Agenda Item 7

ESPO

ESPO MANAGEMENT COMMITTEE – 6 MARCH 2014

FORECAST OUTTURN 2013/14 AND DRAFT MTFS 2014/15 – 2017/18

JOINT REPORT OF THE DIRECTOR AND CONSORTIUM TREASURER

Purpose of Report

1. To update the Management Committee on the financial implications of the Four Year Medium Term Financial Strategy document currently being prepared for 2014/15 -2017/18.

2. To present the 2014-15 budget.

3. To present draft outline budgets for 2015-16, 2016-17 and 2017-18.

Background

4. The intention to move to a four year Medium Term Financial Strategy was presented to the Finance and Audit Sub Committee and Management Committee in June 2012, together with a draft outline budget for 2013-14, 2014-15 and 2015-16.

5. The assumptions underlying this budget and MTFS were presented to the Finance and Audit Sub Committee on 19 November 2013. That meeting was however inquorate and the exempt report provided instead to the Management Committee meeting held on 5 December 2013 to ensure member consideration.

6. During consideration of those budget assumptions, the following principal points were noted:

    a. Members were advised that further work was needed to align the strategy cycle with the financial cycle and that the MTFS would need to reviewed regularly to recognise the dynamics of the market in which ESPO operated. The Finance and Audit Subcommittee would be kept updated on a regular basis.

    b. Members acknowledged the challenges facing ESPO and the need for investment to reduce the cost base (e.g. a new stock pick and control system) and to grow the business and hence enhance the value of the business.

7. An exempt report containing the draft 2013-14 budget and the MTFS was presented to the Finance and Audit Subcommittee on 17 February 2014. The report was considered in detail and arising from discussion the following additional points were noted, for presentation to the Management Committee:

    (i) ESPO had developed its e-ordering capabilities and an improved web interface for customers was in progress, due to go live during the first quarter of the

2014/15 financial year; this, alongside working with suppliers to be able to fulfil 'just in time' deliveries, would create further efficiencies, improve the customer experience and stock accuracy/levels over the course of the MTFS;

(ii) There remained strong demand from customers for the ESPO catalogue. Whilst this meant fixed 12 month headlining pricing for stores products, members supported the use of marketing initiatives and promotions applied throughout the year to drive sales and manage stock levels;

(iii) As the new Indigo Warehouse system became fully operation, ESPO's agency manpower costs was expected to fall as a proportion of the previous year's budget;

(iv) A contractor was currently being employed by the Servicing Authority to assess major spend on energy at Leicestershire County Council buildings. Members felt this could be extended to cover ESPO's Grove Park building, acting as a form of review as to whether elements of its 40 efficiency projects should be altered to gain greater returns.

Updated Outline ESPO Four Year Strategy 2014/15 – 2017/18

8. The financial implications of the four year strategy document along with the key assumptions can be summarised in the following table:

ESPO BUSINESS PLAN MODEL **SUMMARY**

		2010/11 Actual	2011/12 Actual	2012/13 Actual	2013/14 Forecast	2014/15 Year 1	2015/16 Year 2	2016/17 Year 3	2017/18 Year 4
		£m	£m	£m	£m	£m	£m	£m	£m
PROJECTED USE OF ESPO SERVICES									
INVOICED SALES		86.6	86.5	94.1	99.7	100.1	103.9	106.4	108.6
CONTRACTS & COMMISSIONING		449.1	1009.0	500.0	510.0	520.2	530.6	541.2	552.0
TOTAL		535.7	1095.5	594.1	609.7	620.3	634.5	647.7	660.6
TRADING INCOME		18.1	17.8	17.9	18.4	18.7	18.9	19.4	19.7
TRADING SURPLUS		3.1	2.6	2.7	2.1	2.2	2.4	2.7	3.0
MEMBERS' DIVIDEND		1.0	1.7	1.5	1.4	1.4	1.6	1.8	2.1
USABLE CASH RESERVES		5.9	6.6	7.5	8.2	9.0	9.8	10.6	11.6
NET WORTH		6.8	9.8	11.0	12.2	12.6	13.4	14.2	15.1
PROPERTY, PLANT AND EQUIPMENT		11.0	11.2	10.9	11.0	11.0	11.0	11.0	11.0
LOAN LIABILITY		-10.0	-9.5	-9.0	-8.5	-8.0	-7.5	-7.0	-6.5
FORECAST ASSUMPTIONS:									
Stores Income Growth			3.8%	7.0%	5.7%	3.6%	6.2%	3.0%	2.0%
Stores Price Inflation			3.0%	1.9%	0.3%	0.3%	0.3%	0.3%	0.3%
Stores Volume Growth			-3.3%	5.1%	5.4%	3.4%	5.9%	2.7%	1.7%
Wage Inflation			0.0%	0.0%	1.0%	2.0%	2.0%	2.5%	2.5%
Headcount	- Stores Average FTE		196.4	194.7	163.2	175.6	175.6	175.6	175.6
	- Procurement Average FTE		150.9	150.5	178.0	182.6	182.6	182.6	182.6
	-Total		347.3	345.2	341.2	358.2	358.2	358.2	358.2
Cost Efficiencies				0	0	115	447	621	884
Warehouse Payroll Costs as % of Stores T/O			11.52%	11.35%	10.04%	9.98%	9.63%	9.30%	9.30%

The figures for 2013-14 represent the forecasted out turn for this financial year. The figures for 2014-15 represent the draft budget as it currently stands. A detailed scenario analysis has been prepared to allow members to see the impact of various events and allow consideration as to whether they should be included in the budget for 2014-15. This information is of a commercially sensitive nature and it is thus included in the exempt report providing supplementary information informing the forecast outturn and draft MTFS elsewhere on the agenda.

The Four Year MTFS presented in February 2013 was as follows:

ESPO BUSINESS PLAN MODEL				SUMMARY			
	2010/11 Actual	2011/12 Actual	2012/13 Forecast	2013/14 Year 1	2014/15 Year 2	2015/16 Year 3	2016/17 Year 4
	£m	£m	£m	£m	£m	£m	£m
PROJECTED USE OF ESPO SERVICES							
INVOICED SALES	86.6	86.5	91.6	94.5	96.6	99.7	102.4
CONTRACTS & COMMISSIONING	449.1	1009.0	445.0	499.0	514.0	529.0	534.3
TOTAL	535.7	1095.5	536.6	593.5	610.6	628.7	636.7
TRADING INCOME	18.1	17.8	17.9	17.8	17.8	17.9	17.9
TRADING SURPLUS	3.1	2.6	2.7	1.8	1.9	2.2	2.3
MEMBERS' DIVIDEND	1.0	1.7	1.5	1.1	1.2	1.4	1.6
USABLE CASH RESERVES	5.9	6.6	7.8	8.0	8.7	9.4	10.2
NET WORTH	6.8	8.5	9.6	10.5	11.2	11.9	12.7
PROPERTY, PLANT AND EQUIPMENT	11.0	11.2	11.0	11.1	11.9	11.9	11.9
LOAN LIABILITY	-9.5	-9.0	-8.5	-8.0	-7.5	-7.0	-6.5
FORECAST ASSUMPTIONS:							
Price Inflation - Energy		0.2%	15.0%	5.0%	6.0%	2.0%	2.0%
Stores Income Growth		3.8%	8.1%	3.7%	5.3%	3.3%	2.0%
Stores Price Inflation		3.0%	1.9%	1.5%	1.0%	1.0%	1.0%
Stores Volume Growth		-3.3%	6.2%	2.2%	4.3%	2.3%	1.0%
Wage Inflation		0.0%	0.0%	1.0%	1.0%	1.0%	1.0%
Headcount - Stores Average FTE		196.4	192.0	189.4	188.4	188.4	188.4
- Procurement Average FTE		150.9	149.2	170.7	179.9	179.9	179.9
-Total		347.3	341.2	360.1	368.2	368.2	368.2
Cumulative Indigo Warehouse Efficiencies £k			0	200	400	600	800
Other Project Efficiencies			100	150	350	650	900
Warehouse Payroll Costs as % of Stores T/O		11.52%	11.19%	9.97%	9.43%	9.21%	9.10%

Key financial drivers for the strategy over the next four years are as follows:

- ESPO commitment to value for money; the organisation's main objective;
- Clear focus on achieving cost efficiencies, being transferred in to business growth initiatives and sustained lower prices;
- Secure and adapt to maintain core business

  - Grow Stores volume by 20% through competitive pricing and outstanding service;
  - Maintain rebate income through increased numbers of frameworks offset by pressure on rebate margins.
- Development of staff capabilities and new skill sets;
- Expand the services offered to customers thus broadening the offering and hence the customer base.
- Spread the benefit of ESPO to all users in the form of competitive pricing;
- A fair return to members relative to the risk they take;
- Grow the net worth of the business;
- Minimise risk and maximise opportunities by growing ESPO capability and unique skills.

As with all strategies ESPO will be flexible to the impact of external events and will respond accordingly should the need arise. In particular note is taken of the pressure on Member budgets and this is allowed for in the scenario analysis.

9. A critical contribution underpinning the financial strategy will be the use of efficiency projects to support the sub inflationary price rises predicted over the next four years. In simple terms the efficiencies will support the margin which would otherwise have been eroded by unavoidable supplier price increases. This supports the value for money key objective and maintains the appropriate surplus level.

10. The Indigo warehouse efficiency project is largely implemented now with up to 90% of despatches being processed through this system.

11. Beyond the headcount increases allowed for in the 2013-14 budgets and rolled forward in to the 2014-15 budget, there are no significant further increases built in. Payroll inflation has been kept at minimal levels throughout the 4 year period.

12. As a result of the tight headcount controls, minimal wage inflation, new systems and a policy of driving volume through the warehouse, the warehouse payroll costs as a percentage of stores turnover decreases from 11.52% in 2011-12 to 9.30% in 2017-18.

13. The financial model includes allowance for the training and development of staff in both procurement and finance. Structured training schemes are in place in both areas to ensure staff have the best and latest capabilities and skills.

14. The model has been structured to generate a growing surplus from £2.2m to £3.0m in 2017-18 of which 80% each year would be distributed as a dividend. In total over the four year period 2014-18 £6.9m is forecast to be distributed to members. This is after allowing £0.4m each year for the building replacement fund which was not included in the original MTFS presented in June 2012.

15. In 2014-15 net debt will be zero as cash will be greater than the outstanding loan liability. The business will thus have zero net gearing and this represents a strong balance sheet for ESPO going forward.

Detailed Review of Forecast Outturn 2013-14 Compared to Budget

Income

16. A breakdown of the Forecast Income for 2013-14 compared to budget is show below

	FCAST	BUDGET	PRIOR YEAR
	£000	£000	£000
SALES			
STORES	42,598.6	42,254.0	40,316.1
DIRECT	22,288.3	21,132.4	23,296.1
GAS	29,440.6	25,639.7	24,404.2
CATALOGUE ADVERTISING	872.6	896.3	918.5
REBATE INCOME	4,345.4	4,073.8	4,858.0
MISCELLANEOUS INCOME	196.9	203.7	278.1
TOTAL SALES	99,742.4	94,199.8	94,071.0

17. Total Sales are 5.8% ahead of budget or £5,543k. The key positive variance is in gas sales which is £3,801k ahead of budget driven by higher gas usage and increasing customer footprint. Store sales are forecast to be 1% ahead of budget.

18. Total Rebates at £4.3m are ahead of budget by £272k.

19. Direct Orders are £1,156k ahead of budget driven by higher Phonics orders as a result of a targeted marketing campaign in Q3.

20. Other income includes bank interest which is higher than budget due to maintaining a higher average cash balance than expected.

21. Catalogue advertising is £24k behind budget

22. Total gross margin is £18,408k compared to the budget £17,823k.

23. The increased margin is principally down to additional rebates and higher store sales.

Employee Expenditure

24. A breakdown of Employee Expenditure for 2013-14 compared to budget is shown below.

	FCAST	BUDGET	PRIOR YEAR
	£000	£000	£000
EMPLOYEES			
Staff	9,330.7	9,828.7	9,180.5
Agency/Contract	982.0	323.1	830.0
Total	10,312.7	10,151.8	10,010.5

25. The 2013-14 budget included an allowance of £0.6m for the implementation of the Procurement and Marketing restructure. This has now been implemented and the full year impact will be shown in the 2014-15.

26. The benefits and impacts of the restructure has been as follows:

- Additional services to members as outlined in the ESPO strategic review at no additional cost.
- Lower risk
- Growth in the number of framework contracts available to members and non-members and hence directs/rebates
- Sustained growth in the stores operation
- Strong marketing function supporting a national procurement operation leading to further growth

27. Included in employee expenditure are agency costs. These are running substantially ahead of budget due to the delayed implementation of Indigo and a heightened focus on ensuring that store business is delivered as far as possible in line with customer expectations during peak trading periods despite the increased volume. This has been offset by lower full time staff costs as the vacancies that have arisen as a result of the restructure have proved difficult to fill.

28. Total average FTE is expected to end the year at 341.2 compared to a budget of 360.1.

Non Employment Expenditure

29. The summary position for non-employment expenditure for 2013-14 compared to budget is shown below:

	FCAST	BUDGET	PRIOR YEAR
	£000	£000	£000
OVERHEAD EXPENSES			
Stores	3,928.1	3,684.1	4,016.0
CP	2,069.8	2,169.8	1,984.0
Total	5,997.9	5,853.9	6,000.0

30. In total non-employment expenditure is £145k over budget. The key variance is in Transport as a result of the aged fleet.

Surplus

31. As a result of the additional income (£585k), higher employment costs (£161k) and higher non employment costs (£144k) the surplus for 2012-13 will be £280k ahead of budget at £2,097k. This compares with an outturn last year of £2,685k. The detailed P&L is included in appendix 1E for 2013-14.

Efficiencies

32. The total number of projects supporting the efficiency drive total 45 and when fully implemented will generate £1.0m of annual savings on a cost base budget for 2013-14 of £16.3m, a target saving of 6%. These projects are currently being reviewed so that management can focus on a reduced number of projects that will deliver the savings required.

Balance Sheet

33. A summary balance sheet compared to the prior year is detailed in Appendix 1A and 1B.

34. Stock has decreased by 2% in line with the increase in stores turnover. Stock turn will end the year at approximately 9x with a key target next year to increase this to 10x.

35. Debtor days are expected to outturn at 31.7, a fractional increase on the prior year of 30.8.

36. At year end the land and buildings will not be re-valued in line with the decision at Management Committee in December 2013.

37. During the year £1.5m was paid to members for prior years dividends and it is forecast that a provision will be required for £1.4m this year.

38. Other creditors represents, VAT, Climate Change Levy, specific accruals, PAYE/NI, Directs/Gas not invoiced etc.

39. A detailed cash flow is included in appendix 1C for 2013-14.

Service Line Analysis

40. One of the requirements of the ESPO strategic review was the production of detailed service line analysis and this is produced in the exempt report elsewhere on the agenda.

41. **Capital Expenditure**

There has been minimal capital expenditure during the year and this has been reflected in the budget for next year to maintain the organisations infrastructure and capability.

Detailed Review 2014-15 Budget

Income

42. A breakdown of the Budget Income for 2014-15 compared to the prior year is show below:

	Forecast 2013-14	Final Budget 2014-15
	£000	
SALES		
STORES	42,598.6	44,140.7
DIRECT	22,288.3	19,519.1
GAS	29,440.6	30,939.4
CATALOGUE ADVERTISING	872.6	940.2
REBATE INCOME	4,345.4	4,338.0
MISCELLANEOUS INCOME	196.9	200.0
TOTAL SALES	99,742.4	100,077.4

43. Total Sales are broadly flat compared to the prior year. Store sales are budgeted to grow by 3.6% next year compared to 5.6% the prior year. We remain on track to deliver the 20% volume growth identified in the original four year business plan.

44. Total Rebates at £4.3m show no significant change on the prior year.

45. Direct Sales fall due to the DofE Phonics initiative coming to an end in October 2013.

46. Other income includes bank interest and sales of fixed assets which we expect to increase on the prior year as a result of the planned capital investment programme.

47. Catalogue advertising increases by 7.8% as a result of a concerted marketing campaign with suppliers to advertise in key pages in the catalogue e.g. the inside front cover.

48. Total gross margin is £18,693k compared to the prior year £18,408k.

Employee Expenditure

49. A breakdown of Employee Expenditure for 2014-15 compared to the prior year is shown below.

	Forecast 2013-14	Final Budget 2014-15
	£000	
EMPLOYEES		
Staff	9,330.7	9,551.7
Agency/Contract	982.0	901.8
Total	10,312.7	10,453.5

The year on year movement is explained as follows:

Opening Payroll Value		10,312.8
Agency & contractor Saving/Loss	-	81.4
Vacancy Provision & Staffing Efficiencies	-	300.0
Employee Number Decrease/Increase		224.5
Pay Scale Annual Increases		88.7
Inflation Increases		97.4
Pension Fund Increases		87.2
Other Increases/(decreases)		24.4
Closing Value		10,453.5

50. The 2013-14 budget included an allowance of £0.6m for the implementation of the Procurement and Marketing restructure. This is now implemented and has been rolled forward in to this budget. The benefits of the restructure will be:

- Additional services to members as outlined in the ESPO strategic review at no additional cost;
- Lower risk;
- Growth in the number of framework contracts available to members and non-members and hence directs/rebates;
- Sustained growth in the stores operation;
- Strong marketing function supporting a national procurement operation leading to further growth.

51. It is assumed that Indigo will be implemented and that efficiency savings in agency labour of £0.1m will be achieved.

52. Included in this is a 1% pay award across all grades at a cost of £0.1m.

53. Total average FTE is expected to end the year at 358.2. The movement in FTE over the previous 4 years has been as follows

2011-12 347.3
2012-13 345.2
2013-14 341.2
2014-15 358.2

Ten agency staff have been converted to full time employees in the warehouse, this explains the bulk of the increase in the FTE's the balance is the full year impact of the Procurement and Marketing restructure. The additional warehouse staff are the drivers behind the £300k efficiencies in staff identified in paragraph 46.

Non Employment Expenditure

54. The summary position for non-employment expenditure for 2013-14 compared to prior year is shown below:

	Forecast 2013-14	Final Budget 2014-15
	£000	
OVERHEAD EXPENSES		
Stores	3,928.1	3,960.6
CP	2,069.8	2,108.2
Total	5,997.9	6,068.8

55. In total non-employment expenditure is budgeted to increase by 1.1% which is sub inflationary and is reflective of the delivery of some of the 45 efficiency projects.

Surplus

56. As a result of the higher income (£286k), higher employment costs (£141k) and higher non employment costs (£70k) the surplus for 2013-14 will be £75k higher than prior year at £2,172k. The detailed P&L is included in appendix 1F for 2014-15.

Efficiencies

57. The total number of projects supporting the efficiency drive total 45 and when fully implemented will generate £1.0m of annual savings on a cost base budget for 2013-14 of £16.3m, a target saving of 6%. Further efficiency projects will evolve during the year, as the current efficiency activity nears completion.

Balance Sheet

58. A summary balance sheet compared to prior year is detailed in appendix 1B

59. Stock has decreased by £89k in line with the target stock turn of 10x. This will be one of the benefits of the new stock optimisation system implemented as part of the restructure with no adverse impact on stock availability.

60. Debtor days are expected to outturn at 32.0, a consistent on the prior year of 31.7.

61. Other creditors represents, VAT, Climate Change Levy, specific accruals, PAYE/NI, Directs/Gas not invoiced etc.

62. Over the year the Net Worth of the business as measured by net assets has increased by £0.41m as a result of a reduction in the loan of £0.5m and

retailed surplus.

63. A detailed cash flow is included in appendix 1F for 2014-15.

Service Line Analysis

64. One of the requirements of the ESPO strategic review was the production of detailed service line analysis and this is produced in the exempt report elsewhere on the agenda.

Capital Expenditure

65. There had been minimal capital expenditure in the prior year but draft budgetary provision has been made as follows – this expenditure will be managed in line with the 'standing orders' set out in the constitution.

£000	
Replacement of 12 Vehicles	£360k
Replacement of Fork Lift Trucks	£100k
Total	£460k

Performance Management Framework

66. To ensure the successful delivery of this budget a performance management framework will be implemented around the recently introduced balanced scorecard. This will include a number of specific procurement measures as well as the balance sheet and cash flow targets mentioned earlier in this paper. These will flow down in to the PDR's of the Senior Management team, their direct reports, and through the business.

Detailed Scenario Analysis of 2014-15 Budget

67. A detailed scenario analysis has been prepared as follows for members to consider alongside this budget. This will allow members to review alternative financial solutions for ESPO, but also to be satisfied that risk scenarios have been considered throughout this exercise. Each scenario can be considered in isolation or grouped. The full impact of each scenario on its own has been assessed though the impact of several being implemented may not be a simple sum of the parts.
68. The detailed scenario analysis is included in the exempt report elsewhere on the agenda.

Supplementary Information Informing the Budget

69. Further information which informs the budget, of a commercially sensitive nature, is contained elsewhere on the agenda for this meeting.

Resources Implications

70. The Medium Term Financial Strategy is the key financial plan for ESPO.

Recommendation

71. Members are asked to note:

a) The forecast outturn for 2013/14; and

b) Approve the four year medium term financial strategy which incorporates the recommended budget for 2014-15, and draft projected budgets for 2015-16, 2016-17 and 2017-18.

Equal Opportunities Implications

72. None

Risk Assessment

73. None identified

Officers to Contact

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Appendices

Appendix 1A Detailed Balance Sheet 2013-14

Appendix 1B Detailed Balance Sheet 2014-15

Appendix 1C Detailed Cash Flow 2013-14

Appendix 1D Detailed Cash Flow 2014-15

Appendix 1E Detailed P&L 2013-14

Appendix 1F Detailed P&L 2014-15