


INTERNAL MEMO

Rick Honey, C22, 6682

TO: Dick Williams, Pete DiCorti, Dale Beckles
CC: Alda Hearne, Gale Steiner
FROM: Rick Honey 

DATE: March 2, 1990

RE: Egghead Discount Software

HISTORY

In the past Egghead has been considered by vendors as a convenient vehicle through which large quantities of product could be moved. With 207 stores and the decision as to which products will be carried in these stores made at the corporate level indeed it has been. The following is a brief history of our involvement to date with Egghead.

November 1987, Egghead wanted our letter of supply for their initial involvement with the GSA. Note, the GSA letter supply is good from April 1st through March 31st. We were not happy with our involvement with GTSI at that point so we offered Egghead an exclusive listing. In order to give them this exclusive status we, among other items, expected Egghead to stock our full line of products in their stores. Additionally we negotiated a direct relationship with Egghead Government sales, this gave Egghead pricing which enabled them to compete more effectively in the government area.

October 1988, Egghead once again agreed to stock products in return for our letter of supply to GSA. This was agreed to in spite of our products slow sell through at the stores level. In addition we were asked to participate in their Direct 100 program, which cost \$75,000 approximately.

During this time we were aggressively seeking a direct relationship with Egghead commercial sales. We were told repeatedly that our products did not move enough units per month to warrant a direct relationship. We persisted, to no avail.

October 1989, When we renewed our letter of supply this time there was no provision that required Egghead to stock any product in their stores. That letter of supply begins April 1, 1990.

November 1989, we owed Egghead approximately \$90,000.00 for the Direct 100 program and some additional advertising with them. I was able to arrange for this bill to be paid for in product.

Presently Egghead has undergone major changes. They have brought in new management, reorganized the purchasing department, reduced the number of stores and canceled all their Eggzhibitions (consumer trade shows). This new management is focused on inventory reduction and increasing margins.

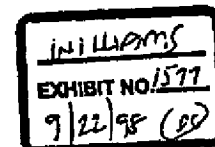
Now, unlike prior years, the stocking decision is no longer a mandate from corporate purchasing. Purchasing will make choices as to what products are stocked in their warehouses, and these at only two (2) months supply. Egghead's new direction is to have each store manager be responsible for which products to stock. This format makes it very difficult for a vendor to stipulate their products be carried in each Egghead location. Each product will be stocked according to their customer demand and it's ability to maintain acceptable profit margins.

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Plaintiff's Exhibit

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Comes V. Microsoft

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STOCK LEVELS

Current stocking issues urgently need to be addressed. As I mentioned in my memo dated January 18, 1990 we have a potential return liability close to \$500,000.00. (see attached copy) Based on the current "turns" of our products, through Egghead, there is at least one full year of stock on hand. This stock results greatly from the negotiations regarding our listing on their GSA schedule in 1987.

Our relationship with Egghead at this point is not good, at best. Resulting from the stock issues and the manner in which it came about. The ideal situation Dave Barrow would like to see is two (2) months supply in stock. Two months supply at the current turn rate is approx. \$137,000.00 of stock.

TO PROCEED

First, we must evaluate Egghead's present structure and determine Egghead's importance to us as a vehicle to move large quantities of our product. If we want to go forward in our relationship with Egghead, I suggest a quick reduction of product to their acceptable stock levels.

Secondly, we must be prepared to work with Egghead using their marketing programs to move our products through their sales channel. This will insure stocking in most of their stores and increase the sell through and our visibility throughout Egghead.

If we determine that Egghead's current structure does not give them any advantage over other national chains, then we need not move so quickly to reduce their inventory.

In any event this situation will cost DRI either in cash up front or in lost sales over a period of time.

In light of my limited knowledge of DRI's overall financial picture, I have no specific recommendations as to the course of action we should pursue. However, I am asking for your advice in this matter to develop a mutually beneficial solution to this challenge.

SUGGESTIONS

1. Advertise reduced price (and price protect products sold) on Artline and Presentation Team. This would cost us roughly \$11,000 to advertise with Egghead and \$50.00 per each product sold during the sale period. The sale period is for only one week at a time. Each week we participate would cost an additional \$11,000.00 for ads in the newspaper.
2. Allow Egghead to return all but two months supply of product, an approx. \$330,000.00 RMA. Actual cost of goods for this amounts to approx. \$66,000.00. Unless we worked a special program with distribution we would have to take this back directly. I would assume that we pay them the wholesale cost if it came back directly. If we issued a return for credit on this we would not see a cash sale to Egghead in over a year. Unless of course our new product offering exceeds all of our expectations.
3. We could price protect the entire stock with the assurance they would reduce the selling price. This could cost from \$90,000.00 to \$100,000.00.

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4. We could offer to price protect selected products, such as Desktop Publisher, Desktop, and Concurrent DOS/386. While we offer to stock balance Artline and Presentation Team.

5. Spread the RMA over a period of time, reducing the intensity of the returns on any one quarter.

6. Work with Kenfil to redistribute this coverage in inventory. Perhaps a special dispensation allowing them to sell to areas not currently open to them.

7. Do nothing, since Egghead signed the agreement to stock these products and the onus is on them to move the product. This would most likely result in Egghead returning the product to Kenfil. With this option moving forward with our relationship in positive terms would be next to impossible.

Are there any other options we could look at?

One stipulation I would make is that if we "help out" Egghead on this one, they should carry our new applications and DR DOS in their stores for at least one full year. This would allow the products to prove themselves in the marketplace.

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