CAPITAL SUGGESTIONS

It takes money to make money, but it takes smart planning to spend it well. With interest rates low and cap-ex plans evolving rapidly in the wake of Covid, we asked three experts for advice and counsel.

BY RICK KAHL

Capital planning is the dose of reality that makes resort master plans real—and keeps the power on for day-to-day operations. Yes, figuring out where the money will come from for expansion and maintenance projects can seem a burden. It's essential work, though, and it can require as much creativity as the most imaginative master plan itself. For any resort to succeed long-term, it must choose its expenditures wisely.

And that takes some careful thought. "I've heard it said, 'We are in a high-risk, capital-intensive, weather-dependent business. And in many cases, the federal government is our landlord.' How messed up is that? You've got to have the right mettle to be in this industry," says Kent Sharp, president and CEO of resort planning firm SE Group.

To help us grasp the concept of capital planning, Sharp joined Rick Kelley, former GM of Loon Mountain and COO of Eastern operations for Boyne Resorts, and Steve Rice, of Mountain Advisors, Inc. and a veteran of Intrawest and CNL Lifestyle Properties, to explain it all.

Let's start with the basics. Resort expenditures fall into three main types: ongoing expenses (staff, electricity, F&B supplies), maintenance expenditures (replacing lift tower sheaves, repairing snowguns, and maintaining grooming vehicles), and growth expenditures (buying a new lift, expanding the base lodge). The trick to staying in business is to have enough income to pay for expenses and maintenance, with enough left over to help fund those long-term dreams.

Here's the advice our experts offered:

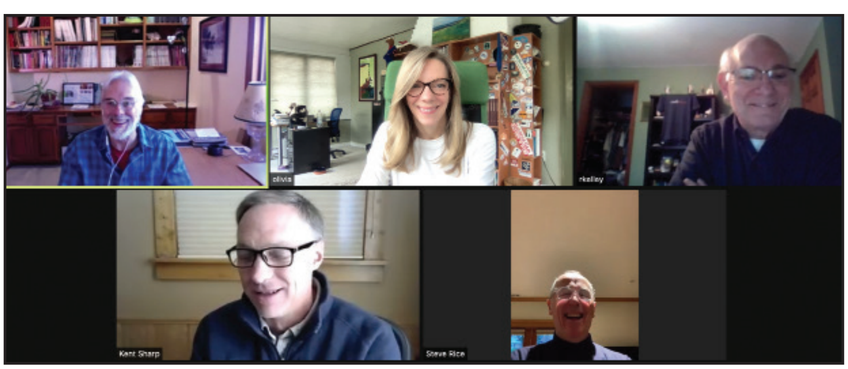
How does capital planning figure into long-term planning?

Rick Kelley: They are sort of hand in glove, in that a good long-range plan has capital iterations every year. And hopefully those capital expenses roll up to a goal of where the resort wants to be. As you're doing things, you have the eye toward where you'd like to end up, whether it's a five-year plan or a 10-year plan, and you're adding incrementally as you go along.

Kent Sharp: Resorts that strategically, and even serially, continue to make capital investments in the facility continue to grow, or at least maintain market share. And then those that don't, don't—they start to lose net operating income and start to then lose the ability to make those capital investments in the facility.

Steve Rice: Extending the useful life of your existing assets is your first and foremost responsibility. You have to do that or you'll end up in life safety issues, let alone a raggedy-appearing mountain that doesn't serve the present needs of your guests. Your guests must have total belief that you are care about them as evidenced by the upkeep of your resort and its perceived safety.

Beyond that, you have to change as the market changes. You have to discern those changes as best you can, and then make sure capital expansionary investments are serving those needs.



Nothing makes these panelists smile like talking about spending money. Clockwise, starting upper left: Rick Kahl and Olivia Rowan, *SAM* Magazine; Rick Kelley, Boyne Resorts; Steve Rice, Mountain Advisors, Inc.; Kent Sharp, SE Group.

What are examples of growth expenditures and maintenance expenditures?

Kelley: There's always a little bit of a gray area, whether an expense is growth capital or maintenance capital, or is it going to be an expense item. A lot of that lies with your accounting practices.

Keep going back to the plan. If it's a maintenance capital item that you're doing, it could help you slowly inch forward. If it's a capital expenditure, that's going to take a larger leap. All of these things should roll up and move you toward your vision. Your guests recognize all those things you do, from the smallest to the largest.

Rice: The definition I always use is, that which extends the useful life of an existing asset is maintenance capital. Growth capital is anything that isn't that, is expansionary and is something to create enhanced or new revenue flows.

Sharp: Or to change the guest experience. Steve's characterization is a really helpful way to look at it. We're working on an existing base lodge facility, and there's so much of a remodel involved—it could be considered maintenance, but if you're doing new things that are going to completely alter the guest experience—seating, food venues, food variety, those kinds of things—you are actually starting to move the needle forward. Always looking at that guest experience piece is really, really critical.

What are some of the key aspects of capital planning and prioritizing that every ski area operator should know?

Kelley: There's a lot of information that's available to resorts today that we didn't have 15 years ago or 10 years ago. Whether it's looking at competitive sets, what's happening with guest surveys, the local communities—there's a lot of information to help resort leaders look at what they want to do and how they want to do it. There are many avenues to get really good data to help make good decisions and create a holistic plan.

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Rice: There's got to be sort of a truth test that you apply to all of your growth capital investments. That new project comes with potential investment costs, including interest, but also operating costs. So first, understand the incremental cost of operating that new investment. If you're building a larger facility, you're going to need more people and more power and so forth to operate it. Then you have to understand, on the revenue side, what are the incremental sources of improved cashflow. If it costs you more to build than you're taking in, the investment doesn't make sense.

This is a discipline that needs to be broken down in very fine P-and-L-related impacts, or you are kind of flying by the seat of your pants.

A lot of resort leaders say, "If I put in a new lift, I'm really not going to increase my visitation, but I'm increasing my costs. So where's the sense in that?" How do you respond to that?

Kelley: There's a couple issues with that. One is, are you preserving the base you have by improving technology? You need to stay in the forefront of having good technology, because that's what people are looking for. The other piece is improving the experience and creating really a much better product. Yeah, there's an ROI that needs to come along with that, but you have much better uphill capacity, you have a more comfortable lift to ride, and again, it's extending the experience for the guest, and in time these investments pay off, because people appreciate them.

Sharp: Keep in mind that demand for skiing and demand from the guest is qualitative and quantitative. We so often get trapped in the quantitative trap of 'what are we going to do for skier visits?' But it's also important to think about the quality of the product, the quality of the experience, and constantly challenge ourselves to ask, 'What business are we in these days?'

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In the '70s and '80s, it was all about get them parked, get them a lift ticket, get them on the mountain, get them a burger, and get them back in their cars and out of here. That's not the business we're in anymore; we're in the business of the overall experience. And skiing is just a small piece of that these days.

How can resorts make that go/no go decision on capital projects?

Sharp: A lot of it comes back to, as Steve mentioned earlier, data-driven decisions, doing a whole lot of great analysis around what a particular capital project will do for the overall operation, possibly in terms of visitation, but more often than not in terms of net margins.

As we lay out a 10- , 15-, or 20-year capital expansion program, we triage through the things that start to move the net operating income needle. What are the things that contribute to margin? We're not just chasing the projects that make money. So if we can prioritize some of the projects that produce the largest increases proportionately in margin, then that income starts to fuel those other capital expansion projects that don't have as much margin associated with them.

There's a lot of money that ski areas have to spend on things that are just so not sexy. A sewer line upgrade—when did that ever cause more skier visits? But it has to be done. If we can prioritize some of those projects that do produce that margin, that helps finance the ones that don't.

Many resorts are very wary of taking on debt. How smart is that?

Sharp: I'm constantly amazed at how many resort operators and owners that are absolutely 100 percent averse to any kind of leverage whatsoever. Granted, it's not a bad position to be in for operating

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in business. And we see a lot of folks do it effectively. But with the availability of capital these days and the price of capital, it's a little bit short-sighted. If you can borrow the money very inexpensively, which you can these days, for sure you can absolutely accelerate the capital investment and accelerate the business.

Rice: If you have built up a nest egg to buy a lift, say, you can still borrow the money for the lift. You can create a safe reserve with the nest egg that will help you sleep better at night. And the leverage allows you to actually do more, for less capital down. It's not just the lift; you need that food and beverage outlet at the top and maybe a food outpost halfway down to really make that pod of new skiing work. Debt is a way you can do that when you are confident in your numbers and confident in the demand that it will uncork.

Capital planning in our business often requires owners and sources of capital with a long-term perspective. Do local banks fit that description?

Kelley: When you build relationships with them, yes. When you're presenting a good plan, you're talking about the positive pieces of how this is going to impact your business. You're obviously enthused about it, but that enthusiasm has to go out to the investors so they see the data and the support you've generated. That's critical in trying to get a partnership with any financial organization.

Bold thinking and careful planning seem like the essential ingredients of a capital plan. Yet how can you follow a 10-year plan when things change so fast as they seem to?

Sharp: Maintaining a nimble stance is key. We talked about not overleveraging and still having some sprint capacity to react to things that the market, the economy, and the weather are going to throw at you, and not stretching so far that it's going to break the organization's back if something comes along next year that you've absolutely got to invest in.

Kelley: A great plan allows you to be flexible. You create a five- or a 10-year plan so you can plug and play as the economy changes, as your business changes, and as your customers' needs change. Good plans can be iterated different ways if the background work has been done.

There are a lot of outside influences that we need to look at as we build our plans, whether it's utilities—is there enough electricity available?—water, sewer; and the permitting process, whether it's local, state, or federal, all those things need to be included in the plan. You need to be out in front of these things with a long enough timeframe to get through these processes, so you're not being held up when you're ready to go. That pre-work is extremely valuable. ■