Fabrikam Q4 Executive Update

Prepared by the Executive Leadership Council.

# Introduction

The challenges we face as we move into the planning cycle are significant, but with hard work and clear thinking we are confident that we will be able to continue the strong growth path we’ve established over the last twelve months. Now is not the time to rest on our laurels – rather it is the time to consolidate our market position and seek new markets for our products.

# Market Analysis

The worldwide market for musical instruments is a very mature, very competitive market. Overall market growth for 2007 is estimated to be 7% and 9% over 2006, in revenue and units respectively. Distribution patterns vary a great deal by segment, from the mass retail distribution of the low end to the specialized distribution of the high-quality and high-price segments. Fabrikam operates in a narrow part of the market, instruments and equipment sold to professionals who insist on the highest-quality sound. Most of our customers are concert musicians.

# Industry Analysis and Update

The market for musical instruments divides easily into several segments. Several market segments are relevant, and for this discussion we define the segments in which Fabrikam operates:

#### Customers

Customers. Customers range from children learning how to play to professional musicians in concert settings. However, Fabrikam sells almost exclusively to professional musicians.

#### Instruments

Instrument or type of instrument. Fabrikam manufactures and distributes both acoustic and electric guitars, electric keyboards, speakers, electronic music equipment, and related accessories.

#### Type-of-music

At the high end of the market, Fabrikam has an excellent reputation among musicians dedicated to more traditional music. One of our challenges is to manage the transition to new technologies without losing our carefully guarded position with the devotees of traditional music. So far, we have managed to create a model for that transition with our keyboard line, which is very respected among the better concert musicians.

#### Current Operating Assessment

The growth segments of the market are highly competitive, technology dependent, and distribution dependent. They include a vast range of electronics-dependent products such as keyboards, guitars, sound amplification equipment, and synthesizers. Of the markets for low-end traditional instruments, the piano and organ markets are now completely tied to new electronic technologies, and markets for traditional band instruments are as dependent as ever on price-sensitive specialty retail distribution.

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# Management Restructuring

While the industry focuses on quality and reputation, it still is threatened by technology, new competition, the general decline of traditional music, rising costs, and other difficult market forces. Survivors must maintain quality of product and reputation, without ever forgetting the basics of managing personnel, fixed costs, product costs, marketing expenses, and working capital.

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| --- | --- | --- | --- |
| Region | Vice President | Office Location | Sales Offices |
| North America | Rich Haddock | Dallas | 23 |
| Canada | Wilson Pais | Montreal | 5 |
| Japan | Makoto Yamagishi | Kyoto | 14 |
| Germany | Soren Francker | Hannover | 20 |
| Italy | Stephanie Bourne | Milan | 12 |
| Ireland | Isabel Martins | Galway | 4 |

# Keys to On-Going Success

In the market for traditional high-quality musical instruments, the keys to success have not been significantly changed by new technology. They are not too different from what they have been for most of this century: product quality, reputation, and management.

# Product Quality

The target customer wants and usually *needs* the highest quality sound. Consistency and reliability are also very important. Longevity is a lesser factor, but still considered because of high price.

# Reputation—A New Formula

Professional musicians and very successful amateurs are often judged by the instruments they use. Newcomers to the instrument-making industry can be accepted when their product offers exceptional quality, but generally it takes time and tradition to compete in this market.

# Changing the way we do business: Decision making process

Fabrikam will implement a standardized model for decision making in the next fiscal year to improve accountability and transparency throughout our corporation. This will enable others who are observing or consuming the results of decision committees to understand how decisions were made and for what reason without having to involve the members of the original team. This will especially helpfully in the long-term, when the original team members are no longer on the project or no longer with our company. The figure below is an illustration of the new decision making process, and will serve as the basis for virtual team settings moving forward.

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