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SATS ASA (SATS.NO)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Sondre Gravir
Chief Executive Officer, SATS ASA

Cecilie Haugen Elde
Chief Financial Officer, SATS ASA

MANAGEMENT DISCUSSION SECTION

Sondre Gravir
Chief Executive Officer, SATS ASA

Good morning and welcome to the presentation of the Third Quarter 2021. My name is Sondre Gravir, the CEO of SATS, and together with me here today is Cecilie Elde, our CFO. We will run a Q&A session on Teams at 10:30 today to allow some more time for those of you following this to look into our report and the numbers. You will find the link to this Q&A session on our website under Investor Relations and we really hope to see many of you there.

This third quarter has been a strong quarter for SATS. We are back on track after a rather quick and very positive recovery. We have seen a record high a member growth, increasing the member base with 41,000 during the quarter, the strongest member growth during a quarter in SATS' history. And after October, the member base was back to pre-pandemic level.

We have managed a strong activation of the member base and we see a similar behavior as pre-pandemic. This, combined with increased focus on health and training, has resulted in positive development in yield, visits, personal training and retail. We have also been investing in growth during the pandemic, hence the foundation for future growth is strengthen both in club expansion and in our digital offering, including the launch of Mentra by SATS.

So, let's start with an overview of the quarter. Summarizing the third quarter, we ended the quarter with 256 clubs and 653,000 members. Revenues and EBITDA were negatively affected by higher freeze levels and restrictions early in the quarter. However, we see that revenues going out of the quarter is getting back on track, and Cecilie will come back to the details and financials later in the presentation.

During the quarter, all clubs have been open. We operated the clubs with restrictions in all countries in the beginning of the quarter. However, towards the end, most relevant restrictions were removed across the Nordics, with the exception of Finland. We now get some questions regarding potential new restrictions due to increased infection levels in the society.

First of all, it's important to remember the fact that we proved that by having good routines, it was safe to work out and train in SATS clubs during the pandemic. And the closure of our clubs was more linked to a full closure of all mobility in the society. And now, we don't expect a new lockdown, but potentially more local restrictions regarding face mask and social distancing, and these type of restrictions we can easily handle within our current operation.

During the pandemic, we have seen also many speculations regarding changes in people's habits. Many have asked us how we would be able to recover after the pandemic, if at all. We have seen questions like, would the recovery be slowed down due to changes in member habits and preferences after a long lockdown? Would members wait with returning to gyms because of infection fear, or have you actually seen a permanent change in habits, would people prefer to only train outside or only at home after the pandemic?

And now, I think it's fair to say that the facts and numbers are clear. The fears have been proven wrong. Member demographics and habits are largely unchanged. The pandemic has highlighted the importance of living a healthy lifestyle, and people's willingness to invest time and money in health and fitness is stronger than ever. So we experience high demand, strong sales, and active members and lower churn.

And the result of all of that is very clear. The recovery of the member base in SATS was stronger and quicker than we expected. We ended the quarter with a member base only 2% behind pre-pandemic level, and by the end of October, the member base was fully recovered. And needless to say, we are extremely happy and proud about this performance. It's a result of a tremendous effort in the whole SATS organization across all countries.

We also see several other important results in the recovery. In SATS, our vision is to make people healthier and happier. And they will not get healthy and happy by staying on the sofa. So after reopening, we have been very focused on activating our members. We really want our members to succeed with their training and to get back to their good old habits. And we have been using a wide range of channels, very active with targeted and segmented communication based on member behavior before and after the pandemic.

We have used both external channels and internal direct channels, for example, app push and email notifications. And we see high interest and engagement in social media from our members. And the effort, it has paid off. We want our members to be active, so the visit level is one of the most important performance metrics we follow. And we are very happy to see that our members are now even more active than before the pandemic.

Visit per member has been higher in Q3 2021 than in Q3 2019, which was a very strong visit quarter for SATS. With heavy restrictions on our group training offering though, the result has been somewhat lower group training visits, but this has been compensated by non-group visits. And as I will come back to, group training visits is also now picking up.

We also see that member behavior and demographic is returning to normal as society is opening up. When people get back to their offices, the visit patterns get back to normal. And visits in our city clubs are picking up, while people in home offices are continuing to visit our clubs somewhat more during daytime than before. Member demographics is also largely unchanged. Gender mix is back at equal levels, with a slightly higher share of female members, and the average member age is very stable, only one year younger now than compared to 2019.

We have made many improvements in our digital member journeys throughout the pandemic, which is showing strong results and contributing to the strong recovery. We have launched an improved onboarding journey, helping our members to get started after signing up, and the journey is getting personalized during the first eight weeks of a membership based on the actual member behavior. We have also launched a new digital exit journey to increase motivation for our members to continue their membership, or if they leave us, god forbid, I'm sure a positive exit experience and keeping a digital connection.

We have also launched our loyalty program, SATS Rewards. In SATS Rewards, there are four member levels and we want to reward our members both for being loyal, but also for being active, actually using their memberships. Hence, your member reward level is based on both membership duration and the amount of visits you have in the SATS club. SATS Rewards has been very positively received among our members, creating a lot of engagement and high usage of the reward gifts which we are very happy for.

Another important area we have worked with is the number of frozen memberships due to COVID-19. Throughout the whole pandemic, we have made it really easy to freeze your membership without any fees and this resulted in very high freeze levels as reported earlier. When restrictions were lifted after the summer and vaccination levels in the society improved, we have been actively engaging the frozen members and the result is that the freeze level out of October is very close to a normal level, as seen in 2019.

Our strong sales of new memberships is a result of also a very targeted marketing activity period. Our marketing push has been focused on tactical offerings in digital performance campaigns. It's positive to see that the very strong sales of new memberships has been achieved with a less attractive offering than we had during the reopening last year and without giving continued discounts on membership prices. Hence, new members are paying list prices when the campaign period is ending, which is supporting a continued positive yield development as Cecilie will come back to in the financial section. This will also be our strategy going forward as we have a very strong product offering and value proposition to new members.

Group training and classes is very important for SATS and highly appreciated by our members. It's the core of our product offering and we have so many inspiring and knowledgeable group training instructors. And this will also be one of the most important focus areas going forward for SATS.

Our group training offering was heavily affected by governmental restrictions during COVID, and in some periods, we could not offer group training at all. And in long periods, capacity was limited, all the way down to five participants per class. This was challenging and demotivating for our members. And as a natural consequence of this, the share of members with the group training membership was significantly reduced. But this is now changing and I'm so happy, on behalf of all of our members and also as a group training enthusiast myself, to see that we now have a stronger group training offering than ever before.

As an example, in the larger Stockholm area, the number of classes was 12% higher in October this year than in October 2019, with close to 3,400 classes per week. So, demand for group training is increasing, and the share of group training access in new membership is already back at the levels we experienced during 2019, and we expect the positive momentum to continue.

We have a very strong group training offering for members and we will, as I said, continue to develop this. And there is nothing similar to our offering in the markets. The breadth and depth of our offering is super strong and targeting different member needs and different member segments.

The offering includes classes within strength, running, cycling, dance, martial arts and the list continues. And we have also developed a very strong yoga offering over the last year. As an example, last week, only in Oslo, we had 524 yoga classes on the schedule. And as running is also very popular now, we had 424 running classes on the schedule in Oslo last week. So, there is no excuse not to workout. You will find a class somewhere close to you during all day.

We also received many questions around the recovery for our personal training and retail business. And I can say, our personal trainers, they are great and they are more busy than ever helping our members. The average number of PT hours per paying member is 2% higher now in Q3 2021 compared to Q3 2019. Hence, we are now recruiting many new personal trainers to SATS.

Our retail business has also been important in the recovery. We have launched new SATS clothing and nutrition products and retail demand is really strong. Retail sales per visit was up as much as 27% in the quarter compared to Q3 2019. This was partly driven by increased use of gift cards as a part of the SATS Reward program, but the underlying growth is also very positive and we expect this area of our business to continue to grow.

The last area I want to mention is our treatment business. As some of you who have been following us for a while might remember, we have launched a very successful physiotherapy business in Sweden. And before the pandemic, we also launched in Norway. This was naturally paused during COVID, but after the reopening, we are continuing to grow and develop this business in both Sweden and Norway. And the offer is well received by members and non-members, and it's important for us as we deliver an even more holistic health service. The margin in the business is also good. So now we will continue to ramp this up, and we are also recruiting more talented and knowledgeable physiotherapists.

The last area I want to focus on before leaving the word to Cecilie is the foundation we created for future growth. We have spent the time well during the pandemic. We have developed our product offering, as you have seen examples of during the presentation, and we have invested for future growth, both by increasing our club footprint through organic openings and M&A, and developed our digital offering, including the launch of Mentra by SATS.

We have, during the pandemic, accelerated our growth in new clubs. In 2020, and so far in 2021, we have opened 22 new clubs and have already confirmed 17 new openings through 2023. We have focused our growth mainly on already strong club clusters. We are then both recruiting new members, but also strengthening our competitive position, as this is very positive for existing members in the cluster. And we expect to continue to grow our clusters also going forward, as demand for fitness is increasing and the interesting new real estate areas are being developed, and we experience that SATS is the preferred operator for landlords.

During the pandemic, we also developed our digital offering, both the digital tools for members and the digital training content. We have also launched Mentra by SATS commercially now. Even though people are returning to fitness clubs, we believe we have a very interesting growth potential within digital training. We are targeting people who are currently going to SATS or another physical gym, but want to also have the flexibility to be able to work out at home. Secondly, we are targeting people who don't have access to a good fitness club. And the third target group is people who have some type of barriers to enter a physical club and hence want to do the training at home. We have just launched the Rflex fitness mirror, and we now have more than 150 classes available. New content is made available each week, with great coaches within cardio, yoga, strength, and dance, and we have also started to run live classes.

And a lot has happened during a short time period this fall, and we have a full engaged Mentra by SATS team in place with great coaches, developers, and designers, and a state-of-the-art studio. We expect the first deliveries of the Rflex mirror to members in Sweden and Norway from December and we'll continue to develop the Mentra by SATS position throughout 2022.

The Rflex fitness mirror is a new product in the market, and users need some time to experience the product. Hence, we are very satisfied with the early feedback from our users and also the strong reviews we have received from tech magazines and various testers, which is proving positive for the growth ahead.

So looking ahead, we see several significant growth opportunities for SATS, and we believe we have an even stronger position coming out of COVID than before. We will continue to grow the member base, both in our current clubs and also by adding more clubs to the clusters. Secondly, we will grow the average revenue per member by increasing membership yield and by adding new products and services. And then we will continue to strengthen the scale advantages in our business enabled by technology. So the accelerated club rollout, combined with digital presence, really support strong growth ambitions.

And with this, and I'll give the word to our CFO, Cecilie Elde, to give you more insights into financials.

Cecilie Haugen Elde

Chief Financial Officer, SATS ASA

And good morning, everyone. We are leaving behind us a third quarter that has been all about recovering and members returning to our clubs, with a record high net member growth of 41,000 in the quarter. And as you've seen, the positive momentum is not fully reflected in the financial results as the ramp up in members and reactivation of frozen memberships came late in the quarter. And I will, in this financial section, run through the numbers in detail and give you some more color on the development and what to expect going forward.

And then in the following presentation, we are showing both 2020 and 2019 comparators where relevant, and we're including the 2019 figures just to give you more relevant benchmarks for the underlying scale and operating performance for the group when allowed to operate under normal conditions.

So, across the group, we closed the quarter with 653,000 members in total, which was 1% down from last year and only 2% behind pre-COVID levels for the same period in 2019, in October, adjusted for the nine divested clubs in Denmark. And as we have commented on over the last quarters, the decline in the member base since the pandemic started in March last year is caused by lost membership sales during the club closures and not as a consequence of increased drop-offs. So, our targeted sales campaigns have proven successful. And coupled with stable churn in the period, this has resulted in a record high growth in the quarter and the positive net growth trend has continued into October as well, ending with a fully recovered member base in line with October 2019.

And as we have seen in the previous quarters, restrictions on capacity and higher average levels of freeze affected reported yield significantly. However, if you look at the more relevant yield adjusted for frozen members, as can be seen on the left-hand side of the page, membership yield surpasses pre-pandemic level, up 3% in the quarter.

Still, the most important metric that we follow from membership yield is, as can be seen in the middle graph, the development in the contractual membership price, which has had a solid development over the last two years, some flattening in the curve over the last six months due to tight restrictions for group training, members training at one club only and delay in scheduled price adjustments. But as Sondre showed earlier, we now see that members are returning to similar behavior and habits as before the pandemic and we see a significant increase in demand for group training and multi-club access membership.

And just a recap of our pricing strategy, which has proven to be successful to lift yield in the past, we have a flexible membership structure with a model there where you pay for what you use logic, which addresses both the budget segment, but also provides opportunities into more premium offerings. And we have an annual price optimization process where we increase prices every year, both list prices for new members, inflation adjustment for existing members, in addition to actively listing the lowest priced members closer to list prices. As a result, we expect the positive yield development to pick up again now in line with what we've seen historically.

Other revenues are also returning to pre-COVID-19 level, both in terms of average revenue per member and actual revenues. Currently, we are tracking above 2019, especially retail, up 17% compared to 2019, and 24% up in terms of revenues per visits. And as Sondre said, retail revenue is somewhat boosted by gift card usage, but we still see that improved assortment and more targeted campaigns and communication results in strong development in the quarter.

And for personal training revenue specifically, we have somewhat fewer PTs in the third quarter than in 2019. So, increased PT hours per member and increased activity per PT showed a continued potential in the personal training revenues area, despite that actual revenues are showing a slight decline of 6% in the quarter compared to 2019. So, strong focus in getting new members to try personal training and stimulating user frequency has shown results. And remember, both personal training and retail have significant earnings contribution as the margins on these products are 35% to 40% flowing directly to EBITDA.

The third quarter revenues are still affected by COVID-19 as selling new memberships has been tougher with closed clubs and heavy restrictions during the last 18 months. So, total revenues for the quarter sums up to NOK 971 million, which is 4% above 2019, but the increase comes from receiving governmental support in Denmark and Norway, in total NOK 87 million related to the club closures from March to June.

So adjusting for the governmental support, the underlying revenues are 6% below 2019 level, despite members base – member base close to full recovery. And as mentioned in the beginning, the ramp up in members came towards the end of the quarter. So the average base was still significantly lower than in 2019. And as the middle graph shows, this results in a deviation of NOK 60 million related to member volumes.

Further, the July and August months were also affected by freeze related to COVID, still at higher levels than normal, and that also caused an additional revenue loss compared to 2019 of NOK 20 million. The yield development, on the other hand, has been positive despite heavy campaigning with an effect of NOK 19 million in the quarter.

So more importantly, as seen on the right-hand side, revenues improved throughout the quarter, as more members reactivate their memberships, and our sales engine has allowed to operate as normal. And September revenues are approaching pre-COVID run rate, as the number of members – the gap in number of members is closing. We do, however, expect the higher freeze level to continue into Q4, temporarily reducing member revenues. But revenues are expected to continue to grow as like-for-like members are returning to 2019 levels and new clubs are maturing.

After the club closures in March last year, significant effort was made to reduce operating expenses and all variable and semi-fixed costs were taken down according to the reduction in the activity level. Total operating expenses increased by 5.9% in the quarter, currency adjusted, compared to 2019, partly pure inflation-driven, but mainly due to adding a net of 10 additional clubs to the portfolio compared to 2019. In addition, we have some extraordinary marketing push and campaign costs, which also increased the cost in the quarter.

Looking at the like-for-like development, the increase is lower, 2.8%, again mainly inflation-driven adjustments, especially in lease and increased electricity prices, but this is partly offset by the efforts that we have done to compensate for increasing costs. And looking at the right-hand side, around 85% of our cost base is fixed or semi-fixed, which means that incremental revenue – membership revenue has a drop through of 90% to EBITDA for existing clubs. And therefore, as like-for-like member levels return and new clubs fill up with new members, additional revenues growth flows directly to adjusted EBITDA.

And since 2019, we have accelerated our rollout of new clubs, both through acquisitions and establishing new clubs greenfields. And as you saw on the previous page, the new clubs obviously add costs, negatively impacting profits in the short term. But the cost base required to operate these new clubs already are established and largely fixed, additional revenue growth flows directly to EBITDA.

On average, a greenfield takes around 6 to 12 months to reach breakeven, resulting in a short-term drag in profits. And the maturing phase, it takes another additional 12 to 24 months to reach full maturity, where the club performs, on average, as the rest of the like-for-like portfolio in terms of members and financial results.

And we have and we will continue to invest in future growth through establishing new clubs at attractive white spots in the portfolio. And as seen on the right-hand side, this illustrates what the different vintages of newly opened clubs will contribute to when they reach maturity, here estimated to around NOK 120 million for the newly opened and signed clubs.

So, the adjusted EBITDA for the segment ends at NOK 83 million in the quarter, which is 16% behind the same period last year and 36% behind 2019. And the results per country are all negatively affected by the same factors as just discussed.

Average member base was lower than pre-pandemic, which we expect to have neutralized after October. Average freeze levels are higher than normal in the quarter, which we, however, do expect to continue into Q4, and a higher cost base driven by growing the club portfolio, which will continue forward, but as these new clubs mature, the EBITDA drag will gradually decrease and improve future profits. So run rate profits will return to healthy financial once the member base and activities are back to COVID – pre-COVID-19 levels.

Moving on to capital expenditure, which in the quarter was at NOK 66 million, slightly higher than last year, but with maintenance spend minimized during the quarter, partly as an effect to preserve liquidity, keeping upgrades at a responsible level during this recovery phase. And despite the pandemic, we have continued to invest for the long-term both in our technology team, systems and infrastructure, but also in club expansion. And as we've shown, we have a strong pipeline of new clubs opening and we will continue to look for attractive acquisition opportunities in the time to come.

Moving on to liquidity and the key message here is that we are in a well-controlled and satisfactory position, as we close to third quarter with NOK 150 million in cash in the balance sheet and NOK 271 million in undrawn revolving credit facility. This will, in our view, be sufficient to handle current operations as well as facilitating our growth strategy with a planned expansions in both greenfields and digital offering, of course, provided no material change in the current regulatory environment.

Free cash flow for the third quarter is negative at NOK 80 million, mainly due to working capital effects caused by the accrual for governmental compensation coming in the fourth quarter. And with the member base recovering, we will again generate positive operating cash flow. And with the granted governmental compensation, the liquidity situation will be further strengthened in the fourth quarter.

And now, finally, looking at the group's net debt position, as the club closures have continued throughout the year, the net debt increased just below NOK 2 million in the quarter. Operating under normal conditions, we have historically shown a strong deleveraging profile on the back of EBITDA growth and high cash conversion. And we are confident that once we are through the remaining COVID closure impacts, we will return to the same approach as before with responsible deleveraging again.

And with that, I will leave the world back to Sondre for closing remarks.

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie. So, at the end there, I thought I would just summarize our messages. And as you understand, we have seen – and have seen, we achieved a record high member growth in the quarter, driven by both strong sales and lower churn. The member base was fully recovered at the end of October, which was ahead of our own expectations. Member habits are largely unchanged, and we see underlying growth in visits, yield, personal training, and retail revenues.

The positive momentum, as Cecilie described, is not fully reflected yet in the financials results, but the revenue run rate at the end of the quarter is approaching pre-pandemic levels. And we have sufficient liquidity to handle existing operations and our accelerated expansion plan. So, we see a strengthened foundation for future growth through multiple levers.

And finally, SATS continues to be a key contributor in reducing inactivity and making people healthier and happier. So, as you understand, we are optimistic looking ahead. And I was thinking this morning when I was standing here, then looking at the name of the SATS nutrition product, this is for building strength. That's what we have done, and this is for staying ahead, and this is what we will do.

So, the pandemic has increased the general focus and the importance of living a healthy lifestyle. And we, as an organization, are full of energy and ready to fire on all cylinders.

So, with this, we wish you a great day. Stay healthy and happy. Thank you.