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NORTHWEST fitness: An expansion opportunity

Jessica Welsh wrote this case under the supervision of Ian Dunn solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On September 1, 2018, David Bryan, owner of Northwest Fitness (Northwest), was analyzing the past year of operations and planning for the future of the business. Northwest was a fitness studio in London, Ontario that focused on “functional fitness” training, which could help people improve everyday aspects of their lives. Bryan had launched the studio with the help of a bank loan and a CA$20,000[[1]](#footnote-1) line of credit. After three years of success, he wondered if the company was now in a financial position that would allow him to expand the studio’s services.

**the fitness industry**

The fitness industry was in a period of growth. People of all ages had begun to view exercise as part of a regular weekly routine. Obesity and inactivity-related health issues were on the rise, with more of the population seeking regular exercise as a preventive measure and a way to maintain health and well-being. In an effort to reduce spending on obesity-related health care, health insurance companies and businesses had begun to provide monetary incentives for employees to take part in physical fitness activities. With both individuals and businesses seeing the importance of regular physical fitness, the industry was expected to grow at an annualized rate of 3.1 per cent to reach revenues of $3.6 billion by 2022.[[2]](#footnote-2)

In Canada, the top fitness trend in 2018 was functional fitness training. Canadians were beginning to see fitness as a way to improve their everyday lives rather than just as a means to lose weight. Functional fitness training simulated movements that individuals regularly made, such as carrying groceries.[[3]](#footnote-3) Due to the working population’s limited leisure time, high-intensity interval training (HIIT) was also popular because it focused on brief high-intensity activities (e.g., sprinting) followed by a short period of rest[[4]](#footnote-4) and promoted weight loss in less time than other types of workouts.

To become a personal trainer, candidates had to complete a certification program recognized by the industry-governing bodies and insurance companies. Continuing education credits were required to ensure personal trainers were kept up to date with the evolving fitness industry. New fitness trends and training methods emerged regularly; to guarantee quality training sessions, personal trainers were required to be educated on them.

**NORTHWEST fitness**

Bryan had been involved in fitness from a young age—from taking part in team sports to competing in body building competitions, he had experience in almost all facets of the fitness industry. After completing his education in Police Foundations at Fanshawe College in London, Ontario, Bryan joined the Canadian Armed Forces (CAF) as an artilleryman. Upon leaving the CAF in 2015, Bryan opened Northwest and turned his passion for fitness into a career.

He completed his personal trainer certification through the International Sports Science Association (ISSA), a distance-education and certifying agency. Certification from the ISSA was recognized in 91 countries, offered 12 different fitness certifications, and had certified over 200,000 trainers.[[5]](#footnote-5) Wanting to further his education and differentiate himself from traditional gym personal trainers, Bryan took certification courses in the United States from the Onnit Academy in Austin, Texas, which focused on unconventional training for functional strength, conditioning, and agility using alternative tools such as kettlebells, sandbags, steel maces, steel clubs, and battle ropes.[[6]](#footnote-6) Bryan believed that these types of alternative fitness regimens helped his clients improve functional fitness while adding variety to their workouts and avoiding boredom. Bryan was the only certified Onnit Specialist in Northwest in London.

Northwest operated out of a private 600-square-foot (approximately about 183 square metres) studio equipped with all of the aforementioned tools along with dumbbells, barbells, and a large multi-station rig.[[7]](#footnote-7) Bryan offered one-on-one personal training, small group personal training, and regularly scheduled group fitness classes. To avoid hiring an administrative assistant, he used an online appointment scheduler, which allowed clients to book, cancel, or reschedule their personal training sessions and sign up for fitness classes using a computer or smartphone.

**competition**

The fitness industry was becoming increasingly competitive, and Northwest competed with large established fitness chains such as GoodLife Fitness, Movati Athletic, and Planet Fitness (see Exhibit 1). Smaller independent gyms and many specialized fitness classes such as crossfit training and yoga were also competitors, but these different types of activities often lacked the privacy that Northwest was able to offer its customers. With new fitness businesses consistently opening, fitness companies were constantly competing to retain clients. Businesses that were able to offer additional services such as nutritional programs and meal planning had an easier time retaining clients than those that did not.[[8]](#footnote-8)

**northwest’s historical financial performance**

While Bryan was happy with the success he had achieved over the last three years, if he did not expand his location and his services, revenue growth would become stagnant. At the current location, Northwest was nearing capacity in both space and time. Bryan wanted to add additional services but did not have the space to house more fitness equipment. He also wanted to add more fitness classes for those clients who had become more advanced, but he could not do so without limiting his availability for one-on-one personal training sessions. If he decided to expand his operations, he would be able to use internal financing for a portion of it and would need to extend his line-of-credit limit to $50,000.[[9]](#footnote-9) Bryan wanted to create and analyze the company’s statement of cash flows and financial ratios since inception to determine if his current financial position was healthy enough to take on additional debt (see Exhibits 2 and 3).

**future outlook**

If he were to move forward with the expansion, Bryan was confident that he would see revenue growth of 25 per cent for fiscal 2019. To achieve this growth, however, he needed to increase marketing expenditures by $15,000 and move to a larger facility. The building where Northwest was currently located had a vacancy in a larger unit that was available for immediate occupancy for $3,500 per month. The landlord charged Bryan rent only on the new unit and had agreed to let Bryan continue using his existing unit until he was ready to run the studio out of the new one. Bryan would immediately need to increase his prepayment of last month’s rent and September 2018’s rent. He was confident that with some help from his family and friends he could have the new unit up and running before the end of September. All preparations for the move would take place outside of normal business hours, allowing regularly scheduled classes and personal training sessions to take place in the existing unit without interruption. The new unit would come with increased utility and insurance costs, making each $250 and $150 per month, respectively.

Bryan had a small group of clients who always paid on credit, and he offered credit terms of net 30. These clients had been devoted customers of Northwest from the beginning, and they preferred to pay for their monthly personal training sessions and fitness classes in one lump sum rather than before each session or class. These clients had consistently represented 10 per cent of all of Northwest’s revenue since inception, and Bryan did not expect that this percentage of total projected revenue would change in fiscal 2019.

He would need to hire an additional personal trainer to facilitate the added personal training sessions and fitness classes. Bryan estimated that the new personal trainer would be required to work an average of 12 hours per week throughout the year and be paid $25 per hour. He planned to increase his own annual salary to $80,000.

Bryan would need to purchase new fitness equipment to accommodate the additional services. The new equipment would cost $65,000 and would be depreciated using the straight line method over a useful life of six years with no residual value. The existing fitness equipment had a useful life of eight years and the office equipment had a useful life of four years. Both were depreciated using the straight line method with no residual value. He would need to renew his industry certifications every two years on August 31 at a cost of $3,700.

The bank loan was repaid in equal monthly installments with the principal and interest payments due on the last day of each month. Total interest expenses for the bank loan were projected to be $1,310 for fiscal 2019, and the following expenses would remain unchanged from fiscal 2018: internet and phone, licensing fees, online scheduler, travel, and website hosting or domain. All other operating expenses were projected to remain the same percentage of sales as in fiscal 2018.

**conclusion**

Bryan knew that he would not be satisfied with his work life if he continued with his existing business operation. He also knew, however, that he would be happy taking on the additional responsibilities of a growing business only if he could be confident of earnings growth in the future. Bryan wondered if this growth would be the first step toward a self-sustaining business model. He hoped to eventually own and manage the studio without being involved in the training sessions. Bryan wanted to project a statement of earnings and a statement of financial position to determine whether he could achieve these goals. He also wanted to analyze the company’s past financial performance to determine if it was likely that the bank would increase his line of credit.

**EXHIBIT 1: SELECT FINANCIAL RATIOS FOR PLANET FITNESS INC.**

|  |  |  |
| --- | --- | --- |
|  | **2017** | **2016** |
| Current ratio | 1.6 | 1.1 |
| Interest coverage | 4.2 | 4.3 |
| Return on assets | 5.1% | 7.1% |
| Revenue growth | 13.7% | 11.7% |
| Operating expense growth | 7.6% | 1.6% |

Source: Created by the case authors based on Planet Fitness*, SEC Filings: 2017*, 36–67, December 2017, accessed September 28, 2018, <https://investor.planetfitness.com/investors/financial-information/sec-filings/2017/default.aspx>.

EXHIBIT 2: northwest STATEMENT OF EARNINGS (years ending August 31, in CA$)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | | |  | **2017** | | |  | **2018** | | |
|  |  |  | (%) |  |  |  | (%) |  |  |  | (%) |
| Revenue | 82,500 |  | 100.0 |  | 137,500 |  | 100.0 |  | 220,000 |  | 100.0 |
| Cost of sales | 2,393 |  | 2.9 |  | 3,988 |  | 2.9 |  | 6,380 |  | 2.9 |
| **Gross profit** | **80,107** |  | **97.1** |  | **133,512** |  | **97.1** |  | **213,620** |  | **97.1** |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Operating expenses** |  |  |  |  |  |  |  |  |  |  |  |
| Advertising | 15,578 |  | 18.9 |  | 19,473 |  | 14.2 |  | 27,262 |  | 12.4 |
| Amortization | 1,850 |  | 2.2 |  | 1,850 |  | 1.3 |  | 1,850 |  | 0.8 |
| Depreciation | 5,875 |  | 7.1 |  | 7,250 |  | 5.3 |  | 10,000 |  | 4.5 |
| Insurance | 565 |  | 0.7 |  | 600 |  | 0.4 |  | 650 |  | 0.3 |
| Internet and phone | 2,280 |  | 2.8 |  | 2,508 |  | 1.8 |  | 2,759 |  | 1.3 |
| Licensing fees | 800 |  | 1.0 |  | 800 |  | 0.6 |  | 800 |  | 0.4 |
| Miscellaneous | 328 |  | 0.4 |  | 435 |  | 0.3 |  | 480 |  | 0.2 |
| Office supplies | 729 |  | 0.9 |  | 940 |  | 0.7 |  | 1,032 |  | 0.5 |
| Online scheduler | 318 |  | 0.4 |  | 312 |  | 0.2 |  | 314 |  | 0.1 |
| Rent | 27,000 |  | 32.7 |  | 27,000 |  | 19.6 |  | 27,000 |  | 12.3 |
| Salary | 48,000 |  | 58.2 |  | 52,000 |  | 37.8 |  | 65,000 |  | 29.5 |
| Travel | 2,144 |  | 2.6 |  | 2,573 |  | 1.9 |  | 3,602 |  | 1.6 |
| Utilities | 2,016 |  | 2.4 |  | 2,218 |  | 1.6 |  | 2,439 |  | 1.1 |
| Website hosting or domain | 331 |  | 0.4 |  | 334 |  | 0.2 |  | 341 |  | 0.2 |
| **Total operating expenses** | **107,814** |  | **130.7** |  | **118,293** |  | **86.1** |  | **143,529** |  | **65.2** |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Net income before interest and tax | (27,707) |  | –33.6 |  | 15,219 |  | 11.1 |  | 70,091 |  | 31.9 |
| Interest expense | 3,860 |  | 4.7 |  | 3,105 |  | 2.3 |  | 2,160 |  | 1.0 |
| Net income before tax | (31,567) |  | –38.3 |  | 12,114 |  | 8.8 |  | 67,931 |  | 30.9 |
| Income tax expense | – |  | 0.0 |  | 1,817 |  | 1.3 |  | 10,190 |  | 4.6 |
| **Net income** | **(31,567)** |  | **–38.3** |  | **10,297** |  | **7.5** |  | **57,741** |  | **26.2** |

Source: Company files.

EXHIBIT 3: northwest Statement of FINANCIAL POSITION (As at August 31, in CA$)

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | | | | **2017** | | **2018** | |
| **Assets** |  | | |  |  |  |  |  |
|  |  | | |  |  |  |  |  |
| Current assets |  | | |  |  |  |  |  |
| Cash |  | | | 45 |  | (925) |  | 44,074 |
| Accounts receivable |  | | | 646 |  | 1,287 |  | 2,133 |
| Office supplies |  | | | 225 |  | 250 |  | 375 |
| Prepaid rent |  | | | 2,250 |  | 2,250 |  | 2,250 |
| **Total current assets** |  | | | **3,166** |  | **2,862** |  | **48,832** |
|  |  | | |  |  |  |  |  |
| Long-lived assets |  | | |  |  |  |  |  |
| Office equipment | 2,500 | | |  | 5,500 |  | 5,500 |  |
| Less: accum. depreciation | 625 | | | 1,875 | 2,000 | 3,500 | 3,375 | 2,125 |
| Fitness equipment | 42,000 | | |  | 47,000 |  | 69,000 |  |
| Less: accum. depreciation | 5,250 | | | 36,750 | 11,125 | 35,875 | 19,750 | 49,250 |
| Certifications | 3,700 | | |  | 3,700 |  | 3,700 |  |
| Less: accum. amortization | 1,850 | | | 1,850 | – | 3,700 | 1,850 | 1,850 |
| Total long-lived assets |  | | | 40,475 |  | 43,075 |  | 53,225 |
|  |  | | |  |  |  |  |  |
| **Total assets** | |  | **43,641** | |  | **45,937** |  | **102,057** | |
|  | |  |  | |  |  |  |  | |
| **Liabilities and Shareholders’ equity** | | |  | |  |  |  |  | |
|  | |  |  | |  |  |  |  | |
| Current liabilities |  | | |  |  |  |  |  |
| Accounts payable\* |  | | | 208 |  | 294 |  | 396 |
| Interest payable |  | | | – |  | 96 |  | – |
| Income tax payable |  | | | – |  | 1,817 |  | 10,190 |
| Current portion–bank loan |  | | | 10,000 |  | 10,000 |  | 10,000 |
| **Total current liabilities** |  | | | **10,208** |  | **12,207** |  | **20,586** |
|  |  | | |  |  |  |  |  |
| Long-term liabilities |  | | |  |  |  |  |  |
| Bank loan |  | | | 40,000 |  | 30,000 |  | 20,000 |
|  |  | | |  |  |  |  |  |
| Shareholders’ equity |  | | |  |  |  |  |  |
| Common stock |  | | | 25,000 |  | 25,000 |  | 25,000 |
| Retained earnings |  | | | (31,567) |  | (21,270) |  | 36,471 |
| Total shareholders’ equity |  | | | (6,567) |  | 3,730 |  | 61,471 |
|  |  | | |  |  |  |  |  |
| **Total liabilities and shareholders’ equity** | | | | **43,641** |  | **45,937** |  | **102,057** |

Note: \*Accounts payable charges solely related to internet and phone and utilities charges; accum. = accumulated.

Source: Company files.

1. All currency amounts are in CA$ unless otherwise specified. [↑](#footnote-ref-1)
2. “Gym, Health & Fitness Clubs in Canada – Market Research Report,” IBISWorld, November 2019, accessed August 9, 2018, [www.ibisworld.com/canada/market-research-reports/gym-health-fitness-clubs-industry/](http://www.ibisworld.com/canada/market-research-reports/gym-health-fitness-clubs-industry/). [↑](#footnote-ref-2)
3. “Functional Fitness is the New #1 Canadian Fitness Trend Expected for 2018,” Canfitpro, August 28, 2018, accessed September 4, 2018, [www.canfitpro.com/2018/08/28/functional-fitness-is-the-new-1-canadian-fitness-trend-expected-for-2018/](http://www.canfitpro.com/2018/08/28/functional-fitness-is-the-new-1-canadian-fitness-trend-expected-for-2018/). [↑](#footnote-ref-3)
4. Susan Scutti, “Interval Training and Group Classes: The Top Fitness Trends for 2018,” CNN: Health, March 9, 2018, accessed September 4, 2018, www.cnn.com/2018/01/03/health/exercise-trends-survey-2018/index.html. [↑](#footnote-ref-4)
5. “About the ISSA,” ISSA, accessed August 30, 2018, www.issaonline.edu/company/. [↑](#footnote-ref-5)
6. “What is Onnit Academy?,” NN Academy, accessed August 30, 2018, www.onnit.com/academy/onnit-academy/. [↑](#footnote-ref-6)
7. A multi-station rig was a piece of gym equipment that allowed for a variety of exercises. [↑](#footnote-ref-7)
8. “Gym, Health & Fitness Clubs in Canada,” op. cit. [↑](#footnote-ref-8)
9. The line of credit carried an interest rate of 9.5 per cent with interest due on the 15th of the following month. [↑](#footnote-ref-9)