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MERGER AND TAKEOVER UPDATE

Merger and takeover activity continues at a fevered pace. The following is a brief current review of the many factors affecting merger and takeover activity:

Accounting. Pooling continues to be available, although under increasing pressure from the FASB and the SEC. In many cases, particularly with large strategic acquisitions, the market has been as receptive to purchase accounting, combined with a large stock repurchase program, as it is to pooling. In some cases where pooling is not available the market has been receptive to valuation based on cash flow instead of book earnings.

Antitrust enforcement, notwithstanding Staples/Office Depot and the differentiated product theory in vogue at the FTC, has not changed significantly. FTC and DOJ continue to recognize that markets are now global and have been willing to work out divestitures and licensing to solve problems, although the FTC is more frequently insisting on parties finding a buyer or licensee prior to consummating the merger.

Arbitrageurs do not today have the capital they had in the 1980s, but in the last few years they have been supplemented by hedge funds so that the aggregate capital available for arbitrage is greater today than it was in the 1980s. Arbitrageurs and hedge funds suffered significant losses as a result of the decrease in the price being paid for MCI by British Telcom and it is not clear whether this will have an impact on arbitrage activity.

Currencies impact is not clear. Worldwide cross-border mergers have increased dramatically. However, acquisition of U.S. companies by non-U.S. companies has not expanded at the same rate. It would seem that domestic economic factors have had more of an effect on Japanese and German companies' interest in U.S. acquisitions than the significant increase in the dollar in relation to the yen and mark.

Efficiency gains from reducing excess capacity in the defense, banking, utility, healthcare, paper, transportation, and natural resource industries account for the major part of current merger activity. Unlike the conglomerate merger wave of the 1960's and the highly-leveraged bust-up wave of the 1980's, much current merger activity is soundly based and appears to be having a positive effect on the economy.

Financing for acquisitions is readily available, with the banks competing to arrange multi-billion dollar loans on short notice. The debt markets are providing both liquidity at size and favorable rates. LBO and investment funds are awash with cash and actively seeking and bidding for deals.

Institutional investors and other activist shareholders have had considerable success in urging (in some cases forcing) companies to restructure or seek a merger. Shareholder pressure and the enhanced ability of shareholders to communicate among themselves and to pressure management and boards has had a significant impact on the willingness of companies to merge or restructure.

Joint venture activity continues to grow, with major consolidations of refining and marketing operations of oil and gas companies for the purpose of reducing costs by eliminating overcapacity.

Legislation. Apart from the elimination of the Morris Trust merger, no new legislation with deal impact appears to be imminent.

Litigation has not had a meaningful impact on deals. The courts are less receptive to acquisition transaction strike suits. The general acceptance by courts of the "just say no" defense has also not had a meaningful impact on hostile tender offers in light of the success of the tactic of combining a tender offer with a proxy fight. The pending suit by Hilton to enjoin ITT from spinning off most of its assets in order to defeat Hilton's proxy fight to replace the ITT board to enable Hilton to proceed with its takeover presents an interesting issue that has attracted the attention of the investor community, which strongly supports Hilton.

Major companies are increasingly willing to make hostile bids to accomplish a strategic objective like IBM for Lotus and Johnson & Johnson for Cordis or to prevent a competitor from gaining an advantage like Norfolk Southern's bid to break up the CSX-Conrail merger.

Poison pills continue to be the most effective defense against a hostile takeover. They have been proven not to adversely affect market value when adopted and to significantly enhance the ability of boards of directors to either "just say no" or to get the best price. Institutional investor opposition to the pill and successful proxy resolution attacks, such as the Fleming and Harrahs situations, have given new life to pill opponents. On balance the pill continues alive and well.

Real estate merger activity has increased substantially. The ongoing shift from private financing to public financing in the commercial real estate markets which is evidenced by the marked growth in the public REIT industry has brought with it pressure to consolidate and make more liquid the ownership of commercial real estate. Existing public REITs are seeking to grow through acquisitions in order to increase stock liquidity and access to capital, while at the same time pension funds, insurance companies and other private investors are seeking to swap their properties for more liquid stock in publicly traded REITs.

Regulation (deregulation) has had a very significant impact. Examples are interstate banking and the relaxation of restrictions on banks engaging in the investment banking business. Healthcare and utilities are other areas that have also seen a great increase in acquisitions as a result of changing regulations.

Stock market volatility has not had a discernible impact on acquisitions. The market remains very receptive to synergy stories. A key factor in major mergers is the analyst conference immediately after the announcement and the follow-through road show.

Taxes. The amendment (retroactive to April 16, 1997) to the tax law to kill the Morris Trust spin-off-merger transaction has eliminated new Morris Trust deals. In addition, there is a congressional study of tax-free spin-offs in general and the possibility of legislation in this area as well.

Technology. Rapid changes in technology have sparked an increasing number of mergers. Again banking is a cogent example. Also the inflated stock prices of high-tech companies have given them an acquisition currency that the market has been willing to accept at face value. There continues to be increasing merger activity among high-tech companies.

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