GNC CORP
Form 10-Q
November 05, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

Form 10-Q

(Mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2004**

[ ] 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 (Address of principal executive offices)	15222 (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. [ ] Yes [X] No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [X] No

As of September 30, 2004, 29,854,663 shares of the registrant s common stock, par value $0.01 per share (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)

	December 31, 2003 *	September 30, 2004
		(unaudited)
Current assets:		
Cash and cash equivalents	$ 33,176	$ 72,384
Receivables, net (Note 2)	87,984	76,938
Inventories, net (Note 3)	256,000	255,546
Deferred tax assets, net	15,946	
Other current assets	33,507	31,389
Total current assets	426,613	436,257
Long-term assets:		
Goodwill, net (Note 4)	83,089	87,787
Brands, net (Note 4)	212,000	212,000
Other intangible assets, net (Note 4)	32,667	29,656
Property, plant and equipment, net	201,280	194,293
Deferred financing fees, net	19,796	18,436
Deferred tax assets, net	15,289	8,496
Other long-term assets (Note 5)	34,160	22,684
Total long-term assets	598,281	573,352
Total assets	$ 1,024,894	$ 1,009,609
Current liabilities:		
Accounts payable	$ 102,926	$ 80,053
Accrued payroll and related liabilities (Note 10)	33,277	14,531
Accrued income taxes (Note 8)	438	
Accrued interest (Note 7)	1,799	6,473
Current portion, long-term debt (Note 7)	3,830	3,875
Other current liabilities (Note 6)	84,739	69,221
Total current liabilities	227,009	174,153

Long-term liabilities:		
Long-term debt (Note 7)	510,374	507,462
Other long-term liabilities	9,796	9,497
Total long-term liabilities	520,170	516,959
Total liabilities	747,179	691,112
Cumulative redeemable exchangeable preferred stock, $0.01 par value, 110,000 shares authorized, issued and outstanding 100,000 shares (Note 15)	100,450	109,667
Stockholders equity:		
Common stock, $0.01 par value, 100,000,000 shares authorized, issued and outstanding 29,566,666 and 29,854,663 shares, respectively	296	299
Paid-in-capital	176,667	178,245
Retained earnings		29,692
Accumulated other comprehensive income (Note 13)	302	594
Total stockholders equity	177,265	208,830
Total liabilities and stockholders equity	$1,024,894	$1,009,609

* Footnotes summarized from the Audited Financial Statements.

The accompanying summarized 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 except share data)

	Predecessor	Successor	Predecessor	Successor
	For the three months ended September 30,		For the nine months ended September 30,	
	2003	2004	2003	2004
Revenue	$ 362,576	$ 323,141	$ 1,085,753	$ 1,043,424
Cost of sales, including costs of warehousing, distribution and occupancy	254,379	216,818	758,141	690,541
Gross profit	108,197	106,323	327,612	352,883
Compensation and related benefits	62,349	54,034	182,001	172,959
Advertising and promotion	9,115	10,042	30,958	35,252
Other selling, general and administrative	17,408	19,171	58,405	55,831
Income from legal settlements	(4,631)		(7,190)	
Foreign currency (gain) loss	(255)	(300)	(2,477)	118
Impairment of goodwill and intangible assets	709,367		709,367	
Other expense		1,330		1,330
Operating (loss) income	(685,156)	22,046	(643,452)	87,393
Interest expense, net (Note 7)	33,048	8,570	97,840	25,786
(Loss) income before income taxes	(718,204)	13,476	(741,292)	61,607
Income tax (benefit) expense	(170,774)	4,977	(164,281)	22,513
Net (loss) income	(547,430)	8,499	(577,011)	39,094
Other comprehensive (loss) income (Note 13)	(23)	747	1,041	292
Comprehensive (loss) income	$ (547,453)	$ 9,246	$ (575,970)	$ 39,386

Income Per Share - Basic and Diluted:				
Net (loss) income	$ (547,430)	$ 8,499	$ (577,011)	$ 39,094
Cumulative redeemable exchangeable preferred stock dividends and accretion		(3,245)		(9,402)
Net (loss) income available to common stockholders	$ (547,430)	$ 5,254	$ (577,011)	$ 29,692
Net (loss) income per share	$ (18.34)	$ 0.18	$ (19.35)	$ 1.00
Weighted average common shares outstanding - basic and diluted	29,854,663	29,854,663	29,812,620	29,812,620

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

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GNC CORPORATION AND SUBSIDIARIES

Consolidated Statements of Stockholders Equity
(in thousands except share data)

	Common Stock				Other	Total
	Shares	Dollars	Additional Paid-in-Capital	Retained Earnings	Comprehensive Income	Stockholders Equity
Balance at December 31, 2003	**29,566,666**	**$ 296**	**$ 176,667**	**$**	**$ 302**	**$ 177,265**
Issuance of common stock	287,997	3	1,578			1,581
Preferred stock dividends				(9,335)		(9,335)
Accretion of preferred stock issuance costs				(67)		(67)
Net income				39,094		39,094
Foreign currency gain					292	292
Balance at September 30, 2004 (unaudited)	**29,854,663**	**$ 299**	**$ 178,245**	**$ 29,692**	**$ 594**	**$ 208,830**

The accompanying summarized 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)

	Predecessor	Successor
	For the nine months ended September 30,	
	2003	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(577,011)	$ 39,094
Depreciation expense	40,957	24,976
Impairment of intangible assets	709,367	
Amortization of intangible assets	6,608	3,011
Amortization of deferred financing fees		2,058
Change in stock-based compensation	541	
Stock appreciation rights compensation	2,414	
Inventory non-cash decrease	25,417	8,470
Provision for losses on accounts receivable	2,472	1,942
Change in net deferred taxes	(193,319)	21,682
Changes in assets and liabilities:		
Decrease (increase) in receivables, net	85,878	(3,657)
Increase in inventory, net	(10,075)	(7,651)
(Increase) decrease in franchise note receivables, net	(357)	8,520
(Increase) decrease in other assets	(8,667)	5,406
Decrease in accounts payable	(21,355)	(19,023)
Increase (decrease) in accrued taxes	11,989	(438)
Increase in interest payable	33,082	4,674
Increase (decrease) in accrued liabilities	1,685	(28,532)
Net cash provided by operating activities	109,626	60,532
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(23,587)	(17,865)
Proceeds from disposal of assets	2,615	168
Store acquisition costs	(881)	(522)
Purchase transaction fees		(7,710)
Payments for purchase price adjustments		(5,899)
Proceeds from purchase price adjustments		15,711
Net cash used in investing activities	(21,853)	(16,117)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock		1,581
Decrease in cash overdrafts	(585)	(3,813)
Payments on long-term debt - related party	(75,000)	
Payments on long-term debt - third parties	(658)	(2,866)
Deferred financing fees		(327)
Net cash used in financing activities	(76,243)	(5,425)
Effect of exchange rate on cash	(335)	218
Net increase in cash	11,195	39,208
Beginning balance, cash	38,765	33,176
Ending balance, cash	$ 49,960	$ 72,384

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

GNC CORPORATION AND SUBSIDIARIES

SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Summary of Significant Accounting Policies

General Nature of Business. GNC Corporation (the Company), formerly known as General Nutrition Centers Holding Company, a Delaware corporation, is a leading specialty retailer of vitamin, mineral and herbal supplements, diet and sports nutrition products and specialty supplements. The Company is also a provider of personal care and other health related products. The Company operates primarily in three business segments: Retail, Franchising and Manufacturing/Wholesale. 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. In August 1999, General Nutrition Companies, Inc. (GNCI) was acquired by Numico Investment Corp. (NIC), which subsequent to the Acquisition, was merged into GNCI. NIC was a wholly owned subsidiary of Numico U.S. L.P., which was merged into Nutricia USA, Inc. (Nutricia) in 2000. Nutricia (now known as Numico USA, Inc.) is a wholly owned subsidiary of Koninklijke (Royal) Numico N.V. (Numico), a Dutch public company headquartered in Zoetermeer, Netherlands. The results of GNCI were reported as part of the consolidated Numico financial statements from August 1999 to December 4, 2003.

On October 16, 2003, the Company entered into a purchase agreement (the Purchase Agreement) with Numico and Numico USA, Inc. to acquire 100% of the outstanding equity interest of GNCI from Numico USA Inc., a subsidiary of Numico (the Acquisition). The purchase equity contribution was made by GNC Investors, LLC, (GNC LLC) an affiliate of Apollo Management LP (Apollo), together with additional institutional investors and certain management of the Company. The equity contribution from GNC LLC was recorded on the Company s books. 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. The transaction closed on December 5, 2003 and was accounted for under the purchase method of accounting. The net purchase price was $733.2 million, which was paid via a combination of cash, and the proceeds received by Centers from the issuance of senior subordinated notes and borrowings under a senior credit facility, and is summarized herein. Apollo and certain institutional investors, through GNC LLC and the Company, contributed a cash equity investment of $277.5 million to Centers. In connection with the Acquisition on December 5, 2003, Centers also issued $215.0 million aggregate principal amount of its 8 1/2 % Senior Subordinated Notes, due 2010, resulting in net proceeds to Centers of $207.1 million. In addition, Centers obtained a new secured senior credit facility consisting of a $285.0 million term loan facility and a $75.0 million revolving credit facility. Centers borrowed the entire $285.0 million under the term loan facility to fund a portion of the Acquisition price, which netted proceeds to Centers of $275.8 million. These total proceeds were reduced by certain debt issuance and other transaction costs. Subject to certain limitations in accordance with the Purchase Agreement, Numico and Numico USA, Inc. agreed to indemnify the Company on losses arising from, among other items, breaches of representations, warranties, covenants and other certain liabilities relating to the business of GNCI, arising prior to December 5, 2003 as well as any losses payable in connection with certain litigation including ephedra-related claims. The Company utilized these proceeds to purchase GNCI with the remainder of $19.8 million used to fund operating capital. Subsequent to the Acquisition, in 2004, the Company received a cash payment of $15.7 million from Numico related to a working capital contingent purchase price adjustment. This adjustment was recorded as a contingent purchase price receivable as of December 31, 2003. Also in 2004, the Company remitted a payment to Numico of

$5.9 million related to a tax purchase price adjustment.

In conjunction with the Acquisition, fair value adjustments were made to the Company s financial statements as of December 5, 2003. As a result of the Acquisition and fair values assigned, the accompanying financial statements as of December 31, 2003 reflect adjustments made in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations. The following table summarizes the original and adjusted, due to purchase price adjustments, fair values assigned at December 5, 2003 to the Company s assets and liabilities in connection with the Acquisition.

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

Fair value Opening Balance Sheet:

	Original December 5, 2003	Adjusted December 5, 2003
	(in thousands)	
Assets:		
Current assets	$ 438,933	$ 434,913
Goodwill	83,089	87,787
Other intangible assets	244,970	244,970
Property, plant and equipment	201,287	201,287
Other assets	54,426	54,426
Total assets	1,022,705	1,023,383
Liabilities:		
Current liabilities	217,033	217,711
Long-term debt	513,217	513,217
Other liabilities	14,955	14,955
Total liabilities	745,205	745,883
GNC Corporation investment in General Nutrition Centers, Inc.	$ 277,500	$ 277,500

NOTE 1. Basis of Presentation and Principles of Consolidation

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 Article 210-10-01 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 for the year ending December 31, 2003, which are included in the Company s S-4 filing with the Securities and Exchange Commission (the SEC).

The accompanying unaudited consolidated financial statements include all adjustments (consisting of a normal and recurring nature) that management considers necessary for a fair presentation 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, 2004.

For the three and nine months ended September 30, 2003 the consolidated financial statements of our predecessor, GNCI, were prepared on a carve-out basis and reflect the consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America. The financial statements for this period reflected amounts that were pushed down from the former parent of GNCI in order to depict the financial position, results of operations and cash flows of GNCI based on these carve-out principles.

The financial statements as of December 31, 2003 and September 30, 2004 reflect periods subsequent to the Acquisition and include the accounts of the Company and its wholly owned subsidiaries. Included in the period ending December 31, 2003 are fair value adjustments to assets and liabilities, including inventory, goodwill, other intangible assets and property, plant and equipment. Accordingly, the accompanying financial statements for the periods prior to the Acquisition are labeled as Predecessor and the periods subsequent to the Acquisition are labeled as Successor .

The Company s normal reporting period is based on a 52-week calendar year.

Certain reclassifications have been made to the financial statements to ensure consistency in reporting and conformity between prior year and current year amounts.

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

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, 2003.

Stock Compensation. In accordance with Accounting Principles Board (APB) No. 25, Accounting for Stock issued to Employees , the Company accounts for stock-based employee compensation using the intrinsic value method of accounting. For the three months ended September 30, 2004 and nine months ended September 30, 2004, stock compensation represents shares of the Company s stock issued pursuant to the General Nutrition Centers Holding Company (presently known as GNC Corporation) 2003 Omnibus Stock Incentive Plan. The common stock associated with this plan is not registered or traded on any exchange. Stock compensation for the three months ended September 30, 2003 and nine months ended September 30, 2003 represents shares of Numico stock under the Numico 1999 Share Option Plan. SFAS No. 123, Accounting for Stock-based Compensation , prescribes that companies utilize the fair value method of valuing stock based compensation and recognize compensation expense accordingly. It does not require, however, that the fair value method be adopted and reflected in the financial statements. The Company has adopted the disclosure requirements of SFAS No. 148 Accounting for Stock Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123 by illustrating compensation costs in the following table.

On February 11, 2004 the Company issued additional stock options to certain management and directors. On March 31, 2004, the Company performed a valuation of their common stock using the same model that was used by Apollo to acquire GNCI, which resulted in a value under $6.00 per share. On July 23, 2004 the Company issued additional stock options to certain management and directors. On September 30, 2004, the Company performed a valuation of their common stock using the same model that was used by Apollo to acquire GNCI, which resulted in a value under $6.00 per share. Therefore, no compensation expense was recognized in connection with these issuances.

Had compensation costs for stock options been determined using the fair market value method of SFAS No. 123 and SFAS No. 148, the effect on net (loss) income for each of the periods presented would have been as follows:

	Three months ended		Nine months ended	
	September 30, 2003	**September 30, 2004**	**September 30, 2003**	**September 30, 2004**
	(unaudited) (in thousands except share data)			
Net (loss) income as reported	$ (547,430)	$ 8,499	$ (577,011)	$ 39,094
Less: total stock based employee compensation costs determined using fair value		(217)	(215)	(647)

method, net of related tax effects				
Net (loss) income available to common stockholders	(547,430)	8,282	(577,226)	38,447
Cumulative redeemable exchangable preferred stock dividends and accretion		(3,245)		(9,402)
Adjusted net (loss) income	$ (547,430)	$ 5,037	$ (577,226)	$ 29,045
Income Per Share Basic and Diluted				
Basic and diluted (loss) income per share - as reported	$ (18.34)	$ 0.28	$ (19.35)	$ 1.31
Basic and diluted (loss) income per share - pro forma	$ (18.34)	$ 0.17	$ (19.36)	$ 0.97
Weighted average common shares outstanding - basic and diluted	29,854,663	29,854,663	29,812,620	29,812,620

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

New Accounting Pronouncements.

In January 2003, the FASB issued FASB Interpretation (FIN) No. 46, Consolidation of Variable Interest Entities an interpretation of Accounting Research Bulletin (ARB) No. 51 . This interpretation addresses the consolidation of variable interest entities (VIEs) and its intent is to achieve greater consistency and comparability of reporting between business enterprises. It defines the characteristics of a business enterprise that qualifies as a primary beneficiary of a variable interest entity. In December 2003, the FASB issued a modification to FIN 46, titled FIN 46R. FIN 46R delayed the effective date for certain entities and also provided technical clarifications related to implementation issues. In summary, a primary beneficiary is a business enterprise that is subject to the majority of the risk of loss from the VIE, entitled to receive a majority of the VIE s residual returns, or both. The implementation of FIN No. 46R has been deferred for non-public entities. For non-public entities, such as the Company, FIN No. 46R requires immediate application to all VIEs created after December 31, 2003. For all other VIEs, the Company is required to adopt FIN No. 46R by no later than the beginning of the first period beginning after December 15, 2004. FIN No. 46R also requires certain disclosures in financial statements regardless of the date on which the VIE was created if it is reasonably possible that the business enterprise is required to disclose the activity of the VIE. The Company adopted FIN No. 46R on January 1, 2004 and determined that it does not have an impact to its financial statements.

In March, 2004, the Emerging Issues Task Force issued EITF 03-6, Participating Securities and the Two-Class Method under FASB Statement No. 128 . This statement provides additional guidance on the calculation and disclosure requirements for earnings per share. The FASB concluded in EITF 03-6 that companies with multiple classes of common stock or participating securities, as defined by SFAS No. 128, calculate and disclose earnings per share based on the two-class method. The adoption of this statement does not have an impact to the Company s financial statement presentation.

NOTE 2. RECEIVABLES, NET

Receivables at each respective period consisted of the following:

	December 31, 2003	September 30, 2004
		(unaudited)
	(in thousands)	
Trade receivables	$77,481	$ 79,003
Contingent purchase price receivable	12,711	
Other	5,536	4,158
Sales returns and allowance for doubtful accounts	(7,744)	(6,223)
	$87,984	$ 76,938

NOTE 3. INVENTORIES, NET

Inventories at each respective period consisted of the following:

	December 31, 2003		
	Gross cost	Reserves	Net Carrying Value
		(in thousands)	
Finished product ready for sale	$235,984	$(15,319)	$220,665
Unpackaged bulk product and raw materials	35,615	(3,932)	31,683
Packaging supplies	3,652		3,652
	$275,251	$(19,251)	$256,000

	September 30, 2004		
	Gross cost	Reserves	Net Carrying Value