

# PERSPECTIVES

*Insights on Healthy Living & Aging*

## Eye on Exercise:

# Fuel Your Life with Octane Fitness

Each year approximately 250,000 people die in the U.S. as a result of not exercising. For men, the failure to exercise is the number one risk factor for death, greater than smoking or high blood pressure. For women, the lack of exercise was the third greatest risk factor trailing behind diabetes and smoking. Physical activity is a necessity for living a healthy life. It minimizes the risks and effects of chronic conditions, including arthritis, heart disease, diabetes and obesity. Yet so many people do not get enough physical activity. Why? Generally, people don't exercise because it is viewed as hard work. The team at Octane Fitness understands this obstacle and has created its elliptical, a product series of low-impact cardiovascular fitness equipment, to help consumers attain their fitness goals.

Since 1990, the fitness equipment industry has more than doubled in size and has been the most successful category of the sporting goods industry. Interest in exercising with fitness equipment is supported by the increase in health club memberships in the U.S. which, according to the International Health, Racquet and Sportsclub Association, have increased 106% from 20.7 million in 1990 to 42.7 million in 2006. Ellipticals and other low-impact cardio equipment have enjoyed steady double-digit growth since their introduction.

For North Castle Partners, a leading private equity firm focused on consumer businesses that benefit from Healthy Living and Aging trends, an investment in the fitness equipment industry was a natural fit. In 2005, Octane Fitness joined the North Castle family through a proprietary transaction sourced from North Castle's powerful and expanding network of

knowledgeable executives in the Healthy Living and Aging industry.

We recently spoke with Dennis Lee, the CEO of Octane Fitness, Jim Eason, a North Castle Managing Director, and two of North Castle's Operating Advisors and fitness industry legends, Augie Nieto and John McCarthy, about the fitness equipment industry and Octane's plan to be the innovation leader in the industry.

### What are ellipticals?

Dennis: Ellipticals are machines that replicate walking, jogging and running with relatively low impact to the body.

### Is low-impact important?

Dennis: Yes, low-impact is important for two main reasons. First, the user gets the physical benefit of the activity without the wear and tear on the body. Second, is the psychological advantage. What we call "low perceived exertion," which allows people to workout more often and be more excited about working out.

Personally, the physical benefit is very important for someone like me. I played sports when I was younger and I tore my ACL ligaments in my left and right knees. So running whether outside or on a treadmill is no longer enjoyable for me because I feel the impact of the exercise the next day in my knees. Whereas, with an elliptical I can workout every day and I wake up the next morning and feel great. Ellipticals give people with knee, hip or back injuries, a viable option to exercise consistently.

### This must be a real selling point for the aging population.

Jim: Yes, low-impact exercise equipment is a key benefit to the aging consumer, where such ailments are even more prevalent.

Fueled by the aging of the Baby Boomers and their desire to live longer, healthier and more active lives, we expect the demand for this type of low-impact product to continue to grow.

### Can you explain what you mean by "low perceived exertion?"

Dennis: Let's say, you tried three different types of exercise - a stationary bike, jogging outside and an elliptical - and for all three you got your heart rate to the same beats per minute, and then rated the difficulty of the workout from 1-10 with one being not that hard and ten as very hard. What you would find is with ellipticals for the same benefit or heart rate; the user does not feel like they're working out as hard so the



Dennis Lee



Jim Eason



Augie Nieto



John McCarthy

user will work out longer and burn more calories because of this “low perceived exertion.”

### **Who are Octane's consumers?**

*Dennis:* Our consumers cross all age groups and levels of fitness. At one end of the spectrum, our equipment is used in professional football players' training centers, at the other end our equipment is found in retirement communities. In the middle are the folks 30, 40, 50, etc. years old, whose bodies and metabolic rates are changing. They know they need to do something. In some cases, their doctors have told them they need to lose 20 pounds and reduce their cholesterol level. Our products are great for all of these people from the professional athlete to the aging Baby Boomer with pre-existing health conditions.

What is unique about our machines is that depending on how you use them, you can be a beginner or an elite athlete, and experience an appropriate workout for your level of fitness and ability. I believe the flexibility of our equipment meets various user needs because of our innovative designs.

### **How about rehabilitation centers? Is that an area of focus for you in the future?**

*Dennis:* It's actually happening now. We have recently started to hear orthopedic surgeons recommend an elliptical for patients coming out of knee surgery. What is great about an elliptical is that it helps you take that step forward while preventing subsequent injuries that result from impact. It can be a rehabilitation treatment that ultimately turns into a person's full time exercise program.

### **How did Octane become part of the North Castle family?**

*Jim:* Octane was a perfect fit for North Castle due to our focus on consumer products that benefit from Healthy Living and Aging trends. So when we were introduced to Dennis, we knew that a North Castle-Octane partnership could be very successful.

*Dennis:* It was interesting because as we began our discussions it became apparent that North Castle's network within the fitness industry overlapped with our network. Being

able to get multiple endorsements for each other jump-started our relationship.

### **Was North Castle's focus important to you?**

*Dennis:* North Castle's focus on healthy living and aging was very important because both companies share a similar vision. We believed that North Castle's focus would provide competitive advantages in terms of knowledge, experience and network. This alignment of philosophy formed the foundation for beginning a relationship, which is ultimately what leads to a strong partnership.

### **Let's discuss the North Castle-Octane partnership.**

*Dennis:* From the beginning, North Castle cultivated a relationship of trust. Even before the transaction was completed, there were con-

**Because of our  
focus on low-impact  
cardio equipment,  
we are constantly  
improving our machines  
to more closely match  
real world activity**

structive interactions. We discussed and agreed upon our long-term objectives, which allowed both North Castle and management to feel comfortable going into the new partnership. Additionally, North Castle helped provide the discipline in our organization to look at our long-term goals on a quarterly basis to ensure that we were on the right track.

*Jim:* Our partnership is based on trust and a shared set of values. North Castle guides the strategic direction of the company at the board level, monitors the financial results against short and long term plans and provides the experience and expertise of our vast network to company management to help them achieve success.

### **What was North Castle's original vision for Octane?**

*Jim:* We saw significant growth potential for Octane by continuing to grow in its core market as well as expanding into new channels, specifically the commercial channel and the international market. To achieve this growth, we believed that Octane would benefit from a strong, world-class board of directors with experience in the dealer and commercial channels as well as sales and manufacturing expertise. Such a powerful board would help Octane avoid some of the obstacles associated with high growth. A “been there and done that” advantage.

*Dennis:* Truly, one of the advantages of North Castle's focus can be seen in our Board of Directors. It is more than just having industry icons with vast knowledge, experience and contacts. It is having a board and partners who are truly “fueled” about Octane and about what we are trying to accomplish. Having a hands on, high value added Board of Directors and investors, including: Augie Nieto, the founder and former CEO of Life Fitness, the largest commercial fitness equipment manufacturer in the world; Andy Maduza, the former COO/CFO of Life Fitness; Jerry Dettinger, the founder and former CEO of Parabody, a leading manufacturer of fitness equipment in the Specialty Channel; and Al Fuller, former EVP Manufacturing and Engineering of Life Fitness, who can take their learnings and apply them to our business, is an invaluable asset for an entrepreneur like me. I look forward to gaining further insights from the newest member of North Castle's team of Operating Advisors, John McCarthy.

### **As Operating Advisors, you are an integral part of the North Castle team. Augie and John, tell us a little about your background and what you bring to North Castle's companies.**

*Augie:* I think one of the best ways I have added value to Octane and the other North Castle companies has been to utilize my network by introducing my colleagues to the North Castle companies. I believe that part of

North Castle's success stems from surrounding the CEOs of their companies with proven executives that help the business achieve their goals by leveraging our collective experience. It is not that we know what to do, but we know what not to do. So instead of having five doors to open, our experience tells us not to open up doors one, three and five, which significantly increases Octane's chance of success.

*John:* For the past 25 years, I was the founding Executive Director of the International Health, Racquet, and Sportsclub Association (IHRSA), which is the largest trade association in the world for the health club industry. IHRSA represents 7,000 member clubs across four continents. I believe my 25 years of experience and contacts in the Health and Fitness Club industry will be valuable to Octane as they expand into new channels and pursue their growth potential.

*Jim:* I expect John and Augie to be very helpful as we expand into the commercial channel as well as expand our international presence. We are in the process of building a commercial product line that will allow us to continue our leadership in innovation, which is at the core of this company and its success. By leveraging our Advisors' contacts together with Octane's focus on sales, service and a strong, patented new product pipeline, we expect Octane to be recognized as the innovation leader in the low-impact cardio area across several channels.

*Augie:* Another analogy is when you are young, you use your physical stamina to win. You win by brute force. But if you think about who the best players are in a sport, they usually are not the youngest. They are usually not the best athletes. They are the people who can anticipate where the ball will be on the court. Whether in sports or business, you have to find ways to get the most in the least amount of time because anyone can make the right decision if they have all of the information. The winners will be the leaders who are able to make the right decisions with the least information in the shortest period of time. Having access to industry experts, such as John, who know the names, the operators and the markets, will be a great advantage to Octane.

## What else does North Castle bring to a company like Octane?

*Dennis:* North Castle's network and experience has been very valuable. From an industry perspective, at the beginning of the North Castle-Octane partnership, I was able to spend time with Harvey Spevak, the CEO of Equinox Fitness. The success our products had in the Equinox clubs gave Octane instant credibility in the commercial marketplace.

More recently, I saw the benefits of North Castle's financial connections as we underwent a recapitalization of the business. Initially, a recapitalization was not something I was thinking about. But after discussing it with North Castle, I realized that such an opportunity would provide liquidity to shareholders while giving Octane additional flexibility to execute our long term goals.

## As a leader in innovation, Octane has received significant press for its award winning designs. What makes Octane different from its competitors and gives Octane that edge?

*Jim:* From my perspective, the real difference between Octane and others is what we call the "ride." What people really care about is how does the equipment feel and does it work for them? Even against the "big boys" in the industry, we win that taste test every time.

*Dennis:* With our focus on low-impact, we spend more time thinking about low-impact cardio than our competition. This is why we come to work every day and that makes a huge difference in the results. We are constantly tweaking our models so that we get closer and closer to real world activity. Motion is better experienced than talked about. You don't have to be an exercise physiologist to get on a few products and understand what feels best for your body.

We have the closest pedal spacing in the industry because when we examined the motions of walking, running and jogging outside, we saw that our feet actually cross over the center line or at least get very close. By moving the pedals closer together we make the motion more nat-



## exercise facts

- ▶ In the U.S., 140 million people are overweight, 105 million have high cholesterol, 43 million suffer from joint problems and 20 million have diabetes.
- ▶ Computers eliminated the need for secretaries to get up to get files, the impact of which is estimated to be a 15 pound weight gain per year simply by eliminating this one movement.
- ▶ TV viewers are 47% less likely to walk 10,000 steps than non-viewers. People reduce their number of steps by 144 for each hour of TV watched, resulting in 1,152 fewer steps per day for the average person who watches 8 hours of TV per day.
- ▶ Daily cardio activity, such as walking, reduces the risk of catching a cold.
- ▶ Every pound of trained muscle, if used every day, burns 35-50 calories versus a pound of fat, which burns 7-10 calories.
- ▶ In 2005, 62% of adults in the U.S. were not engaging in vigorous leisure-time physical activity.

ural and comfortable for the user. We applied the same thought process to the upper body and focused on what we do with our hands when we walk, jog, or run. This resulted in one of our trademark innovations - the multi grip handlebar system, which allows a user to move their hands into multiple positions. The old straight, what I call "rabbit ears," handlebars only allows for one position. Our equipment provides multiple grip positions to accommodate different sized users as well as a single user who may want to have different hand positions based on speed and direction.

A recent innovation that we put into our Q37 is the concept of "converging path upper body." If you stood up and went through a walking, jogging or running motion you would notice that your hands move towards the center of your body. They don't go straight back and forth. So we introduced a patented technology that provides the first converging motion for the upper body in ellipticals. These are just a few examples, and there's more, but I think you can see because of our focus we are better equipped to constantly innovate our products to better simulate real world experiences.

*John:* Octane chose to build its consumer business through fitness specialty retailers because they provide trained sales personnel that are able to consult with the customers and help them make educated purchase decisions. Add to that the training and service to make the experience the most effective and enjoyable. This is not a product that you are going to find at Wal-Mart.

### **Does your consumer recognize the power of your focus on sales, service and product innovation?**

*Dennis:* We believe they do. More than 90% of our team is focused on sales, service and product innovation. It is what we do and we are passionate about it. This focus has resulted in not only Octane earning the *Best of Fitness Award* from *Health* magazine, but also winning an award from *SNEWS*, the annual fitness retail survey, for the industry's best elliptical. The awards were based not just on the product but the level of service and support that they received.

Finally, our largest customer on the retail side, a \$100 million plus organization with 100 locations, graded us their top supplier. Each year, this company grades their top six vendors based on a traditional A through F format on various factors, everything from our service support to how our field sales team did in training their people and supporting them to the responsiveness to the products. We were their only supplier to receive an A. It's great to get that kind of feedback because it lets us know that we are doing the right things for our customers.

### **I understand you recently won the 2007 Ernst & Young Entrepreneur of the Year Award.**

*Dennis:* Yes, we won for the consumer products category in the Minnesota and Dakotas region. We believe that the award is another reflection of the power of our unique business model and the benefits of that come from focusing on excellence in sales, service and product innovation.

### **What's hot in the fitness equipment industry?**

*John:* One type of fitness equipment is called the perennials, which include bikes, treadmills and ellipticals, with ellipticals being the most recent entry. There will always be a market for well-made perennials. The interesting part is being able to identify the innovative technologies that improve and grow the industry. I believe the hot trend to watch will be low-impact cardiovascular equipment like ellipticals or some new technology that provides that type of benefit but may be different than a traditional standing elliptical.

*Jim:* I believe that due to the aging demographics of the population and their desire to stay fit longer; the elliptical will continue to be the hot category because of its low-impact advantage. As the low-impact category evolves, innovation will continue to be important and the leaders, such as Octane, will expand the market to equipment that is more than just the traditional elliptical. Although I do believe the traditional elliptical will experience significant growth as we go forward.

### **How do you think about exit?**

*Jim:* With our focus, I believe that Octane will clearly be the leader in low-impact cardio fitness equipment at the time of exit and whenever you build a great company, somebody is going to want to buy it. The potential buyers range from the significant players in the fitness industry who will want to purchase Octane for the strength of its products and diversified distribution network, to the manufacturers of these products. Foreign manufacturers may be particularly interested in purchasing a U.S. brand and distribution system.

### **To close, what advice can you give our readers about buying exercise equipment?**

*Dennis:* When friends ask me what piece of exercise equipment should they use, I don't tell them the type of equipment or the brand, I tell them to buy something that they can use four to five times a week, something that is comfortable, which will allow them to exercise and reach their target heart rate. In the end, ellipticals help people stick with an exercise program, achieve health benefits and stay in shape because of the physical and psychological benefits of the equipment. ●

## **NORTH CASTLE PARTNERS** *Investors in Healthy Living & Aging*

North Castle targets high-growth, middle market companies in the Aesthetics & Personal Care, Consumer Health, Fitness & Recreation, Home & Leisure and Nutrition industries. North Castle is a hands-on, value-added investor. We utilize our cumulative knowledge and network, which results from our industry focus, to partner with management and entrepreneurs to create world-class companies.

*Perspectives is published by North Castle Partners, a leading private equity firm focused exclusively on investments in consumer-driven product and service businesses that benefit from "Healthy Living and Aging" trends.*

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