FINAL TRANSCRIPT

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LTM - Q2 2006 Life Time Fitness Earnings Presentation

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PRESENTATION

Operator

Good morning ladies and gentlemen and welcome to your Q2 2006 Lifetime Fitness Earnings presentation. My name is Rob and I will be your operator today.

[OPERATOR INSTRUCTIONS]

At this time, I would like to turn the conference over to your host for today's call, Mr. Ken Cooper.

Ken Cooper - *Life Time Fitness, Inc. - IR*

Good morning and thank you for joining us on today's conference call to discuss Lifetime Fitness's second quarter 2006 financial results. We issued our second quarter earnings press release this morning. If you did not obtain a copy, you may access it at our Web site which is lifetimefitness.com.

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In a moment, Bahram Akradi, our Chairman and CEO, will discuss key highlights from the second quarter, our press release that was issued earlier today regarding our newest operations, and our other recent events. Following that, Mike Robinson, our CFO, will review the quarter and financial information in greater detail.

Once we have completed our prepared remarks, we will then take your questions until 11:00 a.m. Eastern time. At that point in today's call, the operator will give instructions on how to prompt the questions. Finally, a replay of today's teleconference will be available on our Web site after 1:00 p.m. Eastern time today.

To make sure we have time for everyone's questions, we respectfully request that you limit yourself to one specific question. If you have additional questions or follow-up questions, please reenter the queue again.

Before I turn the call over to Bahram, I would like to remind everyone that today's conference call contains forward-looking statements and future results could differ materially from the forward-looking statements made today.

Actual results may be affected by many important factors including risks and uncertainties identified in today's earnings release and in our SEC filings. Concurrent with the issues of our second quarter earnings 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 that comply with Regulation G, included in our earnings release or in our Form 8K or reconciliation of the differences between GAAP and non-GAAP measures, including EBITDA and share based compensation expense affect the comparisons. Other required information about our non-GAAP data is included in our Form 8K.

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

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Thanks. Good morning, everyone. We are very excited to be with you to discuss our second quarter and first six months of the year results. However, before I do that I would like to take a quick moment to say thanks.

We are just past our two-year anniversary date of becoming a public company. Thanks to our investors and just as importantly, thanks to our 11,000 team members who helped us fulfill the Life Time Fitness experience.

I hope you saw our press release from this morning regarding an exciting opportunity to expand our business by adding several health and fitness centers to our portfolio through new leases. This transaction further solidifies our geographic presence in the Twin Cities and immediately expands the array of our product offerings to our members. In addition, it allows us to enter the Florida market with a large format center in a very strong demographic and attractive area, Boca Raton.

Mike Robinson will discuss the financial details a little bit later. However, let me highlight that this opportunistic transaction required no cash purchase price. We believe it will be slightly accretive, yet this year and will improve firmly in the future years. All in all, we are able to serve over 25,000 additional memberships immediately with great opportunities to grow that number over the next few years.

The foundation of our success as always is driven by continuous focus on our member’s point of view. We have thoughtfully and diligently planned how to apply this foundation to these new facilities, programs and team member certification processes which will deliver a wow experience to a whole new group of members.

I will now turn to our second quarter results. Revenue is up 28% for the quarter. Net income is up 20% for the second quarter and is up 43% when excluding share based compensation expense. In addition, we increased operating margins in the quarter if you exclude share based compensation expense. And our cash flow delivery remains strong.

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Let me review our three fundamental growth strategies with you. First, is new center growth. Our 2006 plan calls for eight new center openings. We opened our third center of the year on May 4, in Allen-McKinney, Texas, which is a suburb of Dallas. We remain on track to open the other five centers for the year. This includes South Valley, Utah on August 3, and additional openings in Overland Park, Kansas, Palm Valley, Arizona, Scottsdale, Arizona, and Alpharetta, Georgia. With the transaction announced today, we will add an incremental six centers to our portfolio, and we will end 2006 with 60 centers.

Our second growth strategy is optimizing dues revenue growth through membership ramp and pricing. We closed the quarter with more than 393,000 memberships, or 17% year-over-year growth. I want to take a second to remind everyone how we look at growth at Life Time Fitness. Our primary goal is for membership dues growth to outpace our unit growth rate. And for the 14th consecutive quarter, we've done that. Our dues revenue grew 25.2% for the quarter. This incremental growth above membership growth is driven by selective price increases and positive membership mix changes.

Our third growth strategy is increasing our in-center revenue, which grew over 40% for the quarter, and is up over 41% year-to-date. Average in-center revenue for membership increased by nearly 19% in the quarter to $90, from $75 in 2005. We continue to place a laser focus on this part of our business. In particular, I'm excited at the strides our fitness R&D team have made on developing new industry leading programs for our members.

Through our focus and commitment, we continue to deliver on each of our three growth strategies. In addition, we enhance the Life Time Fitness brand through our magazine, Experience Life, and our athletic events. Along those lines, our marquis event, the Life Time fitness Triathlon was held on July 15 with great success. You can see the broadcast of the event as it will be televised in high definition nationally this weekend on Saturday, July 29, at 4:30 p.m. Eastern time on NBC. I strongly encourage all of you to tune in if you can.

The event continues to enhance our brand nationally and will continue to grow. New this year is creation of the Life Time Fitness Triathlon Series, that will include the four most prominent Olympic distance triathlons in the United States, including New York, Chicago, Los Angeles and Minneapolis. My many, many thanks to each of our race producers for their partnership in making this inaugural series a reality.

Our company and our management team remains focused on delivering solid results. I cannot stress enough how pleased I am with the commitment and energy of our senior management team and the enthusiasm of our entire work force to make a difference in people's lives. It's an exciting time for our company.

With that let me now turn it over to Mike Robinson for more detailed discussion of second quarter and year-to-date financial results.

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

Thanks, Bahram. Before I get into our second quarter financial results, let me discuss some of the highlights of the transactions we communicated earlier this morning. We entered into a lease with WP Carey for five fitness centers in Minnesota and one in Boca Raton Florida. As you may recall, WP Carey is the firm with which we executed a sale-leaseback transaction for two centers in Michigan in 2003. In consideration for entering these six leases, WP Carey transferred ownership of four other properties in Minnesota to us for no additional cost. We will continue to operate two of these properties, Oakdale, located in Minnetonka, which is a standalone racquet facility operated as a satellite facility of our Minnetonka center; and Burnsville, which will be used as an operating preview location for the Lakeville, Minnesota center which we will open in 2007.

The other two clubs have been announced for closure by Wellbridge, and we plan to sell these two properties in the future once they are vacant to help fund the capital improvements we plan to make to the leased facilities. In addition, we entered into a separate lease with the City of Minneapolis for a fitness center in the Target Center Arena in Minneapolis. When everything is said and done, we will have effectively increased our total portfolio of centers by six, to 55 operating centers as of today,

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including the additions of Moore Lake in Fridley, Minnesota, St. Louis Park, Minnesota, 98th Street center in West Bloomington, Minnesota, Crosstown center in Eden Prairie, Minnesota, Flagship Athletic Club also located in Eden Prairie, Minnesota, the Arena Club in the Target Center in Minneapolis, and the Boca Raton Florida Athletic Club.

We are consolidating one small format Brooklyn Park center of ours into the Moore Lake center. The Oakdale tennis facility will operate as a satellite of or Minnetonka facility. The Burnsville facility will operate as a pre-sale location for the planned Lakeville center we plan to open next year. Because of their functionality, these three locations are not considered centers in the overall count.

The net incremental effect of this transaction for 2006 is expected to be approximately 25,000 memberships, approximately 18 to 20 million dollars in revenue, approximately $800,000 to $900,000 in incremental net income, or approximately $.02 in diluted EPS, and an additional 10 to 15 million dollars in additional capital expenditures.

As Bahram mentioned, we did not pay any cash or stock for these properties. The 10 to 15 million dollars in capital expenditures reflects our plan of 2006 remodel investment to help bring these centers to our expectations. We plan to invest an additional $15 to $20 million in capital expenditures in these facilities next year as well.

On an annualized basis, we expect this transaction to result in approximately 45 to 50 million dollars in revenue, and approximately 3 to 3.5 million dollars in net income, or $.08 to $.09 of diluted EPS. We will increase our square footage by approximately 800,000 fitness center square feet, net of the Brooklyn Park consolidation.

Now, let me provide details from the second quarter. We continue to see strong financial performance across the board. Let's start with revenue. For the second quarter, total revenue was $122.5 million, versus $95.6 million for the second quarter 2005, an increase of $26.9 million or 28.1%. Revenue for the first six months of 2006 totaled $237.9 million, up 28.6% from last year.

This strong growth was driven by total center revenues, which grew $26.1 million or 27.8% to $119.9 million for the quarter and is up 28.3% to $233.1 million year-to-date.

Our membership dues stream which represented 65.8% of total revenue grew 25.2% or $16.2 million in the quarter. As you may recall from our first quarter comments mentioned earlier by Bahram, we're using the price of our dues to manage the member experience. Therefore, initiatives like our junior memberships, sports upgrades and selective price increases in capacity centers have all played a role in the dues growth, while at the same time managing membership levels of some of our centers operating over capacity.

Enrollment fee revenue reported net of refunds represented about 4.5% of total revenue for the quarter, an increased to $5.6 million to $5.5 million last year, an increase of 2%. We're up slightly on a year-to-date basis, increasing from $10.1 million to $10.6 million or 5%.

As you may recall, we defer enrollment fee revenue and related direct costs until a center is open, and then recognize them over 36 months or the average life of a member. In-center revenue, which is primarily generated from personal training, cafes, spas and member activities business and represents 27.6% of total revenue grew to $33.8 million, up $9.8 million or 40.6% over last year's second quarter due to general membership growth across our system, as well as the increased penetration to our existing membership based, as evidence by the nearly 19% growth in average in-center revenue per membership. Year-to-date, in-center revenues totaled $66.1 million, up 41.6% from last year. In-center revenue continues to be the fastest growing segment of our business.

Other revenue totaled $2.6 million for the quarter, up from $1.8 million last year due primarily to increased revenue from our media advertising sales in our Experience Life magazine and rental income. Please keep in mind that the financial results of the Life Time Fitness Triathlon are deferred until the event occurs, which will be in the third quarter, where we still expect this to be an investment for the company. On a year-to-date basis, other revenues increased from $3.3 million to $4.8 million or 44.2%.

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Moving to operating expenses, just a note here as I did last quarter, I will discuss these expenses both including and excluding share based compensation expensed to aid in your comparison. The company's operating margin decreased from 21.4% to 19.2% as compared to the prior second quarter. For comparison purposes, excluding the $3.7 million of share based compensation expense in the second quarter, which included the final two tranches of the market condition options which did vest, operating margins improved from 21.4% to 22.2%, even with the significant growth of our in-center business that come at a lower margin and the waiting of centers early in their lives.

The main drivers of this margin improvement included G&A leverage, more efficient labor utilization in our center operations, and improved financial performance in our corporate businesses such as our media and magazine.

As we look to the rest of 2006, excluding the impact of share based compensation, we expect operating margins to expand slightly in the second half of the year in our base business driven by our G&A leverage and a more balanced mix between newer and mature centers.

This is prior to layering in the new centers we talked about earlier. Including the operations we just assumed, we anticipate total operating margins to reduce slightly due to integration acquisition costs and the lease expenses associated with these new facilities.

Center operating expenses totaled $68.5 million for the quarter, up from $52.8 million for the quarter last year. This increase of $15.7 million is due to increased payroll and other general costs to support the membership ramp in our new center growth. Year-to-date, center operating expenses were $133.6 million, up from $102.4 million for the first half last year. Share based compensation expenses within center operating expenses totaled $.9 million for the quarter and $1.3 million for year-to-date.

For the quarter, total center operating costs as a percent of total revenue increased to 56% from 55.3% in the second quarter 2005. This increase was due to incremental share based compensation expense. Year-to-date, total center operating costs as a percent of total revenue were 56.2%, compared to 55.4%. For comparison purposes, excluding share based compensation expenses, total center operating costs for the quarter improved as a percent of total revenue to 55.2% of total revenue, down from 55.3% in the second quarter 2005.

Advertising and marketing expense was $4.7 million for the quarter, up from $2.6 million the same period last year. As a percent of revenue, advertising expense increased from 2.7% last second quarter to 3.9% this year. The variance from quarter to quarter is due to the number of pre-sales in operations and a more focused marketing programs promoting in-center businesses.

On a year-to-date basis, advertising and marketing expenses totaled $10.6 million, up from $6.9 million last year. As we look at the rest of 2006, advertising and marketing as a percent of revenue will fluctuate quarter to quarter based on pre-sale activity and center initiatives. For the year, we continue to expect these costs as a percent of revenue to be slightly up as we invest in programs highlighting our in-center businesses.

General and administrative costs totaled $10.9 million for the quarter, up from $7.3 million in last year's second quarter due primarily to approximately $2.8 million in share based compensation expenses. As a percent of revenue, G&A increased from 7.7% to 8.9% in the quarter. For comparative purposes, excluding the share based compensation expense, G&A expense as a percent of revenue decreased from 7.7% to 6.6%. For the first six months of 2006, G&A totaled $19.7 million as compared to the $13.8 million for the first six months of 2005. This included $3.6 million of share based compensation expense in the first half of 2006. As a percent of revenue, G&A increased from 7.5% to 8.3% for the first six months of the year. For comparative purposes, excluding the share based compensation expense, G&A expense as a percent of revenue decreased from 7.5% to 6.7% for the first six months of the year.

Longer term, again, excluding the impact of share based compensation expense, we expect G&A leverage to continue to be a key component in driving operating margin expansion this year.

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Other operating expenses which include costs associated with our Experience Life magazine, our nutritional business, our athletic events division, our restaurant, Martini Blu, and rental property costs totaled $2.6 million for the quarter, versus $3.2 million last year, and year-to-date totaled $5.6 million, compared to $6.2 million last year. These decreases were mainly driven by cost improvement.

As a percent of revenue, these expenses improved to 2.2% from 3.4% last Q2 driven by these cost improvements. We continue to expect these costs as a percentage of revenue to improve slightly in fiscal 2006. Our Triathlon branding investment will be absorbed here in the third quarter.

Depreciation and amortization totaled $12.1 million, compared to $9.2 million in the second quarter last year, and $23.7 million year-to-date, compared to $17.9 million last year. This increase is due to depreciation on new centers, including the seven new centers open in 2005, and the three centers opened thus far in 2006. As a percent of revenue, depreciation is increased slightly to 9.6% last second quarter to 9.9% this quarter due to the weighting of the immature centers in our base. We expect depreciation to increase slightly as a percent of revenue for the rest of fiscal 2006.

Income from operations was $23.5 million for the quarter, compared to $20.4 million last second quarter, or up 15.3%. Year-to-date, income from operations totaled $44.7 million, up 18.5% from $37.7 million last year. Interest expense, net of interest income increased to $4.1 million from $3.2 million last second quarter, as we continue to use our revolver for cash management purposes.

Year-to-date interest expense was $8.3 million, compared to $7.1 million last year. Just a reminder here that interest associated with the construction of our new centers is capitalized and incorporated in the total investment of these centers. We expense interest costs once the center opens. We anticipate interest expense to increase in the second half of the year as we finance new centers.

Our tax rate for the quarter is 36.9%, as compared to 41% last Q2. This tax rate is below our 40% guidance due primarily to a state tax law change in Texas, which resulted in a one time net deferred tax reduction of approximately $400,000 or $.01 per diluted share. We expect our third and fourth quarter effective tax rate to be approximately 40%.

That brings us to net income for the quarter of $12.4 million, compared to $10.3 million last second quarter, or up 20.4%. Our net income margin for the quarter decreased to 10.1% from 10.8%. For the first half of 2006, net income totaled $22.8 million, up 24% from the $18.4 million for the first half of 2005, a net income decrease from 10% to 9.6% For comparative purposes, excluding share based compensation expense, net income increased 43% for the quarter and 40% year-to-date. In addition, net income margin improved to 12% for the quarter and 10.9% year-to-date.

Total common shares outstanding as of June 30, 2006, were 36.3 million. Weighted average fully diluted shares totaled 37 million for the second quarter. We still expect our 2006 total weighted average diluted share count for the year to be approximately 37.2 to 37.4 million shares, which is an increase of approximately 2% from fiscal 2005. Based on our 2006 second quarter weighted average share count, our diluted EPS for the quarter was $.33, up 17.9% from the $.28 in the second quarter last year. On a year-to-date basis, our diluted EPS for the quarter was $.62, compared to $.51 last year, or up 21.6%.

Let me spend a minute on other operating data. The number of open centers are June 30, 2006 was 49, compared to 41 at June 30, 2005. Our current number of open centers is 55, which reflects today's transaction announcement. Membership at June 30, 2006, totaled 393,011, compared to 335,816 memberships last year, up 17%.

EBITDA totaled $35.9 million for Q2 of 2006 compared to $29.9 million for Q2 2005, up 20.3 percent. Year-to-date EBITDA totaled $68.9 million, compared to $56.2 million last year, or up 22.5%. This increase is driven by pre-tax income, which is up 18.4% for the year. EBITDA margin was 29.3% for the second quarter, compared to 31.2 percent last second quarter, and 28.9% year-to-date, down from 30.4% for the first half 2005.

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For comparative purposes, excluding share based compensation expense, EBITDA margin was up to 32.4% for the second quarter and 31% year-to-date, which were both higher than the respective comparable periods.

Same center revenue growth for centers in their 13th or more full month of operations for the second quarter totaled 6.9%. During the quarter, we added one center to the same center revenue base. The same center revenue growth for mature centers or centers in their 37th or more full month of operation was 1.6%. If you were to include the impact of planned cannibalization on these two metrics, the results would be 7.6% and 2.5% respective for the 13th and 37th month calculation.

Average revenue per member totaled $318.00 for the quarter, compared to $294.00 in the second quarter of 2005, or up 8.1%. When you remove pre-sale memberships from the calculation, the average grew 7%. Average in-center revenue per membership totaled $90.00 for the quarter, compared to $75.00 in the second quarter last year, or up 18.9%. When you remove pre-sale memberships from the calculation, the average was 17.%.

Net debt to total capital at June 30, 2006, was 46.1%, which is down slightly from the 46.6% at year end 2005. Turning to the balance sheet, total assets have increased to $805 million, up from $723 million at year end 2005 due to increased building and equipment from our new centers both recently opened and under construction.

Total debt including current maturities grew slightly by $26 million to $299 million. Current liabilities have increased $11 million from December 31, 2005, reflecting continued growth in the business.

In addition to our revolving line of credit, which we recently expanded to $300 million, please keep in mind that with the opening of our Allen McKinney Center, we now have 16 large centers without mortgage financing which can also be used to fund our long term development plan.

Total shareholder equity increased from $307.8 million at year end 2005, to $350.2 million as of June 30, 2006, reflecting the retained earnings growth in stock option exercise activity during the year.

The company continues to deliver strong cash flow. Total year-to-date cash flow from operations was $61 million, up from $54 million for the first six months of 2005. During the first half of 2006, we spent $110 million in capital expenditures, of which $18.8 million was for maintenance CapEx at existing facilities and corporate capital purchases.

Regarding our growth capital expenditures, our 2006 and 2007 centers continue to progress. As Bahram highlighted, we are under construction on the five remaining current model centers to open in 2006, including South Valley, Utah, a suburb of Salt Lake City, which will open next week. Our remaining openings planned for the second half include Alpharetta, Georgia, a suburb of Atlanta, Overland Park, Kansas, Palm Valley, Arizona, and Scottsdale, Arizona.

Regarding our plans for 2007, we currently have land purchased for five sites and Purchase Agreements signed for the other three sites. We will update you on our 2007 centers throughout the year as they open their pre-sale centers or appear on our website. We publicly announced two of these sites, Dublin, Ohio, our second center in the Columbus, Ohio market, and Lakeville, Minnesota, our 23rd center in the twin cities market.

I'm going to discuss our updated guidance for 2006. Based on our strong Q2 results, we are raising our previous revenue guidance of 480 to 488 million dollars or 23% to 25% growth to $502 million to $512 million dollars, or approximately 29% to 31% growth. This growth will be driven by 15% new center growth, optimizing our dues revenue growth, and in-center revenue growth, and includes $18 million to $20 million of incremental revenue from the transaction announced today.

Excluding share based compensation expense and including today's transactions, we now expect net income of $52.5 million to $53.5 million or approximately 28 to 30 percent growth. This is an increase from our previous guidance of $51.2 million to $51.8 million, or approximately 24 to 26 percent growth. We expected diluted EPS before shared based compensation expense to be $1.42 to $1.44, up from $1.38 to $1.40.

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Stock compensation expense under FAS 123R was introduced in the first quarter 2006, and the company is using the modified perspective method for its accounting. Our baseline share based compensation expense including stock option expense under FAS 123R and restricted stock expense is expected to be approximately $.08 per share for fiscal 2006. In addition, as indicated on our last call, the company had certain market condition vesting options granted at the time of our IPO that have a strike price of $18.50.

The final two tranches vested in the second quarter based on our stock price remaining above $40.00 and $45.00 for 60 consecutive days. This occurred on April 10 and May 15 respectively. These market condition vesting options have added approximately $.04 per share to our baseline share based compensation expense during the first six months of 2006. All these market condition options have now vested.

Including share based compensation expense and the approximately $800,000 expected impact of today's transaction, we now expect net income of $48 million to $49 million, up from our previous guidance of $46.7 million to $47.3 million. This results in diluted EPS guidance of $1.30 to $1.32 per share, up from $1.26 to $1.28.

For 2006, we've increased CapEx guidance from $220 million to $230 million, to $240 million to $250 million to reflect planned incremental capital improvements we plan to make to several of the centers we began operating today, as well as slightly higher building costs. As discussed earlier, we plan to invest $25 million to $35 million in new centers we assume over the next two years to significantly improve the member experience. Much of this capital be funded through tenant improvement money provided by the lessor and the sale of property we received in the transaction.

This guidance also includes approximately $10 million for startup construction for our new office building for our corporate insured service employees. This building is planned to open in October, 2007, upon our lease expiring for our current space and will provide tremendous efficiency to our company as it will reside next to our Chanhassen fitness center. The building is planned to be 100,000 square feet, with an additional $10 million of capital expenditures estimated to be incurred in 2007.

For the third quarter, we expect our revenue growth, including the transaction announced today to be in the same range as our overall annual guidance, or approximately 29% to 31%. Excluding share based compensation expense, we expect net income growth in the same range as revenue growth, or 29% to 31%, including the incremental impact of the transactions. The share based compensation expense for the third quarter is expected to be approximately $800,000 after tax or $.02 per diluted share. This results in approximately 21% to 23% net income growth including share based compensation expense.

That concludes our prepared comments regarding our second quarter 2006 financial results. As a management team, we will continue to focus on building a strong growth company, which provides opportunities for all of our employees, delivers solid results for our shareholders, and focuses on the members' point of view. With that we've completed our prepared remarks, and we're happy to take your questions now.

QUESTIONS AND ANSWERS

Operator

[OPERATOR INSTRUCTIONS]

I have your first question today coming to you from Mr. Michael Lasser of Lehman Brothers.

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Michael Lasser - *Lehman Brothers - Analyst*

Hi, guys. You had a nice quarter. I guess the only disappointing thing from the quarter is that Bahram you did not win the triathlon. But I guess that wouldn't have looked so good.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Yeah. That didn't work out.

Michael Lasser - *Lehman Brothers - Analyst*

My question, and I hope this doesn't break the rules, but it has a couple of parts. These acquired locations are different than the current center model you are using to build out your [inaudible] across the country. As you look out over the next couple of years, do you envision the company will seek to replicate what you have in the Twin Cities where you build a handful of the current center models and then a collection of other types of centers in each city?

And then secondly, how do you plan on handling the varying customer economics from these acquired locations. As I understand they have a higher membership rate than what you charge at the other centers.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

This is a great question. So let me give you my best effort to answer. We are very selective. As we have told all of our investors all along is to only count on the number of new unit growth that we commit to, as an example, the eight next year. We also have said that occasionally we look at opportunistic locations if they completely fit into our strategy in a certain market.

Remember that in Minneapolis we have always told people we have a collection of clubs, whereas in the rest of the country we more or less have a chain of clubs. Clubs look very much alike outside of Minneapolis. In Minneapolis we have everything from 10,000 square feet to 100,000 square feet. So these clubs (that were part of the transactions) were built in Minnesota by a very, very high quality standards and very large when they were built. They are not in the condition today, for various reasons. They're just not as high level of customer experience as we'd like them to be. However, over the past several years, I have worked and worked and worked, I mean, we were looking at these clubs five years before we were public. So I know them intimately. Our management knows these clubs intimately. We know we can improve these clubs and deliver the Life Time Fitness big box experience with additional tennis amenity to the members.

So as a result, as you guys know, we have had three types of memberships available in our clubs. We have had a sports membership at $59.00, a fitness at $49.00; and then athletic membership that has been $109.00, $119.00 a month. We have thought through this very diligently over the past several months, and we have developed a membership that we call Advantage at $79.00 a month that allows certain clubs to remain at $79.00 a month. But that will give the other 70,000 roughly, 65,000 -- I can't tell you the exact number -- memberships in Minnesota an opportunity to upgrade to an Advantage membership if they want to to have access to these new additional facilities.

Some of the facilities that we have taken over, they are in markets where $79.00 is too high of a price. As a result, these facilities are largely not to the full opportunity in terms of capacity because the clubs have priced themselves out of market. In those markets, we will offer a sports membership for those who don't want to play tennis at $59.00, so we can gather quite a few more members in those locations; and then if somebody wants to play tennis or have access to the clubs that they are marked exclusively at Advantage, they will have to have the Advantage membership at $79.00.

So this is really, if you think about it, would be a product like a Mercedes Benz where they have not one product. As time has gone over they have created an extension of product line so the customer will choose to buy the product that is absolutely

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most appropriate for them based on the number of locations that they want to have access to, the type of amenities they want to. So we look at this as pure upside. Again, the emphasis is can we deliver Life Time experience to these members? And the answer is absolutely yes. And we don't like to go into these type of facilities really thinking about them as acquiring a different club or chain.

So as we come through these clubs, immediately, as of today, we have a massive program that is deployed in all of these clubs. The members will transition into our member management system over the next 35 days. We will have no legacy systems. So again, you can really think about these as new Life Time Fitness facilities over the next six to 12 months that they will be completely remodeled; they will look like our facilities; feel like our facilities; the team members will all have gone through our specific certification programs; so different department heads, GM, etc. So again, we feel very confident that we can deliver those types of criteria that are important to us, and get financial results we're looking for.

Now, the next question is is this going to happen in other markets? I would always tell investors, don't plan on it. We don't want to make an expectation for people that every year there is going to be the number of clubs we open, plus a bunch of these types of expansion. But as we come across those opportunities, obviously, we thoroughly study them and make sure they fit into the overall strategy that we want to deploy in a particular market. So it's the possibility of those type of things in the future. I just do not want you guys to count on that.

Michael Lasser - *Lehman Brothers - Analyst*

Okay. Thank you.

Operator

We'll go to Mark Rupe of Ryan Beck & Co.

Mark Rupe - *Ryan Beck & Company - Analyst*

Hey, guys. Congrats on the quarter. Just back on the acquisition here of these leases, spinners, you started $45 million to $50 million in annualized run rate; and based on the 800,000 square foot, it looks like it's about $50.00 a square or somewhere around there. And compared to your current revenue per square foot, it's like $100. Is there that much opportunity to really get out of these clubs that you have got today?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

There are definitely opportunities, but not nearly that much. The square footage that is dedicated to tennis is a square foot that does not generate -- tennis space does not generate the same type of revenue per square foot as the other space does. So we are getting these tennis facilities, the square footage, at a significantly discounted rate as if we were going to go build 100 tennis courts in the Twin Cities today.

So when you think about what our cost is going into this, the return will be great. But when you think about revenue per square foot, while there is plenty of opportunity to improve the revenue per square foot on these facilities, you should not consider that these are going to deliver the same revenue per square foot as a just typical prototype Life Time Fitness box.

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

Also, the layouts of these, although we will adjust some of the layouts, the layouts aren't nearly as conducive to the productivity that we deliver in our boxes.

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Mark Rupe - *Ryan Beck & Company - Analyst*

Okay. And just on the Boca Raton location, it seems like an outlier in the transaction, and I know WP Carey has Wellbridge facilities in Hampton and two in Atlanta, was Boca somehow special or somewhat different not to include the others?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Yes. Boca is definitely special. It's a facility that was built by a different gentleman in the '80's. Very, very high end facility when it was built. Once again, similar to the ones we took over here. Very much delayed in proper upkeep and maintenance. So the deferred maintenance is significant. However, that club will serve as a Life Time Athletic, which is a higher end price point. It will be built to our Life Time Fitness - Life Time Athletic standards, and it is a phenomenal market for that type of club, but not a great market for a $39.00 a month facility. There are plenty of other players in the $30.00 to $40.00 a month product, but there is no one within 30 to 40 miles of that space.

Mark Rupe - *Ryan Beck & Company - Analyst*

Okay. Perfect. And then just a real fast last. The four facilities that were transferred to you, the details on that, is that a full ownership transfer?

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

It's a full ownership transfer, that's correct.

Mark Rupe - *Ryan Beck & Company - Analyst*

Is there an estimated value on that at all that you place on that?

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

We aren't going to disclose that.

Mark Rupe - *Ryan Beck & Company - Analyst*

Okay. Thank you.

Operator

We'll go to Paul Lejuez of Credit Suisse.

Paul Lejuez - *Credit Suisse - Analyst*

Anything that you can share with us on some of the pricing power that you are somewhat experimenting with the kid's program, the moving certain facilities to support members? Anything in terms of resistance that you're seeing, or any other ways that you might be testing your pricing power?

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

Well, as we talked about, there are a number of things that we are doing. Obviously, junior memberships rolling in for incremental new memberships; that's going well. We see no resistance. As you build up through the year, that starts to flow more and more into our membership base. We continue to look at mix and moving sports members, moving from fitness memberships to sports membership. Again, that's going just as we have planned. And then selectively across markets, an example is in the Chicago market we have taken some price points up generally in the couple's and family memberships up $10.00, and those have gone very, very well.

Again, we're using those pricing points really to moderate demand in some of these over capacity clubs at the same time, and that is working. So overall, when you look at dues revenue increase of 25.2%, compared to the 17% membership roll, we are very pleased with the roll out of these initiatives.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Paul, to add to that, again, just like Mike said, we really don't feel any resistance to some of these introduction. Once again, we do these very moderately. They are minor adjustments. They are not deployed in all places universally, and some of them are. There is gradual opportunities to make improvements on these things.

Third or more, I am super excited about the introduction of the Advantage membership of $79.00 price point. There are going to be many facilities across the country that we would want to price our product because of either cost of construction and land and labor, like the East Coast, and also the member experience; we need to price at $79.00. We want to price at $79.00 and coming down. So this gives us the absolute flexibility that allows us to deploy the strategy very comfortably across the country.

Paul Lejuez - *Credit Suisse - Analyst*

Great. Thanks. Good luck.

Operator

We'll go to Ed Aaron of RBC Capital Markets.

Andrew Hudson - *RBC Capital Markets - Analyst*

This is actually Andrew Hudson sitting in for Ed. Looking at your customer acquisition costs, we saw a small bit of discounting in the enrollment fees in the month of June, but an up tick on your advertising costs. Can you just talk a little bit about the acquisition costs?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Just like Mike mentioned, these are -- we may have a month or two where we go through just purely member referral program, then the next month we can come back and have a heavy marketing program. I would not try to at all -- I've been giving this suggestion to all investors and all analysts for a long time -- I would not focus on those items on a month to month or quarter by quarter basis at all. We use, as Mike always explains it, advertising and initiation fee in the form of a throttle and a brake.

In some markets we spend no dollars at all in marketing; in some markets we spend a lot of money in marketing. They are non-event in the sense that we want to accomplish the ultimate results we're looking for, the type of memberships we want to

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gain, upgrading members from the fitness memberships to sports or additional. Sometimes we spend quite a bit of internal marketing dollars on those. I can tell you, you cannot read into those items.

So if you look at them on a year to year basis, then you can try to make some sense out of it, but not on a quarter by quarter or month by month.

Andrew Hudson - *RBC Capital Markets - Analyst*

Okay. Thank you.

Operator

We'll go to Mr. Brian Nagel of UBS.

Brian Nagel - *UBS Securities LLC - Analyst*

Good morning. Congratulations on another strong quarter. One quick question. As you look closely at your business, have you seen any signs whatsoever that your customers are a little more hesitant to spend in what may be a slower consumer spending environment?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

I have a quick answer for you. Absolutely not. We do not see virtually any weakness in any side of our business. What we are seeing is the more we focus, the more we pay attention to that customer experience, the more we're able to have the customer respond the way we want. We have had for about a year and a half, a very, very high level of focus on what we call healthy way of life perspective in how we even sell memberships. Our approach is not to sell the customer, help the customer choose what they want to buy or what's right for them. To us that's a healthy way of life approach. And the more we fine tune the execution at each facility to focus on the member experience, whether if you're buying something or they're utilizing the service, the more we don't see resistance that we'll hear from other retailers.

Andrew Hudson - *RBC Capital Markets - Analyst*

Thanks a lot, and good luck the next quarter.

Operator

We'll go to Kathryn Thompson of Avondale Partners.

Kathryn Thompson - *Avondale Partners LLC - Analyst*

Thanks. Nice quarter. Just a quick clarification on the Q3 EPS growth, including stock option expenses. I didn't catch that.

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

The EPS growth including stock option expense is 21% to 23%.

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Kathryn Thompson - *Avondale Partners LLC - Analyst*

And what is the percentage of your mature centers as of quarter end?

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

By mature you mean over three years old. It's approximately 60%.

Kathryn Thompson - *Avondale Partners LLC - Analyst*

Also, I know you've given us a lot of good information on the net impacts of the centers, the new centers, the smaller centers in Minnesota and Florida, but could you give us a little bit more clarification of what the overall margin impact may be, and maybe discuss a little bit its margins relative to say your more newly opened, larger format centers.

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

Our base margins when you take share based compensation expense out improved fairly significantly. Operating margins improved 80 basis points from 21.4% to 22.2% in the quarter. That's reflective of leverage in our system. It's also reflective of center operating expenses actually improving. They have actually been growing as a percent of revenue for the last year or so. That turned around in the second quarter and we actually improved. Again excluding share based compensation expense, they improved by 10 basis points. That right there is a combination of better labor utilization that we're able to introduce into these centers, coupled with margin improvement. It's not just mature centers; it's coming into the new centers also.

And this is in the face of headwinds that we've talked about a lot. When we grow our in-center revenues at these 40% rates or these higher rates, they are coming in at lower margins. So you've got to significantly [inaudible] underlying base to be able to deliver margin expansion, and that has happened. So we're excited about that. We had talked that we expected that to happen, and it has.

When you now layer in these new centers, they've got a slightly different operating model to them, and the biggest piece of that is that lease expense is up in operating costs of these. Whereas, for most of the other facilities, it's ownership and it's down in depreciation and interest.

So that's really the significant change or driver that will happen. And when we layer that in, we do expect that center operating margins and operating profit margin might come down just slightly.

Kathryn Thompson - *Avondale Partners LLC - Analyst*

That's helpful. Thank you.

Operator

We'll go to Greg McKinley of Dougherty & Company.

Greg McKinley - *Dougherty & Company - Analyst*

Could you real quickly comment on some of the changes in your advertising initiatives? I know you indicated that you're testing some different stuff to promote the in-center programs you're launching. So can you give us a little color on what you're doing

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in the centers and outside of the centers on that front? And then the quick follow-up would be, if I back into your per membership revenue implication for the acquired centers, it looks to me like it's about $1,700 or $1,800, well above that $1,200 rate you guys did last year. If you could just help me understand the difference?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Let me start with your second question. The revenue per membership in the facilities that we are acquiring is higher than ours. These are tennis facilities. Tennis members do spend more money in facilities, not to mention that these clubs at large even though they are not nearly as nicely kept as our facilities, they have charged more than us in this market. So, yes, you have a higher price, which is not a problem. That allows us to do a lot of upgrades in this market. So we won't be losing. Those memberships don't come down. But we will have the opportunity to creep up a little bit of our memberships towards those numbers.

As far as the marketing goes, I have to break it down to these two parts. Part of it I don't like to -- you're asking trade secrets from us in terms of how we do our marketing. There are a lot of in-center incentives that we are giving people for referral programs. We are including lots of gifts, packages they receive when they join the club that may have a massage or personal training. I mean, I'm not telling you specifically what we did last quarter nor I would. I can tell you that there are so many different things that we do to work with our marketing. And it could be that last year this quarter we spent very little on our marketing.

So I emphasize, it's not a trend that you can take it and say marketing dollars now are higher in order to get the numbers. It's just specific to a quarter.

Greg McKinley - *Dougherty & Company - Analyst*

Okay. Thank you. Nice quarter.

Operator

We'll go to Hardy Bowen of Arnhhold & Bleichroeder.

Hardy Bowen - *Arnhold & Bleichroeder - Analyst*

Bahram, are we inclined to open Utah, Palm Valley, Scottsdale as fitness membership clubs or as sports membership clubs, or what's our inclination?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Right now, Overland Park, Scottsdale and Alpharetta are scheduled to be sports clubs, and Palm Valley, Arizona and South Jordan, Salt Lake City area are both fitness. Now, we have a couple of these clubs that really I don't know if they shouldn't be Advantage memberships. At some point, we may stop the sale of one and go to the other, but we can't tell you that right now.

Hardy Bowen - *Arnhold & Bleichroeder - Analyst*

You're talking about a place like Scottsdale, which is very upper end?

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Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

It may be better suited as an Advantage membership than sports. So we will make that determination. You will know as soon as we do.

Hardy Bowen - *Arnhold & Bleichroeder - Analyst*

Okay. I guess that's my question.

Operator

We'll go to Scott Mushkin, Bank of America.

Scott Mushkin - *Bank of America Securities - Analyst*

[Inaudible] look at the incentive growth you guys are seeing and try to understand what's driving it, how sustainable it is, and how the older facilities perform on incentive revenue growth.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Hey, Scott, this is Bahram. How are you? The question I barely heard you, but you're asking about incentive revenues, can we maintain the growth, etc. Again, we have not guided you guys in the past to the numbers that we're delivering. We've guided you to a much lower number. What is that, Mike, about?

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

High single to low double digits.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

Low double digits. And that's what we are going to continue to guide you to.

That should be your expectation. However, we as we mentioned, we delivered the team weight loss program, which has been a great success. Our polar heart rate training system that we have implemented for the last year and half now across the system is paying great dividends. Changes to our senior management in the personal training, and the way we are modeling things have made an impact.

We still have a tremendous amount of opportunity in our cafes, in our spas, in our programming, space optimization, and we plan to continue to attack those areas, test programs and keep implementing new ideas. So we feel comfortable that we can deliver what Michael has guided you guys with and hopefully we can beat it.

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

The second piece of your question, Scott, was is there a difference between the older clubs and the newer clubs, and can we grow the older clubs. Some of the older clubs have a little bit different physical space issues which will limit the overall amount of incentive revenue that can come from them. Some of them don't have caf s, things like that. But overall, if you combine some these space optimization things that Bahram is talking about and the drive and the focus on new programs and focus on

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increased penetration, and getting that through better marketing, better education, we are seeing improvement in those older centers, and we continue to believe that they should grow as well as our new centers do.

Scott Mushkin - *Bank of America Securities - Analyst*

So, Mike, to take a market position, we were just out in Chicago and kind of surveying those clubs out there. Some of them [inaudible], and some of them have been around for a while. But it seems like you brought team weight loss into a lot of those clubs. The boot camp is in there and so the implication is they seem to be doing very well. So the thought I have is that as you look at some of the clubs that are three years and older, that the [inaudible] on those, in Chicago specifically, that would drive costs and returns on the clubs up incrementally if you're successful in bringing those programs in. Is there something wrong with that thought process?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

No.

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

No. That's true. The other thing you've got to measure in there is that some of those clubs in the Chicago market as well as clubs in other ones, they're running at higher membership levels than we want. So we're also trying to move that a little bit. Now, the good thing there is that that should be coming with more revenue dollars from price increase, if we roll through price increases to help control that.

The second thing is you get some of those newer memberships in they have a tendency to spend more money. They have a tendency to engage in those things that we are offering. So the thought process is there, yes.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

And let me just confirm. There is no reason that team weight loss program once it's introduced should do less in Schaumburg club, which is the first club in Chicago, than a club that just opened four months ago. There is no reason. We don't see that. We see easily the same results and sometimes we actually see better results in the older clubs when we introduce something new because we have sole memberships in those facilities.

Scott Mushkin - *Bank of America Securities - Analyst*

So the suggestion with the [inaudible] that you talked about those, perhaps the newer clubs are seeing better sell through, or is that wrong?

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

There is some better sell through mainly because of the education certification programs that we have really focused on the new clubs first. And so we're seeing some better attention to the members. We're seeing better knowledge of our programs that come through. So we've seen that. As we're going through certification process from everybody, we would expect to some more of that.

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The other piece of it though is that there are simply some limitations in some of the older, older clubs. Not necessarily the [inaudible] you're talking about, from a space perspective. And so we won't get it some of those clubs, wont get as much in some of those clubs.

Scott Mushkin - *Bank of America Securities - Analyst*

That's great. Can I slip one more in here about Minnetonka. I just wanted an update on that facility. I know that was kind of a different look that you put in there. I had the chance [inaudible] around that facility, and I was just curious how that's going?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

It's going great. We gain memberships in those clubs two ways. One, we get members that have been paying $49.00 a month and now they're coming up, they're upgrading to pay $119.00 a month. So we don't necessarily pick up as our whole numbers and new members added. So when you look at membership counts it's not going up in those cases.

What you're getting is you're getting more then double the revenue, new revenue from that customer, and they are still going to get three workouts a week; now it just happens to maybe one in Minnetonka, two in Minnetonka, and one maybe in their old club.

We also pick up new members in those facilities. And I just want to take a minute to explain just some metrics for all the investors and analysts in here. When we got to a box that is an athletic box, and we're charging nearly double the dues, the customer has got to get something. Our big box $49.00, 59.00 a month is what you consider a high quality, high volume club. Yet still high volume. You've got to put up with a lot of people in that space.

The athletic club is a high quality, lower volume club. So really what I'm giving the customer is, by charging them twice as much for dues or more, we basically want to give them more elbow room in that space. This is basically what is not there that would help them.

So ultimately, we have focus on revenue per square foot, dues revenues per square foot. Now, in the more expensive clubs that comes from fewer members. Did that explain that you?

Scott Mushkin - *Bank of America Securities - Analyst*

It definitely does.

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

And the club is doing exactly in accordance to our ramps right now. It's going very well. It's ramping up. And if you look at that club at 40 some thousand square feet, if a typical pricing needed 4,000 memberships at this pricing you need approximately two thousand. So basically if you double the number of the counts because you're getting much more dues, we are at a better place for ramp in just seven months of operation than you would be in an existing club ramp, versus the total capacity. So it's going very well.

Scott Mushkin - *Bank of America Securities - Analyst*

Do you think you'd ever use the format, Boca's upscale market and some other more dense upscale markets, or you're not to that point yet?

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Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

I have no -- and I'm going to be very confident in this answer to you. I have no doubt in my mind that what we have planned for Boca is the absolutely right plan, right strategy and it will absolutely be a phenomenal success for us in Boca. And it allows us to get -- and I'll start in the Florida market and start looking for other sites. The other sites may be athletic model, may be Advantage or maybe sports or fitness, depending on the particular site we find.

Scott Mushkin - *Bank of America Securities - Analyst*

That's great. That is a little softer question, but I get it a lot from investors and some of the press that companies receive from you in particular. How do you feel about running a public company? Are you still as pumped up as you were six to eight months ago?

Bahram Akradi - *Life Time Fitness, Inc. - President and CEO*

That's a great question. I have to tell you when the whole thing will be news for people they find out this is an absolute ridiculous, silly thing. It's not a big factor. Past that I have never been more excited than how excited I am about all the different opportunities we can grow this business and improve what we do. The opportunities are endless. And as I mentioned when I was in William Blair Conference to the same question, the day that I don't know how to improve the business we have, I hope we have somebody around us that can do that and I think at that point I am obsolete. I got to step a side.

Today, we have a longer list of ways we can improve our customer experience, the programs, the services, the pricing, the certification processes. We're just tackling those things one, two, three, four, five at a time, and then we still have a long way to go after. So I'm very excited.

Scott Mushkin - *Bank of America Securities - Analyst*

Thanks very much for answering all those questions. I appreciate it.

Operator

[OPERATOR INSTRUCTIONS]

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

I think it's past our time, Robert. So think we'll shut things down. So with that why don't I turn it over to Ken for a final comment?

Ken Cooper - *Life Time Fitness, Inc. - IR*

With that I would like to thank everyone for participating. We look forward to reports for our third quarter 2006 results tentatively scheduled for Thursday, October 26. For this and all other key dates, please the events section within the investor relations section on our website. Thank you and good bye.

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Operator

Thank you sir. Thank you again, ladies and gentlemen. This brings your conference call to a close. Please feel free to disconnect your lines now at any time.

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