

## Taking Stock: Life Time Fitness not a good fit

by Malcolm Berko

Dear Mr. Berko: I bought 300 shares of Life Time Fitness centers at \$54.20 recently and in a rising market this stock hasn't been doing too well. In fact, I have a loss. Please tell me what you think of this company. Should I continue owning the stock? And do you think I should buy another 200 shares or do you think I should sell the 200 shares I own? I'm a member of the Life Time Fitness Center in Boca Raton, Fla., and two of the executives there recommended that I buy this stock.

B.E.

Cleveland

Dear B.E.: Life Time Fitness Inc. (LTM-\$52.60) operates a chain of 60 upscale, suburban fitness centers where the young and breathless huff and puff their pounds away in a high-powered meat market ambience. Longhaired, long-legged nubile nymphs in tight Spandex gyrate to ear-splitting aerobic sounds while the 40- and 50-something white Alpha males lift iron or strut their stuff in pickup basketball games.

The Life Time Fitness centers are classy places with brick facades, huge exterior windows, Olympic swimming pools, massage parlors, steam rooms and a food court. LTM also has a nursery for young moms to dump their kids so they can meet special friends while limbering their limbs.

Unlike Bally or Town Sports, LTM typically owns the land and buildings where its clubs are located. And unlike the competition, LTM's physical plants, at 120,000 square feet, are twice the size of its competitors. Unlike its competitors, LTM's facilities are bright, new, attractive and have a high-class ambience.

Last year, LTM generated \$476 million in revenues and reported net income of \$48 million, or \$1.37 a share for each of its 35 million shares outstanding. Those earnings grew from 2 cents a share way back in 2002, when LTM's portfolio only had a few weight rooms, saunas and swimming pools and racquetball courts. Impressive, that!

This year's earnings are expected to come in at \$1.70 a share, or \$59.5 million on higher revenues of \$626 million. That's impressive, too. However, a significant portion of LTM's revenue growth derives from opening new facilities and purchasing existing clubs. In other words, LTM's growth isn't organic. And that's worrisome.

That's worrisome because the company isn't generating enough cash flow to finance its expansion, so management has taken on an increasingly larger debt to finance its growth. That's not good. As a result, profit margins are beginning to fall and recent acquisitions, plus eight new locations to open in 2007, are severely squeezing LTM's resources.

To wit, this expansion has put a crimp on LTM's balance sheet, forcing debt to record levels (which is 90 percent of capital) and eventually putting a heavy burden on net profit margins.

Now I think LTM's chief executive officer, Bahram Akradi, may have delusions of grandeur, or is playing dumb like a fox. Even a CEO with a room-temperature IQ can read a balance sheet and see that revenue growth per unit has been falling since 2002 from 22 percent to 8.1 percent last year. While gross revenues are expanding (new clubs and acquisitions), a slower unit revenue growth is not good news for LTM's stock price.

The percentage growth in the numbers of new clubs is higher than the growth of new club members. That's not good for the stock price, either. Some insiders are telling me that Akradi is becoming testy and may raise dues and fees at most of his clubs. Certainly your Boca Raton club can expect a dues increase to pay for the \$10 million to \$12 million facilities improvement. I doubt they will be able to attract enough new members to justify that huge cost.

However, I can't recommend the stock no matter what those good folks at the Boca Raton facility tell you. Frankly, they should devote their time to managing that club and keep their silly investment opinions to themselves.

While you were buying LTM shares on the advice of his employees, Akradi has been liquidating his shares like a man who may be considering a long journey. In November and December, Akradi dumped more than 2.5 million shares (8 percent of LTM's float) at \$50 plus change, which neatly put more than \$150 million sweet greenbacks in his pocket. That's a lot of stock, and perhaps Akradi knows a few things he hasn't shared with his Boca Raton club managers.

Meanwhile, Prudential Securities isn't thrilled and recently issued an "underweight" opinion on the stock. So if shares are good enough for Akradi to sell, they should be good enough for you to sell, too. In fact, I would even suggest that LTM may be an attractive short sale.

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