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## OTC: AHFI - Absolute Health and Fitness - Strong Buy Recommendation

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## COMMON STOCK DATA

**600% Profit Potential In 6 months - BUY AHFI Now!**

**Recent Stock Price:** \$1.31  
**6 Month Target Price:** \$10.00

	Sales	Net Income	Earnings per Share	Market Value to Sales	EPS
2004(e)	\$8,275,553	\$1,686,658	<b>\$0.08</b>	1.8x	6.3x
2005(e)	\$23,500,000	\$4,970,000	<b>\$0.16</b>	0.6x	3.1x
2006(e)	\$51,625,000	\$13,500,000	<b>\$0.35</b>	0.3x	1.0x

## SUMMARY & INVESTMENT CONCLUSION

- **ABSOLUTE HEALTH & FITNESS** has recently debuted in the stock market, selling at about six times last year's earnings per share
- The physical fitness industry is highly fragmented and appears poised to consolidate amidst burgeoning consumer demand

- **AHFI's** premier corporate objective is to not only participate in the fitness industry's consolidation but to lead it
- Reflecting its existing fitness centers sales **growth of 25% and 40% margins**, plus several strategic business combinations, revenues and **earnings are expected to at least double every year through 2006**
- Based on valuations analytically-derived from three highly recognized methods, we suggest target stock prices at **\$6/share in the next 30 days, \$8/share by year end**, and for long term holders --- **\$10- \$15/share next year and beyond**

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Want to buy AHFI? Our recommended brokers will make your investment a seamless process.

## STOCK PRICE VALUATION TARGETS

Three methods have been deployed to derive a Target Valuation range for this Company: (i) **PEG**---Price / Earnings to Growth Ratio; (ii) **Multiple of Sales** Ratio; and (iii) **Historical Market P/E** valuation.

**Absolute Health & Fitness** is expected to grow at 100% per annum over the next 3 three years --- from 8 ¢ in Earnings Per Share (EPS) in 2003 (see EPS Model at end of this report), to 16 ¢ this year, 35 ¢ in 2005 and 75 ¢ in 2006. Applying a P/E of 50 on EPS growth of such magnitude, and transparency, produces a **PEG** of 0.5 (a ratio under 1.0 is deemed conservative by fundamental securities analysts). This translates into a **LONG TERM** target price of **\$12 / share** (50 x \$0.16 in EPS).

To derive a Nearer-Term target price, consider the multiple the market has assigned to **Bally Fitness' (symbol: BFT)** estimated earnings---after three years of losses. Applying current Bally's P/E of 16 to Absolute's estimated earnings of 16 ¢ yields a **Nearer- Term** target price of **\$3.00** per share, which forms the basis for the lower end price range target by this year's end.

The best **multiple** at which the fitness industry has ever been valued is three times **sales**, For AHFI, this means 3 times \$51.6 million in forecast sales = \$155 million / 29.7 million shares outstanding = **\$10 / share** for a 6-month target price.

Finally, empirical studies of stock prices covering the past 75 years have determined that, on average, stocks sell for 16 times trailing EPS and 12 times forecast EPS. As Absolute Health begins to attract traders' coverage..if not research coverage..we suspect that these ratios will heavily influence early valuations in the stock market.

For AHFI, 16 times trailing EPS (of 8 ¢) equals **\$1.28** and 12 times forecast EPS (of 16 ¢) equals **\$1.92**. Hence, over the next 3-4 months, a trading range of **up to \$8 / share** seems reasonable. These Valuation Ranges establish Target Prices, summarized in this Table.

**Table One: Target Price Ranges to 2005**

<b>Early Stage</b> (now through 12/30)	<b>Mid-Stage</b> (2nd Qtr, 2005)	<b>End Next Year</b> (2005)
<b>\$5.00 - \$7.00</b>	<b>\$8.00 - \$10.00</b>	<b>\$10.00 - \$15.00</b>

Look to subsequent updates on "AHFI - Absolute Health and Fitness including Press Releases from the company, complete our [Contact Form](#) to subscribe to AHFI's Investor database and keep up to date with the latest advancements by the company!

## RECOMMENDATION TO INDIVIDUAL INVESTORS

For Individual Investors seeking significant near-term capital appreciation on a modest investment position, in an emerging growth company, a **\$2,000 to \$10,000** investment in AHFI will buy up to 7,000 shares of stock at current prices. Given a minimum target price of \$10 / share next year, this represents an extraordinary profit opportunity.

Even the \$6 per share minimum target price expected at this year's end translates into a \$4.40 / share capital gain --- or a potential gain of \$12,000 on an initial \$3,000 investment (**\$35,000 potential gain on a \$9,000 initial investment**).

For more aggressive Individual Investors, consider a **\$25,000** investment position, to purchase up to 15,000 shares. Based on a fourth quarter-2004 Exit Strategy of \$6.00---the midpoint of the forecast range--- this position represents potential gains in excess of **\$80,000**.

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## BUSINESS AND INDUSTRY ENVIRONMENT

**Absolute Health & Fitness** currently owns and operates 3 fitness centers in the Southeast, and expects to add another 8 centers via acquisition, resulting in a company generating revenues in excess of \$10 million / year. A business combination with one other major fitness center operator is expected to more than double the Company's revenues to over \$23 million this year, and increase the number of its operating Business Units to 24.

Physical fitness is an \$11 Billion industry, though extremely fragmented. According to the Department of Commerce, there are approximately 8,000 exercise / fitness centers in the country with the seven companies listed in **TABLE TWO** below representing just over half of these units.

About half of these 8,000 physical fitness centers are owned / controlled by seven entities. The YMCA alone has 2,500 units. Another six companies own about 1,800 units. This means there are about 3,500 free-standing independent physical fitness centers in the country (with revenues approximating \$4 Billion) that are owned and operated by "mom-and-pop" proprietors---basically, family-run enterprises at the local, if not neighborhood, level.

Absolute Health intends to amalgamate a number of these independent entities under one corporate umbrella..and in the process, lead a consolidation of this highly fragmented industry.

What would motivate an independent fitness center operator to become part of a larger corporation? To answer this question, we look at the micro-economics of that industry and outline the industry's Business Model as it exists today.

- The vast majority of independent fitness center owners will be health enthusiasts.
- From there, owners fall into two basic categories: (i) Individuals who are 50+ and use a lump sum to launch a fitness center locally<sup>1</sup>; and (ii) Individuals in their 20's---and who have usually relied on family- funds to launch the fitness center.
- **TYPICAL BUSINESS MODEL** --- The average fitness center generates about \$1.2 million in annual revenues, and enables the owner to gross between \$150,000 and \$200,000 in income. There is no Inventory to manage, Accounts Receivable is a minor concern, and the steady nature of the revenue stream means that financing is probably not a major issue.

Industry Business Models do not change frequently. Changing industry fundamentals requires a trigger of such enormous impact that existing Business Models no longer are commercially relevant---and this is the rationale that led to the genesis of Absolute Health & Fitness.

There are now 180 million people in the USA over the age of 30, or 61% of the population. The Baby Boomers, as a group, represent 76 million people. These are compelling demographics that taken together can force an industry to change the manner in which its services are provided.

The distinguishing feature between AHFI and the rest of the independents comprising the fitness industry is its intentional focus to consolidate the better-run fitness centers nationwide, especially those local entities with commanding market shares, and unite these units all under one company.

This is the primary reason AHFI became a public company --- in order to provide the "currency" to not only rapidly consummate acquisitions but in the process, enrich all shareholders in AHFI..including the former owners of the acquired fitness centers.

Indeed, AHFI's management expects to double the number of fitness centers under its corporate roof by the end of this year, primarily by acquisitions. As small as these acquisitions appear to be, the end result is that revenues shoot up to more than \$50 million annually, with Earnings of \$1.00 per share. Even a simple multiple of ten times earnings per share makes this potentially a \$10.00 stock.

There is a relevant historical stock market example to serve as a guideline. **US Delivery** was a ground-delivery company based in Denver with annual sales of about \$10 million. In 1993, the company began amalgamating independent ground delivery businesses nationwide. In 2 years, revenues exceeded \$100 million and by 1997, revenues approximated \$250 million.

US Delivery, in turn, was eventually acquired by Corporate Express. A \$5,000 investment in the stock of US Delivery in 1993 was worth \$94,000 in Corporate Express stock by 1999 --- a return of almost 20 times the initial investment.

Is the same magnitude of investment return achievable with Absolute Health & Fitness..? No one can answer that question with certainty. However, all the right elements appear to be in place for this formula to work again, and all to the financial advantage of the Individual Investor.

TABLE TWO images the identifiable major companies in the physical fitness segment of the economy.

### Table Two: Fitness Center Industry Leaders

Company	Fitness Centers (#)	12 Month Revenues (mm)	# of Employees	Market Value (mm)	Mkt Val/ Revenues	Revenues/ Employee	Stock Symbol
Bally Fitness	420	\$954	22,000	\$143	15%	\$43 K	BFT
Gold's Gym	670	\$980	n/a	n/a	n/a	n/a	Private
Sports Club	10	\$132	2,223	\$28	21%	\$59 K	SCY
Town Sports Int'l	130	\$315	7,700	n/a	n/a	\$41 K	Private
24 Hr Fitness WW	300	\$525	n/a	n/a	n/a	n/a	Private
World Gym Int'l	290	\$250	n/a	n/a	n/a	n/a	Private
YMCA	2,500	\$4,200	n/a	n/a	n/a	n/a	Private
<b>Totals</b>	<b>4,320</b>	<b>\$7,356</b>					

The Fitness & Exercise segment of the US economy, therefore, is exceptionally well-poised for consolidation, similar to the consolidations that overtook a number of other service-related sectors of the economy over the past 30 years.

**Research indicates there are another 3,500 independently- owned ("Mom-and-Pop") fitness centers in the USA with revenues of \$4 Billion.**

Examples of a few other industry consolidations in the past will prove useful..

- There were thousands of newspaper companies in the 1960's --- today, that industry is controlled by fewer than ten companies.
- In the late 1960's / early 1970's, every town in America had numerous choices among Mom-and-Pop Burger stands --- before that industry consolidated into the three companies that own that space today --- either converting the better-run independents into their own Branded Name or putting them out of business.
- In the 1980's, Mom-and-Pop neighborhood convenience stores eventually gave way to 7-11's, Circle K's and other larger merchants, and more recently ~
- In the 1990's, numerous ground shipment delivery service companies prevailed until larger companies either acquired them or made their economic existence non-viable, and of course ~
- Consolidation of the "bloated" dot.com universe is living memory.

Not all service businesses or industries lend themselves to consolidation ~

- Dry cleaning services,
- shoe repair shops, and
- lawn / landscaping services

are three that immediately spring to mind. Characterized by *minimal capital requirements* to enter those businesses, hand-to-mouth financial needs to survive and a neighborhood-centric nature, these businesses are unlikely to ever consolidate into bigger commercial enterprises.

The collapse, and consolidation, of the dot.com universe will serve a useful purpose, since those events are living memory. For a brief moment, 1999 to be precise, it took minimal capital requirements to get into the dot.com business because venture capital was so readily available<sup>2</sup>.

By the end of 1999, the lost investment gain caused by not being in the next IPO that triples in a day was of greater concern than the potential loss

on that investment. As the financial media sought these investors out, any venture capitalist with less than six deals in the pipeline was a piker..! And the money flowed. In other words, by making capital so easily abundant, venture capitalists were planting the seeds for the very consolidation they feared.

Commencing a systemic industry-wide consolidation..any industry..requires a trigger of such enormous impact that prior Business Models are no longer relevant. That systemic trigger for the exercise & fitness industry is the 180 million people over the age of 30.

***There is only one way to slow down this deterioration of human muscle: Exercise, specifically, muscle-stress exercise such as weights and other muscle-stress strengthening equipment. We believe that the demand for fitness services from this demographic to be sufficiently compelling to change the fundamentals of this highly fragmented industry.***

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A thumbnail sketch of the seven companies appearing in our industry table on page four follows, along with the web site of each ~

**Bally Fitness** is arguably the best-known fitness center operator in the USA, with 420 gyms in 29 states and Canada. Bally (stock symbol: BFT) is the largest fitness center operator that is a publicly-traded company, By design, its professed market is the 18 - 34 year old demographic. The company's genesis as a public company dates back to 1996 when it was spun-off from the gaming company, Bally Entertainment. HQ: Chicago [www.ballyfitness.com](http://www.ballyfitness.com)

**Sports Club** is the only other visible leader in this industry that is publicly-traded (stock symbol: SCY). It was organized in 1994 to amalgamate several up-market clubs in major metropolitan areas under one corporate umbrella. Presently, SCY has 10 clubs, located in Los Angeles, San Francisco, New York City and Washington, DC. Revenues per facility average between \$10 and \$15 million. HQ: Los Angeles. [www.thesportsclubla.com](http://www.thesportsclubla.com)

**Gold's Gym** has the most facilities in operation ---670 gyms in 26 countries. These are predominantly franchises, which are sold for \$500,000 to \$1.8 million per location. Purchasing smaller gyms and converting these into branded Gold's Gyms is a relatively new development in its business model. The first Gold's Gym was opened in 1965, so it is factually correct to state that this is the oldest company in the industry. HQ: Venice, CA; tel: 310-392-3005; web site [www.goldsgym.com](http://www.goldsgym.com).

**Town Sports International** was founded in 1973. It owns and operates 130 fitness centers, two-thirds of which are located in New York City. The remaining centers are located in Boston, Philadelphia and Switzerland. Given the metropolitan location of its clubs, per facility revenues of \$2.5 million are above the industry average. HQ: New York City; web site [www.mysportsclubs.com](http://www.mysportsclubs.com).

**24 Hour Fitness Worldwide** owns and operated 300 fitness centers in 16 states plus Europe and Asia. The Company began operations in 1983, making it the third oldest private sector fitness center chain after Gold's Gym and Town Sports. Recent acquisitions include two younger chains --- Q Clubs and Hart's Athletic Clubs. HQ: San Ramon, CA; web site [www.24hourfitness.com](http://www.24hourfitness.com).

**World Gym International** has 290 franchises, all in the Western Hemisphere, with most locations representing franchised businesses. HQ in Marina del Rey, CA; web site [www.worldgym.com](http://www.worldgym.com).

**YMCA** dates back to 1851 in the USA (1844 in the UK), and has 2,500 locations nationwide. Its role in the American socio- economy has morphed markedly in the past 5 years, given its leading role in community projects such as child care and Head-Start. Nevertheless, with 19 million people utilizing its facilities, any fitness industry discussion that does not include the YMCA is incomplete. The fact is, the "Y" is a pervasive presence in the burgeoning physical fitness industry. HQ: Chicago, IL; web site [www.ymca.com](http://www.ymca.com) pleasantly pervasive, if the Village People are to be believed, when they sang "It's fun to stay at the Y - M - C - A!"

**The tale of two fitness companies** ~ The following two charts tell a thousand page story about the only two fitness companies with a publicly-traded track record. At its current price, **Bally Fitness** (BFT) is about where it was when spun-off from Bally Entertainment in 1996.

**Sports Club** (SCY) has been on a downward spiral since 1998 --- when both BFT and SCY were in vogue. BFT peaked in July 1998 at \$37.56 / share, and commanded a Market Value of \$1.3 Billion, or about two times annual sales at the time. Market Value of BFT today: \$136 million.

SCY spiked up a little faster, being a small growth company. It peaked at \$9.25 / share in December 1997, giving the Company a \$167 million market value. Market value today: \$27 million.

The third graph following depicts the below average performance of both companies in relation to the S&P 500 Index. This explains why any portfolio manager whose investment performance is measured in relation to the S&P 500 (and most are) would not be investors in either of these companies. With changing fundamentals and an imminent industry consolidation, investment interest could easily rekindle this sector.

Latest Quotes

Open: 4.150	High: 4.310	Low: 4.150	Last: 4.200	Change: +0.08
P/E: 8.40	Earnings: \$0.50	5Yr Growth: -53.6%	Price/Sales: 0.1	Market Cap: 142M
Bid: N/A	Asked: N/A	Volume: 636,900		

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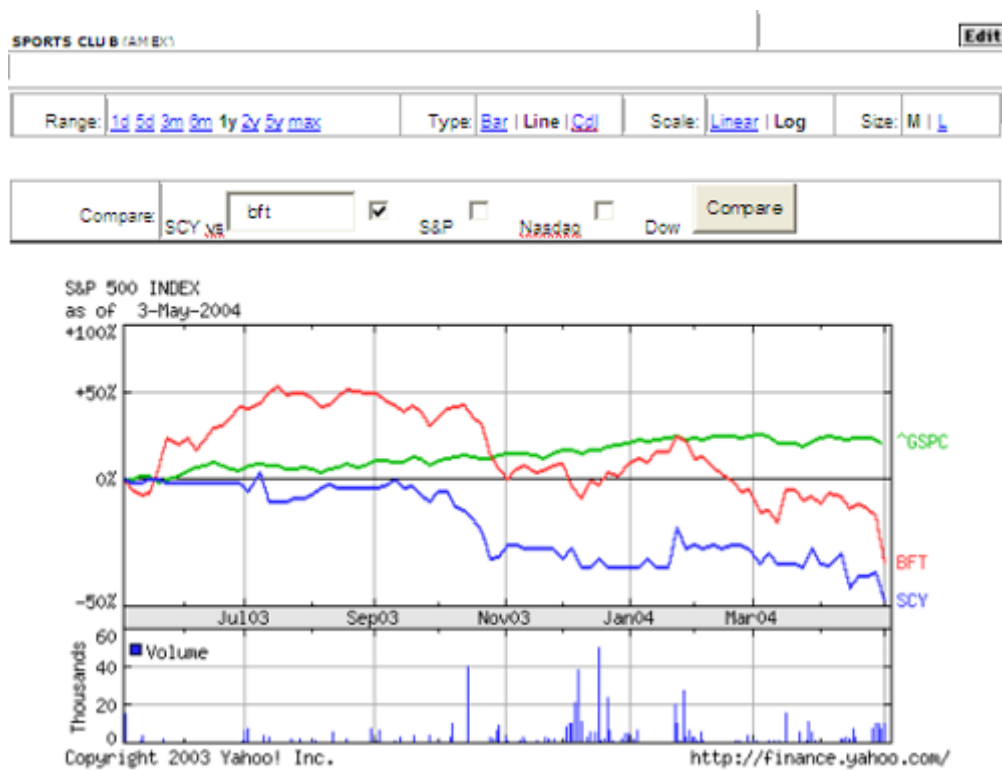


SPORTS CLUB (AM EX)

Range: [1d](#) [5d](#) [3m](#) [6m](#) [1y](#) [2y](#) [5y](#) [max](#)    Type: [Bar](#) | [Line](#) | [Cdl](#)    Scale: [Linear](#) | [Log](#)    Size: [M](#) | [L](#)

Compare:  SCY  S&P  Nasdaq  Dow





<sup>1</sup> People in this category are generally either individuals who have elected early retirement, receiving a lump sum payment OR ex-spouses using the proceeds from divorce settlements.

<sup>2</sup> Look for the forthcoming book Growth, Puncture and Aftermath of The Bubble for a Millenium.

## MANAGEMENT TEAM

**Roland Rohm** is President of the Company, having been in the fitness industry since 1995. His responsibilities include ensuring the application of consistent operational procedures throughout the growing AHFI network. Prior to joining AHFI in a management capacity, Mr. Rohm had previously been a Franchisee of a Gold's Gym. **Thomas Flynn** is VP- Sales and Marketing. His primary responsibility is to increase each center's revenues, including corporate memberships and with affinity groups. Mr. Flynn has been with the Company since 1998.

## EARNINGS MODEL

Absolute Health & Fitness - Three Year Outlook:

	2004(e)		2005 (e)		2006 (e)	
	Sales	Operating	Sales	Operating	Sales	Operating
Kapital Eng	\$2,028,729	\$1,032,557				
EFS	\$1,044,448	\$260,782				
Sampson's Gym	\$863,677	\$222,679				
Maynard	\$1,070,608	\$260,656				
KRS	\$1,098,531	\$302,074				
Garner	\$775,685	\$77,638				
Creedmore	\$1,193,027	\$217,272				
Fuquay	\$200,848	\$35,854				
Eight Core Cntrs	\$8,275,553	\$2,409,512	\$10,500,000	\$4,200,000	\$13,125,000	\$5,500,000
Four New Centers			\$3,000,000	\$900,000	\$6,000,000	\$2,500,000
Other 2004 Acq's			\$10,000,000	\$2,000,000	\$12,500,000	\$5,000,000
2005 Acquisitions					\$20,000,000	\$4,000,000
<b>TOTALS</b>		>>>>>>>>	\$23,500,000	\$7,100,000	\$51,625,000	\$17,000,000
Tax Provision		\$722,854		\$2,130,000		\$3,500,000
Net Income		\$1,686,658		\$4,970,000		\$13,500,000
Shares Outstanding	\$20,000,000	\$0.08	\$29,667,000	\$0.16	\$39,667,000	\$0.35

