SPORTS CLUB CO INC
Form 10-K/A
August 18, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A
(Amendment 1)

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003
OR

|_| TRANSITION REPORT PURSUANT TO SECTON 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT

For the transition period from ___________to __________

Commission File Number: 1-13290

The Sports Club Company, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 95-4479735<br>(I.R.S. Employer Identification No.) |
| 11100 Santa Monica Blvd., Suite 300<br>Los Angeles, California<br>(Address of registrant's principal executive offices) | 90025<br>(Zip Code) |

Registrant's telephone number, including area code:
(310) 479-5200

| Securities registered pursuant to Section 12(b) of the Act:<br>Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock $.01 par value | American Stock Exchange |
| Securities registered pursuant to Section 12(g) of the Act: | None |

Indicate by check mark whether 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 requirements for the past 90 days. Yes |X| 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 III of this Form 10-K/A or any amendment to this Form 10-K/A. [_]

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 15, 2004 was $7,184,586. The number of shares of the Common Stock, par value $ .01 per share, outstanding (the only class of Common Stock of the registrant outstanding) was 18,783,744 on June 15, 2004. Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes |_| No |X|

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (this "Amendment") to the Annual Report of The Sports Club Company, Inc. on Form 10-K for the fiscal year ended December 31, 2003, filed with the Securities and Exchange Commission (the "SEC") on June 21, 2004 (the "Original Filing") is being filed solely for the purpose of responding to comments of the staff of the SEC received by us in connection with our filing of a Form 8-K on July 12, 2004 and the periodic reports of the Company referenced in that Form 8-K filing.

Item 9A. Controls and Procedures has been amended to incorporate additional disclosures requested by the SEC regarding certain reportable conditions in our accounting controls and procedures identified by our independent auditor.

In connection with the filing of this Amendment and pursuant to the rules of the SEC, we are including with this Amendment a currently dated signature page and certain currently dated certifications as Exhibits 31.1, 31.2, 32.1 and 32.2. As no changes have been made to our consolidated financial statements, or the Notes thereto, for the three most recent fiscal years ended December 31, 2003 as reported in the Original Filing, the consent of KPMG LLP contained as Exhibit 23.1 in the Original Filing is incorporated by reference into this Amendment. All other exhibits included as part of the Original Filing are incorporated by reference into this Amendment.

None of these revisions change our previously reported net revenues, income from operations, net income, income per share or cash flows for the periods included, nor result in a restatement to our financial position or results of operations.

Except as described above, no other changes have been made to the Original Filing, however, for the convenience of the reader and because it is our intention to distribute this Amendment to our stockholders in satisfaction of our obligations under the rules of the SEC and the American Stock Exchange, we have restated the Original Filing in its entirety, as amended pursuant to the description above, in this Amendment.

This Amendment continues to speak as of the date of the Original Filing, and we have not updated the disclosures contained therein to reflect any events that occurred at a date subsequent to the filing of the Original Filing.

Accordingly, this Amendment should be read in conjunction with our subsequent filings with the SEC.

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PART I

ITEM 1. BUSINESS

General

We were incorporated in Deleware in 1994 to consolidate the ownership of several sports and fitness clubs. We currently own and operate eight Clubs under "The Sports Club/LA" name in Los Angeles, Beverly Hills, Orange County, Washington D.C., Boston, San Francisco and at Rockefeller Center and the Upper East Side in New York City. We also operate and own a majority interest in Reebok Sports Club/NY, and operate The Sports Club/LA in Miami under a management agreement. Our Clubs offer a wide range of fitness and recreation options and amenities, and are marketed to affluent, health conscious individuals who desire a service-oriented, state-of-the-art club. Our Clubs are widely recognized as being among the finest sports and fitness clubs in the country.

Our Clubs (hereinafter referred to as "Clubs" or "The Sports Club/LA") are conveniently located and are spacious, modern facilities that typically include spas, restaurants, fitness centers, swimming pools and basketball courts. The Sports Club/LA sites are designed as "urban country clubs," and most Clubs range in size from 90,000 to 140,000 square feet. Initiation fees and monthly membership dues at The Sports Club/LA are higher than those charged by most other sports and fitness clubs. Income from ancillary services and products, including private training, food and beverage and spa services, also constitutes a significant portion of our revenues. Our subsidiary, The SportsMed Company ("SportsMed"), operates physical therapy facilities in some Clubs and at other locations.

According to the International Health, Racquet & Sportsclub Association ("IHRSA"), the industry's leading trade organization, it is estimated that 36.3 million Americans were members of more than 20,000 sports and fitness clubs in 2002. Revenues generated by the United States sports and fitness club industry increased at a compound annual rate of 8.1% from $6.5 billion in 1993 to $13.1 billion in 2002. The industry has benefited from the general public's increasing awareness of the importance of physical exercise. Among other groups, we target members age 35 and older who, according to IHRSA, represent 54% of all memberships and are the fastest growing segment of the industry.

Recent Events

On March 12, 2004, we completed a $6.5 million private placement of a newly created series of Convertible Preferred Stock. We received $6.1 million in cash, net of costs, and issued 65,000 shares of $.01 par value Series D Convertible Preferred Stock at a price of $100 per share. Proceeds from the sale were primarily used to make our March 15, 2004 interest payment on our Senior Secured Notes.

In November 2003, we opened The Sports Club/LA - Miami. This 40,000 square foot Club is located in the new Four Seasons Resort and Towers project in downtown Miami. We manage this Club for which we receive a management fee based upon both the gross revenue and net cash flow of the Club. We also license The Sports Club/LA name to the owner. This management structure allows us to expand our brand and receive an immediate earnings stream, with the potential for additional profits, without making any capital investment.

In October 2003, we opened The Sports Club/LA - Beverly Hills. This 40,000 square foot Club is located in the heart of the Beverly Hills retail and commercial district and is located approximately three miles east of our flagship property The Sports Club/LA - Los Angeles. This Club may serve as the prototype for smaller size Clubs to be built in locations near existing Sports Club/LA sites.

On June 12, 2003, we replaced our Bank Credit Agreement with a new $20.0 million secured loan from Orange County's Credit Union. The new loan is evidenced by a promissory note that bears interest at a fixed interest rate of 7.25% per annum; requires monthly principal and interest payments of $144,561; is secured by the common stock and all the assets of Irvine Sports Club Inc. our wholly owned subsidiary that

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owns The Sports Club/LA - Orange County; and is guaranteed by two of our major shareholders. The note may be prepaid at any time without penalty and requires a final principal payment of $18.3 million on July 1, 2008.

The Sports Club/LA

The Sports Club/LA ranges in size from 40,000 to 140,000 square feet and typically includes the following features:

- large, fully equipped gyms with state-of-the-art fitness equipment, including weight training, cardio- vascular equipment, flexibility centers and functional performance areas,
- basketball, volleyball, racquetball, squash, tennis and paddle tennis courts,
- group exercise studios featuring classes throughout the day and evening, seven days a week, including aerobics, yoga, dance, muscle conditioning, boxing, martial arts, pilates and bodymind,
- group cycling studios,
- rock climbing walls,
- boxing studios,
- swimming pools, sundecks, golf practice nets and running tracks,
- destination city spa offering massage, facials and full body treatments,
- men's and women's locker rooms featuring wood lockers,
- steam rooms, saunas and jacuzzis,
- restaurants, sports bars, private dining/conference rooms and media centers,
- valet parking, pro shops, hair salons and childcare services,

- sports medicine and physical therapy facilities,
- personal trainers to develop and supervise members' exercise routines,
- registered dietitians for nutritional consultations,
- FitLab assessment centers,
- PTS Private Trainer System nutritional programs and products,
- interactive children's' classes, as well as supervised age-specific junior recreation rooms and junior programs such as gymnastics, martial arts and dance,
- instruction in racquet sports, golf, swimming, boxing, martial arts and rock climbing,
- full-time activities directors responsible for social and media events for members, including organizing trips, lectures and charity events,
- sports instructors who present sports tournaments, leagues and classes, and
- wellness protocols such as exercise regimens designed for specific groups of members.



We currently have ten Sports Clubs in operation. The original Sports Club/LA opened in 1987 in West Los Angeles, California, near the affluent communities of Santa Monica, Brentwood, Beverly Hills, Bel Air, Westwood and Century City. We opened The Sports Club/LA-Beverly Hills in October 2003. This 40,000 square foot Club is located in the heart of Beverly Hill's retail and commercial district. The Sports Club/LA - Orange County opened in 1990 in Irvine, California near Newport Beach.

We operate three Clubs in New York City. Reebok Sports Club/NY opened in 1995 on Manhattan's upper west side, and was developed in partnership with a subsidiary of Reebok International, Ltd. ("Reebok") and Lincoln Metrocenter Partners, L.P. (collectively with its affiliates "Millennium"). We manage the operations and own a 60% interest in the partnership that owns this Club. Reebok and Millennium have each retained an interest in the partnership. We opened The Sports Club/LA at two locations in New York City in 2000. The Sports Club/LA - New York at Rockefeller Center was opened in February 2000. This Club was designed to service the executive business community in midtown Manhattan. The Sports Club/LA - New York in New York City's Upper East Side was opened in September 2000. This site is the location of the former Vertical Club, which was closed in February 1999 for major renovation and conversion to The Sports Club/LA and serves the affluent residential Upper East Side area of New York City.

We also operate The Sports Club/LA at four other sites developed by Millennium. The Sports Club/LA - Washington D.C. opened in October 2000. This 100,000 square foot Club is located at 22nd and M Streets between Washington D.C.'s business district and Georgetown. The Sports Club/LA - Boston opened in September 2001. This Club overlooks the historic Boston Common and is located a short distance from the city's financial district. Both of these Clubs are co-located with a Ritz Carlton Hotel. The Sports Club/LA - San Francisco has been open since October 2001. This Club is located in the Four Seasons Hotel and Residences in the emerging South of Market Area in San Francisco. The Sports

Club/LA - Miami opened in November 2004. We operate this Club pursuant to a management agreement with Millennium, which has retained 100% ownership in the Club's operations. We receive a management fee consisting of a flat percentage of cash revenues plus a share of the Club's operating income.

The SportsMed Company, Inc.

Our SportsMed subsidiary operates physical therapy facilities within The Sports Club/LA in Los Angeles and Orange County, the Spectrum Club - Valencia and the Spectrum Club - Thousand Oaks. SportsMed also operates in a stand-alone facility in Calabasas, California. The clinics are staffed by exercise physiologists, physical therapists and registered dietitians who provide services to members and others. We believe that SportsMed provides valuable services, which are complementary to the other services provided by the Clubs, and are considering placing physical therapy facilities in other Clubs in the future.

Development of New Clubs

Recent New Club Developments. In October 2003, we opened The Sports Club/LA - Beverly Hills. This 40,000 square foot Club is located in the heart of the Beverly Hills retail and commercial district. This Club may serve as the prototype for smaller size Clubs to be built in locations near existing Sports Club/LA sites.

In 2000 and 2001, we completed the development of five new The Sports Club/LA sites. Two of these Clubs are located in New York City and, when combined with our Reebok Sports Club/NY site, form a trio of Clubs located in residential areas on the East and West sides and the central midtown business district. Three of the new The Sports Club/LA sites were developed with Millennium, with whom we developed Reebok Sports Club/NY. Millennium is a developer of premier multi-use projects and is funded by Quantum Realty Fund, a member of the Quantum Group of Funds, which are off-shore investment funds managed by Soros Fund Management, a management firm headed by George Soros; Goldman Sachs' Whitehall Street Real Estate Limited Partnerships; and Millennium Entertainment Partners L.P., a consortium of German insurance companies. These Clubs are located in projects developed by Millennium



in prime, metropolitan locations that, like Reebok Sports Club/NY, include commercial, retail, entertainment and residential space. In addition, each of these developments includes either a Ritz Carlton or Four Seasons hotel. These Clubs are approximately 100,000 square feet and offer services typically found at other Sports Club/LA sites. We believe that such projects offer ideal locations for The Sports Club/LA and would consider developing The Sports Club/LA with Millennium or other developers in other major metropolitan areas.

Performance of Newly Developed and Acquired Clubs. Based on our experience, a newly developed Club tends to achieve significant increases in revenues until a mature membership level is reached. In the past, recently opened Clubs that have not yet achieved mature membership levels have operated at a negative cash flow or only a slight positive cash flow during the first two years of operation as a result of fixed expenses that, together with variable operating expenses, approximate or exceed membership fees and other revenues. This trend has continued at The Sports Club/LA sites we opened since 2000. Three of these Clubs are now operating at a positive cash flow level while three Clubs are still building the membership base necessary to achieve this level. We believe that our revenues from these Clubs will significantly increase as membership levels mature.

Future New Club Developments

The completion of The Sports Club/LA at five new sites has required significant financial resources. In addition, our current financing arrangements and level of operating cash flow make it difficult to secure the required financing to develop additional new sites. Therefore, our primary focus is now on improving the operating performance of our existing Clubs. We are pursuing The Sports Club/LA developments at new sites that are financially structured in a way that will not require us to make a significant capital investment. We would consider entering into joint ventures, partnership agreements or management agreements for the purpose of developing new Clubs.

We currently operate The Sports Club/LA - Miami. Millennium is the owner of this Club. They are responsible for providing all funds necessary to construct, equip and operate the Club. We manage the Club's operations for which we receive a management fee based upon both the gross revenues and net cash flow of the Club. We also license The Sports Club/LA name to Millennium. This structure allows us to expand our brand and receive an immediate earnings stream, with the potential for additional profits, without making any capital investment. We would consider entering into similarly structured agreements to manage other Clubs for Millennium or other developers.

Sales and Marketing

Strategy. The Sports Club/LA is marketed as an "urban country club" offering personalized attention and multiple amenities and services. We believe that the image of The Sports Club/LA as the leader in the sports and fitness industry justifies charging a premium. Our members include professionals, sports and entertainment personalities and business people. The Sports Club/LA emphasize personalized service and instruction and the creation of an "urban country club" atmosphere in which members can relax and socialize. Our marketing efforts at The Sports Club/LA emphasize retaining existing members, replacing members who leave with new members and increasing ancillary revenues from services such as private training and spa services. Our focus at the newer Sports Club/LA locations is on attracting additional members.

Referrals, Endorsements and Advertising. Word-of-mouth referrals and endorsements by existing members are The Sports Club/LA's most important source of new members. In addition, The Sports Club/LA utilizes targeted marketing programs which include advertisements, promotions, public relations and community events. The principal marketing media for the Clubs are direct mail and print advertisements. Special events and special membership programs supplement the print advertisements. The Sports Club/LA hosts corporate parties and charity benefits and often donates free or discounted memberships to charitable organizations. We also conduct periodic membership drives whereby referring members are entitled to receive special gifts and other incentives. We believe that we will be able to continue to utilize these marketing strategies.



Targeted Members. The largest segment of the membership base for The Sports Club/LA consists of health-conscious individuals. We target four other groups in order to expand membership: corporate members, medical referrals, families, and seniors. Each of these groups requires specialized exercise/fitness programs and we have developed specific programs to attract members of these groups.

Corporate Programs. We believe the corporate market is a significant source of new members, due to the proximity of The Sports Club/LA to business centers. Our members use the Clubs to conduct business and to develop and maintain business contacts. We employ several Corporate Membership Directors whose principal responsibilities are to solicit corporate memberships from businesses operating in the vicinity of the Clubs. The Sports Club/LA offers corporate group-discounted initiation fees depending upon the number of new members involved. Our SportsMed subsidiary has developed several corporate wellness programs to fit the needs of this particular market. We believe that corporations are favorably disposed to The Sports Club/LA and The SportsMed programs because of the positive impact regular exercise and overall fitness can have on employee absenteeism, morale and productivity.

Medical Referrals. We target members from the medical referral market through our SportsMed subsidiary by offering specific rehabilitation and exercise protocols to complement other forms of physical therapy recommended by a physician or medical group. We also offer a "next-step" program for SportsMed patients who complete their physical therapy programs and are looking for an option to complete their rehabilitation by becoming members at The Sports Club/LA.

Family Programs. We believe that the family market has considerable potential, as younger members grow older, marry and have children and seek recreational activities in which the entire family can participate. To attract the family market, we have implemented "Fun-N-Fit" programs that offer programs to children between the ages of 6 months and 15 years and involve youth sports camps and clinics, fitness programs, art classes and birthday parties. The Sports Club/LA's weight-training, basketball and swimming pool facilities are made available to children and their parents during Family Day, and specially-designed movement classes utilizing a variety of fitness equipment are offered to younger children. The Sports Club/LA provides individualized sports instruction and offers multiple fitness activities such as gymnastics, martial arts and dance that are age appropriate.

Senior Programs. We anticipate that as the current core membership group ages, we will meet the changing fitness needs of seniors and attract additional members from the senior population. We maintain training and exercise protocol manuals for the senior market (that we generally define as members who are over 60 years old) that include a description of exercise and fitness programs specifically designed for seniors. These manuals also contain discussions of the biological, psychological and medical aspects of aging and the benefits of regular exercise. We believe this market will expand as the "baby boomers" mature.

Employee Training

We believe that a key component of our operating strategy is a well-trained and knowledgeable staff. We have comprehensive training programs to enhance the effectiveness of our personnel. All newly hired employees are required to attend an orientation seminar that is led by members of our management staff and a personnel instructor. Topics include our history and philosophy, The Sports Club/LA policies and procedures, member service, interaction skills and product knowledge. These orientation seminars are held weekly.

To aid in the development and continuing education of our management staff, we offer a workshop entitled "Introduction to Management" for newly hired management personnel and other employees demonstrating management skills. The workshop is intended to educate managers in the areas of instilling our Company philosophy, policies and procedures, safety, workers' compensation, managing people, communication, group problem solving, training, coaching, motivation, feedback, recognition, counseling, evaluations, as well as time and stress management. Topics are added periodically to reflect new management techniques or operating issues. These seminars, generally consisting of three eight-hour sessions, are held six times a year or as needed for new employees. Additionally, our management

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personnel are required to participate in our Manager on Duty Program and other management and sales seminars to maintain and develop their skills.

We provide additional seminars specifically designed for targeted employee groups. Seminars providing specialized instruction for program directors, private trainers, group exercise instructors and sales/marketing personnel are offered at various times during the year, for which attendance on the part of newly-hired personnel is mandatory. We place particular emphasis on our sales/marketing training seminars that are given once every two months by a personnel instructor. In these seminars, all new membership directors complete 20 hours of participation and all other membership directors are expected to complete four hours of participation every two months. Our fitness instructors are trained to assist in the sales function and to implement fitness testing and individually-tailored exercise programs. Most instructors are college-educated and all trainers are required to be certified by the National Academy of Sports Medicine. Our group exercise instructors hold nationally recognized certifications and must have at least one year of teaching experience before they are permitted to teach at The Sports Club/LA. They are also required to participate in ongoing training and periodic re-evaluation.

Lastly, all line staff can voluntarily participate in quarterly workshops that are offered through our human resources department. Workshop topics include conflict resolution, communication and member service; however, topics vary depending on the Club's current training needs.

Membership Programs

Membership at The Sports Club/LA requires an initiation fee plus monthly membership dues. Initiation fees are required to be paid upfront or during the member's first year. Members are currently required to pay their dues on a monthly basis by electronic funds transfer, by which each member is automatically debited each month for dues either through a checking account or credit card. At established Clubs, the average life of a membership is four to five years.

The Sports Club/LA offers three types of memberships: executive, health and racquet sports. The Sports Club/LA's initiation fees and monthly membership dues vary depending on the location of the Club. The Sports Clubs' market rate for initiation fees range from $400 to $2,900 and monthly membership dues range from $110 to $300. Corporate, bicoastal and spousal memberships are also available. We offer the following membership options:

Executive Membership. Executive membership offers the greatest number of amenities and services, including unlimited use of all facilities, racquet sports privileges, personal locker assignments within an executive locker room, laundry service, free valet parking and charge privileges for dining and other Club services. Executive membership entitles a member to use all The Sports Club/LA locations.

Health Membership. Health membership is the basic membership offering unlimited use of the facility excluding those privileges associated with a racquet membership; courts are available to holders of health memberships for an additional fee. We also offer a bi-coastal membership that entitles a member to use all The Sports Club/LA locations throughout the country and both an Access

West and Access East membership that allows a member the ability to use all of our Clubs located on either the west coast or east coast.

Racquet Sports Membership. Racquet sports memberships are currently offered at The Sports Club/LA - Orange County, The Sports Club/LA - Boston and The Sports Club/LA - Washington D.C. In addition to use of the Club's facilities, this membership includes unlimited use of racquetball, squash, paddle tennis and tennis courts, depending upon the individual Club's facilities.

Competition

Although the sports and fitness industry is still fragmented, the industry has experienced significant consolidation in recent years and certain of our competitors are significantly larger and have greater financial and operating resources than we do. In addition, a number of individual and regional



operators compete with us in our existing markets. Many of these sports and fitness clubs attract the same types of members we target. We also compete with recreational facilities established by governments and businesses, the YMCA and YWCA, country clubs and weight-reducing salons, as well as products and services that can be used in the home. As the general public becomes increasingly aware of the benefits of regular exercise, we expect that additional sports and fitness businesses will emerge. We believe that there will continue to exist a market for The Sports Club/LA and that our operating experience, our highly visible image, the professionalism of our staff and our state-of-the-art equipment and exercise facilities afford us an advantage over our competitors. However, we may be unable to maintain our membership fees or membership levels in areas where another sports and fitness club offers competitive facilities and services at a lower cost.

Trademarks and Trade Names

We have registered our "flying lady" logo as a stand-alone design and in combination with "The Sports Club/LA" name under federal trademark laws. Internationally, we have registered "The Sports Club/LA" name and logo in Japan, Australia and throughout Europe under a joint "European Community" trademark.

We have also obtained federal protection for our food and nutritional products that are marketed under the trade names of Private Trainer System and PTS.

Additionally, we have received trademark approval for several of our fitness programs, including BodyArt, REV and others. We have not been able to obtain full protection under Federal trademark laws for our SportsMed subsidiary name, Splash, the name of our spas, and For Kids Only, our child care and children's fitness program; however, each of these have been granted "allowed" status.

Government Regulation

Our operations and business practices are subject to regulation at the federal, state and, in some cases, local levels. State and local consumer protection laws and regulations govern our advertising, sales and other trade practices.

Statutes and regulations affecting the fitness industry have been enacted or proposed in California, Florida and New York. Many other states into which we may expand have or likely will adopt similar legislation. Typically, these statutes and regulations prescribe certain forms and provisions of membership contracts, limit the amount of prepaid revenues we can collect, afford members the right to cancel the contract within a specified time period after signing, require an escrow of funds received from pre-opening sales or the posting of a bond or proof of financial responsibility and may impose numerous limitations on the terms of membership contracts. In addition, we are 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 in order to comply with these requirements and believe that our activities are in substantial compliance with all applicable statutes, rules and decisions.

Under so-called state "cooling-off" statutes, a member has the right to cancel his or her membership for a period of three to ten days (depending on the applicable state law) and, in such event, is entitled to a refund of any down payment. In addition, our membership contracts provide that a member may cancel his or her membership at any time upon death, disability or relocation beyond a certain distance from our nearest Club. The specific procedures for cancellation in these circumstances vary due to differing state laws. In each instance, the canceling member is entitled to a refund of prepaid amounts only. Furthermore, where permitted by law, a cancellation fee is due to us upon cancellation and we may offset such amount against any refunds owed.



Employees

At May 31, 2004, we had 2,399 employees, most of whom are employed on a part-time basis in Club operating activities such as aerobics, private training and food and beverage services. At May 31, 2004, we employed 1,091 full-time employees, 981 of whom were involved in The Sports Club/LA operations such as sales, management, private training, food and beverage or support staff, 42 of whom work for our SportsMed subsidiary and 68 of whom were in general and administrative functions. We are not a party to any collective bargaining agreement with our employees. Although we experience high turnover of non-management personnel, we have never experienced any labor shortages nor had any difficulty in obtaining adequate replacements for departing employees. We consider our relations with our employees to be good.

Available Information

Quarterly and annual reports on Form 10-Q and Form 10-K can be accessed through the SEC website at http://www.sec.gov/edgar/searchedgar/webusers.htm. The website for the "Public Company Accounting Oversight Board" is http://www.pcaobus.org/.



ITEM 2. PROPERTIES

We own the real estate at The Sports Club/LA - Orange County and The

Sports Club/LA - Los Angeles (subject to a minority interest held by our Chairman D. Michael Talla). All other premises on which the Clubs are located are leased.

The following table provides certain information concerning our Clubs:

| Club | Approximate Square Feet | Open Date (1) | Own or Lease Expiration Date | Re |
|---|---|---|---|---|
| The Sports Club/LA - Los Angeles (2)....... | 100,000 | 1994 A | Own | |
| The Sports Club/LA - Orange County......... | 130,000 | 1994 A | Own | |
| Reebok Sports Club/NY(3).................. | 140,000 | 1995 O | 4/17/15 | Thre |
| The Sports Club/LA - Rockefeller Center.... | 90,000 | 2000 O | 1/31/13 | Tw |
| The Sports Club/LA - Upper East Side....... | 140,000 | 2000 O | 12/31/20 | Tw |
| The Sports Club/LA - Washington D.C.(4) | 100,000 | 2000 O | 10/31/20 | Thre |
| The Sports Club/LA - Boston(4)............. | 100,000 | 2001 O | 8/31/21 | Thre |
| The Sports Club/LA - San Francisco(5)...... | 90,000 | 2001 O | 9/30/21 | Thre |
| The Sports Club/LA - Beverly Hills......... | 40,000 | 2003 O | 4/30/18 | On |

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(1) Date of acquisition ("A") or opening ("O").

(2) D. Michael Talla, our Chairman, has the right to 49.9% of the first $300,000 of annual operating income from the partnership which owns The Sports Club/LA - Los Angeles.

(3) We have entered into a lease agreement with Millennium with respect to this property. We are entitled to certain priority distributions from the partnership that owns this Club. After payment of such priority distributions, we are entitled to 60% of all additional profits.

(4) We have entered into a lease agreement with Millennium for this Club. The lease provides that Millennium is to receive 25% of cash flows as additional rent after we earn certain priority distributions.

(5) We have entered into a lease agreement with Millennium for this Club. The lease provides that Millennium is to receive 60% of cash flows as additional rent after we earn certain priority distributions.

We remain obligated under lease agreements for seven of our former Spectrum Club locations. We have subleased each of these properties to the buyer of these Clubs under sublease agreements that provide for all operating costs of these facilities to be assumed by the new owners.

All of the Clubs maintain comprehensive casualty, liability and business interruption insurance. In March 2003, we secured insurance against acts of terrorism. Clubs located in California maintain a blanket $35.0 million earthquake insurance policy. We believe that our insurance coverage is in accordance with or above industry standards. There are, however, certain types of losses that may be either uninsurable or not economically insurable, and insurance proceeds may not adequately compensate us for all economic consequences of any loss. Should a loss occur, we could lose both our invested capital and our anticipated profits from the affected Clubs. Any such event could have a material adverse effect on our operations.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various claims and lawsuits incidental to our business, including claims arising from accidents. However, in the opinion of management, we are adequately insured against such claims and lawsuits involving personal injuries, and any ultimate liability arising out of any such proceedings will not have a material adverse effect on our financial condition, cash flow or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

Not applicable



PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED MATTERS

Our Common Stock is traded on the American Stock Exchange ("AMEX") under the symbol "SCY". The following table sets forth the quarterly high and low sale prices for the Common Stock for the periods indicated, as reported by the AMEX.

| Calendar Quarter | | Price Range of Common | |
|---|---|---|---|
| | | High | |
| Year Ended December 31, 2002: | | | |
| First Quarter | $ | 2.90 | $ |
| Second Quarter | | 2.60 | |
| Third Quarter | | 2.45 | |
| Fourth Quarter | | 3.45 | |
| Year Ended December 31, 2003: | | | |
| First Quarter | | 2.50 | |
| Second Quarter | | 2.87 | |
| Third Quarter | | 3.00 | |
| Fourth Quarter | | 2.70 | |
| Year Ending December 31, 2004: | | | |
| First Quarter | | 2.35 | |
| Second Quarter (through June 15th) | | 1.98 | |

As of June 15, 2004, we had 63 stockholders of record and approximately 600 beneficial owners. The closing price of our Common Stock as reported by the American Stock Exchange ("AMEX") on June 15, 2004, was $1.61.

On April 15, 2004, AMEX notified us that we had not met certain of the AMEX continued listing standards as set forth in Section 1003(d) of the AMEX Company Guide. We were afforded an opportunity to respond and on April 30th, submitted a plan to comply with the AMEX listing standards. The plan was amended on May 19, 2004. On May 25, 2004, AMEX approved our amended plan. We have an extension until June 21, 2004, to complete the filing of our Form 10-K for the year ended December 31, 2003 and Form 10-Q for the quarter ended March 31, 2004 with the Securities and Exchange Commission. We are subject to periodic AMEX review and our failure to regain compliance with the continued listing standards by the end of the extension period could result in our Common Stock being delisted from the AMEX.

Dividend Policy

We have never declared or paid any dividends on our Common Stock or Preferred Stock and we do not anticipate doing so in the foreseeable future. It is our present policy to retain earnings for use in our operations, debt service and the expansion of our business. In addition, our ability to pay cash dividends is limited by our current financing agreements and may be similarly limited by future financing agreements.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents our summary financial and operating data for the fiscal years ended December 31, 1999 through 2003 and has been derived from our consolidated financial statements. Such consolidated financial statements and summary financial and operating data have been restated as described in Note 2 to the consolidated financial statements. The summary financial and operating data should be read in conjunction with, and is qualified in its entirety by reference to, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the notes thereto appearing elsewhere in this Form 10-K/A.

| | Fiscal Year Ended December 3 | | | |
|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 200 |
| | | | | (Resta |
| | (Dollars in thousands, except per s | | | |
| Statement of Operations Data: | | | | |
| Revenues: | | | | |
| Membership revenues............................ | $ 86,787 | $ 75,217 | $ 100,165 | $ 120,8 |
| Reimbursed costs.............................. | -- | -- | -- | |
| Total revenues.............................. | 86,787 | 75,217 | 100,165 | 120,8 |
| Operating expenses: | | | | |
| Direct........................................ | 60,065 | 58,575 | 87,560 | 100,9 |
| Reimbursed costs.............................. | -- | -- | -- | |
| General and administrative.................... | 6,810 | 7,326 | 8,468 | 7,4 |
| Selling....................................... | 2,608 | 2,915 | 3,880 | 4,9 |
| Depreciation and amortization................. | 6,147 | 7,428 | 11,883 | 11,9 |
| Pre-opening expenses.......................... | 3,090 | 9,589 | 5,884 | 1 |
| Impairment charge............................. | -- | -- | 5,044 | |
| Total operating expenses................. | 78,720 | 85,833 | 122,719 | 125,3 |

| | | | | |
|---|---|---|---|---|
| Income (loss) from operations............. | 8,067 | (10,616) | (22,554) | (4,4 |
| Other income (expense): | | | | |
| Interest........................................ | (5,991) | (6,478) | (13,001) | (13,4 |
| Minority interests............................. | (150) | (150) | (150) | (1 |
| Equity interest in net income of unconsolidated subsidiary.................................. | 931 | -- | -- | |
| Non-recurring items............................ | 768 | (3,242) | 397 | 1 |
| Total other income (expense).............. | (4,442) | (9,870) | (12,754) | (13,4 |
| Income (loss) before income taxes and cumulative effect of change in accounting principle............................... | 3,625 | (20,486) | (35,308) | (17,9 |
| Provision (benefit) for income taxes............. | 2,021 | (7,982) | 5,370 | (3 |
| Income (loss) before cumulative effect of change in accounting principle........... | 1,604 | (12,504) | (40,678) | (17,6 |
| Cumulative effect of change in accounting principle, net of income tax benefit of $600 in 1999 and $0 in 2002............................................ | 899 | -- | -- | 5,1 |
| Net income (loss).......................... | 705 | (12,504) | (40,678) | (22,7 |
| Dividends on Preferred Stock..................... | -- | -- | -- | 8 |
| Net income (loss) attributable to common shareholders............................... | $ 705 | $ (12,504) | $ (40,678) | $ (23,6 |
| Net income (loss) per share: | | | | |
| Basic and diluted.............................. | $ 0.04 | $ (0.70) | $ (2.27) | $ (1. |
| Weighted average number of common shares outstanding: | | | | |
| Basic.......................................... | 18,114 | 17,773 | 17,939 | 18,0 |
| Diluted........................................ | 18,290 | 17,773 | 17,939 | 18,0 |

| | At December 31, | | | |
|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 |
| | | | | (Restated |
| | (Dollars in thousands) | | | |
| Balance Sheet Data: | | | | |
| Cash and cash equivalents......................... | $ 36,107 | $ 11,059 | $ 1,482 | $ 3,1 |
| Restricted cash.................................. | 41,389 | 6,996 | -- | 2 |
| Property and equipment, net....................... | 118,959 | 169,907 | 170,799 | 156,6 |
| Total assets...................................... | 225,088 | 223,773 | 197,114 | 181,2 |
| Deferred membership revenue (Short and Long-Term).. | 13,025 | 16,214 | 19,026 | 18,2 |
| Long-term debt including current installments...... | 103,887 | 110,331 | 115,491 | 104,0 |
| Redeemable Preferred Stock........................ | -- | -- | -- | 5,1 |
| Stockholders' equity.............................. | 94,806 | 82,793 | 42,469 | 24,1 |

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our historical results of operations and our liquidity and capital resources should be read in conjunction with the consolidated financial statements and related notes appearing elsewhere herein. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures. On an on-going basis, we evaluate our estimates and judgments that are based on historical experience and other assumptions that we believe to be reasonable under the circumstances. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements.

Overview

We are the operator of ten sports and fitness Clubs located in major metropolitan markets across the United States, including one Club operated under a management agreement. Our Clubs are spacious, modern facilities that typically include spas, restaurants, fitness centers, swimming pools and basketball courts. Our Clubs, which are usually named The Sports Club/LA are recognized as among the finest sports and fitness facilities in the United States. In 1999, we decided to focus our efforts on the national development of The Sports Club/LA brand. At that time, we sold all of our smaller sized Clubs. We also issued $100.0 million of Senior Secured Notes due in March 2006. The proceeds from these transactions were utilized to develop five additional new Clubs in New York City, Washington D.C., Boston and San Francisco. We have since opened The Sports Club/LA in Beverly Hills and in Miami.

Most of our Clubs range in size from 90,000 to 140,000 square feet. Due to the size of these facilities and the additional amenities included in our Clubs, we spend significant amounts to construct a new facility. We compare the results of our Clubs based upon how long the Clubs have been open at the most recent measurement period. We categorize Clubs as either mature or recently opened. Mature Clubs are those Clubs at which we believe the membership levels have reached a stable level and based upon the amount of new membership sales and attrition, or the size of the Club, we do not believe a significant additional growth in the membership level will occur. Clubs are considered to be recently opened while the membership level is increasing. Three of the Clubs that we own are considered to be mature while the other six are considered to be recently opened. Five of these Clubs were opened between 2000 and 2001 while The Sports Club/LA - Beverly Hills was opened in October 2003. Newly developed Clubs tend to achieve significant increases in revenues until a mature membership level is reached. Recently opened Clubs that have not yet achieved mature membership levels have operated at a loss or only a slight profit as a result of fixed expenses that, together with variable operating expenses, approximate or exceed membership fees and other revenues. Since 2000, we have invested significant amounts of cash in the construction and operation of these new Clubs. Our operating performances and our liquidity have been negatively impacted due to the start up nature of these Clubs and the initial construction cost.

We measure performance using key operating statistics such as initiation fees, monthly dues and ancillary revenues per member. We closely focus on new membership sales and the level of membership attrition at each Club. We also closely evaluate our expenses with an emphasis on controlling payroll costs. We use Club operating income, before depreciation expenses and rent expense as a means to evaluate the overall performance of an individual Club.

We have two primary sources of revenues. First, our largest source of revenue is from membership dues and initiation fees. We recognize revenue from dues in the month it is earned. Initiation fees are deferred and recognized as revenue on a straight-line basis over a period of three years, which represents the average life of a membership based upon historical data. Secondly, we generate ancillary revenue from our membership within each Club. The largest of these revenues comes from individual private training. We also generate revenues from our spas, restaurants, childcare, sports programs and guest fees. Our total ancillary revenues represent 36.5% of total Club revenue and we believe that percentage is among the highest in the industry. We believe that membership levels are the primary indicator of a Clubs ability to generate revenue. Therefore, we are consistently generating programs to



market the Clubs to potential new members as well as striving to reduce our membership attrition rates. We believe our current attrition rate of 27% is well below the normal in the industry.

Our direct expenses include costs to operate our Clubs. These consist primarily of payroll and employee benefits, rent and other occupancy related costs, supplies, repairs, costs of products sold and various other operating costs. A significant amount of these costs are fixed in nature.

General and administrative expenses include costs related to our centralized support functions such as accounting, information technology, development and our executive management. Costs associated with being a publicly owned Company are also included in this category. Selling expenses include our advertising, marketing department and promotional costs associated with the generation of new memberships.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base these estimates and assumptions upon historical experience and existing known circumstances. Actual results could differ from those estimates. Specifically, we must make estimates in the following areas:

Revenue Recognition. We receive initiation fees and monthly membership dues from our members. Substantially all of our members join on a month-to-month basis and can therefore cancel their membership at any time. Initiation fees and related direct expenses, primarily sales commissions, are deferred and recognized, on a straight line basis, over a period of three years, which represents the average life of a membership based upon historical data. Dues that are received in advance are recognized on a pro-rated basis over the periods in which services are to be provided. In addition, payments of last months' dues are deferred. Revenues for services including private training, spa treatments and physical therapy sessions are recorded when such services are performed. Amounts received in advance are recorded as deferred revenues. Revenues from our SportsMed subsidiary are recognized based upon the estimated amount to be collected.

Effective July 1, 2003, we adopted EITF 00-21, Revenue Arrangements with Multiple Deliverables. As a result of the adoption of EITF 00-21, the fair value of any free products or services bundled with new memberships is now recorded as revenue when the product is delivered or the service is performed. Prior to the adoption of EITF 00-21, we considered all payments as initiation fees and no revenue was recorded for the free products or services bundled with new memberships. The impact upon implementation of EITF 00-21 was to increase our 2003 revenues by $862,000.

Allowance for doubtful accounts. We provide a reserve against our receivables for estimated losses that may result from our members' inability to pay. We determine the amount of the reserve by analyzing known uncollectible accounts, economic conditions and historical losses and our members' creditworthiness. The likelihood of a material loss from this area is minimal due to our limited exposure to credit risk.

Impairment of long-lived assets. The carrying value of our long-lived assets is reviewed annually and whenever events or changes in circumstances indicate that such carrying values may not be recoverable. We consider a history of consistent and significant operating losses to be our primary indicator of potential impairment. Assets are grouped and evaluated for impairment at the lowest level for which there are identifiable cash flows, which is generally at an individual Club or a group of Clubs located in the same geographical area. The determination of whether an impairment has occurred is based on an estimate of undiscounted future cash flows directly related to that Club or group of Clubs compared to the carrying value of the assets. If an impairment has occurred, the amount of impairment recognized is



determined by estimating the fair value of the assets and recording a loss if the carrying value is greater than the fair value. There was no impairment of long-lived assets at December 31, 2003.

Valuation of goodwill. Prior to January 1, 2002, we amortized goodwill, which represents the excess of the purchase price over the net assets acquired in business acquisitions, over 40 years. We recorded goodwill in connection with our acquisitions of The Sports Club/LA in Los Angeles and Orange County, Reebok Sports Club/NY and SportsMed. In January 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets, and as a result have ceased to amortize goodwill. Instead, we were required to perform a transitional impairment review of our goodwill as of January 1, 2002. We initially completed the transitional impairment test, in 2002, which did not result in the impairment of goodwill. In early 2004, we determined that the methodology used to determine if goodwill was impaired was incorrect and that a reevaluation was required. We reperformed the transitional impairment test and determined that goodwill was impaired as of January 1, 2002 by $5,134,000. The 2002 consolidated financial statements have been restated to reflect this adjustment. We are also required to evaluate goodwill on an annual basis. We performed the analysis, as of December 31, 2002 and 2003, and determined that our remaining goodwill was not impaired.

Valuation of deferred income taxes. Valuation allowances are established to reduce deferred tax assets to the amount expected to be realized. The likelihood of material change in our expected realization of these assets depends on future taxable income, our ability to deduct tax loss carry forwards against future taxable income, the effectiveness of our tax planning and strategies among the various tax jurisdictions in which we operate and any significant changes in the tax laws.

Results of Operations

Fiscal 2003 compared to Fiscal 2002

Total revenue increased $12.5 million or 10.4% to $133.4 million for the year ended December 31, 2003 from $120.9 million for the year ended December 31, 2002. Of the $12.5 million increase, $6.0 million was from membership dues and initiation fees, $4.1 million was from ancillary revenues, and $2.4 million was related to the recovery of operating costs at The Sports Club/LA - Miami, a Club that we manage.

Revenue increased by $8.1 million at the five Sports Club/LA Clubs opened in 2000 and 2001, primarily as a result of a 9.7% increase in membership at these five Sports Club/LA Clubs from December 31, 2002 through December 31, 2003 and to annual rate increases for monthly dues and other ancillary services. Revenue increased by $2.4 million due to cost reimbursements we received from the owners of The Sports Club/LA - Miami, a Club we manage, which opened in November 2003. Revenue increased by $1.3 million due to the opening of The Sports Club/LA - Beverly Hills on October 7, 2003 and by $810,000, at our three mature Clubs, primarily due to a $327,000 increase in food and beverage revenues and a $444,000 increase in dues revenues. Revenue increased by $348,000 at our SportsMed subsidiary primarily due to increased patient visits and by $88,000 due to management fees received from The Sports Club/LA - Miami. Revenue decreased by $547,000 as a result of the sale of The Sports Club/Las Vegas on January 31, 2002.

Our direct expenses increased by $6.9 million (6.8%) to $107.9 million for the year ended December 31, 2003, versus $101.0 million for the same period in 2002. Direct expenses increased by $4.0 million at our five most recently opened Sports Club/LA Clubs primarily due to increases in variable direct expenses associated with the 9.7% membership increase and resulting revenue growth that occurred at these five Sports Club/LA Clubs between December 31, 2002 and December 31, 2003 and to increases in workers' compensation, group medical and property/liability insurance rates. Direct expenses increased by $1.4 million as a result of the opening of The Sports Club/LA - Beverly Hills on October 7, 2003. Direct expenses increased by $2.0 million at our three mature Clubs primarily due to increased payroll, utility and property tax costs and to increases in workers' compensation, group medical and property/liability insurance rates. Direct expenses decreased by $505,000 due to the sale of The Sports Club/Las Vegas on January 31, 2002. Direct expenses as a percent of revenue for the year ended December 31, 2003,

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decreased to 80.9% from 83.6% for the same period in 2002. As membership levels and therefore revenues increase at the five Sports Club/LA Clubs opened in 2000 and 2001 and at The Sports Club/LA - Beverly Hills opened in October of 2003, the direct expense percentage should continue to decrease. There is no assurance, however, that such membership or revenue growth will occur.

Reimbursed costs were $2.4 million for the year ended December 31, 2003. These costs relate to The Sports Club/LA - Miami, which is a non-owned Club that we manage for its owner. We receive a management fee for managing the Club and are reimbursed for all costs we incur pursuant to the management agreement. As required by generally accepted accounting principles, reimbursed costs are recorded as both revenue and expense in our consolidated financial statements. The reimbursed costs of $2.4 million in the year ended December 31, 2003 represents both pre-opening expenses and normal operating expenses after the Club opened in November 2003.

Our general and administrative expenses were $7.8 million for the year ended December 31, 2003, versus $7.4 million for the same period in 2002, an increase of $426,000 or 5.7%. The increase in our general and administrative expenses was primarily the result of increased workers' compensation insurance rates, increased group medical and property/liability insurance costs, plus a small increase in payroll costs. General and administrative expenses decreased as a percentage of revenue to 5.9% for the year ended December 31, 2003, from 6.1% for the same period in 2002. We believe that general and administrative expenses should continue to decrease as a percentage of future revenues as we expand and achieve economies of scale. There is no assurance, however, that said expansion or economies of scale will be achieved.

Our selling expenses remained flat at $4.9 million for the years ended December 31, 2003 and December 31, 2002. We continue to concentrate our advertising and promotion efforts at the five Sports Club/LA Clubs opened in 2000 and 2001 and at The Sports Club/LA - Beverly Hills, which opened on October 7, 2003. Selling expenses decreased as a percentage of revenue to 3.7% for the year ended December 31, 2003, from 4.1% for the same period in 2002.

Our depreciation and amortization expenses increased by $143,000 (1.2%) to $12.1 million for the year ended December 31, 2003, versus $11.9 million for the same period in 2002. Depreciation and amortization expenses increased by $132,000 as a result of the opening of The Sports Club/LA - Beverly Hills on October 6, 2003 and by $43,000 due to capital additions made at the Clubs during 2002 and 2003. Depreciation and amortization expenses decreased by $32,000 as a result of the sale of The Sports Club/Las Vegas on January 31, 2002.

Pre-opening expenses were $2.3 million for the year ended December 31, 2003, versus $130,000 for the same period in 2002. Pre-opening expenses for the year ended December 31, 2003, consisted of expenses related to The Sports Club/LA - Beverly Hills, which opened on October 7, 2003. The pre-opening expenses for the year ended December 31, 2002, consisted of expenses related to a possible Club site on Long Island in New York. We have since decided not to develop the Long Island site.

Our net interest expense increased by $330,000 (2.5%) to $13.7 million for the year ended December 31, 2003, versus $13.4 million for the same period in 2002. Interest expense decreased by $182,000 due to a reduction of equipment financing loans. Net interest expense increased by $944,000 primarily as a result of interest incurred on our new five-year mortgage loan secured by The Sport Club/LA - Orange County. We used a portion of the proceeds of the loan to construct The Sports Club/LA - Beverly Hills and therefore, capitalized $432,000 of that interest during the construction period.

We recorded two non-recurring gains, totaling $127,000, during the year ended December 31, 2002. We recorded a non-recurring gain of $30,000, related to the sale of The Sports Club/Las Vegas on January 31, 2002 and a non-recurring gain of $97,000, related to the sale of real estate in Houston, Texas on August 30, 2002.

In January 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets, and as a result have ceased to amortize goodwill. Instead, we were required to perform a transitional impairment



review of our goodwill as of January 1, 2002 and to review goodwill annually for impairment thereafter. We initially completed the transitional impairment test, in 2002, which did not result in the impairment of goodwill. In early 2004, we determined that the methodology used to determine if goodwill was impaired was incorrect and that a revaluation was required. We reperformed the transitional impairment test and determined that goodwill was impaired as of January 1, 2002 by $5,134,000. The 2002 consolidated financial statements have been restated to reflect this adjustment.

The tax provision of $485,000 recorded for the year ended December 31, 2003, is comprised of New York City and New York State income taxes incurred on pre-tax earnings at Reebok Sports Club/NY. We did not record any federal or state deferred tax benefit related to our consolidated pre-tax loss incurred for the year ended December 31, 2003. After the tax provision of $485,000 and dividends on preferred stock of $1.4 million, our consolidated net loss attributable to common shareholders for the year ended December 31, 2003, was $19.8 million or $1.08 per basic and diluted share. The tax benefit of $310,000 recorded for the year ended December 31, 2002, was the result of a $900,000 federal income tax refund we recorded due to tax law changes that allowed us to carry-back our 2001 loss to prior tax years and New York City and New York State income taxes of $590,000 incurred on pre-tax earnings at Reebok Sports Club/NY. We did not record any federal or state deferred tax benefit related to our consolidated pre-tax loss incurred for the year ended December 31, 2002. After the tax benefit of $310,000 and dividends on preferred stock of $888,000, our consolidated net loss attributable to common shareholders for the year ended December 31, 2002, was $23.6 million or $1.31 per basic and diluted share.

Fiscal 2002 compared to Fiscal 2001

Total revenue increased $20.7 million or 20.7%, to $120.9 million for the year ended December 31, 2002 from $100.2 million for the year ended December 31, 2001. Of the $20.7 million increase, $11.1 million was from membership dues and initiation fees and $9.6 million was from ancillary revenues.

Revenue increased by $21.1 million, due to the opening of The Sports Club/LA - Boston in September of 2001 and The Sports Club/LA - San Francisco in October of 2001 and revenue increased by $6.2 million as a result of membership growth at the three Sports Club/LA Clubs opened in 2000. Revenue decreased by $5.4 million as a result of the sale of The Sports Club/Las Vegas on January 31, 2002, and by $2.2 million due to the transfer of our retail operations to outside third party vendors. Revenue increased by $1.0 million at our other Sports Clubs and our SportsMed subsidiary primarily due to an increase in private training and monthly dues revenues at the Sports Clubs, partially offset by a decrease in SportsMed revenues primarily due to the closing of The SportsMed Agoura Hills location.

Our direct expenses increased by $13.4 million to $101.0 million for the year ended December 31, 2002, versus $87.6 million in 2001. Direct expenses increased by $20.8 million, due to the opening of The Sports Club/LA - Boston in September of 2001 and The Sports Club/LA - San Francisco in October of 2001 and by $1.8 million as a result of an increase in expenses associated with the membership growth at the three Sports Club/LA Clubs opened in 2000. Direct expenses decreased by $5.4 million due to the sale of The Sports Club/Las Vegas on January 31, 2002, by $2.5 million due to the transfer of our retail operations to outside third party vendors and by $1.3 million at our other Sports Clubs and our SportsMed subsidiary primarily as a result of cost cutting measures we implemented at these Clubs and the closing of The SportsMed Agoura Hills location. Direct expenses as a percent of revenue for the year ended December 31, 2002, decreased to 83.6% from 87.4% in 2001.

Our general and administrative expenses were $7.4 million for the year ended December 31, 2002, versus $8.5 million in 2001, a decrease of $1.1 million or 12.4%. Our general and administrative expenses decreased by $1.0 million due to lower legal fees resulting from the settlement or dismissal of certain legal matters in which we were involved. General and administrative expenses decreased by $519,000 as a result of expense cutting measures that have reduced our payroll and payroll related expenses. General and administrative expenses increased by $419,000 primarily as a result of higher corporate office rent, increased insurance premiums and a reduction in corporate costs capitalized on certain development and information systems projects. General and administrative expenses decreased as a percentage of revenue to 6.1% for the year ended

December 31, 2002, from 8.5% in 2001.



Our selling expenses were $4.9 million for the year ended December 31, 2002, versus $3.9 million in 2001, an increase of $1.0 million or 26.5%. The increase in selling expenses was the result of expanded advertising and promotion efforts at the five Sports Club/LA Clubs opened in 2000 and 2001 with the majority of this increase attributable to our two most recently opened Clubs. We also placed special emphasis on membership growth at The Sports Club/LA - Rockefeller Center. Selling expenses for the year ended December 31, 2002 at these five most recently opened Clubs increased by $1.2 million as compared to 2001. Selling expenses decreased by $432,000 as a result of the sale of The Sports Club/Las Vegas on January 31, 2002 and selling expenses declined by $63,000 at our other Sports Club/LA Clubs and our SportsMed subsidiary. Selling expenses as a percentage of revenue for the year ended December 31, 2002, were 4.1% versus 3.9% in 2001.

Our depreciation and amortization expenses stayed flat at $11.9 million for the years ended December 31, 2002 and 2001. Depreciation and amortization expenses increased by $610,000 as a result of the opening of The Sports Club/LA - Boston in September 2001 and The Sports Club/LA - San Francisco in October of 2001 and by $709,000 at our corporate headquarters, primarily due to the start of amortization of our recently installed membership accounting software. Depreciation and amortization expenses decreased by $344,000 as a result of the sale of The Sports Club/Las Vegas on January 31, 2002 and by $455,000 at our other Sports Club/LA Clubs primarily due to assets becoming fully depreciated. Depreciation and amortization expense also decreased by $494,000 due to the adoption of Statement of Financial Accounting Standards No. 142, effective January 1, 2002, that requires goodwill and other indefinite lived intangibles no longer be amortized.

Pre-opening expenses were $130,000 for the year ended December 31, 2002, versus $5.9 million in 2001. Pre-opening expenses for the year ended December 31, 2002, consisted of legal fees incurred related to a possible club site on Long Island in New York. We have since terminated our interest in this site. Pre-opening expenses by Club for the year ended December 31, 2001, were $2.6 million at The Sports Club/LA - Boston, $2.9 million at The Sports Club/LA - San Francisco and $405,000 at the possible club site on Long Island in New York.

We incurred impairment charges during the year ended December 31, 2001, of $5.0 million. These impairment charges consisted of a $3.2 million impairment charge related to the write down of fixed assets at The Sports Club/Las Vegas and a $1.8 million impairment charge related to the write down of goodwill at our SportsMed subsidiary.

We incurred net interest expense of $13.4 million for the year ended December 31, 2002, versus $13.0 million in 2001, an increase of $419,000. Net interest expense increased by $496,000 due to our discontinuance of capitalizing interest costs on Sports Clubs under development after the last Sports Club/LA was opened in October 2001. Net interest expense increased by $323,000, due to a reduction in interest income earned on invested cash balances. There was a $162,000 decrease in net interest expense due to reductions of equipment financing loans and a $238,000 decrease resulting from interest incurred in 2001 related to a sales tax audit at one of our Clubs.

We recorded a non-recurring gain of $97,000, related to the sale of undeveloped land in Houston, Texas and a $30,000 non-recurring gain, related to the sale of The Sports Club/Las Vegas during the year ended December 31, 2002. The Houston, Texas site was sold on August 30, 2002 and The Sports Club/Las

Vegas was sold on January 31, 2002. We recorded a non-recurring gain of $397,000 during the year ended December 31, 2001. The non-recurring gain in 2001 was the result of the reversal of accrued interest expense related to the settlement of litigation. As part of the settlement we were no longer required to pay the accrued interest due on the note in question.

In January 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets, and as a result have ceased to amortize goodwill. Instead, we were required to perform a transitional impairment review of our goodwill as of January 1, 2002 and to review goodwill annually for impairment thereafter. We initially completed the transitional impairment test, in 2002, which did not result in the impairment of goodwill. In early 2004, we determined that the methodology used to determine if goodwill was impaired

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was incorrect and that a revaluation was required. We reperformed the transitional impairment test and determined that goodwill was impaired as of January 1, 2002 by $5,134,000. The 2002 consolidated financial statements have been restated to reflect this adjustment.

The tax benefit recorded for the year ended December 31, 2002, is comprised of a $900,000 federal income tax refund we received as a result of tax law changes that allowed us to carry-back our 2001 loss to prior tax years, partially offset by New York State and City income taxes incurred at Reebok Sports Club/NY. We did not record any deferred tax benefit related to our loss incurred for the year ended December 31, 2002. After the tax benefit and the Preferred Stock dividends of $888,000, our loss attributable to common shareholders for the year ended December 31, 2002, was $23.6 million or $1.31 per basic and diluted share. The income tax provision of $5.4 million for 2001 is related to the establishment of a valuation allowance against our deferred tax assets that were recorded prior to January 1, 2001 and an accrual for any current state income taxes due. We did not record any deferred tax benefit related to our loss incurred in 2001. After the 2001 income tax provision of $5.4 million, our net loss attributable to common shareholders was $40.7 million or $2.27 per basic and diluted share. We did not record any deferred tax assets related to the losses incurred in 2002 and 2001 based on our analysis of current and projected operating results and our determination that it is more likely than not that future taxable income will be insufficient to utilize any deferred tax assets.

Non-GAAP Financial Measures

We use the term "EBITDA" in this discussion. EBITDA consists of net income plus interest expense, net, provision for income taxes and depreciation and amortization. This term, as we define it, may not be comparable to a similarly titled measure used by other companies and is not a measure of performance presented in accordance with GAAP. We use EBITDA and EBITDA margin as measures of operating performance. EBITDA should not be considered as a substitute for net income, cash flows provided by operating activities, or other income or cash flow data prepared in accordance with GAAP. We believe EBITDA is useful to an investor in evaluation our operating performance and liquidity because:

- it is a widely accepted financial indicator of a company's ability to service its debt;

- it is widely used to measure a company's operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired; and

- it helps investors to more meaningfully evaluate and compare the results of our operations from period to period by removing from our operating results the impact of our capital structure, primarily interest expense from our outstanding debt, and asset base, primarily depreciation and amortization of our properties.

Our management uses EBITDA:

- as a measurement of operating performance because it assists us in comparing our performance on a consistent basis, as it removes from our operating results the impact of our capital structure, which includes interest expense from our outstanding debt, and our asset base, which includes depreciation and amortization of our properties;

- in presentations to the members of our board of directors to enable our board to have the same consistent measurement basis of operating performance used by management; and

- as the basis for incentive bonuses paid to selected members of senior and Club level management.



Below is a reconciliation of EBITDA to net income:

| | Year Ending December 31, 2003 |
|---|---|
| EBITDA | $ 7,913 |
| Depreciation and amortization | (12,052) |
| Interest, net | (13,750) |
| Provision for income taxes | (485) |
| Net loss | $ (18,374) |

## Liquidity and Capital Resources

### Liquidity

Historically, we have satisfied our liquidity needs through various debt arrangements, sales of Common or Preferred Stock and cash from operations. Our primary liquidity needs the past several years have been the development of new Clubs and the interest cost associated with our $100.0 million Senior Secured Notes.

In order to make our March 15, 2004 interest payment on the Senior Secured Notes, we were required to issue $6.5 million of a newly created class of Series D Convertible Preferred Stock. We are not certain that amounts we will generate from operations through September 15, 2004 will be sufficient for us to make the Senior Secured Note interest payment due on September 15, 2004. If cash flows from operations are insufficient to make the September 15, 2004 or future interest payments, we would be required to sell assets, offer additional equity securities or increase our cash flow from operations to meet our cash flow needs. There can be no assurance that we will be able to sell assets, raise capital by offering additional equity securities or increase our cash flow from operations.

Additional funds will be required to undertake any future acquisitions or the development of additional new Clubs. We would consider entering into joint ventures, partnership agreements or management agreements (subject to the restrictions and limitations on such transactions in the Indenture) for the purpose of developing new Clubs, but only if such arrangements would generate additional cash flow or further enhance The Sports Club/LA brand name in the market place.

Operating Activities

Our cash balance on December 31, 2003 was $1.9 million. During 2003, our earnings before interest, taxes, depreciation and amortization ("EBITDA") were $7.9 million. We believe we will continue to generate positive EBITDA and that such amount will increase as our new Clubs continue to mature.

We have various deposits that secure our performance under several contracts. We expect to receive back $800,000 of such deposits in the second quarter of 2004, $1.0 million in the third quarter of 2004 and the remaining $1.7 million in the fourth quarter of 2004.



Investing Activities

Investing activities consist of new Club development and expenditures to maintain and update our existing Clubs. Capital expenditures related to new Clubs were $16.1 million in 2001, $6.7 million in 2002 and $10.6 million in 2003. Our Clubs are upscale and capital improvements are regularly needed to retain the upscale nature and presentation of the Clubs. A deterioration of the quality of the Clubs can lead to reduction in membership levels and lower revenues. Capital expenditures to maintain and update our existing Clubs were $5.3 million in 2001, $2.6 million in 2002 and $2.2 million in 2003. We estimate that expenditures of between 2% and 4% of revenues, depending on the age of the Club, will be necessary to maintain the quality of the Clubs to our satisfaction. We also expect to spend approximately $600,000 during the next year to upgrade our management information systems and enhance our disaster recovery capabilities.

On April 22, 2002, we signed a lease to develop The Sports Club/LA - Beverly Hills. The new Sports Club/LA, of approximately 40,000 square feet, is located at 9601 Wilshire Boulevard in the heart of the Beverly Hill's retail and commercial district. We view the Beverly Hills market as an excellent location for The Sports Club/LA brand and this Club may serve as a prototype for smaller size Clubs to be built in locations near existing Sports Club/LA sites. At December 31, 2003, approximately $1.1 million of construction costs are accrued and remain to be paid on this Club. The Club opened in October 2003.

We entered into a management service agreement with Terremark Brickell II Ltd., an affiliate of Millennium to manage The Sports Club/LA - Miami. Millennium provided all the capital to develop this facility and Millennium retained a 100% ownership in the Club. We earn a management fee based upon the Club's revenues and can also earn a profit participation based upon the Club's net operating income. We were not required to invest any of our capital into this development. The Club opened in November 2003.

We currently have no other plans for new Club developments that would require our own capital.

During 2002, we generated $9.3 million of cash proceeds from the sale of real estate in Houston, Texas and from the sale of The Sports Club/Las Vegas.

Financing Activities

On April 1, 1999, we issued in a private placement $100.0 million of 11 3/8% Senior Secured Notes (the "Senior Secured Notes") due in March 2006, with interest due semi-annually. The Senior Secured Notes were issued pursuant to the terms of an indenture agreement dated April 1, 1999 (the "Indenture"). The Senior Secured Notes are secured by substantially all of our assets, other than certain excluded assets. The Indenture includes certain covenants that restrict our ability to: (i) incur additional indebtedness; (ii) pay dividends or other distributions, or repurchase capital stock or other equity interests or subordinated indebtedness; and (iii) make certain investments. The Indenture also limits our ability to: (i) enter into transactions with affiliates; (ii) create liens on or sell certain assets; and (iii) enter into mergers and consolidations. The Indenture requires us to make an offer to retire the Senior Secured Notes if the net proceeds of any asset sale are not reinvested in assets related to our business, unless the remaining net proceeds are less than $10.0 million. To the extent we sell assets, the proceeds from those sales would be subject to the excess proceeds provision of the Indenture. We are currently not required to make such an offer as a result of the sale of any of our assets. The Indenture requires us to make semi-annual interest payments of $5.7 million on March 15th and September 15th of each year.

On June 12, 2003, we obtained financing in the form of a secured five-year promissory loan in the amount of $20.0 million. The new loan is evidenced by a promissory note that bears interest at a fixed interest rate of 7.25%; requires monthly principal and interest payments of $144,561; is secured by the common stock and all the assets of Irvine Sports Club, Inc., our wholly owned subsidiary that owns The Sports Club/LA - Orange County; and is guaranteed by two of our major stockholders. The note may be prepaid at any time without penalty and requires a final payment of $18.3 million on July 1, 2008.



The Indenture allows us to incur up to $10.0 million of equipment financing obligations. At December 31, 2003, we had $2.0 million of equipment financing obligations outstanding and would be allowed to finance an additional $8.0 million with our equipment serving as collateral. We make monthly principal and interest payments on this debt. These monthly payments are currently $205,000 and they will continue until December 2004, when a significant portion of the debt will be repaid.

In March 2004, three of our principal shareholders purchased $6.5 million of a newly created class of Series D Convertible Preferred Stock in a private placement offering. The proceeds were used to pay the March 15, 2004 interest payment on our Senior Secured Notes and to provide additional working capital.

Contractual Obligations

The following schedule lists known contractual obligations (amounts in thousands):

| | | | | | |
|---|---|---|---|---|---|
| | | Payments Due By Period | | | |
| Contractual Obligations | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | |
| Senior Secured Notes (1)........ | $ 100,000 | $ -- | $ 100,000 | $ -- | $ |
| Mortgage note (2)............... | 19,855 | 305 | 677 | 18,873 | |
| Equipment financing loans (3)... | 1,975 | 1,794 | 139 | 42 | |
| Operating leases (4)............ | 356,584 | 24,404 | 48,032 | 48,323 | |
| Minority interest (5)........... | 900 | 150 | 750 | -- | |
| Redeemable Preferred Stock (6).. | 10,500 | -- | -- | -- | |
| Total | $ 489,814 | $ 26,653 | $ 149,598 | $ 67,238 | $ |

-------------

(1) On April 1, 1999, we issued in a private placement $100.0 million of 11 3/8% Senior Secured Notes due in March 2006 with interest due semi-annually.

(2) On June 12, 2003, we obtained financing in the form of a secured five-year promissory loan in the amount of $20.0 million. The new loan bears interest at a fixed interest rate of 7.25%; requires monthly principal and interest payments of $144,561; and requires a final principal payment of $18.3 million on July 1, 2008.

(3) The equipment financing loans are secured by furniture, fixtures and equipment. The amounts are generally repayable in monthly payments over four or five years with effective interest rates between 3.5% and 13.3%.

(4) We lease certain facilities pursuant to various operating lease agreements. Club facility leases are generally long-term and noncancelable triple-net leases (requiring us to pay all real estate taxes, insurance and maintenance expenses), and have an average remaining term of 43.17 years, including renewal options which are included in the lease term, with the earliest Sports Club lease expiration date of January 31, 2013. We are also obligated under lease agreements for seven of our former Spectrum Club locations. We have subleased each of these properties to the buyer of these Clubs under sublease agreements which provide that all operating costs of these facilities be assumed by the new owners. Amounts due for Spectrum Club leases are excluded from this table.

(5) We own a 50.1% interest in the partnership that owns The Sports Club/LA - Los Angeles, and D. Michael Talla, our Chairman, beneficially owns the remaining 49.9%. We have the option to redeem Mr. Talla's preferred partnership interest for $600,000, which expires on January 31, 2006. We have included the annual preferred distribution of $149,700 to Mr. Talla in the above table for the next two years and the redemption amount is included in 2006 (Year 3).

(6) On March 18, 2002, the Company issued 10,500 shares of Series B Preferred Stock. The stock is redeemable by the stockholders on March 18, 2009.

Impact of Inflation

We do not believe inflation has had a material impact on our results of operations for any of the years in the three-year period ended December 31, 2003. We cannot provide assurance that future inflation will not have an adverse impact on our operating results and financial condition.

Seasonality of Business

Seasonal trends have a limited impact on our operations. We typically experience a slight increase in membership sales in the first quarter. Additionally, we normally experience a slight decrease in our ancillary revenues during the summer months at our east coast Clubs due to lower membership attendance.

Forward Looking Statements

From time to time we make "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include the words "may," "will," "estimate," "continue," "believe," "expect" or "anticipate" and other similar words. The forward-looking statements generally appear in the material set forth under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" but may be found in other locations as well. Forward-looking statements may also be found in our other reports filed with the Securities and Exchange Commission and in our press releases and other public disclosures. These forward-looking statements generally relate to our plans and objectives for future operations and are based upon management's reasonable estimates of future results or trends. Although we believe that our plans and objectives reflected in or suggested by such forward-looking statements are reasonable, such plans or objectives may not be achieved. Actual results may differ from projected results due to unforeseen developments, including developments relating to the following:

- the availability and adequacy of our cash flow and financing facilities for our requirements, including payment of the Senior Secured Notes,

- our ability to attract and retain members, which depends on competition, market acceptance of new and existing sports and fitness clubs and services, demand for sports and fitness club services generally and competitive pricing trends in the sports and fitness market,

- our ability to successfully develop new sports and fitness clubs,

- disputes or other problems arising with our development partners or landlords,

- changes in economic, competitive, demographic and other conditions in the geographic areas in which we operate, including business interruptions resulting from earthquakes or other causes,

- competition,

- changes in personnel or compensation, and

- changes in statutes and regulations or legal proceedings and rulings.

We will not update forward-looking statements even though our situation may change in the future.



ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to risk from a change in interest rates to the extent we are required to refinance existing fixed rate indebtedness at rates higher than those prevailing at the time the existing indebtedness was incurred. As of December 31, 2003, we had Senior Secured Notes totaling $100.0 million due in March 2006 bearing an interest rate of 11.375%. Annual interest of $11.4 million is payable semi-annually in March and September. At December 31, 2003, the fair value of the Senior Secured Notes is approximately $93.0 million. We also have a $20.0 million loan with a fixed rate of 7.25% that matures and requires a final principal payment of $18.3 million on July 1, 2008. A change in interest rates of 1% would impact our interest expense by approximately $1.2 million per year.

ITEM 8. FINANCIAL STATEMENTS

Index to Consolidated Financial Statements



All other schedules are omitted because they are not applicable or the required information is shown in our consolidated financial statements or notes thereto.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.



ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Our management, with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the fiscal year covered by this Annual Report on Form 10-K. This evaluation included a review of the steps management undertook in an effort to ensure that information required to be disclosed in its Exchange Act filings is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (the "SEC"), in light of certain deficiencies in our controls and procedures identified by our independent auditor, KPMG LLP ("KPMG"), as more particularly described below. Based on such evaluation and input from KPMG, the CEO and CFO concluded that, as of the end of such period, these deficiencies have caused our disclosure controls and procedures not to be effective at a reasonable assurance level.

In performing its audit of our Consolidated Financial Statements for the year ended December 31, 2003, KPMG noted a matter involving our internal controls that it considered to be a "reportable condition," as defined under standards established by the American Institute of Certified Public Accountants. A "reportable condition," which may or may not be deemed a material weakness, involves matters relating to significant deficiencies in the design or operation of internal controls that, in KPMG's judgment, could adversely affect our ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

The reportable condition, which KPMG considered to be a material weakness, was that the Company does not have adequate internal controls over the application of new accounting principles or the application of existing accounting principles to new transactions. In this regard, KPMG noted that, during their review of our financial statements for the quarter ended March 31, 2003, the Company had not properly accounted for private training revenues. In addition, in connection with their audit of our financial statements for the year ended December 31, 2003, KPMG determined that we were not properly accounting for our management arrangement with The Sports Club/LA-Miami; that we had not properly followed Financial Accounting Standard No. 142 relating to goodwill; and that we had not properly accounted for the accretion of dividends on our Series C Convertible Preferred Stock. Finally, KPMG suggested that we needed to consider additional staffing in our accounting department, and take other action (such as encouraging attendance at training seminars on new accounting rules and pronouncements) to ensure that we have the expertise and resources to implement new accounting standards and apply existing accounting standards to new transactions. KPMG's observations were summarized in its letter dated June 16, 2004, to the Audit Committee of the Board of Directors.

In connection with the completion of the 2003 audit, the Company's accounting personnel worked with, and considered the recommendations of, KPMG in accounting for private training revenues, goodwill, management fees and dividend accrual on our Series C Convertible Preferred Stock. They conducted detailed validation work on these accounts to substantiate the accuracy of the financial information and related disclosures contained in this Form 10-K/A. The accounting personnel reviewed the requirements of Financial Accounting Standards 142 to understand the methodology underlying the accounting treatment of goodwill and continue to monitor any new developments or changes in accounting treatment or policies for these assets to ensure that they are accurately disclosed in our financial statements.

As a result of KPMG's observations, the Audit Committee has authorized and directed management to devise and implement actions to address these deficiencies and to enhance the reliability and effectiveness of the Company's internal controls over financial reporting and to provide reasonable assurance that our disclosure controls and procedures allow for the accurate presentation and timely filing of our financial statements. The Company's accounting personnel have reviewed their reporting and certification obligations under the Exchange Act and the Sarbanes Oxley Act of 2002, and have consulted with the Company's outside counsel with respect to those obligations. We are now performing regular analyses of revenues attributable to private training and management fees. In addition, our accounting



personnel have determined that if there should occur any changes in existing accounting rules or policies, or if accounting principles are adopted, which apply to the Company's financial accounts (particularly with respect to the manner in which private training revenues, management fees, goodwill and dividend accrual is accounted for), such matters will be brought to the attention of our independent auditor and, if necessary, outside counsel to ensure that all required disclosures are accurate and complete and are made in a timely fashion. We have assigned a high priority to both the short-term and long-term strengthening of these controls and have identified certain additional measures which we believe will address the conditions identified by KPMG as a material weakness, including the following:

o engaging an independent accounting or financial consulting firm (other than the Company's independent auditor) to consult with the Company on accounting issues, including the interpretation of new accounting rules and releases promulgated by the SEC, the Financial Accounting Standards Board and other organizations, and the application of accounting principles to new transactions in which the Company engages;

o creating and maintaining a written "log" in which new FASB, EITF, SOP and other accounting rules and pronouncements are recorded. The log will include a description of the new rule or pronouncement; whether or not it amends or modifies an existing rule or pronouncement; its applicability to the Company or any transactions in which the Company has engaged, or proposes to engage; and the appropriate accounting ramifications of the new rule or pronouncement. Management intends to submit this log to the Audit Committee and its independent auditors on a quarterly basis, as part of their respective financial statement review;

o subscribing to selected professional publications that discuss new accounting rules and regulations applicable to reporting companies, and encouraging its accounting personnel to attend seminars and other presentations which focus on new accounting and financial disclosure rules and pronouncements; and

o establishing an internal audit procedure to ensure that transactional recording, transactional review and adherence to applicable accounting policies and principles are observed.

Management believes that the foregoing measures will address the conditions identified as a material weakness by KPMG. We will continue to monitor and evaluate the effectiveness of our disclosure controls and procedures and our internal controls over financial reporting on an ongoing basis, and are committed to taking further action and implementing additional enhancements or improvements, as necessary. We believe that these measures are reasonably likely to have a material impact on both our internal controls over financial reporting and disclosure controls and procedures in future periods.

(b) Changes in internal controls.

Except as described above, there have been no changes in the Company's internal controls over financial reporting (as those terms are defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.



Report of Independent Registered
Public Accounting Firm

The Board of Directors and Stockholders
The Sports Club Company, Inc.:

We have audited the accompanying consolidated financial statements of The Sports Club Company, Inc. and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the Standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Sports Club Company, Inc. and subsidiaries as of December 31, 2002 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has suffered recurring net losses, has a working capital deficiency and has negative cash flows from operating activities that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 2 to the consolidated financial statements, the

Company restated its 2002 consolidated financial statements.

As discussed in Note 4 to the consolidated financial statements the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002.

/s/ KPMG LLP

Los Angeles, California
May 24, 2004

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THE SPORTS CLUB COMPANY, INC.
CONSOLIDATED BALANCE SHEETS
December 31, 2002 and 2003
(in thousands, except per share amounts)

ASSETS

| | 20 |
|---|---|
| | (Rest |
| Current assets: | |
| Cash and cash equivalents | $ 3 |
| Accounts receivable, net of allowance for doubtful accounts of $534 and $517 at December 31, 2002 and 2003, respectively | 3 |
| Inventories | 1 |
| Prepaid expenses | 1 |
| Total current assets | 9 |
| Property and equipment, net | 156 |
| Goodwill | 7 |
| Restricted cash | |
| Other assets | 7 |
| | $ 181 |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | |
|---|---|
| Current liabilities: | |
| Current installments of notes payable and equipment financing loans | $ 2 |
| Accounts payable | 2 |

| | |
|---|---|
| Accrued liabilities | 12 |
| Deferred revenues | 17 |
| Total current liabilities | 34 |
| Notes payable and equipment financing loans, less current installments | 101 |
| Accrued lease obligations | 8 |
| Deferred revenues | 1 |
| Minority interest | |
| Total liabilities | 146 |
| Commitments and contingencies | |
| Redeemable Preferred Stock, Series B, $.01 par value, 10,500 shares authorized; 10,500 shares issued and outstanding at December 31, 2002 and December 31, 2003 (liquidation preference of $11,248 and $12,198 at December 31, 2002 and 2003, respectively) | 10 |
| Stockholders' equity: | |
| Preferred Stock, $.01 par value, 984,500 shares authorized; no shares issued or outstanding | |
| Preferred Stock, Series C, $.01 par value, 5,000 shares authorized; 5,000 shares issued and outstanding (liquidation preference of $5,140 and $5,590 at December 31, 2002 and 2003, respectively) | 5 |
| Common Stock, $.01 par value, 40,000,000 shares authorized; 21,068,717 and 21,074,717 shares issued at December 31, 2002 and 2003, respectively | |
| Additional paid-in capital | 101 |
| Accumulated deficit | (67 |
| Treasury Stock, at cost, 2,964,764 and 2,650,003 shares at December 31, 2002 and 2003, respectively | (15 |
| Stockholders' equity | 24 |
| | $ 181 |

See accompanying notes to consolidated financial statements.

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THE SPORTS CLUB COMPANY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
Three-Year Period ended December 31, 2003
(in thousands, except per share amounts)

| | 2001 | 2 (Res |
|---|---|---|
| Revenues: | | |
| Membership revenues | $ 100,165 | $ |
| Reimbursed costs | -- | |

| | | |
|---|---|---|
| Total revenue | 100,165 | |
| Operating expenses: | | |
| Direct | 87,560 | |
| Reimbursed costs | -- | |
| General and administrative | 8,468 | |
| Selling | 3,880 | |
| Depreciation and amortization | 11,883 | |
| Pre-opening expenses | 5,884 | |
| Impairment charges | 5,044 | |
| Total operating expenses | 122,719 | |
| Loss from operations | (22,554) | |
| Other income (expense): | | |
| Interest, net | (13,001) | |
| Minority interests | (150) | |
| Non-recurring items | 397 | |
| Loss before income taxes and cumulative effect of change in accounting principle | (35,308) | |
| Provision (benefit) for income taxes | 5,370 | |
| Loss before cumulative effect of change in accounting principle | (40,678) | |
| Cumulative effect of change in accounting principle | -- | |
| Net loss | (40,678) | |
| Dividends on Preferred Stock | -- | |
| Net loss attributable to common stockholders | $ (40,678) | $ |
| Loss per share before cumulative effect of change in accounting principle - basic and diluted | $ (2.27) | $ |
| Per share effect of cumulative effect of change in accounting principle - basic and diluted | -- | |
| Net loss per share - basic and diluted | $ (2.27) | $ |
| Weighted average number of common shares outstanding: | | |
| Basic and diluted | 17,939 | |

See accompanying notes to consolidated financial statements.

THE SPORTS CLUB COMPANY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Three-Year Period ended December 31, 2003
(in thousands)

| | Preferred Stock Series C Shares | Preferred Stock Series C Amount | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital |
|---|---|---|---|---|---|
| Balance, December 31, 2000 | -- | $ -- | 21,053 | $ 211 | $ 102,743 |
| Net loss | -- | -- | -- | -- | -- |
| Reissuance of Treasury Stock for employee stock plans | -- | -- | -- | -- | -- |
| Reissuance of Treasury Stock for loan guarantee fee | -- | -- | -- | -- | -- |
| Exercise of employee stock options | -- | -- | 2 | -- | 5 |
| Issuance of Common Stock to outside directors | -- | -- | 6 | -- | 16 |
| Balance, December 31, 2001 | -- | -- | 21,061 | 211 | 102,764 |
| Net loss, as restated | -- | -- | -- | -- | -- |
| Issuance of series C Preferred Stock | 5 | 5,000 | -- | -- | -- |
| Issuance of Common Stock to outside directors | -- | -- | 8 | -- | 15 |
| Reissuance of Treasury Stock for employee stock plans | -- | -- | -- | -- | -- |
| Accretion of dividends on Series B Preferred Stock | -- | -- | -- | -- | (748) |
| Accretion of issuance costs on Series B Preferred Stock | -- | -- | -- | -- | (70) |
| Accretion of dividends on Series C Preferred Stock, as restated | -- | 140 | -- | -- | (140) |
| Balance, December 31, 2002, as restated | 5 | 5,140 | 21,069 | 211 | 101,821 |
| Net loss | -- | -- | -- | -- | -- |
| Issuance of Common Stock to outside directors | -- | -- | 6 | -- | 12 |
| Reissuance of Treasury Stock for loan guarantee fee | -- | -- | -- | -- | -- |
| Reissuance of Treasury Stock for employee stock plans | -- | -- | -- | -- | -- |
| Accretion of dividends on Series B Preferred Stock | -- | -- | -- | -- | (950) |
| Accretion of dividends on Series C Preferred Stock | -- | 450 | -- | -- | (450) |
| Accretion of issuance costs on Series B Preferred Stock | -- | -- | -- | -- | (85) |
| Balance, December 31, 2003 | 5 | $ 5,590 | 21,075 | $ 211 | $ 100,348 |

See accompanying notes to consolidated financial statements.

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THE SPORTS CLUB COMPANY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three-year Period ended December 31, 2003
(in thousands)

| | 2001 | 200 |
|---|---|---|
| | | (Resta |
| Cash flows from operating activities: | | |
| Net loss | $(40,678) | $(22,7 |
| Adjustments to reconcile net loss to cash used in operating activities: | | |
| Loss (gain) on disposition of real estate | 282 | (1 |
| Impairment charges | 5,044 | |
| Depreciation and amortization | 11,883 | 11,9 |
| Related party costs settled with common stock | 349 | 2 |
| Cumulative effect of change in accounting principle | -- | 5,1 |
| Deferred taxes | 4,524 | |
| (Increase) decrease in: | | |
| Accounts receivable, net | (1,215) | 7 |
| Inventories | 1,629 | ( |
| Other current assets | 2,547 | (4 |
| Other assets, net | 1,164 | (2,2 |
| Increase (decrease) in: | | |
| Accounts payable | 1,102 | (2 |
| Accrued liabilities | 1,834 | 6 |
| Deferred revenues | 2,812 | (4 |
| Accrued lease obligations | 2,758 | 3,2 |
| Net cash used in operating activities | (5,965) | (4,3 |
| Cash flows from investing activities: | | |
| Capital expenditures | (16,122) | (6,6 |
| Distributions from unconsolidated subsidiary | 32 | |
| (Increase) decrease in restricted cash | 6,996 | |
| Proceeds from sale of The Sports Club/Las Vegas - net of costs | -- | 6,1 |
| Proceeds from sale of Houston real estate - net of costs | -- | 3,1 |
| Net cash provided by (used in) investing activities | (9,094) | 2,6 |
| Cash flows from financing activities: | | |
| Proceeds from issuance of Preferred Stock - net of costs | -- | 14,9 |
| Exercise of employee stock options | 5 | |
| Proceeds from notes payable and equipment financing loans | 24,588 | 21,7 |
| Repayments of notes payable and equipment financing loans | (19,111) | (33,1 |
| Net cash provided by financing activities | 5,482 | 3,4 |
| Net increase (decrease) in cash and cash equivalents | (9,577) | 1,7 |
| Cash and cash equivalents at beginning of year | 11,059 | 1,4 |
| Cash and cash equivalents at end of year | $ 1,482 | $ 3,1 |

| | | |
|---|---|---|
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the year for interest.............................. | $ 12,118 | $ 11,9 |
| Cash paid during the year for income taxes........................... | $ 533 | $ 2 |

See accompanying notes to consolidated financial statements.



THE SPORTS CLUB COMPANY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001, 2002 and 2003

1. Organization

The Sports Club Company, Inc. (the "Company") operates sports and fitness Clubs ("Clubs"), primarily under the "The Sports Club/LA" name. The Sports Club/LA sites are developed as "urban country clubs" offering a full range of services including numerous fitness and recreation options, diverse facilities and other amenities. The Sports Club/LA is marketed to affluent, health conscious individuals who desire a premier Club.

2. Restatement

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires that goodwill and certain intangibles no longer be amortized, but instead be reviewed for impairment on at least an annual basis. The Company adopted SFAS No. 142 effective January 1, 2002. The Company initially completed the transitional impairment test, in 2002, which did not result in the impairment of goodwill. During the first quarter of 2004, the Company determined that the methodology used to determine if goodwill was impaired was incorrect and that a reevaluation was required. The Company has reperformed the transitional impairment test and determined that goodwill was impaired as of January 1, 2002, by $5,134,000. The 2002 consolidated financial statements have been restated to reflect this adjustment.

The Company has restated the December 31, 2002 balance sheet to reclassify $1,197,000 of deferred revenues to a long-term liability and to accrete/record $140,000 of Series C Preferred Stock dividends from paid in capital to Series C Preferred Stock.

A restated consolidated balance sheet at December 31, 2002, a restated consolidated statement of operations and a restated consolidated statement of cash flows for the year ended December 31, 2002, reflecting the above adjustments, is presented below. The amounts are in thousands, except per share amounts:

| | At December 31, 2002 | | |
|---|---|---|---|
| | As Reported | Restatement Adjustments | A Rest |
| **ASSETS** | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 3,185 | $ -- | $ 3 |
| Accounts receivable, net of allowance for doubtful accounts | 3,951 | -- | 3 |
| Inventories | 1,169 | -- | 1 |
| Other current assets | 1,148 | -- | 1 |
| Total current assets | 9,453 | -- | 9 |
| Property and equipment, net | 156,630 | -- | 156 |
| Goodwill | 12,794 | (5,134) | 7 |
| Restricted cash | 227 | -- | |
| Other assets | 7,282 | -- | 7 |
| | $ 186,386 | $ (5,134) | $ 181 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | |
| Current liabilities: | | | |
| Current installments of notes payable and equipment financing loans | $ 2,158 | $ -- | $ 2 |
| Accounts payable | 2,545 | -- | 2 |
| Accrued liabilities | 12,657 | -- | 12 |
| Deferred revenues | 18,231 | (1,197) | 17 |
| Total current liabilities | 35,591 | (1,197) | 34 |
| Notes payable and equipment financing loans, less current installments | 101,882 | -- | 101 |
| Accrued lease obligations | 8,307 | -- | 8 |
| Deferred revenues | -- | 1,197 | 1 |
| Minority interest | 600 | -- | |
| Total liabilities | 146,380 | -- | 146 |
| Commitments and contingencies | | | |
| Redeemable Preferred Stock | 10,727 | -- | 10 |
| Shareholders' equity: | | | |
| Preferred Stock, Series C | 5,000 | 140 | 5 |
| Common Stock | 211 | -- | |
| Additional paid-in capital | 101,961 | (140) | 101 |

| | | | |
|---|---|---|---|
| Accumulated deficit | (62,709) | (5,134) | (67 |
| Treasury Stock, at cost | (15,184) | -- | (15 |
| Stockholders' equity | 29,279 | (5,134) | 24 |
| | $ 186,386 | $ (5,134) | $ 181 |



| | Year Ended December 31, 2002 | | |
|---|---|---|---|
| | As Reported | Restatement Adjustments | A Rest |
| Membership revenues | $ 120,853 | $ -- | $ 120 |
| Operating expenses: | | | |
| Direct | 100,973 | -- | 100 |
| General and administrative | 7,414 | -- | 7 |
| Selling | 4,907 | -- | 4 |
| Depreciation and amortization | 11,909 | -- | 11 |
| Pre-opening expenses | 130 | -- | |
| Total operating expenses | 125,333 | -- | 125 |
| Loss from operations | (4,480) | -- | (4 |
| Other income (expense): | | | |
| Interest, net | (13,420) | -- | (13 |
| Minority interests | (150) | -- | |
| Non-recurring items | 127 | -- | |
| Loss before income taxes and cumulative effect of change in accounting principle | (17,923) | -- | (17 |
| Provision (benefit) for income taxes | (310) | -- | |
| Loss before cumulative effect of change in accounting principle | (17,613) | -- | (17 |
| Cumulative effect of change in accounting principle | -- | 5,134 | 5 |
| Net loss | (17,613) | (5,134) | (22 |
| Dividends on Preferred Stock | 888 | -- | |
| Net loss attributable to common stockholders | $ (18,501) | $ (5,134) | $ (23 |

| | | | |
|---|---|---|---|
| Net loss per share: | | | |
| Basic and diluted.................................... | $ (1.02) | $ (0.29) | $ ( |
| Weighted average number of common shares outstanding: | | | |
| Basic and diluted.................................... | 18,080 | -- | 18 |



| | Year Ended December 31, 2002 | | |
|---|---|---|---|
| | As Reported | Restatement Adjustments | A Rest |
| Cash flows from operating activities: | | | |
| Net loss............................................ | $ (17,613) | $ (5,134) | $ (22 |
| Adjustments to reconcile net loss to cash used in operating activities: | | | |
| Gain on disposition of real estate.................. | (127) | -- | |
| Impairment charges.................................. | -- | -- | |
| Depreciation and amortization....................... | 11,909 | -- | 11 |
| Related party costs settled with common stock........ | 241 | -- | |
| Cumulative effect of change in accounting principle.. | -- | 5,134 | 5 |
| (Increase) decrease in: | | | |
| Accounts receivable, net......................... | 725 | -- | |
| Inventories...................................... | (50) | -- | |
| Other current assets............................. | (439) | -- | |
| Other assets, net................................ | (2,283) | -- | (2 |
| Increase (decrease) in: | | | |
| Accounts payable................................. | (233) | -- | |
| Accrued liabilities.............................. | 679 | -- | |
| Deferred revenues................................ | (439) | -- | |
| Accrued lease obligations........................ | 3,242 | -- | 3 |
| Net cash used in operating activities.......... | (4,388) | -- | (4 |
| Cash flows from investing activities: | | | |
| Capital expenditures.................................. | (6,653) | -- | (6 |
| Proceeds from sale of The Sports Club/Las Vegas-net of costs............................................ | 6,154 | -- | 6 |
| Proceeds from sale of Houston real estate-net of costs.. | 3,133 | -- | 3 |
| Net cash provided by investing activities | 2,634 | -- | 2 |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of Preferred Stock-net of costs | 14,908 | -- | 14 |
| Proceeds from notes payable and equipment financing loans | 21,725 | -- | 21 |
| Repayments of notes payable and equipment financing loans | (33,176) | -- | (33 |

| | | | |
|---|---|---|---|
| Net cash provided by financing activities..... | 3,457 | -- | 3 |
| Net increase in cash and cash equivalents...... | 1,703 | -- | 1 |
| Cash and cash equivalents at beginning of year............. | 1,482 | -- | 1 |
| Cash and cash equivalents at end of year................... | $ 3,185 | $ -- | $ 3 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the year for interest................. | $ 11,902 | -- | $ 11 |
| Cash paid during the year for income taxes............. | $ 242 | -- | $ |



3. Liquidity/Going Concern

The Company has experienced recurring net losses of $40.7 million, $22.7 million and $18.4 million during the years ended December 31, 2001, 2002 and 2003, respectively. The Company has also experienced net cash flows used in operating activities of $6.0 million, $4.4 million and $3.5 million during the years ended December 31, 2001, 2002 and 2003, respectively. Additionally, the Company may suffer a significant loss and net cash flows used in operating activities during the year ending December 31, 2004. The Company has had to raise funds through the offering of equity securities in order to make the interest payments due on its Senior Secured Notes. The above historical and estimated future results of operations and cash flows raise doubt about the Company's ability to continue as a going concern.

The Company's continued existence is primarily dependent upon its ability to increase membership levels at its six most recently opened Clubs. Five Clubs were opened during 2000 and 2001 and The Sports Club/LA-Beverly Hills was opened in October 2003. Recently opened Clubs that have not yet achieved mature membership levels have operated at a loss or only a slight profit as a result of fixed expenses that, together with variable operating expenses, approximate or exceed current membership fees and other ancillary revenues. Increasing membership levels at these six most recently opened Clubs is the key to producing operating profits and positive cash flows from operating activities. The Company is constantly generating programs to market the Clubs to potential new members as well as striving to reduce its membership attrition rates. The Company has also pursued aggressive cost cutting programs that have reduced general and administrative expenses (including employment costs) from $8.5 million during the year ended December 31, 2001 to $7.8 million during the year ended December 31, 2003. Direct and selling expenses have also dropped as a percentage of revenues during the last three years.

If the Company is unable to increase membership levels or reduce costs to the point where cash flows from operating activities are sufficient to make the September 15, 2004 or future interest payments, the Company would be required to sell assets or issue additional equity securities. There can be no assurance that the Company will be able to sell assets or raise capital by offering additional equity securities. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

4. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The Company has a 50.1% interest in the partnership that owns The Sports Club/LA - Los Angeles, and the Company's Chairman beneficially owns the remaining 49.9%. The Company includes The Sports Club/LA - Los Angeles in its consolidated financial statements. The partnership agreement provides that, on an annual basis, the partners will share in the first $300,000 of the Club's net cash flow and profits in proportion to their percentage interests. The next $35.0 million of annual net cash flow will be distributed to the Company. All distributions of net cash flow thereafter, if any, will be made to the partners in proportion to their percentage interests. The Company has the option to redeem the preferred partnership interest in the partnership held by the Company's Chairman. The option expires as of January 31, 2006. The preferred partnership interest is carried at its redemption amount, which is $600,000 at December 31, 2003 and 2002 and has been classified as minority interest on the accompanying consolidated balance sheets.

Revenue Recognition

The Company receives initiation fees and monthly membership dues from its members. Substantially all of the Company's members join on a month-to-month basis and can therefore cancel their membership at any time. Initiation fees and related direct expenses, primarily sales commissions, are deferred and recognized, on a straight-line basis, over an estimated membership period of three years.



Dues that are received in advance are recognized on a pro-rata basis over the periods in which services are to be provided. In addition, payments of last month dues are deferred. Revenues for services including private training, spa treatments and physical therapy sessions are recorded when such services are performed. Amounts received in advance of performing these services are recorded as deferred revenues. Revenues from the Company's SportsMed subsidiary are recognized as services are performed based upon the estimated amount to be collected by the Company. Management fees, including reimbursed costs, are recognized as the management services are provided.

Effective July 1, 2003, the Company adopted Emerging Issues Task Forces ("EITF") 00-21, Revenue Arrangements with Multiple Deliverables. As a result of the adoption of EITF 00-21, the fair value of any free products or services bundled with new memberships is now recorded as revenue when the product is delivered or the service is performed. Prior to the adoption of EITF 00-21, the Company considered all payments as initiation fees and no revenue was recognized specifically for the free products or services bundled with new memberships. The impact upon implementation of EITF 00-21 was to increase the Company's 2003 revenues by $862,000.

Membership fees and other ancillary revenues are often prepaid and amortized to revenue as the membership fees and other ancillary revenues are earned. The following is a rollforward of deferred revenues for the years ended December 31, 2001, 2002 and 2003:

Years Ended December 31,

| | 2001 | 2002 | 200 |
|---|---|---|---|
| | | (in thousands) | |
| Deferred revenues - beginning of year......... | $ 16,214 | $ 19,026 | $ 18, |
| Plus cash received from members............... | 13,404 | 12,555 | 14, |
| Less revenue recognized as earnings........... | (10,592) | (13,350) | (13, |
| Deferred revenues - end of year.............. | $ 19,026 | $ 18,231 | $ 19, |

Reimbursed Costs

The Company accounts for reimbursed costs in accordance with Emerging Issue Task Force ("EITF") 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. EITF 99-19 requires that revenue be reported gross with separate display of cost of sales to arrive at gross profit or on a net basis, when the Company acts as a primary obligor in the transaction, has discretion in selecting the service provider and has credit risk as the Company receives reimbursements after the goods or services have been purchased. Reimbursed costs relate to The Sports Club/LA - Miami, which is a non-owned Club that the Company manages for its owner. The Company receives a management fee for managing the Club and is reimbursed for all costs that are advanced on the owner's behalf. Reimbursed costs are recorded as both revenue and expense in the consolidated financial statements. Reimbursed costs represent both pre-opening expenses and normal operating expenses of the Club during 2003.

Allowance for Doubtful Accounts.

The Company provides a reserve against its receivables for estimated losses that may result from its members' inability to pay. The Company determines the amount of the reserve by analyzing known uncollectible accounts, economic conditions and historical losses and its members' creditworthiness. The likelihood of a material loss from this area is minimal due to the Company's limited exposure to credit risk.

Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2002 and 2003, cash and cash equivalents were $3.2 million and $1.9 million, respectively.

The Company considers cash, cash equivalents and other short-term investments that are required to be held as deposits to satisfy certain governmental regulatory or Club operating lease security deposits as



restricted cash. At December 31, 2002 and 2003, the Company had $227,000 and $4.4 million, respectively, of restricted cash.

Inventories

Inventories are stated at the lower of average cost or market. Inventories consist of retail merchandise sold at spas, nutritional products, food and beverage products, uniforms and supplies.

Advertising Costs

Amounts incurred for advertising costs with third parties are expensed as incurred. Advertising expense totaled approximately $1.2 million, $1.5 million and $1.4 million for the years ended December 31, 2001, 2002 and 2003, respectively.

Loan Costs

Loan costs and the debt discount on the Senior Notes are amortized over the terms of the related loans using the straight line method which approximates the effective interest method.

Start-up Costs

All costs related to the development of new sports and fitness clubs, except for real estate related costs are expensed as incurred. Real estate related costs, which include construction costs and rent payments prior to opening, are capitalized.

Long-Lived Assets

Property and equipment are recorded at cost.

Depreciation is computed primarily using the straight-line method over the estimated useful lives of the assets, ranging from five to seven years for equipment and forty years for buildings. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term (including option periods in which the Company will incur a penalty for non-renewal) or the estimated useful lives of the improvements.

The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company adopted SFAS No. 144 on January 1, 2002. The Company evaluates its long-lived assets on a club-by-club basis with the exception of its three New York Clubs, which are evaluated on a combined basis due to the inter-related nature of the operations of the New York Clubs.

The Company reviews its long-lived assets and certain identifiable intangible assets for impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted operating cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Goodwill

In July 2001, the FASB issued SFAS No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method be used for all business combinations initiated after June 30, 2001. SFAS No. 142 requires that goodwill and certain intangibles no



longer be amortized, but instead be reviewed for impairment on at least an annual basis. Through December 31, 2001, goodwill was being amortized on a straight-line basis over forty years. In December 2001, the Company recorded an impairment loss of $1.8 million related to goodwill at its SportsMed subsidiary. The amortization of goodwill and certain intangibles ceased upon the adoption of SFAS No. 142, which is effective for fiscal years starting after December 15, 2001. The Company adopted SFAS No. 141 and SFAS No. 142 effective January 1, 2002. The Company has goodwill recorded which will no longer be amortized subsequent to the adoption of SFAS No. 142. The Company initially completed the transitional impairment test, in 2002, which did not result in the impairment of goodwill. In early 2004, the Company determined that the methodology used to determine if goodwill was impaired was incorrect and that a reevaluation was required. The Company has reperformed the transitional impairment test and determined that goodwill was impaired as of January 1, 2002 by $5,134,000. The 2002 consolidated financial statements have been restated to reflect this adjustment. In addition, the Company was not required to reclassify any portion of goodwill as a result of the adoption of SFAS No. 142.

The adoption of SFAS No. 142 had the following effect on the Company's reported net income (loss) attributable to common shareholders and net income (loss) per share for the years ended December 31, 2001, 2002 and 2003 (in thousands, except per share amounts):

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 (Restated) | 2003 |
| Reported loss attributable to common stockholders | $ (40,678) | $ (23,635) | $ (19,774) |
| Add back: Goodwill amortization, net of tax | 494 | -- | -- |
| Adjusted loss attributable to common stockholders | $ (40,184) | $ (23,635) | $ (19,774) |
| Reported basic and diluted loss per share | $ (2.27) | $ (1.31) | $ (1.08) |
| Adjusted basic and diluted loss per share | $ (2.24) | $ (1.31) | $ (1.08) |

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

In the fourth quarter of 2001, the Company determined, based on year to date operating results and projections for the next three years, that it was more likely than not that future taxable income will be insufficient to utilize its deferred tax assets. As a result of this determination, the Company ceased recording any further deferred tax benefit related to its taxable losses incurred in 2001, 2002 and 2003, and in the fourth quarter of 2001, the Company recorded a valuation allowance of $19,627,000 to offset its net deferred tax asset recorded through that date (See Note 12 - Income Taxes). The Company will continue to evaluate its projected future taxable operating income and reconsider its current determination when appropriate.

Earnings per Share

The Company presents basic and diluted earnings per share. Basic earnings reflects the actual weighted average shares of Common Stock outstanding during the period. Diluted earnings per share



includes the effects of all dilutive options, warrants and other securities and utilizes the treasury stock method or if converted method as appropriate.

The securities whose conversion would result in an incremental number of shares that would be included in determining the weighted average shares outstanding for diluted earnings per share if their effect was not antidilutive are as follows:

- December 31, 2003 - 1,754,609 stock options, 10,500 shares of Series B mandatorily redeemable convertible Preferred Stock and 5,000 shares of Series C convertible Preferred Stock.

- December 31, 2002 - 1,785,333 stock options, 10,500 shares of Series B mandatorily redeemable convertible Preferred Stock and, 5,000 shares of Series C convertible Preferred Stock.

- December 31, 2001 - 1,850,275 stock options.

Stock Based Compensation

The Company has elected to account for stock options granted to employees and directors under the provisions of APB Opinion No. 25, using the intrinsic value method. Entities electing to continue using the accounting prescribed by APB Opinion No. 25 must make pro forma disclosures of net income (loss) and income (loss) per share, as if the fair value based method of accounting defined in SFAS No. 123 had been applied. In accordance with APB Opinion No. 25, no compensation cost has been recognized as the fair value of the Company's stock was equal to the exercise price of the options at the date of grant. Had compensation cost for the Company's plan been determined consistent with SFAS No. 123, the Company's net loss attributable to common shareholders and loss per share would have been increased to the pro-forma amounts indicated below:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 | |
| | | (Restated) | |
| | (in thousands, except per share d | | |
| Net loss attributable to common stockholders, as reported.................. | $ (40,678) | $ (23,635) | $ |

| | | | |
|---|---|---|---|
| Stock-based employee compensation expense included in reported net loss.............. | -- | -- | |
| Stock-based employee compensation expense determined under fair value based method for all awards................................ | (1,540) | (1,239) | |
| Adjusted net loss attributable to common stockholders................................ | $ (42,218) | $ (24,874) | $ |
| Net loss per share as reported basic and diluted.................................... | $ (2.27) | $ (1.31) | $ |
| Adjusted net loss per share basic and diluted.... | $ (2.35) | $ (1.38) | $ |

The fair value of all option grants for the Company's plans are estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for all option grants in 2001: dividend yield of 0%; expected volatility of 119%; risk-free interest rate of 4.48% and expected economic life of 6.0 years. There were no options granted in 2002 and 2003.



Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions. These affect the reporting of assets and liabilities, the disclosure of any contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting periods. Those estimates include the estimated undiscounted cash flows used to determine any potential impairment of long-lived assets and a change in such undiscounted cash flows may change the Company's conclusion as to their impairment. Actual results could differ from these estimates.

Fair Value of Financial Instruments

The carrying amounts related to cash equivalents, short-term investments, accounts receivable, other current assets and accounts payable approximate fair value due to the relatively short maturity of such instruments. The fair value of long-term debt is estimated by discounting the future cash flows of each instrument at rates currently available to the Company for similar debt instruments of comparable maturities or by obtaining the then current fair value from the publicly traded bond market. The fair value of long-term debt at December 31, 2003 was estimated to be $112.7 million.

Redeemable Preferred Stock

Mandatorily redeemable convertible Preferred Stock (Series B) is stated at redemption value, less the unamortized discount. The discount is accreted into the carrying value of the mandatorily redeemable convertible Preferred Stock through the date at which the Preferred Stock is redeemable at the option of the holder with a charge to accumulated deficit using the effective-interest method. Due to the inherent uncertainties regarding the ability and ultimate timing of either the redemption or conversion of these preferred shares and the accretion method used, it is not practicable for management to determine their fair value.

Segment Reporting

Management has determined that the Company has one reporting segment.

Impact of Recent Accounting Pronouncements

In June 2002, the FASB issued Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities. Statement No. 146 nullified Emerging Issues Task Force ("EITF") issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). Under EITF issue 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. Under Statement No. 146, the liabilities associated with an exit or disposal activity will be measured at fair value and recognized when the liability is incurred and meets the definition of a liability in the FASB's conceptual framework. This Statement is effective prospectively for exit or disposal activities initiated after December 31, 2002. The adoption of Statement No. 146 did not have any impact on the Company's consolidated financial statements.

On December 31, 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure ("SFAS 148"), which amends SFAS No. 123, Accounting for Stock-Based Compensation ("SFAS 123"). SFAS 148 amends the disclosure requirements in SFAS 123 for stock-based compensation for annual periods ending after December 15, 2002 and for interim periods beginning after December 15, 2002. The disclosure requirements apply to all companies, including those that continue to recognize stock-based compensation under APB Opinion No. 25, Accounting for Stock Issued to Employees. Effective for financial statements for fiscal years ending after December 15, 2002, SFAS 148 also provides three alternative transition methods for companies that choose to adopt the fair value measurement provisions of SFAS 123. Management has chosen not to adopt the fair value measurement provisions of SFAS 123.



In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"), which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. The disclosure requirements are effective for interim and annual financial statements ending after December 15, 2002. The Company does not have any guarantees that require disclosure under FIN 45.

In November 2002, the EITF issued EITF 00-21, Revenue Arrangements with Multiple Deliverables ("EITF 00-21"). EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, EITF 00-21 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. In applying EITF 00-21, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary. EITF 00-21 also addresses how consideration should be measured and allocated to the separate units of accounting in the arrangement. The guidance in EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Alternatively, companies may elect to report the change in accounting as a cumulative-effect adjustment. Effective July 1, 2003, the Company adopted EITF 00-21, Revenue Arrangements with Multiple Deliverables on a prospective basis. As a result of the adoption of EITF 00-21, the fair value of any free products or services bundled with new memberships is now separated and recognized as revenue when the product is delivered or the service is performed. Prior to the adoption of EITF 00-21, the Company considered all payments as initiation fees and no revenue was recognized separately for the free products or services bundled with new memberships. The impact upon implementation of EITF 00-21 was to increase the Company's 2003 revenues by $862,000.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"), which addressed the consolidation by business enterprises of variable interest entities, which have one or both of the following characteristics: (i) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional financial support from other parties, or (ii) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) the direct or indirect ability to make decisions about the entity's activities through voting or similar rights, (b) the obligation to absorb the expected losses of the entity if they occur, or (c) the right to receive the expected residual returns of the entity if they occur. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after December 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. In December 2003, the interpretation was revised by the FASB when it issued FIN 46R, which clarified its scope and also extended the requirement to apply its provisions to investments created prior to January 31, 2003 until the end of the Company's first quarter in 2004. The implementation extension does not apply to special purpose entities. The Company does not expect FIN 46 or FIN 46R to have an impact on the consolidated financial statements.

On April 30, 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities ("SFAS 149"). SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. This Statement is effective for contracts entered into or modified after June 30, 2003, and hedging relationships designated after June 30, 2003. The Company has no derivative instruments and is not involved in any hedging activities and therefore the adoption of SFAS 149 did not have any impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("SFAS 150"), which addresses how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument as a liability if it embodies an



obligation for the issuer such as a mandatorily redeemable financial instrument. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective for the first interim period beginning after June 15, 2003. The application of SFAS 150 did not have any effect on the Company's consolidated financial statements and it did not change the presentation of any liability or equity items in its consolidated balance sheets.

## 5. Dispositions

### Disposition of Real Estate

In June 1998, the Company acquired undeveloped land in Houston, Texas with the intention of developing a Club on the site. In 2000, the Company decided not to develop this site and to dispose of the property. An impairment loss of $749,000 was recorded in December 2000 to reduce the carrying value of the asset to its estimated fair value less costs to sell. The Houston site was sold on August 30, 2002 and a non-recurring gain of $97,000 was recorded (See Note 13).

### Disposition of Club

In January 2002, the Company sold The Sports Club/Las Vegas to another club operator. An impairment loss of $3,243,000 was recorded in December 2001 to reduce the carrying value of The Sports Club/LasVegas to its fair value less costs to sell. A gain of $30,000, related to the sale of The Sports Club/Las Vegas was recorded in January 2002. The gain was based upon the actual proceeds received from the sale of this Club.

## 6. Property and Equipment

Property and equipment is carried at cost, less accumulated depreciation and amortization, which is summarized as follows:

| | At December 31, | |
|---|---|---|
| | 2002 | 2 |
| | (in thousands) | |
| Land | $ 10,621 | $ 10 |
| Building and leasehold improvements | 146,814 | 153 |
| Furniture, fixtures and equipment | 40,314 | 44 |
| | 197,749 | 208 |
| Less accumulated depreciation and amortization | 41,119 | 53 |
| Net property and equipment | $ 156,630 | $ 155 |

Equipment, which secures equipment financing loans, was $8,151,000 and $8,251,000 at December 31, 2002 and 2003, respectively.



## 7. Notes Payable and Equipment Financing Loans

Notes payable and equipment financing loans are summarized as follows:

At December 31,

| | 2002 | |
|---|---|---|
| | (in thousands) | |
| Senior secured notes (a) | $ 100,000 | $ 1 |
| Equipment financing loans (b) | 4,040 | |
| Mortgage note (c) | -- | |
| | 104,040 | 1 |
| Less current installments | 2,158 | |
| | $ 101,882 | $ 1 |

(a) On April 1, 1999, the Company issued in a private placement $100.0 million of 11 3/8% Senior Secured Notes due in March 2006 (the "Senior Notes") with interest due semi-annually. In May 1999, the Senior Notes were exchanged for registered Series B Senior Secured Notes (the "Senior Secured Notes"). The Senior Secured Notes are secured by substantially all of the Company's assets, other than certain excluded assets. In connection with the issuance of the Senior Secured Notes, the Company entered into an indenture dated as of April 1, 1999 (the "Indenture") that includes certain covenants, which as of December 31, 2003, restrict the Company's ability, subject to certain exceptions, to: (i) incur additional indebtedness; (ii) pay dividends or other distributions, or repurchase capital stock or other equity interests or subordinated indebtedness; and (iii) make certain investments. The Indenture also limits the Company's ability to: (i) enter into transactions with affiliates, (ii) create liens on or sell certain assets, and (iii) enter into mergers and consolidations. The Senior Notes are subject to redemption at the option of the Company, in whole or in part, at the redemption prices (expressed as percentages of principal amount) set forth below, plus accrued and unpaid interest thereon:

| Period | Percentage |
|---|---|
| Prior to March 15, 2004 | 105.688% |
| Prior to March 15, 2005 | 102.844% |
| Thereafter | 100.000% |

If the Company undergoes a "change in control", as defined in the Indenture, it must give holders of the Senior Secured Notes the opportunity to sell their Senior Secured Notes to the Company at 101% of their face amount, plus interest. At December 31, 2003, the Company was in compliance with the terms of the Indenture, except as noted below. At December 31, 2003, the estimated fair value of the Senior Secured Notes was $93.0 million.

On May 25, 2004, the Company received a letter from the Trustee of the Indenture Agreement notifying the Company that an "event of default" under the Indenture would arise if the Company failed to file its financial reports with the Securities and Exchange Commission ("SEC") within thirty (30) days after the Company's receipt of such notice. The Company has filed its report with the SEC within the thirty (30) day period thereby curing and nullifying the Trustee's notice.

(b) The equipment financing loans are secured by furniture, fixtures and equipment. The amounts are generally repayable in monthly payments over four or five years with effective interest rates between 3.5% and 13.3%.

(c) Prior to June 12, 2003, the Company had a $10.0 million credit facility from a commercial bank. On June 12, 2003, the Company obtained alternative financing in the form of a secured five-year mortgage in the amount of $20.0 million.

Amounts outstanding under the previous bank credit facility were repaid with a portion of the proceeds of the new loan. The new loan is evidenced by a promissory note that bears interest at a fixed interest rate of 7.25%; requires monthly principal and interest payments of $144,561; is secured by the common stock and all the assets of Irvine Sports Club, Inc., the Company's wholly owned



subsidiary that owns The Sports Club/LA - Orange County; and is guaranteed by two of the Company's major shareholders. The note requires The Sports Club/LA - Orange County to maintain a minimum operating income, as defined, or the Company will be required to establish a payment reserve account of up to $607,000. As of December 31, 2003, the Company has maintained the minimum operating income. The note may be prepaid at any time without penalty and requires a final principal payment of $18.3 million on July 1, 2008.

Future minimum annual principal payments at December 31, 2003, are as follows (in thousands):

| | |
|---|---|
| 2004 | $ 2,099 |
| 2005 | 444 |
| 2006 | 100,372 |
| 2007 | 400 |
| 2008 | 18,515 |
| | $ 121,830 |

8. Commitments and Contingencies

Lease Commitments

The Company leases certain facilities pursuant to various operating lease agreements. Club facility leases are generally long-term and noncancelable triple-net leases (requiring the Company to pay all real estate taxes, insurance and maintenance expenses). The Company is also obligated under lease agreements for seven of its former Spectrum Club locations. The Company has subleased each of these properties to the buyer of these Clubs under sublease agreements which provide that all operating costs of these facilities be assumed by the new owners. Future minimum noncancelable operating lease payments as of December 31, 2003 are as follows (in thousands):

| | Commitments | Sublease Rentals | N Re Commi |
|---|---|---|---|
| Year ending December 31: | | | |
| 2004 | $ 30,116 | $ 5,712 | $ 24 |
| 2005 | 29,892 | 5,917 | 23 |
| 2006 | 29,974 | 5,917 | 24 |
| 2007 | 30,004 | 5,990 | 24 |
| 2008 | 29,726 | 5,417 | 24 |
| Thereafter | 266,139 | 30,314 | 235 |
| Total minimum lease payments | $ 415,851 | $ 59,267 | $ 356 |

Rent expense for facilities, including minimum lease payments recorded on a straight-line basis over the lease term, aggregated $18,685,000, $23,301,000 and $23,743,000 for the years ended December 31, 2001, 2002 and 2003, respectively.

Litigation

The Company is involved in various claims and lawsuits incidental to its business, including claims arising from accidents. However, in the opinion of management, the Company is adequately insured against such claims and lawsuits involving personal injuries, and any ultimate liability arising out of any such proceedings will not have an material adverse effect on the Company's financial condition, cash flow or results of operations.

Employment Agreements

At December 31, 2003, the Company did not have any employment agreements with any employees.



9. Series B Redeemable Preferred Stock

On March 18, 2002, the Company completed a $10.5 million private placement of a newly created series of its Convertible Preferred Stock. The Company received $9.9 million in cash, after issuance costs, and issued 10,500 shares of Series B Preferred Stock, $.01 par value ("Series B Preferred"), at a price of $1,000 per share. The Company has the option to redeem any outstanding shares of Series B Preferred at any time and the holders may require the redemption of any outstanding shares of Series B Preferred on or after March 18, 2009 at a price of $1,000 per share plus accrued but unpaid dividends. Dividends accrue at the annual rate of $90.00 per share. Such dividends are cumulative but do not accrue interest and at the Company's option, may be paid in cash or in additional shares of Series B Preferred. The Series B Preferred may, at the option of the holder, be converted into shares of Common Stock at the rate of $2.8871 per share, as adjusted for the issuance of Series D Preferred Stock in March 2004 (resulting in the issuance of 3,636,867 shares of Common Stock if 100% of the Series B Preferred is converted at that price). The conversion price will be adjusted downward in the event the Company issues additional shares of Common Stock at a price below $2.8871 per share, subject to certain exceptions; and any such downward adjustment is subject to the prior approval of the American Stock Exchange. In the event the Series B Preferred is redeemed before March 18, 2005, the holders will receive warrants to purchase shares of Common Stock at a price of $3.00 per share, exercisable before March 18, 2007. In the event of liquidation, the Series B Preferred holders are entitled to receive, prior and in preference to any distribution to common shareholders and pari passu with holders of the Series C Preferred Stock, an amount equal to $1,000 for each share of Series B Preferred then outstanding.

The initial carrying value of the Series B Preferred was recorded at its "fair value" (sale price less costs to issue) on the date of issuance. The carrying value of the Series B Preferred will be periodically adjusted so that the carrying value equals the redemption value on the redemption date. The carrying value of the Series B Preferred will also be periodically adjusted for any accrued and unpaid dividends. The Series B Preferred carrying value consisted of the following (in thousands):

| | | |
|---|---|---|
| Initial fair value, sale price of $10,500 less costs to issue of $592.................... | $ | 9,908 |
| Redemption value accretion.......................... | | 71 |
| Accrued and unpaid dividends accretion................ | | 748 |

| | | |
|---|---|---|
| Total carrying value at December 31, 2002......... | | 10,727 |
| Redemption value accretion............................ | | 84 |
| Accrued and unpaid dividends accretion................ | | 950 |
| Total carrying value at December 31, 2003......... | $ | 11,761 |



10. Series C Preferred Stock

On September 6, 2002, the Company completed a $5.0 million private placement of a newly created series of Convertible Preferred Stock. The Company received $5.0 million in cash and issued 5,000 shares of Series C Convertible Preferred Stock, $.01 par value ("Series C Convertible Preferred"), at a price of $1,000 per share. Dividends are earned at an annual rate of $90.00 per share. Dividends are payable when and as declared by the Board of Directors. Such dividends are cumulative, but do not accrue interest and at the Company's option, may be paid in cash or additional shares of Series C Convertible Preferred. Dividends are paid pari passu with dividends on the Series B Preferred Stock. In addition, upon conversion any earned and unpaid dividends would become payable. Accordingly, the Company has recorded such Series C divdidends. The Series C Convertible Preferred may, at the option of the holder, be converted into shares of Common Stock at the rate of $2.8871 per share, as adjusted for the issuance of Series D Preferred Stock in March 2004 (resulting in the issuance of 1,731,842 shares of Common Stock if 100% of the Series C Convertible Preferred is converted at that price). Upon conversion, any earned and unpaid dividends would become payable in cash or additional shares of Series C Convertible Preferred, at the Company's option. The conversion price will be adjusted downward in the event the Company issues additional shares of Common Stock at a price below $2.8871 per share, subject to certain exceptions; and any such downward adjustment is subject to the prior approval of the American Stock Exchange. At the option of the Company the Series C Convertible Preferred Stock may be redeemed in whole or in part by paying in cash the sum of $1,000 per share plus any earned and unpaid dividends. In the event the Series C Convertible Preferred is redeemed before September 6, 2005, the holders will receive warrants to purchase shares of Common Stock at a price of $3.00 per share, exercisable before September 6, 2007. In the event of liquidation, the Series C Convertible Preferred holders are entitled to receive, prior and in preference to any distribution to common shareholders, and pari passu with holders of the Series B Preferred, an amount equal to $1,000 for each share of Series C Convertible Preferred then outstanding, plus earned and unpaid dividends.

The carrying value of the Series C Convertible Preferred is periodically adjusted for any accrued and unpaid dividends. The Series C Convertible Preferred dividends are accrued because they must be paid concurrently with any redemption of the Series B Preferred. At December 31, 2003, the Series C Convertible Preferred carrying value consisted of the following (in thousands):

| | |
|---|---|
| Initial fair value............................$.... | 5,000 |
| Accrued and unpaid dividend accretion.............. | 590 |
| Total carrying value at December 31, 2003......$.... | 5,590 |

= ============

11. Loss per Share

Basic and diluted loss per share computations for the years 2001, 2002 and 2003 are as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 | |
| | | (Restated) | |
| | (in thousands, except per share | | |
| Net loss attributable to common shareholders used for basic and diluted loss per share...................... | $ (40,678) | $ (23,635) | $ |
| Weighted average shares outstanding: | | | |
| Basic and diluted.................................... | 17,939 | 18,080 | |
| Loss per share: | | | |
| Basic and diluted.................................... | $ (2.27) | $ (1.31) | $ |

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12. Income Taxes

The provision for income taxes consists of the following:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 | |
| | | (in thousands) | |
| Current: | | | |
| Federal.......................................... | $ 89 | $ (930) | $ |
| State............................................ | 757 | 620 | |
| | 846 | (310) | |
| Deferred: | | | |
| Federal.......................................... | 3,486 | -- | |
| State............................................ | 1,038 | -- | |
| | 4,524 | -- | |
| Income tax provision (benefit)........................ | $ 5,370 | $ (310) | $ |

Income tax expense (benefit) as computed differs from the statutory rate as applied to pre-tax net income (loss) as follows:

| | Years ended December 31 | | |
|---|---|---|---|
| | 2001 | 2002 | |
| | (in thousands) | | |
| Computed "expected" tax expense (benefit)............. | $ (12,005) | $ (7,839) | $ |
| Increase (decrease) in tax resulting from: | | | |
| State taxes - net of federal benefit............. | (2,091) | (1,102) | |
| Meals and entertainment.......................... | 63 | 75 | |
| Change in valuation allowance................... | 19,627 | 9,048 | |
| Other........................................... | (224) | (492) | |
| Income tax provision (benefit)....................... | $ 5,370 | $ (310) | $ |

The effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities are presented as follows:

| | At December 31, | |
|---|---|---|
| | 2002 | |
| | (in thousands) | |
| Deferred tax assets: | | |
| Deferred revenues................................. | $ 1,368 | $ |
| Operating loss carry forwards....................... | 24,198 | |
| Accrued vacation.................................. | 257 | |
| Bad debt.......................................... | 193 | |
| Depreciation and amortization....................... | 507 | |
| State taxes....................................... | 315 | |
| Other............................................. | 1,837 | |
| Gross deferred tax assets......................... | 28,675 | |
| Valuation allowance.................................... | (28,675) | ( |
| Net deferred tax asset................................. | $ -- | $ |

The Company has determined, based on historical operating results and projections for the next three years that it is more likely than not that future taxable income will be insufficient to utilize its deferred tax assets. As a result of this determination, the Company ceased recording any deferred tax benefit related to its taxable losses and recorded valuation allowances of $19,627,000, $9,048,000 and $6,592,000 in 2001, 2002 and 2003, respectively to offset the Company's net deferred tax assets.

As of December 31, 2003, the Company had federal and state net operating loss carryforwards of $70,094,000 and $84,147,000 respectively, beginning expiration in 2020 and 2005, respectively.

13. Non-Recurring Items

The Company recorded the following as non-recurring items for 2001, 2002 and 2003:

| | Years Ended December | |
|---|---|---|
| | 2001 | 2002 |
| | | (in thousands) |
| Gain on sale of Houston real estate (See Note 5)................ | $ -- | $ 97 |
| Gain on sale of The Sports Club/Las Vegas (See Note 5).......... | -- | 30 |
| Interest expense reversal on litigation settlement (a).......... | 397 | -- |
| | $ 397 | $ 127 |

(a) The Company recorded a non-recurring gain of $397,000 during the year ended December 31, 2001. The non-recurring gain in 2001 was the result of the reversal of accrued interest expense related to the settlement of litigation. As part of the settlement the Company was no longer required to pay the accrued interest due on the note in question.

14. Stock Plans

Stock Incentive Plans

The Company's shareholders reserved 1,800,000 shares of Common Stock under the Company's Amended and Restated 1994 Stock Incentive Plan, which authorized the issuance of various stock incentives to directors, officers, employees and consultants including options, stock appreciation rights and purchase rights. On December 31, 2000, the 1994 Stock Incentive Plan expired and in May 2001, the Company's shareholders adopted the 2001 Stock Incentive Plan (the "Plan"). The 2001 Stock Incentive Plan reserves 2.5 million shares of Common Stock, expires in May 2011 and also authorizes stock appreciation rights and purchase rights.

Options allow for the purchase of Common Stock at prices determined by the Company's Compensation Committee. Incentive stock options must be granted at a price equal to or greater than the fair value of a share of Common Stock on the date the option is granted. Non-statutory options must have an exercise price equal to at least 85% of the fair value of the Company's Common Stock at the date of grant. Options granted under the Plans may, at the election of the Compensation Committee, become exercisable in installments. Except for the number of options granted to the Company's former Co-Chief Executive Officer D. Michael Talla, which expire on the fifth anniversary of the grant date, all options expire on the tenth anniversary of the grant date.

A summary of the status of the Company's stock option plans as of December 31, 2001, 2002 and 2003 and changes during the years then ended are presented below:

| | Shares | We Averag P |
|---|---|---|
| Outstanding at January 1, 2001 | 1,533,832 | $ |
| Granted | 411,915 | |
| Canceled | (93,472) | |
| Exercised | (2,000) | |
| Outstanding at December 31, 2001 | 1,850,275 | |
| Options exercisable at December 31, 2001 | 915,284 | |
| Weighted-average per share fair value of options granted during year ended December 31, 2001 | | |
| Outstanding at January 1, 2002 | 1,850,275 | |
| Granted | -- | |
| Canceled | (64,942) | |
| Exercised | -- | |
| Outstanding at December 31, 2002 | 1,785,333 | |
| Options exercisable at December 31, 2002 | 1,296,448 | |
| Outstanding at January 1, 2003 | 1,785,333 | |
| Granted | -- | |
| Canceled | (30,724) | |
| Exercised | -- | |
| Outstanding at December 31, 2003 | 1,754,609 | |
| Options exercisable at December 31, 2003 | 1,621,965 | |

The following table summarizes information about stock options outstanding at December 31, 2003:

| Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Options Exercisable |
|---|---|---|---|
| $2.5625 | 24,333 | 2.41 | 24,334 |

| | | | |
|---|---|---|---|
| 2.6875 | 70,000 | 2.11 | 70,000 |
| 2.7500 | 26,000 | 2.84 | 26,000 |
| 3.0100 | 282,932 | 7.39 | 188,621 |
| 3.3110 | 115,000 | 2.39 | 76,667 |
| 3.9375 | 210,000 | 5.10 | 210,000 |
| 4.2500 | 219,344 | 6.85 | 219,343 |
| 4.3750 | 60,000 | 3.22 | 60,000 |
| 5.2500 | 42,000 | 1.24 | 42,000 |
| 5.3750 | 32,000 | 3.50 | 32,000 |
| 8.0000 | 211,000 | 4.29 | 211,000 |
| 8.0000 | 450,000 | 6.11 | 450,000 |
| 8.3750 | 12,000 | 3.85 | 12,000 |
| | 1,754,609 | | 1,621,965 |



Stock appreciation rights ("SAR's") may be granted in combination with options or on a stand-alone basis. SAR's permit the holder to receive shares of stock, cash or a combination of shares and cash based upon by the difference between the option price and the fair value of the Common Stock on the date of exercise. Upon exercise of a SAR granted in combination with an option, the related option is canceled. At December 31, 2003, no SAR's had been granted.

Rights to purchase shares of Common Stock to be offered for direct sale under the Plan must be at a purchase price equal to not less than 85% of the fair value of the shares on the day preceding the date of grant. Purchase rights are generally exercisable for a period of thirty days following the date of grant. At December 31, 2003, no purchase rights had been granted.

1994 Stock Compensation Plan

In July 1994, the Company instituted its 1994 Stock Compensation Plan (that was amended by the Company's shareholders in July 1999) for the purpose of compensating outside directors by issuing them shares of the Company's Common Stock as part of their directors' fees. A total of 50,000 shares were reserved for issuance pursuant to this plan and a total of 50,000 shares have been issued to outside directors under the plan. During the years ended December 31, 2001, 2002 and 2003, the Company issued 6,000, 8,000 and 6,000 shares of Common Stock as director compensation for aggregate consideration of $16,000, $15,000 and $12,000, respectively.

15. Related Party Transactions

Millennium Partners LLC (collectively with its affiliate "Millennium") is a significant shareholder of the Company and has jointly developed Clubs with the Company. A representative of Millennium is on the Company's Board of Directors. Millennium is a partner in the Reebok Sports Club/NY partnership as well as the landlord of the building in which the Reebok Sports Club/NY is located. The Reebok Sports Club/NY pays rent to Millennium in the amount of $2.0 million per year and the partnership agreement provides for a first priority annual distribution of $3.0 million to Millennium. The Company is entitled to certain additional priority distributions and 60% of the remaining cash flow. Millennium is entitled to 20% of such remaining cash flows.

The Company pays rent to Millennium for The Sports Club/LA - Washington D.C., The Sports Club/LA - Boston and The Sports Club/LA - San Francisco and in 2001, 2002 and 2003 a total of $4.8 million, $9.5 million and $9.5 million, respectively, was paid to Millennium for rent on these three Clubs. All such payments are reflected as rent expense in the Company's consolidated statements of operations. In addition, after the Company receives a management fee equal to 6% of all revenues, an amount equal to its capital investment in the Boston and Washington D.C. Clubs and a 11% annual return on the capital investment and an amount equal to its operating investment in the Club and a 10% annual return on the operating investment, Millennium is entitled to receive a percentage of all additional cash flows from each Club as additional rent. Millennium's percentage of the excess cash flow, as defined, is 25% for the Washington and Boston Clubs and 60% for the San Francisco Club. Millennium has not received any payments to date under these provisions.

On November 24, 2003, the Company opened The Sports Club/LA - Miami as part of the exclusive new Four Seasons Hotel and Tower in Miami, Florida. The Company operates this 40,000 square foot Club pursuant to a management agreement with Millennium, the developer of the project. The Company receives a fee of 6% of gross revenues and a participation in the Club's net cash flow. For the year ended December 31, 2003, management fees of $131,000 were earned by the Company. The Company was also reimbursed $2,383,000 for costs it incurred related to the operation of The Sports Club/LA - Miami.

The Company has a 50.1% interest in the partnership that owns The Sports Club/LA - Los Angeles, and the Company's Chairman beneficially owns the remaining 49.9%. The Company includes The Sports Club/LA - Los Angeles in its consolidated financial statements. The partnership agreement provides that, on an annual basis, the partners will share in the first $300,000 of the Club's net cash flow in



proportion to their percentage interests. The next $35.0 million of annual net cash flow will be distributed to the Company. All distributions of net cash flow thereafter, if any, will be made to the partners in proportion to their percentage interests. The Company has the option to redeem the preferred partnership interest in the partnership held by the Company's Chairman. The option expires as of January 31, 2006. The preferred partnership interest is carried at its redemption amount, which is $600,000 at December 31, 2003 and 2002 and has been classified as minority interest on the accompanying consolidated balance sheets.

As of May 4, 2001, the Company entered into a ten-year sublease for space located within The Sports Club/LA - Upper East Side. The sublease provides for two five-year renewal options and one seven-year renewal option; an initial monthly rent of $125,000, and rental increases of 10% at the end of each five-year period. The subtenant for this lease is Club at 60th Street, Inc., a New York corporation owned by Mr. Talla.

In September 1999, the Company sold the property on which the Spectrum Club - Thousand Oaks is located for a sales price of $12.0 million. The Company entered into a sale and leaseback agreement for the property under a long-term lease with an initial annual base rent of $1.3 million. The Thousand Oaks property consists of the Spectrum Club - Thousand Oaks, a SportsMed facility, unimproved office space, and a parking ramp. The Company is currently subleasing the Spectrum Club space to another club operator. Mr. Licklider owns an approximate 4.6% interest in the purchaser of the property, and trusts for the benefit of Mr. Talla's minor children own an approximately 5.2% interest in the purchaser of the property.

On March 18, 2002, the Company sold an aggregate of 10,500 shares of Series B Convertible Preferred Stock to Kayne Anderson Capital Advisors and four affiliates thereof for aggregate offering proceeds of $10.5 million. The shares of Series B Preferred may, at the option of the holder, be converted into shares of the Company's Common Stock at the current rate of $2.8871 per share; entitle each holder to one vote for each share of Common Stock into which such Series B Preferred could then be converted; and provide for the payment of dividends at an annual rate of $90.00 per share. Dividends are cumulative, do not accrue interest and, at the Company's discretion, may be paid in additional shares of Series B Preferred. As part of the sale of the Series B Preferred to Kayne Anderson, the Company agreed that for so long as Kayne Anderson beneficially owns at least 12% of the Company's equity securities (on an "as-converted basis") Kayne Anderson will have the right to designate one member to the Company's Board of Directors. Mr. Charles A. Norris is currently serving on the Board as the nominee of Kayne Anderson.

On September 6, 2002, the Company sold an aggregate of 5,000 shares of Series C Convertible Preferred Stock to three of the Company's major shareholders, D. Michael Talla, Rex Licklider and MDP Ventures II, LLC, an affiliate of Millennium, for aggregate offering proceeds of $5.0 million. The shares of Series C Preferred may, at the option of the holder, be converted into shares of the Company's Common Stock at the current rate of $2.8871 per share; entitle each holder to one vote for each share of Common Stock into which such Series C Preferred could then be converted; and provide for the payment of dividends at an annual rate of $90.00 per share. Dividends are cumulative, do not accrue interest and, at the Company's discretion, may be paid in additional shares of Series C Preferred.

In consideration of executing a guaranty in favor of Comerica-Bank - California (the "Bank") in connection with the Bank's renewal of the Company's credit facility (the "Credit Facility"), Messrs. Talla and Licklider and MDP Ventures II, LLC, an affiliate of Millennium, entered into agreements with the Company as of July 3, 2001, pursuant to which the Company was obligated to pay a 1% annual commitment fee to each of the guarantors. In addition to the committee fee, the Company was obligated to pay to each guarantor a usage fee equal to 2% per annum of such guarantor's pro rata portion of any amounts advanced to the Company by the Bank. At the Company's discretion all earned commitment fees and usage fees under the agreements were paid in restricted shares of Common Stock with each guarantor receiving in the aggregate 86,392 shares. In June 2003, the Company replaced the Credit Facility and, as of February 15, 2004, all payment obligations due the guarantors have been met.



Upon termination of the Credit Facility, on June 12, 2003, the Company entered into a new promissory note with another financial institution. The new note is for $20.0 million (the "Loan") and is guaranteed by Messrs. Talla and Licklider. Messrs. Talla and Licklider entered into agreements with the Company as of December 1, 2003, pursuant to which the Company is obligated to pay a quarterly fee to each guarantor equal to 3% per annum of their pro rata portion of the average outstanding principal balance of the Loan. At the Company's discretion, such fees may be paid in Common Stock, cash or a combination thereof. The third quarter 2003 fee was paid in stock with each guarantor receiving 28,509 shares. The Company has also elected to pay the fourth quarter 2003 fee in stock and has determined that each guarantor will receive 40,731 shares.

16. Concentration of Credit Risk

The Company markets its products principally to customers in Southern California, New York City, Washington D.C., Boston and San Francisco. Management performs regular evaluations concerning the ability of its customers to satisfy their obligations and records a provision for doubtful accounts based upon these evaluations. The Company's credit losses for the periods presented are insignificant and have not exceeded managements' estimates (see Note 4 - allowance for doubtful accounts).

17. Subsequent Events

On March 12, 2004, the Company completed a $6.5 million private placement of a newly created series of Convertible Preferred Stock. The Company received $6.1 million in cash, net of costs, and issued 65,000 shares of $.01 par value Series D Convertible Preferred Stock ("Series D Convertible Preferred"), at a price of $100 per share. The Series D Convertible Preferred Stock was purchased by three of the Company's major shareholders consisting of Rex Licklider (the Company's Chief Executive Officer), Millennium and Kayne Anderson Capital Advisors. Dividends are earned at an annual rate of $9.00 per share and shall be paid prior and in preference to any dividends earned on the Series B Preferred, Series C Preferred, Common Stock or any other class of equity security that is junior to the Series D Convertible Preferred. Dividends are payable when and as declared by the Board of Directors. Such dividends are cumulative, but do not accrue interest and at the Company's option, may be paid in cash or additional shares of Series D Convertible Preferred. The Series D Convertible Preferred may, at the option of the holder, be converted into shares of Common Stock at the rate of $2.00 per share (resulting in the issuance of 3,250,000 shares of Common Stock if 100% of the Series D Convertible Preferred is converted). Each share of Series D Convertible Preferred shall automatically be converted into shares of Common Stock upon the consummation of a qualified secondary stock offering of at least $50.0 million or if the closing price of the Common Stock for a period of thirty consecutive trading days exceeds $4.00 per share until March 15, 2005, or $6.00 per share thereafter, and at least 150,000 shares of Common Stock have been traded during such applicable thirty day period. Upon conversion, any earned and unpaid dividends would become payable. The conversion price will be adjusted equitably in the event of any combination, recapitalization, merger, reclassification or similar transaction or issuance of Common Stock (or any instrument convertible into or exercisable into Common Stock) at a price per share less than the Series D Convertible Preferred conversion price then in effect. Commencing on the sixth anniversary of the issuance of the Series D Convertible Preferred the Company at its option may redeem the Series D Convertible Preferred in whole or in part by paying in cash the sum of $100 per share plus any earned and unpaid dividends. In the event of liquidation, the Series D Convertible Preferred holders are entitled to receive, prior and in preference to any distribution to common shareholders and holders of the Series B Preferred and Series C Convertible Preferred, an amount equal to $100 for each share of Series D Convertible Preferred then outstanding, plus any earned and unpaid dividends. The holders of the Series D Convertible Preferred are afforded protective rights that among other things restrict the Company's ability to incur debt or lease obligations, make investments or acquisitions, sell a Club leased from Millennium, issue any new class of equity securities, repurchase or redeem any equity securities, hire or fire the Chief Executive Officer, enter into any new line of business or change the primary line of business and issue options under the Company's stock option plans. In addition, Millennium is entitled to designate two directors (at least one of whom must be independent) and the other two holders are each entitled to designate one director, to serve on the Company's Board of Directors.

18. Quarterly Summary of Information (Unaudited)

Revenues and operating expenses for the first, second, and third quarters of 2003 have been restated to record the impact of reimbursed costs which previously had not been shown on the consolidated statement of operations. Reimbursed costs relate to The Sports Club/LA - Miami, which is a non-owned Club that the Company manages for its owner. The Company receives a management fee for managing the Club and is reimbursed for costs that are advanced on the owner's behalf. Reimbursed costs are recorded as both revenue and expense in the consolidated financial statements. The effect of reimbursed costs on the Company's loss from operations, net loss, loss attributable to common stockholders and net loss per share (basic and diluted) is zero, since reimbursed costs are reported both as revenue and as operating expenses in the consolidated financial statements in equal amounts. Reimbursed costs represent both pre-opening expenses and normal operating expenses of the Club. Reimbursed costs by quarter for the first, second, third and fourth quarters of 2003 were $258,000, $448,000, $327,000 and $1,350,000, respectively.

| | 2003 | | |
|---|---|---|---|
| | March 31 | June 30 | September 30 |
| | (in thousands, except per share amou | | |
| Revenue: | | | |
| As reported | $ 32,403 | $ 32,181 | $ 31,727 |
| As restated | $ 32,661 | $ 32,629 | $ 32,054 |
| Operating expenses: | | | |
| As reported | $ 32,788 | $ 33,193 | $ 33,399 |
| As restated | $ 33,046 | $ 33,641 | $ 33,726 |
| Net loss attributable to common stockholders: | | | |
| As reported | $ (4,243) | $ (4,822) | $ (5,618) |
| As restated | $ (4,243) | $ (4,822) | $ (5,618) |
| Net loss per share basic and diluted: | | | |
| As reported | $ (0.23) | $ (0.26) | $ (0.31) |
| As restated | $ (0.23) | $ (0.26) | $ (0.31) |

The following unaudited condensed quarterly financial data for the four quarters ended December 31, 2002 have been restated as described in Note 2:

| | 2002 | | |
|---|---|---|---|
| | March 31 | June 30 | September 30 |
| | (in thousands, except per share amou | | |

| | | | |
|---|---|---|---|
| Revenues: | | | |
| As reported | $ 29,968 | $ 29,946 | $ 30,195 |
| As restated | $ 29,968 | $ 29,946 | $ 30,195 |
| Net loss attributable to common stockholders: | | | |
| As reported | $ (4,312) | $ (5,239) | $ (3,882) |
| As restated | $ (9,446) | $ (5,239) | $ (3,882) |



| | | | |
|---|---|---|---|
| Net loss per share basic and diluted: | | | |
| As reported | $ (0.24) | $ (0.29) | $ (0.21) |
| As restated | $ (0.52) | $ (0.29) | $ (0.21) |

19. Employee Benefit Plan

The Company maintains a 401(k) defined contribution plan and is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). The Plan provides for the Company to make a discretionary employer matching contribution currently equal to 33% of the first 8% of each participating employees' wages. The employer matching contribution can be made in cash or Company stock, at the Company's discretion. Employer matching contributions totaling $225,667, $233,995 and $256,066 were made for the Plan years ended December 31, 2001, 2002 and 2003, respectively. The employer contribution vests pro-rata over four years. In order to participate in the Plan, employees must have been employed by the Company for at least one year and must have worked at least 1,000 hours during that one year period. In order to receive an employer matching contribution the participant must be employed by the Company at December 31st and must have worked a minimum of 1,000 hours for each applicable Plan year.



THE SPORTS CLUB COMPANY, INC.
VALUATION AND QUALIFYING ACCOUNTS
Three-year period ended December 31, 2003

| Description | Balance at beginning of period | Additions | Deletions |
|---|---|---|---|
| Year ended December 31, 2001: | | | |
| Allowance for doubtful accounts | $ 671,000 | $ 782,000 | $ 1,135,000 |
| Year ended December 31, 2002: | | | |
| Allowance for doubtful accounts | $ 318,000 | $ 798,000 | $ 582,000 |
| Year ended December 31, 2003: | | | |
| Allowance for doubtful accounts | $ 534,000 | $ 684,000 | $ 701,000 |



# PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers and directors and their ages as of June 15, 2004 are as follows:

| Name | Age | Position |
|---|---|---|
| D. Michael Talla...................... | 57 | Chairman of the Board |
| Rex A. Licklider...................... | 61 | Vice Chairman of the Board and Chief Executive Officer |
| Philip J. Swain....................... | 46 | President and Chief Operating Officer |
| Nanette Pattee Francini................ | 55 | Executive Vice President |
| Timothy M. O'Brien.................... | 52 | Chief Financial Officer and Assistant Secretary |
| Mark S. Spino......................... | 49 | Senior Vice President of Development |
| Andrew L. Turner...................... | 57 | Director |
| George J. Vasilakos................... | 66 | Director |
| Charles A. Norris..................... | 58 | Director |
| Christopher M. Jeffries............... | 54 | Director |
| Charles J. Ferraro.................... | 60 | Director |

The following information summarizes the business experience during at least the past five years of each of our executive officers and directors.

D. Michael Talla began developing sports and fitness clubs in 1977 when he co-founded our predecessor non-public company. He has served as Chairman of the Board since the inception of our public company in 1994, and served until July 1999 as our Chief Executive Officer. From February 2000 until March 2004, Mr. Talla held the position of Co-Chief Executive Officer with Mr. Licklider. Since 1978, Mr. Talla has owned Talla Development Company and West Hollywood Development Company, both real estate holding companies with properties in California and Nevada. He has served on the Board of Trustees for the Curtis School in Brentwood, California; West L.A. Little League; For Kids Only Foundation; American Youth Soccer Association and Los Angeles Youth Programs.

Rex A. Licklider has served as Vice Chairman of the Board since 1994 and as Chief Executive Officer since March 2004, having served with Mr. Talla as Co-Chief Executive Officer from February 2000. Previously, Mr. Licklider served as a consultant to us for strategic and financial planning. He founded Com Systems, Inc., a publicly traded long-distance telecommunications company, and at various times between 1975 and April 1992 served as its Chairman, President and Chief Executive Officer. Since January 1993, Mr. Licklider has been a member of the Pentium Group, an entity investing, and often taking a management role, in early stage and turn around/growth businesses. He is a director of The Learning Network, Inc., and Deckers Outdoor Corporation. He also serves on the Board of Directors of The Children's Bureau of Southern California, The Achievable Foundation and For Kids Only Foundation.

Philip J. Swain was appointed President and Chief Operating Officer in April 2003, having been our Senior Vice President of Operations since February 2000. Mr. Swain served as Vice President of Operations from 1994 until his promotion in 2000.

Nanette Pattee Francini began developing sports and fitness clubs in 1977 when she co-founded our predecessor non-public company. She has served as our Executive Vice President and has been responsible for overseeing all Branding/Marketing as well as new concept development since the inception of our public company in 1994. Ms. Francini served on the Board of Directors from 1994 until April 2004. She founded and is Chairman of the Board of Directors of For Kids Only Foundation. In 2003, Ms. Francini received the Golden Star Award from Big Brothers Big Sisters, and in 2004 she accepted the Visionary Award bestowed by the City of Beverly Hills.



Timothy M. O'Brien has been our Chief Financial Officer since February 1995 and since June 1995 has also served as Assistant Secretary. Mr. O'Brien is a Certified Public Accountant.

Mark S. Spino was appointed Senior Vice President of Development in February 2000, having served as Vice President of Development since 1994.

Andrew L. Turner has been a director since 1994. Mr. Turner currently serves as Chairman of the Board for EnduraCare Therapy Management, the nation's largest privately held contract physical therapy company. He serves on the Board of Directors for Watson Pharmaceuticals, Inc., a New York Stock Exchange traded pharmaceutical manufacturing company. From 1989 until August 2000, Mr. Turner served as Chairman and Chief Executive Officer of Sun Healthcare Group, Inc., a New York Stock Exchange traded health care services provider. In October 1999, Sun Healthcare Group, Inc. filed voluntary petitions with the U.S. Bankruptcy Court to reorganize under Chapter 11 of the Federal Bankruptcy Code.

George J. Vasilakos has been a director since June 2002. Since January 1993, Mr. Vasilakos has been a member of the Pentium Group, an entity investing, and often taking a management role, in early stage and turn around/growth businesses. He was a principal and served as the Chief Executive Officer of Golden Tel, the largest payphone provider in Nevada, which was sold in 1998. Currently, Mr. Vasilakos serves as Chief Executive Officer for The Learning Network, Inc., an e-learning company, and DiTronics, LLC, a provider of Automated Teller Machine services. He has served as a member of the Board of Directors and Executive Committee for the long distance industry trade association, COMPTEL, and on the advisory committees for the masters programs in telecommunications at Colorado University and Golden Gate University.

Charles A. Norris was elected to the Board of Directors in August 2002. Mr. Norris currently serves as Chairman of the Board of Directors of Glacier Water Services, Inc. Previously, Mr. Norris was President of McKesson Water Products Company and a Senior Vice President of McKesson Corporation. He is past President and served on the Board of Directors and Executive Committee of the International Bottled Water Association. Mr. Norris is also a member of the Board of Directors of the AEM/DC Sports, a mid sized auto after market company. As part of the sale of the Series D Convertible Preferred Stock in March 2004, we agreed that Kayne Anderson, one of the three principal purchasers of the Series D would be entitled to designate one director to serve on our Board of Directors. Mr. Norris is currently serving as Kayne Anderson's designee pursuant to this agreement.

Christopher M. Jeffries became a member of the Board of Directors in April 2004. Mr. Jeffries has founded, owned and managed several real-estate development companies. He founded Millennium Partners in 1990 to meet the lifestyle demands of affluent urbanites by creating luxury mixed-use properties in the New York marketplace. The Millennium portfolio now includes projects in New York, Boston, Washington D.C., Miami and San Francisco. Mr. Jeffries graduated from Columbia College in 1968 and the University of Michigan Law School in 1972. As part of the sale of the Series D Convertible Preferred Stock in March 2004, we agreed that Millennium has the right to designate two directors (one of whom must be independent) to serve on our Board of Directors. Mr. Jeffries is a principal of Millennium and is currently serving as one of Millennium's two designees pursuant to this agreement.

Charles J. Ferraro became a member of the Board of Directors in April 2004. Mr. Ferraro has been with the Four Seasons Hotels and Resorts since 1980 and currently serves as its Senior Vice President of Operations with operating responsibilities in Texas, California, Hawaii, Washington, Florida, the Caribbean, Mexico, Central America and South America. Mr. Ferraro graduated from Paul Smith's College of Hotel and Restaurant Management. As part of the sale of the Series D Convertible Preferred Stock in March 2004, we agreed that Millennium has the right to designate two directors (one of whom must be independent) to serve on our Board of Directors. Mr. Ferraro meets the criteria of "independent" as defined by the Securities and Exchange Commission and the American Stock Exchange and is serving as Millennium's independent designee pursuant to this agreement.



The rules of the American Stock Exchange generally require that a majority of the directors of a listed company be independent directors, that nominations for members of the Board of Directors must be selected or recommended either by a nominating committee comprised solely of independent directors or by a majority of independent directors on the Board, that the compensation of all officers must be determined or recommended to the Board for determination either by a compensation committee comprised of independent directors or by a majority of the independent directors on the Board and that the Chief Executive Officer may not be present during discussion of his compensation. However, a company in which over 50% of the voting power is held by a "group" (a "Controlled Company") is not required to comply with these general rules.

Rex A. Licklider ("Licklider"), Millennium and Kayne Anderson Capital Advisors, L.P. and its affiliates ("Kayne") own Common Stock and various series of voting Convertible Preferred Stock, which in the aggregate, constitute 63.7% of the voting power of the Company. In connection with their purchase of the Series D Convertible Preferred Stock on March 12, 2004, Licklider, Millennium and Kayne entered into an Investors' Rights Agreement with us, which affords each of them certain consent rights with respect to the operation of our business. In addition, the Investors' Rights Agreement affords each of Licklider and Kayne the right to designate one director and affords Millennium the right to designate two directors, one of whom must be an independent director, in each case so long as certain specified Common Stock ownership thresholds are maintained. As a result of the provisions of the Investors' Rights Agreement, Licklider, Millennium and Kayne are a group that holds over 50% of the voting power of the Company within the meaning of the rules of the American Stock Exchange.

We have determined that we are a Controlled Company and as such we are entitled to take advantage of the exceptions set forth above. Therefore, it is likely that nominations for members of our Board as well as officers' compensation will be determined by the entire Board and not solely by our independent directors.

Both the Securities and Exchange Commission and the American Stock Exchange require that a public company maintain a permanent independent audit committee. The designation of a company as a Controlled Company does not negate this responsibility. The Board has appointed Messrs. Vasilakos, Turner and Norris to the Audit Committee and has charged them with the responsibility of (i) reviewing our annual audit and appointing our independent auditors, and (ii) reviewing our internal controls and financial management practices and (iii) implementing and maintaining procedures for the reporting and treatment of any complaints or concerns regarding accounting matters or otherwise as specified under the Sarbanes-Oxley Act of 2002.

The Board has created two other permanent committees: Compensation and Nominating and Governance. The Compensation Committee, composed of Messrs. Turner, Vasilakos and Norris (Mr. Collins also served on this Committee until his resignation in April 2004), recommends compensation for key-employees, oversees the management bonus program and administers our stock incentive plans. The Nominating and Governance Committee, composed of Messrs. Norris, Vasilakos and Turner, insures that the Board meets its fiduciary responsibilities to our stockholders and that we are in full compliance with standard governance policies and procedures.

Pending adoption by the stockholders at the next annual meeting, the Board of Directors on April 8, 2004, approved an amendment to the our Restated Certificate of Incorporation providing for the annual election of directors. Previously the directors had been divided into three classes with the stockholders electing approximately one-third of the members of the Board of Directors at each annual meeting. If approved, the Amendment would call for the annual election of each member of the Board of Directors, with each Director being elected to serve a one-year term.

In August of 2002, the Board approved certain cash compensation to be paid to non-employee directors. Because of the declared Controlled Company status, in April 2004 the Board modified the plan so that only independent directors were eligible for cash compensation. This action in effect results in Mr. Jeffries, a principal of Millennium, not receiving any cash award. Our independent directors (currently, Messrs. Ferraro, Norris, Turner and Vasilakos) will be paid the following compensation: (i) an annual directorship retainer of $12,000, (ii) an annual committee chair retainer of $4,000, (iii) $1,000 for each Board and committee meeting attended and (iv) an annual option award of 2,000 shares under our 2001 Incentive Stock Plan. All directors are entitled to reimbursement of expenses for attending meetings.

Additionally, in December 2002, the Board created a special committee and in recognition of the added responsibilities and demands of the work to be performed by this committee, its members will receive additional compensation of: (i) $1,000 for each meeting of the special committee attended in person, (ii) $500 for each telephonic meeting, and (iii) $1,000 for each day committee members devote a material portion of their business day to the affairs of the committee.

Section 16(a) Beneficial Ownership Reporting Compliance

Under Section 16(a) of the Securities Exchange Act of 1934 our directors, executive officers and any persons holding more than 10% of our Common Stock (who we refer to as "Reporting Persons") are required to report their initial ownership and any subsequent changes in that ownership to the Securities and Exchange Commission. Such Reporting Persons are also required to furnish us with copies of all Section 16(a) forms they file. Specific due dates for these reports have been established and we are required to identify all Reporting Persons who failed to timely file these reports.

To our knowledge, based solely on review of copies of such reports furnished to us and written representations that no other reports were required, during the fiscal year ended December 31, 2003, all the Reporting Persons complied with applicable filing requirements, except:

D. Michael Talla, a director and executive officer, did not timely file a Form 4 relating to a March 18, 2003 transaction.

Rex A. Licklider, a director and executive officer, did not timely file a Form 4 relating to an April 8, 2003 transaction.

Philip J. Swain, an executive officer, did not timely file a Form 4 relating to an April 8, 2003 transaction.

Millennium did not timely file Forms 4 with respect to various transactions that occurred in 2001 and 2002.

Each party subsequently filed the required report.



Code of Ethics

We have drafted a written code of ethics that applies to our principal executive officers, principal financial officer, principal accounting officer and other persons performing similar functions. This code of standards fulfills the requirements recently imposed by the Securities and Exchange Commission and covers such topics as conflict of interest, confidentiality, compliance with legal requirements and other business ethics subjects. We have also drafted a Code of Business Conduct for members of our Board of Directors. This code of conduct seeks to guide our Board members in (i) recognizing and dealing with ethical issues, (ii) fulfilling their fiduciary and oversight responsibilities and (iii) establishing and maintaining mechanisms for reporting by our employees of unethical conduct. Once approved, we intend to post these codes on our website www.thesportsclubla.com in connection with our investor relations materials. We further intend to promptly disclose on our website (i) the nature of any amendment to these codes and (ii) the nature of any waiver, including an implicit waiver, from a provision of our codes that is granted, the name of such person who is granted the waiver and the date of the waiver. We presently rely on the written policies in our Employee Handbook, as well as informal policies and procedures, our directors' awareness of their fiduciary duties and our employees' understanding of their responsibilities to the Company and our shareholders to fulfill our duties as a public company. These policies may not adequately protect us from all conflict of interest situations; therefore, it is our intention in addition to the code of financial conduct and the code of business conduct to also adopt: (i) corporate governance principles that will establish oversight responsibilities for the conduct of our business and (ii) a code of standards that will expand our current Employee Handbook and define how all employees and directors will act in areas of professional conduct.

To demonstrate our commitment to operating fairly and ethically, we currently require that each employee acknowledge receipt of our Employee Handbook, which sets forth, among other things, our professional standards requiring proper business conduct and confidentiality of proprietary information. We are in the process of finalizing a contract with an independent outside hotline provider to implement an anonymous avenue for the reporting of employee concerns relating to our financial reporting.

ITEM 11. EXECUTIVE COMPENSATION

The table below shows, for the last three fiscal years, the amount of compensation earned by the Chairman, the Chief Executive Officer and the next four most highly-compensated executive officers (the "Named Executive Officers"). The current salaries of such executive officers are described below under "Employment Agreements."

| | | Annual Compensation | | Long-Term Compensation | |
|---|---|---|---|---|---|
| Name & Position | Year | Salary($) | Bonus($) | Shares Underlying Options Awards | C |
| D. Michael Talla.......... | 2003 | 200,000(b) | -- | -- | |
| Chairman of the Board | 2002 | 200,000(b) | -- | -- | |
| | 2001 | 240,000(b) | -- | 115,000 | |
| Rex A. Licklider.......... | 2003 | 200,000 | -- | -- | |
| Chief Executive Officer and | 2002 | 200,000 | -- | -- | |
| Vice Chairman of the Board | 2001 | 240,000 | -- | 115,000 | |
| Philip J. Swain........... | 2003 | 160,000 | -- | -- | |
| President and | 2002 | 160,000 | 20,000 | -- | |

| | | | | |
|---|---|---|---|---|
| Chief Operating Officer | 2001 | 200,000 | -- | 21,733 |
| Nanette Pattee Francini... | 2003 | 160,000 | -- | -- |
| Executive Vice President | 2002 | 160,000 | 20,000 | -- |
| | 2001 | 200,000 | -- | 21,733 |
| Mark S. Spino............. | 2003 | 160,000 | -- | -- |
| Senior Vice President of | 2002 | 160,000 | 20,000 | -- |
| Development | 2001 | 200,000 | -- | 21,733 |
| Timothy M. O'Brien........ | 2003 | 160,000 | -- | -- |
| Chief Financial Officer | 2002 | 160,000 | 20,000 | -- |
| and Assistant Secretary | 2001 | 200,000 | -- | 21,733 |

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(a) Represents value of (i) amounts paid by us on behalf of the Named Executive Officer and dependents for medical and life insurance and (ii) our Common Stock contributed for the benefit of the Named Executive Officer under the 401K Profit Sharing Plan, based upon the December 31 closing market price each year of our Common Stock, on the American Stock Exchange.

(b) Mr. Talla also receives, on an annual basis, 49.9% of the first $300,000 of The Sports Club/LA - Los Angeles' net cash flow. This amount is not included in Mr. Talla's compensation. See "Certain Relationships and Related Transactions."

Option Grants, Exercises and Year-End Values

There were no option grants made to any Named Executive Officer during the last fiscal year.

Unexercised Stock Options and Fiscal Year-End Option Values

None of the Named Executive Officers exercised stock options during the last fiscal year. The following table provides information with respect to unexercised stock options outstanding as of December 31, 2003.

| | Number of Shares Underlying Unexercised Options at Fiscal Year-End(a) | | Value of In-the-Money Unexercised Options at Fiscal Year-End(b) | |
|---|---|---|---|---|
| Name | Exercisable (#) | Unexercisable (#) | Exercisable ($) | Unexercisable ($) |
| D. Michael Talla........ | 326,667 | 38,333 | -0- | -0- |
| Rex A. Licklider........ | 76,667 | 38,333 | -0- | -0- |
| Philip J. Swain......... | 212,756 | 7,244 | -0- | -0- |
| Nanette Pattee Francini. | 202,756 | 7,244 | -0- | -0- |
| Mark S. Spino........... | 202,756 | 7,244 | -0- | -0- |
| Timothy M. O'Brien...... | 232,756 | 7,244 | -0- | -0- |

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(a) All options were granted pursuant to one of our two Stock Incentive Plans.

(b) The closing price of our Common Stock on the American Stock Exchange on December 31, 2003 was $1.81. Since all options have been granted at prices above $1.81, there are no options considered to be in-the-money.

Employment Agreements

The Company has no written employment agreements. Currently, our executive officers receive the following salaries:

| | | |
|---|---|---|
| Rex A. Licklider | Chief Executive Officer | 200,000 |
| Philip J. Swain | President and Chief Operating Officer | 180,000 |
| Nanette Pattee Francini | Executive Vice President | 160,000 |
| Mark S. Spino | Senior Vice President | 160,000 |
| Timothy M. O'Brien | Chief Financial Officer | 160,000 |

On March 16, 2004, D. Michael Talla, founder and Chairman of the Board, relinquished his position as Co-Chief Executive Officer. In light of this change, the Compensation Committee is reviewing Mr. Talla's current salary package and is expected to present their recommendations for future compensation based solely on services rendered as Chairman at the next meeting of our Board of Directors. Until our Board makes this determination, Mr. Talla will continue to receive his current annual salary of $200,000.



Compensation of Directors

Our independent directors receive the following compensation:

- Annual retainer fee of $12,000,
- Annual retainer fee of $4,000 for each committee chair,
- $1,000 for each Board and committee meeting attended,
- Reimbursement of expenses for attending Board and committee meetings,
- Annual option award of 2,000 shares under our 2001 Incentive Stock Plan (timing of such grant is at the discretion of the Board, and as of June 15, 2004 no option awards have been granted).

Messrs. Turner, Vasilakos, Norris and Ferraro currently serve on the Board as independent directors. Prior to April 2004, compensation for services on the Board was given to non-employee directors. Therefore, Mr. Licklider received amounts due non-employee directors until his appointment to Co-Chief Executive Officer in February 2000; and until his resignation in June 2002, Mr. Dennison T. Veru also received amounts due non-employee directors. From 2001 through his resignation in 2004, Mr. Collins, because of his executive position with Millennium, waived all cash compensation. All directors receive reimbursement of reasonable out-of-pocket expenses incurred in connection with meetings of the Board.

In December 2002, Messrs. Turner and Vasilakos were appointed to a special committee, and in recognition of the added responsibilities and demands of the work to be performed by them, Messrs. Turner and Vasilakos are to receive the following additional compensation: $1,000 for each meeting of the special committee attended in person, $500 for each telephonic meeting and $1,000 per day on which they devote a material portion of their business day to the affairs of the committee.

Following are the amounts paid to all directors for each of the last three years:

| Year | Amount |
|---|---|
| 2001 | $ 56,863 |
| 2002 | 68,502 |
| 2003 | 112,675 |

Under the Amended and Restated 1994 Stock Compensation Plan an aggregate of 50,000 shares of Common Stock was issued to non-employee directors through December 31, 2003. There are no more shares available for issuance under this current plan.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee of the Board (the "Committee") administers executive compensation. Mr. Turner has been a member of the Committee since September 13, 1994, and became its Chairman on February 27, 1995. Mr. Vasilakos was appointed on August 2, 2002 following the resignation of Dennison Veru. Mr. Norris was appointed to the Committee on February 25, 2003. Mr. Collins had been a member of the Committee from 1998 until his resignation in April 2004. None of these individuals has ever been an officer or employee.



ITEM 12. SECURITIES OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table shows the shares of our Common Stock beneficially owned as of June 15, 2004 by our directors and Named Executive Officers. It also shows other individuals or entities that beneficially owned more than 5% of our Common Stock.

| Name and Address of Beneficial Owner(a) | Shares Owned Directly (b) | Shares Issuable Upon Conversion of Preferred Stock | Shares Issuable upon Exercise of Options within 60 days(c) | Shares Hel Under 401-K Plan(d) |
|---|---|---|---|---|
| D. Michael Talla (e).................. | 4,629,019 | 346,365 | 365,000 | 8,126 |
| Nanette Pattee Francini (e)........... | 256,107 | -- | 210,000 | 4,086 |
| Mark S. Spino (e)..................... | 227,969 | -- | 210,000 | 6,030 |
| Philip J. Swain (e)................... | 112,164 | -- | 220,000 | 6,002 |
| Voting Trust (e)...................... | 5,225,259 | 346,365 | 1,005,000 | 24,244 |
| Timothy O'Brien....................... | 3,000 | -- | 240,000 | 6,242 |
| The Licklider Living Trust Dated May 2, 1986 .................. | 2,055,132 | 1,192,730 | 115,000 | -- |
| Andrew L. Turner...................... | 7,500 | -- | -- | -- |
| Charles A. Norris(f).................. | 3,500 | 173,183 | -- | -- |

| | | | | |
|---|---|---|---|---|
| George J. Vasilakos.................. | 327,400 | -- | -- | -- |
| Christopher M. Jeffries (g).......... | 29,000 | -- | -- | -- |
| Charles J. Ferraro................... | -- | -- | -- | -- |
| All Directors and Executive Officers as a Group (11 persons)................. | 7,650,791 | 1,712,278 | 1,360,000 | 30,486 |
| Millennium (g)....................... | 6,243,749 | 2,942,730 | -- | -- |
| Kayne Anderson Capital Advisors, L.P. (f).................................. | 797,128 | 4,136,833 | -- | -- |

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* Less than 1%

(a) The address of all directors and executive officers is c/o The Sports Club Company, Inc., at 11100 Santa Monica Blvd., Suite 300, Los Angeles, California 90025.

(b) Includes shares for which the named person is considered the owner because:
1. the named person has sole voting and investment power,
2. the named person's spouse has voting and investment power, or
3. the shares are held by other members of the named person's immediate family.

(c) Includes shares that can be acquired through stock option exercises through August 14, 2004.

(d) Includes shares issued pursuant to our 401(k) Profit Sharing Plan's discretionary match as of June 15, 2004.

(e) Named persons share voting power pursuant to a voting agreement that requires each party to vote his or her shares in the manner determined by a majority of all holders. The agreement is effective until October 20, 2004, or until terminated by persons holding 66 2/3% of the shares of our Common Stock subject to the agreement. Each of the parties to the voting agreement effectively controls the voting of all shares held by the parties to the agreement, and, under SEC rules, are deemed beneficial owners of the shares subject to the agreement.

(f) Kayne Anderson Capital Advisors, L.P. and several of their affiliates are owners of our Convertible Preferred Stock. Kayne Anderson is deemed to be the beneficial owner of the shares. Mr. Norris is also deemed to beneficially hold these shares because of his affiliation with Kayne Anderson. Mr. Norris' ownership has therefore been reflected (1) next to his name so that the table accurately reflects the share ownership of our officers and directors and (2) in the totals for Kayne Anderson so that the Kayne Anderson total accurately reflects their joint ownership as noted below. The address of all such entities is 1800 Avenue of the Stars, Second Floor, Los Angeles, California 90067.

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The Preferred Stock carries voting rights and is convertible into shares of Common Stock. The following table reflects the ownership of the Kayne affiliates as to outstanding Common Stock currently owned and Common Stock into which the preferred shares are convertible:

| Owner | Outstanding Common Directly Held | Series B Convertible Preferred | Series D Convertible Preferred | Total |
|---|---|---|---|---|
| Kayne Anderson Capital Advisors, L.P............ | 793,628 | 3,073,990 | -- | 3,867,618 |
| Ric Kayne...................... | -- | 346,365 | -- | 346,365 |
| Charles Norris................. | 3,500 | 173,183 | -- | 176,683 |
| Howard Zelikow................. | -- | 34,636 | -- | 34,636 |
| David Shladovsky............... | -- | 8,659 | -- | 8,659 |
| Arbco Associates, L.P.......... | -- | -- | 166,668 | 166,668 |
| Kayne Anderson Non-Traditional Investments, L.P. | -- | -- | 166,666 | 166,666 |
| Kayne Anderson Select Investments A, L.P.... | -- | -- | 166,666 | 166,666 |
| Total..................... | 797,128 | 3,636,833 | 500,000 | 4,933,961 |

(g) Millennium Entertainment Partners and several of their affiliates are owners of our Common and our Preferred Stock. Millennium is deemed to be the beneficial owner of the shares. Mr. Jeffries because of his position with Millennium is also deemed to be a beneficial owner of these shares. Mr. Jeffries' ownership has therefore been reflected (1) next to his name so that the table accurately reflects the share ownership of our officers and directors, and (2) in the totals for Millennium so that the Millennium total accurately reflects their joint ownership as noted below. The address of all such entities is c/o Millennium Partners Management LLC, 1995 Broadway, New York, New York, 10023.

The Preferred Stock carries voting rights and is convertible into shares of Common Stock. The following table reflects the ownership of the Millennium affiliates as to outstanding Common Stock currently owned and Common Stock into which the preferred shares are convertible:

| Owner | Outstanding Common Directly Held | Series C Convertible Preferred | Series D Convertible Preferred | Total |
|---|---|---|---|---|
| Christopher M. Jeffries... | 29,000 | -- | -- | 29,000 |
| Millennium Partners LLC... | 2,253,863 | -- | -- | 2,253,863 |
| Millennium Development Partners L.P............. | 978,900 | -- | -- | 978,900 |
| MDP Ventures I LLC........ | 72,100 | -- | -- | 72,100 |
| MDP Ventures II LLC....... | 2,284,886 | 692,730 | 2,250,000 | 5,227,616 |
| Millennium Entertainment Partners L.P............. | 625,000 | -- | -- | 625,000 |
| | 6,243,749 | 692,730 | 2,250,000 | 9,186,479 |

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

From time to time we have entered into transactions with our officers, directors and stockholders. We believe that each of the following transactions have been on terms no less favorable to us than could have been obtained from unaffiliated third parties. All transactions between us and any of our directors or officers are subject to the approval of the disinterested directors.

Millennium. Millennium is a partner in the Reebok-Sports Club/NY partnership as well as the landlord of the building in which Reebok Sports Club/NY is located. Reebok-Sports Club/NY partnership pays rent to Millennium in the amount of $2.0 million per year, and the partnership agreement provides for a first priority annual distribution of $3.0 million to Millennium. We are entitled to certain additional priority distributions and 60% of the remaining cash flow. Millennium's partnership interest entitles them to 20% of such remaining cash flow.

In June 1997, we issued to Millennium 2,105,263 shares of our Common Stock in exchange for $10.0 million. In December 1997, we sold 625,000 shares of Common Stock to Millennium for $5.0 million. We also granted to Millennium certain registration and preemptive rights regarding its shares.

We have entered into leases with Millennium relating to The Sports Club/LA - San Francisco, The Sports Club/LA - Washington, D.C. and The Sports Club/LA - Boston. On March 27, 2001, the leases were amended with Millennium's landlord contribution increasing by $16.5 million in exchange for additional rent payments. In addition, after we receive a management fee equal to 6% of all revenues, an amount equal to our capital investment in the Boston and Washington D.C. Clubs and an 11% annual return on the capital investment and an amount equal to our operating investment in the Clubs and a 10% annual return on the operating investment, Millennium is entitled to receive a percentage of all additional cash flows from each Club as additional rent. Millennium's percentage of the excess cash flow, as defined, previously was 20% for each of these Clubs. Under the amended lease agreements, their percentage increases to 25% for the Washington and Boston Clubs and 60% for the San Francisco Club. Millennium has not received any payments to date under these provisions.

On November 24, 2003, we opened The Sports Club/LA - Miami as part of the exclusive new Four Seasons Hotel and Tower in Miami, Florida. We operate this 40,000 square foot Club pursuant to a management agreement with Millennium, the developer of the project. We will receive a fee of 6% of gross revenues and a participation in the Club's net cash flow.

Mr. Talla. We have a 50.1% interest in the partnership that owns The Sports Club/LA - Los Angeles and Mr. Talla beneficially owns the remaining 49.9%. The partnership agreement provides that, on an annual basis, the partners will share in the first $300,000 of the Club's net cash flow in proportion to their percentage interests. The next $35.0 million of annual net cash flow will be distributed to us. All distributions of net cash flow thereafter, if any, will be made to the partners in proportion to their percentage interests. The Company has the option to redeem the preferred partnership interest in the partnership held by Mr. Talla. The option expires as of January 31, 2006. The preferred partnership interest is carried at its redemption amount, which is $600,000 at December 31, 2003.

As of May 4, 2001, we entered into a ten-year sublease for space located in the building in which The Sports Club/LA - Upper East Side is located. The sublease provides for two five-year renewal options and one seven-year renewal option, an initial monthly rent of $125,000, and rental increases of 10% at the end of each five-year period. The subtenant for this lease is Club at 60th Street, Inc., a New York corporation owned by Mr. Talla.

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Messrs. Talla and Licklider. In September 1999, we sold the property on which the Spectrum Club - Thousand Oaks is located for a sales price of $12.0 million. We entered into a sale and leaseback agreement for the property under a long-term lease with an initial annual base rent of $1.3 million. The Thousand Oaks property consists of the Spectrum Club - Thousand Oaks, a SportsMed facility, unimproved office space, and a parking ramp. We are currently subleasing the Spectrum Club space to another club operator. Mr. Licklider owns an approximate 4.6% interest in the purchaser of the property, and trusts for the benefit of Mr. Talla's minor children own an approximately 5.2% interest in the purchaser of the property.

Kayne Anderson. On March 18, 2002, we sold an aggregate of 10,500 shares of Series B Convertible Preferred Stock to Kayne Anderson Capital Advisors and four affiliates thereof for aggregate offering proceeds of $10.5 million. The shares of Series B Preferred may, at the option of the holder, be converted into shares of our Common Stock at a rate of $2.8871 per share; entitle each holder to one vote for each share of Common Stock into which such Series B Preferred could then be converted; and provide for the payment of dividends at an annual rate of $90.00 per share. Dividends are cumulative, do not accrue interest and, at our discretion, may be paid in additional shares of Series B Preferred.

Messrs. Talla and Licklider and Millennium. In consideration of executing a guaranty in favor of Comerica-Bank - California (the "Bank") in connection with the Bank's renewal of our $15.0 million credit facility (the "Credit Facility"), Messrs. Talla and Licklider and MDP Ventures II, LLC, an affiliate of Millennium, entered into agreements with us as of July 3, 2001, pursuant to which we were obligated to pay an 1% percent annual commitment fee to each of the guarantors. In addition to the commitment fee, we were obligated to pay to each guarantor a usage fee equal to 2% per annum of such guarantor's pro rata portion of any amounts advanced to us by the Bank. At our discretion all earned commitment fees and usage fees under the agreements were paid in restricted shares of Common Stock with each guarantor receiving in the aggregate 86,392 shares. In June 2003, we replaced the Credit Facility and, as of February 15, 2004, all payment obligations due the guarantors have been met.

Upon termination of the Credit Facility, on June 12, 2003, we entered into a new promissory note with another financial institution. The new note is for $20.0 million (the "Loan") and is guaranteed by Messrs. Talla and Licklider. Messrs. Talla and Licklider entered into agreements with us as of December 1, 2003, pursuant to which we are obligated to pay a quarterly fee to each guarantor equal to 3% per annum of their pro rata portion of the average outstanding principal balance of the Loan. At our discretion, such fees may be paid in Common Stock, cash or a combination thereof. The third quarter 2003 fee was paid in stock with each guarantor receiving 28,509 shares. On May 20, 2004, we paid the fourth quarter 2003 and the first quarter 2004 fees in Common Stock and each guarantor received 80,269 shares. These obligations have been funded out of Treasury Shares.

On September 6, 2002, we sold an aggregate of 5,000 shares of Series C Convertible Preferred Stock to three of our major shareholders, D. Michael Talla, Rex Licklider and MDP Ventures II, LLC, an affiliate of Millennium, for aggregate offering proceeds of $5.0 million. The shares of Series C Preferred may, at the option of the holder, be converted into shares of our Common Stock at a rate of $2.8871 per share; entitle each holder to one vote for each share of Common Stock into which such Series C Preferred could then be converted; and provide for the payment of dividends at an annual rate of $90.00 per share. Dividends are cumulative, do not accrue interest and, at our discretion, may be paid in additional shares of Series C Preferred.



Mr. Licklider , Millennium and Kayne Anderson. On March 12, 2004, we sold an aggregate of 65,000 shares of Series D Convertible Preferred Stock to these three shareholders for aggregate proceeds of $6.5 million. The shares of Series D Preferred may, at the option of the holders, be converted into shares of our Common Stock at a rate of $2.00 per share; entitle each holder to one vote for each share of Common Stock into which such Series D Preferred could then be converted; and provide for the payment of dividends at an annual rate of $9.00 per share. Dividends are cumulative, do not accrue interest and, at our discretion, may be paid in additional shares of Series D Preferred. Each share of Series D Preferred shall automatically be converted into shares of Common Stock upon the consummation of a qualified secondary stock offering of at least $50.0 million or if the closing price of our Common Stock for a period of thirty consecutive trading days exceeds $4.00 per share until March 15, 2005, or $6.00 per share thereafter, and at least 150,000 shares of Common Stock have been traded during such applicable thirty day period. As part of the sale of the Series D Preferred, we agreed that for so long as certain specified Common Stock ownership is maintained, Mr. Licklider and Kayne Anderson each have the right to designate one director and Millennium has the right to designate two directors, one of whom must be independent. Pursuant to this agreement, Mr. Licklider is currently serving as the designee of Mr. Licklider; Mr. Norris is currently serving as the designee of Kayne Anderson and Messrs. Jeffries and Ferraro (an independent board member) are currently serving as Millennium's designees.



PART IV

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

We were billed for the following services provided by KPMG LLC, our principal independent accountants, during 2002 and 2003:

| | 2002 | 2003 |
|---|---|---|

| | | |
|---|---|---|
| Audit fees(1) | $ 129,500 | $ 161,500 |
| Audit related fees | 3,000 | 3,000 |
| Tax fees | -- | -- |
| All other fees | -- | -- |
| Total | $ 132,500 | $ 164,500 |

(1) Audit fees include fees for (i) the audits of the Company's consolidated financial statements, (ii) review of the unaudited condensed consolidated interim financial statements included in quarterly reports and (iii) the review of debt agreements and issuance of compliance letters.

The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by the independent accountants. These services may include audit services, audit-related services, tax services, and other services. Pre-approval is generally provided for up to one year and is detailed as to the particular service or category of services. The Audit Committee may also pre-approve particular services on a case-by-case basis. The Audit Committee pre-approved 100% of the audit fees for the fiscal year ended December 31, 2003.

The Audit Committee determined that the provision of services discussed above is compatible with maintaining the independence of KPMG LLC from the Company.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) Financial Statements filed as part of this Report are listed in Item 8 of this Report.

(2) No other financial schedules have been included because they are not applicable, not required or because required information is included in the consolidated financial statements or notes thereto.

(3) The following exhibits are filed as part of this Report.

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
|---|---|---|---|---|
| 3.1 | Restated Certificate of Incorporation of the Registrant. | S-1 | 33-79552 | 10/ |
| 3.2 | Bylaws of the Registrant. | S-1 | 33-79552 | 10/ |
| 3.3 | Amendment to Bylaws dated February 1, 1995. | 10-K/A | 1-13290 | 10/ |
| 3.4 | Certificate of Designation of Series B Convertible Preferred Stock of the Registrant. | 8-K | 1-13290 | 03/ |

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
|---|---|---|---|---|
| 3.5 | Corrected Certificate of Designation of Series B Convertible Preferred Stock of the Registrant. | 8-K | 1-13290 | 09/ |
| 3.6 | Certificate of Designation of Series C Convertible Preferred Stock of the Registrant. | 8-K | 1-13290 | 09/ |
| 3.7 | Amendment No. 2 to Bylaws dated July 21, 1999. | 10-K | 1-13290 | 03/ |
| 3.8 | Certificate of Designation of Series D Convertible Preferred Stock of the Registrant | 8-K | 1-13290 | 03/ |
| 4.1 | Specimen Common Stock Certificate. | S-1 | 33-79552 | 10/ |
| 4.2 | Rights Agreement by and between the Registrant and American Stock Transfer & Trust dated as of October 6, 1998. | 8-K | 1-13290 | 10/ |
| 4.3 | First Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of February 18, 1999. | 8-K | 1-13290 | 03/ |
| 4.4 | Indenture by and among Registrant, U.S. Bank Trust National Association and the Subsidiary Guarantors referred to therein, dated as of April 1, 1999. | 8-K | 1-13290 | 04/ |
| 4.5 | Registration Rights Agreement by and among the Registrant, Jeffries & Company, Inc. and CIBC Oppenheimer Corp., dated as of April 1, 1999. | 8-K | 1-13290 | 04/ |
| 4.6 | Purchase Agreement by and among the Registrant, Jeffries & Company, Inc. and CIBC Oppenheimer Corp., dated March 29, 1999. | 8-K | 1-13290 | 04/ |
| 4.7 | Second Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of July 2, 1999. | 10-K | 1-13290 | 03/ |

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
| --- | --- | --- | --- | --- |
| 4.8 | Third Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust made and entered into as of April 27, 2000. | 10-K | 1-13290 | 03/ |
| 4.9 | Fourth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of June 27, 2001. | 8-K | 1-13290 | 07/ |
| 4.10 | Fifth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of September 6, 2002. | 8-K | 1-13290 | 09 |
| 4.11 | Sixth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of March 5, 2003. | 10-K | 1-13290 | 03/ |
| 4.12 | Seventh Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of April 14, 2003. | 8-K | 1-13290 | 04/ |
| 4.13 | Eighth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of May 30, 2003. | 8-K | 1-13290 | 06/ |
| 4.14 | Ninth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of July 30, 2003. | 8-K | 1-13290 | 07/ |
| 4.15 | Tenth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of September 30, 2003. | 8-K | 1-13290 | 10/ |

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| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
| --- | --- | --- | --- | --- |
| 4.16 | Eleventh Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered | 8-K | 1-13290 | 12/ |

| | | | | |
|---|---|---|---|---|
| | into as of November 25, 2003. | | | |
| 4.17 | Twelfth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of March 3, 2004. | 8-K | 1-13290 | 03/ |
| 4.18 | Thirteenth Amendment to Rights Agreement by and between the Registrant and American Stock Transfer & Trust entered into as of March 10, 2004. | 8-K | 1-13290 | 03/ |
| 9.1 | Voting Agreement among D. Michael Talla, Nanette Pattee Francini, Mark S. Spino, Peter Feinstein, Philip J. Swain and FP II. | S-1 | 33-79552 | 10/ |
| 10.1 | 1994 Stock Incentive Plan. # | S-1 | 33-79552 | 10/ |
| 10.2 | Form of Stock Option Agreement. # | S-1 | 33-79552 | 10/ |
| 10.3 | Form of Stock Purchase Agreement. # | S-1 | 33-79552 | 10/ |
| 10.4 | 1994 Stock Compensation Plan. # | S-1 | 33-79552 | 10/ |
| 10.5 | Form of Indemnification Agreement between the Registrant and its directors and certain officers. | S-1 | 33-79552 | 10/ |
| 10.6 | Indemnification Agreement between the Registrant and D. Michael Talla. | S-1 | 33-79552 | 10/ |
| 10.7 | Indemnification Agreement between Registrant and Rex A. Licklider. | S-1 | 33-79552 | 10/ |
| 10.8 | Lease of premises for Reebok Sports Club/NY located at 160 Columbus Avenue, New York 10023 dated June 3, 1992. | S-1 | 33-79552 | 10/ |
| 10.9 | Management Agreement effective as of June 3, 1992, between R-SC/NY, Ltd. and Pontius Realty, Inc. | S-1 | 33-79552 | 10/ |



| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
|---|---|---|---|---|
| 10.10 | License Agreement between Reebok Fitness Centers, Inc. and R-SC/NY, Ltd. dated June 3, 1992. | S-1 | 33-79552 | 10/ |

| | | | | |
|---|---|---|---|---|
| 10.11 | Letter Agreement regarding R-SC/NY dated June 3, 1992. | S-1 | 33-79552 | 10/ |
| 10.12 | Memorandum of Agreement between Reebok Fitness Centers, Inc. and the Company dated as of June 3, 1992. | S-1 | 33-79552 | 10/ |
| 10.13 | Seventh Amendment and Restated Agreement of Limited Partnership of L.A./Irvine Sports Club, Ltd., a California Limited Partnership, dated as of October 12, 1994. | S-1 | 33-79552 | 10/ |
| 10.14 | First Amendment to Seventh Amended and Restated Agreement of Limited Partnership of L.A./Irvine Sports Club, Ltd., a California Limited Partnership, dated as of October 12, 1994. | S-1 | 33-79552 | 10/ |
| 10.15 | Form of Option Agreement by and between D. Michael Talla, an individual, TTO Partners, a California Limited Partnership, and Sports Club, Ltd., a California Corporation, relating to L.A./Irvine Sports Club, Ltd., a California Limited Partnership. | S-1 | 33-79552 | 10/ |
| 10.16 | Amended and Restated Agreement of Limited Partnership of TTO Partners, a California Limited Partnership, dated June 30, 1992, as amended January 1, 1993, January 4, 1993 and February 12, 1994 and as assigned January 1, 1993. | S-1 | 33-79552 | 10/ |
| 10.17 | First Amended and Restated Agreement of Limited Partnership of Reebok-Sports Club/NY, Ltd. Dated as of October 12, 1994. | S-1 | 33-79552 | 10/ |
| 10.18 | Letter Agreement by and between Reebok Fitness Centers, Inc. and the Company dated October 12, 1994. | S-1 | 33-79552 | 10/ |



| Exhibit | | Incorporated by Reference | | |
|---|---|---|---|---|
| Number | Exhibit Description | Form | File No. | Fili |
| 10.19 | Amendment to First Amended and Restated Agreement of Limited | S-1 | 33-79552 | 10/ |

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|---|---|---|---|---|
| | Partnership of Reebok-Sports Club/NY, Ltd. dated as of October 12, 1994. | | | |
| 10.20 | Letter Agreement by and between Reebok Fitness Centers, Inc. and the Company, which became effective on October 29, 1994. | S-1 | 33-79552 | 10/ |
| 10.21 | License Agreement by and between Reebok Fitness Centers, Inc. and the Company, which became effective on October 20, 1994. | S-1 | 33-79552 | 10/ |
| 10.22 | Agreement by and among Reebok-Sports Club/NY Ltd., Talla New York, Inc., RFC, Inc., LMP Health Club Co., Millennium Entertainment Partners, L.P. and Registrant dated as of December 30, 1996. | 10-K/A | 1-13290 | 10/ |
| 10.23 | Letter Agreement between Millennium Entertainment Partners, L.P. and the Registrant dated as of March 13, 1997. | 10-K/A | 1-13290 | 10/ |
| 10.24 | First Amendment to Option Agreement between D. Michael Talla and TTO Partners dated May 27, 1997. | 10-K | 1-13290 | 02/ |
| 10.25 | Amendment of Lease between Lincoln Metrocenter Partners, L.P. and Reebok-Sports Club/NY Ltd. as of January 31, 1998. | 10-K | 1-13290 | 02/ |
| 10.26 | Lease Agreement between RCPI Trust and the Registrant as of February 27, 1998. | 10-K | 1-13290 | 03/ |
| 10.27 | Amended and Restated Net Operating Lease among Hirschfeld Realty Club Corporation and 328 E. 61 Corp., and Vertical Fitness and Racquet Club, Ltd., dated March 26, 1985. | 10-K | 1-13290 | 03/ |



| Exhibit | | Incorporated by Reference | | |
|---|---|---|---|---|
| Number | Exhibit Description | Form | File No. | Fili |
| 10.28 | Lease Modification Agreement by and among Hirschfeld Realty Corporation and 328 E. 61 Corp., and Vertical Fitness and Racquet Club, Ltd., dated July 1, 1990. | 10-K | 1-13290 | 03/ |

| | | | | |
|---|---|---|---|---|
| 10.29 | Assignment and Assumption of Lease by and between Vertical Fitness and Racquet Club, Ltd., and Bally Entertainment Corporation dated January 8, 1996. | 10-K | 1-13290 | 03/ |
| 10.30 | Assignment of Lease executed by Hilton Hotels Corporation, as successor to tenant, and agreed to and accepted by the Registrant, dated April 15, 1998. | 10-K | 1-13290 | 03/ |
| 10.31 | Second Amendment to Amended and Restated Net Operating Lease by and among Hirschfeld Realty Club Corporation and 328 E. 61 Corp., and the Registrant dated April 15, 1998. | 10-K | 1-13290 | 03/ |
| 10.32 | Note Payable issued by the Registrant to Hilton Hotels Corporation dated April 15, 1998. | 10-K | 1-13290 | 03/ |
| 10.33 | Amended and Restated 1994 Stock Incentive Plan as of June 2, 1998. # | 10-K | 1-13290 | 03/ |
| 10.34 | Letter Agreement between the Registrant and Millennium Partners LLC dated as of October 27, 1998. | 10-K | 1-13290 | 03/ |
| 10.35 | First Amendment to Lease between RCPI Trust and the Registrant dated October 30,1998. | 10-K | 1-13290 | 03/ |
| 10.36 | Second Amendment to Lease between RCPI Trust and the Registrant dated March 4, 1999. | 10-K | 1-13290 | 03/ |
| 10.37 | Lease between CB-1 Entertainment Partners LP and S.F. Sports Club, Inc. dated June 1, 1997. | 10-K | 1-13290 | 03/ |
| 10.38 | Lease between 2200 M Street LLC and Washington D.C. Sports Club, Inc. dated March 1999. | 10-K | 1-13290 | 03/ |

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| Exhibit | | Incorporated by Reference | | |
|---|---|---|---|---|
| Number | Exhibit Description | Form | File No. | Fili |
| 10.39 | Fourth Amended and Restated Loan Agreement by and among the Registrant, certain of its subsidiaries and Comerica Bank-California, dated April 1, 1999. | 8-K | 1-13290 | 04/ |
| 10.40 | Intercreditor Agreement by and among the Registrant, certain of its subsidiaries, Comerica | 8-K | 1-13290 | 04/ |

| | | | | |
|---|---|---|---|---|
| | Bank-California and U.S. Bank Trust National Association, dated April 1, 1999. | | | |
| 10.41 | Amended and Restated 1994 Stock Compensation Plan. # | 10-K | 1-13290 | 03/ |
| 10.42 | Lease Agreement as of September 24, 1999 between The Spectrum Club Company, Inc. and West Hollywood Property Limited Partnership and 2400 Willow Lane Associates Limited Partnership. | 10-K | 1-13290 | 03/ |
| 10.43 | Lease Agreement as of November 5, 1999 by and between New Commonwealth Center Limited Partnership and Washington D.C. Sports Club, Inc. | 10-K | 1-13290 | 03/ |
| 10.44 | Letter Agreement dated March 11, 1999 amending the October 27, 1998 Letter Agreement between the Registrant and Millennium Partners, LLC. | 10-K | 1-13290 | 03/ |
| 10.45 | Amendment adopted November 4, 1999 to the Registrant's 1994 Stock Incentive Plan. # | 10-K | 1-13290 | 03/ |
| 10.46 | Certificate representing Series B Senior Secured Notes. | 10-K | 1-13290 | 03/ |
| 10.47 | First Amendment to Fourth Amended and Restated Loan Agreement among the Registrant and certain of its subsidiaries and Comerica Bank - California as of December 3, 1999. | 10-K | 1-13290 | 03/ |
| 10.48 | Form of The Sports Club Membership Agreements. | 10-K | 1-13290 | 03/ |



| Exhibit | | Incorporated by Reference | | |
|---|---|---|---|---|
| Number | Exhibit Description | Form | File No. | Fili |
| 10.49 | Second Amendment to Fourth Amended and Restated Loan Agreement among the Registrant and certain of its subsidiaries and Comerica Bank-California as of August 10, 2000. | 10-K | 1-13290 | 03/ |
| 10.50 | Reaffirmation of Intercreditor and Subordination Agreement dated as of | 10-K | 1-13290 | 03/ |

| | | | | |
|---|---|---|---|---|
| | August 10, 2000 among the Registrant and certain of its subsidiaries and U.S. Bank Trust, National Association. | | | |
| 10.51 | First Supplemental Agreement of Lease made as of the 27th day of March, 2001 between CB-1 Entertainment Partners, LP and S.F. Sports Club, Inc. | 10-K | 1-13290 | 03/ |
| 10.52 | First Supplemental Agreement of Lease made as of the 27th day of March 2001 between New Commonwealth Center Limited Partnership and Washington D.C. Sports Club, Inc. | 10-K | 1-13290 | 03/ |
| 10.53 | First Supplemental Agreement of Lease made as of the 27th day of March 2001 between 2200 M Street LLC and Washington D.C. Sports Club, Inc. | 10-K | 1-13290 | 03/ |
| 10.54 | Third Amendment to Fourth Amended and Restated Loan Agreement entered into as of June 1, 2001 by and among Registrant and various of its subsidiaries and Comerica Bank - California. | 8-K | 1-13290 | 07/ |
| 10.55 | Indemnification and Contribution Agreement entered into as of July 3, 2001 by and among the Registrant., Rex A. Licklider, D. Michael Talla and MDP Ventures II LLC. | 8-K | 1-13290 | 07/ |
| 10.56 | The Sports Club Company, Inc. 2001 Stock Incentive Plan. # | 10-K | 1-13290 | 03/ |

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| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
|---|---|---|---|---|
| 10.57 | Preferred Stock Purchase Agreement made as of March 18, 2002 by and among Registrant and the holders of the Series B Convertible Preferred Stock. | 8-K | 1-13290 | 03/ |
| 10.58 | Investor Rights Agreement made as of the 18th day of March 2002 by and between the Registrant and the holders of the Series B Convertible Preferred Stock. | 8-K | 1-13290 | 03/ |
| 10.59 | Asset Purchase Agreement dated as of | 10-K | 1-13290 | 03/ |

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|---|---|---|---|---|
| | January 25, 2002, by and between SCC Nevada, Inc. and LSI-Nevada, LLC. | | | |
| 10.60 | Standard Form Lease between the Registrant and Club at 60th St., Inc. for space located at 333 East 60th Street, New York, dated May 4, 2001. | 10-K | 1-13290 | 03/ |
| 10.61 | First Amendment to Lease by and among Registrant and Club at 60th St., Inc. dated as of March 1, 2002. | 10-K | 1-13290 | 03/ |
| 10.62 | Waiver of Covenant Compliance Letter Agreement between the Registrant and Comerica Bank - California dated March 14, 2002. | 10-K | 1-13290 | 03/ |
| 10.63 | Fourth Amendment to Fourth Amended and Restated Loan Agreement and First Amendment to Amended and Restated Revolving Loan between the Registrant and certain of its Subsidiaries and Comerica Bank - California dated May 31, 2002. | 8-K | 1-13290 | 06/ |
| 10.64 | Fifth Amendment to Fourth Amended and Restated Loan Agreement between the Registrant and certain of its Subsidiaries and Comerica Bank - California dated August 30, 2002. | 8-K | 1-13290 | 09/ |



| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
|---|---|---|---|---|
| 10.65 | Reaffirmation of Intercreditor and Subordination Agreement dated as of August 30, 2002 among the Registrant and certain of its Subsidiaries and U.S. Bank Trust, National Association. | 8-K | 1-13290 | 09/ |
| 10.66 | Investors' Rights Agreement made as of September 6, 2002 by and between the Registrant and the holders of the Series C Convertible Preferred Stock. | 8-K | 1-13290 | 09/ |
| 10.67 | Preferred Stock Purchase Agreement made as of September 6, 2002 by and among the Registrant and the holders of the Series C Convertible Preferred Stock. | 8-K | 1-13290 | 09/ |
| 10.68 | Sixth Amendment to Fourth Amended and | 8-K | 1-13290 | 11/ |

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|---|---|---|---|---|
| | Restated Loan Agreement by and among the Registrant and certain of its Subsidiaries, Comerica Bank - California and KASCY, L.P. dated October 31, 2002. | | | |
| 10.69 | Consent and Reaffirmation of Intercreditor and Subordination Agreement dated as of October 31, 2002 among the Registrant and certain of its Subsidiaries, Comerica Bank - California and U.S. Bank Trust, National Association. | 8-K | 1-13290 | 11/ |
| 10.70 | Fitness Club and Spa Management and Pre-Opening Service Agreement between Terramark Brickell II, Ltd. and the Registrant effective as of January 1, 2003. | 10-K | 1-13290 | 06/ |
| 10.71 | First Supplement to Fitness Club and Spa Management and Pre-Opening Services Agreement effective as of January 1, 2003. | 10-K | 1-13290 | 06/ |
| 10.72 | Waiver of Covenant Compliance Letter from Comerica Bank - California dated March 26, 2003. | 10-K | 1-13290 | 03/ |
| 10.73 | Promissory Note dated June 12, 2003 in favor of Orange County's Credit Union in the amount of $20,000,000. | 8-K | 1-13290 | 06/ |



| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Fili |
|---|---|---|---|---|
| 10.74 | Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing dated as of June 12, 2003, made by Irvine Sports Club, Inc. for the benefit of Orange County's Credit Union. | 8-K | 1-13290 | 06/ |
| 10.75 | Reserve and Security Agreement made as of June 12, 2003 by Irvine Sports Club, Inc. in favor of Orange County's Credit Union. | 8-K | 1-13290 | 06/ |
| 10.76 | Pledge and Security Agreement made as of June 12, 2003 by the Registrant and Irvine Sports Club, Inc. in favor | 8-K | 1-13290 | 06/ |

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|---|---|---|---|---|
| | of Orange County's Credit Union. | | | |
| 10.77 | Indemnity and Guaranty Agreement entered into as of December 1, 2003 among the Registrant, Irvine Sports Club, Inc., Rex A. Licklider and D. Michael Talla. | 10-K | 1-13290 | 06/ |
| 10.78 | Supplemental Indenture dated as of March 28, 2003 between the Registrant, the Subsidiary Guarantors and U.S. Bank Trust National Association. | 8-K | 1-13290 | 04/ |
| 10.79 | Supplemental Indenture dated as of February 4, 2004 between the Registrant, the Subsidiary Guarantors and U.S. Bank National Association. | 10-K | 1-13290 | 06/ |
| 10.80 | Third Supplemental Indenture made as of March 9, 2004 between the Registrant, the Subsidiary Guarantors and U.S. Bank National Association. | 8-K | 1-13290 | 03/ |
| 10.81 | Investors' Rights Agreement made as of March 10, 2004, by and among the Registrant and the holders of the Series D Convertible Preferred Stock. | 8-K | 1-13290 | 03/ |
| 10.82 | Preferred Stock Purchase Agreement made as of March 10, 2004 by and among the Registrant and the holders of the Series D Convertible Preferred Stock. | 8-K | 1-13290 | 03/ |



| Exhibit | | Incorporated by Reference | | |
|---|---|---|---|---|
| Number | Exhibit Description | Form | File No. | Fili |
| 10.83 | Consent Letter dated March 10, 2004 by holders of the Series B Convertible Preferred Stock. | 8-K | 1-13290 | 03/ |
| 10.84 | Consent Letter dated March 10, 2004 by holders of the Series C Convertible Preferred Stock. | 8-K | 1-13290 | 03/ |
| 21.1 | Subsidiaries of the Registrant. | 10-K | 1-13290 | 06/ |
| 23.1 | Consent of Independent Registered Public Accounting Firm. | 10-K | 1-13290 | 06/ |
| 31.1 | Certification of Rex A. Licklider | | | |

| | |
|---|---|
| | Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002. |
| 31.2 | Certification of Timothy O'Brien Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002. |
| 32.1 | Certification of Rex A. Licklider Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002. |
| 32.2 | Certification of Timothy O'Brien Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002. |

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# Compensation agreement or plan.

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(b) Reports on Form 8-K

The following reports on Form 8-K were filed from October 1, 2003 through December 31, 2003:

o On October 3, 2003, we filed a report on Form 8-K announcing that on September 29, 2003, the Special Committee of our Board of Directors approved an amendment to our Rights Agreement adopted on September 29, 1998. The Amendment provides that until November 30, 2003, the Rights Plan will not be triggered as a result of any non-binding "going private" negotiations or understandings between and among the principal shareholders, so long as such negotiations or understandings relate to a transaction that has been, or is intended to be, proposed to our special committee.

o On October 9, 2003, we filed a report on Form 8-K stating that on October 8, 2003, we issued a press release announcing the opening of The Sports Club/LA - Beverly Hills. The new Club opened on October 7, 2003 and is located in Beverly Hills, California. The Club, a two-story 40,000 square foot luxury sports and fitness complex offers a state-of-the art environment including a Bar and Lounge and spa services.

o On October 14, 2003, we filed a report on Form 8-K stating that on October 13, 2003, we issued a press release announcing that we had mutually agreed with Palisade Concentrated Equity Partnership, L.P. ("Palisade") to set aside the previously announced offer of "going private." We also stated that we expected to receive an amended letter of intent setting forth the revised terms and conditions under which Palisade would propose to make an $18.5 million equity investment in us, subject to an additional investment by certain of our existing stockholders, the proceeds of which would be retained by us to fund operations.

o On November 3, 2003, we filed a report on Form 8-K stating that on November 3, 2003, we issued a press release announcing operating results for the third quarter and nine months ending September 30, 2003.

o On December 3, 2003, we filed a report on Form 8-K announcing that on November 25, 2003, the Special Committee of our Board of Directors approved an amendment to our Rights Agreement adopted on September 29, 1998. The Amendment provides that until February 29, 2004, the Rights Plan will not be triggered as a result of any non-binding "going private" negotiations or understandings between and among the principal shareholders, so long as such negotiations or understandings relate to a transactions that has been, or is intended to be, proposed to our Special Committee.



(c) Exhibits

Index to Exhibits of Form 10-K/A

| Exhibit Number | Exhibit |
|---|---|
| 31.1 | Certification of Rex A. Licklider Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002. |
| 31.2 | Certification of Timothy O'Brien Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002. |
| 32.1 | Certification of Rex A. Licklider Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002. |
| 32.2 | Certification of Timothy O'Brien Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002. |



SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized, on the 18th day of August 2004.

THE SPORTS CLUB COMPANY, INC.

/s/ Rex A. Licklider

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Rex A. Licklider
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K/A has been signed below by the following persons on behalf of the Registrant, in the capacities and on the date indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ Rex A. Licklider<br>Rex A. Licklider | Vice Chairman of the Board<br>and Chief Executive Officer | Augu |
| /s/ Timothy O'Brien<br>Timothy M. O'Brien | Chief Financial Officer<br>(Principal Financial and Accounting Officer) | Augu |
| /s/ D. Michael Talla<br>D. Michael Talla | Chairman of the Board | Augu |
| /s/ Charles Ferraro<br>Charles Ferraro | Director | Augu |
| /s/ Christopher M. Jeffries<br>Christopher M. Jeffries | Director | Augu |
| /s/ Charles Norris<br>Charles Norris | Director | Augu |
| /s/ Andrew L. Turner<br>Andrew L. Turner | Director | Augu |
| /s/ George Vasilakos<br>George Vasilakos | Director | Augu |

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EXHIBIT
31.1

CERTIFICATION OF
REX LICKLIDER

CERTIFICATIONS

I, Rex A. Licklider, Chief Executive Officer of The Sports Club Company, Inc. certify that:

1. I have reviewed this annual report on Form 10-K/A (Amendment 1) of The Sports Club Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures (as of the end of the period covered by this report based on such evaluation); and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the

   audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated, August 18, 2004

/s/ Rex A. Licklider
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Rex A. Licklider
Chief Executive Officer

EXHIBIT
31.2

CERTIFICATION OF
TIMOTHY O'BRIEN

CERTIFICATIONS

I, Timothy O'Brien, Chief Financial Officer of The Sports Club Company, Inc. certify that:

1. I have reviewed this annual report on Form 10-K/A (Amendment 1) of The Sports Club Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures (as of the end of the period covered by this report based on such evaluation); and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial financial information; and
(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated, August 18, 2004

/s/ Timothy O'Brien
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Timothy O'Brien
Chief Financial Officer

EXHIBIT
32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of The Sports Club Company, Inc. (the "Company") on Form 10-K/A for the period ending December 31, 2003 filed with the

Securities and Exchange Commission on the date hereof (the "Report"), I, Rex A. Licklider, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. (Section Mark) 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

i. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

ii. The information contained in the Report fairly represents, in all material respects, the financial condition and result of operations of the Company.

/s/ Rex A. Licklider
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The Sports Club Company, Inc.
Chief Executive Officer
August 18, 2004

EXHIBIT
32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of The Sports Club Company, Inc. (the "Company") on Form 10-K/A for the period ending December 31, 2003 filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Timothy O'Brien, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. (Section Mark) 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(i) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(ii) The information contained in the Report fairly represents, in all material respects, the financial condition and result of operations of the Company.

/s/ Timothy O'Brien
------------------------------------------
The Sports Club Company, Inc.
Chief Financial Officer
August 18, 2004