Is it possible to see into the (FINANCIAL) FUTURE?

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Funding a capital project requires a sound financial feasibility study.

It's been talked about for a long time that clubs need to continually reinvest in their businesses to maintain standards and remain competitive. There has also been much talk in recent years about the need for clubs to diversify, to reduce their reliance on traditional revenue sources, and introduce new revenue streams.

Of course these strategic initiatives involve significant investment, and it is vital that a detailed feasibility assessment of the financial impact of an investment is carried out. If the club is borrowing money to fund capital projects, prospective financiers require detailed cashflows before funding approval is given. Even if the club is using its cash reserves, it should still complete financial forecasts as part of a financial feasibility study to determine return on investment and impact on future cash flows.

A sound and thorough financial model should be used as the basis of this financial assessment. Ideally, the financial model should include an integrated, month-on-month departmental profit and loss statement, cashflow and balance sheet. It should also include annual summaries that provide an overview of the outcomes of the financial modelling. These summaries, combined with a covering report of outcomes, are most useful for review by the board of directors and the club's prospective financier.

So how many years should be projected? It needs to be for a length of time that is adequate to demonstrate the period of construction/investment, then a period of time for stabilisation of the new or altered business units, and then a period of time following that which demonstrates stabilised financial performance and debt servicing capability where relevant. The period for investment and stabilisation will vary depending on the size and type of projects undertaken. Usually a period of at least five to seven years would be ideal. At Russell Corporate Advisory, the longest financial forecast we have prepared was for a 14-year period – this was for a project with multiple significant stages involving a $90+ million investment.

A financial projection model usually produces at least two scenarios, including a low case and high case scenario with a range of results that the project is expected to produce. The level of revenue growth required in order to meet minimum debt servicing parameters may also be necessary. Or perhaps the maximum level of debt/capital expenditure the club can afford based on a certain projected revenue level. There are numerous possible iterations and, once the base case financial model for existing trading is established, the ability for a well-built financial model to produce scenario analysis can be very powerful.

An important part of financial forecasting is communicating the detailed results in a more summarised fashion, particularly using key performance indicators. These indicators include the typical KPIs in clubs such as gross profit percentage, wage percentage, net poker machine revenue per machine per day, and the all-important EBITDA percentage. Where the club is borrowing money to partially or fully fund the proposed project(s), there are two other KPIs that are very important – interest cover and principal and interest cover. The financial forecast should calculate these on a monthly and annual basis.

The forecasting process involves obtaining information from a variety of sources. Start with an assessment of the club's existing trading levels using the club's own historical financial data. Information about the proposed capital works can be obtained from the builder, architect and quantity surveyor. It is also important that the market for new or altered business units is assessed so that projected revenue streams can be incorporated into the financial model.

Depending on the human resources that the club has at its disposal, the preparation of financial forecasts could be completed by the club's own financial team or you may need to source external assistance. Either way, the modelling needs to produce the sort of detail referred to above to gain an accurate assessment of the feasibility of the intended project.

And once the initial financial model is created, it can and should be updated periodically to reflect more recent trading data, the clubs current circumstances, and to incorporate any new initiatives that a well-run, continually evolving club will inevitably be required to undertake.

One final but significant benefit such modelling creates is the ability for board and management to demonstrate compliance with the business judgment rule. The process of documenting the rationale for significant decisions is important and can be overlooked. However, detailed feasibility studies and financial projections clearly assist in achieving this objective.

If you have any questions about this article or need assistance with seeing into your club's financial future, please call Harry Harris or Greg Russell at Russell Corporate Advisory on 02 9957 6700. ♣