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Xponential Fitness, Inc. (XPOF) Q3 2024 Earnings Call Transcript

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Press Release



10-Q

EPS of -\$0.04 **misses by \$0.36** | Revenue of \$80.49M (0.07% Y/Y) **beats by \$4.03M**Xponential Fitness, Inc. (NYSE:[XPOF](#)) Q3 2024 Earnings Conference Call November 7, 2024 4:30 PM ET

Company Participants

Avery Wannemacher - IR

Mark King - CEO

John Meloun - Chief Financial Officer

Conference Call Participants

Randy Konik - Jefferies

John Heinbockel - Guggenheim Partners

Joe Altobello - Raymond James

Chris O'Cull - Stifel

Jonathan Komp - Baird

J.P. Wollam - ROTH Capital Partners

Richard Magnusen - B. Riley Securities

Korinne Wolfmeyer - Piper Sandler

Operator

Greetings and welcome to the Xponential Fitness, Inc. Third Quarter 2024 Earnings Conference Call. [Operator instructions] As a reminder, this conference is being recorded. It is now my pleasure to turn the call over to Avery Wannemacher, Investor Relations. Please go ahead, Avery.

Avery Wannemacher

Thank you, operator. Good afternoon and thank you all for joining our conference call to discuss Xponential Fitness third quarter 2024 financial results. I am joined by Mark King, Chief Executive Officer; and John Meloun, Chief Financial Officer. Sarah Luna, President, will also be available for questions. A recording of this call will be posted in the Investors section of our website at investor.xponential.com.

We remind you that during this conference call, we will make certain forward-looking statements, including discussions of our business outlook and financial projections. These forward-looking statements are based on management's current expectations and involve risks and uncertainties that could cause our actual results to differ materially from such expectations. For a more detailed description of these risks and uncertainties, please refer to our recent and subsequent filings with the SEC. We assume no obligation to update the information provided on today's call.

In addition, we will be discussing certain non-GAAP financial measures in this conference call. We use non-GAAP measures because we believe they provide useful information about our operating performance that should be considered by investors in conjunction with the GAAP measures that we provide. A reconciliation of these non-GAAP measures to comparable GAAP measures is included in the earnings release that was issued earlier today prior to this call.

Please note that all numbers reported in today's prepared remarks refer to global figures, unless otherwise noted. As a reminder, in order to ensure period-over-period comparability and consistent with our reporting methods since IPO, we present all KPIs on a fully pro forma basis, meaning for the full KPI history presented, we only include brands that are under our ownership as of the current reporting period. For the period ended September 30th, 2024, this includes AKT, BFT, Club Pilates, CycleBar, Lindora, Pure Barre, Rumble, StretchLab and YogaSix.

I will now turn the call over to Mark King, CEO of Xponential Fitness.

Mark King

Thank you, Avery, and good afternoon to all of you. I'm excited to speak with you today and share some updates from my first 100-plus days as CEO of Xponential. I want to start with what's great about Xponential, but I also want to talk about some of the challenges we're facing. So let's get started with what's going well.

My 3 key takeaways are the following. First and perhaps most importantly, people really love what Xponential offers. On one level, that's self-evident from the growth in our membership base and total studio visits. But I'm beginning to appreciate just how integral our health and wellness experiences are to our members' weekly routines. Second, our domestic and international growth have been terrific. And as we'll discuss in more detail, I think I probably underestimated the extent of the future opportunity. Third, my feelings haven't changed at all about this 100 days in. This is just a great business model. Once we've worked through some of the challenges I'm going to discuss, I expect our business to become highly profitable and cash generative at scale.

I pride myself on being candid, so let me be equally clear about some of the challenges we're facing, many of which are commonly faced by companies experiencing rapid growth. Challenge number one is infrastructure and processes. When companies grow very quickly, it's hard for these things to keep pace. In order to achieve sustainable, profitable growth, we must implement the infrastructure and processes needed to adequately support our franchisees and studios at scale.

Challenge number 2 is fostering a culture that is conducive to long-term success. At Xponential, this means shifting from a sales-first to a marketing and operations-driven culture that places franchisees' success at the center. One of the main reasons we were so successful at Taco Bell was that supporting franchisees was our core focus. It drove every organizational decision we made. Everything we do must focus relentlessly on delivering a best-in-class franchisee experience and maximizing franchisee profitability.

Challenge number 3 is figuring out where are we going to allocate our capital. Today, some of our brands are clearly outperforming others. We are working to optimize performance across the portfolio, but if the performance gaps continue to exist, we will not be afraid to consider further divestitures.

With this as a backdrop, I'd like to share my vision for the company as I promised I would do during my first earnings call in August. That vision has 5 key pillars. Number one, our ambition is to become the franchiseur of choice in health and wellness. We will do this through pillar number 2, delivering a worldclass member experience. Pillar number 3, transforming our data capabilities to become a data-driven company. And pillar 4, to create a culture of innovation. Our fifth pillar is to significantly build out our international footprint.

Looking at pillar number one, first and foremost, we need to become and remain the franchiseur of choice in the health and wellness category. Our portfolio must be made up of relevant and growing brands that provide franchisees with profitable investment opportunities. As I alluded to a moment ago, we're going to focus on improving every part of the franchisee experience from the initial selection process to daily studio operations. We need to revamp the recruiting process to ensure we attract the most qualified franchisees, and we need to make operating our studios easier. We plan to by year-end institute physical operating playbooks for all of our brands, which will include step-by-step instructions of how to open and operate profitable studios. We will also implement annual franchisee audits to ensure studio operations are evaluated for consistency and to provide coaching and support for franchisees.

Our second pillar, delivering a worldclass member experience, includes all of our member interactions, be that inside or outside the studio. We need to become better at tracking our members' entire journeys and ensuring we deliver best-in-class experience at every touchpoint. Some of our planned technology improvements will help with this. The goal here is to reduce friction for members with things like sign-up experience and scheduling. We want to make it easier for members to communicate with studios, we want to collect more feedback, and we want to do all of this in the context of continuously gathering data so we can provide a tailored experience. We expect all of this to drive increased engagement, lower attrition and higher member lifetime value.

Our third pillar is to become a data-driven company. I want us to start drawing on predictive analytics to guide our operations. I want to implement a culture of analytics-based decision making. This will optimize franchisee operations and improve the member experience as well as drive insights and efficiency throughout the organization.

Our fourth pillar, creating and fostering a culture of innovation, is critical to all aspects of driving growth and efficiency. I'm implementing a culture that is constantly challenging the status quo. We are engaging all of our employees to discover new, more effective ways to support franchisees. This encompasses everything from the member experience to the workouts to lowering studio buildout costs. On studio buildout costs in particular, I think we can make our supply chain more efficient by assessing every supplier in our system, introducing new suppliers to drive cost competition and ultimately concentrating spend to gain purchasing power.

Lastly, our fifth pillar is to significantly build out our international footprint. International is a huge opportunity that I plan to make a core focus. In my experience, international must be treated as a key initiative with significant support to be successful. I've experienced this success firsthand at 2 previous companies. When I became president of the TaylorMade Golf Company in 1999, only about 20% of our business was outside the U.S. When I left the company, international was a \$1 billion business, representing approximately 55% of the company's revenue. Additionally and more recently, during my 4 years at Taco Bell, we more than tripled total restaurants outside the U.S. I understand how to grow a business internationally, and I believe Xponential has all the attributes needed to capitalize on this opportunity. Speaking here today, I see no reason why Xponential shouldn't have as many studios operating outside the U.S. as it does domestically.

We will leave some of the specifics for the year-end call, but it's worth noting that over my career, I found that growing a significant presence in select countries with large potential is more effective than focusing on many small markets. Japan is one of the international opportunities where we have been successful, and Japan typifies the kind of market where we will allocate material resources. Furthermore, it's been my experience and remains critical that we continue to identify the right international master franchise partners who understand their local markets and are well capitalized to rapidly scale.

Before we get to financials, let me spend a few minutes letting you know some of the tactical progress we've achieved in my first 100 days. First, everything we do at Xponential starts with people. I've begun augmenting the executive leadership team to ensure we are well positioned to execute on our vision. I hired a new Head of Retail, John Kawaja. John is a seasoned operator. He was at Adidas from 1988 to 2004, rising all the way from Footwear Manager to Head of Marketing for North America. After that, John spent 10 years at TaylorMade where he, among other things, served as President when I was CEO. John has held various other leadership roles since. I'm confident John is the right person to optimize our retail operations. I am also in the process of hiring a CMO, a CTO and a COO.

On the data-driven company front, we have been working with a leading data consultancy firm since July. We are automating the reporting of key operational data so that data can become available to our teams in real time. The initial data dashboards have already starting rolling out within the organization for user feedback with many more coming before the end of the year.

Finally and perhaps most importantly, since day one, everything I've done has centered on moving away from a sales-driven culture and towards a marketing and operations-focused organization, all in ultimate support of franchisees. Everything we do is geared towards increasing studio traffic and lowering studio buildout and operating costs, which will maximize franchisee returns and translate to best-in-class franchisee experience. Needless to say, by helping our franchisees win, of course Xponential wins, too.

As I started out with my remarks, there are a lot of opportunities and challenges here. At one point or another, every hypergrowth company must architect a path to sustainable profitability. I would venture to say that every CEO who has been successful in that regard knows that success comes down to people, processes, exceeding the expectations of your stakeholders and building a culture of relentless innovation and accountability, and that's exactly what I plan to do here.

Before turning the call over to John, I'd like to provide a heartfelt thanks to John, our Chief Financial Officer, for all his support prior to my arrival and over the past 100 days. I don't have to tell all of you how integral John is to the success of Xponential, but he's really gone above and beyond as a partner during my first 100 days. And I look forward to having him by my side as we make the most of the opportunity in front of us. With that, I'll turn the call over to John.

John Meloun

Thanks, Mark, and thank you to everyone for joining the call. I'll begin with an overview of our third quarter results.

North America run rate average unit volumes of \$631,000 in the third quarter increased 8% from \$585,000 in the prior year period. As we'll discuss next quarter in more detail when we provide our annual brand level KPIs, the increase in AUVs was predominantly driven by the sales growth at our scaled brands. AUV growth has been driven by a higher number of actively paying members and the continued favorable trend of proportionate studio openings coming from our scaled brands.

We ended the third quarter with 3,178 global open studios, opening 125 gross new studios during Q3 with 96 in North America and 29 internationally. There were 49 global studio closures in the period. On our previous call, we estimated closures in the range of 3% to 5% of the global system and are trending to come in at the higher end of the range for this year. In future years, we do expect a number of closures as a percentage of the global system to decrease from the current level.

We sold 84 licenses globally in the third quarter, which trended lower due to lingering concerns in the franchise sales process around regulatory issues, personnel turnover in our franchise sales team and the culture shift that Mark spoke to earlier. Despite these hurdles, we still have over 1,700 licenses sold and contractually obligated to open in North America, plus an additional over 1,000 master franchise obligations internationally. This backlog of already sold licenses will provide a sufficient funnel of future new studio openings globally for the next few years.

Third quarter North American system-wide sales of \$431.2 million were up 21% year-over-year, with growth driven primarily by 5% same-store sales increase within our existing base of open studios, coupled with growth from new studio openings. Roughly 96% of system-wide sales growth came from volume or new members, which has remained consistent with historical performance, and approximately 4% came from price. On a consolidated basis, revenue for the quarter was \$80.5 million, up slightly from \$80.4 million in the prior year period.

72% of the revenue for the quarter was recurring, which we define as including all revenue streams, except for franchise territory revenues and equipment revenues given these materially occur upfront before a studio opens.

Let's turn to the components that make up revenue. Franchise revenue was \$44.5 million, up 22% year-over-year. The growth was primarily driven by a larger base of operating studios, which contribute to a higher number of franchise license revenue being amortized in addition to higher royalties generated by the increase in system-wide sales and positive same-store sales growth. Q3 year-over-year growth in memberships and visits increased 16% and 19%, respectively, demonstrating that our consumers continue to value our offerings, driving healthy traffic to our studios.

Equipment revenue was \$14.7 million, up 17% year-over-year. This increase was due to a higher volume of equipment installs in the period, which occur a short period before a studio is near opening and offering classes. Club Pilates and StretchLab made up 67% of the total equipment installations in the period, which was in line with the company's expectations on where the growth in new studios will continue to come from.

Merchandise revenue of \$6.5 million was down 23% year-over-year, and the decrease was in line with our expectations. Like last quarter, we continue to focus on reducing inventory levels by selling merchandise to franchisees at lower prices. Inventory levels have now reached their lowest levels since 2022. And although we are planning to continue to see similar merchandise revenues in the fourth quarter, as Mark alluded to, we are focused on further driving efficiencies and scalable practices that will eventually result in higher revenues.

Franchise marketing fund revenue of \$8.6 million was up 23% year-over-year, primarily due to continued growth in system-wide sales from a higher number of operating studios in North America.

Lastly, other service revenue, which includes sales generated from company-owned transition studios, rebates from processing studio system-wide sales, B2B partnerships, XPASS and XPLUS, amongst other items, was \$6.2 million, down 61% from the prior year period. The decline in the period was primarily due to our strategic move away from company-owned transition studios over the last year, resulting in lower package and membership revenues.

Turning to our operating expenses. Cost of product revenue were \$17.1 million, up 34% year-over-year. The increase was primarily driven by a higher volume of equipment installations and higher volumes of merchandise sales during the period. Cost of sales for merchandise were higher in the period while merchandise revenues were down, resulting in a negative wholesale retail margin in the period as we focused on reducing inventory levels.

Cost of franchise and service revenue were \$4.9 million, up 37% year-over-year. The increase in franchise sales commissions was driven primarily by a higher number of studios operating in the period, resulting in a higher amortization of franchise sales commissions in the period.

Selling, general and administrative expenses of \$46.2 million were up 5% year-over-year. The increase in SG&A was primarily associated with increased restructuring costs in the period from settling the leases from company-owned transition studios and increased legal fees to address regulatory inquiries. With that said, our strategy to shift away from operating company-owned transition studios has decreased run rate SG&A expenses compared to the prior year period.

We continue to make progress on the remaining leases and expect to have entered settlement agreements with landlords for substantially all remaining lease liabilities by the end of the year. We have entered into settlement agreements on approximately \$19.3 million in the original estimated \$25 million in leases. The company has paid approximately \$16.1 million through the third quarter.

Impairment of goodwill and other assets was \$4.5 million, down 4% year-over-year and was primarily related to the impairment of operating lease right-of-use assets in connection with our restructuring plan.

Depreciation and amortization expense was \$4.2 million, flat compared to the prior year period.

Marketing fund expenses were \$6.4 million, up 10% year-over-year, driven by increased spending afforded by higher franchise marketing fund revenue. As the number of studios and system-wide sales grow, our marketing fund increases. Since we are obligated to spend marketing funds, an increase in marketing fund revenue will always translate into an increase in marketing fund expenses over time.

Acquisition and transaction expenses were \$3.7 million compared to a credit of \$1.9 million in the third quarter of 2023. As I have noted on prior earnings calls, this includes the contingent consideration activity, which is related to the Rumble acquisition earnout and is driven by the share price at quarter end. We mark-to-market the earnout each quarter and accrue for the earnout.

We recorded a net loss of \$18 million in the third quarter, or a loss of \$0.29 per basic share, compared to a net loss of \$5.2 million, or \$0.91 per basic share in the prior year period. The net loss was a result of \$6 million of higher overall profitability and a \$0.2 million decrease in impairment of goodwill and other assets, offset by an \$8.9 million increase in litigation expenses; a \$5.6 million increase in acquisition and transaction income, which includes non-cash contingent consideration primarily related to the Rumble acquisition; a \$2.6 million increase in restructuring and related charges from the company-owned transition studios; a \$1.4 million increase in non-cash equity-based compensation expense; and a \$0.4 million increase in loss on brand divestiture.

We continue to believe that adjusted net income is a more useful way to measure the performance of our business. A reconciliation of net income and loss to adjusted net income and loss is provided in our earnings press release.

Adjusted net loss for the third quarter was \$0.2 million, which excludes \$3.7 million in acquisition and transaction income; \$0.1 million expense related to the remeasurement of the company's tax receivable agreement; \$4.5 million related to the impairment of goodwill and other assets; \$0.4 million loss on brand divestiture and wind down; and \$9.2 million related to the restructuring and related charges. This results in an adjusted net loss of \$0.04 per basic share on a share count of 32.2 million shares of Class A common stock after accounting for income attributable to non-controlling interest and dividends on preferred shares.

Adjusted EBITDA was \$31 million in the third quarter, up 17% compared to \$26.5 million in the prior year period. Adjusted EBITDA margin expanded to 38% in the third quarter, up from 33% in both the previous quarter and the prior year period.

Turning to the balance sheet. As of September 30, 2024, cash, cash equivalents and restricted cash were \$37.8 million, down from \$51.9 million as of September 30, 2023. In Q3 of 2024, the company's cash position increased \$11.8 million, which includes the \$24.3 million in net cash received from borrowing debt for lease termination liquidity and general working capital needs. The material cash usage in the period included approximately \$8.8 million on tax receivable agreement and tax distributions to pre-IPO LLC members; 3.5 million promissory notes payable for vertical integration payments; \$1.8 million for purchases of property and equipment; \$1.8 million on preferred stock dividends; and \$1.5 million on lease settlements.

Total long-term debt was \$353.8 million as of September 30, 2024, compared to \$329.7 million as of September 30, 2023. The increase in long-term debt is primarily due to the company drawing \$25 million in additional debt to address the lease termination payments on previously owned studios and for general working capital purposes.

Let's now discuss our outlook for 2024. Based on current business conditions and our expectations as of the date of this call, we are reiterating guidance for system-wide sales, total revenue and adjusted EBITDA, and we are lowering guidance for global new studio openings for the current year as follows. We expect 2024 global new studio openings to be in the range of 490 to 510, representing a 10% decrease at the midpoint from the prior year and down from previous guidance of 500 to 520. This updated range is being driven by our shift to a franchisee-first organization, which would include ensuring franchisees have met minimum membership levels and preparedness prior to opening their studios.

We project North America system-wide sales to range from \$1.705 billion to \$1.715 billion, representing a 22% increase at the midpoint from the prior year and is unchanged from the previous guidance.

Total 2024 revenue is expected to be between \$310 million to \$320 million, representing a 1% year-over-year decrease at the midpoint of our guided range and is unchanged from previous guidance.

Adjusted EBITDA is expected to range from \$120 million to \$124 million, representing a 16% year-over-year increase at the midpoint of our guided range. This range translates into roughly 39% adjusted EBITDA margin at the midpoint and is unchanged from the previous guidance.

We now expect total SG&A to range from \$145 million to \$160 million, an increase driven by higher legal costs stemming from regulatory inquiries and one-time lease restructuring charges. When further excluding the one-time lease restructuring charges, we are expecting SG&A of \$120 million to \$135 million and a range of \$105 million to \$120 million when further excluding stock-based costs. As a reminder, in the fourth quarter, the company does hold its annual franchise convention, which will result in an approximate increase in spend in SG&A of about \$5 million in the period and is partially offset by about \$3 million in increased other service revenues.

In terms of capital expenditure, we anticipate approximately \$8 million to \$10 million for the year or approximately 3% of revenue at the midpoint. Going forward, capital expenditure will primarily be focused on our technology transformation initiative as well as the integration of Lindora and maintenance of the technology that supports our digital offerings.

For the full year, our tax rate is expected to be mid- to high-single digits, share count for purposes of earnings per share calculation to be 31.8 million, and \$1.9 million in quarterly cash dividends related to our convertible preferred stock or \$2.2 million if paid in kind. A full explanation of our share count calculation associated pro forma EPS and adjusted EPS calculations can be found in the tables at the end of our earnings press release as well as our corporate structure and capitalization FAQ on our investor website.

This concludes today's prepared remarks. Thank you for all your time today. We will now open the call for questions. Operator?

Question-and-Answer Session

Operator

[Operator Instructions] Our first question today is coming from Randy Konik from Jefferies.

Randal Konik

Mark, I really appreciate the thoughtfulness in the approach going forward. I guess you mentioned -- you talked a little bit about the potential to divest certain concepts or some concepts or whatever, if we're not meeting hurdles. Maybe give us some perspective on maybe some of the qualitative or quantitative factors you're thinking about in assessing that decision across those different -- across these concepts. And maybe give us a little bit more thought around potential timing of making a decision on that -- across those different concepts.

Mark King

Thanks, Randy. First of all, I think having been here now just a little over 120 days, or right around 120 days, I'm getting really much more familiar with the brands. We like all of the brands. We like them strategically. We like the potential of those brands. I guess my comment was more around we're going to spend 2025 investing in different brands in different ways than we have in the past. We want to give every brand a chance to gain some momentum. And I think the way we evaluate that will be on a couple of fronts. Are the studios profitable for franchisees, which will result in us selling license and opening brands? If we start to see momentum in brands or continued momentum in brands, we wouldn't divest anything. So short term, there's no plan to divest any of our brands other than go into our planning process, which we're in right now, looking at next year, where we want to invest. And each year, we'll make that evaluation based on performance during the year.

Randal Konik

Great. Last question would be around your focus on bringing up the country of Japan. Maybe kind of elaborate a little bit more on why you brought that up as an example for international expansion as a focus. Just what kind of makes it special from your perspective, obviously from the golf days, but as it relates to the fitness industry? And just maybe elaborate on other countries you may have in focus beyond Japan.

Mark King

Well, thanks for the question. It's really based on the momentum that we have. So the biggest territory we have today is Australia. They have approximately 240 studios that are open. Japan would be #2 with 75 studios that are open. And the success there is really very positive. So there's a lot of positive momentum. We have good partners in those countries. And we just signed a deal recently in Mexico for Club Pilates for a master franchise deal for 50 locations.

So I think there's a couple of keys to the expansion. One is the size of the potential market, and then the other is the strength of the franchisee, the potential master franchisee. They have to be well capitalized. They have to be in the local market. They have to have local talent. So we have others like Singapore is doing very well. New Zealand's doing very well. So it's really a combination of does the market have decent potential, and what would that be? I would say it's 100-plus studios. Does it have the potential for that? And if it does, then can we find the right franchise partner in those markets.

Operator

Next question is coming from John Heinbockel from Guggenheim Partners.

John Heinbockel

Mark, let me start with when you think about sort of execution, and I know it'll vary across brands, but when you look at that, because I know you sort of talked about the operational playbook. How would you assess the consistency of your execution? And do you have a view on franchisee consolidation, right, meaning -- I'm sure you're going to say that the guys that are operating 1 or 2 or 3 can do so well. Do you think the business would benefit from some consolidation over time or no?

Mark King

I don't -- I actually don't know if it would benefit from consolidation. I'm still evaluating all of that and looking at it. I think the first thing that we need to do is really evolve the way we think about franchisees. And as we do that, we'll look at these different brands, and we'll evaluate how we make them grow. And also the starting point to your first question is, I think the execution across the brands is a little bit different. Some Club Pilates, for example, has excellent execution. Some of the smaller brands does not. I now have the 7 of the 8 brand presidents are reporting to me.

I've spent countless hours this week already talking about standardizing some things across all of the platforms, all of the brands and creating this playbook that all the tabs will be the same in the playbooks, but the execution or the nuance will be dependent on the brand. I think we have to go through -- and the brand presidents are very excited about really standardizing best practices, so we have better execution. Because I don't think we can really evaluate the brands until we have consistent execution across them. So that's my focus right now. And I've jumped in myself to help drive that process.

John Heinbockel

Maybe as a follow-up to that, right. When you think about sort of operational performance, I mean, obviously the AUVs are good, but they're partly driven by a couple of brands. So when you think about member experience versus franchisee experience, right, where is -- so is there a good member experience in a lot of places, but it's not -- it should be, but it's not translating into ease of use or profitability for the franchisees? How do you look at that between the member experience and the franchisee experience?

Mark King

Well, they're obviously both very, very important. And for me, the focus is on looking at the entire experience both for the franchisees starting out, opening up. My belief is we should give more support upfront so that they get out of the gates in a more positive way, because we can really track. If franchisees start in a bad way, it's very difficult for them to overcome that. So I want to put the emphasis on preselling, opening, having the right economics, looking at all the buildout costs, looking at our vendor selection. I think that's really, really important.

On the member experience, I think when you get actually into the studio and you do your exercising, I think we do pretty well there. I think the improvement opportunity is in the entire member journey from the first time we make contact with them, leading up to when they come into the studio and when they leave the studio. And the more we get to know them, the more we know why they exercise, what other modalities are they interested in, can we really curate specific customized programs for our consumers. Now that's down the road a little bit, but that's the ambition. So I think it's a holistic look at both the franchisee experience and the member experience.

Operator

Next question is coming from Joe Altobello from Raymond James.

Joe Altobello

So I guess first question, Mark. Earlier you mentioned the need for infrastructure and processes to support growth. Does that require meaningful spending? And is the outlook still 45% or so EBITDA margins by 2026? Does that impact that?

Mark King

Well, I'll let John comment on the EBITDA margin in 2026. I don't believe the infrastructure and processes is a very expensive evolution. I think it's around discipline. I think it's around people wanting to have an infrastructure that's efficient and effective. I think we do that internally by looking at -- so for example, I'm starting to have all of the job descriptions looked at. Like what exactly is your job and how do you perform it and how can we perform it in a more efficient way.

I think the data warehouse is going to give us a lot of data that we don't have today in real time that will allow us to look at our efficiencies and how do we structure the infrastructure. Processes is around disciplined management. It's not really about money investment. So I'm really comfortable. I think people are asking for that because with this hyper focus on growth, which has been fantastic, a lot of the jobs are very chaotic. And it's really a lot of in the moment reaction to things that happen without really building the proper infrastructure. So I think the company is very -- they're embracing it, they're looking forward to it, and we'll engage everyone in helping us in that process.

John Meloun

Yes. And Joe, just to kind of add, irrespective of everything that's going on, it should be assumed that the performance in 2025 will be better than 2024. And the assumption around 2026 should be the same, that it will build off of 2025. Today, as we go through the AOP process, and as Mark addresses what investments are needed to execute on the 5 pillars, there are a lot of moving parts right now to optimize the future of the business, noting that all the work that we are going to do is really from the perspective of protecting and growing that underlying business. The investments that we do make in the short term, the expectation is that they will generate better than the status quo or improved ROI benefits. There will be probably some short-term investments that may cause the SG&A to increase slightly now, but the efficiencies that we gain should improve it over the long term, so into 2026.

So I do think the 45% that we talked about is a very doable target still, but I want to be prudent about not completely committing to that right now until we go through this AOP process. So again, just going back to that, I do believe that the benefits of these investments will have better than today's return on investment, so it should get us relatively within those ballparks of a 45% adjusted EBITDA margin. I just can't commit to that until we finish the AOP process. And we'll have a lot more to talk about that on our Q4 earnings call.

Joe Altobello

Okay. Understood. And just a follow-up on that. In terms of the 500 or so openings you've got planned for this year, can you roughly break that down by brand? I mean how much are Pilates and StretchLab, for example?

John Meloun

Yes. I think as you saw, 2/3 of the openings in Q3 were Pilates and StretchLabs. That should be the same assumption for the fourth quarter. And as you look into 2025, that's where the growth is coming from. I mean you'll see roughly 2/3 of the growth really coming from those brands. Body Fit Training and YogaSix are the 2, I would say, next in line as far as volume of openings that will make up the lion's share of that last 1/3. So those are the 4. Now BFT is largely going to be an international growth story in the near term. YogaSix, Club Pilates and StretchLab will primarily be the domestic growth story. But that's -- those are the 4 areas that you'll see a lot of the growth in 2025.

Operator

Next question today is coming from Chris O'Cull from Stifel.

Chris O'Cull

Mark, I know the company hasn't had many levers to drive comp sales in the past, and I'm glad to hear you're obviously planning to address that issue. But can you talk about what can be done in the near term to support sales trends at the concepts that may be experiencing decelerating trends?

Mark King

Well, we'll be able to answer that a lot better in -- at the next call because we've challenged all the brand presidents to put together their plan for 2025 and how they want to drive business, drive same-store sales, drive profitability. But short of that, I would say it really needs to be a focus on the member. That's really the -- short term, that's the answer here. So we're looking at how we spend our money. For example, we spend \$1,500 a month in the local market, and how are we spending that and how are we helping the franchisee maximize the benefit of that in their market. And we'll do that one franchisee at a time by the brand teams in the different brands. So to answer your question today, the best I can give you is it's a member-focused approach. The next earnings call, we could be more specific by brand, actually, and what are we going to do to drive business in 2025.

Chris O'Cull

And then just, John, I apologize if I missed this, but can you provide some more information about the \$10 million litigation expense and whether a portion or even all of it is going to be expected to be reimbursed?

John Meloun

Yes. So we have about a \$7.5 million retainer on our D&O policy. We have cash outflowed that to date or through the third quarter. In the process of working with the carriers to get some of that reimbursed. Going forward, all the legal costs will be -- or I guess I'd say the legal costs related to this regulatory defense will come back in the return -- or in part related to our D&O, so the D&O will cover it. So the cash outflow should be pretty minimal. You'll see the expense show up in the P&L until we actually receive the cash in hand back from the carriers. But at this point, most of the legal costs should be capped from a cash outflow, and the P&L should show very little of this because it will be reimbursed to the company.

Operator

Next question is coming from Jonathan Komp from Baird.

Jonathan Komp

Can I just follow up on the closures? Could I -- and maybe if you could clarify the expectation for the fourth quarter? And then just more broadly, what's your handle on the current state of the units that are open and the time line or sort of comfort that the closure rate will start to lessen here at some point?

John Meloun

Yes. The closures in Q3 were 49, so they were down from Q2. I think Q2 was the high point, given there was mostly a lot of backlog from the prior year shift in strategy, Jonathan. So from that perspective, Q4 I expect to be, I would say, in line to lower than Q3 as we kind of work through a little bit of the tennis ball and the snake on that shift in strategy from 2023. As you move into 2025, I want to make sure it's very clear. I said the estimated closure rate we would expect to see is around 3% to 5%. Really meant that was for 2024. As the system continues to grow and the effectiveness of the management and supporting franchisees and just kind of the tail of the strategy shift from 2023 plays through, you should see a much lower percent of total system closures in 2025 and beyond. So we expect to be at the high end of the range this year. In 2025, I expect that percent to decline to something much smaller. So ideally, we'd love to be in that 1% to 2% range. I think that's pretty normal for most franchisees. We got some work to do, but I do believe that in 2025, that'll be lower than the 5%.

Jonathan Komp

Okay. Sorry, just to clarify, John. Do you think you could get to 1% to 2% in 2025, or is 3% to 5% still the range to expect in 2025?

John Meloun

Yes. Yes, I mean at the end of the day, I think 3% is a good aspirational goal to show progress there, but 1% to 2% is obviously what we ultimately want to get back to. So short answer, yes. I mean, 3% is probably a good, safe assumption.

Jonathan Komp

Okay. Great. And then maybe a broader question just on appetite for new openings from franchisees, as you clearly are working on putting new processes and new programs in place here. Are there any gaps in sort of the short-term appetite for openings as we think forward to 2025? Or what sort of visibility do you have today?

John Meloun

Good vis -- I mean we've always had good visibility into our openings. I mean the key for us is we are very involved in the lease signing upfront with franchisees and supporting them through that process. So as the lease signing pipeline stays healthy, then it makes it really easy for us domestically to be able to predict approximately 6 months or so from the time they get their lease signed when they'll approximately get opened. So we do have good visibility into that.

For us, even in 2024, we do want to be very careful about making sure franchisees are launching, as Mark mentioned earlier on his earlier comments, successfully. So making sure that prior to opening, they get up to the right pre-membership counts, they have the right training, the right staffing, everything is in place, so when they do launch, they start strong. And typically when you see that, that studio performs very well. So we will be very careful about 2025 and not overcommitting on openings and making sure that it's more about the franchisee launching successfully. So as part of our AOP process, we'll be doing that on a brand-by-brand basis and assessing which franchisees and when. But yes, I think the total openings for next year, right now we've talked about 500 a year. It's a doable number. But we'll provide more comments around that when we get to our Q4 earnings call as what we think is the right range based off of the studios or the brands that are performing and the volume openings, we have in regards to line of sight in 2025.

Jonathan Komp

Okay. And sorry, just last one for me. On the full year revenue guidance for 2024, the implied range for Q4 is pretty wide. And I guess I'm asking the low end of the implied range would imply a sequential revenue decline, which would be a bit unusual. So just any further color on the expectations in Q4 and any directional color within the range since you reiterated the annual guidance?

John Meloun

Yes, it is a wide range, but the expectation is sequentially, it will be an increase in Q4, because our visibility right now shows us within the goalpost there that we didn't move the guidance at all. But the expectation around Q4 will be that, one, Jonathan, we have a lot of openings coming in the fourth quarter. So you're going to benefit from a lot of equipment revenue in the fourth quarter. We do get additional revenue related to our franchisee conference that happens in the fourth quarter. So you get an extra \$3 million there in rebates. Obviously, there's \$5 million of additional costs, but you get the revenue benefit. So assumption fourth quarter should be sequentially growing revenue, but within the range of the guidance that we provided.

Operator

Next question is coming from J.P. Wollam from ROTH Capital Partners.

J.P. Wollam

Maybe if we could just start first, I want to kind of touch on sort of customer and some of the purchasing patterns. It sounds like maybe the merchandise sell-through is still a challenge. But could you just share a little bit more in terms of the mix of class packs versus actual subscriptions and just if you're seeing any changes in terms of spending trends there? Or just anything else you might want to point out in terms of the customer.

John Meloun

Yes. In regards to what we sell to the end consumer, we haven't seen really any shift there. The majority of our members are on the unlimited with about 50%, and then the 8 packs and 4 packs are split 25% and 25%. We do sell single base, whether it's walk-in or classes, but the majority of our system is on a membership base.

In regards to the sales within the studio and talking about retail, we have seen, as we mentioned on our Q2 call, a decline in retail sales. We do believe it's more of a function of what we had in the warehouse and what we were selling. There could be some elements around consumers just tightening their purchases within the studio, but it's too early to tell given kind of the inventory situation that we talked about in Q2. We do expect that to get better, obviously, with the processes and the improvements we're going to make around our retail and our supply chain. But for the fourth quarter, for Q3, I think they'll look largely the same as far as kind of the performance of retail sales in the studio.

J.P. Wollam

Okay. That's very helpful. And then if I could, just in terms of new units, I don't know -- maybe I missed. But just the lower guide there, is there anything that we should be taking away about the current development environment and whether there's anything to read through in terms of 2025?

John Meloun

No, I don't think there's anything to read into the shift in the guidance. I mean the reason we pulled back guidance is exactly what we talk about in regards to the pillars is the franchisee first. We have the ability to pull in openings -- accelerate buildouts, pull in openings, but then what that means is the franchisee has less time to acquire members prior to opening. And we're not going to do that in the fourth quarter. We're going to let the organic opening of the studio happen the way it should. Therefore, given that, we said let's just be prudent and pull down the expectations around the full year openings now, and then we'll just continue to execute. So 500 openings is still in play for sure. It's just we're not going to put pressure on the system to try and pull in openings at the sacrifice of franchisees not being ready.

Operator

Next question is coming from Richard Magnusen from B. Riley Securities.

Richard Magnusen

You mentioned that you weren't going to make any divestitures, I believe. But in the time that you've been there, what modalities or concepts do you feel strongest about? And are there any that you feel that might be weak or ultimately not such a good match for the company's goals going forward?

Mark King

I think strategically they make sense, because if you look at how they all go together, even CycleBar, which has struggled post-COVID, still is a modality that I can't see us not being in as if we're a fitness company. The new openings of CycleBar are actually doing quite well. So we're going to look at each one all the time. We're going to make the proper investment. I like the lineup today. So today, we're not thinking about a divestiture. We're thinking about how do we get the brands that aren't really -- that don't have much momentum, how do we build that momentum. And that's really the plan at this point, Richard.

Richard Magnusen

Okay. And then kind of related to that, I think you may have addressed a little bit about potential acquisitions, but do you see some opportunities to change like modalities or even adjacencies that are a little different that you may want to acquire and move into? For example, StretchLabs is a little bit different, but it seems to fit very well. Do you have -- what can you say about that type of concept?

Mark King

I would say this, Richard. I think one of the things I really want to embed here is innovation, new ideas and different thinking. And I think everything is on the table. And I've challenged all the brand presidents and their teams to be thinking differently. Is there a way to put 2 brands together? Is there a way to cross-sell? Just I want everything on the table to be thinking about how do we continue to grow each of these brands and Xponential. And if it benefits the franchisee and the model -- the result of the model, is you have franchisees that are making money, there's going to be organic growth and people are going to want to do it. So I'm not ruling anything out. I think we have a great starting point from the 8 brands that we have today, and I think the future is really bright for all of them. That's where I sit today.

Operator

Next question today is coming from Korinne Wolfmeyer from Piper Sandler.

Korinne Wolfmeyer

Could you provide a little bit of color on general membership and visitation trends as the quarter progressed, and then into the early parts of Q4, what you saw, just to give us a little bit more comfort around the general macro state of the business? And then separately, as we think about some of the unit openings heading into the, I guess, next couple of quarters and years, obviously Club Pilates and StretchLab are very heavy. But what are you doing to encourage franchisees to try and open or want to open some of the smaller brands? What kind of processes and motivations do you have in place for that?

John Meloun

Do you want me to take the member one first? Korinne, I'll do the member one first. As far as the macro, yes, not seeing any variation there. When you look at the total members through Q3 on the average per studio, it's actually in line and slightly growing. So the macro hasn't had an impact on our system. I think, again, when you look at fitness, it's one of these things that people just don't trade off as part of their daily lifestyles due to the cost of other things in their life. So the membership growth has remained constant on the average per studio.

Now obviously brands like Club Pilates, they have an oversized impact on that given their size. But across the board, you are seeing growth in members for the most part. The total member count is a function of the fact that we just continue to open more studios, Therefore, you get the volume impact, as we talked on the call, 94% of the -- or excuse me, 96% of the growth in system-wide sales came from volume. So we are bringing more members into the system. We are seeing overall higher member counts per studio through the third quarter. Briefly got a view of that for the fourth quarter, and October results look relatively consistent with what I just kind of talked about in Q3. So not seeing the macro impacts in our business, and that aligns with what we said on previous quarters as well.

Mark King

Korinne, I'll comment on franchisees by brand. We've -- we're changing the license sales team, and we're bringing in new people. But we're also going to make a nuanced shift there, which is I want the brand presidents to own their own development. Because rather than just have a licensed sales team that's going to sell the hottest brands, we really need to be putting together plans by brand that help drive development for their brands. And that's a different way of doing it than we have in the past. And I do think that will really be able to have brands speak specifically to a potential franchisee on why he or she might want to be in that brand.

So I think it will help all of the smaller brands sell more licenses and open. It's all contingent on profitability in the model, which is part of this. So we're looking at all of the elements from the brands on how can we reduce cost, find members, more effective marketing spend. Because my experience is this in the franchise world. If franchisees are making money that they expected, they are going to organically grow. And that is the long-term vision for this is franchisee profitability, a lot of help to get up and started and along the way, and see more organic growth. We'll always be selling through the open market. That's not something we're going to stop. But that's really going to be the focus.

Operator

We have reached the end of our question-and-answer session. I'd like to turn the floor back over to Mark for any further or closing comments.

Mark King

Thank you. Hey, everyone, I want to thank you again for joining the call today. We look forward to seeing many of you and franchises -- franchisees at our annual convention in Las Vegas in December. This will be a great opportunity to get everyone in the same place and continue building our vision together. This will be my first convention with the group, and I'm really looking forward to it. We also plan to meet with many of you at upcoming investor meetings and conferences, and we are planning to host an Investor Day sometime mid-2025. We'll continue to communicate more details on this event as we get closer to the date. And again, thank you for joining.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.

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