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## Planet Fitness: No Judgements, No Lunks

"Planet Fitness Is Not a Gym: And it's stupid to keep pretending it is."<sup>1</sup> In January 2014, this headline appeared in *Men's Health*—a popular health, fitness, and nutrition magazine. Executives at most fitness center chains might be quite alarmed at such a news story. However, the headline didn't faze McCall Gosselin, head of public relations for Planet Fitness. She told the magazine, "We say we're not a gym, we're Planet Fitness." Gosselin explained, "The gym industry was built on bodybuilders, people who work out multiple times a week. Planet Fitness was founded as a place for the other 85 percent."<sup>2</sup>

Planet Fitness proudly proclaimed itself a "judgement-free zone" where people could exercise without feeling intimidated by serious athletes and muscular bodybuilders. Each gym possessed a "lunk alarm"—a siren that would sound if someone grunted too loudly while working out, or dropped their weights. Its television commercials poked fun at bodybuilders and hard core "gym rats" on a regular basis and made it clear that they were not welcome at the firm's fitness centers. In one scene, a Planet Fitness employee asked a new customer what type of exercise he enjoys. The man with bulging muscles and very short, tight pants kept repeating, "I lift things up and put them down." The employee tricked the man into leaving the gym and locked the door. The commercial ended with the message: "Not his planet...yours."<sup>3</sup> The gym even offered free pizza on the first Monday of each month, free bagels on the second Tuesday, and Tootsie Roll candies in the lobby on a regular basis. These policies stirred the ire of fitness enthusiasts, as evidenced by the rants against the company on many online forums. One blogger wrote, "Planet Fitness is a big, purple-colored adult daycare marketed to people afraid to go to an actual gym."<sup>4</sup>

Despite the negative reaction from some observers, Planet Fitness had grown rapidly over the past decade in a highly competitive industry. While competitors Bally Total Fitness experienced bankruptcy twice and Curves closed thousands of locations, Planet Fitness continued to thrive. In its 2017 annual report, the firm reported 44 consecutive quarters of same-store sales growth. The company had doubled its number of locations over the past four years and boasted 10.6 million members across 1,518 gyms.<sup>5</sup> By August 2018, the company's stock price had risen by over 150% since its initial public offering in 2015, outpacing the S&P 500 index by a wide margin (see **Exhibit 1**).<sup>6</sup>

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Planet Fitness had aggressive growth plans for the future. Management believed that it could grow to 4,000 locations in the United States alone. In fact, franchisees had signed contracts to open 1,000 additional locations in the next five years.<sup>7</sup> Could the firm sustain its competitive advantage while trying to grow at such a rapid pace? Could it succeed over the long haul in an industry where many chains had grown rapidly in the past, only to falter or fizzle out eventually? Some analysts harbored doubts. Stock analyst Vince Martin wrote, “Planet’s valuation looks awfully stretched at the moment. A leveraged balance sheet has helped the stock on the way up, but could pressure the stock if the narrative here turns at all. Competition remains intense—and the history of the fitness industry is littered with fallen stars.”<sup>8</sup>

## The Health Club Industry

The health club industry generated \$30 billion of revenue in the United States in 2017, but remained highly fragmented despite the growth of larger chains such as LA Fitness, Gold’s Gym, and Anytime Fitness. Slightly over 60 million people belonged to 38,477 fitness clubs in 2017 yet membership varied substantially across the country. While more than 23% of residents belonged to clubs in states such as Connecticut, Massachusetts, and California, fewer than 15% of people were members in states such as Michigan, Tennessee, Alabama, and Indiana.<sup>9</sup>

Many entrepreneurs owned and operated a single fitness location since opening a small health club required a limited amount of capital, potentially less than \$50,000 for those who leased the space and equipment.<sup>10</sup> However, fitness center chains with large, multi-purpose facilities spent considerably more to open a new location. Planet Fitness estimated that its franchisees spent \$1.5-\$3.2 million to establish a new location, including leasehold improvements and equipment purchases.<sup>11</sup> Wages, rent, and utilities represented the most significant operating expenses for a gym (see **Exhibit 2**).<sup>12</sup>

The total number of clubs in the industry had grown at a compound annual growth rate of 2.9% in the past decade. Between 2007 and 2017, the total number of clubs increased by 8,800 (see **Exhibit 3**).<sup>13</sup> A wave of retail bankruptcies in recent years had made it much easier for entrepreneurs and existing chains to find attractive space for new locations. Chris Rondeau, CEO of Planet Fitness, explained: “Seven or eight years ago, it was much harder to get good sites. We were fighting with Best Buy and Barnes & Noble. Now landlords are looking for new business to drive traffic, and we’re getting much better locations at cheaper costs.”<sup>14</sup>

## The Competitive Landscape

Traditional multi-purpose gyms, such as LA Fitness, Gold’s Gym and Life Time Fitness, offered a wide range of services. They provided cardio and strength equipment as well as a large selection of free weights. Many of these gyms offered additional services and amenities including personal trainers, group exercise classes, swimming pools, racquetball and/or squash courts, massage therapy, saunas and steam rooms, childcare centers, and juice/smoothie bars. Memberships at these clubs ranged from \$25-\$60 per month with additional charges for some services. Many of these gyms tended to have a footprint of 35,000-45,000 square feet and Life Time Fitness operated much larger facilities.

Over the past decade, these traditional gyms faced increasing competitive pressure from boutique/luxury health clubs, as well as budget chains. Boutique clubs included companies such as SoulCycle, YogaWorks, and Orangetheory Fitness. These clubs often focused on group exercise classes with a specialized fitness/exercise approach. Orangetheory, for instance, offered a one-hour interval workout class. According to the company, “Orangetheory’s heart rate monitored training is designed to maintain a target zone that

stimulates metabolism and increases energy. We call it the afterburn.”<sup>15</sup> The prices at these boutique health clubs tended to be significantly higher than the traditional gyms. For instance, Orangetheory ranged from \$59 per month (4 classes) to \$159 per month (unlimited classes). Luxury fitness centers, such as Equinox, had also grown during the past decade. Described as the “swankiest gym chain in America,” Equinox offered a wide range of equipment and premium services, and it charged from \$159 to \$240 per month. The brand did not employ franchise arrangements; all gyms were corporate-owned.<sup>16</sup>

Budget chains, on the other hand, tended to offer basic fitness equipment and very limited services in a simple environment. This segment of the market grew considerably since 2010, with franchising as the dominant organizational model. These chains included Planet Fitness, Crunch Fitness, Snap Fitness, and Fitness 19. These chains typically offered base memberships at roughly \$10-\$20 per month, and in some cases, waived the need to sign an annual contract. In 2017, Fitch, the credit rating agency, described the pressures facing traditional gyms as follows:

“Traditional gym operators are disadvantaged relative to some boutiques due to their high fixed investments in real estate and equipment. Traditional facilities also face pressure from budget-oriented, lower-amenity gyms, which are gaining popularity and market share. To tackle this challenge, some traditional operators are transitioning to tiered membership-pricing strategies that limit access to certain amenities (pools, courts, etc.).”<sup>17</sup>

Budget clubs seemed to be thriving because many customers were highly price sensitive and hesitant to make a long-term commitment. Gyms responded to these price conscious shoppers by cutting monthly fees, eliminating annual contracts, and waiving sign-up charges. Television, print, and internet advertising often focused on a gym’s low prices in an attempt to attract new members. Customers valued convenience, as well. According to Dstillery, a market research firm, the typical member traveled only four miles, on average, to visit his or her gym.<sup>18</sup> Finding a nearby club did not prove to be a problem for many consumers. For example, in 2017, almost 600 health clubs were located in the greater Boston area alone.<sup>19</sup>

## The Consumers

Given the plethora of competitors, health clubs faced a great deal of customer churn. According to some estimates, the average club lost more than 40% of its members each year. Customers left for various reasons, with price being one of the most significant factors. Also, many people dropped their membership after failing to adhere to a New Year’s resolution. A study by Professors Kylie Wilson and Darren Brookfield showed that one half of people who committed to a new fitness regimen at the start of the year had stopped actively pursuing that goal six months later.<sup>20</sup>

Others chose not to renew their memberships and switched gyms because their personal trainers had moved to different fitness centers. Health club owners often complained about personal trainers “stealing” clients when they departed to start their own businesses or work for another gym. Fitness instructor and trainer Krista Popowych explained:

“When personal trainers leave your organization, clients may also leave. Owing to the relationships fostered during one-on-one training, it is not uncommon for clients to feel compelled to continue training with the same personal trainers, regardless of where the trainers work. Unfortunately, all client departures hurt organizations financially. Lost clients mean lost revenues. From my experience, when a trainer leaves, your organization may lose as few as 10% of the trainer’s clients (an ideal scenario) or as many as 80%.”<sup>21</sup>

Consumers had a wide variety of options when it came to fitness. In fact, they did not have to become members of a gym at all. Many people chose to work out in their home, using equipment such as treadmills, exercise bikes, and dumbbells. From 2006 to 2013, roughly 25 million Americans per year engaged in home gym exercise.<sup>22</sup> Many individuals chose to run or walk outdoors to stay fit and/or lose weight. Some runners trained extensively for marathons and half-marathons, with approximately 2.4 million people completing such races in 2016.<sup>23</sup>

Other consumers took advantage of gyms available at their school, university, or workplace. Companies increasingly offered on-site fitness facilities as a means of promoting a healthy employee population, keeping healthcare costs down, and attracting the most talented people. Googleplex, the online search giant's campus in Mountain View, California, featured seven on-site fitness centers.<sup>24</sup> Deloitte's corporate university in Texas contained a 12,000 square foot state-of-the-art fitness facility.<sup>25</sup> Some firms offered discounts to employees to subsidize memberships at health clubs, rather than operating their own fitness centers. Universities, meanwhile, continued to build bigger and better gyms for their students. Tuition payments typically covered the price of admission to these facilities.

Many families—9 million children and 13 million adults—participated in health and wellness activities at their local YMCA, one of the largest nonprofit organizations devoted to promoting healthy living with 2,700 locations around the country.<sup>26</sup> Each YMCA tried to insure access to all local residents by providing financial assistance to needy families and individuals. Many locations provided free summer memberships for local teenagers; over 7,000 kids benefited from this program at the Greater Boston YMCA alone.<sup>27</sup>

An International Health, Racquet and Sportsclub Association (IHRSA) survey showed that a majority of consumers joined fitness centers to lose weight.<sup>28</sup> In its October 2017 report, the National Center for Health Statistics reported that 39.8% of American adults and 18.5% of youths were obese.<sup>29</sup> However, some people pursued other weight loss options that included a variety of diet plans, and in some cases, gastric bypass surgery. About 4.6 million people were members of Weight Watchers in 2018, and many others belonged to competitor organizations such as Nutrisystem and Jenny Craig.<sup>30</sup> The IHRSA survey demonstrated that people also joined health clubs for reasons other than weight loss including a desire to remain in good physical shape, improve health, and enjoy a fun social experience.

### **Fitness Equipment Manufacturers**

The fitness equipment business had experienced consolidation in recent years. Five major players accounted for 72% of the global commercial fitness equipment market in 2015.<sup>31</sup> Then Brunswick, the industry leader, acquired the fifth largest firm, Cybex, in 2016 to bring its total market share to 30%. Brunswick's major brands included Life Fitness, Cybex, Hammer Strength, and Indoor Cycling. Brunswick had grown its fitness business by acquisition. However, in March 2018 the Illinois-based conglomerate announced that it would be spinning off its fitness equipment division into a new publicly-traded company. Brunswick indicated that it would focus on its boat manufacturing and marine engine business moving forward.<sup>32</sup>

Italian manufacturer Technogym had the second highest market share at 17%, followed closely by Amer Sports of Finland. Founded by Nerio Alessandri in his garage, Technogym began in 1982 with a focus on innovative strength-training equipment and later began manufacturing cardiovascular-training machines. It served as the official fitness equipment supplier for many Olympic Games, beginning with the 2000 summer games in Sydney, Australia.<sup>33</sup> Amer Sports owned the Precor brand and it sold 90% of its products to commercial customers. Founded in 1980, Precor had introduced the first ergonomically-sound rowing machine and now produced a variety of cardio and strength-training machines.<sup>34</sup> Founded in 1975, Taiwan-

based Johnson Health Tech sold to commercial customers under the Matrix and Vision brands. It also served its home market with brands such as Horizon and Tempo.<sup>35</sup>

Industry analysts expected further mergers and acquisitions but as of 2018, the market beyond the four big players remained relatively fragmented. Some new firms continued to emerge. Most notably, Peloton launched in 2012 and sold premium indoor bicycles to home consumers for \$2,000 each, plus a \$39 per month subscription plan that offered individuals thousands of workout regimens as well as on-demand and livestreamed classes. Technology on each bike enabled individuals to communicate with fellow riders. By the summer of 2018, Peloton had developed a cult-like following. The firm had sold more than 100,000 bikes and had begun to produce a \$3,000 bike aimed at the commercial market. The company also announced that it would be manufacturing a \$4,000 high-tech treadmill. By August 2018, Peloton had raised roughly \$1 billion in outside capital, and the most recent investment valued the firm at \$4 billion—more than the estimated value of Brunswick's fitness business.<sup>36</sup> CEO and founder John Foley remarked, "We're not a hardware company. We don't compete with those companies. Those companies are yesteryear...We're not committed to trying to sell you a treadmill. We want to get you fantastic content and great classes and instructors and community—whenever you want it, however you want it, so it works for you."<sup>37</sup>

## History of Planet Fitness

In the early 1990s, Marc and Michael Grondahl purchased a defunct Gold's Gym in Leominster, Massachusetts. Marc Grondahl described the failure of this initial foray into the health club business; "It wasn't the right decision. We ended up getting evicted. We didn't have enough experience, the location was bad and it didn't have enough parking. There were lots of problems."<sup>38</sup> They tried again with a new location in 1993 and adopted the name Planet Fitness in the following year. The brothers experimented with the business model until finally settling on the \$10 per month pricing plan and the "judgement-free zone" brand philosophy in 1997. Michael Grondahl explained how the company learned from its early missteps:

"It's very, very difficult to make money in the fitness industry. In order to thrive, you really have to have a niche and sell it. You've either got to be at the high end or at the low end; otherwise, you're not in at all. We're at the very low end: Members have access to a great club for 10 bucks a month, and I don't see that changing. We keep it as simple as possible, so that there are as few areas to disappoint as possible. When we started out, we included perks that everyone else had, such as day care and yoga classes, but none of that made sense for us. We got rid of unnecessary perks and went hard with cardio equipment."<sup>39</sup>

The company opened its first "bare-bones" gym in 1998 in Portsmouth, New Hampshire. They ditched many of the features and amenities that they had put in place in their original gyms. Chris Rondeau, one of the earliest employees, explained the "aha" moment that he experienced when this gym opened:

"We realized my pager was going off for the first three stores which had all these moving parts and pieces with things that were going wrong. In the day care, you would have one kid bit another kid, or they had run out of protein drinks and the blender is broken, or the aerobics instructor has not shown up and people are going mad. In that fourth store, our members were happier because we couldn't disappoint them. We were open 24 hours a day, seven days a week and the product runs no matter what."<sup>40</sup>

The Concord, New Hampshire gym experienced a water problem for several days in 1999, frustrating its customers who could not take hot showers. Managers apologized for the inconvenience and provided

members with free pizza. The “Pizza Monday” tradition each month began with that small, much-appreciated gesture.<sup>41</sup> Growth accelerated in 2003 when the company began opening franchise locations. By 2006, the company operated more than 100 gyms around the country.

As the company grew, Michael Grondahl served as the CEO, while his brother worked as the chief financial officer. Rondeau became an owner ten years later and also became the COO. The three men sold a large stake in the company to TSG Consumer Partners, a private equity firm, in November 2012. Soon thereafter, the Grondahls stepped away from management, and Rondeau became the CEO.<sup>42</sup> Planet Fitness conducted an initial public offering in August 2015.<sup>43</sup>

Rondeau continued to serve as CEO for the New Hampshire-based firm in 2018. He had come a long way from the 19 year old who began working at the front desk of a Planet Fitness gym in 1993. Rondeau reflected back on his decision to drop out of college to work at Planet Fitness full time:

“Unfortunately, I was never one for school, yet I loved to work, and haven’t stopped since my first job busing tables and dishwashing at the age of 14. Planet Fitness is only the third job I ever had. I liked fitness and I liked the work environment at a gym, meaning it’s a positive atmosphere, and we were doing good things. I believed we were onto something special with making fitness affordable and comfortable for the masses. So I stayed, followed my passion, and chose not to pursue my bachelor’s degree.”<sup>44</sup>

Rondeau believed fervently in the company’s mission to create a gym that was comfortable and attractive to the 80% of the population that did not have a fitness center membership. Rondeau commented, “The founders are truly visionaries...We have a very unorthodox business.”<sup>45</sup> He described the company as “the Southwest Airlines of the gym industry.”<sup>46</sup> It offered a simple low-priced service, seeking to democratize fitness much as Southwest aimed to democratize air travel. Rondeau explained, “The key to success in business is not to be afraid of doing things differently. Don’t be afraid of going against the grain.”<sup>47</sup>

## Planet Fitness in 2018

At the start of 2018, Planet Fitness had 1,518 locations. Many, but not all, of these clubs remained open 24 hours per day. The company operated gyms in fifty states plus Puerto Rico, the Dominican Republic, and Canada. It opened its first gym in Mexico in the spring of 2018. The company had doubled its number of locations in the last four years. Membership had grown slightly faster than the number of gyms. The number of members had grown by a compound annual growth rate of 21.9% since the end of 2013, as compared to a 19.3% growth rate for locations (see **Exhibit 4**).<sup>48</sup>

### Product/Service Offering

Planet Fitness typically operated 20,000 square foot facilities featuring bright lighting, large flat-screen televisions, and its iconic purple and yellow color scheme. Its gyms usually had 75-100 pieces of cardio equipment, a variety of strength machines, and a 30-minute circuit area. The fitness centers did not contain squat racks or other heavy free weights. The heaviest dumbbells available weighed 80 pounds. Historically, Planet Fitness contracted with Brunswick’s Life Fitness division for all of its cardio equipment purchases and purchased co-branded purple and yellow machines from them. However, the firm issued a request for proposal to several possible new partners in early 2018 and hoped to offer its franchisees several equipment purchasing options moving forward, rather than relying on a sole supplier.<sup>49</sup>

Planet Fitness gyms contained locker rooms and showers. Customers who purchased a premium plan also had access to an area with tanning booths, massage chairs, and hydro massage. Unlike many rivals, Planet Fitness gyms did not have swimming pools, racquetball/squash courts, childcare areas, basketball courts, or juice/smoothie bars. Planet Fitness personal trainers provided limited services. They worked with members, often in small groups, to explain how the various pieces of equipment functioned, as well as how to structure an exercise regimen. However, the company did not offer one-on-one personal training services or group exercise classes.<sup>50</sup>

## Marketing

Rondeau explained that many people viewed going to the gym as a chore. Planet Fitness wanted to convert these people into gym members, rather than trying to steal customers from direct rivals. He stated:

“The first main competitors are honestly Chili’s and Uno’s and the movie theaters...Other brands look at working out as a hobby, and I think personally that working out is a chore, and I believe most of America thinks of it the same way, they know they have to [but] they’d rather go to Chili’s and have a beer and have some chips and salsa, but you know, you have to, you don’t want to, so you kind of wince your way throughout. And I think most of Americans think this way.”<sup>51</sup>

Jamie Medeiros, vice president of national marketing, argued that Planet Fitness hoped to provide a fun, relaxed atmosphere that would be attractive to those who might otherwise not join a gym. She explained, “The common person doesn’t have time to work out every day, and they may not aspire to the type of person who has six-pack abs and eats egg whites. But we want to be the type of facility that people want to go to as opposed to, ‘Oh my god, I have to go to the gym today!’”<sup>52</sup> She further explained that the Planet Fitness atmosphere appealed particularly to women, who made up 60% of the chain’s members—far higher than many traditional gyms. Roughly one-third of customers had incomes of more than \$100,000 per year.<sup>53</sup>

In his most recent letter to shareholders, Rondeau proudly proclaimed, “We were honored that Planet Fitness ranked number one in J.D. Power’s Health and Fitness Center Satisfaction Report for 2017, reinforcing that our operational model and Judgement Free environment resonates with our members.” Planet Fitness achieved the number one ranking in this influential industry report for the first time in 2017 (see **Exhibit 5**).<sup>54</sup>

Michael Grondahl explained how many traditional gyms failed to appeal to a huge segment of the population: “For years the industry was missing the mark because they were selling the unattainable ideal of beautiful bodies. Over the years hardly anybody was making money with a plan that could never appeal to the general population. They appealed to a small group that acted like idiots, used steroids, and wanted 2 percent body fat.”<sup>55</sup>

Planet Fitness relied on national television advertising to recruit new members, as well as local marketing and outreach programs by its franchisees. The humorous “I lift things up and put them down” advertising campaign created a great deal of buzz. Another popular advertisement featured a woman, wrapped completely in a towel, sitting quietly in the corner of a locker room. Meanwhile, in the middle of the room, a group of very athletic, scantily clad women repeatedly told each other how “hot” they were. The “lunk alarm” then sounds, and the scene shifts to a Planet Fitness employee walking through the gym with the women who had been sitting in the corner. She says to the employee, “And that’s why I don’t like gyms.” The associate responds, “Well, we’re not a gym. We’re Planet Fitness.” The commercial ends with the narrator explaining, “No gymtimidation. No lunks. Just \$10 a month.”<sup>56</sup> Grondahl explained the philosophy

of these advertisements: “We believe it’s much easier to say who we don’t want as a customer than try to explain the satisfaction of our members.”<sup>57</sup>

### Pricing

The standard membership at Planet Fitness cost \$10 per month. However, the company also offered a premium plan called the PF Black Card, priced at \$21.99 per month. Black Card membership offered a series of benefits. Members could bring one guest with them on every visit. Moreover, their membership applied to all 1,500+ Planet Fitness locations (more than 50% of Black Card members took advantage of reciprocity). PF Black Card holders also could use the massage chairs, hydro massage machines, and tanning booths at each gym. Additionally, the premium plan entitled members discounts for cooler drinks at the gym, as well as purchases from Reebok.com.<sup>58</sup>

From 2013 to 2017, PF Black Card holders rose from 38% of the total membership to 60%. As a result, the average monthly dues collected from all members rose from \$15.09 to \$16.10 during this four-year period. Planet Fitness collected over 85% of its fees through direct debit (through the Automated Clearing House system) which was less costly than credit card transactions and minimized the disruption caused by expiring credit cards.<sup>59</sup>

### Franchising

Planet Fitness operated 62 corporate-owned gyms at the start of 2018, having opened seven such locations over the past three years. About 76% of the corporate-owned fitness centers were located in three states: Pennsylvania, New York, and New Hampshire. The average corporate-owned gym had 13 employees, generated roughly \$1.9 million in annual revenue, and earned an EBITDA margin of 41.8%.<sup>60</sup>

Approximately 170 franchisees operated the rest of the company’s locations, with gym-level economics similar to the corporate-owned locations. Planet Fitness referred to these local operators as “raving FANchisees.” Franchisees who owned three or more gyms operated 95% of all the company’s fitness centers. However, only one fifth of the franchisees owned more than ten locations. Planet Fitness did not award exclusive territories to franchisees.<sup>61</sup> Rondeau explained his philosophy regarding the company’s franchisees:

“It’s truly important that both the corporate staff and franchisees wholeheartedly believe in the judgment-free zone. A lot of our staff and franchisees have been members of our clubs, and they’ve seen and experienced the judgment-free zone firsthand and they believe in it. That culture keeps us grounded and doesn’t allow us to get diluted as we continue to scale. We all have a common belief to make fitness comfortable, affordable and accessible to the first-time gym user.”<sup>62</sup>

Planet Fitness believed that its large network of gyms across the country conveyed certain competitive advantages. Specifically, it cited the ability to purchase equipment at lower prices due to its purchasing power. Moreover, Planet Fitness believed that its large geographic footprint enabled it to engage in national advertising campaigns that provided a solid return on investment. Finally, company executives felt that the company’s brand image, size, and scope helped to attract high-quality franchisees.

Existing franchisees opened over 90% of the new locations in 2017. It typically took fourteen weeks for a new location to be set up and opened. The company usually signed up 1,200 members prior to the grand opening of a new gym. Each franchisee and his or her employees took part in training programs to prepare for the launch. Planet Fitness worked closely with franchisees to select new locations, as well as to ensure a consistent appearance across all locations that included key features such as the infamous “lunk alarm.”

Michael Grondahl explained the importance of ensuring that each physical location reflected the company's brand image:

"Branding is really important to us. When you take the time to make a door handle that looks like your logo, a member thinks, 'If they've thought of that—branding the door handle to get into the club—they're going to take care of me when I need something.' It's a very simple business. Some people look at it and scoff, but I just keep smiling and buying door handles."

Planet Fitness required each franchisee to purchase its equipment through the corporate parent. The equipment revenue accounted for 39% of the company's revenue in 2017. The corporate parent specified the number of each type of equipment that each gym should procure, and it provided guidelines regarding the layout of each location. Franchisees had to purchase new equipment for each gym every five to seven years. Each franchisee contributed 2% of membership revenue to subsidize national advertising and the company required them to spend 7% of their revenue on local advertising, public relations, and outreach programs. Planet Fitness spent \$33.7 million on national advertising in 2017. In addition, the company invested each year in the Judgement Free Generation, a philanthropic initiative designated to support anti-bullying programs throughout the country.

New franchise locations paid a 7% royalty rate to the corporate parent but older franchise locations operated under grandfathered arrangements at lower rates. At the end of 2017, only 5% of the company's gyms paid the new 7% royalty rate. Additionally, the company rarely needed to close underperforming locations and in the past three years had only debranded, sold, or consolidated 14 gyms.<sup>63</sup>

The company communicated regularly with its franchisees. The corporate office distributed a weekly email and monthly newsletter to all locations and hosted meetings, called PF Huddles, each year with its franchisees. Moreover, it held a franchise conference every eighteen months. Each franchisee also had to participate in ongoing training programs. The company's Franchise Advisory Council consisted of seven owners, elected by their peers, who organized a series of committees that worked on key topics throughout the year, with roughly forty franchisees involved in these efforts. The Franchise Advisory Council shared suggestions and provided management with feedback on a variety of matters including marketing and advertising, information technology, and new product/service offerings. Rondeau commented on his relationship with the franchisees:

"If I can gain their respect and they have my passion, then they'll do right for our members. I always tell my staff we're in a unique business with two sets of customers—our franchisees and our members. If we can make our franchisees a happy customer, then that will trickle down to our members. I have a very collaborative and open relationship with franchisees. We have about 200 different franchisee groups. I look at that as an asset. Our franchisees bring me ideas and thoughts on how to fine-tune the business and we work collaboratively."<sup>64</sup>

## The Competition

Planet Fitness had a wide range of competitors. These rivals came in three categories: boutique health clubs, traditional multi-purpose gyms, and budget fitness chains. Examples included LA Fitness (traditional/multi-purpose), SoulCycle (boutique), and Crunch Fitness (budget). In addition to major chains, Planet Fitness also competed with many independent players in each of its geographic markets.

## LA Fitness

Founded in 1984 in southern California, LA Fitness operated 705 health clubs in the United States and Canada at the end of 2017.<sup>65</sup> The typical location was open from 5:00 a.m. to 11:00 p.m. on weekdays and from 8:00 a.m. to 8:00 p.m. on weekends. The company generated \$2.1 billion in revenue from approximately 5 million members. LA Fitness had roughly 24,000 employees, with 300 working at the corporate office. Its average gym had a footprint of 45,000 square feet, though the company's largest gym in Long Island, New York measured a whopping 96,000 square feet.<sup>66</sup>

The typical gym had a swimming pool, spa, sauna, café, free weights, strength machines, and cardio equipment. Many locations also had basketball and racquetball courts, and the gyms offered volleyball, basketball, and racquetball leagues for members. LA Fitness gyms featured 20 types of group exercise classes and personal training services. Classes included Kickbox Cardio, Pilates, Zumba, Cycle Zone, Tai Chi, and Yoga. LA Fitness advertised monthly membership fees as low as \$24.99 for individuals who only wanted access to one club, and \$29.99 per month for access to all locations. In addition, customers paid a one-time \$99 initiation fee and a \$35 annual fee to be billed three months after a customer's start date.<sup>67</sup>

The company owned most of its gyms, eschewing the franchising model used extensively throughout the industry. The company grew over the years through a series of acquisitions, becoming the largest fitness center chain by revenue. In many cases, LA Fitness acquired underperforming clubs from rivals. After Bally Total Fitness' second bankruptcy filing, LA Fitness purchased 171 clubs from that rival for \$153 million, although it closed dozens of these locations in subsequent years.<sup>68</sup> Among its larger acquisitions was a 33-club chain in Florida and a 36-club chain based in Kentucky in 2012, as well as 11 clubs in Arizona in 2015.<sup>69</sup>

LA Fitness scored below average in the 2017 J.D. Power's Health and Fitness Center Satisfaction Report, ranking behind chains such as Planet Fitness, Equinox, Gold's Gym, and Life Time Fitness.<sup>70</sup> In June 2018, *USA Today* reported on a ranking by *24/7 Wall St.* of the worst companies to work for in the United States. The organization compiled its ranking by reviewing evaluations on *Glassdoor*, a popular site where current and former employees provide anonymous reviews of companies for which they have worked. Only 33% of reviewers on *Glassdoor* said they would recommend working at LA Fitness. Based on its assessment, *24/7 Wall St.* rated LA Fitness the ninth worst company to work for in the US.

"Many LA Fitness employees feel they have no chance of turning their job at the gym into a career. Though many reviewers appreciate the free gym membership that comes with the job, others say the company offers low pay with few benefits or room to advance within the company. There were also complaints about long hours and a lack of work-life balance. Employees rate the compensation and benefits offered by LA Fitness just a 2.1 out of 5.0. These issues could be driving the high turnover rate noted by many employees."<sup>71</sup>

## SoulCycle

Elizabeth Cutler, Julie Rice, and Ruth Zukerman founded SoulCycle in New York City in 2006. The company owned and operated roughly 80 small cycling studios around the United States and Canada in 2018; it did not employ any franchising arrangements. Zukerman left the company and founded Flywheel Sports, a direct competitor, in 2010. Flywheel owned and operated 42 studios in 2018.<sup>72</sup> Cutler and Rice continued to lead SoulCycle until their departure in 2016.<sup>73</sup>

SoulCycle's signature cycling class lasted 45 minutes, led by a highly fit and energetic instructor who shouted encouragement amidst the booming music. The company described these classes as "high-intensity

cardio, muscle-sculpting strength training, and rhythm-based choreography.”<sup>74</sup> The nearly pitch-black, candle-lit studios occupied between 2,000 and 5,500 square feet of space. A single class cost \$30, while a five-pack cost \$145. The five-pack expired 45 days after purchase. The company also offered longer classes on a regular basis.<sup>75</sup> SoulCycle generated 84% of its revenue from class fees and 16% from branded apparel sales.<sup>76</sup>

As the company grew, it attracted a cult-like following. Celebrities such as Lady Gaga, Kelly Ripa, Chelsea Clinton, and Katie Holmes flocked to the studios. Writing in *Vanity Fair*, Vanessa Grigoriadis explained the system to sign up for classes each week:

“On Mondays at noon—when the upcoming week’s schedule for SoulCycle is released—if you’re not on the computer hitting the keys right then like an eBay addict on the hunt for porcelain figurines, you’re often out of luck. Then you’re a desperate wait-list Soulie, standing outside class dejectedly in case someone doesn’t show up. If this sounds unfun, that’s because it is, but it’s also a masterful psychological trick. The withholding creates that rare thing among the well-heeled—unfulfilled material desire. If this is a cult, it’s a cult of success—worshipping the ability to pay for classes, to buy the clothes, to live a life among the elite. In fact, SoulCycle has introduced a “SuperSoul” package: for \$60 per session, you can get into the coveted classes, like you always wanted.”<sup>77</sup>

Not everyone became a fan of the company. Writing for *Business Insider* in 2015, Mallory Schlossberg described her experience trying out classes at the firm’s studios: “While this may not be true for all of the clientele, there’s something about being shoved to the back of a room amid a sea of perfectly sculpted and tanned women with massive diamond rings, clad in SoulCycle’s signature apparel, that doesn’t make you feel great.”<sup>78</sup>

Nevertheless, the company’s explosive growth attracted investors. In May 2011, Equinox acquired a 75% stake in the business. Equinox CEO Harvey Spevak remarked, “In 15 years in the industry, I haven’t seen a boutique trend with real staying power like SoulCycle.”<sup>79</sup> In 2015, the company announced plans for an initial public offering. However, it experienced a surge in competition as rivals observed its success. In May 2018, the company cancelled its plans for an IPO.<sup>80</sup> A year earlier, CEO Melanie Whelan had remarked about the copycat nature of the business:

“When SoulCycle launched, the boutique fitness industry wasn’t well established. Arguably, we created the space. Now competitors are opening spin, boot camp, and other hybrid-format studios in a fragmented market. We don’t pay a lot of attention to other companies in the indoor-cycling or general fitness space, but competition does challenge us to innovate and reconnect with the needs of core customers—our strongest brand ambassadors.”<sup>81</sup>

## Crunch Fitness

Doug Levine founded Crunch Fitness in 1989. He tried to create a flashy hip environment, heavy on entertainment as well as exercise. One location featured a disc jockey booth, for instance. Some elements proved over-the-top. In one gym, Levine installed frosted glass in the hallway separating the men’s and women’s showers, so that people could see the silhouettes of those bathing after a workout.<sup>82</sup> In the mid-1990s, a gym membership at Crunch cost \$65 per month, which included a variety of quirky and unconventional group exercise classes such as coed wrestling, pole dancing, and bicycle yoga. The company’s

marketing featured a “no judgments” motto. Constance White of the *New York Times* described the gym’s unorthodox approach:

“Unlike the light-filled spartan environments favored by some gyms, the preference at Crunch is to create a womb of hip otherworldliness. The place reverberates with the vibe of a cool nightclub. Walls in the East 13th Street club are a deep yellow and slick black. Black rubber floors lead to locker rooms worthy of a Philippe Starck hotel. Conical stainless-steel sinks are just one blissful touch, and then there are the lounges with the zebra-striped banquettes and the polished-wood bars dispensing free fitness magazines and health bars.”<sup>83</sup>

After growing the chain to 19 urban locations, Levine sold Crunch to Bally Total Fitness in 2001 for \$90 million.<sup>84</sup> Unfortunately, Bally could not operate the Crunch gyms profitably, and it sold the chain to a private equity firm in 2005 for \$45 million.<sup>85</sup> And, four years later, Crunch filed for bankruptcy and was acquired by New Evolution Fitness Company.<sup>86</sup>

By 2018 Crunch Fitness had grown to over 200 locations, having repositioned itself as a low-priced fitness chain after Ben Midgley, a former Planet Fitness executive, became the chain’s CEO. The company shifted away from the edgy image Levine created back in the 1990s.<sup>87</sup> Locations ranged from 16,000 to 25,000 square feet and could be found in suburban strip malls around the country. Each gym featured cardio and strength equipment, a selection of free weights including a few squat racks, and personal training services. The company marketed memberships starting at \$9.99 per month, though that did not include the gym’s popular group fitness classes. The chain operated 32 “signature” locations that featured more space and amenities including towel service, sauna and steam rooms, and dedicated spin and yoga studios. Crunch continued to employ the “no judgments” motto, proclaiming on its website: “What we are is a diverse community; what we have is a culture of fun; what there is, is room for everyone: all kinds of people with all kinds of goals who’ve chosen to come reach them with us.”<sup>88</sup>

## Moving Forward

CEO Chris Rondeau faced some critical strategic questions in the fall of 2018. Would the firm’s unique strategy enable it to continue to thrive in a notoriously tough industry, or would changes have to be made? Which competitive forces posed the greatest threat to the firm’s competitive advantage? Perhaps most importantly, had the executive team set overly aggressive growth targets for the years ahead?

At the start of 2018, Brian Sozzi of the *TheStreet.com* interviewed Rondeau after he rang the opening bell at the New York Stock Exchange. Sozzi noted that a number of Wall Street research analysts had expressed skepticism about the company’s growth goals. He asked Rondeau, “What don’t these guys get?” The CEO responded:

“Once you understand the model, then you get why we are growing. The fact that we are catering to the 80% of the population that doesn’t have a gym membership, and we’re the only ones going after those people. We’re affordable, we’re judgement free, and we have a comfortable atmosphere. You are not going to be intimidated. So, it’s almost like everyone else is selling burgers, and we’re selling pizza. We’re going after a whole different customer. In fact, over 40% of our customers are first-time gym members.”<sup>89</sup>

Sozzi pressed the CEO, asking him how he would achieve his stated goal of operating 4,000 locations. Would it require acquisitions? Rondeau responded that he thought Planet Fitness could achieve its objective through organic growth. He concluded, "I am more confident today than ever."<sup>90</sup> When asked by *CNBC's* Jim Cramer about low-cost rivals, Rondeau noted that many of these firms only had a few hundred locations. The CEO stressed, "Our scale now is a true competitive advantage." He described the budget competitors as follows: "They're affordable - \$10 or \$15 per month. But, they are really doing the old model. They are not catering to the first-time gym user. They are going after the Gold's Gym guy."<sup>91</sup>

Skeptics, such as investment analyst Vince Martin, remained. He wrote, "The business is working at the moment. But the history of the fitness space is that businesses usually work...until they don't. Some of the recent growth has come from steadily increasing royalty rates, which can't last forever. New store count growth will decelerate as well, although the company expects to open roughly 500 stores in the next three years (again, according to the 10-K)...I do question whether the Planet Fitness model is so unique that it can avoid the pitfalls that have snared so many companies in its industry."<sup>92</sup>

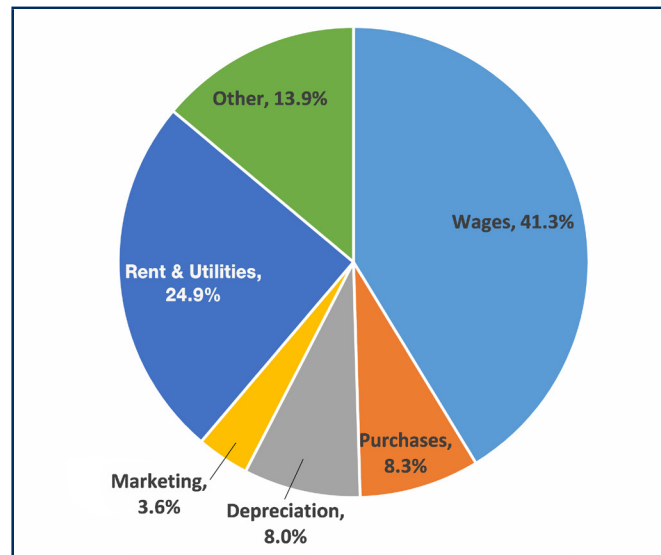
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**Exhibits****Exhibit 1****Planet Fitness Stock Price Performance vs. S&P 500 Index:  
August 6, 2015 – August 22, 2018**

Source: Created by the author using <http://bigcharts.marketwatch.com>.

**Exhibits (cont.)**

**Exhibit 2**  
**Typical Health Club's Cost Structure**



Source: Created by the author using data from IBIS World Industry Report: Gym, Health, and Fitness Clubs, July 2018.

**Exhibits (cont.)**

**Exhibit 3**  
**Industry Statistics, 2007-2017**

|                                      | <b>2007</b>       | <b>2017</b>       | <b>CAGR*</b> |
|--------------------------------------|-------------------|-------------------|--------------|
| <b>Health Clubs</b>                  | 29,636            | 38,477            | 2.9%         |
| <b>Club Members</b>                  | 46,700,000        | 60,866,000        | 3.0%         |
| <b>Industry Revenue</b>              | \$ 18,700,000,000 | \$ 30,007,722,000 | 5.4%         |
| <b>Members/Club</b>                  | 1,576             | 1,582             | 0.0%         |
| <b>Revenue/Member</b>                | \$ 400.43         | \$ 493.01         | 2.3%         |
| <b>Revenue/Club</b>                  | \$ 630,989        | \$ 779,887        | 2.4%         |
| * CAGR = Compound Annual Growth Rate |                   |                   |              |

Source: Created by the author with data drawn from industry reports of the International Health, Racquet, and Sportsclub Association.

**Exhibits (cont.)**

**Exhibit 4**  
**Planet Fitness Financial Performance Data**

| <i>(in thousands)</i>                         | <b>2015</b>       | <b>2016</b>       | <b>2017</b>       |
|-----------------------------------------------|-------------------|-------------------|-------------------|
| Franchise Segment Revenue                     | \$ 88,085         | \$ 116,488        | \$ 150,155        |
| Corporate-Owned Stores Revenue                | \$ 98,390         | \$ 104,721        | \$ 112,114        |
| Equipment Sales Revenue                       | \$ 144,062        | \$ 157,032        | \$ 167,673        |
| <b>Total Revenue</b>                          | <b>\$ 330,537</b> | <b>\$ 378,241</b> | <b>\$ 429,942</b> |
| Net Income (attribute to Planet Fitness Inc.) | \$ 18,518         | \$ 21,500         | \$ 33,146         |
| Total Assets                                  | \$ 699,177        | \$ 1,001,442      | \$ 1,092,465      |
| Total Debt & Capital Lease Obligations        | \$ 492,320        | \$ 716,654        | \$ 709,470        |
| Total Members (millions)                      | 7.3               | 8.9               | 10.6              |
| Franchise-Owned Stores                        | 1,066             | 1,255             | 1,456             |
| Corporate-Owned Stores                        | 58                | 58                | 62                |
| <b>Total Stores</b>                           | <b>1,124</b>      | <b>1,313</b>      | <b>1,518</b>      |
| Franchise Same Store Sales Growth             | 8.3%              | 9.0%              | 10.5%             |
| Corporate Same Stores Sales Growth            | 1.9%              | 4.9%              | 4.9%              |
| Overall Same Store Sales Growth               | 7.7%              | 8.8%              | 10.2%             |

Source: Created by the author using data drawn from Planet Fitness 2018 10-K Report.

**Exhibits (cont.)**

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**Exhibit 5****J.D. Power 2017 Health & Fitness Center Overall Satisfaction Index Rating**

| Company                                      | Satisfaction Index |
|----------------------------------------------|--------------------|
| Planet Fitness                               | 872                |
| Equinox                                      | 861                |
| Gold's Gym                                   | 861                |
| 24 Hour Fitness                              | 835                |
| Life Time Fitness                            | 834                |
| Average Health & Fitness Center in the Study | 831                |
| LA Fitness                                   | 817                |

Source: <http://www.jdpower.com/business/press-releases/jd-power-2017-health-and-fitness-center-satisfaction-report>. Accessed 24 Aug. 2018.

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**Notes**

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