

# TOWN SPORTS INTERNATIONAL HOLDINGS INC

## FORM 10-Q (Quarterly Report)

Filed 11/01/07 for the Period Ending 09/30/07

Address	5 PENN PLAZA 4TH FLOOR NEW YORK, NY 10001
Telephone	(212) 246-6700
CIK	0001281774
Symbol	CLUB
SIC Code	7997 - Membership Sports and Recreation Clubs
Industry	Recreational Activities
Sector	Services
Fiscal Year	12/31

## Table of Contents

---

---

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, 2007

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" Exchange Act Rule 12b-2. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2 of the Exchange Act).  
Yes  No

As of October 31, 2007 there were 26,239,653 shares Common of Stock of the Registrant outstanding.

---

---

**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES**

**FORM 10-Q**

**For the Quarter Ended September 30, 2007**

**INDEX**

	<u>Page</u>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Balance Sheets as of December 31, 2006 and September 30, 2007	3
Condensed Consolidated Statements of Operations and Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2006 and 2007	4
Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2006 and 2007	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3. Quantitative and Qualitative Disclosures About Market Risk	20
Item 4. Controls and Procedures	20
<b>PART II. OTHER INFORMATION</b>	
Item 1. Legal Proceedings	21
Item 1A. Risk Factors	21
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	21
Item 3. Defaults upon Senior Securities	21
Item 4. Submission of Matters to a Vote of Security Holders	22
Item 5. Other Information	22
Item 6. Exhibits	23
SIGNATURES	24
EX-10.1: LETTER AGREEMENT	
EX-10.2: AMENDMENT NO. 1 TO 2004 COMMON STOCK OPTION PLAN	
EX-10.3: FORM OF NON-QUALIFIED STOCK OPTION AGREEMENT	
EX-31.1: CERTIFICATION	
EX-31.2: CERTIFICATION	
EX-32.1: CERTIFICATION	
EX-32.2: CERTIFICATION	

## TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

December 31, 2006 and September 30, 2007

(All figures in \$'000s, except share data)

(Unaudited)

	December 31, 2006	September 30, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,810	\$ 7,669
Accounts receivable (less allowance for doubtful accounts of \$2,026 and \$2,986 as of December 31, 2006 and September 30, 2007, respectively)	8,028	12,263
Inventory	435	225
Prepaid expenses and other current assets	14,757	14,923
Total current assets	30,030	35,080
Fixed assets, net	281,606	324,389
Goodwill	50,112	50,139
Intangible assets, net	922	574
Deferred tax asset, net	32,437	42,215
Deferred membership costs	15,703	17,537
Other assets	12,717	12,841
Total assets	<u>\$ 423,527</u>	<u>\$ 482,775</u>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Current portion of long-term debt	\$ 181	\$ 1,898
Accounts payable	9,972	15,709
Accrued expenses	33,220	40,983
Accrued interest	3,466	737
Corporate income taxes payable	2,577	2,028
Deferred revenue	38,980	44,522
Total current liabilities	88,396	105,877
Long-term debt	280,948	302,394
Deferred lease liabilities	54,929	59,086
Deferred revenue	5,807	6,868
Other liabilities	11,276	14,907
Total liabilities	441,356	489,132
Commitments and contingencies (Note 9)		
Stockholders' deficit:		
Common stock, \$.001 par value; issued and outstanding 25,975,948 and 26,239,653 shares at December 31, 2006 and September 30, 2007, respectively	26	26
Paid-in capital	(21,068)	(17,396)
Accumulated other comprehensive income (currency translation adjustment)	539	698
Retained earnings	2,674	10,315
Total stockholders' deficit	(17,829)	(6,357)
Total liabilities and stockholders' deficit	<u>\$ 423,527</u>	<u>\$ 482,775</u>

See notes to the condensed consolidated financial statements.

## TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the three and nine months ended September 30, 2006 and 2007

(All figures in \$'000s except share and per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2007	2006	2007
<b>Revenues:</b>				
Club operations	\$ 108,173	\$ 117,425	\$ 318,755	\$ 349,893
Fees and other	1,245	1,461	4,158	4,148
	<u>109,418</u>	<u>118,886</u>	<u>322,913</u>	<u>354,041</u>
<b>Operating Expenses:</b>				
Payroll and related	39,724	43,331	121,211	132,645
Club operating	37,677	42,360	108,928	119,662
General and administrative	6,668	8,368	22,635	25,248
Depreciation and amortization	10,125	10,950	30,911	33,772
	<u>94,194</u>	<u>105,009</u>	<u>283,685</u>	<u>311,327</u>
Operating income	15,224	13,877	39,228	42,714
Loss on extinguishment of debt	7,446	—	16,113	12,521
Interest expense	7,388	6,493	28,471	19,902
Interest income	(475)	(344)	(1,862)	(882)
Equity in the earnings of investees and rental income	(463)	(447)	(1,371)	(1,351)
Income (loss) before provision (benefit) for corporate income taxes	1,328	8,175	(2,123)	12,524
Provision (benefit) for corporate income taxes	543	3,100	(121)	4,884
Net income (loss)	<u>\$ 785</u>	<u>\$ 5,075</u>	<u>\$ (2,002)</u>	<u>\$ 7,640</u>
<b>Earnings (loss) per share:</b>				
Basic	\$ 0.03	\$ 0.19	\$ (0.09)	\$ 0.29
Diluted	\$ 0.03	\$ 0.19	\$ (0.09)	\$ 0.29
<b>Weighted average number of shares used in calculating earnings (loss) per share:</b>				
Basic	25,933,506	26,225,449	21,669,090	26,122,531
Diluted	26,345,601	26,678,939	21,669,090	26,583,782
<b>Statements of Comprehensive Income (Loss)</b>				
Net income (loss)	\$ 785	\$ 5,075	\$ (2,002)	\$ 7,640
Foreign currency translation adjustments	(53)	(171)	115	(183)
Comprehensive income (loss)	<u>\$ 732</u>	<u>\$ 4,904</u>	<u>\$ (1,887)</u>	<u>\$ 7,457</u>

See notes to the condensed consolidated financial statements.

**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the nine months ended September 30, 2006 and 2007**  
**(All figures in \$'000s)**  
**(Unaudited)**

	Nine Months Ended September 30,	
	2006	2007
Cash flows from operating activities:		
Net income (loss)	\$ (2,002)	\$ 7,640
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	30,911	33,772
Non-cash interest expense on Senior Discount Notes	11,480	9,268
Loss on extinguishment of debt	16,113	12,521
Payment of interest on Payment-in-Kind Notes	(12,961)	—
Amortization of debt issuance costs	1,117	630
Noncash rental expense, net of noncash rental income	65	495
Compensation expense incurred in connection with stock options	961	616
Net changes in certain operating assets and liabilities	15,228	3,168
Increase in deferred tax asset	(5,887)	(9,778)
Landlord contributions to tenant improvements	6,413	3,958
Change in reserve for self-insured liability claims	2,025	2,085
Increase in deferred membership costs	(3,752)	(1,834)
Other	(76)	215
Total adjustments	<u>61,637</u>	<u>55,116</u>
Net cash provided by operating activities	<u>59,635</u>	<u>62,756</u>
Cash flows from investing activities:		
Capital expenditures, net of effect of acquired business	(41,354)	(64,580)
Acquisition of business	(819)	(4,450)
Net cash used in investing activities	<u>(42,173)</u>	<u>(69,030)</u>
Cash flows from financing activities:		
Proceeds from New Credit Facility	—	185,000
Costs related to issuance of New Credit Facility	—	(2,634)
Repayment of Senior Notes	(128,684)	(169,999)
Premium paid on extinguishment of debt and related costs	(13,273)	(9,309)
Proceeds from initial public equity offering, net of underwriting discounts and offering costs	91,750	—
Repayment of long term borrowings	(2,733)	(1,105)
Change in book overdraft	(986)	2,122
Repurchase of common stock	(433)	—
Proceeds from exercise of stock options	124	1,997
Excess tax benefit from stock option exercises	—	1,061
Net cash provided by (used in) financing activities	<u>(54,235)</u>	<u>7,133</u>
Net increase (decrease) in cash and cash equivalents	<u>(36,773)</u>	<u>859</u>
Cash and cash equivalents at beginning of period	<u>51,304</u>	<u>6,810</u>
Cash and cash equivalents at end of period	<u>\$ 14,531</u>	<u>\$ 7,669</u>
Summary of change in certain operating assets and liabilities:		
Increase in accounts receivable	\$ (4,870)	\$ (4,479)
Decrease (increase) in inventory	(70)	210
(Increase) decrease in prepaid expenses and other current assets	787	(1,219)
Increase in accounts payable, accrued expenses and accrued interest	5,358	2,509
Change in prepaid corporate income taxes and corporate income taxes payable	2,746	(456)
Increase in deferred revenue	11,277	6,603
Net changes in certain operating assets and liabilities	<u>\$ 15,228</u>	<u>\$ 3,168</u>
Supplemental disclosures of cash flow information:		
Cash payments for interest <sup>1</sup>	<u>\$ 27,194</u>	<u>\$ 13,517</u>
Cash payments for income taxes	<u>\$ 2,758</u>	<u>\$ 14,054</u>

<sup>1</sup> Amount includes payment of interest on Payment-in-Kind Notes of \$12,961 for the nine months ended September 30, 2006.

See notes to the condensed consolidated financial statements.

**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(All figures \$'000s except share and per share data)**  
**(Unaudited)**

**1. Basis of Presentation**

As used herein, the “Company,” “we,” “us,” or “our” means Town Sports International Holdings, Inc., and its subsidiaries, except as expressly indicated or unless the context otherwise requires. The Company owned and operated 152 fitness clubs (“clubs”) and partly-owned and operated two additional clubs as of September 30, 2007. The Company operates in a single segment. The Company operated 105 clubs in the New York metropolitan market under the “New York Sports Clubs” brand name, 21 clubs in the Boston market under the “Boston Sports Clubs” brand name; 18 clubs in the Washington, D.C. market under the “Washington Sports Clubs” brand name, seven clubs in the Philadelphia market under the “Philadelphia Sports Clubs” brand name and three clubs in Switzerland as of September 30, 2007. The Company’s geographic concentration in the New York metropolitan market may expose the Company to adverse developments related to competition, demographic changes, real estate costs, acts of terrorism and economic down turns.

Effective June 30, 2006, Town Sports International, Inc., a wholly owned subsidiary of TSI Holdings, merged with and into TSI Club, LLC, a New York limited liability company (the “Merger”). TSI Club, LLC was the surviving entity in the Merger and changed its name to Town Sports International, LLC (“TSI LLC”). TSI Holdings is the sole member of TSI LLC.

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 (“SEC”). The condensed consolidated financial statements should be read in conjunction with TSI Holdings’ December 31, 2006 consolidated financial statements and notes thereto, included in the Company’s Annual Report on Form 10-K, as filed on March 13, 2007 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, 2007 are not necessarily indicative of the results for the entire year ending December 31, 2007.

**2. Initial Public Offering**

The registration statement filed in connection with the Company’s initial public offering (“IPO”), as filed with the SEC, was declared effective on June 1, 2006. The Company’s shares of common stock (“Common Stock”) began trading on the NASDAQ Global Market on June 2, 2006 under the symbol CLUB. In connection with the IPO, the Board of Directors approved a 14-for-1 Common Stock split. All share and per share data have been adjusted to reflect this stock split. The Company closed this transaction and received proceeds on June 7, 2006. The IPO consisted of 8,950,000 shares of Common Stock, including 7,650,000 shares issued by the Company and 1,300,000 shares sold by certain selling stockholders to certain specified purchasers. The Company’s sale of 7,650,000 shares of Common Stock resulted in net proceeds of \$91,750 as of September 30, 2006. These proceeds are net of underwriting discounts and commissions and offering costs payable by the Company totaling \$7,700. The IPO proceeds were used for the redemption of 35% of the aggregate principal amount of the Company’s outstanding 11% Senior Discount Notes due 2014 (the “11% Senior Discount Notes”), and the remainder of the proceeds together with cash on hand was used to consummate the tender offer for \$85,001 of TSI LLC’s 9 5/8% Senior Notes due 2011 (the “9 5/8% Senior Notes”).

**3. Recent Accounting Changes**

In September 2006, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements* (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008 for the Company. The Company is currently evaluating the impact of SFAS 157 on its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB No. 115* (“SFAS 159”), which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by mitigating volatility in reported earnings caused by measuring related assets and liabilities separately. SFAS 159 is effective January 1, 2008 for the Company. The Company is currently evaluating the impact of SFAS 159 on its Consolidated Financial Statements.

**4. Long-Term Debt**

	December 31, 2006 (\$'000s)	September 30, 2007 (\$'000s)
Term Loan Facility	\$ —	\$ 184,075
9 5/8% Senior Notes	169,999	—
11% Senior Discount Notes (Payment-in-Kind Notes)	110,850	120,118
Notes payable for acquired businesses	280	99
	<u>281,129</u>	<u>304,292</u>
Less, current portion to be paid within one year	181	1,898
Long-term portion	<u>\$ 280,948</u>	<u>\$ 302,394</u>

On June 8, 2006, the Company paid \$93,001 to redeem \$85,001 of the outstanding principal of TSI LLC’s 9 5/8% Senior Notes, together with \$6,796 of early termination fees and \$1,204 of accrued interest. Deferred financing costs totaling \$1,601 were written off and fees totaling \$222 were incurred in connection with this early extinguishment.

On July 7, 2006, the Company paid \$62,875 to redeem 35% of the 11% Senior Discount Notes. The aggregate accreted value of the 11% Senior Discount Notes on the redemption date totaled \$56,644 and early termination fees totaled \$6,231. Deferred financing costs totaling \$1,239 were written off and fees totaling \$24 were incurred in connection with this early extinguishment.

On February 27, 2007, TSI LLC entered into a \$260,000 senior secured credit facility (“New Senior Credit Facility”). The New Senior Credit Facility consists of a \$185,000 term loan facility (the “Term Loan Facility”), a \$75,000 revolving credit facility (the “Revolving Loan Facility”), and an incremental term loan commitment facility in the maximum amount of \$100,000, which borrowing thereunder is subject to compliance with certain conditions precedent by TSI LLC and agreement upon certain terms and conditions thereof between the participating lenders and TSI LLC. The Revolving Loan Facility replaced the Company’s senior secured revolving credit facility (the “Senior Credit Facility”) of \$75,000 that was to mature on April 16, 2008.

All of TSI LLC’s domestic subsidiaries have guaranteed the New Senior Credit Facility, however, TSI LLC’s foreign subsidiary has not guaranteed the New Senior Credit Facility.

The proceeds of the Term Loan Facility were used to purchase all of the 9 5/8% Senior Notes outstanding, in the aggregate principal amount of \$169,999, together with applicable tender or call premiums. The Company incurred \$8,759 of tender premium and \$215 of call premium together with \$335 of fees and expenses related to the tender of the 9 5/8% Senior Notes. Net deferred financing costs related to the Senior Credit Facility and the 9 5/8% Senior Notes totaling approximately \$3,212 were expensed in the first quarter of 2007. The loss on extinguishment of debt is summarized as follows:

Tender premium	\$ 8,759
Call premium	215
Write-off of deferred financing costs related to the Senior Credit Facility and 9 5/8% Senior Notes	3,212
Fees and expenses	335
Loss on early extinguishment of debt	<u>\$ 12,521</u>

## Table of Contents

The New Senior Credit Facility contains various debt covenants including the maintenance of a maximum permitted total leverage ratio, if any loans or letters of credit under the facility are outstanding. As of September 30, 2007, the Company was in compliance with its debt covenants under the related credit agreement. These covenants may limit TSI LLC's ability to incur additional debt. As of September 30, 2007, TSI LLC's permitted borrowing capacity of \$75,000 was not restricted by such covenants.

Borrowings under the Term Loan Facility will, 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 related credit agreement. The interest rate on these borrowings was 7.50% as of September 30, 2007. 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. TSI LLC is required to repay 0.25% of principal, or \$463, per quarter beginning on June 30, 2007.

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 the Eurodollar rate plus 2.25% as defined in the related credit agreement. TSI LLC's applicable base rate and Eurodollar rate margins, and commitment commission percentage vary with the Company's consolidated secured leverage ratio, as defined in the related credit agreement. As of September 30, 2007, TSI LLC is required to pay a commitment fee of 0.50% per annum on the daily unutilized amount. The Revolving Loan Facility contains a maximum total leverage covenant ratio, as defined, which covenant is subject to compliance, on a consolidated basis, only during the period in which borrowings and letters of credit are outstanding thereunder. There were no borrowings outstanding at September 30, 2007 and outstanding letters of credit issued totaled \$11,944. The unutilized portion of the Revolving Loan Facility as of September 30, 2007 was \$63,056.

## 5. 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 Common Stock outstanding during the period. Diluted earnings per share is computed similarly to basic earnings per share, except that the denominator is increased to account for the assumed exercise of dilutive stock options using the treasury stock method. The effect of the shares issuable upon the exercise of stock options were not included in the calculation of diluted EPS for the nine months ended September 30, 2006 as they were antidilutive due to a net loss position in these periods. The number of equivalent shares excluded totaled 442,804 for the nine months ended September 30, 2006.

The following table summarizes the weighted average common shares for basic and diluted earnings per share ("EPS") computations.

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2006	2007	2006	2007
Weighted average number of common shares outstanding — basic	25,933,506	26,225,449	21,669,090	26,122,531
Effect of diluted stock options	412,095	453,490	—	461,251
Weighted average number of common shares outstanding — diluted	<u>26,345,601</u>	<u>26,678,939</u>	<u>21,669,090</u>	<u>26,583,782</u>

## 6. Stock-Based Compensation

On May 30, 2006, the Board of Directors of the Company approved the 2006 Stock Incentive Plan. The 2006 Stock Incentive Plan authorizes the Company to issue up to 1,300,000 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 Stock Incentive 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 Stock Incentive Plan generally qualify as "non-qualified stock options" under the U.S. Internal Revenue Code. Options granted under the 2004 Common Stock Option Plan generally qualify as "incentive stock options" under the U.S. Internal Revenue Code. The exercise price of a stock option is not less than the fair market value of the Company's Common Stock on the option grant date.

## Table of Contents

Options granted during the nine months ended September 30, 2007 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)
March 28, 2007	3,000	\$ 21.75	\$ 10.38	45.0%	0.0%	4.54%	5.5
March 28, 2007	5,000	\$ 21.75	\$ 11.23	45.0%	0.0%	4.49%	6.5
April 9, 2007	5,500	\$ 22.87	\$ 12.28	45.0%	0.0%	4.62%	7.0
April 9, 2007	5,000	\$ 22.87	\$ 11.86	45.0%	0.0%	4.61%	6.5
August 7, 2007	444,500	\$ 17.46	\$ 7.09	32.5%	0.0%	4.53%	6.0
Total	<u>463,000</u>						

At September 30, 2007, the Company had 719,220 and 882,315 stock options outstanding under its 2004 Common Stock Option Plan and 2006 Stock Incentive Plan, respectively. The total compensation expense, classified within Payroll and related on the condensed statements of operations, related to these plans was \$240 and \$633 for the three and nine months ended September 30, 2006 and \$258 and \$613 for the three and nine months ended September 30, 2007, respectively.

As of September 30, 2007, a total of \$4,550 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 3.7 years.

### 7. Goodwill and Other Intangibles

Goodwill has been allocated to reporting units that closely reflect the regions served by our four trade names; "New York Sports Clubs", "Boston Sports Clubs", "Washington Sports Clubs" and "Philadelphia Sports Clubs", with certain more remote clubs that do not benefit from a regional cluster being considered single reporting units.

In each of the quarters ended March 31, 2006 and 2007, the Company performed its annual impairment test. 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 2006 and 2007 impairment tests supported the recorded goodwill balances and as such no impairment of goodwill was required. The change in the carrying amount of goodwill from December 31, 2006 through September 30, 2007 is as follows:

Balance as of December 31, 2006	\$50,112
Changes due to foreign currency exchange rate fluctuations	27
Balance as of September 30, 2007	<u>\$50,139</u>

Acquired Intangible Assets	As of December 31, 2006 (\$'000s)		
	Gross Carrying Amount	Accumulated Amortization	Net Intangibles
Membership lists	\$ 12,146	\$ (11,389)	\$ 757
Covenants-not-to-compete	1,151	(1,004)	147
Beneficial lease	223	(205)	18
	<u>\$ 13,520</u>	<u>\$ (12,598)</u>	<u>\$ 922</u>

## Table of Contents

	As of September 30, 2007		
	(\$'000s)		
	Gross Carrying Amount	Accumulated Amortization	Net Intangibles
Membership lists	\$ 12,146	\$ (11,687)	\$ 459
Covenants-not-to-compete	1,151	(1,046)	105
Beneficial lease	223	(213)	10
	<u>\$ 13,520</u>	<u>\$ (12,946)</u>	<u>\$ 574</u>

The amortization expense of the above acquired intangible assets for each of the two years ending September 30, 2009 is as follows:

Aggregate Amortization Expense for the twelve months ending September 30, (\$'000s)	
2008	\$ 389
2009	185
	<u>\$ 574</u>

Amortization expense for the nine months ended September 30, 2006 and 2007 amounted to \$504 and \$348, respectively.

### 8. Income Taxes

The Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48") on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. FIN 48 requires that a Company recognize in its consolidated financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The Company did not have a change to the liability for unrecognized tax benefits as a result of the implementation of FIN 48. At the adoption date of January 1, 2007, the Company had \$1,155 of unrecognized tax benefits. Of this total, \$751 represents the amount of unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate in any future periods. This amount had not changed significantly as of September 30, 2007 and the Company does not anticipate that the total amount of unrecognized benefits will significantly change in the next 12 months.

Effective upon the adoption of FIN 48, the Company recognizes both interest accrued related to unrecognized tax benefits and penalties in income tax expense. The Company had no accruals for interest or penalties as of January 1, 2007. As of September 30, 2007 the amount accrued for interest and penalties was \$93.

The Company files Federal income tax returns, foreign jurisdiction income tax returns and multiple state and local jurisdiction income tax returns. The State of New York is currently examining tax returns for the years 2003, 2004 and 2005. The Company is no longer subject to examinations of its Federal income tax returns by the Internal Revenue Service for years 2000 and prior.

### 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 to determine the ultimate outcome of the above actions at this time, 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.

On or about June 12, 2001, TSI LLC and several other third parties were named as defendants in an action styled *Carlos Urbina et ano v. 26 Court Street Associates, LLC et al.*, filed in the Supreme Court, New York County, seeking damages for personal injuries.

## Table of Contents

Following a trial, TSI LLC received a directed verdict for indemnification against one of TSI LLC's contractors and the plaintiffs received a jury verdict of approximately \$8.9 million in their favor. Both of those verdicts are being appealed. TSI LLC filed an appeal bond in the amount of \$1.8 million in connection with those appeals. TSI LLC is vigorously opposing the appeal of the directed verdict and prosecuting the appeal of the jury verdict, which appeals were argued on May 16, 2006. Depending on the ultimate outcome, this matter may have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

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, 2006 and 2007 are as follows:

	Three months ended September 30, (\$'000s)		Nine months ended September 30, (\$'000s)	
	2006	2007	2006	2007
Revenue	\$881	\$907	\$2,667	\$2,738
Income from operations	391	331	1,186	1,111
Net income	334	307	1,093	1,030

### 11. Subsequent Event

On October 4, 2007, the Company announced the resignation of Robert Giardina, the Chief Executive Officer of the Company, due to personal and health reasons. Mr. Giardina's resignation was effective October 31, 2007. He will continue to serve as a member on the Board of Directors of the Company and will work with the Company in an advisory capacity effective November 1, 2007. Alexander Alimanestianu, President of the Company, succeeded Mr. Giardina as the Company's Chief Executive Officer. In connection with his impending promotion, on October 2, 2007, the size of the Board was increased to 9 persons, and Mr. Alimanestianu was elected by the Board to fill the newly created Board position. An amount of approximately \$480 will be accrued as of November 1, 2007 for fees to be incurred related to the resignation of Mr. Giardina including amounts to be incurred by the Company for five months salary, five years of health care benefits and two months of his 2007 bonus.

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

**Introduction**

We are one of the two leading owners and operators of fitness clubs in the Northeast and Mid-Atlantic regions of the United States and the fourth largest fitness club operator in the United States, in each case as measured by number of clubs. As of September 30, 2007, we owned and operated 152 fitness clubs and partly owned and operated two fitness clubs. These 154 clubs collectively served approximately 483,000 members, excluding pre-sold, short-term and seasonal memberships, as of September 30, 2007. We have developed and refined our fitness club model through our clustering strategy, offering fitness clubs close to our members' work and homes. Our club model targets the "upper value" market segment, comprising individuals aged between 21 and 50 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 the suburbs and neighboring communities. Capitalizing on this clustering of clubs, as of September 30, 2007, approximately 42% of our members participated in our Passport Membership plan that allows unlimited access to all of our clubs in our clusters for a higher monthly membership fee. The remaining 58% of our members participate in a Gold Membership plan that allows unlimited access to a designated club and limited access to all of our clubs.

We have executed our clustering strategy successfully in all of our markets. In the New York region, through the network of fitness clubs, we operate under our New York Sports Clubs brand name. We are the largest fitness club operator in Manhattan with 39 locations (more than twice as many as our nearest competitor) and operated a total of 105 clubs under the "New York Sports Clubs" brand name within a 75-mile radius of New York City as of September 30, 2007. We operated 21 clubs in the Boston region under our "Boston Sports Clubs" brand name, 18 clubs in the Washington, D.C. region under our "Washington Sports Clubs" brand name and seven clubs in the Philadelphia region under our "Philadelphia Sports Clubs" brand name as of September 30, 2007. In addition, we owned and operated three clubs in Switzerland as of September 30, 2007. 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 two principal sources of revenue:

- Our largest sources of revenue are dues and initiation fees paid by our members. These comprised 81.3% of our total revenue for the nine months ended September 30, 2007. We recognize revenue from membership dues in the month when the services are rendered. Approximately 93.0% 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 average life of the membership.
- For the nine months ended September 30, 2007, we generated 12.0% of our revenue from personal training and 5.5% 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.

The balance of our revenue (approximately 1.2% for the nine months ended September 30, 2007) principally relates to rental of space in our facilities to operators who offer wellness-related offerings such as physical therapy. In addition, we sell in-club advertising and sponsorships and generate management fees from five university fitness clubs in which we did not have an equity interest. We refer to this as "Fees and other revenue".

## Table of Contents

Revenue (in \$'000s) was comprised of the following:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006		2007		2006		2007	
Membership dues	\$ 87,257	79.7%	\$ 93,735	78.8%	\$257,160	79.6%	\$278,537	78.7%
Initiation fees	2,586	2.4%	3,202	2.7%	6,839	2.1%	9,181	2.6%
Membership revenue	<u>89,843</u>	<u>82.1%</u>	<u>96,937</u>	<u>81.5%</u>	<u>263,999</u>	<u>81.7%</u>	<u>287,718</u>	<u>81.3%</u>
Personal training revenue	11,564	10.6%	13,243	11.2%	36,915	11.5%	42,646	12.0%
Other ancillary club revenue	6,766	6.2%	7,245	6.1%	17,841	5.5%	19,529	5.5%
Ancillary club revenue	18,330	16.8%	20,488	17.3%	54,756	17.0%	62,175	17.5%
Fees and other revenue	1,245	1.1%	1,461	1.2%	4,158	1.3%	4,148	1.2%
Total revenue	<u>\$109,418</u>	<u>100.0%</u>	<u>\$118,886</u>	<u>100.0%</u>	<u>\$322,913</u>	<u>100.0%</u>	<u>\$354,041</u>	<u>100.0%</u>

Our revenues, operating income and net income for the three months ended September 30, 2007 were \$118.9 million, \$13.9 million and \$5.1 million, respectively. Our revenues, operating income and net income for the nine months ended September 30, 2007 were \$354.0 million, \$42.7 million and \$7.6 million, respectively.

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, utilities, 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 and member relations, legal and consulting fees and real estate development 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.

Our primary capital expenditures relate to the construction or acquisition of new club facilities and upgrading and expanding our existing clubs. The construction and equipment costs vary based on the costs of construction labor, as well as 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% 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. In this connection, facility remodeling is also considered where appropriate.

### Historical Club Growth

The following table sets forth our club growth during each of the quarters in 2006 and the first three quarters of 2007.

	2006					2007		
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3
Wholly owned clubs operated at beginning of period	139	143	142	145	139	147	150	150
New clubs opened	5	—	2	3	10	3	1	2
Clubs acquired	—	—	1	—	1	—	—	—
Clubs closed, relocated, merged or sold (1)	(1)	(1)	—	(1)	(3)	—	(1)	—
Wholly owned clubs at end of period	<u>143</u>	<u>142</u>	<u>145</u>	<u>147</u>	<u>147</u>	<u>150</u>	<u>150</u>	<u>152</u>
Total clubs operated at end of period (2)	<u>145</u>	<u>144</u>	<u>147</u>	<u>149</u>	<u>149</u>	<u>152</u>	<u>152</u>	<u>154</u>

(1) In 2005, we temporarily closed a club for a renovation and expansion. This club reopened in February 2006 and is included with new clubs opened in the first quarter of 2006.

(2) Includes wholly owned and partly owned clubs. In addition to the above, as of December 31, 2006 and September 30, 2007, we managed five university fitness clubs in which we did not have an equity interest.

## Table of Contents

### Existing 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 at the prior year. We define mature club revenue as revenue at those clubs that were operated by us for the entire period presented and that entire comparable period of the preceding year. Under this definition, mature clubs are those clubs that were operated for more than 24 months.

Comparable club revenue growth was 4.1% and 6.0% for the three and nine months ended September 30, 2007. Mature club revenue growth was 3.1% and 4.5% for the three and nine months ended September 30, 2007.

### Results of Operations

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2007	2006	2007
Revenue	100.0%	100.0%	100.0%	100.0%
Operating expenses:				
Payroll and related	36.3	36.5	37.5	37.5
Club operating	34.4	35.6	33.7	33.8
General and administrative	6.1	7.0	7.0	7.1
Depreciation and amortization	9.3	9.2	9.6	9.5
	<u>86.1</u>	<u>88.3</u>	<u>87.8</u>	<u>87.9</u>
Operating income	13.9	11.7	12.2	12.1
Loss on extinguishment of debt	6.8	—	5.0	3.5
Interest expense	6.7	5.5	8.8	5.6
Interest income	(0.4)	(0.3)	(0.6)	(0.2)
Equity in the earnings of investees and rental income	(0.4)	(0.4)	(0.4)	(0.4)
Income (loss) before provision (benefit) for corporate income taxes	1.2	6.9	(0.6)	3.6
Provision (benefit) for corporate income taxes	0.5	2.6	0.0	1.4
Net income (loss)	<u>0.7%</u>	<u>4.3%</u>	<u>(0.6)%</u>	<u>2.2%</u>

#### *Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006*

*Revenues.* Revenues increased \$9.5 million, or 8.7%, to \$118.9 million during the three months ended September 30, 2007 from \$109.4 million in the three months ended September 30, 2006. This increase in revenue was driven primarily by growth in membership revenue and ancillary club revenue. Revenues increased during the three months ended September 30, 2007 by \$3.2 million, or 3.1%, at our mature clubs. During the three months ended September 30, 2007, revenue increased \$6.4 million at the 18 clubs opened or acquired subsequent to September 30, 2005. These increases in revenue were offset by a \$431,000 revenue decrease related to the two clubs that were closed and/or relocated subsequent to July 1, 2006.

Comparable club revenue increased 4.1% during the three months ended September 30, 2007. Of this 4.1% increase, 2.0% was due to an increase in membership, 0.9% was due to an increase in price and 1.2% was due to an increase in ancillary club revenue and fees and other revenue.

## Table of Contents

*Operating Expenses.* Operating expenses increased \$10.8 million, or 11.5%, to \$105.0 million during the three months ended September 30, 2007, from \$94.2 million in the three months ended September 30, 2006. The increase was due to the following factors:

Payroll and related expenses increased \$3.6 million, or 9.1%, to \$43.3 million in the three months ended September 30, 2007, from \$39.7 million in the three months ended September 30, 2006. This increase was attributable to a 4.9% increase in the total months of club operation from 430 to 451 as well as the following: In addition, payroll costs directly related to our personal training, group fitness training, and programming for children increased \$1.4 million or 16.0%, due to an increase in demand for these programs.

Club operating expenses increased \$4.7 million, or 12.4%, to \$42.4 million in the three months ended September 30, 2007, from \$37.7 million in the three months ended September 30, 2006. This increase was principally attributable to the following:

- Rent and occupancy expenses increased \$1.6 million. Rent and occupancy costs at clubs that opened after July 1, 2006, or that are currently under construction, increased \$1.1 million. The remaining \$500,000 increase in rent and occupancy expenses relates to rent at our clubs that were open prior to July 1, 2006.
- Advertising and marketing expenses increased \$930,000, as we expended \$3.8 million during the three months ended September 30, 2007 compared to \$2.9 million during the same period in 2006, primarily due to a shift in the timing of our advertising plans.
- As part of a customer service initiative, we had outsourced towel laundry service in 52 clubs as of September 30, 2007 as compared to 27 clubs as of September 30, 2006. As our clubs have become more intensely clustered in our markets, and member cross usage becomes more prevalent, we have found it increasingly necessary to offer towel laundry services at more of our clubs. We have experienced a \$610,000 increase in laundry expenses during the three months ended September 30, 2007 when compared to the three months ended September 30, 2006.

General and administrative expenses increased \$1.7 million, or 25.5%, to \$8.4 million during the three months ended September 30, 2007, from \$6.7 million during the same period in the prior year. Legal fees and expenses increased \$421,000 due in part to increased lease negotiation activity and fees and expenses associated with ongoing litigation matters. General liability insurance expense increased \$403,000 due to increased actuarial valuations principally attributed to prior year claims brought in 2007. The remaining increase of general and administrative expense is due to increased costs to support the growth in our business in the three months ended September 30, 2007.

Depreciation and amortization increased \$825,000, or 8.1%, to \$10.9 million in the three months ended September 30, 2007 from \$10.1 million in the three months ended September 30, 2006, principally due to new and expanded clubs.

*Loss on Extinguishment of Debt.* During the three months ended September 30, 2006 loss on extinguishment of debt was \$7.4 million. On July 7, 2006, we paid \$62.9 million to redeem 35% of the 11% Senior Discount Notes. The aggregate accreted value of the 11% Senior Discount Notes on the redemption date totaled \$56.6 million and early termination fees totaled \$6.2 million. Deferred financing costs totaling \$1.2 million were written off and fees totaling \$24,000 were incurred in connection with this early extinguishment. There were no such costs in the three months ended September 30, 2007.

*Interest Expense.* Interest expense decreased \$895,000 to \$6.5 million during the three months ended September 30, 2007 from \$7.4 million in the three months ended September 30, 2006. This decrease is a result of the February 2007 refinancing of the the 9 5/8% Senior Notes with our Term Loan Facility, which interest approximated 7.20% for the quarter. In addition, on July 7, 2006, we redeemed \$56.6 million of the 11% Senior Discount Notes.

*Interest Income.* Interest income decreased \$131,000 to \$344,000 in the three months ended September 30, 2007 from \$475,000 in the three months ended September 30, 2006 due to a decrease in the average cash balance in the three months ended September 30, 2007 when compared to the three months ended September 30, 2006.

*Provision for Corporate Income Taxes.* We have recorded an income tax provision of \$3.1 million in the three months ended September 30, 2007 compared to a provision of \$543,000 in the three months ended September 30, 2006, calculated using the Company's effective tax rate. During the three months ended September 30, 2007, we filed our Federal tax returns for the year ended December 31, 2006, upon which we recognized a \$251,000 tax benefit principally related to employment credits and relief for federal surcharges

## Table of Contents

on our communication expenses previously incurred. This adjustment was made in the three months ended September 30, 2007 accounting for the difference between the calculated tax rate and the effective tax rate.

### *Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006*

*Revenues.* Revenues increased \$31.1 million, or 9.6%, to \$354.0 million during the nine months ended September 30, 2007 from \$322.9 million in the nine months ended September 30, 2006. This increase in revenue was driven primarily by growth in membership revenue and ancillary club revenue. Revenues increased \$13.9 million, or 4.5%, at our mature clubs during the nine months ended September 30, 2007. During the nine months, revenue increased \$19.0 million at the 18 clubs opened or acquired subsequent to September 30, 2005. These increases in revenue were offset by a \$2.0 million revenue decrease related to the four clubs that were closed and/or relocated subsequent to January 1, 2006.

Comparable club revenue increased 6.0% during the nine months ended September 30, 2007. Of this 6.0% increase, 3.0% was due to an increase in membership, 1.0% was due to an increase in price and 2.0% was due to an increase in ancillary club revenue and fees and other revenue.

*Operating Expenses.* Operating expenses increased \$27.6 million, or 9.7%, to \$311.3 million in the nine months ended September 30, 2007, from \$283.7 million in the nine months ended September 30, 2006. The increase was due to the following factors:

Payroll and related expenses increased \$11.4 million, or 9.4%, to \$132.6 million in the nine months ended September 30, 2007, from \$121.2 million in the nine months ended September 30, 2006. This increase was attributable to a 4.3% increase in the total months of club operation from 1,286 to 1,341 as well as the following:

- Payroll costs directly related to our personal training, group fitness training, and programming for children increased \$3.7 million or 13.6%, due to an increase in demand for these programs.
- In the nine months ended September 30, 2006, we incurred a charge relating to severance agreements with our former Chairman and certain employees totaling \$1.6 million. The total costs of these severance packages were recorded in the nine months ended September 30, 2006 while no such costs were incurred in the nine months ended September 30, 2007.

Club operating expenses increased \$10.7 million, or 9.9%, to \$119.6 million in the nine months ended September 30, 2007, from \$108.9 million in the nine months ended September 30, 2006. This increase was principally attributable to the following:

- Rent and occupancy expenses increased \$5.8 million. Rent and occupancy costs at clubs that opened after January 1, 2006, or that are currently under construction, increased \$4.6 million. The remaining \$1.1 million increase in rent and occupancy expenses relates to rent at our clubs that were open prior to January 1, 2006.
- Advertising and marketing expenses for the nine months ended September 30, 2007 were in-line with the nine months ended September 30, 2006, increasing only \$180,000.
- As part of a customer service initiative, we had outsourced towel laundry service in 52 clubs as of September 30, 2007 as compared to 27 clubs as of September 30, 2006. As our clubs have become more intensely clustered in our markets, and member cross usage becomes more prevalent, we have found it increasingly necessary to offer towel laundry services at more of our clubs. Accordingly, we have experienced a \$1.7 million increase in laundry expenses during the nine months ended September 30, 2007 when compared to the nine months ended September 30, 2006.

General and administrative expenses increased \$2.6 million, or 11.5%, to \$25.2 million during the nine months ended September 30, 2007 from \$22.6 million during the same period in the prior year. There was an increase in corporate rent of \$708,000, primarily due to the relocation of our corporate headquarters in the beginning of June 2007. The costs for the remainder of the lease obligation of the vacated location were recorded in the three months ended June 30, 2007. Legal fees and expenses increased \$700,000 due in part to increased lease negotiation activity as well as corporate restructuring and fees and expenses associated with ongoing litigation matters. General liability insurance expense increased \$848,000 due to increased actuarial valuations principally attributed to prior year claims brought in 2007. The remaining increase of general and administrative expense was due to increased costs to support the growth in our business in 2007. In the nine months ended September 30, 2006, we incurred \$1.7 million of costs related to the examination of strategic and financing alternatives.

## Table of Contents

Depreciation and amortization increased \$2.9 million, or 9.3%, to \$33.8 million in the nine months ended September 30, 2007 from \$30.9 million in the nine months ended September 30, 2006, principally due to new and expanded clubs.

*Loss on Extinguishment of Debt.* During the nine months ended September 30, 2007, loss on extinguishment of debt was \$12.5 million compared to \$16.1 million during the nine months ended September 30, 2006. The proceeds from the New Senior Credit Facility obtained on February 27, 2007 were used to repay \$170.0 million, representing the remaining outstanding principal of TSI LLC's 9 5/8% Senior Notes. We incurred \$8.8 million of tender premium and \$215,000 of call premium together with \$335,000 of fees and expenses related to the tender of the 9 5/8% Senior Notes. Net deferred financing costs related to the Senior Credit Facility and TSI LLC's 9 5/8% Senior Notes totaling approximately \$3.2 million were expensed in the first quarter of 2007.

During the second quarter of 2006, we paid \$93.0 million to redeem \$85.0 million of the outstanding principal of the 9 5/8% Senior Notes, together with \$6.8 million of early termination fees and \$1.2 million of accrued interest. Deferred financing costs totaling \$1.6 million were written off and fees totaling \$222,000 were incurred in connection with this early extinguishment of debt. During the third quarter of 2006, we paid \$62.9 million to redeem 35% of the 11% Senior Discount Notes. The aggregate accreted value of the 11% Senior Discount Notes on the redemption date totaled \$56.6 million and early termination fees totaled \$6.2 million. Deferred financing costs totaling \$1.2 million were written off and fees totaling \$24,000 were incurred in connection with this early extinguishment.

*Interest Expense.* Interest expense decreased \$8.6 million to \$19.9 million during the nine months ended September 30, 2007 from \$28.5 million in the nine months ended September 30, 2006. This decrease is a result of the repayment of our debt in connection with the June 2006 IPO and the refinancing of our debt at a lower interest rate in February 2007. On June 8, 2006, we redeemed \$85.0 million of TSI LLC's 9 5/8% Senior Notes and on July 7, 2006 we redeemed \$56.6 million of the 11% Senior Discount Notes.

*Interest Income.* Interest income decreased \$980,000 to \$882,000 in the nine months ended September 30, 2007 from \$1.9 million in the nine months ended September 30, 2006 due to a decrease in the average cash balance in the nine months ended September 30, 2007 when compared to the same period of 2006.

*Provision for Corporate Income Taxes .* We have recorded an income tax provision of \$4.9 million in the nine months ended September 30, 2007 compared to a benefit of \$121,000 in the nine months ended September 30, 2006, calculated using the Company's effective tax rate. During the three months ended September 30, 2007, we filed our Federal tax returns for the year ended December 31, 2006, upon which we recognized a \$251,000 tax benefit principally related to employment credits and relief for federal surcharges on our communication expenses previously incurred. This adjustment was made in the three months ended September 30, 2007 accounting for the difference between the calculated tax rate and the effective tax rate. In the nine months ended September 30, 2006, an income tax charge totaling \$751,000 was recorded to reflect the reduction in state tax assets that we believed were not more likely than not to be realized in association with the interest related to the pay-down of debt, resulting from our use of the proceeds from the IPO, which was consummated on June 7, 2006.

## 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, 2007 was \$62.7 million compared to \$59.6 million for the nine months ended September 30, 2006, for a \$3.1 million or 5.2% increase. Our operating income increased from \$39.2 million to \$42.7 million. In addition, during the nine months ended September 30, 2006 the Company received a \$3.6 million Federal tax refund and paid \$2.8 million in Federal and state taxes, resulting in a net tax related cash inflow of \$800,000. The Company's cash payments for taxes totaled \$14.1 million for the first nine months of 2007. This resulted in a \$14.9 million increase in cash paid for taxes during the nine months ended September 30, 2007 when compared to the same period in 2006. Our cash payments for interest in the nine months ended September 30, 2006 totaled \$27.2 million compared to \$13.5 million in the nine months ended September 30, 2007, resulting in a \$13.7 million decrease.

Excluding the effects of cash and cash equivalent balances, we normally operate with a working capital deficit because we receive dues and program and services fees either (i) during the month services are rendered, or (ii) when paid-in-full, in advance. As a result, we typically do not have significant accounts receivable. We record deferred liabilities for revenue received in advance in connection

## Table of Contents

with dues and services paid-in-full and for initiation fees paid at the time of enrollment. Initiation fees received are deferred and amortized over a 30-month period, which represents the approximate life of a member. At the time a member joins our club we incur enrollment costs which are deferred over 30 months. These costs typically offset the impact initiation fees have on working capital. We do not believe we will have to finance this working capital deficit in the foreseeable future, because as we increase the number of clubs open, we expect we will continue to have deferred revenue balances that reflect services and dues that are paid-in-full in advance at levels similar to, or greater than, those currently maintained. The deferred revenue balances that give rise to this working capital deficit represent cash received in advance of services performed, and do not represent liabilities that must be funded with cash.

*Investing Activities.* 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 \$69.0 million and \$42.2 million during the nine months ended September 30, 2007 and 2006, respectively. The increase in capital expenditures is due to the increase in the number of clubs under construction in 2007 compared to 2006. During the year ending December 31, 2007, we estimate we will invest a total of \$88.0 million in capital expenditures. This amount includes \$17.0 million to continue to upgrade existing clubs, \$4.3 million for the relocation of our corporate headquarters, and \$4.1 million to enhance our management information systems. The remainder of our 2007 capital expenditures will be committed to building, acquiring or expanding clubs. These expenditures will be funded by cash flow provided by operations, available cash on hand and, to the extent needed, borrowings from our Revolving Loan Facility.

*Financing Activities.* Net cash provided by financing activities was \$7.1 million for the nine months ended September 30, 2007 compared to net cash used in financing activities of \$54.2 million in the same period in the prior year for an increase in financing cash of \$61.3 million. In June 2006, we filed a registration statement with the SEC in connection with our IPO. Our sale of 7,650,000 shares of Common Stock resulted in net proceeds of \$91.8 million. The IPO proceeds were used for the redemption of 35% of the aggregate principal amount of its outstanding 11% Senior Discount Notes, and the remainder of the proceeds together with cash on hand was used to consummate the tender offer for \$85.0 million of 9 5/8% Senior Notes. These transactions, including premium and fees in connection with the extinguishment of debt of \$13.3 million, totaled approximately \$50.2 million.

This increase can also be attributed to the refinancing of our debt on February 27, 2007. The net proceeds after issuance costs from the New Senior Credit Facility of \$182.4 million were used to repay the remaining principal of \$170.0 million of the outstanding principal of TSI LLC's 9 5/8% Senior Notes. In addition, we paid a premium and fees in connection with the extinguishment of debt of \$9.3 million. These transactions accounted for a \$3.1 million increase in cash related to financing activities in the nine months ended September 30, 2007. In addition, in the nine months ended September 30, 2007, there was a \$2.0 million increase in cash received upon the exercise of stock options when compared to the nine months ended September 30, 2006.

As of September 30, 2007, our total consolidated debt was \$304.3 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 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 LLC entered into a \$260.0 million senior secured credit facility (the "New Senior Credit Facility"). The New Senior Credit Facility consists of a \$185.0 million term loan facility (the "Term Loan Facility"), a \$75.0 million revolving credit facility (the "Revolving Loan Facility"), and an incremental term loan commitment facility in the maximum amount of \$100.0 million, under which borrowing is subject to compliance with certain conditions precedent by TSI LLC and agreement upon certain terms and

## Table of Contents

conditions thereof between the participating lenders and TSI LLC. The Revolving Loan Facility replaced the senior secured revolving credit facility of \$75.0 million that was to mature on April 16, 2008.

As of September 30, 2007, TSI LLC had \$184.1 million outstanding under the Term Loan Facility. Borrowings under the Term Loan Facility will, 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 related credit agreement. The interest rate on these borrowings was 7.5% as of September 30, 2007. 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. TSI LLC is required to repay 0.25% of principal, or \$462,500, per quarter beginning June 30, 2007. Total principal payments of \$925,000 have been paid as of September 30, 2007.

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 related credit agreement. 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 related credit agreement. TSI LLC is required to pay a commitment fee of 0.50% per annum on the daily unutilized amount. There were no borrowings outstanding under the Revolving Loan Facility at September 30, 2007 and outstanding letters of credit issued totaled \$11.9 million. The unutilized portion of the Revolving Loan Facility as of September 30, 2007 was \$63.1 million.

As of September 30, 2007, we were in compliance with our debt covenants in the related credit agreement and given our operating plans and expected performance for 2007, we expect we will continue to be in compliance during the remainder of 2007. These covenants may limit TSI LLC's ability to incur additional debt. As of September 30, 2007, permitted borrowing capacity of \$75.0 million was not restricted by the covenants.

As of September 30, 2007, we had \$120.1 million of the 11% Senior Discount Notes outstanding.

As of September 30, 2007, we had \$7.7 million of cash and cash equivalents.

We believe that we have, or will be able to obtain or generate sufficient funds to finance our current operating and growth plans through the end of 2008. Any material acceleration or expansion of our plans through newly constructed clubs or acquisitions (to the extent such acquisitions include cash payments) may require us to pursue additional sources of financing prior to the end of 2008. There can be no assurance that such financing will be available or that it will be available on acceptable terms.

Notes payable were incurred upon the acquisition of various clubs and are subject to possible post acquisition reductions arising out of operations of the acquired clubs. These notes bear interest at rates between 6% and 7% and are generally non-collateralized. The notes are due on various dates through 2009.

The aggregate long-term debt, and operating lease obligations as of September 30, 2007 were as follows:

	Payments Due by Period (in \$'000s)				
	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
<b>Contractual Obligations (3)</b>					
Long-Term Debt(1)	\$ 398,772	\$ 1,898	\$ 25,327	\$ 34,159	\$337,388
Operating Lease Obligations(2)	918,609	72,643	159,001	150,358	536,607
<b>Total Contractual Cash Obligations</b>	<b>\$1,317,381</b>	<b>\$74,541</b>	<b>\$184,328</b>	<b>\$184,517</b>	<b>\$873,995</b>

### Notes:

- (1) The long-term debt contractual cash obligations include principal and interest payment requirements on the 11% Senior Discount Notes. These amounts do not include interest on the Term Loan Facility, as this interest rate is variable. The interest rate as of September 30, 2007 was 7.5% or \$13.8 million on an annualized basis.
- (2) 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.
- (3) Excluded from the table above, as of September 30, 2007, we had \$751,000 of unrecognized tax benefits plus \$93,000 of interest and penalties that, if recognized, would affect our effective tax rate in any future periods.

### Recent Changes in or Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS 157, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008. We are currently evaluating the impact of SFAS 157 on our Consolidated Financial Statements.

In February 2007, the FASB issued SFAS 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by mitigating volatility in reported earnings caused by measuring related assets and liabilities separately. SFAS 159 is effective January 1, 2008. We are currently evaluating the impact of SFAS 159 on our Consolidated Financial Statements.

### 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, which are intended to be covered by the safe harbors created thereby. All statements herein that are not historical facts, including statements about our beliefs or expectations, are forward-looking statements. We generally identify these statements by words or phrases, such as “anticipate,” “estimate,” “plan,” “expect,” “believe,” “intend,” “foresee,” “will,” “may,” and similar words or phrases. These statements discuss, among other things, our strategy, the level of market demand for the Company’s services, competitive pressures, club openings and renovations, future financial or operational performance, anticipated cost savings, future financings, integration of club acquisitions, the application of Federal and state tax laws and regulations. These statements are subject to risks, uncertainties, and other factors, including, among others, competition in the fitness club industry, changes in consumer preferences and consumer spending patterns, general economic conditions in the United States, our ability to implement our strategy, our level of indebtedness and related debt service obligations and the covenants in our debt agreements, availability of adequate financing and risks, uncertainties and factors set forth in our reports and documents filed with the United States Securities and Exchange Commission (which reports and documents should be read in conjunction with this Quarterly Report on Form 10-Q). 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 they were made, and we undertake no obligation to update these statements in light of subsequent events or developments. Actual results and outcomes 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 debt facilities. As of September 30, 2007, a total of \$184.1 million of our debt consisted of a 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 six 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. For the nine months ended September 30, 2007, this debt was outstanding for 215 days. If short-term interest rates had increased by 100 basis points during the nine months ended September 30, 2007, our interest expense would have increased by approximately \$1.1 million. 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 to our December 31, 2006 financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC.

### ITEM 4. *Controls and Procedures.*

(a) As of September 30, 2007, the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2007, the Company’s disclosure controls and procedures were effective, to ensure that information required to be disclosed by the Company in reports that it files or furnishes under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and to ensure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

## Table of Contents

(b) We also maintain a system of internal accounting controls that are designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our policies and procedures are followed. On April 1, 2007, the Company implemented the Oracle suite of accounting systems by replacing its general ledger and consolidation software. This conversion involved various changes to the Company's internal processes and control procedures over financial reporting; however, the basic internal controls over financial reporting have not materially changed as a result of the continuation of the implementation. There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The controls in place under the new software have been evaluated by management as of September 30, 2007 and management believes that this conversion enhances the Company's internal control over financial reporting.

## 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, 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 to determine the ultimate outcome of the above actions at this time, 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.

On or about June 12, 2001, TSI LLC and several other third parties were named as defendants in an action styled *Carlos Urbina et ano v. 26 Court Street Associates, LLC et al.*, filed in the Supreme Court, New York County, seeking damages for personal injuries. Following a trial, TSI LLC received a directed verdict for indemnification against one of TSI LLC's contractors and the plaintiffs received a jury verdict of approximately \$8.9 million in their favor. Both of those verdicts are being appealed. TSI LLC filed an appeal bond in the amount of \$1.8 million in connection with those appeals. TSI LLC is vigorously opposing the appeal of the directed verdict and prosecuting the appeal of the jury verdict, which appeals were argued on May 16, 2006. Depending on the ultimate outcome, this matter may have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

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.

### Item 1A. *Risk Factors*

There have not been any material changes to the information related to the ITEM 1A. "RISK FACTORS" disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

### 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.*

On October 4, 2007, we announced that Robert Giardina, our Chief Executive Officer, will resign from his position with the Company due to personal and health reasons. Mr. Giardina's resignation became effective October 31, 2007. He will continue to serve as a member of the Company's Board of Directors and will work with the Company in an advisory capacity. Effective November 1, 2007, Alexander Alimanestianu, President, succeeded Mr. Giardina as Chief Executive Officer. In connection with the

## **Table of Contents**

promotion, the size of the Board was increased on October 2, 2007 to 9 persons, and Mr. Alimanestianu was elected by the Board of Directors to fill the newly created Board position.

On September 14, 2007, the Compensation Committee of the Board of Directors approved certain changes with respect to the mechanisms used by option holders to pay the exercise price of stock options granted under the Town Sports International Holdings, Inc. 2004 Common Stock Option Plan (the “2004 Plan”) and the Town Sports International Holdings, Inc. 2006 Stock Incentive Plan (the “2006 Plan”) As a result, under each of the Plans, option holders now may exercise their vested stock options and pay the applicable purchase price through a brokerage-assisted exercise procedure, whereby the participant delivers irrevocable instructions to one of the pre-approved brokers to deliver to the Company an amount equal to the purchase price of the stock options being exercised. In addition, the Committee also amended the 2004 Plan and each of the stock option agreements to eliminate the requirement for each option holder that desires to exercise a stock option to deliver a statement to the Company acknowledging that the option holder had read and been afforded an opportunity to ask questions of management of the Company regarding financial and other information of the Company.

### **Item 6. Exhibits**

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

**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: November 1, 2007

By: /s/ Richard Pyle  
Richard Pyle  
*Chief Financial Officer*  
*(principal financial, accounting officer)*

**INDEX TO EXHIBITS**

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

<b><u>Exhibit No.</u></b>	<b><u>Description of Exhibit</u></b>
10.1	Letter Agreement, dated October 4, 2007, between the Registrant and Robert Giardina.
10.2	Amendment No. 1 to the Registrant's 2004 Common Stock Option Plan.
10.3	Form of Non-Qualified Stock Option Agreement pursuant to the Registrant's 2006 Stock Incentive Plan.
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.



October 4, 2007

Mr. Robert Giardina  
c/o Town Sports International Holdings, Inc.  
5 Penn Plaza  
New York, NY 10001

Dear Bob:

This letter agreement confirms the terms that Town Sports International, LLC (the “**Company**”) is offering you in connection with your resignation from the employ of the Company and its affiliates and from all officer and director positions that you currently hold with the Company and its affiliates other than as a director of Town Sports International Holdings, Inc. (“**TSI Holdings**”).

1. Resignation Date. The effective date of your resignation from the employ of the Company and its affiliates in all capacities (other than as a director of TSI Holdings) shall occur on October 31, 2007 (the “**Resignation Date**”). During the period through the Resignation Date, you shall continue to perform the duties associated with your position and shall receive your base salary at the rate in effect on the date hereof, participate in the Company’s benefit plans in accordance with their terms and your options to purchase TSI Holdings common stock shall remain outstanding and continue to vest. You shall be paid for any accrued, but not taken, PTO (personal time off) days in accordance with the Company’s prevailing payroll practices.

2. Severance Benefits. In return for your execution and delivery of this Agreement, and subject to the terms of this Agreement:

(a) The Company shall continue to pay you your base salary (at the rate in effect on the Resignation Date) for a period commencing on the Resignation Date and ending on March 15, 2008 (the “**Severance Period**”), as severance, payable in accordance with the Company’s prevailing payroll practices; provided, however, that the last installment of severance shall be in respect of a full month of base salary for the month of March 2008.

(b) You shall be entitled to receive the annual bonus under the terms of the Company’s Bonus Plan for 2007 that you would have received had you remained in the employ of the Company through the payment date of such 2007 bonus, which amount shall be payable at such time as bonuses are paid to the Company’s employees generally.

(c) The Company shall continue (or provide comparable substitute coverage) your health and dental coverage, and continue to pay that portion of the premium that it pays for active employees at such times as the Company makes such payments for its active employees until the earlier of December 31, 2012 and the date on which you are eligible for coverage under another comparable plan. You agree to promptly notify the Company in writing in the event that you are eligible for coverage under another such plan. This period shall run concurrently with

---

the Company's obligations pursuant to COBRA and the Company may require you to elect COBRA for the applicable period.

(d) During the Severance Period, each of you, your wife (April) and two daughters (Allison and Jennifer) may continue a Passport Membership at no cost (provided however that such memberships shall cease in the event you commence employment or a consulting role with a competitor of the Company or in the event of your material breach of this Agreement). The aforementioned membership is subject to all of the Company's rules, regulations and policies currently in effect and as may be amended from time to time (the "Rules").

(e) During the Severance Period, you agree to be available to the Company to provide certain consulting and advisory services at such times as may be reasonably requested by the Company. The Company will reimburse you for any reasonable out-of-pocket expenses incurred by you in connection with the performance of such services, provided that such expenses shall not be required to be incurred by you, and shall not be reimbursed, unless such expenses have been approved in writing in advance by the Chief Executive Officer or Chief Financial Officer of the Company.

### 3. Consulting Engagement.

(a) You hereby agree to serve, and the Company hereby agrees to retain you, as a consultant to the Company for the period (the "**Consulting Period**") beginning April 1, 2008 through and including March 31, 2009, provided that the Consulting Period may be terminated prior to the aforementioned expiration date by either party upon 30 days prior written notice without any further liability. Your services hereunder during the Consulting Period will consist of such consulting and advisory services, and will be provided at such times, as may be reasonably requested from time to time by the Company. The Company will reimburse you for any reasonable out-of-pocket expenses incurred by you in connection with the performance of such consulting and advisory services, provided that such expenses shall not be required to be incurred by you, and shall not be reimbursed, unless such expenses have been approved in writing in advance by the Chief Executive Officer or Chief Financial Officer of the Company.

(b) In consideration for the consulting services to be performed hereunder and for entering in the Release, the Company will pay you a monthly fee of five thousand dollars (\$5,000). Such payments shall commence on April 30, 2008 and shall be payable in arrears on the last day of each month, pro rated for the number of days elapsed in any month in which the Consulting Period is earlier terminated. In addition, during the Consulting Period, each of you, your wife (April) and two daughters (Allison and Jennifer) may continue a Passport Membership at no cost (provided however that such memberships shall cease in the event you commence employment or a consulting role with a competitor of the Company or in the event of your material breach of this Agreement). The aforementioned membership is subject to all of the Rules.

(c) You understand that, as a consultant, you will not be entitled to receive benefits available to Company employees, including, but not limited to, health, dental, life and disability insurance and participation in any 401(k) plan except by virtue of Section 2 above. In addition, you shall be responsible for the payment of taxes and the Company shall not withhold any

amounts in satisfaction of such taxes, unless required to do so by law. You further agree that if any portion of the consulting fee is deemed by the Internal Revenue Service, or any other federal or state governmental agency, to be taxable and to have been subject to withholding, you will pay all taxes, as well as all penalties and interest, the Company is found to owe and you will indemnify, defend and hold the Company harmless with respect to any claims, demands, actions or causes of action relating to liability for, and/or collection of, any such taxes, penalties and/or interest.

(d) Nothing contained in this Agreement shall be construed as creating an agency relationship between you and the Company and, without the Company's prior written consent, you shall have no authority hereunder to bind the Company or make any commitments on the Company's behalf. You shall not take any action in connection with the rendering of your services hereunder which you reasonably believe would cause any third party to assume that you have such authority.

#### 4. Release.

(a) In consideration of the obligations contained in Section 2 of this Agreement and for other valuable consideration, you (for yourself, your heirs, legal representatives, executors or administrators (collectively, your "**Representatives**") hereby release and forever discharge the Company, TSI Holdings, their respective subsidiaries and affiliates and each of their respective officers, employees, directors and agents (collectively, the "**Released Parties**") from any and all claims and rights which you may have against them, and you hereby specifically release, waive and forever hold them harmless from and against any and all such claims, liability, causes of action, compensation, benefits, damages, attorney fees, costs or expenses, of whatever nature or kind and whether known or unknown, fixed or contingent, and by reason of any matter, cause, charge, claim, right or action whatsoever, which have arisen at any time up to and including the date of execution of this Agreement, including, but not limited to, those arising during or in any manner out of your employment with, or your resignation from, the Company, or anything else that may have happened up to and including the day you sign this Agreement. The rights, claims, causes of action, and liabilities that you are releasing and waiving include, but are not limited to, those that concern, relate to, or might arise out of the following: salary, overtime, bonuses, equity and severance arrangements, benefit plans; and commissions; tort; breach of express or implied contract or promise; harassment, intentional injury or intentional tort, fraud, misrepresentation, battery, assault, defamation, breach of fiduciary duty, tort or public policy claims, whistleblower claims, negligence (including negligent hiring, retention and/or supervision), wrongful or retaliatory discharge, infliction of emotional injury, or any other facts or claims; retirement, stock option or any other benefits; the Fair Labor Standards and the Equal Pay Acts (29 U.S.C. §201, 29 U.S.C. §206(d), et seq.); the Age Discrimination in Employment Act (ADEA) (29 U.S.C. §621, et seq.); Title VII of the Civil Rights Act of 1964 (42 U.S.C. §2000e, et seq.); ERISA (the Employee Retirement Income Security Act of 1974 (29 U.S.C. §1001, et seq.) other than any vested ERISA benefit; COBRA (the Consolidated Omnibus Budget Reconciliation Act of 1986, 29 U.S.C. §21161, et seq.); the federal WARN Act; the American with Disabilities Act (42 U.S.C. §12101, et seq.); the National Labor Relations Act and the Labor Management Relations Act, 29 U.S.C. §141 et seq.; the Family and Medical Leave Act (29 U.S.C. §2601, et seq.); the United States Constitution; the Civil Rights Act of 1991; the

Civil Rights Acts of 1866 or 1871 (42 U.S.C. §§1981,1983,1985, et seq.); retaliation under any federal, state, or local law; any claims for costs or attorney fees; the fair employment practices (FEP) laws and employment-related laws of any federal, state, or local jurisdiction (including the New York State Human Rights Law, New York Administrative Code), and any other federal, state, city, county or other common law, law, or ordinance, including but not limited to those where you work and/or reside.

(b) Notwithstanding the foregoing, the release set forth in Section 4(a) and the release referenced in Section 4(e), shall not apply to (i) the obligations of the Company under this Agreement, (ii) your vested benefits under the Company's 401(k) plan, (iii) your rights as a director of TSI Holdings and (iv) the Company's obligations under the 2004 Option (as defined and set forth below in Section 5). You further agree that the payments and benefits described in this Agreement shall be in full satisfaction of any and all claims for payments or benefits, whether express or implied, that you may have against the Company, TSI Holdings or any of their respective subsidiaries or affiliates arising out of your employment relationship, your service as an employee or officer of the Company, TSI Holdings or any of their respective subsidiaries or affiliates and your resignation therefrom. You hereby acknowledge and confirm that you are providing the release and discharge set forth in this Section 4 only in exchange for consideration in addition to anything of value to which you are already entitled.

(c) You represent and agree that you have not filed any lawsuits against any Released Party, or filed or caused to be filed any charges or complaints against any Released Party with any municipal, state or federal agency charged with the enforcement of any law. Pursuant to and as a part of your release and discharge of the Released Parties, you agree, to the maximum extent permitted by applicable law, not to sue or file a charge or complaint against any Released Party in any forum or assist or otherwise participate willingly or voluntarily in any claim, suit, action, investigation or other proceeding of any kind which relates to any matter that involves any Released Party, and that occurred up to and including the date of your execution of this Agreement, unless as required to do so by court order, subpoena or other directive by a court, administrative agency or legislative body, other than to enforce this Agreement. With respect to the claims you are waiving herein, you are waiving any right to receive money or any other relief in any action instituted on your behalf by any other person, entity or government agency.

(d) Nothing in this release shall affect the Company and TSI Holdings' obligation to indemnify, defend and hold you harmless to the fullest extent allowable by applicable law and their respective charter and by-laws with respect to your acts or omissions in your capacity as a director or officer of the Company, TSI Holdings and their respective subsidiaries and affiliates. The Company shall continue to maintain directors and officers liability insurance with respect to actions or omissions by you as an officer or director of TSI Holdings, the Company (or any of its subsidiaries) to the fullest extent permitted by law in the same manner that it maintains such insurance for other officers and directors.

(e) As a further condition to the payments under Section 2, you shall be required to execute a release of claims through the Resignation Date in substantially the form of this Section 4.

5. Options. Your options to purchase TSI Holdings common stock granted on February 4, 2004 (the "2004 Option") pursuant to the 2004 Stock Option Plan, to the extent vested as of the Resignation Date, shall remain outstanding for the post-termination exercise period specified in the applicable option agreement (until 90 days after the Resignation Date). Such vested options will expire at the conclusion of such post-termination exercise period to the extent not previously exercised. That portion of the 2004 Option that is unvested shall be forfeited on the Resignation Date without any payment. Notwithstanding anything to the contrary contained in the 2006 Stock Incentive Plan or the applicable option agreement, the options to purchase 50,000 shares of TSI Holdings common stock granted to you on August 7, 2007 shall be forfeited without any payment made therefor.

6. Club Membership. Commencing at the conclusion of the Consulting Period (but in no event prior to May 1, 2008), each of you, your wife (April) and two daughters (Allison and Jennifer) may continue a lifetime Passport Membership at no cost (provided however that such memberships shall cease in the event you commence employment or a consulting role with a competitor of the Company or in the event of your material breach of this Agreement). The aforementioned membership is subject to all of the Rules.

7. No Other Compensation or Benefits; Director Compensation. Except as otherwise specifically provided herein or by virtue of your service on the Board of Directors of TSI Holdings, you shall not be entitled to any compensation or benefits or to participate in any past, present or future employee benefit programs or arrangements of the Company, TSI Holdings or any of their respective subsidiaries or affiliates on or after the Resignation Date. In addition, you acknowledge and agree that during the Severance Period and Consulting Period, you shall not be entitled to receive compensation as a non-employee director. Following the expiration or earlier termination of the Consulting Period, you shall be eligible for compensation as a non-employee director in accordance with the compensation practices of TSI Holdings as they are in effect from time to time.

8. Return of Company Property. On or prior to the Resignation Date, you agree to deliver to the Company all Company property and equipment in your possession or control, including, but not limited to, any and all records, manuals, customer lists, notebooks, computers, computer programs and files, Company credit cards, papers, electronically stored information and documents kept or made by you in connection with your employment and you shall not retain any copies thereof. You also agree to leave intact all electronic Company documents, including those that you developed or helped develop. You are required to return all such property whether or not you sign this Agreement. Notwithstanding the foregoing, you shall be permitted to retain the cell phone (and number) provided by the Company, at your expense after the Resignation Date.

9. Breach. You acknowledge and agree that, notwithstanding any other provision of this Agreement, in the event you breach this Agreement, the Company is entitled to appropriate injunctive relief (which shall also apply to threatened breaches of this Agreement) and retains the right to recoup any and all payments and benefits provided for in this Agreement, any damages suffered by the Company, plus reasonable attorneys' fees incurred in connection with such recovery and, to the extent that such payments and/or benefits have not been fully made to you, the Company reserves its rights to stop all such future payments and/benefits. You agree that in

the event you bring a claim covered by the release in Section 4 (including the release described in Section 4(e)) in which you seek damages against the Company or any other Released Party or in the event you seek to recover against any of such entities in any claim brought by a governmental agency on your behalf, this Agreement shall serve as a complete defense to such claims.

10. Waiver of Rights. No delay or omission by the Company in exercising any right under this Agreement shall operate as a waiver of that or any other right. A waiver or consent given by the Company on any one occasion shall be effective only in that instance and shall not be construed as a bar or waiver of any right on any other occasion.

11. Nondisclosure of Confidential Information.

(a) You acknowledge and agree that in the course of your employment with the Company, you have acquired certain Confidential Company Information which you knew or understood was confidential or proprietary to the Company and which, as used in this Agreement, means: information belonging to or possessed by the Company which is not available in the public domain, including, without limitation (i) information received from the customers, suppliers, vendors, employees or agents of the Company under confidential conditions; (ii) customer and prospect lists, and details of agreements and communications with customers and prospects; (iii) sales plans and projections, product pricing information, acquisition, expansion, marketing, financial and other business information and existing and future products and business plans of the Company; (iv) the Company's confidential accounting, tax, or financial information, results, procedures and methods; (v) information relating to existing claims, charges and litigations; (vi) sales proposals, demonstrations systems, sales material; and (vii) employee information (including, but not limited to, personnel, payroll, compensation and benefit data and plans), including all such information recorded in manuals, memoranda, projections, reports, minutes, plans, drawings, sketches, designs, formula books, data, specifications, software programs and records, whether or not legended or otherwise identified by the Company as Confidential Information, as well as such information that is the subject of meetings and discussions and not recorded. You understand that such Confidential Company Information has been disclosed to you for the Company's use only. You understand and agree that you (i) shall not disclose or communicate Confidential Company Information to any person or persons; and (ii) shall not make use of Company Confidential Information on your own behalf, or on behalf of any other person or persons. You shall give immediate notice to the Company if you are ordered by a court or otherwise compelled by law to reveal any Confidential Company Information to any third party. In view of the nature of your employment and the nature of the Company Confidential Information you have had access to (and shall continue to have access to through the Consulting Period), you acknowledge and agree that any unauthorized disclosure to any person or persons of Company Confidential Information, or other violation or threatened violation of this Agreement shall cause irreparable damage to the Company and that, therefore, the Company shall, in addition to any other available remedy, be entitled to an injunction prohibiting you from any further disclosure, attempted disclosure, violation or threatened violation of this Agreement.

Nothing contained in Sections 11, 12 and 13 of this Agreement is intended to limit your fiduciary duties to TSI Holdings and its subsidiaries and your obligations under applicable securities laws in your capacity as a director of TSI Holdings.

12. Non-Compete and Non-Solicitation.

(a) In consideration of the payments and benefits received pursuant to this Agreement, you agree that from the date hereof through two years following the later of (i) the end of the Consulting Period and (ii) the conclusion of your service as a member of the Board of Directors (the "Restricted Period"), you shall not directly or indirectly own, manage, control, participate in, consult with, be employed by, render services for, or in any manner engage in, any business competing directly or indirectly with the business as now or hereafter conducted by the Company or the businesses which are logical extensions of the Company's current business, within any metropolitan area in which the Company engages or has definitive plans to engage in such business during the Consulting Period or the period in which you are a director of TSI Holdings; provided, that you shall not be precluded from purchasing or holding publicly traded securities of any such entity so long as you hold less than 2% of the outstanding units of any such class of securities and have no active participation in the business of such entity. Notwithstanding the foregoing, you hereby agree that you shall not directly or indirectly own, manage, control, participate in, consult with, be employed by, render services for any competitor in the United States that had revenues during the preceding year of at least \$30 million or any of the following entities: Crunch, 24 Hour, Equinox, NY Health and Racquet Club, LA Fitness, Sports & Health, Lifetime or Bally's (or any of their successors) for three years following the later of (i) the end of the Consulting Period and (ii) the conclusion of your service as a member of the Board of Directors.

(b) In consideration of the payments and benefits received pursuant to this Agreement, you agree that through the Restricted Period, you shall not: (i) induce or attempt to induce any employee or consultant of the Company to leave the employ or services of the Company, or in any way interfere with the relationship between the Company and any employee or consultant thereof; or (ii) hire any person who was an employee of the Company at any time during your employment period for a position which would compete with the business of the Company in the Company's markets as of the date hereof, except for such employees who have been terminated for at least six months.

(c) In consideration of the payments and benefits received pursuant to this Agreement, you agree that through the Restricted Period, you shall not, directly or indirectly: (i) solicit or attempt to enter into a contractual relationship with any customer, supplier, vendor, licensee, franchisee or other business relation of the Company, which relationship will have an adverse impact on the Company in a market in which the Company does business during the Consulting Period or the period in which you serve as a director, without prior approval from the Company; or (ii) induce or attempt to induce any customer, supplier, vendor, licensee, franchisor or other business relation of the Company to cease doing business with the Company, or in any way interfere with the relationship between any such customer, supplier, vendor, licensee, franchisor or business relation, on the one hand, and the Company, on the other hand.

13. Non-Disparagement; Cooperation.

(a) You understand and agree that as a condition for payment to you of the consideration herein described, you, on your behalf and on behalf of your Representatives, shall not (and your Representatives shall not) at any time engage in any form of conduct, or make any statements or representations that disparage or otherwise impair the reputation, goodwill, or commercial interests of the Company, its management, stockholders, subsidiaries, parents, and/or other affiliates.

(b) From and after the Resignation Date, you shall (i) cooperate in all reasonable respects with the Company and its affiliates and their respective directors, officers, attorneys and experts in connection with the conduct of any dispute, action, proceeding, investigation or litigation involving the Company or any of its affiliates, including, without limitation, any such dispute, action, proceeding, investigation or litigation in which you are called to testify and (ii) promptly respond to all reasonable requests by the Company and its affiliates relating to information concerning the Company which may be in your possession. The Company shall, as a condition to your obligations under this Section 13(b), reimburse you for any reasonable out of pocket expenses incurred as a result of such cooperation, provided that such expenses have been approved in writing in advance by an executive officer of the Company.

14. Applicable Law. This Agreement shall be interpreted and construed by the laws of the State of New York, without regard to conflict of laws provisions. You hereby irrevocably submit to and acknowledge and recognize the jurisdiction of the courts of the State of New York, or, if appropriate, a federal court within New York (which courts, together with all applicable appellate courts, for purposes of this agreement, are the only courts of competent jurisdiction), over any suit, action or other proceeding arising out of, under or in connection with this Agreement or the subject matter hereof.

15. Entire Agreement/Severability. You understand and agree that this Agreement contains the entire understandings and agreements between the parties hereto with respect to the subject matter hereof. For avoidance of doubt, nothing contained herein shall have any effect on your rights and obligations under the Registration Rights Agreement, dated February 4, 2004, as amended. The parties agree that this Agreement may not be modified, altered or changed except by a written agreement signed by the parties, hereto. If any provision of this Agreement is held by a Court to be invalid, the remaining provisions shall remain in full force and effect.

16. Acceptance. You shall have twenty-one (21) days from the date set forth above to consider the terms of this Agreement. In order to receive the benefits and payments provided for by Section 2 of this Agreement and for the Company to retain you as a consultant, you must execute this Agreement and return it to the Company addressed to the Company, Attention: General Counsel, at the address specified in Section 22 so that it is received any time on or before the expiration of the 21-day period. After executing the Agreement, you shall have seven (7) days (the "Revocation Period") to revoke it by indicating your desire to do so in writing addressed to and received by the General Counsel at the address set forth in Section 22 no later than the seventh (7<sup>th</sup>) day following the date you executed the Agreement. In the event you do not accept this Agreement or in the event you revoke this Agreement during the Revocation

Period, the obligations of the Company to make the payments and provide the benefits set forth herein shall automatically be deemed null and void. No payments or benefits shall be paid or provided under Section 2 of this Agreement until the Resignation Date so long as you have signed this Agreement, the Release attached hereto and the applicable Revocation Period has expired without a revocation by you.

17. Voluntary Assent. You affirm that you have read this Agreement, and understand all of its terms, including the full and final release of claims set forth in Section 4. You further acknowledge that you have voluntarily entered into this Agreement; that you have not relied upon any representation or statement, written or oral, not set forth in this Agreement; that the only consideration for signing this Agreement is as set forth herein; that the consideration received for executing this Agreement is greater than that to which you may otherwise be entitled; and that this document gives you the opportunity and encourages you to have this Agreement reviewed by your attorney and/or tax advisor. You also acknowledge that you have been given up to twenty-one (21) days to consider this Agreement and that you understand that you have seven (7) days after executing it to revoke it in writing, and that, to be effective, such written revocation must be received by the Company within the seven (7) day Revocation Period.

18. No Admission. Nothing contained in this Agreement, or the fact of its submission to you, shall constitute or be construed as an admission of liability or wrongdoing by either party.

19. Counterparts. The Agreement may be executed in two (2) signature counterparts, each of which shall constitute an original, but all of which taken together shall constitute but one and the same instrument.

20. Taxes; Section 409A. All payments hereunder shall be subject to all applicable federal, state and local tax withholding obligations. It is intended that the payments provided for herein are intended to comply with the terms of Section 409A ("Section 409A") of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder. In the event, however, that any such payments are determined to be subject to Section 409A, then the Company will make such adjustments as are reasonably required to comply with such section, including delaying any such payments that would have been required to be paid to you pursuant to this Agreement during the first six months following the Resignation Date until the end of such six-month period in accordance with the requirements of Section 409A. In addition, any expense reimbursement under Section 2(e), 3(a) or 13(b) hereof shall be made on or before the last day of the taxable year following the taxable year in which such expense was incurred by you, and no such reimbursement or the amount of expenses eligible for reimbursement in any taxable year shall in any way affect the expenses eligible for reimbursement in any other taxable year. The resignation of your employment on October 31, 2007 is intended to constitute a "separation of service" for purposes of Section 409A. Without limiting the generality of the foregoing, the amount of time that you will provide in your capacity as a director of TSI Holdings and as a consultant to the Company shall not exceed 40% of the time spent by you in performing services for TSI Holdings and the Company for the thirty-six months preceding the Resignation Date.





**AMENDMENT NO. 1  
TO THE  
TOWN SPORTS INTERNATIONAL HOLDINGS, INC.  
2004 COMMON STOCK OPTION PLAN**

**WHEREAS**, Town Sports International Holdings, Inc. (the “**Corporation**”) maintains the Town Sports International Holdings, Inc. 2004 Common Stock Option Plan (the “**Plan**”);

**WHEREAS**, pursuant to Section 6.11 of the Plan, the Compensation Committee of the Board of Directors of the Corporation (the “**Compensation Committee**”) may at any time, and from time to time, amend, in whole or in part, any of or all the provisions of the Plan in such respects as the Committee may deem advisable; and

**WHEREAS**, the Compensation Committee deems it advisable to amend the Plan, effective as of September 14, 2007;

**NOW, THEREFORE**, pursuant to Section 6.11 of the Plan, the Plan hereby is amended, effective as of September 14, 2007, as follows:

Section 5.5 of the Plan is amended in its entirety to read as follows:

“Section 5.5 Exercise Procedure. Options shall be exercised in whole or in part by written notice to the Company (to the attention of the Chief Financial Officer of the Company), together with payment in full of an amount (the “**Option Price**”) equal to the product of (i) the applicable Exercise Price for the applicable Options multiplied by (ii) the number of Option Shares to be acquired. Payment of the Exercise Price may be made (i) in cash (including certified check, bank draft or money order or the equivalent thereof acceptable to the Company), (ii) if approved by the Committee prior to exercise (in the case of an incentive stock option, if approved by the Committee in the grant), by delivery of a full recourse promissory note of the Participant bearing interest at a rate not less than the applicable federal rate determined pursuant to Section 1274 of the Code as of the date of purchase or exercise, (iii) by the delivery of shares of Common Stock valued at their Fair Market Value as of the date of exercise as provided in Section 5.6 below, (iv) solely to the extent permitted by applicable law, if the Common Stock is traded on a national securities exchange, The NASDAQ Stock Market (or its successor) or quoted on a national quotation system sponsored by the National Association of Securities Dealers, through a broker-assisted cashless exercise procedure whereby the Participant delivers irrevocable instructions to a broker reasonably acceptable to the Committee to deliver promptly to the Company an amount equal to the purchase price; or (v) in a combination of the foregoing. Unless otherwise specified in the Option grant or as determined by the Committee, no Option may be exercised for a fraction of a share of Common Stock.”

---

**IN WITNESS WHEREOF**, the Corporation has caused this Amendment to be executed as of the 14<sup>th</sup> day of September, 2007.

**TOWN SPORTS INTERNATIONAL  
HOLDINGS, INC.**

By: /s/ David M. Kastin  
Name: David M. Kastin  
Title: Senior Vice President — General  
Counsel and Corporate Secretary



**NON-QUALIFIED STOCK OPTION AGREEMENT  
PURSUANT TO THE  
TOWN SPORTS INTERNATIONAL HOLDINGS, INC.  
2006 STOCK INCENTIVE PLAN**

**THIS AGREEMENT**, dated as of \_\_\_\_\_, 200\_\_ (this “**Agreement**”), between Town Sports International Holdings, Inc. (the “**Company**”) and \_\_\_\_\_ (the “**Participant**”).

**Preliminary Statement**

The Compensation Committee of the Board of Directors of the Company (the “**Committee**”) has authorized this grant of a non-qualified stock option (the “**Option**”) on \_\_\_\_\_, 200\_\_ (the “**Grant Date**”) to purchase the number of shares of the Company’s common stock, par value \$0.001 per share (the “**Common Stock**”), set forth below to the Participant, as an Eligible Employee of the Company or an Affiliate of the Company. Unless otherwise indicated, any capitalized term used but not defined herein shall have the meaning ascribed to such term in the Town Sports International Holdings, Inc. 2006 Stock Incentive Plan (as the same may be amended from time to time, the “**Plan**”). A copy of the Plan as in effect on the date hereof and prospectus has been delivered to the Participant. By signing and returning this Agreement, the Participant acknowledges having received and read a copy of the Plan as in effect on the date hereof and prospectus and agrees to comply with the Plan, this Agreement and all applicable laws and regulations.

Accordingly, the parties hereto agree as follows:

1. **Tax Matters**. No part of the Option granted hereby is intended to qualify as an “incentive stock option” under Section 422 of the Internal Revenue Code of 1986, as amended (the “**Code**”).

2. **Grant of Option**. Subject in all respects to the Plan and the terms and conditions set forth herein and therein, the Participant is hereby granted an Option to purchase from the Company \_\_\_\_\_ shares of Common Stock (the “**Option Shares**”), at a price per share of \$\_\_\_\_ (the “**Option Price**”), which may not be less than Fair Market Value on the Grant Date.

3. **Vesting and Exercise**.

(a) Except as set forth in Section 3(c), the Option shall vest and become exercisable in installments as provided below, which shall be cumulative. To the extent that the Option has become vested and exercisable as provided below, the Option thereafter may be exercised by the Participant, in whole or in part, at any time or from time to time prior to the expiration or earlier termination of the Option as provided herein and in accordance with Section 6.3(d) of the Plan, including, without limitation, the filing of such written form of exercise notice, if any, as may be required by the Committee or the Company and the payment in full of the Option Price multiplied by the number of Option Shares underlying the portion of the Option exercised. Upon expiration of the Option, the Option shall be canceled and no longer exercisable. The following table indicates each date upon which the Participant shall be vested and entitled to exercise the Option with respect to the percentage of the Option Shares indicated beside such date, provided that the Participant has not had a Termination of Employment any time prior to such date (each of the dates set forth below being herein called a “**Vesting Date**”):

---

Vesting Date	Percentage of Option Shares Vested
First Anniversary of Grant Date	25%
Second Anniversary of Grant Date	50%
Third Anniversary of Grant Date	75%
Fourth Anniversary of Grant Date	100%

(b) There shall be no proportionate or partial vesting in the periods prior to each Vesting Date and all vesting shall occur only on the appropriate Vesting Date, provided that the Participant has not had a Termination of Employment at any time prior to such Vesting Date.

(c) The Option will become fully vested on a Change in Control.

(d) In consideration for the grant of the Option and in addition to any other remedies available to the Company, the Participant acknowledges and agrees that the Option is subject to the provisions in the Plan regarding any Detrimental Activity. If the Participant engages in any Detrimental Activity prior to the exercise of the Option, then the Option shall terminate and expire as of the date the Participant engaged in such Detrimental Activity. As a condition of the exercise of the Option, the Participant shall be required to certify (or be deemed to have certified) at the time of exercise in a manner acceptable to the Company that the Participant is in compliance with the terms and conditions of the Plan and that the Participant has not engaged in, and does not intend to engage in, any Detrimental Activity. If the Participant engages in any Detrimental Activity, then, in accordance with the terms of the Plan, the Company shall be entitled to recover from the Participant, and the Participant shall pay over to the Company, an amount equal to any gain realized as a result of the exercise (whether at the time of exercise or thereafter).

4. **Option Term.** The term of the Option shall be 10 years after the Grant Date and the Option shall expire at 5:00 p.m. (New York City time) on the 10<sup>th</sup> anniversary of the Grant Date, subject to earlier termination in the event of the Participant's Termination of Employment as specified in Section 5.

5. **Termination.**

(a) Subject to Section 4, the terms of the Plan and this Agreement, the Option, to the extent vested at the time of the Participant's Termination of Employment, shall remain exercisable as provided in Section 11.1(a) of the Plan.

(b) Any portion of the Option that is not vested as of the date of the Participant's Termination of Employment for any reason shall terminate and expire as of the date of such Termination of Employment.

6. **Restriction on Transfer of Option.** No part of the Option shall be subject to Transfer other than by will or by the laws of descent and distribution. During the lifetime of the Participant, the Option may be exercised only by the Participant or the Participant's guardian or legal representative. The Option shall not be subject to levy by reason

of any execution, attachment or similar process. Upon any attempt to Transfer the Option or in the event of any levy upon the Option by reason of any execution, attachment or similar process contrary to the provisions hereof, the Option shall immediately and automatically become null and void.

**7. Non-Compete; Nonsolicitation .**

(a) (i) As an inducement to the Company to enter into this Agreement and grant the Option, the Participant agrees that (A) during the Participant's period of employment with the Company or any of its Affiliates, and (B) if the Participant resigns or the Participant's employment is terminated by the Company or any of its Affiliates for any reason, during the period which the Company or any of its Affiliates is paying the Participant severance compensation (which shall be at a rate and an amount equal to the Participant's base salary received by the Participant immediately prior to the Participant's Termination of Employment), such period not to exceed one year (the "**Noncompete Period**"), the Participant shall not, directly or indirectly, own, manage, control, participate in, consult with, render services for, or in any manner engage in, any business competing directly or indirectly with the business as conducted by the Company or any of its Affiliates during the Participant's period of employment with the Company or any of its Affiliates or at the time of the Participant's Termination of Employment or with any other business that is the logical extension of the Company's and its Affiliates' business during the Participant's period of employment with the Company or any of its Affiliates or at the time of the Participant's Termination of Employment, within any metropolitan area in which the Company or any of its Affiliates engages or has definitive plans to engage in such business; provided, however, that (1) the Participant shall not be precluded from purchasing or holding publicly traded securities of any entity so long as the Participant shall hold less than 2% of the outstanding units of any such class of securities and has no active participation in the business of such entity, and (2) the Company shall have notified the Participant of its agreement to provide (or cause to be provided) such severance compensation a)(x) in the event of resignation, within five days following the date of the Participant's Termination of Employment, or (y) in the event of termination, on or before the date of the Participant's Termination of Employment. Notwithstanding anything contained herein to the contrary, the Participant's agreement set forth in clause (B) above shall not apply if the date of the Participant's Termination of Employment occurs after the fifth anniversary of the Grant Date.

(ii) During the Noncompete Period, the Participant shall not directly or indirectly (i) induce or attempt to induce any employee of the Company or any of its Affiliates to leave the employ of the Company or any of its Affiliates, or in any way interfere with the relationship between the Company or any of its Affiliates and any employee thereof, (ii) hire any person who was an employee of the Company or any of its Affiliates at any time during the Participant's employment period except for such employees who have been terminated for at least six months, or (iii) induce or attempt to induce any customer, supplier, licensee, franchisor or other business relation of the Company or any of its Affiliates to cease doing business with such member, or in any way interfere with the relationship between any such customer, supplier, licensee, franchisor or business relation, on the one hand, and the Company or any of its Affiliates, on the other hand.

(iii) The provisions of this Section 7(a) shall survive any expiration or termination of this Agreement or the Option.

(iv) If it is determined by a court of competent jurisdiction that any of the provisions of this Section 7(a) is excessive in duration or scope or otherwise is

unenforceable, then such provision may be modified or supplemented by the court to render it enforceable to the maximum extent permitted by law.

(b) The Participant acknowledges that the Participant may have access to certain confidential, non-public and proprietary information (the “ **Confidential Information** ”), concerning the Company and its Affiliates and their respective officers, directors, stockholders, employees, agents and representatives and agrees that: (i) unless pursuant to prior written consent by the Company, the Participant shall not disclose any Confidential Information to any Person for any purpose whatsoever unless compelled by court order of subpoena; (ii) the Participant shall treat as confidential all Confidential Information and shall take reasonable precautions to prevent unauthorized access to the Confidential Information; (iii) the Participant shall not use the Confidential Information in any way detrimental to the Company or any of its Affiliates and shall use the Confidential Information for the exclusive purpose of effecting the Participant’s duties of employment with the Company or any of its Affiliates; and (iv) the Participant agrees that the Confidential Information obtained during the Participant’s employment with the Company shall remain the exclusive property of the Company and its Affiliates, and the Participant shall promptly return to the Company all material which incorporates, or is derived from, all such Confidential Information upon termination of the Participant’s employment with the Company or any of its Affiliates. The Participant shall be responsible for any breach of the terms of this **Section 7(b)** by any holder of the Option Shares. It is hereby agreed that Confidential Information does not include information generally available and known to the public other than through the disclosure thereof by or through the Participant or obtained from a source not bound by a confidentiality agreement with the Company or any of its Affiliates.

(c) The Participant hereby agrees that all inventions, innovations or improvements in the method of conducting the business (including improvements, ideas and discoveries, whether patentable or not) of the Company or any of its Affiliates, whether prior to the date hereof or thereafter, in each case conceived or made by the Participant in the course of the Participant’s employment with the Company or any of its Affiliates, belong to the Company and its Affiliates, except for such inventions, innovations and improvements that have become part of the public domain other than through the disclosure thereof by or through the Participant and are not entitled to statutory or common law protection. The Participant will promptly disclose such inventions, innovation or improvements to the Company and perform all actions reasonably requested by the Company to establish and confirm such ownership by the Company or any of its Affiliates.

8. **Rights as a Stockholder**. The Participant shall have no rights as a stockholder with respect to any Option Shares unless and until the Participant has become the holder of record of the Option Shares. No adjustments shall be made to the Option, the Option Shares or the Option Price for dividends in cash or other property, distributions or other rights in respect of any Option Shares, except as otherwise may be specifically provided for in the Plan. No shares of Common Stock shall be issued unless and until payment therefor has been made or provided and the conditions set forth in Section 15.6 of the Plan are satisfied.

9. **Provisions of Plan Control**. This Agreement is subject to all the terms, conditions and provisions of the Plan, including, without limitation, the amendment provisions thereof, and to such rules, regulations and interpretations relating to the Plan as may be adopted by the Committee and as may be in effect from time to time. The Plan is incorporated herein by reference. If and to the extent that this Agreement conflicts or is inconsistent with the terms, conditions and provisions of the Plan, the Plan shall control, and this Agreement shall be deemed to be modified accordingly. This Agreement contains the entire agreement and understanding of

the parties with respect to the subject matter hereof and supersedes any prior agreements and understandings (whether written or oral) between the Company and the Participant with respect to the subject matter hereof.

10. **Notices** . Any notice or communication given hereunder (each a “ Notice ”) shall be in writing and shall be sent by personal delivery, by courier or by United States mail (registered or certified mail, postage prepaid and return receipt requested), to the appropriate party at the address set forth below:

If to the Company, to:

Town Sports International Holdings, Inc.  
5 Penn Plaza (4<sup>th</sup> Floor)  
New York, New York 10001  
Attention: Chief Financial Officer

with a copy to:

Town Sports International Holdings, Inc.  
5 Penn Plaza (4<sup>th</sup> Floor)  
New York, New York 10001  
Attention: General Counsel

If to the Participant, to the address for the Participant on file with the Company ; or such other address or to the attention of such other person as a party shall have specified by prior Notice to the other party. Each Notice will be deemed given and effective upon actual receipt (or refusal of receipt).

11. **No Obligation to Continue Employment** . This Agreement is not an agreement of employment. This Agreement does not guarantee that the Company or its Affiliates will employ, retain or continue to, employ or retain the Participant during all, or any part of the term of this Agreement, including but not limited to any period during which any Option is outstanding, nor does it modify in any respect any right of the Company or of any Affiliate of the Company to terminate or modify the Participant’s employment or compensation.

12. **Waiver of Jury Trial** . EACH OF THE PARTIES HERETO WAIVES ANY RIGHT IT MAY HAVE TO TRIAL BY JURY IN RESPECT OF ANY LITIGATION BASED ON, ARISING OUT OF, UNDER OR IN CONNECTION WITH THIS AGREEMENT OR ANY COURSE OF CONDUCT, COURSE OF DEALING, VERBAL OR WRITTEN STATEMENT OR ACTION OF ANY PARTY HERETO.

13. **Governing Law** . All questions concerning the construction, validity and interpretation of this Agreement will be governed by, and construed in accordance with, the domestic laws of the State of New York, without giving effect to any choice of law or conflict of law provision or rule (whether of the State of New York or any other jurisdiction) that would cause the application of the laws of any jurisdiction other than the State of New York.

14. **Consent to Jurisdiction** . In the event of any dispute, controversy or claim between the Company or any Affiliate and the Participant in any way concerning, arising out of or relating to the Plan or this Agreement (a “ Dispute ”), including without limitation any

Dispute concerning, arising out of or relating to the interpretation, application or enforcement of the Plan or this Agreement, the parties hereby (a) agree and consent to the personal jurisdiction of the courts of the State of New York located in New York County and/or the Federal courts of the United States of America located in the Southern District of New York (collectively, the “Agreed Venue”) for resolution of any such Dispute, (b) agree that those courts in the Agreed Venue, and only those courts, shall have exclusive jurisdiction to determine any Dispute, including any appeal, and (c) agree that any cause of action arising out of this Agreement shall be deemed to have arisen from a transaction of business in the State of New York. The parties also hereby irrevocably (i) submit to the jurisdiction of any competent court in the Agreed Venue (and of the appropriate appellate courts therefrom), (ii) to the fullest extent permitted by law, waive any and all defenses the parties may have on the grounds of lack of jurisdiction of any such court and any other objection that such parties may now or hereafter have to the laying of the venue of any such suit, action or proceeding in any such court (including without limitation any defense that any such suit, action or proceeding brought in any such court has been brought in an inconvenient forum), and (iii) consent to service of process in any such suit, action or proceeding, anywhere in the world, whether within or without the jurisdiction of any such court, in any manner provided by applicable law. Without limiting the foregoing, each party agrees that service of process on such party pursuant to a Notice as provided in Section 10 shall be deemed effective service of process on such party. Any action for enforcement or recognition of any judgment obtained in connection with a Dispute may be enforced in any competent court in the Agreed Venue or in any other court of competent jurisdiction.

15. **Counterparts**. This Agreement may be executed (including by facsimile transmission) with counterpart signature pages or in separate counterparts each of which shall be an original and all of which taken together shall constitute one and the same agreement.

*[Remainder of Page Left Blank]*

**IN WITNESS WHEREOF** , the parties have executed this Agreement as of the date and year first above written.

**Company :**

**TOWN SPORTS INTERNATIONAL  
HOLDINGS, INC.**

By: \_\_\_\_\_

Name:

Title:

**Participant :**

\_\_\_\_\_  
[Name]



I, Alex Alimanestianu, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Town Sports International Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

By: /s/ Alex Alimanestianu  
Alex Alimanestianu  
*Chief Executive Officer*

Date: November 1, 2007



I, Richard Pyle, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Town Sports International Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Richard Pyle  
Richard Pyle  
Chief Financial Officer

Date: November 1, 2007



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Alex Alimanestianu, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2007 (the "Report") fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78m); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Alex Alimanestianu

Alex Alimanestianu  
Town Sports International Holdings, Inc.  
Chief Executive Officer

November 1, 2007

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Richard Pyle, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2007 (the "Report") fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78m); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard Pyle  
*Town Sports International Holdings, Inc.*  
*Chief Financial Officer*

November 1, 2007

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.