

M&A Monitor

Piper Jaffray Middle Market Mergers & Acquisitions

M&A Monitor: Analyzing M&A Activity—August 3, 2005

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Feature Article**Will Accounting for Business Combinations Change Once Again?**by Gary Vaynberg, garry.x.vaynberg@pjc.com, 612 303-6348

In its quest to make the accounting for business combinations more transparent and in line with international accounting standards, FASB has recently proposed to implement a new rule that would essentially replace the current purchase method with a more stringent acquisition method. Although not as drastic as the elimination of pooling a few years ago, the changes are nevertheless rather radical compared to the current practices. So, what does the new proposed method imply for mergers and acquisitions in general and the middle market sector in particular? The following is a summary of the material differences between the purchase and acquisition methods.

Consideration—All items of consideration transferred by the acquirer in exchange for the target would be measured and recognized at fair value at the acquisition date, including contingent consideration, the acquirer's equity securities and any non-controlling equity investment in the target that the acquirer owned immediately before the acquisition date.

Acquisition-Related Costs—The costs the acquirer incurs in connection with the business combination, such as legal, accounting and banking fees, would be accounted for separately from the total consideration and instead expensed at the time of acquisition.

Measuring and Recognizing the Assets Acquired and Liabilities Assumed—The assets acquired and liabilities assumed would be measured and recognized at their fair values as of the acquisition date, with limited exceptions. The new rule proposes the following:

- Assets and liabilities arising from contingencies that are acquired or assumed as part of the business combination would be measured and recognized as fair value at the acquisition date. Any changes in fair value would be recognized in income.
- In those business combinations in which the acquirer holds a non-controlling stake in the target prior to the acquisition, the acquirer would measure and recognize the non-controlling interest as the sum of the non-controlling interest's proportional interest in the acquisition-date values of the identifiable assets acquired and liabilities assumed plus the goodwill attributable to the non-controlling interest.
- Costs associated with restructuring or exit activities that are not liabilities at the acquisition date would not be recognized as liabilities assumed in the business combination and instead would be expensed as they are incurred.
- Research and development assets acquired in a business combination that currently are required to be written off would be recognized and measured at fair value.

Goodwill would still be created and tested for "impairment" once a year. The changes would have more of an impact on the public market, especially for those companies whose valuation is based on net income. In the cash-flow-driven middle market world, the effect would be muted due to the irrelevancy of the earnings dilution analysis. For transactions in which contingent payments are involved, those considerations would now have to be recognized at fair market value and gains and losses recognized in the income statement. For example, the acquirer would record a gain on the reversal of the liability if a milestone in an earnout arrangement has not been met.

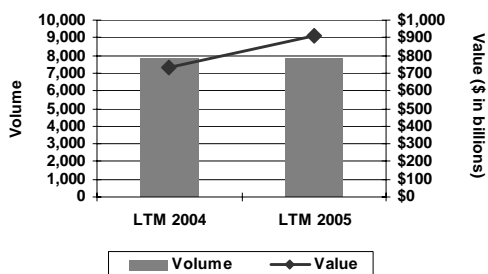
If implemented, the new ruling will become effective on December 15, 2006. Piper Jaffray will continue to monitor the developments in this area.

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Domestic Transactions

(\$ in billions)	Value*	Volume
LTM: 2004	\$728.7	7,828
LTM: 2005	\$910.0	7,795

LTM 2004 vs. LTM 2005



*Total value based on deals with reported values

Source: Thomson Financial Securities Data Corporation

LTM median deal value for 2005 is \$28.8 million compared to \$26.7 million for 2004.

LTM Transaction Multiples

By Size (\$ in millions)	EBIT	EBITDA
Less than \$25	8.1x	5.8x
\$25 to \$100	11.0x	10.1x
\$100 to \$250	12.0x	8.4x
\$250 to \$1,000	15.5x	9.9x
Over \$1,000	15.0x	10.2x

Current data as of August 1, 2005

Source: Thomson Financial Securities Data Corporation

Based on multiples between 0x and 25x; excluding media and telecom.

Public Company Premiums

1 week prior to announcement	22.5%
4 weeks prior to announcement	28.2%

Current data as of August 1, 2005

Source: Thomson Financial Securities Data Corporation

Deal Financing

	Current	1 Year Ago
Leveraged Bank Loan	5.81%	4.87%
High Yield Bond Rate	7.47%	7.79%
Senior Debt/EBITDA*	4.7x	3.3x
Total Debt/EBITDA*	4.7x	4.3x

Current data as of August 1, 2005

Source: Portfolio Management Data, The Wall Street Journal and Gold Sheets Daily

*Represents leverage statistics for middle market LBOs (less than \$50 million of EBITDA)

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Buyout Fund Market

(\$ in billions)	2005	2004	2003
Funds Raised	\$81.7	\$42.2	\$24.0
Deals Completed	\$88.8	\$136.5	\$94.8

Data as of July 4, 2005
Source: Buyouts

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