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EXPERT INTERVIEW

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TEAM

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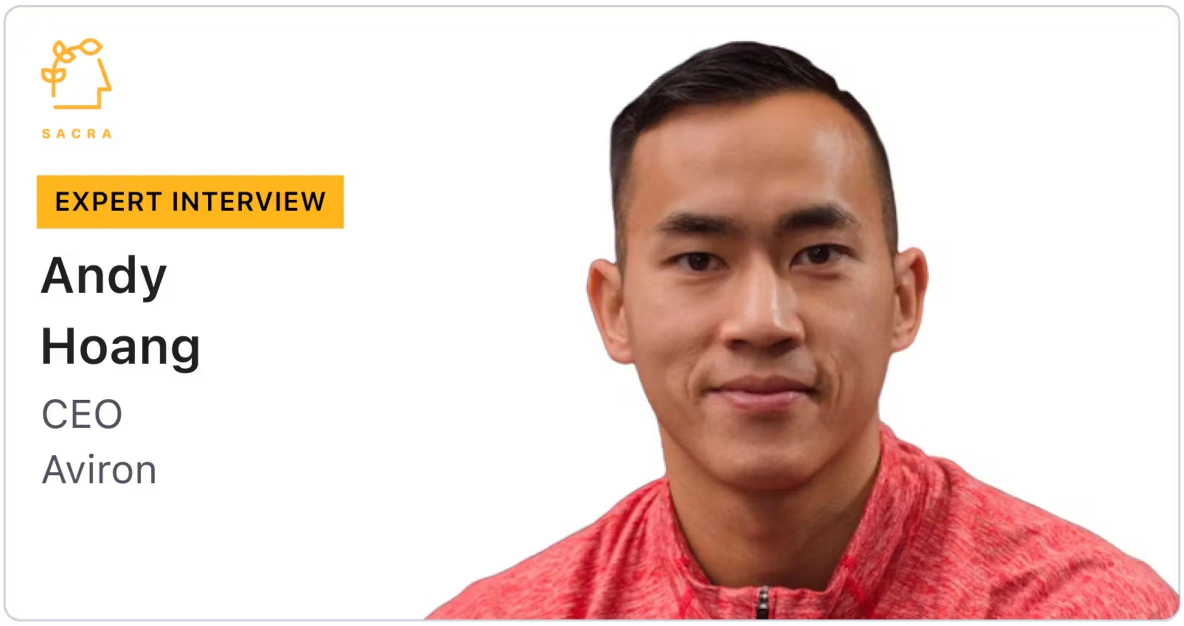

Background

Andy Hoang is the CEO and co-founder of Aviron. We talked to Andy to get a better understanding of the current state of connected fitness, why companies like Peloton will struggle post-pandemic, and the unit economics of fitness content and games.

Interview

Can you give us an introduction into what Aviron is and what you were thinking about when you started the idea?

Aviron is a game-based connected rowing machine. Where we differ from most of the connected products out there, aside from obviously being a rowing machine, is that we use game design and psychology to make the fitness experience fun and exciting—some would say addictive.

I really built the product for myself. I think when you start a company, you should try to solve a problem that is affecting

you or someone you know, or because it’s a passion. For me, it was two things.
For one, I hate cardio, and I think a lot of people hate cardio.

Second, I learned about Peloton and I thought it was a great concept—how you could get the same type of workout experience as a boutique fitness studio in the comfort of your home. But after purchasing a Peloton, I found the class, instructor-led texperience didn't resonate with me. I'm someone who's a little more competitive.

I like short, more intense workouts vs. long form cardio, unless I’m being active in a team sports environment. So marrying video games with a rowing machine—which is one of the best or most efficient exercises out there—is how the idea behind the product came about.

As far as the folks that were first buying rowers, did you identify what the product–market fit was? Was it a specific type of person, athletes or fitness enthusiasts?

I'll give you a bit of the backstory. We’re unlike traditional connected fitness companies because we bootstrapped our first three or four years. That meant, obviously, we didn't have a lot of money, which meant we weren't going after direct-to-consumer.

Acquiring customers is not cheap. We went the B2B route and sold to what we call vertical markets. Vertical markets are pretty much all businesses that are not gyms - so hotels, corporate wellness, apartment buildings. Those were our typical customers, and we sold through a reseller network. Really, our early customers were some YMCAs and some Holiday Inn Expresses.

It was a challenging way to get started with a long sales cycle but it showed us there was interest in our type of product and we started to see the beginning of product market fit. Once the pandemic hit and we made the decision to pivot to a direct to consumer product is where we truly experienced volume and hence product-market fit.

What changed that enabled you to go direct-to-consumer? What were some of the big obstacles to doing that originally?

The biggest obstacle was just cash, being able to acquire customers, support the customers, logistics. All that is a lot more complicated—going direct-to-consumer and running an ecommerce site—than it is to sell to value added resellers that go out and do all the sales and installs for you. We were forced into the pivot because we launched the business and started selling in 2019, which was pre-pandemic.

When the pandemic began businesses abruptly stopped purchasing and consumer began purchasing in greater volumes. So although we had already been planning an additional home rower and eventual addition of a DTC business we were forced to pivot and modify and launch the home rower much more quickly. It wasn't crazy unlock, it was more the conditions of the market.

Among those consumers, what do they look like in terms of profile of person? Did the profile change when you shifted from the B2B days to direct–to-consumer?

We were a much different company back then, much smaller. The content wasn't as clean. I think we were appealing to an older demographic at first, because the product appealed to families where it's something that the parents can use, but also their children could use. And it's rowing, so it's super efficient and low impact; if you only had five or 10 minutes during lunch or after work, you'd hop on and play a video game.

I thought it would appeal to a younger demographic at first, and I also thought it would appeal more towards men. But in the early days it was 50 and older, and skewing actually more female than men. As we've grown and we're getting to a larger scale, that demographic has gotten a lot younger and it is starting to skew slightly more towards males, but still relatively balanced between both males and females.

To what extent do you see it penetrating throughout the home? To what degree is one person driving the Aviron usage versus families getting one?

The unique thing about Aviron versus a Peloton type of product is that we do appeal to a much broader audience. So there are more people using it in the household.

On average, every machine has at least two profiles on it, versus a Peloton, it's specifically for one person, at most two people. At a minimum, we're at two profiles, but if you have kids, you have grandparents, you have any family members they all tend to get interested in the product because the content's so broad.

We're a gaming based company, but we have Netflix and a whole bunch of streaming platforms, guided programs, virtual rows, and a variety of different games that are very game-y to less game-y. That has allowed us, and just digressing, but that's given us an advantage in terms of retention and usage is extremely high on our rowers.

Our monthly usage is a lot higher than a Peloton because customers are getting on more frequently because the workouts are shorter and because more people are using it in your household. It also translates to having higher retention because more than one person's using it, you're less likely to churn.

On the content business model side, it seems like there's two models. One is this Peloton model where you're paying this army of instructors to produce new content every day, and a lot of it is live, although not as much anymore. Or it's themed, and that drives subscriptions. The other is an Aviron model, which seems built more on evergreen games, and stuff that you make, that the company only has to pay for once and can keep selling it to people. How do you think about driving the value of the subscription with that kind of model?

In terms of unit economics, we're in a much better place. I think Peloton pays around 30% of their subscription toward music royalties. We don't have to pay any royalties, and we don't have to pay any trainers. We just integrate to Spotify, as an example, and you can listen to your own music and do our workouts. From a business economics standpoint, we're in a much better position.

Obviously, the challenge with that is, like you mentioned, how do you justify paying a membership when on the Peloton model consumers are getting this live instructor and these amazing songs? For one, we don't charge as much, and that's where our price point is lower.Our membership fee, instead of

being $44 a month—which is what Peloton was, I don't know if they've increased it—but ours is down to $25 a month. That's more in line with getting closer to your Zwift or pretty much any other streaming service. It's just a lot more approachable.
In terms of content, for a software based product that doesn't rely on instructors as new content we're releasing pretty frequent updates. We aim for 2 major updates a quarter with new content, new games, additional features and some smaller updated peppered throughout.

For example, adding all the streaming services, adding Spotify integration, adding a brand new game, those aren't things you can do each week, but the cadence is pretty good and the customers seem to be happy with it. The updates definitely justify the price of the membership. Another feature where customers find value is all of the interactive and social features.

For example, we have a group workout lobby. When you click on that, you can see that there's always ongoing workouts that you can join with other people. There's a community of people that you can workout with all the time and you can do it with real people from around the world.

Then, once you finish that workout, you have high scoreboards, leaderboards, monthly challenges, and consumers are unlocking new achievements, and even using their Aviron coins to unlock backgrounds and vehicles in our Power Play category.

How do you think about the balance between building a Peloton-style walled garden and Aviron's more open ecosystem? What are the pros and cons of each approach?

There's a lot of benefits to both. The biggest advantage of a Peloton is it's not broad, but it's very deep. That one experience is an amazing experience. That's very valuable to people who are new to the sport or the exercise, where you can go in and there's just so much. As a beginner, you can start real slow and there's content that's catered towards you, then as you progress, you get deeper and deeper.

Aviron is very broad, and you can compare our experience to gaming systems and we intentionally designed it this way. If I

get on my Aviron machine or my Nintendo or PlayStation, every day can be different. Do I have an hour to play or do I have 30 minutes to play? If I have 30 minutes, do I want to do something that's very high intensity? Or do I want to do something that is low intensity and relaxed? That's how we approach it. It's based on providing consumers an alternative way of getting motivated and staying engaged then the class driven approach that's currently dominating the market, but does not appeal to all.
Our variety approach is also backed by the data. When we first came out with our product, we were heavily focused on games as the differentiator and core of our business. But as we looked at the data and started adding on different types of content we found that customers really enjoy the variety. They enjoy the fact that there are short workouts, long workouts, high resistance, and low resistance, and games and streaming and group workouts etc.

Instead of just focusing on one area, we decided to take the approach of a video game system and have a very broad approach, a wide array of different options. And for us that's yielded very good results along with a fanatical community that raves about the product.

How does the technical work that's gone into the Aviron tablet and operating system give you an advantage over other connected fitness companies? What's hard about what you've done?

One thing that not many people speak about as to why our competitors don't do what we're doing is, it's actually really hard to do the integrations. I'll explain it at a super high level.

When you run Netflix on our rower, you're running Netflix and then you're also running our application on top of Netflix and overlaying a transparent bar that shows your metrics on top of the native Netflix app. There's a lot of value to that because you're getting the full Netflix experience.

To accomplish that, you not only have to be able to create a great application, but you need to understand how to modify the operating system, the layer that's underneath that. We're not only building a great app that sits on top of it, but we're making significant changes to the Android operating system.

Once you're a company like Peloton, you built this product and you have 100,000 users already using it, to modify that app to now interface and work with the operating system isn't that simple. That's where a lot of these companies are stuck. They've done something one way for so long and they have so many customers, it's really hard to pivot off of that.

Peloton and Hydrow have had big layoffs recently. How do you think about building for the long-term and building a sustainable business?

I have a strong opinion and I don't know if I should have a strong opinion because my company's super small compared to all these monsters out there, but I think cash has been really cheap for the last five years or so.

When cash is cheap, you're able to run a less efficient and effective business. That's what most of our competitors have done, they've overhired and overpaid, and they don't have a good pulse on their unit economics. They haven't really been growing a business, they're just fueling that business by raising additional capital, and that's how they've gotten to where they are.

But now that we're headed to an economic downturn, business fundamentals and unit economics are very important. Aviron being small really helps, but the first four years of our existence was bootstrapped and we never had any institutional capital until we sold over a million and a half dollars. So our fundamentals are very strong and we understand unit economics very well, along with margin and acquisition costs.

That's why we're actually doing more hiring now because we're still growing really quickly, and our business is quite strong.

How do you think about controlling acquisition costs as a fitness hardware company?

High customer acquisition costs are super problematic, because everyone's operating on a very thin margin. Many connected fitness companies lose a ton of money on the sale of their hardware. From what I understand, margins are typically between 20-30% on average on hardware for most connected fitness. If companies are selling a product that's $1,000—let's just round it up to $2,000 because most products

around that $2,000 range—maybe they're making $400 to $600 after costs, shipping it to North America etc. The margins are quite thin.
But then they can justify it and justify a high acquisition cost that goes way beyond the contribution margin because there's a very strong lifetime value (LTV). If retention is 1-2%, then if the LTV is huge, and they're really digging into one year, one and a half years of membership, then that's how companies have been able to justify their business.

That has allowed all these companies to continue raising capital and continue growing because they're like, 'My LTVs are $7,000, even though I'm only making $400 on contribution margin, because my churn is so low.' That's where it started.

When COVID lockdowns ease off is where we get into the problem. Because now when I'm ABC Company, and my top line is a $100 million and I'm supposed to be bringing in $10 million a month, if not more, and growing 150% a year. And suddenly the acquisition cost increases by 20-30%, the impact on business is significant.

When shipping overseas to get the product to North America has increased 200%, all these changes are having a really significant impact on the business. Because traditionally, pre-pandemic, a company wouldn't be able to get away with a $400 contribution margin with one or two years of LTV.

A lot of startups were able to do that because cash was so cheap and everyone was growing and valuations were inflated. Now that we're back to reality, some startups are in big trouble because the CAC went from maybe $600 and now it could be $1,000,or more and investors aren't going to continue fueling those businesses. That's the issue with all these companies and why we're seeing huge cuts.

Can you talk about what the big customer acquisition costs are in connected fitness—mostly paid advertising and paid marketing, and what kinds?

Yes, it's mainly paid marketing via Facebook and Google. For our business, it's maybe a little bit different because attribution is very challenging due to the length of the sales cycle. It's very long and it's a high-consideration item; people are taking

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two to three months, sometimes they can take 12 months to purchase our product.
So we don't always know where our customers are coming from, which leads to pouring in money everywhere. This especially changed when iOs 14 came on last year where the access to data dried up, so there's even less visibility and that's what's driving up acquisition costs.

You mentioned Tonal, we talked about Hydrow. Do you have a take on this adjacent space of the fitness trackers with the Garmin Watch, Apple Watch, Whoop, Aura. Is it complimentary or slightly overlapping and competitive with the tracking of metrics?

I think the industry that is going to get hurt the most in the connected fitness space is going to be the instructor-led classes. That space is going to get hit the hardest, because there's a strong alternative, boutique fitness, which is really where that industry came from.

So when people say gyms are opening up, it impacts all the connected fitness companies, but it impacts the Pelotons the most because now you can go back to SoulCycle and one of many local spin classes.

If you look at the adjacent spaces, the Tonals, all the wearables, even us, the impact is still significant, but less significant because there is less of a comparable alternative to go "back to". There is no alternative to all the wearables, people still want to get those metrics and track.

They may have less disposable income and therefore for some companies sales are going to drop because people are just buying less. But a Peloton, not only people are going to buy less, but people are like, 'I can go and do a spin class at my YMCA now, and I'm getting the same experience.'

Are at-home gyms forming, and there's going to be some capacity limit on how many elements people will have in their basement? Like, is there a rough estimate for how many items people will want to have? Do you think there's a logical limit?

That's a view that I don't really think about, and I'll explain why. That's assuming that everyone has access to gyms. That's the

biggest thing, because most people that are proposing this question live in big cities and the alternatives to their Peloton is going down the street to SoulCycle. But the majority of our customers aren't in major cities.
Gyms are opening up and more people are going there, but it doesn't have the same impact on connected fitness, the way that people think just because gyms are opening up people aren't going to workout at home. Maybe for a Peloton that is at such a scale that a significant portion of their customers can now opt for the gym, that's true.

But many of our customers and people who buy our product don't necessarily have access to a gym. They may have access to a gym, but maybe it's far away, but they definitely don't have access to a SoulCycle type of experience.

What do you see as the universe of workouts that make sense to have connected hardware for? And what doesn't? Maybe something boutique and instructor-led, for example, is less amenable.

My viewpoint on connected fitness is it's definitely an industry that is still in it's infancy. If you look at pre-pandemic, no one was really talking about it pre-pandemic, but Peloton had already raised nearly a billion dollars before Covid-19 hit.

It's not like because of Covid-19 and all these gyms were closing, is why connected fitness exploded. It was already growing before that, and it was just accelerated due to the pandemic. That's my first take on it.

I always think there's a place for connected fitness as well, because what connected fitness solves, to me it solves a few things. It solves convenience, that's the main thing. Going to the gym can be a pain. Going to a boutique gym and then finding parking and reserving a class the night before and making sure you show up exactly on time, those are all inconveniences.

That's what connected fitness solves: Consumers can have a great workout with the same experience in the comfort of home whenever they want.

In addition to that, consumers have access to more variety, in terms of content, because they're not going to the same gym

and seeing the same instructor. I have access to, on Aviron, 500 different workout options, thousands of members, and dozens of games.
Also from a cost standpoint, when you first look at a Peloton, you're going $44 a month, that's pretty expensive. But when you can split that cost across multiple family members, it's quite easy to justify that price. And it actually is a lot cheaper than the alternative.

To loop back around to customer acquisition costs, how does Aviron think about it differently? Is it just trying to keep CAC down, even if it means growing a little slower? Or is there some other differentiation around it that leans more toward word of mouth and that sort of thing?

For Aviron specifically, we look at CAC every day, but we are very fortunate that our contribution margin is very strong. We're almost net zero on every sale. That gives us a lot more freedom to do more testing and be more aggressive and to lose money some months because of our strong margin. Like I mentioned, most of our competitors are in the 20-30% range, we're way north of that. That's why we look at it a little bit differently and that's why we're still spending a lot.

Right now, it's funny because we are noticing that most competitors are spending a lot less, so CPMs are a lot more affordable. We're using this opportunity to actually ramp up and sell even more. There's a famous Brazilian F1 driver, Ayrton Senna, and one of his lines is "You can't overtake 15 cars in sunny weather, but you can when it's raining."

We're using this opportunity for that same reason. We're not the biggest company, but because we have strong business fundamentals and strong economics, we can actually take advantage of this opportunity to grow our business.

From a hardware standpoint, we're just good at making hardware and keeping our costs low. In terms of the content, you nailed it, Peloton is paying 30% of their membership fees on just music licenses, and then they have to pay instructors. To make our video game, we pay $0 on any type of music licensing, and our developers, we make a game and pay them a salary and they just produce a game and then work on the next game.

Our costs are very manageable and predictable, which gives us better margins and allows us to be more aggressive in our ads, and to have a higher CAC because we can afford to market while our competitors can't. Then we can do more testing and more experimentation—it just gives us an advantage.

Disclaimers