

Confidential Report

TO: Council

FROM: Dunedin Venues Management Limited

MEETING DATE: January 2013

SUBJECT: DUNEDIN VENUES MANAGEMENT LIMITED FINANCIAL POSITION

SUMMARY

Following a detailed review of the financial position of Dunedin Venues Management Limited (DVML) there is a need to stabilise company finances. This follows a detailed review undertaken by the Board of DVML, supported by the new chief executive, and the Board of Dunedin City Holdings Limited (DCHL). This paper considers financial options for stabilising the position as part of the Annual Plan process.

RECOMMENDATIONS

- 1 That Council establishes an Events Attraction Fund of \$400,000 pa to secure major events at the Stadium;
- 2 That Council pay an annual call on capital of \$725,000 pa for four years beginning in 2013/14 to be used for the repayment of debt associated with the purchase of the East End seats, Stadium Vision System and the pitch machinery.

BACKGROUND

While DVML was incorporated in September 2009, Forsyth Barr Stadium operations commenced when it opened in August 2011. This left only a month of testing through smaller events before the venue was handed over to Rugby World Cup 2011 for four matches. A month later, in November 2011, the stadium hosted the Big Night In community concert and Elton John. An economic impact report for the Elton John concert concluded that over half of attendees came from outside the City and the event provided an economic impact to the City of over \$14m.

The stadium has hosted an All Blacks test match, first seasons for both the Highlanders (averaging 17,000 attendees per game) and Otago Rugby, as well as two A-League games and Otago United home games. Other entertainment events have been held such as the Rodeo, the community Sunday Market has commenced, and various events such as Masters Games, Young Farmer of the Year, marching, school productions, and OUSA Orientation Week have all taken place.

Off the pitch in the 2011/12 financial year, 120 meetings, 55 dinners and 18 conferences took place in the function rooms at the stadium.

In the next few months Forsyth Barr Stadium will host Nitro Circus, the Hollies concert combined with an equestrian event, the Winery Tour concert, the new Highlanders season, a Warriors pre-season friendly, and a further A-league match. Otago United will also complete

their second season in the stadium, while more community events will take place such as Relay for Life. Further events are also in discussion for this period. Into the next financial year, the stadium will host a Bledisloe Cup test match as well as the second season of Otago Rugby. The acquisition of major concerts has been a challenge, and this is discussed further in this paper.

Away from the stadium, DVML will take over the management of the newly refurbished Dunedin Centre and Town Hall in April 2013.

DISCUSSION

The stadium is being well utilised in a variety of ways, but issues remain with the stability of the financial position. An analysis of the financial results has highlighted the need to undertake a review of DVML's financial performance. There are several aspects to this and each is explained in more detail as follows.

DVML Shareholder's Funds

DVML was established in 2009 and between then and its opening in August 2011, incurred establishment costs amounting to \$3.256m. In the year following its opening, further losses of \$3.214m in the 2011/12 year, as previously advised to Council, brought its accumulated deficits to \$6.470m. This is reflected in its year end 2012 negative shareholder's funds position of (\$6.270m), after allowing for its paid up capital of \$0.2m.

The operations of DVML prior to opening were funded by advances from DCC amounting to \$3.381m. These advances were for the purpose of establishing the company - hiring the CEO and staff, acquiring offices and IT equipment, entering into contracts for services and building the marketing and event attraction capability of the company. As such the costs were very much capital in nature. Having completed the establishment phase, it is now appropriate to convert the DCC's advances of \$3.381m into paid up share capital.

The procedure for doing this is in two steps: first DVML repays the advances to DCC and secondly, DCC subscribes to \$3.381m of share capital in DVML. This will improve the shareholder's funds from negative \$6.270m to negative \$2.889m, before the impact of net income. This transaction requires no rates from DCC nor any cash from DVML as it is a simultaneous exchange of cheques, each of the same amount.

DVML Debt and Cash Flow

The cash flow position was positive in 2011/12 and the company met all its obligations, in spite of the accounting losses. This was because a number of ground members and sponsors paid for their future rights five and sometimes ten years in advance. However this positive cash position will be eroded by the end of this financial year because DVML has to continue to service and repay just over \$2.5m of debt.

DVML carries three lines of debt and the projected balances at 30 June 2013 are:

i)	East end seats	\$1,150,748
ii)	Stadium Vision system	\$1,300,371
ii)	Pitch machinery	<u>\$ 42,485</u>
	Total	\$2,503,604

If support was given to speed up this debt repayment over four years at the rate of \$0.725m per annum the company's annual cash flow would become positive and its ability to pay its rent to service debt would be enhanced.

DVML Revenue and Expense

Much has been learnt from the first year of operation and this will translate into an improvement to revenues and expenses for the 2012/13 financial year. The six month result for this year will be released at the end of February and will show that DVML has made a profit before rent, subvention receipts and tax. With the quantity of events that are occurring at Forsyth Barr Stadium over the course of the second half of the financial year, the projected full year result will certainly be an improvement on the previous year. In addition, this result will include the \$750,000 provided by the Council via a service level agreement.

There is room for some small improvement in revenues for this financial year for the stadium. However bearing in mind the large number of events for the second half of the financial year, it is difficult to see how revenues can be increased much more. Work has taken place on the level of expenses over the last few months following the appointment of the new CEO of DVML and operational savings have been found. While operating costs are tightly controlled, the level of fixed cost for the asset remains high. Both revenue and expenses have been reviewed in some detail by DCHL as part of their review and have been reinforced by the work of the new CEO.

It is a reasonable expectation for the stadium to net in the order of \$3.5m profit per year from operations before rent, subvention receipts and tax. The financial model ultimately approved by Council envisaged a stadium rent at a level sufficient to service debt held by DVL. Rent was set at \$4m per year - close to the amount that was calculated as necessary to service the debt. While DVML accept it cannot change this, it will continue to be a struggle to achieve this level of profitability to pay the rent. Thus if the situation remains the same the stadium is likely to post annual losses in the order of \$300,000 to \$350,000.

There are two key issues that councillors now need to consider. The first is that DVML is carrying a level of debt that requires more cash to service than it generates. The second issue is the need to increase revenue to cover the high fixed costs of operating the stadium.

Options to address these issues are suggested later in the paper.

DCHL Review

In May 2012, Council established a Stadium Model Subcommittee to consider the operation of the Stadium. While the Subcommittee has been working through the community feedback on possible options for generating income, DCHL has been undertaking a review of the position of both DVML and DVL.

Budget Preparation

In preparing the DVML three year budget to June 2016, DCHL have been able to undertake a detailed review of revenues and expenses as part of the process. This has involved interrogating and challenging DVML across all budget lines. It has identified that revenues are at an optimum level, while expenses are tightly controlled.

At the current time the budget is in draft form as it requires guidance from Council as to the options, if any, that it wishes to adopt. Comments on stadium revenues and expenses for the 2013/14 financial year are as follows.

Revenues

Many of the revenue sources for the stadium are fixed for a number of years. This includes elements such as suites, memberships, and various naming rights. Some sponsorships are fixed for a number of years, however others are on a year to year basis. Around 60% of revenue is fixed for the 2013/14 financial year. It should be noted that while DVML is steadily increasing membership numbers and has the capacity to sell more, demand is close to saturation level.

The key component of variable revenue is events. This relates to bowl events including commissions from food and beverage (F&B), ticketing fees and to a lesser degree

merchandising. There is also revenue from the functions business (meetings, incentives, conferences and exhibitions).

One of the challenges faced by DVML has been securing major concert events. While a roofed stadium is attractive, the first question usually asked by a promoter is: "what is the city putting in to attract a particular event, as the city will derive economic benefit?" The competition from venues in both Australia and New Zealand to attract events is high. Most cities in Australasia have some form of event attraction funding available and DVML must compete against this to attract events. While the covered venue mitigates the risk of a weather disruption, promoters see the city as risky in terms of ticket sales due to the demographic of the population re size and disposable income. To counteract this, promoters look for contributions toward advertising and promotion. Promoters also cite the logistics of getting acts and equipment to Dunedin and the additional costs associated with this compared to say Auckland. Without an event attraction fund, the only ability DVML has to incentivise major events is on the venue hire fee, which reduces revenue potential. This paints a simplistic picture and there are more complex issues in relation to securing major concerts which will vary dependent on the event in question. However, the fact remains: DVML faces a challenge to attract international events without an event attraction fund.

An issue that also needs to be noted are the constraints associated with use of the pitch. In the first half of 2013, 23 events or matches on the pitch are confirmed with a further 11 events or matches proposed. This equates to 34 pitch events over 26 weeks and excludes any training by sports teams over and above this high level of utilisation. The focus for increasing revenue from main bowl events is therefore not necessarily about increasing the quantity of events, but improving the profitability of events with, wherever possible, improved scheduling to reduce the risk of excessive wear to the pitch.

In terms of other revenues, DVML will be focussing on improving the offerings for stadium tours and improving commissions on equipment hire such as temporary seating and audio-visual equipment.

Expenses

Operating expenses for the 2013/14 financial year (including business support expenses) are budgeted to be approximately 5.8% lower than projected for the current financial year. This is in addition to reductions made in recent months, such as the reduction in standing power charges.

It is worth noting fixed costs make up more than half of the operating costs. Fixed costs include items such as rates, insurance, contract cleaning, annual compliance costs as well as costs for contracts to maintain warranties on the building elements. About a third of variable costs are event-related costs. Other variable costs largely relate to maintenance costs, but also include supplies, on-site security (e.g. night patrols), health and safety and other utility costs. Initiatives have already been put in place to reduce these in the current financial year.

Reflecting on the amount of usage that the pitch can sustain, an assessment of the cost of pitch maintenance and upkeep per hour of usage has been carried out in comparison with what occurred in a typical year at Carisbrook. This shows that the pitch at Forsyth Barr Stadium is maintained at a lower proportional cost than Carisbrook, even though factors such as the roof and turf reinforcement increase maintenance costs in comparison.

During the review with DCHL levels of staff were reviewed. There are two types of staffing in respect of the stadium: permanent DVML staff; and casual staff that are brought in for events. In respect of permanent DVML staff, a comparison of the staffing structure for the 2013/14 financial year was made with that at Westpac Stadium. In relation to stadium operations, it is always difficult to ensure like for like comparisons. However, it is believed that based on the operating model of the stadium, the organisational structure for DVML is comparatively lean. Further, it should be noted that DVML staff costs have reduced by around 10% since its opening in 2011.

In respect of casual staff for events, these fall under a number of categories. Generally the costs are borne by either the venue hirer or the service provider. DVML's contracted security company provide gate staff, ushers and security personnel. Depending on the type of event,

approximately a third to a half will be volunteers from various community organisations which is a way for these groups to fund raise. For the majority of events there are certain regulations or guidelines that need to be followed which determine the minimum number of staff required. Costs for security are generally borne by the venue hirer. The same applies to cleaning costs. In respect of catering, the caterer bears the cost of providing staff as they receive the revenue.

As such, DVML does not carry a significant cost for casual staff for events. Where such costs are unavoidable planning is based on the type of event and expected number of attendees, and staffing levels are minimised where possible.

Further Opportunities

Along with a continuous review of expenses, there are possible opportunities to increase revenue during the course of the 2013/14 financial year. These opportunities include the sales of additional memberships, open club reserves sales and sponsorships, as well as the upside for the development of stadium tour packages including thrill-seeker type options. However, there is a risk that certain revenues or savings may not be achieved. As such, DVML continues to progress a number of ideas for these opportunities, but has not accounted for them in the budget.

OPTIONS

Addressing the Issues

The review that DCHL and DVML have carried out has identified two key financial issues for DVML.

The first is that DVML is carrying debt that requires stronger cash flows than it can generate and the second relates to the ability to attract major events to the venue. Having consulted with Council officers the options for dealing with these matters are as follows:

Option 1 - Status Quo

The first option is to leave the situation as it is. This will result in annual losses to DVML in the order of \$300,000 to \$350,000 per annum and negative cash flows. This will make it increasingly difficult for the company to find the cash to service debt and pay the rent to DVL. Ultimately, in spite of everyone's best efforts, DCC, as shareholder, will be called upon to provide financial support so that the Company can meet all its obligations.

Option 2 - Shareholder's Funds and Debt Repayment

There are two steps to improving DVML's position on both Debt and Shareholder's Funds.

First, as discussed above, DVML could pay DCC \$3.381m in order to settle the advances made by DCC during the company's establishment phase. The mechanism for doing this is for DCC to subscribe to share capital each year and for DVML to use the proceeds from its share issue to repay debt. The added benefit from these transactions would be to improve DVML's Shareholder's Funds balance by \$0.725m pa, or, over four years, by \$2.9m. This would materially improve Shareholders Funds.

By this simultaneous exchange of cheques of the same amount, the shareholder's advance of \$3.381m would be converted into paid up share capital of \$3.381, so reducing the negative balance as follows:

Shareholder's Funds

At 30 June 2012	(\$6.270m)
Deduct: Shareholder's Advance converted to share capital	<u>\$3.381m</u>
Balance before 2012/13 net income	<u>(\$2.889m)</u>

Secondly, repayment of debt in DVML, as also discussed above, will, by virtue of the mechanism employed and the accounting for it, much improve the company's cash flow and further reduce the balance of negative Shareholder's funds.

Over four years, at a rate of \$0.725m per annum, all DVML's term debt will be eliminated. This improves DVML's annual cash flows by the same amount. Crucially, it ensures that it can meet all its obligations to suppliers and to DVL in order for it to service debt.

The mechanism for conveying the funds from DCC to DVML is for DCC to purchase shares in DVML to the value of \$0.725m each year for four years. In doing so, the balance of Shareholder's Funds increases from its negative balance towards a positive figure.

If support was given to speed up this debt repayment over four years at the rate of \$0.725m per annum, the company's annual cash flow would become positive and its ability to pay its rent to cover the private sector funding would be enhanced.

Under this scenario and subject to the results of the company in 2012/13, according to DVML's budgets, the following would occur;

	<i>Cash flow</i>	<i>Shareholder's Funds</i>
2013/14	\$33,682	(\$3.011m)
2014/15	\$85,818	(\$2.760m)
2015/16	\$311,402	(\$1.463m)

The advantage of proceeding with this option is to improve and secure the overall cash flow position of the company, and indirectly, DVL as well. It will also enable DVML to move towards a positive balance of its Shareholder's funds. It does not, however, address the issue of improving revenues.

Revenues

An option to improve the revenues of DVML is to establish an event attraction fund to be drawn down if required. The quantum of any possible event attraction fund needs to be considered by Council but based on the levels of funding available in other centres, a figure of \$400,000 per annum would be sufficient to attract events with a potential to drive increases in the company's revenue and generate an economic impact for the city.

Aside from additional revenue that would flow to the company, the wider economic benefits for the region are significant. An event such as the Elton John concert for example, had an estimated economic benefit of circa \$14m for the city.

This option does not, however, address the issue of capitalisation and therefore should be considered in addition to the previous option.

Rental

DVML has entered into a rental agreement with DVL to rent the stadium for a term of 20 years at a commercially determined value of \$4m per year. An option that Council may wish to explore is whether there is room to discount the rental. The difficulty with this option is that it simply transfers the debt to DVL which then has to find the cash from either the CCTOs or DCC, both of which may have other priorities.

CONCLUSION

To stabilise its financial position, DVML needs both an increase in revenue and improved cashflows. Based on the requirements, as outlined above, three year draft budgets have been prepared on the assumptions:

- The shareholders advance of \$3,381,065 is capitalised.

- DCC pay an annual call on capital of \$725,000 per annum for four years for the repayment of debt raised to purchase the East End Seats, Stadium Vision System and pitch machinery.
- DCC provide to DVML an annual amount of \$400,000 to be used as an event attraction fund.

Based on these assumptions, the annual net cashflow for DVML for the next three financial years would be as follows:

	2013/14 \$'000	2014/15 \$'000	2015/16 \$'000
Revenue	10,972	11,191	11,335
Expenses	(7,098)	(7,178)	(7,213)
Net profit/(loss) before rent	3,874	4,013	4,122
Less rent to DVL	(4,000)	(4,000)	(4,000)
Subvention/(tax)	28	(4)	(34)
Net profit/(loss)	(98)	9	88
Annual net cash flow	33	86	311



Darren Burden
Chief Executive
Dunedin Venues Management Ltd

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