M&A Monitor

Piper Jaffray Middle Market Mergers & Acquisitions
M&A Monitor: Analyzing M&A Activity—February 8, 2006

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Feature Article

Is There a Renewed Prospect of Going-Private Transactions?
by Robert Frost, robert.d.frost@pjc.com, 612 303-8248
Michael Kenworthy, michael.s.kenworthy@pjc.com, 612 303-6477

The plight of small-cap public companies has been much publicized and discussed in recent years. Beginning in the mid-1990s, the significant changes in the equity capital markets added not only a headwind to the challenges faced by small-cap companies, but they also appeared to suggest a "point of no return" in the lack of liquidity and the valuation gap that existed between small-caps and their larger brethren. From 1999 to 2001, Piper Jaffray released a series of reports highlighting this phenomenon entitled "Endangered Species" and the evidence was plentiful:

- Companies with smaller market caps were trading at a significant discount to larger companies, with the bottom two deciles of companies in the Russell 2000 offering a 25% discount to the median EBIT multiple of companies in the S&P 500 and nearly a 40% discount to the median P/E multiple on a trailing 12-month basis.
- Companies with market caps between $50 million and $250 million had approximately 1.7 analysts covering their stocks versus 8.2 analysts for companies with a market caps greater than $250 million.
- Many of the companies with market caps less than $250 million were trading less than 100,000 shares per day.

To put this in perspective, in 2001, there were approximately 8,426 U.S. public companies under $500 million in market capitalization. The vast majority of these companies suffered many or all of the challenges described above, notably little or no Wall Street research coverage and minimal trading liquidity in their stock. In fact, there were more than 2,600 public companies in 2001 that had no research coverage.

2001: Here Come the Going-Private Transactions! Or Not.
The conclusion seemed clear at the time: Here come the going-private transactions! So what happened? Not surprisingly, going-private transactions were not immune to the significant challenges experienced across the M&A market in 2001 and 2002 as the economy slowed and conditions in the leveraged finance markets were generally unsupportive. In fact, 2000 was a high-water mark in going-private M&A transactions with 190. Weaker financial performances, depressed stock prices, and internal operating challenges brought on by the tough economic conditions caused many boards of small-cap public companies to feel there was little incentive to seriously consider the alternative.

Historical Going-Private M&A Activity

($ in millions)	1998	1999	2000	2001	2002	2003	2004	2005
No. of 13E-3 Filings[1]	25	52	41	65	59	101	114	137
No. of M&A Transactions[2]	69	151	190	139	147	126	55	77

¹Source: Foley & Lardner LLC; Piper Jaffray; Data includes all companies that filed a Schedule 13E-3 filing in year stated.
²Source: SDC Platinum; Data encompasses all announced M&A transactions where a private company acquires a public company and, upon completion, will become a private company.

Because there is no single data source that provides a clear picture of activity where public companies were taken private in a change of control transaction, we have included two different sources of activity. The first is from a review of 13E-3 SEC filings (going-private filings) in any given year. The information is interesting but somewhat misleading because it fails to capture a sale of a public company where no affiliates (e.g., management) have a continuing equity stake yet does include instances such as a delisting as a result of a reverse stock split. The second source of information is from Securities Data Corporation and provides a more telling picture of going-private transactions involving a true change of control. The main limitation here is that it only includes transactions where the buyer is private and would therefore exclude situations where a public company buyer prevailed in an auction of a public company (even if it was initiated because of a desire to no longer be an independent public company).

Feature Article, Cont.

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2006: Here Come the Going-Private Transactions! Maybe?
At the risk of painting ourselves as the "Boys Who Cried Wolf," we again find ourselves drawing many of the same conclusions we did in 2001. So what has changed to suggest more going-private transactions are in front of us? Two counter-influencing factors have significantly impacted the equation for small-cap public companies. On the positive side for small-cap public companies, there has been a significant recovery of small-cap stock values, and the valuation gap between large-caps and small-caps has been largely closed. However, the burdens and costs of being a public company have been dramatically increased by the passage of the Sarbanes-Oxley legislation.

Small-Cap Stocks Outperform
Small-cap stocks have experienced a dramatic resurgence over the past five years. With weak performances from large-cap stocks, small-caps have become more favorable investments with better returns and stronger trading multiples. Here is what we have seen:

- Over the last one-, three- and five-year periods, companies in the Russell 2000 have offered average returns of 21%, 227% and 240%, respectively, compared to S&P 500 companies with average returns of 16%, 89% and 57%, respectively.
- The valuation gap that we saw five years ago between the bottom two deciles of companies in the Russell 2000 and the S&P 500 no longer exists, with the last two deciles in the Russell trading at only a 3% discount to the median EBIT multiple of S&P 500 companies and a 9% premium over the median P/E multiple.

Russell 2000 Decile	Mean Market Capitilization ($ mm)	Mean 1 Year Return	Mean 3 Year Return	Mean 5 Year Return	Median LTM P/E Ratio	Median EBIT Multiple	Median EBITDA Multiple	Average Daily Vol. (000s)
1	$2,413	54.6%	318.9%	249.4%	23.5x	13.8x	11.1x	988.0
2	1,425	36.6%	579.6%	160.4%	21.3x	13.4x	10.4x	630.4
3	1,139	31.9%	170.6%	189.1%	21.9x	13.9x	10.6x	461.8
4	907	23.5%	161.1%	160.5%	23.1x	13.5x	10.0x	465.4
5	727	24.1%	187.3%	178.4%	23.9x	13.5x	10.8x	434.0
6	593	18.2%	164.3%	342.7%	22.7x	14.5x	9.8x	330.4
7	452	19.9%	147.5%	219.1%	20.3x	12.9x	9.4x	303.9
8	357	14.8%	252.0%	137.4%	20.1x	12.6x	10.6x	202.3
9	278	4.2%	125.3%	610.7%	21.9x	12.7x	10.1x	176.1
10	179	(12.9%)	137.2%	156.6%	19.3x	12.9x	8.3x	223.6
Total Russell	**$847**	**21.4%**	**226.8%**	**239.7%**	**22.0x**	**13.4x**	**10.2x**	**421.6**
S&P 500	**$23,819**	**16.4%**	**89.4%**	**56.7%**	**19.5x**	**13.2x**	**10.2x**	**4,014.7**

Source: FactSet, Capital IQ

Despite the rebound in valuations, small-cap stocks continue to face the same capital market challenges:

- For companies with market caps between the $50 million and $250 million range, there are approximately 1.3 analysts covering each stock versus 7.7 analysts for companies with market caps of more than $250 million.
- Trading volumes are slightly higher, with the last three deciles trading an average 202,276, 176,092 and 223,599 shares, respectively, per day, but still significantly below the volume of S&P 500 companies, which trade an average of 4.0 million shares per day.

Sarbanes-Oxley Adds to the Pain of Being Public
The introduction of the Sarbanes-Oxley Act in 2002, and especially the more recent adoption of Section 404, which essentially makes managers liable for maintaining adequate internal control structures and procedures, has had a dramatic impact on the cost of being a public entity, particularly for small-caps. Not only have audit expenses soared, but increased costs related to decreased productivity, increased directors' fees due to greater management liability, and higher insurance premiums from increased litigation have further depressed operating incomes across the board. A recent survey by law firm Foley & Lardner LLC yielded the following results:

- Responses from 93 companies with revenues under $1 billion reported overall cost increases from 2001 to 2004 related to the adoption of SOX of $2.4 million from $1.1 million to $3.4 million, or 223%.
- For companies in the S&P 500 Small-Cap index, audit fees alone increased an average of 42% year-over-year from 2001 to 2004 compared to 36% for companies in the S&P 500.
- Directors' fees increased an average 46% from 2001 to 2004 for S&P Small-Cap companies versus 43% for S&P 500 companies.
- The cost of D&O insurance has risen dramatically with premiums growing approximately 25-40% for companies with healthy balance sheets and 300-400% for distressed companies.

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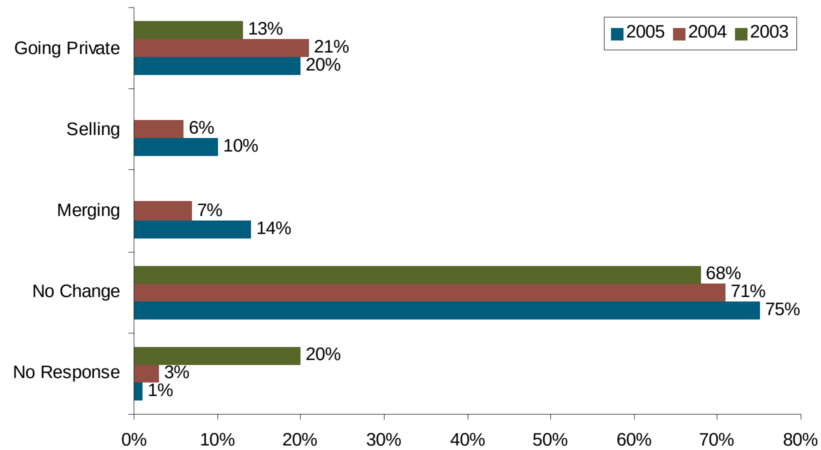
The costs related to SOX compliance have been significant for all public companies, but the small-caps have clearly felt the biggest impact on a relative basis. Equally significant has been the management time and focus required to implement and monitor the changes. Not surprisingly, Foley & Lardner's survey indicates a significant increase in the number of small-cap companies seriously considering a going-private or sale transaction.

In summary, it has become increasingly painful to be a public company. Despite the strong rebound in small-cap valuations, many management teams and boards are again questioning whether the benefits of being a public company justify the costs and the diversion of management's attention. For many small-cap companies with improved stock price performance, a significant premium may not be reliable in the M&A market. However, for many others, a premium is likely available and the current strength of the M&A market and leveraged lending market have created a very favorable environment for boards to evaluate this alternative. If the M&A market environment remains favorable, we expect a substantial increase in the number of going-private transactions in the next few years.

Survey Question: *As a result of the new corporate governance and public disclosure reforms implemented since the enactment of the Sarbanes-Oxley Act in 2002, is your company considering any of the following?*



Source: Foley & Lardner LLC

Feature Transaction

Piper Jaffray Advises WS Packaging Group, Inc.
by Andrew Schwartz, andrew.h.schwartz@pjc.com, 312 920-3273

On January 3, 2006, WS Packaging Group, Inc. ("WS Packaging" or the "Company"), a portfolio company of Brantley Partners and Mellon Ventures, was recapitalized by J.W. Childs Associates. WS Packaging, headquartered in Algoma, Wisconsin, is the leading provider of high-quality, innovative pressure sensitive labels and other complementary printing and packaging products. As one of the largest platforms within the highly fragmented label converter market, the Company serves customers in the food and beverage, health and beauty, household, promotional, direct response, pharmaceutical, industrial, commercial, medical and security markets. WS Packaging has led the consolidation in the label market over the past several years, acquiring eight companies since 2001. The Company maintains a network of production facilities located throughout the U.S.

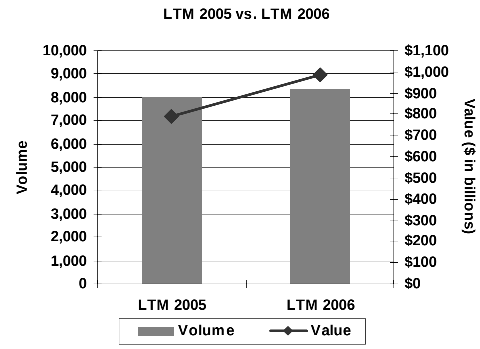
Brantley Partners, located in Beachwood, Ohio, invests in privately held companies in a variety of industries, including manufacturing, technology and services. Brantley partners with entrepreneurs and management teams committed to long-term growth and capitalizing on favorable industry trends. Brantley typically commits between $2 million and $10 million in majority, as well as non-controlling ownership positions, and can invest up to $20 million in any one company.

Mellon Ventures is a $1.4 billion private equity investment partnership affiliated with Mellon Financial Corporation. With professionals located in Atlanta, Los Angeles and Pittsburgh, Mellon Ventures invests across the entire private equity spectrum, from venture capital to long-term growth and buyouts.

Piper Jaffray served as financial advisor to WS Packaging Group, Inc., Brantley Partners and Mellon Ventures. Terms of the transaction were not disclosed.

Domestic Transactions

($ in billions)	Value*	Volume
LTM: 2005	$791.5	7,980
LTM: 2006	$985.0	8,342



*Total value based on deals with reported values
Source: Thomson Financial Securities Data Corporation
LTM median deal value for 2006 is $30.0 million compared to $28.0 million for 2005.

LTM Transaction Multiples

By Size ($ in millions)	EBIT	EBITDA
Less than $25	7.4x	4.1x
$25 to $100	10.1x	8.4x
$100 to $250	12.7x	7.1x
$250 to $1,000	16.5x	9.3x
Over $1,000	14.7x	10.1x

Current data as of February 6, 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	23.8%
4 weeks prior to announcement	25.4%

Current data as of February 6, 2006
Source: Thomson Financial Securities Data Corporation

Deal Financing

	Current	1 Year Ago
Leveraged Bank Loan	7.23%	5.17%
High Yield Bond Rate	8.07%	7.05%

Senior Debt/EBITDA*	4.4x	3.4x
Total Debt/EBITDA*	5.2x	4.6x

Current data as of February 6, 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 February 6, 2006
Source: Buyouts

Middle Market M&A Group Contacts
(General and Deal Related Questions)

Minneapolis

Glenn A. Gurtcheff
Co-Head of Middle Market M&A
612 303-5548
glenn.a.gurtcheff@pjc.com

John A. Hogan
Head of Financial Sponsors
612 303-6380
john.a.hogan@pjc.com

Michael R. Dillahunt
Managing Director
612 303-6337
michael.r.dillahunt@pjc.com

Robert D. Frost
Principal
612 303-8248
robert.d.frost@pjc.com

Daniel A. Efron
Vice President
612 303-6438
daniel.a.efron@pjc.com

Matthew M. Sznewajs
Vice President
612 303-2030
matthew.m.sznewajs@pjc.com

Chicago

Jeff A. Rosenkranz
Co-Head of Middle Market M&A
312 920-2133
jeff.a.rosenkranz@pjc.com

Douglas J. Lawson
Principal
312 920-2139
douglas.j.lawson@pjc.com

Walter D. Murphy
Principal
312 920-2147
walter.d.murphy@pjc.com

London

David I. Wilson
Chief Executive Officer
Piper Jaffray Ltd.
44 20 7743-8701
david.i.wilson@pjc.com

Matthew J. Flower
Principal
44 20 7743-8702
matthew.j.flower@pjc.com

James O. Steel
Vice President
44 20 7743-8705
james.o.steel@pjc.com

The M&A Monitor is published every two weeks by the Middle Market Mergers & Acquisitions Group within the Investment Banking Department at Piper Jaffray. To report any technical difficulties with this e-mail transmission, please contact Cindy Zebro at cynthia.k.zebro@pjc.com.
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