

THE BOSTON CONSULTING GROUP

Spotlight on Growth

The Role of Growth in Achieving Superior Value Creation

THE 2006 VALUE CREATORS REPORT



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The financial analyses in this report are based on public data and forecasts that have not been verified by BCG and on assumptions that are subject to uncertainty and change. The analyses are intended only for general comparisons across companies and industries and should not be used to support any individual investment decision.

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Table of Contents

About This Report	4
For Further Contact	5
Preface: The Challenge of Growth	6
The Importance of Growth in Achieving Superior Value Creation	9
Why Growth Is Critical to Value Creation	9
Why Growth Doesn't Necessarily Create Value	10
How Top Performers Use Growth to Achieve Superior Value Creation	11
The Impact of Growth on Valuation Multiples	13
Why Multiples Matter	13
Growth, Margins, and Multiples	13
Focusing on the Right Kind of Growth	14
Evaluating Growth Investments Against Alternative Uses of Capital	17
The Illusion of EPS Accretion	17
How Investors Value Company Growth Initiatives	17
Growth—Compared to What?	18
Setting Growth Targets That Drive Value Creation	21
Establishing a TSR Target	21
Determining What TSR Drivers Can Deliver	22
Debating Alternative TSR Scenarios	23
Getting Ready to Grow	25
Ten Questions About Growth That Every CEO Should Know How to Answer	27
Appendix: The 2006 Value Creators Rankings	28
Global Rankings	31
Industry Rankings	35

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Preface: The Challenge of Growth

After years of retrenchment and restructuring, many leading global companies are poised to grow. Systematic cost reduction and improvements in asset productivity have boosted returns on invested capital. Profits as a share of GDP are at record-high levels, providing excess cash for new investment. Indeed, many companies find that they can fund far more growth than their traditional core markets can sustain. One sign of this situation: the M&A market is heating up again as more and more companies look to acquisition to consolidate their industry and gain market share or to move into new, higher-growth businesses.

Senior executives are right to focus on growth. Consistent revenue growth is critical to delivering above-average shareholder value. Indeed, BCG research demonstrates that for top-quartile companies, revenue growth is by far the most important contributor to total shareholder return (TSR) over the long term. But the relationship between growth and shareholder value is neither simple nor straightforward. Growth can destroy value just as easily as create it. And different types of investors value growth differently. Depending on a company's investor mix and the type of growth it pursues, capital markets can end up punishing a company's growth strategy rather than rewarding it.

What's more, the very fact that so many companies are currently looking for growth is exacerbating the value creation challenge. Individual companies may be flush with cash, but so are their competitors. The growing role of private equity in M&A is boosting competition for available targets and raising prices for acquisition. What's more, after years of low interest rates and high liquidity, central banks around the world are systematically tightening credit, thus putting a damper on consumer demand, especially in the United States.¹ As companies compete over a constrained set of growth opportunities, finding the right path (that is, one that generates additional shareholder value) will become more and more difficult. Therefore, for

many companies, it is imperative to take a fresh look now at the role of growth in their value-creation strategies.

Spotlight on Growth, the eighth annual report in the Value Creators series published by The Boston Consulting Group, examines how senior executives can navigate the key choices and tradeoffs around growth in order to create superior shareholder value.² The purpose of the report is not to tell companies how to grow. (For additional BCG perspectives on growth, see the list of publications on the inside back cover of this report.) Rather, it is to provide an analytical framework for thinking strategically about growth and its role in shareholder value creation. The report helps senior executives address important questions such as

- How much revenue growth does a company need in order to achieve its aspirations for shareholder value?
- What is the right tradeoff between that growth and other priorities—for example, improving returns on capital or increasing payout to investors?
- Does the source of growth matter? Should a company focus on organic growth, acquisitive growth, or both?
- How does growth affect a company's valuation multiple?
- What is the right tradeoff between short-term and long-term growth?
- How should a company's growth strategy be positioned with its current investors?

In the tradition of recent Value Creators reports, our approach to these questions is to consider growth not in isolation but as one element in an integrated strategy for value creation. (For an overview of BCG's approach, see the sidebar "BCG's Integrated Value-Creation Model.")

1. For more information, see Stephen Roach, "The Great Global Growth Debate," Morgan Stanley Global Economic Forum, April 3, 2006, available at <http://www.morganstanley.com/GEFdata/digests/20060403-mon.html>.

2. Previous Value Creators reports are available at http://www.bcg.com/corporatefinance/cfs_value.html.

The report has six sections:

- We begin with a review of the importance of growth in achieving superior value creation.
- Next, we address the dynamic and often counter-intuitive impact of growth on a company's valuation multiple.
- We then consider how a company should make the critical tradeoffs between investments in growth and alternative uses of capital.
- We also discuss how a company can determine the growth it needs in order to achieve its TSR aspirations and set growth targets to drive value creation.
- We summarize our recommendations in the form of ten critical questions about growth that every CEO should know how to answer.
- Finally, we conclude, as we do every year, with an appendix presenting detailed empirical rankings on the five-year stock-market track record of the world's top performers.

BCG'S INTEGRATED VALUE-CREATION MODEL

In recent Value Creators reports, BCG has made the case for taking an *integrated* approach to value creation.¹ We have argued that when a company defines its value-creation strategy, it is critical to understand the linkages and manage the tradeoffs across three dimensions of an integrated value-creation system.

Fundamental Value. Improvements in fundamental value—represented by the discounted value of the future cash flows of a business (based on its margins, asset productivity, growth, and cost of capital)—are at the core of value creation. Fundamental value drives a company's total shareholder return (TSR) over the long term.² And of all the factors contributing to fundamental value, by far the most important is revenue growth.

Investor Expectations. While improvements in fundamental value are the main source of long-term TSR, changes in how investors value a company's fundamental performance at any given moment in time can increase—or decrease—TSR in the short term. These changes in investor expectations can be measured by a company's expectation premium (the difference between its actual stock price and the price derived from an analysis of its underlying fundamentals). They are also reflected in a company's valuation multiple, usually expressed as some ratio—for example, the ratio of price to earnings (the P/E multiple) or the ratio of enterprise value to earnings before interest, taxes, depreciation, and amortization (the EBITDA multiple). Our research suggests that for top-quartile companies, improvements in the valuation multiple are the most common contributor to near-term TSR.

Free Cash Flow. Improving a company's fundamental value generates cash. Companies face the choice of reinvesting that cash (through internal investments or

acquisitions) or distributing it to debt holders and stockholders (through debt repayment, share buybacks, or dividends). Such distributions of free cash flow contribute both directly and indirectly to TSR.

For example, dividend yield is an integral part of the calculation of TSR. But dividends can contribute indirectly as well. Investors have expectations not only for a company's capital gains but also for how much free cash flow it ought to distribute. Whether or not a company pays dividends, and at what level, can have an effect on its valuation multiple. Increasing dividend payout can raise a company's multiple by reducing perceived risk, by adding credibility to the quality or sustainability of the company's earnings, and by signaling management's commitment to shareholder value. What's more, a meaningful payout of free cash flow can also discipline a company's strategy to improve fundamental value—for instance, by creating competition for cash, by increasing the pressure on managers to improve profitability, and by making it more likely that only the most promising investment projects go forward.

As the above example makes clear, fundamental value, investor expectations as reflected in the valuation multiple, and free-cash-flow yield are integral parts of a dynamic value-creation system. (For a graphic illustration, see the exhibit "Companies Must Understand the Linkages and Manage the Tradeoffs Across the Drivers

1. See *The Next Frontier: Building an Integrated Strategy for Value Creation*, the 2004 Value Creators report, December 2004; and *Balancing Act: Implementing an Integrated Strategy for Value Creation*, the 2005 Value Creators report, November 2005.

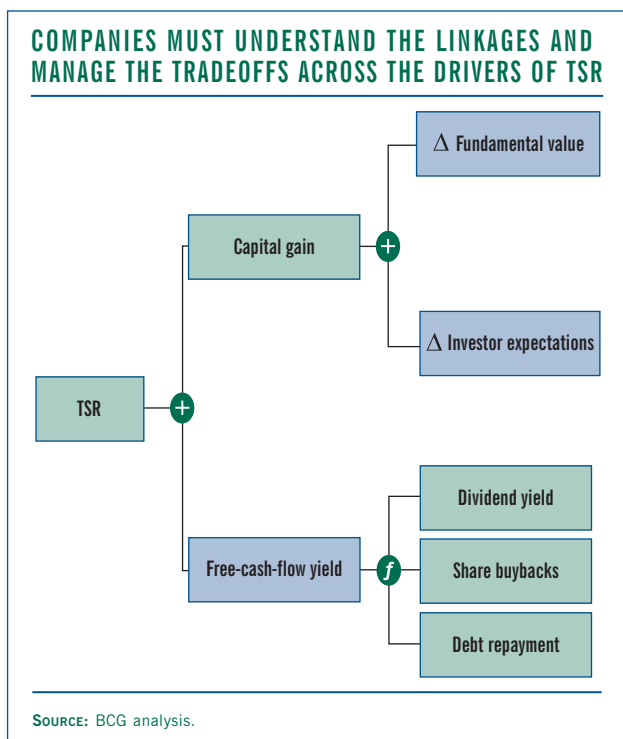
2. Total shareholder return (TSR) is the most comprehensive and most widely accepted measure of value creation. TSR measures the change in a company's stock price, plus its dividend yield, over a given period of time.

BCG'S INTEGRATED VALUE-CREATION MODEL (continued)

of TSR.”) Changes in any one can affect the others. The basic challenge of value creation is to understand the linkages among these three components and manage the tradeoffs across them to ensure that management actions are mutually reinforcing rather than contradictory.

Of course, it is one thing to understand that value creation is the product of an integrated system. It is quite another to use that understanding to shape a company's value-creation strategy. In last year's

Value Creators report, we introduced a structured process for doing so. (See the exhibit “Companies Can Follow a Three-Step Process for Implementing an Integrated Value-Creation Strategy.”) The process begins with building a TSR fact base that accurately reflects the specific dynamics of value creation in a company and its industry. Next, it uses that fact base to establish a TSR goal that reflects the key tradeoffs across the entire value-creation system. Finally, it shows how companies can redesign their management processes to align the organization around a strategy that effectively balances those tradeoffs. In this year's report, we focus on one aspect of this integrated value-creation system that for many companies is especially important today: the role of growth.



COMPANIES CAN FOLLOW A THREE-STEP PROCESS FOR IMPLEMENTING AN INTEGRATED VALUE-CREATION STRATEGY

Step 1: Create a TSR fact base

Identify the historical sources of TSR
Understand what drives relative valuation multiples
Engage with dominant investor groups

Step 2: Establish an appropriate TSR goal

Quantify the TSR potential of current plans
Debate alternative TSR scenarios
Define comprehensive targets and objectives

Step 3: Redesign management processes

Make an explicit commitment to shareholder value
Hold strategic planning to a higher standard
Design incentives around TSR

SOURCE: BCG analysis.

The Importance of Growth in Achieving Superior Value Creation

Growth is the most important and the most sustainable driver of TSR success. But just because a company has above-average growth does not necessarily mean it is delivering above-average shareholder value. The ultimate impact of growth on a company's total shareholder return will depend on the interaction between growth and the other dimensions of value creation.

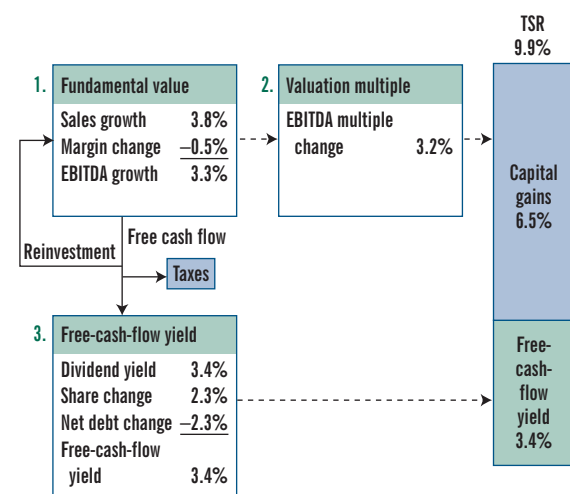
Why Growth Is Critical to Value Creation

To quantify the relative importance of the various drivers of TSR, BCG has developed a model for identifying the contribution each one makes to a company's TSR. (See Exhibit 1.) This TSR decomposition model uses the combination of sales growth and change in margins (resulting in growth in EBITDA, or earnings before interest, taxes, depreciation, and amortization) as a rough indicator of a company's improvement in fundamental value (see box 1 in Exhibit 1). It then uses the EBITDA multiple—the ratio of enterprise value (the market value of equity plus the market value of debt) to EBITDA—to calculate a company's valuation multiple, a rough measure of investor expectations for future performance (box 2).³ Finally, it tracks the distribution of free cash flow—dividend yield, change in shares outstanding, and net debt change—to investors (box 3). Using this model, we can analyze the various sources of TSR for an individual company, a peer group of companies, an industry, or an entire market index over a given period of time.

We used this decomposition model to analyze the TSR performance of top-quartile companies in the U.S. S&P 500 over rolling periods of one, three, five, and ten years from 1987 through 2005. (See Exhibit 2.) The results show that although other

3. There are many ways to measure a company's valuation multiple, and different metrics are appropriate for different industries and different company situations. In this study, we have chosen the EBITDA multiple in order to have a single measure with which to compare performance across our global sample. (See "Appendix: The 2006 Value Creators Rankings," beginning on page 28.) For a specific client project, of course, we would analyze the most meaningful multiple for the company and industry in question.

EXHIBIT 1
BCG'S DECOMPOSITION MODEL ALLOWS A COMPANY TO IDENTIFY THE SOURCES OF ITS TSR

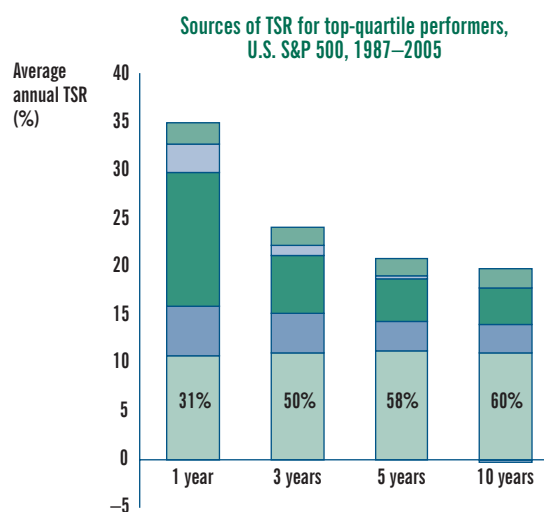


SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; BCG analysis.

NOTE: This calculation is based on an actual company example; the contribution of each factor is shown in percentage points of annual TSR.

EXHIBIT 2
FOR TOP PERFORMERS, REVENUE GROWTH IS THE CHIEF SOURCE OF LONG-TERM SHAREHOLDER VALUE

Legend: Dividend yield (dark green), Change in shares, cash, and debt (light blue), Change in multiple (medium green), Margin improvement (dark blue), Growth (light green)



SOURCES: Compustat; BCG analysis.

NOTE: The sample excludes financial companies; the rolling analysis covers one-, three-, five-, and ten-year time frames from 1987 through 2005.

factors (in particular, improvements in margins and valuation multiples) can loom large in the short term, growth is an increasingly dominant source of TSR over time, accounting for as much as 60 percent of top-quartile average TSR over ten years.

This finding makes intuitive sense. Companies inevitably reach a point of diminishing returns in their ability to improve margins, increase valuation multiples, or continue to deliver high or improving free-cash-flow yields to investors. Without sufficient growth, therefore, they cannot consistently deliver high TSR. Precisely how much revenue growth is “enough” will, of course, depend on a company’s TSR aspiration and its competitive situation. (For a more detailed discussion, see the section “Setting Growth Targets That Drive Value Creation,” beginning on page 21.) But even for average TSR companies, revenue growth is the single most important and sustainable driver of TSR success over the medium and long term.⁴

Why Growth Doesn’t Necessarily Create Value

And yet, although growth is clearly necessary for above-average value creation, it is not sufficient. When one analyzes growth not only of the top-quartile performers but also across the entire S&P 500, it quickly becomes clear that just delivering high revenue growth does not necessarily guarantee a high TSR. In fact, there is a wide divergence between growth rates among all S&P 500 companies and their TSR performance.

The scatter plot on the top of Exhibit 3 charts the revenue growth performance of the S&P 500 from 2000 through 2005 against the TSR performance of these companies. The broad scatter of data points above and below the diagonal line shows the weak relationship between growth and TSR—a multiple regression correlation coefficient (R^2) of only 0.15. In other words, company revenue growth rates explain only 15 percent of the variance in TSR results. The scatter plot on the bottom repeats the analysis with a different growth measure: growth in earnings per share (EPS). The correlation is better (0.25) but still quite weak.

4. Indeed, BCG research suggests that investors consider growth so important that they don’t care whether it is organic or acquisitive, just as long as it is profitable. See *Growing Through Acquisitions: The Successful Value Creation Record of Acquisitive Growth Strategies*, BCG report, May 2004.

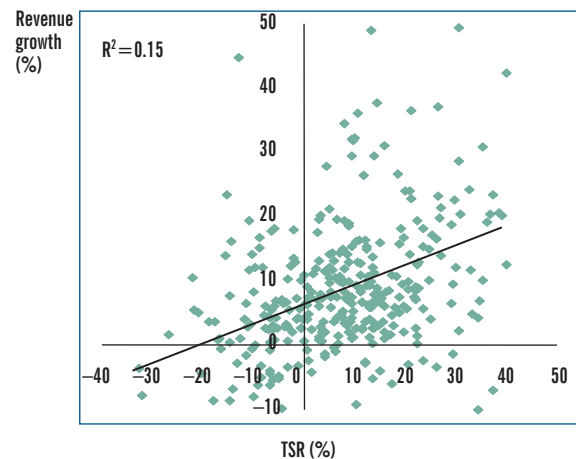
What explains these low correlations between growth in revenue and earnings, on the one hand, and TSR, on the other? The answers vary by company but most often include one or more of the following factors:

- In some cases, while growth during the period studied was still high, it was declining—and faster than investors expected, thus resulting in a decline in the valuation multiple.

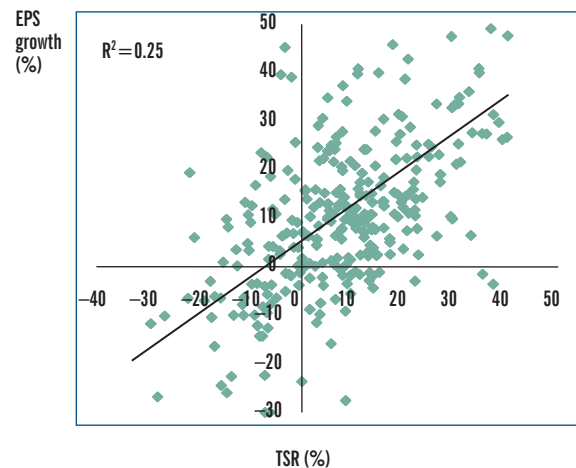
EXHIBIT 3 REVENUE GROWTH AND EPS GROWTH ARE POOR PREDICTORS OF SHAREHOLDER VALUE

◆ Company

The correlation between revenue growth and TSR, U.S. S&P 500, 2000–2005



The correlation between EPS growth and TSR, U.S. S&P 500, 2000–2005



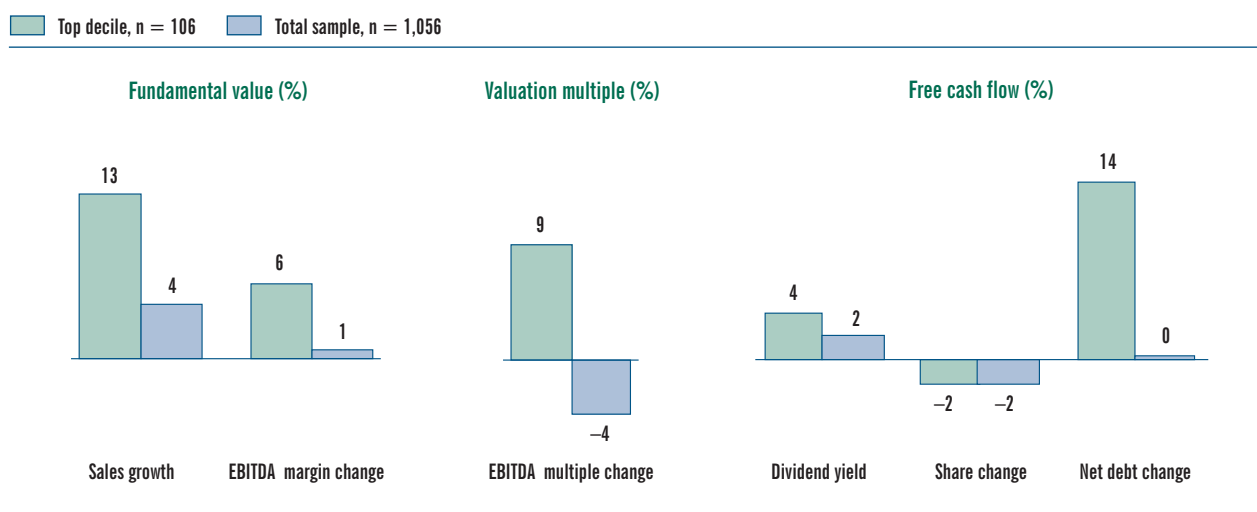
SOURCES: Compustat; BCG analysis.

NOTE: The sample excludes financial companies; R^2 stands for multiple regression correlation coefficient.

EXHIBIT 4

THE TOP PERFORMERS IMPROVED ON ALL THREE DIMENSIONS OF TSR

TSR Decomposition Profile, Global Sample, 2001–2005



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

NOTE: The bars show the contribution of each factor in percentage points of five-year average annual TSR.

- In other cases, companies experienced strong growth through acquisitions, but this growth was not profitable and therefore caused an erosion in free-cash-flow yield due to increased debt or increased shares to fund the acquisitions.
- In still other cases, organic growth was strong but came at too high a price in the form of weakened margins or declining returns on invested capital, thus reducing the valuation multiple or the cash available for dividends, debt refinancing, or share repurchases.
- In some situations, a company’s growth initiatives had the impact of changing its risk profile in the eyes of investors, leading to a decline in the valuation multiple due to increased operating or financial risk.
- Finally, in some cases, growth was strong on average but delivered in ways that neither appealed to a company’s current investors nor attracted a new type of investor, causing the valuation multiple to decline. This phenomenon often affects companies that add new growth businesses to a portfolio consisting largely of mature core businesses.

What all these examples suggest is that revenue growth is not really an independent variable that can be pursued without first thinking through its

second- and third-order effects on the other drivers of TSR.

How Top Performers Use Growth to Achieve Superior Value Creation

How do the top performers combine above-average growth with above-average value creation? Exhibit 4 portrays the complete TSR decomposition profile for the 1,056 global companies in this year’s Value Creators rankings.⁵ The exhibit shows the average decomposition both for the sample as a whole and for the top decile (106 companies).

Three trends are immediately apparent. First, the top performers delivered significantly more TSR from growth itself than the sample average—more than three times as much. Second, they did so even as they improved their margins significantly and increased their valuation multiples. Finally, these top performers generated so much cash that they were also able to pay out significant amounts to investors. Of their five-year average annual TSR of 44 percent, nearly one-third (14 percentage points) was from debt retirement, which had the effect of shifting substantial amounts of equity value from debt holders to equity holders. In other words, the

5. For the complete rankings, see “Appendix: The 2006 Value Creators Rankings,” beginning on page 28.

actions of the top performers improved all three dimensions of the value creation system. By contrast, average performers barely improved their margins, saw considerable erosion in their valuation multiples, and delivered no additional TSR through their free-cash-flow yield.

These results suggest that a company needs strong growth to create superior shareholder returns. But even strong growth will not create value if it comes at the expense of too large an erosion in margins (in most industries, cutting price to gain share is not a sustainable value-creation strategy), if it is below the level of growth that investors expect or comes with increased risk (thus eroding the multiple), or if it comes at too high a price in terms of

invested capital (for example, by paying too much for an acquisition or by investing in organic growth at returns below the cost of capital).

To ensure that growth reinforces rather than erodes the other dimensions of value creation, executives need to understand the linkages between growth and the other drivers of TSR. Two tradeoffs in particular are especially important:

- The tradeoff between growth and a company's valuation multiple
- The tradeoff between investments in growth and alternative uses of free cash flow

The next two sections examine both of these tradeoffs in detail.

The Impact of Growth on Valuation Multiples

Many executives wonder and worry about their company's valuation multiple. On the one hand, they often complain that their multiple doesn't accurately reflect the true value of their business plans. On the other, they assume that there is nothing they can do to affect the level of their multiple. As a result, they tend to ignore the multiple when they develop their business plans.

We believe this is a mistake. A company's valuation multiple has important implications for its long-term value-creation strategy. What's more, it is possible for executives to identify what drives differences in multiples within an industry and, therefore, to anticipate the likely impact of their business plans on their company's multiple, relative to peers. Doing so is especially important when it comes to growth.

Why Multiples Matter

A company's multiple, relative to industry peers, is a signal of how investors evaluate factors such as growth potential, risk, quality of earnings, and the sustainability of competitive advantage. In this respect, it can be a significant enabler of—or constraint on—a company's value-creation strategy. For example, a below-average multiple can put a company at a disadvantage in acquisitions because its stock will be a relatively weaker acquisition currency, thus limiting one important pathway to growth. It can even increase the risk of takeover by signaling to competitors that the company is undervalued relative to its peers. Conversely, too high a multiple can cause a company's TSR to stagnate, despite good fundamental performance.

Many executives assume that revenue growth (and its resulting improvement in earnings per share) nearly always has a positive impact on a company's valuation multiple. In one respect, they are entirely correct. In most industries, there is a relatively strong correlation between investor expectations for revenue growth and the *average* level of valua-

tion multiples within an industry. In other words, slow-growth industries generally have lower multiples than high-growth industries.

But when it comes to the *differences* among individual company multiples within a specific industry or peer group (and, from a competitive point of view, it is these differences that matter most), revenue growth is often not the determining factor. And even in those cases in which growth is important in setting relative multiples, it often operates in complex and not immediately straightforward ways. Therefore, it is incumbent upon executives to develop a more nuanced understanding about the specific impact of growth on valuation multiples in their industry peer group.

Growth, Margins, and Multiples

In recent Value Creators reports, BCG has introduced a new research technique that we call *comparative multiple analysis*.⁶ The methodology identifies the drivers of differences in valuation multiples in a specific industry or peer group by analyzing the statistical correlations between observed multiples and a broad range of financial and other performance data. Over the past two years, we have done hundreds of these analyses for clients in many different industries and sectors. Typically, we find that there are roughly three to six operating or financial characteristics that will explain 70 to 90 percent of the observed differences in peer-group valuation multiples over a five-year time frame.

Exhibit 5, on page 14, summarizes some of the most prevalent patterns we have observed from these comparative multiple analyses. The exhibit categorizes four typical industry situations on the basis of varying degrees of growth and of returns on capital. For each industry type, the exhibit shows some important factors that influence relative valuation multiples. The plus signs indicate a positive influence on the multiple; when these factors increase, so does a company's relative multiple. The minus

6. For a detailed description of this approach, see *The Next Frontier: Building an Integrated Strategy for Value Creation*, the 2004 Value Creators report, December 2004, pp. 29–36; and *Balancing Act: Implementing an Integrated Strategy for Value Creation*, the 2005 Value Creators report, November 2005, pp. 11–13, 15–18.

signs indicate a negative influence: when these factors increase, the multiple goes down.

As Exhibit 5 suggests, although the specific drivers vary significantly across industry types, some measure of profitability—usually EBITDA margin or gross margin, as a percentage of sales—frequently turns out to be the most important driver. This finding has broad implications for how executives think through the impact of their growth initiatives on the value creation system. Take the classic example of the tradeoff between growth and margins. Every executive knows that growth can sometimes come at the expense of margins. To manage this tradeoff, most have used a simple rule of thumb: some erosion of margin is acceptable, as long as earnings grow at a faster rate than would otherwise be the case. So, for example, if lower cereal prices result in sufficiently higher volume of cereal sold so that earnings increase, that is an acceptable way to grow. Or if, say, increasing selling or distribution expenses increases sales volume enough so that earnings grow, this too is a worthwhile growth strategy.

Our research, however, demonstrates that in many industries, margin erosion can have a severely negative impact on a company's relative multiple—

even when earnings are growing. The consumer staples sector is an illustrative case in point. Exhibit 6 portrays the results of a comparative multiple analysis for this sector covering the ten-year period from 1996 through 2005. The scatter plot on the left side charts the actual average ten-year valuation multiples for a sample of 16 companies from this sector against the predicted multiples derived from the regression analysis. The correlation (R^2) is a relatively strong 0.79, which means that the regression model explains nearly 80 percent of the observed differences in valuation multiples in the sample.

The bar chart on the right side shows the relative weight of the factors identified by the regression analysis as the most important for determining relative multiples in the consumer staples sector. Gross margin as a percentage of sales accounts for nearly 50 percent of the variance among multiples. The reason: many investors in this sector view gross margin as a strong indicator of the power of a company's brand. These investors lower their valuation of expected future cash flows when they perceive an erosion in brand strength and resulting pricing power.⁷ So, in consumer staples, sacrificing gross margin (for example, by discounting prices) in order to gain volume may grow earnings; it may even improve net present value (NPV). But it is also likely to erode a company's valuation multiple, thus lowering its stock price and degrading its TSR.

The conclusion that revenue growth, by itself, does not drive differences in multiples in the consumer staples sector has been confirmed by interviews that BCG has conducted with sell-side analysts. The consensus opinion was that above-average revenue growth is not really sustainable in so competitive an industry. Therefore, it is unlikely to have a positive effect on a company's valuation multiple. In contrast, growth that comes at the expense of gross margins is likely to have a strong negative effect on a company's relative multiple.

Focusing on the Right Kind of Growth

There are, of course, sectors in which growth plays a more positive role in setting a company's relative

7. Another important driver, accounting for roughly one quarter of the variance among industry multiples, is selling, general, and administrative (SG&A) expenses as a percentage of sales. The lower the percentage, the more likely that a company's operating model benefits from scale advantages and advantaged distribution channels.

EXHIBIT 5
THE DRIVERS OF RELATIVE VALUATION MULTIPLES VARY BY INDUSTRY TYPE

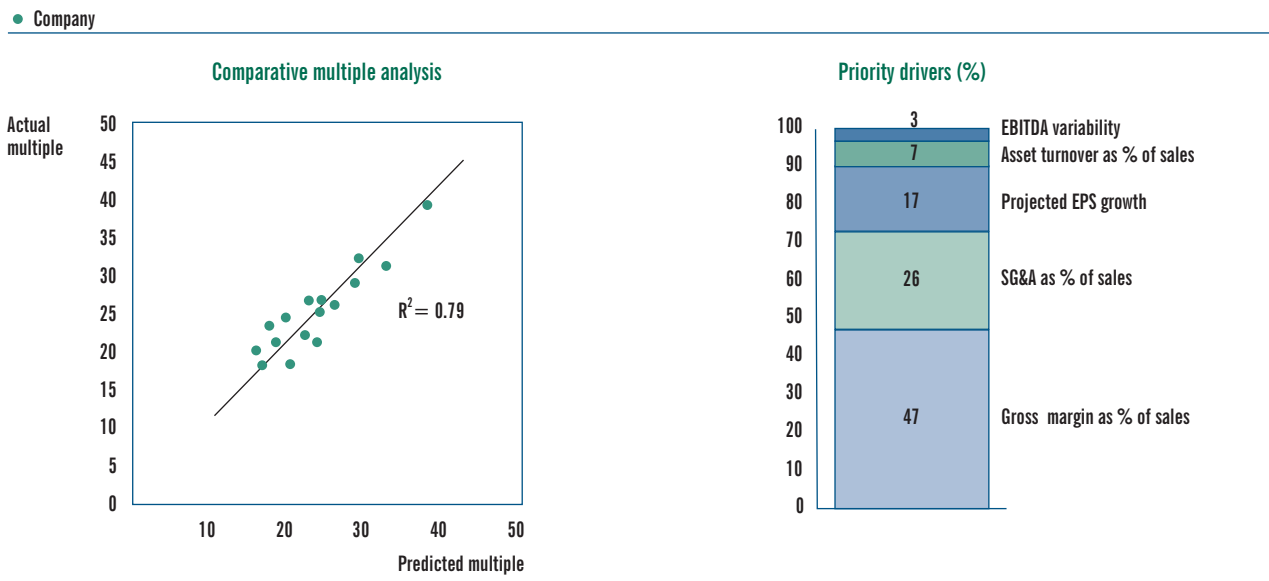
<p>Average growth, average returns (example: manufacturing)</p> <p>+++ EBITDA margin (%) ++ Capex as % of revenue + Dividend payout (%)</p> <p>-- Debt-to-capital ratio - Volatility</p>	<p>Average growth, high returns (example: specialty retail)</p> <p>+++ Gross margin (%) ++ New store openings as % of revenue + Dividend payout (%)</p> <p>--- Operating expense -- Debt-to-capital ratio</p>
<p>Above-average growth, above-average returns (example: services)</p> <p>+++ EBITDA margin (%) ++ Forecasted EPS growth + Margin variability</p> <p>- Debt-to-capital ratio</p>	<p>High growth (example: biotech)</p> <p>+++ Forecasted EPS growth ++ Gross margin (%) ++ Patent-protected sales life > 5 years + R&D as % of revenue</p>

SOURCE: BCG analysis.

NOTE: The plus signs indicate a positive directional impact on the multiple; the minus signs indicate a negative directional impact.

EXHIBIT 6

IN CONSUMER STAPLES, GROSS MARGINS ACCOUNT FOR NEARLY 50 PERCENT OF THE VARIANCE AMONG VALUATION MULTIPLES



Sources: Compustat; BCG analysis.

NOTE: The scatter plot charts actual average ten-year (1996–2005) price-to-earnings ratios for 16 consumer-staples companies against the predicted multiples derived from the regression analysis; R² stands for multiple regression correlation coefficient.

multiple. But understanding that role often requires focusing on a measure that is more fine-grained than revenue growth itself. In retail, for example, it is the specific *type* of growth that matters more than the absolute amount of revenue growth. For restaurant chains that are launching new concepts, for instance, what really matters is revenue growth from new-store openings, not increases in same-store sales. For more mature retailers, by contrast, the dynamic is reversed: because investors assume that these companies are already present in the most economically attractive locations, same-store revenue growth drives the multiple, whereas sales growth from new stores is relatively less important.

In the pharmaceutical industry, by contrast, what really matters is not revenue growth itself so much as patent-protected sales and R&D spending as a percentage of revenue, because investors see these metrics as indicators of the long-term health of a company’s product pipeline. And in some capital-intensive sectors, capital expenditure as a percentage of current revenue is far more important than either current or forecasted revenue growth. Wide commodity-price swings or inevitable shifts in cyclical demand make revenue growth a poor indicator of sustainable future growth. For this reason,

investors consider spending on capacity a far more robust signal.

In fact, probably the only situation in which revenue growth itself drives relative multiples in the manner that traditional managerial wisdom suggests is in high-growth industries where winner-take-all dynamics convey first-mover advantages to those companies that grow the fastest. But this is relatively rare. And even when this has historically been the case (for example, in the biotech industry, as illustrated in Exhibit 5), once a sector starts to mature, the dynamics that determine multiples can shift quite quickly.

As each of these examples suggests, the impact of revenue growth on a company’s valuation multiple is complex and often depends on the interaction of that growth with other dimensions of the value creation system. The good news is that the drivers of a company’s multiple, relative to its peers, can be identified, allowing companies to anticipate the potential impact of their growth moves on investor expectations and to take that impact into account when they define their growth strategies. (For a more detailed industry example, see the sidebar “How Growth Affects Multiples in the Information and Data-Services Industry,” page 16.)

HOW GROWTH AFFECTS MULTIPLES IN THE INFORMATION AND DATA-SERVICES INDUSTRY

To understand some of the complexities in the relationship between revenue growth and relative valuation multiples, consider the example of the information and data-services sector. Companies in this sector provide major corporations with outsourced information and data-processing services—for example, in payroll, benefits, and taxes. Spurred by the outsourcing trend, the sector has above-average growth and a high average valuation multiple. But an analysis of relative multiples reveals that revenue growth per se has little to do with what distinguishes one company's multiple from another.

In the exhibit below, the scatter plot on the left charts the actual valuation multiples for a sample of 12 companies from this sector from 1996 through 2005 against the predicted multiples derived from the regression analysis. The correlation (R^2) is a quite strong 0.86, which means that the regression model explains a full 86 percent of the differences in valuation multiples observed among these companies.

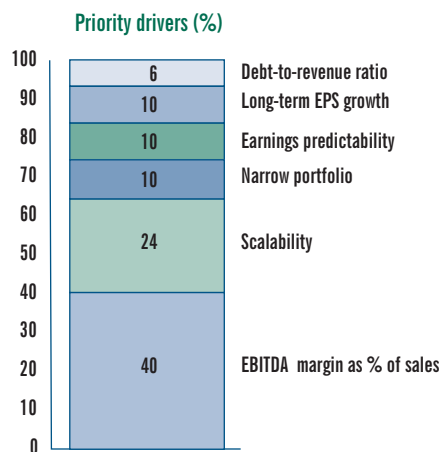
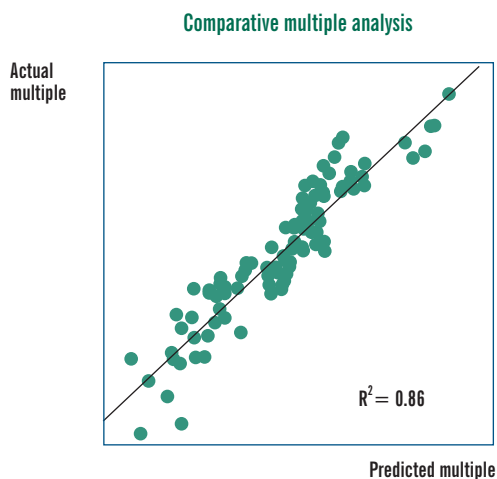
The bar chart on the right shows the relative weight of the factors identified by the regression analysis as the most important for determining relative multiples in the industry. EBITDA margin as a percentage of sales was by far the most important determinant of valuation multiples, accounting for 40 percent of the differences among multiples in the sample. This suggests that investors viewed high profitability as the most important indicator of a company's future prospects. By con-

trast, company revenue growth did not show up among the top drivers of industry multiples—and even the long-term EPS-growth forecast for the industry explained only 10 percent of the observed differences among multiples.

But this is not to say that growth doesn't matter. The second most important driver was the scalability of a company's operating model. We determined a company's scalability by measuring its revenue per employee, as well as the relative sensitivity of its margins to changes in revenue growth. Scalability, which accounted for 24 percent of the observed differences among multiples, is important because it signals that a company's existing software platforms can be leveraged to translate increases in sales volume quickly into bottom-line earnings. In other words, increasing revenue growth matters in this sector but only when it is leveraging an existing base of investment. To the degree that additional growth requires investment, it has significantly less impact on relative multiples.

The bottom line: Nearly two-thirds of a company's relative valuation rests on the strength of its existing margins and on the prospect that incremental revenue growth will have a positive and scalable impact on those margins. Therefore, a company's value-creation strategy should emphasize market leadership in products and services with high margins. And it should avoid unnecessary diversification that would harm scalability.

IN DATA SERVICES, EBITDA MARGIN, NOT REVENUE GROWTH, IS THE KEY DRIVER OF RELATIVE VALUATION MULTIPLES



SOURCES: Compustat; BCG analysis.

NOTE: The scatter plot charts actual multiples for 12 data-services companies over a ten-year period (1996–2005) against the predicted multiples derived from the regression analysis; R^2 stands for multiple regression correlation coefficient.

Evaluating Growth Investments Against Alternative Uses of Capital

Most executives believe that the best use of available capital is to fund profitable growth, not to increase payments to capital owners. In principle, they are right. All other things being equal, growth initiatives that earn returns above the cost of the capital employed increase value for investors.

But in practice, it's not so simple. First, properly evaluating the attractiveness of a growth initiative requires using the right metric: whether the initiative in question will actually improve TSR. Second, in determining the initiative's impact on TSR, executives must take into account the impact of the initiative on the company's valuation multiple. Finally, executives cannot assess the initiative in isolation but rather must determine whether it will deliver more TSR than alternative uses of capital (for example, dividend payouts, share repurchases, or debt reduction).

The Illusion of EPS Accretion

Far too many companies today evaluate the profitability of their future growth initiatives solely on the basis of whether they will deliver improved earnings per share. This preoccupation with EPS accretion is highly misleading because it does not really take into account the true opportunity costs of capital.

Consider the example of a situation that is increasingly common today. Many companies find themselves in the position of having excess cash on their balance sheets. Usually, this cash is earning relatively low interest rates after tax, typically in the neighborhood of 2 to 3 percent. In an effort to make more productive use of this cash, it is tempting for a company to, say, make an acquisition that will grow EPS and provide a return of 5 or 6 percent on the cash. And yet, such an acquisition destroys shareholder value. After all, if the cash used for the acquisition were returned to investors, they could invest that cash in an index fund providing market-average returns of roughly 8 percent—and at a much lower level of risk than would be the case with the acquisition.

In response to the distortions that come with too exclusive a focus on EPS accretion, some companies have turned to cash-based metrics such as cash flow return on investment (CFROI), net present value (NPV), economic profit, or cash value-added (CVA). These metrics represent a significant improvement for two reasons. First, they look beyond accounting earnings to measure the actual cash that a company is generating. Second, they explicitly incorporate the cost of capital in their calculations. Thus, they are preferable to EPS accretion as an internal measure of fundamental value.

However, these cash-based metrics also have their limitations. In particular, they are not designed to measure the external impact of a company's growth initiatives on investor expectations, as reflected in a company's valuation multiple. But unless executives also systematically assess this impact, they risk pursuing growth initiatives that may increase earnings per share or that even are NPV positive but that do not optimize (and may even erode) shareholder value. To understand why requires looking at how investors typically value a company's growth initiatives.

How Investors Value Company Growth Initiatives

Although it is true that all growth investments earning returns below the cost of capital inevitably erode shareholder value, it is not equally true that all growth investments delivering returns above the cost of capital necessarily create value. Despite the theoretical long-term efficiency of capital markets, there are many situations in which profitable growth initiatives are not fully valued by investors and end up delivering less TSR than executives expect, given their own NPV calculations.

Different types of investors have different priorities for TSR, different appetites for risk, and therefore different expectations for growth. For example, value investors tend to reward increasing the payout of free cash flow over growth. Growth-at-reasonable-price (GARP) investors, by contrast, favor stable, low-risk EPS growth. Growth investors target revenue growth greater than 15 percent. Depending on

the precise nature of a company's growth strategy and which investor types dominate its investor mix, there can be a disconnect between a company's growth plans and the priorities and expectations of its investors. If so, the company is unlikely to realize the value from these plans that executives expect. Such disconnects can be overcome, but it can take years to migrate a company's investor base from one dominant investor group to another—with major near-term damage to the company's TSR. (In the next section, we will describe how a company can achieve such a migration in a managed way, with minimal impact on short-term TSR.)

Another reason why a company's growth initiatives may appear to be not fully valued by the capital markets is a basic difference in perspective between management teams and investors. Executives tend to assess the potential of a growth initiative incrementally—that is, will the project in question have a positive NPV, given reasonable assumptions about future cash flows and likely risks? Investors, however, have a different point of view. They tend to focus not on standalone NPV (unless the investment in question is extremely large) but on how a company's new growth initiatives fit in with their view of the company's overall NPV profile.

Recently, for example, a large industrial-goods company made a number of tuck-in acquisitions. The companies in question were small niche businesses with relatively low gross margins. But because the acquirer was able to reduce overhead, realize synergies in manufacturing and distribution, and significantly improve cash flows, the acquisitions were NPV positive and improved earnings per share.

And yet investors punished the company's stock price. They were focused on the fact that despite the improved cash flow, the acquisitions eroded the acquirer's gross margins. What's more, the newly acquired businesses had a relatively low potential for additional growth. Because investors perceived that the deals reduced the future NPV profile of the company, the valuation multiple declined, resulting in TSR substantially below what the company's executives had expected.

Growth—Compared to What?

The impact of company moves on investor expectations has a further implication: even when a pro-

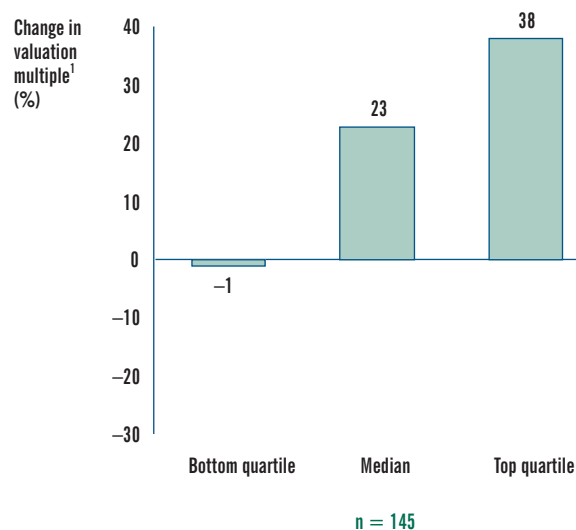
posed growth initiative delivers returns above the cost of capital, a company may be able to get even greater returns by returning the cash to investors. Companies that are overleveraged, that are undervalued compared with their future plans, or that suffer from a low valuation multiple relative to peers can often realize major improvements in their valuation multiples and TSR by paying out more cash to capital owners or by using that cash to reduce debt.

Take the example of dividends. BCG recently performed a study on the TSR impact of decisions to increase dividend payout at a sample of 145 U.S. companies. (See Exhibit 7.) Each of the companies had raised its dividend-payout ratio by more than 25 percent, resulting in a dividend payout of more than 10 percent of earnings, and then maintained that higher payout for at least one year. We found that the median increase in relative valuation multiples for the companies was a full 23 percent over the two quarters following the decision. And the top quartile of the sample enjoyed increases in their multiples of 38 percent, on average.

EXHIBIT 7

INCREASING DIVIDENDS CAN HAVE A MAJOR IMPACT ON A COMPANY'S RELATIVE VALUATION MULTIPLE

The impact of dividend increases on relative valuation multiples, U.S. S&P 1500, 1999–2004



SOURCES: Compustat; BCG analysis.

NOTE: The sample includes all S&P 1500 companies that raised their dividend-payout ratio by more than 25 percent between September 1999 and September 2004, resulting in a dividend payout of more than 10 percent of earnings for at least one year.

¹This is the change in price-to-earnings ratio, relative to the S&P 500 average, over the two quarters following the decision to increase the dividend payout.

In conclusion, although profitable growth is every company's first priority, determining how to grow and when to grow requires more than just a standalone analysis of individual growth initiatives, whether in terms of EPS or NPV. Executives need to consider carefully key tradeoffs concerning the type of growth (organic versus M&A), the focus of growth (served markets versus adjacent markets versus diversifying markets), the size of the investment required (in M&A, for instance, relatively modest tuck-in acquisitions versus ambitious and expensive large deals), and the timing of growth (see the sidebar "Balancing Short-Term Growth with Long-Term Growth"). Then they need to evaluate each new growth initiative against alternative uses of capital and take into account the impact on investor expectations.

At one extreme, organic growth initiatives in a company's served markets that increase TSR will almost always be a clear high priority relative to paying out more cash. At the other extreme, large M&A deals that add a new leg to the portfolio of existing businesses will usually be a low priority relative to maximizing free-cash-flow yield. But it is the many situations in between that require careful judgment. Executives must ask themselves such important questions as

- What is the relative risk of the various growth options—and the respective appetite for risk of

the senior management team and the company's investors?

- How does each option fit with the expectations and priorities of current investors?
- Will current investors fully value the company's growth plan? If not, is it possible to migrate to different types of investors who would?
- Will growth initiatives adversely affect investors' views of the NPV profile of the company?
- Would increasing free-cash-flow yield by itself create above-average TSR due to an expansion in the company's valuation multiple?

Whatever the final decision—to proceed with the growth initiatives in question, to employ the capital required in other ways, or some combination of the two—conducting an explicit analysis of the tradeoffs is an important value-creation discipline. It informs a company's risk taking and ensures that its growth initiatives have an impact on TSR that is at least equal to alternative uses of capital. The result is often a more nuanced, balanced, and appropriately sequenced growth strategy. The process also helps align the organization and the board around the company's strategy and results in a detailed game plan for communicating that strategy to investors.

BALANCING SHORT-TERM GROWTH WITH LONG-TERM GROWTH

In today's economic environment, many companies are able to fund a lot more growth than the underlying organic growth rates in their served markets can sustain. This gap is a direct result of the many actions to improve returns on capital that global companies have successfully implemented in recent years.

Take, for example, the consumer staples sector discussed earlier. For most companies in this sector, the sustainable growth rate (that is, the rate of revenue growth that the company can fund with internally generated cash, on the basis of given sales-to-capital, debt-to-capital, and dividend-payout ratios) is as much as two to six times the industry's underlying organic growth rate of approximately 5 percent. (See the exhibit "In Consumer Staples, Most Companies Can Fund More Growth Than Industry Growth Rates Can Sustain," page 20.)

This substantial imbalance between demand growth and sustainable growth is not limited to consumer staples. We analyzed sustainable growth rates in 100 different industry sectors, covering the largest 1,500 publicly traded companies in the United States. We found that the vast majority of sectors had sustainable growth rates above (and, in some cases, significantly above) the forecasted revenue growth rates for their markets. (See the exhibit "The Vast Majority of U.S. Industries Can Fund More Growth Than Markets Can Sustain," page 20.) And the median industry had an average sustainable growth rate that was 4.7 percentage points greater than its underlying demand growth.

Such imbalances represent a challenge for long-term value creation. In an attempt to find productive uses for all this cash, executives will be tempted to invest

BALANCING SHORT-TERM GROWTH WITH LONG-TERM GROWTH (continued)

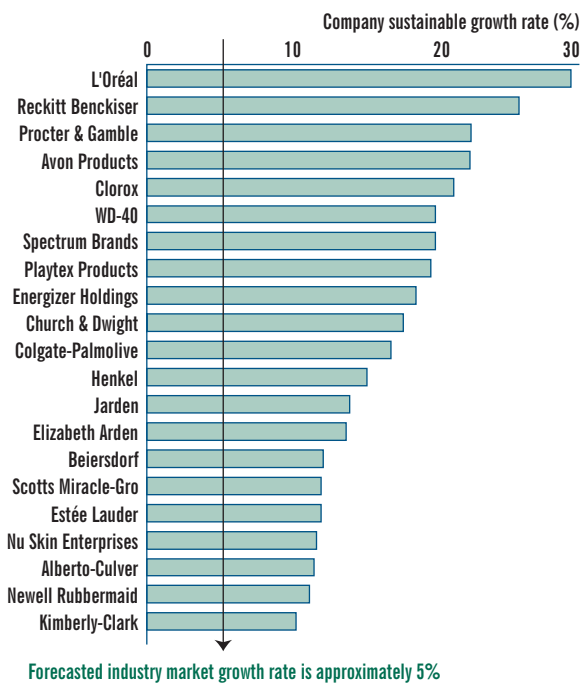
in any growth initiatives that have a positive NPV, even if those initiatives generate returns below the company's current return on capital.

But this erosion in return on capital could cause investors to reset their expected future NPV profile for the company downward. Since most investors don't have detailed information on individual company growth investments, they tend to rely on a company's average return as a guide to the likely return that new growth projects will generate. The higher a company's average return on capital, the higher the value that investors will likely ascribe to

each future dollar spent on growth. A substantial downward trend in return on capital is often taken as a signal that a company's returns are fading faster than investors have already priced into the company's current valuation.

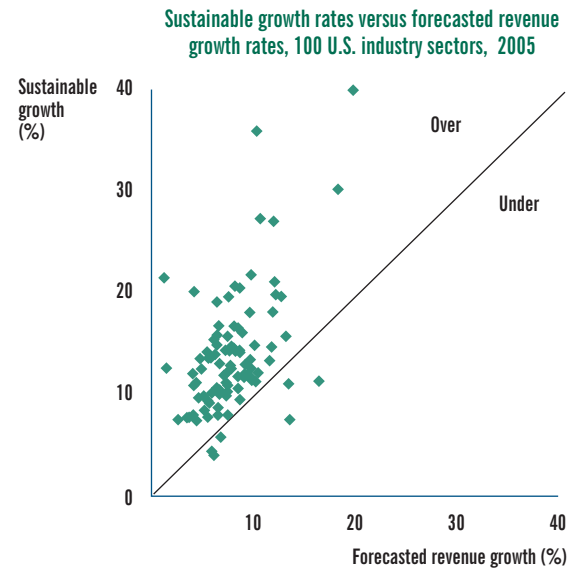
At a time when many companies have substantial resources chasing relatively limited growth opportunities, executives need to be sensitive to how their portfolio of proposed growth projects will affect the company's return on invested capital and long-term sustainable growth rate. If a proposed project will substantially erode these metrics over the next three to five years, then a reassessment may be in order. Otherwise, higher growth spending today may result in a lower valuation multiple, lower TSR, and, paradoxically, a constrained ability to fund growth in the future.

IN CONSUMER STAPLES, MOST COMPANIES CAN FUND MORE GROWTH THAN INDUSTRY GROWTH RATES CAN SUSTAIN



SOURCE: BCG analysis.

THE VAST MAJORITY OF U.S. INDUSTRIES CAN FUND MORE GROWTH THAN MARKETS CAN SUSTAIN



SOURCES: Compustat; Valueline; BCG analysis.

Setting Growth Targets That Drive Value Creation

Once executives understand the dynamic impact of growth on value creation in their company and industry, they are in a position to define a growth strategy that will deliver superior TSR.

There are at least two key challenges. First, they need to determine *how to grow*, by examining thoroughly all the ways their company can create growth, given its market opportunities and organizational capabilities. Second, they need to determine *what the impact of growth will be on the company's TSR*, by quantifying the impact of the company's growth on the other elements of the value creation system. The first challenge is outside the scope of this report. (For BCG perspectives on the broad challenges of designing a growth strategy, see the publications listed on the inside back cover of this report.) The second challenge is the focus of this section—in particular, how to set growth targets that drive TSR.

The best approach to defining a growth strategy that will deliver superior TSR depends on a company's starting point. For companies with a clear and stable strategy, the task is mainly one of determining “how much growth do we need?” The key questions are

- Can our current business plans deliver on our TSR target?
- If not, how much additional growth is required?

But when a company's competitive environment is changing or there is disagreement within the management team or with the board about the best path ahead, a more elaborate process is necessary—one in which senior executives and the board discuss and debate alternative TSR scenarios.

Establishing a TSR Target

When most companies set their targets for revenue growth, they typically take one of two approaches. Either they pursue a “bottom-up” approach—for example, deriving a target from the plans sub-

mitted by business units or setting it on the basis of some incremental improvement over historical growth rates. Or they take a “top-down” approach—for instance, having top management set a target stock price and stretch goals for improved growth in order to meet it.

There are problems with both approaches. Too much of a bottom-up focus can cause a company to become so trapped in negotiations about internal plans or debates about whether peer-group benchmarks are appropriate that it never achieves anything but modest incremental growth. Too much of a top-down focus, by contrast, can cause a company to develop unrealistically high growth aspirations that promote excessive risk taking—or simply frustration at what appear to be unachievable goals. And neither approach takes into account the all-important tradeoffs between growth and other drivers of TSR.

We advocate starting with an explicit TSR target and then using both top-down and bottom-up approaches to test and refine it. The advantage of using TSR (as opposed to a target stock price) as a metric is that it is more comprehensive—incorporating the value of dividends, not just that of share-price appreciation. What's more, a TSR target forces explicit consideration of potential changes in a company's future valuation multiple as a result of its business plan.

The first step in setting a TSR target is to determine the likely market-average (or, preferably, industry-peer-group average) TSR. For example, most current forecasts estimate a market-average TSR in the neighborhood of 8 percent over the next five years. The next step is to quantify the long-term historical spread between this average TSR and the breakpoints for top-third, top-quartile, or top-quintile TSR over a variety of time horizons. Exhibit 8, on page 22, for instance, uses historical data from 1950 through 2005 to determine these spreads for the universe of companies in the U.S. S&P 500 over rolling time periods of three, five, and ten years.⁸

8. To learn the quartile breakpoints in the 14 industries in our global sample, see “Appendix: The 2006 Value Creators Rankings,” starting on page 28.

EXHIBIT 8

HISTORICAL BENCHMARKS AND MARKET FORECASTS HELP DEFINE LEVELS OF SHAREHOLDER VALUE PERFORMANCE

		U.S. S&P 500		
		Historical ¹		Forecasted TSR (%)
		Average TSR (%)	Spread from median (%)	
3 years	Top Quintile	25	13	21
	Top Quartile	22	10	18
	Top Third	18	6	14
	Median	12	—	8
5 years	Top Quintile	22	10	18
	Top Quartile	20	8	16
	Top Third	17	5	13
	Median	12	—	8
10 years	Top Quintile	19	7	15
	Top Quartile	17	5	13
	Top Third	15	3	11
	Median	12	—	8

Sources: Compustat; BCG analysis.

¹The TSR spreads are based on S&P 500 benchmarks, measured as three-, five-, and ten-year rolling periods from 1950 through 2005.

Notice that the longer the time period, the less the spread between median TSR and the three above-average breakpoints. For example, given the assumptions in Exhibit 8, achieving top-quartile TSR over the next three years will require a higher TSR (18 percent) than achieving it over the next five (16 percent) or the next ten (13 percent). Because it is so difficult to deliver above-average performance consistently, year in and year out, the hurdle tends to become lower over longer time frames. It's important to factor this trend into TSR target setting.

Of course, no goal-setting process is foolproof. But the advantage of this approach is that it is explicit about a TSR goal, more empirically grounded in long-term benchmarks for achieving that goal, and less affected by internal negotiations over plans or subjective opinions about what constitutes superior performance. In this respect, this approach reflects how companies are ultimately judged by investors and establishes expectations for business units that they would have to meet if they were publicly traded.

Determining What TSR Drivers Can Deliver

Once a company has established a TSR target, the next step is to determine how close the nongrowth

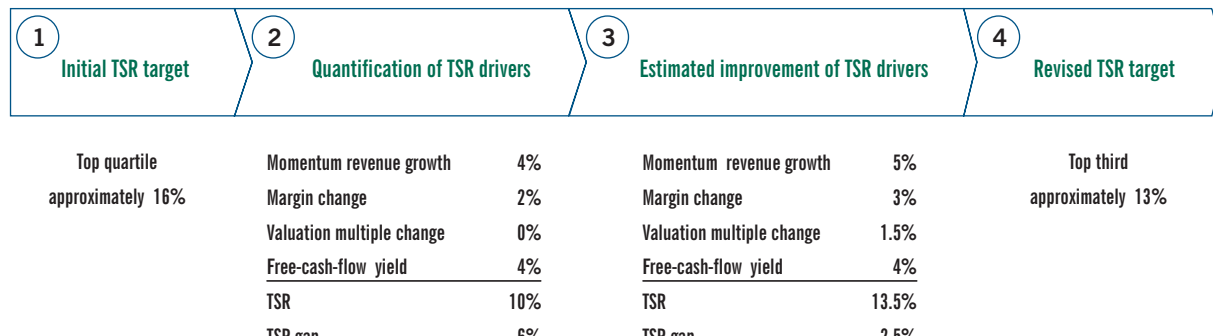
drivers of shareholder value can bring the company to that target. For example, how many percentage points of TSR are likely to result from improvements in margin? Is a company's relative valuation multiple likely to expand or contract given its industry situation and business plans? What is a company's potential free-cash-flow yield (assuming optimal use of excess cash)? The purpose of such questions is to develop a confident opinion about the expected momentum for each TSR driver—and thus the TSR required from growth in order to reach a company's TSR target.

For an idea of how this process works, consider the following example. The senior management team at one U.S. company initially set a top-quartile TSR goal of about 16 percent over the next five years. The executives then estimated what each driver of TSR would likely deliver under the current business plan. Momentum revenue growth in served markets was roughly 4 percent. Planned cost reductions would increase EBITDA margin by 2 percent per year. Excess free cash flow would average a yield of 4 percent per year. And the executives assumed that the company's valuation multiple would remain constant at a price-to-earnings ratio of 16 times earnings. The result was a momentum TSR of 10 percent—6 percent short of their goal. (For a graphic illustration of the company's target-setting process, see Exhibit 9.)

Next, the executives explored how they might improve each of these drivers. They concluded that they could add no more than an additional percent to the company's organic revenue growth rate without negatively affecting their EBITDA margin. However, since their valuation multiple was only average for their peer group, they believed they could potentially raise it from 16 times earnings to 18 times (in effect, entering the top third of multiples in their category). An analysis of the drivers of relative multiples in their peer group suggested the following activities to reach this goal: they would have to improve their gross margins about 1 percent through better pricing discipline, use excess cash flow to reduce their debt-to-capital ratio to their peer-group average, and increase their dividend payout from below average to above average for their peer group. These improvements, executives estimated, would trigger a rise in the multiple that would deliver an additional TSR of roughly 1.5 percent per year over the five-year period.

EXHIBIT 9

AT ONE COMPANY, SETTING A TSR TARGET WAS AN ITERATIVE PROCESS



SOURCE: BCG analysis.

NOTE: The contribution of each TSR driver is shown in percentage points of annual TSR.

The combination of increased organic growth, improved margins, and a higher relative multiple would move the company’s TSR from 10 percent to 13.5 percent—still short of the team’s initial goal.

The next move the executives considered was to use acquisitions to further close the gap. But given the need to use additional cash to increase dividends and reduce debt, their unwillingness to use equity to fund M&A, and the relative paucity of good deals in what was a pricey M&A market, they concluded that this alternative was not realistic in the near term. So the team decided to scale back its TSR target from top quartile (16 percent) to top third (13 percent)—a goal that the executives were quite confident the company could achieve. They agreed to revisit the top-quartile aspiration at a later date—including consideration of potential changes in the company’s portfolio of brands (to raise substantially the underlying potential for organic growth) and strategies to improve returns on invested capital (to generate more cash to fund acquisition-based growth).

This example illustrates three key points about the challenge of determining the right revenue growth goals to meet a TSR target. First, given the linkages across the integrated value-creation system, all the drivers of TSR need to be continuously reexamined. Second, a company’s initial TSR target may well need to be modified to take into account what the organization can realistically achieve. Finally, for many companies the level of their returns on capital will play a large role in shaping the rate

at which they can improve TSR, either through funding growth or through improving free-cash-flow yield.

Debating Alternative TSR Scenarios

Deriving a target for revenue growth from a company’s TSR target works well for companies with stable business models and a relatively normal risk profile. But many companies find themselves in a different situation. They face some discontinuity in the way they have traditionally created value and, therefore, need to rethink their value-creation strategy. This need for a more systematic rethinking can be appropriate in any number of situations. For example:

- High-growth companies with high valuation multiples eventually reach a point at which the growth rates of their core businesses begin to slow considerably. At that moment, they face a fundamental strategic choice: either to manage a “soft landing” in their growth rate and valuation multiple or to take on more risk—by adding new business models and market extensions or by using their “overvalued” stock as a currency to do M&A deals in an attempt to prolong high growth.
- Other companies find themselves serving businesses that are growing only modestly. These companies lack both the internal platforms to boost organic growth and sufficiently high returns on capital that would allow them to fund significant M&A. They face the strategic chal-

lence of migrating their business portfolio in order to increase growth, returns on capital, or both over the long term—while minimizing the impact on near-term TSR.

- Still other companies in cyclical or commodity businesses have enjoyed significant improvement in returns on capital in recent years and find themselves able to fund far more growth than their served markets will support in the long term. Here the challenge is deciding whether to leverage current prosperity (which, given the typical swing of commodity prices, may be temporary) in order to build platforms for future long-term TSR success or simply to maximize near-term TSR by paying out more cash.

In such situations, companies face distinct strategic choices. Often, these choices present fairly stark contrasts in terms of the degree of risk, the potential disruption to the expectations of current investors, the impact on near-term versus long-term TSR, and the consequences for a company's TSR aspirations. Frequently, individual senior executives and members of the company's board will have divergent, if not conflicting, points of view on the correct strategy to pursue.

When such conflicts occur, it can be extremely useful to develop and debate a set of alternative TSR strategy scenarios. The process begins with defining two or three different strategic paths the company could take and quantifying the characteristics of each one. Often, these different paths are closely aligned with the preferences of different investor groups that could buy the company's shares. (See the sidebar "Engaging with Dominant Investor Groups.")

Exhibit 10 illustrates three alternative TSR strategy scenarios based on the priorities and expectations of three different investor groups. The investor priorities described in the exhibit are illustrative, not exhaustive. There are many other possible investor styles that a company could consider and many additional factors that, depending on a company's specific situation, may be important. But at a high level, the differences illustrated in Exhibit 10 describe fairly common directional paths that many companies can take and, more often than not, capture the full range of perspectives that individual executives and board members have as they approach the challenge of charting a new path forward.

ENGAGING WITH DOMINANT INVESTOR GROUPS

A critical step for any company that is debating alternative TSR scenarios is to identify its dominant investors and listen closely to what they have to say. This is partly a matter of quantifying the mix of investor styles (value, income, growth at reasonable price, aggressive growth, and so forth) and determining which groups are overweighted (compared with market, industry, or peer-group averages) and therefore most attracted to the company's current value proposition.

But in addition to quantifying the investor mix, it is also essential to engage in a genuine dialogue with dominant investor groups. The senior team must go beyond what the company typically does in its investor-relations activities and analyst calls, and take the time to understand investors' attitudes and requirements. Fair disclosure requirements may limit the depth of information that management can share. But there is no law against asking investors good questions and listening carefully to

their answers. Who owns the company's shares and what are their priorities? Are the company's plans in sync with those priorities? Do current or desired investors find the company's growth plans credible? Savvy investors have strong—and often illuminating—views on all these questions.

When a company engages in such a dialogue, however, it is important to remember that learning more about what investors really want doesn't mean letting them determine the company's value-creation strategy—any more than learning about what customers really want means letting them determine a company's product strategy. The goal, rather, is to ensure that a company's strategy is informed by the perspectives and requirements of its investor base and then to work over time to achieve alignment between strategy and shareholders.¹

1. See "Treating Investors Like Customers," BCG Perspectives, June 2002.

EXHIBIT 10

THE PRIORITIES OF DIFFERENT INVESTOR GROUPS PROVIDE A STARTING POINT FOR ALTERNATIVE TSR STRATEGIES

Dimensions of TSR strategy	Value investors	GARP investors	Growth investors
Organic revenue growth	0%–4%	6%–8%	15% +
M&A growth priority	Low (small tuck-ins only)	Modest (tuck-ins)	High (consolidating)
Level and key driver of valuation multiple (P/E)	10–15x/free-cash-flow yield	18–24x/EPS growth	30x/revenue growth
Priority use of cash flow	High payout, low growth funding	Balanced payout and growth funding	All growth funding
Appetite for debt	Medium	Low	High
Target return on capital	Low to average, improving over time	High, stable	Escalating, improving with growth
EPS growth consistency	Low priority	High priority	Low priority
Risk factors	Large M&A	Debt volatility	Drop-off in growth

SOURCE: BCG analysis.

NOTE: GARP = growth at reasonable price.

Getting Ready to Grow

Often, the end result of debating alternative TSR scenarios will be a sequence of carefully crafted steps that balance management’s strategic goals, the priorities of current and desired investors, and a realistic appreciation of the company’s organizational capabilities. Such a strategy optimizes both near-term and long-term TSR and provides a clear pathway for the company’s growth strategy.

Take, for example, the experience of a major U.S. consumer-goods company that used this process to reorient its long-term growth agenda. For years, the company’s TSR had been stuck around the market average. A major reason the company couldn’t break through to superior performance was that its valuation multiple was low compared with those of its peers and had not improved.

The company’s senior executives were convinced that the problem was the company’s relatively anemic growth. Organic growth was only about 3 percent, whereas executives estimated that the company would need to grow at 8 percent in order to achieve their top-quartile TSR target. So the company embarked on a new growth strategy, featuring some high-profile acquisitions. These acquisitions successfully boosted earnings. And yet they had little impact on the valuation multiple and the company’s stock price.

The company’s value-creation challenge was, in fact, more complicated than the executives had initially

thought. An analysis of the company’s investor base showed that value investors predominated, and these investors were not rewarding the company for growth. At the same time, the company’s management team had yet to establish the kind of track record that would attract more growth-oriented investors who might have welcomed a more aggressive growth strategy. This misalignment between the company’s growth strategy and its investors’ preferences meant that the company’s moves had little impact on its weak multiple, trapping the company’s stock price in a suboptimal equilibrium.

This insight caused senior management to step back and reassess the role of growth in its value-creation strategy. The executives analyzed two distinct TSR strategy scenarios. The company could maximize its appeal to value investors—for example, by increasing dividend payout and downplaying growth. Or it could recruit growth-at-reasonable-price (GARP) investors by using acquisitions even more aggressively to migrate its portfolio to businesses with more potential for organic growth.

Neither alternative was ideal. The value scenario would significantly improve near-term TSR but leave the company with a weak future TSR potential. And yet migrating the company’s portfolio to higher-growth businesses, whatever its long-term impact, ran the risk of causing value investors to flee the company’s stock before GARP investors were confident enough about the company’s future prospects to buy it—thus destroying TSR performance in the near term.

The solution was to reframe the company's value-creation strategy in terms of three sequential steps. Given the dominance of value investors in the company's investor mix, the first step was to optimize the company's margins, multiple, and free-cash-flow yield. The company needed to prune low-margin businesses and reinvest in businesses with higher margins. At the same time, it had to boost dividends and limit debt, all the while emphasizing management's commitment to the priorities of value investors in its investor-relations activities.

In parallel, however, the company also needed to continue to create the conditions for future growth. In the near term, that meant limiting itself to a few modest tuck-in acquisitions with a relatively high hurdle rate, and also building some key internal platforms that would be necessary to support its long-term growth agenda. For example, the company needed to put in place improved processes and capabilities to support organic growth and innovation, and to make sure it had the right managerial skills and the right incentives to encourage growth.

As its relative valuation multiple began to rise under the impact of its new financial policies, the company could start appealing directly to more growth-oriented investors—for example, by making major acquisitions to migrate the portfolio so that it

could consistently deliver organic growth in the neighborhood of 6 to 8 percent and by clearly distinguishing between those business units and brands that would *fund* future growth and those that would be the *engines* of such growth.

The ultimate goal, to be implemented over a five-year period, is a full-fledged growth agenda: to increase M&A as the multiple increases, to continue migrating the business portfolio to more growth-oriented but relatively low-risk businesses, and, over time, to build advanced management capabilities that deliver consistent performance and earn credibility with new investors.

It is still early in this reorientation process, and much can change as the economy and the company's competitive position evolve. Still, initial signs are encouraging. In the six months since refining its investor-relations strategy and then significantly increasing its dividend payout, the company's TSR outpaced the market average by 22 percentage points. The company is building the kind of reputation with investors that over time will translate into support for its long-term growth strategy and will ensure that that strategy is properly valued by the capital markets. At a time when creating value from growth is becoming more and more of a challenge, no company can ask for more.

Ten Questions About Growth That Every CEO Should Know How to Answer

In conclusion, we offer ten questions about the role of growth in value creation that every CEO should know how to answer. The questions synthesize the basic arguments and recommendations made in this year's report in a concise format.

1. *What is your TSR aspiration?* Is that aspiration appropriate given the expectations embedded in your stock price and the ability of your plans to deliver improved performance?
2. *How much growth do you need in order to deliver on that aspiration?* What target revenue-growth rate is required in order to meet your goal given the momentum contribution of other TSR drivers?
3. *Will optimizing growth and margins in your existing businesses be sufficient to meet your goal?* Or will TSR success require you to consider a more radical strategy?
4. *What drives the differences in valuation multiples in your industry?* Will your growth plans enhance or erode your multiple relative to peers?
5. *Will your growth initiatives create more TSR than alternative uses of cash or capital?* In particular, what would be the impact of increasing dividend payout rather than investing in growth?
6. *Is your investor mix aligned with your growth agenda?* If not, do you have a plan for migrating to investors who are likely to be more closely aligned with your strategy?
7. *Is there a balance between your sustainable growth rate and the growth rate of your served markets?* If not, what is your plan for effectively using excess cash to optimize TSR?
8. *How will today's growth initiatives affect your ability to fund growth and deliver superior TSR in the future?* In particular, what will be the impact of your growth initiatives on your company's average return on capital?
9. *Do you need to revisit your company's TSR target and strategy in light of your answers to the above questions?* If so, do you have a process in place for doing so?
10. *Are your management team, board, and investors aligned on the optimal role for growth in achieving your TSR objectives?* If not, do you have a plan for creating such an alignment?

Appendix: The 2006 Value Creators Rankings

The 2006 Value Creators rankings are based on an analysis of total shareholder return at 1,056 global companies for the five-year period from 2001 through 2005.

To arrive at this sample, we began with TSR data for some 5,000 companies provided by Thomson Financial Worldscope. We eliminated all companies that were not listed on some world stock exchange for the full five years of our study or did not have at least 25 percent of their shares available on public capital markets. We also eliminated certain industries from our sample—for example, financial services.⁹ We further refined the sample by organizing the remaining companies into 14 industry groups and establishing an appropriate market-valuation hurdle to eliminate the smallest companies in each industry. (The size of the market-valuation hurdle for each individual industry can be found in the tables in the “Industry Rankings,” beginning on page 35.) In addition to our 1,056-company sample, we also separated out those companies with market valuations of more than \$35 billion. We have included rankings for these large-cap companies in the “Global Rankings,” on pages 33 and 34.

The global and industry rankings are based on five-year TSR performance from 2001 through 2005.¹⁰ We also show TSR performance for 2006, through June 30. In addition, we break down TSR performance into key operational and financial metrics. First, for every company, we calculate the growth (or decline) in fundamental value and in expectation premiums (the difference between a company’s actual stock price and the price derived from a discounted-cash-flow analysis of its underlying fundamentals) for the five-year period from 2001 through 2005. Second, we break down TSR performance into the six investor-oriented financial metrics used in the BCG decomposition model described on pages 9 and 10.

The average annual return for the 1,056 companies in our sample was 2 percent. Although this is an extremely modest return, it reflects the beginnings of the revival of global capital markets after the massive loss of value caused by the bursting of the late-1990s financial bubble.

What kind of improvement in TSR was necessary to achieve top-quartile status, given the sample average? The exhibit “Average Annual Total Shareholder Return by Quartile, 2001–2005,” on page 31, arrays the 1,056 companies in our global sample according to their five-year TSR performance. In order to achieve top-quartile status, companies needed to post an average annual TSR of at least 21.5 percent. The very best performers had returns of 60 percent and higher.

The modest TSR performance for the sample as a whole hides quite good performance in terms of improved fundamentals. The exhibit “Change in Fundamental Value and Expectation Premiums, 2001–2005,” on page 32, uses a discounted-cash-flow analysis to compare the trend in fundamental value and expectation premium for three groups: the 1,056 companies in our global sample, the 106 companies in the top-performing decile of this sample, and the top ten global performers. The sample as a whole improved its fundamental value by 5 percent per year; however, this improvement in fundamentals was counteracted by the major meltdown in expectations, which declined by an average 18 percent per year.

The top decile, by contrast, improved its fundamental value by 13 percent annually. What’s more, these companies were able to reverse what in 2000 was a negative expectation premium of –30 percent (in other words, the market valued these companies at a full 30 percent *less* than what one would expect from an analysis of their fundamental value) and turn it into a positive expectation premium of 20

9. We chose to exclude financial services because measuring value creation in the sector poses unique analytical problems that make it difficult to compare the performance of financial-services companies with companies in other sectors. For BCG’s view of value creation in financial services, see *How the World’s Top Performers Managed Profitable Growth: Creating Value in Banking 2006*, BCG report, May 2006.

10. TSR is a dynamic ratio that includes price gains and dividend payments for a specific stock during a given period of time. To measure performance from 2001 through 2005, 2000 end-of-year data must be used as a starting point in order to capture the change from 2000 to 2001, which drives 2001 TSR. For this reason, all exhibits in the report showing 2001–2005 performance begin with a 2000 data point.

percent by 2005. As a result, they achieved an average annual TSR of 44 percent.

Finally, the top ten global performers were able to use a truly extraordinary growth in fundamental value (33 percent per year) to exceed investor expectations and turn a negative expectation premium of -51 percent in 2000 into a positive expectation premium of 25 percent in 2005. The average annual TSR of the top ten was 78 percent.

There were also interesting variations across the 14 industries in our sample. Exhibit 11, below, and Exhibit 12, on page 30, show the decomposition of TSR performance by industry for the sample as a whole and for the top ten companies in each industry, respectively. A few key trends stand out:

- As befits the subject of this year’s report, top-line growth was a major driver of value creation. In 10

of the 14 industries studied, sales growth was the dominant single driver of TSR, on average. What’s more, in 9 of the 14 industries, sales growth at the top ten companies accounted for double-digit TSR, on average. Finally, growth’s contribution to TSR at the global top ten was more than six times that for the sample average (25 percentage points versus 4 percentage points).

- For average performers in most industries, sales growth did not come with much improvement in margins. For the top performers, however, it did. The top ten companies in 11 of the 14 industries improved margins. And the top ten in the best-performing industry (retail) did so by as much as 13 percentage points. This performance reflects the successes that many top-performing companies have had during this period in turning around their businesses and making them more consistently profitable.

EXHIBIT 11

FOR THE BEST-PERFORMING INDUSTRIES, TOP-LINE GROWTH IS A MAJOR DRIVER OF VALUE



SOURCES: Thomson Financial Worldscope; Thomson Financial Datastream; Bloomberg; annual reports; BCG analysis.

NOTE: Decomposition shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

¹Five-year average annual TSR (2001–2005) for weighted average of respective sample.

- In some industries—for example, the pharmaceutical and biotech sector—returns from healthy growth and margin improvement were offset by declines in valuation multiples. Although sales growth was responsible for 8 percentage points of TSR in this sector, and margin improvement an additional 2 percentage points, changes in multiples were responsible for the loss of 12 percentage points, giving that industry a five-year average annual TSR of –2 percent.
- Returning cash to investors was a positive contributor of shareholder value, on average, in 9 of the 14 industries studied. For the top performers, it

was a major source of TSR in all but two industries. In particular, the top performers created substantial TSR—in some cases, more than 20 percentage points—by reducing debt, again a reflection of efforts by global companies in recent years to put their balance sheets on a sounder footing.

- In conclusion, the top performers not only enjoyed far more growth than the average company but also benefited from major improvements in margins, multiples, and yields. This was the case in 9 of the 14 industries we studied.

EXHIBIT 12

THE TOP PERFORMERS IN MOST INDUSTRIES SUCCESSFULLY MANAGE ALL THREE DRIVERS OF VALUE CREATION



SOURCES: Thomson Financial Worldscope; Thomson Financial Datastream; Bloomberg; annual reports; BCG analysis.

NOTE: Decomposition shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

¹Five-year average annual TSR (2001–2005) for weighted average of top ten companies.

Global Rankings

Total Global Sample

THE GLOBAL TOP TEN, 2001–2005

#	Company	Country	Industry	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
							Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	URBAN OUTFITTERS	UNITED STATES	RETAIL	91.1	4.168	35	28	6	62	0	-3	-3	-30.9
2	TRACTOR SUPPLY	UNITED STATES	RETAIL	90.2	2.082	37	28	9	40	0	-2	15	4.4
3	HYUNDAI MOBIS	SOUTH KOREA	AUTOMOTIVE	87.6	7.846	26	39	-4	21	15	-1	17	-13.1
4	PUMA	GERMANY	CONSUMER GOODS	82.5	4.916	-10	38	30	10	1	0	3	24.1
5	CHICO'S FAS	UNITED STATES	RETAIL	80.1	7.950	4	54	7	22	0	-3	0	-38.6
6	EDGARS STORES	SOUTH AFRICA	RETAIL	76.7	2.987	25	19	8	27	10	5	8	-14.6
7	CAEMI ⁷	BRAZIL	MINING AND MATERIALS	74.1	5.752	24	34	19	0	3	0	18	N/A
8	METCASH	AUSTRALIA	RETAIL	71.5	2.460	31	7	13	26	6	-7	26	-15.7
9	BOYD GAMING	UNITED STATES	TRAVEL AND TOURISM	70.3	4.253	17	16	4	22	1	-6	32	-14.9
10	GLAMIS GOLD	CANADA	MINING AND MATERIALS	67.9	3.618	84	28	43	10	0	-11	-2	32.4

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 1,056 global companies.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

³As of December 31, 2005.

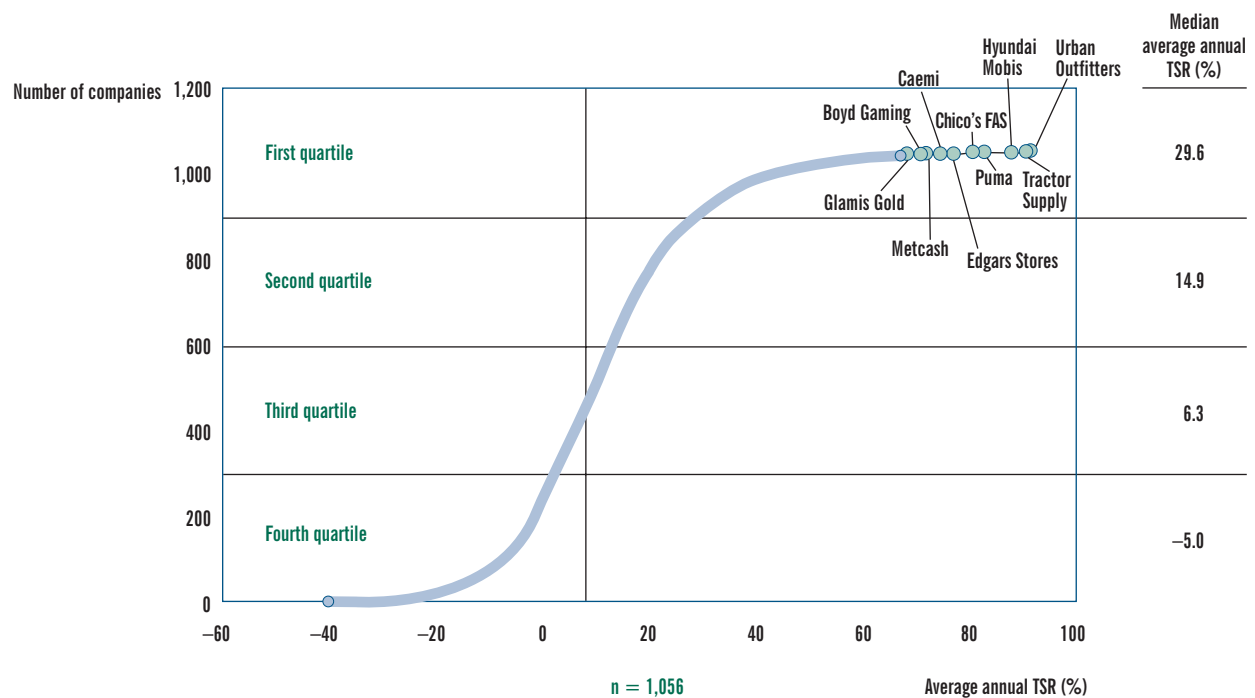
⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

⁷Caemi was delisted in May 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

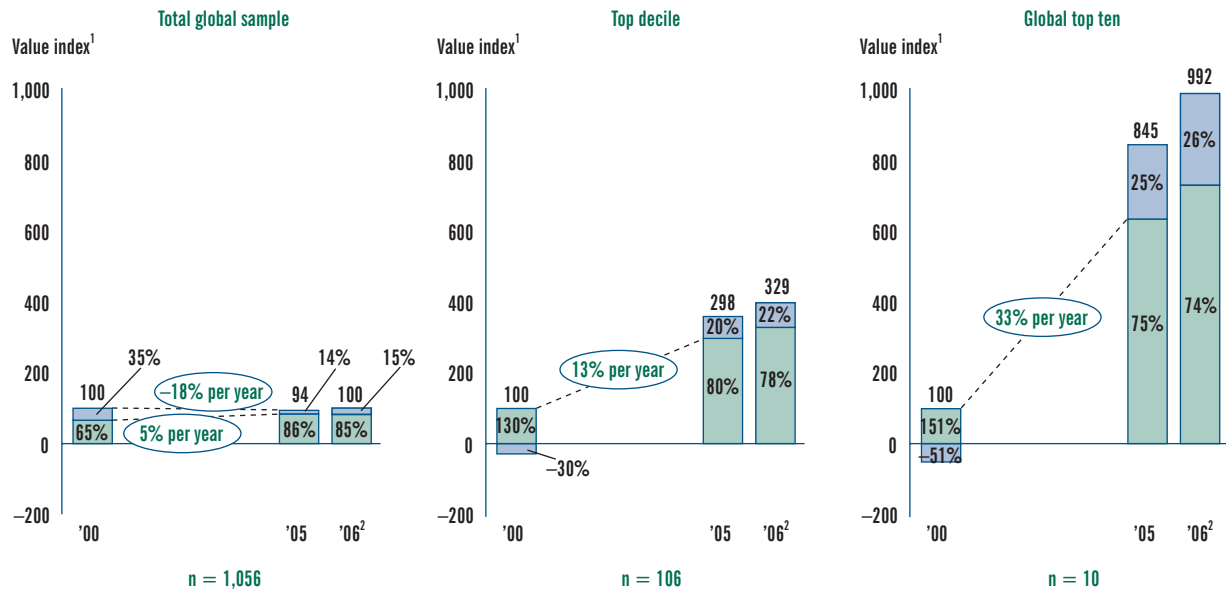


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data; values shown for top ten companies only.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



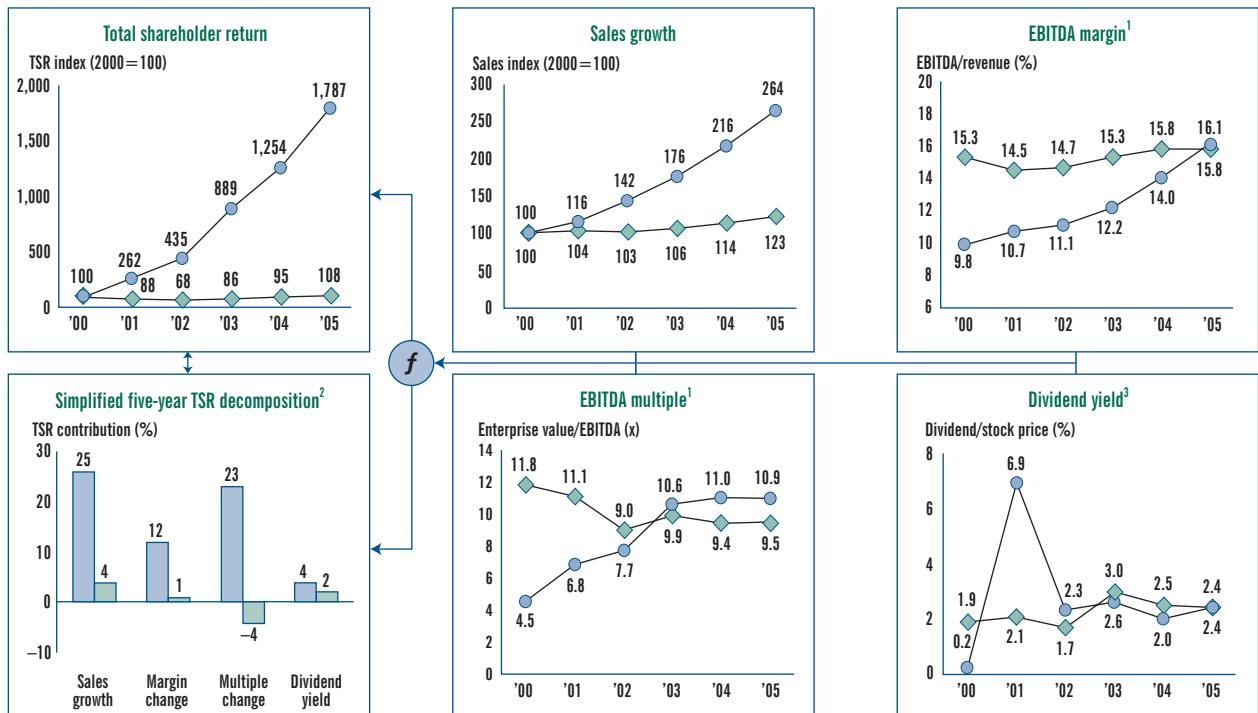
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS GLOBAL SAMPLE, 2001–2005

● Global top ten ◆ Total sample, n = 1,056



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE LARGE-CAP TOP TEN, 2001–2005

#	Company	Country	Industry	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
							Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	APPLE COMPUTER	UNITED STATES	TECHNOLOGY	57.4	60.587	32	11	8	66	0	-5	-22	-20.3
2	VALE DO RIO DOCE	BRAZIL	MINING AND MATERIALS	53.5	45.807	38	31	7	2	10	0	3	10.7
3	EBAY	UNITED STATES	RETAIL	39.3	60.239	78	54	15	-23	0	-6	-1	-32.2
4	SAMSUNG ELECTRONICS	SOUTH KOREA	TECHNOLOGY	35.3	96.171	37	13	-9	17	2	1	10	-8.5
5	SOFTBANK	JAPAN	TECHNOLOGY	30.7	44.517	48	14	-13	29	0	-1	1	-48.5
6	BRIT. AMERICAN TOBACCO	UNITED KINGDOM	CONSUMER GOODS	27.4	47.558	31	-3	4	14	7	1	4	7.2
7	MITSUBISHI CORPORATION	JAPAN	MULTIBUSINESS	26.8	37.225	-10	6	10	-3	2	0	12	-11.7
8	LOWE'S	UNITED STATES	RETAIL	24.8	52.123	35	19	6	-1	0	0	0	-8.8
9	BHP BILLITON	AUSTRALIA	MINING AND MATERIALS	24.1	59.916	7	17	-1	3	3	1	1	28.4
10	CATERPILLAR	UNITED STATES	MACHINERY AND CONSTR.	22.5	39.296	14	13	1	2	3	0	3	29.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 100 global companies with a market valuation greater than \$35 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

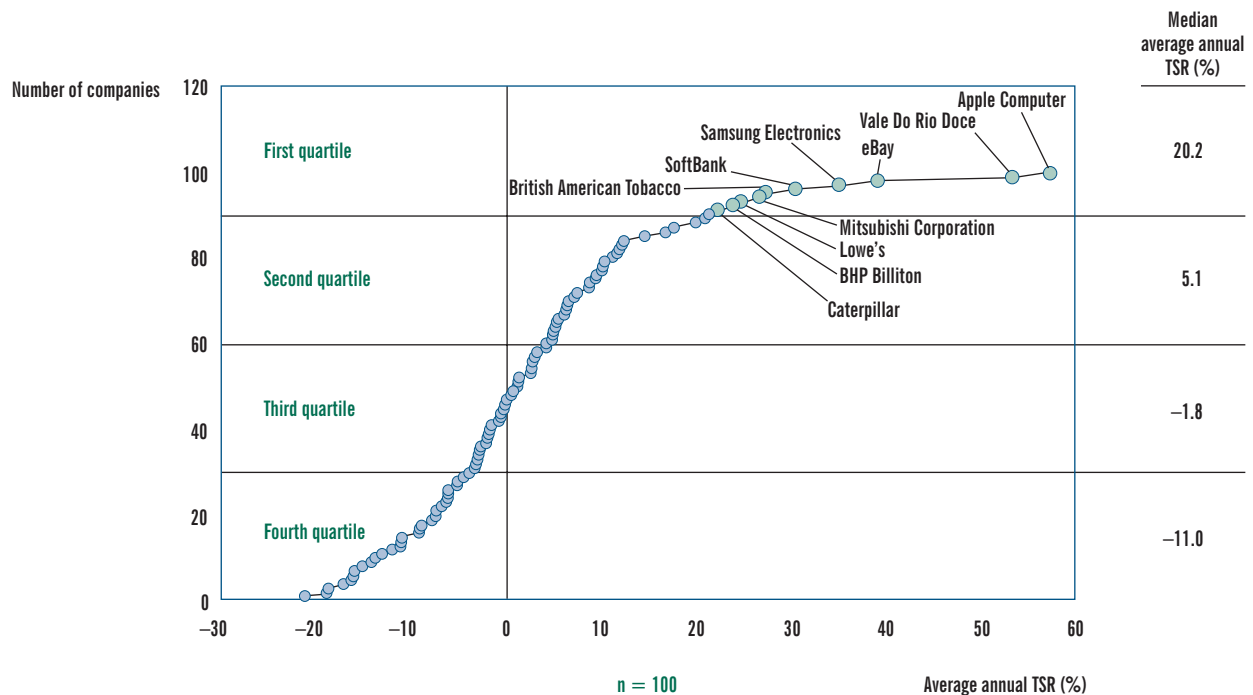
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

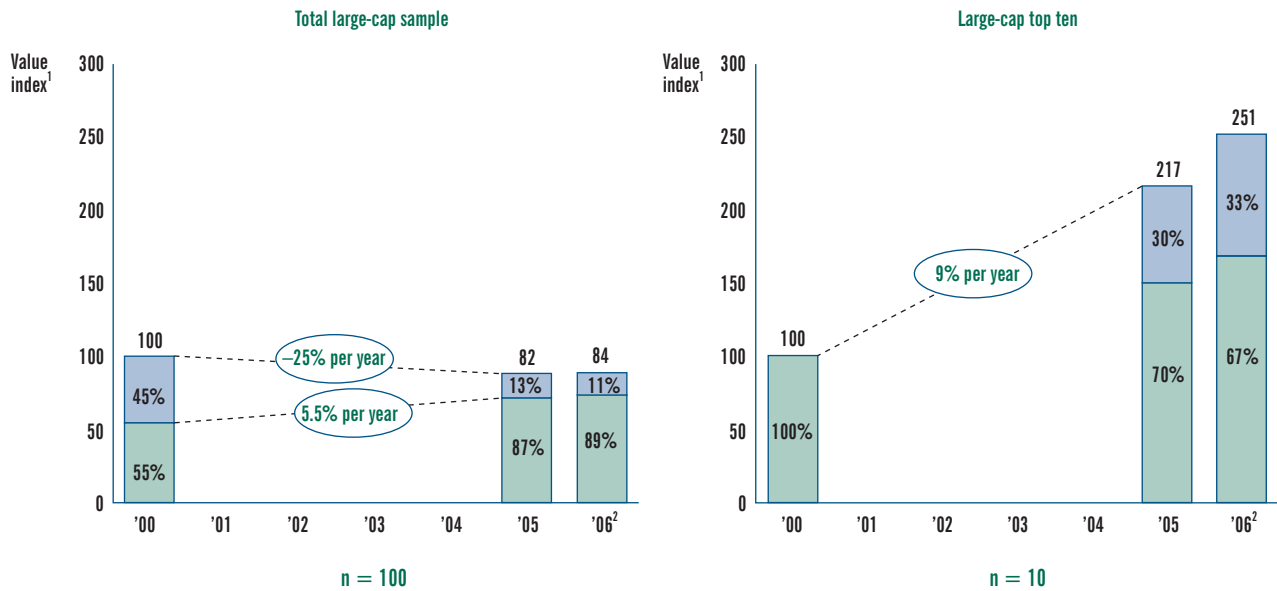


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



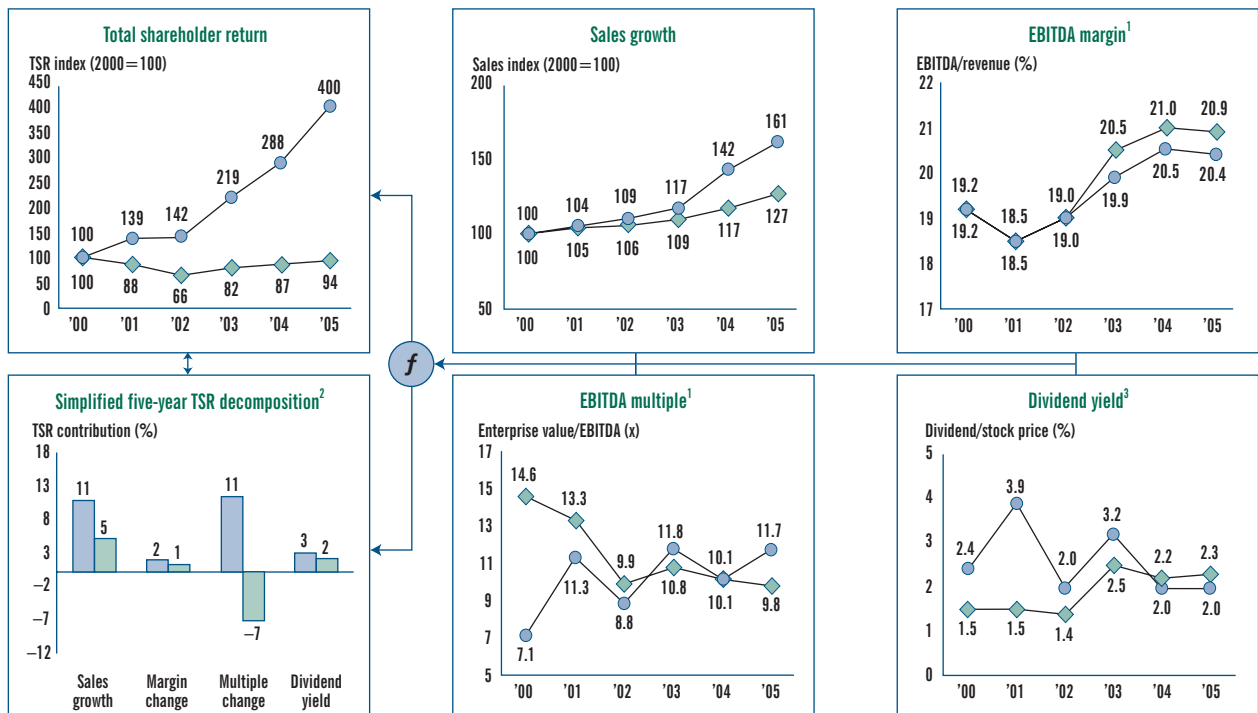
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS GLOBAL SAMPLE, 2001–2005

● Large-cap top ten ◆ Total sample, n = 100



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Industry Rankings

Automotive and Supply

THE AUTOMOTIVE TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	HYUNDAI MOBIS	SOUTH KOREA	87.6	7,846	26	39	-4	21	15	-1	17	-13.1
2	HANKOOK TIRE	SOUTH KOREA	57.8	2,120	7	14	1	3	5	-1	34	-21.8
3	BAJAJ AUTO	INDIA	56.7	4,494	28	14	-3	39	3	4	0	38.9
4	HYUNDAI MOTOR	SOUTH KOREA	56.7	21,117	-13	13	-4	15	6	-3	29	-17.2
5	MAHINDRA & MAHINDRA	INDIA	52.0	2,642	19	23	-1	22	6	-1	3	23.3
6	TATA MOTORS	INDIA	50.3	5,454	28	23	22	-7	2	-7	17	23.7
7	ASTRA INTERNATIONAL	INDONESIA	48.4	4,199	7	18	3	1	3	-4	28	-1.0
8	HERO HONDA MOTORS	INDIA	45.1	3,811	31	29	3	3	7	0	2	-7.9
9	CONTINENTAL	GERMANY	37.1	12,936	15	7	10	5	3	-3	15	8.0
10	DENWAY MOTORS	HONG KONG	36.2	2,497	51	2	13	23	3	-3	-2	4.3

SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

NOTE: n = 62 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

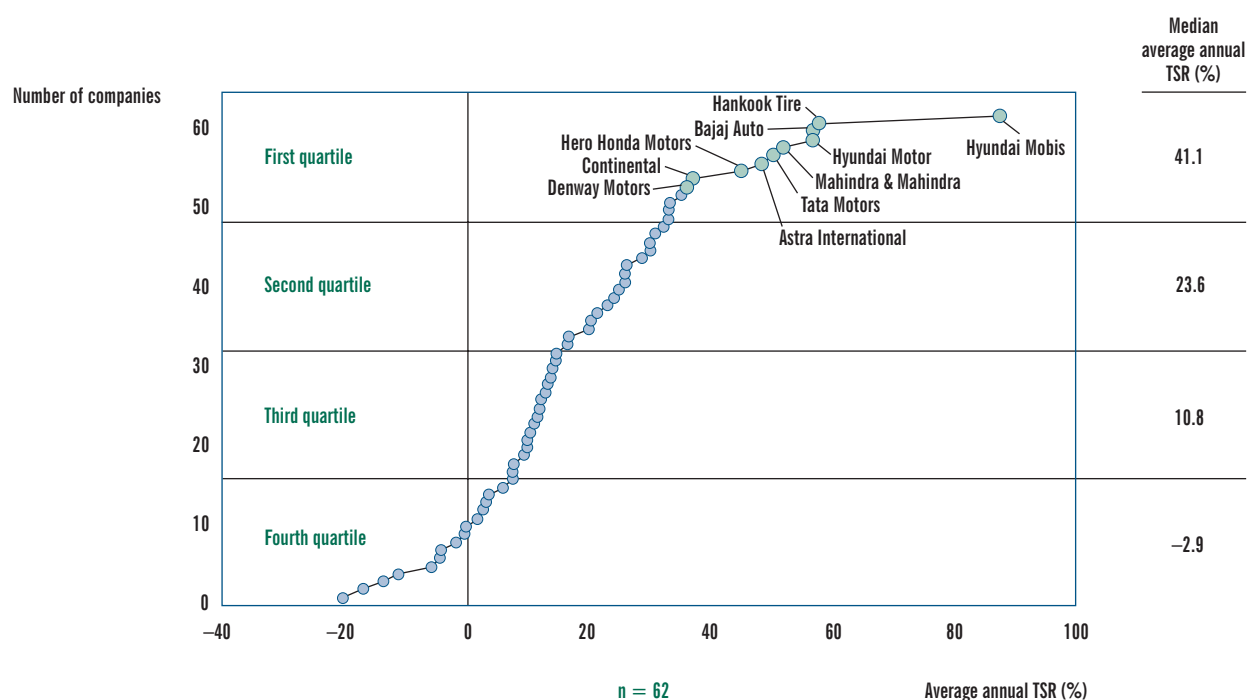
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

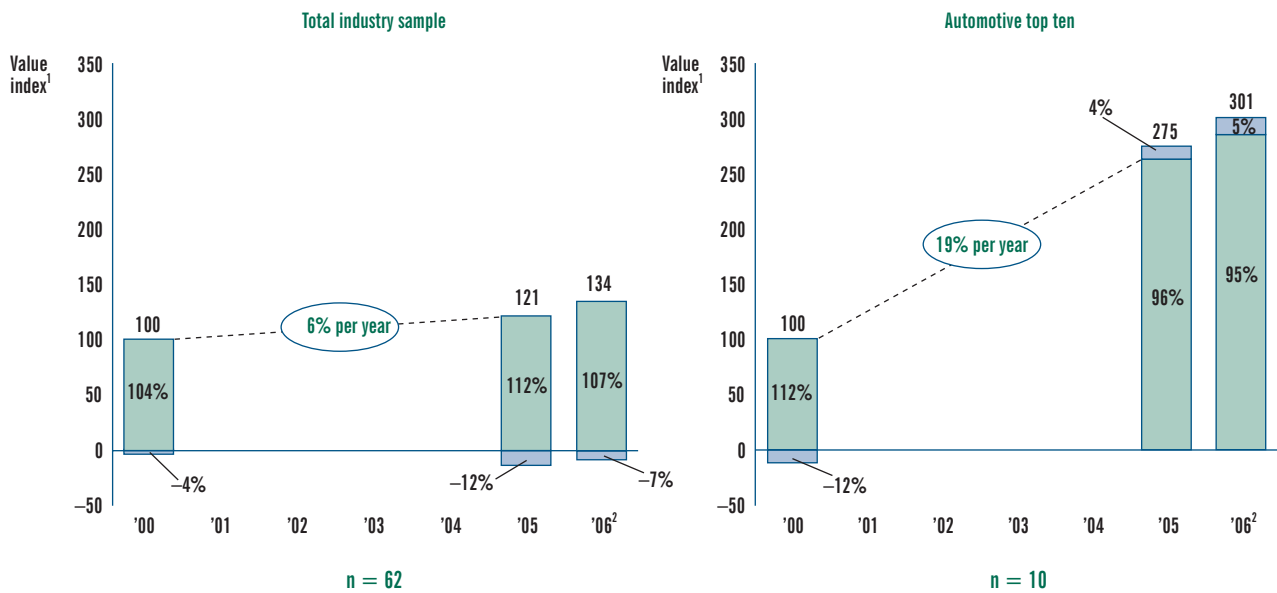


SOURCES: Thomson Financial Datastream; BCG analysis.

NOTE: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



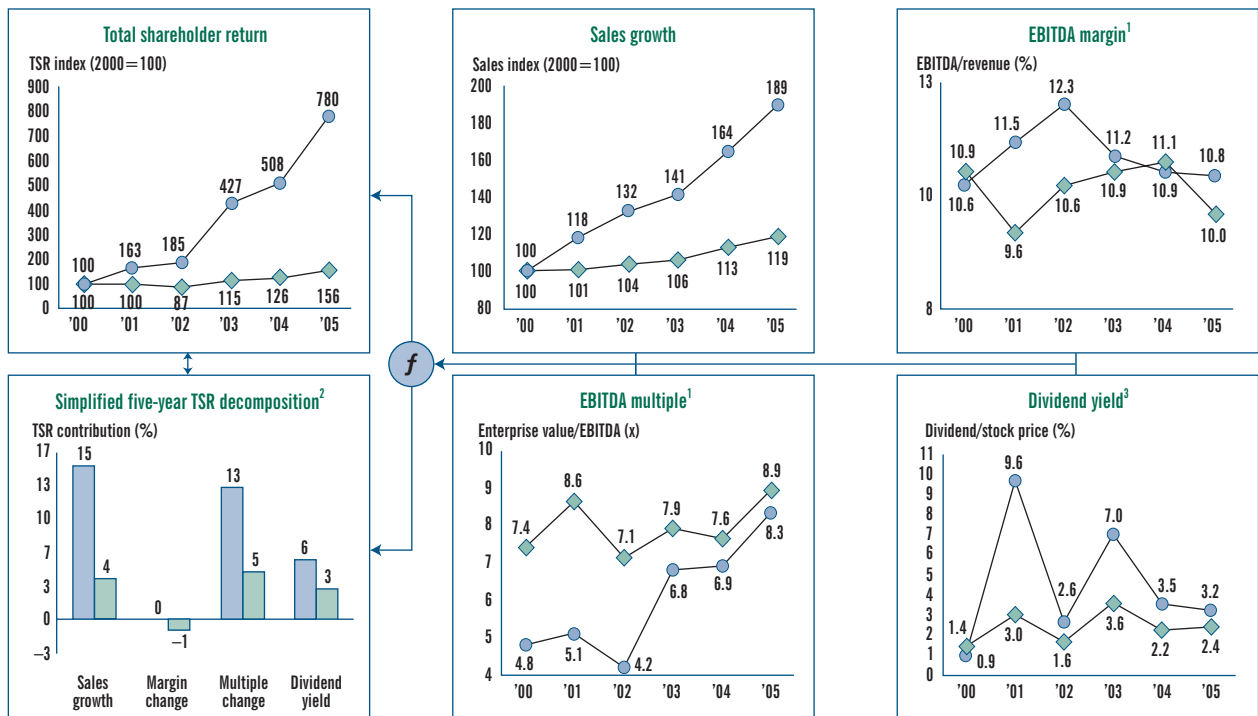
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Automotive top ten ◆ Total sample, n = 62



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE CHEMICAL TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	QUIMICA Y MINERA DE CHILE	CHILE	40.3	2.879	44	12	2	12	4	0	11	2.2
2	ORICA	AUSTRALIA	34.8	4.652	36	7	8	8	6	0	6	18.9
3	ISRAEL CHEMICALS	ISRAEL	34.7	5.016	32	13	2	1	5	-1	14	2.4
4	ZEON	JAPAN	31.7	3.201	27	7	4	9	1	0	10	-12.3
5	TOKUYAMA	JAPAN	29.2	3.540	-9	1	0	14	2	0	13	12.4
6	FORMOSA CHEMICALS & FIBRE	TAIWAN	29.2	8.661	18	22	1	-4	5	0	5	-5.7
7	K+S	GERMANY	28.9	2.567	16	6	-1	23	5	0	-5	26.9
8	mitsubishi gas chemical	JAPAN	28.1	4.570	-14	7	9	3	2	2	6	18.2
9	NIPPON SHOKUBAI	JAPAN	26.6	2.205	-28	4	6	9	2	1	4	5.4
10	UMICORE	BELGIUM	26.4	3.042	22	11	-9	20	3	-1	2	6.0

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 78 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

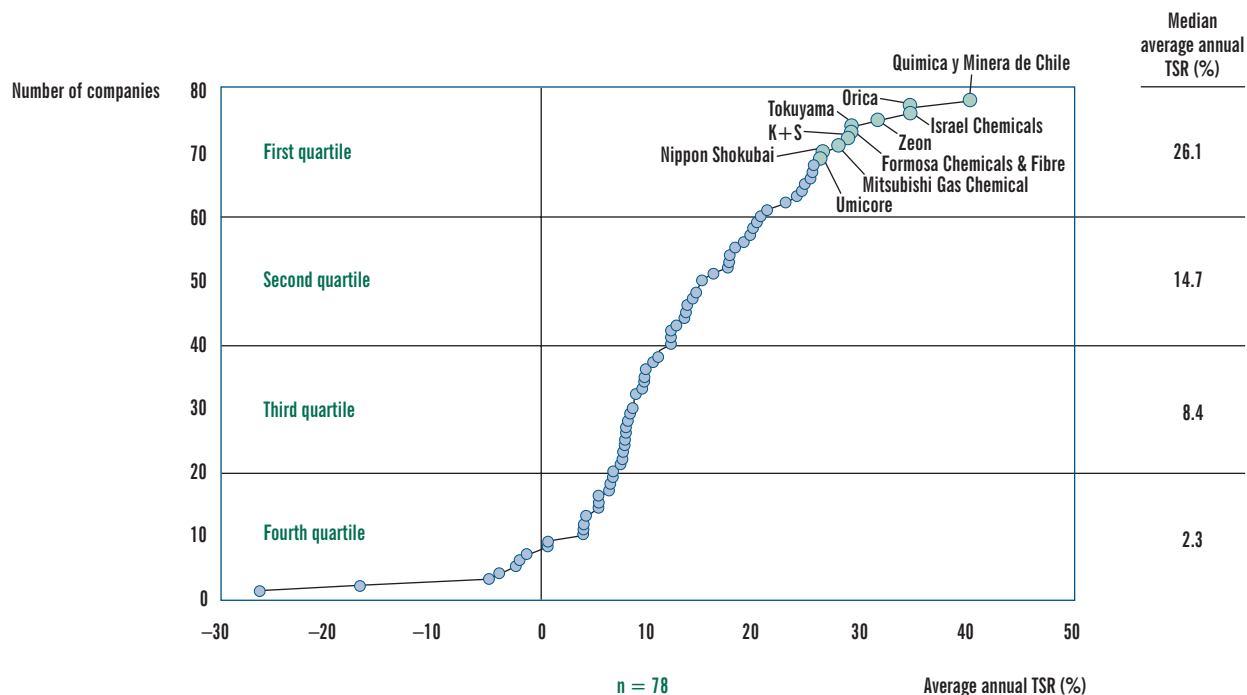
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

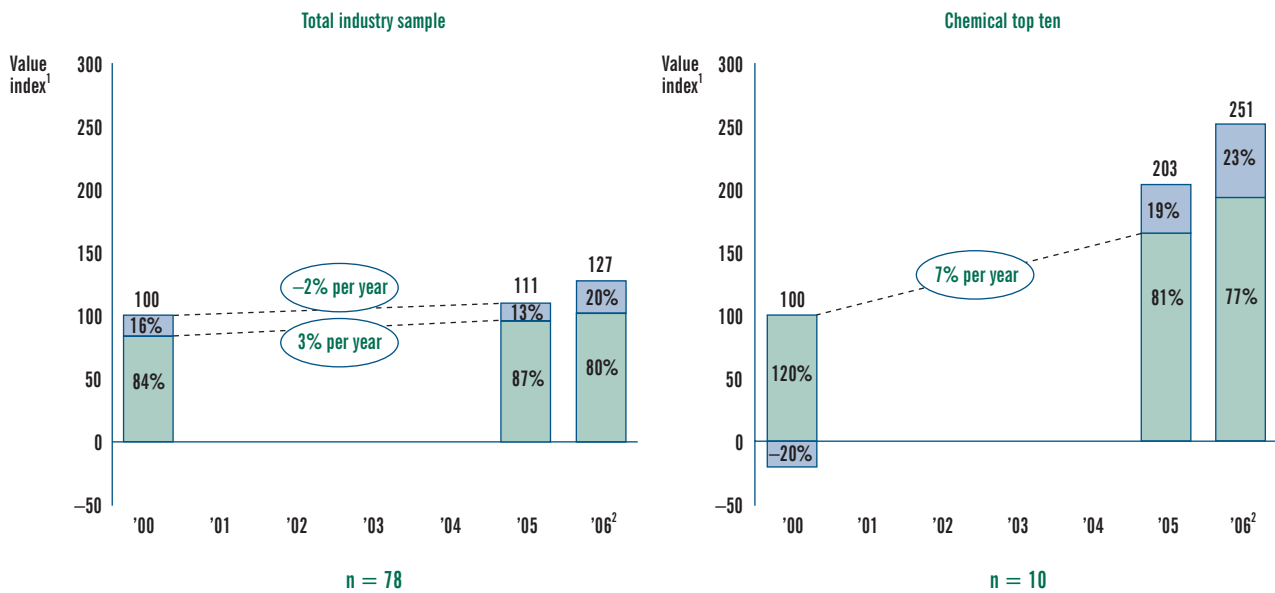


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



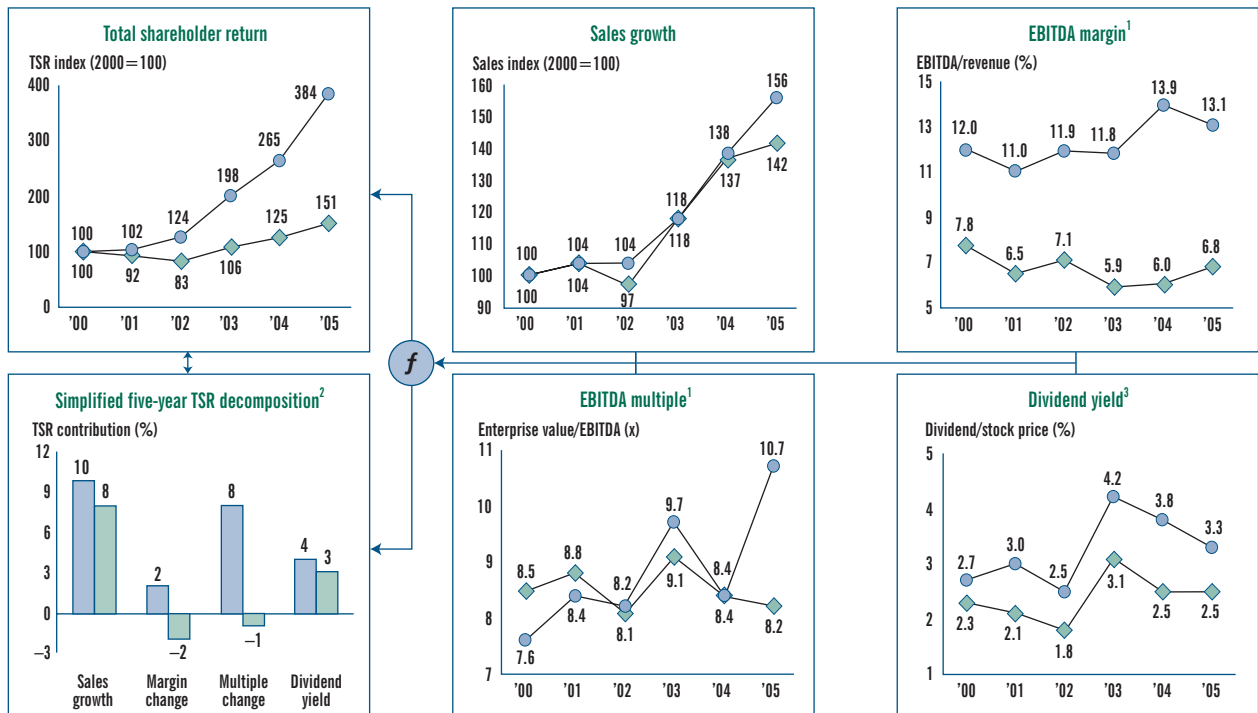
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Chemical top ten ◆ Total sample, n = 78



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Consumer Goods

THE CONSUMER GOODS TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	PUMA	GERMANY	82.5	4.916	-10	38	30	10	1	0	3	24.1
2	COACH	UNITED STATES	56.1	12.671	55	28	25	8	0	-5	1	-10.3
3	HARMAN INTERNATIONAL	UNITED STATES	40.1	6.445	51	14	8	13	0	0	4	-12.7
4	YUE YUEN INDUSTRIAL	HONG KONG	32.2	4.523	33	13	-5	19	6	-3	1	0.6
5	IMPERIAL TOBACCO	UNITED KINGDOM	29.8	21.215	32	20	-1	6	5	-3	2	-1.6
6	CONSTELLATION BRANDS	UNITED STATES	29.0	5.798	27	12	5	12	0	-8	7	-4.7
7	KT&G	SOUTH KOREA	28.4	7.250	-11	8	4	8	9	4	-4	23.0
8	BRIT. AMERICAN TOBACCO	UNITED KINGDOM	27.4	47.558	31	-3	4	14	7	1	4	7.2
9	MOHAWK INDUSTRIES	UNITED STATES	26.0	5.818	21	14	0	18	0	-5	-2	-19.1
10	FORTUNE BRANDS	UNITED STATES	25.1	11.400	35	5	4	14	3	1	-1	-8.2

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 104 companies with a market valuation greater than \$4 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

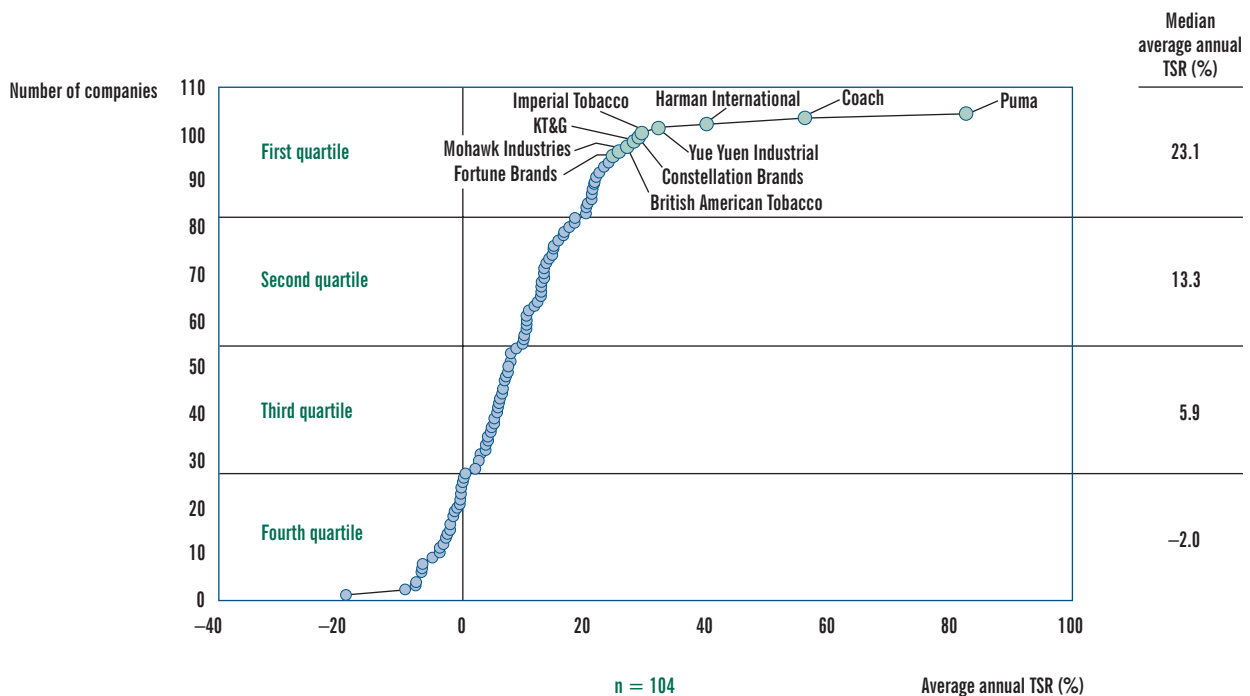
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

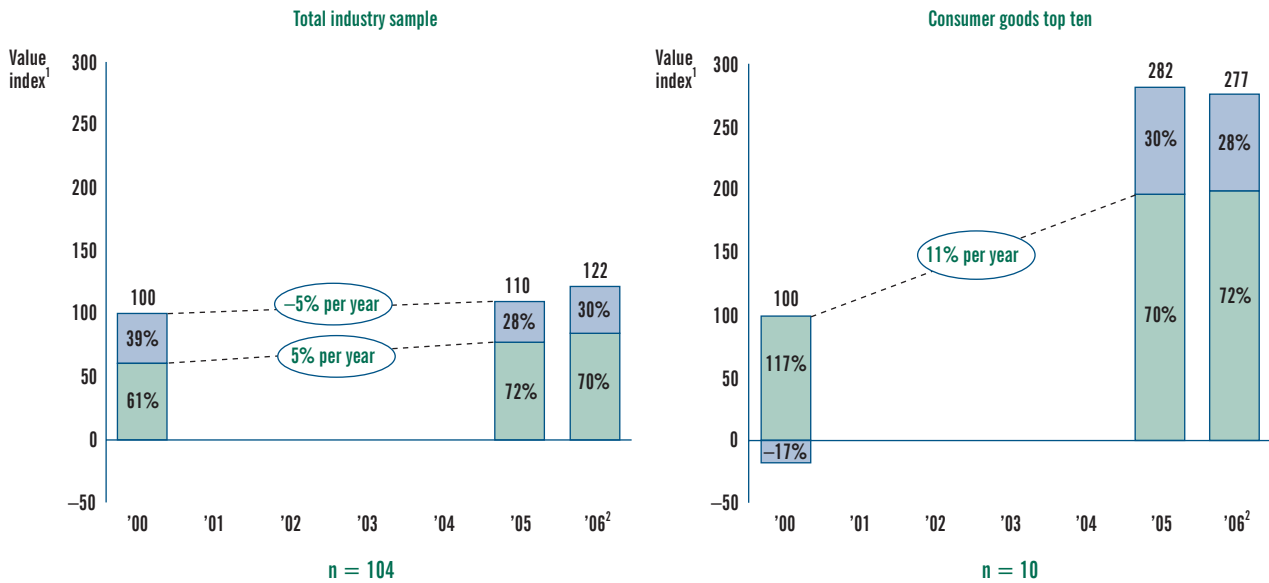


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

Expectation premium Fundamental value



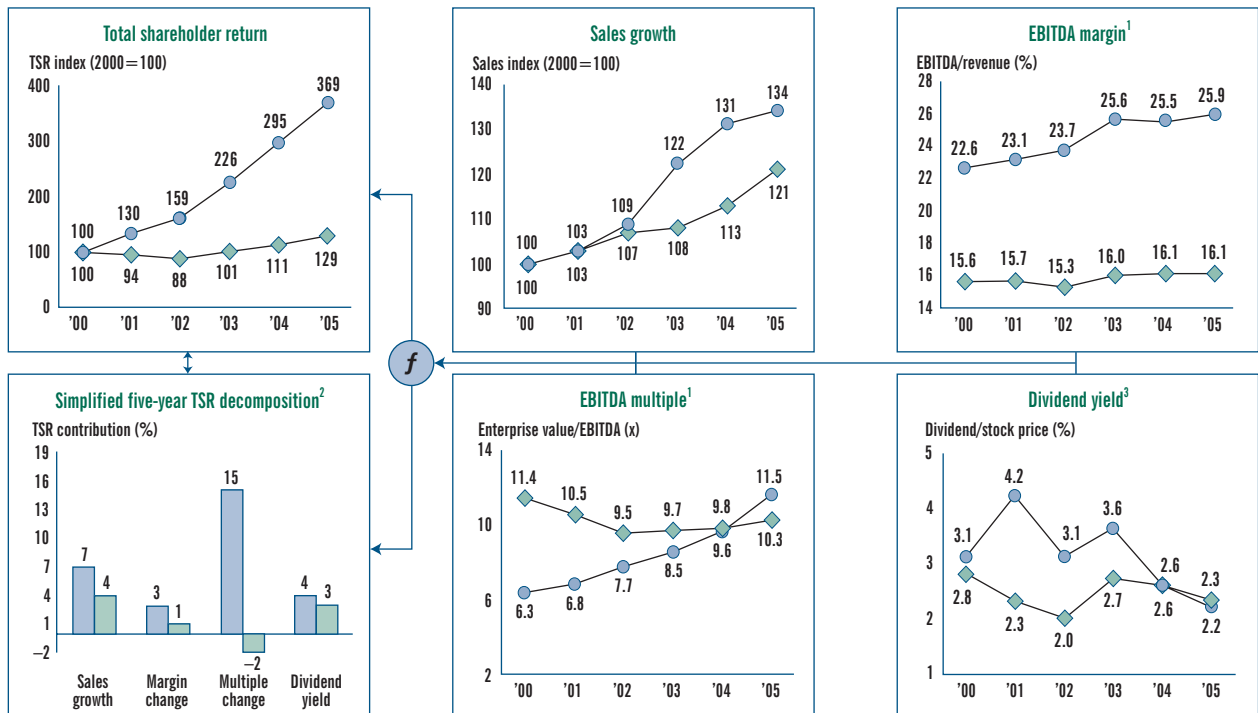
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

Consumer goods top ten Total sample, n = 104



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Machinery and Construction

THE MACHINERY AND CONSTRUCTION TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	LARSEN & TOUBRO	INDIA	61.2	5.518	51	17	-8	29	5	-1	19	21.6
2	BHARAT HEAVY ELECTRICALS	INDIA	55.6	7.532	48	11	7	34	3	0	1	41.3
3	PERSIMMON	UNITED KINGDOM	44.3	6.305	26	26	9	9	6	-9	4	-0.5
4	SUMITOMO HEAVY INDUSTRIES	JAPAN	41.2	5.057	-7	-2	19	-2	0	0	26	7.1
5	D.R. HORTON	UNITED STATES	38.7	11.186	9	31	14	-6	2	-6	6	-32.9
6	GRUPO FERROVIAL	SPAIN	36.1	9.710	10	21	8	-4	2	-1	9	2.8
7	KOMATSU	JAPAN	32.7	16.517	8	7	10	4	2	0	10	17.2
8	SKF	SWEDEN	32.1	6.383	23	5	1	19	5	0	3	5.0
9	SACYR VALLEHERMOSO	SPAIN	31.0	6.690	11	47	-5	7	3	-15	-7	32.6
10	ROCKWELL AUTOMATION	UNITED STATES	30.1	10.598	28	2	2	19	3	0	4	22.5

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 81 companies with a market valuation greater than \$5 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

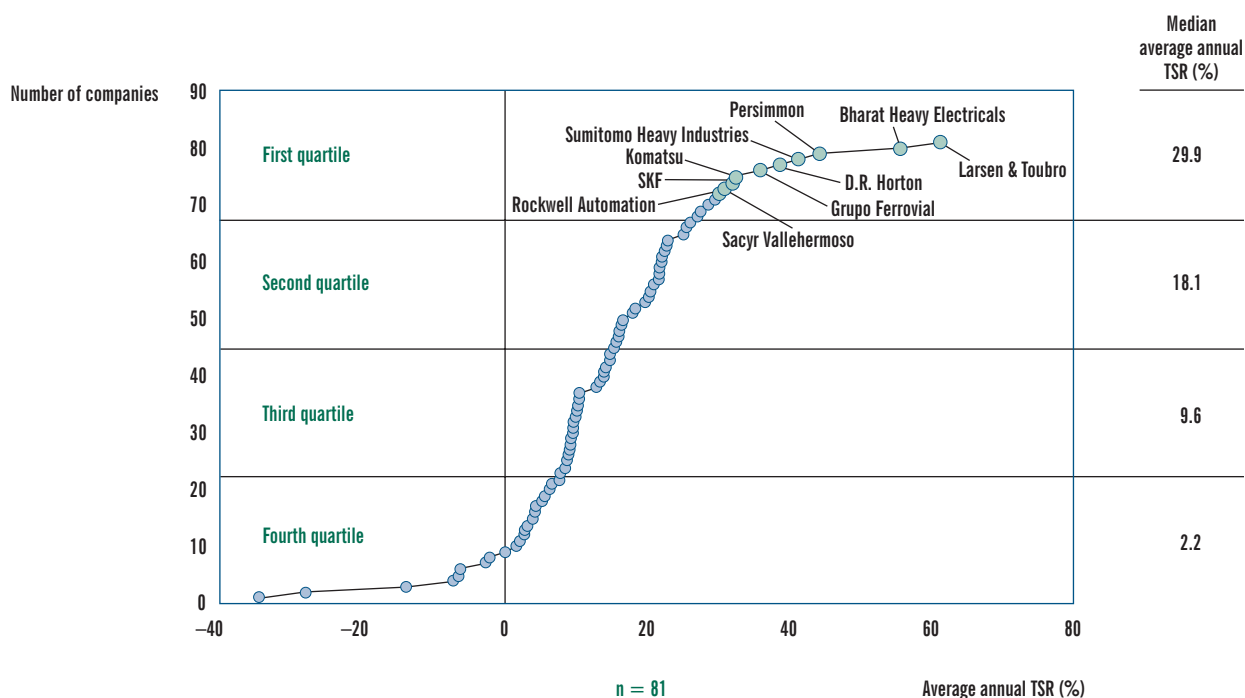
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

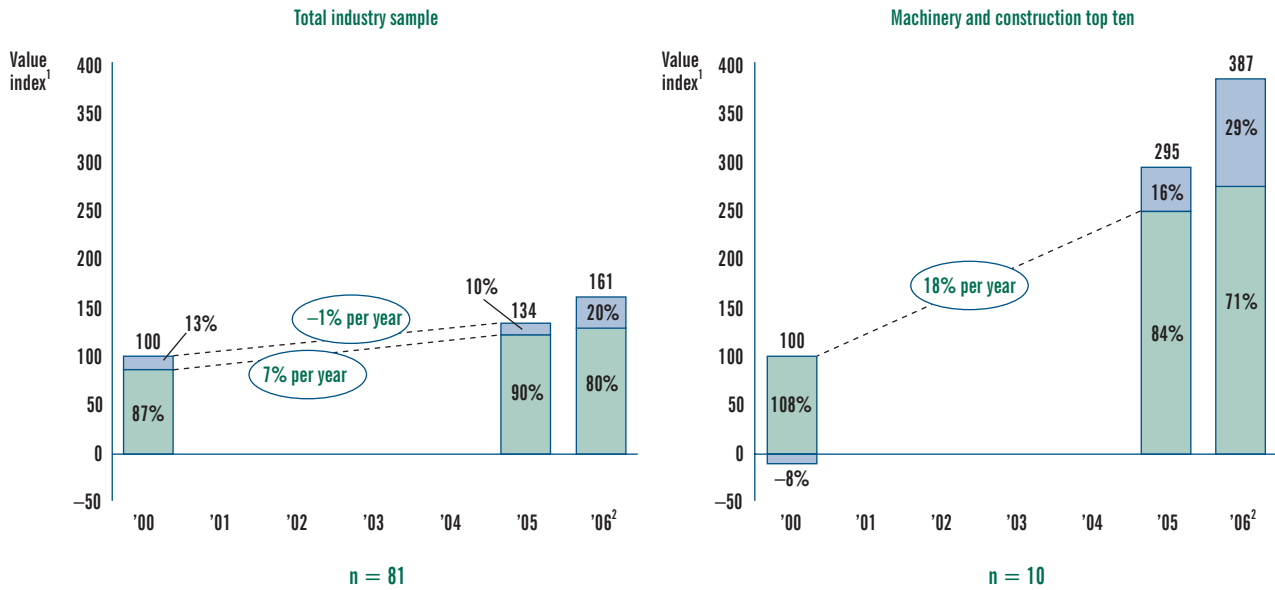


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



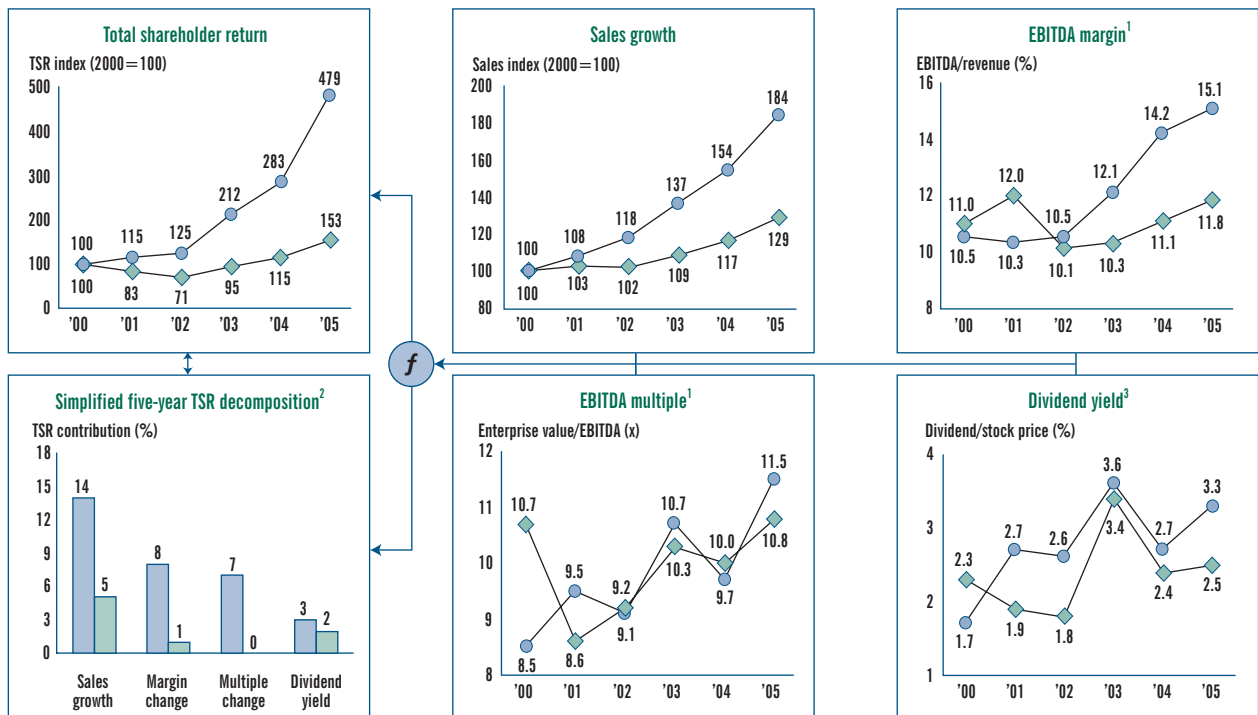
Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Machinery and construction top ten ◆ Total sample, n = 81



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Media and Entertainment

THE MEDIA AND ENTERTAINMENT TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	PENN NATIONAL GAMING	UNITED STATES	66.8	2.749	33	41	2	21	0	-6	9	17.7
2	SCIENTIFIC GAMES	UNITED STATES	56.0	2.449	54	28	7	3	0	-14	32	30.6
3	GTECH HOLDINGS	UNITED STATES	44.9	3.970	19	5	1	27	1	4	6	10.1
4	ACTIVISION	UNITED STATES	40.4	3.761	13	21	8	14	0	-10	8	-17.2
5	NASPERS	SOUTH AFRICA	30.9	5.556	14	16	21	0	2	-12	5	8.8
6	PIXAR ⁷	UNITED STATES	28.6	6.269	35	11	1	20	0	-4	1	N/A
7	GETTY IMAGES	UNITED STATES	22.8	5.541	38	9	15	-1	0	-4	3	-28.9
8	ARISTOCRAT LEISURE	AUSTRALIA	22.0	4.262	42	19	9	-8	3	-2	0	5.6
9	INTL. GAME TECHNOLOGY	UNITED STATES	21.7	10.371	43	21	9	-9	1	-3	3	24.1
10	ELECTRONIC ARTS	UNITED STATES	19.7	15.734	34	17	11	-9	0	-2	3	-17.7

SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

NOTE: n = 76 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

³As of December 31, 2005.

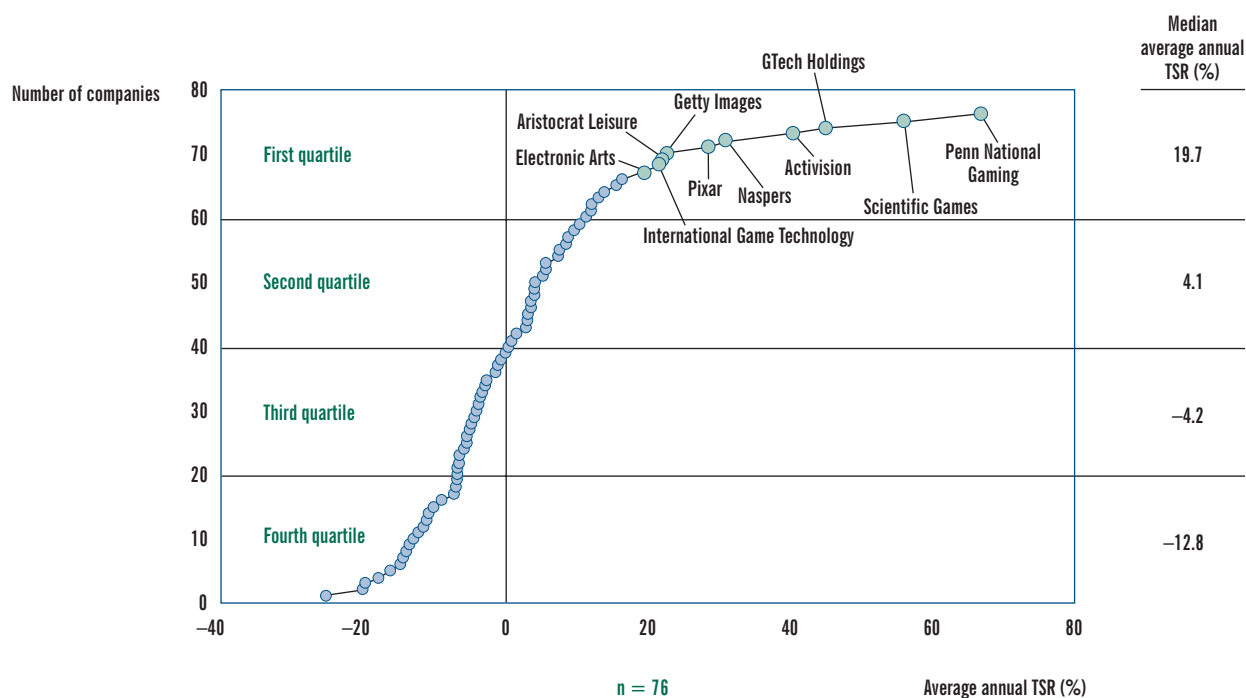
⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

⁷Pixar was delisted in May 2006.

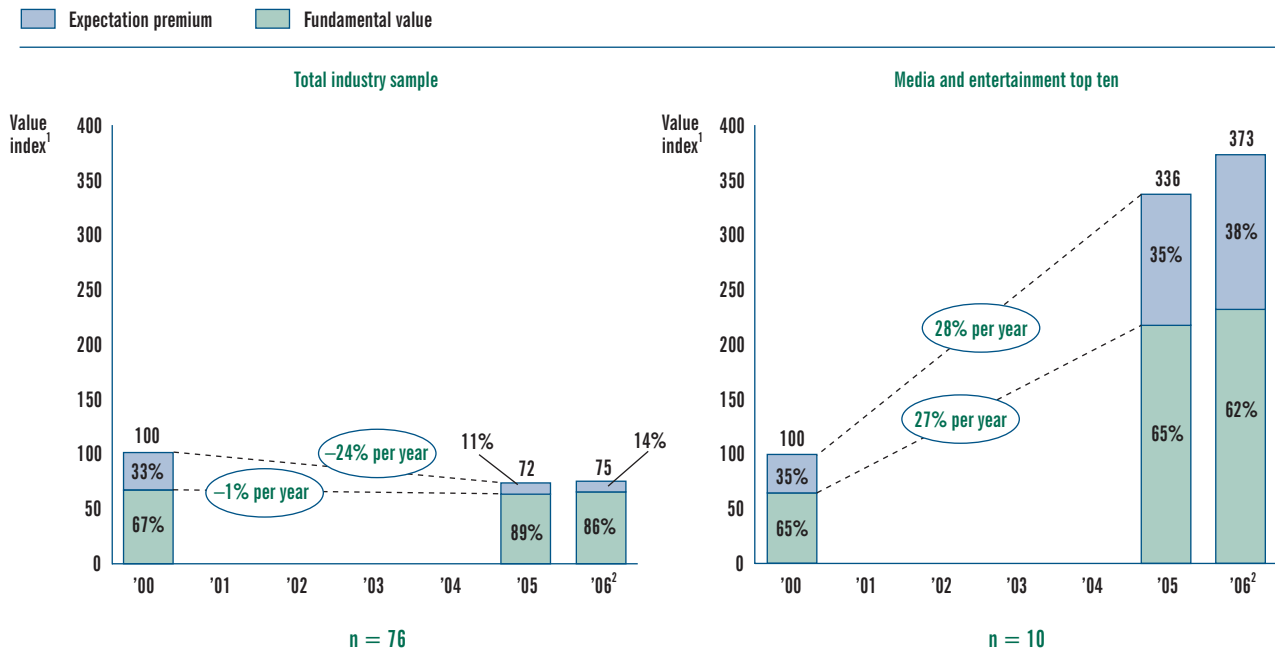
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005



SOURCES: Thomson Financial Datastream; BCG analysis.

NOTE: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005



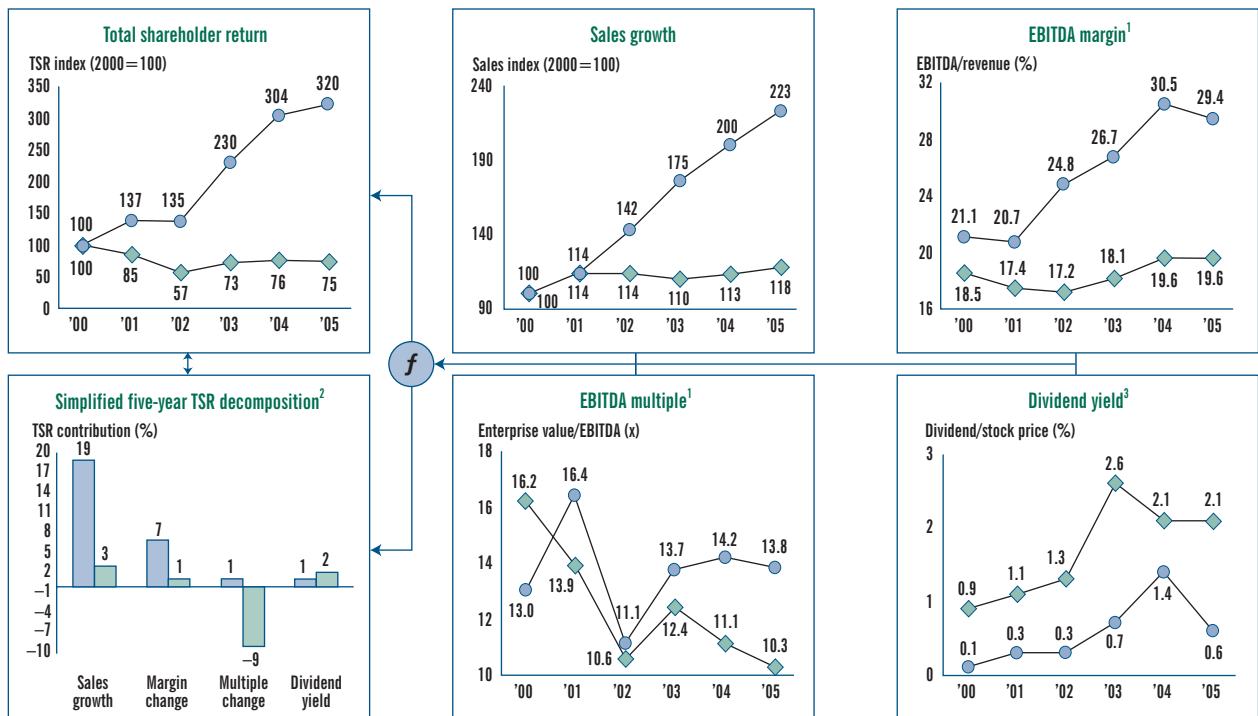
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

Media and entertainment top ten (blue circles) Total sample, n = 76 (green diamonds)



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Mining and Materials

THE MINING AND MATERIALS TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	CAEMI ⁷	BRAZIL	74.1	5.752	24	34	19	0	3	0	18	N/A
2	GLAMIS GOLD	CANADA	67.9	3.618	84	28	43	10	0	-11	-2	32.4
3	GERDAU	BRAZIL	65.4	6.888	-30	35	2	1	13	0	14	26.5
4	SIAM CEMENT	THAILAND	59.5	7.140	31	15	-1	2	5	0	39	-9.5
5	SIDERURGICA NACIONAL	BRAZIL	59.5	5.890	-46	24	5	-10	31	2	6	53.4
6	VALLOUREC	FRANCE	58.3	5.830	-7	16	24	4	7	-2	9	102.2
7	CAMECO	CANADA	54.7	11.050	63	15	-4	38	2	-1	5	20.8
8	USINAS SIDER MINAS	BRAZIL	53.8	5.202	-70	26	4	-16	12	0	29	45.7
9	VALE DO RIO DOCE	BRAZIL	53.5	45.807	38	31	7	2	10	0	3	10.7
10	MITTAL STEEL	NETHERLANDS	53.4	18.879	-12	38	14	-2	1	-32	34	8.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 88 companies with a market valuation greater than \$3 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

³As of December 31, 2005.

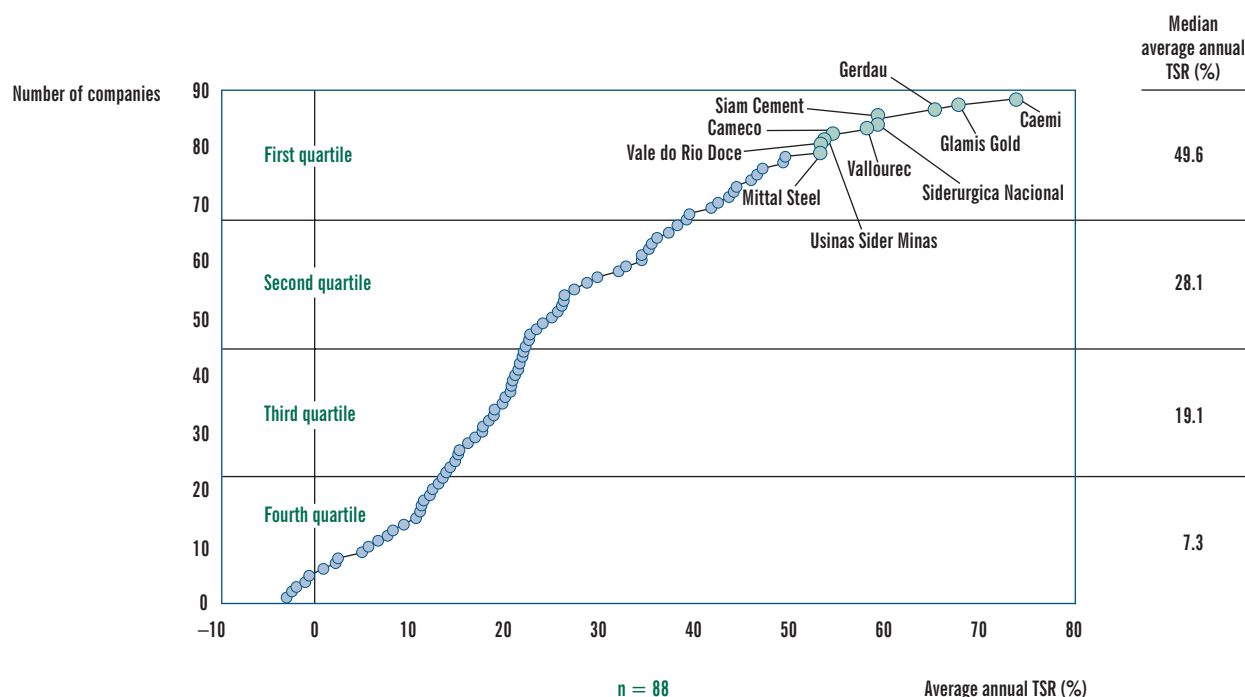
⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

⁷Caemi was delisted in May 2006.

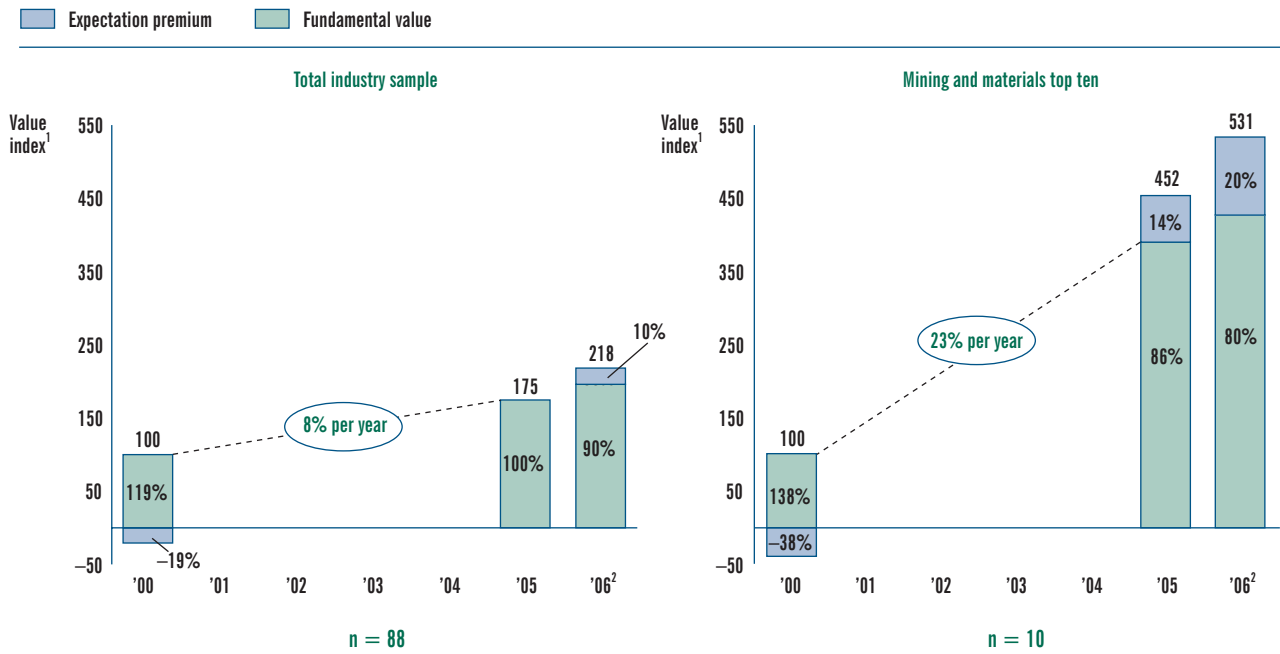
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005



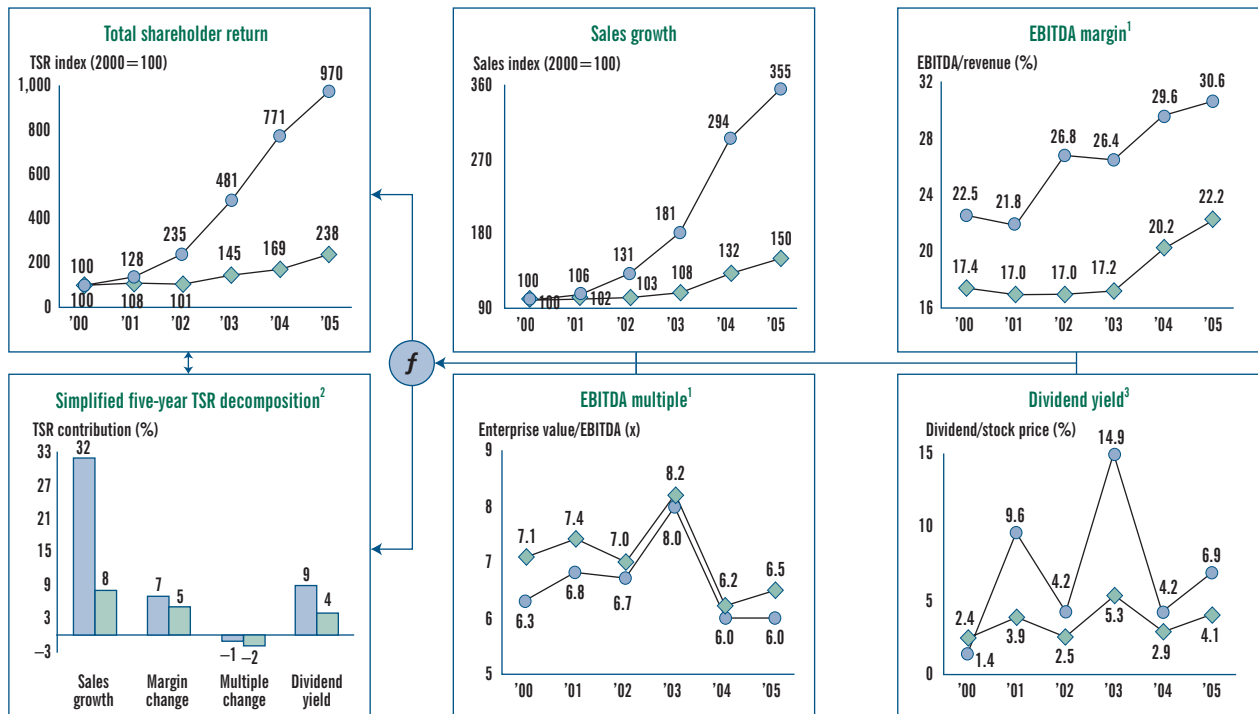
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Mining and materials top ten ◆ Total sample, n = 88



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE MULTIBUSINESS TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	TOYOTA TSUSHO	JAPAN	49.9	6.426	13	16	13	-3	2	-1	23	2.7
2	KEPPEL	SINGAPORE	37.2	5.185	19	22	-16	-5	6	-1	30	37.1
3	GRUPO CARSO	MEXICO	29.5	5.808	9	-7	5	9	1	3	19	3.3
4	MITSUBISHI CORPORATION	JAPAN	26.8	37.225	-10	6	10	-3	2	0	12	-11.7
5	BARLOWORLD	SOUTH AFRICA	23.3	3.973	25	12	7	-1	5	-1	1	11.6
6	ITT	UNITED STATES	22.8	9.495	42	9	-2	11	1	-1	3	-3.3
7	WESFARMERS	AUSTRALIA	22.7	10.253	58	19	4	1	5	-7	1	-1.9
8	TOMKINS	UNITED KINGDOM	22.2	3.983	5	0	-5	-2	7	4	18	-1.6
9	MARUBENI	JAPAN	19.8	8.017	-15	-24	41	-18	2	0	20	-2.8
10	mitsui & co.	JAPAN	17.5	20.339	-15	8	8	-9	2	0	8	7.6

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 41 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

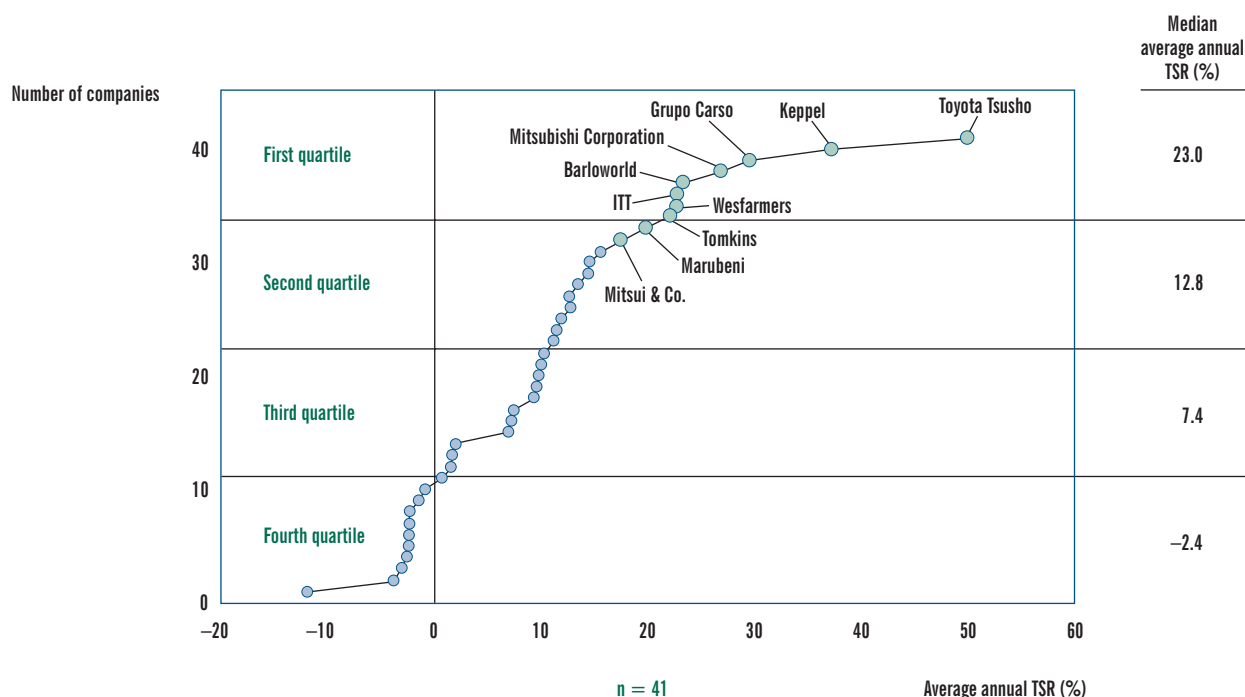
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

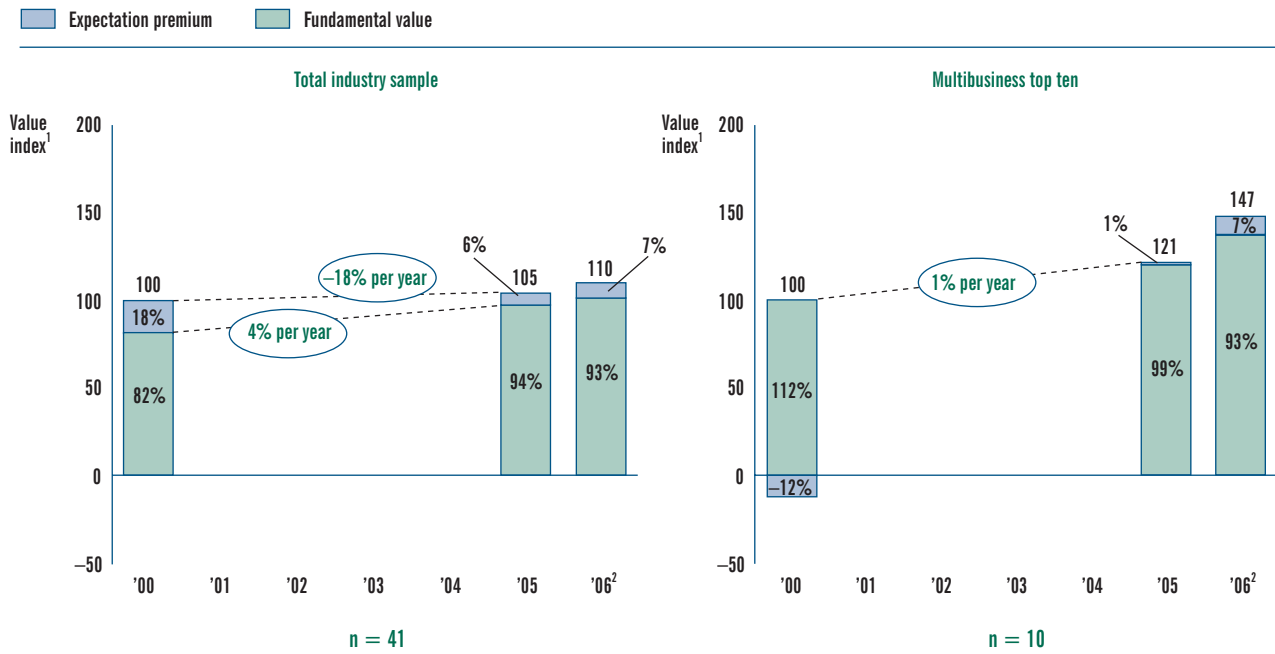
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005



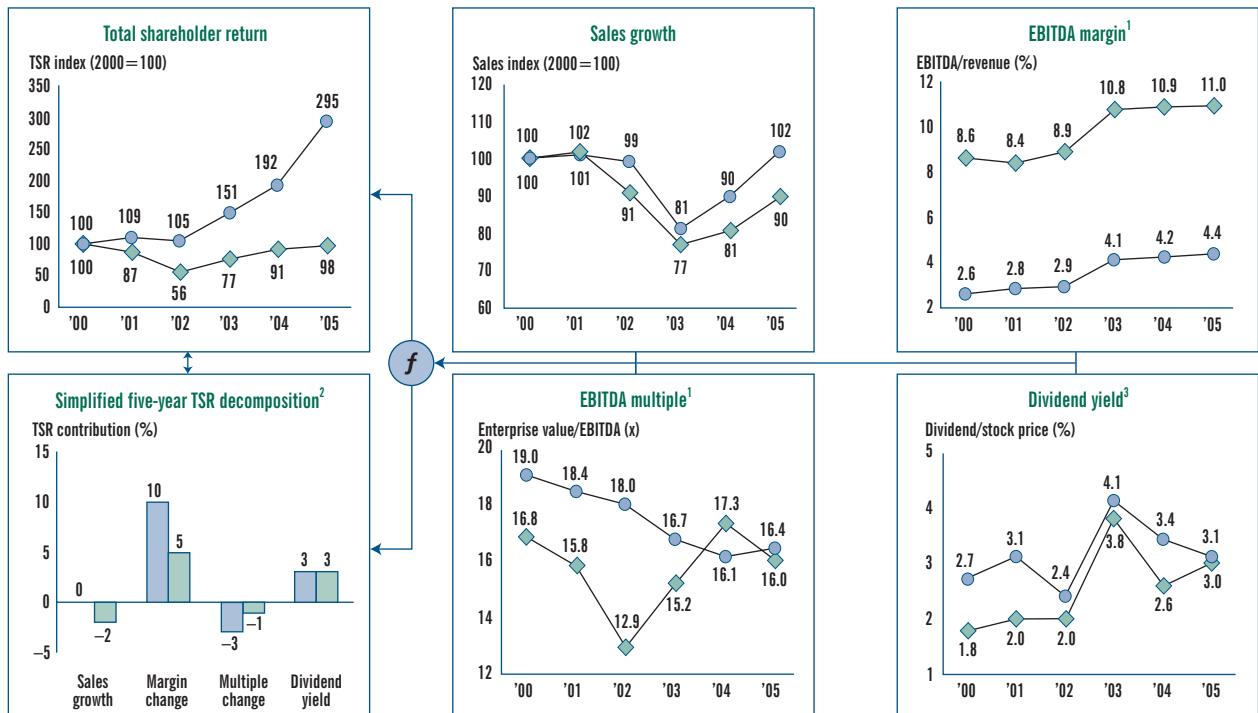
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Multibusiness top ten ◆ Total sample, n = 41



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Pharmaceuticals and Biotech

THE PHARMACEUTICAL AND BIOTECH TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	GILEAD SCIENCES	UNITED STATES	38.4	24.073	28	43	0	0	0	-5	0	12.5
2	ENDO PHARMACEUTICALS	UNITED STATES	38.2	4.016	-2	32	17	-11	0	-8	7	9.0
3	CELGENE	UNITED STATES	31.9	10.991	75	38	0	0	0	-3	-2	46.4
4	BOSTON SCIENTIFIC	UNITED STATES	29.0	20.069	3	20	5	3	0	0	2	-31.2
5	ST. JUDE MEDICAL	UNITED STATES	26.7	18.402	39	21	3	5	0	-1	0	-35.4
6	TEVA PHARMACEUTICAL	ISRAEL	21.9	27.973	11	23	7	-3	0	-8	2	-29.9
7	EDWARDS LIFESCIENCES	UNITED STATES	18.6	2.474	19	5	4	4	0	0	6	9.2
8	GENENTECH	UNITED STATES	17.8	97.542	60	30	-4	-7	0	0	0	-11.6
9	ORION	FINLAND	15.8	2.570	12	14	-7	-1	11	-1	-1	6.5
10	BARR PHARMACEUTICALS	UNITED STATES	14.0	6.702	9	17	23	-21	0	-6	1	-23.4

SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

NOTE: n = 65 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

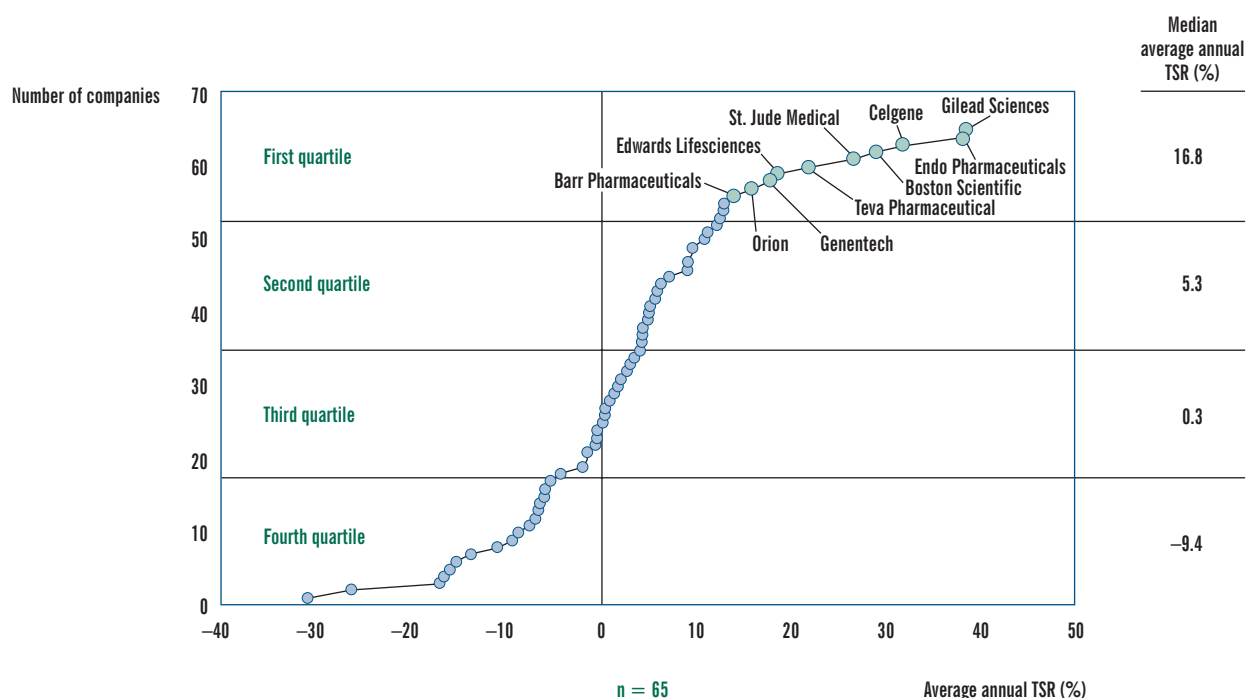
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

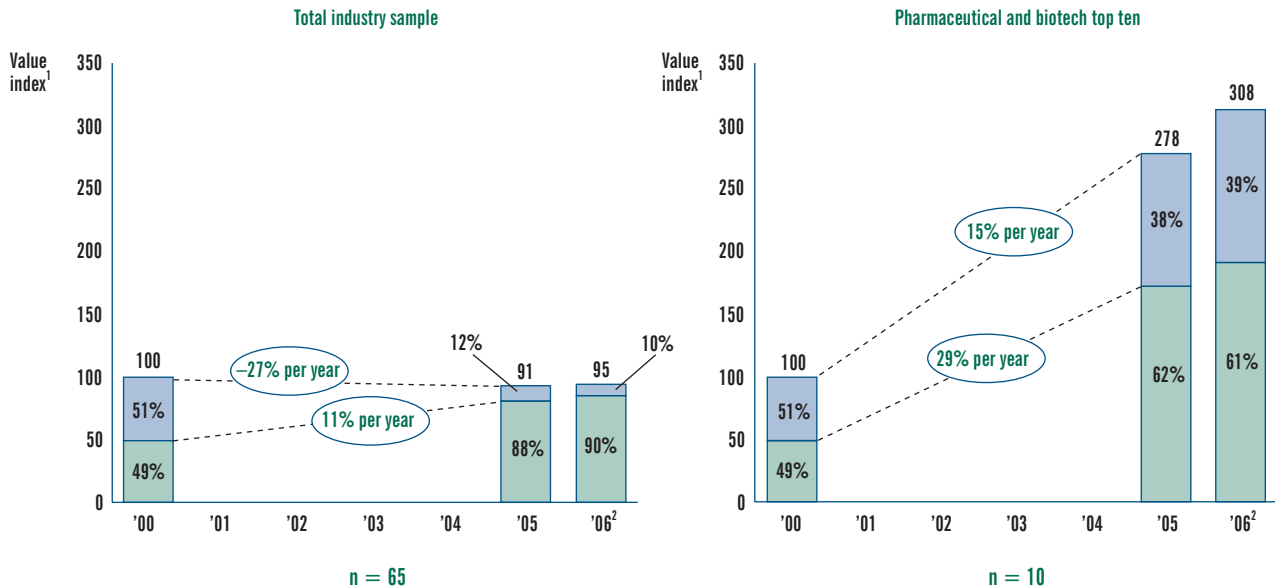


SOURCES: Thomson Financial Datastream; BCG analysis.

NOTE: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



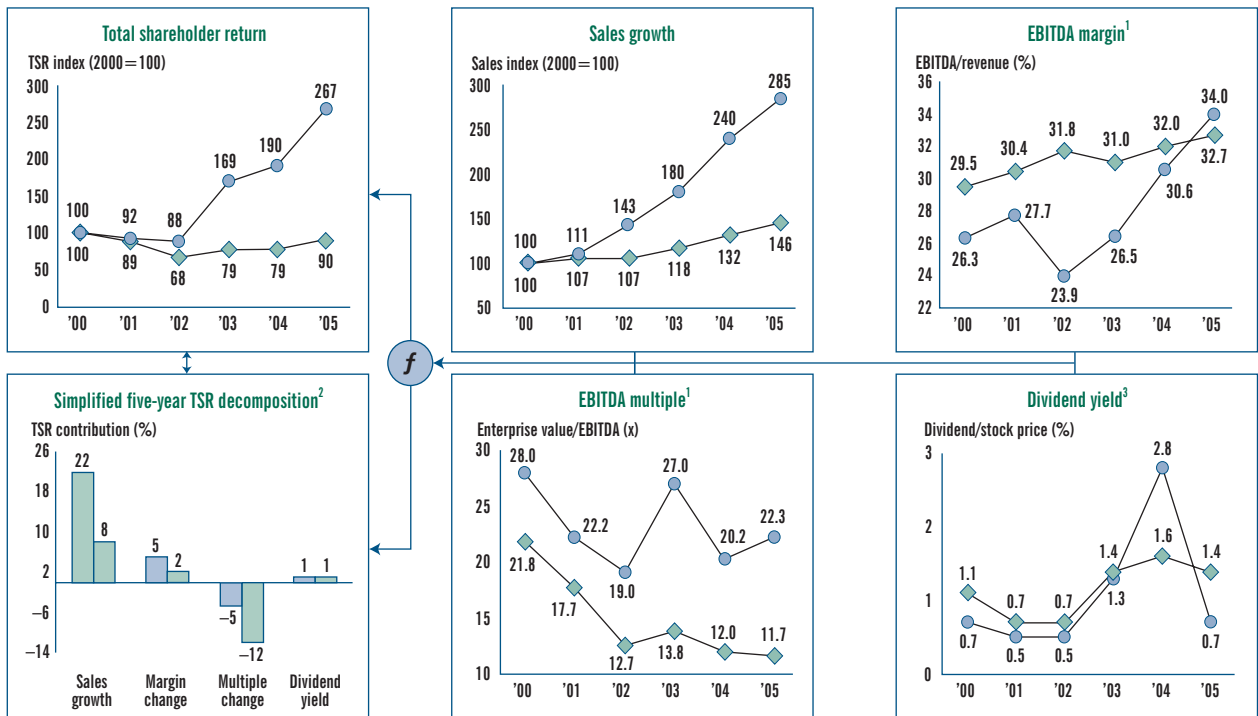
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Pharmaceutical and biotech top ten ◆ Total sample, n = 65



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE PULP AND PAPER TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	ARACRUZ CELULOSE	BRAZIL	33.5	3.762	13	20	-9	18	7	0	-2	25.7
2	SUZANO PAPEL E CELULOSE	BRAZIL	27.3	1.388	-32	28	-15	16	6	-10	2	8.2
3	VOTORANTIM CELULOSE E PAPEL	BRAZIL	26.2	2.391	-25	18	-13	25	4	0	-9	16.9
4	MAYR-MELNHOF KARTON	AUSTRIA	23.5	1.677	-12	7	0	9	3	2	3	8.5
5	EMPRESAS CMPC	CHILE	21.0	4.942	-14	6	-8	17	3	0	2	16.6
6	GRUPO EMPRESARIAL ENCE	SPAIN	14.0	1.053	-25	-1	11	3	4	-5	2	14.8
7	TEMPLE-INLAND	UNITED STATES	13.9	5.034	-30	2	-6	7	3	-16	24	-3.3
8	RENGO	JAPAN	13.4	1.464	-22	2	2	-1	2	0	8	21.8
9	POTLATCH	UNITED STATES	12.2	1.488	-2	-4	10	-8	4	0	11	7.3
10	SVENSKA CELLULOSA	SWEDEN	12.0	8.781	-10	7	-21	26	4	0	-2	3.6

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 27 companies with a market valuation greater than \$1 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

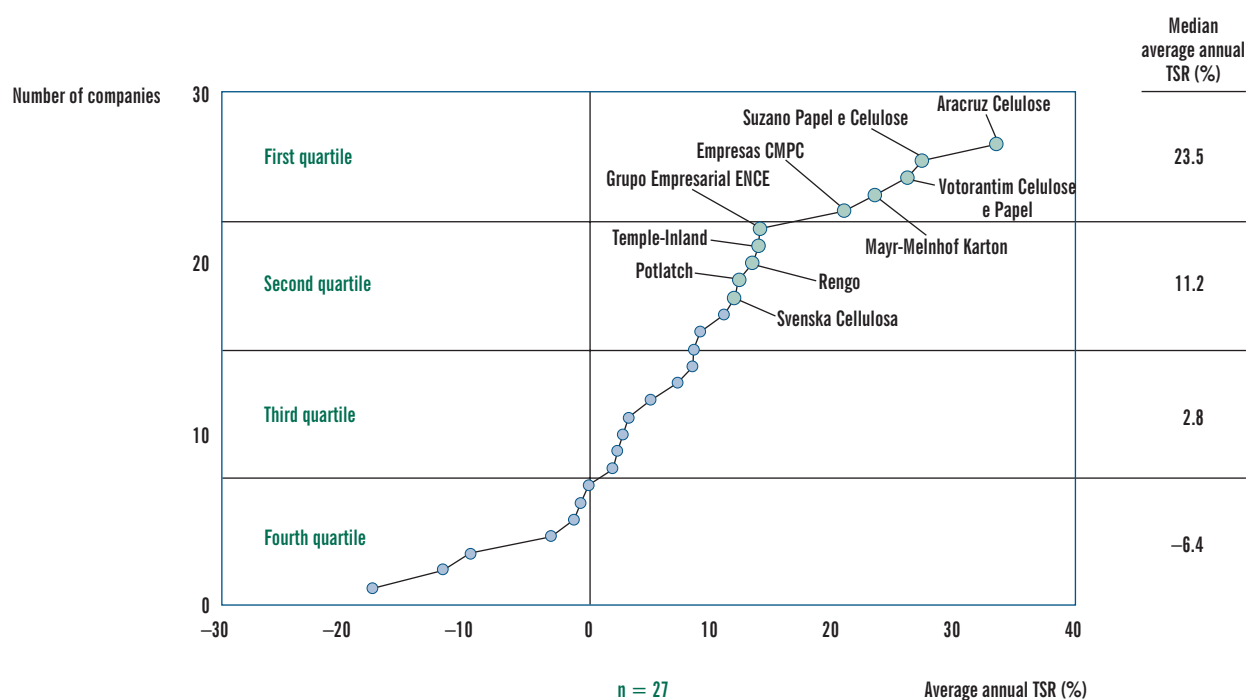
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

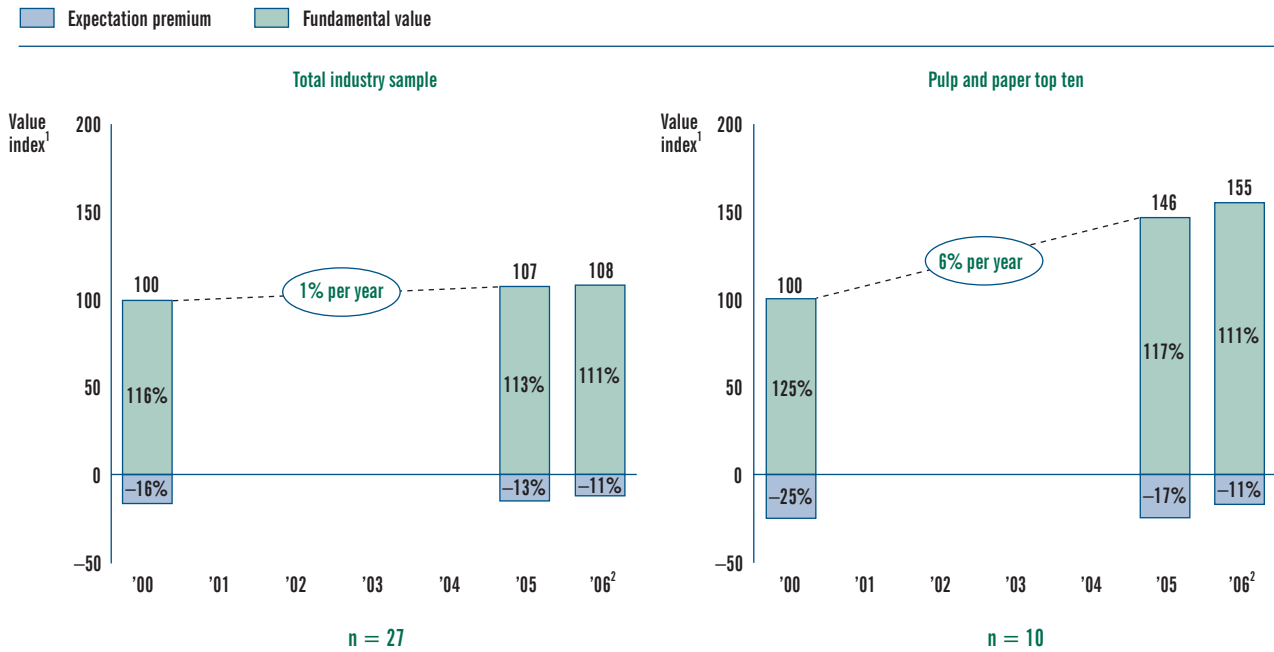
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005



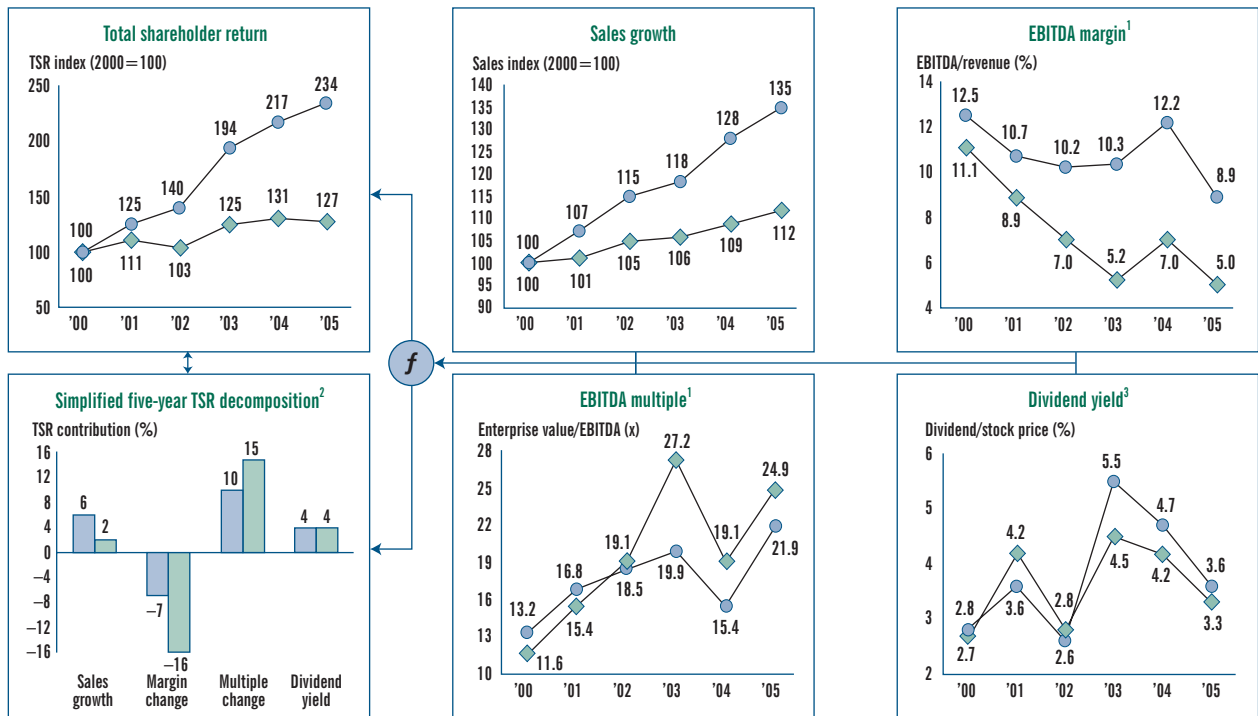
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Pulp and paper top ten ◆ Total sample, n = 27



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE RETAIL TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	URBAN OUTFITTERS	UNITED STATES	91.1	4.168	35	28	6	62	0	-3	-3	-30.9
2	TRACTOR SUPPLY	UNITED STATES	90.2	2.082	37	28	9	40	0	-2	15	4.4
3	CHICO'S FAS	UNITED STATES	80.1	7.950	4	54	7	22	0	-3	0	-38.6
4	EDGARS STORES	SOUTH AFRICA	76.7	2.987	25	19	8	27	10	5	8	-14.6
5	METCASH	AUSTRALIA	71.5	2.460	31	7	13	26	6	-7	26	-15.7
6	SHINSEGAE	SOUTH KOREA	60.2	8.278	32	19	12	12	1	-4	19	7.2
7	ESPRIT HOLDINGS	HONG KONG	56.8	8.527	23	26	9	19	5	-1	0	16.0
8	PETSMART	UNITED STATES	55.2	3.602	30	11	16	18	0	-4	14	0.0
9	ALIMENTATION COUCHE-TARD	CANADA	45.8	4.072	-2	48	-3	3	0	-6	3	2.6
10	ENTERPRISE INNS	UNITED KINGDOM	41.6	5.569	19	39	5	3	3	-10	1	2.0

SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

NOTE: n = 119 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

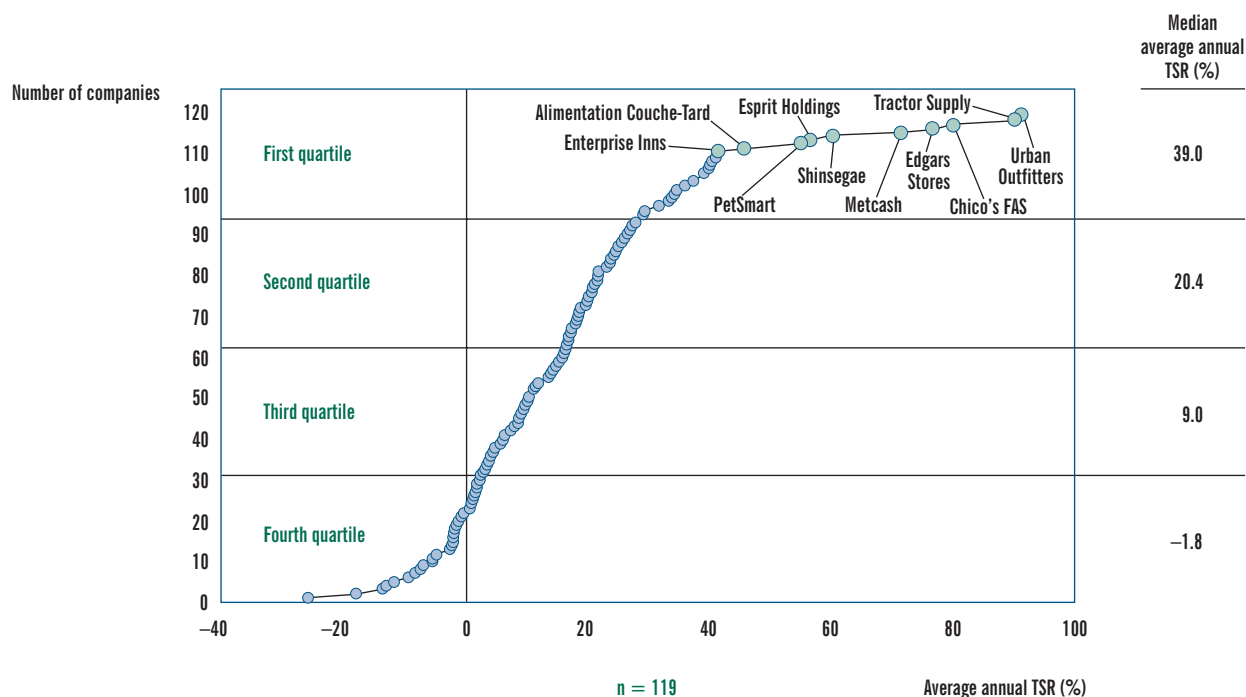
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

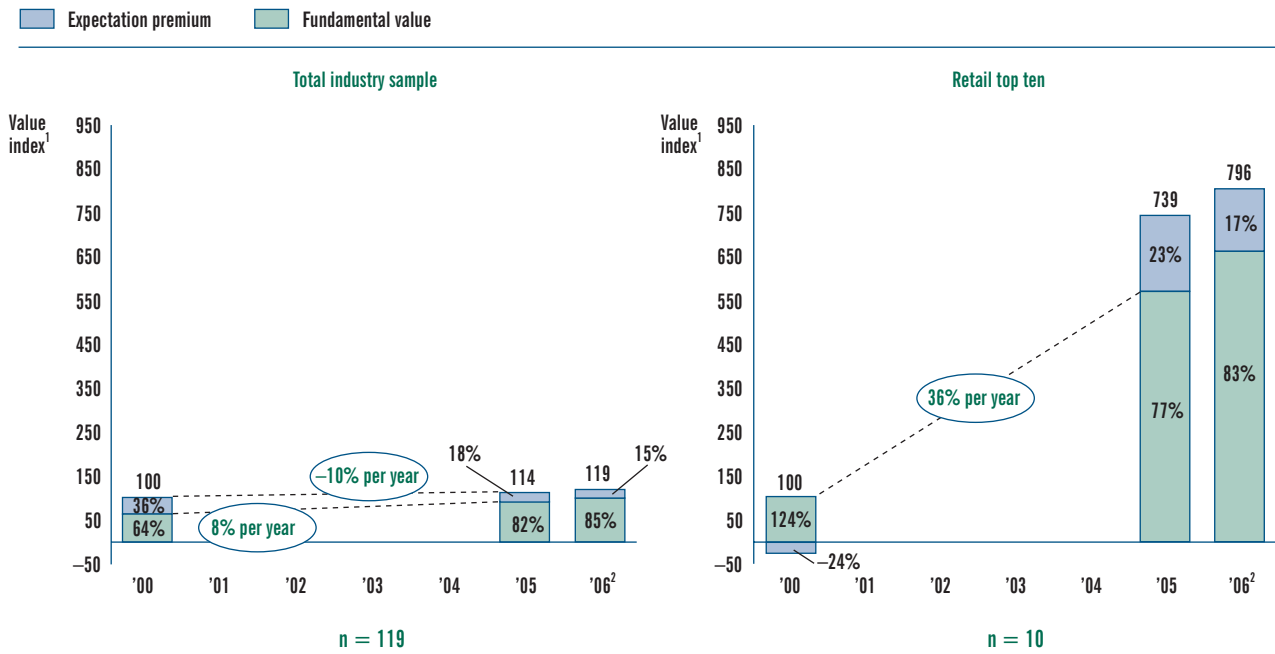
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005



SOURCES: Thomson Financial Datastream; BCG analysis.

NOTE: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005



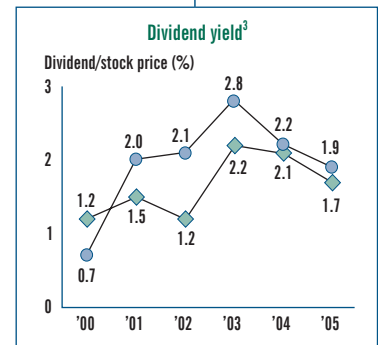
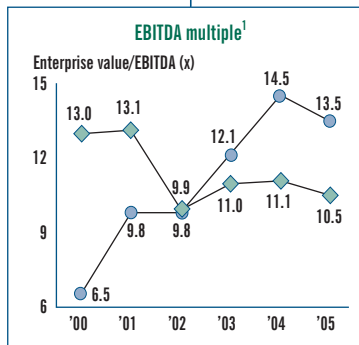
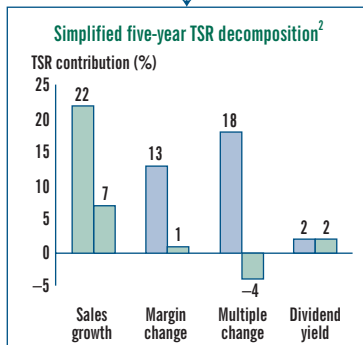
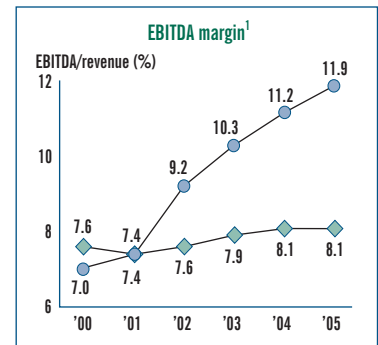
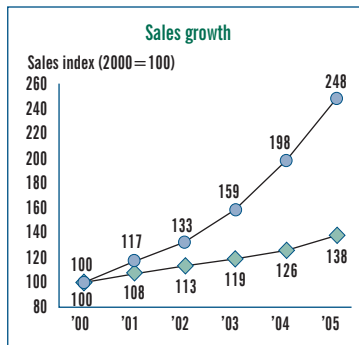
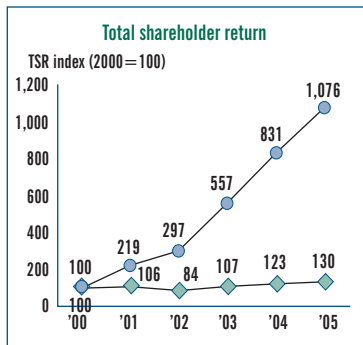
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Retail top ten ◆ Total sample, n = 119



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE TECHNOLOGY TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	APPLE COMPUTER	UNITED STATES	57.4	60.587	32	11	8	66	0	-5	-22	-20.3
2	PT TELEKOMUNIKASI INDONESIA	INDONESIA	48.6	12.094	1	30	-1	12	7	0	0	24.6
3	AUTODESK	UNITED STATES	45.6	9.908	27	8	15	24	1	1	-4	-19.7
4	SAMSUNG ELECTRONICS	SOUTH KOREA	35.3	96.171	37	13	-9	17	2	1	10	-8.5
5	SANDISK	UNITED STATES	35.2	11.566	12	31	4	10	0	-6	-3	-18.8
6	SYMANTEC	UNITED STATES	33.2	18.926	15	28	7	5	0	-7	0	-11.2
7	SOFTBANK	JAPAN	30.7	44.517	48	14	-13	29	0	-1	1	-48.5
8	NIDEC	JAPAN	30.0	12.194	34	29	2	2	1	-2	0	-18.2
9	XEROX	UNITED STATES	26.2	14.056	12	-4	5	-3	0	-7	34	-5.1
10	YAHOO!	UNITED STATES	21.1	55.586	73	34	-3	-4	0	-5	-1	-15.8

SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

NOTE: n = 107 companies with a market valuation greater than \$8 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

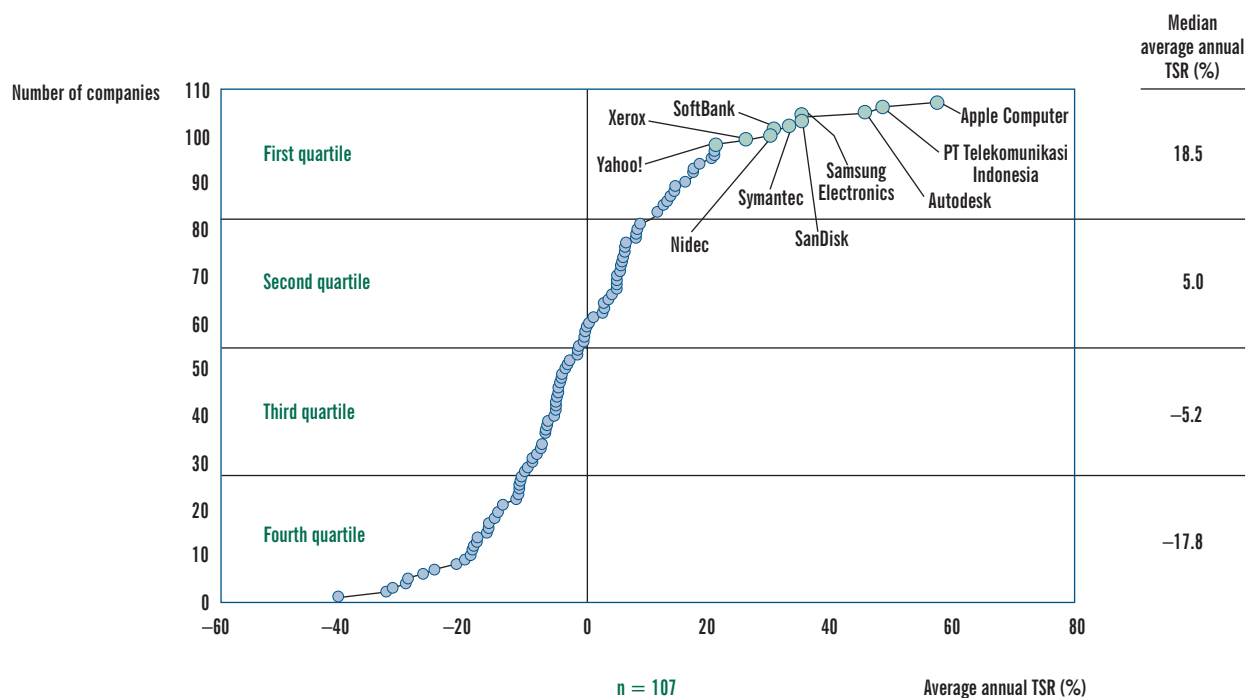
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

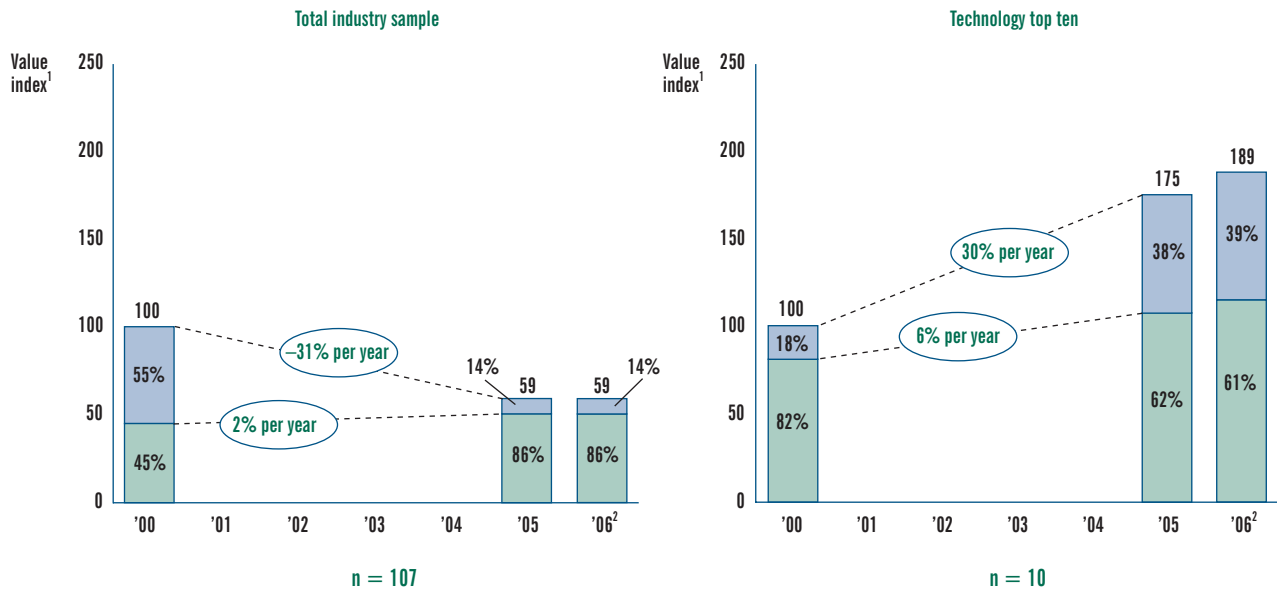


SOURCES: Thomson Financial Datastream; BCG analysis.

NOTE: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



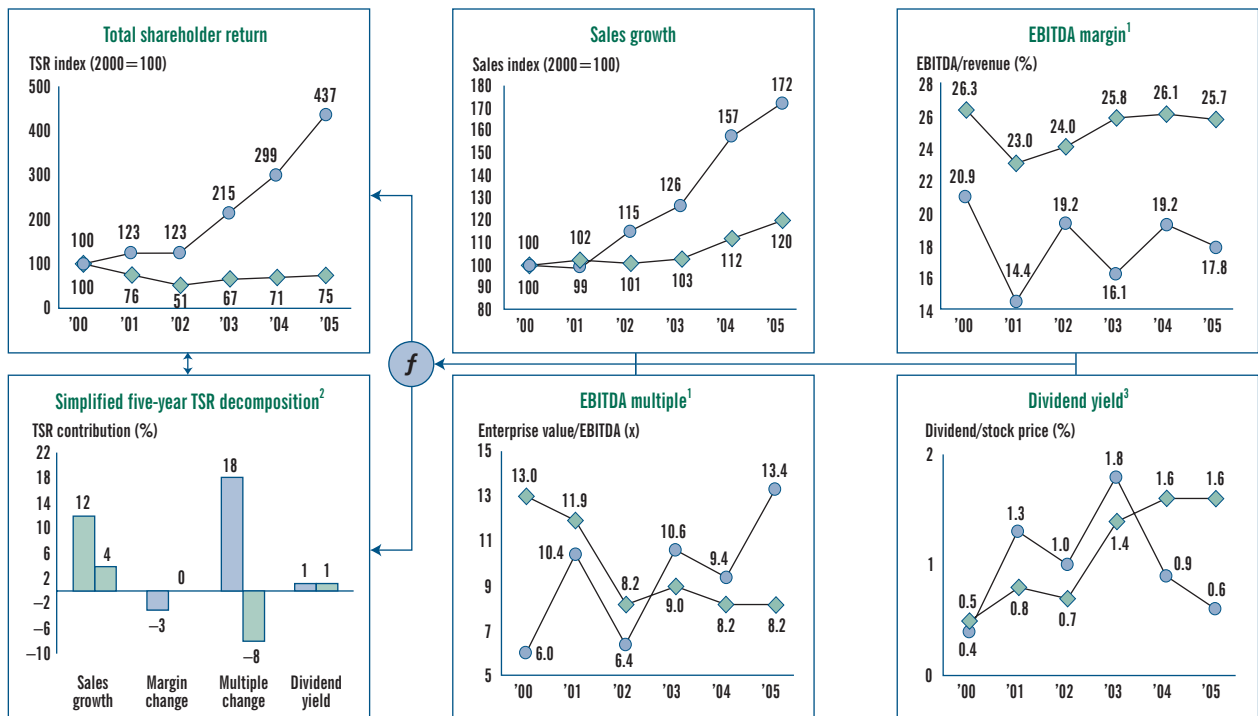
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Technology top ten ◆ Total sample, n = 107



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

Transportation and Logistics

THE TRANSPORTATION AND LOGISTICS TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	LANDSTAR SYSTEM	UNITED STATES	43.3	2.443	31	14	5	19	0	3	2	13.3
2	TOLL HOLDINGS	AUSTRALIA	41.2	3.627	30	24	15	7	2	-6	-2	-4.7
3	CHINA SHIPPING DEVELOPMENT	CHINA	40.7	2.336	10	22	5	0	6	-2	9	3.0
4	MITSUI OSK LINES	JAPAN	40.5	10.514	-4	6	7	-1	4	1	24	-23.6
5	J.B. HUNT TRANSPORT SERVICES	UNITED STATES	40.5	3.501	43	9	15	7	0	-2	11	10.8
6	KAWASAKI KISEN KAISHA	JAPAN	37.1	3.725	12	12	1	-1	4	0	21	-9.4
7	ZHEJIANG EXPRESSWAY	CHINA	36.7	2.689	20	24	0	0	6	0	7	1.5
8	KUEHNE & NAGEL	SWITZERLAND	33.1	6.761	33	12	3	19	3	-1	-4	21.5
9	NORFOLK SOUTHERN	UNITED STATES	29.2	18.220	13	7	13	-6	2	-1	14	19.4
10	CHINA MERCHANTS	HONG KONG	28.6	4.768	44	16	-12	26	4	-1	-4	42.4

SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

NOTE: n = 58 companies with a market valuation greater than \$2 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

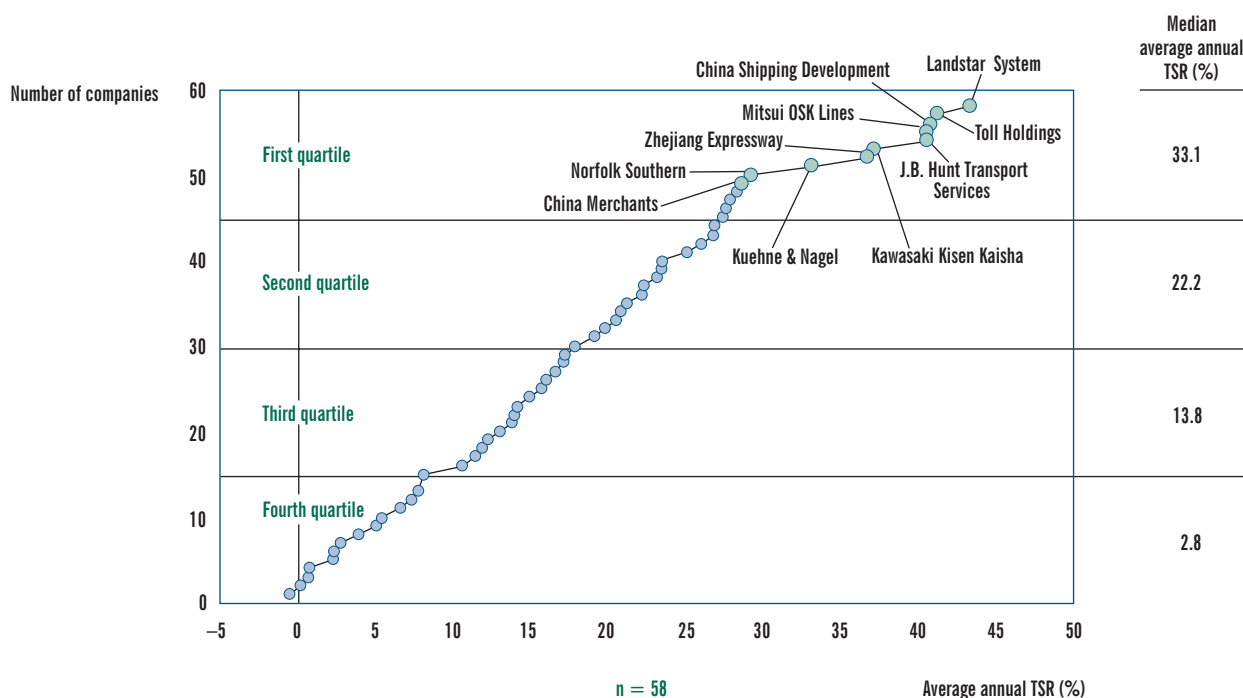
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

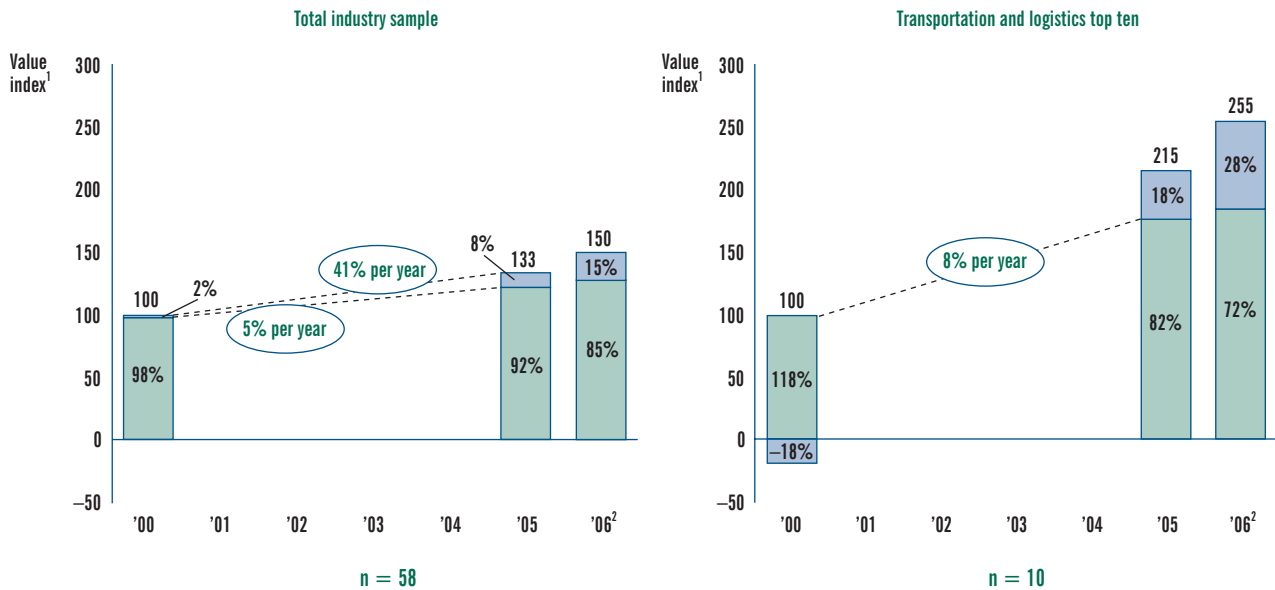


SOURCES: Thomson Financial Datastream; BCG analysis.

NOTE: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



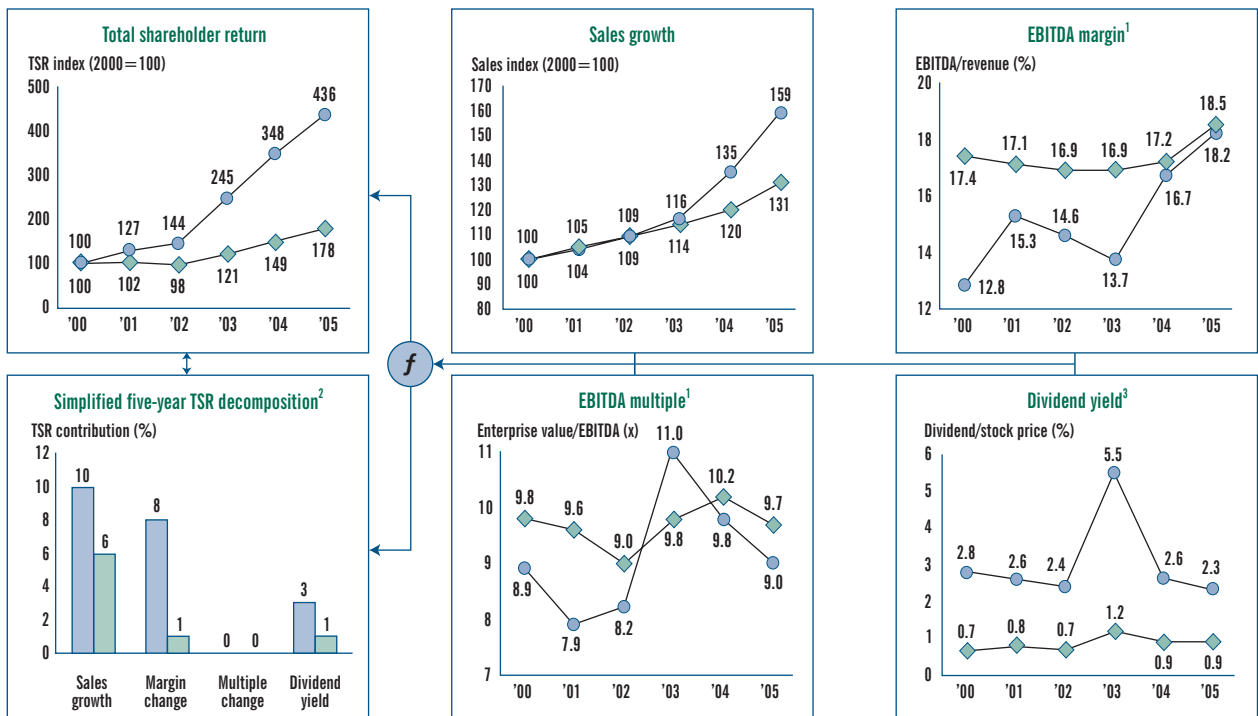
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Transportation and logistics top ten ◆ Total sample, n = 58



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE TRAVEL AND TOURISM TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	BOYD GAMING	UNITED STATES	70.3	4.253	17	16	4	22	1	-6	32	-14.9
2	AEROFLOT	RUSSIA	46.9	1.583	9	14	-1	8	0	1	24	2.4
3	CHOICE HOTELS INTERNATIONAL	UNITED STATES	44.5	2.731	36	7	1	19	1	11	5	46.0
4	DAIICHIKOSHO	JAPAN	41.2	1.142	23	7	3	8	2	3	17	-29.8
5	KOREAN AIR LINES	SOUTH KOREA	39.2	2.253	-10	6	0	-11	1	-1	44	9.7
6	STATION CASINOS	UNITED STATES	36.3	4.644	45	2	7	22	1	-2	6	1.1
7	INDIAN HOTELS	INDIA	36.3	1.203	13	17	-2	18	4	-1	-1	15.7
8	IMPERIAL HOTEL	JAPAN	36.0	1.762	13	-2	0	39	1	0	-2	-27.9
9	SOCIETE DES BAINS DE MER	FRANCE	27.3	1.166	33	3	1	22	2	0	-1	-15.9
10	SKYCITY ENTERTAINMENT	NEW ZEALAND	27.2	1.337	35	18	-3	4	9	-2	1	18.4

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 67 companies with a market valuation greater than \$1 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

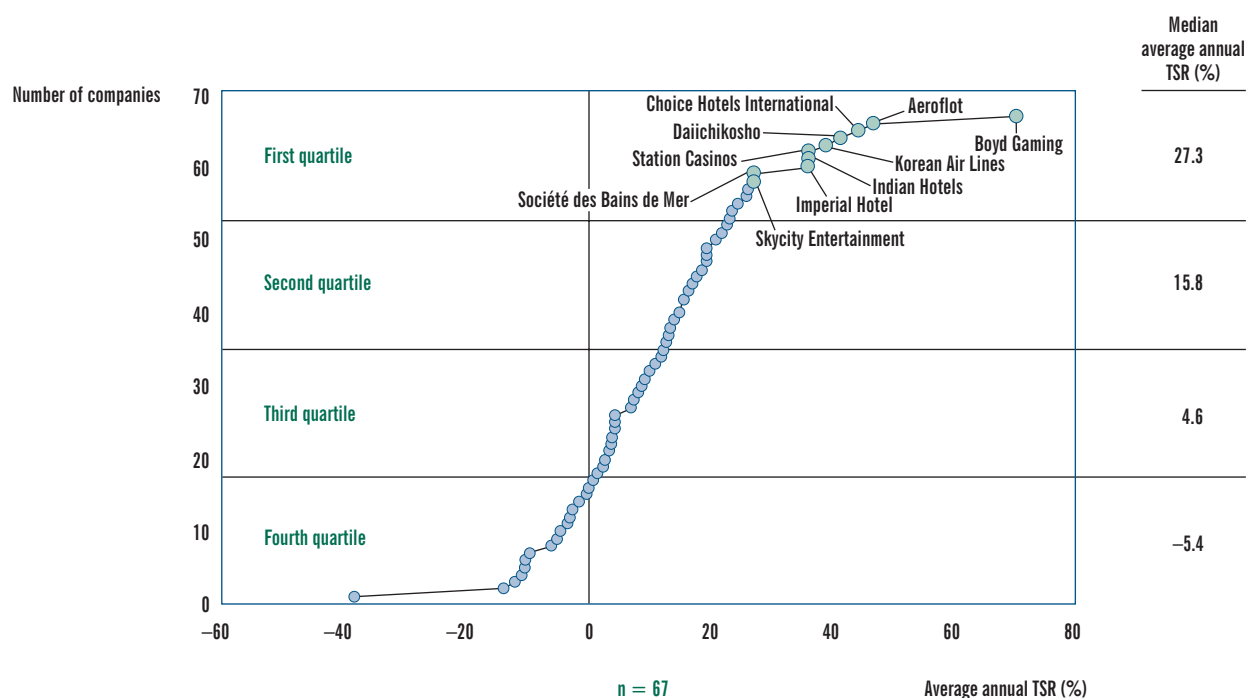
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

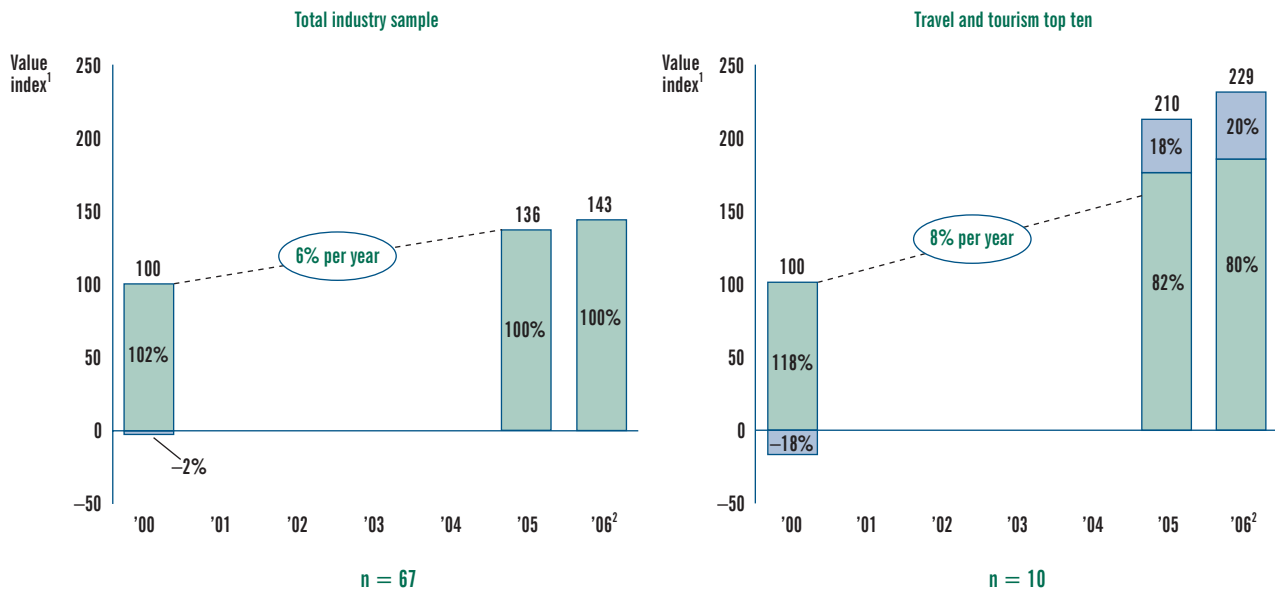


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



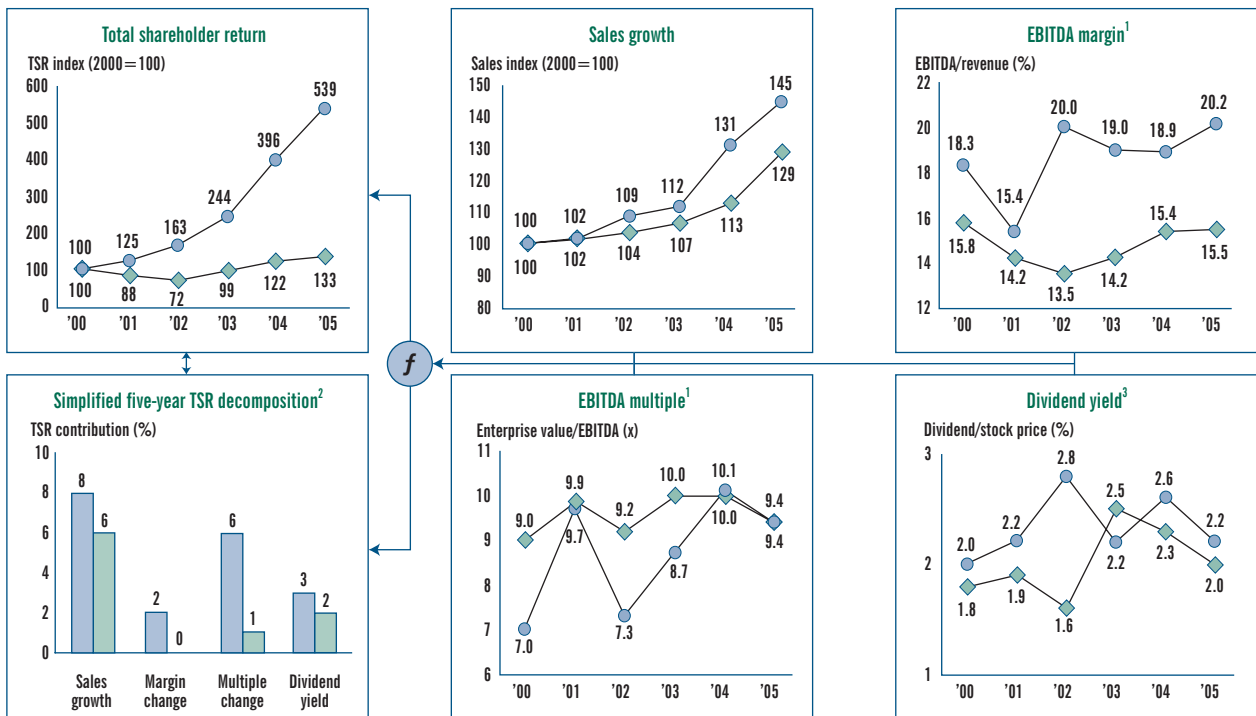
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Travel and tourism top ten ◆ Total sample, n = 67



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

THE UTILITIES TOP TEN, 2001–2005

#	Company	Country	TSR ² (%)	Market value ³ (\$billions)	Expect. premium ⁴ (%)	TSR Decomposition ¹						2006 TSR ⁶ (%)
						Sales growth (%)	Margin change (%)	Multiple change ⁵ (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	
1	CEZ	CZECH REPUBLIC	52.6	17.730	24	21	-1	15	5	0	13	4.3
2	TRACTEBEL ENERGIA	BRAZIL	51.4	4.228	33	20	2	3	15	-1	13	19.0
3	FORTUM	FINLAND	43.8	16.406	11	-19	29	9	6	-2	21	33.0
4	ENERGETICA DE MINAS GERAIS	BRAZIL	34.3	6.172	-10	20	-2	9	6	0	1	6.7
5	AREVA	FRANCE	28.2	17.006	-9	2	-7	20	10	-3	6	36.3
6	HUANENG POWER INTERNATIONAL	CHINA	27.4	8.500	10	25	-9	10	6	-1	-3	5.3
7	RED ELECTRICA DE ESPANA	SPAIN	25.2	4.187	22	9	9	10	4	0	-7	4.1
8	OESTERREICHISCHE ELEK.	AUSTRIA	24.6	10.949	19	14	-6	3	2	0	12	26.5
9	EDISON INTERNATIONAL	UNITED STATES	24.4	14.209	-56	3	-6	5	2	0	21	-9.4
10	QUESTAR	UNITED STATES	23.1	6.456	38	17	0	1	3	-1	4	7.0

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 83 companies with a market valuation greater than \$4 billion.

¹Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

²Average annual total shareholder return, 2001–2005.

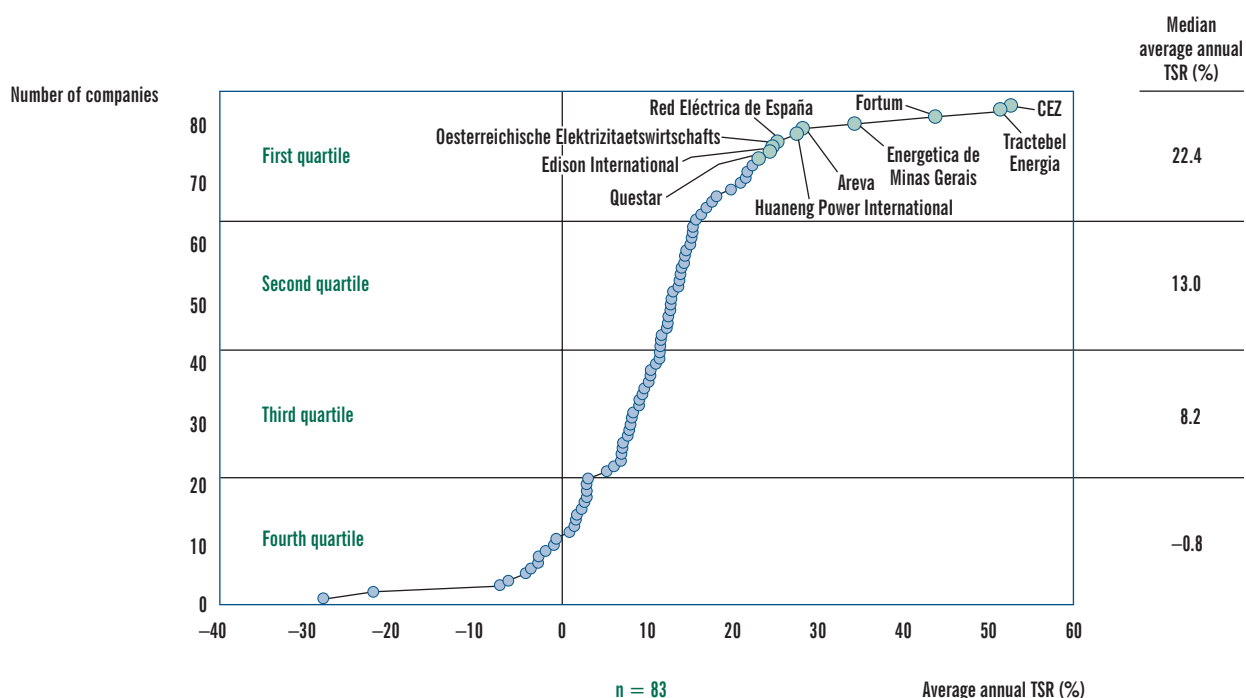
³As of December 31, 2005.

⁴Expectation premium as percentage of total 2005 market value.

⁵Change in EBITDA multiple.

⁶As of June 30, 2006.

AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2001–2005

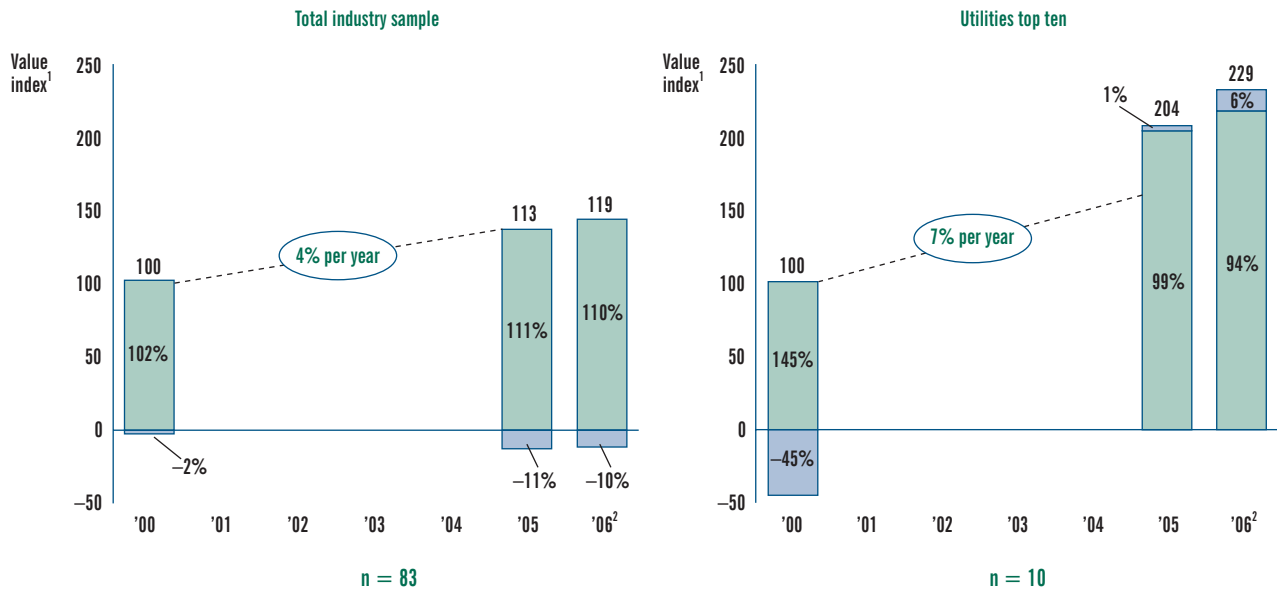


Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGE IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2001–2005

■ Expectation premium ■ Fundamental value



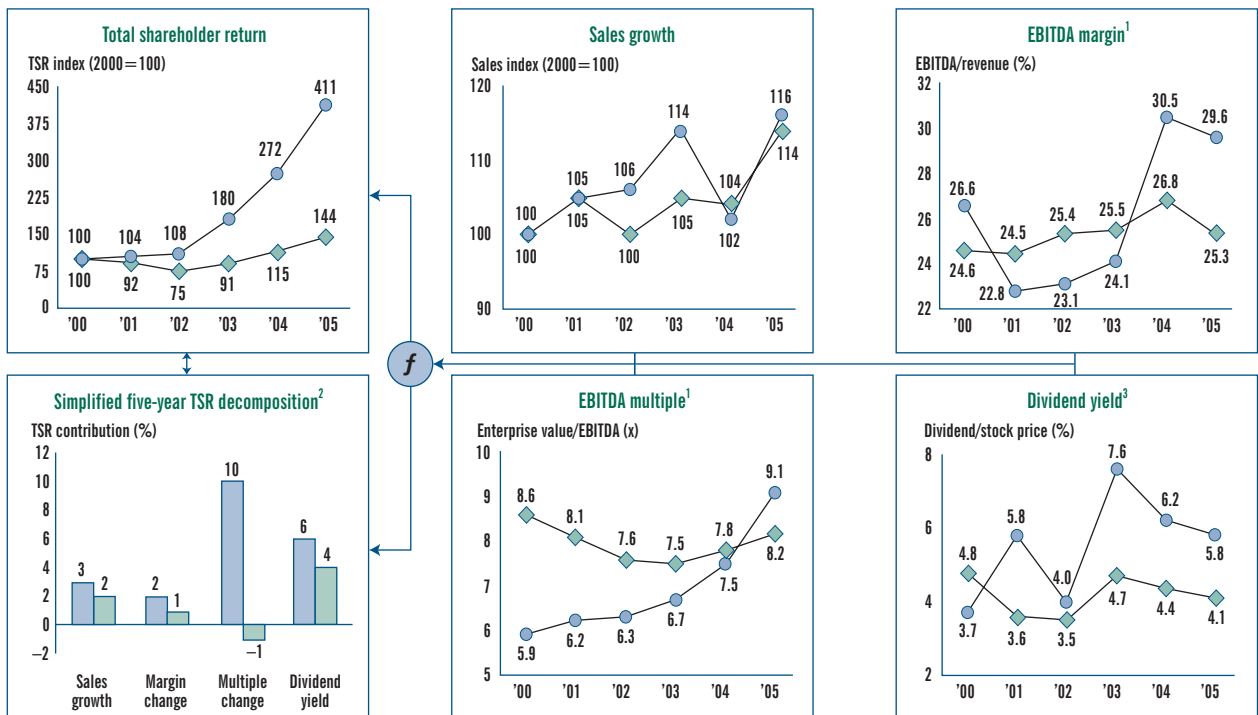
SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Market capitalization plus net debt, 2000 = 100.

²Market value as of June 30, 2006; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2001–2005

● Utilities top ten ◆ Total sample, n = 83



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

¹Industry calculation based on aggregate of entire sample.

²Share change and net debt change not shown.

³Industry calculation based on sample average.

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Budapest	Miami	Stuttgart
Buenos Aires	Milan	Sydney
Chicago	Monterrey	Taipei
Cologne	Moscow	Tokyo
Copenhagen	Mumbai	Toronto
Dallas	Munich	Vienna
Detroit	Nagoya	Warsaw
Düsseldorf	New Delhi	Washington
Frankfurt	New Jersey	Zürich
Hamburg	New York	
Helsinki	Oslo	