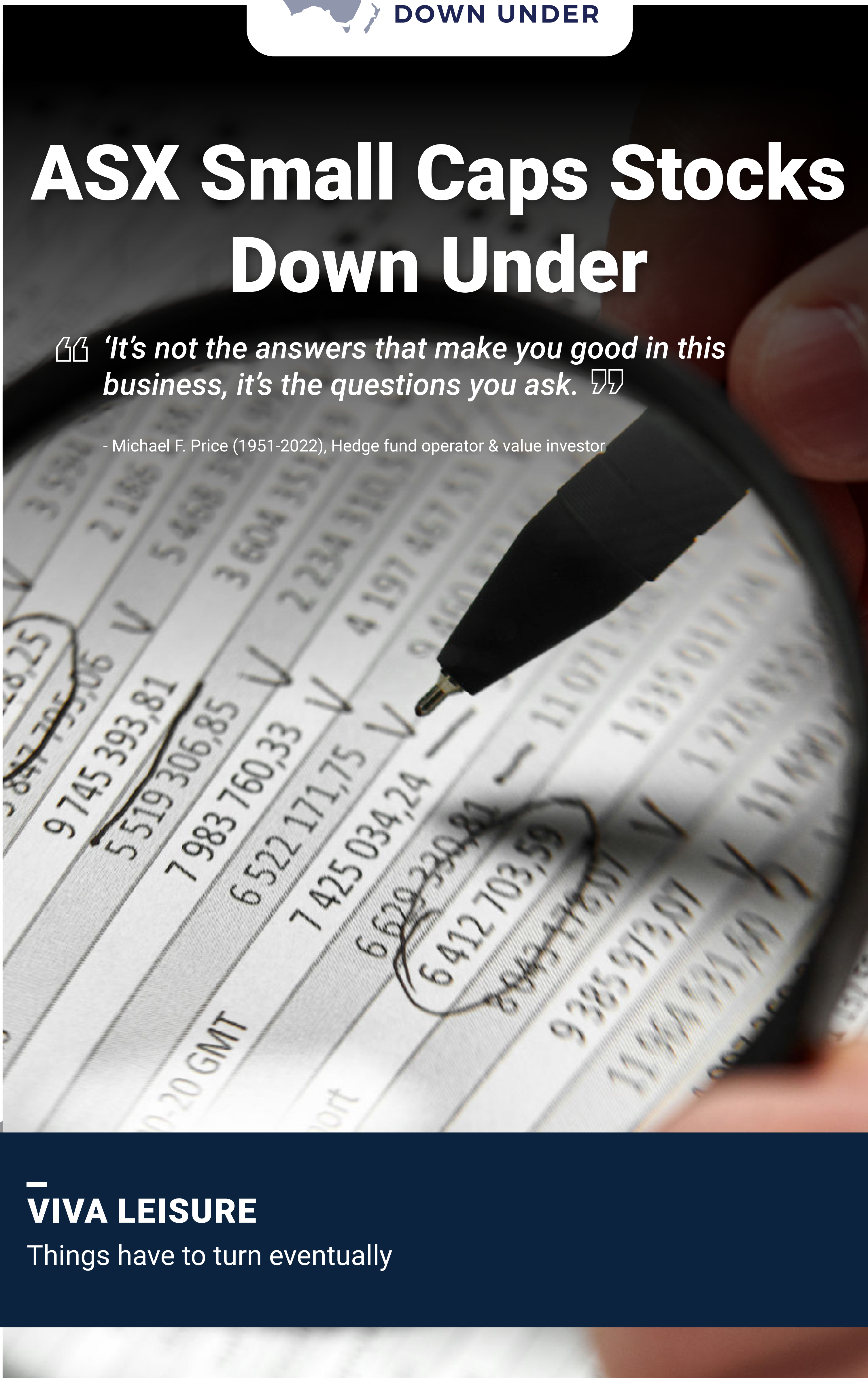
STOCKS DOWN UNDER

9 DEC 2022



ASX Small Caps Stocks Down Under

‘It’s not the answers that make you good in this business, it’s the questions you ask.

- Michael F. Price (1951-2022), Hedge fund operator & value investor

VIVA LEISURE

Things have to turn eventually

VIVA LEISURE

Things have to turn eventually

Stocks Down Under rating: ★ ★ ★ ★

ASX: VVA
Market cap: A$108.3M

52-week range: A$1.05 / A$2.33
Share price: A$1.20

If there is one company on the ASX where there is too large a gap between investor perceptions about what is happening to a company and reality – it is Viva Leisure (ASX: VVA). The fitness club franchisor has been hit by several COVID waves, although its share price has been more than its revenues. And now, investors fear that as the cost-of-living bites, gym memberships will be on the chopping block. We believe these fears have been mistaken.

Share price chart

Source: Tradingview

A track record of growth, but not without impediments

We last wrote about Viva Leisure [back in April](). To briefly recap the company, it listed in 2019 and has grown significantly since then. It is the Master Franchisor of Plus Fitness and the outright owner of several other fitness brands in multiple segments. For instance, it has clubs just for women, clubs just for cyclists, clubs just for boxers and several others. Viva has several competitive advantages, including market share, utilising data in its operations (to predict things such as when a member is at risk of cancelling) and offering members roaming between locations.

In FY22 (the 12 months to 30 June 2022), the company made $90.8m in revenue (up 8.5% from FY22) and $5.5m in EBITDA (down 55% in 12 months), although it made a $12.1m NPAT loss in FY22. Its memberships hit a record 325,000, up 28,000 in 12 months and its Annualized and Monthly Revenue Run Rates were up over 40% in 2HY22 compared to 1HY.

FY23 has begun well

Another thing to like about this company is that it provides regular trading updates. From the company's updates, we know that FY23 has begun well. Viva has provided 3 trading updates so far in FY23 with the most recent being a month ago on 7 November. It boasted 333,504 members (up ~10% in 12 months), grew its

Annualised and Monthly Revenue Run Rates by over 40% (to $138.6m and $11.8m respectively) and grew its Average Revenue Per Member by 10% to $15.23.

After not providing FY23 guidance at its FY22 results, Viva provided guidance in October. It expects $137-$140m in revenue (up 51-54%) and $28-$30m in EBITDA (up 409%). This was off the back of strong Q1 results with $33m in revenue (nearly triple the prior corresponding period) and $6.4m in EBITDA (compared with -$5.1m in 1Q22). Obviously, with FY23 being the first year since FY19 without COVID restrictions has helped. But it also dispels the myth that fitness is a discretionary expenditure.

Consensus estimates for FY23 agree, with $138.7m in revenue and $29.1m in EBITDA called for. These figures give us an EV/EBITDA multiple of 12.5x and a P/E multiple of 13.5x for FY23. Analysts also expect the company to be NPAT positive, expecting $0.12c per share. This would equate to an NPAT of ~$10.8m considering the company's ~90m shares on issue.

Transitioning to sustainable growth

Viva is one of several companies that have grown significantly through M&A activity in recent years. When Viva kicked off its IPO marketing activities in late 2018, it had 30 clubs and just 42,500 members. Today, these numbers are <10x and ~8x higher respectively. Other examples of companies in this situation include Healthia (ASX: HLA), DGL (ASX: DGL) and WiseTech (ASX: WTC). Many of these companies gained substantially in a low-interest rate and bull market environment, but have gone in the other direction as interest rates have grown.

Investors have become more attracted to companies with organic growth (that is to say growth without acquisitions) and wary of companies growing through continued M&A activity. Even if companies don't use a cent of debt and rely on equity, they are still feeling the pinch. In fact, issuing equity can be just as costly to the company given the impact of dilution and lower share prices. Of course, if companies do rely on debt – that too is obviously more expensive in a rising interest rate environment.

The challenge for Viva Leisure is to show organic growth. We think if it can achieve its guidance with limited acquisitions, then it will be re-rated. In the last quarter, it opened just four new locations, indicating it is slowing down the pace of expansion. We think shareholders can take hope from the case study of WiseTech (ASX:WTC). This company went through a period of investor skepticism about whether its growth was sustainable. But these doubts have evidently ended in recent months judging by its share price performance. We think the same may happen with Viva Leisure.

The challenge is meeting its guidance

You might argue that if Viva's turnaround was really going to happen, the share price would have gained after the company's most recent trading updates. Or alternatively, that we may need to wait until the company's next set of full-year results, not due until August next year. We think investors will begin to take notice of this company when it delivers its 1HY23 results in February next year.

Assuming that Viva can meet its guidance and that there are no more mandated closures due to COVID, there's little reason to suspect that investors will persist in their bearish sentiment on the company. Therefore, we're giving this one four stars.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

Stocks Down Under gives you an information advantage to better invest and trade in ASX-listed stocks!