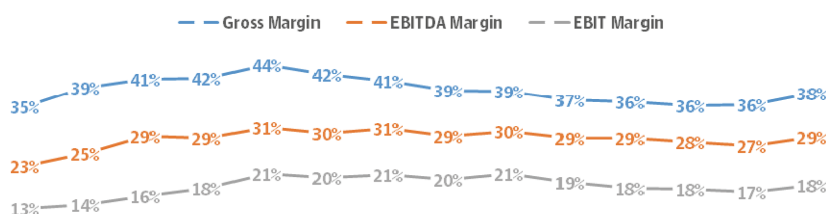
SINGULAR DILIGENCE

Life Time Fitness (LTM)

Life Time Fitness (NYSE: LTM)
Stock Price: $48.51

	EV/Sales	EV/Gross	EV/EBITDA	EV/EBIT	EV/Owner Earnings
ClubCorp	2.14	7.99	9.73	18.4	13.58
Accordia Golf	2.34	NMF	9.96	15.98	12.31
Weight Watchers	2.48	4.18	8.28	8.86	10.16
Clublink	2.76	NMF	9.32	14.32	11.16
Town Sports	3.15	6.4	7.13	9.5	7.96
Minimum	2.14	4.18	7.13	8.86	7.96
Maximum	3.15	7.99	9.96	18.4	13.58
Median	2.48	6.4	9.32	14.32	11.16
Mean	2.57	6.19	8.89	13.41	11.03
Standard Deviation	0.39	1.91	1.18	4.13	2.14
Variation	15%	31%	13%	31%	19%
Life Time Fitness	2.85	6.83	8.88	13	8.61



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Minimum	Maximum	Median	Mean	Standard Deviation	Variation
Sales	54	94	137	195	257	312	390	512	656	770	837	913	1,014	1,127	54	1,127	451	519	365	70%
Gross Profit	19	37	56	81	114	132	159	199	254	283	304	325	362	431	19	431	179	197	131	67%
EBITDA	12	24	40	56	79	92	119	148	196	220	240	253	272	323	12	323	134	148	102	69%
EBIT	7	14	22	35	54	63	81	101	137	147	149	161	173	208	7	208	91	97	66	68%
Receivables					1	1	3	3	3	5	5	5	6	8	1	8	4	4	2	51%
Inventory					4	5	5	7	12	14	15	16	19	24	4	24	13	12	7	56%
PP&E					428	509	661	868	1,165	1,487	1,700	1,833	2,030	2,273	428	2,273	1,326	1,295	663	51%
Working Liabilities					28	32	43	57	71	78	78	83	93	109	28	109	74	67	27	40%
Net Tangible Assets					405	483	626	822	1,109	1,429	1,642	1,771	1,962	2,196	405	2,196	1,269	1,244	646	52%
Margins																				
Gross Profit/Sales	35%	39%	41%	42%	44%	42%	41%	39%	39%	37%	36%	36%	36%	38%	35%	44%	39%	39%	3%	0.07
EBITDA/Sales	23%	25%	29%	29%	31%	30%	31%	29%	30%	29%	29%	28%	27%	29%	23%	31%	29%	28%	2%	0.08
EBIT/Sales	13%	14%	16%	18%	21%	20%	21%	20%	21%	19%	18%	18%	17%	18%	13%	21%	18%	18%	2%	0.13
Turnover																				
Sales/Receivables					211.82	259.59	143.06	155.43	193.02	145.36	165.09	185.69	169.48	146.09	143.06	259.59	167.29	177.46	36.72	21%
Sales/Inventory					60.97	64.84	73.33	70.89	56.79	53.16	57.22	57.23	52.14	46.15	46.15	73.33	57.23	59.27	8.44	14%
Sales/PPE					0.6	0.61	0.59	0.59	0.56	0.52	0.49	0.5	0.5	0.5	0.49	0.61	0.54	0.55	0.05	9%
Sales/NTA					0.64	0.65	0.62	0.62	0.59	0.54	0.51	0.52	0.52	0.51	0.51	0.65	0.56	0.57	0.06	10%
Returns																				
Gross Profit/NTA					28%	27%	25%	24%	23%	20%	19%	18%	18%	20%	18%	28%	21%	22%	4%	0.17
EBITDA/NTA					20%	19%	19%	18%	18%	15%	15%	14%	14%	15%	14%	20%	17%	17%	2%	0.14
EBIT/NTA					13%	13%	13%	12%	12%	10%	9%	9%	9%	9%	9%	13%	11%	11%	2%	0.17
Growth																				
Sales		74%	45%	43%	32%	21%	25%	31%	28%	17%	9%	9%	11%	11%	9%	74%	25%	27%	19%	0.67
Gross Profit		94%	51%	44%	41%	16%	21%	25%	28%	12%	7%	7%	12%	19%	7%	94%	21%	29%	24%	0.84
EBITDA		94%	65%	41%	42%	16%	29%	24%	33%	12%	9%	6%	8%	19%	6%	94%	24%	31%	26%	0.84
EBIT		86%	63%	57%	54%	16%	29%	24%	37%	7%	1%	8%	8%	20%	1%	86%	24%	32%	26%	0.83
Receivables					1%	-2%	259%	-46%	93%	37%	-34%	44%	6%	51%	-46%	259%	21%	41%	87%	2.14
Inventory					23%	7%	14%	55%	63%	2%	0%	18%	25%	26%	0%	63%	21%	23%	21%	0.9
PP&E					8%	29%	30%	32%	36%	22%	8%	7%	14%	10%	7%	36%	18%	20%	11%	0.58
Working Liabilities					10%	15%	49%	24%	24%	-2%	3%	10%	14%	19%	-2%	49%	15%	17%	14%	0.85
Net Tangle Assets					8%	30%	29%	33%	37%	23%	8%	7%	14%	10%	7%	37%	18%	20%	12%	0.58

NOVEMBER 2013

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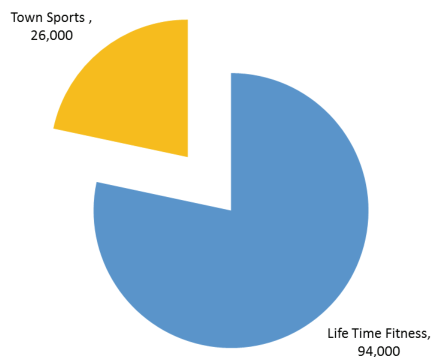
Life Time Fitness (NYSE: LTM): A Repeatable Superclub Model That Can Triple in Size

OVERVIEW

Life Time Fitness is the product of Bahram Akradi. Akradi's family left Iran when he was 17. He started school in the United States as a high school senior. A couple years later, he took a graveyard shift with the Nautilus Fitness club in Colorado Springs, Colorado. He became a salesman for the club while in college. Akradi remembers that being a lucrative job: "By the end of my last semester, by selling memberships, I was already making more money than I ever would as an electrical engineer." Two years later, he was co-manager of a Nautilus club in Minnesota. And then manager of a new club in that state. Akradi reshaped Nautilus into U.S. Swim and Fitness. He developed new clubs in the Twin Cities (Minneapolis and Saint Paul) area. Akradi decided on locations for the club and negotiated the leases. He did not stick with the old, smaller format. Instead, he used his drafting skills to design new, larger clubs. This shift grew out of his own experience as a club user. According to Akradi: " People who build clubs only from the financial point of view sometimes fail – not always, but sometimes, they fail because they are not giving the customer what he is looking for. I tell people: Watch the customer. See what they want. If you can react fast enough you can't go wrong."



The average Life Time Fitness center has 3.6 times the square footage of a Town Sports club.

U.S. Swim and Fitness started offering new services like day care and nutrition advice. The company targeted families and high income households. Akradi got a 12% stake in U.S. Swim and Fitness. He started looking through the demographic data of local radio and TV stations to find the local areas that had the best addressable market for his new kind of club. However, Akradi was just a minority owner of U.S. Swim and Fitness. When Bally's Total Fitness offered to buy U.S. Swim and Fitness, Akradi opposed the deal. But it went through anyway. Akradi left the company and decided to found his own customer centric club business. He called it Life Time Fitness.

Life Time Fitness was founded in 1992 in Minnesota (where it is still headquartered). Akradi had a difficult time raising money. He spent two and a half years trying to get investors interested in his new model. Finally, a local businessman named Wheelock Whitney put in $75,000. Life Time Fitness's first club was in Brooklyn Park, Minnesota. It was far from ideal. Instead of being a new club, it was an old club that Akradi refurbished. The location did not have the demographics of higher income families that Akradi believed were the engine of his model. The second club was built in Eagan, Minnesota in September 1994. This club – although half the size of Life Time's current model – was in many ways the first proof of concept of Akradi's big club format. At 65,000 square feet it was far larger than most clubs (which even today average less than half of that) and offered a lot of amenities. Akradi continued to scale up. In May 1996, Life Time Fitness built a 90,000 square foot club. That is the model the company started replicating across the country.

By 2000, LifeTime Fitness was expanding rapidly. The company was in the midst of developing 6 clubs. Developing the super-sized clubs Akradi had in mind is very expensive. The land is usually owned rather than leased. Those 6 clubs each required – on average - $25 million of capital investment to open. Life Time Fitness had to raise an additional $100 million to complete the projects. This need for outside capital lead to a 2004 IPO. The company raised $80 million. All of it was used for expansion.

Life Time Fitness owns and operates fitness clubs. However, these fitness clubs are not like the urban gyms run by Town Sports International (New York Sports Club, Boston Sports Club, etc.) or the suburban strip mall locations of franchises like Curves.

The current model that Life Time uses for its new clubs is 114,000 square feet. It targets between 7,500 and 11,000 memberships at each location. A membership is different from a member. Life Time Fitness has a large number of families using its clubs. So, the average membership is actually being used by just under 2 people (1.9). Compared to other fitness clubs with high membership – like the nation's largest YMCAs or the clubs of Town Sports International – Life Time Fitness's clubs are not especially crowded. Members per square foot are very similar at Life Time Fitness and Town Sport International (about one member per 6 square feet). However, Life Time Fitness's clubs have many more square feet. This allows for the convenience of having a lot of parking spaces and lockers. The present model includes 600 parking spaces and 600 cherry wood lockers.

Life Time Fitness offers more amenities than other clubs. A typical Life Time Fitness location has cardio equipment, free weights, resistance equipment, basketball courts, volleyball courts, racquetball courts, squash courts, a lap pool, whirlpool spa, swimming pools, waterslide, sauna, and rock climbing wall. Many locations offer related services like a childcare center, spa, café (serving healthy food), and pool side dining.

The physical plant is far superior to that offered by clubs like Town Sports International. Life Time designs its clubs in house and acts as the general contractor on its development projects. These include limestone floors, granite countertops, and the aforementioned cherry lockers. The clubs are built with little touches meant to suggest a premium experience and encourage heavy use by members. This is important, because unlike virtually all other club operators – Life Time Fitness offers only month-to-month memberships. They do not sell annual memberships. There are cancellation fees and other factors that discourage quitting the gym (especially in the first few months).

Life Time Fitness generates a lot of money from cross-selling added services to its members. Programs include group fitness, yoga, swimming, running racquetball, squash, tennis, pilates, martial arts, cycling, basketball, and swimming. These range from one on one to small group to large group. They range in price from included in the membership to quite an expensive add on. Many of the services are marketed directly to members by an in club sales team that is paid on commission.

The cost of a membership (which averages 1.9 members) varies by location. Clubs with the least amenities are cheapest at just $65 a month for a gold membership. A platinum membership is $85, an Onyx membership is $105, and a Diamond membership is $135 a month.

The company has 105 locations. Management believes the concept can support 250 to 300 clubs around the country. Since the company is only in 28 markets, that expectation seems reasonable. The best measure of the company's valuation is EV/EBITDAR where EV includes capitalized rent (which is low for Life Time Fitness since they own most of their locations, but high for competitors since they rent theirs) and EBITDAR is Earnings Before Interest Taxes Depreciation and Rent.

Today, Life Time Fitness has an EV/EBITDAR of 8.6. This would be reasonable if all of the company's clubs were mature and the economic environment was normal. Neither of these statements are true. EBITDAR is held down by immature clubs - since Life Time Fitness is still expanding – and low consumer confidence. Both of these factors will normalize given time. Life Time Fitness's model leads to returns on capital around 15%. At maturity, the company should be worth 10 times pre-tax owner earnings. The business is a long way from maturity. EBITDAR can grow 10% a year for at least the next decade.

The greatest risk at Life Time Fitness is debt abuse. All clubs use debt to expand. Life Time's founder and CEO, Bahram Akradi, had to sell some Life Time Fitness shares to meet a margin call. This shows he does not know how to use debt prudently when managing his own finances. He may overleverage his company and ruin investors like he almost ruined himself.

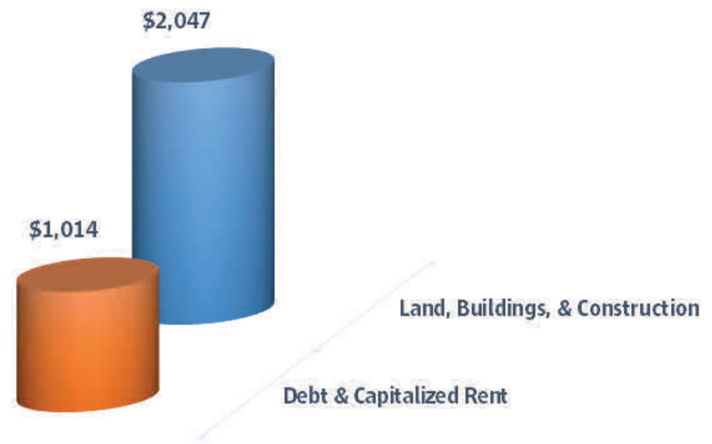
DURABILITY: *Life Time Fitness Owns the Most Beautiful Gyms in America – Mostly Mortgage Free*

Health club industry membership in the U.S. grew 4.4% a year from 20.7 million members in 1990 to 51.4 million members in 2011. Only 22 million (43%) of these members are involved. These 22 million people go to clubs more than once a week. Life Time Fitness's members are more involved than the industry average. They average one visit every 3-4 days (100 visits a year). This group of active health club members is about 7% of the American population or 19% of households. In other words, close to 4 out of 5 households still do not belong to any health club. Life Time Fitness has about 683,000 memberships. The average membership is used by about 2 people (1.9). So, Life Time Fitness currently serves about 1.3 million people. Assuming active health club members in the U.S. are the company's addressable market, Life Time Fitness has about a 6% market share nationwide. This is due to Life Time's small geographic footprint. The company has only 105 centers. The average center has about a 50% local market share (when the market is defined as a 5 mile radius of the club). Yet the company has only a 6% market share nationwide. The durability of Life Time Fitness's business depends on its ability to retain customers, to dominate local markets, and to expand beyond the 28 markets in which it now operates.

Life Time Fitness has only closed 2 clubs in its history. Both were smaller format stores in the company's home state of Minneapolis. The siting, design, and development of a Life Time Fitness center is a longer and more expensive process than that undertaken by most health clubs. The company owns 67 of its sites. And 55 (82%) of those clubs have no mortgage. According to CFO Mike Robinson: "We…expect to run these clubs long-term. So we are not making investments for 5 and 10 years. We are making investments in areas where we see substantial growth in that for time periods much longer than that…One of our key competitive advantages from a cost perspective is our occupancy costs are significantly lower than others in the fitness industry because of that ownership. That isn't to say that we…need to own…Rockville, Maryland is a leased facility, and we converted a federal office building into a beautiful 75,000 square foot Life Time Fitness in a tremendous area and a tremendous demographic." The CEO, Bahram Akradi, put the advantage of ownership in terms of replacement cost: "Mike talks about approximately by the time we finished Colorado Springs and Summerlin, Nevada we'll have 51 open facilities with no mortgage against….while Mike puts in the conservative book value of $1 billion in that, those 51 facilities under no circumstances could be purchased for land and built in nowhere near $1.5 billion or more in today's market. So the…real estate value is significantly higher."

Life Time Fitness invests more in its clubs initially than anyone else. This results in members raving about great looking clubs – even when those clubs are a decade old.

Here is one member commenting on a 10 year old club: "The facilities are always really clean, and they offer every machine that I would need to work out. There is even an outdoor pool with a waterslide. Everything is kept very clean, and there is so much space. I never had to wait for a machine, and it was never too crowded when I was there…All in all, probably the best workout chain that I've been to. You definitely get what you pay for."



Life Time Fitness's debts are just 49.5% ($1,014 million) of the depreciated cost of its properties

Members tend to review Life Time Fitness very favorably for upkeep, breadth of amenities, and the design of their centers. Members are not so fond of the aggressive in-center sales of add-on services. Life Time Fitness has increased EBITDA per member over time by cross-selling many services to people in the gyms. This is the greatest threat to the company's image and durability because some people are seriously put off by these sales tactics.

Here is a typical review: "The sales pitches are relentless here….You will be hounded (uncomfortably and constantly asked) to buy additional testing packages, heart rate monitors, nutrition packages, vitamins, personal training…Every time you turn around you will hear another poor newbie being pitched the same thing…you really need the cardio point assessment in order to get the best results. After you shell out an extra $119 for that, they ask you to kick in another $75 a month so you can learn how to use the data gathered from the test. They will email workouts to you for an extra $75 a month. I have never been to a gym that was so obscenely relentless on selling. It never stops. But the facility is beautiful. The people are nice and overall, this is a great place for families. Just be careful not to get hustled for every penny you got. We have already spent over $900 this month I am ashamed to admit. So far, I think the extras were an utter waste."

On one hand, that member likes the facility and did spend over $900 in a single month. On the other hand, that member spread bad word of mouth about the company. They may also be less likely to stick with a membership. However, Life Time Fitness's memberships are month to month. And retention rates have remained stable even as cross-selling has increased.

It is also important to separate customer comments from customer behavior. Some of the most negative comments were actually from members who kept using Life Time Fitness. Regardless, the company's marketing techniques can definitely harm their premium, customer centric image.

Here is a good example of the very mixed reviews – positive about the amenities, negative about the aggressive in center marketing – that members report: "My first impression of this place was wow….I agree with the other members who mentioned they do try to scam you….I get the whole sales tactic but don't lie. The gym, well it's really amazing…it's spacious, clean (very

clean in fact). Tons of machines and free weights. Tons of treadmills and other machines. Although it's pricey you do get a lot. There is a large café as well as spa (haircut, massage). Lots of classes, basketball court, rock climbing, and two pools. One indoor and one out."

Life Time Fitness has a special subsidiary that designs all of its own clubs. Praise for the club design is almost unanimous among members. Complaints are about pricing (it's expensive) and cross-selling (it's annoying). However, the company has succeeded in creating a reputation for having the very best gym in each local market. Although the company does not report its Net Promoter Score (a question about "how likely are you to recommend the service to a friend"), we believe it is very high compared to competitors.

The biggest risk to Life Time Fitness's durability is not business risk but corporate risk. Bankruptcy is common among gyms. Life Time Fitness now uses much less leverage than competitors because it owns lots of unmortgaged real estate. However, the company's CEO got in personal trouble using margin debt. Bally's, the company that bought U.S. Swim & Fitness, went bankrupt in 2007. That company was very aggressive in its use of debt. Debt was more than 10 times EBITDA in 2002. Although Bally's reduced debt relative to EBITDA over time, it had so little cash flow from operations left after paying interest that it couldn't afford to invest in the basic cap-ex needed to keep clubs looking new and inviting.

The coupling of financial and operating leverage causes the stocks of fitness clubs to react violently during an economic crisis. Life Time Fitness is a $50 stock today and was a $60 stock in early 2007. In February 2009, it was a $9 stock. Town Sports fell from over $23 a share to under $2 a share during the same time period. Both companies proved durable. But it was a frightening ride for shareholders.

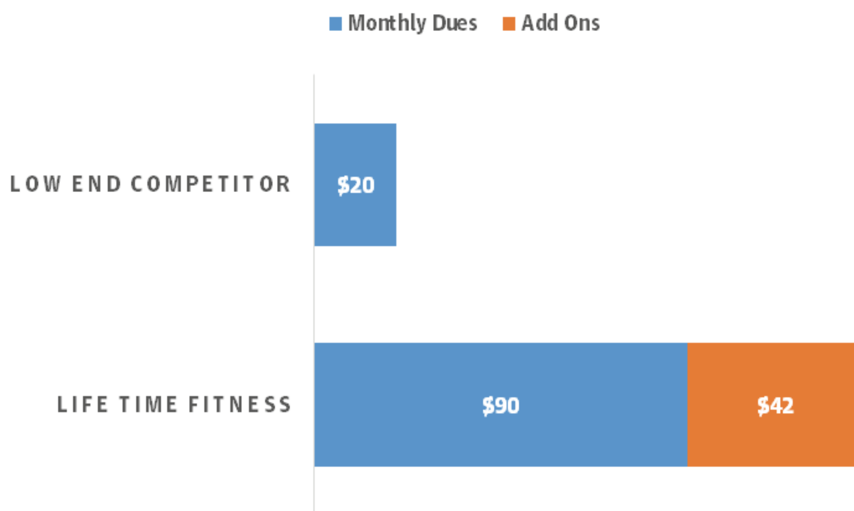
MOAT: *Life Time Fitness Markets a Country Club Experience to the Masses*

Life Time Fitness's moat is its ability to bundle together a variety of services and programs in one place. No other gym offers the amenities that Life Time Fitness does. The economies of scale are not on the cost side of the business. They are customer economies of experience. Life Time Fitness and Town Sport International - the company that runs New York Sports Club - both have similar numbers of users per square foot. Each club tends to have about 8.5 members per 100 square feet (depending on economic climate, actual utilization varies from about 6 people to 10 people per 100 square feet). This is a matter of overcrowding. No gym can avoid the problem of overcrowding. To serve more customers, you need to have more square feet. In fact, most clubs do not try to attract more net members after the first few years of operation.

It takes a Life Time Fitness center 3-4 years to reach maturity. Once a location matures, Life Time Fitness cuts down on the marketing operations in that club. Like all gyms, Life Time Fitness cannot really increase the number of members it has (comfortably) at each gym without increasing the square footage.

This is why it is best to analyze companies like Life Time Fitness and Town Sports on the basis of system wide square footage rather than the number of centers. Life Time Fitness can have many times more members at each location than Town Sports simply because Life Time Fitness builds bigger locations. But this does not increase economies of scale on a per square foot basis. It does, however, increase the economies of customer experience. Life Time Fitness can offer 114,000 square feet of amenities to every member. The amount of members per square foot is the same. But, the amount of amenities available to each member quintuples (or more) versus the average sized clubs most competitors run. This increases the possibility of charging more for each customer, of retaining more customers, and of cross-selling to existing customers. So, the moat of Life Time Fitness is not cost based. It is a customer experience moat. Life Time Fitness can compete with other gyms the way Disney World can compete with other amusement parks.

In each local market, Life Time Fitness really is the Disney World of fitness centers. It tends to have a greater than 50% market share within 5 miles (about a 12 minute driving radius). Life Time Fitness can also charge a lot



Life Time Fitness generates total revenue of $132 a month per membership

more than other fitness centers in the suburbs. Depending on the quality of the gym, Life Time Fitness charges between $65 for a Gold Membership and $135 for a Diamond membership. The average membership is used by about 2 people (1.9). So, the average price per person using a Life Time Fitness gym is $33 to $67 a month. That is a premium price in the suburbs. Life Time Fitness adds more cross selling revenue - add-ons they charge for - than any other gyms. This brings the average revenue per person using the gym up far above the industry average. As a result, Life Time Fitness can invest in providing a superior experience for each customer.

A big club is able to offer a lot of programs. The average Life Time Fitness member uses 5.5 programs. These programs include yoga, swimming, running, racquetball, squash, tennis, pilates, martial arts, and basketball. Some of these programs are easy to offer even at small clubs. Other are not. For example, Life Time Fitness can offer more than one pool (indoor and outdoor) at each club. Since members are interested in using a lot of programs, they can simply use the parts of the club that are less busy and rotate between their favorite activities. This is an advantage big clubs have over small clubs. The overcrowding issue is really the same for all clubs, because they tend to have the same usage per square foot. However, the enjoyment each customer gets is always greater with big clubs than small clubs.

So why don't all of Life Time's competitors build large clubs? A company like Town Sports chooses to focus on cities like New York and Boston. It is impossible to build 114,000 square foot clubs in Manhattan. But many companies operate in the suburbs. Why don't they breach Life Time Fitness's local moat by building an equally big club? The investment is simply too high. Life Time Fitness designs all its own clubs. It has a dedicated subsidiary that just focuses on drawing up the plans for each new club. These investments are so big that each new site is presented to the finance committee of the board of directors for approval. The investment is generally between $30 million (in low cost real estate states like Ohio) to $50 million in locations with very high priced real estate (like Long Island and Northern New Jersey). Life Time Fitness owns most of its locations. This property has a book value of over $2 billion. The company has about $300 million of land on its books (at original cost) and over $1.7 billion in buildings (at their depreciated cost).

To open 6 new supercenters a year - which Life Time Fitness was doing at its peak, and hopes to one day do again - can cost anywhere from $180 million to $300 million. It is possible to borrow a lot of the cost of development. But the time, effort, and capital involved is far beyond what most fitness companies are used to doing. The average fitness chain in America is either a franchise (like Curves) or a non-profit like the YMCA. More direct competitors (in terms of business model) of Life Time Fitness include Town Sports and Bally Total Fitness. Town Sports is focused almost exclusively on the Washington D.C. to Boston megapolis. They have clubs in New York, Boston, Philadelphia, Washington D.C., and suburbs of those cities. They have not expanded much beyond that. Life Time Fitness does not compete directly with Town Sports.

Life Time Fitness is a suburban focused company. Town Sports is urban focused. Most suburban fitness centers are very small. These can not be viewed as direct competitors of Life Time Fitness. They are not substitutes in terms of customer experience. Over 75% of fitness centers in the U.S. are 5,000 square feet or less. Each Life Time Fitness location is more than 20 times the median size of a fitness center in the U.S. The median location in the industry has very low start-up costs. It is often franchised. And it is often a rental location in a strip mall. Companies like Life Time Fitness and Town Sports focus on highly desirable locations. They either buy the location (Life Time Fitness) or get long-term leases in cities where ownership is a near impossibility (Town Sports). These location based models are entirely different from the low entry cost approach of small operators. There is little evidence that these 5,000 square foot locations have much of an impact on Life Time Fitness. They charge much less. The average fitness center in the U.S. is 5,000 square feet, draws people from a 1 to 2 mile radius, and charges $10 a month (non-peak hours) to $20 a month. Life Time Fitness charges about 3 times more, draws from a radius about 3 times larger, and has a location more than 20 times the size of these competitors. In a sense, the barrier to entry in the industry is low. However, entry is defined as a 5,000 square foot club charging no more than $20 a month with little ability to cross -sell add ons. The revenue per customer of these clubs is very low compared to Life Time Fitness. They simply are not effective competitors. That is Life Time Fitness's moat. It is not a barrier to entry on the low end. It is a barrier to gaining sufficient scale per location to provide a premium customer experience.

QUALITY: *Life Time Fitness's Need for Tangible Assets Makes it a Good – Not Great – Business*

Life Time Fitness's business quality is good not great. In his 2007 letter to shareholders, Warren Buffett defined the difference between a great business, a good business, and a gruesome business. The difference between a great business and a good business is that a great business can increase its profits over time without increasing its assets. A good business can only increase its profits in line with its assets. This need for a lot of assets constrains profitability. It is a problem at railroads and cruise companies and some other businesses with excellent margins and strong competitive positions but only okay returns on capital. Although Life Time Fitness appears to have nothing in common with transportation companies like railroads and

cruise lines, its asset turns and EBITDA margins are remarkably similar to leading companies in those industries.

Town Sports appears to earn a much higher return on its capital than Life Time Fitness. This is a mirage caused by Town Sports leasing its properties while Life Time Fitness owns its properties. A better measure of the asset intensity of each business is sales divided by average net tangible assets including capitalized leases. For Life Time Fitness this number is about 0.5 (0.49) over the last 10 years. The number is 0.39 for Town Sports over the same time period. This difference from about a 0.5 times asset turnover to 0.4 times asset turnover is typical of the difference between the very best company in an industry (Life Time Fitness) and a slightly inferior competitor, Town Sports. Town Sports is a fine company. But its customer experience is poorer. It has a hard time cross-selling and therefore is unlikely to increase revenue relative to assets. In fact, its assets - long-term leases clustered in key parts of New York City and other major cities - are what drives its sales. It has a mini-monopoly on local neighborhood gyms. Meanwhile, Life Time Fitness's revenue beyond membership fees have grown 9.4% a year over the last 10 years. This explains Life Time's improved asset turnover. The trend would be more obvious if consumer confidence had not been trending in the opposite direction (from high in the early 2000s to low in the late 2000s).

EBITDA margins are very high in this business. The combination of high EBITDA margins (37% of sales at the club level - that is, before corporate costs) with a low asset turnover has led to good returns on net tangible assets. Life Time Fitness combines about a 0.5 net tangible asset turnover ratio with a 40% EBITDA margin. The result is a roughly 20% EBITDA return on net tangible assets. After taxes, such EBITDA would always lead to a greater than 10% return on equity. Fitness centers - like cruise lines and railroads - use

The Great Recession caused an 18% decline in sales relative to assets

some leverage. So, the likely return on equity of such a business model is closer to 15% to 20%. What is important here is the predictability of that result. Life Time Fitness is very likely to earn greater than a 10% return on equity and less than a 20% return on equity. It would be very hard - because of the need for expensive assets - to earn more than a 20% return on equity (ever). On the other hand, it has been quite easy for Life Time Fitness to always earn a double-digit return on equity.

The repeatability of the business model is key. Life Time Fitness has 105 centers. Of those 105 centers, it has - over its entire history - closed only two locations. This gross closure rate of less than 2% is extraordinarily low. Other companies that depend on repeating the same store format around the country - like McDonalds (7% in the last 5 years), Whole Foods (10% in the last 10 years), and Starbucks (13% in the least 5 years) - usually close far more locations. The Life Time Fitness model has worked everywhere it has been tried. Both of the closed locations were smaller, older clubs in Minnesota. They no longer fit the new model for expansion. One was 27,000 square feet. It operated for 14 years before closing. The other closure was an 85,000 square foot location that opened in 1997 and closed 13 years later. These are the outliers.

It is important to note both are in Minnesota where Life Time Fitness has 22 centers. However, some of those early centers are very small. So, there is only the equivalent of about 12 centers in Minnesota. Nationwide, Life Time Fitness would not reach the same saturation level – in terms of square footage to population – it now has in Minnesota until it had over 500 centers. The company has no plans to ever open that many centers. They claim the Life Time Fitness model can support 250 to 300 centers nationwide. Even in the case of the 2 closings, both locations lasted more than 12 years. This repeatability makes Life Time Fitness a good, solid business. It will never achieve unleveraged returns on equity above 20%. But it should avoid unleveraged returns on equity below 10%. In today's interest rate environment - where the 30-Year BAA yield is below 6% - Life Time Fitness is very likely to earn returns on capital far in excess of its cost of capital for at least the next decade as it expands.

When choosing a new site, management looks for a 20% levered return on capital. It aims to achieve 15% after-tax. The company will always earn less than each location does, because there are some corporate expenses. Most recently, these have run about 2.3% of sales. In general, it is safe to assume

that corporate expenses do not exceed 3% of sales. So, if each location is able to achieve a 43% EBITDA margin, that will result in a companywide 40% EBITDA margin. The best single year result Life Time Fitness ever achieved was about a 43% EBITDA margin at the club level. So, it is unrealistic to assume the company can do better than a 40% EBITDA margin overall. Life Time's best net tangible asset turnover was 0.55. The median result is 0.5. So, assuming better than 40% EBITDA margins or better than 0.5 turns is too aggressive based on the company's past record. These two numbers together suggest a 20% EBITDA return on net tangible assets is possible. Maintenance cap-ex is about 4% of sales. So, when the company achieves an EBITDA margin of 40%, it is really getting more like a 36% owner earnings margin. It is best to assume pre-tax owner earnings are equal to no more than 35% of sales. This means the pre-tax return on capital is no better than 17.5%.

The issue is a little complicated based on the immaturity of certain locations. Reported results always include clubs that have been open for less than 3 years. These do not earn anywhere near the 20% return target. So, this can drag the results down closer to a 15% pre-tax return on capital for the company. In reality, the companywide return on equity (after taxes, but assuming no leverage) is likely no less than 12% a year. That is probably a good after-tax figure to use when thinking about Life Time Fitness. If the company did not use leverage, it would probably be able to earn about 12% a year on its owner's equity. The company's actual goal is for at least a 15% return on equity using leverage.

Life Time Fitness is capable of earning at least 12% a year using zero leverage. In fact, a new location may be able to earn 20% a year using leverage. That is how Life Time Fitness's finance committee analyzes new investments. If Life Time Fitness more than doubles its number of locations from 105 centers today to 250 to 300 centers at saturation and it does so using debt borrowed in a relatively low interest rate environment, there will be a lot of value created for shareholders.

CAPITAL ALLOCATION: *Capital Allocation is Unproven Outside of Consistently High Return Investments in New Clubs*

Capital allocation is the topic where Life Time Fitness has its poorest showing. The company's capital allocation is not bad. It is just inconclusive. Share dilution has been high. From 2001 to 2012, the company increased the number of shares outstanding at a compound rate of 2.6% a year. This takes directly from the annual returns of investors. So, an investor who buys Life Time Fitness expecting a 10% annual return will - because of the compounding of shares outstanding - find that return dwindle to just 7.4% a year. This is a big difference. It means that an investor with a 10% hurdle rate really has a 12.6% hurdle rate in terms of the value created at Life Time Fitness before the impact of share dilution. To be fair to management, the shares issued were deserved. By any measure, the company increased its business value by far more than 12.6% a year. Since 2002, EBITDA has grown at 19% a year. Profit measures like EBITDAR (Earnings Before Interest Taxes Depreciation Amortization and Rent) have grown faster than debt with capitalized leases. In other words, the company did not just grow EBITDA through the use of debt. It actually grew its profits faster than it grew its debt. This shows definitively that the equity value of the company was increasing at close to 19% a year over the last 12 years. Even after share issuance of 2.6% a year, that leaves more than 16% a year in value added for the existing shareholders. Obviously, it is better to have a company growing in value by 19% a year and diluting your interest by 2.6% a year than it is to have a company growing 10% a year and not diluting your interest at all. However, investors should expect dilution of up to 3% a year at Life Time Fitness. This means they need to raise their hurdle rate by 3% from say 10% a year to 13%.

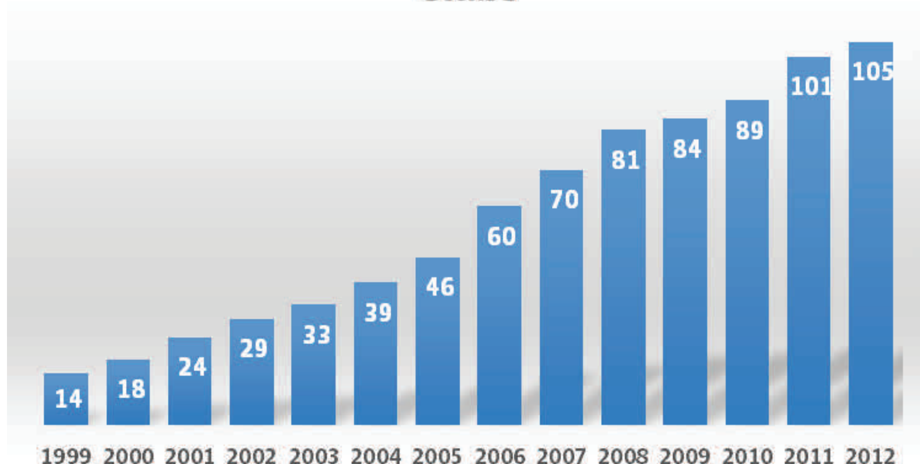
The organic capital allocation that simply replicates the same model from one town to the next has been very profitable. However, it is only one very specific form of capital allocation. It is more centered in the history of the company and the customer centric focus of its founder than in a carefully crafted capital allocation strategy. Returns on each of these projects is excellent. But that is because the business model is excellent. Each club is just a clone of previous locations. The company is able to replicate its results. But this just means they have a good store model. It does not mean they are especially disciplined capital allocators.

The biggest concern about capital allocation is the personal finances of the founder, Bahram Akradi. Akradi is the CEO of Life Time Fitness to this day. He owns a significant percentage of the business. He is a very rich man because of the business he built. He has no need to risk using debt in his personal finances. And yet Akradi had to sell a lot of Life Time Fitness stock to pay down margin debt in his personal portfolio. Owning stock on margin is risky for any investor. It is absolutely reckless for the CEO of a public company. This is by far the biggest capital allocation concern at the company. The man in control of the company engaged in very risky behavior with his personal finances. This raises the risk that he will engage in risky behavior with his fellow shareholders' finances by overleveraging Life Time Fitness.

The part of Life Time Fitness's capital allocation where there is a proven record is expansion. The company's top priority is always to add new centers. They target new locations based on demography: "We study the 100 plus clubs we have. Geocode the members that come for each individual club. So we have data for every single club, what percent of our members come from inside of the 12 minute drive time, between 12 and 20, and outside of 20. And we model that particular location to the top three or four facilities that are most likely like that facility, from all those aspects. Then we model that. We model how many memberships we are going to get from each of those rings.

Then we basically price it where we feel like the pricing is appropriate either positioning or what we need to get, to get the investment to work. If the investment works, passes those three measures, then we will take it through." Each new location is approved as a project by the finance committee of the board of directors. The key factor is the return on capital expectation. Remember, these are marginal returns on capital - the return on an investment in a completely new center - we are talking about: "We have been pushing the company in the past several years very hard on trying to have a 15%, 14%, 13% ROIC, which is a really high hurdle considering the marginal cost of capital today. If you take a look at a - let's take a $45 million investment, and you took 50% of that into mortgage at a 5%, which is easily doable right now - and I mean easily doable to do a 50% mortgage on a $45 million at a 5% or better rate. If you take that, you take a 20 year mortgage or 15 year mortgage and you put that aside. You can take $500,000 of annual cap-ex out. Very, very comfortably we can hit in the high 20 percent: 27%, 28%, 30% cash on cash return on those models at the club maturity which just takes two or three, four years." That was the CEO, Bahram Akradi, in 2013.

It is important to keep a few factors in mind. One, Life Time Fitness is replicating the same model over and over again in locations they are choosing based on the similarities to the demography of existing locations. Two, the company has only closed 2 of its 105 centers in its entire history. Both centers were smaller than the current model. Both centers were in the company's home state of Minnesota - which has by far the most saturated market in terms of Life Time Fitness centers relative to population - and both centers lasted more than 12 years before closing. For these reasons, it is possible - given today's very low interest rates, and thus discount rates - that the company can earn good returns on an investment project even if it takes 4 years to reach maturity.



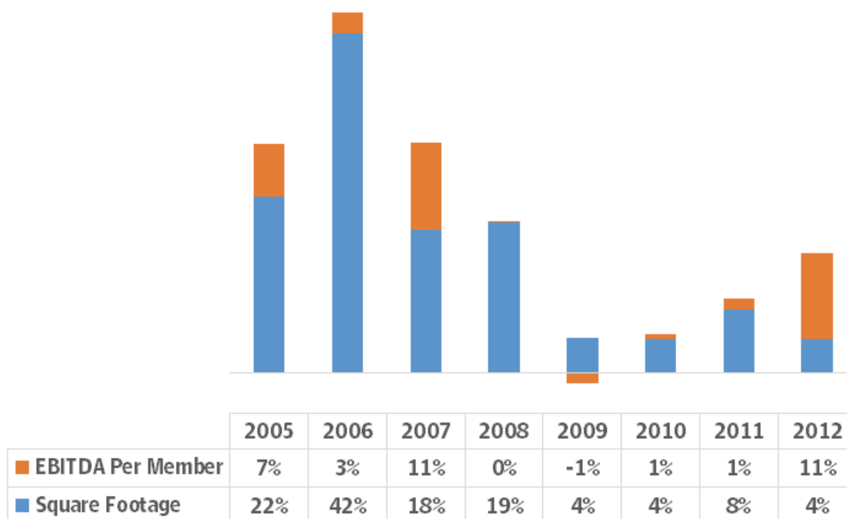
Since 1999, Life Time Fitness has grown its total locations by 17% a year

It is important to remember that the company's cost of capital and return on capital don't have anything tying them together. Life Time Fitness employs a very different - very capital intensive - model from its competitors. Life Time Fitness is already one of the bigger fitness companies in the country. Yet it has a small share of the national market. It always will. The cost of capital is determined by long-term interest rates in the United States. Those rates are outside the control of Life Time Fitness. The return on capital is purely an internal factor. There is a slight influence from the level of consumer confidence. But, it is very slight. The difference in asset turns caused by the financial crisis was only an 18% decline from 2006 to 2009. A vibrant economy will not necessarily benefit Life Time Fitness as much as might be expected, because an asset intensive company greatly benefits from a low cost of long-term borrowing. Right now, Life Time Fitness can obtain mortgages below 6% a year. So, low interest rates benefit Life Time Fitness. This is good for shareholders. But it does not reflect good capital allocation. It just means money is cheap and Life Time Fitness needs a lot of money to invest in new centers. It can not be determined based on the past record whether management has any special skills allocating capital beyond simply rolling out its proven supercenters.

VALUE: *Life Time Fitness's Value Depends on its Square Footage and Profitability Per Member*

Life Time Fitness's value depends on its EBITDA. The company's EBITDA is the product of two factors. One factor is EBITDA per membership. The other is memberships per a given amount of square feet. A good assumption is that Life Time Fitness will have about 8.5 memberships per 100 square feet at its mature clubs in a normal economic environment. The best method for valuing Life Time Fitness is a square footage based approach. Square footage is the key constraint of profitability, because the number of people using a gym is tied closely to the amount of square footage in that gym.

Even with two people using one membership, this means that the average person using a Life Time Fitness center is paying somewhere between $35 and $65 a month. It is a meaningful expense. So, it is one of the things people cut back on when times are tough. The Great Recession reduced the utilization of each club below what Life Time Fitness now targets, what it achieved in the past, and what it is likely to achieve in the future. The best way to value Life Time Fitness is using the assumptions of the existing center footprint but normalized for both maturity and economic climate. A buy and hold investor who purchases Life Time Fitness stock today does not care



	2005	2006	2007	2008	2009	2010	2011	2012
EBITDA Per Member	7%	3%	11%	0%	-1%	1%	1%	11%
Square Footage	22%	42%	18%	19%	4%	4%	8%	4%

EBITDA per membership growth stalled from 2008 through 2011

what earnings are now. What matters is what earnings will be when he sells the stock. Each center takes 3-4 years to mature. Life Time treats a center as mature for comparison purposes after 36 months (they use this when reporting same store sales). However, some clubs continue to improve their EBITDA performance between years 3 and 4. So, it is safe to assume that the number of clubs that are less than 4 years old drags down the performance of the company relative to what it would be in 4 years if the company stopped expanding. This steady state approach to valuation makes the most sense. Life Time Fitness should be valued based on the cash flow it would produce when it stopped growing. Right now, growth is adding value. But, that is a speculative component of the valuation that can be discussed later. The non-speculative part of the valuation is the existing centers. Right now, Life Time Fitness has 10.12 million square feet. The company can accommodate about 8.5 memberships for every 100 square feet. This means Life Time Fitness can have a normalized membership base of about 860,000 memberships. This figure can be used to make assumptions about the earnings the company is likely to produce.

The value of Life Time Fitness comes from memberships. Virtually all of the revenue can be modeled with members as the source. About 65% of revenue comes directly from membership dues. There are also enrollment fees, but at 1% of revenue this is a totally insignificant category and always will be. Today, almost a third of revenue (30%) comes from "in center business like personal training and our spas and our cafes and kids activities". However, this can easily be modeled simply by looking at EBITDAR per membership.

The square footage determines the number of memberships that are likely to exist in a normal economic climate when the existing square footage is all mature. It is best to assume that for every 100 square feet, the company will be able to have about 8.5 memberships. This number was once as high as 10 memberships per 100 square feet. It is now much lower. It is a little under 7 memberships per 100 square feet. The average on this range is probably the best measure for the future. That is about 8.5 memberships per 100 square feet. On today's square footage, that is more than 850,000 members. The amount of EBITDAR per member can increase over time due to cross-selling. The monthly fees do not increase much at all. They can keep pace with inflation at mature clubs, because once a club is at capacity, Life Time Fitness begins raising prices at that club.

However, the much bigger source of possible EBITDAR per member growth is cross-selling of other services. Revenue in the clubs other than the monthly dues have increased 9.4% a year over the last 10 years. They are a significant source of revenue for the company. However, they are also based entirely on customers being at the center and regularly using it. In this way, virtually all of Life Time Fitness's revenue - and certainly all of its profits - simply comes from attracting enough members and then keeping them happy. In that sense, it is a very simple business. The square footage of the entire system determines the possible number of members. The economic climate has an influence. The maturity of that square footage has a large influence. But, that is entirely predictable and can be adjusted for. There is little difficulty in estimating future EBITDA at Life Time Fitness. And there is very little difficulty in estimating EBITDA per square foot. As mentioned before, the key constraint on profitability is the asset intensity of Life Time's business. Most EBITDA growth comes from square footage growth. This means the business is a good, not a great one. For that reason, it should be valued at about 10 times pre-tax owner earnings at maturity (this equates to a P/E of 15 given U.S. tax rates).

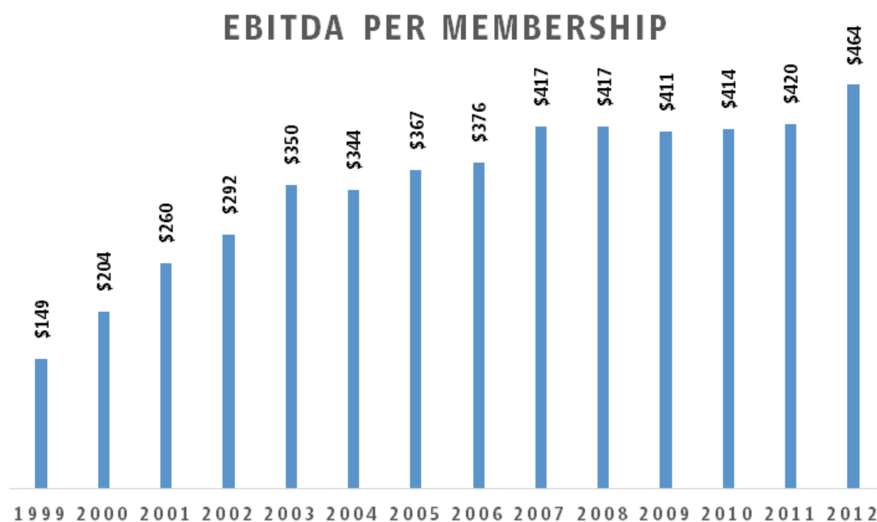
However, Life Time Fitness as a company is more valuable than the sum of its clubs. The clubs Life Time already has are worth only 10 times pre-tax owner earnings. However, there is a speculative growth component. In truth, geographic expansion using the same store model is not very speculative at all. Many retailers and restaurants have proven that the same model can be replicated across the country until it reaches saturation nationally. Life Time is unusual in how asset intensive it is. This slows the pace of expansion. But, that simply means the company is able to grow for a long time to come. The company has 105 clubs today. It expects to one day be able to have between 250 and 300 clubs across the country. Based on saturation rates in the company's oldest market, this certainly seems doable. That means square

footage can grow at 6% a year (older centers are smaller than newer centers) for a long time to come. With the addition of revenue increases due mostly to cross-selling at clubs and to a much lesser extent simple price increases along with inflation, the company can grow at a high single digit (probably 9%) annual rate for a long time to come. The company's past record is actually much better than this. But that was on a smaller store count. A 9% annual growth rate is conservative if Life Time Fitness is committed to growing the business.

At the spread between Life Time's cost of capital (mortgages can be obtained for less than 6% a year) and the company's return on capital (which will probably exceed 10% a year based on the success of the model in similar locations) there is a lot of potential value in the company's growing national square footage. With today's low cost of capital, Life Time's value may end up being closer to 15 times pre-tax owner earnings than 10 times. Quan believes the appropriate multiple is 12 times the entire company's pre-tax owner earnings. This is 10 times pre-tax owner earnings for the existing square footage and then an added value component based on the doubling or tripling of square footage between now and the concept's national maturity. The biggest speculative part of the value equation is EBITDA per membership growth. Since 1999, EBITDA per membership has grown 9.1% a year. However, the rate has slowed to just 3.2% a year over the last 9 years. So, 3.2% a year is the safer assumption. That makes a growth rate around 9% a year likely and a price around 12 times pre-tax earnings a fair multiple.

GROWTH: *Life Time Fitness Can Grow at 10% a Year For the Next 15 Years*

Geoff's view of Life Time Fitness's growth is simple: "The company has 10.12 million square feet. It expects it can have about 250 of its current model – 114,000 square foot – centers at the concept's maturity. We expect EBITDA per member to grow at least 3% a year. The company can certainly self-finance a 10% growth rate. So, 10% minus 3% equals 7% square footage growth. If 10.12 million square feet grow at 7% a year for 15 years, that becomes 27.92 million square feet. Divide 27.92 million square feet by the 114,000 square foot model and you get 245 centers. So at a 10% annual growth rate, the company has 15 years of national expansion ahead of it."



Over the last 10 years, EBITDA per membership has grown 4.7% a year

Any projections of future growth are speculative. The growth of the existing clubs is not very speculative. It will be 2% at the minimum and closer to GDP type growth rates at the maximum. Something like an increase between inflation and nominal GDP is likely. The safest estimate is to assume about a 3% increase at mature clubs. There are cross-selling opportunities. There are also opportunities to raise membership dues for the existing customers. However, having a mature club in a local area really is not all that different from owning an apartment complex in a mature rental market. Prices can be increased about as fast as inflation. However, you can not simply add to the square footage of your property. So, you can not benefit from population growth. Considering these factors, a slightly conservative - but basically reasonable - estimate would be for a 3% revenue and profit growth rate at mature clubs. The more important question then is the question of square footage growth. Square footage growth is a better measure than center growth because a few of Life Time's centers are smaller than the ones the company focuses on when expanding today.

This is most notable in Life Time Fitness's original market of Minneapolis. In 2010, the CFO laid out the possible growth in centers and square footage clearly: "So today we are in 19 states and 24 markets, and in those 24 different markets they range from a high for us of 24 centers in the Minneapolis Saint Paul market. Now, Minneapolis St. Paul is our home, that's where we were founded, and I would call Minneapolis Saint Paul more of a collection of clubs, not a chain of fitness centers for Life Time Fitness. Because we have everything from a 10,000 square foot female only, another, 10,000 square foot club up to a couple hundred thousand square feet, in some instances. So it is really more of a collage. And on the equivalent basis it is probably about 11 to 12 clubs, what we build today in most other markets across the U.S. We have 9 centers in Chicago. There's still room to expand in the Chicago market. We have 2 centers in New Jersey, we have four centers in Atlanta, and we've got one center in Cleveland, Ohio. So if you look at existing markets, we have got room to grow there. There's about 60 metropolitan areas in the U.S. that have a population of one million or more,

right around a million or more in that MSA. We feel we can go to every one of those markets with one, and in almost every case with multiple centers. When you look at that, the bigger centers we've been building, historically we said there's 200 plus and we feel that's the same." Now, using the estimate of an equivalent of 11 to 12 big format (current expansion model) centers for Minnesota, it is possible to estimate what that same ratio of centers to population would look like in the U.S. The number is between 500 and 550 centers. However, that's somewhat misleading because there are areas of the country with significant population in total that are not densely packed enough to support Life Time Fitness centers. The relevant figure is the 200 plus clubs the company has talked about. At times, they have estimated saturation is as high as 250 to 300 clubs. Based on population alone, a figure closer to 500 clubs would be the most accurate estimate.

However, GDP per square mile may be a factor here. When a business that is very local - like a bank or grocery store - operates stores in different locations around the country, it will often find that its highest returns (despite the high cost of entering these markets) is in locations with the highest GDP per square mile. In the U.S., this is in places like Northern New Jersey, Southern California, and the suburbs of Washington D.C. Population density is high. And the population is wealthy. This is what gets the best results for Life Time Fitness. The company's CEO, Bahram Akradi examined this difference in returns based on a couple examples: "In the East and West Coast, you could think $40 million to $45 million, $50 million deepening on the location on average. And to make sure everybody is clear - it's a simple mathematic. It doesn't - it shouldn't concern or confuse people. When we got to a more expensive market, it's more expensive for everyone. An extra $10 a month for dues on the membership in that market justifies an extra $2 million in the price of the land and construction or more, so it's a simple proposition. We have obviously been doing this. Interestingly enough, right now, looking in a rearview mirror, we have better returns in clubs like Long Island, New Jersey, etc., than we may have on clubs in Ohio, where we spent a lot less on land and construction, so it all takes care of itself."

Then he moved on to what Quan considers the greatest constraint on Life Time Fitness's future growth, the ability to find suitable locations and develop a large number of projects in a single year: "The gestation time for these things are long. Sometimes deals will take an extra 6 months or 9 months to get through the approval process. We would have liked to have our 3 open clubs in 2013 be in the first quarter and hopefully, have a fourth one or a fifth one in the latter part of the year. It didn't work out. Some of them got pushed back to later in the year. And then, fortunately enough, we have been actually able to work some of the ones where we were thinking they're going to open later in 2014 to earlier in 2014." Life Time Fitness has a subsidiary dedicated to these projects. It is important to keep in mind the scale of investment of money, time, and attention that is required to open anything like half a dozen 114,000 square foot fitness centers in one year. That is one opening every 2 months.

The investment for each fitness center is between $30 million and $50 million. That leads to an annual investment in growth cap-ex of $180 million to $300 million. This is difficult for any company to do. That difficulty in opening more and more centers - in managing more than 6 development projects at once - is why it will be too hard for Life Time Fitness to grow at 15% a year even though the company is earning returns on capital that would allow for reinvestment fueled growth of 15% to 20% a year. Life Time Fitness will produce more than 10% returns on its equity. As a result, it will start generating significant amounts of free cash flow that it will need to do something with. That cash flow will be put toward buybacks or dividends of some kind. Life Time Fitness is already underleveraged relative to its properties. So debt repayment is unlikely. That means share buybacks will become a feature of Life Time Fitness at some point in the future.

MISJUDGMENT: *The CEO's Own Reckless Use of Debt is a Warning Sign for Shareholders*

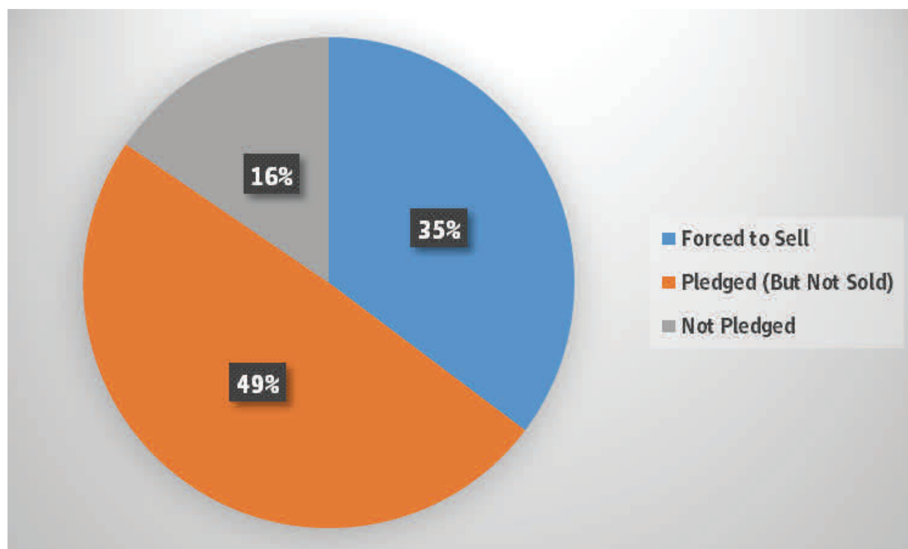
The biggest risk of misjudging Life Time Fitness is not understanding the risk of the company overleveraging and getting into trouble during difficult times. The best evidence that this might happen is the personal finances of Life Time Fitness's founder, Bahram Akradi. Akradi owned 4.14 million shares. That was 10.6% of the company he founded. Of those 4.14 million shares he had pledged 3.5 million shares to secure margin loans. Due to a margin call, he was forced to sell 1.46 million of those shares for an average price of $18.50 a share. This cost him a lot of money. It also cost him a meaningful part of his ownership of the company. More importantly, it shows the reckless way he manages his own finances. He was already a very rich man - a multi-millionaire - when he borrowed on margin. Using debt to try to increase wealth faster like that is a sign of reckless behavior brought on by an appetite to maximize returns regardless of the risks involved. It is possible that this episode taught Akradi a lesson and that he is unlikely to do the same thing with the company he founded.

However, it is important for shareholders to remember there have been situations in the U.S. and elsewhere where a public company CEO was reckless in his own finances and this recklessness was reflected in the company's own behavior. The story of Audrey McClendon at Chesapeake Energy is one such example. There is nothing to say that this situation is similar to that one, because there is no evidence that the board took the kind of actions they did it that company. But it is clear that Akradi was unusually

reckless in the use of debt in his own personal portfolio.

This is especially disturbing for shareholders of a fitness center company, because a big reason for failures in the past has been the overleveraging of companies. In fact, the company that bought U.S. Swim and Fitness - Bally Total Fitness - went into bankruptcy (twice) because of an excessive debt load. The company had increased debt relative to EBITDA to such a point that there simply was not enough cash flow from operations left over after making interest payments to allow for the kind of upkeep a chain of fitness centers need to continue to look new and inviting for customers. There are some other risks of misjudgment. But these are very small concerns compared to the risk of excessive financial risk taking in the future.

This next concern is also a big opportunity for Life Time Fitness. The company has an excellent reputation with customers. Everyone considers the physical plant of the gyms to be in truly great shape. They are the top of the line gym wherever they choose to compete. Customer reviews reflect this. However, customer reviews do frequently include one complaint: aggressive in store sales tactics. This relates to a larger issue. Life Time Fitness is a very growth oriented company. This is certainly not a negative for shareholders. The company's return on marginal investment is excellent. Each new center added starts to contribute meaningfully to the intrinsic value growth of the company by its fourth year. The model is an excellent one. It should be replicated around the country to give shareholders the best results. But square footage growth is not the only avenue to higher sales that Life Time Fitness has taken. The company has also pushed more programs in the centers. This clearly bothers some of the customers. Members are paying between $65 and $135 a month to go to a premium gym. The aggressive cross-selling of add on services in that environment may lower the



An October 2008 margin call cost Akradi a third of his LTM stake

reputation of Life Time Fitness with its customers. This can harm the company's image. It can reduce word of mouth referrals. It can reduce the company's net promoter score. To be fair, the company compensates employees on measures like net promoter score (essentially word of mouth) rather than just paying based on commissions. It also decreases the membership drive in its centers once they approach maturity and capacity so that the gyms do not become overcrowded. But there is no doubt that some members are turned off by the aggressive sales tactics. This is even true of some members who actually purchased the add-ons. So, it is a case of increasing revenue while risking some of the company's reputation

Those concerns are all much smaller than the risk of overleveraging the company. Most CEOs do not use their own company's stock as collateral in a margin account. He owned more than 10% of the company when the margin call happened. That is not an especially liquid position, it is certainly a very large position. And once others know that a major shareholder is in financial trouble and using margin debt, they will be eager to sell ahead of the CEO - not after him. It is very reckless behavior. This would not be such a big concern in certain asset light industries.

As mentioned in the section on growth, the company's return on capital is now higher than its expected growth rate. This is due to the difficulty in having more than 6 club openings a year. To keep up a pace of full reinvestment the company would soon be in a position of needing to open something like 20 new locations a year. Otherwise, it will have free cash flow left over at the end of the year. This means that there is no longer a desperate need for financing to fuel all the growth the company want to achieve in the upcoming year.

This is a reversal of Life Time Fitness's early history. It does not reflect a change in capital allocation or risk taking by management. It simply indicates a shift in the relationship between the company's return on its equity and the company's desired growth rate.

As recently as the fourth quarter of 2007, the CEO was still talking about debt and expansion in the same breath: "We feel extremely confident with activities that Mike and his team have right now that we will obtain necessary financing to maintain our growth. There are, as he mentioned, a huge number of assets with no mortgage against them. I want to kind of refer to the fact that back in the 200 time period, with only about $20 million of EBIDA, we

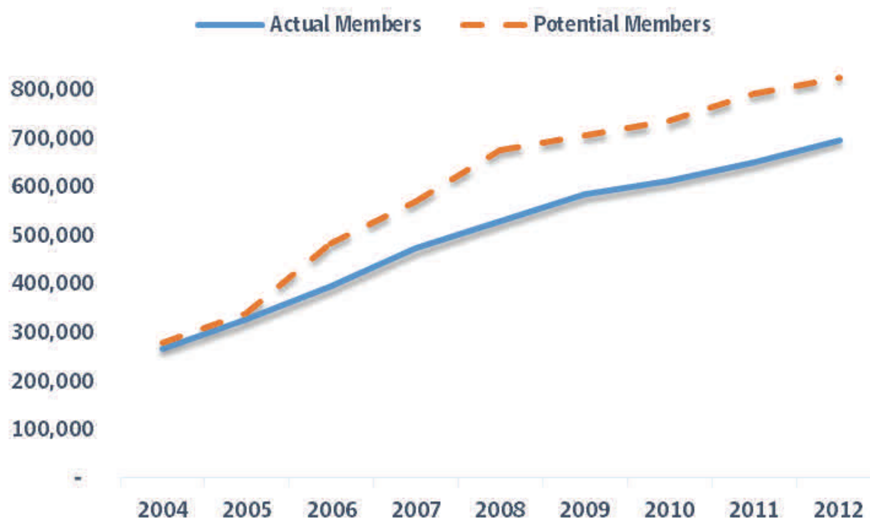
were able to get financing in excess of a hundred and some million dollars for a bunch of facilities in a very tough financing environment. We have so many assets available for financing."

The company has plenty of unmortgaged properties. The cost of debt is low. It is in shareholders' best interest for Life Time Fitness to use debt in place of equity because debt is much, much cheaper than diluting shareholders. Leverage would be beneficial to returns at this point. However, that is often the case in good times. A company starts the buildup of excess debt from a position of strong finances and a desire to grow rapidly while debt is cheap. Then hard times come - as they did in 2007 - and the situation changes. There is no immediate threat to the financial position of Life Time Fitness. And the high returns on capital relative to the future need for capital to grow suggests the company can be more self-financing in the future than it ever was in the past. All of these factors suggest the risk of misjudging Life Time Fitness because of overlooking a future risk of financial risk taking is not so great. It may have been great in the past. But the time to worry was in the past. This may be true. However, future expectations for the company and the past behavior of the CEO are at odds here. The CEO's business skills are not in doubt – his caution is. Excessive leverage is a clear danger. But it is not a present danger.

CONCLUSION:

Repeatability: Life Time Fitness Has a Model it Can Grow for the Next 15 Years

The value of Life Time Fitness is almost certainly between 10 and 15 times pre-tax owner earnings. This gives a valuation per share of between $60 and $105 (roughly). That is quite a range. The low end of that range ($60) is almost certainly wrong. A company with as clear a future of repeatable growth across the country simply by rolling out the same proven store model is worth more than the average public company. And 10 times pre-tax owner earnings is about average for a large, public company in normal times. For many companies in the U.S., 10 times pre -tax earnings is the same as a P/E ratio of about 15 when the company does not use any debt. Of course, Life Time Fitness does use debt. And it has value adding growth that is a very high probability in front of it. These factors should make the company worth more than 10 times pre-tax owner earnings. On the other side of the scales - keeping the company worth less than 15 times pre-tax owner earnings - is the constant need for assets. This need for tangible asset growth to fuel profit growth is what Warren Buffett used as the defining difference between a great business and a good business. Life Time Fitness is not a great business. Life Time Fitness is a good business with a clear future. That clear future makes it worth more than 10 times pre-tax owner earnings. However, the lack of greatness makes it worth less than 15 times pre-tax owner earnings. That is a valuation reserved for companies that can grow profits faster than they grow their assets. It is especially appropriate for companies that do not need to grow assets at all.



Since 2004, Life Time Fitness's membership has grown 13% a year

Life Time Fitness will undergo a lot of change in its financial results over the next 10 to 15 years. The business model will not change much. The expansion across the country will continue. But the finances of the company will change. Right now, Life Time Fitness is using relatively little debt compared to its $2 billion of real estate (which probably has an appraisal value above that). This includes $300 million of land. The biggest item is $1.7 billion of buildings (at depreciated cost). On the other side of the ledger, there is only total debt and capitalized rent of about $1 billion. This is low compared to the company's own history. It is also low compared to the industry's history. The growth rate of Life Time Fitness has not increased. In fact, while the rate of new location openings may increase to a record pace - the percentage growth rate certainly will not. It is simply too hard to open that many locations that fast. These are very big locations: $30 million to $50 million investments, open 24 hours a day, needing 600 parking spaces. These kinds of projects take a long time to go through development. That will restrict the growth rate of the company. As the base of centers increases each year, it becomes difficult to keep increasing the new additions at the same proportionate pace. Meanwhile, the company's return on capital is not dropping. All of this combined with very low interest rates leads to one obvious conclusion: at some point soon, Life Time Fitness is going to have to accept the fact that it simply can not reinvest all of its free cash flow.

Whatever the exact ratio will be (a 25% to 33% payout seems likely) the company will need to consider large scale buybacks or dividends. This is not unusual. It is a naturally part of the evolution of many public companies. However, it is not the way investors are looking at Life Time Fitness today. Today, the company is seen mostly as a stalled - because of the economic environment - growth stock. However, it will begin to generate significant amounts of free cash flow. The results will - within just a few years - be a reappraisal of the company and the stock as it matures. The company will be seen more for the kind of cash flow machine it already is at the individual center level. To the extent there are reinvestment opportunities beyond the cash generated by the existing centers, it is easy for the company to add low cost debt given its based of unmortgaged assets. This means that retained earnings may not need to grow as fast as gross property, plant, and equipment. In the past, PP&E grew at 19% to 20% a year. This will not happen in the future. A rate of 12% to 15% growth is more likely. The company can supply this from its own cash earnings.

The two key numbers for buy and hold investors to focus on are both debt ratios. They are Net Debt/Gross Property, Plant, & Equipment and Net Debt (Including Rent Capitalized at 8 times) divided by EBITDAR. These two measures will help investors see what is going on in terms of financial risk taking at Life Time Fitness. Both ratios are perfectly fine today. However, these are where the first signs of trouble will appear. It is important especially to focus on the first ratio, because it does not fluctuate between good times and bad. EBITDAR rises in good times and falls in bad times. Even today it is possible to see that Life Time Fitness is performing below its potential at each club because consumer confidence is low and people simply do not feel they can justify the monthly expense of $65 to $135 on something as discretionary as a gym membership. These cyclical fluctuations are irrelevant to a buy and hold investor. Life Time Fitness has a solid business model. What will determine its EBITDA in the long-run is simply the company's system wide square footage and is profit per member. EBITDA is what allows the company to carry a substantial debt load. So, having a low amount of debt relative to the gross - undepreciated - value of the company's buildings and land is a key indicator of financial prudence. Just as importantly, lenders are willing to accept buildings as collateral. Mortgages are easy to obtain on such properties. So keeping some of the property unmortgaged is a way to ensure access to capital when it is needed. This is a major concern because of how freely the company issued stock in the past. For a company that does not make acquisitions, Life Time Fitness has a fairly high growth in share count. This is caused by stock option growth. However, it shows that the management is not so careful about issuing stock that it would avoid a dilution at all costs. If Life Time Fitness gets into serious trouble with its debt - and it is far from any such problem - it will possibly need to issue a lot of equity. That is the major concern. Bahram Akradi was too aggressive in using debt with his own personal portfolio. As a result, he was forced to sell a big chunk of his own shares at a bad price. He became a distressed seller of his own company's stock. The same situation would happen to Life Time Fitness's shareholders if Akradi ran the company's finances the way he ran his own finances.

Since the financial crisis, the company has actually been underleveraged. It also appears likely to produce more cash flow than is needed to reinvest in growth. So, this entire question of whether the CEO will overleverage the company may now be a moot point. Life Time Fitness is now beyond the highest risk phase of its growth. The future of Life Time Fitness's business is not in doubt. It is simply the same local model being repeated around the country. The finances are solid today. Investors should not get complacent. They need to watch Akradi carefully for signs of recklessness. Absent those signs, Life Time Fitness will make a great buy and hold investment.

Life Time Fitness (NYSE: LTM) Appraisal: $79.69

Margin of Safety: 30%

Owner Earnings	
Normal Revenue	
Conservative Level of Access Memberships	801,851
* Total Revenue per Access Membership	$1,567
= Normal Revenue	$1,256.50
EBITTDAR	
Normal Revenue	$1,256.50
* Club-level EBITDAR Margin	40%
= Club-level EBIDTAR	$502.60
- G&A	$60.00
= EBITDAR	$442.60
Maintenance CapEx	
Club Maintenance CapEx	$50.00
+ Normal Corporate CapEx	$20.00
= Maintenance CapEx	$70.00
EBITDAR	$442.60
- Maintenance CapEx	$70.00
= Pre-tax Owner Earnings	$372.60

Business Value

LTM's business value is $4,476 million.

- Pre-tax owner earnings are $373 million
- Fair multiple = 12x pre-tax owner earnings
- $373 million * 12 = $4,476 million

Fair Multiple

LTM's business is worth 12x pre-tax owner earnings

- Quan thinks: "Each mature club deserve 10x pre-tax owner earnings. A growing LTM deserves at least 12x pre-tax owner earnings"

Share Value

LTM's stock is worth $79.69 a share

- Business value is $4,476 million
- Net debt is $1,078 million
  - Debt: $789 million
  - Capitalized lease: $309 million
  - Cash: $20 million
  - $789 million + 309 million – 20 million = $1,078 million
- Equity value is $3,398 million
- $4,476 million - $1,078 million = $3,398 million
- Equity Value = $79.69/share
  - 42.64 million outstanding shares
  - $3,398 million / 42.64 million = $79.69

Margin of Safety

LTM stock has a 30% margin of safety.

- Business Value = $4,476 million
- Enterprise Value = $3,146 million
- Discount = $1,330 million ($4,476 million - $3,146 million)
- Margin of Safety = 30% ($1,330 million / $4,476 million)

	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
ClubCorp	2.14	7.99	9.73	18.4	13.58
Accordia Golf	2.34	NMF	9.96	15.98	12.31
Weight Watchers	2.48	4.18	8.28	8.86	10.16
Clublink	2.76	NMF	9.32	14.32	11.16
Town Sports	3.15	6.4	7.13	9.5	7.96
Minimum	2.14	4.18	7.13	8.86	7.96
Maximum	3.15	7.99	9.96	18.4	13.58
Median	2.48	6.4	9.32	14.32	11.16
Mean	2.57	6.19	8.89	13.41	11.03
Standard Deviation	0.39	1.91	1.18	4.13	2.14
Variation	15%	31%	13%	31%	19%
Life Time Fitness (Market Price)	2.85	6.83	8.88	13	8.61
Life Time Fitness (Appraisal Price)	4.05	9.7	12.61	18.46	12

ABOUT THE TEAM

Geoff Gannon, Writer

Geoff is a writer, blogger, podcaster, and interviewer. He has written hundreds of articles for Seeking Alpha and GuruFocus. He hosted the Gannon On Investing Podcast, The Investor Questions Podcast, and The Investor Questions Podcast Interview Series. He wrote the Gannon On Investing newsletter in 2006 and two GuruFocus newsletters from 2010-2012. In 2013, he co-founded The Avid Hog (the predecessor to Singular Diligence) with Quan Hoang. Geoff has been blogging at Gannon On Investing since 2005.

Quan Hoang, Analyst

Quan is a stock analyst. Quan won first prize in Vietnam's National Olympiad in Informatics in 2006. He graduated from Manhattanville College in 2012 with a B.A. in finance and a minor in math. In 2013, Quan co-founded The Avid Hog (the predecessor to Singular Diligence) with Geoff Gannon.

Tobias Carlisle, Publisher

Tobias Carlisle is the founder and managing director of Eyquem Investment Management LLC, and serves as portfolio manager of the Eyquem Fund LP and the separately managed accounts.

He is best known as the author of the well regarded website Greenbackd, the book Deep Value: Why Activists Investors and Other Contrarians Battle for Control of Losing Corporations (2014, Wiley Finance), and Quantitative Value: a Practitioner's Guide to Automating Intelligent Investment and Eliminating Behavioral Errors (2012, Wiley Finance). He has extensive experience in investment management, business valuation, public company corporate governance, and corporate law.

Prior to founding Eyquem in 2010, Tobias was an analyst at an activist hedge fund, general counsel of a company listed on the Australian Stock Exchange, and a corporate advisory lawyer. As a lawyer specializing in mergers and acquisitions he has advised on transactions across a variety of industries in the United States, the United Kingdom, China, Australia, Singapore, Bermuda, Papua New Guinea, New Zealand, and Guam. He is a graduate of the University of Queensland in Australia with degrees in Law (2001) and Business Management (1999).

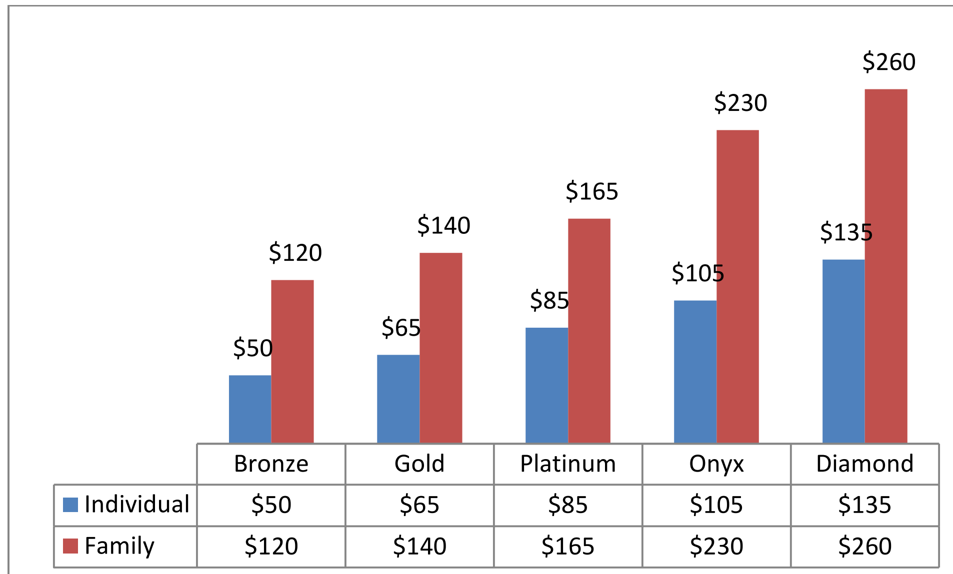
NOTES

Life Time Fitness (LTM)

Originally published November, 2013 as The Avid Hog: Issue 3

Overview

Life Time Fitness Sells Country-club Experience at an Affordable Price



	Bronze	Gold	Platinum	Onyx	Diamond
Individual	$50	$65	$85	$105	$135
Family	$120	$140	$165	$230	$260

An Individual membership costs from $50 to $135 monthly

- Bahram Akradi founded the company
    - Left Iran in 1978
        - Several months before the revolution
        - He was 17 years old
            - The son of an Iranian air force officer
    - Enrolled in his senior year of U.S. high school
    - After several semester, he took a graveyard shift with Colorado Springs Nautilus Fitness club
        - Quickly became a salesman
    - After 2 years
        - He co-managed a Nautilus club in Minnesota
            - With the promise to manage the next one the company opened
    - Akradi transformed Nautilus into U.S. Swim and Fitness
        - He scoured the Twin Cities for buildings
        - Negotiated leases
        - Designed new, much larger clubs
            - Based on his own experience as a club user[i]
        - Offer new services
            - Day care
            - Nutrition advice
        - Aimed at

            - Prosperous baby boomers
            - Young families
    - He became one-eight partner in U.S. Swim and Fitness
        - Sift through demographic data from
            - Radio
            - TV stations
            - University libraries
        - Determine ideal locations for more clubs
    - Bally's Total Fitness acquired U.S. Swim and Fitness
        - He advised against
    - He decided to build a customer-centric company
        - Life Time
    - Founded in 1992
    - It took two and a half year to generate investor interest in his new club model
        - Got the first $75,000 from Wheelock Whitney
        - Built the first club in Brooklyn Park
            - Refurbish an existing club
            - The location wasn't the demographic Akradi had in mind
                - But he had to start
        - The second club was built in Eagan
            - September 1994
            - 65,000 square feet
            - Closer to his model
            - Gave investors a taste of his vision
                - Large size
                - A lot of amenities
    - Continued building new clubs in Minnesota
        - Built the first 90,000 square-foot club
            - May 1996
        - That's the model he replicated around the country
    - In 2000
        - LTM was a $100 million company
        - Was developing 6 clubs
            - $25 million each
            - Had to raise $100 million to finish
    - IPO in 2004
        - Raised $80 million for further expansion
- LTM sell country-club experience at an affordable price
    - Clubs are in medium to large-sized metropolitan areas
        - Exurban

        - Fringe suburban areas
        - Orland Park, Chicago
        - Rochester Hills, Detroit
        - Garland, Dallas
        - Overland Park, Kansas City
        - Dublin, Columbus, Ohio
        - Florham Park, New Jersey
        - Syosset, Long Island
    - Operate big clubs
        - 114,000 square feet
        - Target 7,500 to 11,000 memberships
        - 600 parking place
        - 600 cherry lockers
    - Resort-like environment
        - Offer a lot of amenities
            - Cardiovascular equipment
            - Free weight and Resistance equipment
            - Basketball/volleyball courts
            - Racquetball/squash courts
            - Lap pool and whirlpool spas
            - Swimming pools
            - Two-story waterslides
            - Saunas
            - Rock climbing cavern
            - Child center
            - Spa
            - Café
            - Pool-side Bistro
            - Locker rooms
        - Limestone floor
        - Granite countertops
        - Cherry lockers
        - A lot of programs
            - Group fitness
            - Yoga
            - Swimming
            - Running

            - Racquetball
            - Squash
            - Tennis
            - Pilates
            - Martial Arts
            - Cycling
            - Basketball
            - Swimming
            - Running
            - Etc.
    - Price is affordable
        - Individual membership
            - Gold: $65
            - Platinum: $85
            - Onyx: $105
            - Diamond: $135
- Each of LTM's club has a local moat
    - Attract family customers
        - 50-55% of memberships are individuals
            - 30% are couple
            - 15-20% are family
            - Even individual membership has a high family component
                - A mom with two kids
        - Average household size is 4[ii]
        - Selling to family customers requires availability of many programs/amenities
    - 75% customers are within 5 miles
        - 12 minute drive
    - Each club cost $30-$50 million
    - Population may support only one club
        - A club target 7,500 to 11,000 membership
            - 1.9 members per membership
            - => 14,250 to 20,900 members
            - => 10,687 to 15,675 members within 5 miles
        - LTM target location with over 150,000 population within 5 miles
            - 16.6% of US population belong to a health club
                - 24,900 people within 5 miles

- Each club has a competitive position similar to that of WTW
  - Compete with several smaller competitors
    - Smaller clubs draw customers within 1 or 2 mile-radius
    - LTM draw customers within 5-mile radius
  - LTM gets a big share of the profit pool
    - Smaller clubs have low barrier to entry
    - There are a lot of churn and replacement
    - There's a lot of noise

- Local moat allows LTM to earn 15% ROIC
  - Each club has strong cash flow
  - Maintenance CapEx is low
    - About $4 a square foot a year
    - $500,000 a club
  - Example
    - Cleveland, Ohio
      - Opened in 2010
      - Cost $30 million
      - $60 a month for an individual membership
      - On track to reach 10,000 memberships
      - => $13-$14 million revenue
        - 40% EBITDAR margin
        - $5.2 million to $6.4 million EBITDA
        - $4.7 million to $5.9 million pre-tax owner earnings
  - With leverage, LTM was able to grow in the last 10 years
    - Gross PPE: 19%
    - EBITDA: 19%
- LTM can grow 12-15% in the next 10 years
  - Geographic expansion is very reliable
  - Potential 250-300 clubs around the country
- Value
  - At $50 per share, Capitalized EV/EBITDAR = 8.6
  - LTM deserve 12 to 15x Capitalized EV/EBITDAR
    - 12x Capitalized EV/EBITDAR results in $79.69 value per share
    - 15x Capitalized EV/EBITDAR results in $105.93 value per share

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[i] ""By the end of my last semester, by selling memberships, I was already making more money than I ever would as an electrical engineer. **Nautilus morphed into U. S. Swim and Fitness at the behest of Akradi, who scoured the Twin Cities for buildings suitable for transforming into new**

fitness clubs, negotiating the leases and using his drafting talents to design new, much larger clubs based on his own experience as a club user.

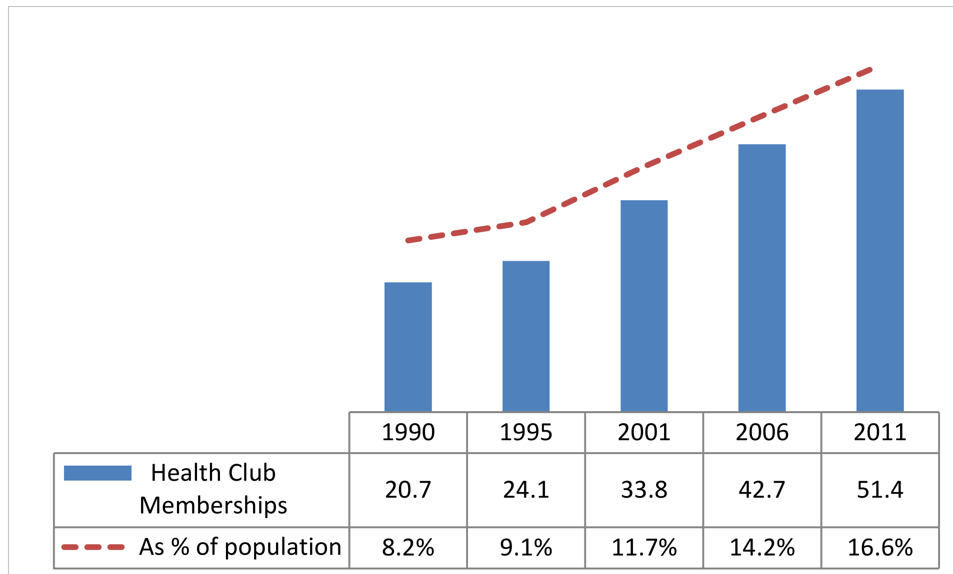
"People who build clubs only from the financial point of view sometimes fail—not always, but sometimes," Akradi says. "T**hey fail because they are not giving the customer what he is looking for. I tell people, 'Watch your customer. See what they want. If you can react fast enough you can't go wrong.'**" – Bakram Akradi Story

[ii] "Just a little snapshot of who is a member of Life Time Fitness and it really -- [in our focus], it's very, very balanced. If there's one true bull's eye or one true target for us, it starts with the family. We want to locate our centers in residential areas. So most of our centers are located in suburban markets. That doesn't mean they all have to be, but they should be at or near the focal point of a residential area. **Half of our members are men, half of our members are women. The median age, 40; the average household size -- the average family size, we look at that, is four members**.

Median household income, above $100,000. So what you start to see is where we positioned these is in the reasonably affluent to affluent areas. And our target, if you want to look at it, you step back at it, is family in reasonably affluent areas and also those types of people that are focused and passionate on living a healthier way of life. That's who we want, that's who we are marketing toward, that's who we really desire as members of Life Time Fitness." – Michael Robinson, CFO, CFA Society of Minnesota 2012 Investment Conference

Durability

The Nordstrom of the Heath Club Industry



	1990	1995	2001	2006	2011
Health Club Memberships	20.7	24.1	33.8	42.7	51.4
As % of population	8.2%	9.1%	11.7%	14.2%	16.6%

Health club memberships increased as % of population overtime

- Home exercise won't take business from clubs
  - The experience is better in clubs
    - A wide variety of equipment
    - Atmosphere
    - Music
  - Industry's membership has grown slightly better than population
    - Compounded 4% over the last 10 years
      - According to IHRSA, the industry has
        - 20.7 million in 1990
        - 24.1 million in 1995
        - 33.8 million in 2001
        - 51.4 million members in 2011
      - People pay more attention to health and beauty
        - People have more income, more leisure time, and inactive life
      - There's a lot of health benefits of exercise
        - Researchers found that each dollar spent on wellness programs saves[i]
          - $3.27 in medical costs

                - $2.73 in absenteeism
                - Employees are more productive
        - 22 million members are "involved" members[ii]
            - Go to clubs several times a week
            - About 100 times a year
            - LTM's customers are more active
                - Before the crisis, 80% of LTM's members utilize the clubs[iii]
                    - Increase to 85% after the crisis
                - Average number of visits per year, per membership is 100
    - Low-end clubs are more vulnerable to home competition than LTM
        - Low-end clubs are just rooms full of equipment
        - LTM offer a lot of amenities that people can't have at home
            - Swimming pools
            - Courts
            - Spas
            - Rock climbing wall
            - Sauna
            - Etc.
- LTM's positioning is durable
    - LTM positions as The Healthy Way of Life Company
        - They try to have the best programs in one place[iv] [v]
            - They can make acquisitions to get better programs for each of LTM's "interest groups"[vi]
                - Acquired athletic events
                - Acquired education business
                - Acquired yoga teacher training[vii]
            - Is the largest provider of indoor & outdoor tennis in the country[viii]
                - Wouldn't be in the tennis business alone
                - In certain market, need tennis & other components
        - They want the brand to be a solid as Whole Food
            - Food at LifeCafe is consistent with the brand[ix]
                - Meat has no
                    - Hormones
                    - Antibiotics

            - No food coloring
            - No preservatives
            - No bleached flour
            - No processed sugar
    - It wouldn't require a lot of capital investment to maintain the positioning
        - Faddy programs tend to be capital-light
            - Yoga
            - Kettle bell
            - Pilates
            - TRX
            - Etc.
        - Demand for something like swimming, racquet courts, etc. tends to be stable
    - LTM's position can always attract a segment of the population
        - Just like some people want organic foods at Whole Foods
- The management is long-term oriented
    - Bahram Akradi
        - Founder, CEO, and Chairman
        - Founded the company in 1992
        - Has been in the business since 1984
            - Founded U.S. Swim & Fitness Corporation
    - They expect to run the clubs long-term, not just 5 or 10 years[x]
        - Own the clubs to have a better control of occupancy cost
        - 107 clubs
            - Lease 30 clubs
            - Long-term ground lease 9 clubs
            - Own 67 sites
            - The member of a joint-venture that own 1 site
            - No mortgage financing on 55 centers
                - Market value is well over $1.5 billion[xi]
        - LTM compare cap rate with other options to consider owning or leasing
            - Cost of ownership is lower[xii]
            - Owning the clubs give a better control of occupancy cost
            - Lower occupancy cost give them a competitive advantage
            - More accurately, lower leverage result in lower risk
                - Owning clubs have lower asset turnover

            - But higher margin
                - Provide a cushion against bad times
    - LTM doesn't sell annual memberships[xiii]
        - Despite selling annual membership may improve retention rate
            - WTW monthly pass member stay longer and attend more meetings
                - Stay for 8 months
                    - Pay-as-you-go member stay for 3-4 months[xiv]
            - CLUB improve retention rate with annual subscriptions[xv]
        - LTM must earn member's business by keeping them satisfied
            - Sales people are encouraged to reach out and engage new members[xvi]
                - The largest attrition happen in the first year of a membership
            - Bonus is based on Net Promoter Score[xvii]
            - Maintain the facility well[xviii]
                - A big retrofit every 5 years[xix]
                    - Replace cardiovascular equipment
                    - Do a lot of surface work
    - Keep investing in new programs that fit The Healthy Way of Life Company strategy[xx]
        - Invest MyHealthCheck[xxi] [xxii]
            - Lost $3.5 million EBITDA in 2011
            - Lost $1 million EBITDA in 2012
        - Invest in athletic events business
            - Lost $2.5 million EBITDA in 2012[xxiii]
                - Improve connection to memberships who are interested in running, cycling, triathlon, etc.
        - Invest in Life Time Weight Loss[xxiv]
    - During the crisis, didn't reduce membership fee
        - Try to retain customers by improving value proposition[xxv]
            - More services
            - More programming
            - More connectivity
        - Reduce initiation fee to make it easier for people to sign up
- 3 risks to LTM's durability
    - Overleverage

- Bankruptcy is common in this business
    - High fixed investment
        - So, operators tend to have a lot of debt
    - Expensive leases due to aggressive, undisciplined growth
- Bally Total Fitness went bankrupt in 2007
    - Too much debt
        - Debt/EBITDA was
            - 10.5 in 2002
            - Reduced to 5 in 2006
    - Left little CFFO
    - Spend little in Cap-Ex to keep the clubs new
- Crunch went bankrupt in 2009
- (More discussion about LTM in the Capital Allocation section)

- Expansion from YMCA's clubs would kill LTM
    - Unlikely
- Aggressive in-center sales would hurt LTM's image
    - In-center revenue per member increased from
        - $129 in 1999, to
        - $507 in 2012
    - A lot of members complain about LTM's aggressive sales pitch[xxvi]

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[i] "Quite a bit, as it turns out. **For every dollar a business spends on wellness programs, it saves $3.27 in medical costs and $2.73 in absenteeism costs**, according to a recent study by three Harvard University researchers." - As health care costs rise, more companies invest in fitness programs, Leslie Kwoh, www.nj. Com, 25 July 2011

[ii] "If you step back a little bit and you just look at the market for health clubs, not the total Healthy Way of Life market that we really aspire to participate in, but just in the health club market in the United States, it's a $20 billion market. It's growing. The revenue growth on a compound basis has been 6% per year over the last 10 years. There are 50 million Americans that belong to health clubs. That works out to be just above 15% of the total population of the United States. 22 million of those members are really core members, meaning that they come to health clubs at least a couple of times a week or in this measure 100 times a year." – Michael Robinson, CFO, CFA Society of Minnesota 2012 Investment Conference

[iii] "It varies by club. You could look at it, and in some cases, take a -- a club might be, historically, maybe 80% utilizing and 20% and non-utilizing. And, in a club like that, that has probably moved now to 85%, 85%-plus utilizing and 15% or so non-utilizing." – Michael Robinson, CFO, Oppenheimer 2010 Conference

[iv] **"I want the brand to be solid, trusted across every one of those programs, not overall**. It needs to be like a Whole Foods. People need to believe that they -- where they're coming in. **To that effect, LifeCafe, as an example, it's -- we just -- all three stores that we just opened, news clubs, and all the Minneapolis stores are already all converted**.

There is no hormones, no antibiotics in any of the meat. There is no high fructose corn syrup. There is no food coloring. There is no preservatives. There is no bleached flour. There is no processed sugars in any of the food. You can come in, close your eyes, grab anything off of our cafe, anything off the wall, and rest assured that you don't have to worry about reading labels. I want the customer to be able to trust our product and our programs. By end of the year, every single club, every single LifeCafe is doing that.

To make sure the community aspect of this is right, we changed one school, one elementary school last year. Our foundation completely covered the cost of transitioning one elementary school last year, full year. We took -- we went in, we took their food out, we changed their food with exactly the criteria that I just told you. We have hundreds and hundreds and hundreds of letters of appreciation from parents and the school. This year, our foundation will expand that to five schools.

So, we're branding Life Time as the product that you can trust. **It's the best product, the best program for the area of your passion**. And with that, we are just extremely happy and ecstatic with the fact that it's all working. And I'll let Mike step up and put the stats for you -- metrics for you. Thank you." – Bahram Akradi, CEO, William Blair 2012 Growth Stock Conference

[v] **"We basically focus on the customer interest points. They may be interested in basketball, may be interested in kids' activity, they may be interested in yoga, they may be interested in weight loss, and the list goes on. So we have developed actually 19 companies inside**. Each one of those companies are focused on delivering the customer the best in what they're looking for." – Bahram Akradi, CEO, William Blair 2011 Growth Stock Conference

[vi] "Well, acquisitions are a part of it, and it's not just acquisitions of clubs but also acquisition of businesses that supports the Healthy Way of Life approach that we have put together. **And it provides all of the better programs for each of our interest groups. So it all ties in together as a Healthy Way of Life Company**. It gives us many, many ways to grow the top line and the bottom line of this company." – Akradi, CEO, 2011 Q1 Earnings Transcript

[vii] "**We are really focused on broadening our position.** You've seen investments that we've been making over the last year or so in areas like acquiring athletic events and acquiring education businesses the yoga teacher training, really broadening the position as a Healthy Way of Life Company." – Michael Robinson, CFO, Barclay Capital 2011 Retail & Restaurant Conference

[viii] "**Michael Lasser** - UBS Investment Bank, Research Division

Okay. Can I ask one last question? You're adding more tennis to the new locations. Tennis isn't a great return on investment capital, or at least it hasn't been historically. So what's the thought process behind adding tennis in some of the new clubs?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

It's a great question. **We are the largest provider of indoor and outdoor tennis in the country by a magnitude of 2. We have the lowest attrition rate and the highest revenue spend by the members that they are in that space. We have a strategy to be the best in every product and service that we offer, and we are executing against that strategy in opportunistic areas. Certain markets, as we go in, we feel that we want to have the tennis as well as the other components to be the most complete provider of healthy way of life array of interest for people**. And so, it's part of an overall strategy. I would not choose to be strictly in tennis business if that's -- was what we were going to do. But it is part of the overall strategy of building Life Time's brand to be the top-shelf country club resort-like athletic facilities." – 2013 Q2 Earnings Transcript

[ix] "**I want the brand to be solid, trusted across every one of those programs, not overall**. It needs to be like a Whole Foods. People need to believe that they -- where they're coming in. **To that effect, LifeCafe, as an example, it's -- we just -- all three stores that we just opened, news clubs, and all the Minneapolis stores are already all converted**.

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[x] "MIKE ROBINSON: The question is, why do we choose to buy our land for the most part versus operating leases?

There are several aspects to it. First and foremost, when we look at these, **we are making decisions that are in general and expect to run these clubs long-term. So we are not making investments for five and 10 years**. We are making investments in areas where we see substantial growth in that for time periods much longer than that.

From a pure economic perspective, over the last 10 years or so, **the all-in cost of capital of ownership has been significantly less than the cost of leasing**. When you look at the ability to obtain mortgages and to control the occupancy costs long-term, it's been the best economic decision -- best economic decision for us.

One of our key competitive advantages from a cost perspective is our occupancy costs are significantly lower than others in the fitness industry because of that ownership, because of that ownership profile. Those are the big drivers.

That isn't to say that we must and need to own. When we make our location decisions -- and I'll argue that the site selection process is one of if not the most important processes that we as an executive management team do -- that demographic and that psychographic is so important to the success of our business, that that's what drives the sites themselves is making sure that we have the right demographics, the right psychographic.

If we can't find land or we can't find a land to be able to build outself on, on that, that shouldn't and doesn't stop us. We will look for conversion ability. Maybe we'll buy a different type of building and convert it into a Life Time Fitness, or we'll look for leasing opportunities, and we do that.

It's -- but we are still relatively early -- we are early in our growth prospects in that sense. And so generally we will be driven more toward buying and building today than driving the conversion process. But we have a number of centers. Rockville, Maryland, is a leased facility, and we converted a federal office building into a beautiful 75,000 square foot Life Time Fitness in a tremendous area and a tremendous demographic. So we will do all, and the intention in the future is to look at and do all of those things." – Oppenheimer 2012 Consumer Conference

[xi] "And I'd like to close the gap on something that -- Mike talks about approximately by the time we finished Colorado Springs and Summerlin, Nevada, **we'll have 51 open facilities with no mortgage against. And as while Mike puts in the conservative book value of $1 billion in that, those 51 facilities under no circumstances could be purchased for land and built in nowhere near $1.5 billion or more in today's market**. So the real value, real estate value of those assets, the real estate value is significantly higher." – Bahram Akradi, CEO, 2011 Q1 Earnings Transcript
[xii] "MIKE ROBINSON: The question is, why do we choose to buy our land for the most part versus operating leases?

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[xiii] "A second thing is, back to that member point of view view of us, **we don't sell long-term memberships**. Our view is, what does a member want? The member wants the ability, if they need to, to get out of something and not to have to fight to get out of a type of membership. **We view that we have to earn our members' business every time they come in, and that works very, very well culturally and attitudinally from our perspective.**" – Michael Robinson, CFO, Piper Jaffray 2011 Consumer Conference

[xiv] "our members are staying engaged longer. **The average Monthly Pass member maintains its subscription for about eight months versus three to four months of elapse time with Weight Watchers for a pay as you go member**." – David Kirchhoff , WTW CEO, 2007 Q4 Earnings Transcript

[xv] "We decided that the Company should do some multivariable testing. That's when you test a number of opportunities within your club, scientifically, to see

what things make it work. We looked at our membership and pricing structure closely. Being a gym rat and a sales guy my whole life, I wasn't going to mess around with our sales model because we knew we could sell people. What we didn't know was how to keep them.

So, we started testing a number of different models. And where we landed was we felt that for us, in our test results, the best opportunity was to give consumers the choice of a month-to-month, one year or two year, slight discount for staying longer, and consumer self-selected; they chose the membership they wanted. And they were also very comfortable with the idea of a two-year membership, simply because they were committing to a two-year cellphone commitment now. So, cellphones came into the discussion quite a bit as we started testing this model. **So, by giving consumers a choice, not only did we see the attrition rate at our whole company improve, but the month-to-month memberships improved because they were self-selecting**." – Bob Giardina, CLUB's CEO, RBC Capital Markets 2006 Consumer Conference

[xvi] **"The second thing that we do is we monitor daily -- in fact, incent our salespeople to make sure that they are watching the profile of the membership base that they've signed up**. And if they seek inactivity -- and we have reports that will come to those people on a daily basis that they can pull up -- if they see inactivity that starts to cross a three- or a four-week threshold or a 45-day threshold, our expectation is that they are proactively reaching out, calling and really trying to engage those people into coming in and utilizing the services of the club." – Michael Robinson, Barclay Capital 2011 Retail & Restaurants Conference

[xvii] "We know it these are healthy way of life minded people. They are motivated to work at Life Time Fitness because of what is that -- because of what we stand for. In addition to that, people are motivated by compensation, right? **So we set up custom compensation systems, bonus systems, around three key tenants -- financial and operating performance, the member point of view or that Net Promoter Score, and team member relations**.

We use that same Net Promoter Score, would you recommend Life Time Fitness to a family member or friend as an employer? There is no better indicator of how Life Time Fitness is doing as a premier employer than asking our team members if they would recommend Life Time as employer to a loved one. So across those three measures we compensate our individuals. So they are motivated by compensation to drives the right strategic objectives in an intuitive way and they are healthy way of life minded people." – Mike Gerend, COO, Avondale Partners 2008 Consumer Conference

[xviii] "**Meredith F.**
Farmington, MI

4 stars
8/8/2010

One of my friends' families had a membership, and I loved going as a guest. I plan on getting my own membership soon, once I am back home. Though it is a bit pricey, so I may have to wait until I have more money.
The facilities are always really clean, and they offer every machine that I would need to workout. There is even an outdoor pool with a water slide!
Everything is kept very clean, and there is so much space. I never had to wait for a machine, and it was never too crowded when I was there. They even offer classes for a pretty good price.
All in all, probably the best workout chain that I've been to. You definitely get what you pay for. said a member about a LTM club built in 1999 in Novi, Michigan

[xix] "MIKE ROBINSON: The question is, how has the maintenance CapEx held up over time as you look at these centers that are eight, nine, 10 or more years old? And the answer is, it's held up quite well. We have clubs, big clubs -- **our first large club that we ever built was in Eagan, Minnesota, in 1994. So that club is now in its 16th year of operation. And I would hope, if you went into that club today, you would look at it and say, this looks and feels like new, which is exactly what we want and we expect of our general managers when we do that**.

We typically spend about $3.50 a square foot a year. That has remained relatively constant over the last several years, but it goes in five-years cycles, four- or five- or six-year cycles, depending on utilization. **So a typical center we might spend $0.50, $0.75, $1 a square foot in years one, two, three, four or years six, seven, eight, nine and then come on year five or so and do a fairly major retrofit. And that retrofit will replace cardiovascular equipment and it will do a lot of surface work. So we are replacing and upgrading surfaces so, again, these clubs look and feel like new.**

In addition to that, and I know many of you have heard me talk about this, **we spend 2% to 3% of revenue on repairs and maintenance**. It goes right in the P&L, and still hit those units and those all-in EBITDA margins that we were talking about earlier. And that's high. That's higher than most health clubs that I'm aware of. And the reason for that is, we're doing a lot of replacement and proactive work replacing high-wear carpets, replacing the belts and treadmills, whatever it is, on an annual or an 18-month basis. We are just taking that straight to the P&L. Again, I can't tell you how critical it is that these clubs look and feel

like new. And they do. That's our goal and that's what we hold our general management accountable for. And that's a key differentiator for us as we look into the future." – Oppenheimer 2010 Conference

[xx] "**Gregory J. McKinley** - Dougherty & Company LLC, Research Division

Okay. And then within the center margins, are there other costs other than new center development there that you're bringing in, maybe new services or different amenities to the member, that are changing the cost structure there at all?

Michael R. Robinson - Chief Financial Officer and Executive Vice President
There are always new costs. As we look at all of the programming that we have, there's investments in some, and we're experiencing growth in margin expansion in others. So I -- and as you look at it overall, with this differentiated business model, we're going to continue to invest in this -- in the programming of the in-center businesses as well as the core itself. That said, overall, we also are, longer-term, expecting that these things, just as we've seen in the last couple of years, they produce long-term margin expansion. And that's really what we're driving for." – 2013 Q2 Earnings Transcript

[xxi] "My Health Check is our wellness company. It's a unique delivery of a results-based wellness program that enables the corporation to adjust their healthcare program to cost-differentiate between the customers who are fit, healthy, and those who are not, based on all the legalities of this system. As you guys know or should know, **in 2008 there was a legislation where corporations can distribute healthcare cost with as much as 20% between different employees based on their health. And that number grows to 30% in 2014 for large companies**. It's a substantial difference for the companies.

We are able to -- the program we have built completely -- to walk up to a company, enable the company to author a health plan that they can push personal responsibility about their healthcare cost and enable employees to actually get healthier. This is not health club membership. We are not walking into a place and selling them corporate membership sales. But this company has the potential to grow several hundred percent a year." – Bahram Akradi, CEO, William Blair 2011 Growth Stock Conference

[xxii] "**Paul Swinand** - Morningstar Inc., Research Division

I'm just trying to think longer-term about the myHealthCheck business and just to be clear how it works. Those members, they would actually be members and could use the club, too, or only use it in a capacity of the company-sponsored myHealthCheck?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

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Latter. They actually are not counted in the membership counts we are offering you right now. So I want to make sure there's no confusion. **They are -- they have access to myLT and everything we offer online, they actually have access to our telephonic health advisors. They have many benefits, but they do not have access to our facilities other than coming in for testing or something like that or some particular events sponsored, as you mentioned, by their employer**. However, in a lot of ways, as we look at growth of myHealthCheck, it creates an opportunity for upgrading those people to access memberships.

Paul Swinand - Morningstar Inc., Research Division

So then there wouldn't be any kind of capacity constraint because you could schedule them during the day or off-peak hours. Again, if you're thinking out of a long-term model, could you think of each club having 20% or some number ancillary on myHealthCheck members or...

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

Yes, let's go through that. It has nothing to do with that. **There is no capacity restraint on the club use or on our ability to deliver myHealthCheck screening**. That's business we can go to the employers, corporate office and execute. We have numerous mobile units that they can drive right in front of their parking lot and do it, and they can come to our facilities to get the testing, but that testing does not constitute a club use broader than that screening. So therefore, there is absolutely no restraint on anything.

Paul Swinand - Morningstar Inc., Research Division

Okay, got it, got it. And then, obviously, there's some data. Is it hard for the customer to switch once they sign up? Or is it like could another company say, "hey, we do the testing cheaper" and take over the next year?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

This program is not a program that a company would switch around. If it was just the testing alone, that would be a commodity people can do biometric screening. Ours is a proprietary system with a health score that will tie into their incentives that they would put around their premiums as we do for Life Time employees ourselves. And once the company goes ahead and sets that up, it's very, very unlikely -- it's possible, but unlikely to try to switch because it will be very, very complicated. So I see it, while you may sign a 2-year or 3-year agreement with a company, it would be a much longer term than that, unless you fail them in your execution, which hasn't been our style in failing anybody." – 2012 Q2 Earnings Transcript

[xxiii] "**Brent R. Rystrom** - Feltl and Company, Inc., Research Division

The one final twist that I would ask then, you didn't mention events. EBITDA -- I think you've said EBITDA breakeven on the events business in 2013. Can you refresh us where that was in '12?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

About $2.5 million negative, not counting Commitment Day. So -- and then we expect that by 2014 -- so 2013 will still have some impact from Commitment Day, albeit not near what we took charge in 2012. But in 2014, we expect that to be EBITDA neutral or better, as well as all the other events. **We've been buying some events, consolidating, rebranding to create solid brands like Life Time Tri, Swedish E [ph], Leadman Tri, Torchlight, et cetera**. And then, we're working through those -- each of those brands to make sure they become what we expect them to become. **These events substantially improve our connection to our memberships who are interested in running, in cycling, in triathlons, et cetera. So they have tremendous impact from media impressions, which we'll really never include in the numbers**. So as a whole strategy, they're an absolute winner. Now what we want to get to is to have this company athletic event business to be a solid for-profit entity of its own. **And we feel like we will absolutely accomplish that, making $2 million, $3 million, $4 million hopefully in profit in 2000 -- now that's just a guess and that's a hope, but in 2014 and then build on top of that every year going forward.**" – 2012 Q4 Earnings Transcript

[xxiv] "If we were a gym, we would be a lifetime athletic box or a lifetime fitness box. That's just one of the businesses we are in. **Life Time Weight Loss is its own separate company. We have subscribers who are not members. We are building the weight-loss program that doesn't just reach to the members of the club, but reaches out to the people who are nonmembers**." – Bahram Akradi, CEO, William Blair 2011 Growth Stock Conference

[xxv] "I'll give you a little bit of color. As Robinson mentioned last year, the bulk of increased attrition, we had seen was people who were dropping out more quickly when they were not using the club. And we also saw the last six months, a number of people who are using the club and they were financially so pressured that they just really needed to sit out for a while, even though they loved the club, et cetera.

What we are doing is increase the value proposition by providing more services, more value, more programming, more connectivity, but not reducing our fees or our dues which we really don't believe is necessary.

And we're confident we can improve the attritions from the where they are at today, to what level I can tell you, the level I like to get to as I mentioned is 36% or under.

I also want to emphasize as we have demonstrated, we have confidence and the ability to replace those members. However, again as I mentioned you will see a higher acquisition cost when you are trying to replace the higher churn than 36%. It's not that -- that is not doable, it's just not desirable. So in the details of what we are doing I prefer not to get into. We are doing a lot of stuff, I am excited about where we are going to keep it to ourselves as a competitive advantage." **–** Bahram Akradi, CEO, 2009 Q1 Earnings Transcript

[xxvi] **"**Trudy G.
Woodbury, NY

2 stars

5/12/2011

Bring your Credit Card .... the sales pitches are RELENTLESS here! My family joined without any hassle, but the hard core sales started at the FitPoint assessment that comes "free" with each membership. **You will be HOUNDED (uncomfortably and constantly asked) to buy additional testing packages, heart rate monitors, nutrition packages, vitamins, personal training... I mean HOUNDED**!! Every time you turn around you will hear another poor newbie being pitched the same thing... "you really need the cardio point assessment in order to get the best results." After you shell out an extra $119 for that, they ask you to kick in another $75 a month so you can learn how to use the data gathered from the test - they will email workouts to you for an extra $75 a month!!! **I have NEVER been to a gym that was SO OBSCENELY RELENTLESS on selling... it NEVER stops. But the facility is BEAUTIFUL. The people are nice and overall, this a great place for families - just BE CAREFUL not to get HUSTLED for every penny you got! We have already spent over $900 this month... I am ashamed to admit**. So far, I think the extras were an utter waste. **NY – Syosset**

////

Pasquale R.
Madison, NJ

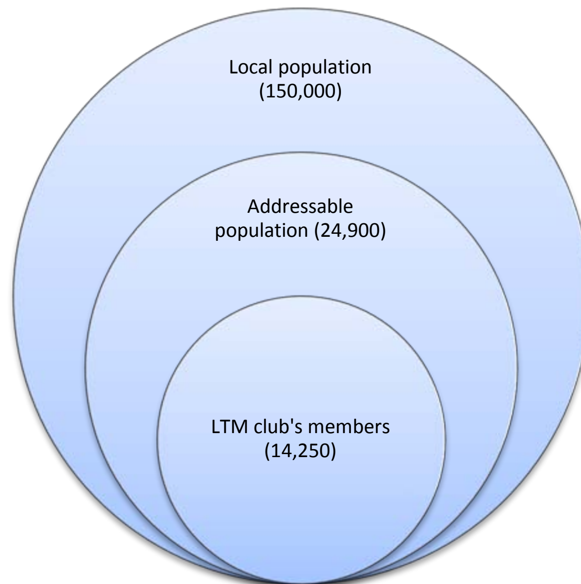
4 stars

2/5/2010 361 check-ins here

My first impression of this place was WOW. **Going with a friend of mine so he can "refer" me was one of the reasons why I decided to give this place a shot. After my workout they had me sit down with one of their sales reps and get schpeeled...and I agree with the other members who mentioned they do try to scam you**. I knew going in my company offered a discount and what my coworkers were paying. He tried to tell me that wasn't true. He even looked up one of my friends accounts and said he pays the same that I would be paying which is BS!!! (the moniter was turned towards him so he thought he could be slick). I simply got up and walked out. The next day I called the manager who stated we do have a discount and signed me up. I get the whole sales tactic but don't lie!!!! The gym, well it's really amazing. Minus the occasional meathead for the most part it's spacious, clean (very clean infact). Tons of machines and free weights. Tons of tredmills and other machines. Although it's pricey you do get a lot. There is a large cafe as well as Spa (haircut, massage). Lot's of classes, bb court, rock climbing and 2 pools!!!! 1 indoor and one out. **NJ – Bekerley Heights**" *– Too see more quotes, look at the Scuttlebutt Folder*

Moat

Life Time Fitness Has a Wide Local Moat



Each club has over 50% local market share

- Fragmented market[i]
    - The industry includes 22,000 companies and nonprofits
    - About 30,000 fitness and recreation centers
    - Total revenue is about $22 billion
    - Major companies include
        - Curves
        - Life Time Fitness (“LTM”)
        - Bally Total Fitness
        - 24 Hour Fitness
        - Spectrum, and
        - Town Sports International (“CLUB”)
        - YMCAs
            - 2,600 centers
        - 2,500 community centers
    - **50** largest companies account for **30%** of revenue
    - Only **a few dozen** companies own more than **10** centers
- 75% of total store count are small centers
    - 5,000 square feet

- Rooms full of equipment
- Cost about $20 a month
  - $10 in non-peak hours
- Have low barrier to entry[ii]
- Draw people from 1 or 2 miles
- A lot of churn and replacement
  - Recent growth in franchise-based operators replaced mom-and-pop clubs
- Total number of footage didn't change much

- LTM competes in the moderate-end family-focused clubs
  - Operate big clubs
    - 114,000 square feet
    - Target 7,500 to 11,000 memberships
    - 600 parking place
    - 600 cherry lockers
  - Resort-like environment
    - Offer a lot of amenities
      - Cardiovascular equipment
      - Free weight and Resistance equipment
      - Basketball/volleyball courts
      - Racquetball/squash courts
      - Lap pool and whirlpool spas
      - Swimming pools
      - Two-story waterslides
      - Saunas
      - Rock climbing cavern
      - Child center
      - Spa
      - Café
      - Pool-side Bistro
      - Locker rooms
    - Limestone floor
    - Granite countertops
    - Cherry lockers
  - Strong for families[iii]
    - 50-55% of memberships are individuals
      - 30% are couple

        - 15-20% are family
        - Even individual membership has a high family component
            - A mom with two kids
      - Average household size is 4[iv]
  - Price is 2 or 3 times higher than 10,000-15,000 square feet clubs
      - Individual membership
        - Gold: $65
        - Platinum: $85
        - Onyx: $105
        - Diamond: $135
- Each LTM's big club has a local moat
  - LTM draws customers from further than low-end clubs
      - 25% of memberships are outside of 5-mile radius[v]
  - It's costly to build a clubs
      - $40-50 million areas like New Jersey or Long Island
      - $30 million in Cleveland, Ohio
  - Operation is complicated[vi]
      - 300 certified employees
      - Offer 20 programs
        - Group fitness
        - Yoga
        - Swimming
        - Running
        - Racquetball
        - Squash
        - Tennis
        - Pilates
        - Martial Arts
        - Cycling
        - Basketball
        - Swimming
        - Running
        - Etc.
  - LTM differentiates by offering many programs and by store experience
      - Big clubs allow members to use many programs
        - On average, members use 5.5 programs[vii]

        - Example[viii]
            - For people who are interested in triathlon
                - Indoor triathlon series
                - Outdoor triathlon series
                - Experts to train in running, biking, swimming
                - Heart rate training to build your base & endurance
                - T.E.A.M weight-loss to help you lose weight
    - CLUB's fitness-only clubs in big cities average 20,000 square feet
        - Targets 3,300 members at maturity
    - Members appreciate having a lot of programs/amenities in one place[ix]
- LTM creates unique store experience
    - Open 24 hours a day
    - LTM tries to deliver sensory experience to build long-lasting relationship[x]
        - Sight: clean facility/open/airy/light to them
        - Smell
            - Fresh air
            - Different smells in different places
                - Eucalyptus smell in locker rooms
                - Fresh fruit & vanilla smell in the café
                - Candle smell in spa
        - Right temperature
            - Spa is warmer than in café or fitness floor
        - Taste: café menu: tasteful & nutritious
        - Music is delivered at decibel levels that fit the mood that LTM is trying to create in each one of those areas
        - Our senses are linked to memory & tap immediately into emotion
        - => hit people at a completely different level
    - LTM provides Ritz-Carlton experience at Holiday Inn Prices[xi]

        - LTM creates events to keep customers connected[xii][xiii]
    - A local area may support only one big club
        - A club must get enough memberships to survive
        - LTM target areas with 150,000 population within a 5-mile radius
        - Each club has 10,000 memberships
            - 25% from outside of 5-mile radius
        - Average members per membership is 1.9
        - => more than 19,000 people have access to LTM at anytime
            - 75% of these people are from within 5-mile radius
                - 14,250 people
        - About 16.6% of US population belong to a health club
            - 24,900 people in LTM's 5-mile radius
            - LTM only targets richer people in each area
                - Look for median household income of $75,000-80,000
                - Target $100,000 household income
                - Position as top-shelf facilities[xiv]
                    - Example
                        - In Des Moines, IOWA
                        - Choose platinum price to be a top-shelf
                            - $85 for an individual membership
                - Target members are not money pinchers
                    - They're time pinchers[xv]
        - Churning rate is 33-34%
            - Every year, a club replaces about one third of its memberships
        - So, a local area can support only one big club
            - If a circle can support 2 clubs
                - LTM can look at a smaller circle when building a club
- YMCA is LTM's direct competitor
    - YMCA is a non-profit organization
    - 2,600 clubs around the country
    - YMCAs are run in a very utilitarian way[xvi]
    - LTM's price is close to YMCAs[xvii]
        - The breadth of service and quality is much better[xviii]
            - And LTM opens 24 hours
    - YMCA operates less efficiently

        - Summerset Hills YMCA
            - Revenue: $10.7 million
            - Grants: $0.5 million
            - Salaries and other compensation: $6.3 million
                - 59% of revenue
        - Los Angeles YMCA
            - Revenue: $60.7 million
            - Grants: $23.6 million
            - Salaries and other compensation: $42.8 million
                - 70% of revenue
        - Houston Texas YMCA
            - Revenue: $87 million
            - Grants: $22.3 million
            - Salaries and other compensation: $58.9 million
                - 68% of revenue
        - Central Ohio YMCA
            - Revenue: $22.3 million
            - Grants: $8.7 million
            - Salaries and other compensation: $20.3 million
                - 91% of revenue
        - Atlanta YMCA
            - Revenue: $54 million
            - Grants: $32 million
            - Salaries and other compensation: $44 million
                - 81% of revenue
        - Salaries and other compensation is about 36% of LTM's revenue
            - Assuming salaries include
                - ½ of club operating expense and advertising expense[xix]
                - G&A expense
            - The actual number would be closer to 30%
    - 3 main threats from YMCA
        - Limit the number of locations LTM can enter
        - YMCA can open in areas that LTM plans to enter
        - Expansion from existing YMCA clubs
            - Big YMCA clubs were expanded overtime

                - Somerset Hills YMCA
                    - 88,000 square feet
                    - Started in the 1950s
                    - First financial campaign in 1970s
                        - Built the Engelhard Memorial pool
                    - Second financial campaign in 1980s
                        - Adult fitness center
                        - Gymnastics facility
                        - Gymnasium
                    - Built the Dillon Family wellness center in 1990s
                    - Raised $7 million to build the Mount Airy Road Facility
                        - Open in 2004
                        - Somerset Hills YMCA's first satellite facility
            - Bigger YMCA would be more competitive with LTM
            - There wouldn't be much expansion where population and wealth don't grow much
                - LTM usually target more affluent areas
                    - More difficult and expensive to expand
                - LTM is already big in these areas
                - LTM also operates more efficiently
- Overall, each LTM club has a competitive position similar to that of WTW
    - Compete with several smaller competitors
        - Smaller clubs draw customers within 1 or 2 mile-radius
        - LTM draw customers within 5-mile radius
    - LTM gets a big share of the profit pool
        - Smaller clubs have low barrier to entry
        - There are a lot of churn and replacement
        - There's a lot of noise
    - LTM closed only two clubs so far
        - LTM's 27,000 square foot center in Brooklyn Park, Minnesota
            - Opened in 1992
            - Lease expired in 2006
            - Closed because LTM have 5 other locations in the vicinity
        - LTM's 85,630 square foot center in St. Paul, Minnesota

- Opened in 1997
- Lease expired in 2010
- LTM closed the center
    - Transferred its membership to LTM's surrounding locations
    - LTM has 22 centers in Minnesota
        - With various size when they did experiment in early years

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[i] "The US fitness centers industry includes about 22,000 companies and nonprofits in the US that operate about 30,000 fitness and recreation centers with combined annual revenue of around $22 billion. Major companies include Curves, Life Time Fitness, Spectrum Club, and Town Sports International, operator of the Sports Club brand. About 2,600 centers are operated by YMCAs and another 2,500 by community centers. The industry is fragmented: the 50 largest companies account for about 30 percent of revenue, and only a few dozen companies own more than 10 centers." – *2012 Report on the $22 billion U.S. Fitness Centers Market*, Marketing Business Weekly, 06 May 2011

[ii] "I tend to segregate the market into three relatively -- maybe four relatively easy to think of. There's really high-end clubs; there's the moderate-end family-focused clubs that we are positioned in, really the middle, single, focus driver; and then, these low-end rooms full of fitness equipment. **That low end represents a significant amount of the capacity, as far as store count itself. It might represent 60%, 75% of the actual store count; maybe not anywhere near that as far as square footage or actual members**.
There's been a lot of churn and turmoil in that, as you can imagine. Very low barriers to entry there. Somebody can go in, in a 5000-square-foot center, get it for very reasonable. Maybe take out a small loan and put some equipment in, and things like that. People can hang out a shingle. Mom-and-pops, running on low margins, in and out of the business because of the economy. A lot of franchise operators coming into it over the last five years. So there's been a lot of churn and replacement. But net-net, not a whole lot of square footage growth. A little bit, and we've started see a little bit over the last year or two. We have seen a fairly significant growth in membership base over the last year or two, also, across the industry. And I think that's a good sign." – Michael Robinson, CFO, UBS Global Conference 2012

[iii] "The question is we've seen some mix shift from -- we've seen a mix shift in average dues that is actually flattened out and come down a little bit driven by -- and that's been driven by a mix shift where we've seen more single members

come in. A typical -- **typically we run about 50% to 55% individual memberships, roughly 30% couples and 15% to 20% families. Now when we talk about individuals -- that could be a mom that loves to exercise, a dad that loves to sit on the couch, so the mom joins with their two kids, so there's still a heavy family component to it**." – Michael Robinson, CFO, Piper Jaffray Consumer Conference 2009

[iv] "Just a little snapshot of who is a member of Life Time Fitness and it really -- [in our focus], it's very, very balanced. If there's one true bull's eye or one true target for us, it starts with the family. We want to locate our centers in residential areas. So most of our centers are located in suburban markets. That doesn't mean they all have to be, but they should be at or near the focal point of a residential area. **Half of our members are men, half of our members are women. The median age, 40; the average household size -- the average family size, we look at that, is four members**.

Median household income, above $100,000. So what you start to see is where we positioned these is in the reasonably affluent to affluent areas. And our target, if you want to look at it, you step back at it, is family in reasonably affluent areas and also those types of people that are focused and passionate on living a healthier way of life. That's who we want, that's who we are marketing toward, that's who we really desire as members of Life Time Fitness." – Michael Robinson, CFO, CFA Society of Minnesota 2012 Investment Conference

[v] "Our clubs, more than 25% of our members across the country; it's not specific to one location, come from outside of the five mile radius." – Bahram Akradi, CEO, 2009 Q4 Earnings Transcript

[vi] "That's the part that we see a lot of competition. Again, if you call it -- we see a lot of players expanding in that low-end market. We -- in our space, as you can appreciate, **they would have to spend $40 million, $50 million to build a facility**. They would have to have the infrastructure to go get the approvals and the gestation and doing all that. **They would have to have 300 certified employees. They would have to have 20 branded programs that accompanies inside, and this is a daunting business proposition**. If you spend $40 million, $50 million and you don't have all those details worked out, you're going to have a big, huge white elephant. You're going to have $50 million cost and not enough people in it to make the numbers work. So it's a very, very difficult business model to execute, and we've done this deliberately to build a "high barrier to entry" model in a "low barrier to entry" industry." – Bahram Akradi, CEO, 2012 Q4 Earnings transcript

[vii] "So, what we have been working on for the last four years is to take every program that our customer -- yes, we offer 20 things. But, no one customer of Life Time uses the 20 things. **They use five on average, five and a half. Some only use one thing or two things**.

And if that one or two things is not the best program, then we are off our strategy. So, our whole commitment has been to build the people, the places, and the programs that brings the people in for the goodness of the program itself and keeps them there." – Bahram Akradi, CEO, William Blair 2012 Conference

[viii] "So, to create a paradigm that everybody understands, think about a tennis club today. What do tennis clubs have that almost no other interest club, if you want to call tennis and cycling an interest club, what do tennis clubs have today? **They have pros, they have courts, they have tournaments, they have social activities, they have leagues, they have lessons -- got a lot of stuff going on, right**?
And when people are done playing in these leagues or participating in a lesson or in a pickup game, what do they typically do? They go have coffee together, they go get something to eat together. They usually hang together, don't they? So, I talked about the emotional connection that we have in attaching to someone's sensory experience and I talked about an initiative strategically around building communities. Well, think about this and think about how Life Time can uniquely deliver this.

What if I told you that I was interested in cycling, or how about a better one, triathlon, and I came to Life Time Fitness. Life Time Fitness is uniquely qualified to deliver connectivity similar to what you would find in tennis, if you think about it. **Indoor triathlon series; outdoor triathlon series; experts inside that help you train in running, swimming, and biking; heart rate training in order to build your base or endurance; T.E.A.M. weight loss to help you lose weight to be able to get into an endurance race**.

Every day there's opportunities within our clubs to have a fun run, to go for a masters swim class, to enter into the spinning studio and check-in for a cycling class. Can any other business that you can think of deliver with those kinds of facilities, that kind of expertise, those types of events, to create a connection unique relative to anything else that is out there?

So when you look at these interest groups that we have formed. **And we have now started to sign each one of our perspective members up for cycling, swimming, running, nutrition, weight loss, racquetball, squash, climbing -- I**

can go on up to about 35 of those." – Mike Gerend, COO, Avondale Partners 2008 Consumer Conference

[ix] "**Shinko S.**

Westbury, NY

4 stars

3/3/2012 1 check-in here

When you hear gym, it's like oh man, this sucks. **But this place makes you want to work out**. I feel like a spoiled baby here. They have everything from rock climbing to swimming pools, hot tub, sauna, basketball room, steam room, and the lockers are beautiful! They also have a cafe, even a salon! WHAT! This place has the right mind set. It's not about treadmilling it every day, it should also be fun time. **My only complaint is the salespeople**. I got it guys, but no need to follow me all the way to the locker room for deals and etc. **- NY – Syosset**

alexis a.

Brooklyn, NY

5 stars

12/12/2012

Lifetime Fitness at the Florham Park, NJ location is fantastic! I had been a member of Sport Club LA in Rockefeller Center which was then bought out by Equinox. It was very expensive and incredibly convenient to where I was working but it pales in comparison to Lifetime in Florham Park and to be honest the service went waaaay down when Equinox took over and got super crowded... not to mention Lifetime is about 50% cheaper with 200% more amenities.

Speak to Jen Duran in Member services - she is fantastic!

I specifically came to yelp to review the LifeSpa, which is the spa located directly inside of Lifetime.

I was apprehensive as I am a chronically finicky person when it comes to getting my haircut. I was spending a LOT to get it done in the City and happily so because I loved what she did for me. After starting work in NJ I just did not have time to be in NY during the day or any normal time of evening for a haircut so I looked to my gym because it was so convenient. Initially I booked the haircut thinking I would just get a blowout because "what if it's horrible!" .... BUT Antonia, who I saw, was fantastic I felt immediately comfortable and resolved to do the trim. I'm a believer - I will happily go to Antonia for my trims and blowouts

too.

This gym is a God-sent specifically Antonia... Thank you for making me a believer ;) **NJ – Berkeley Heights**

Rhonda S.
Laurel, MD

5 stars
1/18/2012

I love this place. In my opinion it's one of the best gyms in the area. It is clean, has just about every piece of equipment you can think of, challenging classes,, great instructors and the facilities are just awesome!

Yes it is kind of pricey about $130 for a couple but I dont mind paying double for the quality. This place has a spa, hot tubs, cafe, eucalyptus steam room, basketball court, rock climbing wall, keys for the lockers, and an indoor and outdoor pool. The place is just massive similar to the size of a department store. It is 24 hours and the kids club has Mac computers, I mean come on it doesn't get any better. They also always have towels available to use, this is what I can honestly call a health club.

In addition there are metabolic classes that you can take for a fee but there are also running and walking clubs that you can get involved with and those are free.

Some may complain about the crowds during peak periods but the gym is so large it does not feel crowded once you get it. It can be hard to find a parking space up close, but it is the gym just walk. This gym is perfect for me and after coming here I will never go back to SportFit or anything else. **MD – Columbia**" – *Too see more quotes, look at the Scuttlebutt Folder*

[x] "So you look at this and you say to yourself this is a rational value proposition. But if you hit the rational and you don't hit the emotional, it's a missed opportunity for us. So how do we hit this emotional level with our consumer or member?

First of all we attack the sensory experience. If you attach to someone's sensory experience, not only do hit an emotive level with them, you're also going to hit a deeper level of connection with them that is long-term and long-lasting. So throughout the club we try to deliver a sensory experience, an experience that delivers at multiple levels.

First, sight. The facility needs to be clean, needs to be uncluttered, needs to feel open, airy, light to them. Needs to feel comfortable. So, the sightline that they get when they walk into the club, they need to feel that it is being tightly operated for them.

The smell, we introduced fresh air into the clubs so that its never a stale environment. **The air is always moving through the club. We introduced different smells in different places**. **In the locker rooms there is a eucalyptus smell, in the cafe there is a fresh fruit and vanilla smell, in the spas there is a candle smell**. So attaching an experience with smell in each one of those areas gives us an opportunity to, again, create an experience for them unlike anything that they have experienced elsewhere.

Feel, the temperature has to be right. If I'm taking my kids to the summing pool and their lips turn blue, that is not going to be a great experience for my kids and it sure as heck isn't going to be one for me. I think people have probably been there. In the spa the temperature has to be in little bit warmer than it is in the cafe or on the fitness floor. So making sure that temperature and feel is calibrated appropriately.

Taste, our cafe menu, as I mentioned before, needs to be tasteful. It needs to be nutritious. People have to understand that it is good for them, but it also has to taste good. And then sound.

Within each area of the club we make sure that the sounds, the music in particular, is being delivered at decible levels and according to genres that fit the mood that we are trying to create in each one of those areas. So, critically important because our senses are linked to memory and tap immediately into emotion, which gives us an opportunity to hit people at a completely different level." – Mike Gerend, COO, Avondale Partners 2008 Consumer Conference

[xi] "**Michelle C.**
Ann Arbor, MI

1/28/2012
This is the Ritz Carlton of gyms in Southeast Michigan.

Locker room: It's very well-kept, clean, and very spacious. There are several "privacy" stalls for you to change. There are about 10 private showers as well as a steam room.

Gym: There is a very large cardio area. I have never counted how many treadmills and eliptials there are, but I imagine it's there are at least 50 of each. There are no "30-minute rules" that many other gyms have. You can run or walk on your treadmill for as long as you'd like. There is a large free weights area, which can be a little intimidating at times due to the number of jersey-shore looking guys. There are plenty of mats, medicine balls, space for you to do whatever you need to do for an optimal workout.

Classes: I have been to many spinning classes here. The bikes were upgraded in 2010 and are wonderful. The classes are challenging- some instructors are better than others, but overall, I very much enjoy their spinning classes. Although I have never attended, the Saturday morning hip hop class is always full before it even begins. If you're into it, I suggest you get there a little earlier.

Pool: There is a lap pool as well as a warmer and shallower pool for younger kids with 2 indoor water slides. There are also 2 outdoor pools with 2 additional water slides. There are 2 dry sauna rooms as well as 2 large hot tubs in the pool area. It's heavenly to relax here after a tough workout.

Once you get used to lifetime, all other gyms will look and feel like hourly motels.... **MI – Canton**

Melissa M.
Chicago, IL

4 stars

5/20/2010

I miss this place something fierce. Seriously, this gym would cost $500/month if it was in NYC, and I paid $40. Ugh. **The NY gym scene is BLEAK. I just love Lifetime Fitness. I never thought I would like a shopping mall-sized gym but alas, I was wrong**. Plus my sister and I had an awesome trainer who is no longer there... but all of the trainers that worked there were really cool. The classes are amazing and all of the machines are new. The place is crazy clean. They have WATERSLIDES. Waterslides, people! And the cafe makes bomb protein shakes. It was really hard for me to cancel my membership here. OK I need to just get over it. But if you live in the Chicagoland area and you don't belong to Lifetime, you're a nutter. **IL – Warrenville**

Crystine W.
New York, NY

2/18/2011

Whereas many people look for excuses to not go to the gym, I make extra efforts to completely clear out my schedule to spend a day at Life Time Fitness.

They are hands-down the most sophisticated (and clean) gym I have ever been to offering **a HUGE selection of gym equipment & cardio machines, whirlpools, sauna, steam room, fitness classes, yoga, Pilates (even with the Reformer), an indoor racquetball court & even a rock-climbing wall!** You will never have to fight for a cardio machine, they're that plentiful. It's an extremely large venue sitting on top of a steep hill, but despite its size, I always find my ohm here.

Their locker rooms & showers are top-notch. They supply an endless amount of towels along with beauty products (lotion, shampoo, conditioner, razors, shaving cream, hairspray, makeup remover etc) and they're insanely clean! I feel like a showgirl getting ready for a performance when I'm pampering in front of their Hollywood-esque mirrors.

Not only are their facilities immaculate, but so is their customer service! The staff here really go the extra mile to make your gym experience personable & they try to address you (and remember you) by your first name. I haven't been to their cafe before, but there are always amazing smells emanating from it so I don't doubt for a second that their food is good.

Yes, along with all this luxury, a price does come with it. It's about $100/month for a single, but extremely worth it. **Unfortunately, I live too far away to sign up as a member so I pay for day passes ($25) and go whenever I can make a day trip over instead**. **NJ – Florham Park**" – *Too see more quotes, look at Scuttlebutt Folder*

[xii] "In addition to this, I want to talk about a new initiative that's not up here on the screen, but it's incredibly important to us going forward, and I like to call it club-within-a-club. So let's say you're a member coming into the club and you say, Mike, I'm really interested in cycling. Okay?

So, to create a paradigm that everybody understands, think about a tennis club today. What do tennis clubs have that almost no other interest club, if you want to call tennis and cycling an interest club, what do tennis clubs have today? **They have pros, they have courts, they have tournaments, they have social activities, they have leagues, they have lessons -- got a lot of stuff going on, right?**

And when people are done playing in these leagues or participating in a lesson or in a pickup game, what do they typically do? They go have coffee together, they go get something to eat together. They usually hang together, don't they? So, I talked about the emotional connection that we have in attaching to someone's sensory experience and I talked about an initiative strategically around building communities. Well, think about this and think about how Life Time can uniquely deliver this.

What if I told you that I was interested in cycling, or how about a better one, triathlon, and I came to Life Time Fitness. Life Time Fitness is uniquely qualified to deliver connectivity similar to what you would find in tennis, if you think about it. Indoor triathlon series; outdoor triathlon series; experts inside that help you train in running, swimming, and biking; heartrate training in order to build your base or endurance; T.E.A.M. weight loss to help you lose weight to be able to get into an endurance race.

Every day there's opportunities within our clubs to have a fun run, to go for a masters swim class, to enter into the spinning studio and check-in for a cycling class. Can any other business that you can think of deliver with those kinds of facilities, that kind of expertise, those type of events, to create a connection unique relative to anything else that is out there?

So when you look at these interest groups that we have formed. And we have now started to sign each one of our perspective members up for cycling, swimming, running, nutrition, weight loss, racquetball, squash, climbing -- I can go on up to about 35 of those.

So while soliciting our members, in this is in test today, which member interest groups are they interested in? Which club-within-a-club would they like to be signed up for? **So that they can get notices about fun events that are happening, leagues, tournaments, races, social opportunities, information and education that we provide from Life Time Fitness or we connection in through our interactive group.** So a powerful opportunity to create custom programs according to the expressed interest of individuals when they join the club.

So, great opportunity when you look at the business proposition earlier. Rational, great value proposition, rational platform that delivers great value. If you take the sensory experience and the power of connectivity through club-within-a-club and this referral system across products, and you start to attach yourself to members individually on a custom basis like no one else can." – Mike Gerend, COO, Avondale Partners 2008 Consumer Conference

[xiii] "Lila R.
New York, NY

4 stars
12/31/2012

It is expensive and is not perfect. But, after belonging to quite a few gyms in the NJ area, I can say this is, by far, the best. The facility is super clean, they make your post workout shower easy by providing all of your toiletries and towels, the on premisies cafe is good (not great, but solid) and **they are constantly having fitness events, camps and challenges to help you keep things interesting**. The facility offers rock climbing, racketball, full size basketball courts.

The facility has a pool offering table service from the cafe. I do not have children so the pool gets to be a little challenging during the summer months. It is filled with screaming children. **For those with kids, the facility also offers camps and host birthday parties on site**.

The only things I do not like is that **some of the trainers are rude and rush you off the equipment if they want to use it with a client**. Also, the gym ropes off certain equipment during the day for sole use by members who are signed up for team fitness. It's always the most popular equipment and is kind of annoying. **NJ – Florham Park**" – *Too see more quotes, look at Scuttlebutt Folder*

[xiv] "When we look at each market, obviously, the clubs are sized and priced to the marketplace that we're going to. Obviously, the bulk of the markets we're going to are much more affluent, heavily populated areas. Land prices are significantly higher and construction costs are higher, cost of operation, payroll, you must pay higher. As a result of that, we are, number one, forced to have a higher price point, so we have to use more of our Diamond and Onyx pricing. Number two, in the positioning way that **we want to position our clubs is to be the top-shelf facilities**. And as a result of that, we are priced higher. So it's -- but if we go to a market like Des Moines, Iowa, obviously, we're not going to have a Diamond pricing because it's just not necessary, both for the cost of land, cost of operation and the competitive price point. **We're still going to be a top-shelf, but in order to be a top-shelf, we can do it at the Platinum pricing**. So the strategy is always the same: to be the best provider of all the programs and services we offer. For that, we -- just Mike explained a little earlier, we will spend the necessary dollars to deliver the best product. And then we accordingly price to get the right margin for our business model." – Bahram Akradi, CEO, 2013 Q2 Earnings Transcript

[xv] "Why is that important today? Our members tend to be, according to our business planning process and what we know about them, **they are white-collar, they are families, they've got higher household incomes. They are not money pinchers, they are time pinchers.** They need to have the convenience in one facility under one roof of all the activities to live a healthy way of life underneath one roof. So it is critical that we provide the convenience and value underneath one roof to offer a value of uncompromising quality to meet the health and fitness needs of the entire family." – Mike Gerend, COO, Avondale Partners 2008 Consumer Conference

[xvi] "I belong to both a YMCA and and to a Fitcorp gym. The Y is near my home and I mostly go there for swimming or during holidays. The gym (no pool) is in the building where I work - used mostly on lunch hours.

The biggest difference I see between the YMCA's that I've been to and the gyms is in the locker rooms. They gyms are much fancier with additional amenities. The YMCA is pretty basic - gang shower, basic locker room, few accesories. Works for me but if you want "fancy", the Y ain't the place.

//

I have liked all the Y's I've gone too. I'm OK with Spartan locker rooms, whatever. And I have seen fabulous staff, as a general rule, at them because oftentimes they are in it for the community service (it is a christian based organization - not community service as in judge enforced!) much more so than the park district places (which have cheapest help possible) and then the commercial (which have rotating staff oftentimes)." – To see more quotes, read the YMCA\Scuttlebutt folder

[xvii] "When you break down where we go, the competition typically would be something like a YMCA or a Jewish Community Center or a Park and Rec Board or something like that. And we do extremely well against those. **They typically tend to be managed in a very utilitarian way**.

Our price points are generally very close to them. Our product offering, the breadth of service, the quality, et cetera, is significantly better. And we tend to do very, very well in those areas." – Mike Robinson, CFO, Oppenheimer 2011 Consumer Conference

[xviii] **“A rip-off? The Braundera YMCA is $60 for one person, and there aren't nearly the same amenities.** $70 for one person *[for Life Time Fitness]* is just about right, IMHO. If you don't use it, I guess you could see it as a rip-off, but by your own actions, not theirs!

If you're going for cheap but good, I hear Anytime Fitness is great.

We decided to go with Lifetime because it is very family-oriented. With all the classes included, plus childcare for 2 hours a day, the kick-a*s swimming pools, spa, cafe, and free towels...well, it was hard to beat. And frankly, Spectrum was pissing me off with their "sales" technique. Ugh.

Anyway, for a family of 4, it's $149 a month. Considering that babysitting would cost me $10 an hour at home, it's really a deal for me!

///

Lifetime is more expensive, but it is much nicer than any other place. The conditions inside the facility are absolutely immaculate. I know that you don't necessarily need all that stuff to work out, but for some people it creates an environment that makes them want to keep going. I am fine going anywhere, but my wife is a little different. She has a real hard time getting motivated and doesn't like going. Since we moved a little further west of town and don't go to lifetime any more, she has really struggled with going. **She always said Lifetime felt like a Country Club and even though she was working out, it almost felt like she was working out on a vacation**. Everyone has their own thing though and I understand why people wouldn't want to pay the money.

///
Briana M.
Columbus, OH

4 stars
8/12/2012

The only issue I have is the parking. I get plenty of exercise just in the walk to the fitness area. But I suppose that's a good thing, right? **lol I used to go to the Y which was $48 a month with tax. However- all their exercise classes were extra. Lifetime charges me $66 per month but I am on a month to month contract which is nice. And their classes are free**. You don't have to sign up, just show up. I have yet to take one, but I like that this is open to me. I also got 2 personal training sessions for free which were awesome. I loved my PT Aman. Wish I could afford him on a regular basis. He got me to do way more than I

thought I could. What I also love is there are NO CHILDREN on the fitness area. There are plenty of machines, they keep the gym very nice. There are two indoor pools- one is a lap pool the other is a rec pool. They also have a spa which you get a reduced price facial and massage for your first time. They have an agreement with Gahanna Parks and Rec that you can use that pool for free during the summer. I love Gahanna's public pool. I was shocked at how nice it was. There are two enormous pools plus there are designated lap lanes which is great because I go to work out- not just to play. It is a bit pricey but not that much more and you get what you pay for. **OH – Columbus**

///
Linda P.
Kingman, AZ

4 stars
9/4/2010

I've been a member of LTF for 3 months and absolutely love it. I just moved to Northville and was looking for a place to take exercise classes. **I was thinking about the Northville Rec Center because they have unlimited classes for $50/month (but have maybe 2-3 classes a day to choose from). However, when I went to LTF for a tour, I realized I could get access to unlimited classes (~10+/day) and an entire 24 hr facility for only $55 a month.** I also received many personal training sessions which were very very helpful. Jeff is an enthusiastic, honest, motivational, and dedicated trainer. Thank you man! **MI – Novi**

///
Rena I.
Long Island City, NY

5 stars
9/26/2011

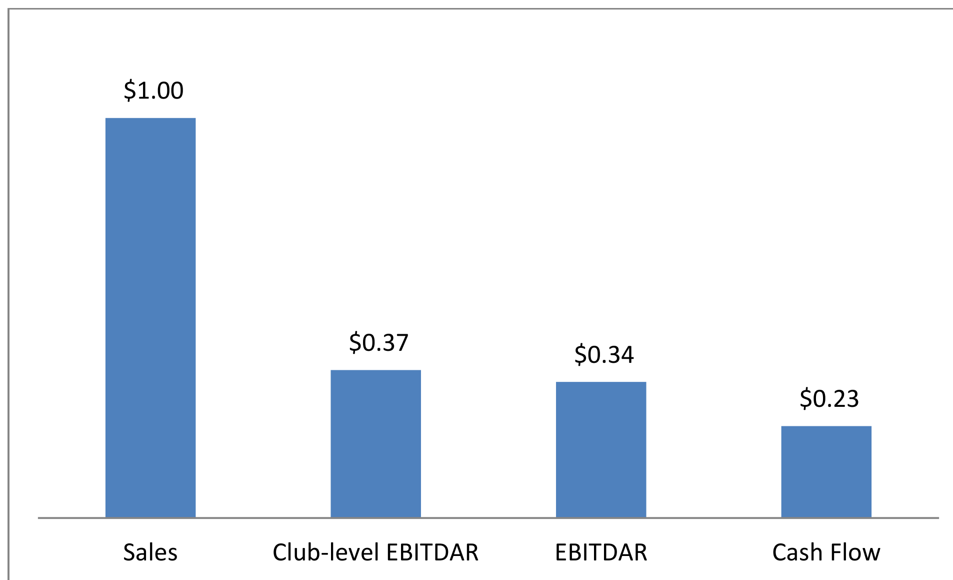
I cannot believe this place could be rated any less. It is a gem! It is nothing short of beautiful for a gym in New York. Absolutely beautiful all the way, and the yoga classes are top notch. **Indoor pool, outdoor pool with water slide, excellent activities, and the kids classes are cheaper than the Y**!!!! If I could give this place 10 stars I would, **it is a lifesaver for people with children. I drive from Astoria just to work out here, and it is well worth the trip.** :)))) . - **NY – Syosset**" – To see more quotes, read the YMCA\Scuttlebutt folder

[xix] "Let me tackle those things a couple ways. From a club cost center model, if you look at a mature center that last year delivered about 37% average EBITDA margin, or before corporate overheads allocated out to somewhere around 45% EBITDA margins. **If you look at $1 of revenue and $0.55 of costs there, I'll bet**

$0.55 of costs, a little over half of that is labor costs. That's by far the largest single expense in our business. We've worked very hard over the last several years, and it has been inherent in this business model from early on, that as much of that cost structure is variable as we possibly can -- the member adviser, the sales, the personal training, a big part of the spa, certainly your group fitness instructors and people in the member activities area and the like. They really are a variable cost structure. So -- and then, certainly the management team has a significant piece of their pay really as variable pay. So a pretty good chunk of that -- of that labor is variable." – Michael Robinson, CFO, 2008 Q3 Earnings Transcript

Quality

Each Club Is a Durable Cash Machine



Each dollar of sales turns into 34 cents EBITDAR and 23 cents cash flow

- Economics of each center is good
    - Low asset turnover
        - This is because of industry quality
            - Require a lot of upfront investment
            - $40-50 million to build a club in New Jersey or Long Island
                - $30 million in Cleveland, Ohio
            - A club's volume depends on its size
                - LTM's clubs
                    - 114,000 square-foot clubs
                    - 10,000 memberships
                    - Average 1.9 members per membership
                        - 19,000 members
                        - 6 square feet per person
                - CLUB's fitness-only clubs
                    - 20,000 square feet
                    - 3,000 members
                        - 6.67 square feet per person
            - So, a company can improve turn over only by improving revenue per membership

        - LTM's club sales/Average Gross NTA is about 0.55 from 2003 to 2012
            - Min: 0.50
            - Max: 0.62
            - Median: 0.55
            - Mean: 0.56
            - STDEV: 0.05
            - CV: 10% (very stable)
        - LTM's club sales/Average Gross Capitalized NTA is about 0.49 from 2003 to 2012
            - Min: 0.43
            - Max: 0.55
            - Median: 0.49
            - Mean: 0.49
            - STDEV: 0.06
            - CV: 11% (very stable)
        - CLUB's sales/Average Gross NTA is about 0.93 from 2004 to 2012
            - Min: 0.76
            - Max: 1.13
            - Median: 0.93
            - Mean: 0.94
            - STDEV: 0.16
            - CV: 17% (stable)
        - CLUB's sales/Average Gross Capitalized NTA is about 0.39 from 2004 to 2012
            - Min: 0.31
            - Max: 0.44
            - Median: 0.39
            - Mean: 0.38
            - STDEV: 0.06
            - CV: 15% (stable)
    - LTM's club margin is high
        - Club-level EBITDA/Sales is about 37% since 1999
            - Min: 34%
            - Max: 42%

                - Median 37%
                - Mean: 37%
                - STDEV: 2%
                - CV: 0.07 (very stable)
                - Mature club EBITDA/sales is even higher
            - Club EBITDA/Sales is about 30% since 1999
                - Min: 23%
                - Max: 34%
                - Median 30%
                - Mean: 30%
                - STDEV: 3%
                - CV: 0.09 (very stable)
            - Club EBITDAR/Sales is about 34% since 1999
                - Min: 23%
                - Max: 37%
                - Median 34%
                - Mean: 33%
                - STDEV: 4%
                - CV: 0.11 (very stable)
            - Bally Total Fitness's EBITDAR/Sales is much lower
                - Only 27% in its best year in 2006
                    - Before going bankrupt
        - LTM's high margin is due to LTM's quality
            - LTM differentiate from low-end clubs
                - Able to charge 2-3 times higher
            - Each club has a local moat in its target market
                - A local area can support only one big club
            - The target market in a local area is stable
            - So, LTM is able to fill its clubs
                - Mature club runs at 90% capacity pre-crisis
                    - Because of the crisis
                        - Run at 80-85% capacity[i]
        - Each club has an adequate ROIC
            - Club-level EBITDA/Average Gross NTA is about 20% from 2003 to 2012
                - Min: 17%

        - Max: 26%
        - Median 20%
        - Mean: 21%
        - STDEV: 3%
        - CV: 0.16 (stable)
    - Club-level EBITDAR/Average Capitalized Gross NTA is about 20% from 2003 to 2012
        - Min: 17%
        - Max: 24%
        - Median 20%
        - Mean: 20%
        - STDEV: 3%
        - CV: 0.16 (stable)
    - Before crisis, the number is about 23%
        - Mature club's number is even better
    - That's consistent with LTM's model
        - 15% NOPAT/Average investment[ii]
        - 20% IRR on a levered basis[iii]
        - Over 25% cash on cash return[iv]
        - Examples[v]
            - Cleveland, Ohio
                - Opened in 2010
                - Cost $30 million
                - $60 a month for an individual membership
                - On track to reach 10,000 memberships
                - => $13-$14 million revenue
                    - 40% EBITDAR margin
                    - $5.2 million to $6.4 million EBITDA
                    - $4.7 million to $5.9 million pre-tax owner earnings
                        - 15.7% to 19.7% pre-tax ROIC
            - Syosset, NY
                - Opened in 2011
                - Cost $50 million
                - $120 a month for an individual membership
                - Tracking to deliver $22 - $25 million revenue

                - 45% EBITDAR margin
                - Using 40% EBITDAR margin
                    - $8.8 million to $10 million EBITDA
                    - $8.3 million to $9.5 million pre-tax owner earnings
                        - 16.6% to 19% pre-tax ROIC
- Each club deliver stable and attractive cash flow
    - Ramp schedule[vi] [vii] [viii]
        - 30-35% capacity through presale activities
            - Cash flow positive in the first 3-6 months
        - 60% capacity at the end of the first year
            - 20% EBITDAR margin
        - 90% at the end of 3 years
        - 37%-40% EBITDAR margin for mature clubs
    - Store sales are stable
        - The business is about filling the club
            - Attrition is about 33-34% in normal time[ix] [x]
                - 1/3 of attrition is due to moving out
                    - Get other people moving in
                - 1/3 of attrition is non-utilizing members
                    - Cyclical members
                - 1/6 of attrition is due to financial reason
                    - They'll come back when they have money
                - 1/6 of attrition is due to 25 other reasons
            - Because of the crisis
                - Non-utilizing members cancel faster
                    - Cancel after 30 or 60 days instead of 6 or 9 months of non-utilizing
                    - But people who are utilizing clubs stay[xi]
                        - They skip travelling
                - Money
                    - Attrition due to money increased to 35-40% of attrition[xii]
                    - Replace by getting people who skip travelling and pay for the membership[xiii]
                - So, attrition increased

            - 42.3% in 2008
            - 36-38% right now
        - During crisis, mature store sales declined only 7.5%
            - Capacity utilization declined from
                - 90% to
                - 80-85%
        - Unit EBITDAR margin declined to low 30%
- In normal time, sales can grow 3%
    - LTM don't sell long-term contract
    - So they can always adjust price monthly
        - LTM prices to maximize revenue[xiv]
            - Normally target 90% capacity
            - When increase price
                - New customers pay more than cancelled customers[xv]
                - => improve average price
            - When a club is overcrowded, they increase price on every memberships[xvi]
    - Attrition is stable
    - Capacity utilization is stable
    - Membership fees can increase 1-3% a year
        - In-center revenue can increase faster
            - Average 9.4% increase in the last 10 years
    - So, sales can grow at least as fast as inflation rate

- Maintenance CapEx is low
    - Average $3.5-$4 a square foot[xvii]
        - A big retrofit every 5 years[xviii]
            - Replace cardiovascular equipment
            - Do a lot of surface work
    - About 4% of sales
        - 10-11% of EBITDAR
- LTM's clubs are more durable than restaurants, grocery stores, etc.
    - LTM had to close only two clubs

        - LTM's 27,000 square foot center in Brooklyn Park, Minnesota
            - Opened in 1992
            - Lease expired in 2006
            - Closed because LTM have 5 other locations in the vicinity
        - LTM's 85,630 square foot center in St. Paul, Minnesota
            - Opened in 1997
            - Lease expired in 2010
            - LTM closed the center
                - Transferred its membership to LTM's surrounding locations
                - LTM has 22 centers in Minnesota
                    - With various size when they did experiment in early years
- Whole Foods
    - Since 2008, closed or relocated 35 stores
        - 276 stores at the beginning of 2008
        - 335 stores at the end of 2012
    - => close or relocate over 10% of store during the last 10 years
- Wal-Mart
    - In the last 5 years
        - Supercenters
            - Started with 163 centers
            - Closed 14 centers
            - Ended with 286 centers
        - Discount stores
            - Started with 3,595 stores
            - Closed 21 stores
            - Ended with 4,005 stores
- Darden Restaurants
    - In the last 5 years
        - Red Lobster
            - Started with 680 restaurants
            - Closed 9 restaurants

            - Ended with 705 centers
            - => less than 1% of total
        - Longhorn Steakhouse
            - Started with 305 restaurants
            - Closed 12 restaurants
            - Ended with 430 centers
- Starbucks
    - In the last 5 years, number of US-operated stores
        - Started with 6,793 stores
        - Closed 943 stores
        - Ended with 7857 stores
        - => closed about 13%
- McDonald's
    - In the last 5 years, number of system-wide stores
        - Started with 31,377 stores
        - Closed 2,341 stores
        - Ended with 34,480 stores
        - => closed about 7%
- LTM's lower rate of closure means
    - LTM's clubs are more durable
        - LTM has a sustainable local moat
        - Restaurants may lose favor
        - Grocery stores face more competition
    - LTM owns most clubs
        - Don't have problems with negotiating lease
        - Barrier to exit is higher than companies that lease their locations
    - Successful rate of opening a new club is higher

- We can think of LTM as a hedge fund
    - They have a formula for 15% after-tax ROIC
        - 20% IRR on a levered basis
    - Management fee is stated as G&A
        - 2012 Gross PPE is $2,452 million
        - 2012 G&A is $56 million
            - 2.3% management fee
        - => create a lot of value for investors

[i] "Our economic model continues to be very, very strong. If you look at a typical center of ours, it takes about three years to hit maturity. **And the first year we would like to presell a center to about 30%, 35% of its capacity. By the end of the first year we like to be at about 60% of its capacity. And it should grow linearly from there to at least around 90% of capacity at the end of the third year. If you took a snapshot today at what the recession impact has had on that, that mature center is really ranging now between 80% and 85% of capacity**. So we have lost a little bit there, and that's really a focus of ours to be able to regroup, slow that attrition rate down to be able to grow that membership base in those mature centers. **A typical center of ours will have somewhere around 8,000 to 9,000 memberships in it. One of these large centers will typically produce just under 40% EBITDAR margins**. So very, very strong financials, very, very strong cash flow generation from this business." – Michael Robinson, CFO, Telsey Advisory 2010 Consumer Conference

[ii] "MIKE ROBINSON: Sure, sure, Sharon. If you look at it, we target at an individual club level. **When we look at each project of that, we target a 15% return on invested capital. And that target -- the formula for that is quite simple. It's NOPAT -- net operating profit after tax, divided by the average investment that's going into that center**.

Historically, if you look up through 2008, our mature centers in aggregate, we're delivering 15%. As we dipped, as we went through the recession we saw that dip is now down into the low teens, really driven by the fact that that attrition rate was up higher. **We lost net membership at those centers, and so we saw some dip in that. But it's still in the double digits.**" – Michael Robinson, CFO, William Blair 2011 Growth Stock Conference

[iii] "Our business model, when we go through the modeling, **we look for midteens type of ROIC. We also look at internal rate of return on a leverage basis and look for 20% plus that. We look for cash-on-cash returns again on an ownership scenario of as you get out into the mature years of 25% or more as we build these business models.**" – Michael Robinson, CFO, Oppenheimer 2012 Consumer Conference

[iv] "One thing I want to expand on is we have been pushing the Company in the past several years very hard on **trying to have a 15%, 14%, 13% ROIC**, which is a really high hurdle considering the marginal cost of capital today. If you take a look at a -- **let's take a $45 million investment, and you took 50% of that into mortgage at a 5%, which is easily doable right now -- and I mean easily doable to do a 50% mortgage on a $45 million at a 5% or better rate. You take that, you take a 20-year mortgage or 15-year mortgage and you put that aside. You take the $500,000 of annual CapEx out. Very, very**

comfortably we can hit in the high 20%s, 27%, 28%, 30% cash on cash return on those models at the club maturity which just takes two or three years, four years.

And that only equates to roughly maybe about a 9%, 10% ROIC. So there is lots of room in our model to be able to generate great cash flow with just a modest level of mortgage put on the real asset." – Bahram Akradi, CEO, William Blair 2013 Growth Stock Conference

[v] "Yes, and it's a great point and something that strategically, we really are driving for and I want to use an example of a couple of clubs that have actually been opened a couple of years that we really get a sense of and to ground everybody on that. Between two and three years ago, we opened a club in Cleveland, Ohio, a suburb of Beachwood, Ohio; and we also opened Syosset, New York.

The Cleveland club, we invested about $30 million in; the Syosset club, we invested, at the end of the day, probably in the neighborhood of $50 million. There happened to be a land lease there, but if you kind of -- if you looked at that on a capitalized land lease basis, **that was probably about a $50 million investment**. That Cleveland club, the Beachwood, Ohio club, our price points in that were in the **$60 a month individual price point**. Came out of the gates very strong. Membership levels at that will probably drive around **10,000 memberships and tracking well to that. That will be a club that delivers $13 million, $14 million, $15 million worth of revenue for us at about a 40% unit EBITDA margin**. So very good, very strong economics for us.
Syosset, we priced our individual monthly membership price point is $120. That's what it started out; it's actually grown a little bit since then. So double the individual price point. **That club is tracking to deliver revenues of between $22 million and $25 million. So probably 75% more than that Beachwood, Ohio club and tracking to deliver if you adjust for the land lease cost, et cetera, about a 45% unit EBITDA margin. So again, very, very, very powerful unit economics on that business.**" – Michael Robinson, CFO, Piper Jaffray 2013 Consumer Conference

[vi] "The economic model for Life Time all starts with the membership and the membership brand. It typically takes us about three years for a club to reach maturity. **We like to have that club open its doors through presale activities at about 30% to 35% of our target membership, and that grows to 60% or so by the end of the first year and over 90% of our target membership by the end of three years.**

We're cash flow positive in the first three to six months of a center's operations. Below the second half of this chart you see what typically we have been averaging for our large format and our current model centers. **A typical center of ours at maturity on a fully loaded basis averages over 37% EBITDA margin**." – Michael Robinson, CFO, Piper Jaffray 2011 Consumer Conference

[vii] "The second thing to consider is that, as you look at these centers, a typical center of ours, **we like to open at about 30%, 35% of our targeted capacity**. **It takes generally two or three months to break even on an EBITDA contribution perspective in these centers after it's opened. By the end of the first year, it's typically delivering of 20%, 20% plus EBITDA margins** and it's generally breakeven on a bottom line, on a net income basis. But you have to layer those effects in also, as you're looking at how you accelerate the growth on this." – Michael Robinson, CFO, Piper Jaffray 2013 Consumer Conference

[viii] "Our model is a very attractive economic model. We [goal] and want to see our businesses at a 15% return on invested capital at maturity or after its third year of operation. **A typical center of ours on a unit level or on a fully absorbed level, excuse me, will deliver EBITDAR margins near 40%. Some of the newer models that we've been seeing with some higher investments in New Jersey, etc., our expectation is actually higher than that because we're delivering a higher dues price point.**" – Michael Robinson, CFO, Oppenheimer 2010 Conference

[ix] "I think one thing to keep in mind on our attrition, and year-in, year-out before the recession, **our attrition rate ran in the mid-30%s, about 35% or so. And a third of that attrition came from people moving out of the area. And when somebody moves out of the area, somebody new moves in and generally has exactly the same demographic profile as what we're looking for as a great potential member for us. So we're really not losing much in that**.

Another third of our membership base leaves either because they weren't utilizing the club -- they had joined, but hadn't been in in six months or nine months -- or they are a cyclical member for us. In other words, they join in the fall and leave in the spring, or they join for the summer pool season, and that makeup is a significant piece of our overall attrition rate.

And then the other third, about half of that was price, and then the other half of that was 25 different reasons, none of which really added up to anything in any significance.

So for us, this mid-30% attrition rate works very, very well in our business model. And the churn that would happen from that, and the ability to bring the new blood in that tends to spend more money in the center and things like that, worked very, very well.

What happened in late 2008 and 2009, when the recession hit, **we really got this bubble of people that weren't utilizing the club, that moved through and made a decision that was typically a six- to a nine-month decision of whether -- I'm not using it. I've got my credit card statement. Yes, I should go. I'm going to go next month, or it's not that big a deal. And so they just kept hanging on and hanging on. Well, when the recession hit, those people made that decision in 30 or 60 days rather than six months or nine months**. So, that moved through the system.
We changed our own philosophy much more at that time. We really didn't play defense up through that. And now we do, and there's a lot more focus on connectivity and getting people involved, because if they are involved, they are much, much less likely to attrit.

And we think that even in a headwind situation -- because unemployment is still high -- the ability to take that attrition rate down into the -- close to the mid- -- well, 36% now, is a good indicator of the fact that many, many of the programs that we are working on and that we've been -- and initiatives that we've been doing are really working, and we're back down to what I would call a normalized level for us." – Michael Robinson, CFO, Barclays Capital 2011 Retail & Restaurants Conference

[x] "As we have said clearly over and over, **one-third of our membership approximately that drops out because of location moving**; **they're changing, they're moving, they're from one place to another, that population naturally is being replaced by somebody of generally equal demographic, psychographic moving back in, so we get a large number of those people coming in**. The second portion and the third portion of our attrition, when you add those two to the first one, **85% of our total attrition is either because they moved, which is not a problem because somebody is replacing them; two, they have stopped using the club long enough that they think they shouldn't be paying their due, so they come back, and that's a large portion of what we have been reselling**. A large number of the people we sign-up each year have been before members of last time again. As long as their experience with Life Time was great when they dropped out, because they felt like they're not using the club anymore, when they want to use the club again they come back to us, and that's the experience we have and what we see. I don't see them as a concern.

The next group is the people who drop out, love the club, they think everything is that they wish they could afford it, but they've lost their job and now they're reaching to the last end of their savings or whatever, and so when they have money again they comeback. So if we were not signing up, a large portion of the people who drop out again and again and again I would be concerned, but we have no concern of other attrition rates. In the mid-30s, when I wrote the business plan for this company in 1988, I expected about a 36% attrition rate on a mature club year after year after year, and with that number clubs that they are 15 years old, they're still performing beautifully, and so there is no concern. Do I like a 40 plus percent attrition? No we don't, because we have to comprise on the enrollment and some other gymnastics to replace that membership, but it's not such a large attrition rate that we couldn't sustain our business; we just don't like it." – Bahram Akradi 2009 Q4 Earnings Transcript

[xi] "I can tell you we know this, we've told – since we went public and in the IPO period I have told people **I've been doing this business for 25 plus years and during the recessionary time people are insensitive about spending their $50, $60, $70, $80 a month as long as they're utilizing the club**.

They can skip one travel for $800 three days and then pay for their membership dues for the entire year and have all that entertainment available to them and pastime. So the key is not make it difficult for them to get in on the initiation fee and we were kind of tough on not lowering those during the first couple of months of the year and now that we have been able to get past those two quarters that we had commitments in advance on TV campaigns et cetera, we are in a great position for remainder of the year to pivot as necessary on the marketing, types of marketing and adjustments of the enrollment fees to get the membership counts we want to get in the door and then with the improved programs that I'm working on right now with connectivity, we feel very comfortable we can keep the members and therefore solid in terms of confidence about delivering what we have promised you guys with our plan for the year." – Bahram Akradi, CEO, 2008 Q1 Earnings Transcript

[xii] "I think that if you go back to pre-recession time we had about 28-29% of our total attrition was due to non-utilization and only 16 - 17% of our attrition was due to money. **Today, more than a third of our attrition probably 35 to 40% of our attrition right now is due to financial**. And some clubs and this doesn't breakdown exactly. But, some months in certain clubs you may see 50 - 60% of the attrition they write down money, as the reason they are dropping out.

So it's completely has shifted to money being a number one reason why we have had our increase in attrition and it's the largest portion of our attrition today. And that's why we're focusing on increasing the value proposition

every which way we can. So the customer feels like they just can't let go of this because there is too much value. And that's what we have to continue to work on and of course little things come back, all of that will help us tremendously to have a strong come back. So that's just the value proposition is going to be stronger and stronger all the time." – Bahram Akradi, CEO, 2009 Q1 Earnings Transcript

[xiii] "The marketing program we are going to continue what we have been doing in the second quarter. As I have mentioned before it is a natural leverage you use with your enrollment fee and your direct marketing. We can turn up the heat, making the traffic, generate more membership sales. **During times like this you are going to see as Mike mentioned as well a little more people concerned about the dollars and dropping out and you get more people coming in because we provide a fantastic, healthy way of life, family entertainment for very little money. They could cut out one trip, one vacation for the family and save $1,500 or $2,000 for 3-4 days and use that money for the entire year and show up in our pool decks in our facilities and different types of programs every day**.

We see a significant amount of people coming in and offsetting those people who drop out for other financial reasons that force them to go out. We feel very comfortable we can continue to deliver the membership growth that we have mapped out utilizing the new connectivity programs and new value adds as well as the old traditional levers which is initiation fee and direct marketing." – Bahram Akradi 2008 Q2 Earnings Call Transcript

[xiv] "It really is more -- our pricing is based on the demand for each club. So as we look at our facilities, some locations, we can see that they are just basically being overran with customers. **We went into beach with Ohio last year way too conservatively. We priced it initially at $49 per month. And we had more memberships than we really should have gotten coming in. So early in the quarter last year, we changed the price to $59 a month. Looking in the rearview mirror, maybe we could have gone to $69 a month. So that allows us the opportunity, as an example, in that particular club to move the rack rates to a platinum membership $69 or $79, and gradually bring the existing members up to that**. So I do not want to give you a answer about all of our clubs in the system, a generic answer, because I don't allow our team members to think about our company as a blanket. We think of every asset individually. We evaluate that asset. We decide what -- overall, I don't see anywhere in the country where we need to take the price down. And I see opportunities probably in a handful of clubs throughout the year, that we would transition them from one price membership to another one." – Bahram Akradi, CEO, 2010 Q4 Earnings Transcript

[xv] "I think that we have the opportunity. We still have that same group. I don't believe that most of that group reached to their rack rate. **We gave them a bump, but we didn't give them a bump all the way to the rack rate or the rate that the new members are joining. So as those types of members drop out and we gain new members at the full rack rate, we see that the average dues of the member we sign up is more than the average dues of the members we lose. So we will see average dues improvement just due to the churn, that's one thing. The second thing is we, at the right opportunity, we will not do a price increase for a member, for any member, for more than once a year. It doesn't matter how low their rate is. So if we've given them a $2 price increase, we won't raise it again for at least 12 months for that for them. We don't have any legal obligation not being able to do this. It's just the company's moral policy that we won't do that from a customer service point of view**. But we have opportunities. So in a long shot, my vision is every member in every club will pay the same rate, monthly rate, and we won't have special prices on the dues for anyone. So as time goes on, we have the ability to improve dues without necessarily raising the rack rate on a national basis." – Bahram Akradi, CEO, 2011 Q1 Earnings Transcript

[xvi] "UNIDENTIFIED PARTICIPANT: When you say force people out, is there anything more other than just raising price and assuming you're going to get some level of attrition by raising price or are you actually telling John Jones, you can't be a member any more?

BAHRAM AKRADI: No you're correct with your assessment on that deal**. What we have done is we have clubs where their memberships were in excess of 12,000 memberships. It's just uncomfortable.** So what we've done in those clubs, we go in and we bump the prices even on existing members, not only we've been selling for several months at much higher dues, **we raised the prices on existing members. And if we don't take it from $59 to $79 but we step them up gradually to and when 12,000 memberships get a letter saying, hey your dues is going to go up from $59 to $65 for this year, you get a increased reaction to the people who have mostly is the people who haven't been using the club. They say yes I haven't used this for six months. It prompts them to react. So you see a slight bump in your attrition.** It's not a significant number, but you always see it standard. It's not a function of this year because we're in a macroeconomic and it wasn't that way two years ago. It's the same thing all the time.

So that allows us to get the membership count of that particular club down a little bit. **And then the members we're signing up and replacing of those**

members are coming in at a $79 price point. So our dues are in these clubs are all growing. I mean if we're all focused on revenue, dues revenue which is our most powerful revenue that we bring in the club, the trend line in almost most of our clubs are on the way up." – Bank of America Securities 2008 Consumer Conference

[xvii] "Paul, your second question really relates to the ongoing maintenance CapEx and how we look at that. Obviously, it is absolutely critical that we keep these clubs looking like new. **And we have built into our models and have spent over the past several years and continue to spend in a range of $3.5 to $4 a square foot for that maintenance CapEx, and that continues to be a number that we feel can deliver the quality and the look and the feel that we want to see for our business**. As you mentioned, the club in Chicago that you're seeing, we go through a normal routine of reviewing these clubs and their needs and want them looking fresh all the time. And the benefits of it, obviously, you see in customer satisfaction, and retention of our membership base, and it works." – Michael Robinson, CFO, 2012 Q1 Earnings Transcript

[xviii] "MIKE ROBINSON: The question is, how has the maintenance CapEx held up over time as you look at these centers that are eight, nine, 10 or more years old? And the answer is, it's held up quite well. We have clubs, big clubs -- **our first large club that we ever built was in Eagan, Minnesota, in 1994. So that club is now in its 16th year of operation. And I would hope, if you went into that club today, you would look at it and say, this looks and feels like new, which is exactly what we want and we expect of our general managers when we do that**.

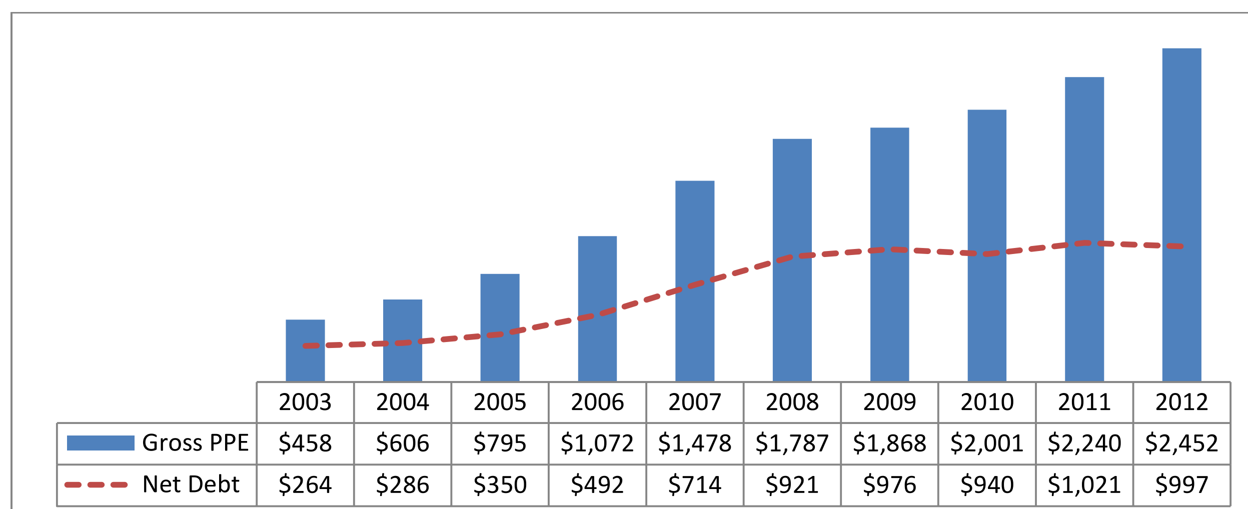
We typically spend about $3.50 a square foot a year. That has remained relatively constant over the last several years, but it goes in five-years cycles, four- or five- or six-year cycles, depending on utilization. **So a typical center we might spend $0.50, $0.75, $1 a square foot in years one, two, three, four or years six, seven, eight, nine and then come on year five or so and do a fairly major retrofit. And that retrofit will replace cardiovascular equipment and it will do a lot of surface work. So we are replacing and upgrading surfaces so, again, these clubs look and feel like new.**

In addition to that, and I know many of you have heard me talk about this, **we spend 2% to 3% of revenue on repairs and maintenance**. It goes right in the P&L, and still hit those units and those all-in EBITDA margins that we were talking about earlier. And that's high. That's higher than most health clubs that I'm aware of. And the reason for that is, we're doing a lot of replacement and proactive work replacing high-wear carpets, replacing the belts and treadmills,

whatever it is, on an annual or an 18-month basis. We are just taking that straight to the P&L. Again, I can't tell you how critical it is that these clubs look and feel like new. And they do. That's our goal and that's what we hold our general management accountable for. And that's a key differentiator for us as we look into the future." – Oppenheimer 2010 Conference

Capital Allocation

Cash Flow, Debt, and Equity Are All Used to Finance New Club Openings



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross PPE	$458	$606	$795	$1,072	$1,478	$1,787	$1,868	$2,001	$2,240	$2,452
Net Debt	$264	$286	$350	$492	$714	$921	$976	$940	$1,021	$997

Gross PPE more than quintupled since 2003

- Investors should expect 2.2% share dilution because of share-based compensation
    - Used to pay options[i]
        - But used restricted shares since 2006
    - Each year, they grant restricted stocks based on EPS
        - Vested 25% in each of the following 4 years
    - Every 3 years, they grant special long-term incentive awards
        - Based on cumulative EPS and ROIC
            - Over the next 3 years
    - So, share dilution is lumpy
    - Average is about 2.2%
        - From 2006 to 2012
            - 36,817 thousand shares in 2006
            - 5,080 thousand shares issued
            - => # of share compounded by 2.18%
        - From 2001 to 2012
            - 26,608 thousand shares in 2001
            - 8,690 thousand shares issued
            - => # of share compounded by 2.6%
- Share dilution is not good

        - But the management deserve the compensation
        - Equity value per share compounded by about 15% since 2002
            - EBITDA
                - 2002: $56 million
                - 2012: $323 million
                - => 19.1% annual growth
            - EBITDAR
                - 2002: $61 million
                - 2012: $362 million
                - => 19.5% annual growth
            - Net debt
                - 2002: $222 million
                - 2012: $688 million
                - => 12% annual growth
            - Rent expense
                - 2002: $5 million
                - 2012: $39 million
                - => 23% annual growth
            - Net Debt with capitalized lease
                - 2002: $255 million
                - 2012: $995 million
                - => 14.6% annual growth
            - Net debt grew slower than EBITDA
            - Net Debt with capitalized lease grew slower than EBITDAR
            - => Equity value grew faster than EBITDAR
                - 19.5%
            - Total shares were
                - 2002: 28,161 thousand
                - 2012: 43,149 thousand
                - => 4.36% annual share dilution
                - => Equity value per share compounded by about 15%
- Priority is always to open new clubs
    - Focus on opening big clubs in the suburbs[ii]
        - Land is available
        - 150,000 population within a 5-mile radius
            - 12 minute drive

        - Test against
            - Natural trade areas
            - Trade boundaries
                - Do they trade over freeway?
                - Do they trade across river?
        - Look for median household income: $70-$75k
        - Look for average household size of 2.5 or more
            - => large family population
        - Look for psychographics & buying behaviors to have very high correlation with LTM's successful clubs
            - Families spending outside of their home on physical & recreational things
                - Soccer moms
                - Kids in Cul de sacs, etc.
    - Focus on getting 13-15% ROIC[iii]
        - Or 20% IRR on a levered basis
        - Geocode members from existing clubs
        - Model how many memberships they'll get from a new clubs
        - Price it
            - Appropriate for the positioning
            - Get the target return
    - Mature clubs through 2008 delivered over 15% ROIC[iv]
        - In the low teen because of the recession
    - The success rate is perfect
        - LTM had to close only two clubs
            - LTM's 27,000 square foot center in Brooklyn Park, Minnesota
                - Opened in 1992
                - Lease expired in 2006
                - Closed because LTM have 5 other locations in the vicinity
            - LTM's 85,630 square foot center in St. Paul, Minnesota
                - Opened in 1997
                - Lease expired in 2010
                - LTM closed the center
                    - Transferred its membership to LTM's surrounding locations

                - LTM has 22 centers in Minnesota
                    - With various size when they did experiment in early years
- LTM prefer owning the clubs
    - 107 clubs
    - Lease 30 clubs
    - Long-term ground lease 9 clubs
    - Own 67 sites
    - The member of a joint-venture that own 1 site
    - No mortgage financing on 55 centers
        - Market value is well over $1.5 billion[v]
    - LTM compare cap rate with other options to consider owning or leasing
        - Cost of ownership is lower[vi]
        - Owning the clubs give a better control of occupancy cost
            - Lower occupancy cost give them a competitive advantage
            - More accurately, lower leverage result in lower risk
                - Owning clubs have lower asset turnover
                - But higher margin
                    - Provide a cushion against bad times
- Fund by debt & equity
    - LTM had 2 stock offerings
        - 2004:
            - IPO
            - Issued 4,775 thousand shares
            - At $18.5 a share
            - $80 million proceeds
        - 2007:
            - raised money to reduce debt
            - Issued 1,675 thousand shares
            - At $55.4 a share
            - $92.5 million proceeds
            - LTM issued new shares at all time high
            - The share offerings wasn't prompted by a debt issue
            - LTM issued shares to afford its growth
                - Opened 8 clubs in 2007
                    - $416 million CapEx
                - Opened 10 clubs in 2008

            - $$463 million CapEx
        - We don't know if they would grow so aggressive if they couldn't issue new share at such a high price
  - Debt include
    - $447 million revolving credit
      - LIBOR + 1.25% to 2.25%
      - Expire in June 2018
    - $96 million mortgage loan
      - 6.03%
      - Expire in Feb 2017
    - $72 million mortgage loan
      - 4.45%
      - Expire in 2023
    - $69 million mortgage loan
      - 5.75%
      - Expire in 2016
    - $50 million mortgage loan
      - 4.48%
      - Expires in 2026
    - LTM should take advantage of the low interest rate environment
      - Use long-term debt
- We don't know how much debt they would have if the crisis didn't hit
  - Debt/EBITDA increased steadily from 2004 to 2008
    - 2004: 2.16
    - 2005: 2.25
    - 2006: 2.58
    - 2007: 2.85
    - 2008: 3.19
  - Debt-with-lease/EBITDAR also increased
    - 2004: 2.77
    - 2005: 2.70
    - 2006: 3.04
    - 2007: 3.31
    - 2008: 3.72
  - But reduced from 2001
  - So, Debt/EBITDA goes up and down with the economy
    - In good times, LTM build new clubs

        - Increase debt
      - In bad times, LTM slow down its growth
        - Reduce debt
- LTM seems to focus on Net Debt/Total Capital[vii]
  - Since IPO, Debt-with-lease/Gross PPE was lower than 0.52
  - 0.5 Net Debt/Total Capital can be safe
    - Minimum turnover was 0.43
    - Minimum EBITDAR margin was 23%
      - In 1999
      - That's about the level after the first year of opening
      - Since 2001, minimum EBITDAR margin was 33%
    - EBITDAR/Gross NTA would be at least 10%
    - In that case, Net Debt/EBITDAR is **5**
      - Able to survive if they use long-term debt
    - Based on minimum 14% EBITDAR/Gross NTA
      - Net Debt/EBITDAR is **3.57**
    - In normal time
      - Turnover is 0.49
      - Mature club can have 40% EBITDAR margin
      - => 20% EBIDTAR/Gross NTA
      - => Net Debt/EBIDTAR is **2.5**
    - It's reasonable to expect Net Debt/EBIDTAR to fluctuate between 2.5 and 4
  - Can create a lot of value by using an adequate level of debt
    - A mature club can return 15% after-tax ROIC
    - Even at 10% ROIC
      - 0.5 Net Debt/Total Capital at 8%
        - 5.2% after tax
        - => 14.8% return for shareholders
- LTM would be careful with club openings
  - The number of clubs opening each year is not high
  - The most clubs they opened during a year was in 2008
    - 10 clubs
  - That's because it's expensive to build a club
  - So, each project would get a lot of attention from the management
- They'll continue opening new clubs for many years

    - => We can expect capital allocation to be consistent with what they did in the past
    - LTM has financial strength to finance future growth
        - 2012 CFFO is $256 million
        - 2012 EBITDA is $323 million
        - Will have $1,250 to $1,300 million sales in 2013
            - $363 million EBITDA
            - $287 million CFFO
        - Maintenance CapEx for existing clubs is about $50 million
        - => $237 million FCF
        - They can finance new club with 50% debt
            - => Potential $474 million for growth
                - Each club costs $30-$50 million
                    - Depending on locations
                - => Can open 9 to 16 clubs
                - LTM plans to open 6 clubs in 2014
                    - More in 2015
        - LTM can also add some more debt
            - Current Debt-with-lease/Gross PPE is 0.44
- LTM is losing money in other business
    - Education
        - Online content
            - Lifetimefitness.com
            - Experiencelife.com
            - Revolutionaryact.com
            - myLT.com
            - myhealthcheckonline.com
            - lifetimeendurance.com
        - Include
            - Articles
            - Videos
            - Blogs
            - E-newsletters
            - Social media offerings
            - Experience Life
                - An award-wining magazine
                - Distribute to more than 650,000 members

            - Circulation of over 700,000 copies
                - Available to general consumer audience by subscription
    - Athletic events
        - Athletic events for members and non-members
            - Inside and outside LTM's centers
        - Focus on endurance activities
            - Running
            - Cycling
            - Triathlon
        - In 2012
            - 100 events
            - 90,000 participants
        - Lost $2.5 million EBITDA in 2012[viii]
            - Improve connection to memberships who are interested in running, cycling, triathlon, etc.
            - Synergistic
                - Sell to existing members
                - Sell club memberships to event participants
            - Expect to make money from these events
                - Some events make 25-30% EBITDA margin[ix]
    - Invest MyHealthCheck
        - Lost $3.5 million EBITDA in 2011
        - Lost $1 million EBITDA in 2012
        - This is a good business
            - Allow companies to cost differentiate their healthcare programs[x]
                - Score employee's health status
                - Employees with good scores will have lower premium with their employers
            - Companies are loyal customers[xi]
    - These business helps build LTM's brand[xii]
        - The event business created over 26 million impressions
        - The health business can be potential feeder systems for the clubs
        - Operation is synergistic with the club business
            - Share online infrastructure

[i] "In fiscal 2006, based on a review and analysis provided by Pearl Meyer & Partners, the committee began to make a shift in the equity instruments to be issued under the 2004 Plan. Based on the review and analysis conducted by Pearl Meyer & Partners, **our compensation committee feels that restricted stock is preferred over stock options as it has higher retention value, has immediate value to the recipient upon grant and is less dilutive to shareholders. Moreover, our compensation committee determined that the granting of restricted stock which featured both time-based and performance-based vesting to our executives would create both retention and shareholder alignment while creating a true "at risk" portion of the award**. The committee feels that performance-based vesting provisions are best linked to challenging, but achievable, short-term actual financial performance measures.

In general, we grant awards that as of the grant date are proportional to the executive's total potential cash compensation for the current fiscal year, which the compensation committee believes, based on the review and analysis provided by Pearl Meyer & Partners, is the best measure to use in order to remain competitive with the equity awards being granted to executives of the companies identified as part of the peer groups identified in the "Overview" section. The proportion of equity to total cash compensation to be granted as well as the actual number of shares awarded to each executive officer is determined and approved by the compensation committee after considering the expected expense to our company in addition to the factors outlined under "Compensation Determination Process." The compensation committee annually reviews the long-term incentive program and information relevant to approving annual awards for executive officers." – 2006 Proxy

[ii] "The addressable market for us, let me start by talking a little bit about what the demographic and the psychographic of a successful center of ours is. We typically look for **densities of 150,000 people or more in a five mile radius**. We test that against **12 minute drive times**, **we test that against the natural trade areas and the trade boundaries whether they be do people trade over freeways, do they trade across rivers or whateve**r. We want that same more or intensity within that. We look for a median household income generally in the **$70,000, $75,000** range in the Midwest, and we adjust that accordingly depending on the demographic of the cities around that. **We look for an average household size of 2.5 or more indicating that there's a large family population within those areas. And we look for the psychographics or the buying behaviors to have a very very high correlation with our successful clubs. That correlation generally has to do with those families, those individuals spending money outside of their home on physical or**

recreational things -- soccer moms, kids in cul de sacs, and those types of people. If we can find those, that's what gives us a high degree of confidence that any sight we select would be successful for us." – Michael Robinson, Telsey Advisory Group 2010 Consumer Conference

[iii] "We look at a variety of factors -- demographics, psychographics, competition, geographical, or mental barriers. It is very, very intense.

We study the 100-plus clubs we have; geocode the members that come for each individual clubs. **So we have data for every single club, what percent of our members come from inside of the 12-minute drive time, between 12 and 20, and outside of 20. And we model that particular location to the top three or four facilities that are most likely like that facility, from all those aspects.**

Then we model that. **We model how many memberships we are going to get from each of those rings.**

Then we basically price it where we feel like the pricing is appropriate for either positioning or what we need to get, to get the investment work. If the investment works, passes those three measures, then we will take it through.

One thing I want to expand on is we have been pushing the Company in the past several years very hard on trying to have a **15%, 14%, 13% ROIC**, which is a really high hurdle considering the marginal cost of capital today. If you take a look at a -- **let's take a $45 million investment, and you took 50% of that into mortgage at a 5%, which is easily doable right now -- and I mean easily doable to do a 50% mortgage on a $45 million at a 5% or better rate. You take that, you take a 20-year mortgage or 15-year mortgage and you put that aside. You take the $500,000 of annual CapEx out. Very, very comfortably we can hit in the high 20%s, 27%, 28%, 30% cash on cash return on those models at the club maturity which just takes two or three years, four years**.

And that only equates to roughly maybe about a 9%, 10% ROIC. So there is lots of room in our model to be able to generate great cash flow with just a modest level of mortgage put on the real asset." – Bahram Akradi, CEO, William Blair 2013 Growth Stock Conference

[iv] "If you look at it, we target at an individual club level. When we look at each project of that, **we target a 15% return on invested capital**. And that target --

the formula for that is quite simple. It's NOPAT -- net operating profit after tax, divided by the average investment that's going into that center.

Historically, if you look up through 2008, our mature centers in aggregate, we're delivering 15%. As we dipped, as we went through the recession we saw that dip is now down into the low teens, really driven by the fact that that attrition rate was up higher. We lost net membership at those centers, and so we saw some dip in that. But it's still in the double digits." – Michael Robinson, CFO, William Blair 2011 Growth Stock Conference

[v] "And I'd like to close the gap on something that -- Mike talks about approximately by the time we finished Colorado Springs and Summerlin, Nevada, **we'll have 51 open facilities with no mortgage against. And as while Mike puts in the conservative book value of $1 billion in that, those 51 facilities under no circumstances could be purchased for land and built in nowhere near $1.5 billion or more in today's market**. So the real value, real estate value of those assets, the real estate value is significantly higher." – Bahram Akradi, CEO, 2011 Q1 Earnings Transcript

[vi] "MIKE ROBINSON: The question is, why do we choose to buy our land for the most part versus operating leases?

There are several aspects to it. First and foremost, when we look at these, **we are making decisions that are in general and expect to run these clubs long-term. So we are not making investments for five and 10 years**. We are making investments in areas where we see substantial growth in that for time periods much longer than that.

From a pure economic perspective, over the last 10 years or so, **the all-in cost of capital of ownership has been significantly less than the cost of leasing**. When you look at the ability to obtain mortgages and to control the occupancy costs long-term, it's been the best economic decision -- best economic decision for us.

One of our key competitive advantages from a cost perspective is our occupancy costs are significantly lower than others in the fitness industry because of that ownership, because of that ownership profile. Those are the big drivers.

That isn't to say that we must and need to own. When we make our location decisions -- and I'll argue that the site selection process is one of if not the most important processes that we as an executive management team do -- that demographic and that psychographic is so important to the success of our

business, that that's what drives the sites themselves is making sure that we have the right demographics, the right psychographic.

If we can't find land or we can't find a land to be able to build outself on, on that, that shouldn't and doesn't stop us. We will look for conversion ability. Maybe we'll buy a different type of building and convert it into a Life Time Fitness, or we'll look for leasing opportunities, and we do that.

It's -- but we are still relatively early -- we are early in our growth prospects in that sense. And so generally we will be driven more toward buying and building today than driving the conversion process. But we have a number of centers. Rockville, Maryland, is a leased facility, and we converted a federal office building into a beautiful 75,000 square foot Life Time Fitness in a tremendous area and a tremendous demographic. So we will do all, and the intention in the future is to look at and do all of those things." – Oppenheimer 2012 Consumer Conference

[vii] "**Anthony Gikas** - Piper Jaffray

Thanks. Good morning, guys. Couple of questions. Could you just talk a little bit more about financing and where will financing come from looking forward? **It looks like equity, at this point, is going to be dilutive [*Quan: $33.5 at that point*], credit facilities are going to cover this for too long**. So may be just talk a little bit about that. You talked about nine of the 11 centers looking forward are going to be owned. Is there a little change of strategy there? And what would that look like going a little bit more forward? And do you have visibility of financing for calendar '09? And then I have a follow up.

Bahram Akradi

Sure. Tony, this is Bahram. We feel extremely confident with activities that Mike and his team have right now that we will obtain necessary financing to maintain our growth. There are, as he mentioned, huge number of assets with no mortgage against them. **I want to kind of refer the fact that back in the 2000 time period, with only about $20 million of EBITDA, we were able to get financing in excess of hundred and some million dollars for a bunch of facilities in a very tough financing environment**.

We have so much assets available for financing. The question is not, whether or not we get financing? **The question is, do we get it at the ratios that we want to get in terms of debt to the cost of construction and the building et cetera? So, we'll be able to continue to expand the same way we have expanded in the past**. And that is truly not a concern. But there are many, many different initiatives that we are working on and I don't think we have the time to go through each and everyone with you at this point." – 2007 Q4 Earnings transcript

[viii] "**Brent R. Rystrom** - Feltl and Company, Inc., Research Division

The one final twist that I would ask then, you didn't mention events. EBITDA -- I think you've said EBITDA breakeven on the events business in 2013. Can you refresh us where that was in '12?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

About $2.5 million negative, not counting Commitment Day. So -- and then we expect that by 2014 -- so 2013 will still have some impact from Commitment Day, albeit not near what we took charge in 2012. But in 2014, we expect that to be EBITDA neutral or better, as well as all the other events. **We've been buying some events, consolidating, rebranding to create solid brands like Life Time Tri, Swedish E [ph], Leadman Tri, Torchlight, et cetera**. And then, we're working through those -- each of those brands to make sure they become what we expect them to become. **These events substantially improve our connection to our memberships who are interested in running, in cycling, in triathlons, et cetera. So they have tremendous impact from media impressions, which we'll really never include in the numbers**. So as a whole strategy, they're an absolute winner. Now what we want to get to is to have this company athletic event business to be a solid for-profit entity of its own. **And we feel like we will absolutely accomplish that, making $2 million, $3 million, $4 million hopefully in profit in 2000 -- now that's just a guess and that's a hope, but in 2014 and then build on top of that every year going forward.**" – 2012 Q4 Earnings Transcript

[ix] "**Scott Hamann** - KeyBanc Capital Markets Inc.

Okay, and then just a follow-up on some of the newer investments that you're making at some of these ancillary businesses. Can you kind of help frame up what the profitability profile looks like, the return profile, kind of what types of numbers you're looking for, stuff around like the Cooper initiatives and those programs?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

We always look at a 15% ROIC for our big-box facilities at the maturity level. So the way we look at investment is similar. We want to be able to get to a nice double-digit ROIC at the maturity of an investment. With that, I'm going to turn it over to Mike. Mike?

Michael Robinson - Chief Financial Officer and Executive Vice President

Sure. Let me try to take you through a couple of these businesses. **You've heard us talk about the Events business, and a good Events business runs at 25% to 30% EBITDA margin**. So that's really where we're trying to drive this

business, and we have events that run at those levels. And so, as you start to think about that business and that business model, these should be solid EBITDA performance drivers, and they should be return-enhancing vehicles for us because generally, they come at a relatively low investment. **If you look at our investment in our Training and Certification businesses, we now have our yoga teacher training. We've got aerobics instruction and certification, and we just opened, in the second quarter, a personal training certification. Again, we're utilizing our own centers for the most part, for the delivery of this. So the investment side of this is quite low, and the overall profitability of these, clearly in our mind, is going to be above the profitability -- we're driving it to be above the profitability of our in-center businesses**. So I think that should give you a good example of where we are. We're young in the certification businesses. We've got some investment there, but we are off to a really good start on that. We now have critical mass, and I think you'll start to see that growth showing through in the third quarter on Events. Keep in mind, the Events business is very seasonal, and a significant piece of that is in the summer months. And so you've been seeing investment in that come through for the first 6 months, and our expectation is that you'll start to see some of the revenue that derives from that infrastructure investment coming through in the third quarter.

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President
And then to add to Mike's comments just for clarity, a lot of these businesses, like the yoga teacher training, the practical personal training school, et cetera, they are all at the infancy stages in our company. We're working hard to leverage and connect the dots across the board. **We are at the stage where we're investing more money in the infrastructure at this point than early on. But as Mike mentioned, 2 or 3 years from now, we look at having great margin opportunities from these, as well as the ROIC improvement on our overall business**" – 2012 Q2 Earnings Transcript

[x] "My Health Check is our wellness company. It's a unique delivery of a results-based wellness program that enables the corporation to adjust their healthcare program to cost-differentiate between the customers who are fit, healthy, and those who are not, based on all the legalities of this system. As you guys know or should know, **in 2008 there was a legislation where corporations can distribute healthcare cost with as much as 20% between different employees based on their health. And that number grows to 30% in 2014 for large companies**. It's a substantial difference for the companies.

We are able to -- the program we have built completely -- to walk up to a company, enable the company to author a health plan that they can push personal responsibility about their healthcare cost and enable employees to actually get healthier. This is not health club membership. We are not walking into a place and selling them corporate membership sales. But this

company has the potential to grow several hundred percent a year." – Bahram Akradi, CEO, William Blair 2011 Growth Stock Conference

[xi] "Paul Swinand - Morningstar Inc., Research Division

I'm just trying to think longer-term about the myHealthCheck business and just to be clear how it works. Those members, they would actually be members and could use the club, too, or only use it in a capacity of the company-sponsored myHealthCheck?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

Latter. They actually are not counted in the membership counts we are offering you right now. So I want to make sure there's no confusion. **They are -- they have access to myLT and everything we offer online, they actually have access to our telephonic health advisors. They have many benefits, but they do not have access to our facilities other than coming in for testing or something like that or some particular events sponsored, as you mentioned, by their employer**. However, in a lot of ways, as we look at growth of myHealthCheck, it creates an opportunity for upgrading those people to access memberships.

Paul Swinand - Morningstar Inc., Research Division

So then there wouldn't be any kind of capacity constraint because you could schedule them during the day or off-peak hours. Again, if you're thinking out of a long-term model, could you think of each club having 20% or some number ancillary on myHealthCheck members or...

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

Yes, let's go through that. It has nothing to do with that. **There is no capacity restraint on the club use or on our ability to deliver myHealthCheck screening**. That's business we can go to the employers, corporate office and execute. We have numerous mobile units that they can drive right in front of their parking lot and do it, and they can come to our facilities to get the testing, but that testing does not constitute a club use broader than that screening. So therefore, there is absolutely no restraint on anything.

Paul Swinand - Morningstar Inc., Research Division

Okay, got it, got it. And then, obviously, there's some data. Is it hard for the customer to switch once they sign up? Or is it like could another company say, "hey, we do the testing cheaper" and take over the next year?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President

This program is not a program that a company would switch around. If it was just the testing alone, that would be a commodity people can do biometric screening. Ours is a proprietary system with a health score that will tie into their incentives that they would put around their premiums as we do for Life Time employees ourselves. And once the company goes ahead and sets that up, it's very, very unlikely -- it's possible, but unlikely to try to switch because it will be very, very complicated. So I see it, while you may sign a 2-year or 3-year agreement with a company, it would be a much longer term than that, unless you fail them in your execution, which hasn't been our style in failing anybody." – 2012 Q2 Earnings Transcript

[xii] "**Michael Lasser** - UBS Investment Bank, Research Division

One strategic initiative has been extending the model out in a variety of ways whether to an events business by running triathlons and various events, myHealthCheck. So A, can you describe the strategic rationale behind that? And where are the most promising opportunities within that portfolio of businesses that you've been cultivating?

Michael R. Robinson - Chief Financial Officer and Executive Vice President

Okay, okay. 97% of our revenue comes from the clubs. 65% of it comes from dues. 1% comes -- still comes from enrollment fees and roughly 30%, 31% comes from in-center business like personal training and our spas and our cafés and kids activities. What Mike is talking about is about 3% of our revenue. And frankly, the fastest growing, but on a very low base is a group of activities outside the 4 walls. **And the strategy is, that we're building businesses outside the 4 walls that either grow our brand. They continue to differentiate us as a business and a business model from a club aspect, and they act as potential feeder systems into the subscription or dues revenue of our clubs**. So we have 3 businesses. We have an events business, we have a media business, and we have a health business. And I'll go through all 3 of those. **The events business, we run over 100 different races or race events across the United States, predominantly in markets that we have our own clubs in**. Those events can be anything from what we call a turkey trot, which is a 5k fun run the morning of Thanksgiving. 16,000 participants in Minneapolis on Thanksgiving morning to give you an example. We run triathlons in Minneapolis, Chicago, which we believe is one, if not the largest triathlon in the world. We run them in Dallas. We run them in South Beach. We run them in Austin, Texas. We have an iconic mountain bike race called the Leadville 100 mountain bike race. **The events business itself last year delivered over 26 million impressions from an advertising or a branding perspective**. So it's the single largest impression or brand-building activity we get. It also really helps to differentiate us.

I mean, we can utilize and advertise to our own membership base to help fill and drive registration revenue in these events. And in some cases, in sold-out events, we can allow some early lottery activity or something like that, that raise the chances of you getting into a race like the Leadville 100 race. So again, it fits this image of brand. It fits really the differentiation side of a business that these objectives and strategies go for. **That business overall loses money. But we think we've got races that deliver 20%, 25% EBITDA margin**. We're clearly focused to be able to move that business to profitability and hope to over the next couple of years. **We've got a media business, and that media business is a combination of selling advertising and sponsorships. We have a magazine that we publish 10x a year, then circulation is 600,000, 700,000 to our members and to others. We sell advertising that is consistent with our brand. So when you open that magazine, you're going to see advertising maybe for DASANI water or Toyota or somebody**. If you think about the demographic that it allows us to reach, it's a very good demographic that many, many advertisers and companies are really longing to reach. We're trying to drive that business. We also sell sponsorships to the events that we just talked about. Again, we're trying to do here is build awareness, build brand and take advantage of the power of the demographic we have to raise more revenues. We advertise tastefully within our clubs, et cetera. So it's really trying to drive a little bit more revenue out of the square footage there also. The third area we have is a health business, and that health businesses is predominantly our -- an access to corporations that are around Life Time Fitness and Life Time Fitness locations around the country. **We go and we work with corporations. They're a good feeder system for memberships within Life Time Fitness, and so we'll go work with a corporation to, in some cases, help lower health care costs by running what we call a myHealthCheck**, w**hich is really a testing service that works employee by employee and identifies high-risk areas, high health risk areas. We give the employees scores. The aggregation of those scores, the companies can use to determine overall health risk within a company and potentially to change the premiums that they charge to their own employees based on health and health risk**. The ability down to the individual level then is to isolate specific health risks and work with those employees either online or in our clubs and drive more and more memberships. So again, it's all linked. They're all, I would call, all of these businesses still immature in their evolution, but they all have a solid strategy behind them to ultimately support the clubs and the club businesses themselves.

Michael Lasser - UBS Investment Bank, Research Division

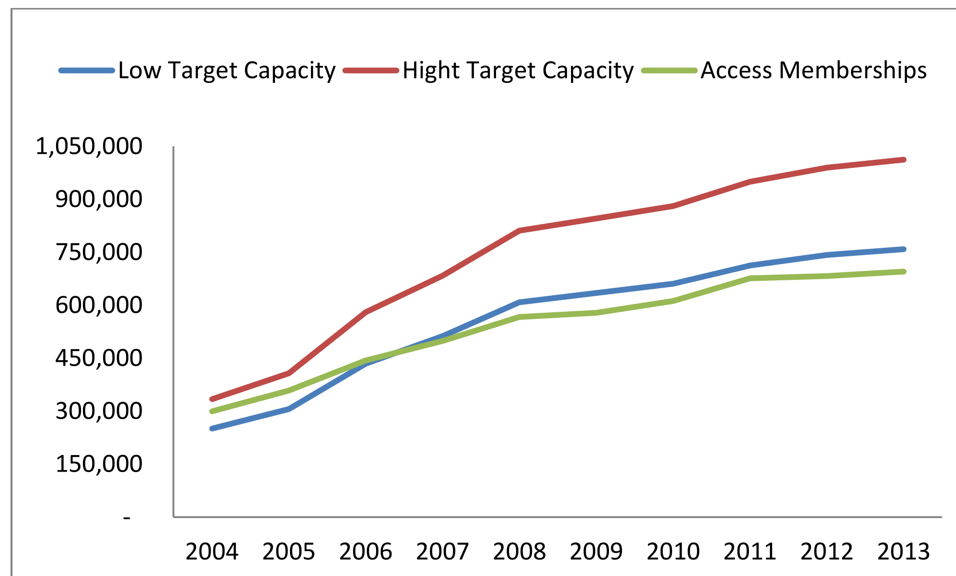
And do you see other businesses at the embryonic stage that will be deployed or is the portfolio right where it's at now?

Michael R. Robinson - Chief Financial Officer and Executive Vice President

I think you're always going to see other exploratory types of businesses. When this -- if you think about this business from an investment perspective, it's a subscription business. And again 65% of our dues comes from -- of the revenue comes from dues and that's subscription. So we're going to continue to look at other areas that we can enhance that subscription business. The non-access or Flex dues is an example of that. **We talked briefly about a weight loss product that we're looking at that could run very synergistically with memberships that we have within the club and potentially a membership that is outside of the club, but utilizes technology that we're building, infrastructure that we're building for a member to go online for weight loss and nutritional classes, nutritional tracking, personal training classes, other types of classes that makes sense and perhaps ultimately grows the dues or the revenue stream of the company.**" – UBS 2013 Consumer Conference

Value

Current Earnings Substantially Understates Life Time Fitness's Potential



Life Time Fitness is operating below capacity

- Normal EBITDAR is $447 million
    - 2013 revenue would be between $1,250 and $1,300 million
        - **$363** million EBITDA
            - **$401** million EBITDAR
        - **$287** million CFFO
    - LTM is operating at well below capacity
        - Before crisis, targeted capacity of a club is 750 to 1,000 memberships for every 10,000 square feet at a center
            - 10 to 13.33 square feet per membership
            - Current model clubs average 2.4 members per membership
        - Today
            - 14.5 square feet per membership
            - Current model clubs average 2.1 members per membership
            - Economic condition is not very good
    - LTM Can have **758,939 to 1,011,919** memberships
        - 10,119,196 center square footage
        - 750-1000 memberships for every 10,000 square feet

- If LTM can turn non-access memberships into access membership, they would have 801,851 memberships
    - 105,928 non-access memberships
    - Non-access memberships pay about $11 a month
        - Freeze rather than terminate access memberships
- **801,851** memberships is a conservative expectation
    - LTM opened two new clubs in 2013
    - As of the end of 2012
        - 22 mature center operated at 60.7% of targeted capacity
        - Total 1,527,198 square feet
- **900,000** memberships is a reasonable expectation
- **801,851** memberships result in **$447 million** EBITDAR
    - Each access memberships make $1,568 revenue a year
        - $1,257 million club revenue
    - Club-level EBITDAR margin is 40%
        - Is higher for mature clubs
    - Club-level EBITDAR would be
        - $1,257 * 0.4 = $503 million
    - G&A is $60 million
        - **$443 million EBITDAR**

- Normal pre-tax owner earnings is **$373 million**
    - Maintenance Cap-Ex is less than **$50** million
        - 2007: $25 million
        - 2008: $23.2 million
        - 2009: $30 million
        - 2010: $31 million
        - 2011: $61 million
            - Included
                - Remodels of acquired centers
                - Corporate capital expenditure
        - 2012: $60 million
            - Included corporate initiative
        - 2013: $85 - $100 million
            - 50% for maintenance CapEx
                - $50 million
            - 50% for
                - Remodel of acquired centers

            - Technology initiatives
            - Other revenue growth
        - Maintenance CapEx averages $3.5-$4 a square foot[i]
            - A big retrofit every 5 years[ii]
                - Replace cardiovascular equipment
                - Do a lot of surface work
        - Spend 2-3% of sales on repair & maintenance
            - Included in P&L
    - Investment in corporate initiatives is higher than normal in 2013
        - Corporate initiatives + Remodel of acquired centers = 50% of $85-$100 million = $42.5 million to $50 million
        - Spent a lot in technology[iii] [iv]
        - These spending tend to be lumpy
        - Example:
            - Wiley introduced Wiley InterScience in 2004
                - The predecessor of the Wiley Online Library
            - Wiley's spending in technology was
                - 2001: $29 million
                - 2002: $34 million
                - 2003: $63 million
                - 2004: $29 million
                - 2005: $27 million
                - 2006: $21 million
        - **$20 million** a year for corporate initiatives sounds normal
    - **$70 million** a year for maintenance CapEx and Corporate initiatives
    - => Pre-tax owner earnings is **$373 million**
- Peers is trading at
    - 9.32 EV/EBITDA
    - 11.16 EV/Pre-tax Owner Earnings
    - Peers include
        - CLUB
        - Weight Watchers
        - ClubCorp Holdings
        - Clublink
        - Accordia Golf
- LTM may be attractive to PE firm
    - Stable cash flow

- Strong balance sheet
  - Net Debt-with-lease/Gross PPE is 0.44
  - LTM owns 55 centers with no mortgage financing
    - Market value is well over $1.5 billion[v]
  - Market value of clubs is higher than cost on balance sheet[vi]
- PE firms can buy LTM
  - Lever up
  - Grow the business
- Some deals in the past
  - 24 Hour Fitness Worldwide
    - Acquired by Forstmann Little
    - $1.6 billion
    - 9 times EBITDA
  - Fitness First
    - Acquired by BC partners
    - $1.5 billion
    - 8.5 EBITDA
  - LA Fitness
    - Acquired by Mid Ocean Partners
    - $158 million
    - 6.9 EBITDA

- LTM deserves 12 times Pre-tax Owner Earnings
  - Each club deserves 10 times pre-tax owner earnings
    - 40% tax rate
    - => 6% earnings yield
    - 2-3% growth thanks to inflation
    - => 8-9% return
    - Cash flow is stable
    - Moat is durable
  - LTM has lower tax rate
    - High D&A
    - Income Taxes/EBITDA is about 22%
    - Income Taxes/(EBITDA – Interest Expense) is about 25%
  - LTM is growing
    - May have at least 12% growth in the next 10 years
  - Will get benefit of share repurchase
    - LTM is unlikely to be able to fully reinvest its cash flow

- At 12 times Pre-tax Owner Earnings, business value is $4,476 million
  - Total debt is $789 million
  - Capitalized lease is $309 million
  - Cash is $20 million
  - Debt-with-lease is $1,078 million
  - Equity value is $3,398 million
  - At $50 per share, EV is $3,210 million
    - 42,639,353 outstanding shares
    - 28% margin of safety

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[i] "Paul, your second question really relates to the ongoing maintenance CapEx and how we look at that. Obviously, it is absolutely critical that we keep these clubs looking like new. **And we have built into our models and have spent over the past several years and continue to spend in a range of $3.5 to $4 a square foot for that maintenance CapEx, and that continues to be a number that we feel can deliver the quality and the look and the feel that we want to see for our business**. As you mentioned, the club in Chicago that you're seeing, we go through a normal routine of reviewing these clubs and their needs and want them looking fresh all the time. And the benefits of it, obviously, you see in customer satisfaction, and retention of our membership base, and it works." – Michael Robinson, CFO, 2012 Q1 Earnings Transcript

[ii] "MIKE ROBINSON: The question is, how has the maintenance CapEx held up over time as you look at these centers that are eight, nine, 10 or more years old? And the answer is, it's held up quite well. We have clubs, big clubs -- **our first large club that we ever built was in Eagan, Minnesota, in 1994. So that club is now in its 16th year of operation. And I would hope, if you went into that club today, you would look at it and say, this looks and feels like new, which is exactly what we want and we expect of our general managers when we do that**.

We typically spend about $3.50 a square foot a year. That has remained relatively constant over the last several years, but it goes in five-years cycles, four- or five- or six-year cycles, depending on utilization. **So a typical center we might spend $0.50, $0.75, $1 a square foot in years one, two, three, four or years six, seven, eight, nine and then come on year five or so and do a fairly major retrofit. And that retrofit will replace cardiovascular equipment and it will do a lot of surface work. So we are replacing and upgrading surfaces so, again, these clubs look and feel like new.**

In addition to that, and I know many of you have heard me talk about this, **we spend 2% to 3% of revenue on repairs and maintenance**. It goes right in the P&L, and still hit those units and those all-in EBITDA margins that we were talking about earlier. And that's high. That's higher than most health clubs that I'm aware of. And the reason for that is, we're doing a lot of replacement and proactive work replacing high-wear carpets, replacing the belts and treadmills, whatever it is, on an annual or an 18-month basis. We are just taking that straight to the P&L. Again, I can't tell you how critical it is that these clubs look and feel like new. And they do. That's our goal and that's what we hold our general management accountable for. And that's a key differentiator for us as we look into the future." – Oppenheimer 2010 Conference

[iii] "No. We'll give you guys -- I mean what I want to kind of describe to all of you, my vision for the future is that the **3 categories that I have talked about are all not only synergetic to one another, but also significant in revenue, revenue growth, EBITDA, EBITDA growth, net income growth**. I mean those businesses are not meant to be kind of a little pet project. They're meant to actually change the profile of our company and **provide an opportunity for the company to grow beyond the proportional growth that would come with the bricks-and-mortar. So that, we have been investing significant amount of money over the last 3 years, in 4 years in all of them in staging, planning. This last year is significant with the technology. We're not done yet. We're still investing in those businesses. But I expect those businesses to be real. And I mean real businesses. I expect them to get to hundreds of million dollars each in revenue and more. They'll be substantially profitable**. And they're very, very synergetic, not only the way the customer views it, but also similar engines run many portions of those businesses as they run the portions of our healthy way of life destination, the club business. **So very synergistic from operational standpoint**. Furthermore, Life Time, in many ways, is the only company that could offer the products the way we offer them. So I think they are -- they're going to have a competitive advantage in the market. So furthermore, I know I have been throwing around this 14%, 15%, 13%, year-on-year growth. And we are, right now, as you can see, at half of that number. **And so, that number is just completely unacceptable to me and the rest of the management. We're comfortable that this is just a short-term lull that has happened between 2009, '10, '11, where we rent that down to 3 clubs a year to make sure we get all the things build to match our new strategy**. I really would have loved to have opened 5 clubs, and 3 of them in the first quarter -- the first half of the year in 2013. The disappointment for me really is the fact that we did not get the timing that we wanted on many of the projects. And it just has created such a lull on those. And the new businesses as well. Sometimes when you start something from the scratch, they take an extra year in the

incubation or an extra year in that super infancy stage to become relevant material of working the bugs out. But we are in a very, very good place with those businesses. I expect both segments, other than the club segments, to be substantially EBITDA positive in 2014. Albeit they're small businesses still, but they will have good margin of positive EBITDA, and then in the right track, we can make more improvement for 2015 with both of them." – Bahram Akradi, CEO, 2013 Q3 Earnings Transcript

[iv] "**Michael Lasser** - UBS Investment Bank, Research Division

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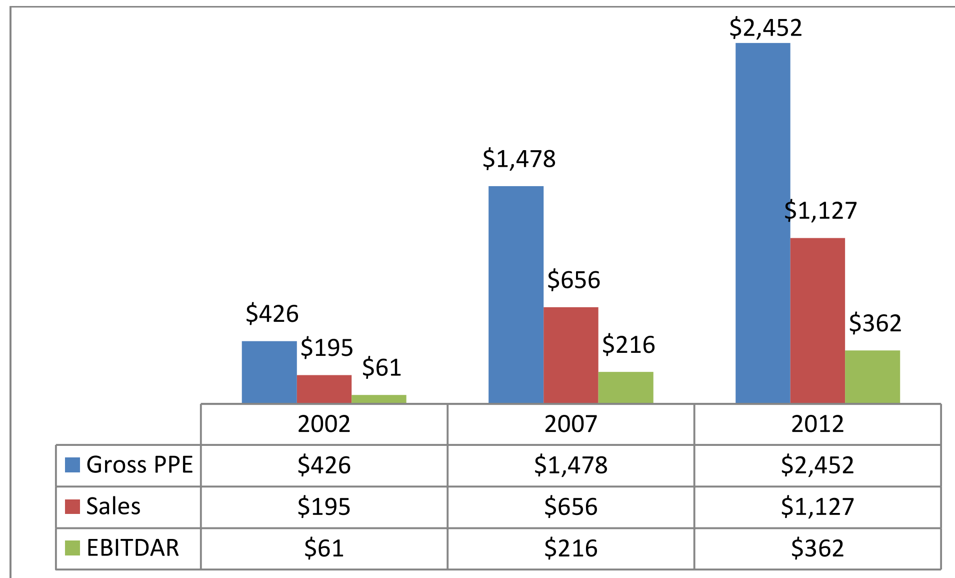
subscription business. And again 65% of our dues comes from -- of the revenue comes from dues and that's subscription. So we're going to continue to look at other areas that we can enhance that subscription business. The non-access or Flex dues is an example of that. **We talked briefly about a weight loss product that we're looking at that could run very synergistically with memberships that we have within the club and potentially a membership that is outside of the club, but utilizes technology that we're building, infrastructure that we're building for a member to go online for weight loss and nutritional classes, nutritional tracking, personal training classes, other types of classes that makes sense and perhaps ultimately grows the dues or the revenue stream of the company.**" – UBS 2013 Consumer Conference

[v] "And I'd like to close the gap on something that -- Mike talks about approximately by the time we finished Colorado Springs and Summerlin, Nevada, **we'll have 51 open facilities with no mortgage against. And as while Mike puts in the conservative book value of $1 billion in that, those 51 facilities under no circumstances could be purchased for land and built in nowhere near $1.5 billion or more in today's market**. So the real value, real estate value of those assets, the real estate value is significantly higher." – Bahram Akradi, CEO, 2011 Q1 Earnings Transcript

[vi] "I don't have a current market value for every one of the clubs. I can tell you that obviously as we have gone through **market appraisals on clubs, the clubs that we mortgaged late or in 2007, those appraisals came in on average 110-130% above our costs**. Other clubs, certainly the appraisals we are seeing come in above costs and in some cases significantly above costs. But again I don't have a specific market value." – Michael Robinson, CFO, 2008 Q2 Earnings Transcript

Growth

Life Time Fitness Can Have Double Digit Growth For Many Years



	2002	2007	2012
Gross PPE	$426	$1,478	$2,452
Sales	$195	$656	$1,127
EBITDAR	$61	$216	$362

Since 2002, Gross PPE, Sales, and EBITDAR grew 19% annually

- Opening new clubs is very repeatable
  - Focus on opening big clubs in the suburbs[i]
    - Land is available
    - 150,000 population within a 5-mile radius
      - 12 minute drive
    - Test against
      - Natural trade areas
      - Trade boundaries
        - Do they trade over freeway?
        - Do they trade across river?
    - Look for median household income: $70-$75k
    - Look for average household size of 2.5 or more
      - => large family population
    - Look for psychographics & buying behaviors to have very high correlation with LTM's successful clubs
      - Families spending outside of their home on physical & recreational things
        - Soccer moms
        - Kids in Cul de sacs, etc.

- Focus on getting 13-15% ROIC[ii]
  - Or 20% IRR on a levered basis
  - Geocode members from existing clubs
  - Model how many memberships they'll get from a new clubs
  - Price it
    - Appropriate for the positioning
    - Get the target return
- The success rate is perfect
  - Mature clubs through 2008 delivered over 15% ROIC[iii]
  - In the low teen because of the recession
  - LTM had to close only two clubs
    - LTM's 27,000 square foot center in Brooklyn Park, Minnesota
      - Opened in 1992
      - Lease expired in 2006
      - Closed because LTM have 5 other locations in the vicinity
    - LTM's 85,630 square foot center in St. Paul, Minnesota
      - Opened in 1997
      - Lease expired in 2010
      - LTM closed the center
        - Transferred its membership to LTM's surrounding locations
        - LTM has 22 centers in Minnesota
          - With various size when they did experiment in early years
- LTM has been successful in different places
  - Started in lower income areas
  - Expanded into the Northeast and Nevada
    - Enjoyed better return
    - Had better return in New Jersey and Long Island than Ohio[iv]
      - Investment is well over $40 million
      - Compared to other clubs in the high $20 million or low $30 million
        - Double revenue per square foot
        - Significantly better EBITDA margin[v]

        - LTM would have the best return in areas with highest GDP per square foot
            - The question is whether land is available
- LTM is looking at 250-300 clubs around the country[vi] [vii]
- New clubs can contribute 10%-15% growth
    - New club's contribution to growth approximates Gross PPE growth rate
    - LTM targets 15% ROIC
    - In the last 10 years, Gross PPE grew faster at 19.1%
        - 2002: $426 million
        - 2012: $2,452 million
        - In line with EBITDA growth of 19.1%
            - 2002: $56 million
            - 2012: $323 million
        - Gross PPE growth rate was faster than ROIC thanks to leverage
            - Example:
                - Company A and B has 10% ROIC
                - Company A:
                    - Year 0:
                        - $100 million equity
                        - $0 million debt
                        - EV: $100 milion
                    - Year 1:
                        - Earns $10 million
                        - Reinvests $10 million in the business
                        - $110 million Equity
                        - EV: $110 million
                        - => 10% growth rate
                - Company B:
                    - Year 0:
                        - $50 million equity
                        - $50 million debt
                            - After-tax rate is 5%
                        - EV: $100 million
                    - Year 1:
                        - ROE: 15%
                        - Earns $7.5 million

                - Borrows $7.5 million
                - Reinvest $15 million
                - $57.5 million equity
                - $57.5 million debt
                - EV: $115 million
                - => 15% growth rate
    - So, LTM can maintain 19-20% growth rate while keep the balance sheet strong
    - The questions is can they grow that fast?
        - At 10% growth rate
            - LTM increase their reinvestment at 10% growth rate
                - Year 1: $245 million
                - Year 10: $578 million
                    - Equivalent to
                        - 20 $30-million clubs, or
                        - 12 $50-million clubs
        - At 15% growth rate
            - LTM increase their reinvestment at 15% growth rate
                - Year 1: $368 million
                - Year 10: $1,293 million
                    - Equivalent to
                        - 43 $30-million clubs
                        - 26 $50-million clubs
                    - => too difficult
    - LTM can have long-term growth between 10% and 13% from opening new clubs
- Mature clubs can grow 2-3%
    - Each club has a local moat
    - It can grow with the local economy
    - Its capacity is limited
    - It's conservative to expect it to grow at inflation rate
        - Instead of GDP rate

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[i] "The addressable market for us, let me start by talking a little bit about what the demographic and the psychographic of a successful center of ours is**.** We typically look for **densities of 150,000 people or more in a five mile radius.** We test that against **12 minute drive times**, **we test that against the natural trade**

areas and the trade boundaries whether they be do people trade over freeways, do they trade across rivers or whatever. We want that same more or intensity within that. We look for a median household income generally in the **$70,000, $75,000** range in the Midwest, and we adjust that accordingly depending on the demographic of the cities around that. **We look for an average household size of 2.5 or more indicating that there's a large family population within those areas. And we look for the psychographics or the buying behaviors to have a very very high correlation with our successful clubs. That correlation generally has to do with those families, those individuals spending money outside of their home on physical or recreational things** -- soccer moms, kids in cul de sacs, and those types of people. If we can find those, that's what gives us a high degree of confidence that any sight we select would be successful for us.

So today we are in 19 states and 24 markets, and in those 24 different markets they range from a high for us of 24 centers in the Minneapolis St. Paul market. Now, Minneapolis St. Paul is our home, that's where we are founded, and I would call Minneapolis St. Paul more of a collection of clubs, not a chain of fitness centers for Life Time Fitness. Because we have everything from a 10,000 square foot female only, another 10,000 square foot club up to a couple hundred thousand square feet, in some instances. So it is really more of a collage. And on the equivalent basis it is probably about 11 to 12 clubs, what we build today in most other markets across the US. **We have nine centers in Chicago. There's still room to expand in the Chicago market**. We have two centers in New Jersey, we have four centers in Atlanta, we've got one center in Cleveland, Ohio. **So if you look at the existing markets, we have got room to grow there. There's about 60 metropolitan areas in the US that have a population of a million or more, right around a million or more in that MSA. We feel we can go to every one of those markets with one, and in almost every case with multiple centers**. **When you look at that, the bigger centers we've been building, historically we said there's 200-plus and we feel that's the same, certainly that.** And then the ability to infield from that should be able to raise that number even more over time." – Michael Robinson, Telsey Advisory Group 2010 Consumer Conference

[ii] "We look at a variety of factors -- demographics, psychographics, competition, geographical, or mental barriers. It is very, very intense.

We study the 100-plus clubs we have; geocode the members that come for each individual clubs. **So we have data for every single club, what percent of our members come from inside of the 12-minute drive time, between 12 and 20, and outside of 20. And we model that particular location to the top**

three or four facilities that are most likely like that facility, from all those aspects.

Then we model that. **We model how many memberships we are going to get from each of those rings.**

Then we basically price it where we feel like the pricing is appropriate for either positioning or what we need to get, to get the investment work. If the investment works, passes those three measures, then we will take it through.

One thing I want to expand on is we have been pushing the Company in the past several years very hard on trying to have a **15%, 14%, 13% ROIC**, which is a really high hurdle considering the marginal cost of capital today. If you take a look at a -- **let's take a $45 million investment, and you took 50% of that into mortgage at a 5%, which is easily doable right now -- and I mean easily doable to do a 50% mortgage on a $45 million at a 5% or better rate. You take that, you take a 20-year mortgage or 15-year mortgage and you put that aside. You take the $500,000 of annual CapEx out. Very, very comfortably we can hit in the high 20%s, 27%, 28%, 30% cash on cash return on those models at the club maturity which just takes two or three years, four years**.

And that only equates to roughly maybe about a 9%, 10% ROIC. So there is lots of room in our model to be able to generate great cash flow with just a modest level of mortgage put on the real asset." – Bahram Akradi, CEO, William Blair 2013 Growth Stock Conference

[iii] "If you look at it, we target at an individual club level. When we look at each project of that, **we target a 15% return on invested capital**. And that target -- the formula for that is quite simple. It's NOPAT -- net operating profit after tax, divided by the average investment that's going into that center.

Historically, if you look up through 2008, our mature centers in aggregate, we're delivering 15%. As we dipped, as we went through the recession we saw that dip is now down into the low teens, really driven by the fact that that attrition rate was up higher. We lost net membership at those centers, and so we saw some dip in that. But it's still in the double digits." – Michael Robinson, CFO, William Blair 2011 Growth Stock Conference

[iv] "**Brian W. Nagel** - Oppenheimer & Co. Inc., Research Division

It does. And so as a follow-up to that, Bahram, having followed your company for a while now, the cost to open a facility has climbed over time, increased over

time and then as you push into some of these more expensive markets. So as we look now, particularly on the East and West Coast of the United States, how much should we be thinking you're going to be spending to open each one of these facilities?

Bahram Akradi - Founder, Chairman, Chief Executive Officer and President
The fairly -- look, I'm just giving you some examples. **In the East and West Coast, you could think $40 million to $45 million, $50 million depending on the location on average**. And to make sure everybody is clear, it's a simple mathematic. It doesn't -- it shouldn't concern or confuse people. When we go to a more expensive market, it's more expensive for everyone. **An extra $10 a month for dues on the membership in that market justifies an extra $2 million in price of the land and construction or more, so it's a simple proposition**. We have obviously been doing this. Interestingly enough, right now, looking in a rearview mirror, **we have better returns in clubs like Long Island, New Jersey, et cetera, than we may have clubs in Ohio, where we spent a lot less on land and construction, so it all takes care of itself.** At this point, we're just excited about the pipeline that we have. As you guys know, the gestation time for these things are long. Sometimes deals will take an extra 6 months or 9 months to get through the approval process. We would have liked to have our 3 open clubs in 2013 be in the first quarter and hopefully, have a fourth one or a fifth one in the latter part of the year. It didn't work out. Some of them got pushed back to later in the year. And then, fortunately enough, we have been actually able to work some of the ones where we were thinking they're going to open later in 2014 to earlier in 2014. So things are looking really, really great as our new team in the real estate, expanded team in real estate are doing a great job filling up the pipeline with really solid deals." – 2012 Q4 Earnings Transcript

[v] "The business model itself continues, and the economic model is attractive. We see solid EBITDA. Unit metrics -- **a typical center of ours on a historic basis at a unit level produces about 40% unit EBITDA margins, and it's in the mid-to-low 30% when you fully incorporate all of the burden and the corporate overheads**.

As we look forward and when we build and grow some of our centers in higher cost locations, and Syosset is a good example of that -- Syosset, Long Island -- that investment is **well over $40 million**. But the revenue that we get, the revenue per square foot really can be **double the revenue per square foot that we see in some of the other centers that we may be investing in the high $20 million or low $30 million in. So the contribution and ultimately the EBITDA margin delivery of these centers is going to be significantly above what we've seen in some of our past centers.**" – Michae Robinson, CFO, William Blair 2011 Growth Stock Conference

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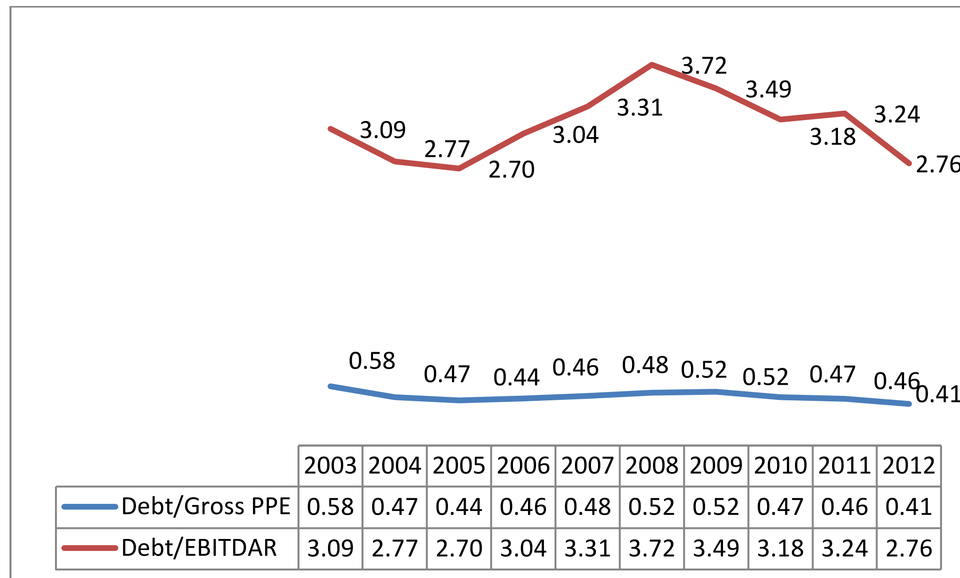
[vi] "Well, we -- I personally am more involved right now, at least for this period of time, with the real estate again. **We have a significant number of sites selected from East Coast to West Coast with higher demographics, more affluence, and we have a variety of different products** developed so that we can appropriately go to some of these markets. Most recently, **I have designed some prototypes, smaller boxes, which allow us to penetrate in the markets that may be difficult to find 10 or 12 or 13 acres of land**. And also because of their geographical situation and traffic and such, the draw may not be as large as our -- places we have boxes. So we have, regardless of -- the order of priority for this is to look at the customer that we're after, and then develop a product that can take us to that customer, whether if it's large or small or combination of the 2. So I don't see anywhere less than what we have told you guys before in number of opportunities. **We've always talked about 250 to 300 total facilities across the country and I certainly don't see any reason that number would be any smaller now than it has been before**. So we have, in order to kind of hit our head on top right now in terms of how many we can. The question is how fast we can fill up a pipeline in production per year and that's what -- our most important effort is to make sure we have a good robust number of Greenfields coming out of the ground in the future years to come." – 2012 Q2 Earnings Transcript

[vii] "We have -- as we look at the country, we see a lot of opportunities across the country. We are in 29 markets; 24 centers in Minnesota. We've got one on Long Island. We've got one in the Greater Toronto area. There's a tremendous amount of fill-in opportunity in those 29 markets that we have today. We have nine in Chicago. Yes, we think we can put -- certainly, I can think of at least two or three locations, and probably many more, that we could potentially put in the Chicago market. And I think, over time, you should expect that we're willing to be doing that.

We're also not in -- if you look at in the US, there's about 60 metropolitan areas, and about 1 million population or more. We're not in half of them yet. And we think we can put one center, or in many cases, multiple centers in those markets. And so, our thought, and what we're talking about and expanding is, we're going to emphasize a little bit more high demographic areas, but at the same time, continue to establish beachheads in new markets and grow those in as we go forward." – Michael Robinson, CFO, Oppenheimer 2013 Consumer Conference

Misjudgment

How Much Debt Is Life Time Fitness Willing to Take?



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Debt/Gross PPE	0.58	0.47	0.44	0.46	0.48	0.52	0.52	0.47	0.46	0.41
Debt/EBITDAR	3.09	2.77	2.70	3.04	3.31	3.72	3.49	3.18	3.24	2.76

Life Time Fitness had the highest level of leverage in 2008

- The biggest risk is that LTM can overextend their balance sheet
  - We don’t know how much debt they’re willing to take
    - They would keep building a lot of clubs if the crisis didn’t happen
  - The CEO faced a margin call
    - Bahram Akradi
      - Founder, CEO, and Chairman
    - He owned 4,135,700 shares
      - 10.6% of the company
    - He pledge 3.5 million of his shares
      - Secure various margin loans
    - Was force to sell more than 1.46 million shares
      - For $27.5 million
        - At about $18.5 a share
  - If the CEO faced that problem, the company he runs may also face that problem
- We may not understand competition from YMCA and community centers well enough
- The business may be more volatile than we think
  - We only have the numbers through one recession

        - Mature 37-month same-store sales declined
            - 2007: 0.8%
            - 2008: -2.8%
            - 2009: -7.5%
            - 2010: -2.3%
        - Over-12-month same store sales:
            - 2007: 6.1%
            - 2008: 2.8%
            - 2009: -3.1%
            - 2010: 5%
    - LTM was also able to survive and grow back in the 2000 time period[i]
        - Was developing 6 clubs
            - $25 million each
            - Had to raise $100 million to finish
- We may underestimate maintenance CapEx
    - Our estimate is based on what the management says
    - We only check the status of the club based on customer reviews in Yelp.com
    - Because LTM don't sell annual subscription, we think they must maintain the club well
    - We look at total center square feet by age
        - Over 10 years: 2,026,081 square feet
        - 5-10 years: 4,498,668 square feet
        - Less than 5 years: 3,140,033 square feet
    - LTM's clubs have a major retrofit every 5 years
        - So, we shouldn't concern about maintenance CapEx being lower than normal because the clubs are young
- The top complaint is about aggressive sales
    - In-center revenue per member increased from
        - $129 in 1999, to
        - $507 in 2012
    - A lot of members complain about LTM's aggressive sales pitch[ii]
    - Aggressive in-center sales would hurt LTM's image
        - LTM wouldn't be Nordstrom of the health club industry if their sales people lie to customers
- Selling more personal training and group training reduce members' access to the facility[iii]

- If that's true, our estimate of owner earnings based on square feet might be wrong
- But only a few people complain about this issue
- Why would group training use more space than people using the facility?
    - If it's not group training but people who attend the group training come and use equipment exactly at that time, the complaint would just be that the facility is overcrowded
- LTM's clubs are generally rated 3.5 stars and above
- We can see selling group training and personal training as part of their pricing action
    - Increase price by optimally charge the access to their facility
- The management said their mature clubs operate at 80%-85% capacity
    - The numbers seem to validate what they said
- The last several years weren't good for the industry
    - Similarly for restaurants

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[i] "**Anthony Gikas** - Piper Jaffray

Thanks. Good morning, guys. Couple of questions. Could you just talk a little bit more about financing and where will financing come from looking forward? **It looks like equity, at this point, is going to be dilutive [*Quan: $33.5 at that point*], credit facilities are going to cover this for too long**. So may be just talk a little bit about that. You talked about nine of the 11 centers looking forward are going to be owned. Is there a little change of strategy there? And what would that look like going a little bit more forward? And do you have visibility of financing for calendar '09? And then I have a follow up.

Bahram Akradi

Sure. Tony, this is Bahram. We feel extremely confident with activities that Mike and his team have right now that we will obtain necessary financing to maintain our growth. There are, as he mentioned, huge number of assets with no mortgage against them. **I want to kind of refer the fact that back in the 2000 time period, with only about $20 million of EBITDA, we were able to get financing in excess of hundred and some million dollars for a bunch of facilities in a very tough financing environment**.

We have so much assets available for financing. The question is not, whether or not we get financing? **The question is, do we get it at the ratios that we want to get in terms of debt to the cost of construction and the building et cetera? So, we'll be able to continue to expand the same way we have**

expanded in the past. And that is truly not a concern. But there are many, many different initiatives that we are working on and I don't think we have the time to go through each and everyone with you at this point." – 2007 Q4 Earnings transcript

[ii] "Trudy G.
Woodbury, NY

2 stars

5/12/2011

Bring your Credit Card .... the sales pitches are RELENTLESS here! My family joined without any hassle, but the hard core sales started at the FitPoint assessment that comes "free" with each membership. **You will be HOUNDED (uncomfortably and constantly asked) to buy additional testing packages, heart rate monitors, nutrition packages, vitamins, personal training... I mean HOUNDED**!! Every time you turn around you will hear another poor newbie being pitched the same thing... "you really need the cardio point assessment in order to get the best results." After you shell out an extra $119 for that, they ask you to kick in another $75 a month so you can learn how to use the data gathered from the test - they will email workouts to you for an extra $75 a month!!! **I have NEVER been to a gym that was SO OBSCENELY RELENTLESS on selling... it NEVER stops. But the facility is BEAUTIFUL. The people are nice and overall, this a great place for families - just BE CAREFUL not to get HUSTLED for every penny you got! We have already spent over $900 this month... I am ashamed to admit**. So far, I think the extras were an utter waste. **NY – Syosset**

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Pasquale R.
Madison, NJ

4 stars

2/5/2010 361 check-ins here

My first impression of this place was WOW. **Going with a friend of mine so he can "refer" me was one of the reasons why I decided to give this place a shot. After my workout they had me sit down with one of their sales reps and get schpeeled...and I agree with the other members who mentioned they do try to scam you**. I knew going in my company offered a discount and what my coworkers were paying. He tried to tell me that wasn't true. He even looked up one of my friends accounts and said he pays the same that I would be paying which is BS!!! (the moniter was turned towards him so he thought he could be slick). I simply got up and walked out. The next day I called the

manager who stated we do have a discount and signed me up. I get the whole sales tactic but don't lie!!!! The gym, well it's really amazing. Minus the occasional meathead for the most part it's spacious, clean (very clean infact). Tons of machines and free weights. Tons of tredmills and other machines. Although it's pricey you do get a lot. There is a large cafe as well as Spa (haircut, massage). Lot's of classes, bb court, rock climbing and 2 pools!!!! 1 indoor and one out. **NJ – Bekerley Heights**" – *Too see more quotes, look at the Scuttlebutt Folder*

iii "Diane H.
Tinley Park, IL

1 star
Updated - 2/24/2012

If you're not part of the family plan, this place is not for you. They have a family locker room, which I don't think anyone uses--I gladly would-make it a kid-free zone. Considering as a single person, you pay the highest per person fees, you'd think they would give some consideration to your needs but it doesn't happen. **There are alway 97 kids in the pool practicing their cannonballs, or throwing footballs, balls, and anything else that flies through the air. It's a bit of a nightmare as far as a healthclub goes but it remains the closest club to my house**.

1 Previous Review: ***Hide »***

- *2 stars*
  11/13/2010

  I just cancelled my membership (this month would have been 5 years there) I stayed because geographically it was so convenient. Here's what I didn't like about the club. I almost always found the shower area to be pretty gross. **They don't tell you when you sign up that much of the equipment you'll want to use during prime hours is reserved for their group fat clubs**. (that pay extra for this service) Too much of the equipment is broken for long periods of time. The middle rowing machine (they have3) has had the timer broken for more than 8 months, which to me says no one checks the equipment regularly. (you'll start rowing and it will work for a few minutes then resets itself to 0 so you have no idea collectively how long you've rowed for.) they have a very high staff turnover and while I used to use the salon a lot, once you start to go regularly they just start to jack your fees up. (My massage started out at $55 til it made its way up to $75--same with my waxing until I quit and went elsewhere for those services.) It's my understanding that the salon is not doing very well because they always try to solicit you for services when

you're there. ANd your membership fees will go up 1-2 times per year while the services they offer to you continue to decline. And by the way, in the summer there are 8,000 kids there all the time!WHich leads to them using an EXCESSIVE amount of chlorine in the pools--buy one dedicated suit you don't care about ruining because the color will fade in no time due to all the chlorine bleach. The rock wall is never open--I think it just collects dust at this point. **IL – Orland Park**

Nick S.
Elk Grove Village, IL

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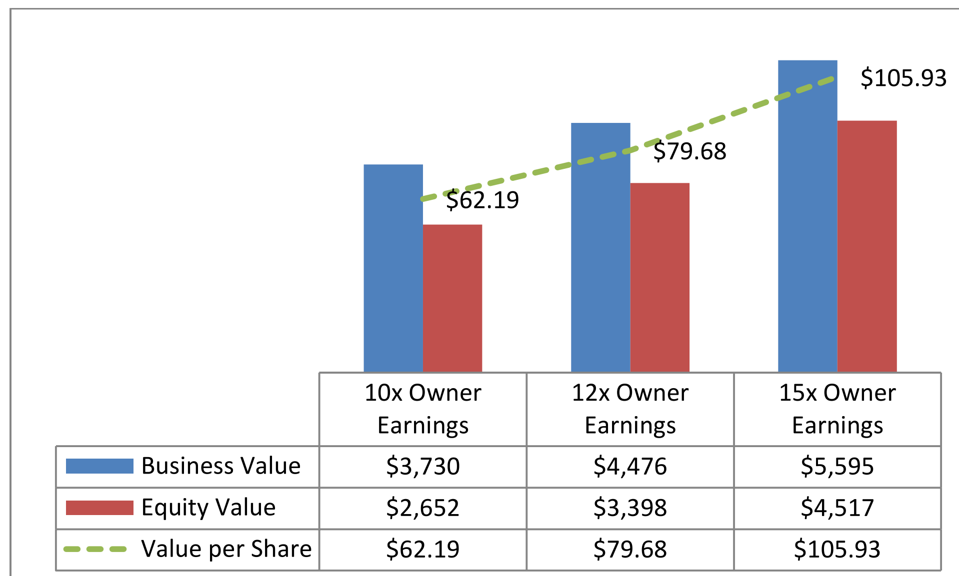
3 stars
9/28/2009

It's still a nice gym, but they put people that pay for personal training ahead of the members. **For example, they will take an entire basketball court, during peak hours, to do a group fitness. They'll even kick people off one of the courts for this**. Not cool. **IL - Schaumburg**

" *– Too see more quotes, look at the Scuttlebutt Folder*

Conclusion

Life Time Fitness Offers Profitable Growth at a Great Price



	10x Owner Earnings	12x Owner Earnings	15x Owner Earnings
Business Value	$3,730	$4,476	$5,595
Equity Value	$2,652	$3,398	$4,517
Value per Share	$62.19	$79.68	$105.93

Fair value per share is between $62 and $106

- Quality of each club is very high
    - Durable cash flow
    - Quite stable cash flow
    - Sustainable local moat
        - Each club has a competitive position similar to that of WTW
            - Compete with several smaller competitors
                - Smaller clubs draw customers within 1 or 2 mile-radius
                - LTM draw customers within 5-mile radius
            - LTM gets a big share of the profit pool
                - Smaller clubs have low barrier to entry
                - There are a lot of churn and replacement
                - There's a lot of noise
    - Can grow with the local economy
- LTM is like an investment fund
    - They have a reliable formula to earn 15% ROIC
        - 20% ROE
- The business is as durable as WTW's
- The company's durability depends on the risk level that the management take

- This is the most important area that investors should pay attention to
  - Net Debt/Gross PPE
- LTM may overextend in good times
  - In that case, Mr. Market can be also optimistic
  - Investors can possibly exit at good price
    - Investors shouldn't fall in love with LTM and lenient with its risk-taking behavior

- Geographic expansion is very reliable
  - LTM can grow 12-15% in the next 10 years
- Our estimate of intrinsic value is very conservative
  - Just assume that LTM can convert non-access memberships into access memberships
    - Total **801,851** memberships
  - Based on club capacity, **900,000** memberships is a reasonable expectation
    - Would add
      - $154 million to revenue
      - $62 million to pre-tax owner earnings
        - **$435 million**
- It makes sense to value LTM based on expectation about the total number of memberships
  - Current result may be lower than potential
  - But LTM keeps opening new clubs
    - The potential keeps expanding
  - The economy won't be bad forever
  - One day, the actual performance will reach the potential
- Quan's multiple for LTM can be unfair
  - LTM can grow 12-15% in the next 10 years
    - Very likely
    - $1 will grow to between
      - $3.11, and
      - $4.05
  - Assuming multiple contract from 15 to 10 in 10 years
    - Value today: $15
    - Value in 10 years is between
      - $31.1
        - 7.53% annual return

- $40.5
  - 10.44% annual return
- **15x** Pre-tax Owner Earnings is justifiable
- Using the same calculation
  - 12 Pre-tax Owner Earnings and 10% growth results in 8% annual return

- Unlevered return would be between **13.5% and 16.5%** in the next 10 years
  - Pre-tax Owner Earnings/EV = 11.6%
    - 7.6% after-tax yield
      - Using 65% tax rate
      - Effective tax rate is lower
        - Less than 30%
        - Thanks to high D&A
          - Depreciate land
  - LTM can grow 12%-15% in the next 10 years
  - Multiple can expand from current 8.6 to 10
    - In 10 years, would add 1.5% yield
  - Expected return is between 13.5% and 16.5%
- Actual return is higher
  - Using debt is the fact of life in this business
  - Current debt level is very low in LTM's history
  - The management mentioned they'll lever up
  - Benefits of debt
    - Lower income taxes
    - Improve return on equity
      - By keeping the same debt to capital ratio, potential growth is equal to ROE
        - If they can't grow as fast as ROE, they can have excess money to repurchase shares
  - LTM would make **$287** million CFFO in 2013
    - $70 million maintenance CapEx
    - $217 million levered FCF
    - At $50 per share, the market cap is $2,132 million
      - 10.2% levered FCF yield
  - Levered FCF/Average (Gross NTA – Capitalized Debt) was over 20%
    - To get 12-15% growth
      - 10-13% gross PPE growth

        - Need to retain less than 70% levered FCF
        - 30% of levered FCF would be used to repurchase shares
            - Add 3% (= 30% * 10.2%)
    - So, expected return would be between
        - 13.5% + 3% = 16.5%
        - 16.5% + 3% = 19.5%