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SATS ASA (SATS.NO)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Sondre Gravir
Chief Executive Officer, SATS ASA

Good morning and welcome to this presentation of our Fourth 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 in Teams at 10:30 today, to allow some more time to look into the report and numbers. And you will find the link to this Q&A session on our website under Investor Relations, and we hope to see many of you there.

Let's start with a short summary of the quarter. We ended the quarter with 262 clubs and 669,000 members. Total revenues of NOK 1,002 million and adjusted EBITDA of NOK 26 million. And Cecilie will, as always, come back to the financials later in the presentation.

Our key messages today are we delivered a strong member growth in the quarter. But the growth slowed down during the second half of the quarter due to heavy restrictions related to the Omicron uncertainty. And now, restrictions are being lifted and we see sales accelerating again. But the activity level among our members has remained high despite restrictions, proving the importance of health activity and fitness in people's lives, and the continued importance of physical gyms.

Hence, we are ramping up our growth ambitions, both through an accelerated club expansion with greenfield and M&A, strengthening of our current club and product portfolio and our digital offering in Mentra by SATS.

Coming into the fourth quarter, all our clubs were open and restrictions very mostly lifted but then came Omicron and new restrictions were implemented in all countries. In Norway, heavy capacity restrictions were introduced and all group training was closed for several weeks. In Sweden, the restriction with 10 square meter per person were again introduced, heavily reducing our capacity. In Denmark, we had capacity restrictions and corona passport control. And then in Finland was the most extreme, all fitness clubs were forced to close and just recently opened.

The club closure in Finland is very difficult for us to understand and the government actually lost a legal case we raised in the Turku region where the government closing was ruled to be illegal and we open the clubs after 1.5 week of closing. Given all this, we are very relieved and happy now to see that restrictions across all countries are being lifted. Denmark was first from beginning of February then Norway where most restrictions for fitness clubs were lifted last week, then came Sweden this Wednesday and Finland from next week.

Hence, finally, we are operating close to the situation we had in February 2020, two years ago before the pandemic, with all clubs being open and we have close to full product offering and capacity for our members and that is a fantastic feeling the first time in two years.

We saw a strong member growth during the quarter. Our member base grew by 16,000 compared to a decline of 34,000 in Q4 2020 and a pretty flattish Q4 in 2019. Hence, our member base reached 669,000 at the end of December, which is the same level as we had in December 2019. The record growth in the start of the quarter was heavily slowed down in the second half following a drop in new membership sales as new restrictions and club closures came to force. This lasted also into January but now, sales is strongly improving again as restrictions are being lifted, giving a positive outlook for Q1 member growth.

The development in sales have been very linked to the restriction level throughout the pandemic. The media pick up of sales now after restrictions are being lifted is hence as expected and planned for supported by a strong sales and marketing push. And the restrictions during the second half of the quarter and into January heavily affected our business. Group training is an important part of our business and was hit especially hard with closure were up to 70% reduction in capacity.

So, GX visits declined significantly in December after a strong October. But now we see that GX visits is also picking up immediately as restrictions are being lifted.

In Q4, we continued to have multiple measures in place in our clubs in order to ensure safe training for everyone. And just to mention some examples, in our app, our members could see the real-time visit level in the club they wanted to visit and pre-book a slot first to do their training. We have full digital tracking of all visits and, of course, we make sure that the clubs were cleaned properly and ensure social distancing between members in all our clubs. And we will continue with several of these measures also now that restrictions are being lifted to ensure continued safe training at SATS.

And when restrictions are limiting us, we find new ways to continue to deliver on our vision of making people healthier and happier. When indoor group training was closed, we quickly set up outdoor training and in December, with snow and ice outside, in December alone, we had more than 2,500 outdoor classes, and we also offered free access to the Mentra by SATS app for all SATS group training members during December and January.

Then, despite restrictions, the activity level among our members remained high throughout Q4, proving the importance of health, activity and fitness in people's life, and the continued importance of physical gyms. With the reopening during fall, we saw a strong visit development. From July to September, we had higher visits per member in total than in 2019.

Then total visits came down especially in December. This was driven, as I said earlier, by the strict restrictions on – especially group training. But if you look at our studio visits, studio training actually develop positive, with a higher level of visits per member throughout the whole Q4 also compared to Q4 2019.

And this development has continued and strengthened in January this year, clearly showing the interest and demand among our members to visit our clubs. With a strong visit development in mind, we are also very happy to see the member satisfaction is strong and very positive. One of our core values is members first. We want to ensure a positive member experience every time a member is visiting a SATS club. And we have tuned our operational routines to ensure this, and then it's rewarding to see that the result of this is proven by the strong member satisfaction.

So, we see a strong demand for our product. And coming out of the pandemic, we are even more positive than earlier on behalf of SATS and our industry, and there are several drivers supporting this. Consumers are even more focused on living a healthy lifestyle and staying active, and we see increased political focus on supporting this as well. We also see that younger generations are working out more than the older generations, and they keep their habits as they get older. And population growth and urbanization is also supporting SATS strong city clusters. And then lastly, digital fitness solutions will expand the market and drive higher customer penetration.

So with this background, we are ramping up our growth ambitions both through an accelerated club expansion with greenfield on M&A, a strengthening of our current club and product portfolio and our digital offering through Mentra by SATS.

In our IPO, we guided at five to seven new club openings per year. And we have, during the pandemic, significantly ramped up our club expansion, both through greenfields and selected infill acquisitions. In total, we have opened 29 new clubs during 2020 and 2021, 5 being relocations and 24 additions to our clusters. The latest club openings are Slemmestad in Norway, Valila, Circus and Iso Omena in Finland, Gamlestaden, Saltsjöbaden and Bromma Blocks in Sweden. And these are fantastic clubs at key and very attractive locations for us, strengthening our clusters both for existing and new members.

And looking ahead, we are definitively not slowing down. We see several interesting growth opportunities, both in white spots and due to increased demand in areas where we already have clubs. We see opportunities materializing now in areas where we over time have been searching for attractive locations. And we experience that we are the preferred operator by real estate developers.

So, looking ahead, we have already confirmed 15 new club openings and more will come. In addition to these greenfield openings, we expect to do selected acquisitions in the short to medium term to further strengthen our position and support our growth. And we can't wait to welcome all the new members to all of these new strong clubs.

And in addition to opening new clubs, we are continuously investing in our existing clubs both to upgrade the clubs, but also to introduce new concepts. And we see a very positive visit and member development as a result of these upgrades. Illustrated here, among others, by pictures from SATS studio plan, one of our key clubs in the Stockholm cluster, which we upgraded during 2021 and now developing stronger than ever. And to continue to grow visits and members in our existing clubs is a key growth driver for us also going forward.

We are also strengthening our product portfolio by introducing a new design for group training rooms in selected clubs. The new design caters to all our members, but we especially think it caters to our younger members and will help us to deliver an even better atmosphere and workout experience. The new concept is currently being tested in both Oslo and Stockholm, giving us important learnings from members before we will roll it out further.

And lastly, we are also looking forward to opening our first high intensity interval training zone in just a few days at SATS Colosseum. We will run several hit concepts. And after a period of testing and learning, we will launch this concept in our key clubs to strengthen our HIIT offering for both existing and new members.

And then, in addition to investing in our physical offering, we will continue to invest in and grow our digital offering. We are firm believers of a hybrid future for fitness, physical and digital training are complementary products, and we see that both markets are growing. And the majority of us wants to do a little bit of both or, hopefully, a lot of both, and this is why we, in Q4, launched Mentra by SATS.

We see that Mentra by SATS is extending our vision of making people healthier and happier beyond our physical club footprint, and we can target the 80% of the population who is not a fitness club member or all of those people living in the areas where we don't have a physical club.

The first product that we launched is called Rflex. This is an interactive fitness mirror, fitting in your living room, and we're also planning to expand the product portfolio in Mentra by SATS by launching a connected fitness bike towards the end of the year.

And, through Mentra by SATS, we offer both live and on-demand classes across verticals such as cardio, strength, yoga and dance and, in their in-house studio allows us to be very flexible and agile to try out new concepts. And currently, we have 20 coaches on the platform and more than 350 on-demand classes, in addition to the live classes.

It is still early days after the launch, but we have received a lot of positive user reviews and feedback. This is naturally very fun and motivating, and the boost for the team in their continuous effort to develop and improve the product. And after we launched MVP product last year, we launched the product fully commercially with live classes in November. And so far, we have more than 6,000 registered users and more than 20,000 workouts have been completed. This is a good start for building a strong digital position in addition to our strong physical club footprint.

As we understand, we are ready to leave the pandemic behind us and accelerate our growth. And I will 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. In the following financial presentation, we are showing both 2020 and 2019 comparators were relevant, and we include 2019 to give a more relevant benchmark for the underlying scale and operating performance of the group when we are allowed to operate under normal conditions.

We are leaving behind this fourth quarter where the first half has been all about recovery and members returning to our clubs and then the second half, yet another round of imposed restrictions affecting our business. Across the group, we closed the quarter with 669,000 members in total, which is up 6% compared to the same period last year. The member base grew with 16,000 members, or 2% in the quarter, which in a normal year has a more flattish member development.

So, this is a clear sign that our targeted sales campaigns have proven successful coupled with stable churn levels has resulted in a very strong quarter. However, the reimposed restrictions across the Nordics resulted in weaker sales development towards the end of the quarter, but we still end the year with a member base fully recovered compared to pre-COVID 2019 after adjusting for the nine sold clubs in the [ph] market (18:20).

The fourth quarter revenues show strong recovery, up 18% compared to last year to just above NOK 1 billion, almost closing the gap towards 2019. Member revenues increased throughout the quarter driven by both strong new membership sales in the previous quarter and unfreezing of memberships. But as for new member sales, restrictions on group training, visits capacity and club closure in Finland, this temporarily softens the revenue growth in the second half of the quarter.

And the member revenue bridge on the right hand side illustrates where we stand end of year in terms of run rate of revenues compared to 2019. Average number of members in the quarter was slightly behind 2019 but was fully neutralized after October, closing the volume gap towards 2019. And the positive yield development that we have seen over recent years improves revenues further so the underlying revenues end of year are now fully recovered versus 2019.

However, COVID-related freeze is still inflated compared to normal periods and extraordinary campaign cost to recover member base impacts revenues short term.

But as we've seen in the previous quarters, restrictions on capacity and higher average levels of freeze affect the reported yield. But looking at the most relevant metric that we follow from membership yield is that development in the contractual membership price. And this shows 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 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 memberships.

And our annual price optimization process to increase membership yield has historically proven very successful, and we are constantly working on optimizing price level in the member base to ensure fairness and that all members pay the same price for the same membership and access rights.

And there are three main levers which are utilized to increase prices. We have an annual list price adjustment for new members coming in, annual inflation adjustment for existing members and, in addition, an annual proactive, significant price adjustment of members that, for some historic reason, have a membership price far below current list price. And there were several years the experience is that there is a significant resilience in such price adjustments. And, concretely, we see that the annual adjustment performed late last year has had a significant positive effect as of January. And as a result, we expect the positive yield development to pick up again in line with what we have seen historically.

After the club closures in March 2020, significant efforts were made to reduce operating expenses, and variable and semi-fixed costs were taken down according to their reduction in the activity level. With operations returning to normal, cost also returns to a normal level, and total operating expenses increased by 9% compared to 2019, partly pure inflation-driven, but mainly due to adding net 14 clubs to the portfolio.

In addition, we have spent extraordinary in – costs in marketing and campaign costs to increase – which increased the overall cost in the quarter. For like-for-like clubs, the increase is lower at 4.4%, mainly inflation-driven, adjustments on lease costs, and significantly increased electricity prices. This is partly offset by successful cost saving efforts to compensate for the overall cost increase that we have seen in recent years.

And, looking at the right-hand side, around 85% of the cost base is fixed or semi-fixed, which means that the incremental membership revenue has a 90% drop-through to the EBITDA for the existing clubs. Therefore, as the like-for-like members return and the new clubs fill up with new members, additional revenue growth flows directly to adjusted EBITDA.

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

On average, greenfields take around 6 to 12 months to reach breakeven, resulting in a short-term drag in profits in the maturing phase of its lifetime, and it takes about additional 12 to 24 months to reach a full maturity, performing at portfolio average in terms of members and profitability.

We have and we will continue to invest in future growth through establishing new clubs at attractive white spots in the portfolio. And as the right-hand side graph illustrates the different cohorts of newly opened clubs will considerably contribute to the bottom line when they reach maturity, here, estimated to around NOK 150 million for the newly opened and signed clubs.

Adjusted EBITDA of NOK 26 million in the quarter is significantly improved compared to last year and show that EBITDA is on track for recovery, but reimposed restrictions across the Nordics resulted in weaker development in sales and increased freeze towards the end of the quarter.

The result for the quarter is also impacted by increasing costs driven by lease costs, significantly higher electricity prices, and extra marketing and campaign costs to recover the member base. And the results per segment are also negatively affected by the same factors as just discussed.

Average member base is still somewhat lower than pre pandemic, but is neutralized after October. Average freeze levels are higher than normal in the quarter, which we also expect to continue into the first quarter. Higher cost base driven by growing the club portfolio, which will continue somewhat forward. But as the clubs mature, EBITDA drag will gradually decrease and improve future profits.

But the key message is that we are in the process of regaining our solid financial platform. Members are returning, yield is increasing, operating expenses are well controlled, and we have a strong lineup of new clubs fueling future growth.

And on the topic of growth, despite the pandemic, we have prioritized to invest for the long-term, both in our technology team, systems and infrastructure, but also in club expansion. As we have shown, we have a very strong pipeline of new clubs opening, and we will continue to look for attractive acquisition opportunities in the time to come.

Maintenance CapEx in 2021 is lower than normal due to focus on cash preservation, less wear and tear on equipment because of reduced visits, and a lower average age in the club portfolio. But going forward, we expect normalized annual maintenance CapEx to return to approximately 5% of group revenues.

Moving on to liquidity. The key message here is that we are in a well-controlled and satisfactory position. As we close the fourth quarter with NOK 280 million in cash in the balance sheet and NOK 289 million in undrawn revolving credit facility. In our view, we are sufficiently funded to handle our current operations, as well as facilitating our growth strategy with the planned expansion in both greenfield and digital offering, provided that we don't see any material change in the current regulatory environment.

Free cash flow for the third quarter is positive at NOK 160 million mainly due to working capital effects from receiving governmental compensation from previous periods. With a ramp up in the member base and activity level, prepaid revenues from both memberships and personal training results in positive working capital effects, as can be seen also in the fourth quarter.

With member base recovering, we will again generate positive operating cash flow. And now finally, looking at the group's net debt position, slightly improving in the quarter following the positive cash flow development to just above NOK 1.8 billion. And 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 restriction impacts, we will return to the same approach to responsibly deleveraging again as we have done in the past.

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

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie. As you have seen today, we achieved strong member growth in Q4, slowed by new restrictions, but now visits and sales are accelerating as restrictions are lifted. We ended 2021 with the same member base as 2019, and we are now ready to grow after catching up. We experienced increased demand and growing visits per member, and we see a solid financial run rate as a member base is recovering positive cash flow and sufficient liquidity. And finally, we firmly believe in continued growth of the fitness market, and that SATS is well-positioned to take advantage of this growth.

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