

FINAL TRANSCRIPT

Thomson StreetEventsSM

CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

Event Date/Time: Oct. 30. 2008 / 4:30PM ET

Oct. 30. 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

CORPORATE PARTICIPANTS

Dan Gallagher

Town Sports International Holdings, Inc. - CFO

Alex Alimanestianu

Town Sports International Holdings, Inc. - President & CEO

CONFERENCE CALL PARTICIPANTS

Sharon Zackfia

William Blair & Co. - Analyst

Laura Richardson

BB&T Capital Markets - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Town Sports International Holdings, Inc. conference call. My name is Krista and I'll be your coordinator for today. At this time all participants are in listen-only mode. We'll be facilitating a question-and-answer session towards the end of this call. (OPERATOR INSTRUCTIONS.)

I would now like to turn the presentation over to your host for today's call, Mr. Dan Gallagher, Chief Financial Officer. Please proceed, sir.

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

Thank you for joining us today. This is the Town Sports International Holdings earnings conference call, discussing third quarter 2008 results. I am Dan Gallagher, Chief Financial Officer of the Company.

I caution listeners that, to the extent we make any forward-looking statements in this conference call, they are made pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. These statements are subject to various risks and uncertainties, many of which are outside of our control, which may cause actual results to be materially different from any forecasts we have made.

We have issued a press release discussing our results for the quarter, which will also be filed with the SEC under a Form 8-K. In addition, to those of you who do not have access to this release and filing, we have also made them available at our website, www.mysportsclubs.com. This conference call is also being webcast and may be accessed via the Investor Relations section of our website. Also, a replay and transcript of the call will be available via the Company's website following this call.

I will now turn this call over to Alex Alimanestianu, the President and Chief Executive Officer of Town Sports International, for discussion on the operations of the Company. And then I will give further detailed financial discussion later in the call. Alex?

Alex Alimanestianu - *Town Sports International Holdings, Inc. - President & CEO*

Thank you, Dan, and good afternoon everyone. As you are well aware, the economic environment has been tumultuous since the last time we reported earnings, especially in our core New York City metropolitan area. We finished the first half of the year with solid results, including stable year-over-year attrition rates and we expected first-half trends to continue through the balance of the year. However, in July and August, and as the financial crisis escalated in September, we saw consumer behavior

Oct. 30. 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

change and, as a result, we saw new member sign-ups fall short of plan and attrition rates move higher than expected. As many of you know, September is a very important new member sign-up month for us, second only to the month of January. And this year the challenge of acquiring new members in the month of September was made more difficult by the steady stream of negative economic news and the drop in consumer confidence.

As you see from our guidance for the fourth quarter, much of the fallout from September and the third quarter generally will have a bigger impact in October and after. While we were able to grow our total membership in the third quarter, we expect it to be down in the fourth quarter as a result of likely increases in attrition and continued slower new member sign-ups.

Now, looking at some key performance indicators for the third quarter, our comparable club revenue growth of 2.2% for the quarter was down sequentially from 3.2% in the second quarter. Our attrition rate averaged 3.58% per month, or 11 basis points higher than prior year.

On the positive side, our personal training revenue was up 12.3% in the third quarter, which is an improvement from the first half of the year. Member participation in personal training grew 16%, which we believe is a result of better execution in this area of the business. Corporate memberships continued to grow versus prior year, but the year-to-date double-digit rate of growth in new unit sales has slowed to single digits as companies are now more focused on cost controls, layoffs, and other critical needs.

Another positive for the quarter was the performance of our new club portfolio which continues to perform ahead of expectations. In the quarter we opened one multi-recreational club in Westborough, Massachusetts, our 23rd club in Boston. This brings the total number of clubs under operation at the end of the period to 164. We also began pre-opening sales at our new multi-recreational club in Hicksville, Long Island, our 12th club in that market.

Looking out over the balance of 2008, we now expect to open a total of nine clubs this year, as two clubs that we planned to open in 2008 will open in early Q1 2009. In addition to the six clubs opened in the first nine months, we expect to open three clubs in the fourth quarter, including our first club in the Providence, Rhode Island market.

So while our members and prospective members are sorting out their current employment and financial positions and outlooks, we too are sorting through the different moving parts of our business and reacting to the recent marked changes in consumer behavior. While we will play defense and cut costs where possible, we also believe that a offensive game plan will help turn today's challenging economic environment into a great opportunity for us to take or inherit share in the industry as the weaker players inevitably shake out.

In any case, we will continue to focus on heightening the member experience in our clubs and strengthening financial performance by moving forward with the five key operational initiatives that are COO, Marty Annese, and his team are pursuing, namely an operational excellence system which creates an emotional connection and promotes member satisfaction and referrals; building and stabilizing the talent level in the clubs and in operations generally; driving membership sales by among other things optimizing our sales by channel and developing value-based promotions; driving member retention; and driving ancillary revenue growth.

But we will also be particularly prudent about capital expenditures for growth in the near term. At this time we expect to reduce our unit growth to four to six new clubs in 2009, as we await for signs of a consumer recovery and for real estate opportunities to become increasingly compelling. This four to six new club count includes the two clubs that slipped from this year to next.

With respect to maintenance capital expenditures, we expect to increase slightly our level of investments so that our existing clubs can deliver the quality experience that our members expect.

Oct. 30. 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

The success of our company over its 34-year history has been driven by our strategy to offer an affordable and convenient way for our members to achieve their fitness and lifestyle goals and by our mission to improve lives through exercise. Nothing has changed in that regard. We have been through recessions before. We will come out of this one a better and stronger company.

Now I would like to turn the call back over to Dan Gallagher to provide more details regarding our financial performance to date. Dan?

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

Thank you, Alex. Looking at our third quarter results, our consolidated revenue was \$128.1 million, an increase of 7.8% over the prior year. The growth was driven by an increase in membership revenue, which rose by \$10.6 million, or 7.6% (sic - see press release) to \$104.5 million. Ancillary club revenue rose \$1.7 million, or 8.1%, to \$22.2 million for the quarter, including a 12.3% increase in personal training revenue.

Revenue at our comparable clubs, those clubs opened over 12 months, increased by 2.2%. This increase was driven by member growth of 0.9% and overall average price increase of 0.9% and ancillary and other revenue growth of 0.4%.

Total operating expenses for the quarter were \$116.5 million, an increase of 11% from last year's third quarter. This includes a fixed asset impairment charge of \$839,000, or approximately \$0.02 per share on the quarter. Backing out that charge, total expenses were up 10.7%.

Payroll and related expenses increased \$5.8 million, or 13.5% to \$49.2 million, as compared to \$43.3 million in the same period last year. The increase was driven by a net increase of ten clubs during the 12 months ended September 30, 2008, as well as an increase in payroll expense related to the sales staff. Because we continue to run promotions on our joining fees in an effort to drive membership sales, and because we are limited in the amount of payroll cost that can be deferred by the amount we collect in joining fees, we experienced an increase in sales-related payroll expense of approximately \$2.1 million this year versus prior year.

Club operating expenses totaled \$44.4 million, an increase of 4.8% over the prior year. Rent and occupancy-related expenses increased \$2.6 million, while advertising and marketing expenses decreased \$1.5 million.

Depreciation and amortization expense was \$13.4 million, or 10.5% of sales, versus 9.2% of sales in the year-ago quarter. With our revised sales outlook and planned new club openings, we expect depreciation and amortization expense to approximate 10.9% of revenue in the fourth quarter of 2008.

We recorded an asset impairment charge of \$839,000 related to a club we have elected to close prior to the expiration of its lease.

Operating income for the quarter was \$11.6 million, compared to \$13.9 million in the prior year's quarter. The aforementioned increases in payroll, increases in depreciation and amortization and the asset impairment charge were the major reasons for the decline in operating income.

We have included in our earnings release made available today an analysis of our EBITDA for the quarter. EBITDA was \$25.6 million for the third quarter, a 1.4% increase over the third quarter of 2007. Our EBITDA margins were 20% for the third quarter of 2008 as compared to 21.3% for the third quarter of 2007. Adjusting 2008 EBITDA for the asset impairment charge, EBITDA totals \$26.5 million with a margin of 20.7%.

Gross interest expense was \$5.8 million for the quarter compared to \$6.5 million in the prior year's quarter. The reduction in interest expense was principally due to a decrease in the interest rate charged on term loan facility. Interest charged on our

Oct. 30, 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

term loan averaged 4.3% for the quarter ended September 30, 2008. Our term loan borrowings were under the LIBOR-based rate option through September 30th, and given the recent volatility of LIBOR, we have moved our term loan facility borrowings to the bank's prime-rate-based option, which is prime rate plus 75 basis points, or 5.25% all in. This all-in rate is based on the bank's prime lending rate prior to any impacts of the Federal Reserve's 50 basis point cut yesterday.

Fully diluted earnings per share were \$0.14 a share, compared to \$0.19 per diluted share in 2007. Earnings per share were \$0.16 per share excluding the effect of the asset impairment charge.

Turning to our liquidity, total debt at the period end stood at \$315.9 million and cash was at \$10.7 million, giving a net debt figure of \$305.3 million. In addition, we have a \$75 million credit facility in place of which \$63.1 million was unutilized as of September 30th. Cash flows from operations for the first nine months of 2008 totaled \$76.9 million, compared to \$62.6 million for the quarter -- comparable period in 2007.

Capital expenditures totaled \$63.2 million year to date, and we expect capital expenditures for the full year of 2008 to approximate \$90 million to \$95 million. This annual amount includes \$22 million to continue to upgrade existing clubs. We will spend approximately \$9 million to enhance our management information system and \$5 million towards the construction of a new regional laundry facility in our New York market. The remainder of our 2008 capital expenditures will [probably] be committed to building new clubs. We also expect to receive approximately \$9 million in tenant incentives from this construction from our landlords during the full year of 2008.

While we are still evaluating our investment plans for 2009, we currently expect total capital expenditures to range between \$60 million and \$70 million. We expect to open four to six clubs, and close four clubs in 2009. As of September 30, 2008 we had 4.25 million square feet of club facilities under management compared to 3.9 million square feet at the end of the third quarter of 2007, a 10% increase. Our target is to bring our total club count to 166 clubs, with a total of 4.31 million square feet by December 31, 2008. Our net club increase will be five this year, with nine openings and four closures.

As you know, we previously announced a 19-month stock repurchase program to purchase an aggregate of 25 million of the Company's common stock, which is expected to continue through December 2009. We have not made any repurchases to date. As previously stated when we announced the program, repurchases may be made from time to time at our discretion and depending upon a variety of factors, including prevailing market conditions.

During this quarter our growth in net members was weaker than anticipated. We are forecasting these membership trends to soften further in the fourth quarter. Based on the current business environment, our recent performance, and the current trends in our marketplace, and subject to the risks and uncertainties in our forward-looking statements, the Company is lowering its guidance for 2008. We expect to open nine new clubs in 2008, down from 11 in our previous guidance. Two of our clubs that are currently under construction will open in early 2009 instead of late 2008.

We now expect revenues for the full year to be in the range of \$504 million to \$508 million, or approximately 6.5% to 7.5% growth over 2007. This is down from our previous outlook for revenues of \$510 million to \$520 million, or 8% to 10% growth. We now expect net income to be between \$16.5 million and \$17.5 million for 2008 for the full year, and EPS to be between \$0.62 and \$0.66 for the full year. This is down from our previous guidance of \$0.80 to \$0.84. This EPS guidance assumes 26.5 million shares outstanding and does not assume any potential share repurchases.

We would now like to turn the call over to any questions anyone may have.

Oct. 30, 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS.) Sharon Zackfia; William Blair.

Sharon Zackfia - William Blair & Co. - Analyst

You may have said this. I didn't catch it. What was the membership number at the end of the September quarter?

Dan Gallagher - Town Sports International Holdings, Inc. - CFO

519,000.

Sharon Zackfia - William Blair & Co. - Analyst

Okay. And then can you give us some kind of insights into what you're really looking at in the fourth quarter from a membership standpoint? I know you said you expected it to soften further, but it would be helpful to maybe compare and contrast the last six weeks versus how much cushion you've given yourself for the next two months.

Dan Gallagher - Town Sports International Holdings, Inc. - CFO

I mean, generally on this call I'm probably going to give a little more guidance than what we would typically do under normal circumstances, so I don't want to make this to be a precursor to what would come in future quarters. But it's safe to say that October we're seeing a higher rate of cancellations than we would have expected this time when we had our call back in July. We're actually forecasting attrition to approximate 3.8% for the fourth quarter, based upon what we're seeing in October.

Sharon Zackfia - William Blair & Co. - Analyst

Are the issues that you're seeing primarily concentrated in New York or are you seeing it bleed into your other regions?

Alex Alimanestianu - Town Sports International Holdings, Inc. - President & CEO

Sharon, this is Alex. The New York Metro area suburban markets, not all of them, but certainly a majority of them, are being impacted significantly more than other areas. Manhattan is actually performing better in most respects than other areas. Boston is also performing well. And as Dan said, we're not always going to break down regional variances to this degree. But it's really the New York City suburban markets that are - that seem to be having the most net member loss impact.

Sharon Zackfia - William Blair & Co. - Analyst

You -- I mean, you guys have been doing this for a while and you've seen attrition spike before. What -- are there any kind of tools that you can use going forward to try to minimize that attrition? I know there are a lot of customer [saving] initiatives, but they take a while to kind of implement.

Oct. 30, 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

Alex Alimanestianu - *Town Sports International Holdings, Inc. - President & CEO*

Yes. I mean, it is a similar environment to what we saw after the dot-com and 9/11 disaster, but it's more of a consumer recession this time. So it does feel a little different to us. But some things are similar. For example, the -- in tough economic times usage actually increases in the clubs. September same-store usage, or number of visits, was up 10% over the prior year. So the fundamental demand among the core members is very good. The difference between now and 9/11 -- another significant difference is that half of our members are under committed programs. So that's -- they're either one- or two-year programs. So we don't expect the dropout rates to get to the historical highs that we hit in '02 and '03 when almost all of the members were month-to-month members. But we we're developing several programs to reduce the growth in attrition, primarily fostering -- by trying to foster greater member engagement.

But we're segmenting the membership in different groups based on to what degree we think they are at risk in a consumer recession like this. And the -- so we're trying to target specific groups based on such things as usage and ancillary spend patterns. And then we're always trying to get the controllable cancels, trying to improve there by pursuing the initiatives that Marty's pursuing on the member experience side. We have intervention programs to save members who've given the 30-day notice of cancellation. And I can't talk in too much detail about them, but we're fully engaged in trying to minimize the impact of the consumer recession on our attrition.

Sharon Zackfia - *William Blair & Co. - Analyst*

And can I ask maybe one last question as I kind of go through the math. I mean, you're looking for \$6 million to \$12 million less in sales but an \$8.2 million shortfall in operating income, so obviously really high flow-through on the revised guidance, and understandable given the fixed-cost nature of your business. But as you look into '09 I can't imagine that you're expecting a better environment in '09. So what can you do from a corporate level perspective to kind of ratchet down some of the cost structure going into '09 to try to preserve earnings?

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

Well, if you look at our cost structure in general we are fairly heavy on the fixed side. We're -- rent and occupancy are certainly fixed, as is our depreciation once we have the clubs built. We're working on the utility costs as I mentioned on the earlier call. And while we have no definitive plans to cut payroll costs, which is -- it will approximate \$200 million of our payroll in 2008 -- we are going to be looking at our payroll very closely with Marty to see are there things that we can do to streamline and have a more efficient payroll setup or labor model at the club that will not impact the member experience. But if there are things that impact the member experience we are not going to act on them, but we are going to sharpen our pencils both on the corporate side and at the club to see if there's things we can do to our payroll expense.

Sharon Zackfia - *William Blair & Co. - Analyst*

Can you remind us what savings you're expect to see from laundry in '09?

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

\$1 million to \$1.5 million, I believe.

Sharon Zackfia - *William Blair & Co. - Analyst*

Was that all in the back half?

Oct. 30. 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

It would certainly be more on the back half, yes.

Sharon Zackfia - *William Blair & Co. - Analyst*

Thank you.

Operator

Laura Richardson; BB&T.

Laura Richardson - *BB&T Capital Markets - Analyst*

Hi guys. Sorry about the business trends, but can you talk just a little bit about any interest due next year on the senior notes and the cash flow that you're expecting with the CapEx cuts and -- ? So what interest is due when and your debt, your note valuation suggests people think you're going to pay, but can you just talk us through how you do

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

Okay. Well, in general terms I'm not giving 2009 guidance, but we did want to help you guys out a little bit with our preliminary CapEx numbers, which are down substantially from this year. They're going to be in the \$60 million to \$70 million range. Our interest on our senior discount notes, those are our 11% notes, become cash pay for the first time in August of '09. It'll be between \$7.5 million and \$8.0 that we owe for that, which I don't foresee that being a problem at all.

Our capitalization -- we're very well capitalized right now with our February '07 refinancing. Our revolver is in place all the way to 2012 and we're well ahead of our debt covenants. So I don't think we have any issues going forward on our debt.

Laura Richardson - *BB&T Capital Markets - Analyst*

Okay. Thanks.

Operator

At this time there are no questions.

Dan Gallagher - *Town Sports International Holdings, Inc. - CFO*

Okay. I guess that's going to wrap it up. I look forward to talking to everyone in February 2009 when we release our fourth-quarter earnings and we'll provide our guidance for 2009 at that time.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.

Oct. 30. 2008 / 4:30PM, CLUB - Q3 2008 Town Sports International Holdings, Inc. Earnings Conference Call

DISCLAIMER

Thomson Financial reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON FINANCIAL OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2008, Thomson Financial. All Rights Reserved.