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M&A Monitor

Piper Jaffray M&A Monitor
Analyzing M&A Activity—September 20, 2006

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Feature Article

Simple Math Behind the Leveraged Buyout Market

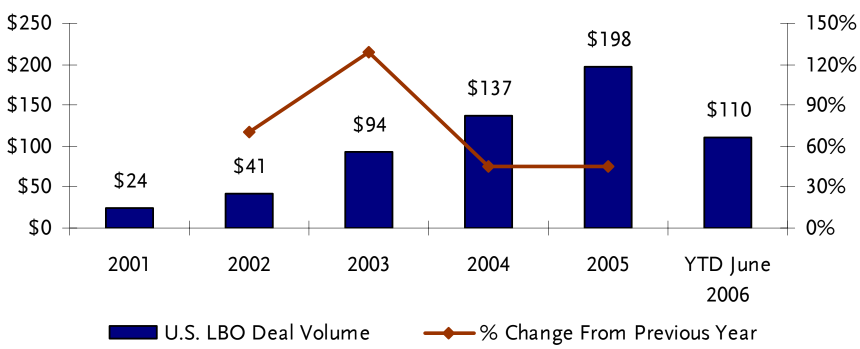
by Walter Murphy, 312 920-2147, walter.d.murphy@pjc.com

By almost any measure or source, deal statistics through the second quarter of 2006 point to another active year for M&A transactions. According to Thomson Financial Securities Data Corp., there were 8,935 domestic deals announced during the 12-month period ended Aug. 30, 2006, a 7.5% increase over the 8,313 transactions announced during the 12 months ended Aug. 30, 2005. The aggregate value of deals with reported pricing increased nearly 23% to $1.1 trillion for the 12 months through August 2006, as compared to $928 billion for the 12-month period ended August 2005. There are a number of tangible and anecdotal factors contributing to this trend, including strong business performance, a relatively positive economic environment, strategic buyers aggressively pursuing growth through acquisitions, financial sponsors with substantial untapped funds and a highly available debt market, among others.

Private equity firms have played a major role in the acceleration of both deal values and volume over the past few years. According to *Buyouts*, the total value of completed U.S. LBO transactions has increased substantially in each of the past four years, reaching $198 billion in 2005 after bottoming out at $24 billion in 2001. And with year-to-date activity through June topping $110 billion, 2006 is on pace to exceed last year's totals.

While many of the large sponsor deals, such as the pending buyouts of HCA, the GMAC financing unit of GM, Kinder Morgan and Univision, to name a few, have received significant press given their size, the market for small and mid-size private equity-backed transactions also remains very strong. Though individually these deals do not have the same empirical "move-the-needle" impact as the higher profile, multibillion dollar LBOs, middle market private equity transactions in the aggregate have been a major contributor to the increase in deal values over the past two years.

($ in billions)



Source: Buyouts

The recent increase in financial sponsor M&A has been driven in part by the significant overhang of capital that was raised in the late 1990s but not widely used as of early 2005 following the 2001 through 2003 downturn. Heading into 2005, an estimated $125 billion of committed private equity capital was available, and there was much publicity regarding the pressures to put this "dry powder" to work. To keep the math simple by assuming an average equity contribution of 33%, the $308 billion of LBO transactions effected from the beginning of 2005 through June 2006 would have required just over $100 billion of equity capital, leaving approximately $25 million of unused capital outstanding from the pre-2005 period.

Feature Article, Cont.

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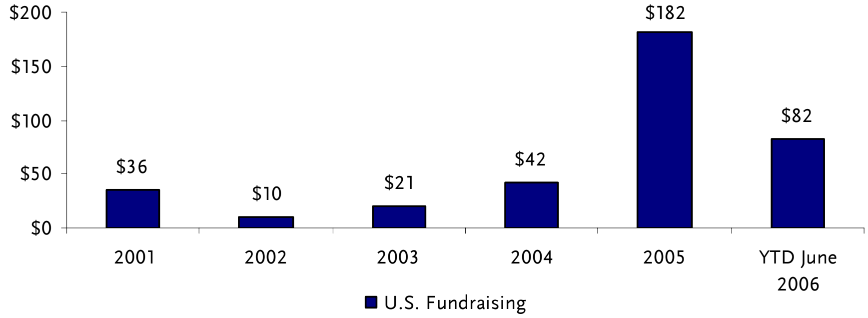
Though a significant amount of capital has been deployed in support of this recent LBO activity, recent record fundraising has again created a surplus of private equity money that needs to be expended. As indicated in the chart below, nearly $265 billion in new capital has been raised over the past 18 months, ranging from mega funds such as the $14.5 billion Blackstone Capital Partners V, the $10 billion Bain Capital IX and the $6.5 billion Madison Dearborn Capital Partners V, to more middle market-oriented firms, including Brockway Moran & Partners Fund III at $700 million, Sterling Investment Partners II at $545 million and Cortec IV at $410 million. Applying the same ratio assumptions from above (one-third equity and two-thirds debt) to the approximate $290 billion of equity capital (rounding $25 billion unused from pre-2005 plus $265 billion raised since 2005) currently available, there is a conservative estimate of $870 billion of purchasing power within the financial sponsors community today.

($ in billions)



Source: Buyouts

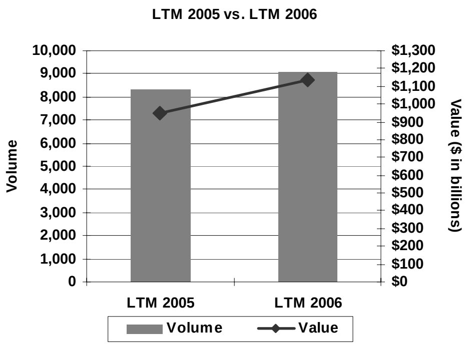
So what does this sizeable backlog of private equity capital mean for M&A over the next few years, assuming that the financing markets generally remain accommodating and accessible? If the estimated $290 billion of equity capital was deployed at roughly the same pace of transactions in 2005 (i.e., approximately $200 billion in aggregate value annually), and the average equity contribution was assumed at one-third of a typical capital structure, the current $870 billion in available equity and debt financing theoretically could support LBO M&A activity for more than the next four years, even without any new fundraising in the market. It is interesting to note that this timeframe is generally consistent with the private equity community's intent to put new money to work within the first three to four years of a fund's life.

Given the traditional cyclicality of the M&A market, one could question whether the current deal environment is sustainable over the coming years, particularly in light of the recent pace of activity, and, admittedly, there are likely valid challenges to certain of the fundamental assumptions in this simple mathematical exercise. However, we do believe that the observations and conclusions are directionally correct.

Considering the current availability of debt financing (both in terms of liquidity and leverage multiples), the substantial levels of idle capital today and anticipated private equity fundraising in the future, we expect the LBO market to continue to be active and aggressive over the next few years.

Domestic Transactions

($ in billions)	Value*	Volume
LTM: 2005	$945.9	8,336
LTM: 2006	$1,138.9	9,079



*Total value based on deals with reported values
Source: Thomson Financial Securities Data Corporation
LTM median deal value for 2006 is $33.3 million compared to $27.9 million for 2005.

LTM Transaction Multiples

By Size ($ in millions)	EBIT	EBITDA
Less than $25	8.9x	5.8x
$25 to $100	10.8x	6.8x
$100 to $250	13.9x	8.8x
$250 to $1,000	15.5x	7.4x
Over $1,000	14.3x	9.0x

Current data as of September 13, 2006
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	23.2%
4 weeks prior to announcement	25.7%

Current data as of September 13, 2006
Source: Thomson Financial Securities Data Corporation

Deal Financing

	Current	1 Year Ago
Leveraged Bank Loan	7.99%	5.92%
High Yield Bond Rate	8.21%	7.67%
Senior Debt/EBITDA*	4.2x	4.6x
Total Debt/EBITDA*	4.8x	4.7x

Current data as of September 14, 2006
Source: Portfolio Management Data, The Wall Street Journal and LCD Comps
*Represents leverage statistics for middle market LBOs (less than $50 million of EBITDA)

Buyout Fund Market

($ in billions)	2005	2004	2003
Funds Raised	$173.5	$42.2	$24.0
Deals Completed	$198.0	$136.5	$94.8

Data as of September 13, 2006
Source: Buyouts

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