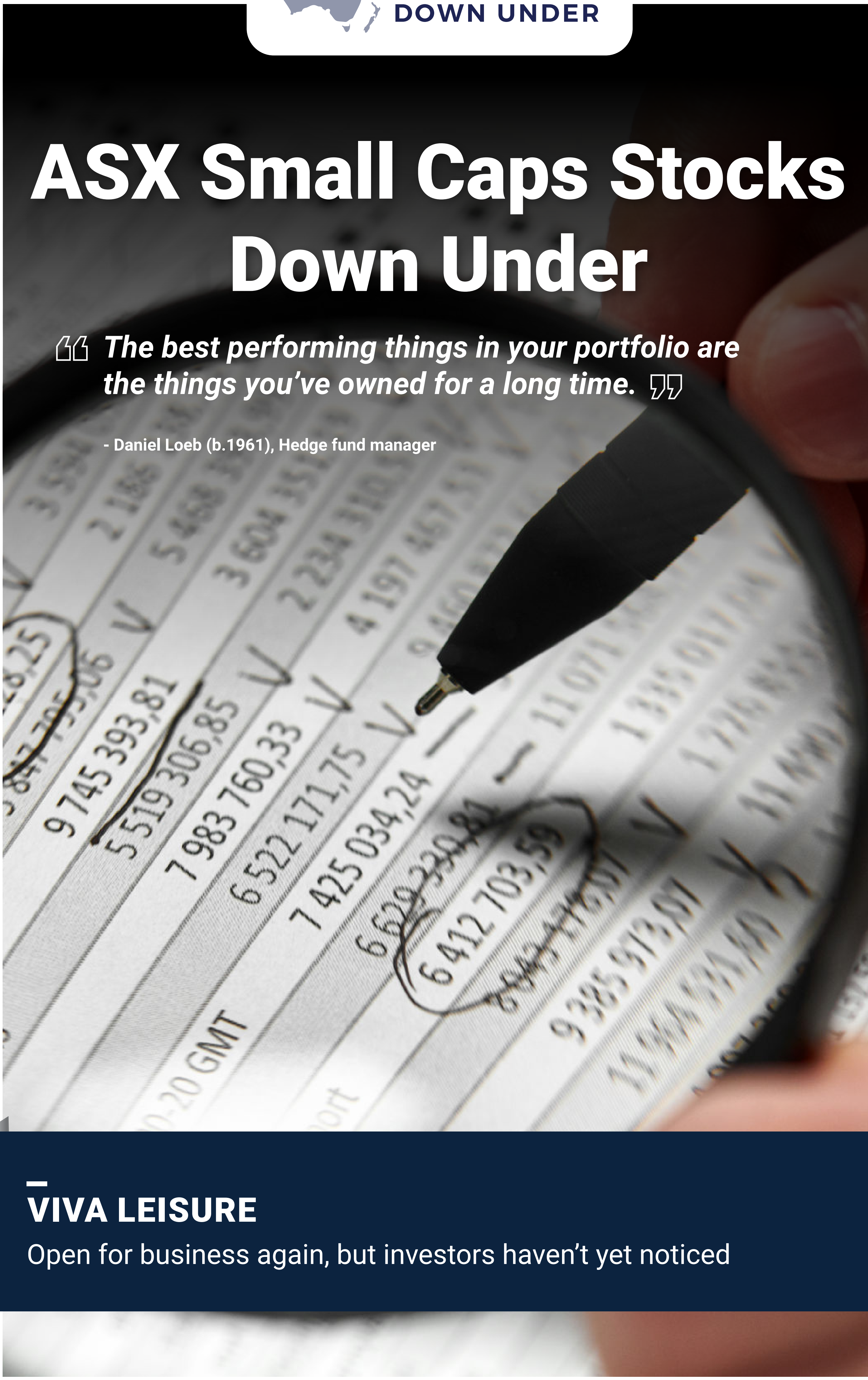
STOCKS DOWN UNDER

8 APRIL 2022

ASX Small Caps Stocks Down Under

> *The best performing things in your portfolio are the things you've owned for a long time.*
>
> **- Daniel Loeb (b.1961), Hedge fund manager**



VIVA LEISURE

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Stocks Down Under rating: ★★★★

ASX: VVA
Market cap: A$154.0M

52-week range: A$1.50 / A$2.80
Share price: A$1.70

While down over 35% in the past 12 months, Viva Leisure (ASX: VVA) is nevertheless up nearly 60% from its IPO in June 2019. At the time of its IPO, no one could have anticipated the global pandemic that would hit the world and gyms were particularly hit hard. But even though Viva's share price is well off its all-time highs, long term shareholders would still be pleased with the stock not trading below its issue price in nearly 2 years. Although the Delta lockdowns last year will drag on its FY22 results, we think the worst of COVID is behind us and the company is primed to grow in the years ahead.

Share price chart

Source: Tradingview

Viva Leisure is a gym and health club operator that was co-founded in 2004 by Harry and Angelo Konstantinou. Viva has expanded rapidly, especially since its listing in mid-2019. As of 25 March 2022, it runs 321 facilities with another 66 opening soon. It is the Master Franchisor of Plus Fitness, which it acquired the rights to in August 2020 and outright owns several other brands in multiple segments. These brands offer different target price points and facilitate different fitness activities – for instance, its Psycle Life brand caters to cycling only. Viva facilities offer 24-hour access, roaming between locations and flexible membership options to add different services. It seems this approach is paying off - Viva has over 310,000 members, including direct members and Plus Fitness franchise members.

COVID hasn't stopped a rapid period of expansion

In FY19, the last-COVID free financial year and Viva's first as a listed company, it made $33.1m in revenue and $7.3m in EBITDA. When COVID-19 hit, all its gyms were forced to close, but it activated 'at home' work-out and work-in options via apps for members at a reduced rate. It cut operating expenditures by standing down its staff and securing significant rent abatement. With the exemption of Victoria, Viva's gyms re-opened by the end of June 2020 and in FY20, it actually grew its revenue by 23.6% to $40.9m, although its EBITDA fell 17% from $7.3m to $6.1m.

Things kicked off in FY20 by Viva acquiring Australian Fitness Management (AFM), the company which held Plus Fitness, for $18m. AFM had 190 facilities in Australia as well as a handful overseas in New Zealand and India. It finished FY21 with $83.7m in revenue (up 104.8%) and $12.0m EBITDA (up 97%). Unfortunately, shares fell because its gyms in some states were forced to close due to lockdowns and there were fears of a legal stoush with a group of disgruntled franchisees. This was seen in Viva's 1HY22 results, in which the company's revenue amounted to $34m – down from $36m – and its EBITDA swung $3.8m into the red. The company guided to 2HY22 revenue of $54m-$56m and while it did not give EBITDA guidance, it tipped an EBITDA margin of 15% to 17%.

Consensus estimates are for $4.9m in EBITDA, which would be less than half of FY21 and the revenue range Viva has provided would be 33-35% down on FY21. However, in a recent trading update, Viva revealed that the 2022 calendar year had begun well, with February revenue comfortably exceeding pre-COVID levels.

A re-opening stock that's re-open already

Viva is a good example of a so-called 're-opening stock', others include travel and tourism stocks. While the travel and tourism industry isn't tipped to return to pre-COVID levels until 2024, Viva Leisure has been re-open for months. However, this has not been reflected in the share price - the company is down from $2.45 to $1.70 in the last five months.

We think investors are too pessimistic about omicron and the impact it is having on the fitness sector, including on Viva. It is correct that we will see a dent in its full year FY22 results, but as long as we do not see a worse variant of concern, the company should continue on the current upward trajectory.

Consensus estimates for FY23 are $135.9m in revenue and $27.1m in EBITDA, which would be up 62% and 126% respectively from FY21. Viva's FY23 EV/EBITDA is just 14.3x, which is quite cheap considering its forecasted EBITDA growth. Also, we will inevitably see further M&A from the company - it wants to have 400 corporate owned locations by the end of CY2025.

A tech-driven gym franchise

Viva has significant pride in the underlying technology, making it a point of difference compared to its peers. It utilises its own direct debit systems, allows its members to self-service their memberships and claims to have the 'simplest online joining system in the market'. It also makes it easy to cancel memberships, which is a good thing because ~30% of new signups are ex-users coming back. Of course, there were members who cancelled due to lockdowns but came back, yet others may want to try something else to keep fit but realise what they were giving up – they can re-join easily. Still, the company does its best to minimise cancellations through leveraging its data points. It monitors visitation patterns and usage to identify what services or equipment it needs more (or less) of at certain locations. Harry Konstantinou claimed at a Market Eye conference earlier this week that Viva could identify if a user was a cancellation risk before they knew themselves.

There are a few other unique aspects of this company that we like. One is that it has been providing bi-monthly trading updates in recent months. There are too many stocks on the ASX with solid fundamentals that are ignored or sold down by investors because they are not providing updates to shareholders – this won't happen with this company. It also has stable and regular cash flows, with 85% of its members on 14-day direct debit payment plans instead of annual upfront payments.

And finally, its management have significant skin in the game, with a shareholding of over 20%. So, it's four stars from us.

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