PureGym Q2 2022 Results call
Conference call Thursday 25th August 2022

Humphrey Cobbold (CEO)
Good morning, everybody. Welcome to our presentation of results for the second quarter of 2022. This is Humphrey Cobbold here. Today we'll be running through the presentation that was posted on our website at 7:00 a.m. this morning, dated 25th August 2022. Hopefully you will all have this in front of you. As usual, we'll guide you to the relevant page references as we go through the document.

Turning to page 3, let's start with an overview of the headlines for the period and where things stand now. We saw a continued progression in our revenue, which was up 43% vs 2021 and 8% vs 2019. We delivered Adjusted EBITDA of £26 million in the quarter and Run Rate Adjusted EBITDA grew to £114 million by the end of Q2 for the last 12 months.

We opened 9 sites in Q2, taking the total new site openings in the first half of the year to 18. We will have opened a further 9 by the end of this month, 5 of which are open already. Given the fundraising we successfully closed at the beginning of the year, we have £285 million of available cash on the balance sheet to fund investment and £430 million of accessible liquidity.

In terms of outlook, the recent hot weather and transport strikes, coupled with obvious consumer confidence issues, quantified by research firms such as GfK, has slowed recovery somewhat over the summer months. But all things considered, the business is holding pretty steady despite those challenges. The good news is that to date we have not seen any signs of customer churn being materially impacted by the cost of living crisis, and we continue to believe we offer excellent value for money to consumers, and our business model therefore stands up well in the current tightening environment.

We continue to focus more effort and resources on cost management as well as maintaining our continued strong focus on revenue management and growth. Our investment program is progressing well, with a ramp up in refurbishment across the owned estate, particularly in Denmark, which I will talk about in more detail later on. We expect to open over 50 sites in total this year and are building the capacity and capability to double that rate of opening and increase the number of refurbishments next year.

Whilst we are the first to acknowledge the challenges we are facing, with both near term disruption and longer-term economic uncertainty, we remain cautiously positive about the future given our positioning in the market, balance sheet strength and investor support. So, with that overview let me now hand over to Alex to take you through some more of the details. Alex, over to you.

Alex Wood (CFO)

Thank you, Humphrey, and good morning. Let me begin on page 5 with a summary of the financial results for the 3 months ending 30th of June. In overview, there is not much new news this quarter. Despite the macro challenges, this was a relatively robust performance that shows modest growth quarter on quarter at both a revenue and an EBITDA level.

Let me pull out a few highlights from this page for you. Firstly, we saw continued revenue progression, with revenue reaching £119 million in the quarter. To save you doing the comparison, that's up £3 million from Q1. We ended the period with nearly 1.7 million members, when you remove seasonality by looking at the LTM figure, this represents a 2.5% progression quarter on quarter. Run Rate Adjusted EBITDA reached £114 million, that's up £8 million vs the prior quarter. Adjusted EBITDA was £26 million, up £1 million from Q1.

This Adjusted EBITDA in turn converted into £21 million of operating cash flow, which was an 82% conversion. In terms of capital investment, we invested £24 million in refurbishments and new site development which is ramping up nicely. Finally, we closed the quarter with £285 million in cash on the balance sheet, which supports our expansion plans, and we continue to benefit from plenty of liquidity.

So, with those as the headlines let me now go into some more detail taking you onto page 6. This page shows 2019 as a comparator, as well as the prior year so you can see both reference points to gauge recovery and progression. The prior year comparator is now increasingly relevant because Q2 is the first period where we are lapping a quarter when the business was open and trading.

Starting with revenue on the left-hand side, you can see that Q2 was up £9 million vs Q2 2019 pre-pandemic, and up a significant 43% vs Q2 in the prior year. That revenue performance has been supported by strong average revenue per member growth, which closed the quarter around 10% ahead of 2019 with continued price progression and premium product penetration being the main drivers of that, as we've discussed several times before. You can see that total members are back in line with pre-COVID levels and 6% ahead of the prior year. In terms of like for like, which is the other lens that we look through to track our recovery, like for like revenue in June was 95% of 2019's level in the UK and 90% across the Group as a whole.

Moving across the page to EBITDA, you can see clear progression vs the prior year, up £10 million in the quarter. You can see this quarter's EBITDA performance was around 80% of pre-pandemic levels. This is exactly what you'd expect in an operationally geared business while we're waiting for like for like revenues to fully recover. We do fully expect to get back to, and surpass, that pre-pandemic level of EBITDA in due course.

In terms of Run Rate Adjusted EBITDA, this has moved on significantly over the last few quarters. As I said last time, the LTM measure is becoming more meaningful now as a metric to assess progression and recovery. This is because covid closure months have now annualised out of the trading LTM frame of reference, and new and immature sites are being added into the mix. Looking forward, we expect the summer months to be relatively uneventful in terms of

member progression, that's absolutely normal, with the next step ups in member recovery expected in September, and then the January traditional peak period.

Let me now provide some detail on our capital investment over on page 7. We invested £24 million in the quarter as we continue to open new sites and deploy capital into the estate. You'll note that this is a scaling up of investment activity vs the prior year. £17 million of capital was invested in new corporate owned sites, 9 of which opened in Q2, ending the first half of this year with 525 gyms in total. We've also ramped up refurbishment activities, with £7 million invested across the Group in the quarter.

As I flagged in the last two updates, there have been increases in lead times on equipment and other construction items, but in general this is being very well managed. Ongoing cost inflation is impacting construction costs to a degree, but again we're carefully managing these dynamics and continue to focus on value engineering to combat this cost inflation.

It's also worth flagging that we frequently find ourselves competing for the best new site locations, but in general landlords are noting PureGym's relative financial strength and reputation when granting leases. This means we find ourselves in a good overall position with respect to future site pipelines.

Finally, in this section let me touch on the net debt position over on page 8. As a reminder, we completed a funding deal with KKR in Q1, bringing in £300 million of additional cash. This has significantly reduced our net debt, as you would expect, and our net debt position was £562 million at the end of Q2, significantly lower than pre-pandemic. This gives us the financial capacity to push on with our strategic plans and take full advantage of the opportunities for growth.

Net debt was very slightly higher in absolute terms vs Q1, as I flagged it would be. This is because we're deploying cash into new site openings. You can expect this trend to continue as we deploy capital in a measured and controlled manner, and I'll continue to be very transparent with you in this regard. We closed the quarter with ample available liquidity of £430 million.

I shall now hand you back over to Humphrey to provide an update on our strategic direction outlook.

Humphrey Cobbold (CEO)
Thank you very much, Alex. Well, where we stand is the following: notwithstanding the headwinds, overall, I believe the momentum of strategic execution for the PureGym Group is building and progressing really well. In this section, I'm going to update you on our strategic progress and the Group's outlook.

Starting on Page 10, which is taken from our FY2021 results presentation. The good news is that we are very much executing on the strategy that we said we would, despite the challenges that exist in the marketplace. This strategy is now what we'd call very much "in flight." I think we're making good progress in all these areas.

We're progressing well with the franchise model in the Middle East, with another 2 sites opened this month and several more in the pipeline for the next 6 months. We're ramping up new site openings, as Alex has alluded to, in the UK and Switzerland in particular. We're deploying capital to upgrade and strengthen the existing estate. We continue to invest in digital and technology, appointing a new CIO to strengthen our focus and leadership in this area. We continue to raise the bar in terms of discipline, governance, and control, so that we can maintain the quality of execution as we continue to grow. We're strengthening management in these key control areas; with plans to recruit a Group General Counsel and a Head of Internal Audit now well-advanced.

We often focus on the UK, our largest business unit, in these updates. However, I thought it would be helpful to focus a little more attention on Denmark, our second-largest market and business unit, providing an update on our strategy and progress there. On page 11, we show the four-point post-pandemic recovery plan that we laid out for Denmark when we updated you with our annual results in April this year. The plan here is less about adding many more sites, we have an enviable and comprehensive market presence in Denmark already, rather, the focus is on driving value from the solid foundation of a clear market-leading position.

To summarise, firstly we are working to optimise the existing estate with particular focus on greater Copenhagen and the other major cities in Denmark. Secondly, we will be investing over £50 million over the next 2-3 years in refurbishments to fundamentally improve the existing estate, product quality and layout to significantly enhance the member experience. This is investment that we knew we would have to make when we originally acquired the Danish business in early 2020, it's just been delayed because of the rigors of the pandemic. Thirdly, we are deploying our Group approach to revenue management and variable pricing capability to drive performance and optimise our position in the market vs the competition. Finally, we are also well progressed in revitalising the local management team, the organisation and culture. We regard these softer areas as critical to performance success and the progress that we need to make.

Let's start with the first of those, estate optimisation investment, over on page 12. We've used the cities of Aarhus and Randers as test beds for our estate optimisation in Denmark. Aarhus is the second-largest city in Denmark, and Randers is a small city just to the north of Aarhus. In Aarhus, 3 sites were refurbished in 2022, 5 sites having been refurbished in 2020 and 2021, and 1 new gym was opened in 2022. In Randers, we refurbished 2 gyms in 2022, opened a further site and are planning to close a site here and move it to another, better location. These trial investments have been a voyage of discovery but have been successful and given us the confidence to carry on with the program of investment, not only in this area, but across Denmark. Additionally, across both sites, we've been able to trial and fine tune changes to the commercial proposition as well as setting variable pricing and product options.

Turning onto page 13, in Copenhagen, which is obviously the key metropolitan market in Denmark, we operate and co-exist alongside local operators. One major gym operator, SATS, who are a mid-market operator, their closest comparator in the UK would be Fitness First. We

are the clear market leader in this city, with 27 Fitness World sites vs 12 SATS sites in Central Copenhagen, and 53 vs 21 sites in the greater Copenhagen area. Our strategy is to remain market leader.

We will maintain our overall estate advantage, opening new sites where pools of unfulfilled demand exist and seeking consolidation opportunities of sites on the margin, where we can combine sites or withdraw from uneconomic sites, if necessary.

We will invest significant capital to upgrade the quality of member experience, with 18 sites in the Copenhagen area scoped for reinvestment in 2022, and numerous further sites scheduled for 2023 and 2024. We will maintain our great value price position and use variable pricing to optimise our position within each of the localised markets within the Copenhagen metropolis. Finally, we will continue to tune our product offering to the specific site, conditions and demographics of individual neighbourhoods.

Moving briefly onto page 14 to illustrate this a little, our goal is to upgrade the Danish sites through the investment that we make to transform the member experience. This aims to deliver something of a boutique fitness experience at a budget gym price, a pretty compelling proposition. It is in line with the standards that we set out across the rest of the Group. We also plan to deploy the Group's pricing and revenue management toolkit and strategy in Denmark, let me cover that now on page 15.

We focus a lot of effort on our pricing and revenue management because it's so important for an operationally geared business like ours and for a market leader in our position to exercise good focus, discipline, and control in revenue management. I won't run through all the detail on this page, which I hope you're largely familiar with as we've explained it before conceptually. We aim to get the positioning right at the premium end of the value segment. We set prices to optimise local market positions, we don't have a nationwide price. We drive premiumisation in our membership where we can add value to members that they're willing to pay for, wherever we can. This is the Group's overall approach, and we will apply it and are applying it in Denmark, as elsewhere.

Now, moving to page 16, and to close out on these critical commercial factors, I'll show you how it works in practice in Denmark. On the left-hand side of this page, we illustrate how we adapt our pricing to different cities, showing our headline price per gym, you can see this variability at work. On the right-hand side, you can see how we are managing promotional activity, it's critical to think about promotional activity in the light of headline pricing. Here you can see that, despite the challenges of rebuilding after the pandemic, we are promoting nearly 40% less in 2022 than the business was doing so before our ownership in the equivalent period in 2019. We believe that promotional discipline and control is essential for any operator to optimise returns in the marketplace, otherwise you leak too much revenue.

We think hard about three clear key variables: First, the frequency of promotion, how many days we promote for. Secondly, depth, the level of promotion and what you're giving people as an incentive to join. Thirdly, specificity of promotional activity, targeting promotions to gyms in

neighbourhoods that need them and not applying promotions to gyms that are already full and are trading very well.

Turning last, but not least to page 17, we truly believe that our people, organisation, and culture will be key factors in supporting our success in Denmark. First, we have new senior leadership and management team in place. The business is now managed by Morten Bentzen, a seasoned executive from the 'Telco school of management'. We have also fully refreshed the senior management team: finance, commercial, marketing, IT, and operations. Morten and his team have done a tremendous job of both dealing with the challenges of the post-pandemic era and becoming part of a larger Group. These are not easy tasks to manage, and we've had to do much of it remotely. I didn't actually meet Morten until we'd been working together for eight months, through the pandemic. He and his team have been great examples of how to embrace change and development and are a great strength in the organisation. Together, these colleagues are setting a new mindset to implement best practice and keep innovating in the business.

Secondly, we fundamentally reformed the operational organisation. We've removed the distraction of Poland, which we sold at the end of 2020, Switzerland now reports separately and away from Denmark and other complexities, so that the team there can really focus on the Danish situation. Secondly, we've been re-establishing the role of gym managers who really develop a sense of ownership for their club and really focus on the NPS measures and member experience. Thirdly, we've streamlined the management organisation with a clear connection to the PureGym Group's expertise and experience. We continue to focus on culture and belonging for our people, through clear articulation of values, the behaviours that we want to see and the attitudes that we think are important, alongside aligning incentives and rewards to ensure our colleagues in Denmark are embracing and feeling that they're full members of the PureGym Group.

So, in summary, therefore, on page 18, we have a clear strategy to invest to strengthen in Denmark. As I've explained, we're now coming out of the pandemic, and we can increase the focus on making sure these four elements combine in a strong outcome for the business there.

Now, let me step away from Denmark and turn to the Group overall on page 19, and summarise our outlook for the rest of the year. There's no doubt that we're clearly facing challenging times. There is the near-term disruption to consider, and we're seeing headwinds which are challenging business momentum, I think pretty much everyone is seeing that to some degree. Additionally, consumers are feeling the pinch and being careful about how they spend constrained disposable income. While assessing the consequences of these conditions for the business and for our customers, we're also very attentive to the needs of our colleagues at the current time and we're ensuring that they're receiving appropriate, carefully judged support.

It's hard to make predictions as the storm clouds gather, but despite these challenges, we as a business are well positioned to weather the storms. So far, there's no evidence of a buyer's strike, although you can sense that there is a degree of consumer caution on memberships. We are however, reassured by research, which suggests consumers continue to attach a very high

priority to maintaining gym memberships. After all, we've just been through a major health and wellbeing crisis, and we know from the feedback that we got from members when we were closed, just how important their membership of gyms is and their ability to exercise for both their physical and mental wellbeing.

The focus of management and of our procurement team remains very strongly on driving savings through cost control and cost mitigation projects. While we acknowledge the current cost inflation storm, we have limited exposure to cost pressures in the near term, as we've explained previously in our presentations earlier this year. We're a low labour cost model and have a simple operating model, with most of our cost lines reasonably well protected. Property costs are contractual and largely bound by caps and collars. Utilities are on forward contracts and are largely fixed through 2022, and a part of 2023. Pricing yield and revenue management are key in an operationally geared business, as I've already said. We think we have the best technology, systems, and approach to enable us to vary pricing per product and on a per gym basis so we can mitigate some of the economic pressures in an appropriate way.

I hope we've made clear that we remain very much committed to our new site opening plans, with new sites in particular performing very well due to the format, flexibility, incredibly careful site selection that we undertake and the tailored, excellent operational management that we put in place. Refurbishment site volumes are increasing, we're going to continue to invest in the existing estate, and the capital that we spend on refurbishment is delivering a modest but positive rate of return for us as well.

So, to conclude, and wrap everything up on page 21. In the quarter we continued our progression with Q2 revenue up 43% on Q2 2021 and 8% on Q2 2019. Our Run Rate Adjusted EBITDA continues its upward trajectory, reaching £114 million by the end of the quarter. We're in a strong and robust liquidity position, with £285 million of cash and £430 million total liquidity. There are challenges ahead, but we are prepared for these with a clear focus on mitigating any demand and cost pressures through management action and yield management. We continue with our plan to invest significantly to strengthen the existing estate and to drive performance. We're encouraged by the strong new site performance and the good momentum we see in the global pipeline, the key drivers of our future growth.

I hope this update has been informative for you. I'd like to take this opportunity to thank you once again, for your continued support. As investors of the business, we know that this is not an easy time for you as well in the investment community. We really appreciate the support that you give us, and we hope that we are seen to reciprocate by giving appropriate levels of transparency to what we're doing. Our next results announcement will be towards the end of November when we'll be updating on our Q3 results, and we very much look forward to speaking to you again then.

With that, I'd like to close the formal presentation. I think we're happy to take a few questions.