FINAL TRANSCRIPT

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LTM - Q3 2008 Life Time Fitness Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the third quarter 2008 Life Time Fitness earnings conference call. My name is Erika and I will be your coordinator for today. (Operator Instructions). I would now like to turn the presentation over to your host for today's call, Mr. Ken Cooper, Vice President of Finance.

Ken Cooper - *Life Time Fitness Inc. - VP, Finance*

Good morning and thank you for joining us on today's conference call to discuss the third quarter 2008 financial results for Life Time Fitness. We issued our earnings press release this morning. It has also been posted to our website, which is lifetimefitness.com.

In a moment, Bahram Akradi, our Chairman and CEO, will make his introductory comments regarding the quarter. 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 AM Eastern time. At that point in the call, the operator will provide instructions on how to ask a question. I will close with information about our Florham Park grand opening and information about our fourth quarter 2008 earnings call. Finally, a replay of this teleconference will be available on our website at approximate 1 PM Eastern time today.

This 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 factors, including the risks and uncertainties identified in this morning's earnings release and in our SEC filings. Concurrent with the issuance of our third 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. With that, let me turn the call over to our Founder and CEO, Bahram Akradi.

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

I'm pleased to provide you with an update on our business. Before I do so, I want to briefly address some personal sales of Life Time Fitness stock that were disclosed by the Company in a recent press release. As announced in filings with the SEC, approximately 1.5 million of my shares of the Company were sold between October 9 and yesterday to cover calls on margin loans. After these sales, approximately 2.6 million of my 2.8 million shares in Life Time Fitness remain pledged against those loans. This is all I am going to say on this call, other than to state that I continue to have confidence in the long-term prospect of Life Time Fitness. The focus of this call is Life Time Fitness earnings and future performance, so now, let me turn to our business.

As has been the theme for the first two quarters of this year, I was pleased with our performance in the face of continuing challenged consumer environment. For the quarter, revenue was up 17% and we delivered nearly 18% growth in net income. Both were good in this environment but below our expectations. The biggest driver for not meeting our internal revenue projections were some moderation in our in-center revenue per membership growth rate, to the low end of our expectation, and we also did not see as much of the same-store sales improvement we expected in our mature clubs.

We did, however, achieve good membership growth, and we continued to see dues growth above this, both positive indicators for our unique clubs and offerings. During the quarter, we opened three clubs, including two -- including our two three-story format clubs. And as we expected over a year ago when we introduced the three-story format, our initial indications of membership ramp and membership feedback are that they will be successful clubs. It continues to give us the confidence that we have the ability to build the right club format for any particular demographic and site plan.

Heading into the fourth quarter, we are very excited to open four more clubs, two of which already have opened. Although we feel that each club is a special, for many of you on this call who live in the New Jersey or New York City area, we feel an extra level of excitement as we plan to open our Florham Park, New Jersey, club in just two weeks. Ken will provide you more details later about our planned investor event during the grand opening celebration. However, I wanted to say that I look forward to joining -- forward to you joining me and our team on this special night to see our differentiated product firsthand.

Now I would like to take a few moments to update you on connectivity initiatives. We made good progress on those initiatives during the quarter and into October. We piloted the LTF Vision Network at our Vernon Hills opening in late September. We recently hosted all of our general managers and area directors at the corporate office for training and certification around our new member connectivity program.

We also continue to add value to our member advantage program, whereby members receive meaningful discounts at our businesses -- at other businesses, leveraging the power of their Life Time Fitness membership. In short, we're moving forward with these initiatives in a pragmatic way to ensure that the membership -- member relationship and connectivity we intended to uphold is achieved.

Before I turn the call over to Mike, I would also like to take a minute to thank two of our directors who resigned from our Board during the quarter and welcome a new director who joined our Board. Jim Halpin, who served as a Director of our Company since February 2005, and as [Steve Supten], who has served as a director since May of ['96], resigned since our last call. We thank them for their many years of service to our company, and for their invaluable advice and support. We all wish them the best of luck in their future endeavors.

We're also excited to welcome Marty Morfitt to our Board of Directors. Marty is the former President and CEO of CNS Inc., manufacturer and marketer of consumer health care products, a position she held from 2001 through March 2007 when CNS was acquired by GlaxoSmithKline. Marty brings great leadership experience to our Board, and we look forward to working with her. We're also glad to announce that Joseph Vassalluzzo, one of our current Board members, was elected to serve as the Lead Director of Board of Directors at the Board meeting earlier this week. Now I would like to turn the call over to our CFO, Mike Robinson, who will provide more details regarding our financial performance to date.

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

I will start my comments on an update to our capital structure. First, I'd like to take a step back. Over the past five months, we have raised $265 million in a very difficult credit environment, in fact, one of the toughest ever. One of our service partners even told me that, on one of our recent deals, was the only deal they were currently working on in their entire nationwide network.

In the third quarter, we completed the two sale leaseback transactions, which were in a letter-of-intent stage back in July. This brought in approximately $160 million in cash, which we used to partially pay down our revolver. The initial rent rate for these transactions ranged from 9.1% to 9.4% and both were approximately P&L neutral when compared to incremental debt options. Our current revolver balance is approximately $355 million, which leaves us over $100 million of availability through the third quarter.

We are still working on several different financings, albeit generally small in nature. As we look to the near-term future, the current credit environment has given us pause. Over the past four weeks, we have been exhaustively reviewing our various sensitivities as it relates to our expansion efforts. And what we kept coming back to is that in this unpredictable environment, we should maintain prudence.

Accordingly, we have decided to establish a new baseline of 12 clubs to open over 2009 and 2010. We currently look at this as six clubs in 2009 and six clubs in 2010. We feel 12 is the appropriate number since our capital planning models indicate we can fund this growth with the financings we have raised or in progress, our current operating cash flow, and our current revolver availability. This equates to about 8% square footage growth each of those years.

It's very important to note that this change in our development plan is related solely to the credit environment. Our pipeline is robust and our confidence in the performance of our model remains high. As always, we will constantly monitor the current credit environment. As we see the credit market improve and we're able to secure additional capital, we are well-positioned to ramp our expansion plans back towards higher square footage growth.

Moving to our P&L performance for the third quarter, total revenue was up 17.3% from last third quarter. As Bahram indicated, our revenue growth was below the expectations we discussed with you in July as we saw further impact on in-center businesses in the latter part of the quarter, as well as our mature same-store sales did not accelerate as much as we had planned. Nevertheless, we are pleased with this growth in this environment.

Revenue growth was due to several factors, including membership dues growth of 17.4%. We continue to see a positive gap between our dues growth and our membership growth, which was 13.2% in the quarter, or 420 basis points difference. This gap continues to be driven by our price changes, either in new or existing memberships over the past year or so. We have not had any significant pricing changes across our system since the first quarter.

In-center revenue grew by 18.2% in the quarter, again led by personal training. The in-center businesses have continued to be relatively resilient for us across the -- however, across the board, we have had some slower growth in each of the individual businesses. Our spa business continues to be the business that has seen the most impact from the slower consumer. But we did see some slowdown in personal training and cafe later in the quarter. To stimulate demand in this consumer environment, we continue to deploy new products, programs, and services in each of our in-center businesses.

Highlights from our other revenue metrics include our third quarter same-store sales saw some modest improvement during the quarter as we achieved a 3.9% increase in our comps. This is a 60 basis point improvement from the second quarter, driven primarily through the performance of clubs entering the 13-month comp base, as well as the Wellbridge Club portfolio. We are very pleased with that.

For our 37 month mature same-store sales, we had a 10 basis-point improvement from the second quarter as we achieved a 1.9% decline as compared to a 2% decline we had in the second quarter. Year-to-date, we generated a 3.8% increase in same-store sales and had a 1.9% decline in our 37 month comps.

The lower mature comps continue to be driven by a softer spa business, especially massage, as well as some revenue loss at some of our lower demographic locations due to higher attrition levels. In addition, we did experience some revenue loss due to Hurricane Ike as we closed our three mature clubs in the Houston market for several days. Plus, we had reduced hours for several additional days once they reopened. Notably, we were among the first businesses to reopen and our members greatly appreciated the ability to escape from their challenges and get a work-out in, or even just a hot shower.

During the third quarter, we had three centers enter the 13-month comp base and two centers enter the 37-month comp base.

With respect to revenue for membership, we generated a 3.9% increase to $358 in the quarter. In-center revenue per membership increased in the third quarter to $104, or a 4.8% increase over the last third quarter. Both were at the low end of our expectations. In particular, we have seen some pullback in in-center business spending across the system, and across each of the businesses.

Moving to our margin analysis, the Company's operating margin decreased to 21.2% for the quarter, as compared to 22.1% for the third quarter of 2007. Let me take a few seconds to walk you through each of our operating expenses. During the quarter, we improved our G&A margin by 100 basis points, driven primarily by the leverage of a growing business, focused efficiency improvement, and the elimination of rent costs at our corporate office. We look for continued leverage from our G&A as we continue to implement further belt-tightening initiatives at our corporate office.

Offsetting the G&A improvement was approximately 50 basis points of increased spend in marketing and 90 basis points of increased center operations expense. The increased marketing spend and just about half of the increased center operations expense were related to our membership acquisition efforts in the third quarter. The other increase in center operations expense is primarily related to rent for the sale leaseback transactions completed during the quarter.

Depreciation and amortization increased 60 basis points for the quarter. The primary reason for this was the full impact of the Wellbridge remodels, which were completed in the second quarter, a full quarter impact of our second quarter openings, and the partial quarter impact of our third quarter openings.

This was partially offset by leverage gained in the quarter due to the sale leaseback transactions, whereby buildings were sold and therefore depreciation ended.

As we make our way down the P&L, interest expense net of interest income increased to $7.2 million, from $7.1 million last third quarter, as we continue to grow our new center base and our average debt balances grew slightly.

One of the more common questions we've dealt with in the past quarter, meeting with investors, centered around capitalized interest. As you know, we follow accounting standards for capitalization of interest that is incurred during the construction phase as a part of a project. Our capitalized interest is related directly to the construction activity in a given quarter. In the third quarter, we capitalized approximately $2.8 million on about $200 million of construction progress, which is up slightly from the second quarter, which was $2.7 million.

Our tax rate for the quarter was 38.8%, and was 39.8% year-to-date. This reflects a small benefit from the closeout of our 2004 tax year. We expect our 2008 effective tax rate to be approximately 40%. That brings us to net income for the quarter of $21.6

million, which is up seven point -- 17.6%. Our net income margin for the quarter increased 10 basis points to 10.9%, driven by lower interest costs as a percent of revenue.

Total shares outstanding as of September 30, 2008, were 39.7 million shares. Weighted average fully-diluted shares totaled 39.4 million shares for the third quarter. We expect our total weighted average diluted-share count for 2008 to be approximately 39.5 million shares.

Based on the 2008 third quarter weighted average share count, our diluted EPS for the quarter was $0.55, up from $0.48 in the third quarter of last year, or 15%. As a reminder, the difference between our net income growth and our EPS growth is related primarily to the equity offering we completed in August 2007.

In addition, we had about $0.01 of tax benefit in the quarter as compared to our standard 40% tax rate expectation. This was offset by about $0.01 of impact on our final estimate for damages and lost business as a result of Hurricane Ike in our Houston clubs, including the delayed opening of our City Centers facility by over one week. Year-to-date, our diluted EPS is $1.49, up from $1.30 last year.

Moving to our operating data, the number of opened centers at September 30, 2008, was 77 compared to 67 at September 30, 2007. Of the 77 centers, 44 are current model and 56 have been -- 56% have been opened three years or more, which we classify as mature centers. As of September 30, 2008, we had approximately 7.6 million square feet, which is 17.6% greater than we had at September 30, 2007, when we have approximately 6.5 million square feet.

EBITDA totaled $61.2 million in Q3, up 15.9% from last third quarter. EBITDA margin decreased 30 basis points from 31.1% to 30.8%, driven by the sale leaseback transactions.

Membership at our September 30 -- at September 30, 2008, totaled 557,164 memberships, compared to 492,410 memberships last Q3, up 13.2%. We were pleased with our ability to meet our expectations and to attract members to Life Time Fitness. As an update of our attrition rate, our trailing 12-month attrition rate increased as we expected and is now approximately 41%. This increase in attrition rate is driven primarily by members leaving earlier than in the past if they were not active.

It's important to remember that we have been able to offset our increased attrition with new membership editions. In the third quarter, we delivered a net membership sequential increase of nearly 10,000 memberships as compared to only just 3,000 memberships last third quarter.

Cash flow from operations totaled $151 million, up from $107 million for the first three quarters of 2007. This 40% increase is driven by our EBITDA growth rate and increase in deferred taxes related to the accelerated depreciation on new assets placed into service pursuant to the economic stimulus package of 2008 and 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 through September 30 were $361 million, which includes approximately $276 million related to growth or the construction of new centers, $50 million for the gross cash cost for remodels and acquired clubs, and $35 million for maintenance of our existing club base and corporate initiatives.

Regarding our debt activity during the third quarter, our overall debt balances reduced by approximately $75 million, to $647 million as of September 30. This includes $355 million outstanding on our $470 million revolver. Our net debt to capital ratio decreased during the third quarter to 50%.

I would like to also provide a few comments on the interest rate environment. As of September 30, less than 50% of our debt was floating rate debt. Most of our floating rate debt is with our revolver. Approximately $230 million of the $355 million revolver outstanding is floating rate. As a reminder, we entered into a floating to fixed rate swap in October of 2007 for $125 million of our revolver, where the interest is fixed at slightly more than 6%. Our revolver was tied to LIBOR or our bank base rate, which is currently 4.5%. We will continue to use the most favorable rate, either base or LIBOR, in the future.

Other balance sheet variances to note. Our working capital deficit grew by $2 million to $141 million from last quarter, driven primarily by growth in construction accounts payable. Other liabilities grew approximately $6 million from the second quarter, primarily driven by deferred gains on our sale leaseback transactions. These will be amortized over the life of the lease, which is 20 years.

Deferred revenue declined by approximately $6 million, driven mainly by the delivery of services from our summer member activities programs, such as kids camps and aquatics lessons, which were paid for in an earlier period. Accrued expenses decreased sequentially by slightly more than $1 million, primarily due to reduced payroll and related operating expenses coming out of the busy summer aquatics and camp season.

Now, as it relates to our outlook for the rest of the year, we expect to open four more centers in the fourth quarter, of which two are already opened. We plan to end the year with a total of 81 clubs. Our last two clubs to open in 2008 will be Florham Park, New Jersey, and Westminster, Colorado, both in November.

We are lowering our total year guidance based on our outlook in this challenged economy, taking into consideration our most recent quarter performance, our year-to-date EPS of $1.49, and the heavy load of club openings and presale operations of the Company in September through December. Our revenue guidance is now 18% to 19% growth, which equates to $775 million to $780 million, down from 19% to 22% growth, or approximately $780 million to $800 million. We expect net income growth of 16% to 18%, which equates to approximately $79 million to $80.5 million, down from 21% to 23% growth, or approximately $82 million to $83.5 million. This results in diluted EPS guidance of 13% to 15% growth, which equates to approximately $2.01 to $2.04 per share, down from 16% to 18% growth or approximately $2.06 to $2.09 per share.

Regarding our CapEx guidance, we maintain our expectations of $440 million to $460 million net cash outlay for the year. This includes approximately $360 million for growth, which works out to approximately $35 million per club for the class of 2008. It also includes approximately $40 million of maintenance CapEx on our existing club base and corporate infrastructure, and approximately $45 million of one-time remodel costs net of leasehold improvement credit and asset sales for our recently acquired clubs.

Before moving to the Q&A session, I want to reiterate some key points regarding our current expansion plan. In the spirit of fiscal responsibility and prudence, we felt it was necessary to lower our expansion plans starting in 2009. We feel slowing our club openings' schedule is a smart move today, since it will allow us to continue to drive profitable growth, but not put pressure on the capital structure. Plus, we believe you will have the opportunity to see firsthand the backlog of return power that we have massed in our growth plan.

However, it is important to know that we will be moving full throttle in obtaining appropriately-priced financing, mainly in the form of mortgages and sale leasebacks. And if we're successful in obtaining the necessary capital, either because the credit markets have improved or through our own ingenuity, we then stand poised and ready to ramp expansion plans. Internally, we're simply looking at this as taking our foot off the gas slightly. We still will have growth from at least six club openings and 44% of our clubs that are currently immature.

In keeping with our established practice, we will provide specific 2009 guidance in the February time frame. But I can tell you now as it relates to 2009 and 2010, we've completed nine land purchases, plus completed one land lease we've entered into. We have two sites well underway with construction. These sites are Atascocita, Texas, which is a suburb of Houston, and Berkeley Heights, New Jersey. These clubs plan to open in Q1 2009.

We have four sites which are in Phase II of construction. These will be managed through the rest of 2009 as it relates to their respective openings. And we have two sites that we are in a Phase I construction, which we currently plan to open in 2010. We have the ability to expedite, if desired, given the power and control we have in owning our own construction subsidiary.

That concludes our prepared remarks regarding our third quarter 2008 financial results. We continue to be pleased with our performance relative to the external pressures. And with that, we are happy to take your questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Tony Gikas, Piper Jaffray.

Tony Gikas - *Piper Jaffray - Analyst*

Good morning. A couple questions. I guess you talked about the average cost of a club today around $35 million. What's the expectation during calendar '09? And then, maybe just give us a little visibility on the expected funding of those six centers opening in calendar '09, including not only cash flows, but expected sale leasebacks, maybe mortgaging additional facilities. And then, an update on interest expense for '09, how that's going to shift for us, and maybe the related impact to rent. And are there any costs associated with the fewer openings next year? Was there anything in the pipeline that you're locked into?

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

Tony, that's a lot of questions. You may have to help me with some of them as we go through. First of all, regarding -- regarding 2009. Again, we're not going to -- we're not planning to and won't give detailed guidance in 2009 until February of 2009. I can talk a little bit about -- as we look at the makeup of the six clubs we plan to open in 2009, we have -- roughly the same makeup in locations. And as you know, location is really the biggest driver to the cost of these clubs. Right now, as we look at it, I don't expect any significant difference in that.

You asked about the financing expectations of 2009. When we -- in doing all of these sensitivity analyses, what we have done is we have looked at the current financing we have in place, a very small piece that we've got in progress, very, very small, and the expected cash flow and revolver availability. We are not expecting in this plan to generate any significant external funding. This is -- it is being funded through our planned cash flows, and the revolver availability and the debt we've got on our books.

You also asked about interest assumptions in 2009, again I think it's too early to give any specific guidance on that.

And I think -- your last question had to do with committed costs related to 2009 or costs related to -- can you repeat that?

Tony Gikas - *Piper Jaffray - Analyst*

Are there any costs -- how easy is it to slow down new center openings? Are there any costs there of getting out of some of the centers that you planned on opening?

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

No. As we -- I mean, obviously, we looked center by center at where we are, where we are in committed costs in contracts etc., and believe that by managing through that and delays where we -- where it makes sense to, including winter condition delays and things like that, that we can manage that with very little impact to us.

Tony Gikas - *Piper Jaffray - Analyst*

Last question and then I'll get back in the queue. How many centers currently today are you getting a little more aggressive on, fees and dues, to maintain and encourage new enrollments? And are there any centers currently where you continue to increase price, to deter new enrollments?

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

Let's talk about that in two segments. Let's talk about that from a dues perspective, and then I'll go back and I'll talk about that from an enrollment fee perspective.

From a dues perspective, as we have talked about the last few quarters, we took dues up in about 40% of our club base generally in the first quarter, maybe going in just a slight bit into the second quarter. There have been no significant dues changes in our system since then. From an enrollment fee perspective, we continue to be very active and very much working club by club in what I would call -- in a lower enrollment fee environment, really to drive and stimulate more demand. You saw a combination of increasing marketing spend, as well as on average, average enrollment fees down. And they have been down, really, since the March time frame. And that's something that we have always said we would do, is to be -- when you saw a challenged environment like that, aggressively work with people to make sure that it's easier for them to come into our clubs. Bahram, do you have anything to add there?

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

As we have been saying all along, since we were really on the roadshow for going public, the experience from the past is during the recessionary time, tough consumer recession time, the thing that you have to do is make it easy for the consumer to step in. And that is the key factor in getting the memberships into the door.

The position of Life Time facilities as a healthy way of life destination, entertainment, puts us in a great place to bring in people at this time, when they might be difficult for them to go on a vacation that may cost $1,000 or $2,000. And, for anywhere from $50 to $100, roughly, per month, depending on the type of club and location, they're able to get a full month of healthy way of life entertainment. So, our focus will be to bring the customers in, would make it easier for them to come in with initiation fees and maybe a little more aggressive marketing or suggestion that this could be their healthy way of life entertainment for them. Then build a great connectivity, and deliver the connectivity programs we have been working on, to make sure they have a fantastic experience.

It's fun and it's entertaining. It's a social time. It's a good pastime and it's healthy, and they get their workouts. All of that, and then continue to keep the business moving forward until such time that the recession hopefully subsides, and then you gradually start lifting your cost on the initiation fee to manage the membership at that point again. So that it doesn't get too much. Right now, we just need to make sure we're bringing the customers in and maintain the proper level of memberships at each club.

Tony Gikas - *Piper Jaffray - Analyst*

Thank you, guys. Good luck.

Operator

Ed Aaron, RBC Capital Markets.

Ed Aaron - *RBC Capital Markets - Analyst*

Good morning. A couple questions for you. Could you talk about any changes that you're considering making to your format, just as a result of the economy? You may be using the spa business as a point of discussion. Does it make sense to maybe not have spas in the clubs going forward, or eliminate spas from certain clubs? And I have a couple other questions after that.

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

Let me start out on that from a big-picture perspective. We continually look at many, many different things that we can do. I think most of our efforts, as Bahram has talked about earlier on in that, are -- looking for ways to continue to attract more memberships in through our in-center -- our businesses, and to keep those members more engaged. So that's the real focus that we have.

Now, to get specifically to you and the question -- and let's call it for spa, we've talked now for, I think, two or three quarters that we've seen the spa business slower and it clearly has been impacted from an economic perspective. But let me be clear, it makes money. And it is one of many, many key elements that help draw members into our club and talk about the entire membership experience.

So, again, we look at things both from a macroperspective, as far as what's going on in cafe and spa and personal training and member activities. We continue to believe that in all of those cases, they are a valuable asset to Life Time Fitness and the overall member experience. That's not to say that potentially that wouldn't change in the future, but today as we look at it, that's really how we see it.

And then, we, below that, look for many, many ways to enhance that experience within those businesses, and frankly add other types of businesses, too. We talked a little bit over the last quarter or so about the introduction of a concept we're very excited about called Life Lab, where we bring really the health risk assessment processes that we have been doing for years in a corporate environment, and bring that to a club level and allow members at a very reasonable cost to go through health risk assessments, including questionnaires and blood panel work and the like. Not to replace your doctor but to work with a doctor on living a healthier way of life. So we continue to do all of those types of things.

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

I'd like to add that, as Mike suggested, there are -- Life Time Fitness healthy way of life entertainment destination model is unique, and -- than other health clubs and so forth that kind of are there. The spa, the cafe, the healthy foods, the healthy products, the Life Lab, and outdoor pools, the whole resort style experience is very, very important at this time, which we believe uniquely positions us to be able to bring in people and give them a great, full experience and entertaining environment, like I said, in a very, very tough, recessionary times. So we feel very good about what we have, and we think that -- just like Mike said, they're also profitable. And we don't want to go back and kind of break the model.

Ed Aaron - *RBC Capital Markets - Analyst*

Understood, thanks. And then a couple model-related questions for you, Mike. First, could you just remind us how your cost structure breaks down between fixed versus variable cost? And then second, with the slowdown in the square footage growth for next year, can you talk about, all else being equal, what that means? I am assuming that it would help your margins in '09, probably not make a whole lot of difference to the EPS.

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

Let me tackle those things a couple ways. From a club cost center model, if you look at a mature center that last year delivered about 37% average EBITDA margin, or before corporate overheads allocated out to somewhere around 45% EBITDA margins. If you look at $1 of revenue and $0.55 of costs there, I'll bet $0.55 of costs, a little over half of that is labor costs. That's by far the largest single expense in our business. We've worked very hard over the last several years, and it has been inherent in this business model from early on, that as much of that cost structure is variable as we possibly can -- the member adviser, the sales, the personal training, a big part of the spa, certainly your group fitness instructors and people in the member activities area and the like. They really are a variable cost structure. So -- and then, certainly the management team has a significant piece of their pay really as variable pay. So a pretty good chunk of that -- of that labor is variable.

You go next to the next largest category for us would be occupancy costs, and whether that's a lease expense, which obviously would be fixed, and we've got leases in roughly one-third of our centers. Or it is real estate taxes, it's utilities, it's repairs and maintenance, things like that. Most of that is of fixed nature; however, we do and have instituted over the last three years or so a variable cost or an activity-based costing model on things such as utilities and repairs and maintenance and things like that, that allow us to react to different usage levels within the club and control those expenses.

Beyond that, you've got marketing costs, which are variable, and you've got supplies expense, which -- you've got some fixed and some variable component to that. Remind me again of your other questions?

Ed Aaron - *RBC Capital Markets - Analyst*

It was just the impact of pulling back on growth in '09 on margins and earnings, all else being equal.

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

I think you had mentioned that certainly, we would not have as many presale costs as we would if we were opening 11 centers. So that helps. You would get a little bit more matured nature to your club base, which should drive some margin improvement. It's too early -- and again, I'm not going to give any other specific guidance beyond that.

Ed Aaron - *RBC Capital Markets - Analyst*

Thanks for taking my questions.

Operator

Scott Hamann, KeyBanc Capital.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Good morning. Can you guys talk a little bit in more detail about the attrition and membership trends, maybe month-to-month throughout the quarter? And also, if there were any regional or differences in maturity of the clubs on those metrics that you might be willing to share?

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

Yes, I think, in general, it was relatively steady through the quarter. We didn't see any significant changes throughout the quarter from a new membership add perspective or a net membership add perspective. And, as we expected, we saw the attrition rate go up a little bit. That probably continues to go up a little bit as we work through the economy. Where we are seeing the attritions primarily are from people that have not been using the club. Where, if you look back maybe three months ago or six months ago or a year ago or two years ago when we measured our attrition and attrition rates and reasons, people that didn't use the club probably stayed -- they would get their monthly Visa statement or MasterCard base -- statement and see a $49 charge or a $59 charge, question it but probably not take action. And that action might not have -- that might have been for three, four, five, six months.

But that's changed in this environment. And when somebody looks at that Visa statement, and they know that times are tougher, they're making a decision a little bit quicker to leave the club if they're not utilizing it. Those people that are utilizing it, and we continue to watch those trends, in fact, the utilization has consistently run above our own expectations, our own budget numbers throughout 2008, which we regard as a very good sign that this base business is strong.

So the focus that we've got on that is really the member connectivity that Bahram talked about on the front end, working with members, getting them involved, making them see the value of Life Time Fitness, those things. We've always tried to do those things, but there is a much more urgent effort in doing that and has been for the last several months. But they'll take -- they take some time to work through the system.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Bahram, just on the Wellbridge clubs, are they kind of where you want them in terms of remodeling now, and how are they performing? I know it's still kind of early relative to your expectations.

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

The results have been improving significantly on the clubs that they have. Now they've completed St. Louis Park, 98th Street, we call Bloomington South, Moore Lake, we're seeing a membership, a net membership increase in the clubs, where there were absolutely really no membership increases in those clubs or downward pressure during the past -- during -- you know, before the construction was done.

We also finished the bulk of these clubs during the summer months and beginning of the summer in Minnesota, which is a very, very -- a very not-attractive time from a membership standpoint in Twin Cities. Our best time in Twin Cities for selling membership starts about now and goes through March or so forth. I think the members now will come back, see those clubs, and we should see great lift from that.

And to add to Mike's comment about our connectivity issues, connectivity efforts, we have been working feverishly for literally about a year with a series of programs that are interconnected, complex, and they would need to be rolled out systematically and altogether. Then we, just like we mentioned in the call, we brought in our team -- the management team and ADs and our regional category training people -- to Minnesota this month and trained everybody through that program, and we're getting ready to launch that here by the end of this month, beginning of next month throughout the system.

I believe strongly that the initiatives we are taking will help us dramatically to get the members more connected, more involved, enjoying their facilities and -- we're taking all the measures we can to make sure that the people can see the value and experience the clubs, just like Mike said. Our net promoter scorer, the results of what the -- happiness of the customers are from the clubs are -- have been solid and steadily moving up, slowly, which is what -- again, it's a good sign members love Life Time Fitness as they are experiencing it, as they're using it, they love their facility. And that's important to us.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Thank you.

Operator

Brian Nagel, UBS Securities.

Brian Nagel - *UBS Securities - Analyst*

Good morning. Thanks for taking my question. A couple of questions. First off, Mike, we've had a lot of retailers of discretionary companies talk about a pretty sharp decline in trends in September. I was wondering if you could just -- alluded to that in your comments as well. Maybe you can give us some sense of magnitude with respect to [internal] revenues and such, how much things slowed in September, or even in the second half of September, from earlier in the quarter.

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

You are correct. When we looked at personal training and the cafe and member activities, to a certain extent, although member activities moving into September is kind of a slower season. But -- sense of magnitude, we probably saw 10% to 15% reduction. We've actually seen that, we have watched that, we've watched that in October, and so far, what we've seen in October is at least stability in those levels. So, as we go forward, and we will continue to watch that and are continuing to look at different ways, like I said in the call, to really drive more participation in those areas.

Brian Nagel - *UBS Securities - Analyst*

The second question I have, if you look at the operating cash flow growth, and significant growth in the third quarter, it was again a discrepancy there. And I think it looks like it may have been tied to the deferred membership revenue and deferred membership costs. Maybe you could help explain the discrepancy there versus prior quarters.

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

Overall operating cash flow growth -- $151 million of cash flow production for the year. If you look at what goes on -- and I mentioned it a bit in the call, our deferred revenue reduced by about $6 million in the third quarter. The primary driver for that is, if you think about our summer and our summer programs, we have a number of kids camps and swimming lessons and camps that crossover periods. We may be selling camps that last 10 weeks, seven weeks, 12 weeks, where we are taking the cash up front in May or June as they sign up for those classes but recognizing the revenue as the services delivery delivered June July or August. So the reduction in deferred revenue is really driven by that. And that seasonal. I think if you go back to the second or third quarters in previous years, you'll see some of that same type of movement where you're building deferred revenue for those short term programs because of the cash coming in, and then amortizing bat out as the service is delivered in the predominantly in the third quarter.

Brian Nagel - *UBS Securities - Analyst*

Thanks a lot.

Operator

Paul Lejuez, Credit Suisse.

Paul Lejuez - *Credit Suisse - Analyst*

Good morning. Can you tell us what percent of your members currently are not using the club, and then how you define that? Over what time period are they not using the club to kind of land them in that category? And Bahram, just wondering how has this environment and considering the new growth plans, slower growth plans, how has it changed how you're going to spend your time?

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

Let's talk about the member utilization and the likes. It varies and we look at it in several ways. But one of them that we looked at it is what is the average activity level of a member? What we like to see is about one to two times a week. When a member doesn't come in for -- and again, it varies a bit by club and the pricing structure in that, but generally, if the member doesn't come in in 30 or 45 days, that becomes a trigger point or a point where we see a propensity for them to leave. It really means that they're not involved. And so that's really the area that we're really focusing on targeting, is trying to get these members in and involved with us.

We've got the capabilities with our systems to identify those members, and as we work through some of these plans, we will be doing more and more to be able to identify and reach out to those members and really try to drive more activity.

Paul Lejuez - *Credit Suisse - Analyst*

But what is that level?

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

It -- I don't have an exact number now. Historically, it had been probably about 80% active, 20% inactive. But given these changes, my guess is that that inactive level has probably been shrinking.

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

Let me respond to your question about how I'm going to spend my time. Obviously, with the slowing down of building new clubs, more time spent on the initiatives right now that we have been working on for the last year with member connectivity. I want to make sure that these things will grow in the clubs. I will be spending more time in our existing clubs myself to feel -- the customers' reaction to the programs that we're launching.

We basically will have the ability to improve the utilization of the members in the areas of the club that they are really interested in. This is something that -- you know, I really look at it as a revolutionary change in our connectivity with the members, with my life time -- with myLT.com -- allows them to have a focus on their interest areas. And this is -- what I believe we had to do, and we had started working at this initiative a long time ago, and I think the timing is just perfect to allow us to connect our members to our business much better right now.

So my time will be spent more with the operation and execution of all the new connectivity programs with our memberships.

Paul Lejuez - *Credit Suisse - Analyst*

Thanks. Good luck.

Operator

Greg McKinley, Dougherty & Company.

Greg McKinley - *Dougherty & Co. - Analyst*

With your revised outlook for revenues this year, any change to your year-end expectations for total membership growth, or are you still targeting 13% to 14%?

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

We're still targeting in that general range.

Greg McKinley - *Dougherty & Co. - Analyst*

And then, from a revenue growth per membership perspective, that moderated somewhat here in the recent quarter, I think, to 3.9%. When I was looking at it on a dues-only basis, that also moderated a little bit. Given the price increases earlier in a year, is that happening -- is that attrition-driven or why are we seeing some of that occur prior to having hit anniversary dates on some of these price actions?

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

It really has to do with mix more than anything else. And that's the mix of some of the attritions and what's dropping out from an attrition perspective, as well as new member acquisitions. Keep in mind that some of the clubs, some of the higher-end clubs that we're opening, didn't open until late third quarter or are scheduled to open fourth quarter. So we're really not seeing much of the positive mix from that. You also have summer downgrades, where families may have joined or they may have bought up to include families for the summer aquatic season and things like that, and as they have moved into the fall season and beyond, they had taken these kids back off the junior memberships or things like that. So it really is mixed revenue.

Greg McKinley - *Dougherty & Co. - Analyst*

Is that a mix an impact that we should likely expect to continue to be the case in Q4?

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

There should be a natural transition of membership. As we have raised the membership prices, the new membership prices for the customers coming in at a higher dues structure than the members that -- we didn't raise the dues of existing members to that level immediately, so you will see that as members drop out, you will have a smaller dues dropping out and members coming in, coming in with a slightly higher dues. So that will continue on. And I believe that we should be seeing more of the same kind of small increase in our dues, without raising dues, which, at this point, we're not planning to raise dues in the clubs.

Greg McKinley - *Dougherty & Co. - Analyst*

One final question. Looking back historically, your non-center revenues have tended to decline modestly sequentially from Q3 to Q4. But that wasn't the case at the end of 2007. How should we be thinking about that heading into the end of the year?

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

Our expectation is that you would see a modest increase in those corporate revenues, really driven by the fact that we have expanded our triathlon series. We've got some more sponsorship dollars that come in on that as well as a number of the running programs that we've got, like the Turkey Trot and Reindeer Run and things like that. So you should see -- I should say a modest increase.

Greg McKinley - *Dougherty & Co. - Analyst*

Thank you.

Operator

This concludes our question-and-answer portion of the call. I would now like to turn the call over to Mr. Ken Cooper for closing remarks.

Ken Cooper - *Life Time Fitness Inc. - VP, Finance*

Thank you for participating. As Bahram mentioned, we're planning some investor events surrounding our grand opening of the Florham Park club. If you're interested in attending and experiencing our grand opening on Thursday, November 6, or taking part in investor [chores] on Friday, November 7, please send me an e-mail at IR@LifeTimeFitness.com. Again, that's IR@LifeTimeFitness.com, IR@LifeTimeFitness.com, and we'll get you the details. We look forward to reporting to you our fourth quarter and full-year 2008 results, which will take place in February of 2009. For these and other key dates, please see the [offensive] section within the investor relations section of our website. Thank you and goodbye.

Operator

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