

TOWN SPORTS INTERNATIONAL HOLDINGS INC

Form 10-Q

October 29, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

Form 10-Q

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

For the quarterly period ended September 30, 2009

or

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

For the Transition period from _____ to _____ .

Commission File Number 000-52013

TOWN SPORTS INTERNATIONAL HOLDINGS, INC.

(Exact name of Registrant as specified in its charter)

Delaware

*(State or other Jurisdiction of
Incorporation or Organization)*

20-0640002

*(I.R.S. Employer
Identification Number)*

**5 Penn Plaza (4th Floor)
New York, New York 10001
Telephone: (212) 246-6700**

*(Address, zip code, and telephone number, including
area code, of registrant's principal executive office.)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 and 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods 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 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

*(Do not check if a 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

As of October 24, 2009, there were 22,603,437 shares of Common Stock of the registrant outstanding.

TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
FORM 10-Q
For the Quarter Ended September 30, 2009
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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
September 30, 2009 and December 31, 2008
(In \$ 000s, except share data)
(Unaudited)

| | September 30, 2009 | December 31, 2008 |
|--|-----------------------------------|----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 12,021 | \$ 10,399 |
| Accounts receivable (less allowance for doubtful accounts of \$3,037 and \$3,001 as of September 30, 2009 and December 31, 2008, respectively) | 6,130 | 4,508 |
| Inventory | 138 | 143 |
| Prepaid income taxes | 3,571 | 8,116 |
| Prepaid expenses and other current assets | 11,779 | 14,154 |
| | | |
| Total current assets | 33,639 | 37,320 |
| Fixed assets, net | 360,678 | 373,120 |
| Goodwill | 32,636 | 32,610 |
| Intangible assets, net | 198 | 281 |
| Deferred tax asset, net | 45,740 | 42,266 |
| Deferred membership costs | 10,117 | 14,462 |
| Other assets | 9,682 | 11,579 |
| | | |
| Total assets | \$ 492,690 | \$ 511,638 |
| LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 10,650 | \$ 20,850 |
| Accounts payable | 7,223 | 7,267 |
| Accrued expenses | 31,693 | 35,565 |
| Accrued interest | 2,917 | 523 |
| Deferred revenue | 38,298 | 40,326 |
| | | |
| Total current liabilities | 90,781 | 104,531 |
| Long-term debt | 316,975 | 317,160 |
| Deferred lease liabilities | 72,088 | 69,719 |
| Deferred revenue | 1,602 | 4,554 |
| Other liabilities | 12,654 | 14,902 |
| | | |
| Total liabilities | 494,100 | 510,866 |
| Commitments and contingencies (Note 9) | | |
| Stockholders (deficit) equity: | | |
| Common stock, \$.001 par value; issued and outstanding 22,603,437 and 24,627,779 shares at September 30, 2009 and December 31, 2008, | 23 | 25 |

respectively

| | | |
|--|------------|------------|
| Paid-in capital | (23,020) | (18,980) |
| Accumulated other comprehensive income (currency translation adjustment) | 1,252 | 1,070 |
| Retained earnings | 20,335 | 18,657 |
| Total stockholders (deficit) equity | (1,410) | 772 |
| Total liabilities and stockholders (deficit) equity | \$ 492,690 | \$ 511,638 |

See notes to the condensed consolidated financial statements.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the three and nine months ended September 30, 2009 and 2008
(In \$ 000s except share and per share data)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Revenues: | | | | |
| Club operations | \$ 119,282 | \$ 126,682 | \$ 367,370 | \$ 379,318 |
| Fees and other | 1,167 | 1,427 | 3,700 | 4,504 |
| | 120,449 | 128,109 | 371,070 | 383,822 |
| Operating Expenses: | | | | |
| Payroll and related | 47,487 | 49,171 | 146,480 | 146,228 |
| Club operating | 45,589 | 44,398 | 137,499 | 128,799 |
| General and administrative | 8,103 | 8,697 | 23,938 | 25,898 |
| Depreciation and amortization | 14,353 | 13,423 | 42,995 | 38,788 |
| Impairment of fixed assets | 3,473 | 839 | 4,604 | 1,981 |
| | 119,005 | 116,528 | 355,516 | 341,694 |
| Operating income | 1,444 | 11,581 | 15,554 | 42,128 |
| Interest expense | 5,378 | 5,783 | 15,944 | 17,930 |
| Interest income | (1) | (76) | (2) | (291) |
| Equity in the earnings of investees and rental income | (444) | (634) | (1,452) | (1,701) |
| Income (loss) before provision (benefit) for corporate income taxes | (3,489) | 6,508 | 1,064 | 26,190 |
| Provision (benefit) for corporate income taxes | (2,004) | 2,668 | (614) | 10,738 |
| Net income (loss) | \$ (1,485) | \$ 3,840 | \$ 1,678 | \$ 15,452 |
| Earnings per share: | | | | |
| Basic | \$ (0.07) | \$ 0.15 | \$ 0.07 | \$ 0.59 |
| Diluted | \$ (0.07) | \$ 0.14 | \$ 0.07 | \$ 0.58 |
| Weighted average number of shares used in calculating earnings per share: | | | | |
| Basic | 22,565,564 | 26,445,288 | 22,770,792 | 26,389,804 |
| Diluted | 22,565,564 | 26,547,121 | 22,790,102 | 26,464,915 |
| Statements of Comprehensive Income (Loss) | | | | |
| Net income (loss) | \$ (1,485) | \$ 3,840 | \$ 1,678 | \$ 15,452 |

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| | | | | |
|--|------------|----------|----------|-----------|
| Foreign currency translation adjustments | 259 | (441) | 182 | 16 |
| Comprehensive income (loss) | \$ (1,226) | \$ 3,399 | \$ 1,860 | \$ 15,468 |

See notes to the condensed consolidated financial statements.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended September 30, 2009 and 2008
(In \$ 000s)
(Unaudited)

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | September 30, | |
| | 2009 | 2008 |
| Cash flows from operating activities: | | |
| Net income | \$ 1,678 | \$ 15,452 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 42,995 | 38,788 |
| Impairment of fixed assets | 4,604 | 1,981 |
| Write-off of deferred financing costs | 100 | |
| Non-cash interest expense on Senior Discount Notes | 1,203 | 10,328 |
| Amortization of debt issuance costs | 643 | 583 |
| Noncash rental expense, net of noncash rental income | (1,686) | (242) |
| Compensation expense incurred in connection with stock options and common stock grants | 1,257 | 876 |
| Net changes in certain operating assets and liabilities | 2,156 | 3,187 |
| Increase in deferred tax asset | (3,474) | (2,400) |
| Landlord contributions to tenant improvements | 4,664 | 4,282 |
| Change in reserve for self-insured liability claims | 430 | 1,738 |
| Decrease in deferred membership costs | 4,345 | 1,940 |
| Other | (133) | (190) |
| Total adjustments | 57,104 | 60,871 |
| Net cash provided by operating activities | 58,782 | 76,323 |
| Cash flows from investing activities: | | |
| Capital expenditures | (39,805) | (63,162) |
| Insurance Proceeds | | 1,074 |
| Net cash used in investing activities | (39,805) | (62,088) |
| Cash flows from financing activities: | | |
| Proceeds from borrowings on Revolving Loan Facility | 82,800 | |
| Repayment of borrowings on Revolving Loan Facility | (93,000) | (9,000) |
| Repayment of long-term borrowings | (1,388) | (1,435) |
| Costs related to deferred financing | (615) | |
| Repurchase of common stock | (5,355) | |
| Proceeds from exercise of stock options | 36 | 1,194 |
| Tax benefit from stock option exercises | 21 | 174 |
| Net cash used in financing activities | (17,501) | (9,067) |

| | | |
|---|------------|------------|
| Effect of exchange rate changes on cash | 146 | 31 |
| Net increase in cash and cash equivalents | 1,622 | 5,199 |
| Cash and cash equivalents at beginning of period | 10,399 | 5,463 |
| Cash and cash equivalents at end of period | \$ 12,021 | \$ 10,662 |
| Summary of change in certain operating assets and liabilities: | | |
| Increase in accounts receivable | \$ (1,618) | \$ (3,611) |
| Decrease (increase)in inventory | 6 | (4) |
| Decrease in prepaid expenses and other current assets | 1,018 | 3,478 |
| Increase in accounts payable, accrued expenses and accrued interest | 651 | 4,301 |
| Increase in accrued interest on Senior Discount Notes | 2,538 | |
| Change in prepaid corporate income taxes | 4,545 | (2,120) |
| (Decrease) increase in deferred revenue | (4,984) | 1,143 |
| Net changes in certain operating assets and liabilities | \$ 2,156 | \$ 3,187 |

See notes to the condensed consolidated financial statements.

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**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(In \$ 000s except share and per share data)

(Unaudited)

1. Basis of Presentation

As of September 30, 2009, Town Sports International Holdings, Inc. (the Company or TSI Holdings), through its wholly-owned subsidiary, Town Sports International, LLC (TSI LLC), operated 165 fitness clubs (clubs) comprised of 111 clubs in the New York metropolitan market under the New York Sports Clubs brand name, 26 clubs in the Boston market under the Boston Sports Clubs brand name, 19 clubs (two of which are partly-owned) in the Washington, D.C. market under the Washington Sports Clubs brand name, six clubs in the Philadelphia market under the Philadelphia Sports Clubs brand name, and three clubs in Switzerland. The Company operates in a single segment.

The condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The condensed consolidated financial statements should be read in conjunction with the Company s December 31, 2008 consolidated financial statements and notes thereto, included in the Company s Annual Report on Form 10-K, as filed on March 5, 2009 with the SEC. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). Certain information and footnote disclosures that are normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations. The information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods set forth herein. The results for the three and nine months ended September 30, 2009 are not necessarily indicative of the results for the entire year ending December 31, 2009.

The Company has determined our income tax provision for the nine months ended September 30, 2009 on a discrete basis. We could not reliably estimate our 2009 effective annual tax rate because minor changes in our annual estimated income before provision for corporate income taxes (pre-tax results) could have a significant impact on our annual estimated effective tax rate. Accordingly, we calculated our effective tax rate based on pre-tax results through the nine months ended September 30, 2009.

Certain reclassifications were made to the reported amounts for the three and nine months ended September 30, 2008 to conform to the presentation for the three and nine months ended September 30, 2009.

2. Recent Accounting Changes

In June 2009, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Codification (ASC) 105-10 (formerly Statement of Financial Accounting Standard (SFAS) No. 168), The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (ASC 105-10). ASC 105-10 has become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernment entities. It also modifies the GAAP hierarchy to include only two levels of GAAP; authoritative and non-authoritative. ASC 105-10 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Therefore, the Company adopted ASC 105-10 for the reporting in the 2009 third quarter. The adoption did not have an impact on the reporting of the Company s financial position, results of operations or cash flows.

In May 2009, the FASB issued ASC 855-10 (formerly SFAS No. 165), Subsequent Events, (ASC 855-10), which establishes general standards for accounting and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The pronouncement requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date the financial statements were issued or were available to be issued. ACS 855-10 was effective for the Company at the beginning of the 2009 second quarter. The adoption did not have a significant impact on the subsequent events that the Company reports, either through recognition or disclosure, in our consolidated financial statements.

On April 9, 2009, the FASB issued ASC 825-10 (formerly FSP FAS 107-1 and Accounting Principles Board (APB) 28-1, Interim Disclosures about Fair Value of Financial Instruments). This statement requires disclosures about the fair value of financial instruments for annual and interim reporting periods of publicly traded companies. This also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial

information at interim reporting periods. ASC 825-10 is

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effective for interim reporting periods ending after June 15, 2009. The required disclosures are included in Note 3-Long-Term Debt to the consolidated financial statements in this Form 10-Q.

3. Long-Term Debt

| | September 30, 2009 | December 31, 2008 |
|---|-----------------------------------|----------------------------------|
| Term Loan Facility | \$ 180,375 | \$ 181,763 |
| Revolving Loan Facility borrowings | 8,800 | 19,000 |
| 11% Senior Discount Notes | 138,450 | 137,247 |
| | 327,625 | 338,010 |
| Less current portion to be paid within one year | 10,650 | 20,850 |
| Long-term portion | \$ 316,975 | \$ 317,160 |

On February 27, 2007, TSI Holdings and TSI LLC entered into a \$260,000 senior secured credit facility (the 2007 Senior Credit Facility). The 2007 Senior Credit Facility consisted of a \$185,000 term loan facility (the Term Loan Facility) and a \$75,000 revolving credit facility (the Revolving Loan Facility).

On July 15, 2009, the Company and TSI LLC entered into the First Amendment to the 2007 Senior Credit Facility (the Amendment), which amends the definition of Consolidated EBITDA , as defined in the 2007 Senior Credit Facility to permit TSI LLC (as Borrower), solely for purposes of determining compliance with the maximum total leverage ratio covenant, to add back the amount of non-cash charges relating to the impairment or write-down of fixed assets, intangible assets and goodwill. The Amendment also reduced the total Revolving Loan Facility by 15%, from \$75,000 to \$63,750. Additionally, the Company incurred an aggregate of approximately \$615 in fees and expenses related to the Amendment.

Borrowings under the Term Loan Facility, at TSI LLC 's option, bear interest at either the administrative agent 's base rate plus 0.75% or its Eurodollar rate plus 1.75%, each as defined in the 2007 Senior Credit Facility. As of September 30, 2009, TSI LLC had elected the Eurodollar rate option, equal to 2.1% as of September 30, 2009. Interest calculated under the base rate option would have equaled 4.0% as of September 30, 2009, if TSI LLC had elected this option. The Term Loan Facility matures on the earlier of February 27, 2014, or August 1, 2013 if the 11% Senior Discount Notes are still outstanding as of that date.

The Revolving Loan Facility contains a maximum total leverage ratio covenant, as defined in the 2007 Senior Credit Facility, of 4.25:1.00. The covenant is subject to compliance, on a consolidated basis, only during the period in which borrowings and letters of credit are outstanding thereunder. As of September 30, 2009, the leverage ratio, as defined under the Amendment, was 2.25:1.00. Borrowings under the Revolving Loan Facility currently, at TSI LLC 's option, bear interest at either the administrative agent 's base rate plus 1.25% or its Eurodollar rate plus 2.25%, each as defined in the 2007 Senior Credit Facility. As of September 30, 2009, there was \$8,800 in borrowings outstanding at the base interest rate option of 4.5%. There were outstanding letters of credit issued of \$14,226. The unutilized portion of the Revolving Loan Facility as of September 30, 2009 was \$40,724. The Revolving Loan Facility expires on February 27, 2012.

Fair Market Value

Based on quoted market prices, the 11% Senior Discount Notes had a fair value of approximately \$71,994 and \$83,070 at September 30, 2009 and December 31, 2008, respectively. The Term Loan Facility had fair values of approximately \$166,847 and \$126,034 at September 30, 2009 and December 31, 2008, respectively based on quoted market prices. The Company had short-term debt of \$8,800 and \$19,000 outstanding under the Revolving Loan Facility at September 30, 2009 and December 31, 2008, respectively, which approximates fair value as of such dates.

Table of Contents**4. Earnings (Loss) Per Share**

Basic earnings (loss) per share is computed by dividing net income (loss) applicable to common shareholders by the weighted average numbers of shares of the Company's common stock, par value \$0.001 per share (Common Stock) outstanding during the period. Diluted earnings per share is computed similarly to basic earnings (loss) per share, except that the denominator is increased to account for the assumed exercise of dilutive stock options and restricted stock using the treasury stock method.

The Company did not include stock options to purchase 993,680 shares for the three months ended September 30, 2008 and 1,147,915 and 849,469 shares for the nine months ended September 30, 2009 and 2008, respectively, of the Company's Common Stock in the calculations of diluted earnings (loss) per share because the exercise prices of those options were greater than the average market price over the respective periods and their inclusion would be anti-dilutive.

For the three months ended September 30, 2009, there was no effect of diluted stock options and restricted common stock on the calculation of diluted earnings (loss) per share as the Company had a net loss for this period.

The following table summarizes the weighted average number of shares of Common Stock for basic and diluted earnings (loss) per share computations.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Weighted average number of shares of Common Stock outstanding basic | 22,565,564 | 26,445,288 | 22,770,792 | 26,389,804 |
| Effect of dilutive stock options and restricted Common Stock | | 101,833 | 19,310 | 75,111 |
| Weighted average number of shares of Common Stock outstanding diluted | 22,565,564 | 26,547,121 | 22,790,102 | 26,464,915 |

5. Common Stock and Stock-Based Compensation

The Company's 2006 Stock Incentive Plan, as amended and restated (the 2006 Plan), authorizes the Company to issue up to 2,500,000 shares of Common Stock to employees, non-employee directors and consultants pursuant to awards of stock options, stock appreciation rights, restricted stock, in payment of performance shares or other stock-based awards. Under the 2006 Plan, stock options must be granted at a price not less than the fair market value of the stock on the date the option is granted, generally are not subject to re-pricing, and will not be exercisable more than ten years after the date of grant. Options granted under the 2006 Plan generally qualify as non-qualified stock options under the U.S. Internal Revenue Code of 1986, as amended. The 2006 Plan was approved by stockholders at the 2008 Annual Meeting of Stockholders on May 15, 2008. Certain options granted under the Company's 2004 Common Stock Option Plan, as amended (the 2004 Plan), generally qualify as incentive stock options under the U.S. Internal Revenue Code; the exercise price of a stock option granted under this plan may not be less than the fair market value of Common Stock on the option grant date.

At September 30, 2009, the Company had 297,080 and 1,371,065 shares of restricted stock and stock options outstanding under the 2004 Plan and the 2006 Plan, respectively.

Option Grants

Options granted during the nine months ended September 30, 2009 to employees of the Company and members of the Company's Board of Directors were as follows:

| Date | Number of Options | Exercise Price | Black-Scholes Valuation | Volatility | Dividend Yield | Risk Free Interest Rate | Expected Term (Years) |
|-------------|----------------------------------|---------------------------|------------------------------------|-------------------|---------------------------|--|--------------------------------------|
|-------------|----------------------------------|---------------------------|------------------------------------|-------------------|---------------------------|--|--------------------------------------|

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| | | | | | | | |
|------------------|--------|---------|---------|-------|------|-------|------|
| January 2, 2009 | 7,000 | \$ 3.21 | \$ 1.94 | 69.2% | 0.0% | 1,81% | 5.50 |
| January 20, 2009 | 12,750 | \$ 2.51 | \$ 1.63 | 71.8% | 0.0% | 1.71% | 6.25 |
| Total | 19,750 | | | | | | |

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There were no options granted during the three months ended September 30, 2009.

The total compensation expense, classified within Payroll and related on the condensed consolidated statements of operations, related to options outstanding under the 2006 Plan and the 2004 Plan was \$385 and \$1,163 for the three and nine months ended September 30, 2009, respectively, and \$341 and \$797 for the three and nine months ended September 30, 2008, respectively.

As of September 30, 2009, a total of \$1,705 in unrecognized compensation cost related to stock options is expected to be recognized, depending upon the likelihood that accelerated vesting targets are met in future periods, over a weighted-average period of 3.0 years.

Restricted Stock Grants

The total compensation expense, classified within Payroll and related on the condensed consolidated statements of operations, related to restricted stock granted under the 2006 Plan and the 2004 Plan was \$14 and \$41 for the three and nine months ended September 30, 2009, respectively, and \$12 and \$14 for the three and nine months ended September 30, 2008.

As of September 30, 2009, a total of \$126 in unrecognized compensation expense related to restricted stock grants is expected to be recognized over a weighted-average period of 2.8 years. There was no restricted stock granted during the nine months ended September 30, 2009.

6. Fixed Asset Impairment and Club Closures

ASC 820-10 (formerly SFAS No.157) defines fair value, establishes a framework in generally accepted accounting principles for measuring fair value and expands disclosures about fair value measurements. The standard establishes a hierarchy of inputs employed to determine fair value measurements, with three levels. Level 1 inputs are quoted prices in active markets for identical assets and liabilities, are considered to be the most reliable evidence of fair value, and should be used whenever available. Level 2 inputs are observable prices that are not quoted on active exchanges. Level 3 inputs are unobservable inputs employed for measuring the fair value of assets or liabilities.

Fixed assets are evaluated for impairment periodically whenever events or changes in circumstances indicate that related carrying amounts may not be recoverable from undiscounted cash flows in accordance with FASB released guidance. The Company's long-lived assets and liabilities are grouped at the individual club level which is the lowest level for which there is identifiable cash flow. To the extent that estimated future undiscounted net cash flows attributable to the assets are less than the carrying amount, an impairment charge equal to the difference between the carrying value of such asset and its fair value is recognized. In the three months ended September 30, 2009, the Company tested 10 underperforming clubs and recorded impairment losses of \$3,473 on fixed assets at two of these clubs that experienced decreased profitability and sales levels below expectations and were therefore written down to their fair values. As of September 30, 2009, these two clubs had approximately \$778 and \$864, respectively, in remaining net leasehold improvements. The eight clubs tested that did not have impairment charges had an aggregate of \$7,339 of net leasehold improvements remaining as of September 30, 2009.

The fair values of fixed assets evaluated for impairment were calculated using Level 3 inputs using discounted cash flow. The Company's non-financial assets and liabilities that are reported at fair value on a nonrecurring basis in the accompanying condensed consolidated balance sheet, as of September 30, 2009, were as follows:

| Date | Fair Value of Assets (Liabilities) | Basis of Fair Value Measurements | | |
|------|---|--|---|---|
| | | Quoted Prices in Active markets for Identical Items (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |

| | | | | | | |
|--------------|----|-------|----|----|----|-------|
| Fixed assets | \$ | 1,642 | \$ | \$ | \$ | 1,642 |
|--------------|----|-------|----|----|----|-------|

In the three months ended March 31, 2009, the Company tested 10 underperforming clubs and recorded impairment losses of \$1,131 on fixed assets at four of these clubs. Total impairment charges in the nine months ended September 30, 2009 were \$4,604. Impairment charges for the three and nine months ended September 30, 2008 were \$839 and \$1,981, respectively.

The impairment losses are included as a separate line in operating income on the consolidated statement of operations.

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The Company expects to record early lease termination costs of \$500 to \$600 related to two club closures prior to their lease expiration dates, which are expected to occur in November 2009.

7. Goodwill and Other Intangibles

The Company's goodwill is related to the New York Sports Clubs trade name and other certain remote clubs that do not benefit from being part of a regional cluster and are therefore considered single reporting units.

In the three months ended March 31, 2009, the Company performed its annual impairment test. The test was performed as a roll-forward of the December 31, 2008 test. Please refer to Note 5 - Goodwill and Intangible Assets to the consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008 for information on the specific assumptions used. The assumptions used during 2009 did not change from those used during 2008 as there were no significant changes in the business since the test was performed as of December 31, 2008.

Goodwill impairment testing requires a comparison between the carrying value and fair value of reportable goodwill. If the carrying value exceeds the fair value, goodwill is considered impaired. The amount of the impairment loss is measured as the difference between the carrying value and the implied fair value of goodwill, which is determined using discounted cash flows. The 2009 impairment test supported the recorded goodwill balances and as such no impairment of goodwill was required. The valuation of intangible assets requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows and discount rates. Adverse changes in expected operating results and/or unfavorable changes in other economic factors used to estimate fair values could result in a material non-cash impairment charge in the future. Given the current economic environment and the uncertainties regarding the impact on the Company's business, there can be no assurance that the Company's estimates and assumptions regarding the duration of the ongoing economic downturn, or the period or strength of recovery, made for purposes of the Company's goodwill impairment testing as of March 31, 2009, will prove to be accurate predictions of the future. If the Company's assumptions regarding forecasted revenue or margin growth rates of certain reporting units are not achieved, the Company may be required to record goodwill impairment charges in future periods, whether in connection with the Company's next annual impairment testing in the quarter ending March 31, 2010 or prior to that period, if any such change constitutes a triggering event outside of the quarter from when the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment charge would result. There were no events triggering a review of goodwill for the three months ended September 30, 2009.

The change in the carrying amount of goodwill from December 31, 2008 through September 30, 2009 was as follows:

| | |
|--|-----------|
| Balance as of December 31, 2008 | \$ 32,610 |
| Changes due to foreign currency exchange rate fluctuations | 26 |
| Balance as of September 30, 2009 | \$ 32,636 |

| | As of September 30, 2009 | | |
|-----------------------------------|--------------------------------------|-------------------------------------|----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Intangibles |
| Acquired Intangible Assets | | | |
| Covenants-not-to-compete | \$ 1,508 | \$ (1,310) | \$ 198 |

| | As of December 31, 2008 | |
|-----------------------------------|--------------------------------------|-------------------------------------|
| | Gross Carrying Amount | Accumulated Amortization |
| Acquired Intangible Assets | | |

| | | | Net Intangibles |
|--------------------------|-----------|-------------|----------------------------|
| Membership lists | \$ 10,890 | \$ (10,836) | \$ 54 |
| Covenants-not-to-compete | 1,687 | (1,460) | 227 |
| | \$ 12,577 | \$ (12,296) | \$ 281 |

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The amortization expense of the above-acquired intangible assets for each of the twelve month periods ending September 30, 2010 and September 30, 2011 is as follows:

| | |
|--|---------------|
| Aggregate Amortization Expense for the twelve months ending September 30, | |
| 2010 | \$ 137 |
| 2011 | 61 |
| | \$ 198 |

Amortization expense for the nine months ended September 30, 2009 and 2008 amounted to \$213 and \$544, respectively.

8. Income Taxes

The amount of unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate in any future periods had not changed significantly as of September 30, 2009 and the Company does not anticipate that the total amount of unrecognized benefits will significantly change in the next 12 months.

The Company recognizes both interest accrued related to unrecognized tax benefits and penalties in income tax expense, if deemed applicable. As of September 30, 2009, the amount accrued for interest was \$131.

The Company files federal income tax returns, a foreign jurisdiction return and multiple state and local jurisdiction tax returns. The Company is subject to examinations of its federal income tax returns by the Internal Revenue Service (IRS) for years 2006 through 2008. The IRS examined the Company's 2006 and 2007 federal income tax returns and concluded those audits with no findings.

The Company has determined our income tax provision for the nine months ended September 30, 2009 on a discrete basis. We could not reliably estimate our 2009 effective annual tax rate because minor changes in our annual estimated income before provision for corporate income taxes (pre-tax results) could have a significant impact on our annual estimated effective tax rate. Accordingly, we calculated our effective tax rate based on pre-tax results through the nine months ended September 30, 2009.

The Company recorded a benefit for corporate income taxes of \$614 for the nine months ended September 30, 2009 compared to a provision of \$10,700 for the nine months ended September 30, 2008. The Company's effective tax rate decreased from 41% in the nine months ended September 30, 2008 to (57.7)% in the nine months ended September 30, 2009. Because of the reduction in pre-tax book income, the expected benefits from our Captive Insurance arrangement are giving rise to a tax benefit and negative effective tax rate.

New York City enacted legislation on July 11, 2009 that impacts the apportionment factor and phases in a single sales factor between 2009 and 2017. The Company recorded a benefit of \$291 to recognize the impact of this legislation on our deferred tax asset position.

9. Commitments and Contingencies

On or about March 1, 2005, in an action styled *Sarah Cruz, et al v. Town Sports International, dba New York Sports Club*, plaintiffs commenced a purported class action against the Company in the Supreme Court, New York County, seeking unpaid wages and alleging that TSI LLC violated various overtime provisions of the New York State Labor Law with respect to the payment of wages to certain trainers and assistant fitness managers. On or about November 2, 2005, the complaint and the lawsuit were stayed upon agreement of the parties pending mediation. On or about November 28, 2006, the plaintiffs gave notice that they wished to lift the stay. On or about June 18, 2007, the same plaintiffs commenced a second purported class action against the Company in the Supreme Court, New York County, seeking unpaid wages and alleging that TSI LLC violated various wage payment and overtime provisions of the New York State Labor Law with respect to the payment of wages to all New York purported hourly employees. While we are unable at this time to estimate the likelihood of an unfavorable outcome or the potential loss to the Company in the event of such an outcome, we intend to contest these cases vigorously. Depending upon the ultimate outcome, these matters may have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

The landlord of one of TSI LLC's former health clubs filed a lawsuit in state court against it and two of its health club subsidiaries alleging, among other things, breach of lease in connection with the decision to close the club and taking additional space in another

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facility nearby. The court granted the landlord damages in the amount of approximately \$700, including interest and costs. TSI LLC is party to an agreement with a third-party developer, which by its terms indemnifies TSI LLC for the full amount of this liability.

On September 22, 2009, in an action styled *Town Sports International, LLC v. Ajilon Solutions, a division of Ajilon Professional Staffing LLC (Supreme Court of the State of New York, New York County, 602911-09)*, TSI LLC brought an action in the Supreme Court of the State of New York, New York County, against Ajilon Solutions Professional Staffing LLC (Ajilon) for breach of contract, conversion and replevin, seeking, among other things, money damages against Ajilon for breaching its agreement to design and deliver to TSI LLC a new sports club enterprise management system known as GIMS, including failing to provide copies of the computer source code, related documentation, properly identified requirements documents and other property owned and licensed by TSI LLC. On October 2, 2009, TSI LLC moved for injunctive relief, demanding that Ajilon turn over the materials and work product needed for the project so that TSI LLC can evaluate the status of the project and plan for its completion. On October 15, 2009, the court ruled on the TSI LLC's motion for injunctive relief and ordered Ajilon to provide certain materials created in connection with the project and reserved judgment on other aspects of TSI LLC's request. On October 14, 2009, Ajilon brought a counterclaim against TSI LLC for breach of contract, alleging, among other things, failure to pay outstanding invoices in the amount of \$2,900 plus other damages. The Company intends to vigorously defend these allegations and claims. To date, the Company has paid Ajilon \$9,600 and has accrued \$2,900 in accrued expenses on the Company's consolidated balance sheet based on invoices relating to the GIMS project received to date. The Company currently is in the process of assessing the scope of the work on GIMS completed by Ajilon, the amounts as well as the time frame and other resources required to complete GIMS, and the extent, if any, to which work on GIMS may have to be remediated. The Company cannot yet determine the extent of any potential negative effect on its operations if it fails to complete GIMS or if, once completed, GIMS fails to operate as expected.

In addition to the litigation discussed above, we are involved in various other lawsuits, claims and proceedings incident to the ordinary course of business. The results of litigation are inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in diversion of significant resources. The results of these lawsuits, claims and proceedings cannot be predicted with certainty. However, we believe that the ultimate resolution of these current matters will not have a material adverse effect on our financial statements taken as a whole.

10. Investments in Affiliated Companies

The Company has investments in Capitol Hill Squash Club Associates (CHSCA) and Kalorama Sports Managements Associates (KSMA) (collectively referred to as the Affiliates). The Company has a limited partnership interest in CHSCA, which provides the Company with approximately 20% of CHSCA's profits as defined in the partnership agreement. The Company has a co-general partnership and limited partnership interests in KSMA, which entitles it to receive approximately 45% of KSMA's profits as defined in the partnership agreement. The Affiliates have operations that are similar, and related, to those of the Company. The Company accounts for these Affiliates in accordance with the equity method. The assets, liabilities, equity and operating results of CHSCA and the Company's pro rata share of CHSCA's net assets and operating results were not material for all periods presented. KSMA's balance sheets for the periods presented are not material to the Company's balance sheets for these respective periods. Total revenue, income from operations and net income of KSMA for the three and nine months ended September 30, 2009 and 2008 were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------|---|-------------|--|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Revenue | \$739 | \$813 | \$2,219 | \$2,587 |
| Income from operations | (61) | 229 | 30 | 961 |
| Net income | (82) | 190 | (91) | 851 |

11. Subsequent Event

The Company has performed an evaluation of subsequent events through October 28, 2009, the date the financial statements were issued. No material subsequent events were noted.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Introduction

In this Form 10-Q, unless otherwise stated or the context otherwise indicates, references to TSI Holdings, Town Sports, TSI, the Company, we, our and similar references refer to Town Sports International Holdings, Inc. and its subsidiaries, and references to TSI LLC refer to Town Sports International, LLC (formerly known as Town Sports International, Inc.), our wholly-owned operating subsidiary.

Based on the number of clubs, we are one of the leading owners and operators of fitness clubs in the Northeast and Mid-Atlantic regions of the United States and one of the largest fitness club owners and operators in the United States. As of September 30, 2009, the Company, through its subsidiaries, operated 165 fitness clubs under our four key brand names: New York Sports Clubs; Boston Sports Clubs; Philadelphia Sports Clubs; and Washington Sports Clubs. These clubs collectively served approximately 494,000 members, excluding short-term and seasonal members. We are the largest fitness club owner and operator in Manhattan with 39 locations (more than twice as many as our nearest competitor) and owned and operated a total of 111 clubs under the New York Sports Clubs brand name within a 120-mile radius of New York City as of September 30, 2009. We owned and operated 26 clubs in the Boston region under our Boston Sports Clubs brand name, 19 clubs (two of which are partly-owned) in the Washington, D.C. region under our Washington Sports Clubs brand name and six clubs in the Philadelphia region under our Philadelphia Sports Clubs brand name as of September 30, 2009. In addition, we owned and operated three clubs in Switzerland as of September 30, 2009. We employ localized brand names for our clubs to create an image and atmosphere consistent with the local community and to foster recognition as a local network of quality fitness clubs rather than a national chain.

We have developed and refined our fitness club model through our clustering strategy, offering fitness clubs close to our members' workplaces and homes. Our club model targets the upper value market segment, comprising individuals aged between 21 and 60 with income levels between \$50,000 and \$150,000 per year. We believe that the upper value segment is not only the broadest segment of the market but also the segment with the greatest growth opportunities. Our goal is to be the most recognized health club network in each of the four major metropolitan regions we serve. We believe that our strategy of clustering clubs provides significant benefits to our members and allows us to achieve strategic operating advantages. In each of our markets, we have developed clusters by initially opening or acquiring clubs located in the more central urban markets of the region and then branching out from these urban centers to suburbs and neighboring communities.

We currently offer three types of memberships in our clubs: Passport, Regional Passport and Gold. The Regional Passport Membership was added in the fourth quarter of 2008 and allows a member access to all of our clubs within a single region, while the Passport Membership allows access to all clubs in all four regions. As of September 30, 2009, approximately 39% of our members participated in our Passport or Regional Passport Memberships and 61% of our members participate in a Gold Membership, which allows unlimited access to a designated or home club at all times and access to all of our other clubs during off-peak hours. Members can elect to commit to a predetermined minimum contract period of one or two years in order to benefit from reduced dues and joining fees. Alternatively, our memberships are available on a month-to-month basis.

We have two principal sources of revenue:

Membership revenue: Our largest sources of revenue are dues and initiation fees paid by our members. These dues and initiation fees comprised 82.0% of our total revenue for the nine months ended September 30, 2009. We recognize revenue from membership dues in the month when the services are rendered. Approximately 96% of our members pay their monthly dues by Electronic Funds Transfer, or EFT, while the balance is paid annually in advance. We recognize revenue from initiation fees over the expected life of the membership. Prior to April 1, 2009, the expected life of a membership was 30 months. Effective April 1, 2009, we changed our estimated membership life to 28 months. See Note 1 Basis of Presentation to the consolidated financial statements in this Form 10-Q.

Ancillary club revenue: For the nine months ended September 30, 2009, we generated 11.7% of our revenue from personal training and 5.1% of our revenue from other ancillary programs and services consisting of programming for children, group fitness training and other member activities, as well as sales of miscellaneous sports products.

We also receive revenue (approximately 1.0% of our revenue for the nine months ended September 30, 2009) from the rental of space in our facilities to operators who offer wellness-related services such as physical therapy. In addition, we sell in-club advertising

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and sponsorships and generate management fees from certain club facilities that we do not wholly own. We refer to this as Fees and Other revenue.

Our revenues, operating income and net income (loss) for the three months ended September 30, 2009 were \$120.4 million, \$1.4 million and (\$1.5) million, respectively, and \$128.1 million, \$11.6 million and \$3.8 million, respectively, for the three months ended September 30, 2008. Our revenues, operating income and net income for the nine months ended September 30, 2009 were \$371.1 million, \$15.6 million and \$1.7 million, respectively, and \$383.8 million, \$42.1 million and \$15.5 million, respectively, for the nine months ended September 30, 2008.

Our operating and selling expenses are comprised of both fixed and variable costs. Fixed costs include club and supervisory salary and related expenses, occupancy costs, including certain elements of rent, housekeeping and contracted maintenance expenses, as well as depreciation. Variable costs are primarily related to payroll associated with ancillary club revenue, membership sales compensation, advertising, certain facility repairs and club supplies.

General and administrative expenses include costs relating to our centralized support functions, such as accounting, insurance, information systems, purchasing, member relations, legal and consulting fees and real estate development and management expenses.

As clubs mature and increase their membership base, fixed costs are typically spread over an increasing revenue base and operating margins tend to improve. Similarly, as clubs mature and the member base decreases at these clubs, total fixed costs related to the base are spread over a lower revenue amount.

Our primary capital expenditures relate to the construction or acquisition of new club facilities and upgrading and expanding of our existing clubs. The construction and equipment costs vary based on the costs of labor, materials and the planned service offerings and size and configuration of the facility. We perform routine improvements at our clubs and partial replacement of the fitness equipment each year for which we budget approximately 4.0% to 5.0% of projected annual revenue. Expansions of certain facilities are also performed from time to time, when incremental space becomes available on acceptable terms, and utilization and demand for the facility dictate. As we renew and extend leases on older clubs, we often consider committing to upgrades or remodeling at these clubs where we deem it to be appropriate.

In the three months ended March 31, 2009, the Company performed its annual goodwill impairment test. The test was performed as a roll-forward of the December 31, 2008 test. Please refer to Note 5 Goodwill and Intangible Assets to the consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008 for information on the specific assumptions used.

Goodwill impairment testing requires a comparison between the carrying value and fair value of reportable goodwill. If the carrying value exceeds the fair value, goodwill is considered impaired. The amount of the impairment loss is measured as the difference between the carrying value and the implied fair value of goodwill, which is determined using discounted cash flows. The 2009 impairment test supported the recorded goodwill balances and as such no impairment of goodwill was required. The valuation of intangible assets requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows and discount rates. Adverse changes in expected operating results and/or unfavorable changes in other economic factors used to estimate fair values could result in a material non-cash impairment charge in the future. Given the current economic environment and the uncertainties regarding the impact on the Company's business, there can be no assurance that the Company's estimates and assumptions regarding the duration of the ongoing economic downturn, or the period or strength of recovery, made for purposes of the Company's goodwill impairment testing as of March 31, 2009 will prove to be accurate predictions of the future. If the Company's assumptions regarding forecasted revenue or margin growth rates of certain reporting units are not achieved, the Company may be required to record goodwill impairment charges in future periods, whether in connection with the Company's next annual impairment testing in the quarter ending March 31, 2010 or prior to that period, if any such change constitutes a triggering event outside of the quarter from when the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment charge would result. There were no events triggering a review of goodwill for the three months ended September 30, 2009.

Table of Contents**Historical Club Count**

The following table sets forth the changes in our club count during each of the quarters in 2008 and the first three quarters of 2009.

| | Q1 | Q2 | 2008 Q3 | Q4 | Total | Q1 | 2009 Q2 | Q3 |
|--|-----|-----|------------|-----|-------|-----|------------|-----|
| Wholly owned clubs operated at beginning of period | 159 | 160 | 161 | 162 | 159 | 164 | 165 | 164 |
| New clubs opened | 2 | 3 | 1 | 3 | 9 | 4 | | |
| Clubs acquired | | | | | | | | |
| Clubs closed, relocated or merged | (1) | (2) | | (1) | (4) | (3) | (1) | (1) |
| Wholly owned clubs at end of period | 160 | 161 | 162 | 164 | 164 | 165 | 164 | 163 |
| Total clubs operated at end of period (1) | 162 | 163 | 164 | 166 | 166 | 167 | 166 | 165 |

(1) Includes wholly-owned and partly-owned clubs. In addition to the above, as of September 30, 2009 and December 31, 2008, we managed four university fitness clubs in which we did not have an equity interest.

Comparable Club Revenue

We define comparable club revenue as revenue at those clubs that were operated by us for over 12 months and comparable club revenue growth as revenue for the 13th month and thereafter as applicable as compared to the same period in the prior year. Growth in comparable club revenue as compared to the same period in the prior fiscal year has decreased sequentially for each of the three-month periods ended in 2008 and in each of the three-month periods ended March 31, 2009, June 30, 2009 and September 30, 2009. The increase (decrease) in comparable revenue as compared to the same period in the prior fiscal year was as follows:

2008:

| | |
|---------------------------------------|--------|
| Three months ended March 31, 2008 | 4.5% |
| Three months ended June 30, 2008 | 3.2% |
| Three months ended September 30, 2008 | 2.2% |
| Three months ended December 31, 2008 | (1.4)% |

2009:

| | |
|-----------------------------------|--------|
| Three months ended March 31, 2009 | (2.1)% |
|-----------------------------------|--------|

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| | |
|---------------------------------------|--------|
| Three months ended June 30, 2009 | (6.3)% |
| Three months ended September 30, 2009 | (7.0)% |

As shown above, comparable club revenue has been trending downward during 2008 and throughout 2009. This downward trend is expected to continue in the fourth quarter of 2009.

In the three months ended September 30, 2009, membership at our comparable clubs decreased 5.5% as compared to the same period in the prior year. This drop in membership coupled with expected decreases in personal training revenue are expected to result in a further decline in comparable club revenue and therefore operating margins.

Table of Contents**Results of Operations**

The following table sets forth certain operating data as a percentage of revenue for the periods indicated:

| | Three Months | | Nine Months | |
|---|-----------------------------|-------------|-----------------------------|-------------|
| | Ended September 30 , | | Ended September 30 , | |
| | 2009 | 2008 | 2009 | 2008 |
| Revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Operating expenses: | | | | |
| Payroll and related | 39.4 | 38.3 | 39.5 | 38.1 |
| Club operating | 37.9 | 34.7 | 37.1 | 33.5 |
| General and administrative | 6.7 | 6.8 | 6.4 | 6.8 |
| Depreciation and amortization | 11.9 | 10.5 | 11.6 | 10.1 |
| Impairment of fixed assets | 2.9 | 0.7 | 1.2 | 0.5 |
| | 98.8 | 91.0 | 95.8 | 89.0 |
| Operating income | 1.2 | 9.0 | 4.2 | 11.0 |
| Interest expense | 4.5 | 4.5 | 4.3 | 4.7 |
| Interest income | | (0.1) | | (0.1) |
| Equity in the earnings of investees and rental income | (0.4) | (0.5) | (0.4) | (0.4) |
| Income (loss) before provision (benefit) for corporate income taxes | (2.9) | 5.1 | 0.3 | 6.8 |
| Provision (benefit) for corporate income taxes | (1.7) | 2.1 | (0.2) | 2.8 |
| Net income (loss) | (1.2)% | 3.0% | 0.5% | 4.0% |

Total revenue for the three months ended September 30, 2009 decreased \$10.8 million, or 9.1%, at clubs opened for more than 24 months when compared to the same period last year. Total revenue for the nine months ended September 30, 2009 decreased \$26.9 million, or 7.4%, at clubs opened for more than 24 months when compared to the same period last year. Our operating margins decreased to 1.2% and 4.2% in the three and nine months ended September 30, 2009, respectively, from 9.0% and 11%, respectively, in the same periods in the prior year.

Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008

Revenue was comprised of the following for the periods indicated (in 000 s):

| | Three Months Ended September 30, | | | | Variance |
|------------------------------|---|----------------|----------------|----------------|-----------------|
| | 2009 | % | 2008 | % | |
| | Revenue | Revenue | Revenue | Revenue | |
| Membership dues | \$ 95,400 | 79.2% | \$ 101,025 | 78.9% | (5.6)% |
| Initiation fees | 3,113 | 2.6% | 3,505 | 2.7% | (11.2)% |
| Membership revenue | 98,513 | 81.8% | 104,530 | 81.6% | (5.8)% |
| Personal training revenue | 13,526 | 11.2% | 14,871 | 11.6% | (9.0)% |
| Other ancillary club revenue | 7,243 | 6.0% | 7,281 | 5.7% | (0.5)% |

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| | | | | | |
|------------------------|------------|--------|------------|--------|---------|
| Ancillary club revenue | 20,769 | 17.2% | 22,152 | 17.3% | (6.2)% |
| Fees and other revenue | 1,167 | 1.0% | 1,427 | 1.1% | (18.3)% |
| Total revenue | \$ 120,449 | 100.0% | \$ 128,109 | 100.0% | (6.0)% |

For the three months ended September 30, 2009, revenue increased \$5.1 million at the 22 clubs opened or acquired subsequent to September 30, 2007. This increase in revenue was offset by decreases in revenue of 9.1%, or \$10.8 million, at clubs opened or acquired prior to September 30, 2007 and \$2.0 million related to the 11 clubs that were closed subsequent to September 30, 2007.

Comparable club revenue decreased 7.0% for the three months ended September 30, 2009 compared to the same period in the prior year. Of this 7.0% decrease, 3.7% was due to a decrease in membership, 1.3% was due to a decrease in price and 2.0% was due to a decrease in ancillary club revenue and fees and other revenue.

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Fees and other revenue decreased 18.3% for the three months ended September 30, 2009 compared to the same period in the prior year primarily due to a decrease in marketing revenue as we had less demand for our in-club advertising programs.

Operating expenses were comprised of the following for the periods indicated (in 000 s):

| | Three Months Ended | | % Variance |
|-------------------------------|---------------------------|-------------|-------------------|
| | September 30, | | |
| | 2009 | 2008 | |
| Payroll and related | \$ 47,487 | \$ 49,171 | (3.4)% |
| Club operating | 45,589 | 44,398 | 2.7% |
| General and administrative | 8,103 | 8,697 | (6.8)% |
| Depreciation and amortization | 14,353 | 13,423 | 6.9% |
| Impairment of fixed assets | 3,473 | 839 | 313.9% |
| Operating expenses | \$ 119,005 | \$ 116,528 | 2.1% |

Operating expenses for the three months ended September 30, 2009 were impacted by a 0.8% increase in the total months of club operation from 486 to 490 and a 5.7% increase in club member usage as well as the following factors:

Payroll and related. This decrease for the three months ended September 30, 2009 compared to the same period in the prior year was primarily due to a decrease in ancillary club payroll of \$1.2 million directly related to the decrease in ancillary club revenue and a decrease of \$674,000 in club commissions and bonuses related to the decrease in the number of memberships sold.

These decreases were partially offset by increases resulting from the discounting of our new member initiation fees in an effort to drive membership sales. Our payroll costs that we defer are limited to the amount of these initiation fees, thus causing an increase of approximately \$431,000 in payroll expense.

Club operating. This increase was principally attributable to the following:

Rent and occupancy expenses increased \$1.6 million for the three months ended September 30, 2009 compared to the same period in the prior year. Rent and occupancy costs increased \$718,000 at clubs that opened after July 1, 2008 and increased \$1.5 million at our clubs that opened prior to July 1, 2008. Rent and occupancy expenses decreased \$661,000 at our clubs that were closed after July 1, 2008.

Expenses relating to laundry and towels decreased \$695,000 for the three months ended September 30, 2009 compared to the same period in the prior year primarily related to the opening of our laundry facility in Elmsford, NY in January 2009.

General and administrative. This \$594,000 decrease for the three months ended September 30, 2009 compared to the same period in the prior year was principally attributable to a \$430,000 decrease in general liability insurance expense. Our claims activity has been decreasing as a percentage of our revenue, causing a decreased loss trend rate. In addition, we reduced our insurance claims reserves because we have lower claims exposure as a result of a decrease in the number of memberships. The remainder of the expense decrease was due to cost reduction efforts realized within various general and administrative expenses.

Depreciation and amortization. The increase in depreciation and amortization expenses was principally due to the eight clubs that opened after July 1, 2008 as well as the new laundry facility and corporate office in Elmsford, NY, which opened in January 2009.

Impairment of fixed assets. In the three months ended September 30, 2009, we recorded fixed asset impairment charges totaling \$3.5 million, which represented the write-offs of fixed assets at two underperforming clubs. In the nine months ended September 30, 2008, we recorded an impairment loss of \$839,000 on fixed assets related to the planned closure of a club prior to its lease expiration. The impairment loss is included as a separate line in operating income on the consolidated statement of operations.

Table of Contents**Interest Expense**

Interest expense decreased \$405,000, or 7.0%, for the three months ended September 30, 2009 compared to the same period in the prior year. This decrease is primarily a result of the lower variable rate of interest on our Term Loan Facility during the three months ended September 30, 2009. For the three months ended September 30, 2009, the average variable interest rate was 2.1% as compared to 4.3% for the three months ended September 30, 2008.

Provision for Corporate Income Taxes

We have determined our income tax provision for September 30, 2009 on a discrete basis based on the results for the first nine months of 2009. We could not reliably estimate our 2009 effective annual tax rate because minor changes in our annual estimated income before provision for corporate income taxes (pre-tax results) could have a significant impact on our annual estimated effective tax rate. Accordingly, we calculated our effective tax rate based on pre-tax results through the nine months ended September 30, 2009.

We recorded a benefit for corporate income taxes of \$2.0 million for the three months ended September 30, 2009 compared to a provision of \$2.7 million for the three months ended September 30, 2008. The Company's effective tax rate decreased from 41% in the nine months ended September 30, 2008 to (57.7)% in the nine months ended September 30, 2009. Because of the reduction in pre-tax book income, the expected benefits from our Captive Insurance arrangement are giving rise to a tax benefit and negative effective tax rate.

Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008

Revenue was comprised of the following for the periods indicated (in 000 s):

| | Nine Months Ended September 30, 2009 | | 2008 | | Variance |
|------------------------------|---|--------|------------|--------|----------|
| | Revenue | % | Revenue | % | |
| Membership dues | \$ 294,465 | 79.4% | \$ 301,696 | 78.6% | (2.4)% |
| Initiation fees | 9,622 | 2.6% | 10,393 | 2.7% | (7.4)% |
| Membership revenue | 304,087 | 82.0% | 312,089 | 81.3% | (2.6)% |
| Personal training revenue | 43,696 | 11.7% | 47,712 | 12.4% | (8.4)% |
| Other ancillary club revenue | 19,587 | 5.3% | 19,517 | 5.1% | 0.4% |
| Ancillary club revenue | 63,283 | 17.0% | 67,229 | 17.5% | (5.9)% |
| Fees and other revenue | 3,700 | 1.0% | 4,504 | 1.2% | (17.9)% |
| Total revenue | \$ 371,070 | 100.0% | \$ 383,822 | 100.0% | (3.3)% |

Revenue decreased 3.3%, to \$371.1 million for the nine months ended September 30, 2009 from \$383.8 million for the nine months ended September 30, 2008. This decrease in revenue was driven primarily by a decline in membership revenue and ancillary club revenue. For the nine months ended September 30, 2009, revenues increased \$19.4 million as compared to the nine months ended September 30, 2008 at the 22 clubs opened or acquired subsequent to September 30, 2007. For the nine months ended September 30, 2009, revenue decreased 7.4% or \$26.5 million at our clubs opened or acquired prior to September 30, 2007 and \$5.6 million at the 11 clubs that were closed subsequent to September 30, 2007.

Comparable club revenue decreased 5.1% for the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. Of this 5.1% decrease, 1.8% was due to a decrease in membership, 1.3% was due to a decrease in price and 2.0% was due to a decrease in ancillary club revenue and fees and other revenue.

Effective April 1, 2009, we changed the estimated life of our memberships from 30 months to 28 months. The change in estimated membership life is principally due to an unfavorable trend in membership retention rates, and it has the effect of increasing initiation fees revenue recognized in the current period because a shorter amortization period is being applied resulting in a \$758,000 increase in initiation fee revenue recognized when compared to the

same period in the prior year.

Fees and other revenue decreased 17.9% in the nine months ended September 30, 2009 compared to the same period in the prior year primarily due to a decrease in marketing revenue from less demand for our in-club advertising programs.

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Operating expenses were comprised of the following for the periods indicated (in 000 \$):

| | Nine Months Ended September | | % Variance |
|-------------------------------|------------------------------------|-------------------|-----------------------|
| | 30, | | |
| | 2009 | 2008 | |
| Payroll and related | \$ 146,480 | \$ 146,228 | 0.2% |
| Club operating | 137,499 | 128,799 | 6.8% |
| General and administrative | 23,938 | 25,898 | (7.6)% |
| Depreciation and amortization | 42,995 | 38,788 | 10.8% |
| Impairment of fixed assets | 4,604 | 1,981 | 132.4% |
| Operating expenses | \$ 355,516 | \$ 341,694 | 4.0% |

Operating expenses for the nine months ended September 30, 2009 were impacted by a 2.6% increase in the total months of club operation from 1,446 to 1,484 and a 9.9% increase in club member usage as well as the following factors:

Payroll and related. This slight increase was primarily due to the discounting of our new member initiation fees in an effort to drive membership sales. Our payroll costs that we defer are limited to the amount of these initiation fees, thus causing an increase of approximately \$4.3 million in payroll expense. Adding to this increase was the change in estimated membership life from 30 months to 28 months, effective April 1, 2009, which resulted in an increase in payroll expense of \$715,000. Also adding to this was an increase in severance charges of \$503,000 principally related to a reduction in force in January 2009.

These increases were partially offset by a decrease in management incentive bonuses of \$888,000 in the nine months ended September 30, 2009. In addition, there was a decrease in ancillary club payroll of \$2.7 million directly related to the decrease in ancillary club revenue and a decrease of \$2.3 million in club commissions and bonuses related to the decrease in the number of memberships sold.

Club operating. This change was primarily impacted by the following:

Rent and occupancy expenses increased \$6.9 million. Rent and occupancy costs increased \$4.3 million at clubs that opened after January 1, 2008 and increased \$2.3 million at our clubs that opened prior to January 1, 2008. In addition, we recorded early lease termination costs of \$811,000 in the nine months ended September 30, 2009, at three clubs that were closed prior to their lease expiration dates. Adding to this was \$700,000 of damages recorded in June 2009 granted to a landlord of one of TSI LLC's former health clubs, resulting from a lawsuit in state court against it and two of its health club subsidiaries alleging, among other things, breach of lease in connection with the decision to close the club and leasing space in another facility nearby. See Note 9 Commitments and Contingencies to the consolidated financial statements in this Form 10-Q. Rent and occupancy expenses decreased \$1.0 million, before rent penalties, at our clubs that were closed after January 1, 2008.

Electric, gas and oil expenses increased \$756,000 primarily due to the 13 clubs that opened after January 1, 2008 as well as the new laundry facility in Elmsford, NY.

Expenses relating to laundry and towels decreased \$630,000 primarily related to the opening of our laundry facility in Elmsford, NY in January 2009.

General and administrative. This decrease was principally attributable to a \$1.3 million decrease in general liability insurance expense. Our claims activity has been decreasing as a percentage of our revenue, causing a decreased loss trend rate. In addition, we reduced our insurance reserves because we have lower claims exposure as a result of a decrease in the number of memberships. The remainder of the expense decrease was due to cost reduction efforts realized within various general and administrative expenses.

Depreciation and amortization. The increase in depreciation and amortization expenses was principally due to the 13 clubs that opened after January 1, 2008 as well as the new laundry facility and corporate office in Elmsford, NY, which opened in January 2009.

Impairment of fixed assets. In the nine months ended September 30, 2009, we recorded fixed asset impairment charges totaling \$4.6 million, which represented the write-offs of fixed assets at six underperforming clubs. During the nine months ended

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September 30, 2008, we recorded an impairment loss of \$755,000 on fixed assets of a remote club that did not benefit from being part of a regional cluster and did not sustain profitable membership levels given the competition in its market and \$1.2 million related to the planned closures of two clubs prior to their lease expiration dates.

Interest Expense

Interest expense decreased \$2.0 million, or 11.1%, for the nine months ended September 30, 2009 compared to the same period in the prior year. This decrease is a result of the lower variable rate of interest on our Term Loan Facility during the nine months ended September 30, 2009 period. For the nine months ended September 30, 2008, the average variable interest rate was approximately 5.5%, while the average variable interest rate for the nine months ended September 30, 2009 decreased to approximately 2.2%.

Provision for Corporate Income Taxes

We have determined our income tax provision for the nine months ended September 30, 2009 on a discrete basis. We could not reliably estimate our 2009 effective annual tax rate because minor changes in our annual estimated income before provision for corporate income taxes (pre-tax results) could have a significant impact on our annual estimated effective tax rate. Accordingly, we calculated our effective tax rate based on pre-tax results through the nine months ended September 30, 2009.

We recorded a benefit for corporate income taxes of \$614,000 for the nine months ended September 30, 2009 compared to a provision of \$10.7 million for the nine months ended September 30, 2008. The Company's effective tax rate decreased from 41% in the nine months ended September 30, 2008 to (57.7)% in the nine months ended September 30, 2009. Because of the reduction in pre-tax book income, the expected benefits from our Captive Insurance arrangement are giving rise to a tax benefit and negative effective tax rate.

Liquidity and Capital Resources

Historically, we have satisfied our liquidity needs through cash generated from operations and various borrowing arrangements. Principal liquidity needs have included the acquisition and development of new clubs, debt service requirements and other capital expenditures necessary to upgrade, expand and renovate existing clubs.

Operating Activities. Net cash provided by operating activities for the nine months ended September 30, 2009 was \$58.8 million compared to \$76.3 million for the nine months ended September 30, 2008. This \$17.5 million decrease is primarily related to the decrease in overall earnings.

In the nine months ended September 30, 2009, deferred revenue decreased \$5.0 million, while in the nine months ended September 30, 2008, there was an increase of \$1.1 million. This decrease in cash generated by deferred revenue was driven by the movement in deferred personal training and deferred initiation fees. Changes in timing differences related to vendor payments resulted in a decrease in operating cash flow of approximately \$3.7 million when comparing the nine months ended September 30, 2009 compared to the same period in the prior year. Cash paid for taxes, net of refunds, decreased \$16.4 million.

On August 1, 2009, the first semi-annual payment of interest on the 11% Senior Discount Notes of \$7.6 million was paid at the stated annual rate of 11% of principal. Payments are due semi-annually on February 1 and August 1. As of September 30, 2009 the related accrued amount was \$2.5 million compared to \$0 as of September 30, 2008. Total cash paid for interest increased \$4.6 million for the nine months ended September 30, 2009 compared to the same period in the prior year.

Investing Activities. Our investing activities consist primarily of construction of new clubs and the purchase of new fitness equipment. In addition, we make capital expenditures to expand and remodel our existing clubs. We finance construction and the purchase of equipment by using cash generated by operations and various borrowing arrangements. Net cash used in investing activities was \$39.8 million and \$62.1 million for the nine months ended September 30, 2009 and 2008, respectively. For the year ending December 31, 2009, we estimate that we will invest approximately \$53.0 million in capital expenditures. This amount includes \$16.3 million of growth capital expenditures primarily related to clubs added in 2008 and 2009, \$23.4 million to continue to upgrade existing clubs, \$8.8 million to enhance our management information systems and \$4.5 million for the construction of corporate offices and the completion of our new regional laundry facility in our New York Sports Clubs market. These expenditures will be funded by cash flow provided by operations, available cash on hand and, to the extent needed, borrowings from the Revolving Loan Facility.

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Financing Activities. Net cash used in financing activities increased \$8.4 million to \$17.5 million for the nine months ended September 30, 2009 from \$9.1 million for the same period in the prior year. In the first quarter of 2009, we repurchased 2.1 million shares of common stock at a cost of \$5.4 million. In addition, we had net repayments on the Revolving Loan Facility of \$10.2 million compared with \$9.0 million in the nine months ended September 30, 2008 and proceeds from the exercise of stock options decreased \$1.2 million.

As of September 30, 2009, our total consolidated debt was \$327.6 million. This substantial amount of debt could have significant consequences, including:

making it more difficult to satisfy our obligations;

increasing our vulnerability to general adverse economic conditions;

limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions of new clubs and other general corporate requirements;

requiring cash flow from operations for the payment of interest on our credit facility and our 11% Senior Discount Notes and reducing our ability to use our cash flow to fund working capital, capital expenditures, acquisitions of new clubs and general corporate requirements; and

limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.

These limitations and consequences may place us at a competitive disadvantage to other less-leveraged competitors.

On February 27, 2007, TSI Holdings and TSI LLC entered into the 2007 Senior Credit Facility. The 2007 Senior Credit Facility consists of the Term Loan Facility and the Revolving Loan Facility.

As of September 30, 2009, TSI LLC had \$180.4 million outstanding under the Term Loan Facility. Borrowings under the Term Loan Facility, at TSI LLC's option, bear interest at either the administrative agent's base rate plus 0.75% or its Eurodollar rate plus 1.75%, each as defined in the 2007 Senior Credit Facility. As of September 30, 2009, TSI LLC had elected the Eurodollar rate option, equal to 2.1% as of September 30, 2009. Interest calculated under the base rate option would have equaled 4.0% as of September 30, 2009, if TSI LLC had elected this option.

The Term Loan Facility matures on the earlier of February 27, 2014, or August 1, 2013 if the 11% Senior Discount Notes are still outstanding as of that date. TSI LLC is required to repay 0.25% of principal, or \$462,500, per quarter. Total principal payments of \$4.6 million have been made as of September 30, 2009.

The Revolving Loan Facility expires on February 27, 2012 and borrowings under the facility currently, at TSI LLC's option, bear interest at either the administrative agent's base rate plus 1.25% or its Eurodollar rate plus 2.25%, each as defined in the 2007 Senior Credit Facility. TSI LLC's applicable base rate and Eurodollar rate margins, and commitment commission percentage, vary with our consolidated secured leverage ratio, as defined in the 2007 Senior Credit Facility. TSI LLC is required to pay a commitment fee of 0.50% per annum on the daily unutilized amount. As of September 30, 2009, there were \$8.8 million of borrowings outstanding at the base interest rate option of 4.5%. There were outstanding letters of credit issued at that date of \$14.2 million. The unutilized portion of the Revolving Loan Facility as of September 30, 2009 was \$40.7 million. As a result of an amendment to the 2007 Senior Credit Facility on July 15, 2009 (the Amendment), the total amount of borrowings under the Revolving Loan Facility was reduced by 15% from \$75.0 million to \$63.8 million. Additionally, the Company incurred an aggregate of approximately \$615,000 in fees and expenses related to the Amendment. See Note 3 Long-Term Debt to the Company's consolidated financial statements in this Form 10-Q for further details.

As of September 30, 2009, we were in compliance with the debt covenants in the 2007 Senior Credit Facility and given our operating plans and expected performance for 2009, we expect we will continue to be in compliance during the remainder of 2009. The Revolving Loan Facility contains a maximum total leverage covenant ratio of 4.25:1.00, which covenant is subject to compliance, on a consolidated basis, only during the period in which borrowings and letters of credit are outstanding thereunder. As of September 30, 2009, the Company's leverage ratio, as defined under the Amendment, was 2.25:1.00. These covenants may limit TSI LLC's ability to incur additional debt. As of

September 30, 2009, permitted aggregate borrowing capacity of \$63.8 million was not restricted by the covenants.

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We do not have plans to repurchase our debt. The terms of our 2007 Senior Credit Facility significantly restrict our ability to repurchase our 11% Senior Discount Notes or repurchase a portion of the outstanding Term Loan.

The terms of the indenture governing our 11% Senior Discount Notes and the 2007 Senior Credit Facility significantly restrict, or prohibit, the payment of dividends by us. Our subsidiaries are permitted under the 2007 Senior Credit Facility and the indenture governing our 11% Senior Discount Notes to incur additional indebtedness that may severely restrict or prohibit the payment of dividends by such subsidiaries to us. Our substantial leverage may impair our financial condition and we may incur significant additional debt. For further information regarding our 11% Senior Discount Notes and our 2007 Senior Credit Facility, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

As of September 30, 2009, we had an aggregate principal amount of \$138.45 million of 11% Senior Discount Notes outstanding.

As of September 30, 2009, we had \$12.0 million of cash and cash equivalents.

The aggregate long-term debt and operating lease obligations as of September 30, 2009 were as follows:

| Contractual Obligations | Total | Payments Due by Period (in (000) s) | | | |
|---|---------------------|--|-------------------|-------------------|----------------------|
| | | Less than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
| Long-Term Debt | \$ 327,625 | \$ 10,650 | \$ 3,700 | \$ 313,275 | \$ |
| Operating Lease Obligations(1) | 833,156 | 81,347 | 159,127 | 143,395 | 449,287 |
| Total Contractual Cash Obligations | \$ 1,160,781 | \$ 91,997 | \$ 162,827 | \$ 456,670 | \$ 449,287 |

Notes:

(1) Operating lease obligations include base rent only. Certain leases provide for additional rent based on real estate taxes, common area maintenance and defined amounts based on the operating results of the lessee.

The following long-term liabilities included on the consolidated balance sheet are excluded from the table above: income taxes (including uncertain tax positions), insurance accruals and other accruals. The Company is unable to estimate the timing of payments for these items.

Throughout the nine months ended September 30, 2009, the ongoing U.S. and global economic recession has resulted in additional significant pressures and declines in consumer confidence and economic growth. These economic conditions have led to reduced consumer spending and have contributed to an increase in member cancellations, decreases in new memberships and reductions in revenue from ancillary services and marketing. These economic conditions could continue to adversely affect our industry, business and results of operations.

These economic conditions have also resulted in a tightening of the credit markets, including lending by financial institutions, which are the source of credit for our borrowing and a source of our liquidity. It is difficult to predict how long the current economic and capital and credit market conditions will continue; however, if current levels of economic and capital and credit market volatility continue or worsen, there can be no assurance that we will not experience further adverse impact, which may be material to our business and therefore our results of operations and liquidity, including our ability to borrow under the Revolving Loan Facility. An affiliate of CIT Group Inc., The CIT Group Equipment Finance Inc., is one of the lenders under the Revolving Credit Facility, having provided a commitment of \$4.3 million of the \$63.8 million. On October 2, 2009, CIT Group Inc. filed a current report on Form 8-K with the SEC, reporting that it was soliciting bondholders and other holders of CIT debt to approve a prepackaged plan of reorganization. According to CIT, in this process, CIT Bank and CIT's operating entities would not file for bankruptcy, which would allow CIT to continue to service its customers. It is not certain whether CIT will honor its commitment to make loans under the Revolving Credit Facility or whether another lender under the Revolving Credit Facility might assume CIT's commitment. Consequently, our ability to borrow under the Revolving Loan Facility may be adversely impacted.

Our Term Loan Facility matures on the earlier of February 27, 2014, or August 1, 2013 if the 11% Senior Discount Notes are still outstanding as of that date and the Revolving Loan will mature in 2012. Our 11% Senior Discount Notes will mature in 2014. We expect to refinance our outstanding indebtedness under these arrangements with new indebtedness prior to their maturity dates. The

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availability of refinancing will depend on a variety of factors, such as economic and market conditions, business performance, the availability of credit and our credit ratings, as well as the lenders' perception of the prospects of our company or our industry generally. We may not be able to successfully obtain any necessary refinancing on favorable terms or at all. In that event, our business and financial condition may be materially adversely affected.

In recent years, we have typically operated with a working capital deficit. We had a working capital deficit of \$57.1 million at September 30, 2009, as compared with \$55.6 million at September 30, 2008. Major components of our working capital deficit on the current liability side are deferred revenues, accrued expenses (including, among others, accrued construction in progress and equipment, payroll and occupancy costs) and the current portion of long-term debt. These current liabilities more than offset the main current assets, which consist of cash and cash equivalents, accounts receivable, and prepaid expenses and other current assets. Payments underlying the current liability for deferred revenue are generally not held as cash and cash equivalents, but rather are used for the Company's business needs, including financing and investing commitments, which use contributes to the working capital deficit. The deferred revenue liability relates to dues and services paid-in-full in advance and initiation fees paid at the time of enrollment and totaled \$38.3 million and \$40.3 million at September 30, 2009 and December 31 2008, respectively. Initiation fees received are deferred and amortized over a 28-month period, which represents the estimated membership life of a club member. Prepaid dues are generally realized over a period of up to twelve months, while fees for prepaid services normally are realized over a period of one to nine months. In periods when we increase the number of clubs open and consequently increase the level of payments received in advance, we anticipate that we will continue to have deferred revenue balances at levels similar to or greater than those currently maintained. By contrast, any decrease in demand for our services or reductions in initiation fees collected would have the effect of reducing deferred revenue balances, which would likely require us to rely more heavily on other sources of funding. The Company's club growth plans have slowed from net club openings of five in 2008 to net club closures of two in 2009. This decrease in number of clubs is expected to result in a decrease in the working capital deficit. In addition, there has been a decrease in both personal training and initiation fees, which has also contributed to decreased deferred revenue. In either case, a significant portion of the deferred revenue does not constitute a liability that must be funded with cash. At the time a member joins our club, we incur enrollment costs which are deferred over 28 months. These costs are recorded as a long-term asset and as such, do not offset the working capital deficit. We expect to record a working capital deficit in future periods and, as in the past, will fund such deficit using cash flows from operations and borrowings under our 2007 Senior Credit Facility or other credit facilities, which resources we believe will be sufficient to cover such deficit.

On April 29, 2008, the Board of Directors approved a plan to repurchase up to an aggregate of \$25.0 million of the Company's common stock through December 31, 2009. The repurchases will be made from time to time in the open market at prevailing market prices, through privately negotiated transactions as conditions permit, or pursuant to a 10b5-1 plan adopted by the Company which permits the Company to repurchase its shares during periods in which the Company may be in possession of material non-public information. The stock repurchase program may be modified, extended or terminated by the Board of Directors at any time. As of March 31, 2009, the Company had repurchased a total of 3.9 million shares at a total cost of \$10.0 million. There were no repurchases made in the three months ended September 30, 2009 or June 30, 2009.

Recent Changes in or Recently Issued Accounting Pronouncements

See Note 2 – Recent Accounting Changes to the consolidated financial statements in this Form 10-Q.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding future financial results and performance, potential sales revenue, legal contingencies and tax benefits, and the existence of adverse litigation and other risks, uncertainties and factors set forth under Item 1A., entitled "Risk Factors", in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and in our other reports and documents filed with the SEC. These statements are subject to various risks and uncertainties, many of which are outside our control, including, among others, the level of market demand for our services, economic conditions affecting the Company's business, the geographic concentration of the Company's clubs,

competitive pressure, the ability to achieve reductions in operating costs and to continue to integrate acquisitions, environmental matters, any security and privacy breached involving customer data, the levels and terms of the Company's indebtedness, and other specific factors discussed herein and in other SEC filings by us (including our reports on Form 10-K and 10-Q filed with the SEC). We believe that all forward-looking statements are based on reasonable assumptions when made; however, we caution that it is impossible to predict actual results or outcomes or the effects of risks, uncertainties or other factors on anticipated results or outcomes and that, accordingly, one should not place undue reliance on these statements. Forward-looking statements speak only as of the date

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they were made, and we undertake no obligation to update these statements in light of subsequent events or developments. Actual results may differ materially from anticipated results or outcomes discussed in any forward-looking statement.

ITEM 3. *Quantitative and Qualitative Disclosures About Market Risk*

Our debt consists of both fixed and variable rate debt facilities. As of September 30, 2009 and December 31, 2008, a total of \$180.4 million and \$181.8 million, respectively, of our debt consisted of the Term Loan Facility for which borrowings are subject to variable interest rates. Borrowings under this Term Loan Facility are for periods of one, two, three or nine months in the case of Eurodollar borrowings and no minimum period in the case of base rate borrowings, and upon each continuation of an interest period related to a Eurodollar borrowing the interest rate is reset and each interest rate would be considered variable. If short-term interest rates had increased by 100 basis points for the three and nine months ended September 30, 2009, our interest expense would have increased by approximately \$462,000 and \$1.4 million, respectively. These amounts are determined by considering the impact of the hypothetical interest rates on our debt balance during this period.

For additional information concerning the terms of our fixed-rate debt, see Note 7 Long-Term Debt to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008 filed with the SEC.

ITEM 4. *Controls and Procedures.*

Evaluation of Disclosure Controls and Procedures: We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that the information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired controls.

As of September 30, 2009, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2009, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting: There were no changes in our internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****ITEM 1. *Legal Proceedings.***

On or about March 1, 2005, in an action styled *Sarah Cruz, et al v. Town Sports International, d/b/a New York Sports Club*, plaintiffs commenced a purported class action against the Company in the Supreme Court, New York County, seeking unpaid wages and alleging that TSI LLC violated various overtime provisions of the New York State Labor Law with respect to the payment of wages to certain trainers and assistant fitness managers. On or about November 2, 2005, the complaint and the lawsuit were stayed upon agreement of the parties pending mediation. On or about November 28, 2006, the plaintiffs gave notice that they wished to lift the stay. On or about June 18, 2007, the same plaintiffs commenced a second purported class action against the Company in the Supreme Court of the State of New York, New York County, seeking unpaid wages and alleging that TSI, LLC violated various wage payment and overtime provisions of the New York State Labor Law with respect to the payment of wages to all New York purported hourly employees. While we are unable at this time to estimate the likelihood of an unfavorable outcome or the potential loss to the Company in the event of such an outcome, we intend to contest this case vigorously. Depending upon the ultimate outcome, this matter may have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

On September 14, 2009, the staff of the SEC advised the Company that a formal order of private investigation had been issued with respect to the Company. Since May 2008, the Company has been providing documents and testimony on a voluntary basis in response to an informal inquiry by the staff of the SEC, which primarily relates to the deferral of certain payroll costs incurred in connection with the sale of memberships in the Company's health and fitness clubs and the time period utilized by the Company for the amortization of (i) such deferred costs into expense and (ii) initiation fees into revenue. The Company intends to cooperate fully with the staff of the SEC. The Company cannot predict the outcome of, or the timeframe for, the conclusion of this investigation.

On September 22, 2009, in an action styled *Town Sports International, LLC v. Ajilon Solutions, a division of Ajilon Professional Staffing LLC (Supreme Court of the State of New York, New York County, 602911-09)*, TSI LLC brought an action in the Supreme Court of the State of New York, New York County, against Ajilon Solutions Professional Staffing LLC (Ajilon) for breach of contract, conversion and replevin, seeking, among other things, money damages against Ajilon for breaching its agreement to design and deliver to TSI LLC a new sports club enterprise management system known as GIMS, including failing to provide copies of the computer source code, related documentation, properly identified requirements documents and other property owned and licensed by TSI LLC. On October 2, 2009, TSI LLC moved for injunctive relief, demanding that Ajilon turn over the materials and work product needed for the project so that TSI LLC can evaluate the status of the project and plan for its completion. On October 15, 2009, the court ruled on the TSI LLC's motion for injunctive relief and ordered Ajilon to provide certain materials created in connection with the project and reserved judgment on other aspects of TSI LLC's request. On October 14, 2009, Ajilon brought a counterclaim against TSI LLC for breach of contract, alleging, among other things, failure to pay outstanding invoices in the amount of \$2.9 million plus other damages. The Company intends to vigorously defend these allegations and claims. To date, the Company has paid Ajilon \$9.6 million and has accrued \$2.9 million in accrued expenses on the Company's consolidated balance sheet based on invoices relating to the GIMS project received to date. The Company currently is in the process of assessing the scope of the work on GIMS completed by Ajilon, the amounts as well as the time frame and other resources required to complete GIMS, and the extent, if any, to which work on GIMS may have to be remediated. The Company cannot yet determine the extent of any potential negative effect on its operations if it fails to complete GIMS or if, once completed, GIMS fails to operate as expected.

In addition to the litigation discussed above, we are involved in various other lawsuits, claims and proceedings incidental to the ordinary course of business. See, e.g., Note 9 - Commitments and Contingencies to the consolidated financial statements in this Form 10-Q. The results of litigation are inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in diversion of significant resources. The results of these other lawsuits, claims and proceedings cannot be predicted with certainty. We believe, however, that the ultimate resolution of these current matters will not have a material adverse effect on our financial statements taken as a whole.

Item 1A. *Risk Factors*

There have not been any material changes to the information related to the ITEM 1A. Risk Factors disclosure in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

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ITEM 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

Not applicable.

ITEM 3. *Defaults Upon Senior Securities.*

Not applicable.

ITEM 4. *Submission of Matters to a Vote of Security Holders*

Not applicable.

ITEM 5. *Other Information.*

Not applicable.

Item 6. *Exhibits*

Required exhibits are listed in the Index to Exhibits and are incorporated herein by reference.

From time to time we may use our Web site as a channel of distribution of material company information. Financial and other material information regarding the Company is routinely posted on and accessible at <http://corporate.mysportsclubs.com>. In addition, you may automatically receive email alerts and other information about us by enrolling your email by visiting the Email Alert section at <http://corporate.mysportsclubs.com/>.

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SIGNATURES

Pursuant to requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TOWN SPORTS INTERNATIONAL
HOLDINGS, INC.

DATE: October 28, 2009

By: /s/ Dan Gallagher
Dan Gallagher
Chief Financial Officer
*(principal financial and accounting
officer)*

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INDEX TO EXHIBITS

The following is a list of all exhibits filed or furnished as part of this report:

| Exhibit No. | Description of Exhibit |
|--------------------|---|
| 3.1 | Amended and Restated Certificate of Incorporation of Town Sports International Holdings, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006). |
| 3.2 | Second Amended and Restated By-laws of the Company (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K, filed on May 19, 2008). |
| 10.3 | First Amendment to Credit Agreement, dated as of July 15, 2009, among Town Sports International Holdings, Inc., Town Sports International, LLC, as the borrower, the lenders from time to time party to the Credit Agreement, dated as of February 27, 2007, and Deutsche Bank Trust Company Americas, as administrative agent for the lenders (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on July 17, 2009). |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |