

Widget Contract Negotiation

WidgiCorp / Massive Enterprises, Inc., Industrial Production & Conveyance Division (MEI-IPCD)

WidgiCorp is a fabricator of precisely-machined, high-volume specialty mechanical components. In 2010 it passed \$100m gross revenues. It is privately and closely-owned within the family of its founder, Archie Buckles, who is still President/CEO. It made its mark building aviation components and has recently branched into providing its hallmark high-volume, precision-tooled parts for applications in other industries. His son, "Buddy" Buckles serves as COO and his son-in-law, Christopher Flentrop, as Senior Executive VP for Sales & Marketing.

MEI is a Fortune 100 multi-national conglomerate with over \$30b annual gross revenues. **IPCD** is a builder and installer of mechanical systems used in various industries for production, assembly, warehousing and packaging applications. MEI is known for acquiring distressed enterprises in the industrial and mechanical sector and turning them around, and eventually spinning them off. When the assets that became ICPD were purchased five years ago, IPCD was in the tank. It has since been built into one of MEI's star performing divisions having increased its ROR five-fold in 2010.

MEI-IPCD has contracted with WidgiCorp to produce widgets IPCD uses in the complex systems it designs, builds and installs for its clients. They are used by the score in nearly every one of its projects.

WidgiCorp/MEI-IPCD Contracts

The first two-year contract for calendar years 2008-2009, valued at \$8m:

- Price: \$2000 per gross
- Quantity: 2000 gross annual minimum IPCD must order
- Delivery within 30 days of order

For that first contract term IPCD used WidgiCorp's standard widget. IPCD actually ordered and WidgiCorp delivered 4500 gross during each of the years in the 2008-2009 contract period.

For the second two-year contract (2010-2011), IPCD requested a redesign and WidgiCorp developed a custom widget. To recapture the development and retooling costs, they agreed to a higher price and a higher minimum quantity. To deal with the time it takes for WidgiCorp to retool between production of its standard and its custom widgets, they agreed to a quarterly maximum over which WidgiCorp is not required to produce or deliver (though it was certainly hoping it would). Valued at \$15m. Terms:

- Price: \$2500 per gross
- Quantity: 3000 gross annual minimum IPCD must order; 1000 gross quarterly maximum
WidgiCorp is required to produce, more at its option
- Delivery within 30 days of order

5000 gross widgets were delivered during 2010, and a similar amount is projected for 2011.

Negotiate the terms of the widget contract for 2012-2013.

Private Information for MEI-IPCD Representative

IPCD has taken-off, in large part because of the redesign of the WidgiCorp widget in 2010. Having reduced the number of fasteners and improving the tensile strength of the extension arm, the building and installation of IPCD's systems is now 15% faster to assemble and build and the failure rate went down to almost nil. When a widget failed, it usually took the rest of the subsystem with it, which required expensive on-site repairs that were very disruptive and resulted in really upset customers.

The management of IPCD just changed. Initially managed by MEI's team of crack turnaround experts, it's now being managed by a "Tiger Team" tasked with taking the stratospheric growth created by the earlier management team and turning it into sustained growth for possible spin-off. Target date is 4Q 2012.

To create the growth necessary, you have been tasked with reducing the cost of the widget contract at current production levels to \$14m (at quantity 3000 gross annually). Though there may be an increase in IPCD's installations using the widget, and you certainly hope there is, you have no market indication that there would be a need for more widgets over the 5000 projected for this current contract term

(2010-2011), and you don't want to agree to 5000 as a minimum to hedge against the possibility of a downturn. So the 3000 gross minimum and other terms still work for you. You may negotiate at the same contract price, but you won't be helping the division meet its goals if you do.