

TOWN SPORTS INTERNATIONAL HOLDINGS INC  
Form 10-Q  
November 02, 2015  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2015

or

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

For the Transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 001-36803

TOWN SPORTS INTERNATIONAL HOLDINGS, INC.  
(Exact name of Registrant as specified in its charter)

Delaware  
(State or other Jurisdiction of  
Incorporation or Organization)  
5 Penn Plaza (4th Floor)  
New York, New York 10001  
Telephone: (212) 246-6700

20-0640002  
(I.R.S. Employer  
Identification Number)

(Address, zip code, and telephone number, including area code, of registrant's principal executive office.)

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

Indicate by check mark whether the registrant 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 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 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.:

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

As of October 27, 2015, there were 24,879,897 shares of Common Stock of the registrant outstanding.



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FORM 10-Q

For the Quarter Ended September 30, 2015

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CONDENSED CONSOLIDATED BALANCE SHEETS

September 30, 2015 and December 31, 2014

(All figures in thousands except share and per share data)

(Unaudited)

|  | September 30,<br>2015 | December 31,<br>2014 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$88,286              | \$93,452             |
| Accounts receivable (less allowance for doubtful accounts of \$2,814 and \$2,511 as of September 30, 2015 and December 31, 2014, respectively)     | 2,428                 | 3,656                |
| Inventory  | 456                   | 573                  |
| Deferred tax assets  | 533                   | 724                  |
| Prepaid corporate income taxes   | 9,843                 | 11,588               |
| Prepaid expenses and other current assets  | 15,809                | 12,893               |
| Total current assets   | 117,355               | 122,886              |
| Fixed assets, net  | 206,255               | 233,644              |
| Goodwill   | 1,055                 | 32,593               |
| Intangible assets, net   | 182                   | 394                  |
| Deferred tax assets  | 217                   | —                    |
| Deferred membership costs  | 4,443                 | 7,396                |
| Other assets   | 12,454                | 12,920               |
| Total assets   | \$341,961             | \$409,833            |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>   |                       |                      |
| Current liabilities:   |                       |                      |
| Current portion of long-term debt  | \$3,114               | \$3,114              |
| Accounts payable   | 5,422                 | 2,873                |
| Accrued expenses   | 28,927                | 26,702               |
| Accrued interest   | 129                   | 376                  |
| Dividends payable  | 173                   | 291                  |
| Deferred revenue   | 43,657                | 36,950               |
| Deferred tax liabilities   | 229                   | 300                  |
| Total current liabilities  | 81,651                | 70,606               |
| Long-term debt   | 295,394               | 296,757              |
| Building financing arrangement   | 83,900                | 83,400               |
| Dividends payable  | 123                   | 211                  |
| Deferred lease liabilities   | 52,292                | 53,847               |
| Deferred tax liabilities   | 577                   | 11,999               |
| Deferred revenue   | 1,571                 | 2,455                |
| Other liabilities  | 10,343                | 8,642                |
| Total liabilities  | 525,851               | 527,917              |
| Commitments and Contingencies (Note 12)  |                       |                      |
| Stockholders' deficit:   |                       |                      |
| Preferred stock, \$0.001 par value; no shares issued and outstanding at both September 30, 2015 and December 31, 2014                              |                       |                      |
| Common stock, \$0.001 par value; issued and outstanding 24,879,897 and 24,322,249 shares at September 30, 2015 and December 31, 2014, respectively | 24                    | 24                   |

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|   |           |            |   |
|---|-----------|------------|---|
| Additional paid-in capital                                | (8,586    | ) (10,055  | ) |
| Accumulated other comprehensive (loss) income             | (923      | ) 395      | ) |
| Accumulated deficit                                       | (174,405  | ) (108,448 | ) |
| Total stockholders' deficit                               | (183,890  | ) (118,084 | ) |
| Total liabilities and stockholders' deficit               | \$341,961 | \$409,833  | ) |
| See notes to condensed consolidated financial statements. |           |            |   |

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three and Nine Months Ended September 30, 2015 and 2014

(All figures in thousands except share and per share data)

(Unaudited)

|  | Three Months Ended September 30, |            | Nine Months Ended September 30, |             |
|--|----------------------------------|------------|---------------------------------|-------------|
|  | 2015                             | 2014       | 2015                            | 2014        |
| Revenues:  |                                  |            |                                 |             |
| Club operations  | \$102,119                        | \$110,956  | \$318,748                       | \$339,600   |
| Fees and other   | 1,645                            | 1,565      | 4,736                           | 4,521       |
|  | 103,764                          | 112,521    | 323,484                         | 344,121     |
| Operating Expenses:  |                                  |            |                                 |             |
| Payroll and related  | 42,889                           | 43,994     | 135,886                         | 133,329     |
| Club operating   | 49,280                           | 46,664     | 151,386                         | 144,877     |
| General and administrative   | 6,696                            | 7,813      | 23,144                          | 23,600      |
| Depreciation and amortization  | 12,190                           | 11,638     | 36,042                          | 35,289      |
| Impairment of fixed assets   | 12,420                           | —          | 14,571                          | 4,513       |
| Impairment of goodwill   | —                                | —          | 31,558                          | 137         |
|  | 123,475                          | 110,109    | 392,587                         | 341,745     |
| Operating (loss) income  | (19,711)                         | ) 2,412    | (69,103)                        | ) 2,376     |
| Interest expense   | 5,204                            | 4,519      | 15,562                          | 13,927      |
| Equity in the earnings of investees and rental income                | (571)                            | ) (580)    | ) (1,761)                       | ) (1,820)   |
| Loss before benefit for corporate income taxes                       | (24,344)                         | ) (1,527)  | ) (82,904)                      | ) (9,731)   |
| Benefit for corporate income taxes                                   | (2,338)                          | ) (660)    | ) (17,066)                      | ) (4,430)   |
| Net loss   | \$(22,006)                       | ) \$(867)  | ) \$(65,838)                    | ) \$(5,301) |
| Basic and diluted loss per share                                     | \$(0.89)                         | ) \$(0.04) | ) \$(2.68)                      | ) \$(0.22)  |
| Weighted average number of shares used in calculating loss per share | 24,654,267                       | 24,301,677 | 24,554,390                      | 24,251,682  |
| Dividends declared per common share                                  | \$—                              | \$—        | \$—                             | \$0.32      |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For the Three and Nine Months Ended September 30, 2015 and 2014

(All figures in thousands)

(Unaudited)

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|----------|------------------------------------|------------|
|  | 2015                                | 2014     | 2015                               | 2014       |
| Statements of Comprehensive Loss:  |                                     |          |                                    |            |
| Net loss   | \$(22,006 )                         | \$(867 ) | \$(65,838 )                        | \$(5,301 ) |
| Other comprehensive (loss) income, net of tax:   |                                     |          |                                    |            |
| Foreign currency translation adjustments, net of tax of \$0 for each of<br>the three and nine months ended September 30, 2015 and 2014   | (238 )                              | (364 )   | (44 )                              | (253 )     |
| Interest rate swap, net of tax of \$0 for each of the three and nine<br>months ended September 30, 2015 and 2014, respectively, and (\$333)<br>and \$193 for the comparable prior-year periods | (558 )                              | 433      | (1,274 )                           | (250 )     |
| Total other comprehensive (loss) income, net of tax  | (796 )                              | 69       | (1,318 )                           | (503 )     |
| Total comprehensive loss   | \$(22,802 )                         | \$(798 ) | \$(67,156 )                        | \$(5,804 ) |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2015 and 2014

(All figures in thousands)

(Unaudited)

|   | Nine Months Ended September |            |
|---|-----------------------------|------------|
|   | 30,                         |            |
|   | 2015                        | 2014       |
| Cash flows from operating activities:   |                             |            |
| Net loss  | \$(65,838                   | ) \$(5,301 |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                             |            |
| Depreciation and amortization   | 36,042                      | 35,289     |
| Impairment of fixed assets  | 14,571                      | 4,513      |
| Impairment of goodwill  | 31,558                      | 137        |
| Amortization of debt discount   | 972                         | 978        |
| Amortization of debt issuance costs   | 588                         | 443        |
| Amortization of building financing costs  | 95                          | —          |
| Non-cash rental income, net of non-cash rental expense                          | (2,694                      | ) (4,913   |
| Share-based compensation expense  | 1,187                       | 1,563      |
| Net change in deferred taxes  | (11,519                     | ) (23,567  |
| Net change in certain operating assets and liabilities                          | 12,961                      | (10,172    |
| Decrease in deferred membership costs   | 2,953                       | 930        |
| Landlord contributions to tenant improvements                                   | 296                         | 1,302      |
| Increase in insurance reserves  | 689                         | 760        |
| Other   | 340                         | (60        |
| Total adjustments   | 88,039                      | 7,203      |
| Net cash provided by operating activities                                       | 22,201                      | 1,902      |
| Cash flows from investing activities:   |                             |            |
| Capital expenditures  | (24,073                     | ) (29,196  |
| Change in restricted cash   | (1,100                      | ) —        |
| Net cash used in investing activities   | (25,173                     | ) (29,196  |
| Cash flows from financing activities:   |                             |            |
| Proceeds from building financing arrangement                                    | 500                         | 83,400     |
| Principal payments on 2013 Term Loan Facility                                   | (2,335                      | ) (3,160   |
| Debt issuance costs   | (350                        | ) (2,437   |
| Cash dividends paid   | (82                         | ) (7,666   |
| Redemption paid pursuant to the Rights Plan                                     | (246                        | ) —        |
| Proceeds from stock option exercises  | 282                         | 47         |
| Tax benefit from restricted stock vesting                                       | —                           | 1,692      |
| Net cash (used in) provided by financing activities                             | (2,231                      | ) 71,876   |
| Effect of exchange rate changes on cash   | 37                          | (229       |
| Net (decrease) increase in cash and cash equivalents                            | (5,166                      | ) 44,353   |
| Cash and cash equivalents beginning of period                                   | 93,452                      | 73,598     |
| Cash and cash equivalents end of period   | \$88,286                    | \$117,951  |
| Summary of the change in certain operating assets and liabilities:              |                             |            |
| Decrease (increase) in accounts receivable                                      | \$943                       | \$(44      |
| Decrease (increase) in inventory  | 118                         | (90        |
| Increase in prepaid expenses and other current assets                           | (781                        | ) (1,496   |



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|  |          |           |   |
|--|----------|-----------|---|
| Increase (decrease) in accounts payable, accrued expenses and accrued interest | 5,052    | (4,612    | ) |
| Change in prepaid corporate income taxes and corporate income taxes payable    | 1,806    | (6,166    | ) |
| Increase in deferred revenue   | 5,823    | 2,236     |   |
| Net change in certain working capital components                               | \$12,961 | \$(10,172 | ) |
| Supplemental disclosures of cash flow information:                             |          |           |   |
| Cash payments for interest, net of capitalized interest                        | \$12,981 | \$12,741  |   |
| Cash payments for income taxes   | \$88     | \$23,552  |   |
| See notes to condensed consolidated financial statements.                      |          |           |   |

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands except share and per share data)

(Unaudited)

1. Basis of Presentation

As of September 30, 2015, Town Sports International Holdings, Inc. (the “Company” or “TSI Holdings”), through its wholly-owned subsidiary, Town Sports International, LLC (“TSI, LLC”), operated 153 fitness clubs (“clubs”) and three BFX Studio locations. The clubs are composed of 105 clubs in the New York metropolitan market under the “New York Sports Clubs” brand name, 27 clubs in the Boston market under the “Boston Sports Clubs” brand name, 13 clubs (two of which are partly-owned) in the Washington, D.C. market under the “Washington Sports Clubs” brand name, five clubs in the Philadelphia market under the “Philadelphia Sports Clubs” brand name and three clubs in Switzerland. The condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed consolidated financial statements should be read in conjunction with the Company’s December 31, 2014 consolidated financial statements and notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. The year-end condensed consolidated balance sheet data included within this Form 10-Q was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (“US GAAP”). Certain information and footnote disclosures that are normally included in financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to SEC rules and regulations. The information reflects all normal and recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods set forth herein. The results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results for the entire year ending December 31, 2015.

Change in Estimated Average Membership Life

The Company completed the introduction of a new pricing model to a substantial majority of its clubs in the second quarter of 2015. As of September 30, 2015, approximately 80% of its clubs were operating under this new pricing model, with the remaining clubs principally comprising the Company's passport-only model. Prior to introducing this model, the Company tracked membership life of restricted members (primarily students and teachers) separately from unrestricted members. The Restricted Membership was discontinued as clubs transitioned and therefore the Company now aggregates all members for purposes of tracking average membership life. For the three and nine months ended September 30, 2015 and the full-year ended December 31, 2014, the average membership life was 22 months. The Company monitors factors that might affect the estimated average membership life including retention trends, attrition trends, membership sales volumes, membership composition, competition, and general economic conditions, and adjusts the estimate as necessary on a quarterly basis.

Initiation and processing fees, as well as related direct and incremental expenses of membership acquisition, which include sales commissions, bonuses and related taxes and benefits, are currently deferred and recognized, on a straight-line basis, in operations over the estimated average membership life or 12 months to the extent these costs are related to the first annual fee paid at the time of enrollment. Annual fees are amortized over 12 months.

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2. Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-03, “Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs”.

This standard changes the presentation of debt issuance costs in the financial statements to present such costs as a direct deduction from the related debt liability rather than as an asset. Amortization of debt issuance costs will be reported as interest expense. In August 2015, the FASB issued ASU No. 2015-15, “Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements”. ASU 2015-15 clarifies that the U.S. Securities Exchange and Commission would not object to the deferral and presentation of debt issuance costs as an asset and subsequent amortization of debt issuance costs over the term of the line-of-credit arrangement, whether or there are any outstanding borrowings on the line-of-credit arrangement. These standards are effective for annual reporting periods beginning after December 15, 2015. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

In April 2015, the FASB issued ASU No. 2015-05, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 35-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement.” This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If an arrangement includes a software license, the accounting for the license will be consistent with licenses of other intangible assets. If the arrangement does not include a license, the arrangement will be accounted for as a service contract. ASU 2015-05 is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the effect this standard will have on its financial statements.

In January 2015, the FASB issued ASU No. 2015-01, “Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.” This guidance eliminates the concept of extraordinary items from GAAP. As a result, an entity will no longer be required to segregate extraordinary items from the results of ordinary operations, to separately present an extraordinary item on its income statement, net of tax, after income from continuing operations or to disclose income taxes and earnings-per-share data applicable to an extraordinary item. However, the ASU does not affect the reporting and disclosure requirements for an event that is unusual in nature or infrequent in occurrence. This guidance is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

In November 2014, the FASB issued ASU No. 2014-16, “Derivatives and Hedging” (Topic 815): “Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity, which provides guidance on identifying whether the nature of the host contract in a hybrid instrument is in the form of debt or equity”. This standard requires management to consider the stated and implied substantive terms and features of the hybrid financial instrument, including the embedded derivative features, in order to determine whether the nature of the host contract is more akin to debt or to equity. The ASU is effective for annual periods and interim periods with those annual periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

In August 2014, the FASB issued ASU No. 2014-15, “Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern.” The standard requires management to evaluate, at each annual and interim reporting period, the Company’s ability to continue as a going concern within one year of the date the financial statements are issued and provide related disclosures. This accounting guidance is effective for the Company on a prospective basis for the annual period ending December 31, 2016 and is not expected to have a material effect on its financial statements.

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In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers". The standard provides a single, comprehensive revenue recognition model for all contracts with customers and supersedes current revenue recognition guidance. The revenue standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The new standard also includes enhanced disclosures which are significantly more comprehensive than those in existing revenue standards. In August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers" (Topic 606): "Deferral of the Effective Date", which defers the effective date of ASU No. 2014-09 for all entities by one year, to annual reporting periods beginning after December 15, 2017. Early adoption will be permitted for annual reporting periods beginning after December 15, 2016. The standard allows for either "full retrospective" adoption, meaning the standard is applied to all of the periods presented, or "modified retrospective" adoption, meaning the standard is applied only to the most current period presented in the financial statements. The Company is evaluating the impact of this standard on its financial statements.

## 3. Long-Term Debt

|   | September 30, 2015 | December 31, 2014 |
|---|--------------------|-------------------|
| 2013 Term Loan Facility outstanding principal balance | \$305,949          | \$308,284         |
| Less: Unamortized discount                            | (7,441             | ) (8,413          |
| Less: Current portion due within one year             | (3,114             | ) (3,114          |
| Long-term portion                                     | \$295,394          | \$296,757         |

## 2013 Senior Credit Facility

On November 15, 2013, TSI, LLC, an indirect, wholly-owned subsidiary, entered into a \$370,000 senior secured credit facility ("2013 Senior Credit Facility"), among TSI, LLC, TSI Holdings II, LLC, a newly-formed, wholly-owned subsidiary of the Company ("Holdings II"), as a Guarantor, the lenders party thereto, Deutsche Bank AG, as administrative agent, and Keybank National Association, as syndication agent. The 2013 Senior Credit Facility consists of a \$325,000 term loan facility maturing on November 15, 2020 ("2013 Term Loan Facility") and a \$45,000 revolving loan facility maturing on November 15, 2018 ("2013 Revolving Loan Facility"). Proceeds from the 2013 Term Loan Facility of \$323,375 were issued, net of an original issue discount ("OID") of 0.5%, or \$1,625. Debt issuance costs recorded in connection with the 2013 Senior Credit Facility were \$5,119 and are being amortized as interest expense and are included in other assets in the accompanying condensed consolidated balance sheets. The Company also recorded additional debt discount of \$4,356 related to creditor fees. The proceeds from the 2013 Term Loan Facility were used to pay off amounts outstanding under the Company's previously outstanding long-term debt facility originally entered into on May 11, 2011 (as amended from time to time), and to pay related fees and expenses. None of the revolving loan facility was drawn upon as of the closing date on November 15, 2013, but loans under the 2013 Revolving Loan Facility may be drawn from time to time pursuant to the terms of the 2013 Senior Credit Facility. The borrowings under the 2013 Senior Credit Facility are guaranteed and secured by assets and pledges of capital stock by Holdings II, TSI, LLC, and, subject to certain customary exceptions, the wholly-owned domestic subsidiaries of TSI, LLC.

Borrowings under the 2013 Term Loan Facility and the 2013 Revolving Loan Facility, at TSI, LLC's option, bear interest at either the administrative agent's base rate plus 2.5% or a LIBOR rate adjusted for certain additional costs (the "Eurodollar Rate") plus 3.5%, each as defined in the 2013 Senior Credit Facility. With respect to the outstanding initial term loans, the Eurodollar Rate has a floor of 1.00% and the base rate has a floor of 2.00%. Commencing with the last business day of the quarter ended March 31, 2014, TSI, LLC is required to pay 0.25% of the principal amount of the term loans each quarter, which may be reduced by voluntary prepayments. As of September 30, 2015, TSI LLC has made a total of \$19,051 in principal payments on the 2013 Term Loan Facility.

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The terms of the 2013 Senior Credit Facility provide for a financial covenant in the situation where the total utilization of the revolving loan commitments (other than letters of credit up to \$5,500 at any time outstanding) exceeds 25% of the aggregate amount of those commitments. In such event, TSI, LLC is required to maintain a total leverage ratio, as defined in the 2013 Senior Credit Facility, of no greater than 4.50:1.00. While not subject to the total leverage ratio covenant as of September 30, 2015 as the Company's only utilization of the 2013 Revolving Loan Facility as of September 30, 2015 was \$2,850 of issued and outstanding letters of credit thereunder, because the Company's total leverage ratio as of September 30, 2015 was in excess of 4.50:1.00, the Company is currently not able to utilize more than 25% of the 2013 Revolving Loan Facility. The Company will continue not to be able to utilize more than 25% of the 2013 Revolving Loan Facility until it has a total leverage ratio of no greater than 4.50:1.00. The 2013 Senior Credit Facility also contains certain affirmative and negative covenants, including covenants that may limit or restrict TSI, LLC and Holdings II's ability to, among other things, incur indebtedness and other liabilities; create liens; merge or consolidate; dispose of assets; make investments; pay dividends and make payments to shareholders; make payments on certain indebtedness; and enter into sale leaseback transactions, in each case, subject to certain qualifications and exceptions. In addition, at any time when the total leverage ratio is greater than 4.50:1.00, there are additional limitations on the ability of TSI, LLC and Holdings II to, among other things, make certain distributions of cash to TSI Holdings. The 2013 Senior Credit Facility also includes customary events of default (including non-compliance with the covenants or other terms of the 2013 Senior Credit Facility) which may allow the lenders to terminate the commitments under the 2013 Revolving Loan Facility and declare all outstanding term loans and revolving loans immediately due and payable and enforce its rights as a secured creditor.

TSI, LLC may prepay the 2013 Term Loan Facility and 2013 Revolving Loan Facility without premium or penalty in accordance with the 2013 Senior Credit Facility. Mandatory prepayments are required relating to certain asset sales, insurance recovery and incurrence of certain other debt and commencing in 2015 in certain circumstances relating to excess cash flow (as defined) for the prior fiscal year, as described below, in excess of certain expenditures. Pursuant to the terms of the 2013 Senior Credit Facility, the Company is required to apply net proceeds in excess of \$30,000 from sales of assets in any fiscal year towards mandatory prepayments of outstanding borrowings. In connection with the sale of the East 86th Street property, accounted for as a building financing arrangement, described in Note 5 – Building Financing Arrangement, the Company received approximately \$43,500 in net sales proceeds (after taxes, before giving effect to utilization of net operating losses and carryforwards) during the third quarter of 2014. Accordingly, the Company made a mandatory prepayment of \$13,500 on the 2013 Term Loan Facility in November 2014. In connection with this mandatory prepayment, during the year ended December 31, 2014, the Company recorded loss on extinguishment of debt of \$493, consisting of the write-off of unamortized debt issuance costs and debt discount of \$119 and \$374, respectively. To the extent the proceeds of the sale of the East 86th Street property are not reinvested, the Company may be required to use such amounts, other than amounts used in 2014 to repay debt, to pay down its outstanding debt, as provided under the terms of its 2013 Senior Credit Facility. Based on increased capital expenditures related to the building of new clubs and new BFX Studio locations, the Company does not expect to be required to make a payment at any time. In addition, the 2013 Senior Credit Facility contains provisions that require excess cash flow payments, as defined, to be applied against outstanding 2013 Term Loan Facility balances. The excess cash flow is calculated annually for each fiscal year ending December 31 and paid 95 days after the fiscal year end. The applicable excess cash flow repayment percentage is applied to the excess cash flow when determining the excess cash flow payment. Earnings, changes in working capital and capital expenditure levels all impact the determination of any excess cash flow. The applicable excess cash flow repayment percentage is 50% when the total leverage ratio, as defined in the 2013 Senior Credit Facility, exceeds or is equal to 2.50:1.00; 25% when the total leverage ratio is greater than or equal to 2.00:1.00 but less than 2.50:1.00 and 0% when the total leverage ratio is less than 2.00:1.00. The first excess cash flow payment would have been due in April 2015. The excess cash flow calculation performed as of December 31, 2014 did not result in any required payments in April 2015. The second excess cash flow payment is due in April 2016, if applicable. Based on the Company's unit growth projection and capital expenditures related to club renovations, the building of new clubs and new BFX Studio locations, together with its operating forecast, the Company does not expect there will be an excess cash flow payment required at that

time.

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As of September 30, 2015, the 2013 Term Loan Facility has a gross principal balance of \$305,949 and a balance of \$298,508 net of unamortized debt discount of \$7,441 which is comprised of the unamortized portions of the OID recorded in connection with the May 11, 2011 debt issuance and the unamortized balance of the additional debt discounts recorded in connection with the first amendment and second amendment to the 2011 Senior Credit Facility. The unamortized debt discount balance is recorded as a contra-liability to long-term debt on the accompanying condensed consolidated balance sheet and is being amortized as interest expense using the effective interest method. As of September 30, 2015, the unamortized balance of debt issuance costs of \$3,127 is being amortized as interest expense, and is included in other assets in the accompanying condensed consolidated balance sheets.

As of September 30, 2015, there were no outstanding 2013 Revolving Loan Facility borrowings and outstanding letters of credit issued totaled \$2,850. The unutilized portion of the 2013 Revolving Loan Facility as of September 30, 2015 was \$42,150 and the available unutilized portion, based on the Company's total leverage ratio exceeding 4.50:1.00, was \$11,250.

On January 30, 2015, the 2013 Senior Credit Facility was amended (the "Amendment") to permit TSI Holdings to purchase term loans under the Credit Agreement. Any term loans purchased by TSI Holdings will be cancelled. The Company may from time to time purchase term loans in market transactions, privately negotiated transactions or otherwise; however the Company is under no obligation to make any such purchases. Any such transactions, and the amounts involved, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

**Fair Market Value**

Based on quoted market prices, the 2013 Term Loan Facility had a fair value of approximately \$183,569 and \$221,964 at September 30, 2015 and December 31, 2014, respectively, and is classified within level 2 of the fair value hierarchy. Level 2 is based on quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. The fair value for the Company's 2013 Term Loan Facility is determined using observable current market information such as the prevailing Eurodollar interest rate and Eurodollar yield curve rates and includes consideration of counterparty credit risk.

For the fair market value of the Company's interest rate swap instrument refer to Note 4 — Derivative Financial Instruments.

**4. Derivative Financial Instruments**

In its normal operations, the Company is exposed to market risks relating to fluctuations in interest rates. In order to minimize the possible negative impact of such fluctuations on the Company's cash flows the Company may enter into derivative financial instruments ("derivatives"), such as interest-rate swaps. Derivatives are not entered into for trading purposes and the Company only uses commonly traded instruments. Currently, the Company has used derivatives solely relating to the variability of cash flows from interest rate fluctuations.

The Company originally entered into an interest rate swap arrangement on July 13, 2011 in connection with the Company's previous credit facility. Effective as of November 15, 2013, the closing date of the 2013 Senior Credit Facility, the interest rate swap arrangement had a notional amount of \$160,000 and will mature on May 15, 2018. The swap effectively converts \$160,000 of the \$325,000 total variable-rate debt under the 2013 Senior Credit Facility to a fixed rate of 5.384%, when including the applicable 3.50% margin. As permitted by FASB Accounting Standards Codification ("ASC") 815, Derivatives and Hedging, the Company has designated this swap as a cash flow hedge, the effects of which have been reflected in the Company's condensed consolidated financial statements as of and for the three and nine months ended September 30, 2015 and 2014. The objective of this hedge is to manage the variability of cash flows in the interest payments related to the portion of the variable-rate debt designated as being hedged.

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When the Company's derivative instrument was executed, hedge accounting was deemed appropriate and it was designated as a cash flow hedge at inception with re-designation being permitted under ASC 815, Derivatives and Hedging. Interest rate swaps are designated as cash flow hedges for accounting purposes since they are being used to transform variable interest rate exposure to fixed interest rate exposure on a recognized liability (debt). On an ongoing basis, the Company performs a quarterly assessment of the hedge effectiveness of the hedge relationship and measures and recognizes any hedge ineffectiveness in the condensed consolidated statements of operations. For the three and nine months ended September 30, 2015 and 2014, hedge ineffectiveness was evaluated using the hypothetical derivative method. There was no hedge ineffectiveness for the three and nine months ended September 30, 2015 and 2014.

Accounting guidance on fair value measurements specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1—Quoted prices for identical instruments in active markets.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The fair value for the Company's interest rate swap is determined using observable current market information such as the prevailing Eurodollar interest rate and Eurodollar yield curve rates and include consideration of counterparty credit risk. The following table presents the aggregate fair value of the Company's derivative financial instrument:

|   | Total<br>Fair Value | Fair Value Measurements Using:   |  |   |
|---|---------------------|--|--|---|
|   |                     | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Other<br>Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Interest rate swap liability as of September 30, 2015 | \$2,568             | \$—  | \$2,568  | \$—   |
| Interest rate swap liability as of December 31, 2014  | \$1,294             | \$—  | \$1,294  | \$—   |

The swap contract liability of \$2,568 and \$1,294 are recorded as a component of other liabilities as of September 30, 2015 and December 31, 2014, respectively, with the offset to accumulated other comprehensive income (\$1,451 and \$1,215, net of taxes, as of September 30, 2015 and December 31, 2014, respectively) on the accompanying condensed consolidated balance sheet.

There were no significant reclassifications out of accumulated other comprehensive income during the three and nine months ended September 30, 2015 and 2014 and the Company does not expect that significant derivative losses included in accumulated other comprehensive income at September 30, 2015 will be reclassified into earnings within the next 12 months.



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## 5. Building Financing Arrangement

On September 12, 2014, the Company completed the legal sale of its property (building and land) on East 86th Street, New York City, to an unaffiliated third-party for gross proceeds of \$85,650, which includes \$150 of additional payments to the Company. Concurrent with the closing of the transaction, the Company leased back the portion of the property comprising its health club. The Company expects to lease (“Initial Lease”) the premises to at least March 2016 and then, upon at least 120 days notice from the purchaser/landlord, the Initial Lease will terminate and the Company will vacate the property while the purchaser/landlord demolishes the existing building and the adjacent building and builds a new luxury, high-rise multi-use building. In connection with vacating the property, the Company intends to enter into a new lease (“New Club Lease”) for approximately 24,000 square feet in the new building for the purpose of operating a health club upon completion of construction by the purchaser/landlord. The term of the Initial Lease is 10 years, and at the end of this initial term, the Company has two options at its sole discretion to renew the lease; the first for an additional 10 year period and a second for an additional five year period (although the Company expects that the purchaser/landlord will exercise its right to early terminate the Initial Lease so that it may commence the construction of the new building). Under the Initial Lease (and New Club Lease if entered into), the purchaser/landlord has agreed to pay the Company liquidated damages if the new club is not available by a certain date. The latest date that the liquidated damages would begin to be paid would be April 13, 2020 and would continue until the new club is available. For accounting purposes, the nature of these potential liquidated damages constitutes continuing involvement with the purchaser/landlord’s development of the property. As a result of this continuing involvement, the sale-leaseback transaction is currently required to be accounted for as a financing arrangement rather than as a completed sale. Under this treatment, the Company has included the proceeds received as a financing arrangement on its balance sheet. Except for payments under the Initial Lease and the New Club Lease, the Company does not expect to make any cash payments to the purchaser/landlord with respect to the building financing arrangement. The Company recorded a taxable (for federal and state income tax purposes) gain on the sale of the property and made estimated tax payments in September 2014 in this regard. In March 2015, the Company received the remaining proceeds held in escrow of \$500, which was included in the Company’s cash flow statement for the nine months ended September 30, 2015 as a financing cash inflow.

As of September 30, 2015, the total financing arrangement was \$83,900, which is net of \$1,750 held in escrow for the Company’s former tenant. Because the transaction is characterized as a financing for accounting purposes rather than a sale, the rental payments and related transaction costs are treated as interest on the financing arrangement. As these interest amounts are less than the interest that would be charged under a typical financing, the financing is characterized as an interest only financing with no reduction in the principal throughout the Initial Lease term until any continuing involvement has ceased. Until such time, even though the Company no longer has legal title to the building and the land, the building, building improvements and land remain on the Company’s consolidated balance sheet and the building and building improvements will continue to be depreciated over their remaining useful lives. Similarly, the Company does not have a loan or borrowing arrangement with the purchaser/landlord but the building financing arrangement will remain on the Company’s balance sheet until any continuing involvement has ceased.

As of September 30, 2015, the net book value of the building and building improvements was \$2,865 and the book value of the land was \$986. As part of the transaction, the Company incurred \$3,160 of real property transfer taxes, broker fees and other costs which will be deferred and amortized over the term of the Initial Lease of 25 years, which includes the option periods. The net fees are recorded in Other assets on the accompanying condensed consolidated balance sheets as of September 30, 2015 and December 31, 2014.

Payments made under the Initial Lease, including rental income related to the Company’s tenant in the building that was assigned to the purchaser/landlord, are recognized as interest expense in the underlying financing arrangement. Included in the table below is the Company’s future lease commitment of \$750 per year under the remaining term of the Initial Lease, which includes the options periods and will be recorded as interest expense.

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|                                |          |
|--------------------------------|----------|
| 12 months ending September 30, |          |
| 2016                           | \$750    |
| 2017                           | 750      |
| 2018                           | 750      |
| 2019                           | 750      |
| 2020                           | 750      |
| 2021 and thereafter            | 14,208   |
| Minimum lease commitments      | \$17,958 |

Not included in the table above are the cash rent portion of rental income related to the Company's former tenant in the building ranging between \$1,883 and \$2,617 per year through March 2028 and the amortization of the deferred costs of \$126 per year through September 2039, and such amounts will be recorded as interest expense (unless the purchaser/landlord exercises its right to terminate the lease before the end of the 10-year Initial Lease).

#### 6. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and the interest rate swap. Although the Company deposits its cash with more than one financial institution, as of September 30, 2015, \$75,558 of the cash balance of \$88,286 was held at two financial institutions. The Company has not experienced any losses on cash and cash equivalent accounts to date, and the Company believes that, based on the credit ratings of these financial institutions, it is not exposed to any significant credit risk related to cash at this time.

The counterparty to the Company's interest rate swap is a major banking institution with a credit rating of investment grade or better and no collateral is required, and there are no significant risk concentrations. The Company believes the risk of incurring losses on derivative contracts related to credit risk is unlikely.

#### 7. Loss Per Share

Basic earnings (loss) per share ("EPS") is computed by dividing net earnings (loss) applicable to common stockholders by the weighted average numbers of shares of common stock outstanding during the period. Diluted EPS is computed similarly to basic EPS, except that the denominator is increased for the assumed exercise of dilutive stock options and unvested restricted stock calculated using the treasury stock method.

For the three and nine months ended September 30, 2015 and 2014, there was no effect of dilutive stock options and unvested restricted common stock on calculation of diluted EPS as the Company had a net loss for these periods. As a result, the Company reported basic and diluted loss per share of \$0.89 and \$2.68 for the three and nine months ended September 30, 2015, respectively, and \$0.04 and \$0.22 for the comparable prior-year periods. If the Company had not been in a net loss position, there would have been anti-dilutive shares of 807,228 and 329,847 in the three and nine months ended September 30, 2015, respectively, and 366,417 and 383,956 in the comparable prior-year periods.

#### 8. Stock-Based Compensation

The Company's 2006 Stock Incentive Plan, as amended and restated (the "2006 Plan") in May 2008, authorizes the Company to issue up to 3,000,000 shares of common stock to employees, non-employee directors and consultants pursuant to awards of stock options, stock appreciation rights, restricted stock, in payment of performance shares or other stock-based awards. In April 2015, the Company further amended the 2006 Plan to increase the aggregate number of shares of Common Stock issuable under the 2006 Plan by 500,000 shares to a total of 3,500,000.

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Under the 2006 Plan, stock options must be granted at a price not less than the fair market value of the stock on the date the option is granted, generally are not subject to re-pricing, and will not be exercisable more than ten years after the date of grant. Options granted under the 2006 Plan generally qualify as “non-qualified stock options” under the U.S. Internal Revenue Code. Certain options granted under the Company’s 2004 Common Stock Option Plan, as amended (the “2004 Plan”), generally qualified as “incentive stock options” under the U.S. Internal Revenue Code; the exercise price of a stock option is equal to the fair market value of the Company’s common stock on the option grant date. As of September 30, 2015, there were 702,352 shares available to be issued under the 2006 Plan.

At September 30, 2015, the Company had no stock options outstanding under the 2004 Plan while the 2006 Plan had 849,866 stock options outstanding and 324,243 shares of restricted stock outstanding.

Effective December 31, 2014, the Company’s Board of Directors adopted a stockholder rights plan (the “Rights Plan”). Pursuant to the Rights Plan, the Board of Directors declared a dividend distribution of one preferred share right (a “Right”) for each share of Common Stock held as of January 12, 2015. Each Right entitled the holder to purchase one one-thousandth of a share of Series A Junior Participating Preferred Stock (the “Preferred Shares”) at an initial exercise price of \$15, subject to certain adjustments. On March 24, 2015, the Company entered into a nomination and standstill agreement (the “Nomination and Standstill Agreement”). Pursuant to the Nomination and Standstill Agreement, the Company agreed to redeem, effective immediately, the rights issued pursuant to the Rights Plan. Pursuant to the terms of the Rights Plan, the Company paid a redemption price to the holders of the rights equal to \$0.01 per right in cash, or \$246, on April 20, 2015.

**Stock Option Awards**

On August 19, 2015, the Company granted an award of non-qualified options to purchase 250,000 shares of its common stock to its Chief Operating Officer (“COO”) under the Company’s 2006 Plan. In addition to awards granted under the 2006 Plan, the Company granted its COO an award of non-qualified options to purchase 450,000 shares (“Non-Plan Options”) of its common stock. These Non-Plan Options were granted outside of any shareholder-approved plan as an inducement to accept employment with the Company. The options granted on August 19, 2015 shall vest in three equal installments on each of the first three anniversaries of the date of grant and have a term of five years. These options have an exercise price of \$2.61 per share, equal to the closing price of the Company’s common stock on the date of grant.

The Company calculated the expected term of stock options to be 3.50 years, which represents the period of time that options are expected to be outstanding. The risk free interest rate for periods within the contractual life of the option is based on the U.S. treasury yield in effect at the time of grant. The volatility is determined based on management’s estimate or historical volatilities of comparable companies.

The estimated fair value of the options as of the grant date was \$0.98 per underlying share. The fair value of the stock option award is estimated on the grant date using the Black-Scholes option pricing model with the following assumptions:

| Grant Date      | Risk-free Interest Rate | Expected Dividend Yield | Expected Term (Years) | Expected Volatility |
|-----------------|-------------------------|-------------------------|-----------------------|---------------------|
| August 19, 2015 | 1.05                    | % —                     | % 3.50                | 50.70 %             |

Total compensation cost, classified within payroll and related on the condensed consolidated statements of operations, related to stock options outstanding was \$28 for both the three and nine months ended September 30, 2015, versus \$61 and \$273 for the comparable prior-year periods.

As of September 30, 2015, a total of \$647 in unrecognized compensation expense related to stock options is expected to be recognized over a weighted-average period of 2.9 years.

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## Restricted Stock Awards

On August 19, 2015, the Company issued 300,000 shares of restricted stock to its COO (“Non-Plan RSA”). These Non-Plan RSA were granted outside of any shareholder-approved plan as an inducement to accept employment with the Company. The fair value of the Non-Plan RSA was \$2.61 per share, representing the closing stock price on the date of grant. These shares will vest in three equal installments on each of the first three anniversaries of the date of grant.

On March 2, 2015, the Company issued 207,000 shares of restricted stock to employees under the 2006 Plan. The fair value for these awards was \$6.68 per share, representing the closing stock price on the date of grant. These shares will vest 25% per year over four years on the anniversary dates of the respective grants.

The total compensation expense, classified within payroll and related on the condensed consolidated statements of operations, related to restricted stock was \$186 and \$714 for the three and nine months ended September 30, 2015, respectively, versus \$369 and \$1,045 for the comparable prior-year periods. In the three months ended September 30, 2015, the Company adjusted the forfeiture estimates to reflect actual forfeitures. The actual forfeitures experienced in the third quarter of 2015 differ from the Company's previous estimate mainly due to the termination of one of its executive management level employees in August 2015. The impact of forfeiture adjustment reduced stock-based compensation expense by \$191 for the three months ended September 30, 2015.

As of September 30, 2015, a total of \$2,175 in unrecognized compensation expense related to restricted stock awards is expected to be recognized over a weighted-average period of 2.8 years.

## Stock Grants

In the nine months ended September 30, 2015, the Company issued shares of common stock to members of the Company's Board of Directors in respect of their annual retainer. The total fair value of the shares issued was expensed upon the date of grant. The total compensation expense, classified within general and administrative expenses, related to Board of Director common stock grants was \$445 and \$245 for the nine months ended September 30, 2015 and 2014, respectively. There was no compensation expense related to Board of Director common stock grants for the three months ended September 30, 2015 and 2014.

Total shares issued to members of the Company's Board of Directors during the nine months ended September 30, 2015 were:

| Grant Date       | Number of Shares | Price Per Share | Aggregate Grant Date Fair Value |
|------------------|------------------|-----------------|---------------------------------|
| February 2, 2015 | 35,764           | \$6.85          | \$245                           |
| March 24, 2015   | 31,845           | \$6.28          | \$200                           |

## 9. Fixed Asset Impairment

Fixed assets are evaluated for impairment periodically whenever events or changes in circumstances indicate that related carrying amounts may not be recoverable from undiscounted cash flows in accordance with FASB guidance. The Company's long-lived assets and liabilities are grouped at the individual club level, which is the lowest level for which there are identifiable cash flows. To the extent that estimated future undiscounted net cash flows attributable to the assets are less than the carrying amount, an impairment charge equal to the difference between the carrying value of such asset and their fair values is recognized.

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In the three months ended September 30, 2015, the Company tested its underperforming clubs and recorded an impairment charge of \$12,420 on leasehold improvements and furniture and fixtures at nine clubs that experienced decreased profitability and sales levels below expectations during this period. This charge was recorded within the Traditional Clubs segment. The remaining clubs tested that did not have impairment charges had an aggregate of \$22,712 of net leasehold improvements and furniture and fixtures remaining as of September 30, 2015. The Company will continue to monitor the results and changes in expectations of these clubs closely during the remainder of 2015 to determine if additional fixed asset impairment charges will be necessary.

In the nine months ended September 30, 2015, the Company recorded a total of \$14,571 fixed asset impairment charges compared to impairment charges of \$4,513 in the nine months ended September 30, 2014. The fixed asset impairment charges are included as a component of operating expenses in a separate line on the condensed consolidated statements of operations.

In determining the recoverability of fixed assets, Level 3 inputs were used in determining undiscounted cash flows, which are based on internal budgets and forecasts through the end of the life of the primary asset in the asset group which is normally the life of leasehold improvements. The most significant assumptions in those budgets and forecasts relate to estimated membership and ancillary revenue, attrition rates, estimated results related to new program launches and maintenance capital expenditures, which are generally estimated at approximately 3% to 5% of total revenues depending upon the conditions and needs of a given club. The fair value of fixed assets evaluated for impairment is determined considering a combination of a market approach and a cost approach.

10. Goodwill and Other Intangibles

Goodwill has been allocated to reporting units that closely reflect the regions served by the Company's four trade names: New York Sports Clubs ("NYSC"), Boston Sports Clubs ("BSC"), Washington Sports Clubs ("WSC") and Philadelphia Sports Clubs ("PSC"), with certain more remote clubs that do not benefit from a regional cluster being considered single reporting units ("Outlier Clubs"), the Company's three clubs located in Switzerland being considered a single reporting unit ("SSC"), and our BFX Studio ("BFX Studio"). As of September 30, 2015, only the SSC region has a remaining goodwill balance.

The Company's annual goodwill impairment test is performed on the last day of February, or more frequently, should circumstances change which would indicate the fair value of goodwill is below its carrying amount. The determination as to whether a triggering event exists that would warrant an interim review of goodwill and whether a write-down of goodwill is necessary involves significant judgment based on short-term and long-term projections of the Company. As a result of the significant decrease in market capitalization and a decline in the Company's current performance primarily due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates, the Company performed an interim impairment test as of May 31, 2015.

The Company's current year annual goodwill impairment test as of February 28, 2015 and the interim test performed as of May 31, 2015 were performed using the two-step goodwill impairment analysis. Step 1 involves comparing the fair value of the Company's reporting units to their carrying amounts. If the estimated fair value of the reporting unit is greater than its carrying amount, there is no requirement to perform step two of the impairment test, and there is no impairment. If the reporting unit's carrying amount is greater than the estimated fair value, the second step must be completed to measure the amount of impairment, if any. Step 2 calculates the implied fair value of goodwill by deducting the estimated fair value of all tangible and intangible assets, excluding goodwill, of the reporting unit from the estimated fair value of the reporting unit as determined in Step 1. The implied fair value of goodwill determined in this step is compared to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment charge is recognized equal to the difference.

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As a result of the May 31, 2015 interim impairment test, the Company concluded that there would be no remaining implied fair value of goodwill attributable to the NYSC and BSC regions. Accordingly, in June 2015, the Company wrote off \$31,558 of goodwill associated with these reporting units. The Company did not have a goodwill impairment charge in the SSC region as a result of the interim test given the profitability of this unit. The February 28, 2015 annual impairment test supported the recorded goodwill balance and as such no impairment of goodwill was required. The February 28, 2014 annual impairment test resulted in a goodwill impairment charge of \$137 associated with the Outlier Clubs in the nine months ended September 30, 2014.

For the May 31, 2015 and February 28, 2015 impairment tests, fair value was determined by using a weighted combination of two market-based approaches (weighted 50% collectively) and an income approach (weighted 50%), as this combination was deemed to be the most indicative of the Company's fair value in an orderly transaction between market participants. Under the market-based approaches, the Company utilized information regarding the Company, the Company's industry as well as publicly available industry information to determine earnings multiples and sales multiples that are used to value the Company's reporting units. Under the income approach, the Company determined fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn, which are unobservable Level 3 inputs, and taking into account the firm offer. The discounted estimates of future cash flows include significant management assumptions such as revenue growth rates, operating margins, weighted average cost of capital, and future economic and market conditions. The estimated weighted-average cost of capital of NYSC and SSC were 9.2% and 11.2% as of May 31, 2015, respectively, compared to 13.3% and 13.9% as of February 28, 2015. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and operating margins, discount rates and future market conditions, among others. These assumptions were determined separately for each reporting unit. The Company believes its assumptions are reasonable, however, there can be no assurance that the Company's estimates and assumptions made for purposes of the Company's goodwill impairment testing as of May 31, 2015 and February 28, 2015 will prove to be accurate predictions of the future. If the Company's assumptions regarding forecasted revenue or margin growth rates of certain reporting units are not achieved, the Company may be required to record goodwill impairment charges in future periods, whether in connection with the Company's next annual impairment testing or prior to that, if any such change constitutes a triggering event outside the quarter when the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment charge would result. The estimated fair value of SSC was greater than book value by 65% as of May 31, 2015 and 84% as of February 28, 2015.

Solely for purposes of establishing inputs for the fair value calculation described above related to goodwill impairment testing, the Company made the following assumptions. The Company developed long-range financial forecasts (three years) for all reporting units and assumed known changes in the existing club base. Terminal growth rates were calculated for years beyond the five year forecast. As of May 31, 2015, the Company used discount rates ranging from 8.2% to 11.2% and terminal growth rates ranging from 1.0% to 3.0%. As of February 28, 2015, the Company used discount rates ranging from 13.2% to 13.9% and terminal growth rates ranging from 0.5% to 3.0%. These assumptions are developed separately for each reporting unit.

The Company's next annual impairment test will be performed as of February 28, 2016 or earlier, if any such change constitutes a triggering event outside the quarter when the annual goodwill impairment test is performed. The Company determined a triggering event did not occur in the three months ended September 30, 2015.

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The changes in the carrying amount of goodwill from December 31, 2014 through September 30, 2015 are detailed in the charts below.

|   | NYSC     | BSC  | SSC     | Outlier<br>Clubs | Total    |
|---|----------|------|---------|------------------|----------|
| Goodwill, net of accumulated amortization                     | \$31,549 | \$9  | \$1,035 | \$137            | \$32,730 |
| Less: accumulated impairment of goodwill                      | —        | —    | —       | (137             | ) (137   |
| Balance as of December 31, 2014                               | 31,549   | 9    | 1,035   | —                | 32,593   |
| Changes due to foreign currency exchange rate<br>fluctuations | —        | —    | 20      | —                | 20       |
| Less: impairment of goodwill                                  | (31,549  | ) (9 | ) —     | —                | (31,558  |
| Balance as of September 30, 2015                              | \$—      | \$—  | \$1,055 | \$—              | \$1,055  |

Amortization expense was \$11 and \$213 for the three and nine months ended September 30, 2015, respectively, versus \$128 and \$385 for the comparable prior-year periods. Intangible assets are as follows:

|                      | As of September 30, 2015 |                             |                          |
|----------------------|--------------------------|-----------------------------|--------------------------|
|                      | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Intangible<br>Assets |
| Membership lists     | \$11,344                 | \$(11,344                   | ) \$—                    |
| Management contracts | 250                      | (102                        | ) 148                    |
| Trade names          | 40                       | (6                          | ) 34                     |
|                      | \$11,634                 | \$(11,452                   | ) \$182                  |
|                      | As of December 31, 2014  |                             |                          |
|                      | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Intangible<br>Assets |
| Membership lists     | \$11,344                 | \$(11,163                   | ) \$181                  |
| Management contracts | 250                      | (73                         | ) 177                    |
| Trade names          | 40                       | (4                          | ) 36                     |
|                      | \$11,634                 | \$(11,240                   | ) \$394                  |

#### 11. Income Taxes

For the nine months ended September 30, 2015, the Company recorded an income tax benefit of \$17,066 inclusive of valuation allowance compared with an income tax benefit of \$4,430 for the nine months ended September 30, 2014, reflecting an effective income tax rate of 21% for the nine months ended September 30, 2015 and 46% for the nine months ended September 30, 2014. For the nine months ended September 30, 2015 and 2014, the Company has determined its income tax benefit on a discrete basis since the potential impact of fluctuations in the Company's forecast may have a significant impact on the estimated annual effective tax rate.

As of September 30, 2015 and December 31, 2014, the Company had a net deferred tax liability of \$61 and \$11,576, respectively. The state net deferred tax liability was \$17 and \$3,274 as of September 30, 2015 and December 31, 2014, respectively. As of September 30, 2015 and December 31, 2014, the Company maintained a full valuation allowance against its U.S. net deferred tax assets.

As of September 30, 2015 and December 31, 2014, the Company had \$1,187 of unrecognized tax benefits and it is reasonably possible that the entire amount could be realized by the Company in the year ending December 31, 2015 since the income tax returns may no longer be subject to audit in 2015.

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The following state and local jurisdictions are currently examining the Company's respective income tax returns for the years indicated: New York State (2006 through 2011) and New York City (2006 through 2011). On April 9, 2015, the Company received a "no change" letter from the Commonwealth of Massachusetts for the periods ended December 31, 2009 and 2010. On March 26, 2014, the Company received from the State of New York a revised assessment related to tax years 2006-2009 in the amount of \$3,500, inclusive of \$1,174 of interest. In a letter dated June 1, 2015, the Company has requested a meeting with New York State Department of Finance and Taxation to resolve the examination. This meeting is scheduled to be held in early 2016. The Company continues to evaluate the merits of the proposed assessment as new information becomes available during continued discussions with the State of New York. The Company has not recorded a tax reserve related to the proposed assessment. It is difficult to predict the final outcome or timing of resolution of any particular matter regarding these examinations; however, it may be reasonably possible that one or more of these examinations may result in a change in the reserve for uncertain tax positions over the next twelve months.

### 12. Commitments and Contingencies

On February 7, 2007, in an action styled *White Plains Plaza Realty, LLC v. TSI, LLC et al.*, the landlord of one of TSI, LLC's former health and fitness clubs filed a lawsuit in state court against it and two of its health club subsidiaries alleging, among other things, breach of lease in connection with the decision to close the club located in a building owned by the plaintiff and leased to a subsidiary of TSI, LLC, the tenant, and take additional space in a nearby facility leased by another subsidiary of TSI, LLC. Following a determination of an initial award, which TSI, LLC and the tenant have paid in full, the landlord appealed the trial court's award of damages, and on August 29, 2011, an additional award (amounting to approximately \$900) (the "Additional Award"), was entered against the tenant, which has recorded a liability. Separately, TSI, LLC is party to an agreement with a third-party developer, which by its terms provides indemnification for the full amount of any liability of any nature arising out of the lease described above, including attorneys' fees incurred to enforce the indemnity. As a result, the developer reimbursed TSI, LLC and the tenant the amount of the initial award in installments over time and also agreed to be responsible for the payment of the Additional Award, and the tenant has recorded a receivable related to the indemnification for the Additional Award. The developer and the landlord are currently litigating the payment of the Additional Award and judgment was entered against the developer on June 5, 2013 in the amount of approximately \$1,045, plus interest, which judgment was upheld by the appellate court on April 29, 2015. TSI, LLC does not believe it is probable that TSI, LLC will be required to pay for any amount of the Additional Award.

On or about October 4, 2012, in an action styled *James Labbe, et al. v. Town Sports International, LLC*, plaintiff commenced a purported class action in New York State court on behalf of personal trainers employed in New York State. Labbe is seeking unpaid wages and damages from TSI, LLC and alleges violations of various provisions of the New York State labor law with respect to payment of wages and TSI, LLC's notification and record-keeping obligations. The Court has bifurcated class and merits discovery. The deadline for the completion of pre-class certification document discovery was December 31, 2014. On June 12, 2015, the plaintiff made a motion for class certification. On July 24, 2015, the court indefinitely adjourned the plaintiff's motion for class certification to allow the court to first decide a motion for sanctions by TSI, LLC against Labbe. TSI, LLC made that motion for sanctions on June 30, 2015. The motion seeks dismissal of Labbe's complaint, and reimbursement of certain of TSI, LLC's legal fees, on the ground that Labbe has not complied with his discovery obligations and the court's discovery orders. TSI, LLC's motion for sanctions remains pending. TSI, LLC has proposed a settlement offer and the parties are working towards a resolution of this matter. If the parties are unsuccessful in these settlement negotiations, TSI, LLC intends to continue to contest this case vigorously.

In addition to the litigation discussed above, the Company is involved in various other lawsuits, claims and proceedings incidental to the ordinary course of business, including personal injury, employee relations claims and landlord tenant disputes. The results of litigation are inherently unpredictable. Any claims against the Company, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in diversion of significant resources. The results of these other lawsuits, claims and proceedings cannot be predicted with certainty. The Company establishes accruals for loss contingencies when it has



determined that a loss is probable and that the amount of loss, or range of loss, can be reasonably estimated. Any such accruals are adjusted thereafter as appropriate to reflect changes in circumstances. The Company concluded that an accrual for any such matters is not required as of September 30, 2015.

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## 13. Reportable Segments

The Company's operating segments are New York Sports Clubs, Boston Sports Clubs, Philadelphia Sports Clubs, Washington Sports Clubs, Swiss Sports Clubs and BFX Studio, which is the level at which the chief operating decision makers review discrete financial information and make decisions about segment profitability based on earnings before income tax depreciation and amortization. The Company has historically determined that these clubs have similar economic characteristics and meet the criteria which permit them to be aggregated into one reportable segment. During the fourth quarter of 2014, BFX Studio started to be managed separately and reported as a separate reportable segment as it does not meet the aggregation criteria to be aggregated with the clubs. Geographically, the Company operates its fitness clubs mainly in the United States. Segment information on geographic regions is not material for presentation.

The following tables set forth the Company's financial performance by reportable segment for the three and nine months ended September 30, 2015 and 2014.

|                | Three Months Ended September<br>30, |            | Nine Months Ended September<br>30, |            |
|----------------|-------------------------------------|------------|------------------------------------|------------|
|                | 2015                                | 2014       | 2015                               | 2014       |
| Revenues:      |                                     |            |                                    |            |
| Clubs          | \$ 103,075                          | \$ 112,419 | \$ 321,875                         | \$ 344,019 |
| BFX Studio     | 689                                 | 102        | 1,609                              | 102        |
| Total Revenues | \$ 103,764                          | \$ 112,521 | \$ 323,484                         | \$ 344,121 |

The Company presents earnings (loss) before interest expense (net of interest income), provision (benefit) for corporate income taxes, and depreciation and amortization ("EBITDA") as the primary measure of profit and loss for its operating segments in accordance with FASB guidance for segment reporting. Clubs EBITDA includes all corporate overhead expenses and the impact of equity in the earnings of investees and rental income. In the three and nine months ended September 30, 2015, BFX Studio reported EBITDA loss of \$856 and \$2,896, respectively, and \$1,060 and \$2,624, respectively, for the comparable prior-year periods, primarily reflecting the rent and occupancy costs, start-up costs and overhead payroll for the Company's three BFX Studio locations opened in September 2014, March 2015 and June 2015, and one other studio location under development.

|  | Three Months Ended September<br>30, |            | Nine Months Ended September<br>30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2015                                | 2014       | 2015                               | 2014       |
| EBITDA:  |                                     |            |                                    |            |
| Clubs  | \$(6,094 )                          | \$ 15,690  | \$(28,404 )                        | \$ 42,109  |
| BFX Studio                                     | (856 )                              | (1,060 )   | (2,896 )                           | (2,624 )   |
| Total reportable segments                      | (6,950 )                            | 14,630     | (31,300 )                          | 39,485     |
| Depreciation and amortization                  | 12,190                              | 11,638     | 36,042                             | 35,289     |
| Interest expense                               | 5,204                               | 4,519      | 15,562                             | 13,927     |
| Loss before benefit for corporate income taxes | \$(24,344 )                         | \$(1,527 ) | \$(82,904 )                        | \$(9,731 ) |
|  | Three Months Ended<br>September 30, |            | Nine Months Ended September<br>30, |            |
|  | 2015                                | 2014       | 2015                               | 2014       |
| Capital Expenditures:                          |                                     |            |                                    |            |
| Clubs  | \$ 5,468                            | \$ 11,594  | \$ 17,267                          | \$ 25,536  |
| BFX Studio                                     | 1,812                               | 1,414      | 6,806                              | 3,660      |
| Total Capital Expenditures                     | \$ 7,280                            | \$ 13,008  | \$ 24,073                          | \$ 29,196  |

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14. Separation Obligation

In March 2015, Robert Giardina's employment with the Company as Executive Chairman was terminated.

Mr. Giardina continues to serve as a member of the Board and will be treated as a non-employee director. Pursuant to a letter agreement entered with Mr. Giardina in February 2015, Mr. Giardina was entitled to receive payment of \$1,100 in accordance with the terms of the agreement, which has been placed by the Company in a Rabbi Trust, and the Company accrued an additional \$208 of payroll taxes and medical benefits related to this agreement. These amounts were classified within payroll and related as well as general and administrative on the condensed consolidated statements of operations for the nine months ended September 30, 2015. Of the \$1,100 separation obligation, \$679 was paid in April 2015, \$140 was paid in September 2015 and the remaining balance of \$281 will be paid over a 12-month period beginning October 2015. The \$281 remaining separation obligation was included in Prepaid expenses and other current assets on the accompanying condensed consolidated balance sheets as of September 30, 2015. The \$281 is classified as restricted cash as of September 30, 2015 and is restricted in its use as noted above.

In June 2015, Daniel Gallagher's employment with the Company as Chief Executive Officer and President was terminated. Pursuant to a letter agreement entered with Mr. Gallagher in June 2015, Mr. Gallagher received payment of \$150 in June 2015, and is entitled to receive severance payment of \$550, payable over a 12-month period beginning July 2015. The Company also accrued an additional \$76 of payroll taxes and medical benefits related to this agreement. These amounts were classified within payroll and related on the condensed consolidated statements of operations for the nine months ended September 30, 2015. Of the \$550 severance payment, \$138 was paid in the third quarter of 2015 and the remaining balance of \$412 was included in Accrued Expenses on the accompanying condensed consolidated balance sheets as of September 30, 2015.

In connection with Mr. Gallagher's termination, the Company's Board of Directors named Patrick Walsh, then Chairman of the Board of the Company, to serve as Executive Chairman, on an interim basis, in which capacity Mr. Walsh is responsible for the general management and control of the affairs and business of the Company while the Board of Directors conducts a search for the Company's next Chief Executive Officer. In exchange for his service as Executive Chairman, Mr. Walsh is entitled to receive compensation of \$30 per month, payable from June 19, 2015. In the three and nine months ended September 30, 2015, the Company incurred compensation expense of \$90 and \$101, respectively, to Mr. Walsh in connection with this arrangement.

In September 2015, Paul Barron's employment with the Company as Chief Information Officer was terminated. Pursuant to a letter agreement entered with Mr. Barron in February 2015, Mr. Barron will receive payments totaling \$402 with \$83 payable in December 2015, and \$319 payable over a 12-month period beginning December 2015. The Company also accrued an additional \$44 of payroll taxes and medical benefits related to this agreement. These amounts were classified within payroll and related on the condensed consolidated statements of operations for the three and nine months ended September 30, 2015, and were included in accrued expenses on the condensed consolidated balance sheets as of September 30, 2015.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

In this Form 10-Q, unless otherwise stated or the context otherwise indicates, references to "Town Sports," "TSI," "the Company," "we," "our" and similar references refer to Town Sports International Holdings, Inc. and its subsidiaries, references to "TSI Holdings" refers to Town Sports International Holdings, Inc., and references to "TSI, LLC" refer to Town Sports International, LLC, our wholly-owned operating subsidiary.

Based on the number of clubs, we are one of the leading owners and operators of fitness clubs in the Northeast and Mid-Atlantic regions of the United States and one of the largest fitness club owners and operators in the United States. As of September 30, 2015, the Company, through its subsidiaries, operated 153 fitness clubs ("clubs") and three BFX Studio locations. Our clubs collectively served approximately 534,000 members as of September 30, 2015. We owned and operated a total of 105 clubs under the "New York Sports Clubs" brand name within a 120-mile radius of New York City as of September 30, 2015, including 37 locations in Manhattan where we are the largest fitness club owner and operator. We owned and operated 27 clubs in the Boston region under our "Boston Sports Clubs" brand name, 13 clubs (two of which are partly-owned) in the Washington, D.C. region under our "Washington Sports Clubs" brand name and five clubs in the Philadelphia region under our "Philadelphia Sports Clubs" brand name as of September 30, 2015. In addition, we owned and operated three clubs in Switzerland as of September 30, 2015. 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 develop clusters of clubs to serve densely populated major metropolitan regions and we service such populations by clustering clubs near the highest concentrations of our target customers' areas of both employment and residence. Our clubs are located for maximum convenience to our members in urban or suburban areas, close to transportation hubs or office or retail centers. Our members include a wide age demographic covering the student market to the active mature market. In each of our markets, we have developed clusters by initially opening or acquiring clubs located in the more central urban markets of the region and then branching out from these urban centers to suburbs and neighboring communities.

In the second quarter of 2015, we completed the introduction of a new low price model to a substantial majority of our clubs. As of September 30, 2015, approximately 80% of our clubs were operating under this new pricing model, with the remaining clubs principally comprised of our passport-only model. Monthly dues at the clubs under the new pricing model are offered at reduced prices and advertising cost were initially increased. These clubs offer the same level of service and amenities as our traditional clubs but at a lower price point giving us an opportunity to recapture market share and compete against low cost gyms that have opened in our markets. We believe our offerings are more compelling than other low cost operators because we include exciting group exercise classes, top of the line equipment, pools and courts with price of certain memberships, when available.

The clubs under the new pricing model are expected to experience continued earnings pressure in the near-term related to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates. The effect of existing members opting for lower dues and new members enrolling at lower rates have only partially been offset by an increase in membership sales volume. Our total member count increased 14,000 to 534,000 in the three months ended September 30, 2015 compared to a decrease of 9,000 in the same prior-year period. In the nine months ended September 30, 2015, our total member count increased 55,000 compared to a decrease of 18,000 in the nine months ended September 30, 2014. We continue to consider pricing adjustments in order to increase revenue while also driving membership growth.

We completed the conversion from our internally developed Club Management legacy system to a third-party developed software system. This conversion resulted in a one-time adjustment to our historical legacy member count of approximately 5,000 members. We believe this adjustment was non-revenue generated and therefore no impact on our consolidated financial statements.

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Due to the rise in popularity of private studio offerings, we introduced our BFX Studio brand in 2014. We currently have three BFX Studio locations and expect to open one additional location in early 2016. This three-dimension luxury studio brand takes advantage of the rise in consumer demand for studio experiences. BFX Studio includes three unique offerings: Ride Republic, which is indoor cycling, Private Sessions for personal training and Master Class for certain group exercise classes. BFX Studio is staffed with high caliber instructors in each of the three core offerings and the studios are designed to appeal to all ages and all experience levels of metropolitan, active healthy lifestyles. This studio concept requires approximately 9,000 to 12,000 square feet of space per studio which compares to the approximately 26,000 square feet aggregate average size of our clubs.

Revenue and operating expenses

We have two principal sources of revenue:

Membership revenue: Our largest sources of revenue are dues inclusive of monthly membership fees, annual maintenance fees, initiation and processing fees paid by our members. In addition, we collect usage fees on a per visit basis for non-passport members using non-home clubs. These dues and fees comprised 76.0% of our total revenue for the nine months ended September 30, 2015. We recognize revenue from membership dues in the month when the services are rendered. Approximately 98% of our members pay their monthly dues by Electronic Funds Transfer, or EFT, while the balance is paid annually in advance. We recognize revenue from initiation and processing fees over the estimated average membership life and annual fees over a twelve month period.

Ancillary club revenue: For the nine months ended September 30, 2015, we generated 17.1% of our revenue from personal training and 5.4% of our revenue from other ancillary programs and services consisting of BFX Studio classes, programming for children, Small Group Training and other member activities, as well as sales of miscellaneous sports products. We continue to grow ancillary club revenue by building on ancillary programs such as our personal training membership product and our fee-based Small Group Training programs.

We also receive revenue (approximately 1.5% of our total revenue for the nine months ended September 30, 2015) from the rental of space in our facilities to operators who offer wellness-related offerings, such as physical therapy and juice bars. In addition, we sell in-club advertising and sponsorships and generate management fees from certain club facilities that we do not wholly own. We also collect laundry related revenue for the laundering of towels for third parties. We refer to these revenues as Fees and other revenue.

In September 2014, we completed the legal sale of our East 86th Street property to an unaffiliated third-party, which housed one of our New York Sports Clubs as well as our former retail tenant that generated rental income for us. Because the transaction is characterized for accounting purposes as a financing rather than a sale, the rental payments are treated as interest on the financing arrangement. Further, we will continue to account for the rental income from this former retail tenant until the tenant's lease is terminated. Rental income from this former retail tenant was approximately \$1.5 million for each of the nine months ended September 30, 2015 and 2014. Refer to Note 5 - Building Financing Arrangement to our condensed consolidated financial statements.

Our performance is dependent in part on our ability to continually attract and retain members at our clubs. In the three months ended September 30, 2015 and 2014, our monthly average attrition rate was 4.4% and 4.0%, respectively. Our operating and selling expenses are comprised of both fixed and variable costs. Fixed costs include club and supervisory and other salary and related expenses, occupancy costs, including most elements of rent, utilities, housekeeping and contracted maintenance expenses, as well as depreciation. Variable costs are primarily related to payroll associated with ancillary club revenue, membership sales compensation, advertising, certain facility repairs and club supplies.

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General and administrative expenses include costs relating to our centralized support functions, such as accounting, insurance, information and communication systems, purchasing, member relations, legal and consulting fees and real estate development expenses. Payroll and related expenses are included in a separate line item on the condensed consolidated statements of operations and are not included in general and administrative expenses. Approximately 40% of general and administrative expenses relate directly to club operations including phone and data lines, computer maintenance, business licenses, office and sales supplies, general liability insurance, recruiting and training. As clubs mature and increase their membership base, fixed costs are typically spread over an increasing revenue base and operating margins tend to improve. Conversely, when our membership base declines, our operating margins are negatively impacted.

As of September 30, 2015, 151 of our fitness clubs were wholly-owned by us and our condensed consolidated financial statements include the operating results of all such clubs. Two locations in Washington, D.C. were partly-owned and operated by us, with our profit sharing percentages approximating 20% (after priority distributions) and 45%, respectively, and are treated as unconsolidated affiliates for which we apply the equity method of accounting. In addition, we provide management services at private fitness locations where we do not have an equity interest which include three fitness clubs located in colleges and universities and eight managed sites.

**Historical Club Count**

The following table sets forth the changes in our club count during each of the quarters in 2014, the full-year 2014, and the first, second and third quarters of 2015.

|  | 2014 |     |      |      |           | 2015 |      |      |
|--|------|-----|------|------|-----------|------|------|------|
|  | Q1   | Q2  | Q3   | Q4   | Full Year | Q1   | Q2   | Q3   |
| Wholly owned clubs operated at beginning of period | 160  | 160 | 161  | 156  | 160       | 156  | 156  | 152  |
| New clubs opened                                   | —    | 1   | —    | 3    | 4         | 1    | —    | —    |
| Clubs closed, relocated or merged                  | —    | —   | (5 ) | (3 ) | (8 )      | (1 ) | (4 ) | (1 ) |
| Wholly owned clubs at end of period                | 160  | 161 | 156  | 156  | 156       | 156  | 152  | 151  |
| Total clubs operated at end of period (1) (2)      | 162  | 163 | 158  | 158  | 158       | 158  | 154  | 153  |

Includes wholly-owned and partly-owned clubs. Not included in the total club count are locations that are managed (1) by us in which we do not have an equity interest. These managed sites include three fitness clubs located in colleges and universities and eight managed sites.

(2) Excludes three BFX Studio locations.

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## Comparable Club Revenue

We define comparable club revenue as revenue at those clubs that were operated by us for over 12 months and comparable club revenue increase (decrease) as revenue for the 13th month and thereafter as applicable as compared to the same period of the prior year.

Key determinants of comparable club revenue decreases shown in the table below are new memberships, member retention rates, pricing and ancillary revenue increases (decreases).

|                         | 2014    |         |         |         | 2015    |         |         |  |
|-------------------------|---------|---------|---------|---------|---------|---------|---------|--|
|                         | Q1      | Q2      | Q3      | Q4      | Q1      | Q2      | Q3      |  |
| Comparable club revenue | (4.7 )% | (4.5 )% | (4.5 )% | (3.9 )% | (3.5 )% | (5.4 )% | (7.1 )% |  |

The comparable club revenue declines experienced in 2014 are primarily due to the impact of membership declines. We experienced an overall member loss of 13,000 in the year ended December 31, 2014. The decline in comparable club revenue for the nine months ended September 30, 2015 is mainly driven by lower membership revenue due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates under our new pricing model. The effect of existing members opting for lower dues and new members enrolling at lower rates was only partially offset by an increase in membership sales volume. In the nine months ended September 30, 2015, our total member count increased 55,000 compared to a decrease of 18,000 in the nine months ended September 30, 2014. We continue to consider pricing adjustments in order to increase revenue while also driving membership growth.

## Consolidated Results of Operations

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

|   | Three Months Ended September 30, |         | Nine Months Ended September 30, |         |
|---|----------------------------------|---------|---------------------------------|---------|
|   | 2015                             | 2014    | 2015                            | 2014    |
| Revenue   | 100.0                            | % 100.0 | % 100.0                         | % 100.0 |
| Operating expenses:                                   |                                  |         |                                 |         |
| Payroll and related                                   | 41.3                             | 39.1    | 42.0                            | 38.7    |
| Club operating  | 47.5                             | 41.6    | 46.8                            | 42.1    |
| General and administrative                            | 6.5                              | 6.9     | 7.2                             | 6.9     |
| Depreciation and amortization                         | 11.7                             | 10.3    | 11.1                            | 10.3    |
|   | 107.0                            | 97.9    | 107.1                           | 98.0    |
| Impairment of fixed assets                            | 12.0                             | —       | 4.5                             | 1.3     |
| Impairment of goodwill                                | —                                | —       | 9.8                             | —       |
|   | 12.0                             | —       | 14.3                            | 1.3     |
| Operating (loss) income                               | (19.0 )                          | 2.1     | (21.4 )                         | 0.7     |
| Interest expense                                      | 5.0                              | 4.0     | 4.8                             | 4.0     |
| Equity in the earnings of investees and rental income | (0.5 )                           | (0.5 )  | (0.5 )                          | (0.5 )  |
| Loss before benefit for corporate income taxes        | (23.5 )                          | (1.4 )  | (25.7 )                         | (2.8 )  |
| Benefit for corporate income taxes                    | (2.3 )                           | (0.6 )  | (5.3 )                          | (1.3 )  |
| Net loss  | (21.2 )%                         | (0.8 )% | (20.4 )%                        | (1.5 )% |

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Three Months Ended September 30, 2015 compared to Three Months Ended September 30, 2014  
Revenue (in thousands) was comprised of the following for the periods indicated:

|                                  | Three Months Ended September 30, |           | 2014        |           | % Variance |
|----------------------------------|----------------------------------|-----------|-------------|-----------|------------|
|                                  | 2015                             | % Revenue | Revenue     | % Revenue |            |
| Membership dues                  | \$74,806                         | 72.1      | % \$84,377  | 75.0      | % (11.3 )% |
| Initiation and processing fees   | 3,373                            | 3.2       | 2,886       | 2.6       | 16.9       |
| Membership revenue               | 78,179                           | 75.3      | 87,263      | 77.6      | (10.4 )    |
| Personal training revenue        | 17,868                           | 17.2      | 17,703      | 15.7      | 0.9        |
| Other ancillary club revenue (1) | 6,072                            | 5.9       | 5,990       | 5.3       | 1.4        |
| Ancillary club revenue           | 23,940                           | 23.1      | 23,693      | 21.0      | 1.0        |
| Fees and other revenue (2)       | 1,645                            | 1.6       | 1,565       | 1.4       | 5.1        |
| Total revenue                    | \$103,764                        | 100.0     | % \$112,521 | 100.0     | % (7.8 )%  |

(1) Other ancillary club revenue primarily consists of BFX Studio classes, Small Group Training, Sports Clubs for Kids, and racquet sports.

(2) Fees and other revenue primarily consist of rental income, marketing revenue and management fees.

Revenue decreased \$8.8 million, or 7.8%, in the three months ended September 30, 2015 compared to the same prior-year period, as a result of lower membership revenue partially offset by higher ancillary club revenue. Revenue decreased approximately \$7.7 million at our clubs opened or acquired prior to September 30, 2013 and \$3.1 million at clubs that closed subsequent to September 30, 2013. These decreases were partially offset by a \$2.0 million increase in revenue from our clubs that were opened or acquired subsequent to September 30, 2013.

Membership dues revenue decreased \$9.6 million, or 11.3%, in the three months ended September 30, 2015 compared to the same prior-year period primarily due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates, both as a result of the new pricing model. These decreases were partially offset by an increase in annual fees recognized of \$3.0 million. Beginning in the third quarter of 2014, new memberships charge an annual fee beginning on the first day of membership and on each annual anniversary date thereafter and are deferred and recognized, on a straight-line basis over 12 months. We continue to consider pricing adjustments in order to increase revenue while also driving membership growth.

Initiation and processing fees revenue increased \$487,000, or 16.9%, in the three months ended September 30, 2015 compared to the same prior-year period, primarily reflecting an increased amount of initiation and processing fees under the new pricing model associated with an increase in membership sales volume beginning in the third quarter of 2014. Our total member count increased 14,000 to 534,000 in the three months ended September 30, 2015 compared to a decrease of 9,000 in the same prior-year period. Initiation and processing fees are recognized into revenue over the estimated average membership life.

Personal training revenue increased \$165,000, or 0.9%, in the three months ended September 30, 2015 compared to the same prior-year period, primarily reflecting increased interest on our multi-session personal training membership products and an increase in overall membership level.



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Other ancillary club revenue increased \$82,000, or 1.4% in the three months ended September 30, 2015 compared to the same prior-year period primarily driven by increased revenue from our BFX Studio classes, partially offset by decreased revenue from guest fees as guest fees are no longer charged in most of our clubs.

Comparable club revenue decreased 7.1% in the three months ended September 30, 2015 as compared to the same prior-year period. The price of our membership dues and fees decreased which was partially offset by an increase in memberships at our comparable clubs.

Operating expenses (in thousands) were comprised of the following for the periods indicated:

|                               | Three Months Ended September 30, |           |            |
|-------------------------------|----------------------------------|-----------|------------|
|                               | 2015                             | 2014      | % Variance |
| Payroll and related           | \$42,889                         | \$43,994  | (2.5 )%    |
| Club operating                | 49,280                           | 46,664    | 5.6        |
| General and administrative    | 6,696                            | 7,813     | (14.3 )    |
| Depreciation and amortization | 12,190                           | 11,638    | 4.7        |
| Impairment of fixed assets    | 12,420                           | —         | N/A        |
| Total operating expenses      | \$123,475                        | \$110,109 | 12.1 %     |

Operating expenses increased due to the following factors:

Payroll and related. Payroll and related expenses decreased \$1.1 million, or 2.5%, in the three months ended September 30, 2015 compared to the same prior-year period. Overhead and club expenses decreased \$2.4 million primarily associated with the initial results of our cost savings initiatives, including a headcount reduction. These reductions primarily occurred in September 2015. These decreases were partially offset by severance charges of \$954,000 in the 2015 period, including \$446,000 in separation obligations related to our former Chief Information Officer. (Note 14 - Separate Obligation to our condensed consolidated financial statements). In addition, personal training payroll increased \$307,000, which was related to an increase in personal training revenue.

Club operating. Club operating expenses increased \$2.6 million, or 5.6%, in the three months ended September 30, 2015 compared to the same prior-year period. This increase was principally attributable to the following:

Rent and occupancy expenses increased \$1.8 million in the three months ended September 30, 2015 compared to the same period last year principally due to the following:

Mature clubs expenses increased \$860,000 resulting from rent escalations.

Expenses associated with newly opened and future clubs and BFX Studio locations increased \$221,000.

In the three months ended September 30, 2014, we recognized \$2.9 million of gains related to the reversal of deferred rent in connection with leases terminated early which decreased rent and occupancy expenses in that period.

Offsetting the above increases were savings of \$1.5 million for closed clubs.

Lease termination penalties decreased \$641,000.

Electric utilities expense increased \$694,000 in the three months ended September 30, 2015 compared to the same prior-year period primarily as a result of rate increases, as well as the warmer weather and therefore higher electricity consumption.

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General and administrative. General and administrative expenses decreased \$1.1 million, or 14.3%, in the three months ended September 30, 2015 compared to the same period last year, primarily reflecting the initial results of our cost savings initiatives of \$1.7 million. The decrease was partially offset by increased general liability insurance expenses of \$581,000 associated with an increase in reserves for claims related to prior periods.

Depreciation and amortization. In the three months ended September 30, 2015 compared to the same period last year, depreciation and amortization expense increased \$552,000, or 4.7%, principally due to the addition of new clubs and BFX Studio locations during 2014 and 2015.

Impairment of fixed assets. In the three months ended September 30, 2015, we recorded a total of \$12.4 million fixed asset impairment charges at underperforming clubs. We did not have fixed asset impairment in the three months ended September 30, 2014.

Interest expense

Interest expense increased \$685,000, or 15.2%, in the three months ended September 30, 2015 compared to the same period last year, primarily reflecting the non-cash rental income related to our former tenant at the East 86th Street property. Because the legal sale of our East 86th Street property is characterized for accounting purposes as a financing rather than a sale, rental income related to our former tenant in the building that was assigned to the purchaser/landlord is treated as interest on the financing arrangement. We will continue to account for the rental income from this former retail tenant as interest expense until the tenant's lease is terminated. This was partially offset by a decrease in interest expense due to principal payments made on our 2013 Term Loan Facility.

Benefit for Corporate Income Taxes

We recorded an income tax benefit of \$2.3 million inclusive of valuation allowance and an income tax benefit of \$660,000 for the three months ended September 30, 2015 and 2014, respectively, reflecting an effective income tax rate of 10% for the three months ended September 30, 2015 and 43% for the three months ended September 30, 2014. For the three months ended September 30, 2015 and 2014, we have determined our income tax provision and benefit on a discrete basis since the potential impact of fluctuations in our forecast may have a significant impact on the estimated annual effective tax rate.

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Nine Months Ended September 30, 2015 compared to Nine Months Ended September 30, 2014

Revenue (in thousands) was comprised of the following for the periods indicated:

|                                  | Nine Months Ended September 30, |           | 2014        |           | % Variance |
|----------------------------------|---------------------------------|-----------|-------------|-----------|------------|
|                                  | 2015                            | % Revenue | Revenue     | % Revenue |            |
| Membership dues                  | \$235,185                       | 72.7      | % \$260,571 | 75.7      | % (9.7 )%  |
| Initiation and processing fees   | 10,650                          | 3.3       | 9,080       | 2.7       | 17.3       |
| Membership revenue               | 245,835                         | 76.0      | 269,651     | 78.4      | (8.8 )     |
| Personal training revenue        | 55,527                          | 17.1      | 52,857      | 15.3      | 5.1        |
| Other ancillary club revenue (1) | 17,386                          | 5.4       | 17,092      | 5.0       | 1.7        |
| Ancillary club revenue           | 72,913                          | 22.5      | 69,949      | 20.3      | 4.2        |
| Fees and other revenue (2)       | 4,736                           | 1.5       | 4,521       | 1.3       | 4.8        |
| Total revenue                    | \$323,484                       | 100.0     | % \$344,121 | 100.0     | % (6.0 )%  |

(1) Other ancillary club revenue primarily consists of BFX Studio classes, Small Group Training, Sports Clubs for Kids, and racquet sports.

(2) Fees and other revenue primarily consist of rental income, marketing revenue and management fees.

Revenue decreased \$20.6 million, or 6.0% in the nine months ended September 30, 2015 compared to the same prior-year period, as a result of lower membership revenue partially offset by higher ancillary club revenue. Revenue decreased approximately \$18.0 million at our clubs opened or acquired prior to September 30, 2013 and \$8.8 million at clubs that closed subsequent to September 30, 2013. These decreases were partially offset by a \$6.2 million increase in revenue from our clubs that were opened or acquired subsequent to September 30, 2013.

Membership dues revenue decreased \$25.4 million, or 9.7%, in the nine months ended September 30, 2015 compared to the same prior-year period primarily due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates, both as a result of the new pricing model. These decreases were partially offset by an increase in annual fees recognized of \$6.2 million. Beginning in the third quarter of 2014, new memberships charge an annual fee beginning on the first day of membership and on each annual anniversary date thereafter and are deferred and recognized, on a straight-line basis over 12 months. We continue to consider pricing adjustments in order to increase revenue while also driving membership growth.

Initiation and processing fees revenue increased \$1.6 million, or 17.3%, in the nine months ended September 30, 2015 compared to the same prior-year period, primarily reflecting an increased amount of initiation and processing fees under the new pricing model associated with an increase in membership sales volume. Our total member count increased 55,000 to 534,000 in the nine months ended September 30, 2015 compared to a decrease of 18,000 members in the same prior-year period primarily due to the implementation of the new pricing model. Total initiation and processing fees collected in the nine months ended September 30, 2015 were \$10.0 million compared to \$8.3 million in the same period last year. Initiation and processing fees are recognized into revenue over the estimated average membership life.

Personal training revenue increased \$2.7 million, or 5.1%, in the nine months ended September 30, 2015 compared to the same prior-year period, primarily reflecting an increased interest on our multi-session personal training membership products and an increase in overall membership level.

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Other ancillary club revenue increased \$294,000, or 1.7% in the nine months ended September 30, 2015 compared to the same prior-year period primarily driven by increased revenue from our BFX Studio classes, partially offset by decreased revenue from guest fees as guest fees are no longer charged in most of our clubs.

Comparable club revenue decreased 5.3% in the nine months ended September 30, 2015 as compared to the same prior-year period. The price of our membership dues and fees decreased which was partially offset by an increase in memberships at our comparable clubs.

Operating expenses (in thousands) were comprised of the following for the periods indicated:

|                               | Nine Months Ended September 30, |           |            |   |
|-------------------------------|---------------------------------|-----------|------------|---|
|                               | 2015                            | 2014      | % Variance |   |
| Payroll and related           | \$135,886                       | \$133,329 | 1.9        | % |
| Club operating                | 151,386                         | 144,877   | 4.5        |   |
| General and administrative    | 23,144                          | 23,600    | (1.9)      | ) |
| Depreciation and amortization | 36,042                          | 35,289    | 2.1        |   |
| Impairment of fixed assets    | 14,571                          | 4,513     | >100%      |   |
| Impairment of goodwill        | 31,558                          | 137       | >100%      |   |
| Total operating expenses      | \$392,587                       | \$341,745 | 14.9       | % |

Operating expenses increased due to the following factors:

**Payroll and related.** Payroll and related expenses increased \$2.6 million, or 1.9%, in the nine months ended September 30, 2015 compared to the same prior-year period. Personal training payroll increased \$1.7 million which was related to the increase in personal training revenue. The increase also included \$2.5 million separation obligations related to the departure of certain executive officers and severance charges of \$546,000 associated with certain employees.

These increases were partially offset by decreased overhead expenses and club expenses of \$2.2 million associated with a headcount reduction and other cost savings initiatives. These cost reductions primarily occurred in September 2015, reflecting the initial results of our cost savings initiatives.

**Club operating.** Club operating expenses increased \$6.5 million, or 4.5%, in the nine months ended September 30, 2015 compared to the same prior-year period. This increase was principally attributable to the following:

• **Marketing expenses** increased \$5.0 million in the nine months ended September 30, 2015 compared to the same period in the prior year principally due to increased advertising spend associated with the new pricing model.

• **Rent and occupancy expenses** increased \$2.6 million in the nine months ended September 30, 2015 compared to the same period last year principally due to the following:

Mature clubs expenses increased \$2.5 million resulting from rent escalations.

Expenses associated with newly opened and future clubs and BFX Studio locations had increased \$868,000.

In the nine months ended September 30, 2014, we recognized \$2.9 million of gains related to the reversal of deferred rent in connection with leases terminated early which decreased rent and occupancy expenses in that period.

Lease termination penalties increased \$230,000.

Offsetting the above increases were savings of \$3.6 million for closed clubs.

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General and administrative. General and administrative expenses decreased \$456,000, or 1.9%, in the nine months ended September 30, 2015 compared to the same period last year, primarily reflecting the initial results of our cost savings initiatives of \$1.8 million, partially offset by increased general liability insurance expenses of \$425,000 associated with an increase in reserves for claims related to prior periods. In addition, in 2015 there was an increase in costs of \$200,000 associated with stock awards granted to the new members of the Board of Directors and \$699,000 associated with the changes to our Board of Directors and other related expenses.

Depreciation and amortization. In the nine months ended September 30, 2015 compared to the same period last year, depreciation and amortization expense increased \$753,000, or 2.1%, principally due to the addition of new clubs and BFX Studio locations during 2014 and 2015.

Impairment of fixed assets. In the nine months ended September 30, 2015, we recorded a total of \$14.6 million fixed asset impairment charges compared to \$4.5 million in the nine months ended September 30, 2014 all related to underperforming clubs.

Impairment of goodwill. As a result of the significant decrease in market capitalization and a decline in our current performance primarily due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates, we performed an interim impairment test as of May 31, 2015. We concluded that there would be no remaining implied fair value of goodwill attributable to the NYSC and BSC regions. Accordingly, in June 2015, we wrote off \$31.6 million of goodwill associated with these reporting units. The February 28, 2014 annual impairment test resulted in a goodwill impairment charge of \$137,000 associated with the Outlier Clubs in the nine months ended September 30, 2014.

Interest expense

Interest expense increased \$1.6 million, or 11.7%, in the nine months ended September 30, 2015 compared to the same period last year, primarily reflecting the non-cash rental income related to our former tenant at the East 86th Street property. Because the legal sale of our East 86th Street property is characterized for accounting purposes as a financing rather than a sale, rental income related to our former tenant in the building that was assigned to the purchaser/landlord are treated as interest on the financing arrangement. We will continue to account for the rental income from this former retail tenant as interest expense until the tenant's lease is terminated. This was partially offset by a decrease in interest expense due to principal payments made on our 2013 Term Loan Facility.

Benefit for Corporate Income Taxes

We recorded an income tax benefit of \$17.1 million inclusive of valuation allowance and an income tax benefit of \$4.4 million for the nine months ended September 30, 2015 and 2014, respectively, reflecting an effective income tax rate of 21% for the nine months ended September 30, 2015 and 46% for the nine months ended September 30, 2014. For the nine months ended September 30, 2015 and 2014, we have determined our income tax provision and benefit on a discrete basis since the potential impact of fluctuations in our forecast may have a significant impact on the estimated annual effective tax rate.

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## Segment Results of Operations

The following discussion sets forth our financial performance by reportable segment for the three and nine months ended September 30, 2015 and 2014. We present earnings (loss) before interest expense (net of interest income), provision (benefit) for corporate income taxes, and depreciation and amortization (“EBITDA”) as the primary measure of profit and loss for our operating segments in accordance with FASB guidance for segment reporting.

Clubs (New York Sports Clubs, Boston Sports Clubs, Philadelphia Sports Clubs, Washington Sports Clubs, and Swiss Sports Clubs)

|          | Three Months Ended September 30, |             | Nine Months Ended September 30, |             |
|----------|----------------------------------|-------------|---------------------------------|-------------|
|          | 2015                             | 2014        | 2015                            | 2014        |
| Revenues | \$ 103,075                       | \$ 112,419  | \$ 321,875                      | \$ 344,019  |
| EBITDA   | \$(6,094                         | ) \$ 15,690 | \$(28,404                       | ) \$ 42,109 |

Three Months Ended September 30, 2015 compared to Three Months Ended September 30, 2014

Clubs revenue decreased \$9.3 million, or 8.3%, in the three months ended September 30, 2015 compared to the same prior-year period, mainly driven by lower membership revenue due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates under our new pricing model. The effect of existing members opting for lower dues and new members enrolling at lower rates was only partially offset by an increase in membership sales volume. These decreases were partially offset by an increase in annual fees recognized of \$3.0 million. Our total member count increased 14,000 to 534,000 in the three months ended September 30, 2015 compared to a decrease of 9,000 in the same prior-year period. We continue to consider pricing adjustments in order to increase revenue while also driving membership growth.

In the three months ended September 30, 2015, Clubs had an EBITDA loss of \$6.1 million compared with an EBITDA of \$15.7 million in the three months ended September 30, 2014, primarily reflecting increased fixed asset impairment charges of \$12.4 million and the decline in revenue.

Nine Months Ended September 30, 2015 compared to Nine Months Ended September 30, 2014

Clubs revenue decreased \$22.1 million, or 6.4%, in the nine months ended September 30, 2015 compared to the same prior-year period, mainly driven by lower membership revenue due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates under our new pricing model. The effect of existing members opting for lower dues and new members enrolling at lower rates was only partially offset by an increase in membership sales volume. These decreases were partially offset by an increase in annual fees recognized of \$6.2 million. Our total member count increased 55,000 to 534,000 in the nine months ended September 30, 2015 compared to a decrease of 18,000 members in the same prior-year period. We continue to consider pricing adjustments in order to increase revenue while also driving membership growth.

In the nine months ended September 30, 2015, Clubs had an EBITDA loss of \$28.4 million compared with an EBITDA of \$42.1 million in the nine months ended September 30, 2014, primarily reflecting increased fixed asset and goodwill impairment charges of \$41.5 million and the decline in revenue, as well as increased marketing expenses associated with our new pricing model.

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## BFX Studio

|          | Three Months Ended September |            | Nine Months Ended September |            |
|----------|------------------------------|------------|-----------------------------|------------|
|          | 30,<br>2015                  | 2014       | 30,<br>2015                 | 2014       |
| Revenues | \$689                        | \$102      | \$1,609                     | \$102      |
| EBITDA   | \$(856                       | ) \$(1,060 | ) \$(2,896                  | ) \$(2,624 |

Three Months Ended September 30, 2015 compared to Three Months Ended September 30, 2014

BFX Studio's revenue was \$689,000 in the three months ended September 30, 2015, reflecting revenue of our three BFX Studio locations which opened in September 2014, March 2015 and June 2015. We currently plan to open one additional BFX Studio location in early 2016.

BFX Studio had an EBITDA loss of \$856,000 and \$1.1 million for the three months ended September 30, 2015 and 2014, respectively, primarily reflecting the rent and occupancy costs, start-up costs and overhead payroll for our three BFX Studio locations and one other location with leases executed and development underway.

Nine Months Ended September 30, 2015 compared to Nine Months Ended September 30, 2014

BFX Studio's revenue was \$1.6 million in the nine months ended September 30, 2015, reflecting revenue of our three BFX Studio locations opened in September 2014, March 2015 and June 2015. We currently plan to open one additional BFX Studio location in early 2016.

BFX Studio had an EBITDA loss of \$2.9 million and \$2.6 million for the nine months ended September 30, 2015 and 2014, respectively, primarily reflecting the rent and occupancy costs, start-up costs and overhead payroll for our three BFX Studio locations and one other location with leases executed and development underway.

## Liquidity and Capital Resources

As of September 30, 2015, we had \$88.3 million of cash and cash equivalents. Financial instruments that potentially subject us to concentrations of credit risk consist of cash and cash equivalents. Although we deposit our cash with more than one financial institution, as of September 30, 2015, \$75.6 million was held at two financial institutions. We have not experienced any losses on cash and cash equivalent accounts to date and we do not believe that, based on the credit ratings of the aforementioned institutions, we are exposed to any significant credit risk related to cash at this time.

Historically, we have satisfied our liquidity needs through cash generated from operations and various borrowing arrangements. Principal liquidity needs have included the acquisition and development of new clubs, debt service requirements, and other capital expenditures necessary to upgrade, expand and renovate existing clubs. In March 2014 and June 2014, we paid a cash dividend of \$0.16 per share. Any determination to pay future dividends will be made by the board of directors and will take into account such matters as cash on hand, general economic and business conditions, our strategic plans, our financial results and condition, contractual, legal and regulatory restrictions on the payment of dividends by us and our subsidiaries and such other factors as our board of directors may consider to be relevant. We believe that our existing cash and cash equivalents, cash generated from operations and our existing credit facility will be sufficient to fund capital expenditures, working capital needs and other liquidity requirements associated with our operations through at least the next 12 months.

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Operating Activities. Net cash provided by operating activities for the nine months ended September 30, 2015 increased \$20.3 million compared to the same period last year, primarily related to the total change in cash flow from income taxes of \$31.0 million. Cash paid for income taxes decreased \$23.5 million mainly related to the legal sale of the East 86th Street property in 2014, which was treated as a financing arrangement for accounting purposes, but recognized as of the date of sale for Federal and State income taxes. Additionally, in the 2015 period we received an income tax refund of \$7.5 million. The increase in cash flows also reflected an \$13.5 million increase in cash collected for member enrollment in the nine months ended September 30, 2015 related to an increase in memberships sold. The increase in accrued payroll expenses generated a favorable cash flow variance of \$6.1 million in the nine months ended September 30, 2015 compared to the same period in 2014 principally due to timing differences in payroll payments. The increase in cash flows also reflected the timing of certain payments and collections made associated with our accrued expenses. These increases were partially offset by a decrease in membership dues collected of \$29.0 million in the nine months ended September 30, 2015.

Investing Activities. Net cash used in investing activities decreased \$4.0 million in the nine months ended September 30, 2015 compared to the same prior-year period. The decrease was primarily due to the decreased activity in the building of new clubs. The increase was partially offset by a \$1.1 million executive separation obligation related to our former Executive Chairman during the nine months ended September 30, 2015. Investing activities in the nine months ended September 30, 2015 and 2014 both included capital expenditures related to expanding and remodeling existing clubs, and the purchase of new fitness equipment.

Financing Activities. Net cash used in financing activities for the nine months ended September 30, 2015 was \$2.2 million compared to net cash provided by financing activities of \$71.9 million in the same period in 2014. In the nine months ended September 30, 2014, financing activities consisted of \$83.4 million in cash proceeds from the sale of the East 86th Street property, partially offset by \$3.2 million of real property transfer taxes, broker fees and other costs associated with the property sale. In addition, there was a decrease in cash dividends paid to common stockholders of \$7.6 million related to dividends declared prior to 2015.

As of September 30, 2015, our total principal amount of debt outstanding was \$305.9 million. This substantial amount of debt could have significant consequences, including:

- making it more difficult to satisfy our obligations, including with respect to our outstanding indebtedness;
  - increasing our vulnerability to general adverse economic and industry conditions;
  - limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions of new clubs and other general corporate requirements;
  - requiring a substantial portion of our cash flow from operations for the payment of interest on our debt, which is variable on our 2013 Revolving Loan Facility and partially variable on our 2013 Term Loan Facility, and/or principal pursuant to excess cash flow requirements and reducing our ability to use our cash flow to fund working capital, capital expenditures and acquisitions of new clubs and general corporate requirements;
  - increasing our vulnerability to interest rate fluctuations in connection with borrowings under our 2013 Senior Credit Facility, some of which are at variable interest rates;
  - limiting our ability to refinance our existing indebtedness on favorable terms, or at all; and
  - limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.
- These limitations and consequences may place us at a competitive disadvantage to other less-leveraged competitors.



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We believe that we have, or will be able to, obtain or generate sufficient funds to finance our current operating and growth plans through the next 12 months. Any material acceleration or expansion of our plans through newly constructed clubs or acquisitions (to the extent such acquisitions include cash payments) may require us to pursue additional sources of financing. There can be no assurance that such financing will be available, or that it will be available on acceptable terms.

### 2013 Senior Credit Facility

On November 15, 2013, TSI, LLC, an indirect, wholly-owned subsidiary, entered into a \$370.0 million senior secured credit facility (“2013 Senior Credit Facility”), among TSI, LLC, TSI Holdings II, LLC, a newly-formed, wholly-owned subsidiary of the Company (“Holdings II”), as a Guarantor, the lenders party thereto, Deutsche Bank AG, as administrative agent, and Keybank National Association, as syndication agent. The 2013 Senior Credit Facility consists of a \$325.0 million term loan facility maturing on November 15, 2020 (“2013 Term Loan Facility”) and a \$45.0 million revolving loan facility maturing on November 15, 2018 (“2013 Revolving Loan Facility”). Proceeds from the 2013 Term Loan Facility of \$323.4 million were issued, net of an original issue discount (“OID”) of 0.5%, or \$1.6 million. Debt issuance costs recorded in connection with the 2013 Senior Credit Facility were \$5.1 million and are being amortized as interest expense and are included in other assets in the accompanying condensed consolidated balance sheets. We also recorded additional debt discount of \$4.4 million related to creditor fees. The proceeds from the 2013 Term Loan Facility were used to pay off amounts outstanding under our previously outstanding long-term debt facility originally entered into on May 11, 2011 (as amended from time to time), and to pay related fees and expenses. None of the revolving loan facility was drawn upon as of the closing date on November 15, 2013, but loans under the 2013 Revolving Loan Facility may be drawn from time to time pursuant to the terms of the 2013 Senior Credit Facility. The borrowings under the 2013 Senior Credit Facility are guaranteed and secured by assets and pledges of capital stock by Holdings II, TSI, LLC, and, subject to certain customary exceptions, the wholly-owned domestic subsidiaries of TSI, LLC.

Borrowings under the 2013 Term Loan Facility and the 2013 Revolving Loan Facility, at TSI, LLC’s option, bear interest at either the administrative agent’s base rate plus 2.5% or a LIBOR rate adjusted for certain additional costs (the “Eurodollar Rate”) plus 3.5%, each as defined in the 2013 Senior Credit Facility. With respect to the outstanding initial term loans, the Eurodollar Rate has a floor of 1.00% and the base rate has a floor of 2.00%. Commencing with the last business day of the quarter ended March 31, 2014, TSI, LLC is required to pay 0.25% of the principal amount of the term loans each quarter, which may be reduced by voluntary prepayments. As of September 30, 2015, we have made a total of \$19.1 million in principal payments on the 2013 Term Loan Facility.

The terms of the 2013 Senior Credit Facility provide for a financial covenant in the situation where the total utilization of the revolving loan commitments (other than letters of credit up to \$5.5 million at any time outstanding) exceeds 25% of the aggregate amount of those commitments. In such event, TSI, LLC is required to maintain a total leverage ratio, as defined in the 2013 Senior Credit Facility, of no greater than 4.50:1.00. While not subject to the total leverage ratio covenant as of September 30, 2015 as our only utilization of the 2013 Revolving Loan Facility as of September 30, 2015 was \$2.9 million of issued and outstanding letters of credit thereunder, because our total leverage ratio as of September 30, 2015 was in excess of 4.50:1.00, we are currently not able to utilize more than 25% of the 2013 Revolving Loan Facility. We will continue not to be able to utilize more than 25% of the 2013 Revolving Loan Facility until we have a total leverage ratio of no greater than 4.50:1.00. The 2013 Senior Credit Facility also contains certain affirmative and negative covenants, including covenants that may limit or restrict TSI, LLC and Holdings II’s ability to, among other things, incur indebtedness and other liabilities; create liens; merge or consolidate; dispose of assets; make investments; pay dividends and make payments to shareholders; make payments on certain indebtedness; and enter into sale leaseback transactions, in each case, subject to certain qualifications and exceptions. In addition, at any time when the total leverage ratio is greater than 4.50:1.00, there are additional limitations on the ability of TSI, LLC and Holdings II to, among other things, make certain distributions of cash to TSI Holdings. The 2013 Senior Credit Facility also includes customary events of default (including non-compliance with the covenants or other terms of the 2013 Senior Credit Facility) which may allow the lenders to terminate the commitments under the 2013 Revolving Loan Facility and declare all outstanding term loans and revolving loans immediately due and payable and

enforce its rights as a secured creditor.

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TSI, LLC may prepay the 2013 Term Loan Facility and 2013 Revolving Loan Facility without premium or penalty in accordance with the 2013 Senior Credit Facility. Mandatory prepayments are required relating to certain asset sales, insurance recovery and incurrence of certain other debt and commencing in 2015 in certain circumstances relating to excess cash flow (as defined) for the prior fiscal year, as described below, in excess of certain expenditures. Pursuant to the terms of the 2013 Senior Credit Facility, we are required to apply net proceeds in excess of \$30.0 million from sales of assets in any fiscal year towards mandatory prepayments of outstanding borrowings. In connection with the sale of the East 86th Street property, accounted for as a building financing arrangement, described in Note 5 – Building Financing Arrangement, we received approximately \$43.5 million in net sales proceeds (after taxes, before giving effect to utilization of net operating losses and carryforwards) during the third quarter of 2014. Accordingly, we made a mandatory prepayment of \$13.5 million on the 2013 Term Loan Facility in November 2014. In connection with this mandatory prepayment, during the year ended December 31, 2014, we recorded loss on extinguishment of debt of \$493,000, consisting of the write-off of unamortized debt issuance costs and debt discount of \$119,000 and \$374,000, respectively. To the extent the proceeds of the sale of the East 86th Street property are not reinvested, we may be required to use such amounts, other than amounts used in 2014 to repay debt, to pay down our outstanding debt, as provided under the terms of our 2013 Senior Credit Facility. Based on increased capital expenditures related to the building of new clubs and new BFX Studio locations, we do not expect to be required to make a payment at any time. In addition, the 2013 Senior Credit Facility contains provisions that require excess cash flow payments, as defined, to be applied against outstanding 2013 Term Loan Facility balances. The excess cash flow is calculated annually for each fiscal year ending December 31 and paid 95 days after the fiscal year end. The applicable excess cash flow repayment percentage is applied to the excess cash flow when determining the excess cash flow payment. Earnings, changes in working capital and capital expenditure levels all impact the determination of any excess cash flow. The applicable excess cash flow repayment percentage is 50% when the total leverage ratio, as defined in the 2013 Senior Credit Facility, exceeds or is equal to 2.50:1.00; 25% when the total leverage ratio is greater than or equal to 2.00:1.00 but less than 2.50:1.00 and 0% when the total leverage ratio is less than 2.00:1.00. The first excess cash flow payment would have been due in April 2015. The excess cash flow calculation performed as of December 31, 2014 did not result in any required payments in April 2015. The second excess cash flow payment is due in April 2016, if applicable. Based on our unit growth projection and capital expenditures related to club renovations, the building of new clubs and new BFX Studio locations, together with our operating forecast, we do not expect there will be an excess cash flow payment required at that time.

As of September 30, 2015, the 2013 Term Loan Facility has a gross principal balance of \$305.9 million and a balance of \$298.5 million net of unamortized debt discount of \$7.4 million which is comprised of the unamortized portions of the OID recorded in connection with the May 11, 2011 debt issuance and the unamortized balance of the additional debt discounts recorded in connection with the first amendment and second amendment to the 2011 Senior Credit Facility. The unamortized debt discount balance is recorded as a contra-liability to long-term debt on the accompanying condensed consolidated balance sheet and is being amortized as interest expense using the effective interest method. As of September 30, 2015, the unamortized balance of debt issuance costs of \$3.1 million is being amortized as interest expense, and is included in other assets in the accompanying condensed consolidated balance sheets.

As of September 30, 2015, there were no outstanding 2013 Revolving Loan Facility borrowings and outstanding letters of credit issued totaled \$2.9 million. The unutilized portion of the 2013 Revolving Loan Facility as of September 30, 2015 was \$42.2 million and the available unutilized portion, based on our total leverage ratio exceeding 4.50:1.00, was \$11.3 million.

On January 30, 2015, the 2013 Senior Credit Facility was amended (the “Amendment”) to permit TSI Holdings to purchase term loans under the Credit Agreement. Any term loans purchased by TSI Holdings will be cancelled. We may from time to time purchase term loans in market transactions, privately negotiated transactions or otherwise; however we are under no obligation to make any such purchases. Any such transactions, and the amounts involved, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.



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Financial Instruments

In our normal operations, we are exposed to market risks relating to fluctuations in interest rates. In order to minimize the possible negative impact of such fluctuations on our cash flows we may enter into derivative financial instruments (“derivatives”), such as interest-rate swaps. Derivatives are not entered into for trading purposes and we only use commonly traded instruments. Currently, we have used derivatives solely relating to the variability of cash flows from interest rate fluctuations.

We originally entered into our interest rate swap arrangement on July 13, 2011 in connection with our previous credit facility. Effective as of November 15, 2013, the closing date of the 2013 Senior Credit Facility, the interest rate swap arrangement had a notional amount of \$160.0 million and will mature on May 15, 2018. The swap effectively converts \$160.0 million of the \$325.0 million total variable-rate debt under the 2013 Senior Credit Facility to a fixed rate of 5.384%, when including the applicable 3.50% margin. As permitted by FASB Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging, we have designated this swap as a cash flow hedge, the effects of which have been reflected in our condensed consolidated financial statements as of and for the three and nine months ended September 30, 2015 and 2014. The objective of this hedge is to manage the variability of cash flows in the interest payments related to the portion of the variable-rate debt designated as being hedged.

When our derivative instrument was executed, hedge accounting was deemed appropriate and it was designated as a cash flow hedge at inception with re-designation being permitted under ASC 815, Derivatives and Hedging. Interest rate swaps are designated as cash flow hedges for accounting purposes since they are being used to transform variable interest rate exposure to fixed interest rate exposure on a recognized liability (debt). On an ongoing basis, we perform a quarterly assessment of the hedge effectiveness of the hedge relationship and measure and recognize any hedge ineffectiveness in the condensed consolidated statements of operations. For the three and nine months ended September 30, 2015 and 2014, hedge ineffectiveness was evaluated using the hypothetical derivative method. There was no hedge ineffectiveness for the three and nine months ended September 30, 2015 and 2014.

The counterparty to our derivatives is a major banking institution with a credit rating of investment grade or better and no collateral is required, and there are no significant risk concentrations. We believe the risk of incurring losses on derivative contracts related to credit risk is unlikely.

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## Building Financing Arrangement

On September 12, 2014, we completed the legal sale of our property (building and land) on East 86th Street, New York City, to an unaffiliated third-party for gross proceeds of \$85.7 million, which includes \$150,000 of additional payments to us. Concurrent with the closing of the transaction, we leased back the portion of the property comprising our health club. We expect to lease (“Initial Lease”) the premises to at least March 2016 and then, upon at least 120 days notice from the purchaser/landlord, the Initial Lease will terminate and we will vacate the property while the purchaser/landlord demolishes the existing building and the adjacent building and builds a new luxury, high-rise multi-use building. In connection with vacating the property, we intend to enter into a new lease (“New Club Lease”) for approximately 24,000 square feet in the new building for the purpose of operating a health club upon completion of construction by the purchaser/landlord. The term of the Initial Lease is 10 years, and at the end of this initial term, we have two options at our sole discretion to renew the lease; the first for an additional 10 year period and a second for an additional five year period (although we expect that the purchaser/landlord will exercise its right to early terminate the Initial Lease so that it may commence the construction of the new building). Under the Initial Lease (and New Club Lease if entered into), the purchaser/landlord has agreed to pay us liquidated damages if the new club is not available by a certain date. The latest date that the liquidated damages would begin to be paid would be April 13, 2020 and would continue until the new club is available. For accounting purposes, the nature of these potential liquidated damages constitutes continuing involvement with the purchaser/landlord’s development of the property. As a result of this continuing involvement, the sale-leaseback transaction is currently required to be accounted for as a financing arrangement rather than as a completed sale. Under this treatment, we have included the proceeds received as a financing arrangement on our balance sheet. Except for payments under the Initial Lease and the New Club Lease, we do not expect to make any cash payments to the purchaser/landlord with respect to the building financing arrangement. We recorded a taxable (for federal and state income tax purposes) gain on the sale of the property and made estimated tax payments in September 2014 in this regard. In March 2015, we received the remaining proceeds held in escrow of \$500,000, which was included in our cash flow statement for the nine months ended September 30, 2015 as a financing cash inflow.

As of September 30, 2015, the total financing arrangement was \$83.9 million, which is net of \$1.8 million held in escrow for our former tenant. The accrued interest on financing arrangement was not material at September 30, 2015. Because the transaction is characterized as a financing for accounting purposes rather than a sale, the rental payments and related transaction costs are treated as interest on the financing arrangement. As these interest amounts are less than the interest that would be charged under a typical financing, the financing is characterized as an interest only financing with no reduction in the principal throughout the Initial Lease term until any continuing involvement has ceased. Until such time, even though we no longer have legal title to the building and the land, the building, building improvements and land remain on our consolidated balance sheet and the building and building improvements will continue to be depreciated over their remaining useful lives. Similarly, we do not have a loan or borrowing arrangement with the purchaser/landlord but the building financing arrangement will remain on our balance sheet until any continuing involvement has ceased.

As of September 30, 2015, the net book value of the building and building improvements was \$2.9 million and the book value of the land was \$986,000. As part of the transaction, we incurred \$3.2 million of real property transfer taxes, broker fees and other costs which will be deferred and amortized over the term of the Initial Lease of 25 years, which includes the option periods. The net fees are recorded in Other assets on our accompanying condensed consolidated balance sheets as of September 30, 2015 and December 31, 2014.

Payments made under the Initial Lease, including rental income related to our former tenant in the building that was assigned to the purchaser/landlord, are recognized as interest expense on the underlying financing arrangement. Included in the contractual obligation table below is our future lease commitment of \$750,000 per year under the remaining term of the Initial Lease, which includes the options periods and will be recorded as interest expense. Rental income related to our former tenant in the building of approximately \$2.0 million and the amortization of the deferred costs of \$126,000 per year will be recorded as interest expense (unless the purchaser/landlord exercises its right to terminate the lease before the end of the 10-year Initial Lease).



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## Contractual Obligations

As of September 30, 2015, our contractual obligations listed in the table below and payments due by period were as follows:

|   | Payments Due by Period (in thousands) |                     |           |           |                      |
|---|---------------------------------------|---------------------|-----------|-----------|----------------------|
|   | Total                                 | Less than<br>1 Year | 1-3 Years | 3-5 Years | More than<br>5 Years |
| Contractual Obligations (4)             |                                       |                     |           |           |                      |
| Long-term debt (1)                      | \$305,949                             | \$3,114             | \$6,228   | \$6,228   | \$290,379            |
| Interest payments on long-term debt (2) | 73,281                                | 15,333              | 29,462    | 26,816    | 1,670                |
| Operating lease obligations (3)         | 602,754                               | 90,057              | 161,824   | 133,365   | 217,508              |
| Total contractual obligations           | \$981,984                             | \$108,504           | \$197,514 | \$166,409 | \$509,557            |

Notes:

(1) Principal amounts paid each year may increase if annual excess cash flow amounts are required (as described above). Excess cash flow was calculated as of December 31, 2014 and no payments are currently required in 2015 or any future period.

(2) Based on interest rates pursuant to the 2013 Term Loan Facility and the interest swap agreement as of September 30, 2015.

(3) Operating lease obligations include base rent only. Certain leases provide for additional rent based on real estate taxes, common area maintenance and defined amounts based on our operating results. Amounts include obligations under the Initial Lease related to the Building financing arrangement and does not include any amounts relating to the New Club Lease. See "Building Financing Arrangement."

(4) The table above does not reflect payments related to planned club closures and executive separation obligations to our former Executive Chairman, our former Chief Executive Officer and our former Chief Information Officer.

Refer to Note 14 - Separation Obligation to our condensed consolidated financial statements.

The following long-term liabilities included on the condensed consolidated balance sheet are excluded from the table above: income taxes (including uncertain tax positions or benefits), insurance accruals and other accruals. We are unable to estimate the timing of payments for these items.



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### Working Capital

We had working capital of \$35.7 million and \$52.3 million at September 30, 2015 and December 31, 2014, respectively. Major components of our working capital on the current assets side are cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, and the current portion of deferred tax assets. As of September 30, 2015, these current assets more than offset the current liabilities, which consist of deferred revenues, accounts payable, accrued expenses (including, among others, accrued construction in progress and equipment, payroll and occupancy costs), the current portion of deferred tax liabilities and the current portion of long-term debt. The deferred revenue that is classified as a current liability relates to dues and services paid-in-full in advance and fees paid at the time of enrollment and totaled \$43.7 million and \$37.0 million at September 30, 2015 and December 31, 2014, respectively. Initiation and processing fees received are deferred and amortized over the estimated average membership life of a club member and all annual fees are deferred and amortized over a twelve month period. Prepaid dues and fees for prepaid services are generally realized over a period of up to twelve months. In periods when we increase the number of members and consequently increase the level of payments received in advance, we would expect to see increased deferred revenue balances. By contrast, any decrease in demand for our services or reductions in joining fees collected would have the effect of reducing deferred revenue balances, which would likely require us to rely more heavily on other sources of funding. In either case, a significant portion of the deferred revenue is not expected to constitute a liability that must be funded with cash. At the time a member joins our club, we incur enrollment costs, a portion of which are deferred over the estimated average membership life or 12 months to the extent these costs are related to the first annual fee paid at the time of enrollment. These costs are recorded as a long-term asset and as such do not affect working capital. We believe our cash and cash equivalents and our 2013 Revolving Loan Facility, which had \$11.3 million of availability at September 30, 2015 based on our leverage ratio and utilization at that date, are sufficient to fund our operating, investing and financing requirements for the next twelve months.

### Recent Changes in or Recently Issued Accounting Pronouncements

See Note 2 — Recent Accounting Pronouncements to the condensed consolidated financial statements.

### Use of Estimates and Critical Accounting Policies

Fixed and intangible assets. Fixed assets are recorded at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, which are 30 years for building and improvements, five years for club equipment, furniture, fixtures and computer equipment and three to five years for computer software. Leasehold improvements are amortized over the shorter of their estimated useful lives or the remaining period of the related lease. Payroll costs directly related to the construction or expansion of the Company's club and BFX Studio base are capitalized with leasehold improvements. Expenditures for maintenance and repairs are charged to operations as incurred. The cost and related accumulated depreciation of assets retired or sold, is removed from the respective accounts and any gain or loss is recognized in operations. The costs related to developing web applications, developing web pages and installing developed applications on the web servers are capitalized and classified as computer software. Web site hosting fees and maintenance costs are expensed as incurred.

Long-lived assets, such as fixed assets and intangible assets are reviewed for impairment when events or circumstances indicate that their carrying value may not be recoverable. Estimated undiscounted expected future cash flows are used to determine if an asset group is impaired, in which case the asset's carrying value would be reduced to its fair value, calculated considering a combination of market approach and a cost approach. In determining the recoverability of fixed assets, Level 3 inputs were used in determining undiscounted cash flows, which are based on internal budgets and forecasts through the end of the life of the primary asset in the asset group which is normally the life of leasehold improvements. The most significant assumptions in those budgets and forecasts relate to estimated membership and ancillary revenue, attrition rates, estimated results related to new program launches and maintenance capital expenditures, which are generally estimated at approximately 3% to 5% of total revenues depending upon the conditions and needs of a given club. If we continue to experience competitive pressure, certain assumptions may fluctuate materially. See Note 9 — Fixed Asset Impairment to our condensed consolidated financial statements.



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In the three months ended September 30, 2015, we recorded a total of \$12.4 million fixed asset impairment charges. We did not have fixed asset impairment in the three months ended September 30, 2014. In the nine months ended September 30, 2015, we recorded a total of \$14.6 million fixed asset impairment charges compared to \$4.5 million in the nine months ended September 30, 2014. The fixed asset impairment charge is included as a component of operating expenses in a separate line on the condensed consolidated statements of operations.

Goodwill has been allocated to reporting units that closely reflect the regions served by the Company's four trade names: New York Sports Clubs ("NYSC"), Boston Sports Clubs ("BSC"), Washington Sports Clubs ("WSC") and Philadelphia Sports Clubs ("PSC"), with certain more remote clubs that do not benefit from a regional cluster being considered single reporting units ("Outlier Clubs"), the Company's three clubs located in Switzerland being considered a single reporting unit ("SSC"), and our BFX Studio ("BFX Studio"). As of September 30, 2015, only the SSC region has a remaining goodwill balance.

As of February 28, 2015 and February 28, 2014, we performed our annual impairment test of goodwill. The February 28, 2015 annual impairment test supported the recorded goodwill balance and as such no impairment of goodwill was required. The February 28, 2014 annual impairment test resulted in a goodwill impairment charge of \$137,000 associated with the Outlier Clubs in the nine months ended September 30, 2014.

As a result of the significant decrease in market capitalization and a decline in our current performance primarily due to existing members downgrading their memberships to those with lower monthly dues and new members enrolling at lower rates, we performed an interim impairment test as of May 31, 2015. The determination as to whether a triggering event exists that would warrant an interim review of goodwill and whether a write-down of goodwill is necessary involves significant judgment based on our short-term and long-term projections. As a result of the May 31, 2015 interim impairment test, we concluded that there would be no remaining implied fair value of goodwill attributable to the NYSC and BSC regions. Accordingly, in June 2015, we wrote off \$31.6 million of goodwill associated with these reporting units. We did not have a goodwill impairment charge in the SSC region as a result of the interim test given the profitability of this unit.

For the May 31, 2015 and February 28, 2015 impairment tests, fair value was determined by using a weighted combination of two market-based approaches (weighted 50% collectively) and an income approach (weighted 50%), as this combination was deemed to be the most indicative of the our fair value in an orderly transaction between market participants. Under the market-based approaches, we utilized information regarding the Company, the Company's industry as well as publicly available industry information to determine earnings multiples and sales multiples that are used to value our reporting units. Under the income approach, we determined fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn, which are unobservable Level 3 inputs, and taking into account the firm offer. The discounted estimates of future cash flows include significant management assumptions such as revenue growth rates, operating margins, weighted average cost of capital, and future economic and market conditions. The estimated weighted-average cost of capital of NYSC and SSC were 9.2% and 11.2% as of May 31, 2015, respectively, compared to 13.3% and 13.9% as of February 28, 2015. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and operating margins, discount rates and future market conditions, among others. These assumptions were determined separately for each reporting unit. We believe our assumptions are reasonable, however, there can be no assurance that our estimates and assumptions made for purposes of our goodwill impairment testing as of May 31, 2015 and February 28, 2015 will prove to be accurate predictions of the future. If our assumptions regarding forecasted revenue or margin growth rates of certain reporting units are not achieved, we may be required to record goodwill impairment charges in future periods, whether in connection with our next annual impairment testing or prior to that, if any such change constitutes a triggering event outside the quarter when the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment charge would result. The estimated fair value of SSC was greater than book value by 65% as of May 31, 2015 and 84% as of February 28, 2015.



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Solely for purposes of establishing inputs for the fair value calculation described above related to goodwill impairment testing, we made the following assumptions. We developed long-range financial forecasts (three years) for all reporting units and assumed known changes in the existing club base. Terminal growth rates were calculated for years beyond the five year forecast. As of May 31, 2015, we used discount rates ranging from 8.2% to 11.2% and terminal growth rates ranging from 1.0% to 3.0%. As of February 28, 2015, we used discount rates ranging from 13.2% to 13.9% and terminal growth rates ranging from 0.5% to 3.0%. These assumptions are developed separately for each reporting unit.

The valuation of intangible assets requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows and discount rates. We will continue to complete interim evaluations of the goodwill by reporting unit if a triggering event exists.

Deferred Income Taxes. We had a net deferred tax liability of \$61,000 and \$11.6 million as of September 30, 2015 and December 31, 2014, respectively. We had a state net deferred tax liability of \$17,000 and \$3.3 million as of September 30, 2015 and December 31, 2014, respectively. As of December 31, 2014, we maintained and as of September 30, 2015 continued to maintain a full valuation allowance of our deferred tax assets.

Forward-Looking Statements

This Quarterly Report on Form 10-Q 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, potential club closures, results of cost savings initiatives, legal contingencies and tax benefits and contingencies, future declarations and payments of dividends, and the existence of adverse litigation and other risks, uncertainties and factors set forth under Item 1A., entitled “Risk Factors”, in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and in our other reports and documents filed with the 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”, “intends”, “plans”, “estimates”, “anticipates”, “target”, “could” 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, among others, the level of market demand for our services, economic conditions affecting our business, the success of our pricing model, the geographic concentration of our clubs, competitive pressure, the ability to achieve reductions in operating costs and to continue to integrate acquisitions, outsourcing of certain aspects of our business, environmental matters, the application of Federal and state tax laws and regulations, any security and privacy breaches involving customer data, the levels and terms of the Company’s indebtedness, and other specific factors discussed herein and in other SEC filings by us (including our reports on Forms 10-K and 10-Q filed with the SEC). 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 when 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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our debt effectively bears interest at fixed and variable rates so that we are exposed to market risks resulting from interest rate fluctuations. We regularly evaluate our exposure to these risks and take measures to mitigate these risks on our consolidated financial results. We do not participate in speculative derivative trading.

Interest rates on borrowings for the 2013 Term Loan Facility are for one-month periods in the case of Eurodollar borrowings. Our exposure to market risk for changes in interest rates relates to interest expense on variable rate debt. As of September 30, 2015, we had \$305.9 million of outstanding borrowings under our 2013 Term Loan Facility of which \$160.0 million of this variable rate debt is hedged to a fixed rate under an interest rate swap agreement.

Changes in the fair value of the interest rate swap derivative instrument is recorded each period in accumulated other comprehensive income (loss). Based on the amount of our variable rate debt and our interest rate swap agreement as of September 30, 2015, a hypothetical 100 basis point interest increase would have increased our annual interest cost by approximately \$760,000.

For additional information concerning the terms of our 2013 Term Loan Facility, see Note 3 — Long-Term Debt to the condensed consolidated financial statements.

Item 4. Controls and Procedures

**Evaluation of Disclosure Controls and Procedures:** We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that the information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and such information is accumulated and communicated to management, including the Executive Chairman and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired controls.

As of September 30, 2015, we carried out an evaluation, under the supervision and with the participation of our management, including the Executive Chairman and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures defined above. Based upon that evaluation, our Executive Chairman and Chief Financial Officer have concluded that, as of September 30, 2015, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in Internal Control over Financial Reporting:** There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

On February 7, 2007, in an action styled White Plains Plaza Realty, LLC v. TSI, LLC et al., the landlord of one of TSI, LLC's former health and fitness clubs filed a lawsuit in state court against it and two of its health club subsidiaries alleging, among other things, breach of lease in connection with the decision to close the club located in a building owned by the plaintiff and leased to a subsidiary of TSI, LLC, the tenant, and take additional space in a nearby facility leased by another subsidiary of TSI, LLC. Following a determination of an initial award, which TSI, LLC and the tenant have paid in full, the landlord appealed the trial court's award of damages, and on August 29, 2011, an additional award (amounting to approximately \$900,000) (the "Additional Award"), was entered against the tenant, which has recorded a liability. Separately, TSI, LLC is party to an agreement with a third-party developer, which by its terms provides indemnification for the full amount of any liability of any nature arising out of the lease described above, including attorneys' fees incurred to enforce the indemnity. As a result, the developer reimbursed TSI, LLC and the tenant the amount of the initial award in installments over time and also agreed to be responsible for the payment of the Additional Award, and the tenant has recorded a receivable related to the indemnification for the Additional Award. The developer and the landlord are currently litigating the payment of the Additional Award and judgment was entered against the developer on June 5, 2013 in the amount of approximately \$1.0 million, plus interest, which judgment was upheld by the appellate court on April 29, 2015. TSI, LLC does not believe it is probable that TSI, LLC will be required to pay for any amount of the Additional Award.

On or about October 4, 2012, in an action styled James Labbe, et al. v. Town Sports International, LLC, plaintiff commenced a purported class action in New York State court on behalf of personal trainers employed in New York State. Labbe is seeking unpaid wages and damages from TSI, LLC and alleges violations of various provisions of the New York State labor law with respect to payment of wages and TSI, LLC's notification and record-keeping obligations. The Court has bifurcated class and merits discovery. The deadline for the completion of pre-class certification document discovery was December 31, 2014. On June 12, 2015, the plaintiff made a motion for class certification. On July 24, 2015, the court indefinitely adjourned the plaintiff's motion for class certification to allow the court to first decide a motion for sanctions by TSI, LLC against Labbe. TSI, LLC made that motion for sanctions on June 30, 2015. The motion seeks dismissal of Labbe's complaint, and reimbursement of certain of TSI, LLC's legal fees, on the ground that Labbe has not complied with his discovery obligations and the court's discovery orders. TSI, LLC's motion for sanctions remains pending. TSI, LLC has proposed a settlement offer and the parties are working towards a resolution of this matter. If the parties are unsuccessful in these settlement negotiations, TSI, LLC intends to continue to contest this case vigorously.

In addition to the litigation discussed above, the Company is involved in various other lawsuits, claims and proceedings incidental to the ordinary course of business, including personal injury, employee relations claims and landlord tenant disputes. The results of litigation are inherently unpredictable. Any claims against the Company, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in diversion of significant resources. The results of these other lawsuits, claims and proceedings cannot be predicted with certainty. The Company establishes accruals for loss contingencies when it has determined that a loss is probable and that the amount of loss, or range of loss, can be reasonably estimated. Any such accruals are adjusted thereafter as appropriate to reflect changes in circumstances. We currently believe that the ultimate outcome of such lawsuits, claims and proceedings will not, individually or in the aggregate, have a material adverse effect on our consolidated financial position, results of operations or liquidity. However, depending on the amount and timing, an unfavorable resolution of some or all of these matters could materially affect our future results of operations in a particular period.

ITEM 1A. Risk Factors

There have not been any material changes to the information related to the ITEM 1A. "Risk Factors" disclosure in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.





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ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

Required exhibits are listed in the Index to Exhibits and are incorporated herein by reference.

From time to time the Company may use its Web site as a channel of distribution of material company information.

Financial and other material information regarding the Company is routinely posted on and accessible at

<http://investor.mysportsclubs.com>. In addition, you may automatically receive email alerts and other information about the Company by enrolling through the "Email Alerts" section at <http://investor.mysportsclubs.com>.

The foregoing information regarding the Company Web site and its content is for convenience only. The content of its Web site is not deemed to be incorporated by reference into this report nor should it be deemed to have been filed with the Securities and Exchange Commission.

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SIGNATURES

Pursuant to requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TOWN SPORTS INTERNATIONAL  
HOLDINGS, INC.

DATE: November 2, 2015

By:

/s/ Carolyn Spatafora  
Carolyn Spatafora  
Chief Financial Officer

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INDEX TO EXHIBITS

The following is a list of all exhibits filed or furnished as part of this report:

| Exhibit<br>No. | Description of Exhibit   |
|----------------|--|
| 3.1            | Amended and Restated Certificate of Incorporation of Town Sports International Holdings, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006).   |
| 3.2            | Third Amended and Restated By-laws of the Company (incorporated by reference to Exhibit 3.2 of the Registrant's Current Report on Form 8-K, filed on September 17, 2014).  |
| 3.3            | Certificate of Designations of Series A Junior Participating Preferred Stock of Town Sports International Holdings, Inc. filed with the Secretary of State of the State of Delaware on January 2, 2015 (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K, dated January 2, 2015). |
| 4.1            | Rights Agreement, dated as of December 31, 2014, between Registrant and Computershare Trust Company N.A., as Rights Agent (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K, dated January 2, 2015).  |
| 10.1           | Letter Agreement with Gregory Bartoli, dated August 17, 2015 (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed August 18, 2015).   |
| 10.2           | Form of Indemnification Agreement for Directors.   |
| 10.3           | Form of Non-Qualified Stock Option Agreement for Gregory Bartoli pursuant to the 2006 Incentive Plan, as amended.  |
| 10.4           | Form of Restricted Stock Agreement for Gregory Bartoli.  |
| 10.5           | Form of Non-Qualified Stock Option Agreement for Gregory Bartoli.  |
| 31.1           | Certification of Executive Chairman pursuant to Rule 13a – 14(a) and Rule 15d – 14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2           | Certification of Chief Financial Officer pursuant to Rule 13a – 14(a) and Rule 15d – 14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1           | Certification of Executive Chairman pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2           | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101.INS        | XBRL Instance Document   |

|         |   |
|---------|---|
| 101.SCH | XBRL Taxonomy Extension Schema                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |