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2009

Quality of Earnings

The outward facing term for this three year plan is Quality of Earnings or QOE. When you think about the stage the company is currently at, having accomplished so much, you realize we are at a bit of a tipping point. This book talks about *more and better, new and different*, breaking our expertise into practice areas, productizing services, obtaining new accounts by mastering new up and coming products, and listening to our clients as they “Define a Homerun” with Trace|3. All of these things are client focused efforts to separate Trace|3 from the fray and truly start changing our image from a traditional “VAR” to look and feel more like a System Integrator.

In short, these next 3 years are all about the client. QOE is all about delivering a higher level of service to our clients. By focusing on and listening to our clients needs via the Client Advisory Boards (CABs) and sales calls, we will continue to adjust our offerings to meet and exceed their needs. The CABs are a great venue to have clients open up and talk about their problems. We will set up the EBC each year to be similar. The better we can understand their issues, the more valuable we can be.

The best part about the relevance we have obtained in the last three years is that we can really focus on client homeruns and as a byproduct, achieve our vendor’s homeruns. Most all of our vendors want to start moving more and more to System Integrators. We have seen Riverbed do it, as well as NetApp. HP and EMC are buying them. Like it or not, that is where we need to head to stay relevant. The safest way to do that is to let our clients lead the way...

QOE does something else. It helps us achieve 6% EBITDA (net income before taxes) as a percent of revenue. It does this by making us more “sticky” to our clients. The more solutions and areas of infrastructure we consult and sell product to, the more entangled we are in their business. QOE creates more value, better relationships, less vendor hassle, and this all points to higher margins.

More and Better + New and Different

The toughest thing about hitting goals is that very soon after the achievement, you need to set out on a new course toward what will matter next. I would argue that striving toward the goal is actually even more enjoyable than achieving it.

Regardless of where the fun comes from, striving or achieving, companies never really have the option to stop doing either. I think the thing we find most difficult is the change that sometimes must come with the new goals we set. I waited a while this year to officially lay out in writing for all of you the next “Homerun” for Trace3. I cover it briefly in the 2009 EBC/Kickoff but wanted to really have it all gel in my mind before I put it to paper.

I have learned many things in the brief period of Jan-June 2009. We went from the exaltation of hitting \$100M to a very listless Jan and Feb. These slow months immediately followed me setting goals for all the Sales Management that instituted change in the way they were paid. I tied the goals for 2009 to their comp. It is the first time I had put teeth in the MBO's in a comp plan. If they were to fail in hitting our goals, they would lose a significant amount of pay. Change.

We also decided that going into the next three years we would need to split our focus into 4 areas of technology that would allow us to gather better resources and more clearly

describe our offering to clients and vendors. Storage, Networking, Virtualization, Backup and Archiving. Change.

After re-aligning comp to management's dismay, I realized that if the poor performance in Jan and Feb of 2009 continued, we could be in jeopardy. Not necessarily the jeopardy of going bankrupt, but of losing a great deal of momentum by having to do layoffs due to the economy. I therefore decided to institute a minimum pay cut of 20% across the board for all employees with no promise of a return pay to get back to full pay. (These cuts were made for safety, not for profitability.) Change.

The goals for 2009 were really pretty simple. They lead to much larger ideas and success when refined to the 2011 goals, but for 2009 it was simply, 100 Net New accounts that do more than \$40K in revenue and \$1.8M in Professional Services billing/costing. Change.

Change, change, change. It seems a little confusing doesn't it? Here we are coming off a record six year period. We proved our national relevance, reduced corporate risk by diversifying to over 500 clients (26 of which we did more than \$1M in sales with), and successfully branded the Southwestern United States as Trace|3's for Data Management. All of this went perfectly to plan. So you must ask yourself, why change something that is working so well? Why not just keep doing more of the same?

In some ways we will. From 2009-2011 I want to refine the things that we do very well and add things that will allow us to take advantage of what we have built. My dad gave me this idea to use the terms "More and Better" and "New and Different." I thought they very simply put things in perspective. There is plenty we are all doing right. We want to figure out how to do more of the right things more efficiently. There are also plenty of revenue streams and

services we could add that would make us more valuable to our clients and partners. Those things would be new and different.

The High Level Goal or 3YG

I think that sometimes to have all these ideas make even more sense it is good to start at the end. When I try to make plans for us, I try to start with the end result I am shooting for. The goal that I started with for 2011 was to limit our financial risk by raising the net income (EBITDA to be specific, if you don't know what that is don't worry about it) of the company from 1.5% to 6%. This percentage is based off revenue. Every three year plan starts with limiting downside. We currently run close to 1.5% net income as a percentage of sales/revenue. This is below industry average but has made sense for us because of how fast we were growing. The rebates/MDF/headcount funding we get from our vendors makes up about 1% of that 1.5%. Once again, this was to plan. I ran the business this tightly because of the more important risk factors we were facing in the previous three year plan. Now that those risk factors have been mitigated, we need to focus on how to make sure we can be cash flow viable without vendors rebates/MDF/headcount funding. In fact, I don't just want to be viable at the end of 2011, I want to be comfortable. 6% not only equals safe; it equals comfortable.

The other thing you look at when setting this goal is to look at the upside to achieving it instead of the risk factors. 6% would create many opportunities for us. First, it will be much easier to add resources as needed to help everyone maintain QOL (and sanity) as we grow with a large amount of money saved. Secondly, bonuses could be given on a quarterly basis versus having to wait till year end. Third, potential opportunities in the market that present themselves

to us will be much easier to obtain and capitalize on. Next, banks would find us much more interesting with the financial ratio that 6% in net income would provide us. (We all know banks only really want to deal with you when you don't need the money.) We would also be able to handle a sizable bad (God forbid) receivable. Lastly (and there are many more that would get tedious to list), the value of your SARs, would be worth at least 3 times as much given the same market condition. SARs value is mainly based on Net Income and growth rates.

Many of those examples were things I came up with by looking at it from your perspectives. Those are some of the things I would be thinking about if I were you. Being the CEO I am looking toward future events or opportunities that might happen when I set a goal like this. I joked about Trace3 being like a "Choose Your Own Adventure" book when we achieve this goal. For those of you that are unfamiliar with these books, they allow the reader to choose what the main character should do when the character faces a dilemma. 6% allows Trace3 (our main character) to choose what we do when we face opportunity. Most of you know the reason I am involved in this business is because I want to create something special and different. I want it to create its own legacy over time. I want this company to raise all the employee's boats as the tide rises. As long as we can "Choose Your Own Adventure" we can keep doing that. There might be opportunities to merge with other companies, hire a group of key people to crush a region, take our top 50 clients and their wife's to Europe for an "EBC"; or even, and I know this sounds crazy, buy an up and coming new manufacturer that we could quickly take to market through our client base. In any of these scenarios, I want Trace3's culture, vision, and personnel to be running the show. I think we have a different kind of company that can do great

things. 6% doesn't mean we have to do any of them, it allows us to choose to if it gives us an unfair advantage.

I hope that gives you a good perspective of why I selected 6% as the 3 year goal. It means many things for us. I am also committed and putting it here in writing, any dollar of EBITDA generated over 6% (as a percentage of revenue) will be split up amongst the W-2ed employees of Trace|3. This is true for any year that occurs before 2012. So your specific monetary upside is this potential bonus combined with the additional value your SARs shares will derive from the tripling of our bottom line. A nice byproduct will also be knowing Trace|3 will absolutely be here for the long haul and this really can be the last job you will ever need...

So, now that we have established 6% is worthy of being our 3 year goal (3YG), how the hell do we achieve it?. In order to achieve it we need to set up tactical goals.

Tactical Goals

Let's make a couple of assumptions. First, we are not going to stop growing in order to hit the high level goal. We still need to stay relevant and outgrow the industry. Second, we are not going to decrease everyone's Quality of Life (QOL) by doing layoffs and over working everyone to cut costs and raise net income. Third, we will not do this by cutting compensation to up net income. (As stated before, the temporary cuts made this year were for safety not profitability) Yes, doing those things would be easy; but I think we can all see that it goes against everything we are trying to build at Trace|3.

We have to do this the hard way. We have to figure out how to be two percent higher than the highest EBITDA I have seen in the industry. We will need to set simple tactical

goals each year that will lead to achieving the 3YG. Let's talk through the main ones:

Double the Anchors

This goal falls under the "More and Better" category of what Trace3 needs to continue doing. Here is the beauty of the idea of "Double the Anchors." On the surface, just like the \$100M in '08 (100-08) goal, it looks like we are trying to just achieve a number. We know different though. Terms like 100-08 and Double the Anchors are great because they are easy for our vendors to understand and get excited about. In truth, they do a great deal for us to limit risk and increase our opportunity. I am not going to go over what 100-08 did for us because the other playbooks covered that. Double the Anchors on the surface is this - we want to double the amount of important accounts Trace3 sells to. At the end of 2008 we had 5 accounts we did more than \$3M with and 26 accounts we did more than \$1M with. By 2011 I want to double both of those numbers. In 2009 our goal is to get 100 net new accounts that can all do more than \$40K with us. Why \$40K you ask? It is because the 2009 goal *must* lead to the 2011 goal. If an account cannot do \$40K with us, what are the chances it could contribute to hitting the Double the Anchors goal in 2011? It will work something like this.

- 2009: 100 net new > 40K
- 2010: 20 of the '09 100 generated do over \$500K
- 2011: 5 of those 20 will do over \$3M

Simple I know. Even a vendor could understand it... ☺
Kidding of course. There really is not a huge need to complicate it more than that. There will be goals set each year for net new account acquisition, but 2009 will be the most important. What will be interesting to see at the end of

2011 is the amount of revenue that is generated from new accounts in the 2009-2011 timeframe.

My bet is this: the revenue will grow from approx 20% to 50% over the three year period. This is to say that the net new accounts we generate will be roughly half of our total revenue in 2011.

At its core, this is why long term planning is important. The changes and decisions made in year one have massive impact in the following years.

So, you ask yourself, how does this lead to hitting the high level 3YG of 6%? Good question, I am glad you asked.

How do you suppose that we will get into 100 Net New accounts?

Most of you know, we have set up our line card/solution set so that we have 2-3 low average selling price products and 5-6 high average selling price products. The low average selling price products are usually newer, don't compete against a sunk cost, and allow us entry into new accounts. Selling the high average selling price products is usually a bit of a brawl because we have to unseat or kick out a sunk cost. We have a good deal of National relevance with 2-3 product lines currently. We average great margin with these products. I would argue that the products we sell the most (NetApp, Riverbed) we make the best margin on not to mention MDF and other funding. This makes sense since relevance should have a correlation to the vendor wanting Trace3 to be successful and continue growing. By setting a new account goal, all of you are going to have to reach outside of your comfort zones and sell some products that we might not be relevant with yet. For example, VMware, Palo Alto Networks, Symantec, or Juniper. After those initial sales, I can assure you all of you will try and sell NetApp and Riverbed to every net new client. *But as a collective*

group of salespeople, getting these 100 net new accounts is going to make you better at selling these other product lines. That will grow our revenue number with those vendors and we will become more relevant to them. That will lead to higher margins on those product lines, increased MDF, rebates, and headcount funding. THAT will lead to more technical expertise in your local region for those product lines. And FINALLY, that will lead to everyone selling more (now) high margin product lines to your existing account base. Hypothetically, even if the product lines are not that much higher on GP than they were originally, just because you are selling 6-8 lines to a client should mean your margin is higher regardless of line. At that point you are a trusted advisor and much more valuable than you were before. More value, more margin, better client and vendor relationships. This is truly what delivering on Net New gets us as an organization. If you think it sounds too good to be true, just look at the lines this strategy has already worked with. Once we established local and national relevance, margins really became one of the last concerns the vendors had with us.

This means that stepping out of your comfort zone can be good. Palo Alto can be very good for you. Virtualization can be amazing... Tactically establishing great relationships with some of our other product lines can be hugely beneficial to you years from now. This is especially true for the SEs since you will spot a great deal of the opportunity in our existing accounts.

So “Double the Anchors” is simple for a vendor to understand, and a crucial piece of the 3YG. Those are my favorite kind of goals. They have many different levels to them.

Professional Services

PS falls under the “New and Different” category. Let us now discuss the dreaded Professional Services goals I have levied upon the sales people this year. I chose the word “levy” because I know that it what it feels like to many of you. If done correctly this is not a “tax.”

The PS goal I gave John Pfaff for 2009 was \$1.8 million dollars. That is roughly 1.5-1.8% of the company’s total expected revenue in 2009. Let us discuss the not so obvious “why” to this goal, then we can talk about the obvious one.

Why did I make the move at the beginning of the year to separate Practice Managers? There are many reasons, but the main one, is that we have to grow up a bit. We need to change from being viewed just as a VAR and move more towards being viewed as a Systems Integrator. This will make us more interesting and valuable not only to our clients but to our vendors. There are certain products that are just difficult to sell without the ability to consult. To be specific let’s talk about VMware. This product has an approximate drag of hardware and services of \$11 dollars for every dollar of licenses spent. That is interesting. Many of those dollars are spent on storage. I think that many of you are finding the better VMware expertise you have in your region, the more successful the storage practice is.

Regardless, having Practice Managers ties us into having PS goals and the QOE goal. I would like to be farther along with this than we are today, but with the setbacks we had in Jan/Feb and subsequent temporary pay cuts, it was difficult to backfill the practice managers out of their daily routine. This means that though Dave Titov and Bret MacInnes have the title of Practice Manger they are still crushed just supporting the territories they are covering. What the Practice Managers will do, (and Hekimian is) is actually start

evangelizing the expertise we have in the Practice Area and build our reputation for delivering productized services. The goal of these services will be to lead to larger multi-product solution sales. In the beginning, many of these productized services will be directly taken from something a vendor has already created. Our goal in years one and two is not to get stuck onsite forever doing large scope of work based projects, but instead to do quick and effective \$4-12K canned service jobs that are slightly customized for each customer. I will be working with the Practice Managers to finish defining these services and rolling them out to the field.

I have also let the PMs know that I do not expect the regional SE's to be delivering these services. It will most likely start that way so each region knows how to do and sell them; but our goal is to staff PS people in each region that will complete these services. **We will build this slowly.** I have already told Hekimian to have resume's ready as we start to sell the Virtualization services. So far the very simple assessments he has done have lead to great multi vendor product sales. So have the few that Titov has done. Whether people like it or not, taking a small step to productized services is something the market is demanding of us in order to continue scaling. We even have some clients demanding we begin doing Managed Services for them. Those types of demands will be dealt with on a case by case basis because of the additional risk but it enforces the point. We don't have to do everything our clients ask, but we must continue to evolve our products and services.

So, let me specifically speak to 2009 and the \$1.8M PS goal. I know that many of you have been just costing that amount out of your GP and considering it a tax. That is definitely one way to look at it. The average rep has a \$100K goal for PS. The average rep also does about \$5M in sales. That is

2% of your revenue coming from PS. You basically need to attach \$8,333 per month in installs. If I were you, I would bill for installs. In fact, I struggle to understand when Reps do not bill some amount for installs with good existing clients. I understand how sometimes it is beneficial to give away services with new clients, but \$8K of installs a month should not be that difficult. Charging small amounts for installs will never change. Reps need to do that going forward. Installs are really just a small part of the 3 year PS goal. I spend time on it here because if you are struggling with that, the rest will be difficult for you. I do not want you to take the entire PS goal you get each year out of your GP. My hope is that the goal was simple enough and low enough this year that by Q4 you have figured out how to charge your clients for it. By learning in 2009 how to prove to your clients the value of some of our simplest services (installs, selling blocks of hours on open PO's, productized services, etc.) you will be set up for the following goals.

PS Goals:

2010 – 3% of total company revenue

2011 – 4% of total company revenue

Having the productized services in place for next year will obviously help a great deal in attaining these goals. Selling 1-2 per month plus your normal installs will probably do it. If these goals seem high, please know that Netapp's average for PS attach rate (to rev) is 8%. We are only going to shoot for half of that.

Funny as it may sound, these *dreaded* services we are going to be adding are going to reap major benefits with clients, vendors, and your account control. We will be architecting and writing specs for requirements. The practice areas will help many of our best clients realize we sell more than

storage and non-core networking. These multi product bundles we can put together as a result of a health check or assessment will be very difficult to bid against or check PVRs on. Proving our value to vendors will be even easier.

Now to the obvious result of getting PS to 4% of revenue in 2011. *This simple goal almost single handily moves us to over 6% in EBITDA as a percent of revenue.* With it we should make approx \$12M in net income before taxes in 2011. Without it, we would make approx \$4M. This goal buys us 3 times the breathing room to operate. I know \$4M sounds like a lot of money. But trust me, when you are trying to run a \$200M business averaging \$14-18M in receivable and payables, \$12M sounds a lot better. Especially when you consider we will lose approximately half of whatever we make in taxes.

PS is a simple goal. It will take some discipline. The PMs will be doing everything they can to make selling a \$5-12K productized service easy for you. But you all need to care about this goal. Netapp is pushing us to look like a Systems Integrator (SI). They want to go the way of Riverbed and start signing all the SI's because they think SI's have better account control than a "VAR" does. Rick Congdon and I are stalling them from aggressively doing that in the west. The reality of it is in many ways pushing hard on the SI's is the right direction for them to move. Because of the deep practice areas and Managed Services SI's currently offer, they are attractive to our large clients and vendors. I never would have thought that in 2002 I would be stating this, but in the beginning of 2012 – I want Trace3 to look as good or better than most of the SI's in the Southwest. Honeywell is already asking us to compete against them for Managed Services on solutions we provide. Ruben is competing daily with them at Kaiser. We either evolve to compete against them, or we get boxed in by a "VAR" glass ceiling.

What I think about Hayes...

The last topic I want to cover is my favorite...myself.
(kidding)

I am so tired of people saying Trace|3 is “Hayes’ company.” I want that to change by 2012. For OUR business to scale and adjust the way it needs to, we need to change into a company with many vendor and client facing leaders. This business needs to be more about all of you , and much less about me. I am not planning on going anywhere. I am just planning on taking more of a back seat and letting the Directors, Practice Managers, and local regions use their ingenuity and leadership skills to take us to the next level. I am tired of hearing that “Hayes is Trace|3.” It truly frustrates me. All of you have made this company what it is today and what it will be in the future. My main goal is to help continue steering. John Pfaff has taken a more prominent role and will continue to. Sandy Salty will continue to build out Business Development, Marketing, and PR for us. Nate Julson will probably have a team of 15-20 people running a \$200 million dollar business for us in 3 years. Our DM’s, Reps, Engineers, and Inside Sales teams are the best eyes and ears we have to achieve QOE. You are the life blood of the business. Not Hayes Drumwright. You all are building a very big, very successful business. Be proud of it. Fight for it.

I asked John to write down something that he presented to me a few months back. I asked him to do this because it inspired me. It inspired me again when I read it. I hope it does the same for you.

"In preparing for battle I have always found that plans are useless, but planning is indispensable."

Dwight D. Eisenhower

Where is the Horizon Line?

By John Pfaff

We all have this vision or concept (at least I think we all do) of an event or a period of time in our career's that we will look back on and say, "That was it... the timeframe in my career when I really was crushing it, having a great time, building a business, those were some of my best years where I was part of something which was unique, the thing which was very defining for me." This level of satisfaction and achievement usually comes in many different forms for different people: for some it is quality of life, for other's it was an invention, for others it could have been building a business and for others maybe this was defined by the contribution they were able to make to benefit the greater good. No matter which one it is, what is exciting is that all of us have the opportunity to be part of, and to have these defining experiences throughout our lives. An even smaller subset of individuals have the opportunity not only to have defining moments in their personal lives, but have the fortune of being part of a company that was truly unique, and be part of a team of people who were able to break through the boundaries of traditional businesses, and truly achieve something special... beyond the norm.

It has always been a goal of mine to be part of something that was looked upon differently than everything else, something that when people spoke of it, was held in very high regard. I always knew that in order to be part of something like this I would have to find an environment that at a level was unconventional and allowed for very creative thinking. I believe there is something to be said for things that are unconventional because the greatest ideas typically come from places you would least expect them. In my career, I have always asked myself the question as to whether or not I am part of something where I feel I am

having to think in order to survive and I am pushing the envelope at all times. The answer has been yes so far and that gives me a very high level of confidence I will always be part of something unique.

If you were able to go back in time and talk to people in the early stages of very successful, unique companies; I bet with all of them there would be a period of time where they could not see through all the challenges they had ahead of them and realize they were part of something bound to be a defining experience in their careers and lives. What is the tipping point at which this occurs to someone that they are a part of something that has turned out or may turn out to be to be much, much larger than they have ever imagined?

Two Stories

The last time I talked in person to Tom Mendoza, President of NetApp, was at his kickoff in Spring 2008. There were a few thousand people at NetApp's kickoff that year and in talking to Tom I told him we would have about 50 or so at our Trace3 2008 kickoff and we were trying to do 100MM in 2008. This was a big year for us I told him... but I could never image what it must be like to run a kickoff / billion dollar business on a scale NetApp does. He laughed, looked down then looked back at me and said “John, I remember when the NetApp kickoff was about 40 people and we were trying to be a 100MM company.” That was over 15 years ago. Today, NetApp is a global, multi-billion dollar company. I wonder if at the time Tom was referring to, when there were 40 people at NetApp’s kickoff, if he had any idea how successful and unique NetApp as a company would grow to be?

Kentucky Fried Chicken was founded by Harland Sanders. Colonel Sanders (as he is commonly known) in his

earlier years came up with the idea to serve people “to go” food (his fried chicken) at the gas station he owned in Kentucky. It is funny to note “The Colonel” was actually an attorney prior to owning this gas station but was kicked out of the legal profession for starting a fist fight in court with a client. For 20 years he perfected his fried chicken recipe and served thousands of travelers from his station and at large venue events in Kentucky. His fried chicken became so popular in Kentucky that he was granted the name Kentucky Colonel by the governor. Time went on and in 1956 a freeway was built right above the gas station he owned. This crushed his business and Sanders was forced to declare personal bankruptcy. He persisted though and lived solely off social security checks. He started going out to hundreds (over 1000 according to the story) of restaurants trying to convince the restaurants to use his special recipe and pay Colonel Sanders a licensing fee for it. By 1960, he had 400 "franchisers". That is a good sales guy with a good product! Colonel Sanders sold the company in 1964 and today KFC is a very well known global brand. There is now a museum built in his name at the KFC HQ in Louisville. When you are broke, living off social security, selling a chicken recipe to restaurants are you envisioning your name on a museum? Ha!...I doubt it.

Trying to imagine at what point it occurred to Tom Mendoza or to Harland Sanders that they were on the front end of what would become huge successes is interesting to think about. It is hard to theorize when they knew they were on to something huge, but that is really not my main point. The point here is that when people are in these types of situations (especially at the early stages), which may turn out to be tremendously successful and unique, chances are they may not even know it or really even be able to see it at the time. Looking outside at the potential opportunity from the inside is never easy for anyone, but when you can manage to

get there, open your eyes, and start making decisions based on the big picture, the insight and first mover advantage you get is tremendous.

In Closing

I have given a lot of thought this year to where our company has come from and what it means. You could say I am having "enthusiasms" about it, to quote Al Capone.

- When was the last time you talked to someone who was working for a company that grew from 0-100 Million in 6 years?
- When was the last time you talked to someone who was working for a company that grew from 3 employees to 60 in 6 years?
- When was the last time you talked to someone who was working for a company that grew from 1 region to 5 regions across the entire Southwestern United States in 6 years.
- When was the last time you talked to someone who was working for a company that grew from 1 to over 400 clients in 6 years?

For me, I rarely hear stories like that. So as I have started to think about this more and more it is clear to me that we may all be in one of these defining events right now. If you look at everything we have accomplished as a team you have to ask yourself, if we were able to do that, what could we do next? Or as I like to think of it...what can't we do?

Trace|3 has evolved into 5 companies: LA, OC, SD, Arizona and Denver. One of the things that I feel lucky to have

learned is how diverse each of the businesses in these regions are. The clients are different, the approach is different, and the feel is different. I think this is a good thing as it adds depth to our business. Each one of these regions has the ability to be a 30-50MM+ business at some point in time. Each one of these regions has the ability to be the strongest Systems Integrator in its given operating area. Each one of these regions has already and will continue to have the ability to build a long-term, dominant, sustainable business. In doing that, all of the teams in each one of the regions will have built something THEMSELVES from the ground up, out of nothing other than the ability to be creative thinkers and smart business people.

Wow, take a second to think about that because this scenario is happening right now and you are part of it. Just think what is this thing going to look like in 5 or 10 years? If Trace|3 can fully dominate the southwestern United States we write our own ticket, it's over, we win.

I had an interview with a guy Eric Carter was looking at a few weeks ago that really took me back. The guy was ok and made me laugh when he told me he would be the top sales person in the company within the first 3-6 months and if he did not succeed he would fire himself. What was interesting about the interview was at the end I asked the guy how he found us, after all, Trace|3 is kind of a niche player. He looked at me and smirked and then said, "Well everyone knows about you guys, Trace|3 is the 800lb gorilla." Carter and I looked at each other in somewhat of disbelief that this guy said this since it was totally unsolicited, but this is what is starting to happen. Our reputation is starting to precede us and Trace|3 is now viewed as one of the, if not the dominant channel partner /

VAR in the Southwestern United States. This did not exist a few years ago. As I mentioned before, it is difficult at times to look outside of the "day to day" in order to realize the magnitude of what is happening on a larger scale when you are in one of these unique experiences, but I would argue that at Trace|3, we are all in one of these types of scenarios at this very moment.

When I get caught up in the chaos of deals or whatever the latest and greatest drama is... I always take myself back to what we have all built. The Trace|3 Phoenix office did not exist in 2005, now it is going to be a 15-20MM business run by a great team. Trace|3 operations was Nate, now we have an entire operations team. Trace|3 marketing and all sales management was Hayes, now we have an entire sales management team and business development team. Inside Sales was just a few people and we had nowhere near the level of efficiency and expertise we have today. The company started with less than \$500 in the bank?!? Denver was just Sue and Mark, the list goes on... Take that and compare it to the business we have built today. I know..... it's frightening, and very impressive.

As each of us does our jobs as part of the company, as members of a great team, remember what is important: We have built a company that is unique and sustainable, and it was built from the ground up, do not lose sight of that fact. The question now becomes where we take Trace|3 and just how big it will get. Think big, think smart in terms of your business and your contribution to the company's success and I know all of us will look back on our time at Trace|3 as something that was special. We are the ones who now get to define where the horizon line is, and I can tell you that if you look at where we are positioned in the industry we

are on path to continued major success and nobody is going to catch us.

2010 Constant Improvement

A Letter

So I do not want to get too sappy on this, but I probably will. I wanted you all to know that the way you represented Trace3 this week really meant a lot to me. There were many times at the event - whether it was being on stage speaking to just the company, watching everyone interact at the Stack dinner, or talking individually with many of you - that I had to stop and just really be proud of how far we have come as an organization. Many of the vendors asked me this week if I thought Trace3 would become what it is today back in 2002 when we started it. The honest answer is no I did not. I had expectations in the early days to be a company that people loved to work for but I did not really understand our potential until 2-3 years into it. Many of my conversations with you all parallel that statement.

When Shane Savage started at Trace3 he had an expectation of what he was capable of. So did Erik Durand, Dan Freedman, Jon Friese, Dag, Rod, Sandy, John Pfaff, Steve Mercier, Nate Julson, Bryan Moss, Sue W, Dara, Becky Helton, David Hekimian, Jason Aston, Cyrus, etc.. Shane told me last night about how proud he was to be here and how successful he felt. Successful financially yes, but more just happy to come in every day and work with such talented people. Shane and I have had many talks over the last 2 years about his career at Trace3. Shane feels successful and happy here. I think he is happy. I do not think he is successful...yet. I have told Shane many times I want him to stop thinking he is successful for a guy that never went to college. From the outside looking in he is. But Shane's potential does not give a shit whether he went to college. And neither do I. College does not define your

potential, you do. Shane is working on some things that are outside of his job description right now. These things are going to add great value to all of us at Trace3. He is getting to a point like I did 2 or 3 years into Trace3 where I realized I was selling myself and everyone that worked here short if I did not constantly re-evaluate OUR potential. He is re-evaluating and voluntarily taking on new challenges to improve our company.

You all need to do that. Do you think Sandy thought she would manage a whole department or that she would conceptualize, fund, deliver an event like this year's EBC (over 200 clients, vendors, T3 people) when I hired her 3 years ago to do inside sales? Yes, THREE years ago, for inside sales...and she had ZERO industry experience. Do you know how she did it? She was always willing to fail. She never did fail on anything major, but she was relatively fearless every time I gave her a task that forced her into the unknown. She is resourceful and has unlimited potential. She is not alone here at Trace3. Many of you have these traits. You just might not be pushing yourself.

Re-evaluate what is possible as you become more successful and efficient. We will be a company of 160 people soon. Then 300. Then 500. What you are capable of now matters for today. But PLEASE, don't sell yourself short. Even the latest hire is only employee number 82 at this company. How will you define success when we have 300 people? Is it Numbers, New Titles, New Skill Sets, becoming a manager, clients thinking you are so impressive they want to quit and work with you??? What could you become? I know this, we cannot help you achieve that unless you know it for yourself and are willing to push yourself out of your comfort zone to try and get it.

Whether you joined Trace3 three weeks ago or three years ago, EVERYONE here wants you to succeed. EVERYONE wants you to be more tomorrow than you are today. Learn more, sell more, and take well calculated risks. Don't just talk to your managers about what you are capable of. Talk to yourself. Most of you I talked with this week seemed to have a goal you were shooting for at Trace3. All of you were shooting to low. (except maybe Bryan Moss who wants to have a \$20M Utah office ☺ in a couple years)

Over time you will have the same epiphany I did.

In 2002 I said I would be super happy if Trace3 was a \$25 Million company. I was right. I was super happy when we hit \$25M. That is also the exact point I wrote the plan to be \$100M. I didn't write it because I was mad or upset with where we were at. I just knew we would be wasting our potential staying still. We would also face the danger of becoming irrelevant if we do not grow.

We need to constantly improve.

I personally made more money at \$25M than I do now. That is a fact. I make over 40% less now at \$110M than I did at \$25M. For me, money equals security, not happiness. It is a necessity, but has nothing to do with my potential as a leader or business owner. I think most of you will come to a point that this becomes true for you as well. Remove the money and work becomes different. You start focusing on: accomplishing something, growing something, helping people/clients, feeling good about what you do.

I think many of you that have been here a while feel this way. And to a person, I think you all make more money than you ever have at any other company. It is nice how it can work that way.

Do not sell yourself short here. Do that somewhere else. This job is your chance. I had at least 8 new people tell me the same thing this week. They said this company is different and special and they were so happy they joined us. I smiled all eight times. Cause to me, that is success.

- Hayes

This was an email I wrote to the company on January 22nd at 10:14PM. This was the day we returned from the 2nd ever Client EBC. The event was very well done and we received terrific feedback from both the clients and the vendors. I wanted to include it in this book because that was a special moment for me and I felt that I really started to see our potential as a group at that event.

More and Better

For those of you that read the 2009 Playbook you know this term refers excelling at the traditional business we grew up on. Trace3 began as a reseller and has grown to be one of the best in the Southwest if not the Nation. The reason we are able to grow new businesses within this organization is because of the resale business. With all the topics focused on our future, I do not want to minimize that fact in this book. I understand how we got to this point and I am very proud of it.

2009 was one of the most difficult years I have ever dealt with as a leader. We made a sacrifice as a group betting on a future outcome. The bet paid off. The fourth quarter of 2009 was massive. It led me to believe that the first quarter of 2010 would suffer because of that amazing performance. It did not. In March of 2010 Trace3 broke every record in the books and booked over \$19,000,000 in sales in one month. We booked over \$3,600,000 in GP.

John and I talked after that month and just had to laugh. It is one thing to know the potential of a team. It is another to see it happen right in front of your eyes. You all beat our best month, achieved only 2 months earlier, by over 30%. You guys continue to do “More and Better” and I am proud of you.

More and Better will continue as we accomplish our goals. You guys will continue to break the records. There may be a time when resale is not at the core of what we do, but for now it is and I have not taken it for granted. I love the simplicity of the business and what it has allowed us to move toward.

Themes

I want to expand on some major themes this year that I spoke about at the EBC. The topics are as follows:

1. Constant Improvement
2. Securing the Family
3. Mitigating Risk
4. Letting People Fail

More than ever, I see my role at Trace3 changing. There are certain things that I am focused on more than ever, and some that I am stepping away from and entrusting to John, Dave Titov, Sandy, and Nate.

I think some feel a shiver of dread at the thought of turning over responsibility to others in an organization. I just feel pride and a sense of accomplishment.

It has always been a goal of mine to create scale and maintain my quality of life. With three young kids and my wife at home, I want to be there as much as possible. At the

same time, I want to completely dominate the markets that Trace3 occupies. It seems as if these two things cannot co-exist. I promise you they can.

Scaling a business is a formula, but there is more than one person that makes that happen. This is true at Trace3 more than anywhere I have worked before. I plan on working on the things that will give us consistent competitive advantage. I don't have any concern that you all will keep scaling Trace3 as I do that.

More than any time in company history, I really love this job. I love the things that it affords me. I know as long as I work smart, take calculated risks, and entrust this team with our future, I will always have time. Time for family, for fun, and for friends I care about. This will be the last job I ever have... I have no doubt about that now. It is a great feeling. I hope you feel that too. If not today as you read this, then soon.

Constant Improvement

Tom Mendoza from NetApp once gave a speech where he talked about how he expected the most out of the employees that had been at NetApp the longest. He believed that the longer you have been there, the more you owed the organization. His rationale was that you owe something to the people that come after you. You owe them the same level of effort and self inspection that you had when you started. Sometimes, people that have jobs for a number of years get comfortable in their position, or knowledge, or political rank and stop focusing on what matters. What really matters is constant improvement. You need to continually move forward: learn more, produce more, teach others, build teams, enhance our reputation.

I agree with Tom. One of the toughest things for me to handle is when I see someone that has worked at Trace3 for 3-4 years start to think that the company owes them something. Like all the hard work that was put in during your first three years has bought you a pass to leave it up to others to move us forward. It is not enough to be the best Netapp SE in the company. If you have been here 4 years, I would hope you are equally as good in Virtualization now, or Backup, etc. The Trace3 “Theory of Relevance” I discussed in the first playbook does not just apply to companies. It applies to you as an individual... You must not plateau.

If you do plateau technically, you will become irrelevant to the organization.

There are many of you that are approaching that right now. New skill sets are key to us moving forward. Each year you should update your personal plan for what you want to accomplish here. I write one for the business and you should write one for yourself. The people with the most tenure understand our business the best. They understand the clients, vendors, processes and weakness. You must be focused on making your region and the entire company stronger. This does not mean you need to work 16 hours a day. It just means you need to stay proactive in how you grow personally. This will translate into company growth.

Trace3 is loyal to those that have loyalty. *The way you show that loyalty is by constantly improving yourself and those around you.* It will garner you respect and a leadership position in this organization. Make everyone around you better. Don’t take this opportunity for granted.

You all know I write three year plans for the company. We are in the middle of this one. If you were to try and figure out your individual value and why improving is so important consider this: A corporation is really just a group of

individuals. It is even treated by the government as an individual with specific rights. What would have happened to Apple if they would have stopped innovating past computers? What happened to Netscape when they battled Microsoft during the browser wars? What will happen to Riverbed? Why did F5 buy Acopia? How did 3PAR create a space for itself in storage? Is it because the market needed another player or the existing players stopped innovating? How will the “Cloud” affect Trace3? Stop reading and see if you can answer all these questions.

What is your latest innovation? What calculated risk did you take recently to improve your market relevance. Riverbed was a great company for 5 years and never came out with a new product. I would predict in a couple of years they will be swallowed up for it.

How many people do you think told Steve Jobs he was totally nuts when he produced the iPod? Think of how set in their ways the media companies were back then. It must have seemed like an almost impossible product to launch. Some analysts are making fun of the iPad. It is attacking Papers, Magazines, books, etc. Equally daunting and perhaps even a more rigid industry. I bet the masses will think they can do it though. With the iPod where it is today, they are considered mavericks and complete game changers. They have the ability now to convince others that they can transform markets. That would be a pretty cool place for a company to be.

Do you think it is possible that you could be considered that kind of person? Do you think that we could group enough of those types of people at Trace3 that we could be considered that type of company? We currently have a great reputation for growth and people. What would you like our reputation to be 10 years from now?

A vendor just sent me an email stating the following, “Trace3 has become a juggernaut under your leadership.” He sent this to me because of our ability to grow and take share regardless of market conditions. It made me smile. Eight years ago I would have laughed if you told me a company with a \$2 Billion market cap would say that about Trace3 (and not be kidding). Improvements each year have earned us this praise. It has to continue for us to keep it.

Trace3 is moving toward consulting in order to improve our market relevance. I say market, but it really applies to everything. Client relevance first. Then Vendors. Then Financial Strength. Then unlimited options...

Let’s say that Trace3 takes our tech to sales ratio from 1.7:1 to 5:1 over the next two years. In doing so, we have massive expertise in most areas of infrastructure and specific applications of our choosing. By building this group we become “Technical Advisors” for over 1000 companies in the southwest (250 of which 80% of our revenue comes from). We would have really transformed our image from being a VAR to being a Systems Integrator or Consulting Partner. What could we do after that? (and no, I do not want to make an iPad)

How much faith would our clients, vendors, and even you have in whatever the next task was? Do you think they would assume we would accomplish it as we had every goal in our past?

Proving to the markets and yourself that you can change and evolve to stay relevant is very difficult. It is also what makes you great. Period. GREAT companies evolve and continue to innovate. They set big goals, promote the victories, and learn as much as they can from the defeats. Trust me, there will be defeats. The setbacks will hit you just like they did Trace3 in Q1 of 2009. Learn from them and move forward.

Trace3 can go from being a good company to being a great company. *We can become great as an organization if you decide you will not stagnate as the key asset in our equation.* If you all improve and evolve then so will the company, our brand, and our foreseeable future.

A couple of examples:

Our improvement is everyone's job, not just mine. Dag and the Practice Managers proved at the EBC that our pitch can be improved. The idea of building to a Reference Architecture and investing in Trace3's vision of the future was a beautiful thing. I have a feeling it is going to completely reposition us with the clients that were paying attention. We already have serious momentum with many of them just days after the event. No one prompted them to come up with that... After listening to our clients, they took it upon themselves to evolve the current way we pitch the Trace3 Value Prop.

The EBC in itself was an innovation that is now contributing to our reputation and brand. Sandy Salty has completely changed the way our Vendors view our level of influence with our clients by involving both in the EBC. Kickoff used to be all about Trace3 employees interacting with the vendors. Now it is all about letting the vendors see and understand the connection we have to our clients. We also give them greater understanding of how every one of them is just a PIECE of what we do. The event decreases their influence with the clients and increases ours. It is really a stroke of genius. It is a massive improvement over what we had. How many clients do you think will come to the Trace3 EBC in 2020? All big ideas start somewhere...

Titov has one of the biggest challenges I have ever put on someone. He has to build a team of consultants from scratch and become so relevant to our organization that his group

will singlehandedly raise our net income percentage from 3% to 6%. This means he will need to be at an average billing of approximately \$800,000 per month for the entire year of 2011. Sound impossible since the group started in Jan of 2010 right?

Impossible Goals

Impossible goals need to be broken down and delivered to teams in measurable chunks. It is the only way to stay sane. Telling your team about how you are going to achieve a very difficult goal 3 years from now without giving them a detailed map is asking for trouble.

Titov is breaking down his two years into bite size pieces and by doing that, he will hit the goals. As an example: In Q2 the PS team will get POs from 20 accounts. 5 of those 20 will be able to give us additional POs on a monthly basis. We need to do the same thing in Q3. By Q4 of 2010 we should have 10-15 accounts giving us a base level of PS of approximately \$30K per month per account. (If you want to slow down here and make a spreadsheet, go ahead.) In addition to that, the numbers should prove out that one to two accounts in Q3 and 3-4 accounts in Q4 give us big orders (north of \$60K per month). This should give us a December 2010 in the \$500-600K range. This would mean we would have a great shot at \$600K being our base month (low end) for 2011. By the end of the year, we should have a large enough team and a strong enough footprint to get the reps in the field involved in a significant way. By the end of Q1 we will have added another 20 accounts and should be in the \$700K range going into Q2. This continues and by the end of the year, we would have the average we need.

But all of this matters very little if we can't get 20 Consulting accounts in Q2 2010. In order for Titov and team to improve this company immeasurably, they have to put a

stake in the ground now. Each quarter the goals will need to be accomplished to \$800K per month becomes a reality. They will need all of you, reps and SE's and Project Managers, to help them. Our future hinges more on accomplishing this goal than any other we have set.

The lesson on goals like this is to break them down. Use excel, write playbooks, basically do anything you need to so you can communicate the "how" effectively to your teams.

Securing the Family

Why are Services so important? There is a lot happening in the market right now. It is happening faster than I would like it to. Secretly I wish this whole "Cloud" phenomenon would just go away. It is the friendliest looking "outsourcing" model I have seen. Many new companies are trying to figure out how to set up their entire IT environments in the Cloud. More well established companies with large IT staffs are trying to figure out what they will hold on to and what to outsource.

I asked a client last night at a dinner what they thought Trace3's value would be in 3 years. He paused. I told him to be honest, I could take it. He said he saw the value of our current model diminishing greatly every 12 months. In three years he thought our current model would probably be irrelevant.

He is a current consulting client that is looking to outsource as much as possible to the cloud so he can focus on tackling the business objectives (from an IT perspective). He said some of his engineering guys are already using Amazon for test and dev.

I then asked him what he would do if he was Trace3. (Note: this is an amazing question to ask your best clients over

lunch or dinner.) He gave me a great answer I am not going to write here. In this answer he told me he thought our technical team was one of the most talented he had ever worked with (20 year IT veteran) and we were terrifically positioned in our market to change into the company we need to be to compete three years from now. You could say this is just one guys opinion. You would be right. I promise you there will be more with the same opinion coming to a theatre near you very soon.

“Securing the Family” is about keeping Trace3 successful, in front of the curve, and safe. For me, you all are the family. It is my main focus. I wish just as much as all of you that we could just keep doing the same thing year in and year out and get great results. I have hopes that our current model will work very well for the next 5-7 years. Unfortunately, I refuse to make plans on the hopes that things will not change. We are in technology, everything changes.

The plan is to be ready for the 3-5 most likely instances of what *might* occur. I feel good about that. We have enough market knowledge and client touch to stay abreast of trends and market direction. To be secure, we must do some things now that make some of you uncomfortable because they are new to us. It started with selling Installs. Many of you struggled with this. Struggling is no longer an option and many of you have overcome this sales hurdle easily. Installs made the Consulting conversation easier.

Now we must engage with the traditional field team to start aggressively selling Consulting Services. We need to embed ourselves in the decision making process much earlier than we have in the past because the outsourcing decisions are made by people we traditionally did not touch or deal with. Over time, the Consulting team will help you reach those

people. The Consulting team allows us to create tremendously more value at higher level in our accounts.

A successful consulting team will allow us to be positioned for what we might have to do next. Those options could be Managed Services, Limited Outsourcing, Cloud Partnerships, or God forbid – a Trace3 cloud... Do any of those options have me jumping for joy???

No.

Do we need to be overly realistic about what is coming with the current market transformation and make sure Trace3 has a secure place in its future?

Yes.

I want you all to cross train yourselves.

When Titov tells you he is ready, I want you to get out of your comfort zone with our clients and introduce the Consulting team so we can expand our influence.

I want you to improve our place in the market so we can secure the future of Trace3. When the correct next step is dictated by market conditions, John and I will be ready to take us there.

For now the steps are very clear to me. We need to average \$800K per month in consulting revenue in 2011 as an organization. We need every rep attaching installs to Work Orders in addition to the SOW based consulting mentioned above. Titov will have a system in place by Q4 2010 that will break down the resources in each region and how he will help you all achieve those numbers on a quarterly basis. It will be hard, but manageable. For some of you, it might even

be fun... Many of you have been doing the same thing for a long time and I would expect this to be a welcome challenge.

Know this, if you all can embrace this change and adapt to where the market will steer us, we will be secure till the next challenge confronts us.

Opportunity

I want to take one moment and let you know that while adjusting to quickly moving markets can be painful, I am a little excited about the opportunity it will provide Trace3 if we navigate it correctly. I think there is a very good chance that many of the “VARs” and companies we all know and love will go out of business in the next 5 years. If we can evolve, there is going to be a TREMENDOUS market share opportunity for Trace3. *What we have that most of these “Cloud” providers do not have are clients. We have over 600 clients. What we need to do in the next 24 months is get close enough to those clients that we can begin to influence their behavior for what moves out to the cloud and what stays in house.* Most VARs are so confused right now and so against “change” that they will get run over by what is coming. Others will spend millions of their own dollars trying to create Cloud services from scratch to find they lose constantly to AT&T and Rackspace.

The closer we get to our clients the more everyone needs us: Vendors, Cloud Providers, and Clients. The only way to increase our influence is to constantly be on site guiding them in these tough decisions. If you for some reason are not following this logic than I will just ask you this. Trust in the leadership of this company. Put your heart into making the services portion of Trace a huge success and in 2012 we will have options most others will not.

Mitigating risk

I think you can all see how our services component of the business helps mitigate vendor consolidation and market change risk so I am not going to spend time on that.

In this section I want to re-emphasize the importance of growth. While growth for many can be a double edged sword. For Trace3, it is part of our DNA. The Double the Anchors goal is a huge part of what will make us successful in this Three Year Plan and I want to make sure you all continue to focus on this. Last year we added approximately 85 net new accounts that did over \$40K in business with us. We need to do better than that. 2009 was a VERY difficult economy and I think I understand why we fell short on our goal of 100 net new. We must make up that difference in 2010. I want to book 90 net new accounts over \$40K this year. It does not matter if it is product or services POs for over \$40K. Either one counts.

Last year approximately 20% of the revenue for the year came from Net New accounts generating in that year. That is over \$20 Million dollars. It is important. Stay on it.

In 2011 we want 10 accounts that do more than \$3 Million (each) and 40 additional accounts that do more than \$1 Million each. That will be almost exactly double what we had in 2008. Expanding the account base is one of the best risk mitigating factors we can truly control.

Letting People Fail

Successful people fail. Unsuccessful people fail.
Successful people see failure as a step on the road.
Unsuccessful people see failure as the end of the road.

I am enjoying the pain the company is going through now building out the services team more than I will enjoy it when we have it all figured out. We are making mistakes and constantly correcting as we build the new group. *While certain days are more painful than others, building something with people you like is exciting.*

That is really the key to it all – Do you like the people you are in the fox hole with? As you build your regions, make sure you do. Is there a difference in how you perceive someone's failures based on liking them or not? I would argue there is. We all cheer for people we like. Consider Tiger Woods both pre and post scandal. For many it went from, "what a bummer he lost," to, "he deserved to lose and serves him right." You need to be able to cheer for the people you give challenges to.

As a manager and/or employee, you need to be conscious of the slight difference for the following reason. I don't mind letting people I believe in fail. I never set them up to fail, but I give them a lot of leeway to try things. I know they are smart, motivated, and able to be agile with their plans to get around roadblocks. If some part of their plan fails, we adjust and move forward. I am constantly advising and trying to help. You do that with people you like. Give them challenges that stretch their ability's and then help like crazy. Don't just walk away. That is what managers or peers do when they do not believe in someone or the task at hand. That is not what we do at Trace3.

There are unfortunate cases when people keep failing, don't adjust, and just stay on the same track. This does not happen often, but when it does, we probably have to move away from that individual. These are the employees that always have a reason as to why it was the client's, or the sales guy's, or the vendor's fault. Since no responsibility is taken, no

adjustment is made. This usually means the problem continues and it is up to that person's management to act to solve the problem. Please know that if it is left up to management, management will likely decide the problem is that individual.

Lucky for Trace3, this is rarely the case. We stretch the people that work here to try and achieve more. We encourage you to learn more. We let you build your own P&L and hire people directly on to your team if you make a good business case. This will also be true in Services as we build out the PS Manager, PS Architect, and PS Consultant job descriptions. We will have the ability to have multiple PSM's managing different teams with in the same region. This is very similar to Mini-Districts within Districts.

The point of all this is that Trace3 management is always looking for ways to improve and make this a better company. Many of those ideas come from you and our clients, not management.

Allowing you all try new things and take on difficult challenges betters us all as a company. We are very entrepreneurial. We encourage risk taking and allow failure. Just make sure you get back up and keep pushing forward.

What if QOE Fails?

I think most of you believe that Trace3 can accomplish most anything it sets its mind to. I would agree. For the purpose of this topic, let's assume we failed at QOE. Let's assume that we hired too fast on the consulting side of the house, the clients were not interested in Trace3 providing services, and our bottom line margins did not improve.

Let's say consulting and installs failed to generate any perceived client value and we continued on as the "Company that provides Netapp (or Riverbed, or F5)" to most of our clients. I have had Dag, Tim Abbott, and Dave Hekimian all ask me where I think Trace3 will be in 2012 if you do not offer advanced (cloudlike) services to our clients. They want to know how I thought we would compete.

My answer is something I feel pretty certain about and is the reason I am so aggressive about achieving QOE.

I believe that if we were to fail at achieving the QOE goals we would need to position Trace3 to be sold by 2012.

I think that the market for traditional "VARs" will generally disappear by 2015. We would have very few options at that point to compete against the cloud which many clients are telling me they view as "Cheaper, better, faster" but hard to customize. Now I could be wrong. I might be a little over the top in my prediction. But I am comfortable writing it down for all of you to read. I am comfortable because I have always wanted to treat you all like adults and the professionals I know you are. We currently have many options for the future of Trace3. It is exciting to be here. In order to keep it that way, QOE MUST NOT fail.

We have to get closer to our clients and create more value. It is not a choice for me or for you as an employee of this company. The market is dictating the direction, and we need to "innovate" our offerings and evolve as a company or become a thing of the past.

If this section of the book scares you or worries you because you think this is the best company/group of people you have ever worked with, then really take it to heart. We as a collective unit have control of how we navigate difficult economies and market trends. A perfect example was the

temporary pay cut we did in 2009 instead of a lay off. That move was against general thinking and continues to pay off huge for us as we moved into 2010 with a ramped group in every office.

We always have a choice: We can make things happen for us or just let them happen to us. I think you all know where I stand.

In Conclusion

I think 2010 is going to be a pretty special year in many ways. All the messages in the other playbooks still apply to what we are trying to achieve: Relevance, Limiting Risk, Preparing for Scale, Staying Humble, Making Investments, Constant Improvement, More and Better, New and Different, OTOV, Creating Client Value, etc...

The goal has never changed. Create something special. Listen to the Market and make adjustments. Build a business comprised of special people that will stand the test of time.

Here is my little Choose Your Own Adventure theorem:

More and Better + New and Different = Quality of Earnings

QOE= CYOA.

When Trace3 = CYOA...watch out.

CYOA will not be easy. But it is going to be SO worth it. Thanks for reading this and I hope you found some value in it.

- Hayes

2010 - The Bullet Points

If you do plateau technically, you will become irrelevant to the organization.

The way you show loyalty is by constantly improving yourself and those around you.

We can become great as an organization if you decide you will not stagnate as the key asset in our equation.

When Titov tells you he is ready, I want you to get out of your comfort zone with our clients and introduce the Consulting team so we can expand our influence.

What we have that most of these “Cloud” providers do not have are clients. We have over 600 clients. What we need to do in the next 24 months is get close enough to those clients that we can begin to influence their behavior for what moves out to the cloud and what stays in house.

While certain days are more painful than others, building something with people you like is exciting.

I believe that if we were to fail at achieving the QOE goals we would need to position Trace3 to be sold by 2012.

We always have a choice: We can make things happen for us or just let them happen to us.

2011

Enough is Enough

Preface

An Email from Tom

Hello Hayes,

I apologize for the delay in getting this to you.

Constant Improvement – In reading the Constant improvement section in this year's playbook, I couldn't help but think of a baseball comparison for improvement. Baseball is game where as a hitter, if you fail 70% of the time, you can be a Hall of Famer. So by being successful 30% of the time or by hitting .300, you could be a millionaire in the big leagues. Well for most ball players I know, when you are hitting .300, you want to hit .400. If you hit 20 home runs a year, you want to hit 30 the next year. You start evaluating your swing, your weight training, your diet, the amount of sleep you get, the size of bat you are using and your approach at the plate. You start tinkering with your swing even though you are "successful". I would imagine that it's a horrible feeling when a manager sees a player stop trying to improve. To punch in and punch out year after year.

In looking at myself in this position, I have tried to apply this same baseball mentality towards my work ethic. Most recently, I've been tasked to train Eric Inocencio on some of the tasks for inside sales. I've looked at where he is coming in at and where I was when I entered into the role. Sandy Salty trained me about three and half years ago and did a great job making sure that I felt comfortable with my role but also allowing me to solve problems in my own way

(allowing me to fail will be seen later). In looking at Eric's position, I told him my goal was to teach him everything I know and how I make decisions to solve problems in my own way. From that training, I told Eric that I hope that he would take that information and improve on it and be a better Inside Sales Rep than I am. If he has all of my knowledge and uses that as well as his own, he should be able to build the role. Of course, this is part of the role in the first place. From the first day Shane Savage and I started, we have built off of each others ideas and knowledge to continue to improve at our jobs.

As the product line, services piece and ever evolving improvement of Trace3 increases, the need for improvement each of our jobs will also increase. Growth of a company requires growth of each of the individuals inside of it. In order to do that, you have to teach yourself how to learn new things. Be a self starter and your own teacher.

Securing the Family – When I was brought into Hayes' office to hear that the entire company was taking a hit on salary, I was taken back. Did I like the news that I was receiving? No. Did I respect Hayes for calling me into the office to let me know personally what was going on? Hell yes. I put myself in Hayes' situation, calling employees in and telling them they were going to take a hit. Not a fun conversation by any means. He let everybody know that they were taking a hit. But I realized this was same guy who put bonuses together and profit sharing plans together as well. With a family, you have to take the good with the bad. Hayes had developed a plan to keep the company in the best position as possible. His plan worked, things were restored to normal and he continues to look out for the good of the family. You have to look at the big picture to understand some of the small sacrifices we have to make. Thank you Hayes.

Mitigating Risk – Anybody that knows anything about investing knows that diversifying your portfolio mitigates risk. By diversifying the way Trace3 makes profit, Trace3 will be able to weather a storm in one of the sectors. With more avenues to make money, Trace3 will be protected against a lull in any market. I'm sure some of the outside sales reps would agree with this strategy in regards to their majors or the accounts they manage. If all your accounts were in automotive over the last couple of years, you would take a hit. But if you mixed pharmaceuticals, automotive, insurance, media, medical, banking, education, government, etc you could survive a low in one market by working your diversified accounts.

Trace3 is building a model that will be able to survive the storm. The “clouds” are building and like most weather reports, there's no telling how bad the storm will be. As a company, our leaders are creating a shelter from the storm. Not only that, but they are creating multiple shelters to ensure that no matter what kind of storm occurs, we will survive.

Letting People Fail – What better way of find each individuals maximum potential? Growth is nearly impossible without risking failure. Columbus, Tesla, the Wright Bros and Trace3 would have all failed to get off the ground without looking in the face of failure and looking to overcome it. The same rules apply to smaller levels at Trace3. Titov and the service piece. Sandy Salty in marketing. Rod Berg in outside sales. These successes would not have come without the acceptance of letting people fail. Individuals learning from failures or even other individuals' failures can learn lessons to adjust before they make the same mistake. Sometimes those mistakes need to be made in order to find out if you have a viable solution.

In closing, I would like to say that I feel better about working for this company that I ever have. I think that with most companies or relationships, you appreciate them less and less as time goes by. Trace3 is not like most companies. Trace3 continues to grow as a company and grow the individuals inside it.

I also would like to point out the quality of individuals that I work with. I recently suffered a loss in my family and the individuals that I work with have supported me and surrounded me with care. This extends beyond individuals working with one another. I am humbled by their support and care for my family and myself. To say I am impressed with the group of people I work with would be an understatement. I'm proud to work with these individuals and proud to work at this company.

Thank you,

Tom

--

Tom Powell
Inside Sales
Trace3

An Email from Rod

Sent: Fri May 21 15:29:31 2010

It is rare that I ever take the time to send a note like this, but after reading a blog entry about you on the T3 site, it kind of perked my interest in taking the time to do this (Don't tell anyone, I should really be closing business:-). While I write this at a time that you want responses for the book, my original intent in this message was not that.

I can't imagine the stress that you went through when Techfuel collapsed and the shot that you took when that happened. I think all too often people get exemplified for their success, and often times their triumph over failure goes unnoticed. Almost to the extent that the failure tarnishes the successes that have been had. I tend to think that the failures we all have are the reasons for our success. A successful person is a person that has found perseverance and has found the positive in a negative situation and creates something great out of it. The greatest leaders in history all had failures or strong adversity, and I believe that is what tests the mettle and the drive of the person behind the success. I am very glad for what happened with Techfuel. Had it not happened, I don't think you would be where you are at right now, and I definitely know I wouldn't be here to share the road with you.

I also think with failure in the past you become more prone to look for trends that could affect you adversely. You picked up the economy and made corrections by lessening everyone's comp without layoffs. The plan worked and it propelled us forward to take more share on the upswing. You have managed the credit situation closely (almost painfully:-) but is a good thing). You are also now building the war chest that we spoke of when I was first hired and that war chest is what enables us to shift direction or weather a bad storm. I don't think that you would have

made these same decisions had Techfuel not happened. Maybe some of these decisions you would have, but I think that success without failure blinds us to indicators that we should be paying attention to.

This year I decided I wanted to lose more deals.. While that might not make sense, think of being dominant in a given market space and winning all the time. Are you emerging or settling for what is in front of you, and are satisfied with status quo? I won every transaction I had last year, except for one. I did \$1.5M in GP. This year I have lost 3 transactions (painfully), but my pipeline puts me at the number I did last year at or around the 6-7 month mark. It is not that I am doing worse, I am just engaged in that much more business. My point of this is that failure and losing can sometimes be good, depending on how we view those failures and losses and the reasons they exist.

So, on to the next challenge. More and better..

The goals that you have set forward are good, and we do need to protect the family. Sometimes we all take for granted what we have. Being part of a growing company and to witness that growth is often lost with me because I am so focused on my day-to-day business, and as you know, I rarely take the time to sit back and look at where I have come, let alone sit back even further and revel in all of the accomplishments we have had as a company. The one thing that is never lost with me is how much I like it here. Getting the right services mix and keeping us all together instead of being bought out is huge to me. When Stack was bought out everything became so different and broken into verticals which I never liked and I hated the structure at EMC that so often stifled my ability to do the things that I knew needed or could be done. Trace3 enables us to succeed and enjoy more independent and creative thought. You actually expect that

out of us where I believe many business owners and managers are threatened by it to some degree. We achieve what we do because we don't have boundaries placed upon us.

Services... I don't think that we stay in our majors without it. The problem that I see is not realized with small product acquisitions or non-mainstream products, but with products that are mainstream where the client has significant spend, investment, and personnel to support. Are we really that relevant to the client if they think they can buy a few points cheaper without us? They have to know that we inject cost somewhere. With everything I have been through with Intuit over the past year or so I know that if I am unable to get people on site billing, being part of the team, and to have Intuit rely on us for that service, my chances of staying in are not good. Truthfully, I don't see services as a revenue source, although I know it will be. I see services as a way to enable my business, and most importantly fortify my defenses of being taken out due to a customer demanded direct relationship or a new integrator coming into power. I think that in the majors, not having a "strategic" services engagement with the customer will only lead to problems later. It is no surprise that the value of a services company is much higher than the value of a like sized VAR – the services company is sticky, a VAR really is not. God knows I have kicked a few out this year at different accounts. I never forget that can happen to me if I am not successful in doing more services and getting more sticky with my clients.

Balanced participation. I have gone back and looked at your services goals for the year. I don't see one team that is accomplishing them. I know my team is close, but we are off as well. Doing this services revenue is a top priority. It has to be, otherwise we stand to be replaced by other companies that are willing to have some of those tough

conversations. If we don't do it, we will be replaced in our majors by large integrators and to your point we will be forced to sell. In our mid market accounts, services led opportunities and proof of excellence will drive additional product pull-through and enable us to be truly relevant to our clients. I am feeling this with Active Network where we led with services and also with Mitchell1. Taking 80-100% share of a mid market account makes them feel like an enterprise account from a revenue perspective, and likely at better margins. This strategy supports your goal to grow more accounts above \$1M or even \$3M. However, if we fail to do this across all sales teams, the imbalance will be difficult if not impossible to make up by a few. I know we corrected without balance last year, but the goals that you have set will now require all teams to each hit the services goal. I fear that those teams that do not embrace being truly consultative with services will be affected by market changes in the coming 12-18 months, especially in our majors.

PLEASE DO NOT SEND THIS NOTE OUT TO THE
WORLD AS YOU HAVE THE OTHERS!:-)

Thanks Hayes.

--

Rod Berg

Senior Account Executive

Author's Note: I got permission to forward it. Never asked if I could put it in the book though...

Looking Past Relevance

Relevance

On the 3rd page of the very first book I ever wrote, I typed the following:

“I think people typically answer that the reason they start a business or switch jobs is for money; but if you really dig into it, it is for *relevance*.”

Many people found that to be a very novel idea. It leads to many truths about the need to scale and change in order to stay alive as a business. We covered much of that in the first playbook. Over the last couple of years the economy has also taught us many hard lessons. During our years at Trace3 we have seen some very uncertain circumstances, and we have overcome them and thrived... (I honestly feel like I have aged 20 years in the last 8 with some of the things we have had to face.) These challenges have made us more thoughtful and strategic in our planning. The reality is Trace3 is not a young start up anymore. Relevance is still a key to our success and we strive for it, but we are joining new market segments, increasing brand awareness, and becoming a legitimate player that others will soon take aim at. We are growing up and the way we managed before might need some adjustments.

I heard a speaker once say, “You cannot expect your children to behave the same way at 5, 10, 15, and 25 years old. Your parenting style must evolve with them as they grow. This is also true with your business. It will need different “parenting” styles at different ages. I really liked this metaphor. The core parenting style or management style does not need to change, but adjustments must be made as the children/management team ages and becomes more responsible. You have a choice as things grow. You can

choose to stifle them, or give them freedom and encourage them to take chances and grow. There is a perceived safety in micromanaging this child and a perceived danger in taking chances. With both you need to consider what type of child you are trying to raise? What will instill confidence and self esteem? What reactions will you illicit with encouragement versus criticism? What will foster the right type of creative thinking and risk taking? How do you continue to abide by the rules of relevance without over diversifying? Raising your babies/companies requires the best of what you have to offer. Let me tell you a little story of a company that has had similar challenges.

Foreshadowing

Yesterday I received a call from a salesperson I used to work with. We had once left a company together to buy out another VAR in Southern California. Our little venture did not pan out as we had hoped. I had thought he had always blamed me for it not working. His message thirteen years later on my cell phone said the following:

“Hayes, blast from the past I know. I am tired of selling a product I don’t believe in. I would like to go sell a product I do believe in and the industry here in town really believes in Trace3. I would like to investigate your interest in bringing me on board.”

To date, I had never heard anyone describe Trace3 that way. He implies that “Trace3” is a product. It almost makes the culture and personality of how we do things seem like a tangible thing. In a very real way, I felt like we had achieved relevance. It was only satisfying for about half a second.

This man worked at what was one of the most powerful VARs in the nation. When Sun Microsystems ruled in the late 90s, this company was on top of the world, expanding

like crazy, and he was one of the best they had. They had absolutely achieved industry relevance and were on top of the world. When Sun struggled so much they had to sell to Oracle, this VAR lost a little shine as well. Now some of their best people are looking to jump ship. They went from top of the world to splintering as a company as the best people leave to start their own companies or jump to competitors. What happened? How did this very talented rep lose faith in something he had been a part of for 12 years? When he started there they were approx \$40 Million in sales and now they have expanded to over \$400 Million. Somewhere along the way, they forgot what they were about and who their clients were.

Your employees are just as important as your company's customers.

This phenomenon of reps calling us is happening in every region we have an office. It is happening with VAR, SI, and manufacturer reps. It is happening with consulting engineers and fortune 500 companies. So many of them want to come work here. I know it shouldn't, but it gives me a feeling of dread...

I have always been the underdog. I love being the underdog. We are no longer that dog...

We are now faced with a new type of risk. We are no longer a 3 year old company as we were when I typed the first playbook. We are almost nine years old. To use a children's sports analogy, it is like we have shown we are one of the best kids on a seasonal team and now all the club coaches are telling our parents that if we want to be seriously competitive we need to join them, practice year round, travel across the country, and start competing with the big boys. It is time to move from the minor leagues to the majors. Or as my dad

used to say, today we are the big fish in a small pond. Turns out, we just got thrown into a lake.

About 6 years ago, the company that rep called me from was an even bigger fish than we were when they made the move to the lake....

A Small Adjustment to Parenting Style

Going from the minor leagues to the big leagues can be a tough transition. Most never attempt it. In order to do it well you have to go past relevance. If we are truly becoming our own product (as that rep stated), I want to be the best product in the market. I want to go from being relevant to becoming a market leader. I want competitors and clients wondering how we applied the models to our business that we did.

Think about Apple for a moment. They came out with the Mac and became so relevant in the personal computer market. They were everyone's darling during that time. They then began to lose momentum and market share. In my opinion, they were trying to do things like everyone else was doing them for a long period of time. They then hired Steve Jobs back and something changed. They created a vision, focused on the customer experience, and started to innovate again. How many times in the last decade have you picked up an Apple product and been close to stunned with how cool it was. How easy it was to use. How helpful their staff was. How thoughtful their packaging is. iPod, iPhone, iPad...Apple has gone from relevant, to irrelevant, to absolute, de facto market leader. They are the ones everyone wants to copy. They get thousands of calls from very talented people wanting to work there. They performed the way they did in very difficult economic times. They made bets. They went back to remembering what made them

special. Trace3 can do this. And we can do it without having to become irrelevant in order to achieve it.

Market Leadership

Many companies will point to mission statements, value statements, and so on to describe why they are special. I am not a fan of Mission Statements and never have been. They get so shortened they end up looking a little cliché. I guess some could consider our books to be the longest mission statements ever...And we add to them every year. Just know this, by reading this I think you have a great understanding of how Trace3 does what it does, why it works, and why it is infectious once it starts working.

The majority of this book will talk about why I think we scale so well as a business and how not to lose sight of those key cultural aspects as we grow. If we get away from them, we will lose the heart of what makes Trace3 special. Shortly after that we will lose the people that make this company what it is. The rest is pretty simple to figure out.

We must never lose sight of why we are special the way Apple and so many others have at one time or another. Never...

I believe if we do, we will suffer a similar fate. We will begin to splinter off into smaller companies. Our chance to change the industry and lead so many will disappear.

Outside of our culture, our absolute key to staying relevant and becoming a market leader is by staying very close to the clients.

The clients are the key to our direction.

They will Define Our X for us if we take the time to listen to what they need. STOP selling to them and listen to them...

Ask them questions about their jobs and what makes life difficult. What would they change if they were in charge? Is there a way to do that without being in charge? How do their IT goals relate to the company goals? Who is in charge of branding IT to their co-workers and executives? Help them with their issues and when you hear the same issues across multiple clients, float them up to management and let's look at whether we can formally begin assisting them via new offerings.

Market leading companies often talk about innovation. Most all of them that talk about innovation have products to sell. I used to think innovation did not apply to Trace3 since we are really a services organization. I was wrong. By listening to our clients we have started developing services that are new to the market. Dare I say they appear to be innovative... Co-Management and Virtual Headcount... These "offerings/products" were defined by our clients. The Define Your X pitch and strategy sessions were 80% developed by the Denver Client Advisory Board (CAB). I then took it to the other CABs and they agreed it had massive value. Service offerings were born.

I guess the response should not have shocked me when I went to a client two days ago and gave them the presentation our CABs had come up with. The new client told me they had never heard anything like it and wanted to engage immediately. I was shocked. I had never had a net new client, that did not really know Trace3 well, react in such a genuine and open way off one presentation. They did not do so because of my ability to present. They did it because I was presenting exactly what my clients told me to present. I listened and regurgitated. It has never been so easy to look smart...

Market Leadership Means Taking Chances

I have had two people in the last month tell me they had never seen a VAR successfully do both services and resale. They said the clients see right through this and become disenchanted with one or the other. One went as far as to say we will fail at attacking this new line of business at Trace3. That made me happy. I felt a little bit like an underdog again.

People will always tell you a new idea will fail. Truth is, most of them do.

Most of them originate from a smart group of people in a room thinking up great ideas. When you take them to market, turns out the clients wanted something different. People offer me this sage wisdom on future failure all the time. I think they do it because they genuinely love what we have created and don't want me to mess it up. I know some of you reading this might even feel that way. I have even gotten texts from employees asking me to please be careful with our PS plans and to make sure we do not ruin a great thing. I hear and appreciate all these sentiments.

We are no longer a 5 year old company. We are rapidly approaching 10 years old. We are capable of doing more. We must continue to innovate and become experts in new areas as we grow. I must manage us differently and let you all take more chances. To answer my earlier parenting questions: I want to raise a child with confidence and high self esteem. This means I need to guide and let them fail at times. I need to constantly remind that occasional failure MUST occur if the goal is great success.

I want to foster creative thinking and risk taking. I want to do this within the confines of our client's needs and desires.

We will abide by the rules of relevance by diversifying and then becoming the best in the new segment. There might be times we take on two new market segments at once, but at 10 years old, one at a time will be fine. Another age might need another tact, but we can examine that then. When I wrote “raising companies requires the best you have to offer” this is exactly what that means to me. The best I have to offer is encouragement not criticism, applying the golden rule from the top, deciding that enough is enough, teaching you all to be kingmakers, and focusing on the clients to ensure market leadership and future relevance...

Here is what I know. Our clients thought of where we are going and are telling us the gaps in the market that need to be filled. This will give us a head start on succeeding. It will now come down to execution.

Market leaders delight their clients. In order to do that, they interview them vigorously. They then prototype new offering for them off the feedback. If the prototype is not well done, trusted clients help with the reiteration. This continues until the client gets what they want. While doing this, we will keep doing what they have always loved us for.

Over the years, as we add these new offerings, I can guarantee something. I guarantee we will fail at some things.

We will prove some of the naysayers right. I will even tell the clients this. But over the years the successes will begin to change our total value. We will begin to delight our clients. We will go from being one of many vendors, to a market leader they hope to partner with. They will seek us out the way sales and engineering talent now seeks us out for employment. The key with these innovations is to fail fast, correct, then stay humble when we succeed. Always

remember what makes us special. Every book goes into detail on it.

Embrace the clients and they will make us a market leader.

Succeed in new offerings for them, and we become something even more special.

An Email Thread Worth Saving

From: Hayes Drumwright

Sent: Thursday, November 04, 2010 2:31 PM

To: All

Subject: Update

So, October is in the books. We are now officially in the thick of it...After 10 months of hard work we have produced \$142M in sales with \$4M in EBITDA. Our goal for EBITDA for the year is \$5M. We will give \$2.5M of this to Uncle Sam and happily move forward into 2011 knowing we have helped capitalize the company in preparation for our most challenging year ever. I have been going over the financial models for next year and have decided that doing 6% is going to be really hard. Now for those of you that have been here a while, you know that I am pretty annoying. I really do not think anything is that hard. I think most people do not write plans (literally write them down) or give them the amount of thought necessary to accomplish them and therefore miss their goals. So when I say I think it is going to be really hard to hit 6%, we should all probably be slightly concerned...

Here is the reason I think 6% will be difficult. It is simple: Our product sales are blowing up. This fact is screwing up the product to service ratio I had planned on for next year. We would eventually like our services revenue to be

approx 25% of our total revenue. With our overall revenue growth moving at the rate it is, that legitimately might be too much to ask. Our focus next year needs to be becoming experts on delivery. Delivery of services, products, training, 1st call support, etc. We need to analyze what we have done this year, choose what we want to continue doing, and become the best at delivering it. The move to quality has to occur after aggressively adding footprint. So all this being said, I am more concerned with doing everything at a very high level of customer satisfaction next year than I am making sure we hit 6% as the product revenue growth continues to take off on us. My original model called for \$12,000,000 in EBITDA. This was 6% on \$200,000,000 in sales. We totally screwed up and will be very close to \$200,000,000 in sales in 2010 instead of waiting till 2011... ;)

The goal for next year is switching from 6% to \$12,000,000 in EBITDA. This will still be very difficult. Very difficult. But we have a written plan that is been given a lot of serious thought. We will hit it the way we hit all our other goals. My plan is to give everything over \$12M in EBITDA out in profit sharing.

Now, back to the present. The next 6 weeks will make or break the year. We need to get moving. Most of you had an okay performance last month. We need everyone to move back up to great performance levels to finish the year. I have faith you guys will pull it off.

Please feel free to respond to this if you have any questions on next year.

Thanks,

Hayes

From: Matt Hallmark
Sent: Thursday, November 04, 2010 6:13 PM
To: Hayes Drumwright
Subject: RE: Update

Ideas and questions:

How can our earnings actually be recognized as capital gains? Is it time to not be a S-Corp any longer? I guess it's a smallish %age we could net from changes, but those seemed like interesting ideas. ☺

Is it time for reps to make a lower %, over a higher revenue amount and have that made up w/ consulting GP, which is presumably higher margin for T3?

When do we change the comp plans to force consulting to be ID'd, chased and sold? 2% of 200m is the same EBITA % as 2% of 400m - we never get there w/o the higher margin consulting dollars. It's the only way (imo) to "motivate" many of our reps into a blended sales attack.

Quality (of delivery) over Quantity (of trees humped) will help the consulting group sleep more often too. I was very, very relieved to hear that on our call last week.

Have we started to analyze the cost of delivering the various types of consulting revenue this year? Do we know what type of services has the largest margins of work actually delivered?

What was the top3 factors leading to another 70%+ YOY revenue growth year? Let's do more of those too. ☺

Matt Hallmark

Professional Services Manager
Trace3

(my response)

This is a response to some terrific questions from Matt Hallmark.

So, earning cannot be considered capital gains. Any type of corp has to report their EBITDA and then pay taxes on it. What you are referring to is a C-Corp dividend. After a C-Corp pays its taxes it can then distribute dividends to the shareholders. This is not good since you are getting double taxed on the money. Taxed once on the earnings, then again on the dividend. It is better to just do a bonus during the year that lowers income taxes rather than a dividend later. Hope that makes sense.

To answer the margin question on services, the answer is I am not sure yet. I know the P&L is playing out the way I thought it would, but our biggest issue is getting the services billed. We probably have a backlog of almost \$2M in services waiting to bill. Until we can establish a consistent bill rate it will be hard to do much analysis on different types of services. That being said, since the P&L is working right, I am assuming our initial assumptions are pretty close to correct (within 5-8% on profit margin).

I had a long talk with Guthrie yesterday and I believe the reason we are scaling the way we have this year is that there is now a real trust between management and most of the employees that had to deal with the pay cut in 2009. That was miserable for all of us and many thought I would never bring the pay back up. When I did, I think people realized it

was a move we made only to protect ourselves versus trying to pull a fast one on people or just cut comp in general.

Have you ever given any real thought to why it is that Trace3 continues to grow at the pace it has without any major setbacks? I believe (and it is just my theory) that we are able to do this because we have avoided “splintering.” I talked about this to everyone at a kickoff many years ago, but the reasons companies like ours usually get stuck around \$30-50 Million is that the start cutting pay so the owners can make more EBITDA. The owners figure that there is a certain amount that is enough for all the employees and that the employees should be happy making that much. Therefore they cap them just like manufacturers do. The result is splintering...

Most highly successful sales reps decide that since they are capped (or pay has been unfairly reduced) they should try and start the same company on their own. The barriers to entry in our industry are pretty low. Most that do this fail, but they never go back to the company they left. In essence the “A” players start to leave. That said, I do believe there is an amount of money that is “enough” for people. **I just do not think that is Hayes Drumwright’s decision to make for everyone.** That is an individual decision that each of you make depending on your circumstances. That is why we can spiff at Trace3. The smartest most successful reps share the wealth in a big way in order to help the team grow. I want this control to stay in the field, not with me. I want loyalty and teams to stay in small groups with an overriding loyalty and appreciation for the whole entity that has provided the opportunity. It is truly a way to keep a small feel as the company gets huge. I think it is a huge part of our secret sauce that the other VARs and SI’s ask all the vendors to try and explain to them about Trace3. They will never understand it because they will never trust their local teams

to do the right thing. My new playbook goes into MASSIVE detail on this. I am almost done with it. For someone to “splinter” off from Trace3 with our pay model would make very little sense. Odds are they would make less. I want to keep it that way. I want to keep everyone focused on what matters. **And that is not money.** It is client value, building teams, and staying generous. Those things equal scale.

So instead of cutting comp, I want to add services to our portfolio that anyone with a brain would realize will add to the client value prop therefore leading to more business therefore allowing us to build better teams and be more generous as we make more money. The profit sharing plan I have laid out is a Macro version of that. Each sales team is the Micro version of that. I do a crazy thing at Trace3. I make the assumption that if I can clearly communicate “why” we are doing what we are doing that all of you will respond correctly to it. I believe in this because I think most of the people that work here could run their own companies. Therefore I would rather treat you like CEOs than employees. It goes back to the golden rule, “Treat people the way you want to be treated.” I would have been very inspired to work for a leader that did treat me that way... *So the basis of all my plans is founded in a VERY deep seated belief in all of you.* Pure and simple.

Thank you so much for the questions. It always helps me get my thoughts more clarified in answering them. I am sending this to everyone because I think many of you probably have similar questions.

Hayes

Author's Note

This next section is a little different than anything I have written in the past. I had a bit of an epiphany when I was beginning my interviewing with all the judges for the E&Y Entrepreneur of the Year awards. Almost every single one of them asked me what made Trace3 so special. I anticipated they would. I wrote most of this after a week or two of thought on the matter, letting the upside down pyramid sit on my whiteboard for weeks staring at me, making sure I felt I had it right. Six months later, I know I have it right and I hope that I have described it well enough so it makes sense to you all. I think the remainder of this book explains our “secret sauce” that I began to explain in the email response to Matt.

It makes me so proud to re-read it and believe deep down that we have created something that applies the generosity I wrote about. I hope you enjoy it.

Theory of Scale

At each stage I have been told that scaling the company further will be harder and more complicated. I have also been told I will not enjoy it as much as the company gets bigger. I am not sure I agree with what I have been told.

I think we have cracked the code on how to scale.

Before I explain my theory, let me state my assumption.

Most everyone in this world is looking out for number one. Number one being themselves.

In fact in the early days of the company, I used to tell the reps the better they understood that about the reps they worked with at our manufacturer partners, the more successful they would be.

I believe when people begin a family they change from looking out for number one to looking out for “number ones.” With families, the bread winner now takes providing very seriously and with new urgency. Some even base their importance on their ability to deliver it.

I believe this inner need to take care of yourself and your own (family) can in many cases halt a collective group’s ability to take advantage of opportunities and scale. There is this belief that once you can get yourself to a secure/stable financial position that you can *then* start considering the needs of others. The problem with this premise is as one begins to make *more*, they want *more*. Not more for the good of all, but more for themselves and their family. They always continue to want and therefore can never truly focus on giving back or scale. They will always have a hard time seeing beyond themselves.

I believe that Trace3 has proven (not figured out, but proven) that you can hire people worried about themselves, place them in the correct environment, exceed their financial desires, and the result will be a person focused on creating something GREATER than themselves.

In other words: Scale.

Scale is derived from the ability to be generous.

Generosity of time, knowledge, trust, and funds. The complicated part is not figuring out how to create an environment of empowerment as much as it is figuring out how to get everyone to think about their personal needs second instead of first. How do you get humans thinking about others before themselves?

Before I answer that, I want to examine why I think my theory works. Let's discuss a person's needs as they progress in life. We will start with our end goal and work backwards.

Focus on the Creating Something Beyond Self

This is our desired end state. It starts with the entrepreneur. It has to be the original goal of the organization. I have met with so many successful companies and it is clear to me that the best CEOs care more about the employees, shareholders, and clients than they do about themselves. Some very rare ones are this way from the beginning before they become financially secure. Many become this way after having initial financial success somewhere else then decide they will start something new without the stress of maintaining income hanging over their heads. Then there are some CEOs that no matter the level of success, they cannot get their egos out of the way and their company's success must be equated to their own. Eventually the management teams in those

environments begins to turnover and leave. In many, many cases, for a CEO to truly create something beyond self, he/she has to be willing to turn the company over to their protégé(s).

In order to Create Something Beyond Self, you have to become a facilitator. You want others to become the equation that equals success. **You must be generous.** Generous with your time. Generous with your thought processes. Generous in your trust and faith in others. Generous with your money.

I have realized that if I can help people *consistently* exceed their financial goals while at the same time learn there is a level of W2 that is *enough* money for their number ones, then I can show them that *the best way to achieve more is to give the overage away...*

A Conversation in Early 2010

Rod, a sales rep in San Diego, told me that he recently had a conversation with Frank, his project manager that was recently hired. Rod said, “Frank, I want you to try and staff 7-10 technical people at this account we are working on together. As you are successful in doing this, I have decided that I am going to give you all of the commissions I receive for these placements.”

Frank was a bit taken aback. Frank said, “Rod, you know that could be a lot of money. And it would be a consistent monthly commission.”

“I know.” said Rod.

Frank responded, “Well you don’t have a base and I have a salary so I am not sure that is really fair.”

“Look,” said Rod, “I have a great business going. I hired you to help me make it better. I want you to be an owner in making it better. That means you participate in the upside. I need you and want you to be incented and excited about growing this business with me. This is a tremendous opportunity for both of us. Not to mention Frank...I make enough money.”

In other words, Rod told Frank he wants him to be relevant. He wants him to FEEL relevant. Rod wants Scale. He views his sales efforts as being CEO of his own Trace3 division. He wants to backfill in talented people, let them participate in the upside and therefore CREATE *more* for *more people*.

Rod will probably make more as his plan succeeds but my bet will be that he will not keep it all. Eventually Rod could have a situation where Frank and others do 80 percent of Rod’s current daily activities and Rod does nothing but set the vision for the team and continue to help them become financially secure enough that they could start focusing on making other team members something greater than they thought they could be (selfless). Rod would have more time, *enough* money, and create something greater than himself.

The key to Creating Something Beyond Self is personally defining what is *enough*. After you define it, stick to it. ***More for the sake of more is an empty goal.*** More for the good of all has value.

Focus at all times on the VALUE of the MORE. Give it purpose.

How Much is Enough?

Let me put it this way. If I was to give you \$300,000 a year for the next 20 years in pay and you knew you could count on it, would you change anything in your life?

Don't answer that question with what you would buy or pay off. Answer it holistically. Would you treat people differently? Would you give to charities? Would you buy gifts for people you had never gotten gifts for before? Would you pick up the check at a group dinner? Would you pay to send your entire family out to Hawaii for a family reunion? Would you coach your kid's sports? Would you make sure you never missed one of their school plays? Would you commit to a weekly date night with your spouse since paying babysitters no longer mattered?

Would you be more present?

That is often how I think of grandparents. I think of them as "present" in the moment. They appreciate the time they have with the people they care about. Would having consistent income above what you needed do that to you?

Regardless of your answer to that last question answer this - If you were personally satisfied with how much money you were making, would any of the decisions you make on a daily basis at work change? Do you think that your work focus would be on creating scale and helping others?

I do. The decision process of a person that is "present" versus that of someone under financial stress is very different. One has the ability to think, be proactive, see different ways of doing things, write silly playbooks, etc. The others main concern is how to make the most for number one. It doesn't mean they become totally self

consumed and selfish, they just have less ability to consider others and options.

What if I told you my main purpose at Trace3 is to make sure you all make a high enough income that you reach your enough?

Now for the big question... (drumroll please)

I now want to change the situation on the 20 years of pay. I am going to change the annual W2 pay from \$300,000 to \$600,000. That is \$300K more per year. Would you make any changes? Was \$300,000 *enough*? What if you took the extra \$300K per year and gave \$50K to six different people on your immediate team or to peers in your district? How would your team view you if all of the extra money went to them? Generous? Great Leader? Crazy? Brilliant?

Honestly, if \$300,000 was enough for you and your loved ones to live very comfortably, what does the extra \$300,000 create for you personally?

What can the extra \$300,000 create for you if you use it to invest in your team/future at Trace3? Could it create an additional \$200,000 the next year for a total of \$800,000 in W2 earnings? If it did, what would you do with the extra \$500,000 that year? Keep \$100K of it and re-invest the rest? In other words, would you use the extra for scale, or for yourself?

I hope by now you all know my answer to these questions.

I have always strived for relevance and scale. This is how I have tried to lead since we had 2 employees.

It has infected many not because of me, but because we have proven over and over that it creates more for all. John did it with Rod. Rod is doing it with Frank. Susan did it with Paul Markel and Ladd. Paul Markel did it with Erik Durand. Chad and Ian are doing it with their teams. Ruben is doing it with his entire team. Dag is doing it with Paul Martin. George Folden is doing it with Sue. Eric is doing it with Mike Stanley. They are being selfless. They are being generous. They know it will equal scale.

They understand that when you have built a strong team the leader of that team has time to be proactive and innovate. That can apply to process, product, or people.

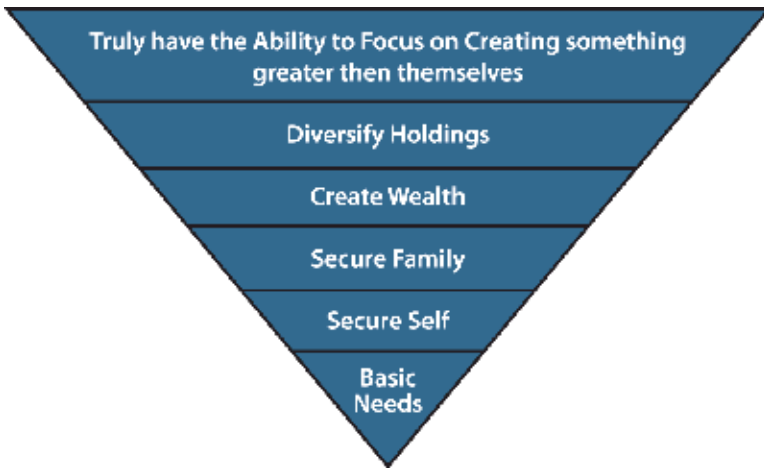
This is not theory. This is proven. There is an amount of W2 earnings that is enough. The only way to consistently build towards *more* is by being selfless. And trust me when I say that the greatest “reward” for being selfless has nothing to do with money. Your ability to be “present” and enjoy everyone’s individual triumphs at home and at work is a special thing.

How Is It Done?

I have come up with an inverse pyramid of needs. It is a slight rip off from Maslow’s pyramid of needs, but I figure he probably won’t mind. At the bottom are basic needs like food, water, and shelter. After that, I believe most people focus on trying to overcome financial stresses. I propose that once you begin a family these financial stresses quadruple in the mind of the family bread winner. It is hard to focus on much else if financially providing somehow becomes unstable. So for the purpose of my pyramid, the middle sections of Self, Family, and Wealth are mostly based on the ability of one to earn and retain money.

There is a reason I asked many of you “What is a lot of money?” when I interviewed you.

I want to get an understanding of what you think *enough* is. I want to know if Trace3 can help you accomplish *enough*. Now you know why I am so focused on that. If we can help you achieve it consistently, you will be a driver for scale in the business.



The biggest change I have seen in many of the top earners at Trace3 comes in the 2nd and 3rd years that they make money. They begin to trust in the opportunity at hand and believe they can consistently earn enough money to provide for themselves and their families. Almost all the top earners have financial goals. After providing security for their families they want to have funds for college, investments, and especially rainy days. I consider that the Create Wealth phase. Past that, people vary, but most start looking at diversifying their investments/holdings into real estate, stocks, bond, etc.

It is in these two stages (Create Wealth, and Diversify Holdings) that everything can get screwed up. What many do at this point is create MORE risk and MORE debt rather than diversify.

This is why it is important to define what enough is before you get to this stage. (Define Your Homerun...sound familiar?) It is so easy to get caught up wanting more. If you do this and something goes wrong you can send yourself right back down the pyramid to Secure Self or Secure Family.

In a macro way, you could say this occurred to Trace3 as a company in 2009. We were so focused on revenue instead of profits thru 2008 that we left ourselves exposed to an unstable economy in 2009 and had to pay a price for that. It sent us back down to Secure Family (Trace3 Family) and did not allow us to diversify into consulting as quickly as we would have liked to. We spent almost all of 2009 working our way back up to diversify holdings (in this case “offerings”).

There is a self serving purpose to wanting you all to make more money than you have ever made before. Many of you hear me talk about that all the time. Now you know why.

If I can get the majority of people at Trace3 to the “Create Wealth” and “Diversify” levels of the pyramid, that is when they start to begin thinking about sharing the wealth, giving back (sometimes in the form of accounts), and scale. This is the point they start trying to build a team. This is when they can become powerful for all of us.

The reason we are switching to profit sharing from SARs is because I want to move people up the levels of the pyramid faster. The 6% profit sharing goal is my attempt at influencing all of you at the same time. I have decided that

6% is *enough* for Trace3. I want the entity you work for to be the example on defining *enough*. Trace3 does not need to make more than that.

I believe that the only way to guarantee that we consistently make more than 6% year over year is to give the overage to all of you. I know by doing that, and leading by example, many of you will begin to understand how to achieve scale in this business.

The pinnacle in anyone's life, be they great or small, will be the great triumphs of those they hold most dear...

An Email From Avi

Hayes,

Sorry in advance for the long email: ☺ First I'd like to thank you for the incredible time my wife and I had at the holiday party last night. Having only been here 6 months I expected not to know a lot of people, but having someone like Bret say he doesn't know half the people either was quite laughable. As I was introducing my wife to our fellow T3 employees, I kept saying "...so incredibly smart... So talented... Awesome... And these were all adjectives I was using describing each and every person meeting my wife. She later made a joke about it, saying I keep repeating myself about everyone being awesome. Well the joke is on her, because everyone here IS awesome, incredibly smart, and extremely talented.

You said, and I've heard it from many employees, that we hope that Trace3 is the last company we have to work for. I can't begin to tell you how true that rings to my ears. This "culture" of Trace3 is truly unique, and almost impossible to fully quantify. It's a living, organic thing and I think it means

different things to different people, but to me it brings a sense of Family.

From my first day at Trace, that's exactly what I've felt, a sense of Family. Everyone is here to make everyone else successful. From answering questions, to showing how things work, to just simple compliments, I see people ready to prop each other on their shoulders rather than step on them for their own gain. Tim Abbott said it best, and has said it numerous times: "What else do you need from me to help you be successful?" It's that kind of comradeship that is prevalent throughout this entire organization.

In my first weeks at Trace3, as I was reading the past playbooks, I was trying to figure out what made Trace3 so successful. I've had dealing with other System Integrators, some that started the same year as T3, however they're but a tiny fraction of what T3 is today. At first I was convinced that it was your relationships with the manufacturers. You built a strong relationship with them, and they in turn gave us more share of the business. While that may have been true, I missed the connection at first, that the manufacturers would never continue to invest in our future if there was nothing standing behind the relationship. As time passed, that connection quickly became clear to me, and that's when I got my real first whiff of "culture". It was kind of like an "Ah-ha" moment for me, and it all made sense. Everyone was saying it all along, it's just I didn't really get it until that moment... The reason T3's been so successful is because of the dedication, knowledge, and true badassness of our people. ☺

Throughout my career, I've always dreamed of working at a technology firm. My love, and thirst really, for knowledge always begged for an opportunity to work at a company

centered in technology, yet the opportunity never presented itself to me. For that I'm grateful, as I believe one's life is a culmination of experiences. All those years working at various companies, still working on technology, yet not focusing on it, allowed me to hone and adapt my skills, and thirst for "more". And now as I write this, I realize that it was all a culmination and a preparation, to bring me to Trace3. I really feel honored and humbled to be working for such an incredible organization. For the first time, in a long time, I'm driving home with a smile on my face, truly happy. Thank you, and have a Merry Christmas,

--

Avi Drabkin

My Adventure

A plan within a plan within a master plan... That is my adventure. I have talked so much about CYOA in the last couple of years. I actually chose an adventure for myself 5-6 years ago and most everything we have been doing is leading towards making it a reality. Before I cover it though, I want to be clear. I do not want to spend too much time on it in this book since there is still so much for us to do with QOE. We still need to establish excellence in all the new market segments we have taken on in QOE. We have only begun the process of becoming Market Leaders. We will do that in 2011. I did not need to spend much time on *how* in this book because the last two really covered it. You all tactically understand what to do. We now need to focus on doing it well, refining it, and becoming great. After we do that, I will let you in fully on the next adventure.

I *will* share that I will only be writing a small portion of the new playbooks. Most of the writing for the 2012-2014 plan will be done in the regions. That in itself is exciting. You

are all different with different market challenges. You all have great leadership. I know they will write great plans.

I will also share that I personally have a goal in mind that will center around each of you climbing the pyramid I laid out in this book. I want to help raise you ALL to a place that you will be able to participate in what could become something completely new and different to an old market segment. There will be risk, but I have already thought of how to mitigate it. The great part is, if done correctly, we can mitigate the downside risk and all participate in the upside.

The key for this Adventure to work is to get everyone in this company to W2 at least \$200,000 per year. That will be very difficult if the principles in this book are not followed. If they are I can tell you this - *in the coming years, we will look back at this 3 year plan and smile because QOE realized is when the Trace3 opportunity truly began for all of us.*

Thank you all so much for allowing me to write this. If you are reading it for the first time, I would love to receive your feedback on the concepts that were covered...

- Hayes

2011 – Bullet Points

Your employees are just as important as your company's customers.

The clients are the key to our direction.

People will always tell you a new idea will fail. Truth is, most of them do.

I want to foster creative thinking and risk taking. I want to do this within the confines of our client's needs and desires.

Over the years, as we add these new offerings, I can guarantee something. I guarantee we will fail at some things.

Embrace the clients and they will make us a market leader.

Scale is derived from the ability to be generous.

The best way to achieve more is to give the overage away...

Focus at all times on the VALUE of the MORE. Give it purpose.

What if I told you my main purpose at Trace3 is to make sure you all make a high enough income that you reach your enough?

I have always strived for relevance and scale. This is how I have tried to lead since we had 2 employees.

There is a reason I asked many of you “What is a lot of money?” when I interviewed you.

It is in these two stages (Create Wealth, and Diversify Holdings) that everything can get screwed up. What many do at this point is create MORE risk and MORE debt rather than diversify.

The pinnacle in anyone's life, be they great or small, will be the great triumphs of those they hold most dear...

So the basis of all my plans is founded in a VERY deep seated belief in all of you.

In the coming years, we will look back at this 3 year plan and smile because QOE realized is when the Trace3 opportunity truly began for all of us.