



# RISK REDUCTION STRATEGIES

## FOR END OF LIFE / LAST TIME BUY (EOL/LTB) INVENTORY

### MANAGING RISK

*Strategies for reducing risk as it relates to End of Life and Last Time Buy Inventory*

- *A unique methodology for creating and enhancing the Last Time Buy / End of Life Process.*
- *An "Execution Engine" for delivery immediate costs savings.*
- *A proven methodology that has been successful in dozens of accounts. (K0)*

What is risk? Webster's defines risk as exposure to the chance of loss. What is risk as it relates to inventory? Some might define it as the exposure to obsolescence while others associate inventory risk with demand uncertainty. At Fusion, we know from highly-focused, multiple client exposure that inventory risk encompasses much more. These additional elements are:

- *Procurement Costs*
- *Carrying Costs*
- *Demand Uncertainty (too few, too little)*
- *Obsolescence*
- *Manufacturer Uncertainty (quality problems, allocations)*
- *Market Risks (pricing fluctuations)*

Most Important! - the higher the risk, the higher the cost!

### INTRODUCTION

This paper deals with strategies to reduce risk and associated costs in the EOL/LTB portion of the product life cycle. The amount of risk associated with this type of inventory is very high. There are a number of reasons for this:

- 1. Manufacturers often misjudge the importance and implications of this issue.*
- 2. Responsibility for managing the inventory is usually fragmented and spread across a number of groups (i.e. planning, engineering, procurement, service, etc.).*
- 3. Forecasted demand almost always results in a mismatch to actual usage - creating either dangerous shortages or costly excess.*

In summary, manufacturers simply buy a bucket of components, based on disparate and sometime conflicting inputs, and place them on the shelf to either complete a current build and/or support product under contractual obligation. This is a most critical area, however, and if managed by Fusion, yields significant cost reduction.

### OBVIOUS COSTS

Inventory has an enormous cost in any industry. In the technology industry the cost is often more significant due to volatility in demand and the shortened lifecycle of certain products. There are costs associated with the procurement of inventory, of receiving and holding this inventory, cost of the inventory itself and distribution. These costs are the most basic and the easiest to identify. What about additional, less tangible costs?

### INTANGIBLE COSTS

The cost of inventory mismatch is a significant but intangible cost. Mismatch is referred to as undersupply or oversupply based upon some unpredicted factor (i.e. forecasting error, product change notifications, obsolescence, etc.). There is simply too much or too little of a given product. In either case, there is significant cost to the manufacturer. In the instance of undersupply, there are costs of missed sales, downed production lines with idled labor and significantly higher cost of procuring product in the broker channel. In the instance of oversupply, there are costs of writing down inventory and disposition. While it is true that excess inventory may be sold to recover some of the value, there is a cost to that sale and a loss that must be recognized and recorded.

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## SIGNIFICANT SAVINGS

*Fusion's proprietary process achieves the following results.*

- *EOL and LTB acquisition costs reduced by 5% to 30%.*
- *Write downs on obsolescence reduced up to 30%.*
- *Return on excess inventories increased up to 70%.*
- *Instances of certain excess inventories reduced up to 99.9%.*
- *Delivery accuracy increased up to 99.9%.*
- *Hedge demand uncertainty up to 99.9%.*

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Most OEM's have exhausted their ability to lessen risk and cost of inventory ownership. Consequently, contract electronic manufacturers have now assumed a large part of the liability as have distributors who operate in plant stores or participate in vendor managed inventory programs. However, in specific critical areas of the product lifecycle, such as EOL/LTB product, OEM's still have not been able to mitigate the risks of inventory ownership.

## HOW IS EOL/LTB INVENTORY CREATED

EOL/LTB inventories are created for a number of reasons. They may occur because the manufacturer of a given product has been informed of a Part Change Notification (PCN) or Manufacturers Discontinuation Notification (MDN) by a component manufacturer. The finished good manufacturer will either have to make a Last Time Buy in order to continue building the product or "design-in" a new component to replace the discontinued item. Generally it is more convenient and less expensive to make a LTB than to qualify a new manufacturer and/or "design-in" a new component. To continue supporting the product, the finished good manufacturer must make a best guess decision as to how much component inventory it thinks will be needed to support the product. This inventory is then purchased and shelved until needed.

Alternatively, a manufacturer may stop producing a certain finished good. But due to contractual service obligations they must make a Last Time Buy to support the End of Life product for a number of years. Again, this inventory is purchased and placed on a shelf until needed.

In both cases, the manufacturer that makes the Last Time Buy relies on information from a number of different business areas including, engineering, planning, procurement, finance, service, etc. The multitude of inputs and unknowns clearly represent the highest risk in

terms of mismatch and subsequent costs.

In each of the above cases, the inventory amounts to an investment that the OEM will carry for months, if not years before it is actually used, if ever. Worse, if the inventory is not used, value drops precipitously due to rapid obsolescence of electronic components. The costs occurred for carrying this inventory and resulting write-downs for obsolescence can have a significant impact on the balance sheet.

## TOTAL SOLUTION

From extensive experience tightly focused on solving the problem, Fusion has developed a proprietary, process based, methodology to mitigate these risks and reduce cost. By combining the unique but complimentary disciplines of Supply Chain Consulting and Open Market Distribution, Fusion is able to achieve the following results:

- *EOL and LTB acquisition costs reduced by 5% to 30%*
- *Write downs on obsolescence reduced up to 30%*
- *Return on excess inventories increased up to 70%*
- *Instances of certain excess inventories reduced up to 99.9%*
- *Delivery accuracy increased up to 99.9%*
- *Hedge demand uncertainty up to 99.9%*

The ability to correctly and advantageously combine these two disciplines is paramount to the creation of an end-to-end solution. There have been software offerings introduced to the market over the years that do provide alerts to upcoming PCNs or a potential mismatch in the end of life inventory. However, such programs fail to provide a complete solution. The process continues to be fragmented. It remains the decision of the engineering department to determine if use of the product should continue; the planning department to determine quantities; the procurement department



## BENEFITS OF USING FUSION

*By executing the programs we innovate, Fusion delivers value in the following ways.*

- *Defer or reduce acquisition Costs*
- *Reduce reserves for obsolescence.*
- *Comprehensive benchmarking information and "real-time" ROI status.*
- *Eliminate the costs of mismatch between forecasted demand and actual usage.*
- *Increase "cash to cash" cycles.*
- *Hedge against demand uncertainty and alleviate the errors inherent to forecasting.*

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to source, buy and stock the product; the asset recovery department to disposition product in the case of an oversupply. Fusion's programs provide all of these functions: from the active management and alert functions, to the sourcing and procurement or sale of inventory by leveraging the open market.

## TYPICAL PROBLEM

Let's look at an example of the process before the Fusion Solution is applied:

1. *A commodity manager for a large Telecomm manufacturer was notified via a PCN or MDN that a component manufacturer of a certain SKU they use will no longer be available after a certain date.*
2. *The commodity manager must then notify the EOL Manager who will begin to coordinate with engineering, planning, purchasing, finance and service.*
3. *Input from all groups is aggregated and returned to the EOL Manager.*
4. *The EOL Manager notifies purchasing as to the decision and gives the go ahead to buy.*
5. *Purchasing contacts the manufacturer and makes a \$5,000,000 Last Time Buy.*
6. *The product is received into inventory and recorded on the books.*
7. *An invoice is received from the component manufacturer and recorded into accounts payable.*
8. *Finance creates or amends a reserve for obsolescence to reflect the new inventory.*
9. *Finance pays the component manufacturer \$5,000,000 for the Last Time Buy as agreed.*
10. *Product is pulled at a rate slower or faster than forecasted demand.*
11. *If product is pulled faster than expected a shortage occurs. Purchasing must now go into the broker market and run the risk of not finding the now obsolescent product or having to pay a substantial premium for the part. This assumes that they are even aware of the shortage.*

*12. If product is pulled too slow then the resulting excess will need to be dispositioned at the end of the projected life at a drastically reduced price from book value.*

## FUSION BENEFITS

So, what are the problems and consequently the potential risks and costs the Telecomm Manufacturer is likely to incur in this scenario? More importantly, how could the Telecomm Manufacturer benefit from the use of Fusion's proprietary service?

1. *There is an upfront cost and outlay of \$5,000,000 in capital for this example of a Last Time Buy. Using Fusion, this telecomm manufacturer could have saved anywhere from \$250,000 to \$1,500,000 (5% to 30%) in upfront acquisition costs. More importantly, it may have been possible to defer this cost or at least substantially delay it.*
2. *The "cost of capital" for this inventory will result in charges ranging from \$450,000 to \$650,000. Due to changing economic condition some of today's larger manufacturers are facing rising costs of capital. Various industry studies have shown that most of today's Fortune 50 manufacturers are incurring capital costs of 9% to 13.2%. In some instances, Fusion is able to procure the product directly from the component manufacturer, the open market or a combination of the two in an off balance sheet transaction. The product is then warehoused, shipped and billed over time. The resulting savings are immense.*
3. *A reserve for obsolescence should be created at the time of purchase. Alternatively, an existing reserve should be amended to reflect this new inventory. This increase in reserves is an immediate hit on the balance sheet against income. Using Fusion, it may be possible to mitigate these reserves altogether. At the very least, the Fusion process can reduce obsolescence write downs up to 30% by actively managing and cycling the inventory.*



## POWERING PROFITABILITY

*The ability to execute solutions  
and document the ROI.*

- *Real Time Forecasting: Fusion's ability to actively and automatically identify potential mismatches in forecasted demand vs. actual usage.*

- *Commodity Cycling: Fusion uses its "Execution Engine" to proactively cycle any mismatches in order to maintain the proper inventory levels.*

*4. Due to the previously mentioned inventory mismatch that typically occurs over a Last Time Buy, this manufacturer will experience either an oversupply of product, or worse yet and undersupply/shortage. Both scenarios will result in significant tangible costs (procurement costs, premium prices paid in broker channel, etc.) and intangible costs (reduced customer satisfaction, implication of having a potential line down situation). By utilizing Fusion's Real Time Forecasting and Commodity Cycling our customers realize up to a 99.9% reduction in certain excess inventories; up to a 70% increase in return on excess and 99.9% hedge against demand uncertainty and undersupply.*

*5. In those instance where the Last Time Buy is maintaining inventory levels for service and repairs, the manufacturer must deal with the returns from their customers, the testing of that product and the distribution of new product out to repair depots, field engineers and customers. The Fusion solution provides comprehensive logistic capabilities for FRU management including warehousing, testing, shipping, invoicing, etc.*

Fusion is a leading open market distributor offering unique Inventory Risk Management services. Our unique methodology combines Supply Chain Consulting with Open Market Distribution in order to power profitable inventory solutions. The advantages of the Fusion process are clear. Our programs offers a proven, solid methodology to reduce risk and positively impact the bottom line.

***To learn more, or to discuss beginning a pilot program, please contact Bill Masterson at 978-470-8989.***

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