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PLNT - Q4 2019 Planet Fitness Inc Earnings Call

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PRESENTATION

Operator

Good afternoon. My name is Chris, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Planet Fitness Fourth Quarter 2019 Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference over to Brendon Frey. Please go ahead.

Brendon Frey - ICR, LLC - MD

Thank you for joining us today to discuss Planet Fitness' fourth quarter 2019 earnings results. On today's call are Chris Rondeau, Chief Executive Officer; Dorvin Lively, President; and Thomas Fitzgerald, Chief Financial Officer. Following Chris and Dorvin's prepared remarks, we'll open the call up for questions.

I would like to remind you that certain statements we will make in this presentation are forward-looking statements. These forward-looking statements reflect Planet Fitness' judgment and analysis only as of today, and actual results may differ materially from current expectations based on a number of factors affecting Planet Fitness' business. Accordingly, you should not place undue reliance on these forward-looking statements.

For a more thorough discussion of the risks and uncertainties associated with the forward-looking statements to be made in this conference call and webcast, we refer you to the disclaimer regarding forward-looking statements included in our fourth quarter 2019 earnings release, which was furnished to the SEC today on Form 8-K as well as our filings with the SEC referenced in that disclaimer.

We do not undertake any obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.



In addition, the company may refer to certain adjusted non-GAAP metrics on this call. Explanation of these metrics can be found in the earnings release filed earlier today.

With that, I'll turn the call over to Chris Rondeau, Chief Executive Officer of Planet Fitness. Chris?

Christopher J. Rondeau - Planet Fitness, Inc. - CEO & Director

Thank you, Brendon, and welcome to Planet Fitness' Q4 earnings call. We wrapped up another fantastic year for Planet Fitness in terms of brand growth, and financial performance, with another strong fourth quarter. Our recent quarterly results were highlighted by an 8.6% increase in same-store sales for a 3-year stack comp of 30.3%. This also marked our 52nd consecutive quarter posting positive same-store sales, an incredible accomplishment for the brand.

For the quarter, net member growth contributed to approximately 75% of the increase in same-store sales, reinforcing that consumers continue to be attracted to our judgment-free affordable approach to fitness. For the full year, same-store sales increased 8.8% or 29.2% on a 3-year stack comp basis, and we added approximately 1.9 million net new members in 2019, with approximately 14.4 million members system-wide.

Fourth quarter adjusted net income per diluted share grew 29.4% to \$0.44, compared with \$0.34 in the prior year period and increased 30.3% to \$1.59 for the full year. Thanks to our asset-light business model, we generated approximately \$204 million in operating cash flow, which allowed us to invest in the business, including our headquarter support team and continue technology-focused initiatives, and along with our financing activities, returned over \$450 million to shareholders through share repurchases.

In 2019, we also had a big year in terms of expansion, and our well-capitalized franchisees continue to drive our strategic aggressive growth in both new and existing markets. In 2019, we opened 261 locations, a company record, consisting of 255 franchise locations and 6 corporate stores.

Coincidentally, we opened our 2,000th location on New Year's Eve and ended the year with 2001 stores. This milestone is an incredible achievement and speaks to the passion and commitment of our entire system, franchisees, their team members on the front line of our stores, and our headquarter support team, to further our mission of making fitness accessible, affordable and nonintimidating, regardless of your fitness level.

To put our growth in perspective, in the last 5 years, our store count has grown 118% and member growth has grown 137%. We continue to be excited about the long runway for growth ahead of us, as we believe we have the ability to reach 4,000 locations in the U.S. alone.

Outside the U.S., our opportunity is also substantial. Today, our international presence is modest, consisting of 55 stores, mostly in Canada, with a handful in Dominican Republic, Panama, Mexico, and as of late last year, Australia. While domestic expansion remains our near term priority, the pace of international openings is gaining speed, and we believe we are well-positioned to capitalize on our long-term potential in current and future international markets.

Helping fuel our growth is our size and scale of our marketing budgets. Along with our differentiated messaging, geared toward first timers and casual gym users, these have proven to be important competitive advantages for Planet Fitness and have further widened the moat around our business. In 2019, between national and local advertising funds, collectively with our franchisees, we spent approximately \$220 million on marketing, up from approximately \$175 million a year ago.

Every new member we acquired, 2% of monthly dues goes toward our national advertising fund, while 7% goes to local advertising fund, growing our overall marketing machine with each new join to attract tomorrow's new member. A prime example of our marketing size and scale advantage continues to be our partnership with Time Square's iconic New Year's Eve celebration.

This was our 5th year as presenting sponsor of the event, and we believe that having Planet Fitness' brand on a global stage, with consumers who have health and wellness top of mind, drives brand awareness leading into January, the busiest time of year for our industry.

Findings from our annual brand health study confirm that Planet Fitness not only remains #1 in aided and unaided awareness in gym category, our awareness level continues to increase post-New Year's Eve, as it relates to our overall marketing strategy. We continue to be pleased with the enhancements we've made to our messaging, creative and channel mix, to optimize overall effectiveness and results.

Now on to an update on our technology initiatives. In addition to attracting new members to our brand, engaging existing members via our mobile app remains a priority, with a focus on driving downloads, app usage and enhanced functionality in future releases, such as referral incentives, in-app messaging, notifications and enhanced account management tools.

Features, such as upgrades from our classic White Card membership to our Black Card, remains an opportunity for us to drive rate. We believe word-of-mouth marketing, driven by our vast membership base, through the referrals feature in the app, extends the reach of our marketing machine, capitalizing on our size and scale advantage and helps to further expand brand awareness in consideration through our 14 million members.

Finally, in the fourth quarter, we welcomed our new Chief Marketing Officer, Jeremy Tucker; and in January, our new Chief Financial Officer, Tom Fitzgerald, came on board. As you know, Tom succeeds Dorvin, who has served as our Chief Financial Officer since July 2013, and was promoted to Chief Financial Officer and President in April 2017.

In Dorvin's continuing role as President, he remains focused on domestic and international store development, our corporate store portfolio, and providing leadership for the technology team. He'll also continue to work closely with Tom and me to execute our strategic growth initiatives and long-term vision for the business.

In closing, 2019 was another very successful year for Planet Fitness. We posted strong financial results, opened a company record number of new locations, and added approximately 1.9 million net new members, invested in enhancing member experience, and collectively, with our franchisees, spent approximately \$220 million to further increase brand awareness and acquisition.

We also strengthened our foundation to support long-term growth by adding people and resources to our franchise support team, bringing on additional leadership to deepen our bench and bolster execution throughout the organization. It is extremely gratifying when our efforts are recognized outside the company.

To highlight a few, this past year, Planet Fitness has once again received numerous industry accolades, including being named One of America's Best Companies for Customer Service by Newsweek, and ranking among Fortune Magazine's 100 Fastest-Growing Companies List as a top performer in revenues, profit and stock returns over the past 3 years.

2020 is off to a good start, and I'm confident that Planet Fitness is poised to deliver increased shareholder value over the long term. I look forward to exciting things ahead and building upon our strong momentum.

I'll now turn the call over to Dorvin.

Dorvin Donald Lively - Planet Fitness, Inc. - President

Thanks, Chris. Good afternoon, everyone. I'll begin by reviewing the details of our fourth quarter results, highlights from 2019 and discuss our full year 2020 outlook.

For the fourth quarter of 2019, total revenue increased 9.8% to \$191.5 million from \$174.4 million in the prior year period. Total system-wide same-store sales increased 8.6%, and from a segment perspective, franchise same-stores sales increased 8.8%, and our corporate store same-store sales increased 5.8%. Approximately 75% of our Q4 comp increase was driven by net member growth, with the balance being from rate growth.

The rate growth was driven by 120 basis points increase in our Black Card penetration to 61.3% compared with the prior year period, combined with higher Black Card pricing for new joins. The rate growth was mostly driven by the Black Card price increases over the past 2 years. The impact from Black Card pricing drove approximately 190 basis points of the increase in system-wide same-store sales.

Our franchise segment revenue was \$73.3 million, an increase of 29.6% from \$56.5 million in the prior year period. Let me break down the drivers for the quarter. Royalty revenue was \$48.4 million, which consists of royalties on monthly membership dues and annual membership fees. This compares to royalty revenue of \$38.5 million in the same quarter of last year, an increase of 25.7%.

This year-over-year increase had 3 drivers: first, we ended the quarter with 237 more franchise stores compared to the same period last year; second, as I mentioned, our franchise same-store sales increased by 8.8%; and then third, a higher overall average royalty rate. For the fourth quarter, the average royalty rate was 6.3%, up from 5.8% in the same period last year, driven by more stores at higher royalty rates compared to the same period last year.

Next, our franchise and other fees were \$4.5 million, compared to \$3.5 million in the prior year period. These are fees received from online new member sign-ups, the recognition of fees paid to us for new franchise agreements, area development agreements, and the transfer of the existing stores, and fees received from processing dues through our point-of-sale system.

Also within franchise segment revenue is our placement revenue, which was \$5.6 million in the fourth quarter, compared to \$3.8 million a year ago. These are fees we received for assembly and placement of equipment sales to our franchise-owned stores within the U.S.

Finally, national advertising fund revenue was \$13.2 million, compared to \$9.2 million last year. Our corporate-owned store segment revenue increased 13.7% to \$41.2 million from \$36.2 million in the prior year period. The \$5 million increase was due to higher revenue of \$3.1 million from corporate-owned stores opened or acquired since the end of the third quarter of last year, an increase in corporate-owned same-store sales of 5.8%, contributing \$1.7 million and increased annual fee revenue of \$1.1 million.

Turning to our equipment segment. Revenue decreased by \$4.6 million, or 5.6%, to \$77 million from \$81.6 million. The decrease was primarily due to lower replacement equipment sales to existing franchise-owned stores. Replacement equipment sales were 27% of total equipment sales in the quarter, compared to 37% during the same time last year.

For the full year, replacement equipment sales were 25% higher than last year and were 46% of total equipment sales, compared to 44% the previous year. Our cost of revenue, which primarily relates to direct cost of equipment sales to new and existing franchise-owned stores, amounted to \$59.4 million, compared to \$62.5 million a year ago, a decrease of 5%, which was driven by the decrease in equipment sales during the quarter as discussed above.

Store operation expenses, which are associated with our corporate-owned stores, increased to \$22.7 million, compared to \$19.9 million a year ago. The increase was primarily driven by costs associated with the 9 new stores opened and 16 stores acquired since the end of third quarter of last year.

SG&A for the quarter was \$20.9 million compared to \$20.4 million a year ago. For the quarter, we leveraged our SG&A as a percent of revenue by approximately 75 basis points, and for the full year, by approximately 120 basis points. National advertising fund expense was \$13.1 million, offsetting the aforementioned NAF revenue we generated in the quarter.

Our operating income increased 16.7% to \$61.6 million for the quarter, compared to operating income of \$52.7 million in the prior year period, while operating margins increased 190 basis points to 32.2%. Our GAAP effective tax rate for the quarter was 24%, compared to 15.6% in the prior year. As we've stated before, because of the income attributable to the noncontrolling interest and not taxed at the Planet Fitness corporate level, an appropriate adjusted income tax rate would be approximately 26.8%, up 20 basis points from what I discussed on the last call.

On a GAAP basis, for the fourth quarter of 2019, net income attributable to Planet Fitness, Inc. was \$29.7 million or \$0.36 per diluted share compared to net income attributable to Planet Fitness, Inc. of \$24.8 million or \$0.29 per diluted share in the prior year period. Net income was \$34.3 million, compared to \$28.8 million a year ago.

On an adjusted basis, net income was \$39.2 million, compared to \$32.5 million in the prior year period, an increase of 20.6%. Adjusted net income per diluted share was \$0.44, compared with \$0.34 per diluted share in the prior year period, an increase of 29.4%. Adjusted net income has been adjusted to exclude nonrecurring expenses and reflect a normalized tax rate of 26.8% and 26.3% for the fourth quarter of 2019 and 2018, respectively. We have provided a reconciliation of adjusted net income to GAAP net income in today's earnings release.

Adjusted EBITDA, which is defined as net income before interest, taxes, depreciation and amortization, adjusted for the impact of certain noncash and other items that are not considered in the evaluation of ongoing operating performance, increased 23% to \$76.6 million from \$62.3 million in the prior year period. A reconciliation of adjusted EBITDA to GAAP net income can also be found in the earnings release.

By segment, our franchise segment EBITDA increased 30.8% to \$50.7 million, driven by royalties received from additional franchise-owned stores not included in the same-store sales base, and an increase in franchise-owned same-store sales of 8.8%, as well as a higher overall average royalty rate. Our franchise segment adjusted EBITDA margins increased approximately 85 basis points to 69.5%.

Corporate-owned store segment EBITDA increased 3.6% to \$15.1 million, driven by the 5.8% increase in corporate same-store sales, higher annual fees, the 9 new stores opened and stores acquired since the end of the third quarter of last year. Our corporate store segment adjusted EBITDA margins increased by approximately 75 basis points to 43.2%. Our equipment segment EBITDA decreased 1.7% to \$18.7 million, driven by lower replacement equipment sales to existing franchise-owned stores versus a year ago. Our equipment segment adjusted EBITDA margins increased by approximately 100 basis points to 24.3%.

Turning to the full year. Let me quickly summarize the highlights for 2019. Revenue increased 20.2%. System-wide same-store sales were up 8.8%, on top of a 10.2% increase in 2018, for a 3-year stacked comp of 29.2%. Corporate store same-store sales increased 6.1%. Our average royalty rate for the year increased 50 basis points to 6.1%.

We placed equipment in a record 263 new stores, and replacement equipment sales increased 25%. Our adjusted EBITDA increased 26.4% to \$282.2 million. We bought back and retired 6.1 million shares of Class A common stock, and our adjusted net income per diluted share was up 30.3%.

Now turning to the balance sheet. As of December 31, 2019, we had cash and cash equivalents of \$436.3 million, compared to \$289.4 million on December 31, 2018. We announced a few transactions throughout 2019 that impacted our overall capital structure. In December, we completed an additional securitized financing transaction, which resulted in the issuance of \$550 million of 10-year notes. After expenses related to the transaction of approximately \$11 million, the net proceeds from this transaction were approximately \$539 million. Total long-term debt, excluding deferred financing cost, was \$1.74 billion at December 31, 2019.

As I've previously stated, we believe the appropriate capital structure for the company would be a targeted gross leverage ratio in the range of 4 to 6x adjusted EBITDA. This is based upon the free cash flow generation of the business, our asset-light model, and our long runway for continued growth. Our gross debt to adjusted EBITDA leverage ratio, as of 12/31/2019, on a trailing 12-month basis, was approximately 6.1x.

Shifting to our share repurchase activity, we closed out the 2018 share repurchase authorization in Q3 of 2019. As previously announced, in November, the Board approved a new \$500 million share repurchase program. In December, we announced that we entered into a \$300 million accelerated share repurchase agreement, which we expect to conclude in Q2 of 2020. For the year, we utilized \$458 million to repurchase 6.1 million shares, and have \$200 million remaining on our 2019 share repurchase authorization.

With respect to cash used in investing activities, our total net spend in 2019 was \$111 million, which included approximately \$53 million for the 16 franchise stores we acquired during the year, including 12 in December. Additionally, we incurred approximately \$17 million for new corporate stores, including 6 opened in 2019 and \$23 million on our existing stores, including \$7 million for replacement equipment. We incurred approximately \$17 million on IT infrastructure investments in 2019.

Now to our outlook. For the year ended December 31, 2020, we currently expect revenue to increase approximately 12% over the 2019 levels, driven by same-store sales growth of approximately 8%, and the placement of equipment in approximately 240 new stores. In terms of quarterly cadence, 2020 will be different than 2019. In quarter 1, we expect to see new equipment placements lower by approximately 10 to 12 new stores, with quarter 2 flat to slightly up.

As our line of sight becomes clearer through 2020, we will update our new equipment placement outlook. Replacement equipment sales are projected to be slightly less than 50% of total equipment sales, compared with 46% in 2019. Additionally, we expect our average royalty rate to increase approximately 30 basis points over 2019 levels, and expect the Black Card pricing to drive an approximately 200 basis points increase in same-store sales.

With respect to profitability, we currently expect adjusted EBITDA to grow approximately 15%, and adjusted earnings per share to increase approximately 16%, compared with 2019 levels. Our adjusted earnings per share guidance includes approximately \$0.07 of dilution related to the 2019 securitized financing transaction. Excluding this impact, we expect adjusted earnings per share to increase approximately 20%.

This guidance is based on a fully diluted share count of 87.7 million shares and assumes no additional share repurchases and includes net interest expense of approximately \$70 million, consisting of \$80 million in interest expense and \$10 million in interest income.

For 2020, we anticipate CapEx to be approximately \$65 million, including approximately 8 new corporate stores. Compared to 2019, our 2020 spend includes approximately \$13 million of additional expenditures on corporate-owned stores, with no acquisitions planned and approximately \$6 million less on IT infrastructure investments.

I'll now turn the call back to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from Oliver Chen with Cowen & Company.

Jungwon Kim - *Cowen and Company, LLC, Research Division - Research Associate*

This is Jonna on for Oliver today. Just curious on your new store guide of \$240 million versus \$260 million in '19, just what you're seeing in terms of this year and what's leading to that guide? And also in terms of your 8% guide, how much is it attributable to the price increase and how you're thinking about the new membership growth, as you're also making changes to your marketing strategy?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, thanks, Jonna. This is Dorvin. So when we took a look at the way we guided in the past, and we look at kind of what's in the pipeline, what's in the line of sight, and based on where our franchisees are with respect to deals they're working on and kind of the history of the franchisees, we decided to guide to the \$240 million.

So a couple of things to comment on. One is, we still have over 1,000 in the pipeline, and about half of those are in the next 3 years, so that's pretty consistent with the past. In terms of factors that would affect development, such as real estate, any of these other kind of factors we've talked about in the past, we don't see any deterioration of any of those things that necessarily would slow that down. Timing is such a huge element when it comes to real estate and really, pipeline deals. We did guide slightly lower in Q4 -- or Q1, rather, this year. Q1 of 2019 was the highest number of placements the company's ever had. And the implied guide that we have now would still be higher than it was back in 2017 and 2018.

And then I think the last point I'd make is, is that the guide we have as of right now, is even higher than it was this time last year. So as we did last year, quarter-by-quarter, as we get more insight into kind of that line of sight, which is generally about a 3- to a 6-month kind of time period, then we'll update our guidance as we go throughout the year.

But we feel very good about the economics of the model, the franchisees have continued to deploy capital in building out their markets, but we think \$240 million is kind of an appropriate number for right now. In terms of your same-store sales question, the 8% guide includes approximately 200 basis points related to the Black Card pricing, which is a combination of both the \$2 pricing increase back in '17, as well as the dollar price that we took back in early September of last year.

Operator

Your next question is from John Heinbockel with Guggenheim Securities.

John Edward Heinbockel - *Guggenheim Securities, LLC, Research Division - Analyst*

Can we start with your take on member growth this year? Obviously, opening a few less clubs, but do you think the member growth tracks close to what you had this past year, a little bit less? And then from a seasonality perspective, right, it's becoming gradually a little less first quarter-centric and more in 2, 3 and 4, do you think that continues in '20, that, that gradual shift away from the first quarter?

Christopher J. Rondeau - *Planet Fitness, Inc. - CEO & Director*

Yes, John, this is Chris. Yes, we do see the seasonality doesn't affect it quite like it used to, like we mentioned last year, where the summers aren't quite as a fall off as we once used to see years ago. But I think what we've learned back on the marketing front from the third quarter, as we talked about end of last year from the marketing mix and driving acquisition, we feel really good on the changes we had made and the reallocations of NAF dollars in those learnings into this year. So we're really pleased with the momentum we're carrying.

John Edward Heinbockel - *Guggenheim Securities, LLC, Research Division - Analyst*

Okay. And then maybe secondly, talk of your thoughts on Teen Summer Challenge, kind of year 2 here, in terms of how you get started, what you do differently on the marketing budget? And then -- I mean I would think that it would be more impactful this year, right? That 900,000 would go up and the 60,000-member lift would go up as well. But maybe talk about how you're going to attack that?

Christopher J. Rondeau - *Planet Fitness, Inc. - CEO & Director*

Yes, we're definitely relaunching it again this year, for sure. We continue to get many accolades and awards, even just as early as last week from a Golden Halo Award that we got granted for it. So it's a great, great initiative that we'll do this year. The beauty of it now is you now have -- you have hundreds of thousands of kids, teens, to now we directly go after, and parents, as we mentioned before, e-mails that we're launching it.

So we have a base already baked in that we can go after and say, we're relaunching, come be the first of the teens in the U.S. to activate your second, second free summer. So we've got a lot of initiatives around that to get more momentum. So hopefully, we blow that 900,000 teen number out of the water. On top of that, we're going to use our new app, actually, too, on the onboarding process for the teens. So they will actually check-in, almost feeling like a real true member, with their barcode on their app, and some teen content, and so on. So we're looking forward to a little bit more structure around how we capture, interact with the teens this go around.



Operator

Your next question is from Randy Konik with Jefferies.

Randal J. Konik - Jefferies LLC, Research Division - Equity Analyst

Just curious, Dorvin, is there -- I think you said that Black Card penetration was up about 120 basis points year-over-year. Is that correct?

Dorvin Donald Lively - Planet Fitness, Inc. - President

Yes. The end of the year, Black Card percent, yes.

Randal J. Konik - Jefferies LLC, Research Division - Equity Analyst

Yes. And I think that's kind of gone up a tick more than being more flattish. Was there anything kind of that you're seeing in the way that you're going about kind of approaching conversion of White to Black? Any amenities being added more than in the past at locations? And as you think about the future, are there other areas or amenities that your customers or your members are asking for that are a little bit outside the box that you're kind of thinking through that could be more impactful for them as you continue to think through of innovative ways to kind of continue to grow more things for those members to keep them happy and talk about those benefits to other potential members in the future? Can you give us some thoughts there, please?

Dorvin Donald Lively - Planet Fitness, Inc. - President

Sure, Randy. We've talked a lot in the past about kind of the biggest values out of the Black Card membership. Clearly, reciprocity is the #1 benefit. And as we just continue to add more and more clubs, and now over 2,000, the availability and the more likelihood of using that, whether it's you, yourself, you wanting to use a club closer to home, closer to work, or just the fact that you have friends or someone that you want to take that might be at another location, so the big value of reciprocity and guest privileges just continues to increase.

And you've heard us talk about that's really why we took the first price increase. And then, basically, 2 years later, we tested it again and took the dollar increase. And in both cases, we continue to see the Black Card percentage increase, quite frankly, even more so than while we were during the pilot. So I think it speaks to the value of the actual benefit you get from that just with the scale that we continue to have as we open more stores. Second thing is, is that we continue to sign up more members online year-after-year through our web join process. And there's a higher propensity of those members to join as a Black Card member when you join online, on a percentage basis, versus when you join in a club.

So you kind of got a little bit of built-in momentum there. And then I think the last thing I'd say is that, clearly, over the last 4, 5 years-or-so and continue to do so today, we keep continuing building really nicer Black Card spa areas than where we had been, if you go back years ago when that Black Card percentage was less. And we always are looking for other options to add kind of in the club that would cause you, if you come in to a tour and you want to join, we want to be able to present that value proposition that would, hopefully, drive you to take the Black Card membership.

I think down the road, and to your point of kind of maybe the wish list or what people might want, we've talked in the past, Chris and I, about digital content, and you walk into our club today, you'll see people that are -- they're consuming data off of their cell phone, leaning up against the wall or on the treadmill, they're looking at various types of content, whether it's exercise and fitness or entertainment, whatever the case may be, and as we continue to enhance what we can offer through our mobile app, we want to be able to offer content that can be consumed not only in the club, that most likely would require Black Card membership to get full access to that, and then maybe content that's kind of on-the-go as well, that could be consumed outside the club.

So those are the things that, as we think about our overall strategy and then particularly to drive more Black Card members, those are the pieces to the puzzle.

Christopher J. Rondeau - Planet Fitness, Inc. - CEO & Director

I guess the only thing I'd add to that is the new -- sorry, Randy. I think the only I'd add to, Randy, as with the app now, the only way you could upgrade your membership to a Black Card would be to physically walk into a facility and go to the front desk and have a staff member upgrade you. With the app today, it's a one-click upgrade option.

So as more people adopt the app, the convenience of being able to upgrade on the fly has already proven to be really beneficial here. We just got to get more people upgraded and adopt the app, for a 1-click option to be able to get it is an easy way to upgrade.

Randal J. Konik - Jefferies LLC, Research Division - Equity Analyst

Great. And I guess 1 last question. On -- I think you said in the past, you used Buxton and what have you, to help with to help with thinking through the long-term opportunity on real estate. Have you contemplated doing any -- kind of updated work there, perhaps in a more, on a more micro level basis, kind of look at specific, different densities in different parts of the country, for example?

If you say your highest density is New Hampshire, I'm assuming, I'm not sure, how that -- the density work may look where you could have added kind of unit opportunity than previously contemplated when the work was done, I don't know, 4 or 5 years ago. What's the update there in terms of density work or you're that, that you're either doing or potentially doing and thinking through long-term real estate opportunity for the business?

Dorvin Donald Lively - Planet Fitness, Inc. - President

Sure, Randy. You're right. We used to actually use Buxton, and today, we use a company called Tango, which really incorporates a lot more data inputs that we can put in about site location, a lot of other factors, including population density, drive times, income levels, et cetera. So it's a more powerful tool for us and for our franchisees to use as we do our market planning. But I think what I would say is, is that if you go back at the time of the IPO, we said that we had over 1,000 stores in the pipeline, and look at the number of stores we've opened in the last 4 years or so now, and we still have over 1,000 stores in the pipeline.

So what we do, in concert with our franchisees, is either voluntarily, they come in and they say, I bought a 15-store area development agreement and I built 10, I think I can do 10 more. And so we amend their agreements and add more locations. And today, we can do that in a much more sophisticated way with these tools. So it's all the way from things like having access to third-party data with, that track cell phone usage, how many people -- how many cell phone devices are in parking lots, where they're coming from, where they're going. .

We've done some studies with consumer intercepts in our centers where we have stores, we know where they shop within the center, we know if they -- if this is the first time that they really ever shopped in this location, because they joined Planet Fitness or vice versa, that they -- this is kind of their home shopping center, so to speak. And then all of a sudden, we opened in the center, so they join Planet.

So we have a lot of data that we can then take back to these landlords and REITs and prove to them that the old fallacy of the parking lot hogs of, back in the day, is no longer a reality. And quite frankly, they're trying to find retailers that are not only wanting to take space but are driving traffic. And we've even been able to get a number of our landlords and REITs and centers where we wanted to go into, to give up their exclusion for fitness centers, which used -- back in the day, was kind of a given that they wanted to protect their parking.

So I think the net-net of it, Randy, is, is that, one is, we have, obviously, all the data to know the population density and then our penetration within the market and what percent of that penetration of the population do we have within a 12- to 15-minute drive time, which is kind of the sweet spot, and then we can see where we're not. And that's how we do the market planning to maximize the number of stores that we think we can put in that market.



And as you know, a number of the franchisees have monetized over the last 2 or 3 years, we're bringing in private equity, we've resized all those markets that -- where those area development agreements got sold and resized them based upon, in essence, much better data that we have today, not only with more stores, more members, but with more sophisticated tools as well.

Operator

Your next question is from Jonathan Komp with Baird.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I wanted to first ask on the comps. I looked at the last 2 quarters, it looks like things have stabilized and accelerated a little bit in the fourth quarter. And now, obviously, pretty different approach to the marketing so far in 2020. So just maybe wanted to hear your thoughts on what you're seeing and how you're planning comps for the year here?

Christopher J. Rondeau - *Planet Fitness, Inc. - CEO & Director*

Well, I'd say, approximately 8% of what we're forecasting for this year, and I think you're right, I think towards the fourth quarter, we saw some momentum, and on the findings of that, we relooked at our data that supported our spend on digital and moving some of that into more TV and, specifically, cable advertising, which is 1 of the bigger shifts we did.

And I think even the January sale, you saw, I think you couldn't -- I could go away from the TV commercial every time I put on the TV. So I think you saw quite a bit of change here from the previous years. So I think the momentum's good. We're happy with how the year started and coming from fourth quarter for sure.

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

I think the only thing I'd add to that, John, is that kind of implied in that guide of approximately 8%, we anticipate about 200 basis points or so related to pricing for 2020. And I think that when you kind of back that out, you're really not all that far off for the last couple of years or so of on -- at least on an annual basis, of kind of the non-pricing related comp.

We think probably about 75% of our growth will be member growth as kind of where it's been fairly recently, with still some pricing embedded into the -- some lingering on the \$2 and then the \$1 that we've talked about at the end of Q3 last year. But the other factor, as we've also talked about, we just have another 250-some-odd stores that are in that base of stores on the comp waterfall that comps in that low- to mid-single-digit range.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, great. And then maybe a separate question on the unit growth outlook. I guess 1 question I had, maybe bigger picture. I know the annual unit growth has been a part of the annual incentives at the executive level. I just wanted to ask maybe if that still is the case. And if it is, how those targets align with the targets that you've put out for the guidance here for the year?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, we have different incentive factors that, depending on the pyramid that you work in functionally, but clearly, store openings and placements is a critical factor. Same-store sales is also an element of that as well as EBITDA to drive profits to the bottom line. So it still is a factor in our overall compensation plan.



Operator

Your next question is from Sharon Zackfia with William Blair.

Sharon Zackfia - *William Blair & Company L.L.C., Research Division - Partner & Group Head of Consumer*

Two different sets of questions. So I guess, first, on equipment, I didn't hear you mention anything about supply chain challenges with China. So if you could just talk to us about supply and whether or not you feel good about the equipment you have to facilitate new unit openings and replacement demand? And then should we expect as well equipment revenue to be down in the first quarter if placements are down? And then secondarily, on marketing, you have a huge ad budget. And I'm just wondering as you delve into optimization there, kind of where the next legs could be on more optimization for the money you're spending?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, Sharon, I'll take the first part, and Chris can talk about the marketing. I mean we're having fairly regularly contact with our suppliers, as you can imagine, as a lot of companies are right now. We've been assured by all 3 of our manufacturers that they have plenty of supply in the distribution centers or in transit to get us all the way through the end of Q2.

So we have plenty of supply for Q1 and Q2 at this point, and we continue to monitor that on a regular basis. In terms of revenue for Q1, revenue will be down. I mentioned we'll have, say, 10 to 12 placements less this year than the highest we've ever had, which was in Q1 last year.

We do expect that our replacement equipment sales on a full year basis will continue to grow. This year, it was about -- this past year, 2019, it was about 46%, we think it'll be a bit higher in 2020. That is a little bit lumpy quarter-by-quarter, but we do expect a slight decrease in sales on Q1.

Sharon Zackfia - *William Blair & Company L.L.C., Research Division - Partner & Group Head of Consumer*

Can I ask a follow-up just on that before the marketing question? What -- is all of the equipment assembled or made in China? And if you had to prioritize, would you prioritize new unit openings relative to replacement equipment if you were kind of limited in supply at some point?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes. So we -- our franchisees have the -- they have the election to choose any of the 3 manufacturers -- for new equipment, they can pick any of the 3. And a lot of the equipment is actually manufactured in the U.S., some in Taiwan and a little bit in Europe, but a lot of it is in the U.S. So they can do that. And then when it comes to reequipping their clubs, they also can do that, but we don't let them kind of pick and choose.

You can't replace some pieces with 1 brand and then some pieces with another brand, because we like the consistency of the branding from a member-facing experience perspective. But we're not at a point where we think we will ever have to prioritize that, but we -- as I said earlier, we've been in contact with these guys, if not daily, weekly, just to make sure that we've got enough supply on hand, and they've assured us that we don't have any issues to get through Q1 and Q2. And quite frankly, we're probably the most important customer some of these guys have in terms of volume on an annual basis, so we get some prioritization with respect to our manufacturers.

Christopher J. Rondeau - *Planet Fitness, Inc. - CEO & Director*

On the marketing front, Sharon, the -- I'd say, we did the New Year's Eve, we renewed that contract for 2 more years. We also did the Biggest Loser this year, which they brought that back, that started into January, another integration there.



I think the bigger lever we have is, we started to collect, and towards the tail end of last year, although we've got the spends with the franchisees we're doing locally, it was more the means and methods that we weren't capturing as diligently, so learning best practices around the system so that we can figure out and guide franchisees on their local spend for the 7%, what tactics they should be using, so they were all aligned and all growing in the same direction. That, I think, is a bigger lever for us to be pulling this year and in the future.

Operator

Your next question is from Peter Keith with Piper Sandler.

Peter Jacob Keith - Piper Sandler & Co., Research Division - Director & Senior Research Analyst

Just ask a question more on the revenue growth outlook. Hopefully, it's not an easy answer that I overlooked, but why is the revenue growth guided at 12% this year versus 15% at the start of last year, with what looks like a fairly in-line comp outlook to last year?

Dorvin Donald Lively - Planet Fitness, Inc. - President

Yes, it's -- I mean, the equipment, the total equipment -- the total revenue number, obviously, is impacted in a big way by the equipment sales. That's the reason I made the comment to Sharon's question a while ago that we expect overall, the replacement as a percent of the revenue to be up on a year-over-year basis. But this year, in 2019, when we placed around 260 in total, so it's down, call it, 20 new stores on a year-over-year basis.

That is really the only factor that's driving down revenue. I mean it's offset by growth in our other segments, but the biggest decrease is coming from the guide of approximately 240 new stores.

Peter Jacob Keith - Piper Sandler & Co., Research Division - Director & Senior Research Analyst

Okay. And does that carry forward to the EBITDA and net income guide? Is it also this year, a little bit lower than how you started last year? Or are there other expenses we should be aware of?

Dorvin Donald Lively - Planet Fitness, Inc. - President

No, it's really a pretty straightforward flow through, call it a, 23% to 24% kind of margin business. There's not a lot of SG&A in that segment. So when you take that in -- and flow it through your model, really on a year-over-year basis, the only other change is the debt structure, and we -- in my prepared remarks earlier, I addressed kind of what the total gross and net interest expense we expect in 2020, but those are really the only other factors affecting the model.

Peter Jacob Keith - Piper Sandler & Co., Research Division - Director & Senior Research Analyst

Okay. That's helpful. I did want to pivot then to some of the comments you made around the app. It seems like there's some interesting benefits that are helping your business. I was wondering if you were able to assess what the penetration of app usage is today, maybe versus where it started 2019 and where'd you like, where are you -- excuse me, where you would like to get it to over the next year or so?

Christopher J. Rondeau - Planet Fitness, Inc. - CEO & Director

Yes. I mean, it's still a small -- we rolled out at the tail-end of last year, so it's a couple of million active users, so it's really just starting off here, but we're really focused on new joins, how do we get them on-boarded correctly, that's our main focus. I mean the current members are 1 thing, but the newer members, as they're joining, how do we get them just start using it right off the bat, so that we can capitalize on it.

And you're right, whether it's the upgrades, the referral function, too. I mean, you think, we never really had a formal way for a member to refer another member. And we have a huge volume of joins, how do they tell their friends and family that they joined and, hopefully, offer them an incentive through them to join. So just have some really neat tactics there. So now it's just a matter of getting everybody onboard and so that we can capitalize on them.

And we haven't even rolled out messaging or in-app messaging and notifications. So once we roll that out, being able to speak to our members about promos we run so that they can refer people. You can't underestimate -- if think about with 14-plus million members here, we're so much larger than even our competition that, it's such a huge member base that if you can talk to them and offer their incentives, that in itself, and word-of-mouth marketing is just a powerful tool that no one else in the industry has.

Operator

Your next question comes from John Ivankoe with JPMorgan.

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

The cost of incremental debt would suggest that any acquisition of already established franchise clubs would actually be accretive to earnings, I mean just by the straight math of it. So is there a number that you guys think about in terms of the number of company clubs that you would want to operate in the United States or maybe there's a percentage of the total gyms that exist in the United States that you would potentially want to operate? And would you consider actually owning any company stores internationally, given what your overall cost of incremental debt is?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, it's a good question, John. And we get to this a lot, obviously, from both sides of the equation. I mean there are some investors who will question why we have any, and that's a good answer for -- 2 good answers to that. One is, it really is a great kind of R&D lab for us, so to speak, because not only can we test things, but we've got a lot of people that work in our corporate office or now work out in the field with our franchisees that kind of grew up on the corporate store side. So they understand the business and can be great business coaches to our franchisees, so it's good to have that.

Secondly, we've gone down a strategy of saying, we would like to operate some stores in most geographies, so that we understand the different aspects of those geographies, all the way from -- we have a store in downtown Boston, as you know, so we have an urban store. We have a couple of stores in a really, fairly high crime area out in Oakland that you know quite well. We have stores in rural Pennsylvania and stores in New York and a lot of stores in New Hampshire, where it's very rural.

And so it gives us a good read and a good kind of pulse on how the business operates in different geographies. In terms of the strategy, we have a roper on every single location, and we take a look at not only is -- does it make sense if a franchisee decides to sell, and we're nearby, that's kind of a no-brainer to take a look at. And sometimes, we've done that, and we did a couple of acquisitions last year.

But we're also looking at some of the better operators and some of the locations where there's some pipeline that could be built out, incremental stores, and maybe it's a market where, if we could dominate that market and kind of build the moat around us by building out stores and kind of getting there first, even in a -- if you take a, kind of a decent-sized city, you got a lot of storage you could build there, we'd rather be first to market within that kind of shopping hub, so to speak.

So we will continue to do that. We don't have a set number of stores that we would target in any year. And in fact, our guidance for the year does not assume that we would buy any corporate stores, but when those opportunities come up because, quite frankly, the EBITDA that they generate is pretty significant. We know everything about the store, we know the members. The operating costs are pretty easy because it's pretty much the same from store to store.

But it's something we're going to continue to focus on. And I don't think we have to be the largest, but I do believe, Chris and I have talked about this a lot, that we have historically been 1 of the larger groups, we'd like to stay kind of up in some of the larger groups and be a key player of our brands in some of those markets where we have stores.

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

And we've seen restaurants go from what used to be kind of 20% need-to-own in terms of underspending markets to well under 5%. I mean is there kind of a percent, just in terms of a philosophy that you would like to commit to? And then secondly, for the record, my sister does say that the high crime area in Oakland is much less high crime than it used to be as that area has significantly changed. So thank you for that comment.

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

That's good, John. I appreciate that and keep telling us how it's going. I think the way we look at it, John, is, is that we are an asset-light model. We generate a lot of cash. We've said we want to return cash to shareholders. But yet, we are and have deployed capital in buying some of the stores. There's a lot of strategies of markets where you have some onesies and twosies, so to speak. And it makes a lot of sense, whether it's us or a franchisee, to control that market, we're looking at that as well as working with franchisees to kind of dominate the market with 1 or 2 operators.

I think when you get up into probably the 20%, 25% range in that, that starts to get maybe a little bit high, but I think you would say, just because you know the QSR business so well, that there's not many franchise businesses out there that generate high 30s or 40% EBITDA margin. So you could make an argument that, that in terms of kind of the way investors tend to look at it, maybe you'd look at our business a little bit different? But we're under 5% today, and I would say, over time, we probably would increase that percentage a little bit.

Operator

Your next question is from Rafe Jadrosich from Bank of America Merrill Lynch.

Rafe Jason Jadrosich - *BofA Merrill Lynch, Research Division - Associate*

I just wanted to follow-up on the question in terms of the priorities of capital allocation. And how do you think about the buyback longer-term in terms of whether it's accretive to you on a near-term basis or not? Does that matter to you when you're deciding to, whether to buy a hub or buy back stock?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, I think, Rafe, the way we think about it is, the acquisitions that we've done historically, have all been in the, call it 5 to 7x EBITDA. And obviously, we're trading at a much larger multiple than that, and that kind of goes to John's question that I just answered, in that you could make an argument to buy a business all day long at 5, 6, 7x EBITDA, when you're getting the kind of multiple valuation that we're getting. And rightly so, because we've been able to take stores, and in essence, generate with the kind of comps we're generating, they just become more accretive.

So on the 1 hand, we haven't deployed a significant amount of cash in that area, but that's something that, albeit not embedded into our guidance or budget for 2020, we will always look at all the ropers that come along. In terms of the way we think about the broader strategy of capital allocation, we've stated this now since the last couple of years or so, that we will return cash to shareholders. And in fact, we've done so, well north of \$400 million last year and over 6 million shares.

It is dilutive to 2020, and I mentioned that in my remarks. We believe that, over time, it's the right thing to do. And if we can keep growing comps, we have the confidence in our business, we have a confidence in our pipeline, this business will generate so much cash flow that we believe that's sort of the right thing to do.

We have had conversations with our Board about the right priorities of capital allocation, and those discussions have always been around stock buybacks, dividends, and then deploying capital in terms of like corporate stores, both organic as well as acquisitive. So far, obviously, the bigger piece has been cash returned via shareholder purchases or stock repurchases. And -- but we'll continue to look at all of those options every time we meet with our Board and have a capital allocation conversation.

Rafe Jason Jadrosich - BofA Merrill Lynch, Research Division - Associate

Okay. That's really helpful. And then, Chris, you mentioned international growth accelerating this year and then kind of going forward. Can you talk about, within the guide, like how many of the openings will be international versus domestic? And then can you sort of go through some of the key markets between Mexico, Canada and Australia and talk about what you can see there in terms of the long-term potential and then compare it to the U.S.?

Dorvin Donald Lively - Planet Fitness, Inc. - President

Yes, I'll take a stab at it, and Chris can add to it. So last year, we opened 261 stores, out of that, 16 were international, so it's still a small percentage. We ended the year with 55 stores, mostly in Canada, as we've talked about, so that's where -- we have 44 stores in Canada. Last year, we opened 12. And then we just, most recently, at the end of the year, as we talked about Australia, so we have 2 stores open there.

In terms of the opportunities and the way we currently see international, clearly, Canada, we've sized it at about 300, so it's a really important country for us. And now with a base of 44 stores and growing, it's starting to get more scale, and there's things that you can do with scale that you can't do when you only have just a small number of stores, whether be it in this case, let's say, Mexico or even Australia. But Mexico, we also believe is a really important market for us.

We do extremely well in a lot of Hispanic markets, from Southern Florida to Southern Texas and California. And the stores we have down there at the moment, we think -- I mean they do very well and we think our brand will resonate in that as well.

So we're opening some more stores in the Monterey area, testing kind of some different income levels to try to determine exactly where our brand can really excel in different economic structures down there, but those are really probably the 2 markets at the moment that have kind of the biggest opportunity within most recently, as I mentioned, just going into Australia.

Operator

Your next question is from Joe Altobello with Raymond James.

Joseph Nicholas Altobello - Raymond James & Associates, Inc., Research Division - MD & Senior Analyst

I guess, first question, Dorvin, I just want to go back to some comments you made earlier about marketing and the fine-tuning of the marketing that needs to be done in 2020. And I know you guys have done a very good job of reorienting the marketing effort back towards traditional and cable TV, for example, and away from digital. But beyond that sort of high-level, what other fine-tuning do you guys see happening in 2020 on the marketing side?

Christopher J. Rondeau - Planet Fitness, Inc. - CEO & Director

Yes, more of -- this is Chris, actually. The -- you may recall, last year, we did a big market segmentation study in our member base and categorized our members into 5 different buckets and learned a lot about TV channels, retailers that they shop at and so on and so forth.

So not only have we directed more towards cable and from digital, but also fine-tuned what particular channel of networks we're actually going to be on besides network television being ABC or NBC, for example, but Food Network, History Channel, A&E, goes on a big list of them, insights that we really didn't have before. So we fine-tune a lot of that part of it and use that for -- and last year as well as 2020.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD & Senior Analyst*

Got it. Okay. Just one more on productivity. And this sort of goes back to the commentary about opening 240 new stores this year versus 260 last year. If you look at the productivity of your recent new store openings compared to some of the older cohorts, how do they stack up? Is the productivity improving on the newer stores?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, I'd say if you look over the last, call it, 3 years, 4 years or so, and you look at kind of the comps of older stores versus how stores kind of get out of the gate, there hasn't been any significant difference. And we get this question a lot in terms of, if you are in a higher market penetration kind of area of the country where we have more stores and, therefore, more -- a higher percentage of the TAM, it -- we don't see really any significant difference from that than we do in a market where you have a lower percentage, which comes back to why we keep saying that we continue to have confidence in kind of that 4,000 potential in the U.S.

And we even looked at our 100 oldest stores in the system, and our 100 oldest stores, which goes way back, actually, last year outperformed even the more mature stores, older than, say, 3 or 4 years old. So not only are we seeing kind of those newer stores and then kind of year 2-, 3-, 4-, 5-year ramp, even the 100 oldest stores continue to comp positive and, in fact, higher than some of the mature stores.

So I think it speaks to a number of things. It's more and more marketing dollars, as Chris just talked about, going into a market. Obviously, in those stores -- in those markets where some of the oldest stores are, we have a lot more stores today, so you have the availability of reciprocity, so you got the Black Card penetration can contribute to the total revenue, and then, therefore, the comp. But it just speaks to the power of the brand as we go into more and more markets, including some of the oldest we have and some of the highest penetrated markets we have today. And we feel really good about how our store performance has been and feel good about what it's going to do, even this year.

Operator

Our last question comes from Simeon Siegel with BMO Capital Markets.

Simeon Avram Siegel - *BMO Capital Markets Equity Research - Analyst*

Any color you can share on what percent of Black Card members are still grandfathered in at the lower rates? And then just congrats on that ongoing SG&A leverage. Can you -- how are you thinking about that for -- the line item for next year?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes. We don't break out the, I guess, the layers of our pricing. We give what our total Black Card is versus our standard classic membership. But I mean we still have pretty good-sized numbers at the \$19.99 membership as well. We've talked about in the past as to maybe there's some stickiness to that. And over time, we'll see, because it's only been now 9 quarters, I guess, since we put that price in effect, but we don't break out that. What was the second part of your question?



Simeon Avram Siegel - *BMO Capital Markets Equity Research - Analyst*

How are you thinking about SG&A for next year?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

SG&A.

Simeon Avram Siegel - *BMO Capital Markets Equity Research - Analyst*

Just given the leverage?

Dorvin Donald Lively - *Planet Fitness, Inc. - President*

Yes, I mean we, yes, we -- and we had -- if you remember back in Q3, we said we'd get leverage for Q4 and then full year. I think that we will -- based on our guide, we believe we'll continue to get some leverage this year.

Operator

This does conclude the Q&A period. I'll now turn it back over to Chris Rondeau for any closing remarks.

Christopher J. Rondeau - *Planet Fitness, Inc. - CEO & Director*

Great. Well, thanks, everybody, for joining the call today. And it was a record year for us. We broke 2,000 stores. So we're halfway to that 4,000 number as well as a record year openings at 261. We're really pleased with the changes in marketing and the performance there and look forward to the Q1 release. Thank you.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation, and you may now disconnect.

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