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SATS ASA (SATS.NO)

Q2 2023 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Sondre Gravir

Chief Executive Officer, SATS ASA

Good morning, and welcome to our quarterly presentation. I'm Sondre Gravir, the CEO of SATS and I'm here with Cecilie Elde, SATS' CFO. We will run a Q&A session today in Teams at 10 o'clock to allow some more time to look into the report and numbers. It's 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 [ph] Newsfeed (00:00:34) and on our website.

First, let's take the highlights from the quarter. Revenues in the quarter increased by 12% currency adjusted and 18% non-adjusted. The revenue growth is driven both by a combination of increased number of members and higher yield. We have throughout the quarter have strong cost control mitigating the current inflationary pressure. The result is a record high quarterly EBITDA of NOK 194 million in Q2, following the significant financial step up delivered in Q1 resulting in an EBITDA delivery of NOK 332 million the first six months of 2023, up 192% from 2022 first half.

Following this financial delivery and the prospects for the coming period, we expect to cancel the covenant waiver of the revolving credit facility ahead of expiry at the end of 2023, returning to the original covenant of 4 times net debt to adjusted EBITDA. Lastly, I would like to highlight the high activity levels in our clubs with 16% more visits during the second quarter.

We ended the quarter with 273 clubs across the four Nordic countries and 715,000 members. I have already commented on the financial highlights and Cecilie will come back to this in detail in the financial section of this presentation. We have shown a strong and stable member growth in the past year, as can be seen in this graph showing the rolling four quarters members base. The number of members is today 6% higher than it was one year ago with a club growth of only 2% in the same period. So, this growth is really driven by more members in our existing clubs. With a high operating leverage and high dropthrough to EBITDA, this yields significant financial effect. In Q2 isolated, the member base was reduced as the second quarter is typically a period with lower sales. However, the reduction was [ph] fully (00:03:12) in line with expectations and historical comparables.

Since last summer, we have received a lot of questions about the effects of the weakened consumer sentiment on SATS. This is also something we have been following very closely with action plans in place in case of any weakened demand. However, we have seen a very consistent and strong demand for gym memberships all the way. Taking a closer look at the most recent figures, we see more members joining this quarter than in the comparable quarter last year at the higher price points. The average currency adjusted price for new members joining was 15% higher and the number of new members was 6% higher. So there are still no sign of weakening of our core business making up 80% of our revenues. However, we do see some weakening in retail and personal training, making up 20% of the revenues with a somewhat lower sales of clothes and personal training sessions.

SATS' vision is to make people healthier and happier. And in order to deliver on this visions, our members have to visit us and actually use our product. At the same time, total number of members is the key driver for such financial profitability. And we see that active members are happy members and they stay with us over time.

It is mostly the passive members who are cancelling their memberships. So if we manage to increase the activity levels in our member base, we will grow the base and hence, see a positive development both in our financial delivery and in our positive contribution to public health. And this is why the number of visits is such an important KPI for us.

And we increase number of visits by making sure that we have the best product offering possible to our members and that we continuously improve our product offering, which we have really done over the last year by, for example, launching new classes, improving the fitness floor, upgrading our clubs and so on. And communication with our members is also important through nudging and inspiring our members through the SATS app, we see that the activity level and workout routines are improving. And we now have close to 400,000 weekly users in our app, which makes this a great communication channel.

The result of this work, and of course, our members' great effort is clear and has shown very positive trend over time. Now, in the second quarter this year, we had 16% more visits to our clubs than in the same quarter last year. This was both driven by the mentioned member base increase and also by higher activity levels per member. The trend continued also into the summer with an impressive 24% increase in visits in July year-over-year. This was partly driven by a significant 38% increase in number of group training visits proving the value of this product to our members, which separates SATS from low cost players in the market.

We have a massive offering of classes both in volume and variety, and from this week, we are operating our full schedule after the summer period and we now offer our members in total 9,500 classes every week in our clubs across the Nordics. So, if you haven't tried our class yet at SATS, please do so, it's fun and hard at the same time. And then, some of you might remember, it was a bit challenging for us to recover the group training activity among our members after COVID. But now, after improving the product offering, the scheduling, and the communication, we are really seeing strong results and a positive development for group and classes in SATS.

If we go one step further, the effect of all of these SATS workouts is a significant improvement in public health. We have aggregated and measured the socioeconomic impact of our members' workout. SATS members have in the past 12 months contributed to around 15,000 quality adjusted life years. And what is that? That is 15,000 extra years of living with good quality, representing and translating into a NOK 22 billion in socioeconomic welfare gain. So if we grow, our business in SATS, the society benefits. And I think SATS is one of the true positive ESG companies listed at the Oslo Stock Exchange. And we will continue to grow. The whole fitness industry will continue to grow. And this is driven by three strong factors. First, we see a global megatrend around higher health awareness in the population. People want to invest in and live a healthy and active life.

Second, younger generations are typically working out more than older generations, and the higher share of workouts are done in fitness clubs, and they keep their habits as they get older replacing generations with relatively lower activity levels.

And thirdly, SATS' own efforts to increase the activity level and spread awareness of the importance of physical activity in our member base of 715,000 members also improve the overall activity level in the population.

So with these three trends and the fact that currently nearly 80% of the Nordic population is not having a fitness club membership, the positive contribution to society from SATS and the whole fitness industry will continue to strengthen.

Then moving over to portfolio development. We do have available capacity in our existing clubs. So for a period now, we have chosen to slow down the club expansion after a couple of years of high club growth. As presented during the Capital Markets Day in October last year, we are focusing on optimizing the existing club portfolio, including closing down selected clubs, relocating where that makes sense, and taking all the newly added clubs up to the same profitability level as the rest of the portfolio. Hence, during Q2, we have added two new clubs to the portfolio and closed two. And going forward, we have seven confirmed new openings in the pipeline.

So finally, to summarize before we go into financial section, we presented this slide also in the last quarterly presentation. I will therefore not go through it in detail, but I wanted to again highlight that we are following the plan presented on the Capital Markets Day last fall. We see several important growth drivers also going forward for SATS, improvement in the like for like profitability, continued development of maturing clubs and greenfields, utilizing the operational leverage and scale through club optimizations and further club expansions in the longer term.

And I will come back to the outlook, but now I leave it over to Cecilie to take you 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 showing an adjusted comparators leaving 2019 behind and focusing on development since 2022. We do however have significant currency translations when comparing to last year. So in the following we are showing both actual divisions and currency adjusted development where relevant. And I will comment on the latter.

The member base has proven to be quite resilient through several price increases even in a challenging macro environment and we are closing the quarter with a base of 715,000 members. This is an increase of 6% compared to last year with member growth in all our markets. Over the past year, the growth in the member base of 6% 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 higher operating leverage.

The second quarter is seasonally a period with a decline in members due to lower sales, as is the case this year with a decline of 17,000 in the quarter, but both sales and drop-off are in line with historical pre-COVID comparables. So far, we see no signs of change in member behavior or willingness to invest in own health.

An important lever in order to improve profitability is to increase prices both to keep a fair price level across our member base and to mitigate the inflation-driven cost increases we have seen over the past year. Our pricing strategy has, over time, yielded significant results, and over the past year alone, we have a currency-adjusted improvement of 8% compared to last year, implying a membership yield-driven revenue improvement of NOK 76 million in the quarter.

Other revenues, on the other hand, show a more moderate growth development and the increase in members does not fully translate into additional revenues, resulting in a slight decline in our [indiscernible] (00:13:36) other revenues compared to last year. But the combination of volume growth and price increases resulted in a significant lift in revenues in the quarter, and total revenues are up 12% to NOK 1.2 billion.

Member revenue alone has had an even stronger development, increasing by 16% since last year and is an important proof point of our ability to build member base and charge a fair price for our membership, which is an important contributor to our long-term profitability. And as said, other revenues are showing a more moderate development.

The personal training business is lower due to fewer personal trainers, both in SATS and in the industry overall, as it has been since the corona period, ending in line with last year. Retail sales is also in line with last year, but distributed across more members.

That said, we are pleased to see that our core business, our member base and corresponding membership revenues, and 80% of the total revenues, is performing very well, even after several price increases in the challenging macro environment with deteriorating disposable income for many of our members.

And looking at the development across the four Nordic markets, the picture is fairly similar; strong development in member revenues, and stable development in other revenues, with all countries contributing positively relative to their size.

Total operating expenses show only a slight increase of 1% compared to last year, mainly as a result of the profitability program initiated last year gradually coming into effect. In addition, we see some benefit from lower cost of goods sold following lower additional sales and somewhat lower marketing spend, which should not be considered permanent cost reductions.

Energy costs are stabilizing but continue to be higher than usual at NOK 45 million in the quarter, including a NOK 6 million loss on the energy hedge. And energy hedges will be considered going forward as well as part of our long-term strategy.

But looking ahead, we expect continued inflationary pressure as we see increased prices on our input sectors, especially wages with the annual adjustment coming into effect in the third quarter and rent related costs continuing to be high driven by inflation. However, over time, we are aiming to continue counteracting inflation with continued cost discipline and price increases.

Moving to a EBITDA and on this slide we are showing both reported EBITDA and EBITDA before IFRS 16 adjustments. And I will comment on the latter as this is the metric that makes the most sense in our business, including the important rent cost element.

And we are reporting an EBITDA before IFRS 16 of NOK 194 million and 16% margin in the quarter, which is not a result of short-term actions, but is strong operational performance over time that is yielding results and continues the strong development we reported last quarter. For the first half year, EBITDA of NOK 332 million confirms that we have a significant change of pace in our financial delivery. And the combination of strong member development over time, increasing average revenue per member and cost discipline are the drivers to the positive development and the foundation for our long term value creation. And with this, we are also proving our ability to handle the higher than normal inflation through price increases and cost discipline.

Our like-for-like portfolio is back to decent profitability, but we still have untapped potential in further improving our newest and maturing clubs. And with the operating leverage in our business model, we are now reaping the benefits, getting our financial performance back on track.

The level of upgrades and maintenance CapEx has been moderate both in the second quarter and in the first half of the year, due to precautionary spending approach. We have a structured approach to club portfolio assessment in order to optimize prioritization of investments and club quality, competitive situation and cluster strategy. And with the recent financial development, we plan to return to more normal levels of investments in the second half of the year and onwards at around 5% of revenues. And going forward, we have a pipeline of four new clubs opening in 2023 and three clubs opening in 2024. But further expansion has been temporarily paused due to the current macroeconomic climate.

Operating cash flow for the second quarter is positive by NOK 70 million despite significant negative capital effects reflecting normal seasonal settlements on deferred liabilities. And SATS benefits from structurally negative working capital driven by membership prepayments and follows the seasonality of the business. So working capital tends to be lower in November to May and higher in June to October, with accrued holiday pay paid out in June for Norwegian employees affecting the second quarter working capital.

Positive free cash flow improves overall liquidity, but is somewhat affected by a financing cost in the quarter related to the share repurchase program, as well as currency effects in our cash flow and credit facility. And our liquidity position is well controlled and satisfactory as we close the quarter with NOK 334 million in cash on the balance sheet and NOK 367 million in undrawn revolving credit facility. And in our view, we are sufficiently funded to handle the current operations and growth strategy.

The COVID-19 period resulted in substantial losses and significant increase in debt. And last year, an addendum to the rolling credit facility was entered into with adjusted temporary covenants set to apply until the end of 2023. Over the last quarters, net debt has been fairly stable, but leverage has come significantly down with increased earnings. And with the addition of cash generation capabilities improving, we expect to see a rapid and continued deleveraging throughout the remainder of the year and onwards. And as a result, we expect to cancel the covenant waiver ahead of expiration, returning to the original covenant being below 4 times net debt to EBITDA, resulting in a lower margin and interest expenses going forward.

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

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie. So, this summarized the second quarter of 2023. Looking ahead, we expect an active second half of the year with continued high activity levels in our clubs. And based on what we know today, we don't expect the weakened consumer sentiment to impact our core business, member development and revenues. We expect steady member growth in the next months, though not in line with the high extraordinary COVID recovery years like the second half of 2021 and 2022. Our member yield is expected to continue to outperform 2022 levels, and we will continue to follow the plan and ambitions outlined on the CMD in October 2022.

So that was it for today. Thank you for listening. We wish you all a healthy and happy day.