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To Our Clients:

Have We Seen the End of Takeovers?

The past year has witnessed,

(1) the collapse of the junk bond market and the demise of the related bridge loan activity;

(2) the disappearance of bank financing for highly leveraged transactions and in recent weeks the virtual cessation of all bank financing;

(3) the need to restructure many of the highly leveraged deals of the 1980's;

(4) malaise among the dealmakers, with a sharp reduction in personnel by many investment and commercial banks;

(5) growing concern that the economy is heading into a deep and longlasting recession;

(6) unwillingness to undertake major risks pending resolution of the Gulf crisis;

(7) huge losses by arbitrageurs and the withdrawal of many from the market;

(8) in reaction to the bad experiences of the 1980's, reluctance by directors to approve acquisitions without extensive due diligence;

(9) acceptance of the just say no defense which has forced raiders to combine tender offers with proxy fights; and

(10) retreat to the sidelines by the corporate raiders and LBO sponsors.

These factors have resulted in a sharp reduction -- over 50% -- in merger activity generally and the virtual disappearance of hostile tender offers.

Is this a permanent condition? Before concluding that we have seen the end of takeovers, one should consider,

(1) as both the stock market and the dollar decline, American companies are cheaper and cheaper for foreign acquirors;

(2) for those acquirors, domestic or foreign, with money and a strategic objective, the absence of takeover financing limits greatly the likelihood of a takeover bid developing into a competitive situation;

(3) many of the investment partnerships formed during the 1980's and the corporate raiders have funds available for acquisitions -- some estimates run as high as $25 billion;

(4) institutional investors own more than a majority of the shares of most major companies and they continue to promote and facilitate takeovers;

(5) depressed stock market prices and the proxy resolution activity of institutional investors erode the confidence of management and directors and make them less willing to defend aggressively against a hostile takeover;

(6) the need for strategic combinations to enhance the ability to compete in global markets continues and at very depressed market prices concerns about due diligence are overcome by the "opportunity";

(7) the 1973-74 and 1981-82 recessions were followed by significant asset inflation which may lead many to conclude that inflation will follow the current recession and induce aggressive asset acquisitions in anticipation; and

(8) there continue to be significant tax and accounting advantages to acquisition rather than greenfield investment.

One is led to believe that there has been a long-term fundamental change in takeover activity and it will be a generation or more before conditions would be ripe for the return of 1980's level of activity. Further it is unlikely that the decline in takeover activity will be interrupted until the Gulf crisis is resolved. If a deep and longlasting recession is avoided, following the resolution of the Gulf situation there is a high probability of a return of takeover activity -- not to the level of the 1980's but to a level where it again constitutes a threat to the independence of many major companies. In the interim the increased level of proxy fights experienced during the past year will continue.

At this time we are in an important window period. There is an opportunity now to accomplish old fashioned strategic common stock mergers with little danger of the merger being broken up by a competing bid. This is also a period when it would be advisable to reexamine takeover defenses to bring them up to state-of-the-art.

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