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SATS ASA (SATS.NO)

Q3 2023 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 SATS' Q3 2023 Presentation. My name is Sondre Gravir, the CEO of SATS and together with me here today, we have Cecilie Elde, our CFO. We will run a Q&A session in teams at 10:00 today to allow those of you who follow this presentation 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 NewsWeb and at satsgroup.com. In SATS, we are strongly dedicated to deliver on our vision of making people healthier and happier. This is what we do every hour, every day of the year. We are improving people's and public health. And only so far this morning, 15,129 members have entered into the doors in our clubs, ready to start their day with the SATS workout. That's a real energy boost.

Then, moving into Q3, Cecilie will, as usual, cover the financials later in her section. But summarized, we are today reporting a strong financial result. Number one, we delivered Q3 EBITDA before IFRS 16 of NOK 155 million. We have had the consistent strong financial delivery throughout the full 2023 with year-to-date revenues of NOK 3.5 billion and year-to-date EBITDA of NOK 486 million.

Number two, we closed Q3 with 731,000 members. We have delivered steady member growth over time, significantly increased yield and improved utilization by increasing members per square meter. This has substantially increased our financial results due to high drop through from revenues to EBITDA from new members in existing clubs.

And number three, we have maintained a strong cost discipline and the conservative CapEx spend.

And number four, improved earnings and cash generation results in high-paced deleveraging from 10.5x to 3.1x net debt to EBITDA ratio.

Overall, we delivered strong growth in our core business. We have seen a very consistent and strong demand for gym memberships all the way, even with the more challenging macroeconomic situation. And remember, member revenues makes up 80% of our total revenues. We have delivered strong sales in Q3, somewhat down from 2022, which was a COVID recovery quarter, but significantly higher than the last normalized Q3 back in 2019.

And we sold new membership at the 18% higher average price than in Q3, 2022. This is a result of both increased prices and lower share of sales in campaigns. And this is a very strong delivery. The average yield in the full member base is up to 6%. However, we also mentioned in our Q2 reporting we are not growing additional sales from PT and retail indicating a slowdown in demand for these products, which we do believe is explained by the current macro macroeconomic situation.

But I want to highlight that we have significantly improved our retail margins compared to last year, and we don't have large inventories that we need to clear like many other retailers these days.

And then, looking over to visits in our clubs. We continue to see increased activity level in all our clubs and this is how we really make people healthier and happier. Total visits are up 17% year-over-year. And the increase is especially strong for our classes where we have a strong competitive advantage with an increased participation of 26%.

And this, we are very proud of and it's a result of hard work with scheduling and recruitment and education of our great instructors. And no one, no one in this market is close to deliver so many classes, as we do for cycling, for running, for strength, for flexibility and yoga. Just in Oslo this week, we have 600 running classes and 500 yoga classes on the schedules. There's something for everyone.

And all these workouts are having a great impact on the lives and health of our members. And with healthier members comes healthier society. SATS members have in the past 12 months contributed to around 16,000 quality-adjusted life years. That means 16,000 extra years of living with good quality and it translates into over NOK 22 billion in socio-economic welfare gain. This is our contribution to a sustainable society.

And one-year ago we had our Capital Markets Day and deep dived into the company's history, current status and outlook. And we are dedicated to continuously improve SATS. So let's evaluate where we stand one year after the Capital Markets Day. First of all, at the CMD, we pointed out that the long-term strategy for SATS remains the same. The fitness industry has not changed significantly after COVID.

The fitness market is growing and 80% of the Nordic population does not have a fitness club membership. And the global megatrend around living a healthy lifestyle is stronger than ever. And we have a club portfolio in SATS, ELIXIA and Fresh Fitness now that is both stronger and with more potential compared to the level we had at our IPO. However, we did after the pandemic faced some short-term challenges that we needed to address in terms of uncertain macro-economic situation, increased energy prices, and a lower member utilization per club.

So we went back to basics. We focused on improving our products, growing members per club, increasing the average revenue per member and improving square meter efficiency. And we implemented several cost initiatives. We also stated clearly at the Capital Markets Day that we will prioritize to reduce our leverage ratio.

And with the high drop through from membership revenues to EBITDA of 90%, the earnings potential from increasing the member base in existing clubs is significant. We highlighted that we will deliver on this by improving the product offering that we would upgrade and relocate existing clubs, that we would optimize the club laid out and that we would downsize and relocate the clubs that had spare capacity.

And, yes, we have delivered on all of these levers. Members per club is up from last year. And we have potential for further growth. First, coming back to 2019 levels and then continuing the growth from there. We are optimizing our clubs and members per square meters is hence developing positively and is actually higher now than we saw pre-pandemic, which is a significant improvement over the last year.

And these club optimizations include smarter club configuration at new clubs. It includes adjusting the size of existing clubs and optimizing the square meter distribution and equipment mix. So let's have a look at a few examples. Many of you probably walk by our club at Nationaltheateret in Oslo from time-to-time. This is a relatively small club in the micro cluster of clubs that has a broad range of group training availability.

And based on the data-driven approach of usage data, we therefore chosen to remove the group training room at Nationaltheateret and increase the space of the fitness floor [indiscernible] (09:52) increase in both visits of 126% and member satisfaction increasing by 37%.

Another example is from Finland. The main focus of the club optimizations there have been on relocations and there have been several good relocation examples. As one example, let's take ELIXIA [ph] Ruoholahti (10:17) which was relocated in December 2022 to premises nearby with better availability and visibility. The results have been outstanding. Despite a slightly smaller club space, the member base has increased, leading to a 148% increase in members per square meter and comparing the financial result prior to the pandemic, Q3 2019 club EBITDA has increased by 221% in this club.

And these are only two examples and we have many more. And we will continue to optimize our club portfolio to deliver further growth. The club growth pipeline has been unchanged since the Q2 presentation and we now have five remaining new clubs to be opened over the next 12 months.

So overall, we are delivering on the actions we communicated on the Capital Markets Day. We have increased the club utilization of existing club portfolio, member per square meter is growing by 4%. We are increasing revenues per member. The yield is up 6% from last year and the average price for new members is up 18%.

We have demonstrated strong cost discipline and executed an effective cost reduction program. Despite the high inflationary pressure, we've reduced the total operating cost by 3%. And we have taken down CapEx significantly. And going forward, we will return to a normalized level of 5% of revenues in maintenance CapEx.

And lastly, we have grown within the existing club footprint, improving cash generation and reduced our leverage ratio from NOK 10.5 million one year ago to NOK 3.1 million today. And we are also committed to deliver on this going forward.

Our subscription-based model provides predictability for revenues and time to adapt to external changes, as also proven in the past. And going forward, we will continue to improve our club efficiency. This will include both growing the member base and optimizing the square meters. And with a high drop through to EBITDA, these improvements have significant effect.

We will also further deleverage as we have done in the past year and reduce our net debt. We have positioned ourselves so we are able to increase the investments in our current club portfolio, which will further strengthen the competitive advantage of SATS. And this is overall resulting in strengthened product offering to our members, improved financial robustness through higher cash generation and the deleveraged balance sheet, positioning us for future growth in the growing fitness market.

And with that, I leave the word over to Cecilie for the financial section.

Cecilie Haugen Elde
Chief Financial Officer, SATS ASA

Thank you, Sondre, and good morning, everyone. So, the member base has proven to be quite resilient through several price increases, even in a challenging macro environment. We're closing the quarter with 731,000 members. This is an increase of 3% compared to last year, both in the member base and in number of members per club with member growth in all our markets.

The third quarter of the year is seasonally a period with which starts off slow, with half of the quarter still being in vacation mode and the second half finishing strong with members coming back after summer. Normally, this results in a fairly flat quarter in terms of member growth. So net growth of 16,000 members is considered strong even if we are behind tough comparable numbers from last year.

But this confirms what we've been commenting on over the last quarter that so far we see no significant signs of change in member behavior or willingness to invest in own health. And in addition to growing the member base in a tough market, we have been able to do so at higher prices, both for new and existing members.

And our pricing strategy has over time yielded significant results for membership prices and over the past year alone, we have a currency adjusted improvement of 6% compared to last year, implying a membership yield driven revenue improvement in the quarter of NOK 50 million.

Membership yield is down compared to last quarter, which is normal seasonality due to increased freeze level during summer and we have recently implemented new freeze rules as a churn preventative initiative during the summer months, which have increased freeze somewhat, but we expect to see positive long-term effect on churn.

And the combination of volume growth and price increases resulted in a significant lift in revenues in the quarter, and total revenue are up 11% to NOK 1.1 billion. The member revenue increase of 11% in the quarter and 16% year-to-date is an important proof point of our ability to build member base and charge a fair price for membership, which is important for our long-term profitability.

And other revenues show more moderate development. The personal training business is somewhat slower due to fewer personal trainers, both in SATS and in the industry overall. And in addition, we see fewer PT customers and lower spending per PT customer as the both PT packages are spread over a long period of time.

But we do however see improvement in margin after both lifting prices and running fewer campaigns than what we have done historically. Retail sales is in line with last year and also for retail, we have improved margins substantially the past year through tight inventory control, price management, and reduced number of campaigns.

But that said, we are pleased to see that our core business, our member base, and corresponding member revenues and 80% of total revenues is performing very well even after several price increases and in a challenging macro environment.

The profitability improvement program initiated last year continues to yield results and the operating expenses are significantly down after successful reductions for costs related to salaries, mainly overhead, rent-related costs and marketing spend. Total operating cost is down 3% after adjusting for currency, which is also partly driven by the reduction in direct costs and energy costs.

The direct costs are lower than last year, following lower additional revenues from personal training and retail sales. And energy cost is also significantly lower than last year, with reduced spot prices in the areas where we operate.

And if you exclude these two items, the underlying cost increase is up by 1.7% in the quarter, which better reflect the cost base going forward after effects from the implemented cost reductions. And year-to-date, the corresponding cost base is up by 2.6%, which is still significantly lower than inflation and reflect the impact of the cost reducing initiatives.

And to reduce risk, we have hedged the electricity spot price for 50% of estimated consumption for Q4 of 2023 and the first quarter of 2024. And looking ahead and moving into next year, we expect continued inflationary pressure as we see increased prices on our input sectors, especially wages and rent, continuing to be high driven by inflation. But over time, we are aiming to continue to counteract inflation with continued cost discipline and price increases.

Then, moving on to EBITDA. On this slide, we are showing both reported EBITDA and EBITDA before IFRS 16 and I will comment on the latter as this is the metric that makes more sense in our business where we include the rent cost element constituting a third of our cost base. And we are reporting an EBITDA of NOK 155 million in the quarter and 40% margin. And this is not a result of short-term actions, but strong operational performance over time yielding results.

And the year-to-date, EBITDA of NOK 486 million confirms that we now have established a new run rate for financial delivery and the combination of strong member development over time, increasing average revenue per member and cost discipline are drivers of the positive development and the foundation for our long-term value creation.

And the subscription-based business model gives us visibility for revenue development and gives us time to adapt if necessary. And we have [ph] improved (20:00) our ability to handle higher than normal inflation through price increases and cost discipline.

Moving on to CapEx. The level of upgrades and maintenance CapEx has been moderate so far this year, both due to a precautionary spending approach, but also delay of some projects planned for the third quarter, expected to be implemented in the fourth quarter and with some spillover effect to 2024.

With the recent financial development, we will return to normal levels of maintenance CapEx at an average 5% of annual 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 going forward, we will increase investments in our existing clubs, growing the existing club capacity, improving our product offering for our members. And when it comes to expansion, we have a pipeline of one new club opening in 2023 and four clubs opening in 2024 as further expansion has been temporarily paused to focus on existing portfolio improvements and deleveraging.

Operating cash flow for the third quarter is positive by NOK 139 million, resulting in a cash conversion of 90%, which is especially high this quarter due to the described low maintenance CapEx. We have positive working capital effects in the quarter following the growing business with prepayment of memberships.

And looking on the right-hand side, operating cash flow over the last 12 months of NOK 361 million and cash conversion of 80% shows that our cash generating ability is recovering, as is now well on way to a more normal level. And cash development over the last 12 months shows that the business generated sufficient cash flow to more than cover operating cost, maintenance, and growth CapEx, financial costs and leaving room to reduce debt and [ph] deleverage (22:13).

Our liquidity position is well controlled and satisfactory as we closed the third quarter with NOK 442 million in cash at hand and NOK 380 million in an undrawn revolving credit facility. With free cash flow of NOK 81 million and positive currency effects in the quarter, mainly from currency translations in the cash flow and rolling credit facility, the liquidity position is improved by NOK 121 million.

In our view, we are sufficiently funded to handle our current operations, plans for communicated deleveraging and growth strategy. The COVID-19 period resulted in substantial losses and a significant increase in debt. And over the last quarters, net debt has been fairly stable, but leverage has come significantly down with increased earnings.

This quarter, we see a step down in absolute net debt with a combination with the strong momentum in earnings resulting in significantly deleveraging from 10.5 last year to 3.1 times net EBIDTA this quarter. And with the addition of cash generation capabilities improving, we expect to continue to see rapid deleveraging throughout the remainder of the year and onwards.

And as a result, we have cancelled the covenant waiver ahead of expiration, returning to the original leverage covenant of a maximum four times net debt to adjusted EBITDA before IFRS 16, which results in lower margin and interest expenses as of November, and the effect of lower margins will all else equal reduce annual interest costs by NOK 25 million.

So, to conclude this section, we have been very consistent in our messaging the past year and delivered strong financial results these three quarters in a row and this corresponds well with indications that we gave last year at the Capital Markets Day.

We have stronger results now than in 2019 and we have proved our ability to grow and increase prices, control cost, reduce CapEx, and leverage. But these are not exceptional nor extraordinary results, this is a new normal and illustrates the run rate of the machine of this business. And with that, I will leave the word back to Sondre.

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie. So, before we round off, let's take a minute to look into the period to come. We expect membership sales and churn in Q4 to develop according to plan. We expect slightly negative net growth in the quarter, driven by normal sales, but somewhat higher churn after high volume growth in the second half of 2022.

We will continue to exploit the unleash potential to increase member utilization in the existing club portfolio and the forecast maintenance CapEx for the second half of 2023 around to be around 5% of total revenues with delay of some Q3 projects into Q4. And we maintain the cautious approach to further club growth, prioritizing to continue our deleveraging.

And with that, I thank you all for watching. Wish you a healthy and happy Thursday. Thank you.