

M&A Monitor

Piper Jaffray Middle Market Mergers & Acquisitions

M&A Monitor: Analyzing M&A Activity—November 9, 2005

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Feature Article**Deducting Versus Capitalizing Transaction Costs for Tax Purposes**by Matthew Sznewajs, matthew.m.sznewajs@pjc.com, 612 303-2030

Last year, changes in the law and regulations revised the ability to deduct certain fees and expenses associated with merger transactions. Treasury Regulation Section 1.263(a)-5 requires the capitalization of most amounts paid or incurred to “facilitate” the acquisition of a trade or business, a change in capital structure of a business entity, and certain other transactions, subject to certain tests as outlined in the regulation. According to Regulation 1.263(a)-5, an amount is considered paid to facilitate a transaction, as defined, if it is “paid in the process of investigating or otherwise pursuing the transaction.” However, the regulation further states that “the fact that amount would (or would not) have been paid but for the transaction is relevant, but is not determinative.”

While this regulatory change enumerates a more encompassing view of what should be capitalized versus what should be deductible relative to the prior regulation, it still provides an opportunity to deduct a portion of the transaction costs, including success-based M&A fees, if particular tests are met.

Regulation 1.263(a)-5 creates an exception for costs incurred prior to a specified “bright-line” date and that are not “inherently facilitative.” The bright-line date is the earliest of: (i) the date on which a letter of intent, exclusivity agreement, or similar written communication (other than a confidentiality agreement) is executed by the acquirer and target; (ii) the date on which the material terms of the transaction are agreed to by the taxpayer’s board of directors or similar governing body; or (iii) in the absence of (i) or (ii), the signing of a binding definitive agreement. “Inherently facilitative” costs, which are required to be capitalized, include costs for securing an appraisal, a formal written evaluation or a fairness opinion; structuring the transaction, preparing and reviewing transaction documents; obtaining regulatory approval; obtaining shareholder approval; and conveying property. Alternatively, acquisition costs that are: (a) incurred prior to the bright-line date and (b) that are not deemed “inherently facilitative” will generally be deductible. For example, legal and accounting due diligence fees incurred prior to the bright-line date would generally be deductible, but those incurred after the bright-line date would not. The regulation is specific with respect to integration costs. Integration and related costs are deductible regardless of when the integration activities take place because they do not facilitate the transaction.

For success-based costs, like a typical M&A fee, the regulation requires the taxpayer to maintain “sufficient documentation,” to establish that a portion of the fees are allocable to activities that do not facilitate the transaction. It is not clear what qualifies as “sufficient documentation” although it “must consist of more than merely an allocation between activities that facilitate the transaction and activities that do not facilitate the transaction.” The portion of the costs that occur prior to the bright-line date and do not facilitate the transaction, such as business planning and other due diligence activities, will generally be deductible.

We have provided a link to the IRS Regulation. (http://www.irs.gov/irb/2004-07_IRB/ar07.html)

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Feature Transaction

Piper Jaffray Advises Exopack Holding Corporation

by Doug Lawson, douglas.j.lawson@pic.com, 312 920-2139

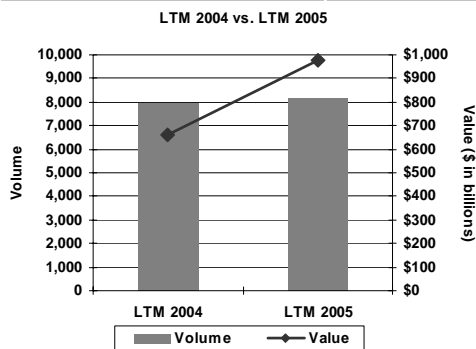
On October 13, 2005, Exopack Holding Corporation (“Exopack”) was acquired by an affiliate of Sun Capital Partners, Inc., a Boca Raton, Florida-based private equity firm. Exopack was previously a portfolio company of The Sterling Group, L.P., a Houston, Texas-based private equity firm. Terms of the deal were not disclosed.

Exopack is a market leading provider of paper and plastic flexible packaging solutions. Exopack has established the leading market presence in multiple substrates, earning a reputation for excellent levels of quality, reliability, innovation and customer support. Headquartered in Spartanburg, South Carolina, the company has seven plastic and seven paper production facilities, which enable it to effectively serve the diverse needs of a broad and attractive customer base. 2004 revenues were approximately \$510 million.

Piper Jaffray served as exclusive financial advisor to Exopack Holding Corporation and The Sterling Group, L.P.

Domestic Transactions

(\$ in billions)	Value*	Volume
LTM: 2004	\$662.4	7,943
LTM: 2005	\$978.0	8,183



*Total value based on deals with reported values
Source: Thomson Financial Securities Data Corporation
LTM median deal value for 2005 is \$30.0 million compared to \$27.6 million for 2004.

LTM Transaction Multiples

By Size (\$ in millions)	EBIT	EBITDA
Less than \$25	8.9x	5.8x
\$25 to \$100	10.8x	9.5x
\$100 to \$250	12.0x	7.1x
\$250 to \$1,000	15.7x	9.7x
Over \$1,000	14.8x	10.1x

Current data as of November 6, 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	22.7%
4 weeks prior to announcement	25.1%

Current data as of November 6, 2005

Source: Thomson Financial Securities Data Corporation

Deal Financing

	Current	1 Year Ago
Leveraged Bank Loan	6.00%	5.07%
High Yield Bond Rate	8.21%	6.94%
Senior Debt/EBITDA*	3.9x	3.2x
Total Debt/EBITDA*	4.5x	4.2x

Current data as of October 28, 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)

Buyout Fund Market

(\$ in billions)	2005	2004	2003
Funds Raised	\$109.1	\$42.2	\$24.0
Deals Completed	\$139.7	\$136.5	\$94.8

Data as of October 17, 2005

Source: Buyouts

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