of any such request or requirement so that KW and its Subsidiaries may seek a protective order or other appropriate remedy.

Section 5.2 *Insurance.* Through the Closing Date, KW shall cause KW and its Subsidiaries to maintain insurance policies providing insurance coverage for the businesses in which KW and its Subsidiaries are engaged and the assets and properties of KW and its Subsidiaries of the kinds, in the amounts and against the risks as are commercially reasonable for such businesses and risks covered and for the geographic areas where KW and its Subsidiaries engage in such businesses.

Section 5.3 *Fulfillment of Conditions.* KW shall use its commercially reasonable efforts, and shall cause its Subsidiaries to use their commercially reasonable efforts, to fulfill the conditions specified in Article VIII to the extent that the fulfillment of such conditions is within their control. The foregoing obligation includes (a) executing and delivering documents necessary or desirable to consummate the transactions contemplated hereby, (b) engaging in a road show, at mutually agreed times and places, to seek the approval of the transactions, and (c) taking or refraining from such actions as may be necessary to fulfill such conditions (including using their commercially reasonable efforts to conduct their respective businesses in such manner that on the Closing Date the representations and warranties of the each of KW contained herein shall be accurate as though then made, except as contemplated by the terms hereof).

Section 5.4 *Disclosure of Certain Matters.* From the date hereof through the Closing Date, KW shall give Prospect prompt written notice of any event or development that occurs that (a) is of a nature that, individually or in the aggregate, would have or reasonably be expected to have a Material Adverse Effect on KW, or (b) would require any amendment or supplement to the Proxy Statement/Prospectus.

Section 5.5 *Regulatory and Other Authorizations; Notices and Consents.*

(a) KW shall use its commercially reasonable efforts to obtain all authorizations, consents, orders and approvals of Governmental Authorities and all material Consents that may be or become necessary for its execution and delivery of, and the performance of its obligations pursuant to, this Agreement and the Transaction Documents including the consents set forth on Section 5.5 of the KW Disclosure Schedule ("**Required Consents**") will cooperate with Prospect in promptly

Table of Contents

seeking to obtain all such Required Consents (and in such regard use commercially reasonable efforts to cause the relevant Governmental Authorities to permit Prospect and/or its counsel to participate in the conversation and correspondence with such Governmental Authorities together with KW's counsel).

(b) KW shall give promptly such notices to third parties under any Material Contract.

(c) KW shall use its commercially reasonable efforts to obtain, prior to the date of the mailing of the Proxy Statement/Prospectus, all necessary approvals from holders of KW Securities for the Merger, including the KW Stockholder Approvals.

(d) KW shall promptly notify Prospect if KW determines that it may be unable to obtain a Required Consent prior to November 13, 2009.

Section 5.6 *Related Taxes.* From the date hereof through the Closing Date, each of KW and its Subsidiaries, consistent with past practice, shall (i) duly and timely file all Tax Returns and other documents required to be filed by it with applicable Governmental Authorities, the failure to file of which could have a Material Adverse Effect on KW, subject to extensions permitted by law and properly granted by the appropriate authority; *provided*, that KW shall (i) promptly notify Prospect that any of KW and its Subsidiaries is availing itself of such extensions, and (ii) pay all Taxes shown as due on such Tax Returns.

Section 5.7 *Proxy Statement/Prospectus.* KW shall use commercially reasonable efforts to provide promptly to Prospect such information concerning the business affairs and consolidated financial statements of KW and any required financial statements of its Subsidiaries as may reasonably be required for inclusion in the Proxy Statement/Prospectus and shall direct that its counsel cooperate with Prospect's counsel in the preparation of the Proxy Statement/Prospectus and shall request the cooperation of KW's auditors in the preparation of the Proxy Statement/Prospectus.

Section 5.8 *Employment Agreements.* KW will enter into amended employment agreements with each of William McMorrow, Mary Ricks and Donald Herrema substantially in the forms attached hereto as *Exhibits B-1, B-2* and *B-3*, respectively.

Section 5.9 *Lock-Up Agreements.* Each of those Persons listed in Section 5.9 of the KW Disclosure Schedule will enter into a lock-up agreement substantially in the form of *Exhibit C* attached hereto.

Section 5.10 *No Claim Against Trust Fund.* Notwithstanding anything else in this Agreement, KW acknowledges that it has read Prospect's final prospectus dated November 14, 2007 and understands that Prospect has established the Trust Fund for the benefit of Prospect's public stockholders and that, subject to the limited exceptions described therein, Prospect may disburse monies from the Trust Fund only (a) to Prospect's public stockholders in the event they elect to convert their shares into cash in accordance with Prospect's certificate of incorporation and/or the liquidation of Prospect or (b) to Prospect after it consummates a business combination. KW further acknowledges that, if the transactions contemplated by this Agreement, or, upon termination of this Agreement, another business combination, are not consummated by November 14, 2009, Prospect shall be obligated to return to its public stockholders the amounts being held in the Trust Fund. Accordingly, KW, for itself and each of its Subsidiaries, hereby waives all rights, title, interest or claim of any kind against Prospect to collect from the Trust Fund any monies that may be owed to them by Prospect or KW for any reason, including but not limited to a breach of this Agreement by Prospect or any negotiations, agreements or understandings with Prospect (whether in the past, present or future), and shall not seek recourse against the Trust Fund at any time for any reason other than a breach by Prospect of Section 4.3 hereof. This paragraph shall survive this Agreement and shall not expire and may not be altered in any way without the express written consent of Prospect. Notwithstanding the foregoing, KW does not waive a claim for damages, not to exceed \$10 million, against Prospect if such damages arise from Prospect's breach of Section 4.3 hereof.

Table of Contents

ARTICLE VI

Additional Covenants of Prospect

Section 6.1 *Proxy Statement/Prospectus Filing, SEC Filings and Special Meeting.*

(a) Prospect shall cause a meeting of its stockholders (the "**Prospect Stockholders' Meeting**") to be duly called and held as soon as reasonably practicable for the purpose of voting on the adoption and approval of, among others, this Agreement and the transactions contemplated hereby. Prospect shall cause a meeting of the holders of Prospect Warrants (the "Prospect Warrant holders Meeting") to be duly called and held as soon as reasonably practicable for the purpose of voting to approve the Prospect Warrant Agreement Amendment. The board of directors of Prospect shall recommend to its stockholders and the holders of Prospect Warrants that they vote in favor of the adoption of such matters. In connection with the Prospect Stockholders' Meeting and the Prospect Warrant holders Meeting, Prospect (a) shall use commercially reasonable efforts to file with the SEC as promptly as practicable the Proxy Statement/Prospectus, (b) upon receipt of approval from the SEC, will mail to its stockholders and the holders of Prospect Warrants the Proxy Statement/Prospectus and other proxy materials, (c) will use commercially reasonable efforts to obtain the necessary approvals by its stockholders of this Agreement and the transactions contemplated hereby, (d) will use commercially reasonable efforts to obtain the necessary approvals by the holders of Prospect Warrants of the Warrant Agreement Amendment and (e) will otherwise comply with all Legal Requirements applicable to the Prospect Stockholders' Meeting and the Prospect Warrant holders Meeting.

(b) Prospect shall timely provide to KW all correspondence received from and to be sent to the SEC and shall not file any amendment to the filings with the SEC without (i) providing KW the opportunity to review and comment on any responses to the SEC and (ii) the prior consent of KW, which consent shall not be unreasonably delayed or withheld. In addition, Prospect shall use commercially reasonable efforts to cause the SEC to permit KW and/or its counsel to participate in the SEC conversations on issues related to Prospect's SEC filings together with Prospect's counsel.

Section 6.2 *Fulfillment of Conditions.* From the date hereof to the Closing Date, Prospect shall use its commercially reasonable efforts to fulfill the conditions specified in Article VIII. The foregoing obligation includes, without limitation, (a) executing and delivering documents necessary or desirable to consummate the transactions contemplated hereby, (b) engaging in a road show, at mutually agreed to times and places, to seek the approval of the transactions contemplated hereby, and (c) taking or refraining from taking such actions as may be necessary to fulfill such conditions (including using its commercially reasonable efforts to conduct the business of Prospect in such manner that on the Closing Date the representations and warranties of Prospect contained herein shall be accurate as though then made).

Section 6.3 *Disclosure of Certain Matters.* From the date hereof through the Closing Date, Prospect shall give KW prompt written notice of any event or development that occurs that (a) is of a nature that, individually or in the aggregate, would have or reasonably be expected to have a Material Adverse Effect on Prospect, or (b) would require any amendment or supplement to the Proxy Statement/Prospectus.

Section 6.4 *Regulatory and Other Authorizations; Notices and Consents.* Prospect shall use its commercially reasonable efforts to obtain all authorizations, consents, orders and approvals of all Governmental Authorities that may be or become necessary for its execution and delivery of, and the performance of its obligations pursuant to, this Agreement and the Transaction Documents to which it is a party and shall cooperate fully with KW in promptly seeking to obtain all such authorizations, consents, orders and approvals (and in such regard use commercially reasonable efforts to cause the

Table of Contents

relevant Government Authorities to permit KW and/or its counsel to participate in the conversation and correspondence with such Government Authorities together with Prospect's counsel). Subsequent to the Closing, Prospect shall use commercially reasonable efforts to inform former market-makers in KW Common Stock of the Closing and that trades should no longer be made in KW Common Stock.

Section 6.5 *Related Taxes.* From the date hereof through the Closing Date, Prospect, consistent with past practice, shall (i) duly and timely file all Tax Returns and other documents required to be filed by it with applicable Governmental Authorities, the failure to file of which could have a Material Adverse Effect on Prospect, subject to extensions permitted by law and properly granted by the appropriate authority; *provided*, that Prospect shall (i) promptly notify KW that Prospect is availing itself of such extensions, and (ii) pay all Taxes shown as due on such Tax Returns.

Section 6.6 *Valid Issuance of Prospect Common Stock.* Prospect shall ensure that the authorized share capital of Prospect be sufficient to enable Prospect to issue the Prospect Common Stock in the Merger and to meet its obligations under the Prospect Stock Rights issued and outstanding as of such time. At the Closing, the shares of Prospect Common Stock to be issued in the Merger hereunder will be duly authorized, validly issued, fully paid and nonassessable and will have been issued in compliance with all applicable federal and state securities laws.

Section 6.7 *Securities Purchases.* Prospect agrees, either itself or through any affiliate, that it shall not, without the prior written consent of KW, purchase, agree to purchase or otherwise acquire or agree to acquire, directly or indirectly, any of Prospect's securities other than in accordance with the terms of the Transaction Documents.

Section 6.8 *Management Incentive Plan.* Prior to Closing, Prospect shall adopt an equity incentive plan ("**Management Incentive Plan**"), for the issuance of up to 4.0 million shares of Prospect Common Stock (the "**Management Incentive Shares**") and, at the Closing, Prospect shall grant awards under the Management Incentive Plan for the aggregate number of Management Incentive Shares to key employees of the Surviving Corporation in the amounts and upon terms and conditions to be mutually agreed upon between Prospect and KW.

Section 6.9 *Director and Officer Liability.* Prospect shall, or shall cause the Surviving Corporation, to do the following:

(a) For six years after the Merger Effective Time, the Surviving Corporation shall provide each current and former director and officer of Prospect (collectively, the "**Indemnified D&Os**") with "tail" insurance (to the extent available in the market) in respect of acts or omissions occurring prior to the Merger Effective Time covering each such Person on terms with respect to coverage and amount not materially less favorable than those currently covered by Prospect's officers' and directors' liability insurance policy, provided that the premium for such coverage will not exceed \$200,000 (the "**Tail Coverage Amount**"). Without limiting the generality of the foregoing (and not withstanding any other provision of this Agreement), prior to the Merger Effective Time, and with the prior consent of Prospect, KW and Prospect shall be entitled to obtain prepaid insurance policies providing for the coverage contemplated by this Section 6.9 with annual premiums not to exceed the Tail Coverage Amount. If such prepaid policies are obtained prior to the Merger Effective Time, Prospect shall not cancel such policies or permit such policies to be cancelled. Notwithstanding the foregoing, neither Prospect nor the Surviving Corporation shall be required to pay annual premiums for such policy in excess of the Tail Coverage Amount and, in the event any future annual premiums for such policy exceeds such amount, Prospect or the Surviving Corporation will be entitled to reduce the amount of coverage that can be obtained for an annual premium equal to the Tail Coverage Amount.

(b) For six years after the Merger Effective Time, maintain in effect the provisions in its certificate of incorporation and bylaws providing for indemnification of such Persons with respect

Table of Contents

to the facts or circumstances occurring at or prior to the Merger Effective Time to the fullest extent permitted from time to time under the DGCL, which provisions shall not be amended except as required by changes in Law or except to make changes permitted by Law that would enlarge the scope of such Persons' indemnification rights thereunder.

(c) The provisions of this Section 6.9 (i) are intended to be for the benefit of, and will be enforceable by, each Indemnified D&O, his or her heirs and his or her representatives and (ii) are in addition to, and not in substitution for, any other rights to indemnification or contribution that any such Person may have by contract or otherwise. The obligations of Prospect and the Surviving Corporation under this Section 6.9 shall not be terminated or modified in such a manner as to adversely affect the rights of any indemnified party to whom this Section 6.9 applies unless (x) such termination or modification is required by applicable Law or (y) the affected indemnified party shall have consented in writing to such termination or modification.

ARTICLE VII

Additional Agreements and Covenants

Section 7.1 Disclosure Schedules. Each of the Parties shall, as of the Closing Date, have the obligation to supplement or amend its respective Disclosure Schedules being delivered concurrently with the execution of this Agreement and annexes and exhibits hereto with respect to any matter hereafter arising or discovered which resulted in, or could reasonably be expected to result in a Material Adverse Effect on such Party. The obligations of the Parties to amend or supplement their respective Disclosure Schedules being delivered herewith shall terminate on the Closing Date. Notwithstanding any such amendment or supplementation, the representations and warranties of the Parties shall be made with reference to the Disclosure Schedules as they exist at the time of execution of this Agreement.

Section 7.2 Confidentiality. Between the date hereof and the Closing Date, each of Prospect and KW shall hold and shall cause its Affiliates and Representatives to hold in strict confidence, unless compelled to disclose by judicial or administrative process or by other requirements of law or by the rules and regulations of, or pursuant to any agreement, rules or regulations of, the relevant stock exchange or trading system, all documents and information concerning the other Party furnished to it by such other Party or its Representatives in connection with the transactions contemplated hereby, except to the extent that such information can be shown to have been (a) previously known by the Party to which it was furnished with no obligation of confidentiality, (b) in the public domain through no fault of such Party, or (c) later lawfully acquired by the Party to which it was furnished from other sources, which source is not an Affiliate or Representative of the other Party, and each Party shall not release or disclose such information to any other Person, except its Affiliates and Representatives in connection with this Agreement. Each Party shall be deemed to have satisfied its obligations to hold confidential information concerning or supplied by the other Party in connection with the transactions contemplated hereby, if it exercises the same care as it takes to preserve confidentiality for its own similar information. For the avoidance of doubt, any disclosure of information required to be included by Prospect or KW in their respective filings with the SEC as required by applicable Laws will not be a violation of this Section 7.2 provided that the other Party was given notice of such disclosure prior to its release and did not object to its release.

Section 7.3 Public Announcements. From the date of this Agreement until the Closing or termination of this Agreement, Prospect and KW shall cooperate in good faith to jointly prepare all press releases and public announcements pertaining to this Agreement and the transactions contemplated hereby, and neither of them shall issue or otherwise make any public announcement or communication pertaining to this Agreement or the transactions contemplated hereby without the prior consent of Prospect (in the case of KW) or KW (in the case of Prospect), except as required by

Table of Contents

applicable Law or by the rules and regulations of, or pursuant to any agreement, rules or regulations of, the relevant stock exchange or trading system. Each Party will not unreasonably withhold approval from the other with respect to any press release or public announcement. If any Party determines with the advice of counsel that it is required to make this Agreement and the terms of the transactions contemplated hereby public or otherwise issue a press release or make public disclosure with respect thereto, it shall, at a reasonable time before making any public disclosure, consult with the other Parties regarding such disclosure, seek such confidential treatment for such terms or portions of this Agreement or the transactions contemplated hereby as may be reasonably requested by the other Parties and disclose only such information as is legally compelled to be disclosed. This provision will not apply to communications by any Party to its Representatives.

Section 7.4 HSR. If required pursuant to the HSR Act, as promptly as practicable after the date of this Agreement, Prospect and KW shall each prepare and file the notification required of it thereunder in connection with the transactions contemplated hereunder and shall promptly and in good faith respond to all information requested of it by the Federal Trade Commission and Department of Justice in connection with such notification and otherwise cooperate in good faith with each other and such Governmental Authorities. Prospect and KW shall (a) promptly inform the other of any communication to or from the Federal Trade Commission, the Department of Justice or any other Governmental Authority regarding the transactions contemplated hereunder, (b) give the other prompt notice of the commencement of any action, suit, litigation, arbitration, proceeding or investigation by or before any Governmental Authority with respect to such transactions, and (c) keep the other reasonably informed as to the status of any such action, suit, litigation, arbitration, proceeding or investigation. Each of Prospect and KW shall pay one-half of the filing fees with respect to the notifications required under the HSR Act.

Section 7.5 Fees and Expenses. Except as provided in Section 7.4, in the event that there is no Closing of the transactions contemplated by this Agreement, all fees and expenses incurred in connection with this Agreement shall be paid by the Party incurring such fees or expenses.

Section 7.6 Reporting. From and after the date of this Agreement, each of the Parties will, and will cause its Affiliates to, (i) act in a manner consistent with the treatment of the Merger contemplated by this Agreement as a reorganization under Section 368(a) of the Code and (ii) consistently take the position on all Tax Returns, before any taxing authority, and in any judicial proceeding, that the Merger contemplated by this Agreement qualifies as a reorganization under Section 368(a) of the Code.

Section 7.7 Counsel Tax Letters. Prospect and KW will each use its reasonable best efforts to cause its respective counsel to provide it with an opinion with respect to certain statements of United States federal income tax law as set forth in the Proxy Statement/Prospectus under the caption "Material United States Federal Income Tax Consequences of the Merger" (the "**Proxy Statement/Prospectus Tax Section**"). In the case of the opinion provided by KW's counsel, such opinion shall be subject to the assumptions, limitations and qualifications stated in such opinion and in the Proxy Statement/Prospectus Tax Section, and shall relate to the statements made in the Proxy Statement/Prospectus Tax Section regarding the United States federal income tax consequences of the Merger to United States holders (as such term is defined in the Proxy Statement/Prospectus Tax Section) of KW Securities. In the case of the opinion provided by Prospect's counsel, such opinion shall be subject to the assumptions, limitations and qualifications stated in such opinion and in the Proxy Statement/Prospectus Tax Section, and shall relate to the statements made in the Proxy Statement/Prospectus Tax Section regarding the United States federal income tax consequences of the Merger to Prospect and to United States holders of Prospect Common Stock. Each of the Parties, to the extent reasonably requested by counsel for a Party, shall timely provide to such requesting counsel, to the extent possible, reasonable and customary tax representations in connection with the United States federal income tax consequences of the Merger that are described in the Proxy Statement/Prospectus Tax Section.

Table of Contents

ARTICLE VIII

Conditions to Closing

Section 8.1 *KW Conditions Precedent*. The obligations of KW to enter into and complete the Closing are subject, at the option of KW, to the fulfillment on or prior to the Closing Date of the following conditions by Prospect, any one or more of which may be waived by KW in writing:

(a) *Representations and Covenants*. The representations and warranties of Prospect contained in this Agreement shall be true on and as of the Closing Date, except where the failure of such representations or warranties to be so true and correct, individually or in the aggregate, has not had or would not reasonably be expected to have a Material Adverse Effect on Prospect (disregarding for purposes of determining a Material Adverse Effect for purposes of this Section 8.1(a) any materiality qualifier set forth in Prospect's representations and warranties), and Prospect shall have performed and complied in all material respects with all covenants and agreements required by this Agreement to be performed or complied with by it on or prior to the Closing Date.

(b) *Litigation*. No action, suit or proceeding shall have been instituted before any court or governmental or regulatory body or instituted by any Governmental Authorities (i) to restrain, modify or prevent the carrying out of the transactions contemplated by this Agreement, or to seek damages or a discovery order in connection with the transactions contemplated by this Agreement, or (ii) which has or may have, in the reasonable opinion of KW, a Material Adverse Effect on Prospect.

(c) *Filing of Proxy Statement/Prospectus; Effectiveness of Registration Statement*. Prospect shall have filed the definitive Proxy Statement/Prospectus with the SEC and mailed it to Prospect's stockholders. The SEC shall have declared the Registration Statement effective and no stop order suspending the effectiveness of the Registration Statement or any part thereof shall have been issued by the SEC and no proceeding for that purpose shall have been initiated or, to the Knowledge of Prospect or KW, be threatened by the SEC.

(d) *Approval by Prospect's Stockholders*. (i) The Merger and this Agreement shall have been approved by the affirmative vote of the holders of a majority of the shares of Prospect Common Stock sold in the Prospect Public Offering voted at the meeting in accordance with Prospect Constituent Instruments, (ii) a majority of the issued and outstanding shares of Prospect Common Stock shall have approved an amendment to Prospect's certificate of incorporation in the form attached as **Exhibit D**, (iii) to the extent required, a majority of the shares of Prospect Common Stock present or represented by proxy shall have approved the issuance to the holders of KW Securities of the Prospect Common Stock to be issued hereunder, and (iv) the aggregate number of shares of Prospect Common Stock held by public stockholders of Prospect who exercise their redemption rights with respect to their Prospect Common Stock in accordance with the Prospect Constituent Instruments shall not constitute thirty percent (30%) or more of the Prospect Common Stock sold in the Prospect Public Offering (collectively, the approvals described in clauses (i)-(iv), the "**Prospect Stockholder Approvals**").

(e) *Approval by KW's Stockholders*.

(i) The Merger shall have been approved by a majority of the issued and outstanding KW Common Stock in accordance with Section 251 of the DGCL and other applicable laws, and this Agreement shall have been approved by the affirmative vote of the holders of a majority of the shares of KW Common Stock in accordance with KW Constituent Instruments (the "**KW Common Approvals**").

Table of Contents

(ii) Prior to the Closing Date, the Certificate of Designation of the KW Preferred Stock, shall have been amended pursuant to a majority vote of the holders of the KW Preferred Stock such that each share of KW Preferred Stock issued and outstanding immediately prior to the Merger Effective Time shall be automatically converted into the right to receive shares of Prospect Common Stock at the Preferred Stock Exchange Ratio (the "***KW Preferred Approval***" and, collectively with the KW Common Approvals, the "***KW Stockholder Approvals***").

(f) *No Material Adverse Effect.* Since the date of this Agreement, there shall not have been any occurrence, event, change, effect or development that, individually or in the aggregate, has had or is reasonably expected to have a Material Adverse Effect on Prospect.

(g) *Amendment of Warrants.* The holders of Prospect Warrants shall have approved the Prospect Warrant Agreement Amendment.

(h) *Notice to Trustee.* Prospect shall have delivered to the trustee of the Trust Fund instructions to disburse on the Closing Date the monies in the Trust Fund in accordance with the documents governing the Trust Fund.

(i) *Transaction Documents.* Prospect shall have executed and delivered each of the Transaction Documents to which it is a party.

(j) *Merger Documents.* Merger Sub shall have executed and delivered the Certificate of Merger to be filed in accordance with the DGCL as of the Merger Effective Time.

(k) *Resignations.* Effective as of the Closing, the directors and officers of Prospect who are not continuing as directors or officers of Prospect after the Closing shall have resigned and the copies of the resignation letters of such directors and officers shall have been delivered to Prospect, stating, among others, that they shall have no claim for employment compensation in any form from Prospect except for any reimbursement of outstanding expenses existing as of the date of such resignation.

(l) *Opinion.* KW shall have received the legal opinion of Bingham McCutchen LLP as to corporate matters which opinions shall be in form and substance reasonably satisfactory to KW.

(m) *Officer's Certificate.* KW shall have received a certificate from Prospect, signed by an authorized officer, certifying that the attached copies of the Prospect Constituent Instruments and resolutions of the Prospect Board approving the Agreement and the transactions contemplated hereby are all true, complete and correct and remain in full force and effect.

(n) *Compliance Certificate.* KW shall have received a certificate from Prospect signed by an authorized officer, certifying that the conditions specified in Section 8.1(a), (b) and (f) have been fulfilled.

(o) *Certificate of Good Standing.* KW shall have received a certificate of good standing under the applicable Law for Prospect.

(p) *Injunctions or Restraints on Conduct of Business.* No temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or other legal or regulatory restraint provision limiting or restricting Prospect's conduct or operation of the business of Prospect following the Merger shall be in effect, nor shall any proceeding brought by an administrative agency or commission or other Governmental Authority, domestic or foreign, seeking the foregoing be pending.

(q) *Completion of the Merger and Conversion.* The Merger shall have become effective under the DGCL.

Table of Contents

(r) *Governmental Approvals.* Each of KW and Prospect shall have timely obtained from each Governmental Authority all approvals, waivers and consents, if any, necessary for consummation of or in connection with this Agreement and the transactions contemplated hereby, and the waiting period under the HSR Act shall have lapsed.

(s) *SEC Reports.* Each of Prospect or Merger Sub, as appropriate, shall have filed all reports and other documents required to be filed by it under the U.S. federal securities laws through the Closing Date.

(t) *Transaction Documents.* The Transaction Documents shall have been executed and delivered by Prospect.

(u) *SEC Actions.* No formal or informal SEC investigation or proceeding shall have been initiated by the SEC against Prospect or any of its officers or directors.

(v) *AMEX Listing.* Prospect shall have maintained its status as a company whose common stock and warrants are listed on AMEX and no reason shall exist as to why such status shall not continue immediately following the Closing.

(w) *Prospect Founder Forfeited Shares.* The Prospect Founders will have delivered certificates representing 2.575 million shares of Prospect Common Stock duly endorsed in blank with executed blank stock powers pursuant to the terms of the Forfeiture Agreement.

(x) *Trust Fund Minimum.* Upon the Closing, Prospect will have available for use by the Surviving Corporation, after taking into account all expenses and liabilities of Prospect and KW and other payments ("*Trust Fund Expenses*") required to be made by Prospect and KW at or immediately after the Closing, a minimum of (i) \$75,000,000, plus (ii) an amount equal to (x) the number of shares of Prospect Common Stock which would have been issuable pursuant to Dissenting Shares if such Dissenting Shares had not exercised dissenter's rights, multiplied by (y) \$37.00, up to a maximum of \$11,370,026. Trust Fund Expenses does not include (a) amounts paid to KW officers and directors in connection with the Merger and (b) any KW debt that is accelerated by the failure of KW to obtain a Consent.

Section 8.2 *Prospect Conditions Precedent.* The obligations of Prospect to enter into and complete the Closing are subject, at the option of Prospect, to the fulfillment on or prior to the Closing Date of the following conditions by KW, any one or more of which may be waived by Prospect in writing (subject to the limitation set forth in Section 8.2(r)):

(a) *Representations and Covenants.* The representations and warranties of KW contained in this Agreement shall be true on and as of the Closing Date, except where the failure of such representations or warranties to be so true and correct, individually or in the aggregate, has not had or would not reasonably be expected to have a Material Adverse Effect on KW (disregarding for purposes of determining a Material Adverse Effect for purposes of this Section 8.2(a) any materiality qualifier set forth in KW's representations and warranties), and KW shall have performed and complied in all material respects with all covenants and agreements required by this Agreement to be performed or complied with it on or prior to the Closing Date.

(b) *Litigation.* No action, suit or proceeding (i) shall have been instituted before any court or governmental or regulatory body or instituted by any Governmental Authorities to restrain, modify or prevent the carrying out of the transactions contemplated by this Agreement, or to seek damages or a discovery order in connection with such transactions, or (ii) has or may have, in the reasonable opinion of Prospect, a Material Adverse Effect on KW.

(c) *Effectiveness of Registration Statement.* The SEC shall have declared the Registration Statement effective and no stop order suspending the effectiveness of the Registration Statement

Table of Contents

or any part thereof shall have been issued by the SEC and no proceeding for that purpose shall have been initiated or, to the Knowledge of Prospect or KW, be threatened by the SEC.

(d) *Approval by Prospect's Stockholders.* Prospect Stockholder Approvals shall have been obtained.

(e) *Approval by KW's Stockholders.* The KW Stockholder Approvals shall have been obtained.

(f) *No Material Adverse Effect.* Since the date of this Agreement, there shall not have been any occurrence, event, change, effect or development that, individually or in the aggregate, has had or is reasonably expected to have a Material Adverse Effect on KW.

(g) *Amendment of Warrants.* The holders of Prospect Warrants shall have approved the Prospect Warrant Agreement Amendment.

(h) *Employment Agreements.* KW and each of the employees named in Section 5.8 shall have entered into the employment agreements contemplated by Section 5.8.

(i) *Transaction Documents.* KW shall have executed and delivered each of the Transaction Documents to which it is a party.

(j) *Merger Documents.* KW shall have executed and delivered the Certificate of Merger to be filed in accordance with the DGCL as of the Merger Effective Time.

(k) *Cancellation of Options and Equity Compensation.* Prior to the Closing, (i) the holders of all outstanding options granted under KW's 1992 Incentive and Nonstatutory Stock Option Plan shall have exercised such options for shares of KW Common Stock, (ii) holders of all options and other equity compensation granted under KW's 2009 Equity Participation Plan shall have agreed to cancel all such options and other equity compensation owned by them, and (iii) KW shall have terminated its 1992 Incentive and Nonstatutory Stock Option Plan and 2009 Equity Participation Plan.

(l) *Opinions.* Prospect shall have received the legal opinion of KW's legal counsel, which opinion shall be in form and substance reasonably satisfactory to Prospect.

(m) *Officer's Certificate.* Prospect shall have received a certificate from KW signed by an authorized officer, certifying that the attached copies of the KW Constituent Instruments and resolutions or other authorizing documents approving the Agreement and the transactions contemplated hereby are all true, complete and correct and remain in full force and effect.

(n) *Compliance Certificate.* Prospect shall have received a certificate from KW signed by an authorized officer, certifying that the conditions specified in Section 8.2(a), (b) and (f) have been fulfilled.

(o) *Certificate of Good Standing.* Prospect shall have received a certificate of good standing or equivalent under the applicable Law of KW.

(p) *Injunctions or Restraints on Conduct of Business.* No temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or other legal or regulatory restraint provision limiting or restricting KW's conduct or operation of its business or any of its Subsidiaries following the Merger shall be in effect, nor shall any proceeding brought by an administrative agency or commission or other Governmental Authority, domestic or foreign, seeking the foregoing be pending.

(q) *Completion of the Merger.* The Merger shall have become effective under the DGCL.

Table of Contents

(r) *Dissent Rights.* The number of shares of KW Preferred Stock that have validly exercised their Dissent Rights shall not exceed 10% of the outstanding number of shares of KW Preferred Stock, and the number of shares of KW Common Stock that have validly exercised their Dissent Rights shall not exceed 10% of the outstanding number of shares of KW Common Stock. Prospect shall not waive this condition if the number of Dissenting Shares as of the Closing Date is such that, pursuant to the transactions contemplated by this Agreement, Prospect will not be acquiring "control" of KW as defined in Section 368(c) of the Code solely in exchange for Prospect Common Stock.

(s) *Governmental Approvals.* Each of KW and Prospect shall have timely obtained from each Governmental Authority all approvals, waivers and consents, if any, necessary for consummation of or in connection with this Agreement and the transactions contemplated hereby, and the waiting period under the HSR Act shall have lapsed.

(t) *Required Consents.* KW shall have delivered to Prospect evidence that all Required Consents have been obtained.

(u) *Transaction Documents.* The Transaction Documents shall have been executed and delivered by KW.

(v) *SEC Actions.* No formal or informal SEC investigation or proceeding shall have been initiated by the SEC against KW or any of its officers or directors.

ARTICLE IX

Indemnification

Section 9.1 *Survival.* All of the representations and warranties of the Parties contained in this Agreement shall survive the Closing for a period of twelve (12) months and shall thereafter be of no further force and effect; *provided, however*, that the representations and warranties contained in Sections 2.14, 2.24 and 2.26 and Sections 3.15 and 3.22, shall survive the Closing for a period equal to any applicable statute of limitations (including any waivers or extensions thereof). All of the covenants and obligations of the Parties contained in this Agreement shall survive the Closing unless they expire sooner in accordance with their terms. The term during which any representation, warranty, or covenant survives hereunder is referred to as the "*Survival Period*." Except as expressly provided in this paragraph, no claim for indemnification hereunder may be made after the expiration of the Survival Period.

Section 9.2 *Indemnification by KW.* KW shall, subject to limitations set forth in this Article IX hereof, indemnify, defend and hold harmless Prospect (which term, for the purposes of this Article IX shall include any of Prospect's successors) and permitted assigns (the "*Prospect Indemnified Parties*") from and against any liabilities, loss, claims, damages, fines, penalties, expenses (including costs of investigation and defense and reasonable attorneys' fees and court costs) (collectively, "*Damages*") arising from: (i) any breach of any representation or warranty made by KW in Article II hereof or in any certificate delivered by KW pursuant to this Agreement; or (ii) any breach by KW of its covenants or obligations in this Agreement to be performed or complied with by KW at or prior to the Closing.

Section 9.3 *Indemnification by Prospect.* Prospect shall, subject to the terms hereof, indemnify, defend and hold harmless KW (which term, for the purposes of this Article IX shall include any of KW's successors) and permitted assigns (the "*KW Indemnified Parties*") from and against any Damages arising from: (i) any breach of any representation or warranty made by Prospect in Article III hereof or in any certificate delivered by Prospect pursuant to this Agreement; or (ii) any breach by Prospect of its covenants or obligations in this Agreement to be performed or complied with by Prospect at or prior to the Closing.

Table of Contents

Section 9.4 *Limitations on Indemnity.* Notwithstanding any other provision in this Agreement to the contrary, the Prospect Indemnified Parties and the KW Indemnified Parties shall not be entitled to indemnification pursuant to Section 9.2 or Section 9.3, unless and until the aggregate amount of Damages under Section 9.2 or Section 9.3, as applicable, collectively exceeds \$1,000,000 (the "**Deductible**"). The aggregate amount of Damages for which a Party may be liable under this Agreement shall not exceed \$10,000,000 (the "**Cap**").

Section 9.5 *Defense of Third Party Claims.* If any Prospect Indemnified Party or KW Indemnified Party determines to make a claim for indemnification under Section 9.2 or 9.3 (each an "**Indemnitee**"), such Indemnitee shall notify the indemnifying party (an "**Indemnitor**") of the claim in writing promptly after receiving notice of any action, lawsuit, proceeding, investigation, demand or other claim against the Indemnitee (if by a third party), describing the claim, the amount thereof (if known and quantifiable) and the basis thereof in reasonable detail (such written notice, an "**Indemnification Notice**"); provided that the failure to so notify an Indemnitor shall not relieve the Indemnitor of its obligations hereunder except to the extent that (and only to the extent that) such failure shall have caused the damages for which the Indemnitor is obligated to be greater than such damages would have been had the Indemnitee given the Indemnitor prompt notice hereunder. Any Indemnitor shall be entitled to participate in the defense of such action, lawsuit, proceeding, investigation or other claim giving rise to an Indemnitee's claim for indemnification at such Indemnitor's expense, and at its option shall be entitled to assume the defense thereof by appointing a reputable counsel reasonably acceptable to the Indemnitee to be the lead counsel in connection with such defense; *provided*, that the Indemnitee shall be entitled to participate in the defense of such claim and to employ counsel of its choice for such purpose; *provided, however*, that the fees and expenses of such separate counsel shall be borne by the Indemnitee and shall not be recoverable from such Indemnitor under this Article IX. If the Indemnitor shall control the defense of any such claim, the Indemnitor shall be entitled to settle such claims; *provided*, that the Indemnitor shall obtain the prior written consent of the Indemnitee (which consent shall not be unreasonably withheld, conditioned or delayed) before entering into any settlement of a claim or ceasing to defend such claim if, pursuant to or as a result of such settlement or cessation, injunctive or other equitable relief will be imposed against the Indemnitee or if such settlement does not expressly and unconditionally release the Indemnitee from all liabilities and obligations with respect to such claim. If the Indemnitor assumes such defense, the Indemnitor shall not be liable for any amount required to be paid by the Indemnitee that exceeds, where the Indemnitee has unreasonably withheld or delayed consent in connection with the proposed compromise or settlement of a third party claim, the amount for which that third party claim could have been settled pursuant to that proposed compromise or settlement. In all cases, the Indemnitee shall provide its reasonable cooperation with the Indemnitor in defense of claims or litigation, including by making employees, information and documentation reasonably available. If the Indemnitor shall not assume the defense of any such action, lawsuit, proceeding, investigation or other claim, the Indemnitee may defend against such matter as it deems appropriate; provided that the Indemnitee may not settle any such matter without the written consent of the Indemnitor (which consent shall not be unreasonably withheld, conditioned or delayed) if the Indemnitee is seeking or will seek indemnification hereunder with respect to such matter.

Section 9.6 *Determining Damages.* The amount of Damages subject to indemnification under Section 9.2 or 9.3 shall be calculated net of (i) any Tax Benefit inuring to the Indemnitee on account of such Damages, (ii) any reserves set forth in any of KW Financial Statements relating to such Damages and (iii) any insurance proceeds or other amounts under indemnification agreements received or receivable by the Indemnitee on account of such Damages. If the Indemnitee receives a Tax Benefit on account of such Damages after an indemnification payment is made to it, the Indemnitee shall promptly pay to the Person or Persons that made such indemnification payment the amount of such Tax Benefit at such time or times as and to the extent that such Tax Benefit is realized by the Indemnitee. For purposes hereof, "**Tax Benefit**" shall mean any refund of Taxes to be paid or reduction

Table of Contents

in the amount of Taxes which otherwise would be paid by the Indemnitee, in each case computed at the highest marginal tax rates applicable to the recipient of such benefit. To the extent Damages are recoverable by insurance, the Indemnitees shall take all commercially reasonable efforts to obtain maximum recovery from such insurance. In the event that an insurance or other recovery is made by any Indemnitee with respect to Damages for which any such Person has been indemnified hereunder, then a refund equal to the aggregate amount of the recovery shall be made promptly to the Person or Persons that provided such indemnity payments to such Indemnitee. The Indemnitors shall be subrogated to all rights of the Indemnitees in respect of Damages indemnified by the Indemnitors. The Indemnitees shall take all commercially reasonable efforts to mitigate all Damages upon and after becoming aware of any event which could reasonably be expected to give rise to Damages. For Tax purposes, the Parties agree to treat all payments made under this Article IX as adjustments to the consideration received for KW Securities.

Section 9.7 *Right of Setoff.* To the extent that any Party is obligated to indemnify any other Party after Closing under the provisions of this Article IX for Damages reduced to a monetary amount, such Party after Closing shall have the right to decrease any amount due and owing or to be due and owing under any agreement with the other Party, whether under this Agreement or any other agreement between such Parties on the one hand, and any of the other Party or any of their respective Affiliates, Subsidiaries or controlled persons or entities on the other.

Section 9.8 *Limitation on Recourse; No Third Party Beneficiaries.*

(a) No claim shall be brought or maintained by any Party or its respective successors or permitted assigns against any officer, director, partner, member, agent, representative, Affiliate, equity holder, successor or permitted assign of any Party which is not otherwise expressly identified as a Party, and no recourse shall be brought or granted against any of them, by virtue of or based upon any alleged misrepresentation or inaccuracy in or breach of any of the representations, warranties, covenants or obligations of any Party set forth or contained in this Agreement or any exhibit or schedule hereto or any certificate delivered hereunder.

(b) The provisions of this Article IX are for the sole benefit of the Parties and nothing in this Article IX, express or implied, is intended to or shall confer upon any other Person any legal or equitable right, benefit or remedy of any nature whatsoever under or by reason of this Article IX.

Section 9.9 *Fraud.* Notwithstanding anything to the contrary in this Agreement, the limitations and thresholds set forth in this Article IX shall not apply with respect to fraud, intentional misrepresentation or willful misconduct.

ARTICLE X

Termination

Section 10.1 *Methods of Termination.* Unless waived by the Parties hereto in writing, the transactions contemplated by this Agreement may be terminated and/or abandoned at any time but not later than the Closing:

(a) by mutual written consent of the Parties;

(b) by either Prospect or KW, if the Closing has not occurred by November 13, 2009;

(c) by either Prospect or KW, if a Governmental Authority shall have enacted, issued, promulgated, enforced or entered any statute, rule, regulation, executive order, decree, injunction or other order, in each case which has become final and non-appealable, and which permanently restrains, enjoins or otherwise prohibits the transactions contemplated hereby;

Table of Contents

(d) by KW if it is not in material breach of this Agreement, and if there has been a breach by Prospect of any representation, warranty, covenant or agreement contained in this Agreement which has prevented the satisfaction of the conditions to the obligations of KW at the Closing under Section 8.1 and such violation or breach has not been waived by KW or cured by Prospect within ten (10) business days after written notice thereof from KW;

(e) by Prospect, if it is not in material breach of this Agreement, and if (i) there has been a breach by KW of any representation, warranty, covenant or agreement contained in this Agreement which has prevented the satisfaction of the conditions to the obligations of Prospect at the Closing under Section 8.2 and such violation or breach has not been waived by Prospect or cured by KW within ten (10) business days after written notice thereof from Prospect, or (ii) KW has notified Prospect that KW will be unable to obtain a Required Consent prior to October 15, 2009;

(f) by KW, if the Prospect Board (or any committee thereof) shall have failed to recommend or shall have withdrawn or modified in a manner adverse to KW its approval or recommendation of this Agreement and the transactions contemplated hereunder;

(g) by Prospect, if the board of directors of KW (or any committee thereof) shall have failed to recommend or shall have withdrawn or modified in a manner adverse to Prospect its approval or recommendation of this Agreement and the transactions contemplated hereunder;

(h) by either Prospect or KW if, at the Prospect Stockholders' Meeting (including any adjournments thereof), the Prospect Stockholder Approvals shall not have been obtained, or the aggregate number of shares of Prospect Common Stock held by public stockholders of Prospect who exercise their redemption rights with respect to their Prospect Common Stock in accordance with the Prospect Constituent Instruments shall constitute thirty percent (30%) or more of the Prospect Common Stock sold in the Prospect Public Offering.

(i) by either Prospect or KW if the KW Common Approval shall not have been obtained on or prior to November 13, 2009.

Section 10.2 *Effect of Termination.*

(a) In the event of termination by either Prospect or KW, or both of them, pursuant to Section 10.1 hereof, written notice thereof shall forthwith be given to the other Party, and except as set forth in this Article X and subject to Section 5.10 hereof, all further obligations of the Parties shall terminate, no Party shall have any right against the other Party hereto, and each Party shall bear its own costs and expenses.

(b) If the transactions contemplated by this Agreement are terminated and/or abandoned as provided herein:

(i) each Party hereto shall destroy all documents, work papers and other material (and all copies thereof) of the other Party relating to the transactions contemplated hereby, whether so obtained before or after the execution hereof, to the Party furnishing the same; and

(ii) all confidential information received by either Party hereto with respect to the business of the other Party hereto shall be treated in accordance with Section 7.2 hereof, which shall survive such termination or abandonment. The following other provisions shall survive termination of this Agreement: Section 5.10, Section 7.5, Article XI and this Section 10.2.

(c) If this Agreement is terminated by either Party pursuant to Section 10.1(i), KW shall be obligated to pay Prospect, as liquidated damages, \$10,000,000 within thirty (30) days following the

Table of Contents

date of such termination. If KW shall have failed to pay such liquidated damages on or before the thirtieth (30th) day following termination, interest will begin to accrue on such amount at a rate equal to 2% per month (compounded monthly), provided that in no event will such rate be higher than the highest rate permitted by law.

ARTICLE XI

Miscellaneous

Section 11.1 *Notices.* All notices, requests, claims, demands and other communications under this Agreement shall be in writing and shall be deemed given upon receipt by the Parties at the addresses set forth on the signature pages (or at such other address for a Party as shall be specified in writing to all other Parties).

Section 11.2 *Amendments; Waivers.* No provision of this Agreement may be waived or amended except in a written instrument signed by all of the Parties hereto. No waiver of any default with respect to any provision, condition or requirement of this Agreement shall be deemed to be a continuing waiver in the future or a waiver of any subsequent default or a waiver of any other provision, condition or requirement hereof, nor shall any delay or omission of any Party to exercise any right hereunder in any manner impair the exercise of any such right.

Section 11.3 *Interpretation.* When a reference is made in this Agreement to a Section, such reference shall be to a Section of this Agreement unless otherwise indicated. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation." The terms "hereof," "herein," and "hereby" and words of similar import will, unless otherwise stated, be construed to refer to this Agreement as a whole and not to any particular provision of this Agreement.

Section 11.4 *Severability.* If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule or Law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated by this Agreement is not affected in any manner materially adverse to any Party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the Parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the Parties as closely as possible in an acceptable manner to the end that transactions contemplated by this Agreement are fulfilled to the extent possible.

Section 11.5 *Counterparts; Facsimile Execution.* This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the Parties and delivered to the other Parties. Facsimile or electronic execution and delivery of this Agreement is legal, valid and binding for all purposes.

Section 11.6 *Entire Agreement; Third Party Beneficiaries.* This Agreement, taken together with all Exhibits, Annexes and Schedules hereto (a) constitute the entire agreement, and supersede all prior agreements and understandings, both written and oral, among the Parties with respect to the transactions contemplated hereby and (b) are not intended to confer upon any Person other than the Parties any rights or remedies; *provided* that Section 6.9 of this Agreement is intended to benefit the Indemnified D&Os, each Indemnified D&O shall be deemed a third-party beneficiary of Section 6.9 of this Agreement, and Section 6.9 of this Agreement shall be enforceable by the Indemnified D&Os.

Section 11.7 *Governing Law.* This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

Table of Contents

Section 11.8 *Consent to Jurisdiction.*

(a) Each of the Parties irrevocably agrees that any legal action or proceeding with respect to this Agreement and the rights and obligations arising hereunder, or for recognition and enforcement of any judgment in respect of this Agreement and the rights and obligations arising hereunder brought by the other party hereto or its successors or assigns, shall be brought and determined exclusively in state or federal court within the City and State of New York. Each of the Parties hereby irrevocably submits with regard to any such action or proceeding for itself and in respect of its property, generally and unconditionally, to the personal jurisdiction of the aforesaid courts and agrees that it will not bring any action relating to this Agreement or any of the transactions contemplated by this Agreement in any court other than the aforesaid courts. Each of the Parties hereby irrevocably waives, and agrees not to assert as a defense, counterclaim or otherwise, in any action or proceeding with respect to this Agreement, (i) any claim that it is not personally subject to the jurisdiction of the above-named courts for any reason other than the failure to serve in accordance with this Section 11.8, (ii) any claim that it or its property is exempt or immune from jurisdiction of any such court or from any legal process commenced in such courts (whether through service of notice, attachment prior to judgment, attachment in aid of execution of judgment, execution of judgment or otherwise), and (iii) to the fullest extent permitted by applicable Law, any claim that (1) the suit, action or proceeding in such court is brought in an inconvenient forum, (2) the venue of such suit, action or proceeding is improper or (3) this Agreement, or the subject matter hereof, may not be enforced in or by such courts.

(b) EACH OF THE PARTIES IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR RELATING TO ANY OF THE TRANSACTION DOCUMENTS, THE TRANSACTION OR THE ACTIONS OF THE PARTIES IN THE NEGOTIATION, ADMINISTRATION, PERFORMANCE OR ENFORCEMENT THEREOF.

Section 11.9 *Assignment.* Neither this Agreement nor any of the rights, interests or obligations under this Agreement shall be assigned, in whole or in part, by operation of law or otherwise by any of the Parties without the prior written consent of the other Parties. Any purported assignment without such consent shall be void. Subject to the preceding sentences, this Agreement will be binding upon, inure to the benefit of, and be enforceable by, the Parties and their respective successors and permitted assigns.

[Signature Page Follows]

Table of Contents

IN WITNESS WHEREOF, the Parties hereto have caused this Agreement to be duly executed by their respective authorized signatories as of the date first indicated above.

PROSPECT ACQUISITION CORP.

By: /s/ DAVID A. MINELLA

Name: David A. Minella
Title: Chairman & CEO
Address: 9130 Galleria Court, Suite 318
Naples, FL 34109

With a copy to:

Bingham McCutchen LLP
399 Park Avenue
New York, NY 10022
Attention: Floyd I. Wittlin, Esq.

KW MERGER SUB CORP.

By: /s/ DAVID A. MINELLA

Name: David A. Minella
Title: President & Secretary
Address: c/o Prospect Acquisition Corp.
9130 Galleria Court, Suite 318
Naples, FL 34104

KENNEDY-WILSON, INC.

By: /s/ WILLIAM J. MCMORROW

Name: William J. McMorrow
Title: Chief Executive Officer
Address: 9601 Wilshire Blvd.
Beverly Hills, CA 90210

A-44

Table of Contents

ANNEX A

Definitions

"*Action*" has the meaning set forth in Section 2.10 of the Agreement.

"*Affiliate(s)*" means any Person that directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the Person specified. For purposes of this definition, control of a Person means the power, direct or indirect, to direct or cause the direction of the management and policies of such Person whether by Contract or otherwise and, in any event and without limitation of the previous sentence, any Person owning fifty percent (50%) or more of the voting securities of a second Person shall be deemed to control that second Person. For the purposes of this definition, a Person shall be deemed to control any of his or her immediate family members.

"*Agreement*" has the meaning set forth in the preamble to this Agreement.

"*Amended Public Warrant*" means an amended and restated Public Warrant (as defined in the Prospect Warrant Agreement) having the same terms as the Public Warrants except that it shall have an exercise price of \$12.50 per share, a redemption price of \$19.50 per share and a termination date of November 14, 2013.

"*Amended Sponsor Warrant*" means an amended and restated Sponsor Warrant (as defined in the Prospect Warrant Agreement) having the same terms as the Sponsor Warrants except that it shall have an exercise price of \$12.50 per share, a redemption price of \$19.50 per share and a termination date of November 14, 2013.

"*AMEX*" means the NYSE Amex LLC.

"*Business Day*" means a day (excluding Saturdays, Sundays and public holidays) on which commercial banks are generally open for banking business in the United States.

"*Cap*" has the meaning set forth in Section 9.4 of the Agreement.

"*Cash Consideration*" means \$0.55 in cash.

"*Certificate of Merger*" has the meaning set forth in Section 1.2 of the Agreement.

"*CGCL*" has the meaning set forth in Section 1.7(f) of the Agreement.

"*Closing*" has the meaning set forth in Section 1.9 of the Agreement.

"*Closing Date*" has the meaning set forth in Section 1.9 of the Agreement.

"*COBRA*" means Code Section 4980B, Part 6 of Subtitle B of Title I of ERISA and any applicable state law providing for similar group health or welfare plan continuation coverage.

"*Code*" means the United States Internal Revenue Code of 1986, as amended.

"*Common Stock Exchange Ratio*" has the meaning set forth in Section 1.7(a) of the Agreement.

"*Consent*" has the meaning set forth in Section 2.5 of the Agreement.

"*Contract*" means a contract, lease, license, indenture, note, bond, agreement, permit, concession, franchise or other instrument.

"*Conversion Shares*" has the meaning set forth in Section 1.7(a) of the Agreement.

"*Damages*" has the meaning set forth in Section 9.2 of the Agreement.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

"*Deductible*" has the meaning set forth in Section 9.4 of the Agreement.

"*DGA*" has the meaning set forth in the background to the Agreement.

A-45

Table of Contents

"*DGAH*" has the meaning set forth in the background to the Agreement.

"*DGCL*" has the meaning set forth in the background to the Agreement.

"*Disclosure Schedules*" means the KW Disclosure Schedule and the Prospect Disclosure Schedule.

"*Dissent Rights*" has the meaning set forth in Section 1.7(f) of the Agreement.

"*Dissenting Shares*" has the meaning set forth in Section 1.7(f) of the Agreement.

"*Environment*" means soil, land surface or subsurface strata, surface waters (including navigable waters, ocean waters, streams, ponds, drainage basins, and wetlands), groundwaters, drinking water supply, stream sediments, ambient air (including indoor air), plant and animal life, and any other environmental medium or natural resource.

"*Environmental Law*" means any Legal Requirement that requires or relates to:

(a) advising appropriate authorities, employees, and the public of intended or actual releases of pollutants or hazardous substances or materials, violations of discharge limits, or other prohibitions and of the commencements of activities, such as resource extraction or construction, that could have significant impact on the Environment;

(b) preventing or reducing to acceptable levels the release of pollutants or hazardous substances or materials into the Environment;

(c) reducing the quantities, preventing the release, or minimizing the hazardous characteristics of wastes that are generated;

(d) assuring that products are designed, formulated, packaged, and used so that they do not present unreasonable risks to human health or the Environment when used or disposed of;

(e) protecting resources, species, or ecological amenities;

(f) reducing to acceptable levels the risks inherent in the transportation of hazardous substances, pollutants, oil, or other potentially harmful substances;

(g) cleaning up pollutants that have been released, preventing the threat of release, or paying the costs of such clean up or prevention; or

(h) making responsible parties pay private parties, or groups of them, for damages done to their health or the Environment, or permitting self-appointed representatives of the public interest to recover for injuries done to public assets.

"*ERISA*" means the Employee Retirement Income Security Act of 1974, as amended.

"*ERISA Affiliate*" means any trade or business (whether or not incorporated) which is or which has at any time in the last six (6) years been considered a single employer with KW or any of its Subsidiaries within the meaning of Section 414(b), (c), (m) or (o) of the Code or Section 4001(b) of ERISA.

"*Exchange Act*" means the Securities Exchange Act of 1934, as amended, supplemented or otherwise modified from time to time.

"*Exchange Agent*" has the meaning set forth in Section 1.8 of the Agreement.

"*Exchange Ratio*" has the meaning set forth in Section 1.7(a) of the Agreement.

"*Exclusivity Period*" has the meaning set forth in Section 4.3(a) of the Agreement.

"*Expenses*" means all out-of-pocket expenses (including all fees and expenses of counsel, accountants, investment bankers, experts and consultants to a party hereto and its Affiliates) incurred

Table of Contents

by a party on its behalf in connection with or related to the authorization, preparation, diligence, negotiation, execution and performance of this Agreement and the Transaction Documents.

"*Forfeiture Agreement*" has the meaning set forth in the background to the Agreement.

"*FCPA*" has the meaning set forth in Section 2.20 of the Agreement.

"*Governmental Authority*" means any national, federal, state, provincial, local or foreign government, governmental, regulatory or administrative authority, agency or commission or any court, tribunal or judicial or arbitral body of competent jurisdiction, or other governmental authority or instrumentality, domestic or foreign.

"*HSR Act*" means the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

"*Indemnitee*" has the meaning set forth in Section 9.5 of the Agreement.

"*Indemnitor*" has the meaning set forth in Section 9.5 of the Agreement.

"*Indemnification Notice*" has the meaning set forth in Section 9.5 of the Agreement.

"*Indemnified D&Os*" has the meaning set forth in Section 6.9(a) of the Agreement.

"*Intellectual Property Rights*" has the meaning set forth in Section 2.13 of the Agreement.

"*Judgment*" means any judgment, order or decree.

"*Knowledge*", (i) with respect to KW, means the actual knowledge of its executive officers and members of its board of directors, and (ii) with respect to Prospect, means the actual knowledge of its executive officers and the members of its board of directors.

"*KW*" has the meaning set forth in the preamble to the Agreement.

"*KW Balance Sheet*" means the unaudited balance sheet as of June 30, 2009 included in the KW Financial Statements.

"*KW Benefit Plans*" has the meaning set forth in Section 2.15(a) of the Agreement.

"*KW Certificates*" has the meaning set forth in Section 1.7(d) of the Agreement.

"*KW Common Stock*" has the meaning set forth in background to the Agreement.

"*KW Common Approval*" has the meaning set forth in Section 8.1(e) of the Agreement.

"*KW Constituent Instruments*" means the certificate of incorporation and bylaws, or other constitutive documents, of KW and each of its Subsidiaries each as amended to the date of the Agreement.

"*KW Disclosure Schedule*" has the meaning set forth in Article II of the Agreement.

"*KW Financial Statements*" has the meaning set forth in Section 2.6(a) of the Agreement.

"*KW Group*" has the meaning set forth in Section 4.3(b) of the Agreement.

"*KW Indemnified Parties*" has the meaning set forth in Section 9.3 of the Agreement.

"*KW Preferred Approval*" has the meaning set forth in Section 8.1(e) of the Agreement.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

"*KW Preferred Stock*" has the meaning set forth in the background to the Agreement.

"*KW Securities*" has the meaning set forth in the background to the Agreement.

"*KW Stock Rights*" means that certain 7% convertible subordinated note due November 3, 2018 issued by KW to the Guardian Life Insurance Company of America, as the same is in effect on the date of this Agreement.

A-47

Table of Contents

"*KW Stockholder Approvals*" has the meaning set forth in Section 8.1(e) of the Agreement.

"*KW Third Party Acquisition*" means (a) any sale of 15% or more of the consolidated assets of KW and its Subsidiaries, or 15% or more of the equity or voting securities of KW or any Subsidiary whose assets, individually or in the aggregate, constitute 15% or more of the consolidated assets of KW (each, a "*Material Subsidiary*"), (b) any tender offer or exchange offer that, if consummated, would result in a third party beneficially owning 15% or more of the equity or voting securities of KW or of any Material Subsidiary, (c) a merger, consolidation, business combination, share exchange, sale of substantially all the assets, reorganization, recapitalization, liquidation, dissolution or other similar transaction involving KW or any Material Subsidiary, in each such case in this clause (c) that would result in either (x) a third party beneficially owning 15% or more of any class of equity or voting securities of KW or any Material Subsidiary, or 15% or more of the consolidated assets of KW or (y) the stockholders of KW receiving securities traded in the U.S. on any nationally-recognized exchange or over-the-counter market.

"*Law(s)*" means any law, statute, ordinance, rule, regulation, order, writ, injunction or decree.

"*Legal Requirement*" means any federal, state, local, municipal, provincial, foreign or other law, statute, constitution, principle of common law, resolution, ordinance, code, edict, decree, rule, regulation, ruling or requirement issued, enacted, adopted, promulgated, implemented or otherwise put into effect by or under the authority of any Governmental Authorities (or under the authority of any national securities exchange upon which a Party's securities are then listed or traded)

"*Liens*" means any liens, security interests, pledges, equities and claims of any kind, voting trusts, shareholder agreements and other encumbrances.

"*Management Incentive Shares*" has the meaning set forth in Section 6.8 of the Agreement.

"*Management Incentive Plan*" has the meaning set forth in Section 6.8 of the Agreement.

"*Material Adverse Effect*" means any event, change or effect that is materially adverse to the condition (financial or otherwise), properties, assets, liabilities, business, operations or results of operations of such Person and its Subsidiaries, taken as a whole. Notwithstanding the foregoing, none of the following shall be deemed, either alone or in combination, to constitute, and none of the following shall be taken into account in determining whether there has been or would be, a "Material Adverse Effect" with respect to any Person: any facts, changes, developments, events, occurrences, actions, omissions or effects (i) generally affecting (A) the economy, or financial or capital markets, in the United States or elsewhere in the world, to the extent that they do not disproportionately affect such Person in relation to other companies in the industry in which such Person primarily operates or (B) the industry in which such Person operates to the extent that they do not disproportionately affect such Person in relation to other companies in the industry in which such Person primarily operates, or (ii) arising out of, resulting from or attributable to (1) changes (after the date of this Agreement) in Law or in generally accepted accounting principles or in accounting standards or (2) any decline in the market price, or change in trading volume, of the capital stock of such Person or any failure to meet publicly announced revenue or earnings projections or internal projections, or (iii) changes related to or arising from the execution, announcement or performance of, or compliance with, this Agreement or the consummation of the transactions contemplated hereby, including the impact thereof on relationships, contractual or otherwise, governmental authorities, customers, cooperators, suppliers, distributors or employees;

"*Material Contract*" means a written Contract, as amended and supplemented to which KW or any of its Subsidiaries is a party or by which any of their respective assets and properties is currently bound, that is material to KW's business, properties, assets or condition (financial or otherwise), results of operations or prospects and was not executed in the ordinary course of business, including contracts

Table of Contents

that have expired by their terms or otherwise terminated but have liabilities that continue to attach to KW or any of its Subsidiaries.

"*Material Permits*" means all Permits other than such franchises, licenses, permits, authorizations and approvals the lack of which, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect on any Parties.

"*Merger*" has the meaning set forth in the background to the Agreement.

"*Merger Sub*" has the meaning set forth in the preamble to the Agreement.

"*Merger Effective Time*" has the meaning set forth in Section 1.2 of the Agreement.

"*Money Laundering Laws*" has the meaning set forth in Section 2.21 of the Agreement.

"*OFAC*" has the meaning set forth in Section 2.25 of the Agreement.

"*Off-balance Sheet Arrangement*" means with respect to any Person, any securitization transaction to which that Person or its Subsidiaries is party and any other transaction, agreement or other contractual arrangement to which an entity unconsolidated with that Person is a party, under which that Person or its Subsidiaries, whether or not a party to the arrangement, has, or in the future may have: (a) any obligation under a direct or indirect guarantee or similar arrangement; (b) a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement; or (c) derivatives to the extent that the fair value thereof is not fully reflected as a liability or asset in the financial statements.

"*Party*" or "*Parties*" has the meaning set forth in the preamble to the Agreement.

"*Permits*" means all governmental franchises, licenses, permits, authorizations and approvals necessary to enable a Person to own, lease or otherwise hold its properties and assets and to conduct its businesses as presently conducted.

"*Permitted Lien*" means (a) any restriction on transfer arising under applicable securities law; (b) any Liens for Taxes not yet due or delinquent or being contested in good faith by appropriate proceedings for which adequate reserves have been established in accordance with U.S. GAAP; (c) any statutory Liens arising in the ordinary course of business by operation of Law with respect to a liability that is not yet due and delinquent and which are not, individually or in the aggregate, significant; (d) minor title defects, recorded easements, and zoning, entitlement, building and other minor land use regulations imposed by governmental agencies having jurisdiction over the Real Property, which minor title defects, recorded easements, and regulations do not, individually or in the aggregate, impair the continued use, occupancy, value or marketability of title of the property to which they relate and are not violated by the current or proposed use and operation of the Real Property; (e) covenants, conditions, restrictions, easements and other similar matters of record affecting title to the Real Property which do not materially impair the occupancy or use of the Real Property for the purposes for which it is currently used or proposed to be used in connection with the such relevant Person's business; (f) Liens identified on title policies, title opinions or preliminary title reports or other documents or writings included in the public records; (g) Liens arising under worker's compensation, unemployment insurance, social security, retirement and similar legislation; (h) Liens of lessors and licensors arising under lease agreements or license arrangements; and (i) those Liens set forth in KW Disclosure Schedule.

"*Person(s)*" means an individual, partnership, corporation, joint venture, unincorporated organization, cooperative or a governmental entity or agency thereof.

"*Preferred Stock Exchange Ratio*" has the meaning set forth in Section 1.7(a) of the Agreement.

"*Prospect*" has the meaning set forth in the preamble to the Agreement.

Table of Contents

"*Prospect Board*" means the board of directors of Prospect prior to the Merger.

"*Prospect Common Stock*" means the Common Stock of Prospect, \$0.001 par value per share.

"*Prospect Constituent Instruments*" has the meaning set forth in Section 3.2 of the Agreement.

"*Prospect Disclosure Schedule*" has the meaning set forth in Article III of the Agreement.

"*Prospect Financial Statements*" has the meaning set forth in Section 3.7 of the Agreement.

"*Prospect Founders*" shall mean Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., Capital Management Systems, Inc., SJC Capital LLC, Michael P. Castine, Daniel Gressel, Michael Downey, James J. Cahill and John Merchant.

"*Prospect Group*" has the meaning set forth in Section 4.3(a) of the Agreement.

"*Prospect Indemnified Parties*" has the meaning set forth in Section 9.2 of the Agreement.

"*Prospect Material Contract*" has the meaning set forth in Section 3.21(a) of the Agreement.

"*Prospect Public Offering*" means the initial public offering of Prospect completed on November 14, 2007, in which Prospect sold 25,000,000 Units at a price of \$10.00 per unit.

"*Prospect SEC Documents*" has the meaning set forth in Section 3.7 of the Agreement.

"*Prospect Stockholder Approvals*" has the meaning set forth in Section 8.1(d) of the Agreement.

"*Prospect Stockholders' Meeting*" has the meaning set forth in Section 6.1(a) of the Agreement.

"*Prospect Share(s)*" has the meaning set forth in the background to the Agreement.

"*Prospect Stock Right(s)*" shall mean a warrant or other right to purchase a share of common stock of Prospect.

"*Prospect Third Party Acquisition*" means: (a) any purchase of 15% or more of the consolidated assets of a third party and its subsidiaries, or 15% or more of the equity or voting securities of a third party or a Material Subsidiary (as defined in KW Third Party Acquisition definition) thereof, (b) any tender offer or exchange offer that, if consummated, would result in Prospect beneficially owning 15% or more of a third party's equity or voting securities or any Material Subsidiary thereof, (c) a merger, consolidation, business combination, share exchange, purchase of substantially all the assets, reorganization, recapitalization, liquidation, dissolution or other similar transaction involving Prospect and any third party, in each such case in this clause (c) that would result in Prospect beneficially owning 15% or more of any class of equity or voting securities of such third party or any Material Subsidiary thereof, or 15% or more of the consolidated assets of such third party.

"*Prospect Warrant*" means an outstanding warrant of Prospect which entitles the registered holder to purchase one share of Prospect Common Stock at a price of \$7.50 per share, subject to adjustment at any time commencing on the completion of a business combination.

"*Prospect Warrant Agreement*" means the Warrant Agreement, by and between Prospect and Continental Stock Transfer & Trust Company (as Warrant Agent), dated as of November 14, 2007.

"*Prospect Warrant Agreement Amendment*" means an amendment to the Prospect Warrant Agreement substantially in the form attached as **Exhibit E** that provides that, simultaneously with the Closing: (i) each Sponsor Warrant (as defined in the Prospect Warrant Agreement) will be converted into the Amended Sponsor Warrant; and (ii) each Public Warrant (as defined in the Prospect Warrant Agreement) will be converted into either (x) the Cash Consideration or (y) the Amended Public Warrant, in each case as the holder of Public Warrants shall have elected or be deemed to have elected; provided that no more than 50% of the outstanding Public Warrants shall be converted into the right to receive the Amended Public Warrant.

Table of Contents

"*Prospect Warrant Holders Meeting*" has the meaning set forth in Section 6.1(a) of the Agreement.

"*Proxy Statement/Prospectus Tax Section*" has the meaning set forth in Section 7.7 of the Agreement.

"*Proxy Statement/Prospectus*" has the meaning set forth in Section 2.28 of the Agreement.

"*Real Estate Leases*" means the leases for the properties located at 9601 Wilshire Blvd., Beverly Hills, CA, 90210 and 9701 Wilshire Blvd., Beverly Hills, CA, 90210.

"*Real Property*" has the meaning set forth in Section 2.12(a) of the Agreement.

"*Registration Statement*" has the meaning set forth in Section 2.28 of the Agreement.

"*Regulation S-K*" means Regulation S-K promulgated under the Securities Act of 1933, as amended.

"*Representatives*" of any Party means such Party's employees, accountants, auditors, actuaries, counsel, financial advisors, bankers, investment bankers and consultants and any other person acting on behalf of such Party.

"*Required Consent*" has the meaning set forth in Section 5.5(a) of the Agreement.

"*Sarbanes-Oxley Act*" has the meaning set forth in Section 3.13 of the Agreement.

"*SEC*" means the United States Securities and Exchange Commission.

"*Securities Act*" means the Securities Act of 1933, as amended, supplemented or otherwise modified from time to time.

"*Subsidiary*" means with respect to a Person an entity if (a) such Person directly or indirectly owns, beneficially or of record, an amount of voting securities or other interests in such entity that is sufficient to enable such Person to elect at least a majority of the members of such entity's board of directors or other governing body, or (b) at least 50% of the outstanding equity or financial interests of such entity such that its financial results are consolidated with such other Person.

"*Survival Period*" has the meaning set forth in Section 9.1 of this Agreement.

"*Surviving Corporation*" has the meaning set forth in Section 1.1 of the Agreement.

"*Tail Coverage Amount*" has the meaning set forth in Section 6.9(a) of the Agreement.

"*Tangible Personal Property*" has the meaning set forth in Section 2.12(b) of the Agreement.

"*Taxes*" means all United States federal, state, local or foreign taxes, charges, fees, levies or other assessments, including, without limitation, income, gross receipts, excise, real and personal property, profits, estimated, severance, occupation, production, capital gains, capital stock, goods and services, environmental, employment, withholding, stamp, value added, alternative or add-on minimum, sales, transfer, use, license, payroll and franchise taxes or any other tax, custom, duty or governmental fee, or other like assessment or charge of any kind whatsoever, imposed by the United States, or any state, county, local or foreign government or subdivision or agency thereof, and such term shall include any interest, penalties, fines, related liabilities or additions to tax attributable to such taxes, charges, fees, levies or other assessments.

"*Tax Benefit*" has the meaning set forth in Section 9.6 of the Agreement.

"*Tax Return*" means all federal, state, local, provincial and foreign Tax returns, declarations, statements, reports, schedules, forms and information returns and any amended Tax return relating to Taxes.

Table of Contents

"*Trade Secrets*" means all trade secrets under applicable law and other rights in know-how and confidential or proprietary information, processing, manufacturing or marketing information, including new developments, inventions, processes, ideas or other proprietary information that provides advantages over competitors who do not know or use it.

"*Transaction Documents*" means this Agreement and any other agreement or document to be delivered by the Parties on the Closing Date.

"*Trust Fund*" has the meaning set forth in Section 3.19 of the Agreement.

"*Trust Fund Expense*" has the meaning set forth in Section 8.1(x) of the Agreement.

"*U.S.*" or "*United States*" means the United States of America.

"*U.S. GAAP*" means generally accepted accounting principles of the United States.

"*Unit*" means the Unit of Prospect which entitles the registered holder to one share of Prospect Common Stock and one Warrant.

"*Voting Prospect Debt*" has the meaning set forth in Section 3.1(c) of the Agreement.

"*Voting KW Debt*" has the meaning set forth in Section 2.1(b) of the Agreement.

Table of Contents

Omitted Schedules

The portions identified below in the following schedules have been omitted from the merger agreement:

Section 2.1(b) Capital Structure Breakdown of company stock, option and bond holders

Section 2.3 Subsidiaries List of all subsidiaries of the Company

Section 2.4(a) No Conflicts Loan obligations, guaranties, and lease obligations

Section 2.5 Consents and Approvals Consents required to consummate the merger

Section 2.8 Absence of Changes None

Section 2.9 No Undisclosed Liabilities None

Section 2.11 Material Permits List of real estate brokers licenses

Section 2.12(a) Real Property List of properties with 50% or greater interest; Leases that are greater than \$750,000 in annual rent

Section 2.14 Taxes None

Section 2.15(a) Employment and Employee Benefits Matters Description and listing of employee benefits of Kennedy-Wilson employees

Schedule 2.15(j) Severance and Termination Agreements Executive employment agreements

Section 2.16 Transactions with Affiliates and Employees Internal transactions

Section 2.17 Insurance Kennedy-Wilson insurance coverage

Section 2.18(b) Material Contracts Loan agreements, shareholders agreements, lease agreements, sample property level loan agreements, and loan guaranties

Section 2.24 Brokers Schedule of Fees and Expenses Fees to brokers of the merger

Section 2.26 Environmental Matters None

Section 5.5 Required Consents List of consents

Section 5.59 Lock Up Agreement Signatories List of signatories

Permitted Lien None

Prospect agrees to furnish supplementally a copy of any omitted schedule to the Securities and Exchange Commission upon request.

Table of Contents

**AMENDMENT NO. 1 TO
AGREEMENT AND PLAN OF MERGER**

THIS AMENDMENT NO. 1 (this "*Amendment*") dated as of October 22, 2009, to that certain AGREEMENT AND PLAN OF MERGER dated as of September 8, 2009 (the "*Original Agreement*"), by and among PROSPECT ACQUISITION CORP., a company incorporated under the laws of Delaware ("*Prospect*"), KW MERGER SUB CORP., a company incorporated under the laws of Delaware and a wholly owned subsidiary of Prospect ("*Merger Sub*") and KENNEDY-WILSON, INC., a company incorporated under the laws of Delaware ("*KW*").

RECITALS

WHEREAS, the Parties are parties to the Original Agreement; and

WHEREAS, the Parties wish to amend the Original Agreement pursuant to and in accordance with Section 11.2 thereof as further set forth herein.

NOW, THEREFORE, in consideration of the mutual promises contained herein and in the Original Agreement, pursuant to and in accordance with Section 11.2 of the Original Agreement, the Parties agree to amend the Original Agreement as follows:

1. *Definitions.* All capitalized terms used herein without definition shall have the meanings assigned to such terms in the Original Agreement.

2. *Amendment to Background Section.* The fourth full paragraph of the Background section of the Original Agreement shall be deleted in its entirety and replaced with the following:

"Concurrently with the execution of this Agreement, Prospect, the Prospect Founders, De Guardiola Advisors, Inc. ("*DGA*"), De Guardiola Holdings, Inc. ("*DGH*") and KW are entering into a letter agreement, of even date herewith, as may be amended and/or restated from time to time hereafter (as so amended and/or restated, the "*Forfeiture Agreement*"), in the form attached hereto as *Exhibit A*, pursuant to which, subject to the terms and conditions set forth therein (i) the Prospect Founders have agreed to the forfeiture and cancellation of 4,750,000 shares of Prospect Common Stock and (ii) Prospect has agreed to issue to DGH an aggregate of 250,000 shares of Prospect Common Stock upon the closing of the transaction contemplated by this Agreement in satisfaction of an obligation of Prospect under its engagement letter with DGA."

3. *Replacement of Section 6.8.* Section 6.8 of the Original Agreement shall be deleted in its entirety and replaced with the following:

"Section 6.8 *Management Incentive Plan.* Prior to Closing, Prospect shall adopt an equity incentive plan (the "*Management Incentive Plan*"), for the issuance of up to 2,475,000 shares of Prospect Common Stock (the "*Management Incentive Shares*") and, effective at the Closing, Prospect shall grant awards under the Management Incentive Plan for the aggregate number of Management Incentive Shares to key employees of the Surviving Corporation in the amounts and upon terms and conditions to be mutually agreed upon between Prospect and KW.

4. *Replacement of Section 8.2(w).* Section 8.2(w) of the Original Agreement shall be deleted in its entirety and replaced with the following:

"(w) *Prospect Founder Forfeited Shares.* The Prospect Founders will have delivered certificates representing 4,750,000 shares of Prospect Common Stock duly endorsed in blank with executed blank stock powers pursuant to the terms of the Forfeiture Agreement."

5. *Full Force and Effect.* Except as expressly amended hereby, the Original Agreement shall continue in full force and effect in accordance with the provisions thereof.

Table of Contents

6. *Governing Law.* This Amendment shall be governed by and construed in accordance with the laws of the State of New York regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

7. *Counterparts; Facsimile Execution.* This Amendment may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the Parties and delivered to the other Parties. Facsimile or electronic execution and delivery of this Amendment is legal, valid and binding for all purposes.

8. *Headings.* All section titles and captions contained in this Amendment are for convenience only and shall not be deemed a part of this Amendment.

9. *Severability.* If any term or other provision of this Amendment is invalid, illegal or incapable of being enforced by any rule or Law, or public policy, all other conditions and provisions of this Amendment shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby are not affected in any manner materially adverse to any Party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the Parties shall negotiate in good faith to modify this Amendment so as to effect the original intent of the Parties as closely as possible in an acceptable manner to the end that transactions contemplated by this Amendment are fulfilled to the extent possible.

Table of Contents

IN WITNESS WHEREOF, the Parties hereto have caused this Amendment to be duly executed by their respective authorized signatories as of the date first indicated above.

PROSPECT ACQUISITION CORP.

By: /s/ DAVID A. MINELLA
Name: David A. Minella
Title: Chairman & CEO
Address: 9130 Galleria Court, Suite 318
Naples, FL 34109

With a copy to:

Bingham McCutchen LLP
399 Park Avenue
New York, NY 10022
Attention: Floyd I. Wittlin, Esq.

KW MERGER SUB CORP.

By: /s/ DAVID A. MINELLA
Name: David A. Minella
Title: President & Secretary
Address: c/o Prospect Acquisition Corp.
9130 Galleria Court, Suite 318
Naples, FL 34104

KENNEDY-WILSON, INC.

By: /s/ WILLIAM J. MCMORROW
Name: William J. McMorro
Title: Chief Executive Officer
Address: 9601 Wilshire Blvd.
Beverly Hills, CA 90210

A-56

Table of Contents

**AMENDMENT NO. 2 TO
AGREEMENT AND PLAN OF MERGER**

THIS AMENDMENT NO. 2 (this "*Amendment*") dated as of October 26, 2009, to that certain AGREEMENT AND PLAN OF MERGER dated as of September 8, 2009 (the "*Original Agreement*"), as amended by Amendment No. 1 dated as of October 22, 2009, in each case by and among PROSPECT ACQUISITION CORP., a company incorporated under the laws of Delaware ("*Prospect*"), KW MERGER SUB CORP., a company incorporated under the laws of Delaware and a wholly owned subsidiary of Prospect ("*Merger Sub*") and KENNEDY-WILSON, INC., a company incorporated under the laws of Delaware ("*KW*").

RECITALS

WHEREAS, the Parties are parties to the Original Agreement, as amended; and

WHEREAS, the Parties wish to amend the Original Agreement, as amended, pursuant to and in accordance with Section 11.2 thereof as further set forth herein.

NOW, THEREFORE, in consideration of the mutual promises contained herein and in the Original Agreement, pursuant to and in accordance with Section 11.2 of the Original Agreement, the Parties agree to amend the Original Agreement, as amended, as follows:

1. *Definitions.* All capitalized terms used herein without definition shall have the meanings assigned to such terms in the Original Agreement.
2. *Amendment to Definition of Prospect Warrant Agreement Amendment.* The definition of Prospect Warrant Agreement Amendment in Annex A of the Original Agreement shall be deleted in its entirety and replaced with the following:

"*Prospect Warrant Agreement Amendment*" means an amendment to the Prospect Warrant Agreement substantially in the form attached as *Exhibit E* that provides that, simultaneously with the Closing: (i) each Sponsor Warrant (as defined in the Prospect Warrant Agreement) will be converted into the Amended Sponsor Warrant; and (ii) each Public Warrant (as defined in the Prospect Warrant Agreement) will be converted into either (x) the Cash Consideration or (y) the Amended Public Warrant, in each case as the holder of Public Warrants shall have elected or be deemed to have elected; provided that no more than 50% of the outstanding Public Warrants shall be converted into the right to receive the Amended Public Warrant (the "*Warrant Limit*"); and provided further that in the event that holders of in excess of the Warrant Limit shall have elected to receive the Amended Public Warrant, the holders of the Public Warrants who elect to receive the Amended Public Warrant and the holders of the Sponsor Warrants will receive the Cash Consideration for a portion of their Warrants, as further set forth in and in accordance with *Exhibit E* hereto.

3. *Full Force and Effect.* Except as expressly amended hereby, the Original Agreement shall continue in full force and effect in accordance with the provisions thereof.

4. *Governing Law.* This Amendment shall be governed by and construed in accordance with the laws of the State of New York regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

5. *Counterparts; Facsimile Execution.* This Amendment may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the Parties and delivered to the other Parties. Facsimile or electronic execution and delivery of this Amendment is legal, valid and binding for all purposes.

6. *Headings.* All section titles and captions contained in this Amendment are for convenience only and shall not be deemed a part of this Amendment.

Table of Contents

7. *Severability.* If any term or other provisions of this Amendment is invalid, illegal or incapable of being enforced by any rule or Law, or public policy, all other conditions and provisions of this Amendment shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby are not affected in any manner materially adverse to any Party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the Parties shall negotiate in good faith to modify this Amendment so as to effect the original intent of the Parties as closely as possible in an acceptable manner to the end that transactions contemplated by this Amendment are fulfilled to the extent possible.

IN WITNESS WHEREOF, the Parties hereto have caused this Amendment to be duly executed by their respective authorized signatories as of the date first indicated above.

PROSPECT ACQUISITION CORP.

By: _____ /s/ DAVID A. MINELLA

Name: David A. Minella
Title: Chairman & CEO
Address: 9130 Galleria Court, Suite 318
Naples, FL 34109

With a copy to:

Bingham McCutchen LLP
399 Park Avenue
New York, NY 10022
Attention: Floyd I. Wittlin, Esq.

KW MERGER SUB CORP.

By: _____ /s/ DAVID A. MINELLA

Name: David A. Minella
Title: President and Secretary
Address: c/o Prospect Acquisition Corp.
9130 Galleria Court, Suite 318
Naples, FL 34109

KENNEDY-WILSON, INC.

By: _____ /s/ WILLIAM J. MCMORROW

Name: William J. McMorro
Title: Chief Executive Officer
Address: 9601 Wilshire Blvd.
Beverly Hills, CA 90210

A-58

**FORM OF
AMENDMENT NO. 1 TO WARRANT AGREEMENT**

This Amendment No. 1, dated as of _____, 2009 (this "**Amendment**"), to the Warrant Agreement, dated as of November 14, 2007 (the "**Warrant Agreement**"), by and between Prospect Acquisition Corp., a Delaware corporation (the "**Company**"), and Continental Stock Transfer & Trust Company, a New York corporation ("**Warrant Agent**").

WHEREAS, the Company consummated its initial public offering on November 14, 2007, pursuant to which the Company issued 25,000,000 units;

WHEREAS, each unit consisted of one share of common stock, par value \$0.0001 per share, of the Company (the "**Common Stock**") and one warrant to purchase one share of Common Stock at an exercise price of \$7.50 per share (the "**Public Warrants**");

WHEREAS, pursuant to a private placement, simultaneously with the Company's initial public offering, the Company issued to Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P. and Capital Management Systems, Inc. (the "**Sponsors**"), 5,250,000 warrants (the "**Sponsors' Warrants**"), with each Sponsors' Warrant exercisable into one share of Common Stock at \$7.50;

WHEREAS, the terms of the Warrants are governed by the Warrant Agreement and capitalized terms used, but not defined, herein shall have the meaning given to such terms in the Warrant Agreement;

WHEREAS, the Company has entered into that certain Agreement and Plan of Merger, as amended from time to time (as so amended, the "**Merger Agreement**"), by and among the Company, KW Merger Sub Corp., a Delaware corporation and newly-formed wholly-owned subsidiary of the Company ("**Merger Sub**"), and Kennedy-Wilson, Inc., a Delaware corporation ("**KW**"), which provides for the merger of Merger Sub with and into KW as a result of which KW will become a wholly-owned subsidiary of the Company (the "**Merger**") and outstanding shares of KW's common stock, par value \$0.01 per share, and KW's convertible preferred stock, par value \$0.01 per share, will be exchanged for Common Stock;

WHEREAS, pursuant to the Merger Agreement, the Company agreed to seek the approval of the holders of its outstanding Warrants to amend the Warrant Agreement to: (i) allow each holder of Public Warrants to elect to receive upon the closing of the Merger, for each outstanding Public Warrant, either (a) the right to receive \$0.55 in cash or (b) an amended and restated Public Warrant with a new exercise price of \$12.50, a redemption trigger price of \$19.50 and an expiration date of November 14, 2013, subject to adjustment and proration as described below and (ii) amend and restate the terms of the Sponsor Warrants to provide for an exercise price of \$12.50, a redemption trigger price of \$19.50 and an expiration date of November 14, 2013 (collectively, the "**Warrant Amendment Proposal**"); and

WHEREAS, holders of Warrants exercisable for a majority of the Warrant Shares (as defined in the Warrant Agreement) issuable upon exercise of all outstanding Warrants have approved the Warrant Amendment Proposal at a meeting of the holders of Warrants.

NOW, THEREFORE, in consideration of the mutual agreements contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and

Table of Contents

intending to be legally bound hereby, the parties hereto agree to amend the Warrant Agreement as set forth herein:

1. Amendment of Warrant Agreement.

(a) *New Section 11A.* The following shall be added as a new Section 11A of the Warrant Agreement:

"SECTION 11A. *The Merger.* Pursuant to the Merger (as defined below), the Warrants shall be treated as follows:

(a) Public Warrants.

(1) Each Public Warrant will be automatically (without any action on the part of the holders of Public Warrants) converted into the right to receive either (x) \$0.55 in cash (the "**Cash Amount**") or (y) an amended and restated Public Warrant with an exercise price of \$12.50, a redemption trigger price of \$19.50 and an expiration date of November 14, 2013 (the "**Amended and Restated Public Warrant**"), in each case as the holder of such Public Warrant shall have elected or be deemed to have elected (an "**Election**") in accordance with *Sections 11A(a)(2) and 11A(c)*. Following the Merger, the Warrant Agreement shall be amended and restated in the form attached hereto as Exhibit C (the "**Amended and Restated Warrant Agreement**"). The Amended and Restated Public Warrants will contain the terms and conditions set forth in the Amended and Restated Warrant Agreement.

(2) Subject to the procedures in *Section 11A(c)* and the limitations in *Section 11A(a)(3)*, each holder of Public Warrants outstanding immediately prior to the Election Date who makes a valid Election to receive Amended and Restated Public Warrants will be entitled to receive the Amended and Restated Public Warrants in respect of such Public Warrants; *provided that*, notwithstanding anything in this Agreement to the contrary, a holder of a Public Warrant shall not be able to make a valid election to receive an Amended and Restated Public Warrant with respect to any Public Warrants that it voted against this Amendment. All holders of Public Warrants immediately prior to the Election Date who do not make a valid Election for Amended and Restated Public Warrants will be deemed to have elected to receive the Cash Amount in respect of their Public Warrants.

(3) Notwithstanding anything in this Agreement to the contrary:

(A) the maximum number of Public Warrants to be converted into the right to receive the Amended and Restated Public Warrants will be equal to 12,500,000 (the "**Warrant Limit**"); and

(B) the minimum number of Public Warrants to be converted into the right to receive the Cash Amount will be equal to (x) the number of Public Warrants outstanding immediately prior to the Effective Time less (y) the Warrant Limit.

(4) Upon the closing of the Merger:

(A) all Public Warrants for which Elections to receive the Cash Amount have been made or deemed to have been made (the "**Cash Election Warrants**") will be converted into the right to receive the Cash Amount; and

(B) to the extent that the aggregate number of Public Warrants making an Election to receive Amended and Restated Public Warrants (the "**Warrant Election Warrants**") exceeds the Warrant Limit, a portion of the Warrant Election Warrants and the Sponsor Warrants will be

Table of Contents

automatically converted into the right to receive the Cash Amount, in each case, on a pro rata basis as follows:

holders of the number of Warrant Election Warrants covered by each Form of Election (as defined below) to be converted into Amended and Restated Public Warrants and holders of Sponsor Warrants will receive the Cash Amount with respect to that percentage of their respective Warrants held by each of them as is equal to the percentage determined by multiplying the number of Warrant Election Warrants or the number of Sponsor Warrants held by them, as applicable, by a fraction (a) the numerator of which is the number by which the Warrant Election Warrants exceeds the Warrant Limit and (b) the denominator of which is the sum of the aggregate number of Warrant Election Warrants plus the number of Sponsor Warrants.

(b) *Sponsors' Warrants.* Subject to the terms of Section 11A(a)(4)(B), each Sponsors' Warrant will be amended and restated to provide for an exercise price of \$12.50, a redemption trigger price of \$19.50 and an expiration date of November 14, 2013 (the "**Amended and Restated Sponsors' Warrants**"). The Amended and Restated Sponsors' Warrants will have the terms and conditions set forth in the Amended and Restated Warrant Agreement.

(c) *Election/Exchange Procedures for Public Warrants.*

(1) The Company will authorize the Exchange Agent (as defined in the Merger Agreement) to receive Elections.

(2) The Company will prepare, for use by the holders of Public Warrants in surrendering Warrant Certificates, a form (the "**Form of Election**") pursuant to which each holder of Public Warrants may make an Election. The Form of Election will be delivered to such Warrant holders by means and at a time upon which the Company and KW will mutually agree.

(3) An Election will have been properly made only if a Form of Election properly completed and signed and accompanied by the Warrant Certificate or Warrant Certificates to which such Form of Election relates (x) is received by the Exchange Agent prior to the date and time (the "**Election Date**") of the special meeting of warrant holders being held to approve the Warrant Amendment Proposal (the "**Special Meeting**") or (y) is tendered for delivery to the Exchange Agent at the Special Meeting.

(4) Any Public Warrant holder may at any time prior to the Election Date change such holder's Election if the Exchange Agent receives (x) prior to the Election Date written notice of such change accompanied by a properly completed Form of Election or (y) at the Special Meeting a new, properly completed Form of Election. The Company will have the right in its sole discretion to permit changes in Elections after the Election Date.

(5) The Company will have the right to make rules, not inconsistent with the terms of this Agreement or the Merger Agreement, governing the validity of Forms of Election, the manner and extent to which Elections are to be taken into account in making the determinations prescribed by this section, the issuance and delivery of certificates for the Amended and Restated Public Warrants, and the payment of the Cash Amount.

(6) In connection with the above procedures, (A) the holders of Warrant Certificates evidencing Public Warrants will surrender such certificates to the Exchange Agent, (B) upon surrender of a Warrant Certificate the holder thereof will be entitled to receive the Cash Amount or Amended and Restated Public Warrants, as applicable, and (C) the Warrant Certificates so surrendered will forthwith be canceled.

Table of Contents

(d) *Definitions.*

(1) "**Merger Agreement**" means that certain Agreement and Plan of Merger, dated as of September 8, 2009, as amended from time to time, by and among the Company, KW Merger Sub Corp. ("**Merger Sub**") and Kennedy-Wilson, Inc. ("**KW**").

(2) "**Merger**" means the merger of Merger Sub with and into KW as a result of which KW will become a wholly-owned subsidiary of the Company."

(b) *New Exhibit C.* Exhibit A attached to this Amendment shall be added as a new Exhibit C to the Warrant Agreement.

2. Miscellaneous.

(a) *Governing Law.* This Agreement and each Warrant Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of New York and for all purposes shall be construed in accordance with the internal laws of said State. The parties agree that all actions and proceedings arising out of this Agreement or any of the transactions contemplated hereby shall be brought in the United States District Court for the Southern District of New York or in a New York State Court in the County of New York and that, in connection with any such action or proceeding, submit to the jurisdiction of, and venue in, such court. Each of the parties hereto also irrevocably waives all right to trial by jury in any action, proceeding or counterclaim arising out of this Agreement or the transactions contemplated hereby.

(b) *Binding Effect.* This Amendment shall be binding upon and inure to the benefit of the parties hereto and to their respective heirs, legal representatives, successors and assigns.

(c) *Entire Agreement.* This Amendment sets forth the entire agreement and understanding between the parties as to the subject matter thereof and merges and supersedes all prior discussions, agreements and understandings of any and every nature among them. Except as set forth in this Amendment, provisions of the Warrant Agreement which are not inconsistent with this Amendment shall remain in full force and effect.

(d) *Severability.* This Amendment shall be deemed severable, and the invalidity or unenforceability of any term or provision hereof shall not affect the validity or enforceability of this Amendment or of any other term or provision hereof. Furthermore, in lieu of any such invalid or unenforceable term or provision, the parties hereto intend that there shall be added as part of this Amendment a provision as similar in terms to such invalid or unenforceable provision as may be possible and be valid and enforceable.

(e) *Counterparts.* This Amendment may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall constitute but one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

Table of Contents

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed as of the date first above written.

PROSPECT ACQUISITION CORP.

By: _____

Name:

Title:

**CONTINENTAL STOCK TRANSFER &
TRUST COMPANY, as Warrant Agent**

By: _____

Name:

Title:

B-5

KENNEDY-WILSON HOLDINGS, INC.

and

CONTINENTAL STOCK TRANSFER & TRUST COMPANY, as Warrant Agent

AMENDED AND RESTATED WARRANT AGREEMENT

Dated as of [_____], 2009

Table of Contents**WARRANT AGREEMENT****TABLE OF CONTENTS**

Section 1.	Appointment of Warrant Agent	1
Section 2.	Warrant Certificates	1
Section 3.	Execution of Warrant Certificates	1
Section 4.	Registration and Countersignature	1
Section 5.	Registration of Transfers and Exchanges; Transfer Restrictions	2
Section 6.	Terms of Warrants	3
(a)	Exercise Price and Exercise Period	3
(b)	Redemption of Warrants	4
(c)	Exercise Procedure	4
(d)	Cashless Exercise	5
(e)	Registration Requirement	6
Section 7.	Payment of Taxes	6
Section 8.	Mutilated or Missing Warrant Certificates	7
Section 9.	Reservation of Warrant Shares	7
Section 10.	Obtaining Stock Exchange Listings	7
Section 11.	Adjustment of Number of Warrant Shares	7
(a)	Adjustment for Change in Capital Stock	8
(b)	Adjustment for Rights Issue	8
(c)	Adjustment for Other Distributions	9
(d)	Adjustment for Common Stock Issue	10
(e)	Adjustment for Convertible Securities Issue	10
(f)	Adjustment for Tender or Exchange Offer	11
(g)	Consideration Received	12
(h)	Defined Terms; When De Minimis Adjustment May Be Deferred	13
(i)	When No Adjustment Required	13
(j)	Notice of Adjustment	13
(k)	Notice of Certain Transactions	14
(l)	Reorganization of Company	14
(m)	Warrant Agent's Disclaimer	15
(n)	When Issuance or Payment May Be Deferred	15
(o)	Adjustment in Exercise Price	15
(p)	Form of Warrants	16
(q)	Other Dilutive Events	16
Section 12.	Fractional Interests	16
Section 13.	Notices to Warrant Holders	16
Section 14.	Merger, Consolidation or Change of Name of Warrant Agent	17
Section 15.	Warrant Agent	18
Section 16.	Change of Warrant Agent	20
Section 17.	Notices to Company and Warrant Agent	20
Section 18.	Supplements and Amendments	21
Section 19.	Successors	21
Section 20.	Termination	21
Section 21.	Governing Law	21
Section 22.	Benefits of This Agreement	21
Section 23.	Counterparts	22
Section 24.	Force Majeure	22
EXHIBIT A	Form of Warrant	
EXHIBIT B	LEGEND	

Table of Contents

AMENDED AND RESTATED WARRANT AGREEMENT dated as of [_____], 2009, between Kennedy-Wilson Holdings, Inc. (formerly Prospect Acquisition Corp.), a Delaware corporation (the "**Company**"), and Continental Stock Transfer & Trust Company, a New York corporation, as Warrant Agent (the "**Warrant Agent**").

WHEREAS, on November 14, 2007, the Company issued (i) 5,250,000 warrants in a private placement bearing the legend set forth in Exhibit B hereto (the "**Sponsors' Warrants**"), and (ii) 25,000,000 warrants pursuant to a registration statement filed with the Securities and Exchange Commission (the "**Public Warrants**" and together with the Sponsors' Warrants, the "**Warrants**"), which in each case entitle the holders thereof to purchase shares of common stock of the Company, \$0.0001 par value per share ("**Common Stock**," and the Common Stock issuable on exercise of the Warrants, the "**Warrant Shares**"); and

WHEREAS, the Company desires the Warrant Agent to act on behalf of the Company, and the Warrant Agent is willing so to act, in connection with the issuance, transfer, exchange and exercise of Warrants and other matters as provided herein.

NOW, THEREFORE, in consideration of the premises and the mutual agreements herein set forth, the parties hereto agree as follows:

SECTION 1. *Appointment of Warrant Agent.* The Company hereby appoints the Warrant Agent to act as agent for the Company in accordance with the instructions set forth hereinafter in this Agreement, and the Warrant Agent hereby accepts such appointment.

SECTION 2. *Warrant Certificates.* The certificates evidencing the Warrants (the "**Warrant Certificates**") to be delivered pursuant to this Agreement shall be in registered form only and shall be substantially in the form set forth in Exhibit A attached hereto.

SECTION 3. *Execution of Warrant Certificates.* Warrant Certificates shall be signed on behalf of the Company by its Chairman of the Board or its President or Chief Executive Officer or a Vice President and by its Secretary or an Assistant Secretary. Each such signature upon the Warrant Certificates may be in the form of a facsimile signature of the present or any future Chairman of the Board, President, Chief Executive Officer, Vice President, Secretary or Assistant Secretary and may be imprinted or otherwise reproduced on the Warrant Certificates and for that purpose the Company may adopt and use the facsimile signature of any person who shall have been Chairman of the Board, President, Chief Executive Officer, Vice President, Secretary or Assistant Secretary, notwithstanding the fact that at the time the Warrant Certificates shall be countersigned and delivered or disposed of he or she shall have ceased to hold such office.

In case any officer of the Company who shall have signed any of the Warrant Certificates shall cease to be such officer before the Warrant Certificates so signed shall have been countersigned by the Warrant Agent, or disposed of by the Company, such Warrant Certificates nevertheless may be countersigned and delivered or disposed of as though such person had not ceased to be such officer of the Company; and any Warrant Certificate may be signed on behalf of the Company by any person who, at the actual date of the execution of such Warrant Certificate, shall be a proper officer of the Company to sign such Warrant Certificate, although at the date of the execution of this Warrant Agreement any such person was not such officer.

Warrant Certificates shall be dated the date of countersignature by the Warrant Agent.

SECTION 4. *Registration and Countersignature.* Warrant Certificates shall be countersigned by the Warrant Agent and shall not be valid for any purpose unless so countersigned. The Warrant Agent shall, upon written instructions of the Chairman of the Board, the President or Chief Executive Officer, a Vice President, the Treasurer or the Chief Financial Officer of the Company, countersign, issue and deliver Warrants as provided in this Agreement.

The Company and the Warrant Agent may deem and treat the registered holder(s) of the Warrant Certificates as the absolute owner(s) thereof (notwithstanding any notation of ownership or other

Table of Contents

writing thereon made by anyone), for all purposes, and neither the Company nor the Warrant Agent shall be affected by any notice to the contrary.

SECTION 5. *Registration of Transfers and Exchanges; Transfer Restrictions.* The Warrant Agent shall from time to time, subject to the limitations of this Section 5, register the transfer of any outstanding Warrant Certificates upon the records to be maintained by it for that purpose, upon surrender thereof duly endorsed or accompanied (if so required by the Warrant Agent) by a written instrument or instruments of transfer in form satisfactory to the Warrant Agent, duly executed by the registered holder or holders thereof or by the duly appointed legal representative thereof or by a duly authorized attorney. Upon any such registration of transfer, a new Warrant Certificate shall be issued to the transferee(s) and the surrendered Warrant Certificate shall be cancelled by the Warrant Agent. Cancelled Warrant Certificates shall thereafter be disposed of by the Warrant Agent in its customary manner.

The Sponsors' Warrants may not be sold or transferred prior to [_____], 2009⁽¹⁾ (such date, the "**Transfer Restriction Termination Date**") except to a Permitted Transferee who agrees in writing with the Company (i) to be subject to such transfer restrictions and (ii) that such Sponsors' Warrants will be held in an escrow account established pursuant to the Escrow Agreement referred to below until the Transfer Restriction Termination Date. As used herein, "**Permitted Transferee**" means a transfer (i) to any officer or director of the Company, any affiliates or family members of any officer or director of the Company or any affiliates of any Sponsor (as defined herein), (ii) in the case of a natural person, by gift to a member of such person's immediate family or to a trust, the beneficiary of which is a member of such person's immediate family, an affiliate of such person or to a charitable organization, (iii) in the case of a natural person, by virtue of the laws of descent and distribution upon death of such person, (iv) with respect to any Sponsor, by virtue of the laws of Delaware or such Sponsor's organizational documents upon dissolution of such Sponsor, (v) in the case of a natural person, pursuant to a qualified domestic relations order, or (vi) in the event the Company's consummation of a liquidation, merger, stock exchange or other similar transaction which results in all of the Company's stockholders having the right to exchange their shares of common stock for cash, securities or other property. Upon issuance, the Sponsors' Warrants will be deposited with the Continental Stock Transfer & Trust Company, as escrow agent (the "**Escrow Agent**") pursuant to the terms of the Escrow Agreement dated November 14, 2007 between the Company and the Escrow Agent, (the "**Escrow Agreement**"), where they will remain until the Transfer Restriction Termination Date.

The holders of any Sponsors' Warrants or Warrant Shares issued upon exercise of any Sponsors' Warrants further agree prior to any transfer of such securities, to give written notice to the Company expressing its desire to effect such transfer and describing briefly the proposed transfer. Upon receiving such notice, the Company shall present copies thereof to its counsel and the holder agrees not to make any disposition of all or any portion of such securities unless and until:

(a) there is then in effect a registration statement under the Securities Act covering such proposed disposition and such disposition is made in accordance with such registration statement, in which case the legends set forth in Exhibit B or Section 6(c) hereof, as the case may be (collectively the "Legends") with respect to such securities sold pursuant to such registration statement shall be removed; or

(b) if reasonably requested by the Company, (A) the holder shall have furnished the Company with an opinion of counsel, reasonably satisfactory to the Company, that such disposition will not require registration of such Securities under the Securities Act, (B) the Company shall have received customary representations and warranties regarding the transferee that are reasonably satisfactory to the Company signed by the proposed transferee and (C) the Company shall have received an agreement by such transferee to the restrictions contained in the Legends.

(1)

30 days after the closing of the Merger.

Table of Contents

Subject to the terms of this Agreement, Warrant Certificates may be exchanged at the option of the holder(s) thereof, when surrendered to the Warrant Agent at its principal corporate trust office, which is currently located at the address listed in Section 17 hereof, for another Warrant Certificate or other Warrant Certificates of like tenor and representing in the aggregate a like number of Warrants. Any holder desiring to exchange a Warrant Certificate shall deliver a written request to the Warrant Agent, and shall surrender, duly endorsed or accompanied (if so required by the Warrant Agent) by a written instrument or instruments of transfer in form satisfactory to the Warrant Agent, the Warrant Certificate or Certificates to be so exchanged. Warrant Certificates surrendered for exchange shall be cancelled by the Warrant Agent. Such cancelled Warrant Certificates shall then be disposed of by such Warrant Agent in its customary manner.

The Warrant Agent is hereby authorized to countersign, in accordance with the provisions of this Section 5 and of Section 4 hereof, the new Warrant Certificates required pursuant to the provisions of this Section 5.

SECTION 6. *Terms of Warrants.*

(a) *Exercise Price and Exercise Period.*

The initial exercise price per share at which Warrant Shares shall be purchasable upon the exercise of Warrants (the "**Exercise Price**") shall be \$12.50 per share, and each Warrant shall be initially exercisable to purchase one share of common stock of the Company, \$0.0001 par value per share ("**Common Stock**"). The Sponsors' Warrants shall be exercisable on a cashless basis as set forth in Section 6(d) at the option of any Sponsor (as defined herein) or a Permitted Transferee.

Subject to the terms of this Agreement (including without limitation Section 6(e) below), each Warrant holder shall have the right, which may be exercised commencing at the opening of business on the first day of the applicable Warrant Exercise Period set forth below and until 5:00 p.m., New York City time, on the last day of such Warrant Exercise Period, to receive from the Company the number of fully paid and nonassessable Warrant Shares which the holder may at the time be entitled to receive on exercise of such Warrants and payment of the Exercise Price then in effect for such Warrant Shares. No adjustments as to dividends will be made upon exercise of the Warrants.

The "**Warrant Exercise Period**" shall commence (subject to Section 6(d) below), on [_____], 2009⁽²⁾ and shall end on the earlier of:

(i) November 14, 2013; and

(ii) the Business Day preceding the date on which such Warrants are redeemed pursuant to Section 6(b) below or expire pursuant to Section 6(f) below;

provided that the Sponsors' Warrants may not be exercised prior to the Transfer Restriction Termination Date.

The "**Closing Price**" of the Common Stock on any date of determination means;

(i) the closing sale price for the regular trading session (without considering after hours or other trading outside regular trading session hours) of the Common Stock (regular way) on the American Stock Exchange on that date (or, if no closing price is reported, the last reported sale price during that regular trading session),

(ii) if the Common Stock is not listed for trading on the American Stock Exchange on that date, as reported in the composite transactions for the principal United States securities exchange on which the Common Stock is so listed,

(iii) if the Common Stock is not so reported, the last quoted bid price for the Common Stock in the over-the-counter market as reported by the OTC Bulletin Board, the National Quotation Bureau or similar organization, or

(2)

The date of the closing of the Merger.

Table of Contents

(iv) if the Common Stock is not so quoted, the average of the mid-point of the last bid and ask prices for the Common Stock from at least three nationally recognized investment banking firms that the Company selects for this purpose.

Each Warrant not exercised or redeemed prior to 5:00 p.m., New York City time, on the last day of the Warrant Exercise Period shall become void and all rights thereunder and all rights in respect thereof under this Agreement shall cease as of such time.

(b) *Redemption of Warrants.*

The Company may call the Warrants for redemption, in whole and not in part, at a price of \$.01 per Warrant, upon not less than 30 days' prior written notice of redemption to each Warrantholder, at any time after such Warrants have become exercisable pursuant to Section 6(a), if, and only if, (i) the Closing Price has equaled or exceeded \$19.50 per share for any 20 trading days within a 30-trading-day period ending on the third Business Day prior to the notice of redemption to Warrant holders and (ii) at all times between the date of such notice of redemption and the redemption date a registration statement is in effect covering the Warrant Shares issuable upon exercise of the Warrants and a current prospectus relating to those Warrant Shares is available.

Upon a call for redemption of Warrants by the Company, the Company shall have the right to require all holders of Warrants subject to redemption who exercise such Warrants after the Company's call for redemption to do so on a cashless basis in accordance with the procedures set forth in Section 6(d).

Notwithstanding the foregoing, no Sponsors' Warrants shall be redeemable so long as they are held by the purchasers set forth in Schedule I hereto (the "Sponsors") or a Permitted Transferee; *provided* that the fact that one or more Sponsors' Warrants are non-redeemable because they are held by a Sponsor or a Permitted Transferee shall not affect the Company's right to redeem the Public Warrants and all Sponsors' Warrants that are not held by a Sponsor or a Permitted Transferee pursuant to the preceding paragraph.

(c) *Exercise Procedure.*

A Warrant may be exercised upon surrender to the Company at the principal stock transfer office of the Warrant Agent, which is currently located at the address listed in Section 17 hereof, of the certificate or certificates evidencing the Warrants to be exercised with the form of election to purchase on the reverse thereof duly filled in and signed and such other documentation as the Warrant Agent may reasonably request, and upon payment to the Warrant Agent for the account of the Company of the Exercise Price (adjusted as herein provided if applicable) for the number of Warrant Shares in respect of which such Warrants are then exercised. Subject to any Sponsor or Permitted Transferee's election to exercise its Sponsors' Warrants on a cashless basis as set forth in Section 6(d), payment of the aggregate Exercise Price shall be made in cash or by certified or official bank check payable to the order of the Company in New York Clearing House Funds, or the equivalent thereof. In no event will any Warrants be settled on a net cash basis.

Subject to the provisions of Sections 6(e) and 7 hereof, upon such surrender of Warrants and payment of the Exercise Price, the Company shall issue and cause to be delivered with all reasonable dispatch to and in such name or names as the Warrant holder may designate, a certificate or certificates for the number of full Warrant Shares issuable upon the exercise of such Warrants together with cash as provided in Section 12 hereof. Such certificate or certificates shall be deemed to have been issued and any person so designated to be named therein shall be deemed to have become a holder of record of such Warrant Shares as of the date of the surrender of such Warrants and payment of the Exercise Price.

Table of Contents

The Warrants shall be exercisable, at the election of the holders thereof, either in full or from time to time in part and, in the event that a certificate evidencing Warrants is exercised in respect of fewer than all of the Warrant Shares issuable on such exercise at any time prior to the date of expiration of the Warrants, a new certificate evidencing the remaining Warrant or Warrants will be issued, and the Warrant Agent is hereby irrevocably authorized to countersign and to deliver the required new Warrant Certificate or Certificates pursuant to the provisions of this Section 6 and of Section 4 hereof, and the Company, whenever required by the Warrant Agent, shall supply the Warrant Agent with Warrant Certificates duly executed on behalf of the Company for such purpose. The Warrant Agent may assume that any Warrant presented for exercise is permitted to be so exercised under applicable law and shall have no liability for acting in reliance on such assumption.

All Warrant Certificates surrendered upon exercise of Warrants shall be canceled by the Warrant Agent. Such canceled Warrant Certificates shall then be disposed of by the Warrant Agent in its customary manner. The Warrant Agent shall account promptly to the Company with respect to Warrants exercised and concurrently pay to the Company all monies received by the Warrant Agent for the purchase of the Warrant Shares through the exercise of such Warrants.

The Warrant Agent shall keep copies of this Agreement and any notices given or received hereunder available for inspection by the holders with reasonable prior written notice during normal business hours at its office. The Company shall supply the Warrant Agent from time to time with such numbers of copies of this Agreement as the Warrant Agent may request.

Certificates evidencing Warrant Shares issued upon exercise of a Sponsors' Warrants shall contain the following legend:

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAW, AND MAY NOT BE OFFERED, SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND ANY APPLICABLE STATE SECURITIES LAWS OR AN EXEMPTION FROM SUCH REGISTRATION IS AVAILABLE.

SECURITIES EVIDENCED BY THIS CERTIFICATE WILL BE ENTITLED TO REGISTRATION RIGHTS UNDER A REGISTRATION RIGHTS AGREEMENT TO BE EXECUTED BY THE COMPANY.

(d) *Cashless Exercise.* The Sponsors' Warrants may be exercised on a cashless basis by any Sponsor or Permitted Transferee, at such Sponsor or Permitted Transferee's election (the "*Cashless Exercise Election*"). If any Sponsor or Permitted Transferee makes a Cashless Exercise Election with respect to any Sponsors' Warrants, then upon surrender of such Sponsors' Warrants in accordance with Section 6(c), the Company shall issue and cause to be delivered with all reasonable dispatch to and in such name or names as the Sponsors' Warrant holder may designate, a certificate or certificates for the

Table of Contents

number of full Warrant Shares issuable upon the exercise of such Sponsor Warrants computed by using the following formula:

$$X = \frac{(A)(Y)}{(B)}$$

X = The number of Shares of common stock to be issued in connection with such exercise to the holder of the Sponsors' Warrants being exercised.

Y = The number of shares of Common Stock purchasable under the Sponsor Warrant upon such exercise.

A = The value of one Sponsors' Warrant as of the date of the exercise, which shall be determined by using the following formula:

$$A = B - \text{the Exercise Price}$$

B = The Fair market Value of a share of Common Stock.

For purposes of this Section 6(d), the "Fair Market Value" of a share of Common Stock shall mean the average of the closing price of the Company's Common stock quoted on the American Stock Exchange for the ten (10) trading days ending on the trading day prior to the date of exercise. If the shares of Common Stock are traded on a securities exchange other than the American Stock Exchange, the Fair Market Value of a share of Common Stock shall mean the average of the closing prices of the Company's Common Stock quoted on such exchange for the ten (10) trading days ending on the trading day prior to the date of exercise. If the shares of Common Stock are not traded on the American Stock Exchange or any other exchange, the Fair Market Value shall be the price per share that the Company could obtain from a willing buyer for shares of Common Stock sold by the Company from authorized but unissued shares of Common Stock, as such prices shall be determined in good faith by the Company's Board of Directors.

(e) *Registration Requirement.* Notwithstanding anything else in this Section 6, no Warrant may be exercised unless at the time of exercise (i) a registration statement covering the Warrant Shares to be issued upon exercise is effective under the Act and (ii) a prospectus thereunder relating to the Warrant Shares is current. The Company shall use its best efforts to have a registration statement in effect covering Warrant Shares issuable upon exercise of the Warrants from the date the Warrants become exercisable and to maintain a current prospectus relating to those Warrant Shares until the Warrants expire or are redeemed. In the event that, at the end of the Warrant Exercise Period, a registration statement covering the Warrant Shares to be issued upon exercise is not effective under the Act, all the rights of holders hereunder shall terminate and all of the Warrants shall expire unexercised and worthless, and as a result purchasers of the Units will have paid the full Unit purchase price solely for the share of Common Stock included in each Unit. In no event shall the Warrants be settled on a net cash basis nor shall the Company be required to issue unregistered shares upon the exercise of any Warrant.

SECTION 7. *Payment of Taxes.* The Company will pay all documentary stamp taxes attributable to the initial issuance of Warrant Shares upon the exercise of Warrants; provided, however, that the Company shall not be required to pay any tax or taxes which may be payable in respect of any transfer involved in the issue of any Warrant Certificates or any certificates for Warrant Shares in a name other than that of the registered holder of a Warrant Certificate surrendered upon the exercise of a Warrant, and the Company shall not be required to issue or deliver such Warrant Certificates unless or until the person or persons requesting the issuance thereof shall have paid to the Company the amount of such tax or shall have established to the satisfaction of the Company that such tax has been paid.

Table of Contents

SECTION 8. *Mutilated or Missing Warrant Certificates.* In case any of the Warrant Certificates shall be mutilated, lost, stolen or destroyed, the Company shall issue and the Warrant Agent shall countersign, in exchange and substitution for and upon cancellation of the mutilated Warrant Certificate, or in lieu of and substitution for the Warrant Certificate lost, stolen or destroyed, a new Warrant Certificate of like tenor and representing an equivalent number of Warrants, but only upon receipt of evidence satisfactory to the Company and the Warrant Agent of such loss, theft or destruction of such Warrant Certificate and indemnity, also satisfactory to the Company and the Warrant Agent. Applicants for such new Warrant Certificates must pay such reasonable charges as the Company may prescribe.

SECTION 9. *Reservation of Warrant Shares.* The Company will at all times reserve and keep available, free from preemptive rights, out of the aggregate of its authorized but unissued Common Stock or its authorized and issued Common Stock held in its treasury, for the purpose of enabling it to satisfy any obligation to issue Warrant Shares upon exercise of Warrants, the maximum number of shares of Common Stock which may then be deliverable upon the exercise of all outstanding Warrants. The Warrant Agent shall have no duty to verify availability of such shares set aside by the Company.

The Company or, if appointed, the transfer agent for the Common Stock (the "*Transfer Agent*") and every subsequent transfer agent for any shares of the Company's Common Stock issuable upon the exercise of any of the Warrants will be irrevocably authorized and directed at all times to reserve such number of authorized shares as shall be required for such purpose. The Company will keep a copy of this Agreement on file with the Transfer Agent and with every subsequent transfer agent for any shares of the Company's Common Stock issuable upon the exercise of the Warrants. The Warrant Agent is hereby irrevocably authorized to requisition from time to time from such Transfer Agent the stock certificates required to honor outstanding Warrants upon exercise thereof in accordance with the terms of this Agreement. The Company will supply such Transfer Agent with duly executed certificates for such purposes and will provide or otherwise make available any cash which may be payable as provided in Section 12 hereof. The Company will furnish such Transfer Agent a copy of all notices of adjustments and certificates related thereto, transmitted to each holder pursuant to Section 13 hereof.

Before taking any action which would cause an adjustment pursuant to Section 11 hereof to reduce the Exercise Price below the then par value (if any) of the Warrant Shares, the Company will take any commercially reasonable corporate action which may, in the opinion of its counsel (which may be counsel employed by the Company), be necessary in order that the Company may validly and legally issue fully paid and nonassessable Warrant Shares at the Exercise Price as so adjusted.

The Company covenants that all Warrant Shares which may be issued upon exercise of Warrants will, upon payment of the Exercise Price therefor and issue, be fully paid, nonassessable, free of preemptive rights and free from all taxes, liens, charges and security interests with respect to the issue thereof.

SECTION 10. *Obtaining Stock Exchange Listings.* The Company will from time to time take all commercially reasonable actions which may be necessary so that the Warrant Shares, immediately upon their issuance upon the exercise of Warrants, will be listed on the principal securities exchanges and markets within the United States of America, if any, on which other shares of Common Stock are then listed.

SECTION 11. *Adjustment of Number of Warrant Shares.*

The number of Warrant Shares issuable upon the exercise of each Warrant is subject to adjustment from time to time upon the occurrence of the events enumerated in this Section 11. For purposes of this Section 11, "*Common Stock*" means shares now or hereafter authorized of any class of common stock of the Company and any other stock of the Company, however designated, that has the right

Table of Contents

(subject to any prior rights of any class or series of preferred stock) to participate in any distribution of the assets or earnings of the Company without limit as to per share amount.

(a) *Adjustment for Change in Capital Stock.*

If the Company:

- (1) pays a dividend or makes a distribution on its Common Stock in either case in shares of its Common Stock;
- (2) subdivides its outstanding shares of Common Stock into a greater number of shares;
- (3) combines its outstanding shares of Common Stock into a smaller number of shares;
- (4) makes a distribution on its Common Stock in shares of its capital stock other than Common Stock; or
- (5) issues by reclassification of its Common Stock any shares of its capital stock,

then the number of shares of Common Stock issuable upon exercise of each Warrant immediately prior to such action shall be proportionately adjusted so that the holder of any Warrant thereafter exercised shall receive the aggregate number and kind of shares of capital stock of the Company which he would have owned immediately following such action if such Warrant had been exercised immediately prior to such action.

The adjustment shall become effective immediately after the record date in the case of a dividend or distribution and immediately after the effective date in the case of a subdivision, combination or reclassification.

Such adjustment shall be made successively whenever any event listed above shall occur.

(b) *Adjustment for Rights Issue.*

If the Company distributes any rights, options or warrants to all holders of its Common Stock entitling them to purchase shares of Common Stock at a price per share less than the Closing Price per share on the Business Day immediately preceding the ex-dividend date for such distribution of rights, options or warrants, the number of shares of Common Stock issuable upon exercise of each Warrant shall be adjusted in accordance with the formula:

$$N' = N \times \frac{O + A}{O + (A \times P/M)}$$

where:

- N' = the adjusted number of shares of Common Stock issuable upon exercise of each Warrant.
- N = the current number of shares of Common Stock issuable upon exercise of each Warrant.
- O = the number of shares of Common Stock outstanding on the record date for such distribution.
- A = the number of additional shares of Common Stock issuable pursuant to such rights or warrants.
- P = the purchase price per share of the additional shares.
- M = the Closing Price per share of Common Stock on the record date.

Table of Contents

The adjustment shall be made successively whenever any such rights, options or warrants are issued and shall become effective immediately after the record date for the determination of stockholders entitled to receive the rights, options or warrants. If at the end of the period during which such rights, options or warrants are exercisable, not all rights, options or warrants shall have been exercised, the number of shares of Common Stock issuable upon exercise of each Warrant shall be immediately readjusted to what it would have been if "N" in the above formula had been the number of shares actually issued.

(c) *Adjustment for Other Distributions.*

If the Company distributes to all holders of its Common Stock any of its assets (including cash) or debt securities or any rights, options or warrants to purchase debt securities, assets or other securities of the Company (other than Common Stock), the number of shares of Common Stock issuable upon exercise of each Warrant shall be adjusted in accordance with the formula:

$$N' = N \times \frac{M}{M - F}$$

where:

N' = the adjusted number of shares of Common Stock issuable upon exercise of each Warrant.

N = the current number of shares of Common Stock issuable upon exercise of each Warrant.

M = the Closing Price per share of Common Stock on the Business Day immediately preceding the ex-dividend date for such distribution.

F = the fair market value on the ex-dividend date for such distribution of the assets, securities, rights or warrants distributable to one share of Common Stock after taking into account, in the case of any rights, options or warrants, the consideration required to be paid upon exercise thereof. The Board of Directors shall reasonably determine the fair market value in good faith.

The adjustment shall be made successively whenever any such distribution is made and shall become effective immediately after the record date for the determination of stockholders entitled to receive such distribution.

This subsection (c) does not apply to regular quarterly cash dividends including increases thereof or rights, options or warrants referred to in subsection (b) of this Section 11. If any adjustment is made pursuant to this subsection (c) as a result of the issuance of rights, options or warrants and at the end of the period during which any such rights, options or warrants are exercisable, not all such rights, options or warrants shall have been exercised, the Warrant shall be immediately readjusted as if "F" in the above formula was the fair market value on the ex-dividend date for such distribution of the indebtedness or assets actually distributed upon exercise of such rights, options or warrants divided by the number of shares of Common Stock outstanding on the ex-dividend date for such distribution. Notwithstanding anything to the contrary contained in this subsection (c), if "M - F" in the above formula is less than \$1.00, the Company may elect to, and if "M - F" is a negative number, the Company shall, in lieu of the adjustment otherwise required by this subsection (c), distribute to the holders of the Warrants, upon exercise thereof, the evidences of indebtedness, assets, rights, options or warrants (or the proceeds thereof) which would have been distributed to such holders had such Warrants been exercised immediately prior to the record date for such distribution.

Table of Contents

(d) *Adjustment for Common Stock Issue.*

If the Company issues shares of Common Stock for a consideration per share less than the Closing Price per share on the date the Company fixes the offering price of such additional shares, the number of shares of Common Stock issuable upon exercise of each Warrant shall be adjusted in accordance with the formula:

$$N' = N \times \frac{A}{O + P/M}$$

where:

N' = the adjusted number of shares of Common Stock issuable upon exercise of each Warrant.

N = the current number of shares of Common Stock issuable upon exercise of each Warrant.

O = the number of shares outstanding immediately prior to the issuance of such additional shares.

P = the aggregate consideration received for the issuance of such additional shares.

M = the Closing Price per share on the date of issuance of such additional shares.

A = the number of shares outstanding immediately after the issuance of such additional shares.

The adjustment shall be made successively whenever any such issuance is made, and shall become effective immediately after such issuance.

This subsection (d) does not apply to:

- (1) any of the transactions described in subsections (b) and (c) of this Section 11,
- (2) the exercise of Warrants, or the conversion or exchange of other securities convertible or exchangeable for Common Stock, or the issuance of Common Stock upon the exercise of rights or warrants issued to the holders of Common Stock,
- (3) Common Stock (and options exercisable therefor) issued to the Company's employees, officers, directors, consultants or advisors (whether or not still in such capacity on the date of exercise) under bona fide employee benefit plans or stock option plans adopted by the Board of Directors of the Company and approved by the holders of Common Stock when required by law, if such Common Stock would otherwise be covered by this subsection (d),
- (4) Common Stock issued in a bona fide public offering for cash,
- (5) Common Stock issued in a bona fide private placement in which at least one non-affiliate of the Company participates, including without limitation the issuance of equity as consideration or partial consideration for acquisitions from persons that are not affiliates of the Company.

(e) *Adjustment for Convertible Securities Issue.*

If the Company issues any securities convertible into or exchangeable for Common Stock (other than securities issued in transactions described in subsections (b) and (c) of this Section 11) for a consideration per share of Common Stock initially deliverable upon conversion or exchange of such securities less than the Closing Price per share on the date of issuance of such securities, the number of

Table of Contents

shares of Common Stock issuable upon exercise of each Warrant shall be adjusted in accordance with this formula:

$$N' = N \times \frac{O + D}{O + P/M}$$

where:

- N' = the adjusted number of shares of Common Stock issuable upon exercise of each Warrant.
- N = the current number of shares of Common Stock issuable upon exercise of each Warrant.
- O = the number of shares outstanding immediately prior to the issuance of such securities.
- P = the aggregate consideration received for the issuance of such securities.
- M = the Closing Price per share on the date of issuance of such securities.
- D = the maximum number of shares deliverable upon conversion or in exchange for such securities at the initial conversion or exchange rate.

The adjustment shall be made successively whenever any such issuance is made, and shall become effective immediately after such issuance.

If all of the Common Stock deliverable upon conversion or exchange of such securities have not been issued when such securities are no longer outstanding, then the number of shares of Common Stock issuable upon exercise of each Warrant shall promptly be readjusted to what it would have been had the adjustment upon the issuance of such securities been made on the basis of the actual number of shares of Common Stock issued upon conversion or exchange of such securities.

This subsection (e) does not apply to:

- (1) convertible securities issued in a bona fide public offering for cash; or
- (2) convertible securities issued in a bona fide private placement in which at least one non-affiliate of the Company participates, including the issuance of convertible securities as consideration or partial consideration for acquisitions from persons that are not affiliates of the Company.

(f) *Adjustment for Tender or Exchange Offer.* If the Company or any of its subsidiaries makes a payment in respect of a tender offer or exchange offer for the Common Stock, if the cash and value of any other consideration included in the payment per share of the Common Stock exceeds the Closing Price of the Common Stock on the trading day next succeeding the last date on which tenders or

Table of Contents

exchanges may be made pursuant to such tender or exchange offer, the number of shares of Common Stock issuable upon exercise of each Warrant will be increased based on the following formula:

$$N' = N_o \times \frac{AC + (SP' \times OS')}{OS_o \times SP'}$$

where:

- N' = the adjusted number of shares of Common Stock issuable upon exercise of each Warrant;
- N_o = the current number of shares of Common Stock issuable upon exercise of each warrant;
- AC = the aggregate value of all cash and any other consideration (as determined by the Board of Directors of the Company) paid or payable for shares purchased in such tender or exchange offer;
- OS_o = the number of shares of Common Stock outstanding immediately prior to the date such tender or exchange offer expires;
- OS' = the number of shares of Common Stock outstanding immediately after the date such tender or exchange offer expires; and
- SP' = the Closing Price of the Common Stock on the trading day next succeeding the date such tender or exchange offer expires.

The adjustment shall be made successively and shall become effective immediately following the date such tender or exchange offer expires.

(g) *Consideration Received.*

For purposes of any computation respecting consideration received pursuant to subsections (d), (e) and (f) of this Section 11, the following shall apply:

- (1) in the case of the issuance of shares of Common Stock for cash, the consideration shall be the amount of such cash, provided that in no case shall any deduction be made for any commissions, discounts or other expenses incurred by the Company for any underwriting or other sale or disposition of the issue or otherwise in connection therewith;
- (2) in the case of the issuance of shares of Common Stock for a consideration in whole or in part other than cash, the consideration other than cash shall be deemed to be the fair market value thereof as reasonably determined by the Board of Directors of the Company (irrespective of the accounting treatment thereof) and described in a Board resolution which shall be filed with the Warrant Agent; and
- (3) in the case of the issuance of securities convertible into or exchangeable for shares, the aggregate consideration received therefor shall be deemed to be the consideration received by the Company for the issuance of such securities plus the additional minimum consideration, if any, to be received by the Company upon the conversion or exchange thereof for the maximum number of shares used to calculate the adjustment (the consideration in each case to be determined in the same manner as provided in clauses (1) and (2) of this subsection).

Table of Contents

(h) *Defined Terms; When De Minimis Adjustment May Be Deferred.*

As used in this section 11:

(1) "ex-dividend date" means the first date on which the shares of Common Stock trade on the applicable exchange or in the applicable market, regular way, without the right to receive the issuance or distribution in question;

(2) "trading day" means, with respect to the Common Stock or any other security, a day during which (i) trading in the Common Stock or such other security generally occurs, (ii) there is no market disruption event (as defined below) and (iii) a Closing Price for the Common Stock or such other security (other than a Closing Price referred to in the next to last clause of such definition) is available for such day; provided that if the Common Stock or such other security is not admitted for trading or quotation on or by any exchange, bureau or other organization, "trading day" will mean any Business Day;

(3) "market disruption event" means, with respect to the Common Stock or any other security, the occurrence or existence of more than one-half hour period in the aggregate or any scheduled trading day for the Common Stock or such other security of any suspension or limitation imposed on trading (by reason of movements in price exceeding limits permitted by the stock exchange or otherwise) in the Common Stock or such other security or in any options, contract, or future contracts relating to the Common Stock or such other security, and such suspension or limitation occurs or exists at any time before 1:00 p.m. (New York time) on such day; and

(4) "Business Day" means, any day on which the American Stock Exchange is open for trading and which is not a Saturday, a Sunday or any other day on which banks in the City of New York, New York, are authorized or required by law to close.

No adjustment in the number of shares of Common Stock issuable upon exercise of each Warrant need be made unless the adjustment would require an increase or decrease of at least 1% in such number. Any adjustments that are not made shall be carried forward and taken into account in any subsequent adjustment.

All calculations under this Section 11 shall be made to the nearest cent or to the nearest 1/100th of a share, as the case may be.

(i) *When No Adjustment Required.*

No adjustment need be made for a transaction referred to in subsections (b), (c), (d), (e) or (f) of this Section 11 if Warrant holders are to participate, without requiring the Warrants to be exercised, in the transaction on a basis and with notice that the Board of Directors of the Company reasonably determines to be fair and appropriate in light of the basis and notice on which holders of Common Stock participate in the transaction.

No adjustment need be made for a change in the par value or no par value of the Common Stock.

To the extent the Warrants become convertible into cash, no adjustment need be made thereafter as to the amount of cash into which such Warrants are exercisable. Interest will not accrue on the cash.

(j) *Notice of Adjustment.*

Whenever the number of shares of Common Stock issuable upon exercise of each Warrant is adjusted, the Company shall provide the notices required by Section 13 hereof.

Table of Contents

(k) *Notice of Certain Transactions.*

If:

(1) the Company takes any action that would require an adjustment in the Exercise Price pursuant to subsections (a), (b), (c), (d), (e) or (f) of this Section 11 and if the Company does not arrange for Warrant holders to participate pursuant to subsection (i) of this Section 11;

(2) the Company takes any action that would require a supplemental Warrant Agreement pursuant to subsection (l) of this Section 11; or

(3) there is a liquidation or dissolution of the Company,

the Company shall mail to Warrant holders a notice stating the proposed record date for a dividend or distribution or the proposed effective date of a subdivision, combination, reclassification, consolidation, merger, transfer, lease, liquidation or dissolution. The Company shall mail the notice at least 15 days before such date. Failure to mail the notice or any defect in it shall not affect the validity of the transaction.

(l) *Reorganization of Company.*

If the Company consolidates or merges with or into, or transfers or leases all or substantially all its assets to, any person, upon consummation of such transaction the Warrants shall automatically become exercisable for the kind and amount of securities, cash or other assets which the holder of a Warrant would have owned immediately after the consolidation, merger, transfer or lease if such holder had exercised the Warrant immediately before the effective date of the transaction; provided that (i) if the holders of Common Stock were entitled to exercise a right of election as to the kind or amount of securities, cash or other assets receivable upon such consolidation or merger, then the kind and amount of securities, cash or other assets for which each Warrant shall become exercisable shall be deemed to be the weighted average of the kind and amount received per share by the holders of Common Stock in such consolidation or merger that affirmatively make such election or (ii) if a tender or exchange offer shall have been made to and accepted by the holders of Common Stock under circumstances in which, upon completion of such tender or exchange offer, the maker thereof, together with members of any group (within the meaning of Rule 13d-5(b)(1) under the Exchange Act) of which such maker is a part, and together with any affiliate or associate of such maker (within the meaning of Rule 12b-2 under the Exchange Act) and any members of any such group of which any such affiliate or associate is a part, own beneficially (within the meaning of Rule 13d-3 under the Exchange Act) more than 50% of the outstanding shares of Common Stock, the holder of a Warrant shall be entitled to receive the highest amount of cash, securities or other property to which such holder would actually have been entitled as a shareholder if such Warrant holder had exercised the Warrant prior to the expiration of such tender or exchange offer, accepted such offer and all of the Common Stock held by such holder had been purchased pursuant to such tender or exchange offer, subject to adjustments (from and after the consummation of such tender or exchange offer) as nearly equivalent as possible to the adjustments provided for in this Section 11. Concurrently with the consummation of any such transaction, the corporation or other entity formed by or surviving any such consolidation or merger if other than the Company, or the person to which such sale or conveyance shall have been made, shall enter into a supplemental Warrant Agreement so providing and further providing for adjustments which shall be as nearly equivalent as may be practical to the adjustments provided for in this Section. The successor Company shall mail to Warrant holders a notice describing the supplemental Warrant Agreement.

If the issuer of securities deliverable upon exercise of Warrants under the supplemental Warrant Agreement is an affiliate of the formed, surviving, transferee or lessee corporation, that issuer shall join in the supplemental Warrant Agreement.

Table of Contents

If this subsection (l) applies, subsections (a), (b), (c), (d), (e) and (f) of this Section 11 do not apply.

(m) *Warrant Agent's Disclaimer.*

The Warrant Agent has no duty to determine when an adjustment under this Section 11 should be made, how it should be made or what it should be. The Warrant Agent has no duty to determine whether any provisions of a supplemental Warrant Agreement under subsection (l) of this Section 11 are correct. The Warrant Agent makes no representation as to the validity or value of any securities or assets issued upon exercise of Warrants. The Warrant Agent shall not be responsible for the Company's failure to comply with this Section.

(n) *When Issuance or Payment May Be Deferred.*

In any case in which this Section 11 shall require that an adjustment in the number of shares of Common Stock issuable upon exercise of each Warrant be made effective as of a record date for a specified event, the Company may elect to defer until the occurrence of such event (i) issuing to the holder of any Warrant exercised after such record date the Warrant Shares and other capital stock of the Company, if any, issuable upon such exercise over and above the Warrant Shares and other capital stock of the Company, if any, issuable upon such exercise on the basis of the number of shares of Common Stock issuable upon exercise of each Warrant and (ii) paying to such holder any amount in cash in lieu of a fractional share pursuant to Section 12 hereof; provided, however, that the Company shall deliver to such holder a due bill or other appropriate instrument evidencing such holder's right to receive such additional Warrant Shares, other capital stock and cash upon the occurrence of the event requiring such adjustment.

(o) *Adjustment in Exercise Price.*

Upon each event that provides for an adjustment of the number of shares of Common Stock issuable upon exercise of each Warrant pursuant to this Section 11, each Warrant outstanding prior to the making of the adjustment shall thereafter have an adjusted Exercise Price (calculated to the nearest ten millionth) obtained from the following formula:

$$E' = E \times \frac{N}{N'}$$

where:

E' = the adjusted Exercise Price.

E = the Exercise Price prior to adjustment.

N' = the adjusted number of Warrant Shares issuable upon exercise of a Warrant by payment of the adjusted Exercise Price.

N = the number of Warrant Shares previously issuable upon exercise of a Warrant by payment of the Exercise Price prior to adjustment.

Following any adjustment to the Exercise Price pursuant to this Section 11, the amount payable, when adjusted and together with any consideration allocated to the issuance of the Warrants, shall never be less than the par value per Warrant Share at the time of such adjustment. Such adjustment shall be made successively whenever any event listed above shall occur.

(p) *Form of Warrants.*

Irrespective of any adjustments in the number or kind of shares issuable upon the exercise of the Warrants or the Exercise Price, Warrants theretofore or thereafter issued may continue to express the

Table of Contents

same number and kind of shares and Exercise Price as are stated in the Warrants initially issuable pursuant to this Agreement.

(q) *Other Dilutive Events.*

In case any event shall occur affecting the Company, as to which the provisions of this Section 11 are not strictly applicable, but would impact the holders of Warrants adversely as compared to holders of Common Stock, and the failure to make any adjustment would not fairly protect the purchase rights represented by the Warrants in accordance with the essential intent and principles of this Section then, in each such case, the Company shall appoint a firm of independent public accountants, investment banking or other appraisal firm of recognized national standing which shall give their opinion upon the adjustment, if any, on a basis consistent with the essential intent and principles established in this Section 11, necessary to preserve, without dilution, the purchase rights represented by the Warrants.

SECTION 12. *Fractional Interests.* The Company shall not be required to issue fractional Warrant Shares on the exercise of Warrants. If more than one Warrant shall be presented for exercise in full at the same time by the same holder, the number of full Warrant Shares which shall be issuable upon the exercise thereof shall be computed on the basis of the aggregate number of Warrant Shares purchasable on exercise of the Warrants so presented. If any fraction of a Warrant Share would, except for the provisions of this Section 12, be issuable on the exercise of any Warrants (or specified portion thereof), the Company shall pay an amount in cash equal to the fair market value on the day immediately preceding the date the Warrant is presented for exercise, multiplied by such fraction.

SECTION 13. *Notices to Warrant Holders.* Upon any adjustment of the Exercise Price pursuant to Section 11, the Company shall promptly thereafter, and in any event within five days, (i) cause to be filed with the Warrant Agent a certificate executed by the Chief Financial Officer of the Company setting forth the number of Warrant Shares issuable upon exercise of each Warrant after such adjustment and setting forth in reasonable detail the method of calculation and the facts upon which such calculations are based, and (j) cause to be given to each of the registered holders of the Warrant Certificates at his address appearing on the Warrant register written notice of such adjustments by first-class mail, postage prepaid. Where appropriate, such notice may be given in advance and included as a part of the notice required to be mailed under the other provisions of this Section 13. The Warrant Agent shall be fully protected in relying on any such certificate and on any adjustment therein contained and shall not be deemed to have knowledge of such adjustment unless and until it shall have received such certificate.

In case:

- (a) the Company shall authorize the issuance to all holders of shares of Common Stock of rights, options or warrants to subscribe for or purchase shares of Common Stock or of any other subscription rights or warrants; or
- (b) the Company shall authorize the distribution to all holders of shares of Common Stock of evidences of its indebtedness or assets (other than regular cash dividends or dividends payable in shares of Common Stock or distributions referred to in subsection (b) of Section 11 hereof); or
- (c) of any consolidation or merger to which the Company is a party and for which approval of any shareholders of the Company is required, or of the conveyance or transfer of the properties and assets of the Company substantially as an entirety, or of any reclassification or change of Common Stock issuable upon exercise of the Warrants (other than a change in par value, or from par value to no par value, or from no par value to par value, or as a result of a subdivision or combination), or a tender offer or exchange offer for shares of Common Stock; or
- (d) of the voluntary or involuntary dissolution, liquidation or winding up of the Company; or

Table of Contents

(e) the Company proposes to take any action not specified above which would require an adjustment of the Exercise Price pursuant to Section 11 hereof;

then the Company shall cause to be filed with the Warrant Agent and shall cause to be given to each of the registered holders of the Warrant Certificates at his address appearing on the Warrant register, at least 10 calendar days prior to the applicable record date hereinafter specified, or as promptly as practicable under the circumstances in the case of events for which there is no record date, by first-class mail, postage prepaid, a written notice stating (i) the date as of which the holders of record of shares of Common Stock to be entitled to receive any such rights, options, warrants or distribution are to be determined, or (ii) the initial expiration date set forth in any tender offer or exchange offer for shares of Common Stock, or (iii) the date on which any such consolidation, merger, conveyance, transfer, dissolution, liquidation or winding up is expected to become effective or consummated, and the date as of which it is expected that holders of record of shares of Common Stock shall be entitled to exchange such shares for securities or other property, if any, deliverable upon such reclassification, consolidation, merger, conveyance, transfer, dissolution, liquidation or winding up. The failure to give the notice required by this Section 13 or any defect therein shall not affect the legality or validity of any distribution, right, option, warrant, consolidation, merger, conveyance, transfer, dissolution, liquidation or winding up, or the vote upon any action.

Nothing contained in this Agreement or in any of the Warrant Certificates shall be construed as conferring upon the holders thereof the right to vote or to consent or to receive notice as shareholders in respect of the meetings of shareholders or the election of Directors of the Company or any other matter, or any rights whatsoever as shareholders of the Company.

SECTION 14. *Merger, Consolidation or Change of Name of Warrant Agent.* Any corporation into which the Warrant Agent may be merged or with which it may be consolidated, or any corporation resulting from any merger or consolidation to which the Warrant Agent shall be a party, or any corporation succeeding to all or substantially all the corporate trust or agency business of the Warrant Agent, shall be the successor to the Warrant Agent hereunder without the execution or filing of any paper or any further act on the part of any of the parties hereto, provided that such corporation would be eligible for appointment as a successor warrant agent under the provisions of Section 16. In case at the time such successor to the Warrant Agent shall succeed to the agency created by this Agreement, and in case at that time any of the Warrant Certificates shall have been countersigned but not delivered, any such successor to the Warrant Agent may adopt the countersignature of the original Warrant Agent; and in case at that time any of the Warrant Certificates shall not have been countersigned, any successor to the Warrant Agent may countersign such Warrant Certificates either in the name of the predecessor Warrant Agent or in the name of the successor to the Warrant Agent; and in all such cases such Warrant Certificates shall have the full force and effect provided in the Warrant Certificates and in this Agreement.

In case at any time the name of the Warrant Agent shall be changed and at such time any of the Warrant Certificates shall have been countersigned but not delivered, the Warrant Agent whose name has been changed may adopt the countersignature under its prior name, and in case at that time any of the Warrant Certificates shall not have been countersigned, the Warrant Agent may countersign such Warrant Certificates either in its prior name or in its changed name, and in all such cases such Warrant Certificates shall have the full force and effect provided in the Warrant Certificates and in this Agreement.

Table of Contents

SECTION 15. *Warrant Agent.* The Warrant Agent undertakes the duties and obligations imposed by this Agreement (and no implied duties or obligations shall be read into this Agreement against the Warrant Agent) upon the following terms and conditions, by all of which the Company and the holders of Warrants, by their acceptance thereof, shall be bound:

(a) The statements contained herein and in the Warrant Certificates shall be taken as statements of the Company and the Warrant Agent assumes no responsibility for the correctness of any of the same except such as describe the Warrant Agent or action taken or to be taken by it. The Warrant Agent assumes no responsibility with respect to the distribution of the Warrant Certificates except as herein otherwise provided.

(b) The Warrant Agent shall not be responsible for any failure of the Company to comply with any of the covenants contained in this Agreement or in the Warrant Certificates to be complied with by the Company.

(c) The Warrant Agent may consult at any time with counsel of its own selection (who may be counsel for the Company) and the Warrant Agent shall incur no liability or responsibility to the Company or to any holder of any Warrant Certificate in respect of any action taken, suffered or omitted by it hereunder in good faith and in accordance with the opinion or the advice of such counsel. The Warrant Agent may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or through agents or attorneys and the Warrant Agent shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it hereunder.

(d) The Warrant Agent may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Warrant Agent and conforming to the requirements of this Agreement. The Warrant Agent shall incur no liability or responsibility to the Company or to any holder of any Warrant Certificate for any action taken in reliance on any Warrant Certificate, certificate of shares, notice, resolution, waiver, consent, order, certificate, or other paper, document or instrument (whether in its original or facsimile form) believed by it to be genuine and to have been signed, sent or presented by the proper party or parties.

(e) The Company agrees to pay to the Warrant Agent such compensation for all services rendered by the Warrant Agent in the administration and execution of this Agreement as the Company and the Warrant Agent shall agree in writing to reimburse the Warrant Agent for all expenses, taxes and governmental charges and other charges of any kind and nature incurred by the Warrant Agent in the execution of this Agreement (including fees and expenses of its counsel) and to indemnify the Warrant Agent (and any predecessor Warrant Agent) and save it harmless against any and all claims (whether asserted by the Company, a holder or any other person), damages, losses, expenses (including taxes other than taxes based on the income of the Warrant Agent), liabilities, including judgments, costs and counsel fees and expenses, for anything done or omitted by the Warrant Agent in the execution of this Agreement except as a result of its negligence or willful misconduct. The provisions of this Section 15(e) shall survive the expiration of the Warrants and the termination of this Agreement.

(f) The Warrant Agent shall be under no obligation to institute any action, suit or legal proceeding or to take any other action likely to involve expense unless the Company or one or more registered holders of Warrant Certificates shall furnish the Warrant Agent with security and indemnity satisfactory to it for any costs and expenses which may be incurred, but this provision shall not affect the power of the Warrant Agent to take such action as it may consider proper, whether with or without any such security or indemnity. All rights of action under this Agreement or under any of the Warrants may be enforced by the Warrant Agent without the possession of any of the Warrant Certificates or the production thereof at any trial or other proceeding relative

Table of Contents

thereto, and any such action, suit or proceeding instituted by the Warrant Agent shall be brought in its name as Warrant Agent and any recovery of judgment shall be for the ratable benefit of the registered holders of the Warrants, as their respective rights or interests may appear.

(g) The Warrant Agent, and any stockholder, director, officer or employee of it, may buy, sell or deal in any of the Warrants or other securities of the Company or become pecuniarily interested in any transaction in which the Company may be interested, or contract with or lend money to the Company or otherwise act as fully and freely as though it were not Warrant Agent under this Agreement. Nothing herein shall preclude the Warrant Agent from acting in any other capacity for the Company or for any other legal entity.

(h) The Warrant Agent shall act hereunder solely as agent for the Company, and its duties shall be determined solely by the provisions hereof. The Warrant Agent shall not be liable for anything which it may do or refrain from doing in connection with this Agreement except for its own negligence or willful misconduct. The Warrant Agent shall not be liable for any error of judgment made in good faith by it, unless it shall be proved that the Warrant Agent was negligent in ascertaining the pertinent facts. Notwithstanding anything in this Agreement to the contrary, in no event shall the Warrant Agent be liable for special, indirect, punitive or consequential loss or damage of any kind whatsoever (including but not limited to lost profits), even if the Warrant Agent has been advised of the likelihood of the loss or damage and regardless of the form of the action.

(i) The Warrant Agent shall not at any time be under any duty or responsibility to any holder of any Warrant Certificate to make or cause to be made any adjustment of the Exercise Price or number of the Warrant Shares or other securities or property deliverable as provided in this Agreement, or to determine whether any facts exist which may require any of such adjustments, or with respect to the nature or extent of any such adjustments, when made, or with respect to the method employed in making the same. The Warrant Agent shall not be accountable with respect to the validity or value or the kind or amount of any Warrant Shares or of any securities or property which may at any time be issued or delivered upon the exercise of any Warrant or with respect to whether any such Warrant Shares or other securities will when issued be validly issued and fully paid and nonassessable, and makes no representation with respect thereto.

(j) Notwithstanding anything in this Agreement to the contrary, neither the Company nor the Warrant Agent shall have any liability to any holder of a Warrant Certificate or other Person as a result of its inability to perform any of its obligations under this Agreement by reason of any preliminary or permanent injunction or other order, decree or ruling issued by a court of competent jurisdiction or by a governmental, regulatory or administrative agency or commission, or any statute, rule, regulation or executive order promulgated or enacted by any governmental authority prohibiting or otherwise restraining performance of such obligation; provided that (i) the Company must use its reasonable best efforts to have any such order, decree or ruling lifted or otherwise overturned as soon as possible and (ii) nothing in this Section 15(j) shall affect the Company's obligation under Section 6(d) to use its best efforts to have a registration statement in effect covering the Warrant Shares issuable upon exercise of the Warrants and to maintain a current prospectus relating to those Warrant Shares.

(k) Any application by the Warrant Agent for written instructions from the Company may, at the option of the Warrant Agent, set forth in writing any action proposed to be taken or omitted by the Warrant Agent under this Agreement and the date on and/or after which such action shall be taken or such omission shall be effective. The Warrant Agent shall not be liable for any action taken by, or omission of, the Warrant Agent in accordance with a proposal included in such application on or after the date specified in such application (which date shall not be less than

Table of Contents

three Business Days after the date any officer of the Company actually receives such application, unless any such officer shall have consented in writing to any earlier date) unless prior to taking any such action (or the effective date in the case of an omission), the Warrant Agent shall have received written instructions in response to such application specifying the action to be taken or omitted.

(l) No provision of this Agreement shall require the Warrant Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder or in the exercise of its rights.

(m) In addition to the foregoing, the Warrant Agent shall be protected and shall incur no liability for, or in respect of, any action taken or omitted by it in connection with its administration of this Agreement if such acts or omissions are not the result of the Warrant Agent's reckless disregard of its duty, gross negligence or willful misconduct and are in reliance upon (i) the proper execution of the certification concerning beneficial ownership appended to the form of assignment and the form of the election attached hereto unless the Warrant Agent shall have actual knowledge that, as executed, such certification is untrue, or (ii) the non-execution of such certification including, without limitation, any refusal to honor any otherwise permissible assignment or election by reason of such non-execution.

SECTION 16. *Change of Warrant Agent.* The Warrant Agent may at any time resign as Warrant Agent upon written notice to the Company. If the Warrant Agent shall become incapable of acting as Warrant Agent, the Company shall appoint a successor to such Warrant Agent. If the Company shall fail to make such appointment within a period of 30 days after it has been notified in writing of such resignation or of such incapacity by the Warrant Agent or by the registered holder of a Warrant Certificate, then the registered holder of any Warrant Certificate or the Warrant Agent may apply, at the expense of the Company, to any court of competent jurisdiction for the appointment of a successor to the Warrant Agent. Pending appointment of a successor to such Warrant Agent, either by the Company or by such a court, the duties of the Warrant Agent shall be carried out by the Company. The holders of a majority of the unexercised Warrants shall be entitled at any time to remove the Warrant Agent and appoint a successor to such Warrant Agent. If a Successor Warrant Agent shall not have been appointed within 30 days of such removal, the Warrant Agent may apply, at the expense of the Company, to any court of competent jurisdiction for the appointment of a successor to the Warrant Agent. Such successor to the Warrant Agent need not be approved by the Company or the former Warrant Agent. After appointment the successor to the Warrant Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Warrant Agent without further act or deed; but the former Warrant Agent upon payment of all fees and expenses due it and its agents and counsel shall deliver and transfer to the successor to the Warrant Agent any property at the time held by it hereunder and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Failure to give any notice provided for in this Section 16, however, or any defect therein, shall not affect the legality or validity of the appointment of a successor to the Warrant Agent.

SECTION 17. *Notices to Company and Warrant Agent.* Any notice or demand authorized by this Agreement to be given or made by the Warrant Agent or by the registered holder of any Warrant Certificate to or on the Company shall be sufficiently given or made when and if deposited in the mail, first class or registered, postage prepaid, addressed (until another address is filed in writing by the Company with the Warrant Agent), as follows:

Kennedy-Wilson Holdings, Inc.
9130 Galleria Court, Suite 318
Naples, FL 34109
Fax No.: (239) 254-4481
Attention: Chief Executive Officer

Table of Contents

In case the Company shall fail to maintain such office or agency or shall fail to give such notice of the location or of any change in the location thereof, presentations may be made and notices and demands may be served at the principal corporate trust office of the Warrant Agent.

Any notice pursuant to this Agreement to be given by the Company or by the registered holder(s) of any Warrant Certificate to the Warrant Agent shall be sufficiently given when and if deposited in the mail, first-class or registered, postage prepaid, addressed (until another address is filed in writing by the Warrant Agent with the Company) to the Warrant Agent as follows:

Continental Stock Transfer & Trust Company
17 Battery Place
New York, NY 10004
Fax No.: (212) 509-5150
Attention: Compliance Department

SECTION 18. *Supplements and Amendments.* The Company and the Warrant Agent may from time to time supplement or amend this Agreement without the approval of any holders of Warrant Certificates in order to cure any ambiguity or to correct or supplement any provision contained herein which may be defective or inconsistent with any other provision herein, or to make any other provisions in regard to matters or questions arising hereunder which the Company and the Warrant Agent may deem necessary or desirable and which shall not in any way adversely affect the interests of the holders of Warrant Certificates theretofore issued. Upon the delivery of a certificate from an appropriate officer of the Company which states that the proposed supplement or amendment is in compliance with the terms of this Section 18, the Warrant Agent shall execute such supplement or amendment. Notwithstanding anything in this Agreement to the contrary, the prior written consent of the Warrant Agent must be obtained in connection with any supplement or amendment which alters the rights or duties of the Warrant Agent. The Company and the Warrant Agent may amend any provision herein with the consent of the holders of Warrants exercisable for a majority of the Warrant Shares issuable on exercise of all outstanding Warrants that would be affected by such amendment.

SECTION 19. *Successors.* All the covenants and provisions of this Agreement by or for the benefit of the Company or the Warrant Agent shall bind and inure to the benefit of their respective successors and assigns hereunder.

SECTION 20. *Termination.* This Agreement will terminate on any earlier date if all Warrants have been exercised or expired without exercise. The provisions of Section 15 hereof shall survive such termination.

SECTION 21. *Governing Law.* This Agreement and each Warrant Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of New York and for all purposes shall be construed in accordance with the internal laws of said State. The parties agree that, all actions and proceedings arising out of this Agreement or any of the transactions contemplated hereby, shall be brought in the United States District Court for the Southern District of New York or in a New York State Court in the County of New York and that, in connection with any such action or proceeding, submit to the jurisdiction of, and venue in, such court. Each of the parties hereto also irrevocably waives all right to trial by jury in any action, proceeding or counterclaim arising out of this Agreement or the transactions contemplated hereby.

SECTION 22. *Benefits of This Agreement.* Nothing in this Agreement shall be construed to give to any person or corporation other than the Company, the Warrant Agent and the registered holders of the Warrant Certificates any legal or equitable right, remedy or claim under this Agreement, and this Agreement shall be for the sole and exclusive benefit of the Company, the Warrant Agent and the registered holders of the Warrant Certificates.

Table of Contents

SECTION 23. *Counterparts.* This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument.

SECTION 24. *Force Majeure.* In no event shall the Warrant Agent be responsible or liable for any failure or delay in the performance of its obligations under this Agreement arising out of or caused by, directly or indirectly, forces beyond its reasonable control, including without limitation strikes, work stoppages, accidents, acts of war or terrorism, civil or military disturbances, nuclear or natural catastrophes or acts of God, and interruptions, loss or malfunctions of utilities, communications or computer (software or hardware) services.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed, as of the day and year first above written.

KENNEDY-WILSON HOLDINGS, INC.

By: _____

Name:

Title:

CONTINENTAL STOCK TRANSFER & TRUST
COMPANY, as Warrant Agent

By: _____

Name:

Title:

C-23

Table of Contents

Schedule I

Sponsor	Sponsor Warrants
Flat Ridge Investments LLC	3,150,000
LLM Structured Equity Fund L.P.	1,646,400
LLM Investors L.P.	33,600
Capital Management Systems, Inc.	420,000

C-24

[Form of Warrant Certificate]

[Face]

NUMBER

WARRANTS

**THIS WARRANT WILL BE VOID IF NOT EXERCISED PRIOR TO
5:00 P.M. NEW YORK CITY TIME, NOVEMBER 14, 2013**

KENNEDY-WILSON HOLDINGS, INC.
Incorporated Under the Laws of the State of Delaware

CUSIP

WARRANT CERTIFICATE

This Warrant Certificate certifies that _____, or registered assigns, is the registered holder of _____ warrants (the "Warrants") to purchase shares of Common Stock, \$.0001 par value (the "Common Stock"), of Kennedy-Wilson Holdings, Inc. (formerly Prospect Acquisition Corp.), a Delaware corporation (the "Company"). Each Warrant entitles the holder, upon exercise during the period set forth in the Warrant Agreement referred to below, to purchase from the Company that number of fully paid and non-assessable shares of Common Stock (each, a "Warrant Share") as set forth below at the exercise price (the "Exercise Price") as determined pursuant to the Warrant Agreement payable in lawful money of the United States of America upon surrender of this Warrant Certificate and payment of the Exercise Price at the office or agency of the Warrant Agent, but only subject to the conditions set forth herein and in the Warrant Agreement. Defined terms used in this Warrant Certificate but not defined herein shall have the meanings given to them in the Warrant Agreement.

Each Warrant is initially exercisable for one fully paid and non-assessable share of Common Stock. The number of Warrant Shares issuable upon exercise of the Warrants is subject to adjustment upon the occurrence of certain events set forth in the Warrant Agreement.

The initial Exercise Price per share of Common Stock for any Warrant is equal to \$12.50 per share. The Exercise Price is subject to adjustment upon the occurrence of certain events set forth in the Warrant Agreement.

Warrants may be exercised only during the Warrant Exercise Period subject to the conditions set forth in the Warrant Agreement and to the extent not exercised by the end of such Warrant Exercise Period such Warrants shall become void.

Reference is hereby made to the further provisions of this Warrant Certificate set forth on the reverse hereof and such further provisions shall for all purposes have the same effect as though fully set forth at this place.

This Warrant Certificate shall not be valid unless countersigned by the Warrant Agent, as such term is used in the Warrant Agreement.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

This Warrant Certificate shall be governed and construed in accordance with the internal laws of the State of New York, without regard to conflicts of laws principles thereof.

KENNEDY-WILSON HOLDINGS, INC.

By: _____

William J. McMorrow
President

By: _____

Freeman A. Lyle
Secretary

Countersigned:

Dated: _____, 20__

CONTINENTAL STOCK TRANSFER & TRUST COMPANY,
as Warrant Agent

By: _____

Authorized Signatory

C-26

Table of Contents

[Form of Warrant Certificate]

[Reverse]

The Warrants evidenced by this Warrant Certificate are part of a duly authorized issue of Warrants entitling the holder on exercise to receive shares of Common Stock, par value \$0.0001 per share, of the Company (the "**Common Stock**"), and are issued or to be issued pursuant to an amended and restated Warrant Agreement dated as of [_____], 2009 (the "**Warrant Agreement**"), duly executed and delivered by the Company to Continental Stock Transfer & Trust Company, a New York corporation, as warrant agent (the "**Warrant Agent**"), which Warrant Agreement is hereby incorporated by reference in and made a part of this instrument and is hereby referred to for a description of the rights, limitation of rights, obligations, duties and immunities thereunder of the Warrant Agent, the Company and the holders (the words "holders" or "holder" meaning the registered holders or registered holder) of the Warrants. A copy of the Warrant Agreement may be obtained by the holder hereof upon written request to the Company. Defined terms used in this Warrant Certificate but not defined herein shall have the meanings given to them in the Warrant Agreement.

Warrants may be exercised at any time during the Warrant Exercise Period set forth in the Warrant Agreement. The holder of Warrants evidenced by this Warrant Certificate may exercise them by surrendering this Warrant Certificate, with the form of election to purchase set forth hereon properly completed and executed, together with payment of the Exercise Price as specified in the Warrant Agreement, at the principal corporate trust office of the Warrant Agent. In the event that upon any exercise of Warrants evidenced hereby the number of Warrants exercised shall be less than the total number of Warrants evidenced hereby, there shall be issued to the holder hereof or his assignee a new Warrant Certificate evidencing the number of Warrants not exercised. No adjustment shall be made for any dividends on any Common Stock issuable upon exercise of this Warrant.

Notwithstanding anything else in this Warrant Certificate or the Warrant Agreement, no Warrant may be exercised unless at the time of exercise (i) a registration statement covering the Warrant Shares to be issued upon exercise is effective under the Act and (ii) a prospectus thereunder relating to the Warrant Shares is current. In no event shall the Warrants be settled on a net cash basis during the Warrant Exercise Period nor shall the Company be required to issue unregistered shares upon the exercise of any Warrant.

Once the Warrants become exercisable and there is an effective registration statement covering the shares of Common Stock issuable upon exercise of the Warrants available and current throughout the 30-day redemption period defined below, the Company may redeem the outstanding Warrants (except with respect to the sponsors' Warrants held by a sponsor or its permitted transferee) in whole and not in part at a price of \$0.01 per Warrant upon a minimum of 30 days' prior written notice of redemption (the "**30-day redemption period**") and if, and only if, the last sale price of the Company's Common Stock equals or exceeds \$19.50 per share for any 20 trading days within a 30-trading day period ending three business days before the notice of redemption is sent. If the Company calls the Warrants for redemption, it will have the option to require all holders that wish to exercise Warrants to do so on a "cashless basis." In such event, each holder would pay the exercise price by surrendering the Warrants for that number of shares of Common Stock equal to the quotient obtained by dividing (x) the product of the number of shares of Common Stock underlying the Warrants, multiplied by the difference between the exercise price of the Warrants and the "fair market value" (defined below) by (y) the fair market value. The "**fair market value**" shall mean the average reported last sale price of the Common Stock for the ten trading days ending on the third trading day prior to the date on which the notice of redemption is sent to the holders of Warrants.

The Warrant Agreement provides that upon the occurrence of certain events the number of Warrant Shares set forth on the face hereof may, subject to certain conditions, be adjusted. No

Table of Contents

fractions of a share of Common Stock will be issued upon the exercise of any Warrant, but the Company will pay the cash value thereof determined as provided in the Warrant Agreement.

Warrant Certificates, when surrendered at the principal corporate trust office of the Warrant Agent by the registered holder thereof in person or by legal representative or attorney duly authorized in writing, may be exchanged, in the manner and subject to the limitations provided in the Warrant Agreement, but without payment of any service charge, for another Warrant Certificate or Warrant Certificates of like tenor evidencing in the aggregate a like number of Warrants.

Upon due presentation for registration of transfer of this Warrant Certificate at the office of the Warrant Agent a new Warrant Certificate or Warrant Certificates of like tenor and evidencing in the aggregate a like number of Warrants shall be issued to the transferee(s) in exchange for this Warrant Certificate, subject to the limitations provided in the Warrant Agreement, without charge except for any tax or other governmental charge imposed in connection therewith.

The Company and the Warrant Agent may deem and treat the registered holder(s) thereof as the absolute owner(s) of this Warrant Certificate (notwithstanding any notation of ownership or other writing hereon made by anyone), for the purpose of any exercise hereof, of any distribution to the holder(s) hereof, and for all other purposes, and neither the Company nor the Warrant Agent shall be affected by any notice to the contrary. Neither the Warrants nor this Warrant Certificate entitles any holder hereof to any rights of a stockholder of the Company.

Table of Contents

Election to Purchase

(To Be Executed Upon Exercise Of Warrant)

The undersigned hereby irrevocably elects to exercise the right, represented by this Warrant Certificate, to receive _____ shares of Common Stock and herewith tenders payment for such shares to the order of Kennedy-Wilson Holdings, Inc. in the amount of \$_____ in accordance with the terms hereof. The undersigned requests that a certificate for such shares be registered in the name of _____, whose address is _____ and that such shares be delivered to _____ whose address is _____. If said number of shares is less than all of the shares of Common Stock purchasable hereunder, the undersigned requests that a new Warrant Certificate representing the remaining balance of such shares be registered in the name of _____, whose address is _____, and that such Warrant Certificate be delivered to _____, whose address is _____.

In the event that the Warrant has been called for redemption by the Company pursuant to Section 6(b) of the Warrant Agreement and the Company has required cashless exercise pursuant to Section 6(d) of the Warrant Agreement, the number of shares that a Warrant is exercisable for shall be determined in accordance with Section 6(d) of the Warrant Agreement.

In the event that the Warrant is a Sponsors' Warrant (as such term is defined in the Warrant Agreement), such Warrant may be exercised, to the extent allowed by the Warrant Agreement, through cashless exercise pursuant to Section 6(d) of the Warrant Agreement, in which case, (i) the number of shares that a Sponsors' Warrant is exercisable for would be determined in accordance with Section 6(d) of the Warrant Agreement and (ii) the holder of the Sponsors' Warrant will complete the following:

The undersigned hereby irrevocably elects to exercise the right, represented by its Sponsors' Warrant Certificate, through the cashless exercise provision of Section 6(d) of the Warrant Agreement, to receive _____ shares of Common Stock. If said number of shares is less than all of the shares of Common Stock purchasable hereunder (after giving effect to the cashless exercise), the undersigned requires that a new Sponsors' Warrant Certificate representing the balance of such shares be registered in the name of _____, whose address is _____, and that such Sponsors' Warrant Certificate be delivered to _____, whose address is _____.

Dated: _____

(SIGNATURE)

(ADDRESS)

(TAX IDENTIFICATION NUMBER)

Signatures(s) Guaranteed:

Edgar Filing: VALHI INC /DE/ - Form 10-Q

THE SIGNATURE(S) SHOULD BE GUARANTEED BY AN ELIGIBLE GUARANTOR INSTITUTION (BANKS, STOCKBROKERS, SAVINGS AND LOAN ASSOCIATIONS AND CREDIT UNIONS WITH MEMBERSHIP IN AN APPROVED SIGNATURE GUARANTEE MEDALLION PROGRAM, PURSUANT TO S.E.C. RULE 17Ad-15).

C-29

LEGEND

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED OR ANY STATE SECURITIES LAWS, AND MAY NOT BE OFFERED, SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND ANY APPLICABLE STATE SECURITIES LAWS OR AN EXEMPTION FROM REGISTRATION IS AVAILABLE. IN ADDITION, THE SECURITIES REPRESENTED BY THIS CERTIFICATE MAY NOT BE SOLD OR TRANSFERRED PRIOR TO [_____], 2009 EXCEPT TO A PERMITTED TRANSFEREE (AS DEFINED IN THE WARRANT AGREEMENT) WHO AGREES IN WRITING WITH THE COMPANY TO BE SUBJECT TO SUCH TRANSFER PROVISIONS AND MAY NOT BE EXERCISED DURING SUCH PERIOD. FOR SO LONG AS THE SECURITIES ARE SUBJECT TO SUCH TRANSFER RESTRICTIONS, THEY WILL BE HELD IN AN ESCROW ACCOUNT MAINTAINED BY CONTINENTAL STOCK TRANSFER & TRUST COMPANY AS ESCROW AGENT UNDER THE ESCROW AGREEMENT (AS DEFINED IN SECTION 5 OF THE WARRANT AGREEMENT).

SECURITIES EVIDENCED BY THIS CERTIFICATE AND SHARES OF COMMON STOCK OF THE COMPANY ISSUED UPON EXERCISE OF SUCH SECURITIES WILL BE ENTITLED TO REGISTRATION RIGHTS UNDER A REGISTRATION RIGHTS AGREEMENT TO BE EXECUTED BY THE COMPANY.

No. _____

C-30

_____ Warrants

**SECOND AMENDED AND
RESTATED CERTIFICATE OF INCORPORATION
OF
PROSPECT ACQUISITION CORP.**

[now known as Kennedy-Wilson Holdings, Inc.]

PROSPECT ACQUISITION CORP., a corporation existing under the laws of the State of Delaware, does hereby certify as follows:

1. The name of the Corporation is "Prospect Acquisition Corp."
2. The Corporation was originally incorporated under the name "Prospect Acquisition Corp." The original Certificate of Incorporation of the Corporation was filed in the office of the Secretary of State of the State of Delaware on July 9, 2007, which was amended by the Company by the filing of a Certificate of Amendment in the office of the Secretary of State of the State of Delaware on October 12, 2007 (the "**Original Certificate**").
3. The First Amended and Restated Certificate of Incorporation was filed on March 31, 2008 (the "**First Amended and Restated Certificate**") and it amended, restated and integrated the provisions of the Original Certificate of the Corporation.
4. This Second Amended and Restated Certificate of Incorporation (this "**Second Amended and Restated Certificate**") amends, restates and integrates the provisions of the First Amended and Restated Certificate of the Corporation.
4. This Second Amended and Restated Certificate was duly approved and adopted by the board of directors and stockholders of the Corporation in accordance with the applicable provisions of Sections 242 and 245 of the General Corporation Law of the State of Delaware ("**DGCL**").

5. The text of the Amended and Restated Certificate is hereby amended and restated to read in its entirety as follows:

FIRST: The name of the corporation is Kennedy-Wilson Holdings, Inc. (the "**Corporation**").

SECOND: The purpose of the Corporation shall be to engage in any lawful act or activity for which corporations may be organized under the DGCL.

THIRD: The address of the Corporation's registered office in the State of Delaware is 2711 Centerville Road, Suite 400, Wilmington, County of New Castle, Delaware 19808. The name of the Corporation's registered agent at such address is the Corporation Service Company.

FOURTH: The total number of shares of all classes of capital stock which the Corporation shall have authority to issue is 81,000,000, of which 80,000,000 shares shall be Common Stock with a par value of \$.0001 per share (the "**Common Stock**") and 1,000,000 shares shall be Preferred Stock with a par value of \$.0001 per share (the "**Preferred Stock**").

A. *Preferred Stock.* The Board of Directors (the "**Board**") is expressly granted authority to issue shares of Preferred Stock, in one or more series, and to fix for each such series such voting powers, full or limited, and such designations, preferences and relative, participating, optional or other special rights and such qualifications, limitations or restrictions thereof as shall be stated and expressed in the resolution or resolutions adopted by the Board providing for the issue of such series (a "**Preferred Stock Designation**") and as may be permitted by the DGCL. The number of authorized shares of Preferred Stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the voting

Table of Contents

power of all of the then outstanding shares of the capital stock of the Corporation entitled to vote generally in the election of directors, voting together as a single class, without a separate vote of the holders of the Preferred Stock, or any series thereof, unless a vote of any such holders is required pursuant to any Preferred Stock Designation.

B. *Common Stock.* Except as otherwise required by law or as otherwise provided in any Preferred Stock Designation, the holders of the Common Stock shall exclusively possess all voting power and each share of Common Stock shall have one vote.

FIFTH: The Corporation's existence shall be perpetual.

SIXTH: The following provisions are inserted for the management of the business and for the conduct of the affairs of the Corporation, and for further definition, limitation and regulation of the powers of the Corporation and of its directors and stockholders:

A. The Board of Directors shall consist of such number of directors as is determined from time to time by resolution adopted by the affirmative vote of a majority of the entire Board of Directors; provided, however, that in no event shall the number of directors be less than one nor more than twelve. The directors shall be divided into three classes, designated Class I, Class II and Class III. The number of directors in each class shall be as nearly equal as possible. The directors in Class I shall be elected for a term expiring at the Annual Meeting of Stockholders to be held in 2010. The directors in Class II shall be elected for a term expiring at the Annual Meeting of Stockholders to be held in 2011. The directors in Class III shall be elected for a term expiring at the Annual Meeting of Stockholders to be held in 2012. Beginning with the 2010 Annual Meeting of Stockholders, each class of directors will be elected for a term of office to expire at the third succeeding Annual Meeting of Stockholders after its election. Except as the DGCL may otherwise require, in the interim between annual meetings of stockholders or special meetings of stockholders called for the election of directors and/or the removal of one or more directors and the filling of any vacancy in that connection, newly created directorships and any vacancies in the Board, including unfilled vacancies resulting from the removal of directors for cause, may be filled by the vote of a majority of the remaining directors then in office, although less than a quorum (as defined in the Corporation's bylaws), or by the sole remaining director. All directors shall hold office until the expiration of their respective terms of office and until their successors shall have been elected and qualified. A director elected to fill a vacancy resulting from the death, resignation or removal of a director shall serve for the remainder of the full term of the director whose death, resignation or removal shall have created such vacancy and until his successor shall have been elected and qualified.

B. Election of directors need not be by ballot unless the bylaws of the Corporation so provide.

C. The Board shall have the power, without the assent or vote of the stockholders, to make, alter, amend, change, add to or repeal the bylaws of the Corporation as provided in the bylaws of the Corporation, subject to the power of stockholders to alter or repeal any bylaw whether adopted by them or otherwise.

D. The directors in their discretion may submit any contract or act for approval or ratification at any annual meeting of the stockholders or at any meeting of the stockholders called for the purpose of considering any such act or contract, and any contract or act that shall be approved or be ratified by the vote of the holders of a majority of the stock of the Corporation which is represented in person or by proxy at such meeting and entitled to vote thereat (provided that a lawful quorum of stockholders be there represented in person or by proxy), unless a higher vote is required by applicable law, shall be as valid and binding upon the Corporation and upon all the stockholders as though it had been approved or ratified by every stockholder of the

Table of Contents

Corporation, whether or not the contract or act would otherwise be open to legal attack because of directors' interests, or for any other reason.

E. In addition to the powers and authorities hereinbefore or by statute expressly conferred upon them, the directors are hereby empowered to exercise all such powers and do all such acts and things as may be exercised or done by the Corporation; subject, nevertheless, to the provisions of the statutes of Delaware, of this Second Amended and Restated Certificate, and to any bylaws from time to time made by the stockholders; provided, however, that no bylaw so made shall invalidate any prior act of the directors which would have been valid if such bylaw had not been made.

SEVENTH: The following paragraphs shall apply with respect to liability and indemnification of the Corporation's officers and directors and certain other persons:

A. A director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the DGCL, or (iv) for any transaction from which the director derived an improper personal benefit. If the DGCL is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the DGCL, as so amended. Any repeal or modification of this paragraph (A) by the stockholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation with respect to events occurring prior to the time of such repeal or modification.

B. The Corporation, to the full extent permitted by Section 145 of the DGCL, as amended from time to time, shall indemnify all persons whom it may indemnify pursuant thereto. Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative, or investigative action, suit or proceeding for which such officer or director may be entitled to indemnification hereunder shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized hereby.

EIGHTH: Whenever a compromise or arrangement is proposed between the Corporation and its creditors or any class of them and/or between the Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of the Corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for the Corporation under Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for the Corporation under Section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of the Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of the Corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of the Corporation as a consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of the Corporation, as the case may be, and also on the Corporation.

NINTH: The Corporation reserves the right to amend, alter, change or repeal any provision contained in this Second Amended and Restated Certificate in the manner now or hereafter prescribed by law, and all rights and powers conferred herein on stockholders, directors and officers are subject to this reserved power.

[Signature Page Follows]

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

IN WITNESS WHEREOF, the Corporation has caused this Second Amended and Restated Certificate of Incorporation to be duly executed by the undersigned as of this the ___ day of November, 2009.

David A. Minella
Chief Executive Officer
Signature Page to Second Amended and Restated Certificate of Incorporation

D-4

Table of Contents

Annex E

KENNEDY-WILSON HOLDINGS, INC.

2009 EQUITY PARTICIPATION PLAN

Table of Contents

KENNEDY-WILSON HOLDINGS, INC.

2009 EQUITY PARTICIPATION PLAN

**ARTICLE I
PURPOSE**

The purpose of this Plan is to assist the Company in attracting, retaining and providing incentives to key management employees and nonemployee directors of, and non-employee consultants to, the Company and its Affiliates, and to align the interests of such employees, nonemployee directors and nonemployee consultants with those of the Company's stockholders. Accordingly, the Plan provides for the granting of Distribution Equivalent Rights, Incentive Stock Options, Non-Qualified Stock Options, Performance Share Awards, Performance Unit Awards, Restricted Stock Awards, Restricted Stock Unit Awards, Stock Appreciation Rights, Tandem Stock Appreciation Rights, Unrestricted Stock Awards or any combination of the foregoing, as may be best suited to the circumstances of the particular Employee, Director or Consultant, as provided herein.

**ARTICLE II
DEFINITIONS**

The following definitions shall be applicable throughout the Plan unless the context otherwise requires:

"*Affiliate*" shall mean any corporation which, with respect to the Company, is a "subsidiary corporation" within the meaning of Section 424(f) of the Code.

"*Award*" shall mean, individually or collectively, a grant or sale pursuant to the Plan of any Distribution Equivalent Right, Option, Performance Share Award, Performance Unit Award, Restricted Stock Award, Restricted Stock Unit Award, Stock Appreciation Right or Unrestricted Stock Award.

"*Award Agreement*" shall mean a written agreement between the Company and the Holder setting forth the terms and conditions of the Award.

"*Board*" shall mean the Board of Directors of the Company.

"*Cause*" shall mean (i) if the Holder is a party to an employment or similar agreement with the Company or an Affiliate which agreement defines "Cause" (or a similar term) therein, "*Cause*" shall have the same meaning as provided for in such agreement, or (ii) for a Holder who is not a party to such an agreement, "*Cause*" shall mean termination by the Company or an Affiliate of the employment (or other service relationship) of the Holder by reason of the Holder's (A) intentional failure to perform reasonably assigned duties, (B) dishonesty or willful misconduct in the performance of the Holder's duties, (C) involvement in a transaction which is materially adverse to the Company or an Affiliate, (D) breach of fiduciary duty involving personal profit, (E) willful violation of any law, rule, regulation or court order (other than misdemeanor traffic violations and misdemeanors not involving misuse or misappropriation of money or property), (F) commission of an act of fraud or intentional misappropriation or conversion of any asset or opportunity of the Company or an Affiliate, or (G) material breach of any provision of the Plan or the Holder's Award Agreement or any other written agreement between the Holder and the Company or an Affiliate, in each case as determined in good faith by the Board, the determination of which shall be final, conclusive and binding on all parties.

"*Change of Control*" shall mean (i) for a Holder who is a party to an employment or consulting agreement with the Company or an Affiliate which agreement defines "Change of Control" (or a similar term) therein, "*Change of Control*" shall have the same meaning as provided for in such agreement, or (ii) for a Holder who is not a party to such an agreement, "*Change of Control*" shall

Table of Contents

mean the satisfaction of any one or more of the following conditions (and the "Change of Control" shall be deemed to have occurred as of the first day that any one or more of the following conditions have been satisfied):

(a) Any person (as such term is used in paragraphs 13(d) and 14(d)(2) of the Exchange Act, hereinafter in this definition, "*Person*"), other than the Company or an Affiliate or an employee benefit plan of the Company or an Affiliate, becomes the beneficial owner (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the combined voting power of the Company's then outstanding securities;

(b) The closing of a merger, consolidation or other business combination (a "*Business Combination*") other than (I) the Business Combination between Kennedy-Wilson, Inc. and Prospect Acquisition Corp. or (II) any Business Combination in which holders of the Common Stock immediately prior to the Business Combination (A) own more than fifty percent (50%) of the total voting power of the corporation resulting from such Business Combination (or the direct or indirect parent corporation of such surviving corporation), and (B) have substantially the same proportionate ownership of common stock of the surviving corporation immediately after the Business Combination as immediately before;

(c) The closing of an agreement for the sale or disposition of all or substantially all of the Company's assets to any entity that is not an Affiliate;

(d) The approval by the holders of shares of Common Stock of a plan of complete liquidation of the Company other than a liquidation of the Company into any subsidiary or a liquidation a result of which persons who were stockholders of the Company immediately prior to such liquidation have substantially the same proportionate ownership of shares of common stock of the surviving corporation immediately after such liquidation as immediately before; or

(e) Within any twenty-four (24) month period, the Incumbent Directors shall cease to constitute at least a majority of the Board or the board of directors of any successor to the Company; *provided, however*, that any director elected to the Board, or nominated for election, by a majority of the Incumbent Directors then still in office, shall be deemed to be an Incumbent Director for purposes of this paragraph (e), but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of either an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of an individual, entity or "group" other than the Board (including, but not limited to, any such assumption that results from paragraphs (a), (b), (c), or (d) of this definition).

Notwithstanding the foregoing, a "Change of Control" shall not be deemed to occur if the Company files for bankruptcy, liquidation or reorganization under the United States Bankruptcy Code.

"*Code*" shall mean the Internal Revenue Code of 1986, as amended, any successor statute thereto and any regulations issued from time to time thereunder.

"*Committee*" shall mean a committee comprised of not less than three (3) members of the Board who are selected by the Board as provided in Section 4.1.

"*Common Stock*" shall mean the common stock, par value \$.0001 per share, of the Company.

"*Company*" shall mean Kennedy-Wilson Holdings, Inc., a Delaware corporation, and any successor thereto.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

"*Consultant*" shall mean any non-Employee (individual or entity) advisor to the Company or an Affiliate who or which has contracted directly with the Company or an Affiliate to render bona fide consulting or advisory services thereto.

"*Director*" shall mean a member of the Board or a member of the board of directors of an Affiliate, in either case, who is not an Employee.

"*Distribution Equivalent Right*" shall mean an Award granted under Article XIII of the Plan which entitles the Holder to receive bookkeeping credits, cash payments and/or Common Stock distributions equal in amount to the distributions that would have been made to the Holder had the Holder held a specified number of shares of Common Stock during the period the Holder held the Distribution Equivalent Right.

"*Distribution Equivalent Right Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to a Distribution Equivalent Right Award.

"*Effective Date*" shall mean _____, 2009.

"*Employee*" shall mean any employee, including officers, of the Company or an Affiliate.

"*Exchange Act*" shall mean the Securities Exchange Act of 1934, as amended.

"*Fair Market Value*" shall mean, as determined consistent with the applicable requirements of Sections 409A and 422 of the Code, as of any specified date, (i) the closing sales price of the Common Stock for such date (or, in the event that the Common Stock is not traded on such date, on the immediately preceding trading date) on the principal U.S. national securities exchange on which the Common Stock is listed and traded on such date, or, if there is no such sale on that date, then on the last preceding date on which such a sale was reported; (ii) if the Common Stock is not listed on any U.S. national securities exchange but is quoted in an inter-dealer quotation system on a last sale basis, the final ask price of the Common Stock reported on the inter-dealer quotation system for such date, or, if there is no such sale on such date, then on the last preceding date on which a sale was reported; or (iii) if the Common Stock is neither listed on a U.S. national securities exchange nor quoted on an inter-dealer quotation system on a last sale basis, the amount determined by the Committee to be the fair market value of the Common Stock as determined by the Committee in its sole discretion. If the Common Stock is not quoted or listed as set forth above, Fair Market Value shall be determined by the Committee in good faith by any fair and reasonable means (which means, with respect to a particular Award grant, may be set forth with greater specificity in the applicable Award Agreement). The Fair Market Value of property other than Common Stock shall be determined by the Committee in good faith by any fair and reasonable means, and consistent with the applicable requirements of Sections 409A and 422 of the Code.

"*Family Member*" shall mean any child, stepchild, grandchild, parent, stepparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law, including adoptive relationships, any person sharing the Holder's household (other than a tenant or employee of the Holder), a trust in which such persons have more than fifty percent (50%) of the beneficial interest, a foundation in which such persons (or the Holder) control the management of assets, and any other entity in which such persons (or the Holder) own more than fifty percent (50%) of the voting interests.

"*Holder*" shall mean an Employee, Director or Consultant who has been granted an Award or any such individual's beneficiary, estate or representative, to the extent applicable.

"*Incentive Stock Option*" shall mean an Option which is intended by the Committee to constitute an "incentive stock option" under Section 422 of the Code.

Table of Contents

"*Incumbent Director*" shall mean, with respect to any period of time specified under the Plan for purposes of determining whether or not a Change of Control has occurred, the individuals who were members of the Board at the beginning of such period.

"*Non-Qualified Stock Option*" shall mean an Option which is not an Incentive Stock Option.

"*Option*" shall mean an Award granted under Article VII of the Plan of an option to purchase shares of Common Stock, and includes both Incentive Stock Options and Non-Qualified Stock Options.

"*Option Agreement*" shall mean a written agreement between the Company and a Holder with respect to an Option.

"*Performance Criteria*" shall mean the criteria that the Committee selects for purposes of establishing the Performance Goal(s) for a Holder for a Performance Period.

"*Performance Goals*" shall mean, for a Performance Period, the written goal or goals established by the Committee for the Performance Period based upon the Performance Criteria.

"*Performance Period*" shall mean one or more periods of time, which may be of varying and overlapping durations, selected by the Committee, over which the attainment of one or more Performance Goals or other business objectives shall be measured for purposes of determining a Holder's right to, and the payment of, a Qualified Performance-Based Award.

"*Performance Share Award*" shall mean an Award granted under Article XII of the Plan under which, upon the satisfaction of predetermined individual and/or Company (and/or Affiliate) performance goals and/or objectives, shares of Common Stock are paid to the Holder.

"*Performance Share Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to a Performance Share Award.

"*Performance Unit*" shall mean a Unit awarded to a Holder pursuant to a Performance Unit Award.

"*Performance Unit Award*" shall mean an Award granted under Article XI of the Plan under which, upon the satisfaction of predetermined individual and/or Company (and/or Affiliate) performance goals and/or objectives, a cash payment shall be made to the Holder, based on the number of Units awarded to the Holder.

"*Performance Unit Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to a Performance Unit Award.

"*Plan*" shall mean this Kennedy-Wilson Holdings, Inc. 2009 Equity Participation Plan, as amended from time to time.

"*Qualified Performance-Based Award*" shall mean Awards intended to qualify as "performance-based" compensation under Section 162(m) of the Code.

"*Restricted Stock Award*" shall mean an Award granted under Article VIII of the Plan of shares of Common Stock, the transferability of which by the Holder shall be subject to Restrictions.

"*Restricted Stock Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to a Restricted Stock Award.

"*Restricted Stock Unit*" shall mean a Unit awarded to a Holder pursuant to a Restricted Stock Unit Award.

"*Restricted Stock Unit Award*" shall mean an Award granted under Article X of the Plan under which, upon the satisfaction of predetermined individual service-related vesting requirements, a

Table of Contents

payment in cash or shares of Common Stock shall be made to the Holder, based on the number of Units awarded to the Holder.

"*Restricted Stock Unit Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to a Restricted Stock Unit Award.

"*Restriction Period*" shall mean the period of time for which shares of Common Stock subject to a Restricted Stock Award shall be subject to Restrictions, as set forth in the applicable Restricted Stock Award Agreement.

"*Restrictions*" shall mean forfeiture, transfer and/or other restrictions applicable to shares of Common Stock awarded to an Employee, Director or Consultant under the Plan pursuant to a Restricted Stock Award and set forth in a Restricted Stock Award Agreement.

"*Rule 16b-3*" shall mean Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act, as such may be amended from time to time, and any successor rule, regulation or statute fulfilling the same or a substantially similar function.

"*Stock Appreciation Right*" shall mean an Award granted under Article XIV of the Plan of a right, granted alone or in connection with a related Option, to receive a payment on the date of exercise.

"*Stock Appreciation Right Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to a Stock Appreciation Right.

"*Tandem Stock Appreciation Right*" shall mean a Stock Appreciation Right granted in connection with a related Option, the exercise of which shall result in termination of the otherwise entitlement to purchase some or all of the shares of Common Stock under the related Option, all as set forth in Section 14.2.

"*Ten Percent Stockholder*" shall mean an Employee who, at the time an Incentive Stock Option is granted to him or her, owns stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or of any parent corporation or subsidiary corporation thereof (both as defined in Section 424 of the Code), within the meaning of Section 422(b)(6) of the Code.

"*Total and Permanent Disability*" shall mean the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve (12) months, all as described in Section 22(e)(3) of the Code.

"*Units*" shall mean bookkeeping units, each of which represents such monetary amount as shall be designated by the Committee in each Performance Unit Award Agreement, or represents one (1) share of Common Stock for purposes of each Restricted Stock Unit Award.

"*Unrestricted Stock Award*" shall mean an Award granted under Article IX of the Plan of shares of Common Stock which are not subject to Restrictions.

"*Unrestricted Stock Award Agreement*" shall mean a written agreement between the Company and a Holder with respect to an Unrestricted Stock Award.

**ARTICLE III
EFFECTIVE DATE OF PLAN**

The Plan shall be effective as of the Effective Date, provided that the Plan is approved by the stockholders of the Company within twelve (12) months of such date.

Table of Contents

**ARTICLE IV
ADMINISTRATION**

Section 4.1 *Composition of Committee.* The Plan shall be administered by the Committee, which shall be appointed by the Board. The Committee shall consist solely of three (3) or more Directors who are each (i) "outside directors" within the meaning of Section 162(m) of the Code ("*Outside Directors*"), (ii) "non-employee directors" within the meaning of Rule 16b-3 and (iii) "independent" for purposes of any applicable listing requirements ("*Non-Employee Directors*"); *provided, however*, that the Board or the Committee may delegate to a committee of one or more members of the Board who are not (x) Outside Directors, the authority to grant Awards to eligible persons who are not (A) then "covered employees" within the meaning of Section 162(m) of the Code and are not expected to be "covered employees" at the time of recognition of income resulting from such Award, or (B) persons with respect to whom the Company wishes to comply with the requirements of Section 162(m) of the Code, and/or (y) Non-Employee Directors, the authority to grant Awards to eligible persons who are not then subject to the requirements of Section 16 of the Exchange Act. If a member of the Committee shall be eligible to receive an Award under the Plan, such Committee member shall have no authority hereunder with respect to his or her own Award. In addition, to the extent not inconsistent with applicable law, including Section 162(m) of the Code, or the rules and regulations of the principal U.S. national securities exchange on which the Common Stock is traded), the Committee may delegate to one or more executive officers or a committee of executive officers the right to grant Awards to Employees who are not directors or executive officers of the Company and the authority to take action on behalf of the Committee pursuant to the Plan to cancel or suspend Awards to Employees who are not directors or executive officers of the Company.

Section 4.2 *Powers.* Subject to the provisions of the Plan, the Committee shall have the sole authority, in its discretion, to make all determinations under the Plan, including but not limited to determining which Employees, Directors or Consultants shall receive an Award, the time or times when an Award shall be made (the date of grant of an Award shall be the date on which the Award is awarded by the Committee), what type of Award shall be granted, the term of an Award, the date or dates on which an Award vests (including any acceleration of vesting), the form of any payment to be made pursuant to an Award, the terms and conditions of an Award (including the forfeiture of the Award (and/or any financial gain) if the Holder of the Award violates any applicable restrictive covenant thereof), the Restrictions under a Restricted Stock Award and the number of shares of Common Stock which may be issued under an Award, all as applicable. In making such determinations the Committee may take into account the nature of the services rendered by the respective Employees, Directors and Consultants, their present and potential contribution to the Company's (or the Affiliate's) success and such other factors as the Committee in its discretion shall deem relevant.

Section 4.3 *Additional Powers.* The Committee shall have such additional powers as are delegated to it under the other provisions of the Plan. Subject to the express provisions of the Plan, the Committee is authorized to construe the Plan and the respective Award Agreements executed hereunder, to prescribe such rules and regulations relating to the Plan as it may deem advisable to carry out the intent of the Plan, and to determine the terms, restrictions and provisions of each Award, including such terms, restrictions and provisions as shall be requisite in the judgment of the Committee to cause designated Options to qualify as Incentive Stock Options, and to make all other determinations necessary or advisable for administering the Plan. The Committee may correct any defect or supply any omission or reconcile any inconsistency in any Award Agreement in the manner and to the extent it shall deem expedient to carry it into effect. The determinations of the Committee on the matters referred to in this Article IV shall be conclusive and binding on the Company and all Holders.

Section 4.4 *Committee Action.* In the absence of specific rules to the contrary, action by the Committee shall require the consent of a majority of the members of the Committee, expressed either

Table of Contents

orally at a meeting of the Committee or in writing in the absence of a meeting. No member of the Committee shall have any liability for any good faith action, inaction or determination in connection with the Plan.

**ARTICLE V
STOCK SUBJECT TO PLAN AND LIMITATIONS THEREON**

Section 5.1 *Stock Grant and Award Limits.* The Committee may from time to time grant Awards to one or more Employees, Directors and/or Consultants determined by it to be eligible for participation in the Plan in accordance with the provisions of Article VI. Subject to Article XV, the aggregate number of shares of Common Stock that may be issued under the Plan shall not exceed Two Million Four Hundred Seventy-Five Thousand (2,475,000) shares. Notwithstanding any provision in the Plan to the contrary, the maximum number of shares of Common Stock that may be subject to Awards of Options under Article VII and/or Stock Appreciation Rights under Article XIV, in either or both cases granted to any one Employee during any calendar year, shall be Two Million (2,000,000) shares (subject to adjustment in the same manner as provided in Article XV with respect to shares of Common Stock subject to Awards then outstanding). The limitation set forth in the preceding sentence shall be applied in a manner which shall permit compensation generated in connection with the exercise of Options or Stock Appreciation Rights to constitute "performance-based" compensation for purposes of Section 162(m) of the Code, including, but not limited to, counting against such maximum number of shares, to the extent required under Section 162(m) of the Code, any shares subject to Options or Stock Appreciation Rights that are canceled or repriced.

Section 5.2 *Stock Offered.* The stock to be offered pursuant to the grant of an Award may be authorized but unissued Common Stock, Common Stock purchased on the open market or Common Stock previously issued and outstanding and reacquired by the Company.

**ARTICLE VI
ELIGIBILITY FOR AWARDS; TERMINATION OF
EMPLOYMENT, DIRECTOR STATUS OR CONSULTANT STATUS**

Section 6.1 *Eligibility.* Awards made under the Plan may be granted solely to persons or entities who, at the time of grant, are Employees, Directors or Consultants. An Award may be granted on more than one occasion to the same Employee, Director or Consultant, and, subject to the limitations set forth in the Plan, such Award may include, a Non-Qualified Stock Option, a Restricted Stock Award, an Unrestricted Stock Award, a Restricted Stock Unit Award, a Distribution Equivalent Right Award, a Performance Stock Award, a Performance Unit Award, a Stock Appreciation Right, a Tandem Stock Appreciation Right, any combination thereof or, solely for Employees, an Incentive Stock Option.

Section 6.2 *Termination of Employment or Director Status.* Except to the extent inconsistent with the terms of the applicable Award Agreement (in which case the terms of the applicable Award Agreement shall control), the terms of the Holder's employment agreement with the Company or an Affiliate (in which case the terms of the applicable employment agreement shall control) and/or the provisions of Section 6.4, the following terms and conditions shall apply with respect to the termination of a Holder's employment with, or status as a Director of, the Company or an Affiliate, as applicable, for any reason, including, without limitation, Total and Permanent Disability or death:

(a) The Holder's rights, if any, to exercise any then exercisable Non-Qualified Stock Options and/or Stock Appreciation Rights shall terminate:

(1) If such termination is for a reason other than the Holder's Total and Permanent Disability or death, ninety (90) days after the date of such termination of employment or after the date of such termination of Director status;

Table of Contents

(2) If such termination is on account of the Holder's Total and Permanent Disability, one (1) year after the date of such termination of employment or Director status; or

(3) If such termination is on account of the Holder's death, one (1) year after the date of the Holder's death.

Upon such applicable date the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any rights or interests in or with respect to any such Non-Qualified Stock Options and Stock Appreciation Rights.

(b) The Holder's rights, if any, to exercise any then exercisable Incentive Stock Option shall terminate:

(1) If such termination is for a reason other than the Holder's Total and Permanent Disability or death, three (3) months after the date of such termination of employment;

(2) If such termination is on account of the Holder's Total and Permanent Disability, one (1) year after the date of such termination of employment; or

(3) If such termination is on account of the Holder's death, one (1) year after the date of the Holder's death.

Upon such applicable date the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any rights or interests in or with respect to any such Incentive Stock Options.

(c) If a Holder's employment with, or status as a Director of, the Company or an Affiliate, as applicable, terminates for any reason prior to the actual or deemed satisfaction and/or lapse of the Restrictions, vesting requirements, terms and conditions applicable to a Restricted Stock Award and/or Restricted Stock Unit Award, such Restricted Stock and/or Restricted Stock Units shall immediately be canceled, and the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any rights or interests in and with respect to any such Restricted Stock and/or Restricted Stock Units. The immediately preceding sentence to the contrary notwithstanding, the Committee, in its sole discretion, may determine, prior to or within thirty (30) days after the date of such termination of employment or Director status, that all or a portion of any such Holder's Restricted Stock and/or Restricted Stock Units shall not be so canceled and forfeited.

Section 6.3 *Termination of Consultant Status.* Except to the extent inconsistent with the terms of the applicable Award Agreement and/or the provisions of Section 6.4, the following terms and conditions shall apply with respect to the termination of a Holder's status as a Consultant, for any reason:

(a) The Holder's rights, if any, to exercise any then exercisable Non-Qualified Stock Options and/or Stock Appreciation Rights shall terminate:

(1) If such termination is for a reason other than the Holder's death, ninety (90) days after the date of such termination;
or

(2) If such termination is on account of the Holder's death, one (1) year after the date of the Holder's death.

(b) If the status of a Holder as a Consultant terminates for any reason prior to the actual or deemed satisfaction and/or lapse of the Restrictions, vesting requirements, terms and conditions applicable to a Restricted Stock Award and/or a Restricted Stock Unit Award, such Restricted Stock and/or Restricted Stock Units shall immediately be canceled, and the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any rights or

Table of Contents

interests in and with respect to any such Restricted Stock and/or Restricted Stock Units. The immediately preceding sentence to the contrary notwithstanding, the Committee, in its sole discretion, may determine, prior to or within thirty (30) days after the date of such termination of such a Holder's status as a Consultant, that all or a portion of any such Holder's Restricted Stock and/or Restricted Stock Units shall not be so canceled and forfeited.

Section 6.4 *Special Termination Rule.* Except to the extent inconsistent with the terms of the applicable Award Agreement, and notwithstanding anything to the contrary contained in this Article VI, if a Holder's employment with, or status as a Director of, the Company or an Affiliate shall terminate, and if, within ninety (90) days of such termination, such Holder shall become a Consultant, such Holder's rights with respect to any Award or portion thereof granted thereto prior to the date of such termination may be preserved, if and to the extent determined by the Committee in its sole discretion, as if such Holder had been a Consultant for the entire period during which such Award or portion thereof had been outstanding. Should the Committee effect such determination with respect to such Holder, for all purposes of the Plan, such Holder shall not be treated as if his or her employment or Director status had terminated until such time as his or her Consultant status shall terminate, in which case his or her Award, as it may have been reduced in connection with the Holder's becoming a Consultant, shall be treated pursuant to the provisions of Section 6.3; *provided, however*, that any such Award which is intended to be an Incentive Stock Option shall, upon the Holder's no longer being an Employee, automatically convert to a Non-Qualified Stock Option. Should a Holder's status as a Consultant terminate, and if, within ninety (90) days of such termination, such Holder shall become an Employee or a Director, such Holder's rights with respect to any Award or portion thereof granted thereto prior to the date of such termination may be preserved, if and to the extent determined by the Committee in its sole discretion, as if such Holder had been an Employee or a Director, as applicable, for the entire period during which such Award or portion thereof had been outstanding, and, should the Committee effect such determination with respect to such Holder, for all purposes of the Plan, such Holder shall not be treated as if his or her Consultant status had terminated until such time as his or her employment with the Company or an Affiliate, or his or her Director status, as applicable, shall terminate, in which case his or her Award shall be treated pursuant to the provisions of Section 6.2.

Section 6.5 *Termination for Cause.* Notwithstanding anything in this Article VI or elsewhere in the Plan to the contrary, and unless a Holder's Award Agreement specifically provides otherwise, should a Holder's employment, Director status or engagement as a Consultant with or for the Company or an Affiliate be terminated by the Company or Affiliate for Cause, all of such Holder's then outstanding Awards shall expire immediately and be forfeited in their entirety upon such termination.

**ARTICLE VII
OPTIONS**

Section 7.1 *Option Period.* The term of each Option shall be as specified in the Option Agreement; *provided, however*, that except as set forth in Section 7.3, no Option shall be exercisable after the expiration of ten (10) years from the date of its grant.

Section 7.2 *Limitations on Exercise of Option.* An Option shall be exercisable in whole or in such installments and at such times as specified in the Option Agreement.

Section 7.3 *Special Limitations on Incentive Stock Options.* To the extent that the aggregate Fair Market Value (determined at the time the respective Incentive Stock Option is granted) of Common Stock with respect to which Incentive Stock Options are exercisable for the first time by an individual during any calendar year under all plans of the Company and any parent corporation or subsidiary corporation thereof (both as defined in Section 424 of the Code) which provide for the grant of Incentive Stock Options exceeds One Hundred Thousand Dollars (\$100,000) (or such other individual

Table of Contents

limit as may be in effect under the Code on the date of grant), the portion of such Incentive Stock Options that exceeds such threshold shall be treated as Non-Qualified Stock Options. The Committee shall determine, in accordance with applicable provisions of the Code, Treasury Regulations and other administrative pronouncements, which of a Holder's Options, which were intended by the Committee to be Incentive Stock Options when granted to the Holder, will not constitute Incentive Stock Options because of such limitation, and shall notify the Holder of such determination as soon as practicable after such determination. No Incentive Stock Option shall be granted to an Employee if, at the time the Option is granted, such Employee is a Ten Percent Stockholder, unless (i) at the time such Incentive Stock Option is granted the Option price is at least one hundred ten percent (110%) of the Fair Market Value of the Common Stock subject to the Option, and (ii) such Incentive Stock Option by its terms is not exercisable after the expiration of five (5) years from the date of grant. No Incentive Stock Option shall be granted more than ten (10) years from the date on which the Plan is approved by the Company's stockholders. The designation by the Committee of an Option as an Incentive Stock Option shall not guarantee the Holder that the Option will satisfy the applicable requirements for "incentive stock option" status under Section 422 of the Code.

Section 7.4 Option Agreement. Each Option shall be evidenced by an Option Agreement in such form and containing such provisions not inconsistent with the provisions of the Plan as the Committee from time to time shall approve, including, but not limited to, provisions intended to qualify an Option as an Incentive Stock Option. An Option Agreement may provide for the payment of the Option price, in whole or in part, by the delivery of a number of shares of Common Stock (plus cash if necessary) that have been owned by the Holder for at least six (6) months and having a Fair Market Value equal to such Option price, or such other forms or methods as the Committee may determine from time to time (including, with the consent of the Committee, by withholding shares of Common Stock otherwise issuable in connection with the exercise of the Option), in each case, subject to such rules and regulations as may be adopted by the Committee. Each Option Agreement shall, solely to the extent inconsistent with the provisions of Sections 6.2, 6.3 and 6.4, as applicable, specify the effect of termination of employment, Director status or Consultant status on the exercisability of the Option. Moreover, without limiting the generality of the foregoing, an Option Agreement may provide for a "cashless exercise" of the Option by establishing procedures whereby the Holder, by a properly-executed written notice, directs (i) an immediate market sale or margin loan respecting all or a part of the shares of Common Stock to which he is entitled upon exercise pursuant to an extension of credit by the Company to the Holder of the Option price, (ii) the delivery of the shares of Common Stock from the Company directly to a brokerage firm and (iii) the delivery of the Option price from sale or margin loan proceeds from the brokerage firm directly to the Company. Each Option Agreement shall, solely to the extent inconsistent with the provisions of Sections 6.2, 6.3 and 6.4, as applicable, specify the effect of the termination of the Holder's employment, Director status or Consultant status on the exercisability of the Option. An Option Agreement may also include provisions relating to (i) subject to the provisions hereof, accelerated vesting of Options, including but not limited to upon the occurrence of a Change of Control, (ii) tax matters (including provisions covering any applicable Employee wage withholding requirements and requiring additional "gross-up" payments to Holders to meet any excise taxes or other additional income tax liability imposed as a result of a payment made upon a Change of Control resulting from the operation of the Plan or of such Option Agreement) and (iii) any other matters not inconsistent with the terms and provisions of the Plan that the Committee shall in its sole discretion determine. The terms and conditions of the respective Option Agreements need not be identical.

Table of Contents

Section 7.5 *Option Price and Payment.* The price at which a share of Common Stock may be purchased upon exercise of an Option shall be determined by the Committee; *provided, however,* that such Option price (i) shall not be less than the Fair Market Value of a share of Common Stock on the date such Option is granted, and (ii) shall be subject to adjustment as provided in Article XV. The Option or portion thereof may be exercised by delivery of an irrevocable notice of exercise to the Company. The Option price for the Option or portion thereof shall be paid in full in the manner prescribed by the Committee as set forth in the Plan and the applicable Option Agreement. Separate stock certificates shall be issued by the Company for those shares of Common Stock acquired pursuant to the exercise of an Incentive Stock Option and for those shares of Common Stock acquired pursuant to the exercise of a Non-Qualified Stock Option.

Section 7.6 *Stockholder Rights and Privileges.* The Holder of an Option shall be entitled to all the privileges and rights of a stockholder of the Company solely with respect to such shares of Common Stock as have been purchased under the Option and for which certificates of stock have been registered in the Holder's name.

Section 7.7 *Options and Rights in Substitution for Stock Options Granted by Other Corporations.* Options may be granted under the Plan from time to time in substitution for stock options held by individuals employed by entities who become Employees as a result of a merger or consolidation of the employing entity with the Company or any Affiliate, or the acquisition by the Company or an Affiliate of the assets of the employing entity, or the acquisition by the Company or an Affiliate of stock of the employing entity with the result that such employing entity becomes an Affiliate.

Section 7.8 *Prohibition Against Repricing.* Except to the extent (i) approved in advance by holders of a majority of the shares of the Company entitled to vote generally in the election of directors, or (ii) as a result of any Change of Control or any adjustment as provided in Article XV, the Committee shall not have the power or authority to reduce, whether through amendment or otherwise, the exercise price of any outstanding Option or Stock Appreciation right, or to grant any new Award or make any payment of cash in substitution for or upon the cancellation of Options and/or Stock Appreciation Rights previously granted.

ARTICLE VIII
RESTRICTED STOCK AWARDS

Section 8.1 *Restriction Period to be Established by Committee.* At the time a Restricted Stock Award is made, the Committee shall establish the Restriction Period applicable to such Award. Each Restricted Stock Award may have a different Restriction Period, in the discretion of the Committee. The Restriction Period applicable to a particular Restricted Stock Award shall not be changed except as permitted by Section 8.2.

Section 8.2 *Other Terms and Conditions.* Common Stock awarded pursuant to a Restricted Stock Award shall, unless otherwise determined by the Committee, be issued in book entry form on the books and records as kept by the Company's transfer agent and registered in the name of the Holder of such Restricted Stock Award. If provided for under the Restricted Stock Award Agreement, the Holder shall have the right to vote Common Stock subject thereto and to enjoy all other stockholder rights, including the entitlement to receive dividends on the Common Stock during the Restriction Period, except that (i) the Holder shall not be entitled to delivery of a stock certificate until the Restriction Period shall have expired, (ii) if a stock certificate is prepared before the expiration of the Restriction Period, the Company shall retain custody of the stock certificate during the Restriction Period (with a stock power endorsed by the Holder in blank), (iii) the Holder may not sell, transfer, pledge, exchange, hypothecate or otherwise dispose of the Common Stock during the Restriction Period and (iv) a breach of the terms and conditions established by the Committee pursuant to the Restricted

Table of Contents

Stock Award Agreement shall cause a forfeiture of the Restricted Stock Award. At the time of such Award, the Committee may, in its sole discretion, prescribe additional terms and conditions or restrictions relating to Restricted Stock Awards, including, but not limited to, rules pertaining to the effect of termination of employment, Director status or Consultant status prior to expiration of the Restriction Period. Such additional terms, conditions or restrictions shall, to the extent inconsistent with the provisions of Sections 6.2, 6.3 and 6.4, as applicable, be set forth in a Restricted Stock Award Agreement made in conjunction with the Award. Such Restricted Stock Award Agreement may also include provisions relating to (i) subject to the provisions hereof, accelerated vesting of Awards, including but not limited to accelerated vesting upon the occurrence of a Change of Control, (ii) tax matters (including provisions covering any applicable Employee wage withholding requirements and requiring additional "gross-up" payments to Holders to meet any excise taxes or other additional income tax liability imposed as a result of a payment made in connection with a Change of Control resulting from the operation of the Plan or of such Restricted Stock Award Agreement) and (iii) any other matters not inconsistent with the terms and provisions of the Plan that the Committee shall in its sole discretion determine. The terms and conditions of the respective Restricted Stock Agreements need not be identical. All shares of Common Stock delivered to a Holder as part of a Restricted Stock Award shall be delivered and reported by the Company or the Affiliate, as applicable, to the Holder by no later than the fifteenth (15th) day of the third (3rd) calendar month next following the end of the Company's fiscal year in which the Holder's entitlement to such shares becomes vested.

Section 8.3 *Payment for Restricted Stock.* The Committee shall determine the amount and form of any payment from a Holder for Common Stock received pursuant to a Restricted Stock Award, if any, provided that in the absence of such a determination, a Holder shall not be required to make any payment for Common Stock received pursuant to a Restricted Stock Award, except to the extent otherwise required by law.

Section 8.4 *Restricted Stock Award Agreements.* At the time any Award is made under this Article VIII, the Company and the Holder shall enter into a Restricted Stock Award Agreement setting forth each of the matters contemplated hereby and such other matters as the Committee may determine to be appropriate.

**ARTICLE IX
UNRESTRICTED STOCK AWARDS**

Pursuant to the terms of the applicable Unrestricted Stock Award Agreement, a Holder may be awarded (or sold) shares of Common Stock which are not subject to Restrictions, in consideration for past services rendered thereby to the Company or an Affiliate or for other valid consideration.

**ARTICLE X
RESTRICTED STOCK UNIT AWARDS**

Section 10.1 *Terms and Conditions.* The Committee shall set forth in the applicable Restricted Stock Unit Award Agreement the individual service-based vesting requirement which the Holder would be required to satisfy before the Holder would become entitled to payment pursuant to Section 10.2 and the number of Units awarded to the Holder. Such payment shall be subject to a "substantial risk of forfeiture" under Section 409A of the Code. At the time of such Award, the Committee may, in its sole discretion, prescribe additional terms and conditions or restrictions relating to Restricted Stock Unit Awards, including, but not limited to, rules pertaining to the effect of termination of employment, Director status or Consultant status prior to expiration of the applicable vesting period. The terms and conditions of the respective Restricted Stock Unit Award Agreements need not be identical.

Section 10.2 *Payments.* The Holder of a Restricted Stock Unit shall be entitled to receive a cash payment equal to the Fair Market Value of a share of Common Stock, or one (1) share of Common

Table of Contents

Stock, as determined in the sole discretion of the Committee and as set forth in the Restricted Stock Unit Award Agreement, for each Restricted Stock Unit subject to such Restricted Stock Unit Award, if the Holder satisfies the applicable vesting requirement. Such payment shall be made no later than by the fifteenth (15th) day of the third (3rd) calendar month next following the end of the calendar year in which the Restricted Stock Unit first becomes vested.

**ARTICLE XI
PERFORMANCE UNIT AWARDS**

Section 11.1 *Terms and Conditions.* The Committee shall set forth in the applicable Performance Unit Award Agreement the performance goals and objectives (and the period of time to which such goals and objectives shall apply) which the Holder and/or the Company would be required to satisfy before the Holder would become entitled to payment pursuant to Section 11.2, the number of Units awarded to the Holder and the dollar value assigned to each such Unit. Such payment shall be subject to a "substantial risk of forfeiture" under Section 409A of the Code. At the time of such Award, the Committee may, in its sole discretion, prescribe additional terms and conditions or restrictions, including, but not limited to, rules pertaining to the effect of termination of employment, Director status or Consultant status prior to expiration of the applicable performance period. The terms and conditions of the respective Performance Unit Award Agreements need not be identical.

Section 11.2 *Payments.* The Holder of a Performance Unit shall be entitled to receive a cash payment equal to the dollar value assigned to such Unit under the applicable Performance Unit Award Agreement if the Holder and/or the Company satisfy (or partially satisfy, if applicable under the applicable Performance Unit Award Agreement) the performance goals and objectives set forth in such Performance Unit Award Agreement. The Performance Unit Award Agreement may provide that, depending on the degree of performance achieved, different amounts of Performance Units, or no Performance Units, may be awarded. If achieved, such payment shall be made no later than by the fifteenth (15th) day of the third (3rd) calendar month next following the end of the Company's fiscal year to which such performance goals and objectives relate.

**ARTICLE XII
PERFORMANCE SHARE AWARDS**

Section 12.1 *Terms and Conditions.* The Committee shall set forth in the applicable Performance Share Award Agreement the performance goals and objectives (and the period of time to which such goals and objectives shall apply) which the Holder and/or the Company would be required to satisfy before the Holder would become entitled to the receipt of shares of Common Stock pursuant to such Holder's Performance Share Award and the number of shares of Common Stock subject to such Performance Share Award. Such payment shall be subject to a "substantial risk of forfeiture" under Section 409A of the Code and, if such goals and objectives are achieved, the distribution of such Common Shares shall be made no later than by the fifteenth (15th) day of the third (3rd) calendar month next following the end of the Company's fiscal year to which such goals and objectives relate. At the time of such Award, the Committee may, in its sole discretion, prescribe additional terms and conditions or restrictions relating to Performance Share Awards, including, but not limited to, rules pertaining to the effect of termination of the Holder's employment, Director status or Consultant status prior to the expiration of the applicable performance period. The terms and conditions of the respective Performance Share Award Agreements need not be identical.

Section 12.2 *Stockholder Rights and Privileges.* The Holder of a Performance Share Award shall have no rights as a stockholder of the Company until such time, if any, as the Holder actually receives shares of Common Stock pursuant to the Performance Share Award.

Table of Contents

**ARTICLE XIII
DISTRIBUTION EQUIVALENT RIGHTS**

Section 13.1 *Terms and Conditions.* The Committee shall set forth in the applicable Distribution Equivalent Rights Award Agreement the terms and conditions, if any, including whether the Holder is to receive credits currently in cash, is to have such credits reinvested (at Fair Market Value determined as of the date of reinvestment) in additional shares of Common Stock or is to be entitled to choose among such alternatives. Such receipt shall be subject to a "substantial risk of forfeiture" under Section 409A of the Code and, if such Award becomes vested, the distribution of such cash or shares of Common Stock shall be made no later than by the fifteenth (15th) day of the third (3rd) calendar month next following the end of the Company's fiscal year in which the Holder's interest in the Award vests. Distribution Equivalent Rights Awards may be settled in cash or in shares of Common Stock, as set forth in the applicable Distribution Equivalent Rights Award Agreement. A Distribution Equivalent Rights Award may, but need not be, awarded in tandem with another Award, whereby, if so awarded, such Distribution Equivalent Rights Award shall expire, terminate or be forfeited by the Holder, as applicable, under the same conditions as under such other Award.

Section 13.2 *Interest Equivalents.* The Distribution Equivalent Rights Award Agreement for a Distribution Equivalent Rights Award may provide for the crediting of interest on a Distribution Rights Award to be settled in cash at a future date (but in no event later than by the fifteenth (15th) day of the third (3rd) calendar month next following the end of the Company's fiscal year in which such interest was credited), at a rate set forth in the applicable Distribution Equivalent Rights Award Agreement, on the amount of cash payable thereunder.

**ARTICLE XIV
STOCK APPRECIATION RIGHTS**

Section 14.1 *Terms and Conditions.* The Committee shall set forth in the applicable Stock Appreciation Right Award Agreement the terms and conditions of the Stock Appreciation Right, including (i) the base value (the "*Base Value*") for the Stock Appreciation Right, which for purposes of a Stock Appreciation which is not a Tandem Stock Appreciation Right, shall be not less than the Fair Market Value of a share of the Common Stock on the date of grant of the Stock Appreciation Right, (ii) the number of shares of Common Stock subject to the Stock Appreciation Right, (iii) the period during which the Stock Appreciation Right may be exercised; *provided, however,* that no Stock Appreciation Right shall be exercisable after the expiration of ten (10) years from the date of its grant, and (iv) any other special rules and/or requirements which the Committee imposes upon the Stock Appreciation Right. Upon the exercise of some or all of a Stock Appreciation Right, the Holder shall receive a payment from the Company, in cash or in the form of shares of Common Stock having an equivalent Fair Market Value or in a combination of both, as determined in the sole discretion of the Committee, equal to the product of:

- (a) The excess of (i) the Fair Market Value of a share of the Common Stock on the date of exercise, over (ii) the Base Value, multiplied by;
- (b) The number of shares of Common Stock with respect to which the Stock Appreciation Right is exercised.

Section 14.2 *Tandem Stock Appreciation Rights.* If the Committee grants a Stock Appreciation Right which is intended to be a Tandem Stock Appreciation Right, the Tandem Stock Appreciation Right must be granted at the same time as the related Option, and the following special rules shall apply:

- (a) The Base Value shall be equal to or greater than the per share exercise price under the related Option;

Table of Contents

(b) The Tandem Stock Appreciation Right may be exercised for all or part of the shares of Common Stock which are subject to the related Option, but solely upon the surrender by the Holder of the Holder's right to exercise the equivalent portion of the related Option (and when a share of Common Stock is purchased under the related Option, an equivalent portion of the related Tandem Stock Appreciation Right shall be cancelled);

(c) The Tandem Stock Appreciation Right shall expire no later than the date of the expiration of the related Option;

(d) The value of the payment with respect to the Tandem Stock Appreciation Right may be no more than one hundred percent (100%) of the difference between the per share exercise price under the related Option and the Fair Market Value of the shares of Common Stock subject to the related Option at the time the Tandem Stock Appreciation Right is exercised, multiplied by the number of shares of Common Stock with respect to which the Tandem Stock Appreciation Right is exercised; and

(e) The Tandem Stock Appreciation Right may be exercised solely when the Fair Market Value of a share of Common Stock subject to the related Option exceeds the per share the exercise price under the related Option.

**ARTICLE XV
RECAPITALIZATION OR REORGANIZATION**

Section 15.1 *Adjustments to Common Stock.* The shares with respect to which Awards may be granted under the Plan are shares of Common Stock as presently constituted; *provided, however,* that if, and whenever, prior to the expiration or distribution to the Holder of shares of Common Stock underlying an Award theretofore granted, the Company shall effect a subdivision or consolidation of shares of Common Stock or the payment of a stock dividend on Common Stock without receipt of consideration by the Company, the number of shares of Common Stock with respect to which such Award may thereafter be exercised or satisfied, as applicable, (i) in the event of an increase in the number of outstanding shares, shall be proportionately increased, and the purchase price per share of the Common Stock shall be proportionately reduced, and (ii) in the event of a reduction in the number of outstanding shares, shall be proportionately reduced, and the purchase price per share of the Common Stock shall be proportionately increased. Notwithstanding the foregoing or any other provision of this Article XV, any adjustment made with respect to an Award (x) which is an Incentive Stock Option, shall comply with the requirements of Section 424(a) of the Code, and in no event shall any adjustment be made which would render any Incentive Stock Option granted under the Plan to be other than an "incentive stock option" for purposes of Section 422 of the Code, and (y) which is a Non-Qualified Stock Option, shall comply with the requirements of Section 409A of the Code, and in no event shall any adjustment be made which would render any Non-Qualified Stock Option granted under the Plan to become subject to Section 409A of the Code.

Section 15.2 *Recapitalization.* If the Company recapitalizes or otherwise changes its capital structure, thereafter upon any exercise or satisfaction, as applicable, of a previously granted Award, the Holder shall be entitled to receive (or entitled to purchase, if applicable) under such Award, in lieu of the number of shares of Common Stock then covered by such Award, the number and class of shares of stock and securities to which the Holder would have been entitled pursuant to the terms of the recapitalization if, immediately prior to such recapitalization, the Holder had been the holder of record of the number of shares of Common Stock then covered by such Award.

Section 15.3 *Other Events.* In the event of changes to the outstanding Common Stock by reason of extraordinary cash dividend, reorganization, mergers, consolidations, combinations, split-ups, spin-offs, exchanges or other relevant changes in capitalization occurring after the date of the grant of any Award and not otherwise provided for under this Article XV, any outstanding Awards and any

Table of Contents

Award Agreements evidencing such Awards shall be adjusted by the Board in its discretion in such manner as the Board deems equitable or appropriate taking into consideration the accounting and tax consequences, as to the number and price of shares of Common Stock or other consideration subject to such Awards. In the event of any adjustment pursuant to Sections 15.1, 15.2 or this Section 15.3, the aggregate number of shares available under the Plan under Section 5.1 (and the Code Section 162(m) limit set forth therein) shall be appropriately adjusted by the Board, the determination of which shall be conclusive. In addition, the Committee may make provision for a cash payment to a Participant or a person who has an outstanding Award. The number of shares of Common Stock subject to any Award shall be rounded to the nearest whole number.

Section 15.4 *Powers Not Affected.* The existence of the Plan and the Awards granted hereunder shall not affect in any way the right or power of the Board or of the stockholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other change of the Company's capital structure or business, any merger or consolidation of the Company, any issue of debt or equity securities ahead of or affecting Common Stock or the rights thereof, the dissolution or liquidation of the Company or any sale, lease, exchange or other disposition of all or any part of its assets or business or any other corporate act or proceeding.

Section 15.5 *No Adjustment for Certain Awards.* Except as hereinabove expressly provided, the issuance by the Company of shares of stock of any class or securities convertible into shares of stock of any class, for cash, property, labor or services, upon direct sale, upon the exercise of rights or warrants to subscribe therefor or upon conversion of shares or obligations of the Company convertible into such shares or other securities, and in any case whether or not for fair value, shall not affect previously granted Awards, and no adjustment by reason thereof shall be made with respect to the number of shares of Common Stock subject to Awards theretofore granted or the purchase price per share, if applicable.

**ARTICLE XVI
AMENDMENT AND TERMINATION OF PLAN**

The Plan shall continue in effect, unless sooner terminated pursuant to this Article XVI, until the tenth (10th) anniversary of the date on which it is adopted by the Board (except as to Awards outstanding on that date). The Board in its discretion may terminate the Plan at any time with respect to any shares for which Awards have not theretofore been granted; *provided, however*, that the Plan's termination shall not materially and adversely impair the rights of a Holder with respect to any Award theretofore granted without the consent of the Holder. The Board shall have the right to alter or amend the Plan or any part hereof from time to time; *provided, however*, that without the approval by a majority of the votes cast at a meeting of shareholders at which a quorum representing a majority of the shares of the Company entitled to vote generally in the election of directors is present in person or by proxy, no amendment or modification of the Plan may (i) materially increase the benefits accruing to Holders, (ii) except as otherwise expressly provided in Article XV, materially increase the number of shares of Common Stock subject to the Plan or the individual Award Agreements specified in Article V, (iii) materially modify the requirements for participation in the Plan, or (iv) amend, modify or suspend Section 7.8 (repricing prohibitions) or this Article XVI. In addition, no change in any Award theretofore granted may be made which would materially and adversely impair the rights of a Holder with respect to such Award without the consent of the Holder (unless such change is required in order to cause the benefits under the Plan to qualify as "performance-based" compensation within the meaning of Section 162(m) of the Code) or to exempt the Plan or any Award from Section 409A of the Code.

Table of Contents

**ARTICLE XVII
MISCELLANEOUS**

Section 17.1 *No Right to Award.* Neither the adoption of the Plan by the Company nor any action of the Board or the Committee shall be deemed to give an Employee, Director or Consultant any right to an Award except as may be evidenced by an Award Agreement duly executed on behalf of the Company, and then solely to the extent and on the terms and conditions expressly set forth therein.

Section 17.2 *No Rights Conferred.* Nothing contained in the Plan shall (i) confer upon any Employee any right with respect to continuation of employment with the Company or any Affiliate, (ii) interfere in any way with any right of the Company or any Affiliate to terminate the employment of an Employee at any time, (iii) confer upon any Director any right with respect to continuation of such Director's membership on the Board, (iv) interfere in any way with any right of the Company or an Affiliate to terminate a Director's membership on the Board at any time, (v) confer upon any Consultant any right with respect to continuation of his or her consulting engagement with the Company or any Affiliate, or (vi) interfere in any way with any right of the Company or an Affiliate to terminate a Consultant's consulting engagement with the Company or an Affiliate at any time.

Section 17.3 *Other Laws; No Fractional Shares; Withholding.* The Company shall not be obligated by virtue of any provision of the Plan to recognize the exercise of any Award or to otherwise sell or issue shares of Common Stock in violation of any laws, rules or regulations, and any postponement of the exercise or settlement of any Award under this provision shall not extend the term of such Award. Neither the Company nor its directors or officers shall have any obligation or liability to a Holder with respect to any Award (or shares of Common Stock issuable thereunder) (i) that shall lapse because of such postponement, or (ii) for any failure to comply with the requirements of any applicable law, rules or regulations, including but not limited to any failure to comply with the requirements of Section 409A of this Code. No fractional shares of Common Stock shall be delivered, nor shall any cash in lieu of fractional shares be paid. The Company shall have the right to deduct in cash (whether under this Plan or otherwise) in connection with all Awards any taxes required by law to be withheld and to require any payments required to enable it to satisfy its withholding obligations. In the case of any Award satisfied in the form of shares of Common Stock, no shares shall be issued unless and until arrangements satisfactory to the Company shall have been made to satisfy any tax withholding obligations applicable with respect to such Award. Subject to such terms and conditions as the Committee may impose, the Company shall have the right to retain, or the Committee may, subject to such terms and conditions as it may establish from time to time, permit Holders to elect to tender, Common Stock (including Common Stock issuable in respect of an Award) to satisfy, in whole or in part, the amount required to be withheld.

Section 17.4 *No Restriction on Corporate Action.* Nothing contained in the Plan shall be construed to prevent the Company or any Affiliate from taking any corporate action which is deemed by the Company or such Affiliate to be appropriate or in its best interest, whether or not such action would have an adverse effect on the Plan or any Award made under the Plan. No Employee, Director, Consultant, beneficiary or other person shall have any claim against the Company or any Affiliate as a result of any such action.

Section 17.5 *Restrictions on Transfer.* No Award under the Plan or any Award Agreement and no rights or interests herein or therein, shall or may be assigned, transferred, sold, exchanged, encumbered, pledged or otherwise hypothecated or disposed of by a Holder except (i) by will or by the laws of descent and distribution, or (ii) except for an Incentive Stock Option, by gift to any Family Member of the Holder. An Award may be exercisable during the lifetime of the Holder only by such Holder or by the Holder's guardian or legal representative unless it has been transferred by gift to a Family Member of the Holder, in which case it shall be exercisable solely by such transferee. Notwithstanding any such transfer, the Holder shall continue to be subject to the withholding

Table of Contents

requirements provided for under Section 17.3 hereof. Notwithstanding the foregoing, except for Awards which are Incentive Stock Options, Awards may be transferred pursuant to the terms of any valid separation agreement or divorce decree.

Section 17.6 *Beneficiary Designations*. Each Holder may, from time to time, name a beneficiary or beneficiaries (who may be contingent or successive beneficiaries) for purposes of receiving any amount which is payable in connection with an Award under the Plan upon or subsequent to the Holder's death. Each such beneficiary designation shall serve to revoke all prior beneficiary designations, be in a form prescribed by the Company and be effective solely when filed by the Holder in writing with the Company during the Holder's lifetime. In the absence of any such written beneficiary designation, for purposes of the Plan, a Holder's beneficiary shall be the Holder's estate.

Section 17.7 *Rule 16b-3*. It is intended that the Plan and any Award made to a person subject to Section 16 of the Exchange Act shall meet all of the requirements of Rule 16b-3. If any provision of the Plan or of any such Award would disqualify the Plan or such Award under, or would otherwise not comply with the requirements of, Rule 16b-73, such provision or Award shall be construed or deemed to have been amended as necessary to conform to the requirements of Rule 16b-3.

Section 17.8 *Section 162(m)*. It is intended that the Plan shall comply fully with and meet all the requirements of Section 162(m) of the Code so that Awards hereunder which are made to Holders who are "covered employees" (as defined in Section 162(m) of the Code) shall constitute "performance-based" compensation within the meaning of Section 162(m) of the Code. Any Performance Goal(s) applicable to Qualified Performance-Based Awards shall be objective, shall be established not later than ninety (90) days after the beginning of any applicable Performance Period (or at such other date as may be required or permitted for "performance-based" compensation under Section 162(m) of the Code) and shall otherwise meet the requirements of Section 162(m) of the Code, including the requirement that the outcome of the Performance Goal or Goals be substantially uncertain (as defined in the regulations under Section 162(m) of the Code) at the time established. The Performance Criteria to be utilized under the Plan to establish Performance Goals shall consist of objective tests based on one or more of the following: net sales; revenue; revenue growth or product revenue growth; operating income (before or after taxes); pre- or after-tax income (before or after allocation of corporate overhead and bonus); earnings per share; net income (before or after taxes); return on equity; total shareholder return; return on assets or net assets; appreciation in and/or maintenance of the price of the shares of Common Stock or any other publicly-traded securities of the Company; market share; gross profits; earnings (including earnings before taxes, earnings before interest and taxes or earnings before interest, taxes, depreciation and amortization); economic value-added models or equivalent metrics; comparisons with various stock market indices; reductions in costs; cash flow or cash flow per share (before or after dividends); return on capital (including return on total capital or return on invested capital); cash flow return on investment; expense levels; working capital levels, including cash, inventory and accounts receivable; operating margins, gross margins or cash margin; year-end cash; debt reduction; stockholder equity; operating efficiencies; strategic partnerships or transactions; co-development, co-marketing, profit sharing, joint venture or other similar arrangements); financial ratios, including those measuring liquidity, activity, profitability or leverage; cost of capital; assets under management; financing and other capital raising transactions (including sales of the Company's equity or debt securities; sales or licenses of the Company's assets, including its intellectual property, whether in a particular jurisdiction or territory or globally; or through partnering transactions). Performance Goals may be established on a Company-wide basis or with respect to one or more Company business units, divisions, subsidiaries or individuals; and measured either quarterly, annually or over a period of years, in absolute terms, relative to a pre-established target, to the performance of one or more similarly situated companies, or to the performance of an index covering a peer group of companies, in each case as specified by the Committee. When establishing Performance Goals for the applicable Performance Period, the Committee may exclude any or all "extraordinary items" as determined under

Table of Contents

U.S. generally accepted accounting principles including, without limitation, the charges or costs associated with restructurings of the Company, discontinued operations, other unusual or non-recurring items, and the cumulative effects of accounting changes, and as identified in the Company's financial statements, notes to the Company's financial statements or management's discussion and analysis of financial condition and results of operations contained in the Company's most recent annual report filed with the U.S. Securities and Exchange Commission pursuant to the Exchange Act. Holders who are "covered employees" (as defined in Section 162(m) of the Code) shall be eligible to receive payment under a Qualified Performance-Based Award which is subject to achievement of a Performance Goal or Goals only if the applicable Performance Goal or Goals are achieved within the applicable Performance Period, as determined by the Committee. If any provision of the Plan would disqualify the Plan or would not otherwise permit the Plan to comply with Section 162(m) of the Code as so intended, such provision shall be construed or deemed amended to conform to the requirements or provisions of Section 162(m) of the Code. The Committee may postpone the exercising of Awards, the issuance or delivery of Common Stock under any Award or any action permitted under the Plan to prevent the Company or any subsidiary from being denied a federal income tax deduction with respect to any Award other than an Incentive Stock Option, provided that such deferral satisfies the requirements of Section 409A of the Code. For purposes of the requirements of Treasury Regulation Section 1.162-27(e)(4)(i), the maximum amount of compensation that may be paid to any Employee under the Plan for a calendar year shall be Ten Million Dollars (\$10,000,000).

Section 17.9 *Section 409A.* Notwithstanding any other provision of the Plan, the Committee shall have no authority to issue an Award under the Plan with terms and/or conditions which would cause such Award to constitute non-qualified "deferred compensation" under Section 409A of the Code. Accordingly, by way of example but not limitation, no Option shall be granted under the Plan with a per share Option exercise price which is less than the Fair Market Value of a share of Common Stock on the date of grant of the Option. Notwithstanding anything herein to the contrary and except as provided in the following sentence, no Award Agreement shall provide for any deferral feature with respect to an Award which constitutes a deferral of compensation under Section 409A of the Code. The Plan and all Award Agreements are intended to comply with the requirements of Section 409A of the Code (so as to be exempt therefrom) and shall be so interpreted and construed. In the event that the Board determines that Awards should in the future be subject to deferral, it shall have the authority to make appropriate amendments to this Section 17.8 and other sections of this Plan to authorize deferrals of compensation under Section 409A of the Code.

Section 17.10 *Indemnification.* Each person who is or shall have been a member of the Committee or of the Board shall be indemnified and held harmless by the Company against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred thereby in connection with or resulting from any claim, action, suit, or proceeding to which such person may be made a party or may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid thereby in settlement thereof, with the Company's approval, or paid thereby in satisfaction of any judgment in any such action, suit, or proceeding against such person; *provided, however,* that such person shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive and shall be independent of any other rights of indemnification to which such persons may be entitled under the Company's Articles of Incorporation or By-laws, by contract, as a matter of law, or otherwise.

Section 17.11 *Other Plans.* No Award, payment or amount received hereunder shall be taken into account in computing an Employee's salary or compensation for the purposes of determining any benefits under any pension, retirement, life insurance or other benefit plan of the Company or any Affiliate, unless such other plan specifically provides for the inclusion of such Award, payment or amount received. Nothing in the Plan shall be construed to limit the right of the Company to establish

Table of Contents

other plans or to pay compensation to its employees, in cash or property, in a manner which is not expressly authorized under the Plan.

Section 17.12 *Limits of Liability.* Any liability of the Company with respect to an Award shall be based solely upon the contractual obligations created under the Plan and the Award Agreement. None of the Company, any member of the Board nor any member of the Committee shall have any liability to any party for any action taken or not taken, in good faith, in connection with or under the Plan.

Section 17.13 *Governing Law.* Except as otherwise provided herein, the Plan shall be construed in accordance with the laws of the State of Delaware, without regard to principles of conflicts of law.

Section 17.14 *Severability of Provisions.* If any provision of the Plan is held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provision of the Plan, and the Plan shall be construed and enforced as if such invalid or unenforceable provision had not been included in the Plan.

Section 17.15 *No Funding.* The Plan shall be unfunded. The Company shall not be required to establish any special or separate fund or to make any other segregation of funds or assets to ensure the payment of any Award.

Section 17.16 *Headings.* Headings used throughout the Plan are for convenience only and shall not be given legal significance.

Section 17.17 *Terms of Award Agreements.* Each Award shall be evidenced by an Award Agreement, which Award Agreement, if it provides for the issuance of Common Stock, shall require the Holder to enter into and be bound by the terms of the Company's Stockholders' Agreement, if any. The terms of the Award Agreements utilized under the Plan need not be the same.

Section 17.18 *California Information Requirements.* To the extent applicable, the Company shall comply with the information requirements applicable to the Plan pursuant to Section 260.140.46 of the California Code of Regulations.

September 5, 2009

CONFIDENTIAL

Mr. James J. Cahill
Chief Financial Officer
Prospect Acquisition Corp.
9130 Galleria Court
Naples, FL 34109

Re: Fairness Opinion Opinion to the Board of Directors of Prospect Acquisition Corp.

Dear Mr. Cahill:

Houlihan Smith & Company, Inc. ("Houlihan") has been advised that Prospect Acquisition Corp. ("PAC" or the "Acquirer") executed a letter of intent dated July 13, 2009 to acquire all of the capital stock of Kennedy Wilson, Inc. ("Kennedy Wilson" or the "Target") through a merger with the Acquirer or its affiliate (the "Merger"). We understand that on the effective date of the Merger, each outstanding share of the common stock of the Target ("Target Common Stock") and all of its \$52.4 million of convertible preferred stock ("Target Preferred Stock") will be converted into a number of shares of the common stock, par value \$.0001 per share, of PAC ("PAC Common Stock") such that, in the aggregate, holders of Target Common Stock and Target Preferred Stock prior to the Merger would own 26.0 million shares of PAC Common Stock, representing approximately 52% of the 50.4 million issued and outstanding shares of PAC Common Stock at the effective time of the Merger (assuming 20% of all publicly-traded shares of PAC Common Stock are voted against the Merger and all holders of such shares elect to convert their shares into cash). We further understand that this would result in approximately \$182 million of PAC's cash, after all expenses, being contributed to the merged entity as of closing (collectively, "Merger Consideration").

PAC has formed a wholly owned subsidiary, Merger Sub, solely for the purposes of the merger of Merger Sub with and into Kennedy Wilson pursuant to Section 251 of the General Corporation Law of the State of Delaware (the "DGCL"), in which Kennedy Wilson will be the surviving corporation.

Houlihan was engaged to render an opinion ("Opinion") to the Board of Directors (the "Board") of the Acquirer as to whether, as of the date of such Opinion, (i) the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger is fair from a financial point of view to the shareholders of the Acquirer, and (ii) the fair market value of the Target is at least equal to 80% of the balance in the Acquirer's trust account (excluding the amount held in the trust account representing a portion of the underwriters' discount).

An Employee-owned Company

105 W. Madison Suite 1500 Chicago, IL 60602

Tel: 312.499.5900 Toll Free: 800.654.4977 Fax: 312.499.5901

www.houlihansmith.com www.fairnessopinion.com www.solvencyopinion.com

Table of Contents

Our Opinion is being rendered in such form and substance customary to transactions of a similar nature and on a basis that is consistent with our professional responsibilities to the Acquirer, and shall be subject to the undertaking of certain inquiries concerning the Merger and the business of the Acquirer. In connection therewith, Houlihan has relied upon public and non-public reports of the Acquirer and other information supplied to it by or on behalf of the Acquirer. Houlihan shall not in any respect be responsible for the accuracy or completeness of any such report or information, public or non-public, supplied to it by or on behalf of the Acquirer or for any obligation to verify the same nor for any conclusions based upon inaccurate or incomplete information.

We have not been requested to opine as to, and this Opinion does not express an opinion as to, make any recommendations with respect to, or otherwise address, among other things, (i) the underlying business decision of the Acquirer, shareholders of the Acquirer, or any other party to proceed with or effect the Merger, (ii) the terms of any arrangements, understandings, agreements or documents related to, or the form or any other portion or aspect of, the Merger or otherwise (other than to the extent expressly specified herein), (iii) the relative merits of the Merger as compared to any alternative business strategies that might exist for the Acquirer or the effect of any other transaction in which the Acquirer or any other party might engage, (iv) the solvency or creditworthiness of the Acquirer or any other participant in the Merger under any applicable laws relating to bankruptcy, insolvency, fraudulent conveyance or similar matters, (v) the fairness of the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger to any investors of the Acquirer, other than the shareholders of the Acquirer, or (vi) the prospects of the impact of Acquirer entering into or consummating the Merger under any other contract, agreement or arrangement to which the Acquirer may be a party.

In performing our analyses and for purposes of the Opinion set forth herein, Houlihan has, among other things:

Reviewed the draft Agreement and Plan of Merger by and among PAC, KW Merger Sub Corporation and Kennedy Wilson (the "Merger Agreement"), dated September 2, 2009;

Reviewed and analyzed the Target's audited historical financial statements for the fiscal years ending December 31, 2006 through December 31, 2008;

Reviewed and analyzed the Target's unaudited interim financial statements for the period ending June 30, 2009;

Reviewed the Target's historical trading prices and volume (ticker: KWIC.PK). Houlihan noted that while the Target's shares are publicly traded, the shares are unlisted, unregistered, thinly traded, and have a relatively wide bid-ask spread. Given this illiquidity, Houlihan determined the share price is not necessarily indicative of the Target's fair market value;

Reviewed and analyzed financial projections of the Target prepared by Target's management ("Management") for the years ending December 31, 2009 through December 31, 2014, dated August 10, 2009;

Reviewed projected net operating income (NOI) for income generating office buildings held within Target's direct real estate portfolio;

Held discussions with Management to discuss assumptions used in the projections and Houlihan's analyses;

Reviewed a summary of the capital structure of the Target, assuming conversion of the Target's 7% Convertible Subordinated Notes;

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Reviewed the following documents regarding the Target's 7% Convertible Subordinated Note due November 3, 2018 including:

Securities Purchase Agreement between the Target and The Guardian Life Insurance Company of America ("Guardian"), dated October 31, 2008;

Shareholders Agreement between the Target, Guardian, and the shareholders, dated November 3, 2008;

Authorization of New Class of Common Stock between the Target and Guardian, dated November 3, 2008;

Guardian note payable by Target to Guardian, dated November 3, 2008;

Reviewed the Amended Certificate of Designation Preferences and Rights of Series A Preferred Stock of the Target, dated June 2, 2008;

Reviewed and analyzed the following for the investment properties, including but not limited to:

Assignment and Assumption of Membership Interest;

Amended and Restated LLC Agreement;

Financial Performance (on a Fair Market Value Basis);

Financial statements for holding entities of individual properties;

Stacking Plan and capital expenditure;

Operating and Property Management Agreements with Kennedy Wilson;

Reviewed schedules of the Target's real estate debt, as of May 31, 2009;

Reviewed a schedule of loan guarantees of the real estate held in the Target's direct real estate portfolio;

Reviewed the Kennedy Wilson auction pipeline report as of the second quarter in 2009;

Reviewed the following corporate documents:

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Kennedy Wilson Multifamily Overview presentation, dated July 2009;

Kennedy Wilson Company Overview presentations, dated July 2009 and August 2009;

Kennedy Wilson Road Show presentation, dated August 2009;

Pro forma segment analysis, dated August 17, 2009;

Property Management presentation, dated July 14, 2009;

Held discussions with Management regarding, among other items, the real estate services and fund management industries specifically, and other industries generally;

Reviewed financial and operating information with respect to certain publicly-traded companies in the real estate management and real estate services industries, which we believe to be generally comparable to the business of the Target;

Reviewed the Target's current organizational chart; and

Performed other financial studies, analyses and investigations, and considered such other information, as we deemed necessary or appropriate.

We have relied upon and assumed, without independent verification, the accuracy, completeness and reasonableness of the financial, legal, tax, and other information discussed with or reviewed by us

Table of Contents

and have assumed such accuracy and completeness for purposes of rendering an opinion. We have further relied upon the assurances and representations from Acquirer that they are unaware of any facts that would make the information provided to us to be incomplete or misleading for the purposes of our Opinion. Furthermore, no opinion, counsel or interpretation is intended in matters that require legal, regulatory, accounting, insurance, tax or other similar professional advice. It is assumed that such opinions, counsel or interpretations have been or will be obtained from the appropriate professional sources. Furthermore, we have relied, with your consent, upon Acquirer and their respective advisers, as to all legal, regulatory, accounting, insurance and tax matters with respect to the Acquirer and the Merger.

The Opinion shall be used (i) by the Board in evaluating the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger and the fair market value of the Target is at least equal to 80% of the balance in the Acquirer's trust account (excluding the amount held in the trust account representing a portion of the underwriters' discount) and (ii) in reports made by Acquirer to its shareholders and regulatory agencies. This Opinion has been furnished for the use and benefit of the Board in connection with their evaluation of the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger and may not be used for any other purpose without our prior written consent.

Our Opinion is necessarily based upon our evaluation of information made available to us, as well as, the economic, monetary, market, financial, regulatory and other conditions as they exist and can be evaluated on the date hereof and we have not undertaken, and we assume no responsibility, to update, revise, reaffirm or withdraw this Opinion, or otherwise comment on or consider events or circumstances occurring after the date hereof. We disclaim any obligation to advise the Board or any person of any change in any fact or matter affecting our Opinion, which may come or be brought to our attention after the date of this Opinion. We did not provide, and will not provide, any advice with respect to any legal conclusions as to whether the Merger may be prohibited by law.

In rendering our Opinion, we have assumed, with your consent, that the Merger will be consummated on the terms described in the Merger Agreement, without any waiver or modification of any material terms or conditions, and that in the course of obtaining the necessary regulatory or third party approvals for the Merger, no delay, limitation, restriction or condition will be imposed that would have an adverse effect on the Acquirer or the Merger.

Each of the analyses conducted by Houlihan was carried out to provide a particular perspective of the Merger. Houlihan did not form a conclusion as to whether any individual analysis, when considered in isolation, supported or failed to support our Opinion as to the fairness of (i) the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger to the shareholders of the Acquirer, and (ii) the fair market value of the Target is at least equal to 80% of the balance in the Acquirer's trust account (excluding the amount held in the trust account representing a portion of the underwriters' discount). Houlihan does not place any specific reliance or weight on any individual analysis, but instead, concludes that its analyses taken as a whole, supports its conclusion and Opinion. Accordingly, Houlihan believes that its analyses must be considered in their entirety and that selecting portions of its analyses or the factors it considered, without considering all analyses and factors collectively, could create an incomplete view of the processes underlying the analyses performed by Houlihan in connection with the preparation of the Opinion.

This Opinion is not intended to be, and does not constitute, a recommendation to the Board to proceed with the Merger. This Opinion relates solely to the question of the fairness of (i) the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger to the shareholders of the Acquirer, and (ii) the fair market value of the Target is at least equal to 80% of the balance in the Acquirer's trust account (excluding the amount held in the trust account representing a

Table of Contents

portion of the underwriters' discount). This Opinion should not be construed as creating any fiduciary duty on our part to any person.

Except as set forth in our engagement letter with the Acquirer dated August 20, 2009, this Opinion may not be disclosed, reproduced, disseminated, quoted, summarized or referred to at any time, in any manner or for any purpose, nor shall any references to Houlihan or any of its affiliates be made, without the prior written consent of Houlihan, in each case except as set forth in the fifth preceding paragraph of this letter.

Houlihan, a Financial Industry Regulatory Authority (FINRA) member, as part of its investment banking services, is regularly engaged in the valuation of businesses and securities in connection with mergers and acquisitions, underwritings, private placements, bankruptcy, capital restructuring, solvency analyses, stock buybacks, and valuations for corporate and other purposes. Houlihan has no prior investment banking relationships with either party involved in the transaction. Houlihan has received a non-contingent fee from PAC relating to its services in providing the Opinion. In an engagement letter dated August 20, 2009, PAC has agreed to indemnify Houlihan with respect to Houlihan's services relating to the Opinion.

Based on and subject to the foregoing, we are of the opinion that, as of the date hereof, (i) the Merger Consideration to be paid by the Acquirer for the Target in conjunction with the Merger is fair from a financial point of view to the shareholders of the Acquirer, and (ii) the fair market value of the Target is at least equal to 80% of the balance in the Acquirer's trust account (excluding the amount held in the trust account representing a portion of the underwriters' discount).

Very truly yours,

/s/ Houlihan Smith & Company

Houlihan Smith & Company, Inc.

Table of Contents

October 22, 2009

CONFIDENTIAL

Mr. James J. Cahill
Chief Financial Officer
Prospect Acquisition Corp.
9130 Galleria Court
Naples, FL 34109

Re: Bring-Down Letter: Opinion of the Board of Directors' Financial Advisor

Dear Mr. Cahill:

On October 22, 2009, Houlihan (all terms used herein without definition shall have the meanings ascribed to them as set forth in the fairness opinion letter dated September 5, 2009) received correspondence from PAC detailing changes in the terms of the Merger Consideration. The changes noted were as follows:

Revised terms of the Merger Consideration resulted in certain changes primarily related to a reduction in the number of shares retained by PAC's founders and executive management group, resulting in a higher implied value of the Merger Consideration to Target.

Houlihan noted that these changes do not affect financial projections provided by Target's management. As such, the analyses and assumptions upon which Houlihan based its Opinion have not changed. Houlihan reaffirms, as of the date hereof (and as though made on the date hereof), all statements made in our fairness opinion letter addressed to the Board and dated as of September 5, 2009.

This letter is solely for the information of the Board and it is not to be used, circulated, quoted or otherwise referred to for any other purpose, without our prior consent, except as permitted by the engagement letter, dated August 20, 2009 between Houlihan and PAC.

Very truly yours,

/s/ Houlihan Smith & Company

Houlihan Smith & Company, Inc.

An Employee-owned Company

105 W. Madison Suite 1500 Chicago, IL 60602

Tel: 312.499.5900 Toll Free: 800.654.4977 Fax: 312.499.5901

www.houlihansmith.com www.fairnessopinion.com www.solvencyopinion.com

Section 262 of the Delaware General Corporation Law

§ 262. Appraisal rights.

(a) Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation, who has otherwise complied with subsection (d) of this section and who has neither voted in favor of the merger or consolidation nor consented thereto in writing pursuant to § 228 of this title shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock under the circumstances described in subsections (b) and (c) of this section. As used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a nonstock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a nonstock corporation; and the words "depository receipt" mean a receipt or other instrument issued by a depository representing an interest in one or more shares, or fractions thereof, solely of stock of a corporation, which stock is deposited with the depository.

(b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to § 251 (other than a merger effected pursuant to § 251(g) of this title), § 252, § 254, § 257, § 258, § 263 or § 264 of this title:

(1) Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock, which stock, or depository receipts in respect thereof, at the record date fixed to determine the stockholders entitled to receive notice of the meeting of stockholders to act upon the agreement of merger or consolidation, were either (i) listed on a national securities exchange or (ii) held of record by more than 2,000 holders; and further provided that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in § 251(f) of this title.

(2) Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to §§ 251, 252, 254, 257, 258, 263 and 264 of this title to accept for such stock anything except:

- a. Shares of stock of the corporation surviving or resulting from such merger or consolidation, or depository receipts in respect thereof;
- b. Shares of stock of any other corporation, or depository receipts in respect thereof, which shares of stock (or depository receipts in respect thereof) or depository receipts at the effective date of the merger or consolidation will be either listed on a national securities exchange or held of record by more than 2,000 holders;
- c. Cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a. and b. of this paragraph; or
- d. Any combination of the shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a., b. and c. of this paragraph.

(3) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation.

Table of Contents

(c) Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation contains such a provision, the procedures of this section, including those set forth in subsections (d) and (e) of this section, shall apply as nearly as is practicable.

(d) Appraisal rights shall be perfected as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders who was such on the record date for notice of such meeting with respect to shares for which appraisal rights are available pursuant to subsection (b) or (c) hereof that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. Each stockholder electing to demand the appraisal of such stockholder's shares shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of such stockholder's shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such stockholder's shares. A proxy or vote against the merger or consolidation shall not constitute such a demand. A stockholder electing to take such action must do so by a separate written demand as herein provided. Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective; or

(2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this title, then either a constituent corporation before the effective date of the merger or consolidation or the surviving or resulting corporation within 10 days thereafter shall notify each of the holders of any class or series of stock of such constituent corporation who are entitled to appraisal rights of the approval of the merger or consolidation and that appraisal rights are available for any or all shares of such class or series of stock of such constituent corporation, and shall include in such notice a copy of this section. Such notice may, and, if given on or after the effective date of the merger or consolidation, shall, also notify such stockholders of the effective date of the merger or consolidation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of such notice, demand in writing from the surviving or resulting corporation the appraisal of such holder's shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such holder's shares. If such notice did not notify stockholders of the effective date of the merger or consolidation, either (i) each such constituent corporation shall send a second notice before the effective date of the merger or consolidation notifying each of the holders of any class or series of stock of such constituent corporation that are entitled to appraisal rights of the effective date of the merger or consolidation or (ii) the surviving or resulting corporation shall send such a second notice to all such holders on or within 10 days after such effective date; provided, however, that if such second notice is sent more than 20 days following the sending of the first notice, such second notice need only be sent to each stockholder who is entitled to appraisal rights and who has demanded appraisal of such holder's shares in accordance with this subsection. An affidavit of the secretary or assistant secretary or of the transfer agent of the corporation that is required to give either notice that such notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated therein. For purposes of determining the stockholders entitled to receive either notice, each constituent corporation may fix, in advance, a record date that shall be

Table of Contents

not more than 10 days prior to the date the notice is given, provided, that if the notice is given on or after the effective date of the merger or consolidation, the record date shall be such effective date. If no record date is fixed and the notice is given prior to the effective date, the record date shall be the close of business on the day next preceding the day on which the notice is given.

(e) Within 120 days after the effective date of the merger or consolidation, the surviving or resulting corporation or any stockholder who has complied with subsections (a) and (d) of this section hereof and who is otherwise entitled to appraisal rights, may commence an appraisal proceeding by filing a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any time within 60 days after the effective date of the merger or consolidation, any stockholder who has not commenced an appraisal proceeding or joined that proceeding as a named party shall have the right to withdraw such stockholder's demand for appraisal and to accept the terms offered upon the merger or consolidation. Within 120 days after the effective date of the merger or consolidation, any stockholder who has complied with the requirements of subsections (a) and (d) of this section hereof, upon written request, shall be entitled to receive from the corporation surviving the merger or resulting from the consolidation a statement setting forth the aggregate number of shares not voted in favor of the merger or consolidation and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. Such written statement shall be mailed to the stockholder within 10 days after such stockholder's written request for such a statement is received by the surviving or resulting corporation or within 10 days after expiration of the period for delivery of demands for appraisal under subsection (d) of this section hereof, whichever is later. Notwithstanding subsection (a) of this section, a person who is the beneficial owner of shares of such stock held either in a voting trust or by a nominee on behalf of such person may, in such person's own name, file a petition or request from the corporation the statement described in this subsection.

(f) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the surviving or resulting corporation, which shall within 20 days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the surviving or resulting corporation. If the petition shall be filed by the surviving or resulting corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery, if so ordered by the Court, shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the surviving or resulting corporation and to the stockholders shown on the list at the addresses therein stated. Such notice shall also be given by 1 or more publications at least 1 week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware or such publication as the Court deems advisable. The forms of the notices by mail and by publication shall be approved by the Court, and the costs thereof shall be borne by the surviving or resulting corporation.

(g) At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder.

(h) After the Court determines the stockholders entitled to an appraisal, the appraisal proceeding shall be conducted in accordance with the rules of the Court of Chancery, including any rules specifically governing appraisal proceedings. Through such proceeding the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all

Table of Contents

relevant factors. Unless the Court in its discretion determines otherwise for good cause shown, interest from the effective date of the merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment. Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, proceed to trial upon the appraisal prior to the final determination of the stockholders entitled to an appraisal. Any stockholder whose name appears on the list filed by the surviving or resulting corporation pursuant to subsection (f) of this section and who has submitted such stockholder's certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until it is finally determined that such stockholder is not entitled to appraisal rights under this section.

(i) The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Payment shall be so made to each such stockholder, in the case of holders of uncertificated stock forthwith, and the case of holders of shares represented by certificates upon the surrender to the corporation of the certificates representing such stock. The Court's decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any state.

(j) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon application of a stockholder, the Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rata against the value of all the shares entitled to an appraisal.

(k) From and after the effective date of the merger or consolidation, no stockholder who has demanded appraisal rights as provided in subsection (d) of this section shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (e) of this section, or if such stockholder shall deliver to the surviving or resulting corporation a written withdrawal of such stockholder's demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (e) of this section or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just; provided, however that this provision shall not affect the right of any stockholder who has not commenced an appraisal proceeding or joined that proceeding as a named party to withdraw such stockholder's demand for appraisal and to accept the terms offered upon the merger or consolidation within 60 days after the effective date of the merger or consolidation, as set forth in subsection (e) of this section.

(l) The shares of the surviving or resulting corporation to which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

Chapter 13. Dissenters' Rights. California General Corporation Law

§ 1300 Corp.

(a) If the approval of the outstanding shares (Section 152) of a corporation is required for a reorganization under subdivisions (a) and (b) or subdivision (e) or (f) of Section 1201, each shareholder of the corporation entitled to vote on the transaction and each shareholder of a subsidiary corporation in a short-form merger may, by complying with this chapter, require the corporation in which the shareholder holds shares to purchase for cash at their fair market value the shares owned by the shareholder which are dissenting shares as defined in subdivision (b). The fair market value shall be determined as of the day before the first announcement of the terms of the proposed reorganization or short-form merger, excluding any appreciation or depreciation in consequence of the proposed action, but adjusted for any stock split, reverse stock split, or share dividend which becomes effective thereafter.

(b) As used in this chapter, "dissenting shares" means shares which come within all of the following descriptions:

(1) Which were not immediately prior to the reorganization or short-form merger either (A) listed on any national securities exchange certified by the Commissioner of Corporations under subdivision (o) of Section 25100 or (B) listed on the National Market System of the NASDAQ Stock Market, and the notice of meeting of shareholders to act upon the reorganization summarizes this section and Sections 1301, 1302, 1303 and 1304; provided, however, that this provision does not apply to any shares with respect to which there exists any restriction on transfer imposed by the corporation or by any law or regulation; and provided, further, that this provision does not apply to any class of shares described in subparagraph (A) or (B) if demands for payment are filed with respect to 5 percent or more of the outstanding shares of that class.

(2) Which were outstanding on the date for the determination of shareholders entitled to vote on the reorganization and (A) were not voted in favor of the reorganization or, (B) if described in subparagraph (A) or (B) of paragraph (1) (without regard to the provisos in that paragraph), were voted against the reorganization, or which were held of record on the effective date of a short-form merger; provided, however, that subparagraph (A) rather than subparagraph (B) of this paragraph applies in any case where the approval required by Section 1201 is sought by written consent rather than at a meeting.

(3) Which the dissenting shareholder has demanded that the corporation purchase at their fair market value, in accordance with Section 1301.

(4) Which the dissenting shareholder has submitted for endorsement, in accordance with Section 1302.

(c) As used in this chapter, "dissenting shareholder" means the recordholder of dissenting shares and includes a transferee of record.

§ 1301 Corp.

(a) If, in the case of a reorganization, any shareholders of a corporation have a right under Section 1300, subject to compliance with paragraphs (3) and (4) of subdivision (b) thereof, to require the corporation to purchase their shares for cash, that corporation shall mail to each such shareholder a notice of the approval of the reorganization by its outstanding shares (Section 152) within 10 days after the date of that approval, accompanied by a copy of Sections 1300, 1302, 1303, and 1304 and this section, a statement of the price determined by the corporation to represent the fair market value of the dissenting shares, and a brief description of the procedure to be followed if the shareholder desires

to exercise the shareholder's right under those sections. The statement of price constitutes an offer by the corporation to purchase at the price stated any dissenting shares as defined in subdivision (b) of Section 1300, unless they lose their status as dissenting shares under Section 1309.

(b) Any shareholder who has a right to require the corporation to purchase the shareholder's shares for cash under Section 1300, subject to compliance with paragraphs (3) and (4) of subdivision (b) thereof, and who desires the corporation to purchase shares shall make written demand upon the corporation for the purchase of those shares and payment to the shareholder in cash of their fair market value. The demand is not effective for any purpose unless it is received by the corporation or any transfer agent thereof (1) in the case of shares described in clause(A) or (B) of paragraph (1) of subdivision (b) of Section 1300 (without regard to the provisos in that paragraph), not later than the date of the shareholders' meeting to vote upon the reorganization, or (2) in any other case within 30 days after the date on which the notice of the approval by the outstanding shares pursuant to subdivision (a) or the notice pursuant to subdivision (i) of Section 1110 was mailed to the shareholder.

(c) The demand shall state the number and class of the shares held of record by the shareholder which the shareholder demands that the corporation purchase and shall contain a statement of what that shareholder claims to be the fair market value of those shares as of the day before the announcement of the proposed reorganization or short-form merger. The statement of fair market value constitutes an offer by the shareholder to sell the shares at that price.

§ 1302 Corp.

Within 30 days after the date on which notice of the approval by the outstanding shares or the notice pursuant to subdivision (i) of Section 1110 was mailed to the shareholder, the shareholder shall submit to the corporation at its principal office or at the office of any transfer agent thereof, (a) if the shares are certificated securities, the shareholder's certificates representing any which the shareholder demands that the corporation purchase, to be stamped or endorsed with a statement that the shares are dissenting shares or to be exchanged for certificates of appropriate denomination so stamped or endorsed or (b) if the shares uncertificated securities, written notice of the number of which the shareholder demands that the corporation purchase. Upon subsequent transfers of the dissenting shares on the books of corporation, the new certificates, initial transaction statement, and other written statements issued therefor shall bear a like statement, together with the name of the original dissenting holder of the shares.

§ 1303 Corp.

(a) If the corporation and the shareholder agree that the are dissenting shares and agree upon the price of the shares, the dissenting shareholder is entitled to the agreed price with interest thereon at the legal rate on judgments from the date of the agreement. Any agreements fixing the fair market value of dissenting shares as between the corporation and the holders thereof shall be filed with the secretary of the corporation.

(b) Subject to the provisions of Section 1306, payment of the market value of dissenting shares shall be made within 30 days after the amount thereof has been agreed or within 30 days after statutory or contractual conditions to the reorganization satisfied, whichever is later, and in the case of certificated securities, subject to surrender of the certificates therefor, unless provided otherwise by agreement.

§ 1304 Corp.

(a) If the corporation denies that the shares are shares, or the corporation and the shareholder fail to agree upon the fair market value of the shares, then the shareholder demanding purchase of such shares as dissenting shares or any corporation, within six months after the date on which notice of approval by the outstanding shares (Section 152) or notice to subdivision (i) of Section 1110 was mailed

to the shareholder, not thereafter, may file a complaint in the superior court of the proper county praying the court to determine whether the shares dissenting shares or the fair market value of the dissenting shares or both or may intervene in any action pending on such a complaint.

(b) Two or more dissenting shareholders may join as or be joined as defendants in any such action and two or more actions may be consolidated.

(c) On the trial of the action, the court shall determine issues. If the status of the shares as dissenting shares is issue, the court shall first determine that issue. If the market value of the dissenting shares is in issue, the court determine, or shall appoint one or more impartial appraisers determine, the fair market value of the shares.

§ 1305 Corp.

(a) If the court appoints an appraiser or appraisers, they proceed forthwith to determine the fair market value per share. Within the time fixed by the court, the appraisers, or a of them, shall make and file a report in the office of the clerk of the court. Thereupon, on the motion of any party, the report shall be submitted to the court and considered on such evidence as the court considers relevant. If the court finds the report reasonable, the court may confirm it.

(b) If a majority of the appraisers appointed fail to make and file a report within 10 days from the date of their appointment or within such further time as may be allowed by the court or the report is confirmed by the court, the court shall determine the fair value of the dissenting shares.

(c) Subject to the provisions of Section 1306, judgment shall rendered against the corporation for payment of an amount equal the fair market value of each dissenting share multiplied by number of dissenting shares which any dissenting shareholder who is party, or who has intervened, is entitled to require the to purchase, with interest thereon at the legal rate from the on which judgment was entered.

(d) Any such judgment shall be payable forthwith with respect uncertificated securities and, with respect to securities, only upon the endorsement and delivery to the of the certificates for the shares described in the judgment. party may appeal from the judgment.

(e) The costs of the action, including reasonable compensation the appraisers to be fixed by the court, shall be or apportioned as the court considers equitable, but, if the exceeds the price offered by the corporation, the corporation pay the costs (including in the discretion of the court fees, fees of expert witnesses and interest at the legal rate judgments from the date of compliance with Sections 1300, 1301 and 1302 if the value awarded by the court for the shares is more 125 percent of the price offered by the corporation under subdivision (a) of Section 1301).

§ 1306 Corp.

To the extent that the provisions of Chapter 5 prevent the to any holders of dissenting shares of their fair market value, shall become creditors of the corporation for the amount together with interest at the legal rate on judgments until the of payment, but subordinate to all other creditors in any proceeding, such debt to be payable when permissible under provisions of Chapter 5.

§ 1307 Corp.

Cash dividends declared and paid by the corporation upon dissenting shares after the date of approval of the reorganization the outstanding shares (Section 152) and prior to payment for shares by the corporation shall be credited against the total to be paid by the corporation therefor.

§ 1308 Corp.

Except as expressly limited in this chapter, holders of shares continue to have all the rights and privileges incident their shares, until the fair market value of their shares is upon or determined. A dissenting shareholder may not withdraw demand for payment unless the corporation consents thereto.

§ 1309 Corp.

Dissenting shares lose their status as dissenting shares and holders thereof cease to be dissenting shareholders and cease to be entitled to require the corporation to purchase their shares upon happening of any of the following:

(a) The corporation abandons the reorganization. Upon abandonment of the reorganization, the corporation shall pay on demand to any dissenting shareholder who has initiated proceedings in good under this chapter all necessary expenses incurred in such proceedings and reasonable attorneys' fees.

(b) The shares are transferred prior to their submission for endorsement in accordance with Section 1302 or are surrendered for conversion into shares of another class in accordance with the articles.

(c) The dissenting shareholder and the corporation do not agree upon the status of the shares as dissenting shares or upon the purchase price of the shares, and neither files a complaint or intervenes in a pending action as provided in Section 1304, within six months after the date on which notice of the approval by the outstanding shares or notice pursuant to subdivision (i) of Section 1110 was mailed to the shareholder.

(d) The dissenting shareholder, with the consent of the corporation, withdraws the shareholder's demand for purchase of dissenting shares.

§ 1310 Corp.

If litigation is instituted to test the sufficiency or of the votes of the shareholders in authorizing a reorganization, any proceedings under Sections 1304 and 1305 shall be suspended until final determination of such litigation.

§ 1311 Corp.

This chapter, except Section 1312, does not apply to classes of shares whose terms and provisions specifically set forth the amount to be paid in respect to such shares in the event of a merger.

§ 1312 Corp.

(a) No shareholder of a corporation who has a right under chapter to demand payment of cash for the shares held by shareholder shall have any right at law or in equity to attack validity of the reorganization or short-form merger, or to have reorganization or short-form merger set aside or rescinded, except an action to test whether the number of shares required to or approve the reorganization have been legally voted in favor thereof; but any holder of shares of a class whose terms provisions specifically set forth the amount to be paid in respect them in the event of a reorganization or short-form merger entitled to payment in accordance with those terms and provisions or, if the principal terms of the reorganization are approved pursuant subdivision (b) of Section 1202, is entitled to payment in with the terms and provisions of the approved reorganization.

(b) If one of the parties to a reorganization or short-form is directly or indirectly controlled by, or under common with, another party to the reorganization or short-form merger, subdivision (a) shall not apply to any shareholder of such party has not demanded payment of cash for such shareholder's pursuant to this chapter; but if the shareholder institutes action to attack the validity of the reorganization or merger or to have the reorganization or short-form merger set or rescinded, the shareholder shall not thereafter have any right demand payment of cash for the shareholder's shares

pursuant to chapter. The court in any action attacking the validity of reorganization or short-form merger or to have the or short-form merger set aside or rescinded shall not restrain or the consummation of the transaction except upon 10 days' prior to the corporation and upon a determination by the court that no other remedy will adequately protect the complaining or the class of shareholders of which such shareholder is a member.

(c) If one of the parties to a reorganization or short-form is directly or indirectly controlled by, or under common control with, another party to the reorganization or short-form merger, any action to attack the validity of the reorganization or merger or to have the reorganization or short-form merger set or rescinded, (1) a party to a reorganization or short-form merger which controls another party to the reorganization or merger shall have the burden of proving that the transaction is just and reasonable as to the shareholders of the controlled party, and (2) a person who controls two or more parties to a shall have the burden of proving that the transaction is just reasonable as to the shareholders of any party so controlled.

§ 1313 Corp.

A conversion pursuant to Chapter 11.5 (commencing Section 1150) shall be deemed to constitute a for purposes of applying the provisions of this chapter, in accordance with and to the extent provided in Section 1159.

H-5

Berkshire Capital Securities LLC

535 Madison Avenue, 19th Floor -- New York, New York 10022

Tel: (212) 207-1000 -- Fax: (212) 207-1019

www.berkcap.com

September 4, 2009

Board of Directors
Kennedy-Wilson, Inc.
9601 Wilshire Boulevard, Suite 220
Beverly Hills, CA 90210

Ladies & Gentlemen:

You have advised us that, pursuant to an Agreement and Plan of Merger to be dated as of September 7, 2009 (the "Agreement"), by and among Prospect Acquisition Corp., a company incorporated under the laws of Delaware ("Prospect"), KW Merger Sub Corp., a company incorporated under the laws of Delaware and a wholly-owned subsidiary of Prospect ("Merger Sub") and Kennedy-Wilson, Inc., a company incorporated under the laws of Delaware ("Kennedy Wilson" or "KW"), Merger Sub will be merged with and into Kennedy Wilson (the "Merger"), at which time the separate corporate existence of Merger Sub will cease. The Agreement specifies that Kennedy Wilson will be the surviving corporation in the Merger. You have further advised us that pursuant to the Agreement, at the closing of the Merger, each share of the issued and outstanding shares of common stock, par value \$0.01 per share of Kennedy Wilson (the "KW Common Stock") and of the convertible preferred stock of Kennedy Wilson (the "KW Preferred Stock") will be exchanged for aggregate consideration of 26,000,000 shares of common stock of Prospect, par value \$0.0001 per share (the "Prospect Common Stock"), subject to adjustment in certain circumstances as set forth in the Agreement, whereby each share of KW Common Stock shall be converted into the right to receive 3.8031 shares of Prospect Common Stock (the "Common Stock Exchange Ratio") and each share of KW Preferred Stock shall be converted into the right to receive 105.6412 shares of Prospect Common Stock (the "Preferred Stock Exchange Ratio"). For purposes of this opinion, the shares of Prospect Common Stock to be received by the holders of KW Common Stock pursuant to the Common Stock Exchange Ratio are referred to as the "Merger Consideration". The terms and conditions of the Merger are set forth in more detail in the Agreement, a draft copy of which you have provided to us.

You have informed us that the Merger is expected to be consummated in the fourth quarter of 2009. The Agreement specifies that the Merger requires (i) the affirmative vote of the holders of a majority of the issued and outstanding shares of KW Common Stock and of the KW Preferred Stock, and (ii) the affirmative vote of the holders of a majority of the shares of Prospect Common Stock sold in the initial public offering of Prospect completed on November 14, 2007 (the "Prospect Public Offering") voted at the Prospect Stockholders' Meeting (as defined in the Agreement), *provided*, that the Merger will only proceed if holders of fewer than 30% of the shares of Prospect Common Stock sold in the Prospect Public Offering exercise their redemption rights.

You have requested our opinion as to whether the Merger Consideration to be received in the Merger by the non-management holders of KW Common Stock is fair to such stockholders of Kennedy Wilson from a financial point of view, as of the date hereof.

In arriving at our opinion, we have, among other things:

- (i) reviewed a draft Agreement, dated September 2, 2009;

Edgar Filing: VALHI INC /DE/ - Form 10-Q

- (ii) reviewed Kennedy Wilson's Annual Report for the years ended December 31, 2006, 2007 and 2008, and certain unaudited interim financial statements and other financial information prepared by the management of Kennedy Wilson with respect to the six months ended June 30, 2009;
- (iii) reviewed Prospect's Annual Report on Form 10-K for the year ended December 31, 2008, Prospect's Quarterly Report on Form 10-Q for the period ended June 30, 2009, Prospect's Form S-1/A dated October 17, 2007 and other publicly available financial and operating information;
- (iv) met with certain members of Kennedy Wilson's management to discuss the past and current business operations of KW, the historical financial condition and operations and future prospects of KW, and the effects of the Merger on the financial condition and future operations and prospects of KW;
- (v) reviewed certain pro forma financial effects of the Merger;
- (vi) reviewed certain historical and forward-looking business, financial and other information relating to Kennedy Wilson provided to or discussed with us by the management of KW;
- (vii) reviewed certain financial and stock market data and other information for Kennedy Wilson and Prospect and compared that data and information with corresponding data and information for companies with publicly traded securities that we deemed relevant; and
- (viii) considered such information, financial studies, analyses and investigations and financial, economic and market criteria that we deemed, in our sole judgment, to be necessary, appropriate or relevant to render the opinion set forth herein.

In conducting our review and arriving at our opinion, with your consent, we have not assumed any responsibility for independent verification of any of the foregoing information. We have, with your consent, assumed and relied upon the accuracy and completeness, in all material respects, of the information described in the preceding paragraph, and have relied upon the assurances of the members of management of Kennedy Wilson that they are unaware of any facts that would make the information or projections provided to us incomplete or misleading. We have not been requested to make, and have not made, an independent evaluation or appraisal of any assets or liabilities (contingent or otherwise) of Kennedy Wilson or any of its affiliates, nor have we been furnished with any such evaluation or appraisal. Further, we have assumed, with your consent, that all of the information prepared by the management of Kennedy Wilson provided to us for purposes of this opinion, including the projections for Kennedy Wilson, was prepared in good faith and on a basis reflecting the best currently available estimates and judgments of the management of Kennedy Wilson as to the future financial performance of Kennedy Wilson, and the assumptions underlying such projections were viewed by management as being reasonable at the time made.

We have not undertaken any independent legal analysis of the Merger, any related transactions, the Agreement or any legal or regulatory proceedings pending or threatened related to Kennedy Wilson. We have not been asked to, and do not, express any opinion as to the after-tax consequences of the Merger to the stockholders of Kennedy Wilson. Furthermore, we are expressing no opinion herein as to the price at which the Prospect Common Stock or the KW Common Stock will trade at any future time.

Our opinion is necessarily based on economic, monetary and market conditions existing on the date hereof. We have also assumed that the executed Agreement will conform in all material respects to the draft Agreement, and that the Merger will be consummated on the terms described in the draft Agreement without any waiver of any material terms or conditions by the stockholders of Kennedy Wilson.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Berkshire Capital Securities LLC, as part of its investment banking business, is engaged in the business of providing financial advisory services with regard to mergers and acquisitions. We have acted as financial adviser to Kennedy Wilson in the Merger, have received fees for such services, will receive a fee for our services in rendering this opinion and will receive a fee upon the completion of the Merger. In addition, Kennedy Wilson has agreed to reimburse us for our reasonable expenses, and to indemnify us against certain liabilities that may arise out of this assignment, including the rendering of this opinion.

This opinion is for the use and benefit of the Board of Directors of Kennedy Wilson and is rendered to the Board of Directors of Kennedy Wilson in connection with its consideration of the Merger. Our opinion does not address the merits of the underlying decision by Kennedy Wilson to engage in the Merger or the relative merits of the Merger as compared to other business strategies that might be available to Kennedy Wilson. In that regard, we were not authorized to, and did not, solicit third party indications of interest in acquiring all or a part of Kennedy Wilson or engaging in a business combination or any other strategic transaction with Kennedy Wilson. We express no opinion or recommendation as to how the shareholders of Kennedy Wilson should vote at any stockholders' meeting to be held in connection with the Merger. This letter is not to be used for any other purpose, or reproduced, disseminated, quoted or referred to at any time or in any manner, in whole or in part, without our written consent; provided, however, that this letter may be included in its entirety in any proxy statement or disclosure statement to be distributed to the holders of KW Preferred Stock and KW Common Stock or options to buy KW Common Stock in connection with the Merger.

Based upon and subject to the foregoing, we are of the opinion that the Merger Consideration to be received in the Merger by the non-management holders of KW Common Stock is fair to such stockholders of Kennedy Wilson from a financial point of view, as of the date hereof.

Very truly yours,
/s/ Berkshire Capital Securities LLC
BERKSHIRE CAPITAL SECURITIES LLC
I-3

Table of Contents

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 20. Indemnification of Directors and Officers

Prospect's amended and restated certificate of incorporation provides as follows:

"Section 8.1. Right to Indemnification.

(A) director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the DGCL, or (iv) for any transaction from which the director derived an improper personal benefit. If the DGCL is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the DGCL, as so amended. Any repeal or modification of this paragraph (A) by the stockholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation with respect to events occurring prior to the time of such repeal or modification.

(B) The Corporation, to the full extent permitted by Section 145 of the DGCL, as amended from time to time, shall indemnify all persons whom it may indemnify pursuant thereto. Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative, or investigative action, suit or proceeding for which such officer or director may be entitled to indemnification hereunder shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized hereby."

Prospect's amended and restated by-laws provides as follows:

"Article VII Indemnification of Directors and Officers

7.1 The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

7.2 The Corporation shall indemnify any person who was or is a party, or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another Corporation, partnership, joint venture, trust or other

Table of Contents

enterprise against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

7.3 To the extent that a director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Sections 1 or 2 of this Article VII, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him or her in connection therewith.

7.4 Any indemnification under sections 1 or 2 of this Article VII (unless ordered by a court) shall be made by the Corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in such section. Such determination shall be made:

(a) By the Board of Directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or

(b) If such a quorum is not obtainable, or, even if obtainable a quorum of disinterested directors so directs, by independent legal counsel in a written opinion,

(c) By the stockholders.

7.5 Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized in this Section. Such expenses (including attorneys' fees) incurred by other employees and agents may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate.

7.6 The indemnification and advancement of expenses provided by, or granted pursuant to the other sections of this Article VII shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

7.7 The Corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another Corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under the provisions of this Article VII.

7.8 For purposes of this Article VII, references to "the Corporation" shall include, in addition to the resulting Corporation, any constituent Corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person

Table of Contents

who is or was a director, officer, employee or agent of such constituent Corporation, or is or was serving at the request of such constituent Corporation as a director, officer, employee or agent of another Corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under this Article VII with respect to the resulting or surviving Corporation as he would have with respect to such constituent Corporation if its separate existence had continued.

7.9 For purposes of this Article VII, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to any employee benefit plan; and references to "serving at the request of the Corporation" shall include any service as a director, officer, employee or agent of the Corporation which imposes duties on, or involves services by, such director, officer, employee, or agent with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the Corporation" as referred to in this Article VII.

7.10 The indemnification and advancement of expenses provided by, or granted pursuant to, this Article VII shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

7.11 No director or officer of the Corporation shall be personally liable to the Corporation or to any stockholder of the Corporation for monetary damages for breach of fiduciary duty as a director or officer, provided that this provision shall not limit the liability of a director or officer (i) for any breach of the director's or the officer's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the General Corporation Law of Delaware, or (iv) for any transaction from which the director or officer derived an improper personal benefit."

Section 145 of the DGCL concerning indemnification of officers, directors, employees and agents is set forth below.

"Section 145. Indemnification of officers, directors, employees and agents; insurance.

(a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person's conduct was unlawful.

(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that the person is or was a

Table of Contents

director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

(c) To the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.

(d) Any indemnification under subsections (a) and (b) of this section (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the present or former director, officer, employee or agent is proper in the circumstances because the person has met the applicable standard of conduct set forth in subsections (a) and (b) of this section. Such determination shall be made, with respect to a person who is a director or officer at the time of such determination, (1) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (2) by a committee of such directors designated by majority vote of such directors, even though less than a quorum, or (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (4) by the stockholders.

(e) Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the corporation deems appropriate.

(f) The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding such office. A right to indemnification or to advancement of expenses arising under a provision of the certificate of incorporation or a bylaw shall not be eliminated or impaired by an amendment to such provision after the occurrence of the act or omission that is the subject of the civil, criminal, administrative or investigative action, suit or proceeding for which indemnification or advancement of expenses is sought, unless the provision in effect at the time of such act or omission explicitly authorizes such elimination or impairment after such action or omission has occurred.

(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by

Table of Contents

such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section.

(h) For purposes of this section, references to "the corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under this section with respect to the resulting or surviving corporation as such person would have with respect to such constituent corporation if its separate existence had continued.

(i) For purposes of this section, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to any employee benefit plan; and references to "serving at the request of the corporation" shall include any service as a director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such director, officer, employee or agent with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner such person reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the corporation" as referred to in this section.

(j) The indemnification and advancement of expenses provided by, or granted pursuant to, this section shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

(k) The Court of Chancery is hereby vested with exclusive jurisdiction to hear and determine all actions for advancement of expenses or indemnification brought under this section or under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise. The Court of Chancery may summarily determine a corporation's obligation to advance expenses (including attorneys' fees)."

Commission Position on Indemnification for Securities Act Liabilities

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers, and controlling persons pursuant to the foregoing provisions, or otherwise, Prospect has been advised that, in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

Item 21. Exhibits and Financial Statement Schedules

The following exhibits are filed as part of this proxy statement/prospectus:

Exhibit No.	Description
2.1	Agreement and Plan of Merger, by and among Prospect Acquisition Corp., KW Merger Sub Corp. and Kennedy-Wilson, Inc., dated as of September 8, 2009, included as Annex A to the proxy statement/prospectus.
2.2	Amendment No. 1 to the Agreement and Plan of Merger dated October 22, 2009 between Prospect Acquisition Corp., KW Merger Sub Corp. and Kennedy-Wilson, Inc., included as part of Annex A to the proxy statement/prospectus.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
2.3	Amendment No. 2 to the Agreement and Plan of Merger dated October 26, 2009 between Prospect Acquisition Corp., KW Merger Sub Corp. and Kennedy-Wilson, Inc., included as part of Annex A to the proxy statement/prospectus.
3.1	Amended and Restated Certificate of Incorporation of Prospect Acquisition Corp., previously filed as Exhibit 3.1 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
3.2	Amended and Restated Bylaws of Prospect Acquisition Corp., previously filed as Exhibit 3.2 to Prospect's Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-145110) filed October 26, 2007.
3.3	Form of Second Amended and Restated Certificate of Incorporation of Prospect Acquisition Corp., included as Annex D to the proxy statement/prospectus.
3.4*	Certificate of Incorporation of Kennedy-Wilson, Inc., filed March 27, 1992.
3.5*	Certificate of Amendment of Certificate of Incorporation of Kennedy-Wilson, Inc., dated November 20, 1995.
3.6*	Certificate of Amendment of Certificate of Incorporation of Kennedy-Wilson, Inc., dated November 19, 1996.
3.7*	Certificate of Amendment of Certificate of Incorporation of Kennedy-Wilson, Inc., dated December 15, 1997.
3.8*	Certificate of Amendment of Certificate of Incorporation of Kennedy-Wilson, Inc., dated April 29, 1998.
3.9*	Certificate of Amendment of Certificate of Incorporation of Kennedy-Wilson, Inc., dated April 18, 1999.
3.10*	Certificate of Amendment of Certificate of Incorporation of Kennedy-Wilson, Inc., dated March 25, 2009.
3.11*	Bylaws of Kennedy-Wilson, Inc.
3.12*	Amended Certificate of Designation, Preferences and Rights of Series A Preferred Stock of Kennedy-Wilson, Inc., dated as of May 30, 2008.
4.1	Specimen Unit Certificate of Prospect Acquisition Corp., previously filed as Exhibit 4.1 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
4.2	Specimen Common Stock Certificate of Prospect Acquisition Corp., previously filed as Exhibit 4.2 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
4.3	Specimen Warrant Certificate of Prospect Acquisition Corp., previously filed as Exhibit 4.3 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
4.4	Warrant Agreement between Continental Stock Transfer & Trust Company and Prospect Acquisition Corp., previously filed as Exhibit 4.4 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
4.5	Form of Amendment No. 1 to Warrant Agreement between Continental Stock Transfer & Trust Company and Prospect Acquisition Corp., included as Annex B to the proxy statement/prospectus.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
4.6	Form of Amended and Restated Warrant Agreement between Continental Stock Transfer & Trust Company and Kennedy-Wilson Holdings, Inc., included as Annex C to the proxy statement/prospectus.
4.7*	Form of Specimen Warrant Certificate of Kennedy-Wilson Holdings, Inc.
5.1****	Opinion of Bingham McCutchen LLP regarding the validity of securities.
8.1****	Opinion of Bingham McCutchen LLP regarding certain federal income tax matters.
8.2***	Opinion of Loeb and Loeb LLP regarding certain federal income tax matters.
10.1	Promissory Note issued by Prospect Acquisition Corp. to Flat Ridge Investments LLC on July 17, 2007, previously filed as Exhibit 10.1 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.
10.2	Promissory Note issued by Prospect Acquisition Corp. to LLM Investors L.P. on July 17, 2007, previously filed as Exhibit 10.2 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.
10.3	Promissory Note issued by Prospect Acquisition Corp. to LLM Structured Equity Fund L.P. on July 17, 2007, previously filed as Exhibit 10.3 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.
10.4	Stock Purchase Agreement dated July 18, 2007 between Prospect Acquisition Corp. and Flat Ridge Investments LLC, LLM Structured Equity Fund L.P. and LLM Investors L.P., previously filed as Exhibit 10.4 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.
10.5	Stock Purchase Agreement dated August 1, 2007 by and among Flat Ridge Investments LLC, SJC Capital LLC, Michael P. Castine and Daniel Gressel, previously filed as Exhibit 10.5 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.
10.6	Stock Purchase Agreement dated August 1, 2007 by and among LLM Structured Equity Fund L.P., LLM Investors L.P. and Capital Management Systems, Inc., previously filed as Exhibit 10.6 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.
10.7	Letter Agreement by and among Prospect Acquisition Corp., Citigroup Global Markets Inc. and each executive officer, director and initial stockholders of Prospect Acquisition Corp., previously filed as Exhibit 10.7 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
10.8	Investment Management Trust Agreement between Continental Stock Transfer & Trust Company and Prospect Acquisition Corp., previously filed as Exhibit 10.8 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
10.9	Escrow Agreement between Prospect Acquisition Corp., Continental Stock Transfer & Trust Company and the initial stockholders of Prospect, previously filed as Exhibit 10.9 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
10.10	Administrative Services Agreement dated July 30, 2007 between Teleos Management, L.L.C., LLM Capital Partners LLC and Prospect Acquisition Corp., previously filed as Exhibit 10.10 to Prospect's Registration Statement on Form S-1 (File No. 333-145110) filed August 3, 2007.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
10.11	Registration Rights Agreement dated November 14, 2007 by and among Prospect Acquisition Corp. and Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., Capital Management Systems, Inc., SJC Capital LLC, Michael P. Castine, Daniel Gressel, Michael Downey, James J. Cahill and John Merchant, previously filed as Exhibit 10.11 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
10.12	Sponsors' Warrants Purchase Agreement by and among Prospect Acquisition Corp. and Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P. and Capital Management Systems, Inc., previously filed as Exhibit 10.12 to Prospect's Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-145110) filed October 17, 2007.
10.13	Right of First Review Letter Agreement by and among Prospect Acquisition Corp., David A. Minella, Patrick J. Landers, James J. Cahill, Michael P. Castine, William Cvengros, Michael Downey, Daniel Gressel, William Landman, Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P. and Capital Management Systems, Inc., previously filed as Exhibit 10.13 to Prospect's Annual Report on Form 10-K filed March 31, 2008.
10.14	Stock Purchase Agreement dated September 6, 2007 by and between Flat Ridge Investments LLC and Michael Downey, previously filed as Exhibit 10.14 to Prospect's Amendment No. 1 to the Registration Statement on Form S-1 (File No. 333-145110) filed September 10, 2007.
10.15	Stock Purchase Agreement dated September 6, 2007 by and among James J. Cahill, LLM Structured Equity Fund L.P., LLM Investors L.P. and Capital Management Systems, Inc., previously filed as Exhibit 10.15 to Prospect's Amendment No. 1 to the Registration Statement on Form S-1 (File No. 333-145110) filed September 10, 2007.
10.16	Stock Purchase Agreement dated October 15, 2007 by and among the sellers identified on Schedules B and C thereto, Flat Ridge Investments LLC and James J. Cahill, previously filed as Exhibit 10.16 to Prospect's Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-145110) filed October 17, 2007.
10.17	Stock Purchase Agreement dated October 25, 2007 by and among Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., Capital Management Systems, Inc. and John Merchant, previously filed as Exhibit 10.17 to Prospect's Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-145110) filed October 26, 2007.
10.18	Amendment to Administrative Services Agreement dated December 31, 2008 between Teleos Management, L.L.C., LLM Capital Partners LLC and Prospect Acquisition Corp., previously filed as Exhibit 10.1 to Prospect's Current Report on Form 8-K filed January 7, 2009.
10.19	Executive Office Lease Agreement dated January 1, 2009 between Prospect Acquisition Corp. and Professional Suites at the Galleria, Inc., previously filed as Exhibit 10.2 to Prospect's Current Report on Form 8-K filed January 7, 2009.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
10.20*	Forfeiture Agreement dated September 8, 2009 by and among Prospect Acquisition Corp., De Guardiola Advisors, Inc., De Guardiola Holdings, Inc., Flat Ridge Investments LLC, LLM Structured Equity Fund L.P., LLM Investors L.P., CMS Platinum Fund, L.P., SJC Capital LLC, Michael P. Castine, Daniel Gressel, Michael Downey, James J. Cahill, John Merchant and Kennedy-Wilson, Inc.
10.21*	Letter Agreement dated September 17, 2009 by Prospect Acquisition Corp. and Citigroup Global Markets Inc. Ladenburg Thalmann & Co. Inc. and I-Bankers Securities, Inc.
10.22*	Letter Agreement dated September 4, 2009 by Prospect Acquisition Corp. and De Guardiola Advisors, Inc.
10.23*	Form of Lock-Up Agreement by Prospect Acquisition Corp. and certain stockholders of Prospect.
10.24	Form of Kennedy-Wilson Holdings, Inc. 2009 Equity Participation Plan, included as Annex E to the proxy statement/prospectus.
10.25 *	Form of Consultant Restricted Stock Award Agreement to Kennedy-Wilson Holdings, Inc. 2009 Equity Participation Plan.
10.26 *	Form of Employee Performance Unit Award Agreement to Kennedy-Wilson Holdings, Inc. 2009 Equity Participation Plan.
10.27 *	Form of Employee Restricted Stock Award Agreement to Kennedy-Wilson Holdings, Inc. 2009 Equity Participation Plan.
10.28*	Promissory Note issued by Kennedy-Wilson, Inc. to The Guardian Life Insurance Company of America on November 3, 2008.
10.29 *	Form of Fifteenth Amendment to Employment Agreement by Kennedy-Wilson, Inc. and William J. McMorrow.
10.30 *	Employment Agreement dated August 14, 1992 between Kennedy-Wilson and William J. McMorrow.
10.31 *	Amendment to Employment Agreement dated as of January 1, 1993 between Kennedy-Wilson and William J. McMorrow.
10.32 *	Second Amendment to Employment Agreement dated as of between January 1, 1994 Kennedy-Wilson and William J. McMorrow.
10.33 ***	Third Amendment to Employment Agreement dated as of March 31, 1995 between Kennedy-Wilson and William J. McMorrow.
10.34 ***	Fourth Amendment to Employment Agreement dated as of January 1, 1996 Kennedy-Wilson and William J. McMorrow.
10.35 *	Amendment to Employment Agreement dated as of February 28, 1996 between Kennedy-Wilson and William J. McMorrow.
10.36 ***	Fifth Amendment to Employment Agreement dated as of May 19, 1997 between Kennedy-Wilson and William J. McMorrow.
10.37 *	Sixth Amendment to Employment Agreement dated as of August 20, 1998 between Kennedy-Wilson and William J. McMorrow.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
10.38 *	Seventh Amendment to Employment Agreement dated as of August 9, 1999 between Kennedy-Wilson and William J. McMorrow.
10.39 *	Eighth Amendment to Employment Agreement dated as of January 3, 2000 between Kennedy-Wilson and William J. McMorrow.
10.40 *	Ninth Amendment to Employment Agreement dated as of October 1, 2000 between Kennedy-Wilson and William J. McMorrow.
10.41 *	Tenth Amendment to Employment Agreement dated as of April 22, 2002 between Kennedy-Wilson and William J. McMorrow.
10.42 *	Eleventh Amendment to Employment Agreement dated as of October 1, 2003 between Kennedy-Wilson and William J. McMorrow.
10.43 *	Twelfth Amendment to Employment Agreement dated as of April 21, 2004 between Kennedy-Wilson and William J. McMorrow.
10.44 *	Thirteenth Amendment to Employment Agreement dated as of January 1, 2008 between Kennedy-Wilson and William J. McMorrow.
10.45 *	Fourteenth Amendment to Employment Agreement dated as of February 1, 2009 between Kennedy-Wilson and William J. McMorrow.
10.46 *	Form of Second Amendment to Employment Agreement by Kennedy-Wilson, Inc. and Mary L. Ricks.
10.47 *	Employment Agreement dated February 1, 2009 between Kennedy-Wilson and Mary L. Ricks.
10.48 *	First Amendment to Employment Agreement dated June 1, 2009 between Kennedy-Wilson and Mary L. Ricks.
10.49 *	Form of First Amendment to Employment Agreement by Kennedy-Wilson, Inc. and Donald J. Herrema.
10.50 *	Employment Agreement dated June 15, 2009 between Kennedy-Wilson and Donald J. Herrema.
10.51 *	Employment Agreement dated April 1, 1996 between Kennedy-Wilson and Freeman Lyle.
10.52 *	Amendment to Employment Agreement dated April 1, 1997 between Kennedy-Wilson and Freeman Lyle.
10.53 *	Second Amendment to Employment Agreement dated April 1, 1998 between Kennedy-Wilson and Freeman Lyle.
10.54 *	Third Amendment to Employment Agreement dated as of August 15, 1998 between Kennedy-Wilson and Freeman Lyle.
10.55 *	Fourth Amendment to Employment Agreement dated as of April 1, 1999 between Kennedy-Wilson and Freeman Lyle.
10.56 *	Fifth Amendment to Employment Agreement dated as of April 1, 2000 between Kennedy-Wilson and Freeman Lyle.
10.57 *	Sixth Amendment to Employment Agreement dated as of January 1, 2001 between Kennedy-Wilson and Freeman Lyle.

Table of Contents

Exhibit No.	Description
10.58 *	Seventh Amendment to Employment Agreement dated as of March 28, 2001 between Kennedy-Wilson and Freeman Lyle.
10.59 *	Eighth Amendment to Employment Agreement dated as of September 1, 2002 between Kennedy-Wilson and Freeman Lyle.
10.60 *	Ninth Amendment to Employment Agreement dated October 1, 2003 between Kennedy-Wilson and Freeman Lyle.
10.61 *	Tenth Amendment to Employment Agreement dated January 1, 2004 between Kennedy-Wilson and Freeman Lyle.
10.62 *	Eleventh Amendment to Employment Agreement dated January 1, 2005 between Kennedy-Wilson and Freeman Lyle.
10.63 *	Twelfth Amendment to Employment Agreement dated January 1, 2006 between Kennedy-Wilson and Freeman Lyle.
10.64 *	Thirteenth Amendment to Employment Agreement dated January 1, 2007 between Kennedy-Wilson and Freeman Lyle.
10.65 *	Fourteenth Amendment to Employment Agreement dated March 1, 2007 between Kennedy-Wilson and Freeman Lyle.
10.66 *	Fifteenth Amendment to Employment Agreement dated January 1, 2008 between Kennedy-Wilson and Freeman Lyle.
10.67 *	Sixteenth Amendment to Employment Agreement dated June 1, 2008 between Kennedy-Wilson and Freeman Lyle.
10.68 *	Seventeenth Amendment to Employment Agreement dated January 1, 2009 between Kennedy-Wilson and Freeman Lyle.
10.69 *	Employment Agreement dated January 4, 1999 between Kennedy-Wilson and James Rosten.
10.70 *	Amendment to Employment Agreement dated as of January 1, 2001 between Kennedy-Wilson Properties and James Rosten.
10.71 *	Second Amendment to Employment Agreement dated as of March 15, 2001 between Kennedy-Wilson Properties and James Rosten.
10.72 *	Third Amendment to Employment Agreement dated as of January 3, 2003 between Kennedy-Wilson Properties and James Rosten.
10.73 *	Fourth Amendment to Employment Agreement dated as of September 5, 2003 between Kennedy-Wilson Properties and James Rosten.
10.74 *	Fifth Amendment to Employment Agreement dated as of October 1, 2003 between Kennedy-Wilson Properties and James Rosten.
10.75 *	Sixth Amendment to Employment Agreement dated as of January 1, 2004 between Kennedy-Wilson Properties and James Rosten.
10.76 *	Seventh Amendment to Employment Agreement dated as of April 19, 2004 between Kennedy-Wilson Properties and James Rosten.
10.77 *	Eighth Amendment to Employment Agreement dated as of January 1, 2005 between Kennedy-Wilson Properties and James Rosten.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
10.78 *	Ninth Amendment to Employment Agreement dated as of February 11, 2005 between Kennedy-Wilson Properties and James Rosten.
10.79 *	Tenth Amendment to Employment Agreement dated as of January 1, 2006 between Kennedy-Wilson Properties and James Rosten.
10.80 *	Eleventh Amendment to Employment Agreement dated as of August 1, 2006 between Kennedy-Wilson Properties and James Rosten.
10.81 *	Twelfth Amendment to Employment Agreement dated as of January 1, 2007 between Kennedy-Wilson Properties and James Rosten.
10.82 *	Thirteenth Amendment to Employment Agreement dated as of January 1, 2008 between Kennedy-Wilson Properties and James Rosten.
10.83 *	Fourteenth Amendment to Employment Agreement dated as of January 1, 2009 between Kennedy-Wilson Properties and James Rosten.
10.84 *	Employment Agreement dated January 1, 2006 between KW Multi-Family Management Group and Robert Hart.
10.85 *	Amendment to Employment Agreement dated as of August 1, 2006 between KW Multi-Family Management Group and Robert Hart.
10.86 *	Second Amendment to Employment Agreement dated as of January 1, 2007 between KW Multi-Family Management Group and Robert Hart.
10.87 *	Third Amendment to Employment Agreement dated as of January 1, 2008 between KW Multi-Family Management Group and Robert Hart.
10.88 *	Fourth Amendment to Employment Agreement dated as of January 1, 2009 between KW Multi-Family Management Group and Robert Hart.
10.89 *	Promissory Note issued by Kennedy-Wilson, Inc. to William J. McMorrow on April 10, 2006.
10.90*	Business Loan Agreement dated July 29, 2009 between Kennedy-Wilson, Inc. and Pacific Western Bank.
10.91**	Amended and Restated Loan Agreement dated June 5, 2008 between Kennedy-Wilson, Inc. and U.S. Bank National Association.
10.92*	Junior Subordinated Indenture dated, January 31, 2007 between Kennedy-Wilson, Inc. and The Bank of New York Trust Company, National Association, as trustee.
10.93 *	1992 Non-Employee Director Stock Option Plan.
10.94*	Shareholders Agreement dated November 3, 2008 between Kennedy-Wilson, Inc. and The Guardian Life Insurance Company of America.
10.95*	Office Lease dated August 19, 1998 between Wilshire-Camden Associates and Kennedy-Wilson, Inc.
10.96*	First Amendment to Office Lease dated March 5, 1999 between Wilshire-Camden Associates and Kennedy-Wilson, Inc.
10.97*	Second Amendment to Lease dated June 2, 1999 between Wilshire-Camden Associates and Kennedy-Wilson, Inc.

Edgar Filing: VALHI INC /DE/ - Form 10-Q

Table of Contents

Exhibit No.	Description
10.98*	Third Amendment to Office Lease dated December 20, 2002 between Brighton Enterprises, LLC and Kennedy-Wilson, Inc.
10.99*	Fourth Amendment to Office Lease dated September 11, 2003 between Wilshire-Camden Associates and Kennedy-Wilson, Inc.
10.100*	Fifth Amendment to Office Lease dated January 7, 2006 between Douglas Emmett 2000, LLC and Kennedy-Wilson, Inc.
10.101*	Standard Office Lease dated March 3, 2009 by and among 9701-Hempstead Plaza, LLC, 9701-Carolina Gardens LLC, 9701-West Point Realty LLC, 9701-Dakota Leasing LLC and 9701-Iowa Leasing LLC and Kennedy-Wilson Inc.
10.102*	Second Amended and Restated Guaranty of Payment dated November 4, 2008 by Arthur S. Levine, as Trustee of the Ray J. Rutter Trust, Arthur S. Levine, as Trustee of the Susan Ray Rutter Trust, and Arthur S. Levine, as Trustee of the Robert Jonathan Rutter Trust, and Kennedy-Wilson Inc., to Bank Midwest N.A.
10.103*	Commercial Guaranty dated November 24, 2008 for borrower TDM Beach Villas, LLC, to Pacific Western Bank, by Kennedy-Wilson, Inc.
10.104*	Amended and Restated Guaranty dated October 25, 2007 Agreement by Kennedy-Wilson, Inc. in favor of Bank of America, N.A., as agent for lenders.