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Conference Call Transcript

CLUB - Q1 2009 Town Sports International Holdings, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, everyone, and welcome to Town Sports International Holdings, Inc., First Quarter 2009 Earnings Conference. Please be aware that today's conference is being recorded. (OPERATOR INSTRUCTIONS) And now I would like to turn the call over to Mr. Dan Gallagher, CFO of Town Sports International. Please go ahead, 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 2009 first quarter 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. These risks and uncertainties are described in our reports filed with the SEC. We have issued a press release discussing our results for the quarter, which will also be filed with the SEC under Form 8-K.

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

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

Thank you, Dan, and good afternoon, everyone. We are pleased to be with you to provide our first quarter 2009 results and to update you on our plans and initiatives for 2009.

As expected, weak consumer confidence and spending continue to weigh on our business, making it difficult for us to grow our membership base at historical rates. We ended the quarter with a total membership of 518,000, up 1.2% from March 31, 2008, and up 1.6% sequentially from December 31, 2008.

We continue to focus on our goal of maintaining a strong liquidity position so that we are well prepared to weather this recession. In that regard, at the end of the quarter we had revolver availability of \$42.5 million and cash of \$7.6 million.

During these difficult times, it is critical that we remain on the right track in terms of enhancing the member experience by providing the environment, motivation, and programs our members need to reach their health and fitness goals, which is what will pay off for us in the long run.

As evidence that we are headed in the right direction, our total member usage was up 13.6% for the quarter versus prior year, driven primarily by an increase of approximately 9% at our comparable clubs.

As further evidence, our mystery shopper scores reached their highest average level so far in March of this year.

Turning to the first quarter results, total revenue was essentially the same as in the prior-year quarter, but negative comparable club revenue led to an operating margin decline. Although membership at our comparable clubs was roughly equal to the same quarter a year ago, same-club revenue declined by 2.1%, driven primarily by a decline in ancillary revenue, and specifically by a decrease of 7.1% in personal training revenue, of a year ago, to \$15 million.

This represents our first quarterly decline in personal training revenue and it demonstrates that even though members are using our clubs more often, they are spending less money on our ancillary services, just as they are in other retail venues. While there aren't any magic bullets to address the weaker demand side of the equation, we are making every effort to hold the line until the economy improves.

Our membership grew by 8,000 during the first quarter sequentially, but this was not the increase that we are used to seeing. Part of the limited increase was caused by the addition of fewer clubs on a net basis. The membership growth was also hindered by an attrition rate of 3.6% per month in the first quarter versus 3% per month in the prior-year quarter, and a challenging overall environment for recruiting new members.

However, corporate and group memberships continued to perform well and were a driver of member growth in the quarter. We ended the quarter with approximately 60,000 corporate members, an increase of 26% over Q1 2008. We also sold approximately 5.5% of our new memberships in the quarter on line, through a program we launched in December. The group and online sales channels are helping us reach new members and enhancing the experience of joining our clubs while also reducing our new member acquisition costs.

Solidifying our strong positions in the New York and Boston metro areas, we opened four new clubs in the first quarter, three in the New York City metro area in Deer Park, Long Island; East Brunswick, New Jersey; and Butler, New Jersey; and our second club in Providence, Rhode Island.

We are generally pleased with the overall performance of our new club portfolio, but the weak economic environment does appear to have slowed the ramp-up at some of our newer clubs. We will not be opening any more Greenfield clubs for the remainder of the year and will only pursue acquisitions if they offer unusually high returns on investment.

As part of our continuing effort to strengthen our portfolio of clubs, during the quarter we closed older clubs in Herald Square in Manhattan; East Brunswick, New Jersey; and Norwalk, Connecticut. Many of the members of these closed clubs will transfer their memberships to, or rejoin, at nearby TSI clubs.

As we assess all of our clubs, we are renegotiating rents where we have the opportunity to do so and will also potentially close more clubs that are underperforming. We are also taking advantage of the real estate market's weakness to extend clubs leases where it makes sense to do so.

Along with our real estate assessment, we continue to push forward with our initiative to enhance our IT system. The rebuilding of our enterprise management system is on track for completion in 2009 and deployment by mid-2010. This IT investment will benefit our organization and members in numerous ways. For example, for our employees it will lead to enhanced productivity in membership and personal training sales; the

ability to deliver a better member experience; and the delivery of timely information for decision-making. We are optimistic that the returns on investment on the new enterprise management system will be comparable to our club investment.

In the clubs, our primary initiative remains the rollout of our operational excellence program, that provides our regional and club chains with the standards, training, and tools required to deliver consistent and high-quality experiences to every member. We have now completed about half of the rollout, and by the end of July, the program will be fully rolled out.

Superior member experiences will create the emotional connections that inspire our customers to exercise on a regular basis and derive maximum benefit from their membership. We are convinced that the operational excellence program is the most effective membership retention tool we can deploy and will go a long way towards fostering loyalty, trust, and strong word-of-mouth support for our brand.

Looking ahead, our key goals for 2009 are to maintain a solid balance sheet and stay safely above our debt covenants again this year without undermining our objective of enhancing the member experience.

Now, to review what we have done so far to advance this agenda -- we reduced capital expenditures between \$50 million and \$53 million, down from \$96 million in 2008. The 2009 capital budget includes significant expenditures for our new laundry facility and satellite corporate office and for our new enterprise management system, all of which will be substantially completed in 2009.

In January 2009, we completed a round of layoffs and eliminated 47 non-club positions, or 11% of our non-club workforce. We froze non-club salaries at 2008 levels including, of course, executive salaries. We right-sized our club operating hours and group exercise schedules. We are driving productivity in the clubs by adding secondary functions for club staff. This has allowed us to redirect club payroll to pay for additional club management hours.

We've brought on line our new laundry facility, which will provided savings of more than \$1.5 million per year beginning in 2010. We're working with landlords to reduce occupancy expenses; we are also closing clubs that are falling below our cash flow hurdle rate.

In closing, we are confident that the organization is fully aligned around our strategy and objectives and we are as optimistic as always that, over time, we will deliver superior financial results to our stakeholders as we deliver superior fitness results to our members.

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

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

Thank you, Alex. I will run through the details of the quarter and then discuss our outlook for the second quarter.

For the first quarter, our consolidated revenue was \$126.7 million, an increase of 0.3% over the first quarter of 2008. Membership revenue was \$103.9 million, an increase of 1.3% from the same period last year.

Total ancillary club revenue totaled \$21.6 million, a decrease of 3.3%. Within ancillary revenue, personal training revenue declined 7.1% to \$15 million, while other ancillary revenue rose 6.7% to \$6.6 million, driven by Sports Clubs for Kids at our new clubs.

Revenue at comparable clubs -- those clubs open over 12 months -- declined by 2.1% for the quarter. Price declined 0.5% and membership declined 0.1%. In addition, ancillary club revenue and fees declined 1.5%, with personal training having the biggest impact.

Given the level of fixed costs we operate under, this decline in our comparable-club revenue has contributed to a drop in our operating margin. Operating income as a percent of revenue dropped from 11.2% in the first quarter of 2008 to 4.4% in this first quarter of 2009. I should note that fixed asset impairment charges totaling \$1.1 million were recorded in this first quarter of 2009, and these charges represent 0.9% of revenue and also contributed to the decrease in operating margin.

As of March 31, 2009, we had 1.7% less members at our clubs opened over 12 months when compared to March 31, 2008. We expect this will continue to put pressure on our comparable-club revenue and operating margin. However, costs cuts, along with ongoing cost controls, should keep our second quarter operating margin from deteriorating further when compared to the prior year and what we have experienced in the first quarter when compared to the prior year.

We ended the quarter with a 4.6% increase in total club months under operation, from 477 at the end of the first quarter of 2008 to 499 in the current quarter. In total, member usage was up 13.6%. These increases impact payroll and related expenses as well as club operating expenses.

Payroll and related expenses increased by \$2.3 million, or by 4.8%, to \$50.7 million in the quarter. A large portion of the increase in payroll was caused by a significant decrease in initiation fees collected, which resulted in approximately \$2 million of payroll costs recorded immediately in the 2009 first quarter that, in 2008, would have been deferred and amortized over our average member life. We defer payroll costs directly related to membership sales but we limit this deferral in the amount of initiation fees collected. In the first quarter of 2009, we discounted our initiation fees; and as a result, initiation fees collected averaged only \$16.49, while in the first quarter of 2008 these fees averaged \$50.90.

In the first quarter of 2009, we also incurred \$496,000 of severance charges, which were offset by a decrease in personal training payroll.

Club operating expenses increased \$3.7 million, or 8.7%, to \$46.6 million. Rent and occupancy expenses were up 10%, and accounted for \$2.5 million of the increase, with repairs and maintenance, utilities, and laundry expenses also contributing to the cost pressure in the quarter.

The year-over-year increase in operating expenses in the second quarter should be slightly less than it was in the first quarter as we begin to experience savings from our new laundry facility, which is now fully operational and servicing our clubs as planned.

General and administrative costs totaled \$8.3 million for the quarter, an increase of 0.5% versus the prior year.

Depreciation and amortization expense was \$14.3 million, or 11.3% of revenue, versus \$12.6 million, or 10% of revenue, in the first quarter of 2008. The increase in depreciation and amortization was primarily driven by the 13 new clubs added after January 1, 2008. In each of the remaining quarters of 2009, total depreciation and amortization expense should approximate the levels experienced in this first quarter in total dollars.

During the quarter, we incurred a total of \$1.1 million of fixed asset impairment charges at four of our clubs. These four clubs are older, suburban, fitness-only clubs that are more susceptible to the recession and lower-priced competitors. There were no impairments in the quarter a year ago.

Interest expense was \$5.3 million for the quarter, compared to \$6.5 million in the prior year's quarter. We continue to benefit from a decrease in short-term interest rates charged on our term loan borrowing. Interest charged in our term loan averaged 2.4% this first quarter compared to 6.5% in the first quarter of last year.

Our effective income tax rate is currently 30%. This is compared to a 41% rate in the first quarter of 2008. Reduction in pretax income, and our favorable permanent tax defenses, have had the effect of reducing the overall effective rate.

Fully diluted earnings per share for the quarter were \$0.03, compared to earnings per share of \$0.18 last year. The aforementioned fixed asset impairment charges impacted this quarter's results by approximately \$0.03 per share, and early lease termination costs of \$400,000 and severance charges of \$496,000 together affected this quarter's results by an additional \$0.03. Therefore, in total these costs reduced earnings per diluted share by \$0.06 per share.

Our weighted average diluted share count for the first quarter of 2009 was 23.2 million shares, down from 26.4 million shares in the first quarter of 2008. We had total outstanding shares of 22.6 million shares as of March 31, 2009.

As you know, we previously announced a stock repurchase program to repurchase an aggregate of up to \$25 million of the Company's common stock, which continues through December 2009. During the first quarter, we repurchased 2.1 million shares at a cost of \$5.4 million. In the aggregate, this represents a total of 3.9 million shares repurchased at a total cost of \$10 million. And as we previously stated when we announced the program, the purchases may be made from time to time, at our discretion, and depending upon a variety of factors, including prevailing market conditions.

Cash flow from operations for the first quarter of 2009 totaled \$22.6 million compared to \$37.8 million in the first quarter of 2008. The decrease in our earnings has contributed to this decrease in cash flows, and we generated less cash flows from changes in working capital. In the first quarter of 2008, net decrease in prepayments made to our landlords and other vendors resulted in an increase in cash flows of approximately \$4.6 million; and in 2009, we have not had these fluctuations.

Also in 2008, deferred revenue increased \$4.9 million while in 2009, we experienced an increase of only \$497,000. Reduction in initiation fees collected and the softening of personal training revenue has contributed to this decrease in deferred revenue when compared to last year.

Turning to our balance sheet, total debt, as of March 31, 2009, was \$337.75 million, and our cash position was \$7.6 million, for a net debt figure of \$330.1 million. In addition, we had a \$75 million revolving credit facility in place, of which \$42.5 million was unutilized as of March 31, 2009. We continue to have adequate room on the primary financial covenant within our senior credit facility, which expires February 27, 2012. Our gross leverage ratio, as defined, is 2.54 to 1 as of March 31, 2009, while our covenant requires a ratio of 4.25 to 1 or below.

We are limiting our guidance to the second quarter of 2009. 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, our outlook for the second quarter includes the following.

Revenue in Q2 2009 is expected to be between \$123 million and \$125 million versus \$129.4 million for Q2 2008. We expect general and administrative expense to remain in line with Q1 2009 as a percentage of sales. On a year-over-year basis, payroll, club operating, and depreciation and amortization expenses are expected to increase as a percentage of sales. We expect a \$4.4 million - \$6.4 million decrease in revenue, coupled with a 2.5% expected increase in club months of operation, from 483 in Q2 2008 to 495 in Q2 2009 are contributing to these increases.

In Q2 2009, we expect to record between \$400,000 and \$500,000 for early lease termination costs and \$250,000 of severance and related costs related to the separation agreement with the Company's Chief Information Officer in April 2009.

Including severance and early lease termination costs, we expect net income for Q2 2009 to be between \$1.25 million to \$1.75 million and earnings per share to be in the range of \$0.06 per share to \$0.08 per share, assuming a 30% effective tax rate and 22.6 million weighted average fully diluted shares outstanding.

For the year ending December 31, 2009, we estimate we will invest between \$50 million and \$53 million in capital expenditures. This amount includes approximately \$23 million to continue to upgrade existing clubs, \$8.6 million to support and enhance our management information system, and \$4 million for the completion of a new regional laundry facility and corporate office.

The remainder of our capital expenditures principally relates to 2008 and 2009 new club openings. We opened four clubs and closed three clubs in the first quarter of 2009. We plan to close two additional clubs in 2009.

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

QUESTION AND ANSWER

Operator

Thank you. (OPERATOR INSTRUCTIONS) And we'll take our first question from Paul Lejuez with Credit Suisse.

Tracy Kogan - Credit Suisse - Analyst

Thanks; it's Tracy Kogan filling in for Paul. I had a couple of questions. First, if you could give us some sense of performance by month, in terms of both attrition and the comps. And did this stabilize by the end of the quarter, or did it actually deteriorate?

And then, was hoping you could give us a sense of what you're seeing as far as attrition for customers that have signed up for these month-to-month memberships versus those coming off of one-year agreements. Thank you.

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

Tracy, this is Alex; I'll start off and Dan will jump in. On the attrition side, we are seeing some general stabilization from the third quarter last year, when the attrition spiked up a little bit to the fourth quarter to the first quarter this year and into April as well. So we're not happy with the level of attrition, but we feel that it is stabilized. Still more volatile and higher than we'd like it to be and that it has been historically.

In terms of the sales levels for new member signups, those are also, I'd say, stabilizing, although at levels that we're not delighted about.

The other component that you didn't mention, but we certainly did mention, is the personal training component. And that, obviously, turned down in the first quarter.

Tracy Kogan - Credit Suisse - Analyst

Did that deteriorate as the quarter progressed? So was it worse in March?

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

No, I'd say-- not saying month by month that it jumped out at us in that regard. Dan, do you want to add to that?

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

I guess I could just add a little bit to the second question about the commit to noncommit. In 2008, we were very much still selling commit memberships and over 95% of our memberships were a commit membership base. So we don't have a lot of differentiators to compare the 4% or 5% that signed up on the month to month -- how are they canceling -- given that the vast majority have been joining under commits.

Now, in the first quarter of '09 we sold a little bit more noncommit to members, but still the vast majority was commit membership structures. I don't have the exact numbers in front of me, but it's definitely less than 20% of our members joining under noncommit in the first quarter. But we will start to monitor that as we're offering the noncommit membership again, which we really haven't done in a large way over the last three years.

Tracy Kogan - Credit Suisse - Analyst

Great; thank you. Good luck, guys.

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

Thank you.

Operator

And now we'll take a question from Scott Hamman with KeyBanc Capital Markets.

Scott Hamman - KeyBanc Capital Markets - Analyst

Alex and Dan, just in terms of the lower enrollment fees that hit you pretty good during the quarter, what flexibility do you have going forward to kind of mitigate that impact, either through playing around with initiation fees or the commission structure that you pay? And do you have any plans to do anything, and what are your expectations, in terms of impact for the rest of the year?

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

We are basically trying to sell at initiation fees that our prospective members are expecting; and the vast majority of the competition out there is very much reducing their initiation fees as well. So unfortunately, while I do expect initiation fees to go up slightly over this first quarter, I expect

them to continue to be at lower levels than last year, given what the consumer's expecting. So those trends and the impact of lower initiation fees would probably perpetuate, certainly into the second quarter. But we would do our best -- any opportunity to increase those, we certainly would; but we don't see that right now.

Scott Hamman - KeyBanc Capital Markets - Analyst

Okay. And you talked about potentially pruning the portfolio with underperforming clubs. Can you give a sense of how many clubs are underutilized in terms of capacity, or underperforming, right now and what the opportunity is to close those?

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

There's a lot that go into the criteria -- what we expect to have to pay as far as exiting from that lease; how many years left we have on it, what are the related guarantees? But also, equally important, is how many members are at that club that we think would go to other clubs so that we would retain that revenue? So even when a club is about break-even, there is an opportunity to make more money by closing that club if members were to move to other clubs. So there's quite a bit that goes into that analysis and I don't think, Alex, that we have a number that says, these are the number of clubs we're looking at.

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

No, we review them, Scott, on a regular basis. In this type of economic environment, the performance of some of the smaller clubs does move around a bit more; it's a little more volatile than it has been historically. And I think-- we do have some older clubs that, in the long term, we're better off not having in the portfolio. They're going to start costing us a lot of money to maintain; they're going to hurt the brand if we don't maintain them. It's better off just culling the portfolio. We can't guide you on a specific number, but as Dan said, in a lot of cases, ultimately it's a benefit to the cash flow of the business because we're getting rid of a lot of expense and holding on to members.

Scott Hamman - KeyBanc Capital Markets - Analyst

Okay -- Dan, and then-- finally, the mature club comp and then your expectation for effective tax rate for the balance of this year?

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

The mature club comp for the quarter?

Scott Hamman - KeyBanc Capital Markets - Analyst

Yes.

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

For the quarter, the clubs open over 24 months were down 5.1%. And the tax rate that I had in the press release and in my script is 30% effective tax rate for the year 2009, is what we're forecasting right now.

Scott Hamman - KeyBanc Capital Markets - Analyst

Okay, thank you.

Scott Hamman - KeyBanc Capital Markets - Analyst

You've got it.

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Operator

And we'll take our next question from Sharon Zackfia with William Blair. Ms. Zackfia (OPERATOR INSTRUCTIONS)

Sharon Zackfia - William Blair - Analyst

Hi, sorry (inaudible).

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

We can't hear you.

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

Do you want to try calling back?

Operator

Ms. Zackfia (OPERATOR INSTRUCTIONS)

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

Let's go to the next call and she'll call back.

Operator

Yes, sir. We'll take our next question from Tony Gikas with Piper Jaffray.

Tony Gikas - Piper Jaffray - Analyst

Hi; good afternoon, guys.

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

Hi, Tony.

Tony Gikas - Piper Jaffray - Analyst

A couple of questions for you. What changes are you seeing some of your competitors making to remain competitive in your first key markets? First question.

Second question -- how are some of the new center hours? Are they having any adverse effect on memberships, do you believe?

And then, maybe you could just tell us why the tax rate has come down. Thanks.

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

I'd say the operating hours, we haven't seen any negative impact. We made adjustments in different cases where the membership objected to the cuts, so we were sensitive to it and flexible about it where our data misled us a little bit as to the usage.

In terms of the competition, we're seeing a lot of pressure on the joining fee. That seems to be pretty universal, I would say. But we're not-- the competitive impact, I wouldn't say, is any different than it has been historically, except maybe some more of these low-price, low-service clubs opening up in some of our markets; by no means all, but in some where the real estate is less expensive. There's usually a short-term impact from that and then a rebound of our clubs when they realize that they get what they pay for at those places.

Tony Gikas - Piper Jaffray - Analyst

And the tax rate?

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

Oh, the tax rate -- on the tax rate, basically, as our pre-tax income is dropping from the prior year, we have certain, I'll call it state permanent tax differences that are favorable to us that we have here because of an insurance company we have that, although they're not extremely material, when our pre-tax income comes down to a certain level, it does have the impact of lowering our rate over all.

So I don't expect a 30% rate to be our new long-term rate, but it will be the rate, or about the rate, that we're projecting for 2009. As our pre-tax income comes down, our rate is very sensitive to that; and going forward, I would expect the rate to go back up once we get past 2009.

Tony Gikas - Piper Jaffray - Analyst

Okay. And then, just last question. Going back to the low-cost clubs that you are referring to -- are they taking material share right now, do you think?

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

I don't think so. I don't think so; I think at some of our suburban market, there's an impact. I don't see it in the urban market and I don't see it in all the suburban markets. In an economy like this, there is an appeal to a \$1 joining fee and a \$10 a month fee. But it's not a long-term appeal.

Tony Gikas - Piper Jaffray - Analyst

Okay. Thanks, guys; good luck.

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

Okay, thanks.

Operator

And now we'll hear from Tom Shaw with Stifel Nicolaus.

Tom Shaw - Stifel Nicolaus - Analyst

Hey, guys, three quick questions. One, are you seeing any meaningful changes in April trends?

Second, the no dues in December promotion right now obviously brings up enrollment, but how does that flow through from an accounting standpoint?

And then finally, with the departure of the CIO, is that something that will be replaced, or the role just kept in house amongst the existing team? Thanks.

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

Currently, it is being kept in house; and as we complete the development of the new enterprise management system and deploy it, we will decide how to address the overall IT department as an adjunct to that -- to the overall deployment of the new system. But the good news is, we're about 75% complete on the development of that system and we expect to fully deploy next year, and we're excited about some tremendous benefits that we think we'll get from the new system.

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

Yes. And if I could answer that, we have a very strong IT team that's basically picking up the slack for the departure of our CIO. And in connection with this, the enterprise management system, we have an awful lot of consultants here helping us out with the project and they're also very good, obviously, and very much helping pick up the slack as well. So we feel like we're more than adequately covered for the time being. And as Alex said, once we're up and running with this new program, we'll decide what needs we have and how we're going to handle them.

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

I don't-- no meaningful trend changes in April other than what I said about our sense that we're seeing some stabilization on attrition and new member sign-ups.

The December promotion is something new that we're trying and it gives you an idea, a sense, of how we're trying to generate new member sign-ups. And we are using, certainly, free dues as one incentive, provided that the member stays with us, obviously, through December. It's an environment where we have to try a lot of different promotional activities, and that's exactly what we're doing, and they seem to be certainly helping us out.

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

Yes. And effectively, what that does is it brings down the average amount of dues that we're recording monthly. So the one month off would be basically a percent off the monthly dues as we record it here internally.

Tom Shaw - Stifel Nicolaus - Analyst

Great; thanks, guys.

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

Okay.

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

Thanks, Tom.

Operator

We'll take our last question from David Cohen with Midwood Capital.

David Cohen - Midwood Capital - Analyst

Hi, guys.

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

Hey, David.

David Cohen - Midwood Capital - Analyst

Just to confirm one thing. Just looking at the change in payroll -- if you take out the effect of the way in which initiation fee recognition, revenue recognition change, and the severance, you actually were down, payroll and related, even on the increase in total month club operations. Is that accurate?

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

Yes, but I caution you to just parse out certain things. Because we also benefited from-- horrible to say, but we had a 7% reduction in personal training revenue, and when that goes down, the personal training payroll goes down. So I don't want to give you the illusion that we've cut a lot of operating payroll costs.

David Cohen - Midwood Capital - Analyst

Okay. Well, could you give me a sense of, to that point-- Alex went through the [RIF] at January and two other items; to what extent did you sort of reduce for run rate payroll costs?

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

I don't guide on just the payroll, David, but if you want to-- I could talk to you separately about some of the details you're trying to reconcile. But I don't want to get into a detailed payroll reconciliation on this call other than what we've already put in our release, which is personal training is down; the initiation fee did affect us by \$2 million; and the RIF is helping us out going forward. But we had the RIF in the first quarter, so it hurt us in the first quarter.

David Cohen - Midwood Capital - Analyst

Okay. And then, just in terms of the Q2 severance and early lease terminations -- does that work out to be about just over \$0.02 a share? Is the math right on that?

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

Yes.

David Cohen - Midwood Capital - Analyst

Okay. And then, in your discussion of cash flow, the degree to which the year-over-year number declined, how much of that change-- the biggest item was the working capital. Is it a (inaudible) thing that might start working in your favor as the year progresses?

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

Unfortunately, I don't think much of it's going to come back to us. Because the one item was the \$4.6 million -- that was basically a decent amount of expenses that we previously prepaid. And instead of prepaying them, we pay them on the first of the month back in '08. So we're now anniversarizing that and that's why that went down.

As far as the other component that really bit us, it was largely driven by initiation fees. We're collecting less in initiation fees, and so we're deferring less revenue and that's affecting our working capital. Currently, we don't-- we probably will have higher initiation fees in Q2 versus Q1, but not substantial enough to have a positive effect in the quarter when compared to the prior year.

David Cohen - Midwood Capital - Analyst

And then, last question is, if I look at-- you guys had, I think, sequentially about 8,000 debt numbers and I was trying to back into, based on the attrition you provided, what kind of gross add you had. Can you talk about sort of the degree to which you guys achieved or didn't achieve your gross add expectations? And how those targets are sort of set for the year? I mean, is this something where you guys are taking gross adds, given the environment, to be down 5% or a number above that? How do you guys think about gross adds?

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

David, the only thing we said -- and I can't give you much more -- is that we do expect to end the year with a lower membership, gross membership, number. It's a very-- although we're seeing some signs of stabilization, it's still too volatile to guide beyond the second quarter, which we've done. I think the attrition rate, as we said in April, we're expecting them to hold about the same level as the first quarter. If you extrapolate out through the year, that's up to you. I can't really help you on that.

And then-- it's a tough sales environment; the new prospect traffic is not great. And obviously, we're hoping it's going to pick up but that's about all I can tell you.

Operator

That does conclude our question-and-answer session for today. I would like to turn it over to Mr. Gallagher for any closing or additional remarks.

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

Okay. Thank you, everybody; thank you for attending today's call and we look forward to releasing our second quarter results.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation.

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