

Financial Modelling Assessment 2

Additional information on Festa Fitness Pty Ltd

Use the following information provided by Festa's management team to determine assumptions for your financial model.

Acquisition strategy update

Festa does not intend to make any further acquisitions in this period. Instead, it will consolidate its investment into the current portfolio. The portfolio consists of 140 gyms (also referred to as 'locations').

Investment strategy

Brand refresh

A review of Festa's portfolio determined the brand refresh will require the following capital spend on interior and exterior décor and signage. For the model, you can assume the following:

- The refresh will be started and completed in the allocated month.
- The investment should be capitalised and depreciated in the same month (for a full month).
- Suppliers are paid at the end of the next month (ie equipment purchased in August will be installed, capitalised and depreciated in August, and paid for in September).
- All capital expenditure relating to the brand refresh will be classified as furniture, fixtures and fittings. It will be depreciated at 20%, straight line.

While the actual spend will vary according to the size, condition and location of each gym, for the model you should assume an average of \$65,000 per gym, with the refresh staggered as follows:

Month	August 2023	September 2023	October 2023
Number of gyms	91	14	35

Equipment upgrade

Festa will upgrade the gym equipment and machinery in 40 locations at an average cost of \$90,000 per gym. Full payment is to be made on ordering, at the end of August 2023. It is anticipated that the equipment will be delivered, capitalised and in use in November 2023.

The equipment upgrade capital expense will be classified as plant and equipment, and depreciated at 15% straight line. You can also assume no disposals or write-offs from the upgrades (value immaterial).

Existing PP&E

A breakdown of the existing property, plant and equipment (PP&E) is provided in the Festa Source Data file. All remaining items still have a useful economic life of 12 months or more, and they are depreciated straight line at the following rates:

- Plant and equipment – 15%
- Furniture, fixtures and fittings – 20%
- Leasehold improvements – 10%

The 2024 forecast for existing PP&E is in the Festa Source Data file using these depreciation rates to save time. You will need to prepare similar forecast calculations for the investment strategy.

Revenue drivers

Members (volume)

The key revenue drivers for the gyms and fitness centres industry are as follows:

- Total member numbers
- Member recruitment (new memberships)
- Member churn (rate of loss)
- Net member gain (increase in members after recruitment and churn)
- Weekly revenue per member

In recent years, much of Festa's growth in membership has come from its acquisition strategy. Members of the gyms acquired are automatically transferred to Festa.

In 2024, with no further acquisitions planned and no new gyms to be opened, Festa will focus on organic member growth. The goal for the year to 30 June 2024 is net member growth of 10,000 members.

Member recruitment (the act of signing up new members) is largely driven by marketing spend and its conversion rate. Festa currently measures the response to marketing campaigns by the number of unique visitors to Festa's website and the number of new member sign-ups in the same month.

Festa will start a new online marketing campaign from 1 July 2023 and increase monthly spend from 1 January 2024 (after the brand refresh is completed). The following table shows the monthly spend, cost per click and conversion rate for these two six-month periods, which you should use as assumptions in the model.

Marketing campaign	01-Jul-23	01-Jan-24
Per month	\$70,000	\$140,000
Cost per click	\$3.00	\$3.50
Conversion rate	5.0%	5.5%

For example, a spend of \$70,000 at \$3 per click would drive 23,333 visitors to the website. At a conversion rate of 5%, a total of 1,167 visitors would sign up for membership.

The online marketing campaign spend is separate from the general advertising and marketing spend (included in overheads).

The **member churn** rate is the number of members cancelling each month divided by the total number of members (based on month-end members, including new members). Member churn is currently around 6% per year (0.5% per

month). Festa management believes that the rebrand and upgrade strategy will help to retain members and reduce churn to an anticipated 4.8% per year from January 2024 onwards.

For the model, you should use the net member number at the end of the month to calculate monthly revenue.

All membership fees are collected by direct debit. The rate of default on direct debits is minimal, so there is no requirement to model debtors or bad debts.

Membership fee pricing

Following the brand refresh and capital upgrades, Festa will create new membership tiers, varying in weekly fees. The lowest tier (Amarillo) will provide access to the gym equipment only and will be available at all 140 gyms. The middle tier (Rojo) will apply to members of the full-service gyms, giving access to three classes per week. The premium tier (Verde) will also apply to members of the full-service gyms and grant access to any gym across the portfolio, plus unlimited classes (where available).

The following is the anticipated membership profile across the tiers:

Level	% of members	Membership fee per week
Amarillo	80%	\$12
Rojo	10%	\$18
Verde (premium)	10%	\$23

These fee tiers will be implemented from 1 January 2024. Until then, the weighted average fee across all members is expected to be \$13 per week. Revenue is recognised according to the number of days in the month. In a 31-day month, revenue per member is currently \$57.57.

Other revenue

Other revenue drivers relate to the volume of sales per location rather than per member, as they can also be purchased by non-members.

Merchandise sales have seen growth in 2023 but are expected to level off in 2024. Margins are also expected to slightly decline compared with the peak COVID-19 years. The merchandise sales target is \$3,000 per month per location from July to December 2023 and \$4,000 thereafter (due to increased marketing and brand exposure) at a gross margin of 40%.

Casual visits and pay-per-class visits are expected to decrease over time due to the new pricing tiers giving greater flexibility. However, management expects some activity will remain at this level, as customers like to try out a gym before committing to membership.

Casual visits and classes should be modelled as \$1,500 per month per location. No direct costs need to be modelled as these are already allowed for in the member/staff ratio.

All other payments for classes and merchandise are paid at the time of attending or purchase.

Cost drivers

Key performance indicators (KPIs) have been provided within the financial and operating information in the CFO dashboard. Note actual operating data (such as number of locations, net member numbers and employees) are used to produce historical financial KPIs and ratios, which can be used to derive assumptions for future performance.

Wages

Festa relies on a casual workforce for customer-facing roles in the gyms, so it can easily vary the number of hours worked month to month according to demand. The larger, full-service gyms require more staff to be present due to increased member services such as classes. These gyms also tend to have more members.

For forecasting purposes, Festa assumes one full-time equivalent (FTE) gym employee per 200 members. To model FTEs, you do not need to round up to whole numbers or allocate employees to specific gyms. Note the member/employee ratio assumes that a small percentage of members are physically in the gym at any given time.

Additional relevant assumptions are as follows:

- The number of staff employed at the head office (20 FTE after the recent acquisitions) will remain the same.
- The average annual wage is \$36,000 per gym FTE and \$124,000 per head office FTE.
- Both gym wages and head office wages are subject to superannuation at 11% (2024 rate).
- For the income statement, assume monthly wage and superannuation expenses accrue evenly each month (for example, the gym FTE average salary of \$36,000 per year is expensed as \$3,000 per month). You are not required to determine which months have two or three pay cycles. Wages for all employee types are paid every 14 days.
- Superannuation is paid at the end of the month in which it is accrued (no lag).
- The balance sheet provision for employee entitlements of \$2 million as at 30 June 2023 relates to \$1 million in wages payable and \$1 million in leave provisions. Maintain the leave provision at \$1 million for the forecast period as this has been determined to be relatively consistent.
- The number of FTEs is calculated based on a 38-hour working week for forecasting purposes. Actual hours per employee (headcount) vary.

Overheads

Use the following annual amounts to determine forecast monthly overheads, which are relatively fixed. These have been estimated by management in line with lease agreements for premises, inflation and cost savings (due to lack of acquisition activity).

	2023	2024
Rental expenses	\$26,086,271	\$27,600,000
Advertising and marketing	\$1,691,582	\$1,200,000
Bank charges	\$543,210	\$600,000
Utilities and cleaning	\$3,585,443	\$3,600,000
Licences and subscriptions	\$1,396,890	\$1,500,000
Insurances	\$602,120	\$660,000
Repairs and maintenance	\$1,035,000	\$1,200,000
Professional fees	\$630,000	\$300,000
Other expenses	\$1,620,625	\$1,500,000
Tax rate	30.0%	30.0%

For the model, assume these costs accrue evenly each month and are paid by the end of the relevant month (no balance sheet impact).

Taxation

Ignore GST and other indirect taxes.

The income tax rate is 30%. You can assume that tax is paid in the month after it is incurred, and refunds are received in the same timeframe (one month lag).

You do not need to consider carried forward tax losses from previous years or between months, or deferred taxes.

There is no tax liability outstanding at 30 June 2023.

Capital funding

Borrowings of \$25,700,000 in the 30 June 2023 balance sheet relate to a bank loan and reflect the capital balance payable, but not interest. The loan is being repaid at \$1,500,000 per month (capital) plus interest at an annual rate of 4.5%.

For the model, assume that all borrowing repayments are against non-current liabilities and are made on the last day of the month. Therefore, you do not need to consider the reallocation from non-current to current liabilities each month. Total debt is sufficient as the model is intended to reflect operating performance, not statutory reporting. Assume that the interest expense is payable at the same time as the loan repayment each month.

Other balance sheet items

Please note the following:

- There are no receivables.
- Prepayments of \$900,000 should be maintained in the forecast period.
- Assume a merchandise inventory holding of \$7,000 (at cost) per store at all times.
- Supplier terms (for inventory purchases) are 21 days.
- No new equity has been issued.