Budgeting Today

Why Capital Matters

League of America Orchestras
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Approach and agenda

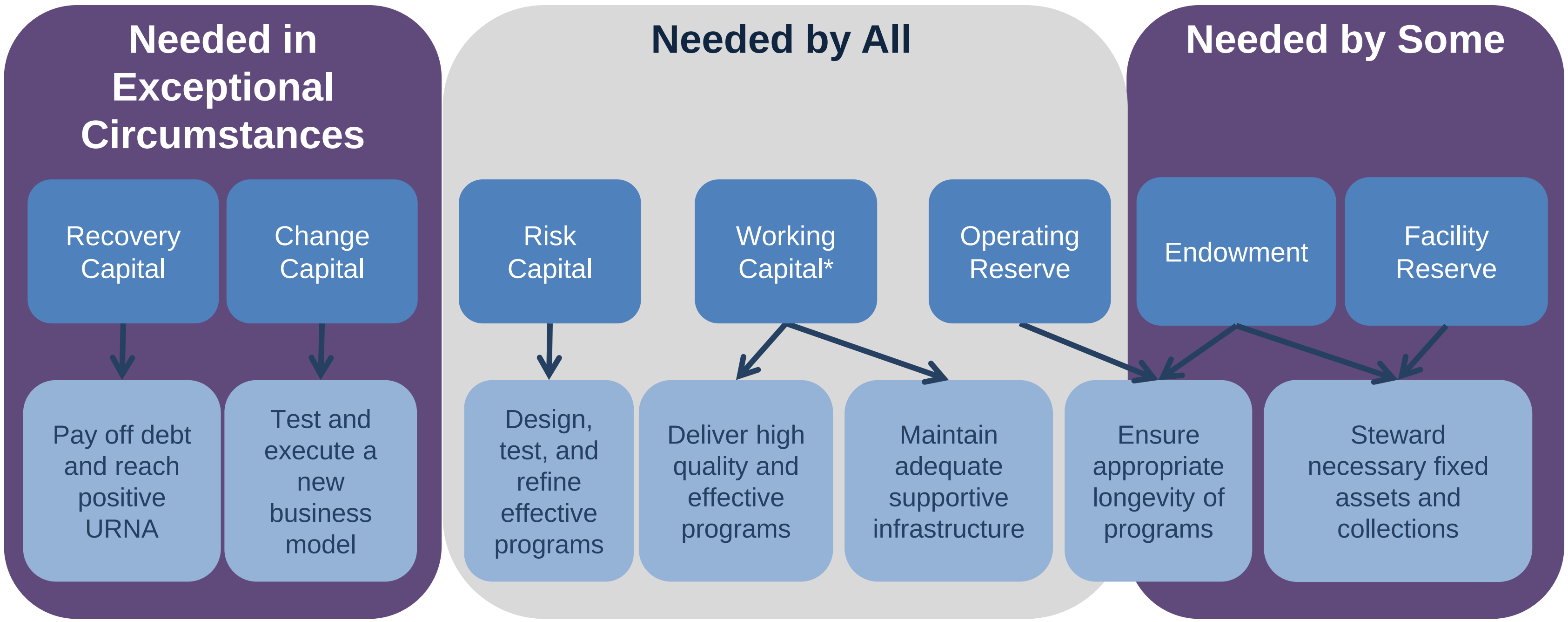
- Capitalization – Why it matters
  - What is capitalization?
  - Why it matters
- Case study
- Multi-year financial projections
  - Principles for creating multi-year financial projections
  - Guidelines and design considerations
  - Managing against your multi-year financial projections
- Capitalization and projections in context: the past three years

What is capitalization?

Defining terms

- Capitalization is the accumulation and application of resources to support achievement of an organization's mission over time.
- In other words, capitalization is having enough of your own cash to do **what** you want to do **when** you need to do it.

Types of capital

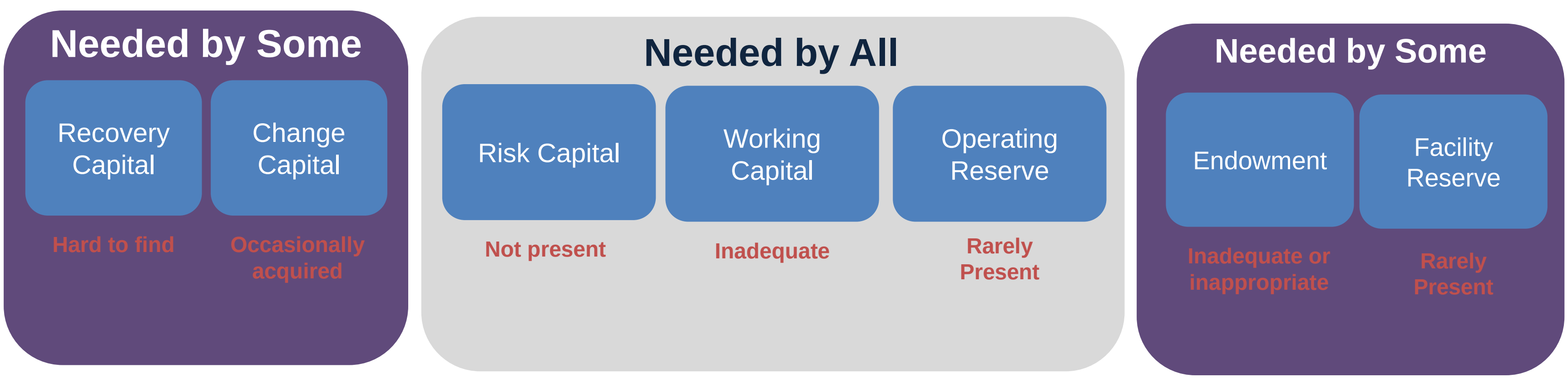


**Sometimes provided via debt (i.e. lines of credit)*

Why it Maters

Pre-COVID, the sector was in distress

- Most organizations have highly constrained capital structures.
- The majority were not ready for Covid or any major shock
- Many balance sheets were eroding from persistent deficits
- The ratio of earned to contributed was shifting



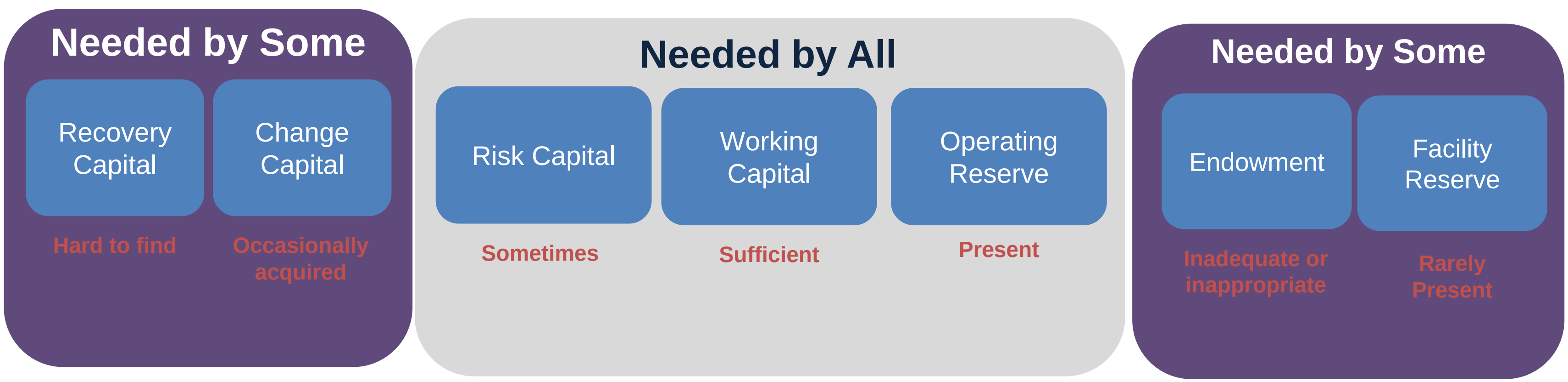
We got rescued

- COVID relief funds bailed the sector out
- Additionally, many organization received large individual donations
- Taken together it covered the loss of earned revenue
- And resulted in a deceptive “strong” financial position
  - Many posted surpluses
  - Balance sheets suddenly looked healthy
- FY24 will likely reveal the true financial state of performing arts organizations

Why it Maters

The Result

- For many core capital buckets have been filled
- But it is from windfall money – not sustainable sources
- How should it be used?



Before: Slow and steady growth of the balance sheet

Now: Investment in rebuilding the operating budget and thoughtful use of temporarily robust balance sheets

How should it be used? – Developing a capitalization strategy

- There are no cookie-cutter answers.
- A capitalization strategy looks at an organization's:
  - Mission and vision
  - Business model drivers
  - Risk profile
  - Marketplace
- With this in mind, the strategy determines the types of funds required.
- It then articulates the necessary size of the funds, the timing of the need, and the method for obtaining the required resources.

The case for multi year projections

Deploying and obtaining capital

The need for reserves and risk capital has increased

Operational Risk

- Program Risk
- External Risk
  - Audiences
    - Audience demand
  - Funders
  - Shifts in the economy
  - Social and racial justice work
  - Pandemic and public health rules
  - Supply chain issues
- Human capital
  - Loss of leadership
  - Salary pressure
  - Difficulty finding staff
  - Pay equity and transparency

RISK MANAGEMENT
(OPERATING RESERVES)

Strategic Risk

- Programmatic
  - Pilots
  - New opportunity
  - Change in core offerings
  - Social and racial justice work
  - **Meta issue: Are we having an audience change moment that we need to respond to?**
- Organizational
  - Marketing/development
  - Facilities
  - Change in scale or size
  - Social and racial justice work

RISK TAKING
(RISK CAPITAL)

Case study:
“Anywhere Symphony”

Case study: “Anywhere Symphony”

- “Anywhere Symphony is a mid-sized orchestra
- They were facing the following challenges pre-pandemic:
  - Compensation for staff was insufficient.
  - While earned revenue was increasing (combination of higher price and increased single tickets), the net was not
    - Subscriptions were declining and marketing costs were increasing.
  - Expenses were outpacing the rate of earned revenue growth creating greater dependency on contributed revenue/
  - There was a core group of very dedicated donors that needed to be expanded.
  - They alternated between modest surplus and deficits over the last few years.
  - Ongoing capital campaigns were fueling the budget
  - Cash was dependent on subscription sales
  - There was no real reserves and risk was covered by donations

Case study: “Anywhere Symphony”

During the Pandemic

- PPP SVOG and ETC
- Increased major donor giving
- Endowment growth from market
- Decreased expense base
- Ticket forgiveness
- One season full lost, two seasons diminished
- Increased cash
- Deferred revenue dependency lessened

Case Study

Income Statement FY17 – FY23

ANYWHERE SYMPHONY STATEMENT OF ACTIVITIES	FY17 Actual Without Restrictions	FY18 Actual Without Restrictions	FY19 Actual Without Restrictions	FY20 Actual Without Restrictions	FY21 Actual Without Restrictions	FY22 Actual Without Restrictions	FY23 Forecast Without Restrictions
	PRE-PANDEMIC			MID-PANDEMIC			POST-PANDEMIC
UNRESTRICTED REVENUE							
Earned							
Ticket Sales - Subscriptions	3,037	2,628	2,645	1,972		1,438	1,771
Ticket Sales - Singles	2,025	2,150	2,745	2,072	11	1,498	1,841
Ticketing Fees + Concessions	1,166	1,546	2,025	1,603	147	813	1,423
Other Earned	70	143	1,167	459	215	435	1,747
Total Earned Revenue	**6,298**	**6,467**	**8,581**	**6,106**	**373**	**4,185**	**6,782**
Contributed							
Individuals	2,690	2,895	2,367	3,357	2,698	2,906	3,300
Comprehensive Campaign Allocation		2,400	2,000	1,100			
Endowment Draw	1,321	1,176	1,179	1,204	1,250	-	2,679
All Other Contributed	3,706	3,187	2,529	2,183	2,390	2,495	7,122
Total Contributed Revenue	**7,716**	**9,658**	**8,075**	**7,843**	**6,338**	**5,401**	**13,101**
Total Revenue	**14,015**	**16,125**	**16,656**	**13,949**	**6,711**	**9,586**	**19,883**
EXPENSES							
Program Services							
Performances	6,985	7,265	8,234	7,473	1,881	6,839	10,470
Marketing	1,603	1,663	1,927	1,970	931	1,748	1,723
Education	351	244	296	380	288	467	884
Operations	3,363	2,830	2,986	2,604	1,139	2,293	3,689
Total Program Expenses	**12,302**	**12,003**	**13,442**	**12,427**	**4,239**	**11,347**	**16,766**
General and Administration	1,672	1,738	1,932	1,790	2,539	3,883	3,445
Fundraising	729	1,286	1,213	1,024	1,096	944	941
Total Expenses	**14,703**	**15,027**	**16,587**	**15,241**	**7,874**	**16,174**	**21,152**
CHANGE IN UR NET ASSETS BEFORE EXTRAORDINARY	**(689)**	**1,098**	**70**	**(1,292)**	**(1,163)**	**(6,588)**	**(1,269)**
Pandemic Support (PPP, SVOG, ETC, Gifts)	-	-	-	1,385	1,377	8,076	214
CHANGE IN UNRESTRICTED NET ASSETS	**(689)**	**1,098**	**70**	**93**	**214**	**1,489**	**(1,055)**

Case Study

Balance Sheet FY17, FY22, FY23

ANYWHERE SYMPHONY BALANCE SHEET	FY17 Actual Without Restrictions	FY22 Actual Without Restrictions	FY23 Forecast Without Restrictions
ASSETS			
Current Assets			
Cash and Cash Equivalents	592	3,114	2,059
Receivables	533	2,158	2,158
Prepaid Expenses	769	612	612
Long-Term Assets			
Property, Plant, and Equipment (net)	30,031	25,677	25,277
Investments	1,461	-	
Due from (to) Funds, Net of Current	-	1,043	1,043
Total Assets	**33,385**	**32,604**	**31,149**
LIABILITIES AND NET ASSETS			
Current Liabilities			
Accounts Payable and Accrued Expenses	1,555	1,914	1,914
Fee Advance	1,444	2,621	2,555
Deferred Revenue	1,215	288	354
Long-Term Liabilities			
Notes Payable, Net	3,053	3,053	3,053
Total Liabilities	**7,267**	**7,876**	**7,876**
TOTAL NET ASSETS	**26,118**	**24,728**	**23,273**
TOTAL LIABILITIES AND NET ASSETS	**33,385**	**32,604**	**31,149**

Case Study

Capitalization FY17, FY22, FY23

CAPITALIZATION ANALYSIS		FY17	FY22	FY23
	Liquid Unrestricted Net Assets			
	Net Assets Without Donor Restrictions	26,118	24,728	23,273
less	Property, Plant, and Equipment (net)	30,031	25,677	25,277
plus	Notes Payable, Net	3,053	3,053	3,053
	Liquid Unrestricted Net Assets	**(859)**	**2,104**	**1,049**
	Months of Unrestricted Operating Cash			
	Cash and Equivalents w/o Restrictions	592	3,114	2,059
less	Deferred Revenue	1,215	288	354
divide	Monthly Expenses	1,225	1,348	1,763
	Months of Operating Cash	**-0.51**	**2.10**	**0.97**
	Capital Allocations			
	Liquid Unrestricted Net Assets	**(859)**	**2,104**	**1,049**
	Working Capital		1,348	1,049
	Change Capital		757	
	Operating Reserve			
	Facility Reserve			
	Risk Capital			
	Endowment - Restricted	*21,579*	*29,100*	*26,704*

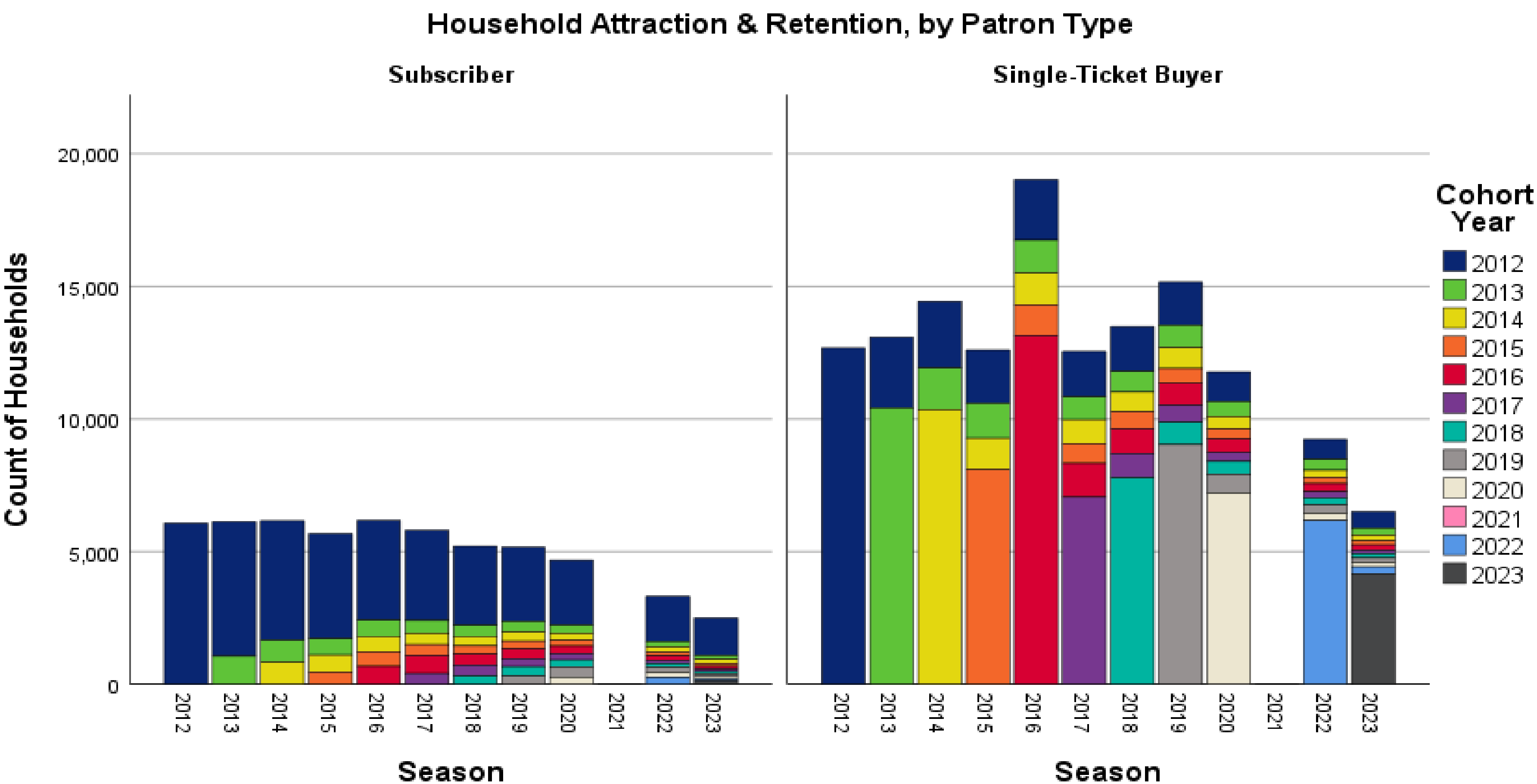
Strategic issues

- Coming out of Covid:
  - Inflation is driving costs
  - Audience return feels opaque
    - Good news recently
    - More single ticket sales
    - New subscribers at higher rate
    - Some evidence of younger and more diverse audience
  - Programming against equity goals has unknown results
  - The endowment has seen significant losses
  - Replacing government funding feels difficult
  - Donor are standing strong.
  - Capital Campaign is almost ready
  - There are reserves and the Campaign is contemplating adding to they
    - Aren't sure about how much and for what ?

Case study - Audience and Inflation

A deeper dive

Total patrons on the decrease since 2019: the 2012 cohort is the dominant one, and missing the 2021 cohort will have permanent ramifications



***Note: the 2023 season is ongoing. Data is as of 2/16/23.**

Subscribers and single-ticket buyers have different retention and spending patterns

- Subscribers
  - Existing older cohorts (2012-2019 cohorts) have high year-on-year retention rates after their cohort year (steadily over 85% for the 2012 cohort; over 75% in most years for the 2013-2019 cohorts), but the loss of retention in 2022 has brought that down to around 60% on average. This will have a permanent impact on the subscription base. Only 27% of the 2022 cohort was retained in 2023.
  - The median spend in the 2012 cohort (over $600) is far higher than that of any other cohort (less than $300), it will take 2+ households to replace the loss of a 2012 cohort household.
- Single ticket buyers
  - They are unlikely to return the year after their cohort year (around 10% will return), but for those who do return, future retention is high (over 70% for most cohorts).
  - The median spend in 2023 has increased in most cohorts since last season (average median spend increased from $100 to $115).

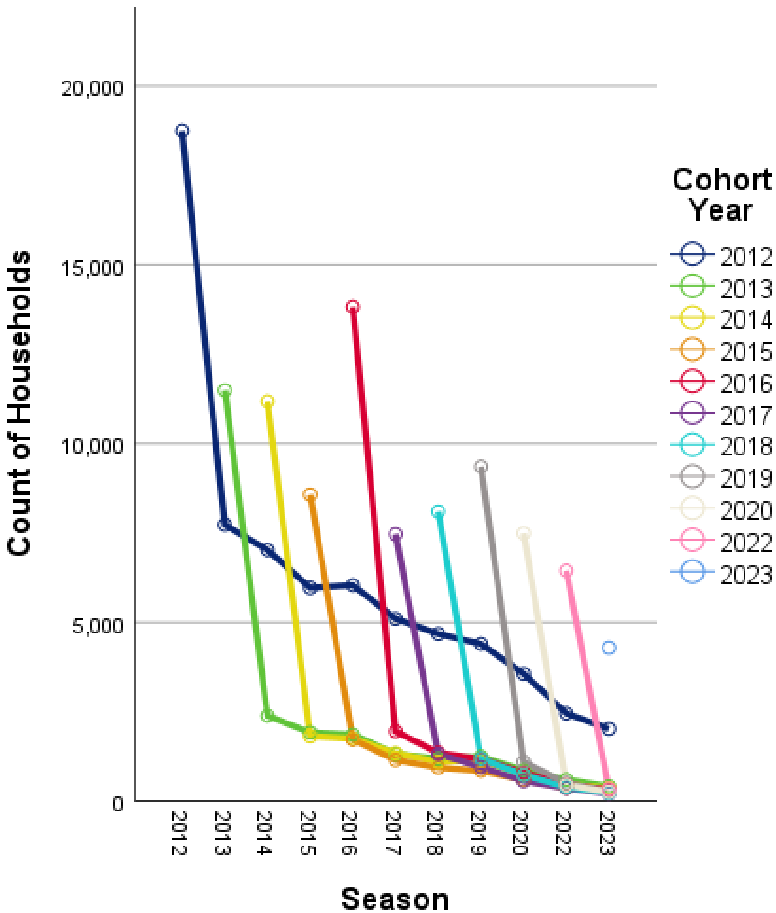
Count of Subscribers

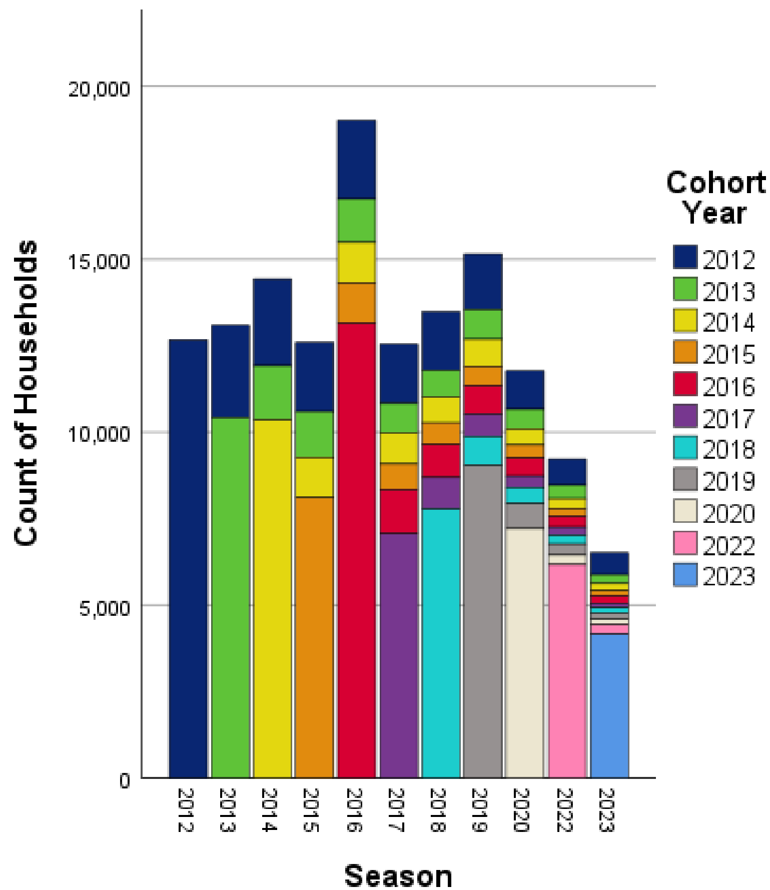
		Season											
		2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Cohort Year	2012	6075	5067	4515	3971	3771	3395	2987	2785	2456	0	1696	1398
	2013		1071	825	598	610	467	410	397	297	0	211	156
	2014			830	639	567	443	365	351	274	0	184	153
	2015				473	565	403	308	289	214	0	143	114
	2016					674	681	417	362	285	0	176	104
	2017						411	401	311	234	0	124	90
	2018							321	351	266	0	137	81
	2019								316	381	0	192	106
	2020									280	0	177	92
	2021										0	0	0
	2022											274	75
	2023												131

Median Spend Trends: Subscribers

		Season											
		2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Cohort Year	2012	423	520	566	600	598	613	635	660	492	0	686	196
	2013		252	278	259	260	266	287	304	237	0	294	134
	2014			277	281	264	270	266	280	227	0	308	147
	2015				296	261	266	266	292	230	0	308	138
	2016					260	260	238	248	201	0	294	134
	2017						281	240	249	200	0	308	133
	2018							263	238	165	0	264	124
	2019								258	201	0	294	124
	2020									204	0	268	120
	2021										0	0	0
	2022											294	115
	2023												98

Overall Buying Patterns: Single-Ticket Buyer Attraction & Retention





The effect of inflation

- What revenue growth is required to keep up with inflation?
  - Roll expenses forward based on a reasonable “inflationary” growth rate
    - You can use different rates for different types of cost
      - Staff Costs – minimum COLA is higher than it has been in the past
      - Artist Costs – the market has changed
      - Direct expenses – inflation is high right now, but won’t stay that way
  - Roll income forward at historical trend growth rates
    - Remove extraordinary income from the trend
  - What is the difference between projected revenue and expense?
    - There will be a need for incremental revenue 90% of the time.
- Step one tells you how much you must grow revenue to keep up with natural expense growth
  - It allows you to think about your theory of staff and artist pay
  - A model that can't pay for natural inflation is not a working model

Inflation FY24 – FY26

ANYWHERE SYMPHONY STATEMENT OF ACTIVITIES	FY23 Forecast Without Restrictions	FY24 Projected Without Restrictions	FY25 Projected Without Restrictions	FY26 Projected Without Restrictions
	POST-PANDEMIC	INFLATION PROJECTIONS		
UNRESTRICTED REVENUE				
Earned				
Ticket Sales - Subscriptions	1,771	1,788	1,806	1,824
Ticket Sales - Singles	1,841	1,859	1,878	1,897
Ticketing Fees + Concessions	1,423	1,437	1,452	1,466
Other Earned	1,747	1,765	1,782	1,800
Total Earned Revenue	**6,782**	**6,849**	**6,918**	**6,987**
Contributed				
Individuals	3,300	3,333	3,366	3,400
Comprehensive Campaign Allocation				
Endowment Draw	2,679	2,759	2,842	2,927
All Other Contributed	7,122	7,193	7,265	7,338
Total Contributed Revenue	**13,101**	**13,286**	**13,474**	**13,665**
Total Revenue	**19,883**	**20,135**	**20,391**	**20,652**
EXPENSES				
Program Services				
Performances	10,470	10,784	11,108	11,441
Marketing	1,723	1,775	1,828	1,883
Education	884	910	938	966
Operations	3,689	3,799	3,913	4,031
Total Program Expenses	**16,766**	**17,269**	**17,787**	**18,321**
General and Administration	3,445	3,548	3,655	3,764
Fundraising	941	969	998	1,028
Total Expenses	**21,152**	**21,786**	**22,440**	**23,113**
CHANGE IN UR NET ASSETS BEFORE EXTRAORD	**(1,269)**	**(1,651)**	**(2,048)**	**(2,461)**
Pandemic Support (PPP, SVOG, ETC, Gifts)	**214**			
CHANGE IN UNRESTRICTED NET ASSETS	**(1,055)**	**(1,651)**	**(2,048)**	**(2,461)**

Capitalization				
Liquid Unrestricted Net Assets	**1,049**	**(602)**	**(2,650)**	**(5,111)**

Assumptions:

- Without a multi pricing and contributed growth strategy revenue grows at 1% YOY, with exception of endowment at 3%
- Expenses grow at 3% YOY

Observations:

- Operating deficit widens over time
- Accumulated pandemic support is exhausted by FY24
- Change capital is likely required

The Approach

Creating Multi-Year Projections

The importance of multi-year financial projections

- Financial planning for long-term goals and strategies
  - Organizational change
  - Building reserves
  - Using reserves
  - Addressing capital expenditure (CAPEX) issues
- PLUS
  - Uncertainty around both earned and contributed revenue
  - Economic pressures – inflation, staffing

Projection scope and ownership

- Multi-year financial projections should be aligned with your strategic plan, programming, and/ or organizational goals
  - Annual operating projections tied to plan and/or season
  - Timeframe
    - Tied to plan or other strategic documents
    - Minimum of 3 years is needed in order to see trends
  - Level of detail
    - Includes key areas where you are tracking change or impact
- Ownership
  - Usually owned by CFO or equivalent with strong executive participation
  - The full board, not just the finance committee, should understand the long-term financial trajectory of the organization
  - The staff should have working knowledge of how the long-term trajectory affects choices in the current moment
- Not a “locked and loaded” budget
  - Forecasts that need to be updated annually

Limitations of historical data benchmarking

- On the revenue side, FY19 captures audience demand prior to COVID constraints, but behavior and circumstances have changed
  - **FY19 should not be used as a goal**
  - Data under FY22 is helpful to understand audience and donor trends
- On the expense side, looking at FY19 as a benchmark helps us understand how core costs have risen when compared to FY23
  - Isolating cost increases that are fundamentally different informs the new baseline costs for your projections
  - Things at play disrupting models:
    - Historic inflation
    - Supply chain issues
    - Wage competition
    - Pay transparency
    - Inability to hire

Step One – Baseline Trajectory

- Determine the revenue growth required to keep up with inflation
  - Roll expenses forward based on a reasonable “inflationary” growth rate
  - Roll income forward based on trends
    - **Remove extraordinary income from the trend**
  - What is the difference between projected revenue and expense?
- Step one tells you how much you must grow revenue to keep up with natural expense growth
  - Tells you how much pricing must keep up with expense growth
  - Tells you how much fundraising has to keep up with expense growth
- Then you need to determine if this growth is possible

Strategic Choices

- Add
  - New programs (revenue and expense)
  - Compensation investments above inflation factor
  - Increased revenue from pricing or donor growth
  - Increased costs above inflation factor:
    - programing
    - marketing and development
    - infrastructure
- Delete
  - Programs or efforts no longer relevant
  - Reduction of overhead

Capital expenses

- Capital expenses matter
  - If you’re breaking even after depreciation, capital expense in excess of depreciation is coming from your reserves – and vice versa
- Include debt principal based on the terms of your debt
- Align to your SRP or planned expenditures to test scenarios
- Draw down dedicated capital funds as they are consumed
  - If timing of pledges and cash is a concern, model them

Use of operating reserves, risk and change capital

- Use projections to determine how much capital you may need by year
  - Change capital for operating deficits caused by the need to change your business model
  - Working capital
  - Operating Reserves
- Determine when the model can go back to generating surpluses and adding back to the reserve
- Forecast balances in each bucket based on projections

Anywhere Symphony: Capital Needs

ANYWHERE SYMPHONY STATEMENT OF ACTIVITIES	FY23 Forecast Without Restrictions	FY24 Projected Without Restrictions	FY25 Projected Without Restrictions	FY26 Projected Without Restrictions
	POST-PANDEMIC	INFLATION PROJECTIONS		
UNRESTRICTED REVENUE				
Total Earned Revenue	6,782	6,849	6,918	6,987
Total Contributed Revenue	13,101	13,286	13,474	13,665
Total Revenue	**19,883**	**20,135**	**20,391**	**20,652**
EXPENSES				
Total Expenses	**21,152**	**21,786**	**22,440**	**23,113**
CHANGE IN UNRESTRICTED NET ASSETS	**(1,055)**	**(1,651)**	**(2,048)**	**(2,461)**

Capitalization	FY23	FY24	FY25	FY26
LIQUID UNRESTRICTED NET ASSETS (URNA)				
Opening Balance	2,104	1,049	(602)	(2,650)
Surplus (Deficit)	(1,055)	(1,651)	(2,048)	(2,461)
Closing Balance	**1,049**	**(602)**	**(2,650)**	**(5,111)**
CAPITAL NEEDS				
Working Capital (target: 1 mo)	1,763			
Change Capital (target: 3 yrs deficit)	6,160			
Operating Reserve (target: 1 mo)	1,763			
Facility Reserve (target: critical needs)	-			
Risk Capital (target: not a priority)	-			
Total Capital Needs	**9,685**			
LIQUID URNA LESS CAPITAL NEEDS	**(8,636)**			
Endowment (target: not a priority)	*26,704*			

Anywhere Symphony – The strategic choices

- What will take to get into balance?
  - What is the role of volume and price? What is the net earned revenue that is realistic?
  - How can the annual fund grow through average gift size, retention and new donors?
  - What programming investments need to be made? What can be stopped?
  - What investments are needed in marketing and development to achieve revenue goals?

- Can your raise the investments required once you can demonstrate the trajectory?

Discussion

Where's the disconnect?

Planning	is internally focused and lacks market context
Financial analysis	is not tied to a larger strategy in support of organizational health
Funders and supporters' incentives	undermine solid capitalization by focusing on isolated projects and breakeven annual budgets rather than reserves and endowment