

M&A Monitor

Piper Jaffray Middle Market Mergers & Acquisitions
M&A Monitor: Analyzing M&A Activity—August 31, 2005**Sections:**

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Feature Article**Value-Generating Tax Considerations**

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While taxes are never far from the minds of successful business owners, tax considerations are particularly important during a merger or acquisition. In addition to careful tax planning, which is essential to minimizing a seller's tax profile, thorough understanding and crisp communication of a seller's portfolio of tax assets can generate value for the business owner. This article briefly touches on several of these potentially value-creating considerations, including net operating loss carryforwards, 338(h)(10) elections and miscellaneous local considerations.

Net Operating Loss Carryforwards (NOLs)

Under normal operating conditions, NOLs can be used to offset taxable income, reducing a business's tax outlays. Within the context of a transaction, NOLs can assume additional value. While the IRS limits the amount of taxable income a buyer can offset in any single year using purchased net operating loss carryforwards (intended to prevent NOL "trafficking"), the buyer can nonetheless extract value from this asset. The astute seller, having previously suffered the losses that gave rise to the NOL, thus may try to capture as much of that value as possible.

338(h)(10) Election

When selling an S Corporation in certain taxable transactions, the Internal Revenue Code allows a stock sale to be treated as an asset sale for tax purposes. From a legal standpoint, the transaction is treated as a stock purchase, limiting the seller's exposure to liabilities and facilitating easier transaction execution. From a tax standpoint, the transaction is treated as an asset purchase, enabling the buyer to step up its cost basis, and thus offset future earnings through higher deductions. If, however, the election results in ordinary income for the seller, which is taxable at a much higher rate than the current long-term capital gains rate produced by a traditional stock sale, then enticing the seller into making the 338(h)(10) election would likely require the buyer to share some of the future tax savings with the selling party.

Miscellaneous Local Considerations

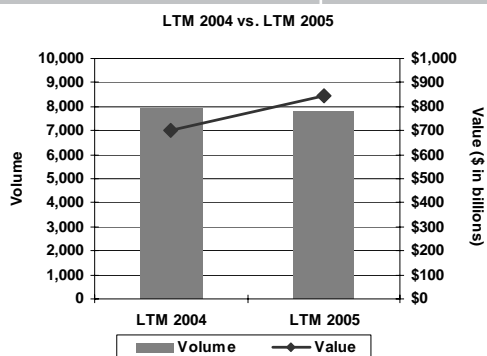
Depending upon location, the seller may enjoy tax benefits from economic development zones, industrial development revenue bonds or other government policies that could be transferred to a buyer. In the past, for instance, the Piper Jaffray Middle Market M&A Group has represented clients that received tax credits for operating manufacturing facilities in Puerto Rico and for employing Native Americans in Oklahoma. While it is not always possible to fully deliver or "monetize" these tax benefits in a transaction, the seller must be able to recognize and articulate the significance of these potential assets if it is to receive any value for them.

While there are other tax considerations in addition to those profiled above, including option tax benefit deductions and low tax basis of net assets, the central message remains the same: Before going to market, sellers must take stock of all their assets—fixed, intangible and, as highlighted herein, financial—and determine the best means to communicate their value to the marketplace.

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Domestic Transactions

(\$ in billions)	Value*	Volume
LTM: 2004	\$738.3	8,039
LTM: 2005	\$859.4	7,816



*Total value based on deals with reported values

Source: Thomson Financial Securities Data Corporation

LTM median deal value for 2005 is \$27.5 million compared to \$25.9 million for 2004.

LTM Transaction Multiples

By Size (\$ in millions)	EBIT	EBITDA
Less than \$25	10.5x	4.7x
\$25 to \$100	10.8x	10.3x
\$100 to \$250	9.9x	7.8x
\$250 to \$1,000	16.2x	10.0x
Over \$1,000	15.0x	10.2x

Current data as of August 29, 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	22.4%
4 weeks prior to announcement	28.1%

Current data as of August 29, 2005

Source: Thomson Financial Securities Data Corporation

Deal Financing

	Current	1 Year Ago
Leveraged Bank Loan	6.01%	4.89%
High Yield Bond Rate	7.54%	7.82%
Senior Debt/EBITDA*	4.7x	3.3x
Total Debt/EBITDA*	4.7x	4.3x

Current data as of August 26, 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	\$86.4	\$42.2	\$24.0
Deals Completed	\$92.6	\$136.5	\$94.8

Data as of August 4, 2005
Source: Buyouts

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(General and Deal Related Questions)

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