TOWN SPORTS INTERNATIONAL HOLDINGS INC
Form 10-Q
October 28, 2011

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

Form 10-Q

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

For the quarterly period ended September 30, 2011

or

o **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 000-52013

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 Number)*

5 Penn Plaza (4th Floor)
New York, New York 10001
Telephone: (212) 246-6700

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

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

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

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

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

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

As of October 24, 2011, there were 22,848,730 shares of Common Stock of the registrant outstanding.

FORM 10-Q
For the Quarter Ended September 30, 2011
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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
September 30, 2011 and December 31, 2010
(All figures in thousands except share data)
(Unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,029	$ 38,803
Accounts receivable (less allowance for doubtful accounts of $2,578 and $2,565 as of September 30, 2011 and December 31, 2010, respectively)	8,478	5,258
Inventory	223	217
Prepaid corporate income taxes	2,603	7,342
Prepaid expenses and other current assets	8,157	13,213
Total current assets	58,490	64,833
Fixed assets, net	290,862	309,371
Goodwill	32,840	32,794
Intangible assets, net		44
Deferred tax assets, net	39,086	41,883
Deferred membership costs	9,492	5,934
Other assets	14,318	9,307
Total assets	$ 445,088	$ 464,166
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Current portion of long-term debt	$ 15,000	$ 14,550
Accounts payable	6,190	4,008
Accrued expenses	24,534	27,477
Accrued interest	956	6,579
Deferred revenue	42,613	35,106
Total current liabilities	89,293	87,720
Long-term debt	277,649	301,963
Deferred lease liabilities	64,859	67,180
Deferred revenue	6,497	3,166
Other liabilities	10,012	11,082
Total liabilities	448,310	471,111
Contingencies (Note 11)		
Stockholders deficit :		
Common stock, $.001 par value; issued and outstanding 22,848,730 and 22,667,650 shares at September 30, 2011 and December 31, 2010, respectively	23	23
Paid-in capital	(20,472)	(21,788)

Accumulated other comprehensive income	1,463	2,121
Retained earnings	15,764	12,699
Total stockholders deficit	(3,222)	(6,945)
Total liabilities and stockholders deficit	$ 445,088	$ 464,166

See notes to condensed consolidated financial statements.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Nine Months Ended September 30, 2011 and 2010
(All figures in thousands except share and per share data)
(Unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues:				
Club operations	$ 114,882	$ 111,970	$ 347,659	$ 344,737
Fees and other	1,256	1,157	3,469	3,585
	116,138	113,127	351,128	348,322
Operating Expenses:				
Payroll and related	43,286	44,409	133,639	141,525
Club operating	45,496	44,451	132,983	131,723
General and administrative	6,139	7,049	19,655	22,280
Depreciation and amortization	12,642	13,151	38,829	40,212
Impairment of fixed assets				3,254
	107,563	109,060	325,106	338,994
Operating income	8,575	4,067	26,022	9,328
Loss on extinguishment of debt			4,865	
Interest expense	6,062	5,305	18,265	15,668
Interest income	(45)	(41)	(135)	(76)
Equity in the earnings of investees and rental income	(578)	(499)	(1,833)	(1,553)
Income (loss) before provision (benefit) for corporate income taxes	3,136	(698)	4,860	(4,711)
Provision (benefit) for corporate income taxes	1,194	(680)	1,795	(3,146)
Net income (loss)	$ 1,942	$ (18)	$ 3,065	$ (1,565)
Earnings (loss) per share:				
Basic	$ 0.09	$ (0.00)	$ 0.13	$ (0.07)
Diluted	$ 0.08	$ (0.00)	$ 0.13	$ (0.07)
Weighted average number of shares used in calculating earnings (loss) per share:				
Basic	22,834,206	22,646,470	22,782,124	22,625,765
Diluted	23,457,058	22,646,470	23,318,879	22,625,765
Statements of Comprehensive Income (Loss)				
Net income (loss)	$ 1,942	$ (18)	$ 3,065	$ (1,565)

Foreign currency translation adjustments		(226)		596		318		382
Interest rate swap		(976)				(976)		
Comprehensive income (loss)	$	740	$	578	$	2,407	$	(1,183)

See notes to condensed consolidated financial statements

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2011 and 2010
(All figures in thousands)
(Unaudited)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net income (loss)	$ 3,065	$ (1,565)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	38,829	40,212
Impairment of fixed assets		3,254
Loss on extinguishment of debt	4,865	
Call premium on redemption of Senior Discount Notes	(2,538)	
Amortization of debt discount	149	
Amortization of debt issuance costs	840	759
Non-cash rental expense, net of non-cash rental income	(3,017)	(3,518)
Compensation expense incurred in connection with stock options and common stock grants	925	1,139
Decrease in deferred tax asset	3,261	5,533
Net change in certain operating assets and liabilities	11,542	(7,174)
(Increase) decrease in deferred membership costs	(3,558)	720
Landlord contributions to tenant improvements	711	100
Decrease in insurance reserves	(1,511)	(1,053)
Other	(323)	(368)
Total adjustments	50,175	39,604
Net cash provided by operating activities	53,240	38,039
Cash flows from investing activities:		
Capital expenditures	(21,641)	(9,976)
Net cash used in investing activities	(21,641)	(9,976)
Cash flows from financing activities:		
Proceeds from 2011 Senior Credit Facility, net of original issue discount	297,000	
Debt issuance costs	(8,065)	
Repayment of 2007 Term Loan Facility	(178,063)	(1,388)
Repayment of Senior Discount Notes	(138,450)	
Principal payment on 2011 Term Loan Facility	(4,500)	
Proceeds from exercise of stock options	291	81
Tax benefit from stock option exercises	100	

Net cash used in financing activities		(31,687)		(1,307)
Effect of exchange rate changes on cash		314		331
Net increase in cash and cash equivalents		226		27,087
Cash and cash equivalents beginning of period		38,803		10,758
Cash and cash equivalents end of period	$	39,029	$	37,845
Summary of the change in certain operating assets and liabilities:				
Increase in accounts receivable	$	(3,206)	$	(3,120)
Increase in inventory		(6)		(119)
Decrease in prepaid expenses and other current assets		4,156		1,386
Decrease in accounts payable, accrued expenses and accrued interest		(5,207)		(626)
Change in prepaid corporate income taxes and corporate income taxes payable		4,738		(11,279)
Increase in deferred revenue		11,067		6,584
Net change in certain working capital components	$	11,542	$	(7,174)
Supplemental disclosures of cash flow information:				
Cash payments for interest, excluding call premium on the redemption of the Senior Discount Notes	$	23,851	$	19,472
Cash payments for income taxes	$	567	$	3,066

See notes to condensed consolidated financial statements.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands except share and per share data)
(Unaudited)

1. Basis of Presentation

As of September 30, 2011, Town Sports International Holdings, Inc. (the Company or TSI Holdings), through its wholly-owned subsidiary, Town Sports International, LLC (TSI, LLC), operated 158 fitness clubs (clubs), comprised of 106 clubs in the New York metropolitan market under the New York Sports Clubs brand name, 25 clubs in the Boston market under the Boston Sports Clubs brand name, 18 clubs (two of which are partly-owned) in the Washington, D.C. market under the Washington Sports Clubs brand name, six clubs in the Philadelphia market under the Philadelphia Sports Clubs brand name and three clubs in Switzerland. The Company s operating segments are New York Sports Clubs, Boston Sports Clubs, Philadelphia Sports Clubs, Washington Sports Clubs and Swiss Sports Clubs. The Company has determined that our operating segments have similar economic characteristics and meet the criteria which permit them to be aggregated into one reportable segment.

The condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The condensed consolidated financial statements should be read in conjunction with the Company s December 31, 2010 consolidated financial statements and notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The year-end condensed balance sheet data included within this Form 10-Q was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (US GAAP). Certain information and footnote disclosures that are normally included in financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to SEC rules and regulations. The information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods set forth herein. The results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results for the entire year ending December 31, 2011.

Change in Estimated Average Membership Life

Joining fees and related direct and incremental expenses of membership acquisition, which include sales commissions, bonuses and related taxes and benefits, are deferred and recognized on a straight-line basis over an estimated average membership life of 28 months. Effective July 1, 2011, the Company changed its estimated average membership life from 27 months to 28 months. The change in estimated average membership life was due principally to a favorable trend in membership retention rates. In particular, the membership retention trend for the Company s pool of members that joined over the last 15 to 24 months has increased. If the estimated average membership life had remained at 27 months for the three months ended September 30, 2011, the impact would have been an increase in revenue and net income of approximately $139 and $35, respectively.

2. Recent Accounting Pronouncements

In October 2009, the FASB issued new accounting guidance related to the revenue recognition of multiple element arrangements. The new guidance states that if vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, companies will be required to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. The guidance, which became effective and was adopted by the Company as of January 1, 2011, applies to all new or materially modified arrangements entered into on or after the effective date, and does not require retroactive application. The adoption of this guidance did not have a significant impact on the Company s financial position or operating results as of or for the three or nine months ended September 30, 2011.

In June 2011, the FASB amended its authoritative guidance on the presentation of comprehensive income. Under the amendment, an entity will have the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This amendment, therefore, eliminates the currently available option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. The amendment does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company will adopt this amended guidance for the fiscal year beginning January 1,

2012. As this guidance relates to presentation only, the adoption of this guidance will not have any other effect on the Company s financial statements.

In September 2011, the Financial Accounting Standards Board (FASB) issued updated guidance allowing the use of a qualitative approach to test goodwill for impairment. The updated guidance would permit companies to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of one of their reporting units is less than its carrying value. If the Company concludes that this is the case, it is then necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The updated guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 with early adoption permitted. The update is not expected to have an impact on the Company s financial statements.

3. Long-Term Debt

	September 30, 2011	December 31, 2010
2011 Term Loan Facility	$ 295,500	$
2007 Term Loan Facility		178,063
Senior Discount Notes		138,450
	295,500	316,513
Less: Unamortized discount	(2,851)	
Less: Current portion due within one year	(15,000)	(14,550)
Long-term portion	$ 277,649	$ 301,963

2011 Senior Credit Facility

On May 11, 2011, TSI, LLC entered into a $350,000 senior secured credit facility (2011 Senior Credit Facility). The 2011 Senior Credit Facility consists of a $300,000 term loan facility (2011 Term Loan Facility), and a $50,000 revolving loan facility (2011 Revolving Loan Facility). The 2011 Term Loan Facility was issued at an original issue discount (OID) of 1.0% or $3,000. The proceeds were used to pay off amounts outstanding under the 2007 Senior Credit Facility, to pay the redemption price for all of the Company s outstanding 11% senior discount notes due in 2014 (the Senior Discount Notes), and to pay related fees and expenses. None of the revolving facility was drawn upon as of the closing date, but loans under the 2011 Revolving Loan Facility may be drawn from time to time pursuant to the terms of the 2011 Senior Credit Facility. The 2011 Term Loan Facility matures on May 11, 2018, and the 2011 Revolving Loan Facility matures on May 11, 2016. The borrowings under the 2011 Senior Credit Facility are guaranteed and secured by assets and pledges of capital stock by TSI, LLC and the wholly-owned domestic subsidiaries of TSI, LLC.

The OID is recorded as a contra-liability to Long-Term debt on the accompanying Condensed Consolidated Balance Sheet and is being amortized as interest expense using the effective interest method. The unamortized balance of the OID as of September 30, 2011 is $2,851.

As of September 30, 2011, there were no outstanding 2011 Revolving Loan Facility borrowings and outstanding letters of credit issued totaled $9,556. The unutilized portion of the 2011 Revolving Loan Facility as of September 30, 2011 was $40,444.

Borrowings under the 2011 Term Loan Facility, at TSI, LLC s option, bear interest at either, the administrative agent s base rate plus 4.5% or its Eurodollar rate plus 5.5% (each as defined in the 2011 Senior Credit Facility). The Eurodollar Rate has a floor of 1.50% and the base rate a floor of 2.50% with respect to the outstanding Term Loans. As of September 30, 2011, the interest rate was 7.0%. TSI, LLC is required to pay 0.25% of principal, or $750 per quarter. If, as of the last day of any fiscal quarter of TSI Holdings (commencing with the fiscal quarter ending September 30, 2011), the total leverage ratio is greater than 2.75:1.00, TSI, LLC is required to pay $3,750, or 1.25% of principal. As of September 30, 2011, TSI, LLC had a total leverage ratio of 3.17:1.00 and TSI, LLC made a principal payment of $3,750 on September 30, 2011. As of September 30, 2011, TSI LLC has made $4,500 in principal payments.

The terms of the 2011 Senior Credit Facility provide for financial covenants which require TSI, LLC to maintain a total leverage ratio (as defined) of no greater than 5.00:1.00 as of September 30, 2011, with step-downs of 0.25 in each of the next two quarters arriving at an ultimate total leverage ratio requirement of 4.50:1.00 or less effective March 31, 2012 and thereafter; an interest expense coverage ratio of no less than 2.00:1.00; and a covenant that limits capital expenditures to $40,000 for the four quarters ending in any quarter during which the total leverage ratio is greater than 3.00:1.00 and to $50,000 for the four quarters ending in any quarter during which the ratio is less than or equal to 3.00:1.00 but greater than

2.50:1.00. This covenant does not limit capital expenditures if the ratio is less than or equal to 2.50:1.00. TSI, LLC was in compliance with these covenants as of September 30, 2011 with a total leverage ratio of 3.17:1.00 and an interest coverage ratio of 3.79:1.00.

TSI, LLC may prepay the 2011 Term Loan Facility and 2011 Revolving Loan Facility without premium or penalty in accordance with the 2011 Senior Credit Facility, except that a prepayment premium of 2.0% is payable prior to May 11, 2012 and a prepayment premium of 1.0% is payable from May 11, 2012 to May 11, 2013. Mandatory prepayments are required in certain circumstances relating to cash flow in excess of certain expenditures, asset sales, insurance recovery and incurrence of certain other debt. The 2011 Senior Credit Facility contains provisions that require excess cash flow payments, as defined, to be applied against outstanding 2011 Term Loan Facility balances. The excess cash flow is calculated as of December 31 and paid on March 31. 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 flows. The applicable excess cash flow repayment percentage is 75% when the total leverage ratio, as defined, exceeds 3.00:1.00; 50% when the total leverage ratio is greater than 2.50:1.00 but less than 3.00:1.00; 25% when the total leverage ratio is greater than 2.00:1.00 but less than 2.50:1.00 and 0% when the total leverage ratio is less than or equal to 2.00:1.00. As of September 30, 2011, the 2011 Term Loan Facility has a balance of $292,649, net of the unamortized OID.

Debt issuance costs related to the 2011 Senior Credit Facility were $8,065, of which, $7,288 is being amortized as interest expense, and are included in Other assets in the accompanying Condensed Consolidated Balance Sheets. Unamortized loan costs of $1,550 related to the 2007 Senior Credit Facility and the Senior Discount Notes and $777 of costs related to the 2011 Senior Credit Facility were written-off on May 11, 2011 and are included in Loss on extinguishment of debt in the accompanying Condensed Consolidated Statements of Operations for the nine months ended September 30, 2011.

Repayment of 2007 Senior Credit Facility

Contemporaneously with entering into the 2011 Senior Credit Facility, TSI, LLC repaid the outstanding principal amount of the 2007 Term Loan Facility of $164,001. The 2007 Term Loan Facility was set to expire on the earlier of February 27, 2014, or August 1, 2013, if the Senior Discount Notes were still outstanding. There were no outstanding amounts under the 2007 Revolving Loan Facility as of this date. The 2007 Term Loan Facility was redeemed for face value plus accrued and unpaid interest of $447 and fees related to the letters of credit of $27. The total cash paid in connection with the redemption was $164,475 as of May 11, 2011 with no early repayment penalty. The Company determined that the 2011 Senior Credit Facility was not substantially different than the 2007 Senior Credit Facility for certain lenders based on the less than 10% difference in cash flows of the respective debt instruments. A portion of the transaction was therefore accounted for as a modification of the 2007 Senior Credit Facility and a portion was accounted for as an extinguishment. On May 11, 2011, the Company recorded refinancing charges of approximately $634, representing the write-off of the remaining unamortized debt costs related to the 2007 Senior Credit Facility, which is included in Loss on extinguishment of debt in the accompanying Condensed Consolidated Statements of Operations for the nine months ended September 30, 2011.

Redemption of Senior Discount Notes

A portion of the proceeds from the 2011 Senior Credit Facility were also used to pay the remaining principal amount on the Senior Discount Notes of $138,450 plus a call premium of 1.833% of the principal amount thereof totaling approximately $2,538 and accrued interest of $5,457. The accrued interest included interest through May 11, 2011 of $4,188, plus 30 days of additional interest of $1,269, representing the interest charge during the 30 day notification period. The Company determined that the 2011 Senior Credit Facility was substantially different than the Senior Discount Notes. On May 11, 2011, the Company wrote-off unamortized deferred financing costs of approximately $916 related to the redemption of the Senior Discount Notes, which is included in Loss on extinguishment of debt in the accompanying Condensed Consolidated Statements of Operations for the nine months ended September 30, 2011.

Fair Market Value

Based on quoted market prices, the 2011 Term Loan Facility had a fair value of approximately $283,680 at September 30, 2011. The Senior Discount Notes and the 2007 Term Loan Facility had a fair value of approximately

$137,066 and $168,270, respectively at December 31, 2010.

During the third quarter of 2011, we entered into an interest rate swap agreement effectively converting the variable rate on half of our long-term borrowings to a three-year fixed rate. See Note 4 Derivative Financial Instruments.

4. Derivative Financial Instruments

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

When a derivative is executed and hedge accounting is appropriate, it is designated as a cash flow hedge. Interest rate swaps are designated as cash flow hedges for accounting purposes since they are being used to transform variable interest rate exposure to fixed interest rate exposure on a recognized liability (debt). On an ongoing basis, the company assesses the hedge effectiveness of all derivatives designated as hedges for accounting purposes to determine if they continue to be highly effective in offsetting changes in cash flows of the underlying hedged items. If it is determined that the hedge is not highly effective, then hedge accounting will be discontinued prospectively.

On July 1, 2011, the Company entered into an interest rate swap arrangement which effectively converted $150,000, of our variable-rate debt based on one-month LIBOR to a fixed rate of 1.983%, or a total fixed rate of 7.483%, on this $150,000 when including the applicable 5.50% margin. This swap matures on July 13, 2014. As permitted by FASB Codification 815, *Derivatives and Hedging*, we have designated this swap as a cash flow hedge, the effects of which have been reflected in the Company s condensed consolidated financial statements as of and for the three and nine months ended September 30, 2011. The objective of this hedge is to manage the variability of cash flows in the interest payments related to the portion of the variable-rate debt designated as being hedged.

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

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

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

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

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

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

	Total Fair Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Interest rate swap liability as of September 30, 2011	$ 1,440	$	$ 1,440	$

No ineffectiveness was experienced in the above-noted cash flow hedge during the three months ended September 30, 2011. The swap contract liability of $1,440 was recorded as a component of Other liabilities on the accompanying Condensed Consolidated Balance Sheet as of September 30, 2011.

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The Company expects that approximately $760 ($502, net of taxes), of derivative losses included in Accumulated other comprehensive income at December 31, 2011, based on current market rates, will be reclassified into earnings within the next 12 months.

5. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and the interest rate swap. Although the Company deposits its cash with more than one financial institution, as of September 30, 2011, $19,096 of the cash balance of $39,029 was held at one financial institution. The Company has not experienced any losses on cash and cash equivalent accounts to date, and the Company believes that, based on the credit ratings of these financial institutions, it is not exposed to any significant credit risk related to cash at this time.

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

6. Earnings (Loss) Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Weighted average number of shares of Common Stock outstanding basic	22,834,206	22,646,470	22,782,124	22,625,765
Effect of dilutive stock options and restricted Common Stock	622,852		536,755	
Weighted average number of shares of Common Stock outstanding diluted	23,457,058	22,646,470	23,318,879	22,625,765
Earnings (loss) per share:				
Basic	$ 0.09	$ (0.00)	$ 0.13	$ (0.07)
Diluted	$ 0.08	$ (0.00)	$ 0.13	$ (0.07)

For the three and nine months ended September 30, 2011, the Company did not include stock options to purchase 473,904 and 675,962 shares of the Company s common stock, respectively, in the calculations of diluted EPS because the exercise prices of those options were greater than the average market price and such inclusion would be anti-dilutive.

For the three and nine months ended September 30, 2010, there was no effect of dilutive stock options and restricted common stock on the calculation of diluted loss per share as the Company reported a net loss for these periods.

7. Common Stock and Stock-Based Compensation

The Company s 2006 Stock Incentive Plan, as amended and restated (the 2006 Plan), authorizes the Company to issue up to 3,000,000 shares of Common Stock to employees, non-employee directors and consultants pursuant to awards of stock options, stock appreciation rights, restricted stock, in payment of performance shares or other stock-based awards. Under the 2006 Plan, stock options must be granted at a price not less than the fair market value of the stock on the date the option is granted, generally are not subject to re-pricing, and will not be exercisable more than ten years after the date of grant. Options granted under the 2006 Plan generally qualify as non-qualified stock options under the U.S. Internal Revenue Code of 1986, as amended. Certain options granted under the Company s

2004 Common Stock Option Plan, as amended (the 2004 Plan), generally qualify as incentive stock options under the U.S. Internal Revenue Code; the exercise price of a stock option granted under this plan may not be less than the fair market value of Common Stock on the option grant date.

At September 30, 2011, the Company had 100,800 stock options outstanding under the 2004 Plan and 2,045,261 shares of restricted stock and stock options outstanding under the 2006 Plan.

Option Grants

Options granted during the nine months ended September 30, 2011 to employees of the Company and members of the Company s Board of Directors were as follows:

Date	Number of Options	Exercise Price	Black-Scholes Valuation	Dividend	Risk Free	Expected Term