

FINAL TRANSCRIPT

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CLUB - Q4 2008 Town Sports International Holdings, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Town Sports International Holdings, Incorporated earnings conference call. At this time, all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of this call. As a reminder, this conference is being recorded for replay purposes. I would now like to turn your presentation over to your host for today's conference, Mr. Daniel Gallagher, CFO for Town Sports.

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 fourth quarter and year end 2008 results. I am Dan Gallagher, Chief Financial Officer of the Company. We 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 forecast 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, 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 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 the call. Alex?

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

Thank you, Dan, and good afternoon, everyone. We are pleased to be with you to provide our fourth quarter and 2008 results and update you on our plans and initiatives for 2009. To state the obvious, the economy weighed on our business in 2008 and will continue to be a negative factor in 2009. Like many consumer-oriented companies, our focus in 2009 is on maintaining our strong liquidity position by reducing capital expenditures until we see evidence of a recovery in consumer sentiment and spending and by managing operating expenses with extreme prudence while continuing to execute against our key strategy of enhancing the member experience in our clubs. Although today we will talk about the bottom line earnings results and the various associated metrics on which we are measured every quarter, our Management Team must also measure itself on the progress we are making toward our longer-term goals.

2008 started out fairly well, but did not finish as we had initially expected. We grew membership by 5.3% in the first quarter but by the second half of the year, the economic crisis had escalated and we ended with a loss of members in the fourth quarter. For the full year, our membership grew a respectable 4.9% and we are pleased to have at least achieved our revised earnings goals for the fourth quarter and year excluding goodwill and fixed asset impairment charges that Dan will elaborate on in his presentation. So in looking at the fourth quarter, total revenue increased 3.4%, but our operating margins declined as a result of increases in payroll and club operating expenses, particularly rent, in excess of revenue. Although same-club revenue declined by a modest 1.4% for the quarter, this is our first negative quarterly comparison since 2004. Naturally, this decline negatively impacted our results as cash flows from operations for the quarter totaled \$18.7 million versus \$20.1 million a year ago. Our attrition rate of 3.5% per month was 10 basis points better than the third quarter and essentially on plan, but 50 basis points worse than the 3% we reported for the fourth quarter of 2007. Personal training revenue was up 4.3% in the quarter and while we increased the number of members using our personal training service, that business, too, is being impacted by the economy as members who use this service are using it less often. Overall club usage increased by more than 15% in the fourth quarter and that trend continues in the first quarter. While this doesn't directly help our earnings results, it is an indicator of the continuing strong demand for our clubs and of a positive experience for our members which should pay off down the road and manifest itself in a reduced attrition rate and positive word of mouth advertising for our clubs.

Corporate memberships, which are a key and growing sales channel, performed well in the fourth quarter and we are targeting our markets outside of the New York metro area for further success. We opened three new clubs in the fourth quarter, including our first club in Providence, Rhode Island. The two other clubs were in Woburn, Massachusetts and in Hicksville, New York on Long Island. These are the 25th and 112th clubs respectively in the Boston and New York metro markets. In December, we we launched our online sales program and we achieved approximately 7% of total sales through this channel in December and January. We expect that this investment will pay for itself in less than three to four months through expense savings alone. With the successful launch of this online sales channel, we have put in place the third pillar of our overall sales structure, the three being in-club sales, corporate group sales and online sales. This organizational structure offers our potential members a range of options that maximizes the ease of joining our clubs.

Looking back at the full year, we opened nine new clubs and finished the year with 166 clubs. This represents a marked slowdown from the 15 new clubs added in 2007. Our original plan at the beginning of the year was to add 11 clubs and as we said on our third quarter earnings call, we decided to move two of the openings to Q1 2009. We ended the year with 510,000 members, up 4.9% from 487,000 members at the end of 2007. Capital expenditures for the year ended at \$96.2 million, of which \$57.8 million was spent on new clubs, \$23.6 million on facility and equipment upgrades at older clubs, \$9.1 million to enhance our IT systems, and \$5.7 million for the construction of our new laundry facility.

Our capital expenditures plan for 2009 is to spend between \$50 million and \$53 million. This amount includes approximately \$23 million for maintenance and upgrades of the existing clubs, \$8.4 million to support and enhance our IT systems, \$4 million for the completion of the new laundry facility and a replacement corporate office in the New York region, and the remainder of our capital expenditures principally relates to 2008 and 2009 club openings. During the fourth quarter, we purchased 1.8 million club shares and thus far in 2009, we have purchased another 2.1 million shares for a total spend on the buyback of \$9.9

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million. Our board and our Management Team have a high degree of confidence in the prospects for Town Sports and its common stock, so we expect our long-term shareholders to be rewarded with the high return on this investment.

As we look at 2009, we are now planning to open just four new clubs, all in the first quarter in order, in order to keep capital expenditures down and to avoid excessive risk in this challenging consumer spending environment. As real estate lease terms improve and construction costs come down, however, returns on new club projects may become more compelling, particularly if there are any signs of an economic recovery. We are pleased with the overall performance of our new club portfolio and are confident that there are still many opportunities for growth in our current markets, so when it makes sense to return to a faster rate of growth, we will do so aggressively. In the first quarter of 2009, we've opened or will open clubs in downtown Providence, Rhode Island, Butler, New Jersey, Deer park, New York on Long Island and East Brunswick, New Jersey. We also plan to close four clubs in 2009 and we expect to retain many of the members of these closed clubs by moving them to nearby Town Sports locations. We continue to review our club and lease portfolio and are working with our landlords to find ways to achieve savings on occupancy expenses. These reviews could result in additional club closures over time as well as rent reductions and lease extensions, amendments and terminations.

In January 2009, we completed a round of layoffs which impacted approximately 47 non-club positions, around 11% of our non-club work force. Layoffs are among the most difficult decisions we face as a Management Team. We will always approach them with extreme care and deliberation. But the current environment clearly necessitated these reductions. These cuts will save approximately \$2.5 million, excluding severance costs. We have also frozen non-club salaries for 2008 levels, including, of course, executive salaries. In 2009, we will expect certain non-recurring expenses and charges, including for the implementation of our new IT system and our laundry warehouse conversion, which will put some additional pressure on our 2009 earnings. However, these added 2009 expenses position us for greater efficiencies going forward. For example, we expect our new laundry facility to reduce expenses by more than \$1.5 million per year beginning in 2010.

Overall, and primarily because of the decline in net membership in the fourth quarter of 2008 and our expectation of continuing declines for the full year 2009 versus 2008, we expect earnings to be down for the first quarter and the year. Although we are relatively pleased with the net members we gained through the end of February of this year, 2009, there's still a high degree of uncertainty regarding the impact of the weak economy on all consumer facing businesses like ours. Given this uncertainty, we are choosing only to offer guidance for the first quarter at this time, which Stan will detail in his comments. However, and very importantly, we expect to stay safely above our debt covenants again this year. Our Senior Management Team is resolute about the direction we are leading our Company and the initiatives we have put in motion. Such has been the case since the beginning of 2008, a key focus is on heightening the member focus in our clubs in order to create the experiences and emotional connections that expire our members to exercise on a regular basis. Our team has just begun the rollout of our operational excellence program that provides our people with the standards, training and tools required to deliver consistent high quality experiences to every member.

The first two areas covered by the operational excellence rollout will be our front desk and housekeeping functions, which will allow us to assure better performance on two basic commitments to our members, namely, the friendliness and cleanliness of our clubs. Ultimately over the next few years, we are striving to create a stronger brand position in each of our markets and improve levels of retention and member referrals, among other things. On certain key performance indicators, the early indications are that our club teams are already succeeding in improving the overall member experience. Our independent shopper scores have increased steadily from April 2008 when we began the program. In addition, our member web feedback and our satisfaction surveys are selling improvements in key areas, such as staff friendliness and club cleanliness. I have no doubt that these improvements will lead to stronger financial results, although the economic environment may well make it difficult to gauge the full impact.

After significant changes in Senior Management in 2007 and 2008, our team has coalesced over the past year and provides the foundational strength to the Company that will make us extremely resilient in tough times. And to repeat what I said on the last call, the success of our Company over its 35 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

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has changed in that regard. We will emerge from these challenging times 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. I will run through the income statement for the quarter and then discuss our balance sheet and our outlook for 2009.

For the fourth quarter, our consolidated revenue was \$122.9 million, an increase of 3.4% over the prior year. Membership revenue of \$102.5 million, ancillary revenue of \$18.9 million, and fees and other revenue of \$1.5 million, all contributed fairly equally to the rate of growth. These increases in revenue were driven by our newer clubs, while revenue at comparable clubs, those clubs opened over 12 months, declined by 1.4% for the quarter. A 1% decrease in price and a 0.4% decrease in ancillary revenue were the two factors that contributed to this comparable club revenue decline. Within ancillary revenue, personal training revenue grew by 4.3%. Sequentially, this 4.3% increase is down from the 12.3% increase realized in the third quarter of 2008.

As of January 1, 2009, we have 4.3 million square feet of club facilities under our Management in our 166 clubs compared to 4.1 million at the beginning of 2007, a 4.8% increase. As Alex mentioned, at the end of the fourth quarter, there are 510,000 members a 4.9% increase over last year. However, this is 9,000 below the 519,000 members we had at the end of the third quarter, and we ended the year with approximately 2.5% less members at our clubs opened over 24 months. This will put pressure on our comparable club revenue and operating margins in 2009. In the fourth quarter, we performed an interim good will impairment test and as a result of the test, it was determined that goodwill in our Boston sports club region totaling \$15.8 million and goodwill at two of our outlier clubs totaling \$1.8 million were impaired and written off. In the fourth quarter we also recorded fixed asset impairment charges totaling \$1.9 million which represents the writeoff of fixed assets at six underperforming clubs. As a group, as of December 31, 2008, these six clubs have just under \$1 million of fixed assets remaining. Excluding these goodwill and fixed asset impairment charges, our total operating expenses for the quarter were \$112.7 million, an increase of 8.6% from last year's fourth quarter.

In the fourth quarter, payroll and club operating expenses increased at a faster rate than our revenue. Payroll and related expenses increased by 5.9% to \$47.4 million in the quarter. Increases in payroll expenses were in large part due to a 6.8% increase in total months of club operations which is driven by a net increase in five clubs over the past year. Also, payroll expense increased \$1.4 million in the quarter due to our continued discounting of initiation fees. The payroll costs we can defer are limited to the amount of initiation fees we collect. In the fourth quarter of 2008, initiation fees collected averaged \$38.10 per new member while in the fourth quarter of 2007, initiation fees collected averaged \$74.19 per member. Club operating expenses increased 17.9% to \$43.6 million, in large part due to increases in utility and occupancy costs. The clubs we opened subsequent to the third quarter of 2007 are driving these increases in utility and occupancy costs. Also within club operating expenses, our advertising and marketing costs, which totaled \$1.7 million in the fourth quarter of 2008 compared to \$1.5 million in 2007.

General and administrative costs totaled \$8.1 million for the quarter, a decrease of 1.8 million versus the prior year. We are actively trying to reduce expenses wherever practical, and there are many small pieces to this G&A drop, including the discontinuing of our holiday party in 2008, which generally costs a little over \$100,000. G&A costs related to accounting, consulting, legal and tax expenses decreased, and we attribute this in large part to having our first year of Sarbanes-Oxley testing behind us in 2007. We also had a \$400,000 decrease in liability insurance expense due to more favorable claim loss experience. Depreciation and amortization expense was \$13.5 million, or 11% of revenue versus \$12.2 million, or 10.3% of revenue in the fourth quarter of 2007. The increase as a percentage of revenue is primarily associated with the 1.4% comparable club revenue decrease recorded in the quarter. Excluding the effect of the aforementioned goodwill and fixed asset impairment charges, operating income for the quarter was \$10.2 million compared to \$15.1 million in the prior year's quarter or 8.3% of sales versus 12.7% of sales for the prior year. Increases in operating expenses at a faster rate than sales growth was the reason for the decline. Interest expense was \$5.9 million for the quarter compared to \$6.5 million in the prior year's quarter. We continue to benefit from the decrease in short-term interest rates. Interest charge in our term loan averaged 4.2% this fourth quarter

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compared to the 7.5% rate on the term loan in 2007. The term loan borrowings were under the euro dollar based options for December 31, which is set at LIBOR plus 125 basis points.

Fully diluted loss per share for the quarter was \$0.51 compared to earnings per share of \$0.23 last year. The aforementioned goodwill and fixed asset impairment charges impacted this quarter's loss by approximately \$0.66 per share. A significant portion of the goodwill impairment charges did not have associated tax benefits. Also in the fourth quarter, we realized favorable provision to return adjustments that approximate \$0.02 per share recorded at the tax provision line. Our average share count for the fourth quarter was 25.8 million shares, down from 26.5 million shares at the end of 2007. At the end of the quarter, we had 24.6 million shares outstanding and as of today, we have approximately 22.6 million shares outstanding. As you know, we previously announced 19 month stock repurchase program to repurchase an aggregate of \$25 million of the Company's common stock, which continues through December 2009. During the fourth quarter, we repurchased 1.8 million shares at a cost of \$4.6 million and subsequent to the fourth quarter through February 26, we purchased approximately 2.1 million shares at a cost of \$5.3 million. In the aggregate, this represents a total of 3.9 million shares repurchased at a total cost of \$9.9 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 flows from operations for 2008 totaled \$95.6 million compared to \$82.7 million in 2007 for an increase of 15.6%. Total cash paid for interest decreased \$7.1 million to \$10 million. Cash paid for income taxes decreased \$4.8 million to \$15.9 million for the year ended December 31, 2008. Turning to our balance sheet, total debt at year end was \$338 million and our cash position was \$10.4 million for a net debt figure of \$327.6 million. In addition, we had a \$75 million credit facility in place, of which \$42.8 million was unutilized as of December 31, 2008. We continue to have adequate room on the primary financial covenant within our senior credit facility which expires on February 27, 2012. Our gross leverage ratio as defined is 2.35 to 1 as of December 31, 2008 while our covenant requires a ratio of 4.25 to 1 or below. Until we see evidence of the stabilization of the consumer environment, we are limiting our guidance to the first 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 first quarter includes the following.

Revenue for the first quarter of 2009 is expected to be between \$123 million and \$125 million versus \$126.3 million in the first quarter of 2008. While we expect general and administrative expenses to remain flat as a percentage of sales on the year-over-year basis, payroll, club occupancy and depreciation and amortization expenses are expected to increase as a percentage of sales. The expected decrease in revenue, coupled with the 7.6% expected increase in square footage under operation from \$4.1 million as of January 1, 2008 to \$4.4 million by March 31, 2009 is contributing to these increases. In the fourth quarter of 2008 and January 2009, we reduced our non-club staff by 47 positions or 11%, including 27 positions through the reduction in force in January of 2009. In connection with the reduction in force, we incurred severance from related costs totaling approximately \$0.5 million in the first quarter of 2009. On an annualized basis, these eliminations will reduce our corporate payroll and related expenses by approximately \$2.5 million excluding severance expense. Including severance and related costs, we expect net income for the first quarter of 2009 to be between \$500,000 and \$1 million and earnings per share to be in the range of \$0.02 per share to \$0.04 per share assuming \$23.5 million weighted average fully diluted shares outstanding. We would now like to turn the call over to any questions anyone may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of Sharon Zackfia with William Blair. Please proceed.

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

Good afternoon. Alex, I think you mentioned that you are relatively pleased with member growth so far in the first quarter. Does that imply that you're expecting member growth to be up now on the comp store level?

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

I'm sorry, Sharon. I lost the last part of that question.

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

Sorry. I'm calling remotely. I'm wondering if you're expecting -- since your comment on the first quarter member growth was that you were relatively pleased with it so far. Do you expect that member growth component of comp to go back in the positive territory? I think it was flat in the fourth quarter.

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

We were relatively pleased with the net member growth in the past -- through February, but that being said, the growth was not as significant as it was last year. So in January, we netted about 12,000 members overall versus about 21,000 in the '08 -- in '08 January. So as Dan said in his comments, we were down about 2.5% over the course of '08 in mature clubs. That's 24 month clubs, right?

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

Yes, and I guess to get to Sharon's -- her one component of the comp sales, I think we are going to dip a little bit on the negative side, Sharon, in Q1 as far as the membership component of the comp sales.

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

Yes.

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

Ever so slightly.

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

In the fourth quarter as well, I didn't think you mentioned this, but it looked like the price component of comps went negative, and I was just curious as to what was driving that.

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

Yes, there's a few things driving that. One is the members that are leaving us in the fourth quarter are leaving us at higher price points than the ones that we're replacing them with by the tune of 4% to 7% actually, from October to December. And also we had price reductions at about 30 of our clubs for gold memberships back at the end of August and what we found is that members at those clubs are trading down from their other memberships to these places, and that's also had an impact on our price. So overall, the quota is down a little bit on an overall basis. (inaudible)

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

So you're seeing trade down from passport to gold in those clubs?

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

Actually, when we looked at it in August, we had about 30 clubs, particularly in the suburbs that we thought were overpriced, and we brought those prices down, and what happens is those members at those clubs, to the extent they are an existing member, they can trade down to the same membership within that club, providing that they either paid the initiation fee or that they commit to a one-year membership, and members are doing that. It's really a gold for gold membership that we're seeing, but it's at the same club. So not only do you get the new members joining at a lower price, it's the existing members that are hurting us a little bit at those same clubs.

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

Okay, and then last question, on the online enrollment part of the equation, can you remind us how much you spent to implement that until that flowed through the P&L, and then I think you said 7% of members in the fourth quarter joined online. Are you paying any kind of commission on that? Is it kind of like a half commission, or how does it work?

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

It was about 7% combined December and January --

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

Okay.

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

-- Sharon, and the commission is a reduced commission. It's a touring commission that's --

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

It's \$30.

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

It's \$30 less than the normal commission.

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

And it's also about \$30.

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

Right. So that's the savings on -- per membership. And that's been very well received. We were, I would say very pleasantly surprised with the amount of velocity we saw, really from day one. Now, our new gym system, new IT system will have a much more robust website and online capabilities. So this is just an interim system, but we're very happy about it. Dan, did you want to say how much we --

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

I know it was less than \$200,000, maybe \$150,000 to \$200,000 we spent on it.

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

Okay, and that flowed through the P&L,, right?

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

No, we actually have it as an asset for about 18 months, up until when we're going to roll out gyms, it's an asset on the books, so a quick amortization.

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

Okay. All right. Well, best of luck.

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

Okay.

Operator

Your next question comes from the line of Paul Lewis with Credit Suisse. Please proceed.

Paul Lejuez - *Credit Suisse - Analyst*

Hey, guys.

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

Hey, Paul.

Paul Lejuez - *Credit Suisse - Analyst*

Can you tell us what percent of your members were locked in at year end versus -- to a one year contract versus last year?

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

Yes, we're around 42%.

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

42%.

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

So a little over 40%.

Paul Lejuez - *Credit Suisse - Analyst*

What was that last year?

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

It was over half.

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

Was it that high?

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

It was right around half. We have been promoting the month-to-month membership in these difficult environment -- economic environmental -- in this context. So we do have more month-to-month memberships that we've put on over the past three or four months. I think we were running about 15% on the month-to-month in the past few months, and that's intentional. We expect -- we don't expect it to go much higher than that, but there's certainly demand for that and we intend to meet the demand to the degree it makes sense for us. So what we did is we brought down the price a little bit, the premium on the month-to-month membership. There's still a \$10 dues gap and a \$20 to \$40 joining fee gap, or premium on the month-to-month. So it makes more sense in terms of dues and joining fee in our view.

Paul Lejuez - *Credit Suisse - Analyst*

Right. I guess, yes. I just wonder, is there kind of an embedded attrition kind of in that from members that are locked up with you currently. So I guess maybe one way to think about that is the members that have rolled off the commitment programs in the fourth quarter, for example, how -- what was their cancel rate like versus fourth quarter of last year?

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

Yes, I don't have that data at my fingertips, but maybe we can discuss that with you offline.

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Paul Lejuez - *Credit Suisse - Analyst*

Okay. And then you guys had said club usage was up -- did you say 15%?

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

Yes, 15%.

Paul Lejuez - *Credit Suisse - Analyst*

Is that from people that would normally use the club and they are just using it more, or is usage up from members that weren't using the club?

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

I think it's a combination, but clearly, people have more time on their hands and they are spending, they are visiting the clubs more often. I think that's an industry wide trend as I speak to other club owners, they are seeing the same phenomenon.

Paul Lejuez - *Credit Suisse - Analyst*

Yes, and, Dan, can you tell us the timing of club closings for the four that you mentioned and also wondering what D&A looks like for '09.

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

We're not giving any '09 annual guidance, even though D&A is pretty much a calculatable number.

Paul Lejuez - *Credit Suisse - Analyst*

You guys just took a big writeoff, so it's less calculable these days, right?

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

No, it's not, because goodwill is not really amortized -- we don't amortize goodwill. That's where most of it came. That's a permanent asset.

Paul Lejuez - *Credit Suisse - Analyst*

So there weren't any fixed assets that got written off there?

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

There were not -- nowhere near as material as the goodwill. It was about \$1.8 million of our \$350 some-odd million.

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Paul Lejuez - *Credit Suisse - Analyst*

Got you. That's helpful. And how about the timing of the closing?

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

During the first -- I think three in the first half, one in the second half, but we haven't necessarily announced them publicly, so we're not -- I don't want to say anything more than that.

Paul Lejuez - *Credit Suisse - Analyst*

Got you. That's it for me. Thank you.

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

Thanks, Paul. Thanks.

Operator

Your next question comes from the line of Scott Hammond with KeyBanc Capital Markets. Please proceed.

Cassandra Stevenson - *KeyBanc Capital Markets - Analyst*

Hi. This is Cassandra Stevenson calling in for Scott.

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

Hi.

Cassandra Stevenson - *KeyBanc Capital Markets - Analyst*

Could you -- even at a reduced level on the CapEx, could you give us an idea as to how much flexibility you have with that and also considering the maintenance CapEx?

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

Yes, I mean as I said in the prepared remarks, the four new clubs are opening in the first quarter, so those are either open or about to open, so the construction investment is already made. The IT system is under way and we're in the back half of that. So that is committed. And the maintenance CapEx, we feel very resolute, I would say, that we have to make that investment in order to maintain the cash flow of the business, keep the members happy, keep the equipment running and the facilities running at a high level. So is there a little flexibility? There always is, but we trimmed it back from \$60 million to \$70 million to 50, a little over \$50 million, and we feel that that's the right level to run this business at.

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

Yes, I would agree with all that. The new CapEx, those clubs are -- will have been open in the first quarter of 2009 and as Alex said, we were -- we spent 95 -- \$95 plus million in '08 when we announced in October -- or third quarter, we were estimating between \$60 million and \$70 million for '09 and we already did spend a lot of time sharpening our pencil and cutting it down to the \$50 million to \$53 million that we're at right now. So the short answer is we don't think there's that much more to cut at this point.

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

Yes, we also already moved any other clubs, new clubs into future periods, so we had -- we have three other leases that are signed for future clubs, and we postponed those already. At no cost, but in order to trim the CapEx to the right level for this year.

Cassandra Stevenson - *KeyBanc Capital Markets - Analyst*

Okay, and then I think last quarter you spoke briefly about segmenting your membership base into different groups. Could you give a little bit more details on that process and maybe what sort of results you're seeing from that?

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

I think it's premature to talk about on this call, but we could certainly do it on the next one. We are -- I think you're referring to the attrition, retention initiatives.

Cassandra Stevenson - *KeyBanc Capital Markets - Analyst*

Right.

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

And the analysis is ongoing. We have some programs that we are already implementing, but -- and some that we're piloting. So I would prefer to keep -- I won't say too much about that now and wait to see more results before we talk in greater detail. But we are -- we think the initial results are promising and one thing we're doing that's fairly -- on the retention side that we're piloting is just a more structured save program when people call in to cancel, whether at the call center or the clubs, and we're already starting to see pretty good results from that. But it's a little early to talk about specifics on it. So we'll fill you in in greater detail on the next call.

Cassandra Stevenson - *KeyBanc Capital Markets - Analyst*

Okay, thank you.

Operator

Your next question comes from the line of David Cohen with Midwood Capital. Please proceed.

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David Cohen - *Midwood Capital - Analyst*

Hey, guys. Thanks for taking my call.

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

Hey, David.

David Cohen - *Midwood Capital - Analyst*

Looking for -- I certainly appreciate you guys sharpening your pencil versus the third quarter on your overall CapEx. I was just looking for a little bit of clarity on the numbers. Of the three clubs already open in 2009, how much of that capital has already been -- had already been -- hit the cash flow statement in 2008?

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

I do not have those details at my fingertips, but it's safe to say a decent amount because those clubs -- a couple of them we opened pretty early in Q1.

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

Right.

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

So I would say more than half, shooting from the hip a little bit. I don't have the exact numbers, David.

David Cohen - *Midwood Capital - Analyst*

Okay. Probably follow up with you on that. And then, Alex, I think you said that the balance of the investment, the outlying couple items, in particular, maintenance, IT, laundry, leading 14.5 roughly to 17.5 that covers, you had principally investments in 2008 and 2009 new club openings?

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

Yes.

David Cohen - *Midwood Capital - Analyst*

Okay. The press release said 2007 for some reason. But what investments would you be making relative to 2008 in your openings?

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

Oh, just fourth quarter, our club openings that -- where the construction costs in part were paid in '09. On a cash basis.

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

Exactly. When we opened a club, for instance, in December of '08, I would not have paid for that whole club at that point in time. So the CapEx was on a cash basis and usually lingers between a month and two months after the club has actually opened that we had paid for all the CapEx.

David Cohen - *Midwood Capital - Analyst*

Okay, and are there any club expansions budgeted for '09?

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

We do have -- we have one.

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

A small one.

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

We have one that's small, and the club is -- it's a new club that got to capacity very, very quickly and that's bursting at the seams.

David Cohen - *Midwood Capital - Analyst*

I guess that's a good problem to have.

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

Yes.

David Cohen - *Midwood Capital - Analyst*

Okay, and again, I appreciate your messaging to investors about the -- addressing your cost structure. I know it's tough to let anyone go. Have there been any actions at the club level along the lines of the headcount reduction that you mentioned and then--

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

Yes, what we did in the clubs, and bear in mind that we're trying to enhance the member experience --

David Cohen - *Midwood Capital - Analyst*

I understand.

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

-- but being in this environment, we know that we have to try to pay for those enhancements with some savings, and what we did was we reviewed the operating hours at all 166 club,s and we cut the operating hours, or trimmed them. I shouldn't say cut, but trimmed in -- at over 100 clubs, not significantly, but enough to -- so, in an effort not to disrupt workout routines across a large segment of the population, but at the same time achieving reasonable savings.

David Cohen - *Midwood Capital - Analyst*

Did you trim the hours the club was open or just the labor hours?

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

Yes, we trimmed the open hours. Usually late--

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

Late on weekends --

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

late in the day and to the extent we got resistance from the members, we obviously listened to that and that took it into account and we're sensitive to it. The other thing we did was we did trim the group exercise schedule to -- so that -- to the extent we have under attended classes, we will -- we took them off the schedules. And those are things that are significant in -- to the members impacted, but we felt that in our -- to achieve the right balance of increasing management coverage in the clubs, which is a critical part of what Marty is trying to do, we had to pay for it out of some other savings. So I'm not suggesting that these -- the trimming we did on the exercise classes and the open hours will necessarily benefit the expense structure, but they will certainly pay for some of the enhancements that we're trying to deliver to the member and -- which I expect to flow through to the retention and referral that we'll get.

David Cohen - *Midwood Capital - Analyst*

Okay. I've visited some clubs and quite frankly, I'm actually quite impressed by the talents you have at the club level. You guys are doing a great job there. And talked about with some folk about hey, there's 40 hours at the front desk that has been trimmed and maybe 40 hours in the cleaning staff. Is that a Company-wide thing where, hey, as we -- there are X number of hours in the aggregate that, hey, you are finding 30 or 40 hours in fitness and in front desk--

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

We're reviewing the labor model across all the clubs, but we're not doing it in a -- with a hatchet, so to the degree that we found that housekeeping or front desk hours could be trimmed and we did it -- Marty did it with his team from the GMs to the VMs to the VPs, we took some steps and -- but again, the effort is to redirect those dollars into areas where the member experience can be enhanced at the club level. We did not make cuts, headcount reduction at the clubs.

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David Cohen - *Midwood Capital - Analyst*

Okay, and I know you guys bought back stock, which I think I first think it's a great investment. It's pretty hard in this environment to actually lend any support to one stock, given the selling pressures out there. But have you guys had an opportunity to, instead of looking at buying back stock, look at buying back any of your high yield debt in the market?

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

I looked at that a long time ago, and our credit facility that we have in place has quite a bit of restrictions against that. So we basic I can't do that. The --

David Cohen - *Midwood Capital - Analyst*

You'll buy stock but not your debt?

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

Correct, not our subordinated debt.

David Cohen - *Midwood Capital - Analyst*

Okay. Doesn't make a whole lot of sense, but. And in terms of your Q1 outlook, I know you're not forecasting the full year, but implicit in getting from that top line to the bottom line, can you give us a sense of the level of depreciation and interest expense you're anticipating?

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

The interest rate on our discount notes is pretty much fixed at the 11%, and we have \$137 million as of December. That stops accruing early February. The term loans, our other big piece of debt, they -- we basically lock into that on a monthly basis, and that's at LIBOR plus 125 basis points. So it's pretty easy to recalculate what that is. I'm not really going on record with what our interest guidance is, but it's fairly recalculatable based on those two numbers.

David Cohen - *Midwood Capital - Analyst*

The issue off of one-month LIBOR?

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

Yes.

David Cohen - *Midwood Capital - Analyst*

Okay.

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

We have the option to do 30, 60 or 90 days, but we've been consistently selecting one month.

David Cohen - *Midwood Capital - Analyst*

Okay. And the -- apart from the personal training, the other ancillary revenue looks like it had a pretty decent size sequential decline. Anything in particular driving that downward?

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

That's typical, because in the -- in that category includes some of our summer pools and summer camps that we experience high revenue in the second and third quarter than we do in the fourth quarter.

Operator

And your next question comes from the line of [Jack Fillion] with Wells Fargo. Please proceed.

Jack Fillion - *Wells Fargo - Analyst*

Hello. I just had a follow-up on your CapEx number. If you needed to, how quickly can you reduce CapEx to your 22 million maintenance number, and how long can you stay at that level without impacting (inaudible)? Is that a true maintenance CapEx number?

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

I'm not sure what a true maintenance CapEx number means. Well it, is a number that's reflective of what we believe our current club base needs to get new equipment or minor face lifts to keep the current membership base happy. It's very similar to what we spent last year, last year being '08, and if we look back to the last five years, we spent between 3.5% and 4% of our revenue on these items. So we're pretty consistent with how much we spend on this as opposed to letting a problem build up, and that's why Alex says we're pretty resolute about keeping that same level this year.

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

If you're asking is the money committed, contractually or legally? The answer is no.

Jack Fillion - *Wells Fargo - Analyst*

No. I was just curious for that's a good number that will keep the members happy, and it sounds like that is the case. And how quickly can you ramp down to that level if you needed to? Because right now you're budgeting --

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

I can't anticipate -- I mean they are not -- it's not a contractually legal obligation so if we said, okay, we're only going to spend money on emergency repairs, we could ramp down to it very quickly. But that would -- you'd be shooting yourself in the foot, because you wouldn't be running the clubs the way they need to be run, and you would just be losing members, and that would be a recipe for disaster. So we're not -- that's not the direction we're going in.

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Jack Fillion - Wells Fargo - Analyst

Of the -- okay. You have \$50 million to \$53 million budgeted, correct, for '09?

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

Yes.

Jack Fillion - Wells Fargo - Analyst

CapEx. Of that, \$22 million is maintenance?

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

\$23 million.

Jack Fillion - Wells Fargo - Analyst

\$23 million. How quickly can you get to \$23 million, which is your maintenance CapEx number?

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

How quickly can we get to it? We spend it all throughout the year.

Jack Fillion - Wells Fargo - Analyst

Okay, but if you needed to run at a \$23 million CapEx number, can you shut off all the growth CapEx overnight? All the other --

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

Or as I said, the four clubs that comprise most of the growth CapEx, three of them have been already open and one is almost open. So the money's spent.

Jack Fillion - Wells Fargo - Analyst

Got it.

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

On the growth CapEx.

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Jack Fillion - Wells Fargo - Analyst

But go forward, you have no (inaudible), that helps that. And then what does the competitive environment look like out there for you guys? Are you seeing anyone else growing clubs and -- do you have to keep up with the Jones' at all?

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

I think the -- most club operators, major competitors are slowing down, and that doesn't mean they don't have some clubs opening in '09. They do. But if you poll the leaders in the industry, lifetime, 24-hour and others, most, or almost all, will tell you that they are cutting back on CapEx.

Jack Fillion - Wells Fargo - Analyst

Thank you.

Operator

Your next question comes from the line of Scott Collins with RT Investments. Please proceed.

Scott Collins - RT Investments - Analyst

Yes, good morning, or good afternoon. Can you tell me, were there any insider sales or purchases by executives in Q4?

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

To the extent we had those, they would be filed with the SEC.

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

Yes, you would see a Form 4. And the Company -- as we said, the Company bought back a significant amount of shares, and that was disclosed and --

Scott Collins - RT Investments - Analyst

That was Company, but the Executives themselves, there was a board member that changed? Was that --

Alex Alimandestianu - Town Sports International Holdings, Inc. - President, CEO

No, the -- our long-time Chairman, Paul Arnold, is still on the board and remaining on the board, but he stepped down and was replaced by another long time director, Jason Fish. So there's no change in the board composition. The chairman position changed.

Scott Collins - RT Investments - Analyst

Okay, and how many members were there in Q4? Did you say 12,000?

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

No, I said there were -- in January, we netted, we added 12,000 members on top of the 510,000 that we had at the end of December.

Scott Collins - *RT Investments - Analyst*

Okay, and what's the rate of cancellation per month that you're -- what's your churn?

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

In Q4, the monthly rate was 3.5%.

Scott Collins - *RT Investments - Analyst*

And how did that compare prior quarter?

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

Prior year was 3.0% and Q3 of '08 was 3.6%, so it's down sequentially, but up from the prior year.

Scott Collins - *RT Investments - Analyst*

Okay, and there was a posting of fraud from Q4 sales of members who bought on Craigslist and eBay?

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

I don't know about that.

Scott Collins - *RT Investments - Analyst*

You're not aware of any memberships that were sold that --

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

I mean our internal audit department or legal department would work on that, but it must not be a material amount of memberships. It must be a one-off person doing this. We have instances of that when you have 510,000 members and 9,000 employees, but I'm not really sure of the instance you're referring to.

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

Do you want to send us something on that? We would be happy to look at it. I'm not sure what you're looking at.

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Scott Collins - *RT Investments - Analyst*

What I heard, it was over a hundred members in the New York area alone.

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

Okay. So it's a 100 members and we have 510,000 members. That's probably why it didn't get to me yet.

Scott Collins - *RT Investments - Analyst*

And current stock price down at the new low today?

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

Yes, we've been preparing for this call, so we're not watching the ticker. But we, we just bought back, what, 3.9 million shares, so we're long.

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

I'm not sure how many new lows there were today. There's been a lot recently as well.

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

Thanks for your question.

Operator

Ladies and gentlemen, this concludes our Q&A session at this time. I would like to turn the call over to Mr. Gallagher for closing remarks.

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

Well, thank you, everybody. That concludes our call for the fourth quarter 2008, and we look forward to updating you when we're ready to release our first quarter 2009. Thank you.

Operator

Thank you for your participation in today's conference. This concludes our presentation. You may now disconnect, and have a good day.

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