ESPO

MANAGEMENT COMMITTEE – 16 NOVEMBER 2022

PROGRESS UPDATE

REPORT OF THE DIRECTOR

Purpose of the Briefing Note

1. The purpose of this update is to inform Management Committee of the actions and progress made since the last written update provided to Members in September 2022.

Financial Performance – 6 months to September 2022

Summary

Year to September 2022 – Period 6					
£m	Actual	B/(w) than Budget		B/(w) than LY	
Stores Sales	31.1	2.2	7.4%	3.4	12.3%
Direct Sales	12.3	2.4	24.5%	2.4	23.9%
Rebate plus fee income	5.5	0.8	18.2%	0.8	17.1%
Total Sales (Exc Gas)	**48.9**	**5.4**	12.5%	**6.6**	15.5%
Stores Margin %	29.0%	(1.7%)		(2.5%)	
Directs Margin %	15.0%	0.2%		1.0%	
Total Gross Margin	17.3	1.4	8.7%	1.7	10.8%
Total Expenditure	12.1	(0.3)	(2.5%)	(1.0)	(7.4%)
Trading Surplus	**5.2**	**1.1**		**0.7**	
Trading Surplus %	10.6%	1.2%		0.0%	

2. After 6 months, **a surplus of £5.2m has been made which is £1.1m better than budget**.

3. Overall, we have seen strong demand through the first 6 months, with sales **volumes well ahead of budget and higher demand being seen through the summer peak** which continued through September with the return to school.

4. Supplier prices have continued to increase by more than normal this year, linked to the high global energy prices and high levels of wage and general inflation. This created pressure on margin in the second half of the year and as a result we increased selling prices in mid-October across a selected range of the most affected products to preserve margin. It's possible this may affect demand but the budget took a cautious approach to sales volumes and benchmarking shows our prices remain competitive.

5. **Rebate income from our frameworks is £0.8m ahead of budget**, continuing to benefit from inflation and continued growth in our core framework offering.

6. Costs continue to be tightly controlled with expenditure of £12.1m, which is slightly higher than budget due to the additional warehouse and distribution costs of fulfilling the additional Stores sales.

7. The **surplus remains at £0.7m better than last year**, with Directs and Rebates in particularly benefitting from entering 2022/23 with robust order pipelines (remembering last year schools were closed until March 8th).

8. **For the full year, the budget is a surplus of £5.7m**. There remains a significant opportunity in rebate income given inflation and framework performance. Catalogue trading remains ahead of budget and although we remain cautious about the impact of the Autumn price rises affecting demand in the second half of the year, benchmarking shows we remain competitive and these are necessary to mitigate the cost of supplier price rises. We're also mindful of the cost of the Local Government Pay Award for 22/23. This remains under consultation with Unions but the National Employers' proposal is estimated to cost ESPO c£0.8m, of which £0.6m was not budgeted.

Sales and Margin

Sales and Margin						
£m	**Actual**		**B/(w) than Budget**		**B/(w) than LY**	
Stores Sales	31.1		2.2	7.4%	3.4	12.3%
Direct Sales	12.3		2.4	24.5%	2.4	23.9%
Rebate income	5.5		0.8	18.2%	0.8	17.1%
Total Sales	**48.9**		**5.4**		**6.6**	
Stores Margin	9.0	29.0%	0.1	(1.7%)	0.3	(2.5%)
Directs Margin	1.9	15.0%	0.4	0.2%	0.5	1.0%
Rebate income	5.5		0.8	0.2%	0.8	1.0%
Gas Margin	0.2	3.1%	0.0	(0.0%)	0.1	0.7%
Catalogue Advertising	0.7		(0.0)		(0.0)	
Misc	0.0		0.0		0.0	
Total Gross Margin	**17.3**	**35.3%**	**1.4**	**(1.2%)**	**1.7**	**(0.3%)**

Gas						
£m	**Actual**		**B/(w) than Budget**		**B/(w) than LY**	
Gas Sales	7.3		1.0	15.3%	1.7	31.7%
Gas Margin	0.2	3.1%	0.0	(0.0%)	0.1	0.7%

9. **Total sales up to September 2022 were £48.9m, which was £5.4m better than budget and £6.6m better than last year**, with trading continuing strongly despite ESPO needing to increase prices to a higher degree than normal back in April 2022 due to the inflationary price increases that we have seen across our range of goods.

10. **Stores sales were £31.1m and £2.2m / +7.4% better than budget**. Customers made good use of our discount windows to 'stock up', perhaps to safeguard their supply and anticipating further price increases. When

considered with the mid-year increases in ESPO selling prices, and wider pressures on school and public sector finances, there may be a risk that sales don’t continue at this pace across Q3 and Q4.

11. **Gross profit margin for Stores at 29% is 1.7% lower than budget** with some impact of the in-year price rises from suppliers being seen through Q2. A selected range of products had mid-year price rises applied in October to mitigate this.

12. Global supply challenges continue to impact stock availability. Stock levels were increased this year to improve availability, with gross stock reaching £10.1m at the end of August before falling in September to £9.6m. Product availability continues to be closely monitored and managed to fulfil customer orders as promptly as possible.

13. **Directs sales were £12.3m and are £2.4m ahead of budget.** High levels of orders (and sales) through 22/23 are being observed with a continued pipeline of orders.

14. **Gross profit margin % for Directs at 15.0% is 0.2% ahead of budget** and this is largely mix. Similar to stores sales there has been some impact of the in-year price rises from suppliers being seen through Q2 affecting margin levels. A selected range of products had mid-year price rises applied in October to mitigate this.

15. **Rebate income of £5.5m is £0.8m ahead of budget** and continues to exceed expectations with a wide range of frameworks offered and a good pipeline in place of contracts secured for the future.

16. **Income from our gas service is closely in line with budget**. This service relates to a customer bill validation service, and also acting as a procurement agent for customers where we buy their gas on their behalf. These attract a fixed charge and so ESPO’s trading surplus isn’t exposed to the price volatility seen in the gas market. The customer ultimately bears this risk, but, part of the service involves ESPO using our expertise and size in forward buying gas to manage this risk more effectively and in line with the agreed risk profile for the service.

17. Our other income from selling advertising space in the catalogue and misc. income like bank interest are all largely in line with budget.

18. **Overall gross profit margin at £17.3m is £1.4m better than budget.**

Expenditure

Expenditure			
£m	Actual	B/(w) than budget	B/(w) than LY
Employee Costs			
Staff	6.4	0.4	(0.1)
Agency/Contract	1.3	(0.5)	(0.4)
Total	**7.7**	**(0.0)**	**(0.5)**
Overhead Expenses			
Transport	1.6	(0.3)	(0.3)
Warehouse	0.4	(0.0)	0.5
Procurement	0.1	0.0	0.0
Sales & Marketing	0.6	(0.0)	(0.0)
Finance	0.8	0.0	(0.6)
IT	0.6	0.1	(0.1)
Directorate	0.3	(0.1)	(0.1)
Total	**4.4**	**(0.3)**	**(0.4)**
Total Expenditure	**12.1**	**(0.3)**	**(1.0)**
As % of Total Sales Excluding Gas	24.7%	2.4%	1.6%

19. **Total expenditure of £12.1m was £0.3m higher than budget** due to higher transport and warehouse costs associated with fulfilling additional sales volumes. A continued focus on strong cost control across all areas remains.

20. **Expenditure as a % of sales** is one KPI which allows us to measure cost control in relation to sales. This KPI is 24.7% and is 2.4% better than budget and shows costs are being controlled in relation to sales activity.

ETL/Eduzone

21. ETL and Eduzone are ESPOs limited companies which service the private sector.

ETL and Eduzone		
£k	Actual	B/(w) than Budget
Eduzone Sales	254	(179)
ETL Sales	624	424
Total Sales	878	246
Eduzone Gross Margin	87	(67)
Eduzone Gross Margin %	34.1%	(1.3%)
ETL Gross Margin	100	15
ETL Gross Margin %	16.1%	(26.8%)
Total Gross Margin	187	(52)
Eduzone Expenditure	(95)	27
ETL Expenditure	(67)	(23)
Total Expenditure	(162)	5
Trading Surplus	25	(47)
Trading Surplus %	2.9%	(8.6%)

22. ETL, our business serving international and private sector customers, has started particularly strongly mainly due to a large furniture contract which was fulfilled across Q1 and Q2. Whilst generating incremental margin (£), as it is furniture the margin % is slightly lower than normal/budget. International sales are also growing and benefitting from a change in model from exclusively using a single international distributor to now using several.

23. Eduzone, our business focusing on early years in the UK, remains behind budget as a result of sales from a major customer stalling after they were put on stop in April for not paying their debts. The customer visited ESPO in September and sales have recommenced during October. Mitigating this, further new nursery groups have signed up to our Nursery package during September and October, broadening the customer base and improving the prospects for the remainder of the year.

24. Overall Eduzone margin is largely in line with budget and costs are being controlled. ETL margin is diluted due to lower margin on the large furniture order contract, other sales within ETL are closely in line with budgeted margins.

25. Overall, a £25k surplus has been generated to the end of September. The combined budget profit for the full year is £100k and we expect to be slightly behind this.

Full Year Expectation

26. The ESPO full year budget is a surplus of £5.7m. We have now completed the peak summer trading period and at September have achieved a YTD surplus of £5.2m. There are however several risks and opportunities emerging, the most significant being:

    a. Sales volumes at the start of the year have far exceeded our expectation. Whilst this gives reason to be optimistic, the wider economic environment, and the Autumn sales price increases effected in October may reduce demand across Q3 and Q4.
    b. Normally any supplier price rises are timed to coincide with the launch of our April catalogue so we can plan our selling prices accordingly. This year multiple suppliers have notified us of a need to increase their prices mid-year and this is expected to have an impact on margin in the second half of the year. Increasing selling prices will reduce the impact of this but we are limiting the products/ranges that we are increasing prices on to a selection of core items and expect to absorb c£0.5m of additional cost.
    c. Framework income via rebates performed well in 21/22 and our baseline for 22/23 starts approximately £0.3m higher than we had assumed in the budget. In addition, our framework income is likely to benefit from inflationary increases that suppliers apply.
    d. The Local Government pay award. An offer was announced in late July from the national employers which (simplified) was a fixed increase of £1,925 per person. Previously a 2% increase was

budgeted for 22/23. The impact has been estimated at £0.8m which would be a 6% average increase across ESPO.

e. The Government announced in mid-September 2023 that NI will be reduced by 1.25% from November 2023. This will benefit ESPO by approximately £75k.

27. Considering all this, **our latest guidance for the full year is a trading surplus in the range of £5.8m - £6.2m.** (Budget = £5.7m)

Financial Planning for 2023/24

28. Through autumn 2022 we will be starting our budgeting and planning cycle for 2023/24. Financial performance and customer demand so far in 2022 has been strong, despite the concerns we held last year on school and wider public sector finances. However, through 2022 we have seen a steady increase in pressure on the cost of living, inflation, and energy prices and we expect school finances to be tighter than ever. We also understand public sector customers to be facing some very difficult budget challenges. This all creates uncertainty in the trading environment for 23/24.

29. From our initial strategic planning we have confidence that we can still reasonably deliver the agreed MTFS targets, which for 2023/24 is a surplus of £5.8m. As is normal, we will provide a full budget update to the Finance and Audit sub-committee in February 2023, and then Management Committee in March 2023. We also hope to be able to provide the Management Committee with a guidance range, the lower end of which we have a very high degree of confidence in.

Warehouse extension at Grove Park – Financial Update

30. The original business case approved by Management Committee was based upon the investment of £6.8m for a new build warehouse. Whilst the strategic need for the additional space remains, the impact of Covid, hybrid working, and planning permission challenges led Management Committee to agree to altering this in November 2021 to extending our existing warehouse within the parameters of the original business case.

31. The economic environment has changed significantly since that time, with a notable increase in inflation and continued supply chain challenges. This increases the strategic need for the additional space as it allows us to protect price and product availability and maximise our service to customers. ESPO's MTFS (Medium Term Financial Strategy) was shared with the Committee in June 2022, and despite the current economic challenges we remain confident that this can be delivered. (We are in the process of updating the MTFS through winter 2022.)

32. The warehouse extension is a key enabler of the MTFS and the cost indicated by the external project manager is currently up to £6m (this includes a contingency). At this level we would expect the extension to pay back within 8 years and have a positive net present value (i.e. viable investment, calculated

over both 10 years and lifetime). The extension is also expected to increase the market value of the site, although this isn't something that could be readily realised. As the tender process completes and more detailed costs are received, the financial model will be updated and an update provided to Management Committee.

33. Given the risk of inflation, we did at this point undertake some sensitivity analysis. The project viability isn't especially sensitive to moderate cost increases given the long-term benefits to the organisation. As an extreme example, a £9m cost (50% overrun and thought to be highly unlikely) would payback in 10 years and the NPV becomes positive in year 13. However, at this level we would exceed the parameters approved by Management Committee and would re-evaluate our options before discussing next steps with the Committee. The risk of a delay in completing the project (for example a delay in sourcing materials) is also not especially sensitive given the contractor payments would also be delayed and the plan includes a measured and gradual increase in sales. For example, a 6-month delay would delay the payback by less than 1 year.

ESPO Full P&L – Sep 2022

	Year to Date @ Sep 22					
	Actual		Budget		Prior Year	
	£000	%	£000	%	£000	%
Sales						
Stores	31,088		28,938	0.07	27,692	
Direct	12,336		9,909	0.24	9,958	
Rebate Income	5,455		4,615	18.2%	4,660	
Total Sales	**48,879**		**43,461**		**42,310**	
Cost of Sales						
Stores	22,077		20,054		18,979	
Direct	10,481		8,442		8,562	
Gas	7,027		6,093		5,373	
Total Cost of Sales	**32,558**		**28,496**		**27,541**	
Margin						
Stores	9,010	29.0%	8,884	30.7%	8,713	31.5%
Direct	1,855	15.0%	1,466	14.8%	1,396	14.0%
Rebate Income	5,455		4,615		4,660	
Gas	226	3.1%	196	3.1%	133	2.4%
Catalogue Advertising	672		700		684	
Other Income	36		10		(7)	
Total Margin	**17,255**	35.3%	**15,872**	36.5%	**15,579**	36.8%
Warehouse and Transport						
Employee Costs						
Staff	2,526		2,774		2,578	
Agency/Contract	1,251		859		936	
Total	**3,777**		**3,634**		**3,514**	
Overhead Expenses						
Transport	1,582		1,316		1,311	
Warehouse	425		421		965	
Total Warehouse and Transport	**5,783**	18.6%	**5,371**	18.6%	**5,789**	20.9%
Head Office						
Employee Costs						
Staff	3,837		4,011		3,646	
Agency/Contract	91		16		33	
Total	**3,927**		**4,027**		**3,678**	
Overhead Expenses						
Procurement	83		107		132	
Sales & Marketing	601		562		568	
Finance	801		815		182	
IT	630		694		575	
Directorate	256		202		196	
Total	**2,371**		**2,380**		**1,653**	
Total Head Office	**6,298**		**6,406**		**5,331**	
Total Expenditure	**12,082**	**24.7%**	**11,777**	**27.1%**	**11,120**	**26.3%**
Trading Surplus	**5,173**	**10.6%**	**4,095**	**9.4%**	**4,459**	**10.5%**

ETL/Eduzone Combined P&L – Sep 2022

	Actual		Budget	
	£000	%	£000	%
Sales				
Sales	877.8		632.3	
Total Sales	**877.8**		**632.3**	
Cost of Sales				
Cost of Sales	690.9		393.5	
Total Cost of Sales	**690.9**		**393.5**	
Margin				
Margin	186.9		238.8	
Total Margin	**186.9**	21.3%	**238.8**	37.8%
Expenditure				
Employee Costs & Agency	53.3		37.9	
Commission	0.8		0.0	
Carrier	22.2		45.4	
Marketing Expenses	34.0		29.3	
Catalogue Print & Distribution	33.0		25.0	
Consultancy	2.0		1.3	
Support / Legal Prof	2.5		5.0	
Accountancy	0.0		0.0	
Insurance	9.5		10.0	
Audit	0.0		0.0	
Office Machine Maint / Software	1.5		1.8	
Merchant Services	0.9		2.5	
Depreciation	0.0		0.0	
Loan Interest	0.0		0.0	
Other Expenses	2.1		8.5	
Total Expenditure	**161.8**	**18.4%**	**166.6**	**26.3%**
Trading Surplus /(Deficit)	**25.1**	**2.9%**	**72.3**	**11.4%**

ESPO Operational Progress

34. In the busy back-to-school month of September ESPO's distribution centre picked and dispatched 228,821 order lines, valued at £6.958m and the transport fleet with couriers made 29,959 deliveries. A large number of

customer back orders were fulfilled as stock arrived from suppliers during the summer recess.

35. Warehouse picking was performed at a rate of 39 lines per hour (target 36) and the error rate detected by QA was 3% against the budget of 3%. The average order value for stock orders YTD to September was £233.80 compared to £212.21 last year. Operational and IT costs year to September were £6.658m against a budget of £6.290m. Stores sales to September were 7.4% higher than budget driving higher transport and picking costs.

36. The Customer Services team handled 13,267 calls across the five customer service channels. Average wait times across all teams was just over two minutes. This was impacted by the sheer demand in the September period. Overall there was a 70% increase in calls from August and call volumes were 7% up on last year. The increase in demand can be traced to customers chasing down outstanding orders, or items on back order which typically increase call-length. The team processed 34,774 customer orders valued at £4.875m. Online and electronic converted orders were at 54% of the total reflecting an increasing trend towards digital ordering via e-catalogues or through the web. Direct orders currently valued at £2.554m are being managed from suppliers to customers. Late suppliers are being expedited by the customer services team. Call performance, impacted by the increase in volume, was 79% of all incoming calls answered with an average wait-time of 2 minutes 7 seconds. Our FEEFO customer rating was disappointing at 70%. This is lower than our long established standard but reflects the significant challenges in pricing, availability and resources exacerbated in peak demand

37. Our new email management solution has now been in place since the middle of August. Customers and the team have responded well to the new solution. The technology has enabled the identification of urgent enquiry types, as well as providing visibility of volumes, trends and pressure points, to enable both remedial actions to be taken quickly as well as move resources to areas of high demand. Work now continues to refine and develop the solution, as well as developing a suite of insightful management information

38. Stock availability averaged 96% in September, stock value was £9.632m with a stock turn of 5.16. Following earlier disruption in the supply chain the availability situation has improved and we are hopeful that outstanding customer orders will be substantially fulfilled by the end of October. Customers are being kept informed of the latest stock availability through a new improvement to the website which provides visibility of products that have an extended lead time but are still available to order. ESPO continues to rely on external storage to manage its stock holding requirements. This includes exercise book stock held at KCS in Maidstone and by its printer in Poland.

39. Facilities management in September included a number of scheduled repairs to the in-rack sprinklers and high-bay racking; mobile and fixed printers; warehouse emergency lighting; warehouse doors and emergency call point repairs. Upgrades were made to the building lighting with LED replacements and the fire damper between the warehouse and offices was serviced. There

were also inspections to fire safety system, pest control, intruder alarm and CCTV system with various repairs to and maintenance of equipment throughout the Grove Park facility.

40. There were four minor accidents in September. This included a cut to the hand from using a tape gun; a driver jarred his knee when entering the cab; an agency picker had a small cut to the finger after catching this on racking; an operative tripped over a power lead and fell to the floor. Safety reminders were issued in respect of the incidents.

41. A fire evacuation drill took place on August 23rd for the night shift and on 26th August for the early shift and office staff. Observations were generally positive with evacuation times of 4.5 minutes and 6 minutes respectively. All gas-powered trucks were removed from the warehouse. The offices were 'swept' to ensure full compliance and staff were marshalled in the north car park as per the agreed procedure. To assist with communications, it was agreed to issue more walkie talkies to enable key staff to report in real time.

42. Random drug and alcohol testing took place on 24th August using a specialist agency. The tests were conducted on the night shift and driver shift. A total of 11 staff were tested. There were no positive results for alcohol which are received on the day. Five agency staff were subsequently released following a positive drug test.

43. The IT helpdesk handled 652 enquiries with a 100% satisfaction rating from internal customers. We began installation of a replacement WIFI system into the office settings in September and will continue into the warehouse in October which will provide much greater strength and resilience into the signal for RDT's and other mobile devices.

44. There were eleven cyber incidents reported in September which were all detected and dealt with. ESPO has made good progress in meeting the recommendations of the Cyber Security Audit undertaken. A number of critical actions were highlighted, as well as a range of further actions and suggestions. In total, 49 Actions were identified, three of which were deemed (HI). ESPO undertook a further risk analysis exercise on all 49 Actions to create transparency and to monitor progress. This identified eight as "Red" risks. Extensive work has been undertaken across the operation, with the net result that all Red risks have now been mitigated down to Amber or Green.

45. The project to automate transport planning is progressing with middleware being written for extracting delivery data from System 21 for input into the Roadshow scheduling system. Eventually this process will be fully automated allowing customer data to be uploaded into the scheduling system which will create a daily transport schedule in a much shorter time and offers greater long-term operational and service benefits. A new e-mail management system was introduced on 15th September for the customer services team.

Staffing Updates

46. Sickness absence continues to be well managed, but we are experiencing high levels of cold and flu absences which reflects the national trend. Too offset this we are giving staff the option of a free Flu injection. Safe working arrangements remain in place for staff in the office to ensure that the potential of any work-based outbreak is reduced as far as is practicable. Reminders have also been provided to staff on the steps they need to follow if they test positive for Covid, to ensure that everyone remains extra vigilant.

47. ESPO continues to carry a higher than normal number of staff vacancies; particularly prevalent in the professional procurement staff. Some agency resource is being utilised as well as prioritisation to mitigate the impact.

48. The national negotiating body for Local Government pay have responded to the Trade Unions pay submission for 2022/23 and have made a final offer of £1,925 on every spinal point, plus a 4% increase on expenses. At the time of writing, this offer has been accepted by Unison and GMB. We are currently awaiting the outcome of Unite ballot of members which is imminent.

ESPO Risk and Governance Update

Health, Safety, Wellbeing and Facilities Management & Corporate Risk Register

49. The ESPO Leadership Team held its quarterly review of Health, Safety and Wellbeing and Major Risk Records (MRRs) and the top risks are attached at Appendix 2.

Resources Implications

None arising directly from this report.

Recommendation

The Management Committee is asked to note and support the contents of this report.

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Appendices

Appendix 1: Balanced Scorecard
Appendix 2: Corporate Risk Register extract