PureGym Q2 2024 Results Conference Call
29 August 2024, 10am UKT

Humphrey Cobbold (CEO):

Good morning, everybody, and welcome to the presentation of our results for the quarter ended 30th of June, 2024. Joining me in the room today are Alex Wood, our Chief Financial Officer, and Rebecca Passmore, our Chief Operating Officer. We'll be running through the presentation that was posted on our website at 07:00 a.m. this morning, dated 29th August, 2024. We'll guide you to the page number references as we go through the document as usual, so you can keep track of where we are. So let's get started on page three with the summary.

First of all, I'd like to address the big news and the management announcement that we made last week, and that we are further updating you on today. There are three parts to this as follows; first, starting in November, I will transition to the role of Chairman of Pinnacle Topco, our holding company, and the PureGym Group as a whole. Second, Clive Chesser will join us as Chief Executive Officer in November. And third, Rebecca Passmore, who's sitting here with me now, will join the Pinnacle Topco board with immediate effect. I'll talk a little bit more about each of these steps in just a moment.

Now, let me get back to the 'normal' course of business, and cover off performance highlights of the quarter. The strong performance from quarter one continued into the second quarter of the year, delivering Adjusted EBITDA of £41 million, up £5 million, or 15%, compared to the second quarter of 2023. We continue to provide reliable, ongoing growth, with Run Rate Adjusted EBITDA increasing to £164 million at the quarter end. That's up £36 million, or 27%, year-on-year, and up £5 million quarter on quarter.

Not surprisingly, you will have noted, I'm sure, that our year-on-year growth has moderated somewhat in this quarter versus the prior quarters. That is not a cause for concern and is in line with our expectations as we start to lap the strong growth last year as we move through this year, and as we see consumers take a somewhat more careful approach with their money after a period of inflation. The overall performance continues to be underpinned by focused revenue management, good cost control, and the predictable maturation of new site openings from 2022 and 2023. And, in that regard, we've opened nine new high-quality sites in the quarter and continue to maintain a strong pipeline for new openings in the future.

Our strategy in Denmark and Switzerland continues to bear fruit, with strong EBITDA growth and margin improvement during the quarter, having delivered +24% year-on-year EBITDA growth in Denmark and +68% year-on-year EBITDA growth in Switzerland, and margin improvements in both territories.
Finally, senior secured net leverage was maintained at 4.1x Run Rate Adjusted EBITDA. So, these results build on top of a robust first quarter, and overall I'm pleased with the solid performance that we've delivered during the first half of the year.

Now, turning on to page five, and to give you a bit more colour around the management changes that we have announced. The overall point to make on this is that this is part of a very thoughtfully managed process and plan to increase the capability and capacity of the management team and ensure a smooth succession of leadership. And, just to be quite clear, there's no scintilla of drama or any problems in this. There will be no

fallings out or anything of that nature. On the contrary, as one of our investors described it to me recently, this, we believe, has been a textbook approach to building out a management team and orchestrating succession.

So, first up on page five, we've appointed Clive Chesser as Chief Executive Officer of the PureGym Group, and he will take up this role in early November when he's completed his notice period at his current employer. Clive will be known, I think, to a number of you in the bond market as he is currently in position as the CEO of Punch Taverns. He's a seasoned operator of multi-site businesses and knows the private equity-owned business model very well. Importantly, as well as extensive U.K. experience (and Clive, remember, has been running a business with a portfolio of over 1,000 sites across the U.K., so he knows the U.K. extremely well), Clive has a background in international development and specifically franchise portfolio development. And it's worth remembering that much of his current pubs business effectively operates under a franchise-style business model.

Clive really gets PureGym as well, not least because he has used PureGym facilities all across the country over the last few years as he's been travelling and visiting his pub estate while he's been training for his various marathons and cycling events. The investors and I particularly like the fact that Clive was willing, and indeed keen, to make a significant personal financial investment into PureGym, and building on this investment (and with the support of our investors in terms of equity issuance), we've been able to make sure that his interests and incentives are 100% aligned with other members of the business management team. And, we don't often talk about this, but it's worth remembering that this alignment to us is very important. We have around 100 people in the company as a whole with personally significant equity positions in the business, and there's no doubt in my mind, and in our minds, that that's a part of what creates powerful alignment within our culture and a common focus on performance and development of the business.

Secondly, when Clive joins, I will transition to becoming Chairman of the PureGym Group as a whole. Clive and I have laid out a clear plan for the three or four months that we'll take to manage that process of transition, so it'll all be done and dusted no later than, and probably before, the end of quarter one 2025. I want to be clear that I've got no intentions of taking on a full-time executive role outside PureGym, and, while my position as chair will technically be Non-Executive, I will, I think it's fair to say, be a more rather than less engaged Non-Executive in the context of PureGym. I'll stay close enough to the business, and key aspects of it, so that I can really support Clive and the rest of the team in its continued development. I will continue, of course, to have a strong personal commitment to supporting PureGym's success, and I'll remain a large individual management investor in the business. So, I really don't think that any of you, as our bond investors, should have any particular concern about the changes that we've announced in the last few days.

Thirdly, I'm very pleased to inform you that we've announced this morning that Rebecca will join the Topco board to sit alongside Alex and Clive as an Executive Director. Rebecca joined us seven years ago after a stellar career across a number of top-performing retail businesses, and not least within the Walmart business, which, as we all know, is the largest multi-site retailer in the world. Having excelled at all stages of her career with us, Rebecca has absolutely nailed the Chief Operating Officer role that she took on last October and I simply can't think of a better person to have joined the Pinnacle Topco board at this time. That's a sentiment that is entirely echoed by our equity investors from both KKR and Leonard Green & Partners who have been unequivocal in their support for Rebecca joining the board.

Then finally, although his picture is not on this page, it would be wrong of me to complete this summary of the go-forward set-up for the management team without mentioning our CFO, Alex Wood. Those of you who know us

well and have travelled with us over the ups and downs of the last seven years - and there have been a couple of ups and downs - will know very well that Alex is the rock on which the foundation of our team and business performance has been built. I've had the privilege of working with many capable financial professionals in my 35-year career, but to borrow from Sinead O'Connor, none of them compare to Alex. Alex is smart, unflappable, an outstanding accounting technician, diligent to a fault, has a phenomenal work ethic, and to boot is a thoroughly decent team member and focused individual, and a great person to work with at any time of the day or the night, as happens occasionally. To put it simply, you, as investors, are in very safe hands with Alex's hand firmly on the financial tiller at PureGym.

So, in summary, with Clive, Rebecca, and Alex as Executive Directors and with me remaining well connected to the business in a Non-Executive capacity, I think you can look forward to the future in confidence from a management point of view with a great deal of confidence for the future. And now, I'd like to pass over to Alex, who will share with you more details on our second quarter results. Alex, over to you.

Alex Wood (CFO):

Thank you very much, Humphrey, and good morning, everyone. I'd like to start by sharing with you the highlights of our financial results for the period ended 30th June 2024 over on page seven.

Quarter two was another solid quarter with steady ongoing growth in EBITDA supported by revenue and ARPM progression. Starting with Run Rate Adjusted EBITDA, which increased year-on-year and quarter on quarter to £164 million. And this means, of course, that we have exceeded our target of £160 million well ahead of the schedule that we indicated to you when we refinanced the business at the end of last year.

This follows sustained growth in Adjusted EBITDA, which increased, as Humphrey mentioned, 15% year-on-year and now exceeds £40 million for the first time in a quarter. The results were underpinned by growth in the like-for-like base, good cost control, and the strong performance and maturation of new sites opened in 2022 and 2023. I'm also pleased to share that the return on capital employed for mature gyms in the U.K. remains very strong at 37%.

Turning to the drivers of this solid performance, revenue for the second quarter increased 10% year-on-year, being a combination of 6% member growth and 2% ARPM growth. I should point out that this was in spite of closing seven sites in Denmark versus the prior year. These closures are, as you will recall, part of our plans to consolidate membership groups into a smaller number of better-invested sites. When we consolidate in this way, it increases the quality of the estate. We maintain a good proportion of revenues, but importantly, reduce operating costs significantly. And this, in turn, boosts EBITDA and EBITDA margin.

Over time, this will make the Danish operating model as high quality and efficient as the U.K., we believe. These trends will continue over the next 12 to 24 months with ongoing growth in Danish EBITDA as a result. Since quarter two, we have closed a further nine lower-quality sites in Denmark across July and August as we successfully execute our estate optimisation plans, which will reduce the company member numbers a little overall, but rest assured that the underlying business quality will be improving.

As we look forward, therefore, the total company year-on-year comps will appear more muted as we execute on these changes. This is entirely what you would expect, especially when coupled with a very strong second half of the prior year and an air of caution in the consumer environment over the summer. You can see the

improvement in Danish EBITDA and margin this quarter, and we're very satisfied with the progress in Denmark so far, and Rebecca may comment further on this shortly.

Lastly, on the highlights, I'd like to call out that we have continued to expand our site footprint in line with expectations, having opened nine new corporate sites in the second quarter. This takes our total to 616 sites at the end of Q2, and of course, we expect to continue to open more high-quality new sites over the second half of this year and beyond.

So, moving to page eight, let me provide a little more detail for you. Overall, we're seeing solid performance across all key metrics and across all key geographies. Run Rate Adjusted EBITDA increased by £36 million, or 28%, compared to the same period last year, and Adjusted EBITDA increased to £41 million for the quarter. That's growth of £5 million, or 15%, compared to Q2 2023. These metrics are as a result of efforts across the company to manage costs and deliver solid revenue to ensure EBITDA flow-through. Revenue growth was supported by the addition of over 100,000 members versus the prior year, closing the quarter with almost 2 million members. This member performance can be attributed to growth in new and maturing sites at the same time as managing our core estate base. And this member performance was further enhanced by controlled progression in ARPM of 2% year-on-year.

Turning to page nine, the business generated £30 million of operating free cash flow in the quarter, and that's after maintenance and refurbishment expenditure. You will see that cash flow conversion was 72% in the quarter, and I just wanted to reassure that this reduction versus the prior year is simply due to the timing of payment runs, and the underlying position remains very healthy. Indeed, you can see that our closing cash was £127 million at the end of the quarter, and that is the same level as in the prior year when you pro forma for our October 2023 refinancing. That shows that the business continues to perform very well from a cash management and cash generation perspective. Capital expenditures for the quarter total £24 million, including the funding of nine new sites during the period, bringing our total site footprint to 616, which comprises 596 corporate-owned sites and 20 franchise gyms.

Lastly, I'd like to call your attention to the bottom corner of this page, which shows senior secured net leverage is holding firm - despite investment in the estate and new sites - at 4.1x run rate adjusted EBITDA at the quarter end, and I'll touch on this in a little more detail shortly.

On capital expenditure, moving over to page 10, during the second quarter, we invested £7 million in new corporate-owned site openings in the U.K., and that was at an average cost per site of £1.2 million. We also invested a further £6 million of capital into the Danish estate during the period.

This has always been part of the strategic plan for Denmark and, as I've just explained, it's to support the long-run unit economics in this geography, improving the quality of the product and the proposition, and consolidating sites to ensure that they are well-invested, efficient, and yielding high-margin returns for us. While still in the early stages, we're already starting to see the benefits of this focused investment program coming through within Danish EBITDA, and you can see growth in Denmark's EBITDA of 24% year-on-year in the quarter. This validates well our strategy of investment and leaves us very excited about the potential for the future.

Alongside growth capex, we spent £9 million on maintenance and refurbishment during the quarter, as we also continue to carefully deploy capital across our existing estate, and as we've said before, we believe that this

careful investment in maintaining a high-quality estate is key to drive value for our members over the long term.

Finally, let me cover leverage over on page 11. The business has shown consistent deleveraging during the period since refinancing in October 2023, and this has been driven by cash generation on the one hand and steady improvements in profitability on the other hand. Following that, and the investment of surplus cash on the balance sheet into new sites, leverage is holding at 4.1x at the quarter end. So, overall, this is a very healthy set of debt performance metrics and all in line with our expectations. And, with that, I'll now hand over to Rebecca - who I am delighted to welcome to the Pinnacle Board - for her to make a few closing remarks.

Rebecca Passmore (COO):

Thank you, Alex, and good morning, everyone.

Let me start on page 12, and, first, briefly thank you, Humphrey, and you, the investors, for showing the confidence in appointing me to the Pinnacle Topco Board. I'm looking forward to that, and having gotten to know Clive, our soon-to-be new CEO, pretty well over the last few months, I'm very much looking forward to working with him when he joins in November. From an operational point of view, we've had a really busy second quarter, working alongside our teams across the U.K., Denmark, and Switzerland businesses, and I continue to be very impressed by what I see.

As Alex has indicated, we're rolling out the program of investment upgrades and consolidation in Denmark. We've made great progress in the first half year, with over 25% of the estate receiving investment, and we're starting to see momentum in performance. I'm also really pleased with the way that David Green - our new managing director in Switzerland who started during quarter one - has settled into his role in the broader business. He has a tight grip on the forward-looking plan for the Swiss market and is leading the charge with the team to deliver. And I would echo what you said, Humphrey, that overall, we're in really good shape managerially from my perspective.

Let me finish on page 13 by highlighting some key points from the presentation and by making some comments about the current status of the market and outlook. I won't repeat all the key facts and figures, which I trust are clear, but just underline a few of the key points that Alex and Humphrey have made.

The business has continued to deliver solid performance, with Adjusted EBITDA of £41 million for the quarter and Run Rate Adjusted EBITDA reaching £164 million.

While we're satisfied with our performance, there is no doubt that we're operating in a market in which general consumer spending is under pressure, and we expect that to continue to be the case for the foreseeable future. In my view, consumers are mopping up the cumulative impact of significant inflation in food and energy prices and much higher mortgage and rental costs. And of course, over the summer, regardless to some degree of budget constraints, consumers have been getting off to more reliable warmth and sunshine with overseas travel.

We opened nine new high-quality corporate-owned sites in the quarter, having opened 11 in Q1 of this year. Notwithstanding the consumer challenges I've referred to, the vast majority of these new sites have performed really very well. I remain confident in our team's ability to locate new sites, open great gyms, and tap into pools of latent demand. By the end of Q2, we will have opened a total of 20 corporate sites in 2024, and I'm confident

that we will deliver between 40 to 45 sites for the full year. I'm always more concerned about quality of openings than quantity, but as I look to the future, I believe that in 2025, we'll exceed the 40 to 45 openings in 2024 by quite some margin, with a pipeline that is building very well.

I'm also particularly pleased with the steady EBITDA and margin growth in both Denmark and Switzerland. These figures validate our investment strategy in these geographies and give confidence that we're successfully building a solid platform for the future. Overall, we're pleased to report a solid first half year, and while things may get a little tougher as we move forward into the future, we remain focused on executing our strategy as we move into quarter 3 and quarter 4.

And with that, I will hand over to Humphrey for concluding remarks.

Humphrey Cobbold (CEO):

Thank you very much for your time and attention today, everybody. Obviously, we'll be back in touch again towards the end of November on the Q3 update. Thank you for the support of all of you as investors. We do value that, and we're continuing to work hard to make sure that we deliver on your expectations. Thank you very much.

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