FMEA Interview Documentation – Intuitive Surgical Simulated Case

Interviewee: **Michelle White, Director, Financial Planning and Analysis**

Date/Time: **July 5, 2022, 6-8PM**

Interviewers: **Fantastic Five Consulting Team**

Risk Category: **Financial - Economic**

Risk: After being about 2% for the last 2 decades, the CPI (Consumer Price Index) accelerated to a fresh 40-year high of 8.6% in May. The home prices surged nearly 19% in 2021. The gas prices are at a 14 year high. Inflation has turned out to be not transitory and Americans are feeling the stress. To fight against the hot inflation, starting from March 16th's FOMC meeting, the Federal Reserve has raised its federal fund rate 3 times in just 3 months. With the most recent interest hike on June 16th, the Fed has approved 150 basis point interest rate increase in total (from 0 - 0.25% to 1.50% - 1.75%). Therefore, there are growing concerns that Fed's fastest pace of rate hikes in nearly three decades will slow down the global economy growth, depress demand, freeze spending, and eventually might lead to economic downturns/pullbacks or potentially recessions as early as next year.

Scenario: **5-A (credible worst-case)**

Scenario Description: The credible worst-case scenario would be a downturn lasting 5 years. Inflation in the U.S. remains between 3% higher than our baseline for the next 4 years and 2% higher for Y5 to Y6. Interest rate gradually rises in response. Consumer disposal income and spending decline and the demand for our products and services reduce significantly.

Likelihood: **15% to 20% likelihood, or about 1 in 6**

Impact(s): 1. Inflation globally is 3% above baseline in years 1 through 4, and 2% higher for Y5 to Y6. The interest rate globally is 0.75% higher than baseline in year 1, 1.5% higher in Y2, 2.25% higher in Y3, and 3% in year 4, and then falling linearly to baseline in years 8 and later.

2. As our customers significantly cut their budgets, our revenues for all business segments are impacted negatively.

For the Systems segment in U.S. and Outside U.S., the revenue of Systems sold is

a. 4% below baseline in year 1
b. 5% below baseline in years 2 and 3
c. 4% below baseline in year 4

For the Instruments & Accessories segment in U.S., the revenue of Instruments & Accessories is

d. 4% below baseline in year 1
e. 4% below baseline in years 2 and 3
f. 3% below baseline in year 4

For the Instruments & Accessories segment Outside U.S., the revenue of Instruments & Accessories is

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a. 6% below baseline in year 1
b. 5% below baseline in years 2 and 3
c. 4% below baseline in year 4

For the Service segment in U.S., the revenue is

a. 3% below baseline in year 1
b. 4% below baseline in years 2 and 3
c. 3% below baseline in year 4

For the Service segment Outside U.S., the revenue is

a. 4% below baseline in year 1
b. 6% below baseline in years 2 and 3
c. 5% below baseline in year 4

3. We will pass the inflation to our customers, so the price per unit for our products and service will increase above baseline. For all business segments, price per unit for all products and services is 0.75% above baseline in year 1, rising linearly to 3% above baseline in year 4.

4. For all business segments, cost of revenue (product and service) as a percent of sales is 2% above baseline in year 1, rising linearly to 5% above baseline in year 4 and later.

5. As we would cut our spending to weather the effects of the economic downturn, Selling, General and Admin expenses decrease 4% below baseline from Y1 to Y3, and 2% below baseline from Y4 to Y5.

6. R&D expenses decrease 4% below baseline from Y1 to Y2, 2% below baseline from Y3 to Y5.

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Scenario: **5-B (moderately pessimistic)**

Scenario Description: Less severe version of Scenario 1. Same range of excess inflation but it only lasts for 3 years.

Likelihood: **20% to 30% likelihood, or about 1 in 4**

Impact(s): 1. Inflation globally is 3% above baseline in years 1 through 3. The interest rate globally is 0.75% higher than baseline in year 1, 1.5% higher than baseline in year 2, and 0.75% higher than baseline in year 3.

2. For the Systems segment in U.S. and Outside U.S., the revenue of Systems sold is

g. 3% below baseline in year 1
h. 2% below baseline in years 2 and 3
i. 3% below baseline in year 4

For the Instruments & Accessories segment in U.S., the revenue of Instruments & Accessories is

j. 2% below baseline in year 1
k. 2% below baseline in years 2 and 3
l. 1% below baseline in year 4

For the Instruments & Accessories segment Outside U.S., the revenue of Instruments & Accessories is

d. 3% below baseline in year 1
e. 3% below baseline in years 2 and 3
f. 2% below baseline in year 4

For the Service segment in U.S., the revenue is

d. 2% below baseline in year 1

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e. 3% below baseline in years 2 and 3
f. 2.5% below baseline in year 4

For the Service segment Outside U.S., the revenue is

d. 3% below baseline in year 1
e. 5% below baseline in years 2 and 3
f. 4% below baseline in year 4

3. For all business segments, price per unit for all products and services is 0.75% above baseline in year 1 and 1.5% above baseline in year 2.

4. For all business segments, cost of revenue (product and service) as a percent of sales is 2% above baseline in year 1 and 3% above baseline in year 2 and later.

5. Selling, General and Admin expenses decrease 4% below baseline from Y1 to Y2, 2% below baseline in Y3.

6. R&D expenses decrease 2% below baseline from Y1 to Y2, 1% below baseline in Y3.