26-Apr-2023

SATS ASA (SATS.NO)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Sondre Gravir
Chief Executive Officer, SATS ASA

Good morning, and welcome to the SATS Q1 2023 Presentation. My name is Sondre Gravir, and I'm here together with Cecilie Elde, our CFO. We will run a Q&A session in Teams at 10:00 today to allow those of you who are following this presentation some more time to look into the report and numbers. It is worth noting that this will be a pure Q&A session without any further presentation. You will find the link to this Q&A session in the invitation to this presentation, both at News Web and on our website.

We are proud to present the best Q1 EBITDA in SATS history as a result of consistent, strong operational performance. This is fully in line with the trajectory, as communicated on the CMD in October and as confirmed in the Q4 presentation. We laid an important member-based foundation in Q3 and Q4 2022, securing a good run rate into 2023. This quarter, we continued the solid member growth and increased prices for both new and existing members, and are thus reassured of the high willingness to pay for gym memberships even in the current macro environment.

We have continued a strong cost control and the group-wide profitability program is now delivering results. The Q1 financial delivery is a result of continued member growth, increased yield and cost control. This also ensures a strong run rate going forward. Combined with record high member activity level, we are comfortable to continue the journey in line with the ambitions outlined on the CMD in October 2022.

Summarizing Q1 2023, we ended the quarter with 274 clubs and 734,000 members, total revenues of NOK 1.2 billion and EBITDA of NOK 137 million. Cecilie will, as usual, come back to the financials later in the presentation.

A key focus area of the past year has been to build up the member base. We cannot stress the importance of this enough. We operate in the business of high operational leverage, which we saw the flip side of during the pandemic, but now we are really gaining the benefits again. And this quarter, we are really starting to see the financial effect of the strong member growth that we had have over time. We have made significant price adjustments for both new and existing members.

Sales continued at high pace, despite the price increases, and the result is volume growth combined with yield improvement. And churn has naturally increased in absolute volume as we have a higher member base, but not increased significant [audio gap] (00:04:16-00:04:23) on activation of our members, inspiring them to visit us often and to establish good habits.

This is at the core of our vision of making people healthier and happier. And we are very happy with the record high activity level in our clubs this quarter, 12.8 million visits, up 27% from last year. And the growth is driven by more members in total and fewer members on freeze, but also that the average number of workouts per member have increased with 14%. This is a strong signal of our product strength and quality and our members' prioritization of own health.

One of our strong competitive advantages is our group training offering. We have a massive offering of classes both in volume and variety. It was a bit challenging to recover the group training activity among our members after COVID, but now, after improving the product offering, the scheduling, and communication, we are seeing really good results. In Q1, we passed our previous top performance from Q1 2019 in terms of number of group training sessions, and we have strong ambitions also going forward.

At SATS, our core product is good for society. Training is incredibly important for the overall public health. Our vision is to make people healthier and happier, and hence UN sustainability goal number three is very important for us: good health and wellbeing. And here, we are a significant contributor in the Nordics, and this goes hand in hand with our financial profitability. More members and more active members improve the financial performance.

We know that physical activity is good for us on an individual level, and we know that it saves society a range of costs through disease prevention. But how much? We have aggregated the impact for all members and measured the socioeconomic impact of SATS members' workouts on a quarterly basis. When only considering the members who have reached World Health Organization's recommendation for physical activity at SATS alone, a conservative estimate, in other words, SATS members have in the past 12 months contributed to around 14,000 quality-adjusted life years. That's 14,000 extra years of living with good quality. That might be hard to grasp, but it translates into more than NOK 20 billion in socioeconomic welfare gain. And we are proud of this and we will continue to strive for making further positive impact for society.

And we want to take an extended public health responsibility with the focus being directed toward youths as it's essential to establish healthy habits early in life. And we also know that physical activity is important for improved mental health. So, we have decided to help all students across the Nordics through an important and challenging exam period. We are opening all our clubs in the Nordics and welcome all students to work out for free during daytime throughout the exam weeks. So, to all of you students, welcome to train your brain.

We also want to make people healthier and happier outside our clubs, and inspire people to work out outdoor or at home. Our previous digital offering, Mentor by SATS is rebranded now to SATS Online. And we offer the largest online fitness library in the market with more than 750 available classes. The digital offer is included in our most extended memberships and is also sold standalone. And we see a positive development on this service [audio gap] (00:09:13). We now have more than 61,000 registered users and little bit above 8,000 weekly digital workouts.

We have during the last quarters opened several new clubs, laying a strong foundation for future growth. We are now, as communicated on the CMD, focusing on improving profitability of the current footprint and slowing down on signing new locations. We are also relocating or closing clubs, if they are low-performing, which is only the case for a small ratio of our club portfolio. In Q1, we opened two new greenfields and closed three clubs. In addition, we rebranded our two HiYoga clubs in Oslo to SATS Yoga, a natural step, given the positive overall development for yoga in SATS. We now have nine club openings and two club closures in the pipeline for the rest of 2023 and 2024.

At the CMD in October, we described our ambitions going forward and the key building blocks to significantly grow our financial delivery. Let's recap the key elements on where we stand after Q1. Number one like-for-like clubs. We have regained the profitability in the like-for-like portfolio back to the pre-pandemic levels, but there is no reason to stop there. With strong operational leverage and marginal contribution from new members, we still have a significant potential to grow profitability further.

Building block number two, maturing clubs and signed greenfields. We have made significant improvements and are on track and according to plan, but we still have a way to go to bring our newly opened clubs to the same average member base as the like-for-like portfolio. This maturing part of the portfolio hence has a strong EBIDTA potential going forward.

And building block number three, utilize operational leverage and scale. We implemented the group-wide profitability program in Q4 2022 and are starting now to see the results. We are making club optimizations and ensure overhead cost discipline to contract in the high inflation, as well as making sure to capitalize on our scale in the long term. And this work will also continue going forward.

Number four, future growth levers. Growth in the more medium and longer term will be accelerated by further club expansion both in existing and new clusters. We will also fuel revenue growth by extending our product offering beyond the current core, unlocking new revenue streams like we, for example, now are doing with the physiotherapy business. With 734,000 healthy and happy members, we have a significant commercial potential for revenues in addition to the member revenues. So, the key message is that we see several important growth drivers also going forward.

I will come back to the outlook, but first, Cecilie will take us through the financials.

Cecilie Haugen Elde

Chief Financial Officer, SATS ASA

Thank you, Sondre, and good morning, everyone. In the following financial presentation, we are for the first time, after pandemic, showing unadjusted comparators, leaving 2019 behind and focusing on the development now since 2022. We do however have significant impact from currency translation in the quarter when comparing to last year. So, in the following, we will show both actual deviations and currency adjusted developments where relevant, and I will comment on the latter.

And as we have presented, the financial result in the quarter shows a significant change in pace. And I want to take a step back and briefly summarize what is driving the strong performance and development, because this is not a result of short-term actions but strong operational performance over time that are yielding results. We now see the impact the operating leverage in our business has on profitability, which we saw the flip side of during the pandemic. And the combination of strong member development over time, increase in average revenue per member and cost discipline are the drivers of the positive development and the foundation for our long-term value creation.

And with this, we are also proving our ability to handle the high inflation through price increases and cost discipline. And starting off with the member development, we are closing the quarter with a base of 734,000 members, which is an all-time high after a period of strong sales and churn overall, in line with historical levels.

And the first quarter is always an important growth quarter. And we have seen continued solid sales development even with less campaign activities compared to previous quarters. And fall-off is also at a decent level considering the significant price increases performed in the quarter, affecting net growth somewhat but less than we have anticipated.

So, there are still no signs of change in member behavior or willingness to invest in own health. And over the past year, the growth in the member base of 7% comes from both like-for-like and maturing clubs. But equally important, the growth in members per club of 4% has a significant impact on profitability due to the high operational leverage.

And the second important lever in order to improve profitability is to increase prices and keep a fair price level. And in Q4 of 2022 and Q1 of this year, we have executed on our annual pricing strategy of adjusting prices for new and existing members.

Cost has increased significantly over the past year and created a lag in our price-driven revenue growth compared to cost increases. And with the latest price adjustments, we are now mitigating the gap by increasing list prices for memberships on average with 8%; inflation adjustment of existing members according to the country-wise Consumer Price Index; and finally, a price adjustments for members that, for some historical reason, have a membership price far below the current list price. And this results in an improvement of membership yield of 6% compared to last quarter and 12% compared to last year. And the combination of volume growth and price increases resulted in a significant lift in revenues in the quarter. And as a result, total revenues are up 15% compared to last year.

And member revenue alone had an even stronger development, increasing by 20% since last year and is an important proof point of our ability to build member base and charge a fair price for memberships, and an important contributor to our long-term profitability. Other revenues, on the other hand, show a more moderate growth development and the increase in members does not fully translate into increase in additional revenues.

So, we will see – we see a slight decline in average revenue per member for other revenues. This is a result of the personal training business, which is somewhat slower due to fewer personal trainers both in SATS and in the industry as a whole, as it has been since the corona period, but ends in line with last year. Retail sales is also in line with last year, but now distributed across more members.

And looking at the development per segment, the picture is fairly similar across markets, a strong development in member revenues and fairly stable in other revenues. And all countries are contributing positively relative to their size.

Total operating expenses have increased with 5% compared to last year, driven by both increased prices on our main input factors, but also from extending the club portfolio. Cost at the like-for-like clubs, the average increase is somewhat lower at 3%, which is mainly inflation-driven and related to rent cost and energy prices. And this is partly offset by cost saving efforts to compensate for the overall cost increase. And as previously presented, the cost base is addressed through a profitability improvement program, gradually coming into effect during 2023, and we have already cut overhead by 7% compared to last year.

Energy costs are stabilizing, but continue to be higher than usual at NOK 59 million in the quarter. And looking ahead, we expect continued inflationary pressure as we see increased prices on our input factors, especially wages and energy prices. But over time, we are aiming to counteract the inflation with cost discipline and further price increases.

So, the EBITDA of NOK 137 million in the quarter and 11% margin is a result of strong operational performance now yielding results. A key focus area over the past year has been to build up the member base and offset inflationary pressure with price increases and cost discipline. Our like-for-like portfolio are back to decent profitability, but we still have untapped potential in further improving our maturing clubs. And with the operational leverage in our business model, we are now reaping the benefits, getting our financial performance back on track.

[indiscernible] (00:19:46) levels of upgrade and maintenance CapEx in the quarter as many of our maintenance activities are optimally planned to periods with lower activity levels at the clubs. And 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 we plan to return to more normal levels of maintenance CapEx in 2023 at around 5% of revenues. We have a pipeline of six new clubs opening in 2023, but further expansion has been temporarily paused due to the current macroeconomic climate.

In the first quarter, we are back to being cash generative with an operating cash flow of NOK 100 million. Working capital has slightly worsened, mainly due to a partial realization of the extraordinary cost accrued for in Q4 of 2022. And the liquidity is severely hit by a negative currency effect in our cash pool and credit facility, resulting in a weakening liquidity position compared to last quarter, despite the strong development in underlying cash flow. Still, we deem our liquidity position as well-controlled and satisfactory as we close the quarter with NOK 340 million in cash on the balance sheet and NOK 356 million in undrawn revolving credit facility. In our view, we are sufficiently funded to handle our current operations, as well as facilitate our communicated growth strategy.

And now ending the financial section with an update on net debt. The COVID-19 period resulted in significantly losses, which has resulted in increase in debt. Historically, we have shown strong cash generation capabilities and stable cash conversion, resulting in a solid deleveraging profile. So despite the positive operational cash flow, net debt is negatively impacted by currency effects in the quarter, with a NOK 48 million negative impact on total bank borrowings, and a NOK 62 million negative impact on cash and cash equivalents, and thus resulting in an increase in net debt in the quarter. In the short term, investments in club expansion will be limited, prioritizing to reduce debt and leverage throughout the year.

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

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie. First of all, we are encouraged by the development over the last quarters and confident looking ahead. We expect member growth to continue in the long term. But the development will, of course, be affected by seasonal variations. As an example, Q2 is typically not a strong member growth quarter. The average revenue per member increased substantially this quarter as a consequence of the price adjustments we have made this winter. We cannot expect the same increase going forward, but we do expect a positive development as new memberships now are sold at the high prices, bringing up the average yield in the member base.

We are well on track on the journey toward healthy financials and healthy members, and in line with the ambition outlined on the Capital Markets Day in October and expect to continue this journey. And lastly, we will focusing on helping members to succeed with their training, increasing visits and support our vision of making people healthier and happier.

With this, we wish you all great day. Thank you.