

Financial Modelling Assessment 2

Case study and requirements

Festa Fitness Pty Ltd

Industry information

Festa Fitness Pty Ltd (Festa) is a privately owned business in the gyms and fitness centres industry. After acquiring several small operators in recent years, Festa now owns and operates 140 gyms (the portfolio) across Australia, in cities, suburbs and regional locations.

The industry experienced a significant loss of revenue during parts of the COVID-19 pandemic due to lockdowns and social distancing restrictions. Some gyms were forced to close for extended periods, and they temporarily cancelled membership fees. Festa was able to trade through the period successfully and acquire some less successful operators at a low value. As a result, Festa's market share is currently approximately 3% of total industry revenue.

Festa gyms have historically operated in the 'budget' segment of the industry, offering free-use equipment but no classes. Following the acquisition of some larger gyms, Festa managements sees an opportunity to expand its offering to full-service gyms and move away from the budget segment.

With high competition in the industry, gyms must focus on both attracting new members and managing the churn rate (members cancelling membership). Gyms that offer high-quality, full-service facilities at low prices are most successful at maintaining clients.

For further information about the gyms and fitness centres industry, and to provide context for the model build, please read the document titled 'Industry Overview'.

Financial performance

It is currently mid-June 2023. The table below summarises Festa's financial performance over the past three years. The forecast to 30 June 2023 includes actual results to 31 May 2023, and projections for June based on the current run rate.

Festa Fitness

Management Accounts

Income Statement

Year ended	30-Jun-21 AUD Actual	30-Jun-22 AUD Actual	30-Jun-23 AUD Forecast
Revenue	56,416,768	84,132,492	96,453,120
Employee benefits expenses	18,465,900	24,858,821	30,845,000
Rental expenses	16,114,439	22,096,273	26,086,271
Merchandise COGS	1,961,671	2,943,223	3,329,375
Advertising and marketing costs	1,387,069	1,537,801	1,691,582
Bank charges	531,331	491,635	543,210
Utilities and cleaning	1,701,957	2,987,341	3,585,443
Licences and subscriptions	1,105,690	1,164,737	1,396,890
Insurances	627,715	490,357	602,120
Repairs and maintenance	806,737	911,427	1,035,000
Professional fees	570,063	558,861	630,000
Other expenses	3,105,975	1,348,857	1,620,625
EBITDA	10,038,221	24,743,159	25,087,605
Depreciation and amortisation expense	5,482,556	7,341,986	8,500,000
EBIT	4,555,665	17,401,173	16,587,605
Interest	175,238	843,076	945,067
PBT	4,380,427	16,558,097	15,642,538
Tax	1,314,128	4,967,429	4,692,761
PAT	3,066,299	11,590,668	10,949,776

Festa's revenue grew between the 2021 and 2023 financial years due to the following key factors:

- Festa acquired 49 gyms in the period, increasing the number of members.
- The impact of COVID-19 restrictions negatively affected the 2021 and 2022 results, so the 2023 results more accurately reflect 'normal' pre-pandemic conditions.
- The business has maintained merchandising revenue streams that were added to compensate for lost membership fees in 2021 and 2022.
- The acquired gyms have generated more revenue per member due to additional facilities and classes. A full year's impact has not yet been achieved, but the average weekly revenue per member has increased in 2023.

Strategy

Festa does not intend to make any further acquisitions in the next two years. Instead, it will consolidate its investment in the current portfolio of 140 gyms to achieve revenue growth and increased profitability.

Investment strategy: brand refresh and equipment upgrade

The recent acquisitions have meant that Festa's gyms vary in brand, size and functionality. Festa's board is concerned that this inconsistency is confusing for existing and prospective customers. It has agreed to a brand refresh strategy to

relaunch Festa's image and change its perception in the market. This brand refresh strategy will be staggered over the financial period from 1 July 2023 to 31 December 2023. Every gym will receive a brand refresh, with updates in décor and signage to offer a fresh, new and consistent look.

Some of the newly acquired gyms will also receive equipment and machinery upgrades to ensure they all meet Festa's health and safety standards. These upgrades will require additional investment.

Revenue growth strategy: membership tiers and online marketing campaign

To reflect the improved facilities across the portfolio, Festa will introduce new membership tiers at different price points. Access will remain largely the same for members with basic plans, while premium-level members will be able to use any Festa gym and take unlimited classes.

Finally, an online marketing campaign will start in July 2023 and ramp up in January 2024 to introduce the new look and attempt to attract new members.

Note the revenue growth strategy relies on the investment strategy being delivered.

Your role

While Festa's board has signed off on the investment strategy and revenue growth strategy in principle, the detailed business case has not yet been presented. The business case will need to demonstrate that the strategies will improve Festa's profitability and can be funded through operating cash flows without increasing debt.

You are a management accountant working in Festa's finance team. Your manager has requested you build a three-way monthly forecast model for the year to 30 June 2024. The outputs of the model should enable Festa's management team to determine whether:

- implementation of both the investment strategy (brand refresh and equipment upgrade program) and the revenue growth strategy (new pricing tiers and online marketing campaign) will improve Festa's financial performance
- the strategies can be funded through operating cash flows
- specific target metrics can be met: EBITDA % margin, net member growth, average weekly revenue per member, and recruitment cost per new member.

You can rely on the 2023 forecast as 'actual' results for the year ending 30 June 2023 in preparing your model.

Available information

The following information has been provided to help you build your financial model:

- Industry Overview – This Microsoft Word document explains the operating environment, recent industry performance and key business drivers
- Festa Source Data – This Microsoft Excel workbook contains Festa's historical financial statements (management accounts – see basis of preparation), key operational indicators and a pro-forma chief financial officer (CFO) dashboard. Use the forecast financials to June 2023 as a starting point for your model, to determine the line items required in the income statement and the opening balances in the balance sheet.
- Additional Information – This Microsoft Word document, provided by management, contains information around business drivers to help you form assumptions and complete the three-way forecast model.

Basis of preparation

Festa's statutory financial statements for the years ended 2021 and 2022 have been audited.

The information presented has been restated for the model build to represent management accounts, reflecting the operational transactions and cash flows within the business. Adjustments typically relating to statutory disclosure are outside the scope of this assessment and do not need to be reflected in the model. Specifically, you do not need to reflect lease liabilities or expenses, deferred tax assets or disclosure of current and non-current liabilities in the model (as required by relevant accounting standards).

The model only needs to reflect the management accounting impacts of business operations and the impact of the changes being implemented, which the model is intended to support.

Required

Part A

In Microsoft Excel, prepare a three-way monthly forecast financial model for Festa for the period from 1 July 2023 to 30 June 2024. It should incorporate the brand refresh, equipment upgrade program, new pricing tiers and the online marketing campaign, and align with best practice principles. Refer to the available information listed.

You are required to follow these 12 steps in building your financial model:

1. Create an overview worksheet (tab) that details the contents of your model (either a model map or a table of contents is sufficient).
2. Create an assumptions tab. Use the Additional Information and Festa Source Data files to determine assumptions for future performance and balances.
3. In a new tab, create a property, plant and equipment (PP&E) schedule by month to reflect the investment strategy and existing PP&E. This should include additions, depreciation and net book value (NBV). You will also need to consider the timing of cash flows.
4. In a new tab, create a revenue schedule. Determine the net number of members at the end of each month. This should include the expected growth in membership generated by the online marketing campaign less the projected member churn.
5. In the same revenue tab, use the month-end net member numbers and pricing tiers to calculate monthly revenue.
6. In the same revenue tab, use the month-end net member numbers to drive gym FTEs (full-time equivalent employees) per month across the forecast period, maintaining the minimum member/staff ratio of 200 (1 gym FTE per 200 members).
7. Within an existing calculation worksheet, or the monthly forecast income statement, calculate the monthly wages expense for all gym FTEs (as calculated above) and head office employees, and derive a total monthly wages expense.
8. In a new tab, create control accounts to calculate monthly movements in working capital, capital expenditure and borrowings.
9. In three (3) new tabs, create integrated monthly financial statements for the period from 1 July 2023 to 30 June 2024 (ie income statement, balance sheet and cash flow). If required, prepare any additional supporting calculations in additional tabs.
10. In a new tab, prepare annual summarised financial statements (ie income statement, balance sheet and cash flow) for the year ending 30 June 2024. You may group together overheads that are relatively fixed (ie they are not impacted by the investment or revenue growth strategies). Provide comparatives (2022 and 2023) where available.
11. Prepare sensitivity analysis to determine the following:
 - i. The impact of a small change in the member/staff ratio on gym wages.
 - ii. The impact of small changes in the churn rate and conversion rate on net member growth (changing the assumptions for January 2024 to June 2024).

- iii. The impact of small changes in the conversion rate and cost per click on the recruitment cost per new member (changing the assumptions for January 2024 to June 2024).
- iv. The impact of a variation in the changeover date to the new pricing tiers, and a small change in the 'Amarillo' tier price on weekly member revenue.

Note that you can use any relevant method, such as data tables, to complete the sensitivity analysis.

12. You have been provided with a CFO dashboard in the Festa Source Data file, summarising key metrics and financial results for 2022 and 2023. This dashboard will be the key output of your model.

Copy the dashboard into your model and complete it with 2024 forecast results by linking to the financial statements and calculations you have prepared.

Your manager has asked that you ensure that the model can help Festa understand the impact of the planned changes, with the aim to meet the following targets for 2024:

- i. EBITDA margin of 30%.
- ii. Net member growth of 10,000.
- iii. Weekly revenue per member of \$13.
- iv. Recruitment cost (online marketing) per net new member of less than \$100.

Note 1: There is no requirement to round figures in the model, including employee numbers or member numbers.

Note 2: Markers will run error checks and other Microsoft Excel auditing tools as part of the marking process. They will assess whether the model has been built in accordance with FAST and other best practice principles.

Part B

Create a video of no more than four (4) minutes to demonstrate the workings of your financial model. Both the financial model and your face should be visible in the recording. The video demonstration should consist of the following:

- a. Introduction (eg 'Hello, my name is X, candidate number Y. Here is my completed model.')
- b. Brief explanation of the structure of the model, identifying the inputs, calculations and outputs.
- c. Demonstration that the balance sheet balances and that 'checks' have been included in the model to ensure reconciliation between the tabs.
- d. Demonstration of 'stress testing' the model, by changing the following two assumptions, and showing the impact on the relevant CFO dashboard figures for 2024:
 - i. Change the online marketing spend from 1 January 2024 to \$0.
 - ii. Decrease the member/staff ratio to 100.

We recommend you copy and paste the results (paste values) of the base case model into a new column so that you can easily demonstrate the impact of these assumption changes on the outputs.

For guidance on recording the video demonstration, refer to the Assessment 2 submission instructions.

Part B is a demonstration of the model only. You do not need to prepare a written presentation, slides or any content beyond requirements a to d above. You do not need to interpret the results of the model, as this is assessed in Part C. However, you will be assessed on the clarity of your delivery (see rubric), and the requirement to record yourself on camera.

After completing Part B, reset your model to the 'base case' (undo your stress testing) before submitting your financial model file in response to Part A, and before completing Part C.

Part C

Prepare a written report of no more than 600 words to interpret the outputs of the financial model you built in Part A, with your CFO dashboard (output) as the basis.

For your report, you should complete the following:

1. Include a screenshot of your CFO dashboard from your model, showing the key financial results and 2024 forecast performance against the four (4) targets identified and briefly conclude whether each target will be met. This screenshot does not impact the word count.
2. Conclude whether Festa's two (2) strategic goals have been met – improving Festa's profitability and funding the investment strategy through operational cash flows. Provide evidence from your CFO dashboard and financial model to support your conclusion.
3. With reference to your sensitivity analysis (Part A, task 11):
 - i. Identify one (1) target that may be met if the relevant assumption(s) changed by a small amount.
 - ii. Change the assumption(s) in your model and include a screenshot of the new CFO dashboard in your report to show the impact of this change. Briefly describe the change made.
 - iii. Advise whether the new assumption(s) should be adopted, by evaluating the commercial practicality of changing the assumption sufficiently to achieve the target, and the potential negative impacts on other financial measures.

Before submitting your financial model for Part A, ensure you reset it to 'base case'.