GYM MARKET PERSPECTIVE

CONFIDENTIAL

Winter 2017

NB Group ("NBG") is an entrepreneurial private equity firm focused on growing small and medium sized Consumer & Retail businesses in North America

NBG offers a unique entrepreneurial approach to private equity

1. **Business Partners:** Our principals have a mix of operational, investing, and consulting experience with both small and large companies. We draw on this experience to add value to our companies, but do *not* involve ourselves in day-to-day operations.

2. **Limited Portfolio**: unlike larger firms with a dozen or more investments, we are intentionally keeping our portfolio small so that we can focus on adding value to each of our companies.

3. **Small Team:** many firms have large teams with layers of analysts, VPs, and Partners. Our team is small, enabling quick decisions and ensuring that you are only dealing with decision makers.

4. **Customized Transactions:** we work patiently to customize a transaction to fit your objectives as a manager/owner, whether it is exiting the business or partnering for future growth. We don’t have a fixed structure for investments.

5. **Industry Knowledge:** we have deep investment and operating experience in the Telecom & Technology space that we can use to accelerate the businesses we invest in.

6. **Growth Focus:** unlike many private equity firms that try to make money through financial engineering or cost cutting, we aim to generate most of our investment returns through business growth.

NBG Core Team: mix of investing, consulting, and company building

NEEL BHARGAVA | Partner

Founder, NB Advisory
Corporate development for high-growth companies

Private Equity, Berkshire Partners
Top quartile firm with retail/consumer focus

Board Observer, Party City
$1.5 billion retail company, pre-IPO

Rocket Internet
Launched largest active venture in India

Consultant, Bain & Co.
Focus on private equity diligence

Education
MBA, Harvard Business School
BBA, University of Michigan

ARIEZ DUSTOOR | Partner

Co-Founder, Scout Finance
Venture capital-backed software company, acquired 2017

Private Equity, Audax Group
Top middle market firm specializing in add-on acquisition strategies

Corporate Development, Yahoo!
M&A and investments globally

Rocket Internet
Global technology holding company

Consultant, McKinsey & Company
Strategy, operational efficiency, and M&A

Education
BA, University of Michigan, Phi Beta Kappa

There is a compelling opportunity to invest in the low cost gym space and build an industry-leading company

After extensive research and analysis of Fitness space, have concluded that gyms are an attractive and underappreciated long-term investment

Gyms are a stable cash flow generating asset with high return on capital and reasonable valuations

Structural changes in industry are leading to shift toward low-cost formats. Planet Fitness is major winner so far in this segment, but no clear #2 yet. Planet's format limits its appeal

Industry still remains highly fragmented with varying levels of performance: ability to consolidate and drive operational improvement

Opportunity to partner with a great operator with an existing footprint to create a large scale #2 low cost player in the next 5 years

Focus on gyms is a result of a thematic investment approach centered on health and wellness

Health & Wellness is one of the major economic themes of next 20 years – and a personal passion.

We started a deep dive into macro and micro trends in Health & Wellness space earlier this year to identify most attractive areas for investment.

Key Evaluation Criteria

BUSINESS MODEL

- High margin, recurring revenue
- Attractive payback period
- Limited obsolescence/fad risk
- Strong downside protection

INDUSTRY

- Growing market with long-term macro tailwinds
- Low cyclicality
- Opportunity for value addition in strategy, finance, operations
- Fragmented market

TRANSACTION

- Reasonable acquisition multiples
- Attractive debt financing if appropriate
- Availability of deals to grow platform through M&A

Looked at several categories including Healthy Fast Casual, Massage, Boutique Fitness, Gyms

Narrowed scope to brick-and-mortar fitness industry

In-depth research conducted over the past four months

Extensive secondary research, including review of SEC filings, buy side research, industry white papers, trade publications, and franchise disclosure documents

One-on-one interviews with over 30 owner-operators, investors active in the space, and franchisors

Visits to industry tradeshows, franchise discovery days, and multiple gym concepts

Proprietary data analysis (e.g. analysis of Yelp review trends)

Discussions with the **top intermediaries** in the space

Research Output

Financial modeling of various concepts, investment strategies, and upside/downside scenarios

Development a proprietary database of investment targets

Comparative analysis of club-level P&Ls and operating metrics

Diligence on seven potential investments to date (ongoing)

Conclusions

Low-cost segment of market will account for majority of new growth & gain share

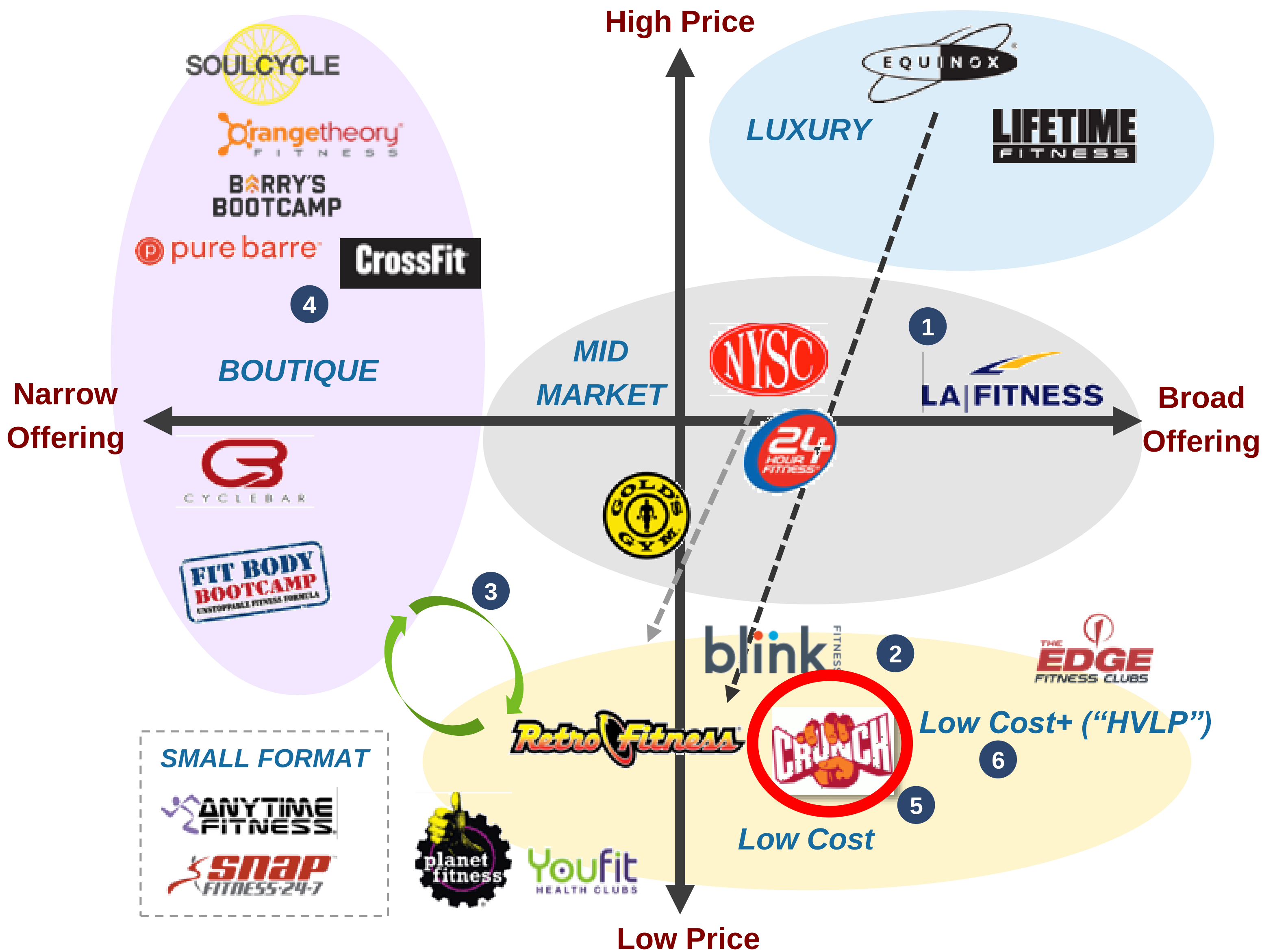
Market trends + financial profile = attractive investment strategy to acquire gyms

Goal: identify an attractive platform acquisition to enter the industry

The “high value, low price” (“HVLP”) gym industry represents an attractive investment area

#	Industry Characteristics	Description
1	**High margin with recurring cash flow generation**	▪ Majority of revenue is recurring and auto-drafted from customer bank accounts ▪ Mature 25k square foot box can generate $350-700k+ annual free cash flow
2	**Attractive ROIC**	▪ 25-35% cash-on-cash returns on new builds when built properly
3	**Positive macro trends lead to long runway for growth**	▪ Massive growth in consumer awareness around health and wellness ▪ Very low penetration (80% of Americans have never belonged to gym)
4	**Stable, growing industry with low cyclicality**	▪ 5.2% market revenue growth 2000-13 (CAGR), steady during recession ▪ Potential to gain share during economic downturns
5	**Highly fragmented industry ripe for consolidation**	▪ Significant fragmentation, top 13 gym chains account for <25% of locations
6	**Attractive acquisition multiples, debt financing, and multiple arbitrage opportunities**	▪ Multiples typically range between 4 to 8x EBITDA, increasing with scale ▪ Many local operators underperforming due to lack of club management skills, underperformers can be turned around quickly

Gym industry moving toward low-cost formats

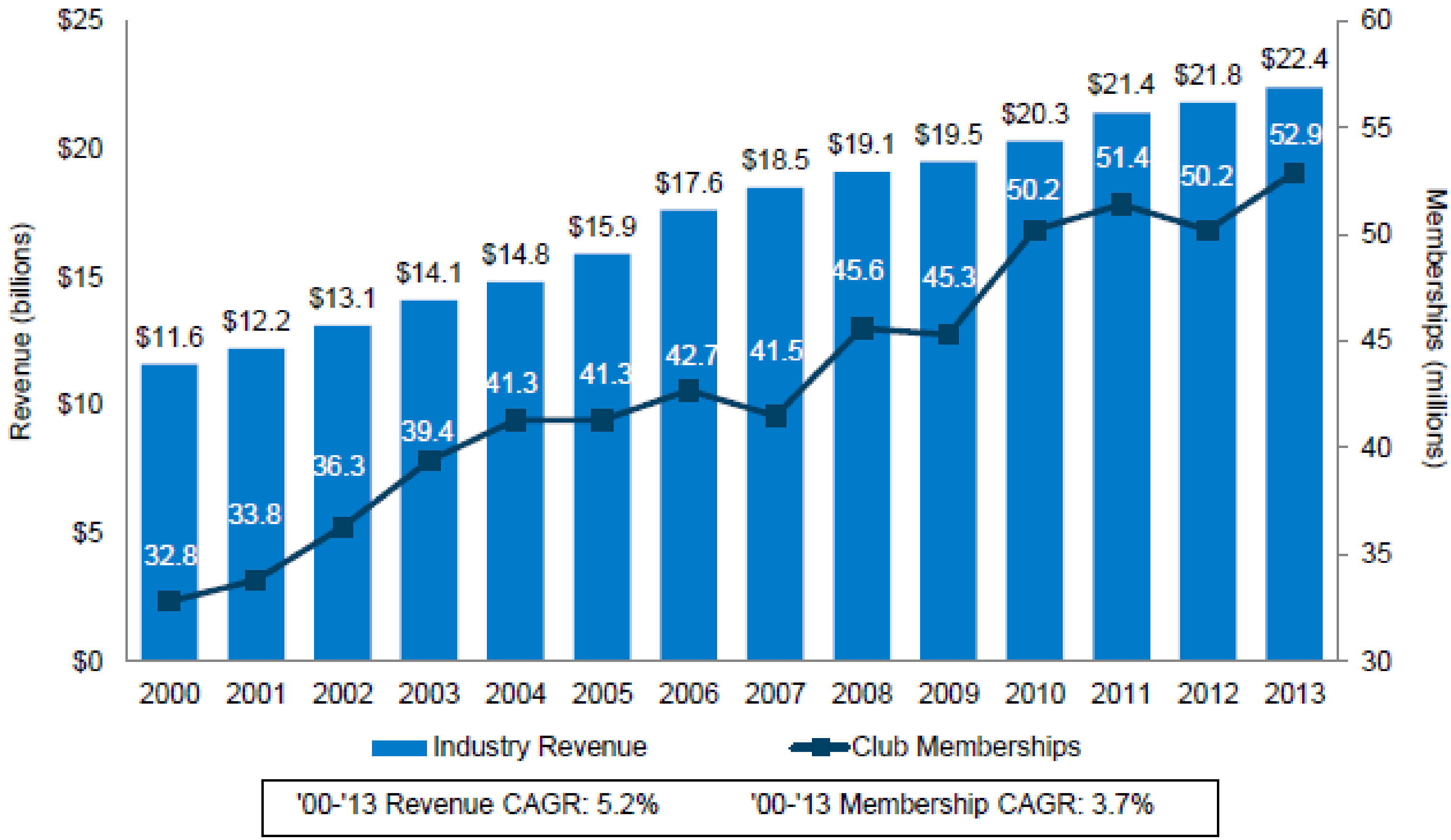


Key Themes

1. Mid-market format increasingly challenged, getting squeezed from all sides
2. Market is converging on the low cost segment
   - Town Sports attempt and pull back converting clubs to HVLP
   - Equinox launched Blink in 2011
   - Crunch operates flagship corporate clubs in NYC, HVLP franchised clubs elsewhere
3. Boutique segment gaining share, but is more a complement than substitute for gyms, particularly low cost gyms. 90% of studio members also belong to a gym (IHRSA).
4. Staying power of boutique concepts remains to be seen, some are fads.
5. Low cost segment, brought to scale by Planet Fitness (~1100 clubs), represents the most resilient and attractive format today
6. Emerging sub-segment of "high value low price" w/ $10 entry point + added fees for additional services

Source: NBG analysis

Fitness industry has grown members, revenue, and average revenue per user ("ARPU") for 15 years, low cyclicality



Source: William Blair

Gym membership is large and growing, but still only ~20% of US population has a membership

Health & Fitness Industry: United States															
	In Millions	Revenue	Y/Y % Change	Members	Y/Y % Change	Gyms	Y/Y % Change	Member per Gym	Y/Y % Change	Population (14 & Older)	Y/Y % Change	Members as % of Population	Revenue per Member	Y/Y % Change
1	2000	$11,600	na	32.8	na	na	na	na	na	225.9	na	14.5%	$354	na
2	2001	$12,200	5.2%	33.8	3.0%	na	na	na	na	228.6	1.2%	14.8%	$361	2.1%
3	2002	$13,100	7.4%	36.3	7.4%	na	na	na	na	231.2	1.1%	15.7%	$361	(0.0%)
4	2003	$14,100	7.6%	39.4	8.5%	na	na	na	na	233.7	1.1%	16.9%	$358	(0.8%)
5	2004	$14,800	5.0%	41.3	4.8%	na	na	na	na	236.6	1.2%	17.5%	$358	0.1%
6	2005	$15,900	7.4%	41.3	0.0%	na	na	na	na	239.4	1.2%	17.3%	$385	7.4%
7	2006	$17,600	10.7%	42.7	3.4%	na	na	na	na	242.2	1.2%	17.6%	$412	7.1%
8	2007	$18,500	5.1%	46.7	9.4%	na	na	na	na	244.8	1.1%	19.1%	$396	(3.9%)
9	2008	$19,100	3.2%	45.5	(2.6%)	30,022	na	1,516	na	247.4	1.1%	18.4%	$420	6.0%
10	2009	$19,500	2.1%	45.4	(0.2%)	29,750	(0.9%)	1,526	0.7%	249.9	1.0%	18.2%	$430	2.3%
11	2010	$20,300	4.1%	50.1	10.4%	29,890	0.5%	1,676	9.8%	252.3	1.0%	19.9%	$405	(5.7%)
12	2011	$21,400	5.4%	51.4	2.6%	29,960	0.2%	1,716	2.4%	254.5	0.9%	20.2%	$416	2.8%
13	2012	$21,800	1.9%	50.2	(2.3%)	30,500	1.8%	1,646	(4.1%)	256.9	0.9%	19.5%	$434	4.3%
14	2013	$22,400	2.8%	52.9	5.4%	32,150	5.4%	1,645	(0.0%)	259.2	0.9%	20.4%	$423	(2.5%)
15	2014	$24,200	8.0%	54.0	2.1%	34,460	7.2%	1,567	(4.8%)	261.5	0.9%	20.6%	$448	5.8%
	5-Year CAGR		4.4%		3.6%		3.0%							1.5%

Low cost format offers most attractive entry point for first time gym-goers

Source: IHRSA and Guggenheim Securities

Gym sector has challenges, but they can be mitigated

	Challenge	Our view and mitigants
1	**Organic growth** levers are limited as membership reaches maturity in year 3-4	▪ ARPU growth via ancillary fees, mix shift, and retail/ merchandise can deliver low single digit annual growth ▪ *Planet Fitness increased "Black Card" membership from 38% to 55% of members between 2010-2014*
2	Low switching costs and limited differentiation challenge **defensibility**	▪ Customer churn is intrinsic to industry, but can be managed through strong club-level management, marketing, and not skimping on maintenance capex ▪ *"You've got to maintain the place, but it doesn't take much – keep the paint fresh, add a few new pieces of equipment every 6 months" – Retro fitness franchisee*
3	**Consumer preferences** are always evolving, leading to various formats going in and out of favor	▪ The basic gym format has been around for decades and consumer tastes can be accommodated by supplementing core offering (e.g. introducing functional training area, new classes) ▪ Keeping systems relatively small allows you to be nimble ▪ *While specialty concepts like Zumba or Curves go in and out of favor, gyms have grown at remarkably consistent rate for 20 years*

Get in touch

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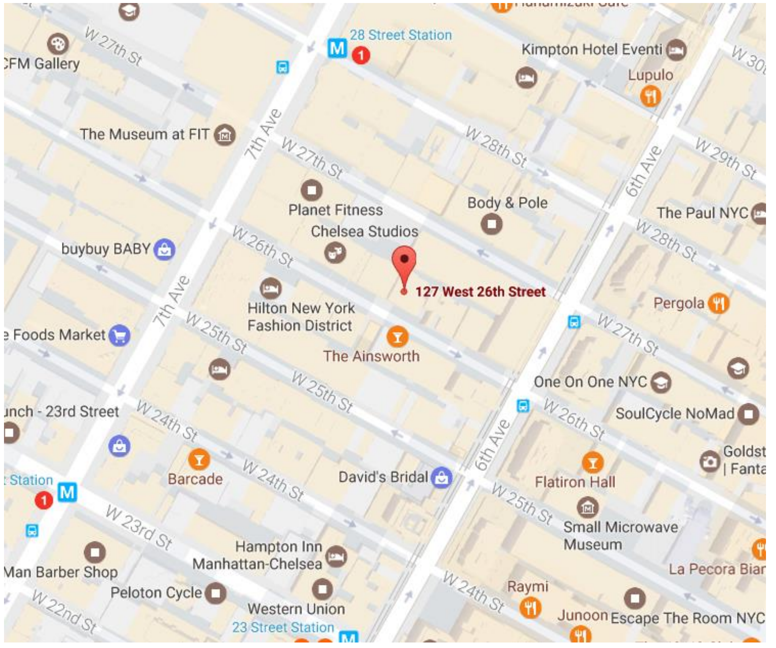
Location



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