THE BOSTON CONSULTING GROUP

Back to Fundamentals

Value Creators Report 2003

BCG | REPORT

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Value Creators Report

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FOREWORD

As we have consistently demonstrated in previous editions of our annual Value Creators Report, now in its sixth year, strong improvements in fundamentals are a prerequisite for sustaining superior shareholder returns: in the long run expectation premiums—the difference between market and fundamental values—vanish, leaving just fundamentals to "keep the show on the road." In short, firms control their stock market destinies. This year's report vindicates this view more firmly than ever before.

In line with our forecasts in earlier reports, which often ran against the grain of popular thinking, especially during the "bubble years," average expectation premiums have continued to decline towards zero in most regions and industries over the last two years. Nearly all of today's top value creators, measured by total shareholder returns (TSR), now owe their success to strong fundamentals. Moreover, this long-overdue return to fundamentals wasn't simply due to a fall in expectation premiums but to an improvement in the key fundamental drivers of value creation: cash flow return on investment (CFROI) and profitable investment growth.

More specifically, the world's top value creators pulled the right levers at the right time. Although investment growth is the strongest driver of shareholder returns, as BCG's Corporate Finance & Strategy practice has demonstrated, companies should only pursue growth once profitability, measured by CFROI, is above the weighted average cost of capital. Equally importantly, firms need to align their strategies with their core investors' expectations to ensure fundamentals translate into shareholder value: "internal" intrinsic value creation has to be linked to "external" capital market value creation.

This year's Value Creators Report highlights the key ingredients for generating and sustaining above-average TSR, based on analysis of over 4,000 listed corporations across the globe, plus case studies of individual companies. At its heart is a detailed analysis of the core principles of fundamental value creation required to achieve superior shareholder returns. Over the last five years many firms have relied on high expectation premiums rather than strong fundamentals to deliver shareholder value. Now that these premiums are declining, as our historical analysis indicated they would, smart companies will re-focus on managing their fundamental value-creation drivers

EXECUTIVE SUMMARY

Fundamentals, not investors' expectations, are once again driving total shareholder returns (TSR), leading to a significant change in the composition of the world's top value creators.

Between 1999 and 2002, fundamentals as a proportion of market value for our total sample rose from 49% to 77%. The increase among the top 10 TSR firms was even more pronounced: 24% to 73%. However, this wasn't simply due to a decline in the high expectation premiums (the difference between market and fundamental values) that characterized the stock market bubble of the late 1990s; it also reflects strong long-term improvements in the leading companies' fundamental performances. Since 1999 the world's top 10 corporations have increased their fundamental or "intrinsic" value by 25% a year on average. Similar trends are evident in all regions and industries. This return to fundamentals has substantially changed the composition of the world's top value creators. For example, only one of the "bubble period" companies remains in the top decile today, while the balance of industries in this decile has shifted away from technology to a more representative cross-section, including more mature sectors such as utilities and automotive.

North America generated the biggest improvements in fundamentals during the period between 1999 and 2002, followed by Asia, and then Europe. The most fundamentally successful industry was pharmaceuticals.

Companies in North America improved their intrinsic value by 8% a year on average between 1999 and 2002, compared to 6% in Asia, and 4% in Europe. In fact, the ten most successful firms in the world were all U.S.-based. In terms of industries, pharmaceuticals led the way with an annual 12.2% rise in fundamentals, while retail weighed in with 9.8%, and pulp and paper with 9.2%. Insurance brought up the rear with an 8.9% drop in its intrinsic value. Nevertheless, in this sector as well as in the other ten industries analyzed, several corporations achieved substantial fundamental growth and shareholder returns well above the global average, demonstrating that superior value creation is possible in all sectors.

Profitability above the cost of capital is one of the hallmarks of a top value creator. Moreover, these players push for increasingly high profitability.

A total of 81% of the top-decile TSR companies achieved profitability above the cost of capital, compared to just 19% of firms in the bottom decile. Our analysis also reveals that companies and industries with the highest profitability—measured by cash flow return on investment (CFROI)—tend to have the highest investment growth, which is the biggest driver of shareholder returns. To lift profitability, the world's top value creators tend to increase both asset productivity and cash flow margins, although the emphasis on each lever varies amongst industries. For example, utilities, pharmaceuticals, and technology relied heavily on increasing cash flow margins, while retail, consumer goods, and automotive depended more on improving asset productivity.

Profitable investment growth is the biggest driver of TSR.

Profitable investment growth accounts for around 70% of TSR. The importance of growth for superior shareholder returns was underlined by the fact that 80% of the top-decile value creators increased their investment base substantially, compared to just 21% of the total sample of companies.

Few firms sustain above-average shareholder returns for more than a few years. However a more holistic approach to value creation—one that aligns firms' fundamental value-creation strategies with their core investors' expectations—can help companies overcome this problem.

Less than 25% of the 1,675 firms analyzed[1] beat their local market indices for more than six years out of ten and only 13 companies outperformed their indices for nine out of ten years. Managing business units as a portfolio of value creators and destroyers is a key step towards resolving this issue. This enables companies to focus units and capital on markets with the greatest value-creation potential, while shedding those with little or no competitive advantage in the future. All units should be controlled with two main drivers of value creation: profitability—as measured by CFROI, and profitable growth, with investment growth only pursued once profitability is above the cost of capital. Equally critically, strategies to improve fundamentals, including portfolio management, should be aligned with firms' core investors' expectations, including their risk appetite, dividend policies, and other aspirations. Research done in conjunction with Thomson Financial has shown that corporations that do this are less likely to be incorrectly valued and experience all the problems this can entail—problems many firms have recently encountered.

1 Analysis includes 1,675 companies that had a minimum market capitalization above $1 billion as of 31 December 2002 and were listed for more than ten years.

FUNDAMENTALS ONCE AGAIN DRIVE TSR

The days of relying on expectation premiums—the difference between market and fundamental values—to fuel total shareholder returns (TSR) are over. As expectation premiums decline towards their long-term market average of zero, only firms with strong fundamentals are able to achieve superior returns.

An historical reminder of the long-term importance of intrinsic value.

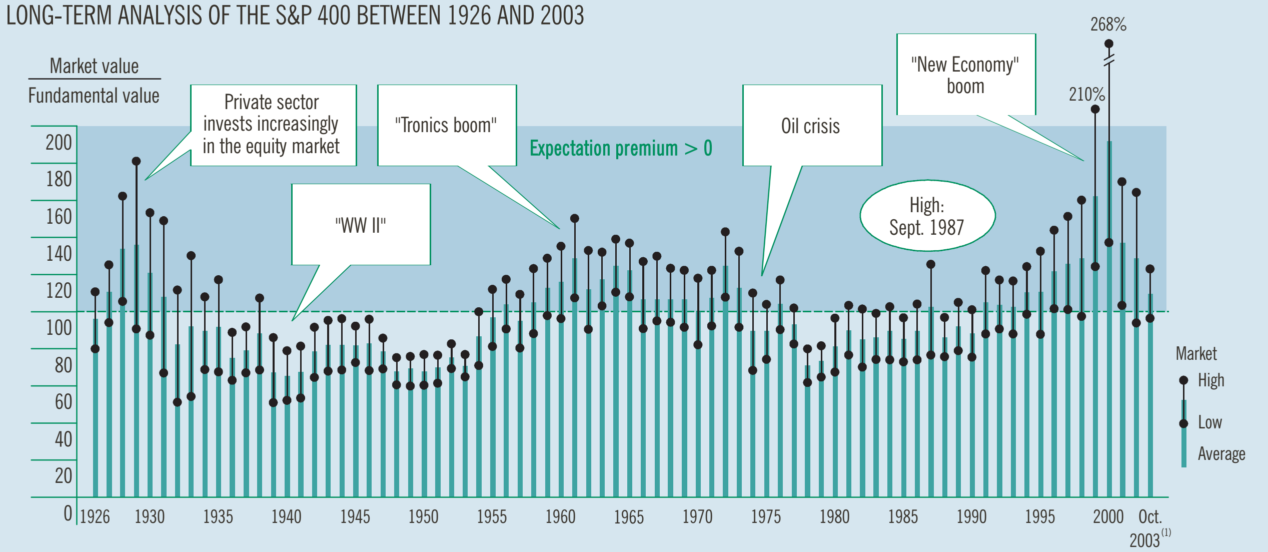
As we showed in our previous two editions of our Value Creators Report, expectation premiums are an inevitable feature of the world's capital markets in the short to medium term, but in the long run they decline towards zero (Fig. 1). In short, fundamentals drive long-term shareholder returns. After the longest running bull market in history, which saw expectation premiums reach record highs in 1999 thereby accounting for 76% of the top 10 TSR players' stock market values, this basic principle of value creation is re-asserting itself, as we demonstrate below.

Expectation premiums fall, bringing stock prices closer to intrinsic value ...

- **Worldwide:** Between 1999 and 2002, expectation premiums as a proportion of market value for our total sample declined steadily each year, from 51% to 23%. The drop in premiums among the top 10 value creators (measured by TSR) was

EXPECTATION PREMIUMS SHOW STRONG OSCILLATIONS OVER TIME

LONG-TERM ANALYSIS OF THE S&P 400 BETWEEN 1926 AND 2003

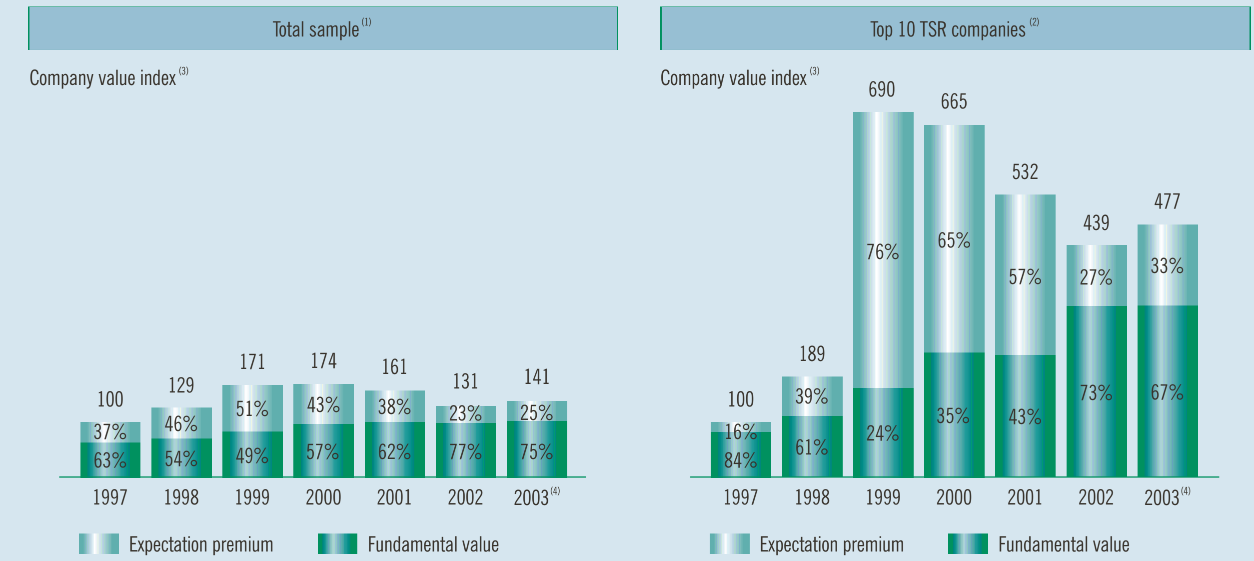


(1) Estimated fundamental value based on forecasted EBITDA
Basis: 1950–2002: 376 companies excluding financial institutions and P/E Corp Bio Systems; 1926–1949: 40 companies taken from Moody's Manual of Investments
Source: Moody's Manual of Investments; Value Management Research Engine; BCG analysis

Figure 1

FUNDAMENTAL VALUE AND EXPECTATION PREMIUM OVER TIME

WORLD

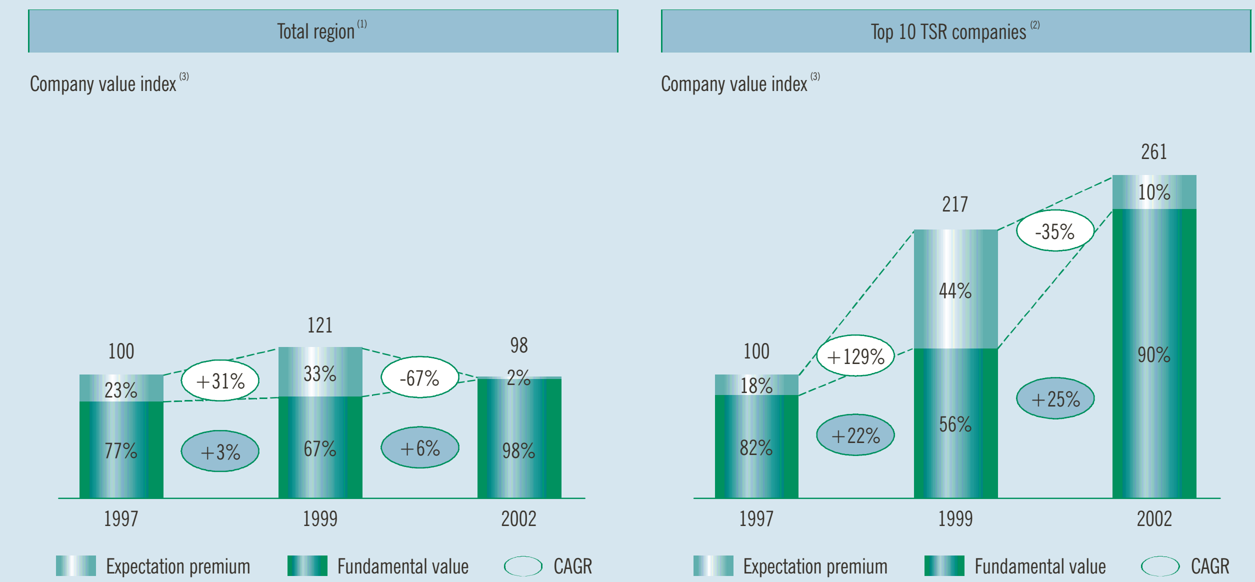


(1) Weighted average; 274 companies; minimum market value 2002: $10B
(2) Companies with highest total shareholder return p.a. 1998–2002; weighted average
(3) Market value of equity plus interest bearing debt, 1997 = 100
(4) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
Source: BCG analysis

Figure 2

FUNDAMENTAL VALUE AND EXPECTATION PREMIUM OVER TIME

ASIA-PACIFIC



(1) Weighted average; 94 companies; minimum market value 2002: $5B
(2) Companies with highest total shareholder return p.a. 1998–2002; weighted average
(3) Market value of equity plus interest-bearing debt, 1997 = 100
Source: BCG analysis

Note: CAGR = compound annual growth rate

Figure 3

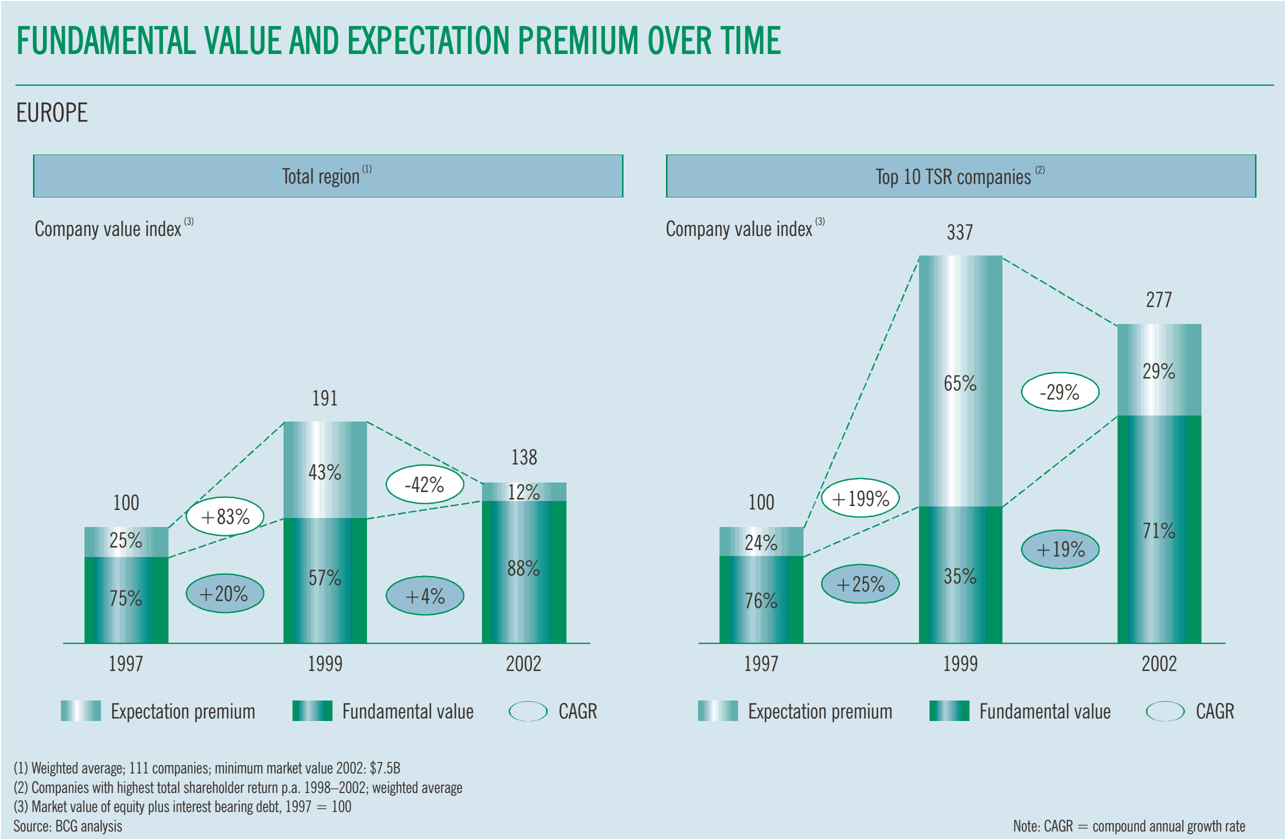


Figure 4

even more pronounced, plummeting from 76% to 27% (reflected in Fig. 2).

- **By region:** Expectation premiums fell in all regions over this period, with Asia experiencing the largest drop (Fig. 3), followed by Europe (Fig. 4). Although North America's premiums also decreased (Fig. 5), they remained relatively high among the top 10 TSR performers by the end of 2002 (48%).

- **By industry:** All industries also experienced a drop in expectation premiums. Three of these (pulp and paper, travel, transport and tourism, and utilities) now have negative premiums, indicating that the market might have overreacted to the previously high premiums—an historically common occurrence discussed in last year's Value Creators Report. Three sectors still have market values significantly higher than their intrinsic values: pharmaceuticals, retail, and consumer goods (Fig. 6).

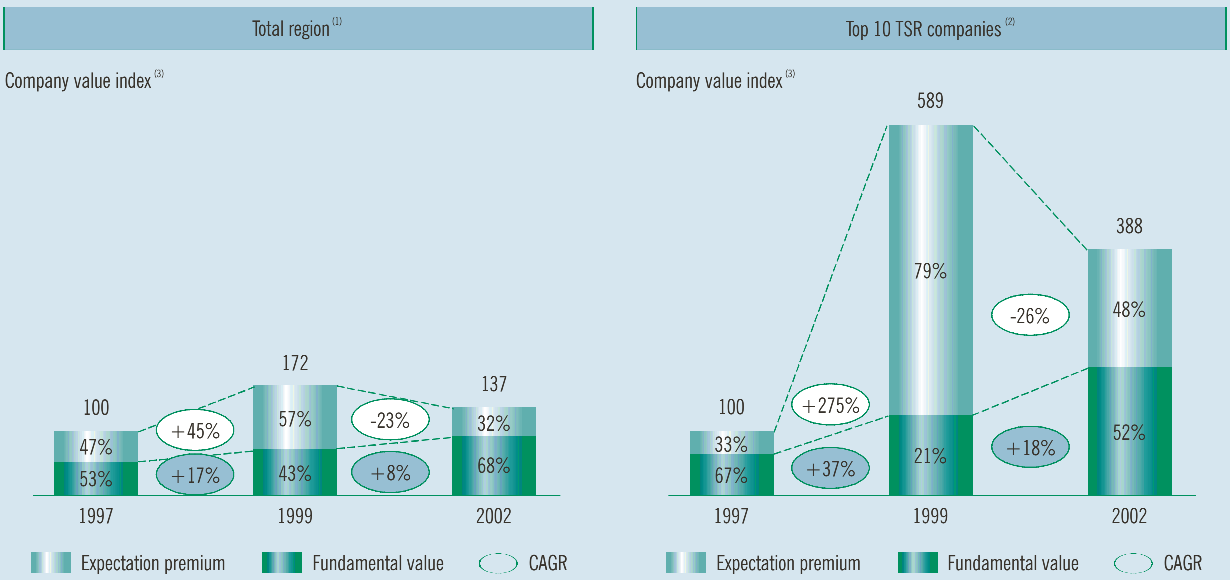
- **Outlook for 2003 and beyond:** Although any forecasts should be tempered with the usual caveats, a slight lift in expectation premiums in certain regions and industries in the first nine months of 2003, notably in Asia and among North America's top value creators, suggests that U.S. investor optimism might be spreading more widely. Whether this will be sustained, given that market and intrinsic values tend to converge in the long run, we will have to wait and see.

... while fundamentals grow strongly among the top performers.

The increase in intrinsic value as a proportion of market value, evident in Figures 2–5, isn't simply due to the general decline in investors' expectations, it also reflects strong long-term fundamental performances among the world's top value creators. In most cases, the top TSR companies' fundamentals grew much more rapidly

FUNDAMENTAL VALUE AND EXPECTATION PREMIUM OVER TIME

NORTH AMERICA

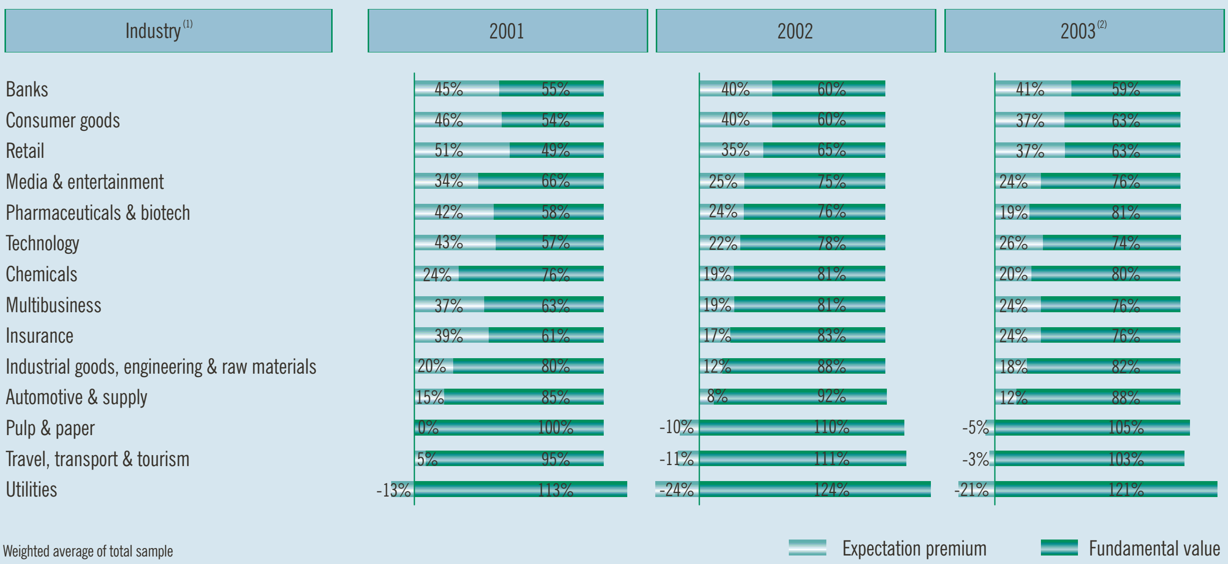


(1) Weighted average; 146 companies; minimum market value 2002: $10B
(2) Companies with highest total shareholder return p.a. 1998–2002; weighted average
(3) Market value of equity plus interest-bearing debt, 1997 = 100
Source: BCG analysis

Note: CAGR = compound annual growth rate

Figure 5

EXPECTATION PREMIUMS BY INDUSTRY

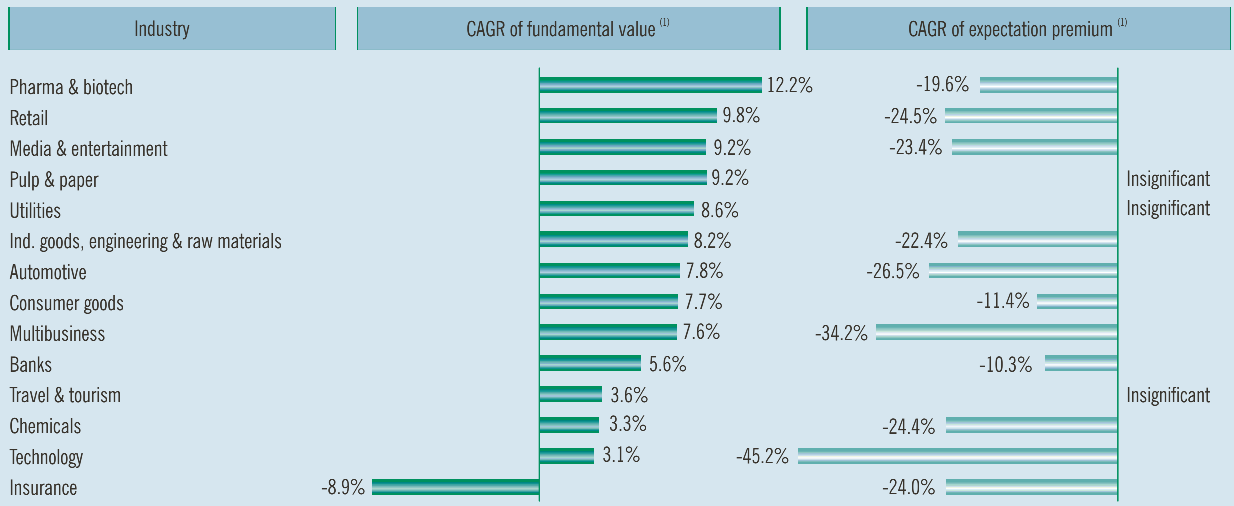


(1) Weighted average of total sample
(2) Based on an estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
Source: BCG analysis

Figure 6

POST-BUBBLE DEVELOPMENT OF EXPECTATION PREMIUMS AND FUNDAMENTAL VALUE BY INDUSTRY (1999–2002)

TOTAL SAMPLE BY INDUSTRY



(1) CAGR 1999–2002 of total sample per industry
Source: BCG analysis

Note: CAGR = compound annual growth rate

Figure 7

than their local market or industry averages, often by a factor of three or four.

Although the recent global economic slowdown has taken some of the steam out of their growth (and dampened investor confidence), the top TSR players have nevertheless produced impressive results since 1999. Typically they increased their intrinsic value by around 25% a year, demonstrating that strong performances are possible in all conditions.

- **Worldwide:** The intrinsic value of all companies in our sample grew by 6% per year during 1999–2002, compared to 16% per year in 1997–1999. As Figure 2 illustrates, the world's top 10 TSR generators increased their fundamentals by 25% a year on average between 1999 and 2002, over four times faster than the average for our total sample.

- **By region:** On average firms in North America increased their intrinsic value by 8% a year during 1999–2002, compared to 6% in Asia and 4% in Europe. However this ranking is reversed if only the top 10 TSR players in each are considered: Asia Pacific's top 10 performers recorded the biggest increase (25% annually), followed by Europe (19%), and North America (18%). This can be seen in the right-hand panels of Figures 3–5.

- **By industry:** Since the end of the stock market bubble, "old economy" sectors have tended to generate the largest improvements in fundamentals (Fig. 7). The top industries were pharmaceuticals (12.2% fundamental growth per year), retail (9.8%), media (9.2%), and pulp and paper (9.2%). The weakest sectors were insurance (-8.9%), technology (3.1%), and chemicals (3.3%). However these figures conceal powerful performances from individual firms as we discuss below.

- **Impact on composition of top value creators:** During 1997–1999, when expectation premiums were rising steadily and driving shareholder returns, 70% of the top-decile value cre-

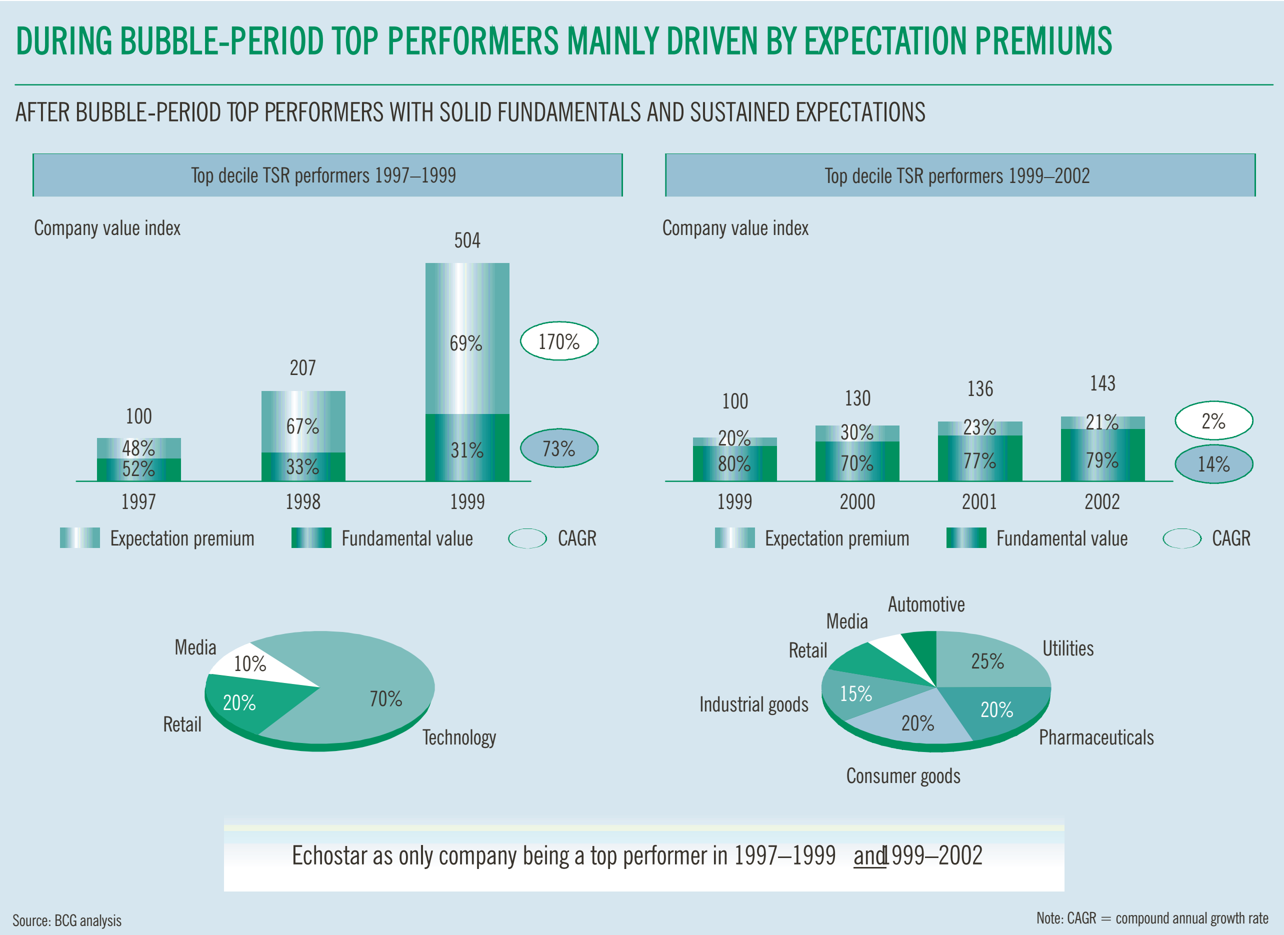


Figure 8

ators were technology companies, with retail and media accounting for the rest. Today, thanks to the "return of fundamentals," the balance is more evenly balanced spread between eight industries (Fig. 8). Moreover, only one of the companies managed to be in the top TSR decile in the 1997–1999 as well as in the 1999–2002 period.

Significant improvements in fundamentals are possible in all industries.

In every industry there were companies whose value creation measured as TSR were significantly above both the world average (5% TSR annually over the period 1998–2002) and the average of every other industry. In the travel and tourism sector, for example, which had the lowest annual average TSR (1%), the top player achieved 66% TSR-higher than the average of the most successful industry, pharmaceuticals (7%), and above the leading players in several other sectors, including media (Fig. 9).

Similarly, significant improvements in fundamentals measured as TBR are possible in every industry (Fig. 10). During 1998–2002, the top 3 sectors by average annual TBR were Retail (14% TBR annually), consumer goods (12%), and pharmaceutical (11%).

HIGH, LOW AND MEDIAN TSR PER INDUSTRY

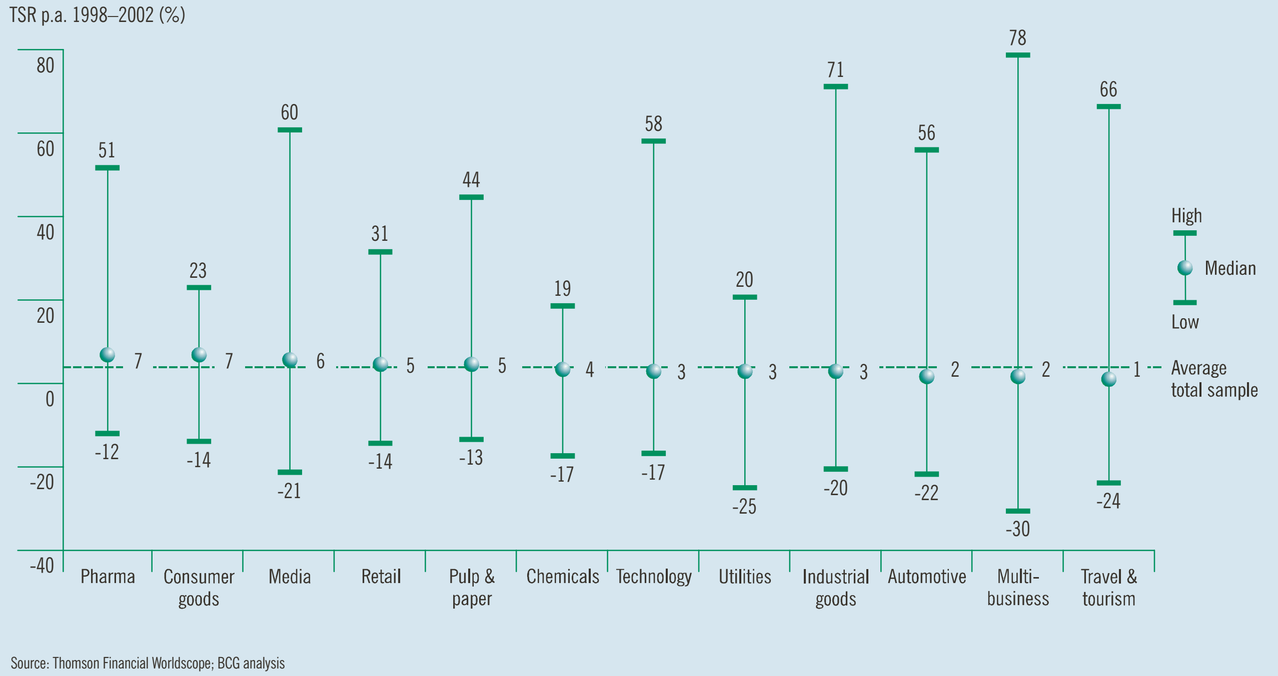
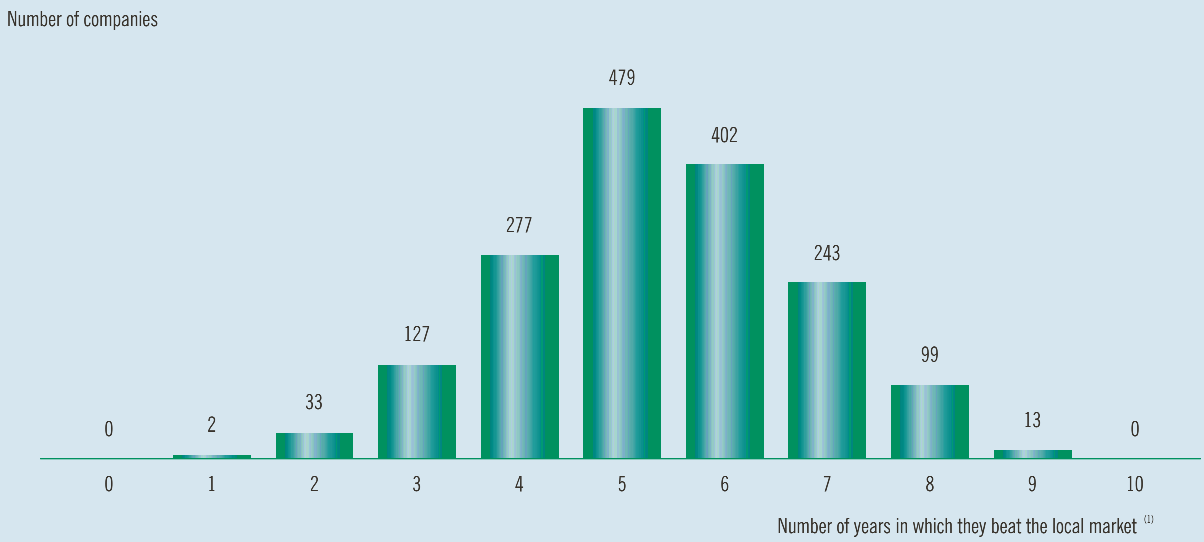


Figure 9

HIGH, LOW AND MEDIAN TBR PER INDUSTRY

Figure 10

CREATING VALUE YEAR AFTER YEAR IS A DIFFICULT TASK



(1) Relative total shareholder return (RTSR) = company TSR vs. local total market index, between 1993 and 2002
Note: Analysis includes 1,675 companies that had a minimum market capitalization above $1B as of 31/12/2002 and were listed for more than ten years
Source: Thomson Financial Worldscope; BCG analysis

Figure 11

Few companies, however, sustain above-average TSR for more than a few years.

Less than 25% of the 1,675 firms analyzed[2] beat their local market indices for more than six out of ten years and only 13 companies outperformed their indices for nine out of ten years. None sustained above-average TSR for ten years (Fig. 11). This was despite the fact that many companies achieved long-term improvements in their fundamentals, suggesting a disconnect between internal value creation and the capital markets. In most cases, however, it was a reflection of firms' inability to maintain fundamental growth in the face of competitive pressures.

2 Analysis includes 1,675 companies that had a minimum market capitalization above $1 billion as of 31 December 2002 and were listed for more than ten years.

KEY INGREDIENTS FOR SUCCESS

On the following pages we draw out the key ingredients for generating and sustaining superior TSR as derived from a detailed analysis of over 4,000 corporations' fundamentals. To bring these points to life, we examine several firms in depth. Although these firms are not necessarily the biggest value creators in their particular industries, their experiences—positive and negative—hold valuable lessons for all companies.

OVERVIEW OF CORE VALUE-CREATION PRINCIPLES

Use appropriate measures to gauge and control internal value creation.

One of the most commonly used measures is EBITDA. However, as we explained in last year's report, it can produce misleading signals due to its omission of balance-sheet-related items, such as depreciation of fixed assets. More suitable alternatives are Total Business Returns (TBR) and "Cash Value Added" (CVA). Both ratios do not suffer from EBITDA's pitfalls and both have a strong relationship with TSR. Moreover, CVA can be disaggregated into a value-driver tree of practical measures, beginning with cash flow return on investment (CFROI) and its appropriate value levers, cash flow margin and capital turnover, as well as profitable growth in terms of gross investment increase. Additionally, these measures can be broken down further into operational value drivers for each business unit providing insight into how value is created in different areas and levels of responsibility throughout a company.

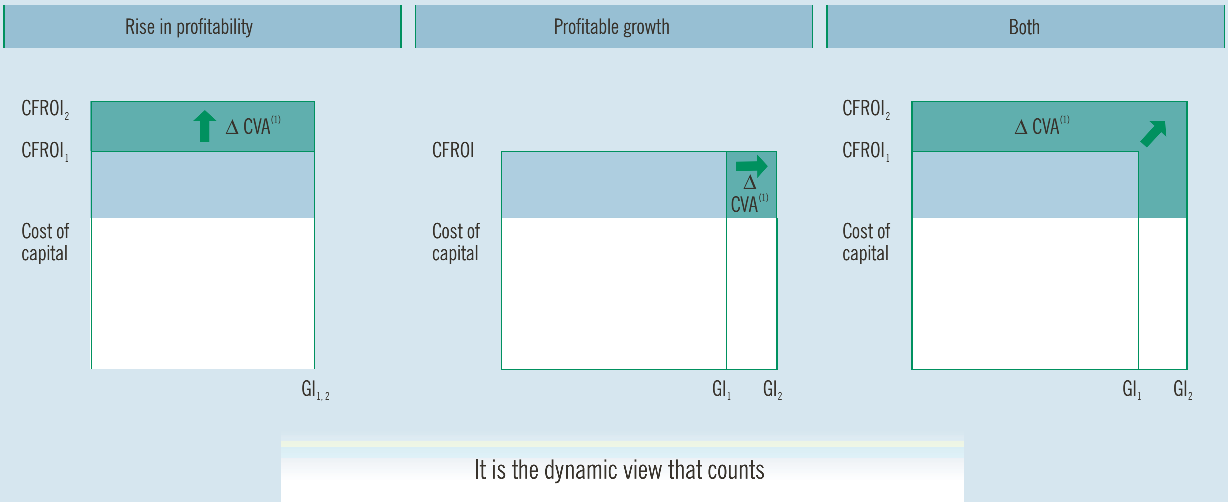
Ensure profitability is above the weighted average cost of capital before increasing gross investment.

There are two ways to generate value, measured by improvements in TBR or Cash Value Added (CVA): by increasing CFROI or by growing gross investment base. Investment growth will only produce value if profitability is above the weighted average cost of capital; unprofitable growth will destroy value (Fig. 12). As we discuss later, there are exceptions to this "rule," notably corporations that need to grow unprofitably in order to achieve competitive scale. But these instances are rare—most top value creators adhere to the profitability principle, as we show.

Manage your business units as a portfolio of value "creators" and "destroyers," aligning your portfolio with your core investors' expectations.

Business units should not be treated homogenously with capital allocated democratically between them—a common pitfall. Instead, the units with the greatest value-creation potential relative to their competitive strengths and markets should be supported and the value destroyers restructured or shed. This should be an ongoing process in order to respond proactively to competitive pressures. Equally crucially, companies' strategies need to be aligned with their dominant investors' expectations to ensure fundamentals translate into shareholder returns. A mismatch between investors' aspirations and fundamentals will suppress value and possibly lead to an unjustifiably low stock price.

HOW CVA IS CALCULATED AND INFLUENCED BY DIFFERENT LEVERS

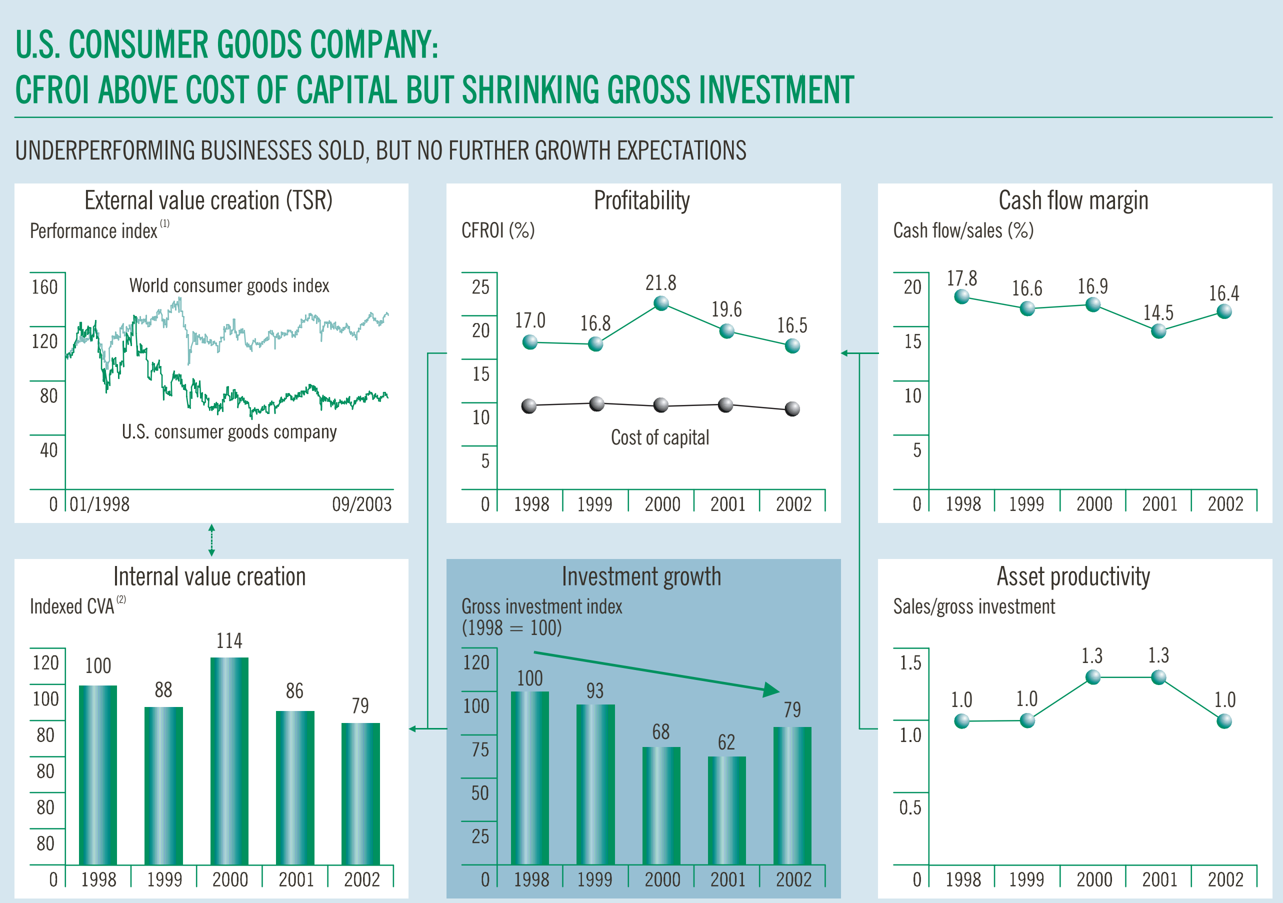


(1) Same principle for banks and insurance companies on an equity basis: CFROI = ROE, GI = equity, ΔCVA = ΔAVE
Note: CVA = cash value added; AVE = added value to equity; CFROI = cash flow return on investment; ROE = return on equity; GI = gross investment

Figure 12

Strive for constant fundamental improvements—value creation is a dynamic process.

Investors expect firms to generate regular improvements in fundamentals, not simply to maintain the status quo. Failure to satisfy this need will lead to suboptimal shareholder returns. This can be seen in Figure 13, which summarizes the key fundamentals of a major U.S. consumer goods company. Although the company's profitability was significantly above the cost of capital, it did not increase its profitability or use its free cash flow "war chest" to fund investment growth. The result—minus 8% TSR. The Indian automotive company Hero Honda, on the other hand, which we discuss in detail on page 31, increased all its fundamentals and reaped the benefits.



(1) Performance including share price and dividends, end of 1997 = 100
(2) Indexed CVA, 1998 = 100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

Figure 13

PROFITABILITY ABOVE THE COST OF CAPITAL IS CRITICAL

A total of 81% of the top-decile TSR companies achieved profitability above the cost of capital, compared to just 19% of the bottom decile firms.

This dramatic fact can be seen in Figure 14. To reach this level of profitability, some companies shrunk their investment base, occasionally too aggressively. Others—the exceptions to the rule—generated superior shareholder returns despite growing unprofitably as investors recognized that these firms needed to invest first to achieve competitive scale. Below we examine three companies that typify each of these situations.

- **Centrica successfully reduces its capital base:** When Centrica was demerged from British Gas in 1997 as part of deregulating the U.K.'s gas market, the company's profitability was languishing below the cost of capital with correspondingly low shareholder returns. It knew that investment growth held the key to its long-term success, but it also recognized that it had to improve its profitability first. The company's solution was to decrease its unprofitable gross investment by reducing its net working capital, notably its high number of debtors, bringing CFROI closer to the cost of capital.

To boost cash flow margins, it also reduced the cost of its retail operations, improved the margins on its service businesses, and lowered its reliance on third-party gas storage, supply, and distribution. Once profitability was above the cost of capital, Centrica was able to increase its gross investment through a string of acquisitions that not only consolidated its position in its core gas and oil markets but also helped it expand into other sectors such as telecommunications and financial services. Figure 15 illustrates this strategy, known as the "C-curve". Together these initiatives increased Centrica's fundamental value by 23% a year and generated 15% annual average TSR above the market index.

- **Major chemical company over-zealously shrinks:** To improve profitability, one major European chemical company dramatically reduced its investment base. Although this lifted its profitability above the cost of capital—with exceptionally high cash flow margins—the company did not use its additional profitability to improve growth in line with the C-curve principle. As a result, it suffered a -17% annual TSR over the period 1998–2002 (Fig. 16).

- **Echostar proves to be an exception to the profitability rule:** Businesses entering markets where scale is critical often have little choice but to grow unprofitably initially, one of the exceptions to the C-curve rule. The U.S. direct broadcast satellite (DBS) TV provider, Echostar, is a case in

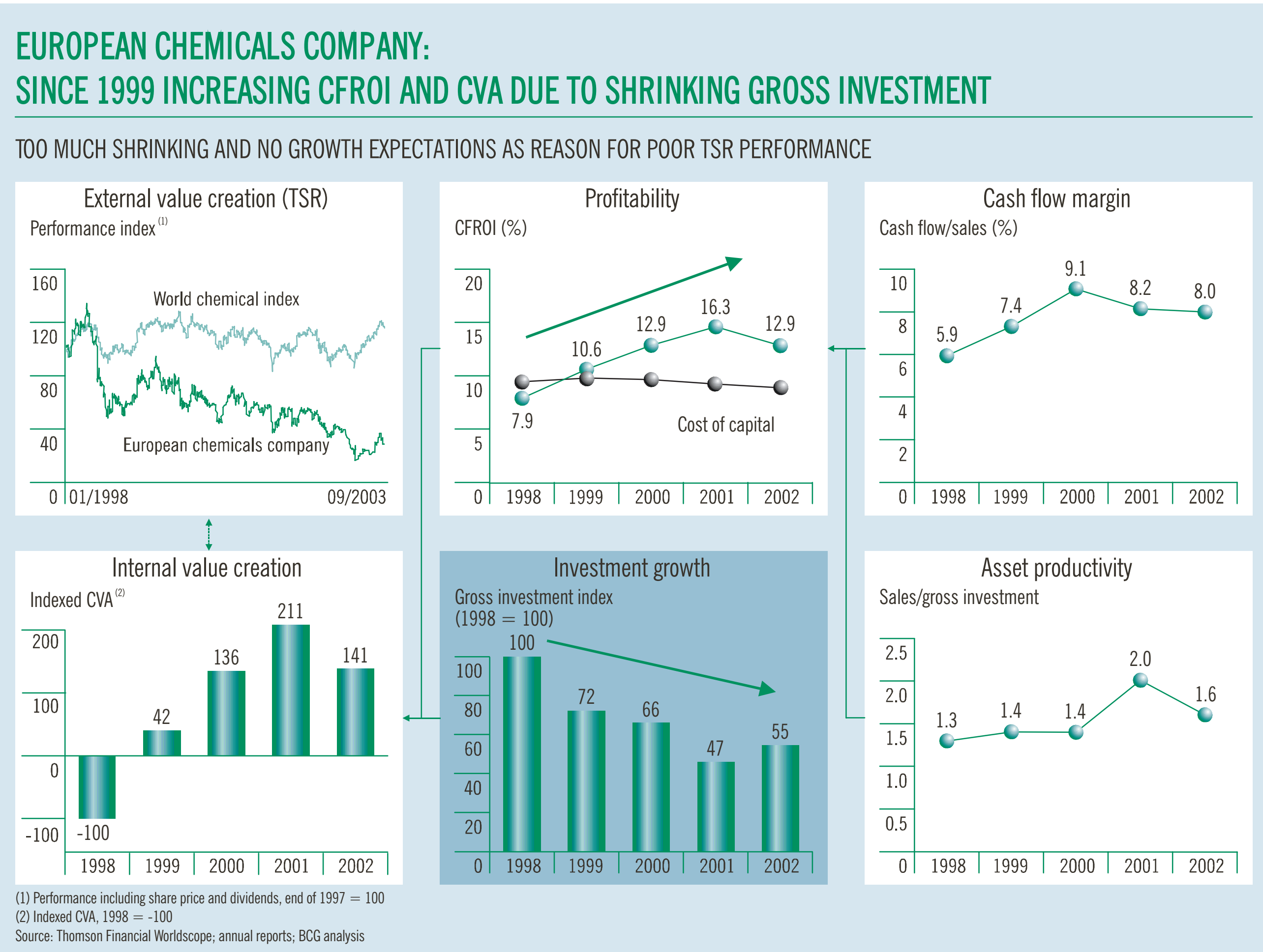
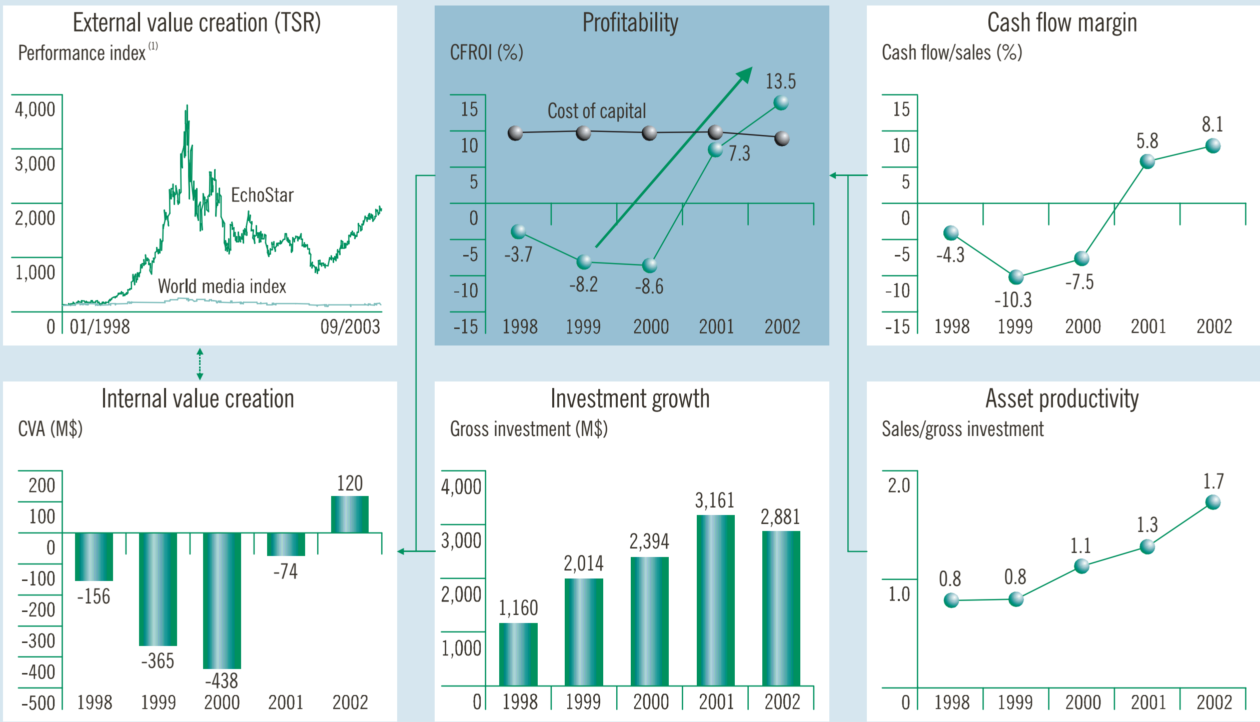


Figure 16

ECHOSTAR: UNTIL 2000 EXTERNAL VALUE CREATION NOT SUSTAINED BY INTRINSIC FUNDAMENTAL PERFORMANCE

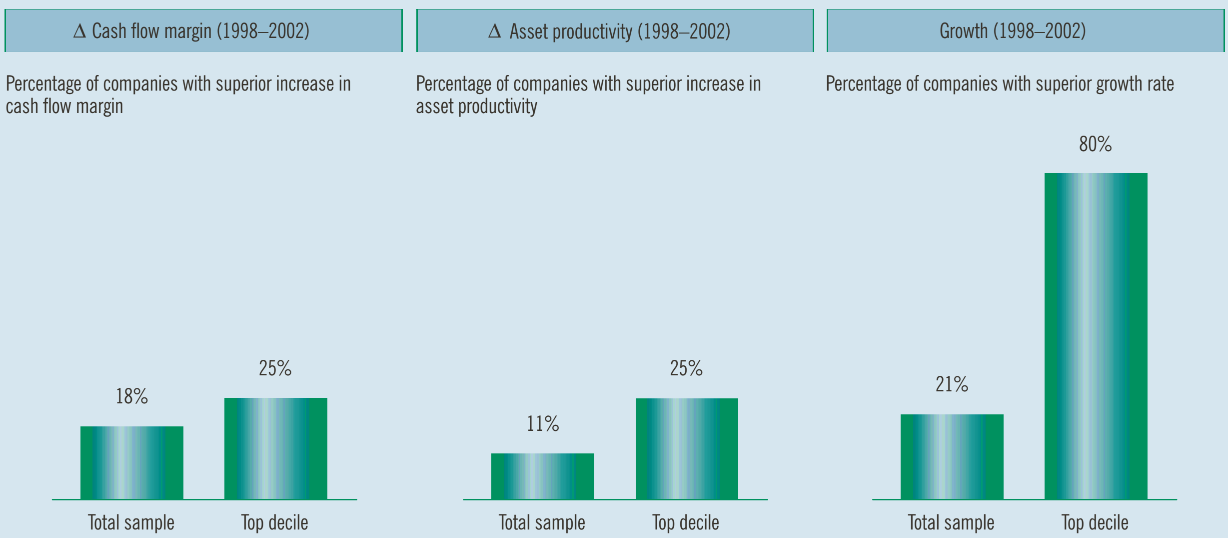
BUT APPARENTLY EXPECTED PROFITABILITY INCREASE STARTED IN 2000



(1) Performance including share price and dividends, end of 1997 = 100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

Figure 17

TOP DECILE TSR PERFORMERS: SUPERIOR CASH FLOW MARGINS AND ASSET PRODUCTIVITY



Source: BCG analysis

Figure 18

point. In 1994 the company was known as Echosphere, the country's largest distributor of conventional home satellite equipment, but it realized the future lay with DBS and started investing heavily in this field, a costly exercise both in terms of launching satellites and achieving a critical mass of subscribers.

As Figure 17 shows, unprofitable growth destroyed internal value between 1998 and 2000 but as the subscriber base swiftly grew, increasing both asset productivity and cash flow margins, the company's profitability steadily increased, rising above the cost of capital in 2002, aided by improved cost control. Throughout this period, investors remained confident that the drive for scale was the right strategy, reflected in high expectation premiums and 60% annual TSR. And this confidence was ultimately justified: during the period 1998–2002 Echostar's fundamental value increased by 39% a year on average. Today, the company is the second biggest player in the DBS market in the U.S. with over 8 million subscribers.

The top players tended to rely more heavily on asset productivity than cash flow margins to lift profitability.

Although the top-decile value creators outperformed the total sample in terms of both cash flow margins and asset productivity, the key differentiator was their superior asset productivity—one of the hardest, but apparently most fruitful, ways to increase profitability (Fig. 18). Here we examine how three companies improved asset productivity and cash flow margins to produce superior value:

- **Morrison highlights the power of asset productivity:** More intensive use of its stores enabled the U.K. food retailer Morrison to increase its asset productivity to around 2.6 over the last five years, well above the sector average, giving it the level of profitability required to grow gross investment. Expanding its stores' product offerings and introducing new services such as cafés and gas stations were just two of the routes used to raise the productivity of its fixed asset base (i.e., higher sales per square foot and inventory turns).

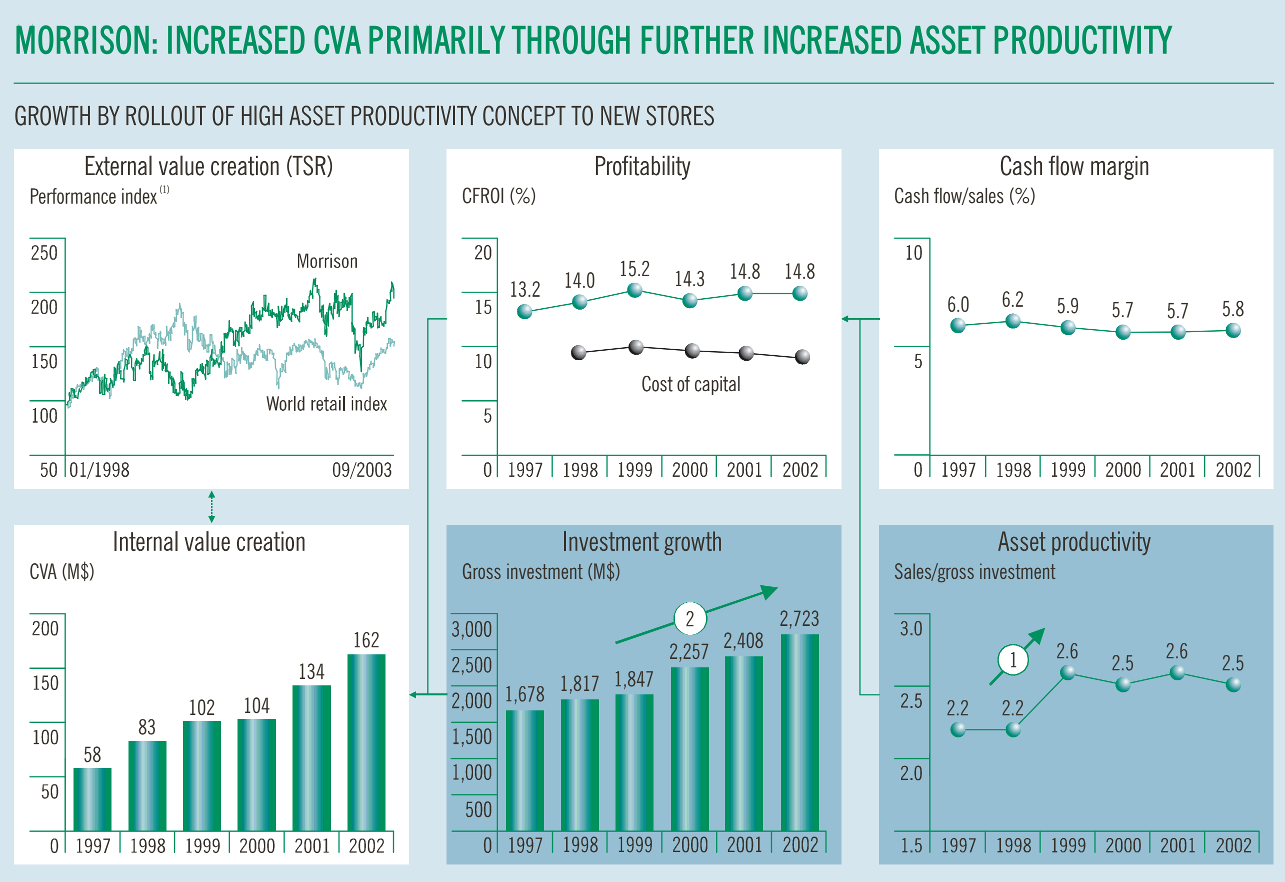
  In conjunction with creating new stores, these developments enabled Morrison, which has historically focused on the north of England, to increase its fundamental value by 15% a year on average between 1998 and 2002. The stock market rewarded this with a 15% annual average TSR. Now the retailer is poised to accelerate its growth with the proposed acquisition of Safeway in the U.K., a move that would make it a leading national player (Fig. 19).

- **SK Telecom plays cash flow margin card:** A steady increase in cash flow margins helped Korea's leading cellular phone service provider, SK Telecom, push its profitability above the cost of capital, enabling the firm to generate substantial TSR. Between 1998 and 2002, cash flow margins rose from 15.8% to 27.6%. This was mainly achieved through a combination of cost reductions and sales of high-margin mobile internet services to its 16 million subscribers. Investment growth was relatively modest and asset productivity generally flat. (Fig. 20)

  Overall, the company's fundamental value grew by 42% a year, earning it 45% TSR, well above the World Technology Index. Today, its intrinsic value accounts for nearly 100% of its stock market value, compared to just 13% in 1999.

- **Forest Labs employs both profitability levers:** The U.S. generic and specialist pharmaceuticals company, Forest Labs, increased both its asset productivity and cash flow margins to take its profitability above cost of capital, earning it an annual average 51% TSR between 1998 and 2002

  During this time, asset productivity more than doubled, thanks to new products coming through the pipeline and licensing of special compounds, enabling the firm to use its production facilities more efficiently. The fact that the company has its own salesforce, which markets its products directly to doctors, drug stores, and other customers,



(1) Performance including share price and dividends, end of 1997 = 100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

Figure 19

also played a pivotal role. Cash flow margins in turn more than tripled due to its highly successful antidepressant, which accounts for 70% of the firm's business, and the development of new high-margin products.

Over these five years, profitability as measured by CFROI leapt from 8.1% to 61.5%, helping the company increase its fundamental value by 78% a year on average (Fig. 21).

The biggest value creators strive for even higher profitability to fuel investment growth

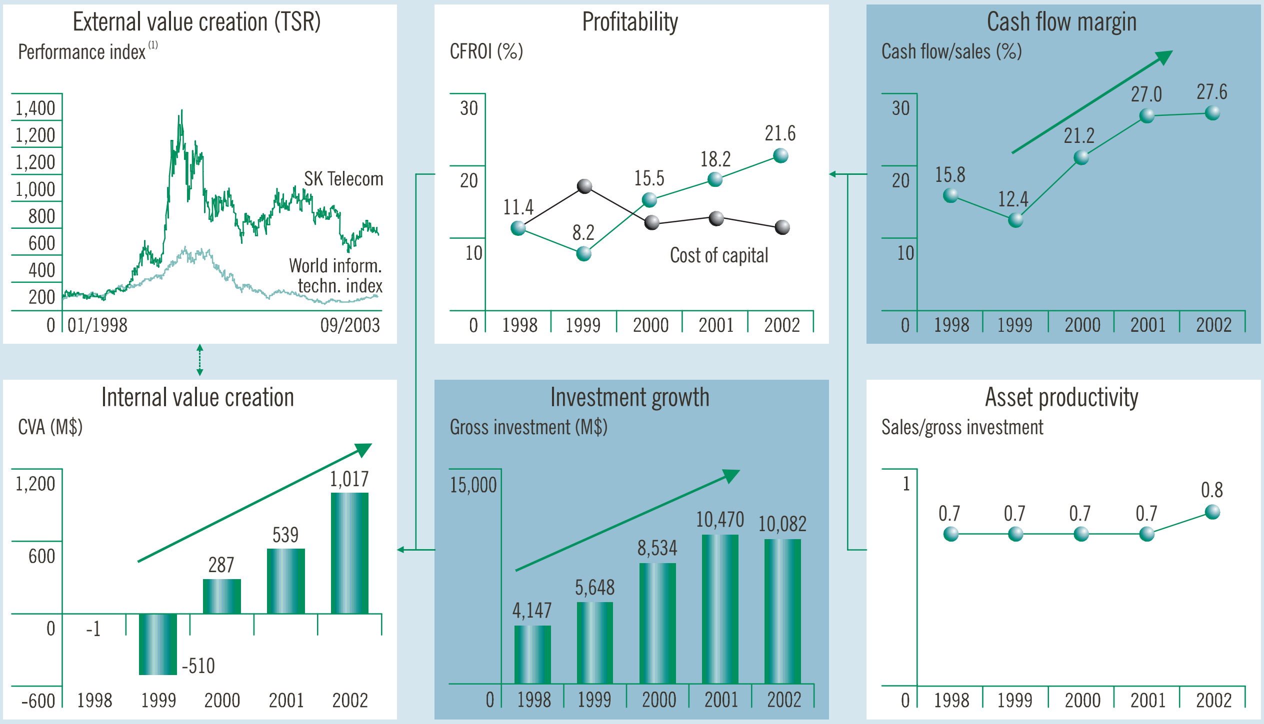
Although profitability above the cost of capital is a prerequisite for long-term value creation, top performers don't stop once they reach this threshold. They strive for higher and higher profitability in order to fund investment growth, the biggest driver of value creation (see next chapter). This is reflected in two analyses:

- As Figure 22 shows, top-decile corporations with high profitability tend to achieve higher growth rates than bottom-decile firms with low profitability. In the technology sector, for example, top-decile companies had on average a CFROI of 30.6% and a gross investment growth of 17.4% per year, compared to an average CFROI of 5.8% and an annual 4.2% gross investment growth for the bottom decile.

- Similarly, the top-performing industries, such as consumer goods and pharmaceuticals, had higher profitability and growth than low value-creation sectors, such as utilities and pulp and paper (Fig. 23).

SK TELECOM: INCREASED CVA PRIMARILY THROUGH HIGHER CASH FLOW MARGIN

SINCE ASSET PRODUCTIVITY REMAINED CONSTANT, GROWTH COULD BE TRANSLATED INTO PROFITS



(1) Performance including share price and dividends, end of 1997 = 100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

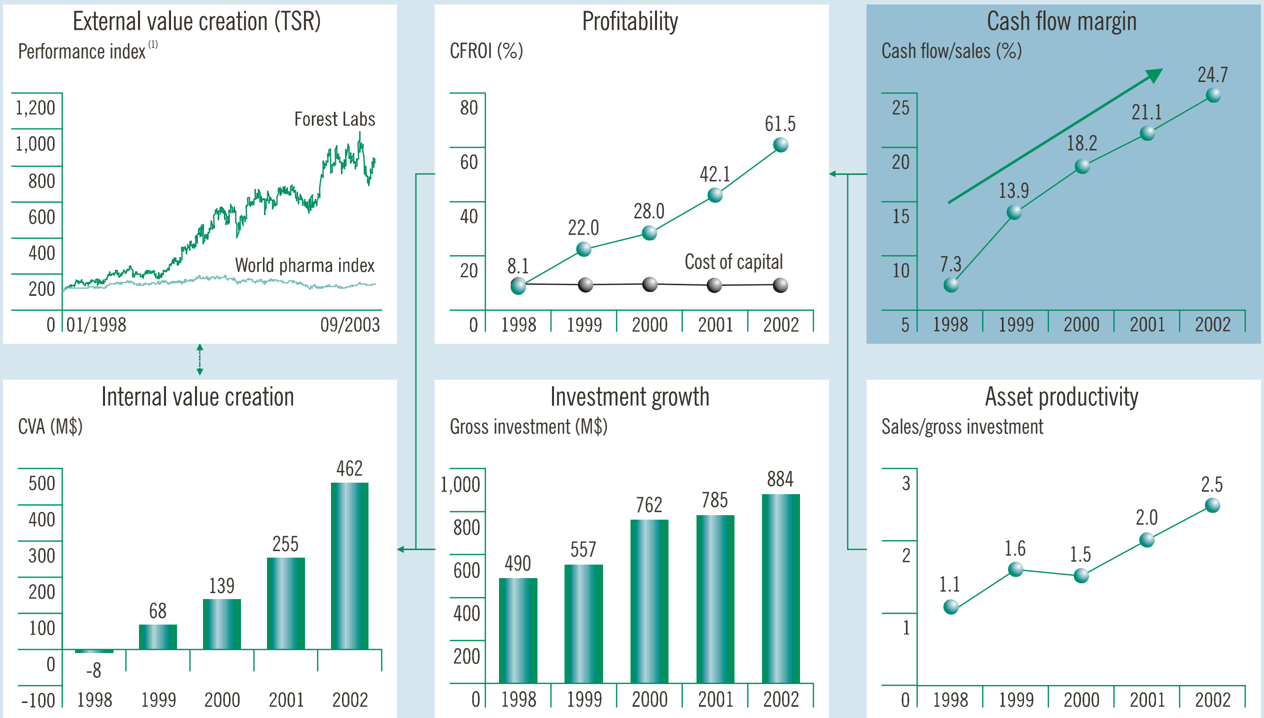
Figure 20

Most companies still have significant opportunities to improve profitability

In virtually every industry most companies could dramatically improve both their asset productivity and cash flow margins. This is reflected in the wide spread of asset productivity and cash flow margins around the average in each sector. In the retail sector, for example, average asset productivity is 2.5, but at least one company has shown that it is possible to achieve 10.5, the highest level recorded in this sector during the period 1998–2002 (Fig. 24). Similarly, the average cash flow margins in the utilities industry over this period was 21% but some firms managed 46% and others as little as 5% (Fig. 25).

FOREST LABS: INCREASED CVA PRIMARILY THROUGH HIGHER CASH FLOW MARGIN

HIGHER MARGIN ADDITIONALLY LEVERAGED BY INCREASED ASSET PRODUCTIVITY

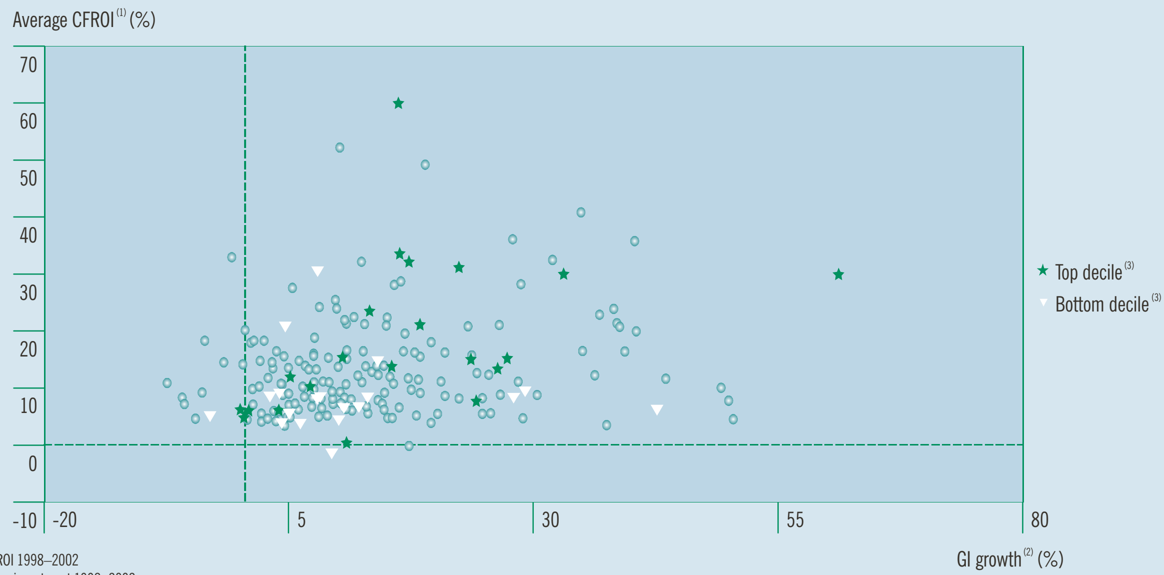


(1) Performance including share price and dividends, end of 1997 = 100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

Figure 21

PROFITABILITY AND GROWTH OF THE WORLD'S TOP PERFORMER

WORLD



(1) Average CFROI 1998–2002
(2) CAGR of gross investment 1998–2002
(3) Selected according to TSR performance p.a. 1998–2002
Note: 207 firms without financial services companies ranked by 5-year TSR, minimum market value 2002: $10B
Source: BCG analysis

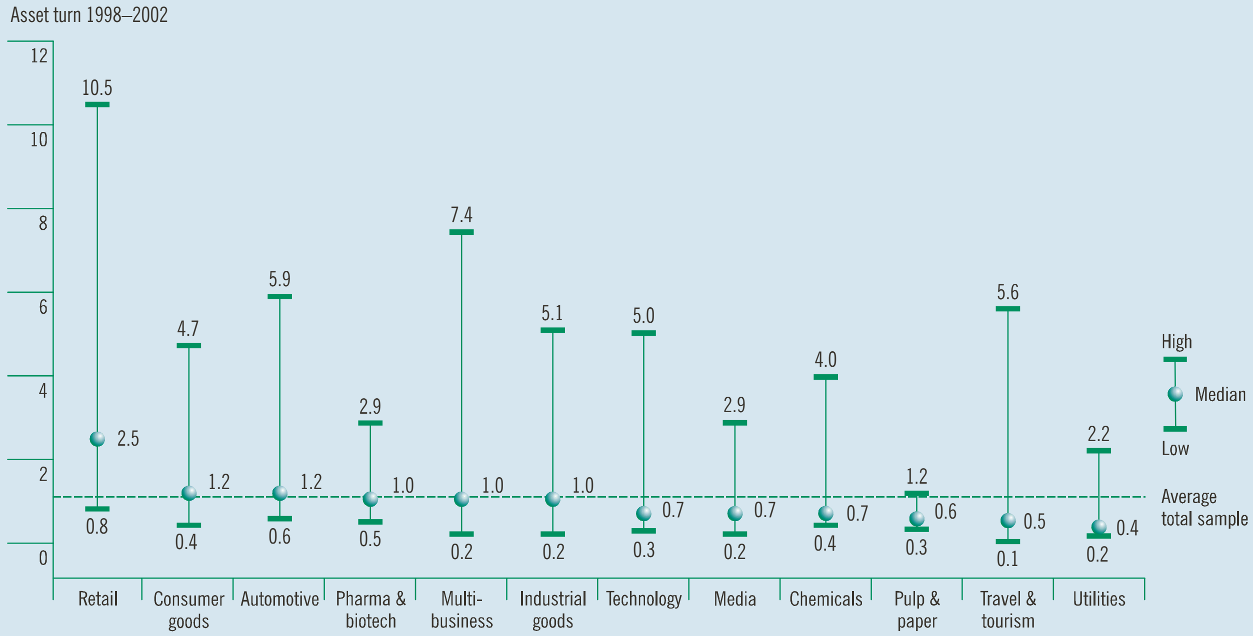
Figure 22

LOW-PERFORMING INDUSTRIES WITH SIGNIFICANT LOWER AVERAGE CFROI THAN HIGH-PERFORMING INDUSTRIES

(1) Average CFROI 1998–2002
(2) CAGR of gross investment 1998–2002
(3) Selected according to TSR performance p.a. 1998–2002
Source: BCG analysis

Figure 23

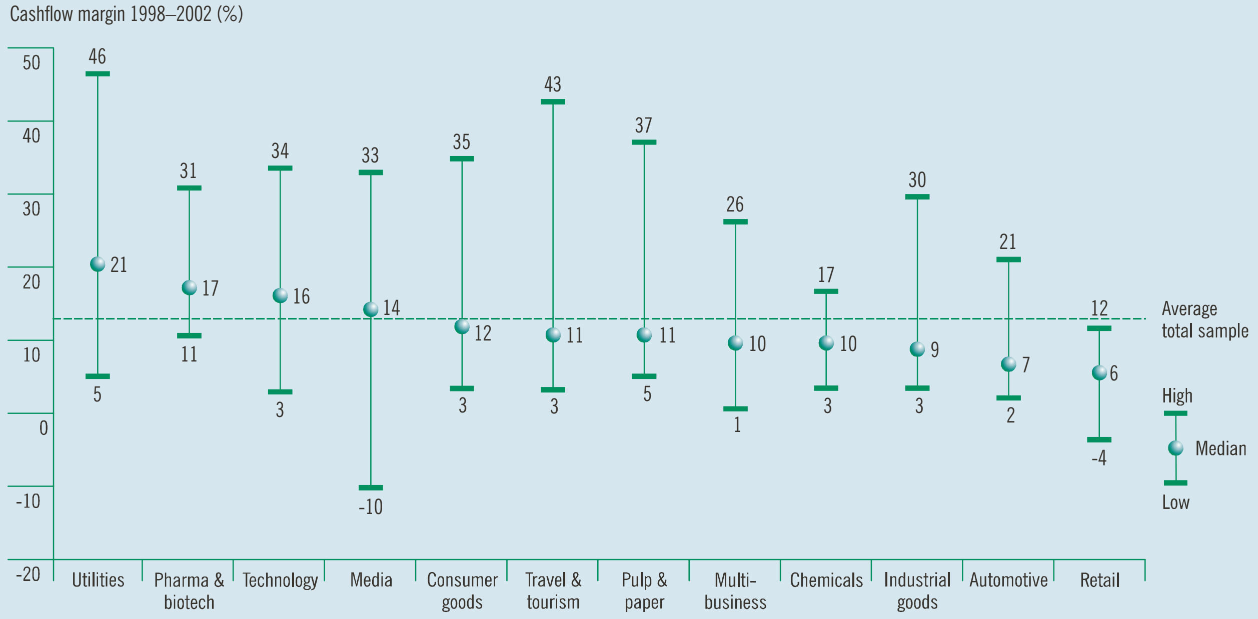
HIGH, LOW AND MEDIAN ASSET TURN PER INDUSTRY



Source: BCG analysis

Figure 24

HIGH, LOW AND MEDIAN CASHFLOW MARGIN PER INDUSTRY



Source: BCG analysis

Figure 25

GROWTH MAKES THE BIGGEST CONTRIBUTION TO TSR

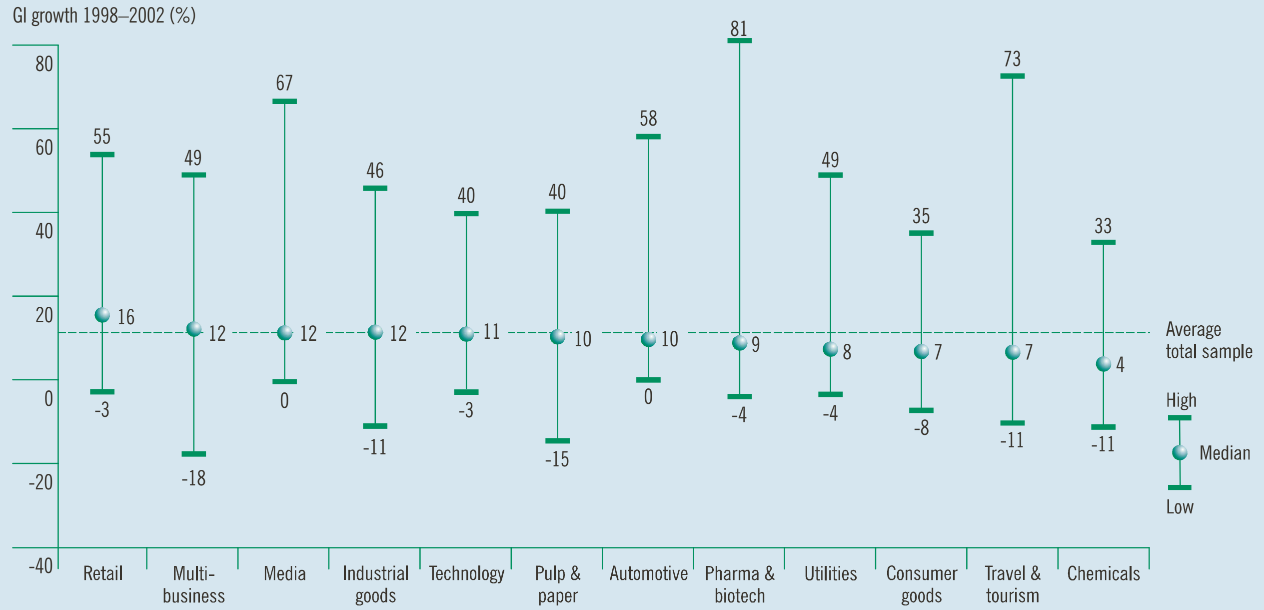
Investment growth is easily the most significant driver of shareholder returns, accounting for 71% of TSR, as Figure 30 shows. The top players pull this lever particularly forcefully.

Superior investment growth is one of the key features of top value creators

A total of 80% of the top-decile value creators grew their investment base profitably by more than 10% during 1998–2002, compared to 21% of firms in the total sample. In fact superior investment growth was the biggest differentiator between the top players and the total sample (Fig. 18). This can be achieved in all industries, as Figure 26 demonstrates. In the travel and tourism industry, for example, which had the lowest TSR and fundamental growth during the period 1998–2002, some firms achieved 73% annual investment growth, over six times higher than the world average (12% annually).

However, as discussed earlier, firms should only grow once profitability is above the cost of capital. Failure to adhere to this principle will destroy value, as one Japanese company recently discovered. During the period 1998–2002, the firm steadily increased its investment base by approximately 13% a year while profitability was below the cost of capital (Fig. 27). This not only destroyed intrinsic value (measured by nega-

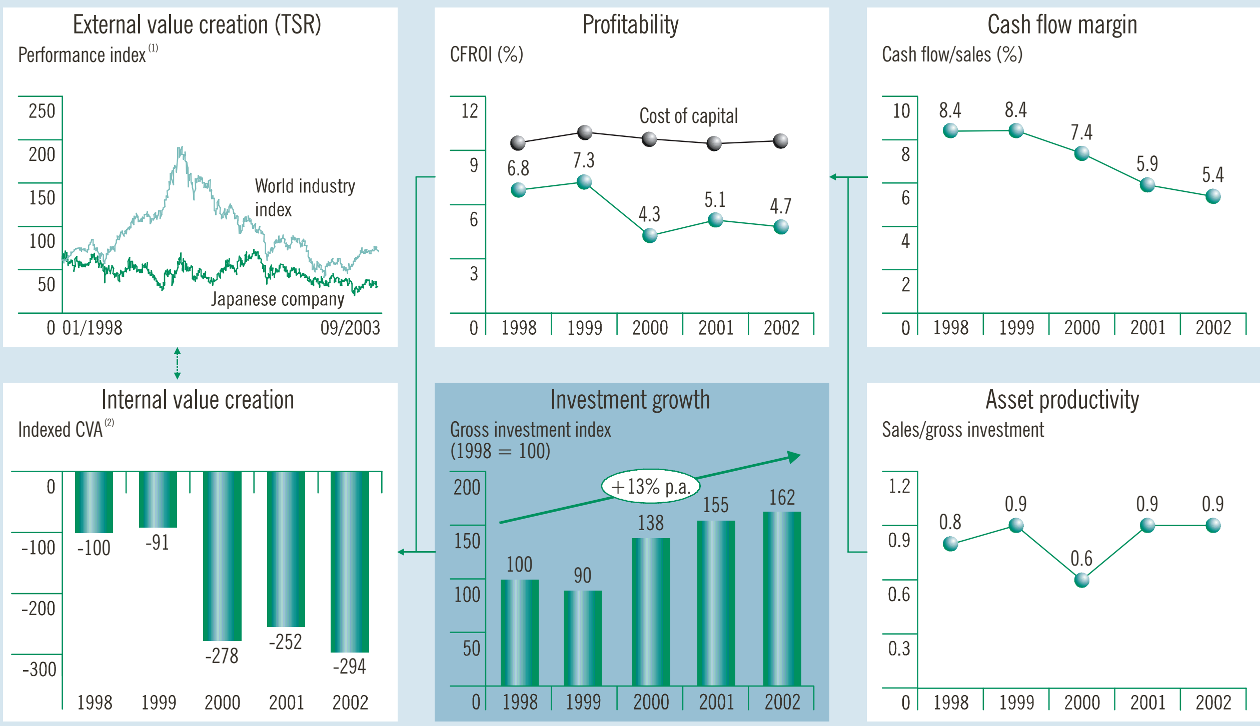
HIGH, LOW AND MEDIAN GROSS INVESTMENT GROWTH PER INDUSTRY



(1) CAGR of gross investment 1998–2002
Source: BCG analysis

Figure 26

JAPANESE COMPANY: CFROI BELOW COST OF CAPITAL, BUT SIGNIFICANT GROWTH OF GROSS INVESTMENT



(1) Performance including share price and dividends, end of 1997 = 100
(2) Indexed CVA, 1998 = -100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

Figure 27

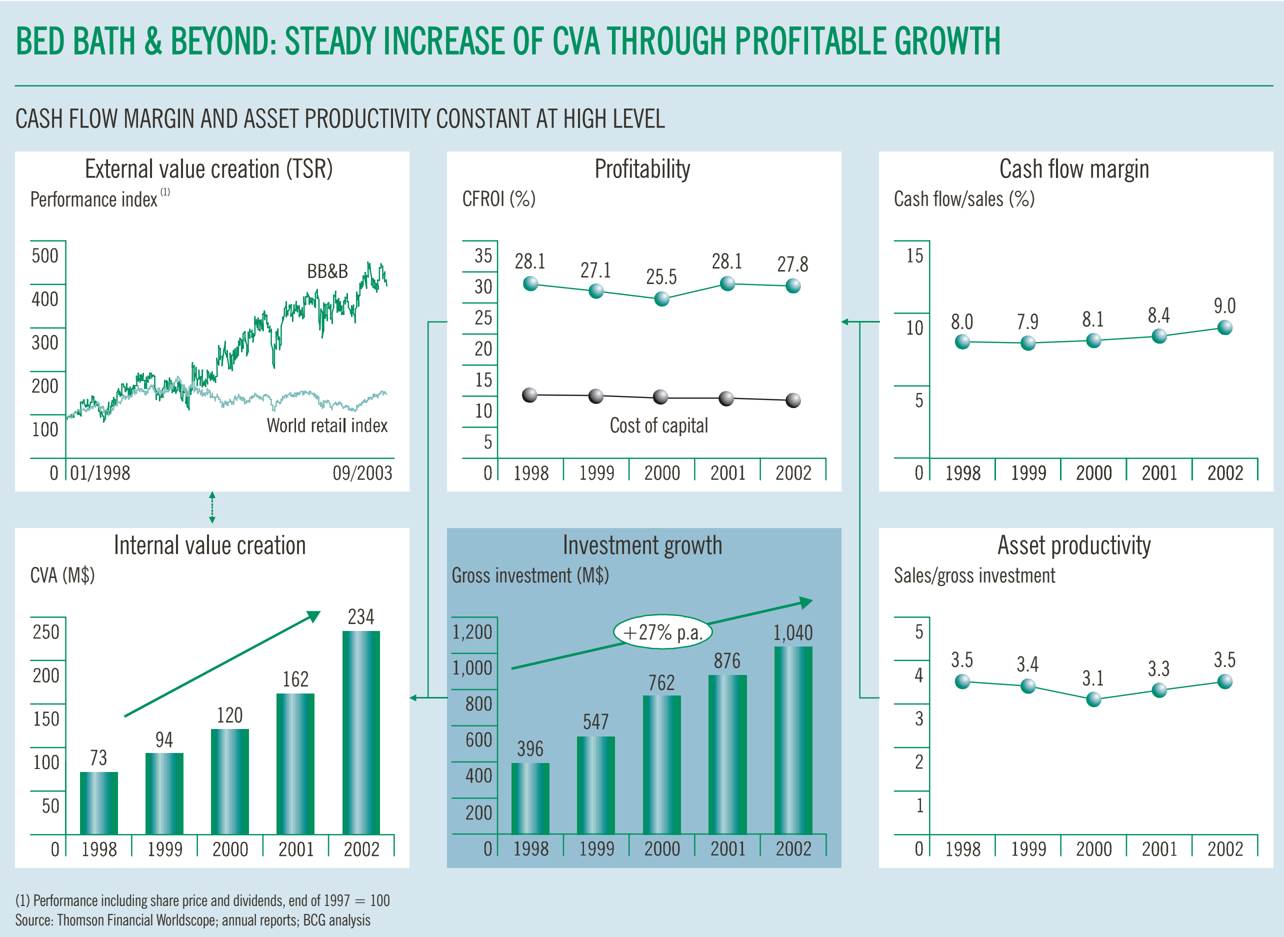


Figure 28

tive CVA), but also led to a total shareholder return of -4.5% a year on average.

Two companies epitomize the value of superior, profitable investment growth, Bed Bath & Beyond and Hero Honda:

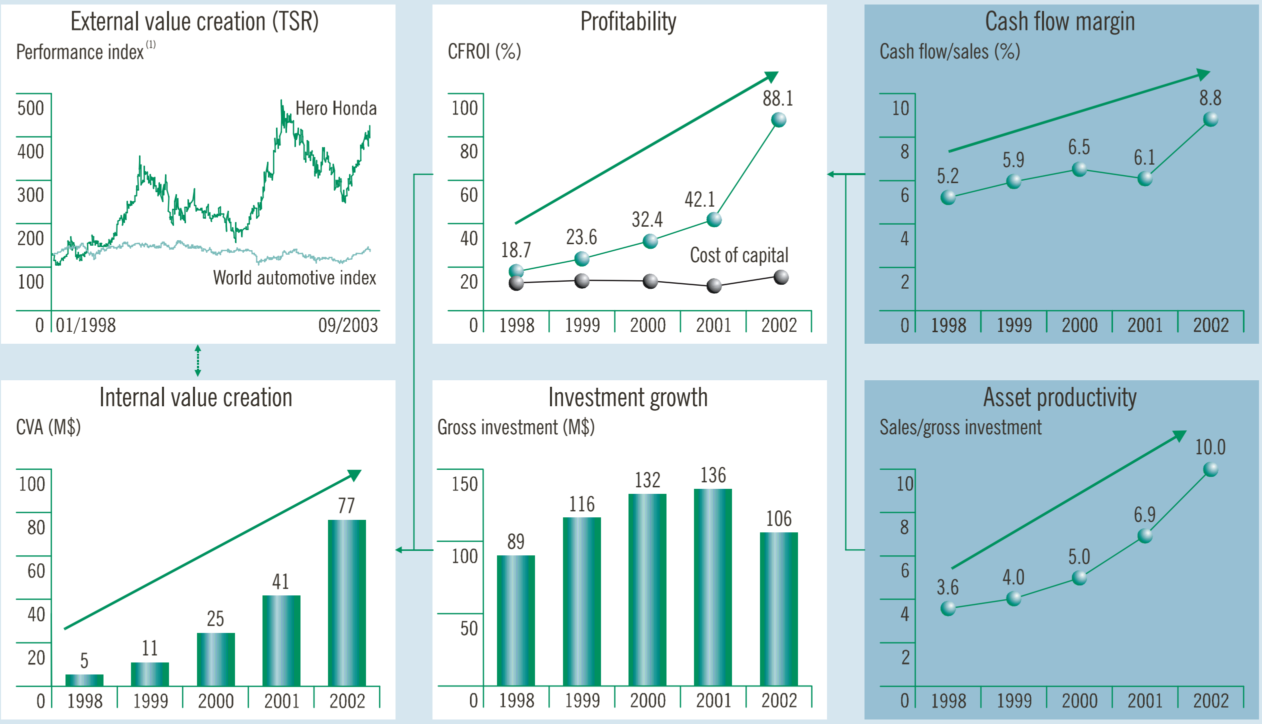
- **Bed Bath & Beyond exploits investment growth to become world's top value creator:** High profitability above the cost of capital gave U.S. household merchandise retailer Bed Bath & Beyond the fuel to grow its investment base by nearly 30% a year during 1998–2002, pushing its annual TSR nearly four times higher than the World Retail Index. (Fig. 28) Although its profitability, which was underpinned by both healthy asset productivity and cash flow margins, remained fairly constant over this period, it was able to use its cash flow "war chest" to fund rolling out an increasing number of new large-format shops each year.

  This was complemented by acquisitions of Harmon Stores and The Christmas Shop, taking Bed Bath into health and beauty and the gift market respectively. Giving store managers the flexibility to manage their inventory, floor layout, and other elements also ensured outlets were able to respond to local market conditions.

  The net effect of all these initiatives was an annual 36% rise in the company's fundamental value on average, leading to an annual average TSR of 29% over this period. By 2002, Bed Bath & Beyond was the world's most successful value creator.

HERO HONDA: STEADY INCREASE OF ASSET PRODUCTIVITY AND CASH FLOW MARGIN RESULTS IN SUPERIOR VALUE CREATION

PROFITABILITY VERY HIGH RELATIVE TO AUTOMOTIVE INDUSTRY



(1) Performance including share price and dividends, end of 1997 = 100
Source: Thomson Financial Worldscope; annual reports; BCG analysis

Figure 29

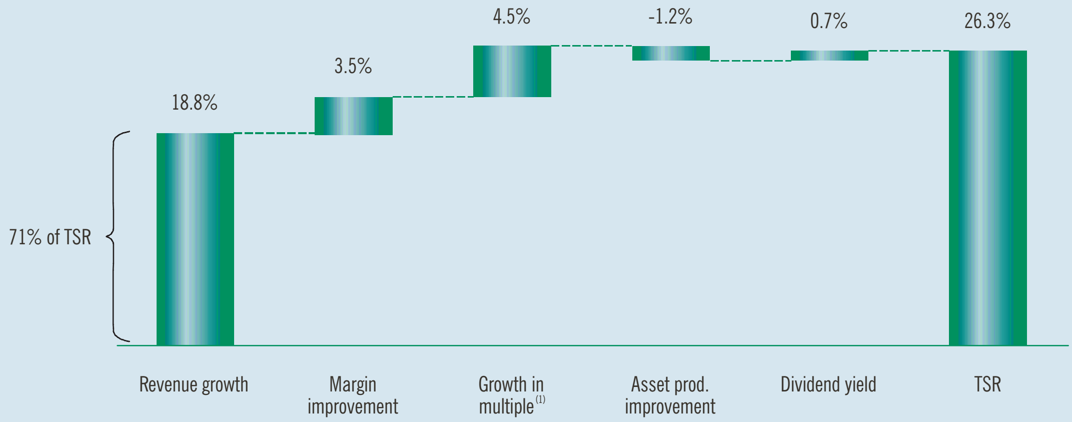
- **Hero Honda pulls out all the stops:** In 1997 investors had high hopes for Hero Honda, a joint venture manufacturer of motorcycles and bicycles in India, owned by Honda Motors and the Munjal Group. At the time, expectation premiums accounted for 81% of the company's market value. To satisfy these, the company, whose profitability was already above the cost of capital, pulled all three fundamental levers of value creation over the next five years: cash flow margins, asset productivity, and investment growth.

  To lift profitability higher, Hero Honda increased cash flow margins from 5.2% to 8.8% through cost reductions and technological and logistical synergies with Honda India, as well as by focusing on medium- to high-margin segments. It also boosted asset productivity from 3.6 to 10 (Fig. 29). Furthermore, it invested in new production capacity in its bid to capture 50% of India's "two-wheeler" market, underpinned by the Munjal brothers' vision of establishing long-lasting relationships with all key stakeholders, including employees, dealers, and vendors.

  Together these developments produced 27% TSR a year during 1998–2002, three times higher than the automotive industry's average. Over this period, the company's intrinsic value grew by 56% annually, halving its expectation premium to 39%.

TSR FOR TOP QUARTILE COMPANIES PRIMARILY DRIVEN BY GROWTH

CONTRIBUTION TO TSR
TOP QUARTILE COMPANIES—10 YEAR AVERAGES



(1) Resulting from decreasing interest rate level and lower market risk premium
Note: Top quartile TSR selected from S&P 1500 companies; 10-year averages 1984 – 2002
Source: Compustat, BCG Value Science Center

Figure 30

THE IMPORTANCE OF RELATIVE EXPECTATION PREMIUMS

Although expectation premiums for the market as a whole tend towards zero in the long run, there are always premiums in the short to medium term (Fig. 1, page 9). More significantly, the scale of these premiums differs between companies as Figure 31, which shows the premiums for the top 10 retail firms in 2002, illustrates. These relative differences in premiums can create problems as well as opportunities.

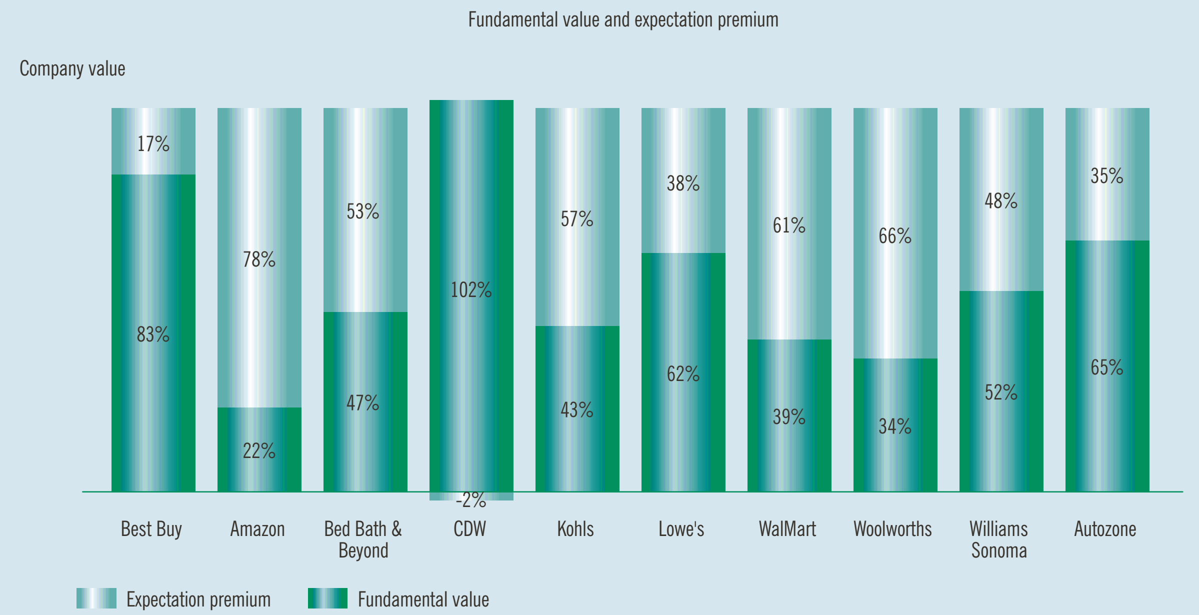
Relatively high premiums, for example, enable firms to acquire companies, as AOL did when it used its paper surplus to "merge" with Time Warner. At the other end of the scale, relatively low premiums not only leave companies vulnerable to takeovers but also limit their ability to raise additional investment capital. These differences in premiums need to be regularly monitored and addressed. In this section we explain how.

What determines relative premiums?

In most cases the differences in firms' expectation premiums are due to time lags in investors acquiring the necessary information needed to value the companies correctly. However BCG has identified a number of factors that enable firms to sustain superior premiums. These include:

- **Transparency:** We found that firms that disclose the most information tend to enjoy a 20% premium.
- **Intellectual property rights:** Patents and other intellectual property rights, including brands, protect profitability and growth from competitive pressures. This is why industries like pharmaceuticals tend to have one of the highest premiums.

TSR CHAMPIONS RETAIL INDUSTRY: BREAKDOWN OF COMPANY VALUE IN 2002



Source: BCG analysis

Figure 31

- **Strong corporate reputations:** On average, firms with the best reputations experience around a 25% premium. This is partly due to their ability to attract high-quality staff and management. A strong reputation also reduces investor risk.

- **Well-structured governance:** The nature and ownership of stocks can affect a company's premiums. For example, investors tend to avoid multiple stock issues that do not entitle them to voting rights, suppressing the stock's price and consequently its premium. Removing these obstacles is one way forward. Increasing the liquidity of the stock, for example through stock splits, can also help: on average the most liquid stocks have a 10% premium over less liquid stocks.

- **Powerful fundamentals:** As Figures 2–5 at the beginning of this report show, companies with the highest TSR not only make the biggest fundamental improvements, they are also rewarded with much higher premiums than average performers. Between 1999 and 2002, for example, North America's top 10 TSR companies increased their intrinsic value by 18% a year, earning them a 48% expectation premium in 2002. The average North American firm, however, only grew its fundamentals by 8%, leading to a 32% premium by 2002—one-third lower than the top players.

Strategic implications of relative expectation premiums

Figure 32, which plots expectation premiums against fundamental value, highlights the strategic implications of relative premiums:

- **Quadrant 1, the underperformer:** The company's premium is below average but justifiably so due to its comparatively poor fundamental performance. Unless investors can be convinced the business can be turned around—lifting its premium to at least the average—its situation is likely to deteriorate further, especially as undervalued companies find it difficult to raise investment capital.

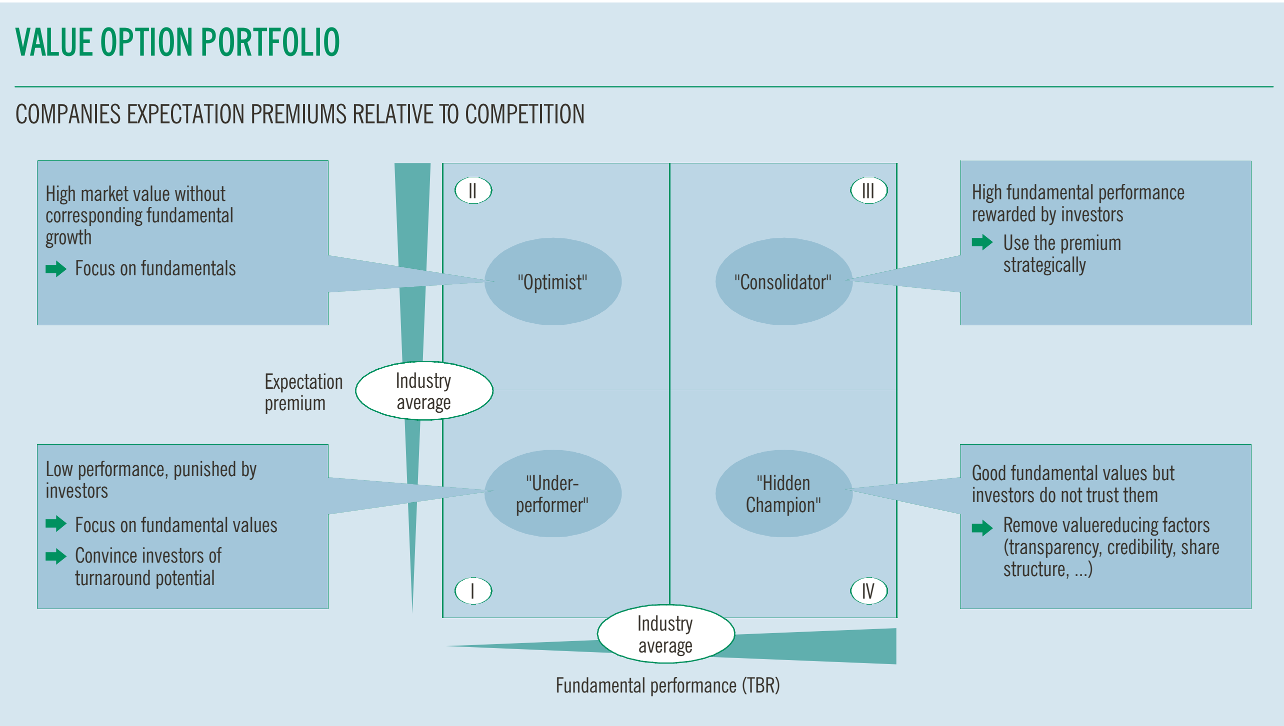


Figure 32

- **Quadrant 2, the optimist:** The company's fundamental performance does not warrant its high premium. As we discussed in last year's report, unreasonably high premiums tend to be punished with disproportionately sharp drops in TSR, leaving firms potentially vulnerable to takeovers and other problems. To avoid this fate, firms must improve their fundamentals, possibly by using their "paper surplus" to acquire a company with strong fundamentals but a relatively low expectation premium—notably a "hidden champion" in quadrant 4 (see below).

- **Quadrant 3, the consolidator:** The ideal position to be in. The company's strong fundamentals and premium enable it to acquire a hidden champion.

- **Quadrant 4, the hidden champion:** The robust fundamentals of the firm have not been rewarded by investors, making the company a potential takeover target. The factors suppressing its premium need to be addressed (see below).

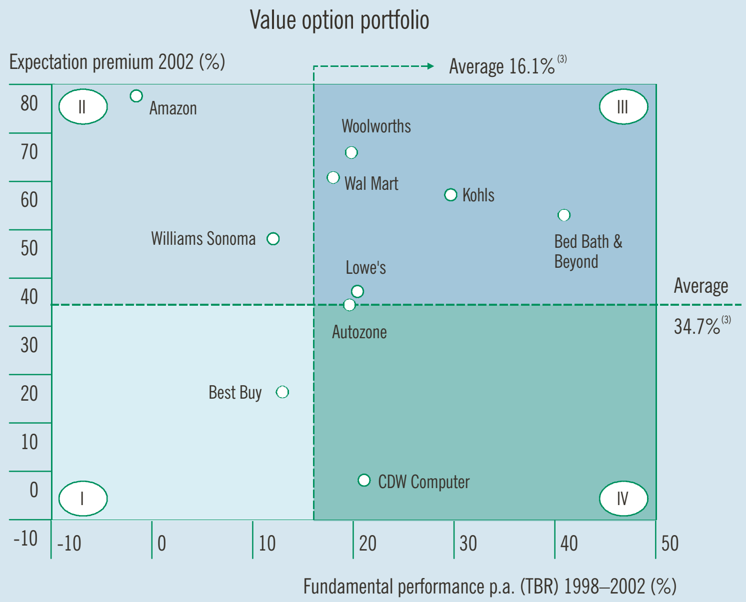
Figure 33 shows how this relative premium matrix can be applied to the retail sector.

Ensuring market and fundamental values are aligned

BCG research, jointly conducted with Thomson Financial, has found that companies that harmonize their strategies with their dominant investors' requirements, based on a BCG investor alignment index[3], are less likely to experience unjustified expectation premiums (Fig. 34). To achieve this yourself, you need to:

- **Identify your dominant investor segment's style:** Most companies have a variety of investor segments—institutional and private—with varying aspirations such as yield, value, and "growth at a reasonable price" (GARP). To establish your core investors' aspirations, a detailed analysis of your investor base is required. BCG has developed tools to facilitate this process.

RETAIL INDUSTRY: FUNDAMENTAL PERFORMANCE VERSUS EXPECTATION PREMIUM

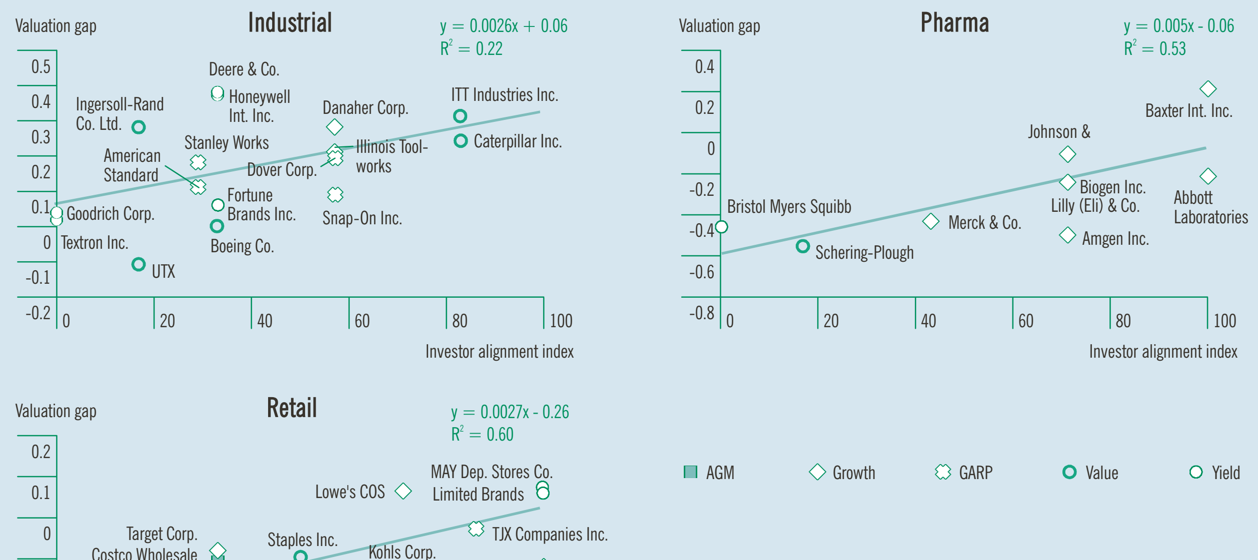


(1) Weighted average of total sample
Source: BCG analysis

Figure 33

3 The index measures the consistency of the fundamental data relative to the investor base. A score of 1 indicates that fundamentals are aligned with investors' criteria.

INVESTOR ALIGNMENT HAS MATERIAL IMPACT ON VALUATION GAP



Note:
Investors classified into different styles: (AGM = aggressive growth and momentum; GARP = growth at reasonable price)
The **investor alignment index** measures the consistency of the fundamental data in relation to the investor base. A score of 1 indicates that the fundamentals are aligned with the criteria of the investors.
Valuation gap defined as (MV - FV)/FV; MV = market value (as of 03/28/02), FV = fundamental value, calculated by proprietary BCG VS methodology

Source: BCG Value Science Center

Figure 34

- **Link your strategy and internal processes with their expectations:** This should include aligning TSR goals, internal plans, and even staff incentives. Some firms even rotate line managers through the investor relations (IR) function to help them think about how to run their units in a more investor-focused manner.

- **Establish a close dialogue with your core investor segment:** Regular, non-defensive, face-to-face contact with core investors is critical, as our research into the importance of transparency (see above) underlines.

A NOTE ON DIVIDENDS

During the bull market of the 1980s and 1990s dividends fell out of fashion. This was largely due to the fact that average TSR was in the high teens, making growth a much more attractive proposition for investors than a 3–4% dividend yield. Moreover, paying dividends during this period, rather than reinvesting the surplus, was often seen as an admission that management had run out of ideas for generating growth.

This preference for growth over yield, however, was unusual. Historically, dividends have accounted for nearly half of shareholder value. Over the last 70 years, for example, the average annual TSR of U.S. equities has been close to 10% and dividend yields around 4%. If TSR continues to decline towards its long-term average of 10%, we can expect a similar balance in the future.

Historical precedents aside, though, there are several reasons why firms should now consider dividends in their shareholder value mix:

- Dividends reassure investors that a firm is making genuine progress—they are paid in cash and cannot be manipulated, unlike accounting-based measures of success such as earnings per share (EPS). This reassurance is particularly important in the wake of recent accounting and governance scandals.
- Research has shown that companies that raise their dividends significantly tend to enjoy higher stock values. Since 2001 for instance a dozen S&P 500 companies have increased their dividends by 20% or more, leading to an average 2.7% lift in their stock values within ten days of announcing the increase. The restaurant chain Lone Star Steakhouse & Saloon is a case in point. When it started paying dividends, its TSR rose by 23% and its P/E ratio by 18%.
- A study in the Financial Analysts Journal[4] found that companies with higher payout ratios have substantially higher long-term earnings growth than those with lower payout ratios.

Whether dividends are an appropriate element of a company's shareholder value mix will depend on the individual firm. A BCG Perspective, Thinking Differently about Dividends, outlines the key issues firms need to consider.

4 See Robert D. Arnott & Clifford S. Asness: "Surprise! Higher Dividends = Higher Earnings Growth" in Financial Analysts Journal Jan./Feb. 2003, Vol. 59, No. 1

CEO CHECKLIST

- ✓ **Measure corporate success by TSR—the "gold standard" of value creation.** Superior TSR not only makes it easier to raise additional investment capital but also to retain and attract high quality staff. It also lowers the risks of a takeover.

- ✓ **Strive for high TSR irrespective of your industry.** As we have shown, firms in all industries are able to generate substantial TSR, often significantly above both the global average and the averages of other industries.

- ✓ **Set a realistic TSR target, stretched over, say, three years.** Overly ambitious goals are likely to lead to unsustainably high expectation premiums, which will ultimately be punished with a disproportionate drop in TSR.

- ✓ **Never lose sight of the fact that fundamentals drive shareholder returns in the long run.** Don't rely on expectation premiums to fuel TSR; in the long run expectation premiums decline to zero. Strong fundamentals are the only way to produce superior, sustainable shareholder returns. Convert your external TSR goal into an internal fundamental equivalent.

- ✓ **Measure fundamental value creation with appropriate tools.** Total Business Returns (TBR) and Cash Value Added (CVA) are the most suitable tools in BCG's view. These not only have a strong relationship with TSR, they also don't suffer from the accounting distortions and other pitfalls associated with the more commonly used measure EBITDA. Moreover they can be disaggregated into a "value-driver tree" of practical targets and control metrics for each business unit.

- ✓ **Control fundamental value with TBR's and CVA's two key components—CFROI and gross investment.** To improve profitability, focus on both asset productivity and cash flow margins. Asset productivity initiatives should include regular reviews of working capital as well as efforts to reduce fixed, unproductive assets. To lift cash flow margins, search for opportunities to introduce "value-added" price increases, for example through more sophisticated customer segmentation and innovation; cost reductions have finite limits. Only grow your investment base once profitability is above the cost of capital. Benchmark all fundamental goals against your peers.

- ✓ **Align incentives with your fundamental value-creation targets.** This should be done at both a business-unit and corporate level, ensuring all areas of the business are working towards the same fundamental (and TSR) goal.

- ✓ **Manage your business units as a portfolio of value creators and destroyers.** "Deconstruct" your portfolio to identify units with competitive strengths in markets with growth potential, as well as those with little value-creation future. Aim for profitable growth with the value creators and shed or milk the value destroyers and laggards. Regularly review your portfolio to ensure it is in step with competitive developments.

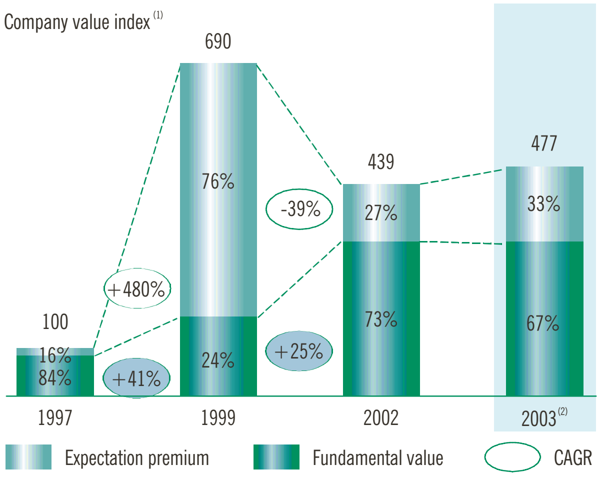
- ✓ **Harmonize your strategy with your dominant investors' expectations.** Assess your core investors' expectations. Either reconfigure your strategy to meet to their demands or (a harder, longer task) reconfigure your investor base to align it with your strategy. Consider your dividend strategy.

✓ **Monitor and manage your relative expectation premiums.** Although fundamentals drive long-term TSR, there will nearly always be expectation premiums in the short to medium term. The relative size and direction of your premium (whether it's positive or negative) will create opportunities and threats that need to be addressed. Also, seek ways to generate sustainable expectation premiums, for example through greater transparency. Ultimately, though, success is a question of superior fundamentals.

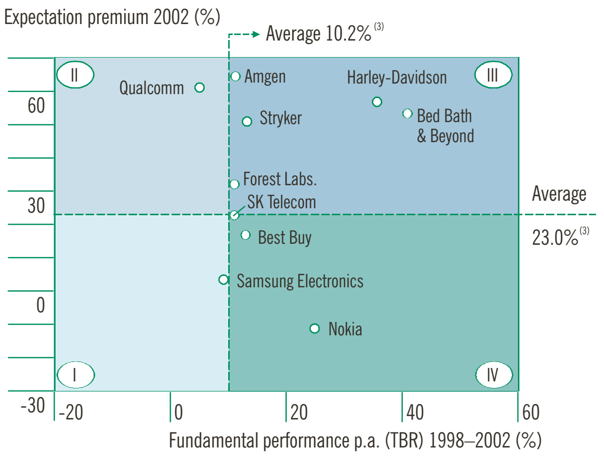
REGIONAL AND INDUSTRY RANKINGS

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

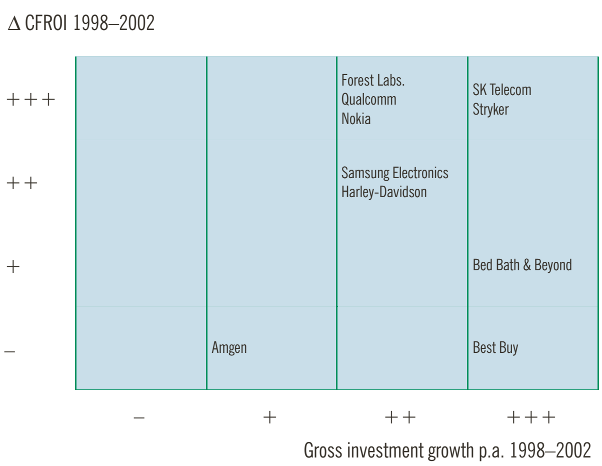


5-YEAR TSR RANKING

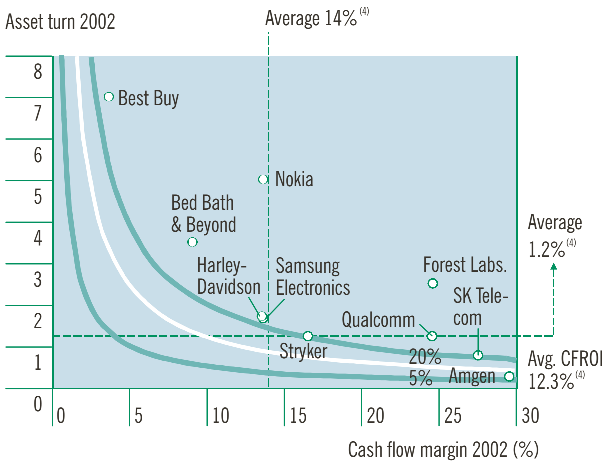
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Samsung Electronics	KR	58%	10%	50,855	25%	39%	2,831	++	+	++	++
2	Forest Labs.	US	51%	11%	18,778	5%	25%	470	++	+++	+++	+++
3	SK Telecom	KR	45%	11%	12,938	-20%	0%	1,018	+++	+++	+	+++
4	Qualcomm	US	43%	5%	33,613	15%	51%	491	++	+++	–	+++
5	Best Buy	US	31%	13%	15,379	97%	26%	296	+++	+	–	–
6	Nokia	FI	31%	25%	66,369	-11%	-18%	2,012	++	–	+++	+++
7	Stryker	US	30%	13%	14,951	12%	47%	331	+++	+	+++	+++
8	Bed Bath & Beyond	US	29%	41%	11,314	11%	48%	162	+++	+	–	+
9	Amgen	US	29%	11%	82,709	34%	62%	-841	+	–	–	–
10	Harley-Davidson	US	28%	36%	14,588	5%	46%	243	++	+	++	++

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002



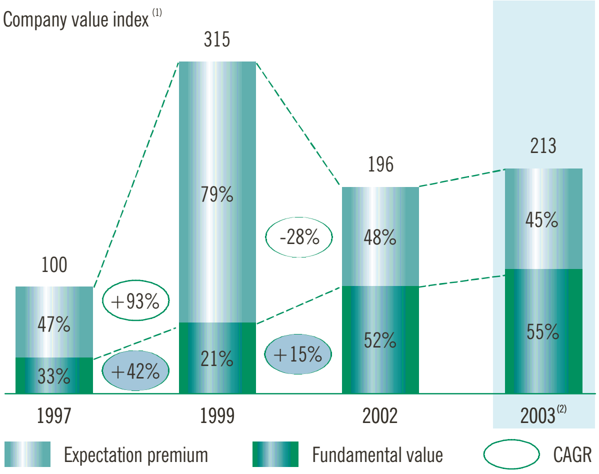
(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 274 companies; minimum market value 2002: $10B
(4) Simple average of total industry sample

Source: BCG analysis

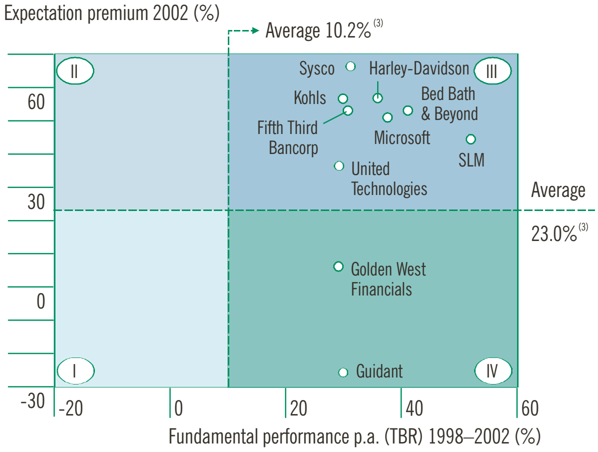
Note:
MV: Market value of equity
EP: Expectation premium
CFM: Cash flow margin
AP: Asset productivity

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

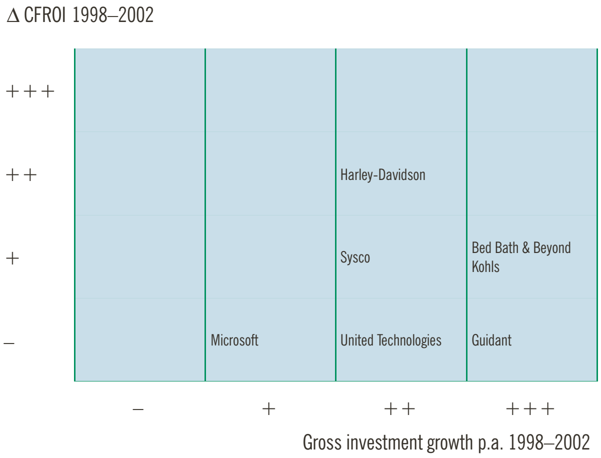


5-YEAR TBR RANKING

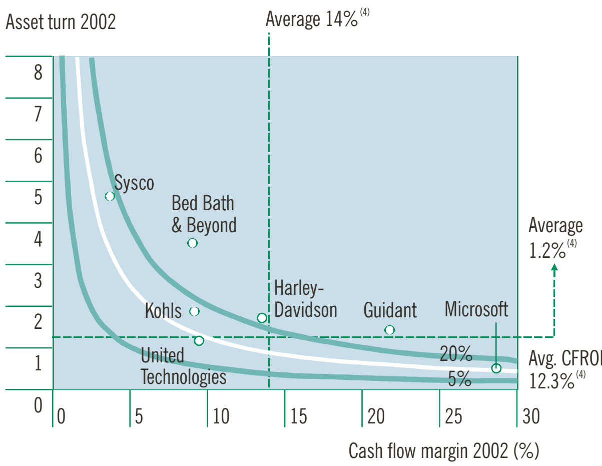
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	SLM	US	23%	52%	17,724	14%	36%	226	NA	NA	NA	NA
2	Bed Bath & Beyond	US	29%	41%	11,314	11%	48%	162	+++	+	–	+
3	Microsoft	US	10%	37%	300,629	8%	48%	-343	+	–	–	–
4	Harley-Davidson	US	28%	36%	14,588	5%	46%	243	++	+	++	++
5	Sysco	US	23%	31%	21,213	11%	62%	262	++	+	+	+
6	Fifth Third Bancorp	US	12%	31%	31,645	-4%	42%	816	NA	NA	NA	NA
7	Kohls	US	27%	30%	18,162	-4%	51%	294	+++	+	–	+
8	Guidant	US	0%	30%	14,576	52%	6%	229	+++	+	–	–
9	United Technologies	US	13%	29%	36,230	26%	42%	189	++	+	–	–
10	Golden West Financial	US	18%	29%	13,635	25%	2%	540	NA	NA	NA	NA

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

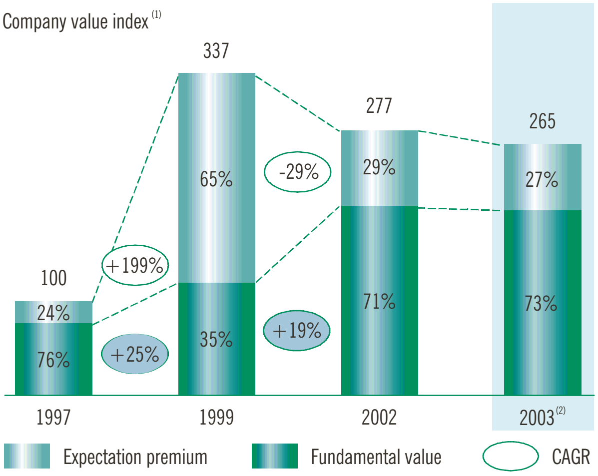


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 274 companies; minimum market value 2002: $10B
(4) Simple average of total industry sample

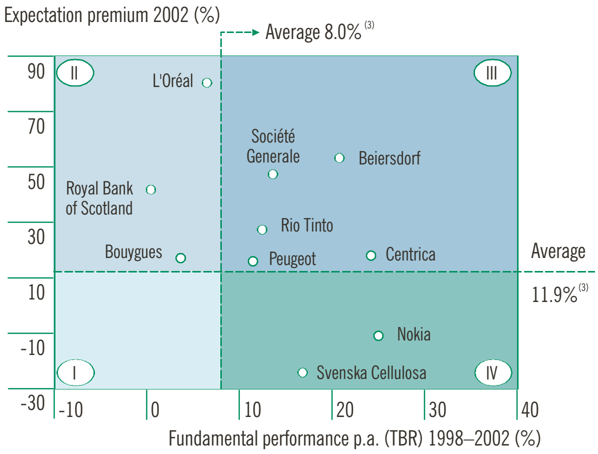
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

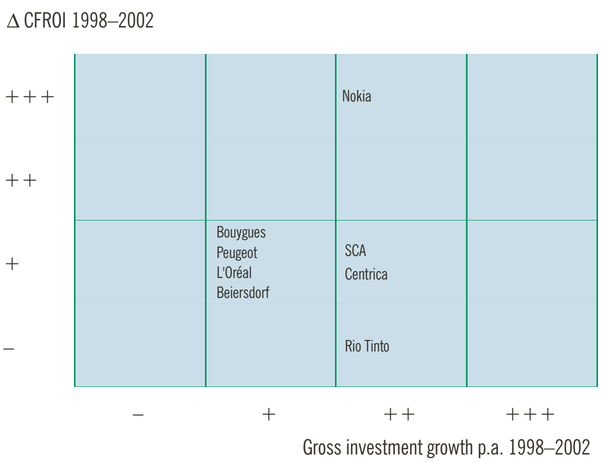


5-YEAR TSR RANKING

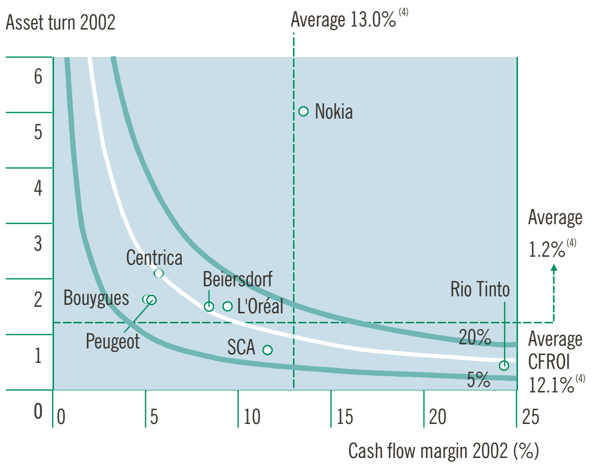
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Nokia	FI	31%	25%	66,369	-11%	-18%	2,012	++	–	+++	+++
2	Bouygues	FR	23%	4%	7,933	-13%	5%	-391	+	+	–	+
3	Beiersdorf	DE	23%	21%	9,609	4%	55%	87	+	+	+	+
4	Royal Bank of Scotland	UK	18%	0%	72,437	7%	49%	47	NA	NA	NA	NA
5	Peugeot SA	FR	17%	12%	9,922	-1%	15%	-445	+	+	++	+
6	Societe Generale	FR	16%	14%	26,272	9%	48%	759	NA	NA	NA	NA
7	L'Oréal	FR	16%	6%	41,611	-18%	74%	-172	+	+	–	+
8	Svenska Cellulosa	SE	16%	17%	7,476	-1%	-19%	5	++	+	–	+
9	Centrica	UK	15%	24%	12,847	9%	5%	404	++	+	–	+
10	Rio Tinto	UK	15%	12%	22,012	7%	28%	10	++	++	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin *versus* asset productivity 2002

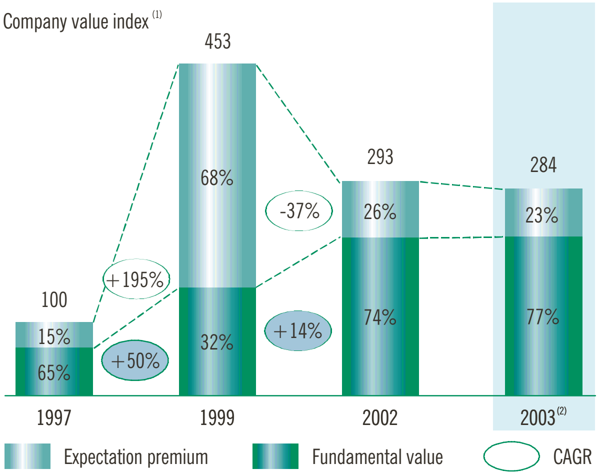


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 111 companies; minimum market value 2002: $7.5B
(4) Simple average of total industry sample

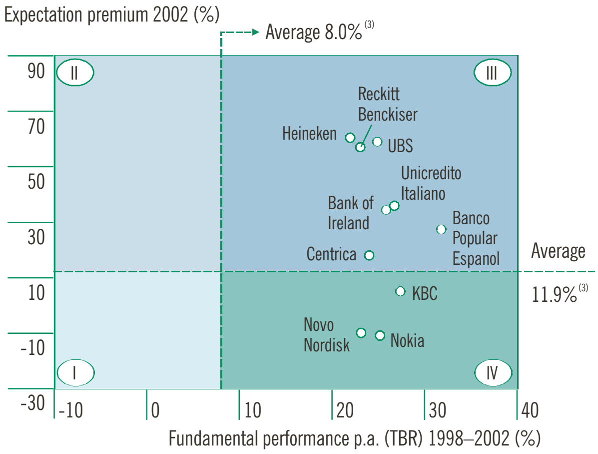
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

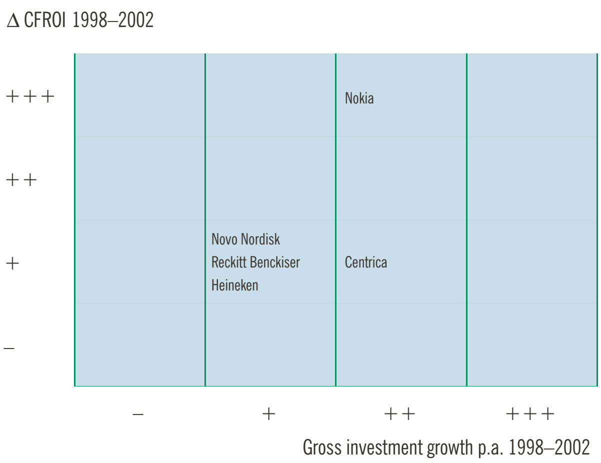


5-YEAR TBR RANKING

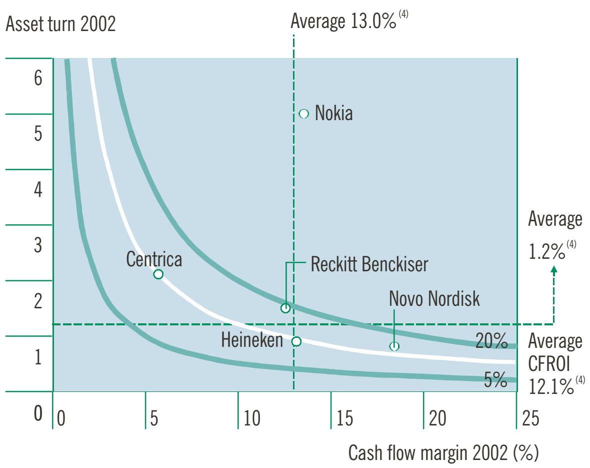
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Banco Popular Espanol	ES	7%	32%	9,678	12%	24%	347	NA	NA	NA	NA
2	KBC	BE	-3%	27%	10,372	12%	8%	-212	NA	NA	NA	NA
3	Unicredito Italiano	IT	8%	27%	26,896	11%	30%	1,236	NA	NA	NA	NA
4	Bank of Ireland	IE	11%	26%	10,515	9%	24%	246	NA	NA	NA	NA
5	Nokia	FI	31%	25%	66,369	-11%	-18%	2,012	++	–	+++	+++
6	UBS	SE	1%	25%	67,318	14%	65%	-1,400	NA	NA	NA	NA
7	Centrica	UK	15%	24%	12,847	9%	5%	404	++	+	–	+
8	Novo Nordisk	DK	4%	23%	10,070	15%	-25%	218	+	+	+	+
9	Reckitt Benckiser	UK	8%	23%	13,772	3%	54%	139	+	–	++	+
10	Heineken	NL	13%	22%	12,830	-15%	40%	174	+	+	+	+

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

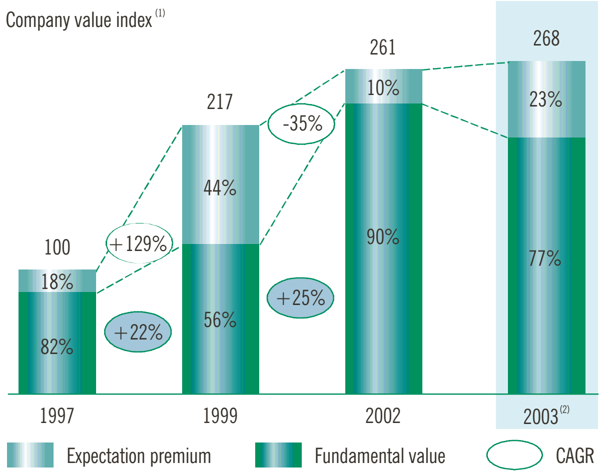


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 111 companies; minimum market value 2002: $7.5B
(4) Simple average of total industry sample

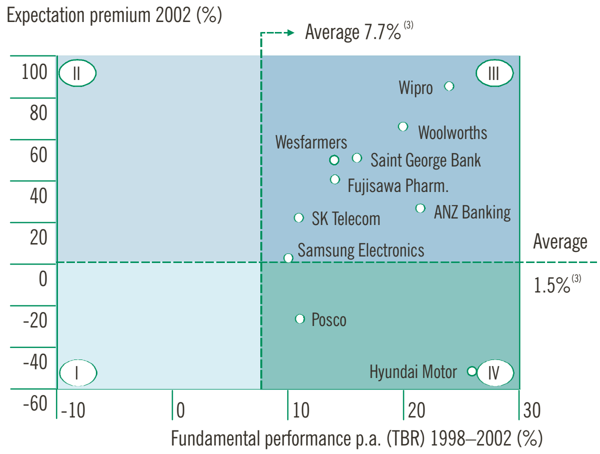
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

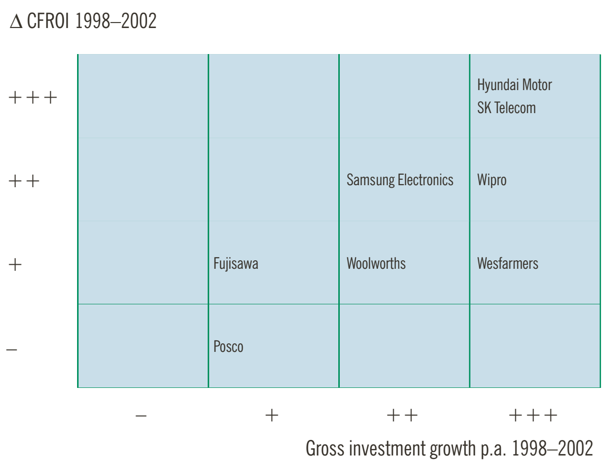


5-YEAR TSR RANKING

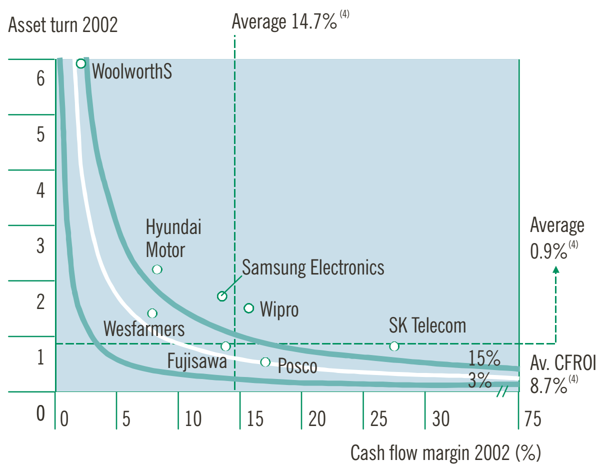
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Wipro	IN	78%	25%	6,077	-24%	80%	39	+++	++	–	++
2	Samsung Electronics	KR	58%	10%	50,855	25%	39%	2,831	++	+	++	++
3	SK Telecom	KR	45%	11%	12,938	-20%	0%	1,018	+++	+++	+	+++
4	Posco	KR	24%	11%	10,103	13%	-16%	-89	+	+	–	–
5	Woolworths	AU	21%	20%	6,743	6%	41%	54	++	+	–	+
6	Saint George Bank	AU	21%	16%	5,817	16%	43%	152	NA	NA	NA	NA
7	Wesfarmers	AU	21%	14%	5,734	5%	38%	49	+++	+	+	+
8	Hyundai Motor	KR	20%	26%	6,114	19%	-26%	1,454	+++	+	+++	+++
9	Fujisawa Pharma	JP	20%	14%	7,067	-6%	41%	87	+	++	–	+
10	ANZ Banking Group	AU	16%	22%	15,336	7%	26%	550	NA	NA	NA	NA

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

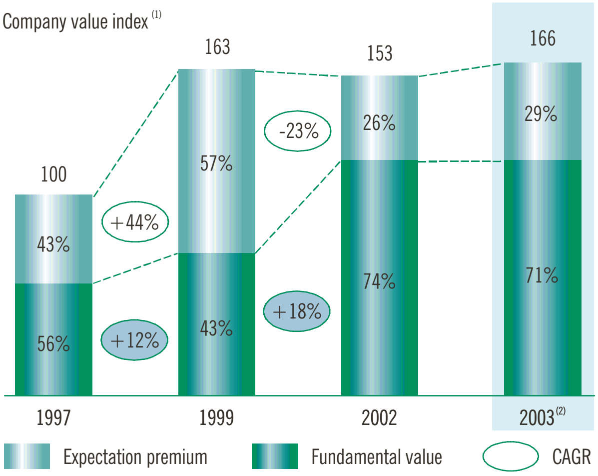


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 94 companies; minimum market value 2002: $5B
(4) Simple average of total industry sample

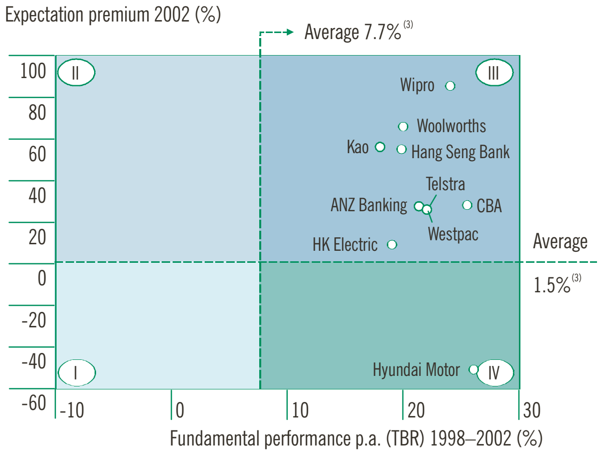
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

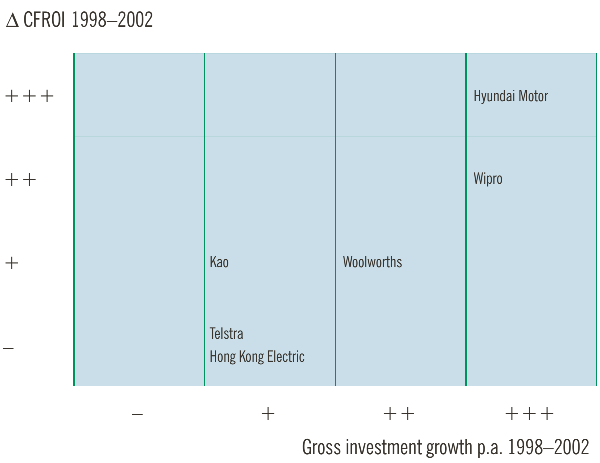


5-YEAR TBR RANKING

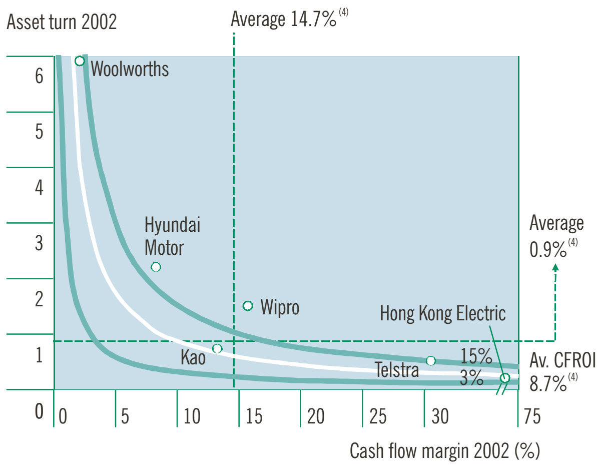
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Hyundai Motor	KR	20%	26%	6,114	19%	-26%	1,454	+++	+	+++	+++
2	Commonwealth Bk.of Aus.	AU	14%	25%	19,504	9%	29%	356	NA	NA	NA	NA
3	Wipro	IN	78%	25%	6,077	-24%	80%	39	+++	++	–	++
4	Westpac Banking	AU	12%	22%	16,256	22%	35%	578	NA	NA	NA	NA
5	Telstra	AU	9%	22%	34,392	14%	25%	320	+	++	–	–
6	ANZ Banking Group	AU	16%	22%	15,336	7%	26%	550	NA	NA	NA	NA
7	Hang Seng Bank	HK	8%	20%	23,290	22%	62%	703	NA	NA	NA	NA
8	Woolworths	AU	21%	20%	6,743	6%	41%	54	++	+	–	+
9	Hong Kong Electric	HK	5%	19%	8,169	7%	14%	-3	+	+++	–	–
10	Kao	JP	8%	18%	11,921	-8%	51%	99	+	++	–	+

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

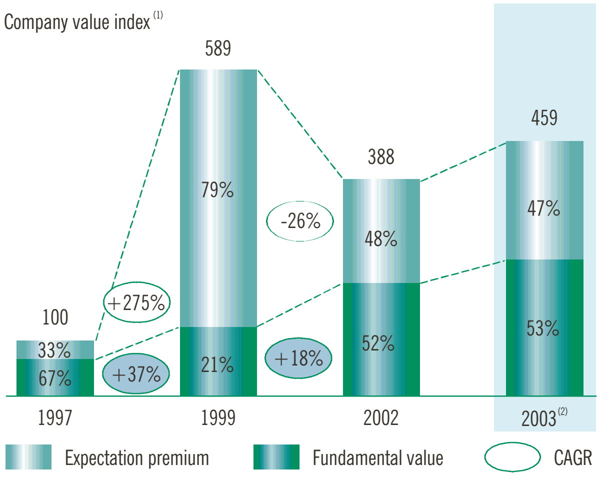


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 94 companies; minimum market value 2002: $5B
(4) Simple average of total industry sample

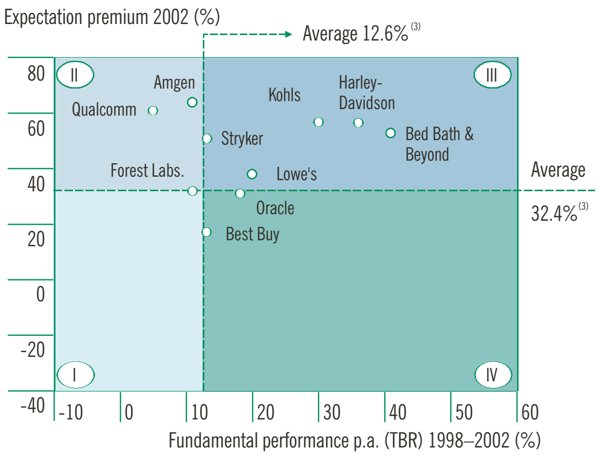
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

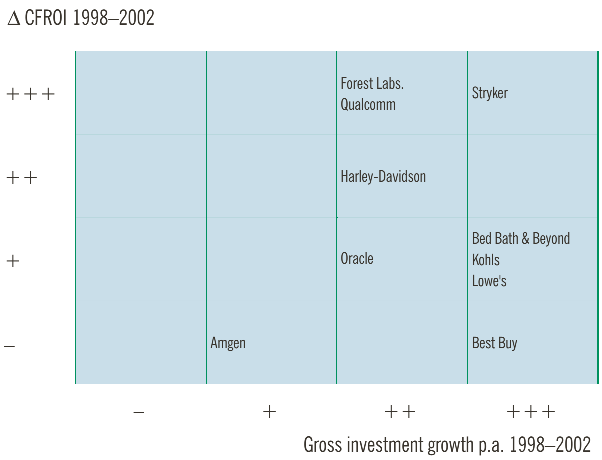


5-YEAR TSR RANKING

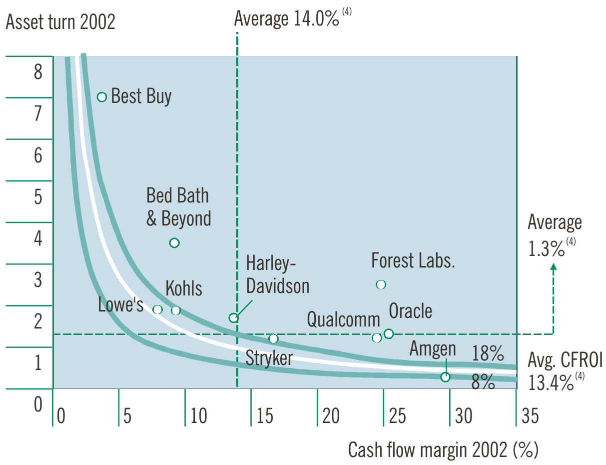
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Forest Labs.	US	51%	11%	18,778	5%	25%	470	++	+++	+++	+++
2	Qualcomm	US	43%	5%	33,613	15%	51%	491	++	+++	–	+++
3	Best Buy	US	31%	13%	15,379	97%	26%	296	+++	+	–	–
4	Stryker	US	30%	13%	14,951	12%	47%	331	+++	+	+++	+++
5	Bed Bath & Beyond	US	29%	41%	11,314	11%	48%	162	+++	+	–	+
6	Amgen	US	29%	11%	82,709	34%	62%	-841	+	–	–	–
7	Harley-Davidson	US	28%	36%	14,588	5%	46%	243	++	+	++	++
8	Kohls	US	27%	30%	18,162	-4%	51%	294	+++	+	–	+
9	Lowe's	US	26%	20%	40,781	39%	47%	574	+++	+	–	+
10	Oracle	US	24%	18%	61,099	4%	34%	818	++	+++	–	+

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

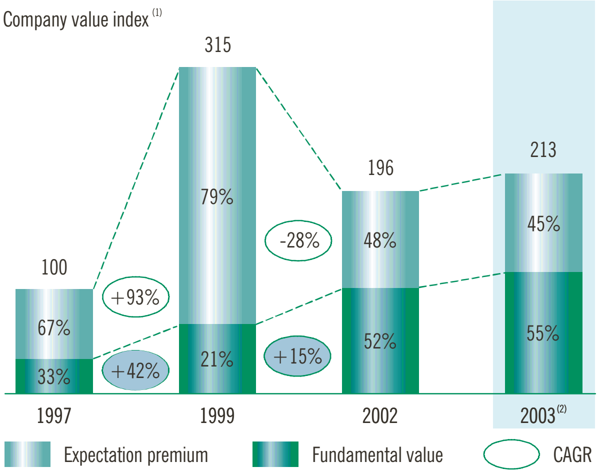


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 146 companies; minimum market value 2002: $10B
(4) Simple average of total industry sample

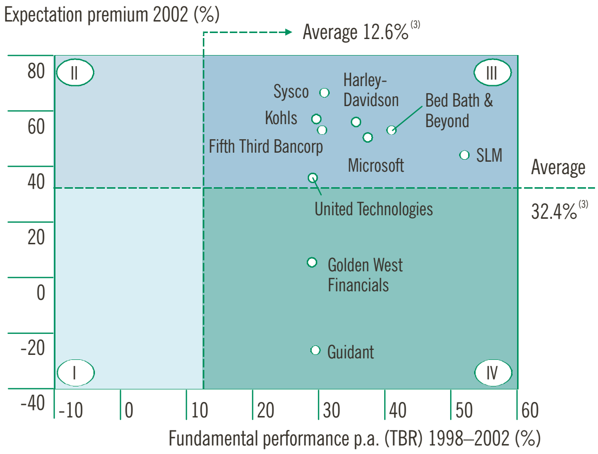
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

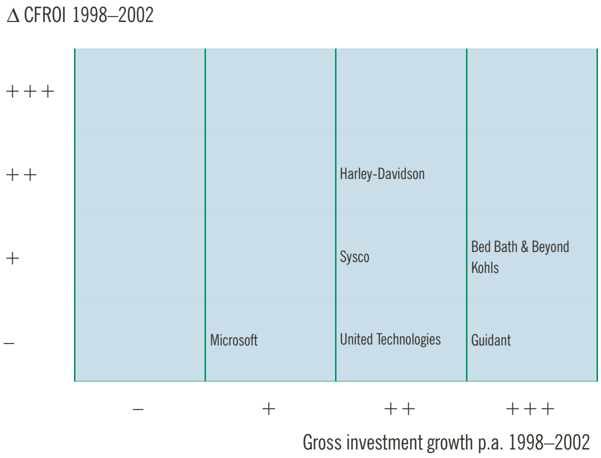


5-YEAR TBR RANKING

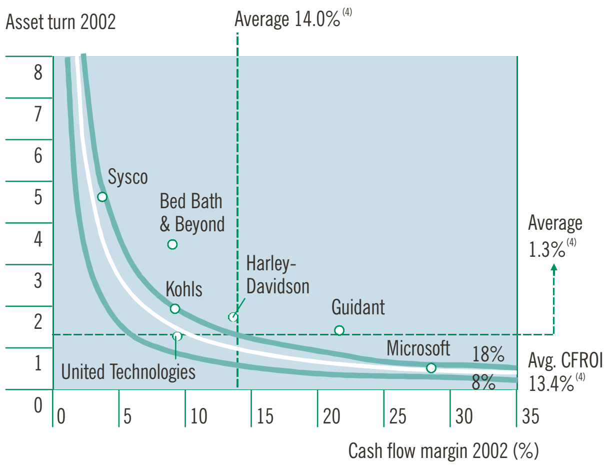
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	SLM	US	23%	52%	17,724	14%	36%	226	NA	NA	NA	NA
2	Bed Bath & Beyond	US	29%	41%	11,314	11%	48%	162	+++	+	–	+
3	Microsoft	US	10%	37%	300,629	8%	48%	-343	+	–	–	–
4	Harley-Davidson	US	28%	36%	14,588	5%	46%	243	++	+	++	++
5	Sysco	US	23%	31%	21,213	11%	62%	262	++	+	+	+
6	Fifth Third Bancorp	US	12%	31%	31,645	-4%	42%	816	NA	NA	NA	NA
7	Kohls	US	27%	30%	18,162	-4%	51%	294	+++	+	–	+
8	Guidant	US	0%	30%	14,576	52%	6%	229	+++	+	–	–
9	United Technologies	US	13%	29%	36,230	26%	42%	189	++	+	–	–
10	Golden West Financial	US	18%	29%	13,635	25%	2%	540	NA	NA	NA	NA

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

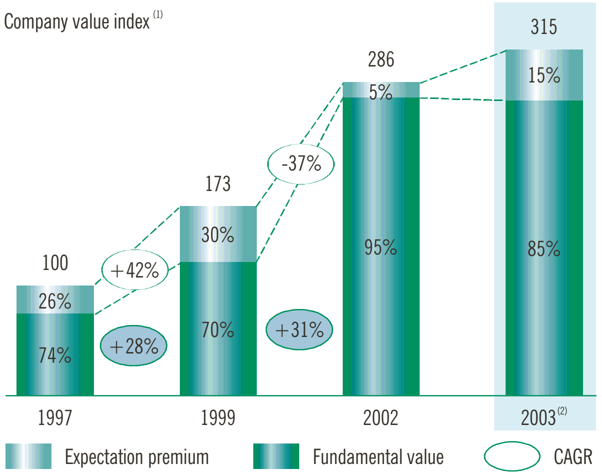


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 146 companies; minimum market value 2002: $10B
(4) Simple average of total industry sample

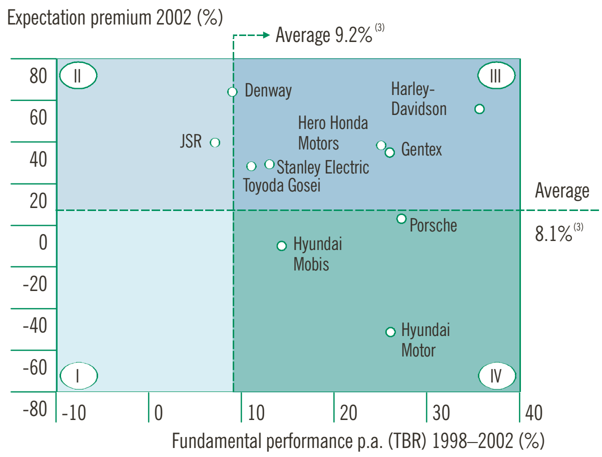
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

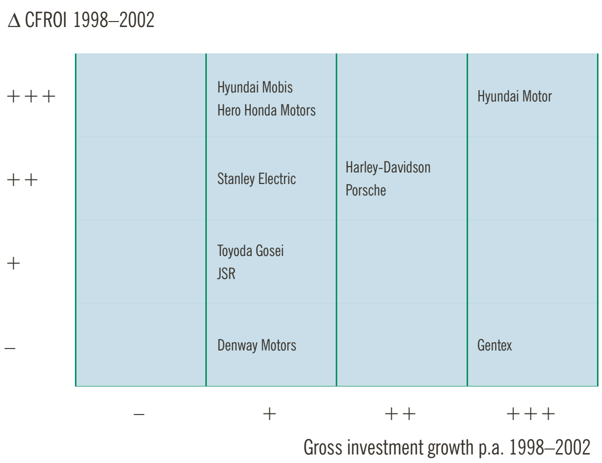


5-YEAR TSR RANKING

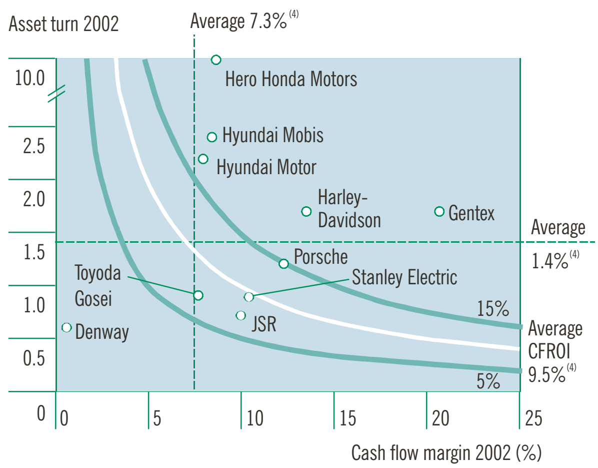
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Hyundai Mobis	KR	56%	14%	2,647	70%	25%	175	+	++	+++	+++
2	Toyoda Gosei	JP	38%	11%	2,504	8%	33%	19	+	+	+	+
3	Stanley Electric	JP	32%	13%	3,172	52%	46%	95	+	++	+	++
4	Denway Motors	HK	29%	9%	2,101	81%	81%	-24	+	–	–	–
5	Harley-Davidson	US	28%	36%	14,588	5%	46%	243	++	+	++	++
6	Hero Honda Motors	IN	27%	25%	1,288	28%	33%	72	+	++	+++	+++
7	JSR	JP	24%	7%	3,877	52%	58%	40	+	++	–	+
8	Porsche	DE	21%	27%	6,630	-5%	-13%	286	++	++	–	++
9	Hyundai Motor	KR	20%	26%	6,114	19%	-26%	1,454	+++	+	+++	+++
10	Gentex	US	19%	26%	2,661	10%	34%	24	+++	–	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

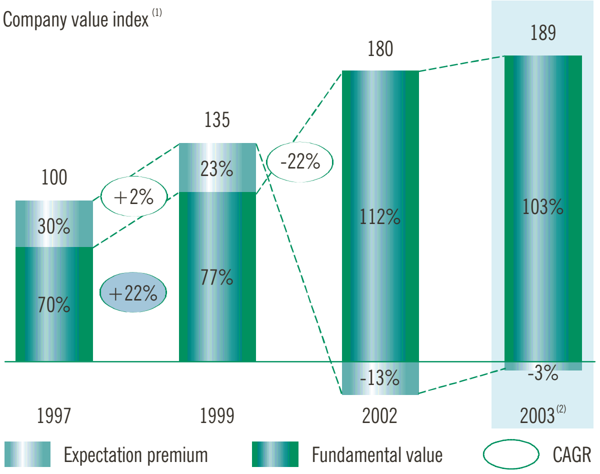


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 56 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

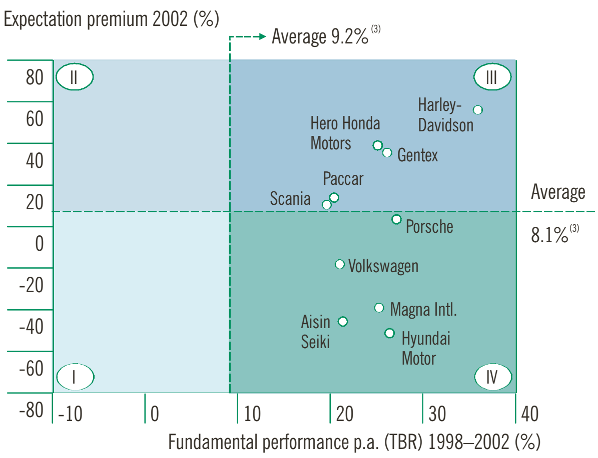
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

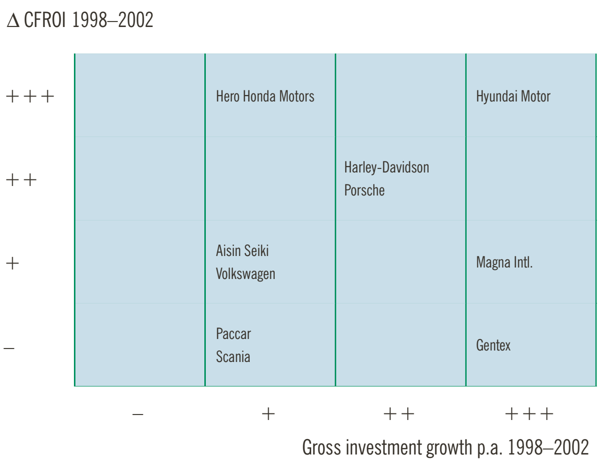


5-YEAR TBR RANKING

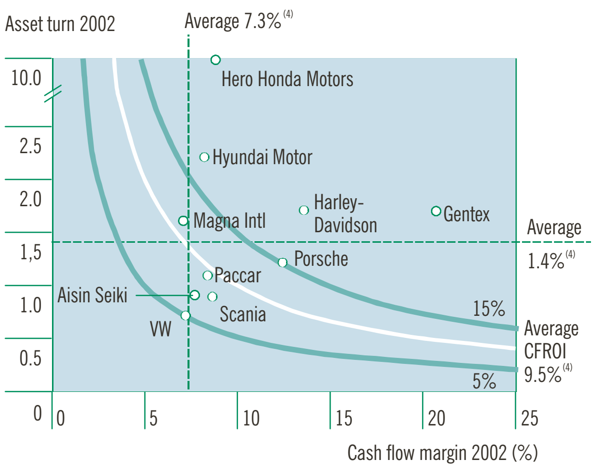
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Harley-Davidson	US	28%	36%	14,588	5%	46%	243	++	+	++	++
2	Porsche	DE	21%	27%	6,630	-5%	-13%	286	++	++	–	++
3	Hyundai Motor	KO	20%	26%	6,114	19%	-26%	1,454	+++	+	+++	+++
4	Gentex	US	19%	26%	2,661	10%	34%	24	+++	–	–	–
5	Magna Intl.	CA	2%	25%	6,165	28%	-3%	126	+++	+	+	+
6	Hero Honda Motors	IN	27%	25%	1,288	28%	33%	72	+	++	+++	+++
7	Aisin Seiki	JP	5%	21%	3,953	0%	-47%	-23	+	+	–	+
8	Volkswagen	DE	-6%	21%	15,774	16%	-12%	-1,232	+	++	–	+
9	Paccar	US	10%	20%	8,671	63%	41%	-57	+	+	–	–
10	Scania	SE	2%	20%	4,441	19%	8%	-63	+	+	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

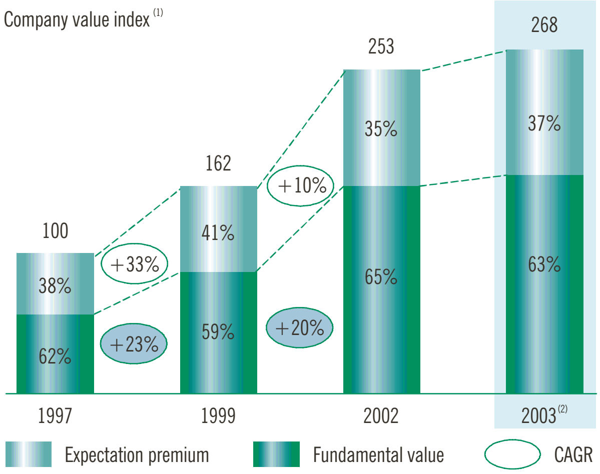


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 56 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

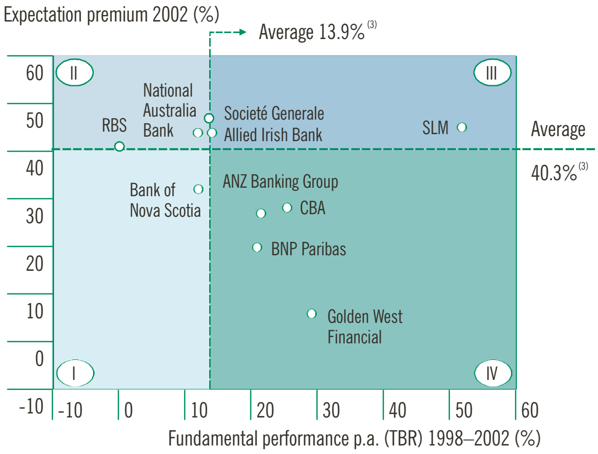
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio



5-YEAR TSR RANKING

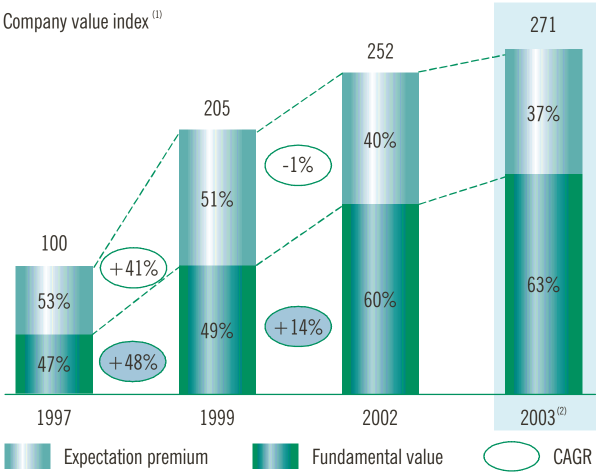
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ AVE in M$ '98–'02
1	SLM	US	23%	52%	17,724	14%	36%	226
2	Royal Bank of Scotland	UK	18%	0%	72,437	7%	49%	47
3	Golden West Financial	US	18%	29%	13,635	25%	2%	540
4	Société Générale	FR	16%	14%	26,272	9%	48%	759
5	ANZ Banking Group	AU	16%	22%	15,336	7%	26%	550
6	Commonwealth Bk. of Aus.	AU	14%	25%	19,504	9%	29%	356
7	National Australian Bank	AU	13%	12%	26,022	1%	37%	147
8	BNP Paribas	FR	13%	21%	39,903	13%	24%	1,816
9	Bank Of Nova Scotia	CA	12%	12%	20,209	23%	36%	510
10	Allied Irish Banks	IE	12%	14%	11,252	3%	46%	-1

(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 51 companies; minimum market value 2002: $10B

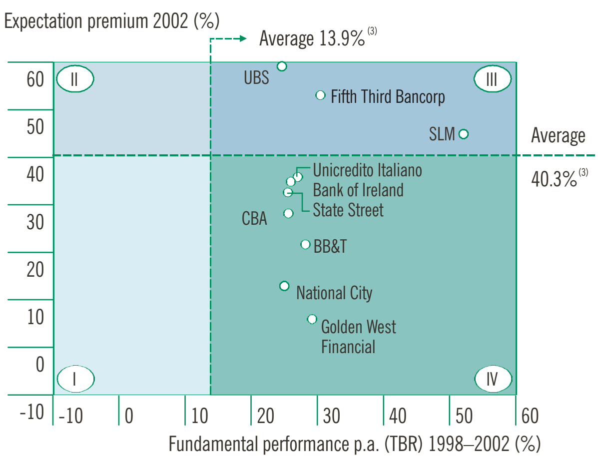
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio



5-YEAR TBR RANKING

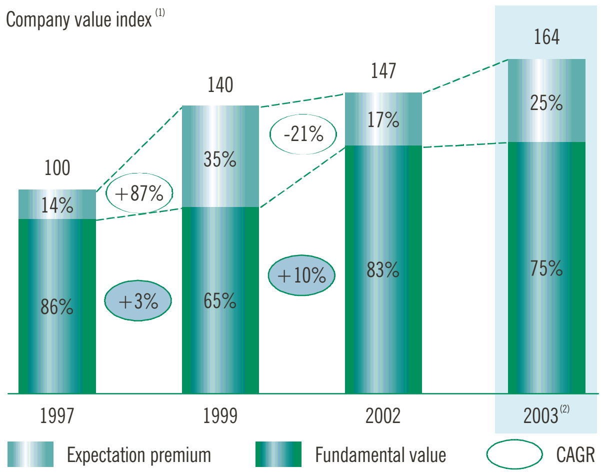
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ AVE in M$ '98–'02
1	SLM	US	23%	52%	17,724	14%	36%	226
2	Fifth Third Bancorp	US	12%	31%	31,645	-4%	42%	816
3	Golden West Financial	US	18%	29%	13,635	25%	2%	540
4	BB & T	US	6%	28%	19,679	0%	14%	532
5	Unicredito Italiano	IT	8%	27%	26,896	11%	30%	1,236
6	Bank of Ireland	IE	11%	26%	10,515	9%	24%	246
7	State Street	US	7%	26%	14,979	17%	36%	440
8	Commonwealth Bk.of Aus.	AU	14%	25%	19,504	9%	29%	356
9	National City	US	0%	25%	18,093	11%	2%	326
10	UBS	CH	1%	25%	60,973	14%	65%	-1,400

(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 51 companies; minimum market value 2002: $10B

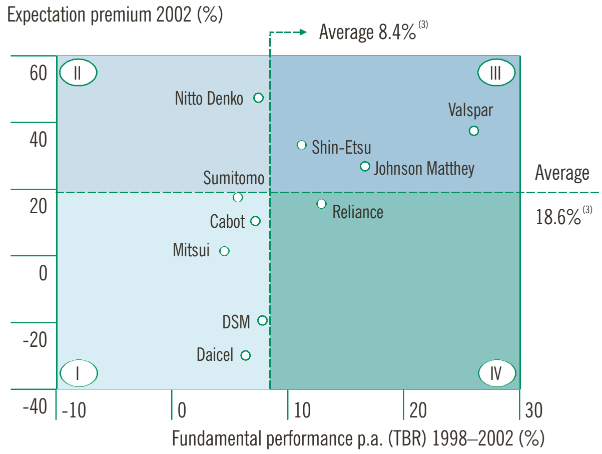
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

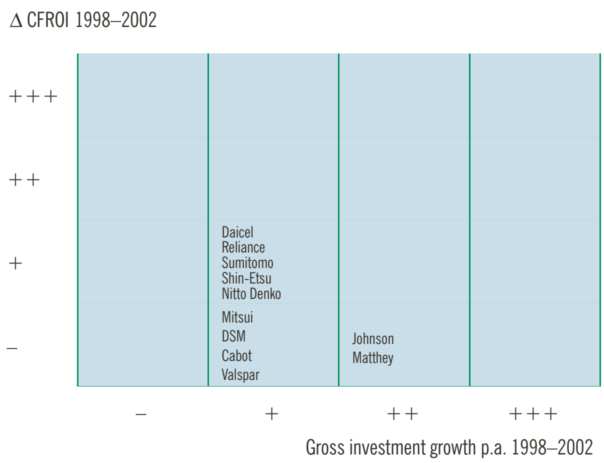


5-YEAR TSR RANKING

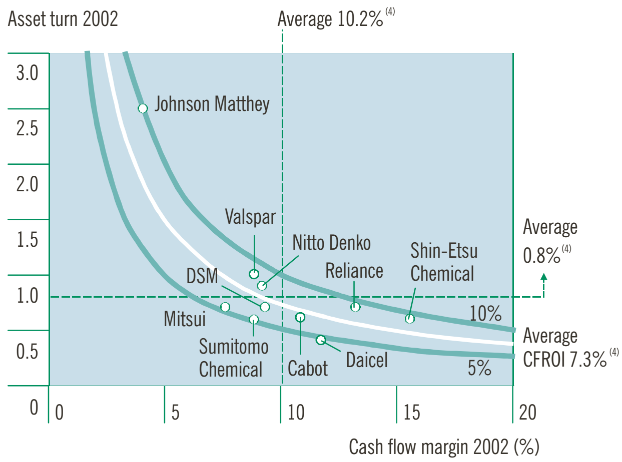
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Mitsui Chemicals	JP	19%	4%	4,289	23%	14%	-128	+	–	+	–
2	Daicel Chem.Inds.	JP	17%	6%	1,399	38%	-10%	-18	+	+	–	+
3	DSM	NL	14%	8%	4,319	-2%	-25%	-233	+	–	–	–
4	Reliance Inds.	IN	14%	13%	12,930	52%	34%	-649	+	–	++	+
5	Cabot	US	12%	7%	1,759	9%	12%	-90	+	–	–	–
6	Johnson Matthey	UK	11%	17%	3,228	17%	33%	7	++	+	–	–
7	Sumitomo Chemical	JP	11%	6%	5,678	-12%	11%	-121	+	+	–	+
8	Shin-Etsu Chemical	JP	10%	11%	14,956	8%	37%	-24	+	+	–	+
9	Nitto Denko	JP	9%	7%	7,072	44%	60%	63	+	+	+	+
10	Valspar	US	8%	26%	2,362	7%	40%	-34	+	+	–	–

VALUE LEVER PERFORMANCE OF TOP TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

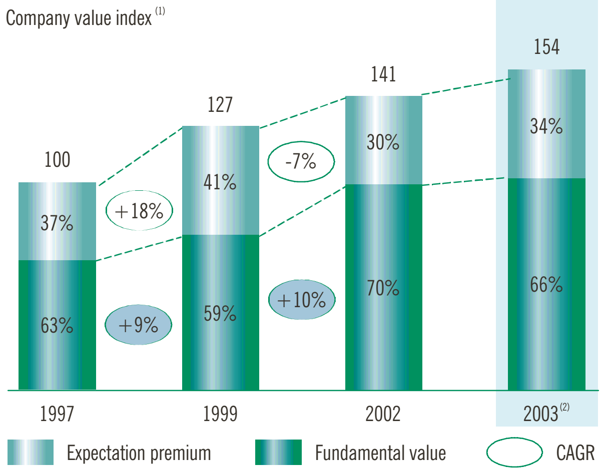


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 55 companies; minimum market value 2002: $1B
(4) Simple average of total industry sample

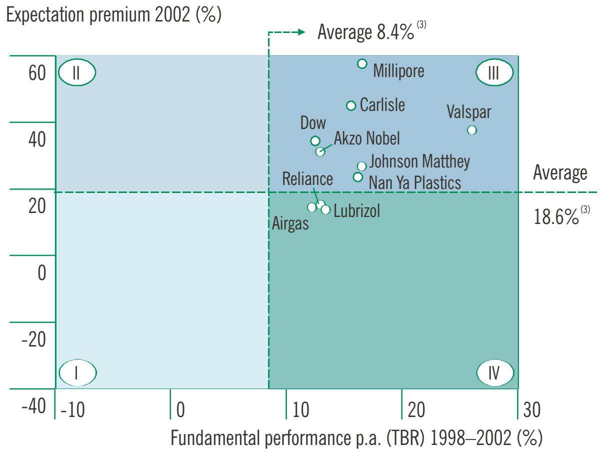
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

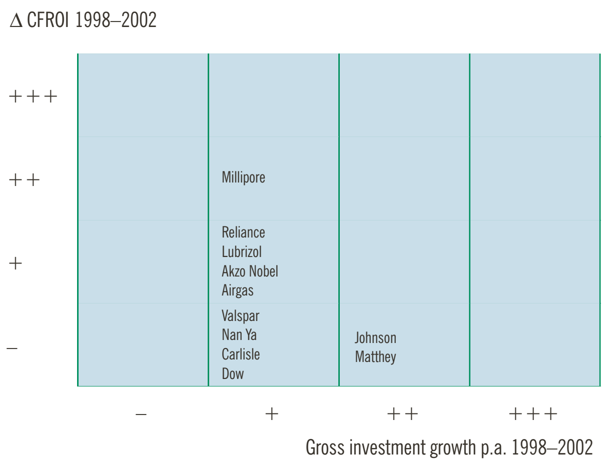


5-YEAR TBR RANKING

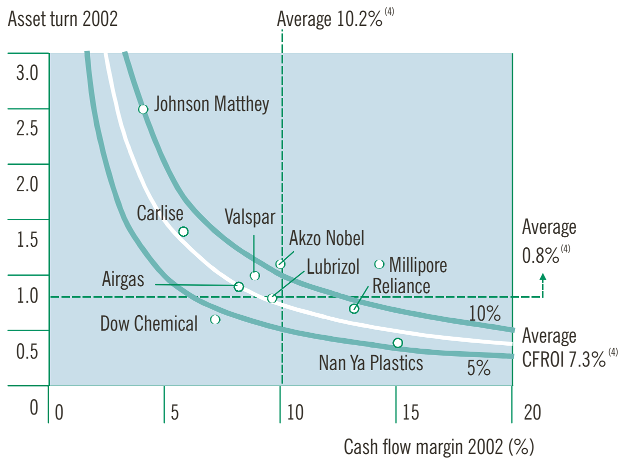
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Valspar	US	8%	26%	2,362	7%	40%	-34	+	+	–	–
2	Millipore	US	4%	17%	2,241	36%	66%	38	+	++	–	++
3	Johnson Matthey	UK	11%	17%	3,228	17%	33%	7	++	+	–	–
4	Nan Ya Plastics	TW	0%	16%	7,578	46%	39%	-578	+	++	–	–
5	Carlisle Cos	US	1%	16%	1,338	7%	34%	-41	+	–	–	–
6	Lubrizol	US	0%	13%	1,671	9%	18%	23	+	–	+	+
7	Akzo Nobel	NL	-3%	13%	8,039	-7%	33%	2	+	+	+	+
8	Reliance Inds.	IN	14%	13%	12,930	52%	34%	-649	+	–	++	+
9	Dow Chemicals	US	1%	13%	29,804	13%	33%	-1,890	+	–	–	–
10	Airgas	US	4%	12%	1,306	4%	18%	27	+	+	+	+

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

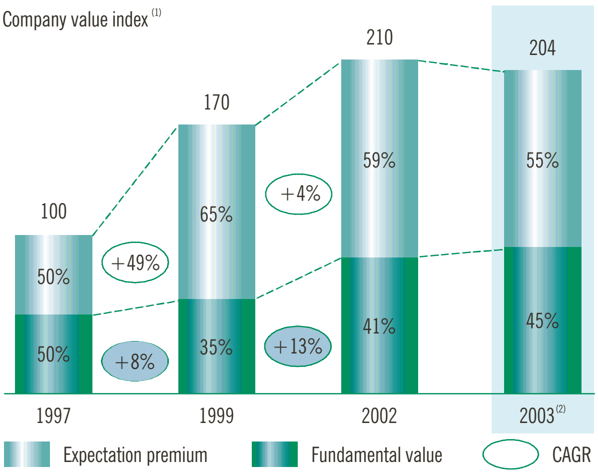


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 55 companies; minimum market value 2002: $1B
(4) Simple average of total industry sample

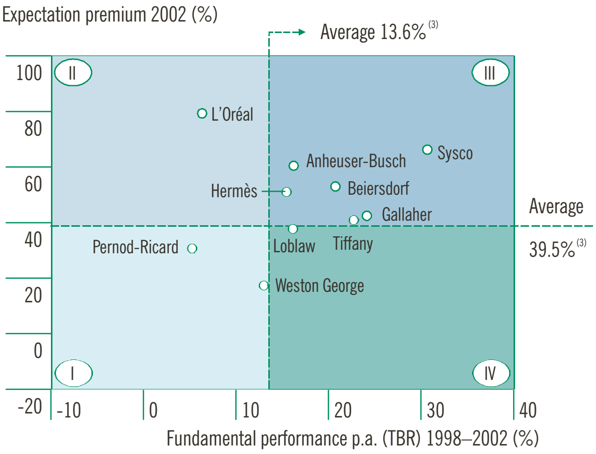
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

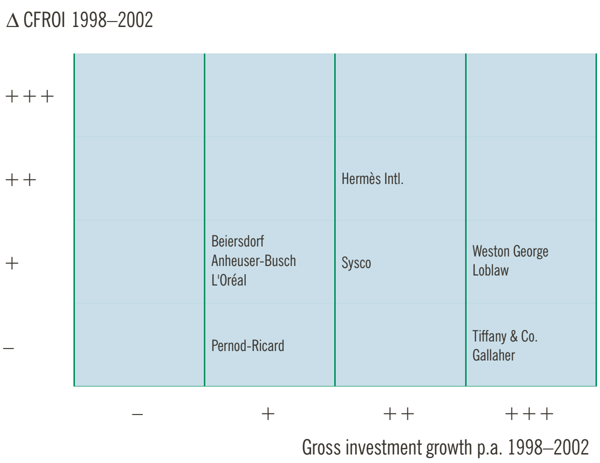


5-YEAR TSR RANKING

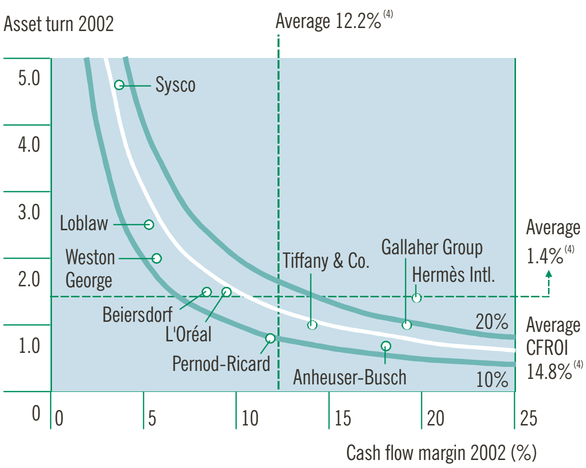
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Sysco	US	23%	31%	21,213	11%	62%	262	++	+	+	+
2	Beiersdorf	DE	23%	21%	9,609	4%	55%	87	+	+	+	+
3	Tiffany & Co.	US	22%	23%	5,438	57%	60%	28	+++	++	–	–
4	Gallaher Group	UK	21%	24%	5,922	-3%	34%	86	+++	–	+	–
5	Anheuser-Busch	US	19%	16%	40,793	3%	57%	325	+	+	–	+
6	Weston George	CA	18%	13%	8,446	13%	16%	162	+++	+	–	+
7	Hermès Intl.	FR	17%	16%	5,136	3%	53%	76	++	++	–	++
8	Loblaw	CA	16%	16%	10,500	14%	38%	177	+++	+	–	+
9	L'Oréal	FR	16%	6%	41,611	-18%	74%	-172	+	+	–	+
10	Pernod-Ricard	FR	15%	5%	6,014	14%	34%	-181	+	++	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

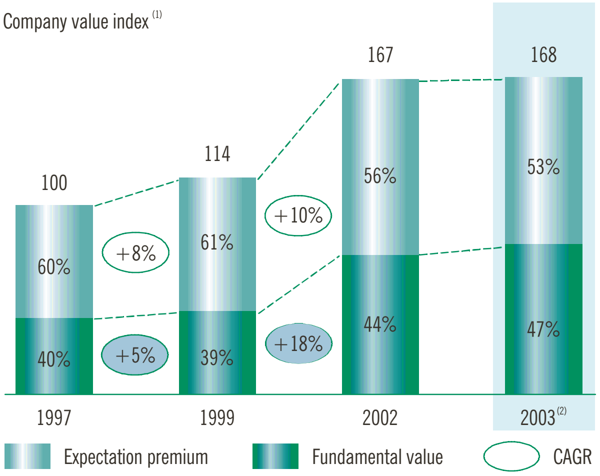


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 63 companies; minimum market value 2002: $5B
(4) Simple average of total industry sample

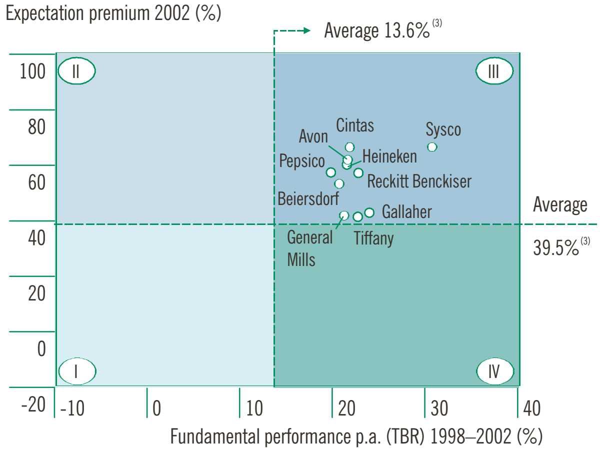
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

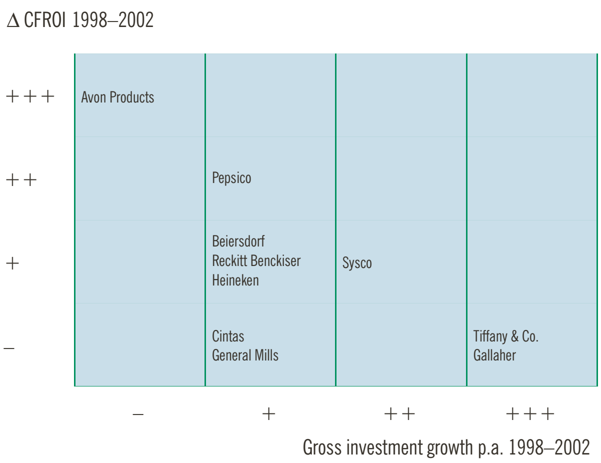


5-YEAR TBR RANKING

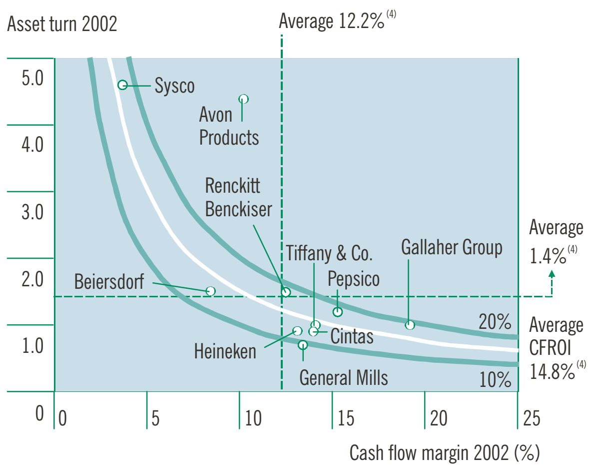
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Sysco	US	23%	31%	21,213	11%	62%	262	++	+	+	+
2	Gallaher Group	UK	21%	24%	5,922	-3%	34%	86	+++	–	+	–
3	Reckitt Benckiser	UK	8%	23%	13,772	3%	54%	139	+	–	++	+
4	Tiffany & Co.	US	22%	23%	5,438	57%	60%	28	+++	++	–	–
5	Cintas	US	12%	22%	6,318	-19%	54%	-54	+	–	–	–
6	Heineken	NL	13%	22%	12,830	-15%	40%	174	+	+	+	+
7	Avon Products	US	14%	22%	15,250	21%	63%	216	–	+	+++	+++
8	Gen. Mills	US	8%	21%	17,540	2%	39%	-487	+	+	–	–
9	Beiersdorf	DE	23%	21%	9,609	4%	55%	87	+	+	+	+
10	Pepsico	US	5%	20%	79,085	10%	56%	1,257	+	++	+	++

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002



(1) Market value of equity plus interest-bearing debt, 1997 = 100
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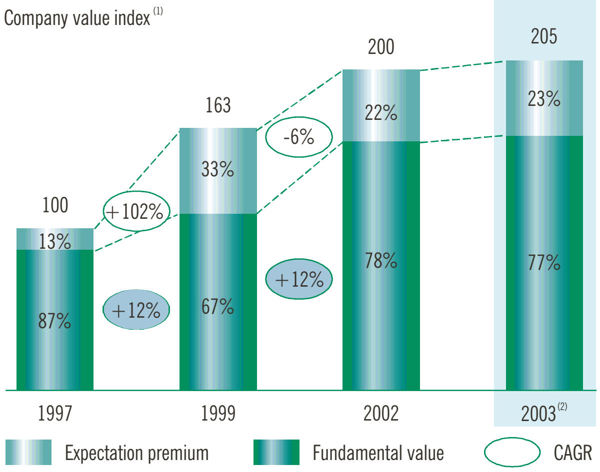
(4) Simple average of total industry sample

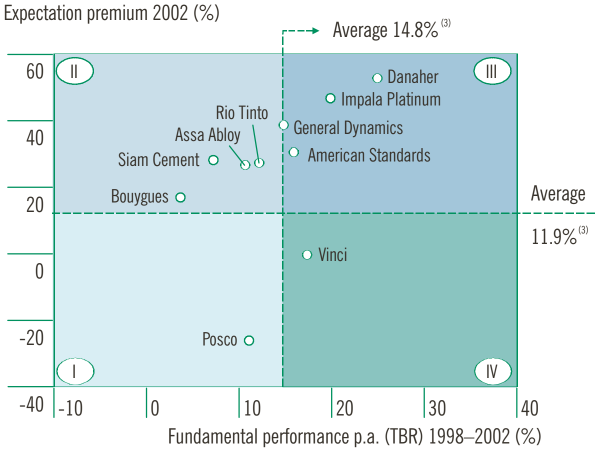
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

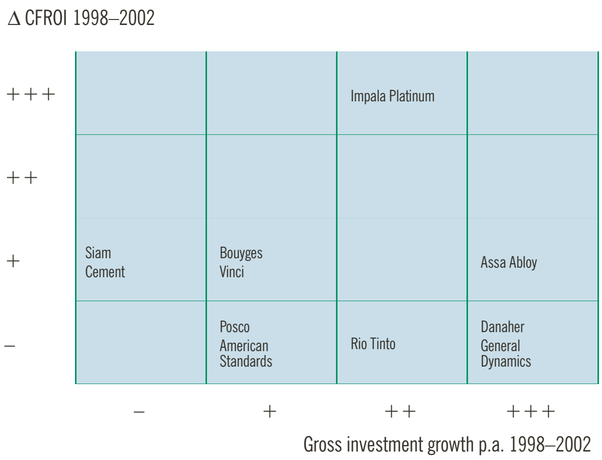


5-YEAR TSR RANKING

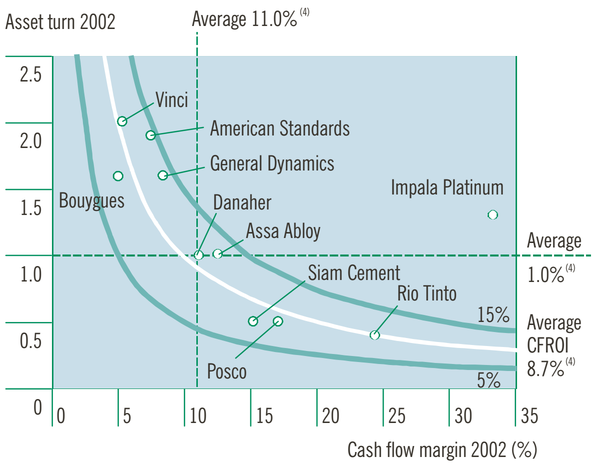
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Impala Platinum	ZA	71%	20%	4,509	12%	58%	238	++	+++	+++	+++
2	Siam Cement	TH	38%	7%	5,151	64%	42%	147	–	–	+	+
3	Posco	KR	24%	11%	10,103	13%	-16%	-89	+	+	–	–
4	Bouygues	FR	23%	4%	7,933	-13%	5%	-391	+	+	–	+
5	Vinci (ex SGE)	FR	22%	17%	5,453	20%	1%	-37	+	++	–	+
6	Danaher	US	16%	25%	11,312	13%	53%	19	+++	+	–	–
7	Assa Abloy	SE	15%	11%	2,706	-31%	7%	113	+++	+	+	+
8	Rio Tinto	UK	15%	12%	22,012	7%	28%	10	++	++	–	–
9	General Dynamics	US	15%	15%	15,395	0%	38%	67	+++	–	++	–
10	American Standards	US	13%	16%	6,088	18%	32%	-67	+	+	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002



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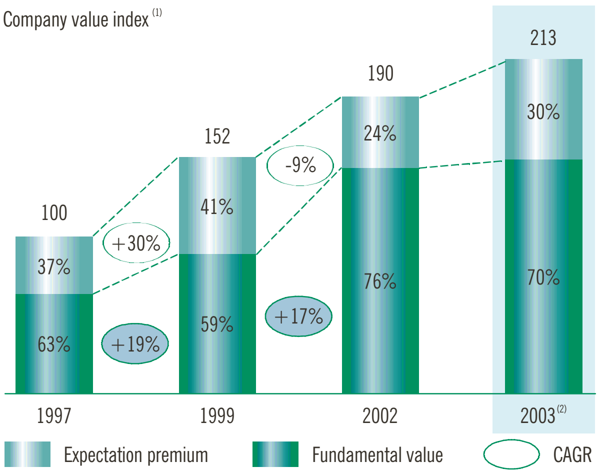
(4) Simple average of total industry sample

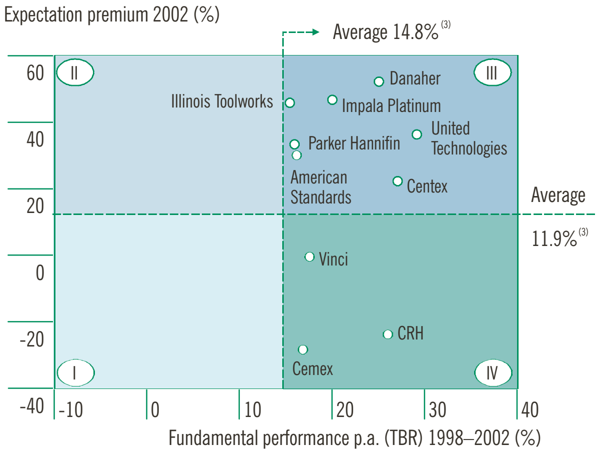
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

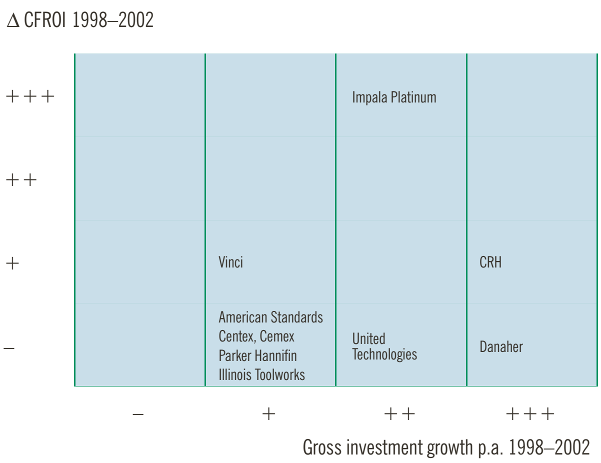


5-YEAR TBR RANKING

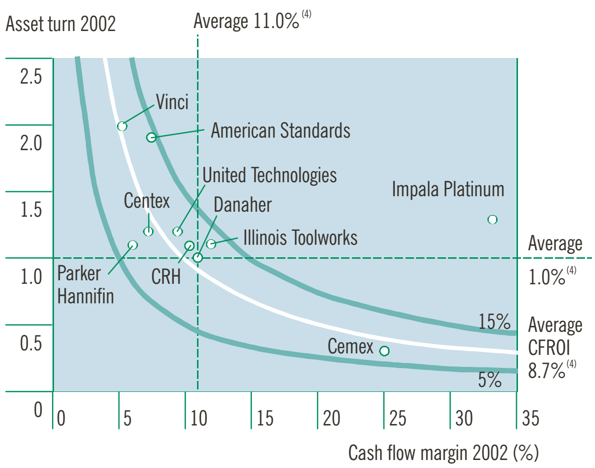
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever			
									Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	United Technologies	US	13%	29%	36,230	26%	42%	189	++	+	–	–
2	Centex	US	10%	27%	4,810	57%	32%	-243	+	+	–	–
3	CRH	IE	6%	26%	8,458	33%	-3%	205	+++	+	–	+
4	Danaher	US	16%	25%	11,312	13%	53%	19	+++	+	–	–
5	Impala Platinum	ZA	71%	20%	4,509	12%	58%	238	++	+++	+++	+++
6	Vinci (ex SGE)	FR	22%	17%	5,453	20%	1%	-37	+	++	–	+
7	Cemex	MX	8%	17%	9,445	27%	-11%	-636	+	–	+	–
8	American Standards	US	13%	16%	6,088	18%	32%	-67	+	+	–	–
9	Parker Hannifin	US	2%	16%	5,282	-2%	29%	-275	+	–	–	–
10	Illinois Toolworks	US	3%	15%	20,399	3%	46%	-192	+	–	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



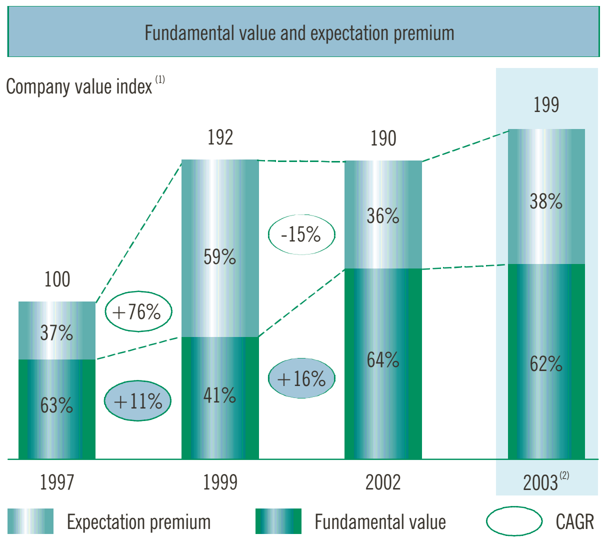
Cash flow margin versus asset productivity 2002

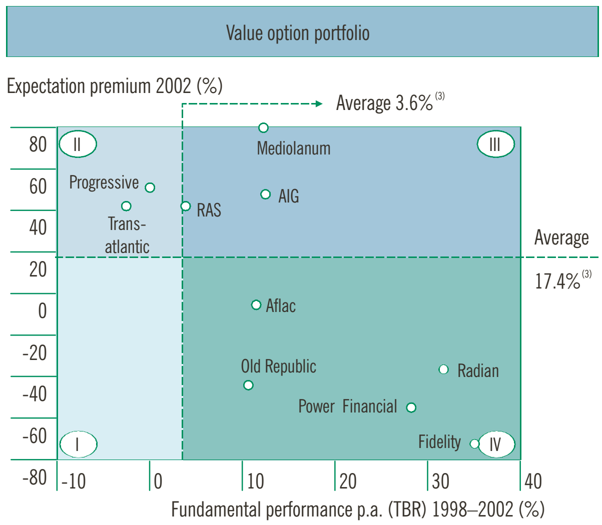


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 55 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES





5-YEAR TSR RANKING

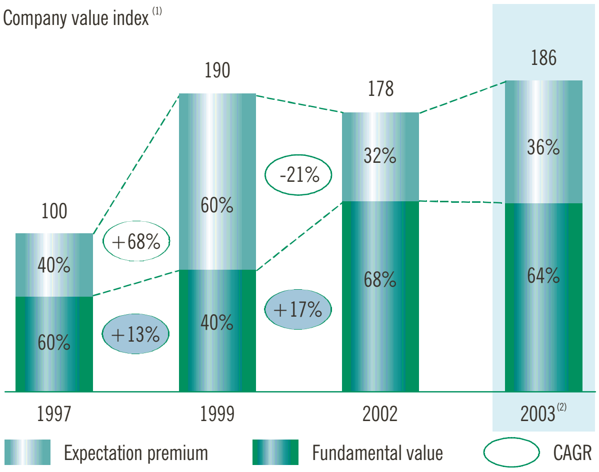
#	Company	Country	Ø TSR '98–'02	Ø TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan– 30 Sept. '03	EP 30 Sept. '03	Δ AVE in M$ '98–'02
1	Aflac	US	20%	12%	16,603	8%	31%	3.817
2	RAS	IT	12%	4%	9,223	17%	45%	-69
3	Power Financial	CA	10%	28%	9,725	24%	-26%	3,867
4	Fidelity	US	9%	35%	4,048	17%	-145%	1,662
5	AIG	US	9%	13%	150,532	0%	47%	4,404
6	Mediolanum	IT	8%	13%	4,204	15%	81%	82
7	Transatlantic	US	8%	-2%	3,728	7%	46%	-1,368
8	Old Republic	US	5%	11%	3,998	20%	-13%	641
9	Progressive	US	5%	0%	15,014	39%	51%	-2,151
10	Radian	US	5%	32%	4,155	20%	-11%	1,530

(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 56 companies; minimum market value 2002: $3B

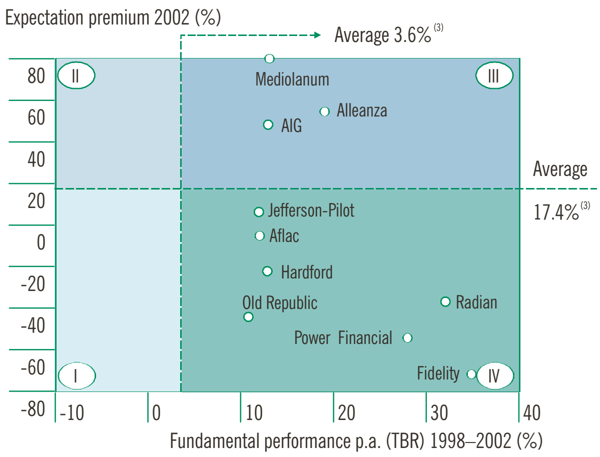
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio



5-YEAR TBR RANKING

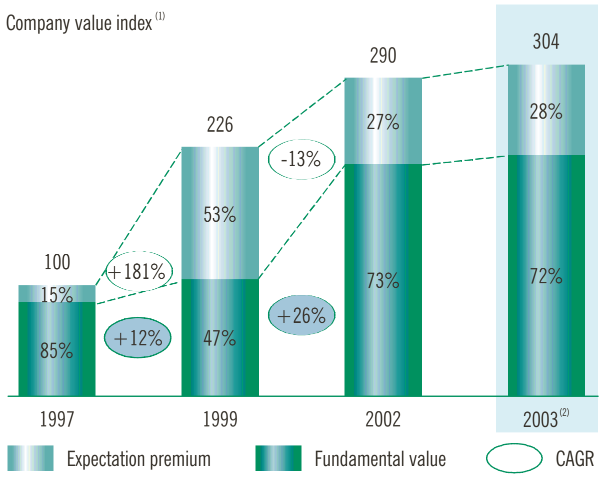
#	Company	Country	Ø TSR '98–'02	Ø TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan– 30 Sept. '03	EP 30 Sept. '03	Δ AVE in M$ '98–'02
1	Fidelity	US	9%	35%	4,048	17%	-145%	1,662
2	Radian	US	5%	32%	4,155	20%	-11%	1,530
3	Power Financial	CA	10%	28%	9,725	24%	-26%	3,867
4	Alleanza	IT	-2%	19%	7,345	17%	67%	572
5	Hartford	US	1%	13%	14,863	18%	31%	-578
6	AIG	US	9%	13%	150,532	0%	47%	4,404
7	Mediolanum	IT	8%	13%	4,204	15%	81%	82
8	Jefferson-Pilot	US	4%	12%	6,293	19%	23%	-141
9	Aflac	US	20%	12%	16,603	8%	31%	3,817
10	Old Republic	US	5%	11%	3,998	20%	-13%	641

(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 56 companies; minimum market value 2002: $3B

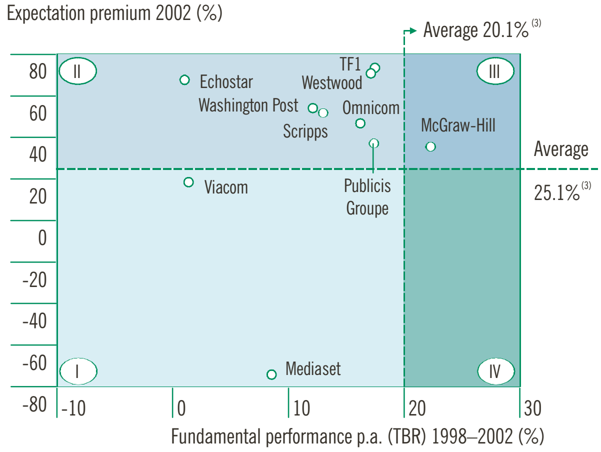
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

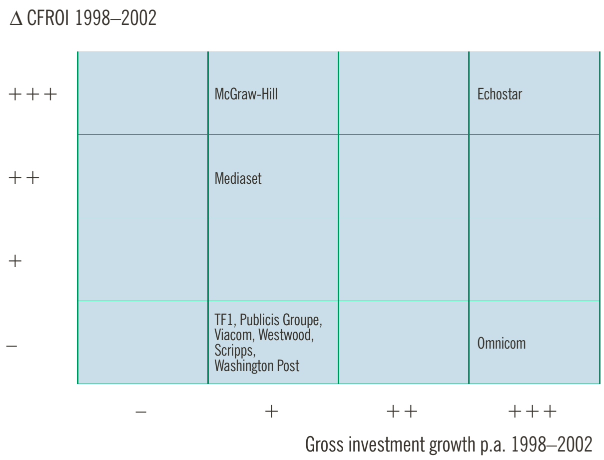


5-YEAR TSR RANKING

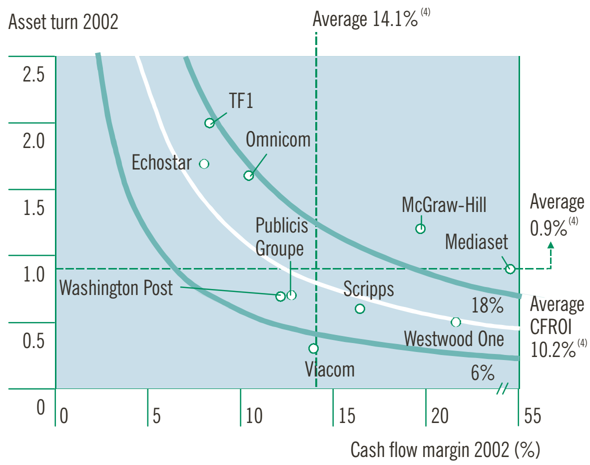
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Echostar Communications	US	60%	1%	15,425	72%	69%	276	+++	+++	+++	+++
2	TF1	FR	25%	17%	5,730	4%	69%	-34	+	–	–	–
3	Publicis Groupe	FR	23%	17%	4,834	19%	35%	-145	+	+	–	–
4	Viacom	US	15%	2%	72,420	-6%	16%	-3,692	+	++	–	–
5	Westwood One	US	15%	17%	3,033	-19%	62%	-2	+	++	–	–
6	Mediaset	IT	12%	9%	9,743	11%	-72%	311	+	+++	–	++
7	McGraw-Hill	US	12%	22%	11,879	4%	30%	442	+	++	+	+++
8	Scripps (EW)	US	11%	13%	5,304	11%	58%	-34	+	–	–	–
9	Omnicom	US	10%	16%	13,654	12%	48%	60	+++	–	–	–
10	Washington Post	US	10%	12%	5,190	-9%	54%	-99	+	–	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

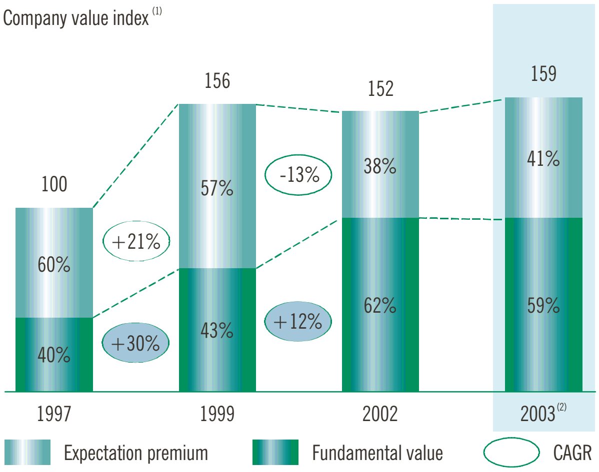


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 42 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

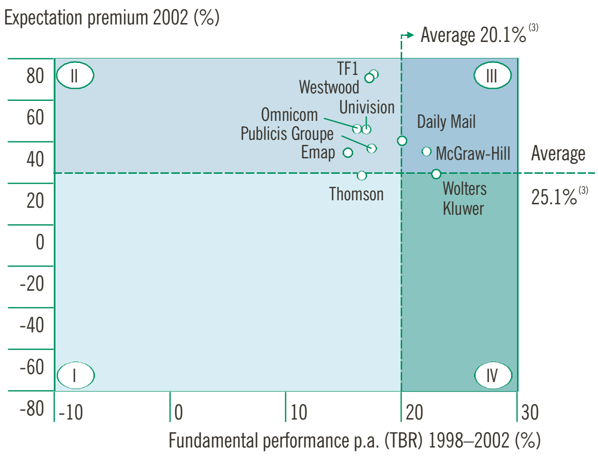
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

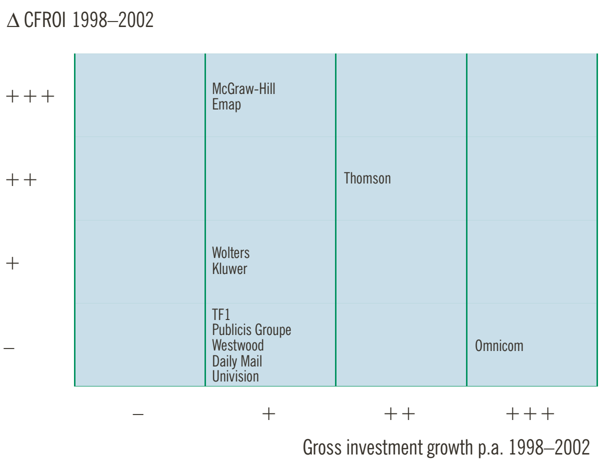


5-YEAR TBR RANKING

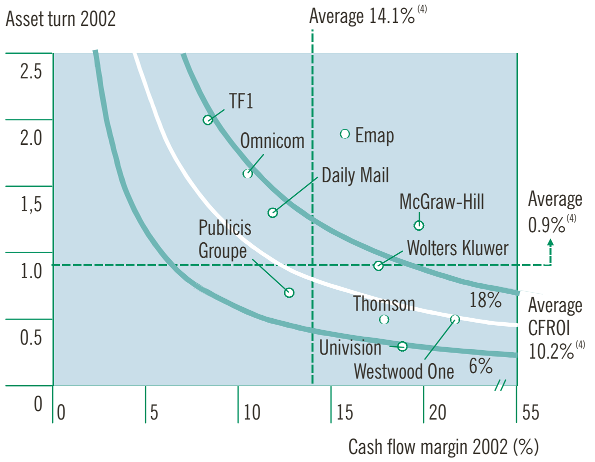
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Wolters Kluwer	NL	-10%	23%	3,657	-23%	10%	81	+	–	+	+
2	McGraw-Hill	US	12%	22%	11,879	4%	30%	442	+	++	+	+++
3	Daily Mail&general	UK	4%	20%	3,666	-7%	37%	0	+	+	–	–
4	TF1	FR	25%	17%	5,730	4%	69%	-34	+	–	–	–
5	Publicis Groupe	FR	23%	17%	4,834	19%	35%	-145	+	+	–	–
6	Westwood One	US	15%	17%	3,033	-19%	62%	-2	+	++	–	–
7	Univision Communications	US	7%	17%	8,082	30%	68%	-163	+	–	–	–
8	Thomson	CA	4%	17%	16,945	1%	33%	463	++	+++	–	++
9	Omnicom	US	10%	16%	13,654	12%	48%	60	+++	–	–	–
10	Emap	UK	-1%	15%	3,195	6%	35%	211	+	+	+++	+++

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

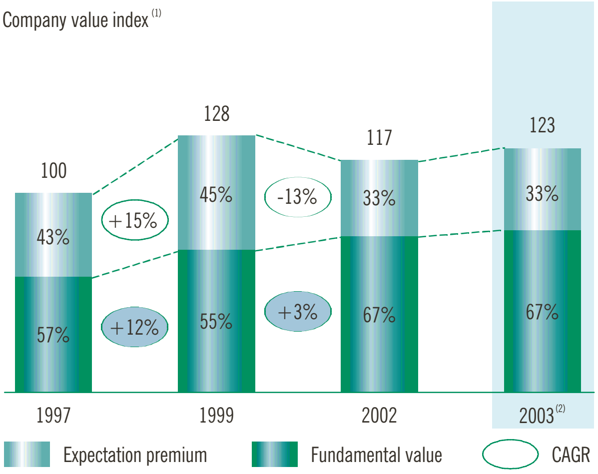


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 42 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

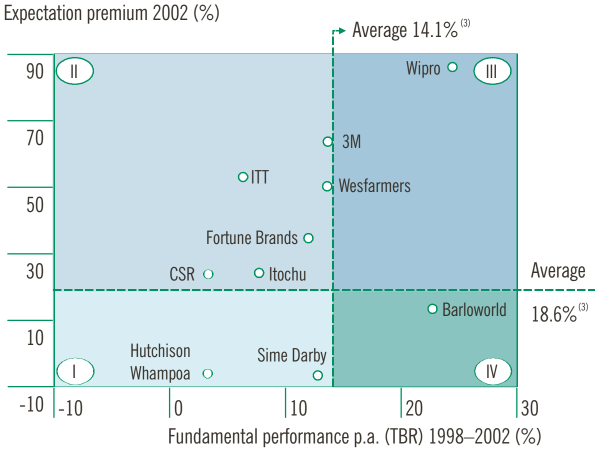
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

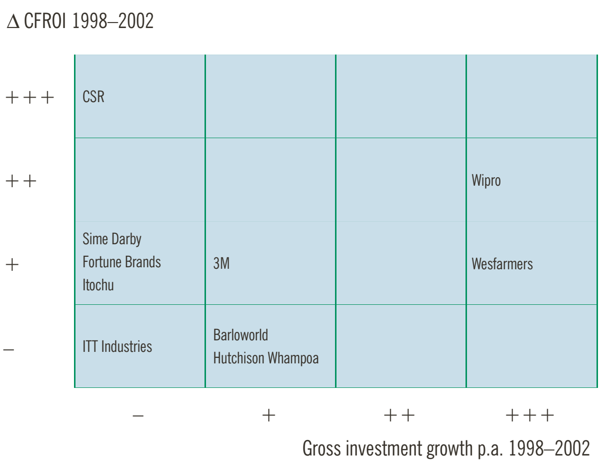


5-YEAR TSR RANKING

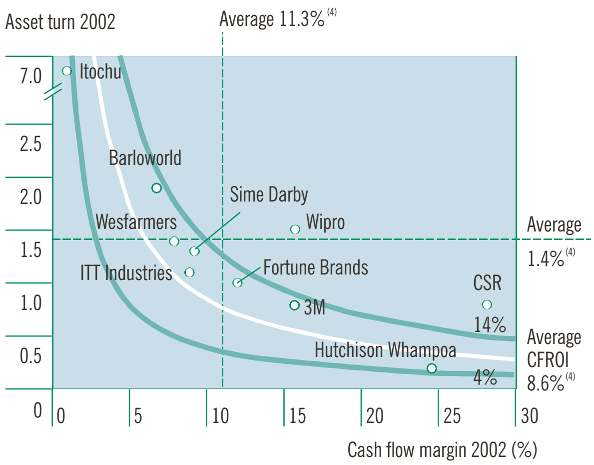
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever			
									Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Wipro	IN	78%	24%	6,077	-24%	80%	39	+++	++	–	++
2	Wesfarmers	AU	21%	14%	5,734	5%	38%	49	+++	+	+	+
3	ITT Industries	US	16%	6%	5,527	-1%	51%	-7	–	+	–	–
4	Barloworld	NZ	12%	23%	1,425	-3%	8%	-149	+	+	–	–
5	3M	US	11%	14%	54,082	14%	63%	213	+	+	–	+
6	Sime Darby	MY	10%	13%	3,153	5%	-6%	55	–	+	–	+
7	CSR	AU	9%	3%	1,061	31%	-100%	212	–	+++	–	+++
8	Fortune Brands	US	7%	12%	8,242	24%	38%	176	–	–	++	+
9	Itochu	JP	5%	8%	4,617	36%	27%	620	–	+	–	+
10	Hutchison Whampoa	HK	4%	3%	30,888	20%	2%	-1,851	+	–	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

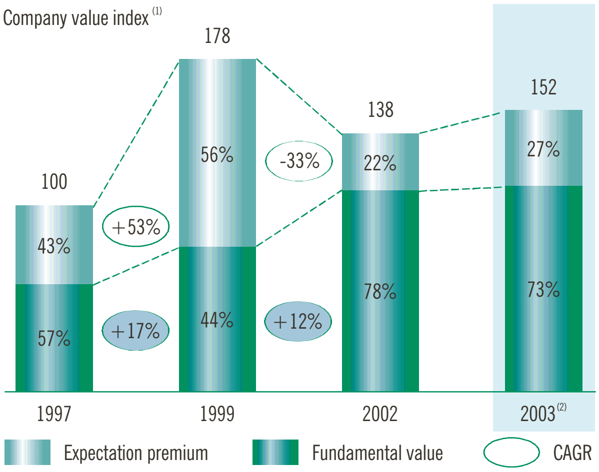


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 36 companies; minimum market value 2002: $1B
(4) Simple average of total industry sample

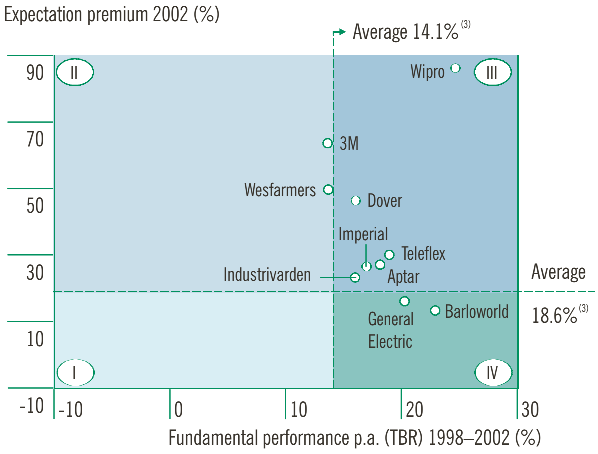
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

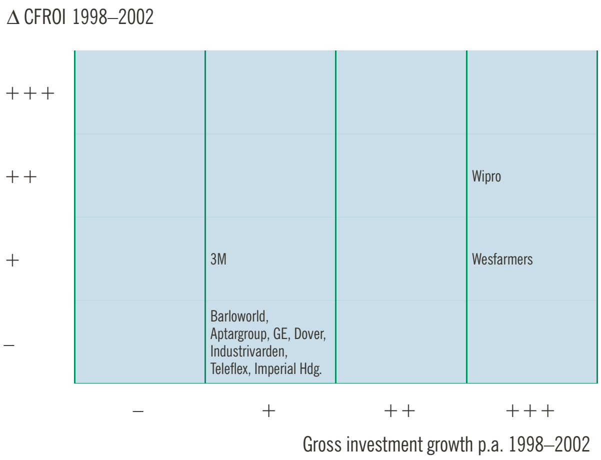


5-YEAR TBR RANKING

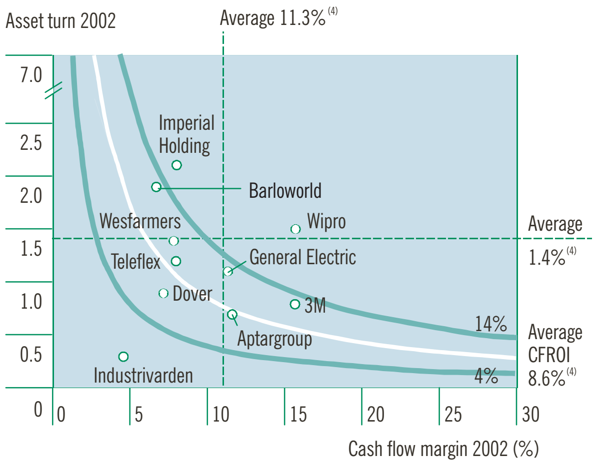
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Wipro	IN	78%	24%	6,077	-24%	80%	39	+++	++	–	++
2	Barloworld	NZ	12%	23%	1,425	-3%	8%	-149	+	+	–	–
3	General Electric	US	1%	20%	298,662	25%	23%	-4,716	+	–	–	–
4	Teleflex	US	4%	19%	1,718	3%	30%	-8	+	–	–	–
5	Aptargroup	US	3%	18%	1,328	18%	35%	-19	+	–	–	–
6	Imperial Hdg.	ZA	2%	17%	1,441	6%	23%	-100	+	–	–	–
7	Dover	US	-3%	16%	7,166	23%	53%	-248	+	–	–	–
8	Industrivarden	SE	2%	16%	2,434	20%	30%	-60	+	–	–	–
9	3M	US	11%	14%	54,082	14%	63%	213	+	+	–	+
10	Wesfarmers	AU	21%	14%	5,734	5%	38%	49	+++	+	+	+

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

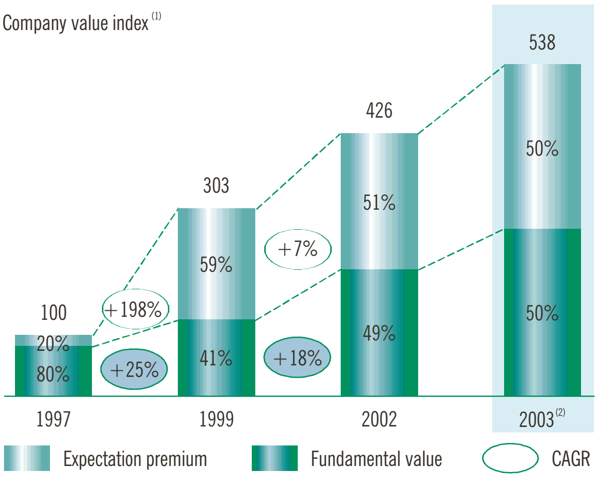


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 36 companies; minimum market value 2002: $1B
(4) Simple average of total industry sample

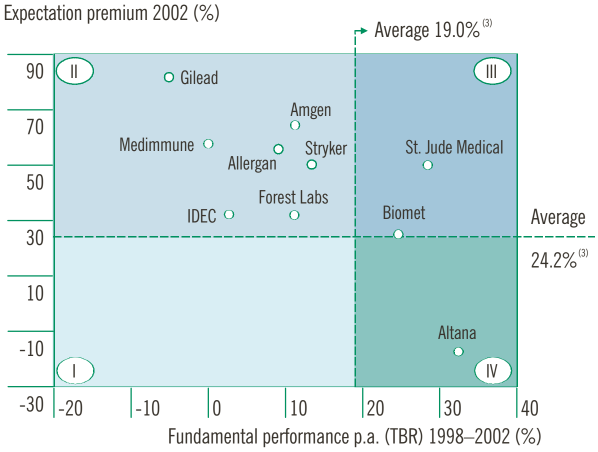
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

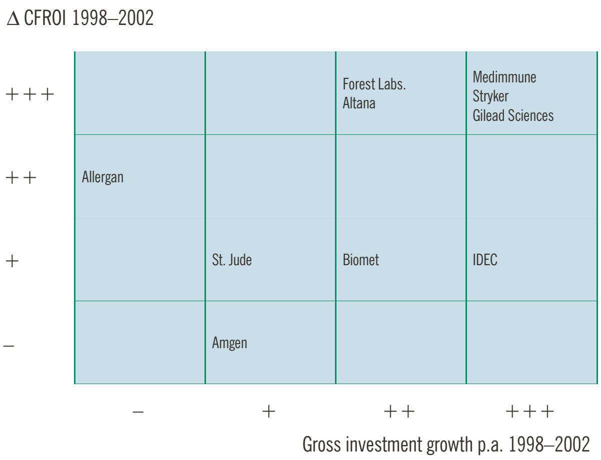


5-YEAR TSR RANKING

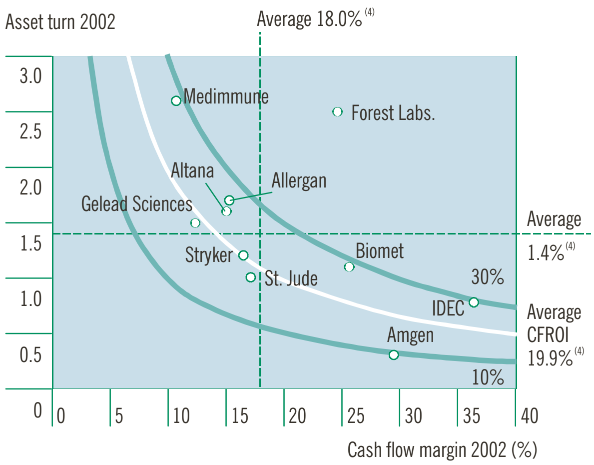
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Forest Labs	US	51%	11%	18,778	5%	25%	470	++	+++	+++	+++
2	IDEC Pharmaceuticals	US	42%	3%	5,175	0%	19%	91	+++	+++	–	+
3	Medimmune	US	31%	0%	8,252	22%	27%	70	+++	+++	+	+++
4	Allergan	US	30%	9%	10,570	37%	57%	56	–	+	++	++
5	Stryker	US	29%	13%	14,951	12%	47%	331	+++	+	+++	+++
6	Amgen	US	29%	11%	82,709	34%	62%	-841	+	–	–	–
7	Gilead Sciences	US	29%	-5%	11,284	65%	87%	90	+++	+++	+++	+++
8	Altana	DE	22%	32%	8,015	28%	-10%	217	++	++	+	+++
9	St. Jude Medical	US	21%	28%	9,733	35%	56%	80	+	+	+	+
10	Biomet	US	21%	24%	8,589	18%	24%	100	++	+	+	+

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

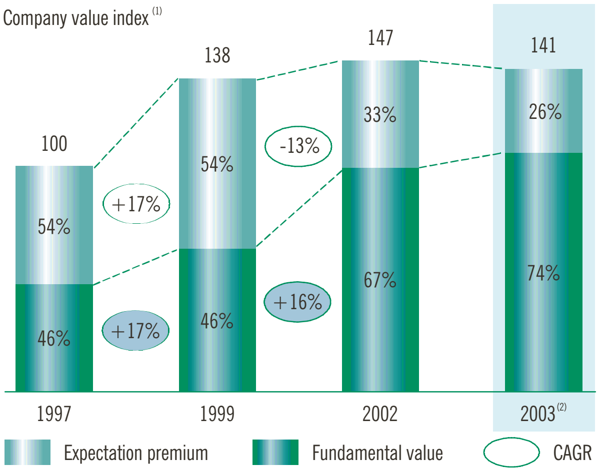


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 43 companies; minimum market value 2002: $5B
(4) Simple average of total industry sample

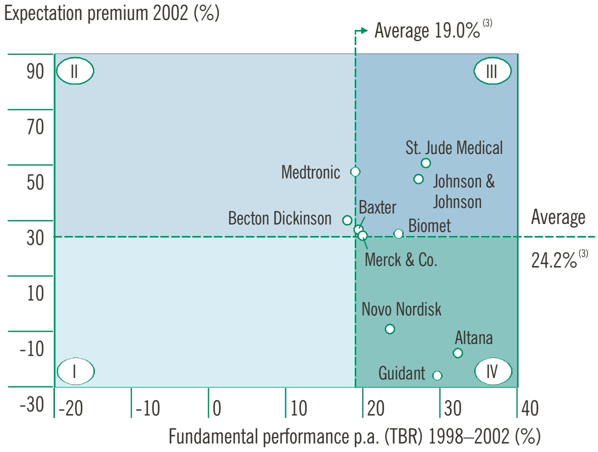
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

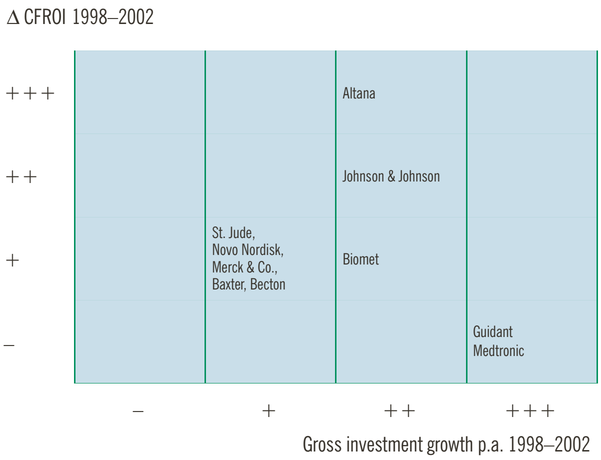


5-YEAR TBR RANKING

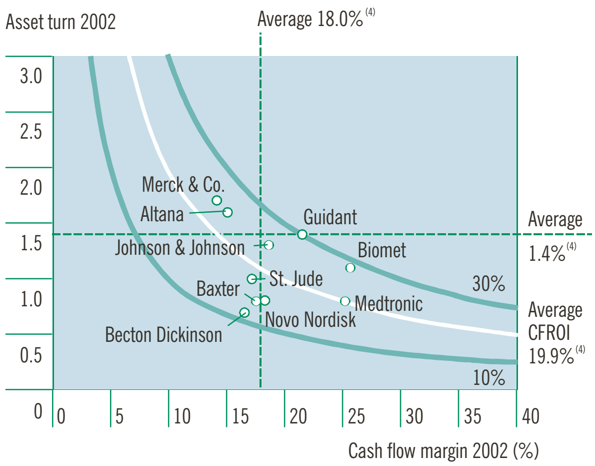
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Altana	DE	22%	32%	8,015	28%	-10%	217	++	++	+	+++
2	Guidant	US	0%	30%	14,576	52%	6%	229	+++	+	–	–
3	St. Jude Medical	US	21%	28%	9,733	35%	56%	80	+	+	+	+
4	Johnson & Johnson	US	12%	27%	146,976	-7%	32%	2,462	++	++	+	++
5	Biomet	US	21%	24%	8,589	18%	24%	100	++	+	+	+
6	Novo Nordisk	DK	4%	23%	10,070	15%	-25%	218	+	+	+	+
7	Merck & Co.	US	3%	20%	113,330	-4%	17%	1,828	+	–	+++	+
8	Baxter Intl.	US	5%	19%	17,055	4%	28%	388	+	++	+	+
9	Medtronic	US	12%	19%	57,088	3%	41%	492	+++	+	–	–
10	Becton Dickinson	US	5%	18%	9,172	19%	32%	72	+	+	–	+

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

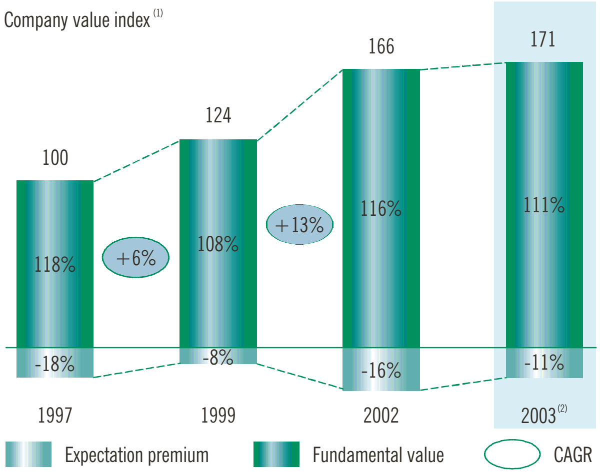


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 43 companies; minimum market value 2002: $5B
(4) Simple average of total industry sample

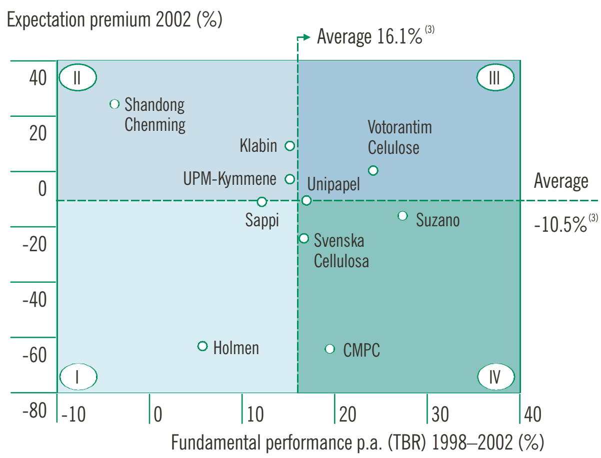
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

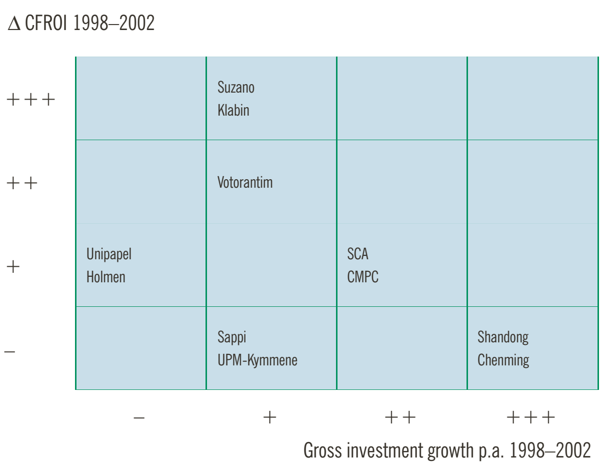


5-YEAR TSR RANKING

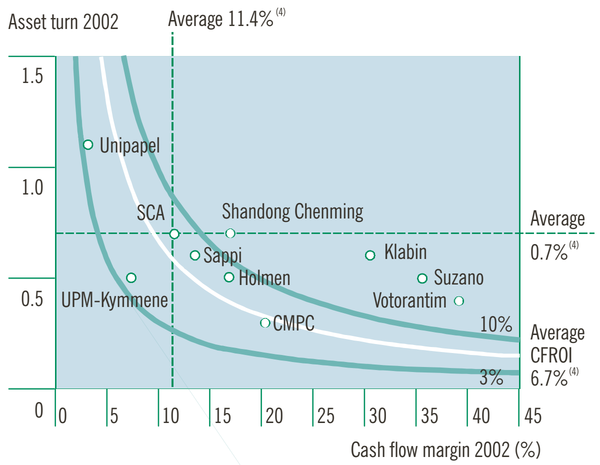
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Votorantim Celulose	BR	44%	24%	740	31%	4%	-126	+	+++	+	++
2	Sappi	ZA	40%	12%	2,556	-18%	-24%	-770	+	–	–	–
3	Suzano	BR	25%	27%	419	106%	-1%	85	+	+++	+	+++
4	Unipapel	ES	20%	17%	146	27%	8%	5	–	–	+++	+
5	Klabin	BR	18%	15%	933	196%	35%	22	+	+++	++	+++
6	Svenska Cellulosa	SE	15%	17%	7,476	-1%	-19%	5	++	+	–	+
7	CMPC	CL	15%	19%	2,999	74%	-1%	48	++	++	+	+
8	UPM-Kymmene	FI	15%	15%	7,853	-1%	-11%	-1,194	+	–	–	–
9	Holmen	SE	14%	6%	2,261	21%	-31%	13	–	++	–	+
10	Shandong Chenming	CN	14%	-4%	831	79%	28%	7	+++	–	+	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

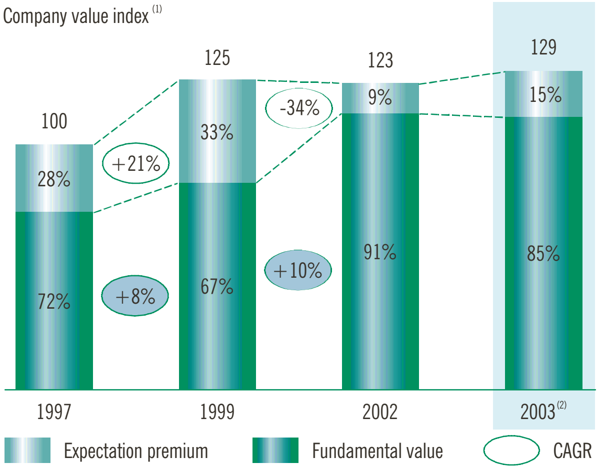


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 42 companies; minimum market value 2002: $0B
(4) Simple average of total industry sample

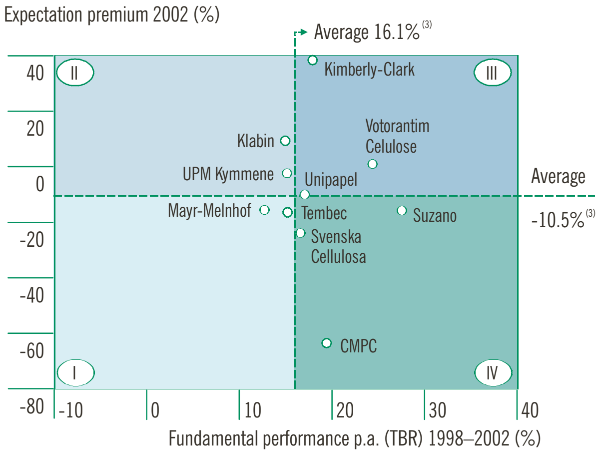
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

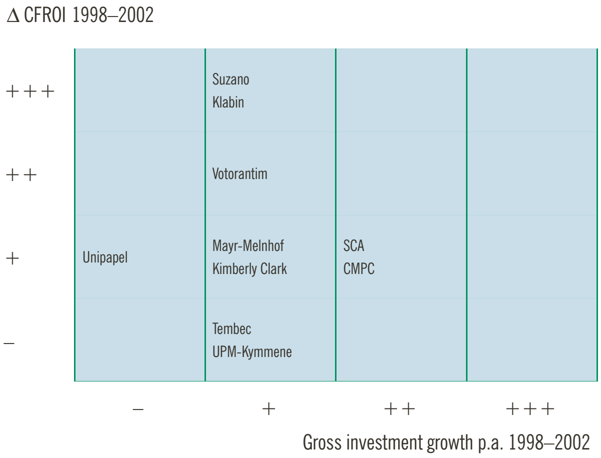


5-YEAR TBR RANKING

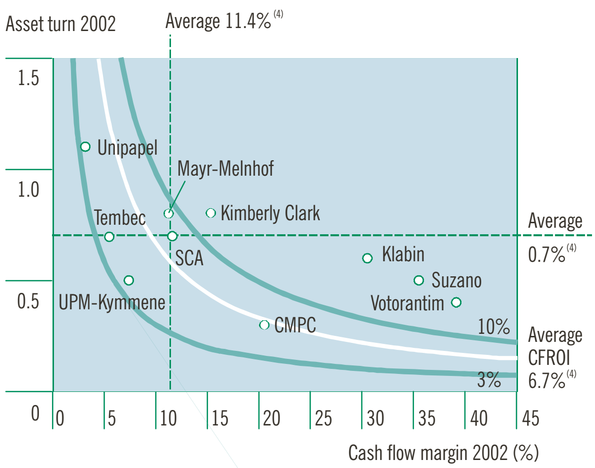
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.–30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever			
									Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Suzano	BR	25%	27%	419	106%	-1%	85	+	+++	+	+++
2	Votorantim Celulose	BR	44%	24%	740	31%	4%	-126	+	+++	+	++
3	CMPC	CL	15%	19%	2,999	74%	-1%	48	++	++	+	+
4	Kimberly-Clark	US	1%	18%	26,001	10%	43%	256	+	++	–	+
5	Unipapel	ES	20%	17%	146	27%	8%	5	–	–	+++	+
6	Svenska Cellulosa	SE	15%	17%	7,476	-1%	-19%	5	++	+	–	+
7	Tembec	CA	7%	15%	445	-26%	-17%	-142	+	–	+	–
8	Klabin	BR	18%	15%	933	196%	35%	22	+	+++	++	+++
9	UPM-Kymmene	FI	15%	15%	7,853	-1%	-11%	-1,194	+	–	–	–
10	Mayr-Melnhof	AT	10%	13%	1,007	16%	-10%	8	+	+	+	+

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

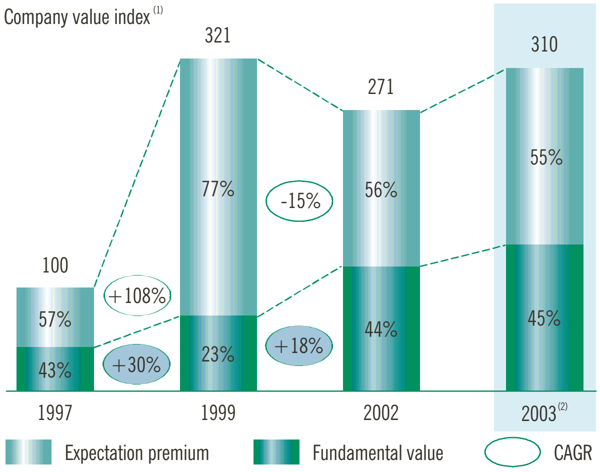


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 42 companies; minimum market value 2002: $0B
(4) Simple average of total industry sample

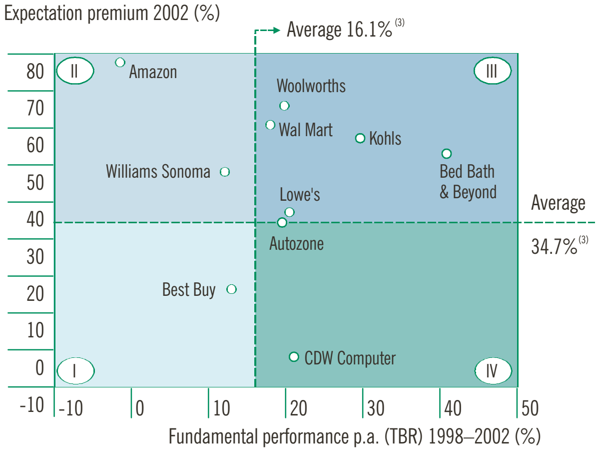
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

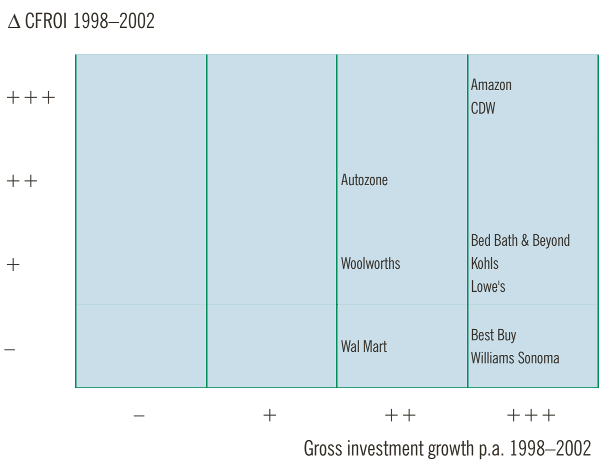


5-YEAR TSR RANKING

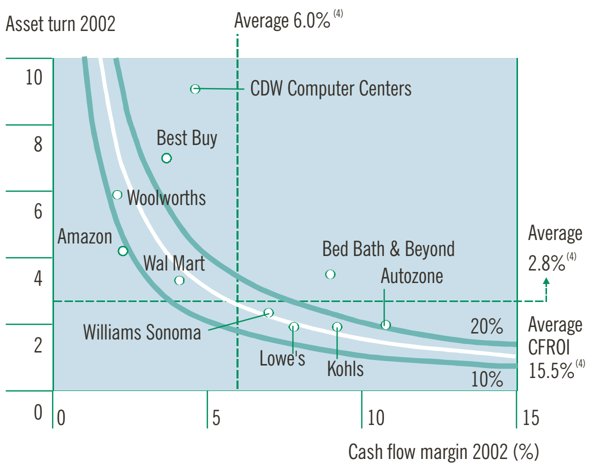
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Best Buy	US	31%	13%	15,379	97%	26%	296	+++	+	–	–
2	Amazon.Com	US	30%	-1%	19,226	156%	87%	90	+++	++	+++	+++
3	Bed Bath & Beyond	US	29%	41%	11,314	11%	48%	162	+++	+	–	+
4	CDW Computer Centers	US	27%	21%	4,766	32%	12%	105	+++	+	+++	+++
5	Kohls	US	27%	30%	18,162	-4%	51%	294	+++	+	–	+
6	Lowe's	US	26%	20%	40,781	39%	47%	574	+++	+	–	+
7	Wal Mart Stores	US	21%	18%	244,020	11%	58%	1,327	++	+	–	–
8	Woolworths	AU	21%	20%	6,743	6%	41%	54	++	+	–	+
9	Williams Sonoma	US	21%	12%	3,150	-1%	40%	42	+++	+	–	–
10	Autozone	US	19%	20%	8,011	27%	27%	239	++	+	+++	++

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

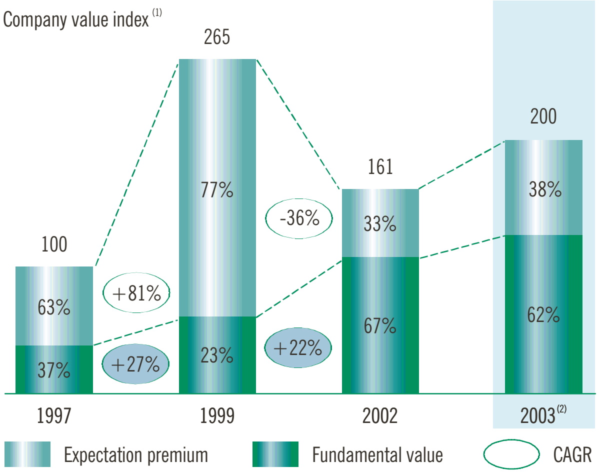


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 53 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

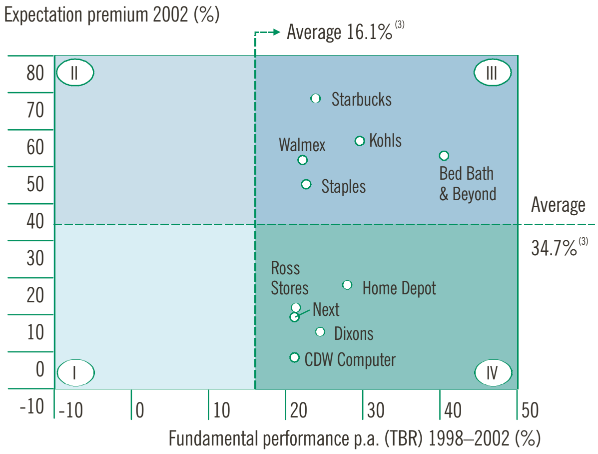
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

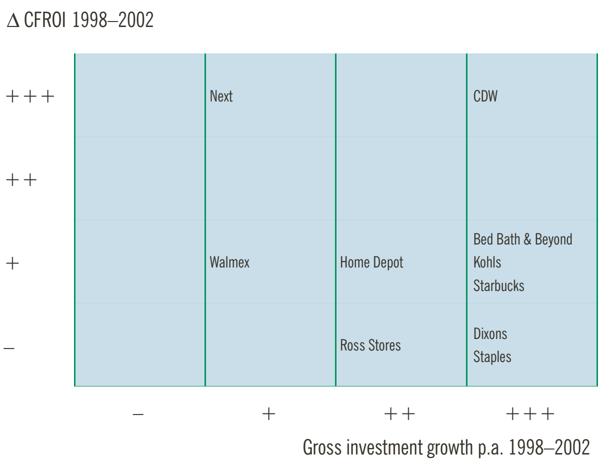


5-YEAR TBR RANKING

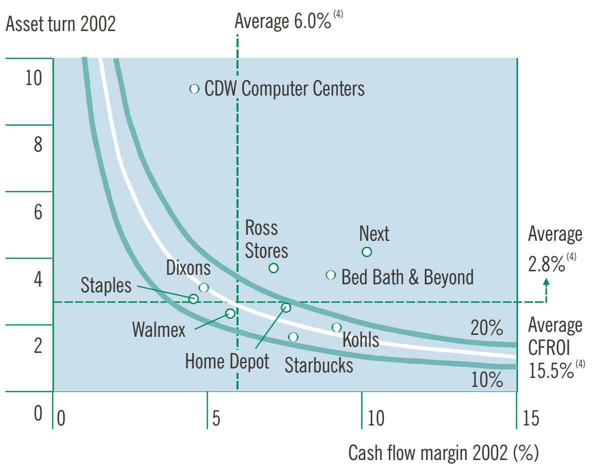
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Bed Bath & Beyond	US	29%	41%	11,314	11%	48%	162	+++	+	–	+
2	Kohls	US	27%	30%	18,162	-4%	51%	294	+++	+	–	+
3	Home Depot	US	5%	28%	75,400	34%	28%	1,390	++	+	–	+
4	Dixons Group	UK	2%	24%	4,215	-2%	-7%	1	+++	–	–	–
5	Starbucks	US	16%	24%	11,263	41%	70%	47	+++	–	+	+
6	Staples	US	8%	23%	11,687	30%	50%	27	+++	+	–	–
7	Walmex	MX	7%	22%	13,408	36%	61%	-28	+	+	–	+
8	Next	UK	5%	21%	4,988	56%	23%	183	+	+	+++	+++
9	CDW Computer Centers	US	27%	21%	4,766	32%	12%	105	+++	+	+++	+++
10	Ross Stores	US	19%	21%	3,526	10%	8%	64	++	–	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

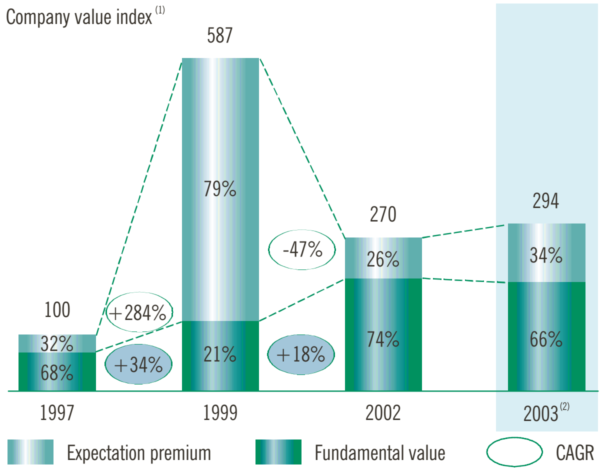


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 53 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

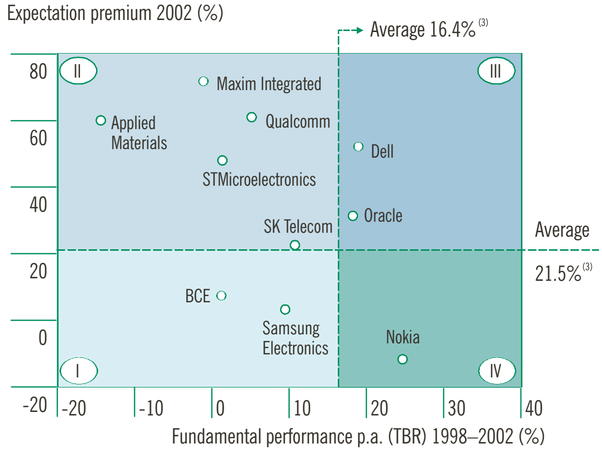
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

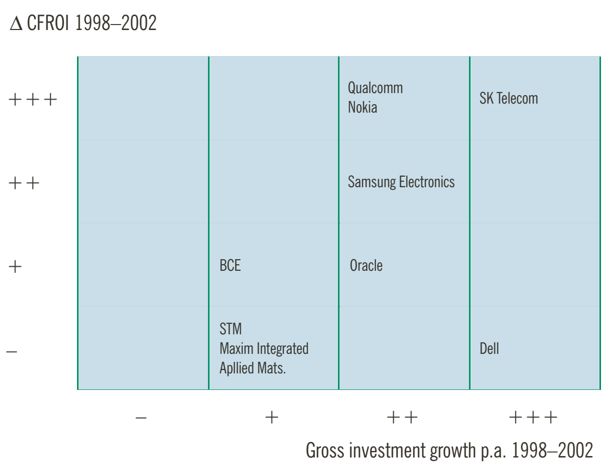


5-YEAR TSR RANKING

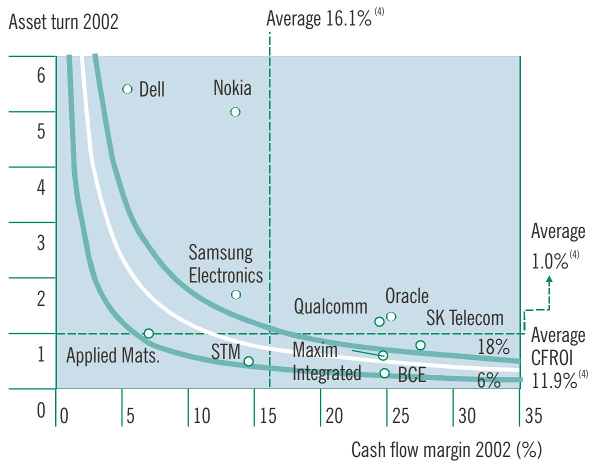
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever			
									Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Samsung Electronics	KR	58%	10%	50,855	25%	39%	2,831	++	+	++	++
2	SK Telecom	KR	45%	11%	12,938	-20%	0%	1,018	+++	+++	+	+++
3	Qualcomm	US	43%	5%	33,613	15%	51%	491	++	+++	–	+++
4	Nokia	FI	31%	25%	66,369	-11%	-18%	2,012	++	–	+++	+++
5	Oracle	US	24%	18%	61,099	4%	34%	818	++	+++	–	+
6	BCE	CA	22%	2%	16,868	6%	10%	248	+	+++	–	+
7	Dell	US	21%	19%	87,385	25%	55%	251	+++	–	–	–
8	STMicroelectronics	FR	15%	1%	19,715	12%	54%	-532	+	+	–	–
9	Maxim Integrated Products	US	14%	-1%	13,364	20%	68%	-40	+	–	–	–
10	Applied Materials	US	12%	-14%	30,868	39%	72%	-339	+	–	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

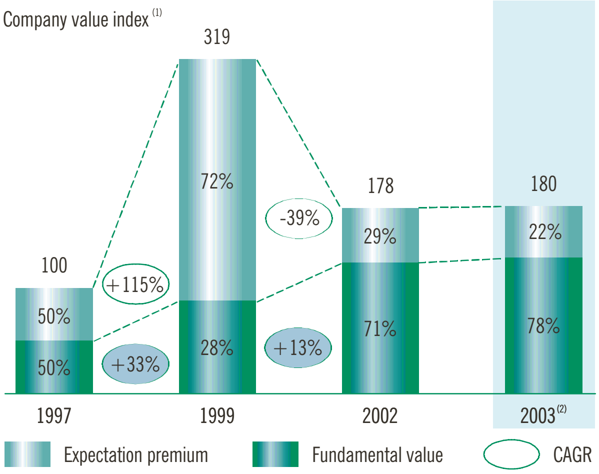


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 49 companies; minimum market value 2002: $10B
(4) Simple average of total industry sample

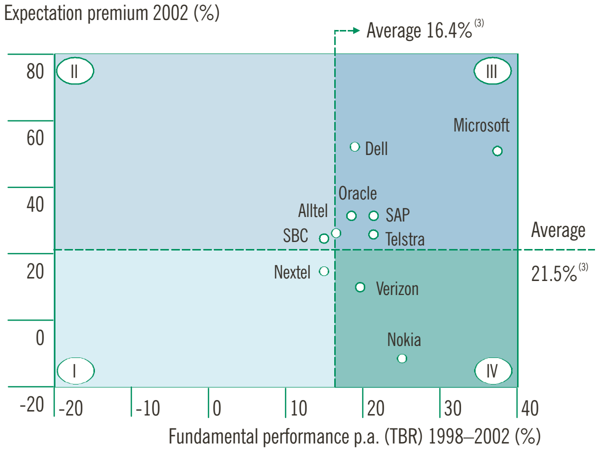
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

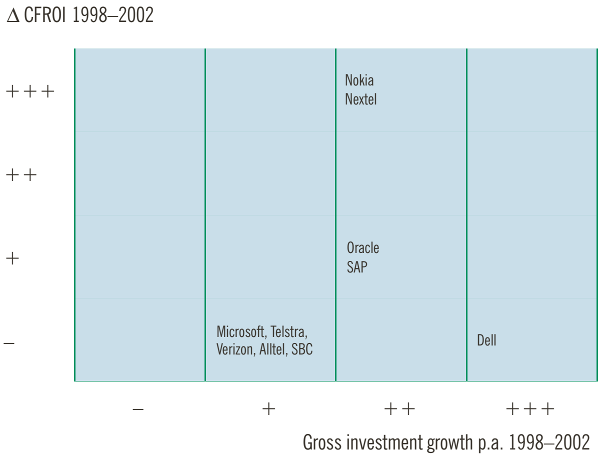


5-YEAR TBR RANKING

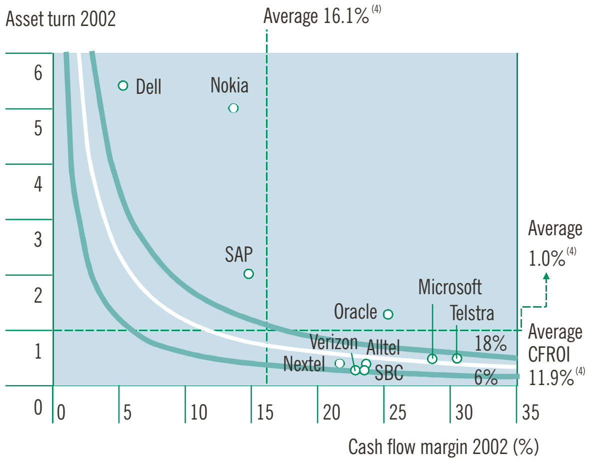
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Microsoft	US	10%	37%	300,629	8%	48%	-343	+	–	–	–
2	Nokia	FI	31%	25%	66,369	-11%	-18%	2,012	++	–	+++	+++
3	Telstra	AU	9%	22%	34,392	14%	25%	320	+	++	–	–
4	SAP	DE	-4%	21%	34,792	42%	51%	376	++	+	–	+
5	Verizon Comms.	US	0%	20%	90,902	-14%	0%	-5,407	+	+	–	–
6	Dell	US	21%	19%	87,385	25%	55%	251	+++	–	–	–
7	Oracle	US	24%	18%	61,099	4%	34%	818	++	+++	–	+
8	Alltel	US	7%	16%	14,730	-7%	22%	-365	+	–	–	–
9	SBC Communications	US	-4%	15%	73,950	-15%	15%	-7,226	+	–	–	–
10	Nextel	US	-2%	15%	19,508	71%	31%	1,292	++	+++	++	+++

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

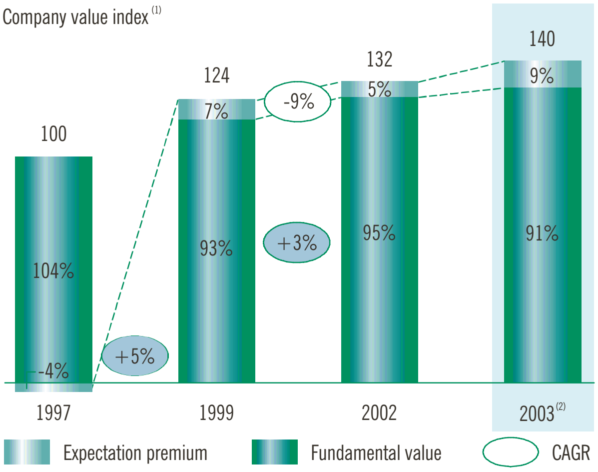


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 49 companies; minimum market value 2002: $10B
(4) Simple average of total industry sample

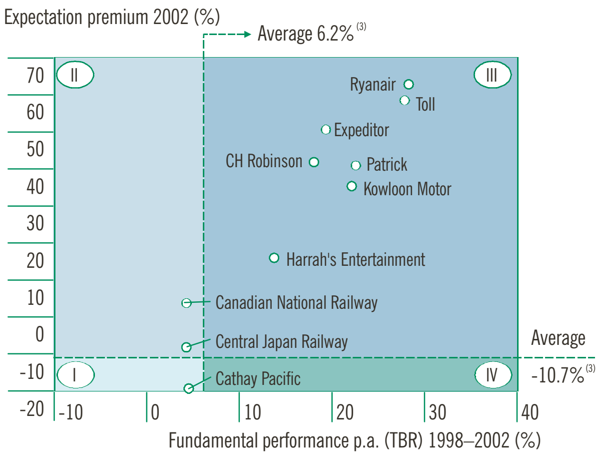
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

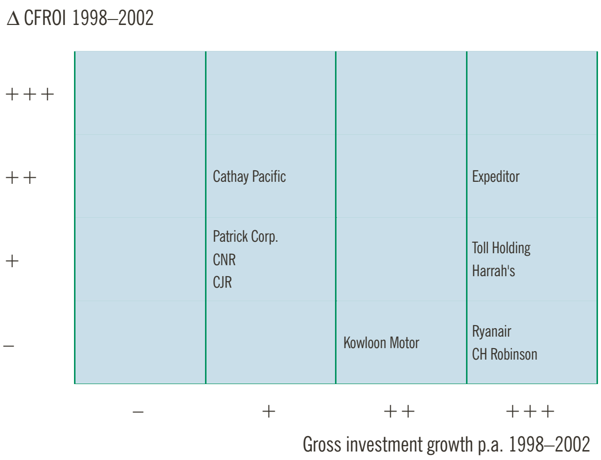


5-YEAR TSR RANKING

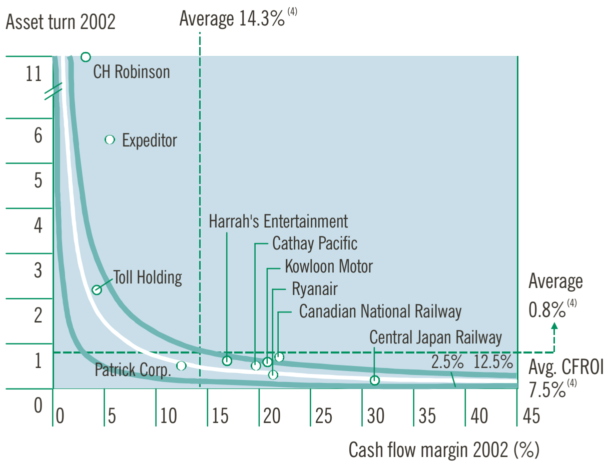
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Toll Holding	AU	66%	28%	1,315	22%	49%	3	+++	+	–	+
2	Patrick Corp.	AU	64%	22%	1,349	3%	38%	-15	+	++	–	+
3	Ryanair	IE	44%	28%	4,615	-14%	35%	23	+++	++	–	–
4	Expeditor Intl.	US	28%	19%	3,690	6%	48%	52	+++	+	+++	++
5	CH Robinson	US	24%	18%	3,271	20%	45%	38	+++	+	–	–
6	Kowloon Motor Bus.	HK	22%	22%	1,931	14%	46%	6	++	++	–	–
7	Harrah's Entertainment	US	16%	14%	4,727	7%	21%	99	+++	+	+	+
8	Canadian National Railway	CA	16%	4%	8,490	8%	1%	-221	+	++	–	+
9	Central Japan Railway	JP	14%	4%	17,083	23%	-1%	107	+	–	+	+
10	Cathay Pacific	HK	14%	5%	5,608	27%	3%	743	+	++	+	++

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

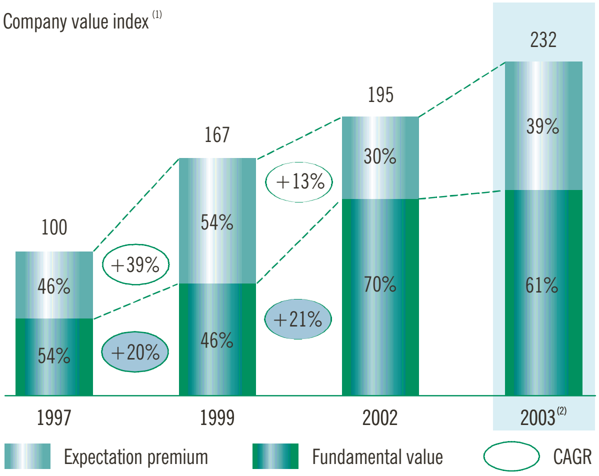


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 75 companies; minimum market value 2002: $1B
(4) Simple average of total industry sample

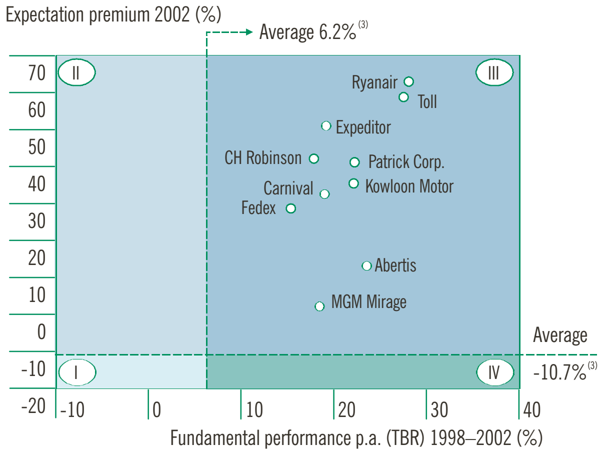
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

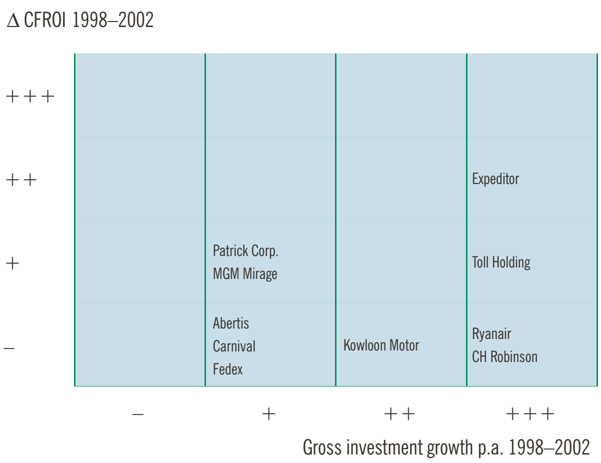


5-YEAR TBR RANKING

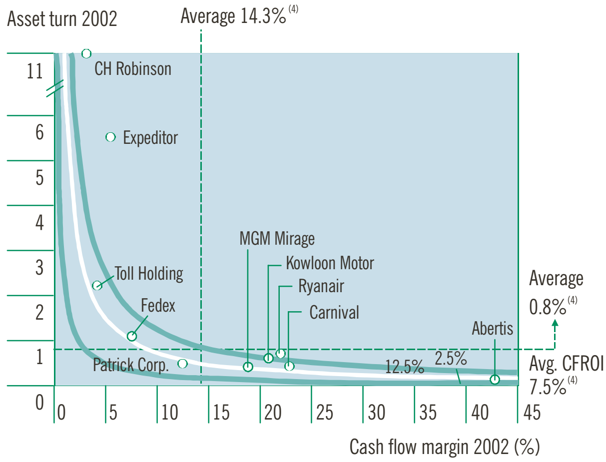
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Ryanair	IE	44%	28%	4,615	-14%	35%	23	+++	++	–	–
2	Toll Holding	AU	66%	28%	1,315	22%	49%	3	+++	+	–	+
3	Abertis	ES	6%	23%	6,170	11%	37%	-213	+	+	–	–
4	Patrick Corp.	AU	64%	22%	1,349	3%	38%	-15	+	++	–	+
5	Kowloon Motor Bus.	HK	22%	22%	1,931	14%	46%	6	++	++	–	–
6	Expeditor Intl.	US	28%	19%	3,690	6%	48%	52	+++	+	+++	++
7	Carnival	US	-1%	19%	21,318	33%	49%	-141	+	–	–	–
8	MGM Mirage	US	13%	18%	5,539	11%	4%	-191	+	++	–	+
9	CH Robinson	US	24%	18%	3,271	20%	45%	38	+++	+	–	–
10	Fedex	US	12%	15%	19,219	19%	41%	-188	+	+	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

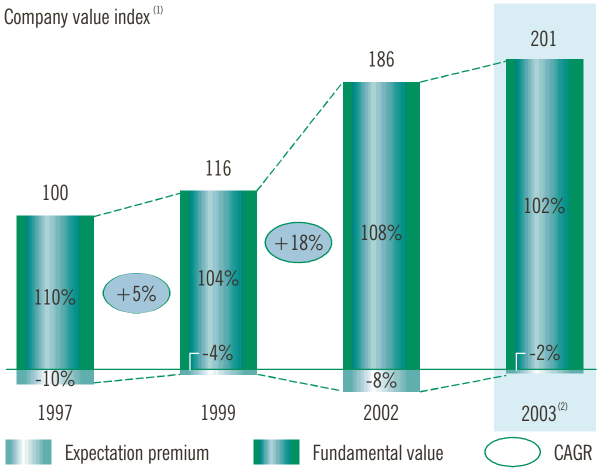


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 75 companies; minimum market value 2002: $1B
(4) Simple average of total industry sample

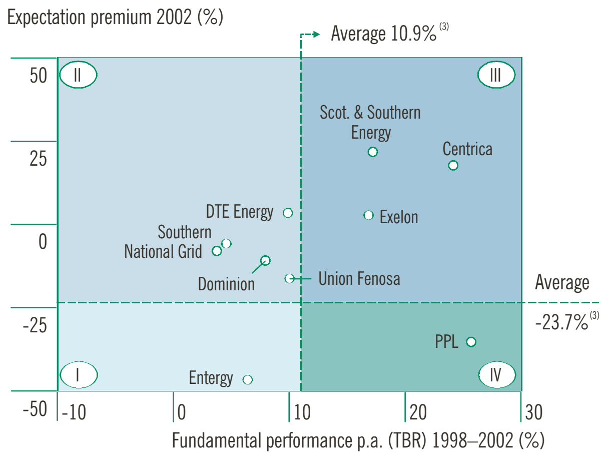
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TSR COMPANIES

Fundamental value and expectation premium



Value option portfolio

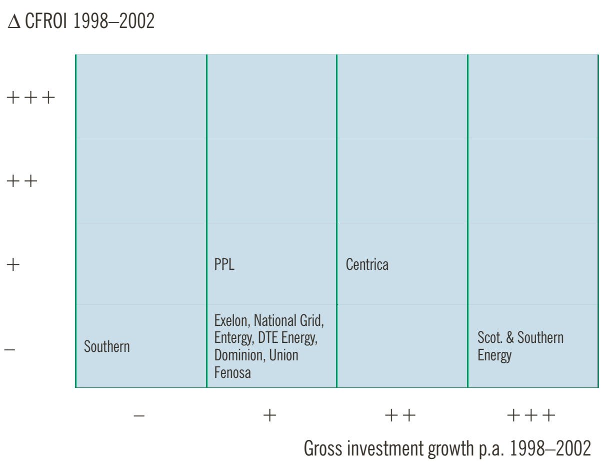


5-YEAR TSR RANKING

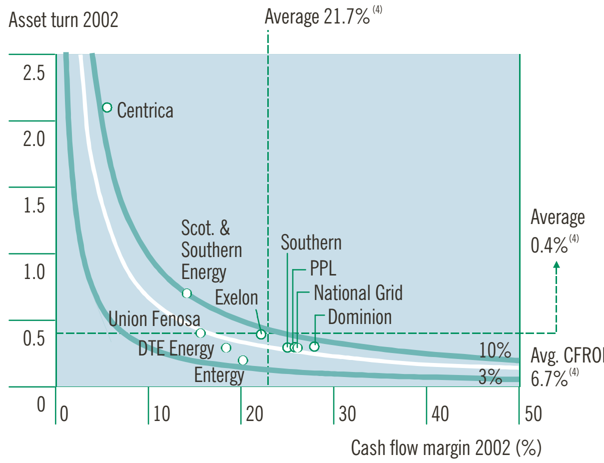
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	Exelon	US	20%	17%	21,050	24%	12%	-268	+	–	–	–
2	Southern	US	18%	5%	21,564	7%	-2%	107	–	–	–	–
3	Centrica	UK	15%	24%	12,847	9%	5%	404	++	+	–	+
4	National Grid Transco	UK	13%	4%	19,542	-13%	4%	-376	+	–	–	–
5	Entergy	US	13%	7%	12,333	22%	-36%	-273	+	++	–	–
6	PPL	US	12%	26%	7,289	21%	-14%	181	+	++	+	+
7	Scot. & Southern Energy	UK	12%	17%	8,415	-5%	8%	1	+++	–	+	–
8	DTE Energy	US	12%	10%	6,267	-17%	-4%	-350	+	–	+	–
9	Dominion Res.	US	11%	8%	20,074	17%	2%	-403	+	++	–	–
10	Union Fenosa	ES	10%	10%	4,470	17%	-13%	-583	+	–	+	–

VALUE LEVER PERFORMANCE OF TOP 10 TSR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002

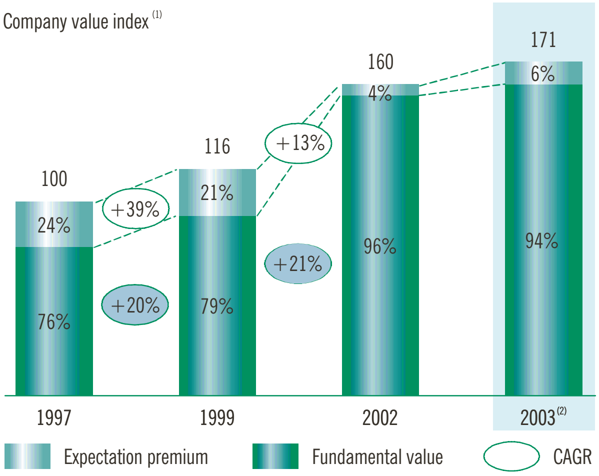


(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 57 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

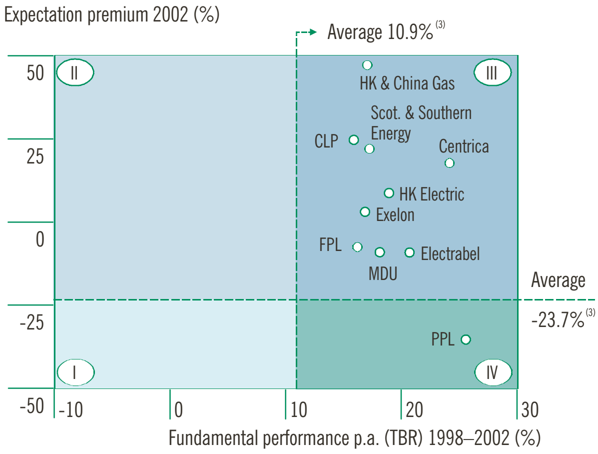
Source: BCG analysis

FUNDAMENTAL VALUE ANALYSIS OF TOP 10 TBR COMPANIES

Fundamental value and expectation premium



Value option portfolio

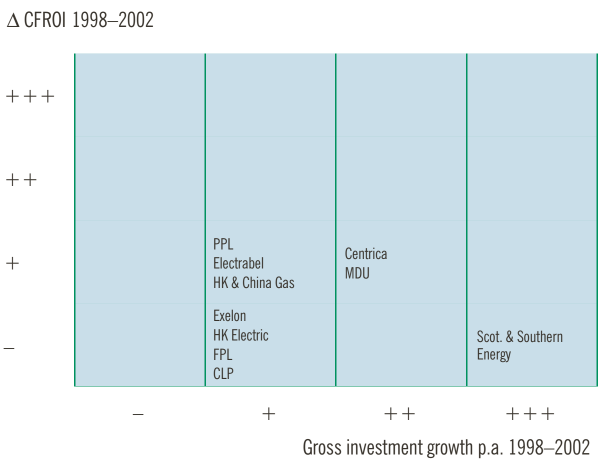


5-YEAR TBR RANKING

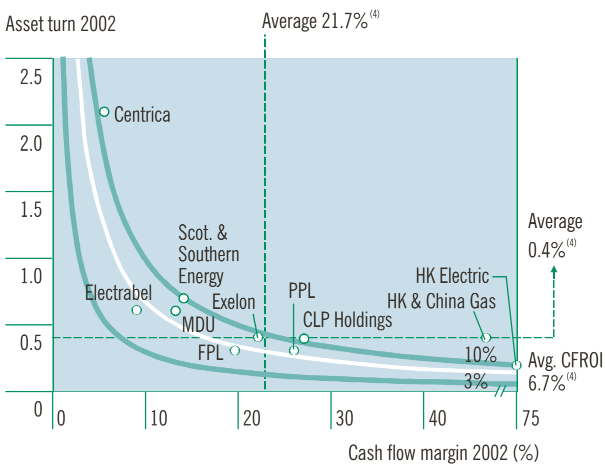
No.	Company	Country	Avg. TSR '98–'02	Avg. TBR '98–'02	MV in M$ 30 Sept. '03	TSR 1 Jan.– 30 Sept. '03	EP 30 Sept. '03	Δ CVA in M$ '98–'02	Contribution of each value lever: Avg. GI	Δ CFM	Δ AP	Δ CFROI
1	PPL	US	12%	26%	7,289	21%	-14%	181	+	++	+	+
2	Centrica	UK	15%	24%	12,847	9%	5%	404	++	+	–	+
3	Electrabel	BE	6%	21%	13,667	7%	-10%	-464	+	+	++	+
4	Hong Kong Electric	HK	5%	19%	8,169	7%	13%	-3	+	+++	–	–
5	MDU Resources	US	8%	18%	2,585	34%	11%	22	++	+	+	+
6	Scot. & Southern Energy	UK	12%	17%	8,415	-5%	8%	1	+++	–	+	–
7	HK & China Gas	HK	5%	17%	7,526	5%	46%	82	+	–	+	+
8	Exelon	US	20%	17%	21,050	24%	12%	-268	+	–	–	–
9	FPL Group	US	4%	16%	11,688	8%	-5%	-450	+	–	–	–
10	CLP Holdings	HK	3%	16%	10,500	13%	24%	-210	+	+	–	–

VALUE LEVER PERFORMANCE OF TOP 10 TBR COMPANIES

Profitability & growth 1998–2002



Cash flow margin versus asset productivity 2002



(1) Market value of equity plus interest-bearing debt, 1997 = 100
(2) Estimated fundamental value using I/B/E/S consensus forecast data; market value as of 30 September 2003
(3) Weighted average of total sample; 57 companies; minimum market value 2002: $3B
(4) Simple average of total industry sample

Source: BCG analysis

TECHNICAL NOTES

1. Background to the study

The study is based on the annual returns of more than 4,000 companies in Datastream's global market indices for the period 1998–2002. Collectively, they represent around 70% of the world's total market capitalization. Businesses were selected from Datastream's database using three main criteria:

- Have uninterrupted stock exchange listing for at least five years.
- Satisfied minimum market capitalization hurdles: different capitalization hurdles were set for each sector and region to reflect their relative economic weight (see Figures A1–A2).
- Could be classified into one of fourteen industrial sectors.
- Free float of shares exceeding 25%.

Several companies meeting these criteria were excluded from the final sample as they had been involved in major mergers or acquisitions over the study period (1998–2002), and it was believed this would distort the findings. All financial figures were converted into U.S. dollars, using the exchange rate as of year end 2002.

2. Different ways to measure value creation

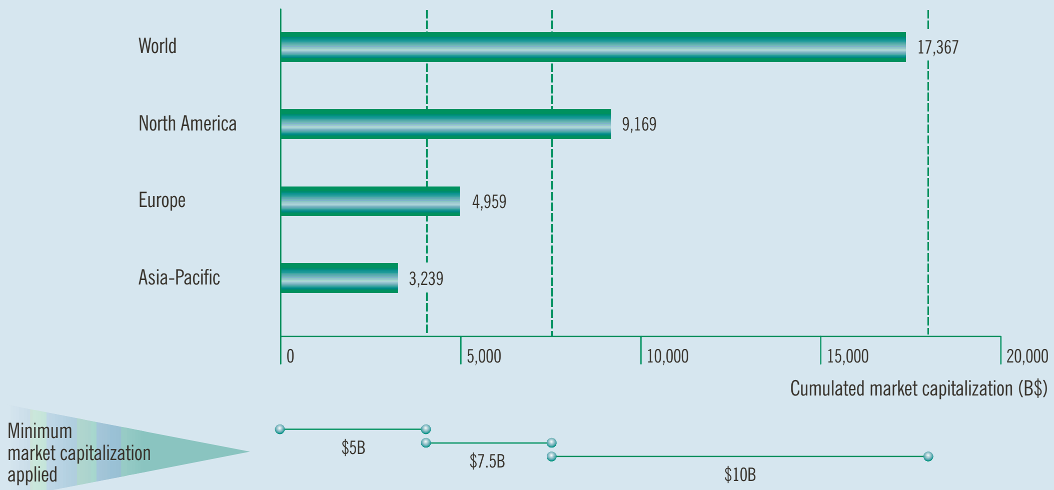
To effectively manage value creation, companies require multiple measures to be used in different applications and at different levels of the organization. Figure A3 depicts the range of measures our clients have found most useful to manage value creation at different levels in the organization.

MARKET CAPITALIZATION HURDLES FOR EACH INDUSTRY

Source: Thomson Financial Datastream; BCG analysis

Figure A1

MARKET CAPITALIZATION HURDLES FOR EACH REGION



Source: Thomson Financial Datastream; BCG analysis

Figure A2

FRAMEWORK OF VALUE MEASURES

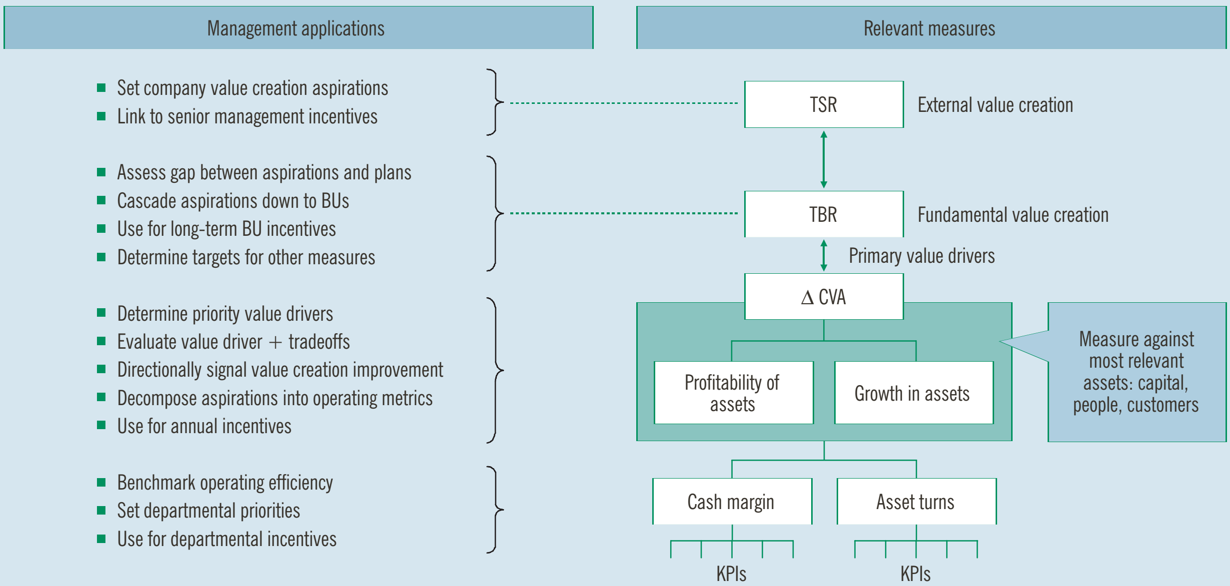


Figure A3

Setting explicit external aspirations: TSR

Beginning at the corporate level, executives must set an explicit value-creation aspiration that will energize their organizations, drive thinking or performance, and focus the agenda of programs that must be implemented. We believe the most appropriate measure for aspiration setting is total shareholder return (TSR) relative to a local market index or industry peer group. Achieving this "external value-creation aspiration" should be embedded within the incentive plans for corporate executives and key business-unit leaders.

Aligning internal aspirations and plans: TBR

The next requirement is to cascade down the overall TSR value-creation aspiration into internal corporate and business-unit goals and targets and assess the gap between plans and aspirations at all levels. The Total Business Return (TBR) measure is an accurate and useful measure for this purpose (Fig. A4). The TBR measure is an internal mirror of actual external TSR. It represents the 'intrinsic' capital gain and dividend yield from a business plan—either at the corporate or business-unitlevel.

Many of our clients have found the TBR measure to be a powerful tool for converting TSR aspirations into performance goals at business-unitlevel and to drive accordingly a portion of long term incentives for business-unit management. In that context, TBR can also be used as a rich planning tool to assess the value-creation potential of business plans and help managers close the gap between aspirations and performance.

TBR is an important high level tool to assess the relative performance of a corporation or a business unit and to set future targets. It also provides a way to link other measures used for detailed value-driver analysis or for setting operational targets back to the TSR aspiration.

Measuring and setting targets for the internal value-creation drivers: CVA

Cash Value Added, CVA (or its financial services equivalent AVE—Added Value to Equity), is an absolute measure of operating performance contribution to value creation. It provides a strong directional indication of when and how value creation is being improved. The CVA measure reflects operating cash flow minus a

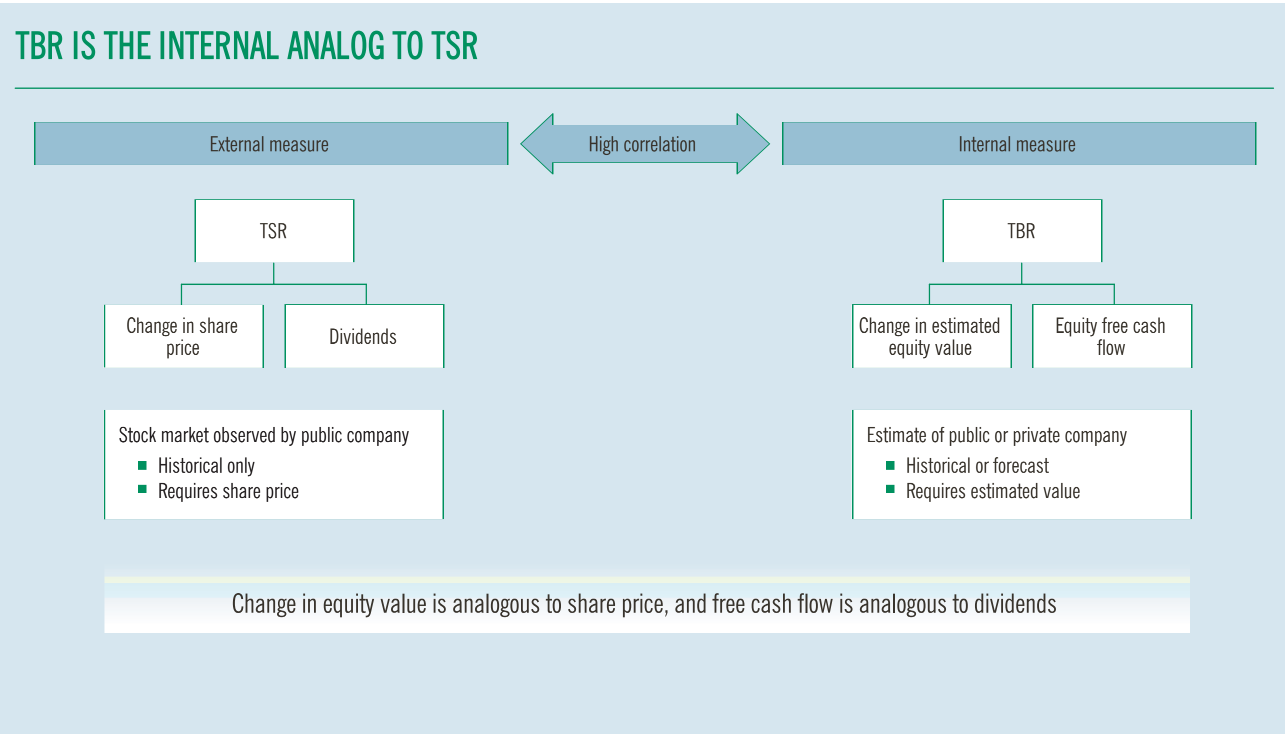


Figure A4

cost of capital charge against gross operating assets employed. The CVA measure is a very powerful tool to help managers pull the appropriate levers to create value. It can indeed accurately assess the contribution of the economic assets that actually drive a business. In some cases they are tangible assets, in others they are either people or customers.

The CVA measure is an accurate tool for determining priority value drivers and assessing value-driver trade-offs. In particular, it is a useful strategic indicator that allows managers to balance the high level trade-offs between improving profitability versus growing the business. Because its measurement is based on cash flow and original cash investment, it avoids the key accounting distortions that can cause profit-oriented residual income measures to give misleading trends in capital-intensive businesses.

Many clients have also found CVA to be an effective measure for annual incentives at the business-unit and operational levels. Moreover, CVA can easily be broken down further into the key performance indicators (KPIs) that are relevant to each management area. KPIs form the basis for internal or external performance benchmarking and for establishing annual incentive targets.

This brief description of value-creation measurement tools does not address the many nuances of applying them effectively. Further information on how to quantify aspirations, tailor the measure to fit your type of business, or identify the highest priority KPIs, can be provided upon request

3. Calculating expectation premiums

A company's expectation premium is the difference between its market value plus debt and its fundamental value. The scale of the premium depends on three main factors:

- **The market value of the company, measured by its market capitalization plus interest-bearing debt:** BCG used calendar year data for this (Fig. A5).

HOW EXPECTATION PREMIUMS ARE CALCULATED

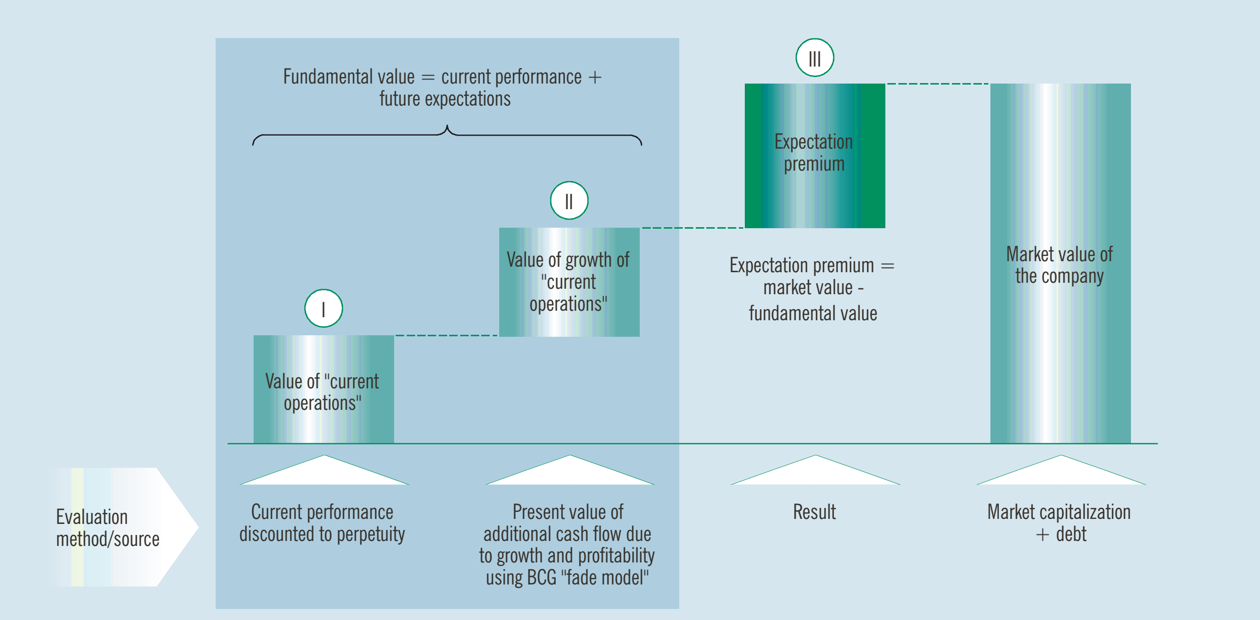


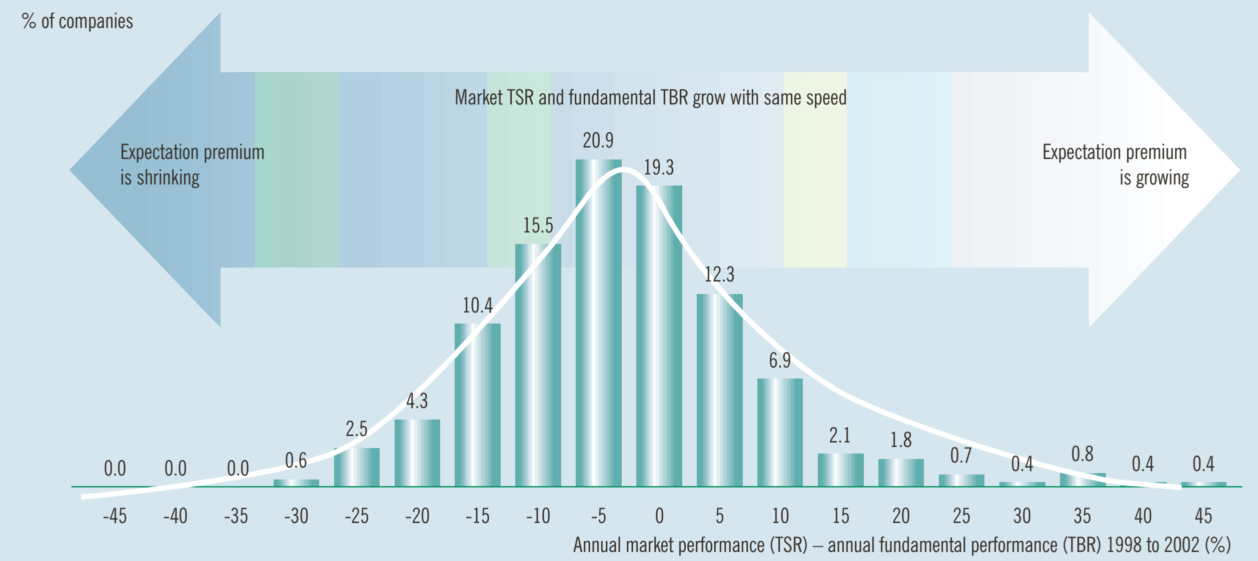
Figure A5

- **Robustness of the valuation model:** Figure A6 demonstrates that over the five-year period from 1998–2002 the difference between the annual market performance and the annual fundamental performance was between +/-10% for three quarters of the companies in the sample.

- **The assumptions used to calculate the company's fundamental value:** BCG applied a standardized residual income valuation framework incorporating cash flow projections, based on the businesses' current profitability and historical growth. Within this framework the present value of a company is derived by adding up capital invested in the business and the amount of discounted future residual income (i.e., payment surpluses after deducting a capital charge on the capital invested). As empirical evidence suggests, it is virtually impossible for top companies to sustain superior profitability and growth for decades due to competitive pressures. Similarly, firms that generate a lower return on capital than investors expect will either have to catch up quickly, be taken over, or exit the market. To account for these competitive pressures, BCG employed sector-specific fade rates that converge the businesses' profitability and growth to an industry average, based on empirical evidence from each sector. Within each industry profitability fade rates differ for companies that exceed their required rate of return (WACC) and firms that fall short of this measure. (Fig. A7).

- **The data used to calculate the company's fundamental value.** BCG used fiscal data for this.

NORMAL DISTRIBUTION DEMONSTRATES ROBUSTNESS OF VALUATION MODEL

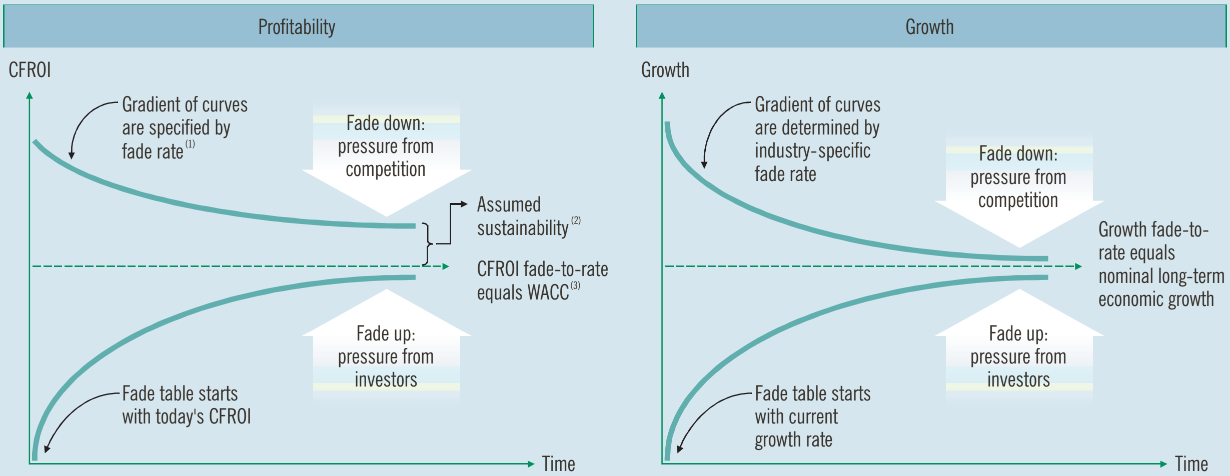


Note: Analysis based on top 721 companies of the total sample
Source: BCG analysis

Figure A6

GROWTH AND PROFITABILITY FADES TO INDUSTRY AVERAGES

FADE RATE ASSUMPTIONS



(1) Fade rates vary according to industry and profitability level (CFROI > WACC or CFROI < WACC)
(2) If CFROI > WACC, profitability is kept to a certain extent above cost of capital, sustainability rates vary across industries
(3) Nominal WACC/cost of equity is calculated for a given year and then assumed to be constant
Source: BCG analysis

Figure A7

HOW BCG CAN HELP

The Corporate Finance and Strategy practice within BCG provides expertise in the areas of corporate strategy, mergers and acquisitions, post merger integration and shareholder value-management. In specific these areas comprises the following tools and approaches:

Strategy:

- Portfolio approach: review business performance and potential pathways to shape long-term development potentials
- Standardized tools: Scenario planning, war gaming and industry landscaping to reveal risks and prospects
- Business unit strategy: assessing market conditions, competition, BU-specific capabilities to drive operational excellence
- Partnering tactics for joint venture opportunities and alliances
- Defining the role of the center
- Corporate governance: conceptual work on effective board practices

Corporate Finance

- Navigating the M&A process: acquisition search, target assessment in terms of financial valuation and strategic fit, negotiation & bid support as well as post-merger integration and change management
- IPO assistance for all phases: conceptual, preparatory, announcement, book building and post-IPO period
- Financial engineering and tools: capital allocation, valuation, risk management techniques, balance sheet restructuring, accounting issues
- Credit rating: rating models, rating management

Shareholder Value Management

- Corporate processes: business procedures organized for value creation, budgeting and controlling
- Value based management: defining appropriate metrics, to be broken down into operational value driver, counsel on suitable target setting and incentives
- Addressing capital markets: understanding investor characteristics & strategy, communication concept, managing the P/E

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