

LIFE TIME FITNESS, INC.  
Form 10-Q  
October 25, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended September 30, 2012

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

Commission File Number: 001-32230

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Life Time Fitness, Inc.  
(Exact name of registrant as specified in its charter)

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Minnesota  
(State or other jurisdiction of incorporation or  
organization)

41-1689746  
(I.R.S. Employer Identification No.)

2902 Corporate Place  
Chanhassen, Minnesota  
(Address of principal executive offices)

55317  
(Zip Code)

952-947-0000  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares outstanding of the registrant's common stock as of October 19, 2012 was 43,586,308 common shares.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	September 30, 2012 (Unaudited)	December 31, 2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$8,625	\$7,487
Accounts receivable, net	9,989	6,156
Center operating supplies and inventories	27,173	21,600
Prepaid expenses and other current assets	23,650	22,905
Deferred membership origination costs	12,174	12,525
Deferred income taxes	7,520	9,850
Income tax receivable	—	5,022
Total current assets	89,131	85,545
PROPERTY AND EQUIPMENT, net	1,822,139	1,740,434
RESTRICTED CASH	1,813	1,088
DEFERRED MEMBERSHIP ORIGINATION COSTS	8,142	8,131
GOODWILL	34,272	25,550
OTHER ASSETS	67,508	55,080
<b>TOTAL ASSETS</b>	<b>\$2,023,005</b>	<b>\$1,915,828</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term debt	\$7,773	\$6,849
Accounts payable	25,832	22,035
Construction accounts payable	17,196	21,892
Accrued expenses	75,424	56,284
Deferred revenue	35,393	33,898
Total current liabilities	161,618	140,958
LONG-TERM DEBT, net of current portion	660,963	679,449
DEFERRED RENT LIABILITY	21,770	19,370
DEFERRED INCOME TAXES	92,473	100,582
DEFERRED REVENUE	8,177	8,203
OTHER LIABILITIES	12,976	9,793
Total liabilities	957,977	958,355
<b>COMMITMENTS AND CONTINGENCIES (Note 6)</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Undesignated preferred stock, 10,000,000 shares authorized; none issued or outstanding	—	—
Common stock, \$.02 par value, 75,000,000 shares authorized; 43,586,308 and 42,428,265 shares issued and outstanding, respectively	872	849
Additional paid-in capital	463,433	441,813
Retained earnings	605,512	517,404
Accumulated other comprehensive loss	(4,789	) (2,593
Total shareholders' equity	1,065,028	957,473

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$2,023,005	\$1,915,828
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See notes to unaudited consolidated financial statements.

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>REVENUE:</b>				
Membership dues	\$187,568	\$171,504	\$547,933	\$496,530
Enrollment fees	3,859	4,403	11,742	14,290
In-center revenue	90,543	80,741	265,277	234,729
Total center revenue	281,970	256,648	824,952	745,549
Other revenue	12,903	8,773	26,672	17,211
Total revenue	294,873	265,421	851,624	762,760
<b>OPERATING EXPENSES:</b>				
Center operations	169,521	159,307	496,790	465,513
Advertising and marketing	8,826	8,940	28,871	26,500
General and administrative	13,631	12,544	41,190	37,307
Other operating	14,091	9,392	35,243	23,397
Depreciation and amortization	29,396	25,358	85,217	73,645
Total operating expenses	235,465	215,541	687,311	626,362
Income from operations	59,408	49,880	164,313	136,398
<b>OTHER INCOME (EXPENSE):</b>				
Interest expense, net	(6,510)	) (5,072)	) (19,332)	) (15,273)
Equity in earnings of affiliate	375	346	1,143	973
Total other income (expense)	(6,135)	) (4,726)	) (18,189)	) (14,300)
<b>INCOME BEFORE INCOME TAXES</b>	<b>53,273</b>	<b>45,154</b>	<b>146,124</b>	<b>122,098</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>21,129</b>	<b>18,163</b>	<b>58,016</b>	<b>49,324</b>
<b>NET INCOME</b>	<b>\$32,144</b>	<b>\$26,991</b>	<b>\$88,108</b>	<b>\$72,774</b>
<b>BASIC EARNINGS PER COMMON SHARE</b>	<b>\$0.77</b>	<b>\$0.67</b>	<b>\$2.13</b>	<b>\$1.81</b>
<b>DILUTED EARNINGS PER COMMON SHARE</b>	<b>\$0.77</b>	<b>\$0.66</b>	<b>\$2.10</b>	<b>\$1.78</b>
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC</b>	<b>41,484</b>	<b>40,421</b>	<b>41,370</b>	<b>40,313</b>
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – DILUTED</b>	<b>41,881</b>	<b>40,868</b>	<b>41,885</b>	<b>40,810</b>

See notes to unaudited consolidated financial statements.

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
NET INCOME	\$32,144	\$26,991	\$88,108	\$72,774
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments, net of taxes of \$81, \$446, \$69 and \$426, respectively	\$(108)	) \$(1,163)	) \$(72)	) \$(1,112)
Unrealized losses on cash flow hedges, net of taxes of \$434, \$813, \$1,416 and \$813, respectively	(650)	) (1,220)	) (2,125)	) (1,220)
Other comprehensive income (loss), net of tax:	(758)	) (2,383)	) (2,197)	) (2,332)
COMPREHENSIVE INCOME	\$31,386	\$24,608	\$85,911	\$70,442

See notes to unaudited consolidated financial statements.

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	For the Nine Months Ended September 30,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$88,108	\$72,774
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	85,217	73,645
Deferred income taxes	(4,387	) 2,212
Loss on disposal of property and equipment, net	1,231	687
Gain on sale of land held for sale	(196	) —
Amortization of deferred financing costs	1,504	1,784
Share-based compensation	10,862	9,913
Excess tax benefit related to share-based payment arrangements	(9,138	) (2,904
Changes in operating assets and liabilities	30,429	20,033
Other	(769	) (822
Net cash provided by operating activities	202,861	177,322
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(164,556	) (122,149
Acquisitions, net of cash acquired	(28,984	) (7,293
Proceeds from sale of property and equipment	673	734
Proceeds from sale of land held for sale	1,758	—
Proceeds from property insurance settlements	901	94
Increase in other assets	(94	) (17
Decrease in restricted cash	376	1,748
Net cash used in investing activities	(189,926	) (126,883
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayments of long-term borrowings	(5,094	) (77,783
(Proceeds from) repayments of revolving credit facility, net	(16,000	) 27,800
Increase in deferred financing costs	(306	) (4,395
Excess tax benefit related to share-based payment arrangements	9,138	2,904
Proceeds from stock option exercises	2,088	1,480
Proceeds from employee stock purchase plan	999	874
Stock purchased for employee stock purchase plan	(1,290	) (1,113
Net cash used in financing activities	(10,465	) (50,233
Effect of exchange rates on cash and cash equivalents	(1,332	) —
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>1,138</b>	<b>206</b>
<b>CASH AND CASH EQUIVALENTS – Beginning of period</b>	<b>7,487</b>	<b>12,227</b>
<b>CASH AND CASH EQUIVALENTS – End of period</b>	<b>\$8,625</b>	<b>\$12,433</b>
See notes to unaudited consolidated financial statements.		





LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

### 1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary to fairly present financial position, results of operations and cash flows for the periods have been included.

These interim consolidated financial statements and the related notes should be read in conjunction with the annual consolidated financial statements and notes included in the latest Form 10-K, as filed with the Securities and Exchange Commission (“SEC”), which includes audited consolidated financial statements for the three fiscal years ended December 31, 2011.

### 2. Share-Based Compensation

#### Stock Option and Incentive Plans

We have four share-based compensation plans, the Life Time Fitness, Inc. 1998 Stock Option Plan (the “1998 Plan”), the Amended and Restated Life Time Fitness, Inc. 2004 Long-Term Incentive Plan (the “2004 Plan”), the Life Time Fitness, Inc. 2011 Long-Term Incentive Plan (the “2011 Plan”) and an Employee Stock Purchase Plan (the “ESPP”), collectively, the share-based compensation plans. We no longer make grants under the 1998 Plan and the 2004 Plan. There are 2,500,000 shares of common stock reserved for grant under the 2011 Plan and, as of September 30, 2012, there were 1,459,902 shares available for grant. The types of awards that may be granted under the 2011 Plan include incentive and non-qualified options to purchase shares of common stock, stock appreciation rights, restricted shares, restricted share units, performance awards and other types of share-based awards.

As of September 30, 2012, we had granted a total of 5,587,165 options to purchase common stock under all of the share-based compensation plans, of which options to purchase 302,360 shares were outstanding and vested, and a total of 4,364,525 restricted shares were granted, of which 2,074,473 restricted shares were outstanding and unvested. We use the term “restricted shares” to define unvested shares granted to employees and non-employee directors, whereas applicable accounting guidance reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time.

Total share-based compensation expense included in our consolidated statements of operations for the three and nine months ended September 30, 2012 and 2011, was as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Share-based compensation expense related to restricted shares	\$3,520	\$3,475	\$10,772	\$9,823
Share-based compensation expense related to ESPP	30	30	90	90
Total share-based compensation expense	\$3,550	\$3,505	\$10,862	\$9,913

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
 (Table amounts in thousands, except share and per share data)

## Summary of Restricted Stock Activity

	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2011	1,902,083	\$24.27
Granted	331,750	\$50.47
Canceled	(6,970)	) \$25.29
Vested	(803,687)	) \$21.98
Outstanding at March 31, 2012	1,423,176	\$31.66
Granted	623,276	\$46.00
Canceled	(11,137)	) \$29.52
Vested	(33,517)	) \$31.94
Outstanding at June 30, 2012	2,001,798	\$36.13
Granted	84,500	\$44.50
Canceled	(3,399)	) \$35.42
Vested	(8,426)	) \$37.88
Outstanding at September 30, 2012	2,074,473	\$36.47

During the nine months ended September 30, 2012 and 2011, we issued 1,039,526 and 362,454 shares of restricted stock, respectively, with an aggregate grant date fair value of \$49.2 million and \$13.9 million, respectively. The grant date fair value of restricted shares that vested during the nine months ended September 30, 2012 and 2011 was \$19.1 million and \$8.2 million, respectively. The total value of each restricted stock grant, based on the fair market value of the stock on the date of grant, is amortized to compensation expense on a straight-line basis over the related vesting period. As of September 30, 2012, there was \$31.4 million of unrecognized compensation expense related to restricted stock that is expected to be recognized over a weighted average period of 1.7 years.

## Special 2009 Restricted Stock Grant

In June 2009, the Compensation Committee of our Board of Directors approved the grant of 996,000 shares of long-term performance-based restricted stock to serve as an incentive to our senior management team to achieve certain diluted earnings per share ("EPS") targets in 2011 and 2012. In August 2010, an additional 20,000 shares of long-term performance-based restricted stock were granted to a new member of senior management using the same diluted EPS targets and vesting schedule. A specified diluted EPS target was achieved for fiscal 2011 and consequently, 50% of the then-outstanding restricted shares (representing 453,500 shares of restricted stock) vested. As of September 30, 2012, 448,000 of the remaining shares were still outstanding and unvested. The remaining shares will vest if a specified diluted EPS target is achieved for fiscal 2012. In the event that we do not achieve the specified diluted EPS target for fiscal 2012, the remaining restricted stock will be forfeited.

In fourth quarter 2010, we determined that achieving the 2011 diluted EPS targets required for vesting of 50% of the restricted shares was probable. As a result, we recognized a cumulative, non-cash performance share-based compensation expense of \$5.6 million in fourth quarter 2010 and \$3.9 million in 2011. In accordance with the related accounting guidance, all of the vested restricted shares were included in our total diluted share count at December 31, 2011 and September 30, 2012.

In fourth quarter 2011, we determined that achieving the 2012 diluted EPS targets required for vesting of the remaining restricted shares was probable. As a result, we recognized a cumulative, non-cash performance share-based compensation expense of \$6.8 million in fourth quarter 2011 and \$1.9 million in the first nine months of 2012. We anticipate recognizing the remaining portion of performance share-based compensation expense of approximately \$0.7 million (pretax) in the fourth quarter of 2012. The probability of reaching the targets is evaluated each reporting

period. If we later determine that it is not probable that the minimum diluted EPS performance threshold for 2012 will be met, no further compensation cost will be recognized and any recognized

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

compensation cost relating to the shares that have not vested will be reversed. In accordance with the related accounting guidance, none of the remaining unvested restricted shares were included in our total diluted share count at September 30, 2012 or 2011.

Special 2012 Restricted Stock Grant

In May 2012, the Compensation Committee of our Board of Directors approved the grant of 598,000 shares of long-term performance-based restricted stock to serve as an incentive to our senior management team to achieve certain cumulative diluted EPS and return on invested capital (“ROIC”) targets during performance periods that end on December 31, 2015 and December 31, 2016. In August 2012, an additional 20,000 shares of long-term performance-based restricted stock were granted to a new member of senior management using the same cumulative diluted EPS and ROIC targets and vesting schedule. These shares are included in the overall number of 1,039,526 restricted shares granted in the first nine months of 2012. The cumulative diluted EPS target measures cumulative diluted EPS for each quarter during the period from April 1, 2012 to the end of the applicable performance period. The ROIC target is measured in the last year of the applicable performance period. If the specified cumulative diluted EPS and ROIC targets are met or exceeded for the performance period ending December 31, 2015, 50% of the restricted shares will vest. If the specified cumulative diluted EPS and ROIC targets are met or exceeded for the performance period ending December 31, 2016, then all of the restricted shares will vest. For example, if the 2015 performance targets were satisfied and 50% of the shares vested, the remaining 50% of the restricted shares will vest in 2016 if the 2016 performance targets were satisfied. If the 2015 performance targets were not satisfied, but the 2016 performance targets are met, 100% of the restricted shares will vest. In the event that we do not achieve the specified cumulative diluted EPS and ROIC targets for the performance period ending December 31, 2016, the restricted shares will be forfeited. A maximum of \$28.5 million could be recognized as compensation expense under this grant if all cumulative diluted EPS and ROIC targets are met.

We consider the specific cumulative diluted EPS and ROIC targets to be competitively sensitive information during the performance period. However, the Compensation Committee set the cumulative diluted EPS targets at 1.5 times the compound annual growth rate under our current long range plan and the ROIC targets at 1.1 times the ROIC under our current long range plan. We do not believe that achievement of either the cumulative diluted EPS or the ROIC targets is currently probable, and, therefore, we did not recognize any compensation expense associated with the grant during the nine months ended September 30, 2012. If all of the targets had been considered probable at September 30, 2012, we would have recognized \$2.8 million of non-cash performance share-based compensation expense during the nine months ended September 30, 2012. If it becomes probable that the cumulative diluted EPS and ROIC performance targets will be achieved, a cumulative adjustment will be recorded and the remaining compensation expense will be recognized over the remaining performance period. The probability of reaching the targets is evaluated each reporting period. If we later determine that it is no longer probable that the minimum cumulative diluted EPS and ROIC performance targets for the grants will be met, no further compensation expense will be recognized and any previously recognized compensation expense will be reversed. In accordance with the related accounting guidance, none of the unvested restricted shares were included in our total diluted share count at September 30, 2012.

LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

Summary of Stock Option Activity

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2011	407,200	\$23.62	2.9	\$9,429
Exercised	(101,040 )	\$19.52		
Canceled	—	\$—		
Outstanding at March 31, 2012	306,160	\$24.98	2.8	\$7,836
Exercised	(350 )	\$28.05		
Canceled	—	\$—		
Outstanding at June 30, 2012	305,810	\$24.97	2.5	\$6,601
Exercised	(3,450 )	\$30.77		
Canceled	—	\$—		
Outstanding at September 30, 2012	302,360	\$24.91	2.3	\$6,329
Vested at September 30, 2012	302,360	\$24.91	2.3	\$6,329

No stock options have been granted since 2007. As of September 30, 2012, there was no unrecognized compensation expense related to stock options, and all outstanding stock options were vested.

The aggregate intrinsic values in the table above represent the total pretax intrinsic values (the differences between our closing stock price and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders, had all option holders exercised their options on that date. This amount changes based on the fair market value of our stock. Total intrinsic value of options exercised during the nine months ended September 30, 2012 and 2011 was \$3.1 million and \$0.8 million, respectively.

Our net cash proceeds from the exercise of stock options were \$2.1 million and \$1.5 million for the nine months ended September 30, 2012 and 2011, respectively. The actual income tax benefit realized from stock option exercises and restricted stock vesting was \$9.1 million and \$2.9 million, respectively, for those same periods. In accordance with the related accounting guidance, this tax benefit is presented as a financing cash inflow. There is a corresponding cash outflow included in cash flows from operating activities.

Employee Stock Purchase Plan

Our ESPP provides for the sale of up to 1,500,000 shares of our common stock to our employees at discounted purchase prices. The cost per share under this plan is 90% of the fair market value of our common stock on the last day of the purchase period, as defined. The current purchase period for employees under the ESPP began July 1, 2012 and ends December 31, 2012. Compensation expense under the ESPP is estimated based on the discount of 10% at the end of the purchase period. During the nine months ended September 30, 2012, \$1.0 million was withheld from employees for the purpose of purchasing shares under the ESPP. There were 1,287,820 shares of common stock available for purchase under the ESPP as of September 30, 2012.

Share Repurchase Plans

In June 2006, our Board of Directors authorized the repurchase of up to 500,000 shares of our common stock from time to time in the open market or otherwise for the primary purpose of offsetting the dilutive effect of shares pursuant to our ESPP. During the first nine months of 2012, we repurchased 26,850 shares for approximately \$1.3 million. As of September 30, 2012, there were 287,820 remaining shares authorized to be repurchased for this purpose. The shares repurchased to date have been purchased in the open market and, upon repurchase, became authorized, but unissued shares of our common stock.



LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

In August 2011, our Board of Directors authorized the repurchase of up to \$60 million of our outstanding common stock from time to time through open market or privately negotiated transactions. The authorization to repurchase shares terminates when the aggregate repurchase amount totals \$60 million or at the close of business on August 17, 2013, whichever comes earlier. The share repurchase program does not obligate us to repurchase any dollar amount or number of shares of our common stock and the program may be extended, modified, suspended or discontinued at any time. As of September 30, 2012, no shares have been repurchased under this program.

### 3. Earnings per Share

Basic EPS is computed by dividing net income applicable to common shareholders by the weighted average number of shares of common stock outstanding for each period. Diluted EPS is computed similarly to basic EPS, except that the denominator is increased for the assumed exercise of dilutive stock options and unvested restricted stock awards using the treasury stock method. Stock options excluded from the calculation of diluted EPS because the option exercise price was greater than the average market price of the common share were 15,540 and 42,277 for the three months ended September 30, 2012 and 2011, respectively, and 2,477 and 42,277 for the nine months ended September 30, 2012 and 2011, respectively.

The basic and diluted EPS calculations are shown below:

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net income	\$32,144	\$26,991	\$88,108	\$72,774
Weighted average number of common shares outstanding – basic	41,484	40,421	41,370	40,313
Effect of dilutive stock options	122	170	122	171
Effect of dilutive restricted stock awards	275	277	393	326
Weighted average number of common shares outstanding – diluted	41,881	40,868	41,885	40,810
Basic earnings per common share	\$0.77	\$0.67	\$2.13	\$1.81
Diluted earnings per common share	\$0.77	\$0.66	\$2.10	\$1.78

### 4. Operating Segment

Our operations are conducted mainly through our distinctive and large, multi-use sports and athletic, professional fitness, family recreation and spa centers in a resort-like environment. We aggregate the activities of our centers and other ancillary products and services into one reportable segment. Each of the centers has similar economic characteristics, services, product offerings and customers, and in-center revenues are derived primarily from services to our members. Each of the other ancillary products and services either directly or indirectly, through advertising or branding, compliment the operations of the centers. Our chief operating decision maker uses EBITDA as the primary measure of operating segment performance. Our chief operating decision maker is our Chief Executive Officer.



LIFE TIME FITNESS, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

The following table presents revenue for the three and nine months ended September 30, 2012 and 2011:

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Membership dues	\$187,568	\$171,504	\$547,933	\$496,530
Enrollment fees	3,859	4,403	11,742	14,290
Personal training	42,138	36,629	126,675	110,709
Other in-center revenue	48,405	44,112	138,602	124,020
Other revenue	12,903	8,773	26,672	17,211
Total revenue	\$294,873	\$265,421	\$851,624	\$762,760

#### 5. Supplementary Cash Flow Information

Decreases (increases) in operating assets and increases (decreases) in operating liabilities are as follows:

	For the Nine Months Ended	
	September 30,	
	2012	2011
Accounts receivable, net	\$(2,566)	\$(629)
Center operating supplies and inventories	(5,008)	(3,035)
Prepaid expenses and other current assets	(443)	(3,838)
Income tax receivable	5,022	9,916
Deferred membership origination costs	340	722
Accounts payable	4,036	386
Accrued expenses	25,618	13,187
Deferred revenue	547	2,251
Deferred rent liability	2,382	1,094
Other liabilities	501	(21)
Changes in operating assets and liabilities	\$30,429	\$20,033

We made cash payments for income taxes of \$45.0 million and \$31.1 million for the nine months ended September 30, 2012 and 2011, respectively.

We made cash payments for interest, net of capitalized interest, of \$17.8 million and \$13.2 million for the nine months ended September 30, 2012 and 2011, respectively. Capitalized interest was \$0.7 million and \$0.8 million for the same periods.

Construction accounts payable was \$17.2 million and \$23.2 million at September 30, 2012 and 2011, respectively.

#### 6. Commitments and Contingencies

Litigation — We are engaged in proceedings incidental to the normal course of business. Due to their nature, such legal proceedings involve inherent uncertainties, including but not limited to court rulings, negotiations between affected parties and governmental intervention. We have established reserves for matters that are probable and estimable in amounts we believe are adequate to cover reasonable adverse judgments not covered by insurance. These reserves are not material to our consolidated financial statements. Based upon the information available to us and discussions with legal counsel, it is our opinion that the outcome of the various legal actions and claims that are



incidental to our business will not have a material adverse impact on our consolidated financial position, results of operations or cash flows. Such matters are subject to many uncertainties, and the outcome of individual matters are not predictable with assurance.

#### 7. Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") issued guidance on goodwill impairment testing. The guidance became effective for us in fiscal 2012. The guidance allows companies to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The guidance also includes examples of the types of factors to consider in conducting the qualitative assessment. We do not expect the implementation of the guidance to have a material impact on our consolidated financial statements.

In June 2011, the FASB updated guidance on presentation of comprehensive income. The FASB subsequently deferred the effective date of certain provisions of this standard pertaining to the reclassification of items out of accumulated other comprehensive income, pending the issuance of further guidance on that matter. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity is required to present either a continuous statement of net income and other comprehensive income or two separate but consecutive statements. As this guidance relates to presentation only, the adoption did not have a material impact on our consolidated financial statements.

#### 8. Derivative Instruments

As part of our financial risk management program, we may periodically use interest rate swaps to manage known market exposures. Terms of derivative instruments are structured to match the terms of the risk being managed and are generally held to maturity.

In August 2011, we entered into an interest rate swap contract that effectively fixed the rates paid on a total of \$200.0 million of variable rate borrowings at 1.32% plus the applicable spread (which depends on our EBITDAR leverage ratio) until June 2016. We pay 1.32% and receive LIBOR on the notional amount of \$200.0 million. The contract has been designated a cash flow hedge against interest rate volatility. In accordance with applicable accounting guidance, changes in the fair market value of the swap contract are recorded in accumulated other comprehensive (loss) income, net of tax. As of September 30, 2012, the \$3.9 million fair market value loss, net of tax, of the swap contract was recorded as accumulated other comprehensive loss in the shareholders' equity section of our consolidated balance sheets and the \$6.5 million gross fair market value of the swap contract was included in long-term debt.

On an ongoing basis, we assess whether the interest rate swap used in this hedging transaction is "highly effective" in offsetting changes in the fair value or cash flow of the hedged item by comparing the current terms of the swap and the debt to assure they continued to coincide and through an evaluation of the continued ability of the counterparty to the swap to honor its obligations under the swap. No ineffectiveness was experienced in the interest rate swap during the three and nine months ended September 30, 2012. If it is determined that the derivative is not highly effective as a hedge or hedge accounting is discontinued, any change in fair value of the derivative since the last date at which it was determined to be effective would be recognized in earnings.

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(Table amounts in thousands, except share and per share data)

### 9. Fair Value Measurements

The accounting guidance establishes a framework for measuring fair value and expanded disclosures about fair value measurements. The guidance applies to all assets and liabilities that are measured and reported on a fair value basis. This enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The guidance requires that each asset and liability carried at fair value be classified into one of the following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

#### Fair Value Measurements on a Recurring Basis

The fair value of the interest rate swap is determined using observable current market information such as the prevailing Eurodollar interest rates, Eurodollar yield curve rates and current fair values as quoted by recognized dealers, and also includes consideration of counterparty credit risk. The following table presents the fair value of our derivative financial instrument as of September 30, 2012 and December 31, 2011:

	Total Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap liability as of September 30, 2012	\$6,521	\$—	\$6,521	\$—
Interest rate swap liability as of December 31, 2011	\$2,980	\$—	\$2,980	\$—

#### Fair Value Measurements on a Nonrecurring Basis

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to our tangible fixed assets, goodwill and other intangible assets, which are remeasured when the derived fair value is below carrying value on our consolidated balance sheets. For these assets, we do not periodically adjust carrying value to fair value except in the event of impairment. If we determine that impairment has occurred, the carrying value of the asset would be reduced to fair value and the difference would be recorded as a loss within operating income in our consolidated statements of operations.

We had no remeasurements of such assets or liabilities to fair value during the three or nine months ended September 30, 2012 or September 30, 2011.

#### Financial Assets and Liabilities Not Measured at Fair Value

The carrying amounts related to cash and cash equivalents, accounts receivable, income tax receivable, accounts payable and accrued liabilities approximate fair value due to the relatively short maturities of such instruments.

The fair value of our long-term debt and capital leases are estimated based on estimated current rates for debt with similar terms, credit worthiness and the same remaining maturities. For variable rate loans that re-price frequently, fair values are based on carrying values. The fair value of fixed rate loans is estimated based on the discounted cash

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(Table amounts in thousands, except share and per share data)

flows of the loans using current market rates, which are estimated based on recent financing transactions (Level 3). The fair value estimates presented are based on information available to us as of September 30, 2012. These fair value estimates have not been comprehensively revalued for purposes of these consolidated financial statements since that date, and current estimates of fair values may differ significantly.

The following table presents the carrying value and the estimated fair value of our financial liabilities:

	September 30, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Fixed-rate debt	\$398,084	\$400,775	\$401,789	\$399,368
Obligations under capital leases	15,745	15,871	16,617	16,690
Floating-rate debt	254,907	254,907	267,892	267,892
Total	\$668,736	\$671,553	\$686,298	\$683,950

#### 10. Acquisitions

We account for business acquisitions in accordance with ASC 805, Business Combinations. This standard requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard prescribe, among other things, the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration) and the exclusion of transaction and acquisition-related restructuring costs from acquisition accounting. In April 2012, we acquired all of the outstanding shares of ChronoTrack Systems LLC ("ChronoTrack"), a transponder timing company that has developed a radio frequency identification timing system for athletic and endurance events including run, bike and multi-sport races. Simultaneous with the acquisition of ChronoTrack, we merged Bazu Media, Inc., in which we previously owned 55% of the equity interests, with ChronoTrack to form ChronoTrack Systems Corp., a portion of which is owned by third parties. We are currently in the process of finalizing the valuation of the assets acquired and liabilities assumed.

During the nine months ended September 30, 2012, we also acquired certain athletic events which complement our existing portfolio of athletic events. We are currently in the process of finalizing the valuation of the assets acquired and liabilities assumed.

#### Item 2.

#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

##### Forward-Looking Statements

The following discussion may contain forward-looking statements regarding us and our business, prospects and results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC that advise interested parties of the risks and factors that may affect our business.



The interim consolidated financial statements filed on this Form 10-Q and the discussions contained herein should be read in conjunction with the annual consolidated financial statements and notes included in the latest Annual Report on Form 10-K, as filed with the SEC, which includes audited consolidated financial statements for the three fiscal years ended December 31, 2011.

#### Overview

We operate distinctive and large, multi-use sports and athletic, professional fitness, family recreation and spa centers in a resort-like environment. As of October 25, 2012, we operated 105 centers primarily in residential locations across 28 markets in 22 states and one Canadian province under the LIFE TIME FITNESS and LIFE TIME ATHLETIC brands.

We compare the results of our centers based on how long the centers have been open at the most recent measurement period. We include a center's revenue in the same center revenue category for comparison purposes beginning on the first day of the thirteenth full calendar month of the center's operations, prior to which time we refer to the center as a new center. We include an acquired center's revenue in the same center revenue category for comparison purposes beginning on the first day of the thirteenth full calendar month after we assumed the center's operations. We also include a center's revenue in the same center revenue category for comparison purposes beginning on the first day of the thirty-seventh full calendar month of the center's operations, prior to which time we refer to the center as a new center.

As we grow our presence in existing markets by opening new centers, we expect to attract some memberships away from our other existing centers in those markets, reducing revenue and initially lowering the memberships of those existing centers. In addition, as a result of new center openings in existing markets, and because older centers will represent an increasing proportion of our center base over time, our same center revenue may be lower in future periods than in the past. Of the three new large format centers we have opened in 2012, one is in an existing market. In addition, in January 2012, we acquired Racquet Club of the South, a tennis facility in the Atlanta market, which we rebranded as Life Time Athletic and Tennis Peachtree Corners. We do not expect that operating costs of our planned new centers will be significantly higher than centers opened in the past, and we also do not expect that the planned increase in the number of centers will have a material adverse effect on the overall financial condition or results of operations of existing centers.

We measure performance using such key operating statistics as member satisfaction ratings, return on investment, average revenue per membership, including membership dues and enrollment fees, average in-center revenue per membership and center operating expenses, with an emphasis on payroll and occupancy costs, as a percentage of sales and same center revenue growth. We use center revenue and EBITDA margins to evaluate overall performance and profitability on an individual center basis. In addition, we focus on several membership statistics on a center-level and system-wide basis. These metrics include change in center membership levels and growth of system-wide memberships; percentage center membership to target capacity; center membership usage; center membership mix among individual, couple and family memberships; Flex memberships; and center attrition rates.

During 2010, our annual attrition rate decreased from 40.6% to 36.3%. During 2011, our annual attrition rate decreased from 36.3% to 35.0%. At September 30, 2012, our annual (or trailing twelve month) attrition rate was 37.3%. In 2010 and 2011, we saw our attrition rate decrease due in part to increased programming focused on member engagement and center utilization. The attrition rate increased during the first nine months of 2012 due primarily to membership transitions in centers we acquired in late 2011, a dues price increase in late 2011 and early 2012 and higher cancellation rates from lower-priced memberships.

We have three primary sources of revenue:

First, our largest source of revenue is membership dues (64.3% of total revenue for the nine months ended September 30, 2012, down from 65.1% for the nine months ended September 30, 2011) and enrollment fees (1.4% of total revenue for the nine months ended September 30, 2012, down from 1.9% for the nine months ended September 30, 2011) paid by our members. We recognize revenue from monthly membership dues in the month to which they pertain.

Second, we generate revenue within a center, which we refer to as in-center revenue, or in-center businesses (31.2% of total revenue for the nine months ended September 30, 2012, up from 30.7% for the nine months ended September 30, 2011), including fees for personal training, registered dietitians, group fitness training and other

member activities, sales of products at our LifeCafe, sales of products and services offered at our LifeSpa, tennis programs and renting space in certain of our centers.



Third, we have expanded the LIFE TIME FITNESS brand into other healthy way-of-life related offerings that generate revenue, which we refer to as other revenue, or corporate businesses (3.1% of total revenue for the nine months ended September 30, 2012, up from 2.3% for the nine months ended September 30, 2011), including our media, health and athletic events businesses. Our primary media offering is our magazine, Experience Life®. Other revenue also includes one stand-alone restaurant in the Minneapolis market and rental income from our Highland Park, Minnesota office building.

We have five primary sources of operating expenses:

Center operations expenses consist primarily of salaries, commissions, payroll taxes, benefits, real estate taxes and other occupancy costs, utilities, repairs and maintenance, supplies, administrative support and communications to operate our centers.

Advertising and marketing expenses consist of our marketing department costs and media and advertising costs to support and grow center membership levels, in-center businesses, new center openings and our corporate businesses.

General and administrative expenses include costs relating to our centralized support functions, such as accounting, information systems, procurement, real estate and development and member relations.

Other operating expenses include the costs associated with our media, health and athletic events businesses, one restaurant and other corporate expenses, as well as gains or losses on our disposal of assets.

Depreciation and amortization are computed primarily using the straight-line method over estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the improvement.

Our total operating expenses may vary from period to period depending on the number of new centers opened during that period, the number of centers engaged in presale activities and the performance of our in-center and corporate businesses.

Our primary capital expenditures relate to the construction of new centers and updating and maintaining our existing centers. The land acquisition, construction and equipment costs for a current model center can vary considerably based on variability in land cost, the cost of construction labor and the size or amenities of the center, including the addition of tennis facilities, an expanded gymnasium or other facilities. We perform maintenance and make improvements on our centers and equipment throughout each year. We conduct a more thorough remodeling project at each center approximately every four to six years.

#### Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S., or GAAP, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ultimate results could differ from those estimates. In recording transactions and balances resulting from business operations, we use estimates based on the best information available. We use estimates for such items as depreciable lives, probability of meeting certain performance targets and tax provisions. We also use estimates for calculating the amortization period for deferred enrollment fee revenue and associated direct costs, which are based on the historical estimated average membership life. We revise the recorded estimates when better information is available, facts change or we can determine actual amounts.

Our critical accounting policies and use of estimates are discussed in and should be read in conjunction with the annual consolidated financial statements and notes included in the latest Form 10-K, as filed with the SEC, which includes audited consolidated financial statements for our three fiscal years ended December 31, 2011.

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Results of Operations

The following table sets forth our statements of operations data as a percentage of total revenue and also sets forth other financial and operating data:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		
	2012	2011	2012	2011	
<b>REVENUE:</b>					
Membership dues	63.6	% 64.6	% 64.3	% 65.1	%
Enrollment fees	1.3	1.7	1.4	1.9	
In-center revenue	30.7	30.4	31.2	30.7	
Total center revenue	95.6	96.7	96.9	97.7	
Other revenue	4.4	3.3	3.1	2.3	
Total revenue	100.0	100.0	100.0	100.0	
<b>OPERATING EXPENSES:</b>					
Center operations	57.5	60.0	58.4	61.0	
Advertising and marketing	3.0	3.4	3.4	3.5	
General and administrative	4.6	4.7	4.8	4.8	
Other operating	4.8	3.5	4.1	3.1	
Depreciation and amortization	10.0	9.6	10.0	9.7	
Total operating expenses	79.9	81.2	80.7	82.1	
Income from operations (operating profit)	20.1	18.8	19.3	17.9	
<b>OTHER INCOME (EXPENSE):</b>					
Interest expense, net	(2.2	) (1.9	) (2.2	) (2.0	)
Equity in earnings of affiliate	0.1	0.1	0.1	0.1	
Total other income (expense)	(2.1	) (1.8	) (2.1	) (1.9	)
<b>INCOME BEFORE INCOME TAXES</b>	<b>18.0</b>	<b>17.0</b>	<b>17.2</b>	<b>16.0</b>	
<b>PROVISION FOR INCOME TAXES</b>	<b>7.1</b>	<b>6.8</b>	<b>6.9</b>	<b>6.5</b>	
<b>NET INCOME</b>	<b>10.9</b>	<b>% 10.2</b>	<b>% 10.3</b>	<b>% 9.5</b>	<b>%</b>
<b>Other financial data:</b>					
Same-center revenue growth (open 13 months or longer) (1)	4.1	% 4.7	% 4.6	% 5.1	%
Same-center revenue growth (open 37 months or longer) (1)	3.1	% 4.1	% 3.9	% 4.2	%
Average center revenue per membership (2)	\$408	\$395	\$1,194	\$1,163	
Average in-center revenue per membership (3)	\$131	\$124	\$384	\$366	
Trailing 12-month attrition rate (4)	37.3	% 35.3	% 37.3	% 35.3	%
Quarterly attrition rate (5)	10.3	% 9.0	% N/A	N/A	
EBITDA (in thousands) (6)	\$89,179	\$75,584	\$250,673	\$211,016	
EBITDA margin (7)	30.2	% 28.5	% 29.4	% 27.7	%
EBITDAR (in thousands) (6)	\$98,866	\$86,242	\$279,626	\$242,808	
EBITDAR margin (8)	33.5	% 32.5	% 32.8	% 31.8	%
Capital expenditures (in thousands) (9)	\$58,454	\$39,126	\$164,556	\$122,149	
Free cash flow (in thousands) (10)	\$2,217	\$19,685	\$38,305	\$55,173	

## Results of Operations (continued)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
Operating data (end of period) (11):				
Centers open	105	92	105	92
Memberships	695,271	653,300	695,271	653,300
Center square footage (12)	9,901,108	9,178,013	9,901,108	9,178,013

(1) Membership dues, enrollment fees and in-center revenue for a center are included in same-center revenue growth - (open 13 months or longer) beginning on the first day of the thirteenth full calendar month of the center's operation and are included in same-center revenue growth - (open 37 months or longer) beginning on the first day of the thirty-seventh full calendar month of the center's operation.

(2) Average center revenue per membership is total center revenue for the period divided by an average number of memberships for the period, where the average number of memberships for the period is derived from dividing the sum of the total memberships outstanding at the end of each month during the period by the total number of months in the period.

(3) Average in-center revenue per membership is total in-center revenue for the period divided by the average number of memberships for the period, where the average number of memberships for the period is derived from dividing the sum of the total memberships outstanding at the end of each month during the period by the total number of months in the period.

(4) Trailing 12-month attrition rate (or annual attrition rate) is calculated as follows: total terminations for the trailing 12 months (excluding frozen/Flex memberships) divided into the average beginning month membership balance for the trailing 12 months.

(5) Quarterly attrition rate is calculated as follows: total terminations for the quarter (excluding frozen/Flex memberships) divided into the average beginning month membership balance for the quarter.

(6) EBITDA is a non-GAAP, non-cash measure which consists of net income plus interest expense, net, provision for income taxes and depreciation and amortization. EBITDAR is EBITDA net of rent expense. These terms, as we define them, may not be comparable to similarly titled measures used by other companies and are not measures of performance presented in accordance with GAAP. We use EBITDA and EBITDAR as measures of operating performance. EBITDA or EBITDAR should not be considered as a substitute for net income, cash flows provided by operating activities or other income or cash flow data prepared in accordance with GAAP. The funds depicted by EBITDA and EBITDAR are not necessarily available for discretionary use if they are reserved for particular capital purposes, to maintain debt covenants, to service debt or to pay taxes.

The following table provides a reconciliation of net income, the most directly comparable GAAP measure, to EBITDA and EBITDAR (in thousands):

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net income	\$32,144	\$26,991	\$88,108	\$72,774
Interest expense, net	6,510	5,072	19,332	15,273
Provision for income taxes	21,129	18,163	58,016	49,324
Depreciation and amortization	29,396	25,358	85,217	73,645
EBITDA	\$89,179	\$75,584	\$250,673	\$211,016
Rent expense	9,687	10,658	28,953	31,792
EBITDAR	\$98,866	\$86,242	\$279,626	\$242,808

(7) EBITDA margin is the ratio of EBITDA to total revenue.

(8) EBITDAR margin is the ratio of EBITDAR to total revenue.

Capital expenditures represent investments in our new centers, remodeling our acquired centers, costs related to updating and maintaining our existing centers and other infrastructure investments. For purposes of deriving capital expenditures from our cash flows statement, capital expenditures include our purchases of property and equipment, excluding purchases of property and equipment in accounts payable at year-end, property and equipment purchases financed through notes payable and capital lease obligations, and non-cash, share-based compensation capitalized to projects under development.

(9) Free cash flow is a non-GAAP measure consisting of net cash provided by operating activities, less purchases of property and equipment, excluding acquisitions. This term, as we define it, may not be comparable to a similarly titled measure used by other companies and does not represent the total increase or decrease in the cash balance presented in accordance with GAAP. We use free cash flow as a measure of cash generated after spending on property and equipment, excluding acquisitions. The funds depicted by free cash flow are not necessarily available for discretionary use if they are reserved for particular capital purposes, to maintain debt covenants, to service debt or to pay taxes. Free cash flow should not be considered as a substitute for net cash provided by operating activities prepared in accordance with GAAP.

The following table provides a reconciliation of net cash provided by operating activities to free cash flow (in thousands):

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net cash provided by operating activities	\$60,671	\$58,811	\$202,861	\$177,322
Less: Purchases of property and equipment	(58,454	) (39,126	) (164,556	) (122,149
Free cash flow	\$2,217	\$19,685	\$38,305	\$55,173

The operating data presented in these items includes the center owned by Bloomingdale LLC, which is jointly-owned with two unrelated organizations. The data presented elsewhere in this section excludes the center owned by Bloomingdale LLC.

(12) The square footage presented in this table reflects fitness square footage which we believe is the best metric for the efficiencies of a facility. We exclude outdoor swimming pools, outdoor play areas, tennis courts and satellite facility square footage. These figures are approximations.

Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011

Total revenue. Total revenue increased \$29.5 million, or 11.1%, to \$294.9 million for the three months ended September 30, 2012, from \$265.4 million for the three months ended September 30, 2011.

Total center revenue grew \$25.4 million, or 9.9%, to \$282.0 million for the three months ended September 30, 2012, from \$256.6 million for the three months ended September 30, 2011. Of the \$25.4 million increase in total center revenue,

63.4% was from membership dues, which increased \$16.1 million, or 9.4%, due to increased memberships, primarily at new and ramping centers, and higher average dues. Our number of memberships increased 6.4% to 695,271 at September 30, 2012, from 653,300 at September 30, 2011.

38.7% was from in-center revenue, which increased \$9.8 million, or 12.1%, primarily as a result of increased personal training revenue, which increased \$5.5 million, or 15.0%, and increased sales of our LifeSpa and LifeCafe products and services, which increased \$2.2 million, or 7.5%. Average in-center revenue per membership increased to \$131 for the three months ended September 30, 2012, from \$124 for the three months ended September 30, 2011.

(2.1)% was from enrollment fees, which are deferred until a center opens and recognized on a straight-line basis over our estimated average membership life. Since the fourth quarter of 2010, the estimated average membership life has been 33 months. For the fourth quarter of 2008 through the third quarter of 2010, the estimated average membership life was 30 months. Enrollment fees decreased \$0.5 million for the three months ended September 30, 2012 to \$3.9 million. The revenue recognized from enrollment fees was lower in the third quarter of 2012 as compared to the third quarter of 2011 primarily due to lower total enrollment fees over the deferral period.

Other revenue increased \$4.1 million, or 47.1%, to \$12.9 million for the three months ended September 30, 2012, which was primarily due to revenue associated with the ChronoTrack acquisition.

Center operations expenses. Center operations expenses totaled \$169.5 million, or 60.1% of total center revenue (or 57.5% of total revenue), for the three months ended September 30, 2012, compared to \$159.3 million, or 62.1% of total center revenue (or 60.0% of total revenue), for the three months ended September 30, 2011. This \$10.2 million increase primarily consisted of an increase of \$6.8 million in additional payroll-related costs to support increased memberships and in-center revenue growth at our centers. Center operations expenses decreased as a percent of total revenue due primarily to leverage provided by dues growth.

Advertising and marketing expenses. Advertising and marketing expenses were \$8.8 million, or 3.0% of total revenue, for the three months ended September 30, 2012, compared to \$8.9 million, or 3.4% of total revenue, for the three months ended September 30, 2011. These expenses decreased primarily due to more targeted and market-specific marketing campaigns.

General and administrative expenses. General and administrative expenses were \$13.6 million, or 4.6% of total revenue, for the three months ended September 30, 2012, compared to \$12.5 million, or 4.7% of total revenue, for the three months ended September 30, 2011. This increase of \$1.1 million is primarily related to corporate initiatives to support our continued growth. For the three months ended September 30, 2012, share-based compensation expense related to the special 2009 restricted stock grant totaled \$0.7 million of which \$0.5 million was reported in general and administrative expenses.

Other operating expenses. Other operating expenses were \$14.1 million for the three months ended September 30, 2012, compared to \$9.4 million for the three months ended September 30, 2011. This increase is primarily due to growth in infrastructure and operating costs to support the \$4.1 million increase in other revenue, including costs associated with the ChronoTrack business that was acquired during the second quarter.

Depreciation and amortization. Depreciation and amortization was \$29.4 million for the three months ended September 30, 2012, compared to \$25.4 million for the three months ended September 30, 2011. This increase was primarily due to the depreciation on the six formerly leased facilities that we acquired in December 2011 and the three new facilities opened in the first nine months of 2012.

Interest expense, net. Interest expense, net of interest income, was \$6.5 million for the three months ended September 30, 2012, compared to \$5.1 million for the three months ended September 30, 2011. This \$1.4 million increase was primarily the result of an increase in debt levels over the three months ended September 30, 2011. Provision for income taxes. The provision for income taxes was \$21.1 million for the three months ended September 30, 2012, compared to \$18.2 million for the three months ended September 30, 2011. This \$2.9 million increase was due to an increase in income before income taxes of \$8.1 million.

Net income. As a result of the factors described above, net income was \$32.1 million, or 10.9% of total revenue, for the three months ended September 30, 2012, compared to \$27.0 million, or 10.2% of total revenue, for the three months ended September 30, 2011.

Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011

Total revenue. Total revenue increased \$88.8 million, or 11.7%, to \$851.6 million for the nine months ended September 30, 2012, from \$762.8 million for the nine months ended September 30, 2011.

Total center revenue grew \$79.5 million, or 10.7%, to \$825.0 million for the nine months ended September 30, 2012, from \$745.5 million for the nine months ended September 30, 2011. Of the \$79.5 million increase in total center revenue,

64.7% was from membership dues, which increased \$51.4 million, or 10.4%, due to increased memberships, primarily at new and ramping centers, and higher average dues. Our number of memberships increased 6.4% to 695,271 at September 30, 2012, from 653,300 at September 30, 2011.

38.5% was from in-center revenue, which increased \$30.5 million, or 13.0%, primarily as a result of increased personal training revenue, which increased \$16.0 million, or 14.4%, and increased sales of our LifeSpa and LifeCafe products and services, which increased \$8.9 million, or 10.1%. Average in-center revenue per membership increased to \$384 for the nine months ended September 30, 2012, from \$366 for the nine months ended September 30, 2011.

(3.2)% was from enrollment fees, which are deferred until a center opens and recognized on a straight-line basis over our estimated average membership life. Since the fourth quarter of 2010, the estimated average membership life has been 33 months. For the fourth quarter of 2008 through the third quarter of 2010, the estimated average membership life was 30 months. Enrollment fees decreased \$2.5 million for the nine months ended September 30, 2012 to \$11.7 million. The revenue recognized from enrollment fees is lower in the first nine months of 2012 as compared to the first nine months of 2011 primarily due to lower total enrollment fees over the deferral period.

Other revenue increased \$9.5 million, or 55.0%, to \$26.7 million for the nine months ended September 30, 2012, which was primarily due to revenue associated with the ChronoTrack acquisition.

Center operations expenses. Center operations expenses totaled \$496.8 million, or 60.2% of total center revenue (or 58.4% of total revenue), for the nine months ended September 30, 2012, compared to \$465.5 million, or 62.4% of total center revenue (or 61.0% of total revenue), for the nine months ended September 30, 2011. This \$31.3 million increase primarily consisted of an increase of \$21.7 million in additional payroll-related costs to support increased memberships and in-center revenue growth at our centers. Center operations expenses decreased as a percent of total revenue due primarily to leverage provided by dues growth.

Advertising and marketing expenses. Advertising and marketing expenses were \$28.9 million, or 3.4% of total revenue, for the nine months ended September 30, 2012, compared to \$26.5 million, or 3.5% of total revenue, for the nine months ended September 30, 2011. These expenses increased primarily due to increased marketing activity to drive memberships and in-center businesses.

General and administrative expenses. General and administrative expenses were \$41.2 million, or 4.8% of total revenue, for the nine months ended September 30, 2012, compared to \$37.3 million, or 4.8% of total revenue, for the nine months ended September 30, 2011. This increase of \$3.9 million is primarily related to corporate initiatives to support our continued growth. For the nine months ended September 30, 2012, share-based compensation

expense related to the special 2009 restricted stock grant totaled \$1.9 million of which \$1.5 million was reported in general and administrative expenses.

Other operating expenses. Other operating expenses were \$35.2 million for the nine months ended September 30, 2012, compared to \$23.4 million for the nine months ended September 30, 2011. This increase is primarily due to growth in infrastructure and operating costs to support the \$9.5 million increase in other revenue, including costs associated with the ChronoTrack business which was acquired during the second quarter.

Depreciation and amortization. Depreciation and amortization was \$85.2 million for the nine months ended September 30, 2012, compared to \$73.6 million for the nine months ended September 30, 2011. This increase was primarily due to the depreciation on the six formerly leased facilities which we acquired in December 2011 and the three new facilities opened in the first nine months of 2012.

Interest expense, net. Interest expense, net of interest income, was \$19.3 million for the nine months ended September 30, 2012, compared to \$15.3 million for the nine months ended September 30, 2011. This \$4.0 million increase was primarily the result of an increase in debt levels over the nine months ended September 30, 2011.

Provision for income taxes. The provision for income taxes was \$58.0 million for the nine months ended September 30, 2012, compared to \$49.3 million for the nine months ended September 30, 2011. This \$8.7 million increase was due to an increase in income before income taxes of \$24.0 million.

Net income. As a result of the factors described above, net income was \$88.1 million, or 10.3% of total revenue, for the nine months ended September 30, 2012, compared to \$72.8 million, or 9.5% of total revenue, for the nine months ended September 30, 2011.

## Liquidity and Capital Resources

### Liquidity

Historically, we have satisfied our liquidity needs through various debt arrangements, sales of equity and cash flow provided by operations. Our principal liquidity needs have included the development of new centers, debt service requirements and expenditures necessary to maintain and update our existing centers and associated fitness equipment and may include the acquisition and remodeling of centers we acquire from time to time, as well as acquisitions to support our in-center and corporate businesses. We believe that we can satisfy our current and longer-term debt service obligations and capital expenditure requirements primarily with cash flow from operations, by the extension of the terms of or refinancing our existing debt facilities, through sale-leaseback transactions and by continuing to raise long-term debt or equity capital, although there can be no assurance that such actions can or will be completed. In the second quarter of 2011, we retired mortgage debt scheduled to mature in July 2011. We also amended, enlarged and extended our revolving credit facility, previously scheduled to mature in May 2012, now scheduled to mature on June 30, 2016. We expect to use the proceeds from the amended revolving credit facility for general corporate purposes, future center expansion and to help fund other growth initiatives.

Our business model operates with negative working capital primarily for three reasons. First, we carry minimal accounts receivable due to our ability to have monthly membership dues paid by electronic draft. Second, we defer enrollment fee revenue. Third, we fund the construction of our new centers under standard arrangements with our vendors that are paid with cash flows from operations or the revolving credit facility.

The following table summarizes our capital structure as of September 30, 2012 and December 31, 2011.

	September 30, 2012	December 31, 2011
	(In thousands)	
Debt		
Long-term debt	\$660,963	\$679,449
Current maturities of long-term debt	7,773	6,849
Total debt	668,736	686,298
Shareholders' Equity		
Common stock	872	849
Additional paid-in capital	463,433	441,813
Retained earnings	605,512	517,404
Accumulated other comprehensive loss	(4,789	) (2,593
Total shareholders' equity	1,065,028	957,473
Total capitalization	\$1,733,764	\$1,643,771

#### Operating Activities

As of September 30, 2012, we had total cash and cash equivalents of \$8.6 million. We also had \$233.6 million available under the existing terms of our revolving credit facility as of September 30, 2012.

Net cash provided by operating activities was \$202.9 million for the nine months ended September 30, 2012, compared to \$177.3 million for the nine months ended September 30, 2011. This increase is primarily due to increased net income and changes in working capital.

#### Investing Activities

Investing activities consist primarily of purchasing real property, constructing new centers, purchasing new fitness equipment, corporate capital expenditures and remodel costs associated with acquired centers. In addition, we invest in capital expenditures to maintain and update our existing centers. We finance the purchase of our property and equipment by cash payments or by financing through notes payable or capital lease obligations.

Net cash used in investing activities was \$189.9 million for the nine months ended September 30, 2012, compared to \$126.9 million for the nine months ended September 30, 2011. The increase of \$63.0 million was primarily due to a \$35.0 million increase in capital expenditures related to maintenance of existing facilities, remodels of acquired centers and corporate capital expenditures, and an increase in acquisitions of \$21.7 million.



Our capital expenditures