AUGUST 2016

CLUB BUSINESS INTERNATIONAL

Wellness Champion

NERIO ALESSANDRI, THE CEO OF TECHNOGYM, HAS MADE A MAJOR CONTRIBUTION TO THIS MONTH'S OLYMPIC GAMES IN RIO DE JANEIRO

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NEW EQUIPMENT: When Should You Buy It?

Recently, Brent Darden, an accomplished and wide-ranging industry veteran who now heads up Brent Darden Consulting, based in Dallas–Fort Worth, was asked to help the leadership team of a hospital-based wellness center in Texas.

"They were struggling to 'speak the language' of hospital administrators, including the chief financial officer, who were unfamiliar with fitness facility operations," he explains. "Essentially, the client was seeking rational and substantiated justification for the purchase of new exercise equipment."

The following is the report that Darden produced for the center, which serves some 5,200 members.

The result: "The client stated the report was 'absolutely instrumental' in the approval of their purchase of new equipment," says Darden. "In addition, it's set the stage for significant future purchases as part of the annual capital expenditure plan."

Darden also is a past chairman of IHRSA's board of directors.

By Brent Darden

The decision to spend money, or "reinvest," in updated facilities or new exercise equipment is never an easy one. Typically, membership prospects expect it, members request it, staff push for it, and investors/owners often resist it. Further, when is the right time to make such reinvestments?

Perhaps most importantly, will the improvements generate more revenue or a return on investment (ROI)?

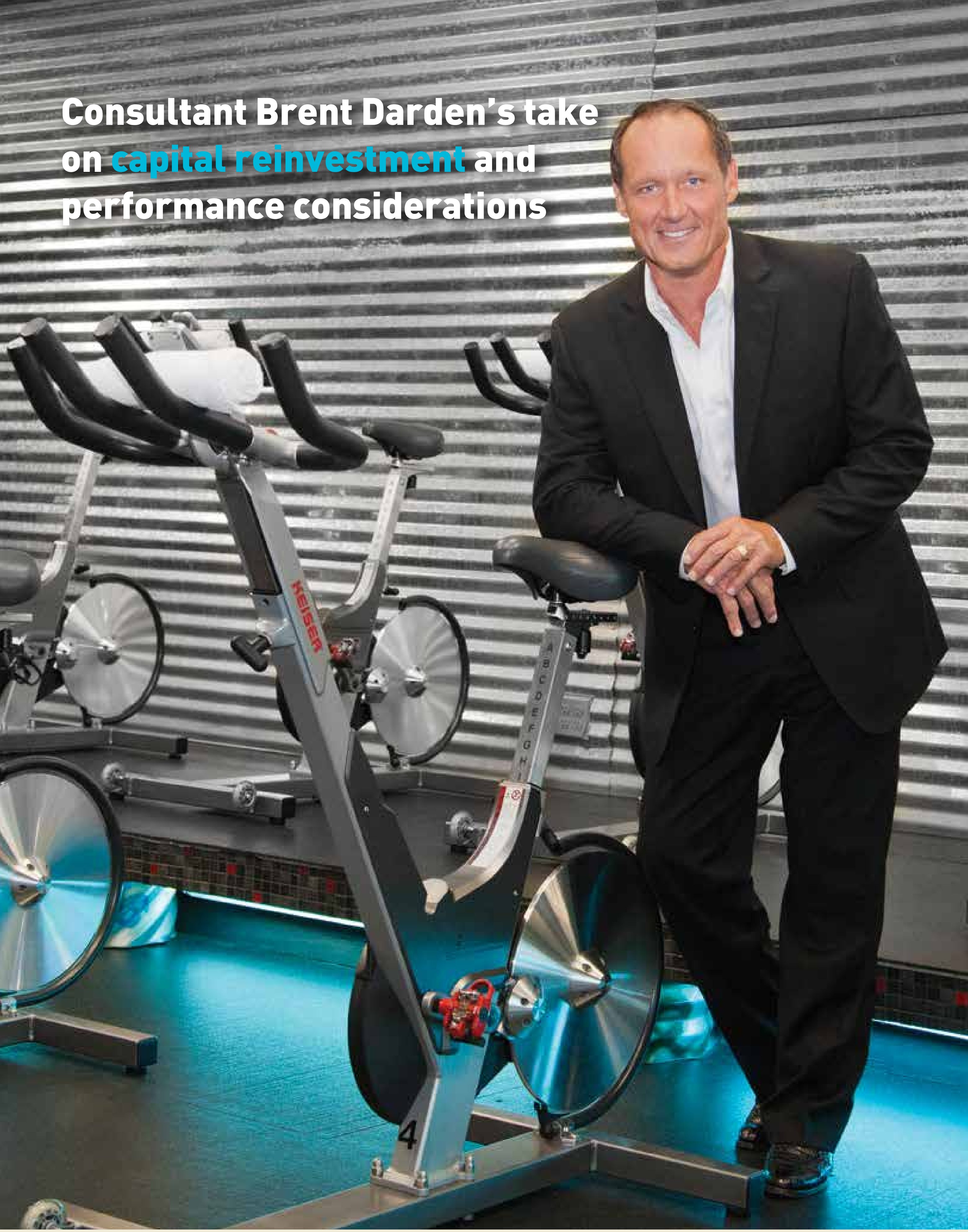
Change is rampant in the health and fitness industry. Today, it continues to show signs of reaching maturity, and diversification is evident on all fronts. There's prolific competition in virtually every market segment—"big box" clubs, boutiques, specialty studios, CrossFit gyms, budget clubs, corporate facilities, hospital entities, online workout programs, etc.

Quite simply, the challenge to retain and attract members has never been greater, and organizations that want to be relevant into the foreseeable future must be committed to a path of continual improvement. Facilities, programming, services, and equipment have to evolve and present a fresh value proposition to survive.

Achieving differentiation in a crowded market is critical to success. As the centerpiece of health and fitness centers, one of the most recognized points of differentiation is a facility's design and its offerings, whether one's talking about multipurpose, fitness-only, aquatics, tennis, movement, or small-group →

Alayna MacPherson

Consultant Brent Darden's take on capital reinvestment and performance considerations



training operations. Consumers also demand and expect quality exercise equipment that's current, offers variety, is plentiful, includes the latest entertainment features, and, of course, is in working order at all times.

Thoughtful discussions regarding possible upgrades in these two areas—differentiation and consumer demand—should be undertaken regularly, as they likely offer a reasonable ROI.

Outlined below are some considerations that may be useful during planning and discussions:

• When did the most recent significant investment in new exercise equipment—not just a few replacement pieces—take place?

• Would a walk-through of all exercise equipment areas reveal any noticeably outdated equipment? Although most strength equipment can last a lifetime—it *shouldn't*. The condition of equipment speaks volumes about the tired/outdated status of the overall facility.

• How much is the club currently spending, per month, on the repair and essential maintenance of older exercise equipment, particularly its cardiovascular pieces? Are there cardiovascular units that are seemingly "out of order" on a consistent basis, even if they're being repaired immediately?

• Adopting a strategy of replacing a few pieces of exercise equipment at a time—usually cardio selections—is important to ongoing customer satisfaction and member retention. This approach generates goodwill within the member community, and sends a consistent message to users that "their" club is constantly reinvesting in the product offering. However, although this "benefit drip" helps retain existing members, it does little, if anything, to attract new ones or to maintain a competitive advantage in the marketplace. It should be augmented periodically with a major/noticeable equipment rejuvenation that produces a "wow" factor.

• Evaluating the "highest and best use" of available space in a facility should be an ongoing endeavor, and informed by proven industry standards. Analyzing usage patterns, capacity metrics, revenue generated per square foot, opportunity costs, and fit with the chosen value proposition, should all be considered.

Strength: When to buy?

• In recent years, there's been a renewed focus on customer/member satisfaction by most health and fitness businesses. Driven by the expansive proliferation of exercise options available to consumers, leading facilities are measuring and evaluating their customer service performance like never before.

- Listen360 is a preferred vendor in the fitness industry that provides net promoter score (NPS) customer feedback management survey services and analysis. They've found the following items (see chart) are what loyal members care about most. Conversely, an analysis of the top reasons "detractors" give for dissatisfaction includes "poor or broken equipment" at No. 2.

5 Things Loyal Members Care About Most

1.	Friendly staff/trainers/instructors
2.	Plenty of good, quality equipment
3.	Variety and schedule of classes/programs
4.	Clean facility
5.	Good customer service

- In a recent *IHRSA Trend Report,* health club members across the U.S. were asked, "What keeps you coming back to the health club you currently belong to?" The fourth most frequent response was "the variety of strength and cardiovascular equipment."

- Medallia is another preferred industry vendor that provides NPS programs and analysis. Study of their collective facility subscriber data reveals there's a significant improvement in net promoter scores, which reflect overall customer satisfaction, immediately following reinvestment in the facility and/or exercise equipment.

• According to *The IHRSA Health Club Business Handbook,* a distinction must be made between "repairs and maintenance," which is an ongoing, month-in, month-out, operating expense at every facility, and "maintenance capex," which involves essential replacements of physical assets. The former appears on the income statement; the latter appears on the balance sheet. It's recommended that annual maintenance capex be set at approximately 4% of revenue or $4 per square foot.

In addition, at least once every five years, a facility will need to spend approximately 10% of revenue to make market-driven improvements, such as acquiring the latest exercise equipment, updated locker rooms, a new small-group training studio, or dedicated performance-programming space.


Cardio:
How much to buy?


Variety:
What to buy?

Then, once every 10 years, most facilities will require a total overhaul/reconfiguration if they wish to maintain market momentum and remain competitive. This once-a-decade, total-facility renewal can cost 20%–30% of sales.

Thus, over a 10-year period, total capex—i.e. maintenance capex plus improvement capex—will often, if computed on a straight-line basis, require a budget allocation of at least 6% per year.

• Research reported in *IHRSA's 2015 Profiles of Success: The Annual Industry Data Survey of the Health and Fitness Industry* found that "Investing in capital expenditures not only maintains the club; it can contribute to an increase in revenues and the bottom line." In addition, "The upper-quartile of health and fitness centers that spent more on reinvestment reported significantly greater pretax earnings, as a percent of total revenue, and reported a much higher increase in revenues." (See chart.) More detailed spending analysis, broken out by club type and size, is available in *Profiles*.

• To offset the costs of reinvestment, as well as ever-rising operating expenses, most leading facilities have developed a practice of increasing monthly dues on an annual basis. Typically, these modest increases are 2%–3% of the current dues rate.

• During the last decade, many health and fitness facilities have effectively adopted an idea common in country clubs, which is to levee an "annual assessment improvement fee." Essentially a one-time annual fee, collected with the express purpose of reinvesting in the facilities and equipment, these monies are used to make upgrades/new purchases. The objective is clearly communicated to the general membership.

• The worldwide members of REX Executive Roundtable, representing over 5,000 health and fitness facilities, meet regularly to collectively share best business practices. Many have successfully collected member annual assessment fees ranging from $19 to $59, with an average charge of $29.

Reinvestment in equipment and facilities is an absolute necessity in the health and fitness business. The exercise environment we live in continues to be so dynamic and fluid that productive changes have to be taking place constantly.

Think about it. Just a few years ago, there were no CrossFit gyms, cycling and barre studios, Orangetheory facilities, budget clubs (e.g., Planet, Anytime, Snap), or online group classes offering all modalities. If maintaining a prominent position in the community of health-conscious consumers is part of an organization's vision, providing a quality product is paramount.

Shift happens …

…but the response is what matters! ⊣

– Brent Darden, brent@brentdarden.com

Reinvestment & Performance	Top 25%	Middle 50%	Bottom 25%
Total Spending as % of Revenue	14.4%	5.7%	1.6%
Revenue Growth	14.5%	4.5%	2.5%
Net Membership Growth	7.1%	4.9%	2.5%
Rate of Member Retention	70%	69.5%	69.6%
EBITDA as % of Revenue	20.5%	14.9%	10.2%
Pretax Earnings as % of Revenue	8.9%	7.0%	5.4%

EQUIPMENT INSIGHTS

A new publication, the *IHRSA Health Club Equipment Report: Spending, Utilization, and Programming Trends*, sponsored by Precor, Inc., contains the most accurate, complete, and up-to-date equipment-related data in the club industry. This comprehensive guide, released in June, allows a company to easily compare its equipment inventory, purchasing, and replacement cycles with those of other facilities. Now available for purchase at ihrsa.org/research-reports. ⊣