LIFE TIME FITNESS INC
Form 10-Q
August 07, 2006

Table of Contents

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

FORM 10-Q

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

For the quarterly period ended June 30, 2006

or

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

For the transition period from __________to __________

Commission File No. 001-32230

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

Minnesota	**41-1689746**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6442 City West Parkway **Eden Prairie, Minnesota**	**55344**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **952-947-0000**

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 þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer þ Accelerated Filer o Non-accelerated filer o

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

The number of shares outstanding of the Registrant s common stock as of July 15, 2006 was 36,268,851 common shares.

TABLE OF CONTENTS

Table of Contents

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)
(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$	$ 4,680
Accounts receivable, net	2,301	4,267
Inventories	6,392	5,669
Prepaid expenses and other current assets	9,901	7,187
Deferred membership origination costs	11,529	10,082
Income tax receivable	2,207	3,510
Total current assets	32,330	35,395
PROPERTY AND EQUIPMENT, net	743,437	661,371
RESTRICTED CASH	3,819	3,915
DEFERRED MEMBERSHIP ORIGINATION COSTS	9,403	8,410
OTHER ASSETS	15,524	14,369
TOTAL ASSETS	$ 804,513	$ 723,460
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 14,305	$ 14,447
Accounts payable	8,229	9,964
Construction accounts payable	28,710	25,811
Accrued expenses	31,849	27,862
Deferred revenue	29,090	23,434
Total current liabilities	112,183	101,518
LONG-TERM DEBT, net of current portion	284,681	258,835
DEFERRED RENT LIABILITY	5,774	5,492
DEFERRED INCOME TAXES	35,934	35,419
DEFERRED REVENUE	15,775	14,352
Total liabilities	454,347	415,616
COMMITMENTS AND CONTINGENCIES (Note 6)		
SHAREHOLDERS EQUITY:		
Undesignated preferred stock, 10,000,000 shares authorized; none issued or outstanding		
Common stock, $.02 par value, 50,000,000 shares authorized; 36,261,414 and 35,570,567 shares issued and outstanding, respectively	726	712

Additional paid-in capital	245,316	228,132
Deferred compensation		(2,306)
Retained earnings	104,124	81,306
Total shareholders equity	350,166	307,844
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 804,513	$ 723,460

See notes to unaudited consolidated financial statements.

3

Table of Contents

LIFE TIME FITNESS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	For the Three Months Ended June 30, 2006	For the Three Months Ended June 30, 2005	For the Six Months Ended June 30, 2006	For the Six Months Ended June 30, 2005
REVENUE:				
Membership dues	$ 80,550	$ 64,313	$ 156,349	$ 124,790
Enrollment fees	5,561	5,452	10,644	10,137
In-center revenue	33,787	24,029	66,121	46,702
Total center revenue	119,898	93,794	233,114	181,629
Other revenue	2,557	1,813	4,766	3,306
Total revenue	122,455	95,607	237,880	184,935
OPERATING EXPENSES:				
Center operations (including $889, $0, $1,277 and $0 related to share-based compensation expense, respectively)	68,540	52,827	133,633	102,398
Advertising and marketing	4,732	2,619	10,571	6,910
General and administrative (including $2,826, $26, $3,649 and $57 related to share- based compensation expense, respectively)	10,861	7,331	19,676	13,821
Other operating	2,646	3,226	5,633	6,164
Depreciation and amortization	12,146	9,190	23,665	17,924
Total operating expenses	98,925	75,193	193,178	147,217
Income from operations	23,530	20,414	44,702	37,718
OTHER INCOME (EXPENSE):				
Interest expense, net of interest income of $80, $64, $149 and $123, respectively	(4,140)	(3,243)	(8,257)	(7,069)
Equity in earnings of affiliate	251	266	494	554
Total other income (expense)	(3,889)	(2,977)	(7,763)	(6,515)
INCOME BEFORE INCOME TAXES	19,641	17,437	36,939	31,203
PROVISION FOR INCOME TAXES	7,256	7,150	14,121	12,794
NET INCOME	$ 12,385	$ 10,287	$ 22,818	$ 18,409
BASIC EARNINGS PER COMMON SHARE	$ 0.34	$ 0.30	$ 0.64	$ 0.54
DILUTED EARNINGS PER COMMON SHARE	$ 0.33	$ 0.28	$ 0.62	$ 0.51
	36,143	34,360	35,915	34,091

WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING BASIC				
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING DILUTED	37,033	36,161	36,888	36,047

See notes to unaudited consolidated financial statements.

LIFE TIME FITNESS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	For the Six Months Ended June 30,	
	2006	**2005**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 22,818	$ 18,409
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,665	17,924
Deferred income taxes	515	(874)
Loss on disposal of property and equipment, net	120	370
Amortization of deferred financing costs	331	701
Share-based compensation	4,926	87
Excess tax benefit from exercise of stock options	(5,228)	
Changes in operating assets and liabilities	13,706	17,291
Other	128	128
Net cash provided by operating activities	60,981	54,036
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(110,432)	(78,510)
Proceeds from sale of property and equipment	6,566	3,778
Increase in other assets	(843)	(425)
Decrease in restricted cash	96	8,219
Net cash used in investing activities	(104,613)	(66,938)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowings	1,650	112,641
Repayments on long-term borrowings	(12,654)	(111,613)
Proceeds from revolving credit facility, net	36,800	
Increase in deferred financing costs	(651)	(1,174)
Excess tax benefit from exercise of stock options	5,228	
Proceeds from exercise of stock options	8,579	3,183
Net cash provided by financing activities	38,952	3,037
DECREASE IN CASH AND CASH EQUIVALENTS	(4,680)	(9,865)
CASH AND CASH EQUIVALENTS Beginning of period	4,680	10,211
CASH AND CASH EQUIVALENTS End of period	$	$ 346
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash payments for interest, including capitalized interest of $1,962 and $2,037, respectively	$ 7,766	$ 7,934
Cash payments for income taxes	$ 7,079	$ 6,549

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of restricted stock	$ 1,458	$ 131

See notes to unaudited consolidated financial statements.

Table of Contents

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

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 consolidated 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 Annual Report on 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, 2005.

2. Share-Based Compensation

We have four share-based compensation plans, the 1996 Stock Option Plan (the 1996 Plan), the 1998 Stock Option Plan (the 1998 Plan), the 2004 Long-Term Incentive Plan (the 2004 Plan), and an Employee Stock Purchase Plan (the ESPP), collectively, the share-based compensation plans. In connection with approval for the 2004 Plan, our Board of Directors approved a resolution to cease making additional grants under the 1996 Plan and the 1998 Plan. The types of awards that may be granted under the 2004 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 June 30, 2006, we had granted a total of 5,550,711 options to purchase common stock under all of the share-based compensation plans, of which options to purchase 2,127,402 shares were outstanding, and a total of 118,777 restricted shares, of which 86,556 restricted shares were unvested. Enrollment in the ESPP began July 1, 2006.

The total number of options to purchase common stock includes shares that vest on continued service (time-based) and shares that vested upon achievement of certain market condition criteria (market-based). Most of the time-based options generally vest over a period of four years. The market-based options were granted to certain members of management at or around the time of our initial public offering. As of June 30, 2006, all of these market-based options had vested. Approximately 20% of these options vested in April 2006 when our stock price remained above $40 per share for sixty consecutive calendar days. The final 20% of these options vested in May 2006 when our stock price remained above $45 per share for sixty consecutive calendar days. Because the market vesting condition criteria was achieved in fiscal 2006, share-based compensation expense was recognized in fiscal 2006 for the $40 and $45 tranches in accordance with the revised Statement of Financial Accounting Standards No. 123 (SFAS 123(R)), Share-Based Payment, as discussed below.

Prior to January 1, 2006, we applied Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, in accounting for the share-based compensation plans. On January 1, 2006, we adopted the fair value recognition provisions of SFAS 123(R), requiring us to recognize expense related to the fair value of our share-based compensation awards. We elected the modified prospective transition method as permitted by SFAS 123(R). Under this transition method, share-based compensation expense for the six months ended June 30, 2006 includes compensation expense for all share-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, Accounting for Stock-Based Compensation. We recognize compensation expense for stock option awards and restricted share awards on a straight-line basis over the requisite service period of the award (or to an employee s eligible retirement date, if earlier). In accordance with the modified prospective transition method of SFAS 123(R), financial results for the prior period have not been restated.

Table of Contents

Total share-based compensation expense, which includes stock option expense from the adoption of SFAS 123(R) and restricted stock expense, included in our consolidated statements of operations for the three and six months ended June 30, 2006 and 2005, was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended, June 30,	
	2006	2005	2006	2005
Share-based compensation expense related to stock options	$ 3,329	$	$ 4,224	$
Share-based compensation expense related to restricted shares	386	26	702	57
Total share-based compensation expense	$ 3,715	$ 26	$ 4,926	$ 57

The table below illustrates the effect on net income and earnings per share as if we had applied the fair value recognition provisions of SFAS 123 to share-based compensation during the three and six-month periods ended June 30, 2005 (in thousands, except per share amounts).

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	$ 10,287	$ 18,409
Net income, pro forma	$ 9,097	$ 16,550
Basic earnings per common share:		
As reported	$ 0.30	$ 0.54
Pro forma	$ 0.26	$ 0.49
Diluted earnings per common share:		
As reported	$ 0.28	$ 0.51
Pro forma	$ 0.25	$ 0.46

The following table summarizes the stock option transactions for the six months ended June 30, 2006:

	Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding on December 31, 2005	2,757,666	$ 17.01		
Granted	37,977	46.02		
Exercised	(659,041)	13.00		
Canceled	(9,200)	13.93		

Outstanding on June 30, 2006	2,127,402	$ 18.78	7.56	$ 58,494,629
Exercisable on June 30, 2006	1,122,745	$ 15.60	6.95	$ 34,437,288

The weighted-average grant date fair value of stock options granted during the six months ended June 30, 2006 and 2005, was $18.33 and $12.25, respectively. The aggregate intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the six months ended June 30, 2006 and 2005 was $19.8 million and $25.5 million, respectively. The fair market value of restricted shares that became vested during the six months ended June 30, 2006 was $0.9 million. As of June 30, 2006, there was $9.4 million of unrecognized compensation expense related to stock options that is expected to be recognized over a weighted-average period of 2.7 years.

Table of Contents

The fair value of each stock option was estimated on the date of the grant using the Black-Scholes option pricing model.

	Three Months Ended June 30,		**Six Months Ended June 30,**	
Weighted Average Valuation Assumptions (1)	**2006**	**2005**	**2006**	**2005**
Risk-free interest rate (2)	5.0%	3.9%	5.0%	4.0%
Expected dividend yield				
Expected stock price volatility (3)	36.0%	40.6%	36.0%	44.0%
Expected life of stock options (in years) (3)	5.0	6.0	5.0	6.0

(1) Forfeitures are estimated based on historical experience and projected employee turnover.

(2) Based on the five-year Treasury constant maturity interest rate whose term is consistent with the expected life of our stock options.

(3) We estimate the expected life and volatility of stock options based on an average of the expected lives and volatilities assumptions reported by a peer group of publicly traded companies.

Our net cash proceeds from the exercise of stock options were $8.6 million and $3.2 million for the six months ended June 30, 2006 and 2005, respectively. The actual income tax benefit realized from stock option exercises total $5.2 million and $4.2 million, respectively, for those same periods. Prior to the adoption of SFAS 123(R), we reported all tax benefits resulting from the exercise of stock options as operating cash flows in our consolidated statements of cash flows. In accordance with SFAS 123(R), for the six months ended June 30, 2006, the excess tax benefits from the exercise of stock options are presented as financing cash flows.

During the six months ended June 30, 2006 and 2005, we issued 31,506 and 5,243 shares of restricted stock, respectively, with an aggregate fair value of $1.5 million and $0.1 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.

3. Earnings per Share

Basic earnings per common share (EPS) is computed by dividing net income by the weighted average number of shares of common stock outstanding during each period. Diluted EPS is computed similarly to basic EPS, except that the denominator is increased for the conversion of any dilutive common stock equivalents, such as the assumed exercise of dilutive stock options using the treasury stock method and unvested restricted stock awards using the treasury stock method. A reconciliation of these amounts is as follows (in thousands, except per share amounts):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 12,385	$ 10,287	$ 22,818	$ 18,409
Weighted average number of common shares outstanding basic	36,143	34,360	35,915	34,091
Effect of dilutive stock options and unvested restricted stock awards	890	1,801	973	1,956
Weighted average number of common shares outstanding diluted	37,033	36,161	36,888	36,047
Basic earnings per common share	$ 0.34	$ 0.30	$ 0.64	$ 0.54
Diluted earnings per common share	$ 0.33	$ 0.28	$ 0.62	$ 0.51

4. Operating Segments

Our operations are conducted mainly through our sports and athletic, professional fitness, family recreation and resort/spa centers. We have aggregated the activities of our centers into one reportable segment as none of the centers meet the quantitative thresholds for separate disclosure under SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, and each of the centers has similar expected economic characteristics, service and product offerings, customers and design. Our chief operating decision makers use EBITDA as the primary measure of segment performance. For purposes of segment financial reporting and discussion of results of operations, Centers represent the revenue and associated costs (including general and administrative expenses) from membership dues and enrollment fees, all in-center activities including personal training, spa, cafe and other activities offered to members and non-member participants and certain rental income generated at the centers. Included in the All Other category in the table below is operating information related to media, athletic events, certain rental income, and a restaurant, and expenses, including interest expense, and corporate assets (including depreciation and amortization) not directly attributable to centers. The accounting policies of the Centers and operations classified as All Other are the same as those described in the summary of significant accounting policies in the annual consolidated financial statements and notes included in the latest Annual Report on Form 10-K, as filed with the SEC.

Financial data and reconciling information for our reporting segment to the consolidated amounts in the financial statements are as follows (in thousands):

	Centers	All Other	Consolidated
Three months ended June 30, 2006:			
Revenue	$ 119,898	$ 2,557	$ 122,455
Net income (loss)	$ 13,872	$ (1,487)	$ 12,385
Provision (benefit) for income taxes	8,247	(991)	7,256
Interest expense, net	3,156	984	4,140
Depreciation and amortization	10,643	1,503	12,146
EBITDA	$ 35,918	$ 9	$ 35,927
Total assets	$ 713,170	$ 91,343	$ 804,513
Three months ended June 30, 2005:			
Revenue	$ 93,794	$ 1,813	$ 95,607
Net income (loss)	$ 11,623	$ (1,336)	$ 10,287
Provision (benefit) for income taxes	8,079	(929)	7,150
Interest expense, net	3,002	241	3,243
Depreciation and amortization	7,565	1,625	9,190
EBITDA	$ 30,269	$ (399)	$ 29,870
Total assets	$ 546,941	$ 70,421	$ 617,362