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Opportunities for growth in the European health and fitness sector

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Abstract

This paper examines whether there are still opportunities left in the UK health and fitness market given the significant growth in recent years. Or are the key opportunities now in continental Europe, where the market is considered to be less mature than that of the UK? Are the key opportunities in organic growth or in consolidation? These issues are considered for both the UK and continental European markets.

INTRODUCTION

It is generally believed among health and fitness operators that the market in the USA is some five years ahead of the UK sector, which in turn is some five years ahead of the continental European health and fitness industry.

Both the US and UK health and fitness industries have experienced phenomenal growth rates in the five years to 2000. The UK market has grown by over 80 per cent to a current market value of around £1.25bn. The more mature US health and fitness sector has grown by 45 per cent in the same period to a market value of over £6.6bn.

The UK sector has evolved from an industry overshadowed by other hospitality/leisure markets to one of primary importance. This has fuelled continued interest in the sector in the UK which has now spread to continental Europe.

But are there still opportunities in a market which has grown so significantly in recent years? Or are the key opportunities in continental Europe, where the market is thought to be less mature than that of the UK? Are the key opportunities in organic growth or in consolidation? These issues are considered for both the UK and continental European markets.

THE UK MARKET

It is estimated that there are some 2,500¹ private health and fitness clubs in the UK. This represents a growth of 24 per cent over 1994, when there were just over 2,000 clubs.

The industry is still fragmented with over 70 per cent² of clubs being operated by small companies, the majority of which have one or two clubs. There are around 40 companies with multi-site operations accounting for just under 680³ clubs. While these 40

Significant market growth

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Statistics

companies have only 30 per cent of the market in terms of number of clubs, they have over 50 per cent of the membership. The growth in the overall UK market in recent years has come from these larger companies, which have undergone organic growth in targeted areas.

It is estimated that there are currently some 2.44 million⁴ members of private health clubs representing a penetration of 4.1 per cent of the population (5.1 per cent of the adult population).

Saturation?

Research undertaken by Deloitte & Touche and confirmed by Mintel⁵ suggests that operators do not believe the UK health and fitness market has yet reached saturation point. 'Club operators . . . are of the belief that market saturation is three–five years away, although this situation will be reached in some sectors of the market (such as large health and rackets clubs) before others.'⁶ There are still a number of areas (secondary towns or sites on key arterial routes easily accessible to main cities/towns) which have development potential. The opportunities at some of these might be of varying scales.

Opportunities still exist

Some of the smaller operators have gone out of business as they have found it difficult to compete against the larger operators. These larger competitors offer:

- larger clubs with a wide range of facilities;
- more sophisticated/up-to-date equipment;
- often at similar/only marginally higher prices than the smaller clubs;
- brand awareness (and therefore a perception of certain minimum standards and facilities);
- significant marketing economies of scale.

The closures of smaller clubs have in certain cases created or extended the opportunities for the larger corporate operators.

Determining at which point saturation has been or will be reached is clearly tricky. The current consensus among operators, however, is that the UK has not reached saturation, and indeed penetration levels (discussed later) are still below those of a number of countries, most notably the USA.

Consolidation

In a highly fragmented market, beginning to reach maturity, the key opportunity for the corporate players is that of consolidation. This trend has already begun, with major transactions during 1998 and 1999 reaching £234m, as shown in Table 1.

Maturity

The most acquisitive corporate has been the Cannons Group plc (formerly Vardon plc) which was responsible for nearly 50 per cent of the major transactions during 1998 and 1999 in terms of value at £114m, and 14 of the 36 clubs which changed hands.

The opportunity is more evident with an analysis of the current price-to-earnings (P/E) multiples of the quoted companies (Table 2).

Table 1: Recent acquisitions of health and fitness clubs

Acquirer	Acquired	Date	No. of clubs	Total price £m	Price per club £m
Whitbread plc	Racquets & Healthtrack Group	Sept. 1999	6	78.3	13.05
Cannons Group plc	Pinnacle Leisure Ltd	May 1999	10	63	6.3
	Club Athletica Worcester Ltd	Aug. 1998	1	3.2	3.2
	Harbour Club	Aug. 1998	1	22.4	22.4
	Cannons Sports and Leisure Ltd	June 1998	<u>2</u>	<u>25.4</u>	<u>12.7</u>
			14	114.0	8.1
Livingwell Health & Leisure	Viva Health & Leisure Clubs Ltd	April 1999	5	24.2	4.84
Holmes Place	Broadgate Club plc	Oct. 1998	2	4.7	2.35
	Aphronis Ltd	Sept. 1998	<u>2</u>	<u>4.2</u>	<u>2.1</u>
			4	14.9	3.7
Dragons Health Clubs plc	Crockfords Health Club	Oct. 1998	1	1	1
Lady in Leisure	Curves & Co	May 1998	6	1.55	0.26
Total			36	£233.95	£6.5

Source: CorpFin+

There are currently eight companies listed on the London Stock Exchange (LSE) which operate health and fitness clubs. Of these, five operate solely in the health and fitness market. The other three companies also own other subsidiaries such as hotels and restaurants. In addition to those companies quoted on the LSE, there are three health club operators (Lady in Leisure, Dragons and Topnotch Health Clubs) which are listed on the Alternative Investment Market (AIM).⁷

There is a large difference in the P/E multiples of the quoted health club companies — ranging from nine to as high as 87. These are much higher figures than the typical leisure, entertainment and hotel multiples which generally lie between ten and 30, with the exception of certain hotel stocks which are below this range and football club stocks which are above this range.

Table 2: Price-to-earnings multiples

	No. of clubs ⁸	Turnover £m ⁹	P/E ¹⁰	Net assets (£m) ¹¹	Return on investment ¹²
Cannons Group	51	69.1	19.4	138.4	8.2%
Holmes Place	53	61.4	35.8	77.6	13.8%
Fitness First	65	27.2	87.3	73.1	9.0%
Dragons	13	9.9	19.8	16.4	9.1%
LA Fitness	15	8.5	N/A	4.6	19.8%
Lady in Leisure	22	7.5	9.2	2.0	9.0%

There are generally two main reasons for high P/E ratios:

- companies operating in high-risk industries tend to have relatively high P/E ratios as the market requires higher than average compensation for the inherent risk
- companies with high growth expectations; current prices often reflect future earnings potential.

The key reason for the high multiples in the UK health and fitness sector are mainly a result of the latter — high growth expectations for the following reasons:

High P/E ratios

- Due to the high levels of expansion, many of the clubs are in the process of growing profits. Once the profitability levels of the clubs have stabilised, the P/E ratios are likely to reduce. The P/E reflects the expected growth in additional profitability;
- Since the market is highly fragmented, there are still many opportunities for consolidation and therefore additional growth. The theory being that companies with high P/E ratios can take over companies with lower P/E ratios and apply their product proposition/brand and marketing muscle to the latter company. The effect being that the P/E ratio of the combined larger company rises to the level of the former company;
- While there are increasingly limited opportunities for organic expansion, as prime sites are now limited in the UK, there is huge potential for development of health and fitness facilities throughout continental Europe. The larger corporates have already made an entry into Europe;
- The likely economies of scale that these companies will benefit from as a result of further expansion is also built into the current P/E ratios; and health and fitness stocks have been popular recently, which has driven the price up, regardless of some of the underlying fundamentals.

The opportunities for UK operators can therefore be summarised as follows:

Future market growth

- Development opportunities in the UK:
 - there are few remaining large sites in prime catchment areas;
 - there are still areas where the development of smaller health and fitness facilities may be appropriate;
 - thus the UK market is thought to be between three to five years away from saturation.
- Consolidation in the UK:
 - the market is highly fragmented. Consolidation in the UK is a major opportunity.
- Continental Europe:
 - continental Europe appears to offer the best organic growth prospects (as discussed below).

THE CONTINENTAL EUROPEAN MARKET

There is a consensus among operators and analysts that the health and fitness industry in continental Europe will provide considerable opportunities over the next five or more years.

What is currently available in continental Europe? Who are the main players? Why does an opportunity exist?

Limited offer

Current product offering

While research shows that there are plenty of clubs on the continent, the majority of facilities are relatively unsophisticated compared to facilities offered in the UK or USA. Most clubs are small, body-building gyms with no other facilities such as:

- swimming pools;
- comprehensive food and beverage facilities;
- creches;
- beauty and pampering facilities, etc.

Operators

The majority of clubs tend to be independently owned and operated. Those multi-site facilities which did exist, and were available for acquisition, to a large extent, have been acquired.

Hot spots

There are a number of overseas operators who have already established a foothold in continental Europe, some are rapidly building chains. Fitness Holdings has developed a business of around 80 clubs, largely in Scandinavia, through acquisition. Fitness First has acquired a German company and one in Belgium. Using the acquisitions as an entry point, these companies are now building through organic growth. Otherwise, the expansion throughout continental Europe by overseas operators has not been through acquisition, but organic growth and joint ventures (Table 3).

Deloitte & Touche has been particularly active in finding strategic partners and investors as well as potential acquisitions in Germany, Scandinavia, France, Portugal, Belgium, Holland and Spain. The company's experience shows that all major UK health and fitness operators are actively seeking potential opportunities in Europe.

The key reasons for the expansion into continental Europe are:

- there are few existing large, sophisticated corporates in the

Table 3: Continental development

Health club operator	Developed/developing in:
Holmes Place	Portugal, Spain, Switzerland
Cannons	Holland
Champneys	Belgium

Source: Deloitte & Touche research

health & fitness industry in continental Europe, thus the UK offering would appear to be desirable compared to the incumbent competition;

- sporting preferences in some European countries, particularly northern ones, are similar to those in the UK;
- there is a long-established spa culture.

Together, these provide a major opportunity for UK/overseas operators to take the market in continental Europe a ‘step up’.

‘There’s an enormous opportunity in Europe’, says Allan Fischer of Holmes Place. Harm Tegelaars of Cannons agrees ‘with 385 million people, Eastern Europe becoming increasingly part of Europe, with the right location and right product at the right price, there are huge opportunities’.¹³ ‘The strong growth seen in the fitness industry has continued into 2000 and we remain optimistic about the prospects for rolling-out our “Affordable Fitness” concept across Europe’, according to Fitness First’s managing director Mike Balfour.

WHY DOES AN OPPORTUNITY IN CONTINENTAL EUROPE EXIST?

The level of demand for health and fitness facilities is dependent upon the number of potential buyers (population within a certain distance from the club itself), their ability and propensity to spend on leisure overall, and health and fitness in particular, and the existing competition. These issues are explored below.

Market size and density

Figure 1 compares the population size and density of the major European countries. The largest markets by population in Europe are Germany, the UK, France and Italy. The high population density of the Netherlands, Belgium and Switzerland may also provide some attractive opportunities.

Source: Deloitte & Touche research/Euromonitor

Figure 1: Population size and density

Consumer expenditure

Figure 2 compares the GDP per capita available to spend on leisure. Some of the largest and most densely populated European markets also exhibit the highest levels of consumer expenditure on 'leisure and education'. These countries include Germany, Switzerland, Belgium, the UK and the Netherlands.

Incumbent competition

Germany and Italy have the highest number of health and fitness clubs in Europe with around 6,000 clubs each. They are followed by France and the UK with around 2,500 clubs each. It is estimated that there are some 2,000 clubs in Spain, 1,500 in the Netherlands and 630 in Belgium.¹⁵

While this may suggest that the markets, particularly in Germany and Italy, are well provided in terms of facilities, this is not the case. When analysed on the basis of number of members per club, revenue per club and average revenue per member, the UK market is more mature, with the highest proportion of larger clubs. The analysis in Table 4 confirms the dominance of the independent operator in the majority of continental European countries.

While Germany and Italy have the highest provision of facilities, the countries with the highest penetration levels in continental Europe are the Netherlands and Switzerland, as shown in Table 5. Penetration levels are the result of the ability and desirability to purchase as well as the availability of facilities. It is believed that the differences in penetration levels throughout Europe are mainly the result of differences in the availability and quality of facilities.

More attractive countries ...

Key indicators by country

Based on this analysis, the countries which appear to offer the most attractive overall investment proposition for the development of private health and fitness facilities are the

Source: Deloitte & Touche research/European Marketing Data and Statistics, Euromonitor

Figure 2: GDP and consumer spend per capita (\$) ¹⁴

Table 4: Club revenues

	Revenue per club*	Members per club	Average revenue per member**
USA	0.82	1,203	687
UK	0.80	976	821
Spain	0.50	780	637
France	0.34	684	501
Germany	0.28	717	390
Netherlands	0.27	673	404
Belgium	0.25	603	411
Italy	0.14	338	408

* Euros (millions)

** Euros

Source: VdF/IHRSA/Mintel

Netherlands, the UK, Germany, Switzerland, Belgium, Denmark and France.

This conclusion has been arrived at using the key indicators discussed above and summarised in Table 5 (size of market, overall wealth, propensity to spend on leisure and the current penetration levels) to suggest which countries are the most attractive for the development of health and fitness clubs.

CONCLUSIONS

The health and fitness market in the UK has matured and grown considerably over the last decade. While the industry believes that there are still opportunities for organic expansion, there are clearly increasing consolidation opportunities. This is particularly the case given the current high P/E ratios of the quoted companies.

Throughout continental Europe there are opportunities for the

Table 5: Club penetration rates in Europe

Country	Population (1997)	Population density per km ² (1997)	GDP per capita (1997 US\$)	Per capita expenditure on leisure/ education (1997 US\$)	Penetration rate (%) (members as % of total population)
Netherlands	15,605	379.14	24,790	1,310	6.5
UK	58,617	239.49	21,856	1,439	4.1
Germany	81,935	229.61	25,901	1,494	5.2
Switzerland	7,126	172.60	35,765	1,938	6.0
Belgium	10,149	332.53	23,875	1,604	3.6
Denmark	5,271	122.36	32,125	1,686	N/A
France	58,580	107.69	23,818	1,050	2.9
Austria	8,102	96.62	26,250	1,218	N/A
Italy	57,412	109.58	19,920	1,064	3.5
Portugal	9,934	108.41	10,188	586	N/A
Spain	39,317	77.87	13,575	603	4.0
Finland	5,147	15.27	23,267	1,058	N/A
Greece	10,516	79.67	11,420	271	N/A
Ireland	3,604	52.31	20,021	1,370	N/A
Sweden	8,878	19.74	25,74	71,055	N/A

Source: Deloitte & Touche research/Mintel/Euromonitor

development of health and fitness clubs because of the lack of sophisticated products on offer and the favourable demand indicators. There is scope to increase the existing penetration levels in a number of countries, and gain considerable market share from the existing smaller gym-only clubs. The size of the independently owned health club market in countries such as Germany is likely to reduce, as it has, and continues to, in the UK. However, there are limited opportunities for acquisitions in continental Europe as there are few large chains left that may be of interest to established health and fitness operators, which may cause difficulties for some UK chains wanting to gain 'a foot in the door'.

References

1. Mintel (1999) Special Report, Health and Fitness Clubs.
2. *Ibid.*
3. *Ibid.*
4. *Ibid.*
5. *Ibid.*
6. *Ibid.*, p. 4.
7. The eight LSE listed companies are Granada (the largest health club operator in terms of number of clubs with 79 units), Whitbread (the second largest with 75 units), Hilton (the third largest with 69 units and, like the previous two, a hotel and health club company), Fitness First with 51 units, Cannons Group plc with 50 units, Holmes Place with 43 units, Esporta with 23 clubs and LA fitness with 16 clubs. The hotel/restaurant/fitness companies have not been included in the table because of their diverse portfolio. Esporta and Topnotch operate solely in the health club sector, but are not included in the table due to lack of information because of their recent listings.
8. Source: Deloitte & Touche research.
9. Source: latest annual accounts.
10. Source: *Financial Times*, 29th February, 2000 (except for Cannons, 8th February, 2000 and Fitness First: Deloitte & Touche research).
11. Excluding goodwill/intangible assets. Source: company accounts.
12. Pre-tax profit as percentage of net assets excluding goodwill. Source: company accounts.
13. Deloitte & Touche research.
14. Expenditure on leisure/education includes:
 - purchase of audio-visual, photographic and information-processing equipment
 - purchase of televisions, video recorders, radios, CD players, cameras, camcorders, audio and video tapes, CDs, films, personal computers and peripherals, computer software and other audio-visual, photographic and information-processing goods
 - hire of audio-visual hardware and software, licence fees and repairs of these goods
 - sports goods and camping equipment, sport and camping items (including sportswear), traditional toys and video games
 - flowers, seeds, plants, pet goods, pets, pet foods, pet accessories, veterinary charges and other recreational goods
 - recreational and cultural services, admissions to cinemas, theatres, sports events, museums, clubs and other cultural institutions, betting and gaming, and other cultural services
 - books, newspapers, magazines and stationery
 - education tuition fees in schools and universities.
15. Mintel, ref. 1 above.