PureGym Q3 2020 Results and Investor Presentation

Conference call 11am GMT Monday 23 November 2020

Humphrey Cobbold (CEO):

Good morning everybody. We'll be running through the presentation that was posted on our website this morning dated 23rd November 2020.

Firstly, let me say thank you to our older investors in the GB Pound bonds. It's been an extraordinary volatile year. As you know, our bonds had traded very well up until the end of February. We, and some of you I'm afraid, got hammered in March, April, and May. And, of course, some of you took advantage of this and have built positions from good entry points in this period. Whatever the route you've taken to be with us today, then thank you for your support.

And second, to our new Eurobond investors, thank you for the confidence you've shown in us by investing in the last couple of weeks. I'm genuinely pleased for all of our investors that the bonds are trading in the mid to upper 90s currently. I think we all hope that, while we're not at the end of the pandemic yet, we are in a position where we can begin to foresee the end and plan for it. I'll talk a bit more about that shortly. That is not to say that there will be no further disruption to come, actually, I think there will be some further disruption to come. But I will encourage you to think of these as aftershocks of decreasing severity, which as Alex will highlight by reference to the current English aftershock and our overall liquidity position, we believe that we are better prepared than any other operator in Europe to deal with the situation. Let's go straight on to page three in the presentation I alluded to earlier. And let me talk through some of the points, which I hope are reasonably familiar to you, but are worth stressing.

Firstly, in summary, we delivered a comprehensive reset of the balance sheet and completed the refinancing of the Bridge after quarter-end, but it is significant nevertheless to have that done. We demonstrated excellent ongoing management of cash and liquidity, leaving us in a very strong position. I believe, as I said, that we're the best capitalized gym and fitness operator in Europe, from the point of view of access to cash and liquidity. We delivered what we regard as a robust financial performance in the quarter in question, given the challenges we faced, and this underscores the resilience of our customer proposition and our business model. And looking to the future, we remain positive, in fact we remain very positive in the medium to longer term, while being exceptionally well prepared for short-term preservations, as they may come along from time to time.

Moving on to page four, and we summarize for you the current situation of sites. We're open in about half our sites across Europe as we stand today. But I would have to say that based on the news of the last 24 to 48 hours, things are looking up in general. I'm hopeful that we'll hear this afternoon from the Prime Minister that our gyms in England will be able to reopen in the middle of next week. That is on the back of a really concerted, ongoing, drumbeat of communication with government and the authorities about the safety of our operations and the protocols that we put in place. There are a couple of counters to that. It looks like our facilities in Northern Ireland will have to close this Friday -- there are eight of them -- for a bit of a firebreak, a lockdown. And as you are probably aware, 13 of our facilities in Scotland were asked to close at the end of last week in order to play their role in some of the protocols that are being put in place by the Scottish government. But we are led to believe that that will only be, in both cases of Scotland and Northern Ireland, for a matter of a few weeks.

Now one final point to make on this page, and that's Poland at the bottom of page four. Our Polish gyms were closed on the 17th of October and they remain closed. And as you may be aware, we've decided to put the Polish business and subsidiary into administration and have started Polish bankruptcy proceedings. We've decided, with regret, that we're not going to be in a position to be able to support that business moving forward, and that process is now advancing. No great need for concern by anybody in that respect. It's a small subsidiary. It was a marginal contributor

to group EBITDA, and we've decided we want to focus our strategic efforts, management resources, and capital in markets that have more promise than we believe that Poland had for us.

So that's a quick summary of where we stand right up to date today. Let me now hand over to Alex, to take you through some of the financial details.

Alex Wood (CFO):

Thank you, Humphrey, and good morning everyone. Right, I'm going to take you through two sections. The first on cash and liquidity, and the second, an update on our quarter three results. Let's begin with the first of those sections please, cashflow and liquidity, and start with the new funding deals over on page six. So, the details of the equity injection and funding deal that we closed this quarter are summarized on the left-hand side of this page for you, and the key point is that this is a comprehensive balance sheet reset. It's not just a short-term stopgap we'll top up, and it delivers two things for us. Firstly, it protects us and, of course, you as bond holders, from near-term COVID disruption. And secondly, it puts us in a position to perform and look beyond the short-term COVID disruption, to allow a measured and methodical return to new site investments that allows us to deliver EBITDA growth and cash generation. We completed the deal in September, so there's no contingency. It's done. And the deal comprised £100 million equity injection from Leonard Green & Partners, as well as a £50 million extension of our revolving credit facilities. And a waiving of covenants for two years, allowing all of those facilities to be accessible to us.

This funding is creating very positive news for you, the bond investors, and is a strong statement of support from Leonard Green. We also completed the refinancing of our €445 million Bridge loan, with 445 million of euro-denominated bonds earlier this month with terms very similar to the sterling notes, with a five and a half percent interest rate payable by the company. I would like to echo Humphrey's earlier comments and take the opportunity to welcome several new investors therefore to the pool and thank them for their participation.

Let me quickly run you through the bridge on the right-hand side of this page which shows how our liquidity has evolved over lockdown and the impacts of that funding deal. I will start on the left-hand side of the bridge where you can see that we have a strong liquidity position going into lockdown on the 23rd of March. Liquidity only reduced by £18 million here in lockdown as we discussed previously in lots of detail. And this was achieved, as a reminder, by pulling every lever at our disposal, including deferring payments, which I'll come on to in a moment. And then moving over to the right-hand side of the bridge, you can see that the funding deal almost doubled that Q2 closing liquidity position.

Let's go now over to page seven, where I give you visibility of how that cash and liquidity position has evolved up until the end of October and is expected to evolve over the rest of the year to the end of December. A few key points to bring out. Firstly, the business quickly bounces back post lockdown reopening, and you can see that the group was cash generative during the relatively clean months of September and October, with both interest and maintenance capex covered. Over that eight-week period, interest paid was £8 million and maintenance was £5 million. So, this gives a useful validation for you that the business is well ahead of cash-flow break even when open.

Secondly, we invested £3 million in new sites across September and October. Cleared down £12 million worth of deferred payments left over from the Q2 lockdown and we repaid our revolving credit facility. So, the whole £145 million facility is undrawn now, and you can see in the middle of the page the £266 million of liquidity as at the end of October.

Thirdly, we estimate the groups liquidity position will only be reduced by between £5 and £10 million in light of the four-week England lockdown. And I shall provide some more detail on that in a moment.

And finally, in terms of remaining deferred payments, given we have settled some already, we now have £23 million

left of deferred payments, which we expect to be settled before the year ends. This is in relation to rents, taxes, and general supplier payments. And then £15 million left in payments that are due in 2021. So, the business will end the year with over £250 million worth of liquidity, which is ample to cover a second wave lockdown disruption.

Okay, so on the next two pages, I want to illustrate in a bit more detail, how well protected we are from a financial perspective to deal with second-wave disruption. Let me start with local lockdowns. We've previously published analysis as to the impact of local lockdowns, and they've been provided in other presentations on our website. For example Leicester, where we have had two sites locked down for 10 weeks, has cost us approximately £400,000 and Liverpool, where we have had seven sites locked down for 10 days, cost us about £200,000. The key point is that localized lockdowns are very manageable for us and the financial impact is not material, at least not in the context that's a newly recapitalised balance sheet. In terms of the England national lockdown, over on page eight now, we estimate that that will drag overall group cash and liquidity by between £5 and £10 million over the rest of the year. Let me break that down for you in a bit more detail.

So, the UK business unit operational cash burn during the four-week English lockdown is shown on the top right-hand bridge on this page, with unmitigated burn anticipated of around about £4 million per week. And the extended government furlough scheme, the ongoing rates holiday, revenue from the other devolved nations, and operational cost savings, all reduced this burn down to just under £2 million a week. And that's without landlord negotiations or deferment of payments which could, of course, reduce that burn a little further. And let's remember, of course, we still have cash from a group perspective coming in from Denmark and Switzerland. So that means that overall, we estimate only £5 to £10 million drag on group liquidity by the year end. That's mapped out in the bottom right hand of this page.

And then over on page nine, of course, we have also had to consider what would happen if we had another full national lockdown across all of our properties. Now we think that that's less likely, that all of our geographies would be totally locked down at the same time as in Q2, but even if that scenario did happen, we are exceptionally well protected. Let me just give you a bit more colour as to why we believe that. We expect to end the year with over £250 million of liquidity as we mentioned earlier and in Q2 we actually delivered a cash burn of just £1.3 million per week when you include the deferment activity.

Now if there was a second full lockdown, the likely cash burn would probably be a little more than £1.3 million. No one knows exactly what this might look like. But there could be less government funding available second time around. Although we have, of course, seen UK government extending furlough for the English lockdown to match that of the previous national lockdown. And we may not be able to lean on our supply base as much next time for deferrals. But even at a burn of say £4.5 million per week, we have sufficient liquidity to last for more than 12 months at that sort of doomsday scenario. And, therefore, you can see that as bond holders you're exceptionally well insulated even from that very severe sort of scenario.

Okay, now let's move on to the results of the third quarter, which was a three-month period to the 30th of September. And in summary was, of course, a steady performance of recovery and stabilization. Could I please direct you to page 11 for the headlines. Across the group, we closed the quarter with 1.6 million members in total, which was 94 percent of the total number of members as of the end of Q3 2019. Our revenue for the quarter was £89 million across the group, 81 percent of the prior year, and adjusted EBITDA was £16.5 million in the quarter, which was a pleasing result if you consider that the UK was largely closed for the first month of the quarter (July). We opened 12 new sites in the quarter, taking the total number of gyms in the group to 518 as at 30 September, and those new sites are performing well, which is something we're going to cover later on in the presentation. We closed the quarter with £277 million left of liquidity, generated £9.1 million of operating cash flow, and closed the period with £703 million in senior secured net debt. And with those as the headlines, I'm now going to provide to you a bit more visibility of the trade and profile by month and by geography over on page 12.

Now the top graph shows the monthly EBITDA for the group as a whole, and the bottom chart segments that by

geography. You can see that EBITDA bounces back very quickly upon reopening and this is clearly the benefit of the membership model where revenue can be literally turned back on as we talked about previously. Switzerland and Denmark continue to perform strongly, having been back into profit since June. And as predicted and announced during the Q2 results, the UK was well and truly back into the black in August, where adjusted EBITDA for the group as a whole was over £8 million, 79 percent of the prior year EBITDA in the same months, and that was without Scotland being opened. And we are pleased to have delivered further progression, in line with expectations, in September, with adjusted EBITDA up to £8.9 million, which was 89 percent of the prior year, which was a very reassuring result.

Now clearly the close of our English gyms is impacting us significantly in the final quarter and we should expect the second wave to cause a degree of further disruption throughout the rest of this year and possibly into Q1-21 as well. However, importantly, while some do expect the next six months to be bumpy, we have more than enough liquidity to manage that bumpiness and we're confident that the underlying trading position is very solid.

So now over onto page 13, to close out the financial update by taking you through our net debt leverage position. On the right-hand side of the page, I've set out our senior secured net debt position as at the end of September, together with its constituent parts. Now one aspect that I want to highlight that may not be immediately obvious is that the equity injection of the funding deal actually puts us into a better net debt position than pre-COVID. You can see this in the middle of the page. Absolute net debt at the end of September was £703 million versus £745 million pre-COVID and liquidity was £277 million, over £100 million better than pre-COVID.

And then, finally, you can see over on the left-hand side, that we have a track record of being very responsible from a deleveraging perspective in the past. Consistently deleveraging through both cash generation on the one hand and growth in EBITDA on the other. And I would like to point out that in the immediate term, we have, of course, got these further deferred payments to clear over the coming months, which we have been very transparent about, all set out clearly on page seven for you. So, you should expect net debt to rise slightly over the coming quarters as we settle those liabilities. But you can rest assured that we are extremely confident that once we are through the COVID closure impacts, we will be adopting the same approach to responsible deleveraging again in the future as we have done in the past. And with that, I shall now pass back to Humphrey to provide you with our business update and outlook. Over to you, Humphrey.

Humphrey Cobbold (CEO):

Thank you very much, Alex. And, yes, thank you also for the exceptional job you and the finance team have done in steering us through the last six to nine months. I've been in business for the better part of the 35 years now, and the performance of the finance team has been absolutely exemplary over what has, without a doubt, been the most difficult time in business for anybody, and most of all perhaps in finance that I've seen in those 35 years. So, thank you very much for that.

Turning across to page 15. We set out some of the like for like member data versus the prior year as at the 18th of October, which is a date which represents an all-open situation position after a reasonable trading period in our geographies. And I hope this gives you a snapshot of how the business performs when it's up and running.

Overall, we are very satisfied with the robustness of our performance in all the key geographies. Looking at the top chart, which sets out like for like paying members versus the prior year, Denmark and Switzerland recovered to 90 percent and 93 percent, respectively. And on the first of November, Switzerland was still at 93 percent and Denmark had only slipped away to 89 percent, despite the COVID second wave environment that has been quite pronounced in both those geographies. And the UK, the green bar, was at 80 percent versus the prior year, 83 percent if you add the frozen members that we expect to convert to paying members. And on the first of November, after the England lock down was announced, this has only slipped back to about 78 percent. Still very robust, given the circumstances.

And then looking at the bottom chart, the question of usage. The like for like member visits were at 91 percent and

100 percent for Denmark and Switzerland, respectively, and 83 percent of the prior year for the U.K. on the green bar. Interestingly, the UK, the number had actually increased to 86 percent just before the English lockdown was announced. It's a great position to be in. It provides a really solid base from which we can rebuild in the future.

A key reason for the strength of the recovery, and we've mentioned this before, is our younger membership profile. The median age is 28 in the UK, 30 in Denmark, and 31 in Switzerland. And there's a bit more information on this available too.

So, overall, you can see the underlying strength in operational parameters, in essence paying members and visits that support the profitability that Alex shared with you on page 12 of this presentation.

Now, let's turn to page 16. We first drew up these charts based on research done as far back as May, sometime ago. And they made two simple points -- that we expected demand to be robust and this to be especially true in the case of younger people. Fast forwarding to today, as we've been able to illustrate, this has been shown absolutely to be true. Demand is indeed resilient, very resilient, as evidenced clearly by the figures Alex has already shared and those on the prior page that I just shared. Of course, in England, that demand has had to be put on hold just for the time being. But that does not mean for one moment that it is not there waiting for us. It is and we are very confident that it will return very quickly once we re-open.

Let's examine a bit further the underpinnings for our belief in the strength of the underlying demand by turning onto page 17. Here there are three separate lines of evidence. In the top left-hand corner, you can see the example of paying membership and visits for the only geography in which we've had a full run of closed, opened, closed, opened sequence -- that's Wales, where we have five gyms. Reopened after the first lockdown on the 10th of August, the starting point of the data, closed again in late October, reopened on the 9th of November after 17 days. As you can see from the far right of the curves, the positive progression demand picture we saw in late October was straight back in when we reopened in early November. We believe that this is exactly what we will see when we are allowed to reopen in England -- resilience in underlying demand. And as I've said, I'm hopeful that we will receive confirmation of our opportunity to reopen in England, in the middle to end of next week, this afternoon when the Prime Minister makes his announcements in Parliament.

On the right-hand side of this page is a reminder of the huge -- and I do mean huge -- support from gym members, and to be honest, a growing body of the broader public, for gyms to be open. There is a debate going on this afternoon in Westminster on exactly this topic. And to put this in context, there's 610,000 plus people who voted for this petition and asked for this debate to take place. It's two to three times greater than any other equivalent petition that's been launched in the last few weeks. In fact, it's only bettered on the government petition list by Marcus Rashford's child policy petition. Now, I'm not a Man United fan, but I have to say, hats off to Marcus Rashford for that one.

And then on the bottom left, we showed the performance, which Alex alluded to a moment ago, from the opening to the end of October of our new gym openings in the UK. These are in places like Birmingham and Leytonstone and Colchester and are spread across a good mix of the country. The vast majority are ahead of expectations and benchmark performance, confirming definitively that the latent demand for our product is robust. It is there now, and we're confident that it'll be there in the future.

Now, one of the questions we get asked quite a lot is whether we are having to over-promote or drop prices to achieve the performance levels of volume and visits that we've seen. And as some of you will know, a number of the industry analysts track our price levels in the market. So, well, I thought we'd do a bit of their job for them. So, if we turn to page 18, you can see on the right-hand side of the page at the top, both the member body growth for ourselves and the Gym Group, who conveniently published all this data in their last results update just a couple of weeks ago. We have both done pretty well in terms of volume -- very solid in August and September, and then steady-ish in October, with just a bit of pull back towards the end of the month as the second lockdown was announced or in the offing in England. But overall, I think for both businesses, a really credible performance over that period.

And at the bottom on the right, you can see the number of headline price changes by month. Again, very steady in August, as we all took stock of the situation. And then, carefully judged increases in September and October. Certainly, no signs of the market crashing prices to hit volume targets. Actually, in the UK, as we observe on the left-hand side of page 18, we have some pretty good discipline in maintaining overall pricing. As we highlight the gym, in gym world, the UK's a sophisticated market in this regard because we have localized pricing, which we can and do choose to vary in line with localized capacity and demand. As we show here, we and our major competitors, the Gym Group, J.D., and others, monitor prices if necessary on a daily basis. And we use carefully calibrated models that cross-reference yield with capacity utilization to optimise revenue. We are not yet as sophisticated as airlines and hotels when it comes to yield management, but we're getting much stronger in this area. Pricing is certainly very transparent, as it is on our website, it's on all of our websites. So, there are not any hidden deals that get done in the store. This leads, in general, to good order in the market. You can't really cheat and you can't really hide what you're doing on price in this market.

And our belief is, in the industry, that large players and smaller players, together, understand that costs have risen a bit due to COVID secure measures. We're spending a lot of money on cleaning equipment and cleaning materials. And we would probably expect there to be some upward momentum on prices over the next six to 18 months to help protect margins. And we think there's room for that to happen.

But of course, we're not naïve. And turning to page 19, we recognize that tough economic times are upon us. Looking to the past on the left-hand side on page 19, we see that consumer's rate gym expenditure as relatively low down the list of things to stop when they're under economic pressure. And indeed, market gyms did well in the last big downturn, as we illustrated in the bottom left-hand corner of page 19. And on the right-hand side, yeah, there are a series of reasons that we can advance to believe that we as Pure Gym, and other leading budget operators, are very well prepared to weather the inevitable coming economic challenges. I think we'll hear some more about some of those from the Chancellor later this week.

And building on this and turning to page 20, I think it's absolutely clear that we're better prepared than most others in the market, not least of all given the liquidity position that Alex has already outlined. Indeed, there have, unfortunately, already been substantial failures of businesses and challenges faced by those that operate much less robust business models than ours. And on the left-hand side, we highlight some of these by name. And on the right-hand side, we draw your attention to the research published by UK Active noting the public provision of gyms and leisure centres. And remember, the public gyms and leisure centres in this country is about 30 percent of capacity. That is quite significantly challenged.

And finally, to close on the question of outlook, we repeat and return, without apology, on page 21 to a perspective we've shared before. We believe that the medium to long run outlook for health and fitness is very strong. We all need to look through the miasma of the pandemic and look at what will be on the other side. In this regard, we have a high level of conviction that as one of the emerging Premier League budget operators in the world, we are right to have a very positive outlook. We'll be investing to ensure we gain value from our scale, to improve our existing sites, and to open new sites, and to maintain or increase our investment in technology, which will be amortized over a larger estate membership base.

All this will be against a background of the world exiting from a health crisis and knowing that physical activity and wellbeing, alongside mental wellbeing, are something that we need to invest in individually and as a society much more than we realised in the past. And to be honest, it was particularly heartening hearing the reports in the press last night on the news and today, specifically mentioning that the government is coming to recognise the efforts that we've put in place as an industry to make gyms safe places to work and safe places to work out, so that we can be viewed as an essential service for the people in this country, and Denmark, and Switzerland where we operate and help support the wellbeing and the recovery from the pandemic.

And so, to conclude and reprise our key messages on page 23. We entered the pandemic as a very strong business. Within the context of the pandemic, we performed exceptionally well in terms of cash and liquidity management. We reopened effectively, not by chance, but because of the hard graft and effort that was put in. Our trading performance while open, and where we are still open, is strong in absolute and relative terms. Indeed, I have to say, that I've yet to see an operator in our industry in the world that has outperformed our statistics in August, September, and October. Our balance sheet reset demonstrates the unequivocal support of our sponsor and of our financial partners in the form of the banks who support us through the RCF, and you as our bond investors. That's very important and I have to take my hat off to Leonard Green & Partners in that regard. They've been tremendous supporters of the business through a difficult period. The management team is focused on pragmatic operational management in the short term and robust preparation for future strategic success in the longer term.

Thank you very much, once again, for your continued patience and support. We know, as I've said at the outset, that this has been a roller coaster year for you as much as it has been for us. You're a vitally important partner for us, and we are working hard to ensure that we deliver and surpass your expectations of us. And with those comments, I'll conclude and say I think we're happy to take a few questions.

Question & Answer session

Operator:
Our first question comes from Glenn Zahn from Seaport Global. Please go ahead.

Glenn Zahn:
Good afternoon. And thank you very much for all of the disclosure and transparency. It's been really helpful, especially on the liquidity front. But I was just going to try to ask you, unfortunately, a loaded question for next year as we go into 2021. You've been using the EBITDA of £161 million, but I was just wondering, where do you operate in metrics? Where do you see them, for example, as far as memberships and attending gyms? Where do you see -- need to see your operating metrics, firstly the break even and then second, to gravitate to that £160 million of EBITDA?

Humphrey Cobbold:
Thanks, Glenn. Let me deal with some overall points on that. And then I'll pass across to Alex to deal with a couple more specifics. Look, and I'll be the first to admit, we don't have a crystal ball, Glenn, in terms of how this is going to unfold from here. I do think there is room for optimism and we're certainly not at the end of the pandemic yet, as I've said, but I think we can start to foresee the end. We're considerably reassured, I have to say, by the robustness and resilience in demand that we saw in the period in August, September, and October. And I think what we will see is progression of the business as confidence returns and we see vaccines come into play, and we see mass testing come into play, which I think we'll see in quarter one, and vaccines probably more as we get through quarter one and into quarter two.

So, overall, we'll see progression. And we know that we're pretty good at translating that confidence and returning of members and members paying us into revenue and EBITDA. So, we'll see the business progress towards that sort of run rate figure over time. But I don't think we can put a definitive timing on it. So, that would be my overall view. Alex, would you add some further comments to that?

Alex Wood:
Yes, sure. I mean, on those two points, cashflow break-even you mentioned. We previously talked about 89 percent as being the sort of revenue level versus the prior year 2019 as the sort of absolute cashflow break-even after all maintenance capex and interest settled. We've disclosed that on our website in the previous presentation. That's

actually a pretty harsh measure as things start to transpire in this. It doesn't take account of the fact that our yield and average revenue per member is slightly up year on year, which is -- which means that at a member level, the break-even is even lower than that. And also, it doesn't take account of sort of government support packages and the like. The rate, for example, is still in place until April next year, which would also lower that member break-even point further. But it's probably sort of low to mid 80s across the group as a whole. And you can see very clearly that in the sort of stats that we've provided in this presentation that in the middle of September and October, the sort of relatively clean, but not without challenges months, the business has been ahead of cash break-even in absolute terms with a sort of representative maintenance and interest cost over those two months.

And then, to your second question around the representation of EBITDA of £161 million for leverage and when we sort of get back to that level again. Look, we can't representatively consider a formulaic leverage calculation with -- that looks back 12 months for the estate to continue to have this sort of dead closure quarter of Q2 in it. So, we then have to wait until that quarter annualises out before underlying performance of the business to be reflected in that leverage ratio. So, what we have done is looked at the absolute leverage number, and that's what we presented in the presentation. And, you know, that's what we urge you to sort of look through to over the course of next year as we recover to a more representative run rate EBITDA and then we'll start to reintroduce that ratio when it feels appropriately representative to do so. Hopefully that helps.

Glenn Zahn:
That was very helpful. That was my only question. Thank you.

Operator:
We currently have no further questions. Humphrey, I will hand it back to you.

Humphrey Cobbold:
Thank you very much. Well, once again, thank you very much for your continued support and confidence. Rest assured, that we're doing everything we can to progress the business forward, even if there are some choppy waters ahead. And we'll be looking forward to getting back in touch with you in April for an update on the full year.

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