Executive Insights

The Future of Fitness: Looking Past COVID-19

The fitness industry has been among the hardest hit by COVID-19. As the latest report from the International Health, Racquet & Sportsclub Association indicates, fitness industry revenue declined by more than 50% in 2020, as the strong growth of digital fitness revenues was far outweighed by the significant decline of traditional fitness membership fees and services.[1]

But while we expect the industry to rebound to pre-COVID-19 levels eventually, consumer trepidation around using in-person facilities will likely push a full recovery out to 2023 or 2024. And even once fitness reaches its pre-COVID-19 levels, it will be based on a different mix of in-person and digital, at-home activity. With that in mind, L.E.K. Consulting has identified several investment opportunities that take advantage of the changing fitness landscape and should be well positioned to deliver substantial top-line growth in a post-COVID-19 world:

- Differentiated boutique studio concepts (e.g., Orangetheory Fitness)
- High-value, low-price (HVLP) gyms and HVLP 2.0 brands (e.g., Crunch Fitness, YouFit Health Clubs)
- Integrated ecosystems of hardware, software and content (e.g., Peloton)
- Wearable-enabled coaching services (e.g., Noom, Strava)

A direct hit on the fitness industry

When the risks of COVID-19 became prominent in the U.S. in March 2020, many gyms and studios shuttered for months due to regionally mandated lockdowns and health concerns for both customers and staff. Even as locations began to reopen throughout 2020, government-mandated capacity constraints, elevated membership churn and stagnant new customer acquisition muted the revenue rebound.

Some major chains, among them Town Sports, Gold's Gym and 24-Hour Fitness, have subsequently declared bankruptcy, while others have remained open but have reduced their footprint. Overall, as many as 17% of U.S. locations had closed by the end of 2020, primarily small, independent gyms and studios.[1] Meanwhile, digital fitness accelerated greatly, led by Peloton and a proliferation of new services along with new service launches from traditional gym and studio operators.

Consumers are in no rush

For the most part, consumers say they are willing to return to in-person fitness — just not right away.

Almost all fitness club members — approximately 94%[2] — expect to return to in-person fitness in some capacity once the pandemic is under control, as equipment access and workout variety is difficult to replicate at home. However, in-person fitness frequency is expected to decline slightly from pre-COVID-19 levels, with roughly 35% of fitness club members saying they expect to attend three to four days per week, down from approximately 42% pre-COVID-19.[2] As for boutique studio

The Future of Fitness: Looking Past COVID-19 was written by **Alex Evans**, **Jon Weber** and **Geoff McQueen**, Managing Directors in L.E.K.'s Retail and Consumer practices. Alex and Geoff are based in Los Angeles, and Jon is based in Boston.

For more information, contact strategy@lek.com.

members, they expect to attend 10% less frequently post-COVID-19 than they did before.[3]

However, in the near term, fitness club members remain hesitant to return to in-person fitness, with approximately 43% of fitness members not expecting to return to in-person fitness in the next three months and 11% of members not expecting to return within the next year.[4]

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Rebound timing will depend on format

Assuming vaccination continues at a reasonable pace, traditional gyms should begin to rebound in the second half of 2021. But the strength — and speed — of recovery will vary by segment.

Traditional gyms: HVLP gyms will likely be the earliest among traditional gym formats to return, driven by their attractive price points and strong value proposition. Premium gyms, which are concentrated in regions harder hit by COVID-19 (e.g., New York City, Chicago, throughout California), are expected to stay resilient as they have the staff, resources and facilities to accommodate social distancing; their members are also less likely to have been adversely impacted by COVID-19. But mid-tier gyms that survived COVID-19 will likely continue to struggle with members on either end of the hourglass: both the high-end premium consumer and the cost-conscious value consumer.

Boutique studios: Overall, boutique studios are expected to rebound slightly faster than traditional gyms. Their growth dynamics will differ, however, depending on the concepts they employ. For example, spinning studios may find it harder to reach pre-COVID-19 levels of participation after Peloton added approximately a million subscribers in 2020 alone. Equipment-light concepts such as yoga and barre will likely face increased competition from digital fitness services that can provide a comparable experience at home, which suggests they will need to invest in the "community" aspect of their offerings to differentiate themselves and realize a full recovery. Multimodal, equipment-heavy and/or highly community-oriented concepts (e.g., Orangetheory Fitness, CrossFit, 9Round), on the other hand, have more points of distinction and are thus likely to be more insulated from digital fitness cannibalization, so they should rebound faster than the broader market once COVID-19 is contained.

Digital fitness: With Peloton adding nearly 100,000 connected fitness subscriptions a month, digital fitness will continue to be additive to the market, though its growth will likely slow from its COVID-19-fueled peak once people start returning to in-person facilities. But the current digital fitness users we surveyed expect their usage to drop just 15%-20% once gyms reopen in a post-COVID-19 environment. This is consistent with our pre-COVID-19 findings on the complementarity of digital fitness subscriptions with in-person facilities: Some 60% of commercial gym members we had surveyed pre-COVID-19 reported spending more time at the gym after subscribing to a digital service.

Key investment themes

Now, armed with this greater understanding of consumer sentiment and behavior, we are focusing on the following key fitness investment themes, which we believe should capitalize on post-COVID-19 conditions:

- **"Hourglass" appeal:** Fitness brands should articulate a clear value proposition geared toward either the high-end premium consumer or the cost-conscious value consumer.
- **Digital fitness relevance:** Fitness concepts can either leverage digital fitness to enhance customer engagement and implement an omnichannel model or have other attributes that insulate them from digital-native competitors.
- **Wearables data integration:** There has been substantial growth in consumer utilization of fitness performance measurement and tracking solutions, yielding more consumer engagement and data collection. Leveraging wearable platforms, and even developing de novo consumer services on top of one or more of them, can enhance the consumer experience and value propositions for gyms and studios alike.
- **Strategic retail footprint optimization:** Traditional fitness operators with a relatively small geographic footprint should be able to capitalize on favorable commercial real estate conditions to outpace the recovery.

Post-COVID-19 fitness investment opportunities

With these themes in mind, we have identified several investment opportunities that should be well positioned to deliver substantial top-line growth in a post-COVID-19 world.

Differentiated boutique studio concepts
(e.g., Barry's Bootcamp, Rumble Boxing)

When it comes to reaching affluent consumers and delivering a premium experience at a premium price, no segment is better positioned than differentiated boutique studios, which also offer an opportunity to integrate with wearables platforms to facilitate performance measurement and tracking.

Their potential for post-pandemic growth differs by concept: Bootcamp/group exercise/kickboxing concepts are expected to experience strong post-COVID-19 growth as fitness enthusiasts return to in-person activities, while yoga/barre concepts may see a muted rebound as they are more susceptible to digital fitness replacement.

Spin is more of a special case. Whereas the strong community element and specialized equipment requirements help keep it insulated from digital fitness, strong Peloton (and Peloton clone) growth may have cannibalized a significant portion of the addressable spinning consumer base during the pandemic.

Well-capitalized concepts with a relatively small footprint, such as Barry's Bootcamp, are uniquely positioned to capitalize on post-COVID-19 commercial real estate dynamics, benefiting from favorable rent terms and location availability. Indeed, even despite COVID-19, many of the stronger boutique concepts (e.g., Orangetheory Fitness and Xponential Fitness) increased their location count in 2020.

HVLP and HVLP 2.0 brands
(e.g., Crunch Fitness, YouFit Health Clubs)

As discussed above, HVLP brands are expected to be among the earliest to return to their pre-COVID-19 heights due to attractive pricing and strong appeal to value-oriented consumers. However, there are several additional tailwinds that will benefit the HVLP brands and other providers within the HVLP ecosystem.

In a post-COVID-19 world, consumers are expected to place a higher degree of importance on fitness, health and wellness. As lingering COVID-19 concerns fade, HVLP brands will be well positioned to capture a disproportionate share of these new members as a result of their affordable entry price point and appeal to new or inexperienced exercisers.

Additionally, HVLP brands may be able to leverage digital fitness to enhance ancillary revenue in a post-COVID-19 world. HVLP members are less likely to adopt a separate digital fitness solution, creating a potentially meaningful opportunity for HVLP brands to upsell their own digital fitness service for an incremental fee.

Integrated ecosystems of hardware, software and content
(e.g., Peloton, Hydrow, Mirror)

Not only do they reach more consumers and deliver a seamless turnkey experience, ecosystems that integrate hardware, software and content can streamline performance measurement and facilitate the tracking of individual users' progress from session to session. In the process, they improve the quality of user experience and enhance user engagement, creating competitive differentiation from stand-alone digital fitness services.

Wearable-enabled performance tracking services
(e.g., Noom, Strava)

Health and fitness has emerged as the "killer app" for wearables; both the recent launch of Apple Fitness+ and Google's ongoing integration of Fitbit are expected to accelerate wearable penetration and grow the digital fitness user base going forward. The integration of Fitness+ content with the Apple Watch in particular should improve the scale and fidelity of data collection, which could be amplified even further if Google pursues a similar strategy with Fitbit. Meanwhile, a growing wearables ecosystem can enhance the value proposition of existing services like Noom and create opportunities for innovative new consumer offerings, such as fitness rewards/incentives programs.

Get ready for the rebound

The COVID-19 pandemic hit the fitness industry hard, in large part due to its reliance on in-person facilities. But it's also greatly accelerated the inroads that were already being made by digital fitness concepts — in particular those, like Peloton, that leverage integrated ecosystems of hardware, software and content to enable the tracking of user performance. And it's highlighted the attractiveness of the various differentiated boutique concepts, which are also uniquely positioned to take advantage of a favorable post-COVID-19 real estate market to deliver a premium in-person experience at a premium price.

So while it may take until 2023 or even 2024, the fitness industry will not only recover from COVID-19, but will offer numerous attractive investment opportunities along the way.

Endnotes

[1]IHRSA report: U.S. Fitness Industry Revenue Dropped 58% in 2020, February 2021

[2]IHRSA report: The COVID Era Fitness Consumer, October 2020

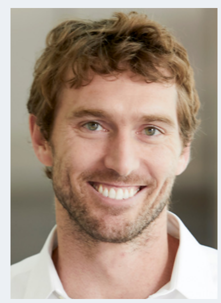
[3]L.E.K. Boutique Studio Fitness Consumer Survey, January 2021

[4]William Blair Consumer Pulse Survey, February 2021

About the Authors

Alex Evans, CFA, is a Managing Director as well as the head of L.E.K. Consulting's Los Angeles office and a member of L.E.K.'s Americas Regional Management Committee. Alex focuses on consumer-facing sectors encompassing both retail and media and specializes in a diverse set of verticals, including health and wellness, direct selling, specialty retail, sports, television, film, and OTT/DTC digital services. He advises corporate and private equity clients on a range of issues, including corporate strategy, new business development, channel strategy, pricing/promotion strategy, international expansion, organizational structure, profit improvement and M&A.

Jon Weber is a Managing Director in L.E.K.'s Boston office and currently serves on the firm's Global Leadership team. He most recently led L.E.K.'s global Retail and Consumer practices. Jon has extensive experience working across retail channels and with worldwide consumer brands. He advises clients on a range of strategic issues, including growth strategy, digital and channel strategy, pricing and promotions, customer experience and engagement, consumer insights and brand position, merchandising and service offering development, performance improvement, and mergers and acquisitions.



Geoff McQueen is a Managing Director in L.E.K. Consulting's Technology, Media & Telecom (TMT) and Consumer practices and is based in the firm's Los Angeles office. He advises clients on growth strategies, international market expansion, new product launches, M&A and digital transformation. His expertise spans digital sports and over-the-top media, digital fitness, pricing, and live events strategies. Geoff holds an MBA from the Booth School of Business at the University of Chicago and a B.S. in economics from the University of Pennsylvania.

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