

LIFE TIME FITNESS, INC.

Form 10-Q

July 29, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2011

or

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

Commission File Number: 001-32230

Life Time Fitness, Inc.

(Exact name of registrant as specified in its charter)

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Minnesota (State or other jurisdiction of incorporation or organization)	41-1689746 (I.R.S. Employer Identification No.)
2902 Corporate Place Chanhassen, Minnesota (Address of principal executive offices)	55317 (Zip Code)
952-947-0000 (Registrant's telephone number, including area code)	

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's common stock as of July 18, 2011 was 42,328,817 common shares.

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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)

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 10,321	\$ 12,227
Accounts receivable, net	4,933	5,806
Center operating supplies and inventories	20,736	17,281
Prepaid expenses and other current assets	18,208	13,318
Deferred membership origination costs	13,480	14,728
Deferred income taxes	3,453	3,628
Income tax receivable	2,458	9,916
Total current assets	73,589	76,904
PROPERTY AND EQUIPMENT, net	1,600,037	1,570,234
RESTRICTED CASH	561	2,572
DEFERRED MEMBERSHIP ORIGINATION COSTS	8,483	7,251
GOODWILL	13,322	13,322
OTHER ASSETS	59,097	48,197
TOTAL ASSETS	\$ 1,755,089	\$ 1,718,480
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 6,486	\$ 7,265
Accounts payable	19,877	18,913
Construction accounts payable	20,013	24,342
Accrued expenses	56,096	50,802
Deferred revenue	40,333	32,095
Total current liabilities	142,805	133,417
LONG-TERM DEBT, net of current portion	574,126	605,279
DEFERRED RENT LIABILITY	33,757	32,187
DEFERRED INCOME TAXES	88,944	89,839
DEFERRED REVENUE	8,595	7,279
OTHER LIABILITIES	10,216	9,901
Total liabilities	858,443	877,902
COMMITMENTS AND CONTINGENCIES (Note 6)		
SHAREHOLDERS EQUITY:		
Undesignated preferred stock, 10,000,000 shares authorized; none issued or outstanding		
Common stock, \$.02 par value, 75,000,000 shares authorized; 42,322,595 and 41,924,985 shares issued and outstanding, respectively	847	839

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Additional paid-in capital	425,147	414,922
Retained earnings	470,570	424,787
Accumulated other comprehensive income	82	30
Total shareholders' equity	896,646	840,578
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,755,089	\$ 1,718,480

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)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
REVENUE:				
Membership dues	\$ 167,013	\$ 152,879	\$ 325,026	\$ 298,044
Enrollment fees	4,686	6,175	9,887	12,499
In-center revenue	80,299	68,457	153,988	133,989
Total center revenue	251,998	227,511	488,901	444,532
Other revenue	4,696	3,577	8,438	6,327
Total revenue	256,694	231,088	497,339	450,859
OPERATING EXPENSES:				
Center operations	156,654	142,151	306,206	279,734
Advertising and marketing	8,997	5,903	17,560	12,675
General and administrative	12,112	11,343	24,763	22,043
Other operating	8,013	5,549	14,005	9,858
Depreciation and amortization	24,663	23,218	48,287	45,984
Total operating expenses	210,439	188,164	410,821	370,294
Income from operations	46,255	42,924	86,518	80,565
OTHER INCOME (EXPENSE):				
Interest expense, net of interest income of \$1, \$3, \$2 and \$21, respectively	(4,697)	(6,917)	(10,201)	(15,013)
Equity in earnings of affiliate	326	303	627	603
Total other income (expense)	(4,371)	(6,614)	(9,574)	(14,410)
INCOME BEFORE INCOME TAXES	41,884	36,310	76,944	66,155
PROVISION FOR INCOME TAXES	16,937	14,426	31,161	26,435
NET INCOME	\$ 24,947	\$ 21,884	\$ 45,783	\$ 39,720
BASIC EARNINGS PER COMMON SHARE	\$ 0.62	\$ 0.55	\$ 1.14	\$ 1.01
DILUTED EARNINGS PER COMMON SHARE	\$ 0.61	\$ 0.53	\$ 1.12	\$ 0.98
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING				
BASIC	40,381	39,885	40,259	39,401
	40,771	41,154	40,763	40,533

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WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING
DILUTED

See notes to unaudited consolidated financial statements.

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	For the Six Months Ended June 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 45,783	\$ 39,720
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	48,287	45,984
Deferred income taxes	(896)	(3,857)
Loss on disposal of property and equipment, net	390	592
Amortization of deferred financing costs	1,297	1,437
Share-based compensation	6,408	3,561
Excess tax benefit related to share-based payment arrangements	(2,765)	(1,697)
Changes in operating assets and liabilities	20,563	15,150
Other	(556)	(182)
Net cash provided by operating activities	118,511	100,708
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(83,023)	(48,164)
Acquisitions, net of cash acquired	(7,181)	(9,414)
Proceeds from sale of property and equipment	453	720
Increase in other assets	(111)	(1,423)
Decrease in restricted cash	2,011	961
Net cash used in investing activities	(87,851)	(57,320)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term borrowings	(73,604)	(35,152)
Proceeds from revolving credit facility, net	41,600	5,101
Increase in deferred financing costs	(4,342)	(258)
Excess tax benefit related to share-based payment arrangements	2,765	1,697
Proceeds from stock option exercises	1,045	2,952
Proceeds from employee stock purchase plan	517	
Stock purchased for employee stock purchase plan	(547)	
Net cash used in financing activities	(32,566)	(25,660)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,906)	17,728
CASH AND CASH EQUIVALENTS Beginning of period	12,227	6,282
CASH AND CASH EQUIVALENTS End of period	\$ 10,321	\$ 24,010

See notes to unaudited consolidated financial statements.

Table of Contents**LIFE TIME FITNESS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

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

1. Basis of Presentation

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

These interim consolidated financial statements and the related notes should be read in conjunction with the annual consolidated financial statements and notes included in the latest Form 10-K, as filed with the Securities and Exchange Commission (SEC), which includes audited consolidated financial statements for the three fiscal years ended December 31, 2010.

2. Share-Based Compensation*Stock Option and Incentive Plans*

We have four share-based compensation plans, the Life Time Fitness, Inc. 1998 Stock Option Plan (the 1998 Plan), the Amended and Restated Life Time Fitness, Inc. 2004 Long-Term Incentive Plan (the 2004 Plan), the Life Time Fitness, Inc. 2011 Long-Term Incentive Plan (the 2011 Plan) and an Employee Stock Purchase Plan (the ESPP), collectively, the share-based compensation plans. We no longer make additional grants under the 1998 Plan and the 2004 Plan. There are 2,500,000 shares of common stock reserved for grant under the 2011 Plan and, as of June 30, 2011, there were 2,477,996 shares available for grant. The types of awards that may be granted under the 2011 Plan include incentive and non-qualified options to purchase shares of common stock, stock appreciation rights, restricted shares, restricted share units, performance awards and other types of share-based awards.

As of June 30, 2011, we had granted a total of 5,587,165 options to purchase common stock under all of the share-based compensation plans, of which options to purchase 512,756 shares were outstanding and vested, and a total of 3,316,880 restricted shares were granted, of which 1,921,414 restricted shares were outstanding and unvested. We use the term restricted shares to define nonvested shares granted to employees and non-employee directors, whereas applicable accounting guidance reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time.

Total share-based compensation expense included in our consolidated statements of operations for the three and six months ended June 30, 2011 and 2010, was as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
Share-based compensation expense related to stock options	\$	\$ 7	\$	\$ 38
Share-based compensation expense related to restricted shares	3,070	1,749	6,348	3,463
Share-based compensation expense related to ESPP	30	30	60	60
Total share-based compensation expense	\$ 3,100	\$ 1,786	\$ 6,408	\$ 3,561

Table of Contents**LIFE TIME FITNESS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****(Table amounts in thousands, except share and per share data)***Summary of Restricted Stock Activity*

	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2010	1,917,873	\$ 21.19
Granted	337,029	\$ 38.32
Canceled	(1,202)	\$ 22.00
Vested	(323,230)	\$ 20.80
Outstanding at March 31, 2011	1,930,470	\$ 24.25
Granted	22,521	\$ 38.36
Canceled	(540)	\$ 21.09
Vested	(31,037)	\$ 30.84
Outstanding at June 30, 2011	1,921,414	\$ 24.31

During the six months ended June 30, 2011 and 2010, we issued 359,550 and 328,719 shares of restricted stock, respectively, with an aggregate fair value of \$13.8 million and \$9.5 million, respectively. The grant date fair market value of restricted shares that vested during the six months ended June 30, 2011 was \$7.7 million. The total value of each restricted stock grant, based on the fair market value of the stock on the date of grant, is amortized to compensation expense on a straight-line basis over the related vesting period. As of June 30, 2011, there was \$26.4 million of unrecognized compensation expense related to restricted stock that is expected to be recognized over a weighted average period of 1.9 years.

Special 2009 Restricted Stock Grant

In June 2009, the Compensation Committee of our Board of Directors approved the grant of 996,000 shares of long-term performance-based restricted stock to serve as an incentive to our senior management team to achieve certain diluted earnings per share (EPS) targets in 2011 and 2012. In August 2010, an additional 20,000 shares of long-term performance-based restricted stock were granted to a new member of senior management using the same diluted EPS targets and vesting schedule. As of June 30, 2011, 907,000 of these shares were still outstanding. If a specified diluted EPS target is achieved for fiscal 2011, 50% of the restricted shares will vest. If a higher diluted EPS target is achieved for fiscal 2011, 100% of the restricted shares will vest. If the grant has not fully vested after fiscal 2011, 50% of the shares will vest if a specified diluted EPS target is achieved for fiscal 2012. If none of the shares vested after fiscal 2011, 100% of the shares will vest if a higher diluted EPS target is achieved for fiscal 2012. In the event that we do not achieve the required diluted EPS targets, the restricted stock will be forfeited. A maximum of \$18.9 million could be recognized as compensation expense under this grant if all diluted EPS targets are met.

In fourth quarter 2010, we determined that achieving the 2011 diluted EPS targets required for vesting of 50% of the restricted stock (representing 453,500 shares of restricted stock) was probable. As a result, we recognized a cumulative, non-cash performance share-based compensation expense of \$5.6 million in fourth quarter 2010 and \$1.9 million in the first six months of 2011. We anticipate recognizing the remaining portion of performance share-based compensation expense of approximately \$1.9 million ratably in last two quarters of 2011. We believe the higher diluted EPS targets, inclusive of compensation expense under this grant, to be aggressive goals in excess of our baseline expectations. The probability of reaching the targets is evaluated each reporting period. If it becomes probable that certain of the remaining target performance levels will be achieved, a cumulative adjustment will be recorded and future compensation expense will increase based on the currently projected performance levels. If we had determined that all of the targets had become probable on June 30, 2011, we would have recognized an additional \$7.5 million cumulative compensation adjustment on that date. If we later determine that it is not probable that the minimum diluted EPS performance threshold for the grant vesting will be met, no further compensation cost will be recognized and any previously recognized compensation cost will be reversed. In accordance with the related accounting guidance, none of these restricted shares

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were included in our total diluted share count at June 30, 2011 or 2010.

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

Summary of Stock Option Activity

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2010	552,625	\$ 23.30	3.8	
Exercised	(28,964)	\$ 26.72		
Canceled				
Outstanding at March 31, 2011	523,661	\$ 23.11	3.6	
Exercised	(10,905)	\$ 24.91		
Canceled				
Outstanding at June 30, 2011	512,756	\$ 23.07	3.3	\$ 8,953
Vested at June 30, 2011	512,756	\$ 23.07	3.3	\$ 8,953

No stock options have been granted since 2007. As of June 30, 2011, there was no unrecognized compensation expense related to stock options, and all outstanding stock options were vested.

The aggregate intrinsic value in the table above at June 30, 2011 represents the total pretax intrinsic value (the difference between our closing stock price at June 30, 2011 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders, had all option holders exercised their options on June 30, 2011. This amount changes based on the fair market value of our stock. Total intrinsic value of options exercised during the six months ended June 30, 2011 and 2010 was \$0.6 million and \$1.9 million, respectively.

Our net cash proceeds from the exercise of stock options were \$1.0 million and \$3.0 million for the six months ended June 30, 2011 and 2010, respectively. The actual income tax benefit realized from stock option exercises and restricted stock vesting was \$2.8 million and \$1.7 million, respectively, for those same periods. In accordance with the related accounting guidance, this tax benefit is presented as cash flows from financing activities and cash flows from operating activities.

Employee Stock Purchase Plan and Related Share Repurchase Plan

Our ESPP provides for the sale of up to 1,500,000 shares of our common stock to our employees at discounted purchase prices. The cost per share under this plan is 90% of the fair market value of our common stock on the last day of the purchase period, as defined. The current purchase period for employees under the ESPP began July 1, 2011 and ends December 31, 2011. Compensation expense under the ESPP is estimated based on the discount of 10% at the end of the purchase period. During the six months ended June 30, 2011, \$0.5 million was withheld from employees for the purpose of purchasing shares under the ESPP. There were 1,329,120 shares of common stock available for purchase under the ESPP as of June 30, 2011.

In June 2006, our Board of Directors authorized the repurchase of up to 500,000 shares of our common stock from time to time in the open market or otherwise for the primary purpose of offsetting the dilutive effect of shares pursuant to our ESPP. During the first six months of 2011,

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we repurchased 13,540 shares for approximately \$0.5 million. As of June 30, 2011, there were 329,120 remaining shares authorized to be repurchased for this purpose. The shares repurchased to date have been purchased in the open market and, upon repurchase, became authorized, but unissued shares of our common stock.

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

3. Earnings per Share

Basic EPS is computed by dividing net income applicable to common shareholders by the weighted average number of shares of common stock outstanding for each period. Diluted EPS is computed similarly to basic EPS, except that the denominator is increased for the conversion of any dilutive common stock equivalents, the assumed exercise of dilutive stock options using the treasury stock method and unvested restricted stock awards using the treasury stock method. Stock options excluded from the calculation of diluted EPS because the option exercise price was greater than the average market price of the common share were 42,277 and 125,156 for the six months ended June 30, 2011 and 2010, respectively.

The basic and diluted EPS calculations are shown below:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
Net income	\$ 24,947	\$ 21,884	\$ 45,783	\$ 39,720
Weighted average number of common shares outstanding basic	40,381	39,885	40,259	39,401
Effect of dilutive stock options	169	201	175	159
Effect of dilutive restricted stock awards	221	1,068	329	973
Weighted average number of common shares outstanding diluted	40,771	41,154	40,763	40,533
Basic earnings per common share	\$ 0.62	\$ 0.55	\$ 1.14	\$ 1.01
Diluted earnings per common share	\$ 0.61	\$ 0.53	\$ 1.12	\$ 0.98

4. Reportable Segment

Our operations are conducted mainly through our distinctive and large, multi-use sports and athletic, professional fitness, family recreation and spa centers in a resort-like environment. We aggregate the activities of our centers and other ancillary products and services into one reportable segment. None of the centers or other ancillary products or services meets the quantitative thresholds for separate disclosure under the applicable accounting guidance. Each of the centers has similar economic characteristics and customers, and generally offers similar service and product offerings. Each of the other ancillary products and services either directly or indirectly, through advertising or branding, compliment the operations of the centers. Our chief operating decision maker uses EBITDA as the primary measure of operating segment performance.

The following table presents revenue for the three and six months ended June 30, 2011 and 2010:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
Membership dues	\$ 167,013	\$ 152,879	\$ 325,026	\$ 298,044
Enrollment fees	4,686	6,175	9,887	12,499
Personal training	36,971	32,215	74,080	64,841

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Other in-center revenue	43,328	36,242	79,908	69,148
Other revenue	4,696	3,577	8,438	6,327
Total revenue	\$ 256,694	\$ 231,088	\$ 497,339	\$ 450,859

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

5. Supplementary Cash Flow Information

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

	For the Six Months Ended June 30,	
	2011	2010
Accounts receivable, net	\$ 843	\$ (284)
Center operating supplies and inventories	(3,255)	(937)
Prepaid expenses and other current assets	(4,883)	(4,225)
Income tax receivable	7,458	
Deferred membership origination costs	16	3,619
Accounts payable	924	6,839
Accrued expenses	8,110	6,296
Deferred revenue	9,262	1,773
Deferred rent liability	1,570	1,708
Other liabilities	518	361
Changes in operating assets and liabilities	\$ 20,563	\$ 15,150

We made cash payments for income taxes of \$21.7 million and \$25.2 million for the six months ended June 30, 2011 and 2010, respectively.

We made cash payments for interest, net of capitalized interest, of \$8.8 million and \$12.9 million for the six months ended June 30, 2011 and 2010, respectively. Capitalized interest was \$0.5 million and \$1.5 million for the same periods.

Construction accounts payable and accounts payable related to property and equipment was \$20.0 million at June 30, 2011 and \$20.1 million at June 30, 2010.

6. Commitments and Contingencies

Litigation We are engaged in proceedings incidental to the normal course of business. Due to their nature, such legal proceedings involve inherent uncertainties, including but not limited to, court rulings, negotiations between affected parties and governmental intervention. We have established reserves for matters that are probable and estimable in amounts we believe are adequate to cover reasonable adverse judgments not covered by insurance. Based upon the information available to us and discussions with legal counsel, it is our opinion that the outcome of the various legal actions and claims that are incidental to our business will not have a material adverse impact on the consolidated financial position, results of operations or cash flows. Such matters, however, are subject to many uncertainties, and the outcome of any matter is not predictable with assurance.

7. Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board issued guidance on revenue arrangements with multiple deliverables effective for us in fiscal 2011. The guidance revises the criteria for measuring and allocating consideration to each component of a multiple element arrangement. The guidance requires companies to allocate revenue using the relative selling price of each deliverable, which must be estimated if the company does not have either a history of selling the deliverable on a standalone basis or third-party evidence of selling price. The

implementation of the guidance did not have a material impact on our consolidated financial statements.

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On June 30, 2011, we entered into a Third Amended and Restated Credit Agreement (the revolving credit facility) with U.S. Bank National Association, as administrative agent, and the other lenders from time to time party thereto, which amended and restated our Second Amended and Restated Credit Agreement effective May 31, 2007. The material changes to the revolving credit facility increase the amount of the facility from \$470.0 million to \$660.0 million, which may be increased by an additional \$240.0 million upon the exercise of an accordion feature by us if one or more lenders commit the additional \$240.0 million, extension of the term of the facility to June 30, 2016, a change in the interest rate and a change in the primary financial covenants under the facility.

Mortgage Notes Payable to Real Estate Investment Trust

On April 4, 2011, we prepaid the ten mortgage notes payable to Starwood Property Mortgage Sub-1, L.L.C. at the par amount of \$69.5 million primarily using our revolving credit facility. Concurrent with the prepayment, the mortgages were released on ten related centers.

9. Fair Value Measurements

The carrying amounts related to cash and cash equivalents, accounts receivable, income tax receivable, accounts payable and accrued liabilities approximate fair value due to the relatively short maturities of such instruments. The fair value of our long-term debt and capital leases are estimated based on estimated current rates for debt with similar terms, credit worthiness and the same remaining maturities. The fair value estimates presented are based on information available to us as of June 30, 2011. These fair value estimates have not been comprehensively revalued for purposes of these consolidated financial statements since that date, and current estimates of fair values may differ significantly.

The following table presents the carrying value and the estimated fair value of long-term debt:

	June 30, 2011	
	Carrying	Estimated
	Value	Fair
	Value	Value
Fixed-rate debt		