

FINAL TRANSCRIPT

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LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Event Date/Time: Apr. 23, 2009 / 10:00AM ET

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

CORPORATE PARTICIPANTS

Ken Cooper

Life Time Fitness - Vice President, Finance

Bahram Akradi

Life Time Fitness - Chairman & CEO

Mike Robinson

Life Time Fitness - EVP & CFO

CONFERENCE CALL PARTICIPANTS

Scott Hamann

KeyBanc Capital Markets - Analyst

Tracy Kogan

Credit Suisse - Analyst

Tom Shaw

Stifel Nicolaus - Analyst

Ed Aaron

RBC Capital Markets - Analyst

Bakley Smith

Jefferies & Company - Analyst

Tania Bykkonen

William Blair & Company - Analyst

Greg McKinley

Dougherty & Company - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first quarter 2009 Life Time Fitness earnings conference call. My name is Lamanuel, and I'll be your coordinator for today.

(Operator Instructions)

Operator

As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to your host for today, Mr. Ken Cooper, Vice President of Finance. Please proceed, sir.

Ken Cooper - *Life Time Fitness - Vice President, Finance*

Thanks, Lamanuel.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Good morning, and thank you for joining us on today's conference call to discuss the first quarter 2009 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.

On today's call, Bahram Akradi, our Chairman and CEO, will discuss his thoughts on the first quarter and our underlying business trends. Following that, Mike Robinson, our CFO, will review our financial highlights. Once we have completed our prepared remarks we will take your questions until 11:00 a.m. Eastern time, and at that point in the call the operator will provide instructions on how to ask a question. I will close with the tentative date of our second quarter 2009 earnings call.

Finally, a replay of this teleconference will be available on our website at approximately 1:00 p.m. Eastern time today.

This conference call contains forward-looking statements, and future results could differ materially from the forward-looking statements made. Actual results may be affected by many factors, including the risks and uncertainties identified in our SEC filings.

Concurrent with the issuance of our first quarter results, we have filed a Form 8-K with the SEC. Certain information in our earnings release and information disclosed on this call constitute non-GAAP financial measures, including EBITDA. We have included reconciliations of the differences between GAAP and non-GAAP measures in our earnings release and our Form 8-K. Other required information about non-GAAP data is included in our Form 8-K.

Also, I'd like to take a moment to remind you that we are holding our annual shareholder meeting at 2:00 p.m. Eastern time today. Accordingly, we will be preparing for and conducting that meeting and will not begin responding to emails or phone inquiries until after that meeting, or approximately 3:00 p.m. Eastern. Your patience and flexibility are appreciated.

With that, let me turn the call over to our founder and CEO, Bahram Akradi.

Bahram?

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Thanks, Ken.

I would like to start with some cautionary comments and our action plan to address each. The macroeconomic environment continues to create headwinds. The effect of these are lower enrollment fees, generally higher marketing cost, a higher attrition rate, higher membership acquisition cost due to the need to offset the increased attrition, and pressure on average dues. Over the last 90 days we have challenged ourselves to create and execute an action plan that would address each of these areas.

First, let me expand on enrollment fees. We created and implemented a plan to control our enrollment fees and saw the results meet the goals we were looking for by the end of the quarter. For now, we believe our enrollment fees have stabilized to an acceptable level, albeit we want to continue to increase them as the environment and particular club demographics allows for it. It is where we need it to be, but not where we want it to be.

Next, our marketing costs -- they were nicely tamed by the second half of the quarter by some changes in our marketing approach, utilizing our existing member satisfaction to our advantage. Still, we're working on many initiatives today which will continue to focus on connectivity and call-to-action concepts. Our marketing costs [are controllable] (inaudible), and we believe we are positioned to maintain and improve efficiencies without losing -- and, in fact, enhancing -- effectiveness for member acquisitions.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

A third area of caution is a big one, attrition. Our membership attrition rates have remained higher than we like, even though we have made a slight improvement from the fourth quarter of 2008 to the first quarter of 2009. To state the obvious, our current attrition rates are much higher than we like. This is one of the biggest areas of focus for our company.

We have numerous initiatives and programs in place to help improve retention, all of which are too early to demonstrate any meaningful trends. However, I am very optimistic that we can make improvements in this area by executing well against most of these initiatives. Our ultimate goal for attrition is to be 36% or under on an annualized basis. I will make no claims of when this will take place or if our initiatives can get us to that result at all. But we are hopeful and intensely focused on getting there.

The next item is the level of membership acquisition cost. Naturally, by having increased churn we will have increased cost to offset the membership loss. There are three measures for this. Number one, our enrollment fees must be controlled at a level that is neutral or better when compared to the direct cost of each membership sale. Two, obviously a reduced attrition will help. Three, we will have more efficient marketing programs in place, which I was just mentioning we were working on.

Lastly, we have experienced a constant pressure on our average dues over the past six months. Some of this is unavoidable and a necessary part of remaining competitive in this tougher environment. Other parts are a function of better management and alignment of our entire sales operation. Over the past 60 days, we have overhauled our commission structure for the entire sales operation group. This went into effect April 1. We have seen immediate dividends in changed behavior and focus of our sales team on dues revenue, which has reduced the pressure on average dues for new memberships sold recently.

Those are the areas of caution. On the positive front, we have never been more invigorated, addressing the changes necessary to combat the macroeconomic trends, and we have had three main positives occur.

First, we have focused on a thoughtful and vigorous cost-cutting measure, with a big goal to eliminate all unnecessary cost, while we do not in any way, shape or form damage our customer satisfaction or our very strong brand. Mike will provide some details shortly.

Another big positive for our company is how quickly we have reacted to adjusting our new center of growth. Our goal has been to reach a level that our growth for the foreseeable future is funded by our cash flow from operations while simultaneously reducing our overall debt balance. We expect a small reduction in 2009 and a more meaningful debt paydown in 2010. To that effort, we have opened two successful clubs this year and we will open one additional club in 2009. We're ecstatic to demonstrate how powerful our cash flow from operation is, and we are confident we can be cash-flow positive this year.

A final positive mention is that we have been demonstrating how we can continue to grow our membership levels. Dues revenue has grown about 15% this quarter. I would like to emphasize that you should expect this growth to slow down as we slow down our new center openings.

With that, let me close with the fact that I can confidently say that Life Time Fitness is invigorated, fully engaged and energized to face the challenges in front of us. We will continue to hit it head on. We will win.

With that, I will now turn to Mike Robinson, our Chief Financial Officer.

Mike, here you go.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Thanks, Bahram.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Let me start with a discussion of our capital structure, cash and debt availability. I've often highlighted the cash flow from operations strength of this business model. Our first quarter results continue to prove this out. Our first quarter cash flow from operations was \$49.7 million, exceeding last first quarter results in a difficult environment.

Over the past several months, we've discussed our plans to slow our new center growth and fund this growth internally through our operating cash flow and current revolver availability. We've set our internal targets to be free cash flow positive in 2009 and 2010, paying down debt by reducing our revolver balance.

To that end, we plan to open three centers in 2009, two of which have opened in February -- Berkeley Heights, New Jersey, and Lake Houston, Texas. And our first club in the Memphis, Tennessee market, in the suburb of Collierville, is planned to open in June. Our capital expenditure expectations are now \$125 million to \$150 million, down from \$150 million to \$200 million. We currently plan to open three large-format centers in 2010.

Our approach is prudent, and we remain flexible with the timing of our capital expenditures. We are prepared to further adjust our spending should the environment dictate it.

We closed the first quarter with approximately \$56 million in cash and revolver availability, up slightly from year end 2008. Our net debt to total capital was 51.2% for the quarter, down slightly from the 51.8% at the end of last year. Our covenant calculations for the quarter continue to show significant room versus our covenant limits.

Although the credit markets remain very tight, we closed on a small mortgage in a Minnesota center during the quarter and remain in active discussions with a variety of financial institutions, primarily regarding mortgages. Please remember, we currently have over 30 facilities, with an asset cost on our balance sheet well in excess of \$500 million, with no mortgage financing against it.

In Bahram's remarks he discussed our focus on costs and efficiency improvement. Let me expand a bit here.

We are focused on cost controls across the Company, including central overhead costs, marketing and member acquisition costs and center operating costs. Central overhead includes our construction, real estate and development groups, which we have continued to downsize because of the slower growth profile. We continue to drive efficiency improvements and [remove] growth infrastructure across the rest of our central overhead structure.

Member acquisition and marketing costs came down in the last half of the quarter, driven by a number of initiatives, including more surgical enrollment fee pricing and commission structures.

Finally, we continue to gain labor efficiency improvement in our centers, as well as benefit from attacking many other center costs.

Now let's discuss operating results for the first quarter. Total revenue was \$206.4 million, up 11.9% from last first quarter. Our revenue growth in the quarter continued to be driven by two factors, including membership dues growth of 14.8% for the quarter. Membership growth of 15.1% outpaced membership dues growth. Part of this reversal is that we didn't see pricing -- that we didn't increase price on existing memberships in Q1 anywhere in the country.

The other factor is a carryover trend from 4Q 2008, where we've seen a mixed shift for incoming membership to be more single-oriented membership base. For example, we continue to see strong acceptance of individuals under the age of 26 joining Life Time Fitness. This mixed shift has continued to put pressure on our average dues.

The in-center revenue grew by 7.3% in the quarter. We did see our personal training business growth slow to approximately 2% over last first quarter, and the rest of our in-center businesses registered approximately 13% quarter-over-quarter growth,

Apr. 23, 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

with our cafe business continuing to register relatively strong growth. And, as has been a recent trend, our spa business continues at a slower pace.

Let me also take a minute to provide some highlights on our other revenue metrics. Memberships at March 31, 2009 totaled 599,919, which is an increase of 15.1% from last Q1. We've grown membership sequentially the last four quarters. As we look to the rest of 2009, we expect this growth rate to slow to single digits as we reduce the number of new center openings.

Our first quarter same-store sales had a 2.7% decline, and our 37-month mature same-store sales were down 7.9%. These two metrics, as expected, were driven by lower dues mix and in-center sales.

With respect to revenue per membership, we generated \$352 per membership, which is down 2.9%. In-center revenue per membership also decreased in the first quarter, to \$103, or a 7% decline. Again, as expected, the faster membership growth rate, the mix shift to more lower priced individual memberships and the economic environment were major drivers in these results.

Center usage remains high, with a slight increase in average member visits during the quarter. In addition, the number of inactive members declined from Q1 2008 to Q1 2009.

Moving to our margin analysis, the Company's operating margin in the first quarter was 15.7%. This is a decrease over Q1 2008 margin of 19.5%, but in line with our expectations. The main drivers in the margin decrease come from an increase in center operations occupancy costs from our sale/leaseback deals we executed in the third quarter last year, which added approximately \$4.3 million of rent expense, or over 200 basis points of cost. In addition, depreciation expense increased 170 basis points, driven by the late 2008 completion of remodel acquired centers, higher investment in centers opened in 2008 and early 2009 and the deceleration of revenue growth rates.

Our center operating margin for the quarter decreased from 41.7% to 38.5% as a percent of total revenue. Excluding the sale/leaseback transactions from the third quarter 2008, our center operating margins would have been 40.5%. As we experienced in the fourth quarter last year, higher membership acquisition costs and lower average dues also pressured center operating margins.

Marketing expense declined by \$1.2 million, or 110 basis points, due primarily to reduced direct mail advertising in the latter portion of the quarter and less pre-sale activity.

G&A expense increased \$1 million but declined as a percent of revenue from 5.8% to 5.7%. The increased costs were primarily the result of unabsorbed construction, real estate and development overhead from the reduction in our new center growth.

Other operating expenses increased slightly from growth in corporate businesses as well as losses on asset disposals.

As we make our way down the P&L, interest expense net of interest income increased to \$7.4 million from \$7.2 million last first quarter. Although debt balances are higher [in] capitalized interest costs reduced during the quarter, we benefited from low variable interest rates on our revolving line of credit.

Our tax rate for the quarter was 40.4%. We expect our 2009 effective tax rate to be approximately 40%.

That brings us to net income for the quarter of \$15.1 million, which is down 13.2%. Our net income margin for the quarter was 7.3%. Weighted average fully diluted shares totaled \$39.4 million for the first quarter. We expect our total year 2009 share count to be approximately 40 million shares. Based on our first quarter weighted average share count, our diluted EPS for the quarter was \$0.38, down from \$0.44 in the first quarter last year.

Apr. 23, 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Moving to our operating data, our first quarter trailing 12-month attrition rate was 42.7%, up slightly from the fourth quarter. Our quarterly attrition rate was 9.8%, compared to 9.3% for the first quarter of 2008. Although higher than we want, we have now seen two successive quarterly reductions, from 11.5% in Q3 to 10.8% in Q4 to 9.8% this quarter.

The number of open centers at March 31, 2009 was 83, compared with 71 at March 31, 2008. Of these 83 centers, 50, or 60%, are our large current model, and only 57% of all the centers have been open three years or more, which we classify as mature centers. As of March 31, 2009, we had approximately 8.3 million square feet, which is 18.5% greater than what we had at March 31, 2008, when we had 7 million square feet.

EBITDA totaled \$54.9 million in Q1, up 3.7% from last first quarter. EBITDA margins decreased to 26.6%, from 28.7% last first quarter. If you remove the impact from the sale/leaseback transactions, the first quarter EBITDA margin is 28.6%.

Cash flow from operations totaled \$49.7 million. This was up from the \$49.3 million reported in the first quarter of 2008. Again, this reinforces the strength of our economic model.

Turning to other financial highlights, cash outlays for capital expenditures for the quarter were \$49 million, which includes approximately [\$42] (corrected by Company) million related to growth or construction of our new centers and \$7 million for maintenance of our existing club base and corporate initiatives.

During the first quarter, our overall debt balance remained relatively flat, only growing \$1.4 million, to \$714.4 million as of March 31. This includes \$414 million outstanding on our \$470 million revolver.

Other balance sheet variances to note include working capital is down about \$10 million, primarily driven by a \$20 million decrease in construction accounts payable as we reduce our new center growth, partially offset by an \$8 million growth in accrued expenses, primarily accrued taxes.

With that, let me discuss our updated guidance for 2009. We've already discussed our CapEx expectation, so let me move on to financial guidance. We have not changed our revenue guidance, which is 8% to 12% growth, which equates to \$830 million to \$860 million. We expect net income of approximately \$62 million to \$68 million. We have increased the low end of the guidance from \$60 million to \$62 million, based on our first quarter results. This results in diluted EPS guidance of \$1.55 to \$1.70 per share. This brought the low end of our range up from \$1.50.

That concludes our prepared remarks regarding our first quarter 2009 financial results.

We're pleased to take your questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question will come from the line of Scott Hamann, with KeyBanc Capital. Please proceed.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Good morning. On the subject of attrition, can you just talk about maybe what your expectations are embedded in your guidance for the rest of 2009 and then kind of walk me through what specifically you're doing to address that situation?

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Mike Robinson - *Life Time Fitness - EVP & CFO*

Sure. I'll cover the first part of that, Scott, and then I'll let Bahram talk about some of the things that we're doing. Our expectations for the year are that the attrition rate, with the economy the way it is and continued pressure on that, our attrition rates will remain at about the levels we've seen over the last couple of quarters. Bahram, do you want to talk a little about --

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Sure. 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 love the club, etc. What we are doing is increasing 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 are confident we can improve the attritions from where they are at today. To what level, I can't tell you. The level I'd like to get to, as I mentioned, is 36% or under. I also want to emphasize, as we have demonstrated, we have confidence in 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 it's not doable. It's just not desirable.

So, and the details of what we are doing, I prefer not to get into. We are doing a lot of stuff I'm excited about, but we're going to keep it to ourselves as a competitive advantage. Now I'm going to turn it over for another question.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Well, okay, on a follow-up question, on your CapEx revision for this year, it seems a little bit higher than I thought it would be lopping off those three clubs at the back end of a year. Does that include some stuff for 2010 openings? Are they going to be early season openings that would -- you would incur some expense for that?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Yes, that's a good question, Scott. It includes two things. First of all, the CapEx number that we report is -- within our guidance -- is the cash outlay for capital expenditures that would be -- that would show up in the cash flow statement. That includes any change in payables. In other words, if you're carrying a higher payable, a construction payable from 2008, any paydown in that is included in that. So, and there, obviously, with the slowdown of growth, you'll take that payable balance -- we expect that we'll take that payable balance down. And it also includes dollars as we prepare for some of the large centers that we would be planning to open in 2009. That's correct.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Thank you.

Operator

And our next question will come from the line of Paul Lejuez, with Credit Suisse. Please proceed.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Tracy Kogan - *Credit Suisse - Analyst*

Thanks. It's Tracy Kogan filling in for Paul. A couple of questions -- first, can you guys talk about what you're seeing in some of the weaker housing markets? Are you seeing any stabilization there, or are they continuing to get worse? And then, Bahram, I was hoping that you could address the competitive landscape and whether you're seeing increased capacity reductions from some of your competitors. Thank you.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Yes, let me cover your first part of the question. And I think I saw something on the news yesterday that obviously the four states that continue under the most pressure are California, Florida, Nevada and Arizona. We have one club in Florida. We don't really feel that pressure in any way that way. We don't have anything in California, and we don't have anything in Nevada. So the real focus for us would be in Arizona.

And, as I've talked about in the past, we have four clubs in Arizona. One that we have felt pressure on through last year, and that continued this year, was a club in Gilbert, Arizona. Gilbert continues to comp negatively from a sales -- a same-store sales perspective, but it appears to be stabilizing. We're not seeing any significant drop from that.

The other thing that I talked about in the past on that, and I think it does give you a sense of how we can -- how these clubs perform even in that type of environment, a typical club for us, we like to have at maturity running at high 30% EBITDA margins. That particular club, with revenue which has come down and decreased over the last four or five quarters, runs at low 30% EBITDA margins, so still does very, very well, again, given the economic pressure that we've seen. So I guess that's a long-winded answer to say that yes, there is still pressure in those markets, but we don't see that pressure increasing any significantly right now.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Okay, I'm going to answer your -- go ahead.

Tracy Kogan - *Credit Suisse - Analyst*

Is that true in Detroit also, Mike? Are you seeing that stabilize, or is that worsening?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Detroit we talked a little bit about in the last quarter, that we've seen some sales -- same-store center decline pressure. That -- we did see the same-store sales decline again in the first quarter. But, again, it's not beyond the expectations that we had.

Tracy Kogan - *Credit Suisse - Analyst*

Thank you.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Okay. And I'll add to that, it hasn't been significant whatsoever. I mean, the -- it's still performing extremely well in Detroit. The question that you asked about other potential players with the -- are we seeing any sort of a breakdown of the lower margin clubs, the answer is yes, we have seen some -- a number of clubs close down. In fact, around the Gilbert club that Mike just mentioned, there has been about four or five small club closings just in the last two or three months.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

And, again, that's offset by still franchise-based operators and some of the local operators are still building. Whether or not this is commitments they've had from the past or the growth in the franchise-based business, the small, what I call kiosk fitness centers, or the 10,000 to 15,000 square foot fitness centers, it's something I expect to continue to see grow. As the real estate market softens, it's easier for these people to get favorable leases from landlords. And as unemployment rises it helps some people find themselves a job.

Short term can be somewhat of a noise. Long term I don't have a total concern about it, because many of these clubs are so unsophisticated in nature that they will continue to open clubs across the street from each other, and eventually, what we're seeing, the four or five clubs closing down around Gilbert facility in Arizona happening in other markets as well.

Tracy Kogan - *Credit Suisse - Analyst*

Great. Thank you. Good luck, guys.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Thank you.

Operator

And our next question will come from the line of Tom Shaw, with Stifel Nicolaus. Please proceed.

Tom Shaw - *Stifel Nicolaus - Analyst*

Hey, thanks, guys. First question, I guess you gave a little bit of color on some of the member acquisition costs and how that changed over the quarter, any kind of current update on what you're seeing from the member spending towards the later part of the quarter or even into April?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Overall, when you look at -- the productivity measure that we would look at is in-center revenue per membership. That was down 7% or so for the quarter. We've not seen it change dramatically from those levels really through the quarter or into April.

Tom Shaw - *Stifel Nicolaus - Analyst*

Okay, that's helpful. I guess for Bahram, what inning are we in here in the evolution of the myLT platform, and how does that really change the philosophy around advertising and marketing expenditures going forward?

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Well, that's a great question. Haven't been satisfied with the execution, internal execution of that at all in the last 18 months. However, we are making some platform changes and many, many operating changes here. We're seeing some rapid improvements now.

My expectation is that overall, the complete shift that we're marketing from the standard marketing of sending out direct mail and catching the response to where we are going with it is going to allow us to bring in the membership count that we need

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

at a reasonably -- and I want to be cautious with that -- more cost saving in the member acquisition. I believe we can acquire all the members we need to maintain the memberships level we need to get.

If we execute those things according to the original vision, I believe it'll take us about 90 more days to see some real improvements that we can share with you guys factually. I don't want to get in too many details right now, if you allow me, because I want to make sure we can show you guys results.

Tom Shaw - *Stifel Nicolaus - Analyst*

Sure.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Okay? I don't want to get into details of it.

Tom Shaw - *Stifel Nicolaus - Analyst*

Okay. And one last one, if you looked at since really 2007 and you opened your first clubs in New Jersey. You had the new three-story format. You had the smaller format such as Rockville, Maryland. What have you learned from these club openings? And obviously the pace of growth is being brought down, but what have you learned so far in how that will maybe impact how you look at new clubs for 2010 and beyond?

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Look, over my personal career in the clubs, club business, and in the course of Life Time, we have built clubs from -- we operate clubs from 10,000, 11,000 square feet all the way to 300,000 square feet. And, frankly, we have small clubs that have great rate of returns and small clubs that don't. We have large clubs that knock the ball out of the park and are at expected ROICs and we have large clubs that don't. So trying to get a formula, an (inaudible) categorization that you would say the jumbo clubs don't work great and the small clubs don't work great, midsize clubs work, you just cannot do that. I mean, if anybody tries to put them in any sort of a classification, I think I can logically and factually rebuttal those comments.

What we know is that when we put the club in the right market and we deliver the right product, it works. And the Rockville club is a successful operation. And the two clubs in New Jersey are great success, as I'm sure any of you guys who are in that market could feel it by just going in there yourselves. So we're seeing a variety of performances in variations of our clubs.

And so the focus right now for Life Time is to demonstrate to everyone for once and for all that we can be very, very strong cash flow by just taming our growth. And that's what we're going to do while the credit environments are uncertain. We're not going to kind of put the foot on the gas in terms of growth. And, but we certainly have the ability to increase that once we are absolutely certain that the headwinds are behind us and the credit markets are open.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Let me add just a little bit of color. I think part of your question implies just how are some of these newer clubs performing? And, as we have talked about in February, those two East Coast clubs that we just opened in New Jersey are performing very well. We're running ahead of our membership plan in both cases. Those centers are over \$1 million a month in revenue. At this point in their very, very young life, that's extremely encouraging for us.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

The three-story center we've talked about, we've got two of those up. We've got one in the Houston market and one in the Chicago market. And, again, together those clubs are performing like we would want. One happens to be a little bit under our plans right now and one happens to be over our plan.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

And the one under our plan, frankly, we have opened in a magnificent lifestyle center, huge, and the -- because of having this happen in the economy, we opened in September, and the first next business that is opening was just about two weeks ago. So we've been sitting in the middle of a construction zone, and I would not have any expectations. In fact, the club has performed above what I would have thought it would do being in the condition it has been. So I have huge expectations for that club to ramp this year as the rest of the center starts coming towards more of a completion by midsummer.

Tom Shaw - *Stifel Nicolaus - Analyst*

Great. Thanks for the color, guys.

Operator

And our next question comes from the line of Ed Aaron, with RBC Capital Markets. Please proceed.

Ed Aaron - *RBC Capital Markets - Analyst*

Great, thanks. Good morning, guys.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Good morning, Ed.

Ed Aaron - *RBC Capital Markets - Analyst*

I was hoping you could elaborate a little bit on your decision to cut the CapEx guidance. I'm all in favor of conservatism, but my impression from last quarter was that that was more or less a contingency plan in the event that earnings were tracking toward the low end of your guidance. But you actually narrowed the low end upward, so I'm just a little puzzled there.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Okay. I emphasize again, I believe that the markets today demonstrate the fact that there's uncertainty in the credit market in the way that even though we are trying, and we have some signs that we will be able to get some mortgages, there is no assurance that it will happen. Furthermore, I think there has been this underlying thought that Life Time Fitness is going to blow itself out with growth and get in trouble.

We have such a strong cash flow, and we just want to demonstrate that, reduce our debt balance and be firmly in control of opportunities ahead. We feel great about still opening three large-format clubs this year, another three next year and so on. Again, and when the market gives us complete green light that everything's back to normal, we can step on increasing the growth very quickly.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Ed Aaron - RBC Capital Markets - Analyst

Okay, thanks. And my second question was just on the center operating expenses. On a per center basis, after making some adjustments for incremental rent and maybe some higher commission expense, it seems like they were probably down about 3% or so on a per club basis year over year, and just with the fact that usage is actually higher on a per member basis, I'm trying to understand where you were able to cut inside the center without hurting the member experience.

Mike Robinson - Life Time Fitness - EVP & CFO

Yes, well, that's -- I'm trying to reconcile the way you're talking about it to overall margin, and you've touched on -- there are three primary elements to that margin pressure. Number one was the increased occupancy cost from the sale/leasebacks, over 200 basis points. The next thing was the commission or direct sales costs in excess of enrollment fees that probably had 50 or 60 basis points of pressure in the quarter. And then the next [overriding] thing was just the lower average dues that bring your -- that brought your revenue line down a little bit. So you're correct in the assumptions as you look at that.

From a cost perspective, it really is every line on -- every controllable expense line on the P&L. It starts with controllable labor, and for us we term that our operations labor costs. We have put more and more tools in place, labor efficiency tools, that help us schedule our labor tighter. And we expect -- we budget and we expect efficiency improvement in that labor cost. We saw that in the first quarter. We actually saw that slightly better than our plan. You move down the line to our occupancy costs, to our utility costs, to our telephone costs, to those types of costs, and, again, there's a tremendous amount of focus, line by line, on ensuring that we are spending only what we need to in those areas.

Now, go back big picture. We are not going to -- we have a tremendous, strong brand, and we are not going to [degragate] that in any way. And so we must maintain the proper repair and maintenance dollars, the proper maintenance CapEx dollars, and that friendly, smiling, helping face where it's expected and needed. So it's a balance, but it's a balance that we continue to see opportunity on, and we work hand in hand with our operations folks day in and day out to prove that.

Ed Aaron - RBC Capital Markets - Analyst

Thank you.

Mike Robinson - Life Time Fitness - EVP & CFO

You're welcome.

Operator

And our next question will come from the line of Bakley Smith, with Jefferies & Company. Please proceed.

Bakley Smith - Jefferies & Company - Analyst

Oh, hey, guys. Just two questions. On -- I guess first on attrition, I mean, do you have the sense for what share was basically people that you kind of shook out that weren't really coming to the clubs versus those that were -- I mean, you spoke about it a little bit, but I just was wondering if you had a sense for sort of the share between that and the people that really had to cut back despite the fact that they were showing up every week.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Well, 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. In some clubs, and this doesn't break down exactly, but some months in certain clubs you may see 50%, 60% of the attrition, they write down money as the reason they're dropping out.

So it completely has shifted to money being the number one reason while we have had our increase in attrition, and it's the largest portion of our attrition today. And that's why we are 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 it's too much value. And that's what we have to continue to work on. Of course, while things come back, all of that will help us tremendously to have a strong comeback, because the value proposition has got to be stronger and stronger all the time.

Bakley Smith - *Jefferies & Company - Analyst*

Okay. And I guess this kind of dovetails with that, because my next question was how do you view -- I know that you're looking at your in-store ops and trying to control those, but how do you view that tradeoff between having that trainer on duty versus not in the case that you get somebody that shows up that's never done it before and wants to try it, but now -- you know what I mean? Like how do you view, how are you weighing, how are you evaluating, the service level versus the cost saves?

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

Yes, now you're asking a question that the answer is a thousand different things. If you heard what I said earlier, our number one asset is our strength, our brand and our member satisfaction. As we've mentioned to you, we run a very systematic approach to customer satisfaction called Net Promoter Score. We do it accurately and according to the book. And we have had steady increase in our member satisfaction surveys to near 45%, 46%, 47% system-wide. This -- compared to other service companies, other products in the country who do this accurately and according to the book average about a single digit, 6%, 7%, 8% customer satisfaction.

So the one thing Life Time Fitness is never going to give up is that intensity towards giving the customer satisfaction. And, in fact, part of my strategy of future marketing is utilize that satisfaction. So we are not going to damage our brand, and we're not going to be accepting any sort of a cost-cutting measure that would result in a lowered experience from our customer base.

Having said that, if you look hard enough, there is always room to find efficiencies, particularly when you're a company that has had four plus years of every quarter hitting our financial results and our estimates. I think sometimes you may think you are running efficient, but there are areas that you probably have been a little more relaxed than you could have been. So we have spent more time focusing on where we can take cost out where it does not affect our customer experience, and we have been successful, and I believe we still have a little bit of additional room at the club.

However, the bulk of the money we are taking out, out of our cost, is at the corporate office overhead, which was largely built on growing at the pace of 12 or 13 or 14 or 15 clubs a year, which at this point is not necessary.

Bakley Smith - *Jefferies & Company - Analyst*

Thanks.

Operator

And our next question will come from the line of Tania Bykkonen, with William Blair. Please proceed.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Tania Bykkonen - *William Blair & Company - Analyst*

Hi, it's Tania, calling in for Sharon.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Hi, Tania.

Tania Bykkonen - *William Blair & Company - Analyst*

One of the questions Sharon has was answered, I guess, on the call, so she wanted more detail on that, cost cutting. But then on the revenue side, we're wondering where do you get the confidence to reiterate revenue guidance given the deterioration in some of the metrics, and then Mike, I think, mentioned the in-center revenue for members, sort of a [dissimilar] rate [as it was]. I'm just trying to understand, and you mentioned increasing the value proposition, just trying to get your thinking on the revenue guidance given the deterioration in metrics.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

It's because when we did our guidance, we were not thinking we're going to be in the land of milk and honey this year. We thought we were going to be in a tough macroeconomic conditions. We thought we will be in headwind throughout the year. And we planned for that.

Tania Bykkonen - *William Blair & Company - Analyst*

Okay. You had built-in cushion? And then, second, you've already mentioned in terms of comp sort of some stabilization in Gilbert and a little bit about Detroit, but just in general, in the aggregate, did comps across the regions show signs of stabilization in the quarter, or did they deteriorate?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Well, comps were down.

Tania Bykkonen - *William Blair & Company - Analyst*

Right.

Mike Robinson - *Life Time Fitness - EVP & CFO*

So, I mean, from the first quarter of last year.

Tania Bykkonen - *William Blair & Company - Analyst*

Right.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Mike Robinson - *Life Time Fitness - EVP & CFO*

So, but again, across the -- or as you're looking at and trying to compare it with the fourth quarter of last year, it was relatively stable.

Tania Bykkonen - *William Blair & Company - Analyst*

Okay. All right. Thank you.

Operator

And our next question will come from the line of Greg McKinley, with Dougherty & Company. Please proceed.

Greg McKinley - *Dougherty & Company - Analyst*

Yes, good morning. Just a couple of real quick numbers questions. I think G&A typically is up sequentially from Q4 to Q1 but maybe a little bit higher this year than what I expected. Could you talk a little bit about that? And should we be expecting expense rates on that line item to decline on a quarterly basis as the year progresses? And then also, with your view for free cash flow this year, should we expect the interest expense sort of having hit a high water mark in Q1?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Well, let me answer that last one first and then go from there. We do not expect interest expense to have hit the high water mark. We expect that will continue to increase, primarily because capitalized interest will continue to come down during the year as our construction progress balance reduces.

Greg McKinley - *Dougherty & Company - Analyst*

Okay.

Mike Robinson - *Life Time Fitness - EVP & CFO*

And I don't know -- it's relatively low rates today. I can't -- I don't have a crystal ball that can tell you what our revolver rate's going to look like in the third and the fourth quarter. So I clearly do not expect that our -- I expect that our interest expense line will continue to grow.

Greg McKinley - *Dougherty & Company - Analyst*

Okay.

Mike Robinson - *Life Time Fitness - EVP & CFO*

Let's talk about G&A a little bit. A couple -- you asked a couple of questions in there, and let me try and address those. It's down as a percent I think 10 basis points, from 5.8% last year to 5.7%. I expect that that leverage will continue, and we should get more leverage as we go through the year.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

In the first quarter we spent about \$1 million more than we did in the first quarter of last year. There are a few elements to that, but one of the bigger ones is we had some costs that accumulate within the construction and the real estate and development groups that typically are fully absorbed into projects, and in this particular case, with the growth slowdown, you've got some timing effect, but you also have some effect where you don't -- we had some costs that were not fully absorbed within projects. And I expect that that will continue on but get to be smaller as we go through the year. So sequentially I would expect that we will start to see some decline in G&A dollars as you go into second, third and fourth quarters.

Greg McKinley - *Dougherty & Company - Analyst*

Okay, great. Thank you.

Mike Robinson - *Life Time Fitness - EVP & CFO*

You're welcome.

Operator

And our next question, a follow-up question from Scott Hamann, with KeyBanc Capital. Please proceed.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Mike, could you just touch on some of the trends that you saw with membership and attrition month to month throughout the quarter?

Mike Robinson - *Life Time Fitness - EVP & CFO*

I'm hesitating because we normally wouldn't give that type of color, and I really don't want to give that type of color. Again, I think that -- I think from my perspective the quarterly results really do lay out what we were seeing month to month, with one caveat. And that is, as Bahram mentioned and I mentioned in the -- in our prepared remarks, that we do expect membership growth, that membership growth rate to slow as you move on each quarter through the year, mainly because we have cut back our growth and we don't have anywhere near the new clubs coming online. For instance, we only have one active pre-sale today. So you should expect that that membership growth -- and it would have come down from that January very, very strong number -- down as you move on through the year.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. And then just maybe in the quarter, what percentage of the memberships that you added were kind of in this single, maybe call it lower margin type membership, versus what you saw in the fourth quarter and your expectations for the year?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Yes, again, we're not going to get into specifics here. However, I will comment on some general things. We have seen -- first of all, historically you see about 50%, 55%, maybe 60% individual membership sales. That has gone up in the last six months or so. We have seen -- we planned and have seen the under-26 memberships be stable at roughly what we were selling in the fourth quarter, and that's about where they came in in the first quarter of this year. We also, we saw early in the quarter more pressure on average dues. That improved a little bit in the second half of the quarter, but not significantly. We've got a number

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

of things that we're looking at to try and help that along, but a lot of those things were initiated late in the first quarter or in the second quarter.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. And then, finally, on the lower enrollment fees for the quarter, can you quantify what impact that had on center ops?

Mike Robinson - *Life Time Fitness - EVP & CFO*

Can you repeat that? The lower enrollment fees -- repeat the question for me.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Yes, just, I mean, last year you had said that you took about a 1% hit because of the lower enrollment fees and the inability to really offset that with --

Mike Robinson - *Life Time Fitness - EVP & CFO*

Right, right, right. The impact in the first quarter was roughly 0.5 point, probably 50 or 60 basis points of increased member acquisition costs coming from lower enrollment fees and higher direct costs associated with the sale of those memberships.

Bahram Akradi - *Life Time Fitness - Chairman & CEO*

But we have corrected that, and we expect to be able to be neutral on acquisition cost versus enrollment fee for the remainder of the year.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

All right. Thank you.

Operator

And at this time I would like to turn the presentation back over to Ken Cooper.

Ken Cooper - *Life Time Fitness - Vice President, Finance*

Thank you for joining us on the call today.

As I mentioned at the start of the call, we will be holding our annual shareholders meeting this afternoon.

We look forward to reporting to you our second quarter 2009 results, which tentatively has been scheduled for Thursday, July 23, at 10:00 a.m. Eastern. Until then, we appreciate your continued interest in Life Time Fitness. Thank you, and goodbye.

Apr. 23. 2009 / 10:00AM, LTM - Q1 2009 Life Time Fitness Earnings Conference Call

Operator

And thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.

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