

IN CONFIDENCE



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Cairngorm Mountain Business Proposal:
Natural Retreats

Economic Impacts

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1. INTRODUCTION AND BACKGROUND

- 1.1 This report outlines the potential economic impacts that might be generated through HIE transferring the operation of Cairngorm Mountain Ltd (CML) to a private operator in 2014. Following a period of negotiation with bidders, HIE is now considering a single operator, Natural Retreats (NR).
- 1.2 HIE is seeking a partner that can deliver a “step change in performance” of CML through “investing for growth, diversification and innovation” at Cairngorm. HIE would continue to own CairnGorm Estate and fulfil its legislative duty to maintain the EU-designated areas in ‘favourable conservation status’.
- 1.3 The existing company CML would be acquired by NR for a nominal sum. The assets (notably the funicular railway, buildings, lifts and equipment) would be leased for 25 years. NR would be expected to comply with defined service requirements and introduce new or enhanced services at the resort. Assets would be maintained and handed back to HIE at the termination of the lease. A base rent and a form of turnover or profit share mechanism is a requirement of the new operator. CML would be cash free and debt free at the point of transfer.
- 1.4 HIE has so far adopted a detailed methodology for evaluating and scoring the final bids, with project management and commercial advice being provided by Ernst & Young.
- 1.5 The source materials for this paper are:
 - NR’s final bid.
 - Economic Impact Analysis reports on Cairngorm Mountain since the introduction of the funicular by Steve Westbrook, the most recently updated version being August 2013.
 - Background data and information made available by CML for these earlier EIAs, including purchasing patterns from CML accounts.
 - The databook compiled earlier this year by Ernst & Young from CML visitor and financial data.
 - Various surveys – including a visitor survey at Cairngorm Mountain and a survey of local businesses carried out for the earlier impact studies, business barometer and tourism reports.
- 1.6 In this paper, we have compared NR’s bid against the figures in the 2012/13 analysis (see Section 2 below) and against the previous 10-year period. Our analysis does not comment upon the commercial implications for the resort or for HIE of CML being taken over by NR. On our analysis, there some **is** degree of uncertainty in the specific activities that might be developed by NR (for example Nordic skiing and cycling/mountain biking) once it has control of the assets. The winter weather conditions that will prevail over the coming years will be of critical importance to profitability but are not possible to predict.

2. COMPARISON BETWEEN NR'S PROJECTIONS AND RECENT EXPERIENCE

- 2.1 NR's financial projections are expressed in real terms with an apparent price base of September 2014 (i.e. the middle of the 2014/15 financial year). Table 1, overleaf, provides baseline 2012/13 data in historic prices as well as adjusted to 2014/15 levels (by adding 5% for inflation) for comparison.
- 2.2 Typically HIE will focus on the third year after a development to assess economic impacts. However, Year 6 (2019/20) is chosen for this comparative analysis because by then the new Day Lodge planned by NR will be fully operational, and the ramp-up in activities (with associated growth in income and employment) will largely have taken effect. Any year before Year 6 would be too early, and there would be no advantage in profiling a year beyond Year 6 owing to the higher level of uncertainty this would involve. We note from its submission that NR assumes continuing underlying growth between Year 6 and Year 25.
- 2.3 The figures in the first column in Table 1 draw upon the August 2013 report on CML by Steve Westbrook. The fte employment total includes rangers paid for by HIE and an allowance for paid director input. Funicular users in 2012/13 were fairly representative of the average for the 5 year period 2008/09 to 2012/13 (129,214 v 129,343). Skier days in 2012/13 were close to the five-year average (103,092 v 102,002). The 11-year average of 74,709, however, was much lower than the 2012/13 total, and, taking global warming into account, might be considered a better baseline for the future average skiing year (were CML to have continued as operator) than the most recent five year average.
- 2.4 The figures in the table for NR in Year 6 are taken from its Income and Expenditure projections. We have reduced NR's total income from £7.131m to £6.660m to exclude projected income from a bike hub and Nordic skiing. This was considered justified (a) because neither of these activities might be viable in practice to provide and would in any case require more detailed feasibility analysis, and (b) because no employment in Year 6 is shown against these two activities in NR's employment projections. Since NR's budgeted staff costs appear to be assumed to be 33% of total income, we have adjusted their staff costs down pro-rata from £2.331m to £2.177m.
- 2.5 Also, we have presented NR's income and staff costs without allowing for its intention to take over the ski school, since the ski school (which is currently operated independently, not by CML) is already generating employment impacts.

Table 1 **2012/13 and Year 6 Projections**

	2012 / 13	2012 / 13 at 2014/15 prices	Year 6 NR
Skier days*	103,092		112,112
Other Funicular users	129,214		144,144
Total Income	£4.400 m	£4.620 m	£6.660 m (<i>adj</i>)
Staff Costs	£1.8 m	£1.9 m	£2.177 m (<i>adj</i>)
Staff Costs as % of Income	40%		33%
Profit	£368,000	£386,000	not comparable
Snow sports Uplift Sales	£1,884,805	£1,979,045	£2,146,348
Other Funicular Sales	£918,523	£964,449	£1,070,302
Catering Sales	£917,412	£963,283	£1,672,153
Retail Sales	£385,837	£405,129	£853,495
Hire Sales	£268,964	£282,412	£286,663
Other Income	£24,000	£25,200	£1,102,028
Fte Employment	90		98

* Skier days to the end March 2013 (78,301 plus 1,907 season pass holders visiting an estimated 13 times). The 2012/13 skiing season extended beyond the financial year-end and so the total number of skier days in the season was higher than the figure shown. The 2012/13 full-season skier day total was 113,582. We have added in season ticket holders for NR in the same way – by multiplying the estimated number of season tickets by an average annual usage of 13.

2.6 We would make the following observations on the table:

- As noted above, we have reduced NR's total income by £0.471m because Nordic skiing and bike hub activities seem not to be matched by projected employment or operating costs.
- The 2012/13 season was typical of funicular usage over the past five years and also reasonably typical for skier days over the most recent five-year period. However, the longer term average (see charts at paragraph 3.11) of skier days reveals a much lower annual number of skier days. In our view, the lower 10-year average for referencing skier days would be more representative and more prudent than the 5-year average.
- A number of comments relating to the Year 6 direct FTE totals are made in the Direct Employment section below.

3. IMPACTS – ASSUMPTIONS AND METHODOLOGY

3.1 The key ratios and assumptions that we have used for this study take account of those from the earlier work by Steve Westbrook, updated to the reference price year of 2014/15 for this study, and with Scottish-level estimates added. These assumptions are:

Gross direct employment:

50% attributable to winter sports;
50% attributable to non-winter sports

Approximately half of CML's current direct ftes over the year relate to winter sports. Some winter staffing relates to non skiing funicular users, but it is assumed from previous liaison with CML that this is more than balanced by winter sports related work at other times of the year, e.g. on maintenance during the summer, fence repairs, season ticket sales etc.

Cairngorm Mountain's operational purchases (from previous actual records) were assumed as:

8.6% in Badenoch and Strathspey
26.4% in the HIE Area
40% in Scotland (new estimate)

It is assumed that these ratios will apply to future operational purchases by NR – although as a company with existing relationships with national suppliers, plans to bring in a Starbucks coffee outlet for example, its regional purchases might be lower proportionately than CML's have been.

Indirect Employment multipliers (based on CML's purchasing records and turnover to employment ratios for purchases and inclusive of induced multiplier effects upon indirect employment) are assumed as:

Badenoch and Strathspey 0.027
HIE Area 0.14
Scotland 0.21(est)

Induced multipliers (for application to direct employment) are assumed as:

Badenoch and Strathspey 0.15
HIE Area 0.3
Scotland 0.4

Average off-site spend per day by skiers (day trippers and overnight stay visitors combined) in Badenoch and Strathspey: £29.50

This average is based on 40% of skier days including an overnight stay, and average spend of £53 "off-the-hill" by overnight stay skiers and £14 for day trip skiers and overnight stay skiers on the day they go home.

Average off-site spend per day by other funicular users (day trippers and overnight stay visitors combined) in Badenoch and Strathspey: £53

Off-site visitor spend to employment ratios (inclusive of the multiplier):

Badenoch and Strathspey £46,000 per fte
HIE Area £38,000 per fte
Scotland £35,000 per fte

Displacement – Skiing Related:

Badenoch and Strathspey 0%
HIE Area 10%
Scotland 20% (new estimate, taking Glenshee into account)

Displacement (direct employment) – Other Funicular Related:

Badenoch and Strathspey 25% (50% for externalities)
HIE Area 40% (80% for externalities)
Scotland 60% (85% for externalities)

Employment Impacts

On-site Direct Employment

3.2 The employment figures below for NR are its Year 6 figures from its submission (P66).

	E&Y Business Review (2012/13)	NR
Gross FTEs		Year 6 FTEs
General Manager	(2)	1
Assistant General Manager		1
Administration	6	
Catering	23	27
Customer Services	11	11
Engineering	23	23
Facilities	3	3
Hire	3	4
Guides	4	5
Marketing	2	
Rangers	2	2
Retail	7	10
Ski Patrol	4	4
Activity Centre	n/a	6
Education Centre	n/a	1
Ski School	n/a	15
Total FTEs	90	113
Total excl. Ski School	90	98
Figures used for impacts		100

- 3.3 In broad terms, for the purpose of impact analysis, we have assumed that NR would employ c100 ftes, i.e. close to its projected Year 6 level of employment. There would not be a linear relationship between direct employment and the number of core visitors, although poor winter sports years would result in marginally fewer ftes.
- 3.4 We would emphasise that the NR employment totals in the table above relate to a typical skiing year, which at c110,000 skier days (see Table 1 on Page 3) is high relative to the skiing numbers achieved at Cairngorm over the past decade. NR has derived its Year 6 skier figures from a baseline which reflects 2012/13 skier numbers (or the recent 5 year average) rather than the longer term average¹.

¹ We make no comment on the commercial implications or business model assumptions adopted by NR, which have been subject to separate scrutiny by Ernst & Young.

Direct Employment Net of Displacement

The table below provides an overview of the effect of applying the displacement percentages listed above to the direct on-site employment.

	Badenoch & Strathspey			HIE Area			Scotland		
	Gross FTEs	Average Displacement	Net of Displacement	Gross FTEs	Average Displacement	Net of Displacement	Gross FTEs	Average Displacement	Net of Displacement
<u>Direct Employment</u>									
2012/13 Comparator	92	12.5%	80.5	92	25%	69.0	92	40%	55.2
NR	100	12.5%	87.5	100	25%	75.0	100	40%	60.0

Indirect Employment

Indirect employment impacts relate to purchases made by the resort operator. The indirect multiplier in the local area would be higher if, say, the operator adopted a policy of high local sourcing for food and drink. The baseline was constructed from a previous analysis of CML's purchase ledgers.

	Badenoch & Strathspey			HIE Area			Scotland		
	Gross FTEs	Average Displacement	Net of Displacement	Gross FTEs	Average Displacement	Net of Displacement	Gross FTEs	Average Displacement	Net of Displacement
<u>Indirect Employment</u>									
2012/13 Comparator	2.5	25%	1.9	13.1	45%	7.2	19.3	60%	7.7
NR	2.7	25%	2.0	14.2	45%	7.8	21.0	60%	8.4

Induced Employment

Induced impacts relate to the spending of wages and salaries by direct employees and the employees of suppliers (indirect jobs). Induced impacts are therefore likely to be higher for more senior employees with higher salaries, if they live and spend locally. If some senior posts within the operating company were to leave the HIE area, or Scotland, then the localities of their spend would change and impact would be lost to the local area and the region.

<u>Induced Employment</u>	Badenoch & Strathspey			HIE Area			Scotland		
	Net Direct FTEs	Induced multiplier	Induced Employment		Induced multiplier	Induced Employment		Induced multiplier	Induced Employment
2012/13 Comparator	80.5	0.15	12.1	69.0	0.3	20.7	55.2	0.4	22.1
NR	87.5	0.15	13.1	75.0	0.3	22.5	60.0	0.4	24.0

Off-Site Impacts

3.5 NR's projected skier days in Year 6 are within 1% of the 2012/13 full-season level.

	2012 / 13	NR Year 6
Skier days	113, 582 ²	112,112 ³
Other Funicular users	129,214	144,144

3.6 NR's Year 6 estimates for other funicular users is 4,930 days (12%) higher than the number in 2012/13. Against the 2012/13 comparator there could be some additional off-site impact – depending on whether the additional funicular users are “additional” to the impact areas.

3.7 The 2013 Westbrook economic impact work estimated an annual spend net of displacement of £3.23m in the Badenoch and Strathspey area and £1.29m net of displacement at the HIE area level in 2012/13. At the Scottish level, displacement would be even higher than the 80% assumed at the HIE area level for non-winter sports visitors' off-site expenditure (85% is assumed for non-winter sports visitors).

3.8 Applying the projected numbers of other funicular users would generate off-site employment impacts in Year 6 as follows:

FTEs Generated Off-Site from Non-Winter Sports Visitors, Year 6

	Badenoch & Strathspey Area	HIE Area	Scotland
	Net FTEs Off-Site	Net FTEs Off-Site	Net FTEs Off-Site
2012/13 Comparator	76.9	35.9	27.7
NR	86.1	40.2	31.0

FTEs Generated Off-Site from Winter Sports Visitors, Year 6

	Badenoch & Strathspey Area	HIE Area	Scotland
	Net FTEs Off-Site	Net FTEs Off-Site	Net FTEs Off-Site
2012/13 and NR	75.7	79.5	90.9

² Skiing season, not CML's April – March financial year which had 103,092 skier days.

³ We have added in season ticket holders by multiplying the estimated number of season tickets by an assumed average annual usage of 13.

Construction Impacts

3.9 HIE has indicated that it is prepared to contribute loan finance towards the estimated £4 million construction cost of a new Day Lodge, and provide up to £1.5m of dilapidation expenditure on buildings and ski tow equipment. Total engineering, refit and construction-related expenditure of £5.5m would provide a one-off boost to the local economy. Broadly, this could support between 35-40 temporary FTEs, inclusive of multipliers. For purposes of comparison with the FTE employment impacts established above, this would equate to around 4 'permanent' FTEs in the Highlands and Islands on the basis that a job can be regarded as equivalent to permanent if lasting for 10 years. The design of the Day Lodge, the home base of the main contractor, and the degree to which local suppliers and materials could be used for the design and works would influence the impacts in practice.

Summary of Net Employment Impacts

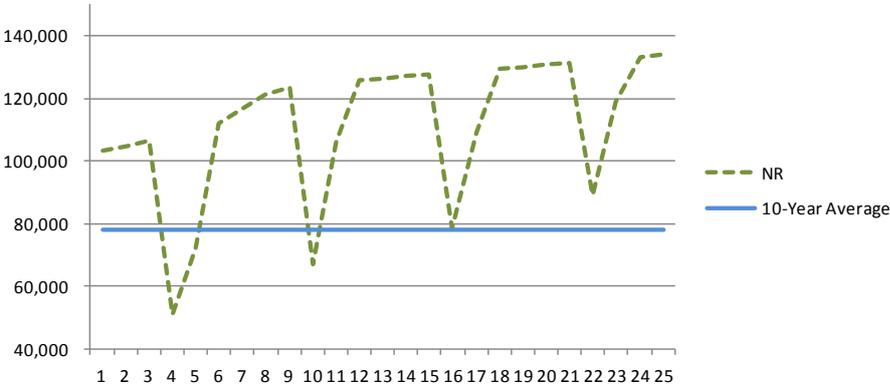
	Badenoch & Strathspey Area	HIE Area	Scotland
<u>2012/13 Comparator</u>			
Direct Employment	80.5	69.0	55.2
Indirect Employment	1.9	7.2	7.7
Induced Employment	12.1	20.7	22.1
Off-site (snowsports)	75.7	79.5	90.9
Off-site (other)	76.9	35.9	27.7
Totals	247.0	212.3	203.6
<u>NR</u>			
Direct Employment	87.5	75.0	60.0
Indirect Employment	2.0	7.8	8.4
Induced Employment	13.1	22.5	24.0
Off-site (snowsports)	75.7	79.5	90.9
Off-site (other)	86.1	40.2	31.0
Construction Stage	1.0	4.0	5.0
Totals	265.5	229.0	219.3

Sensitivity Associated with Multi-Year Averages and Year 6 Employment Projection

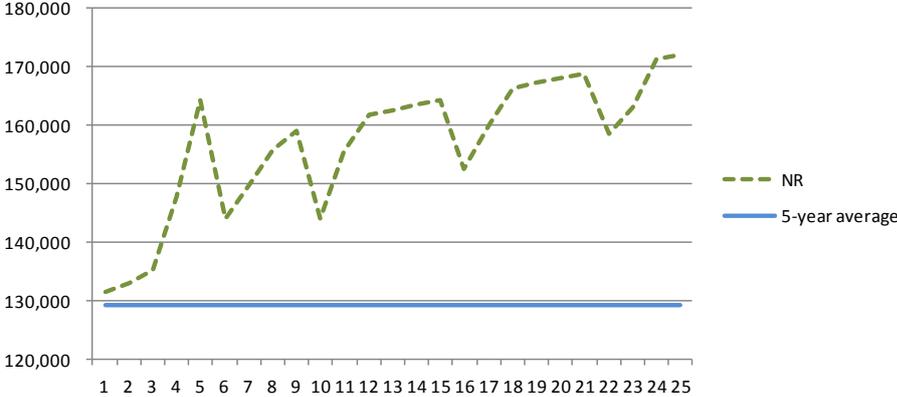
- 3.10 As noted above, we believe NR may be overly optimistic with regard to skier days over time. NR’s projections display a periodic ‘poor’ year followed by a ‘recovery’ year, which, nevertheless, from mid-way through the 25-year period exceed the recent 10-year average in terms of skiing visitors owing to an assumed continual upward trajectory. Based on snow cover over the past ten years, this may represent too high a ‘central’ projection for skier numbers, both in terms of absolute volume and the upward trajectory over time. We understand that commercial considerations and the assumptions underpinning NR’s financial model are addressed in Ernst & Young’s due diligence analysis. In our opinion, this should include assessing the commercial implications for the operator and for HIE if future skiing conditions reflect the most recent ten year average. Indeed, over the next 25 years, the impact of global warming could further reduce skiable days.
- 3.11 NR assumes early growth in funicular passengers, which with effective marketing is considered plausible. However, its longer term upward trajectory seems ambitious against the 10-year trend (funicular numbers have been lower than its early years numbers in recent years).

	5 and 10 Year Averages	Year 6 NR
Skier Days	77,965 (10 yr)	112,112
Other Funicular Users	129,343 (5 yr)	144,144

Skier Uplift Numbers



Funicular Passengers



Sensitivity Associated with Marketing

- 3.12 The greatest contribution of the resort to economic impact is off-site, i.e. through visitor spending in the wider economy on food, accommodation, shopping etc. The off-site impacts of Cairngorm Mountain currently represent over 60% of its estimated total employment impact throughout Badenoch and Strathspey⁴. The most valuable expenditure impact (carrying the lowest risk of displacement) is from new visitors to the area who would come partially or wholly because of the resort. In addition to the quality and reputation of the product offering, marketing is key. The extent to which NR is able to generate genuinely new impact in the area will be greatly influenced by the effectiveness of its marketing.
- 3.13 NR expects to derive higher sales principally through higher spend per skiing and funicular visitor on retailing and catering. In economic impact terms, new visitors will generate the highest impacts. Over the five-year period to 2012/13, CML spent 2.1% of its turnover on marketing. It is not clear how much of NR's Sales and Marketing fee will be spent on marketing and business development activities. With clarity on this point and a more detailed marketing plan, it would be more possible to judge the extent to which NR might attract more new custom from outside the area (either from outside the HIE area or outside Scotland).

Income and GVA

- 3.14 The pattern of on-site income from employment impacts would track the relationship between 2012/13 and Year 6 employment impacts, as would off-site impacts measured in income terms, given our preceding assumptions.
- 3.15 In 2012/13, the direct income from employment and GVA impacts generated by the Cairngorm Mountain business were approximately as follows (at 2014/15 prices). These impacts relate to 90 ftes, inclusive of the 2 ranger posts paid for by HIE. As an approximation, GVA is the total of Employment Costs and Operational Profit.

Gross Earnings	£1.90 million
Earnings net of Employer NI (est)	£1.73 million
GVA (est)	£2.27 million

- 3.16 Gross earnings per fte were c£21,000 and net earnings per fte c£19,000. Applying these as an approximation to the 100 direct ftes that we have assumed NR would be employing in Year 6 would give direct gross earnings of £2.1 million and net earnings of £1.9 million.
- 3.17 It is difficult from its income and expenditure projections for Year 6, for the reasons given earlier, to derive NR's operational profit in the year, but, due to a higher relative proportion of retailing and catering in their annual sales, it is assumed that direct GVA would be c1.5 x Employment Costs (£2.1 million) = £3.15 million.

⁴ Steve Westbrook Economic Impact Assessment 2013.

3.18 In order to estimate earnings from employment and GVA net of displacement for Badenoch & Strathspey, the HIE area and Scotland in Year 6, the following further assumptions are made for construction-related employment, indirect employment, induced employment and off-site employment combined:

Average Gross Earnings per fte	£23,000
Average Net Earnings per fte	£21,000
GVA : Gross Earnings	1.7 : 1.0

3.19 This would give the following net impacts in Year 6:

	Badenoch & Strathspey	HIE Area	Scotland
FTEs (<i>see Table on P10</i>)	265.5	229.0	219.3
Net Earnings	£5.40m	£4.66m	£4.49m
GVA	£9.72m	£8.38m	£8.12m

4. CONCLUSIONS

- 4.1 This analysis of impacts has attempted to compare NR's projected performance with a counterfactual case (continuation of recent operation). In reality, both the NR model and the HIE/CML model would face the same winter weather and snow conditions – which will continue to be the key variable in the resort's commercial operation even after efforts to diversify winter and year-round revenue streams. Our central analysis suggests a modest uplift in terms of employment and income impacts following the instatement of NR – driven principally by a £4m investment in an expanded day-lodge rather than the change in operator per se. The net economic impacts of this investment are, however, limited by high displacement associated with additional retail and catering visitor spend. We make no comment on the commercial (as distinct from the wider economic) rationale for such an investment, or of the merits of bringing in a new operator.
- 4.2 Impacts could be higher than estimated above if certain new activities were to be introduced by NR on a commercially viable basis and helped to retain and attract visitors to Cairngorm. These could include Nordic skiing and / or bike hub activities, which NR included as income streams in its Year 6 projections but without demonstrating viability. Such potential new activity would apply also to CML under HIE's ownership should NR not be appointed, however. Nevertheless, the projected uplift in employment and income under NR could be lower than we have indicated in this impact analysis if the winter snow conditions over the coming decade were to mirror the previous decade. The most recent five-year period has included relatively favourable winter sports conditions, and for this reason may not be the most suitable reference period for forward planning.
- 4.3 Finally, we would point out that were the counter-factual to change, the economic impact assessment would change. In discussion with HIE, the assumption we have worked with is that if NR is not appointed, the Day Lodge investment would not go ahead and business would continue broadly as before with CML under HIE's ownership. The scenario whereby a new Day Lodge would be built under continuing HIE ownership of CML has not formed part of our analysis, although there would be key economic impact variables of interest under such a scenario, including possible investment of financial surpluses generated by a new Day Lodge, e.g. for long-term asset replacement at the resort.