Conference Call Transcript

Smart Fit

4Q22 Results

José Luís Rizzardo Pereira:

Good morning, everyone. Welcome to Smart Fit's conference call to announce the results of the 4Q22. Introducing myself for those who do not know me, my name is José Luís and I am responsible for Investor Relations in the Company.

Before starting, an important message for those listening to us in English. Today with us we have Mr Edgard Corona, CEO, Thiago Borges, CFO, Diogo Corona, CEO, André Pezeta, Director for Latin America, and Alexandre Gregianin, CTO.

Participants will be in listen-only mode during the presentation of the Company, and then we are going to start the Questions and Answers session, when further instructions will be provided. As a reminder, the slides on which this presentation will be available it is in the Company's website.

Before continuing: statements made during this conference call, relative to the Company's operation and financial projection and goals, are beliefs and assumptions of the Company's management and are based on information currently available to the Company. Forward-looking statements are not a guarantee of performance, because they involve risks uncertainties and assumptions.

Now, I would like to give the floor to Edgar Corona, our founder and CEO Mr Corona, please.

Edgar Corona:

Good morning. Thank you very much for attending our conference call for the 4Q22. I would like to start with a few very important messages about 4Q22. The first message is that 2022 ended in a very promising way, and we have made significant accomplishments in the year, despite the uncertainties and challenges.

We have added 884 thousand members to our units during 2022. For the units that existed before the pandemic, the membership versus baseline grew by 14 percentage points in the same period.

Now, talking about 2023. In January, we had a historical record of sales of the Company. Membership in the same units grew 7 percentage points until February, reaching 96% of the levels of March 2020. This reinforces our trust and our confidence that fitness industry will go back to historical levels of high growth.

Message number two: we are even more confident in the recovery of the unit economics of our mature units. In 4Q22, the gross margin in cash reached 48% in mature Smart Fit units. The 583 mature units have generated an annualized average gross profit of R$1.8 million per unit.

In others Latin America, we are going back to historical levels of profitability in the 2Q22. Looking at other geographies within the segment of high value low price, the scenario is the same: gradual recovery of historical KPIs. In this scenario, we are even more confident in the recovery of unit economics, which is a matter of time and not if they will go back.

Our high-end clubs Bio Ritmo, the membership per unit has exceeded historical levels and ended the year with a profitability level similar to historical levels, with the highest NPS of recent years and a churn below historical averages. In studios launched in 2017, we ended 2022 with 13 operating units, and operating for different concepts with our own units and franchise.

The third important message is: during the pandemic, we have reinforced our DNA of focusing on efficiency combined with customer experience. In recent years, most of the digital initiatives were focused on increasing efficiency of the operation. Added to the efforts in other areas of the Company, this has contributed to an increase of cost well below the inflation that accumulated over recent years. In the period from 2020 to 2022, it was 19.4% in Mexico, 21.4% in Colombia, 21.7% in Brazilian in IPCA and for rentals in Brazil, IGPM was 51.9.

Assuming a recurrent cost basis in units opened before 2019, our costs grew only 10%, thereby demonstrating the strong cash management of the Company. The efficiency is always worked combined with the pursuit to improve customer experience, in line with our mission of democratizing high standard fitness.

We continue to improve the digital customer experience based on four pillars: operation efficiency, better customer workout experience, customer engagement and sales. We continue to be recognized for excellent customer service and our strong brand.

In 2022, we won several awards in the different geographies where we operate, recognizing Smart Fit as the most loved in the category. One example is the award "The Most Loved of São Paulo" of Veja magazine. We also received an important recognition of Reclame Aqui, an award for the best companies for consumers. Smart Fit continues to be synonymous of the category in the regions where we operate.

Message number four: We ended 2022 with 1,223 units in 14 countries. We added 158 units with expected returns in line with what we saw in the past. Considering extensive know-how in opening our sound relationship with real estate players and the higher offer of good properties at very good prices, current contracts for rental have values or amounts that are low or below historical levels. The evolution in the pursuit for excellent commercial points and appropriate expansion strategy are reflected on the ramp-up of units that opened recently, which have reached revenue levels per unit above the historical levels, confirming what we have seen in mature units.

Taking advantage of the favorable real estate scenario, the competitiveness of our business model and our strong financials, we intend to accelerate the pace of expansion in 2023.

To end the presentation, I would like to thank immensely our almost 13,000 employees, whose dedication have helped us daily to democratize high standard fitness for more than four million customers. A special thanks to our members, to the support of our suppliers and the trust of shareholders and debenture holders, despite uncertainty.

We are very happy with the results that we obtained in 2022 and very excited with the prospects for 2023. These were my initial messages. Now, I will be waiting for you for the Q&A session at the end of the presentation. I give the floor to Alexandre Gregianin, our CTO, to continue the presentation.

Alexandre Gregianin:

Thank you very much, Edgard. Now, I would like to talk about the evolution of our digital journey for our customers. With the continued improvement of digital platforms, the number of users has been growing. We reached 1.8 million people using Smart Fit's app in 2023, which represents a 29% increase as compared to January 2022, and 55% of the total membership. The app scores stable at 4.8, thereby reflecting the good perception that customers have of Smart Fit's customer digital experience.

One of our objectives in 2022 was to improve the experience in our main sales channel, the self service totem. Present in 143 units, it increased from 47 to 52% of total sales, reducing waiting lines and waiting time in the receptions of our units.

We also rolled out in Brazil the functionality of selling plans in the app without an immediate investment, 100% organic in February 2023, 2% of the total sales were done through this channel. The intention with the sale of apps is to reduce the cost of acquisition of new customers. The evolutions related our workout experience in February, the functionality of automatic workout programs sending to our members was released.

Before, all members had to find a teacher to use our units. Now, after answering a few questions, they receive a workout program that is best suited to their needs. A significant number of 65% of our new members use the automatic workout plan, another 10% were directed to talk to a teacher because they have some sort of restriction, and 25% decided to speak with teachers because they need. So we have 88% good assessments for workout plans, and this is going to reduce the operational demand in stores.

Lastly, with the launch of automatic workout plan, the phygital journey of Smart Fit members is complete. Now, members can download Smart Fit App, choose their favorite unit and enroll. If they have the nutrition app and if they are interested, they can subscribe and get the air workout program, and they can go to the store to record their digital fingerprints to use it and to start practicing.

Now, I am going to give the floor to Thiago, who is going to continue the presentation.

Thiago Borges:

Thank you very much, Alê. Good morning, everyone. I would like to continue the presentation with a highlight to the continuous recovery of our membership during 4Q22, especially in the first months of 2023.

In 4Q22, membership in units continued its expansion trajectory reaching 3.5 million members, 2% above 3Q22, and a 34% growth versus 4Q21. The combination of our efforts to attract members and the organic expansion with maturation of new units has contributed to an increase in our membership, which had the performance that was superior to historical seasonality for the period, with growth in all regions.

We started the year with excellent sales performance. In January, a seasonally strongest month of the year, membership of Smart Fit units existing before the pandemic grew 6 percentage points, the main growth since the recovery and the highest month of sales ever in the history of the Company. In February, the membership continued growing, reaching 96% of pre-pandemic levels.

Now going to the next slide, I would like to say that revenue of units that existed before the pandemic increased 7 percentage points in 4Q22, following the good performance of recent quarters, and already exceeds 10% of revenue levels of pre pandemic levels. This performance reaffirms the growth trend of revenue of mature units combined with the recovery membership associated to a better ticket, reflecting the adjustments conducted in 2021 and the effects along 2022. Along the last 12 months, revenue in these units increased 30 percentage points, an average growth of 2.5 percentage points in a month.

In 4Q22, there was an important landmark. The net revenue of Smart Fit units that opened before 2019 exceeded 100% of pre pandemic level in all units. The recovery dynamics is regionalized and this level of revenue evolution was possible because of the joint performance of geographies where we operate, and Brazil has a revenue that is slightly above pre-pandemic levels. Mexico is 11% above and others Latin America has had an increase of 29%. We should remember that Others Latin America region was the first one to recover members and revenue still along 2022.

Continuing the presentation, I would like to say that the Company's effort is to recover and increased margins and profitability. The gross margin of the 583 own units, mature units has had a significant growth along 2022, gaining 11 percentage points and going from 37% at the end of 2021 to 48% in 4Q22.

Every quarter, we are demonstrating a recovery of gross margin of mature units towards recovering to pre-pandemic levels. First of all, we should highlight that cost control and management is very important for the Company, which made it possible for costs to be only 13% above pre-pandemic levels, well below inflation in the last three years.

Secondly, the revenue growth has been supported by a combination of continuous growth in membership and discipline in an increase of tickets over the past few years, without any major impacts in demand for our services. As a result, the difference between revenue and costs versus baseline in the Smart Fit units that opened before 2019 follows a downward trend, reaching the lowest level of 3 percentage points in the last quarter.

The membership recovery and dynamics of revenue growth occurs every month. In this manner, we can see that in February, it already has a 7 percentage points gain in membership, which indicates a trend of continuing the revenue growth trajectory in the short term. The starting point of 2023 combined with the performance that we have seen in the first months of the year makes us very confident in the total recovery of the Company's margins along the year.

Now, I would like to like to give the floor to Diogo to talk about the performance of new units and other highlights in the period.

Diogo Corona:

Thank you very much, Thiago. Very good to see the recovery of mature units. We have the performance of units especially in 2021, the revenue of new units is 4% above historical levels. If we compare the maturation until 2019, it reflects the maturation curve.

New rentals are 22% below our historical levels of rents. We should highlight that for these units, as well as the mature ones, we are implementing energy efficiency and other measures that will help to recover these margins in the future, and we are going to keep the same discipline in 2023.

Now, on the next slide, we have health and exercise, that will be our priorities in 2023. Looking after health and the practice of exercise are a priority for 2023. In Brazil, 35% of the inhabitants consider looking after health, it is a priority for 2023. Losing weight and exercise is a priority for 28% of the people who were interviewed. So, this is a very important theme for the Brazilian population, and it is incorporated in many studies and publications on the media, where there are lots of articles reinforcing the importance of exercise for health.

Exercising is even more important in Brazil and Mexico, our main regions. A McKinsey study for 2022, the population of these two countries attribute more importance to exercise than the global average. So you can see that 64% of the population of Brazil and Mexico find it very important to exercise.

Another important information is that 6% of the global population find that exercise is not important. But, in Brazil and in Mexico, this is a very small number. Younger generations - millennials - prioritize exercise and health more than older people.

On the next slide: to capture this opportunity in the market, we have aimed our culture-centered on improving customer experience, and this can be seen in three indicators and the awards that we won along 2022, with important awards in Brazil and also in other regions.

We also have foreign recognition, external recognition, and we also have internal recognition from our members. Our NPS is excellent with 61 points in December 2019 and it is with 62 points, in December 2022.

André Pezeta:

Thank you, Diogo. As you can see, the court that has been marked by the acceleration in the pace of opening new clubs. 66 units have been added, the main growth since the beginning of the pandemic and the second biggest growth in the history of the Company.

In accumulated numbers of the year, we opened 158 new units, which accounts for a growth of 15% year, especially because of the opening of new units. We ended the year with 1,223 units, 964 being our own and 256 franchise. Considering our membership in 2022, we decided to focus on Others Latin American and Mexico, adding 126 new units in these two regions, which represented 80% of the expansion of the year versus 55% in the year before. As Diogo mentioned before, we already seen good ramp up curves in all regions and the expansion in 2023. We will, again, have a breakdown that is more similar to what we had before, with Brazil having a larger share.

On the next slide, I would like to highlight that, after three years of lots of uncertainties and challenges posed by the pandemic, we are closing 2022 with excellent operation and financial performance. Since the beginning of pandemic, we increased 389 units in our network of units, a growth of 47% in the period, adding more than 1.1 million new members.

The revenue of 4Q22 annualized has had accumulated growth of 72% as compared to 2019. The EBITDA margin of 4Q22 is 27%, very close to the levels of 2019. Now considering the recent acquisition of our operations in Panama and Costa Rica, the Company's EBITDA is close to one billion.

Now, I would like to give the floor to Thiago for the financial highlights.

Thiago Borges:

Thank you, André. Continuing the presentation, I would like to go into our financial performance, going with the evolution of the revenues. We should point out that this is the sixth consecutive quarter of strong recovery of revenue.

The net revenue of 4Q22 was R$853 million, a 56% growth versus 4Q21, especially because of the 22% growth in the average number of students per own unit, an expansion of 16% in our own units and an increase of the average ticket per member, because of the transfer of prices that took place along 2021.

In Brazil Smart Fit Units have had a raise in revenue of 7% versus 3Q22, a result of the 4% increase in membership per unit and a 2% expansion in the network of our own units. In Mexico, revenue grew 18% over 3Q22, because of the combination of expansion of 8% in our own network of units, an increase in average ticket both partially offset by a smaller average number of members per gym because of historical seasonality.

Now going to the next slide, we can see how the fast growth of revenue combined with high operational efficiency have provided significant operational leverage. Compared to 3Q22, the cash gross profit grew 17% with an expansion of 2.4 percentage points in margin, with a highlight with Smart Fit Brazil cash gross margin, which grew 5.7 percentage points over the quarter before. Since the opening of the units in 2Q21, the gross margin grew for the sixth quarter in a row, reaching 45.2% in a period.

The last message: I would like to emphasize that continuous management focusing on cost reduction could reduce the cost of inflation. In 4Q22, the cash cost of the units opened before 2019 went up only 13% compared to the baseline of three years ago.

Now on slide 17, this is the evolution of expenses. SG&A has presented a 7% growth when compared to the previous quarter, with a dilution of 0.7 percentage points in the period, also driven by an increase in revenue. In this quarter, sales expenses represented 8.3% of net revenue and have grown 14% versus 3Q22, because of the reacceleration of investments in marketing, which contributed positively to sales in the beginning of 2023. General and admin expenses grew 4% over 3Q21, accounting for 10.1% of the net revenue in the quarter, dilution of 0.7 percentage points in the period.

Considering the continuous recovery of revenue in mature units and maturation of new units, we also have a 32% growth over 3Q22 in EBITDA. In this quarter, the EBITDA margin had a strong expansion of 4.2 percentage points, reaching 27%.

We continue confident that we are on the right track to recover the Company's margins with a continuous trajectory for the recovery of revenue, strong discipline in cost and expense management.

Now you can see the financial performance and CapEx. In 4Q22, we invested R$244 million to support the opening of 59 of our own units. After 3Q21, we have robust cash position and low financial leverage. We ended 4Q22 with 2.9 million in cash and net debt of 615 million, a debt profile that is very long, with a financial leverage that is 0.8 times.

Now, I will give the floor to José Luís for the ESG highlights.

José Luís Rizzardo Pereira:

Thank you very much. I would like to highlight that our business model makes it possible to democratize high standard fitness to the population, offering high quality services at affordable prices. More than 1,220 units distributed in Latin America to more than four million members today. In this manner, we contribute for more people to have healthier habits and better quality of life and health.

There are many ESG initiatives related to our activities and I would like to point out a few. First of all, we held approximately 200 campaigns to collect several different items supporting the social development of local communities. We could also reuse, through partnerships with third-sector organizations, more than 3.5 tons of uniforms to make blankets that were donated to institutes focused on helping people at social vulnerability.

Additionally, as Alexandre mentioned, we are investing in the digitalization of different processes, including the prescription of workout plans through the app, thereby contributing to reduce the consumption of paper. In the period, we also intensified our efforts to increase our efficiency in terms of energy consumption and a higher share of renewable energy in our energy metrics.

We automated the system of air conditioning in 75 units and, in the next few years, more units will have automated air conditioning. We also continue to expand the share of renewable energies in our energy metrics through distributed generation. We have signed contracts for more units to use this type of energy generation in the short term. All these initiatives aimed to reduce the emission of gasses along with the lower costs in terms of energy conception.

Last but not least, we have also significantly advanced in people management. In 2022 alone, more than 48,000 trainings were done by our employees through our corporate university.

Now, I end the presentation. Thank you all very much for attending our conference call. We are going to start our questions and answer session.

Victor, Santander:

Good morning, everyone. Congratulations on your results. We have two questions from Santander. We would like to explore a little bit more about the guidance. You say you are going to go back to more normalized levels in Brazil. What would be the breakdown between regions?

As to CapEx per store, you mentioned a more favorable real estate scenario. But, at the same time, many companies in this industry are talking about higher costs related to construction. So how do you see this in terms of the CapEx per store in 2023?

The second question regards the performance of different regions, thinking of the comparison of membership. Do you believe that there is any space to operate in the level of members per unit, going back to pre pandemic levels in Brazil and Mexico, as you are doing in others LatAm?

André Pezeta:

Hi, Victor. This is André answering your question. As to your first question, our guidance is to go back to our historical record, which was between 190-200 stores. Our historical record is 196 stores, and we want to go back to that level. Then, we want to have the same breakdown that we had or something more similar to what we used to have before 2022, with Brazil being much more representative, having a larger share.

As to CapEx, what we see for 2023 is that, to keep CapEx in local currency in the mix, there might be some changes, but the CapEx of stores and local currency should stay the same.

As to your second question about store performance in Brazil and Mexico: we are working to bring these numbers back to 100%. It is not going to go beyond that, and we do not see it going to others Latin America, and we have been working to go back to those levels.

Maria Clara, Itaú:

Hello, everyone. Thank you very much for taking my question. Congratulations on your performance. Here at Itaú we would like to know how we can think about the recovery trajectory of membership in 2023? Is it reasonable to assume that this level might get to pre pandemic level, this year still?

Also, we are asking you to say how the recovery trajectory will affect your profitability.

Thiago Borges:

Maria, thank you very much for your question. This is Thiago answering. In terms of volume, it was 96% in February. And we see that, along the year, this level will go back to pre pandemic levels. So the answer to your question is: yes. This is going on and will take place according to seasonality, getting to 100%.

Seasonality plays a more important role. And the most important month for us is for example the month of May. Obviously, this is related to the recovery trajectory of profitability. You see that margins have been growing quarter after quarter. It is very close to the average of 28% of 2021. We had 27% in 4Q22 and, in 2023, SG&A will continue to go down and this is related to the recovery of mature units, and this number will get close to 50% in the first quarters of 2023 and the maturity of newly opened units along 2022. This will also drive up the growth margin.

Maria Clara:

Thank you all very much.

Alejandro Gongora Lara, HSBC:

Hello, good morning. This is Alejandro from HSBC in Mexico. What is the expansion plan in terms of number of units for 2023? Are you going to take more debt in the market?

André Pezeta:

This is André answering your question. As we said before, our plan is to go back to the record levels of openings that we had before, which was 196 openings in the past, in one year.

As to cash, I am going to give the floor to Thiago.

Thiago Borges:

For 2023, we need to finalize the amortization of the principal along the year. We think that the Company's cash position is sufficient to support the growth and to keep the leverage, just keeping the size of the current debt of the Company without increasing its debt. This is the strategy.

José Luís Rizzardo Pereira:

We have come to the end of our questions and answer session. I would like to thank everyone for your attendance. The Company's Investor Relations team is available to answer any questions you may have. Thank you very much and have a good Friday.