PureGym Q3 2022
Conference call Tuesday 29 November 2022

Humphrey Cobbold (CEO)
Good morning, everybody and welcome to the presentation of our results for the third quarter of 2022. Today, we'll be running through the investor presentation that was posted on our website at 7:00 a.m. this morning, dated 29th November 2022. Hopefully, you'll have this in front of you and as usual we will guide you to the relevant page references as we go through the document.

Turning first to page 3, let's start with an overview of the headlines for the period and where things stand now. We saw continued progression in our revenue, members, and average revenue per member in the quarter which were all up on the same period in 2021. Run rate adjusted EBITDA was £116 million at the end of the quarter, showing progress from Q2, despite the current macro headwinds. We delivered adjusted EBITDA of £24 million in the quarter which was marginally behind last year because of our continued investment in domestic and European growth and as we incurred start-up losses in our U.S. operations.

Across the group, we're pleased to have opened 11 sites in Q3, including 3 new franchise sites in the Middle East. Total site openings as of today, across the business for this year, now stand at 43, including 6 franchise sites. Given the fundraising we successfully closed at the beginning of the year, we still have £261 million of available cash on the balance sheet to fund investment and £406 million of total accessible funds. This liquidity situation puts us in a very strong position relative to pretty much any other operator in our industry, here or abroad.

Now, turning to the broader trading environment and outlook. There's no doubt that managing the business is, and will continue to be, very challenging given the wider macro environment. But, we are laser-focused on navigating the near term headwinds, be they driven by macroeconomic factors, politics, the cost of living crisis, or just general ongoing inflationary pressures. We remain confident, very confident, in fact, for the following reasons that the business is well-placed to weather the stormy conditions in which we find ourselves.

First, we have fixed-rate financing in place and fixed price utility contracts which provide a degree of protection in the near term. Secondly, because we have a strong liquidity position, we have ample capacity for investments in the core operations and in things such as energy saving upgrades to significantly reduce energy consumption for the future. Thirdly, we remain very disciplined and targeted in our approach to pricing and promotion which, as I will try and explain briefly later, we believe is key to good, sustainable performance in a market such as this.

Fourth, performance from new site openings continues to be strong, indeed at least as strong in many cases as openings pre the pandemic. This lends robust support for the inherent appeal of our product in the marketplace. The pipeline of new sites is very healthy indeed and we can therefore look forward to an accelerated stream of openings in the year ahead. And finally, I'm delighted to confirm that our franchise partner in the Middle East and North African region has

signed commitments to deliver a minimum of 130 sites across that region, which stands us well for the future.

So, with that overview, some of which I'll return to later, let me now hand over to Alex to take you through the financial results in more detail. Alex, over to you.

Alex Wood (CFO)
Thank you, Humphrey, and good morning, everyone.

Let me begin on page 5 with a summary of the financial results for the three months ended 30th September 2022. Despite the macro challenges, this was another relatively robust performance from the business that shows modest growth year on year in top-line trading metrics.

Let me pull out a few highlights from this page for you. Firstly, we saw continued revenue progression reaching £120 million in the quarter. That's up 8% from the same period last year. We closed the period with 1.7 million members, up 2% vs the prior year, and up 4% on average across the quarter compared to the same period last year. Adjusted EBITDA was £24 million in the quarter. This was £1 million lower than the prior year, but this is simply due to investments that we're making in driving future growth potential for the business. This result includes, for example, nearly £1 million of start-up losses in the quarter associated with our expansion activities in the United States, and as we ramp up the number of new sites openings more generally, these immature sites drag EBITDA very slightly in the first six months post-opening.

Run rate adjusted EBITDA, on the other hand, normalises for these elements and reached £116 million at the end of the quarter. This was up £2 million vs Q2, and for complete transparency this measure adds back £1.1 million of year to date start-up losses and includes a prudent run-rate assumption for the 3 new and immature U.S. sites. I should also point out that we have not added in recovery of the underlying state in this measure. Adjusted EBITDA converted into £17 million of operating cash flow which was a 68% conversion, slightly lower than last quarter due to working capital phasing.

In terms of total capital investments, we deployed £29 million into refurbishments and new site development, which continues to ramp up in line with expectations. And finally, we close the quarter with £261 million of cash on the balance sheet and £406 million of available liquidity, providing ample support for our expansion plans, as well as an important cushion of protection as we chart our way through these challenging times.

So, with those as the headlines, let me now go into some more detail, moving onto page 6. This page has been included, as usual, to show you 2019 as a comparator as well as the prior year so that you can see both reference points to gauge recovery and progression, and all three periods for context were fully open and trading.

Starting with revenue then on the lefthand side, you can see that Q3 was up £11 million, over 10% vs the 2019 pre-pandemic period, and up £9 million vs Q3 in the prior year. This was

underpinned by strong average revenue per member at £24.22 for the quarter. ARPM was 10% ahead of 2019, with continued premium product penetration coupled to a measure of price progression being the main drivers of that. Price and revenue management in general is a really important area and one that Humphrey will elaborate on briefly later in this presentation.

Total closing members were 2% ahead of Q3, 2021 and firmly back in line with pre-COVID levels. However, the current macroeconomic environment did limit recovery and member numbers during September's peak. We have anticipated more of a step forward in terms of member net gain than appeared. Consumers were cautious and we should not be too surprised about that. In the UK, there was a perfect storm of disruption given the Queen's death, political mayhem, the fear of economic meltdown, strikes, and general social disruption. Even in usually calm Denmark, there's a fair degree of disruption as a general election was called. So, given where we stand now, we expect the remainder of the year to be stable and relatively uneventful in terms of member progression. That's normal for the months of October through to Christmas.

In terms of the other metrics, moving across the page here, you can see run rate adjusted EBITDA has grown significantly vs the prior year as COVID closure periods annualise out and new sites are added in, showing ongoing recovery toward the pre-COVID level of £161 million. You will also note continued expansion of the gym estate, ending the quarter with 535 gyms including 7 franchise gyms, 3 of these franchise gyms opened in the quarter, and an accelerating rate of new openings vs both comparators. Finally, our cash and net debt positions are significantly better than 2019 and 2021 by virtue of the fundraising earlier this year and continued good cash management within the business.

Let me now provide some detail on our capital investment over on page 7. We invested £29 million in the quarter which is a significant scaling of activity vs the prior year. £20 million of capital was invested in expansionary activity, including the development of new corporate-owned sites, 8 of which opened in Q3. We continue to be very pleased with the performance of new sites across the group where performances, as Humphrey highlighted, in general ramping ahead of our feasibility levels. You should expect a further 20 corporate-owned sites to open in the last quarter of the year, as we continue to increase our opening rate, exceeding that of 2019. We also continue ramp our refurbishment activities, particularly in Denmark with significant capital deployment there over the quarter.

You can't just flip a switch and go for growth in a business like ours. You have to build the capacity to grow, and that has been a key focus for us this year. We're now well-placed from an organisational perspective to deploy capital at a higher rate with scaled capabilities in place for new site openings and refurbishment activity. There are no free rides being offered by landlords, either domestically or abroad, for new site openings. However, there is no doubt that our liquidity position, the strength of our offer is prominent, and the scaled up capabilities we have assiduously built this year put us in a good position to continue and indeed accelerate our program of activity for both new site openings and significant estate refurbishment and upgrade.

And finally, in this section let me touch on our liquidity and net debt positions over on page 8.

We covered this in detail at our full-year results and if anybody on the call missed that or wants a refresher on the details, you can listen again via our website. In short, we completed a funding deal with KKR in Q1, bringing in £300 million of additional cash and this has significantly reduced our net debt as you would expect. Our senior secured net debt position was £587 million at the end of Q3, significantly lower than pre-pandemic.

Now, our cash capacity is a significant differentiator vs our peers, especially in the current capital constrained environment. It not only gives us the financial capacity to push on with our strategic plans and take full advantage of our opportunities for growth, but it also insulates us from the unexpected and affords us the flexibility to make strategic investments for the future, for example, in the area of energy-saving infrastructure upgrades which Humphrey will touch on in a moment.

As trailed in the previous quarters, net debt will increase in absolute terms as we deploy this cash, mainly into new site openings, and you should expect this trend to continue as we deploy that capital. But, rest assured this will always be in a measured and a controlled manner. Cash is a very precious commodity in the current environment and we invest our capital with a mindset of capital constraint to ensure that we keep our discipline and invest that capital very wisely. As you can see, we also closed the quarter with ample available liquidity of £406 million.

And with that, I shall now hand you back over to Humphrey. Humphrey, over to you.

Humphrey Cobbold (CEO)
Thank you very much, Alex. Now, in this short section, in keeping with what we've done in the past, we're going to provide an update on the trading environment as we see it and, I hope, shine a little light on some aspects of how we run the business. So, let's start on page 10.

Firstly, as we have said we're clearly facing challenging macroeconomic conditions in our core owner-operated markets across the UK, Denmark, and Switzerland. No one should be surprised that consumers are showing signs of strain or that on the margins this is impacting our business to some degree. And while to be clear there are no signs of member decline, it is the case that, as Alex outlined, the macros present a headwind which is delaying member volume uplift and recovery after the pandemic somewhat. But let's keep the performance challenge in perspective.

We are back well into the 90 percent range when you look at like for like revenue in the UK and approaching 90% on a groupwide basis. By any measure, I think that's a pretty credible performance. As Alex has articulated, we are well ahead of last year and the pre-pandemic era on total revenue and that is before you count the tailwind impact of a growing number of high quality new site openings.

And finally, we can take some solace from the fact that we are well-advanced in progressing our strategy to broaden and diversify the business. Great oak trees grow from small acorns and the 130 site deal we signed with our Middle Eastern partner is a pretty decent acorn to start with. In fact, I had dinner in London with key representatives from our Middle Eastern partner last night

and it was good to hear that they share our ambition for the opportunity there. Based on the excellent performance of the first 8 or 9 sites that have already been opened, they are actively working on a plan to accelerate openings across the region.

Secondly, coming back to the UK and Europe, we are focusing very hard, as you can probably imagine, on energy costs and we've launched a major effort targeting significant consumption reduction and therefore savings. This is an ongoing effort. It involves some of our very best internal resources working closely with a third-party energy consulting expert. As we've explained previously, our utility costs are largely fixed across the UK until September 2023 and in Denmark they've been fixed until the end of this financial year, so we have a degree of protection in the portfolio in the near future.

We have the capital to invest in energy-efficient technologies and we're likely to invest over £10 million in this area in the next 12 to 18 months to step change the efficiency in certain areas of infrastructure in our estate. This expenditure will be in areas such as next generation LEDs, energy-efficient HVAC, and advanced building control systems. The key is that by virtue of our strong cash and liquidity positions we can make these investments now because high energy prices offer very attractive near-term return on investment and payback. Our aim is to reduce per site kilowatt hours of energy consumption by between 30% - 50% over the next two to three years with good progress to be delivered in the next 12 months or so. And of course, in the longer term whether energy prices stay high or normalise, we will have reduced our per-site energy consumption significantly, and that's good for our long-run unit economics and is also wholly aligned with our broader ESG ambitions.

Finally, we're seeing the impact of general cost inflation on CapEx and some of our other aspects of OpEx in the business with national minimal wage and general salary costs rising. However, we've been working hard in this area targeting operational and key procurement-led savings so they're down on costs and adjust certain specifications to partially offset cost inflation. In general, we feel we've made very good progress on that over the last two or three years.

With those headlines on the obvious challenges and what we are doing about them, let me now take a moment to elaborate on two key areas: first, how we are seeing members responding, and second, how we are approaching price and promotions as a key area of revenue management.

First, over on page 11, we show some insights in the UK where we rigorously track member data, and this analysis and tracking indicates overall what we regard to be a healthy degree of consumer resilience that counterbalances some modest indications, I stress modest indications, of the financial strain that we can see consumers are facing.

Let me start in the top lefthand corner of this page. Here we're tracking NPS, net promoter score, using a best in class groupwide platform, and we use this operationally and commercially to track site level performance and decision making. You can see that on average our NPS has been consistently plus-30 every month recently showing really consistent, strong levels of member satisfaction and certainly no indication of any disaffection in the member base. Similar patterns

to this can be seen in general across our European businesses.

In the top right corner, you can see visits per active member per week are actually a little bit ahead of both 2019 and 2021, showing that the desire for our product, the desire to actually use our product, amongst members is holding up very well, again, no signs of disaffection there.

On the bottom left, we track our direct debit success rate. This measures the proportionate direct debits in the UK that we seek to draw on that have sufficient funds in the bank account being drawn against to make the payment to us. As you might expect, we're seeing a modest, and again I stress modest, signs of financial strain amongst members in the data with a success rate being about 1% lower than in 2019. But again, I'd ask us to keep this data in perspective. These success rates are still very high, between 96% and 97%, and through this year it has stayed high and has not deteriorated materially.

Then when you look over on the bottom righthand side of the page at reactivation rates, this is the proportion of those failed direct debits who then pay and reactivate. You can see that over 50% of those who fail a payment go onto reactivate. And that's very much in line with 2019. So, the net payments success rate is still well over 98 percent, which indicates, I hope you would agree, a pretty strong resilience amongst members despite the challenges they are facing in managing their household budgets.

Let me then turn on to page 12 and take a moment to give you a little bit more insight into how we are managing the challenging conditions from a revenue perspective. As I think we've mentioned previously, we enjoy a degree of pricing power and a very high level of pricing and revenue control, controls that we've built up carefully over time. We have a sophisticated revenue management function that balances, carefully, volume and yield in a very measured way. This is the key lever in mitigating inflationary pressures and optimising the business in the market.

The product offer comprises a range of membership options to cover different segments, and we show those as examples on the right hand side of this page. There's been a lot of focus on headline price increases as a route to offsetting cost inflation recently, and we've been making some of those price increases where we can, of course. However, it should also be noted that as well as increasing standard or core product headline prices, we've also recently rolled out a cheaper off-peak saver product to the majority of clubs now to widen the appeal and provide a great and competitive entry price point. We think that this is commercially the right thing to do; it offers a new low entry point for those with flexibility, and it's 100% in line with our core brand philosophy of everybody being welcome. We think it's great that with gyms across the country, hundreds of thousands of people can gain access if they want to to a great facility for often as little as £15 or £16 a month.

On the other side of the equation, our plus products, on the right hand side of each of the schematics on this page, allows consumers to trade up and thereby increase yield. Now, we've been undertaking a considered program of existing member price optimisation as well as

headline price optimisation. We've increased prices in the last year, both in the UK and overseas, but our priority is always to make sure that we're offering great value for money within the context of the product that we're offering and the individual markets in which we trade.

Now, combining these elements of product and price is how we're able to maintain a strong average revenue per member. As Alex mentioned, our Q3 average revenue per member was up 10% vs 2019. Our average headline price progression in the UK is up only 5% vs prior year, significantly below the rate of inflation and indeed below that of some of our competitors. We think it's essential that we remain good value in the eyes of our consumers in the UK and across Europe, and that's what we're aiming to do.

Finally for this section, let me provide some more detail in relation to promotional activity over on page 13. A couple of words of context here, because we haven't provided this sort of data or insight before. Promotional activity is the flipside to upward price management. Whether an operator is offering zero joining fee, first month free, both, or some other revenue device, an operator is giving away headline price and thus revenue to a new joiner in the hope that their long run value more than compensates for the investment of that foregone revenue.

Over the last couple of years, a number of analysts have published data tracking increases in headline prices in the UK and other markets, and we do think that is a very important index and we too track the data of headline prices very, very carefully. What we provide here, however, is data tracking the level of promotional activity for ourselves and an index for the market, which we hope gives an insight into the next level of detail. This is important because overtime, it is promotional investment that needs to be managed carefully to deliver sustainable progression in underlying yields and average revenue per member, which supports revenue and ultimately EBITDA per site.

All this data, just to be clear, is effectively in the public domain as we track these datapoints from websites on a weekly and in some cases daily basis, because we see it as very important for us to have good information on what is going on so that we can take the right trading decisions. This helps us to remain disciplined and controlled so that we ensure that as much headline price drops through into the revenue line and actual yield over time. We try and avoid the temptation of chasing volume for specific periods as we know that that is something of a fool's errand and can get into a vicious circle over the long run.

Now, the chart here shows the number of days on promotion where headline pricing and or joining fees, i.e. some part of the revenue equation has been meaningfully discounted. The analysis compares PureGym with a market basket comprising a dozen significant operators, and we've listed those operators for the purposes of transparency at the bottom of this page. We then weight those operators by the number of sites that each operator has to create an index. Now, in total, these operators have over 700 sites, so we're not suggesting this is a complete market view, but we do think it gives a good indication of the level of activity of market in the market in general.

Now the data presented covers a 16 week period, ended 30th September 2022, and that data point for the whole of the period is on the far right hand side of this page, and we show the underlying data for each four week period, 28 day period, in the other bars across the middle part of the page.

Now, our strategy is to target promotional activity into periods when history tells us that there is likely to be the best response. Normally, September is such a period with the students going back to university, return to school, and a post summer holiday tendency to sign up to memberships. Now, we have already recounted that did not happen to the extent expected this year due to the unique confluence of factors in September. But September, just to be clear, was not a washout. Across the business, we still joined up over 200,000 new members in that month.

Now in August, by comparison as you can see on the chart, we as PureGym tend to do relatively little promotional activity because we don't see very much volume response or upside in that. People who are going to join are going to join and those who aren't are on holiday and not likely to be persuaded by a quick deal. This allows us to maximize yield on those who are going to join anyway effectively.

In summary, we try to think of promotions as a scarce and limited resource that we use sparingly to optimise volume, but always keeping an eye on revenue and the bottom line performance as well. And there are three things specifically that we keep in mind as we make use of this scarce resource. On the left hand side, first, we try to limit the length and depth for promotions to reduce fatigue of consumers. Second, we show restraint in frequency so as not to train the market to expect promotions. I don't think anybody wants to end up like Pizza Express when everybody was dining out with a voucher for a pizza. We routinely exclude busy clubs in high demand areas from promotions because there's little point in boosting acquisition volumes for headline numbers in clubs that are trading at close to capacity because invariably one member joining means another one will leave when you're close to that capacity limit.

We believe that this promotional discipline helps maintain the strong average revenue per member performance and in the long run helps us to secure a higher EBITDA per site than would otherwise be the case. I hope that gives you a snapshot of the way that element of pricing and promotion works.

Turning on to page 15 and to conclude and wrap up everything. In the quarter, we've seen continued progression in Q3 with revenue up 8% on Q3 2021 and 10% on Q3 2019. Run rate adjusted EBITDA has moved on to £116 million despite the very significant macro headwinds. We continue to have a very strong capital and liquidity position that is differentiated in the marketplace. We're laser focused on facing into the near-term challenges, including investing to significantly reduce energy consumption. We have a highly analytical and disciplined approach to pricing and promotion that helps us to optimise the revenue volume and EBITDA and not just to chase volume for the sake of it. Whilst navigating these near-term challenges, we've also remained focused on the long term strategic growth drivers, and here we have many reasons to remain positive. We have a strong and growing property pipeline in Europe. We've been

expanding coverage of franchise sites in the Middle East, as well as seeking discussions with partners beyond the Middle East and North Africa. New sites are performing very well for us, showing that our product and proposition is still resonating very well with consumers and this is the case in Switzerland, Saudi Arabia and the Middle East as well as across the UK. We've just secured, as we've said, the commitments from our Middle Eastern franchise partner for a minimum of 130 sites in that region.

So, despite the many near-term challenges, we and our investors remain confident of the long term prospects of the business. Hopefully this update has been informative for you, and we hope our transparency and openness is appreciated. We'd like once again to take this opportunity to thank you for your continued support of the business. It's sincerely appreciated.

Our next results announcement will be in April, when we will cover for the full year for 2022. We very much look forward to speaking to you again then. With that, I'd like to close the formal proceedings, and I think we'd be happy to take a few questions if there are any there.