Viva Leisure Ltd (VVA)

Rating: Buy | Risk: High | Price Target: $3.60

Bulking Up on Technology, a Unique Format, Greenfield Expansion & Acquisitions. Initiation TP $3.60

Key Information

Current Price ($ps)	3.02
12m Target Price ($ps)	3.60
Target Price Upside (%)	19.2%
TSR (%)	19.2%
Reporting Currency	AUD
Market Cap ($m)	180.5
Sector	Health Care
Avg Daily Volume (m)	0.1
ASX 200 Weight (%)	0%

Fundamentals

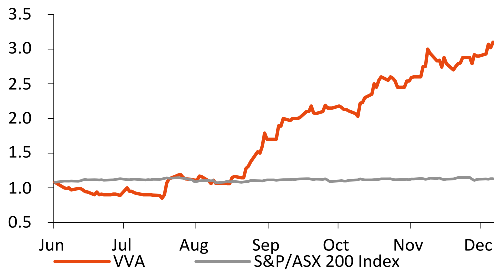
YE 31 Dec (AUD)	FY19A	FY20E	FY21E	FY22E
Sales ($m)	31.1	58.7	98.2	116.5
NPAT ($m)	2.9	6.2	11.5	15.1
EPS (cps)	5.4	10.8	19.3	25.3
EPS Growth (%)	(2.1%)	99.8%	78.0%	31.3%
DPS (cps) (AUD)	0.0	0.0	4.6	10.7
Franking (%)				

Ratios

YE 31 Dec	FY19A	FY20E	FY21E	FY22E
P/E (x)	55.6	27.8	15.6	11.9
EV/EBITDA (x)	21.1	12.2	7.2	6.1
Div Yield (%)	0.0%	0.0%	1.5%	3.6%
Payout Ratio (%)	0.0%	0.0%	23.8%	42.4%

Price Performance

YE 31 Dec	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	12.7%	44.7%	62.5%	(19.4%)
Absolute (%)	12.7%	46.9%	64.0%	
Benchmark (%)	(0.0%)	2.2%	1.5%	19.4%



Price performance indexed to 100 *Source:*

Major Shareholders

Shja Management	36.1%
Mera Vale No1	15.3%
Bennelong	7.6%
Doma Equities	5.7%
OC Funds	4.8%

SHAW AND PARTNERS ACTED AS A CO MANAGER AND UNDERWRITER TO VVA'S RECENT CAPITAL RAISING FOR WHICH IT RECEIVED A FEE.

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Event

Shaw and Partners initiates coverage of Viva Leisure Limited (VVA), an owner operator of gyms and other leisure facilities, with a BUY rating and a $3.60 twelve month target price.

Highlights

- **A unique format.** The 'hub and spoke' model under which VVA is expanding its network of gyms and other leisure facilities relies on IT systems to reduce operating costs, enhance its client's experience, and enable it to quickly realise synergies from acquisitions. The model has proven to be an efficient way to expand VVA's catchment areas, efficiently provide specialist services and enhance the appeal of its facilities as reflected in its strong organic growth (3 year organic sales CAGR 20%, FY19 growth 29%).

- **VVA's current run rate will under pin a strong FY20 and FY21.** VVA's monthly sales run rate exiting June 2019 was up 48% on pcp which provides significant momentum and upside from a full 12 month contribution in FY20. VVA has continued to achieve monthly organic growth since June and has guided to a further 112% increase in its sales run rate by June 2020. This will have it on an EBITDA run rate of $21m at June 30 2020, growing members at 15% pa and with funding to acquire additional facilities which will set the company up for a strong performance in FY21.

- **Acquisitions and greenfield developments are also being delivered which will provide further upside.** VVA's model has shown to work efficiently with spokes providing it with good visibility to natural greenfield developments and acquisitions. It has a track record of delivering value adding acquisitions which arbitrage the difference between private and public multiples and has funding in place (post the Healthworks and FitnFast acquisitions) to develop/acquire an additional estimated $5m of post synergies EBITDA.

- **The Australian Fitness industry provides long term acquisition and development opportunity.** In Regional areas of Australia the fitness industry remains fragmented with relatively inefficient practices operating small businesses which trade at attractive multiples; providing significant consolidation opportunity. Australia's larger gym operators, which have a combined market share of 8%, are primarily focussed on city expansion which is allowing VVA to establish strategic footholds in regional centres where it will replicate the model it has proven in the Australian Capital Territory.

- **Risks are not too onerous.** Key risks include: i) VVA's ability to continue to attract and retain members, ii) increased competition for members and suitable acquisition opportunities, and iii) operational risks associated with integrating acquisitions. We discuss these and other risks on page 3.

Recommendation

VVA has been bid up strongly since its IPO as a result of its accelerating run rate. The strong growth initially derived from organic membership growth and increasingly from green field developments and acquisitions looks to be sustainable and not fully factored into VVA's share price when compared with ASX listed practice managers.

Share price catalysts for VVA include:

- Market recognition of the significance of VVA's recent capital raise and what it means for ongoing growth,
- Settlement of the Healthworks and FitnFast acquisitions and commentary around the number of spokes likely to be built to compliment the acquired facilities,
- Evidence of strong membership growth from the replication of VVA's 'hub and spoke' model in Albury/Wodonga, and
- Delivery of a June 2020 monthly run rate up 112% on pcp as previously guided.

Viva Leisure Ltd
Health Care
Health Care Equipment & Services
FactSet: VVA-AU / Bloomberg: VVA AU

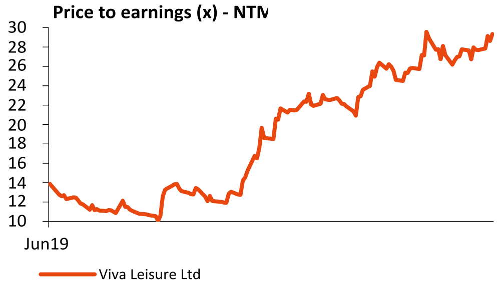
Key Items	Data
Recommendation	BUY
Risk	HIGH
Price ($ps)	3.02
Target Price ($ps)	3.60
52 Week Range ($ps)	-
Shares on Issue (m)	59.8
Market Cap ($m)	180.5
Enterprise Value ($m)	174.1
TSR (%)	19.2%

Valuation NPV	Data
Beta	1.50
Cost of Debt (net) (%)	7.9%
Risk Free Rate (%)	4.3%
Terminal Growth (%)	3.0%
WACC (%)	13.8%

Company Description

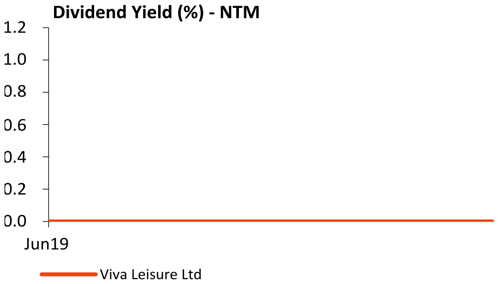
Viva Leisure Ltd. operates health clubs in health and leisure industries. It offers customers with membership options and a range of facilities from big box to boutique fitness. The firm's brands include Club Lime, Ladies Only, Psycle Life, Aquatics, Hiit Republic, Swim School, Gymmy PT and Studio by Club Lime. The company was founded by Harry Konstantinou and Angelo Konstantinou on January 12, 2004 and is headquartered in Mitchell, Australia Capital Territory.

Price to earnings (x) - NTM



Source: Shaw

Dividend Yield (%) - NTM



Source: Shaw

Financial Year End: 31 December

Investment Summary (AUD)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS (Reported) (cps)	**5.5**	**5.4**	**9.3**	**16.0**	**21.5**
EPS (Underlying) (cps)	**5.5**	**5.4**	**10.8**	**19.3**	**25.3**
EPS (Underlying) Growth (%)	119.7%	(2.1%)	99.8%	78.0%	31.3%
PE (Underlying) (x)		**55.6**	**27.8**	**15.6**	**11.9**
EV / EBIT (x)		**30.3**	**20.9**	**13.1**	**10.0**
EV / EBITDA (x)		**21.1**	**12.2**	**7.2**	**6.1**
DPS (cps) (AUD)	0.0	0.0	0.0	4.6	10.7
Dividend Yield (%)		0.0%	0.0%	1.5%	3.6%
Franking (%)					
Payout Ratio (%)	0.0%	0.0%	0.0%	23.8%	42.4%
Free Cash Flow Yield (%)		1.9%	(4.4%)	1.8%	3.8%

Profit and Loss (AUD) (m)	FY18A	FY19A	FY20E	FY21E	FY22E
Sales	24.1	31.1	58.7	98.2	116.5
Sales Growth (%)	*16.3%*	*28.9%*	*88.9%*	*67.3%*	*18.6%*
EBITDA	**5.2**	**7.2**	**14.2**	**25.8**	**31.7**
EBITDA Margin (%)	*21.6%*	*23.3%*	*24.3%*	*26.3%*	*27.2%*
Depreciation & Amortisation	(1.5)	(2.2)	(5.9)	(11.6)	(12.5)
EBIT	**3.7**	**5.0**	**8.3**	**14.2**	**19.1**
EBIT Margin (%)	*15.2%*	*16.2%*	*14.2%*	*14.5%*	*16.4%*
Net Interest	(0.5)	(1.1)	(0.8)	(0.6)	(0.8)
Pretax Profit	3.1	4.0	7.5	13.6	18.4
Tax	(0.2)	(1.1)	(2.3)	(4.1)	(5.5)
Tax Rate (%)	*(7.1%)*	*(28.2%)*	*(30.0%)*	*(30.0%)*	*(30.0%)*
NPAT Underlying	**2.9**	**2.9**	**6.2**	**11.5**	**15.1**
NPAT Reported	**2.9**	**2.9**	**5.3**	**9.5**	**12.8**

Cashflow (AUD) (m)	FY18A	FY19A	FY20E	FY21E	FY22E
EBIT	3.7	5.0	8.3	14.2	19.1
Tax Paid	0.0	(0.5)	(2.3)	(4.1)	(5.5)
Net Interest	(0.5)	(0.6)	(1.2)	(1.0)	(1.0)
Depreciation & Amortisation	1.5	2.2	5.9	11.6	12.5
Other	(3.0)	1.2	2.6	1.5	0.7
Operating Cashflow	**1.7**	**7.3**	**13.4**	**22.2**	**25.9**
Capex	0.0	0.0	(21.0)	(19.0)	(19.0)
Acquisitions and Investments	0.0	(7.1)	(17.0)	0.0	0.0
Disposal of Fixed Assets/Investments	0.1	0.2	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	**0.1**	**(7.0)**	**(38.0)**	**(19.0)**	**(19.0)**
Free Cashflow	**(0.2)**	**3.1**	**(7.6)**	**3.2**	**6.9**
Equity Raised / Bought Back	0.0	22.5	19.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	(5.8)
Other	0.6	(5.5)	3.2	(4.0)	(7.0)
Financing Cashflow	**0.6**	**17.1**	**22.2**	**(4.0)**	**(12.8)**
Net Change in Cash	**2.3**	**17.5**	**(2.4)**	**(0.8)**	**(5.9)**

Balance Sheet (AUD) (m)	FY18A	FY19A	FY20E	FY21E	FY22E
Cash	1.1	14.4	12.0	11.2	5.3
Accounts Receivable	0.1	0.2	0.4	0.6	0.7
Inventory	0.1	0.4	0.4	0.4	0.4
Other Current Assets	0.1	0.0	0.0	0.0	0.0
PPE	9.6	19.2	47.1	46.9	45.5
Goodwill & Intangibles	0.0	6.6	5.7	3.7	1.4
Other Non Current Assets	0.3				
Total Assets	**11.4**	**44.2**	**69.0**	**66.2**	**56.6**
Accounts Payable	2.0	2.5	2.9	4.2	4.8
Short Term Debt	3.3	2.3	2.3	2.3	2.3
Long Term Debt	4.1	5.7	12.5	14.5	14.5
Income Taxes Payable	0.5	1.5	1.5	1.5	1.5
Other	1.6	6.6	5.3	5.3	5.3
Total Liabilities	**11.5**	**18.5**	**24.4**	**27.7**	**28.3**
Total Shareholder Equity	**(0.1)**	**25.8**	**50.0**	**59.6**	**66.6**

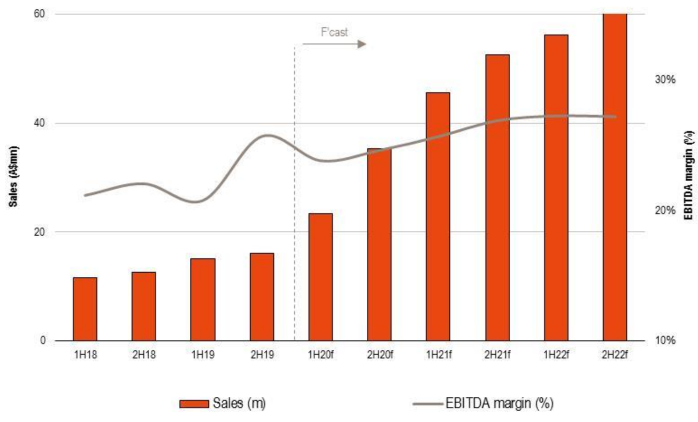
Ratios	FY18A	FY19A	FY20E	FY21E	FY22E
ROE (%)	(8,489.8%)	22.2%	16.2%	21.1%	24.0%
Gearing (%)	101.1%	(33.3%)	5.3%	8.5%	14.7%
Net Debt / EBITDA (x)	1.2	(0.9)	0.2	0.2	0.4

Note forecasts exclude the impact of AASB16 as does VVA's FY20 guidance.

Investment view

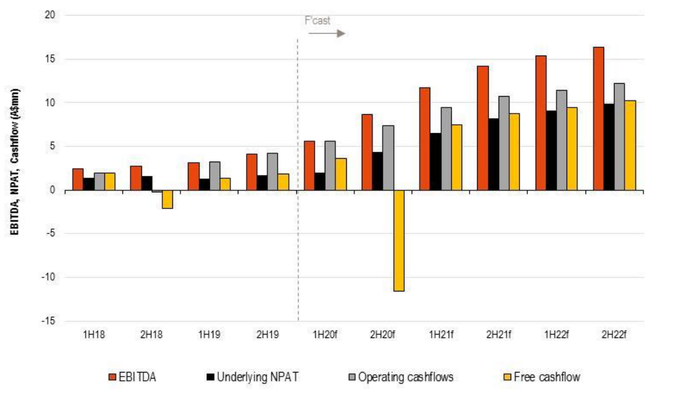
VVA has delivered a 3 year sales CAGR of 20% and consistent margin growth over the last few years each of which look set to accelerate over future years as reflected in Figure 1 and 2.

Figure 1: Sales (A$m) and Gross Margin (%)



Source: Shaw and Partners

Figure 2: Operating cashflow, NPAT & EBITDA (A$M)



Source: Shaw and Partners

VVA's historic growth was primarily organic driven by a unique combination of systems, its 'hub and spoke' model and its unique client proposition, the combination of which permits VVA to offer a competitive value proposition. VVA's hub and spoke model is an important part of its successful formula. It has shown to be an efficient way to expand VVA's catchment area, efficiently provide specialist services, and enhance the appeal of its facilities. The success is reflected in VVA's Australian Capital Territory market share estimated at 66% (see page 8) and its performance relative to the organic growth of ASX listed practice managers.

Figure 3: Comparison of ASX listed practice managers organic growth

Company	Industry Sales growtl	Co. sales growth FY19	Co. organic lfl Sales growth	Comment
Pacific Smiles	3-5%	17%	5.3%	Predominantly rolling out greenfield sites
G8 Education	3%	7%	7%	Battling industry over supply, selling practices, last acquisition 2017
Virtus	1-2%	5%	5%	Low cost services are negatively impacting Aust revenue, growth is int.
National Vetcare	1-2%	41%	2%	Historic growth predominatly from acquisitions
Viva Leisure	2-5%	29%	17%	Delivering organic & acquisition growth

Source: Shaw and Partners, FY19 %

The model has shown to work efficiently with the addition of spokes providing a natural growth profile. This, combined with IPO funding, and VVA's recent $20m raise, attractive acquisition multiples, and a fragmented industry has provided the opportunity for significant value creation from acquisitions relative to listed compcos as shown in Figure 4.

Figure 4: Comparison of value creation of ASX listed consolidators

Company	Market Cap ($m)	Co. FY19 EV/EBITDA (x)	Ave EV/EBITD/ paid for acq's (:	Acquired EBITDA ($m)	Est value creation as % of Mkt cap
Capitol Health	176	8.3	5.8	5.16	7%
Integral Diagnostics	673	15.7	7.9	24.4	28%
National Vetcare	154	11.5	5.2	10.4	44%
Viva Leisure	182	21.1	3.63	4.7	46%

Source: Shaw and Partners, based on acquisitions announced over last 18 months, the analysis excludes synergies ad refurbishment costs.

The combination of these factors delivered VVA sales growth of 29% in 2019. VVA has guided to 89% growth for FY20 and a June run rate of $7.1m up 112% on the previous June. This provides significant momentum and upside from a full 12 month impact for FY21. In addition we estimate, post the Healthworks and FitnFast (FnF) acquisitions and refurbishments, VVA will have $12m of funding for further development/acquisitions; all of which is setting VVA up for another strong result in FY21.

Risks exist, but they are not too onerous

Key risks include:

- VVA's ability to attract and retain members is crucial to its profitability – in VVA's home market the ACT it has achieved 10% penetration compared to an industry average national penetration of 15%. This industry leading penetration suggests VVA can build membership in other regions that it is now expanding into.
- VVA may face increased competition from competitors for members and suitable acquisition opportunities (see page 7 – re well capitalized corporate gym operators).
- VVA operates its facilities from leased premises. There is a risk that leases may not be renewed on acceptable terms. VVA generally has multiple 5 year options for leases in place.
- Operational risks confronting roll ups are greater than those confronted by established businesses.
- ~40% of VVA's total FY19 revenue was reliant on a single contract (CISAC). We expect it will drop to ~27.3% of total revenue for FY20 (see page 6 re VVA's regional expansion plans).
- VVA relies on software and hardware to support the operation of its facilities. Any significant interruption could adversely impact its financial performance.

VVA's growth, despite share price strength, makes its capitalisation look undemanding

Relative to listed compcos VVA is not expensive on forward multiples (comparing well on all the metrics shown in Figure 5) and its growth profile is considerably better. Note we excluded IVF and childcare comps because of poor industry outlooks (see page 8). The average EV/EBITDA of our basket suggests a valuation for VVA of $3.60 ps. We believe there is room for VVA's multiple to expand, however if it carries a PE multiple of 15.6x forward onto FY22 earnings it implies a TP of $3.96. Similarly, recent press reports that, Quadrant is reportedly seeking >17x EBITDA or ~3x sales for its leisure business, albeit a much larger business at an implied valuation of ~$2b, supports a higher valuation for VVA.

Figure 5: ASX listed compco valuation analysis

Compcos		EV/EBITDA FY21	PE FY21	Ent Val $m	2 yr historic sales CAGR	2 yr forecast sales CAGR	Operations
1300 Smiles	ONT	8.9	14.3	157	5%	nav	Ow ns and operates full-service dental facilities in Australia
Ama Group	AMA	8.3	14.6	936	27%	43%	Vehicle Panel Repair, Remanufacturing, and Workshop
Capitol Health	CAJ	6.9	11.5	218	18%	7%	Diagnostic imaging and related services thru 48 clinics
Integral Diagnostics	IDX	9.9	18.2	781	14%	20%	Diagnostic imaging services
National Vetcare	NVL	7.8	12.8	199	32%	17%	100 Veterinary clinics in Astralia and New Zealand
Pacific Smiles	PSQ	9.2	19.5	270	16%	11%	The development and operation of dental centers
	average	*8.5*	*15.1*		*19%*	*16%*	
Viva Leisure	VVA	7.2	15.6	174.1	23%	78%	Leisure/Gym facilities

Source: Shaw and Partners

Our DCF valuation, with relatively conservative assumptions regarding longer term market share, at $3.92 also supports a valuation in excess of VVA's current share price.

Figure 6: DCF valuation

DCF valuation	A$m	A$ per share	ASSUMPTIONS			
NPV - years 1 to 10	79.0	$1.32	Tax Rate	30%	Shares on issue - dil	59.8
NPV - terminal	122.4	$2.05	Risk Free Rate	**4.3%**	Share price	A$3.02
Surplus/assoc assets	0.0	$0.00	Debt Premium	2.60%	Market Value of Equity	A$181m
Enterprise value	201.4	$3.37	After-tax Market Risk Premium	**6.0%**	Fair Value of Net Debt	-A$6m
Debt and prefs (less options)	6.4	$0.11	Equity Beta	1.50	Required Equity Return	13.30%
Equity valuation - current DCF	**207.8**	$3.48	Adj. Terminal Nominal Growth	**3.00%**	Net Debt/Enterprise Value	-6.4%
Franking		$0.44	Franking Percentage	100%	WACC	13.85%
Value including franking		**$3.92**			Implied Terminal EBITDA Multipl	6.1x

Source: Shaw and Partners

Shaw and Partners target price is conservatively set, based on the lowest valuation generated by the various methodologies outlined above, at $3.60 which implies a 19.2% TSR.

Investment view BUY

VVA has been bid up strongly since IPO because of the growth in its monthly sales run rate. Further growth from its run rate, greenfield developments and acquisitions should continue to deliver results over the next two years. This will at its current share price leave VVA on a very attractive FY21 multiple, below comparable practice managers that are not generating equivalent growth. BUY

VVA's successful model – a combination of factors

VVA opened its first location, a purpose-built health club and aquatic facility in Canberra on 12 January 2004. It now (November 2019) has 45 facilities going to 82 by year end, operating under 8 brands.

The relatively quick expansion validates VVA's model. The model relies upon a number of factors that have shown, when combined, provide a formula competitors are not matching and consequently losing market share to. The three key factors are:

1. Use of technology to deliver efficiencies,
2. A client proposition that delivers quality, value and proximity, and
3. Unique brands slotted into a 'hub and spoke' model.

Technology delivers efficiencies & underpins VVA's value proposition

VVA's systems deliver efficiencies that its regional competitors, can't compete with. The systems:

- allow a simplified online joining process – no staff involvement, no staff cost,
- generate data which allows staffing to be managed efficiently aligning with when clubs are being used,
- manage all utilities, access and security allowing for fewer staff and for managers to have fewer tasks and to focus on clients,
- provide data to determine the types of spokes that need to be added,
- cut out 3rd party direct debit providers which charge a 4.5% processing fee, and
- allow VVA to quickly realise synergies from acquisitions.

VVA believes these efficiencies translate into a focus on clients that starts with its gym staff and managers but is a focus through to the Board. The company's focus on clients and client data is integral to its managing of marketing, retention and capacity towards 2 clients per m^2. VVA believes this approach is unique within the industry, but key to its delivery of return on investment (see page 8).

VVA's client proposition

The efficiencies VVA's technology delivers enables it to deliver its membership a proposition that is extremely competitive as reflected in its growth and market share in the ACT. Key aspects of VVA's client proposition are:

1. **A value proposition**. VVA's rates are comparatively cheap (see page 8) and it provides a "no contract" membership. VVA believes that its affordable membership offering and high quality health clubs is not affected by offering members "no contract" membership. We note locked in memberships are a key critisism of many of the larger city club chains.
2. **Proximity**. Close proximity and access to multiple health clubs (multiple brands and facilities see page 6) 24 hours a day, seven days a week (larger city chains typically don't provide roaming because often they are franchises), and
3. **Quality facilities.** VVA provides modern facilities with market leading U.S. Lifefitness equipment that is replaced and clubs are refurbished every five years (see our discussion on VVA's brands below).

Brands and the 'Hub and spoke' model are integral to VVA's formula

One of the most important aspects of VVA's strategy is how its brands fit into its 'hub and spoke' model. This aspect of VVA's strategy delivers broader client experience (part of the value proposition), further efficiencies and natural expansion opportunities.

VVA's larger (big box) Club Lime health clubs hubs are supported by its smaller (standard, express and boutique) Club Lime health clubs and other brands (spokes). The spokes are critical to supporting the hub with unique facilities that help to maintain memberships, prevent overcrowding of hubs (which would lead to a lower standard of service) and keep clients engaged.

The logic of the strategy is supported by the 50% of VVA's clients that pay a premium to have roaming rights. The spokes are also an efficient way to maximize the catchment area around a hub given the importance proximity is to attracting members. The effectiveness of maximizing the catchment area via spokes is supported by VVA's internal data on membership growth.

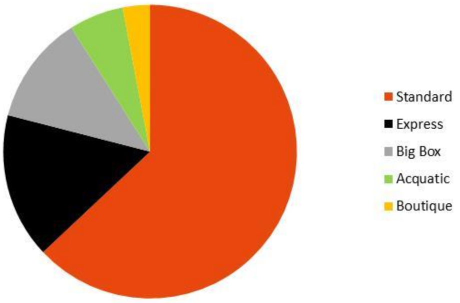
Figure 7: VVA's brands are integral to its formula

BRAND	SEGMENT	PURPOSE
CLUBLIME AFFORDABLE. ACCESSIBLE. AWESOME	Big Box Standard Express	Mixed gender health club offering the full suite of health club services in its big box configuration, and providing a different service offering in its standard and express clubs.
CLUBLIME LADIES ONLY	Standard	Ladies only health club offering the full suite of health club services in a private female-only environment.
CLUBLIME PSYCLE LIFE	Boutique	Boutique indoor cycling studio concept based on a unique class format developed by Viva Leisure, as well as offering other pre-choreographed classes.
hiit republic	Boutique	Boutique functional fitness based on the hiit (high intensity interval training) concept. hiit classes will be offered within big box and standard clubs with *hiit Republic* offering the same experience in a boutique environment and layout.
CLUBLIME AQUATICS	Aquatics	Indoor aquatic facilities for members and the general public.
CLUBLIME SWIM SCHOOL	Aquatics/ Learn to Swim	Swim school teaching learn to swim and aquatic skills from babies (six months) to adults. Operates from within the aquatic facilities.
GymmyPT	Personal Training	Viva Leisure's personal training division operates under the GymmyPT brand. Gymmy Lime is the mascot for *Club Lime*.
Studio BY CLUB LIME	Boutique	Bringing the full Group Exercise (GX) experience outside the health club into a boutique environment with scheduled as well as on demand instructor led or virtual class experiences.

Source: Viva Leisure, Shaw and Partners

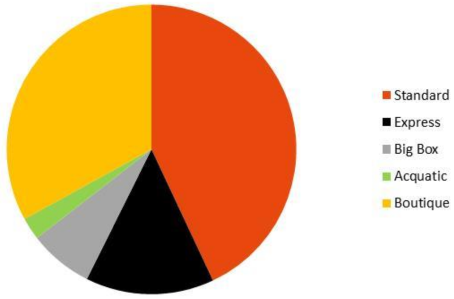
The 'hub and spoke' strategy is expected to see an ongoing evolution in the mix of clubs VVA will have in the future as detailed in Figures 8 and 9.

Figure 8: VVA clubs by type - 2019



Source: Viva Leisure, Shaw and Partners

Fig 9: Future – Boutique & express no.s are expected to grow



Source: Shaw and Partners

Moving towards a greater proportion of boutique and spoke type clubs is expected to: i) further maximize VVA's catchment areas, ii) continue to improve efficiencies, iii) higher client charges and improved yield, iv) continue to improve ROI, and v) result in a diversification away from VVA's home-base, the Australian Capital Territory, which currently accounts for 75% of VVA's clubs or 46% after the FnF acquisition.

Expansion is expected to be by way of greenfield development and acquisition. Regional and smaller metropolitan areas are currently attractive markets due to a lack of interest from larger funded industry participants. Regional facilities are typically owned by small operators with one or a few facilities. Smaller participants don't have the funding to invest to meet the consumer demand profile which is required for a profitable regional facility.

VVA looks to acquire the dominant club in an area, rebrand, then add spokes around it. VVA did this in Albury adding two spokes shortly after acquiring three facilities, membership has already increased from 3700 to 4000. A new main hub will open this month and new hiit Republic in February. VVA will then rebrand expecting significant growth over the subsequent quarters.

VVA expects to have 82 clubs by the end of FY20. The Healthworks and FnF acquisitions are expected to provide the opportunity to add a significant, but as yet not announced number of boutique clubs. VVA has also identified other natural greenfield expansions in regional New South Wales and Victoria.

VVA's intention is to build out these spokes as its brand recognition and membership base grows in each market.

Greenfield growth is providing a payback in 12-18 months

New greenfield locations vary in cost depending on size. A typical standard gym rollout of between 700m^2 will generally cost ~$400,000 in finance leases to secure equipment assets and ~$300,000 in cash for the fit out. Larger gyms, such as the ANU facility, the finance leases can rise to ~$600,000 for equipment. The smaller hiit Republic clubs of 250-400m^2 generally cost half their 700m^2 equivalent. It should also be noted that the finance leases are typically for four to five years and will generally come up for renewal prior to the end of the useful life of equipment.

VVA reported six greenfield facilities, opened in 2018 and 2019, achieved cash flow break-even within six weeks of opening. On average its locations older than 12 months 'had 85% utilisation the six clubs are understood to now be operating at this average and are expected to deliver a 12-18 month payback (excluding lease operating costs).

Acquisition multiples are value accretive & funding is in place

1. VVA's recent acquisitions have been done at a headline multiples of 2.5 and 3.79 x FY19 normalised EBITDA, before synergies. No one else is acquiring regional gyms so headline multiples are lower than often seen with other roll up strategies (vets typically 5x EV/EBITDA, child care 4x EV/EBIT)

2. VVA immediately introduces synergies to each acquired facility which is why with each acquisition it publishes pre and post synergy acquisition multiples. Regional gyms acquired to date have typically previously been trying to provide a multitude of services on the one site (crèches, cycling, cafes etc) limiting the space dedicated to main stream equipment that can be better monetised. Mismanagement of this type is a reason why acquired clubs were typically operating at 0.7 members per square meter. VVA's strategy has been to close many of these extras and only provide one of each 'extra' at different spokes. This has lifted patronage, improved EBITDA and ROI. Given VVA's track record at realising synergies, it provides guidance to post synergy multiples which on recent acquisitions has been a multiple on a full-year run-rate of less than 1.8 x (Healthworks) and 2.87x (FnF) FY19. Including refurbishment costs the multiple rises to 4.3x, however with VVA trading on an EV/EBITDA of 11.6x FY20 acquisitions are extremely value acretive.

3. On 29 October 2019 VVA announced it had secured a credit facility with the Commonwealth Bank for a A$14.5 m, 5-year senior secured debt facility comprising a $10m market rate loan facility to assist in financing future acquisitions. On 2 December 2019 VVA announced it had completed a $20m capital raise. The financing (post the acquisition of Healthworks and FnF and associated refurbishing and rebranding costs) increases our estimate of VVA's acquisition funding capability to $12m. Based on previous multiples typically paid by VVA of ~3x EBITDA (excluding synergies) its current funding potential suggests ~$4m (pre synergies), or $5.2m (post synergies) of EBITDA could be acquired.

Conclusion VVA has good visibility to natural greenfield developments and acquisitions, it also has funding in place and a track record of delivering value adding acquisitions which is why we believe it is reasonable to factor acquisitions into forecasts.

Recent acquisitions – Healthworks and FitnFast

On 16 October VVA announced the acquisition of 8 Healthworks facilities and on 12 November it announced the acquisition of a further two Healthwork facilities for a combined price of $3.35m and a combined FY19 EBITDA of $1.05m. We anticipate additional funds will be put to refurbish and rebrand ing. The 10 acquisitions brought a combined 12,500 members and are expected to settle 30 days from each announcement.

- The first 8 facilities were acquired on a multiple of 3.25 and 2.0 post synergies
- The final 2 facilities were acquired on a multiple of 2.5 and 1.8 post synergies

On 2 December VVA announced a $20m capital raise and the acquisition of 13 FitnFast Health Clubs (FnF) for $13.5m cash.

- FY19 EBITDA $3.6m, post synergies VVA expects to deliver cost and revenue synergies of $1.2m lifting FnF EBITDA to $4.7m,

- FY19 EV/EBITDA multiple of 3.79x and 2.87x including synergies but excluding refurbishment and rebranding costs,
- 21,500 members and 15,600$m^2$of leased gym space equating to 1.38 members/m^2 , and
- The acquisition is expected to complete by 31 March 2020.

The Australian Fitness Industry provides long term growth & acquisition opportunities

In the five financial years through to FY18, revenue within the Australian fitness industry is reported to have risen by over 5.3% pa to ~$2.2b and is forecast to continue to grow at a rate of 2.3% pa over the next five years.

The number of Australians that are members of health clubs, fitness centres and gymnasiums is estimated to be 3.73 m reflecting a 15% participation rate. Surveys suggest 53% of members choose facilities based on proximity to their place of work or residence. The membership penetration rate was 15.3% of the population in Australia, ranking 8th globally and well behind the United States with a penetration rate of 20.3%.

Industry fundamentals are superior to other industries that underpin ASX listed consolidators as shown in Figure 10.

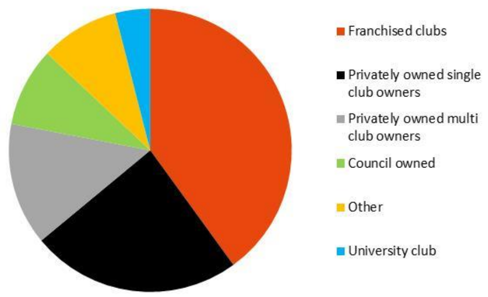
Figure 10: Industry comparison

Industry	ASX listed companies	Industry demand growth	Industry sales growth	Industry supply growth	Industry size $bn	Comment
Dental clinics	1300 Smiles, Pacific Smiles		3-5%		9	
Diagnostic imaging	Capitol Health, Integral	5%	6%		1	Medicare covers 86% of industry sales making it subject to government policy revision. An ageing demographic will support growth
Childcare	G8 Education, Affinity	3%	5%	4%		Top 5 participants have 25% mkt share. Industry is battling over supply - GEM is selling practices, its last acquisition was in 2017.
IVF clinics	Monash IVF, Virtus	1%	1-2%			Unreliable industry dynamics tied to economic conditions. Evolving technology is improving outcomes & new low cost services are negatively impacting revenue
Vet clinics	National Vetcare, Apiam	1-2%	2-3%	0.5%	3	Highly fragmented, highly penetrated, humanisation of animal care is a global trend supporting per capita spend
Gyms	Viva Leisure		2-5%		2.2	Highly framented, under penetrated industry with obesity and a move towards healthier living expected to support demand

Source: Shaw and Partners, Company announcements

IBIS World estimate there are 5,000 businesses within the Australian fitness industry (in all segments). Most of these are franchises of the large industry participants listed below. There are however, ~1000 privately owned single club owners and a similar number of clubs owned by multiclub owners as detailed in Figure 12 most of which are in regional Australia.

Figure 11: Australian Health Club market



Source: Viva Leisure, Shaw and Partners

Industry participants include seven larger well-funded corporate participants. They are:

- Quadrant's Fitness and Lifestyle Group with 650,000 members and revenue estimated at ~$650m pa from 400 clubs. Quadrant owns: i) the Goodlife Health Clubs network. Goodlife has more than 80 city locations around the country, ¾'s of its clubs are 24/7, fees start at $17.99 pw with a $99 joining fee, ii) Fitness First which has 74 clubs of which none are in regional areas, locks clients into contracts with fees starting at $24 pw and has a $99 joining fee, and iii) Jetts Fitness, a franchised budget chain which has more than 250 gyms some of which are in regional areas. Memberships start at $14.95 pw. Quadrants last purchase was in 2016 and press articles indicate it is seeking a trade sale or to sell the business to another PE firm for ~$2b, implying >17x EBITDA or ~3x sales.

- F45 Training is an Australian franchisor with a global presence and 500 facilities in Australia. There are no Australian franchises left. The business is structured around daily classes, membership costs are $60 to $80 p week.
- Snap Fitness is a U.S. franchisee operation with more than 2,200 24-hour "no frills gyms" worldwide with 210 in Australia.
- Anytime Fitness has close to 500 clubs in Australia, a $99 joining fee and a $69.95 fee for after-hours access. Anytime has now stopped selling Australian franchises.
- Plus Fitness is an Australian owned franchise chain that has been in operation for 20 years, with more than 220 gyms in Australia including a small proportion in regional locations.
- Fernwood a female-only gym has 70 locations across Australia - A $199 sign-up fee is standard across most studios, with memberships starting from $22 a week.
- US based Planet Fitness (PF), total facility count 1,899, opened its first two Australian clubs in November 2019 in Tuggerah (ACT) and Gosford, a third location is expected to open in Casula in 2020. It has a franchise agreement with Bravo Fit which will develop 35 locations in coming years. In the U.S. PF reported FY18 revenue of $572.9 m from corporate-owned locations and franchisee fees. 3Q19 revenue was up 22.1 % on pcp.

VVA charges – Club Lime membership starts from $12.50 pw. hiit republic membership fees are from $29.90 pw scaling to $39 pw (half the equivalent F45 fee) which includes a Club Lime membership.

The key take aways from our industry review are that:

1. Corporate facility managers have typically not invested in regional/suburban locations, but could in the future put pressure on acquisition multiples,
2. Similarly VVA could become a takeover target,
3. The structure of the industry results in localised competition between facilities, rather than state or nationwide competition, and
4. Rates being charged by VVA are generally more affordable than what the other large operators charge.

Managing member retention and growth

VVA has experienced relatively strong rates of gross member growth attributable to organic growth, new greenfield facilities and acquisitions. This has only partly been offset by churn. VVA's retention rate (members still paying beyond 12months) for the period Jul-18 to Mar-19 was 74% and is currently 68%. This means that 32% of members (2.7% average per month) cancelled their VVA subscriptions over a 12month period.

VVA believes it effectively manages churn through technology systems that enable it to pre-empt a member cancelling. Key methods utilised include:

- Offers to encourage clients to stay beyond their first few months when attrition is high before they develop a habit of exercising,
- reviewing member visitation history and following up with members whose usage has dropped to encourage them to try classes, different sites etc. Responsibility for this starts with the facility manager but is managed at all levels through to VVA's board.

As at Jun-19, VVA had 54,039 members across all clubs and expects to exit FY20 with 106,500. The net member growth rate over the three years to Apr-19 was 19% pa (excl. swim school). Net member growth excluding acquisitions is currently running at 1,100 members per month.

Net member growth at the local level along with potential member growth from expanding the catchment area plays into VVA's greenfield developments via its target of approximately 2.0 members pm^2. The metric reflects the level of service VVA seeks to offer its members (i.e. accessibility of equipment and no overcrowding), quantum of equipment required, and staffing. VVA's data shows that churn increases once a facility exceeds 2 members pm^2. VVA consequently considers it a key metric when considering the success of an existing location, when assessing new locations and it is a metric used by VVA to determine the upside in a new location or acquisition.

VVA's mature portfolio of locations (those operating more than 12 months) is currently operating at 1.7 members pm^2. In comparison, VVA reported that three recent acquisitions (acquired in September 2018 and March 2019) were, as at April 2019, operating at 0.77 members pm^2.

VVA believes it is reasonable to expect it will close in on 2 members pm^2 in its mature portfolio given:

- 90.4% of its existing portfolio had membership growth in FY19, and
- VVA counts over 10% of the Australian Capital Territory population as members of its facilities (as at 6 April 2019, 39,572 active Australian Capital Territory based members of an estimated population of 397,397 residents, based on the 2016 census).

If VVA's entire current portfolio was operating at 100% capacity it would represent a potential increase across the existing portfolio of 17%, or approximately 11,000 members which could translate into an additional $1.25m of sales.

Conclusion VVA has good visibility towards further organic membership growth from its current facilities.

Shaw and Partners financial forecasts

VVA has guided to FY20 sales of $58.7m. Our sales forecasts for FY21 and beyond are based on the four factors outlined below which total to a sales uplift of $39m in FY21 which is the basis of our $98.2m FY21f.

1. Runrate – Sales growth from member numbers elevated in the previous period is the key driver behind our forecasts accounting for the majority of each years sales forecast. Run rate growth explains why VVA reported organic revenue growth of 16.6% which is well above its organic member growth at 7.8% and it explains VVA's share price performance since listing. Monthly recurring revenue at the end of June 30 2018 was $2.26m, by the end of June 2019 it was $3.34m an increase of 48% and VVA has guided to a run rate of $7.1m pm as at the end of June 2020. This implies over the full twelve month period of FY21 run rate growth should deliver a full 12 month revenue uplift of $13m.

2. Organic growth – As implied above, member growth from existing facilities in excess of the June 2019 run rate is factored into our forecasts at a CAGR of 5% which is conservative given VVA last reported 7.8% organic growth. Similarly over FY21 we have factored in 5% growth on VVA's guided June 2020 run rate.

3. New acquisitions - VVA has good visibility to natural greenfield developments and acquisitions, it also has funding in place and track record of delivering value adding acquisitions which arbitrage the difference between private and public multiples and is why we factor acquisitions into our forecasts. It currently has funding to acquire an estimated ~$20m of sales.

4. Rollout growth – VVA has stated that it expects 9,000 new members as a result of new roll outs in FY20. This is expected to generate $1m of sales. Our expectation is that VVA will look to replicate this over 2020 and 2021.

VVA's expenses are primarily driven by rental and employment costs:

1. Rental costs are generally fixed and subject to contracted lease terms. VVA's policy with regard to property leases is generally an initial term of either five or ten years with multiple five-year options at the conclusion of the initial term. Five years is selected as the preferred option, as that is the general lifecycle of cardio equipment, so at the end of the initial term a decision can be made to renew the lease, relocate the club and at the same time replace equipment. VVA's rent bill typically runs at ~ 21% of revenue;

2. Employment costs are VVA's largest single cost. The majority of VVAs employees are casual employees employed to run training, group classes and swim school. There is an element of variability to this cost which is subject to member demand. An area manager is employed for every 10 clubs. VVA's wages bill runs at ~30% of revenue, and

3. New clubs are typically loss making for the first three months. Breakeven occurring at ~350 members. VVA has a standard formula it uses to build to this level of membership starting with pre opening marketing and various discount schemes to ensure it is not incurring losses for longer than three months.

FY20 EBITDA guidance & Shaw's longer term forecasts

VVA's FY20 guidance excluding the impact of AASB 16 which is the basis for Shaw and Partners FY20 forecasts is to EBITDA at $14.2m from which we expect NPAT at $6.2m (excludes client amortisation). Based on prospectus (prior to the Healthworks and FnF acquisitions) the impact of AASB 16 in FY20 was expected to be ~$10m at the EBITDA line and -$2.8m at the NPAT line. The adjustments include removal of operating rental expenses of approximately $9.8m and the addition of lease interest expense of approximately $6.0m and right of use amortisation expense of approximately $7.6m. This creates an overall adjustment to NPBT of approximately ($3.8m).

Our EBITDA forecasts for FY21 and beyond are based on our sales and expense forecasts outlined above. Notably because the key wage and rental expectations are based on revenue, EBITDA margin growth is limited and we don't expect it to exceed 27-28%.

Cashflow & cash conversion

VVA direct debits members every 14 days. It doesn't carry a significant bad debts and the debtor balance is primarily corporate clients. Cash conversion to EBITDA was 33% in 2018 (reflecting related party debt paid out in cash) and 102% in 2019. We expect it to remain around 100% going forward.

Dividends & VVA's proposed payout ratio

VVA's Board has adopted a dividend policy to distribute to its shareholders funds surplus to the operating needs of the Company as determined by the Directors, with a target dividend payout ratio in respect of each financial year of between 40% and 60% of NPAT with dividends expected to commence in FY21.

Balance sheet

As at June 30 2019 VVA had a Net cash position with limited debt on its balance sheet.

On 29 October 2019 VVA announced it had secured a credit facility with the Commonwealth Bank for a A$14.5 m 5-year Senior Secured debt facility comprising a $10m market rate loan facility to assist in financing future acquisitions, a bank guarantee facility and direct debit facility.

On 2 December 2019 VVA announced a $20m capital raise at $2.65 per share to fund the $13.5m acquisition of FnF. We understand VVA will spend an additional $7m on fitout/rebranding. We have also factored into our forecasts $8m of rollouts following the Healthworks and FnF acquisitions.

Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

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