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SATS ASA (SATS.NO)

Q2 2024 Earnings Call

CORPORATE PARTICIPANTS

Sondre Gravir
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MANAGEMENT DISCUSSION SECTION

Sondre Gravir
Chief Executive Officer, SATS ASA

Good morning, everyone, and welcome to the SATS' Q2 2024 Presentation. My name is Sondre Gravir. I'm the CEO of SATS, and I also have with me here today Cecilie Elde, our CFO.

We will run a Q&A session at Teams at 10 AM today. This will be a pure Q&A session without any further presentation. You will find the link to the Q&A session in the stock market announcement we published this morning both at NewsWeb and at satsgroup.com.

Then moving on, Cecilie will cover the financials from the second quarter later in her section. And I would like to start by taking a step back and look at the development of SATS during the past few years as we have improved our operational and financial performance notably over time.

Number one, looking back, SATS had a solid development prior to the pandemic. The pandemic had a big negative impact on our operational and financial delivery. Then after the pandemic, we have gradually improved our operations, product offering, and financial result quarter-by-quarter. And we are today presenting the sixth quarter in a row with record-high revenues and EBIT levels, and we are in significant better shape today than before the pandemic. We have more members, higher member satisfaction, more clubs, better products, more group training classes, lower churn, and highly educated and motivated employees.

After a period of member-based recovery as a focus, we are now actively optimizing for revenues, making some price and volume trade-offs. And we have increased revenues last 12 months by 10% to NOK 4.9 billion. And with our model, with solid operational leverage, a large share of the revenue improvement turned straight into profitability. LTM revenues increased by 10% while LTM EBIT increased with 260% to NOK 438 million. And we will continue to grow revenues going forward, still with a high drop-through to EBIT.

Then secondly, the pandemic also significantly weakened our balance sheet and our leverage increased. All the way since the Capital Markets Day in October 2022, we have been very clear in our communication. We will use our improved financial delivery to strengthen the balance sheet. And so, we have done. We are now at a leverage ratio well within our communicated target of 1.5 to 2 times net debt over EBIT. The leverage ratio is reduced from 4.7 times a year ago to 1.7 times at the end of Q2. And we expect to be at the lower end of our communicated target range by end of 2024. We plan to stay at this level but not go significantly below.

Then thirdly, we have one year before maturity refinanced a NOK 2.5 billion revolving credit facility at comparable interest levels we had in the previous agreement, which we consider are good levels. The new agreement is with

Swedbank and DNB. And the maturity has been extended to 2027 with options for extension for up to two one-year terms. This means that another important financial building block is in place.

Then number four, we currently have a liquidity position of NOK 1.2 billion and we generate more cash than we need for our daily operations. So, given our current development, cash generation, leverage and liquidity position, and current expansion plans, we have significant capacity for shareholder distribution going forward. We plan for a semiannual earnings distribution of at least 50% of net profit in the combination of share buyback and dividend payment. First, dividend payment will be made after first half of 2025. Share buybacks will be initiated earlier.

We are very happy, of course, to be back to where we should be as a company. We make people healthier and happier. Our members work out more than ever before. We invest significantly in our clubs. We are opening new clubs and we are launching new products as we are also doing this week with our wellness bundle. React on relevant and attractive growth opportunities. We have a solid balance sheet and liquidity position and we are able to return to dividend payout. We will stay on this path and are optimistic and eager to develop SATS going forward.

And with that, I'm now giving the word to Cecilie for the financial section.

Cecilie Haugen Elde

Chief Financial Officer, SATS ASA

Thank you, Sondre, and good morning, everyone.

We are concluding another financially strong quarter marked by continued positive trend in all financial KPIs. The growth in revenues translates into even stronger growth in EBIT resulting in healthy cash flow. Furthermore, we have continued the repayment of debt and the leverage level is now well within the communicated target range.

The member base has proven to be resilient through several price increases, and we are closing the quarter with a base of 719,000 members. The second quarter of the year is seasonally a period with a decline in members due to lower activity levels and sales, as is the case this year, with a member decline of 17,000 members in the quarter. We continue to see the effects of the price/volume trade-off with higher increase in yield than member base. But despite lower campaign activity and price increases, we have a satisfactory new membership sales and [ph] fall off (00:07:17), which is slightly elevated but in line with expectations. The member base is up 1% compared to the same quarter last year. Additionally, we continue tuning the club portfolio to increase utilization and space and assets, primarily by closing underperforming clubs and downsizing and relocating clubs with excess capacity. This led to an increase in member per square meter of 2% compared to last year.

Total revenues in the quarter of just below NOK 1.3 billion is an improvement of 5% compared to last year. Growth in member revenues are even stronger, up 6%, primarily as a result of higher yield. Personal Training revenues increased with 6% compared to the second quarter of 2023, indicating a positive shift mainly driven by yield improvement. Retail revenues remain consistent with last year, but we have improved margin substantially over the past year through tight inventory control, price management, and a reduction in the number of campaigns.

The cost base continues to be well-controlled, up 4% compared to last year. Direct costs are somewhat lower driving margin improvement while other club operational costs have mostly increased with inflation, with some realized savings on reduced energy costs and marketing spend. Overhead cost is seasonally lower in the second quarter primarily due to vacation. But we continue to see a decline in overhead cost as percentage of revenues.

And looking ahead, the cost base is expected to increase in line with last year's inflation. However, as part of our continued work with our product offering to drive member activity, we will continue to invest in our group training offering by adding classes at club with untapped potential. Member activity is the key driver for member loyalty, thus, increasing costs somewhat by adding classes and new concepts will over time drive increased member base and yield. And this spending will come on top of overall inflation in the short term. But, over time, we are aiming to continue to counteract inflation with cost discipline and price increases.

Moving to EBITDA and EBIT. We are reporting an EBITDA before IFRS 16 effects of NOK 219 million, up 13% compared to last year with a 17% margin. This illustrates the impact of operating leverage of profitability in our business where a 5% growth in revenues translates into 13% growth in EBITDA. EBIT also improved with 13% to NOK 159 million with 13% margin in the quarter. The combination of strong member development over time and increase in average revenue per member and cost discipline are driving the positive development and forming the foundation for our long-term value creation.

The level of upgrades and maintenance CapEx have been moderate over the past year, but we are gradually moving towards normal CapEx levels. And we have invested heavily during the summer in upgrades and improved product offering to facilitate further growth. And, going forward, we will further increase investment in our existing clubs, growing the club capacity, and improving our product offering for our members. We aim to return to normal levels of investment in maintenance and upgrades averaging around 5% of annual revenues.

And in terms of changes in the portfolio, we closed two clubs in the quarter, one in Norway and one in Finland. But these clubs are within strong clusters and we expect to transfer most of those members to other clubs in the area. And we have a pipeline of four additional greenfields over the next year and also plan to close four clubs in the second half of 2024.

Following a strong financial quarter, operating cash flow ended at NOK 154 million with a cash conversion of 70%. We experienced negative working capital effects in the quarter, which is normal for a second quarter and reflects the seasonal settlements of deferred liabilities, mainly holiday pay in Norway. However, timing of due dates and payments amounting to around NOK 85 million related to quarterly rent has led to favorable working capital benefit in the period, which will be reversed in the next quarter. And a cash generation of NOK 475 million over the last 12 months, although somewhat inflated by unusual working capital effects, illustrates well our cash generation ability with capacity to continue to reduce debt and distribute excess cash to our shareholders.

Our liquidity position is well controlled and satisfactory as we close the fourth quarter with NOK 347 million in cash account, NOK 854 million in undrawn revolving credit facility, resulting in total available liquidity of NOK 1.2 billion. We repaid NOK 102 million on the revolving credit facility during the quarter, confirming our stated intention of reducing debt also in absolute terms.

The liquidity position has improved by NOK 165 million, including positive currency effects from currency translation in the cash pool and revolving credit facility. And the improved earnings and cash generation have led to continued deleveraging from 4.7 times last year to 1.7 times in the second quarter, positioning us well within the communicated target range of 1.5 times to 2 times net debt over EBITDA.

A new NOK 2.5 million (sic) [billion] (00:13:38) unsecured revolving credit facility was signed in July refinancing the existing RCF, which was set to mature in September of 2025. The new three-year revolving credit facility matures in July 2027 with options for extension for up to two one-year terms. The credit facility does not impose any restriction on distribution of dividends and is otherwise substantially made on the same economic terms as the existing credit facility. And the credit facility includes a leverage covenant requiring the leverage ratio not to exceed 3.5 times net debt to EBITDA.

And finally, we have a solid plan for capital deployment. We will continue to reinvest in our existing clubs and aim for maintenance CapEx of 5% of total revenues. We have a conservative approach to leverage with a target net debt to EBITDA ratio within 1.5 to 2 times, and we expect to be in the lower end of this interval going out of 2024. We prioritize maintaining a robust balance sheet and a strong liquidity position to ensure financial stability and flexibility to invest in growth. And, going forward, we will continue to invest in high-returning growth opportunities and expect to return to an average of 8 to 12 yearly club openings.

We have previously said that we will return excess capital to our shareholders via dividends or share buybacks once our leverage ratio is in the lower end of the target ratio. And the time has now come to elaborate on our intended policy going forward. We have a solid cash position and we intend to distribute at least 50% over annual net profit to our shareholder as a combination of share buybacks and semiannual dividend payments with the first dividend payment expected in the second half of 2025 based on the first half year financials. That said, it's important to note that strategic initiatives and growth opportunities might arise impacting the level of our capital distribution. Maintaining a solid liquidity position will continue to be important going forward.

And with that, I'll leave the word back to Sondre for our outlook.

Sondre Gravir

Chief Executive Officer, SATS ASA

Thank you, Cecilie.

The outlook this quarter remains very much in line with what we presented and communicated after Q1. We expect that our strengthened member product offering enables volume and ARPM growth fueling revenues going forward. We still see an unleashed potential in the existing club portfolio driven by square meter and equipment optimization and increased operational efficiency. And this will be a key driver for improved financial performance accelerated by operating leverage and the high drop-through through EBIT.

This continued positive financial delivery enables us to balance investments in our current portfolio, new product launches, moderate club expansion, maintaining a solid balance sheet, and starting with dividend payments and share buyback program. We are eager to execute on this and continue to make people healthier and happier. Thank you.