from PASSION

As the concept of fitness evolves and grows into BIG BUSINESS, the bodybuilding innovators are giving way increasingly to investors and corporate entities, ultimately leading to more CONSOLIDATION in the market.

Ancient Greeks heaved stones to get strong so they could beat up their enemies in battle. Lumberjacks threw huge tree trunks far distances to win the fair damsel. Turn-of-the-century farmers plunked dogs and horses on manual treadmills so they could create power to run butter churners and threshing machines.

What you wanna bet these folks had no idea their stones, tree trunks and butter-churning power would someday spark the creation of what has become an industry worth billions—one that has spawned companies waging battle to get bigger and stronger but, this time, financially.

Forget stones. Increasingly so, mergers and acquisitions are the battle cry as the fitness industry evolves and grows, suppliers and retailers gain the attention of investors, and the bodybuilders-with-a-better-idea are pushed aside by Madison Avenue outsiders.

"The market is broadening, and it's not just bodybuilders trying to sell dumbbells anymore," said Colleen Logan, Icon Fitness vice president of marketing. "Instead of being a niche market or a fad market or a trend, it's now a lifestyle."

In the last decade alone, the fitness market's wholesale value has doubled, and it is one of the few sporting goods segments that forecasts growth. No wonder investors, private equity firms and financial analysts are front and center. Perhaps, as fitness sits on the crest of one of the first big waves, it's time to take a look at where we've been, where we are, and where we may go as an industry, taking a few lessons from history.

"All industries go through a cyclical process of expansion and contraction in terms of consolidation," said Steve Nero, CEO of Star Trac, "until they get more mature."

CYCLES OF CHANGE

Most industries are launched by enthusiasts of some sort, those passionate about what they do and seeking a way to make it better, easier or more convenient. From soap to soccer balls and from candles to cars, there is always a better idea, thank you, Mr. Ford. James Gamble—yes, whose namesake is Procter & Gamble—was a soap maker who figured out how to make several dozen different kinds of soap to appease different needs, from creamier to more fragrant. But it took 53 years and 30 different types of soap before the founders' children, who were by then in charge, to decide to incorporate in 1890 to raise capital for additional expansion.

In fitness, the passionate bodybuilders who had a better idea for a dumbbell found an avid market of fellow devotees, and their companies' sales began to grow. Soon there was a collection of companies all selling to other passionate people just like them. It can take decades for a collection of companies to become a recognized industry and to reach beyond other enthusiasts for bigger sales, especially for niche or non-essential industries (from the consumer's standpoint) like fitness.

But as the companies grow, develop into an industry, and become more business-like, they also become less nimble and the bodybuilder with the ideas is busy in the boardroom (if he's even still in the house). What happens now? The companies settle into their ways, and the pace of innovation declines dramatically, or dies altogether. That can be the cause of an intermediate contraction of an industry or at least a slowdown.

"This leaves big gaps for the little guy," said Tim Porth, co-founder and vice president of sales and marketing for Octane Fitness, a 4-year-old little guy specializ-

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BY THERESE IKNOIAN

TO PROFIT

> **"WE'LL SEE A DYNAMIC CHANGE FROM THE PASSIONATE, TO THE MARKETING AND THE MAINSTREAM."**
> —Mark Rupe, Adams Harkness

ing in ellipticals. "Little guys, they're there because they're entrepreneurs and they take on challenges."

The introduction of those risky little companies with new ideas can again kick-start the big guys, who in the mean time have been too busy in management meetings dealing with operations, personnel and the cost of widget parts. Here comes more expansion again based on the need to stop being complacent.

"New ideas force them to realize an opportunity they can take advantage of," Nero said. "Companies get locked into a strategy and they build their infrastructure and everything around that one strategy, and it's difficult to change."

If an industry is young enough, its companies can and do change. Or they die. Or go bankrupt. Or get bought—sometimes at a fire sale. Contraction happens.

The cycle of innovation-expansion-contraction can go on and on until the industry is so mature that the little guy with a nifty idea just can't make it over the wall to start his or her own company or to get the product to retail. Then they usually just approach the big guys with their innovations and hope to license or sell it.

"In all industries, enthusiast entrepreneurs have a role and create ideas," said Max Alfthan, senior vice president of Amer Sports, parent of Precor. "Small companies are in many ways the shaper of new ideas and of an industry."

MONEY TALKS

Meanwhile, the forward thinkers, investors and equity firms snooping for money-making opportunities make the leap—one more step that can spur expansion. And when they put their money into a company, they aren't about to let it be run by bodybuilders who aren't business people since the goal is, basically, to make money. They aren't passionate enthusiasts. They measure their involvement by return divided by time and by ROI and P/E Ratios.

"They're in a rush to get rid of these companies," said James Chung of Reach Advisors, a strategy and research firm. After, of course, the investment has had a chance to grow, usually three to five years or so.

"So they bring in executives who have been at public companies because they know the quarterly earnings drill," Chung added.

For example: When numbers didn't click as well as desired, Life Fitness got a new president from the bowling and billiards division at parent Brunswick who is known for tight-fisted management. Nautilus in the last two years has slowly brought in an entirely new management team with backgrounds at Coca-Cola and Levi Strauss. Representatives from both declined to speak to GearTrends® for this story. Even non-public companies can bring in executives from the outside: Coming from a COO position at Dunlop Slazenger, Gordon Boggis came on last year to head up PaceMaster—another little-guy company in the grand scheme of things—to coax it to grow out of its role as a treadmill company. And Star Trac hired Nero two years ago from the medical imaging industry where he had helped take Adac from an $80 million to a $500 million company. (Nero can speak of consolidation and big companies with experience. He left Adac soon after it was acquired by Philips when he said the drive for innovation was replaced with what he called bureaucratic mire.)

And that's where fitness sits now, at the crest of another wave of consolidation and growth. Smaller companies that don't have a well-defined niche or product may just find themselves missing the wave and getting dumped into the blue oblivion. Some particularly see that happening in the strength market, where a dozen-plus companies all started by enthusiasts seem to make similar equipment. One observer said he thinks many of them have five years of life left at most, unless they are acquired by a company that thinks more like a business. Think about Star Trac taking Flex, and Precor/Amer taking FPI (Icarian).

"We'll see a dynamic change from the passionate, to the marketing and the mainstream," said Mark Rupe, vice president of equity research at Adams Harkness, a research, brokerage and investment banking firm that follows the fitness industry.

SIGN OF THE TIMES

Before 1994, companies were either strength companies or

MANUFACTURERS/SUPPLIERS

1995
» Life Fitness acquires Hi Tech

1996
» Icon acquires HealthRider

1997
» Brunswick acquires Life Fitness
» Brunswick acquires Hammer Strength
» Trotter acquires Cybex

1998
» Brunswick acquires Parabody
» Precor acquires Pacific Fitness
» Cybex/Trotter acquires Tectrix
» Icon acquires Nordic Track
» Schwinn acquires Trimline

1999
» Direct Focus acquires Nautilus
» StairMaster acquires Quinton

WHY AN ATTRACTION TO FITNESS?

It's all about health and fitness. As baby boomers have grown up with the Jim Fixx running hype and the Cooper aerobics boom shaping their lifestyles, so has the country and its kids become fatter and less healthy. And now politicos and national organizations are pushing the trend toward getting the country healthy again any way it can. One of those ways is, of course, with activity.

"Investors are attracted to this industry, No. 1, because everybody needs to workout," Rupe said. "And the industry is fairly stable, it's pretty straightforward. Baby boomers are changing lots of industries."

Finland-based Amer Sports took the dive into fitness when it bought Precor in 2002. It already owned companies that specialized in much older sports with long histories, like Wilson and Atomic, with golf, tennis and snowsports. Fitness was youthful.

"We felt it was a big industry, a growing industry," Alfthan said, "and that's not the case for other sporting goods industries. We also felt it was also immature. Still, we felt now was the time to go in because it is still young and it is still shaping itself."

As the booms, trends and fads have washed over us, the push is more toward overall wellness, of which fitness is just one part. Companies the likes of Technogym of Italy ("the wellness company") and Precor ("move beyond") are just two that are eliminating buff bods, six-pack abs and bulging biceps from ads and marketing.

"Fitness was really a child of the '70s, but it's changed a lot during its existence," Alfthan said. "It's come from bodybuilders and beauty fitness, and now it's gone toward wellness."

Rupe pointed out that industries like health and fitness, sleep, and nutrition are gaining steam. Despite that trend, Nautilus discontinued its sleep system line last year. North Castle Partners meanwhile describes itself as a private equity firm that specializes in healthy lifestyle industries. Octane Fitness, acquired by North Castle in January 2005, joined a portfolio that included day spas, fruit juices, natural medicine and vitamins. With the emergence of higher interest in fitness and wellness, 8-year-old North Castle could be the winner in light of its mission of "building great companies that contribute to healthy living and quality of life."

As PaceMaster's Boggis said, "We are all fortunate to be in an industry where the demographics are going in the right direction. Everybody in the industry is well-placed. We are an expanding marketplace."

RETAILING THEM IN

Indeed, the marketplace may be expanding, but it's also contracting, especially for retailers and, perhaps, especially for the small boutique stores. We've seen Kmart eat Sears, The Sports Authority merge with Gart, and Dick's buy Galyan's, not to mention Hancock Park a.k.a. Busy Body Home Fitness swallow up a plateful of reputable regionals. (Hancock Park also didn't return numerous emails or phone calls to talk about this topic.) We can't forget the Wal-Mart phenomenon. What will happen to specialty stores? Will big box sporting goods stores buy the boutique shops? Will specialty stores try to become higher-end sporting goods stores with extremely select product lines? Can specialty continue to get the product it needs from the manufacturers it wants? Can specialty survive?

"The profit-value equation is not at all clear," said Tom Cove, president of the Sporting Goods Manufacturers Association. "There has been serious consolidation on the retail side, but the jury's still out on that.

"Fitness is a really odd duck in this one," Cove continued. "The fitness business is so different. There are so many fitness specialty stores that go bankrupt. It doesn't make sense. Certainly selling a $6,500 treadmill is different than selling a $100 bat, but geez if you're looking for a growth business, it seems the fitness business on paper is the one."

One of the dilemmas has been the affect consolidation on the manufacturing side has had on retailers. It used to be, said Cove, that a retailer would go to a manufacturer, and the manufacturer would say, here's what we have, and this is the price, and what do you want? Now, Cove said, the game is reversed. The larger retailers have the power to go to the manufacturer and say, here's what I want, how I want it, when I want it, how I want it customized, and the price I want to pay, so tell me what you'll do.

That leaves the little-guy retailers struggling to get desired brands at affordable prices, with margins that let a retailer make some money. Specialty stores are effectively competing with the big retailers not only on the front end to get product in the door, but also on the sales floor to get the consumer to buy product there and carry it out. The only way to win the battle, experts said, is to, one, get unique brands and products the big guys don't get and, two, compete on quality, service and value, not price.

But for some jaded observers, that won't even help.

"We all want to have the boutique, but we all go to Costco," Star Trac's Nero said. "So we want our cake and eat it too. The value has dropped off and that forces them out of business."

What's not entirely clear is which came first, retail consolidation or manufacturer consolidation. Some say the lack of retail consolidation allows for the lack of manufacturer consolidation, but once manufacturers increasingly consolidate, retail consolidation is driven forward. Consider the last few years in fitness, and that scenario seems to fit.

*** web extra**

To read additional material on consolidation and a timeline of recent retailer actions, an added benefit for GearTrends® magazine readers, go to www.geartrends.com/extras.

cardiovascular companies. One-stop shops didn't exist. Note the pattern of ebb and flow. Think there's another flow starting?

2000
» Icon acquires FreeMotion Fitness

2001
» Direct Focus acquires Schwinn Fitness

2002
» Nautilus (formerly Direct Focus) acquires StairMaster
» Precor acquired by Amer Sports

2003

2004
» Amer Sports acquires ClubCom
» Star Trac acquires Flex Fitness

2005
» North Castle acquires Octane Fitness

"It's an industry segment in transition," said Jack Lacey, former SGMA board member and longtime sporting goods and fitness industry observer.

GOT YOUR SUNGLASSES?

Despite the growing pains, the future is bright, at least as a whole. Certainly, observers foresee a shakeout on the manufacturer and supplier side, as additional waves of mergers and acquisitions hit. That too will go hand-in-hand with shakeouts at the retail level as shops learn to compete on more than just price, and realize equipment under harsh lights lined up in a cement-block room may sell to their fellow enthusiasts but not to Mr. and Mrs. Jones down the street.

But the continued desire of much larger companies to step into the fitness ring and acquire suppliers is a good sign, said Icon's Colleen Logan.

"It bodes well for the investment big companies are willing to make in this category," she said, calling the marketplace "vibrant."

Most are convinced that fitness is nowhere near its peak, not even close to maturity and most certainly not near a slowdown. What that means is that we can expect more of the innovation-expansion-contraction cycle—more folks with better ideas, more mergers, more acquisitions and, yes, more bankruptcies and adieus too. But smart industry players, suppliers, retailers and others who play their cards wisely, gain lessons from outside the industry, watch trends and move with the times have a future.

Octane's Porth summed it up in a way that applies to all industry segments: "As long as I can do something a little differently and a little better, I sure can survive."

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