

# Forecast From Wall Street

## Stormy Weather for the Remainder of 2009

By: Peter Moore

Five short years ago, private equity and institutional investors finally started to recognize the attractiveness of the health club business model; strong recurring revenue, attractive long-term growth prospects, impressive return on capital characteristics and the overall proliferation of health & fitness throughout the U.S. Over a dozen private equity investments were made in our sector from 2004 to 2008 at attractive valuations for owners.

In addition, the 2004 Initial Public Offering of LifeTime Fitness, Inc. was highly successful and considered a "game changer" as our sector now had a publicly-traded comparable company that everyone respected. The stock traded into the \$60+ per share range in October 2007, with a robust valuation exceeding 14.0 x Latest Twelve Months ("LTM") EBITDA. Analysts touted LifeTime as the Home Depot equivalent, a category killer. We all benefited from this market enthusiasm and started to define how our business was like LifeTime, only better; we spent less on CAPEX, we targeted secondary markets, our cost structure was lower... You name it! With a sigh of relief, we no longer had to "defend" how our business model was different from the tainted and infamous, Bally Total Fitness. Life was good.

Fast forward to March, 2009. The stock market has hit a 12-year low, the stimulus package is not yet working, investor sentiment has been shattered and investors are hammering health club stocks and any other business that is perceived to be tied to "discretionary" consumer spending. LifeTime's stock is now trading under \$8.00 per share, down over 85% from its all-time high. Town Sports International Holdings, Inc., also publicly-traded with over \$100 million in trailing EBITDA, is valued at approximately 3.5 x LTM EBITDA, and its debt trades at a 50% discount to its face value. Private equity investors remain interested in the health club industry but are cautious to invest until they can determine if the health club

industry is really "recession resistant this time around," as it has been in past years.

So, you may be asking yourself how you should think about your business valuation in light of today's market. **My recommendation:** Do not spend too much time thinking about it and try not to "mark to market" your health club company. It is currently not a fruitful exercise, and it will not put a smile on your face! However, if you are like many operators I speak to on a weekly basis, this economic disaster has actually pushed you to focus on your core business, and you are not feeling the same level of pain as the specialty retailers, restaurants or other business owners in your community. The appropriate plan for the next six months is to weather the storm, continue to aggressively sell memberships and control your attrition rates. That is what investors are laser-focused on, and you will be rewarded in the years to come on how you managed through 2009.

The two significant issues in our economy today are (1) Lack of confidence, and (2) Limited access to debt capital. Affordable debt is required for most private equity investors to achieve the return thresholds they require to attract their investment capital. Therefore, if you are seeking private equity investors, you may find they are not willing to pay high multiples for your current business if they, in turn, need to capitalize the company with too much equity (or take on expensive debt). **My recommendation:** Only do a deal if absolutely necessary for distressed reasons or if you are seeing once-in-a-lifetime real estate and growth opportunities in markets you fully understand and do not want to miss the opportunity. However, your business is NOT worth 50% less than what it was a year ago, so do not let a banker (or investor) convince you otherwise.

If you are patient and can maintain your market position and profitability, I would recommend waiting for the irrational pricing in the current markets to subside, which may take another year or more. At some point, stabilized risk/return parameters will return

to the overall market, and we will once again enter an attractive period for the health and fitness sector. We have business models that are proven, and we will continue to benefit from government- and healthcare-related support for increased exercise and preventative care.

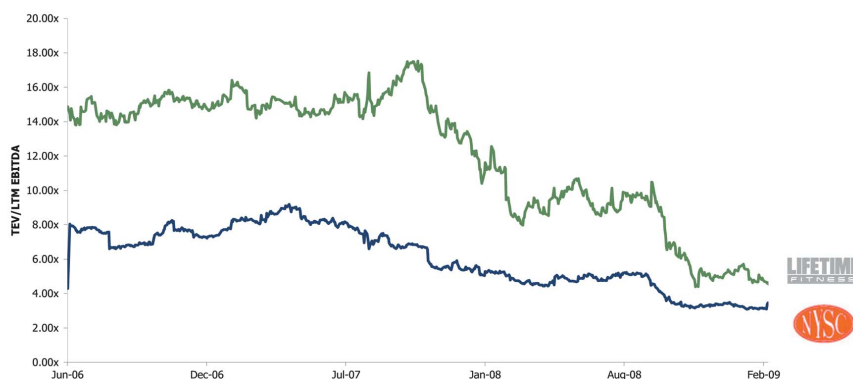
We need to view the current market conditions as hitting the "pause" button on the *remote* while allowing some of the under-performing operators to close their doors so the strong will survive and prosper long-term. Over the past five years, too many locations have opened without a clear purpose or differentiated strategy. In parallel, focus on your core operations and continue to track your club-level performance. Talk to your weaker competitors and take over their membership base when they decide to throw in the towel. Growth equity investors find strong companies and back proven management teams --strive to be one of these companies when the storm clears!

I was recently forwarded the following 1970 article from FORTUNE magazine which includes very sound advice:

**NEW YORK (FORTUNE)** - When FORTUNE published a picture of John Loeb, then 68, in a 1970-article called "Wall Street on the Ropes" (yes, there have been earlier periods of pain), the son of an editor regarded Loeb's imperious mien and said, "That's what people my age think all Wall Street executives look like." But, behind Loeb's hauteur were decades (including the 1930s) of business experience, much of

### Trading Multiple Analysis

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it spent running Wall Street firm Loeb, Rhoades & Co. Fortunately, some of the lessons John Loeb learned got set down on paper, and lately, his bullet points have been making the rounds. Here they are:

- Once in every seven to ten years, there is a period of excessive general speculation culminating in a severe panic or depression when the man who is borrowing money is at great disadvantage and he who has ready cash stands like a tower, four-square to the ill winds that blow.

- Extreme situations do not last, no matter what the apparent justification. While we may have "new eras," old laws will still operate.

- Avoid commitments, particularly of the delayed variety; they are more insidious. Also, be definite about commitments made to you by others. When the storm comes, misunderstandings are so easy and so natural.

- In both 1920 and 1929, the so-called "big fellows" in general said everything was okay. But, if the big fellows in general thought otherwise, the stage could not be set for the unexpected. Panics occur because the leaders themselves have lost their way.

- Never borrow money without continually reviewing and questioning your ability to pay it back under the worst conditions.

- People borrow money in good times and pay it back in bad times --just the opposite of what they



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should do.

- It's right to be an optimist, but always be prepared for the worst.

- The public is just as blind in recognizing the bottom of a depression as it is in recognizing the top of a boom. While there is no ladder that reaches to Heaven, the ladder that reaches all the way down to Hell in a country like America is just as fantastic.

- A reputation for fair and honest dealing will be your greatest asset.

- As my father used to say, "Don't forget, the soup is never eaten as hot as it is cooked."

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