

# TOWN SPORTS INTERNATIONAL HOLDINGS INC

## FORM 10-Q (Quarterly Report)

Filed 08/10/06 for the Period Ending 06/30/06

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



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

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**Form 10-Q**

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

**For the quarterly period ended June 30, 2006**

**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)*

**888 Seventh Avenue (25th Floor)  
New York, New York 10106  
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 (as defined in "accelerated filer and large accelerated filer" Exchange Act Rule 12b-2).

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). Yes  No

As of August 10, 2006 there were 25,933,628 shares of Common Stock of the Registrant outstanding.

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

**FORM 10-Q**

**For the Quarter Ended June 30, 2006**

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## TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

December 31, 2005 and June 30, 2006  
 (All figures in \$'000s, except share data)  
 (Unaudited)

	December 31, 2005	June 30, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 51,304	\$ 71,354
Accounts receivable (less allowance for doubtful accounts of \$1,984 and \$1,764 as of December 31, 2005 and June 30, 2006, respectively)	7,103	6,289
Inventory	421	546
Prepaid corporate income taxes	4,518	1,503
Prepaid expenses and other current assets	13,907	12,794
Total current assets	77,253	92,486
Fixed assets, net	253,131	256,968
Goodwill	49,974	50,024
Intangible assets, net	741	420
Deferred tax asset, net	24,378	28,160
Deferred membership costs	11,522	14,423
Other assets	16,772	13,527
Total assets	<u>\$ 433,771</u>	<u>\$ 456,008</u>
<b>Liabilities and Stockholders' Deficit</b>		
Current liabilities:		
Current portion of long-term debt	\$ 1,267	\$ 58,857
Accounts payable	8,333	6,456
Accrued expense	31,620	33,178
Accrued interest	5,267	3,525
Deferred revenue	33,028	37,253
Total current liabilities	79,515	139,269
Long-term debt	409,895	274,960
Deferred lease liabilities	48,898	50,463
Deferred revenue	2,905	8,012
Other liabilities	8,241	9,583
Total liabilities	549,454	482,287
Commitments and contingencies (Note 8)		
Stockholders' deficit:		
Class A voting common stock, \$.001 par value; issued and outstanding 18,327,722 and 25,930,268 shares at December 31, 2005 and June 30, 2006, respectively. (See Note 2)	1	26
Paid-in capital	(113,588)	(22,099)
Unearned compensation	(509)	—
Accumulated other comprehensive income (currency translation adjustment)	386	554
Accumulated deficit	(1,973)	(4,760)
Total stockholders' deficit	(115,683)	(26,279)
Total liabilities and stockholders' deficit	<u>\$ 433,771</u>	<u>\$ 456,008</u>

See notes to the condensed consolidated financial statements.

## TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the six months ended June 30, 2005 and 2006  
 (All figures in \$'000s except share and per share data)  
 (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
<b>Revenues:</b>				
Club Operations	\$ 97,078	\$ 107,659	\$ 189,909	\$ 210,582
Fees and Other	918	1,810	1,933	2,913
	<u>97,996</u>	<u>109,469</u>	<u>191,842</u>	<u>213,495</u>
<b>Operating Expenses:</b>				
Payroll and related	39,168	40,591	75,564	81,487
Club operating	31,717	36,781	63,166	71,251
General and administrative	6,467	8,106	13,145	15,967
Depreciation and amortization	10,084	10,400	19,823	20,786
	<u>87,436</u>	<u>95,878</u>	<u>171,698</u>	<u>189,491</u>
Operating Income	10,560	13,591	20,144	24,004
Loss on extinguishment of debt	—	8,667	—	8,667
Interest expense	10,508	10,395	20,628	21,083
Interest income	(465)	(662)	(834)	(1,387)
Equity in the earnings of investees and rental income	(404)	(475)	(875)	(908)
Income (loss) before provision (benefit) for corporate income taxes	921	(4,334)	1,225	(3,451)
Provision (benefit) for corporate income taxes	430	(1,682)	555	(664)
Net income (loss)	<u>\$ 491</u>	<u>\$ (2,652)</u>	<u>\$ 670</u>	<u>\$ (2,787)</u>
Earnings (loss) per share:				
Basic	\$ 0.03	\$ (0.13)	\$ 0.04	\$ (0.14)
Diluted	\$ 0.03	\$ (0.13)	\$ 0.04	\$ (0.14)
Weighted average number of shares used in calculating earnings (loss) per share:				
Basic	18,327,722	20,660,229	18,341,428	19,500,419
Diluted	18,332,734	20,660,229	18,343,710	19,500,419
<b>Statements of Comprehensive Income (Loss)</b>				
Net income (loss)	\$ 491	\$ (2,652)	\$ 670	\$ (2,787)
Foreign currency translation adjustments	(287)	162	(473)	168
Comprehensive income (loss)	<u>\$ 204</u>	<u>\$ (2,490)</u>	<u>\$ 197</u>	<u>\$ (2,619)</u>

See notes to the condensed consolidated financial statements.

**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the six months ended June 30, 2005 and 2006**  
**(All figures in \$'000s)**  
**(Unaudited)**

	For the Six Months Ended June 30,	
	2005	2006
Cash flows from operating activities:		
Net income (loss)	\$ 670	\$ (2,787)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	19,823	20,786
Interest expense on Senior Discount Notes	7,545	8,398
Compensation expense incurred in connection with stock options	25	574
Noncash rental expense, net of noncash rental income	968	(42)
Loss on extinguishment of debt	—	8,667
Amortization of debt issuance costs	817	815
Net changes in certain operating assets and liabilities	2,512	13,771
Increase in deferred tax asset	(6,639)	(3,782)
(Increase) decrease in deferred membership costs	168	(2,901)
Increase in reserve for self-insured liability claims	1,014	1,551
Landlord contributions to tenant improvements	2,988	3,271
Other	(336)	86
Total adjustments	28,885	51,194
Net cash provided by operating activities	29,555	48,407
Cash flows from investing activities:		
Capital expenditures, net of effect of acquired businesses	(21,830)	(26,004)
Acquisition of businesses	(2,801)	—
Net cash used in investing activities	(24,631)	(26,004)
Cash flows from financing activities:		
Proceeds from initial public equity offering, net of underwriting discounts and offering costs	—	\$ 91,796
Repayment of Senior Notes	—	(85,001)
Proceeds from exercise of stock options	—	85
Repurchase of common stock	(184)	(433)
Change in book overdraft	—	(986)
Repayment of long term borrowings	(499)	(742)
Premium paid on extinguishment of debt and related costs	—	(7,072)
Net cash used in financing activities	(683)	(2,353)
Net increase in cash and cash equivalents	4,241	20,050
Cash and cash equivalents at beginning of period	57,506	51,304
Cash and cash equivalents at end of period	\$ 61,747	\$ 71,354
Summary of change in certain operating assets and liabilities; net of effects of acquired businesses:		
Increase in accounts receivable	\$ (1,386)	\$ (877)
Increase in inventory	(185)	(123)
Decrease, (increase) in prepaid expenses, prepaid income taxes, and other current assets	(186)	3,665
Increase (decrease) in accounts payable, accrued expenses and accrued interest	(2,889)	1,779
Increase in deferred revenue	7,158	9,327
Net changes in certain operating assets and liabilities	\$ 2,512	\$ 13,771

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**

Town Sports International Holdings, Inc. and Subsidiaries (the “Company” or “TSI Holdings”) owns and operates 142 fitness clubs (“clubs”) and partly owns and operates two additional clubs as of June 30, 2006. The Company operates in a single segment. The Company operates 97 clubs in the New York metropolitan market, 19 clubs in the Boston market, 19 clubs in the Washington, D.C. market, six in the Philadelphia market and three clubs in Switzerland. 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”). TSI Holdings is the sole member of TSI.

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 the annual financial statements and notes included in the final prospectus relating to the Company’s initial public equity offering (“IPO”), as filed on June 1, 2006 with the SEC, which includes the audited financial statements for the three years ended December 31, 2005. 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 six months ended June 30, 2006 are not necessarily indicative of the results for the entire year ending December 31, 2006.

**2. Initial Public Offering**

The registration statement filed in connection with the Company’s 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 Stock 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. The Company’s position is that it was required by the relevant agreements to adjust the options to purchase Common Stock, for the stock split. The 1,309,123 shares of Common Stock outstanding on December 31, 2005 have been adjusted for this stock split resulting in adjusted shares of Common Stock outstanding of 18,327,722. 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 consists of 8,950,000 shares of common stock, which includes 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 \$91,796. These proceeds are net of underwriting discounts and commissions and offering costs payable by the Company totaling \$7,654. The IPO proceeds were used for the redemption of 35% of the aggregate principal amount of its outstanding 11% Senior Discount Notes, due 2014, and the remainder of the proceeds together with cash on hand was used to consummate the tender offer for \$85,001 of 9 <sup>5</sup>/<sub>8</sub>% Senior Notes, due 2011.

On June 8, 2006 the Company paid \$93,001 to redeem \$85,001 of the outstanding principal of the 9 <sup>5</sup>/<sub>8</sub>% Senior Notes, together with \$6,796 of early termination fees and \$1,204 of accrued interest. Deferred



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

financing costs totaling \$1,601 were written off and fees totaling \$270 were incurred in connection with this early extinguishment.

The aggregate accreted value of the 35% of Senior Discount Notes redeemed at the 111% redemption value on July 7, 2006 totaled \$62,875. The accreted principal balance up to, but excluding July 7, 2006, totaled \$56,644 and the redemption premium totaled \$6,231.

### 3. Recent Accounting Changes

In June 2006, the FASB issued an interpretation of SFAS No. 109, *Accounting for Income Taxes* (“FIN 48”). The interpretation prescribes a consistent recognition threshold and measurement attribute, as well as criteria for subsequently recognizing, derecognizing and measuring such tax positions for financial statement purposes. The interpretation also requires expanded disclosure with respect to the uncertainty in income taxes. The interpretation is effective January 1, 2007 for TSI Holdings. We are currently evaluating the impact of this interpretation on our Consolidated Financial Statements.

### 4. Long-Term Debt

	December 31, 2005 (\$'000s)	June 30, 2006 (\$'000s)
Senior Notes 9 <sup>5</sup> / <sub>8</sub> %, due 2011	\$ 255,000	\$ 169,999
Senior Discount Notes 11.0%, due 2014	153,077	161,474
Notes payable for acquired businesses	3,085	2,344
	<u>411,162</u>	<u>333,817</u>
Less, current portion to be paid within one year	1,267	58,857
Long-term portion	<u>\$ 409,895</u>	<u>\$ 274,960</u>

The Company has a \$50,000 senior secured revolving credit facility (the “Senior Credit Facility”) that will mature April 15, 2008. Effective July 7, 2006, the Senior Credit Facility was amended to increase permitted borrowings from \$50,000 to \$75,000. Also, in July, the Company paid commitment fees totaling \$125 related to this amendment. The Senior Credit Facility contains various covenants including limits on capital expenditures, the maintenance of a consolidated interest coverage ratio of not less than 3.00:1.00 during 2006 and a maximum permitted total leverage ratio of 3.50:1.00 from December 31, 2005 through September 29, 2006 and 3.25:1.00 from September 30, 2006 through September 29, 2007. TSI’s interest coverage and leverage ratios were 3.90:1.00 and 1.98:1.00, respectively, as of June 30, 2006. As of June 30, 2006 the Company was in compliance with its debt covenants and given the Company’s operating plans and expected performance for 2006, the Company expects it will continue to be in compliance during 2006. These covenants may limit TSI’s ability to incur additional debt. As of June 30, 2006, permitted borrowing capacity was not restricted by the covenants. Loans under the Senior Credit Facility will at TSI’s option, bear interest at either the bank’s prime rate plus 3.0% or the Eurodollar rate plus 4.0%, as defined. There were no borrowings outstanding at June 30, 2006 and outstanding letters of credit issued totaled \$10,783. TSI is required to pay a commitment fee of 0.75% per annum on the daily unutilized amount. The unutilized portion of the Senior Credit Facility as of June 30, 2006 was \$39,217.

On May 18, 2006 the Senior Credit Facility was amended to consent to: (1) the use by TSI Holdings of the net cash proceeds received by TSI Holdings from an IPO to redeem its 11% Senior Discount Notes, due 2014 in an aggregate amount not to exceed 35% of the original principal amount at maturity of such notes, and with the balance of such net cash proceeds not so used to be contributed as a common equity contribution to TSI; (2) the use by TSI of the cash proceeds received pursuant to clause (1) above and cash on hand to

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

tender for a portion of its 9 <sup>5</sup>/<sub>8</sub> % Senior Notes, due 2011; and (3) the amendments of, and the waivers with respect to, certain provisions of the Indenture governing TSI's 9 <sup>5</sup>/<sub>8</sub> % Senior Notes, due 2011. The lenders also waived any Default or Event of Default that may have arisen solely under Section 9.06 of the Senior Credit Facility as a result of the Company entering into certain agreements with Mark Smith, the former Chairman of TSI Holdings, in connection with Mr. Smith's resignation.

On June 8, 2006 the Company paid \$93,001 to redeem \$85,001 of the outstanding principal of the 9 <sup>5</sup>/<sub>8</sub> % 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 \$270 were incurred in connection with this early extinguishment.

On July 7, 2006, 35% of the aggregate accreted value of the 11% Senior Discount Notes was redeemed at 111% redemption value and totaled \$62,875. The accreted principal balance up to, but excluding July 7, 2006, totaled \$56,644 and the redemption premium totaled \$6,231. As of the June 30, 2006 balance sheet this portion of the Senior Discount Notes that was redeemed on July 7, 2006 has been classified within current portion of long term debt.

### 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 (loss) per share is computed similarly to basic earnings (loss) per share, except that the denominator is increased for the assumed exercise of dilutive stock options using the treasury stock method.

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

	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2005	2006	2005	2006
Weighted average number of common share outstanding — basic	18,327,722	20,660,229	18,341,428	19,500,419
Effective of diluted stock options	5,012	—	2,282	—
Weighted average number of common shares outstanding — diluted	<u>18,332,734</u>	<u>20,660,229</u>	<u>18,343,710</u>	<u>19,500,419</u>

The effect of the shares issuable upon the exercise of stock options were not included in the calculation of diluted EPS for the three and six months ended June 30, 2006 as they were antidilutive. The number of equivalent shares excluded totaled 348,681 and 283,145 for the three and six months ended June 30, 2006 respectively.

### 6. Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "*Share-Based Payments*" ("SFAS 123R"), using the modified prospective transition method and therefore has not restated results for prior periods. Under this transition method, stock-based compensation expense for the three and six months ended June 30, 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123, "*Accounting for Stock-Based Compensation*" ("SFAS 123"). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 will be based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Prior to the

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

adoption of SFAS 123R, the Company recognized stock-based compensation expense in accordance with Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”). Also, prior to January 1, 2006, the Company provided pro forma disclosure amounts in accordance with SFAS No. 148, “Accounting for Stock-Based Compensation — Transition and Disclosure” (“SFAS 148”), as if the fair value method defined by SFAS 123 had been applied to its stock-based compensation. In March 2005, the Securities and Exchange Commission (the “SEC”) issued Staff Accounting Bulletin No. 107 (“SAB 107”) regarding the SEC’s interpretation of SFAS 123R and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

At June 30, 2006, the Company has 1,095,080 stock options outstanding under its 2004 Stock Option Plan. The total compensation expense, classified within payroll and related on the condensed statements of operations, related to this plan was \$531 and \$574 for the three and six months ended June 30, 2006 respectively. Prior to January 1, 2006, the Company accounted for stock options under the recognition and measurement provisions of APB 25. Accordingly, the Company generally recognized compensation expense only when it granted options with a discounted exercise price. Any resulting compensation expense was recognized ratably over the associated service period. In addition, prior to the adoption of SFAS 123R, the Company presented the tax benefit of stock option exercises in operating cash flows. Upon the adoption of SFAS 123R, tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

The pro forma table below reflects net earnings for the three and six months ended June 30, 2005, had the Company applied the fair value recognition provisions of SFAS 123, as follows:

	<u>Three Months Ended, June 30, 2005</u>	<u>Six Months Ended, June 30, 2005</u>
	(\$'000s)	(\$'000s)
Net Income, as reported	\$ 491	\$ 670
Add: Stock-based compensation included in reported net earnings, net of related tax effects	6	15
Less: Stock-based compensation expense determined under the fair-value-based method for all awards, net of related tax effects	(29)	(57)
Pro forma net earnings	<u>\$ 468</u>	<u>\$ 628</u>
Basic earnings (loss) per share:		
As reported	\$ 0.03	\$ 0.04
Pro forma	\$ 0.03	\$ 0.03
Diluted earnings (loss) per share:		
As reported	\$ 0.03	\$ 0.04
Pro forma	\$ 0.03	\$ 0.03

During the second quarter of 2006, the Company issued 67,200 stock options under the 2004 Stock Option Plan to a departing executive. The fair value of these options totaling \$485,000 was expensed during the quarter ended June 30, 2006. These stock options were issued at an exercise price of \$7.20 while the fair market value on the grant date was estimated to be \$12.00. The value of each option was \$7.21 calculated using the Black-Scholes option pricing model with an expected volatility of 50%, divided yield of 0.0%, a risk free interest rate of 4.81% and an expected term of 4.81 years.

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

Options granted under the 2004 Stock Option Plan generally qualify as “incentive stock options” under the U.S. Internal Revenue Code. The exercise price of a stock option is generally equal to the fair market value of the Company’s common stock on the option grant date.

The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model with the following assumptions and weighted average fair values as follows as of June 30, 2006:

	Shares (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (\$'000s)
Outstanding at June 30, 2006	1,095,080	\$ 6.41	6.4	\$ 6,331
Vested at June 30, 2006	304,640	\$ 7.46	5.5	\$ 1,445
Exercisable at June 30, 2006	304,640	\$ 7.46	5.5	\$ 1,445

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company’s estimated fair value of the Company’s common stock and the exercise price, multiplied by the number of in-the -money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. This amount changes based on the fair market value of the Company’s stock. Total fair value of options vested and expensed was \$201 and \$313, net of tax, for the three and six months ended June 30, 2006, respectively.

As of June 30, 2006, a total of \$463 unrecognized compensation cost related to stock options is expected to be recognized, depending upon the likelihood that accelerated vested targets are met in future periods, over a weighted-average period of 6.2 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, 2005 and 2006, 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 2005 and 2006 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, 2005 through June 30, 2006 is as follows:

Balance as of December 31, 2005	\$ 49,974
Changes due to foreign currency exchange rate fluctuations	50
Balance as of June 30, 2006	<u>\$ 50,024</u>

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

<u>Acquired Intangible Assets</u>	As of December 31, 2005 (\$'000s)		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Intangibles</u>
Membership lists	\$ 11,450	\$ (10,939)	\$ 511
Covenants-not-to-compete	1,151	(949)	202
Beneficial lease	223	(195)	28
	<u>\$ 12,824</u>	<u>\$ (12,083)</u>	<u>\$ 741</u>

  

	As of June 30, 2006 (\$'000s)		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Intangibles</u>
Membership lists	\$ 11,450	\$ (11,227)	\$ 223
Covenants-not-to-compete	1,151	(977)	174
Beneficial lease	223	(200)	23
	<u>\$ 12,824</u>	<u>\$ (12,404)</u>	<u>\$ 420</u>

The amortization expense of the above acquired intangible assets for each of the four years ended June 30, 2010 is as follows:

<u>Aggregate Amortization Expense for the years ending June 30, (\$'000s)</u>	
2007	\$ 289
2008	65
2009	57
2010	9
	<u>\$ 420</u>

Amortization expense for the six months ended June 30, 2005 and 2006 amounted to \$288 and \$321, respectively.

## 8. Commitments and Contingencies

On March 1, 2005, in an action styled *Sarah Cruz, et ano v. Town Sports International, Inc.*, plaintiffs commenced a purported class action against us in the Supreme Court, New York County, seeking unpaid wages and alleging that the Company 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. The complaint and the lawsuit is stayed upon agreement of the parties pending mediation. Plaintiffs submitted to us a proposed second Amended Complaint which seeks to add to the class all New York hourly employees. TSI has agreed to mediate with respect to such employees. While we are unable to determine the ultimate outcome of the above actions, we intend to contest the case vigorously. Depending upon the ultimate outcome, this matter may have a material effect on the Company's consolidated financial position, results of operations or cash flows.

The Company and several other third parties have been named as defendants in an action styled *Carlos Urbina et ano v 26 Court Street Associates, LLC et al.*, filed in the Supreme Court, Kings County, on April 4, 2001, seeking damages for personal injuries. Following a trial, the Company received a directed verdict for indemnification against one of the Company's contractors and the plaintiff received a jury verdict of approximately \$8,900 in his favor. Both of those verdicts are being appealed and the Company has filed an

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

appeal bond in the amount of \$1,812 in connection with those appeals. The Company is vigorously opposing the appeal of the directed verdict and prosecuting the appeal of the jury verdict. Depending on the ultimate outcome, this matter may have a material effect on the Company's consolidated financial position, results of operations or cash flows.

**9. 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 the CHSCA profits, as defined. 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. 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 six months ending June 30, 2005 and 2006 are as follows:

	Three months ended June 30, (\$'000s)		Six months ended June 30, (\$'000s)	
	2005	2006	2005	2006
Revenue	\$ 873	\$ 880	\$ 1,761	\$ 1,786
Income from operations	325	428	737	795
Net income	294	412	675	759

**10. Subsequent Events**

On July 7, 2006, the accreted principal balance up to but excluding July 7, 2006 totaling \$56,644 was redeemed at a value of 111% or \$62,875.

On July 7, 2006, the Senior Credit Facility was amended to increase permitted borrowings from \$50,000 to \$75,000. In connection with this amendment the company paid a one-time fee of \$125 to the lending participants of the increased commitment .

On August 4, 2006 the Company granted 430,500 common stock options under the 2006 Stock Incentive Plan at an exercise price of \$12.05 which was the closing market price on August 4, 2006.

**11. Guarantors**

TSI Holdings has unconditionally guaranteed the 11.0% Discount Notes. TSI Holdings, TSI and all of TSI's domestic subsidiaries have unconditionally guaranteed the 9<sup>5/8</sup>% Senior Notes discussed in Note 4. However, TSI's foreign subsidiary has not provided guarantees for these Notes.

Except for TSI Holdings (TSI's parent), each guarantor of the Senior Notes is a wholly owned subsidiary of TSI. The guarantees are full and unconditional and joint and severable. In January 2004, TSI Holdings was incorporated solely for the purpose of issuing the Discount Notes. The following schedules set forth condensed consolidating financial information as required by Rule 3-10d of Securities and Exchange Commission Regulation S-X at December 31, 2005 and June 30, 2006, and for the three and six months ended June 30, 2005 and 2006. The financial information illustrates the composition of the combined guarantors.

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

**Condensed Consolidating Balance Sheet**  
**December 31, 2005**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI</u> <u>Holdings</u>	<u>TSI</u>	<u>Subsidiary</u> <u>Guarantors</u>	<u>Non-</u> <u>Guarantor</u> <u>Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$ 1	1,359	\$ 48,682	\$ 1,262	\$ —	\$ 51,304
Accounts receivable, net	—	3,664	6,144	133	(2,838)	7,103
Inventory	—	—	395	26	—	421
Prepaid corporate income taxes	—	4,550	(32)	—	—	4,518
Inter-company receivable (payable)	1,137	(1,137)	—	—	—	—
Prepaid expenses and other current assets	—	5,425	10,195	(1,713)	—	13,907
<b>Total current assets</b>	<b>1,138</b>	<b>13,861</b>	<b>65,384</b>	<b>(292)</b>	<b>(2,838)</b>	<b>77,253</b>
Investment in subsidiaries	18,941	253,702	—	—	(272,643)	—
Fixed assets, net	—	10,114	242,149	868	—	253,131
Goodwill	—	—	49,215	759	—	49,974
Intangible assets, net	—	—	741	—	—	741
Deferred tax assets, net	13,560	11,354	(492)	(44)	—	24,378
Deferred membership costs	—	94	11,428	—	—	11,522
Other assets	3,755	11,833	1,184	—	—	16,772
<b>Total assets</b>	<b>\$ 37,394</b>	<b>\$300,958</b>	<b>\$ 369,609</b>	<b>\$ 1,291</b>	<b>\$ (275,481)</b>	<b>\$ 433,771</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>						
Current liabilities						
Current portion of long-term debt	\$ —	\$ —	\$ 1,267	\$ —	\$ —	1,267
Accounts payable	—	(82)	8,415	—	—	8,333
Accrued expenses	—	13,364	17,864	392	—	31,620
Accrued interest	—	5,264	2,841	—	(2,838)	5,267
Deferred revenue	—	—	32,940	88	—	33,028
<b>Total current liabilities</b>	<b>—</b>	<b>18,546</b>	<b>63,327</b>	<b>480</b>	<b>(2,838)</b>	<b>79,515</b>
Long-term debt	153,077	255,000	1,818	—	—	409,895
Deferred lease liabilities	—	452	48,446	—	—	48,898
Deferred revenue	—	—	2,905	—	—	2,905
Other liabilities	—	8,019	222	—	—	8,241
<b>Total liabilities</b>	<b>153,077</b>	<b>282,017</b>	<b>116,718</b>	<b>480</b>	<b>(2,838)</b>	<b>549,454</b>
Stockholder's deficit:						
Common stockholders' deficit	(116,069)	18,941	252,881	435	(272,257)	(116,069)
Accumulated other comprehensive income	386	—	10	376	(386)	386
<b>Total stockholders' deficit</b>	<b>(115,683)</b>	<b>18,941</b>	<b>252,891</b>	<b>811</b>	<b>(272,643)</b>	<b>(115,683)</b>
<b>Total liabilities and stockholders' deficit:</b>	<b>\$ 37,394</b>	<b>\$300,958</b>	<b>\$ 369,609</b>	<b>\$ 1,291</b>	<b>\$ (275,481)</b>	<b>\$ 433,771</b>

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

**Condensed Consolidating Balance Sheet**  
**June 30, 2006**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI</u> <u>Holdings</u>	<u>TSI</u>	<u>Subsidiary</u> <u>Guarantors</u>	<u>Non-</u> <u>Guarantor</u> <u>Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$ 63,288	\$ 753	\$ 5,671	\$ 1,642	\$ —	\$ 71,354
Accounts receivable	—	3,909	2,151	229	—	6,289
Inventory	—	—	518	28	—	546
Prepaid corporate income taxes	3,473	(1,989)	19	—	—	1,503
Intercompany receivable (payable)	(97)	97	—	—	—	—
Prepaid expenses and other current assets	—	9,069	5,356	(1,631)	—	12,794
Total current assets	<u>66,664</u>	<u>11,839</u>	<u>13,715</u>	<u>268</u>	<u>—</u>	<u>92,486</u>
Investment in subsidiaries	51,094	198,050	—	—	(249,144)	—
Fixed assets, net	—	9,171	247,004	793	—	256,968
Goodwill	—	—	49,214	810	—	50,024
Intangible assets, net	—	—	420	—	—	420
Deferred tax assets, net	13,864	14,839	(491)	(52)	—	28,160
Deferred membership costs	—	113	14,310	—	—	14,423
Other assets	3,575	8,740	1,212	—	—	13,527
Total assets	<u>\$135,197</u>	<u>\$242,752</u>	<u>\$ 325,384</u>	<u>\$ 1,819</u>	<u>\$ (249,144)</u>	<u>\$ 456,008</u>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>						
Current liabilities:						
Current portion of long-term debt	\$ 56,645	\$ —	\$ 2,212	\$ —	\$ —	\$ 58,857
Accounts payable	—	(1,942)	8,398	—	—	6,456
Accrued expenses and corporate income taxes payable	—	10,354	22,458	366	—	33,178
Accrued interest	—	3,522	3	—	—	3,525
Deferred revenue	—	—	37,160	93	—	37,253
Total current liabilities	<u>56,645</u>	<u>11,934</u>	<u>70,231</u>	<u>459</u>	<u>—</u>	<u>139,269</u>
Long-term debt	104,830	169,999	131	—	—	274,960
Deferred lease liabilities	—	372	50,091	—	—	50,463
Deferred revenue	—	—	8,012	—	—	8,012
Other Liabilities	—	9,353	229	—	1	9,583
Total liabilities	<u>161,475</u>	<u>191,658</u>	<u>128,694</u>	<u>459</u>	<u>1</u>	<u>482,287</u>
Stockholders' Deficit:						
Common Stockholders' deficit	(26,832)	51,094	196,675	1,375	(249,145)	(26,833)
Accumulated other comprehensive income	554	—	15	(15)	—	554
Total stockholders' deficit	<u>(26,278)</u>	<u>51,094</u>	<u>196,690</u>	<u>1,360</u>	<u>(249,145)</u>	<u>(26,279)</u>
Total liabilities and stockholders' deficit	<u>\$135,197</u>	<u>\$242,752</u>	<u>\$ 325,384</u>	<u>\$ 1,819</u>	<u>\$ (249,144)</u>	<u>\$ 456,008</u>



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

**Condensed Consolidating Statements of Operations**  
**For the three months ended June 30, 2005**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI</u> <u>Holdings</u>	<u>TSI</u>	<u>Subsidiary</u> <u>Guarantors</u>	<u>Non-</u> <u>Guarantor</u> <u>Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Revenues:</b>						
Club Operations	\$ —	\$ 24	\$ 95,898	\$ 1,156	\$ —	\$ 97,078
Fees and other	—	142	1,797	—	(1,021)	918
	<u>—</u>	<u>166</u>	<u>97,695</u>	<u>1,156</u>	<u>(1,021)</u>	<u>97,996</u>
<b>Operating expenses:</b>						
Payroll and related	—	5,826	32,896	446	—	39,168
Club operating	—	872	31,385	341	(881)	31,717
General and administrative	5	183	6,343	76	(140)	6,467
Depreciation and amortization	—	1,028	8,965	91	—	10,084
	<u>5</u>	<u>7,909</u>	<u>79,589</u>	<u>954</u>	<u>(1,021)</u>	<u>87,436</u>
Operating Income (loss)	(5)	(7,743)	18,106	202	—	10,560
Interest expense	3,920	6,587	94	(3)	(90)	10,508
Interest income	(1)	(550)	(3)	—	89	(465)
Equity in the income of investees and rental income	—	(267)	(137)	—	—	(404)
Income (loss) before provision (benefit) for corporate income taxes	(3,924)	(13,513)	18,152	205	1	921
Provision (benefit) for income taxes	<u>(1,783)</u>	<u>(6,227)</u>	<u>8,379</u>	<u>61</u>	<u>—</u>	<u>430</u>
Income (loss) before equity earnings	(2,141)	(7,286)	9,773	144	1	491
Equity earnings from subsidiaries	<u>2,632</u>	<u>9,918</u>	<u>—</u>	<u>—</u>	<u>(12,550)</u>	<u>—</u>
Net income	<u>\$ 491</u>	<u>\$ 2,632</u>	<u>\$ 9,773</u>	<u>\$ 144</u>	<u>\$ (12,549)</u>	<u>\$ 491</u>

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

**Condensed Consolidating Statements of Operations**  
**For the three months ended June 30, 2006**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI</u> <u>Holdings</u>	<u>TSI</u>	<u>Subsidiary</u> <u>Guarantors</u>	<u>Guarantor</u> <u>Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Revenues:</b>						
Club operations	\$ —	\$ —	\$ 106,526	\$ 1,133	\$ —	\$ 107,659
Management fees and other	—	199	1,611	—	—	1,810
	<u>—</u>	<u>199</u>	<u>108,137</u>	<u>1,133</u>	<u>—</u>	<u>109,469</u>
<b>Operating expenses:</b>						
Payroll and related	—	6,069	34,060	462	—	40,591
Club operating	—	1,342	35,124	315	—	36,781
General and administrative	—	1,735	6,255	116	—	8,106
Depreciation and amortization	—	843	9,466	91	—	10,400
	<u>—</u>	<u>9,989</u>	<u>84,905</u>	<u>984</u>	<u>—</u>	<u>95,878</u>
Operating income (loss)	—	(9,790)	23,232	149	—	13,591
Loss on extinguishment of debt	—	8,667	—	—	—	8,667
Interest expense	4,363	4,511	1,526	(5)	—	10,395
Interest income	—	(656)	(6)	—	—	(662)
Equity in the income of investees and rental income	—	(260)	(215)	—	—	(475)
Income (loss) before provision (benefit) for corporate income taxes	(4,363)	(22,052)	21,927	154	—	(4,334)
Provision (benefit) for corporate income taxes	(1,920)	(7,987)	8,114	111	—	(1,682)
Income (loss) before equity earnings	(2,443)	(14,065)	13,813	43	—	(2,652)
Equity earnings from subsidiaries	(209)	13,856	—	—	(13,647)	—
Net Income	<u>\$ (2,652)</u>	<u>\$ (209)</u>	<u>\$ 13,813</u>	<u>\$ 43</u>	<u>\$ (13,647)</u>	<u>\$ (2,652)</u>

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

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2005**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI</u> <u>Holdings</u>	<u>TSI</u>	<u>Subsidiary</u> <u>Guarantors</u>	<u>Non-</u> <u>Guarantor</u> <u>Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Revenues:</b>						
Club Operations	\$ —	\$ 36	\$ 187,441	\$ 2,432	\$ —	\$ 189,909
Fees and Other	—	288	3,814	—	(2,169)	1,933
	<u>—</u>	<u>324</u>	<u>191,255</u>	<u>2,432</u>	<u>(2,169)</u>	<u>191,842</u>
<b>Operating expenses:</b>						
Payroll and related	—	11,268	63,375	921	—	75,564
Club operating	—	1,218	63,195	642	(1,889)	63,166
General and administrative	18	614	12,608	185	(280)	13,145
Depreciation and amortization	—	2,165	17,463	195	—	19,823
	<u>18</u>	<u>15,265</u>	<u>156,641</u>	<u>1,943</u>	<u>(2,169)</u>	<u>171,698</u>
Operating income (loss)	(18)	(14,941)	34,614	489	—	20,144
Interest expense	7,706	12,920	184	(3)	(179)	20,628
Interest income	(2)	(1,007)	(4)	—	179	(834)
Equity in the earnings of investees and rental income	—	(535)	(340)	—	—	(875)
Income (loss) before provision (benefit) for corporate income taxes	(7,722)	(26,319)	34,774	492	—	1,225
Provision (benefit) for corporate income taxes	(3,420)	(11,451)	15,284	142	—	555
Income (loss) before equity earnings	(4,302)	(14,868)	19,490	350	—	670
Equity earnings from subsidiaries	4,972	19,840	—	—	(24,812)	—
Net income	<u>\$ 670</u>	<u>\$ 4,972</u>	<u>\$ 19,490</u>	<u>\$ 350</u>	<u>\$ (24,812)</u>	<u>\$ 670</u>

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

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2006**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI</u> <u>Holdings</u>	<u>TSI</u>	<u>Subsidiary</u> <u>Guarantors</u>	<u>Non-</u> <u>Guarantor</u> <u>Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Revenues:</b>						
Club operations	\$ —	\$ —	\$ 208,199	\$ 2,383	\$ —	\$ 210,582
Fees and Other	—	460	2,453	—	—	2,913
	<u>—</u>	<u>460</u>	<u>210,652</u>	<u>2,383</u>	<u>—</u>	<u>213,495</u>
<b>Operating expenses:</b>						
Payroll and related	—	14,112	66,431	944	—	81,487
Club operating	—	1,780	68,848	623	—	71,251
General and administrative	—	3,155	12,557	255	—	15,967
Depreciation and amortization	—	2,124	18,476	186	—	20,786
	<u>—</u>	<u>21,171</u>	<u>166,312</u>	<u>2,008</u>	<u>—</u>	<u>189,491</u>
Operating income (loss)	—	(20,711)	44,340	375	—	24,004
Loss on extinguishment of debt	—	8,667	—	—	—	8,667
Interest expense	8,587	9,778	2,723	(5)	—	21,083
Interest income	—	(1,381)	(6)	—	—	(1,387)
Equity in the income of investees and rental income	—	(521)	(387)	—	—	(908)
Income before provision (benefit) for corporate income taxes	(8,587)	(37,254)	42,010	380	—	(3,451)
Provision (benefit) for corporate income taxes	(3,778)	(12,541)	15,544	111	—	(664)
Income (loss) before equity earnings	(4,809)	(24,713)	26,466	269	—	(2,787)
Equity earnings from subsidiaries	2,022	26,735	—	—	(28,757)	—
Net Income	<u><u>\$(2,787)</u></u>	<u><u>\$ 2,022</u></u>	<u><u>\$ 26,466</u></u>	<u><u>\$ 269</u></u>	<u><u>\$ (28,757)</u></u>	<u><u>\$ (2,787)</u></u>

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

**Condensed Consolidating Statement of Cash Flows**  
**For the six months ended June 30, 2005**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI Holdings</u>	<u>TSI</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Cash flows from operating activities:</b>						
Net income	\$ 670	\$ 4,972	\$ 19,490	\$ 350	\$ (24,812)	\$ 670
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>						
Depreciation and amortization	—	2,165	17,463	195	—	19,823
Compensation expense in connection with stock options	—	25	—	—	—	25
Noncash rental expense, net of noncash rental income	—	(81)	1,049	—	—	968
Amortization of debt issuance costs	161	656	—	—	—	817
Changes in operating assets and liabilities	4,064	2,584	1,275	(335)	—	7,588
Other	(4,954)	(21,164)	1,430	(460)	24,812	(336)
Total adjustments	(729)	(15,815)	21,217	(600)	24,812	28,885
Net cash provided by (used in) operating activities	(59)	(10,843)	40,707	(250)	—	29,555
Net cash used in investing activities	—	(925)	(23,955)	249	—	(24,631)
Net cash (used in) provided by financing activities	(27)	8,677	(9,362)	29	—	(683)
Net increase (decrease) in cash and cash equivalents	(86)	(3,091)	7,390	28	—	4,241
Cash and cash equivalents at beginning of period	274	3,425	51,327	2,480	—	57,506
Cash and cash equivalents at end of period	<u>\$ 188</u>	<u>\$ 334</u>	<u>\$ 58,717</u>	<u>\$ 2,508</u>	<u>\$ —</u>	<u>\$ 61,747</u>

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

**Condensed Consolidating Statement of Cash Flows**  
**For the six months ended June 30, 2006**  
**(All figures in \$'000s)**  
**(Unaudited)**

	<u>TSI Holdings</u>	<u>TSI</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Cash flows from Operating Activities:</b>						
Net Income	\$ (2,787)	\$ 2,022	\$ 26,466	\$ 269	\$ (28,757)	\$ (2,787)
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>						
Depreciation & Amortization	—	2,124	18,476	186	—	20,786
Compensation expense in connection with stock options	—	574	—	—	—	574
Noncash rental expense, net of noncash rental income	—	(81)	39	—	—	(42)
Loss on extinguishment of debt	—	8,667	—	—	—	8,667
Amortization of debt issuance costs	180	635	—	—	—	815
Changes in operating assets and liabilities	(2,239)	20,148	2,551	(152)	—	20,308
Other	6,072	(38,028)	3,208	77	28,757	86
Total adjustments	<u>4,013</u>	<u>(5,961)</u>	<u>24,274</u>	<u>111</u>	<u>28,757</u>	<u>51,194</u>
Net cash provided by operating activities	<u>1,226</u>	<u>(3,939)</u>	<u>50,740</u>	<u>380</u>	<u>—</u>	<u>48,407</u>
Net cash used in investing activities	<u>—</u>	<u>(2,995)</u>	<u>(23,009)</u>	<u>—</u>	<u>—</u>	<u>(26,004)</u>
Net cash provided by financing activities	<u>62,061</u>	<u>6,328</u>	<u>(70,742)</u>	<u>—</u>	<u>—</u>	<u>(2,353)</u>
Net increase (decrease) in cash and cash equivalents	63,287	(606)	(43,011)	380	—	20,050
Cash and cash equivalents at beginning of period	1	1,359	48,682	1,262	—	51,304
Cash and cash equivalents at end of period	<u>\$63,288</u>	<u>\$ 753</u>	<u>\$ 5,671</u>	<u>\$ 1,642</u>	<u>\$ —</u>	<u>\$ 71,354</u>

**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. As of June 30, 2006, we operated 144 clubs that collectively served approximately 441,000 members excluding 13,800, seasonal or pool members. We develop clusters of clubs to serve densely populated major metropolitan regions and we service such populations by clustering clubs near the highest concentrations of our target customers' areas of both employment and residence. Our clubs are located for maximum convenience to our members in urban or suburban areas, close to transportation hubs, or office or retail centers. Our target customer is college-educated, typically between the ages of 21 and 50 and earns an annual income of between \$50,000 and \$150,000.

Each club facility is subject to a long-term facility lease with a third-party landlord, with the exception of East 86th Street, New York City location, where we own the underlying real estate. Our principal capital investment is thus in the facility improvements and equipment and furnishings of each facility.

Our goal is to develop the premier health club network in each of the major metropolitan regions in which we operate. We believe that clustering clubs allows us to achieve strategic operating advantages that enhance our ability to achieve this goal. We have developed these 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 suburban commuter communities. Capitalizing on this clustering of clubs, as of June 30, 2006, approximately 42% of our members participated in a membership plan that allows unlimited access to all of our clubs for a higher membership fee.

Clustering of clubs also affords us significant additional benefits, including:

- Providing our members access to an extensive network of locations;
- Lower capital investment overall, by locating special facilities, such as pools, racquet sports, etc. at selected clubs only;
- More cost-effective regional management and control;
- Allocating certain costs, such as advertising, in a focused region over multiple locations; and
- Strengthening brand awareness.

We have executed this strategy successfully in the New York region through the network of clubs we operate under our New York Sports Clubs ("NYSC") trade name. We are the largest fitness club operator in Manhattan with 37 locations and operate a total of 97 clubs under the NYSC name within a 75 mile radius of New York City. We operate 19 clubs in the Boston region and 19 clubs in the Washington, DC region under our Boston Sports Clubs ("BSC") and Washington Sports Clubs ("WSC") trade names, respectively, and are establishing a similar cluster in the Philadelphia region with six clubs under our Philadelphia Sports Clubs ("PSC") trade name. In addition, we operate three clubs in Switzerland. We employ localized trade names for our clubs to create an image and atmosphere consistent with the local community, and to foster the recognition as a local network of quality fitness clubs rather than a national chain.

We consider that we have two principal sources of revenue:

- Our largest sources of revenue are dues and initiation fees paid by our members. This comprises 81.6% of our total revenue for the six months ended June 30, 2006. We recognize revenue from membership dues in the month when the services are rendered. Approximately 93% 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. Prior to January 1, 2006 the expected average life of a membership was 24 months. Effective January 1, 2006 we have revised this estimate to 30 months based on more favorable membership attrition trends.

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- For the six months ended June 30, 2006, we generated 11.9% of our revenue from personal training and 5.2% 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 1.3% for the six months ended June 30, 2006) principally relates to rental of space in our facilities to operators who offer wellness-related offerings such as physical therapy. In addition, we generate management fees from certain club facilities that we do not wholly own and sell in-club advertising and sponsorships. We refer to this as Fees and Other revenue.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
Membership dues	\$ 77,493	\$ 86,764	\$ 152,071	\$ 169,903
Initiation fees	3,044	2,321	6,122	4,252
Membership revenue	80,537	89,085	158,193	174,155
Personal training revenue	11,593	13,084	21,973	25,352
Other ancillary club revenue	4,948	5,490	9,743	11,075
Ancillary club revenue	16,541	18,574	31,716	36,427
Fees and Other revenue	\$ 918	\$ 1,810	\$ 1,933	\$ 2,913
Total revenue	<u>\$ 97,996</u>	<u>\$ 109,469</u>	<u>\$ 191,842</u>	<u>\$ 213,495</u>

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, contracted maintenance expenses, and depreciation. General and administrative expenses include costs relating to our centralized support functions, such as accounting, information systems, purchasing and member relations, consulting fees, and real estate development expenses. Variable costs are primarily related to personal training and ancillary club revenue related payroll, membership sales compensation, advertising, utilities, insurance and club supplies.

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 annual revenue. Expansions of certain facilities are also performed from time to time, when incremental space becomes available on attractive terms, and utilization and demand for the facility dictates. In this connection, facility remodeling is also considered where appropriate.



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### Historical Club Growth

The following table sets forth our club growth during each of the quarters in 2005 and the first two quarters of 2006.

	2005				Total	2006	
	Q1	Q2	Q3	Q4		Q1	Q2
Clubs at beginning of period	137	140	140	140	137	141	145
Greenfield clubs(a)	3	—	1	1	5	5	—
Acquired clubs	—	1	1	—	2	—	—
Clubs closed and merged into new clubs	—	(1)	(1)	—	(2)	(1)	(1)
Club closed for renovation and expansion	—	—	(1)	—	1	—	—
	<u>140</u>	<u>140</u>	<u>140</u>	<u>141</u>	<u>141</u>	<u>145</u>	<u>144</u>
Number of partly-owned clubs included at the end of the period(b)	2	2	2	2	2	2	2

(a) A “Greenfield club” is a new location constructed by us.

(b) We include in the club count wholly and partly-owned clubs. In addition to the above count, as of December 31, 2005 and June 30, 2006 we managed five university-owned clubs, respectively, in which we did not have an equity interest.

### Results of Operations

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

	Three Months Ended June 30		Six Months Ended June 30	
	2005	2006	2005	2006
Revenue	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Operating expenses:				
Payroll and related	40.0	37.1	39.4	38.2
Club operating	32.3	33.6	32.9	33.4
General and administrative	6.6	7.4	6.9	7.5
Depreciation and amortization	<u>10.3</u>	<u>9.5</u>	<u>10.3</u>	<u>9.7</u>
Operating income	10.8	12.4	10.5	11.2
Loss on extinguishment of debt	—	7.9	—	4.0
Interest expense	10.8	9.5	10.8	9.8
Interest income	(0.5)	(0.6)	(0.4)	(0.6)
Equity in the earnings of investees and rental income	<u>(0.4)</u>	<u>(0.4)</u>	<u>(0.5)</u>	<u>(0.4)</u>
Income before provision (benefit) for corporate income taxes	0.9	(4.0)	0.6	(1.6)
Provision (benefit) for corporate income taxes	<u>0.4</u>	<u>(1.6)</u>	<u>0.3</u>	<u>(0.3)</u>
Net income (loss)	<u>0.5%</u>	<u>(2.4)%</u>	<u>0.3%</u>	<u>(1.3)%</u>

#### *Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005*

*Revenues.* Revenues increased \$11.5 million, or 11.7%, to \$109.5 million during the quarter ended June 30, 2006 from \$98.0 million in the quarter ended June 30, 2005. Revenues increased during the quarter by \$6.2 million, or 6.8%, at the Company’s mature clubs (clubs owned and operated for at least 24 months). During the quarter, revenue increased \$6.5 million at the 15 clubs opened or acquired subsequent to June 30,

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2004. These increases in revenue were offset by a \$1.3 million revenue decrease related to the four clubs that were closed and relocated subsequent to June 30, 2005.

Same club revenue increased 8.2% during the three months ended June 30, 2006 when compared to the same period of the prior year. This increase in same club revenue is due to a 5.2% increase in membership, a 2.3% increase in price and a 1.4% increase related to ancillary revenue, offset by a 0.7% decrease in initiation fee revenue recognized. Effective January 1, 2006 the estimated average-life of our memberships increased from 24 months to 30 months. This increase in membership life is due to a favorable trend in membership attrition rates, and it has the effect of decreasing initiation fees revenue recognized because a longer amortization period is being applied.

*Operating Expenses.* Operating expenses increased \$8.5 million, or 9.7%, to \$95.9 million in the quarter ended June 30, 2006, from \$87.4 million in the quarter ended June 30, 2005. The increase was due to the following factors:

Payroll and related expenses increased by \$1.4 million, or 3.6%, to \$40.6 million in the quarter ended June 30, 2006, from \$39.2 million in the quarter ended June 30, 2005. This increase was attributable to a 3.1% increase in the total months of club operation from 415 to 428, as well as the following:

- Payroll costs directly related to our personal training, Group Exclusive, and Sports Club for Kids programs increased \$0.8 million or 9.0%, due to an increase in demand for these programs.
- Share-based compensation costs related to outstanding stock options increased \$521,000 to \$531,000 from \$10,000 in the quarter ended June 30, 2005. These 2006 charges principally relate to common stock options that were issued to a departing executive.
- Offsetting these aforementioned increases in the quarter ended June 30, 2006 was a \$1.3 million decrease in sales salary and commission and deferred sales related payroll costs. The increase in the estimated average-life of our memberships from 24 months to 30 months resulted in a reduction in amortization of deferred sales related payroll costs in the second quarter of 2006 compared to the second quarter of 2005.

Club operating expenses increased by \$5.1 million, or 16.0%, to \$36.8 million in the quarter ended June 30, 2006, from \$31.7 million in the quarter ended June 30, 2005. This increase was principally attributable to the following:

- Rent and occupancy expenses increased \$1.6 million. Rent and occupancy costs at clubs that have opened since July 1, 2005, or that are currently under construction, increased \$1.0 million. The remaining \$596,000 increase in rent and occupancy expenses relates to our clubs that were open prior to July 1, 2005.
- Utility costs increased \$1.7 million. We saw a \$632,000 increase at our clubs that we opened or acquired in 2005 and 2006. The balance of the increase is due to an increase in utility rates throughout the remainder of our club base.
- Marketing and advertising costs increased \$1.4 million to \$3.5 million in the second quarter of 2006 from \$2.1 million in the second quarter of 2005. This increase was due to an increase in the level of our radio and print advertising campaigns in this second quarter of 2006 when compared to 2005.

General and administrative expenses increased \$1.6 million or 25.3% to \$8.1 million in the quarter ended June 30, 2006 from \$6.5 million in the quarter ended June 30, 2005.

- In the quarter ended June 30, 2006 we incurred \$1.1 million in costs related to the examination of strategic and financing alternatives while no such costs were recorded in the quarter ended June 30, 2005.
- Liability and related insurance increased \$654,000 in the quarter ended June 30, 2006. This increase is related to an increase in premiums associated with the Company's growth as well an increase in our

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general liability reserve. General liability reserves are based on an actuarial analysis that reflects claims processed.

Depreciation and amortization increased by \$316,000, or 3.1%, to \$10.4 million in the quarter ended June 30, 2006, from \$10.1 million in the quarter ended June 30, 2005 principally due to new and expanded clubs.

*Loss on Extinguishment of Debt.* During the second quarter of 2006 the Company paid \$93.0 million to redeem \$85.0 million of outstanding principal of the 9<sup>5</sup>/<sub>8</sub>% 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 \$270,000 were incurred in connection with this early extinguishment of debt.

*Interest Expense.* Interest expense decreased \$113,000 to \$10.4 million during the quarter ended June 30, 2006 from \$10.5 million in the quarter ended June 30, 2005. This decrease is in part, resulting from the June 7, 2006 redemption of \$85.0 million of 9<sup>5</sup>/<sub>8</sub>% Senior Notes offset by an increase in the accretion on the Discount Notes issued in February 2004.

*Interest Income.* Interest income increased \$197,000 to \$662,000 in the quarter ended June 30, 2006 from \$465,000 in the quarter ended June 30, 2005 principally due to increases in the rate of interest earned on invested cash.

*Provision for Corporate Income Taxes.* We have recorded an income tax benefit of \$1.7 million in the quarter ended June 30, 2006 compared to a provision of \$430,000 in the quarter ended June 30, 2005. During the three months ended June 30, 2006 the Company recorded discrete income tax charges totaling \$93,000 to reflect the reduction in state tax benefits associated with our use of IPO proceeds.

### ***Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005***

*Revenues.* Revenues increased \$21.7 million, or 11.3%, to \$213.5 million during the six months ended June 30, 2006 from \$191.8 million in the six months ended June 30, 2005. Revenues increased during the six months ended June 30, 2006 by \$11.8 million, or 6.5%, at the Company's mature clubs (clubs owned and operated for at least 24 months). During the six months ended June 30, 2006, revenue increased \$13.1 million at the 15 clubs opened or acquired subsequent to June 30, 2004. These increases in revenue were offset by a \$3.3 million revenue decrease related to the four clubs that were closed and relocated subsequent to April 1, 2005.

Same club revenue increased 7.9% during the six months ended June 30, 2006 when compared to the same period of the prior year. This increase in same club revenue is due to a 5.0% increase in membership, a 2.2% increase in price and a 1.7% increase in ancillary revenue, offset by a 1.0% decrease in initiation fee revenue recognized. Effective January 1, 2006 the estimated average-life of our memberships increased from 24 months to 30 months. This increase in membership life is due to a favorable trend in membership attrition rates, and it has the effect of decreasing initiation fees revenue recognized because a longer amortization period is being applied.

*Operating Expenses.* Operating expenses increased \$17.8 million, or 10.4%, to \$189.5 million in the six months ended June 30, 2006, from \$171.7 million in the six months ended June 30, 2005. The increase was due to the following factors:

Payroll and related expenses increased by \$5.9 million, or 7.8%, to \$81.5 million in the six months ended June 30, 2006, from \$75.6 million in the six months ended June 30, 2005. This increase was attributable to a 3.4% increase in the total months of club operation from 826 to 854, as well as the following:

- During the first quarter of 2006 our Chairman and certain executives agreed to severance packages totaling an estimated \$1.6 million. The total cost of these severance packages were recorded in the six month period ended June 30, 2006 while no such costs were incurred in the same period of the prior year.

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- Payroll costs directly related to our personal training, Group Exclusive, and Sports Club for Kids programs increased \$2.2 million or 13.5%, due to an increase in demand for these programs.
- Share-based compensation costs related to outstanding stock options increased \$549,000 to \$574,000 from \$25,000 during the six months ended June 30, 2005. These 2006 charges principally relate to common stock options that were issued to a departing executive.
- Offsetting these aforementioned increases during the six months ended June 30, 2006 was a \$2.3 million decrease in sales salary and commissions and deferred sales related payroll costs. The increase in the estimated average-life of our memberships from 24 months to 30 months resulted in a reduction in amortization of deferred sales related payroll costs in the six month period ended June 30, 2006 compared to the same period of 2005.

Club operating expenses increased by \$8.1 million, or 12.8%, to \$71.3 million in the six months ended June 30, 2006, from \$63.2 million in the six months ended June 30, 2005. This increase was principally attributable to the following:

- Rent and occupancy expenses increased \$3.6 million. Rent and occupancy costs at clubs that have opened since July 1, 2005, or that are currently under construction, increased \$2.6 million. Also, during the six months ended June 30, 2006 we closed a club, and merged the membership base at this club into one of our newly opened nearby clubs. This resulted in a \$225,000 lease termination expense. The remaining \$733,000 increase in rent and occupancy expenses relates to our clubs that were open prior to July 1, 2005.
- Utility costs increased \$2.9 million. We saw a \$1.0 million increase at our clubs that we opened or acquired in 2005 and 2006. The balance of the increase is due to an increase in utility rates throughout the remainder of our club base.
- Marketing and advertising costs increased \$773,000. Marketing and advertising costs as a percent of revenue were 2.6% and 2.7% for the first six months of 2005 and 2006 respectively.

General and administrative expenses increased \$2.8 million or 21.5% to \$16.0 million in the six months ended June 30, 2006 from \$13.2 million in the six months ended June 30, 2005.

- In the six months ended June 30, 2006 we incurred \$1.7 million in costs related to the examination of strategic and financing alternatives while no such costs were recorded in the six months ended June 30, 2005.
- Liability and related insurance increased \$900,000 during the six months ended June 30, 2006 when compared to the same period in 2005. The increase is related to an increase in premiums associated with the Company's growth as well as an increase in general liability reserves. General liability reserves are based on an actuarial analysis that claims processed.

Depreciation and amortization increased by \$1.0 million, or 4.9%, to \$20.8 million in the six months ended June 30, 2006, from \$19.8 million in the six months ended June 30, 2005 principally due to new and expanded clubs.

*Loss on Extinguishment of Debt.* During the second quarter of 2006 the Company paid \$93.0 million to redeem \$85.0 million of the outstanding principal of the 9<sup>5</sup>/<sub>8</sub>% 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 \$270,000 were incurred in connection with this early extinguishment of debt.

*Interest Expense.* Interest expense increased \$454,000 to \$21.1 million during the six months ended June 30, 2006 from \$20.6 million in the six months ended June 30, 2005. This increase is due to the accretion of the Discount Notes issued in February 2004, offset, in part, by a decrease in interest due to the reduction of principal on our 9<sup>5</sup>/<sub>8</sub>% Senior Notes.

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*Interest Income.* Interest income increased \$553,000 to \$1.4 million in the six months ended June 30, 2006 from \$834,000 in the six months ended June 30, 2005 due to increases in the rate of interest earned on invested cash.

*Provision for Corporate Income Taxes.* We have recorded an income tax benefit of \$664,000 in the six months ended June 30, 2006 compared to a tax provision of \$555,000 in the six months ended June 30, 2005. During the six months ended June 30, 2006 the Company recorded discrete income tax charges totaling \$751,000 to reflect the reduction in state tax benefits associated with our use of IPO proceeds.

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 six months ended June 30, 2006 was \$48.4 million compared to \$29.6 million during the six months ended June 30, 2005. Net cash flows from operations have increased due to the increase in operating income excluding the effects of accreted interest expense, depreciation and amortization. Net changes in operating assets and liabilities, including the increase in deferred revenue, and a decrease in prepaid corporate income taxes, have further contributed to this increase in cash flows from operations.

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 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.* We invested \$26.0 million and \$24.6 million in capital expenditures during the six months ended June 30, 2006 and 2005, respectively. For the year ended December 31, 2006, we estimate we will invest \$65.0 million in capital expenditures which includes \$15.5 million to continue to upgrade existing clubs and \$4.3 million to enhance our management information systems. The remainder of our 2006 capital expenditures will be committed to build or acquire clubs. These expenditures will be funded by cash flow provided by operations, available cash on hand, and to the extent needed, borrowings from our Senior Credit Facility.

*Financing Activities.* Net cash used in financing activities was \$2.4 million for the six months ended June 30, 2006 compared to \$683,000 in 2005.

The registration statement filed in connection with the Company's IPO, as filed with the SEC, was declared effective on June 1, 2006. The Company's shares began trading on the NASDAQ Stock Market on June 2, 2006 under the National Market symbol CLUB. In connection with the IPO, the Board of Directors approved a 14 to 1 common stock split. The 1,309,123 shares outstanding on December 31, 2005 have been adjusted accordingly to 18,327,722. The Company closed this transaction and received proceeds from the IPO on June 7, 2006. The IPO consists of 8,950,000 shares of common stock, which includes 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 \$91.8 million. These proceeds are net of underwriting discounts and commissions and offering costs payable by the Company totaling \$7.7 million. The IPO proceeds were used for the redemption of 35% of the aggregate

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principal amount of its outstanding 11% Senior Discount Notes, due 2014, and the remainder of the proceeds together with cash on hand was used to consummate the tender offer for \$85.0 million of 9<sup>5</sup>/<sub>8</sub>% Senior Notes, due 2011.

On June 8, 2006 the Company paid \$93.0 million to redeem \$85.0 of the outstanding principal of the 9<sup>5</sup>/<sub>8</sub>% 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 \$270,000 were incurred in connection with this early extinguishment.

The aggregate accreted value of the 35% Senior Discount Notes redeemed at the 111% redemption value on July 7, 2006 and totaled \$62.9 million. The accreted principal balance up to, but excluding July 7, 2006, totaled \$56.6 million and the redemption premium totaled \$6.2 million.

As of June 30, 2006, our total consolidated debt was \$333.8 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 annual payment of \$16.4 million interest on our Senior Notes and reducing our ability to use our cash flow to fund working capital, capital expenditures, acquisitions of new clubs and general corporate requirements; and
- Limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.

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

As of June 30, 2006, TSI had \$170.0 million of Senior Notes outstanding. The Senior Notes bear interest at a rate of 9<sup>5</sup>/<sub>8</sub>% and mature in April 2011. Under the provisions of the Senior Note Indenture, TSI may not issue additional Senior Notes without modification of the indenture with the bondholders' consent.

As of June 30, 2006 we had \$161.5 million of 11% Senior Discount Notes outstanding. On July 7, 2006 the accreted principal on the Senior Notes was reduced by \$56.6 million in connection with the redemption of 35% of these notes.

The Senior Credit Facility contains various covenants including limits on capital expenditures, the maintenance of a consolidated interest coverage ratio of not less than 3.00:1.00 during 2006, and a maximum permitted total leverage ratio of 3.50:1.00 from December 30, 2005 through September 29, 2006 and 3.25:1.00 from September 30, 2006 through September 29, 2007. TSI's interest coverage and leverage ratios were 3.90:1.00 and 1.98:1.00 respectively as of June 30, 2006. Given the Company's operating plans and expected performance for 2006, the Company expects it will continue to be in compliance with its covenants. These covenants may limit TSI's ability to incur additional debt. As of June 30, 2006, permitted borrowing capacity was not restricted by the covenants. Loans under the Senior Credit Facility will, at TSI's option, bear interest at either the bank's prime rate plus 3.0% or the Eurodollar rate plus 4.0%, as defined. There were no borrowings outstanding at June 30, 2006 and outstanding letters of credit issued totaled \$10.8 million. TSI is required to pay a commitment fee of 0.75% per annum on the daily unutilized amount. The unutilized portion of the Senior Credit Facility as of June 30, 2006 was \$39.2 million. The line of credit accrues interest at variable rates based on market conditions, accordingly, future increases in interest rates could have a negative impact on net income should borrowings be required.

As of June 30, 2006, we had \$71.4 million of cash and cash equivalents. On July 7, 2006 \$62.9 million of cash was used for the redemption of the 11% Senior Discount Notes.

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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 2007. Any material acceleration or expansion of our plans through additional greenfields or acquisitions (to the extent such acquisitions include cash payments) may require us to pursue additional sources of financing prior to the end of 2007. 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 5% and 9%, and are non-collateralized. The notes are due on various dates through 2009.

The aggregate long-term debt, and operating lease obligations as of June 30, 2006 were as follows:

Contractual Obligations	Payments Due by Period (in \$'000s)				
	Total	Less than 1 Year	2-3 Years	4-5 Years	After 5 Years
Long-Term Debt(1)	\$ 574,203	\$ 81,565	\$ 63,316	\$ 229,774	\$ 199,548
Operating Lease Obligations(2)	714,940	62,893	125,841	117,784	408,422
Total Contractual Cash Obligations	<u>\$ 1,289,143</u>	<u>\$ 144,458</u>	<u>\$ 189,157</u>	<u>\$ 347,558</u>	<u>\$ 607,970</u>

Notes:

- (1) The long-term debt contractual cash obligations include principal and interest payment requirements. Interest on our 9 <sup>5</sup>/<sub>8</sub> % Senior Notes amounts to \$16.4 million annually.
- (2) Operating lease obligations include base rent only. Certain leases provide for additional rent based on in real estate taxes, common area maintenance and defined amounts based on the operating results of the lessee.

### Subsequent Events

On July 7, 2006, the accreted principal balance up to, but excluding July 7, 2006, totaling \$56.6 million was redeemed at a redemption value of 111%, or \$62.9 million.

On July 7, 2006, the Senior Credit Facility was amended to increase permitted borrowings from \$50.0 million to \$75.0 million. In connection with this amendment the company paid a one time fee of \$125,000 to the lending participants of the increased commitment.

On August 4, 2006 the Company granted 430,500 common stock options to employees at an exercise price of \$12.05 which was the closing market price on August 4, 2006.

### Forward-Looking Statements

Certain statements in this report, Form 10-Q, of the Company for the six-month period ended June 30, 2006 are forward-looking statements, including, without limitation, statements regarding future financial results and performance, capital expenditures, liquidity and potential sales revenue. These statements are subject to various risks and uncertainties, many of which are outside the control of the Company, including the level of market demand for the Company's services, competitive pressures, the ability to achieve reductions in operating costs and to continue to integrate acquisitions, the application of Federal and state tax laws and regulations, and other specific factors discussed herein and in other SEC filings by the Company. The information contained herein represents management's best judgment as of the date hereof based on information currently available; however, the Company does not intend to update this information, except as required by law to reflect developments or information obtained after the date hereof and disclaims any legal obligation to the contrary.



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

We do not believe that we have any significant risk related to interest rate fluctuations since we currently only carry fixed-rate debt. We invest our excess cash in highly liquid short-term investments. These investments are not held for trading or other speculative purposes. Changes in interest rates affect the investment income we earn on our cash equivalents and, therefore impact our cash flows and results of operations. If short-term interest rates were to have increased by 100 basis points during the six months ended June 30, 2006, our interest income from cash equivalents would have increased by approximately \$329,000. These amounts are determined by considering the impact of the hypothetical interest rates on our cash equivalents balance during this period.

For additional information concerning the terms of our fixed-rate debt see Note 6 to our December 31, 2005 financial statements filed with our final prospectus related to our IPO filed with the SEC on June 1, 2006.

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

(a) As of June 30, 2006, 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 Exchange Act Rule 13a-15. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2006, the Company's disclosure controls and procedures were reasonably designed and effective, reasonably ensuring that (i) material information was properly disclosed by the Company in the reports filed or submitted by the Company under the Exchange Act, and (ii) 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.

(b) There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2006 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. *Legal Proceedings.***

On March 1, 2005, in an action styled *Sarah Cruz, et ano v. Town Sports International, Inc.*, plaintiffs commenced a purported class action against us in the Supreme Court, New York County, seeking unpaid wages and alleging that the Company 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. The complaint and the lawsuit is stayed upon agreement of the parties pending mediation. Plaintiffs submitted to us a proposed second Amended Complaint which seeks to add to the class all New York hourly employees. TSI has agreed to mediate with respect to such employees. While we are unable to determine the ultimate outcome of the above actions, we intend to contest the case vigorously. Depending upon the ultimate outcome, this matter may have a material effect on the Company's consolidated financial position, results of operations or cash flows.

The Company and several other third parties have been named as defendants in an action styled *Carlos Urbina et ano v 26 Court Street Associates, LLC et al.*, filed in the Supreme Court, Kings County, on April 4, 2001, seeking damages for personal injuries. Following a trial, the Company received a directed verdict for indemnification against one of the Company's contractors and the plaintiff received a jury verdict of approximately \$8.9 million in his favor. Both of those verdicts are being appealed and the Company has filed an appeal bond in the amount of \$1.8 million in connection with those appeals. The Company is vigorously opposing the appeal of the directed verdict and prosecuting the appeal of the jury verdict. Depending on the ultimate outcome, this matter may have a material effect on the Company's consolidated financial position, results of operations or cash flows.



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### Item 1A. Risk Factors

A description of the risk factors associated with our business is contained in Item 1A, "Risk Factors," of our 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 29, 2006 and the final prospectus relating to our IPO filed on June 2, 2006 with the SEC. These cautionary statements are to be used as a reference in connection with any forward-looking statements. The factors, risks and uncertainties identified in these cautionary statements are in addition to those contained in any other cautionary statements, written or oral, which may be made or otherwise addressed in connection with a forward-looking statement or contained in any of our subsequent filings with the Securities and Exchange Commission.

There have been no material changes to the risk factor described in the Form 10-K or the final prospectus.

### 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.

On May 30, 2006 the holders of a least a majority of the outstanding shares of capital stock of the Company consented in writing to the following matters:

- the adoption and approval of the Company's Amended and Restated Certificate of Incorporation;
- authorized, directed and empowered the proper officers of the Company to execute and file the Company's Amended and Restated Certificate of Incorporation with the Secretary of State of the State of Delaware in order to effectuate the adoption of the Amended and Restated Certificate of Incorporation upon the consummation of the Company's IPO;
- conditioned upon consummation of the Company's IPO, the adoption and approval of the Company's Amended and Restated By-laws;
- upon consummation of the IPO, the proper officers of the Company were authorized, directed and empowered, in the name and on behalf of the Company, to file the Company's Amended and Restated By-laws with the minutes of the Company;
- the adoption and approval of the Company's 2006 Stock Incentive Plan; and
- that reservation by the Company under and pursuant to, the Company's 2006 Stock Incentive Plan, of 1,300,000 shares of the Company's common stock.

### ITEM 5. Other Information.

Not applicable.

### ITEM 6. Exhibits.

#### (a) Exhibits

Exhibit 3.1	Amended and Restated Certificate of Incorporation at Town Sports International Holdings, Inc.
Exhibit 3.5	Amended and Restated By-Laws of Town Sports International Holdings, Inc.
Exhibit 10.9.1	Amendment No. 2 to the Registration Rights Agreement dated as of May 30, 2006.
Exhibit 10.26	Amendment No. 1 to the Town Sports International Holdings, Inc. 2006 Stock Incentive Plan

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Exhibit 31.1	Certification by Robert Giardina pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification by Richard Pyle pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification by Robert Giardina pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Certification by Richard Pyle pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

Pursuant to requirements of the Securities Exchange Act of 1934, 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: August 10, 2006

By: /s/ Richard Pyle

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Richard Pyle  
*Chief Financial Officer*  
*(principal financial, accounting officer)*

DATE: August 10, 2006

By: /s/ Robert Giardina

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Robert Giardina  
*Chief Executive Officer*  
*(principal executive officer)*



**AMENDED AND RESTATED  
CERTIFICATE OF INCORPORATION  
OF  
TOWN SPORTS INTERNATIONAL HOLDINGS, INC .**

(Pursuant to Sections 228, 242 and 245 of the  
General Corporation Law of the State of Delaware)

Town Sports International Holdings, Inc. (the "Corporation"), a corporation organized under the General Corporation Law of the State of Delaware (the "General Corporation Law"),

DOES HEREBY CERTIFY THAT:

FIRST: The date of filing of the Corporation's original certificate of incorporation with the Secretary of State of the State of Delaware was January 20, 2004.

SECOND: The Board of Directors of the Corporation duly adopted resolutions proposing to amend and restate the certificate of incorporation, declaring said amendment and restatement to be advisable and in the best interest of the Corporation and its stockholders, and authorizing the appropriate officers of the Corporation to solicit the consent of the stockholders in lieu of a meeting, all in accordance with the applicable provisions of Sections 228, 242 and 245 of the General Corporation Law.

THIRD: The certificate of incorporation of the Corporation shall be amended and restated in its entirety as follows:

**ARTICLE I**

**Name**

The name of the Corporation is Town Sports International Holdings, Inc.

**ARTICLE II**

**Purpose**

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law.

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### **ARTICLE III**

#### **Registered Office**

The address of the registered office of the Corporation in the State of Delaware is 2711 Centerville Road, Suite 400, City of Wilmington, County of New Castle, Delaware 19808. The name of the Corporation's registered agent at that address is Corporation Service Company.

### **ARTICLE IV**

#### **Capital Stock**

A. Classes of Stock. The total number of shares of stock that the Corporation shall have authority to issue is one hundred five million (105,000,000), consisting of five million (5,000,000) shares of Preferred Stock, par value \$0.001 per share (the "Preferred Stock"), and one hundred million (100,000,000) shares of Common Stock, par value \$0.001 per share (the "Common Stock"). The consideration for the issuance of the shares shall be paid to or received by the Corporation in full before their issuance and shall not be less than the par value per share. The number of authorized shares of Common Stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the stock of the Corporation entitled to vote, irrespective of the provisions of Section 242 (b)(2) of the General Corporation Law.

Effective on June 7, 2006, upon the filing of the Amended and Restated Certificate of Incorporation of the Corporation on such date (the "Effective Date"), each share of Class A Common Stock of the Corporation then issued and outstanding or held in the treasury of the Corporation automatically shall be reclassified and subdivided into fourteen (14) shares of fully paid and nonassessable Common Stock of the Corporation. There shall be no fractional shares of Common Stock issued. Each holder of shares of Common Stock who would otherwise be entitled to receive a fractional share shall be entitled to receive a cash payment in lieu thereof in an amount equal to the fraction to which the holder would otherwise be entitled multiplied by the market price per share of the Common Stock (as determined in a reasonable manner prescribed by the Board of Directors) at the close of business on the subdivision date. The determination as to whether or not any fractional shares are issuable shall be based upon the total number of shares of Common Stock held by any holder thereof that are being subdivided, not upon each share of Common Stock being subdivided.

#### **B. Common Stock**

1. General. All shares of Common Stock will be identical and will entitle the holders thereof to the same rights, powers and privileges. The rights, powers and privileges of the holders of the Common Stock are subject to and qualified by the rights of holders of any then outstanding Preferred Stock.

2. Dividends. Dividends may be declared and paid on the Common Stock from funds lawfully available therefor as, if and when determined by the Board of Directors and subject to any preferential dividend rights of any then outstanding Preferred Stock.

3. Dissolution, Liquidation or Winding Up. In the event of any dissolution, liquidation or winding up of the affairs of the Corporation, whether voluntary or involuntary, each issued and outstanding share of Common Stock shall entitle the holder thereof to receive an equal portion of the net assets of the Corporation available for distribution to the holders of Common Stock, subject to any preferential rights of any then outstanding Preferred Stock. For purposes of this paragraph, a merger, statutory share exchange, consolidation or similar corporate transaction involving the Corporation (whether or not the Corporation is the surviving entity), or the sale, transfer or lease by the Corporation of all or substantially all of its assets, shall not constitute or be deemed a liquidation, dissolution or winding-up of the Corporation.

4. Voting Rights. Except as otherwise required by law or provided herein, each holder of Common Stock shall have one vote in respect of each share of stock held of record by such holder on the books of the Corporation for the election of directors and on all matters submitted to a vote of stockholders of the Corporation. Except as otherwise required by law or provided herein, holders of Preferred Stock shall vote together with holders of Common Stock as a single class, subject to any special or preferential voting rights of any then outstanding Preferred Stock. There shall be no cumulative voting.

C. Preferred Stock. The Board of Directors is authorized, subject to limitations prescribed by law, by the rules of a national securities exchange or automated quotation system of a registered national securities association, if applicable, and by the provisions contained herein, to provide for the issuance from time to time in one or more series of any number of shares of Preferred Stock, and, by filing a certificate pursuant to the General Corporation Law (a "Preferred Stock Designation"), to establish the number of shares to be included in each series, and to fix the designation, relative rights, preferences, qualifications and limitations of the shares of each such series. The authority of the Board of Directors with respect to each such series shall include, but not be limited to, determination of the following:

1. the designation of the series, which may be by distinguishing number, letter or title;
2. the number of shares of the series, which number the Board of Directors may thereafter (except where otherwise provided in the Preferred Stock Designation) increase or decrease (but not below the number of shares thereof then outstanding) in the manner permitted by law;
3. the voting rights, if any, of the holders of shares of the series;
4. whether dividends, if any, shall be cumulative or noncumulative and the dividend rate (or the manner, from time to time, of determining such rate) of the series, and the preferences, if any, over any other series (or of any other series over such series) with respect to dividends;
5. dates (or the manner, from time to time, of determining such dates) at which dividends, if any, shall be payable;
6. the redemption rights and price or prices, if any, for shares of the series;

7. the amounts payable on, and the preferences, if any, of shares of the series in the event of any voluntary or involuntary liquidation, dissolution, distribution of assets or winding up of the affairs of the Corporation;

8. the terms and amount of any purchase, retirement or sinking fund provided for the purchase or redemption of shares of the series;

9. whether the shares of the series shall be convertible into or exchangeable for shares of any other class or series, or any other security, of the Corporation or any other corporation, and, if so, the specification of such other class or series of such other security, the conversion or exchange price or prices or rate or rates, any adjustments thereof, the date or dates at which such shares shall be convertible or exchangeable and all other terms and conditions upon which such conversion or exchange may be made;

10. whether the issuance of additional shares of Preferred Stock shall be subject to restrictions as to issuance, or as to the powers, preferences or other rights of any other series;

11. the right of the shares of such series to the benefit of conditions and restrictions upon the creation of indebtedness of the Corporation or any subsidiary of the Corporation, upon the issue of any additional stock (including additional shares of such series or any other series) and upon the payment of dividends or the making of other distributions on, and the purchase, redemption or other acquisition by the Corporation or any subsidiary of any outstanding stock of the Corporation; and

12. such other powers, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions thereof as the Board of Directors shall determine. The holders of Preferred Stock shall not have any preemptive rights except to the extent such rights shall be specifically provided for in the resolution or resolutions providing for the issuance thereof adopted by the Board of Directors.

Dividends on outstanding shares of Preferred Stock shall be paid or declared and set apart for payment before any dividends shall be paid or declared and set apart for payment on the Common Stock with respect to the same dividend period.

If upon any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, the assets available for distribution to holders of shares of Preferred Stock of all series shall be insufficient to pay such holders the full preferential amount to which they are entitled, then such assets shall be distributed ratably among the shares of all series of Preferred Stock in accordance with the respective preferential amounts (including unpaid cumulative dividends, if any) payable with respect thereto.

Except as may be provided by the Board of Directors in a Preferred Stock Designation or as required by law, shares of any series of Preferred Stock that have been redeemed or purchased by the Corporation, or, if convertible or exchangeable, converted into or exchanged for shares of stock of any other class or classes shall have the status of authorized and unissued shares of Preferred Stock, and may be reissued as a part of the series of which they



were originally a part or may be reclassified and reissued as part of a new series of Preferred Stock.

## **ARTICLE V**

### **Directors**

A. Number. The number of directors of the Corporation shall be such number determined from time to time as set forth in the By-laws of the Corporation (the “By-laws”). Vacancies in the Board of Directors of the Corporation, however caused, and newly created directorships shall be filled by a vote of a majority of the directors then in office, whether or not a quorum, and any director so chosen shall hold office for a term expiring at the annual meeting of stockholders at which the term of the class to which the director has been chosen expires and when the director’s successor is elected and qualified.

B. Written Ballot. Unless, and except to the extent that, the By-laws shall so require, the election of directors of the corporation need not be by written ballot.

C. Removal of Directors. Notwithstanding any other provisions contained herein or in the By-laws, any director or the entire Board of Directors of the Corporation may be removed, at any time, by the affirmative vote of the holders of at least a majority of the outstanding shares of capital stock of the Corporation entitled to vote generally in the election of directors (considered for this purpose as one class) cast at a meeting of the stockholders called for that purpose. Notwithstanding the foregoing, whenever the holders of any one or more series of Preferred Stock shall have the right, voting separately as a class, to elect one or more directors of the Corporation, the preceding provisions of this Article V shall not apply with respect to the director or directors elected by such holders of Preferred Stock.

## **ARTICLE VI**

### **Stockholder Meetings**

Meetings of stockholders may be held within or without the State of Delaware, as the By-laws may provide. The books of the Corporation may be kept (subject to any provision in the General Corporation Law) outside the State of Delaware at such place or places as may be designated from time to time by the Board of Directors or in the By-laws.

## **ARTICLE VII**

### **Limitation of Directors’ Liability**

Except to the extent that the General Corporation Law prohibits the elimination or limitation of liability of directors for breaches of fiduciary duty, no director of the Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for any breach of fiduciary duty as a director, notwithstanding any provision of law imposing such liability. If the General Corporation Law is amended after approval by the stockholders of this Article VII to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the

fullest extent permitted by the General Corporation Law, as so amended. No amendment to or repeal of this provision shall apply to or have any effect on the liability or alleged liability of any director of the Corporation for or with respect to any acts or omissions of such director occurring prior to such amendment.

## **ARTICLE VIII**

### **Indemnification**

The Corporation may, to the fullest extent permitted by Section 145 of the General Corporation Law, as amended from time to time, indemnify each person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by or in the right of the Corporation or otherwise, by reason of the fact that the person is or was, or has agreed to become, a director, officer, employee or agent of the Corporation, or is or was serving, or has agreed to serve, at the request of the Corporation, as a director, officer, employee, agent or trustee of, or in a similar capacity with, an affiliate of the Corporation or another corporation, partnership, joint venture, trust or other enterprise (including any employee benefit plan) (all such persons being referred to hereafter as an "Indemnitee"), or by reason of any action alleged to have been taken or omitted in such capacity, against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the Indemnitee or on the Indemnitee's behalf in connection with such action, suit or proceeding and any appeal therefrom.

Indemnification may include payment by the Corporation of expenses in defending an action or proceeding in advance of the final disposition of such action or proceeding upon receipt of an undertaking by the Indemnitee to repay such payment if it is ultimately determined that such person is not entitled to indemnification under this Article VIII, which undertaking may be accepted without reference to the financial ability of such person to make such repayment.

The Corporation shall not indemnify any such person seeking indemnification in connection with a proceeding (or part thereof) initiated by such person unless the initiation thereof was approved by the Board of Directors of the Corporation.

The indemnification rights provided in this Article VIII (i) shall not be deemed exclusive of any other rights to which Indemnitees may be entitled under any By-law, agreement or vote of stockholders or disinterested directors or otherwise, and (ii) shall inure to the benefit of the heirs, executors and administrators of such persons. The Corporation may, to the extent authorized from time to time by its Board of Directors, grant indemnification rights to other employees or agents of the Corporation or other persons serving the Corporation and such rights may be equivalent to, or greater or less than, those set forth in this Article VIII.

Any repeal or modification of the foregoing provisions of this Article VIII shall not adversely affect any right or protection hereunder of any Indemnitee in respect of any act or omission occurring prior to the time of such repeal or modification.

The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee, agent or trustee of, or in a similar capacity with, an affiliate of the Corporation or another corporation, partnership, joint venture, trust or other enterprise (including any employee benefit plan), against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the Corporation would have the power to indemnify such person against such liability under the provisions of the General Corporation Law.

#### **ARTICLE IX**

##### **Amendment of By-laws**

In furtherance of and not in limitation of powers conferred by statute, the Board of Directors of the Corporation is expressly authorized to adopt, repeal, alter, amend and rescind the By-laws by the affirmative vote of at least a majority of the members of the Board of Directors.

#### **ARTICLE X**

##### **Amendment of Certificate of Incorporation**

The Corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by the General Corporation Law and this Certificate of Incorporation, and all rights conferred upon stockholders herein are granted subject to this reservation. Notwithstanding the foregoing, the provisions set forth in Articles V, VI, VII, VIII, IX and this Article X may not be amended, altered, changed or repealed in any respect unless the same is approved by the affirmative vote of the holders of at least a majority of the outstanding shares of capital stock of the Corporation entitled to vote generally in the election of directors (considered for this purpose as a single class) cast at a meeting of the stockholders called for that purpose (provided that notice of such proposed amendment, alteration, change or repeal is included in the notice of such meeting). Notwithstanding the foregoing, no amendment, alteration, change or repeal to this Certificate of Incorporation shall be adopted that would have the effect of circumventing the provisions of this Article X.

\* \* \*

FOURTH: The foregoing amendment and restatement has been duly adopted in accordance with Sections 242 and 245 of the General Corporation Law.

FIFTH: The foregoing amendment and restatement was approved by the written consent of the stockholders of the Corporation in accordance with Section 228 of the General Corporation Law.

**[REMAINDER OF PAGE INTENTIONALLY BLANK]**

IN WITNESS WHEREOF, this Amended and Restated Certificate of Incorporation has been signed by a duly authorized officer on this 7th day of June, 2006.

**TOWN SPORTS INTERNATIONAL  
HOLDINGS, INC.**

By: /s/ ROBERT J. GIARDINA  
Robert J. Giardina  
Chief Executive Officer



**AMENDED AND RESTATED  
BY-LAWS  
OF  
TOWN SPORTS INTERNATIONAL HOLDINGS, INC.**

**ARTICLE I  
OFFICES**

SECTION 1. The registered office of the Corporation in the State of Delaware shall be located at the principal place of business in said state of the corporation or individual acting as the Corporation's registered agent.

SECTION 2. The Corporation may have other offices, either within or without the State of Delaware, at such place or places as the Board of Directors may from time to time determine or the business of the Corporation may require.

**ARTICLE II  
MEETINGS OF STOCKHOLDERS**

SECTION 1. All meetings of the stockholders for the election of directors shall be held at such place as may be fixed from time to time by the Board of Directors, or at such other place either within or without the State of Delaware as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting. Meetings of stockholders for any other purpose may be held at such time and place, within or without the State of Delaware, as shall be stated in the notice of the meeting or in a duly executed waiver of notice thereof.

SECTION 2. Annual meetings of stockholders shall be held at such date and time as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting. At each annual meeting, the stockholders shall elect directors and transact such other business as may properly be brought before the meeting.

SECTION 3. Written notice of the annual meeting stating the place, date and hour of the meeting shall be given to each stockholder entitled to vote at such meeting not fewer than ten (10) nor more than sixty (60) days before the date of the meeting.

SECTION 4. The officer who has charge of the stock ledger of the Corporation shall prepare and make available, at least ten (10) days before every meeting of stockholders, a

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complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

SECTION 5. Special meetings of the stockholders, for any purpose or purposes, unless otherwise prescribed by statute or by the Corporation's certificate of incorporation, may only be called by the Chairperson of the Board, the Chief Executive Officer, the President or at the written request of at least a majority of the members of the Board of Directors.

SECTION 6. Written notice of a special meeting stating the place, date and time of the meeting and the purpose or purposes for which the meeting is called, shall be given not fewer than ten (10) nor more than sixty (60) days before the date of the meeting, to each stockholder entitled to vote at such meeting.

SECTION 7. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

SECTION 8. The holders of a majority of the stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business except as otherwise provided by statute or by the Corporation's certificate of incorporation. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the chairperson of the meeting, the Chairperson of the Board, the Chief Executive Officer, the President or the holders of a majority of the stock the Corporation entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented any business may be transacted that might have been transacted at the meeting as originally notified. If the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

SECTION 9. When a quorum is present at any meeting:

1. directors shall be elected by a plurality of the votes cast by the holders of stock entitled to vote in the election and present in person or represented by proxy, and
2. the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting,

unless the question is one upon which by express provision of applicable law or of the Corporation's certificate of incorporation, a different vote is required, in which case such express provision shall govern and control the decision of such question.

SECTION 10. Unless otherwise provided in the Corporation's certificate of incorporation, each stockholder shall at every meeting of the stockholders be entitled to one vote in person or by proxy for each share of the capital stock having voting power held by such stockholder, but no proxy shall be voted on after three (3) years from its date, unless the proxy provides for a longer period.

SECTION 11. Unless otherwise provided in the Corporation's certificate of incorporation, the chairperson of the meeting or the Chief Executive Officer may adjourn a meeting of stockholders from time to time, without notice other than announcement at the meeting. No notice of the time and place of an adjourned meeting need be given except as required by law.

SECTION 12. At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before an annual meeting business must be (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (b) otherwise properly brought before the meeting by or at the direction of the Board of Directors, or (c) otherwise properly brought before the meeting by a stockholder. For business to be properly brought before an annual meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary of the Corporation. To be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than 60 days nor more than 90 days prior to the meeting; provided, however, that in the event that less than 70 days' notice or prior public disclosure of the date of the meeting is given or made to stockholders, notice by the stockholder to be timely must be so received not later than the close of business on the 10th day following the day on which such notice of the date of the annual meeting was mailed or such public disclosure was made. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (a) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (b) the name and address, as they appear on the Corporation's books, of the stockholder proposing such business, (c) the class and number of shares of the Corporation which are beneficially owned by the stockholder, and (d) any material interest of the stockholder in such business. Notwithstanding anything in the By-Laws to the contrary, no business shall be conducted at any annual meeting except in accordance with the procedures set forth in this Section. The Chairperson of the annual meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting and in accordance with the provisions of this Section, and any such business not properly brought before the meeting shall not be transacted.



## **ARTICLE III**

### **DIRECTORS**

SECTION 1. The business of the Corporation shall be managed by or under the direction of its Board of Directors which may exercise all such powers of the Corporation and do all such lawful acts and things as are not by statute or by the Corporation's certificate of incorporation or by these By-laws directed or required to be exercised or done by the stockholders.

SECTION 2. The number of directors that shall constitute the whole Board of Directors shall be determined by resolution of the Board of Directors or by the stockholders at the annual meeting of the stockholders. Directors need not be residents of the State of Delaware or stockholders of the Corporation. No decrease in the number of directors shall shorten the term of an incumbent director.

SECTION 3. The Board of Directors shall be elected in the manner set forth in the Corporation's certificate of incorporation.

#### **Meetings of the Board of Directors**

SECTION 4. The Board of Directors of the Corporation may hold meetings, both regular and special, either within or without the State of Delaware.

SECTION 5. Regular meetings of the Board of Directors may be held at such dates, times and places as shall be determined by the Board of Directors.

SECTION 6. Special meetings of the Board of Directors may be called by the Chairperson of the Board, the Chief Executive Officer or the President on two (2) days' notice to each director by mail or twenty-four (24) hours' notice to each director either personally or by telecopy or other means of electronic transmission; special meetings shall be called by the Chairperson of the Board, the Chief Executive Officer, President or Secretary in like manner and on like notice on the written request of two directors unless the Board of Directors consists of only one director, in which case special meetings shall be called by the Chairperson of the Board, the Chief Executive Officer, the President or Secretary in like manner and on like notice on the written request of the sole director.

SECTION 7. At all meetings of the Board of Directors, a majority of the directors fixed by Section 2 of this Article III shall constitute a quorum for the transaction of business and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board of Directors, except as may be otherwise specifically provided by applicable law or by the Corporation's certificate of incorporation. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

SECTION 8. Unless otherwise provided by statute, the Corporation's certificate of incorporation or these By-laws, the vote of a majority of the directors at any meeting at which a quorum is present shall be the act of the Board of Directors. Each director shall have one vote regardless of the number of shares, if any, which he or she may hold.

SECTION 9. Unless otherwise restricted by the Corporation's certificate of incorporation or these By-laws, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

SECTION 10. Unless otherwise restricted by the Corporation's certificate of incorporation or these By-laws, members of the Board of Directors, or any committee designated by the Board of Directors, may participate in a meeting of the Board of Directors, or any committee thereof, by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

### **Committees of Directors**

SECTION 11. The Board of Directors may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of one or more of the directors of the Corporation. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not such member or members constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member.

Any such committee, to the extent provided in the resolution of the Board of Directors, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the Corporation's certificate of incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the Corporation's property and assets, recommending to the stockholders a dissolution of the Corporation or a revocation of a dissolution, or amending the By-laws of the Corporation; and, unless the resolution or the Corporation's certificate of incorporation expressly so provide, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board of Directors. Each such committee, or the Board of Directors, may, but is not required to, adopt a written charter setting forth the matters to be determined by

such committee, the scope of the responsibilities of such committee, and the means by which such committee carries out such responsibilities.

SECTION 12. Each committee shall keep regular minutes of its meetings and report the same to the Board of Directors when required.

### **Compensation of Directors**

SECTION 13. Unless otherwise restricted by the Corporation's certificate of incorporation or these By-laws, the Board of Directors shall have the authority to fix the compensation of directors. The directors may be paid their expenses, if any, of attendance at each meeting of the Board of Directors. The directors may be paid a fixed sum for attendance at each meeting of the Board of Directors, a stated salary as a director or a combination of both. Directors may be compensated in any form, including by payment of cash or property of any kind or by the issuance or grant of stock options, restricted stock or any other equity, equity-linked or debt securities of the Corporation. No such compensation shall preclude any director from serving the Corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

### **Removal of Directors**

SECTION 14. Any director or the entire Board of Directors may be removed only in accordance with the provisions of the Corporation's certificate of incorporation.

## **ARTICLE IV**

### **OFFICERS**

SECTION 1. The Board of Directors shall elect a Chief Executive Officer and a Secretary, each of whom shall hold office until a successor is elected and qualified or until the earlier resignation or removal of such officer. The Board of Directors may elect from its members a Chairperson of the Board and a Vice Chairperson of the Board. The Board of Directors may also elect or appoint a President, one or more Vice Presidents, a Chief Financial Officer, a Treasurer, Assistant Secretaries and Assistant Treasurers.

SECTION 2. The Board of Directors may appoint such other officers and agents as it shall deem necessary or desirable who shall exercise such powers and perform such duties as shall be determined from time to time by the Board.

SECTION 3. Two or more offices may be held by the same person. The officers of the Corporation shall hold office until their successors are chosen and qualified. Any officer

may be removed at any time, with or without cause, by the affirmative vote of a majority of the Board of Directors. An vacancy occurring in any office of the Corporation shall be filled by the Board of Directors.

SECTION 4. The salaries of all officers of the Corporation shall be fixed by the Board of Directors or a committee thereof.

### **The Chairperson of the Board**

SECTION 5. The Chairperson of the Board, if any, shall preside at all meetings of the Board of Directors and of the stockholders at which such individual shall be present. Such individual shall have and may exercise such powers as are, from time to time, assigned by the Board and as may be provided by law.

SECTION 6. In the absence of the Chairperson of the Board, the Vice Chairperson of the Board, if any, shall preside at all meetings of the Board of Directors and of the stockholders at which such individual shall be present. Such individual shall have and may exercise such powers as are, from time to time, assigned by the Board and as may be provided by law.

SECTION 7. In the absence of the Chairperson of the Board and the Vice Chairperson of the Board, if any, the Chief Executive Officer and, in the absence of the Chief Executive Officer, the President, shall preside at all meetings of the Board of Directors and of the stockholders. In such capacity, the Chief Executive Officer or the President shall have and may exercise such powers as are provided for the Chairperson of the Board hereunder or are typically exercised by a chairperson of the board of directors.

### **Chief Executive Officer**

SECTION 8. Subject to the provisions of these By-laws and the direction of the Board of Directors, such individual shall have the responsibility for the general management and control of the affairs and business of the Corporation and shall perform all duties and have all powers which are commonly incident to the office of Chief Executive Officer or which from time to time are delegated to such individual by the Board of Directors. The Chief Executive Officer shall see that all orders and resolutions of the Board of Directors are carried into effect.

SECTION 9. The Chief Executive Officer shall have the power to sign, in the name of the Corporation, all authorized stock certificates, contracts, documents, tax returns, instruments, checks and bonds or other obligations of the Corporation and shall have general supervision and direction of all of the other officers and agents of the Corporation.

### **President and Vice-Presidents**

SECTION 10. The President and each Vice President shall have such powers and shall perform such duties as shall from time to time be designated by the Board of Directors.

### **Chief Financial Officer and Treasurer**

SECTION 11. The Chief Financial Officer, if any, and/or the Treasurer, if any shall have the custody of the corporate funds and securities and shall keep full and accurate account of receipts and disbursements in books belonging to the Corporation. The Chief Financial Officer and/or the Treasurer shall deposit all moneys and other valuables in the name and to the credit of the Corporation in such depositories as may be designated by the Board of Directors.

SECTION 12. The Chief Financial Officer and/or the Treasurer shall disburse the funds of the Corporation as may be ordered by the Board of Directors, or the Chief Executive Officer, taking proper vouchers for such disbursements. The Chief Financial Officer and/or the Treasurer shall render to the Chief Executive Officer and Board of Directors at its regular meetings, or whenever they may request it, an account of all transactions as Chief Financial Officer and/or Treasurer and of the financial condition of the Corporation. If required by the Board of Directors, the Chief Financial Officer and/or the Treasurer shall give the Corporation a bond for the faithful discharge of such person's duties in such amount and with such surety as the Board of Directors shall prescribe and for the restoration to the Corporation, in case of such person's death, resignation, retirement or removal from office, of all books, papers, vouchers, money and other property of whatever kind in such person's possession or under such person's control belonging to the Corporation.

SECTION 13. If there is no Chief Financial Officer and no Treasurer, the functions and duties of the Chief Financial Officer and the Treasurer shall be performed by such other officer or officers of the Corporation as shall be determined by the Board of Directors, the Chief Executive Officer or the President.

### **The Secretary and Assistant Secretary**

SECTION 14. The Secretary shall give, or cause to be given, notice of all meetings of stockholders and Board of Directors, and all other notices required by law or by these By-laws, and in case of the Secretary's absence or refusal or neglect so to do, any such notice may be given by any person thereunto directed by the Chief Executive Officer, the Board of Directors, or stockholders, upon whose requisition the meeting is called as provided in the By-laws. The Secretary shall attend all meetings of the Board of Directors and all meetings of the stockholders and record all the proceedings of the meetings of the Corporation and of the Board of Directors in a book to be kept for that purpose and shall perform like duties for the standing committees when required. Such individual shall perform such other duties as may be prescribed by the Board of Directors or the Chief Executive Officer, under whose supervision such individual shall be.

SECTION 15. The Secretary shall have custody of the seal of the Corporation and the Secretary, or an Assistant Secretary, shall have authority to affix the same to any instrument requiring it, when authorized by the directors or the Chief Executive Officer, and attest the same. The Board of Directors may give general authority to any other officer to affix the seal of the Corporation and to attest the affixing by such officer's signature.

SECTION 16. The Assistant Secretary, or if there is more than one, the Assistant Secretaries in the order determined by the Board of Directors (or if there be no such determination, then in the order of their election) shall, in the absence of the Secretary or in the event of the Secretary's inability or refusal to act, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

## **ARTICLE V**

### **STOCK**

#### **Certificates of Stock**

SECTION 1. Every holder of stock in the Corporation shall be entitled to have a certificate signed by, or in the name of the Corporation by the Chairperson or Vice Chairperson of the Board of Directors, or the President or a Vice President, and by the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary, certifying the number of shares owned by such holder in the Corporation.

SECTION 2. If the Corporation shall be authorized to issue more than one class of stock or more than one series of any class, the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualification, limitations or restrictions or such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock; provided, that except as otherwise provided in Section 202 of the General Corporation Law of the State of Delaware, in lieu of the foregoing requirements, there may be set forth on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, a statement that the Corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

SECTION 3. Any of or all the signatures on the certificates may be facsimiles. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if such individual were such officer, transfer agent or registrar at the date of issue.

#### **Lost, Stolen or Destroyed Certificates**

SECTION 4. A new certificate of stock may be issued in place of any certificate theretofore issued by the Corporation, alleged to have been lost, stolen or destroyed, and the Board of Directors may, in its discretion, require the owner of the lost, stolen or destroyed certificate, or such holder's legal representative, to give the Corporation a bond, in such sum as it may direct, to indemnify the Corporation against any claim that may be made against it on

account of the alleged loss, theft, or destruction of any such certificates of the issuance of any such new certificate.

### **Transfer of Shares**

SECTION 5. Transfers of stock shall be made only upon the transfer books of the Corporation kept at an office of the Corporation or by a transfer agent designated to transfer shares of stock of the Corporation. Upon surrender to the Corporation or its transfer agent of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, the Corporation shall issue or cause its transfer agent to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books.

### **Record Date**

SECTION 6. In order that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or to express consent to corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any other action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

### **Registered Stockholders**

SECTION 7. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a person registered on its books as the owner of shares and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of the State of Delaware.

## **ARTICLE VI**

### **MISCELLANEOUS**

#### **Dividends**

SECTION 1. Subject to the terms of the Corporation's certificate of incorporation, dividends upon the capital stock of the Corporation may be declared by the Board of Directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property, or in shares of the capital stock.

SECTION 2. Subject to the terms of the Corporation's certificate of incorporation, before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the Board of Directors from time to time, in its absolute discretion, thinks proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation, or for such other purposes as the Board of Directors shall think conducive to the interest of the Corporation, and the Board of Directors may modify or abolish any such reserve in the manner in which it was created.

#### **Seal**

SECTION 3. The corporate seal shall have the name of the corporation inscribed thereon and shall be in such form as may be approved from time to time by the Board of Directors. Said seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

#### **Fiscal Year**

SECTION 4. The fiscal year of the Corporation shall be fixed by resolution of the Board of Directors.

#### **Checks**

SECTION 5. All checks, drafts or other orders for the payment of money, notes or other evidences of indebtedness issued in the name of the Corporation shall be signed by such officer or officers, agent or agents of the Corporation, and in such manner as shall be determined from time to time by the Board of Directors.

#### **Notice and Waiver of Notice**

SECTION 6. Except as otherwise provided herein or permitted by applicable law, notices to directors and stockholders shall be in writing and delivered personally or mailed to the directors or stockholders at their addresses appearing in the records of the Corporation. Notice to directors may be given by telecopier, telephone or other means of electronic transmission.

SECTION 7. Any written waiver of notice, signed by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not properly called or convened. Neither the business to be transacted at nor the purpose of any regular or special meeting of the stockholders, directors, or members of a committee of directors need be specified in a waiver of notice.

#### **Transactions with Interested Parties**

SECTION 8. No contract or transaction between the Corporation and one or more of the directors or officers, or between the Corporation and any other corporation,



partnership, association, or other organization in which one or more of the directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because such director or officer is present at or participates in the meeting of the Board of Directors or a committee of the Board of Directors which authorizes the contract or transaction or solely because his, her or their votes are counted for such purpose, if:

(1) The material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested directors, even if the disinterested directors are less than a quorum;

(2) The material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or

(3) The contract or transaction is fair as to the Corporation as of the time it is authorized, approved or ratified, by the Board of Directors, a committee of the Board of Directors, or the stockholders.

Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

### **Close of Business**

SECTION 9. Any reference in these By-laws to the close of business on any day shall be deemed to mean 5:00 P.M. New York time on such day, whether or not such day is a business day.

## **ARTICLE VII AMENDMENTS**

These By-laws may be repealed, altered, amended or rescinded by the stockholders of the Corporation by vote of the holders of at least a majority of the outstanding shares of capital stock of the Corporation entitled to vote generally in the election of directors (considered for this purpose as one class) cast at a meeting of the stockholders called for that purpose (provided that notice of such proposed repeal, alteration, amendment or rescission is included in the notice of such meeting). In addition, in accordance with the Corporation's certificate of incorporation, the Board of Directors may repeal, alter, amend or rescind these By-laws by the affirmative vote of at least a majority of the members of the Board of Directors.

## **ARTICLE VIII**

### **INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES AND AGENTS**

#### **Indemnification of Directors and Officers**

SECTION 1. The Corporation shall, to the fullest extent permitted by Section 145 of the General Corporation Law of the State of Delaware, as amended from time to time, and by the Corporation's certificate of incorporation, indemnify each director and officer of the Corporation.

#### **Indemnification of Employees and Agents**

SECTION 2. The Corporation may, by action taken in writing by its Board of Directors in its sole discretion in a particular case, provide indemnification to employees and agents of the Corporation, and to persons who serve at the request of the Corporation as directors, officers, employees, agents or trustees of, or in a similar capacity with, an affiliate of the Corporation or another corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, in each case individually or as a group, to the same extent (or such lesser extent as the action by the Board of Directors of the Corporation may provide) as the indemnification of directors and officers permitted by Section 1 of this Article VIII.

#### **Defense to Indemnification**

SECTION 3. It shall be a defense to any action brought by a person seeking indemnification that, and the Corporation shall have the right to recover any amounts paid by it to a person on account of indemnification if, such person has not met the standards of conduct that make it permissible under the General Corporation Law of the State of Delaware for the Corporation to indemnify such person for the amount sought or paid or if such person has failed to abide by his or her obligations to the Corporation, whether arising by statute, common law, equity, contract or otherwise.

#### **Insurance**

SECTION 4. The Corporation may maintain insurance, at its expense, to protect itself and any person who is or was serving as a director, officer, employee or agent of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any expense, liability or loss, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the General Corporation Law of the State of Delaware.

#### **Interested Directors**

SECTION 5. No director of the Corporation shall vote on any action by the Board of Directors of the Corporation to provide indemnification of such director, or of a definite

group of persons that includes such director, with respect to any particular action, suit or proceeding. In the event that, on account of the provisions of this Section 5, there shall not be a quorum of the Board of Directors, the Corporation may provide such indemnification only by action of its stockholders.

#### **Advancement of Expenses**

SECTION 6. The Corporation shall make payments to indemnitees hereunder of all expenses in advance of the settlement of or final judgment on any claim, in each case to the fullest extent as may be provided for under the Corporation's certificate of incorporation, the General Corporation Law of the State of Delaware or vote of either the Corporation's stockholders or its disinterested directors.

#### **Effect of Repeal or Modification**

SECTION 7. Any repeal or modification of the foregoing provisions of this Article VIII shall not adversely affect any right or protection hereunder of any indemnitee in respect of any act or omission occurring prior to the time of such repeal or modification.



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RECITALS  
AGREEMENT  
Annex A

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AMENDMENT NO. 2 TO REGISTRATION RIGHTS AGREEMENT dated as of May 30, 2006 (this “Amendment”), among Town Sports International Holdings, Inc., a Delaware corporation (the “Company”), Town Sports International, Inc., a New York corporation (“TSI”), and those of the Stockholders (as defined in the Registration Rights Agreement referred to below) that are signatory hereto (the Company, TSI and such Stockholders are herein referred to collectively as the “Parties”).

### RECITALS

A. The Parties and certain other Stockholders have entered into that certain Registration Rights Agreement dated as of February 4, 2004, as amended by Amendment No. 1 to the Registration Rights Agreement dated as of March 23, 2006 (the “Registration Rights Agreement”).

B. Each of the persons listed on Annex A to this Amendment have either (i) entered into an Executive Stock Agreement with the Company and certain other parties or a joinder agreement with the Company, and pursuant to such Executive Stock Agreements or joinder agreements, the Company has agreed to provide such persons with certain registration rights under the Registration Rights Agreement, or (ii) the Company has otherwise agreed to provide such persons with registration rights under the Registration Rights Agreement.

C. The Company has agreed to register the Canterbury Registrable Securities in connection with the Company’s planned IPO.

D. The Farallon Investors have agreed to purchase 1,300,000 Canterbury Registrable Securities from the Canterbury Investors immediately after the consummation of the Company’s planned IPO.

E. The Company desires to provide the Farallon Investors with registration rights for such Canterbury Registrable Securities.

F. The Parties desire to amend the Registration Rights Agreement in accordance with Section 11(c) of the Registration Rights Agreement.

### AGREEMENT

NOW, THEREFORE, on the basis of the preceding facts, and in consideration of the mutual agreements and covenants set forth below and other good and valuable consideration, the receipt and sufficiency of which hereby are acknowledged, the Parties agree as follows:

1. Definitions. Unless the context otherwise requires, all capitalized and other defined terms not defined in this Amendment shall have the respective meanings accorded to them in the Registration Rights Agreement.

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### 2. Amendments.

(a) The Registration Rights Agreement hereby is amended to provide that, for all purposes of the Registration Rights Agreement (including the Company's planned IPO), each of the persons listed on Annex A shall be deemed an "Executive", as such term is defined in the Registration Rights Agreement, in addition to those stockholders of the Company listed on the Executive Signature Pages to the Registration Rights Agreement as originally entered into.

(b) The definition of "Farallon Registrable Securities" in Section 1 of the Registration Rights Agreement is hereby amended in its entirety to read as follows following the consummation of the Company's IPO:

“ “Farallon Registrable Securities” means (i) any shares of Common Stock held by the Farallon Investors or issued or issuable to the Farallon Investors or their respective affiliates or partners on or after December 10, 1996, (ii) the Purchased Canterbury Registrable Securities, (iii) the 250,000 shares of Common Stock purchased by the Farallon Investors in the Company's IPO and (iv) any shares of capital stock of the Company issued or issuable with respect to the securities referred to in clause (i), (ii) and (iii) by way of a stock dividend or stock split or in connection with a combination of shares, recapitalization, merger, consolidation or other reorganization. For purposes of this Agreement, a Person will be deemed to be a holder of Farallon Registrable Securities whenever such Person has the right to acquire directly or indirectly such Farallon Registrable Securities (upon conversion or exercise in connection with a transfer of securities or otherwise, but disregarding any restrictions or limitations upon the exercise of such right), whether or not such acquisition has actually been effected. Such securities will cease to be Farallon Registrable Securities when sold pursuant to Rule 144 or any offering registered under the Securities Act. For avoidance of doubt, the immediately preceding sentence shall not apply to the sale of the Purchased Canterbury Registrable Securities by the Canterbury Investors to the Farallon Investors pursuant to the transactions contemplated in the Securities Purchase Agreement.”

(c) Section 1 of the Registration Rights Agreement is hereby amended to add the following defined term following the consummation of the Company's IPO:

“ “Purchased Canterbury Registrable Securities” means the 1,300,000 Canterbury Registrable Securities that FCP, FCIP, Farallon Capital Institutional Partners II, L.P. ("FII") and RRC purchased from Canterbury Detroit and Canterbury Mezzanine pursuant to the securities purchase agreement (the "Securities Purchase Agreement") by and among FCP, FCIP, FII, RRC, Canterbury Detroit and Canterbury Mezzanine.”

(d) A new paragraph (c) is hereby added to the end of Section 4 of the Registration Rights Agreement as follows:

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“(c) Notwithstanding anything to the contrary in this Section 4, the provisions of Section 4(a) and Section 4(b) shall not apply in the case of the Company’s IPO, and shall otherwise be waivable at the discretion of the underwriters managing any registered public offering.”

(e) A new Section 12 of the Registration Rights Agreement hereby is added immediately following Section 11 to read in its entirety as follows:

“12. Termination of Registration Rights . Notwithstanding anything to the contrary in this Agreement, at the time at which all Executive Registrable Securities held by a holder (and any affiliate of the holder with whom such holder must aggregate its sales under Rule 144) are (a) included for resale in, or otherwise covered by, an effective registration statement under the Securities Act, (b) saleable in any three (3)-month period without registration under the Securities Act in compliance with Rule 144, including Rule 144(k), or (c) saleable under Rule 701 under the Securities Act, such securities will cease to be Executive Registrable Securities, and thereafter such holder shall not be entitled to exercise any right provided for in Section 2 or Section 3 hereunder, nor be entitled to receive any notice thereunder, in each case with respect to the Executive Registrable Securities.”

3. Governing Law . This Amendment shall be governed by, construed and enforced in accordance with, the laws of the State of New York.

4. Counterparts . This Amendment may be executed (including by facsimile transmission) with counterpart signature pages or in any number of counterparts, each of which when executed shall be deemed to be an original, but all of which taken together shall constitute one and the same agreement.

5. Bound Parties . The Registration Rights Agreement is being amended by this Amendment pursuant to Section 11(c) of the Registration Rights Agreement and this Amendment shall be effective upon the execution and delivery hereof by the requisite approval of the Company and those Stockholders specified in Section 11 of the Registration Rights Agreement.

6. No Other Amendment; Etc . Except as expressly amended by this Amendment, the Registration Rights Agreement otherwise shall remain unaffected and shall be in full force and effect. For the avoidance of doubt, no other agreement now existing or hereafter entered into that provides for, or otherwise contains, any restriction on the sale, disposal or other transfer of Registrable Securities shall be deemed to be limited, modified, amended or waived as a result of the execution and delivery of the Registration Rights Agreement or this Amendment.



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IN WITNESS WHEREOF, the Parties hereto have executed and delivered this Amendment as of the date first above written.

TOWN SPORTS INTERNATIONAL HOLDINGS, INC.

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

TOWN SPORTS INTERNATIONAL, INC.

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

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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BRUCKMANN, ROSSER, SHERRILL & CO., LP

By: /s/ Paul Kaminski

Name: Paul Kaminski

Title: Authorized signer for BRSE Associates, Inc.,  
the General Partner of BRS Partners, LP, the  
General Partner of Bruckmann, Rosser,  
Sherrill & Co., LP

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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FARALLON CAPITAL PARTNERS, L.P.

BY: FARALLON PARTNERS, L.L.C.  
ITS: GENERAL PARTNER

By: /s/ Mark C. Wehrly

Name: Mark C. Wehrly

Title: Managing Member

FARALLON CAPITAL INSTITUTIONAL PARTNERS,  
L.P.

BY: FARALLON PARTNERS, L.L.C.  
ITS: GENERAL PARTNER

By: /s/ Mark C. Wehrly

Name: Mark C. Wehrly

Title: Managing Member

RR CAPITAL PARTNERS, L.P.

BY: FARALLON PARTNERS, L.L.C.  
ITS: GENERAL PARTNER

By: /s/ Mark C. Wehrly

Name: Mark C. Wehrly

Title: Managing Member

FARALLON CAPITAL INSTITUTIONAL PARTNERS  
II, L.P.

BY: FARALLON PARTNERS, L.L.C.  
ITS: GENERAL PARTNER

By: /s/ Mark C. Wehrly

Name: Mark C. Wehrly

Title: Managing Member

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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CANTERBURY DETROIT PARTNERS, L.P.

By: /s/ Patrick Turner

Name: Patrick Turner

Title: Manager

CANTERBURY MEZZANINE CAPITAL, L.P.

By: /s/ Patrick Turner

Name: Patrick Turner

Title: Manager

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ROSEWOOD CAPITAL, L.P.

By: /s/ Kyle Anderson

Name: Kyle Anderson

Title: Managing Director

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CS EQUITY II LLC

By: /s/ Jason M. Fish

Name: Jason M. Fish

Title: Chief Investment Officer

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BCB PARTNERSHIP

By: /s/ S. Sherrill (Power of Attorney)  
Name:  
Title:

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NAZ PARTNERSHIP

By: /s/ S. Sherrill (Power of Attorney)  
Name:  
Title:

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IRA FBO PAUL KAMINSKI DB SECURITIES AS  
CUSTODIAN

By: /s/ S. Sherrill (Power of Attorney)

Name:

Title:

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/s/ Keith Alessi  
KEITH ALESSI

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/s/ Paul Arnold  
PAUL ARNOLD

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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/s/ Bruce C. Bruckmann  
BRUCE BRUCKMANN

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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/s/ S. Sherrill (Power of Attorney)  
ELIZABETH MCSHANE

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

---

/s/ S. Sherrill (Power of Attorney)  
BEVERLY PLACE

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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/s/ S. Sherrill (Power of Attorney)  
D. BRUCKMANN

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---

/s/ S. Sherrill (Power of Attorney)  
HAROLD O. ROSSER

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/s/ S. Sherrill (Power of Attorney)  
VIRGIL SHERRILL

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---

/s/ Stephen Sherrill  
STEPHEN SHERRILL

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---

/s/ S. Sherrill (Power of Attorney)  
NANCY ZWENG

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---

/s/ S. Sherrill (Power of Attorney)  
PAUL D. KAMINSKI

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---

/s/ Mark Smith  
MARK SMITH

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/s/ Robert Giardina  
ROBERT GIARDINA

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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/s/ Richard Pyle  
RICHARD PYLE

[Signature page to Amendment No. 2 to the Registration Rights Agreement]

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/s/ Alexander Alimanestianu  
ALEXANDER ALIMANESTIANU

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/s/ Debbie Smith  
DEBBIE SMITH

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/s/ Carol Cornbill  
CAROL CORNBILL

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/s/ Edward Trainor  
EDWARD TRAINOR

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/s/ Robert Calvo  
ROBERT CALVO

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/s/ Maggie Stevens  
MAGGIE STEVENS

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/s/ Ray Dewhirst  
RAY DEWHIRST

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/s/ Nina Duchaine  
NINA DUCHAINE

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/s/ Felicia Bochicchio  
FELICIA BOCHICCHIO

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Bartlett, Dirk  
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Khan, Asif  
Kraemer, John  
Liang, Chee  
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Marotta, Paul  
McGovern, Maureen  
Meltzer, Jodie  
Napolitano, Frank  
O’Hearen, Sean  
Oberg, Nancy  
Onofrio, Dan  
Priestly, Lisa  
Prue, Jenny  
Rasulo, Pam

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Sullivan, Barbara  
Talty, Fred  
Terlitsky, Mark  
Verina, Daniel  
Werner, Doug

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**AMENDMENT NO. 1  
TO THE  
TOWN SPORTS INTERNATIONAL HOLDINGS, INC.  
2006 STOCK INCENTIVE PLAN**

**WHEREAS**, Town Sports International Holdings, Inc. (the “Corporation”) maintains the Town Sports International Holdings, Inc. 2006 Stock Incentive Plan (the “Plan”);

**WHEREAS**, pursuant to Section 13.1 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; and

**WHEREAS**, the Compensation Committee desires to amend the Plan, effective as of August 4, 2006;

**NOW, THEREFORE**, pursuant to Section 13.1 of the Plan, the Plan hereby is amended, effective as of August 4, 2006, as follows:

1. Section 2.13 of the Plan is amended in its entirety to read as follows:

“ ‘ **Detrimental Activity** ’ means:

- (a) disclosing, divulging, furnishing or making available to anyone at any time, except as necessary in the furtherance of Participant’s responsibilities to the Company or any of its Affiliates, either during or subsequent to Participant’s service relationship with the Company or any of its Affiliates, any knowledge or information with respect to confidential or proprietary information, methods, processes, plans or materials of the Company or any of its Affiliates, or with respect to any other confidential or proprietary aspects of the business of the Company or any of its Affiliate, acquired by the Participant at any time prior to the Participant’s Termination;
  - (b) any activity while employed or performing services that results, or if known could reasonably be expected to result, in the Participant’s Termination that is classified by the Company as a termination for Cause;
  - (c) (i) directly or indirectly soliciting, enticing or inducing any employee of the Company or of any of its Affiliates to be employed by a person or entity that is, directly or indirectly, in competition with the business or activities of the Company or any of its Affiliates; (ii) directly or indirectly approaching any such employee for these purposes; (iii) authorizing or knowingly approving the taking of any such action by a third party on behalf of any such person or entity, or assisting any such person or entity in taking such action; or (iv) directly or indirectly soliciting, raiding, enticing or inducing any person or entity (other than the U.S. Government or its agencies) that is, or at any time from and after the date of grant of the Award was, a customer of the Company or any of its Affiliates to
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become a customer of the Participant or a third party for the same or similar products or services that it purchased from the Company or any of its Affiliates, or approaching any customer of the Company or any of its Affiliates for such purpose, or authorizing or knowingly approving the taking of any action by a third party for such purpose;

- (d) the Participant's Disparagement, or inducement of others to do so, of the Company or any of its Affiliates or their past and present officers, directors, employees or products;
- (e) the Participant's owning, managing, controlling, participating in, consulting with, rendering services for, or in any manner engaging in, any business that, directly or indirectly, is competitive with the business conducted by the Company or any of its Affiliates within any metropolitan area in which the Company or any of its Affiliates engages or has definitive plans to engage in such business, or the rendering of services to such business if such business is otherwise prejudicial to or in conflict with the interests of the Company or any of its Affiliates; or
- (f) a material breach of any agreement between the Participant and the Company or any of its Affiliates (including, without limitation, any employment agreement or noncompetition or nonsolicitation or confidentiality agreement).

Unless otherwise determined by the Committee at grant, Detrimental Activity shall not be deemed to occur after the end of the one-year period following the Participant's Termination.

For purposes of clauses (a), (c), (e) and (f) above, the Chief Executive Officer of the Company has the authority to provide the Participant with written authorization to engage in the activities contemplated thereby and no other person shall have authority to provide the Participant with such authorization. If it is determined by a court of competent jurisdiction that any provision in the Plan in respect of Detrimental Activities 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."

2. Section 4.2(b) of the Plan is amended in its entirety to read as follows:

"Subject to the provisions of Section 4.2(d), if there shall occur any such change in the capital structure of the Company by reason of any stock split, reverse stock split, stock dividend, subdivision, combination or reclassification of shares that may be issued under the Plan, any recapitalization, any merger, any consolidation, any spin off, any reorganization or any partial or complete liquidation, or any other corporate transaction or event having an effect similar to any of the foregoing (a "Section 4.2 Event"), then (i) the aggregate number and/or

kind of shares that thereafter may be issued under the Plan, (ii) the number and/or kind of shares or other property (including cash) to be issued upon exercise of an outstanding Award or under other Awards granted under the Plan, (iii) the purchase price thereof, and/or (iv) the individual Participant limitations set forth in Section 4.1(b) (other than those based on cash limitations) shall be appropriately adjusted. In addition, subject to Section 4.2(d), if there shall occur any change in the capital structure or the business of the Company that is not a Section 4.2 Event (an "Other Extraordinary Event"), including by reason of any extraordinary dividend (whether cash or stock), any conversion, any adjustment, any issuance of any class of securities convertible or exercisable into, or exercisable for, any class of stock, or any sale or transfer of all or substantially all the Company's assets or business, then the Committee, in its sole discretion, may adjust any Award and make such other adjustments to the Plan. Any adjustment pursuant to this Section 4.2 shall be consistent with the applicable Section 4.2 Event or the applicable Other Extraordinary Event, as the case may be, and in such manner as the Committee may, in its sole discretion, deem appropriate and equitable to prevent substantial dilution or enlargement of the rights granted to, or available for, Participants under the Plan. Any such adjustment determined by the Committee shall be final, binding and conclusive on the Company and all Participants and their respective heirs, executors, administrators, successors and permitted assigns. Except as expressly provided in this Section 4.2 or in the applicable Award agreement, a Participant shall have no rights by reason of any Section 4.2 Event or any Other Extraordinary Event."

**IN WITNESS WHEREOF**, the Corporation has caused this Amendment to be executed as of the 4th day of August, 2006.

**TOWN SPORTS INTERNATIONAL HOLDINGS,  
INC.**

By: /s/ Richard Pyle

\_\_\_\_\_  
Name: Richard Pyle

Title: Chief Financial Officer









I, Richard Pyle, Chief Financial Officer of Town Sports International Holdings, Inc., 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 quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements and other financial information included in this quarterly 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 quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 and 15d-15(e)) for the registrant and we 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 quarterly report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls 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 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officers 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

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Richard Pyle  
Chief Financial Officer

Date: August 10, 2006



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

In connection with the quarterly report of Town Sports International Holdings, Inc. (the "Company") on Form 10-Q for the three month period ended June 30, 2006 filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert Giardina, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert Giardina

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Robert Giardina  
Town Sports International Holdings, Inc.  
Chief Executive Officer

August 10, 2006



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

In connection with the quarterly report of Town Sports International Holdings, Inc. (the "Company") on Form 10-Q for the three month period ended June 30, 2006 filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Richard Pyle, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard Pyle

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*Town Sports International Holdings, Inc.*  
*Chief Financial Officer*

August 10, 2006