

TOWN SPORTS INTERNATIONAL HOLDINGS INC
Form 10-K
February 28, 2019

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

Annual Report pursuant to Section 13 OR 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2018

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 20-0640002
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)
1001 US North Highway 1, Suite 201, Jupiter, Florida 33477
(Address and zip code of Registrant’s principal executive office)
399 Executive Boulevard, Elmsford, New York 10523
(Mailing address)
(212) 246-6700
(Registrant’s telephone number, including area code)

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

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

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

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

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

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

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

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

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

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

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2018 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$211.9 million (computed by reference to the last reported sale price on The Nasdaq National Market on that date). The registrant does not have any non-voting common stock outstanding.

As of February 22, 2019, there were 27,923,569 shares of Common Stock of the Registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the 2019 Annual Meeting of Stockholders, to be filed not later than April 30, 2019 are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC.
PART I

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Annual Report”) contains “forward-looking” statements within the meaning of the Private Securities Litigation Reform Act of 1995, 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,” of this Annual Report and in our other reports and documents filed with the Securities and Exchange Commission (“SEC”). You can identify these forward-looking statements by the use of words such as “outlook,” “believes,” “expects,” “potential,” “continues,” “may,” “will,” “should,” “seeks,” “approximately,” “predicts,” “intends,” “plans,” “estimates,” “anticipates,” “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 made by us. We believe that all forward-looking statements are based on reasonable assumptions when made; however, we caution that it is impossible to predict actual results or outcomes or the effects of risks, uncertainties or other factors on anticipated results or outcomes and that, accordingly, one should not place undue reliance on these statements. Forward-looking statements speak only as of the date 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.

Item 1. Business

In this Annual Report, unless otherwise stated or the context otherwise indicates, references to “the Company,” “we,” “our,” “TSI Holdings” and similar references refer to Town Sports International Holdings, Inc. and its subsidiaries. References to “TSI LLC” refer to Town Sports International, LLC, and “TSI Group” refer to Town Sports Group, LLC, both of which are wholly-owned operating subsidiaries of the Company. The Company is a diversified holding company that owns subsidiaries engaged in a number of business and investment activities. The Company’s largest operating subsidiary, TSI LLC, has been involved in the fitness industry since 1973 and has grown to become one of the largest owners and operators of fitness clubs in the Northeast region of the United States (“U.S.”). TSI Group was formed in 2017 to invest in public and private equities and real estate. TSI Holdings’ corporate structure provides flexibility to make investments across a broad spectrum of industries in order to create long-term value for stockholders.

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General

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. Our 185 fitness clubs (“clubs”) collectively served approximately 627,000 members as of December 31, 2018. Our clubs operate under the various brand names below and are primarily located in the United States of America.

Brand	Count
New York Sports Clubs	98
Boston Sports Clubs	33
Washington Sports Clubs	10
Philadelphia Sports Clubs	5
Lucille Roberts	16
TMPL	2
Total Woman Gym and Spa	12
Palm Beach Sports Clubs	3
Christi’s Fitness	1
LIV Fitness	2
New York Sports Clubs - Switzerland	3
	185

We develop clusters of clubs to serve densely populated 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 main regions, 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 2018, we acquired 25 clubs and constructed and opened one club. In 2017, we acquired 18 clubs and constructed and opened two clubs.

Over our 45-year history, since incorporating in 1973, we have developed and refined our club formats, which allows us to cost-effectively construct and efficiently operate our fitness clubs in the different real estate environments in which we operate. Our fitness-only clubs average approximately 18,000 square feet, while our multi-recreational clubs average approximately 40,000 square feet. The aggregate average size of our clubs is approximately 25,000 square feet. Our clubs typically have an open fitness area to accommodate cardiovascular and strength-training equipment, as well as special purpose rooms for group fitness classes and other exercise programs. We seek to provide a broad array of high-quality exercise programs and equipment that are popular and effective, promoting a quality exercise experience for our members. When developing clubs, we carefully examine the potential membership base and the likely demand for supplemental offerings such as swimming, basketball, children’s programs, tennis or squash and, provided suitable real estate is available, we will add one or more of these offerings to our fitness-only format. For example, a multi-recreational club in a family market may include Sports Clubs for Kids programs, which can include swim lessons and sports camps for children.

Industry Overview

According to the most recent information released by the International Health, Racquet and Sports Club Association (“IHRSA”), the U.S. health club industry posted growth in revenue, memberships, and number of club locations. Revenue grew to \$30.0 billion in 2017 from \$27.6 billion in 2016, while membership increased to 60.9 million in 2017 from 57.2 million in 2016. The U.S. club count rose to 38,477 sites in 2017 from 36,540 sites in 2016. Research shows that more than one out of five Americans belonged to at least one U.S. health club or studio. Since 2008, membership has grown by 33.6%, while the total number of club-goers has increased by 31.5%. The total number of health club visits has also increased, amounting to 5.9 billion visits in 2017, up from 4.3 billion in 2008.

According to the Centers for Disease Control and Prevention, state prevalence of obesity continued to remain high across the country in 2017, with no state with a prevalence of obesity less than 20%. In 2017, 48 states had a prevalence of obesity of 25% or more and 29 of these states had a prevalence of obesity 30% or more. As healthcare costs continue to rise in the U.S., some of the focus on combating obesity and other diseases is being directed at prevention. Both government and medical

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research has shown that exercise and other physical activity plays a critical role in preventing obesity and other health conditions, thereby reducing healthcare costs for treating obesity related sicknesses.

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

Competitive Strengths

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

Strong market position with leading brands. Based on number of clubs, we are one of the largest owners and operators of fitness clubs in the Northeast and Mid-Atlantic regions of the U.S. Our strong real estate presence in the New York, Boston, Washington, D.C., and Philadelphia regions enhances convenience to our members. We attribute our positions in these markets in part to the strength of our localized owner and operator brand names, which foster recognition as a local network of quality fitness clubs.

Regional clustering strategy provides significant benefits to members and corporations. By operating a network of clubs in a concentrated geographic area, the value of our memberships is enhanced by our ability to offer members access to multiple clubs in our network, which provides the convenience of having fitness clubs near a member's workplace and home. This is also a benefit to our corporate members, as many corporations have employees that will take advantage of multiple gym locations. Approximately 37% of our members currently have memberships that allow them to use multiple clubs, and because these memberships offer enhanced privileges and greater convenience, they typically generate higher monthly dues than our single club memberships in each respective region. Regional clustering also allows us to provide special facilities to all of our members within a local area, such as swimming pools and squash, tennis and basketball courts, without offering them at every location. In the year ended December 31, 2018, approximately 25% of all club usage was by members visiting clubs other than their home clubs. **A leveraged operating model designed for operational efficiencies.** We are one of the leading owners and operators of fitness clubs in the United States. As of December 31, 2018, we owned and operated 185 fitness clubs under various brand names, primarily located in the United States of America. Our portfolio of distinct brands across these regions, combined with our size and scale which allows for strategic and advantageous partnerships with our third-party vendors and suppliers throughout the organization, gives us a competitive advantage in the fitness market. We believe that our model enables us to scale more rapidly than our competitors. We have greater financial and other resources, which allows us to react to changes in pricing, marketing, and trends in the industry more quickly or effectively than other smaller size companies. We may secure better terms from vendors and devote more resources to technology infrastructure, fulfillment and marketing. We also focus our growth in areas we believe allow us to continue to gain efficiencies through leveraging our fixed costs. We believe we can improve financial performance by continuing to reduce expenses through operational efficiencies, leveraging technology and improving labor planning.

Expertise in site selection. We believe that our expertise in site selection for potential acquisitions and new clubs provides an advantage over our competitors given the complex real estate markets in the metropolitan areas in which we operate and the relative scarcity of suitable sites. Before opening or acquiring a new club, we undertake a process involving financial modeling, site selection and negotiation of lease and acquisition terms to ensure that a potential location meets our criteria for a model club. We believe that there are barriers to entry, particularly, in our metropolitan areas, including restrictive zoning laws, lengthy permit processes and a shortage of appropriate real estate, which could discourage any large competitor from attempting to open a chain of clubs in these markets. We believe that potential new entrants would need to establish or acquire a large number of clubs in a market to compete effectively with us. These barriers of entry are significant in our metropolitan regions; however, they are not as challenging in our surrounding suburban locations.

Business Strategy

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

Growth through acquisitions. We plan to continue to expand our club base through selective acquisitions. This is an important element of our corporate strategy as it strengthens our competitive position and expands and enhances the

services that we can offer to members. In 2018, we acquired 25 clubs and constructed and opened one new club. We expect to continue to acquire selective clubs to continue our expansion of club offerings, including clubs outside of our current regions. In the event we build and acquire additional new clubs, the club expansion is expected to be funded with cash on hand or through

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internally generated cash flows. We may also consider certain acquisitions other than health clubs to diversify the business while enhancing shareholder value.

Grow membership revenues. We seek to grow our membership revenues in existing clubs through driving membership growth and optimizing dues and member retention. We believe our offerings are compelling because we include group exercise classes, top of the line equipment, pools and courts in the price of certain memberships, when available. We will continue to consider and make pricing adjustments in order to increase revenue while also driving membership growth.

Grow ancillary and other non-membership revenues. We intend to grow our ancillary and other non-membership revenues through a continued focus on increasing the additional value-added services that we provide to our members. We offer a multi-session personal training membership product and fee-based Small Group Training classes to generate additional revenue in most of our clubs. In addition, we offer Sports Clubs for Kids programs and spa services at select clubs.

Optimization of our clubs. We remain committed to optimizing our existing club base, including club closures when appropriate. We expect these profit margin initiatives will enable us to improve in club level economics across our portfolio, and to offset the competitive pressure in the geographic regions in which we compete.

Retain members by focusing on the member experience. Our Company's mission is "Bring the best out of every body." By building and nurturing a strong consumer centric culture, we are able to provide a clear road map for how we serve our members and deliver a superior experience. We tailor the hours of each club to the needs of the specific member demographic utilizing each club and offer a variety of ancillary services, including personal training, group classes, Small Group Training programs, Sports Clubs for Kids programs and spa services. We offer a variety of different sports facilities in our clubs; modern, varied and well-maintained exercise and fitness equipment; and an assortment of additional amenities including access to babysitting. Through hiring, developing and training a qualified and diverse team that is passionate about fitness and health; maintaining and enhancing our programs and services; continually increasing our attention to individual member needs; and investing in our digital ecosystem, we expect to demonstrate our commitment to increase the quality of the member experience, and thereby increase net membership. To better measure the member experience, we utilize social media to help analyze the areas we can improve upon as well as the areas in which the members are satisfied overall.

Provide fitness experiences and services. We help educate our members to best practices in their pursuit of fitness, wellness and healthy lifestyles and each of our clubs has an array of cardiovascular machines, resistance training equipment, free weights and functional training zones. We have technicians who service and maintain our equipment on a timely basis. In addition, we have personal viewing television screens on most pieces of cardiovascular equipment which accommodate individual preferences and viewing, and many cardio machines now include embedded technology that offers both entertainment and tracking features that record workout results and communicate with many mobile technologies. Most clubs have between one and three studios used for exercise classes, including at least one large studio used for most group exercise classes, a cycling studio and a mind and body studio used for yoga and Pilates classes. We further offer a large variety of group fitness classes at each club and these classes are accessible to all members. The volume and variety of activities at each club allow each member to enjoy the club, whether customizing their own workout or participating in group activities and classes. In addition, we have a functional training zone within most of our clubs that feature an array of innovative equipment designed to maximize the member's workout. The functional training zones include a variety of functional training equipment, such as Total Body Resistance Exercise ("TRX" brand) suspension training frame, Kettle Bells, Battle Ropes and Power Sleds. Our functional training zones are open to members for free self-guided workouts, personal training sessions and fee-based programs.

Marketing

Our in-house marketing team is responsible for brand positioning, brand strategy, lead generation, sales support and product innovation for the Company and all of its subsidiaries. The primary objective is to ensure that our brands seize market share and opportunities through well-defined and coordinated go-to-market strategies. We are organized to enable close collaboration between our marketing, sales and operations staff, which helps to align efforts around

operational objectives and new product development. We seek to inspire brand experiences and in doing so, drive sustainable and quality growth, while building a strong reputation and loyalty with both existing members and future members. In order to have credible and authentic connections to create such desirability with our audience, we utilize a market segmentation strategy. A marketing segmentation strategy divides our target market into subgroups, whereby consumers in each of these subgroups share one or more characteristics. Using this knowledge, we develop specific plans, including personalized and mass marketing, to reach these targeted customers effectively. We seek to identify and understand consumers' individual motivations and goals in an effort to create meaningful products, services and experiences that build a lasting impression and brand loyalty.

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Sales

We sell our memberships primarily through three channels: direct sales at the club level; through corporate and group sales; and through our websites. Through our corporate and group sales approach we concentrate on building long-term relationships with local and regional companies, organizations and other large groups.

We also sell individual memberships online for our standard membership types and the websites enable us to sell memberships for pre-established corporate and group programs. The websites also allow our members to give us direct feedback about our service levels and enables prospective members to sign up for a free one-day pass, free class trial or purchase a variety of short term guest passes. The online sales channel offers a high degree of convenience for customers who know and trust our brand and do not require up-front interaction with a membership sales consultant to make their decision. In addition, selling online significantly reduces our cost of sale. The websites also provide information about the respective club locations, program offerings, exercise class schedules and sales promotions. Job seekers can also begin the employment application process through the respective websites and investors can access financial information and resources.

Memberships

We offer various types of memberships, including single club access and variations of multiple club access. At certain locations, we also offer memberships that include both gym access and spa services.

The membership prices are dependent on club location and whether the member joins under a “month-to-month” or “commit” contract. Under the commit contract, new members commit to a one-year membership, generally at a lower monthly rate than a month-to-month membership. A member may cancel a commit membership at any time for a fee. When the commit contract period is over, they retain membership as a month-to-month member until they choose to cancel. As of December 31, 2018, approximately 87% of our total members were on a month-to-month basis.

In joining a club, a new member signs a membership agreement that typically obligates the member to pay fees (“Joining Fees”) including a one-time initiation fee and the first annual fee. The annual fee is also charged on each anniversary of the enrollment date, however not considered a joining fee after the first payment. As of December 31, 2018, approximately 99% of our members pay their membership dues through monthly electronic fund transfers (“EFT”), with EFT membership revenue constituting approximately 75% of total consolidated revenue for the year ended December 31, 2018.

Usage

Our total club usage, based on the number of member visits, was approximately 30 million member visits during a year. In the year ended December 31, 2018, approximately 25% of total usage or club visits was to members’ non-home clubs, indicating that our members take advantage of our network of clubs. Our membership plans allow for club members to elect to pay a per visit fee to use clubs that are not defined in their membership plan.

Non-Membership Revenue

The table below presents non-membership revenue (in thousands) components as a percentage of total revenue for the years ended December 31, 2016 through 2018.

	For the Years Ended December 31,					
	2018	%	2017	%	2016	%
Total revenue	\$443,094	100.0%	\$403,042	100.0%	\$396,921	100.0%
Non-Membership Revenue:						
Personal training revenue	73,458	16.5 %	69,735	17.3 %	66,487	16.8 %
Other ancillary club revenue ⁽¹⁾	23,293	5.3 %	17,197	4.3 %	19,642	4.9 %
Fees and Other revenue ⁽²⁾	5,737	1.3 %	5,876	1.4 %	6,361	1.6 %
Total non-membership revenue	\$102,488	23.1 %	\$92,808	23.0 %	\$92,490	23.3 %

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

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

Club Format and Locations

Our clubs are generally located in middle- or upper-income residential, commercial, urban and suburban neighborhoods within major metropolitan areas that are capable of supporting the development of a cluster of clubs. Our clubs typically have

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high visibility and are easily accessible. In the New York metropolitan, Boston, Washington, D.C. and Philadelphia regions, we have created clusters of clubs in urban areas and their commuter suburban areas aligned with our operating strategy of offering our target members the convenience of multiple locations close to where they live and work, reciprocal use privileges, and standardized facilities and services.

Approximately 68% of our existing clubs are fitness-only and 32% are multi-recreational. Our fitness-only clubs generally range in size from 15,000 to 25,000 square feet and average approximately 18,000 square feet. Our multi-recreational clubs generally range in size from 20,000 to 65,000 square feet, with one club being approximately 200,000 square feet. The average multi-recreational club size is approximately 40,000 square feet.

Our existing club base consists of clubs which we have developed and constructed as well as clubs we have acquired. Over the past three years from January 1, 2016 to December 31, 2018, we constructed six new clubs, acquired 43 clubs, closed or relocated 16 clubs, and transitioned one club to a licensed location. Currently, 89 of our clubs, or approximately 48% of our existing club base, were from acquisitions of privately owned single and multi-club businesses. In the year ended December 31, 2018, we acquired 25 clubs, opened one new club, closed six clubs, and transitioned one club to a licensed location, ending the year with 185 total clubs under operation. This compares to the acquisition of 18 clubs, construction and opening of two clubs, and five club closures during the year ended December 31, 2017. In both 2018 and 2017, we also upgraded certain existing clubs and plan to continue to do so in 2019.

Our facilities include a mix of both leased and owned cardiovascular and strength equipment from some of the best manufacturers. At many locations, additional amenities are also offered, including swimming pools, racquet and basketball courts, functional training zones and babysitting services. Personal training services are offered for an additional charge. Our fee-based programs offered at many of our clubs, include personal training, Small Group Training, children's programs, and summer camps for kids.

Our clubs also feature personal entertainment units. The units are typically mounted on or near individual pieces of cardiovascular equipment and are equipped with a flat-panel color screen for television viewing. We believe our members prefer the flexibility to view and listen to the programs of their choice during their cardiovascular workout. Recently most manufacturers are including embedded screens on their newest cardio fitness equipment which offer enhancements to both on-demand entertainment along with workout data tracking and connectivity to most mobile technologies.

Club Services and Operations

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

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

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

Driving excellence in fitness and ancillary programming is critical to our success. Members receive an introductory session with a fitness manager or a personal trainer who helps to develop a customized routine that supports the member's fitness goals. This initial assessment session includes a workout evaluation, cardio, strength and endurance testing, and movement screening. Members who elect to receive personal training can benefit from one-on-one coaching and guidance, with refreshed programs that evolve as the members achieve their fitness goals. The personal training membership product provides members with a certified personal trainer who works with the member to create an individualized goal-based program. Our fitness teams are trained to provide superior fitness solutions to address

member needs. We believe the qualifications of the personal training staff help to ensure that members receive a consistent level of quality service throughout our clubs and that our personal training programs provide valuable guidance to our members as well as a significant source of incremental revenue for us. We believe that members who participate in personal training programs typically have a longer membership life.

Our commitment to providing a quality exercise experience to our members also includes group exercise programming. Our instructors teach a variety of classes, including dance, cycling, strength conditioning, boxing, yoga, and Pilates classes. Instructors report through local club management and are further supported by regional managers responsible for ensuring

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consistency in class content, scheduling, training and instruction. We also provide Small Group Training offerings, which are fee-based programs that have smaller groups, and provide more focused, and typically more advanced classes.

In addition to group exercise, we offer a variety of ancillary programming for children under our Sports Clubs for Kids brand. As of December 31, 2018, Sports Clubs for Kids was being offered in certain club locations throughout our regions. Our Sports Clubs for Kids programming positions our multi-recreational clubs as family clubs, which we believe provides us with a competitive advantage. Depending upon the facilities available at a location, Sports Clubs for Kids programming can include traditional youth offerings such as day camps, sports camps, swim lessons, hockey and soccer leagues, gymnastics, dance, and birthday parties. It also can include non-competitive “learn-to-play” sports programs.

Our facilities and equipment management teams are dedicated to ensuring our clubs and fitness equipment are operating at the highest standard of performance for our members. Local teams are deployed to provide on-site support to clubs as needed.

Our club support and member services groups act as a coordinating point for all departments, supporting excellence in program execution and ensuring consistency of policies and procedures across the entire organization that support the member experience.

Centralized Information Systems

We recognize the value of enhancing and extending the uses of information technology (“IT”) in virtually every area of our business. Our IT strategy is aligned to support our business strategy and operating plans. We maintain an ongoing comprehensive program to monitor, replace or upgrade key technology services and infrastructure.

All of our clubs use a third-party hosted management system to process memberships, bill members, process point of sales transactions, and track member usage of the clubs. In addition, the management system tracks and analyzes key operating measurements such as membership statistics, cancellations, cross-club utilization, member tenure, and demographics profiles.

We continue to create a more customizable and efficient experience for members through updated digital tools, which included an enhanced website and mobile application. These digital tools enable feature membership sign up, club location search, class schedules and booking, training information, custom profiles for group fitness instructors and trainers. In addition, members are able to customize their group fitness experience based on fitness goals and preferences through a personalized search feature. We continue to enhance the digital tools accessibility to increase our online presence and member engagement.

Our back-office computer systems are comprised of a variety of technologies designed to assist in the management and analysis of our revenues, costs and key operational metrics, as well as support the daily operations of our clubs and corporate offices. These systems include an on premise financial system, a third-party hosted data warehouse, a third-party hosted telephone system and call center software to manage and track member service experiences.

We regularly implement cost effective technology solutions to accommodate growth, provide network redundancy, secure operating practices, better manage telecommunications and data costs, increase efficiencies in operations and improve management of all components of our technical architecture, including business continuity and recovery. Improvements in the IT infrastructure will continue to be made in the future in order to better serve our business needs.

Intellectual Property

We have registered various trademarks and service marks with the U.S. Patent and Trademark Office, including, NEW YORK SPORTS CLUBS and NYSC, WASHINGTON SPORTS CLUBS and WSC, BOSTON SPORTS CLUBS and BSC, PHILADELPHIA SPORTS CLUBS and PSC, LUCILLE ROBERTS, TMPL, SPORTS CLUBS FOR KIDS, COMPANIESGETFIT.COM, MASTER CLASS, LATITUDE SPORTS CLUBS, TOTAL WOMEN GYM AND SPA, CHRISTI’S FITNESS, LIV FITNESS CLUBS, WESTBORO TENNIS & SWIM CLUB and PALM BEACH SPORTS CLUBS. We continue to register other trademarks and service marks. We believe that our rights to these properties are adequately protected.

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Competition

The fitness club industry is highly competitive and continues to become more competitive. In each of the regions in which we operate, we compete with other fitness clubs, physical fitness and recreational facilities.

We consider the following groups to be our primary competitors in the health and fitness industry:

- commercial, multi-recreational and fitness-only chains;
- private studios, and other boutique fitness offerings;
- the YMCA and similar non-profit organizations;
- physical fitness and recreational facilities established by local governments, hospitals and businesses;
- exercise and small fitness clubs; racquet, tennis and other athletic clubs;
- amenity gyms in apartments, condominiums and offices;
- weight-reducing salons;
- country clubs;
- the home-use fitness equipment industry; and
- online fitness coaching.

The principal methods of competition include pricing and ease of payment, required level of members' contractual commitment, level and quality of services, age of facility and equipment, training and quality of supervisory staff, size and layout of facility and convenience of location with respect to access to transportation and pedestrian traffic.

We consider our traditional service offerings to be in the mid-tier of the value/service proposition and designed to appeal to a large portion of the population who utilize fitness facilities. The number of competitor clubs that offer lower pricing and a lower level of service have continued to grow in our regions over the last few years. These clubs have attracted, and may continue to attract, members away from both our fitness-only clubs and our multi-recreational clubs.

We also face competition from club operators offering comparable or higher pricing with higher levels of service. Larger outer-suburban family fitness centers, in areas where suitable real estate is more likely to be available, also compete effectively against our suburban formats. Additionally, we face competition from the rising popularity and demand for private studios offering niche boutique experiences.

There can be no assurance that we will be able to compete effectively in the future in the regions in which we operate. Competitors, who may include companies that are larger and have greater resources than us, may enter these regions to our detriment. These competitive conditions may result in increased price competition and limit our ability to attract new members and attract and retain qualified personnel. Additionally, consolidation in the fitness club industry could result in increased competition among participants, particularly large multi-facility operators that are able to compete for attractive acquisition candidates and/or newly constructed club locations. This increased competition could increase our costs associated with expansion through both acquisitions and for real estate availability for newly constructed club locations.

We believe that our market leadership, experience and operating efficiencies enable us to provide the consumer with a superior product in terms of convenience, quality service and affordability. We believe that there are barriers to entry in our metropolitan areas, including restrictive zoning laws, lengthy permit processes and a shortage of appropriate real estate, which could discourage any large competitor from attempting to open a chain of clubs in these regions. However, such a competitor could enter these regions more easily through one, or a series of, acquisitions. These barriers of entry are significant in our four metropolitan regions; however, they are less challenging in our surrounding suburban locations.

Seasonality of Business

Seasonal trends have a limited effect on our overall business. Generally, we experience greater membership through increased sales at the beginning of each year and experience an increased rate of membership attrition during the summer months. In addition, during the summer months, we experience a slight increase in operating expenses due to our outdoor pool and summer camp operations, generally matched by seasonal revenue recognition from season pool memberships and camp revenue.

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Government Regulation

Our operations and business practices are subject to federal, state and local government regulation in the various jurisdictions in which our clubs are located, including general rules and regulations of the Federal Trade Commission, state and local consumer protection agencies and state statutes that prescribe certain forms and provisions of membership contracts and that govern the advertising, sale, financing and collection of such memberships as well as state and local health regulations.

Statutes and regulations affecting the fitness industry have been enacted in jurisdictions in which we conduct business and other states into which we may expand in the future have adopted or may adopt similar legislation. Typically, these statutes and regulations prescribe certain forms and provisions of membership contracts, afford members the right to cancel the contract within a specified time period after signing or in certain circumstances, such as for medical reasons or relocation to a certain distance from the nearest club, require an escrow of funds received from pre-opening sales or the posting of a bond or proof of financial responsibility and may establish maximum prices for membership contracts and limitations on the term of contracts. The specific procedures and reasons for cancellation vary due to differing laws in the respective jurisdictions, but in each instance, the canceling member is entitled to a refund of unused prepaid amounts. We are also subject to numerous other types of federal and state regulations governing the sale of memberships. These laws and regulations are subject to varying interpretations by a number of state and federal enforcement agencies and courts. We maintain internal review procedures to comply with these requirements and believe that our activities are in substantial compliance with all applicable statutes, rules and decisions.

We primarily accept payments for our memberships through EFT from credit cards, and, therefore, we are subject to both federal and state legislation and certification requirements, including the Electronic Funds Transfer Act. Some states, such as New York, have passed or have considered legislation requiring gyms and health clubs to offer non-automatic renewal membership option at all times and/or limit the duration for which gym memberships can auto-renew through EFT payments, if at all. Our business relies heavily on the fact that our memberships continue on a month-to-month basis after the completion of any initial term requirements (if any), and compliance with these laws, regulations, and similar requirements may be onerous and expensive, and variances and inconsistencies from jurisdiction to jurisdiction may further increase the cost of compliance and doing business. States that have such health club statutes provide harsh penalties for violations, including membership contracts being void or voidable. Additionally, the collection, maintenance, use, disclosure and disposal of individually identifiable data by our businesses are regulated at the federal, state and provincial levels as well as by certain financial industry groups, such as the Payment Card Industry Organization and the National Automated Clearing House Association. Federal, state and financial industry groups may also consider from time to time new privacy and security requirements that may apply to our businesses and may impose further restrictions on our collection, disclosure and use of individually identifiable information that are housed in one or more of our databases.

The tax treatment of membership dues varies by state. Some states in which we operate require sales tax to be collected on membership dues and personal training sessions. Several others states in which we operate have proposed similar tax legislation. These taxes have the effect of increasing the payments by our members, which could impede our ability to attract new members or induce members to cancel their membership.

Changes in any statutes, rules or regulations could have a material adverse effect on our financial condition and results of operations.

Employees

On December 31, 2018, we had approximately 7,700 employees, of whom approximately 1,800 were employed full-time. We are not a party to any collective bargaining agreement with our employees. We operate with an open door policy and encourage a culture of openness, innovation and inclusiveness that creates a high level of work accountability. We have good relations with our employees and are proud to offer them a great work environment with opportunities for growth and development.

Available Information

We make available through our web site at <https://www.townsportsinternational.com> in the “Investor Relations — SEC Filings” section, free of charge, all reports and amendments to those reports filed or furnished pursuant to Section 13(a)

or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Occasionally, we may use our 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 <https://www.townsportsinternational.com>. In addition, you may automatically receive email alerts

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and other information about the Company by enrolling through the “Email Alerts” section at <https://www.townsportsinternational.com>.

The foregoing information regarding our website and its content is for convenience only. The content of our website is not deemed to be incorporated by reference into this report nor should it be deemed to have been filed with the SEC.

Item 1A. Risk Factors

Investors should carefully consider the risks described below and all other information in this Annual Report. The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business and operations. If any of the following risks actually occur, our business, financial condition, cash flows or results of operations could be materially adversely affected.

Risks Related to Our Business

We are dependent on our Chief Executive Officer. In addition, the loss of key personnel and/or failure to attract and retain highly qualified personnel could make it more difficult for us to develop our business and enhance our financial performance.

We are dependent on the continued services of our senior management team, including our Chief Executive Officer, Patrick Walsh. We believe the loss of Mr. Walsh could have a material adverse effect on us and our financial performance. Currently, we do not have any long-term employment agreements with our executive officers, and we may not be able to attract and retain sufficient qualified personnel to meet our business needs.

Our future profitability is not assured.

Our operating results for future periods are subject to numerous uncertainties and there can be no assurances that we will be profitable in the foreseeable future, if at all. If our revenues decrease in a given period, we may be unable to reduce operating expenses as a significant part of our operating expenses are fixed, which could materially and adversely affect our business and, therefore, our results of operations and lead to a net loss (or a larger net loss) for that period and subsequent periods.

We may be unable to attract and retain members, which could have a negative effect on our business.

The performance of our clubs is highly dependent on our ability to attract and retain members, and we may not be successful in these efforts. Most of our members hold month-to-month memberships and accordingly, most members can cancel their club membership at any time without penalty. In addition, we experience attrition and must continually engage existing members and attract new members in order to maintain our membership levels and ancillary sales. There are numerous factors that have in the past and could in the future lead to a decline in membership levels or that could prevent us from increasing our membership, including a decline in our ability to deliver quality service at a competitive cost, the age and condition of our clubs and equipment, the presence of direct and indirect competition in the areas in which the clubs are located, the public’s interest in fitness clubs and general economic conditions. In order to increase membership levels, we may from time to time offer lower membership rates and initiation fees. Any decrease in our average membership rates or reductions in initiation fees may adversely impact our results of operations.

Negative economic conditions, including increased unemployment levels and decreased consumer confidence, have in the past contributed to and in the future could lead to significant pressures and declines in economic growth, including reduced consumer spending. In a depressed economic and consumer environment, consumers and businesses may postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values, which could have a material negative effect on the demand for our services and products and such decline in demand may continue as the economy continues to struggle and disposable income declines. Other factors that could influence demand include increases in fuel and other energy costs, conditions in the residential real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence and other macroeconomic factors affecting consumer spending behavior. As a result of these factors, membership levels might not be adequate to maintain our operations at current levels or permit the expansion of our operations.

In addition, to the extent our corporate clients are adversely affected by negative economic conditions, they may decide, as part of expense reduction strategies, to curtail or cancel club membership benefits provided to their

respective employees. Any reductions in corporate memberships may lead to membership cancellations as we cannot assure that employees of corporate customers will choose to continue their memberships without employer subsidies. A decline in membership levels may have a material adverse effect on our business, financial condition, results of operations and cash flows.

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The level of competition in the fitness club industry could negatively impact our revenue growth and profitability. The fitness club industry is highly competitive and continues to become more competitive. In each of the regions in which we operate, we compete with other fitness clubs, private studios, physical fitness and recreational facilities established by local governments, hospitals and businesses for their employees, amenity and condominium clubs, the YMCA and similar organizations and, to a certain extent, with racquet and tennis and other athletic clubs, country clubs, weight reducing salons and the home-use fitness equipment industry. We might not be able to compete effectively in the future in the regions in which we operate. Competitors include companies that are larger and have greater resources than us and also may enter these regions to our detriment. These competitive conditions may limit our ability to increase dues without a material loss in membership, attract new members and attract and retain qualified personnel. Additionally, consolidation in the fitness club industry could result in increased competition among participants, particularly large multi-facility operators that are able to compete for attractive acquisition candidates or newly constructed club locations, thereby increasing costs associated with expansion through both acquisitions and lease negotiation and real estate availability for newly constructed club locations.

The number of competitor clubs that offer lower pricing and a lower level of service continue to grow in our regions. These clubs have attracted, and may continue to attract, members away from both our fitness-only clubs and our multi-recreational clubs, particularly in the current consumer environment. Furthermore, smaller and less expensive weight loss facilities present a competitive alternative for consumers.

We also face competition from competitors offering comparable or higher pricing with higher levels of service or offerings. Larger outer-suburban, multi-recreational family fitness centers, in areas where suitable real estate is more likely to be available, also compete against our suburban, fitness-only models.

We also face competition from the increased popularity and demand for private studios offering group exercise classes. The prevalence of these smaller studios may compete against our own studio type offerings, such as cycling, Yoga and Pilates, as consumers may opt to use these competing studios to fulfill their fitness needs.

In addition, large competitors could enter the urban regions in which we operate to open a chain of clubs in these regions through one, or a series of, acquisitions.

The success of our business depends on our ability to retain the value of our brands.

Our ability to maintain our brand image and reputation is integral to our business. Maintaining, promoting and growing our brands will depend largely on the success of our marketing efforts and our ability to provide a consistent, high-quality member experience. Our reputation could be jeopardized if we fail to maintain high standards for member experiences, fail to maintain high ethical, social, and environmental standards for all of our operations and activities, or we fail to appropriately respond to concerns associated with any of the foregoing or any other concerns from our members. We could be adversely impacted if we fail to achieve any of these objectives or if the reputation or image of any of our brands is tarnished or receives negative publicity. In addition, adverse publicity about regulatory or legal action against us, or by us, could damage our reputation and brand image. Damage to our reputation or loss of consumer confidence for any of these reasons may result in fewer memberships sold or renewed, which in turn could materially and adversely affect our results of operations and financial condition.

We continue to experience revenue pressure, which may adversely affect our results or operations and cash flow from operations and we may be compelled to take additional actions which may not be successful in mitigating such effects. We continue to experience revenue pressure as the fitness industry continues to be highly competitive in the geographic regions in which we compete. We continue to strategize on improving our financial results and focus on increasing membership in existing clubs to increase revenue. We may consider additional actions within our control, including certain acquisitions, licensing arrangements, the closure of unprofitable clubs upon lease expiration and the sale of certain assets. Our ability to continue to meet our obligations is dependent on our ability to generate positive cash flow from a combination of initiatives, including those mentioned above. Failure to continue to successfully implement these initiatives could have a material adverse effect on our liquidity and our operations, and we would need to implement alternative plans that could include additional asset sales, additional reductions in operating costs, additional reductions in working capital, debt restructurings and the deferral of

capital expenditures. There can be no assurance that such alternatives would be available to us or that we would be successful in their implementation.

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Low consumer confidence levels, increased competition and decreased spending could negatively impact our financial position and result in club closures and fixed asset and goodwill impairments.

In the years ended December 31, 2018 and 2017, we closed six and five clubs, respectively. In the year ended December 31, 2018 and 2017, we recognized fixed asset impairment charges of \$2.1 million and \$6.5 million, respectively, at underperforming clubs. Some of our club closures and impairments were due, in large part, to the economic and consumer environment, and increased competition in areas in which our clubs operate. If the economic and consumer environment were to deteriorate or not improve or if we are unable to improve the overall competitive position of our clubs, our operating performance may experience declines and we may need to recognize additional impairments of our fixed assets and goodwill and may be compelled to close additional clubs. In addition, we cannot ensure that we will be able to replace any of the revenue lost from these closed clubs from our other club operations. We will continue to monitor the results and changes in expectations of these clubs closely to determine if additional fixed asset or goodwill impairment charges will be necessary.

Our geographic concentration heightens our exposure to adverse regional developments.

As of December 31, 2018, we owned and operated 185 clubs under various brand names, primarily located in the United States of America. Our geographic concentration in the Northeast and Mid-Atlantic regions and, in particular, the New York metropolitan area, heightens our exposure to adverse developments in these areas, including those related to economic and demographic changes in these regions, competition, severe weather, potential terrorist threats or other unforeseen events.

For example, in the year ended December 31, 2012, as a result of flooding and power outages caused by Hurricane Sandy, 131 clubs were closed on October 29, 2012, with one club that closed permanently, 16 clubs that remained closed for over a week and one club that was closed for over a year and reopened in December 2013. We cannot predict the impact that any future severe weather events will have on our ability to avoid wide-spread or prolonged club closures. Any such events affecting the areas in which we operate might result in a material adverse effect on our business, financial condition, cash flows and results of operations in the future.

Any condition that causes people to refrain, or prevents people, from visiting our clubs, such as severe weather, outbreaks of pandemic or contagious diseases, or threats of terrorist attacks may adversely affect our business, operating results and financial condition.

Our business and operations could be materially and adversely affected by severe weather or outbreaks of pandemic or contagious diseases, threats of terrorist attacks or other conditions that cause people to refrain, or prevent people, from visiting our clubs. Our business could be severely impacted by a widespread regional, national or global health epidemic. A widespread health epidemic or perception of a health epidemic (such as Ebola), whether or not traced to one of our clubs, may cause members and prospective members to avoid public gathering places or otherwise change their behaviors and impact our ability to staff our clubs. Outbreaks of disease, such as influenza, could reduce traffic in our clubs. Any of these events would negatively impact our business. In addition, any negative publicity relating to these and other health-related matters may affect members' perceptions of our clubs, reduce member and prospective member visits to our clubs and negatively impact demand for our club offerings.

Further, terrorist attacks, such as the attacks that occurred in New York City and Washington, D.C. on September 11, 2001, and other acts of violence or war may affect our markets, our operating results or the market on which our common stock trades. Our geographic concentration in the major cities in the Northeast and Mid-Atlantic regions and, in particular, the New York City and Washington, D.C. areas, heightens our exposure to any such future terrorist attacks, which may adversely affect our clubs and result in a decrease in our revenues. The potential near-term and long-term effect these attacks may have for our members, the markets for our services and the market for our common stock are uncertain; however, their occurrence can be expected to further negatively affect the U.S. economy generally and specifically the regional markets in which we operate. The consequences of any terrorist attacks or any armed conflicts are unpredictable; and we may not be able to foresee events that could have an adverse effect on our business.

Our dependence on a limited number of suppliers for equipment and certain products and services could result in disruptions to our business and could adversely affect our revenues and gross profit.

Equipment and certain products and services used in our clubs, including our exercise equipment and point-of-sale software and hardware, are sourced from third-party suppliers. Although we believe that adequate substitutes are currently available, we depend on these third-party suppliers to operate our business efficiently and consistently meet our business requirements. The ability of these third-party suppliers to successfully provide reliable and high-quality services is subject to technical and operational uncertainties that are beyond our control, including, for our overseas suppliers, vessel availability and port delays or congestion. Any disruption to our suppliers' operations could impact our supply chain and our ability to service our existing clubs and open new clubs on time or at all and thereby generate revenue. If we lose such suppliers or our suppliers

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encounter financial hardships unrelated to the demand for our equipment or other products or services, we may not be able to identify or enter into agreements with alternative suppliers on a timely basis on acceptable terms, if at all. Transitioning to new suppliers would be time consuming and expensive and may result in interruptions in our operations. If we should encounter delays or difficulties in securing the quantity of equipment we require to open new and refurbish existing clubs, our suppliers encounter difficulties meeting our demands for products or services, our websites experience delays or become impaired due to errors in the third-party technology or there is a deficiency, lack or poor quality of products or services provided, our ability to serve our members and grow our brand would be interrupted. If any of these events occur, it could have a material adverse effect on our business and operating results. Our trademarks and trade names may be infringed, misappropriated or challenged by others.

We believe our brand names and related intellectual property are important to our business. We seek to protect our trademarks, trade names and other intellectual property by exercising our rights under applicable trademark and copyright laws. If we were to fail to successfully protect our intellectual property rights for any reason, it could have an adverse effect on our business, results of operations and financial condition. Any damage to our reputation could cause membership levels to decline and make it more difficult to attract new members.

Use of social media may adversely impact our reputation or subject us to fines or other penalties.

There has been a substantial increase in the use of social media platforms, including blogs, social media websites and other forms of internet-based communication, which allow individuals' access to a broad audience of consumers and other interested persons. Negative commentary about us may be posted on social media platforms or similar devices at any time and may harm our reputation or business. Consumers value readily available information about health clubs and often act on such information without further investigation and without regard to its accuracy. The harm may be immediate without affording us an opportunity for redress or correction. In addition, social media platforms provide users with access to such a broad audience that collective action against our clubs, such as boycotts, can be more easily organized. If such actions were organized, we could suffer reputational damage as well as physical damage to our clubs.

We also use social medial platforms as marketing tools. For example, we maintain Facebook, Instagram and Twitter accounts. As laws and regulations rapidly evolve to govern the use of these platforms and devices, the failure by us, our employees or third parties acting at our direction to abide by applicable laws and regulations in the use of these platforms and devices could adversely impact our business, financial condition and results of operations or subject us to fines or other penalties.

If we fail to comply with applicable privacy, security, and data laws, regulations and standards, our business could be materially and adversely affected.

We use electronic mail ("email"), text messages and phone calls to market our services to potential members and as a means of communicating with our existing members. The laws and regulations governing the use of telephonic communication, including but not limited to emails, text messages and phone calls, for commercial purposes continue to evolve. Because messaging and phone calls are important to our business, if we are unable to successfully deliver messages or make phone calls to existing members and potential members, if there are legal restrictions on delivering these messages to consumers, or if consumers do not or cannot receive our messages or phone calls, our revenues and profitability could be adversely affected. If new laws or regulations are adopted, or existing laws and regulations are interpreted, to impose additional restrictions on our ability to call or send email or text messages to our members or potential members, we may not be able to communicate with them in a cost-effective manner and it may limit our ability to utilize such forms of communication. In addition to legal restrictions on the use of emails, text messages and phone calls for commercial purposes, service providers and others attempt to block the transmission of unsolicited messages, commonly known as "spam." Many service providers have relationships with organizations whose purpose it is to detect and notify the service providers of entities that the organization believes is sending unsolicited messages. If a service provider identifies messaging from us as "spam" as a result of reports from these organizations or otherwise, we could be placed on a restricted list that will block our messages to members or potential members. If we are restricted or unable to communicate through emails, text messages or phone calls with our members and potential members as a result of legislation, regulation, blockage or otherwise, our business, operating results and financial

condition could be adversely effected.

If we are unable to identify and acquire suitable sites for new clubs, our revenue growth rate and profits may be negatively impacted.

To successfully expand our business over the long term, we must identify and acquire sites at acceptable costs that meet our site selection criteria. In addition to finding sites with the right geographical, demographic and other measures we employ in our selection process, we also need to evaluate the penetration of our competitors in the region. We face competition from

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other health and fitness center operators for sites that meet our criteria and as a result, we may lose those sites or we could be forced to pay higher prices for those sites. If we are unable to identify and acquire sites for new clubs on attractive terms, our revenue, growth rate and profits may be negatively impacted. Additionally, if our analysis of the suitability of a site is incorrect, we may not be able to recover our capital investment in developing and building a new club.

Acquisitions could result in operating difficulties, dilution, and other consequences that may adversely impact our business and results of operations.

Part of our key strategy is to grow through acquisitions. We expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. There can be no assurance that we will continue to be able to successfully integrate these acquisitions into our existing business without substantial costs, delays or other operational or financial difficulties. The areas where we face risks include:

- diversion of management time and focus from operating our business to acquisition integration challenges;
- difficulties in the transition of acquired members onto our systems timely;
- difficulties in accounting for acquired companies that remain under management contracts relating to accounting for operating results and vendor and payroll information;
- challenges related to the compliance with local laws when acquiring into new jurisdictions;
- the acquired businesses failing to provide, or delays in realizing, the benefits originally anticipated;
- integration of the acquired company's accounting, human resource, and other administrative systems, and coordination of sales and marketing functions;
- challenges related to the lack of experience in operating in the geographical regions of the acquired business;
- unanticipated contract or regulatory issues and the assumption of, and exposure to, unknown or contingent liabilities of the acquired businesses.

We anticipate that any future acquisitions we pursue as part of our business strategy may be financed through a combination of cash on hand, operating cash flow and availability under our existing credit facility. If new debt is added to current debt levels, or if we incur other liabilities, including contingent liabilities, in connection with an acquisition, the debt or liabilities could impose additional constraints and requirements on our business and financial performance, which could materially adversely affect our financial condition and operations.

If an acquisition is not successfully completed or integrated into our existing operations or does not result in the benefits we expect, as a result of the factors mentioned above or otherwise, our business, financial condition or results of operations may be adversely affected. In addition, failure to integrate successfully or realize the anticipated business opportunities and growth prospects from our acquisitions, could result in unanticipated expenses and losses and may require significant financial resources that would otherwise be available for the ongoing development or expansion of our existing operations. Accordingly, in connection with any acquisition, there can be no assurance as to whether or when any benefits or cost synergies we hope to achieve will occur, or the extent to which they actually will be achieved.

We have, and will continue to have, significant lease obligations. We are subject to risks associated with leasing substantial amounts of space, including future increases in occupancy costs and the need to generate significant cash flow to meet our lease obligations.

We have, and will continue to have, significant lease obligations. We lease substantially all of our fitness club locations pursuant to long-term leases (generally 15 to 20 years, plus option periods). During the next five years, or the period from January 1, 2019 through December 31, 2023, we have leases for 27 club locations that are due to expire without any renewal options, six of which expire in 2019, and 69 club locations that are due to expire with renewal options. For leases with renewal options, several of them provide for our unilateral option to renew for additional rental periods at specific rental rates (for example, based on the consumer price index or stated renewal terms already set in the leases) or based on the fair market rate at the location. Our ability to negotiate favorable terms on an expiring lease or to negotiate favorable terms on leases with renewal options, or conversely for a suitable alternate location, could depend on conditions in the real estate market, competition for desirable properties and our relationships with current and prospective landlords or may depend on other factors that are not within our control.

Any or all of these factors and conditions could negatively impact our revenue, growth and profitability.

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In addition to future minimum lease payments, some of our club leases provide for additional rental payments based on a percentage of net sales, or “percentage rent,” if sales at the respective clubs exceed specified levels, as well as the payment of common area maintenance charges, real property insurance, and real estate taxes. Many of our lease agreements have defined escalating rent provisions over the initial term and any extensions.

We depend on cash flow from operations to pay our lease expenses. If our business does not generate sufficient cash flow from operating activities to fund these expenses, we may not be able to service our lease expenses, which could materially harm our business. Furthermore, the significant cash flow required to satisfy our obligations under the leases increases our vulnerability to adverse changes in general economic, industry, and competitive conditions, and could limit our ability to fund working capital, incur indebtedness, and make capital expenditures or other investments in our business.

If an existing or future club is not profitable, and we decide to close it, we may nonetheless be committed to perform our obligations under the applicable lease including, among other things, paying the base rent for the balance of the lease term. Moreover, even if a lease has an early cancellation clause, we may not satisfy the contractual requirements for early cancellation under that lease. Our inability to enter into new leases or renew existing leases on terms acceptable to us or be released from our obligations under leases for clubs that we close could materially adversely affect us.

We may experience prolonged periods of losses in our recently opened clubs and when we open new clubs in existing regions our comparable club revenue growth and our operating margins may be negatively impacted.

Upon opening a club, we typically experience an initial period of club operating losses. The sale of memberships typically generates insufficient revenue for the club to initially generate positive cash flow. As a result, a new club typically generates an operating loss in its first full year of operations and substantially lower margins in its second full year of operations than a club opened for more than 24 months. These operating losses and lower margins will negatively impact our future results of operations. This negative impact will be increased by the initial expensing of pre-opening costs, which include legal and other costs associated with lease negotiations and permitting and zoning requirements, as well as depreciation and amortization expenses, which will further negatively impact our results of operations. We may, at our discretion, accelerate or expand our plans to open new clubs, which may adversely affect results from operations.

We currently operate clubs throughout the Northeast, Mid-Atlantic, Florida, California, and Puerto Rico regions of the United States. In the case of existing regions, our experience has been that opening new clubs may attract some memberships away from other clubs already operated by us in those regions and diminish their revenues. In addition, as a result of new club openings in existing regions and because older clubs will represent an increasing proportion of our club base over time, our mature club revenue increases may be lower in future periods than in the past.

Another result of opening new clubs is that our club operating margins may be lower than they have been historically while the clubs build a membership base. We expect both the addition of pre-opening expenses and the lower revenue volumes characteristic of newly opened clubs to affect our club operating margins at these new clubs.

We are subject to government regulation, and changes in these regulations could have a negative effect on our financial condition and results of operations.

Our operations and business practices are subject to federal, state and local government regulation in the various jurisdictions in which our clubs are located, including, but not limited to the following:

- general rules and regulations of the Federal Trade Commission;
- rules and regulations of state and local consumer protection agencies;
- state statutes that prescribe certain forms and provisions of membership contracts
- state statutes that govern the advertising, sale, financing and collection of memberships;
- federal and state laws and regulations governing privacy and security of information; and
- state and local health regulations

Any changes in such laws or regulations could have a material adverse effect on our financial condition and results of operations.

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We could be subject to claims related to health or safety risks at our clubs.

Use of our clubs poses some potential health or safety risks to members or guests through physical exertion and use of our services and facilities, including exercise equipment. Claims might be asserted against us for injury suffered by, or death of members or guests while exercising at a club. We might not be able to successfully defend such claims. As a result, we might not be able to maintain our general liability insurance on acceptable terms in the future or maintain a level of insurance that would provide adequate coverage against potential claims.

Depending upon the outcome, these matters may have a material effect on our consolidated financial position, results of operations and cash flows.

We may be exposed to other litigation from time to time that can have significant adverse effects upon us.

In the ordinary course of conducting our business, we are exposed to litigation from time to time that can have significant adverse effects upon our consolidated financial position, results of operations and cash flows. At any given time there may be one or more civil actions initiated against us, including the matters disclosed under “Legal Proceedings” in this Annual Report. If one or more of these pending lawsuits, or any lawsuits in the future are adjudicated in a manner adverse to our interests, or if a settlement of any lawsuit requires us to pay a significant amount, the result could have an adverse impact on our consolidated financial position, results of operations and cash flows. In addition, any litigation, regardless of the outcome, may distract our management from the operation of our business.

Security and privacy breaches may expose us to liability and cause us to lose customers.

Federal and state law requires us to safeguard our customers’ financial information, including credit card information. Although we have established security procedures and protocol, including credit card industry compliance procedures, to protect against identity theft and the theft of our customers’ financial information, our security and testing measures may not prevent security breaches and breaches of our customers’ privacy may occur, which could harm our business. For example, a significant number of our users provide us with credit card and other confidential information and authorize us to bill their credit card accounts directly for our products and services. Typically, we rely on encryption and authentication technology licensed from third parties to enhance transmission security of confidential information. Techniques used to obtain unauthorized access or to sabotage systems change frequently and are constantly evolving. These techniques and other advances in computer capabilities, new discoveries in the field of cryptography, inadequate facility security or other developments may result in a compromise or breach of the technology used by us or one of our vendors to protect customer data. We may be unable to anticipate these techniques or to implement adequate preventive or reactive measures. Several recent, highly publicized data security breaches at other companies have heightened consumer awareness of this issue. Further, a significant number of states require the customers be notified if a security breach results in the disclosure of their personal financial account or other information.

Additional states and governmental entities are considering such “notice” laws. In addition, other public disclosure laws may require that material security breaches be reported.

Any compromise of our security or that of our third party vendors or noncompliance with privacy or other laws or requirements could harm our reputation, cause our members to lose confidence in us, or harm our financial condition and, therefore, our business. In addition, a party who is able to circumvent our security measures or exploit inadequacies in our security measures or that of our third party vendors, could, among other effects, misappropriate proprietary information, cause interruptions in our operations or expose members to computer viruses or other disruptions. We may be required to make significant expenditures to protect against security breaches or to remedy problems caused by any breaches. Actual or perceived vulnerabilities may lead to claims against us. To the extent the measures taken by us or our third party vendors prove to be insufficient or inadequate, we may become subject to litigation or administrative sanctions, which could result in significant fines, penalties or damages and harm to our reputation.

Changes in legislation or requirements related to electronic fund transfer, or our failure to comply with existing or future regulations, may adversely impact our business.

We primarily accept payments for our memberships through EFT from members’ bank accounts and, therefore, we are subject to federal, state and provincial legislation and certification requirements governing EFT, including the

Electronic Funds Transfer Act. Some states, such as New York, have passed or have considered legislation requiring gyms and health clubs to offer a prepaid membership option at all times and/or limit the duration for which gym memberships can auto-renew through EFT payments, if at all. Our business relies heavily on the fact that our memberships continue on a month-to-month basis after the completion of any initial term requirements, and compliance with these laws and regulations and similar requirements may be onerous and expensive. In addition, variances and inconsistencies from jurisdiction to jurisdiction may further increase the cost of compliance and doing business. States that have such health club statutes provide harsh penalties for violations, including membership contracts being void or voidable. Our failure to comply fully with these rules or requirements may

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subject us to fines, higher transaction fees, penalties, damages and civil liability and may result in the loss of our ability to accept EFT payments, which would have a material adverse effect on our business, results of operations and financial condition. In addition, any such costs, which may arise in the future as a result of changes to the legislation and regulations or in their interpretation, could individually or in the aggregate cause us to change or limit our business practice, which may make our business model less attractive to our members.

We are subject to a number of risks related to ACH, credit card and debit card payments we accept.

We accept payments through automated clearing house (“ACH”), credit card and debit card transactions. For ACH, credit card and debit card payments, we pay interchange and other fees, which may increase over time. An increase in those fees would require us to either increase the prices we charge for our memberships, which could cause us to lose members or suffer an increase in our operating expenses, either of which could harm our operating results.

If we or any of our processing vendors have problems with our billing software, or the billing software malfunctions, it could have an adverse effect on our member satisfaction and could cause one or more of the major credit card companies to disallow our continued use of their payment products. In addition, if our billing software fails to work properly and, as a result, we do not automatically charge our members’ credit cards, debit cards or bank accounts on a timely basis or at all, we could lose membership revenue, which would harm our operating results.

If we fail to adequately control fraudulent ACH, credit card and debit card transactions, we may face civil liability, diminished public perception of our security measures and significantly higher ACH, credit card and debit card related costs, each of which could adversely affect our business, financial condition and results of operations. The termination of our ability to process payments through ACH transactions or on any major credit or debit card would significantly impair our ability to operate our business.

Regulatory changes in the terms of credit and debit card usage, including any existing or future regulatory requirements, could have an adverse effect on our business.

Our business relies heavily on the use of credit and debit cards in sales transactions. Regulatory changes to existing rules or future regulatory requirements affecting the use of credit and debit cards or the fees charged could impact the consumer and financial institutions that provide card services. This may lead to an adverse impact on our business if the regulatory changes result in unfavorable terms to either the consumer or the banking institutions.

Disruptions and failures involving our information systems could cause customer dissatisfaction and adversely affect our billing and other administrative functions.

The continuing and uninterrupted performance of our information systems is critical to our success. We use a fully-integrated information system to process new memberships, bill members, check-in members and track and analyze sales and membership statistics, the frequency and timing of member workouts, cross-club utilization, member life, value-added services and demographic profiles by member. This system also assists us in evaluating staffing needs and program offerings. We believe that, without investing in enhancements, this system would have reached the end of its life cycle. Correcting any disruptions or failures that affect our proprietary system could be difficult, time-consuming and expensive because we would need to use contracted consultants familiar with our system.

Any failure of our current system could also cause us to lose members and adversely affect our business and results of operations. Our members may become dissatisfied by any systems disruption or failure that interrupts our ability to provide our services to them. Disruptions or failures that affect our billing and other administrative functions could have an adverse effect on our operating results.

Infrastructure changes are being undertaken to accommodate our growth, provide network redundancy, better manage telecommunications and data costs, increase efficiencies in operations and improve management of all components of our technical architecture. Fire, floods, earthquakes, power loss, telecommunications failures, break-ins, acts of terrorism and similar events could damage our systems. In addition, computer viruses, electronic break-ins or other similar disruptive problems could also adversely affect our sites. Any system disruption or failure, security breach or other damage that interrupts or delays our operations could cause us to lose members, damage our reputation, and adversely affect our business and results of operations.

Our growth or changes in the industry could place strains on our management, employees, information systems and internal controls, which may adversely impact our business.

Future expansion or changes in the industry will place increased demands on our administrative, operational, financial and other resources. Any failure to manage such growth or changes effectively could seriously harm our business. To be

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successful, we will need to continue to improve management information systems and our operating, administrative, financial and accounting systems and controls. We will also need to train new employees and maintain close coordination among our executive, accounting, finance, marketing, sales and operations functions. These processes are time-consuming and expensive, increase management responsibilities and divert management attention.

Outsourcing certain aspects of our business could result in disruption and increased costs.

We have outsourced certain aspects of our business to third party vendors that subject us to risks, including disruptions in our business and increased costs. For example, we have engaged third parties to host and manage certain aspects of our data center, information and technology infrastructure and electronic pay solutions.

Accordingly, we are subject to the risks associated with the vendor's ability to provide these services to meet our needs. If the cost of these services is more than expected, if the vendor is not able to handle the volume of activity or perform the quality of service that we expect, if we or the vendor are unable to adequately protect our data and information is lost, if our ability to deliver our services is interrupted, or if our third party vendors face financial or other difficulties, then our business and results of operations may be negatively impacted.

Our cash and cash equivalents are concentrated in a small number of banks.

Our cash and cash equivalents are held, primarily, in a small number of commercial banks. These deposits are not collateralized. In the event these banks become insolvent, we would be unable to recover most of our cash and cash equivalents deposited at the banks. Cash and cash equivalents held in one commercial bank as of December 31, 2018 totaled \$24.6 million. During 2018, in any one month, the amount held in one commercial bank has been as high as approximately \$45.9 million.

Because of the capital-intensive nature of our business, we may have to incur additional indebtedness or issue new equity securities and, if we are not able to obtain additional capital, our ability to operate or expand our business may be impaired and our results of operations could be adversely affected.

Our business requires significant levels of capital to finance the development of additional sites for new clubs and the construction of our clubs. If cash from available sources is insufficient or unavailable due to restrictive credit markets, or if cash is used for unanticipated needs, we may require additional capital sooner than anticipated. In the event that we are required or choose to raise additional funds, we may be unable to do so on favorable terms or at all.

Furthermore, the cost of debt financing could significantly increase, making it cost-prohibitive to borrow, which could force us to issue new equity securities. If we issue new equity securities, existing stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise funds on acceptable terms, we may not be able to execute our current growth plans, take advantage of future opportunities or respond to competitive pressures. Any inability to raise additional capital when required could have an adverse effect on our business plans and operating results.

We may incur rising costs related to construction of new clubs and maintaining our existing clubs. If we are not able to pass these cost increases through to our members, our returns may be adversely affected.

Our clubs require significant upfront investment. If our investment is higher than we had planned, we may need to outperform our operational plan to achieve our targeted return. We cannot assure that we can offset cost increases by increasing our membership dues and other fees and improving profitability through cost efficiencies.

We may be required to remit unclaimed property to states for unused, expired personal training sessions.

We recognize revenue from personal training sessions as the services are performed (i.e., when the session is trained). Unused personal training sessions expire after a set, disclosed period of time after purchase (except in California and Florida) and are not refundable or redeemable by the member for cash. We had collected approximately \$12.4 million and \$12.5 million for unused and expired personal training sessions that had not been recognized as revenue and was recorded as deferred revenue as of December 31, 2018 and 2017, respectively. For six of the jurisdictions in which we operate, we have concluded, based on opinions from outside counsel, that monies paid to the company for unused and expired personal training sessions were not escheatable. For the remaining jurisdictions in which we operate, we have likewise concluded that the monies paid to the company for unused personal training sessions were not escheatable, regardless of whether they expire. However, we have not yet obtained opinions from outside counsel for these jurisdictions. It is possible however, that one or more of these jurisdictions may not agree with our position and may

claim that we must remit all or a portion of these amounts to such jurisdiction. This could have a material adverse effect on our cash flows. The State of New York has informed us that it is considering whether we are required to remit the amount received by the Company for unused, expired personal training sessions to the State of New York as unclaimed property.

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We may have exposure to additional tax liabilities.

From time to time, we are under audit by federal and local tax authorities and we may be liable for additional tax obligations and may incur additional costs in defending any claims that may arise. For example, as of December 31, 2018, certain of our state and local tax returns from years 2006 through 2014 were being examined by certain state and local jurisdictions and it is difficult to predict the final outcome or timing of resolution of any particular matter regarding these examinations. In particular, we disagree with the proposed assessment dated December 12, 2016 from the State of New York and attended a conciliation conference with the New York State Department of Taxation and Finance Audit section on June 7, 2017. No settlement was reached at the conference and the proposed assessment was sustained. As such, in a revised letter dated November 30, 2017, we received from the State of New York a revised assessment related to tax years 2006-2009 for approximately \$5.1 million, inclusive of approximately \$2.4 million of interest. The Company has appealed the assessment with the New York State Division of Tax Appeals. On November 17, 2017, we were notified that the State of New York proposed an adjustment in the amount of approximately \$3.9 million for the years 2010 to 2014, inclusive of approximately \$757,000 in interest. In November 2018, we met with the Department officials for the assessment related to 2010 to 2014. The meeting ended with the company disagreeing with the proposed assessment for the years in audit. Subsequently, in a letter dated February 4, 2019, the interest amount is revised to \$1.2 million.

The Company is also under examination in New York City (2006 through 2014). New York City Department of Finance has proposed an audit change notice to the Company dated May 2, 2018, for the tax years ended December 31, 2006 through December 31, 2009 for proposed general corporation tax liability in the amount of \$4.8 million plus \$4.1 million in interest. In a letter dated January 18, 2019, NYC Department of finance has issued a proposed general tax liability of \$5.6 million, inclusive of \$1.6 million in interest for audit periods 2010 to 2014.

We currently are in the process of appealing the assessment with the New York State Division of Tax Appeals. We have not recorded a tax reserve related to the proposed assessments. It is difficult to predict the ultimate outcome of this or any other tax examination and the result of any such tax examination could have a material adverse effect on our results of operations and financial condition.

Risks Related to Our Leverage and Our Indebtedness

On November 15, 2013, TSI LLC entered into a \$370.0 million senior secured credit facility (“2013 Senior Credit Facility”). The 2013 Senior Credit Facility consists of a \$325.0 million term loan facility (“2013 Term Loan Facility”), and a \$45.0 million revolving loan facility (“2013 Revolving Loan Facility”). On November 8, 2018, the 2013 Senior Credit Facility was amended, which modified the revolving loan facility amount to \$15.0 million from \$45.0 million. The 2013 Term Loan Facility matures on November 15, 2020, and the amended 2013 Revolving Loan Facility matures on August 14, 2020.

We may be negatively affected by economic conditions in the U.S. and key international markets.

We must maintain liquidity to fund our working capital, service our outstanding indebtedness and finance investment opportunities. Without sufficient liquidity, we could be forced to curtail our operations or we may not be able to pursue new business opportunities. The principal sources of our liquidity are funds generated from operating activities, available cash and cash equivalents and borrowings under our 2013 Revolving Loan Facility. If our current resources do not satisfy our liquidity requirements, we may have to seek additional financing.

Economic conditions, both domestic and foreign, may affect our financial performance. Prevailing economic conditions, including unemployment levels, inflation, availability of credit, energy costs and other macro-economic factors, as well as uncertainty about future economic conditions, adversely affect consumer spending and, consequently, our business and results of operations.

Our leverage may impair our financial condition, and we may incur significant additional debt.

We currently have a substantial amount of debt. As of December 31, 2018, the principal amount of debt outstanding under our 2013 Term Loan Facility was \$197.8 million. The 2013 Term Loan Facility expires on November 15, 2020. In addition, as of December 31, 2018, under the 2013 Revolving Loan Facility there were no outstanding borrowings and outstanding letters of credit issued associated with this revolving loan facility totaled \$2.2 million, which if still outstanding, will likely need to be funded by our cash upon the expiration of the 2013 Revolving Loan Facility on

August 14, 2020. The Company also had \$2.0 million in outstanding letters of credit issued that were not associated with the 2013 Revolving Credit Facility to secure certain lease related obligations. The unutilized portion of the 2013 Revolving Loan Facility as of December 31, 2018 was \$12.8 million, with borrowings under such facility subject to the conditions applicable to borrowings under our 2013 Senior Credit Facility, which conditions we may or may not be able to satisfy at the time of borrowing. Our substantial debt could have important consequences, including:

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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 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 at variable interest rates;
limiting our ability to refinance our existing indebtedness on favorable terms before the expiration of the current 2013 Term Loan Facility, 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. If new debt is added to our and our subsidiaries' current debt levels, the related risks that we and they currently face could intensify.

The current debt under the 2013 Senior Credit Facility has a floating interest rate and an increase in interest rates may negatively impact our financial results.

Interest rates applicable to our debt are expected to fluctuate based on economic and market factors that are beyond our control. Any significant increase in market interest rates, and in particular the short-term Eurodollar rates, would result in a significant increase in interest expense on our debt, which could negatively impact our net income and cash flows.

Credit market volatility may affect our ability to refinance our existing debt, borrow funds under our existing lines of credit or incur additional debt.

Future disruption and volatility in credit market conditions could have a material adverse impact on our ability to refinance debt when it comes due on terms similar to our current credit facilities, or to draw upon existing lines of credit or incur additional debt if needed as a result of unanticipated downturns in the markets for our products and services, which may require us or our subsidiaries to seek other funding sources to meet our cash requirements. We cannot be certain that alternative sources of financing would be available in the future on terms and conditions that are acceptable.

Our outstanding indebtedness and the inability to renew or refinance our 2013 Senior Credit Facility could materially adversely affect our financial condition and our ability to operate our business.

We will need to refinance our outstanding debt as it matures. There is a risk that we may not be able to refinance existing debt or that the terms of any refinancing may not be as favorable as the terms of our existing debt or refinance our existing debt at all. Furthermore, if prevailing interest rates or other factors at the time of refinancing result in higher interest rates upon refinancing, then the interest expense relating to that refinanced indebtedness would increase. In addition, changes by any rating agency to our outlook or credit rating could negatively affect the value of both our debt and equity securities, which could adversely affect our ability to refinance existing debt or raise additional capital. These risks could impair the Company's liquidity and would likely have a material adverse effect on our businesses, financial condition and results of operations.

Covenant restrictions under our indebtedness may limit our ability to operate our business and, in such an event, we may not have sufficient assets to settle our indebtedness.

Our 2013 Senior Credit Facility and the agreements related thereto contain, among other things, covenants that may restrict our ability to finance future operations or capital needs or to engage in other business activities and that may impact our ability and the ability of our restricted subsidiaries to:

incur debt;
pay dividends or make distributions;

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purchase or redeem stock;
make investments and extend credit;
engage in transactions with affiliates;
engage in sale-leaseback transactions;
consummate certain asset sales or club acquisitions;
effect a consolidation or merger or sell, transfer, lease or otherwise dispose of all or substantially all of our assets; and
create liens on our assets.

The terms of the 2013 Senior Credit Facility, as amended, provide for a financial covenant in the situation where the total utilization of the revolving loan commitments exceeds 20%, or \$3.0 million, 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 4.00:1.00. As of December 31, 2018, TSI LLC had outstanding letters of credit of \$2.2 million and a total leverage ratio that was below 4.00:1.00. Other than these outstanding letters of credit, TSI LLC did not have any amounts utilized on the 2013 Revolving Loan Facility.

Events beyond our control, including changes in general economic and business conditions, may affect our ability to meet certain financial ratios under the 2013 Senior Credit Facility. We may be unable to meet those tests and the lenders may decide not to waive any failure to meet those tests. A failure to satisfy these tests could cause a default under the 2013 Senior Credit Facility. If an event of default under the 2013 Senior Credit Facility occurs, the lenders could elect to terminate any and all outstanding undrawn commitments to lend and declare all amounts outstanding thereunder, together with accrued interest, to be immediately due and payable. If any such event should occur, we might not have sufficient assets to pay our indebtedness and meet our other obligations, which would have a material adverse effect on our business, financial condition and results of operations.

Risks Related to Our Common Stock

The stock ownership of certain large stockholders will likely limit your ability to influence corporate matters. As of February 22, 2019, the Company had two stockholders (including Patrick Walsh, the Chief Executive Officer and Chairman of our board of directors) which, together with each such stockholder's affiliates, beneficially owned 11.0% and 30.4% of our outstanding common stock, respectively, based on public filings made by such stockholders. Each of these stockholders may vote their stock with respect to certain matters, including any determinations with respect to mergers or other business combinations, the acquisition of assets for stock consideration or disposition of all or substantially all of our assets, and the issuance of any additional common stock or other equity securities, in a manner which may not be viewed as beneficial by other stockholders.

Our stock price could be extremely volatile, and, as a result, you may not be able to resell your shares at or above the price you paid for them.

In recent years the stock market in general has been highly volatile. As a result, the market price and trading volume of our common stock is likely to be similarly volatile, and investors in our common stock may experience a decrease, which could be substantial, in the value of their stock, including decreases unrelated to our results of operations or prospects, and could lose part or all of their investment. The price of our common stock could be subject to wide fluctuations in response to a number of factors, including those described elsewhere in this report and others such as: actual or anticipated fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;

changes in the market's expectations about our operating results;
success of competitors;
our operating results failing to meet the expectation of securities analysts or investors in a particular period;
changes in financial estimates and recommendations by securities analysts concerning us or our industry in general;

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operating and stock price performance of other companies that investors deem comparable to us;
our ability to market new and enhanced services on a timely basis;
changes in laws and regulations affecting our business;
our ability to meet compliance requirements;
commencement of, or involvement in, litigation involving us;
changes in our capital structure, such as future issuances of securities or the incurrence of additional debt; any major change in our board of directors or management;
sales of substantial amounts of common stock by our directors, executive officers or significant stockholders or the perception that such sales could occur; and

general economic and political conditions such as recessions, interest rates, fuel prices, and acts of war or terrorism. In the past, securities class action litigation has often been initiated against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources, and could also require us to make substantial payments to satisfy judgments or to settle litigation. Investor percentage ownership in us may be diluted by future issuances of capital stock, which could reduce investor influence over matters on which stockholders vote.

Our board of directors has the authority, without action or vote of our stockholders, to issue all or any part of our authorized but unissued shares of common stock, including shares issuable upon the exercise of options, or shares of our authorized but unissued preferred stock. Issuances of common stock or voting preferred stock would reduce your influence over matters on which our stockholders vote and, in the case of issuances of preferred stock, would likely result in your interest in us being subject to the prior rights of holders of that preferred stock.

Because we have no current plans to pay cash dividends on our common stock for the foreseeable future, you may not receive any return on investment unless you sell your common stock for a price greater than that which you paid for it. We may retain future earnings, if any, for future operations, expansion and debt repayment and have no current plans to pay any cash dividends for the foreseeable future. Any decision to declare and pay dividends in the future will be made at the discretion of our board of directors and will depend on, among other things, our results of operations, financial condition, cash requirements, contractual restrictions and other factors that our board of directors may deem relevant. In addition, our ability to pay dividends may be limited by covenants of any existing and future outstanding indebtedness we or our subsidiaries incur, including our credit facility. As a result, you may not receive any return on an investment in our common stock unless you sell our common stock for a price greater than that which you paid for it.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

We own our 1000 Sunrise Highway location in Massapequa, New York, which houses one of our clubs and a retail tenant. This property was acquired in November 2017. In Florida, we own both the 1250 Old Dixie Highway location and 4540 Donald Ross Road location, which were acquired in January 2018 and August 2018, respectively. These properties each house one of our clubs.

We lease the remainder of our fitness clubs pursuant to long-term leases (generally 15 to 20 years, plus option periods). In the next five years, or the period from January 1, 2019 through December 31, 2023, we have leases for 27 club locations that are due to expire without any renewal options, six of which are due to expire in 2019, and 69 club locations that are due to expire with renewal options. Renewal options include terms for rental increases based on the consumer price index, fair market rates or stated renewal terms already set in the lease agreements.

We lease office space in Jupiter, Florida and New York City, both used for administrative and general corporate purposes. We lease approximately 82,000 square feet in Elmsford, NY, for the operation of a centralized laundry facility for the New York Sports Clubs offering towel service, and for construction and equipment storage. This space also serves as corporate office

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space. Total square footage related to the laundry facility is 42,000 and total square footage related to the corporate office and warehouse space is 40,000.

The following table provides information regarding our club locations:

Location	Address	Date Opened or Management Assumed
New York Sports Clubs:		
Manhattan, NY	61 West 62nd Street	July 1983
Manhattan, NY	1601 Broadway	September 1991
Manhattan, NY	349 East 76th Street	April 1994
Manhattan, NY	248 West 80th Street	May 1994
Manhattan, NY	502 Park Avenue	February 1995
Manhattan, NY	303 Park Avenue South	December 1995
Manhattan, NY	1635 Third Avenue	October 1996
Manhattan, NY	575 Lexington Avenue	November 1996
Manhattan, NY	278 Eighth Avenue	December 1996
Manhattan, NY	200 Madison Avenue	February 1997
Manhattan, NY	633 Third Avenue	April 1998
Manhattan, NY	217 Broadway	March 1999
Manhattan, NY	23 West 73rd Street	April 1999
Manhattan, NY	1372 Broadway	October 1999
Manhattan, NY	300 West 125th Street	May 2000
Manhattan, NY	128 Eighth Avenue	December 2000
Manhattan, NY	2527 Broadway	August 2001
Manhattan, NY	3 Park Avenue	August 2001
Manhattan, NY	10 Irving Place	November 2001
Manhattan, NY	230 West 41st Street	November 2001
Manhattan, NY	1221 Avenue of the Americas	January 2002
Manhattan, NY	200 Park Avenue	December 2002
Manhattan, NY	232 Mercer Street	September 2004
Manhattan, NY	225 Varick Street	August 2006
Manhattan, NY	885 Second Avenue	February 2007
Manhattan, NY	301 West 145th Street	October 2007
Manhattan, NY	1400 5th Avenue	December 2007
Manhattan, NY	75 West End Avenue	April 2013
Manhattan, NY	555 Sixth Avenue	September 2014
Manhattan, NY	28-30 Avenue A	March 2015
Manhattan, NY	30 Broad Street	March 2015
Manhattan, NY	1231 Third Avenue	February 2017
Manhattan, NY	4 Astor Place	May 2017
Manhattan, NY	139 West 32nd Street	September 2018
Manhattan, NY	1915 3rd Avenue	September 2018
Bronx, NY	1601 Bronxdale Avenue	November 2007
Brooklyn, NY	110 Boerum Place	October 1985
Brooklyn, NY	1736 Shore Parkway	June 1998
Brooklyn, NY	179 Remsen Street	May 2001
Brooklyn, NY	324 Ninth Street	August 2003
Brooklyn, NY	1630 E 15th Street	August 2007
Brooklyn, NY	7118 Third Avenue	May 2004
Brooklyn, NY	439 86th Street	April 2008

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Brooklyn, NY	147 Greenpoint Avenue	June 2014
Queens, NY	69-33 Austin Street	April 1997
Queens, NY	153-67 A Cross Island Parkway	June 1998

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Location	Address	Date Opened or Management Assumed
Queens, NY	2856-2861 Steinway Street	February 2004
Queens, NY	8000 Cooper Avenue	March 2007
Queens, NY	99-01 Queens Boulevard	June 2007
Queens, NY	39-01 Queens Boulevard	December 2007
Staten Island, NY	300 West Service Road	June 1998
Scarsdale, NY	696 White Plains Road	October 1995
Mamaroneck, NY	124 Palmer Avenue	January 1997
Croton-on-Hudson, NY	420 South Riverside Drive	January 1998
Larchmont, NY	15 Madison Avenue	December 1998
Great Neck, NY	15 Barstow Road	July 1989
East Meadow, NY	625 Merrick Avenue	January 1999
Commack, NY	6136 Jericho Turnpike	January 1999
Massapequa, NY	1000 Sunrise Highway	November 2017
Oceanside, NY	2909 Lincoln Avenue	May 1999
Long Beach, NY	265 East Park Avenue	July 1999
Garden City, NY	833 Franklin Avenue	May 2000
Huntington, NY	350 New York Avenue	February 2001
Syosset, NY	49 Ira Road	March 2001
West Nyack, NY	3656 Palisades Center Drive	February 2002
Woodmere, NY	158 Irving Street	March 2002
Hartsdale, NY	208 E. Hartsdale Avenue	September 2004
Somers, NY	Somers Commons, 80 Route 6	February 2005
White Plains, NY	4 City Center	September 2005
Hawthorne, NY	24 Saw Mill River Road	January 2006
Dobbs Ferry, NY	50 Livingstone Avenue	June 2008
Smithtown, NY	5 Browns Road	December 2007
Carmel, NY	1880 Route 6	July 2007
Hicksville, NY	100 Duffy Avenue	November 2008
New Rochelle, NY	Trump Plaza, Huguenot Street	March 2008
Deer Park, NY	455 Commack Avenue	March 2009
Garnerville, NY	20 W. Ramapo Road	October 2011
Stamford, CT	106 Commerce Road	January 1998
Greenwich, CT	6 Liberty Way	May 1999
West Hartford, CT	65 Memorial Road	November 2007
Princeton, NJ	301 North Harrison Street	May 1997
Matawan, NJ	450 Route 34	April 1998
Marlboro, NJ	34 Route 9 North	April 1998
Ramsey, NJ	1100 Route 17 North	June 1998
Springfield, NJ	215 Morris Avenue	August 1998
Hoboken, NJ	59 Newark Street	October 1998
Jersey City, NJ	147 Two Harborside Financial Center	June 2002
Newark, NJ	1 Gateway Center	October 2002
Ridgewood, NJ	129 S. Broad Street	June 2003
Westwood, NJ	35 Jefferson Avenue	June 2004
Livingston, NJ	39 W. North Field Road	February 2005
Hoboken, NJ	210 14th Street	December 2006
Englewood, NJ	34-36 South Dean Street	December 2006

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Clifton, NJ	202 Main Avenue	March 2007
Montclair, NJ	56 Church Street	January 2008
Butler, NJ	1481 Route 23	January 2009

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Location	Address	Date Opened or Management Assumed
East Brunswick, NJ	300 State Route 18	March 2009
Bayonne, NJ	550 Route 440 North	December 2011
Lucille Roberts:		
Manhattan, NY	50 East 42nd Street	September 2017
Manhattan, NY	1387 Nicholas Avenue	September 2017
Bronx, NY	2449 Morris Avenue	September 2017
Brooklyn, NY	430 89th Street	September 2017
Brooklyn, NY	925 Kings Highway	September 2017
Brooklyn, NY	1950 Ralph Avenue	September 2017
Queens, NY	32-62 Steinway Street	September 2017
Queens, NY	135-39 38th Avenue	September 2017
Queens, NY	70-20 Austin Street	September 2017
Commack, NY	6534 Jericho Turnpike	September 2017
Bay Shore, NY	1850 Sunrise Highway	September 2017
Holbrook, NY	5801 Sunrise Highway	September 2017
Rockville Centre, NY	298 Sunrise Highway	September 2017
Valley Stream, NY	225 West Merrick Road	September 2017
Clifton, NJ	1075 Bloomfield Avenue	September 2017
Jersey City, NJ	338 Central Avenue	September 2017
TMPL:		
Manhattan, NY	355 West 49th Street	December 2017
Manhattan, NY	125 Seventh Avenue South	December 2018
Boston Sports Clubs:		
Boston, MA	1 Bulfinch Place	August 1998
Boston, MA	201 Brookline Avenue	June 2000
Boston, MA	361 Newbury Street	November 2001
Boston, MA	350 Washington Street	February 2002
Boston, MA	505 Boylston Street	January 2006
Boston, MA	560 Harrison Avenue	February 2006
Boston, MA	695 Atlantic Avenue	October 2006
Boston, MA	One Beacon Street	May 2013
Boston, MA	800 Boylston Street	May 2013
Boston, MA	100 Summer Street	May 2013
Boston, MA	540 Gallivan Road	October 2014
Boston, MA	95 Washington Street	November 2014
Boston, MA	699 Boylston Street	June 2015
Allston, MA	15 Gorham Street	July 1997
Wellesley, MA	140 Great Plain Avenue	July 2000
Lynnfield, MA	425 Walnut Street	July 2000
Lexington, MA	475 Bedford Avenue	July 2000
Cambridge, MA	625 Massachusetts Avenue	January 2001
West Newton, MA	1359 Washington Street	November 2001
Waltham, MA	840 Winter Street	November 2002
Watertown, MA	311 Arsenal Street	January 2006
Newton, MA	135 Wells Avenue	August 2006
Somerville, MA	1 Davis Square	December 2007
Medford, MA	70 Station Landing	December 2007

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Westborough, MA	1500 Union Street	September 2008
Westborough, MA	35 Chauncy Street	January 2018
Woburn, MA	300 Presidential Way	December 2008
Wayland, MA	Wayland Town Center	November 2014

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Location	Address	Date Opened or Management Assumed
Providence, RI	131 Pittman Street	December 2008
Haverhill, MA	3 Ferry Street	December 2018
Methuen, MA	116 Pleasant Valley Street	December 2018
Peabody, MA	194 Newbury Street	December 2018
Salisbury, MA	191 Elm Street	December 2018
Washington Sports Clubs:		
Washington, D.C.	1835 Connecticut Avenue, N.W	January 1990
Washington, D.C.	2251 Wisconsin Avenue, N.W	May 1994
Washington, D.C.	1211 Connecticut Avenue, N.W	July 2000
Washington, D.C.	783 Seventh Street, N.W	October 2004
Washington, D.C.	3222 M Street, N.W	February 2005
Washington, D.C.	14th Street, N.W	June 2008
North Bethesda, MD	10400 Old Georgetown Road	June 1998
Silver Spring, MD	8506 Fenton Street	November 2005
Bethesda, MD	6800 Wisconsin Avenue	November 2007
Clarendon, VA	2700 Clarendon Boulevard	November 2001
Philadelphia Sports Clubs:		
Philadelphia, PA	220 South 5th Street	January 1999
Philadelphia, PA	2000 Hamilton Street	July 1999
Chalfont, PA	One Highpoint Drive	January 2000
Philadelphia, PA	1735 Market Street	October 2000
Radnor, PA	555 East Lancaster Avenue	December 2006
Total Woman Gym and Spa:		
Alameda, CA	2247 S Shore Center	April 2018
San Jose, CA	950 El Paseo de Saratoga	April 2018
Glendale, CA	601 N Brand Boulevard	April 2018
Irvine, CA	14280 Culver Drive	April 2018
Laguna Hills, CA	23541 Calle De La Louisa	April 2018
Northridge, CA	19456 Nordhoff Street	April 2018
Placentia, CA	860 N Rose Drive	April 2018
Studio City, CA	12050 Ventura Boulevard	April 2018
Canoga Park, CA	6600 Topanga Canyon Boulevard	April 2018
Torrance, CA	2755 E Pacific Coast Highway	April 2018
Valencia, CA	24245 Magic Mountain Parkway	April 2018
Westlake Village, CA	30770 Russell Ranch Road	April 2018
Christi's Fitness:		
Vero Beach, FL	1250 Old Dixie Highway	January 2018
Palm Beach Sports Clubs:		
Jupiter, FL	201 N US Highway 1	August 2018
Palm Beach Gardens, FL	4540 Donald Ross Rd	August 2018
Port St. Lucie, FL	250 NW Peacock Blvd	August 2018
LIV Fitness:		
San Juan, Puerto Rico	103 De Diego Avenue	September 2018
Guaynabo, Puerto Rico	Calle Parkside 2	September 2018
New York Sports Clubs - Switzerland:		
Basel, Switzerland	St. Johans-Vorstadt 41	August 1987
Zurich, Switzerland	Glarnischstrasse 35	August 1987

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Item 3. 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 the Appellate Division, Second Department of the Supreme Court of the State of New York 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.

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, landlord tenant disputes, construction matters, employee and member relations, and Telephone Consumer Protection Act claims (a number of which purport to represent a class and one of which was brought by the Washington, D.C. Attorney General's Office). 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 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant’s Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock currently trades on The NASDAQ Global Market, under the symbol CLUB.

Holders

As of February 22, 2019, there were approximately 101 holders of record of our common stock. There are additional holders who are not “holders of record” but who beneficially own stock through nominee holders such as brokers and benefit plan trustees.

Dividends Policy

The Company did not declare any dividends in 2018 and 2017.

The board of directors does not currently intend to declare dividends. The declaration and payment of dividends to holders of our common stock by us, if any, are subject to the discretion of our board of directors. Our board of directors will take into account such matters as 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 relevant. If we decide to pay a dividend, we may rely on cash on hand at TSI Holdings, which was approximately \$2.0 million at December 31, 2018.

The existing credit agreement of TSI LLC restricts the ability of our subsidiaries to pay cash distributions to TSI Holdings in order for TSI Holdings to pay cash dividends except (a) in an amount, when combined with certain prepayments of indebtedness, of up to \$35.0 million, subject to pro forma compliance with a total leverage ratio, as defined, and no default or event of default existing or continuing under the credit agreement, and (b) an additional amount based on excess cash flow, such additional amounts subject to pro forma compliance with a total leverage ratio, as defined, and no default or event of default existing or continuing under the credit agreement. In October 2017, TSI LLC made a dividend distribution of \$35.0 million to TSI Holdings, Inc.

Issuer Purchases of Equity Securities

We did not purchase any equity securities during the fourth quarter ended December 31, 2018.

Recent Sales of Unregistered Securities

We did not sell any securities during the year ended December 31, 2018 that were not registered under the Securities Act of 1933, as amended (the “Securities Act”), other than as previously reported in a Current Report on Form 8-K.

Item 6. Selected Financial Data

Not Applicable.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and consolidated results of operations in conjunction with the “Selected Consolidated Financial and Other Data” section of this Annual Report and our consolidated financial statements and the related notes appearing at the end of this Annual Report. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under the headings “Risk Factors,” “Business” and “Forward-Looking Statements” contained in Item 1A, Item 1, and Part I, respectively, of this Annual Report.

Overview

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. Our clubs collectively served approximately 627,000 members as of December 31, 2018. As of December 31, 2018, we owned and operated 185 fitness clubs (“clubs”) under the various brand names, primarily located in the United States of America.

Brand	Count
New York Sports Clubs	98
Boston Sports Clubs	33
Washington Sports Clubs	10
Philadelphia Sports Clubs	5
Lucille Roberts	16
TMPL	2
Total Woman Gym and Spa	12
Palm Beach Sports Clubs	3
Christi’s Fitness	1
LIV Fitness	2
New York Sports Clubs - Switzerland	3
	185

We develop clusters of clubs to serve densely populated 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 main regions, 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 recent years, our focus has been on acquiring health clubs that have already reached maturity and therefore operating results are established and stable upon acquisition. We also focus on opening and acquiring clubs in areas where we believe the region is underserved or where new clubs are intended to replace existing clubs at lease expiration. We believe these are important elements of our corporate strategies as it strengthens our competitive position and expands and enhances the services that we can offer to members. We expect to continue to acquire selective clubs to continue our expansion of club offerings, including clubs outside of our current regions. In the event we build and acquire additional new clubs, the club expansion is expected to be funded with cash on hand or through internally generated cash flows. We may also consider certain acquisitions other than health clubs to diversify the business while enhancing shareholder value.

In 2018, we acquired 25 clubs and constructed and opened one new club for which we had an existing lease. In 2017, we acquired 18 clubs and constructed and opened two 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, and 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 76.9% of our total revenue for the year ended December 31, 2018. We recognize revenue from membership dues in the month when the

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services are rendered. 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 year ended December 31, 2018, we generated 16.5% of our revenue from personal training and 5.3% of our revenue from other ancillary programs and services consisting of Sports Clubs for Kids, racquet sports, Small Group Training programs and spa services. 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 1.3% of our total revenue for the year ended December 31, 2018) 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, provide laundry services to third parties, and generate management fees from certain club facilities that we do not wholly own. We refer to these revenues as Fees and other revenue.

Our performance is dependent in part on our ability to continually attract and retain members at our clubs. In the years ended December 31, 2018 and 2017, our attrition rate was 49.9% and 46.9%, respectively.

Our operating 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. General and administrative expenses include costs relating to our centralized support functions, such as accounting, insurance, information and communication systems, acquisition related costs, 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 consolidated statement of operations and are not included in general and administrative expenses.

Approximately 45% 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. At acquired clubs, operating margins may initially decline due to costs related to the acquisition and time to implement and integrate into our process.

Our primary capital expenditures relate to routine improvements at our clubs, the construction or acquisition of new club facilities and the upgrade and renovation of our existing clubs. The construction and equipment costs vary based on the costs of construction labor, as well as the planned service offerings and size and configuration of the facility. We perform routine improvements at our clubs and partial replacement of the fitness equipment each year for which we are currently budgeting approximately 2% of projected annual revenue. In this regard, facility remodeling is also considered where appropriate.

As of December 31, 2018, our consolidated operating results included five majority owned clubs for which we had control. In addition, we partly-owned two clubs (one of which operated under a different brand name), with ownership percentages of 45% and 20%, respectively, for which we applied the equity method of accounting. We also owned and licensed one club and provided management services at two locations that we did not have an equity interest.

Operating income is impacted by certain charges and benefits which can fluctuate year to year. In 2018 and 2017, operating income was impacted by fixed asset impairment charges of \$2.1 million and \$6.5 million, respectively, related to underperforming clubs.

	Year Ended	
	December 31,	
	2018	2017
	(\$ amounts in	
	thousands)	
Operating income	\$12,519	\$6,937

Increase over prior period	80.5	%	208.7	%
Net (loss) income	\$(125)		\$4,369	
Decrease over prior period	(102.9)	%	(45.7)	%
Cash flows provided by operating activities	\$64,094		\$28,199	
Increase over prior period	127.3	%	33.1	%

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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.

	Comparable Club Revenue Increase			
	Quarter		Full-Year	
2018				
First Quarter	1.7	%		
Second Quarter	1.8	%		
Third Quarter	1.5	%		
Fourth Quarter	1.1	%	1.6	%
2017				
First Quarter	0.7	%		
Second Quarter	1.2	%		
Third Quarter	1.8	%		
Fourth Quarter	2.8	%	1.6	%

Key determinants of comparable club revenue increases are new memberships, member retention rates, pricing and ancillary revenue increases.

The comparable club revenue increase in 2018 was primarily due to higher average dues per membership, increased annual fees and personal training revenue. The comparable club revenue increase was partially offset by a decrease in member count and other ancillary club revenue, particularly our Sports Clubs for Kids programs. The comparable club revenue increase in 2017 was primarily due to higher average dues per membership and an increase in member count in comparable clubs, partially offset by decreased initiation and processing fees and other ancillary club revenue.

Historical Club Count

	Year Ended	
	December 31,	
	2018	2017
Clubs operated in consolidated operating results:		
Clubs operated at beginning of period	164	149
Acquired clubs	25	18
New clubs opened	1	2
Club converted to licensed club ⁽³⁾	(1)	—
Clubs closed	(6)	(5)
Clubs operated at end of period	183	164
Club included in equity investment at end of period ⁽¹⁾	1	1
Licensed club operated at end of period ⁽³⁾	1	—
Total clubs operated at end of period ⁽¹⁾⁽²⁾	185	165

(1)Excludes one 20% owned club that operated under a different brand name in our Washington, D.C. region.

(2)Excludes two locations that were managed by us in which we did not have an equity interest.

(3) Represents one club that transitioned to a licensed location in the first quarter of 2018 and bears the “Washington Sports Clubs” brand name.

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Consolidated Results of Operations

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

	Year Ended	
	December 31,	
	2018	2017
Revenues	100.0 %	100.0 %
Operating expenses:		
Payroll and related	38.0	36.1
Club operating	44.5	44.8
General and administrative	5.7	5.6
Depreciation and amortization	8.5	10.2
Impairment of fixed assets	0.5	1.6
	97.2	98.3
Operating income	2.8	1.7
Interest expense, net	3.0	3.1
Equity in the earnings of investees and rental income	(0.1)	(0.1)
Loss before benefit for corporate income taxes	(0.1)	(1.3)
Benefit for corporate income taxes	(0.1)	(2.4)
Net income including non-controlling interests	—	1.1
Net income attributable to Town Sports International Holdings, Inc. and subsidiaries	—	% 1.1 %

Year ended December 31, 2018 compared to year ended December 31, 2017

Revenue

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

	Year Ended December 31,					
	2018		2017			
	Revenue	% Revenue	Revenue	% Revenue	% Variance	
Membership dues	\$339,397	76.6 %	\$307,966	76.4 %	10.2 %	
Initiation and processing fees	1,209	0.3 %	2,268	0.6 %	(46.7)%	
Membership revenue	340,606	76.9 %	310,234	77.0 %	9.8 %	
Personal training revenue	73,458	16.5 %	69,735	17.3 %	5.3 %	
Other ancillary club revenue	23,293	5.3 %	17,197	4.3 %	35.4 %	
Ancillary club revenue	96,751	21.8 %	86,932	21.6 %	11.3 %	
Fees and other revenue	5,737	1.3 %	5,876	1.4 %	(2.4)%	
Total revenue	\$443,094	100.0 %	\$403,042	100.0 %	9.9 %	

Revenue increased \$40.1 million, or 9.9%, for the year ended December 31, 2018 compared to the year ended December 31, 2017. Revenue at clubs opened or acquired in the last 24 months increased approximately \$49.9 million and clubs that have operated over 24 months increased approximately \$2.7 million, primarily due to increased membership dues and personal training at these clubs. This was offset by an \$8.7 million decrease in revenue at clubs closed in the last 24 months. In addition to these variances, in the year ended December 31, 2017, we recognized approximately \$3.6 million of out of period personal training revenue at three of our jurisdictions.

Comparable club revenue increased 1.6% in the year ended December 31, 2018 compared to the year ended December 31, 2017, primarily due to higher average dues per membership, increased annual fees and personal training revenue. The comparable club revenue increase was partially offset by a decrease in member count and other ancillary club revenue, particularly our Sports Clubs for Kids programs.

Membership dues revenue increased \$31.4 million, or 10.2%, in the year ended December 31, 2018 compared to the year ended December 31, 2017, primarily reflecting the favorable impact from the newly acquired and opened clubs, higher average dues per membership and increased annual fees. These increases were partially offset by the impact of club closures.

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Initiation and processing fees revenue decreased \$1.1 million, or 46.7%, in the year ended December 31, 2018 compared to the year ended December 31, 2017. Initiation and processing fees revenue is recognized over the estimated average membership life of 26 months. Amounts collected per sale has decreased in recent years, resulting in less revenue recognized in recent months as higher collection periods are fully recognized.

Personal training revenue increased \$3.7 million, or 5.3% in the year ended December 31, 2018 compared to the year ended December 31, 2017. The increase in personal training revenue was primarily related to the newly acquired and opened clubs, and increased member interest resulting from improved product management and marketing strategies. This increase was partially offset by the recognition of \$3.6 million in 2017 related to unused and expired sessions in three of our states, and the impact of club closures.

We recognize revenue from personal training sessions as the services are performed (i.e., when the session is trained). Unused personal training sessions expire after a set, disclosed period of time after purchase and are not refundable or redeemable by the member for cash. For a total of six of the jurisdictions in which we operate, we have concluded, based on opinions from outside counsel, that money held by a company for unused and expired personal training sessions were not escheatable. In 2010, for three jurisdictions, we concluded, based on opinions from outside counsel, that monies held by a company for unused and expired personal training sessions were not escheatable. As a result, we recorded approximately \$2.7 million as personal training revenue in the fourth quarter of 2010. This amount was previously recorded in deferred revenue. In 2017, for another three jurisdictions, we concluded, based on opinions from outside counsel, that monies held by a company for unused and expired personal training sessions were not escheatable. As a result, we recorded approximately \$3.6 million as personal training revenue in the fourth quarter of 2017. This amount was previously recorded in deferred revenue, which was primarily related to sessions purchased prior to the year ended December 31, 2015.

Other ancillary club revenue increased \$6.1 million, or 35.4%, in the year ended December 31, 2018 compared to the year ended December 31, 2017, primarily due to the favorable impact from the newly acquired and opened clubs, which included \$3.0 million related to spa services. These increases were partially offset by decreased revenue from our Sports Clubs for Kids programs and 30-day guest pass.

Operating Expenses

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

	Year Ended				
	December 31,				
	2018	2017	\$ Variance	% Variance	
Payroll and related	\$ 168,315	\$ 145,612	\$ 22,703	15.6	%
Club operating	197,689	180,467	17,222	9.5	%
General and administrative	25,047	22,680	2,367	10.4	%
Depreciation and amortization	37,442	40,849	(3,407)	(8.3)	%
Impairment of fixed assets	2,082	6,497	(4,415)	(68.0)	%
Operating expenses	\$ 430,575	\$ 396,105	\$ 34,470	8.7	%

Operating expenses increased due to the following factors:

Payroll and related. Payroll and related expenses for the year ended December 31, 2018 increased \$22.7 million, or 15.6%, compared to the year ended December 31, 2017, primarily reflecting the impact from newly acquired and opened clubs of approximately \$21.0 million. We also experienced minimum wage increases and increased personal training payroll expenses related to higher personal training revenue. These increases were partially offset by the impact of club closures of approximately \$2.8 million and other saving initiatives.

Club operating. Club operating expenses increased \$17.2 million or 9.5% in the year ended December 31, 2018 compared to the year ended December 31, 2017, primarily reflecting the impact from newly acquired and opened clubs of \$19.6 million, including \$12.7 million for rent and occupancy expenses at these new clubs. Rent and occupancy expenses also increased \$3.9 million at mature clubs due to rent escalations. Partially offsetting these increases were decreases of \$2.6 million reflecting the impact of club closures.

General and administrative. General and administrative expense increased \$2.4 million, or 10.4%, in the year ended December 31, 2018 compared to the year ended December 31, 2017, primarily reflecting increased acquisition costs of \$2.6 million and an increase of in expenses, such as general liability insurance, related to newly acquired and opened clubs of \$1.3 million, partially offset by decreases of such expenses at recently closed clubs and the results of our cost-savings initiatives.

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Depreciation and amortization. In the year ended December 31, 2018 compared to the year ended December 31, 2017, depreciation and amortization expense decreased \$3.4 million, or 8.3%, primarily due to a decrease at our mature clubs and the impact of closed locations. These decreases were offset by depreciation of assets at our new clubs. Impairment of fixed assets. Due to triggering events, we recorded impairment charges of \$2.1 million and \$6.5 million at underperforming clubs in the year ended December 31, 2018 and 2017, respectively.

Benefit for Corporate Income Taxes

We recorded income tax benefit of \$357,000 and \$9.7 million during the year ended December 31, 2018 and 2017, respectively, reflecting an effective income tax rate of 74% for the December 31, 2018 and 182% for the year ended December 31, 2017. Separate from the impact of valuation allowance, our effective tax rate was (41)% and 31% for the years ended December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017, we have a net deferred tax liability of \$0 and \$93,000, respectively, as there is a full valuation allowance recorded against the U.S. net deferred tax assets. Inclusive in these amounts is the state net deferred tax liability balance of \$0 and \$37,000, respectively, as of December 31, 2018 and 2017.

In assessing the realizability of deferred tax assets, we evaluate whether it is more likely than not (more than 50%) that some portion or all of the deferred tax assets will be realized. A valuation allowance, if needed reduces the deferred tax assets to the amount expected to be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in those periods in which temporary differences become deductible and/or net operating loss carry forwards can be utilized. We assess all positive and negative evidence when determining the amount of the net deferred tax assets that are more likely than not to be realized. This evidence includes, but is not limited to, prior earnings history, scheduled reversal of taxable temporary differences, tax planning strategies and projected future taxable income. Significant weight is given to positive and negative evidence that is objectively verifiable.

As required by the authoritative guidance on accounting for income taxes, we evaluate the realizability of deferred tax assets on a jurisdictional basis at each reporting date. Accounting for income taxes requires that a valuation allowance be established when it is more likely than not that all or a portion of the deferred tax assets will not be realized. In circumstances where there is sufficient negative evidence indicating that the deferred tax assets are not more likely than not realizable, we establish a valuation allowance. We recorded valuation allowances in the amounts of \$39.8 million and \$38.8 million as of December 31, 2018 and 2017, respectively.

In recording the valuation allowance, deferred tax liabilities associated with indefinite lived intangible assets generally cannot be used as a source of income to realize deferred tax assets with a definitive loss carry forward period. We do not amortize goodwill for book purposes but have amortized goodwill with tax basis for tax purposes. The deferred tax liabilities recorded at December 31, 2017 related to the tax effect of differences between the book and tax basis of goodwill that was not expected to reverse until some indefinite future period for indefinite lived intangibles.

Following the Tax Legislation, the federal net operating losses generated after December 31, 2017 can be carried forward indefinitely and we have considered its deferred tax liabilities related to indefinite lived intangibles as a source of taxable income against its indefinite lived net operating losses.

The following state and local jurisdictions are currently examining our respective returns for the years indicated: New York State (2006 through 2014), and New York City (2006 through 2014). In particular, we disagree with the proposed assessment dated December 12, 2016 from the State of New York and attended a conciliation conference with the New York State Department of Taxation and Finance Audit section on June 7, 2017. No settlement was reached at the conference and the proposed assessment was sustained. As such, in a revised letter dated November 30, 2017, we received from the State of New York a revised assessment related to tax years 2006-2009 for approximately \$5.1 million, inclusive of approximately \$2.4 million of interest. We have appealed the assessment with the New York State Division of Tax Appeals. On November 17, 2017, the Company was notified that the State of New York proposed an adjustment in the amount of approximately \$3.9 million for the years 2010 to 2014, inclusive of approximately \$757,000 in interest. In November 2018, we met with the Department officials for the assessment related to 2010 to 2014. The meeting ended with the company disagreeing with the proposed assessment for the years in audit. Subsequently, in a letter dated February 4, 2019, the interest amount is revised to \$1.2 million. We disagree

with the proposed assessment and have consented to extend such assessment period through December 31, 2019. We are also under examination in New York City (2006 through 2014). New York City Department of Finance has proposed an audit change notice to the Company dated May 2, 2018, for the tax years ended December 31, 2006 through December 31, 2009 for proposed general corporation tax liability in the amount of \$4.8 million and \$4.1 million in interest. In a letter dated January 18, 2019, NYC Department of finance has issued a proposed general tax liability of \$5.6 million,

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inclusive of \$1.6 million in interest for audit periods 2010 to 2014. We disagree with the proposed assessment and have consented to extend such assessment period through September 31, 2019.

The Company has not recorded a tax reserve related to these proposed assessments. It is difficult to predict the final outcome or timing of resolution of any particular matter regarding these examinations. An estimate of the reasonably possible changes to unrecognized tax benefits within the next 12 months cannot be made.

In March 2018, Commonwealth of Massachusetts began an audit of state tax filing of the company for the state of Massachusetts for the 12 month periods ending December 31, 2014, 2015 and 2016. We have agreed to extend the assessment period for state of Massachusetts through March 31, 2019.

Liquidity and Capital Resources

We continue to experience revenue pressure as the fitness industry continues to be highly competitive in the areas in which we operate. We continue to strategize on improving our financial results and focus on increasing membership in existing clubs to increase revenue. We may consider additional actions within our control, including certain acquisitions, licensing arrangements, the closure of unprofitable clubs upon lease expiration and the sale of certain assets. Our ability to continue to meet our obligations is dependent on our ability to continue to generate positive cash flow from a combination of initiatives, including those mentioned above. Failure to continue to successfully implement these initiatives could have a material adverse effect on our liquidity and our operations, and we would need to implement alternative plans that could include additional asset sales, additional reductions in operating costs, additional reductions in working capital, debt restructurings and the deferral of capital expenditures. There can be no assurance that such alternatives would be available to us or that we would be successful in their implementation.

As of December 31, 2018, we had \$48.1 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 December 31, 2018, \$24.6 million was held at one financial institution. 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, debt purchases and other capital expenditures necessary to upgrade, expand and renovate existing clubs. We believe that our existing cash and cash equivalents, and cash generated from operations will be sufficient to fund capital expenditures, working capital needs and other liquidity requirements associated with our existing operations through at least the next 12 months. To the extent we continue to expand our business through construction of new clubs or acquisitions, we may need to obtain additional sources of financing.

Operating Activities. Net cash provided by operating activities increased \$35.9 million for the year ended December 31, 2018 compared to the year ended December 31, 2017. The changes in operating cash flow were primarily due to timing differences of certain payments. There were also changes resulting from newly opened and acquired clubs. Increases in operating cash included the following:

• Cash collected for membership dues increased \$27.9 million.

• Cash collected for personal training memberships increased \$5.1 million.

• Cash collected for recurring annual fees increased \$2.2 million.

• Cash collected for member enrollment, including the initial annual fee paid upon joining, increased by \$669,000.

• Cash collected for tax refund increased \$12.0 million.

• Cash paid for taxes decreased \$3.4 million.

• Cash paid for occupancy decreased \$2.9 million.

Offsetting decreases in operating cash included the following:

• Cash paid for payroll increased \$13.1 million.

• Cash collected for landlord contributions decreased \$1.3 million.

• Cash paid for utilities increased \$1.2 million.

• Cash paid for interest increased \$959,000 primarily due to the increase in the LIBOR rate.

Investing Activities. Net cash used in investing activities increased \$5.5 million in the year ended December 31, 2018 compared to the year ended December 31, 2017, primarily related to the increase in acquisition activity in 2018. Cash paid in

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connection with the acquisition of businesses, property and other assets, including deposits, increased \$4.5 million in the 2018 period. The increase was also due to an increase in cash related to capital expenditures of approximately \$1.7 million.

Financing Activities. Net cash provided by financing activities for the year ended December 31, 2018 was \$2.6 million compared to net cash used in financing activities of \$2.0 million for the year ended December 31, 2017. For the year ended December 31, 2018 as compared to the year ended December 31, 2017, increased financing activities was primarily related to the \$5.5 million proceeds from a mortgage and term loan related to our properties in Massapequa, New York and Vero Beach, Florida, and principal payments on capital lease obligations for fitness equipment in our clubs in 2018.

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”), pursuant to a credit agreement 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 \$15.0 million revolving loan facility maturing on August 14, 2020 (“2013 Revolving Loan Facility”). Proceeds from the 2013 Term Loan Facility of \$323.4 million were issued, net of an original issue discount of 0.5%, or \$1.6 million. 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.

On January 30, 2015, the 2013 Senior Credit Facility was amended (the “First Amendment”) to permit TSI Holdings to purchase term loans under the credit agreement. Any term loans purchased by TSI Holdings will be canceled in accordance with the terms of the credit agreement, as amended by the First Amendment. 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.

On November 8, 2018, the 2013 Senior Credit Facility was amended (the “Second Amendment”), which modified the revolving loan facility amount to \$15.0 million from \$45.0 million, and extended the maturity date from November 15, 2018 to August 14, 2020. In addition, the Second Amendment restated that the Company is not able to utilize more than 20% or \$3.0 million in accordance with terms of the 2013 Revolving Loan Facility if the total leverage ratio exceeds 4.00:1.00 (calculated on a proforma basis to give effect to any borrowing). Previously, the Company was not able to utilize more than 25% or \$11.3 million in accordance with terms of the 2013 Revolving Loan Facility if the total leverage ratio exceeded 4.50:1.00 (calculated on a proforma basis to give effect to any borrowing).

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 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 December 31, 2018, TSI LLC had made a total of \$26.2 million in principal payments on the 2013 Term Loan Facility.

In May 2017, TSI LLC loaned \$5.0 million to TSI Group, a wholly-owned subsidiary of TSI Holdings, at a rate of LIBOR plus 9.55% per annum. In addition to the interest payments, TSI Group is required to repay 1.0% of the principal amount of the loan, \$50,000 per annum, on a quarterly basis commencing September 30, 2017. The loan is secured by certain collateral. This transaction has no impact on the Company's consolidated financial statements as it is eliminated in consolidation. In October 2017, TSI LLC made a dividend distribution of \$35.0 million to TSI Holdings, Inc. As of December 31, 2018, TSI Group had a cash balance of approximately \$2.0 million.

As of December 31, 2018, TSI LLC had outstanding letters of credit of \$2.2 million and a total leverage ratio that was below 4.00:1.00. Other than these outstanding letters of credit, TSI LLC did not have any amounts utilized on the 2013 Revolving Loan Facility. The unutilized portion of the 2013 Revolving Loan Facility as of December 31, 2018 was \$12.8 million, with borrowings under such facility subject to the conditions applicable to borrowings under the Company's 2013 Senior Credit Facility, which conditions the Company may or may not be able to satisfy at the time of borrowing. In addition, the financial covenant described above, the 2013 Senior Credit Facility contains certain affirmative and negative covenants, including those 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 stockholders; make payments on certain indebtedness; and enter into sale leaseback transactions, in each case, subject to certain qualifications and exceptions. The 2013 Senior Credit Facility also includes customary events of default (including non-

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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 \$30.0 million from sales of assets in any fiscal year towards mandatory prepayments of outstanding borrowings.

In addition, the 2013 Senior Credit Facility contains provisions that require excess cash flow payments, as defined therein, 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. TSI LLC may pay dividends in the amount of cumulative retained excess cash flow to TSI Holdings as long as at the time the dividend is made, and immediately after, TSI LLC is in compliance on a pro forma basis with a total leverage ratio of less than 4.00:1.00. For the year ended December 31, 2018, the Company had approximately \$36.0 million of excess cash flow and expects to pay approximately \$18.0 million in principal payments in April 2019 and such amount is included in Current portion of long-term debt on the Company's accompanying consolidated balance sheet as of December 31, 2018.

As of December 31, 2018, the 2013 Term Loan Facility has a gross principal balance of \$197.8 million and a balance of \$195.3 million net of unamortized debt discount of \$1.9 million and unamortized debt issuance costs of \$634,000.

As of December 31, 2018, both the unamortized balance of debt issuance costs and unamortized debt discount are recorded as a contra-liability and netted with long-term debt on the accompanying consolidated balance sheet and are being amortized as interest expense using the effective interest method.

Financial Instruments

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 entered into derivative financial instruments, such as interest-rate swaps. Derivatives were not entered into for trading purposes and we only used commonly traded instruments. We used derivatives solely relating to the variability of cash flows from interest rate fluctuations.

We originally entered into an interest rate swap arrangement on July 13, 2011 in connection with our previous credit facility. In connection with entering into the 2013 Senior Credit Facility, we amended and restated the interest rate swap agreement initially entered into (and amended in August 2012 and November 2012). 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 matured on May 15, 2018. The swap effectively converted \$160,000 of the outstanding principal of the total variable-rate debt under the 2013 Senior Credit Facility to a fixed rate of 0.884% plus the 3.5% applicable margin and the Eurodollar rate, which had a floor of 1%. As permitted by ASC 815, Derivatives and Hedging, we designated this swap as a cash flow hedge, the effects of which were reflected in our consolidated financial statements as of December 31, 2017 and for the years ended December 31, 2018 and 2017. The objective of this hedge was 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 were designated as cash flow hedges for accounting purposes since they were being used to transform variable interest rate exposure to fixed interest rate exposure on a recognized liability (debt). We performed a

quarterly assessment of the hedge effectiveness of the hedge relationship and measured and recognized any hedge ineffectiveness in the consolidated statements of operations. For the years ended December 31, 2018 (through May 15, 2018, the maturity date) and 2017, hedge ineffectiveness was evaluated using the hypothetical derivative method and there was no hedge ineffectiveness noted.

The counterparty to our 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. We believe the risk of incurring losses on derivative contracts related to credit risk is unlikely.

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Consolidated Debt

As of December 31, 2018, our total principal amount of debt outstanding under our 2013 Term Loan Facility was \$197.8 million, all of which is due by November 15, 2020. 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. We believe that we have, or will be able to, obtain or generate sufficient funds to finance our current operating 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, available on acceptable terms, or permitted under the 2013 Credit Facility.

Recent Changes in or Recently Issued Accounting Standards

For details of applicable new accounting standards, please, see Note 3 — Recent Accounting Pronouncements to our consolidated financial statements in this Annual Report.

Use of Estimates and Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The most significant assumptions and estimates relate to the useful lives of long-term assets, recoverability and impairment of fixed and intangible assets, deferred income tax valuation, valuation of and expense incurred in connection with stock options, valuation of interest-rate swap arrangements, insurance reserves, legal contingencies and the estimated average membership life.

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. 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.

Third-party costs related to developing web applications, developing web pages and installing or enhancing developed applications on the web servers are capitalized and classified as computer software. Website hosting fees and maintenance costs are expensed as incurred.

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 the Financial Accounting Standards Board (“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

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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.

In the years ended December 31, 2018 and 2017, the Company tested underperforming clubs and recorded impairment charges of \$2.1 million and \$6.5 million, respectively, on leasehold improvements and furniture and fixtures at clubs that experienced decreased profitability and sales levels below expectations during these periods.

Goodwill was allocated to reporting units that closely reflect the regions served by the Company: New York, Boston, Washington, D.C., Philadelphia, Florida, California, Puerto Rico and Switzerland. The Company has acquired several clubs since the third quarter of 2017 and has recorded goodwill as applicable to the appropriate regions. For more information on these acquisitions, refer to Note 6 - Acquisitions. Goodwill for all acquisitions was recorded at fair value at the time of such acquisitions and may have changes to the balances up to one year after acquisition. As of December 31, 2018, the New York, Boston, California, Florida, Puerto Rico and Switzerland regions each have goodwill balances.

The Company historically performed its goodwill impairment test annually as of the last day of February and in the interim if a triggering event occurred. In 2018, the Company established August 1 to be the annual testing date for all of the Company's reporting units that have a goodwill balance.

As of February 28, 2018, the Company performed a goodwill impairment test on the Switzerland region in line with the historical policy. As of August 1, 2018, the Company performed a goodwill impairment test on the New York, Boston, California and Switzerland regions, within 12 months of the related acquisitions. For the Florida and Puerto Rico regions, the acquired goodwill was related to the acquisitions of clubs after the annual testing date. As such, these intangible assets were recorded at fair value at the time of acquisitions. The next goodwill impairment test for all reporting units will be August 1, 2019.

The Company's annual goodwill impairment tests as of August 1, 2018 and February 28, 2018 were performed by comparing the fair value of the Company's reporting unit with its carrying amount and then recognizing an impairment charge, as necessary, for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to that reporting unit. The estimated fair value was determined by using an income approach. The income approach was based on discounted future cash flows and required significant assumptions, including estimates regarding revenue growth rates, operating margins, weighted average cost of capital, and future economic and market conditions. The August 1, 2018 and February 28, 2018 annual impairment tests supported the goodwill balance and as such, no impairment of goodwill was required.

Self-insurance reserves. We self-insure our health benefits for all U.S.-based employees and maintain stop loss coverage to limit our exposure. We also limit our exposure to casualty losses on insurance claims by maintaining liability coverage subject to specific and aggregate liability deductibles. Self-insurance losses for claims filed and claims incurred but not reported are accrued based upon a number of factors including sales estimates for each insurance year, claim amounts, claim settlements and number of claims, our historical loss experience and valuations provided by independent third-party consultants. To the extent that estimated self-insurance losses differ from actual losses realized, our insurance reserves could differ significantly and may result in either higher or lower insurance expense in future periods.

Deferred income taxes. Deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities. Deferred tax assets represent items to be used as a tax deduction or credit in future tax returns for which a tax benefit has been recorded in the income statement. We record net deferred tax assets to the extent we believe these assets will more likely than not be realized. In making such determination, we consider all positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations. Significant weight is given to positive and negative evidence that is objectively verifiable.

Our deferred tax asset realization assessment considers future income which considers the execution of our business plans and other expectations about future outcomes and is based on certain assumptions. These assumptions require significant judgment about the forecast of future income and are consistent with the plans and estimates we are using to manage our business. When actual results do not meet our forecasted results or there are changes to future business

results, such changes can lead to a change in judgment related to the realization of the deferred tax asset. Based on the weight of the evidence at December 31, 2014, we were projected to be in a cumulative loss position during the three year period ending in December 31, 2015, which was considered to be a significant piece of negative evidence. Further we determined that there would be projected losses in the near term due to continued competitive pressure. Based on these factors, and most notably the projected three year cumulative loss, in the fourth quarter of 2014, we recorded a \$60.4 million non-cash charge to income tax expense to establish a full valuation allowance against our U.S. net deferred tax assets.

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As of December 31, 2018, we continue to maintain a full valuation allowance of \$39.8 million against outstanding net deferred tax assets as the company continues to have a three year cumulative loss position excluding one-time extraordinary income and expense items.

Tax benefits are recognized for a tax position when, in management's judgment, it is more likely than not that the position will be sustained upon examination by a taxing authority. For a tax position that meets the more-likely-than-not recognition threshold, the tax benefit is measured as the largest amount that is judged to have a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority. The liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances, such as the progress of tax audits, case law developments and new or emerging legislation. Such adjustments are recognized in the period in which they are identified. The effective tax rate includes the net impact of changes in the liability for unrecognized tax benefits and subsequent adjustments as considered appropriate by management. The number of years with open tax audits varies by jurisdiction. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe our liability for unrecognized tax benefits is adequate. Favorable resolution of an unrecognized tax benefit could be recognized as a reduction in our tax provision and effective tax rate in the period of resolution. Unfavorable settlement of an unrecognized tax benefit or a recognized tax position under examination could increase the tax provision and effective tax rate and may require the use of cash in the period of resolution. Interest and penalties recognized on the liability for unrecognized tax benefits is recorded as income tax expense.

Business Combinations. In connection with an acquisition of a business, the Company records all assets acquired and liabilities assumed of the acquired business at their acquisition date fair value, including the recognition of contingent consideration at fair value on the acquisition date. These fair value determinations require judgment and may involve the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, asset lives, and market multiples, among other items. We may utilize independent third-party valuation firms to assist in making these fair value determinations.

Inflation

Although we cannot accurately anticipate the effect of inflation on our operations, we believe that inflation has not had a material impact on our results of operations or financial condition. Should there be periods of high inflation in the future, our results of operations or financial condition would be exposed to the effects of inflation, such as higher rents for our leases under escalation terms based on the consumer price index and higher interest expense on the variable rate portion of our debt.

Off-Balance Sheet Arrangements

None.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

None.

Item 8. Financial Statements and Supplementary Data

Our Financial Statements appear following the signature page hereto, are incorporated herein by reference and are listed in the index appearing under Item 15.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 Chief Executive Officer 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 December 31, 2018, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design

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operation of our disclosure controls and procedures defined above. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2018, our disclosure controls and procedures were effective at the reasonable assurance level.

Management's Annual Report on Internal Control Over Financial Reporting: Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework (2013). Based on our management's assessment using those criteria, our management concluded that, as of December 31, 2018, we maintained effective internal control over financial reporting.

As described in Management's Annual Report on Internal Control over Financial Reporting, management has excluded five entities from its assessment of internal control over financial reporting as of December 31, 2018 because they were acquired by the Company in purchase business combinations during 2018. We have also excluded these five entities from our audit of internal control over financial reporting. These entities, each of which is a consolidated subsidiary, comprised, in the aggregate, total assets and total revenues excluded from management's assessment and our audit of internal control over financial reporting of approximately 0.8% and 2.5% of consolidated total assets and consolidated total revenues, respectively, as of and for the year ended December 31, 2018. The most significant of these entities, representing 1.1%, 0.4% and 0.4% of consolidated total revenues and 0.2%, 0.4%, and 0.0% of consolidated total assets were Westboro Tennis & Swim Club, Palm Beach Sports Clubs, and Christi's Fitness, respectively.

Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP, our independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of December 31, 2018, as stated in their attestation report included following the signature page hereto, included in Item 15.

Changes in Internal Control Over Financial Reporting: There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information with respect to directors, executive officers and corporate governance of the Company is incorporated herein by reference to the following sections of the Company's definitive Proxy Statement relating to the Company's 2019 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the Company's fiscal year ended December 31, 2018 (the "Proxy Statement"): "Matters to be Considered at Annual Meeting — Proposal One — Election of Directors," "Corporate Governance and Board Matters — Corporate Governance Documents," "Corporate Governance and Board Matters — Committee Membership — Audit Committee," "Section 16(A) Beneficial Ownership Reporting Compliance," "Executive Officers," and "Deadline for Receipt of Stockholder Proposals."

The following are the members of our Board of Directors and our Executive Officers:

Board of

Directors:

Patrick Walsh	Chairman and Chief Executive Officer, Town Sports International Holdings, Inc. and Chief Executive Officer, PW Partners Atlas Funds, LLC
Martin Annese	Principal, MJA Consulting, LLC
Marcus B. Dunlop	Managing Partner, HG Vora Capital Management, LLC
Jason M. Fish	Private Investor, Vice Chair of Congressional Bancshares, INC
Thomas J. Galligan III	Former Executive Chairman, Papa Gino's Holdings Corp.
Mandy Lam	General Counsel, HG Vora Capital Management, LLC
L. Spencer Wells	Partner, Drivetrain Advisors, LLC

Executive

Officers:

Patrick Walsh	Chief Executive Officer
Carolyn Spatafora	Chief Financial Officer
Stuart Steinberg	General Counsel
Nitin Ajmera	Senior Vice President — Shared Services and Controller

Item 11. Executive Compensation

The information with respect to executive compensation is incorporated herein by reference to the following section of the Proxy Statement: "Executive Compensation."

The information with respect to compensation of directors is incorporated herein by reference to the following section of the Proxy Statement: "Corporate Governance and Board Matters — Directors' Compensation for the 2018 Fiscal Year."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information about securities authorized for issuance under equity compensation plans is incorporated herein by reference to the following section of the Proxy Statement: "Executive Compensation - Equity Compensation Plan Information."

The information with respect to security ownership of certain beneficial owners and management is incorporated herein by reference to the following section of the Proxy Statement: "Ownership of Securities."

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information with respect to certain relationships and related transactions and director independence is incorporated herein by reference to the following sections of the Proxy Statement: "Certain Relationships and Related Transactions" and "Corporate Governance and Board Matters — Director Independence."

Item 14. Principal Accountant Fees and Services

The information with respect to principal accountant fees and services is incorporated herein by reference to the following section of the Proxy Statement: "Matters to be Considered at Annual Meeting — Proposal Two — Ratification of Independent Registered Public Accounting Firm."

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PART IV

Item 15. Exhibits And Financial Statements

(a) Financial Statements

(1) Financial statements filed as part of this report:

	Page Number
Consolidated Annual Financial Statements of Town Sports International Holdings, Inc:	
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated balance sheets at December 31, 2018 and 2017</u>	F-3
<u>Consolidated statements of operations for the years ended December 31, 2018 and 2017</u>	F-4
<u>Consolidated statements of comprehensive income (loss) for the years ended December 31, 2018 and 2017</u>	F-5
<u>Consolidated statements of stockholders' deficit for the years ended December 31, 2018 and 2017</u>	F-6
<u>Consolidated statements of cash flows for the years ended December 31, 2018 and 2017</u>	F-7
<u>Notes to consolidated financial statements</u>	F-8

(2) Financial Statements Schedules:

The schedules have been omitted because they are not applicable or the required information has been included in the financial statements or notes thereto.

(3) Exhibits. See Item 15(b) below.

(b) Exhibits required by Item 601 of Regulation S-K

The information required by this item is incorporated herein by reference from the Index to Exhibits immediately following page F-36 of this Annual Report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on February 28, 2019.

TOWN SPORTS INTERNATIONAL HOLDINGS,
INC.

By: /s/ PATRICK WALSH

Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
By: /s/ PATRICK WALSH Patrick Walsh	Chairman and Chief Executive Officer (principal executive officer)	February 28, 2019
By: /s/ CAROLYN SPATAFORA Carolyn Spatafora	Chief Financial Officer (principal financial and accounting officer)	February 28, 2019
By: /s/ MARTIN ANNESE Martin Annese	Director	February 28, 2019
By: /s/ MARCUS B. DUNLOP Marcus B. Dunlop	Director	February 28, 2019
By: /s/ JASON M. FISH Jason M. Fish	Director	February 28, 2019
By: /s/ THOMAS J. GALLIGAN III Thomas J. Galligan III	Director	February 28, 2019
By: /s/ MANDY LAM Mandy Lam	Director	February 28, 2019
By: /s/ L. SPENCER WELLS L. Spencer Wells	Director	February 28, 2019

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Report of Independent Registered Public Accounting Firm
To the Board of Directors and Stockholders of
Town Sports International Holdings, Inc.:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Town Sports International Holdings, Inc. and its subsidiaries (the “Company”) as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income (loss), stockholders’ deficit and cash flows for each of the two years in the period ended December 31, 2018, including the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As described in Management's Annual Report on Internal Control over Financial Reporting, management has excluded five entities from its assessment of internal control over financial reporting as of December 31, 2018 because they were acquired by the Company in purchase business combinations during 2018. We have also excluded these five entities from our audit of internal control over financial reporting. These entities, each of which is a consolidated subsidiary, comprised, in the aggregate, total assets and total revenues excluded from management's assessment and our audit of internal control over financial reporting of approximately 0.8% and 2.5% of consolidated total assets and consolidated total revenues, respectively, as of and for the year ended December 31, 2018. The most significant of these entities, representing 1.1%, 0.4% and 0.4% of consolidated total revenues and 0.2%, 0.4%, and 0.0% of consolidated total assets were Westboro Tennis & Swim Club, Palm Beach Sports Clubs, and Christi's Fitness, respectively.

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Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
New York, New York
February 28, 2019

We have served as the Company's auditor since at least 1996. We have not been able to determine the specific year we began serving as auditor of the Company.

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Table of ContentsTOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

As of December 31, 2018 and 2017

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

	2018	2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$48,088	\$30,321
Accounts receivable, net	3,050	2,216
Prepaid corporate income taxes	746	13,563
Prepaid rent expense	63	9,153
Prepaid expenses and other current assets	9,984	12,894
Total current assets	61,931	68,147
Fixed assets, net	157,677	151,498
Goodwill	21,877	6,217
Intangible assets, net	9,439	5,134
Deferred membership costs	1,803	959
Other assets	8,727	4,716
Total assets	\$261,454	\$236,671
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Current portion of long-term debt	\$21,080	\$2,242
Current portion of mortgage and term loan	314	—
Accounts payable	3,672	2,247
Accrued expenses	32,547	24,669
Accrued interest	34	118
Deferred revenue	37,459	33,473
Total current liabilities	95,106	62,749
Long-term debt	178,002	193,947
Long-term mortgage and term loan	5,113	—
Deferred lease liabilities	44,374	47,356
Deferred tax liabilities	—	93
Deferred revenue	258	351
Other liabilities	11,298	10,132
Total liabilities	334,151	314,628
Commitments and Contingencies (Note 16)		
Stockholders' deficit:		
Preferred stock, \$0.001 par value; no shares issued and outstanding at both December 31, 2018 and December 31, 2017		
Common stock, \$0.001 par value; issued and outstanding 27,192,154 and 27,149,135 shares at December 31, 2018 and 2017, respectively	25	25
Additional paid-in capital	(1,644)	(4,290)
Accumulated other comprehensive income	1,841	1,201
Accumulated deficit	(73,212)	(74,893)
Total Town Sports International Holdings, Inc. and subsidiaries stockholders' deficit	(72,990)	(77,957)
Non-controlling interests	293	—
Total stockholders' deficit	(72,697)	(77,957)

Total liabilities and stockholders' deficit	\$261,454	\$236,671
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See notes to consolidated financial statements.

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Table of ContentsTOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2018 and 2017

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

	2018	2017
Revenues:		
Club operations	\$437,357	\$397,166
Fees and other	5,737	5,876
	443,094	403,042
Operating Expenses:		
Payroll and related	168,315	145,612
Club operating	197,689	180,467
General and administrative	25,047	22,680
Depreciation and amortization	37,442	40,849
Impairment of fixed assets	2,082	6,497
	430,575	396,105
Operating income	12,519	6,937
Interest expense	13,478	12,665
Interest income	(133)	(78)
Equity in the earnings of investees and rental income	(344)	(333)
Loss before benefit for corporate income taxes	(482)	(5,317)
Benefit for corporate income taxes	(357)	(9,686)
Net (loss) income including non-controlling interests	(125)	4,369
Less: net loss attributable to non-controlling interests	(202)	—
Net income attributable to Town Sports International Holdings, Inc. and subsidiaries	\$77	\$4,369
Earnings per share:		
Basic	\$—	\$0.17
Diluted	\$—	\$0.17
Weighted average number of shares used in calculating earnings per share:		
Basic	25,858,494	25,229,614
Diluted	26,252,137	25,948,870

See notes to consolidated financial statements.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Years Ended December 31, 2018 and 2017

(All figures in thousands)

	2018	2017
Net (loss) income including non-controlling interests	\$(125)	\$4,369
Other comprehensive income, net of tax:		
Foreign currency translation adjustments, net of tax of \$0 for the years ended in December 31, 2018 and 2017	530	42
Interest rate swap, net of tax of \$0 for the years ended in December 31, 2018 and 2017	110	1,327
Total other comprehensive income, net of tax	640	1,369
Total comprehensive income including non-controlling interests	515	5,738
Less: comprehensive loss attributable to non-controlling interests	(202)	—
Total comprehensive income attributable to Town Sports International Holdings, Inc. and subsidiaries	\$717	\$5,738

See notes to consolidated financial statements.

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Table of ContentsTOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT

Years Ended December 31, 2018 and 2017

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

	Common Stock (\$.001 par)		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings (Deficit)	Total Town Sports International and Subsidiaries' Stockholders' Equity (Deficit)	Non-controlling interests	Total Stockholders' Equity (Deficit)
	Shares	Amount						
Balance at December 31, 2016	26,560,547	24	(6,261)	(168)	(79,265)	(85,670)	—	(85,670)
Stock option exercises	44,114	1	110	—	—	111	—	111
Common stock grants	108,940	—	368	—	—	368	—	368
Restricted stock grants	506,200	—	—	—	—	—	—	—
Forfeiture of restricted stock	(70,666)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	1,493	—	—	1,493	—	1,493
Dividend forfeitures	—	—	—	—	3	3	—	3
Net income	—	—	—	—	4,369	4,369	—	4,369
Derivative financial instruments	—	—	—	1,327	—	1,327	—	1,327
Foreign currency translation adjustment	—	—	—	42	—	42	—	42
Balance at December 31, 2017	27,149,135	25	(4,290)	1,201	(74,893)	(77,957)	—	(77,957)
Stock option exercises	13,110	—	30	—	—	30	—	30
Common stock grants	52,460	—	320	—	—	320	—	320
Restricted stock grants	13,115	—	—	—	—	—	—	—
Shares issued under Employee Stock Purchase Plan	8,643	—	—	—	—	—	—	—
Forfeiture of restricted stock	(44,309)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	2,296	—	—	2,296	—	2,296
Net income (loss)	—	—	—	—	77	77	(202)	(125)
Other increases from non-controlling interests	—	—	—	—	—	—	495	495
Cumulative effect of change in accounting principle	—	—	—	—	1,604	1,604	—	1,604
Derivative financial instruments	—	—	—	110	—	110	—	110
	—	—	—	530	—	530	—	530

Foreign currency

translation adjustment

Balance at December 31, 2018 27,192,154 \$ 25 \$(1,644) \$ 1,841 \$(73,212) \$(72,990) \$ 293 \$(72,697)

See notes to consolidated financial statements.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2018 and 2017

(All figures in thousands)

	2018	2017
Cash flows from operating activities:		
Net (loss) income including non-controlling interests	\$(125)	\$4,369
Adjustments to reconcile net (loss) income including non-controlling interests to net cash provided by operating activities:		
Depreciation and amortization	37,442	40,849
Impairment of fixed assets	2,082	6,497
Amortization of debt discount	976	939
Amortization of debt issuance costs	580	601
Noncash rental income, net of non-cash rental expense	(3,324)	