



MILLIPORE

## Incorporating Initiatives and External Benchmarking into the Management Process

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### Disclaimer

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The following presentation contains metrics and numerical data that are shared for illustrative purposes only. Actual results have been modified to reflect hypothetical scenarios and should not be construed as recommendations.

# Agenda

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- Introduction to Millipore
- Initiative Management
- External Benchmarking
- Conclusion

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# Millipore Corporation is a \$1.5 Billion Life Science leader

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Millipore provides cutting-edge technologies, tools, and services for bioscience research and biopharmaceutical manufacturing.

### Quick Facts:

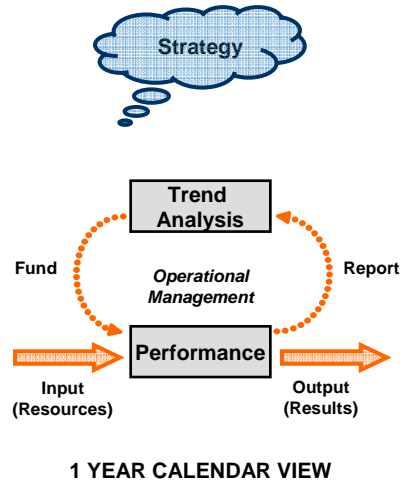
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- S&P 300 company (NYSE: MIL)
  - Created in 1954
  - More than 6,000 employees
  - Headquartered in Billerica, MA
  - Operate in 47 countries

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Manufacturing in Australia, Brazil, France, India, Ireland, Sweden, United Kingdom and United States

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## Prior to 2005, Millipore used a traditional budgeting format

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### Budget Process

- Strategy developed and reviewed annually at corporate level
- Annual budget process took 5-6 months to complete
- Financial forecasts focused on one-year view
- Targets based on past, internal performance

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## In 2005 we began our transformation

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### Platform for change in early 2005

- New CEO with improved strategy and vision
- More clarity on market position versus peers

### Global Leadership Forum commitments:

- Strategy execution a core competency
- Culture of execution, performance and accountability
- Revised approach to strategic and financial planning
- New "Growth Performance System" (GPS)

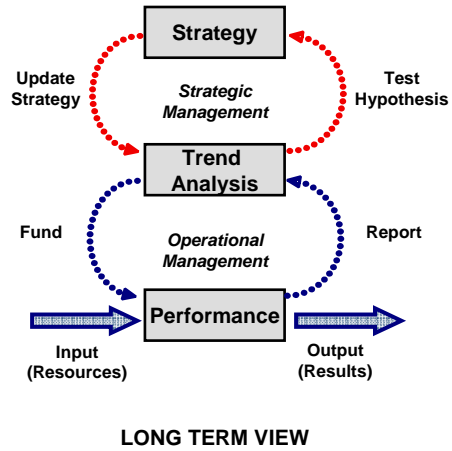


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## We organized to become a Strategy Focused Organization (SFO)

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- Executive Leadership supporting Change and Strategy
- Communication in Operational terms with Strategy Maps
- Organization focused on Execution and Teamwork through:
  - Compensation linked to strategy execution
  - Goals aligned in performance mgt system
- Change embedded in the company culture with new processes:
  - Rolling Financial Forecast
  - Alignment of Strategic Plan and Operational / Reporting cycle
  - Scorecard and Initiatives



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## Our team was formed to lead strategic and financial planning

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**Corporate FP&A and Strategy Management team has 1 Director, 1 Manager and 4 Analysts**

**Our primary roles include:**

- Manage forecast, AOP and 5 Year Plan
- Manage corporate scorecard
- Manage peer analysis
- Define compensation metrics
- Conduct corporate level analysis
- Serve as partner to corporate functions

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## Our GPS incorporates a suite of tools and processes to help us become a SFO

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### The GPS tools and processes in place today are:

- Balance Scorecard (BSC) – track progress of metrics against strategy
- Quarterly Rolling Financial Forecast (RFF) – examine past and upcoming 6 quarters financial performance every quarter
- Performance Management tool - track individual goals

- Initiative Management
- Setting and Measuring Variable Targets

} Focus of Today

### These tools and processes strive to create

- Flexible decision making, execution of strategy, effective results tracking and dynamic funding

The challenge has been to deliver value and not more administration.

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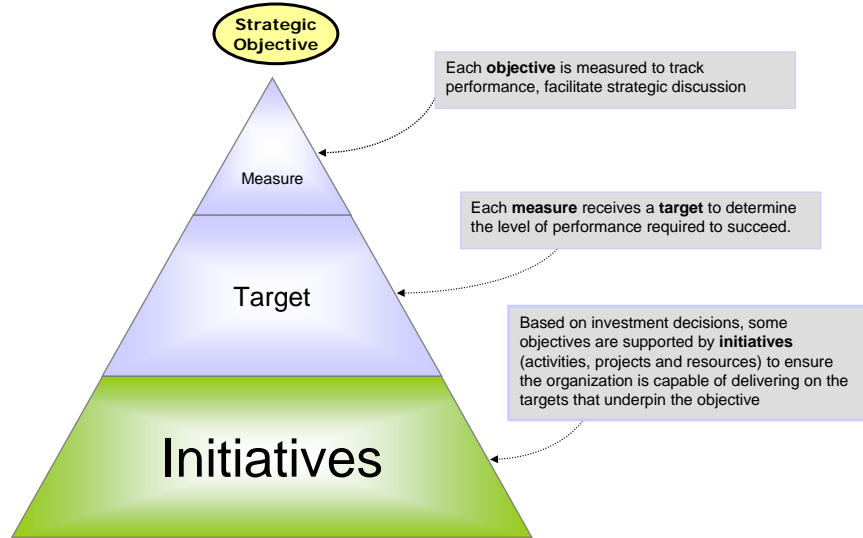
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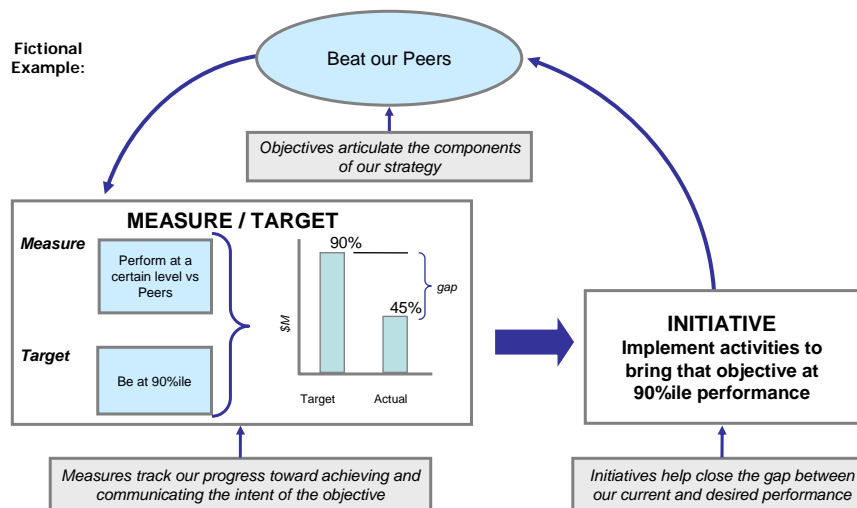
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# Initiatives help execute strategy



# Initiatives are also used to close performance gaps



## Several key characteristics define a corporate initiative

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- **Helps achieve Strategic and Financial Objectives**
- **Drives significant growth, profitability or capability improvement**
- **Requires considerable investment (\$, time, management)**
- **Crosses business and function boundaries**
- **Has a clear charter**

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## Each initiative has to address the following qualitatively in its charter

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### **Define scope of Initiative**

- Define how Millipore changes once Initiative is complete
- Classify Initiative type: Revenue Growth / Operational Efficiency / Organizational Capabilities
- Outline project horizon
- Identify risks

### **Outline the management team**

- Determine Senior Management Owner and Project Lead
- Allocate resources required: internal / external (# and \$ involved)

### **Examine qualitative impact**

- List number of people impacted
- Study complexity to implement
- Evaluate strategic importance for long term success

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## The charter must also detail quantitative elements as well

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### Analyze short and long term quantitative impact

- Study Costs Impact - P&L (GM, SG&A, R&D), B/S (Capital) and resulting Cash Flow
- Review Benefits –P&L (Revenue, GM, SG&A, R&D, Interest), B/S (Capital, Working Capital) and resulting Cash impact

### Define milestones and measures of success

- List start and end date
- Outline key deliverables and milestones

### Provide additional commentary

- List dependencies, other alternative options, etc.

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## Initiatives are grouped and prioritized to have a balanced portfolio

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### Growth

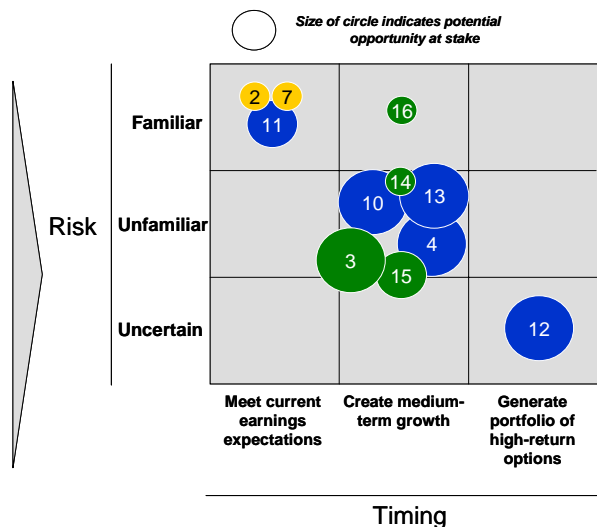
- M&A
- International Expansion
- Brand
- E-Business
- Innovation

### Operational

- Six Sigma
- Gross Margin
- Production technology
- MIS

### Capabilities

- Leadership Development
- GPS



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## Initiative management is intertwined within the AOP process

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### Hold strategy offsite meeting (June)

- Review and prioritize existing initiatives
- Align on near term and long term performance goals
- Discuss current issues
- Identify potential new initiatives

### Build AOP target model (July)

- Separate base business from initiatives

### Send “Planning Letter” targets to Divisions/Functions (August)

- Separate base business from initiatives again

The first part of the AOP process places initiatives at the corporate level

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## Here is an example of how initiatives are separated in practice

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P&L	Base	Initiative	Overall
	Business		
Sales	1,000	20	1,020
Expenses	800	30	830
<u>Profit</u>	<u>200</u>	<u>(10)</u>	<u>190</u>
Forecasting Approach	Trends, Drivers	Discrete, Bus. Case	
Flexibility	<u>Low</u> Restructure, Build Base	<u>High</u> Delay, Stop Accelerate	

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## The latter part of the AOP process places initiative ownership within Divisions MILLIPORE

### **Load bottom up AOP at Division/Function level (September)**

- Include initiatives at Div/Fcn roll-up, but have initiative sub-folder
- Typical result is too many initiatives

### **Refine AOP (October)**

- Make trade-offs between base business and initiatives → make adjustments to both base and initiative P&Ls

### **Finalize AOP (November)**

- Agree on desired base business and initiative performance
- Set final targets by division and function that **INCLUDES** Initiatives → ownership

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## There are many pros to managing initiatives in this manner MILLIPORE

### **Pros**

- Isolate initiative spending → drive accountability and focus around select investments
- Manage cyclicalities with targeted initiative investments
- Integrate initiatives to AOP calendar/process → reduce 1-off requests
- Prioritize organizational direction
- Isolate base business performance
- Present a more accurate/transparent view of performance

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## There are also several cons to this approach to initiative management

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### Cons

#### **Demands more work**

- Prepare several P&L views vs. one

#### **Need high degree of discipline**

- Can easily charge to incorrect cost center

#### **Need to educate non-Finance staff**

- Ensure education and understanding due to complexity

#### **Modify company culture**

- Initiatives are delegated to corporate at first during planning, then moved to Divisions during execution

**While the cons are significant and real, this approach has worked well for us.**

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## Aligning compensation to strategy MILLIPORE is one of our key challenges



- Wall Street expectations
- Fixed guidance targets

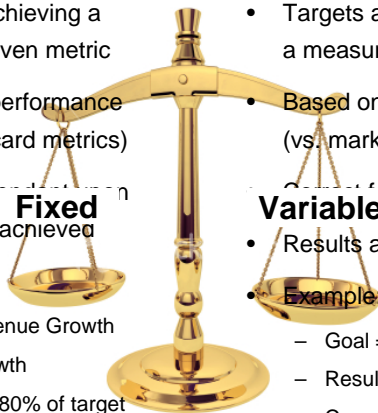
**The path to beyond budgeting must bridge this gap**

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## We balance these constraints by tying MILLIPORE compensation to fixed and variable targets

### Fixed

- Targets focus on achieving a specific result for given metric
- Based on internal performance (AOP, RFF, Scorecard metrics)
- Compensation depends on what % of target is achieved
- Example:
  - Goal = 10% Revenue Growth
  - Result = 8% Growth
  - Compensation = 80% of target



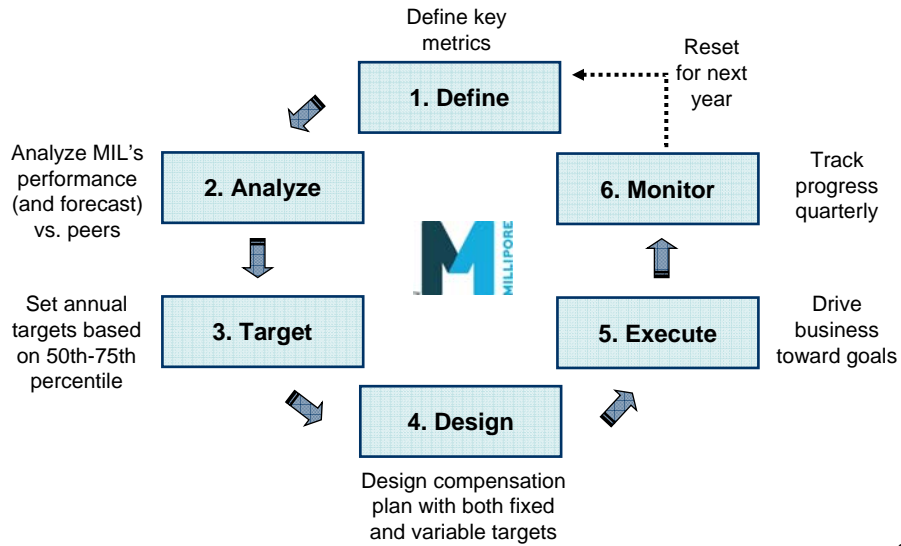
### Variable

- Targets are not specific number but a measure of relative performance
- Based on external performance (vs. market, vs. peers)
- Compensation for errors in fixed targets
- Results are unknown until year end
- Example:
  - Goal = 50th percentile of peers
  - Result = 75th percentile
  - Compensation = 150% of target

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## A six step process guides us through target setting

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## Metric selection is a critical first step in the process

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- S**pecific
- M**easurable
- A**ccurate
- R**eliable
- T**imely



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## Analyzing performance vs. peers requires a customized approach

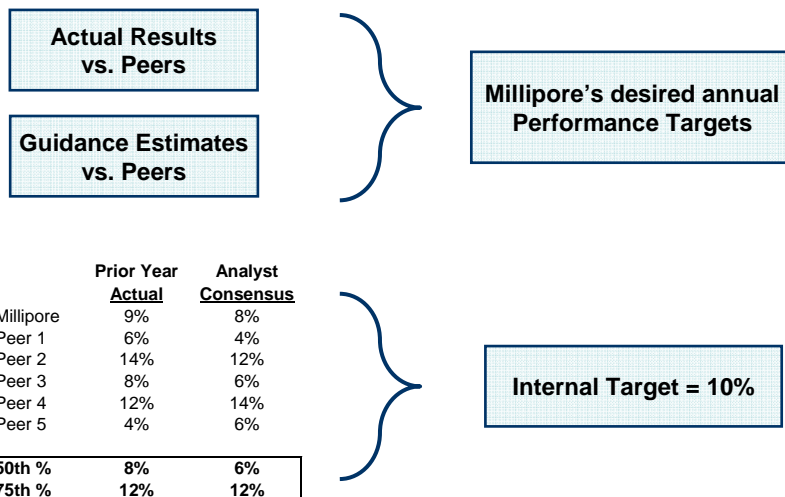
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- No industry panel to provide understanding of competitive landscape
- Number of similar companies (peers) that when aggregated represent market view in terms of Capital, Customers and Talent
- We track performance and outlook of peers and compare to our own performance using the following:
  - Analyst consensus
  - Earning releases
  - Analyst calls
  - Financial Databases

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## Peer analysis results are used to set annual targets

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Note: Figures are for illustrative and learning purposes only and do not reflect actual results for Millipore Corporation

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## Annual targets are built into financial forecasts

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Metric Examples	Targets
Revenue Growth	10%
Operating Income %	25%
Profit per Employee	\$1,000
Return on Invested Capital	10%
Free Cash Flow	\$500MM

### Target Setting Process

- Targets developed from external benchmarking
- Targets built into Annual Operating Plan (AOP), Rolling Financial Forecasts (RFF), and Five Year Plans (5YP)
- Targets used as basis for division / functional targets as well as corporate compensation plan

Note: Figures are for illustrative and learning purposes only and do not reflect actual results for Millipore Corporation

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## Compensation plans are a mix of fixed and variable targets

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Metric		
Revenue Growth		
Profit Margin		
Return on Invested Capital		
<b>Total</b>		

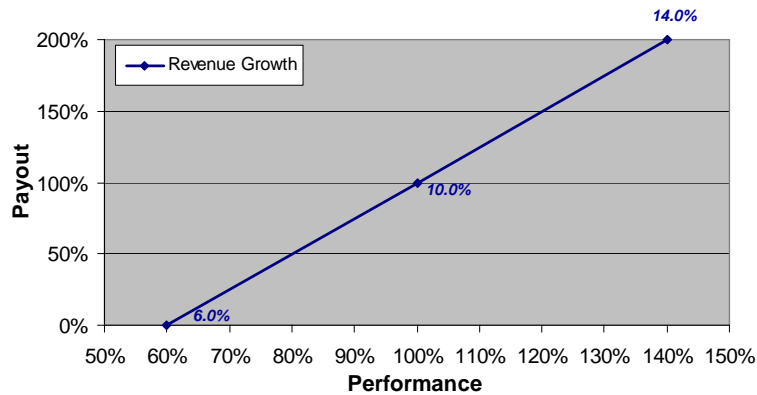
**Targets are weighted to provide appropriate incentives toward long term success**

Note: Figures are for illustrative and learning purposes only and do not reflect actual results for Millipore Corporation

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## Each target has a specific performance-payout slope

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Slopes are based on range of acceptable outcomes for given metrics and are designed to generate specific behavior

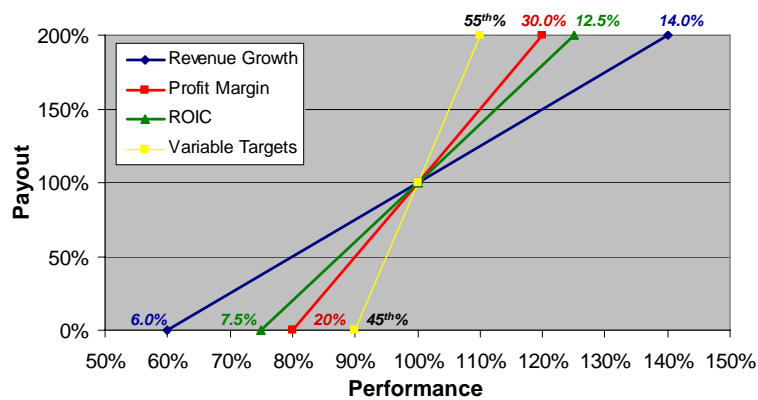
*Tighter band on profit margin to ensure bottom line targets are met*

Note: Figures are for illustrative and learning purposes only and do not reflect actual results for Millipore Corporation

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## Increasing the slope for variable targets can modify behavior

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There is a higher payoff for outperforming peers, which can help to offset forecast error with fixed targets.

*Outperforming peers becomes primary objective of the organization*

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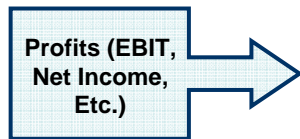
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## Execution is driven by translating strategic targets to operational goals MILLIPORE



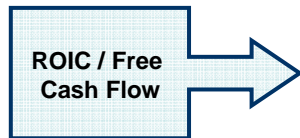
### Sales Growth

- New markets (geography)
- New products (innovation)
- Strengthen existing business (service)



### Profitability Improvements

- COGS, SG&A, R&D (% of Sales)
- Interest Expense
- Tax Rate



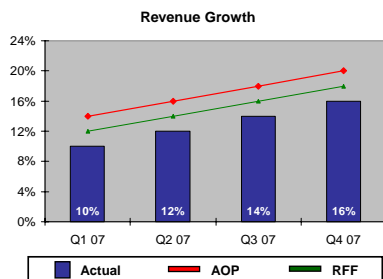
### Working Capital Management

- Inventory (DIOH)
- Accounts Receivable (DSO)
- Accounts Payable (DPO)

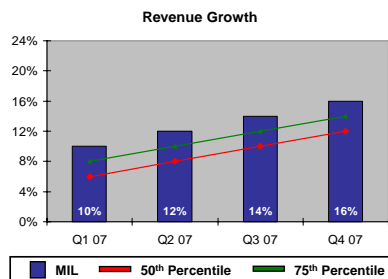
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## Quarterly performance is monitored to understand progress toward goals MILLIPORE

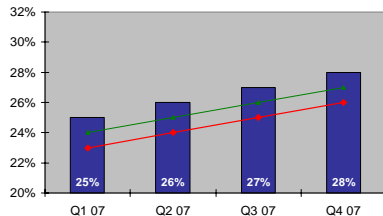
### Internal vs. AOP & RFF



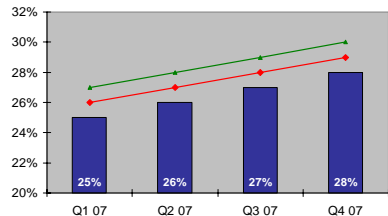
### External vs. Peers



### Profit Margin



### Profit Margin



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## At year end, the process is reset for next year's plans (and beyond)

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- Evaluate market to add / remove peers from comparison group
- Reassess the compensation plan to ensure proper metrics and weights are used
  - *Drive the desired behavior throughout the company*
- Work toward a Long Term Incentive Plan that further develops alignment to Strategy and Market Performance
  - *Find metric that correlates to increasing shareholder value (i.e. Total Shareholder Return)*

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## There are several road blocks to using external benchmarks...

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### Data

- Peer performance data is historical and GAAP (not forward looking)
- Pro forma analyst reports are estimates, not actuals
- Data can be difficult and time consuming to collect

### Definition

- Several definitions for some metrics (ROIC, FCF, etc.)
- Peer group selection is imperfect
- Metrics are not 100% correlated with strategy (e.g. acquisition decreases ROIC)

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## And there are hurdles with setting variable targets MILLIPORE

- Change in process from traditional budgeting
- Difficult to gauge performance throughout year (peer performance is backward looking)
- Industry dynamics can unpredictably affect results on specific metrics (e.g. share buy back)
- Leap of faith that performing well translates into outperforming peers



**One way to ease into the process is to limit the weight of variable targets in final bonus payout**

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## The rewards outweigh the costs and challenges MILLIPORE

- Reduction of “managing the numbers”
- Time freed up for running the business
- Decentralized and performance-based culture
- Employees share capital market and competitive mindset
- One version of the truth for employees and shareholders
- Compensation is aligned with long-term, shareholder success



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## Each selected metric has challenges that must be overcome in order to be relevant MILLIPORE

### Recommendation 1: Settle on a small set of representative measures

- Do not attempt to be perfect → a good proxy is sufficient
- Do not attempt to be complete → more metrics does not always drive more value, plus it creates unnecessary administration

### Recommendation 2: Do not hesitate to change metrics

- Knowledge improves over time
- A consistent success does not add value → measure what goes wrong
- If a measure is always green, then raise or change the target

### Recommendation 3: Define relevant targets

- Financial metrics have targets based on AOP
- Operational metrics have targets based on a stretch goal in the initiative charter or operational improvement (beat year ago)
- Peer metrics have targets set on expected performance vs peer portfolio

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## Final Thoughts MILLIPORE

### *Recipe for Success*

#### Ingredients

1. *Metric selection*
2. *Internal vs. External definition*
3. *Target setting*
4. *Weighting of metrics*
5. *Slope of metrics*
6. *Goals for individuals*

#### Directions

*Develop mix of ingredients to create proper balance of incentives and to deliver strategy execution.*



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# Agenda

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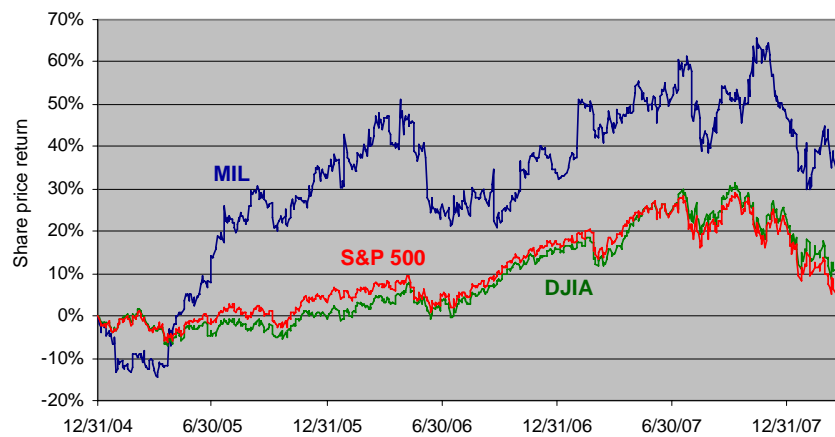
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# Success can be measured in our share price performance

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MIL has outperformed the Dow and S&P since our 2005 transformation (35% share price return vs. 14% and 9% respectively)



Source = Thomson One as of 3/31/08

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## Conclusion

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### 3 key things to remember:

- Dedication to becoming a SFO can deliver real transformation. It relies on tools, processes and discipline made possible by a dedicated team, senior management support and organizational buy-in.
- Initiative management is a secret to executing strategy. It helps translate big ideas into action. The challenge is to prioritize and fund on a dynamic basis.
- Targets are a great motivation and evaluation tool when used wisely. They should consider operational, financial and market perspectives to best reflect their complex reality and linkages.

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## Questions?

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### **Mike Carpenter**

Manager of Financial Planning and Analysis

*Michael\_Carpenter@millipore.com*



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