The Importance of Net Worth Over Time

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HFTP®
Hospitality Financial and Technology Professionals

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Agenda

- Context
- The Most Critical Key Performance Indicator – Net Worth Over Time
- Unveiling the Consequence of Net Worth – Digging into the Balance Sheet
- The Importance of Capital Income
- The Hierarchy of Capital Income
- Why Do We Need Capital?
- Capital Assessments – Are There Pros and What Are The Cons?
- Debt – Good or Bad, Right or Wrong?
- Best Practice Approach to Capital Planning
- Conclusions and Takeaways
- Q&A

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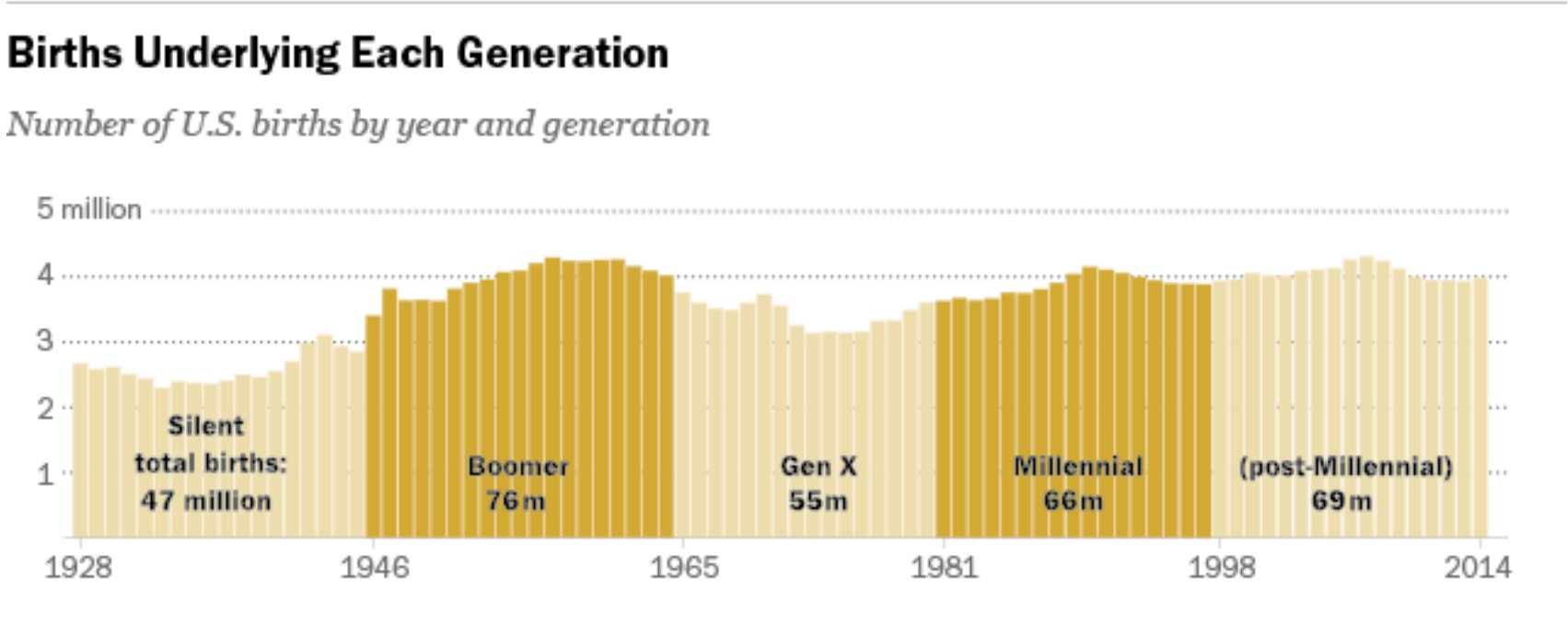
Boomers	**55 – 75**
Gen X	**35 – 55**
Millennials	**20 - 35**



Context

- Gen X 28% smaller than Boomers – they are at club joining age (37 to 52)
- Gen X replacing Baby Boomers who are moving and dying
- Average new club Members (CB research) – 42 Years
- Mass Golf Association Handicaps in 2004 = 100,000 in 2017 = 87,000
- The most STRATEGIC issue in clubs is…where are the new members coming from? Is it discussed enough?

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Context

Financial Insight Model

Key Performance Indicators

Continuous Investment (and Change)	→	Sustainable Success
Diversity of Amenities	→	Relevance
Generating Capital	→	Financial Outcome

Fact-Based Governance & Governance as Leadership

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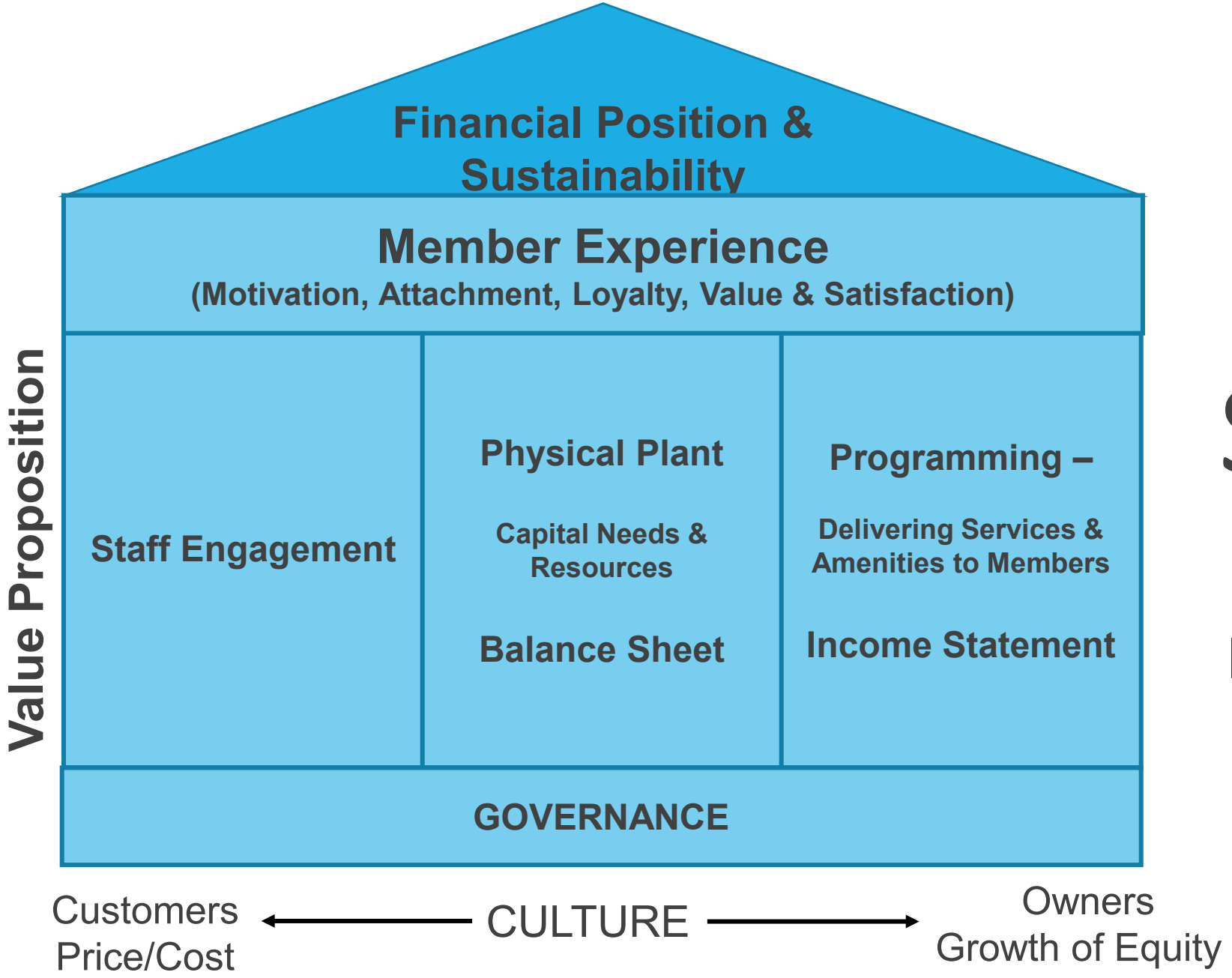
Context

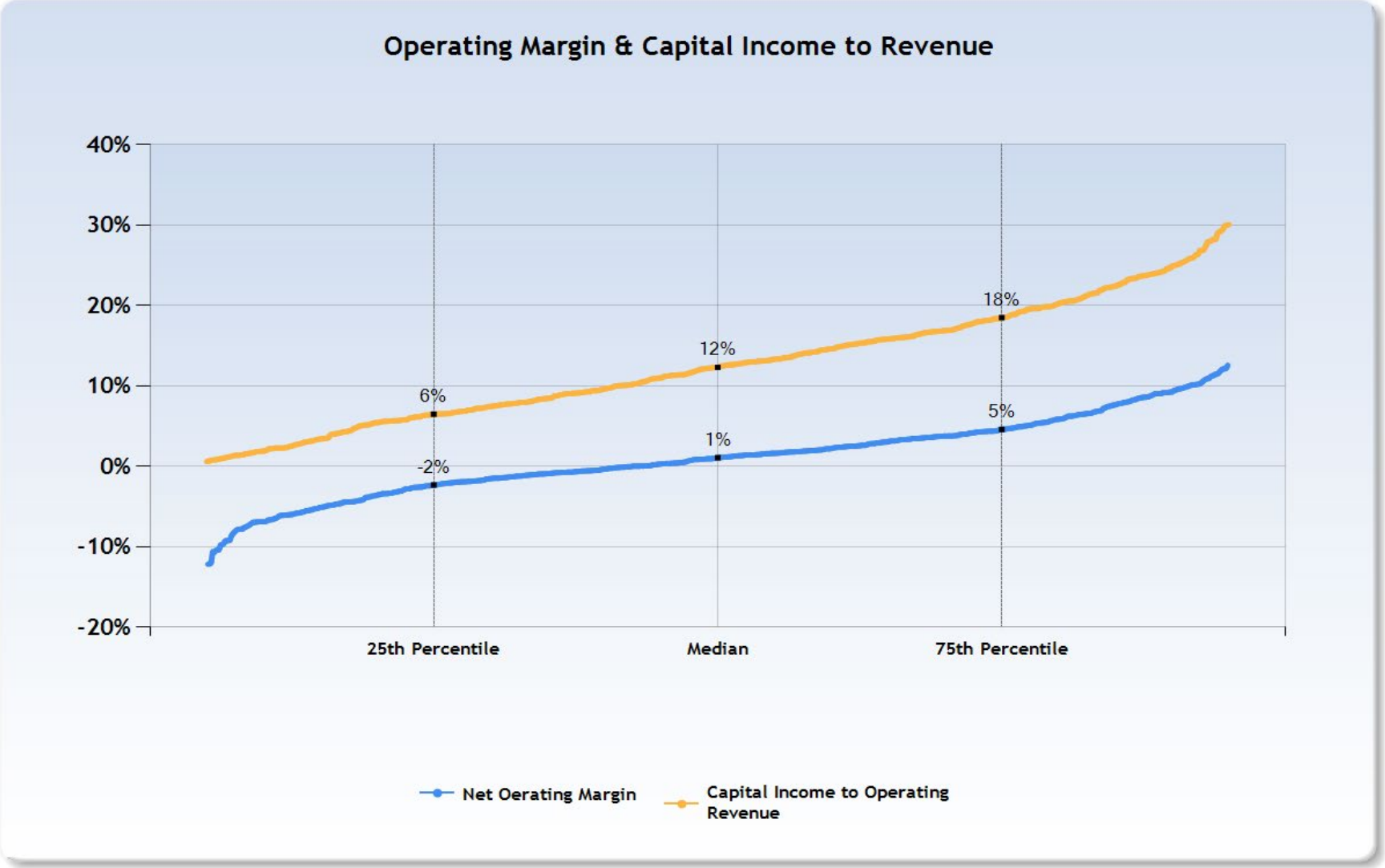


Key Success Factors

In Private Clubs

Understanding Net Worth Over Time

- Clubs set operating budget to break-even – excluding depreciation.
- The operating bottom line pales in comparison to capital income
- Capital income 5X to 10X larger than operating bottom line
- The operating ledger is the vehicle for delivering services & amenities to members. It is **consumed** every year by members enjoying the club
- **Capital income is *THE* financial driver**

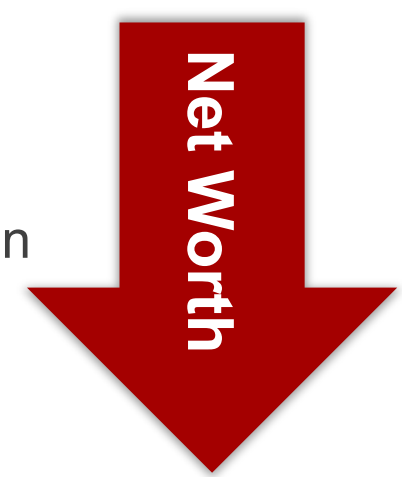


The Industry

Fundamental Concepts

- Unrestricted Net Assets = Net Worth or Book Value of the Club
- Clubs set the Operating Ledger to Break-Even (excluding Depreciation.
- Thus, Net Available Capital (EBDTA) must be greater than depreciation in order for net worth to increase

Net Available Capital
(EBTDA)
Less Than Depreciation



Net Available Capital
(EBTDA)
Greater Than Depreciation

Net Worth growth results from members contributing the necessary Capital

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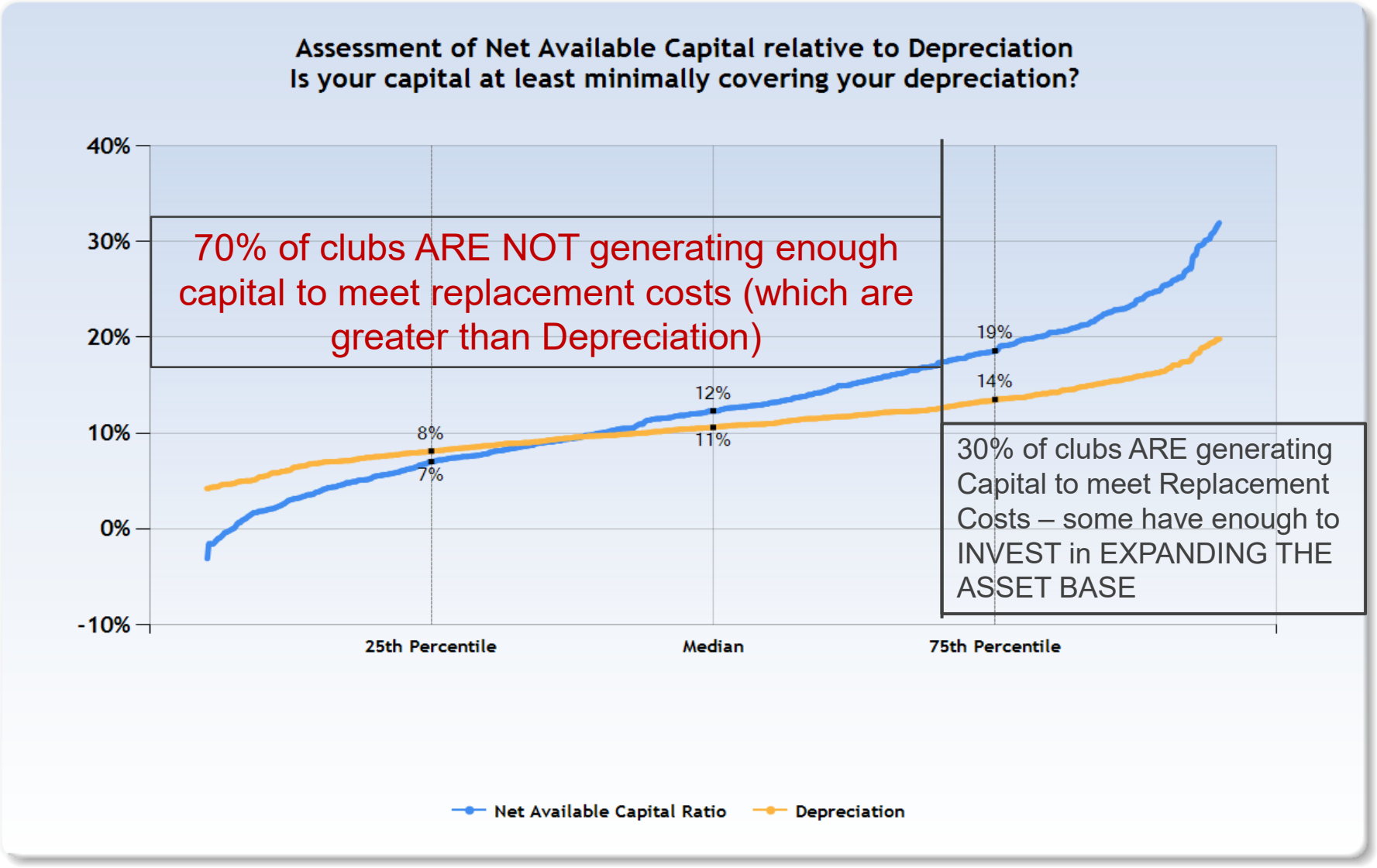
The Driver of Net Worth Over Time

- A forward-looking capital plan (a Capital Strategies Model) is THE MOST CRITICAL financial tool but we estimate less than 15% of clubs have one
- A Capital Strategies Model requires the existence of a Capital Reserve Study



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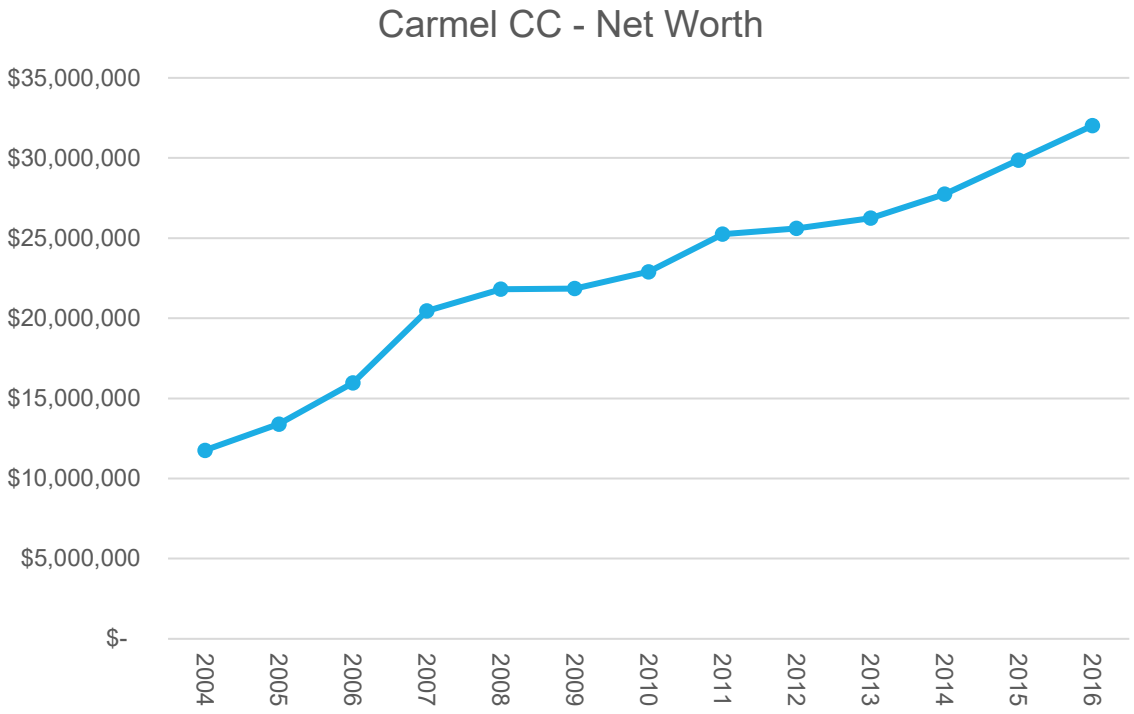
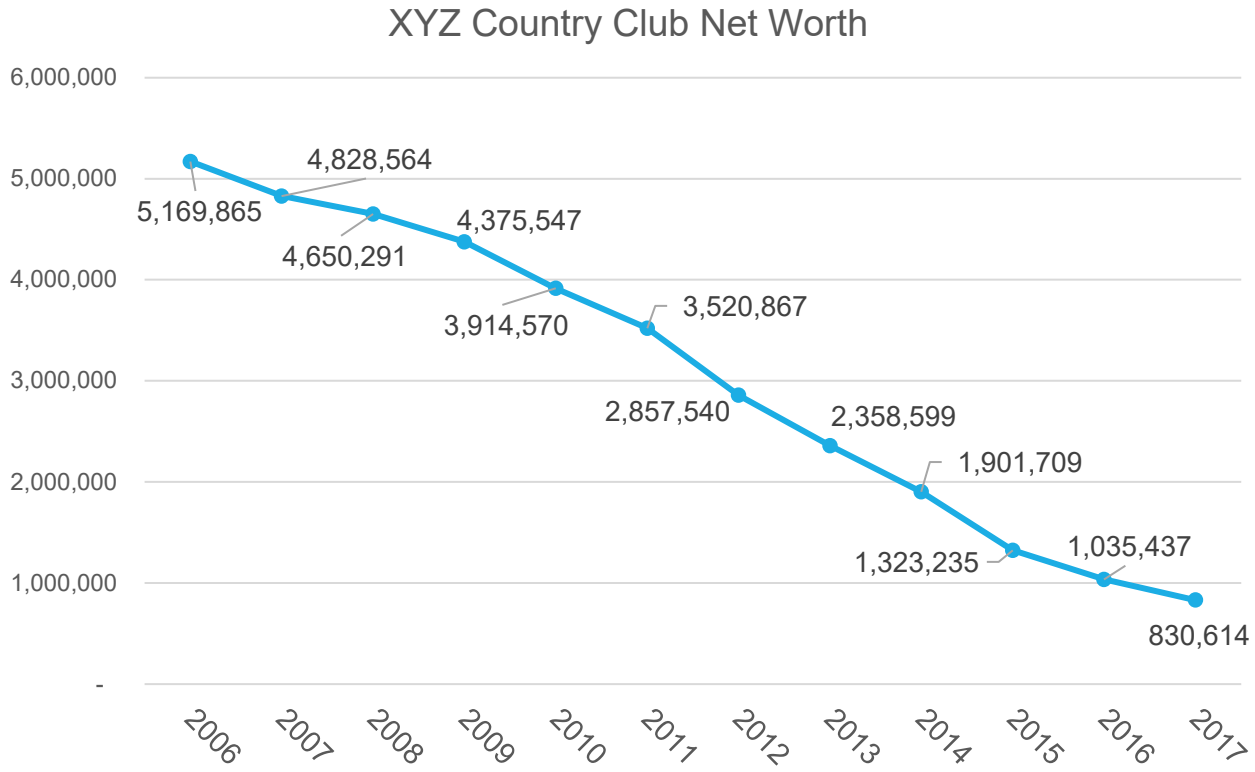
The Driver of Net Worth Over Time

CAGR 8.7%



- Carmel has invested heavily over the last ten years.
- Their Net Worth (Member's Equity) has increased at a Compounded Annual Growth Rate of 8.7% - very close to the top of the industry
- Their Initiation Fee has increased consistently over that period.

CAGR -15.3%



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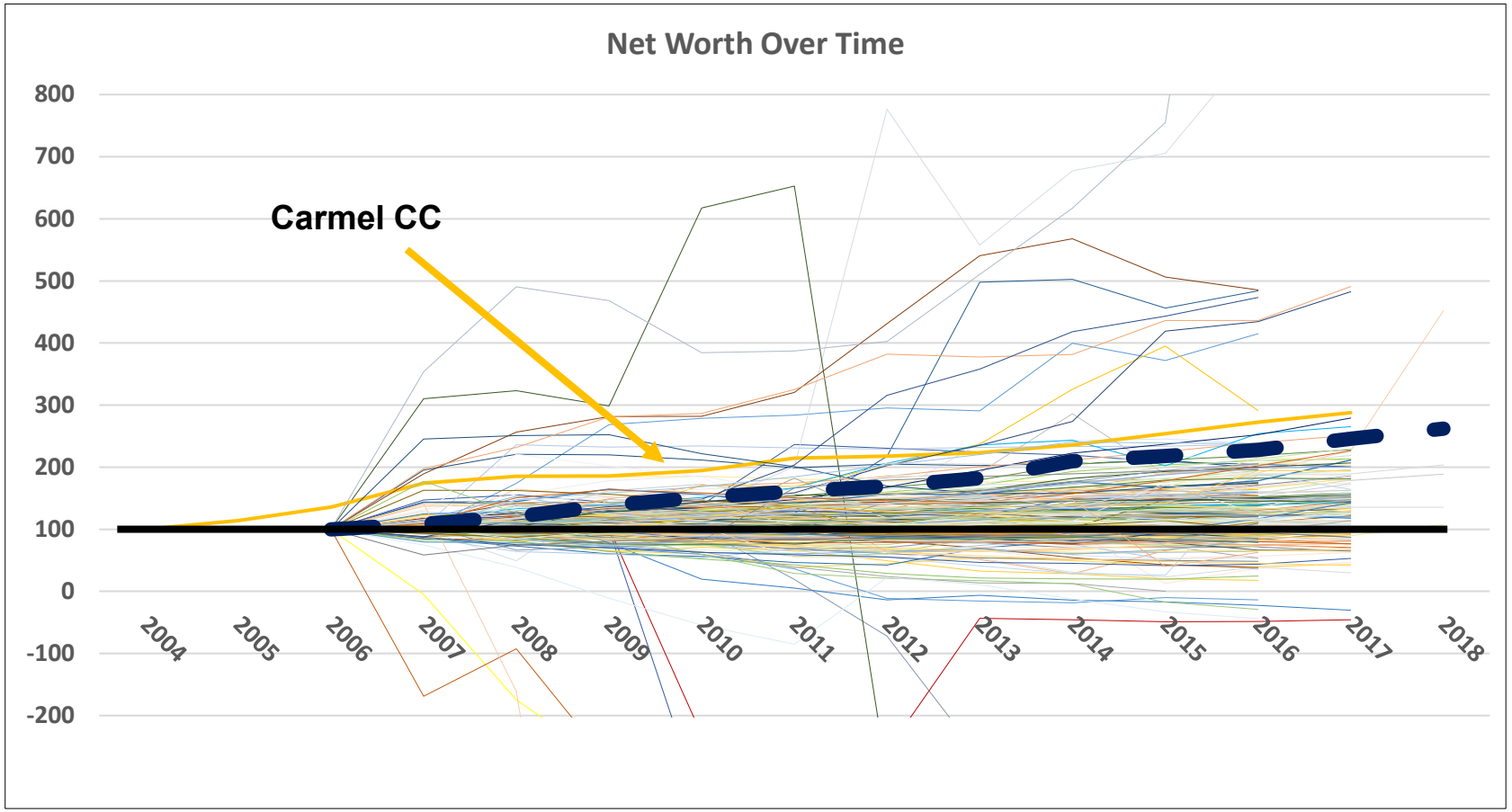
CAGR

25th Percentile = -1%
Industry Median = 2%
75th Percentile = 5%
Carmel CC = 8.4%

30% Net Worth (in absolute terms) is shrinking

50% Net Worth growing less than inflation

38% Meet CB's minimum Net Worth growth of 3.5% per year



Capital Growth Results from Consistently Investing in the Value Proposition Over Time

All Clubs

Carmel

Club XYZ

Assets = Liabilities + Equity

(Unrestricted Net Assets)

30%

21%

87%

70%

79%

13%

From Others (Banks)

From Members & Business (If Ops Surplus)

What We Have

Net Property Plant & Equipment

80%

75%

76%

9%

14%

2%

Cash-to-Assets Ratio

20%

19%

451%

Debt-to-Equity Ratio

The Strength of Capital Manifests on the Balance Sheet

Club Built 50 Years Ago

Total Cost to Build = $3 Million
Zero Reinvestment Over Time

Gross PPE = $3M (ex. Land)
Accumulated Depreciation = $3M
Net PPE = $0
Net-to-Gross-PPE Ratio = 0%

Condition: Worn and Depleted

Property, Plant & Equipment

Net to Gross PPE Ratio

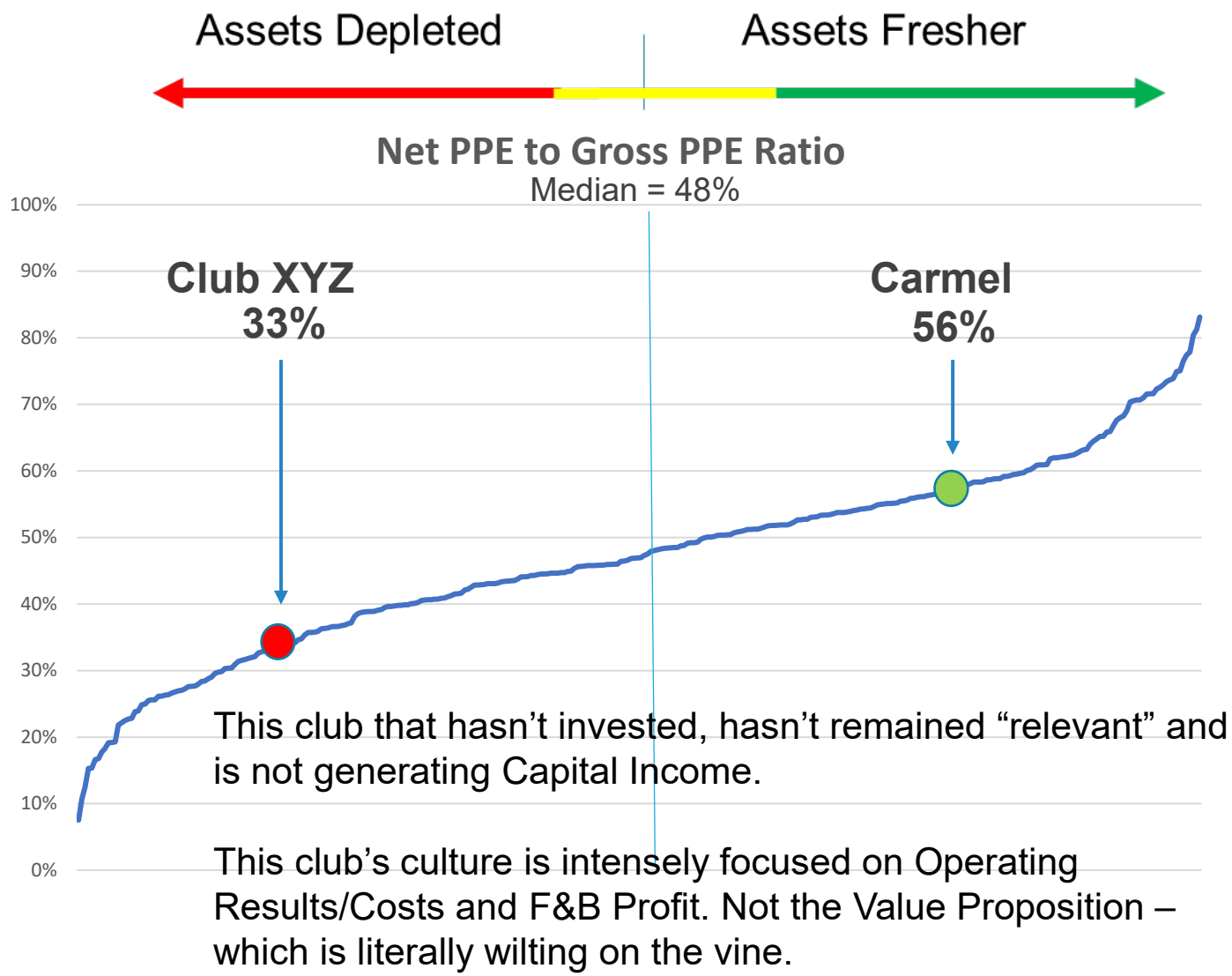
Club Built Yesterday

Total Cost to Build = $30 Million

Gross PPE = $30M (ex. Land)
Accumulated Depreciation = $0
Net PPE = $30M
Net to Gross PPE Ratio = 100%

Condition: Brand New

Fundamental Concepts

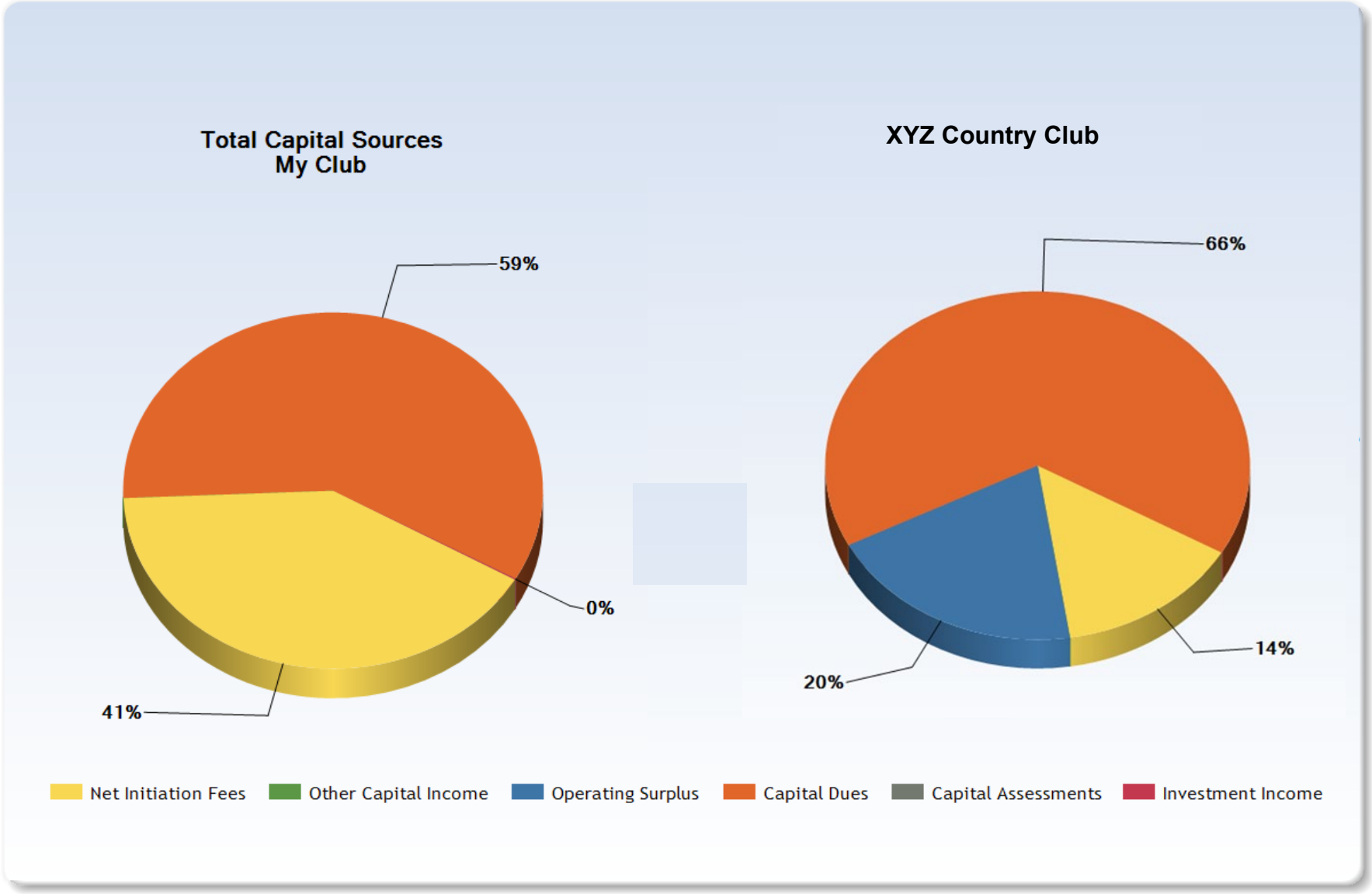


Net to Gross PPE Ratio

- Net PP&E is tied to Member's Equity (Net Worth). Quick, accurate test of physical plant condition.
- Ratio > median = Assets fresher & more up to date. Below median assets are older, more worn & less relevant.
- A precise assessment of your club's physical plant requires a Capital Reserve Study which should be conducted by an objective 3rd party professional well-versed in clubs

The Hierarchy of Capital Income

- **Initiation Fees**
- **Recurring Capital Dues**
  Best Practice: Recurring capital dues tied to precisely quantified future capital needs
- **Operating Surplus**
  Mingling of operating & capital Ledgers
- **Donations & Contributions**
- **Capital Assessments**
- **Sale of Assets**
  (Land, etc.)



Why Do We Need Capital?

- To Make INVESTMENTS in Property, Plant & Equipment
- Clubs invest **REACTIVELY** rather than **PROACTIVELY** due to OVER EMPHASIS on the Operating Ledger in Lieu of the Capital Ledger
- We are so busy scrutinizing last month's Operating Results vs. Budget – we don't have enough time to PLAN FORWARD FOR CAPITAL
- The Capital is invested in
  - **Repair and Replacement** of Existing Assets (**Obligatory Capital**)
  - Expanding and Adding New Assets Related to Expanded or Added Services & Amenities (**Aspirational Capital)**

- Capital Reserve Study (CRS): Physical inventory of every physical asset
- The aim of the CRS is to document and quantify for each asset:
  - The original cost to procure
  - The current replacement cost
  - The condition and expected remaining useful life

Critical Metric: Total Fully Funded Reserve Amount for all assets

Installed in 2000 at $12,000

Replacement Cost 2018 $20,000

Will need replacement in 2020

Current Replacement Cost = $20,000

Fully Funded Reserve = $18,000

18/20ths of useful consumed

2/20ths of useful remaining

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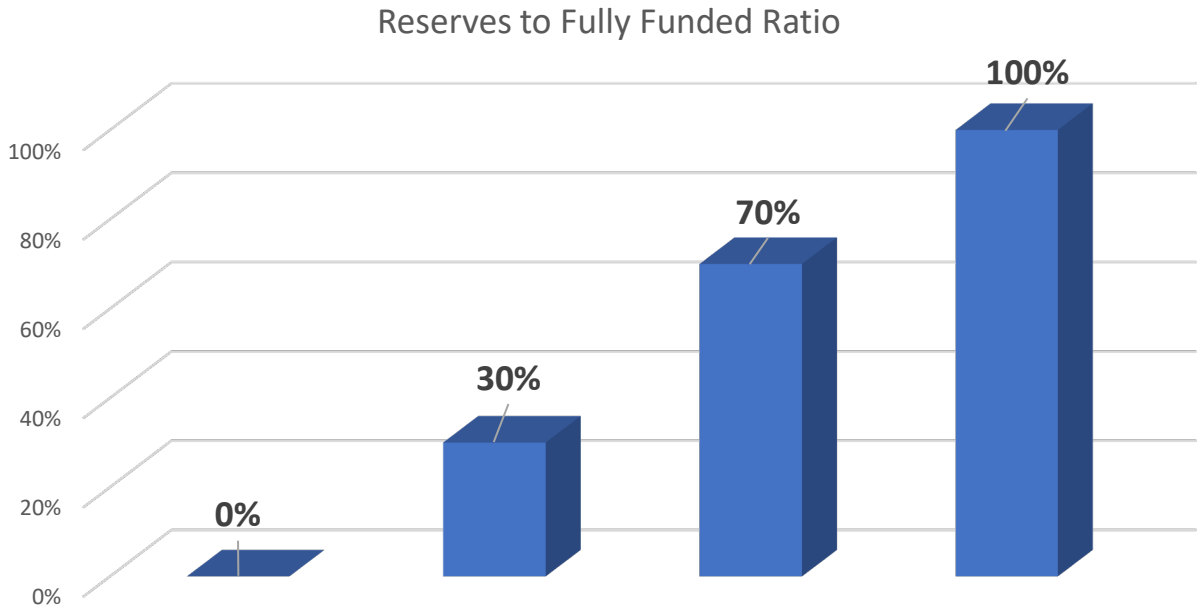

- Club Benchmarking research indicates:
  - Ratio in clubs varies from 0% to 20%
  - Clubs are undercapitalized
  - Clubs have been overly focused on Income Statement and don't address Capital strategically

- POA research over many years concludes:
  - Ratio of 0% – 30% → Extremely high likelihood of future assessments – **Inadequate Reserves**
  - Ratio of 30% - 70% → Likelihood of assessments decreases as ratio increases - **Marginal to Acceptable Reserves**
  - Ratio of 70% - 100% → Future assessment unlikely – **Adequate Reserves**
  - Ratio of 100% → **Fully Funded**

- Current Replacement Cost increases every year due to inflation

- A dynamic, forward-looking model can be used to assess future

Assessing Capital Strength

- XYZ Club's Capital Reserve Study indicates:
  - Excludes Buildings and Land
  - Total Current Replacement Cost = $20 Million
  - Fully Funded Reserve = $6 Million

- If XYZ Club had set aside money equal to capital consumption there would be $6 Million available.

- The Reserves to Fully Funded Ratio is a common metric to assess "capital readiness" or "liquidity" in Property Owner's Associations (POAs) – it has been absent in clubs

- XYZ Club's Reserves to Fully Funded Ratio = $0/6 = 0%

2.1%
10.0%
8.7%
0.0%
0.0%
8.2%
18.8%
10.9%
15.1%
3.7%

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Assessing Capital Strength

- **The Fully Funded Debate**
  - Why should the club hold “my cash” before it is needed?
- **The Real Issue**
  - Capital consumed by a departing member without a match is “debt” for future members…
    It is not a financial issue, it is a FAIRNESS issue
  - Clubs have used debt to fill capital consumption gaps left void by lack of contributions by members in conjunction with their consumption – interest is the penalty
  - XYZ Club’s “Fully Funded” Gap is $10,700 per FME

33,809
11,931
18,678
41,659
19,667
17,600
11,757
6,706
10,987
21,604

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Capital Assessments

- If a club is using assessments and members who have consumed PP&E leave without paying, is that fair?
- Why use an assessment for repair & replacement? If the consumption of the assets could have been matched with **recurring capital dues** then everyone would have paid their **FAIR SHARE**
- Are assessments reactive? Why wouldn't they be PLANNED?
- The one con to recurring capital dues – the club will "hold" members' money in lieu of the member
- In a proper, forward-looking plan, assessments (theoretically) wouldn't happen for repair & replacement
- For aspirational capital, assessments may make sense in lieu of debt. Future members pay with an increased initiation fee (aspirational investments should drive INCREASED DEMAND & HIGHER INITIATION FEE INCOME)

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Debt

Debt for repair & replacement is better than no investment, BUT…

- It is a RESULT OF POOR CAPITAL PLANNING
- Debt makes sense for aspirational investments that will be ENJOYED & PAID FOR by members in the FUTURE
- Debt for repair and replacement is a faux pas and a result of poor planning. Debt is repaid by FUTURE MEMBERS who are thus paying for consumption by PAST MEMBERS. INTEREST is the TAX on that poor planning.

Best Practice Approach

Forward Looking Capital Planning is Critical

- Precisely Quantify future Obligatory Capital Needs (repair and replacement) – A Capital Reserve Study is required.
- Quantify Future Capital Resources (from Initiation Fees, Capital Dues, other)
- Determine Gaps between Resources and Needs – Ahead of TIME!
- Determine methods to Fill the Gap (recurring Capital Dues)

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Conclusions

The Strategic Approach to Finance Is:

- ✓ Understanding How Net Worth Over Time reflects Capital Income and Capital Planning Practices
- ✓ Understand how Net Worth – as a result of Capital Income – ties to Property, Plant & Equipment
- ✓ Use the Quick Ratios to assess where your club/hotel is
- ✓ Embracing the concept that Capital Income IS THE financial driver

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- Clubs that invest properly remain relevant and thus will see suitable rates of net worth growth over time that can be invested in fresh, up-to-date assets that are reflected by an suitable Net to Gross PP&E Ratio
- While it may make sense for aspirational investment, taking on **debt for repair and replacement is a poor practice** and a result of poor capital planning. Debt is a proxy for capital contributions made by members. It will be paid back by members contributing capital in the future. Interest is the tax paid for the poor planning.
- **Assessments** are not “fair” to all. Members who leave before paying haven’t contributed their fair share to cover capital they consumed over time.
- **Best Practice:** Assure there is a forward looking capital plan, centered on a proper Capital Reserve Study, precisely quantifying future Capital needs and resources and assuring the capital income to meet the needs. Recurring capital dues is a very logical answer.

Thank You!

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