

## 1 FEDERAL TRADE COMMISSION

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3 A ROUNDTABLE SPONSORED BY THE BUREAU OF ECONOMICS  
4 UNDERSTANDING MERGERS:  
5 STRATEGY & PLANNING, IMPLEMENTATION AND OUTCOMES  
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11 December 9 and 10, 2002  
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34 **(PANEL 3 EXCERPT)**  
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46 Edited Transcripts: These proceedings were professionally  
47 transcribed as described on page 365 of the transcript. The  
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1 business that you are buying. You can look at this three  
2 kinds of ways, as seen in the slide on the bottom of p. 1 of  
3 my handout. First, there are variations in what management  
4 is trying to accomplish. Second, the M&A process, itself,  
5 is spread out over time and there are variations in the  
6 process. And third, there's the process of implementation  
7 itself, which can vary extraordinarily. We heard just a  
8 sense of that when Pankaj Ghemawat talked about Cemex  
9 looking at the process of acquisitions in the cement  
10 industry one way, Holder Bank looking at it a totally  
11 different way. Both could be successful.

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

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

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

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

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

1 panelists, I suspect.

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

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

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

25           (LAUGHTER)

26           MR. BOWER: Now, what I did was look at all the  
27 M&A in the United States in a three year period that was

1 bigger than \$500 million and try to sort it out by motive,  
2 leaving out bluefish. In order to know whether you're  
3 dealing with bluefish, you have to get inside and actually  
4 look at the plans or the absence of plans. You can't find  
5 that out from public data. What you see from the slide on  
6 the top of p. 3 of my handout is that most of the deals were  
7 product line extensions or consolidation. Then there were  
8 roll-up and investor deals, the latter of which accounted  
9 for about 13 percent of the deals, and then you have a very  
10 small bit of M&A as R&D and a small bit of industry  
11 convergence.

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

23           Now, it's relatively easy to assess and  
24 rationalize assets. Companies have become pretty good at  
25 this. It's very hard to assess processes or to change them.  
26 And it can be even harder to see the depth with which values  
27 are held and whether they are subject to change. Just think

1 of the world we're living in -- the centrality of political  
2 and religious values. The same forces operate in companies.

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

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

25           Implementation is also affected by the price of a  
26 deal, as shown in the slide on the bottom of p. 4 of my  
27 handout. If the price is too high, then even if

1 efficiencies are realized, the deal may destroy shareholder  
2 value. Or, as I mentioned, those efficiencies may be lost  
3 through price competition. But a high price may have a more  
4 destructive affect. Sometimes it forces companies to try to  
5 realize benefits very, very quickly, in a situation where  
6 the integrating process requires more time. Moving too fast  
7 can wreck the implementation process.

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

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

26           Now, as seen in the slide on the top of p. 6 of my  
27 handout, that two by two matrix on the previous slide is

1 just based on a longitudinal study of nine companies, major  
2 deals over time, and it was quite striking. So, the basic  
3 finding is that value creation requires both.

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

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

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

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

27           Juan Pedro Hernandez is Vice President and

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

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

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

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

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

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

27 Once again, we will begin by considering the front

1 end of the M&A process. Juan, do you want to get us  
2 started?

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

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

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

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

27 This is, again, to emphasize simply how linked our

1 M&A program is to the corporate strategies.

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

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

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

23           That leads me to the target selection stage, as  
24 shown in the slide on the top of page 4 of my handout.  
25 Target selection needs to leverage on P&G core competencies.  
26 Branding, innovation and scale/efficiencies are derived from  
27 the growth of our equities; our technology and consumer

1 understanding across different business units; and the scale  
2 from our materials procurement, manufacturing, engineering,  
3 and go-to-market capabilities. We are able to go to market  
4 with a \$40 billion plus portfolio of businesses. So, we can  
5 use co-marketing and co-promotional efforts across brands  
6 and business units.

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

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

25           At this stage, our analysis focuses on the  
26 identification of value creation, which in turn helps us to  
27 start defining our walk-away price range. This is critical

1 when it comes to the success or failure of the M&A program.  
2 Discipline in pricing, obviously, needs to be present at  
3 every different stage of the M&A process: at the offering  
4 memorandum stage, at the due diligence process, and at the  
5 actual negotiation of the terms.

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

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

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

1 transition period to hurt the acquired business.

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

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

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

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

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

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

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

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

23           I want to refer to three examples where we believe  
24 we have been successful with our M&A program, and I'm going  
25 to defer today reference to those where we have not been  
26 that successful. Richardson-Vicks Inc. is one of our big  
27 successes. It probably is the most successful acquisition

1 that Procter & Gamble has done in its 165-year history. I'm  
2 talking about an acquisition, in 1986, that was  
3 transformational for Procter & Gamble because we were not  
4 participants of the personal care business other than with  
5 bar soaps.

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

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

23 The second example, shown in the slide on the  
24 bottom of page 7 of my handout, is Iams. It is obviously a  
25 different profile of acquisition, which will benefit greatly  
26 from the technology platforms that we have developed in  
27 Procter & Gamble from Dental Care, in particular. We are

1 currently selling a tartar control technology for dogs that  
2 is delivered through food. So, our product is making pets  
3 live longer and healthier.

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

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

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

27           I'm going to finish here. I could talk about

1 other acquisitions. Clairol may be on your mind. It has  
2 only been one year since we acquired that asset -- still too  
3 early to declare a success or failure. But prospects look  
4 good. Now, I'll be happy to answer any questions.

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

7 MR. HERNANDEZ: Fantastic, thank you.

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

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

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

21 I'll speak more to GlaxoSmithKline because it's  
22 more recent, it's a larger scale and it is a true merger.  
23 But both were driven by, I think, very common forces coming  
24 out of, as Juan Pedro said in the case of Procter & Gamble,  
25 a look at our strategy. In 1995, Glaxo, which was then the  
26 second-largest research-intensive pharmaceutical company in  
27 the world, but had been built on largely the success of one

1 large blockbuster medicine called Zantac, was looking at  
2 patent expiration in the United States for Zantac in the  
3 year 1998.

4           And, frankly, the pipeline of new products was at  
5 a stage where we knew that we were not going to be able, in  
6 that first year of patent expiration, to replace the almost  
7 80 to 90 percent of sales that you lose in the first few  
8 months today in the United States, with new product sales  
9 because the pipeline just wasn't that far along in terms of  
10 its timing.

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

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

1           However, the Wellcome Trust, which was the largest  
2 shareholder, could see in their business, even in the mid-  
3 '90s, that the research productivity was waning, and  
4 frankly, the commercial capability was not competitive with  
5 companies like Glaxo or Merck or Pfizer or Lilly, to name  
6 some of the names you're familiar with.

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

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

23           But as we go forward, we can see that the science  
24 and technology, it's becoming more and more clear now that  
25 the mapping of the human genome is going to not only be more  
26 complex but more expensive. We will transform ourselves  
27 from an industry that, as I said, has discovered and

1 developed good medicines for big groups of people to an  
2 industry that actually discovers and develops and ultimately  
3 delivers great medicines for subsets of those big groups.  
4 We'll be able to actually not just treat hypertension, but  
5 we'll be able to see what causes your hypertension and we'll  
6 be able to, in many cases, interrupt that chain of events  
7 before it actually presents itself as a chronic disease.  
8 Now, some of that's occurring. More of it will occur as we  
9 go forward.

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

19           So, we approached the Wellcome Trust in late '94.  
20 After three meetings, we reached an agreement which we  
21 announced in January of 1995. The Wellcome management,  
22 frankly, was taken by surprise, which presented a challenge,  
23 which I'll come to in just a minute. We made an active  
24 effort, obviously, to meet with the other investors in  
25 Wellcome, the large institutional investors, to share with  
26 them our vision of an enhanced science base. Not only was  
27 that the legacy of Wellcome, but an enhanced science base

1 also would greatly increase and enhance the commercial  
2 capability of the products Wellcome already had on the  
3 market. Through the increased scale and effectiveness of  
4 our commercial capabilities in marketing and selling, both  
5 in the United States as well as around the world, we would  
6 produce a much more effective return for those shareholders.

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

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

1 found, that difficult to get cost savings. You can, you  
2 should and you will, and I'll come back to that.

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

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

24           And I can remember vividly within the first few  
25 days of the announcement, one of my colleagues, who, to his  
26 credit, had the courage to raise it directly with me said,  
27 Bob, didn't we acquire them. And, of course, the honest

1 answer was yes. And his question was, well, then why is my  
2 job at risk? And the honest answer then was, and should be  
3 today, we want to make sure that we take the best of both if  
4 we're going to really capture the optimal value out of this.

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

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

24           And I remember vividly meeting with my counterpart  
25 at the time who was the president of the Burroughs Wellcome  
26 U.S. business, and to this day, remains a good friend. And  
27 I was saying to him that I saw in two of their products, an

1 anti-depressant called Welbutrin, which some of you may know  
2 by brand name, and in their anti-viral AIDS portfolio,  
3 medicines that in 1995 were in global sales \$100 to \$150  
4 million a year, saying that I thought within five years we  
5 could take each of those medicines to a billion dollars or  
6 more. His response was, if you can do that, why, I will tip  
7 my hat, but I don't believe it can be done.

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

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

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

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

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

26           And as a result -- and you've seen it very  
27 recently with medicines that have become household words,

1 like Prozac, for example. Within the first two months of  
2 its patent expiration, Prozac in the United States lost  
3 about 85 percent of its sales.

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

9           So, in the year 2000, we tried actually first in  
10 '99 and it didn't work, to put Glaxo Wellcome and SmithKline  
11 Beecham together in a true merger of equals. Now, here  
12 again, two British-based companies. Neighbors in London,  
13 but unlike Glaxo and Wellcome, not neighbors in the U.S.  
14 SmithKline Beecham's U.S. headquarters were in Philadelphia;  
15 obviously Glaxo Wellcome's headquarters were in Research  
16 Triangle Park, North Carolina.

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

27           So, here were two British-based global companies,

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

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

24           When I started out 40 years ago in this industry,  
25 the rule was one compound, one chemist, one week. Today,  
26 any company in our business will screen millions of  
27 compounds each day and will be able to screen them against

1 targets very quickly to understand which targets have the  
2 greatest affinity for which compounds. Within the cell,  
3 which part of that cell is it that you're trying to target?  
4 And by developing proteins, small molecules, the promise of  
5 this science, again, is enormous.

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

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

25           Within a matter of a couple of months, because the  
26 vision was so compelling, the two respective boards asked  
27 myself and J.P. Garnier, who was my counterpart at the time

1 at SmithKline Beecham -- and J.P. and I have known each  
2 other and were friends then and still are today -- if we  
3 could see if we could get together and see if we could make  
4 this work.

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

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

26           In the first two years, we were down to around 71,  
27 72 plants, more to go. The challenge in our business is you

1 have to do that, while at the same time, not interrupting  
2 the supply of life-saving medicines as you move product  
3 supply from one plant to the next. This is particularly  
4 true if you're supplying the United States, where the FDA,  
5 as it should be, has to approve that. So, it's time-  
6 consuming.

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

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

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

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

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

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

25           Now, in the area of R&D productivity, we took this  
26 \$5 billion R&D investment every year, and we frankly changed  
27 it. We don't have one monolithic R&D organization, unlike a

1 lot of pharmaceutical companies, because the key challenge  
2 facing this industry is R&D productivity. So, what we've  
3 done is to create what we call Six Centers of Excellence in  
4 Drug Discovery, SCEDD is the acronym. And what we've done  
5 is to focus them along therapeutic lines. So, one focuses  
6 on metabolic disease, one focuses on anti-infective disease,  
7 one focuses on respiratory disease, one focuses on C&S  
8 disease, et cetera. And they compete for resources. And  
9 they're funded much like six individual biotech companies,  
10 if you will. And scientists in those centers, who actually  
11 do discover and develop a medicine that makes it to market,  
12 actually get an equity stake because we realize that one way  
13 you attract and retain top quality scientists is to be able  
14 to do that even in a large pharma company.

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

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

1 find.

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

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

26           We employed both the Boston Consulting Group as a  
27 consultant to help us with, if you will, the organizational

1 design, and Spencer Stewart, a search firm that neither  
2 company had used because we didn't want there to be a bias,  
3 to help us set in place a process for candidate selection.  
4 And we were able, when the deal was approved, at the end of  
5 the year 2000 -- so the company will be two years old the  
6 27th of this month -- within the first six to eight months,  
7 to have our entire global management team, and I'm talking  
8 down to the plant manager, down to the district manager,  
9 down to every department head, chosen and in place. That  
10 may not seem like a lot to you, but we're talking, in this  
11 case, an employee base to start with of 110,000 people, a  
12 management staff within that of about 25,000.

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

26           I'll just close by saying that the cost savings  
27 you must get and you can. The speed of implementation is

1 critical. It's not only critical in terms of getting the  
2 cost savings, it's even more critical in terms of capturing  
3 and retaining the most important asset that you have, and  
4 that is the people that are always going to feel at risk.

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

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

13 (LAUGHTER)

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

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

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

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

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

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

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

19           The other thing that was interesting has been that  
20 until this recent slowdown, the market was really  
21 characterized by an increasing rapidity of decision. So, in  
22 1992, we probably had a year or two before we had to make  
23 decisions. By the end of the bubble in 2000, we were having  
24 to make decisions within sometimes four to five weeks. The  
25 market cycles were shortening and becoming rapid, and the  
26 penalty for us was increasingly draconian. If we missed a  
27 market or we weren't able to develop something internally,

1 we were either out, as happened in a bunch of cases, or we  
2 had to pay what seemed like outrageous prices at the time in  
3 order to enter the market. That obviously has implications  
4 for our ability to generate EPS, and general success for our  
5 shareholders.

6           The environment now has actually changed and we're  
7 180 degrees from the environment that we were in. Today,  
8 there's a draconian penalty if you go too early. If you go  
9 too early, you frequently end up with a product that the  
10 customers aren't going to want because it's developed too  
11 early, it doesn't have the right feature sets, and you're  
12 going to be spending all your time re-engineering something  
13 that you've brought too soon, -- or you're going to end up  
14 with employees building a product that there's no market  
15 for, and there has been, quite frankly, a lot of that out in  
16 the public markets. I'll give you an example. The soft  
17 switch market is one where people were predicting a market  
18 worth billions and billions of dollars. But nobody that's  
19 there has been able to make much of a market. Competitors  
20 that are public are all trading for under \$2, and acquiring  
21 them only would have led to expense to us.

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

25           But for us, risk really is critical and what we've  
26 discovered when we look at our M&A activities is that really  
27 10 to 15 percent of our deals generate 95 percent of our

1 returns. If you think about it, it's really an extension of  
2 the venture business. The venture business is the same way.  
3 When you look at the funds, it's 10 to 15 percent of the  
4 deals generate the returns. If you look at technology  
5 across the public companies, same thing, a very, very small  
6 number of companies, year over year decreasing actually,  
7 generate most of the value that's created.

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

20           I think the role of due diligence is critical, and  
21 our benchmark for due diligence is not whether or not  
22 ultimately we discover and solve every last problem. It is  
23 whether or not we identify the issues and whether or not we  
24 were accurate in identifying the issues. And particularly,  
25 we spend a lot of time focused on chemistry. I've never  
26 been involved in a deal where the two sides have ended up  
27 hating each other at the end of the negotiations where the

1 deal has worked. Most of our deals are small enough that  
2 the negotiating team can't hide from the integration team.  
3 So, we find we spend a lot of time on non-metricable items  
4 like chemistry, shared vision and how the two teams feel  
5 about each other, which, quite frankly, drives a lot of the  
6 quantitative types who work for me crazy because they're not  
7 quite sure how you measure these things, and yet, we find  
8 that those are sort of the critical success factors.

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

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

1 you're in chaos.

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

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

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

22           It was the last closing party we've held. We  
23 don't do closing dinners anymore. We now look for  
24 milestones to try and celebrate the integration teams and  
25 bring them out of the holes and the bunkers and try and say,  
26 hey, congratulations, we've hit this milestone, why don't we  
27 all go out for dinner and sit down and chat. To be frank,

1 during the bubble, as the deal flow increased and we were  
2 doing a deal every other week, it was harder and harder to  
3 keep up and make them feel these things were genuine, here  
4 we are again, another dinner, congratulations.

5 (LAUGHTER)

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

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

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

25 (No response.)

26 MR. BOWER: No? Okay. Then, do we have the  
27 microphone and are there questions from the floor? After

1 this question and answer, I'm tempted to say that we will  
2 take a five-minute break max. I mean, we're really going to  
3 just break briefly and then start again, and we will pick up  
4 with negotiating the deal and then we'll pause and take  
5 questions again, and then go on to the final portion.

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

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

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

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

1 both.

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

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

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

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

20 MR. INGRAM: Joe, I'll be very brief. The two  
21 legacy companies in R&D, in dollar terms, Glaxo was  
22 investing about \$3 billion a year, SmithKline was investing  
23 about \$1.2 billion a year, so the net investment was a  
24 little over \$4 billion. We've taken that now to \$5 billion.  
25 That was funded largely by some of the cost savings,  
26 particularly cost savings that came out of the manufacturing  
27 area, and cost savings that came out of the administrative

1 area. But it was also just the shear decision we made,  
2 which was the heart of why we think this merger will make  
3 sense, that our future is really tied to R&D productivity.  
4 We knew that as a combined company, we would have an  
5 increased ability to invest in R&D. We had to make that a  
6 reality on day one, and it wasn't just throwing money  
7 saying, we're bigger. We saw, as we aligned those six  
8 centers that I spoke to, an opportunity to invest, and as  
9 best as one can tell about an early stage research  
10 investment, make it a good investment.

11 MR. BOWER: Thank you. Any other questions?

12 (No response.)

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

16 **(Whereupon, a brief recess was taken.)**

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

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

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

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

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

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

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

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

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

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

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

25 Some prior presentations have indicated that  
26 almost 50% or more of the acquisitions fail. Some of the  
27 key reasons are over payment of purchase price, and

1 inability to transition the business as planned. This  
2 usually means overly aggressive top line growth assumptions  
3 or unsupported cost reduction assumptions.

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

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

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

23 A key aspect, when we are setting the purchase  
24 price, is that we really don't proceed until we have a clear  
25 fit for the acquisition. There has to be an absolutely  
26 clear strategy of where it's going to fit in the  
27 organization, and why we are making the purchase. We need

1 to clearly understand why we are pursuing the target. There  
2 has to be a clear and logical integration plan.

3 This has been brought up by all of the panelists, earlier  
4 today, that there has to be a very clear integration plan,  
5 and I can't emphasize that enough. I think that's why we  
6 are successful, because the operations people are involved  
7 up front in setting that integration plan.

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

19           When we actually set the price for an acquisition,  
20 we use some of the same traditional methods I think most  
21 companies would use. We do look at revenue growth. We look  
22 at the possibility of increasing prices, which is almost  
23 non-existent in the markets that we serve. We look at  
24 improvement in the cost base, whether it's the delivery of  
25 the product or the actual manufacturing of it. We certainly  
26 look at the working capital that's employed. We look at the  
27 cash flow. Our target measure is to set a price that gives

1 us a return on invested capital anywhere within a 12 to 36-  
2 month period.

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

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

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

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

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

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

1 focus groups to see if our customer base has been served.

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

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

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

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

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

1           We are a private equity firm and we manage about  
2 \$8 billion in assets. We've executed about 400 transactions  
3 worth about \$50 billion over the last 15 years. So, our  
4 firm's success really lives or dies by the success of our  
5 M&A, merger and acquisitions, activity, and we really  
6 measure our success in a very simple way, which is, has an  
7 acquisition enhanced the value of our investment or  
8 decreased the value of our investment.

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

20           The other thing that's slightly different is that  
21 when we buy a company, our funds have a 10 to 15-year life  
22 span. So, any investment that we make, we intend to exit,  
23 on average, between three and seven years later. So,  
24 there's a very finite period of time when the value needs to  
25 be created, there's a very finite period of time when the  
26 acquisition will be deemed to be a success or a failure.  
27 So, in a lot of ways, it makes our job in measuring

1 ourselves simpler because it's such a finite specific target  
2 that we're trying to hit.

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

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

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

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

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

26           And I would say that overpayment really is two  
27 things. One is overly rosy projections of the base

1 business, which are fully paid for up front, but even more  
2 importantly, overly rosy projections of synergies, be they  
3 cost or revenue, that are also paid for up front. If  
4 they're paid for up front then the implementation team, that  
5 the rest of the panel is going to talk about today, is  
6 really in a very difficult situation because the more you  
7 pay for those, the less room for error there is on the  
8 implementation side. Implementation is fraught with error,  
9 and sometimes it's trial and error and not everything goes  
10 according to plan.

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

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

24           So, let me talk a little bit about the different  
25 kinds of efficiencies because there's a different risk  
26 factor to each of these efficiencies. I've categorized them  
27 into three or four buckets and then every time I created a

1 bucket, I found several sub-buckets. So, now, I'm not sure  
2 how many there are, so please bear with me.

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

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

23           One of our most successful deals we actually  
24 bought from American Home Products was their food division.  
25 It was a series of very, very solid brands, Chef Boyardee  
26 and Polaner All Fruit and Jiffy Pop Popcorn, but it just  
27 wasn't being managed actively because it was a tiny division

1 of a huge company that wasn't focused on food. We bought  
2 that company. We paid a very high multiple of current year  
3 cash flow, but there were so many cost synergies and  
4 efficiencies that we could see just from putting in a more  
5 entrepreneurial management team and cutting some fairly  
6 bloated G&A, that we were able to bring our multiple down  
7 fairly rapidly. Then we engaged in a buy and build process  
8 where we added on brands onto that platform, and that's  
9 where we started to see some of the synergies like we've  
10 been talking about today where we were able to take brands  
11 and put them through our distribution pipeline and enjoy  
12 those kinds of synergies.

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

21           And then there are the harder to calculate, harder  
22 to justify revenue synergies that will come from putting two  
23 companies together -- you've got Companies A and B, you can  
24 sell Company B's product to Company A's customers and  
25 Company A's product to Company B's customers and there  
26 should be a tremendous amount of synergy. As you go along  
27 the continuum of this, I can do it better through the cross

1 fertilization, cross marketing, I would say it's going to  
2 get riskier and riskier. And what we try to do as we  
3 negotiate and as we execute is it's okay to pay for a little  
4 bit of the low-hanging fruit synergies, but if you've begun  
5 to pay for every last bit of growth that you're going to see  
6 out of the acquisition, you have a very, very high  
7 likelihood of having overpaid for the deal when you're done.  
8 That is going to be a failure in our book because our equity  
9 value will decline over time.

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

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

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

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

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

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

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

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

17           It's always a tough balance, and there's really no  
18 one answer to try to balance independence and culture of an  
19 acquired business and the desire to try to integrate  
20 quickly. You do need to make decisions quickly, but  
21 respecting a culture that you're bringing into GE is also  
22 very important. We also place a big emphasis on trying to  
23 adopt some of the best practices of the companies we acquire  
24 so that, at the end of the day, a company we acquired  
25 doesn't look like GE necessarily at the end of the  
26 integration period. But some of the things that made the  
27 company valuable to begin with are there and in place. And

1 this really requires not just the team of people who are  
2 involved in the acquisition, but kind of a broad business  
3 ownership and cross functional engagement from different  
4 parts of the business.

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

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

26           Finally, on people, in addition to the commercial  
27 sensitivity, you've heard a number of people say today that

1 making sure you're retaining talent is absolutely critical  
2 in an acquisition. And we focus on commercial and key  
3 talent retention, and in our business, that's primarily  
4 technical R&D type of talent. And what we're hoping for is  
5 to create the right incentives in an integration plan to  
6 have the key players actually give GE a chance to have us  
7 prove to them that we can be a great place for them to  
8 prosper, grow their careers and, hopefully, open up the  
9 whole wealth of new opportunities for them.

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

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

25           We've got a tool that we call E-integration, which  
26 is basically an online tool that helps bring all this  
27 together, that creates clear objectives that we can then

1 track and make sure we're delivering on. I'll use the slide  
2 on the top of page 2 of my handout to take you through this  
3 tool.

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

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

27           Everything kind of starts with the financial

1 performance. This is something that's pretty  
2 straightforward and something we track and our CEO looks at  
3 on a weekly basis. It's a leading indicator of how well  
4 you're doing financially. At GE, hitting your numbers is  
5 critically important. It's no different for acquisitions.

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

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

23           And then the next piece is what we call  
24 operational CTQs, which are more kind of functional metrics,  
25 similar to the overall strategic reasons for doing a  
26 transaction, but things that are sometimes a little bit  
27 softer. Some of it relates to the people side of the

1 integration, new product introductions. So, it's different  
2 milestones from an operational perspective, customer  
3 satisfaction, employee retention, those types of things that  
4 are more operational in nature. Again, these are things  
5 that you want to track that don't necessarily appear in the  
6 financials of the business, but from an integration  
7 perspective are absolutely critical for success.

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

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

25           Finally, this point called customer centricity,  
26 which actually is the result of input that we're getting  
27 directly from our customers -- we call it voice of the

1 customer. When we announce the acquisition of the business,  
2 we will communicate with its customers, in some cases,  
3 common customers to ours, and provide them a forum by which  
4 they can communicate to us and let us know how we're doing,  
5 whether it's around service issues, good, bad, indifferent.  
6 We give them, through the web, a place to come in and tell  
7 us how we're doing, provide input and make sure, again, that  
8 we're maintaining the revenue base and the customer  
9 satisfaction that we think is one of the most critical  
10 success factors in any integration we're doing.

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

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

1 our businesses will come off the screen more quickly.

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

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

20           If we're delivering well against the financial  
21 plan for an acquisition and we're not doing well from a  
22 customer perspective or from an employee satisfaction  
23 perspective, we wouldn't consider this a success. So, all  
24 of these different factors weigh into whether or not we  
25 think we're doing well. Ultimately, the voice of the  
26 customer is probably the best leading indicator, we think,  
27 of the ability of the business to continue on whatever

1 trajectory it's on and to deliver -- whether on revenue  
2 synergies that you might have baked into your acquisition  
3 analysis or into ultimately how it affects your cost  
4 synergies. So, that is what I've got.

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

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

8 First of all, I want to say we're still in the  
9 early days at ConocoPhillips. So, to ask us to talk about  
10 integration and implementation is interesting, although I do  
11 think we have done a lot of things the right way. Our  
12 merger of equals was announced in November 2001, and we  
13 actually got regulatory approval and closed around September  
14 1, 2002. So, we're just three months into our merger  
15 integration.

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

26 Real quickly, I'll just run through the  
27 integration team that we put together. First of all, we

1 established a separate team, an integration management team,  
2 which worked along with the CEO's of the two companies,  
3 Archie Dunham and Jim Mulva. That high level group, for the  
4 first month or two after the announcement, worked on high  
5 level strategies and objectives for the new organization.

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

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

24 Again, the people that led these seven sub-teams  
25 didn't know exactly where they were going to land in the new  
26 company. But, they were key leaders in the company and we  
27 knew the people that were leading the upstream team had a

1 role in the future upstream organization. They didn't know  
2 exactly where, but they had a role and a stake in making it  
3 work, and also had ownership in the synergy targets.

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

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

22           We said we were going to take the "best of the  
23 best" in people selection, and I think we did a first class  
24 job of picking the best people, and keeping the strengths of  
25 the two organizations in place. That did not mean that in  
26 every department 50 percent of the people were Conoco  
27 people, 50 percent were Phillips people. In fact, you'll

1 find that the operating side very much went Conoco's way, at  
2 least at the executive level. Conoco was known for a very  
3 strong operating culture, both in upstream and downstream.  
4 Phillips, on the other hand, was more known for its hard-  
5 nosed financial acumen, and you'll look in the finance  
6 department of ConocoPhillips and you'll see senior  
7 management is predominantly Phillips heritage. We did try  
8 to pick the best of the best, and it just happened to come  
9 out, in total, very close to a 50/50 split.

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

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

23 What was really fortuitous for us was the fact  
24 that we got approval in early September. I think had it  
25 gone a few more months, we wouldn't be nearly as optimistic  
26 about our ability to really make this thing work in the  
27 near-term. The reason is because in the oil and gas

1 industry, the budget cycles begin usually in the summer.  
2 So, you're really planning for the next year's work 12-18  
3 months in advance. September was about as late as we could  
4 get approval to close and still really get all of our plans,  
5 our synergies, everything, built into our operating plans  
6 for 2003. We have really humped it since September, to get  
7 these plans in place, and, in fact, tomorrow in New York,  
8 hopefully, our Board of Directors will approve the 2003  
9 capital budget and operating plan for ConocoPhillips.

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

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

26           Conoco just did an IPO and split off from DuPont  
27 at the end of 1998. In 1999, I was in this building trying

1 to convince the FTC that Conoco was a better competitor for  
2 Arco Alaska than Phillips would be. Phillips had won the  
3 bid from BP to buy Arco Alaska. That was a \$7 billion  
4 transaction that Phillips completed in late '99, early 2000.  
5 In late 2000, Conoco and Phillips got together and talked  
6 about merging. It didn't happen for various reasons, mostly  
7 because of some of the soft issues.

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

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

1 That's all I have.

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

4 (APPLAUSE)

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

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

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

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

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

27 We knew the kind of information we'd like to

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

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

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

24       MR. EARNEST: Yes. Actually, I think we named our  
25 two integration leads, Phil Fredrickson and John Lowe, at  
26 deal announcement. We said they're in charge of  
27 integration. We put our teams in place and each of the

1 teams had lawyers on them. We were very careful about  
2 getting their guidance and we shared what information we  
3 felt that we could, and we didn't share the information we  
4 didn't think we could. I was the leader of one of the  
5 upstream teams and was quite frustrated, actually, in our  
6 inability to share certain information. But, we did what we  
7 could within regulatory and legal limits, and the rest of  
8 it, we're doing on the fly. We're going to make it work.

9 MR. BOWER: Yes, Susanne?

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

21 MR. SCHEINMAN: The simple answer is that it's  
22 more true in down markets than in up markets. In up  
23 markets, we were sometimes counting as management teams if  
24 we had one person we thought was strong enough to survive.  
25 Today, we clearly are looking for management teams. We  
26 believe that the retention of the management team in the  
27 technology business is absolutely critical. We're betting

1 really on the next platform or the integration of two  
2 platforms to create a third platform, and you need the  
3 vision at the management level to do that. So, we really  
4 have a focus on management teams.

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

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

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

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

21           MR. BRODSKY: I think it really depends. But,  
22 there's always room for more G&A efficiencies. For  
23 instance, take a Procter & Gamble example or, in our case, a  
24 branded food example from one of our companies, you're  
25 buying a specific brand. There could be a tremendous amount  
26 of G&A that's currently used to manage that brand by its  
27 current owner that simply isn't necessary anymore once that

1 brand or that product is owned by a different company  
2 because the existing people and facilities in the company  
3 have enough room to take on that additional work, or there's  
4 simply enough office space or something like that.

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

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

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

22           MR. BOWER: Let me just pick up on this and go  
23 back to the example I gave earlier of Snapple and Quaker.  
24 The Quaker people thought for sure that Snapple would have  
25 the characteristics that Peter just described, that it would  
26 fit easily into their portfolio. In fact, it turned out to  
27 have little to do with their portfolio. They didn't know

1 that and they couldn't see it, and they learned it, to their  
2 dismay, because they nearly destroyed Snapple. It's amazing  
3 to me how difficult some of these deals can turn out to be,  
4 because the processes by which two firms will do the same  
5 business turn out to be very, very different.

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

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

19           MR. PIDANO: Thank you.

20           MR. BOWER: Yes?

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

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

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

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

21 MR. SALTZMAN: Just to follow up some. I  
22 recognize that there is a lot of uncertainty, and that each  
23 situation is different. But it sounds like you collectively  
24 have been involved with literally hundreds of acquisitions.  
25 So, I'm wondering, based on your actual experience, is it  
26 very, very likely that the number that is projected as a  
27 cost savings will be realized because the company wants to

1 be conservative, for example? Can you pretty much go to the  
2 bank with that number because in all likelihood you will  
3 reach it or exceed it? Or, is it just as likely that you  
4 will fall short?

5 MR. BOWER: John Mayfield?

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

9 UNIDENTIFIED MALE: More certain.

10 MR. MAYFIELD: most certain. The revenue stream,  
11 price increases, and customer retention, as I said, are our  
12 critical issues, and by far the most difficult to try and  
13 confirm prior to the acquisition. Limited access to  
14 customers and pricing information during the due diligence  
15 process creates a higher degree of uncertainty than  
16 synergies (cost savings) that could result from the  
17 acquisition. So, when we set our acquisition models, we  
18 usually approach them from a synergistic basis with the  
19 upside based on top line growth (volume growth, customer  
20 retention and targeted price increases). Our cost savings  
21 is the most certain number, and if we err on the  
22 conservative side, it is top line growth. Will we get the  
23 numbers in the specific areas? No. However, as the other  
24 panelists have noted, cost savings can be generated from a  
25 number of different sources. Buying power can be improved  
26 through association with a larger enterprise. In ITW's  
27 case, newly acquired companies can gain access to more

1 sophisticated research and development, which can improve  
2 their product cost immediately. So, the cost savings is the  
3 most certain assumption we can make and the revenue growth  
4 on the top line is the least certain in determining  
5 acquisition purchase price.

6 MR. BOWER: I agree. I did a study way back in  
7 1973 that looked at capital budgeting and the process within  
8 a company. And at that time, the mean of realized cost  
9 savings to projected cost savings on capital projects, was  
10 about 1.1, with a tight variance. The mean on revenue  
11 projections was about 0.6 with a broader variance. The mean  
12 on new product areas, essentially innovation, was zero with  
13 a very wide variance.

14 (LAUGHTER)

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

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

25 UNIDENTIFIED MALE: Well said.

26 UNIDENTIFIED MALE: Exactly.

27 MR. EARNEST: I suspect part of it is that there

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

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

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

27 MR. BRODSKY: We do a lot of business in media and

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

10 MR. BOWER: Yes, Paul?

11 MR. PAUTLER: Paul Pautler of the FTC. I just  
12 wanted to follow up on a statement that Bill just made. It  
13 ought to be easy to do the calculations to figure out what  
14 the savings are, but you've just increased your estimates by  
15 67 percent. So, you were a little bit below.

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

22 MR. EARNEST: It was both actually. I think once  
23 we were able to exchange information, we identified a lot  
24 more savings in procurement. We operate in a very capital  
25 intensive business, and together, we were spending \$8  
26 billion a year in capital, and billions more in operating  
27 costs and supplies, and what we found was a third or more of

1 our new synergy target is procurement savings. Those are  
2 the kinds of savings we weren't quite as confident about a  
3 year ago.

4 MR. BOWER: Yes, Susanne?

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

16 MR. BRODSKY: We do that at our firm.

17 MS. TRIMBATH: It's a great service.

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

22 MR. BOWER: Yes. From Wilmer Cutler?

23 MR. KOLASKY: I'm Bill Kolasky.

24 MR. BOWER: Bill, yes?

25 MR. KOLASKY: Following up on the discussion we  
26 were just having about greater uncertainty on the revenue  
27 growth projections, to what extent have failures to meet

1 those projections, in your experience, been the result of a,  
2 shall we say, more vigorous response from your competitors  
3 than you were expecting or from competitors adopting  
4 strategies that you hadn't anticipated in response to your  
5 own merger or acquisition?

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

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

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

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

1 UNIDENTIFIED MALE: Absolutely.

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

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

17 Any more other questions?

18 **(No response.)**

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

23