FEDERAL TRADE COMMISSION

A ROUNDTABLE SPONSORED BY THE BUREAU OF ECONOMICS
UNDERSTANDING MERGERS:
STRATEGY & PLANNING, IMPLEMENTATION AND OUTCOMES

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FEDERAL TRADE COMMISSION
I N D E X

(PANEL 3 EXCERPT)

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Monday, December 9, 2002

AFTERNOON SESSION
(2:05 p.m.)

PANEL 3
DOING, IMPLEMENTING, AND FOLLOWING THE DEAL – "INSIDER" VIEWS

MR. SCHEFFMAN: This is really an extraordinary session we're going to have now. We have seven prominent business people who are actually involved in mergers and acquisitions, to talk about the issues involved in doing M&A, chaired by Professor Joe Bower of the Harvard Business School. Joe is the Donald K. David Professor of Business Administration at the Harvard Business School, a long time professor at the Harvard Business School, and among my favorite case writers at the Harvard Business School. Those of you who know the literature know that in the last few years he has written some very interesting articles about M&A. He's going to chair this panel, so I'll turn it over to him.

MR. BOWER: Thank you, David. It is a great pleasure to be here and particularly to chair this panel.

To begin, I want take a moment to introduce a managerial framework for considering mergers. Because in this session we're not talking about public policy, we're not talking about patterns, we're talking about the problem of M&A, mergers and acquisitions, from the perspective of the managers.

And in practice, M&A is a make or buy decision. In principle you could almost always develop organically the business that you are buying. You can look at this three kinds of ways, as seen in the slide on the bottom of p. 1 of my handout. First, there are variations in what management is trying to accomplish. Second, the M&A process, itself, is spread out over time and there are variations in the process. And third, there's the process of implementation itself, which can vary extraordinarily. We heard just a sense of that when Pankaj Ghemawhat talked about Cemex looking at the process of acquisitions in the cement industry one way, Holder Bank looking at it a totally different way. Both could be successful.

A group of us at Harvard Business School were trying to understand this complex set of issues. As a way of sorting things out, we identified seven major strategic objectives that lead to M&A -- sometimes a given deal may involve more than one objective. I will take a few moments to present these seven objectives, which are shown in the two slides on p. 2 of my handout.

One is simply reducing industry over-capacity. When Chemical Bank merged with Chase, both the company and the financial markets estimated that savings from reduction of excess capacity were worth $7 billion and it showed up the day after the announcement. It was basically a New York City bank acquiring another New York City bank. They understood each other's businesses, they had a pretty grown-up management and they were involved primarily in rationalization.

In some of these deals, not this one, there is the hope that you can use larger market share to strengthen pricing. My impression -- I've been studying this since the early '80s -- is that almost never happens, that while this is something that regulators are frightened of, that we are in a period of hyper-competition in most industries and much as companies would like to get pricing power, they've been unable to do it. It's remarkable.

A second kind of deal is the roll-up of a fragmented industry, and here the example I use is Bank One in the 1980s. They picked up what was happening in deregulation and began to build a national bank. Roll-ups like Bank One involve expanding geographically in an industry where there's local delivery. There is saving through shared overhead, and improvement in products and service. Some of these have been quite successful. A third category is the product or market extension. So, Quaker thought it would buy Snapple. They had Gatorade, why not add Snapple? I'll come back to that. And what that really is is a product line extension or sometimes entering other countries' markets.

A fourth case is where a company is using M&A as a substitute for R&D. They're buying a product or a process technology that they need but cannot develop themselves, or cannot develop fast enough. Microsoft bought Vermeer, that gave them immediately front page capability in their web browser. We'll hear more about that today from one of our panelists, I suspect.

Sometimes there's a thought of building a new industry. When Viacom, which was at that time primarily in cable television and primarily cable television content, bought the Paramount Studios, they were, in effect, trying to create a new industry -- branded content. It was a bet that there were strategic benefits to be gained from integration across industries. Each attempt at industry convergence is different and pulling it off is a different kind of challenge.

Then there are the investor buy-outs. Here what you have are people with significant financial skills betting that value can be created with new, private, leveraged ownership. That's still another kind of operation.

And finally, there's what I call bluefish. Some of you have had the pleasure of standing in the surf when the bluefish are running. The amazing thing is that when they are running, they will bite at anything. So, you have a lot of fun fishing, but they're liable to also bite your feet, they'll bite anything, and that's what seems to happen during the merger frenzy. There are a lot of deals done that are explained as one of the other six, but when you really go look at them, it's bluefish.

(LAUGHTER)

MR. BOWER: Now, what I did was look at all the M&A in the United States in a three year period that was bigger than $500 million and try to sort it out by motive, leaving out bluefish. In order to know whether you're dealing with bluefish, you have to get inside and actually look at the plans or the absence of plans. You can't find that out from public data. What you see from the slide on the top of p. 3 of my handout is that most of the deals were product line extensions or consolidation. Then there were roll-up and investor deals, the latter of which accounted for about 13 percent of the deals, and then you have a very small bit of M&A as R&D and a small bit of industry convergence.

Now, what difference does it make? For managements the work is totally different depending upon what the objective is. To understand these differences we found it useful to think of companies not just the way economists do, as just resources, but as resources, processes and values. As seen in the slide on the bottom of p. 3 of my handout, the resources are the assets, they're both tangible and intangible. Processes are the way companies convert those assets into goods and services, and values are the way employees think about what they do and why. And they shape priorities and decision-making.

Now, it's relatively easy to assess and rationalize assets. Companies have become pretty good at this. It's very hard to assess processes or to change them. And it can be even harder to see the depth with which values are held and whether they are subject to change. Just think of the world we're living in -- the centrality of political and religious values. The same forces operate in companies.

Whatever the strategic objective, M&A itself is a business process, as seen in the slide on the top of p. 4 of my handout. Managements have to learn how to do it well. Some do it very well. The initial piece of the process is targeting: assessing the resources, the processes and the values. Then there's doing the deal: negotiating, getting the price right, and getting to the closing. Lastly is the integrating process discussed this morning. Integrating involves rationalizing the resources. That's not always as easy as it may seem because there may be debates as to which plant is really the most efficient. Integrating also involves imposing or modifying processes. That may be just brutal. Then there is the question of values.

Everyone knows about Quaker’s acquisition of Snapple, that it was such a disaster. Basically, the problem with integration was that the companies used two different processes to do business. Quaker brought big, big trucks to the back door of a supermarket, a lot like Procter & Gamble, and they stock the shelves. Snapple had small trucks going to the front door of mom and pop convenience stores, totally different. They also had totally different advertising, and basically Quaker could not manage Snapple.

Implementation is also affected by the price of a deal, as shown in the slide on the bottom of p. 4 of my handout. If the price is too high, then even if efficiencies are realized, the deal may destroy shareholder value. Or, as I mentioned, those efficiencies may be lost through price competition. But a high price may have a more destructive affect. Sometimes it forces companies to try to realize benefits very, very quickly, in a situation where the integrating process requires more time. Moving too fast can wreck the implementation process.

Still another aspect of the process is how the deal is financed. Someone might want to study carefully the relationship you can see in the slide on the top of p. 5 of my handout. What we've got here is high-yield bonds and bankruptcy assets, and it turns out that the improper financing of mergers is the leading cause of bankruptcy. What you can see is that the high yield bond issues seem to be a leading indicator of bankruptcy. The high yields peak here in the '80s and then you get the bankruptcies. Someone should do that study.

Research on implementation shows that there are two dimensions to success, the level of completion of the human integration and the level of completion of the task. This is shown in the slide on the bottom of p. 5 of my handout. The problem with speed is if you move too fast to get to task integration, it may lead to a failed acquisition because the human integration never gets done. So, the success seems to me to take both.

Now, as seen in the slide on the top of p. 6 of my handout, that two by two matrix on the previous slide is just based on a longitudinal study of nine companies, major deals over time, and it was quite striking. So, the basic finding is that value creation requires both.

Now, what we're going to do in the panel discussion is to essentially structure our discussion along the process of a deal. As seen in the slide on the bottom of p. 6 of my handout, we're going to start by talking about targeting and then we're going to talk about doing the deal, then about implementation. In the process, I think we will be drawing lessons. In the back of our minds will be what Dave Scheffman and Paul Pautler have called the cosmic question, which is what are the implications of all of this for antitrust.

Now, the panelists are really quite remarkable because they are both very experienced and accomplished, and interestingly, the work they've done covers the whole spectrum of deals that I laid out.

Peter Brodsky is a partner of Hicks, Muse, and they are investors that have a remarkable record of successful buyouts.

Bill Earnest, sitting next to him, is the General Manager of Corporate Planning and Strategic Transactions at ConocoPhillips. He's been involved with Conoco through its life as Continental Oil, Conoco, DuPont, and then ConocoPhillips, -- a whole set of deals involving consolidations, a remarkably interesting experience.

Juan Pedro Hernandez is Vice President and

Treasurer of Procter & Gamble and has started out in Spain, then Brussels, Cincinnati, back to Europe -- and now back in Cincinnati with a wealth of experience around the transactions of P&G – product and market extensions.

Robert Ingram is currently the Chief Operating Officer of GlaxoSmithKline, but at various points in time was the Chairman and Chief Executive of Glaxo. Therefore, he is well-positioned to talk to us about the mega mergers in pharma.

Michael Jones is Business Development Leader for GE Medical Systems, which has had a really remarkable record of growth inside the GE organization.

John Mayfield is Group Controller, Construction Products and Finishing Systems Group of the Illinois Tool Works. Some of you may not know Illinois Tool Works, but it is one of the stronger, more profitable, heartland industrial organizations in the country, and they have done hundreds of deals in a product and geographic roll-up.

Finally, Dan Scheinman is the Chief Strategy Officer of Cisco, which has a remarkable record of doing deals in the high tech end of things, where much of the M&A is a substitute for R&D.

So, this panel really covers the range of deals as they are done in the United States. They represent really great companies. It is my great pleasure to work with them. We're headed into a very interesting afternoon.

Once gain, we will begin by considering the front end of the M&A process. Juan, do you want to get us started?

MR. HERNANDEZ: That's fine. Good afternoon.

The agenda for this afternoon is going to be pretty straightforward, as seen in the slide on the bottom of the first page of my handout. What I want to do is to share with you the mergers and acquisitions program, process and planning at Procter & Gamble. I will share, afterwards, some examples about how P&G approaches M&A, mergers and acquisitions, as a way to build shareholder value. Obviously, we are going to have plenty of time for questions and answers in each of the portions of the panel.

Our M&A process is only understood if contextualized within the Procter & Gamble statement of purpose, shown in the slide on the top of page 2 of my handout. Our M&A program flows from here. We are a consumer-centric company. Consumers drive everything we do in Procter & Gamble. And innovation becomes our lifeblood and our mantra in the company.

We are in the branding business and we believe in science and consumer understanding as a way to create sustainable shareholder value. Our business model is very simple. When consumers choose our products, when customers display our products at the right place and when our pricing is competitive, our shareholders win, our consumers win and our customers win.

This is, again, to emphasize simply how linked our

M&A program is to the corporate strategies.

We think about planning very holistically throughout our M&A process. So, it is present at all stages of the acquisition process. As seen in the slide on the top of page 3 of my handout, I have broken this down into eight elements. I'm going to very briefly cover six of them. Transition and integration will be further discussed by other panel members later on.

But I want to emphasize, specifically, that our strategic planning process determines portfolio needs and identifies targets that could eventually fit with the business.

In our company, we are organized on a number of operating units: fabric and home care, beauty and health care, snacks and beverages, and paper. As shown in the slide on the bottom of page 3 of my handout, those business units develop business strategies and set the long and medium term goals. The business units M&A program flows from those strategic choices. The screening, the targeting starts at the business unit level. Obviously, we prioritize at the Corporate/CEO level -- based on our where to play and how to win corporate choices.

That leads me to the target selection stage, as shown in the slide on the top of page 4 of my handout. Target selection needs to leverage on P&G core competencies. Branding, innovation and scale/efficiencies are derived from the growth of our equities; our technology and consumer understanding across different business units; and the scale from our materials procurement, manufacturing, engineering, and go-to-market capabilities. We are able to go to market with a $40 billion plus portfolio of businesses. So, we can use co-marketing and co-promotional efforts across brands and business units.

Our M&A target selections need to fit with Procter & Gamble's growth strategy and core competencies. Our declared intention is to make our company more beauty care-like, more personal health care-like. Those categories have favorable demographics, are faster-growing businesses, higher margin, and more efficient businesses from an asset utilization standpoint.

As shown in the slide on the bottom of page 4 of my handout, planning requires a great deal of analysis to understand the current business model of the target, its sustainability, its current performance and its future potential if combined with our business. It requires the clear identification of where, how and when value is created. M&A creates value essentially through revenue efficiencies and/or by lowering costs throughout the value chain: that is, in sales and distribution, manufacturing, materials and media procurement, product development et cetera.

At this stage, our analysis focuses on the identification of value creation, which in turn helps us to start defining our walk-away price range. This is critical when it comes to the success or failure of the M&A program. Discipline in pricing, obviously, needs to be present at every different stage of the M&A process: at the offering memorandum stage, at the due diligence process, and at the actual negotiation of the terms.

The next item is due diligence, and again, you need to plan well in advance for it. As shown in the slide on the top of page 5 of my handout, you need to have the right team and the right objectives properly identified. You need to make sure that eventually the right individuals are going to be freed up and you need to make sure that there is business ownership through the entire M&A process from planning to integration. You ideally want due diligence to be led by those who are going to ultimately own the results of the business.

Transition and integration are shown in the slide on the bottom of page 5 of my handout. I've already defined these as part of the planning process. It reinforces, again, the comment that I have made before, i.e. the need to think about M&A planning as a continuum of the different stages through the actual integration.

I first want to share a few learnings regarding transition and integration from our M&A activity. Those learnings have consistent themes: First, never take your eye off the ball relative to meeting consumer and customer needs. Competition, will welcome you! Your competitor will take advantage of the distraction associated with the transition period to hurt the acquired business.

Second, the need to properly explain your transaction to the investment community, your shareholders, and to the credit rating agencies. This is a critical element that needs to be thought through, again, at the very earliest stages of any M&A process. It forces you to articulate the transaction, consistent with the strategies and goals that are supposedly well understood by your investors.

Third, the importance of identifying and addressing transition issues. We have found that very basic things are often overlooked during the transition periods, simple things without which we cannot operate efficiently. For example, systems, and specifically, systems compatibility is an issue that needs to be addressed upfront. You cannot wait until you have closed a deal to start addressing basic capabilities like an Order, Shipping, Billing system.

Finally, fourth is the identification of the capabilities and human talent from the acquired asset. Keeping the talent, keeping the capabilities increases the chances for an acquisition to be successful.

I have already talked about most of the items in the slide on the top of page 6 of my handout. The more our M&A program is linked to our strategy and the better it leverages on the company’s core competencies, the greater the chances are for value creation maximization.

Consequently, our success rate is highly a function of the clarity of our strategic choices and the fit with our core competencies.

Conversely, when you cannot leverage on those core competencies, where the strategic rationale is unclear, the chances for failure increase.

To sum up, our business model is very simple; it is not rocket science. We develop and nurture equities that are relevant for consumers. We believe in innovation, and in products that make the lives of consumers better and more delightful. We price these products competitively and we have a cost structure and capital structure that supports our consumer proposition while providing appropriate returns to our shareholders.

When we operate within these parameters, our company does well: we deliver good returns and we generate healthy cash levels. Our free cash flow, before dividends, last year was $6.1 billion. Our acquisition program is obviously one of the key uses of cash. We give back 40 percent of our profits to our shareholders via dividends, and we have a strong share buyback program as well. Our use of cash is completed with our strategic acquisition program.

I want to refer to three examples where we believe we have been successful with our M&A program, and I'm going to defer today reference to those where we have not been that successful. Richardson-Vicks Inc. is one of our big successes. It probably is the most successful acquisition that Procter & Gamble has done in its 165-year history. I'm talking about an acquisition, in 1986, that was transformational for Procter & Gamble because we were not participants of the personal care business other than with bar soaps.

RVI was a terrific acquisition for P&G, not only because it transformed our company, but, as seen in the slide on the top of page 7 of my handout, it gave us global beauty care infrastructure, access to skin and conditioning technology, and great equities like Olay and Pantene that today have revenues of more than $1 billion each. Olay and Pantene are great equities that have developed into global brands over time.

In addition to acquiring these equities, we captured efficiencies across the businesses value chain. At the plant, our shampoo surfactant technology is derived from the laundry manufacturing process. RVI has delivered not only a great value to shareholders, but through our technology we’ve brought forward real science to consumers. Consumers can get Olay Daily Facials and Olay Total Effects at one-half of the price and better efficacy then they could get in other competitive products in department stores.

The second example, shown in the slide on the bottom of page 7 of my handout, is Iams. It is obviously a different profile of acquisition, which will benefit greatly from the technology platforms that we have developed in Procter & Gamble from Dental Care, in particular. We are currently selling a tartar control technology for dogs that is delivered through food. So, our product is making pets live longer and healthier.

With this acquisition, we acquired two great equities, Eukanuba and Iams. And we got access to specialty channels.

Through our go-to-market capabilities, we expanded Iams to food, drug, and mass retailers, so consumers can buy this brand anywhere they do their shopping. Revenue synergy is what drives the value in the Iams acquisition. We are now launching the product internationally, in the U.K., Japan, and some other places in the world.

The last example that I want to mention is Spinbrush. It's shown in the slide on the top of page 8 of my handout. Spinbrush is a battery-operated toothbrush. It is a very simple, low cost and ingenious technology developed by toy manufacturers in Cleveland. The product delivers better performance than manual toothbrushes as it addresses one of the problems that we consumers have in brushing our teeth: we don't brush them long enough. So, the end result is not the desired result. Spinbrush is marketed under the Crest brand name and is a great success. It is more than a quarter of a billion dollar brand here in the U.S. alone, and keeps growing. It has driven huge category revenue growth by offering consumers a very affordable product that delivers a better end benefit.

I'm going to finish here. I could talk about other acquisitions. Clairol may be on your mind. It has only been one year since we acquired that asset -- still too early to declare a success or failure. But prospects look good. Now, I’ll be happy to answer any questions.

MR. BOWER: Juan Pedro, why don't we let the others speak and then we’ll take questions from all of you.

MR. HERNANDEZ: Fantastic, thank you.

MR. BOWER: Bob Ingram, do you want to --

MR. INGRAM: Oh, I'd be glad to, Joe, thank you. I'll just do this from my seat if that's all right. I don't have any overheads.

I'll talk as concisely as I can about two deals that I have been routinely involved with personally. One, an acquisition that was treated, as far as its implementation, more like a merger, and that was when Glaxo acquired what most people in the United States refer to as Burroughs Wellcome in 1995, and obviously, more recently, a true merger of equals when Glaxo Wellcome and SmithKline Beecham came together at the end of the year 2000 to form what is now GlaxoSmithKline.

I'll speak more to GlaxoSmithKline because it's more recent, it's a larger scale and it is a true merger. But both were driven by, I think, very common forces coming out of, as Juan Pedro said in the case of Procter & Gamble, a look at our strategy. In 1995, Glaxo, which was then the second-largest research-intensive pharmaceutical company in the world, but had been built on largely the success of one large blockbuster medicine called Zantac, was looking at patent expiration in the United States for Zantac in the year 1998.

And, frankly, the pipeline of new products was at a stage where we knew that we were not going to be able, in that first year of patent expiration, to replace the almost 80 to 90 percent of sales that you lose in the first few months today in the United States, with new product sales because the pipeline just wasn't that far along in terms of its timing.

So, the interesting thing here with Burroughs Wellcome is that we were both British-based global companies. Ironically, we both had our U.S. headquarters in Research Triangle Park, North Carolina. In fact, we were adjacent to each other. There was already a walking trail connecting the two campuses.

The Wellcome business was owned by a trust, the Wellcome Trust, which as some of you may know, even today, is the world's largest medical philanthropy, and it was operated more like an academic institution and more like a non-profit institution. It was renowned for the quality of its science. It had a number of distinguished Nobel Laureates as scientists, God rest their souls, the two most recent being Trudy Elian and George Hitchings, both of whom were the lead scientists in discovering products like AZT, which was the first anti-retral viral treatment for HIV/AIDS.

However, the Wellcome Trust, which was the largest shareholder, could see in their business, even in the mid-'90s, that the research productivity was waning, and frankly, the commercial capability was not competitive with companies like Glaxo or Merck or Pfizer or Lilly, to name some of the names you're familiar with.

So, Sir Richard Sykes, who at the time was our chairman, and myself and our chief financial officer, we approached Sir Roger Gibbs who was then the head of the Wellcome Trust, about the possibility of Glaxo acquiring the Burroughs Wellcome pharmaceutical business. We presented a strategy that said, as we looked then and as we continue to see today, that the science in our industry, and the science drives our business, is moving very fast.

This is an industry that has historically been built upon the discovery and development of good medicines that treat large populations. We can very well manage hypertension, we can very well manage diabetes, we can very well manage a number of diseases. We can also, through vaccine research, actually cure and prevent many of the diseases that killed our grandparents at a far too early age.

But as we go forward, we can see that the science and technology, it's becoming more and more clear now that the mapping of the human genome is going to not only be more complex but more expensive. We will transform ourselves from an industry that, as I said, has discovered and developed good medicines for big groups of people to an industry that actually discovers and develops and ultimately delivers great medicines for subsets of those big groups. We'll be able to actually not just treat hypertension, but we'll be able to see what causes your hypertension and we'll be able to, in many cases, interrupt that chain of events before it actually presents itself as a chronic disease. Now, some of that's occurring. More of it will occur as we go forward.

We could also see that -- and we see it most pronounced in the United States -- that the patient would become an ever more important driver as a consumer of health care products, whether they be over-the-counter health care products or prescription medicines. And in both cases, you need an increased scale to invest in R&D and you need an increased scale and expertise to commercialize across not only a physician-prescribing audience but a consumer-based population, the outcomes of that discovery effort.

So, we approached the Wellcome Trust in late '94. After three meetings, we reached an agreement which we announced in January of 1995. The Wellcome management, frankly, was taken by surprise, which presented a challenge, which I'll come to in just a minute. We made an active effort, obviously, to meet with the other investors in Wellcome, the large institutional investors, to share with them our vision of an enhanced science base. Not only was that the legacy of Wellcome, but an enhanced science base also would greatly increase and enhance the commercial capability of the products Wellcome already had on the market. Through the increased scale and effectiveness of our commercial capabilities in marketing and selling, both in the United States as well as around the world, we would produce a much more effective return for those shareholders.

We were pleased when it was approved overwhelmingly in late March of 1995. The consummation of that acquisition went very fast. It was quite rewarding working not only with our regulators in Brussels but our regulators here at the FTC -- to look at us in terms of where were the overlaps, and we had some. But fortunately, there were not that many and we, as a result, divested some medicines that later have shown up in competitors' portfolios both in the area of treatment of migraines and in asthma, two areas where Glaxo particularly was already a key player and where Wellcome was an emerging player.

Now, the challenge then really began. I'll come back in just a minute to the GlaxoSmithKline true merger. But let me try to finish in a very abrupt fashion what became Glaxo Wellcome. When Joe asked me to be part of the panel, where I think I could share some insight is it's one thing to make the acquisition or a merger and get the agreement of your shareholders, get the agreement of the regulatory agencies that must approve your transaction. It's quite yet another challenge to then actually make the acquisition or merger work. And therein, it isn't, we have found, that difficult to get cost savings. You can, you should and you will, and I'll come back to that.

The real challenge we found, and we found it particularly in the case of the acquisition of Wellcome, is the so-called soft side of creating a new culture out of what are always going to be different cultures or different sets of value in any two organizations. You can look at the process integration and we looked at that and paid a lot of attention to that. We put together a team that was comprised of legacy people from both Glaxo and Wellcome, augmented by the inevitable consultant. But the inevitable consultant in this case, you limit their role, I believe, based on your experience. We've done some things better than others, to help you define a process. They can't own the process. You have to own that.

The interesting thing is, and I hope you find it interesting, remember, this was an acquisition, and yet, when we announced it, we said that we would take the best in people, in processes, in policies and in values from each company. And therefore, we were saying to the legacy Glaxo people, the acquiring company, there was no guarantee that just because we were the acquirer, you automatically won when it came to who got what jobs.

And I can remember vividly within the first few days of the announcement, one of my colleagues, who, to his credit, had the courage to raise it directly with me said, Bob, didn't we acquire them. And, of course, the honest answer was yes. And his question was, well, then why is my job at risk? And the honest answer then was, and should be today, we want to make sure that we take the best of both if we're going to really capture the optimal value out of this.

And the culture side, and I'll try to be very concise here because I could talk at length about it, could best be described at Wellcome as being an academic type culture, valuing themselves on the high science that they did, almost viewing sales and marketing as a necessary evil. At Glaxo, where there was good science, but not great, there was much more of a commercial, harder-edged, take no prisoners culture. I say that as the Wellcome people would have told you at the time looking at Glaxo.

And I think the proof of the pudding is that, today, in GlaxoSmithKline, yet obviously, another true merger of equals -- and I'll come back to that in just a second -- of the five people who report directly to me and who, today and shortly, will even more so run the five largest segments of our company, two of the five are Wellcome heritage people. And if you look at the portfolio of medicines we sell today, four of our fastest-growing and largest medicines were medicines that were Wellcome heritage medicines that were already on the market in 1995.

And I remember vividly meeting with my counterpart at the time who was the president of the Burroughs Wellcome U.S. business, and to this day, remains a good friend. And I was saying to him that I saw in two of their products, an anti-depressant called Welbutrin, which some of you may know by brand name, and in their anti-viral AIDS portfolio, medicines that in 1995 were in global sales $100 to $150 million a year, saying that I thought within five years we could take each of those medicines to a billion dollars or more. His response was, if you can do that, why, I will tip my hat, but I don't believe it can be done.

Well, at the end of the year 2000 when we formed GlaxoSmithKline, those two medicines alone cumulatively were doing over $3 billion. One was doing a billion eight, the other was doing about a billion three. And it was because they were excellent medicines that benefited from the enhanced scale and effectiveness of promotional capabilities that Glaxo Wellcome had that Wellcome alone didn't have.

Now, as a result, we delivered out of that acquisition far ahead of the expectations we had set. We delivered in excess on cost savings. We greatly exceeded the sales growth projections that we had set. But it started, Joe, by saying we saw here a company with great science, but if you will, not great commercial skills. And it's clearly seen, by acquiring the company, we got the benefit of the science, much of which is still in place today in our new company, GlaxoSmithKline. We built in the enhanced selling commercial skills, and as a result, we became, as Glaxo Wellcome, by the year 2000 -- and this was just before Pfizer purchased Warner Lambert, the largest pharmaceutical company in the world.

Now, what drives the consolidation of our industry is basically three things. First of all, we are still a very fragmented industry. Today, Pfizer, before Pharmacia, GlaxoSmithKline, Merck, J&J, Lilly, if you add the top seven or eight companies, cumulatively, we still won't represent much more than 36, 37 percent of the global market. In the U.S., even slightly less. So, it's fragmented, although not as fragmented as it was 10 years ago.

Secondly, and I've touched upon this already as it related to the history of Glaxo, but it's true in every company's case, it's a matter of where you are in the cycle. We're all exposed to patent expirations, and I don't know how many of you realize, but the research intensive pharmaceutical industry gave up in 1984 something that no other industry has ever given up in terms of intellectual property rights.

As part of what is now referred to as the Hatch-Waxman Legislation, patent term restoration and reform, we now allow a generic copier to have access to all of our data while our patent is still in force. They can see all of our bioavailability, all of our bioequivalents, all of our manufacturing, all of our QA, quality assurance, data. The end result being that the day our patent does expire, they come to the market that day, -- in no other industry is that the case.

And as a result -- and you've seen it very recently with medicines that have become household words, like Prozac, for example. Within the first two months of its patent expiration, Prozac in the United States lost about 85 percent of its sales.

So, you have a fragmented industry, you have patent risk, and you have this escalating cost and complexity of R&D, and you have the consumer growing as a greater and greater force in terms of the outcome of health care choices.

So, in the year 2000, we tried actually first in '99 and it didn't work, to put Glaxo Wellcome and SmithKline Beecham together in a true merger of equals. Now, here again, two British-based companies. Neighbors in London, but unlike Glaxo and Wellcome, not neighbors in the U.S. SmithKline Beecham's U.S. headquarters were in Philadelphia; obviously Glaxo Wellcome's headquarters were in Research Triangle Park, North Carolina.

Here, the history was quite different. These are two companies that had been very aggressive competitors. I take you back to 1980, '81 when the largest-selling medicine in the world was a product called Tagamet, the first of the H2 antagonists for ulcers. But in 1983, Zantac, the second H2 antagonist came to the market, and frankly, ate their lunch. It quickly became the number one product, and it was a very fierce competitive battle, later joined by Pepcid, by Axcid, then succeeded by the proton pump inhibitors like Prilosec and Prevacid and others.

So, here were two British-based global companies, each with over 50 percent of their sales in the United States, but who had been real competitors. But while we were real competitors, we had also each developed a very similar approach to the changing nature of research and development. We both had seen, on our own, the increasing importance of genomics, genetics, and high throughput combinatorial chemistry -- that by making the right investments and gaining the right capabilities in those new disciplines, one could improve your batting average.

I frequently explain our business to lay people in the most simple way I can explain it. Pharmaceutical research is basically a game of failure. The challenge for us is to learn to fail more quickly and more cheaply. Today, the average cost of discovering and developing a new medicine is $800 million. And one out of 5,000 makes it from the time it's synthesized as a compound to the patient's medical cabinet. So, it is a high failure endeavor. But today, and going forward tomorrow, we'll improve that batting average, because, as I've already alluded to, we'll have a better understanding through the study of genetics, genomics, through the ability to screen, through high throughput combinatorial chemistry, millions of compounds in a day.

When I started out 40 years ago in this industry, the rule was one compound, one chemist, one week. Today, any company in our business will screen millions of compounds each day and will be able to screen them against targets very quickly to understand which targets have the greatest affinity for which compounds. Within the cell, which part of that cell is it that you're trying to target? And by developing proteins, small molecules, the promise of this science, again, is enormous.

And, frankly, the leaders of the two companies at the time, again, Sir Richard Sykes, a scientist from the U.K, and Jan Weshley, a Danish businessman, by birth, an American, had worked together at Squibb, and both, on their own, had made these investments. SmithKline Beecham in human genome sciences. In the case of Glaxo Wellcome, in a number of genetic start-ups, in which we had acquired further technology.

So, we started having discussions about the real benefit of putting these two companies together to create, again, a world leader in research. That was and is our vision. So, we tried it in early '99 and we even announced it, and it fell apart for a very simple reason. We had too many cooks in the kitchen, and I don't say that to be sarcastic. We had too many people at the top with not very clear role definitions. And as a result, it didn't take very long before this situation was going to create a nightmare. And as such, we would be hard-pressed to deliver something that really did add value. So, it was called off.

Within a matter of a couple of months, because the vision was so compelling, the two respective boards asked myself and J.P. Garnier, who was my counterpart at the time at SmithKline Beecham -- and J.P. and I have known each other and were friends then and still are today -- if we could see if we could get together and see if we could make this work.

To make a long story short, we did. The end result was both Sir Richard Sykes and Jan retired, to their credit, because they could see that there were too many of us, and we then got on with putting that vision into place. Let me fairly quickly here talk about the benefits we saw short-term, medium-term, long-term, how we've done, and what were some of the key issues. It's still a story in progress.

The obvious short-term issues were cost savings, significant cost savings annualized at around $5 billion a year. We delivered that savings no later than the end of year two and we actually exceeded that. You get a lot of those savings in a global pharmaceutical business in manufacturing. We started out as GlaxoSmithKline with 117 plants around the world. They vary in size. Most are secondary manufacturing plants. A few are primary bulk chemical plants. If you were starting a business of our size from scratch and you had a clean sheet of paper, you could operate a global company of our size with maybe six or seven plants if you scaled them up right and sided them right, but we didn't have that luxury.

In the first two years, we were down to around 71, 72 plants, more to go. The challenge in our business is you have to do that, while at the same time, not interrupting the supply of life-saving medicines as you move product supply from one plant to the next. This is particularly true if you're supplying the United States, where the FDA, as it should be, has to approve that. So, it's time-consuming.

We saw the enhanced marketing scale again. Today, GlaxoSmithKline has 8,000 medical reps in the United States, similar to what Pfizer has. The reason that's important is because you're promoting a broader and broader portfolio of medicines, and when you consider that the average face-to-face selling time of a physician in our business is four to five minutes, you need to have a number of different salespeople to make sure that each medicine gets its appropriate time.

We saw an ability to create leadership in key therapy areas. We are the world leader today in four out of the five leading therapeutic areas. The one that we're not is the one I wish we were, cardiovascular.

Medium term, we, again, coming back to the patient being an ever-increasing driver in health care, saw in SmithKline Beecham consumer marketing skills. Certainly, Procter & Gamble would stand out in that area, but SmithKline Beecham has a very good consumer business, and we wanted to make sure that we had the ability to take some of the consumer marketing skills and apply them to the marketing of prescription medicines.

We saw an increased resource for the pipeline. Today, we invest roughly five billion U.S. dollars a year in research and development. As separate companies, we were investing at roughly three and one. So, we've actually stepped up that investment. And then longer term, we want to, again, be the world leader in research.

How have we done? I've talked about the cost savings. We've delivered those and we continue to deliver those ahead of target. We have real financial strength, and I'll just highlight a couple of facts. In this year that we're about to complete, we have announced and largely completed a 4 billion pound share buyback program, while at the same time delivering mid-teens percentage growth and earnings per share, and reducing our net debt by over two billion pounds.

Sales and marketing scale in effectiveness and efficiency, we're providing better service to our customers. Although I could give you a lot of statistics on that, I'll spare you. But I can tell you that today, as GlaxoSmithKline, we provide much better coverage of not only prescribers, but we now provide much better response to any patient, pharmacist, nurse or any other health care professional around the world, much more effectively than we ever did as legacy individual companies.

Now, in the area of R&D productivity, we took this $5 billion R&D investment every year, and we frankly changed it. We don't have one monolithic R&D organization, unlike a lot of pharmaceutical companies, because the key challenge facing this industry is R&D productiv ity. So, what we've done is to create what we call Six Centers of Excellence in Drug Discovery, SCEDD is the acronym. And what we've done is to focus them along therapeutic lines. So, one focuses on metabolic disease, one focuses on anti-infective disease, one focuses on respiratory disease, one focuses on C&S disease, et cetera. And they compete for resources. And they're funded much like six individual biotech companies, if you will. And scientists in those centers, who actually do discover and develop a medicine that makes it to market, actually get an equity stake because we realize that one way you attract and retain top quality scientists is to be able to do that even in a large pharma company.

We also, by virtue of our scale in marketing and sales, we want to be the partner of choice. If you're a biotech company or if you're a Japanese pharmaceutical company or an Indian pharmaceutical company, and you have a great idea but you need somebody to develop it and really commercialize it, we want to make sure you know that we're the best able to do that.

As far as the issues were concerned, this was a merger of equals, so there was no premium. The financial analysis was pretty much confined to cost savings. There was due diligence, but I think Joe's comments were absolutely right on due diligence, you have to do it right with a clear set of objectives with the best people you can find.

In our case, we knew a lot about each other. We were large, publicly-traded companies. There's not much secret about us. What we did do in each case was really look at two areas, the pipeline, the early stage pipeline to see where there was overlap, both in terms of our preparation for discussions with regulatory agencies and in terms of things we should just quit doing. But also, the other area, not surprising, particularly in the United States, is what's your exposure to litigation, because there, again, that required clear due diligence.

In terms of the differences between a merger of equals and as acquisition, and I've touched on how we treated Glaxo Wellcome, the key thing is once you announce it, put in place very quickly the right integration planning in terms of organizational design and candidate selection. You have to understand that as soon as you announce a merger, everyone feels at risk. And the sooner you can work with the regulators to gain an agreement, the better, stating the obvious. But then also concurrently with that, you cannot over-communicate. You have to share with your people what's going on, and you have to have an open line so that you understand daily what are the questions. In some cases, you'll be able to answer them that day. In other cases, you won't, but you've got to get back to them.

We employed both the Boston Consulting Group as a consultant to help us with, if you will, the organizational design, and Spencer Stewart, a search firm that neither company had used because we didn't want there to be a bias, to help us set in place a process for candidate selection. And we were able, when the deal was approved, at the end of the year 2000 -- so the company will be two years old the 27th of this month -- within the first six to eight months, to have our entire global management team, and I'm talking down to the plant manager, down to the district manager, down to every department head, chosen and in place. That may not seem like a lot to you, but we're talking, in this case, an employee base to start with of 110,000 people, a management staff within that of about 25,000.

I'll wrap up very quickly and say that if we're looking at it today, has it been a success? Yes, in terms of cost savings. Yes, in terms of financial strength. Yes, in terms of sales force, commercial scale and effectiveness. Partially yes in terms of R&D. We have become the partner of choice in that we have completed, since we formed GlaxoSmithKline, 23 business development agreements, largely where we're acquiring product from early stage biotech companies, in some cases Japanese companies. But it is still too early to tell whether we have, in fact, improved the cycle time in terms of R&D productivity, and that will be the ultimate barometer of whether or not this was a success.

I'll just close by saying that the cost savings you must get and you can. The speed of implementation is critical. It's not only critical in terms of getting the cost savings, it's even more critical in terms of capturing and retaining the most important asset that you have, and that is the people that are always going to feel at risk.

MR. BOWER: Thank you. Thank you, Bob.

MR. SCHEINMAN: I want to start first by thanking Joe and David for making me feel so at home here. Since the NASDAQ dropped below 1500 and the California energy crisis, we've ceased heating our house as well, so I feel very comfortable here. I also would say that it's an accomplishment that I've stayed off Welbutrin, even despite the NASDAQ falling below 1500.

(LAUGHTER)

MR. SCHEINMAN: I want to talk a little bit today about the things that are unique in our space and in our industry, and I know a lot has been made about what's different in high tech and what the differences were. But we've heard a lot, I think, that is very common across many of our industries, and I'm just going to focus on some key things that are different from our vantage point and try and touch some of the highlights. There are a lot of things that I could really reinforce that my colleagues have said, which I'm just going to skip over.

For Cisco, M&A, mergers and acquisitions, are a critical activity. It's really A, it's not really M&A. We're really doing acquisitions and it is critical because we exist in open markets.

Now, unlike the pharmaceutical industry where you have 17 years of patent protection, we frequently have a week or two, because what happens is that the underlying standards and protocols in our markets are open, which means that anybody can, and in periods of high investment, frequently anybody does, come into our market and build very similar products.

If you would have looked at what broke Cisco out of its oligopoly back in 1992, it was really the M&A strategy that allowed us to hit scope and scale before our competitors did. I'm going to come back and talk a little bit about the role of failure because failure is very important to us, as well. It's a critical part of what we do. In fact, I was going to use your line, which is that failing early is a core part of our M&A strategy.

Our critical metric is earnings per share, EPS, growth. We try and do that two ways, and I'll go back to Joe's terms. We have our own, but I want to use Joe's words because I think they were much more articulate than ours. We really look at product line extension and R&D as the two areas that we're going to operate in. If we can do that effectively, then we can hold our margins, which is a third benefit. In open markets, the place that you're going to have margins is where you add value, and for us, if we can extend our product lines and if we can enter new markets, we can extend our margins in the markets that we're in very effectively. So, it's critical to us.

When you look at what we've done, I think the single most successful deal in the history of the networking industry, and I would put it on par with any deal in technology, was an acquisition we did of a company called Crescendo -- we acquired it for $85 million. The only press at the time, if you go back, will say that Cisco overpaid. Today, Crescendo and a couple of market extension deals we did represent approximately 40 to 50 percent of the revenue of Cisco. The deal was a new market for Cisco. The management team was largely in place. The president of Crescendo today runs the engineering group for Cisco, and most of his key lieutenants are still in place and still showing up to work despite all that they have. So, I guess that means they're happy, or they want more.

And for us, what it allowed us to do was to enter new markets and, again, it allowed us to preserve our margins in routing and to continue to grow and expand, which we would not, otherwise, have been able to do.

The other thing that was interesting has been that until this recent slowdown, the market was really characterized by an increasing rapidity of decision. So, in 1992, we probably had a year or two before we had to make decisions. By the end of the bubble in 2000, we were having to make decisions within sometimes four to five weeks. The market cycles were shortening and becoming rapid, and the penalty for us was increasingly draconian. If we missed a market or we weren't able to develop something internally, we were either out, as happened in a bunch of cases, or we had to pay what seemed like outrageous prices at the time in order to enter the market. That obviously has implications for our ability to generate EPS, and general success for our shareholders.

The environment now has actually changed and we're 180 degrees from the environment that we were in. Today, there's a draconian penalty if you go too early. If you go too early, you frequently end up with a product that the customers aren't going to want because it's developed too early, it doesn't have the right feature sets, and you're going to be spending all your time re-engineering something that you've brought too soon, -- or you're going to end up with employees building a product that there's no market for, and there has been, quite frankly, a lot of that out in the public markets. I'll give you an example. The soft switch market is one where people were predicting a market worth billions and billions of dollars. But nobody that's there has been able to make much of a market. Competitors that are public are all trading for under $2, and acquiring them only would have led to expense to us.

So, our environment has changed, which is also bringing us back to pricing discipline and other things that we used to do in the old days.

But for us, risk really is critical and what we've discovered when we look at our M&A activities is that really 10 to 15 percent of our deals generate 95 percent of our returns. If you think about it, it's really an extension of the venture business. The venture business is the same way. When you look at the funds, it's 10 to 15 percent of the deals generate the returns. If you look at technology across the public companies, same thing, a very, very small number of companies, year over year decreasing actually, generate most of the value that's created.

And so, our business is no different, but if we can react quickly, if we can move fast or if we can either succeed or fail faster than the next guy, we are going to have a competitive advantage over them. In fact, I think one of the unsung benefits of our merger and acquisition spree was that it encouraged others to go down the same path, and because we were the premier acquirer of choice, they frequently got second tier companies and it took them longer to either reach their decisions or to unwind the things and we had already moved on from mistakes. And the key for us was just to learn and develop that body of learning and then keep moving forward.

I think the role of due diligence is critical, and our benchmark for due diligence is not whether or not ultimately we discover and solve every last problem. It is whether or not we identify the issues and whether or not we were accurate in identifying the issues. And particularly, we spend a lot of time focused on chemistry. I've never been involved in a deal where the two sides have ended up hating each other at the end of the negotiations where the deal has worked. Most of our deals are small enough that the negotiating team can't hide from the integration team. So, we find we spend a lot of time on non-metricable items like chemistry, shared vision and how the two teams feel about each other, which, quite frankly, drives a lot of the quantitative types who work for me crazy because they're not quite sure how you measure these things, and yet, we find that those are sort of the critical success factors.

So, we spend a lot of time, too, on our teams making sure that the high EQ, emotional intelligence quotient, people are as rewarded as the high IQ people and that we make sure that we do both EQ and IQ due diligence when we look at things.

The other thing I would say that our industry dominates is that we have battles internally within the companies going on between the go-to-market side of the house and the product side of the house. Decisions are dictated at varying times by perceived strength or weaknesses between the go-to-market side or the product side. Almost invariably deals fail when one side or the other uses the deal as a fix for a perceived weakness on the other side. So, when people say, gee, we don't really have a good sales strategy in market X, if only we acquire them, then everything will be fine. Well, what will happen is the people who didn't have the particularly good sales strategy are then managing the sales force of the company you've acquired and generally one side or the other leaves and you're in chaos.

So, we have learned that fixing the other side's problems is not really a strong way to go. We've tried to say that we are not going to solve problems that are on your side of the house, we're not going to try and solve the other side's problem when we're the house.

The last point I would make is one that's been made repeatedly, which is that the integration is critical. I'm going to tell one story and then I will turn it over for Q&A.

Our first public deal was a company called Stratcom. I can remember going to the closing dinner. We spent about 45 minutes toasting the acquisition team and what geniuses we were. And I can remember increasingly seeing the people in the back of the room looking more and more sullen because they were the integration team and they recognized that there was not going to be a party to celebrate the integration, there were not going to be toasts, no one was going to say, hey, congratulations, the systems are up and running, and meanwhile, we were toasting ourselves as geniuses.

It was the last closing party we've held. We don't do closing dinners anymore. We now look for milestones to try and celebrate the integration teams and bring them out of the holes and the bunkers and try and say, hey, congratulations, we've hit this milestone, why don't we all go out for dinner and sit down and chat. To be frank, during the bubble, as the deal flow increased and we were doing a deal every other week, it was harder and harder to keep up and make them feel these things were genuine, here we are again, another dinner, congratulations.

(LAUGHTER)

MR. SCHEINMAN: But we're trying to revive some of that culture as we go forward.

So, for us, I think we have opportunities now that we didn't have before. We have an environment that is more rationale, which will allow us to, I think, increasingly do the things that we do that are core to our success. At the end of the day, I think we have opportunities now that we did not have in the bubble, and I think you're going to see that we're going to continue to leverage our strengths going forward to be successful.

MR. BOWER: Thank you. Thank you, Dan. Thank you, Bob, and thank you, Juan Pedro. It's interesting, isn't it? We've tried to suggest how important specifics are, but now we've got Procter & Gamble, GlaxoSmithKline and Cisco, and I think you can see how very, very different are many aspects of M&A, but there are many similarities. And I just wondered first, does anyone on the panel want to either comment on the presentations or raise questions with the speakers?

(No response.)

MR. BOWER: No? Okay. Then, do we have the microphone and are there questions from the floor? After this question and answer, I'm tempted to say that we will take a five-minute break max. I mean, we're really going to just break briefly and then start again, and we will pick up with negotiating the deal and then we'll pause and take questions again, and then go on to the final portion.

Do we have questions for the speakers? Yes? Please wait for the microphone. This comes from Brussels.

MR. PETIT: That's right. This is a question for Mr. Hernandez from Procter & Gamble. You mentioned that essentially value comes from revenue efficiencies. Could you be more specific and explain what you mean by revenue efficiencies?

And then one question to Mr. Ingram for GlaxoSmithKline. You talked about how you increased your R&D budget from “three plus one” to five, and you mentioned that the transaction actually brought financial strength. Could you be more specific about that? Thank you.

MR. HERNANDEZ: Let me address your first question. What I meant to say is that our most successful acquisitions have delivered revenue efficiencies, and I also said that there are two sources of value creation when it comes to acquisitions in our case. One is that of revenue efficiencies. My three examples, Richardson-Vicks Inc., Iams, and Spinbrush essentially support and back up this statement. I also said that we look at improving the profitability and the cost structure of the asset(s) that we acquired. So, it is not either/or, it is a combination of both.

To reiterate, in our case, our most successful acquisitions have common elements in that we are able to build a brand, to expand it through our strong go-to-market capability, so that we delight consumers around the world.

MR. BOWER: So, what you're saying then is, by efficiencies, that you're able to take products, for example, RVI products, and using the Procter distribution system and marketing skills, drive them further into the global market?

MR. HERNANDEZ: Yeah. We use the technology, we use the equities and we use the go-to-market capabilities to increase and to grow the brands that are being acquired.

MR. BOWER: I don't know if everybody is aware of the extent to which Procter is a really remarkable manufacturing company. So, when they say technology, they are really at the leading edge in terms of the specialties that they're dealing with. And for those of us who use their products, that's a good thing.

MR. INGRAM: Joe, I'll be very brief. The two legacy companies in R&D, in dollar terms, Glaxo was investing about $3 billion a year, SmithKline was investing about $1.2 billion a year, so the net investment was a little over $4 billion. We've taken that now to $5 billion. That was funded largely by some of the cost savings, particularly cost savings that came out of the manufacturing area, and cost savings that came out of the administrative area. But it was also just the shear decision we made, which was the heart of why we think this merger will make sense, that our future is really tied to R&D productivity. We knew that as a combined company, we would have an increased ability to invest in R&D. We had to make that a reality on day one, and it wasn't just throwing money saying, we're bigger. We saw, as we aligned those six centers that I spoke to, an opportunity to invest, and as best as one can tell about an early stage research investment, make it a good investment.

MR. BOWER: Thank you. Any other questions?

(No response.)

MR. BOWER: Why don't we just stop here very briefly. This is not a 15-minute break. This is going to be, if anything, a four-minute, five-minute break.

(Whereupon, a brief recess was taken.)

MR. BOWER: As we get started, our hosts have suggested that we now listen to the next presentations and do the Q&A at the end. What I'm going to do is ask Michael Jones to speak next, and then next would be Peter, and then after that, we will focus on M&A implementation with Illinois Tools and Conoco, Bill Earnest.

(Whereupon, there was a brief pause in the proceedings.)

MR. BOWER: Why don't you go ahead, John?

MR. MAYFIELD: You want me to start? All right, very good.

I will cover three key areas here in my allotted time of about 10 to 15 minutes. First of all, I'd like to give you a brief introduction to Illinois Tool Works, ITW, for those of you in the audience that are not familiar with the company. I'll then touch on how we set price in our acquisitions during the negotiation process, and then I'll briefly talk about due diligence process and what we expect to accomplish during that review and intelligence gathering process.

First some background on ITW. In the past five years, ITW has purchased approximately 159 companies. We do not pursue the unreasonable targets (the bluefish that were referred to earlier). The total purchase price paid for all of those companies approximated $6.3 billion, and if we exclude one acquisition in the past two years called Premark, we have purchased companies that average about $20 million.

ITW serves the following key market segments, as we define them -- residential construction, commercial construction, automotive OEM, automotive tier one, and the catch-all called general industry.

ITW is a bit different. We do not have any particular department that is assigned to acquisitions or strategic mergers. Our target identifications come from about 600 operating units. We have eight EVPs, executive vice presidents, that also participate in the identification process, and certainly the CEO.

Most of our acquisitions and ideas come from the bottom up. Almost 90 percent of them come from operations. Less than 5 percent are, what I would call, CEO-generated. So, maybe perhaps that's a criteria for success. Since the vast majority of acquisitions initially emerge from the operating level, it means that the people responsible for integrating and managing the operation are involved on Day 1. There is no drama of a handoff from a corporate mergers and acquisitions department. The operating people will know the target and possess quite a bit of knowledge before we even enter the due diligence phase.

Our due diligence process is a team concept. As I have said, the operating people are involved on Day 1. They are supported by a tax department, legal department, and internal audit. We do outsource a number of areas in terms of environmental law, and even in the Hart-Scott-Rodino area.

We have a standard checklist that we use to gather a number of standard items. For example, we would gather copies of contracts, commitments, employee benefits, leases and so forth. Simultaneous to this, the operating management would refine the acquisition model and attempt to confirm assumptions that have been used in the determination of the purchase price.

Some prior presentations have indicated that almost 50% or more of the acquisitions fail. Some of the key reasons are over payment of purchase price, and inability to transition the business as planned. This usually means overly aggressive top line growth assumptions or unsupported cost reduction assumptions.

ITW seems to go against this failure rate. Over 95% of the acquisitions ITW makes, we term successful, and I'll talk a little bit about that at the end, what we mean by successful.

We talked during the lunch break with the panel and there are some internal criteria that you would use to determine whether an acquisition was successful, and there are also some external criteria.

Let’s move to the negotiation process. One of the key or the most important points, I think, during the negotiation process is actually setting the price. We have found that when the price is not set correctly, when you overpay, you begin to make some very short term, what we think are incorrect decisions -- cost-cutting, reduction of research and development and the like. Certainly, in the long run, that is going to impact the acquisition, and in the end, not only will it be a failure internally, but it will be a failure to the end customers that you're actually trying to serve.

A key aspect, when we are setting the purchase price, is that we really don't proceed until we have a clear fit for the acquisition. There has to be an absolutely clear strategy of where it's going to fit in the organization, and why we are making the purchase. We need to clearly understand why we are pursuing the target. There has to be a clear and logical integration plan. This has been brought up by all of the panelists, earlier today, that there has to be a very clear integration plan, and I can't emphasize that enough. I think that's why we are successful, because the operations people are involved up front in setting that integration plan.

But assuming we get past those points, our biggest question we're going to ask, as we're setting the price, is whether this is going to benefit the customers. What do they expect to get out of this transaction? As I mentioned, we serve some traditional markets, construction and automotive, and we feel, for whatever reasons, that both of those markets are under-served by their suppliers. We think ITW brings a number of new and innovative ideas to those markets, whether its new technology, research and development, or improvement in the supply chain so they can be successful.

When we actually set the price for an acquisition, we use some of the same traditional methods I think most companies would use. We do look at revenue growth. We look at the possibility of increasing prices, which is almost non-existent in the markets that we serve. We look at improvement in the cost base, whether it’s the delivery of the product or the actual manufacturing of it. We certainly look at the working capital that's employed. We look at the cash flow. Our target measure is to set a price that gives us a return on invested capital anywhere within a 12 to 36-month period.

Some factors that go into setting that price and where we see the risk are whether this is a domestic or international acquisition. Internationally, there are some additional risks that we don't necessarily have here domestically. We look at whether we're going to have to do significant restructuring, which is an additional cost to us.

The key question we ask is, "Are we going to be able to retain these customers, and is this a revenue stream something we can count on?" If, in fact, we are a little skeptical of the revenue stream, we're going to have to adjust our purchase price accordingly. The key question is, "Are we going to like it when we get there?"

During the due diligence process, as I said, our most important area that we first look at is determining the revenue stream and whether that can be maintained. During this process, we attempt to survey customers involved in the transaction. We will look at the products they receive, what they perceive as either a lack of product, lack of research and development, lack of attention, or lack of ability to receive product on time. If we can't confirm the revenue stream and we can't talk to customers and we can't develop a thorough understanding of what we're getting into, then we'll either back away from the acquisition or we will discount our price accordingly.

In traditional due diligence, we will actually confirm our financial numbers through audits, internal reporting, tax return data, and the like. Another particular area that we look at in terms of due diligence is our risk. We have entered into a number of acquisitions that had plants that are not one or two years old, but, 50 or 60 years old. We have human resource issues in terms of retaining key employees and there are also issues that deal with product liability and general liability. When we are conducting our due diligence, those particular areas form the basis for our indemnification clauses and/or, again, a price discount.

As I said a little bit earlier, we like to involve the operating people very early on in the process of the acquisition. They are going to be the individuals that will be responsible for running the acquisition. We feel that by having them involved in the process early on, they can hit the ground running when the ink is dry on the acquisition.

At the completion of due diligence, we confirm our price model. We make a go/no-go decision. We make any purchase price adjustment necessary and then we move forward. I think as we look toward success of an acquisition, we measure it two ways. We can measure it from an external viewpoint, the customer. We can see if customers have been retained and are satisfied, whether we have been able to introduce new products and improve customer service. Externally, we can do surveys and perform focus groups to see if our customer base has been served.

Internally, we look at the return on invested capital and whether or not the operation is actually hitting the metrics that we have set up for it. Stockholders can look to our outside numbers, such as earnings per share, goodwill impairment, and return on invested capital to see if we behave the way those who have entrusted funds to us would like us to behave. So, those are some of the ways we can look at success.

Since we do a very large number of acquisitions, we do also have experience with failures. Some of the areas of failure that we've seen in the past occur due to the inability to communicate our corporate philosophy to the newly acquired work force. Another area is the loss of the revenue stream, and as I said, that was our number one due diligence concern. No matter how diligent you may be in that area, losing the revenue stream can be initially devastating as competitors come at you early.

I think that kind of covers the areas, Joe, that you wanted.

MR. BOWER: Thank you, John. That's great. Peter, do you want to pick it up from the point of view of an investor group?

MR. BRODSKY: Sure. Let me just spend two minutes talking a little bit about who Hicks, Muse is because while a lot of the things that my fellow panel members said ring true, we come at it from a slightly different perspective.

We are a private equity firm and we manage about $8 billion in assets. We've executed about 400 transactions worth about $50 billion over the last 15 years. So, our firm's success really lives or dies by the success of our M&A, merger and acquisitions, activity, and we really measure our success in a very simple way, which is, has an acquisition enhanced the value of our investment or decreased the value of our investment.

When it's an initial platform investment, we're calling capital from our investors, say $100 million, the day we invest that money, it needs to be worth more than that six months later or we're not doing our job on behalf of our investors. There are a variety of factors that help determine whether or not our equity is, in fact, growing in value or declining in value. A lot of the things that these gentlemen have talked about, customer satisfaction, also preservation of revenue, execution of cost savings, but at the end of the day, that's the metric that we're measured by and we are measured by with our investors.

The other thing that's slightly different is that when we buy a company, our funds have a 10 to 15-year life span. So, any investment that we make, we intend to exit, on average, between three and seven years later. So, there's a very finite period of time when the value needs to be created, there's a very finite period of time when the acquisition will be deemed to be a success or a failure. So, in a lot of ways, it makes our job in measuring ourselves simpler because it's such a finite specific target that we're trying to hit.

Having said all that, I guess I'm talking today a little bit about negotiation and also about deal structuring. What we do in terms of the negotiation and the deal structuring is the follow-up to what these gentlemen have been talking about for the past couple of hours in terms of preparing and performing due diligence in an acquisition. That is, we go through a very similar process where we target a company -- our criteria typically are strong cash flows. We look for market leaders, we look for companies that are in consolidating industries where we're going to be able to put more capital to work in that company and hopefully realize some cost synergies which I'll talk about in a moment.

Having done that targeting, having done that planning, really, I look at the negotiation and the structuring process of the deal as a competition between the buyer and seller as to who's going to take on more risk and who's going to keep more up-side. And really, you can boil down a negotiation to those two factors. So, for a seller, the ideal structure is a stock sale where all the liabilities go with the company, where the selling company is getting credit for projections that are hockey stick in nature, and which implies a very large multiple of current year's profitability based on a very rosy picture of future growth.

For a buyer, the ideal acquisition is an asset acquisition where there's very limited liability traveling with the deal based on a series of projections showing flat to declining profitability, so that there's a very low multiple. And one side comes to the table with one agenda and the other side comes to the table with the other agenda, and the negotiation ensues. A lot of time is spent negotiating about whose responsibility a variety of liabilities are, a variety of tax liabilities, legal liabilities that you spoke about earlier is important. And then to me, the key area of negotiation is the discussion about who gets paid for the efficiencies that we've been talking about all day today.

The seller's argument is always, look, I've got three bidders bidding for this property. They're all going to ring out the same efficiencies you're going to ring out, be they cost efficiencies or revenue efficiencies, and this is a competitive process. The winner is going to be the one who's going to pay me for those efficiencies.

And the difficult challenge in our industry is to maintain discipline and not pay for those synergies because those synergies are highly speculative in nature and we've talked a lot today about how there's a perception that mergers fail and the reason for that perception is that there's a lot of overpaying.

And I would say that overpayment really is two things. One is overly rosy projections of the base business, which are fully paid for up front, but even more importantly, overly rosy projections of synergies, be they cost or revenue, that are also paid for up front. If they're paid for up front then the implementation team, that the rest of the panel is going to talk about today, is really in a very difficult situation because the more you pay for those, the less room for error there is on the implementation side. Implementation is fraught with error, and sometimes it's trial and error and not everything goes according to plan.

So, really, I view my job and my partners and colleagues view our job, when we structure a deal, is to be disciplined enough, while remaining competitive in a process, so that our management teams have some ability to fail in the implementation process and not have it be devastating to the company.

That is particularly important in a leveraged buyout. We don't do stock deals, we do cash deals financed by leverage. So, the under-performance of a business doesn't just cause the stock price to go down, it can send a company into bankruptcy. That is -- the stakes are very, very high in a leveraged buyout, which is why we try to be very, very precise in how we negotiate deals.

So, let me talk a little bit about the different kinds of efficiencies because there's a different risk factor to each of these efficiencies. I've categorized them into three or four buckets and then every time I created a bucket, I found several sub-buckets. So, now, I'm not sure how many there are, so please bear with me.

In a platform acquisition, which is one unlike anything that these gentlemen would be doing, where we don't have any operations to integrate into the business, we are buying a platform. That doesn't really change the competitive dynamic of the marketplace because we're just becoming a new owner of a business, we're not combining two businesses. There's really one kind of cost synergy, which is I'm going to do it better than the current management team is doing it. And those cost synergies are sometimes very, very real.

Our biggest successes as a firm have been from acquiring subsidiaries of large corporations where that particular subsidiary was non-core. There's only so much that a CEO of a large company can do in a day and those non-core subsidiaries often are under-managed. There are very meaningful cost synergies to be realized from such companies and, also, revenue synergies because you put in an entrepreneurial capital structure and you unleash the management team or put in a new management team and there can be some very meaningful growth.

One of our most successful deals we actually bought from American Home Products was their food division. It was a series of very, very solid brands, Chef Boyardee and Polaner All Fruit and Jiffy Pop Popcorn, but it just wasn't being managed actively because it was a tiny division of a huge company that wasn't focused on food. We bought that company. We paid a very high multiple of current year cash flow, but there were so many cost synergies and efficiencies that we could see just from putting in a more entrepreneurial management team and cutting some fairly bloated G&A, that we were able to bring our multiple down fairly rapidly. Then we engaged in a buy and build process where we added on brands onto that platform, and that's where we started to see some of the synergies like we've been talking about today where we were able to take brands and put them through our distribution pipeline and enjoy those kinds of synergies.

So, getting back to my original point, the first one is just cost synergies, the I can do it better synergies. Another kind are the kinds we've been talking about today where there's actually an existing infrastructure that you can put another product into, you can eliminate a tremendous amount of G&A and you can also drive the top line very significantly by putting that product through your infrastructure.

And then there are the harder to calculate, harder to justify revenue synergies that will come from putting two companies together -- you've got Companies A and B, you can sell Company B's product to Company A's customers and Company A's product to Company B's customers and there should be a tremendous amount of synergy. As you go along the continuum of this, I can do it better through the cross fertilization, cross marketing, I would say it's going to get riskier and riskier. And what we try to do as we negotiate and as we execute is it's okay to pay for a little bit of the low-hanging fruit synergies, but if you've begun to pay for every last bit of growth that you're going to see out of the acquisition, you have a very, very high likelihood of having overpaid for the deal when you're done. That is going to be a failure in our book because our equity value will decline over time.

So, that's really what the negotiation is, particularly in a platform, and in an add-on acquisition, once we have a platform. The transaction we were talking about earlier would be an example where we have a platform and we're adding on products or merging with another company.

The other key negotiation point is the selection of the management team. You referred earlier to how challenging that can be. My experience and my firm's experience is that if you aren't crisp in your selection of a manager to run the process, you have a much higher likelihood of failure. So, a compromise at the negotiating table on a co-CEO or a co-COO or a co-implementation team means that there are going to be sacred cows as the integration process goes through and you can really end up in a nightmare. So, I commend GlaxoSmithKline for recognizing that and redoing it. And that's, I guess, the third element.

I talked earlier about everything in negotiation being a balance between who gets the liabilities and who gets the up-side, and then there's also the ego factor in any negotiation, and to the extent that that can be mitigated, that is going to do good things for the company.

So, hopefully, that addresses the question, but that's really what's on our mind as we seek to negotiate, and then the deal structure is simply the documentation and the implementation of the decision about who's getting what and who's taking what risk. And then, hopefully, from there, there can be a quick execution, so that the implementation can begin, and that's where the real value gets created.

MR. BOWER: Thank you very much, Peter. We now turn to GE and Michael, and go on to the implementation phase.

MR. JONES: Joe asked me to talk today about the acquisition integration and implementation process. Like a lot of my colleagues for GE and GE Medical Systems, the use of acquisitions is a critical component of how we help the business execute on a strategy faster. We've got, at any given time, probably 15 or 20 different integrations going on at once, and it's really kind of the engine that keeps the front end of the process driving. The fastest way for a business, and GE, to kind of lose its ability to acquire businesses to help execute on strategy, is to fall down on the integration and implementation front.

So, what I'm going to take you through today is just some thoughts on process and people around integrations and then through a tool that we actually use to manage our integration process. That way you can see the things that we view as important and see how we get visibility on how we're actually doing it and measuring acquisitions.

A lot of these points have been hit on already and, as seen in the slide on the bottom of the first page of my handout, we kind of boiled down the integration approach into three buckets; process, leadership and people. And, again, probably because GE borders on being process improvement junkies, we spend a lot of time focusing on this. We really try to make sure that a view on integration starts with the due diligence process on a business, so that when it comes time for a hand-off to the business, it's a seamless process.

It's always a tough balance, and there's really no one answer to try to balance independence and culture of an acquired business and the desire to try to integrate quickly. You do need to make decisions quickly, but respecting a culture that you're bringing into GE is also very important. We also place a big emphasis on trying to adopt some of the best practices of the companies we acquire so that, at the end of the day, a company we acquired doesn't look like GE necessarily at the end of the integration period. But some of the things that made the company valuable to begin with are there and in place. And this really requires not just the team of people who are involved in the acquisition, but kind of a broad business ownership and cross functional engagement from different parts of the business.

From a leadership perspective, commercial sensitivity is really our first priority; i.e., the customer. It's always on our screen, it's always an important part of what we're looking at. If we lose our customers at the end of the day, the business that we thought we were acquiring is somewhat irrelevant. So, we set clear measurements and we closely monitor each of the businesses we acquire to make sure that we have early reads on how we're doing on this front. While you may not know if an acquisition is successful or not, at least from the buyer's perspective, for several years, the first 12 to 18-month period, in our experience, is really the critical one. We're looking for real-time information to determine whether or not what you were hoping you acquired turns out to be the case and make sure you're doing the right things there.

Ultimately, from a leadership perspective, the business leader who owns the business and where the business is going to end up, owns the integration -- has dedicated people working on the integration. It's the business leader that has to own the integration, and, again, from the front end through the integration process.

Finally, on people, in addition to the commercial sensitivity, you've heard a number of people say today that making sure you're retaining talent is absolutely critical in an acquisition. And we focus on commercial and key talent retention, and in our business, that's primarily technical R&D type of talent. And what we're hoping for is to create the right incentives in an integration plan to have the key players actually give GE a chance to have us prove to them that we can be a great place for them to prosper, grow their careers and, hopefully, open up the whole wealth of new opportunities for them.

Regarding integration managers, and we learned this probably the hard way when we first started spending a lot of time on acquisitions, you have to make sure that you're not kind of underwhelming an integration by having a player who's not top-notch, fully dedicated leadership, in a leadership position related to the acquisition.

You've got to overwhelm, in many cases, from a leadership perspective, who you're applying to deal with the integration, and also make sure that from the acquired company's perspective, they are also dedicating key leadership positions as well. You're taking top people out of their jobs and making sure that they're motivated, compensated, incented, to make sure that you’re working together on what you're trying to drive as a combined organization and you're doing everything in parallel.

We've got a tool that we call E-integration, which is basically an online tool that helps bring all this together, that creates clear objectives that we can then track and make sure we're delivering on. I'll use the slide on the top of page 2 of my handout to take you through this tool.

This is actually a screen shot taken a little bit of time ago, but essentially this is a tool that the senior leadership of our business and of GE can look at on any given day to see all the acquisitions we're working on or the integrations that we're working on and how we're doing from a performance perspective as well as from an integration executive perspective. And this is really the tool that the integration team works off of, GE management team works off of, and also, the target employees are looking at so that there's transparency and the opportunity for immediate feedback on how we're doing on each of the integrations.

The slide provides an example of a company we acquired a couple years ago. The slide is segregated into acquisition performance, which has a number of components, integration execution, which is kind of more of a functional exercise, and finally what we call customer centricity, which is, again, trying to make sure that we're getting feedback from the customers of the acquired company to make sure that we're meeting their needs. A big part of what we're doing in our acquisition strategy is to attempt to try to bring a broader offering of products and services to our customers and to new customer bases.

Everything kind of starts with the financial performance. This is something that's pretty straightforward and something we track and our CEO looks at on a weekly basis. It's a leading indicator of how well you're doing financially. At GE, hitting your numbers is critically important. It’s no different for acquisitions.

So, we look and track very closely the financial impact relative to the plan that we've put forth during the due diligence and the negotiations to make the case for GE to invest in this business.

We then have what we call deal CTQs. CTQ is a GE vernacular for critical to quality. Essentially, key success factors. And this speaks to some of the key strategies of why we acquired a business, and this may be sales into a new country, into a new region, into a new segment of customers. It may be the timing or the product sales related to a new product introduction. We try to boil it down into one or two or three, for a larger transaction, five things, that from a leadership perspective and from a team perspective on the integration, that you've identified as being the important things, that if you do these things right, you know that your tracking and your integration is on a good path.

And then the next piece is what we call operational CTQs, which are more kind of functional metrics, similar to the overall strategic reasons for doing a transaction, but things that are sometimes a little bit softer. Some of it relates to the people side of the integration, new product introductions. So, it's different milestones from an operational perspective, customer satisfaction, employee retention, those types of things that are more operational in nature. Again, these are things that you want to track that don't necessarily appear in the financials of the business, but from an integration perspective are absolutely critical for success.

We then look at integration execution, which is kind of process-oriented, and really much more detailed. There are almost five functional areas in the business that will track how we're doing versus the integration plan in terms of completion of those items. Then there's a group of things we call GE non-negotiables, things that are important that, again, the CEO of the business and the leadership team wants to make sure that are being done and done in a timely manner beyond a much more detailed integration plan.

There's a component of the tool that gives executive updates. Our CEO and some of his leadership team will review these on a weekly basis, and the integration team will highlight critical issues, key wins that will require leadership input, again, to make sure that issues are highlighted, flagged, related to the integration and to the business that we've acquired, and that we can make real-time decisions on this.

Finally, this point called customer centricity, which actually is the result of input that we're getting directly from our customers -- we call it voice of the customer. When we announce the acquisition of the business, we will communicate with its customers, in some cases, common customers to ours, and provide them a forum by which they can communicate to us and let us know how we're doing, whether it's around service issues, good, bad, indifferent. We give them, through the web, a place to come in and tell us how we're doing, provide input and make sure, again, that we're maintaining the revenue base and the customer satisfaction that we think is one of the most critical success factors in any integration we're doing.

And this has been great when -- in addition to providing us with real information, our customers appreciate the fact that we're going out of the way to make sure the process of integration, which can be a pretty tumultuous time, particularly for the employees of an acquired company, that we're still taking the time to listen to what the customers are saying and we're trying to be responsive to their needs.

Just some more detail on this tool. Again, I highlighted some of these things, but it's drill-downs on some of the live information, and then this is something that we try to keep fresh and it's actually the tool that the integration team is running the integration off of. We will generally keep an integration on this tool for 12 to 18 months to make sure it's kind of well on its way to being a successful platform. New businesses will track much longer than this. Businesses that are more fully integrated into our businesses will come off the screen more quickly.

But, again, the key thing that we have found is the ability to have visibility into actually what's going on in a relatively simple way, and accountability around these actions that have to happen during the integration enables us to make real-time decisions. When you're in this pretty important period, initially when you acquire a business, this tool enables you to make sure that something doesn't drag on for several months before you can respond and make the right decisions, try to correct some action that may have happened as a result of the integration.

Finally, there is this piece on customer voice. This is something that we really, really have spent a lot of time on in our business. It goes all the way back to how we develop products with our customers, the voice of the customer in our product development activities, and then ultimately into how we're doing acquisitions. It is an absolutely critical component in whether or not we think we're doing well from an integration perspective.

If we're delivering well against the financial plan for an acquisition and we're not doing well from a customer perspective or from an employee satisfaction perspective, we wouldn't consider this a success. So, all of these different factors weigh into whether or not we think we're doing well. Ultimately, the voice of the customer is probably the best leading indicator, we think, of the ability of the business to continue on whatever trajectory it's on and to deliver -- whether on revenue synergies that you might have baked into your acquisition analysis or into ultimately how it affects your cost synergies. So, that is what I've got.

MR. BOWER: Great. Thank you, Mike. And, Bill?

MR. EARNEST: I think I might have one slide I may put up in the interest of time.

First of all, I want to say we're still in the early days at ConocoPhillips. So, to ask us to talk about integration and implementation is interesting, although I do think we have done a lot of things the right way. Our merger of equals was announced in November 2001, and we actually got regulatory approval and closed around September 1, 2002. So, we're just three months into our merger integration.

A couple of things we do have going for us - one, we did not pay a premium. It was a true merger of equals, done "at market", meaning neither party overpaid. So, shame on us if we don't make it work. The big value driver for us was synergies and combining the capabilities and opportunity sets of the two companies. We hired McKinsey to help us with the process, and once we got the process down, we took over ownership and McKinsey was gone in a matter of three or four months. But they did help us put a process in place that we now own.

Real quickly, I'll just run through the integration team that we put together. First of all, we established a separate team, an integration management team, which worked along with the CEO's of the two companies, Archie Dunham and Jim Mulva. That high level group, for the first month or two after the announcement, worked on high level strategies and objectives for the new organization.

We also picked two of the brightest and probably most upwardly mobile individuals in the two companies below the CEO level, Phil Fredrickson from the Conoco side and John Lowe from the Phillips side, to lead the integration. So, again, we were picking leaders that we thought had a vested interest in making this merger work, not only in the next few years, but really, in the long-term. If you were to ask the people at Phillips and at Conoco, who were the most likely successors to their current CEO's, these were the two guys most people would mention. And so, they were put in charge of integration.

Below that, we had seven integration teams. One for upstream, which is the exploration and production part of the business, and one for downstream. These are our two major lines of business. Several of the functional areas, such as Finance and Human Resources, also had teams, and then below that, we had 64 sub-teams. So, altogether, we had 500 to 600 people working integration.

Again, the people that led these seven sub-teams didn't know exactly where they were going to land in the new company. But, they were key leaders in the company and we knew the people that were leading the upstream team had a role in the future upstream organization. They didn't know exactly where, but they had a role and a stake in making it work, and also had ownership in the synergy targets.

One of the things I think we did extremely well was getting our organization named, working with the regulatory authorities, naming key people, and trying to get our organization in place as early as we could. And, then as we named these people into their specific positions, they took over ownership of the integration process, the synergy targets, and the organizational goals that had been put in place at the high level.

These were two very proud companies with two very similar backgrounds. Both, in a way, were caught up in the takeover frenzy in the early '80s. Phillips fought off the Boone Pickens takeover attempt, but it had a impact on the company for years to come. Conoco was “rescued” by DuPont in 1981 after a hostile takeover attempt by Seagrams, then was spun back out as a public company in 1998. So, really, we're both survivors in an industry that has seen much consolidation. Both companies were not willing to do this transaction unless it was a merger of equals.

We said we were going to take the “best of the best” in people selection, and I think we did a first class job of picking the best people, and keeping the strengths of the two organizations in place. That did not mean that in every department 50 percent of the people were Conoco people, 50 percent were Phillips people. In fact, you'll find that the operating side very much went Conoco's way, at least at the executive level. Conoco was known for a very strong operating culture, both in upstream and downstream. Phillips, on the other hand, was more known for its hard-nosed financial acumen, and you'll look in the finance department of ConocoPhillips and you'll see senior management is predominantly Phillips heritage. We did try to pick the best of the best, and it just happened to come out, in total, very close to a 50/50 split.

I guess the thing we're the most proud of is that within 45 days of close, September 1st, everybody in ConocoPhillips knew that they had a job and what it was, or they knew they didn't have a job. So, really, by the middle of October the organization was set, and that was a goal that we set early on. We didn't want an organization of people sitting around wondering, “where am I, where do I fit in”.

The other thing I think we did very well was the hand-off. As I said, as we named executives to lead certain groups, the executives basically assumed the integration team responsibilities and became accountable for getting the promised results.

What was really fortuitous for us was the fact that we got approval in early September. I think had it gone a few more months, we wouldn't be nearly as optimistic about our ability to really make this thing work in the near-term. The reason is because in the oil and gas industry, the budget cycles begin usually in the summer. So, you're really planning for the next year's work 12-18 months in advance. September was about as late as we could get approval to close and still really get all of our plans, our synergies, everything, built into our operating plans for 2003. We have really humped it since September, to get these plans in place, and, in fact, tomorrow in New York, hopefully, our Board of Directors will approve the 2003 capital budget and operating plan for ConocoPhillips.

What is really important about that is that each of these synergies, all these targets that we've put in place, are in the operating plans. So, we have clear accountability, we have a clear plan for how we're going to achieve them. We will start seeing the bottom line impact of that March 19, 2003.

You can look at this and say, well, this should be pretty easy, you didn't pay a premium, you've got two companies, all you have to do is get some cost savings. If you look ahead a few years, I think, our real challenge is going to be merging the cultures. Conoco and Phillips really -- if you know anything about it, you'd look at it and say, well, those are two very similar companies. But what you find is really a collection of cultures as a result of some of the deal activity that has occurred in both companies over the last three years.

Conoco just did an IPO and split off from DuPont at the end of 1998. In 1999, I was in this building trying to convince the FTC that Conoco was a better competitor for Arco Alaska than Phillips would be. Phillips had won the bid from BP to buy Arco Alaska. That was a $7 billion transaction that Phillips completed in late '99, early 2000. In late 2000, Conoco and Phillips got together and talked about merging. It didn't happen for various reasons, mostly because of some of the soft issues.

So, within six months of that, Conoco went out and bought Gulf Canada for $6 and a half billion in the middle of 2001. Within a month of that, Phillips announced the acquisition of Tosco, a $7 billion acquisition. I don't know if you want to call it an arms race or what, but -- at that point, the two companies got together again and said, “you know, maybe we let some things get in our way that we shouldn't have”, and the deal was put together rather quickly about a year ago.

So, the big challenge for us I think is making the soft side work with the cultures. We're a combination of cultures. You've got Conoco, you've got Phillips, you've got Tosco, you've got Arco and you've got Gulf Canada, all of which have come together in the last two years. Again, the reason we're very optimistic about it is we have a CEO that is very financially focused, we do have all the synergies from all of these deals baked into our operating plans, and we are going to hold people accountable -- that's how we're all going to be paid. We're very optimistic that we're going to make this work.

That's all I have.

MR. BOWER: Well, first of all, this is an extraordinary panel. So, I think we should thank them.

(APPLAUSE)

MR. BOWER: And now, can we take questions? We do have time for questions. Yes, David?

MR. SCHEFFMAN: David Scheffman, FTC. Bill, could you give us a better idea of what you did prior to when you could close, when you passed regulatory clearance, and what you didn't do?

MR. EARNEST: What we did prior to getting approval?

MR. SCHEFFMAN: In terms of integration planning, et cetera.

MR. EARNEST: We did the obvious things, particularly on the upstream side where there were fewer issues on the regulatory side. We knew we had obvious duplication of offices in the lower 48. We had overlap in the North Sea. So, we could do some planning as far as what kind of organization we thought we would need. The things that we were not able to do were things like exchanging non-public information about our assets, which would have been helpful in making strategic decisions on portfolio. We tried to prepare for that by developing some templates, so once we got approval we could populate the templates with real data, and move quickly.

We knew the kind of information we'd like to share. At Conoco, we knew we'd like to know all the projects that Phillips was working on in the Middle East. We knew the ones we were working on. We knew that Phillips was probably working on some and we knew we probably couldn't work on all of them when we combined. So, we couldn't really share that information, but what we did was have each side separately develop the same kinds of information, which once we received regulatory approval, we could share with each other. Through our budget process, from September until now, we have been able to make some of those judgment calls, but we're still not there.

There are still some areas where I think we haven't made some of the tough calls on portfolio because we just haven't had time to look at the two portfolios and rationalize them. But we did as much preparation as we could pulling data together after receiving regulatory approval. I think the main thing we did was get our organization in place, get people aligned around the objectives on cost synergies, and we were able to do that without really sharing any kind of non-public information.

MR. SCHEFFMAN: So, you did create the integration team and you identified the co-leaders and had all the structure in place?

MR. EARNEST: Yes. Actually, I think we named our two integration leads, Phil Fredrickson and John Lowe, at deal announcement. We said they're in charge of integration. We put our teams in place and each of the teams had lawyers on them. We were very careful about getting their guidance and we shared what information we felt that we could, and we didn't share the information we didn't think we could. I was the leader of one of the upstream teams and was quite frustrated, actually, in our inability to share certain information. But, we did what we could within regulatory and legal limits, and the rest of it, we're doing on the fly. We're going to make it work.

MR. BOWER: Yes, Susanne?

MS. TRIMBATH: Susanne Trimbath with the Milken Institute. I'd like to ask Daniel a question. I think Robert, in particular, and maybe one of the other speakers had mentioned that when they did their management integration, they made it clear that it would be whoever was the best person for the job. I read somewhere that one of Cisco's requirements for the firms they look at is that they have strong management teams already in place. In other words, management is considered part and parcel to the acquisition. Is that true, and if so, how important is that to the success of your acquisitions?

MR. SCHEINMAN: The simple answer is that it's more true in down markets than in up markets. In up markets, we were sometimes counting as management teams if we had one person we thought was strong enough to survive. Today, we clearly are looking for management teams. We believe that the retention of the management team in the technology business is absolutely critical. We're betting really on the next platform or the integration of two platforms to create a third platform, and you need the vision at the management level to do that. So, we really have a focus on management teams.

The one metric, which I was looking to see that GE had up, that we tracked religiously was retention, particularly, of the management team.

MR. BOWER: Any other questions? Yes, in the back?

MR. PIDANO: I'm Chuck Pidano, Bureau of Economics at the Federal Trade Commission. As I think most of you probably know, when we look at efficiencies, we're looking at merger specificity, can these efficiencies be achieved only through the proposed merger. One area that there's probably a predilection to assume that they are not merger specific is general and administrative type efficiencies.

I'd like to hear any of you comment on that, whether some of the G&A efficiencies in the mergers you've been involved with are, in your opinion, merger specific or not, and to what degree.

MR. BRODSKY: I think it really depends. But, there's always room for more G&A efficiencies. For instance, take a Procter & Gamble example or, in our case, a branded food example from one of our companies, you're buying a specific brand. There could be a tremendous amount of G&A that's currently used to manage that brand by its current owner that simply isn't necessary anymore once that brand or that product is owned by a different company because the existing people and facilities in the company have enough room to take on that additional work, or there's simply enough office space or something like that.

So, I think very often G&A is intimately linked to the acquisition.

MR. PIDANO: But does it have to be a competitor? In other words, is Conoco going to get more G&A efficiency by merging with Phillips than by merging with P&G, for example? I know that's a simplistic way of saying it, but that's an issue that comes up pretty frequently here.

MR. BRODSKY: I'd be curious to hear what everyone else says, but my opinion is, yes, if Conoco and P&G merged, you would probably have the need for one CEO and one CFO, but below that, you would need people with very, very distinct skill sets. If you're putting together two companies that are in the exact same industry and simply are different -- manage different products, there's people further down in the G&A that can multi-task, and that directly leads to a combination of businesses in like industries.

MR. BOWER: Let me just pick up on this and go back to the example I gave earlier of Snapple and Quaker. The Quaker people thought for sure that Snapple would have the characteristics that Peter just described, that it would fit easily into their portfolio. In fact, it turned out to have little to do with their portfolio. They didn't know that and they couldn't see it, and they learned it, to their dismay, because they nearly destroyed Snapple. It's amazing to me how difficult some of these deals can turn out to be, because the processes by which two firms will do the same business turn out to be very, very different.

So, I think it's an easy assumption to make, but a dangerous one. There's another one. Mike Scherer said it earlier today -- the assumption that firms will get administrative efficiencies just because they're available is very risky.

I think the head of Mobil is quoted as saying that almost all the efficiencies that they were going to get from Exxon/Mobil could have been realized by Mobil and Exxon separately, except they never would have been, because life being what it was, changing arrangements was hard, -- so, yes, in principle you can realize administrative efficiencies, you know, “if”. But if a frog had wings, it wouldn't bump its bottom on the ground so much.

MR. PIDANO: Thank you.

MR. BOWER: Yes?

MR. SALTZMAN: I am Harold Saltzman, with the Bureau of Economics at the FTC. This two part question goes to various panelists. First, assume that a given acquisition is expected to realize, say, $100 in cost savings. Based on your experience, would the actual cost savings from that acquisition be roughly $100? Would it be less than $100 or more than $100? Would it be $200 or $500?

Second, whatever the cost savings ultimately ended up being, how much of it would be from the original $100 that was expected?

MR. BRODSKY: I think there are surprises in every deal. One thing I can guarantee is that it won't be 100. It might be 50 and it might be 150, but I've never seen a projection that actually came to fruition exactly as originally projected. I think it depends on how aggressive the teams are in their negotiating and it depends on how much access to due diligence there was. There are varying levels of access during the whole process. So, unfortunately, I don't think there's a generalized answer to that.

MR. INGRAM: I would echo what Peter said. When you look at the cost savings, it isn't just eliminating duplication as part of that $100 as you said, but procurement. You become a bigger buyer. You can command much better discounts. We're British Air's biggest corporate customer now, and we can really negotiate much better discounts based on just shear volume.

MR. SALTZMAN: Just to follow up some. I recognize that there is a lot of uncertainty, and that each situation is different. But it sounds like you collectively have been involved with literally hundreds of acquisitions. So, I'm wondering, based on your actual experience, is it very, very likely that the number that is projected as a cost savings will be realized because the company wants to be conservative, for example? Can you pretty much go to the bank with that number because in all likelihood you will reach it or exceed it? Or, is it just as likely that you will fall short?

MR. BOWER: John Mayfield?

MR. MAYFIELD: Well, at ITW, due to the number of acquisitions we've done, obviously, the cost savings is probably the easiest area in which to be --

UNIDENTIFIED MALE: More certain.

MR. MAYFIELD: most certain. The revenue stream, price increases, and customer retention, as I said, are our critical issues, and by far the most difficult to try and confirm prior to the acquisition. Limited access to customers and pricing information during the due diligence process creates a higher degree of uncertainty than synergies (cost savings) that could result from the acquisition. So, when we set our acquisition models, we usually approach them from a synergistic basis with the upside based on top line growth (volume growth, customer retention and targeted price increases). Our cost savings is the most certain number, and if we err on the conservative side, it is top line growth. Will we get the numbers in the specific areas? No. However, as the other panelists have noted, cost savings can be generated from a number of different sources. Buying power can be improved through association with a larger enterprise. In ITW’s case, newly acquired companies can gain access to more sophisticated research and development, which can improve their product cost immediately. So, the cost savings is the most certain assumption we can make and the revenue growth on the top line is the least certain in determining acquisition purchase price.

MR. BOWER: I agree. I did a study way back in 1973 that looked at capital budgeting and the process within a company. And at that time, the mean of realized cost savings to projected cost savings on capital projects, was about 1.1, with a tight variance. The mean on revenue projections was about 0.6 with a broader variance. The mean on new product areas, essentially innovation, was zero with a very wide variance.

(LAUGHTER)

MR. BOWER: That variation of uncertainty as to results is important when we're talking about the outcomes of deals. The results that I gave describe investments made within your own company, projected by its own people, using its own numbers.

MR. BRODSKY: It goes back to what I was saying earlier, that as you're trying to negotiate for who's going to reap the benefits of those savings, it's much less risky to pay for the expense savings, and it's very risky to pay for the revenue enhancements.

UNIDENTIFIED MALE: Well said.

UNIDENTIFIED MALE: Exactly.

MR. EARNEST: I suspect part of it is that there is probably an inverse relationship with the premium that's paid. Quite frankly, one of the analyses we do periodically on all the companies that we might be interested in acquiring is what kind of premium do you have to pay, and then what level of synergies would you have to achieve in order to make up for the value that you paid in the premium. In the case of ConocoPhillips, there was no premium, so we had no pressure to over-promise on a synergy number. And, just a couple of weeks ago in New York, at our first security analysts' meeting, we told the Street that actually we're increasing our synergy target by 67 percent from what we made at announcement. So, we didn't need to over-promise because there was no premium. It's just a theory.

MR. BOWER: But I think, in general, you would agree that when it's an oil company buying an oil company, life is simpler. Bob Ingram said it, it's a drug company buying a drug company-- they've been studying their competitors for years. They talk to the competitors, they know the people. Those kinds of projections are much more likely to be sound. When Viacom buys Paramount, they don't have a clue. They try, but it's a very, very different kind of operation, and what you can see on those deals is that they're totally a function of the leadership.

Sumner Redstone seems to be great. Mike Armstrong seemed to be incapable of doing a good deal. And what can you say?

MR. BRODSKY: We do a lot of business in media and radio and television and, it's not quite once you've seen one TV station, you've seen them all. But when you've been around one industry for a very long time and looked at lots of different stations, during your due diligence, you can ask how many people do you have in your news department, how many people do you have in your promotions department, how many sales people do you have, how much square footage do you have per person, and you can do very quick, but accurate, assessments of what the cost structure should be.

MR. BOWER: Yes, Paul?

MR. PAUTLER: Paul Pautler of the FTC. I just wanted to follow up on a statement that Bill just made. It ought to be easy to do the calculations to figure out what the savings are, but you've just increased your estimates by 67 percent. So, you were a little bit below.

Now, did you find out new information? After the regulatory period stopped and you were able to move forward and actually exchange information, did you find out there was a lot more there or were you just conservative to start with and now you're being sort of a little less conservative?

MR. EARNEST: It was both actually. I think once we were able to exchange information, we identified a lot more savings in procurement. We operate in a very capital intensive business, and together, we were spending $8 billion a year in capital, and billions more in operating costs and supplies, and what we found was a third or more of our new synergy target is procurement savings. Those are the kinds of savings we weren't quite as confident about a year ago.

MR. BOWER: Yes, Susanne?

MS. TRIMBATH: Susanne Trimbath, Milken Institute. I'll just add a comment to what you're saying there. I was at the Association for Corporate Growth's M&A Finance conference in Los Angeles last year when they were talking about this. There are some buy-out firms who work with smaller organizations, certainly not the really large ones, but the smaller ones, who provide exactly this service for the companies that they put into their portfolio. That is, they pull together their acquisition processes to make them bigger buyers for all the types of materials that they have to purchase.

MR. BRODSKY: We do that at our firm.

MS. TRIMBATH: It's a great service.

MR. BRODSKY: Valued-added. That's terrific. Because if you put all of our companies together, it's an enormous amount of purchasing power, whereas individually they're all relatively small.

MR. BOWER: Yes. From Wilmer Cutler?

MR. KOLASKY: I'm Bill Kolasky.

MR. BOWER: Bill, yes?

MR. KOLASKY: Following up on the discussion we were just having about greater uncertainty on the revenue growth projections, to what extent have failures to meet those projections, in your experience, been the result of a, shall we say, more vigorous response from your competitors than you were expecting or from competitors adopting strategies that you hadn't anticipated in response to your own merger or acquisition?

MR. BOWER: Does someone on the panel want to pick that up?

MR. JONES: From GE Medical's perspective, some of it's related to new product introduction. So there's some uncertainty looking at, what a product's going to be able to do a year or two down the line until you actually have the products in the marketplace. There's certainly the comments we heard today about when a transaction is announced, having competition all over customers, all over employees is right, and I think those two, customer base and sales force, are very fragile. I think it's as much not having a handle on what's going to happen to the customer base and to the sales force that impacts that, not necessarily the competitor coming up with a new strategy. I think the strategy is pretty tried and true when an acquisition is announced.

So, I think it's not dealing with that issue effectively that creates the problem as much as some kind of new unique strategy coming on board.

MR. BRODSKY: And it goes to the question that, I think, someone asked at one of the earlier panels, which was why does it matter if it takes a long time for a deal to be approved.

UNIDENTIFIED MALE: Absolutely.

MR. BRODSKY: It's not just the employees that get solicited, it's the customers, because it's a period of uncertainty, and especially for the acquired company, their constituencies don't know what's going to happen to the company. In that uncertainty, there's more of a propensity to change.

MR. BOWER: There's also an issue which Dan Scheinman picked up. Sometimes when you're adding products to fill into a line, what you're doing is you're dealing with a problem that the product division or the sales organization had created for you. And then you put that new product line in an organization which is fundamentally hostile to it or doesn't have the capabilities to sell it or doesn't understand it, or you get into a fight and then you lose your revenue projection for that kind of reason.

Any more other questions?

(No response.)

MR. BOWER: Well, then, I'm going to thank the panel. I've heard a number of comments from the audience and also some of the people who left. They were apologizing and said, “this is just fantastic,”. We really thank you.