The Peril, Promise and Reality of the Pandemic for the Fitness Industry

"The greater the obstacle, the more glory in overcoming it."
Moliere

club intel

Insight Inspiration Impact

Table of Contents

Prologue

Joseph Schumpeter, a renowned economist from the 1940's, said *"Creative Destruction is the essential fact about capitalism"*. In other words, capitalism's existence is dependent upon the destruction of existing value propositions and the emergence of new and more relevant ones. Schumpeter also proclaimed, *"Situations emerge in the process of creative destruction in which many firms may have to perish that nevertheless would be able to live on vigorously and usefully if they could weather a particular storm."* He believed a healthy economic climate demanded "creative destruction" fostered by innovation leading to the introduction of new and more relevant offerings into the marketplace.

Well, in 2020 capitalism was rudely introduced to an entirely new form of economic destruction. This destruction was not fostered by innovation, antiquated thinking, or greed (think the Great Depression or the deep recession from earlier this century). Instead, it was fostered and nurtured by a pandemic that became a catalyst for changing how brick and mortar businesses carry on. One could say the pandemic of 2020 was an apocalyptic capitalist event where the pandemic was an asteroid hit, literally destroying the framework for brick and mortar capitalism.

The fitness industry, like other industries dependent upon a brick and mortar approach to serve customers, has experienced an economic disruption of a magnitude of incredible proportion. This apocalyptic event, like the environmental one that extinguished dinosaurs, is destined to bring the extinction of many brick and mortar fitness businesses. Emerging from this cataclysmic capitalistic occurrence, like the mammals that evolved when dinosaurs became extinct, will be fitness businesses that are nimble, highly fluid, digitally savvy, and prepared to think and act differently.

Our intent with this article is to provide an outlook for the fitness industry over the next six months to two years. To frame our outlook, we will start with an overview of the pandemic's present impact on global economies and consumer confidence. We will then explore the capitalistic impact of the pandemic on the fitness industry. Next, we will touch on consumer fitness behaviors and home fitness equipment sales during facility closures. Lastly, we will bring forward our prognostications for the fitness industry over the next few years.

Impact on the General Economy and Consumer Confidence

Impact on the Global Economy

In the 2nd quarter of 2020, at the height of the pandemic in the U.S., the nation's Gross Domestic Product (GDP) declined by 34.3% over prior year, that after a 3.4% decline in the first quarter. Economists are forecasting that by year-end 2020 the U.S. GDP will decline by 7%. A seven percent annualized decline is considerable when you consider in 2009 during the "Great Recession" the U.S. saw GDP decline by 2.54% and in 1931 at the height of the depression the GDP dropped 13%. The U.S. is not alone in its economic pain. In the European Union, GDP declined by 3.2% in the first quarter and 11.9% in the second quarter. Forecasts are for the EU to experience an 8.3% decline in GDP for 2020. The International Monetary Fund forecasts that GDP globally will fall 4.9% in 2020 and by 8% in advanced economies.

Accompanying these horrific drops in GDP has been a scourge of business closures and Chapter 11 bankruptcy filings. For the first half of 2020 there were a total of 3,604 Chapter 11 filings, the most since 2010 at the height of the "Great Recession". By year-end 2020 the number of Chapter 11 filings will likely surpass the total experienced in 2010. A report from EPIQ indicated that in June 2020 Chapter 11 filings were up 43% over prior year and for the first half of 2020, filings were up 26% over 2019. Among the most recognized brick and mortar retail businesses seeking Chapter 11 protection (business survival) are Ann Taylor, Brooks Brothers, California Pizza Kitchen, GNC, Hertz, J. Crew, J.C. Penny, Men's Warehouse, Modell Sporting Goods, and Neiman Marcus. The destructive impact of the pandemic goes beyond these Chapter 11 filings. According to an article appearing in Moneywise.com from August 3rd, approximately 12,600 stores across the U.S. have closed since January. Forecasts are for as many as 25,000 stores to close in 2020, up from 9,500 closures in 2019 (163% increase). A few of the more notable retail closures, due either to bankruptcy filings, going out of business, or portfolio thinning include:

- AT&T closing 250 stores
- Game Stop closing at least 320 stores (approximately 19% of stores)
- GNC closing 1,200 closures (approximately 16% of stores)
- Men's Warehouse closing approximately 500 stores (approximately 36% of stores)
- New York & Company closing 405 stores (approximately 50% of stores)
- Pier One Imports closing all 936 stores

- Starbucks closing 400 stores
- Walgreens closing 200 stores

Impact on Small Business

According to an article published in the May 12, 2020 online edition of the Washington Post, economists project that more than 100,000 small businesses, equal to 2% of all small businesses, had permanently closed (study conducted by University of Illinois, Harvard Business School and University of Chicago) as of the article's publication. The "U.S. Chamber and MetLife Small Business Coronavirus Impact Poll", published June 2, 2020, offered some additional insights into the impact of the pandemic on small businesses.

- 1% reported being permanently closed and 19% temporarily closed. Among retail small businesses, 29% indicated they were temporarily closed.
- More than eight in ten small businesses report they are making or plan to make adaptions to how they conduct business because of Covid-19.
- 71% expressed concern about financial hardships due to prolonged closure and 57% reported worrying about having to permanently close.
- 55% indicated it will take six months to a year before the U.S. business climate returns to normal. Another 6% said it will never return to normal.
- Mid-sized and large small businesses were the least optimistic with only 27% of those with 5 to 19 employees and 14% with 20 to 500 employees indicating they can operate without closure for another six months.

A July 22, 2020 article appearing in Marketwatch.com indicated that as of July 10, 2020 132,580 businesses listed on YELP remained closed due to the pandemic. Since March, YELP reported that 72,842 businesses or 1.55% of businesses listed on their site had permanently closed with 15,742 of those permanent closures occurring between June 15 and July 10.

The story reads like a Stephen King novel, horror everywhere you look. This is the environment that now frames the general economy, especially brick and mortar retail businesses, of which fitness clubs and studios are a part.

Impact on Private Equity Activity

Private equity (PE) activity is an excellent barometer of business growth and profitability. Since the turn of the Century, private equity has been a primary contributor to growth in both the public and private sectors. One might say, *"how goes private equity, so goes the growth of both private sector businesses and public entities."* In the fitness industry, firms such as 24Hour Fitness, Crunch Fitness, Equinox, Lifetime Fitness, Planet Fitness, Orange Theory, Crunch, and Xponential Fitness (e.g., Cycle Bar, Pure Barre and Club Pilates) have all sourced private equity to scale and grow their businesses. As such, understanding how PE has been impacted by the Covid-19 pandemic can inform us of what lay on the horizon.

Pitch Book's report entitled, *U.S. Private Equity Breakdown Q2 2020*, offers some sobering insights into private equity activity for the first half of 2020. Specifically:

- Deal values for the first half of 2020 have dropped by 20% and by 33% during the 2nd quarter.
- Global PE exit activity in the 2nd quarter of 2020 dropped by 70%.
- PE portfolio companies have seen a surge of downgrades.
- The number of PE portfolio firms with ratings of B3 negative or lower (not good) has more than doubled in 2020.
- PE fund raising activity in 2020 is tracking with 2018 numbers (209.6 billion), but down considerably from 2019 ($314 billion). For the first half of 2020 PE has raised just over 101 billion dollars.
- Over the first half of 2020 PE firms have sharply marked down portfolio companies, preferring to hold on to them rather than sell at a discounted valuation.

The tale told by PE speaks to a capitalistic ecosystem where business valuations are down, exit opportunities are fewer, and the risk of defaults is higher. For the short-term it means investors and businesses seeking to sell are less likely to garner their desired returns. For buyers, it offers an opportunity to acquire complimentary businesses for less, such as RSG Group's acquisition of Gold's Gym. This is an example of Sun Tzu's statement that says, *"In the midst of chaos, there is opportunity."*

Consumer Sentiments about the Economic Climate

In July 2020, the *Consumer Confidence Index* (administered by Conference Board and Nielsen) was 92.6, down from 98.3 in June and a high of 132.6 in February (base score was 100 in 1985). While 92.6 is not good news, when you consider the Index hit a low of 25.3 in February 2009 during the height of the "Great Recession", 92.6 might be good news. Another metric used to gauge consumer confidence is the *U.S. Expectation Index* which measures consumer's short-term outlook (6 months forward) for income, business, and labor. In July, the score was 91.5, down from 106.1 in June. The Eurostat Composite Indicator orchestrated by the European Commission was 87.1 in July, down from 102.6 in January.

These numbers indicate consumers are less confident in the economy today than at the end of 2019, and less optimistic about the near future than earlier in the year, or even last year.

Impact on the Fitness Industry

Overall Fitness Industry Impact

According to IHRSA, during April and May of 2020, nearly 95% of U.S. fitness operators were closed due to the Covid-19 pandemic. An article published in the spring of 2020 by Health Club Management indicated that approximately two-thirds of global fitness operators were closed at the peak of the pandemic. In a July 3, 2020 article appearing in Club Industry, it indicated that in a release by IHRSA it stated that the U.S. industry had lost $5.6

billion in revenue between mid-March and June 1, 2020, the equivalent of 16% of the industry's reported annual revenue for 2019. The article goes on to say the U.S. fitness industry can expect to lose approximately $350 million a month for the remainder of 2020. The cumulative impact of these estimates would equate to $8 billion on an annualized basis for 2020, approximately 22% of the industry's reported revenue in 2019.

Bankruptcies and Closures in the Fitness Industry

Two signs reflective of the financial stress created by the Covid-19 disruption are bankruptcy filings (Chapter 7 or Chapter 11) and club closures. As shared earlier in this report, overall bankruptcy filings for the first half of 2020 were up 26% over prior year. The fitness industry has not been immune to Chapter 11 filings, or for that matter, business closures. As of August 5, 2020, the following fitness firms have filed Chapter 11 bankruptcy and/or closed club(s).

- 24Hour Fitness filed for Chapter 11 in June 2020 and indicated it would be closing 140 of its properties, approximately 30% of its clubs.
- Gold's Gym filed for Chapter 11 in May and indicated it would close approximately 30 of its 90 corporate-owned clubs (approximately 33%). In July, the company was acquired by RSG Group, Germany, owner of McFit, for $100 million.
- Claremont Club, Claremont, California closed for business on August 1, 2020. The club had been in business for over 30 years and had weathered earlier recessions.
- LA Fitness reported in the spring it may permanently close 100 of its 700 clubs.
- Town Sports International indicated in June 2020 it will consider filing for Chapter 11 because of debt obligations coming due.

Impact on Publicly Traded Fitness Operators

Another approach to viewing the destructive impact of the pandemic on the financial performance of the fitness industry is to explore the performance of publicly traded firms. These entities are required to file quarterly and annual financial reports. As a result, one can view the year-over-year financial impact attributable to the pandemic.

Planet Fitness

Planet Fitness, a publicly traded firm, is the world's largest operator of budget clubs. As of 2020, it operated over 2,000 locations, approximately 1,430 in the U.S. In 2019, the company reported revenues of $688.8 million (40% from franchising, 23% from corporate-owned stores and 37% from equipment sales) and an EBITDA of $283 million (40% margin). Going into 2020 Planet Fitness was positioned to have a highly profitable year; then Covid-19 struck. What follows are some KPIs that reflect the destructive impact the pandemic has had on Planet Fitness over the first half of 2020.

- Revenues. 1st quarter down 14.5% from same period 2019 (franchise revenue down 11%, corporate-owned store revenue down 6% and equipment revenue down 37%). 2nd quarter revenues down 77.9% (franchise revenue down 71%, corporate-owned store revenue down 76%, and equipment sales down 86%).
- Adjusted EBITDA. 1st quarter down 26.6% from 2019. 2nd quarter down 112% from 2019. Overall adjusted EBITDA for the 2nd quarter was a negative $9.3 million.
- Debt to EBITA Ratio. Annualized ratio as of March 2020 stands at 9.97 compared to prior year ratio of 3.5.
- Debt to Equity Ratio. As of end of the 1st Quarter 2020 it stood at -2.76
- Enterprise value (EV). Currently at $5.437 billion down from YE 2019 EV of $7.334 billion. Paper loss of close to $2 billion.
- EV/EBITDA Ratio. 21.72. High ratio indicates company is spending a lot to generate each dollar of earnings.
- Stock price. Average share price down approximately 33% since January 2, 2020. Traded at $75.08 on January 2nd and on August 7th was trading at $50.79.

These numbers show a firm that is experiencing financial stress. Specifically:

- *The negative debt to equity ratio indicates the company's interest on debt exceeds its return on investment. It also reflects negative net worth and less than desirable return* *on investment for its shareholders. The high EV/EBITDA ratio reinforces the story showing earnings come at a high cost.*

- *The high debt to EBITDA ratio (9.97) is reflective of Planet being highly leveraged. This could contribute to significantly slower growth in the near-term and a considerable burden on the company's free cash flow. If cash flow for the remainder of the year tracks with the 2nd quarter the company could be at risk with respect to certain debt obligations.*
- *The declines in revenue and EBITDA for the first two quarters of 2020, if continued thru the 3rd quarter could put the company in a negative cash position by year end.*

<u>Basic Fit</u>

Basic Fit is Europe's largest club operator. At YE 2019 they operated 784 corporate-owned stores serving 2.21 million members with reported revenues of 515 million Euros ($611 USD). Like other established fitness operators, the pandemic has had a significant impact on the firm's financial performance over the first half of 2020. Specifically:

- Revenues for the first half o 2020 declined 24% (181.7 million Euro down from 240 million Euros in 2019).
- EBITDA for the first half declined 42% (69.9 million Euro down from 119.5 million Euro in 2019).
- Debt to EBITDA ratio. Presently at 4.44
- Debt to Equity Ratio. Presently 1.7
- EV/EBITDA Ratio. 12.7
- Stock price. Trading at 23.25 as of August 4th, 2020 down from 52 week high of $35.75. A 52-week change of negative 24.56%.

The numbers show that Basic Fit has some considerable challenges ahead. Specifically:

- *The debt to EBITDA ratio indicates the firm is highly leveraged. The company has used debt rather than equity to fuel its growth. While not as highly leveraged as Planet Fitness, it shows its debt levels are approaching the danger zone.*
- *The debt to equity ratio of 1.7 exceeds the desirable range of 1 to 1.5. This is a result of the firm's dependence on debt rather than equity for growth. This ratio will make it harder to acquire debt for fueling ongoing growth. Combined with the revenue declines experienced over the first half of the fiscal year this metric indicates that short-term growth may be hampered.*
- *If the revenue and EBITDA declines of the first two quarters continues, the company could see 2020 revenues decline by over $100 million Euros. This could wipe out a significant portion of its EBITDA and free cash flow for 2020, placing an additional burden on growth ambitions.*

<u>The Gym Group</u>

The Gym Group is the U.K.'s largest operator of budget clubs. At YE 2019 they operated 179 corporate-owned properties serving 870,000 members with revenues of 153.13 million Pounds and an adjusted EBITDA of 48.5 million Pounds (31.6% margin). Like the other budget operators highlighted in this paper, the pandemic has had a significant impact on the firm's financial performance over the first half of 2020. Specifically:

- Debt to EBITDA Ratio. Presently 1.2.
- Debt to Equity Ratio. Presently .35
- EV/EBITDA Ratio. 7.57. This is a good number and makes it an attractive target for other businesses.
- Members. The company reported that its member count declined 20% year over year as of July 9, 2020 (692,000 members down from 870,000 members a year prior).
- Stock price. Trading at 144.20 pounds on August 5th down from 52-week high of 325 pounds, the equivalent of a 56% drop from its previous 52-week high.

These numbers show the Gym Group, while in a healthier financial position than either Basic Fit or Planet, still has some turbulent times ahead. Specifically:

- *The debt to EBITDA ratio indicates the firm has not taken on much debt. Overall, this speaks to a healthy balance sheet.*
- *The debt to equity ratio of .35 reflects growth driven more by equity than debt and a conservative low-risk approach to growth and generating returns for investors.*
- *With 2019 average revenue per member of approximately 180 Pounds, the loss of 178,000 members due to the pandemic represents the potential loss of 31.3 million Pounds on an annualized basis. Depending on what occurs over the second half of 2020, the lost revenue could obliterate anywhere from a third to the entire amount of its EBITDA.*

Town Sports International (publicly traded mid-market operator in U.S.)

At YE 2019, Town Sports International (TSI) operated 186 corporate-owned clubs serving approximately 605,000 members with reported revenues of $460.34 million, EBITDA of $32.77 million and adjusted EBITDA of $41.558 million. Already facing financial difficulty at the end of 2019, the pandemic inflicted additional damage to the firm's shaking financial position. Specifically:

- Financial statements. As of August 4, 2020, the company had not filed 1st quarter or 2nd quarter 10-K reports for 2020. On July 7, 2020, the company was notified by NASDAQ that it was no longer in compliance with continued listing. The company took a material impact charge (impact of an omission or misstatement of information on its financial documents) of $135 million to $155 million in July 2020.
- Debt to EBITDA ratio. Presently 24.77.
- Debt to Equity Ratio. Presently stands at -9.05
- EV/EBITDA Ratio. 24.59. Worst ratio of the four public firms.
- Stock price. Traded at $.44 on August 5th down from a 52-week high of $3.00.

The numbers show that TSI is a financial calamity. Specifically:

- *The debt to EBITDA ratio of over 24 indicates the firm is so heavily leveraged no hope exists for addressing short-term debt obligations without filing Chapter 11 or finding someone to buy them at a considerable discount or for nothing.*
- *The debt to equity ratio of -9.05 reflects a business whose net worth has gone down the drain. Chapter 11 may not save them unless a considerable portion of the portfolio is sold for pennies on the dollar.*
- *The failure to file their 1st quarter, and now 2nd quarter reports, along with having to take a material impact charge, combined with the poor financial metrics, highlight a firm that was taking on water before the pandemic, and with the pandemic is now drowning.*

Impact on the Fitness Industry Consumer

Beyond its impact on global economics, consumer sentiments, and fitness industry economics, the pandemic also changed consumer behavior and sentiments regarding how they exercise and where they exercise. Who would have guessed?

What Consumers Did When Gyms Were Closed?

According to our study, "What Members Say Matters", published in June 2020, we discovered the following about member behaviors during gym closures:

- 68% of consumers exercised outdoors (jogging, cycling, or walking).
- 59% exercised on their own at home
- 30% exercised at home using digital fitness content provided by their club and 24% exercised at home using digital content obtained from a third party (e.g., Daily Burn and Peloton).
- 41% of Millennials reported they used digital on-demand/live workouts offered by their facility, 39% said they participated in digital on-demand/live group exercise classes, and 39% said they participated in online hangouts and social activities sponsored by their facility. Among Gen Z those percentages were 26%, 29% and 37%.

Expected Fitness Behavior when Gyms and Studios Reopen

In this same study, when members were asked about their likelihood of returning to their gym once it reopened, 65% indicated they were fairly or very likely to return. Among Gen Z and Millennials, the percentage dropped to approximately 60%. What we found most interesting was that 61% of members indicated that upon their gyms reopening they would be fairly or very likely to continue using digital fitness content at home, a number that jumped to 67% for Millennials (only 61% reported they were going to return to the gym).

As part of the study we looked at sentiments impacting their decision to return once their gym reopened. 42% indicated it was very or extremely important their facility incorporated digital fitness content into the value proposition. Among Millennials, the percentage jumped to approximately 54% and for Gen Z 47%.

Home Fitness Product Sales

Another barometer of member and consumer fitness behavior during the Covid-19 forced closures of facilities are the sales numbers for home fitness equipment and third-party digital fitness providers. One would suspect that consumers sequestered at home might purchase equipment for home and/or purchase a subscription to a digital fitness content provider. The story from this perspective is breathtaking. Some highlights include:

- Peloton reported that its digital connected subscriber base increased 66% during the closure period. At the end of the 1st quarter they had 563,000 subscribers and by the close of the 3rd quarter they had 886,000 subscribers. They are projecting a base of just over 1 million subscribers by the end of their 2020 fiscal year.
- In an article entitled "COVID-19 and Digital Adoption in the Fitness and Wellness Space", published April 22, 2020, the author brought forward some extraordinary numbers regarding the adoption of digital fitness and wellness content during the initial height of the Covid-19 pandemic. Some of the key highlights included: video streaming bandwidth rose 849%, monthly subscriptions rose 2,150% and annual subscriptions rose 255%.

- According to Research and Markets in an online article from July 10, 2020, home equipment sales went ballistic during the March and April time periods. Some of the mind-numbing numbers for year-over-year sales for this period are as follows: dumbbells sales up 1,980%, weight plate sales up 1,355%, kettlebell sales up 1,000% and bench sales up 530%.
- Gymcatch, a digital platform that allows consumers to schedule in-person, live virtual, and on-demand virtual personal training, said its bookings for virtual personal training increased 2,000% over 2019.

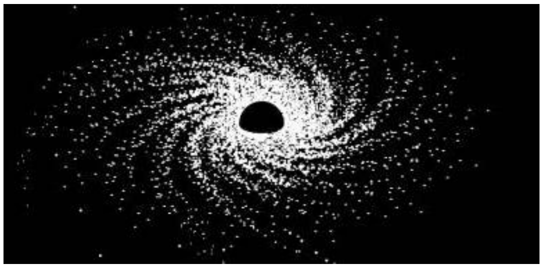
During the period of temporary closures, existing members and non-members adopted new approaches to pursuing fitness. These new behaviors allowed them to exercise at home using home fitness equipment and on-line digital fitness content providers. While gym closures were temporary, our research from May 2020 indicated that 48% of members had been away from their facility for two to three months and 7% had been away for three months or more. We are now in August and some facilities are still closed and others in States such as Arizona and California are closing for a second time. As a result of these closure dynamics, we estimate at least 50% of members have been pursuing fitness on their own using home equipment and digital fitness content for at least 90 days. When you consider it takes on average 66 days for an individual to adopt a new habit with a range of two to eight months (based on study published in 2009 in the European Journal of Psychology), we may be seeing U.S. fitness facility members adopting a new and enduring approach to fitness.

Prognostications for the Fitness Industry

Mark Twain said, "*Prediction is difficult - particularly when it involves the future.*" We agree. Predicting what will happen to the fitness industry six months from now, or 18 months from now, is risky business. Despite the inherent challenge of predicting the future, we also believe in a statement also attributed to Mark Twain. This statement indicated that the best predictor of future behavior is past behavior. Hence, we believe the data reflected earlier in this paper provides a relatively reliable compass for what the fitness industry can expect over the next six to 18 months. So here we go with our seven predictions!

#1 Micro-Black Hole Emerges for Independent Clubs and Fitness Studios

We estimate that between 15% and 25% of independent small and medium sized fitness businesses (operations with fewer than 20 employees), will permanently close for business by YE 2020.



Rationale

We believe the data in this report and online foreshadows a significant percentage of small independent fitness businesses, clubs, and studios, shuttering their doors permanently over the next 6 to 18 months.

#2 Feeding Frenzy of Acquisitions, Mergers, and Club Closures Among PE-Backed Fitness Chains

PE funds and/or PE backed fitness businesses will aggressively pursue the acquisition of distressed, under-valued and/or highly leveraged fitness chains (e.g., RSG Group acquiring Gold's). When these acquisitions, mergers and buyouts are consummated, we predict 20% to 30% of the acquired assets will be shed (e.g., 24 Hour closing over 100 clubs). The result will be fewer, larger, and more financially stable multi-unit fitness operators, and 20% to 30% fewer facilities in each portfolio.

Rationale

Already, there have been multiple Chapter 11 bankruptcy filings among large fitness chains (24 Hour and Gold's Gym as of this article's writing). 24 Hour Fitness and Gold's, as part of their Chapter 11 filings, indicated they would reduce their unit footprint by a considerable margin (approximately 30% to 33% of properties). In July, the RSG Group of Germany, operators of the McFit Clubs in Europe, acquired Gold's Gym for $100 million and plan to leverage that acquisition to expand their footprint globally. We believe TSI and others will soon become targets for acquisition.

#3 A Slimmer More Agile Brick and Mortar Fitness Facility Experience is Born

Success will be framed by facilities achieving 80% to 85% of their pre-Covid-19 membership base. This means operators will need to plan for and execute strategies that allow them to be more efficient at managing expenses and more productive at generating revenues through non-traditional monetization approaches and value-based pricing.

<u>Rationale</u>

The data from our study and others shows existing clubs and studios can expect between 65% and 85% of their members to return at reopening. As a result, the fitness facility of tomorrow will have a reconstructed value proposition that allows it to be profitable and sustainable with fewer members than before the pandemic.

#4 Digital Twins Emerge as a Competitive Edge in the Fitness Industry

Fitness operators who stand out in this post-Covid-19 storm will seamlessly blend digital workouts, digital group exercise, digital events and competitions, mobile portability, AI, and XR (mixed realities) with a modified version of their brick and mortar experience. A digital twin is a digital representation of a physical object or system. It speaks to the physical brick and mortar offering of a fitness business having a digital twin so consumers can engage with the physical experience, the digital experience, or both.

<u>Rationale</u>

Until February 2020 most fitness operators conducted business in one realm, the brick and mortar. A few early adopters saw the wisdom of incorporating digital fitness content, thereby expanding their offering into more than one realm. Covid-19 changed all that. Going forward, fitness operators will need to blend their brick and mortar experiences with a robust and fluid digital experience. Ideally, the physical offering of a fitness business must have its twin, or comparable relative in the digital realm.

#5 Home Gyms become a Fashionable Home Upgrade

5% to 10% of pre-Covid-19 gym members will drop their facility membership and pursue fitness at home using on-demand/live digital fitness content accompanied by home fitness accessories purchased during the pandemic. Another 10% to 20% of pre-Covid members, especially those from Gen Z and Millennials, will scale back their frequency of usage at clubs and studios, shifting to a blended home and facility fitness approach. Collectively, these two predictions mean reduced brick and mortar membership counts and reduced visits from the members.

<u>Rationale</u>

During the pandemic-driven gym closures, members engaged in alternative approaches to exercising. Close to 70% took advantage of the great outdoors, while another 30%+ used digital fitness providers to inspire and guide at home. Just over 60% of members indicated they were very or fairly likely to keep using digital fitness content once their club or studio reopened. Add to this the explosive growth in home fitness equipment and subscriptions to digital fitness providers, and you have a recipe for making one's home the newest gym.

#6 What Went Down Needs to Go Up - The $10 a Month Value Proposition Fades Away

Budget operators will need to take pencil to paper, or mouse to laptop, and arrive at an alternative low-price value proposition that can generate high volume sales, extremely low usage, and be profitable with fewer members and fewer upgrades.

Rationale

Over the past decade the budget club, or high value low priced value proposition, propelled by the subconscious lure of $10 a month will no longer be sustainable. Even Planet Fitness, the granddaddy of the $10 a month lure (No Judgement is a tagline not a lure), will find itself having to adapt its pricing strategy or risk obsolescence post-pandemic. Over the past few years, we have seen the emergence of 2.0 and 3.0 versions of the budget club's value proposition, where operators offer a $10 a month lure and then offer appealing upgrades for another $10 to $20 a month (multi-club access, tanning beds, massage beds, and virtual group exercise). In 2019, Planet Fitness collected approximately $16 a month from each member based on approximately 60% of its members taking the bait to upgrade.

Post Covid-19, consumers are less likely to perceive access to all clubs, sitting on a hydromassage bed, or standing in a tanning booth, as worth another $10 a month. Consumers are traveling less today and are predicted to travel less over the next year or two. This will make multi-facility upgrades less appealing, and therefore not worthy of an additional $10 a month price tag. In addition, consumers' hypersensitivity to cleanliness and desire for a sterile environment, will make hydromassage beds and tanning tubes less appealing and not worth another $10 a month. Combine the upgrade dynamics with the potential for a membership base that is 10% to 20% smaller, $10 a month will not cut the mustard if profit is the end game.

#7 Investor ROI Strategy Shifts from Big Bang Approach to Deliberate Expansion

Multi-unit operators will focus on a more deliberate and slower approach to growth, spending less time on the unchecked addition of new units, to a strategy focused on enhancing individual store profitability. Rather than seeing how many units can be opened, the story will shift to operational profitability first and expansion second. This approach will ensure financial security for investors and grow returns, albeit slower than by aggressively adding units and incurring debt when cash flow is less.

Rationale

Several years ago, an article in Harvard Business Review, talked of a shift in strategy for businesses whose previous strategy for generating investor return was debt-fueled unit growth. The authors stated that debt-fueled growth as the sole approach for generating stakeholder return was not sustainable during times of slower economic growth. The authors stated several reasons for why these businesses needed to switch the paradigm. First was markets become saturated and finding profitable white space erodes. Second, operators focused only on growth through unit growth lose sight of unit profitability. In time, as more units become unprofitable, they suck cash out of the business. In the early 1990s at ClubCorp, we discovered that an unrelenting focus on growth had resulted in a portion of the portfolio being unprofitable. During my tenure at the Russian Fitness Group we came to the same realization. Bigger may feel good, but one of the outcomes is a cancer of unprofitable operations. Think of it like taking steroids. They make you bigger and stronger, but along the way they eat away at your internal organs destroying them slowly. Well, companies enamored by growth at all costs lose sight of the drain an increasingly larger portfolio of unprofitable operations become on the bottom line. This pandemic has brought that image into focus as seen by the large number of units 24Hour Fitness, LA Fitness, and Gold's shed. We expect others will shed unprofitable units over the next 6 to 18 months.

Final Thought

Covid-19 was an asteroid that hit at the heart of the global economy, and the economics of the fitness industry. This cataclysmic event, like the one that brought dinosaurs to extinction and nurtured the rapid ascension of mammals and mankind, has created a new environment that is slowly obliterating the former ways of doing business in the fitness industry and creating an opportunity for an entirely new industry to emerge. Darwin said, *"In the long history of humankind (and animal kind, too) those who learned to collaborate and improvise most effectively have prevailed."* Well, the fitness industry needs to effectively improvise and collaborate. Our prognostications speak to an industry that is different inside and out from the one we knew only a year ago. Socrates said not to spend energy fighting the old, but on building the new. Again, our prognostications speak to building the new, not spending our energies on fighting to bring back the old.

About ClubIntel

ClubIntel https://www.club-intel.com/ is a brand and consumer insights firm serving the health/fitness facility industry, including commercial clubs, fitness studios, private clubs and recreation centers. Our leadership team of Stephen Tharrett and Mark Williamson have extensive industry knowledge with a combined 60+ years of experience. We are passionate about helping clients understand, appreciate, and leverage the needs and wants of their respective audiences in delivering a uniquely differentiated and successful value proposition. We offer a host of custom solution-driven services that provide the insight, inspiration, and impact to enrich a business' value proposition and operations to succeed in a hyper-competitive and quickly evolving marketplace.

Insight

Data can tell you a lot, but it can't speak to you. We have the instinct and experience to decode the numbers and tell you what your members and employees are really saying.

Inspiration

Finding the intangible qualities that turn members into brand fanatics, and employees into apostles, takes an empathy and passion you can only find here.

Impact

Our unique, human-focused approach has helped clubs and manufacturers across the globe reap the benefits of increased member loyalty, higher employee retention and productivity and greater business profitability.