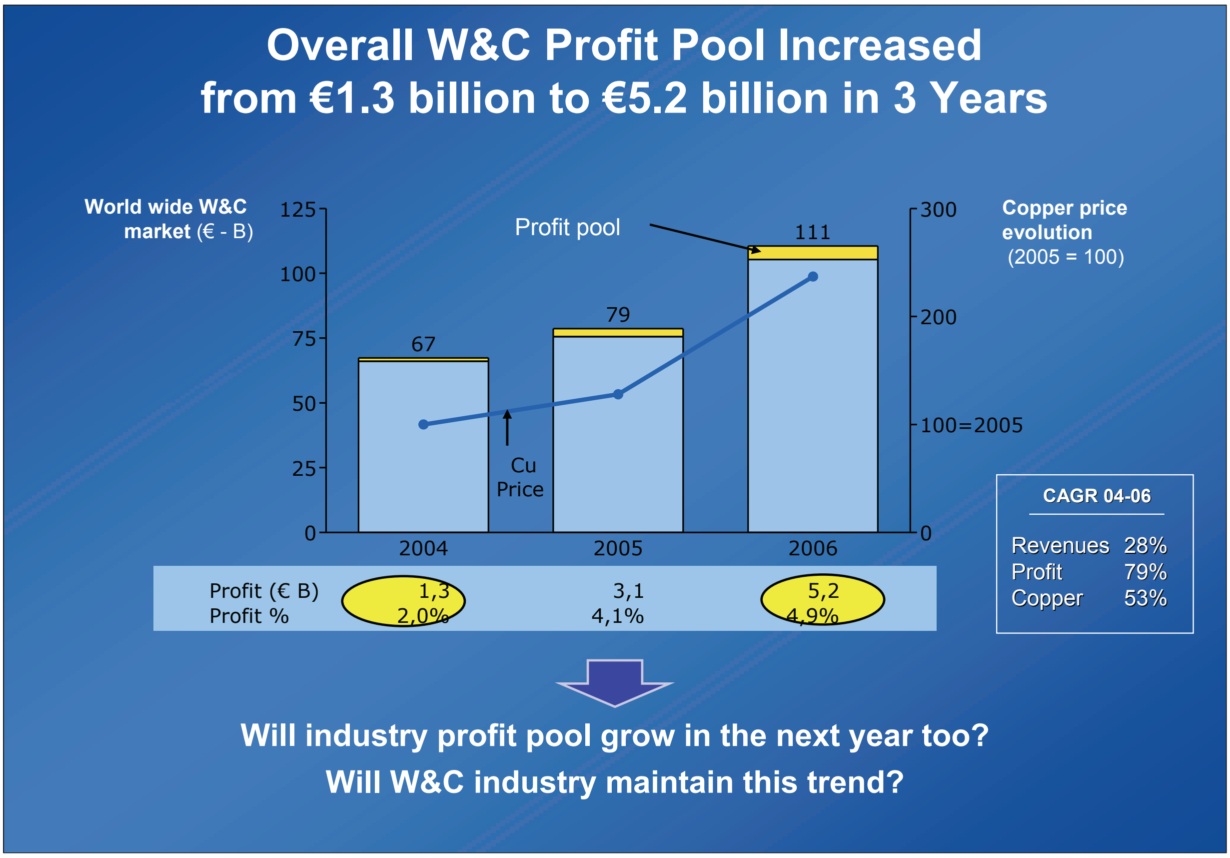
Mr. David Garza, Session Chairman:
Our first speaker is Mr. Piero Galli from Bain & Company. He holds an economics and business degree from the University of Genoa in Italy. He is director of the main office of Bain & Company in Milan and also heads the Italian Telecom, Media and Technology Practice. He has more than 15 years of experience as a strategy and change management consultant. He also has relevant experience in the services area and also in information technology projects with major Italian companies and also worldwide operations. Please welcome Mr. Piero Galli.

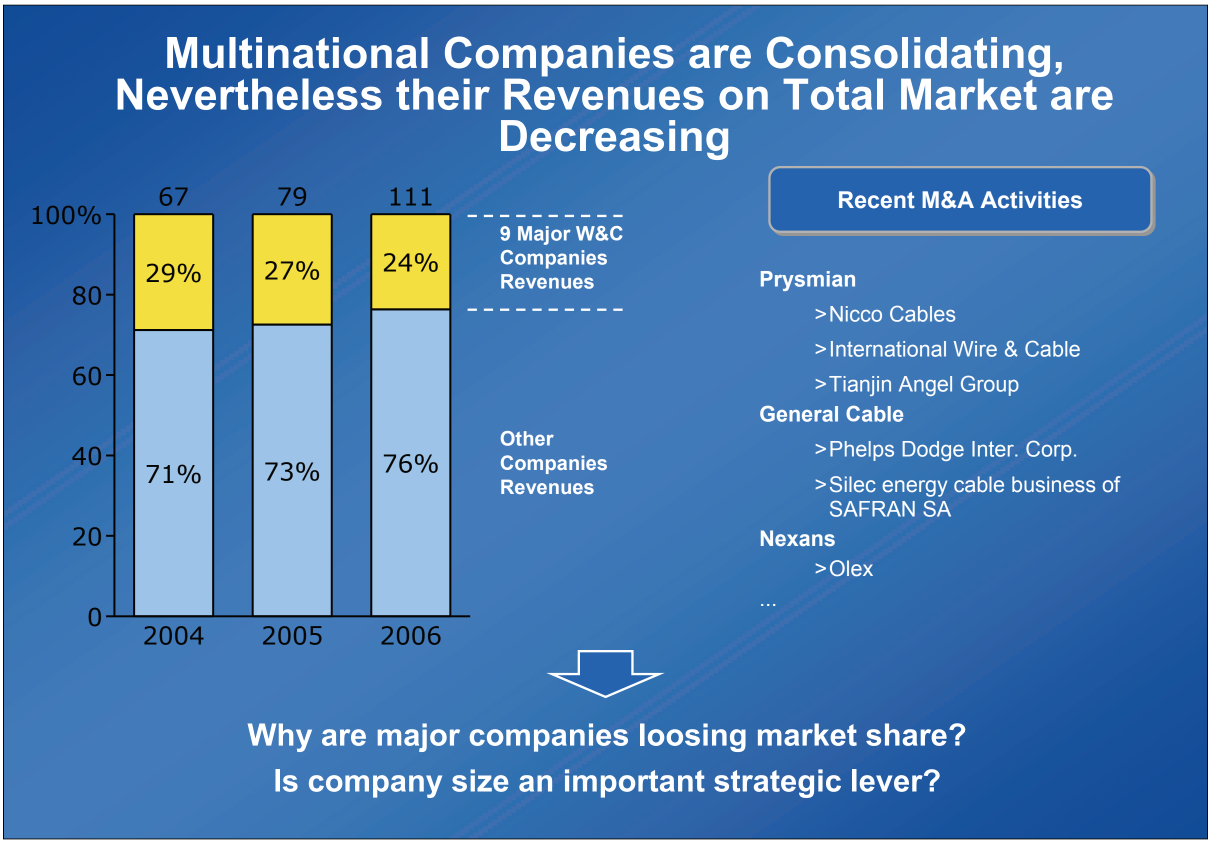
Mr. Piero Galli:
Good afternoon to everyone.
In this presentation I hope to provide you with some provocative ideas.



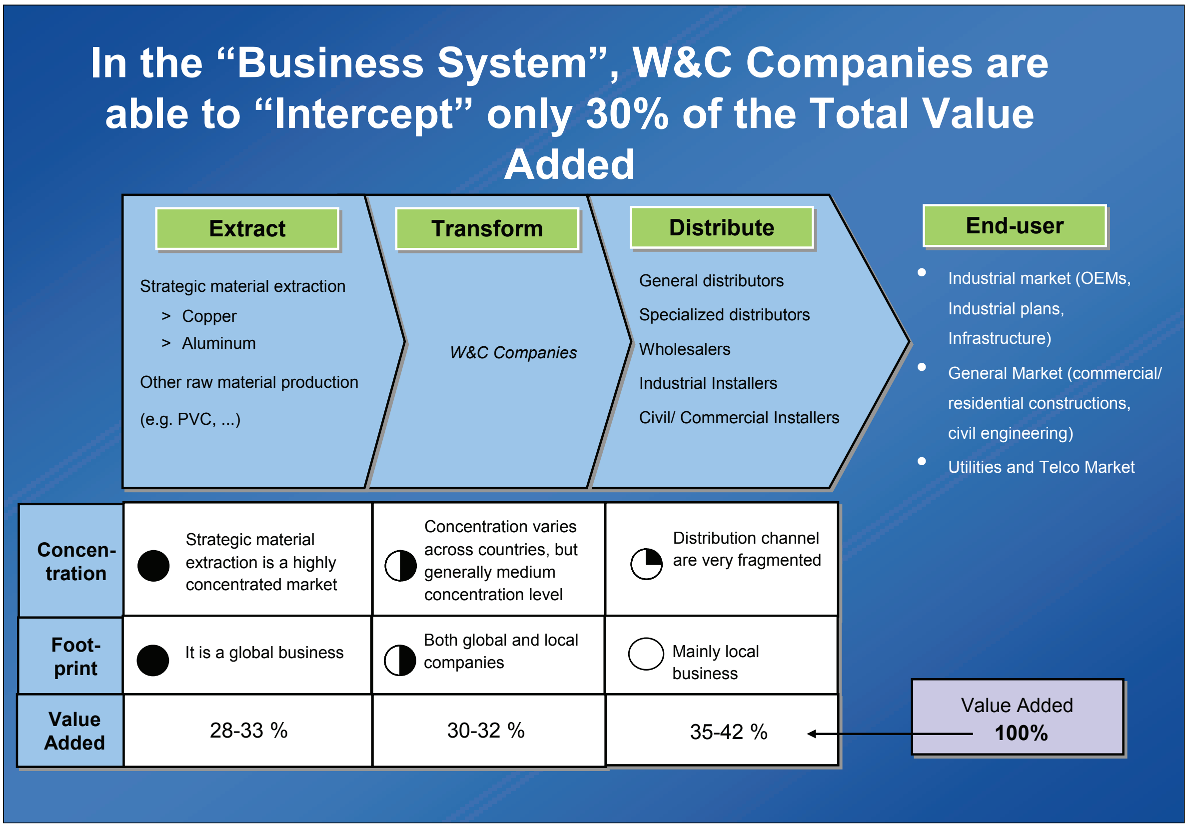
We need some numbers in order to set the strategic framework. These numbers are from the last three years and show the total size of the market. I believe these numbers to be quite accurate, however, some of the data is not publically available.

Here you can see some interesting trends. The market has been growing at a much higher rate than any other industry. Revenues have been growing at something around 28% on average a year. One interesting aspect which is a particular challenge to the industry is the fact that copper has risen 53% on average over these years, while profits have ramped up 80% on average every year. That means the industry as a whole has not been able to transfer the value created by the surging price of copper down to revenues, but at the same time has been able to create more value on the operations side in order to boost profits.

This leads to two questions: Will the industry profit pool grow during the next years too? And also, probably more difficult to predict, will the pace of growth of profits be there in the next years?



One other point is to gradually break down companies into big segments. It is a fact, that the industry has been growing by consolidation as well. If we pick up the first nine major operators in the market, the growth for them has been astonishing as well. To make a quick calculation, they go in range in billions from €19 billion up to almost 27. But in fact, even though the market has been growing organically and inorganically within those nine operators, they have been loosing market share. So one of the questions I would like to look at and discuss: Does size really matter? This is a topic which has certain impacts which are positive and others which are just question marks.



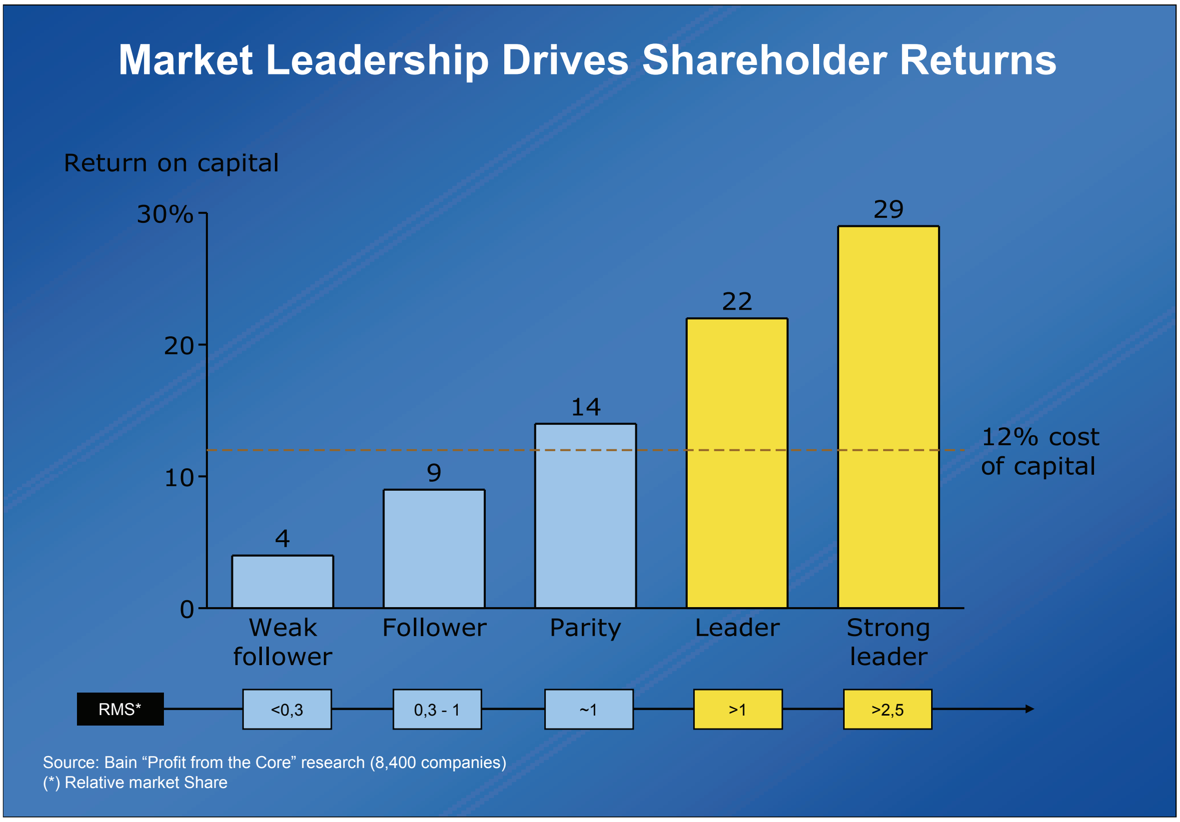
The third point in identifying the strategic scenario is, that in a situation where the industry has been experiencing such a growth in the profit pool, still that profit pool intercepts something around 30% of the total value add of the business system. I have been simplifying of course and I have been picking up the one which has on its distribution side more relevance in terms of end customers. This is typical of your industry and actually characterizes three different segments there. The first one being the extracting segment which is highly concentrated and highly global, which still intercepts something around 28% to 30% of the total value add. The third segment which is downstream is actually intercepting an even higher value in the distributor market, whereby the situation is absolutely opposite with very high fragmentation and a very local market. This is something to keep in mind, which I will get back to when talking about growth, adjacencies etc., because the business system here is something which characterizes your industry. There are situations in other areas where industries may be absolutely different. Just think about software, software would only intercept somewhere between 3% and 5% value in the distribution area. So industries are connotated by differences which need to be taken into account when looking at growth opportunities.

This actually leads to four major blocks of questions. On the one side, which are the strategic levers? What are the challenges under the strategic viewpoint? Which would be the decisions which may have different shading in terms of leadership? Would that be organic growth, with organic growth including operating and performance?

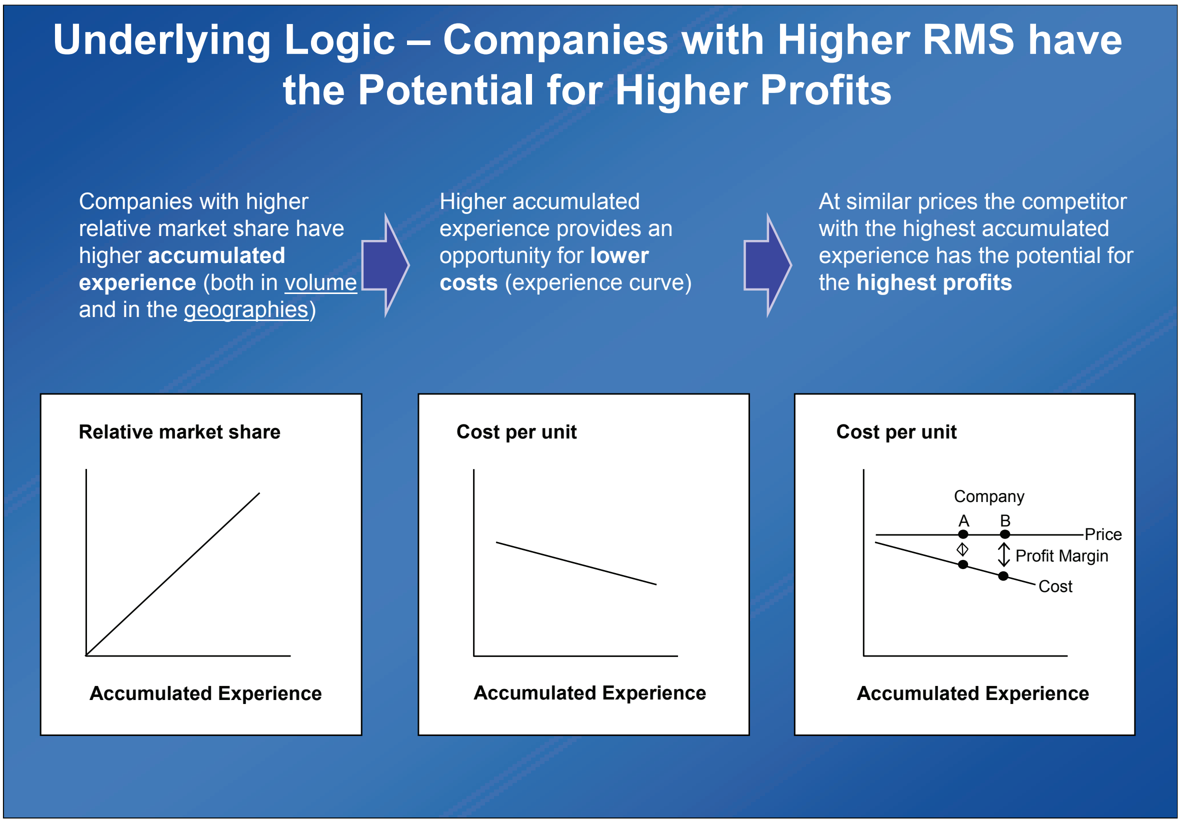
Speaking of growth, where should this growth be pursued, within the organic or the inorganic space? What is good or what is bad about the industry? What should be the business conduct that the operators should be following within that market context?

Thirdly and fourthly, what are the geographies to be taken into account in terms of winning strategies both at local and at global level?

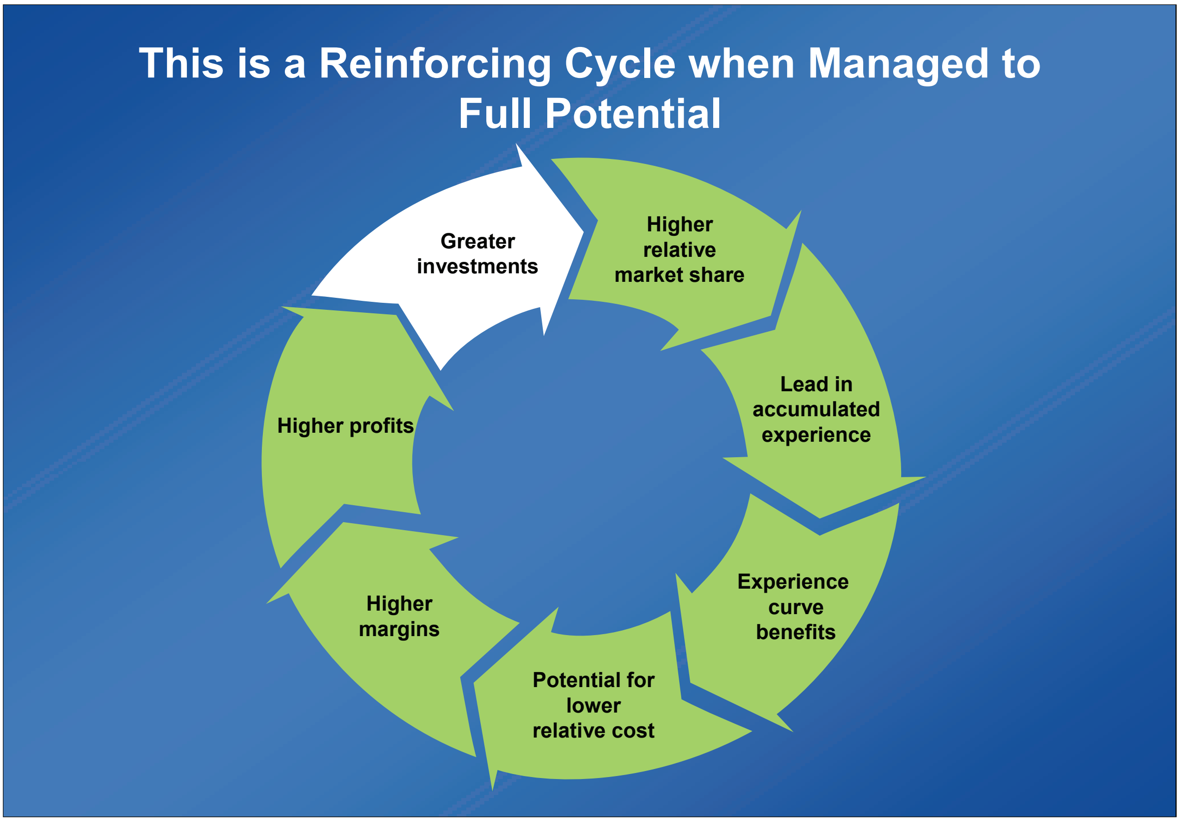
These are the natural questions which might arise when looking at the market context, that I will be trying to address with my next considerations.



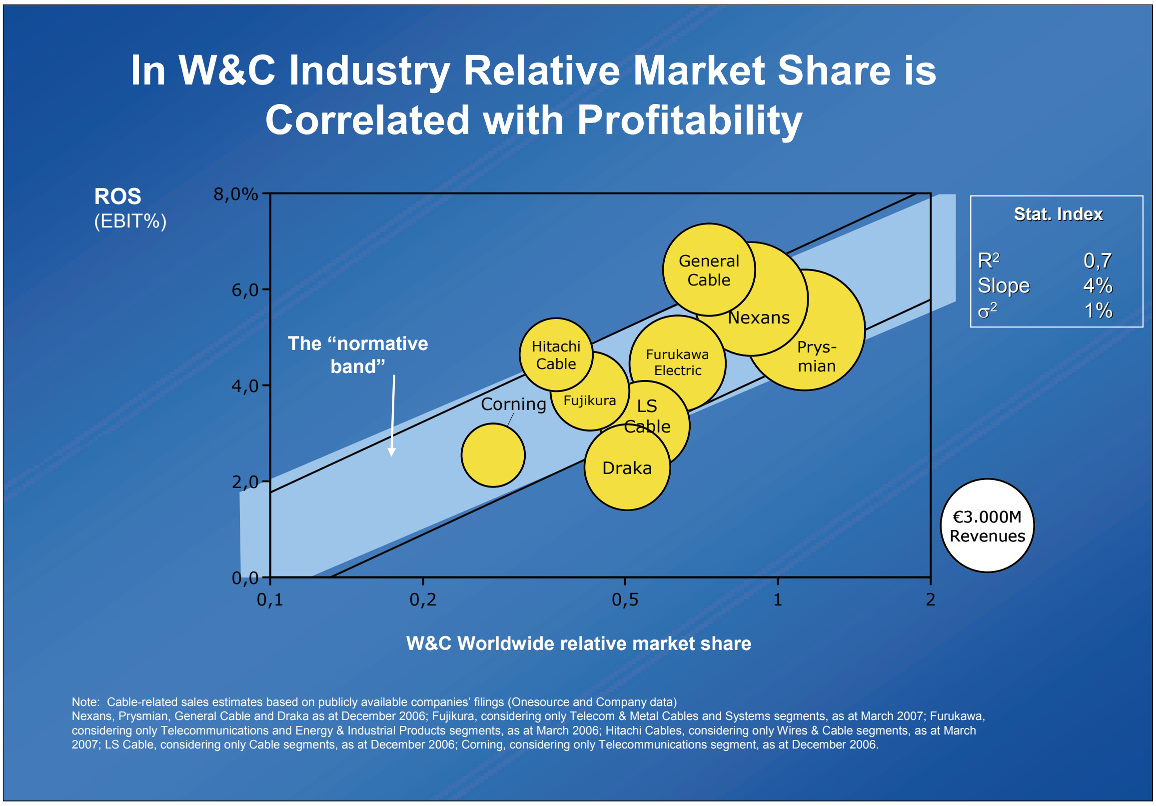
This shows market research which we have been doing accross the world on 8400 companies, trying to measure the relative market shares that these companies were producing all across the industries. Relative market share is calculated as the market share that the market leader has as compared with the follower and the others with their market shares with regard to the leader. Now if you see the breakdown of these 8400 companies, you will see that the ones that have very strong relative market shares are the ones that are paying off value much higher to shareholders. It looks as if size matters.



The topics here are that if you have a relative market share which is high enough, that is actually a proxy of having a higher accumulated experience. Being a leader, be it in niches or local economies or global, still accumulated experience within those perimeters can drive a lower cost position. Learning curve driven by leadership drives better costs, better costs in a stable environment of prices actually drive by definition better margins.

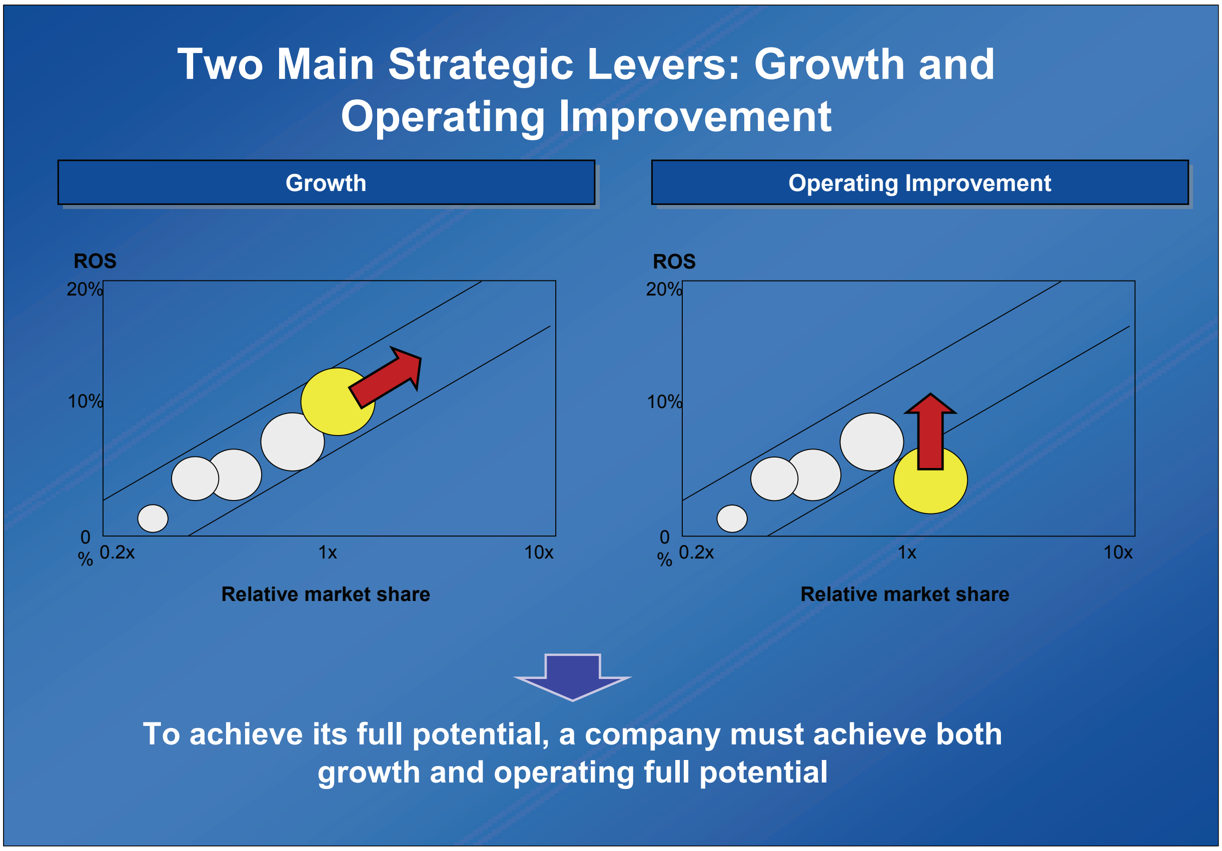


So having that in mind, when you want to bring forth a cycle when managed to full potential, in fact higher relative market share leads to a better accumulated experience, that leads to better experience curves, potential for lower relative cost, higher margins, higher profits, greater investments. So the idea today is to try to see at which entry point you could place yourselves within this potentially positive loop and intercept the best strategic alternitive you have within that market context.

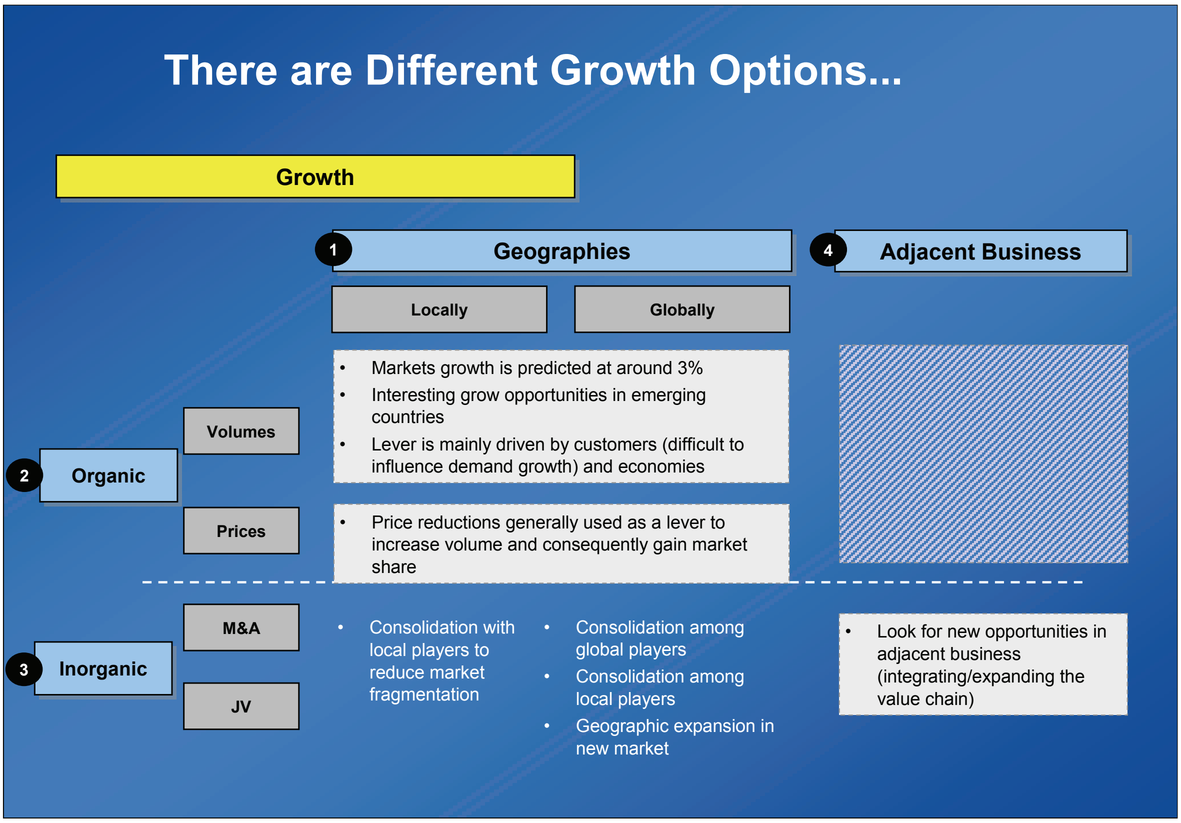


Here is a representation of relative market shares and the returns for the wire & cable business. We have been picking up a substantially evident sub-segment of the industry, the ones where we had updated data on one side and on which we had available data in the perimeter of the wire & cable business.

Two or three things should be noted here. You see that the companies are more or less located around what we call the normative band. The normative band identifies what is an interpolation curve. The squared numbers are actually the measure of the predictiveness of that normative band, that means that more or less, the companies are all aligned around the same logics of the industry. An interesting thing is also that the variance measured by sigma is substantially very little. The one thing which actually identifies the industry is that is not steep. That means that for every single bit of improvement on the relative market share, there is not such a high impact on delta in profitability. Different industries have a normative band and slope which is totally different and a lot steeper, so for every little bit of increase in relative market share the gain in profitability is much higher. This is typical for your industry, which is highly dependent on and highly affected by raw materials, which is a lever which offers little opportunity to manage it.

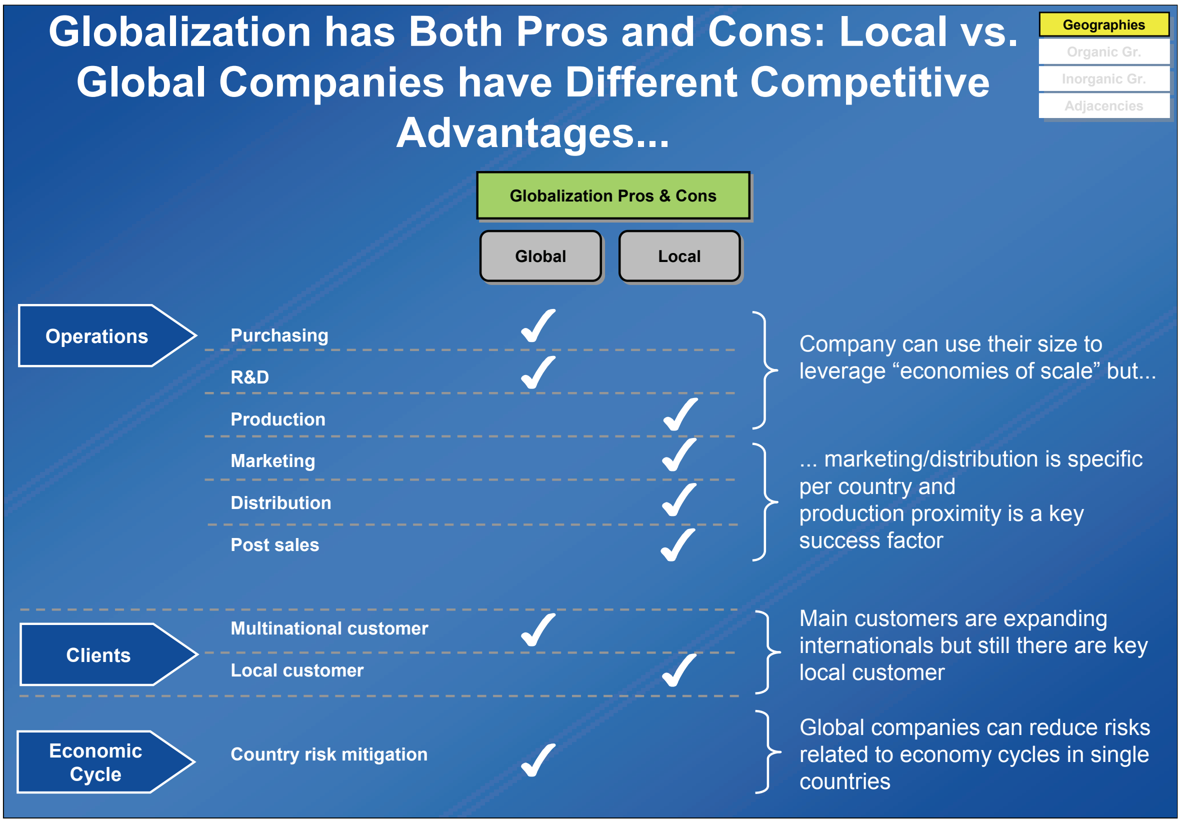


So when talking about how to better exploit the full potential of the round circle I was demonstrating before, actually we have two major axes to act on, on the one side to act on growth and on the other to act on operating improvement. Operating improvement is a matter that affects your companies every single day. I will just leave that as a final and quick point at the end of my speech. Now I will focus in the rest of my presentation around growth opportunities.

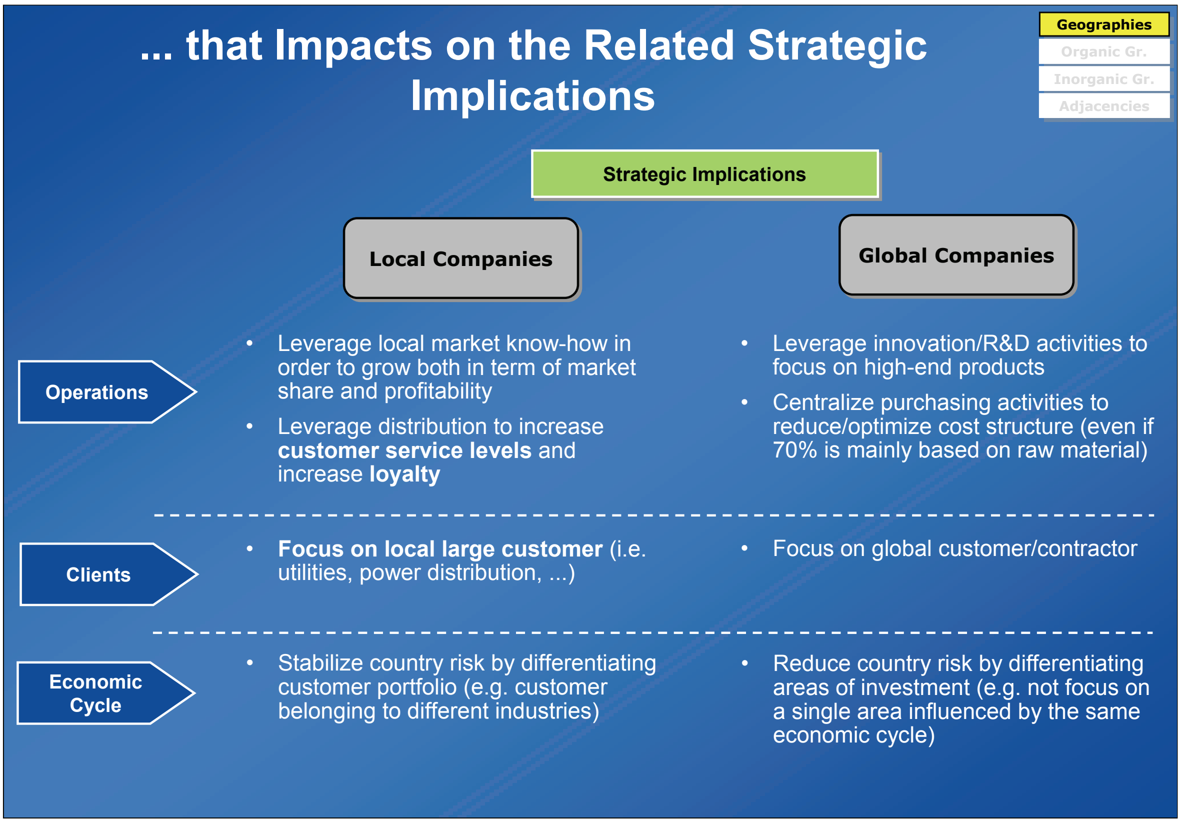


Conceptually, we can break that down into four major areas of activities. Organic or inorganic, organic being affected by volume and prices, which are substantially not dependent on geographies. This means that the logics of the industry are essentially replicable at the local level and at a global level. On the other hand inorganic growth will actually be affected by being a local or a global player. I will show you some examples on this.

The fourth axis of analysis, I will show you, is around adjacencies and how to potentially grow in adjacencies starting from the market context I was showing before.



Let's start with geographies. We start from the three axes which are more affected by the geographical presence. If we are talking about operations, we have different pros and cons depending on whether we are talking about local or global companies. So typically, when we have a global context, operations can be highly affected by purchasing and R&D. Clients are much more multi-national and actually tend to be serviced on a global scale. An economic cycle can be addressed by having a multi-geographical presence. On the other hand, if we are talking about a local basis, there are other aspects which can be exploited, which is around what is more relevant on a local basis, such as customized productions, specific market initiatives and offering distribution and cost saving services, as well as offering better service to local customers. In the end, you can look at economies of scale, but there is the matter of proximity, which is the key shaper of difference of a market on a local or global base. It is also true that main customers, as they expand across borders are more and more demanding on cross-global services, but in a localized way.



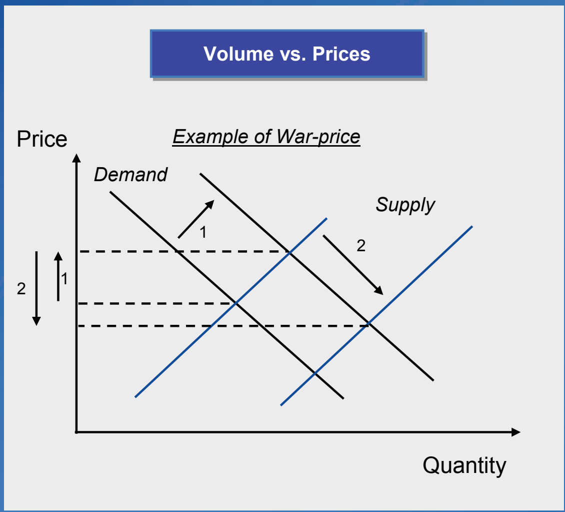
What are the strategic implications here. Looking at local companies and taking into account the three axes mentioned before, when we look at operations, there is a hint of trying to leverage as much as possible local market know-how in order to grow both in terms of market share and profitability. At the same time, and I think this is probably the most important point, on the local basis as far as operations are concerned, leveraging distribution to increase customer service and loyalty. Customers' loyalty, and I will not spend more time on that, has an NPV which is tremendously higher than rotating customers. This is an opportunity for local operations to be exploited.

Looking at clients, the impact on clients should be to focus on large local customers, like in the utilities and power distributions. The economic cycle can be hedged in terms of the risk, by differentiating the customer portfolio on the one side and the business portfolio on the other. This is an axis which is valid for geographies as well as for inorganic growth, and I will deal with that in a minute.

Global companies can leverage on that which is more globally leveragable. That means R&D on the one hand and of course innovation and centralized purchasing, even though we know that on average over 70% of the cost of the product comes from materials. The other implication is of course to focus on large multi-national customers and as far as the economic cycle is concerned to try to expand the presence in geographies which are counter-cycle or actually benefit from high expansion rates.

Geographies
Organic Gr.
Inorganic Gr.
Adjacencies

Volume/Price Levers Need to be Managed to Become an Opportunity to Increase Value for the Company, not to Generate Price War



Volume lever is mainly driven customers (difficult to influence demand growth)

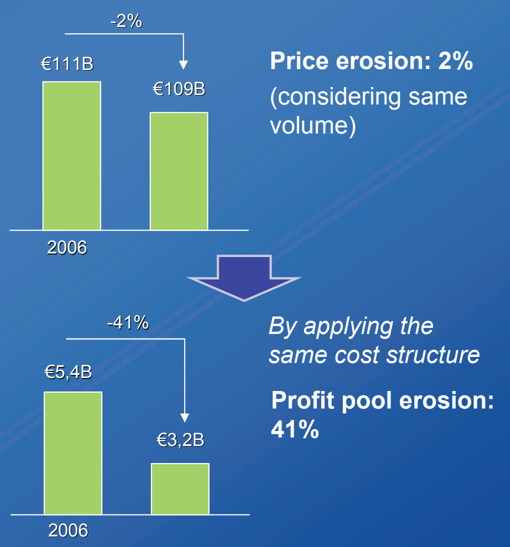
Price lever is usually used to boost **volume** in particular in emerging market where cable market is dominated by local player

Looking at the organic side, volumes are hard to address, because they are dependent on economic cycles and intensity. What is happening in the industry is that price is the lever, which has highest visibility within the industry. Demand has been growing a lot and the industry reacted by adding substantial increases in capacity. In a normal micro-ecoomic situation, when demand grows, prices should typically increase. The excess capacity has actually kept the prices stable or declining. This is a situation which is not healthy for the industry. So, I personally think that price management is a key issue within the industry, even more so, if we think that the profit pool may be strongly affected by the situation which I just showed you in the beginning. If you actually think that there might be a downturn in the total size of the business or just a lowering of the growth rates that have been experienced during the past three years, the industry might be trapped into a price war.

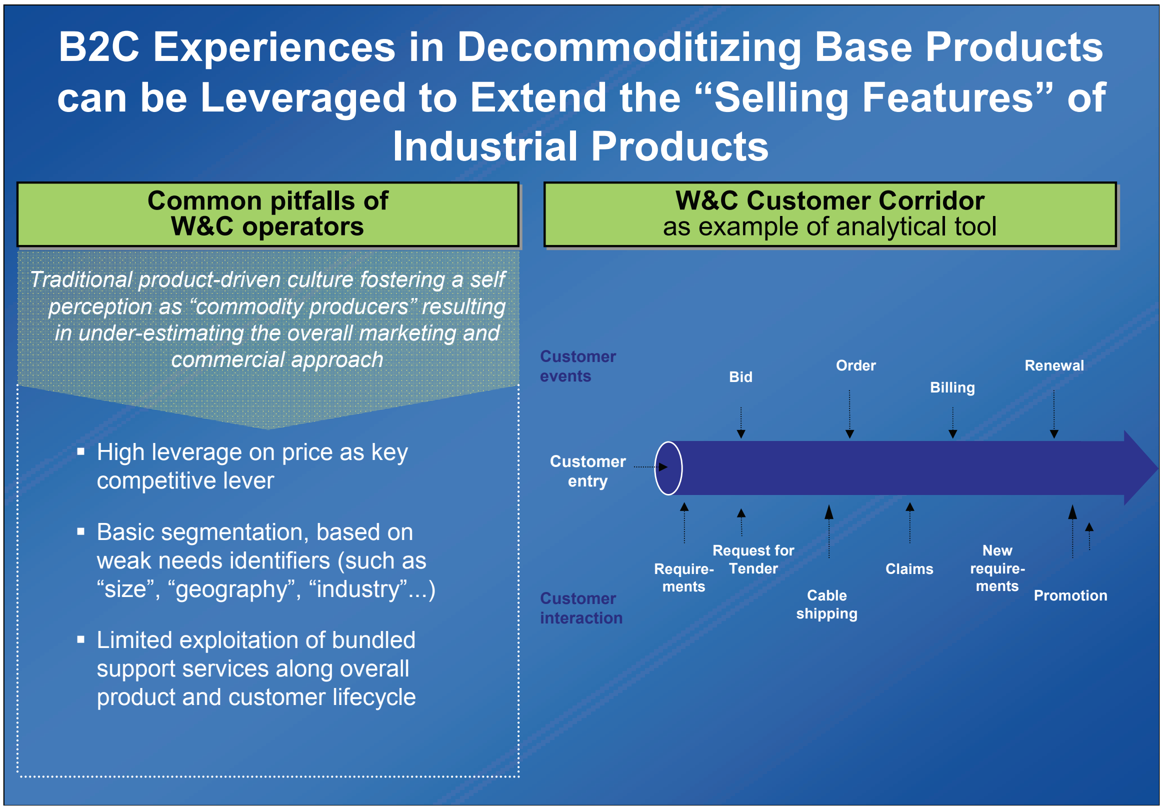
Price Lever is Mainly Used to Boost Volumes, but to Shrink the Industry Profit Pool and is not Successful

- Price reductions are almost **always 'tit for tat'**
  - >Impossible to prevent competitors responding – experience says they will
  - >Tough to confine price wars to single markets where multi-national competitors are involved
- Price and industry profitability **rarely return to pre-price war levels**
  - >Long-term shift in profit base away from the manufacturers
  - >Customers expect lower prices and trade customers lock in long-term deals
  - >Erosion of brand equity allows value brands to develop
- Price wars are usually sustained, and **rarely result in removal of over-capacity** from the industry
  - >Corporate emotions ensure profit pain is sustained
  - >Risk of litigation around predatory pricing
  - >Sustained price wars make it hard to retain and motivate the local team

Example of "Price War" Profit Pool Impact



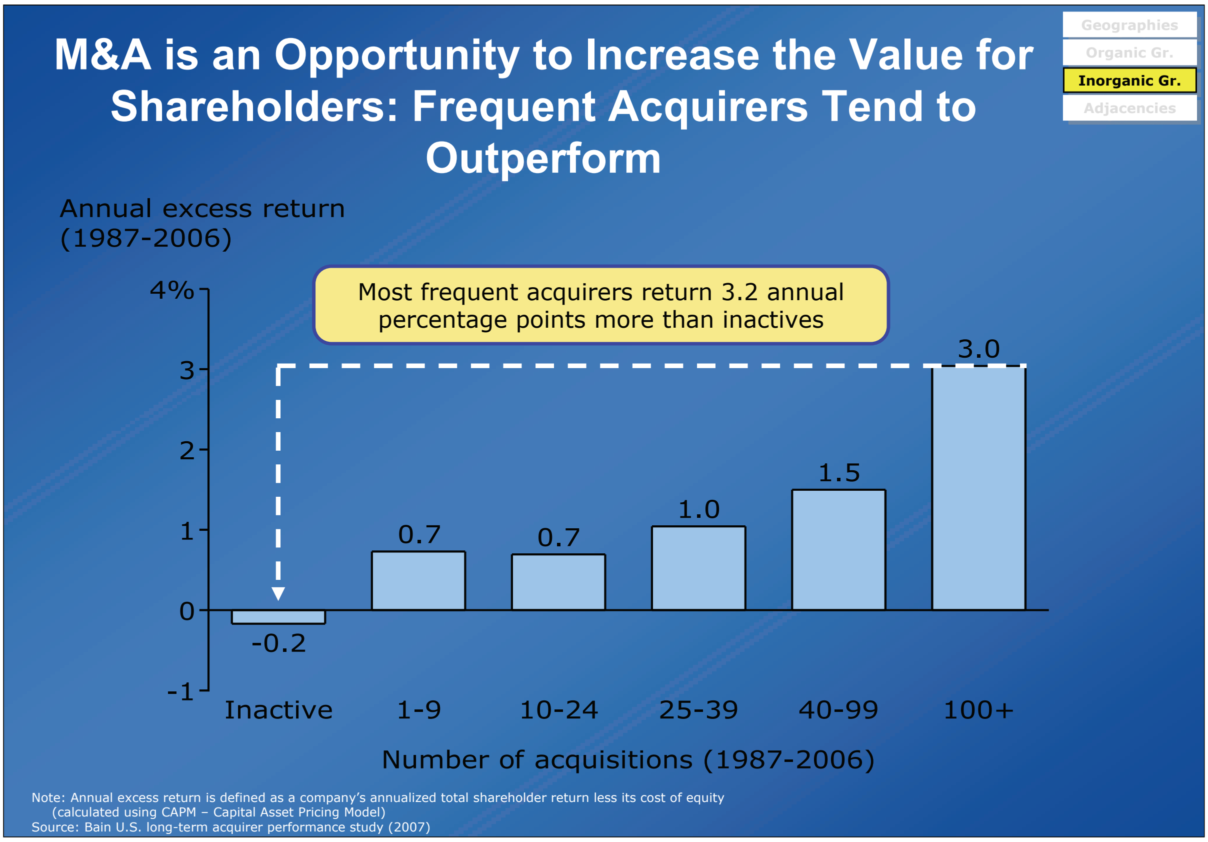
What typically happens is that price reductions are almost always tit for tat. The ones that start are definitely followed by all the others. Secondly, price and industry profitability rarely return to pre-price war levels. Thirdly, price wars are usually sustained and rarely result in removal of overcapacity.



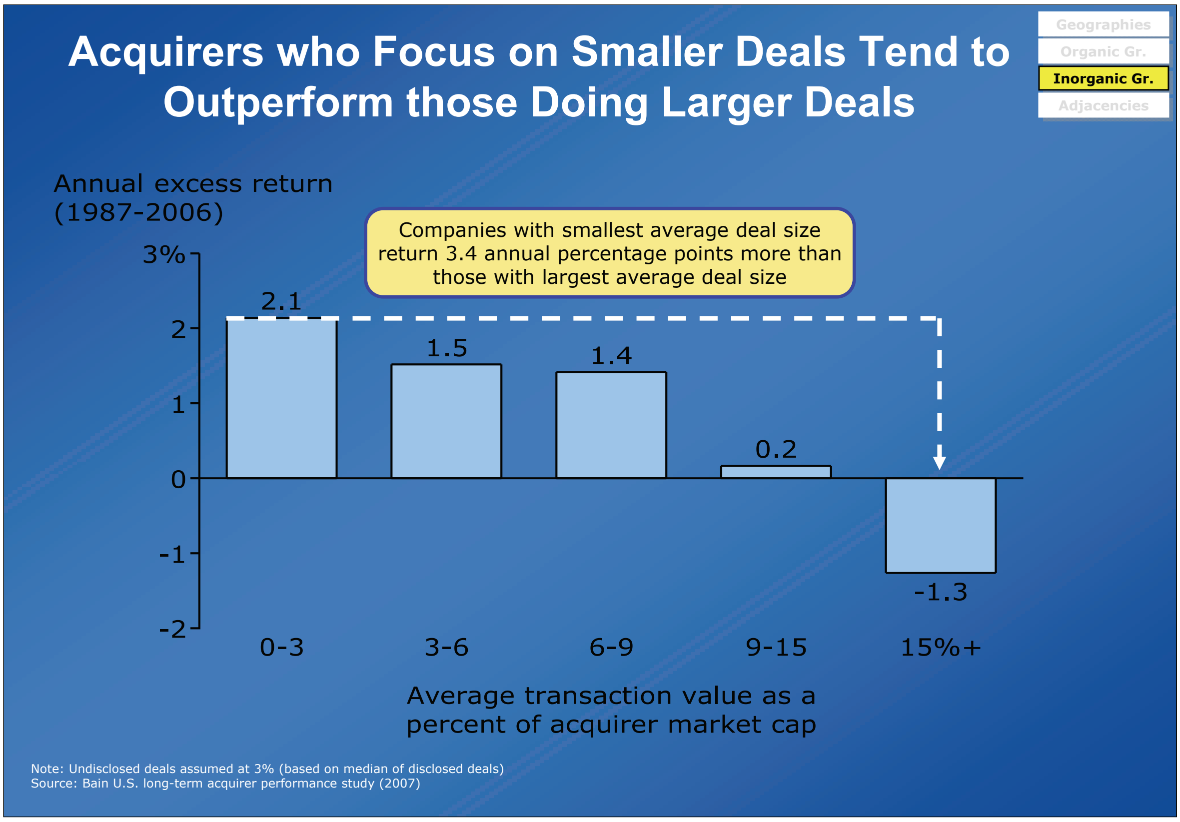
We have examples here of other industries like the automotive industry or the airline industry, which have experienced exactly the same things. The recovery of the airline industry has taken place after years and years of losses, because overcapacity has been removed after years and years of losses. What you see here is what would happen in the profit pool, if you factor is just a 2% price erosion. If you think about applying the same level of cost structure, a 2% erosion in price may mean a 41% reduction in the profit pool. This is coherent with what has been the evolution in the profit pool over the years. This explains why the industry typically looks at this business as being commoditized. There is a high leverage of price as a key competitive lever, there is basic segmentation of customers and thirdly, there is a limited exploitation of support services along all the product and customer life cycles.

My point here for the industry is to start from the B2C experiences and to look at what the customer needs, work it back and look at the customer corridor. The customer corridor shows you on one side what are the customer events and on the other which are the customer interactions. You try to trap and intersect the customer behavior expectations along all of these points.

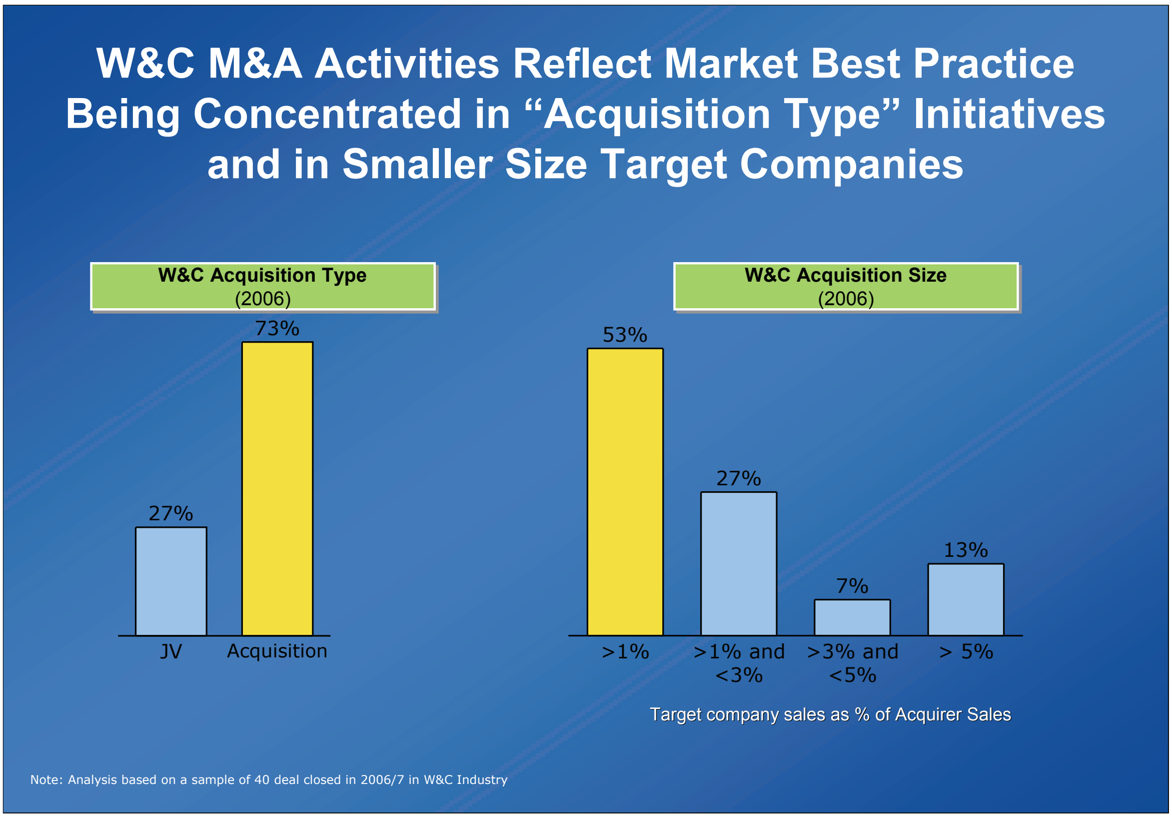
Working those tough points back will enable you to have a much better but stronger segmentation. Driving the delivery of services which will help you in differentiating pricing and protecting pricing. This is typical of industries where the experience of fast growing revenues and profits actually generated the reaction of inducing very high capacity. This is a typical situation where you start segmentation and differentiating the price offering when the growth rates may be flattening out.



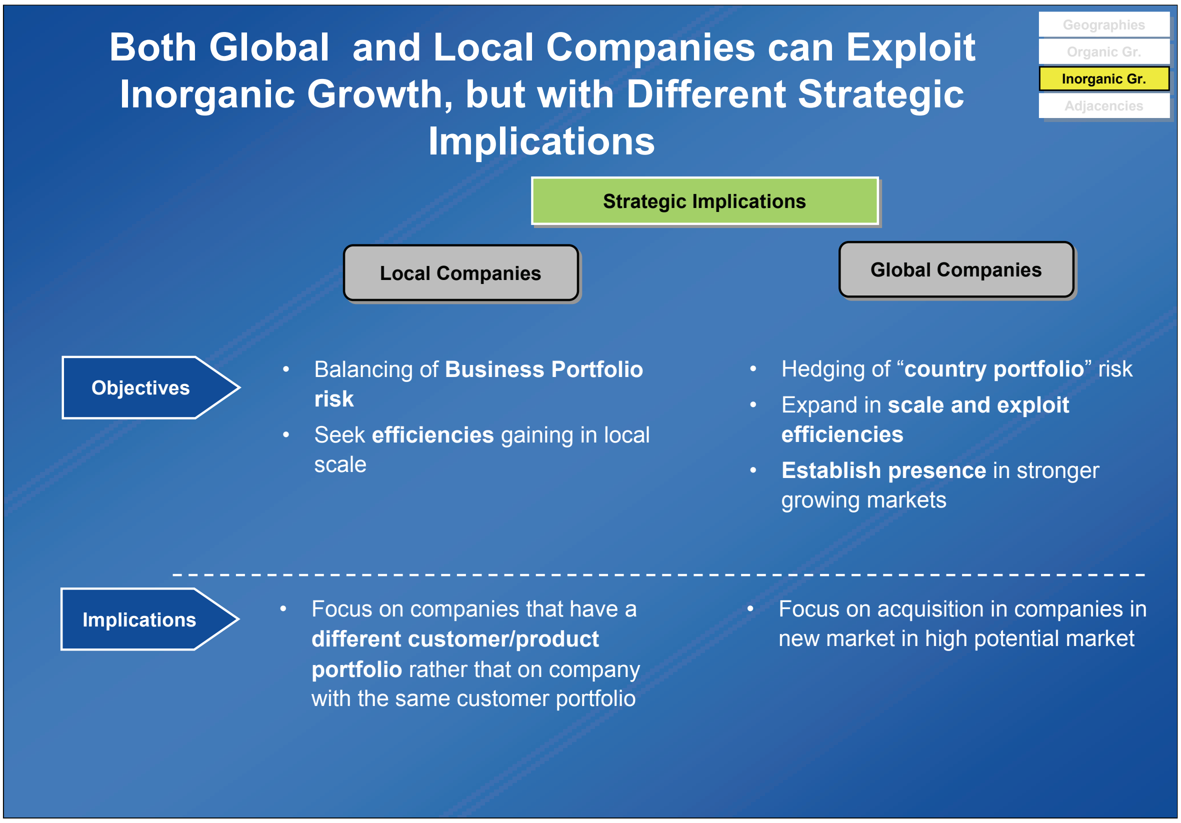
Let's look at inorganic growth. This is another panel of companies whose behavior with regard to acquisitions we have observed over 20 years of time. What this slide tells you is, if you look at this 20 year time frame and look at the expectations of the shareholders as regards repayment by the performance of these companies, the one company which made many more acquisitions over that time, was able to exceed the expectations of the shareholders. This means that 3% was the average excess rate on top of the repay out of the equity capital across those years.



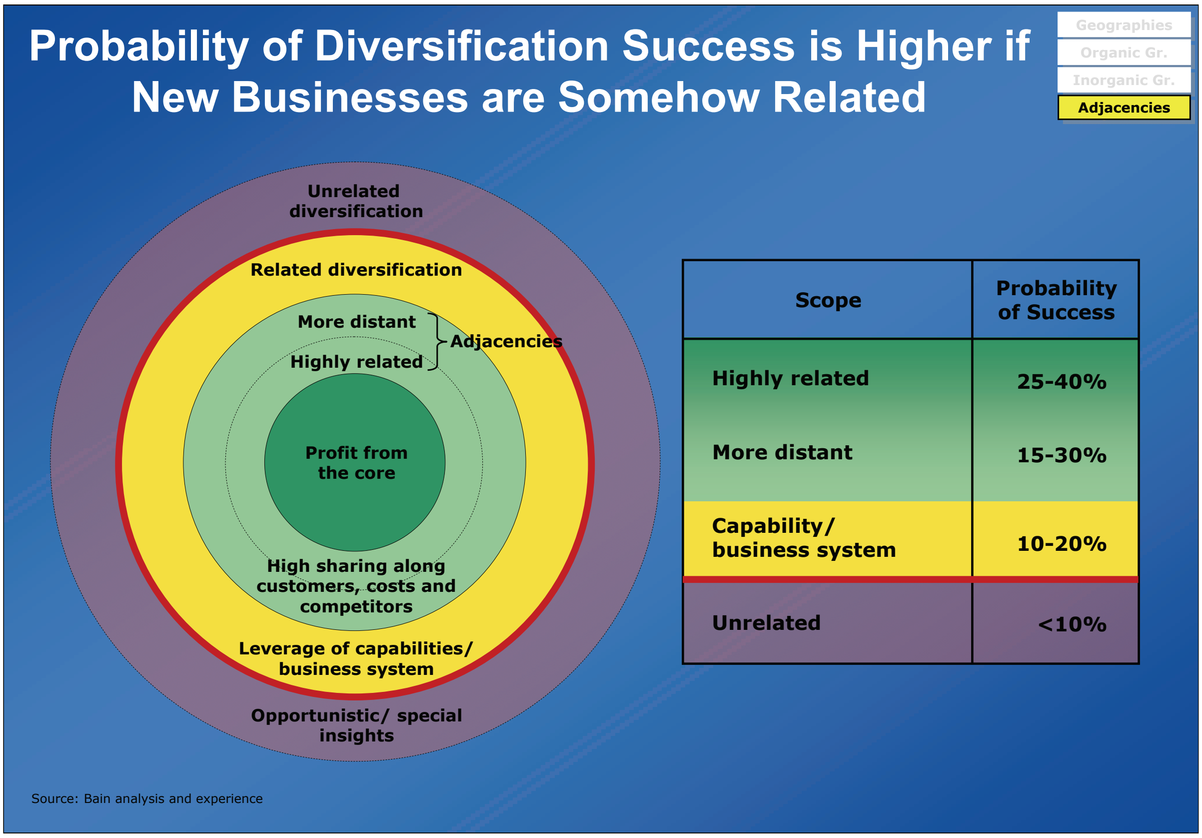
If you look further and see what size acquisitions paid off more for companies which made many acquisitions, the ones which were able to add more value and to repay this value to the shareholders were the companies which were buying small size targets. If you see there 0-3% size in terms of market cap of the target companies vs. the acquiring companies were the ones which were delivering 2% profits and returns to the shareholders, who had invested in those market companies. In the end we say: buy many companies and buy them small.



Here we pick up a selection of the last forty acquisitions done in your industry. What we see is, the acquisition type is prevailing, which is good news, and at the same time there has been a vast concentration on small size companies being acquired. I took revenues as a proxy for market cap here, because some of them were not even listed. The bottom line here is that the acquisition activities being done by industry were in line with what our findings were all over the various industries and has been good so far. The strategic implications for that are, if you look at local companies, the objectives should be on the one hand to balance the business portfolio risk, go back to the geography point I made earlier, at the same time seeking efficiencies and gaining in local scale. The implications for that are complementarity, i.e. trying to find the targets which broaden the business portfolio locally and will enable efficiencies of scale.

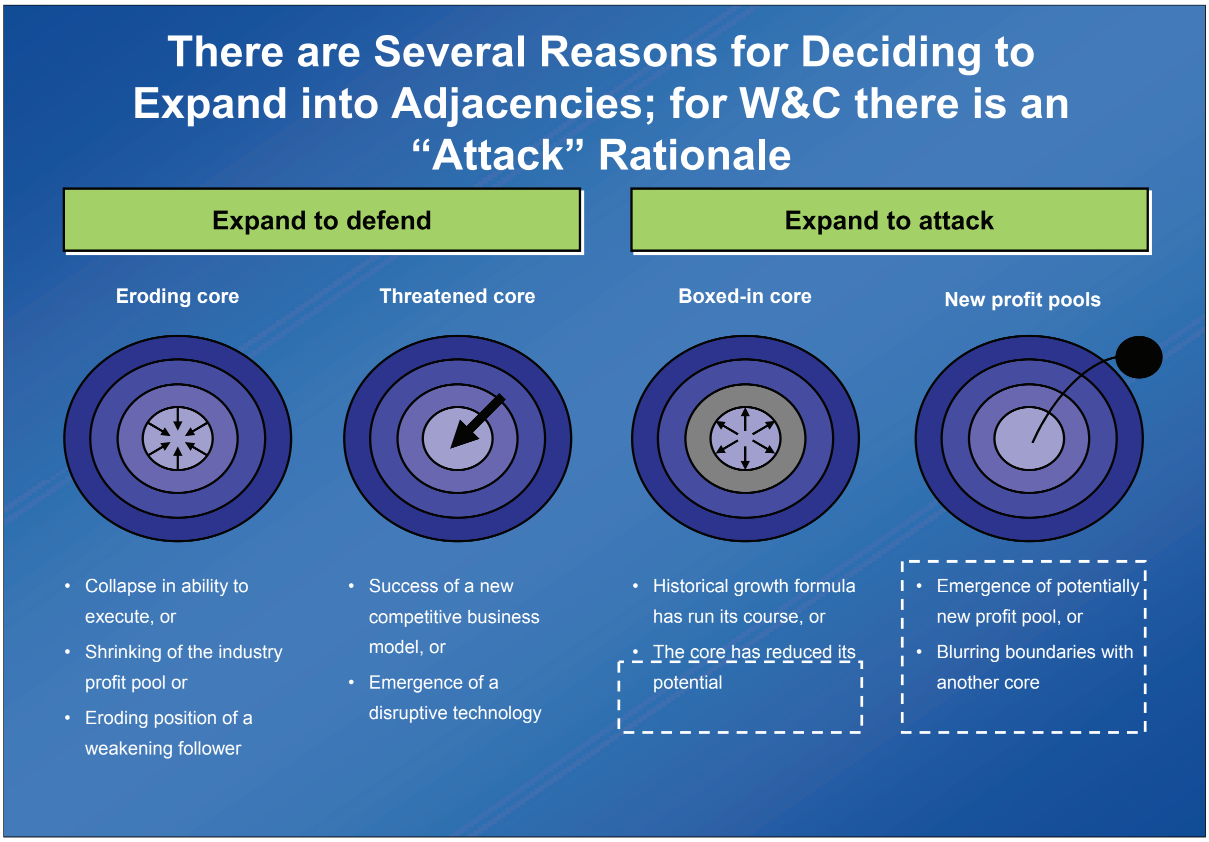


Different strategies for the global companies. On the one side there is definitely a need for hedging the portfolio risks in terms of geographies of presence, still exploit in expanding the efficiencies of scale, which are an aspect of a global player and establish presence in strongly global markets. That means substantially targeting companies in fast growing economies.



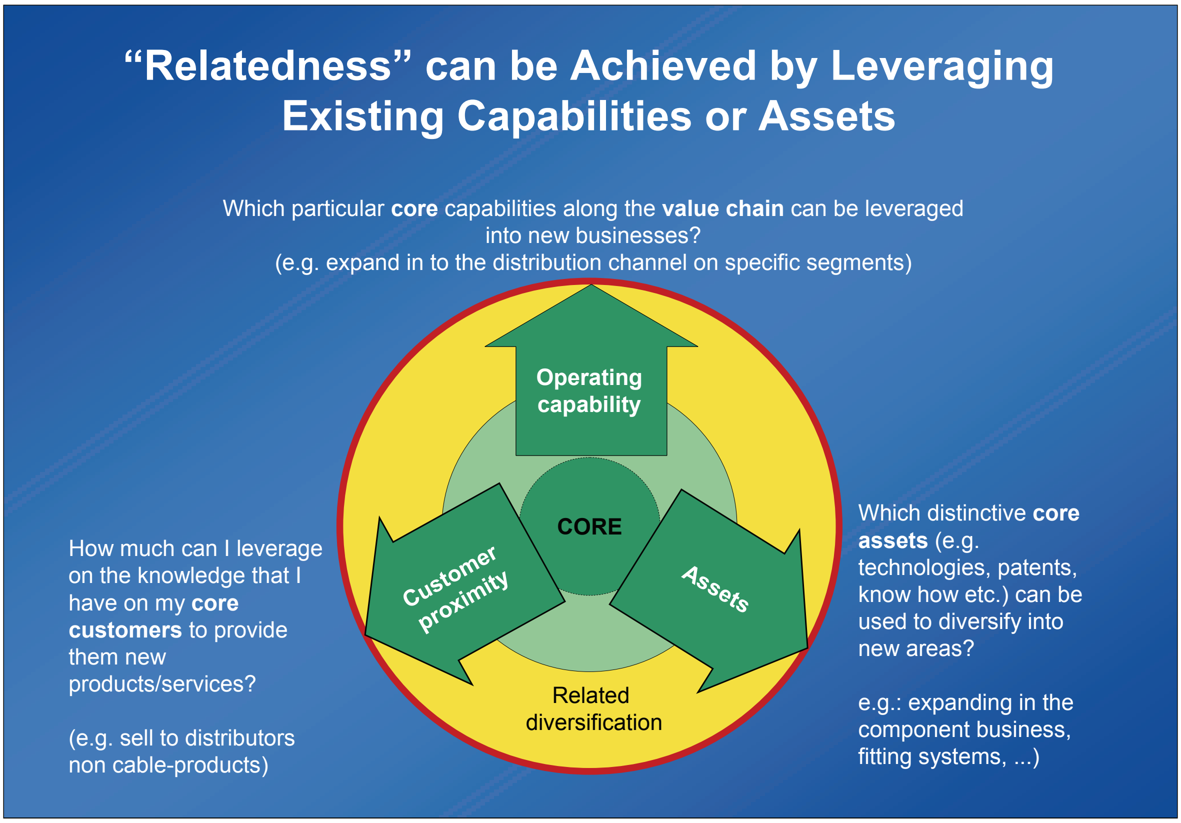
Now consider adjacencies, which will provide you with a new angle of the same analysis we made on those 8400 companies. Our core concept has remained unchanged. We have seen that when expanding by adjacencies, you need to have a substantial and strong definition of what an adjacency is. Here we have defined three levels of adjacencies. One being to have adjacencies to your core which are suitable for high sharing of customer benefits, because you have the same set of customers or a very high overlap. The second level is sharing of cost positions, for example R&D or purchasing or distribution. Thirdly, adjacency of competitors, because you know them better and you know how to attack them in the best way.

The last ring, which is often taken to be the first ring, is leveraging. You see on the right hand of the slide, that once we have been making the evaluation to identify the various levels of adjacencies, the ones which are highly related have demonstrated to have had a much higher success rate for the acquisition and integration process.



This is interesting, if you see what could be the reasons for the industry to decide to move into adjacencies, you can identify moves that reflect a different situation. You could move because the core is eroding, or the core is threatened. Both of these are "expand to defend" situations. You could also decide to "expand to attack". Depending on what your expectation of the market development in the next years will be, you might position yourself to the attack or defend side. I prefer to be more optimistic and anticipate industry to expand by attacks. That would be the situation where the core has reduced its potential, as when copper prices slow down, or you have a blurring of boundaries from one core to another. This is already taking place, especially when you think of the businesses and flow chart I showed you earlier, where I was talking about extraction and transformation and distribution.

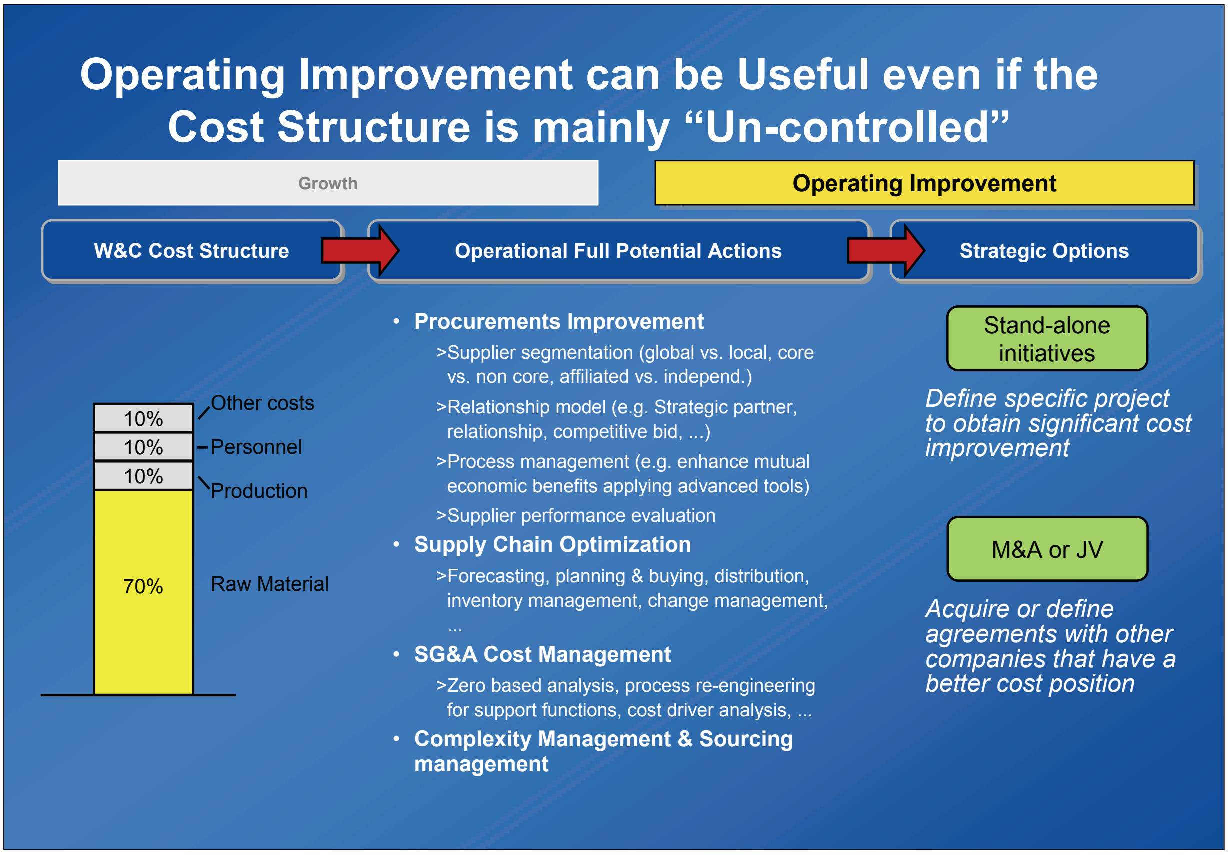
At the same time, if we were to expect or experience a downturn in revenues or prices or margins, then the eroding core option could become interesting.



Let's see how that relates to your industry. We could have a way to leverage operating capability, which could be a way expand into adjacencies which are near your business system today. An example of this would be to go into distribution channels. The ways of doing that might vary very much. We have examples of other totally different industries that experienced your same situation and used this method, for example in the food and beverage industry: Coca Cola, Heineken, etc., which formed a specific initiative adjacent to their core industry by strongly stepping into the distribution world.

The other option is to leverage on assets. The option here is to broaden your portfolio, which is not set and immediate like the fitting systems or in the component business. This again is a trend which we can observe already taking place.

The third one could be in getting customer proximity, especially for certain big subunits of your business such as the trade and installers business, whereby you have customers that you know very well and you might be considering them as a target for additional revenues and enhancing your product portfolio.



Lastly, one final word on costs. All that works, if at the same time you really track your costs down. Industry has been doing this fine in the past. But still even if it is not such "sexy and strategic" argument, this needs to be followed through, because such a large percent of your business does not depend on you, very little of it is addressable. At the same time you might have alternative strategic options. You might have specific stand alone options such as procurement, supply chain, costs and complexity management. This all goes back to the scale factor and learning curves I mentioned earlier.
At the same time, it is also a way to identify M &A and joint venture opportunities, to complement your business portfolio, your geographic presence and also to identify targets which are performing better than you as to the cost aspect.

Conclusion

- **Market is facing a substantial challenge in maintaining profitability growth rates**
- **Even though the trend is common, there is not a specific prevailing strategy valid for the Industry but the various operators need to shape a specific approach**
- **Trying to share a common business conduct is healthy for the Industry and prevents destroying values**
- **Inorganic Growth has proven to be effective so far**
- **It is not clear whether expansion in adjacencies is always a good move within the overall strategy**

Here are my conclusions. The market is facing a substantial challenge in maintaining profitability growth rates. Even though the trend is common, there is not a specific prevailing strategy valid for the industry but the various operators need to shape a specific approach. Trying to share a common business conduct, especially as regards pricing, is healthy for the Industry and prevents destroying values. Inorganic growth has proven to be effective so far. It is not clear whether expansion in adjacencies is always a good move within the overall strategy. If we look back, only one of the three adjacency expansions fall into the highly successful category. That means expansion is good, but it must be done with a specific aim.
I did not to give you a recipe, I just wanted to provide you with some hints.
Thank you.