FINAL TRANSCRIPT

LTM - Q1 2008 Life Time Fitness Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first quarter 2008 Life Time Fitness Earnings Conference Call. My name is Lisa, and I'll be your operator for today. (OPERATOR INSTRUCTIONS.)

I would now like to turn the presentation over to Mr. Ken Cooper, Senior Director of Finance. Please proceed, sir.

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

Thanks, Lisa. Good morning, and thank you for joining us on today's conference call to discuss the first quarter 2008 financial results for Life Time Fitness. We issued our earnings press release this morning. If you did not obtain a copy, you may access it at our website, which is lifetimefitness.com.

In a moment, Bahram Akradi, our Chairman and CEO, will discuss his thoughts on our first quarter and our underlying business trends. Following that, Mike Robinson, our CFO, will review our financial highlights. Once we have completed our prepared remarks, we will take your questions until 11:00 a.m. Eastern time. At that point in the call, the operator will provide instructions on how to ask a question. I will close with the tentative date of our second quarter 2008 earnings call. Finally, a replay of this teleconference will be available on our website at approximately 1:00 p.m. Eastern time today.

I'd like to remind everyone that this conference call contains forward-looking statements and future results could differ materially from the forward-looking statements made. Actual results may be affected by many factors, including the risks and uncertainties identified in this morning's earnings release and in our SEC filings.

Concurrent with the issuance of our first 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 including EBITDA. We have included reconciliations of the differences between GAAP and non-GAAP measures in our earnings release and our Form 8-K. Other required information about our non-GAAP data is included in our Form 8-K.

Before I turn the call over to Bahram, I would like to take a moment to remind you that we are having our annual shareholder meeting at 2:00 p.m. Eastern time today. Accordingly, we will be preparing for and conducting that meeting and will not begin responding to emails and phone inquiries until after that meeting or approximately 3:00 p.m. Eastern. Your patience and flexibility are greatly appreciated.

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

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

Thanks, Ken. On behalf of all Life Time Fitness, I'm very pleased to provide you with an update on our business. We're off to a solid start to the year. Revenue was up over 20%, and we delivered over 23% growth in net income. We hit on our membership growth expectations, and we continue to see strong dues growth.

The metrics with which I was most pleased were the growth of average revenue per membership and average in-center revenue per membership. Both were slightly ahead of our internal plans. Mike will provide greater detail on our financial performance shortly.

Since our last call on February 22, we have received two primary questions for the -- from the investment community. One is obtaining funding to support our growth plan. Mike will share his update with you within his financial highlights. The second is with regards to how our membership base has reacted to our business value proposition and economy. Short answer is great. Now let me give you some color.

First, our existing member base is responding well. Usage level remains high across the system, which is always a great sign. We added over 21,000 net memberships in the quarter. These memberships came in with a higher average dues and higher propensity to use in-center businesses. And we see increase of average revenue per membership and average in-center revenue per membership to support that. For example, we saw an increase of 13.3% in average in-center revenue per membership in the quarter, which is impressive.

What's encouraging to me is that we did not use our typical levers of enrollment fee and marketing to full advantage until the second half of March. I would like to take a moment to share the rationale for this strategy. In keeping with our commitment to the member experience, we know that January and February are the busiest time of the year in terms of club usage. Therefore, it is difficult to justify heightened promotion to bring in even more people in the clubs if we are to stay true to our membership experience initiatives.

However, we have begun the use of lower enrollment fees and marketing more in late March and April, and I am pleased with the response to date. We had an approximate 10% membership growth in the first quarter. Our internal plans and guidance have similar goals in place for the second quarter. This is based on the fact that we are at the tail end of the effect of the dues increase letters and managing memberships down in over-capacity clubs, which should be complete at the end of the second quarter.

Plus, we will complete a number of remodels for our acquired clubs towards the end of second quarter, which should provide membership growth in those centers in the second half of the year. We're simply using our tools to be proactive to environment that we are in. Undoubtedly, the environment is more challenging, but we find the accomplishment of our goal is very doable. And using the levers should set up us nicely to see the growth rate improve in the second half of the year.

One of the more interesting questions I have received from our investors is would we do anything different had we known a year ago what we know today? If we had a crystal ball, we would have avoided our planned branding campaign and use of our marketing dollars solely for direct mail and call to action advertising. However, I feel great about the fact that we have pivoted at this point and we are comfortable with the new results.

As far as pricing action, there are perhaps a couple of clubs that in the hindsight we may have delayed our price changes of the 31 clubs that we have seen changes in classification in the past year or so, but that means that the vast majority are doing what we planned, which is also encouraging.

Another way we are reacting to the current environment is that over the past couple of months we have stepped up our connectivity initiatives into a higher gear. One of the most important things I have learned over 25 years of operating health clubs is that the more connected a member, the better for the member, their experience and results, and better for the business. It is a clear win-win. In support of our efforts in this area, we're in the pilot phase of several initiatives at the corporate center here in Chanhassen. I'm pleased with the progress that our team has made in a short time.

Lastly, we look at several metrics to make sure our plan is working. For instance, we delivered over 900 basis point of dues growth over membership growth. That is a great sign, and we saw revenue per membership and in-center revenue per membership grow at its best rate in over a year. This is another great sign that we are accomplishing our goals of delivering an unparalleled experience to our membership base.

With that, I would like to turn the call over to our CFO, Mike Robinson, who will provide more color on our financial performance to date. Mike?

Mike Robinson - *Life Time Fitness - CFO*

Thanks, Bahram. As Bahram indicated, we had a solid start to the year. I'd like to start my comments with an update on our capital structure. First, we have increased our revolver by $21 million to $421 million at our current pricing. We're also working with our bank group to increase the revolving line by a further $100 million. The full revolver pricing is still to be driven by the market, but we expect it to be below our long-term models, especially since it's driven off of LIBOR, which is currently below 3%.

In addition, we're working to finalize mortgage deals ranging from approximately $20 million to $50 million per transaction. Again, we expect pricing, either fixed or floating, to be at or below our internal return models. Finally, we're negotiating specific sale leaseback facilities ranging from $25 million to $100 million, which we expect to be P&L neutral. This solidifies our needs for 2008 and a good portion of 2009.

Moving to our P&L performance -- for the first quarter, total revenue was up 20.5% from last first quarter. This growth was due to several factors, including membership dues growth of 19%. This was driven mainly by upgraded dues we have enacted for new memberships in clubs where we're actively managing capacities.

In addition, during the first quarter, we applied a dues increase of approximately 3 to 4% to about 40% of our membership base, a big chunk of which were in the 20 clubs where we're actively managing capacities. Also, as Bahram mentioned, we saw over 900 basis points of GAAP between our dues growth and the 9.9% membership growth for the quarter.

In-center revenue grew by 25.9% for the quarter led by personal training. We continue to deploy new products, programs, and services in each of our in-center businesses, which also support our growth. Highlights from other revenue metrics include first quarter same-store sales, which were at the low-end of our expected range. For the quarter, we generated 4.3% increase in same-store sales and had a 1.8% decline in our 37-month mature same-store sales.

Excluding the centers in which we're managing memberships at, our mature same-store sales were down 1% in the quarter. This was driven by a softer spa business, as well as some revenue loss at some of our lower demographic locations. In the first quarter, we had two centers enter the 13-month comp base. There were no additions to the 37-month comp base.

With respect to revenue per membership, we generated an 8.7% increase to $363 in the quarter. In-center revenue per membership increased in the first quarter to $111 or a 13.3% increase over last first quarter. Both are at the high end of our expectations and are a good indicator as we're executing on our strategies.

Moving to our margin analysis -- the Company's operating margin improved 70 basis points to 19.5% for the quarter. The main drivers of this margin improvement were 110 basis points of G&A leverage and 20 basis points improvement in our center operations. Offsetting the G&A and the center op's improvement were approximately 30 basis points of increased spend in marketing and 10 basis points of increased depreciation expense.

Our center operating margin increased from 41.5% to 41.7% as a percent of total revenue for the quarter. This improvement is related to the operating efficiencies realized around operation staffing models and purchasing power on supplies.

As we make our way down the P&L, interest expense net of interest income increased to $7.2 million from $5.5 million last first quarter as we continue to grow our new center base and our average debt balances grow. Our tax rate for the quarter was 40.2%. We expect our 2008 effective tax rate to be approximately 40%.

That brings us to net income from the quarter of $17.4 million, which is up 23.1%. Our net income margin for the quarter increased 20 basis points to 9.4%. Total common shares outstanding as of March 31, 2008 were 39.5 million shares. Weighted average fully diluted shares totaled 39.4 million shares for the first quarter. We expect our total weighted average diluted share count for 2008 to be approximately 39.8 to 40.2 million shares.

Based on the 2008 first quarter weighted average share count, our diluted EPS for the quarter was $0.44, up from $0.38 in the first quarter last year or 16%. As a reminder, the difference between our net income growth and our EPS growth is related to the equity offering we completed in August 2007.

Moving to our operating data -- the number of open centers at March 31, 2008 was 71 compared to 60 at March 31, 2007. Of these 71 centers, 39 are current model centers and 54% have been opened three years or more, which we classify as mature centers. As of March 31, 2008, we had approximately 7 million square feet, which is 19.9% greater than we had March 31, 2007 when we had approximately 5.8 million square feet.

EBITDA totaled $52.9 million in Q1, up 23.8% from the last first quarter. EBITDA margin improved from 27.9% to 28.7%. Memberships at March 31, 2008 totaled 521,177 compared to 474,364 memberships last Q1, up 9.9%. Regarding memberships, I want to update you on our attrition rate. For the first quarter, our trailing 12-month attrition rate was slightly above one percentage point above our run rate for 2007. We believe this step-up is directly related to the existing membership price increases that were implemented in the first quarter.

Cash flow from operations totaled $49.3 million, up from $39 million in the first quarter 2007. This 26.4% increase is driven by our EBITDA growth rate, as well as working capital control.

Turning to the balance sheet highlights, the largest activity continues to be driven by our continued growth in new center construction. Cash outlays for capital expenditures for the quarter were $102 million, which includes approximately $83 million related to growth or construction of new centers, $10 million for remodeled centers of acquired clubs, and $9 million for the maintenance of our existing clubs and corporate initiatives.

To finance our growth, we will continue to use our strong operating cash flow and debt. During the first quarter, our overall debt balances grew by approximately $66 million to $631 million as of March 31. This includes $367 million outstanding on our $421 million revolver. Our net debt to capital ratio increased slightly during the first quarter to 51%.

Other balance sheet variances to note include other assets increased by approximately $10 million, primarily related to the reclassification of land available for sale from current assets to long-term and an increase in lease deposits. Working capital is down by approximately $20 million with about half coming from reduction in current assets, such as collection of accounts receivables and reduction in inventory and half coming from an increase in our current liabilities such as the expected increase in construction accounts payable.

As it relates to deferred revenue and deferred membership origination costs, we increased deferred revenue by approximately $4 million, increased deferred membership origination costs by approximately $2 million.

Now, let me discuss our updated guidance for 2008. We expect to open ten more centers in 2008 to finish the year with a total of 81. We expect three centers to open in the second and the third quarters and four to open in the fourth quarter. Our next club to open will be in May in John's Creek, Georgia, which is a suburb of Atlanta.

Our revenue guidance is maintained at 19 to 22%, which equates to approximately $780 million to $800 million. We expect net income growth of 21 to 23%, which equates to approximately $82 million to $83.5 million, up from 20 to 22% growth or $81.5 million to $83 million. This results in diluted EPS guidance of 16 to 18% growth, which equates to approximately $2.06 to $2.09 a share, up from 15 to 17% growth or $2.05 to $2.08 per share guidance previously issued.

Regarding our CapEx guidance, we maintain our expectations of $440 million to $460 million for the year. This includes approximately $380 million to $400 million for growth, which works out to approximately $35 million per club for the class of 2008. It also includes $30 million to $35 million in maintenance CapEx of our existing club base and $25 million to $30 million of one-time remodel costs for our recently acquired clubs.

For the second quarter, we're expecting revenue growth slightly below 20% and net income growth of approximately 20%.

Before moving into the Q&A session, I want to address an item which has been posed as a question to us more than once via our many discussions. Are you really planning to accept lower returns for your Florham Park club? It's one that I found most interesting, and the answer is no. The investments we have made and will continue to make on the East Coast are higher than typical, however, there's a corresponding higher than typical cost of living adjustment that we plan to use to our advantage in terms of pricing. Thus, we'll be pricing our Northeastern clubs higher than are normal in the Midwest, which will be in the $89 to $119 range. This will allow us to invest more, but maintain our expectations of 15% returns by the time the clubs hit maturity.

Other than how's the economy affecting our business and funding, the return aspect of our business is the most prevalent question we receive. Clearly, as our initial investment and construction progress continues to increase as we've expanded in different areas of the country, we've seen a lower consolidated return profile. The biggest reason for this is it takes three years for a club to reach maturity and there's a significant drag due to the large amount of construction in progress at any given time. So, a large part of our asset base, in fact, over 50%, is not yet producing returns or is still ramping to its targeted returns.

We break our internal return analysis into three major categories. First, mature centers, which continue to run in excess of our 15% hurdle rate. Second, centers in ramp or centers in their first three years of operation actually improved slightly in 2007 as a group. And finally, land and construction progress continues to grow at a fast pace with over $200 million in growth assets yet to be yielding returns. It's the weighting of these assets and the mix of centers in ramp which have driven the lower consolidated returns. I call these assets return in backlog.

Interestingly, if we were to stop expansion, which we are not planning to do, and complete the ramp of our existing membership base, we'd near 15% return for the Company within four to five years and it would still be growing thereafter. We feel that the inherent power of returns is hidden by our current expansion efforts.

That concludes our prepared remarks regarding our first quarter 2008 financial results. We're off to a good start. With that, we're happy to take your questions now.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS.) Your first question is from the line of Ed Aaron with RBC Capital Markets. Please proceed.

Ed Aaron - *RBC Capital Markets - Analyst*

Great, thank you, and nice execution on the quarter.

Mike Robinson - *Life Time Fitness - CFO*

Thanks, Ed.

Ed Aaron - *RBC Capital Markets - Analyst*

A couple questions for you. I was hoping you could talk a little bit more about the improvement in the in-center revenue metrics. How much of that do you think might be attributable to just having a more committed membership base than what you might've had last year because you can make a case that in this environment some of your more marginal customers might be getting weeded out as a result of price increases in a tough economy. Do you think that contributed at all?

Mike Robinson - *Life Time Fitness - CFO*

I think it's a combination of many things. Certainly, strategically, as we move in some demographics to a higher price profile, that's exactly what we're seeing. The higher demographic has a higher propensity to spend and we're seeing that. If you go through the results of the in-center businesses, our personal training business remains very strong, and I know you've heard me say this in the past, this is a -- it's a high price point business. We're talking $75, $85, $95 an hour, yet -- and that tends to stratify the -- our membership base a little bit with those that can afford it, but clearly, they are and they're coming back to it.

We're also doing some things that Bahram indicated a little bit earlier on connectivity. When we can work with people through group training classes and they understand the value of personal training, in many cases they'll opt up to one-on-one types of classes. So, again, it improves our take and the revenue growth within personal training.

We've also seen -- as you go down to the other businesses, our cafe, which, frankly, we were disappointed in its revenue production in last year. That bounced back very, very well really, we believe, driven by execution. It's something that we don't believe we were executing as well as we could. We still don't believe we're executing as well as we could, but we're making improvements there.

We did see some weakness in our spas, predominantly in the massage area. We think that's an area that the economy has impacted the business. But at the end of the day it's a pretty small piece of our overall business.

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

This is Bahram here, and I want to add back to what Mike said. When you look at our cafes and some of the other parts of our business, one of the things about our Company that I am most proud of is our management team being very candid about the things we don't do well. So last year we rolled out a new menu in our cafes, and frankly, we did a very poor job of executing that rollout. The net result was actually negative in terms of the customer reaction and satisfaction. Right now we are testing new menu and a new game plan for what we're going to roll out with a mission for our Life cafes to provide great tasting food that is really good for our customer and doing it friendly and doing it fast.

Within the pilot clubs that this is happening, the sales are dramatically more than the clubs that are not and are still operating mostly under last year's menu. We've made some of the changes and execution, like Mike said, better this first quarter, but we're not even near -- we're just really not even close to what the outcomes could be in overall revenue per cafe, as well as the overall satisfaction of our customer, not just in the cafe, but in the overall business. Because, of course, every piece of the business affects the whole thing. So, we're really, really excited about staying focused and improving in all the areas of the business that we recognize we have room for improvement.

Ed Aaron - *RBC Capital Markets - Analyst*

All right. Thank you, and then one other question if I could. You mention in your prepared remarks that your same-center metrics were at the lower end of your expectations. And I'm trying to reconcile that with the aggregate numbers actually in looking overall pretty favorably because you had mentioned some impact from memberships from the lower demographic, as well as softer spa, but you said the membership numbers overall were consistent with expectations and the in-center was better. So should we just assume that the new clubs are performing further above plan and that the older clubs might be lagging a little bit more?

Mike Robinson - *Life Time Fitness - CFO*

Well, I think you can assume that the new clubs are performing at or potentially a little bit above, and frankly, we'd like to see same-store sales at 5% or above. We clearly got some effect by some lower spa sales. We clearly got effect especially in some of the lower demographic areas on just regular dues sales.

Ed Aaron - *RBC Capital Markets - Analyst*

Okay.

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

We did a couple of -- and again, we're not going to get into the details of exactly which clubs. There were a couple of clubs that we rolled out the dues increase in the much -- like Mike talks about -- the more sensitive economic areas. The reaction was probably a little more severe in terms of the dropout than we would normally see in the majority of the clubs. So, you may have had 28 of the 31 clubs reacting exactly the way we wanted it and a few clubs were softer than that, but those are easy adjustments to make back up. We overall feel really solid about the guidance that we gave you guys and we as always focus on delivering what we promise.

Ed Aaron - *RBC Capital Markets - Analyst*

Helpful. Thank you.

Operator

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

Tony Gikas - *Piper Jaffray - Analyst*

Good morning, guys, and my congratulations, as well, on the quarter. Three questions. Maybe just a little bit of an update on pricing changes. Will they be as significant in the forward 12 months as they were in the trailing 12 months? The second question, member acquisition for the balance of the year, it looks like you're still targeting at a low double-digit growth rate there. Could you help us out by weighting that by quarter a little bit? And then the third question, are there any centers that are underperforming perhaps in some low demographic areas that maybe you'd consider the sale of at some point in time, help you raise some capital and improve margins or really nothing there on the low-end of the range?

Mike Robinson - *Life Time Fitness - CFO*

Sure, Tony. Let me take a couple of them and then I'll have Bahram fill in the blanks on that. Regarding pricing changes, the vast majority of our pricing changes are -- have been implemented. There may be some that we look at again, depending on ramp and the demographics and the success of these clubs, but the vast majority of that was behind us in the first quarter.

Regarding membership growth and how we expect that, I think we talked quite a bit about the fact that the first half of the year we expect about 10% membership growth. That continues to hold true for the second quarter. We expect increase in the second half for a variety of reasons, most of which include the fact that we've got a significant amount of clubs opening in the second half of the year. We're getting through major remodels on acquired centers in Dallas and in the Twin Cities we expect an up tick for. And frankly, there should be some easier comparisons as you move into the second half of the year. I would right now put that in -- we would expect it to grow maybe in the 12 to 15% range over that second half.

And I'm going to let Bahram talk about any centers that are underperforming that we would consider selling.

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

Tony, that's a great question and let me give you the -- two answers. In the event we have a facility that doesn't fit our profile, it doesn't work, we made a mistake in kind of putting it into place, we will obviously be responsible about getting rid of that center. So, that's something that I want to make sure there's no misunderstanding that we're going to be emotionally attached to something that doesn't make sense. If it doesn't make sense, we're going to get rid of it.

Having said that, even in some of these centers that we've seen some harsher response than normal to the dues letter and -- a dues increase letter, etc., that we see some drag on the same-store sales, etc., they're still making a lot of money. If they were not profitable, then I think you start kind of looking about what can we do with this. But they're making a lot of money. They're not making no money, they're not break even. They're still making a lot of money, so if we get to the point where we should really look at the facility that is not a profitable -- doesn't have the promise of becoming profitable in our system, we will think about how to get ourselves detached from that facility. Does that answer your question, Tony?

Tony Gikas - *Piper Jaffray - Analyst*

Yes, that's great. Thanks.

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

Okay.

Tony Gikas - *Piper Jaffray - Analyst*

Good luck, guys.

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

Thank you.

Operator

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

Tracy Kogan - *Credit Suisse - Analyst*

Thanks. It's actually Tracy Kogan filling in for Paul. Two questions. First, related to your comment about Florham Park, stepping back, last year's centers had a higher average cost to build and wondering if you're seeing the revenues associated with those clubs, if the revenues have been at the levels to justify the greater investment? And then secondly, can you tell us what the attrition rates were at the clubs where you weren't managing members down? Thanks.

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

I will take the first one and talk to you about the -- and I'm going to respond to you this way. We go through an exhaustive level of analyzing a club in terms of any investment. Every time we do a club, we build a complete business plan. It goes to a review of all the management and then through the finance committee and the board to get approval on building a new club. Our hurdle rates are 15% ROIC and 22% IRR the way we calculate that. I'm sure you guys are going through that with my team on how that calculation takes place.

We are disciplined and so when we take a look at a facility we think about what we're going to spend. Then we have some obviously contingencies about costs. All of that is in the business plan. So when we spend more money in a club, we expect to get more money coming in, more memberships with higher dues. We basically think about is this a capacity of 9,000, 10,000, 11,000 memberships and at what dues levels we want those customers. When we get to -- when we execute to those plans, we will end up hitting the returns we're looking for.

Now, we have had in 2007, 2006, we had some facilities that came in at a higher cost than our initial plans because we were doing a business plan, going through and by the time we were middle of construction, construction costs may have -- may had risen 15 or 20% accumulatively by that time. So, you will see some, but I also believe very strongly that these clubs have the ability to generate the revenues to give us the return that we are after as a corporate goal. As Mike said, we're looking at this regularly and we feel very confident that these investments will result in 15% ROIC by the time these facilities get to the maturity stage. We have no signs of any of the more expensive facilities not having the ability to get there.

Mike Robinson - *Life Time Fitness - CFO*

Let me put just a little bit more color on that. If you look at an expensive facility like aScottsdale, Arizona or a Columbia, Maryland or something like that, frankly, the expected range of revenues, annual revenues on something like that is $17 million to $20 million, and obviously, you would also expect -- at maturity -- and you would expect an increased EBITDA rate off of our averages also. And those clubs are trending to that, trending toward those as you would expect in their state of maturity.

You had a second question and that was on the attrition rates in some of the lower demographic clubs, I believe, Tracy, that was the focus of the question. We obviously don't give specific attrition rates by clubs, but it would be correct to assume that the attrition rate in a lower demographic club, especially one that we would've hit with a price increase, you would've seen rather than the one point bump on average, you probably saw in the neighborhood of a couple of points increase.

Tracy Kogan - *Credit Suisse - Analyst*

Thank you. Good luck.

Mike Robinson - *Life Time Fitness - CFO*

Thank you.

Operator

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

Scott Mushkin - *Bank of America Securities - Analyst*

Thanks. Just, Mike, quickly, I didn't really fully understand that attrition stuff you went through earlier in your prepared remarks. I was wondering if you could kind of go over it again.

Mike Robinson - *Life Time Fitness - CFO*

Sure. Sure. We have talked to you about the fact that we generally expect and have seen over the last several years' attrition rates ranging from in the 33 to 34 to 34.5% range annually. We closed last year around 34%. The first quarter -- on a rolling 12 month. The first quarter of this year we saw that go up a little over a point annually. The reason -- the primary reason for that and it's something that we see every time we put down -- out a dues increase letter is when you put out -- when you send out a dues increase letter, in effect you awaken what I call some of the sleeping members, those that haven't utilized the club in the last three, four, five, six months, and they look at that letter and they say, "You know, I haven't utilized it. I'm going to opt out. I'm going to take advantage of that month-to-month membership agreement" that we offer. So, invariably, we'll see a spike for generally 60 days or so on that as you go in that particular club, and that's exactly what we saw in -- as we went through the first quarter. As we look at it, it's something that we are aware of, we're focused on, but not something that we expect to continue for the long run.

Scott Mushkin - *Bank of America Securities - Analyst*

Okay. Then I want to ask a question actually off of Bahram was saying before and then ask you a financing question if I could. Bahram, you said that '06 and '07 there were some clubs that came in above budget and the CapEx when we go around talking to investors, the CapEx budget is a topic. And some things that we hear people are struggling with is that kind of the bigger, better model in most stocks has ended not well. In other words, you go -- keeping pushing the square footage up, you keep pushing the investment up and then all of the sudden you end up with some white elephants. So, as we look at '08, what are the chances that that budget, that CapEx budget, would come in at the low to mid-end and are you guys seeing any relief on your cost per square foot in this environment? Then, I'll just go to my financing question. Mike, maybe you want to talk about why sale leasebacks have always been your least preferred option and also the impact as you see it on those lease step-up provisions that usually come along with them.

Mike Robinson - *Life Time Fitness - CFO*

Sure.

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

Okay, I'll take your question regarding the cost -- the CapEx cost. First and foremost, my personal approach as I design and lead the design team is always to build the right product for the customer experience and then try to get it. Then once you determine what that design is, the appropriate product, then you go out and try to execute the best execution you possibly can to lower the cost of acquiring that -- whatever it is that you're coveting.

We did have some facilities that were -- due to timing, opening of the clubs, pressing the schedule, etc., in that time period, where we ended up actually spending more money than we normally spend. I would still argue that compared to having that box built by somebody else, they still came in at a good cost, but nevertheless, it's more than we wanted to spend initially.

We since then again have focused on what can we do better and have put together much, much tighter controls and processes in the class of construction that is coming up, let's say, because of the gestation time. I can always tell you you can make a decision to change a process or something, but you're going to see the real effect of that a year and a half, two years down the road. So, right now I feel extremely confident of the construction team and the process. We should be able to meet our aggregate number that we have in the business plans of all these clubs this year. We're all within their range to hit our target.

In response to your question, I expect to see opposing forces in the cost of construction going forward. That means you have a little bit of advantage with the fact that the commercial construction seems to also taking a breather this year. And we should be able to find some hungrier subcontractors who are willing to work for skinnier profit margins in order to just keep themselves busy where that hasn't been the case up to last year, towards the end of even last year in the commercial side. And then we -- again, you have to think about all the oil-based products and stuff that is inevitable that you would see some price increases on some of the materials. And therefore, I feel like we're going to be able to see close to flat, within 2 or 3% one way or the other, change in the construction costs. So, I feel good about where we're going with those.

Your comment about the fact that many of the other guys who are smarter, more seasoned, and more years ahead of us in terms of large, successful brand names, have maybe gone bigger, bigger, bigger, and then retreated back to some smaller prototypes, that's a valid concern. We don't see right now excessive capacity in our prototype two-story boxes at all. We just don't see that. You know, I have many of these clubs. I was in Scottsdale for four hours, three-four weeks ago just standing around and literally watching different parts of the club and see if we're getting the proper utilization. The answer is yes.

We have a number of clubs, no more than about four I think, where we have the expanded basketball site to it. The idea there is to test the -- all sorts of activity programs for youth, for teens, for adults, functional training, etc, etc., etc. I can tell you right now that I would give us probably a 2 or a 3 on a scale of 0 to 10 in having properly programmed that. So, you can't -- we will not be going out and building 40 more of those facilities with that expanded side until we prove out that in those three or four models that we have developed we can actually run programs that justifies better membership, as well as additional in-center revenues, better connectivity. If we can't prove that out, we're not going to expand the size of these clubs.

I'm also working as last year we created the three-story model for the markets where it just made more sense to have that larger box with better demographics, more density, etc., etc., I'm working on variety of models right now with my design team where it brings maybe a tighter format, but only at 110,000 square feet. Another one that I'm going to be working on in the next few months is at maybe 80 to 90,000 square feet. This is not to say that our boxes are not working, Scott. What it really says that you really need to have a variety of different boxes to build the appropriate product for the demographic, as well as the density traffic patterns, etc. So, we're slowly working our ways, but I don't see a negative. I'm very, very confident that the bulk of -- based on where we're building the clubs, the bulk of increase in the cost of these centers is geographical reasons and we will be able to get the returns to make great results.

Mike Robinson - *Life Time Fitness - CFO*

Scott, your second question on this was sale leasebacks and why historically hasn't that been something at the top of our list and has anything changed. It's all really a cost of capital question and a cost that -- it ultimately is what's the financing cost, what's the differences, etc. As we've seen over the last several years as our balance sheet has improved, our credit has improved, etc., we're actually seeing fairly significant improvement in the cap rates that people are offering us. And so, if you work through that and the full P&L impact of those cap rates compared to alternative costs, i.e., mortgages, things like that, we're at a point now where it's relatively neutral. And that is a difference from the past.

Now, you also asked how do we look at the bumps and things like that. From an accounting perspective, we have to -- you calculate the total ramped over the entire lease and you straight-line it, so you incorporate that in the analysis and you determine from there whether you've got something that from an overall cost of capital perspective is neutral to -- a favorable, neutral, or worse than alternative forms of financing. And today, as we see it right now, it comes in about neutral. So, thus, it's another avenue of funding that we'll look at.

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

And we may do, as a practice, a couple, two, three sale leasebacks from time to time to keep all of the financial metrics in the right [level] so that, as an example, if your revolver is based on a certain price at a certain debt ratio, etc., you may do just one or two sale leasebacks to keep everything at the optimum metrics for the Company, particularly since the P&L impact of that would be neutral.

Scott Mushkin - *Bank of America Securities - Analyst*

Great.

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

Does that answer your question, Scott?

Scott Mushkin - *Bank of America Securities - Analyst*

Yes. No, you did. Thanks for the thorough answers, actually.

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

You're welcome.

Operator

Your next question comes from the line of Sharon Zackfia with William Blair. Please proceed.

Sharon Zackfia - *William Blair - Analyst*

Hi. Good morning. What a relief to have a company beat numbers. I haven't had that in a while.

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

Thank you, Sharon.

Sharon Zackfia - *William Blair - Analyst*

So, I guess I'm curious, Bahram, on the -- did you adjust enrollment fees towards the end of the month of March or towards the end of the March quarter? I was a little confused there.

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

Good question. Only towards the end of month of March.

Sharon Zackfia - *William Blair - Analyst*

Okay.

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

We had committed to a branding campaign early part of '07 and we spent a significant amount of money in the fourth quarter of '07 and first quarter of '08 and we basically, as I mentioned earlier, very focused on the customer experience, not wanting to overcrowd the clubs over the January/February time period. We really didn't start pushing harsh campaigns of membership, lower initiation fees, and more aggressive direct mail towards the second half of March. And results are phenomenal. I mean, I can tell you -- we know this. We've told -- since we went public and in the IPO period, I have told people that I've been doing this business for 25-plus years and during the recessionary time, people aren't so sensitive about spending their $50, $60, $70, $80 a month as long as they're getting -- utilizing the club. They can skip one travel, Sharon, for 800 bucks three days and then pay for their membership dues for the entire year and have all that entertainment available to them and pastime.

So, the key is not make it difficult for them to get in on the initiation fee, and we were kind of tough on not lowering those during the first couple of months of the year. And now that we have been able to get past those two quarters that we had commitments in advance on the TV campaigns, etc., we're in a great position for the remainder of the year to pivot as necessary on the marketing, types of marketing, and adjustments of the enrollment fees to get the membership counts we want to get in the door. And then with the improved programs that I'm working on right now with connectivity, we feel very comfortable we can keep the members and therefore solid in terms of confidence about delivering what we have promised you guys with our plan for the year.

Sharon Zackfia - *William Blair - Analyst*

And have you done that enrollment fee adjustment just at the clubs that are struggling a little bit more or was that something that was done across the board?

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

Well, we've done that -- with those is just recently again, you know, we've kind of taken a club that was a little more challenged with memberships and you take those kind -- you kind of break it up. We're not doing the same price on enrollment fee across the country. Depending on the market, we have a different level of discount on the initiation fee, and like I said, the results are very much coming in exactly as we had expected.

Sharon Zackfia - *William Blair - Analyst*

Okay. And then lastly, can you just remind us on the branding campaign, was that incremental ad dollars you spent or was that just a reallocation of your marketing dollars?

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

No, we spent a lot of our dollars in fourth Q and first half of the first Q here this year. We spent a lot of our dollars on branding and so I took a little bit extra dollars towards the last half of March and added just a little bit of dollars in March to our kind of a direct mail acquisition. As a result, the total marketing spend -- Mark, how much was it over the year before? It's only four-tenths of a --

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Mike Robinson - *Life Time Fitness - CFO*

It was three-tenths over. It was three-tenths over.

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

Yes. So, it wasn't a significant amount, Sharon.

Sharon Zackfia - *William Blair - Analyst*

Okay. Thank you.

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

You're welcome.

Operator

Your next question comes from the line of Karen Howland with Lehman. Please proceed.

Karen Howland - *Lehman Brothers - Analyst*

Good morning. Congrats on the good quarter.

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

Thank you.

Mike Robinson - *Life Time Fitness - CFO*

Thank you, Karen.

Karen Howland - *Lehman Brothers - Analyst*

I was wondering if, Bahram, you can give a little bit more details as far as this -- the pilot phase for increasing connectivity with your customers. Any insights into what that might look like?

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

Okay. Well, let me address your question. I want to be guarded on all the things we have. We're working on what I call a whole thought. It's a complete thought about all the different things that involves the improvement of member connectivity, as well as member communication. If I go back and I say, "What would we give on a scale of 0 to 10 for Life Time Fitness' member communication," I would give us probably a very, very weak low number of maybe 2 or 3 on a scale of 0 to 10 if you look at what's happening, how we communicate with our members. It's kind of a Stone Age archaic.

What we are working on feverishly right now that will come about -- and my goal is to roll out by the first part of the third quarter, systematically across the -- it's a new web design that increases the connectivity, new way that we will connect with each and every member in a way that is much more relevant to their interest area, better communication towards the launch of our LTF vision, which is our own TV network, so I feel really great. I don't want to give you too much details, but I can tell you we are working on that right now pretty much seven days a week and we feel that the results will be dramatic. It will really take an area of our Company that is not -- has been absolutely nothing to brag about compared to the shape and offering of our facilities and programs, it's been really not even in the same league, and bringing it up to as good as everything else is or better.

Karen Howland - *Lehman Brothers - Analyst*

Sounds like it's more communication though as compared to new programs that are being rolled out, is that right?

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

That's not true. It is both.

Karen Howland - *Lehman Brothers - Analyst*

Both.

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

It is both -- more programs, better programming, depending on the area of your interest and better connectivity with those groups, as well as better communication.

Karen Howland - *Lehman Brothers - Analyst*

Okay. Great. Thank you.

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

You're welcome.

Karen Howland - *Lehman Brothers - Analyst*

Talking about the 15% ROIC that you're expecting to get when you get to a mature center, I was wondering if -- with the more expensive centers that you've been opening if that hitting maturity is taking any longer or is it still just taking the three years to achieve?

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

They looked about the same.

Mike Robinson - *Life Time Fitness - CFO*

Yes. The ramp looks about the same. We don't expect any difference.

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

And it's the same kind of mix. Some will do it -- some will look like they get there sooner and some will get there a little later and the average will be about the same.

Karen Howland - *Lehman Brothers - Analyst*

Thank you. And then, Mike, if you wouldn't mind talking quickly a little bit about the financing, and I'm sorry, I was scribbling notes down as you went through that quickly. Am I right that you said that you were going to look for another hundred million of increased revolver from your lending -- your lenders right now?

Mike Robinson - *Life Time Fitness - CFO*

That's correct.

Karen Howland - *Lehman Brothers - Analyst*

And then another $20 million to $50 million in mortgage financing this year?

Mike Robinson - *Life Time Fitness - CFO*

Actually, we've got -- we're pursuing several alternatives that range from $20 million to $50 million, and I expect we're going to close on several of those. So, it's not just $20million to $50 million. There will be quite a bit more than that that we would expect.

Karen Howland - *Lehman Brothers - Analyst*

Okay. So, it -- presumably over -- each one of those is over a grouping of centers?

Mike Robinson - *Life Time Fitness - CFO*

From one to four centers or so, yes.

Karen Howland - *Lehman Brothers - Analyst*

And that would be the actual financing that you get, not the loan -- the value that it's attributable to?

Mike Robinson - *Life Time Fitness - CFO*

That's correct. That's the financing that we would get. In addition to that, as I talked about, we are negotiating on sale leasebacks in a range of $25 million to $100 million.

Karen Howland - *Lehman Brothers - Analyst*

And that $25 million to $100 million is all in not a grouping of multiple -- excuse me. That's going to be the total sale leaseback? It's not as if there's going to be multiple -- ?

Mike Robinson - *Life Time Fitness - CFO*

There could be. There could be multiple of that also, but, again, we're looking at things that go from a $25 million deal to a $100 million deal.

Karen Howland - *Lehman Brothers - Analyst*

Okay. Great. Thank you for that additional color. Then one final question, when looking at the Wellbridge remodeled that I believe come to -- will be finalized after the end of the second quarter, will those immediately be in the comp base or post-remodel or are those not included?

Mike Robinson - *Life Time Fitness - CFO*

They are in the 13 or 14-month comp base right now.

Karen Howland - *Lehman Brothers - Analyst*

Okay.

Mike Robinson - *Life Time Fitness - CFO*

And have been since July of last year.

Karen Howland - *Lehman Brothers - Analyst*

Okay. Great. I wasn't sure how that -- with the remodels if that got impacted at all. And then finally, looking at the center operations margin, do you think that that improvement is maintainable as you shift more towards in-center revenue as a higher percentage of your overall revenue or would you expect that to decrease with time?

Mike Robinson - *Life Time Fitness - CFO*

On the center operating line, I mean, we obviously have -- in overall operating margin, we continue to expect to see improvement, and that is going to be driven by leverage of our G&A line. If you look -- focus directly on the center operating line, there clearly will be pressure down as our in-center revenues grow, but at the same time, we continue to feel that we've got opportunities through scale and labor efficiencies and centralized processing and things like that to be able to hold. Generally, I would expect it should be relatively neutral.

Karen Howland - *Lehman Brothers - Analyst*

Perfect. Thanks so much.

Mike Robinson - *Life Time Fitness - CFO*

You're welcome.

Operator

Ladies and gentlemen, this concludes the question and answer session of today's presentation. I would now like to turn the presentation back over to Mr.Ken Cooper for closing remarks.

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

Thank you for participating. Our annual shareholders meeting occurs later today at 2:00 p.m. Eastern and will be webcast live. We look forward to reporting to you our second quarter 2008 results, which tentatively has been scheduled for Thursday, July 24, at 10:00 a.m. Eastern. For these and other key dates, please see the Events section within the Investor Relations section of our website. Thank you and good-bye.

Operator

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