

# FINAL TRANSCRIPT

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**LTM - Q3 2011 Life Time Fitness Inc Earnings Conference Call**

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**Bahram Akradi**

*Life Time Fitness Inc - Chairman, President, CEO*

**Mike Robinson**

*Life Time Fitness Inc - CFO*

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*Feltl and Company - Analyst*

**Sharon Zackfia**

*William Blair & Company - Analyst*

**Brian Nagel**

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## PRESENTATION

**Operator**

Good day ladies and gentlemen and welcome to the third quarter 2011 Life Time Fitness incorporated earnings conference call. My name is Tony and I will be your operator for today. At this time all participants are in a listen only mode. Later we will conduct a question and answer session.

If at any time you require operator assistance please press star followed by a zero and we will be happy to assist you. As a reminder, this conference is being recorded for replay purposes. I would now like to turn the conference over to your owes for today Mr. John Heller Senior Director of Investor Relations and Treasurer. Please proceed.

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**John Heller** - Life Time Fitness Inc - Senior Director IR, Treasurer

Thanks Tony. Good morning and thank you for joining us on today's conference call to discuss the third quarter 2011 financial results for Life Time Fitness. We issued our earnings press release this morning. If you did not obtain a copy, you may access it at our website which is [lifetimefitness.com](http://lifetimefitness.com). Concurrent with the issuance of third quarter results we filed form 8K with the SEC which also includes the press release.

On today's call Bahram Akradi our Chairman, President, and CEO, will discuss key highlights from our third quarter and our operations. Following that Mike Robinson, our CFO will review our financial highlights and update our financial guidance for 2011. Once we have completed our prepared remarks we will answer your questions until 11AM Eastern Time. At that point in the call Tony will provide instructions on how to ask a question. In order to get as many as possible a chance to ask a question, please limit yourself to only one question.

I will close with a tentative date of our fourth quarter 2011 earnings call. Finally a replay of this teleconference will be available on our website at approximately 1PM Eastern Time today.

Today's conference call contains forward looking statements and future results could differ materially from those statements made. Actual results may be affected by many factors including the risks and uncertainties identified in our SEC filings. Certain information in our earnings release and information disclosed on this call constitute non-GAAP financial measures including EBITDA, free cash flow, and other non-GAAP operating measures. We have included reconciliations of the differences between GAAP and non-GAAP measures in our earnings release and our form 8K. Other required information about our non-GAAP data is included in our form 8K.

With that let me now turn the call over to Bahram Akradi. Bahram?

**Bahram Akradi** - Life Time Fitness Inc - Chairman, President, CEO

Thanks John I'm pleased to be here to share my thoughts and perspective on our third quarter of 2011 results. We had a very solid third quarter. Revenue growth remained strong, up 11% over the third quarter last year continuing the steady pace we have seen over the last several quarters. Dues revenue for the quarter was up over ten percent from a year ago. In-center revenue had its seventh straight quarter of double-digit growth, up over 16% from last year..

Net income was up over 15% versus last year. Excluding the impact of non-cash compensation expense, net income was up nearly 18%. Earnings per share were \$0.66, adjusted for the non-cash compensation expense non-GAAP EPS was \$0.67, 18% higher than last second quarter.

Mature centers same store sales continues its positive trend up 4.1% over the third quarter last year. Attrition for the quarter was 9% versus 9.6% a year ago, and our trailing 12 month attrition was 35.3%.

Last quarter we reached our stated goal of getting attrition under 36%. Even with high unemployment our attrition levels are approaching some of the lowest in the history of the company. We will continue to drive hard to keep attrition below 36%. I am very pleased with these results.

I'm proud of our team. We successfully execute the strategies that differentiate Life Time as a healthy way of life company and impact lives positively each and every day. We remain on track to accomplish our stated objectives for the year. Our balance sheet is solid and our debt leverage is within the range we were targeting. Our revenue performance continues to be strong as we drive for over \$1 billion in sales this year.

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Our transformation into a healthy way of life company is well under way as we focus on helping our communities and members achieve their health, fitness and athletic aspirations by delivering the best programs, people and places. And finally, we are committed to growth and improving our margins and returns. We will achieve this through 1) growth within our existing facilities; 2) square footage growth; 3) more healthy way of life programming both inside and outside the facilities; and 4) finally, all the while driving improved productivity and asset utilization.

I look forward to finishing the year strong and setting our sights and our goals and objectives for the next year. With that, I will now turn to Michael Robinson our chief financial officer. Mike?

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**Mike Robinson** - *Life Time Fitness Inc - CFO*

Thanks Bahram. I would like to provide you with some additional details on our third quarter performance and financial results. First of all let me remind everybody that starting with the fourth quarter last year, we are recognizing non-cash performance share based compensation expense related to a grant of long term performance-based restricted stock approved by the Compensation Committee of our Board of Directors in June 2009. This grant was a retention tool as well as incentive to our senior management team to achieve certain EPS targets in 2011 and 2012. These EPS targets were intended to be an aggressive goals in excess of three and four year baseline expectations set in 2009.

In the fourth quarter of 2010 the Company determined that the 2011 EPS performance criteria required for the vesting of 50% of the stock or approximately 450,000 restricted shares, was probable. In the third quarter we recognized approximately \$1 million of non-cash performance share-based compensation expense and we expect to recognize additional expense of approximately \$1 million in the fourth quarter related to the first 50% of these performance-based restricted shares. While we report our results inclusive of these expenses at times we will refer to adjusted or non-GAAP earnings, ratios and guidance throughout our comments.

We currently believe achieving the remaining 50% target in either 2011 or 2012 is not probable, therefore we have not recognized any compensation expense related to the remaining 50% of this performance-based restricted stock grant. This remaining grant has approximately \$9 million in non-cash pre-tax share-based compensation expense associated with it. We will continue to evaluate the probability of achieving this portion of the grant quarterly.

Now let me talk about attrition and retention. For the quarter our attrition was 9% compared to 9.6% last year. Starting in the second of quarter the quarterly attrition rate is now directly comparable as we have anniversaried the methodology change in our attrition calculation that went into effect April 1st last year. That is, we no longer count potential memberships that elect to cancel during their 14-day trial as members or attritions.

Our trailing 12 month attrition is 35.3% versus 37.1% last year. This includes approximately 60 basis points of improvement related to the methodology change I just mentioned. The estimated average life of a membership is 33 months, unchanged from last quarter but improved from a year ago when it was 30 months.

We finished the quarter with 653,300 memberships. This was a 4.9% increase from the third quarter 2010, or just over 30,000 net memberships added in the last year. Sequentially, we had a decrease of approximately 11,000 memberships from Q2 which is typical as members return to school in September and the pool season ends.

For the third quarter we grew the net balance of Flex memberships by approximately 11,000 units to approximately 84,000. The number of open centers at September 30, 2011 was 92 compared with 88 at September 30, 2010. Of the 92 centers, 57, or 62% are our large current model center, and 73 or 79% of all centers have been open three years or more which we classify as mature centers. We operate 9.2 million square feet of fitness facilities.

Our total revenue was \$265.4 million for the quarter which is up 11.4% from last third quarter.



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Our main revenue drivers are as follows. Membership dues revenue grew 10.4% for the quarter which outpaced our membership growth of 4.9%. Our goal is have continued dues growth in excess of membership growth. One element of our growth strategy you will hear me discuss a bit later is to prudently take price and improve our membership mix to drive higher dues per center. These results demonstrate we are doing that.

Our powerful dues stream accounts for 65% of our revenue. In-center revenue grew by 16.3% in the quarter. We are strategically driving this growth by increasing our products and services in our portfolio and sending members to use these services through our LT Buck\$ affinity program and of continuously enhancing our connectivity initiatives. Our focus is to drive more member involvement which we expect will improve member retention and customer satisfaction.

Our revenue productivity metrics are strong and consistent across the board. Our third quarter same-store sales were up 4.7% and our 37 month mature same-store sales were up 4.1%. Revenue per membership in the third quarter was \$395 per membership which was up 5.9%. In-center revenue per membership of \$124 was up 10.7% in the quarter. For perspective, in the third quarter of 2009 and 2010 we were at \$100 and \$112 of in-center revenue per membership respectively. We believe the improvement over both the last two years is evidence of our member connectivity and engagement as well as expanded program offerings.

Now, I would like to discuss our cost structure. Overall operating profit margin in Q3 improved sequentially 80 basis points to 18.8%. Year over year this margin decreased 30 basis points from 19.1% in Q3 2010, but at the same time profit dollars increased \$4.3 million. Excluding the effect of the \$1 million of incremental non-cash performance-based restricted stock compensation expense, operating profit margin for the quarter increased ten basis points to 19.2%.

Just as we saw in Q3 for the fourth quarter we expect operating margins to improve slightly (in a normalized in-center growth environment excluding the impact of the non-cash performance share-based compensation expense. We continue to see improvement in our center operating margin.

Center operating costs were down about 90 basis points excluding -- including absorbing approximately 10 basis points of non-cash compensation expense related to the performance-based restrictive stock grant. Leverage from increased dues revenue more than offset the negative margin mix resulting from the significant growth in our lower margin in-center businesses. Costs in excess of enrollment fees were essentially flat compared to 3Q 2010.

Marketing and advertising costs were up 80 basis points as we increased marketing campaign spend, continued to invest in our LT Buck\$ affinity program, and incorporated marketing spent in new events and other corporate initiatives such as myHealthCheck. As we have discussed we expect our marketing cost to be up over last year as we invest more in member retention initiatives including myLT Buck\$ as well as our in-center and corporate businesses. These initiatives are showing results as evidenced by our strong top line growth and significantly improved attrition rates.

G&A was up 20 basis points for the quarter as a percent of revenue at 4.7% including absorbing nearly 30 basis points or \$700,000 of non-cash compensation expense related to the performance-base restricted stock grant. While the G&A percent of revenue was essentially flat in the quarter, when we exclude the incremental share-based compensation expense, we are still investing in overhead structure to help drive the retention and connectivity initiatives in our centers and initiatives underway to grow our other healthy way of life related businesses.

Other operating expense was up 40 basis points for the quarter primarily as a result of our investment in our athletic endurance events and the myHealthCheck business infrastructure, and the costs associated with acquired businesses. While other operating expenses increasing slightly as proportion of our total cost structure, as we expect we are seeing top line growth related to these synergistic healthy way of life businesses. The associated revenues related to the other operating expenses increased 17.1% over Q3 2010.

We continue to see leverage in depreciation and amortization as we continue to grow revenue well ahead of square foot expansion. These costs were down 20 basis points for the third quarter. Interest expense, (net of interest income), decreased

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to \$5.1 million from \$6.8 million last third quarter. This decrease in interest expense reflects the payoff of approximately \$70 million in higher rate mortgage debt early in the second quarter this year, and the low variable rate interest rates on our revolving line of credit. For the full year 2011, we expect interest rates to be down from total, we expect interest expense to be down from total year 2010.

Our tax rate for the quarter was 40.2% even with last Q3. We expect our effective tax rate in 2011 to be slightly above 40%. That brings us to net income for the quarter of \$27 million including \$600,000 after tax for the effect of the non-cash compensation expense. Exclusion that charge, non-GAAP net income for the quarter would have been \$27.6 million representing 17.9% growth over last third quarter.

Weighted average diluted shares for the third quarter total 40.9 million shares. Overall we achieved diluted EPS of \$0.66 for the third quarter including, \$0.015 for the the non-cash share-based compensation expense. Excluding this expense and the effect of rounding, the quarterly EPS was \$0.67, a 19% increase over 2010.

My next topic will be cash flow in our capital structure. Our cash flow from operations totalled \$58.8 million for the quarter compared to \$45.4 million last Q3 up 29%. For the quarter we generated nearly \$20 million of free cash flow. We have now generated 11 consecutive quarters of free cash flow.

We continue to focus heavily on our capital structure, cash, and debt availability. Total debt decreased \$16 million in the third quarter. As of September 30, we have \$388 million outstanding including letters of credit on our \$660 million revolver. That leaves approximately \$284 million in cash and revolver availability. Our net debt to total capital came down to 37.4% at the end of the quarter.

Our covenant calculations for the quarter continue to show significant room versus our covenant limits. In August we entered into an interest rate swap to fix rates paid on \$200 million of our revolver at 1.32% plus the applicable spread. We expect the fixed rate on this piece of the revolver to be slightly higher than 3% to June 2016.

Also, in the quarter our Board of Directors authorized a \$60 million share repurchase program with an expiration on August 17, 2013. We view this as an opportunistic program, put in place to use should we feel market conditions warrant. We are not obligated to repurchase stock and we have not modeled it into our 2011 expectations. In the third quarter we did not purchase any shares under the buyback program.

Regarding capital expenditures we expended approximately \$39 million of CapEx in Q3 of 2011. This was comprised of approximately \$24 million for growth and \$15 million for maintenance and corporate infrastructure. For 2011 we expect to spend approximately \$150 to \$160 million for CapEx to open three large centers, commence construction of our on 2012 centers and maintain our portfolio of clubs. This will be comprised of approximately \$100 to \$105 million for growth and \$50 to \$55 million for maintenance and corporate infrastructure. We have spent approximately \$7 million so far in 2011 on acquisitions including small racing and race-related events businesses, a medi-spa business as well as four yoga studios in the Michigan market.

A few balance sheet variances to note include -- deferred revenue decreased about \$8 million for the quarter driven primarily by the completion of summer camps as well as other kids' activities have been paid for in the second quarter. Accrued expenses increased \$5 million driven by general business growth as well as accrued real estate and income taxes. With that let me discuss our updated financial guidance for 2011. We expect our revenue will grow to \$1 billion, to \$1.005 billion or (up from \$985,000,000 to \$1 billion). This growth is approximately 10%, driven primarily by growth in in-center revenue in corporate business as well as dues, mixed growth and membership growth in new centers.

We anticipate our net income will grow to approximately \$94 to \$95.5 million or 16% to 18% growth. Excluding the impact of non-cash compensation expense in 2011 we expect non-GAAP net income to be \$96.5 to \$98 million. We expect our diluted



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EPS will grow to \$2.29 to \$2.32. Excluding the impact of non-cash compensation expense in 2011 we expect non-GAAP diluted EPS to be \$2.35 to \$2.38.

Before I turn it over for questions I would like to reiterate what we discussed on our second quarter call regarding growth in 2012 beyond as well as our focus on driving improved margins and returns. We are planning to grow through five key drivers. First is unit growth, both greenfield and conversion. We currently have three centers representing approximately 4% square footage growth under construction for 2012. We are targeting 6% plus square footage growth for the year, with a difference coming from acquisitions or conversions we are planning to complete in the next year or so.

Our next two growth drivers revolve around optimizing the dues growth in our existing centers. First we will drive price and improve the dues mix in centers and markets that the demographics and psychographics support. Second we will drive occupancy improvement in select centers and markets. Our strategies here will be center-by-center with the ultimate goal to grow dues in each center, either by price, mix, occupancy improvement, or a combination of each.

Our final two growth drivers come from what we internally call our Company's inside. The 19 businesses we have identified that we operate both inside our fitness centers, (in-center revenue), and synergistic to our centers which we report as corporate revenue that differentiate Life Time Fitness as the healthy way of life company.

In-center growth will be driven by further penetration of our member base with targeted connectivity initiatives and our affinity program, myLTBuck\$, as well as continued introduction of new and expanded program offerings such as the 90-day weight loss challenge, life clinic chiropractic services, and medi-spa services. Corporate revenues will be driven by growth in synergistic businesses such as events, media education certification, and myHealthCheck, a program designed to emphasize personal responsibility for employee health, identify health risks, and lower health care costs for both employees and employers.

As we stated in the past we are targeting at least low double digit revenue growth in 2012 and beyond with these balanced growth initiatives. Increasing margins and improving returns are key focuses for the company. We have seen some ROIC improvement over the past year-and-a-half, however, we are not satisfied.

Improving returns starts with our revenue growth strategy. As you can see in what I outlined before four of our five growth initiatives require no or generally low investment. Mixed price, mixed improvement price and occupancy growth are all revenue profit and profit margin drivers requiring no ROIC denominator investment. Our in-center and corporate business initiatives are positioning us to enhance profits with generally no investment. That concludes our prepared remarks regarding our third quarter financial results. We are pleased to take your questions now.

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## QUESTIONS AND ANSWERS

### Operator

Ladies and gentlemen, if you have a question please press star followed by one on your phone. If your question has been answered or you would like to withdraw your question, please star followed by two. Questions will be taken in the order received. Please press star one to begin. Your first question comes from the line of Brent Rystrom with Feltl

### Brent Rystrom - Feltl and Company - Analyst

Yes, I was just wondering if you could give a little more clarity on the acquisitions or other expansion next year beyond the three units you've identified. Would you characterize that you have a high degree of comfort with that in that square footage? Would you characterize it at this point from modeling perspective that it is something that is a 50-50? How would you delineate that opportunity?

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**Mike Robinson** - *Life Time Fitness Inc - CFO*

You are referring really -- we are looking at acquisitions across the board in all elements of the business. But the specific one that I quote when I look at next year and our target of 6% square footage expansion of which 4% is come in green field, I would characterize that as we are certainly confident nothing's done until it's done but we have a number of things that we are looking at and a number of opportunities to able to deliver that incremental growth.

Next question please.

**Operator**

Your next question comes from the line of Sharon Zackfia of William Blair

**Sharon Zackfia** - *William Blair & Company - Analyst*

Hi, good morning you saw a nice increase sequentially in the rate of growth of monthly dues which I assume is a reflection of the some of the optimization you have been doing or talking about. Can you talk about whether a mid-single digit pace is what we should think of going forward and what the reaction was from members as you started to further optimize that price index?

**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

Hi, Sharon. What we are basically continuing to do is working on differentiation of Life Time as a healthy way of life company. We are improving the programming across the board and that allows us to adjust the dues pricing as we go forward. We systematically adjust the pricing for new members going forward. Existing members stay with their current rate. Eventually we adjust them maybe not all the way up, but slightly up.

But this gives us an automatic increase in our dues revenue as the members churn so the attrition actually in this case will help when we replace that member with a newer member. So I can't tell you that we can continue to grow dues on a 10% quarter year-by-year but I can tell you that we have a strong belief we continually raise, dues, same quarter year-on-year. And that's going to keep coming. I think whether if it's 7%, 8%, 9%, 10%, I can't give you an exact guidance.

**Mike Robinson** - *Life Time Fitness Inc - CFO*

I guess if you look at that dues, the actual dues growth of 10%+ that's being driven by several things. It's clearly being driven by mix. Some of our newer clubs opening at higher dues rates than the existing clubs like Syosset at \$119 or Summerlin Nevada at \$119. It's also being driven by what Bahram talked about, in as we prudently raise new members' across the board. As I think about that, I agree with Bahram, I would not, I don't think it's prudent to model in that you can have significant year-over-year growth, but good year-over-year growth, yes.

**Sharon Zackfia** - *William Blair & Company - Analyst*

Okay, thank you.

**Operator**

Next question comes from the line of Brian Nagel of Oppenheimer. Please proceed.

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**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Hi, good morning.

**Mike Robinson** - *Life Time Fitness Inc - CFO*

Good morning, Brian.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Congratulations on another nice quarter.

**Mike Robinson** - *Life Time Fitness Inc - CFO*

Thank you.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

As I look at your results it's very consistent with what we see in the prior quarters where you see nice improvement like the prior question mentioned, the dues growth and (inaudible.) The one seriously weaker spot remains the gross membership adds. The question I have, you see, as you look across the chain, you obviously have some strong starts to some of the new centers you just recently opened, are you starting to see any, as you look across the chain or divide the chain up between the newer and older centers, are you starting to see any let-up in that pressure on the gross membership adds?

**Mike Robinson** - *Life Time Fitness Inc - CFO*

Well, I'm going to start big pictures strategically and let Bahram answer also, but again, I stress all the time, that our focus when we sit down from a management perspective, our look at this is how do we drive dues growth center-by-center. And that dues growth can come from a number of things. It can come from membership growth, it can come from price increases, mix increases et cetera. And that's really how we manage this business.

So just focusing on that one element is certainly, it's an input item but it's not what drives us. I do think that generically as you look at things, the challenges that we have in the membership growth area still reside more in the clubs that are located in lower demographic areas. We still see economic headwinds in areas like that, and frankly expect that as we go into the future and we look ahead at 2012. That said the strategy that we are stating, we are executing and we truly are pleased with the execution of it.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

If I could just follow up with one question too.

**Mike Robinson** - *Life Time Fitness Inc - CFO*

Just a short one, Brian

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**Brian Nagel** - *Oppenheimer & Co. - Analyst*

If you look at, and again I understand we are talking about the growth issues much more holistically with different drivers, committed to three centers next year with some potential acquisitions, what keeps you right now with the company operating and better, what keeps you from sort accelerator faster to really start pushing new center of growth here?

**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

Brian, this is Bahram. We are pushing as hard as we can, however as we stated in the past, we are committed to looking for A and A+ sites across the country. We have numerous fantastic locations in the pipeline with the gestation times of three to four years. Some of them we started two years ago. Some we started a year ago. So we have some great sites that we are so excited about. But they are going to take longer time to get out of the pipeline for the opening.

And I want to emphasize a strategic approach that Life Time took two-and-a-half years ago, three years ago. Our commitment has been to improve every program running, cycling, basketball, yoga, swimming, weight loss, to be actually the best program in the country. I don't claim we are there across every program. But we are sure trying as hard as we can. That's the place we want to be.

And we want the customer to choose Life Time, not because of price, because clearly this is the customer who has recognized the best program for the area of their passion is at Life Time. So we don't really focus on the membership count as much as we focus on optimizing dues revenue and then recognizing that the customer who comes to us because appreciates the better programming and the best operator in the area of their passion. They also are more likely to spend in-center revenue. We like our strategy. We are committed to it.

We are confident and so we are also committed to finding all different ways way to grow the company. And as the next few years will prevail we'll demonstrate that our growth will become more balanced as a healthy way of life company rather than just square footage growth. Now, we are very committed to finding square footage growth and improving that as well but only in great locations.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Thank you.

**Operator**

Your next question comes from the line of Paul Swinand of Morningstar. Please proceed.

**Paul Swinand** - *Morningstar - Analyst*

Good morning, thanks for taking my call. I was wondering if you could comment on the incentive revenue drivers and how much of those are things that are new programs that you have added versus existing programs that you had in the past whether it's massage or the cafe. And then also part of that, have you done any analysis on how much the event business which is growing, is driving additional revenue in the centers or is there still not a lot of crossover?

**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

Good question. Let me take that on. We see two things. We are doing a better job let's say in personal training, but part of that is because of the way we connect the customers to the personal training. Part of that we have increased penetration of just

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pure programming, the personal training and part of it is because we are introducing new programs that our members can get involved in personal training. So it's a combination of all of these things that's driving in-center revenue.

The other piece is, you asked about athletic events. Athletic events, we look at it once we execute the full strategy and we are at the early stages of this, we are still investing more dollars in it than we are getting all the benefits we want out of it, still performing well but again I think we can do better. It isn't fully integrating the way we want to yet. So we are not getting as much, although we are getting some, training dollars or coaching dollars. It's not where we have the plans to get us to at this point. So there is some overlap integration, not as much as is anticipated when the program matures.

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**Paul Swinand** - Morningstar - Analyst

Thank you.

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**Operator**

Your next question comes from the line of Sean Naughton of Piper Jaffray. Please proceed.

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**Sean Naughton** - Piper Jaffray & Co. - Analyst

Hi. Thanks for taking my question. Over the last few years Q4 top line has consistently seen a sequential slowdown in the growth based on the guidance that you're providing for the full year, and it seems like the same thing is going to happen again this year. Is there something in terms of the business or the seasonality that is changing that revenue stream that we may not be thinking of?

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**Mike Robinson** - Life Time Fitness Inc - CFO

If you look at the second and third quarter are generally relatively strong growth for the in-center business pieces of our total revenue portfolio primarily that's summer activity, kids' activities, a number of summer camps, those types of things that really drive the sequential growth up from first to second, second and third quarters. So that's come back down in the fourth quarter. The second thing that drives that is actually the holiday periods. If you think about the holiday periods, the Thanksgiving week and the time around Christmas and New Years there's not a lot of -- there is a reduction in the spend that goes on, especially in areas like personal training, where normal daily routines are interrupted because of all of the holiday (inaudible) those are the big drivers and we anticipate the same thing this year.

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**Sean Naughton** - Piper Jaffray & Co. - Analyst

Okay. Thank you.

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**Operator**

Your next question comes from the line of Scott Hamman of KeyBanc Capital Markets. Please proceed.

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**Scott Hamman** - KeyBanc Capital Markets - Analyst

Hey. Good morning guys. Two questions. Number one, advertising and marketing. Can you help me understand what percentage of the increase or what part of the increase is tied to myLT Buck\$ versus some of the other things and what's the expectation going forward? And then secondly just on the CapEx guidance I believe it's the top end was ratcheted down and maybe you



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can kind of talk to if that was a timing issue around some of the growth stuff for next year or how should we think about that? Thanks.

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**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

Hello, this is Bahram. I will take the marketing and Mike will take the CapEx for you. The marketing, we are spending more and more dollars of our marketing dedicated to our existing customers so that's through myLTBuck\$ keeping them connected, making sure they come back and they engage in a personal training program or something else. So we have been giving these dollars and they also are set up where when somebody comes they get X amount first when they join and then so much in six months, so much in 12 months. So we have budgeted an increase and we're seeing our budgeting is pretty accurate in terms of those increases. So we'll see sequentially \$2 million, \$3 million, \$4 million a year more spent for right now on LT Buck\$ and that takes, I would say, about 60% of the increase on that marketing. And then I still believe that we are not investing as much as I would like towards branding Life Time truly as a healthy way of life company. Differentiating us from other health clubs and gyms. That's going to be work-in-progress so we're going to continue to invest in our branding and positioning of the Company in the next several years. So you should anticipate increase in marketing not flat or decrease.

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**Mike Robinson** - *Life Time Fitness Inc - CFO*

On the question on the CapEx I think you should just look at that reduction as just a refinement of our total year estimate. There's really been no change in our view of how we're driving both 2011, 2012 or beyond elements in the -- in that growth. It's-- the year has progressed just as we had expected it would from a CapEx point. (Multiple speakers)

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**Scott Hamman** - *KeyBanc Capital Markets - Analyst*

But the timing of the openings for next year aren't going to be changed from what you originally anticipated?

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**Mike Robinson** - *Life Time Fitness Inc - CFO*

No. The timing of those openings. I don't think we've gone through and said much about 2012. The three centers, the one center know we've announced is Mississauga, Ontario and that is a first quarter opening. We have begun the presale on that center and the other two centers I don't think we've -- we have not announced those presales yet so you can expect them to come a little bit later in the year, but in general no timing changes.

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**Operator**

Your next question comes from the line of Lee Giordano of Imperial Capital. Please proceed.

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**Lee Giordano** - *Imperial Capital - Analyst*

Thank you. Good morning. Can you talk a little bit about the trend and the cost of building out the new centers and, secondly, will you be changing the format at all evolving the concept as you build out new count units? Thanks.

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**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

The cost so far we don't see any reason to see an increase. Our numbers look very flat the last couple of years in terms of what the cost per square foot to build. It's mostly a function of the market and the cost of the property. We may spend as much as \$3 million to buy a piece of land or \$15 million depending on where we're going so -- and then some of the markets because

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of their just conditions cost more per square foot so we don't see any difference in what's going to happen next two, three years. The models that we have are working extremely well. We have refined a couple of alterations of our two and three stories to give us ability to get into a tighter, smaller site and maybe a little more urban, or the square foot of the land is not as big allows us to get a little more vertical and get up. Otherwise, the concepts are working, the clubs are working beautifully. We don't see a radical need to change the models right now.

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**Operator**

Your next question comes from the line of Michael Lasser of UBS. Please proceed.

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**Michael Lasser** - UBS - Analyst

Good morning. Thanks a lot for taking my question. Bahram, can you parse the price increases a little bit further. From your commentary it sounds like more of them are weighted towards new members but it seems like you have fertile grounds in that some of your members are deeply committed and are very -- have a very low likelihood of attriting so is there an opportunity to raise the pricing there? And then along those lines is the model changing a little bit where you're just trying to generate as much as you can from the in-center side and less worried about optimizing capacity and how is that going to look over the long-term?

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**Bahram Akradi** - Life Time Fitness Inc - Chairman, President, CEO

Okay. So we don't think the market that consumer sentiment is so strong that it's prudent for us to come in with any sort of a radical price increase for existing members. So we're very, very cautious to not send a signal to the customers that we want to take their dues up significantly here or there. Having said that I think as time goes on and we have had very, very modest or small price increases in our overall centers, I think that in years to come, maybe in two years or whatever, it gives us still a nice price-point opportunity.

Beyond that we have been committed as I mentioned, to take Life Time to a place of its own, healthy way of life company, Best-in-Class, programs to the point the customers who choose to come to us are not choosing to come to us because of price. We have been diligently executing towards that strategy. What I believe that will allow us to do in maybe two years or three years when the economy is in a much more robust than it is today, I hope, then we will have opportunity to do a little more dramatic price increase across-the-board. At this point we either do nothing or we do very small price adjustments for existing members, but having said that, I think you will see that our dues should continue to grow and our average dues should continue to grow in the years to come.

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**Mike Robinson** - Life Time Fitness Inc - CFO

I want to tackle the second part of that question in what we're seeing the future. Clearly there's an emphasis -- I want to go back to the comments that I made before. We're looking to optimize the total dues in the center. And we're looking to continue to drive in-center revenue growth because we think that helps the entire center economics in the sense that by getting people involved, by getting them to come into the club more often, to be connected more often, yes they're going to spend money. We're going to grow our in-center revenues in the fee-based services but they're also much, much, much more likely to stay longer.

The average life of a membership should grow, the retention should increase, the attrition rates hopefully continue to come down because of that. So it's a holistic strategy for us that I don't think you can just step back and say okay we're going to go from a model that is 65% to 70% dues to a model that's now 60% dues and 40% in center growth. I don't think that's necessarily what we're talking about here. What we're talking about is a holistic strategy that may differ slightly club by club but it is really

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driven to optimize the dues, the total dues in that club. Sometimes that's coming from price increase and mix increase, sometimes that's going to come from membership ramp or a combination but just as importantly the emphasis on delivering the best programming around because it maintains and grows the length of time and the ultimate take, the ultimate revenue that's coming in from that member -- from the life of that membership.

**Michael Lasser** - UBS - Analyst

That's really -- that's helpful. Let me ask one quick follow-up along those lines. Your commentary before about seeing more difficult trends in clubs that are in areas that are slightly lower on the economic income demographic scale. Presumably the profitability of those clubs is also lower. First, is that's correct? And how much is the delta between those clubs and some your better performing clubs in higher income areas?

**Bahram Akradi** - Life Time Fitness Inc - Chairman, President, CEO

It all depends on what we -- when we went into those markets, what we spent to build the clubs. Some of those clubs also have a lower total invested capital so that ROIC hurdles for those clubs are not as hard so when we go to the market, a market we spend more money on land, we spend more money on construction, operating costs may be more expensive, utilities may be coming at more expensive cost and then we collect significantly more revenue from the members. So you're just playing with bigger numbers. Percentages work out. Having said that strategically.

I emphasize again, we have been focusing on a customer base who can decipher and appreciate the fact that we are not offering hollow boxes full of equipment. They can appreciate the quality of our facilities, the quality of our people and the depth and the intensity that we have demonstrated around proving products -- programs that actually give them results. Not every customer is astute enough to appreciate that. So when we are in the more affluent markets the customer will appreciate the differentiation of Life Time so it works much more naturally when we are in more areas that are more challenged financially it's a little more difficult for them, they might be a little more concerned about price shopping and -- and that's what Mike is talking about. It's not a big number of our clubs. It's a small number of clubs and I don't want to put too much attention on that.

**Mike Robinson** - Life Time Fitness Inc - CFO

I guess I do want to come back to your point on profitability on that, and my comment on the profitability piece, a number of you heard me do a comparison when I call out a club like a Gilbert, Arizona or a Garland, Texas, something like that, where we saw -- we saw the membership counts and the revenue go down more than 10% as we were working through the recession. But if you look at the margins on those businesses, Gilbert, for instance, we were running that at -- at roughly a 38% EBITDA margin. That bottomed out in the 32%, 33% EBITDA margin. So still a very good robust margin, not what we would drive towards but still very, very good. And we have seen some improvement on that as we have worked through these challenging economic times.

**Operator**

Your next question comes from the line of Ed Aaron of RBC capital markets. Please proceed.

**Ed Aaron** - RBC Capital Markets - Analyst

Hi great, thanks. I just have wanted to follow-up on the Q4 guidance a little bit if I could with a clarification question. If I adjust for the performance compensation in both quarters it looks like the key for guidance implies a single-digit earnings growth rate which would imply slow down. Am I thinking about that the right way?

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**Mike Robinson** - *Life Time Fitness Inc - CFO*

I think you should -- you should step back look at it and say what we're giving you is a guidance rate that we feel confident, highly confident in and work from there.

**Operator**

Your next question comes from the line of Greg McKinley of Dougherty markets. Please proceed.

**Greg McKinley** - *Dougherty Markets - Analyst*

Yes. Thank you. In the absence of new centers opening, Mike, you had talked about some seasonal factors impacting the utilization of the club from Q3 to Q4. Should we typically think in the absence of new openings that we would also have sequential member declines from Q3 to Q4 due to the same reasons?

**Mike Robinson** - *Life Time Fitness Inc - CFO*

We typically see early in the fourth quarter continued sequential declines as you move off of -- as you again move back in that back-to-school season and out of the pool season so we don't as we look at it right now we don't see any difference in the trends lines that we have seen over the last couple of years that way.

**Operator**

And your next question comes from the line of Conner Brown of Thornburg. Please proceed.

**Connor Browne** - *Thornburg - Analyst*

Hey, guys. Nice quarter. Two-part question. Where can operating margins go over time as we look out a few years? If I exclude other revenues and other expenses from the calculation I think we got up over 28% in 2003. Since then I think we've add some operating leases into the center operations expense line, but today we're at 21% or so. So where's the upside there over the next few years, number one. Number two when can we expect other operating revenues to be higher than other operating expenses at some point in the future? Thanks.

**Mike Robinson** - *Life Time Fitness Inc - CFO*

So your first question, Conner, we have not given a target operating profit margin rate other than to say that we continue to expect to see improvement and good improvement in that. The one area that I always caveat on this is what's being -- what's going on on our in-center growth because that will come in at lower margins yet is a very good and key element to our businesses. That said as we look at the future and we look at the operating margin opportunities driven by first continuing to drive the strategy of dues and dues optimization that should deliver high leverage points and, second, to your last part of the question starting to see some profitability coming from -- or more profitability coming from some of those corporate businesses.

We continue to see a lot of opportunities. I'm not going to give you a specific number, but over time if you look at the next three, four years the ability to move that couple hundred basis points or more certainly something that we're driving toward. On the corporate businesses and how they relate to the other operating expense we're in various stages of program roll out in those areas. If you look at our endurance and events businesses, we have a number of races that are very profitable delivering 25% to 30% EBITDA margin. Our goal is to -- is to continue to expand this business, drive participation, drive races and continue



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to improve the profitability there. We're in more of a beginning stage in initiative called -- and business called myHealthCheck. We're investing in that. We see tremendous opportunity in that. That may be to another year out or so before we actually see profitability in that. All that said you should -- our end -- we anticipate -- we expected that the operating expense -- the other operating expense as you compare it to that corporate revenue is going to continue to narrow and we're going to continue to drive -- to optimize those businesses.

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**Operator**

And your final question comes from the line of Dana Walker of Kalmar Investments. Please proceed.

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**Dana Walker** - *Kalmar Investments - Analyst*

Good morning, folks.

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**Mike Robinson** - *Life Time Fitness Inc - CFO*

Good morning, Dana.

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**Dana Walker** - *Kalmar Investments - Analyst*

I'm going to try sneak in one or two here. Mike, you were just commenting about myHealthCheck. Can you talk about how many centers you are furthest along in rolling that out to and what it looks like in terms of offerings?

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**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

MyHealthCheck really is an independent program, it's not club-related. It's a company developed to really help rolling out of the new adjustments in the law took place in 2008, 2010, allowing the companies to distribute costs of health care differently than it was in the past. In 2008 the law allowed the corporations to differentiate the contribution by each employee as much as 20% between one and the other based on certain biometrics that is within their control, and in 2010 that law was adjusted that by 2014 that 20% would go to 30%. So for me to kind of give you guys a quick look at that based on average costs of health care per employee today and projected numbers by 2014 those numbers basically mean as much as \$2,000 to \$3,000 annually that would be different between what two different employees in a company could contribute toward their health care cost substantial.

There is a significant migration of companies gradually moving towards this model what we call the results-based or personal responsibilities based health care costs distribution and we believe that's going to be the way it's going to be for everyone in the next three to four, five years. We have built a fantastic program (inaudible) one of our companies inside. We think it has tremendous opportunities of allowing substantial number of memberships not in the clubs, memberships for myHealthCheck company, separate thing again. The revenue model for that is annually roughly about \$250 per employee, once again, it's a low margin business because it's going to be huge volume business. We are committed to it. We're confident it will be a very, very profitable platform. However, at this point it's been nothing more than investment in 2011, it's been basically lowering the operating margins some as a whole and we will see that being the same in 2012 and we think that we will actually see substantial profitability in it in 2013 forward.

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**Dana Walker** - *Kalmar Investments - Analyst*

Bahram do you see this though as being a discrete test done with an employee or is this a commitment to being a part of a physical fitness program?

**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

This is not a program and I'm emphasizing it has nothing to do.

**Dana Walker** - *Kalmar Investments - Analyst*

Okay.

**Bahram Akradi** - *Life Time Fitness Inc - Chairman, President, CEO*

With the clubs. In fact, what I want to be clear is that what we execute with this is not part of the club operation. We drive it, our vans, our trucks, mobile units, trailers, into the front of the corporations, we can test their employees, we can put them on programs. We can coach them, we can help the corporation develop a program where they can cost differentiate. This needs to be HIPAA compliant, it needs to have legal elements. It's complicated. It's not an easy thing. It's not a health club thing. It's a healthy way of life company.

**Operator**

I would now like to turn the call over to Mr. Heller for closing remarks. Please proceed.

**John Heller** - *Life Time Fitness Inc - Senior Director IR, Treasurer*

Thank you for joining our call today. We look toward to reporting to you our fourth quarter and full year 2011 results which tentatively has been scheduled for Thursday, February 16, 2012 at 10.00 AM Eastern. Until then we appreciate your continued interest in Life Time Fitness. Thank you and have a good day.

**Operator**

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect and have a great day.

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