

# FINAL TRANSCRIPT

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## LTM - Q3 2006 Life Time Fitness Earnings Presentation

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*Life Time Fitness - Chairman of the Board, CEO*

**Mike Robinson**

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*Ryan Beck & Company - Analyst*

**Tony Gikas**

*Piper Jaffray - Analyst*

**Paul Lejuez**

*Credit Suisse - Analyst*

**Michael Lasser**

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**Ed Aaron**

*RBC Capital Markets - Analyst*

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Third Quarter of 2006 Life Time Fitness Earnings Presentation. My name is Danielle and I will be your coordinator for today.

[OPERATOR INSTRUCTIONS]

As a reminder, this call is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's call, Mr. Ken Cooper, Senior Director of Finance. Please proceed, sir.

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**Ken Cooper** - *Life Time Fitness - Senior Director of Finance*

Good morning and thank you for joining us on today's conference call to discuss Life Time Fitness' third quarter 2006 financial results. We issued our third quarter earnings press release this morning. If you did not obtain a copy, you may access it at our website, which is [lifetimefitness.com](http://lifetimefitness.com). In a moment, Bahram Akradi, our Chairman and CEO, will discuss key highlights from the third quarter, our press release that was released earlier today regarding our newest board members and other recent events.

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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 o'clock a.m. Eastern time. At that point in today's call, the operator will give instructions on how to prompt a question. Finally, a replay of today's teleconference will be available on our website at approximately 1 o'clock p.m. Eastern time today.

To make sure we have time for everyone's questions, we again respectfully request that you limit yourself to one specific and direct question. We have tailored our prepared comments to leave plenty room to answer as many questions as possible. If you have more than one question or follow-up questions, please be courteous to your fellow investors and analysts and re-enter the queue again.

Before I turn the call over to Bahram, I'd 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 issuance of our third quarter's 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. To comply with Regulation G, included in our earnings release or in our Form 8-K are reconciliations of the differences between GAAP and non-GAAP measures, including EBITDA and share-based compensation expense affected comparisons. Other required information about our non-GAAP data is included in our Form 8-K.

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

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**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Thank you, Ken, and good morning everyone. We are very excited to be with you to discuss our results for the third quarter and first nine months. It has been an eventful three months since we last spoke. Our national roll out has continued with three new openings. We have transitioned the centers we took over on July 27 exactly as planned. And we continue to meet our expectations from an operational and financial perspective. I am very pleased with the results of our company and the efforts of our team members this quarter.

As I hope you saw in our press release, our third quarter results were very strong. This includes revenue up 33% and net income up 27% for the quarter. Now keep in mind that net income is up 34% when excluding share-based compensation expenses. The main driver for this performance is a strong dues growth in this quarter as part of our planned approach to maintain our unparalleled member experience.

To ensure this optimal member experience, we have executed our pricing strategy across the entire portfolio of centers with a roll out of the junior membership and the focus on membership upgrades such as Sports, Advantage and Athletic. This has served a proactive measure to ensure that the centers maintain a balance of activity in membership levels while maintaining a modest price point.

What this means is that some centers are purposefully slowing membership growth, even in the pre-sale period. For instance, we recently changed our pricing at our Scottsdale center to Advantage from Sport before the facility will open here in December. We did this for two reasons: one, those members wanted a more premium experience; secondly, the pre-sale was running very strong. We therefore expect lower membership numbers at this center which is offset with higher dues. I have been pleased, and even pleasantly surprised, at the member response across the system to these initiatives which is another indication that this is the right and the correct approach.

In connection with our financial performance for the quarter, I want to update you on the progress with the centers for which we assumed operations. As a reminder, on July 26, we entered into new leases for a net six centers with W.P. Carey. It has been

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less than a hundred days since we welcomed these new centers to the Life Time Fitness family and I'm very pleased with the progress, including the blending of all the team members to accomplish our initial goal of transitioning all legacy systems to Life Time Fitness systems and converting former members to Life Time Fitness memberships. The result is a tremendous geographic presence and offering particularly the Minneapolis market.

Our next stops are to complete the certification of our new employees which is near completion, finalizing the architectural drawing and beginning the remodels of each of these new centers. Mike Robinson will provide some additional detail on this transaction later in the call.

Turning to our expansion efforts between July 1 and October 13, we opened three new current model centers in three different markets including South Valley, Utah, Overland Park, Kansas and Palm Valley, Arizona. Our last two centers to open this year will be in early December. These will be in Alpharetta, Georgia and Scottsdale, Arizona and will result in us reaching 60 centers in 13 states and 16 metropolitan areas at the end of the year.

Our performance through the third quarter is a direct result of hard work and dedication of our team members. In addition, it is the result of the input and the strong acceptance from our membership base. I would like to add that we continue to drive our company hard to deliver a better experience for our members, not on one or two things, but rather hundreds of small items that we can improve upon.

Included in this list are personal training programs in the pilot stage of roll out, improved communication to our membership base to convey and promote all of the programs available to them and creating better tracking of our members' activity within the centers so we can further cater to them. As we act on these items, now and in the future, the results should enhance value to members and shareholders alike.

Before I turn it over to Mike, I want to formally welcome John Richards and Joe Vassaluzzo to our Board of Directors. Both of these gentlemen bring tremendous experience and a pedigree that is exceptional and relevant to Life Time Fitness. They will be able to make an immediate impact. With John and Joe joining our team, I would also like to offer my sincere thanks to our departing board members, Tim DeVries and David Landau. They were both instrumental to the success in our earliest days of growth and their effort, insight and partnership were very invaluable.

With that, let me now turn it over to our CFO, Mike Robinson, for more detailed discussion of the third quarter and year-to-date financial results. Mike?

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

Thanks, Bahram. As Bahram indicated, our financial performance remained strong across the board. As I provide you with details of our key financial indicators, I will make reference to a couple of items which were not in existence last year. This includes share-based compensation expense including FAS 123R and the leased centers we commenced operations of in late July.

Regarding the recent leased operations, we are pleased with our execution to date. We transitioned in excess of the 25,000 memberships we discussed with you in July. Our revenue from these centers approximated the pro rata share of the 18 to \$20 million guidance that we gave you on the last call. We also discussed on the last call the P&L model of these centers is a bit different because these centers are leased.

Our center operating expenses for the total company are up in the third quarter because of this lease expense combined with the integration costs and other run rate costs of these facilities. If you adjust for all of this and share-based compensation expense, total company center operating expenses are down as a percentage of total revenue. At the same time, depreciation expense is much lower for these leased centers, which is the main driver for depreciation leverage this quarter.

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A few other notes. These centers are not included in the same store sales calculation. They will enter the same store comp base on the 13th month like all other centers. Lastly, revenue performance of these centers is included in the revenue per membership statistics I will talk about shortly. With this transaction, we have created a dynamic presence in the Twin Cities market with a network of over 100,000 memberships. These memberships have proven to utilize the network and its integration of systems and infrastructure as it was intended, that is, to take advantage of the ability to use multiple centers convenient to home and work.

With that, let's start our discussion with revenue. For the third quarter, total revenue was \$134.7 million, up 32.6% from the last third quarter. Revenue for the first nine months of 2006 totaled 372.6 million, up 30% from last year. This strong growth quarter-over-quarter was driven by several factors including membership dues growth of 31.3%. We continued to execute on our pricing plan to optimize the member experience. Year-to-date, our dues have grown 27.4% to \$245.1 million.

Enrollment fee revenue reported net of refunds grew by 15% in the quarter. In-center revenue grew by 41.4% in the quarter. This is attributed to our corporate research and development team facilitating new programs, the center management for executing on these programs and services, our marketing and sales teams for enhanced awareness and our membership base for the acceptance of these exceptional products and services.

Year-to-date, in-center revenues totaled \$102.4 million, up 41.5% from last year. And finally, a 16.7% increase in other revenue which was driven by our fifth annual Life Time Fitness triathlon, media growth within our award-winning "Experience Life" magazine, and rental income. This total company revenue growth has driven an 8.3% increase in the same store sales calculation for the quarter and a 3.1% increase in the 37 month mature same store sales calculation. Excluding planned cannibalizations, these metrics were 9.0% and 3.9%, respectively.

In the third quarter, we had two centers enter the 13 month comp base which were Cinco Ranch and Chanhassen. No centers entered the 37 month comp base. As I've mentioned before, we'll provide you with same store sales metrics since we are compared to other retail companies. However, we focus more closely on revenue per membership. Our goal is to optimize the amount of revenue generated by each membership at the portfolio centers through our membership mix, pricing and growth of in-center products and services.

With that, in the third quarter we generated a 9.9% increase in revenue per membership to \$328.00. In-center revenue per membership increased to \$91.00, or a 16.8% increase over last third quarter, which is above our expected long term range of high single digit to low double digit growth. If you exclude the pre-sale memberships from these metrics, the total revenue per membership increased 9.3% and in-center revenue per membership increased 16.1%.

Moving to our margin analysis. The company's operating margin decreased from 20.8% to 20.6% as compared to the prior third quarter. For comparison purposes, excluding the \$1.2 million of share-based compensation expense in the third quarter, operating margins improved to 21.6%, or 70 basis points above the comparable measure in Q3 2005 even with the significant growth of our in-center businesses that come at a lower margin, the weighting of centers early in their life and the new leases and other costs of our recent transaction.

Excluding share-based compensation expense, the main drivers of this margin of improvement, which more than offset the center operating expense increase from the lease transactions, included a 50 basis points of G&A leverage, 40 basis points of advertising and marketing leverage and 120 basis point improvement in depreciation. This depreciation leverage was driven by the new leased centers which have a very low asset base, as you would expect with leased centers. This has been coupled with slightly more mature legacy centers driving higher revenue.

As we look at the rest of 2006, excluding the impact of share-based compensation expense, we expect operating margins to continue to expand slightly, even as we continue to absorb the incremental lease expense and the transition expenses from the operation of the new leased centers. On a year-to-date basis, the company's operating margin decreased from 20.6% to

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19.5% as compared to the prior period. For comparison purposes, excluding the \$6.2 million of share-based compensation expense so far this year, operating margins improved to 21.1%, or a 50 basis point improvement over last year.

As we make our way down the P&L, income from operations was \$27.8 million for the quarter, up 31.3%. Year-to-date income from operations totaled 72.5 million, up 23.1% from last year. Interest expense net of interest income increased to \$4.2 million from 3.3 million last third quarter, as we continue to grow our new center base and our average revolver debt balances grow. Year-to-date interest expense is 12.5 million compared to 10.3 million last year. We anticipate interest expense to increase as we finance our new centers.

Our tax rate for the quarter was 42.6%. This tax rate is above our 40% guidance primarily due to state tax changes, both positive and negative, which resulted in a net one time deferred tax liability increase and an incremental tax expense increase of approximately \$500,000. We expect our fourth quarter effective tax rate to be approximately 40%.

That brings us to net income for the quarter of \$13.6 million compared to \$10.7 million last third quarter or up 27%. Our net income margin for the quarter decreased to 10.1% from 10.6%. If you exclude the 800,000 of after-tax share-based compensation expense for the quarter, our net income grew 34.3% and our net income margin improved to 10.7%.

For the first nine months of 2006, net income totaled \$36.5 million or up 25.1% from 29.1 million for the same period in 2005 and net income margin decreased from 10.2% to 9.8%. If you exclude \$3.8 million of after-tax share-based compensation expense, net income increased 37.8% year-to-date and net income margin improved 10.8% year-to-date.

Total common shares outstanding as of September 30, 2006 were 36.2 million. Weighted average fully diluted shares totaled 37.1 million for the third quarter. We still expect our 2006 total weighted averaged diluted share count for the year to be approximately 37.1 to 37.3 million shares, which is an increase of approximately 2% from fiscal 2005.

Based on our 2006 third quarter weighted average share count, our diluted EPS for the quarter was \$0.37, up 27.6% from the \$0.29 in the third quarter last year. On a year-to-date basis, our diluted EPS for the three quarters was \$0.99 compared to \$0.81 last year, or up 22.2%. Moving to our other operating data, the number of open centers as of September 30, 2006 was 56 compared with 44 at September 30, 2005. Our current number of open centers is 58. Of these 58 centers, 48% are current model centers and 52% have been opened three years or more.

EBITDA totaled 39.7 million in Q3, up 25.8% from last third quarter. EBITDA year-to-date has grown 23.7% to \$108.6 million. Memberships at September 30, 2006 totaled 427,765 compared to 345,818 memberships last year, up 23.7%. This includes exceeding 25,000 converted membership to Life Time Fitness memberships for the operations we took over in July. This also reflects our planned reduced membership growth in certain clubs which is offset by enhanced dues.

Turning to the balance sheet, the largest activity continues to be driven by our continued growth of new center construction. Capital expenditures year-to-date totaled \$173 million including 62 million in the third quarter. Of this total, 149 million relates to construction of the centers opened in 2006, yet to open in 2006 and the land and construction of the centers set to open in 2007.

To finance our growth, we have recently used our strong operating cash flow and debt. During the third quarter, our overall debt balances grew by approximately \$35 million to 334 million as of September 30. This includes \$186 million outstanding on our revolver. Our net debt to total capital ratio increased slightly during the third quarter to a still low 47.2%.

Let me take a minute to discuss our opportunities within the current capital structure by walking through what we have available for use for funding in the future. First and most important is our strong operating cash flow, which approximated \$103 million through the third quarter. This nearly matches the \$108 million we generated for the entire year 2005. Second, we have significant availability remaining under our revolver.

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And lastly, with our latest opening in Palm Valley, Arizona, we have 20 large format facilities that have no mortgage borrowing against them. We expect to begin tapping into some of those 20 centers and placing mortgages within the next several months. I'd also like to take a minute to comment on one of the most common questions we receive in visiting you on conferences and other events. The question is "When will Life Time Fitness become free cash flow positive?"

The answer is immediately if we change the strategy to leasing these facilities or stopping expansion; however, we are a growth company and do not feel either of these are in the best interests for the long term success of our company for two main reasons. First, we have a better incremental cost of capital with mortgage loans so we can deliver better financial performance. And second, we can control our occupancy costs and therefore better manage our margins by avoiding the annual or every five year step ups in rent.

In short, we conducted specific analyses to ensure that our strategy to own our centers provides more enterprise value to the company. That said, if we are able to achieve cap rates that made a sales lease back equal to or better than mortgage financing, we would certainly take a look at it. We will continue to review all other options and if they are more attractive, we'll certainly consider them also. For now, we continue to favor ownership and will be free cash flow negative as technically defined.

One last item to highlight from our balance sheet is that you will see an increase in other assets. This increase is due to the property available for sale and the tenant allowances received from the landlord in the lease transactions that will be used to offset our remodel investment layer. Let me now switch gears to talking about our expansion plan. We are nearing the opening of our final two centers to open in 2006.

Our center in Alpharetta, Georgia, which is a suburb of Atlanta, is scheduled to open on December 5. Our center in Scottsdale, Arizona is scheduled to open on December 8. Regarding our plans for 2007, we plan to open eight current model centers. We currently have land purchased for seven of these sites and construction started on six of these sites. We have a purchase agreement signed and land purchased imminent for the final site.

We've publicly announced six of these future centers: Cary, North Carolina, which is our first center in the Raleigh-Durham-Research Triangle area; Deerfield Township, Ohio, which is our first center in Cincinnati; Dublin, Ohio, which is our second center in Columbus, Ohio; Lakeville, Minnesota, which will be our 23rd center in the Twin Cities; Omaha, Nebraska, which is our first center in the Omaha market; and, South Austin, Texas, which will be our second center in the Austin market.

Let me discuss our updated guidance for 2006. We are moving to the upper end of our current revenue guidance to 507 to \$512 million, or approximately 30 to 31% growth. This growth includes 18 to \$20 million in incremental revenue from our recent leased transactions. As a reminder, like most companies, we adopted FAS 123R this year. Our baseline share-based compensation expense including stock option expense under FAS 123 and restricted stock expenses, expect to be approximately \$0.08 to \$0.09 per share for fiscal 2006.

In addition, certain market condition vesting options added approximately \$0.04 per share to our baseline share-based compensation expense in the second quarter, to bring our total expected for the year to approximately \$0.12 a share. Year-to-date, we have recognized 6.2 million of pre-tax and approximately 3.8 million of after tax share-based compensation expense. With that, we now expect net income of 49.1 to \$50.1 million, up from our previous guidance of 48 million to 49 million. This results in diluted EPS guidance of \$1.33 to \$1.35 a share, up from our previous guidance of \$1.30 to \$1.32.

Excluding share-based compensation expense, we now expect net income of \$53.6 million to \$54.6 million, or approximately 30 to 32% growth. This is an increase from our previous guidance of 52.5 to 53.5 million, or 28 to 30% growth. This results in diluted EPS, excluding share-based compensation expense, to be \$1.45 to \$1.47, or approximately 28 to 30% growth. This is an increase from our previous guidance of \$1.42 to \$1.44, or 25 to 27% growth.

Regarding our CapEx guidance, we are maintaining our range of 240 to \$250 million for the total year. This is reflective of the higher building costs in 2006 and also includes the first phases of remodel projects on our recently acquired centers as well as

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continued infrastructure development. For the fourth quarter, please keep in mind that in the fourth quarter of 2005, we had a one-time benefit of approximately \$0.03 a share due to the corporate entity realignment that decreased our state income tax and revalued our deferred tax liabilities.

We also expect that the after tax share-based compensation expense for the fourth quarter will be approximately 800,000 to \$1 million. As has been the case in prior years, we will deliver in-depth discussions and details of our 2007 guidance in conjunction with our fourth quarter and full year 2006 results in February of 2007. That concludes our prepared remarks regarding our third quarter 2005 financial results. As a management team, we are very proud of what we have been able to execute our plan with speed, precision and results. We are a special company and we are excited to continue moving forward.

With that, we are happy to take your questions now.

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## QUESTIONS AND ANSWERS

### Operator

Thank you.

[OPERATOR INSTRUCTIONS]

Your first question will come from the line of Mark Rupe with Ryan Beck. Please proceed.

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### Mark Rupe - Ryan Beck & Company - Analyst

Hey, guys, congratulations on a great quarter. A couple of questions here real fast. You mentioned that you might tap 20 of the facilities you have no mortgages on right now. Any idea how many new units that could finance?

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### Mike Robinson - Life Time Fitness - CFO

Again, we have 20 large centers and the thought over time is that we would, if needed, we could finance all of them. What we will- our own thoughts right now is that we'll go to the market probably every six to 12 months and finance an incremental piece to ensure that we keep our revolving line of credit at a reasonable number and continue to drive the right shareholder returns for the company. Not quite sure that that answered specifically what you're looking for.

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### Mark Rupe - Ryan Beck & Company - Analyst

No, that's good enough. It does. And just secondly, the cost of investment for each center obviously has been going up over the past couple of years. How are you managing the return aspect so that the returns are comparable to the previous centers or the past centers?

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### Bahram Akradi - Life Time Fitness - Chairman of the Board, CEO

That's a great question. This is Bahram. You know, our costs are going up not in any more aggressive fashion that the costs go up for all other users of real estate, retailers, other health club operators. And we don't see a detriment to our business model because we have an enormous price elasticity and we also have many, many ways that we can provide products and services to our members who are interested in that type of product or service in the four walls of our space.

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Therefore, we believe we can continue to improve the revenue per square foot and with some margins on those revenues, we can offset any natural increases in the cost of construction and real estate. Again, as we move around the country, in some markets, real estate costs will be significantly less than others but the membership prices directly reflect that as well. So it's going to be all relative and we're not concerned.

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**Mark Rupe** - *Ryan Beck & Company - Analyst*

All right. Thank you, guys.

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**Operator**

Your next question comes from the line of Tony Gikas with Piper Jaffray. Please proceed.

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**Tony Gikas** - *Piper Jaffray - Analyst*

Good morning, guys. My congratulations as well. A question for you here. We've seen a significant update in advertising campaign around the Minneapolis area. Is this to address the new centers or to address member trends, and maybe as part of that question, could you just update us on membership retention and growth for those acquired centers last quarter?

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**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Great question, Tony. I don't believe that it is probably good efficient advertising that you see because we are not spending more dollars for marketing of those facilities than were spent in the marketing of those facilities in the past. We deliberately decided to stay out of the intense marketing for the first month, month and a half, and focus internally on the transition of the memberships inside the facilities and then we have finally focused on doing some marketing externally and the memberships are going great. They are literally going great.

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**Tony Gikas** - *Piper Jaffray - Analyst*

Okay, thanks.

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**Operator**

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

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**Paul Lejuez** - *Credit Suisse - Analyst*

Hey, guys, Paul Lejuez. How aggressive do you plan to be, maybe going back to existing members and raising prices? You mentioned at Scottsdale you changed to the Advantage membership. What shall we read into that and also, if you could just describe how that happens from a logistics perspective. How you make the change to Advantage?

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**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Paul, that's a great question. As we mentioned nearly a year or two years ago, we have continually told you guys "We don't know it all," "We're not perfect," and "We have a lot of room to improve." I also mentioned to you guys one of those ways we

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could improve is to do a better pricing strategy than we had which was more or less one size fits all and that really doesn't work that great.

So what we did was we went through the markets and looked at our facilities based on competition, based on how busy the clubs were, how many people were coming in, and said first and foremost, are we delivering the experience that we want to deliver or we keep claiming we deliver at Life Time Fitness. And quite frankly, at some of the clubs that experience was pinched because with the number of people in the club, new life in the club- it didn't matter how hard we tried, wasn't what I wanted it to be.

So naturally if you have that many members in the club and all you anticipate, you're going to have that many clubs in the club, in that particular, you can decide we want to take this club from Fitness to Sports or Sports to Advantage and then you have two choices. You can come in and say I'm going to let the people who have been here before keep their Sports membership and have them grandfathered, they can stay as long as they don't drop out and come back in, they can remain using this club from here on.

You have to have an Advantage membership, but they can still use it. And all the new people signing up will have to pay the new membership. So if a club has 10, 11,000 memberships and you make that transition, you will have a very, very slow but steady growth in your average dues, which is natural because you're only losing 3 or 400 units in a month out of that base.

Then you get the new ones initially, that number being \$10 more or \$20 more isn't going to be a huge impact but every month that goes by, gradually a little bit more of the portion of your memberships are paying you the higher dues. And then you hopefully reduce the number of new members coming in a little bit so the club doesn't have both. You don't want to keep charging them more and giving them the same or lesser experience. So we actually want to offset a few bodies for the extra dues, and again, the offset should be a net positive on our dues revenue.

Now in some clubs we may decide at one point [and] after we have gone for a number of months with a membership that has been -- a number of people have been grandfathered with certain types of things for, let's say, two years. Now we come to the third year and you may have technically 30 or 40% of your membership still on the old pricing but the club was changed to a higher price point two years back. Now we can come back and say, you know what, as of January 1, or December whatever, all people -- we send a letter to the remainder of the members saying you've got to get caught up with this pricing.

So it's not one strategy that would work for all clubs across the country. It would be very, in my opinion, sloppy and a lack of excellence in that thought process. So what we are doing is reanalyzing all of our clubs, one by one, measuring the customer satisfaction, measuring the capacity of the club. If we have the capacity in the club significantly, we obviously don't need to raise prices.

But if the capacity is projected to be in a pinch, then we might even respond. There have been, over the last three, four or five years, clubs where we started at a Fitness pricing and immediately at the end of the grand opening month, we changed it to Sports, because we had to, because the number of people signing up was so rapid, you could just anticipate having issues with too many people in the facility.

In Scottsdale, it's two reasons; a) we have a strong pre-sale, but more importantly, b) the customer base in that area really wants just one step higher. They just are vocal about wanting to have fewer people in the club but a more touchy-feely experience. So we listen to our customer, we look at the market again, we re-evaluate and decide, you know what, the first three months of the pre-sale with gangbusters, that's Sport, but let's now try to slow it down a little bit.

So it's one by one, and we think through every facility. It's methodical and it's always focused on the member experience. And also, we want to make sure that the net transaction is a positive toward dues revenue. Does that help you?

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**Paul Lejuez** - *Credit Suisse - Analyst*

Yes, that's perfect. Thanks, and good luck.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Thank you.

**Operator**

Your next question will come from the line of Michael Lasser with Lehman Brothers. Please proceed.

**Michael Lasser** - *Lehman Brothers - Analyst*

Hi. Can you quantify the total membership from your efforts to reduce overcrowding and your decision to offer premium priced memberships in the new clubs.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

That's a great question. I don't have a great answer for you. We don't- we haven't been looking at what is the total net loss of membership from versus what we would get. What we're focusing on, more or less, is the dues revenue for that particular club, growing the way we want it or is it becoming stagnant, or is it going the other way? That's the way we look at it.

Again, you can break this a hundred different ways but the most important factor for every club is your dues revenue. Everything else will fall in place from the financial side, the other side of this, the most important factor is that customer experience. And those are the two things that I drive the entire company, can manage.

**Michael Lasser** - *Lehman Brothers - Analyst*

Just the second part to that question. In this environment where you're trying to manage overcrowding in the club and doing so by raising prices, in an environment where perhaps there is economic weakness or tightened competition, would you do the opposite where you would lower prices to attract additional members?

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

It's a great question. You know, we have -- as you know, memberships basically from the \$49 price point all the way to now with an Athletic membership to \$119. So we have huge elasticity. We also have a what we call an Express membership of just \$39 a month for probably a single person, younger, doesn't have kids, doesn't have the need for the children's center. It's a stripped down version of our membership for someone who is not interested in the family recreation stuff.

They just really want the great fitness experience. And in that space we would compete with clubs that they purely offer just the fitness experience and we want some of those young people in the clubs and if we have the capacity, we may have a few facilities throughout our system that are offering maybe a \$39 Express membership. So for competitive reasons, I think we have the opportunity to price our facilities to get the right amount of bodies running through there to make everything feel great all the way up from 39 to \$119 per single membership.

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**Michael Lasser** - *Lehman Brothers - Analyst*

Okay. I'll get back in the queue. Thank you.

**Operator**

The next question comes from the line of Brian Nagel with UBS. Please proceed.

**Brian Nagel** - *UBS Securities LLC - Analyst*

Hi, good morning. It's Brian Nagel, UBS.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Hi, Brian.

**Brian Nagel** - *UBS Securities LLC - Analyst*

Congratulations on another great quarter.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Thank you.

**Brian Nagel** - *UBS Securities LLC - Analyst*

Quick question. You recently opened two centers in new markets, in Kansas and in Utah. Have you seen, as you move into these new markets now, have you seen any difference in the so to say, competitive, the moves by your competitors compared to what you saw historically?

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Not really. I think right now if I was giving you the most accurate answer, the mix of our new clubs openings in the new markets and old markets is exactly the same as it's been in the past. Some clubs open up a little stronger right out of the chute and then slow down because there's just a certain number of people that can get through the club early on comfortably and some clubs will get off to a slower start and once enough people come in and experience how great the facilities are, we start ramping up and every month we sell more memberships. So it's totally the same mix that it's always been.

I can just tell you that from everything I watch on a club by club basis, there are no trends that would concern us about anything from any perspective. And the competitors have found, in my opinion, their space, and we have been focusing on our member experience more than -- what the competitor is doing. Some of our competitors are doing a great job in the fitness space but they are not focused on the bigger, more elaborate and complex model that we are and I'm not saying there model is any less worthy than ours is, it's just different.

**Brian Nagel** - *UBS Securities LLC - Analyst*

Great, thanks a lot.

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**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

So I think they're happy and we're happy and things are going well.

**Brian Nagel** - *UBS Securities LLC - Analyst*

Sounds good. Thank you, congratulations and good luck in the next quarters.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Thank you.

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

Thanks.

**Operator**

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

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

Good morning, everybody.

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

Good morning, Ed.

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

A couple of questions, guys, if I could. If you look at the revenue per member and the in-center revenue from membership members, does the acquisition of those clubs that you made last quarter affect those numbers at all?

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

They slightly enhance both revenue per member because the average dues on these clubs that we acquired is higher and they slightly enhance the in-center revenue per membership primarily because of this tennis component that we have acquired.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Yes, those clubs don't have as strong revenues from media, cafes, spas, as we have in our general, in the large format prototype center. On the other hand, they have strong tennis revenues that offsets those things we have, they don't have, maybe even a little bit to the better. So it's early on. We have a lot of room in those facilities to enhance all those experiences. It's going to require time for us to build- remodel the facilities, build the cafes, spas, in those, and get them up and running, so it's going to be some time and there's still room in improving the tennis experience itself.

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So, again, I want to make sure I temper everybody's ideas of what that means in terms of dollars and cents. It's going to be a slow, methodical process and it will take time for all of it to fall in. You know, it could take all of the next 12 months for us to make all these changes. We are now in the busy season so the amount of remodel we can do in these without disturbing the heavy traffic, it's not a lot. We're doing some but we can't do everything, so it will take us a full year to do all the redesign and remodel the way we want to and we will continually hopefully get the additional revenues and in-center components out of it as well.

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

And then one more if I could. If you look at the pricing environment out there, not Life Time Fitness, but basically just your competitors, are you seeing anything different from a competitive pricing standpoint this year than you did at this time last year, just generally speaking?

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**Bahram Akradi** - Life Time Fitness - Chairman of the Board, CEO

Not at all. I think our Fitness -- again, if I emphasize, that we compete with, we have the 4 in 1 model and one of those areas is the fitness center, and in that fitness center the guy who's coming in interested in getting on the Stairmaster and just doing his Stairmaster and maybe a couple of selectorized machines and leave, there are plenty of options other than Life Time Fitness. So in that space we have to deliver a better, all around experience and a sense of belonging for that customer but we have more competition in the other areas where you bring in the resort spa, the family rec and the athletic components.

We have competition, we have less competition in that space. So, depending on where you are in the market, you will have a variety of different competitions but we are again not seeing anything out there that would force us to change our pricing. We are more focused on working our pricing to deliver the optimum customer experience and still, everything is working.

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

Thank you.

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**Operator**

Your next question comes from the line of Scott Mushkin with Bank of America. Please proceed.

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**Scott Mushkin** - Bank of America - Analyst

Hey, guys, thanks. Do you have a membership number excluding the acquisitions, the growth?

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

We've given you, in essence, the total membership number and an approximation of the brand transition and you can obviously--

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**Scott Mushkin** - Bank of America - Analyst

Do it from there?

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

Yes.

**Scott Mushkin** - *Bank of America - Analyst*

That's great. A couple of other questions and these are more kind of long term strategic. I was just wondering, Bahram, if you could talk about the value you put on the actual box, the asset, versus the value of the quality of service and the atmosphere in the clubs. Where do you think the most value is?

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

This is a great question but it is a judgmental question so I can say great in this- so let me just make a point here. The best answer I can give you. When I think of a facility like us and what we do, there are multiple different assets that you could capitalize on. Your boxes, the facilities, the program services you have inside of there is one. The experience and the systems you have in place and overall the way those things work together to deliver a comprehensive package and a great value for a customer is another one.

The third thing is your total membership. You know, who are the members of the club. What are their interests, what else are they interested in buying from you. And I think one of the greatest assets we will have as we continue to build more centers, acquire more members, and have a truly a national footprint, which while we are on our way to try to create something like that, we are not near close to what the potentials are there.

When you have millions of membership that they have, the specific profile, I think there are a tremendous number of additional opportunities in what a healthy way of life company can earn from the effort they have put forward to gather all those people together. I don't want to elaborate more than that. I hope that answer does enough for you.

**Scott Mushkin** - *Bank of America - Analyst*

No, that's great, actually. My next, almost a follow up: when you look at what's going on in Minneapolis and where you guys have positioned yourself there, to me, as you look forward five years in the industry that seems to be would have some significant advantages as the industry develops, as you say a healthy way of life company, almost like a wellness industry, is this a model that you would like to use in others cities and do you think it does give you some distinctive advantages as you look out a few years?

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

I think you're asking another great question. So if I could rephrase that: are there opportunities in our forecast that things that other metro areas could happen where we would have penetration like we will have in Minneapolis-St. Paul, it wouldn't be smart to think that it's not possible or it's not probable because as time goes on, the competitors are two groups.

They're either solid, good competitors with good models, which we expect to be in those markets with them in all of the markets across the country, and then there are those who are not doing a great job because there are opportunities for them in the particular market from the competitive standpoint not being too aggressive. They can still survive in single digit margins.

If you look at it from that perspective, as more sophisticated national operators expand into those markets, which is inevitable that will happen, you will have fewer of those types of operators being around so you can forecast that we will be able to have opportunistic scenarios around the country over the years where we can dominate in terms of- create a more appropriate penetration throughout the city with- that gives us the opportunity to serve those members much better by allowing them to

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have a lot more square feet of facilities and amenities for the same price that they're paying. So it's actually a great plus for the customer.

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**Scott Mushkin** - Bank of America - Analyst

Doesn't it also open up opportunities, like say, in Minneapolis, go to Target Corporation and say, hey, we could put a great wellness program together that will cover your entire spectrum of employees, or is that something that's just not really feasible enough for you to think about?

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**Bahram Akradi** - Life Time Fitness - Chairman of the Board, CEO

Well, if you think about big corporations, they also have issues because they have employees based all over the country, and so sometimes they feel that they can't do something specifically for employees in one market but not others. But we are seeing a national Fortune 10, Fortune 50, Fortune 100 companies coming to us and wanting a comprehensive wellness program for them from Texas to Minneapolis to other markets. It's happening. It has its challenges but it's also happening on a regular basis.

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**Scott Mushkin** - Bank of America - Analyst

Great. Thanks so much. I appreciate it.

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**Operator**

Your next question comes from Hardy Bowen with Arnhold & Bleichroeder. Please proceed.

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**Hardy Bowen** - Arnhold & Bleichroeder - Analyst

Hello. Good results.

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

Thanks, Hardy.

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**Hardy Bowen** - Arnhold & Bleichroeder - Analyst

Bahram, in the Advantage program for Scottsdale, are we giving something extra with the Advantage membership that is things like free massage, or free yoga or Pilates?

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**Bahram Akradi** - Life Time Fitness - Chairman of the Board, CEO

No, we give them more space.

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**Hardy Bowen** - Arnhold & Bleichroeder - Analyst

Okay. And does the number of people required to run Scottsdale remain the same or can we run it with less people if we have less members?

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**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Yes, when I talk about less members, it's not a ghost town. We will have a modest opportunity to reduce a few of our hourly employees when the club runs at a lower membership because obviously it's not going to get as dirty as quickly, etc. but the focus, remember, on these clubs is not to have a lot less in the way of revenues, dues, in-center revenues, so we want to keep that service level at a level that the customer can say, you know what, I can see why I pay \$20 a month more because I want to have this closer touch, fewer people, a little more space in the locker room.

So, again, not all markets are primed for that. In some markets, the bulk of the median population would rather pay 59 or 49, and still have the extra bodies next to them. The 20 or \$30 may be more important to them. Scottsdale is one of those that we don't think it is.

**Hardy Bowen** - *Arnhold & Bleichroeder - Analyst*

Are there any other locations next year, I guess, really not, there are not too many Scottsdales out there.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Well, I don't think that there actually will be more locations as we come to the East Coast more. We initially will come in at that Advantage pricing right off the bat.

**Hardy Bowen** - *Arnhold & Bleichroeder - Analyst*

Okay. Sounds good.

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Okay? Go ahead.

**Operator**

Your next question comes from- would you like another question, sir?

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

We'll take one more question.

**Operator**

All right. Your final question will come from the line of Sharon Zackfia with William Blair. Please proceed.

**Sharon Zackfia** - *William Blair - Analyst*

Okay. I'll try to be the only analyst that asks one question on the call since I'm at the very end.

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

Okay, Sharon.

**Sharon Zackfia** - *William Blair - Analyst*

Mike, you mentioned integration costs for the new leased clubs. Can you let us know how much those were, if they're spilling over into the fourth quarter as well and where -- center ops would have been without the acquisitions?

**Bahram Akradi** - *Life Time Fitness - Chairman of the Board, CEO*

Sharon, you said you were going to ask one question. That was three.

**Sharon Zackfia** - *William Blair - Analyst*

It was a really long question.

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

There are three things from the leased centers that we took over affecting center operating margin. The first and the largest of those is lease costs on that line trading places, in effect, with the depreciation line. That obviously continues.

The second one; we had modest transition costs and by modest, under a half a million dollars, actually quite a bit under a half a million dollars, and we don't expect- there might be a little bit of that that goes into the fourth quarter but it is not significant. And the third is, keep in mind that these are not running at optimum margins. They're in effect, really behaving as we look at it, more like a first year maybe into a second year club. So that obviously also affects the overall margin.

Excluding those factors and excluding share-based compensation expense, like I said, the center operating margins were slightly better. I'm not giving a specific number, but they were slightly better.

**Sharon Zackfia** - *William Blair - Analyst*

Okay, thanks.

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

Thanks.

**Operator**

I would now like to turn the presentation over to Mr. Ken Cooper for closing remarks.

**Ken Cooper** - *Life Time Fitness - Senior Director of Finance*

With that, I'd like to thank you for participating. We look forward to reporting to you our fourth quarter and full year 2006 results tentatively scheduled for Thursday, February 15, 2007. For this and all other key dates, please see our Events Section within the Investor Relations section of our website. Thank you and goodbye.

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**Operator**

Thank you for your participation in today's conference. This concludes your presentation, you many now disconnect. Have a great day.

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