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To Our Clients:

A New Equity Capital Structure for Multinational Companies

The globalization of the financial markets has thus far been primarily limited to debt financing. Only a handful of companies have real multinational equity structures with direct equity access -- through shares regarded as "local" -- to the national markets in which such companies have principal business operations. This puts United States and United Kingdom companies, which keep their accounts in dollars or sterling and look to their home markets for equity capital, at a significant competitive disadvantage to their German and Japanese competitors. In addition to the lower cost of debt financing in Germany and Japan, equity investors in those countries seem content with approximately 10% compound annual returns, while those in the US and UK seek returns of more than 20% per annum. These disparities, along with the long-term outlook of investors in Germany and Japan versus the short-term outlook in the US and the UK, serve to constantly widen the gap in investment in research and development, plant modernization and marketing to the detriment of the US and UK. Together with the development of the European Economic Community, the huge amounts of equity capital available in the Far East, and the recognition by the United States of the need to ease access to its financial markets by non-United States issuers, the competitive

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disadvantage suffered by companies that finance in the US and UK equity markets requires that we rethink the equity structure of multinational companies.

A multinational equity structure could have a variety of significant benefits, including equalization of the cost of equity capital, a direct shareholder base in the principal national markets in which a company operates, a reduction in enterprise and shareholder tax burdens and the facilitation of future financing and corporate transactions, including acquisitions, by both the parent company and its overseas subsidiaries. Described below is a structure for facilitating direct access to the multiple equity markets in which multinational companies operate and for achieving tax and financing flexibility. A key element in designing such structures is to create equity interests trading in different jurisdictions that have substantially similar economic incidents, while not jeopardizing the financing, tax and other advantages of the local equity securities.

To illustrate what can be done, consider a multinational company based in the UK (UK Co) with substantial operations conducted through a subsidiary organized in the US (US Co). UK Co, which has outstanding ordinary shares primarily traded in the UK market, desires direct access to the US equity markets. Since it has substantial US sourced income, it also desires to have the ability to pay dividends in a tax efficient manner. To achieve these objectives, there would be a public

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offering in the United States of equity units. Each equity unit would consist of one preferred share in US Co and one share of a new class of ordinary shares in UK Co. The preferred shares of US Co and the new ordinary shares of UK Co would be "stapled" by their terms -- i.e., they would be required to be held and transferred together as units.

The equity units would be designed so that the holders have an economic interest in UK Co substantially similar to that of the holders of existing ordinary shares of UK Co. In particular, the holder of a unit would generally receive from US Co a dividend equal to the gross dividends (i.e., cash received plus advance corporation tax (ACT) credit) paid the holder of a share of existing ordinary shares of UK Co. In addition, through the new ordinary share included in the unit, the holder would be entitled to the same rights and interests, including voting rights, that are associated with the existing ordinary shares of UK Co.

To create the equity units, US Co and UK Co would each issue shares and the funds received for the units initially would be allocated between them; thereafter the funds could be used in any part of the consolidated enterprise. The shares issued by UK Co would be a new class of voting ordinary shares, which would be identical to the existing ordinary shares in all material respects except with respect to dividends and liquidation proceeds. With respect to dividends, the new class of ordinary shares would provide for a dividend equal to the

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dividend paid on the existing UK Co ordinary shares, less an amount equal to the dividend paid on the US Co preferred shares. The shares issued by US Co in most cases would be nonvoting participating preferred stock, carrying a relatively low fixed dividend but allowing for additional participating dividends to be declared by US Co. Thus, except with respect to the fixed preferred element of the US Co shares, there would be year-to-year flexibility to declare and pay dividends from either jurisdiction in order to maximize financing and tax benefits.

The dividends (both fixed and participating) paid on the US Co preferred shares contained in the equity units would not be subject to the 5% withholding tax which would otherwise be applicable to dividends paid by US Co to UK Co. Moreover, US corporate holders of equity units would be eligible for the dividends-received deduction on dividends paid from US Co. It is contemplated that for UK tax purposes, no ACT or withholding tax would be payable on dividends from US Co to the holders of the equity units. Although ACT paid is available as a credit against a UK corporation's mainstream UK tax liability, multinational corporations with significant overseas operations often do not have sufficient UK tax liability to utilize fully the ACT as a credit. Therefore if paying additional dividends from UK Co would otherwise generate excess ACT and the structure qualifies in the UK, the overall tax burden of the enterprise would be reduced by making dividend payments from US Co.

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Although the issuance of the units would subject UK Co and US Co to the US securities laws, compliance with such laws should generally not be burdensome. The offering of the units would require filing with the Securities and Exchange Commission a registration statement containing information regarding UK Co, on a consolidated basis, and US Co as a separate entity. UK Co would be required to file with the SEC periodic reports containing summarized financial and other information, but as a foreign corporation would not generally be required to comply with the SEC proxy rules. US Co would be required to comply with the SEC periodic reporting rules, but since the preferred shares would be nonvoting, not the SEC proxy rules. SEC filings by UK Co and US Co would be required to contain financial information either prepared in accordance with US GAAP or containing a reconciliation with US GAAP.

Stapled stock might complicate a hostile takeover bid for UK Co. Under the UK City Code on Takeovers and Mergers, a bidder would appear to be required to make offers for both classes of UK Co ordinary shares. Since the new ordinary shares would be stapled to the preferred shares, the required offer for the new class of ordinary shares would necessarily consist of an offer for the units. Since the units would be held in the US and would include preferred shares issued by US Co, the offer could be fully subject to US tender offer regulation, which is complex and not entirely consistent with the City Code. Thus, incidental to the benefits of access to the US equity market and

favorable tax treatment, the structure described above could complicate a hostile takeover of UK Co in that US takeover rules as well as UK takeover rules could be applicable. In addition, in the US it would not be unusual for the preferred shares of US Co to have provisions (protecting the economic interests of the holders of the equity units in the event of a takeover of UK Co) that could further complicate a hostile takeover. In this connection it should be noted that the SEC is presently considering issuing rules which would facilitate a takeover bid by a UK company for a UK company with a relatively small percentage of its shares held in the US.

The equity units would not create the conflict and fiduciary-duty-to-minority-shareholders problems sometimes associated with partially-owned subsidiaries. In contrast to common stockholders, the rights of preferred stockholders under US corporate law are contractual in nature and do not involve the imposition of fiduciary duties to the holders of the preferred stock. Moreover, the units of new ordinary shares and preferred shares would be designed so that the basic economic interests of the holders of units and the holders of existing UK Co ordinary shares would be identical in most circumstances. Thus, there should not be a conflict of interest between UK Co as the sole common stockholder of US Co and the unit holders as preferred stockholders of US Co.

Implementation of the structure described above, and the related question of preemptive rights, in all probability

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would in most cases require approval of a special resolution by the shareholders of UK Co. Such approval should not be difficult to obtain in light of the clear benefits of the structure to UK Co and its shareholders. While it is possible that a proposal to implement this structure would meet with some resistance from institutions on the basis of perceived antitakeover effects (which would be reduced substantially upon adoption by the SEC of the new facilitating rules for non-US tender offers it is now considering), the overall benefits of the structure are so manifest that even for institutional shareholders they should override the incidental antitakeover effects.

The structure described above is quite similar to the structure that was used to effect the 1989 merger of SmithKline and Beecham. However, the structure is available completely apart from a merger or acquisition. It can be accomplished through an offering of equity units in the US by a UK company with a substantial US subsidiary. Initially, a major UK company with a substantial US subsidiary might issue initially equity units consisting of a number of ordinary shares representing 5-10% of its ordinary share capital. UK Co would not be limited to one such offering, but could access the US market with additional equity units whenever the circumstances dictate (subject only to the caveat, that for US tax purposes, no more than 50% of UK Co shares can be stapled).

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It is recognized that a discount has applied to the market price of the US SmithKline Beecham ordinary shares as compared to the market price of the same UK shares. This is attributable to the US shares having been issued in a merger to all SmithKline shareholders, many of whom were not interested in holding those securities. Therefore, the new US SmithKline Beecham shares have been subjected to the special selling pressure that follows almost every US merger until the shares issued in the merger ultimately come to rest in the hands of investors who desire to purchase them rather than those who had no choice but to acquire them as an incident of the merger. This merger discount would not apply to shares effectively marketed for cash to investors who make an investment decision to purchase those shares. Even for stapled stock issued in a merger, this discount pending full distribution to investors interested in holding for the long term will narrow as the various markets become accustomed to these securities as a result of more companies making use of this type of financing.

While this illustration considers a company based in the UK that has a subsidiary in the US, the principles described may be applicable in other jurisdictions or combinations of jurisdictions where the tax and corporate laws are similar to those in the US. Also, it may be possible to reorganize the existing subsidiary structure of a company to utilize this approach by, for example, setting up an intermediate holding company in a jurisdiction with favorable tax and corporate laws.

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The stapled stock structure is useful to multinational companies in a number of different situations. Each situation must be carefully analyzed from a tax, corporate law, securities regulation, financing and investor relations standpoint in order to adapt the structure to the particular company. While the structure will not by itself equalize the costs of equity capital and the expectations of equity investors among the capital markets of the world, it provides a substantial start in that direction. As the equity securities of companies become known and easily tradable in markets other than their home market, disparities in valuation will narrow and the competitive disadvantages suffered by US and UK companies will be reduced. As these benefits are realized and countries recognize the benefits, the laws of the principal financial markets will be changed to facilitate true globalization and the concomitant equalization of the cost of equity capital. It is only with such equalization that we can have truly global markets.

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