

Finance Report

8th October 2011

Completed by John Cutler

Finance Strategies & Solutions Pty Ltd

On behalf of

Marine Action Group



Introduction

I have been instructed by Marine Action Group (MAG) to provide an independent assessment on the financial forecast that has been compiled. Prior to my appointment I have had no previous involvement in MAG.

In this report I will comment on the following:-

- Sensitize the projections, both on the income line and expense line, to test the viability of the proposal.
- Comment on the assumptions underlying the projections.
- Assess the viability of debt funding (opposed to Gov grant) and on what basis I believe funding could be achieved.

Please note I am not an Accountant, my commentary will be based on in excess of 28 years experience as a Commercial / Corporate Banker,

I will not be making comment on reasons for closure in 2009 nor will be making any commentary of the refurbishment costs. I would anticipate that any funding proposal around the refurbishment would require an independent person

Secondly, my assessment has been based on data provided by the MAG and their supporting assumptions, I have not seen historical trading data to compare to forecasts. However, the business plan and forecasts is the product of months of work and relied upon the input of a large group of experienced and successful business people including a leading hotelier

Key Success Factors

IBISWorld identifies 250 Key Success Factors for a business. The most important for this industry are:

Product is sold at high profile outlets

Having a good location in a tourist or travel area ensures good flows of potential guests all year round, leading to higher revenue

For nearly 40 years Tipplers was the most popular boating destination in SouthEast Queensland and was considered a tourist icon.

This site could once again be the central focus for a group of facilities that would serve as an important meeting point for locals, tourists and day trippers

Having a loyal customer base

Developing a loyal and frequent user guest base ensures higher guest repeat rates, room occupancy rates and revenue

Prior to its closure in 2009 Tipplers was a destination for day trippers and well known within the boating community. It is expected after some advertising and awareness of the re-opening this venue will regain that patronage.

Effective product promotion

Having a sales and marketing plan and a professional sales and marketing team to generate sales and contracts with firms for their business travel accounts ensures good occupancy rates and returns.

There are significant plans in place to heavily market the re-opening of Tipplers. Given it is an iconic destination it is anticipated patronage will be restored within a reasonably short period of time.

Having a clear market position

Understanding the company's position in the hotel market, possessing insight into the needs of your clients, and delivering services above guest expectations are keys to success and will lead to greater financial returns.

Tipplers market position is unique, there is no other venue like it on the Gold Coast

Management of seasonal production

Understanding and managing any seasonality in guest demand over the year assists with managing finances, staffing requirements and other costs. It also places an increased emphasis by owners on strategies to attract off-seasonal markets and guests.

Some seasonality will exist with this venue with the summer months' naturally encouraging higher patronage than the cooler months. Some of this will be offset by the introduction of day trips and educational tours etc.

Source:- IBIS report dated July 2011 – Hotel & Resorts Industry in Australia

Cost Structure Benchmarks**Profits**

Both wages costs (as a labour intensive industry) and changes in purchase of alcoholic beverages for resale have a significant effect on the returns of operators. The average industry return/margin on revenue is estimated at about 6.7%, but varies from 7.4% for establishments with gaming machines and 5.4% for those without these machines. Given the relatively low profit margin, operators rely on high turnover of patrons and their expenditures. Therefore, in times of slower economic activity, as average expenditure per patron generally declines, losses can readily escalate, especially given with high property holding costs, such as interest and lease costs, and other fixed costs.

See financial commentary - margins

Gaming machine taxes and levies

The proportion of revenue accounted by this category has increased recently, as state government increase gaming machine levies. It currently accounts for 9.0% of total industry revenue, but an average of 9.8% of revenue for pubs with gaming machines

NA

Wages

Also, typically for any service industry, the need to provide customer service over extended hours and for seven days a week, employee wages and salaries and on-cost and payments to employment agencies for staff are the next highest cost categories, accounting for about 17.9% of revenue in 2011-12. Again careful control of staff costs (including the balance between casual and full time staff) is essential.

See financial commentary - expenses

Purchases

Typically, with any hospitality industry component, the major expense area is cost of goods sold (liquor and food etc. for re-sale) which accounts for just over 40% of total revenue. The significance of this is that careful control of stock is one of the vital factors in operating successfully in the industry. This relates to both overall stock levels as well as individual products which may or may not be in demand by customers.

See financial commentary - margins

Financial Data

Profit & Loss					
	4	Year 1	Year 2	Year 3	Year 4
1	Income	3623735	3804922	4185414	4394685
2	Cost of Sales	1192308	790104	895308	907403
	Gross Profit	2431427	3014818	3290106	3487282
	Expenses				
3	Employment Costs	1030000	1082500	1137375	1194244
4	Marketing & Selling Costs	80000	90000	100000	105000
5	Rental	0	0	0	0
6	Operating Costs	1052000	1188600	1248030	1310431
7	Depreciation	0	0	0	0
8	Interest	37217	37217	37217	37217
	Operating Profit	232210	616501	767484	840390
9	Non Operating Expenses	0	0	0	0
10	Taxation	0	70011	111815	127070
11	Dividend / Drawings	0	0	0	0
	Retained Profit	232210	546490	655669	713320

Financial Ratios		Year 1	Year 2	Year 3	Year 4
Profitability Ratios					
1	Income Growth (%)		14.90%	10.87%	5.61%
2	Gross Profit Margin (%)	67.10%	79.23%	78.61%	79.35%
3	Net Profit Margin (%)	6.41%	3.81%	5.49%	5.91%
Efficiency Ratios					
5	Asset Turnover per annum	22.83	18.66	15.22	12.48
6	Debtor (Days)	0.00	0.00	0.00	0.00
7	Stock (Days)	9.71	16.16	16.44	16.25
8	Creditor (Days)	17.73	28.79	27.80	28.67
Financial Risk Ratios					
10	Current Ratio (x:1)	0.17	0.88	1.85	2.85
11	Quick Ratio (x:1)	-0.38	0.32	1.26	2.29
13	Interest Cover (times)	1.22	1.52	1.61	1.64
14	\$100 Sales Spread				
	Cost of Goods	\$32.90	\$20.77	\$21.39	\$20.65
	Employment Costs	\$28.42	\$28.45	\$27.17	\$27.17
	Marketing & Selling Costs	\$2.21	\$2.37	\$2.39	\$2.39
	Rental Costs	\$0.00	\$0.00	\$0.00	\$0.00
	Operating Costs	\$29.03	\$31.24	\$29.82	\$29.82
	Depreciation	\$0.00	\$0.00	\$0.00	\$0.00
	Other Operating Costs	\$1.03	\$0.98	\$0.89	\$0.85
	Non Operating Expenses	\$0.00	\$0.00	\$0.00	\$0.00
	Taxation	\$0.00	\$1.84	\$2.67	\$2.89
	Owners Share	\$6.41	\$14.35	\$15.67	\$16.23
	Sales	\$100.00	\$100.00	\$100.00	\$100.00

Assumptions supporting projections:-

Income

The key to this submission is the ability for the MAG to be able to attract clients back to the venue. As mentioned previously we have not obtained historical data from the previous operation. To obtain some comfort around the numbers I have spoken to a number of people who used to frequent Tipplers and they have advised, the numbers are conservative.

The above projections for Year 1 is 2649 visitors per week with an average spend of \$ 22.73 per head. In my opinion both the weekly numbers and the weekly spend are very conservative. A full explanation is provided below, however it should also be noted that there has been no allowance for breakfast or evening trade.

Visitors

The 3 year average for domestic tourism to March 2011 was 3.2M visitors, in addition to this the Gold Coast had 783,000 International visitors. In addition to this there is 78,000 registered boat owners in South East Qld and as well our local population.

The forecast number of visitors to Tiplers equates to less than 3% of tourists or 1 in 5 boats visiting the site once a year.

Average Spend

The average spend per head is considered low, upon advice from a well known hotelier the average spend on food is generally around \$25 per head and \$7 for drinks. The number used in projections is particularly low given that being an island resort, average prices would be higher than those achieved on the mainland.

Other Income

Other income includes the following:-

- Special Events – Weddings etc
- Camping Ground Management
- Souvenirs etc
- Membership

The above represents about 18% of total income. Main revenue items are:-

Special Events \$291K – The venue has potentially 6 areas in the hotel to hold private functions in addition to this there is room at the resort to erect 2 large marquees which could hold up to 100 people each. The demand for special venues for weddings, conferences, 21st etc on the coast is high, and I would expect this budget to be achieved.

Memberships \$201K – it is proposed to sign up for membership to the venue, (similar to the clubs on the mainland) it is anticipated membership will entitle you to discounted food and drinks – similar to the clubs. It is anticipated to charge \$10 for an Annual membership or \$5 for 90 days. There will also be availability to join on-line and it is felt given the amount of publicity surrounding the re-opening of Tiplers the uptake online will be significant.

Summary

I consider the numbers used above both visitors and average spend are very conservative - but consider given the nature of the project a conservative approach is considered appropriate.

Other income is considered appropriate and represents a small % of visitors.

Sensitivity

Whilst I believe the numbers provided as realistic and more than achievable, I have conducted a brief sensitivity based on the following:-

	Year 1 – Projected	Year 1 – Sensitised
Weekly Visitors	2,649	2,000
Annual Visitors	137,748	104,000
Average Spend – Food	\$13.64	\$13.64
Average Spend – Beverage	\$9.09	\$9.09
Total Food	\$1,878,882	\$1,418,560
Gross Profit Food	\$939,441	\$709,280
Total Beverage	\$1,252,129	\$945,360
Gross Profit Food	\$876,491	\$661,752
Gross Profit (F&B)	\$1,815,932	\$1,371,032
Net Margin – Year 1 – say 5%	\$90,802	\$68,551

Average spend has remained unchanged at \$22.73 per head, as we have industry data confirming this is already conservative and below what is currently being achieved on the mainland.

Projected net margin for year 1 is over 6% - for the purpose of this exercise I have reduced to 5% to make some allowances for variations in other incomes such as functions and memberships.

F&B is the main source of income and the above demonstrates even with a significant reduction in visitors, it can still remain profitable.

Gross Profit Margin

Overall projected Gross Profit margins are approximately 60%. The projected margins are within IBIS industry guidelines with purchases of 40%.

Once again I believe the margins to be conservative, as clients have allowed a gross margin of 70% on drinks and 50% on food. These margins are currently being achieved or bettered on mainland hotel sites. It is anticipated margins can be improved further, as a premium can be charged being an island destination.

Margins are improved after Year 1 & 2 which is expected as costs become more refined and other revenue streams come online.

Net Profit Margin

Net Margins projected are with Industry averages described above.

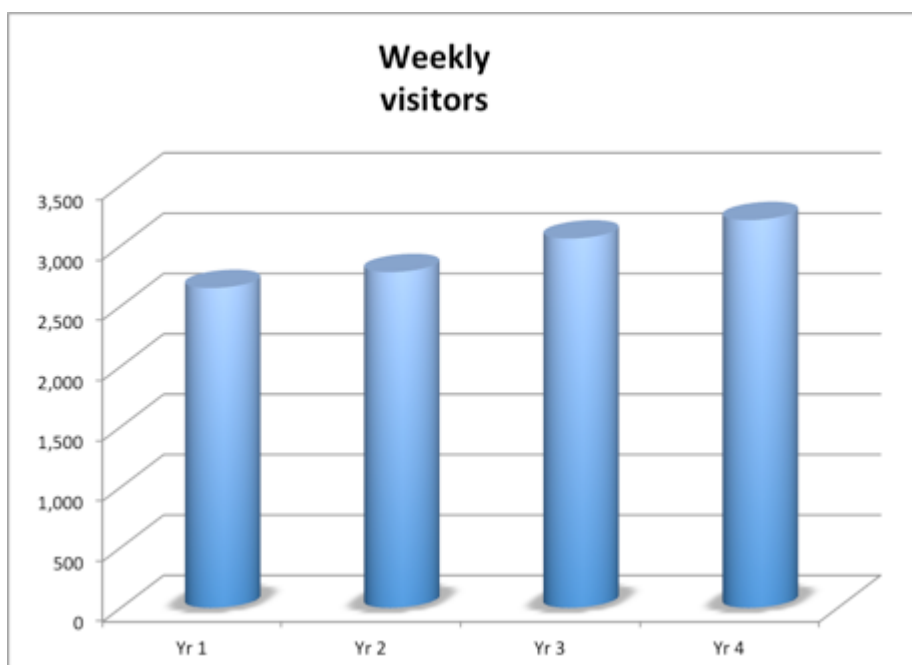
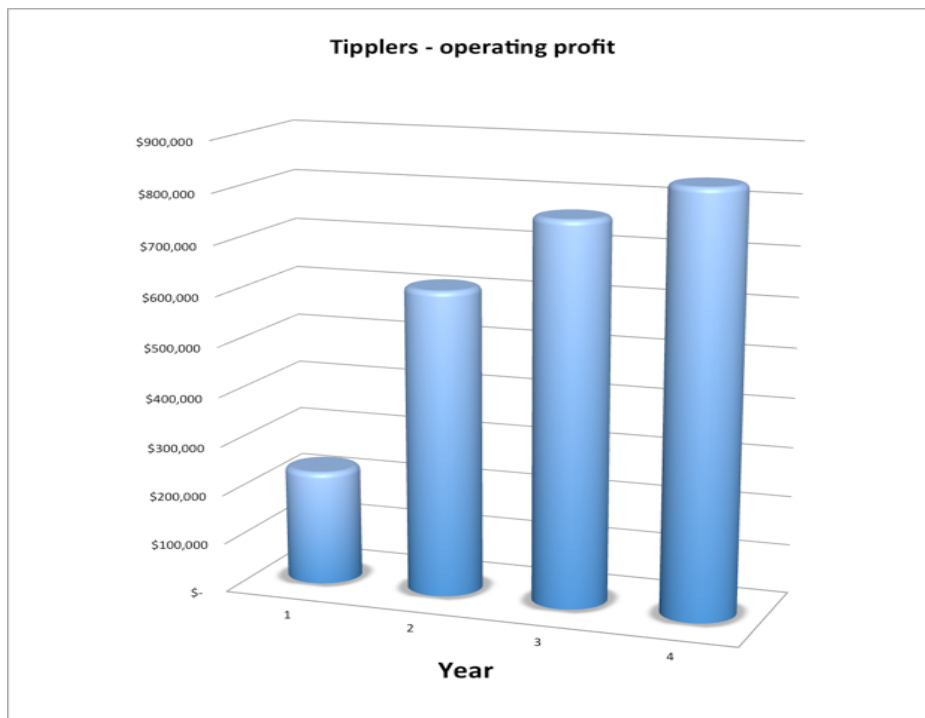
As stated above, in times of slower economic activity, as average expenditure per patron generally declines, losses can readily escalate, especially given with high property holding costs, such as interest and lease costs, and other fixed costs.

Whilst this is acknowledged, the testing on the revenue line would suggest numbers are very conservative and I would consider that the numbers presented reflect a worse position opposed to a bullish view. With this in mind Net Profit as a % of sales will be higher as numbers of visitors increases.

Once again, I would expect margins to be greater than industry average, due to the nature of being located off the mainland.

In addition to the conservative nature of the margin, we have also made an adjustment to the Net Profit year 1 – discounting any F&B income that could be generated from Cabin Occupants.

To illustrate the growth over the future years the following is provided



The above demonstrated the visitor growth will assist in increasing profitability, however the projections are based on gradual growth.

I would expect based on the assumptions of traffic and spend per person, both graphs will be steeper based on actual numbers over the coming years.

Expenses

Staff

Typically for any service industry, the need to provide customer service over extended hours and for seven days a week, employee wages and salaries and on-cost and payments to employment agencies for staff are the major cost. According to the recent IBIS report, staff costs should account for approximately 17.9% of revenue.

In regards to this proposal, wages represents approximately \$28 per \$100 in income. This assumption is based on the equivalent of 10 FTE, which again we consider to be conservative. The redesign of the hotel enables it to be run with minimal staff especially during the quieter mid week period. It is anticipated that majority of staff will be part time and required during peak times, therefore we anticipate this number will be lower.

Key Ratio's

Stock turn

Stock turn is considered low at 9.91 days, this is mainly due to the assistance of well known hotelier who will allow MAG to utilise their stock and ordering system. I consider this is imperative in the early stages to assist cash flow.

Creditors

For the same reason above, Creditor days are low, however the flexibility in payment terms is available due to the relationship between the supplier and the venue.

Funding

I have held preliminary discussions with one of the major Banks about funding this proposal. These discussions have been positive, no formal proposal has been submitted, but we had a verbal indication they were willing to assess the proposal further has been received.

The following issues will need to be addressed in any finance proposal:-

- The Bank will view the proposal as a start up – even though the venue has previously operated.
- The Banks security position will be leasehold land on an island – this type of security is not preferred.
- Given the security above, it is anticipated the Bank will require additional support from stakeholders. As a minimum they will require sponsors guarantees.
- Any facility will need to be provided on a P&I basis over a relatively short period of time (say 5 years). Again, this could be dependent upon the strength of the guarantor's.

The following funding is required (not taking into consideration the potential for Government grants)

Funding	
Outlay	Cost
Hutchinsons refurbishment	\$869,000
Kitchen & bar - Pennant Kitchens	\$250,000
200kVa gas generator	\$250,000
Marquee	\$28,970
Total investment	\$ 1,397,970
less Council contributions	
Tradewinds kitchen savings	\$ 300,000
Demolition savings	\$ 100,000
Total funding required	\$ 997,970

If a proposal was put to a financial institution, it would be on the following basis:-

Amount \$1,000,000

Term 5 years

Repayments It is proposed to seek finance on the following basis:-

Year 1 – Interest Only, this will enable MAG to preserve capital while establishing the business.

Principal payments of \$250,000 pa for the following 4 years, I consider this should easily be achieved given the operating surpluses achieved from Year 2 onwards.

Security Sponsors Guarantees

Fixed and Floating Charge over operating entity

1st mortgage over leasehold land of Tiplers Tavern.

Financial Reporting Quarterly Profit & Loss, Balance Sheet to be provided with actual v budgets to be provided and supported by commentary of any variances

Summary In this environment funding from the Bank's may be difficult to achieve, however I believe with the right structure and the willingness of the sponsors to support the proposal – I am reasonably confident a funder can be found.

Summary

In summary, I believe the numbers provided are conservative and represent a worst case scenario once the Tavern is fully functional.

The key to the success of this project is to ensure the projected numbers of people visiting the island are achieved (the revenue then flows from that) which I am confident can be achieved based on the following:-

1. Tipplers was and will be a destination
2. MAG consists of a large group of experienced and successful business people, who will ensure numbers are achieved.

In my opinion I believe the forecasted numbers can be achieved, key points are:-

- Forecasted income is considered to be based on a very low % of the boating/tourism population without any consideration for local day trippers.
- GP Margins are within Industry benchmarks.
- Net margins are within industry benchmarks.
- There is significant experience in the management team, and one could reasonably assume they have the skills and expertise to deliver above forecasts.
- Whilst food and beverage is the core income associated with Tipplers, there are other revenue streams which will help attract more visitors and also diversify the income.

In addition to the above, the planned Stage 2 development (which hasn't been commented on in this report) will further diversify income streams as it will become a destination for education and art, with particular focus on aboriginal history, art, historical displays and exhibitions.

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