

Vertissimo

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Vertissimo is a young company specializing in the installation, management and operating of climbing gyms. A climbing gym is typically installed in an urban area, and allows for climber to practice bouldering whatever the weather, as it is an indoor installation. It all started with a group of young climbers who at the time simply wanted to arrange their own place to practice. Their first installation in the French city of Toulouse quickly proved so successful that they had to move to a larger place. This also was the opportunity for them to create a real company and turn professionals: Vertissimo was born. The company is now well established with gyms in 5 medium-sized cities in France.

The company is now facing the opportunity to open a 6th installation near the city of Montpellier (south of France). A large and empty gym is available for renting near a big shopping center: access would be easy with the urban transportation, and the shopping center attracts daily a substantial number of people.

Renting the gym would cost 25,000 € per year. It would have to be equipped with climbing walls, a shop and a relaxing area, changing rooms, toilets and showers. The total investment for the climbing area would be 50,000 €, depreciated straight line to zero over 5 years. The other equipments (shop etc.) would cost 100,000 € and be depreciated over 10 years. Vertissimo always considers that a new gym project should provide a positive NPV over a 5 years time horizon. All equipments are considered worthless in the end of the 5 years period.

Vertissimo offers different pricing schemes to its customers, usually through subscriptions. It is estimated that one person coming to the gym provides 10 € as the entrance fee, and on average 10% additional turnover through purchases at the shop. Attendance varies greatly with the days of the week and the season, but it is estimated that on average 50 persons per day over 360 days per year would visit the gym. Sales, General and Administrative costs (including staff wages) would be fixed at 70,000 € per year. The net working capital is negligible.

Vertissimo is too young to be publicly traded. However, the unlevered beta of the “entertainment” and “recreation” sectors is 0.80. Vertissimo has currently a debt ratio of 36% and does not intend to change it significantly in the future. The company can currently borrow at a 6.50% interest rate (per year). Use 30% as a corporate tax rate when needed. The market risk premium is 7.80% this year, and the risk free rate 2.60%.

Questions

1. What is the required rate of return (RRR) you would use on the investment project (in % per year)?
2. What is the operating cash flow the project would provide every year?
3. What is the project NPV?
4. What is the minimum average operating cash flow that would be acceptable?
5. How many people need to visit the climbing gym everyday to provide the minimum operating cash flow?
6. How would you interpret the previous result? What does it tell you?
7. Vertissimo would borrow 140,000 € over 6 years at its current borrowing rate to finance the initial investment. If the loan is repaid by constant annuity, what would be the annuity value?