

LIFE TIME FITNESS INC  
Form 10-Q  
August 08, 2005

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**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, 2005**

**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**

(State or other jurisdiction of  
incorporation or organization)

**6442 City West Parkway  
Eden Prairie, Minnesota**

(Address of principal executive offices)

**41-1689746**

(I.R.S. Employer  
Identification No.)

**55344**

(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  No

Indicate by check mark whether the Registrant is an accelerated filer (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 July 15, 2005 was 34,834,666 common shares.

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**LIFE TIME FITNESS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share data)

	<b>June 30, 2005</b>	<b>December 31, 2004</b>
	<b>(Unaudited)</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 346	\$ 10,211
Accounts receivable, net	3,336	1,187
Inventories	4,733	4,971
Prepaid expenses and other current assets	7,890	7,275
Deferred membership origination costs	9,369	8,271
Deferred tax asset	1,597	1,597
Income tax receivable	1,682	4,579
Total current assets	28,953	38,091
PROPERTY AND EQUIPMENT, net	564,883	503,690
RESTRICTED CASH	3,873	12,092
DEFERRED MEMBERSHIP ORIGINATION COSTS	7,603	7,061
OTHER ASSETS	12,050	11,153
<b>TOTAL ASSETS</b>	<b>\$617,362</b>	<b>\$572,087</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term debt	\$ 15,870	\$ 47,477
Accounts payable	7,629	5,762
Construction accounts payable	22,389	17,633
Accrued expenses	24,555	19,152
Deferred revenue	24,361	20,019
Total current liabilities	94,804	110,043
LONG-TERM DEBT, net of current portion	194,402	161,767
DEFERRED RENT LIABILITY	5,132	3,678
DEFERRED INCOME TAXES	32,827	33,701
DEFERRED REVENUE	13,966	12,264
Total liabilities	341,131	321,453
<b>COMMITMENTS AND CONTINGENCIES (Note 7)</b>		
<b>SHAREHOLDERS EQUITY:</b>		
Undesignated preferred stock, 10,000,000 shares authorized; none issued or outstanding		
Common stock, \$.02 par value, 50,000,000 shares authorized; 34,803,404 and 33,791,610 shares issued and outstanding, respectively	696	676

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Additional paid-in capital	217,187	209,931
Deferred compensation	(154)	(66)
Retained earnings	58,502	40,093
Total shareholders' equity	276,231	250,634
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$617,362</b>	<b>\$572,087</b>

See notes to unaudited consolidated financial statements.

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

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
REVENUE:				
Membership dues	\$64,313	\$51,005	\$124,790	\$100,184
Enrollment fees	5,452	5,073	10,137	9,580
In-center revenue	24,029	17,856	46,702	35,114
Total center revenue	93,794	73,934	181,629	144,878
Other revenue	1,813	2,655	3,306	5,881
Total revenue	95,607	76,589	184,935	150,759
OPERATING EXPENSES:				
Center operations	52,827	40,466	102,398	79,519
Advertising and marketing	2,619	2,774	6,910	6,454
General and administrative	7,331	5,599	13,821	11,549
Other operating	3,226	4,393	6,164	8,949
Depreciation and amortization	9,190	6,971	17,924	13,918
Total operating expenses	75,193	60,203	147,217	120,389
Income from operations	20,414	16,386	37,718	30,370
OTHER INCOME (EXPENSE):				
Interest expense, net	(3,243)	(4,449)	(7,069)	(9,061)
Equity in earnings of affiliate	266	267	554	520
Total other expense	(2,977)	(4,182)	(6,515)	(8,541)
INCOME BEFORE INCOME TAXES	17,437	12,204	31,203	21,829
PROVISION FOR INCOME TAXES	7,150	4,993	12,794	8,970
NET INCOME	10,287	7,211	18,409	12,859
ACCRETION ON REDEEMABLE PREFERRED STOCK		1,737		3,474
NET INCOME APPLICABLE TO COMMON SHAREHOLDERS	\$ 10,287	\$ 5,474	\$ 18,409	\$ 9,385
BASIC EARNINGS PER COMMON SHARE	\$ 0.30	\$ 0.34	\$ 0.54	\$ 0.58
	\$ 0.28	\$ 0.25	\$ 0.51	\$ 0.44

DILUTED EARNINGS PER COMMON  
SHARE

WEIGHTED AVERAGE NUMBER OF  
COMMON SHARES OUTSTANDING -  
BASIC

34,360	16,195	34,091	16,175
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WEIGHTED AVERAGE NUMBER OF  
COMMON SHARES OUTSTANDING -  
DILUTED

36,161	29,123	36,047	29,124
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See notes to unaudited consolidated financial statements.

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

	<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 18,409	\$ 12,859
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,924	13,918
Deferred income taxes	(874)	(118)
Loss on disposal of property, net	370	128
Amortization of deferred financing costs	701	704
Compensation related to stock options and restricted stock	215	149
Tax benefit from exercise of stock options	4,222	
Changes in operating assets and liabilities	13,069	8,719
Net cash provided by operating activities	54,036	36,359
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment (excluding non-cash purchases supplementally noted below)	(83,266)	(58,721)
Increase in construction accounts payable	4,756	9,894
Proceeds from sale of property	3,778	1,247
Increase in other assets	(425)	(2,592)
Decrease (increase) in restricted cash	8,219	(771)
Net cash used in investing activities	(66,938)	(50,943)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from long-term borrowings	112,641	26,466
Repayments on long-term borrowings	(111,613)	(29,172)
Increase in deferred financing costs	(1,174)	(976)
Proceeds from exercise of stock options	3,183	246
Net cash provided by (used in) financing activities	3,037	(3,436)
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(9,865)</b>	<b>(18,020)</b>
<b>CASH AND CASH EQUIVALENTS</b> Beginning of period	<b>10,211</b>	<b>18,446</b>
<b>CASH AND CASH EQUIVALENTS</b> End of period	<b>\$ 346</b>	<b>\$ 426</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash payments for interest, net of capitalized interest of \$2,037 and \$789, respectively	\$ 7,934	\$ 8,410
Cash payments for income taxes	\$ 6,549	\$ 6,819



SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND  
FINANCING ACTIVITIES:

Property and equipment purchases financed through notes payable	\$	\$ 2,954
Property and equipment purchases financed through capital lease obligations	\$	\$ 145

See notes to unaudited consolidated financial statements.

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

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements of Life Time Fitness, Inc. (the Company) 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 financial statements and the related notes should be read in conjunction with the annual financial statements and notes included in the latest 10-K, as filed with the Securities and Exchange Commission (SEC), which includes audited financial statements for the three fiscal years ended December 31, 2004.

Certain prior period amounts have been reclassified to conform with the current period presentation.

**2. Initial Public Offering and Capital Stock**

The registration statement filed in connection with the Company's initial public offering, as filed with the SEC, was declared effective on June 29, 2004. The Company's shares began trading on the New York Stock Exchange on June 30, 2004. The Company closed this transaction and received proceeds from the initial public offering on July 6, 2004. The initial public offering consisted of 11,385,000 shares of common stock, including the underwriters over-allotment option of 1,485,000 common shares. Of the shares of common stock sold in the initial public offering, the Company sold 4,774,941 shares, resulting in proceeds of \$80,398, net of underwriting discounts and commissions and offering expenses payable by the Company of \$7,939. The Company used a portion of the net proceeds to repay amounts outstanding under its previous revolving credit facility and to repay a loan under its previous construction facility that the Company used to finance the development of its center in Plano, Texas. The Company used the remaining net proceeds to finance its growth by opening additional centers.

As a result of the Company's initial public offering, the Company's previously outstanding redeemable preferred stock converted into common stock and accretion on redeemable preferred stock discontinued.

**3. Earnings per Share**

Basic earnings per common share (EPS) is computed by dividing net income applicable to common shareholders 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 numerator is adjusted to add back any redeemable preferred stock accretion and the denominator is increased for the conversion of any dilutive common stock equivalents, such as redeemable preferred stock, and the assumed exercise of dilutive stock options using the treasury stock method and

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unvested restricted stock awards using the treasury stock method. A reconciliation of these amounts is as follows (share amounts in thousands):

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income applicable to common shareholders basic	\$10,287	\$ 5,474	\$18,409	\$ 9,385
Add back: accretion on redeemable preferred stock		1,737		3,474
Net income applicable to common shareholders diluted	\$10,287	\$ 7,211	\$18,409	\$12,859
Weighted average number of common shares outstanding basic	34,360	16,195	34,091	16,175
Effect of dilutive stock options and restricted stock awards	1,801	1,910	1,956	1,931
Effect of dilutive redeemable preferred shares		11,018		11,018
Weighted average number of common shares outstanding diluted	36,161	29,123	36,047	29,124
Basic earnings per common share	\$ 0.30	\$ 0.34	\$ 0.54	\$ 0.58
Diluted earnings per common share	\$ 0.28	\$ 0.25	\$ 0.51	\$ 0.44

**4. Stock-Based Compensation**

The Company has stock option and incentive plans for employees, directors and consultants and accounts for these plans in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. If compensation cost for these plans had been determined consistent with Statement of Financial Accounting Standards (SFAS) No. 123, the Company's net income applicable to common shareholders, basic EPS and diluted EPS would have been reduced to the following pro forma amounts:

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income applicable to common shareholders basic:				
As reported	\$10,287	\$5,474	\$18,409	\$ 9,385
Pro forma	\$ 9,097	\$5,175	\$16,550	\$ 8,793
Basic earnings per common share:				
As reported	\$ 0.30	\$ 0.34	\$ 0.54	\$ 0.58
Pro forma	\$ 0.26	\$ 0.32	\$ 0.49	\$ 0.54

Net income applicable to common shareholders diluted:				
As reported	\$ 10,287	\$ 7,211	\$ 18,409	\$ 12,859
Pro forma	\$ 9,097	\$ 6,912	\$ 16,550	\$ 12,268
Diluted earnings per common share:				
As reported	\$ 0.28	\$ 0.25	\$ 0.51	\$ 0.44
Pro forma	\$ 0.25	\$ 0.24	\$ 0.46	\$ 0.42

**Table of Contents****5. Operating Segments**

The Company's operations are conducted mainly through its sports and athletic, professional fitness, family recreation and resort/spa centers. The Company has aggregated the activities of its 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. The Company's chief operating decision maker uses 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, café and other activities offered to members and non-member participants and rental income. Included in the "All Other" category in the table below is operating information related to media, athletic events, nutritional products sold to third parties, and a restaurant, and expenses, including interest expense, and corporate assets (including depreciation and amortization). 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 financial statements and notes included in the latest 10-K, as filed with the SEC.

Financial data and reconciling information for the Company's reporting segment to the consolidated amounts in the financial statements are as follows:

	<b>Centers</b>	<b>All Other</b>	<b>Consolidated</b>
Three months ended June 30, 2005:			
Revenue	\$ 93,794	\$ 1,813	\$ 95,607
Net income (loss)	\$ 11,832	\$ (1,545)	\$ 10,287
Provision (benefit) for income taxes	8,223	(1,073)	7,150
Interest expense, net	2,867	376	3,243
Depreciation and amortization	7,570	1,620	9,190
<b>EBITDA</b>	<b>\$ 30,492</b>	<b>\$ (622)</b>	<b>\$ 29,870</b>
Total assets	\$546,941	\$70,421	\$617,362
Three months ended June 30, 2004:			
Revenue	\$ 73,934	\$ 2,655	\$ 76,589
Net income (loss)	\$ 9,306	\$ (2,095)	\$ 7,211
Provision (benefit) for income taxes	6,449	(1,456)	4,993
Interest expense, net	4,058	391	4,449
Depreciation and amortization	5,600	1,371	6,971
<b>EBITDA</b>	<b>\$ 25,413</b>	<b>\$ (1,789)</b>	<b>\$ 23,624</b>
Total assets	\$410,934	\$73,811	\$484,745
Six months ended June 30, 2005:			
Revenue	\$181,629	\$ 3,306	\$184,935
Net income (loss)	\$ 21,378	\$ (2,969)	\$ 18,409
Provision (benefit) for income taxes	14,857	(2,063)	12,794
Interest expense, net	6,187	882	7,069

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Depreciation and amortization	14,785	3,139	17,924
EBITDA	\$ 57,207	\$ (1,011)	\$ 56,196
Total assets	\$546,941	\$70,421	\$617,362
Six months ended June 30, 2004:			
Revenue	\$144,878	\$ 5,881	\$150,759
Net income (loss)	\$ 17,011	\$ (4,152)	\$ 12,859
Provision (benefit) for income taxes	11,855	(2,885)	8,970
Interest expense, net	8,236	825	9,061
Depreciation and amortization	11,192	2,726	13,918
EBITDA	\$ 48,294	\$ (3,486)	\$ 44,808
Total assets	\$410,934	\$73,811	\$484,745

For the periods presented, the Company changed certain allocations, primarily the provision (benefit) for income taxes to better represent the costs specifically related to those businesses.

**Table of Contents****6. Supplementary Cash Flow Information**

Changes in operating assets and liabilities are as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
Accounts receivable	\$ (2,149)	\$ (929)
Income taxes receivable	2,897	1,314
Inventories	238	372
Prepays and other current assets	(615)	1,296
Deferred membership origination costs	(2,070)	(492)
Accounts payable	1,867	(653)
Accrued expenses	5,403	4,153
Deferred revenue	6,044	3,160
Deferred rent	1,454	498
	<b>\$13,069</b>	<b>\$8,719</b>

**7. Commitments and Contingencies**

*Litigation* The Company is engaged in legal proceedings incidental to the normal course of business. Although the ultimate outcome of these matters cannot be determined, management believes that the final disposition of these proceedings will not have a material adverse effect on the consolidated financial position or results of operations of the Company.

**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 *Factors That May Affect Future Results* in this report. 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 Securities and Exchange Commission ( SEC ) that advise interested parties of the risks and factors that may affect our business.

The interim 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 10-K, as filed with the SEC, which includes audited consolidated financial statements for our three fiscal years ended December 31, 2004.

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**Overview**

We operate sports and athletic, professional fitness, family recreation and resort/spa centers. As of July 15, 2005, we operated 42 centers primarily in suburban locations across eight states under the LIFE TIME FITNESS brand. We commenced operations in 1992 by opening our first center in the Minneapolis and St. Paul, Minnesota area. During this period of initial growth, we refined the format and model of our center while building our membership base, infrastructure and management team. As a result, several of the centers that opened during our early years have designs that differ from our current model center.

We opened five centers in 2002, four centers in 2003, and six centers in 2004. We have opened three current model centers in 2005 and plan to open three additional current model centers in 2005. We plan to open seven current model centers in 2006.

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 for comparable-center revenue purposes beginning on the first day of the thirteenth full calendar month of the center's operation, 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 already 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 existing centers will represent an increasing proportion of our center base over time, our comparable-center revenue increases may be lower in future periods than in the past. Of the six new centers we have opened or plan to open in 2005, four will be in existing markets. We do not expect that operating costs of our planned new centers will be 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. Another result of opening new centers is that our consolidated center operating margins may be lower than they have been historically while the centers build membership base. This is due to new centers incurring pre-opening expenses and experiencing lower revenue volumes than existing centers. For example, by the end of the third quarter of 2005, we expect to have nine current model centers in their first year of operations, compared to four current model centers and one smaller center in their first year of operations at the end of the third quarter of 2004, which may reduce center operating margins for the third quarter of 2005. Our categories of new centers and existing centers do not include the center owned by Bloomingdale LLC because it is accounted for as an investment in an unconsolidated affiliate and is not consolidated in our financial statements.

We measure performance using such key operating statistics as average center revenue per membership, average in-center revenue per membership and center operating expenses, with an emphasis on payroll and occupancy costs, as a percentage of revenue and comparable-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 growth of 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 and center attrition rates.

We have three primary sources of revenue. First, our largest source of revenue is membership dues and enrollment fees paid by our members. We recognize revenue from monthly membership dues in the month to which they pertain. We recognize revenue from enrollment fees over the expected average life of the membership, which is 36 months. Second, we generate revenue, which we refer to as in-center revenue, at our centers from fees for personal training, group fitness training and other member activities, sales of products at our LifeCafe, sales of products and services offered at our LifeSpa, sales of products to our members from our e-commerce store, and renting space in certain of our centers. And third, we have expanded the LIFE TIME FITNESS brand into other wellness-related offerings that generate revenue, which we refer to as



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other revenue, including our media and athletic events businesses. Our primary media offering is our magazine, *Experience Life*. Other revenue also includes sales of our nutritional products to third parties and revenue from our restaurant located in the building where we operate a center designed as an urban executive facility in downtown Minneapolis, Minnesota.

Center operations expenses consist primarily of salary, 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 center membership growth, in-center businesses, and our media, nutritional product and athletic event 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. Our other operating expenses include the costs associated with our media and athletic events businesses, our nutritional products sold to third parties, our restaurant and other corporate expenses, as well as gains or losses on our dispositions of assets. Our total operating expenses may vary from period to period depending on the number of new centers opened during that period and the number of centers engaged in presale activities.

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 total, on average, approximately \$22.5 million, which could vary considerably based on variability in land cost and the cost of construction labor, as well as whether or not a tennis area is included or whether or not we expand the gymnasium. We expect the total cost of new centers constructed in 2005 to increase above the \$22.5 million average due to higher land costs and higher construction costs in other states where we are opening centers. We perform maintenance and make improvements on our centers and equipment every 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. Actual 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, volatility factors in determining fair value of option grants, tax provisions and provisions for uncollectible receivables. We also use estimates for calculating the amortization period for deferred enrollment fee revenue and associated direct costs, which are based on the average expected life of a membership. We revise the recorded estimates when better information is available, facts change or we can determine actual amounts. These revisions can affect operating results.

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 10-K, as filed with the SEC, which includes audited consolidated financial statements for our three fiscal years ended December 31, 2004.

**Table of Contents****Results of Operations**

The following table sets forth our statement of operations data as a percentage of total revenues and also sets forth other financial and operating data for the three and six-month periods ended June 30, 2005, and 2004.

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Revenue</b>				
Center revenue:				
Membership dues	67.3%	66.6%	67.5%	66.5%
Enrollment fees	5.7	6.6	5.5	6.4
In-center revenue	25.1	23.3	25.2	23.2
Total center revenue	98.1	96.5	98.2	96.1
Other revenue	1.9	3.5	1.8	3.9
Total revenue	100.0	100.0	100.0	100.0
 <b>Operating expenses</b>				
Center operations	55.3	52.8	55.4	52.7
Advertising and marketing	2.7	3.6	3.7	4.3
General and administrative	7.7	7.3	7.5	7.7
Other operating	3.3	5.8	3.3	6.0
Depreciation and amortization	9.6	9.1	9.7	9.2
Total operating expenses	78.6	78.6	79.6	79.9
<b>Income from operations</b>	21.4	21.4	20.4	20.1
Interest expense, net	3.4	5.8	3.8	5.9
Equity in earnings of affiliate	0.3	0.3	0.3	0.3
Total other expense	3.1	5.5	3.5	5.6
<b>Income before income taxes</b>	18.3	15.9	16.9	14.5
Provision for income taxes	7.5	6.5	6.9	6.0
<b>Net income</b>	10.8%	9.4%	10.0%	8.5%

**Other financial and operating data:**

Average center revenue per membership	\$ 294	\$ 282	\$ 585	\$ 567
Average in-center revenue per membership	\$ 75	\$ 68	\$ 150	\$ 136
Centers open at end of period	41	34	41	34
Number of memberships at end of period	335,816	277,924	335,816	277,924

**Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004**

*Total revenue.* Total revenue increased \$19.0 million, or 24.8%, to \$95.6 million for the three months ended June 30, 2005, from \$76.6 million for the three months ended June 30, 2004.

Total center revenue grew \$19.9 million, or 26.9%, to \$93.8 million for the three months ended June 30, 2005, from \$73.9 million for the three months ended June 30, 2004. Comparable-center revenue increased 7.0% for the three

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months ended June 30, 2005 compared to the three months ended June 30, 2004. Of the \$19.9 million increase in total center revenue,

67.0% was from membership dues, which increased \$13.3 million, due to increased memberships at new and existing centers.

31.1% was from in-center revenue, which increased \$6.2 million primarily as a result of our members increased use of our personal training, LifeCafe and LifeSpa products and services. As a result of this in-center revenue growth and our focus on broadening our offerings to our members, average in-center revenue per membership increased to \$75 for the three months ended June 30, 2005, from \$68 for the three months ended June 30, 2004.

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1.9% was from enrollment fees, which are deferred until a center opens and recognized on a straight-line basis over 36 months. Enrollment fees increased \$0.4 million for the three months ended June 30, 2005 to \$5.5 million. Our number of memberships increased 20.8%, to 335,816 at June 30, 2005, from 277,924 at June 30, 2004.

Other revenue decreased 31.7%, to \$1.8 million for the three months ended June 30, 2005, which was primarily due to decreased revenue generated from sales in our nutritional division as a result of our discontinuation of selling our nutritional products at third party retailers.

*Center operations expenses.* Center operations expenses totaled \$52.8 million, or 56.3% of total center revenue (or 55.3% of total revenue), for the three months ended June 30, 2005 compared to \$40.5 million, or 54.7% of total center revenue (or 52.8% of total revenue), for the three months ended June 30, 2004. This \$12.4 million increase primarily consisted of an increase of \$5.7 million in payroll-related costs to support increased memberships at new and existing centers and increased expenses to support in-center products and services. As a percent of total center revenue, center operations expense increased primarily due to the lower operating margins associated with new centers. At June 30, 2005, we had seven centers in the first year of operations compared to four centers in the first year of operations at June 30, 2004.

*Advertising and marketing expenses.* Advertising and marketing expenses were \$2.6 million, or 2.7% of total revenue, for the three months ended June 30, 2005, compared to \$2.8 million, or 3.6% of total revenue, for the three months ended June 30, 2004. As a percentage of total revenue, these expenses decreased primarily due to lower advertising costs associated with our nutritional business.

*General and administrative expenses.* General and administrative expenses were \$7.3 million, or 7.7% of total revenue, for the three months ended June 30, 2005, compared to \$5.6 million, or 7.3% of total revenue, for the three months ended June 30, 2004. This \$1.7 million increase was primarily due to increased costs to support the growth in our membership and center base in 2004 and the first half of 2005, as well as costs associated with being a publicly held company. As a percentage of total revenue, general and administrative costs increased primarily due to costs associated with our leadership conference held in May 2005 and Sarbanes-Oxley readiness expenses. This increase in costs was partially offset by economies of scale achieved in shared service functions, including member relations and procurement, as our membership and center base expanded.

*Other operating expenses.* Other operating expenses were \$3.2 million for the three months ended June 30, 2005, compared to \$4.4 million for the three months ended June 30, 2004. This \$1.2 million decrease was primarily due to lower costs associated with our athletic events and nutritional product businesses.

*Depreciation and amortization.* Depreciation and amortization was \$9.2 million for the three months ended June 30, 2005, compared to \$7.0 million for the three months ended June 30, 2004. This \$2.2 million increase was due primarily to depreciation on our new centers opened in 2004 and early 2005.

*Interest expense, net.* Interest expense, net of interest income, was \$3.2 million for the three months ended June 30, 2005, compared to \$4.4 million for the three months ended June 30, 2004. This decrease was primarily the result of reduced average debt balances. Proceeds from the initial public offering and increased cash flows from operating activities allowed us to limit our borrowings during 2004 and early 2005.

*Provision for income taxes.* The provision for income taxes was \$7.2 million for the three months ended June 30, 2005, compared to \$5.0 million for the three months ended June 30, 2004. This \$2.2 million increase was due to an increase in income before income taxes of \$5.2 million.

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*Net income.* As a result of the factors described above, net income was \$10.3 million, or 10.8% of total revenue, for the three months ended June 30, 2005, compared to \$7.2 million, or 9.4% of total revenue, for the three months ended June 30, 2004.

***Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004***

*Total revenue.* Total revenue increased \$34.2 million, or 22.7%, to \$184.9 million for the six months ended June 30, 2005, from \$150.8 million for the six months ended June 30, 2004.

Total center revenue grew \$36.8 million, or 25.4%, to \$181.6 million for the six months ended June 30, 2005, from \$144.9 million for the six months ended June 30, 2004. Comparable-center revenue increased 7.6% for the six months ended June 30, 2005 compared to the six months ended June 30, 2004. Of the \$36.8 million increase in total center revenue,

67.0% was from membership dues, which increased \$24.6 million, due to increased memberships at new and existing centers.

31.5% was from in-center revenue, which increased \$11.6 million primarily as a result of our members increased use of our personal training, LifeCafe and LifeSpa products and services. As a result of this in-center revenue growth and our focus on broadening our offerings to our members, average in-center revenue per membership increased to \$150 for the six months ended June 30, 2005, from \$136 for the six months ended June 30, 2004.

1.5% was from enrollment fees, which are deferred until a center opens and recognized on a straight-line basis over 36 months. Enrollment fees increased \$0.6 million for the six months ended June 30, 2005 to \$10.1 million. Our number of memberships increased 20.8%, to 335,816 at June 30, 2005, from 277,924 at June 30, 2004.

Other revenue decreased 43.8%, to \$3.3 million for the six months ended June 30, 2005, which was primarily due to decreased revenue generated from external sales in our nutritional division as a result of our discontinuation of selling our nutritional products at third party retailers.

*Center operations expenses.* Center operations expenses totaled \$102.4 million, or 56.4% of total center revenue (or 55.4% of total revenue), for the six months ended June 30, 2005 compared to \$79.5 million, or 54.9% of total center revenue (or 52.7% of total revenue), for the six months ended June 30, 2004. This \$22.9 million increase primarily consisted of an increase of \$10.7 million in payroll-related costs to support increased memberships at new and existing centers and increased expenses to support in-center products and services. As a percent of total center revenue, center operations expense increased primarily due to the lower operating margins associated with new centers. At June 30, 2005, we had seven centers in the first year of operations compared to four centers in the first year of operations at June 30, 2004.

*Advertising and marketing expenses.* Advertising and marketing expenses were \$6.9 million, or 3.7% of total revenue, for the six months ended June 30, 2005, compared to \$6.5 million, or 4.3% of total revenue, for the six months ended June 30, 2004. As a percentage of total revenue, these expenses decreased primarily due to lower advertising costs associated with our nutritional business.

*General and administrative expenses.* General and administrative expenses were \$13.8 million, or 7.5% of total revenue, for the six months ended June 30, 2005, compared to \$11.5 million, or 7.7% of total revenue, for the six months ended June 30, 2004. This \$2.3 million increase was primarily due to increased costs to support the growth in our membership and center base in 2004 and the first half of 2005, as well as costs associated with being a publicly held company and costs associated with our leadership conference held in May 2005. As a percentage of total revenue, general and administrative costs decreased primarily due to economies of scale achieved in shared service functions, including member relations and procurement, as our membership and center base expanded.

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*Other operating expenses.* Other operating expenses were \$6.2 million for the six months ended June 30, 2005, compared to \$8.9 million for the six months ended June 30, 2004. This \$2.7 million decrease was primarily due to lower costs associated with our athletic events and nutritional product businesses.

*Depreciation and amortization.* Depreciation and amortization was \$17.9 million for the six months ended June 30, 2005, compared to \$13.9 million for the six months ended June 30, 2004. This \$4.0 million increase was due primarily to depreciation on our new centers opened in 2004 and early 2005.

*Interest expense, net.* Interest expense, net of interest income, was \$7.1 million for the six months ended June 30, 2005, compared to \$9.1 million for the six months ended June 30, 2004. This decrease was primarily the result of reduced average debt balances. Proceeds from the initial public offering and increased cash flows from operating activities allowed us to limit our borrowings during 2004 and early 2005.

*Provision for income taxes.* The provision for income taxes was \$12.8 million for the six months ended June 30, 2005, compared to \$9.0 million for the six months ended June 30, 2004. This \$3.8 million increase was due to an increase in income before income taxes of \$9.4 million.

*Net income.* As a result of the factors described above, net income was \$18.4 million, or 10.0% of total revenue, for the six months ended June 30, 2005, compared to \$12.9 million, or 8.5% of total revenue, for the six months ended June 30, 2004.

**Liquidity and Capital Resources**

***Liquidity***

Historically, we have satisfied our liquidity needs through various debt arrangements, sales of equity and cash from operations. Principal liquidity needs have included the development of new sports and athletic, professional fitness, family recreation and resort/spa centers, debt service requirements and expenditures necessary to maintain and update our existing centers and their related fitness equipment. We believe that we can satisfy our current and longer-term debt service obligations and capital expenditure requirements with available cash balances, cash flow from operations and our committed debt facility and through the extension of the terms or our refinancing of our existing debt facility, 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. Our business model operates with negative working capital because we carry minimal accounts receivable due to our ability to have monthly membership dues paid by electronic draft, we defer enrollment fee revenue and because we fund the construction of our new centers under standard arrangements with our vendors that are paid with proceeds from long-term debt.

***Operating Activities***

As of June 30, 2005, we had total cash and cash equivalents of \$0.3 million and \$3.9 million of restricted cash that serves as collateral for certain of our debt arrangements. We also had \$150.5 million available under our revolving credit facility as of June 30, 2005.

Net cash provided by operating activities was \$54.0 million for the six months ended June 30, 2005 compared to \$36.4 million for the six months ended June 30, 2004. The increase of \$17.6 million was primarily due to a \$12.1 million increase in net income adjusted for non-cash charges.

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Investing activities consist primarily of purchasing real property, constructing new centers and purchasing new fitness equipment. In addition, we make 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. For current model centers, our investment has averaged approximately \$22.5 million, which includes the land, the building and approximately \$2.5 million of exercise equipment, furniture and fixtures.

Net cash used in investing activities was \$66.9 million for the six months ended June 30, 2005, compared to \$50.9 million for the six months ended June 30, 2004. The increase of \$16.0 million was primarily due to capital expenditures for the construction of new centers and maintenance and updates to our existing centers.

Our total capital expenditures were as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Purchases of property and equipment	\$83,266	\$58,721
Non-cash property and equipment purchases financed through notes payable		2,954
Non-cash property and equipment purchases financed through capital lease obligations		145
Total capital expenditures	\$83,266	\$61,820

The following schedule reflects capital expenditures by type of expenditure:

	<b>For the Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Capital expenditures for new construction	\$68,307	\$50,164
Capital expenditures for maintenance and updating existing centers and corporate infrastructure	14,959	11,656
Total capital expenditures	\$83,266	\$61,820

At June 30, 2005, we had purchased the real property for the six new current model centers that we plan to open in 2005, two of which had already opened. In addition, we had purchased the real property for four of the current model centers we plan to open in 2006, and we had entered into agreements to purchase real property for the development of the remaining three current model centers that we plan to open in 2006 and three of the current model centers we plan to open in 2007.

***Financing Activities***

Net cash provided by financing activities was \$3.0 million for the six months ended June 30, 2005, compared to a use of \$3.4 million for the six months ended June 30, 2004. The change of \$6.4 million was primarily due to lower amounts of proceeds from long-term borrowings in the first and second quarters of 2004 compared to the first and second quarters of 2005.

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On April 15, 2005, we entered into a Credit Agreement, with U.S. Bank National Association, as administrative agent and lead arranger, J.P. Morgan Securities, Inc., as syndication agent, and the banks party thereto from time to time (the U.S. Bank Facility ). The U.S. Bank Facility provides a \$200.0 million five-year revolving credit facility. Proceeds from the U.S. Bank Facility were used to retire all of our outstanding loans under the Antares Facility and the Term Loan Facility, each as defined below, and will be used to provide additional borrowing capacity. As of June 30, 2005, \$49.5 million was outstanding on the U.S. Bank Facility.

In connection with the events described above, on April 15, 2005, we repaid all amounts outstanding under the Second Amended and Restated Credit Agreement dated as of July 19, 2001, by and among us, as Borrower, Antares Capital Corporation, as a Lender and as Agent for all Lenders, BNP Paribas, as a Lender and as Documentation Agent, and other financial institutions party thereto as Lenders (the Antares Facility ) and terminated the Antares Facility. The Antares Facility was a \$55.0 secured revolving credit facility that would have expired on June 30, 2005. On April 15, 2005, we also terminated the Amended and Restated Master Construction and Term Loan Agreement dated as of June 14, 2001, by and among our subsidiary, FCA Real Estate Holdings, LLC, U.S. Bank National Association, and the Lenders party thereto (the Term Loan Facility ). The Term Loan Facility provided a \$75.0 million construction credit facility that would have expired on January 1, 2006.

In addition to refinancing indebtedness under the Antares Facility and the Term Loan Facility, amounts borrowed under the U.S. Bank Facility may be used to finance the acquisition, construction and development of real property, improvements and fixtures for use in connection with centers, make improvements to centers, finance permitted acquisitions and finance working capital requirements. As security for our obligations under the U.S. Bank Facility, we granted a security interest in all of our personal property pursuant to the terms of a Security Agreement, dated as of April 15, 2005, among us and U.S. Bank National Association, as administrative agent.

We have financed 13 of our centers with Teachers Insurance and Annuity Association of America pursuant to the terms of individual notes. The obligations under these notes are due in full in September 2011, and are secured by mortgages on each of the centers specifically financed, and we maintain a letter of credit in the amount of \$5.0 million in favor of the lender. The obligations related to 10 of the notes are being amortized over a 20-year period, while the obligations related to the other three notes are being amortized over a 15-year period. The interest rate payable under these notes has been fixed at 8.25%. The loan documents provide that we will be in default if our Chief Executive Officer, Mr. Akradi, ceases to be Chairman of the Board of Directors and Chief Executive Officer for any reason other than due to his death or incapacity or as a result of his removal pursuant to our articles of incorporation or bylaws. As of June 30, 2005, \$129.8 million remained outstanding on the notes.



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**Factors That May Affect Future Results**

***If we are unable to identify and acquire suitable sites for new sports and athletic, professional fitness, family recreation and resort/spa centers, our revenue growth rate and profits may be negatively impacted.***

To successfully expand our business, we must identify and acquire sites that meet the site selection criteria we have established. In addition to finding sites with the right demographic and other measures we employ in our selection process, we also need to evaluate the penetration of our competitors in the market. We face significant competition from other health and fitness center operators for sites that meet our criteria, and as a result we may lose those sites, our competitors could copy our format or we could be forced to pay significantly higher prices for those sites. If we are unable to identify and acquire sites for new centers, our revenue growth rate and profits may be negatively impacted. Additionally, if our analysis of the suitability of a site is incorrect, we may not be able to recover our capital investment in developing and building the new center.

***We may be unable to attract and retain members, which could have a negative effect on our business.***

The success of our business depends on our ability to attract and retain members, and we cannot assure you that we will be successful in our marketing efforts or that the membership levels at our centers will not materially decline, especially at those centers that have been in operation for an extended period of time. All of our members can cancel their membership at any time upon one month's notice. In addition, we experience attrition and must continually attract new members in order to maintain our membership levels. There are numerous factors that could lead to a decline in membership levels or that could prevent us from increasing membership at newer centers where membership is generally not yet at a targeted capacity, including market maturity or saturation, a decline in our ability to deliver quality service at a competitive price, direct and indirect competition in the areas where our centers are located, a decline in the public's interest in health and fitness, changes in discretionary spending trends and general economic conditions. In addition, we may decide to close a center and attempt to move members of that center to a different center or we may have to temporarily relocate members if a center is closed for remodeling or due to fire, earthquake or other casualty.

***Delays in new center openings could have a material adverse effect on our financial performance.***

In order to meet our objectives, it is important that we open new centers on schedule. A significant amount of time and expenditure of capital is required to develop and construct new centers. If we are significantly delayed in opening new centers, our competitors may be able to open new clubs in the same market before we open our centers. This change in the competitive landscape could negatively impact our pre-opening sales of memberships and increase our investment costs. In addition, delays in opening new centers could hurt our ability to meet our growth objectives. Our ability to open new centers on schedule depends on a number of factors, many of which are beyond our control. These factors include:

obtaining acceptable financing for construction of new sites;

obtaining entitlements, permits and licenses necessary to complete construction of the new center on schedule;

recruiting, training and retaining qualified management and other personnel;

securing access to labor and materials necessary to develop and construct our centers;

delays due to material shortages, labor issues, weather conditions or other acts of God, discovery of contaminants, accidents, deaths or injunctions; and

general economic conditions.

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***Our continued growth could place strains on our management, employees, information systems and internal controls which may adversely impact our business and the value of our shareholders investment.***

Over the past several years, we have experienced significant growth in our business activities and operations, including an increase in the number of our centers. Our past expansion has placed, and any future expansion will place, significant demands on our administrative, operational, financial and other resources. Any failure to manage growth effectively could seriously harm our business. To be successful, we will need to continue to implement management information systems and improve our operating, administrative, financial and accounting systems and controls. We will also need to train new employees and maintain close coordination among our executive, accounting, finance, marketing, sales and operations functions. These processes are time-consuming and expensive, will increase management responsibilities and will divert management attention.

***The opening of new centers in existing locations may negatively impact our comparable-center revenue increases and our operating margins.***

We currently operate centers in eight states. During 2005, we plan to open six additional centers, three of which opened by July 15, 2005. One of the remaining three openings in 2005 is in an existing market. With respect to existing markets, it has been our experience that opening new centers may attract some memberships away from existing centers already operated by us in those markets and diminish their revenues. In addition, as a result of new center openings in existing markets, and because existing centers will represent an increasing proportion of our center base over time, our comparable-center revenue increases may be lower in future periods than in the past.

Another result of opening new centers is that our center operating margins may be lower than they have been historically while the centers build membership base. We expect both the addition of pre-opening expenses and the lower revenue volumes characteristic of newly opened centers to affect our center operating margins at these new centers. We also expect certain operating costs, particularly those related to occupancy, to be higher than in the past in some newly entered geographic regions. As a result of the impact of these rising costs, our total center contribution and operating margins may be lower in future periods than they have been in the past.

***Our debt levels may limit our flexibility in obtaining additional financing and in pursuing other business opportunities.***

As of June 30, 2005, we had total consolidated indebtedness of \$210.3 million, consisting principally of obligations under term notes that are secured by certain of our properties, borrowings under our revolving credit facility that are secured by certain personal property, mortgage notes that are secured by certain of our centers and obligations under capital leases.

Our level of indebtedness could have important consequences to us, including the following:

- our ability to obtain additional financing, if necessary, for capital expenditures, working capital, acquisitions or other purposes may be impaired or such financing may not be available on favorable terms;

- we will need a substantial portion of our cash flow to pay the principal of, and interest on, our indebtedness, including indebtedness that we may incur in the future;

- payments on our indebtedness will reduce the funds that would otherwise be available for our operations and future business opportunities;

- a substantial decrease in our cash flows from operations could make it difficult for us to meet our debt service requirements and force us to modify our operations;

- we may be more highly leveraged than our competitors, which may place us at a competitive disadvantage;

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our debt level may make us more vulnerable and less flexible than our competitors to a downturn in our business or the economy in general; and

some of our debt has a variable rate of interest, which increases our vulnerability to interest rate fluctuations. On April 15, 2005, we entered into a new \$200.0 million five-year revolving credit facility which replaced our existing \$55.0 million revolving credit facility and our \$75.0 million construction credit facility. As of June 30, 2005, in addition to the amount of indebtedness outstanding, we had access to an additional \$150.5 million under this new facility. We also have the ability to incur new debt, subject to limitations under our existing credit facilities and in our debt financing agreements. Furthermore, we have 13 centers financed by Teachers Insurance and Annuity Association of America that are subject to cross-default and cross-collateral provisions, which would allow the lender to foreclose on each of these 13 centers if there is an event of default related to one or more of these centers. If we incur additional debt, the risks associated with our leverage, including our ability to service our debt, could intensify.

***Because of the capital-intensive nature of our business, we may have to incur additional indebtedness or issue new equity securities and, if we are not able to obtain additional capital, our ability to operate or expand our business may be impaired and our operating results could be adversely affected.***

Our business requires significant levels of capital to finance the development of additional sites for new centers and the construction of our centers. If cash from available sources is insufficient, or if cash is used for unanticipated needs, we may require additional capital sooner than anticipated. In the event that we are required or choose to raise additional funds, we may be unable to do so on favorable terms or at all. Furthermore, the cost of debt financing could significantly increase, making it cost-prohibitive to borrow, which could force us to issue new equity securities. If we issue new equity securities, existing shareholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise funds on acceptable terms, we may not be able to take advantage of future opportunities or respond to competitive pressures. Any inability to raise additional capital when required could have an adverse effect on our business plans and operating results.

***The health club industry is highly competitive and our competitors may have greater name recognition than we have.***

We compete with other health and fitness centers, physical fitness and recreational facilities established by local non-profit organizations, governments, hospitals, and businesses, amenity and condominium clubs and similar non-profit organizations, local salons, cafes and businesses offering similar ancillary services, and, to a lesser extent, racquet, tennis and other athletic clubs, country clubs, weight reducing salons and the home fitness equipment industry. Competitors, which may have greater name recognition than we have, may compete with us to attract members in our markets. Non-profit and government organizations in our markets may be able to obtain land and construct centers at a lower cost than us and may be able to collect membership fees without paying taxes, thereby allowing them to lower their prices. This competition may limit our ability to increase membership fees, retain members, attract new members and retain qualified personnel.

***Competitors could copy our business model and erode our market share, brand recognition and profitability.***

We employ a business model that could allow competitors to duplicate our successes. We cannot assure you that our competitors will not attempt to copy our business model and that this will not erode our market share and brand recognition and impair our growth rate and profitability. In response to any such competitors, we may be required to decrease our membership fees, which may reduce our operating margins and profitability.

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***We have significant operations concentrated in certain geographic areas, and any disruption in the operations of our centers in any of these areas could harm our operating results.***

As of July 15, 2005, we operate multiple centers in several metropolitan areas, including 15 in the Minneapolis/St. Paul market, seven in the Chicago market, six in the Detroit market, and five in the Dallas market, with continued planned expansion in these and other markets. As a result, any prolonged disruption in the operations of our centers in any of these markets, whether due to technical difficulties, power failures or destruction or damage to the centers as a result of a natural disaster, fire or any other reason, could harm our operating results. In addition, our concentration in these markets increases our exposure to adverse developments related to competition, as well as economic and demographic changes in these areas.

***If we cannot retain our key personnel and hire additional highly qualified personnel, we may not be able to successfully manage our operations and pursue our strategic objectives.***

We are highly dependent on the services of our senior management team and other key employees at both our corporate headquarters and our centers, and on our ability to recruit, retain and motivate key personnel. Competition for such personnel is intense, and the inability to attract and retain the additional qualified employees required to expand our activities, or the loss of current key employees, could materially and adversely affect us.

***If our founder and chief executive officer leaves our company for any reason, it could have a material adverse effect on us.***

Our growth and development to date have been largely dependent upon the services of Bahram Akradi, our Chairman of the Board of Directors, President, Chief Executive Officer and founder. If Mr. Akradi ceases to be Chairman of the Board of Directors and Chief Executive Officer for any reason other than due to his death or incapacity or as a result of his removal pursuant to our articles of incorporation or bylaws, we will be in default under the loan documents for our 13 centers financed with Teachers Insurance and Annuity Association of America. As a result, Mr. Akradi may be able to exert disproportionate control over our company because of the significant consequence of his departure. We do not have any employment or non-competition agreement with Mr. Akradi.

***We could be subject to claims related to health or safety risks at our centers.***

Use of our centers poses potential health or safety risks to members or guests through exertion and use of our equipment, swimming pools and other facilities and services. We cannot assure you that claims will not be asserted against us for injury or death suffered by someone using our facilities or services. In addition, the childcare services we offer at our centers expose us to claims related to childcare. Lastly, because we construct our own centers, we also face liability in connection with the construction of these centers.

***We are subject to extensive government regulation, and changes in these regulations could have a negative effect on our financial condition and results of operations.***

Various federal and state laws and regulations govern our operations, including:

general rules and regulations of the Federal Trade Commission, state and local consumer protection agencies and state statutes that prescribe certain forms and provisions of membership contracts and that govern the advertising, sale and collection of our memberships;

state and local health regulations; and

regulation of rehabilitation service providers.

Any changes in such laws could have a material adverse effect on our financial condition and results of operations.

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***We have introduced other business initiatives that may not become profitable.***

In addition to our sports and athletic, professional fitness, family recreation and resort/spa centers, we have introduced other business initiatives in the areas of nutritional products, media and athletic events in order to capitalize on our brand identity and membership base. We have limited experience with these other initiatives and face significant competition against established companies with more retail experience and greater financial resources than us. We may not be able to compete effectively against these established companies, and these other business initiatives may not become profitable. In addition, we license from a third party the right to use the mark LIFE TIME in connection with our nutritional products, as well as the right to use certain ingredients of such products. These rights may be material to marketing and distributing our nutritional products. If these licenses are terminated for any reason, we may no longer be able to market and distribute nutritional products under the LIFE TIME FITNESS brand.

***We could be subject to claims related to our nutritional products.***

The nutritional products industry is currently the source of proposed federal laws and regulations, as well as numerous lawsuits. We advertise and offer for sale proprietary nutritional products within our centers and through our website. We cannot assure you that there will be no claims against us regarding the ingredients in, manufacture of or results of using our nutritional products. Furthermore, we cannot assure you that any rights we have under indemnification provisions or insurance policies will be sufficient to cover any losses that might result from such claims.

***If it becomes necessary to protect or defend our intellectual property rights or if we infringe on the intellectual property rights of others, we may be required to pay royalties or fees or become involved in costly litigation.***

We may have disputes with third parties to enforce our intellectual property rights, protect our trademarks, determine the validity and scope of the proprietary rights of others or defend ourselves from claims of infringement, invalidity or unenforceability. Such disputes may require us to engage in litigation. We may incur substantial costs and a diversion of resources as a result of such disputes and litigation, even if we win. In the event that we do not win, we may have to enter into royalty or licensing agreements, we may be prevented from using the marks within certain markets in connection with goods and services that are material to our business or we may be unable to prevent a third party from using our marks. We cannot assure you that we would be able to reach an agreement on reasonable terms, if at all. In particular, although we own an incontestable federal trademark registration for use of the LIFE TIME FITNESS® mark in the field of health and fitness centers, we are aware of entities in certain locations around the country that use LIFE TIME FITNESS or a similar mark in connection with goods and services related to health and fitness. The rights of these entities in such marks may predate our rights. Accordingly, if we open any centers in the areas in which these parties operate, we may be required to pay royalties or may be prevented from using the mark in such areas.

***Our business could be affected by acts of war or terrorism.***

Current world tensions could escalate, potentially leading to war or acts of terrorism. This could have unpredictable consequences on the world economy and on our business.

***We will be exposed to risks relating to evaluations of controls required by Section 404 of the Sarbanes-Oxley Act of 2002***

We are in the process of evaluating our internal controls systems to allow management to report on, and our independent auditors to attest to, our internal control over financial reporting. We will be performing the management assessment and auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002. We are required to comply with Section 404 by no later than December 31, 2005. However, we cannot be certain as to the timing of completion or our evaluation, testing and remediation actions or the impact of the same on our

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operations. Furthermore, upon completion of this process, we may identify control deficiencies of varying degrees of severity under applicable SEC and Public Company Accounting Oversight Board rules and regulations that remain unremediated. As a public company, we will be required to report, among other things, control deficiencies that constitute a material weakness or changes in internal controls that, or are reasonably likely to, materially affect internal controls over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. If we fail to implement the requirements of Section 404 in a timely manner, we might be subject to sanctions or investigation by regulatory authorities such as the SEC or the New York Stock Exchange, and if we fail to remedy any material weakness, our financial statements may be inaccurate, we may face restricted access to the capital markets, and our stock price may be adversely affected.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We do not believe that we have any significant risk related to interest rate fluctuations since we have primarily fixed-rate debt. We invest our excess cash in highly liquid short-term investments. These investments are not held for trading or other speculative purposes. Changes in interest rates affect the investment income we earn on our cash and cash equivalents and, therefore, impact our cash flows and results of operations. As of December 31, 2004, and June 30, 2005, our floating rate indebtedness was approximately \$37.3 million and \$47.1 million, respectively. If long-term floating interest rates were to have increased by 100 basis points during the first six months of 2005, our interest costs would have increased by approximately \$0.2 million. If short-term interest rates were to have increased by 100 basis points during the first six months of 2005, our interest income from cash equivalents would have increased by less than \$0.1 million. These amounts are determined by considering the impact of the hypothetical interest rates on our floating rate indebtedness and cash equivalents balances at June 30, 2005.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

Not applicable.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At the Annual Meeting of Shareholders held on May 5, 2005, the shareholders voted on the following:

1. Proposal to elect a board of six directors, to serve until the next annual meeting of shareholders or until their successors have been duly elected and qualified. The following directors were elected based on the votes listed below:

<b>Nominee</b>	<b>For</b>	<b>Withheld</b>
Bahram Akradi	28,215,570	46,901
Timothy C. DeVries	27,878,975	383,496
James F. Halpin	27,880,010	382,461
Guy C. Jackson	28,221,555	40,916
David A. Landau	27,878,022	384,449
Stephen R. Sefton	28,221,555	40,916

2. Proposal to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2005. The proposal passed on a vote of 21,178,734 in favor, 80,475 against, 3,262 abstentions and no broker non-votes.

As of the close of business on the record date for the meeting, which was March 9, 2005, there were 33,857,179 shares of common stock outstanding and entitled to vote at the meeting. Each share of common stock was entitled to one vote per share.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**Table of Contents****ITEM 6. EXHIBITS***Exhibits filed with this report*

<b>Exhibit No.</b>	<b>Description</b>	<b>Method of Filing</b>
3.1	Amended and Restated Articles of Incorporation of the Registrant	Incorporated by reference to Exhibit 3.1 to the Registrant's Form 10-Q for the quarter ended June 30, 2004 (File No. 001-32230)
3.2	Amended and Restated Bylaws of the Registrant	Incorporated by reference to Exhibit 3.4 to Amendment No. 2 to the Registrant's Registration Statement of Form S-1 (File No. 333-113764), filed with the Commission on May 21, 2004.
4	Specimen of Common Stock Certificate	Incorporated by reference to Exhibit 4 to Amendment No. 4 to the Registrant's Registration Statement of Form S-1 (File No. 333-113764), filed with the Commission on June 23, 2004
10.1	Credit Agreement, dated as of April 15, 2005, among the Company, U.S. Bank National Association, as administrative agent and lead arranger, J.P. Morgan Securities, Inc., as syndication agent, and the banks party thereto from time to time.	Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K dated April 15, 2005 (File No. 001-32230)
10.2	Security Agreement, dated as of April 15, 2005, among the Company and U.S. Bank National Association, as administrative agent.	Incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K dated April 15, 2005 (File No. 001-32230)
31.1	Rule 13a-14(a)/15d-14(a) Certification by Principal Executive Officer	Filed Electronically
31.2	Rule 13a-14(a)/15d-14(a) Certification by Principal Financial Officer	Filed Electronically
32	Section 1350 Certifications	Filed Electronically



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, Life Time Fitness, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on August 8, 2005.

LIFE TIME FITNESS, INC.

By:

/s/ Bahram Akradi

Name: Bahram Akradi

Title: Chairman of the Board of Directors, President and Chief  
Executive Officer

(Principal Executive Officer and Director)

By:

/s/ Michael R. Robinson

Name: Michael R. Robinson

Title: Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

By:

/s/ John M. Hugo

Name: John M. Hugo

Title: Controller  
(Principal Accounting Officer)

**Table of Contents****INDEX TO EXHIBITS**

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