03-May-2022

SATS ASA (SATS.NO)

Q1 2022 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 this presentation of our First Quarter 2022. 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 those of you who follow this presentation some more time to look into the report and numbers. 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.

We are today reporting a quarter still significantly affected by the pandemic, but we are standing here in Oslo today in May and it feels good to say that now it truly seems like we are leaving the pandemic behind us. It's been a rough ride, two years with significant financial losses and challenging operations, but we also gained a lot of positive learnings.

Member base is recovered, member satisfaction is higher than ever and member activity level is high. And we have, in these turbulent two years, added no less than 35 clubs to our portfolio, so we believe SATS is coming out of the pandemic even better positioned than in March 2020.

Then looking ahead, we have ambitious plans. We accept – we expect to deliver accelerated growth driven by several factors; increased number of members in existing and new clubs, increased revenue per member, strengthened digital presence as we believe in the hybrid future for our industry, and of course we will continue focusing on helping our members to succeed with their training because our vision is to make people healthier and happier.

Then summarizing Q1 2022, we ended the quarter with 267 clubs and 686,000 members, total revenues of NOK 1,011 million, and adjusted EBITDA of NOK 30 million. And Cecilie will, as usual, come back to the financials later in the presentations. The situation in January was quite different than today in our operations. Now, all clubs are open with no restrictions, but coming into January, we could not run a single group training class in Norway and the clubs in Finland were closed, and we also had strict restrictions on operations in Sweden and partly in Denmark.

Then gradually throughout the quarter restrictions were lifted, societies were opening up, bringing us to the current state of operations, with all clubs open. The member base reached 686,000 coming out of the first quarter, with a net growth of 16,000 in the quarter adjusted for acquisitions. This is somewhat higher than Q1 2019 and 2020, hence member base is recovered.

Restrictions and closed clubs in January resulted in significantly lower January sales than normal, hence the net growth in the quarter was primarily driven and achieved in February and March, with higher sales than comparable months in 2019.

Looking at the visit levels, visits in January was negatively impacted by COVID restrictions, including the imposed club closures in Finland. When the restrictions were removed in February and society opened up, visits per active member grew significantly, as you can see on the slide here. We still see a somewhat lower visit level in group training classes, but this is gradually improving week by week.

As I said in the beginning of the presentation, we have a strong position coming out of the pandemic in a market that is growing, and we will deliver accelerated growth driven by several factors described on this slide. I will comment briefly and look some more into Mentra by SATS and club expansion, but looking at this slide, we see several drivers for growth.

We will grow the member base in our existing clubs enabled by data and technology, increasing the club capacity, and the marginal contribution from this member growth is very high. We will also add more new clubs to our portfolio, both by greenfield establishments and through acquisitions. Then we will improve and increase revenues per member, both by increasing membership yield through pricing initiatives and by increasing other revenues per member from retail, nutrition, personal training and treatments, and also potential new services. Combining this with scale in operations and cost discipline will contribute to top line growth and profit growth.

We will also continue to improve our digital product offering with the Mentra by SATS platform. We believe in the hybrid future and hence a growing market for digital training. People are getting more and more active, and they will be active both in fitness clubs at home and outdoor, and SATS should be relevant for these different member situations not only in the physical club.

That's why we launched Mentra by SATS, targeting both existing SATS members, those who are active but don't like to access fitness clubs, or those living in areas where SATS don't have a physical footprint. Mentra by SATS is also scalable for expansion into new markets. So, in short, Mentra by SATS is basically extending our vision of making people healthier and happier beyond our physical club footprint.

We have now also launched a pure digital version of Mentra by SATS where you can access the content without the connected hardware. We have increased the amount of content significantly and we are continuously launching new product features in the on-demand content, live content and with one-to-one personal training. In addition, we are planning to expand the product portfolio in Mentra by SATS by launching a connected fitness bike, and currently, the number of registered users on the platform has now surpassed 10,000.

In a few weeks, we are also moving ahead with the planned conversion from SATS online training to Mentra by SATS. Mentra by SATS will be our digital platform going forward, with significantly better content, [ph] designed end (00:08:21) user experience than what we currently have had with SATS online training. And from now, Mentra by SATS is available in all our markets including Denmark and Finland, and the Rflex mirror will also soon be available for purchase in these markets.

Then moving on from digital to physical growth, we completed the equity issue in the quarter and now we have the financial flexibility to pursue growth opportunities in what is still a very fragmented Nordic fitness market. You can see the market shares per country for small and independent clubs on the chart here. And then in our IPO, we guided at five to seven new club openings per year, and we have during the pandemic significantly ramped up club expansion, both through greenfield openings and acquisitions.

In total, we have opened 35 new clubs during 2020, 2021 and the first quarter of 2022, 6 being relocations and 29 new additions in our clusters. The latest club openings are Hinna in Norway and Näsby Slott and Hovås in Sweden. In addition, Ila and Bekkestua stasjon have been included from the acquisition of Gym Gruppen. These are fantastic clubs at key and very attractive locations for us, strengthening our clusters, both for new and existing members.

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

And looking ahead, we have already confirmed 22 new club openings, including the clubs from the acquisition of Bare Trening Sør, and we can't wait to welcome all the new members to these great clubs.

Then looking forward, we expect to continue to add new greenfield locations and do selected acquisitions, and we make decision on how to expand most effectively from case-to-case. There are generally some positive aspects with both greenfields and acquisitions. For example, with greenfields, we can build them from scratch based on SATS' standards and tailored to specific demand, resulting in optimized club square meters and optimized product offering.

But it takes some time for a greenfield club to mature and to generate profit. While with acquisitions, we do not add any more capacity to the market and we start with an existing member base so we can deliver financial results from day one.

During the last weeks, we have done two acquisitions in addition to our greenfield openings. We acquired Gym Gruppen with three clubs filling key white spots, Ila and Manglerud, and strengthening the capacity in the high-growth area Bekkestua in the Oslo region. We also acquired seven clubs through the acquisition of Bare Trening Sør. The Bare Trening concept is similar to Fresh Fitness, with unmanned clubs and group training in only one of the clubs. This acquisition is expected to close in [ph] July (00:12:23).

And when we are doing acquisitions, we are typically looking at an EBITDA multiple in the range of 4 to 6 times EBITDA, depending on the assessment of several factors, as you can see described here on this slide. And we target to create value both through accretive multiples but also through post-transaction operational effects. And after the acquisition of a target and integration, we use the full SATS toolbox.

We typically improve cost efficiency in operations by implementing the SATS operating model. We remove overhead cost, we improve the commercial activities resulting in an increased member base, and we also typically improve revenues per member by optimizing prices and launching new products and services. And this will also be guiding principles for us looking ahead in future M&A decisions to ensure value-creative deals.

And then I'll 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. Before we dive into the latest financial numbers, I would like to take a step back and briefly recap where we stood before COVID-19 pandemic hit and give some context of our historical track record since 2016. We came out of 2019 with a strong financial platform, continuing the positive trend from recent years with a robust top line growth and solid 15% annual improvement in profitability.

The growth in profitability was primarily done through increasing members per club through a relatively stable club portfolio; yield improvement both in terms of lifted membership prices but also significant increase in other revenues; and on top of that, improved cost efficiency, implementing a common operating model, further improving results and margins.

And we are now closing the pandemic chapter, and going forward, our main goal is to continue developing the existing club portfolio like we have done in the past, but on top of that, we have expanded our approach to growth, adding club growth to the list as a major contributor to future earnings.

So, before we start, I would just like to note that we continue to add the first quarter of 2019 and 2020 as comparison in the financial section just to give you a benchmark on the underlying scale and operating performance of the group when we are allowed to operate under normal conditions.

So, as we've shown previously, we have accelerated the club rollout during the pandemic and we have since the beginning of 2020 opened 29 new clubs. 5 of the clubs were opened this quarter, 3 greenfields and 2 acquired clubs; and we already have signed an additional 21 clubs opening over the next couple of years. And more importantly, the equity raise in February enables continued club growth as we now have the capacity to further tap into the attractive market consolidation with M&A.

So, the first quarter is normally our strongest growth quarter in terms of member growth, but as the first half of the quarter still was affected by both club closures and restrictions, this put a slight damper on the anticipated growth. So, across the group, we closed the quarter with 686,000 members in total, which is up 15% compared to last year and on par with 2019 on total club level.

We managed to grow 18,000 members, up 3% from the fourth quarter, which we consider strong taking into the current circumstances. And the growth has not come at the cost of lower prices. Despite heavy campaigning throughout this period, we have been able to increase the underlying membership yield through our pricing strategy, consistently lifting prices, resulting in an 8% price progression over the last three years. And our annual price optimization process to increase membership yield has historically proven successful, and we're constantly working on optimizing price levels 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; annual inflation adjustment for existing members, list price adjustment for new members coming in, and in addition, proactively lifting prices for members that for some historical reason have a membership that is far below the current list price. And over several years, the experience is that there is significant resilience to such price adjustments and concretely, we see that the annual adjustment performed last – late last year with effect as of January confirms the expectations of very low incremental churn.

And the additional positive benefit from lifting prices is the membership mix effect as the members coming in at higher prices than average further drives price progression. But the tight restrictions we saw on group training and multi-club usage temporarily has affected our price expansion during the pandemic. And as you can see on the graph, on the right-hand side, the curve is flattening throughout the most affected pandemic months.

But we now see that members are returning to similar behavior and habits as before the pandemic, we see an significant increase in demand for group training and multi-club access memberships, and the latest price adjustment increased prices with 2.3% and we also plan to do an additional price adjustment with financial effect as of mid-third quarter of this year. So, as a result, we expect positive yield development to pick up again, in line with what we have seen historically.

Other revenues are returning to pre-COVID-19 level, both in terms of average revenue per member and actual revenues. Other revenue per member increased by 3% compared to pre-pandemic despite restrictions early on in the quarter, and the increase is mainly driven by solid retail performance. But also a strong focus on getting new members to try PT and stimulating usage frequency has shown results, and we saw a record high PT start volume in March after significant efforts within this field.

And both personal training and retail have significant earnings contributions, as the margins for these additional products are 35% to 40% flowing directly to EBITDA. Total revenues crossed the NOK 1 billion mark, significantly up from last year and slightly up from the first quarter of 2019. But as we saw for member sales, restrictions on group training, visit capacity and club closures in Finland temporarily softens revenue ramp-up in the first half of the quarter.

Member revenue has developed steadily and improved quarter-by-quarter as restrictions are eased, memberships are unfreezed, and periods with strong membership sale from existing and new clubs. So, membership revenue is now for the first time above 2019 level. And the membership revenue bridge on the right-hand side illustrates where we stand in terms of run rate revenues compared to 2019.

Average number of members after Q1 was slightly ahead of 2019. The strong yield development we have seen over the recent years improves revenues further, with an impact in the quarter of NOK 36 million, so the underlying member revenues are now well above 2019 level. However, COVID-related freeze is still inflated compared to a normal year, but two-thirds of the NOK 29 million deviation is related to club closures in Helsinki in January.

And moving on to development per country, as said, group level revenues are fully recovered versus pre-pandemic, although the revenue recovery varies somewhat between the countries. Norway and Sweden are well above 2019 level, partially driven by new clubs. Finland is affected by the club closures in Helsinki in January but is approaching 2019 level towards the end of the quarter, and the Danish market is progressing somewhat slower than the other Nordic countries.

After the club closures in March, significant effort were made to reduce operating expenses for variable and semi-fixed costs, which were taken down according to the reduction in activity level. Now, with operations and activity returning to normal, costs also returns to normal levels, which explains the increase from last year. But looking at total operating expenses, it has increased by 3.4% annually since 2019, partly pure inflation-driven but mainly due to adding a net of 22 clubs to the portfolio. And in addition, we have extraordinary marketing push and campaign cost increase which increased the overall cost.

And for like-for-like clubs, the annual increase is lower at 1.3%, again, mainly inflation driven, adjustments on rent and related costs, and significantly increased electricity prices. This is partly offset by a successful cost savings to compensate for the overall cost increase, which results in a moderate cost increase in the quarter.

But looking ahead, we see some inflationary pressure as we see increased prices on some of our input factors, especially electricity prices but also our two other main cost items, rent and salaries. And we estimate that cost will increase around 4% to 6% on a like-for-like basis in the coming year. Price increases will offset the expected inflation partially in 2022 and fully in 2023.

So, adjusted EBITDA of NOK 30 million in the quarter is significantly improved compared to last year and show that we are on track for recovery, but reimposed restrictions across the Nordics resulted in weaker development in sales and increased freeze early on in the quarter. But again, the key message is that we are in the process of regaining our solid financial platform, members are returning, yield is increasing, over time should outweigh the inflationary pressure of costs, and we have a strong lineup of new clubs fueling continued growth.

And to elaborate a bit more on growth going forward, our business model benefits from operating leverage as cost base required to operate the current club portfolio is largely fixed. About a third of the costs is rent, a third of the costs is salaries, and the last third is club costs and marketing. So, around 85% of our cost base is fixed or semi-fixed, which means that incremental membership revenue has a 90% drop through to EBITDA for existing clubs.

Therefore, as member levels return and new clubs fill up with new members, the additional revenue growth flows directly to adjusted EBITDA. This also means that new clubs in the short run have a drag on profits in the maturing phase. And as I showed in the beginning of this section, historically, our profitability growth has come from developing a mature club portfolio increasing number of members per club, and our mature clubs still have capacity to continue to grow beyond 2019 level in terms of average members per club.

Yield expansion will contribute to improved profitability going forward, and the high demand for personal training and retail with strong margins is expected to grow in the future as well. 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 drives cost, negatively impacting profits in the short term.

On average, a greenfield takes 6 to 12 months to reach breakeven, resulting in a short-term drag in profits [ph] in (00:25:19) the maturing phase of its lifetime, and it takes an additional 12 to 24 months to reach full maturity, performing at portfolio average in terms of members and financial results. And for acquired clubs, we experience synergies in several areas 6 to 12 months after taking over, in terms of member growth, yield improvement and cost efficiency, implementing the SATS operating model.

So, to summarize, looking ahead, we will improve profitability going forward by member recovery, continued growth in mature clubs as well as yield expansion and other revenues; new and acquired clubs coming to normalized delivery; and further growth from already signed new clubs and future acquisitions. So, we are well on our way for recovery and further growth in EBITDA.

Maintenance CapEx has, through the pandemic, been lower than normal due to focus on cash preservation, less wear and tear on equipment because of reduced visits, and the lower average in age in the club portfolio, but we anticipate returning to more normal level of maintenance CapEx in 2022 at around 5% of revenues. We have a structured approach to club portfolio assessment in order to optimize prioritization of investments based on club quality, competitive situation and cluster strategy.

And in 2022, we will upgrade 28 of our clubs in Stockholm, completing the major Nordic portfolio revival, bringing overall quality level of the portfolio to the desired level. And the upgrades in Stockholm will be ranging from full refurbishment to minor upgrades of leasehold and equipment based on the assessed quality of the respective clubs. And in addition to specific club upgrades, we continuously upgrade our product portfolio in the other important clusters.

So, despite the pandemic, we have prioritized to invest for the long term, both in technology team, systems and infrastructure, but also, as said many times, club expansion. And we have shown that we have a strong pipeline of new clubs opening, and with the capital raise performed in February, we now have the flexibility to tap into attractive M&A consolidation potential, as Sondre described earlier.

And through continuously upgrading our existing clubs as well as expanding the portfolio through filling white spots and increasing micro-clusters' capacity, we maintain the stronghold in the Nordic capital cities.

Moving on to liquidity, we are in a well-controlled and satisfactory position as we close the quarter with NOK 400 million in cash and NOK 600 million in undrawn revolving credit facility. And in February, we raised NOK 600 million in an equity raise, which was conducted to ensure sufficient strategic flexibility to be able to act on organic and inorganic growth opportunities in the short- and medium-term, and to ensure a more robust liquidity position to utilize opportunities in the longer-term.

So, we have sufficient liquidity to handle current operation and signed greenfields, but the equity issue has given us the financial flexibility to pursue growth opportunities while the business is recovering. And in the meantime, we have made a down payment of NOK 300 million to the RCF to reduce interest cost immediately, and we will be able to draw on the facility when attractive acquisition opportunities materialize.

Free cash flow for the first quarter is negative at NOK 177 million, mainly due to negative working capital effects from postponed tax payments occurred during the COVID period and deferral of prepaid membership fees before the clubs were closed in Finland. But with member base recovering, restrictions lifted and deferred payments cleared, we will again start generating positive operating cash flow.

Now, ending this section on an update on net debt, where the equity issue strengthens the balance sheet and resets net debt to pre-pandemic levels at NOK 1.4 billion. And as previously communicated, we have been in close dialogue with the banks throughout the closure period and have a new amendment to the NOK 2.5 billion revolving credit facility, which was signed in March, adjusting the covenant and extending the RCF with one year until September 2025.

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 responsible deleveraging again as we have done in the past.

And with that, I will leave the word open to Sondre for outlook.

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie. As you have seen here today, we expect member volume to increase, driven by healthy and strong demand across the Nordics. We will accelerate the club growth in a market with great consolidation potential, and we will focus on maximizing the utilization of our current clubs. But keep in mind that we are now in the second quarter, typically a seasonally weak quarter for our industry.

We also expect yield to improve, driven by increased membership prices and continued growth of other revenue streams. We will continue to invest in digital products to develop an attractive and high-quality hybrid offering. And lastly, we will keep focusing on helping our members to succeed with their training that, in turn, will support visits and our vision on making people healthier and happier.

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