

TOWN SPORTS INTERNATIONAL HOLDINGS INC

Form 10-K

February 25, 2011

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

**FORM 10-K**

**Annual Report pursuant to Section 13 OR 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2010**

**Transition Report pursuant to Section 13 OR 15(d) of the Securities Exchange Act of 1934  
For the transition period from**

**Commission file number: 000-52013  
Town Sports International Holdings, Inc.  
(Exact name of Registrant as specified in its charter)**

<b>DELAWARE</b> (State or other jurisdiction of incorporation or organization)	<b>20-0640002</b> (I.R.S. Employer Identification No.)
<b>5 PENN PLAZA 4<sup>TH</sup> FLOOR</b> <b>NEW YORK, NEW YORK</b> (Address of principal executive offices)	<b>10001</b> (Zip code)
<b>(212) 246-6700</b> (Registrant's telephone number, including area code)	

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
<b>Common Stock, \$0.001 par value</b>	<b>The NASDAQ Stock Market LLC</b>

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part IV of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2010 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$40.1 million (computed by reference to the last reported sale price on The Nasdaq National Market on that date). The registrant does not have any non-voting common stock outstanding.

As of February 22, 2011, there were 22,678,485 shares of Common Stock of the Registrant outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for the 2011 Annual Meeting of Stockholders, to be filed not later than April 30, 2011, are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K.

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**TOWN SPORTS INTERNATIONAL HOLDINGS, INC.**

**FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding future financial results and performance, potential sales revenue, legal contingencies and tax benefits, and the existence of adverse litigation and other risks, uncertainties and factors set forth under Item 1A., entitled Risk Factors, of this Annual Report on Form 10-K and in our reports and documents filed with the Securities and Exchange Commission (SEC). You can identify these forward-looking statements by the use of words such as outlook, believes, expects, potential, continues, may, will, should, seeks, approximately, predicts, estimates, anticipates or the negative version of these words or other comparable words. These statements are subject to various risks, and uncertainties, many of which are outside our control, including the level of market demand for our services, competitive pressure, the ability to achieve reductions in operating costs and to continue to integrate club acquisitions, environmental initiatives, the application of Federal and state tax laws and regulations, and other specific factors discussed herein and in other SEC filings by us. We believe that all forward-looking statements are based on reasonable assumptions when made; however, we caution that it is impossible to predict actual results or outcomes or the effects of risks, uncertainties or other factors on anticipated results or outcomes and that, accordingly, one should not place undue reliance on these statements. Forward-looking statements speak only as of the date they were made, and we undertake no obligation to update these statements in light of subsequent events or developments. Actual results may differ materially from anticipated results or outcomes discussed in any forward-looking statement.

**PART I**

**Item 1. Business**

In this Annual Report, unless otherwise stated or the context otherwise indicates, references to TSI Holdings, Town Sports, TSI, the Company, we, our and similar references refer to Town Sports International Holdings, Inc. and its subsidiaries and references to TSI, LLC refer to Town Sports International, LLC, our wholly-owned operating subsidiary.

**General**

We are the largest owner and operator of fitness clubs in the Northeast and Mid-Atlantic regions of the United States and the fourth largest fitness club owner and operator in the United States, in each case based on the number of clubs. As of December 31, 2010, the Company, through its subsidiaries, operated 160 fitness clubs under our four key regional brand names; New York Sports Clubs (NYSC), Boston Sports Clubs (BSC), Philadelphia Sports Clubs (PSC) and Washington Sports Clubs (WSC). These clubs collectively served approximately 493,000 members, including 17,000 members under our new student membership as of December 31, 2010. We owned and operated a total of 108 clubs under the New York Sports Clubs brand name within a 120-mile radius of New York City as of December 31, 2010, including 38 locations in Manhattan where we are the largest fitness club owner and operator (more than twice as many as our nearest competitor). We owned and operated 25 clubs in the Boston region under our Boston Sports Clubs brand name, 18 clubs (two of which are partly-owned) in the Washington, D.C. region under our Washington Sports Clubs brand name and six clubs in the Philadelphia region under our Philadelphia Sports Clubs brand name as of December 31, 2010. In addition, we owned and operated three clubs in Switzerland as of December 31, 2010. We employ localized brand names for our clubs to create an image and atmosphere consistent with the local community and to foster recognition as a local network of quality fitness clubs rather than a national chain.

We have developed and refined our fitness club model through our clustering strategy, offering fitness clubs close to our members' workplaces and homes. We target all individuals within each of our regions who aspire to a healthy lifestyle. We believe that the majority of our members have household income levels between \$50,000 and \$150,000. We believe this is not only the broadest sector of the market, but also provides the greatest growth opportunities. Our goal is to be the most recognized health club network in each of the four major metropolitan regions we serve. We believe that our strategy of clustering clubs provides significant benefits to our members and allows us to achieve strategic operating advantages. In each of our markets, we have developed clusters by initially

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opening or acquiring clubs located in the more central urban markets of the region and then expanding our market coverage from these urban centers to suburbs and neighboring communities.

We currently offer two principal types of memberships in our clubs: Passport and Core. There are two types of Passport memberships. The first type allows access to all clubs in all four regions at any time. The second type, the Regional Passport membership, is available in all regions other than the NYSC region and allows a member access to all of our clubs within a single region. We had 215,000 Passport members as of December 31, 2010. The Core membership, consisting of 15,000 members as of December 31, 2010, allows unlimited access to a designated home club. Core members may pay a per visit fee of \$7.50 to use non-home clubs at any hour. Members can elect to commit to a predetermined minimum contract period of one year in order to benefit from reduced dues and joining fees. Alternatively, our memberships are available on a month-to-month basis. Prior to November 1, 2010, we also offered a Gold membership which allows unlimited access to a designated or home club at all times and access to all of our other clubs during off-peak hours. Members who held a Gold membership as of November 1, 2010 are permitted to continue in this membership category. Gold members may pay a per visit fee of \$7.50 to use non-home clubs during peak hours. We had 246,000 Gold members as of December 31, 2010.

As part of our efforts to drive member sales, in April 2010, we began offering a new, favorably-priced, restricted-use membership available to students only. In prior years, we offered a three-month summer membership targeted at students generally priced at \$199.00 for the entire summer. The new membership is a month-to-month membership with dues of \$20.00 per month and \$119.00 for joining fees at the time of enrollment. As of December 31, 2010, we had approximately 17,000 student members.

Over our 37-year history, we have developed and refined our club formats, which allows us to cost-effectively construct and efficiently operate our fitness clubs in the different real estate environments in which we operate. Our fitness-only clubs average approximately 20,000 square feet, while our multi-recreational clubs average 40,000 square feet. The aggregate average size of our clubs is approximately 26,000 square feet. Our clubs typically have an open fitness area to accommodate cardiovascular and strength-training equipment, as well as special purpose rooms for group fitness classes and other exercise programs. We seek to provide a broad array of high-quality exercise programs and equipment that are popular and effective, promoting the quality exercise experience for our members. When developing clubs, we carefully examine the potential membership base and the likely demand for supplemental offerings such as swimming, basketball, children's programs, tennis or squash and, provided suitable real estate is available, we will add one or more of these offerings to our fitness-only format. For example, a multi-recreational club in a family market may include Sports Clubs for Kids programs, which can include swim lessons and sports camps for children.

The U.S. and global economic recession in 2009 and the continuing challenging economic environment in 2010 resulted in significant pressures and declines in consumer confidence and economic growth and high levels of unemployment. These economic conditions have led to reduced consumer spending and have contributed to an increase in member cancellations, a decrease in new memberships and reductions in revenue from ancillary services and marketing. While further signs of economic recovery are appearing, negative economic conditions could continue to adversely affect our business and results of operations.

## **Industry Overview**

Total United States fitness club industry revenues increased at a compound annual growth rate of 5.9% from \$11.6 billion in 2000 to \$19.5 billion in 2009, according to the most recent information released by the International Health, Racquet and Sportsclub Association (IHRSA). Total U.S. fitness club memberships increased at a compound annual growth rate of 3.7% from 32.8 million in 2000 to 45.3 million in 2009, and total number of fitness clubs increased at a compound annual growth rate of 6.4% from 16,983 in 2000 to 29,750 in 2009, according to IHRSA.

In 2009, health club members visited clubs at an all-time high of 102 days on average, with approximately 42% visiting their clubs at least 100 times during the year, according to IHRSA. From 2008 to 2009, the number of people attending a club at least six times per year decreased 2.5%; however, in the last ten years the number has increased nearly 60% from 24.1 million to 38.3 million.

Obesity continues to be a growing problem in the United States, including the continued prevalence of childhood obesity. Consumers under age 18 increased in 2009 to 10% of total fitness club membership. The Center

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for Disease Control and Prevention found that 68% of U.S. adults were considered overweight or obese in 2007-2008, an increase from 64.5% in 1999-2000. As healthcare costs rise in the United States, some of the focus in combating obesity and other diseases is being directed at prevention. Both government and medical research has shown that exercise and other physical activity plays a critical role in preventing obesity and other health conditions, thereby reducing healthcare costs.

Demographic trends have helped drive the growth experienced by the fitness industry over the past decade. The industry has benefited from the aging baby boomer and Eisenhower generations as they place greater emphasis on their health, including a focus on fitness. Members over the age of 55 increased from 8.0 million in 2005 to 10.3 million in 2009.

As the focus on exercise and overall healthy lifestyles continue to impact the health club industry, we believe that we are well positioned to benefit from these dynamics as a large operator with recognized brand names, leading regional market shares and an established operating history.

## **Competitive Strengths**

We believe the following competitive strengths are instrumental to our success:

*Strong market position with leading brands.* Based on number of clubs, we are the fourth largest fitness club owner and operator in the United States and the largest fitness club owner and operator in the Northeast and Mid-Atlantic regions of the United States. We are the largest fitness club owner and operator in the New York, Boston and Washington, D.C. regions, and the fifth largest owner and operator in the Philadelphia region. We attribute our positions in these markets in part to the strength of our localized owner and operator brand names, which foster recognition as a local network of quality fitness clubs.

*Regional clustering strategy provides significant benefits to members and corporations.* By operating a network of clubs in a concentrated geographic area, the value of our memberships is enhanced by our ability to offer members access to any of our clubs, which provides the convenience of having fitness clubs near a member's workplace and home. This is also a benefit to our corporate members, as many corporations have employees that will take advantage of multiple gym locations. Approximately 215,000 of our members have a Passport Membership and because these memberships offer enhanced privileges and greater convenience, they generate higher monthly dues than Core or Gold Memberships in each respective region. Regional clustering also allows us to provide special facilities to all of our members within a local area, such as swimming pools and squash, tennis and basketball courts, without offering them at every location. In the year ended December 31, 2010, 37% of all club usage was by members visiting clubs other than their home clubs.

*Regional clustering strategy designed to enhance revenues and achieve economies of scale.* We believe our regional clustering strategy allows us to enhance revenue and earnings growth by providing high-quality, conveniently located fitness facilities on a cost-effective basis. Regional clustering is attractive to corporations seeking to promote a healthy lifestyle by providing discounted group memberships to their employees. We also partner with many groups that serve our communities, including the New York City Police and Fire Departments in our New York Sports Clubs region, the Southeastern Pennsylvania Transportation Authority (SEPTA) in our Philadelphia Sports Clubs region, and the District of Columbia Government, including all city agencies, in our Washington Sports Clubs region. We believe that potential new entrants would need to establish or acquire a large number of clubs in a market to compete effectively with us. Our clustering strategy also enables us to achieve economies of scale with regard to sales, marketing, purchasing, general operations and corporate administrative expenses and reduces our capital spending needs. Regional clustering also provides the opportunity for members who relocate within a region to remain members of our clubs, thus aiding in member retention.

*Expertise in site selection and development process.* We believe that our expertise in site selection and development provides an advantage over our competitors given the complex real estate markets in the metropolitan areas in which we operate and the relative scarcity of suitable sites. Before opening or acquiring a new club, we undertake a rigorous process involving demographic and competitive analysis, financial modeling, site selection and negotiation of lease and acquisition terms to ensure that a potential location meets our criteria for a model club. We believe our flexible club formats are well suited to the challenging real estate environments in our markets.

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### **Business Strategy**

In the long-term, we seek to maximize our net member growth, revenues, earnings and cash flows using the following strategies:

*Retain members by focusing on the member experience.* Our company's mission is Improving Lives Through Exercise. We enact our mission through our Engage and Inspire operational excellence platform which is designed to inspire members to embrace regular exercise and achieve their fitness goals by securing their loyalty through customer service and providing state-of-the-art facilities, programs and services. We tailor the hours of each club to the needs of the specific member demographic utilizing each club; offer a variety of ancillary services, including personal training, group classes, small group training, Sports Clubs for Kids programs, and the XpressLine program (a high-intensity, efficient workout program). We offer a variety of different sports facilities in each regional cluster of clubs; offer modern, varied and well-maintained exercise and fitness equipment; and offer an assortment of additional amenities including access to babysitting, sports massage and pro-shops. Through hiring, developing and training a qualified and diverse team that is passionate about fitness and health; maintaining and enhancing our programs and services; and continually increasing our attention to individual member needs, we expect to demonstrate our commitment to increase the quality of the member experience, and thereby increase net membership.

To further ensure the member experience remains at a high quality, we provide member surveys to help analyze the areas we can improve upon as well as the areas in which the members are satisfied overall. We also utilize a mystery shopping program that studies each club in areas such as cleanliness and customer service. The scores from this program are used to measure management rewards and bonus payments for certain club employees.

*Drive comparable club revenue and profitability growth by implementing our business strategy.* Our near-term financial performance will depend largely on the growth of revenue at clubs that we have operated for more than 12 months. We define comparable club revenue as revenue at those clubs that were operated by us for over 12 months and comparable club revenue growth as revenue for the 13th month and thereafter as compared to the same period in the prior year. Historically, comparable club revenue growth has been a contributing factor in our revenue growth, with comparable club revenue growth for each of the three years from 2006 to 2008, ranging between 2.2% to 7.9%. For the years ended December 31, 2010 and December 31, 2009, however, our comparable club revenue declined 4.3% and 5.6%, respectively. Although comparable club revenue continued to decline throughout the year ended December 31, 2010 compared with the prior year, we began to see signs of recovery. In 2009, in part as a result of the state of the economy and the impact on consumer spending, we experienced higher member attrition and, therefore, a lower member base for most reporting periods in the year ended December 31, 2010. The lower beginning member counts in 2010 resulted in decreased revenue recognized throughout the year. In the fourth quarter of 2010, we experienced a comparable club revenue decrease of 1.7% compared to a decrease of 7.1% in the fourth quarter of 2009. In 2011, we expect modest improvement and to have slight comparable club revenue increases in the second half of the year when compared to the same periods in 2010.

*Provide state-of-the-art fitness equipment and services.* To help members develop and maintain a healthy lifestyle, train for athletic events or lose weight, each of our clubs has a large array of cardiovascular machines and resistance training equipment and free weights. Exercise equipment is positioned to allow for easy movement from machine to machine, facilitating a convenient and efficient workout. Equipment in these areas is arranged in long parallel rows that are clearly labeled by muscle group, which allows members to conveniently customize their exercise programs and reduce downtime during their workouts. We have technicians who service and maintain our equipment on a timely basis. In addition, we have personal viewing television screens on most pieces of cardiovascular equipment. Most clubs have between one and three studios used for exercise classes, including at least one large studio used for most group exercise classes, a cycling studio and a mind and body studio used for yoga and Pilates classes. We offer a large variety of group fitness classes at each club and these classes generally are at no additional cost to our members.

The volume and variety of activities at each club allow each member to enjoy the club, whether customizing their own workout or participating in group activities and classes.

*Grow ancillary and other non-membership revenues.* We intend to grow our ancillary and other non-membership revenues through a continued focus on increasing the additional value-added services that we provide to our members as well as capitalizing on the opportunities for other non-membership revenues such as in-club advertising and retail sales. Non-membership revenues have increased from \$77.3 million, or 17.9% of revenues for

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the year ended December 31, 2006, to \$92.0 million, or 19.9% of revenues for the year ended December 31, 2010. We intend to continue to enhance and expand the current range of programs and quality of value-added services that we offer to our members, such as personal and small group training. These sources of ancillary and other non-membership revenues generate incremental profits with minimal capital investment and assist in attracting and retaining members.

*Realize benefits from maturation of recently opened clubs.* From January 1, 2009 to December 31, 2010, we opened four clubs. Based on our experience, a new club tends to achieve significant increases in revenues during its first three years of operation as the number of members grows. Because there is relatively little incremental cost associated with such increasing revenues, there is a greater proportionate increase in profitability. We believe that the revenues and profitability of this group of four clubs will improve as the clubs reach maturity.

## **Marketing**

Our marketing campaign, which we believe has increased awareness of our brand names, is directed by our marketing department, which directly reports to the Chief Executive Officer. This team develops advertising strategies to convey each of our regionally branded networks as the premier network of fitness clubs in its region. Our marketing team's goal is to focus on growing our membership base and achieving broad awareness of our regional brand names and be top of mind. We are organized to enable close collaboration between our marketing, sales, fitness and operations staff, which helps to align efforts around operational objectives and new product development while ensuring a primary focus on the member experience.

Brand awareness and preference is aided by a number of factors, including visibility of multiple retail locations and associated signage across each region, our membership base of 493,000 as of December 31, 2010, which generates word-of-mouth and referrals, a 37-year operating history and continual advertising investment. All of these factors provide a strong foundation for our ongoing marketing and advertising efforts.

Our regional concentration and clustering strategy creates economies of scale in our marketing and advertising investments which increase their overall efficiency and effectiveness. Clustering enables broader reach and higher frequency for regional advertising campaigns that typically include a mix of traditional media including radio, newspapers, magazines, out-of-home (especially transit-based) and some television and geo-targeted and behaviorally targeted digital media, such as paid search, email blasts, online banners and video, as well as other emerging new media vehicles. These broader market efforts are bolstered by local marketing plans and tactics, which include direct mail, local sponsorships and co-promotions, community relations and outreach and street-level lead generation activities. Optimization of marketing mix through measurement and modeling of the effectiveness of various media investments and formats continues to be a priority.

Our advertising and marketing message is designed to build our brand while creating an approachable personality that is attractive to prospective members. In contrast to most health club advertising, we generally forego depicting images of hard bodies, facilities and gym equipment. Advertisements generally feature creative slogans that use current events to communicate the serious approach we take toward fitness in a provocative and/or humorous tone. We believe this approach is easily communicated and understood and makes our product more approachable for all consumers regardless of their health club experience.

Promotional marketing campaigns will typically feature opportunities to participate in a variety of value-added services such as personal training, small group training and youth centered sports activities. We also may offer reduced joining fees to encourage enrollment. Additionally, we frequently sponsor member referral incentive programs and other types of member appreciation, acquisition activities and internal promotions to enhance loyalty and to encourage more members to take advantage of our ancillary services.

We also engage in public relations, sponsorships and special events to promote our brand image across our network, regionally and in our local communities. We have created custom programming garnering media interest, such as the Jersey Core workout, Trivia Training and the Burlesque workout, among others. We have been featured in national broadcast television shows, such as Fox & Friends, Access Hollywood, CNN, MSNBC and the CBS Early Show; major newspapers, such as The New York Times, USA Today, Washington Post, Washington Times, Boston Globe, and The Wall Street Journal, and seen in magazines, such as: Fitness, Self, Shape, New York and People Magazines.

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In addition, we participate in and sponsor events in each of our regions. We are a six-time sponsor of the JPMorgan Chase Corporate Challenge Series running event in both the New York and Boston metropolitan regions. In 2010, this popular annual event attracted nearly 40,000 participants in New York and 14,000 in Boston. Boston Sports Clubs is also a four-time sponsor of the Tufts Health Plan 10K for Women, an event that attracted 7,400 competitors in 2010. New York Sports Clubs' sponsorship of the annual TD Bank Five Boro Bike Tour helped to turn out a TSI team of 475 members and employees, all riding in logo jerseys, for the 42-mile ride along with 37,000 other cyclists.

Our association with professional sports teams also enhances our brands and their status in the communities in which we operate. Boston Sports Clubs is the official health club of the Boston Red Sox and Boston Celtics. New York Sports Clubs shares the same designation with the New York Jets Flight Crew, including programming in our clubs with appearances by the Flight Crew, as well as signage in New Meadowlands Stadium.

Our philosophy of giving back to our communities includes sponsoring company-wide and local charitable efforts. Developed in 2009 and launched in early January 2010, we partnered with the City of New York and the Fire Department of New York (FDNY) to develop and deliver easier access to cardiopulmonary resuscitation ( CPR ) training. Called CPR to Go , the graduates of this 40 minute class headed by FDNY EMS trainers, will become certified and therefore will be able to assist in providing CPR. Our club management teams and staff are also encouraged to organize and engage in charitable activities. Some recent events benefited organizations such as the Michael J. Fox Foundation for Parkinson's Research, Tower of Hope, MS Society, Family Research Foundation, American Cancer Society, the Muscular Dystrophy Association, Susan G. Komen Race for the Cure, Avon Walk for Breast Cancer, NYCares, Toys for Tots, as well as many smaller local and specific charities.

Our principal web site is [www.mysportsclubs.com](http://www.mysportsclubs.com). In 2009, we improved the site to facilitate its navigation, functionality and usability and to enhance the member experience. In 2010, we focused on developing new template pages that would allow for more flexibility and efficiency in disseminating content. We also continued to improve upon site navigation, functionality and usability to enhance the member experience. The site provides information about club locations, program offerings, exercise class schedules and sales promotions. The web site also allows our members to give us direct feedback about our service levels and enables prospective members to sign-up for our popular 30 days for 30 dollars web trial membership launched in April 2010. This has increased traffic in the clubs and led to many of these trial members joining as full-time members. Prospective members can also initiate their full membership enrollment process through our web site. In addition, job seekers can begin the employment application process through the site and investors can access financial information and resources.

## **Sales**

We sell our memberships primarily through three channels; at the club level; through our corporate and group sales division; and through our outbound call center. In September 2010, we introduced our outbound call center in order to reach out to former members. We are currently reviewing other opportunities to sell memberships through the call center. We also sell memberships online through our web site. We employ approximately 390 in-club membership consultants who are responsible for new membership sales in and around their designated club locations. Each club generally has either two or three consultants. These consultants report directly to the club general manager, who, in turn, reports to a district manager. We provide additional incentive-based compensation in the form of commissions and bonuses, contingent upon individual, club and company-wide enrollment goals. Membership consultants must successfully complete an in-house training program through which they learn our sales strategy. The training program consists of three days of in-classroom training followed by three weeks of in-club training. In making a sales presentation, membership consultants attempt to match the needs to each prospective member by emphasizing all the aspects of our clubs' selection of equipment, classes and multi-recreational offerings, if available, and the quality of our staff.

In mid-December 2008, we launched the selling of individual memberships online for our standard membership types. This sales channel links directly to our principal web site and an existing web site, which is tailored to selling memberships for pre-established corporate and group programs. The online sales channel offers a high degree of convenience for customers who know and trust our brand and do not require up-front interaction with a membership consultant to make their decision. In addition, selling online significantly reduces our cost of sale. Members who joined online accounted for approximately 3.3% of memberships sold in 2010. In April 2010, we launched a 30 days for 30 dollars web trial membership for prospective members.

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Our corporate and group sales division consists of approximately 20 full-time employees located throughout our markets, who concentrate on building long-term relationships with local and regional companies and large groups. Corporate and group members accounted for approximately 16% of our total membership base as of December 31, 2010. We offer numerous programs to meet our corporate and group clients' needs including an online enrollment program as well as a fully operational call center for enrollment. We believe this focus on relationship building, providing the corporate customer with options for enrollment and our clustering strategy will continue to lead to new group participation in the future. Corporate and group sales are typically sold at a discount to our standard rates. Corporations frequently subsidize the costs of memberships provided to their employees.

We believe that clustering clubs allows us to sell memberships based upon the opportunity for members to utilize multiple club locations near their workplace and their home. As of December 31, 2010, our existing members were enrolled under three types of memberships:

The Passport Membership is our higher priced membership and entitles members to use any of our clubs in any region at any time, or any of our clubs within one region, other than the NYSC region. These membership plans provide the convenience of having fitness clubs near a member's workplace and home. The current list price of an individual commit Passport Membership ranges from \$69 per month to \$89 per month, excluding students and corporate and group members. Our student memberships are offered as restricted-use Passport Memberships and averaged approximately \$20 per month for those sold in the year ended December 31, 2010. Our corporate and group memberships are sold as Passport Memberships and averaged approximately \$60 per month for those sold in the year ended December 31, 2010. The Passport Membership, including our student members and our corporate and group members, was held by approximately 47% of our total members as of December 31, 2010. In addition, we have a Passport Premium Membership at two select clubs, which includes a greater array of member services and facilities, at prices ranging from \$105 to \$115 per month.

The Core Membership was introduced on November 1, 2010 and enables members to use a specific club at any time. The current list price of a commit Core membership ranges from \$39 to \$79 per month based on club specific facilities and services, the market area of enrollment and length of the membership contract. Core members can also elect to pay a per visit fee of \$7.50 to use non-home clubs. This membership was held by approximately 3% of our members as of December 31, 2010.

The Gold Membership enables members to use a specific club at any time and any of our clubs during off-peak times. Gold members can also elect to pay a per visit fee of \$7.50 to use non-home clubs during peak hours. This membership was held by approximately 50% of our members as of December 31, 2010. This membership is no longer offered to new members as of November 1, 2010.

In 2010, we simplified our membership offerings by moving away from many membership offerings to two principal memberships. We still offer some promotional memberships to key segments of our consumer and member base; however, these are not permanent offerings and are only offered periodically on a promotional basis. Examples of such specialized memberships are those designed for the aging population, TSI alumni, gym switchers or couples memberships. We periodically emphasize these specialized membership packages to support with our marketing and sales strategic plan.

We offer both month-to-month and commit membership payment plans. A member may cancel a month-to-month membership at any time with 30-days notice. Under the commit model, new members commit to a one-year membership. These memberships are priced at a moderate discount to the month-to-month membership. In 2010 and 2009, 74% and 85% of our newly enrolled members opted for a commit membership, respectively. We decreased the price gap between the commit membership and the month-to-month membership in 2009, as we saw the month-to-month membership gain popularity due to its flexibility in a time of decreased consumer confidence. As of

December 31, 2010, approximately 17% of our members had originated under a month-to-month non-commit membership and 83% had originated under a commit membership. When the members' commit period is over, they retain membership as a month-to-month member until they choose to cancel. As of December 31, 2010, approximately 70% of our total members were on a month-to-month basis. We believe that members prefer to have the flexibility to choose between committing for one year or to join under the month-to-month non-commit membership.

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In joining a club, a new member signs a membership agreement that typically obligates the member to pay one-time joining fees, if applicable, and monthly dues on an ongoing basis. The one-time joining fees consist of initiation fees and processing fees. In the third quarter of 2008, we had combined these fees. We promoted new memberships by discounting these fees in 2008 and further discounting these fees in 2009, resulting in a low average joining fee per member of \$20 in that year. In June 2010, we re-introduced the one-time processing fee of between \$19 and \$29 per sale. Joining fees collected for new monthly electronic funds transfer, or EFT, members averaged approximately \$30 per member for the year ended December 31, 2010. Monthly EFT of individual membership dues on a per-member basis including the effect of promotions and memberships with reduced dues averaged approximately \$62 and \$64 per month for the years ended December 31, 2010 and 2009, respectively. Throughout 2010, we ran various sales promotions for new members to receive free months of membership and in April 2010 we began our student membership with dues of \$20 per month. Due to the popularity of the student membership, our average per member dues decreased. Throughout 2009, we had also offered various sales promotions for new members to receive free months of membership and also sold discounted membership types, including our alumni and friends and family memberships. We collect approximately 96.0% of all monthly membership dues through EFT and EFT membership revenue constituted approximately 75.5% of consolidated revenue for the year ended December 31, 2010. Substantially all other membership dues are paid in full in advance. Our membership agreements call for monthly dues to be collected by EFT based on credit card or bank account debit authorization contained in the agreement. During the first week of each month, we receive the EFT dues for that month after the payments are initiated by a third-party EFT processor. Discrepancies and insufficient funds incidents are researched and resolved by our in-house account services department. We typically increase our existing member dues annually by between 1% and 3% on average, in line with increases in the cost of living. In 2010, the total membership dues increase was applied to approximately 50.0% of our membership base resulting in an overall dues increase of approximately 1.5%.

**Usage**

Our suburban clubs are generally open 5:00 AM to 10:00 PM on weekdays and 7:00 AM to 8:00 PM on weekends, while our urban clubs are generally open 5:00 AM to 11:00 PM on weekdays and 8:00 AM to 9:00 PM on weekends. Where member demand is high, some clubs remain open for 24 hours. We generally consider our peak usage times to be between 6:00 AM and 8:30 AM and 4:00 PM and 8:30 PM on weekdays. Our hours of business are based on usage patterns at each individual club. Our total club usage was 30.0 million and 30.3 million member visits for the years ended December 31, 2010 and 2009, respectively, representing a 1.2% decrease in total club usage on a year-over-year basis. Usage per member has increased approximately 1.9% in the year ended December 31, 2010 compared to 2009. In the year-ended December 31, 2010, approximately 37% of total usage or club visits was to members non-home clubs, indicating that our members take advantage of our network of clubs.

**Non-Membership Revenue**

Over the past five years, we have expanded the range of ancillary club services provided to our members. Non-membership club revenue has increased by 19.0% from 2006 to 2010 and has increased as a percentage of total revenue from 17.9% in 2006 to 19.9% in 2010. Personal training revenue, in particular, increased 23.0% over this five-year period and increased as a percentage of total revenue from 11.4% in 2006 to 13.2% in 2010. In addition, we offer Sports Clubs for Kids and Small Group Training, both for an additional fee, at select clubs. Consumer confidence and consumer spending deteriorated in the second half of 2008 and throughout 2009, resulting in a non-membership revenue decrease in these periods. In 2010, consumer confidence and consumer spending began to recover. Also in 2010, we recognized \$2.7 million of personal training revenue related to unused and expired sessions in three of our jurisdictions, of which \$570,000 related to expired sessions that would have been recognized in the year ended December 31, 2010. See Management's Discussion and Analysis for further information.



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The table below presents non-membership revenue components as a percentage of total revenue for the years ended December 31, 2006 through 2010.

	For The Years Ended December 31, (In thousands)								
	2010	%	2009	%	2008	%	2007	%	2006
<b>Non-Membership Revenue:</b>									
Total revenue	\$ 462,387	100.0%	\$ 485,392	100.0%	\$ 506,709	100.0%	\$ 472,915	100.0%	\$ 433,080
Membership revenue	60,875	13.2%	56,971	11.7%	61,752	12.2%	56,106	11.9%	49,511
Multi-club revenue	26,355	5.7%	24,589	5.1%	24,329	4.8%	24,247	5.1%	22,863
Other revenue	4,761	1.0%	4,661	1.0%	6,031	1.2%	5,616	1.2%	4,942
Membership	\$ 91,991	19.9%	\$ 86,221	17.8%	\$ 92,112	18.2%	\$ 85,969	18.2%	\$ 77,316

**Club Format and Locations**

Our clubs are generally located in middle- or upper-income residential, commercial, urban and suburban neighborhoods within major metropolitan areas that are capable of supporting the development of a cluster of clubs. Our clubs typically have high visibility and are easily accessible. In the New York metropolitan, Boston, Washington, D.C. and Philadelphia markets, we have created clusters of clubs in urban areas and their commuter suburban areas aligned with our operating strategy of offering our target members the convenience of multiple locations close to where they live and work, reciprocal use privileges, and standardized facilities and services.

Approximately 68% of our clubs are fitness-only clubs and the remaining clubs are multi-recreational. Our fitness-only clubs generally range in size from 15,000 to 25,000 square feet and average approximately 20,000 square feet. Our multi-recreational clubs generally range in size from 25,000 square feet to 65,000 square feet, with one club being 200,000 square feet. The average multi-recreational club size is approximately 40,000 square feet. Membership for each club generally ranges from 2,000 to 4,500 members at maturity.

We have experienced overall growth over the past five years primarily through developing and opening new club locations that we have constructed, despite the reduction in club openings in 2009 and 2010. In addition, we have acquired existing, privately owned single and multi-club businesses. From January 1, 2006 to December 31, 2010, we acquired two existing clubs, constructed 37 new clubs and closed or relocated 20 clubs to increase our total clubs under operation from 141 to 160. In the year ended December 31, 2010, we did not open any new clubs and closed one club, decreasing our total clubs under operation from 161 to 160. In 2010, we upgraded certain existing clubs and plan to continue to do so in 2011. We currently plan to open two clubs in the second half of 2011.

To identify potential target areas for additional clubs, we engage in detailed site analyses and selection processes. Target areas are identified based upon population demographics, psychographics, traffic and commuting patterns, availability of sites and competitive market information. We currently have two lease commitments and have identified over 170 target areas in which we may add clubs under our New York Sports Clubs, Boston Sports Clubs, Washington Sports Clubs or Philadelphia Sports Clubs brand names. In addition, we have identified further growth opportunities in secondary markets located near our existing markets. In the future, we may explore expansion opportunities in other markets in the United States that share similar demographic characteristics to those in which we currently operate.

Our facilities include a mix of state-of-the-art cardiovascular equipment, including AMT ellipticals, E Spinners & Arc Trainers along with bikes, steppers, treadmills and elliptical motion machines; free weight and strength equipment, including Cybex, Nautilus, Techno Gym, Strive, Precor, Star Trac and Hammer Strength equipment; group exercise and cycling studios; the entertainment system network; locker rooms, including shower facilities, towel service and other amenities, such as saunas, babysitting, and a pro-shop. Each of our clubs is equipped with automated external defibrillators (AEDs) for use in cardiac arrest emergencies. Personal training services are offered at all locations for an additional charge. At certain locations, additional facilities are also

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offered, including swimming pools and racquet and basketball courts. Also, we have fee-based programming at many of our clubs, including Small Group Training, children's programs, and other programs targeting adult members.

We also offer our Xpressline strength workout at all of our clubs. Xpressline is an eight-station total-body circuit workout designed to be used in 22 minutes and to accommodate all fitness levels. This service is provided for free to our members.

We have approximately 8,100 personal entertainment units installed in our clubs. The units are typically mounted on or near individual pieces of cardiovascular equipment and are equipped with a flat-panel color screen for television viewing. We believe our members prefer the flexibility to view and listen to the programs of their choice during their cardiovascular workout. The entertainment system network also broadcasts our own personalized music video channel that provides us with a direct means of advertising products and services to our membership base.

In 2010, we began to roll-out an expansion of features of the personal viewing screens on our cardio equipment at select clubs using a new entertainment system network. These additional features include on-demand television and music, iPod/iPhone compatibility and a club information channel. We installed this new system in 12 of our Manhattan clubs in 2010 and have plans to further expand the features of the screens in our remaining Manhattan clubs in the first half 2011.

## **Club Services and Operations**

Our clubs are structured to provide an enhanced member experience through effective execution of our operating plan. Our club and support team members are the key to delivering a valued member experience and our operations are organized to maximize their overall effectiveness. Our club operations include:

*Management.* We believe that our success is largely dependent on the selection and development of our team members. Our management structure is designed to strike the right balance between consistent execution of operational excellence and nurturing a leader's capacity for entrepreneurial decision making. Our learning and development system allows for all club positions to receive training on the key elements of their role as well as development training for growth. We believe a critical component to our growth is our ability to leverage internally-developed management talent.

Our business is divided into regional operating lines with each reporting to a regional vice president. Reporting to the regional vice presidents are regionally-based functional support teams as well as district managers who are responsible for executing the Company's operating plan within a group of clubs. Reporting to the district managers are the individual club general managers who are responsible for the day-to-day management of each club. At each level of responsibility, compensation is structured to incent driving the member experience and profitability.

*Functional Support.* Functional teams provide technical expertise and support designed to drive the member experience and revenue growth in specific areas of our clubs' services, including sales and marketing, fitness and ancillary programming, learning and development as well as facility management and member service.