MEMORANDUM

From: Chief Budgeting Officer

To: Sarah Hughes COO LegacyCo

Subject: Budget Guidance

Please find below a copy of the average of the last three period's Profit & Loss Accounts as guidance for developing your Period 1 budget.

					Last Period
Revenue	**Business**				288,000,000
	Consumer				450,000,000
Total Revenue					738,000,000
Cost of Sales	**Business**				72,000,000
	Consumer				112,500,000
Total Cost of Sales					184,500,000
Total Gross Margin					553,500,000
		Headcount		**Discretionary**	
		#	**Costs**	**Expenditure**	
Leadership		10	**5,535,000**		5,535,000
Marketing & Advertising		369	55,350,000	110,700,000	166,050,000
Sales & Distribution		492	88,560,000	5,535,000	94,095,000
Customer Suppport		369	59,040,000	62,730,000	121,770,000
Logistics & IT		164	27,880,000	55,145,000	83,025,000
Product Development		123	20,910,000	12,300,000	33,210,000
Contingent costs					22,140,000
Administration					13,587,000
Total Overhead Costs					539,412,000
Earnings before interest and taxes					14,088,000
				Return on Sales	1.91

NOTES

1. Our Return on Sales at 1.9% is extremely low and may justify Market Watch's "fat and happy" remark! That said our numbers mirror the rest of our industry. Using the above data as a base, it is quite clear that we must make considerable improvements in efficiency and cut costs if we are going to meet Munro's intentions. This means that the

fears of redundancy in staff and reductions in discretionary expenditures (e.g., advertising) are probably correct.

SOLUTION

The numbers contained in the above Proforma P&L are based on historical data. If we do nothing to improve the business the above are likely to be an accurate reflection of what it will take to maintain our market position.

To gain the efficiencies required by Munro we will need to implement a program of strategic initiatives. Lists of such initiatives will be provided by the Strategy Department as suggestions to each Excom member. Failure to link staffing or expenditure changes to selection of appropriate Actions will put our Revenue at risk

2. **Remarks by Function**:
    a. **Marketing & Advertising** reflects an industry dependence on mass advertising as the primary go-to-market strategy. At $110m it is a major expenditure. Is this dependence logical with the emergence of the much cheaper social media approach? Social media expenditure is located in the accounts under Sales & Distribution so changes will have to be agreed between the departments.

       Advertising costs have historically focused in the B2C market using a 'pull' strategy to get businesses to adopt an offering popular with their staff. At about 15% of our B2C revenue it is substantially higher than the average for consumer offerings that runs typically at 5 to 7% of sales. This needs to be urgently reviewed. Indeed, it may call into question the recommendations of our current advertising agency.

       The HR staffing recommendation ratio is based on one person per $2m sales. To reduce this and lower the advertising expenditure you may need to consider appropriate Actions.

    b. **Sales & Distribution** has focused on close personal relationships with B2B and B2C.
        i. The HR recommendation for salespeople uses a ratio of one person per $1.5m of sales. This is a well-established number used in prior years based on:
            1. The sales force is focused 50% on B2B customers the rest is focused on B2C distribution. There are approximately 3,600 B2B customers each yielding an average of $80,000 in revenue. This

means each sales person yields $1,500,000 for a wage of $100,000 on average.

2. The 50% of the salesforce focused on B2C distribution and responsible for $2m approx. in sales.

ii. To plan on reducing the salesforce we would need to commit to specific efficiency initiatives that would underpin productivity.

iii. Social Media expenditure falls under Sales & Distribution in the accounts. 30% of current S&D discretionary expenditure is devoted to social media. This is about 0.002% of revenue. The rest is promotions with customers and likely to stay constant. The amount budgeted for social media needs to be negotiated with Marketing. Research indicates a social media spend in the region of 1 to 2% of sales mainly focused on search engines.

c. **Customer Support**: the Discretionary Expenditure amount is not really discretionary as most of it is warranty. To reduce the cost of warranty currently at 3% of sales you must consider the Actions suggested so any reduction in this number must be justified by Actions taken.

d. **Logistics & IT** is also not really reducible in the short term as it reflects IT and supply chain expenses that are contractually locked in. At present there is nothing you can do about this number and it will be automatically inserted by budgeting officers

e. **Product Development** Discretionary expenses are linked to 'approved' development projects and is locked in for this period. **Insert the number in the budget data above. Opportunities to review projects will occur in Period 2.**

f. **Contingency Costs:** We recommend that you use 3% of gross margin for contingency costs that will fall out of the acquisition. This is a planning number agreed by the Excom and Board and will be inserted by Accounting

g. **Administrative costs** have been steady at 5% of gross margin for some years. That number will be automatically included by Accounting.