It's Never Too Late...To Turn A Profit

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Times are tough in the amusement industry across many fronts. The consumer dollar is being pulled in hundreds of directions by entertainment options that didn't even exist ten years ago, many of which are outside of our industry. Operators are burdened by ever-increasing equipment pricing that costs a fortune and seems to depreciate faster than just about anything short of a desktop computer. Entertainment center owners are further burdened by increasing labor costs (if they can actually find staff), interest and debt service expenses, and fierce competition. Even the stock market, of late, is not cooperating. When the going gets tough, do the tough really get going?

Assessing The Situation

As my father routinely said to me years ago, "the grass always seems greener elsewhere". In reality, while it might not always look pretty, much can be accomplished with the assets that you already own. The trick seems to be getting everything into a position whereby it can perform at its greatest potential. Take the following scenario, for example: early last year our firm began working with a regional game operator, who hired us to assess his company's current performance and level of profitability. Our client was looking to sell the business, and the would-be buyer wanted some independent assurances that the operation was following a course that was both straight and true. In evaluating the various routes, it became clear that, while our client was not doing a good job of rotating new equipment into the game portfolio, he also wasn't making ideal use of the equipment that was already in use. Quality driving simulators were found at locations that did not have the potential to meet even the minimum levels of revenue needed to substantiate their existence, while popular redemption games sat semi -dormant at other sites that we considered quite seasonal in nature. It appeared that once the units came to rest at a location , they remained there for life! To make matters worse, the route accounts that were showing the greatest potential were either short on equipment or contained the incorrect quality level.

Many accounts were overloaded with equipment, albiet mediocre quality, but still overloaded. In almost all cases, roughly 30% of the on-site inventory could have been liquidated in favor of new equipment purchases for locations deemed to be true winners. Many of these same game units should have been sold long ago, when their earnings curve could no longer support the level of depreciation sustained. A few interviews with the route technicians also revealed the unnecessary labor and parts expenses that continually existed to keep much of this marginal equipment afloat, not to mention the dismay of the location owners, who had grown accustomed to offering refunds to customer for games that routinely malfunctioned.

Once we laid it out on paper, the truth became quite clear - our client's investment assets were dwindling away over a series of months and years without any attempt to protect current asset values or earnings. Our client's philosophy was that once the unit was "paid for" through revenue generation, it became a forever asset, until it was eventually scrapped. Unfortunately, this philosophy was shortchanging the client by not recouping the greatest percentage of value possible from these assets. As a general rule of thumb, once the earnings and depreciation curves cross, it's time to convert that unit's cash value into another higher-earning asset.

Plotting The Solution

Before we knew it, the assignment had changed and the purchaser was now inquiring about the company's potential earnings. Could the damage be reversed? The answer was both yes and no. Much could be done to realign the operator's assets, but a great deal had already been lost from an asset value and historical revenue perspective. The decision was made to move forward and we, in conjunction with our client, laid out the task at hand.

The first order of business was to create a valuation model for each location, so that earnings capability could be impartially compared to equipment asset value requirements. Once the model was set, the asset investment at each location was determined based upon not only the location's historical earnings, but its potential earnings. Potential earnings were defined by examining not only the historical performance of each game unit at a location, but the estimated patron traffic, in an effort to determine how much revenue was being "left on the table". A Location Earnings Target was therefore established for each location, from which the type, number, and quality of games units were selected to match the capital investment requirement. Note that during the process, all of our client's game inventory was considered "available", short of a few prior agreements made with location owners for special game lineups. We began with the most profitable accounts and worked our way down the roster. "Profitable" to us means greatest return on investment, not greatest revenues. There is an important difference between the two, as a few of our client's larger revenue producers proved to be only marginally

profitable when incorporating labor costs, revenue split, on-site damage to equipment, historical revenue theft, insurance riders, and equipment quality requirements into the equation.

A not-so-surprising thing happened when the allocations were complete - we had equipment left over - lots of it! Conversely though, our client would also need to purchase a number of higher-quality game pieces dictated by the location model. Fortunately, these purchases were made with very little new cash, as the liquidated trade-in value of the idle equipment covered almost 60% of the new purchases. It should be noted that this fortunate condition existed only as a result of the sheer number of units traded in, which worked out to about 3 trade-ins for every unit purchased.

Labor and route geographics were reassigned during this time period to more appropriately support key operations, and most importantly, reduce unnecessary mileage and service calls. Route management software was also integrated into the revised operation to allow the Company to more accurately monitor itself and identify concerns earlier in the evaluation process. As an early observation, the technicians commented that they were doing less "back and forth" commutation, fewer out-of-order service calls, and were now able to spend a bit more time on location to handle some preventative maintenance (that had historically been put off indefinitely).

Measuring The Results

A bit more than a year has passed since our firm undertook this particular project. For the record, the sale transaction is still on the table but not finalized, as the original negotiated price is now below the realistic market value of the "rejuvenated" enterprise. I believe, however, that the two parties will eventually reach some common ground and complete the deal soon.

While you might not be selling your own business, the moral of this story is that it's never too late to protect your investment. Take a look in your warehouse or storage facility. Are there games sitting idle (in various stages of repair) that could be used on the route or sold to recoup capital? Are you dissappointed in the performance of some operating locations but doing little to change your investment there? Why not try a similar exercise as described above? Making the most out of every asset you own is not only good business, but a solid plan of managing your investments - and your future. So the next time your broker calls looking to trade a few stocks or bonds from your portfolio, take a few extra

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