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SATS ASA (SATS.NO)

Q2 2021 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Sondre Gravir
Chief Executive Officer, SATS ASA

Good morning and welcome to our Presentation of the Second Quarter of 2021. My name is Sondre Gravir, the CEO of SATS. And together with me here today, we have Cecilie Elde, our CFO.

We will run a Q&A session in Teams at 10:30 today to allow some more time for those of you following us to look into the report and numbers. You will find the link to this Q&A session on our website under Investor Relations. And if you can't join the Q&A session and have questions, please contact our IR responsible, Stine, directly.

The second quarter has been a mixed quarter, starting with closed clubs and ending with a strong reopening of all clubs. In May, we were finally allowed to reopen our clubs in Denmark and late May in the Greater Oslo area. All clubs are now open, and we see a strong recovery after the reopening. We see strong visit levels, high activation of the existing member base, and strong sales of new memberships.

Our vision in SATS is to make people healthier and happier. And during the pandemic, public health has taken a hit, and inactivity is a serious and growing challenge for the society. Pandemic has also accelerated the focus on personal health and the willingness to invest in this, fueling the demand. Hence, we are now investing significantly in future growth. We have already opened 18 new clubs in 2020 and the first half of 2021 and have signed 19 new openings until the end of 2022, 13 coming already in the second half of 2021. And the expansion will continue. In addition, we are investing in digital growth both on the SATS platform and with the new launch of the home training product, Mentra by SATS, in Q3.

Summarizing the second quarter, we ended the quarter with 254 clubs and 612,000 members. Revenues and EBITDA are heavily affected by the club closure during the first two months of the quarter. But with the strong reopening, we see that revenues going after the quarter is getting back on track. We have a strong underlying member price development, and the PT and retail yield is growing. So, when the member base is back on the pre-COVID-19 levels, financial delivery will be strong. Cecilie will come back to the financials and the underlying run rate in the financial section later in the presentation.

So, let's look a little bit more into the reopening and the development we have seen so far. As I said, all clubs are now reopened, but we are still operating with restrictions in all our countries. Actually, the restrictions have been tighter in this reopening compared to last year. We have described the restrictions on the slide you see here and the relevant dates per country.

I just want to give you some examples on the restrictions. For example, in Oslo, we had to open all our clubs without indoor group training, which is a core part of our business and product offering. This restriction was first lifted June 15. And in Sweden, the heavy capacity restrictions are first lifted tomorrow, July 15, and until now being 10-square-meter available per visitor in our clubs, heavily restricting our capacity. But after tomorrow, we will run with close to normal capacity in all our Swedish clubs. Then, the last example from Denmark. All members still have to have a valid corona passport in order to visit our clubs. This restriction will last until September 1.

But most importantly now, all clubs are open and it has been fantastic to welcome back all our members and employees. The excitement and energy in our clubs has been amazing. And our members are sharing their enthusiasm of being back in the SATS club in social media, to a large extent. And as an employer, I really have to say, it's also been strong and a positive milestone for us to have all 8,500 operational staff back at work.

The visit development after opening our clubs has been strong. We now have experienced from two reopenings after COVID closures. And in many clubs, we see an even stronger recovery than after the reopening last year. In our Swedish and Finnish clubs, visits are even back to a normal levels as we saw from before COVID-19 even with the restrictions in place.

The solid visit development is due to a high activation in the member base. We see that higher share of the member base has been activated now compared to the last reopening. And our active members are visiting us more frequent than they did last year. Hence, it is very clear that our members are eager to return to our clubs and return to their training routines. We also see that members in all segments are returning across age and gender, especially also after we opened indoor GX.

And our members, they continue to spread their visits out in our full cluster of clubs and more throughout the full day. This is a result of increased flexibility with home offices for many members, especially in the larger cities. This enables us to have visit levels above 2019 levels, even with strong capacity restrictions in place and overall ensure safe training experiences with social distancing for the members visiting us.

And now, we are also scaling off our product offering as we see increased demand. As restrictions are being lifted, we can increase the capacity in our classes. And we are also increasing the number of classes in our key clusters. We are now running between 2,500 and 3,000 classes per week in Oslo and Stockholm, respectively, improving our offering in core verticals, like running, strength, and yoga. We will also continue with outdoor classes, which has been highly appreciated by our members. As an example, we have more than 1,000 outdoor classes in Oslo in June.

Through the pandemic, we have continuously made sure to comply with the changing regulatory requirements and offering the best service possible to our members. This has included, among others, digital tools for our members; improved operational routines, for example, on cleaning; digital tracking of all visits; and enabling social distancing in our clubs.

And in SATS, we have large high-quality clubs, and this has been important throughout the pandemic to ensure safe training and has been a competitive advantage for us. And we have seen that our members are appreciating the different parts of the SATS experience. One of many examples is, for example, the air quality in our clubs. In our clubs, in average, the air is replaced five to six times per hour with fresh air, both making it safe and pleasant to work out in a SATS club.

The result of all of the actions we have taken is clear. We have proved safety for our members and staff throughout the pandemic, and we will continue to do so going forward. For example, in Norway, we have had more than 7 million visits in our clubs since reopening last June. There have been 383 cases of members testing positively after a club visit, and only two cases of unknown route of transmissions with no confirmed transmission in the SATS club. This is a track record we are proud of and it's being recognized and appreciated by our members. And safe training and our improved operational routines and the right product delivery have really resulted in this significant improvement in member satisfaction, both compared to last year and compared to the levels we saw pre-pandemic. And this, we are very excited for.

We are also experiencing positive new membership sales across our markets, both in our existing clubs and the newly opened clubs. We are doing selective campaigning but we are not discounting the run rate membership price for new memberships. And the offering is, in general, less aggressive than we had after the reopening last year.

If we look at the paying member base, we see an increase of 7% from Q1 to Q2, both as a result of strong sales and decreased freeze rates with the underlying positive yield development. And keep in mind that, in a normal year, the number of paying members would usually decrease from Q1 to Q2 due to seasonality. And we expect the positive development to continue after the summer.

We also see that the two other important areas of our business, our personal training business and the retail business, is quickly recovering back on track. Our PT business has performed well in June after club reopenings as a result of increased demand in our member base for PT services. And we also have experience an improved recruitment positions for PTs. We have also seen a good growth in retail sales in the second quarter, driven by both increased basket size and increased sales per visits. We see this as an early proof point on the fact that the pandemic has increased the focus on personal health and the willingness from consumers and our members to invest in their health. And we believe that this will fuel the growth both in the personal training and in the retail area of SATS going forward.

So, to summarize the reopening, we are happy to see that the key health metrics of our business are positive and strong. Visits are growing. Active members are visiting us more frequent. Member satisfaction is improving. New membership sales is strong. Underlying yield development is positive. And our PT and retail business is recovering sooner than expected.

As I said in the introduction, SATS has a strong vision. We are making people healthier and happier. And our positive contribution to public health is significant. Annual visits of close to 40 million in our clubs make a huge difference for the society. We will, moving forward, play an even more important role in improving public health. There is no doubt that inactivity is a public health problem. And, for example, 55% of the Nordic population does not reach the minimum recommended activity level per week.

And the positive effects of activity on public health are well documented, both in terms of improved mental and physical well-being. And we believe that the United Nations and the World Health Organization's targets should be fully supported with the UN sustainability goal number 3, focusing on good health and well-being, and the WHO aiming to reduce global inactivity by 25% (sic) [15%] within 2030.

And SATS will be a key contributor to enable the Nordic societies to reach these targets. And we are taking several initiatives to fuel this development, among others, efforts to increase the number of training sessions in the SATS member base by activating all member segments, activating young people to improve habits through our Youth activation program. We are introducing new concepts and offerings in our clubs and digitally to activate new parts of the society and the population. We are raising awareness of the SATS' positive contribution in tough times, like on the COVID-19. And also ensure sufficient information to decision-makers to secure that fitness clubs stays open to fight inactivity.

And we expect the increased focus on public health and personal health to further grow demand in our markets looking ahead. Hence, we are stepping up our investments in growth. During the last years, SATS has not opened that many new clubs every year. The focus has really been on improving operations and product offering in our existing clubs. And we have succeeded with this. But now, we have in addition and will also going forward step up significantly in our club expansion. During the pandemic, we have opened more new clubs than ever. In 2020 and first half of 2021, we have opened 18 new clubs. And wow, these are fantastic clubs at key locations for us, strengthening our clusters for both new but also for our existing members.

We have also opened our first club offering in Sweden with strong member interest. And the latest club opening just a few weeks ago was HiYoga at Aker Brygge. And for those of you who are living in Oslo, you actually have to visit the clubs. It's an extraordinary experience. Let's take a look at it.

[Video Presentation] (00:16:52-00:17:35)

That was HiYoga Aker Brygge, and those were the clubs we have already opened.

But looking ahead, we are definitively not slowing down. We see several interesting growth opportunities both in white spots and due to increased demand where we are already present. We have already confirmed further 19 new club openings until end 2022 (sic) [2023], with 30 (sic) [13] already coming now second half of 2021. And we really can't wait to welcome all the new members to these new fantastic SATS clubs.

And as you know, our business is both a physical business with the physical clubs, but it's also a digital business with digital training products. And we are investing in and growing both parts, as we see them very complementary. The pandemic has accelerated an already existing trend around increased digital training, and we see interesting track record and development from several players in international markets. And also, the Nordic market is growing and maturing. And we have extended our digital offerings significantly during the last year.

And now, we are taking a strong and natural, as we see it, next step by launching a new distinct digital home training platform, Mentra by SATS, with the first product being launched in Q3, the Rflex, an interactive fitness mirror. And we are currently running an MVP test, with the Rflex being tested by around 80 families in Norway and Sweden. And we are getting a lot of great and interesting feedback from these families, helping us to improve our product and preparing us well for the commercial launch happening in Q3 this year. We're also doing now some soft marketing just to start to build the brand and product knowledge in the market.

And for the commercial launch, we will have a wide range of live classes in several verticals. We will have digital on-demand workouts and live personal training on the Rflex. And we are looking so much forward to this and to the launch and will, of course, give you more details in the Q3 presentation.

By this, I now give the word to Cecilie for the financial review of the quarter.

Cecilie Haugen Elde

Chief Financial Officer, SATS ASA

Thank you, Sondre. And good morning, everyone.

We are leaving behind us a quarter that has been significantly affected by the club closures, both in Norway, Finland and Denmark, resulting in 27% of the club capacity being closed. However, ending the quarter with all of the clubs in the portfolio open, we are well on our way for a recovery, both in terms of visits and member development despite having to operate under strong restrictions in all countries.

And for this financial presentation, we are showing both 2020 and 2019 comparators where relevant. As you know, the second quarter last year was also affected by the first lockdown, so it provides limited insight into the actual underlying performance of the business. So, we include 2019 to give a benchmark for the underlying scale and operating performance of the group when allowed to operate under more normal conditions.

So, starting off with the member development. Across the group, we close the quarter with 612,000 members in total, which was 4% down from the same period of last year adjusted for the nine divested clubs in Denmark and 8% below pre-COVID levels for the same period in 2019. And as we've commented on over the last quarters, the decline in the member base since the pandemic started is not due to increase drop-off but rather lower sales due to the club closures. So, considering the restrictions from all Nordic governments and local authorities has put a damper on both member visits and new sales, the member base has held up pretty well compared to our peers, indicating high member loyalty.

And freeze continues to be significantly higher than normal also in the second quarter. But this shows that members choose to put their memberships on hold rather than resigning, giving us comfort that members have the intention to restart their training habits over the summer. And as we've seen in the previous quarters, club closures and higher levels of freeze affect the reported yields significantly. But if we look at the more relevant adjusted yield for paying members, the graph in the middle, membership yield is in line with pre-COVID-19 levels. And the development for yield for personal training and retail is strong for returning members, especially in June when the clubs were fully reopened.

But still, the most important metric that we follow for the membership yields is as can be seen on the right-hand side, the development in the contractual membership price, which has shown a solid positive development over the last couple of years. Some flattening in the curve over the last six months due to restrictions on group training, members training on one club only and delay in scheduled price adjustments. So, we expect the positive yield development to pick up again once the restrictions are fully lifted.

And just to repeat what we've said several quarters now, the tactical sales campaigns that we had last year has not affected the contractual price. Discounts for three months are deferred over the full 12 plus 2 months binding period, and that's why the reported yield takes a short-term hit and will continue to be affected throughout the third quarter of this year. And in the second quarter, the negative yield effects from campaigns from last year amounts to around NOK 15 million.

And as said, the second quarter financials are still heavily affected by COVID-19. And as all membership for closed clubs are frozen, revenues have been negatively impacted. Total revenues sum up to NOK 670 million, which is 10% below last year, including governmental supporting packages of NOK 33 million. And please note that, for Norway, no compensation is booked for the second quarter or for March, as indicated last quarter.

New regulations for the compensation scheme came into force from and including March 2021, meaning that, if the applicant is part of a corporate group, the new requirements shall be measured at group level. And as a consequence, due to technicality in the current corporate structure, SATS cannot apply for support for the period March until June. And the estimated compensation for this four-month period would have been around NOK 70 million if applying for support on entity level, as we did for the previous compensation scheme periods. So, adjusted for the decline in governmental compensation, underlying revenues are up 3% compared to last year, driven by a significant pickup in other revenues.

But more importantly, as can be seen on the right-hand side, member revenues improved throughout the quarter as clubs reopen and revenues are turned back on, partly as a result of targeted campaigns and freezing memberships over the past month. But June memberships revenues are approaching pre-COVID run rates. So, despite that we have higher-than-normal freeze levels, COVID is the main reason for members freezing their memberships and accounts for 75% of overall freeze. So, we expect freeze levels to continue to decrease after summer, further strengthening the run rate that we now see in revenues.

Moving on to EBITDA. Adjusted EBITDA of negative NOK 130 million in the quarter is NOK 151 million behind the same period last year, which also was a quarter affected by COVID-19. And the result per segment is fairly similar relative to size. But as can be seen on the right-hand side, the profit reduction for Sweden is significant in the quarter compared to last year due to heavier restrictions on capacity resulting in higher freeze. Denmark, on the other hand, show positive development compared to last year as the nine divested clubs contributed with a negative NOK 16 million in the second quarter of last year.

And immediately following the closure in March 2020, we started the work on reducing the cost base to a minimum. And even though some of the strict infection control measures have been cost-driving, these have been compensated for through reductions in other areas. So, the decline we see in profits is fully a result of the massive loss in revenues from club closures and higher number of freeze. And despite receiving significant fixed cost compensation from both the Norwegian and Danish governments during the lockdowns, we estimate the total COVID-19 financial impact for SATS since March last year to be close to NOK 1 billion compared to the 2019 results. And that is before including the continued impacts of reduced member base that will take some time to recover from.

But we have the financial flexibility to weather the storm. And as we've shown, average revenue per member is steadily improving, overall cost base is unchanged, and this gives us comfort that run rate profits will return to pre-COVID levels once the member base is regained.

Capital expenditure in the quarter was NOK 43 million, in line with last year, but with maintenance spend minimized during the quarter, partly as an effort to preserve liquidity, keeping upgrades at a responsible level during the club closures. Despite the pandemic, we have continued to invest for long-term, both in the technology team, systems, and infrastructure, but also in club expansion. And as we've shown, we have a strong pipeline of clubs opening and will continue to be open for attractive acquisition opportunities in the time to come.

Moving on to cash flow, operating cash flow for the first quarter is negative at NOK 195 million, mainly because of the negative result in the period but also due to negative working capital effects caused by deferrals of prepaid memberships from 2020 from memberships put on hold. We will, for the same reason, have some continues be lower to the third quarter to fully clear the prepaid membership fees.

And with the liquidity position of NOK 495 million including cash and undrawn revolving credit facility we have sufficient financial liquidity to handle the current regulatory environment as well as facilitating our growth strategy with the planned expansion in both greenfield and digital offering.

And now, finally, looking at the group's net debt position. As the closures have continued to be prolonged throughout the main part of the quarter, net debt increased to NOK 1.9 billion. Operating under normal conditions, we have historically shown strong deleveraging profile on the back of EBITDA and growth – EBITDA growth and high cash conversion. But in the immediate term, we have the mentioned deferral effects to be clear over the coming months, so you should expect net debt to increase slightly in the coming quarters. But we are confident that, once we are through the COVID closure impacts, we will return to the same approach to responsible deleveraging, again as we have done in the past.

And with that, I will leave the word back to you, Sondre.

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie.

And let's now round it off with our outlook. As we have said, we have seen a strong reopening and development, and expect demand to increase going forward. And our key focus now is to regain and grow the member base. The pandemic has increased the focus on public health and personal health, resulting in more time and money allocated to this from consumers. And we will continue to expand and grow our offering, both through an extended physical club footprint and increased SATS digital offering and the new home training solution Mentra by SATS. And we want to play an even stronger role and contribute to reducing inactivity and making people healthier and happier, both with our physical club presence and our digital offering as complementary product offerings in the market. So, as you understand, we are optimistic looking ahead to and, basically, it's up to us to deliver because our market is growing.

So, with this, we wish you all a great and active summer. Stay healthy and happy. Thank you very much.