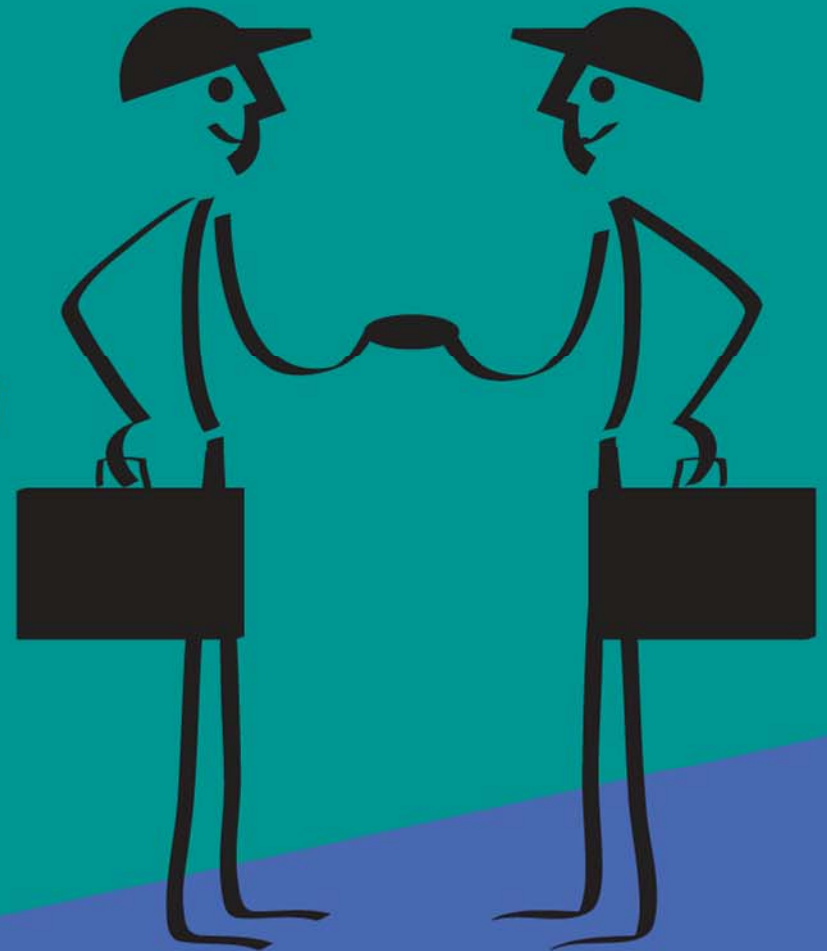


# *A Wall Street View of Lean Transformation*

*Presented by the*  
**Lean Enterprise Institute**



Lean Enterprise Institute



# Today's Speaker



## Cliff Ransom

Cliff Ransom is the President of Ransom Research, Inc., an independent equity investment research firm that acts as an outsourced resource for a limited number of major investment management organizations. The hallmark of the work of the firm is his focus on “going to the gemba”, where he meets corporate managers and insists upon plant tours. In the last five years, he has become increasingly interested in the migration of “lean” off the traditional factory floor, into back office, service, financial, sales and marketing, and new product development realms.

### *A few of Cliff's many accomplishments in the lean community:*

- The first financial services executive made a Life Member of the Shingo Prize Academy; also elected to the Academy's Board.
- The only investment professional made a "Champion" of AME
- Chairman of the Advisory Board of Lean Horizons Consulting LLC.
- Frequent Lean program speaker, including the LEI, Shingo Prize, AME, the Lean Accounting Summit, Parker Hannifin, Regal-Beloit, Terex, among others.



# Genchi Genbutsu

**The essence of what I do for institutional clients is simple: go and see, at the point where the real work is done.**



# I am a Zealot

## This Lean Stuff Just Works!

Today will be all  
about  
proving my thesis to you



# My Basic Thesis

- **Adoption of a lean culture will improve financial performance.**
- **Improved financial performance will enhance valuations.**



# Culture

**How people think, behave, act,  
and respond to problems and  
rewards on a daily basis.**



# Lean is the Toyota Way

- Differentiate between “tools” and “thoughtware.”
- It’s not about tools; it’s about culture.



**Remember just two tenets...**

**Respect for the individual**

**and**

**Constant elimination of waste**



# ...Or is it five tenets?

1. **Voice of the customer**
2. **Empowered people**
3. **Flow and pull**
4. **Value stream focus**
5. **Pursuit of perfection**



# What lean really does:

## Foster

## and

## Finance Growth



# To begin: Let's not kid ourselves

There's good news and bad news for managements and investors...

Wall Street may be clueless, but it can still reward you.



# Lean has to be led from “The Top”

- Lean often starts in the middle, or even close to the bottom.
- But I have never seen it succeed without the boss as Champion.
- I’ve also never seen it succeed without deep Board involvement.
- The question is always: *“How do I make my bosses GET IT?”*



# Why lean? The creation of true business value

## It's all about *Business Valuation*

- Every company, public or private, has to be concerned with creating value.
- Every organization, whether for-profit or not-for-profit, needs to minimize waste.



# There are lots of ways to get to heaven

*Lean concepts: Many do not get it; there is advantage for those who do!*

- 85% are clueless
- Another 10% know the jargon
- Only 5% practice the art skillfully



- Toyota Production System
- Danaher Business System
- Six Sigma (done many places, but few do it as well as GE)
- Lean Six Sigma (not that it kept Maytag independent!)
- 80/20 process at Illinois Tool Works



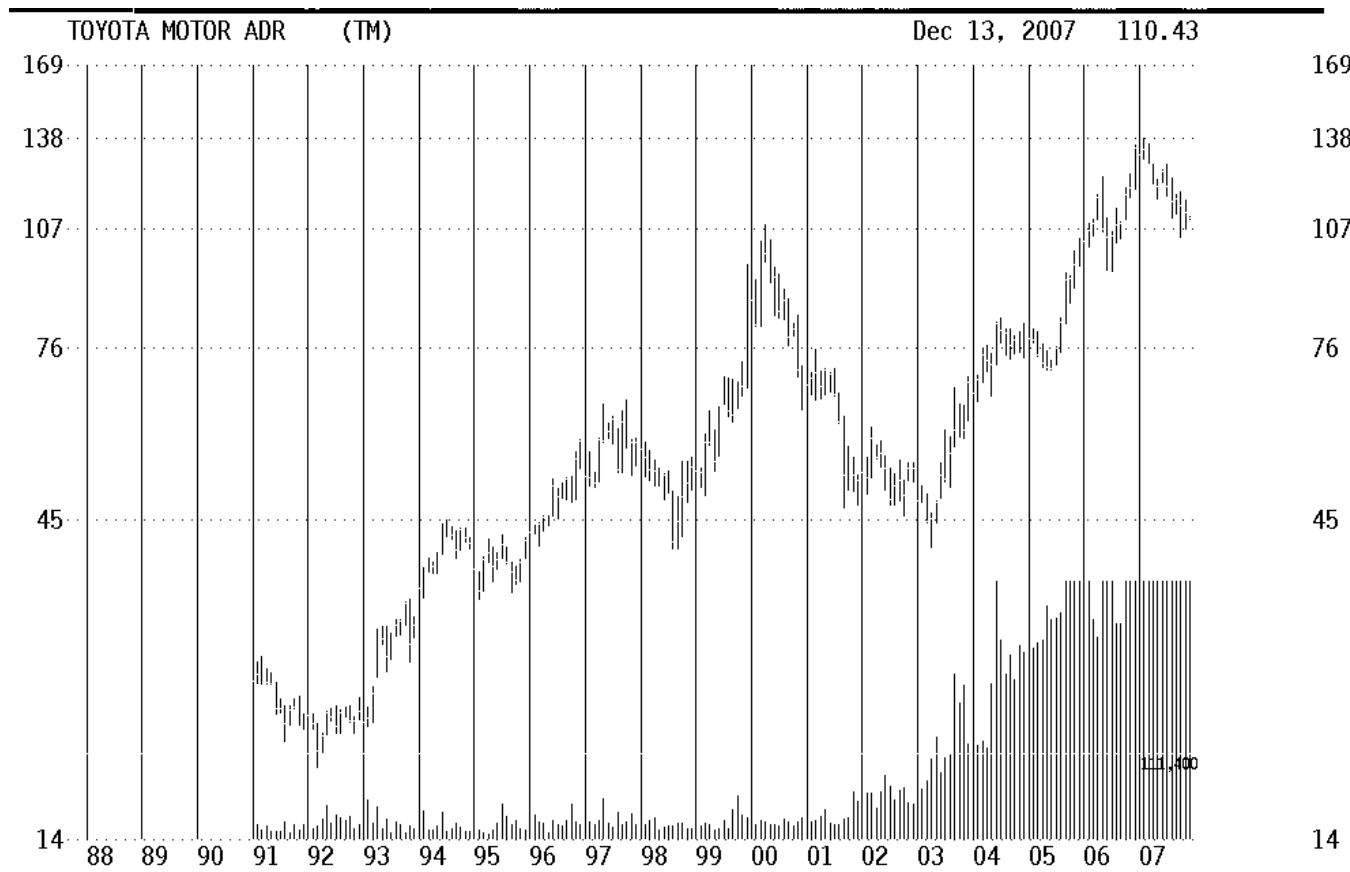
**Why lean?  
“Because it works!”**

**My two archetypes:**

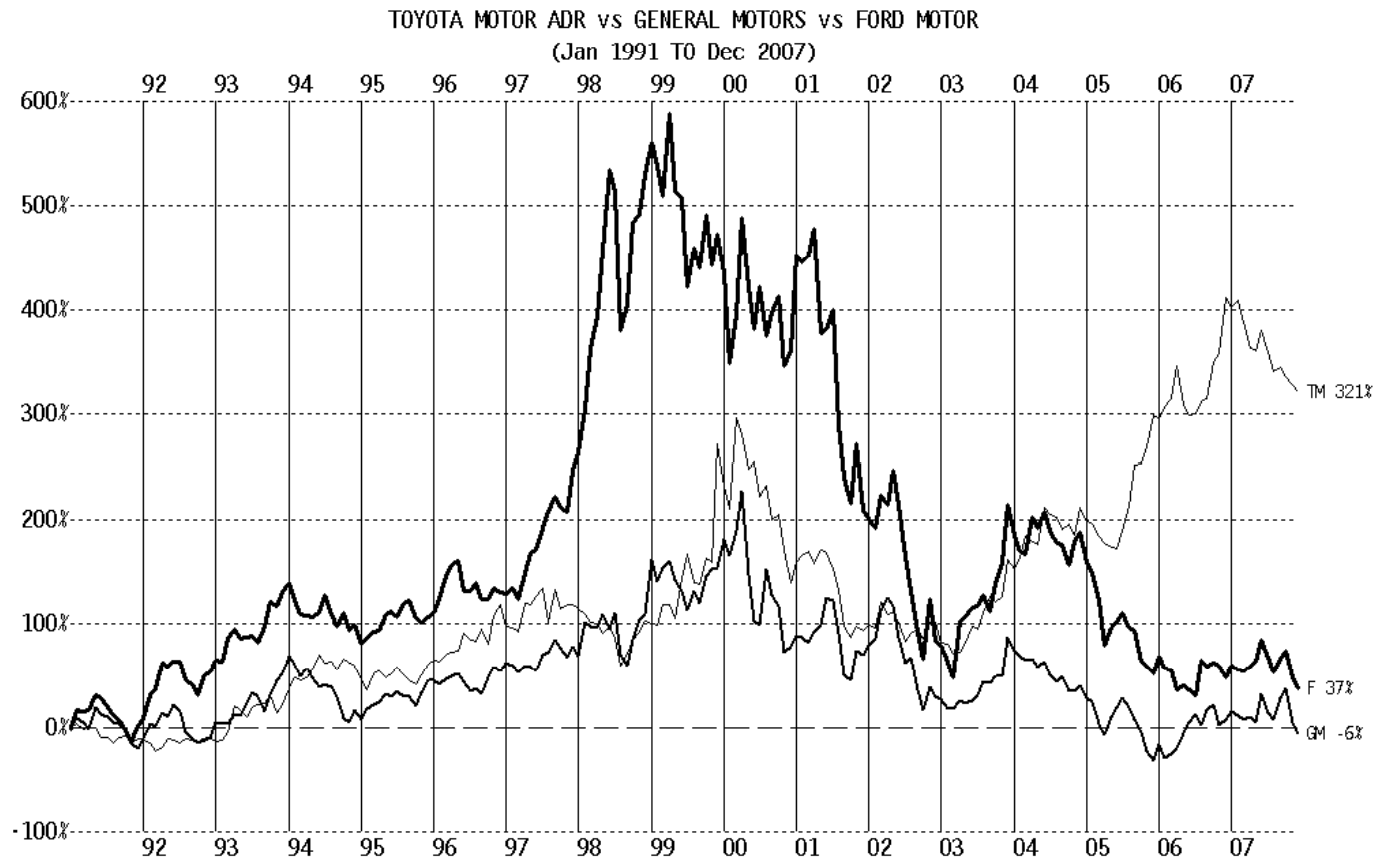
**Toyota  
and  
Danaher**



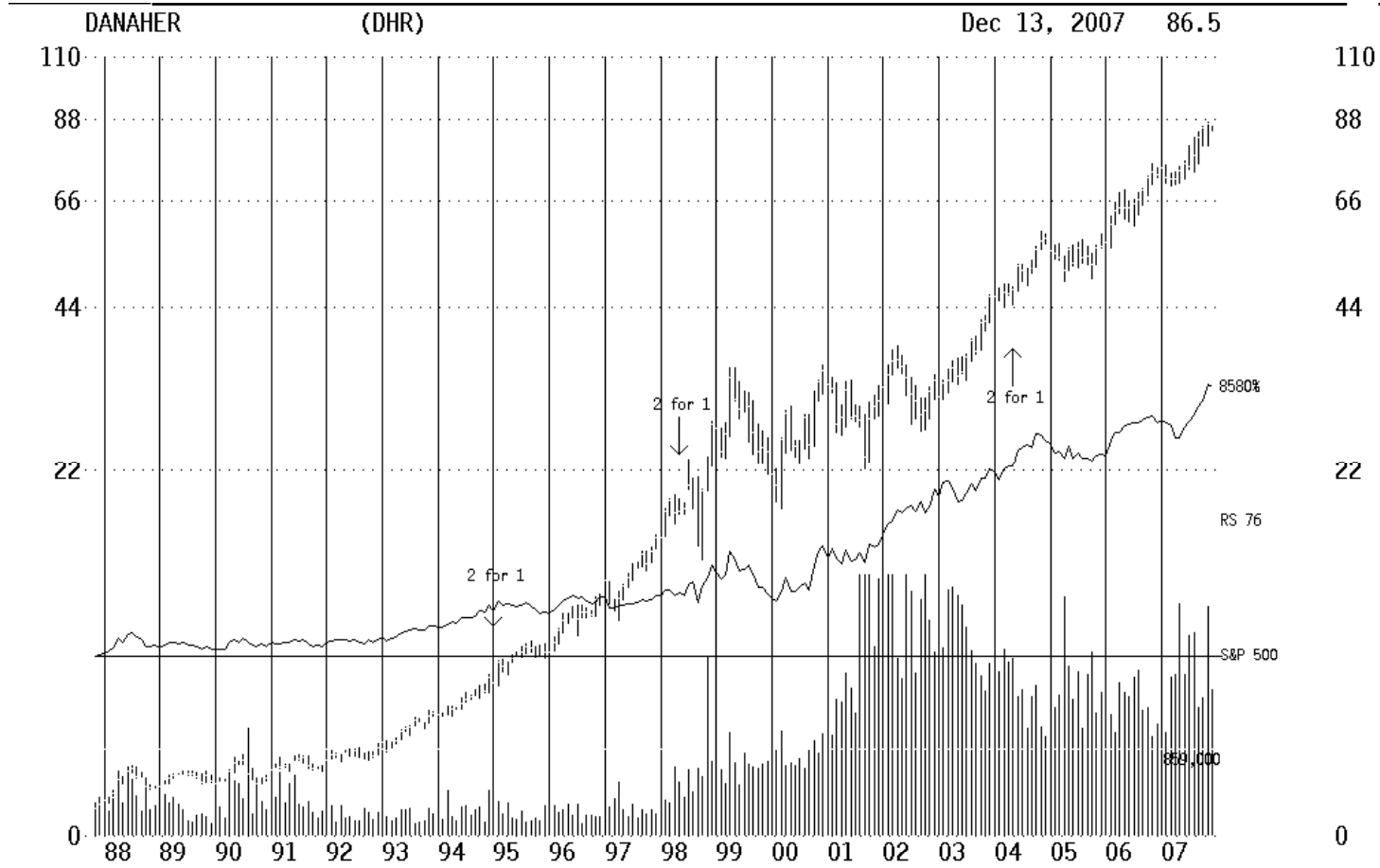
# Taking a long-term view of Toyota's share price



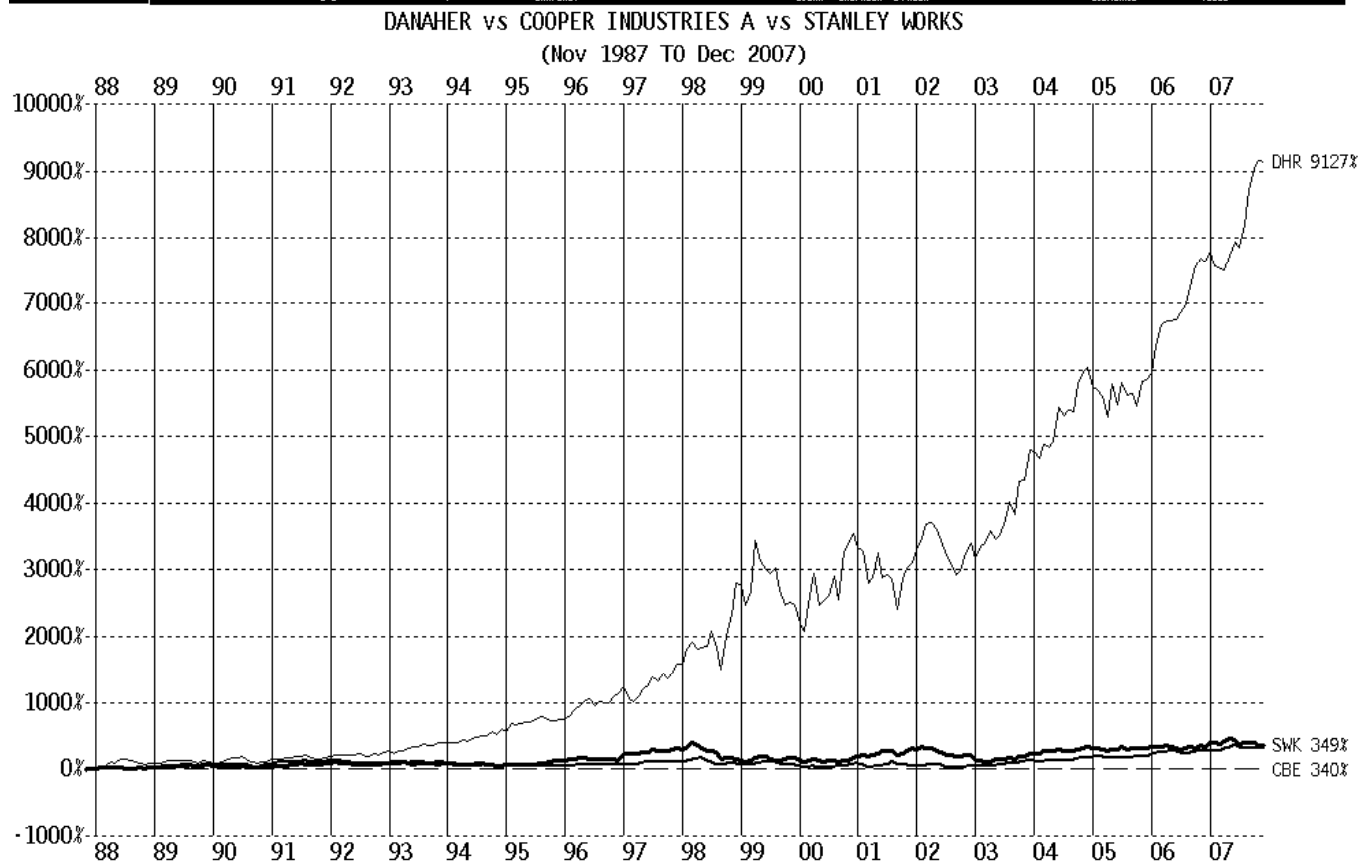
# Understanding relative performance



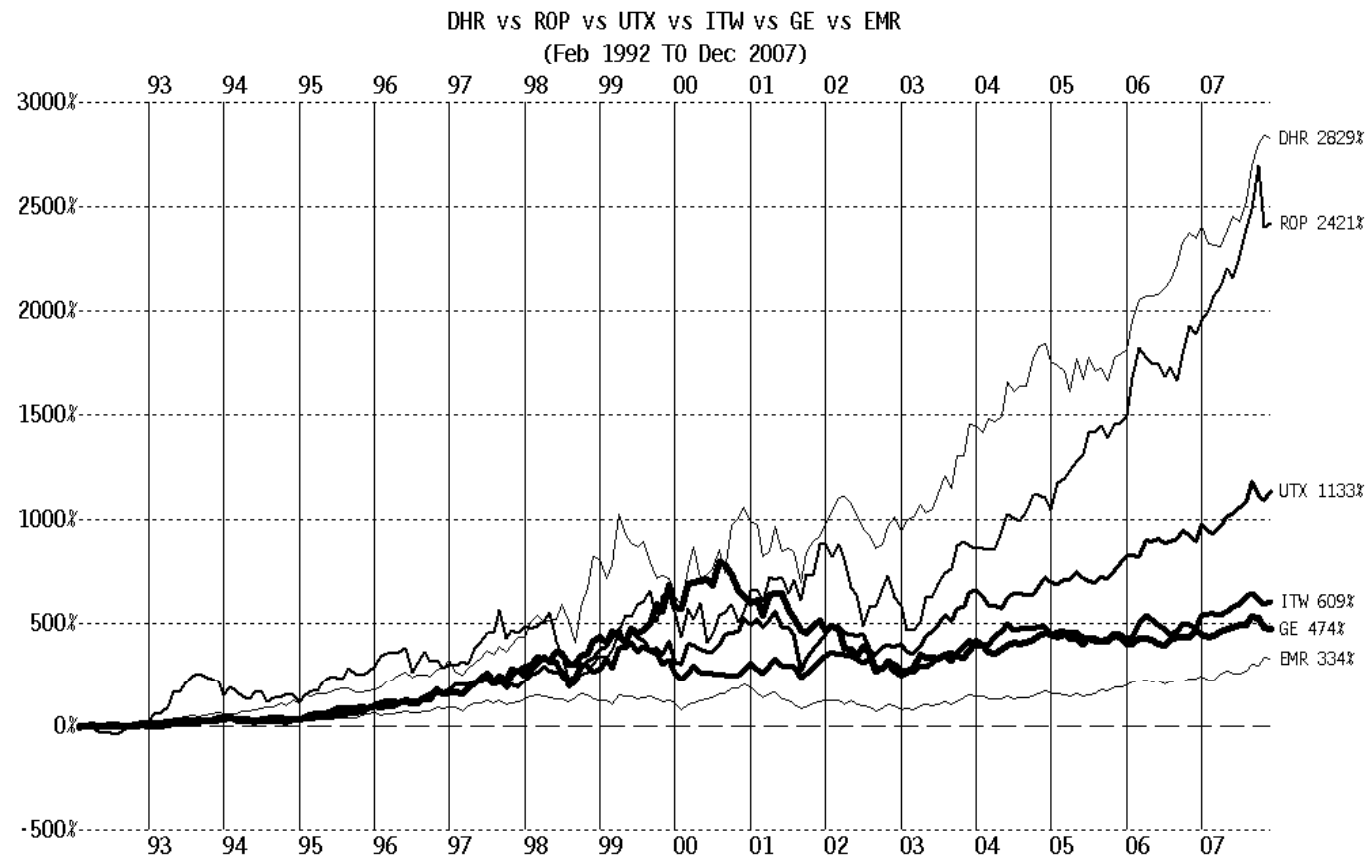
# It's easy to love Danaher



# The dilemma of benchmarking



# Benchmark only against world-class!



# Investor Mindset: “We should like everything about lean”

- Inventory reduction, particularly WIP
- Physical room to grow
- Avoidance of capital expenditures
- Productivity acceleration
- Cycle time acceleration
- Quality enhancement
- Bolstered competitive position
- CASH, CASH, CASH



# Getting started with lean: The real reasons to change? Well, maybe.....

## Lean's "usual" start

- Kaizen-in-a-box
- Reduce WIP
- Reduce footprint
- Reduce cycle time



# The crux of it all!

## The “real” reasons for change

1. Customer intimacy
2. Capital avoidance
3. Enhanced valuation
4. Sustaining the culture



# Think “GROWTH!”

**At the end of the day, lean is about sustaining growth of the enterprise, in revenues, in earnings, and in cash flow.**

**It really is that simple.**



# Again, my dirty little secret...

## Satisfying yourself or Wall Street?

- Again, virtually no one on Wall Street “gets it” when it comes to lean
- They just don’t have visibility into the metrics of lean:
  - Reduced floor space
  - Reduced WIP
  - Elimination of finished goods inventory
  - Decreased cycle times
  - Enhanced quality
  - Correspondence with takt time
  - Improved customer satisfaction.



# How to get a premium valuation!


## The three mantras of Wall Street

- Consistency
- Sustainability, and most importantly,
- PREDICTABILTY



# Enabling the lean life cycle: A Warning for executives

## *Lean is fragile and can fail*

- Lean is NOT robust; it is fragile
  - It needs constant feeding & watering & reinforcing & scrutiny
  - There is no automatic pilot for lean
  - It fails more often than it succeeds
- 
- One-piece flow runs counter to generations of managers who thought only about overhead absorption
  - Lean is hard; it requires great consistency and it takes time
  - Empowering employees can be scary, for both bosses and employees
  - Traditional GAAP accounting can retard lean, particularly in the early stages of implementation



# My best guess is why companies fail at lean

- Comfort with the status quo; Change is threatening
- Fear of failure
- The tyranny of the “end of the quarter”
- Over emphasis on “tools”
- Loss of face/status/seniority
- No definable catalyst: a crisis, champion or leader
- And last, but far from least, STUPIDITY
- I’ll stop...even though I have four more slides!



# Danaher as earnings exemplar

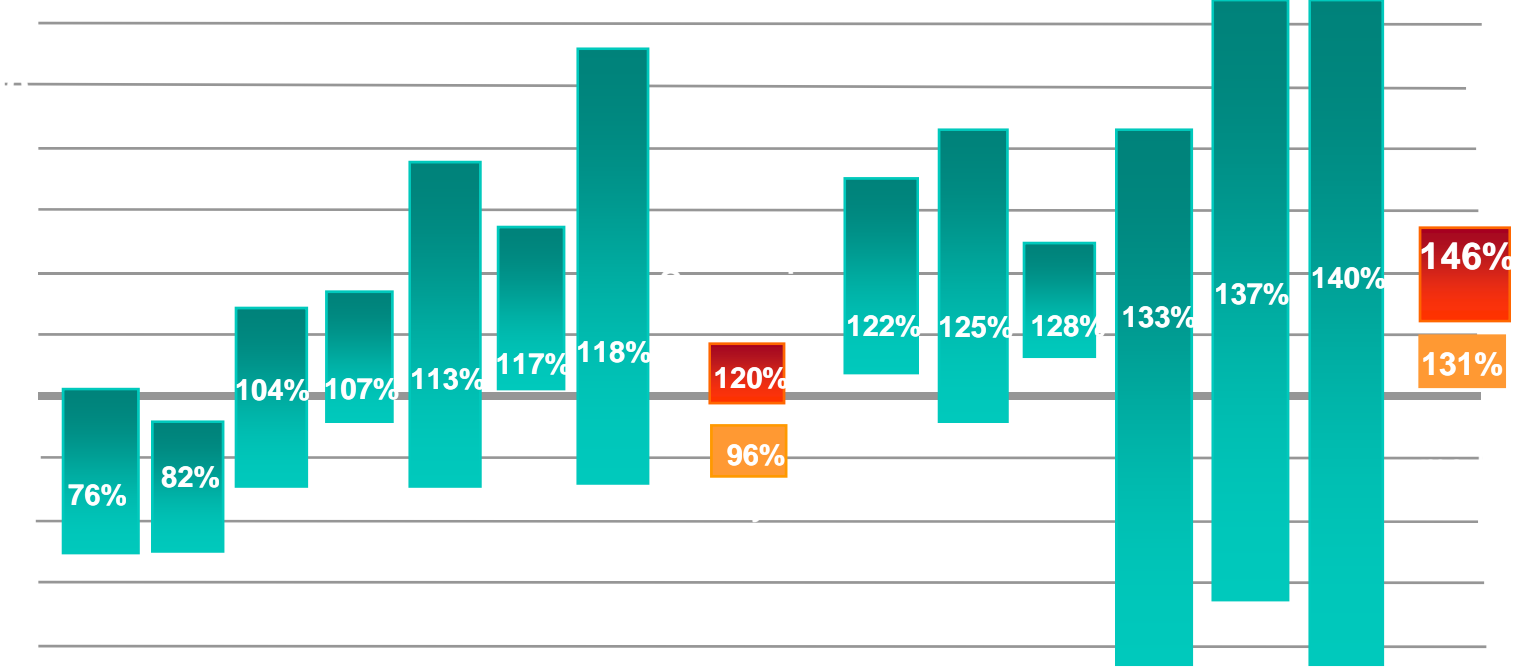
DANAHER		12/13/07					
(DHR)		86.5					
<b>Earnings Per Share - % change</b>							
Latest Qtr (Sep 07) .....up 22 %							
<input type="checkbox"/> %Y	Earnings Per Share						
Next Expected EPS Date: Jan 21							
	85						09
	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Mar	.11	.12	.16	.21	.25	.32	.28
Jun	.14	.17	.20	.23	.28	.36	.33
Sep	.14	.18	.21	.25	.29	.35	.37
Dec	.15	.19	.21	.26	.30	.31	.40
Yr.	.53	.65	.77	.93	1.12	1.33	1.37
Yr. to Yr.		21 %	19 %	22 %	20 %	19 %	3 %
Mean Estimates: First Call							
<input type="checkbox"/> F	(Quarterly numbers may not add to annuals)						
<input type="button" value="Close"/> <input type="button" value="More"/> <input type="button" value="▲"/> <input type="button" value="▼"/>							

DANAHER		12/13/07					
(DHR)		86.5					
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Next Expected EPS Date: Jan 21							
	85						09
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Mar	.33	.45	.58	.66	.78	.89	1.03
Jun	.40	.56	.67	.80	.94	1.06	1.17
Sep	.44	.62	.70	.83	1.01	1.13	1.23
Dec	.49	.67	.80	.95	1.11	1.29	-
Yr.	1.64	2.30	2.75	3.24	3.84	4.37	4.98
Yr. to Yr.		40 %	20 %	18 %	19 %	14 %	14 %
Mean Estimates: First Call							
<input type="checkbox"/> F	(Quarterly numbers may not add to annuals)						
<input type="button" value="Close"/> <input type="button" value="More"/> <input type="button" value="▲"/> <input type="button" value="▼"/>							



# Free cash flow to net income ratio: the Golden Rule

- 2001-2005 Range and Median %



Companies Included: 3M Honeywell Agilent ITW Cooper Parker Hannifin Dover SPX Eaton Thermo Electron Emerson Electric Tyco GE (no GECS)

**But it's more than earnings  
and cash flow**

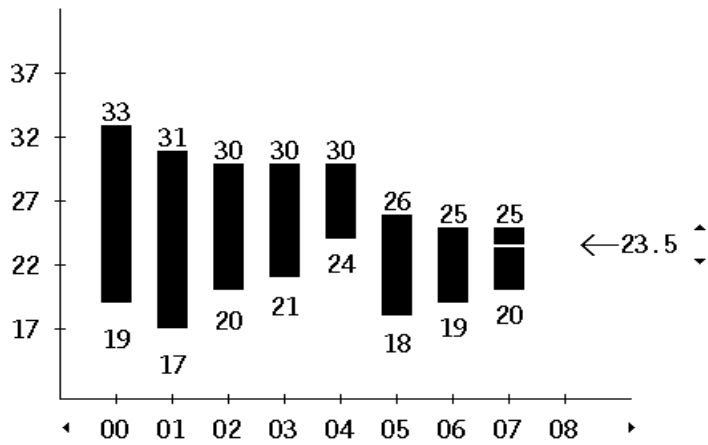
**“It's the multiple, stupid.”**



# Danaher is also a king of industrial valuation

DANAHER (DHR)	12/13/07 86.5
P/E Ratio .....	23.5

P/E Range  
S&P 500 P/E 16.3

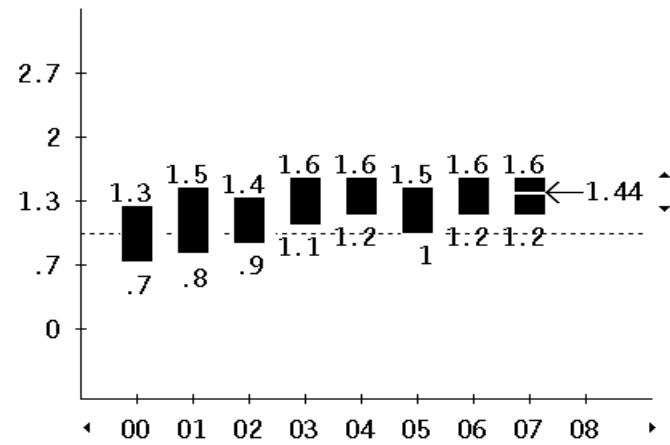


P/E BASED ON ESTIMATED EPS: 23 20

Close More ^ v

DANAHER (DHR)	12/13/07 86.5
P/E Ratio .....	23.5

P/E Range  
Relative To S&P 500



REL P/E BASED ON ESTIMATED EPS: 1.4 1.3

Close More ^ v



# It's not just about the multiple

**“It's about being early, stupid.”**



# ITT Industries: Confidence building about earnings

ITT								12/13/07
(ITT)								64.09
<b>Earnings Per Share - % change</b>								
Latest Qtr (Sep 07) .....up 23 %								
<input type="checkbox"/> %Y	Earnings Per Share							
	Next Expected EPS Date: Feb 04							
	93 ◀						▶ 09	
	1996	1997	1998	1999	2000	2001	2002	
Mar	.17	.19	.23	.23	.29	.38	.39	
Jun	.28	.35	.31	.35	.39	.47	.50	
Sep	.18	.22	.26	.30	.36	.43	.47	
Dec	.30	.30	.30	.39	.44	.48	.50	
Yr.	.92	1.05	1.10	1.27	1.47	1.75	1.85	
Yr. to Yr.	14 %	4 %	16 %	16 %	19 %	6 %		
Mean Estimates: First Call								
<input type="checkbox"/> F	(Quarterly numbers may not add to annuals)							
							Close More ▲ ▼	

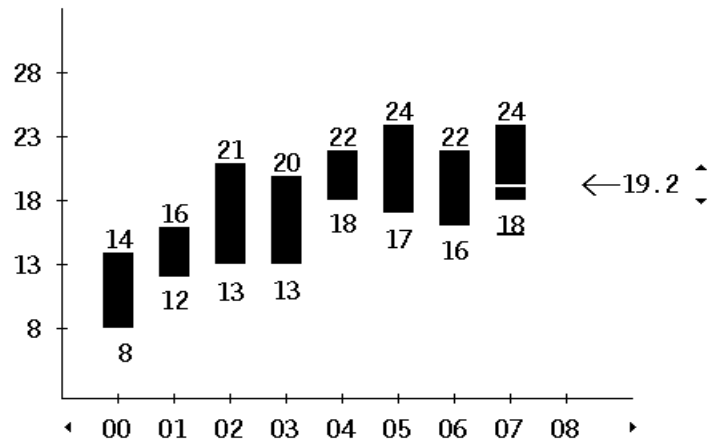
ITT								12/13/07
(ITT)								64.09
<b>Earnings Per Share - % change</b>								
Latest Qtr (Sep 07) .....up 23 %								
<input type="checkbox"/> %Y	Earnings Per Share							
	Next Expected EPS Date: Feb 04							
	93 ◀						▶ 09	
	2003	2004	2005	2006	2007	2008	2009	
Mar	.42	.46	.57	.63	.76	.87	1.01	
Jun	.51	.59	.71	.80	.92	1.05	1.19	
Sep	.48	.58	.69	.75	.92	1.05	1.16	
Dec	.53	.64	.72	.73	.94	1.08	-	
Yr.	1.93	2.27	2.68	2.91	3.48	3.98	4.48	
Yr. to Yr.	17 %	18 %	9 %	20 %	14 %	13 %		
Mean Estimates: First Call								
<input type="checkbox"/> F	(Quarterly numbers may not add to annuals)							
							Close More ▲ ▼	



# ITT valuation: Turning heads

ITT	12/13/07
(ITT)	64.09
P/E Ratio .....	19.2

P/E Range  
S&P 500 P/E 16.3

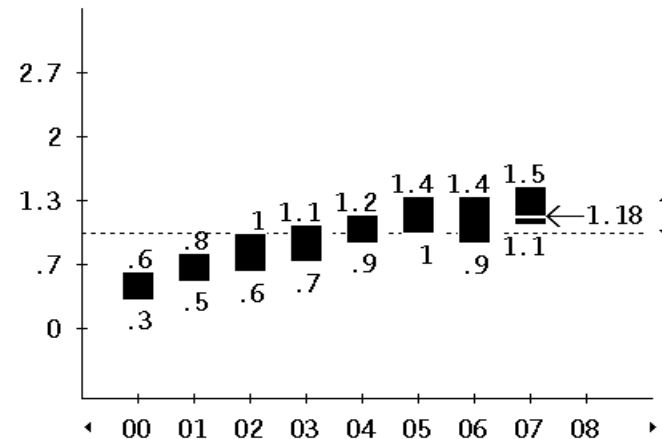


P/E BASED ON ESTIMATED EPS: 18 16

Close More ^ v

ITT	12/13/07
(ITT)	64.09
P/E Ratio .....	19.2

P/E Range  
Relative To S&P 500

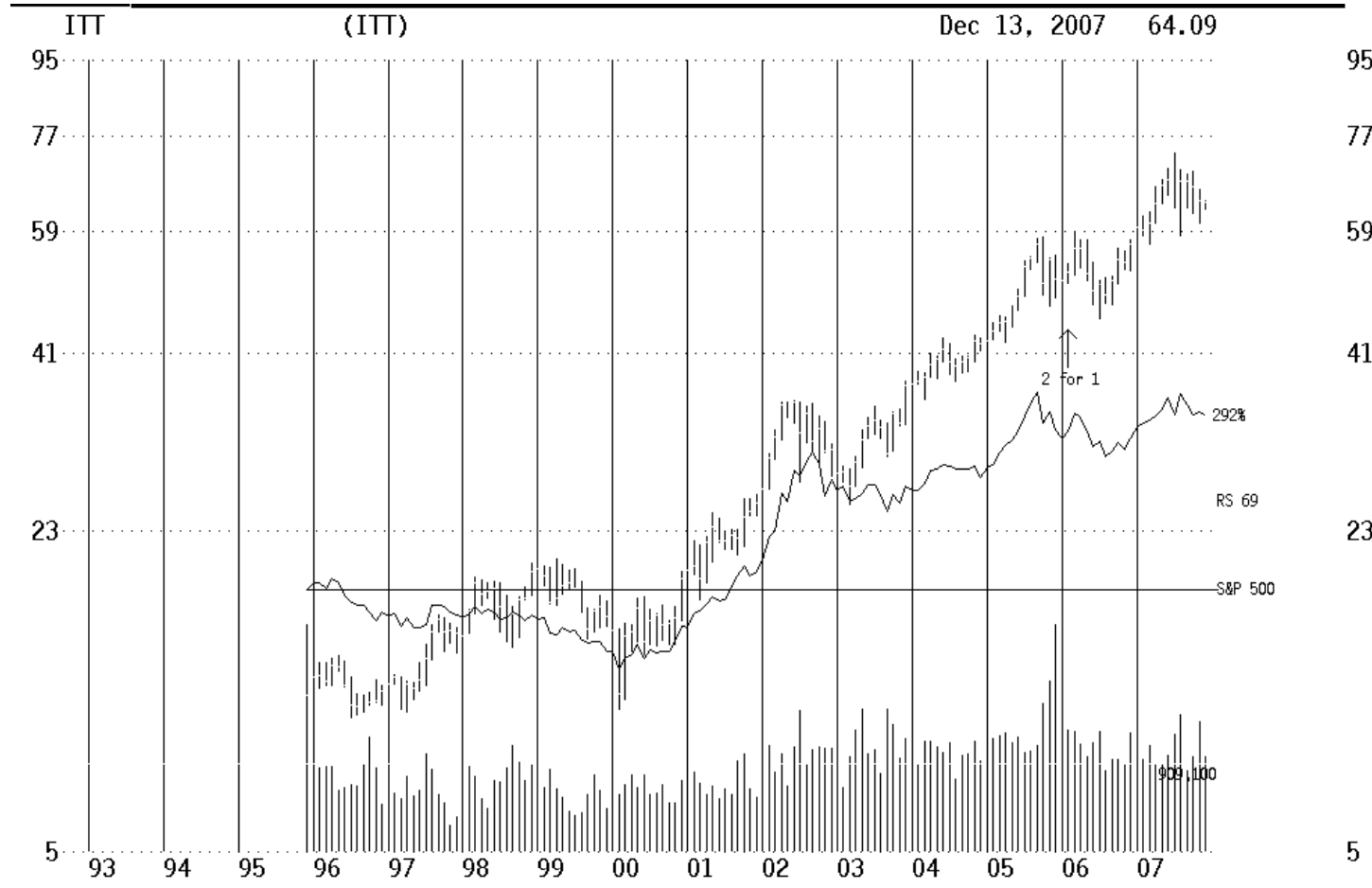


REL P/E BASED ON ESTIMATED EPS: 1.1 1.1

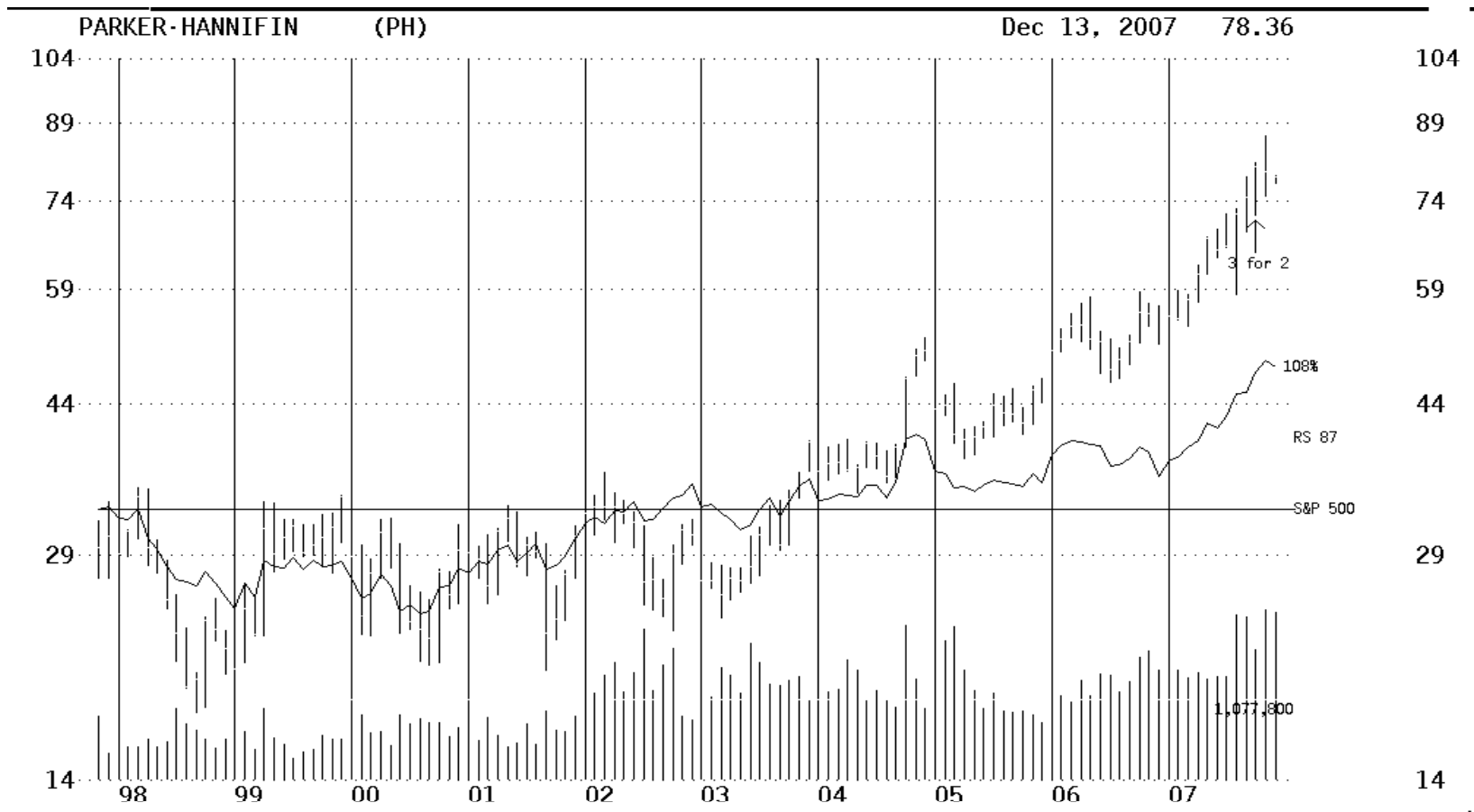
Close More ^ v



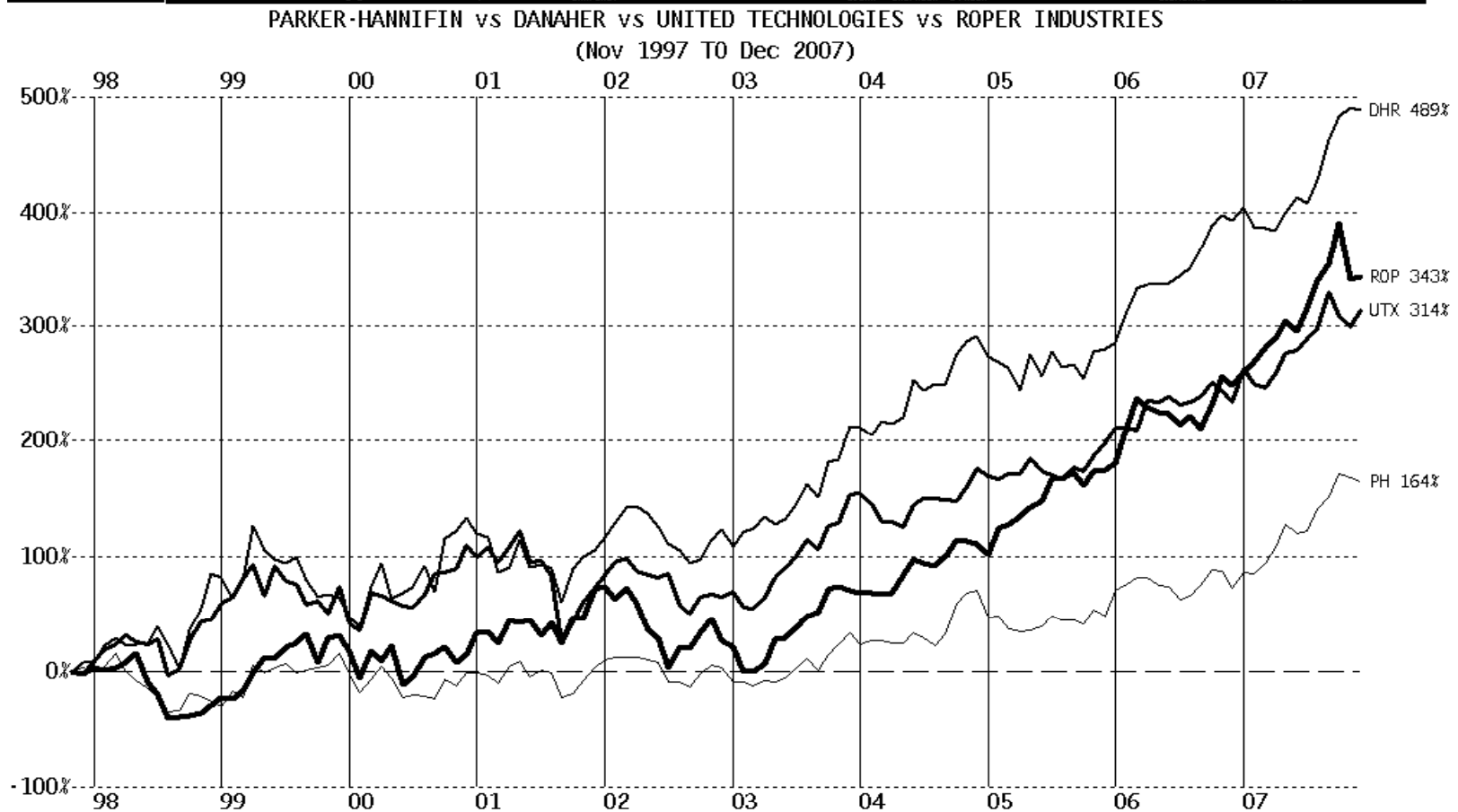
# The end result for ITT



# Parker Hannifin: Another recent adopter



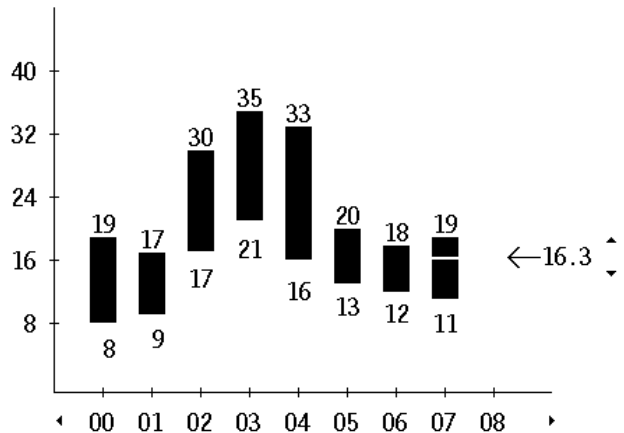
# Parker Hannifin: Don't get jealous... yet.



# Parker Hannifin: Re-valuation comes slowly!

PARKER-HANNIFIN 12/13/07  
(PH) 78.36  
P/E Ratio ..... 16.3

P/E Range  
S&P 500 P/E 16.3

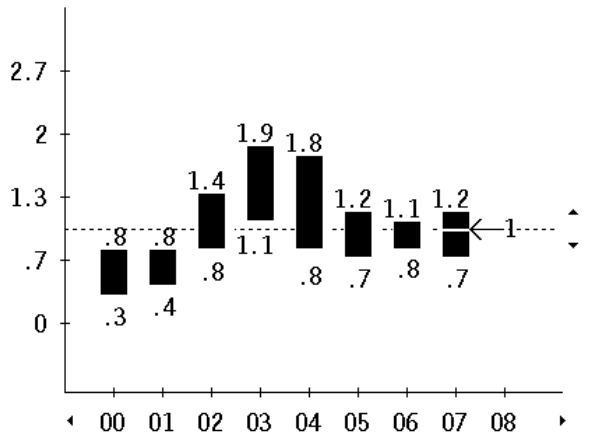


P/E BASED ON ESTIMATED EPS: .. 15

Close More

PARKER-HANNIFIN 12/13/07  
(PH) 78.36  
P/E Ratio ..... 16.3

P/E Range  
Relative To S&P 500

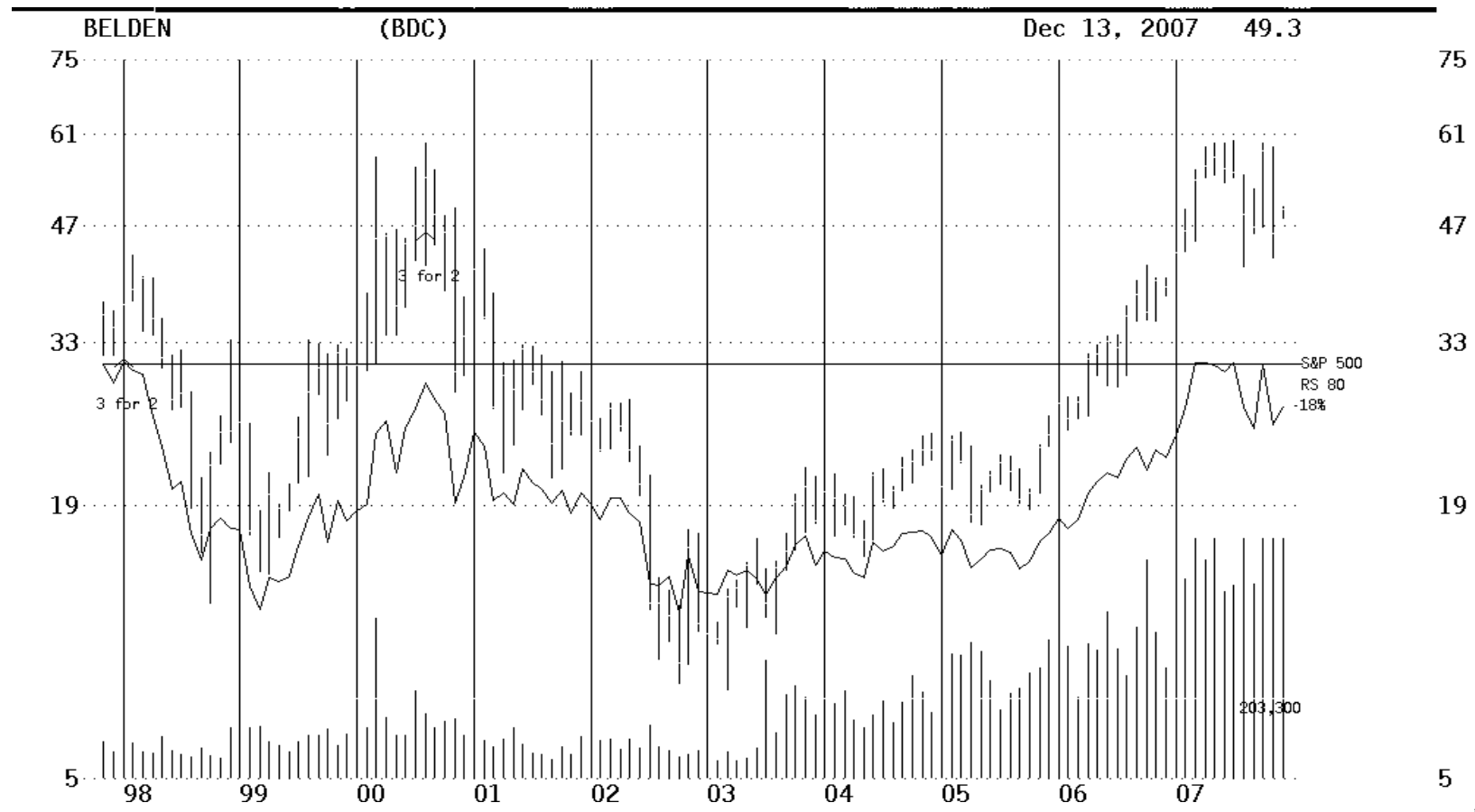


REL P/E BASED ON ESTIMATED EPS: .. 1.0

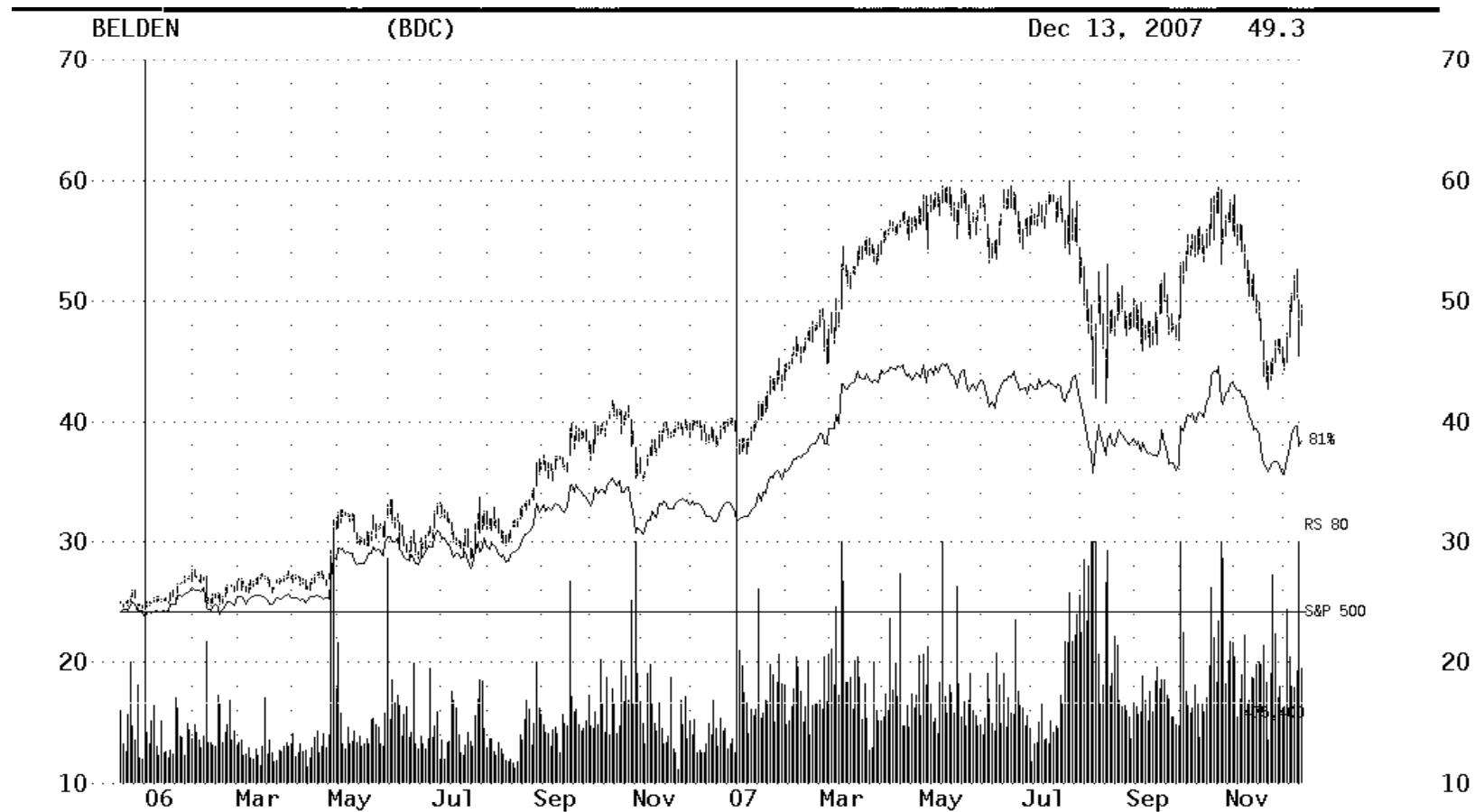
Close More



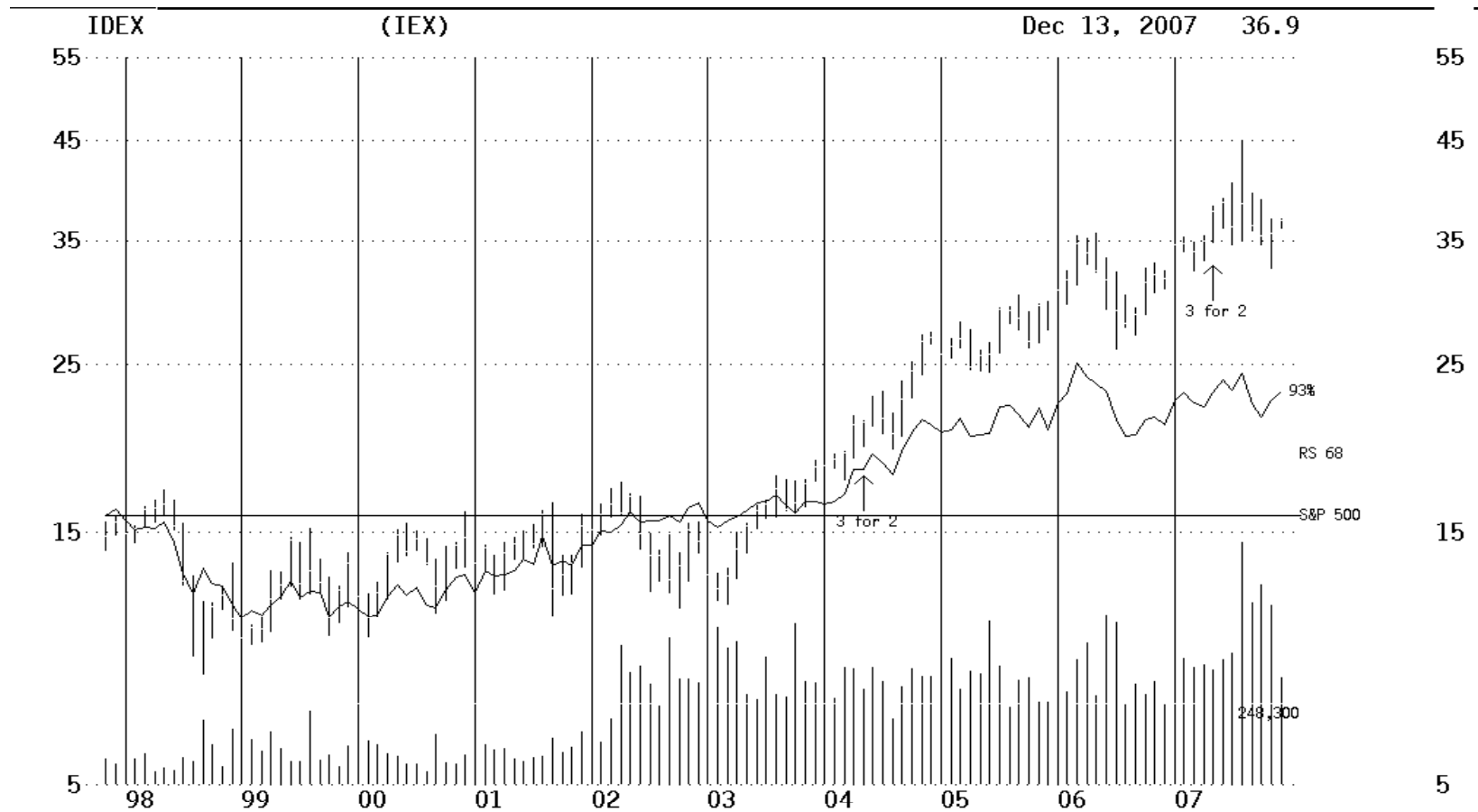
# Belden: Nothing to brag about for half a decade



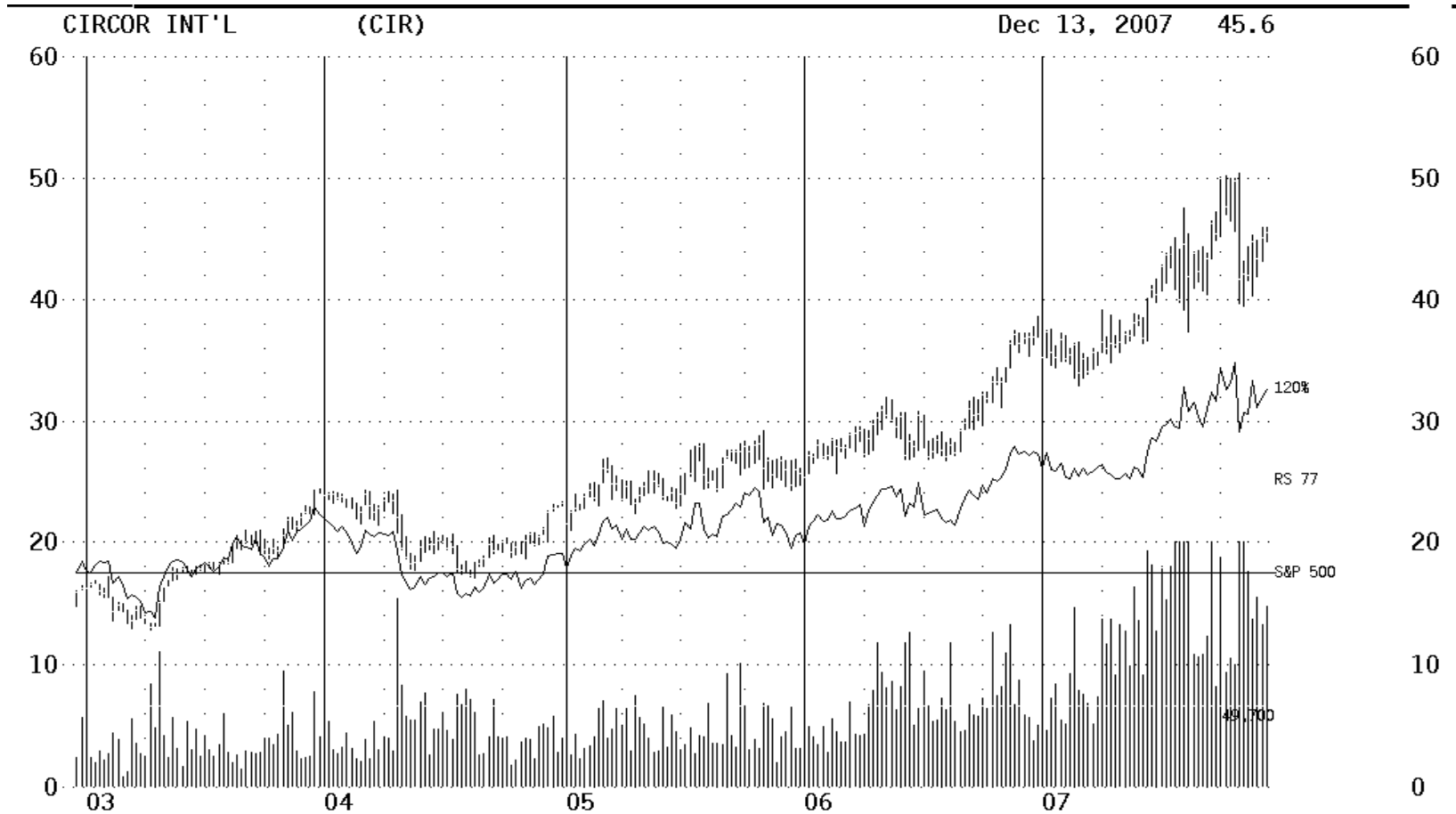
# Belden: Another Danaher alumnus takes the helm



# IDEX: Yet another Danaher alumnus



# Circor: A company early in lean adoption?



# “Transactional” Lean

Here’s the sad part about today’s Webinar:

- Not enough time to explore this realm
- Huge opportunities, albeit hard to identify
- FAR more *muda* than on the factory floor!



# Is The Glass Half Empty Or Half Full?



Leading market positions  
Innovation  
Solid foundation  
Improving working capital  
Healthy cash flow  
Commitment from the top

***Your Answer Matters:  
Are you prepared for the journey?***



# Ransom Lean Adoption Model, Part One

- Organic revenue growth between 6% and 8%
- Total revenue growth at between 10% and 12%
- Annual margin expansion
- Income growth rate between 12% to 15%
- Cash conversion greater than 100% of net income
- An aftermarket or service capability is a real plus
- You probably need to operate globally

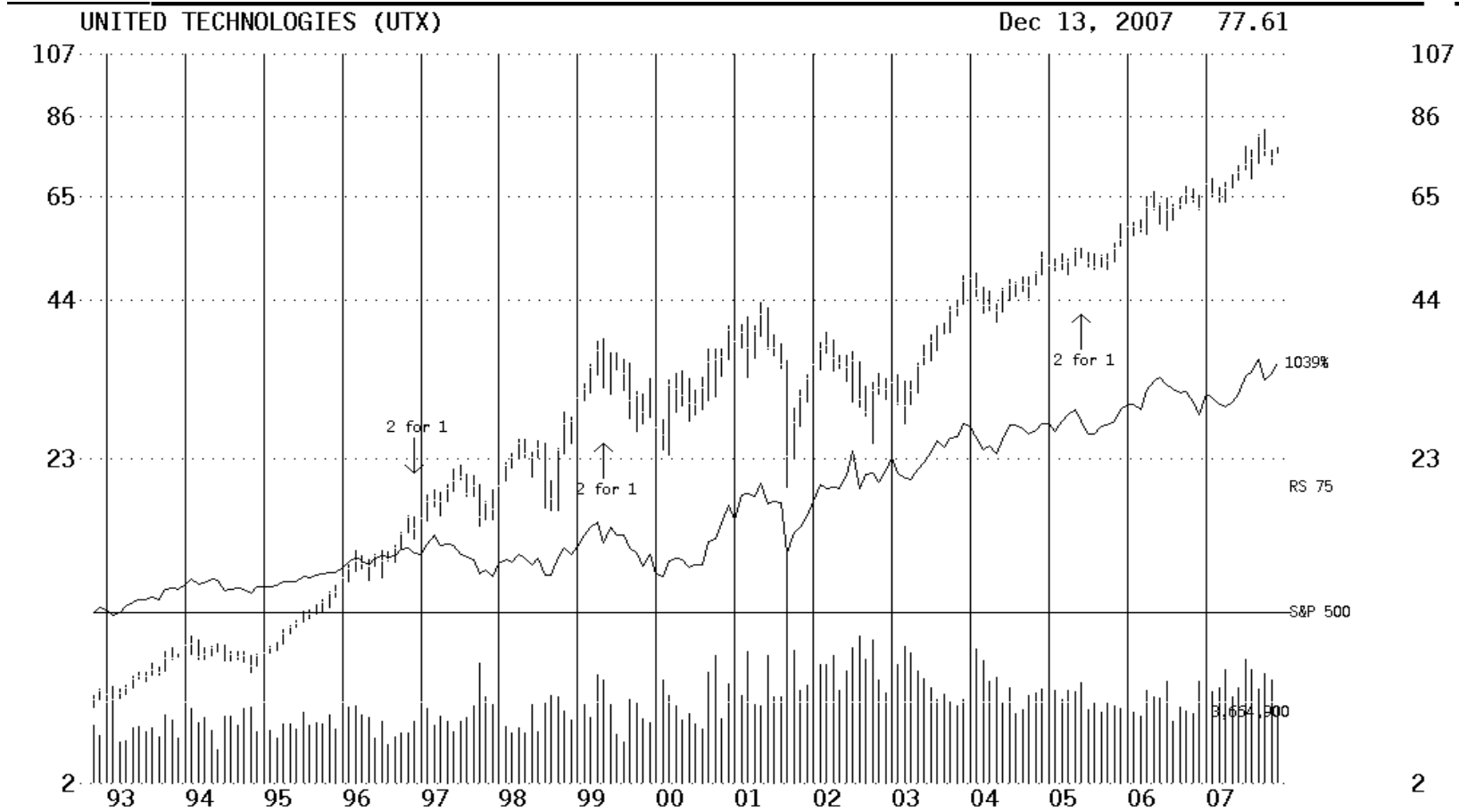


# Ransom Lean Adoption Model, Part Two

- **Demonstrate an ability to utilize cash effectively**
- **Investigate, price, finance, and integrate the right acquisitions**
- **Make acquisitions a seamless, repeatable, and predictable process**
- **Payment of dividends (no special dividends); do stock buybacks to at least offset option dilution**



# United Technologies: Putting it all together



# My final comments: Ask the right questions; Guarantee the result

## The Right Questions

- Does management know what it doesn't know?
- If they do know, are they committed to change?
- If they are committed, do they have the tools?
- Is compensation tied to execution?

## The Right Result

- Consistent, sustainable and predictable results
- Improved earnings and cash flow
- Higher business valuations
- We all make money using lean as our vehicle



# I Am Easy To Find!

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**Lean Transformation Summit**

**March 5th & 6th, 2008 ■ Orlando**  
**Pre-Summit Workshops March 3 & 4**

**Keynote Speaker: Jim Womack**

**Plenary Speakers from:**  
**Boeing, Barry-Wehmiller, Wells Fargo**

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