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To Our Clients:

Takeover Fire Drills

During the junk-bond, highly-leveraged, bust-up takeover era of the 1980s we recommended, and found highly effective, fire drills to determine how a raider would value, finance and attack a company. These fire drills enabled a significant number of companies to recognize their vulnerabilities and take action to deal with them. These fire drills also enabled companies that decided to negotiate a sale to get substantially higher prices than otherwise would have been obtained.

During the 1990s, with the decline in takeover activity, many companies have stopped conducting fire drills. This is a serious mistake. Today, in a period of strategic acquisitions and with a revival of hostile takeover activity, fire drills are even more important than they were in the 1980s. This is particularly applicable today when institutional investor activism makes feasible hostile stock deals of unlimited size.

The fire drill today should focus on two areas:

- (1) identification of companies that would view the target, or a division of the target, as a strategic imperative, and
- (2) restructuring alternatives to increase the market value of the target's stock.

Analyzing potential strategic acquirors enables a target to determine what the pooling and purchase accounting pro formas would look like for each and assess the feasibility of takeover bids at specific price levels. This also enables the target to assess defensive actions such as antitrust issues and devices that make pooling impossible; actions that may be possible only if taken before a bid is made for the target.

Analyzing restructuring alternatives enables a target to take action to increase market value now or to be in a position to effect a restructuring to meet a takeover bid. Again, advance preparation is usually essential to successful implementation.

Fire drills are best conducted by a team of the company's key officers, its investment banker and its counsel. We think they are of critical importance for companies that wish to retain their independence and meet their long-term goals.

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