GNC CORP
Form 10-Q
May 05, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
Form 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2006

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

For the transition period from__________ to __________.

Commission File Number: 333-116040

GNC CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	***72-1575170***
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
300 Sixth Avenue **Pittsburgh, Pennsylvania**	**15222**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(412) 288-4600**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated þ

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

As of May 1, 2006, 29,621,538 shares of the GNC Corporation s $0.01 par value Common Stock (the Common Stock) were outstanding.

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements.

GNC CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except share data)

	March 31, 2006 (unaudited)	December 31, 2005 *
Current assets:		
Cash and cash equivalents	$ 44,290	$ 86,013
Receivables, net of reserve of $7,493 and $8,898, respectively	77,007	70,630
Inventories, net (Note 3)	339,928	298,166
Deferred tax assets, net	13,859	13,861
Other current assets	30,005	30,826
Total current assets	505,089	499,496
Long-term assets:		
Goodwill (Note 4)	80,588	80,109
Brands (Note 4)	212,000	212,000
Other intangible assets, net (Note 4)	25,965	26,460
Property, plant and equipment, net	174,705	179,482
Deferred financing fees, net	15,390	16,125
Deferred tax assets, net	45	45
Other long-term assets	8,399	10,114
Total long-term assets	517,092	524,335
Total assets	$ 1,022,181	$ 1,023,831
Current liabilities:		
Accounts payable, includes cash overdraft of $5,219 and $5,063, respectively	$ 130,607	$ 104,595
Accrued payroll and related liabilities	20,532	20,812
Accrued income taxes	8,830	2,280
Accrued interest	9,181	7,877
Current portion, long-term debt	2,133	2,117
Other current liabilities	68,831	64,826
Total current liabilities	240,114	202,507
Long-term liabilities:		
Long-term debt	470,710	471,244
Other long-term liabilities	10,679	10,891
Total long-term liabilities	481,389	482,135

Total liabilities	721,503	684,642
Cumulative redeemable exchangeable preferred stock, $0.01 par value, 110,000 shares authorized, 100,000 shares issued and outstanding (liquidation preference of $140,183 and $136,349, respectively)	130,982	127,115
Stockholders equity:		
Common stock, $0.01 par value, 100,000,000 shares authorized, 29,546,538 and 29,538,413 shares issued and outstanding, respectively	296	296
Paid-in-capital	128,289	177,615
Retained earnings	40,507	32,939
Accumulated other comprehensive income	604	1,224
Total stockholders equity	169,696	212,074
Total liabilities and stockholders equity	$ 1,022,181	$ 1,023,831

* Footnotes summarized from the Audited Financial Statements.

The accompanying notes are an integral part of the consolidated financial statements.

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GNC CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income
(unaudited)
(in thousands)

	Three months ended March 31, 2006	Three months ended March 31, 2005
Revenue	$ 386,892	$ 336,435
Cost of sales, including costs of warehousing, distribution and occupancy	256,872	230,456
Gross profit	130,020	105,979
Compensation and related benefits	65,852	57,314
Advertising and promotion	15,839	14,601
Other selling, general and administrative	21,063	18,915
Foreign currency gain	(588)	(105)
Other income		(2,500)
Operating income	27,854	17,754
Interest expense, net (Note 5)	9,676	13,471
Income before income taxes	18,178	4,283
Income tax expense	6,743	1,547
Net income	11,435	2,736
Other comprehensive loss	(620)	(264)
Comprehensive income	$ 10,815	$ 2,472

The accompanying notes are an integral part of the consolidated financial statements.

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GNC CORPORATION AND SUBSIDIARIES
Consolidated Statement of Stockholders Equity
(in thousands, except share data)

	Common Stock Shares	Common Stock Dollars	Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders Equity
Balance at December 31, 2005	**29,538,413**	**$ 296**	**$ 177,615**	**$ 32,939**	**$ 1,224**	**$ 212,074**
Repurchase and retirement of common stock	(16,875)		(68)			(68)
Non-cash stock-based compensation	25,000		676			676
Preferred stock dividends				(3,834)		(3,834)
Amortization of preferred stock issuance costs				(33)		(33)
Net income				11,435		11,435
Restricted payment made by General Nutrition Centers, Inc. to GNC Corporation Common Stockholders			(49,934)			(49,934)
Foreign currency translation adjustments					(620)	(620)
Balance at March 31, 2006 (unaudited)	**29,546,538**	**$ 296**	**$ 128,289**	**$ 40,507**	**$ 604**	**$ 169,696**

The accompanying notes are an integral part of the consolidated financial statements.

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GNC CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Three months ended March 31, 2006	Three months ended March 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 11,435	$ 2,736
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	8,656	9,139
Deferred fee writedown early debt extinguishment		3,890
Amortization of intangible assets	978	961
Amortization of deferred financing fees	735	683
Increase in provision for inventory losses	909	2,238
Non-cash stock-based compensation	676	
(Decrease) increase in provision for losses on accounts receivable	(395)	591
Decrease in net deferred taxes		2,408
Changes in assets and liabilities:		
Increase in receivables	(6,977)	(872)
Increase in inventory, net	(42,217)	(23,159)
Decrease in franchise note receivables, net	1,109	3,604
Decrease in other assets	348	1,495
Increase in accounts payable	25,846	26,157
Increase in accrued taxes	6,550	
Increase in interest payable	1,303	7,159
Increase (decrease) in accrued liabilities	3,517	(1,490)
Net cash provided by operating activities	12,473	35,540
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(3,692)	(4,383)
Store acquisition costs	(131)	(558)
Net cash used in investing activities	(3,823)	(4,941)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restricted payment made by General Nutrition Centers, Inc. to GNC Corporation Common Stockholders	(49,934)	
Repurchase and retirement of common stock	(68)	(416)
Increase in cash overdrafts	156	1,760
Proceeds from senior notes issuance		150,000

Payments on long-term debt	(517)	(185,491)
Financing fees		(3,785)
Net cash used in financing activities	(50,363)	(37,932)
Effect of exchange rate on cash	(10)	(63)
Net decrease in cash	(41,723)	(7,396)
Beginning balance, cash	86,013	85,161
Ending balance, cash	$ 44,290	$ 77,765

The accompanying notes are an integral part of the consolidated financial statements.

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. NATURE OF BUSINESS

General Nature of Business. GNC Corporation (GNC or the Company) (f/k/a General Nutrition Centers Holding Company), a Delaware corporation, is a leading specialty retailer of nutritional supplements, which include: vitamins, minerals and herbal supplements (VMHS), sports nutrition products, diet products and other wellness products.

The Company s organizational structure is vertically integrated as the operations consist of purchasing raw materials, formulating and manufacturing products and selling the finished products through its Retail, Franchising and Manufacturing/Wholesale segments. The Company operates primarily in three business segments: Retail; Franchising; and Manufacturing/Wholesale. Corporate retail store operations are located in North America and Puerto Rico and in addition the Company offers products domestically through gnc.com and drugstore.com. Franchising has stores in the United States and operations in 46 international markets. The Company operates its primary manufacturing facilities in South Carolina and distribution centers in Arizona, Pennsylvania and South Carolina. The Company also operates a smaller manufacturing facility in Australia. The Company manufactures the majority of its branded products, but also merchandises various third-party products. Additionally, the Company licenses the use of its trademarks and trade names.

The processing, formulation, packaging, labeling and advertising of the Company s products are subject to regulation by one or more federal agencies, including the Food and Drug Administration (FDA), Federal Trade Commission (FTC), Consumer Product Safety Commission, United States Department of Agriculture and the Environmental Protection Agency. These activities are also regulated by various agencies of the states and localities in which the Company s products are sold.

Acquisition of the Company. On October 16, 2003, the Company entered into a purchase agreement (the Purchase Agreement) with Koninklijke (Royal) Numico N.V. (Numico) and Numico USA, Inc. to acquire 100% of the outstanding equity interest of General Nutrition Companies, Inc. (GNCI) from Numico USA, Inc. on December 5, 2003 (the Acquisition). The purchase equity contribution was made by GNC Investors, LLC (GNC LLC), an affiliate of Apollo Management V L.P, together with additional institutional investors and certain management of the Company. The equity contribution from GNC LLC was recorded by the Company. The Company utilized this equity contribution to purchase the investment in General Nutrition Centers, Inc., (Centers). Centers is a wholly owned subsidiary of the Company.

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and related footnotes that would normally be required by accounting principles generally accepted in the United States of America for complete financial reporting. These unaudited consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements in the Company s Annual Report on Form 10-K filed for the year ended December 31, 2005 (the Form 10-K).

The accompanying unaudited consolidated financial statements include all adjustments (consisting of a normal and recurring nature) that management considers necessary for a fair statement of financial information for the interim periods. Interim results are not necessarily indicative of the results that may be expected for the remainder of the year ending December 31, 2006.

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 estimates and assumptions. Accordingly, these estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Some of the most significant estimates pertaining to the Company include the valuation of inventories, the allowance for doubtful accounts, income tax valuation allowances and the recoverability of long-lived assets. On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results could differ from those estimates. There have been no material changes to critical estimates since the audited financial statements at December 31, 2005.

Cash and Cash Equivalents**.** The Company considers cash and cash equivalents to include all cash and liquid deposits and investments with a maturity of three months or less. The majority of payments due from banks for third-party credit cards process within 24-48 hours, except for transactions occurring on a Friday, which are generally processed the following Monday. All credit card transactions are classified as cash and the amounts due from these transactions totaled $2.1 million at March 31, 2006 and $2.6 million at December 31, 2005.

Recently Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (revised 2004) (SFAS No. 123(R)). SFAS No. 123(R) sets accounting requirements for share-based compensation to employees and disallows the use of the intrinsic value method of accounting for stock compensation. The Company is required to account for such transactions using a fair-value method and to recognize compensation expense over the period during which an employee is required to provide services in exchange for the stock options and other equity-based compensation issued to employees. This statement was effective for the Company starting January 1, 2006 and the Company elected

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

to use the modified prospective application method. The impact of this statement on the Company s consolidated financial statements or results of operations has been historically disclosed on a pro-forma basis and is now recognized as compensation expense on a prospective basis. Based on the equity awards outstanding as of March 31, 2006, the Company expects compensation expense, net of tax, of $1.0 million to $2.0 million for the year ended December 31, 2006. Refer to the Stock Based Compensation Plans note for additional disclosure.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of Accounting Research Bulletin (ARB) No. 43, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal . In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Company adopted this standard starting January 1, 2006 and the adoption did not have a significant impact on the Company s consolidated financial statements or results of operations.

NOTE 3. INVENTORIES, NET

Inventories at each respective period consisted of the following:

	March 31, 2006		
	Gross cost	Reserves	Net Carrying Value
		(unaudited) (in thousands)	
Finished product ready for sale	$ 288,626	$ (8,929)	$ 279,697
Unpackaged bulk product and raw materials	57,395	(2,110)	55,285
Packaging supplies	4,946		4,946
	$ 350,967	$ (11,039)	$ 339,928

	December 31, 2005		
	Gross cost	Reserves	Net Carrying Value
		(in thousands)	
Finished product ready for sale	$ 257,525	$ (10,025)	$ 247,500
Unpackaged bulk product and raw materials	48,513	(2,128)	46,385
Packaging supplies	4,281		4,281
	$ 310,319	$ (12,153)	$ 298,166

NOTE 4. GOODWILL AND INTANGIBLE ASSETS, NET

Goodwill represents the excess of purchase price over the fair value of identifiable net assets of acquired entities. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), goodwill and intangible assets with indefinite useful lives are not amortized, but instead are tested for impairment at least annually. Other intangible assets with finite lives are amortized on a straight-line basis over periods not exceeding 15 years.

For the three months ended March 31, 2006, the Company acquired 27 franchise stores. These acquisitions are accounted for utilizing the purchase method of accounting and the Company records the acquired inventory, fixed assets, franchise rights and goodwill with an applicable reduction to receivables and cash. The total purchase price associated with these acquisitions was $1.6 million, of which $0.1 million was paid in cash. Also as a result of these acquisitions, the Company reclassified $1.3 million of goodwill and $3.5 million of brand intangibles from the Franchise segment to the Retail segment during the three months ended March 31, 2006. The reclassification was determined based on the relative fair value of the acquired franchise stores.

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

The following table summarizes the Company s goodwill activity from December 31, 2005 to March 31, 2006.

	Retail	Franchising	Manufacturing/ Wholesale	Total
		(in thousands)		
Goodwill at December 31, 2005	$ 22,970	$ 56,693	$ 446	$ 80,109
Additions: Acquired franchise stores	479			479
Reclassification: Due to franchise store aquisitions	1,266	(1,266)		
Goodwill at March 31, 2006 (unaudited)	$ 24,715	$ 55,427	$ 446	$ 80,588

The following table summarizes the Company s intangible asset activity from December 31, 2005 to March 31, 2006.

	Gold Card	Retail Brand	Franchise Brand	Operating Agreements	Franchise Rights	Total
			(in thousands)			
Balance at December 31, 2005	$ 514	$ 59,659	$ 152,341	$ 24,296	$ 1,650	$ 238,460
Additions: Acquired franchise stores					483	483
Reclassification: Due to franchise store aquisitions		3,539	(3,539)			
Amortization expense	(129)			(736)	(113)	(978)
Balance at March 31, 2006 (unaudited)	$ 385	$ 63,198	$ 148,802	$ 23,560	$ 2,020	$ 237,965

The following table reflects the gross carrying amount and accumulated amortization for each major intangible asset:

	Estimated Life in years	March 31, 2006 Cost	Accumulated Amortization	Carrying Amount	December 31, 2005 Cost	Accumulated Amortization	Carrying Amount
			(unaudited)				
				(in thousands)			
Brands retail		$ 63,198	$	$ 63,198	$ 59,659	$	$ 59,659
Brands franchise		148,802		148,802	152,341		152,341
Gold card retail	3	2,230	(1,896)	334	2,230	(1,784)	446
Gold card franchise	3	340	(289)	51	340	(272)	68
Retail agreements	5-10	8,500	(2,742)	5,758	8,500	(2,447)	6,053
Franchise agreements	10-15						