



Town Sports International Holdings

(CLUB: \$3.49 Outperform; \$5.50 PT)

*Lowering Our Estimates in Light of Challenging Business Conditions—Maintaining Our Outperform Rating, but Lowering Our Price Target to \$5.50 from \$11.00***Figure 1. Town Sports International Holdings—Key Company Data, Prices as of 4/29/19**

Key Data		FY: Dec	2017A	2018A	2019E		2020E	
Price:	\$3.49	Adj EBITDA:			Old	Est	Old	Est
Price Target:	\$5.50	Q1	10.7	13.7	14.2	11.5	--	--
52-Week Range:	3.59-14.85	Q2	13.2	14.4	14.8	12.2	--	--
Market Cap (\$mn):	92	Q3	11.2	12.7	13.4	10.3	--	--
Shares Out. (mn):	26.4	Q4	16.8	16.0	15.4	11.4	--	--
Avg. Daily Vol.:	100,000	Year	52.0	57.3	57.8	45.4	60.2	45.7
Total Debt (\$mn)*:	205	EV/EBITDA	5.0x			5.7x		5.7x
Net Debt (\$mn)*:	168	FCF (\$mn)	18.0	52.2	27.8	19.2	29.6	21.3
		FCF Yield				20.8%		23.1%
EV (\$mn):	260	Revenue (\$mn)						
Annual Dividend:	0	Q1	99	107	115	117A	--	--
Dividend yield:	0.0%	Q2	100	112	117	120	--	--
		Q3	99	110	113	117	--	--
		Q4	105	113	114	116	--	--
		Year	403	443	458	468	162	470

*vs S&P 500

Sources: Company data and Imperial Capital, LLC.

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Key Data

Symbol: CLUB
Price (4/29/19): \$3.49
Rating: Outperform
Price Target: \$5.50

Estimates:

2019E EBITDA: \$45.4
2020E EBITDA: \$45.7
2019E EV/EBITDA: 5.7x
2020E EV/EBITDA: 5.7x

Company Description

Town Sports is an owner and operator of fitness clubs in the U.S. Key brands include New York Sports Clubs, Boston Sports Clubs, Palm Beach Sports Clubs, and Lucille Roberts. The company has over 600K members.

Financial Summary

Town Sports International Holdings (CLUB) generated revenue of \$453mn and EBITDA of \$55mn in the latest twelve month period ended 3/31/19. CLUB had \$37mn in cash and \$205mn in debt as of that date.

View and Valuation

We are maintaining our Outperform rating and lowering our one-year price target to \$5.50 from \$11. Our price target is based on 6.9x 2020E EBITDA of \$46mn.

Rationale

A multitude of factors have pressured CLUB in recent quarters. We are maintaining our Outperform rating, although we are taking our forward estimates lower to account for the pressures on CLUB's business model.

Quarterly results: On 4/25/19, CLUB reported 1Q19 results that mostly trailed our estimates. Revenue of \$117mn and EBITDA of \$11.5mn compared to \$107mn and \$14.1mn last year. Increased labor costs negatively impacted profitability, and the many acquisitions completed since late 2017 have yet to generate meaningful profitability.

Key metrics: Comparable club revenue declined 1.8%, the first decline since 2016. Attrition improved to 3.8% from 3.9% last year, while average member dues per member per month declined slightly.

Estimate changes: We are lowering our estimates, as shown in Figure 1, to account for higher labor and occupancy costs and only-modest EBITDA contribution from acquisitions. Acquisitions could provide upside to our estimates if transition/integration expenses cycle through faster than expected.

Balance sheet update: CLUB ended 1Q19 with nearly \$170mn in net debt and the company is currently working to refinance (late-2020 maturity). The rate is likely to increase – each 100bp would negatively impact our FCF estimate by nearly \$2mn annually.

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Additional information is available upon request.

Capitalization

Figure 2. Town Sports International Holdings—Capitalization as of 3/31/19, Prices as of 4/29/19

			Debt Face		Net Debt Face		Net Debt Market			Price / YTM Analysis			Interest Exp. Analysis	
			Cum. Debt Face	LTM EBITDA Mult.	Net Debt Face	LTM EBITDA Mult.	Debt Mkt	Debt Mkt	LTM EBITDA Mult.	Price	YTM	Mat.	Rate/Coup.	Est. Int. Exp.
LTM Revenue (03/31/19)	453													
LTM EBITDA (03/31/19)	55													
LTM EBITDA % (03/31/19)	12.1%													
LTM FCF (03/31/19)	35													
Settlement Date	NA													
M/S&P Rating		Balance												
Cash		37												
Senior Secured Credit Facility														
Term Loan	197		197	3.6			195	158	2.9	99		11/15/20	5.40%	10.6
Revolving Loan Facility	NA		NA	NA			NA	NA	NA			11/15/18		NA
Mortgage and Other	8		2				8							
Total	205		205	3.7x		168	3.1x	203	166	3.0x				10.6
Common Equity														
Common Stock (CLUB)	92		92	1.7x		92	1.7x	3.49	26.4 shares					Interest 10.6
Total Equity	92		92	1.7x		92	1.7x	3.49	26.4 shares					10.6

Sources: Company data and Imperial Capital, LLC.

Rationale (continued)

Acquisitions: CLUB completed another major acquisition in 1Q19, Around the Clock Fitness, a Florida based operator with six gyms that was acquired for approximately \$22mn. Around the Clock Fitness represents CLUB's eleventh acquisition (total investment exceeds \$80mn, inclusive of real estate). Most of the acquired brands remained unprofitable in 1Q19, although disclosure is limited.

Pricing trends: Pricing appears stable at CLUB's key brands. CLUB raised pricing until mid-2018, when attrition spiked mid-year. We believe the company is unlikely to again raise prices anytime soon.

Free cash flow profile: Despite the challenging operating environment, CLUB remains solidly free cash flow positive. We estimate the company will generate approximately \$20mn of annual free cash flow, but our estimate is likely to decline whenever the debt is refinanced. As mentioned previously, each 100bp of rate impacts FCF by approximately \$2mn.

Annual meeting: CLUB's annual meeting is scheduled for 5/15/19 in New York. It is the sole forum where management answers questions from investors.

Recent Financial Results

Figure 3. Town Sports International Holdings—Quarterly Overview

	Q1'19A	IC Est.	Growth	Commentary
Sales	116.6	114.6	8.9%	Same store sales declined 1.8%
Cost of Revenue	53.6	51.6		
Gross Profit	63.0	63.0	7.3%	
Gross Margin	54.1%	55.0%		
Payroll	45.3	42.4		Likely impacted by minimum wages - also acquired clubs
G&A	6.9	6.5		
D&A	9.6	9.2		
Other	0.0	0.0		
Operating Income	1.2	4.9		
Net Income	(2.0)	1.3		
EPS	(0.08)	0.05		
Adj EBITDA	11.5	14.2	-18.7%	We exclude m&a transaction costs

Sources: Company data and Imperial Capital, LLC.

Figure 4. Town Sports International Holdings—Income Statement, 2017-2020E

Town Sports (CLUB)	2017	1Q18 March	2Q18 June	3Q18 Sept	4Q18 Dec	2018	1Q19 March	2Q19E June	3Q19E Sept	4Q19E Dec	2019E	2020E
Sales	\$403,042	\$107,111	\$112,329	\$110,173	\$113,481	\$443,094	\$116,598	\$119,568	\$116,557	\$115,678	\$468,401	\$470,124
<i>Growth</i>	1.5%	8.1%	12.3%	11.7%	7.7%	9.9%	8.9%	6.4%	5.8%	1.9%	5.7%	0.4%
Club Operations	397,166	105,675	111,047	108,709	111,926	437,357	115,140	118,068	115,057	114,178	462,443	464,124
Fees and Other	5,876	1,436	1,282	1,464	1,555	5,737	1,458	1,500	1,500	1,500	5,958	6,000
Cost of Operations	180,467	48,364	50,131	50,107	49,087	197,689	53,576	54,643	54,199	52,055	214,473	214,498
Gross Profit	222,575	58,747	62,198	60,066	64,394	245,405	63,022	64,925	62,358	63,623	253,928	255,625
Payroll and Related	145,612	39,474	42,396	42,108	44,337	168,315	45,323	46,034	45,457	45,693	182,507	183,329
G&A	22,680	5,911	6,381	6,700	6,055	25,047	6,870	6,815	6,644	6,594	26,923	26,915
D&A	40,849	9,128	9,640	9,188	9,486	37,442	9,585	9,565	9,325	9,254	37,729	37,610
Other	6,497	0	0	2,082	0	2,082	0	0	0	0	0	0
Operating Income	6,937	4,234	3,781	(12)	4,516	12,519	1,244	2,511	932	2,082	6,770	7,771
Interest Expense	(12,665)	(3,168)	(3,338)	(3,493)	(3,479)	(13,478)	(3,452)	(3,455)	(3,455)	(3,455)	(13,818)	(13,822)
Interest Income	78	36	45	46	6	133	28	0	0	0	28	0
Rental/Equity Earnings	333	105	78	79	82	344	55	80	80	80	295	320
Other	0	0	0	0	0	0	0	0	0	0	0	0
Pretax Income	(5,317)	1,207	566	(3,380)	1,125	(482)	(2,125)	(864)	(2,443)	(1,293)	(6,726)	(5,730)
Taxes	(9,686)	78	(35)	562	(962)	(357)	74	(216)	(611)	(323)	(1,076)	(1,433)
Noncontrolling Int	0	0	0	(4)	206	202	(150)	0	0	0	(150)	0
Net Income	\$4,369	\$1,129	\$601	(\$3,946)	\$2,293	\$77	(\$2,049)	(\$648)	(\$1,832)	(\$970)	(\$5,799)	(\$4,298)
EPS	\$0.17	\$0.04	\$0.02	(\$0.15)	\$0.09	\$0.00	(\$0.08)	(\$0.02)	(\$0.07)	(\$0.04)	(\$0.22)	(\$0.16)
Shares Outstanding	25,949	26,854	26,584	25,850	26,465	26,252	26,444	26,584	26,724	26,864	26,654	27,214
Free Cash Flow	\$17,993	\$28,691	\$9,761	\$872	\$12,883	\$52,207	\$11,531	\$10,917	\$11,992	(\$15,234)	\$19,207	\$21,312
Adjusted EBITDA	\$52,249	\$14,148	\$14,417	\$12,722	\$16,021	\$57,308	\$11,499	\$12,156	\$10,337	\$11,441	\$45,434	\$45,726
Gross Margin	55.2%	54.8%	55.4%	54.5%	56.7%	55.4%	54.1%	54.3%	53.5%	55.0%	54.2%	54.4%
Payroll and Related	36.1%	36.9%	37.7%	38.2%	39.1%	38.0%	38.9%	38.5%	39.0%	39.5%	39.0%	39.0%
Club Contribution	19.1%	18.0%	17.6%	16.3%	17.7%	17.4%	15.2%	15.8%	14.5%	15.5%	15.2%	15.4%
G&A	5.6%	5.5%	5.7%	6.1%	5.3%	5.7%	5.9%	5.7%	5.7%	5.7%	5.7%	5.7%
D&A	10.1%	8.5%	8.6%	8.3%	8.4%	8.5%	8.2%	8.0%	8.0%	8.0%	8.1%	8.0%
Operating Margin	1.7%	4.0%	3.4%	0.0%	4.0%	2.8%	1.1%	2.1%	0.8%	1.8%	1.4%	1.7%
Taxes	182.2%	6.5%	-6.2%	-16.6%	-85.5%	74.1%	-3.5%	25.0%	25.0%	25.0%	16.0%	25.0%
EBITDA Margin	13.0%	13.2%	12.8%	11.5%	14.1%	12.9%	9.9%	10.2%	8.9%	9.9%	9.7%	9.7%
Incr EBITDA Margin	185.7%	42.3%	9.5%	12.4%	-11.6%	12.6%	-27.9%	-31.2%	-37.4%	-208.5%	-46.9%	17.0%

Sources: Company data and Imperial Capital, LLC.

Risk Factors

- **Consumer spending:** Any weakness in consumer spending would negatively impact CLUB.
- **Labor:** Rising minimum wage laws could negatively impact CLUB.
- **Taxes:** CLUB is party to several tax disputes.
- **Competition:** Several well capitalized competitors are expanding across the U.S.

Price Chart and Ratings History

Figure 5. Town Sports International Holdings—Price Chart and Ratings History



Description	Price	IC Rating	Report Date
Common Stock	\$7.77	Outperform	10/30/18
Common Stock	\$10.53	Outperform	7/31/18
Common Stock	\$10.65	Outperform	5/21/18
Common Stock	\$9.30	Outperform	5/1/18
Common Stock	\$8.25	Outperform	4/18/18
Common Stock	\$6.60	Outperform	3/2/18
Common Stock	\$5.80	Outperform	10/30/17
Common Stock	\$5.30	Outperform	7/31/17
Common Stock	\$4.05	Outperform	4/28/17
Common Stock	\$3.80	Outperform	3/22/17
Common Stock	\$3.25	Outperform	2/21/17
Common Stock	\$2.60	Outperform	10/28/16
Common Stock	\$2.46	Outperform	8/1/16
Common Stock	\$3.07	Outperform	5/16/16
Common Stock	\$3.60	Outperform	5/4/16
Common Stock	\$2.19	Outperform	3/23/16

Sources: Bloomberg and Imperial Capital, LLC.

Companies under coverage: George Kelly, CFA: Acushnet Holdings (GOLF), Brunswick Corporation (BC), Callaway Golf Company (ELY), Drive Shack (DS), Freshpet (FRPT), Johnson Outdoors (JOUT), Lindblad Expeditions (LIND), MINDBODY (MB), National Beverage (FIZZ), Nautilus (NLS), OneSpaWorld (OSW), Planet Fitness (PLNT), Primo Water (PRMW), Town Sports (CLUB), YogaWorks (YOGA).

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Ratings Distribution and Definitions

Equity Ratings Definitions (as of 7/1/09)		
Outperform	66.06%	Outperform: TRR expected to exceed basket by at least 10%
In-Line	26.61%	In-Line: TRR expected to be in-line with basket
Underperform	7.34%	Underperform: TRR expected to underperform basket by at least 10%
This Equity Ratings Distribution reflects the percentage distribution for rated equity securities for the twelve month period 4/1/18 through 3/31/19. Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Within the twelve month period ended 12/31/18, IC has provided investment banking services to 8.33% of companies with equity rated an Outperform, 12.50% of companies with equity rated an Underperform, and 10.34% of companies with equity rated an In-Line. As of 3/31/19.		
Fixed Income Ratings Definitions and Equity Ratings Definitions (prior to 7/1/09)		
Buy: TRR expected to exceed basket by at least 10%		
Hold: TRR expected to be in-line with basket		
Sell: TRR expected to underperform basket by at least 10%		
Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Please refer to our publication dated 7/1/09 for details associated with the transition of our Equity Ratings to the current definitions.		

For a discussion of the valuation methods used to determine our price target, if any, please see page 1. See page 4 for the risks that may impede achievement of such price target, and page 4 for our ratings history and price chart.

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