ORD MINNETT RESEARCH

Viva Leisure Limited

Bulking up

Viva beat prospectus guidance by ~4% at the pro-forma NPATA line, which is a solid result given sites originally planned to open in 1Q20 were pulled forward into FY19, acting as a mild drag. Member numbers rose ~8% organically and 52% overall thanks to greenfields and acquisitions. Yield was up on an underlying basis and is set to improve into FY20 thanks to success of high-yielding hiit studios being rolled out. Most pleasing at the result was quantification of the acquisition pipeline at 24 sites. With $14.5m of cash on balance sheet, deployment at 3-4x EBITDA could provide an uplift to FY20 NPATA of 28-37% - we expect management will flex their acquisition muscle shortly. With this result, we move away from FY20 prospectus, upgrading our NPATA estimate by 20% and our price target from $1.50 to $2 per share – offering 56% upside.

Hitting PBs across all metrics……

VVA had a bumper FY19 despite the distraction of running an IPO process twice, with management rolling out 12 new sites, acquired a further seven, establishing a strong FY20 greenfield pipeline of 11-15 new sites and already acquiring two small gyms in the last two months. Viva produced 52% growth in members, a 37% revenue improvement and EBITDA was up 79% (pro-forma).

….and acquisitions on the rack

Management detailed an acquisition pipeline of 24 sites, all on the eastern seaboard and a mix of multi- and single-sites. The business finished FY19 with ~$14m of cash and continues to build cash through strong cashflow conversion (>100% in FY19) providing ample strength to convert the pipeline. We estimate 28-37% upside to FY20 NPATA on a pro-forma basis if Viva can deploy the whole ~$14m. We do not forecast any acquisitions apart from the ones already announced, but see upside risk on the pipeline converting in the short-term.

Retain Buy, with undemanding PE and growth opportunity

Viva is well placed to continue rolling up and rolling out in the highly fragmented fitness industry. With VVA trading on a FY20 PE excluding gross (net) cash from the market cap of 8.3x (9.5x) and set to compound EPS growth of 40% FY19-22 we rate the stock a strong Buy. Our $2 target offers 56% upside.

Key Financials					
Year-end June (A$)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue ($m)	24.1	33.1	48.4	56.9	61.0
EBITDA ($m)	4.2	7.5	12.8	15.7	17.2
EBIT ($m)	2.6	5.3	9.6	11.3	12.7
Reported NPAT ($m)	2.2	3.2	3.1	4.7	5.9
Reported EPS (c)	-	6.0	6.0	9.0	11.2
Normalised NPAT ($m)	2.2	3.3	6.4	7.9	9.0
Normalised EPS (c)	-	6.2	12.2	15.0	17.0
EPS Growth (%)	-	-	96.4	23.5	13.4
Dividend (c)	-	-	-	6.0	7.2
Net Yield (%)	-	-	-	4.7	5.7
Franking (%)	-	-	-	100	100
EV/EBITDA (X)	1.5	8.1	4.8	3.5	2.9
Normalised P/E (x)	-	20.7	10.5	8.5	7.5
Normalised ROE (%)	-	25.3	23.4	25.8	26.7

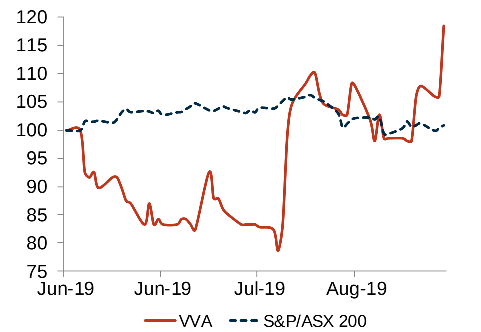
Source: OML, Iress, Viva Leisure Limited

Ord Minnett acted at Lead Manager to the IPO of VVA in June 2019 and received fees for acting in this capacity

Last Price
A$1.28
Target Price
A$2.00 *(Previously A$1.50)*
Recommendation
Buy
Risk
Higher

Consumer Services	
ASX Code	VVA
52 Week Range (A$)	-
Market Cap ($m)	67.3
Shares Outstanding (m)	52.6
Av Daily Turnover ($m)	0.1
3 Month Total Return (%)	-
12 Month Total Return (%)	-
Benchmark 12 Month Return (%)	3.1
NTA FY20E (¢ per share)	41.1
Net Cash FY20E (A$m)	5.7

Relative Price Performance



Source: FactSet

Consensus Earnings	FY20E	FY21E
NPAT (C) ($m)	-	-
NPAT (OM) ($m)	6.4	7.9
EPS (C) (c)	-	-
EPS (OM) (c)	12.2	15.0

Source: OML, Iress, Viva Leisure Limited

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FY19 result surprises on the upside

- **Member numbers** were ahead of the 53k prospectus expectation by 2% at 54k thanks to several new site openings late in the year. The 52% improvement on pcp, or 18.4k members, was driven by 8.7k acquired, 7k from rollouts and 7.8% organic growth (ie 2.8k).
- The Albury/Wodonga acquisition accounted for 3.7k of these acquired members late in June, which skews average member numbers to 44.8k vs a more representative 41k (this has impact on per member metrics)
- **Revenue** was up 37% on pcp thanks to these fresh members, lagging member growth as the business added 3.7k members from an acquisition late in June. Revenue per member based on a more accurate average member number implies ~$64 per month, up $62 in FY18.
- **Costs** were broadly in line with prospectus as a slower ramp up in costs attached to the swim school at ANU and lower than expected IPO costs mostly offset higher rental expense from sites opened earlier than expected in Jun-19.
- **The sites opened in Jun-19 acted as a small drag on earnings in FY19, and the company still managed to beat expectations, which we see as a significant positive heading into FY19.**
- OML assesses FY19 **EBITDA** 1) excluding one-off IPO costs of $0.9m, but 2) including ongoing listed company costs of $0.7m flagged in the prospectus. On that basis, Viva produced EBITDA of $7.5m versus OMLe of $7.2m, a beat of 4%. EBITDA per member based on an adjusted member average was $174 for the year, up from $129 on pcp on a like-for-like basis.
- **EBITDA margin** rose on pcp 5.3% points as more clubs earnings (40% EBITDA margin on average at maturity) were leveraged over the overhead base. Incremental margin was 37% and we expect continued improvement.
- **Normalised NPATA** was $3.3m, 10% ahead of OMLe at $3m thanks to lower than expected interest and D&A costs.

Figure 1 – FY19 result overview vs OMLe and prospectus

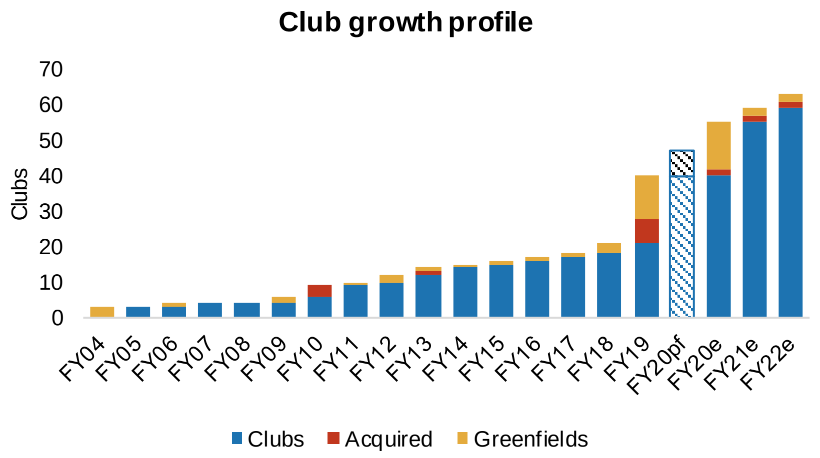
	FY18a	FY19a	%∆ pcp	FY19pf	%∆ prospectus	FY19e	%∆ OMLe
Sales revenue	**24.1**	**33.1**	**37.1%**	**32.9**	**0.5%**	**32.9**	**0.5%**
Rental expense	-4.9	-7.1	-45.2%	-6.6	7.4%	-6.6	-7.4%
Staff	-8.3	-10.2	-22.2%	-11.1	-8.5%	-11.1	8.5%
Other expenses	-6.7	-8.3	-23.6%	-7.9	4.3%	-7.9	-4.3%
Other	0.0	0.0	-	0.0	-	0.0	-
Opex	**-20.0**	**-25.6**	**-28.3%**	**-25.7**	**-0.4%**	**-25.7**	**0.4%**
EBITDA	**4.2**	**7.5**	**79.1%**	**7.2**	**3.9%**	**7.2**	**3.9%**
D&A	-1.5	-2.1	-39.7%	-2.2	-3.2%	-2.4	10.5%
Normalised EBIT	**2.6**	**5.3**	**102.1%**	**5.0**	**7.1%**	**4.8**	**11.1%**
Net interest	-0.5	-0.7	-28.6%	-0.7	-4.2%	-0.7	na
PBT	**2.1**	**4.7**	**120.6%**	**4.3**	**9.0%**	**4.1**	**13.8%**
Tax	0.1	-1.4	-2387.2%	-1.1	23.2%	-1.1	-24.1%
Normalised NPATA	**2.2**	**3.3**	**50.1%**	**3.1**	**3.8%**	**3.0**	**9.8%**
Adjustments	0.0	-0.1	-	-0.3	-62.5%	-0.4	na
Reported NPAT	**2.2**	**3.2**	**45.4%**	**2.4**	**30.8%**	**2.5**	**25.3%**
EBITDA margin	17.3%	22.6%	5.3%pts	21.9%	0.7%pts	21.9%	0.7%pts
Members	35,631	54,039	51.7%	53,000	2.0%	55,825	-3.2%
Average members (adjusted)	32,378	42,985	32.8%	42,466	1.2%	43,878	-2.0%
Member yield per month	62.1	64.1	3.3%	64.6	-0.7%	62.5	2.6%
EBITDA per member	129.0	174.0	34.9%	169.5	2.6%	164.1	6.1%

Source: OML and VVA *pro-form, underlying ex IPO costs, incl listed co costs, excl non-cash amort

Outlook for FY20 muscling up

- The outlook for FY20 is incredibly strong, with more sites than ever slated for opening and a healthy acquisition pipeline poised for conversion.
- The outlook for FY20 greenfields includes:
  - Two sites already opened
  - 11 sites where leases have been signed
  - Four sites where leases are under negotiation
  - This equates to 13 sites locked in, with potential for an additional four
- We now model 15 new sites opening, averaging 600 members per new site versus an average in FY19 of 580 (which includes a number opened late in the period).
- In addition to this greenfield pipeline, Viva also identified 24 sites for potential acquisition. This is the first hard qualification offered by the company and a very encouraging signal of management's ability to deploy the IPO proceeds.
- Simply based on the greenfield pipeline and already executed acquisitions, we have increased our EBITDA forecast for FY20 from $11.4m to $13m, or 15%. Our NPATA forecast rises by 23% to $6.5m.
- As a reminder, VVA has $14.5m on balance sheet, which equates to potential EBITDA of $3.6-4.8m veruss expected EBITDA of $13m in FY20, or an uplift of 28-37% upside.
- Assuming the same drop-through of EBITDA into NPATA, this implies $1.8-2.4m of additional NPATA absent any potential synergies, which implies an uplift to our $6.5m FY20 NPATA of 28-37% also.

Figure 2 – Pipeline of new sites



Source: OML and VVA, FY20pf represents the residual sites guided to in prospectus

Building up to FY20

- We see our $13m EBITDA forecast for FY20 as conservative. We can easily build up to the number on the following assumptions:
  - We are using the $8.2m of EBITDA reported by VVA which excludes IPO costs, but also excludes the incremental listed company costs afoot for FY20 (we adjust for this later)
  - Mature site EBITDA margins of 40% applicable to acquisitions and mature VVA sites – we use this to back out corporate overheads
  - **Based on disclosures in the presentation, new site EBITDA of $450k equates to EBITDA per average member of $150 pa.**
  - **Similarly, mature and acquired site EBITDA per member pa is estimated at ~$315**
  - **Overhead costs bring this down to ~$190 of EBITDA per member per annum at a group level**
  - Knowing that Viva finished FY19 with 54k members, annualised mature site EBITDA is $17m
  - Based on 15 greenfields in FY20 with 600 members on average each (was 580 in FY19) this implies 9k new members. Using EBITDA per member of $150 implies $1.35m of EBITDA
  - Estimated corporate overheads in FY19 were $3.5m (excl IPO costs), so if we assume these grow by the incremental listed company costs (~$700k) plus an additional $800k for conservatism, this implies $5m
  - This gives us
    - Mature site EBITDA run-rate on FY19 members of $17m
    - Greenfield site EBITDA run-rate of $1.35m
    - Corporate overheads of $5m
    - **A Group EBITDA run-rate of $13.35m today**
- **Hence, our FY20 forecast for $12.8m of EBITDA is underpinned by very little improvement in yield or EBITDA margin. This is all before we even factor in any conversion of the acquisition pipeline**

Figure 3 – Estimated EBITDA per member by cohort

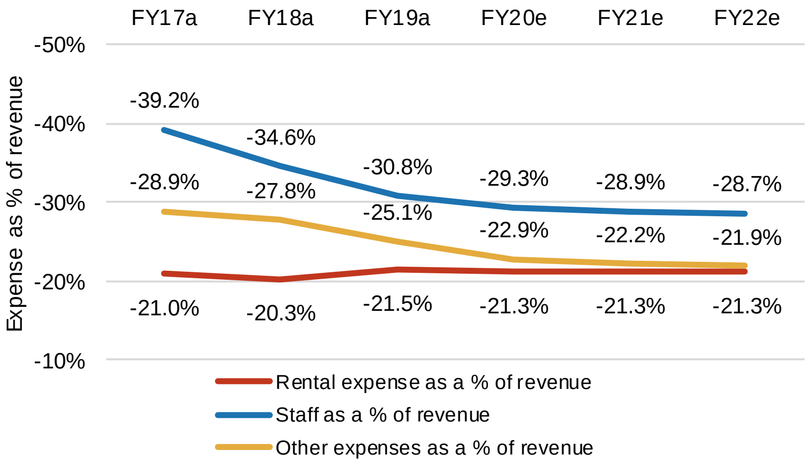
Item	EBITDA	FY19-end members	Estimated average members over FY19	EBITDA per member
Rollouts	0.5	6,954	3,000	150
Acquisitions	1.4	8,669	3,892	347
Estimated mature sites	11.5	38,416	37,024	311
Estimated overhead	-3.3		42,985	-77
Total	**8.2**	**54,039**	**42,985**	**191**
Combined Acquisitions + Mature	**12.9**	**47,085**	**40,916**	**315**

Source: OML and VVA FY19 presentation

EBITDA margins and rental expense

- Rental expense as a % of revenue nudged up in FY19 as a number of new sites were opened in Jun-19. As these sites were loss making in the period, the rent:revenue ratio was rather high. We expect this to moderate back to ~21% from FY20 onward.

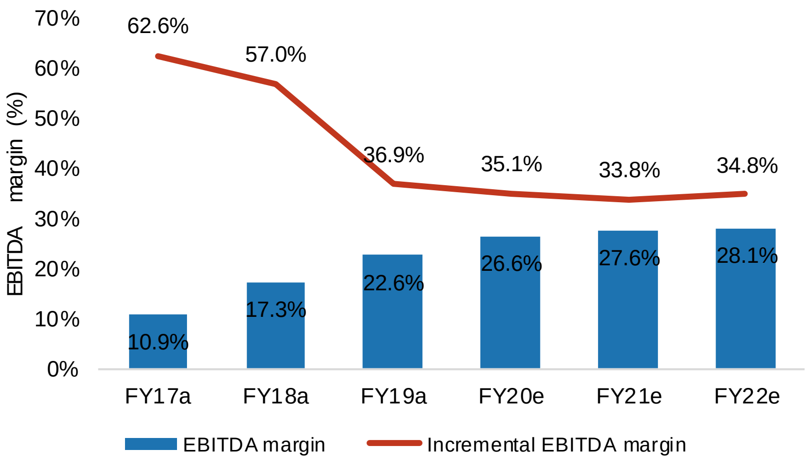
Figure 4 – Expense items as a % of revenue



Source: OML and VVA

- We saw incremental EBITDA margins in FY19 of 37% as compared with EBITDA margin of 22.6%. With incremental margins sitting well above reported margin, we see continued upside in group margin.
- This likely comes thanks to club-level EBITDA margins at 40% being leveraged against a somewhat steady fixed overhead base.
- Management commented that margins in the high-20%s isn't unfair in the long run. We forecast margins reaching ~30% in the long-term.

Figure 5 – EBTIDA margin and incremental margin



Source: OML and VVA

Changes to forecasts

- Increased FY20 greenfield roll-outs from 7 to 13
- Roll-forward to lower than expected staff costs
- Adjusting yield for average member dynamics
- Adjusting new members per site per recent history

Figure 6 – Changes to forecasts

	FY20 old	FY20 new	%Δ	FY21 old	FY21 new	%Δ	FY22 old	FY22 new	%Δ
Sales revenue	**46.8**	**48.4**	**3.3%**	**52.0**	**56.9**	**9.5%**	**54.4**	**61.0**	**12.2%**
Opex	-35.4	-35.5	-0.2%	-39.4	-41.2	-4.5%	-41.1	-43.8	-6.7%
EBITDA	**11.4**	**12.8**	**12.9%**	**12.6**	**15.7**	**25.1%**	**13.3**	**17.2**	**29.1%**
D&A	-3.3	-3.3	0.0%	-3.7	-4.4	-17.8%	-3.8	-4.4	-15.7%
Normalised EBIT	**8.1**	**9.6**	**18.0%**	**8.8**	**11.3**	**28.2%**	**9.5**	**12.7**	**34.6%**
Net interest	-0.8	-0.8	0.0%	-0.3	-0.4	-34.0%	-0.3	-0.4	-27.2%
PBT	**7.4**	**8.8**	**19.9%**	**8.5**	**10.9**	**28.0%**	**9.2**	**12.4**	**34.8%**
Tax	-2.0	-2.4	-19.9%	-2.3	-3.0	-28.0%	-2.5	-3.4	-34.8%
Normalised NPAT	**5.3**	**6.4**	**19.9%**	**6.2**	**7.9**	**28.0%**	**6.6**	**9.0**	**34.8%**
One-offs	-3.2	-3.2	0.0%	-3.2	-3.2	0.0%	-3.1	-3.1	0.0%
Reported NPAT	**2.1**	**3.1**	**50.9%**	**3.0**	**4.7**	**57.2%**	**3.6**	**5.9**	**64.9%**
Members	**65,377**	**69,193**	**5.8%**	**67,818**	**74,343**	**9.6%**	**70,160**	**78,033**	**11.2%**
Average members	60,601	61,616	1.7%	66,598	71,768	7.8%	68,989	76,188	10.4%
Revenue/member p/month	64.4	65.4	1.6%	65.0	66.1	1.6%	65.7	66.7	1.6%
EBITDA/member p/year	187.8	208.5	11.0%	188.8	219.2	16.1%	192.6	225.2	16.9%

Source: OML

Recommendation, valuation and price target

Recommendation

- We retain a Buy recommendation, seeing the business well placed to continue expanding its footprint in regional Australia through concerted club roll-outs and sensible roll-ups.
- With a strong maiden result as a listed company under its belt, we see Viva now poised to execute on its roll-out and roll-up strategy apace, with 13-17 sites identified for FY20 along with a healthy acquisition pipeline of 24 sites.
- Excluding gross (net) cash from VVA's market cap, the stock trades on a FY20 NPATA PE of 8.1x (9.3x), which we consider too cheap.
- Note, we do not include any acquisition upside in our modelling, and estimate full deployment of the balance sheet could lift FY20 EPS by 28-37%

Valuation

Discounted cash flow (DCF) – Captures the long-term nature of Viva's greenfield and acquisition plans, Viva's finance leases and strong cash flow conversion.

We capture all capex and finance lease payments in our free cash flow forecasts (and hence use gross cash to exclude finance leases), so as to appropriately account for all expenditures on maintenance and expansion capex.

Our assumed two greenfields and acquisitions per annum from FY21 onward is a very conservative number given the current pace of expansion, planned 13-17 greenfields in FY20 and sizable balance sheet for deployment into roll-ups.

Figure 7 – DCF valuation

DCF inputs	
Beta	1.20
Risk free rate	5.0%
Market risk premium	6.0%
Cost of equity	12.2%
Debt premium	4.0%
Cost of debt (after tax)	6.3%
D/E	0.0%
WACC	**12.2%**
Terminal growth rate	**2.0%**

DCF valuation	
Forecast cash flows ($m)	34.8
Terminal value ($m)	59.8
Enterprise value ($m)	**94.7**
add FY19 gross cash ($m)	14.4
Equity value ($m)	**109.0**
Equity value per share ($)	2.07
CAGR (FY18-26)	
Members	13.0%
Revenue	15.6%
EBITDA	24.6%
Normalised NPATA	25.8%
FY20PF metrics	
Implied FY20PF EV/EBITDA (x)	7.3
Implied FY20PF PE NPATA (x)	16.7
Implied FY20PF PE NPATA (ex-cash) (x)	14.5

Source: OML

FY20 EV/EBITDA comp – compares Viva to other domestic leisure and discretionary businesses, as well as international fitness centres. We apply an FY20 EV/EBITDA multiple of 5.5x to FY20 EBITDA, implying a discount of ~30% to the most direct comparable.

We see a discount to these already listed comps as reasonable in light of Viva's lack of listed history, emerging expansion strategy into new, less known markets, finance leases (can distort EBITDA comparisons) and Viva's micro-cap status.

The company intends to invest the excess cash on the pro-forma balance sheet into new clubs, making it sensible to assess Viva's implied PE on an "ex-cash" basis.

Figure 8 – FY20 EV/EBITDA valuation

FY20 EV/EBITDA valuation	
FY20PF EBITDA ($m)	13.0
EV/EBITDA multiple (x)	5.50
Enterprise value ($m)	**71.8**
add FY19 net cash ($m)	6.4
Equity value ($m)	**78.2**
Equity value per share ($)	1.49
FY20PF metrics	
Implied FY20PF EV/EBITDA (x)	5.5
Implied FY20PF PE NPATA (x)	12.0
Implied FY20PF PE NPATA (ex-cash) (x)	11.0

Source: OML

Price target

Price target – Based on the average of our DCF and EV/EBITDA valuations, rolled forward at our cost of equity, we derive a price target of $2 per share, implying 57% upside to the current price.

Our $2 target only implies a 15x ex-cash PE on an FY20 basis.

Figure 9 – Price target derivation

Price target derivation	
DCF valuation ($ ps)	2.07
FY20 EV/EBITDA ($ ps)	1.49
Average	**1.78**
Cost of equity (%)	12.2%
Rolled-forward valuations ($ ps)	**2.00**
Less dividend ($ ps)	0.00
One-year forward price target ($ ps)	**2.00**
FY20PF metrics	
Implied FY20PF EV/EBITDA (x)	7.6
Implied FY20PF PE NPATA (x)	17.3
Implied FY20PF PE NPATA (ex-cash) (x)	15.1

Source: OML

Comparables

- We look at domestic leisure and domestic retail/healthcare companies as comparable for our VVA valuation. The comp sets trade on a median FY20 EV/EBITDA range of 7.9-8.9x versus VVA which is currently on 4.7x.
- Our FY20 EV/EBITDA valuation uses a 6x multiple which represents a 25-30% discount to account for VVA's lack of listed history, size and early-stage.
- On a PE basis, VVA trades at ~8.3-9.5x excluding cash from the market cap, compared with the comp sets at ~16.5x. Our target price implies 14-15x ex-cash PE.
- We expect the discount to close as VVA deploys the proceeds of the IPO into highly accretive acquisitions, and continues to execute on its greenfield pipeline.

Figure 10 – Domestic and international comps

Domestic leisure

		Mkt Cap	PE		EV/EBITDA		EPS Growth		PEG	
Code	Company	AUD	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
EVT AU	EVENT Hospitality	2,030	18.2	18.0	9.6	9.6	1%	8%	18.01	2.17
VRL AU	Village Roadshow Ltd	472	20.3	15.8	5.4	5.0	n/a	31%	na	na
ALG AU	Ardent Leisure Group Ltd	506	-	351.7	11.5	7.9	n/a	867%	na	na
THL NZ	Tourism Holdings Ltd	525	18.1	16.5	7.0	6.6	-38%	30%	-0.48	0.56
SLK AU	SeaLink Travel Group Ltd	365	15.5	14.5	9.2	8.8	5%	12%	2.84	1.24
EXP AU	Experience Co Ltd	103	12.3	12.3	4.6	4.5	-48%	13%	-0.26	0.92
ATL AU	Apollo Tourism & Leisure Ltd	76	4.9	4.8	4.9	4.6	-23%	0%	-0.21	-
	Average (excl. EXP/ATL)		**18.0**	**83.3**	**8.5**	**7.6**	**-10%**	**189%**	**6.79**	**1.32**
	Median (excl. EXP/ATL)		**18.1**	**16.5**	**9.2**	**7.9**	**1%**	**30%**	**2.84**	**1.24**

Domestic discretionary and health

		Mkt Cap	PE		EV/EBITDA		EPS Growth		PEG	
Code	Company	AUD	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
BAP AU	Bapcor Ltd	1,911	20.1	18.7	13.6	12.4	7%	8%	2.81	2.25
LOV AU	Lovisa Holdings Ltd	1,298	35.0	31.4	21.2	17.6	12%	26%	3.00	1.21
AX1 AU	Accent Group Ltd	855	16.1	14.6	8.3	7.4	10%	5%	1.58	3.16
LIC AU	Lifestyle Communities Ltd	718	17.9	20.0	11.7	15.5	-11%	22%	-1.68	0.89
NCK AU	Nick Scali Ltd	552	13.2	13.2	8.5	8.5	0%	9%	34.10	1.39
IDX AU	Integral Diagnostics Ltd	490	18.8	18.2	11.3	9.4	3%	13%	6.24	1.42
ADH AU	Adairs Ltd	282	9.7	9.3	5.8	5.5	5%	11%	na	0.81
CAJ AU	Capitol Health Ltd	181	19.6	14.7	7.9	7.4	33%	13%	0.59	1.18
	Average		**18.8**	**17.5**	**11.0**	**10.5**	**7%**	**13%**	**6.66**	**1.54**
	Median		**18.3**	**16.5**	**9.9**	**8.9**	**6%**	**12%**	**2.81**	**1.30**

Source: OML and Bloomberg *prices as at 28 Aug 2019

Viva Leisure Overview

About Viva Leisure

Viva Leisure Pty Ltd (Viva) commenced operations in Canberra in January 2004. The aim was to facilitate the fitness goals of customers through the "Club Lime" brand. Over the last 15 years, Viva has expanded within the ACT, regional New South Wales and regional Victoria.

Viva has >57,000 members and through new clubs roll-outs and acquisitions we expect it to have close to 70,000 members and $48.4m of revenue in FY20. Viva has improved its utilisation rate (assuming a baseline of two members per square metre) to 75% currently, driven by strong visitation (~6 visits per month per member in FY18) effective new member sign-up and strong churn management.

Viva offers flexible membership options, including fortnightly direct debits, to suit a variety of target demographics. Viva operates under a "hub and spoke" model, whereby, larger clubs are surrounded by smaller clubs within specific catchments. This model is a point of differentiation and enhances Viva's operating efficiency.

Viva's growth has been rapid in recent years, both via acquisition and greenfield roll-out. Acquisition of a two clubs and 13 club openings should see Viva reach 55 clubs by FY20. Unannounced acquisitions offer upside to this estimate.

Key brands

Figure 11 – Key brands in the Viva Leisure portfolio

- **CLUB LIME**
  - Core brand offering
- **CLUB LIME – LADIES ONLY**
  - Core brand offering but exclusively targeting the female market
- **CLUB LIME – SWIM SCHOOL**
  - Offers swimming lessons for a range of levels
- **CLUB LIME – ACQUATICS**
  - Pool access and lane bookings
- **CLUB LIME – PSYCLE LIFE**
  - Indoor cycle studio with a classes only offering
- **GYMMY PT**
  - Offers 1-on-1 personal training and group classes operating in CLUB LIME locations
- **HIIT REPUBLIC**
  - Indoor "High Intensity Interval Training (HIIT)" classes
- **CLUB MMM**
  - A day spa offering a variety of treatments
- **STUDIO BY CLUB LIME**
  - Group exercise in a boutique club

Source: OML and Viva Leisure

Key drivers

Recurring revenue and member return rates

- ~85% of Viva Leisure's revenue is derived from recurring fortnightly direct debit payments. Member retention for Jul-18 to Mar-19 was 74% (73% pcp). Calendar year 2018 highlighted that 30-40% of new members joining club lime have been members at some point in the past.

Trend towards gyms and improving lifestyles

- Recent industry data tends to suggest that there has been a continued shift towards a health focussed approach. In part, this has been driven by the increased prevalence of social media influencers and television programs surrounding ultra-fitness challenges.
- Whilst rising obesity rates do not indicate a trend towards fitness, it does indicate that many of the people that fall within this category may look to improve their lifestyle by joining a gym.

Acquisition and greenfield strategy

- Viva Leisure have undertaken a combined acquisition and start-up approach in order to attain market share and help boost its incremental margin.
- Over FY17-20e Viva will have opened or bought 38 clubs, anticipating an end-FY20 network of 55 clubs. Of these new clubs, greenfields account for 29, while 9 clubs will have been acquired (only including those announced).
- The roll-out and roll-up strategy revolved around Viva's hub and spoke model which caters the club type to the demographics of the local community. This provides for strong operating margins and hastened break-even.

Regional strategy

- Viva Leisure attempts to differentiate its offering from the large well known competitors within the Australian gym industry by focusing on the regional and Canberra markets. Part of the benefits attributable to focusing on these locations is that the cost of floor space is generally cheaper than in large cities.
- For example, Savills research from Q2 2018 indicates that the rental expense in Sydney (A-grade) for the period was $1,030 per m2. This means that a 700m2 property is likely to cost ~$721k per annum in rental expense.
- In contrast, Canberra Civic (A-grade) and Non-civic (A-grade) recorded values of $370 and $335 per m2 leading to annual rental expense of $259k and $235k. This aids the generation of strong margins, which we expect to exceed those of Ardent Leisure's Health Club's division at the peak.

Additional concepts and incremental margin uplift

- In order to drive stronger EBITDA margins on a sustainable basis, Viva seeks opportunities to improve member yield atop the benefit of leveraging a fairly fixed overhead across more clubs.
- Viva Leisure have implemented a strategy of offering additional premium services to members such as access to exclusive services in the form of cycle classes and HIIT classes, upgrades to Platinum membership which offers access to all clubs in the network and aquatic/swim school memberships.
- These strategies provide for improved member yield without overt price rises.

Key risks

Execution risk and reliance on membership

Due to Viva leisure's operating model offering "no contract" memberships, Viva Leisure is particularly exposed to execution risk. Viva Leisure faces execution risk in the form of day-to-day management of the business. This includes management of budgets, people and individual locations. Management will also need to be diligent in assessing lease expirations, including finance and operational location leases. Viva Leisure aim to mitigate this risk through the implementation of real-time reporting, analytics and operational technological enhancements.

Acquisition and start-up risk

Viva Leisure's current rapid rate of growth leads to the business facing heightened exposure to acquisition and new location start-up risk. This risk occurs in the form of a new business combination or built location not meeting growth or profitability expectations and requiring additional resources or liquidation.

In order to reduce the overall likelihood of acquisitions or new built locations not performing as planned, Viva Leisure undertake significant due diligence and utilise data analysis. Viva Leisure will leverage population statistics, proximity to current locations and previous acquisition experience to ensure that its acquisitions are successful. Its recent track record has had its last three recent Club Lime openings reaching break-even within 6 weeks.

Reputational risk

Viva Leisure could potentially suffer negative consequences should there be significant dissemination of negative publicity. The negative consequences could be in the form of non-renewal or cancellation of memberships, employee attrition and a reduction in the quality of talent attracted all combining to reduce Viva Leisure's capacity to earn.

Economic discretionary spend

As noted within the industry section of this report, there is currently economic pressure surrounding consumer discretionary spending. Given the substitute for a gym membership is exercising outdoors, Viva Leisure needs to ensure they are able to ensure consumers maintain their memberships.

Viva Leisure could also at risk should there be a decline in consumer discretionary spending attributable to adverse economic conditions.

Competition from new gyms, facilities and fitness concepts

Viva Leisure are potentially exposed to increased competition within the already saturated fitness and health club market. Given the large portion of consumers that select gym offerings based on location and convenience, Viva Leisure needs to ensure that they are either of significantly higher quality or they are able to compete on price.

Another area that Viva Leisure may be potentially impacted by are the ever-changing trends within the fitness market. Viva Leisure need to ensure that they remain on-trend and are able to target the next opportunity ahead of other competitors.

Concentration risk

Viva expects to generate 39% of its revenue in FY19 from the CISAC site, dropping to <30% in FY20, across the Club Lime, MMM and aquatic operations. This has come down in concentration from FY18 (48%), but we note the site remains vitally important to group earnings. This concentration reduces over time as new sites are built or acquired. A number of competing operations exist around CISAC already, but further competition could impede the centre's earnings. We note that no proposed project is of the scale of CISAC nor as centrally located, helping to mitigate this competitive risk. Further, the club's rating on Google reviews is 4.3 stars (4.1 for MMM – Ladies).

Where are they located?

Figure 12 – Club locations

Health clubs | Boutiques

Source: Viva Leisure

Viva Leisure Limited

Buy

PROFIT & LOSS (A$m)	2018A	2019A	2020E	2021E	2022E
Revenue	24.1	33.1	48.4	56.9	61.0
Operating costs	(20.0)	(25.6)	(35.5)	(41.2)	(43.8)
Operating EBITDA	**4.2**	**7.5**	**12.8**	**15.7**	**17.2**
D&A	(1.5)	(2.1)	(3.3)	(4.4)	(4.4)
EBIT	**2.6**	**5.3**	**9.6**	**11.3**	**12.7**
Net interest	(0.5)	(0.7)	(0.8)	(0.4)	(0.4)
Pre-tax profit	**2.1**	**4.7**	**8.8**	**10.9**	**12.4**
Net tax (expense) / benefit	0.1	(1.4)	(2.4)	(3.0)	(3.4)
Significant items/Adj.	-	(0.1)	(3.2)	(3.2)	(3.1)
Normalised NPAT	**2.2**	**3.3**	**6.4**	**7.9**	**9.0**
Reported NPAT	**2.2**	**3.2**	**3.1**	**4.7**	**5.9**
Normalised dil. EPS (cps)	-	6.2	12.2	15.0	17.0
Reported EPS (cps)	-	6.0	6.0	9.0	11.2
Effective tax rate (%)	(2.9)	30.0	27.5	27.5	27.5
DPS (cps)	-	-	-	6.0	7.2
Dividend yield (%)	-	-	-	4.7	5.7
Payout ratio (%)	-	-	-	40.0	42.5
Franking (%)	-	-	-	100.0	100.0
Diluted # of shares (m)	-	52.6	52.6	52.6	52.6

CASH FLOW (A$m)	2018A	2019A	2020E	2021E	2022E
EBITDA incl. adjustments	4.2	7.5	12.8	15.7	17.2
Change in working capital	(2.0)	0.9	1.1	0.6	0.3
Net Interest (paid)/received	(0.5)	(0.6)	(0.8)	(0.4)	(0.4)
Income tax paid	-	(0.5)	(2.4)	(3.0)	(3.4)
Other operating items	-	-	-	-	-
Operating Cash Flow	**1.7**	**7.3**	**10.7**	**12.9**	**13.7**
Capex	(1.8)	(3.9)	(2.7)	(0.5)	(0.5)
Acquisitions	(0.0)	(7.1)	(1.2)	(1.2)	(1.2)
Other investing items	-	(0.3)	-	-	-
Investing Cash Flow	**(1.8)**	**(11.2)**	**(3.9)**	**(1.7)**	**(1.7)**
Inc/(Dec) in equity	-	22.5	-	-	-
Inc/(Dec) in borrowings	0.6	(5.5)	(3.9)	(3.8)	(3.8)
Dividends paid	-	-	-	(1.3)	(3.4)
Other financing items	-	-	-	-	-
Financing Cash Flow	**0.6**	**17.1**	**(3.9)**	**(5.1)**	**(7.2)**
FX adjustment	-	0.6	-	-	-
Net Inc/(Dec) in Cash	0.4	13.2	2.9	6.1	4.8

BALANCE SHEET (A$m)	2018A	2019A	2020E	2021E	2022E
Cash	1.1	14.4	17.3	23.4	28.2
Receivables	0.1	0.2	0.3	0.4	0.4
Inventory	0.1	-	-	-	-
Other current assets	0.1	0.4	0.4	0.4	0.4
PP & E	9.6	19.2	25.0	24.6	24.4
Intangibles	0.0	6.6	7.3	8.1	9.0
Other non-current assets	0.3	3.5	3.5	3.5	3.5
Total Assets	**11.4**	**44.3**	**53.9**	**60.4**	**65.9**
Short term debt	4.9	2.3	3.7	3.4	3.1
Payables	2.0	2.5	3.7	4.4	4.7
Other current liabilities	2.1	4.0	4.0	4.0	4.0
Long term debt	2.5	5.7	7.9	7.9	8.0
Other non-current liabilities	0.0	1.4	2.9	5.6	8.4
Total Liabilities	**11.5**	**18.5**	**24.8**	**27.9**	**30.9**
Total Equity	**(0.1)**	**25.8**	**28.9**	**32.4**	**34.8**
Net debt (cash)	6.3	(6.4)	(5.7)	(12.2)	(17.0)

DIVISIONS	2018A	2019A	2020E	2021E	2022E

KEY METRICS (%)	2018A	2019A	2020E	2021E	2022E
Revenue growth	-	37.1	46.2	17.6	7.2
EBITDA growth	-	79.1	71.7	22.5	9.1
EBIT growth	-	102.1	79.5	18.4	12.5
Normalised EPS growth	-	-	96.4	23.5	13.4
EBITDA margin	17.3	22.6	26.6	27.6	28.1
OCF /EBITDA	53.0	112.4	108.4	103.8	101.7
EBIT margin	10.9	16.1	19.8	19.9	20.9
Return on assets	-	13.4	14.1	14.4	14.6
Return on equity	-	25.3	23.4	25.8	26.7

VALUATION RATIOS (x)	2018A	2019A	2020E	2021E	2022E
Reported P/E	-	21.3	21.4	14.2	11.5
Normalised P/E	-	20.7	10.5	8.5	7.5
Price To Free Cash Flow	-	18.8	8.4	5.4	5.1
Price To NTA	-	3.5	3.1	2.8	2.6
EV / EBITDA	1.5	8.1	4.8	3.5	2.9
EV / EBIT	2.4	11.4	6.4	4.9	3.9

LEVERAGE	2018A	2019A	2020E	2021E	2022E
ND / (ND + Equity) (%)	101.1	(33.3)	(24.7)	(60.5)	(95.8)
Net Debt / EBITDA (%)	151.8	(86.1)	(44.6)	(77.6)	(99.3)
EBIT Interest Cover (x)	5.0	7.8	12.7	25.7	32.8
EBITDA Interest Cover (x)	7.9	11.0	17.0	35.7	44.2

SUBSTANTIAL HOLDERS	m	%
Konstantinou Family	21.7	41.2%
Mark McConnell	4.5	8.6%
Harry Konstantinou	1.5	2.9%

VALUATION	
Cost of Equity (%)	12.2
Cost of debt (after tax) (%)	9.0
D / EV (%)	-
WACC (%)	**12.2**
Forecast cash flow ($m)	33.9
Terminal value ($m)	55.4
Franking credit value ($m)	-
Enterprise Value ($m)	103.7
Less net debt / add net cash & investments ($m)	(14.4)
Equity NPV ($m)	**89.3**
Equity NPV Per Share ($)	**1.97**
Multiples valuation method	FY20 EV/EBITDA
Multiples	6.0
Multiples valuation	1.59
Target Price Method	Rolled fwd DCF and EV/EBITDA
Target Price ($)	2.00
Valuation disc. / (prem.) to share price (%)	56.3

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Guide to Ord Minnett Recommendations

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historic volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.