

GNC HOLDINGS, INC.
Form 10-Q
August 05, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark one)

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

For the quarterly period ended **June 30, 2011**

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: **333-144396**

GNC Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
Incorporation or organization)

300 Sixth Avenue
Pittsburgh, Pennsylvania
(Address of principal executive offices)

20-8536244
(I.R.S. Employer
Identification No.)

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

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such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of July 31, 2011, the number of outstanding shares of Class A common stock, par value \$0.001 per share (the Class A common stock), and the number of outstanding shares of Class B common stock, par value \$0.001 per share (the Class B common stock), of GNC Holdings, Inc. were 90,068,598 shares and 13,782,311 shares, respectively.

Table of Contents

TABLE OF CONTENTS

	PAGE
<u>PART I - FINANCIAL INFORMATION</u>	
Explanatory Note.	
<u>Item 1.</u>	
<u>Financial Statements.</u>	
<u>Consolidated Balance Sheets as of June 30, 2011 (unaudited) and December 31, 2010.</u>	1
<u>Unaudited Consolidated Statements of Operations for the three and six months ended June 30, 2011 and 2010.</u>	2
<u>Unaudited Consolidated Statement of Stockholders' Equity and Comprehensive Income for the six months ended June 30, 2011 and 2010.</u>	3
<u>Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010.</u>	4
<u>Summarized Notes to Unaudited Consolidated Financial Statements.</u>	5
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	21
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	32
<u>Item 4.</u>	
<u>Controls and Procedures.</u>	33
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings.</u>	34
<u>Item 1A.</u>	
<u>Risk Factors.</u>	35
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	36
<u>Item 3.</u>	
<u>Defaults Upon Senior Securities.</u>	36
<u>Item 4.</u>	
<u>Removed and Reserved.</u>	36
<u>Item 5.</u>	
<u>Other Information.</u>	36
<u>Item 6.</u>	
<u>Exhibits.</u>	37
<u>Signatures.</u>	38

Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****GNC HOLDINGS, INC. AND SUBSIDIARIES****Consolidated Balance Sheets**

(in thousands, including share data)

	June 30, 2011 (unaudited)	December 31, 2010
Current assets:		
Cash and cash equivalents	\$ 97,970	\$ 193,902
Receivables, net	100,706	102,874
Inventories (Note 3)	415,720	381,949
Prepays and other current assets	48,478	40,569
Total current assets	662,874	719,294
Long-term assets:		
Goodwill (Note 4)	625,878	625,241
Brands (Note 4)	720,000	720,000
Other intangible assets, net (Note 4)	143,849	147,224
Property, plant and equipment, net	191,053	193,428
Deferred financing fees, net	12,656	14,129
Other long-term assets	7,767	5,767
Total long-term assets	1,701,203	1,705,789
Total assets	\$ 2,364,077	\$ 2,425,083
Current liabilities:		
Accounts payable	\$ 128,793	\$ 98,662
Accrued payroll and related liabilities	24,211	25,656
Accrued interest (Note 5)	2,004	13,372
Current portion, long-term debt (Note 5)	1,592	28,070
Deferred revenue and other current liabilities	73,688	69,065
Total current liabilities	230,288	234,825
Long-term liabilities:		
Long-term debt (Note 5)	900,615	1,030,429
Deferred tax liabilities, net	289,134	288,015
Other long-term liabilities	33,397	33,950
Total long-term liabilities	1,223,146	1,352,394
Total liabilities	1,453,434	1,587,219
Preferred stock, \$0.001 par value, 60,000 shares authorized: Series A, 30,500 shares designated, 30,134 shares issued, 29,867 shares outstanding and 267 shares held in treasury at December 31, 2010	-	218,381
Stockholders' equity:		
Common stock, \$0.001 par value, 150,000 shares authorized: Class A, 90,833 shares issued and 90,064 shares outstanding and 769 shares held in treasury at June 30, 2011 and 59,968 shares issued and 59,199 shares outstanding and 769 shares held in treasury at December 31, 2010	90	60
Class B, 13,782 shares and 28,169 issued and outstanding at June 30, 2011 and December 31, 2010, respectively	14	28
Paid-in-capital	695,800	451,728

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Retained earnings	212,425	171,224
Treasury stock, at cost	(2,277)	(2,277)
Accumulated other comprehensive income (loss)	4,591	(1,280)
Total stockholders' equity	910,643	619,483
Total liabilities and stockholders' equity	\$ 2,364,077	\$ 2,425,083

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

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****Consolidated Statements of Operations****(unaudited)****(in thousands, except per share data)**

	Three months ending June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Revenue	\$ 518,535	\$ 455,730	\$ 1,024,543	\$ 920,749
Cost of sales, including cost of warehousing, distribution and occupancy	327,618	292,118	649,779	591,238
Gross profit	190,917	163,612	374,764	329,511
Compensation and related benefits	75,363	67,641	146,636	135,474
Advertising and promotion	13,391	14,122	27,598	29,576
Other selling, general and administrative	29,418	25,458	57,901	50,963
Foreign currency loss (gain)	48	19	(119)	(57)
Transaction related costs	-	-	12,362	-
Operating income	72,697	56,372	130,386	113,555
Interest Expense, net (Note 5)	15,723	16,274	54,099	32,886
Income before income taxes	56,974	40,098	76,287	80,669
Income tax expense (Note 10)	20,970	14,687	30,360	29,597
Net income	\$ 36,004	\$ 25,411	\$ 45,927	\$ 51,072
Income per share - Basic and Diluted:				
Net income	\$ 36,004	\$ 25,411	\$ 45,927	\$ 51,072
Preferred stock dividends	(494)	(5,086)	(4,726)	(10,048)
Net income available to common shareholders	\$ 35,510	\$ 20,325	\$ 41,201	\$ 41,024
Earnings per share:				
Basic	\$ 0.35	\$ 0.23	\$ 0.43	\$ 0.47
Diluted	\$ 0.34	\$ 0.23	\$ 0.42	\$ 0.46
Weighted average common shares outstanding:				
Basic	102,723	87,353	95,088	87,347
Diluted	105,908	88,223	97,972	88,452

Table of Contents**GNC HOLDINGS INC. AND SUBSIDIARIES****Consolidated Statement of Stockholders Equity and Comprehensive Income (Loss)**

(in thousands, including share data)

	Common Stock Class A		Class B		Treasury Stock	Paid-in- Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
	Shares	Dollars	Shares	Dollars					
Balance at December 31, 2010	59,199	\$ 60	28,169	\$ 28	\$ (2,277)	\$ 451,728	\$ 171,224	\$ (1,280)	\$ 619,483
<i>Comprehensive income (loss):</i>									
Net income	-	-	-	-	-	-	45,927	-	45,927
Unrealized gain on derivatives designated and qualified as cash flow hedges, net of tax of \$2,718	-	-	-	-	-	-	-	4,751	4,751
Foreign currency translation adjustments	-	-	-	-	-	-	-	1,120	1,120
<i>Comprehensive income</i>									<i>51,798</i>
Issuance of common stock	16,000	16	-	-	-	237,237	-	-	237,253
Conversion of stock Preferred stock	14,387	14	(14,387)	(14)	-	-	-	-	-
dividends	-	-	-	-	-	-	(4,726)	-	(4,726)
Exercise of stock options	478	-	-	-	-	4,620	-	-	4,620
Non-cash stock-based compensation	-	-	-	-	-	2,215	-	-	2,215
Balance at June 30, 2011 (unaudited)	90,064	\$ 90	13,782	\$ 14	\$ (2,277)	\$ 695,800	\$ 212,425	\$ 4,591	\$ 910,643
Balance at December 31, 2009	59,170	\$ 60	28,169	\$ 28	\$ (2,474)	\$ 448,556	\$ 95,263	\$ (7,199)	\$ 534,234
<i>Comprehensive income (loss):</i>									
Net income	-	-	-	-	-	-	51,072	-	51,072
Unrealized gain on derivatives designated and qualified as cash flow hedges, net of tax of \$874	-	-	-	-	-	-	-	1,526	1,526
Foreign currency translation adjustments	-	-	-	-	-	-	-	(446)	(446)
<i>Comprehensive income</i>									<i>52,152</i>
Purchase of treasury stock	14	-	-	-	-	90	-	-	90
Preferred stock dividends	-	-	-	-	-	-	(10,048)	-	(10,048)
	-	-	-	-	-	1,576	-	-	1,576

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Non-cash stock-based
compensation

Balance at June 30, 2010 (unaudited)	59,184	\$	60	28,169	\$	28	\$	(2,474)	\$	450,222	\$	136,287	\$	(6,119)	\$	578,004
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The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

(unaudited)

(in thousands)

	Six months ended June 30,	
	2011	2010
<u>CASH FLOWS FROM OPERATING ACTIVITIES:</u>		
Net income	\$ 45,927	\$ 51,072
<u>Adjustments to reconcile net income to net cash provided by operating activities:</u>		
Write-off of deferred financing fees - early debt extinguishment	17,418	-
Amortization of original issue discount - early debt extinguishment	2,437	-
Depreciation expense	19,085	18,821
Amortization of intangible assets	3,806	4,051
Amortization of deferred financing fees	1,401	2,124
Amortization of original issue discount	235	201
Increase in provision for inventory losses	8,847	5,943
Non-cash stock-based compensation	2,215	1,576
Increase (decrease) in provision for losses on accounts receivable	180	(662)
Changes in assets and liabilities:		
Decrease in receivables	831	2,671
Increase in inventory	(40,884)	(31,695)
(Increase) decrease in other working capital	(9,781)	5,374
Increase in accounts payable	30,158	24,052
Decrease in interest payable	(11,369)	(1,264)
Increase in accrued liabilities	9,011	4,351
Net cash provided by operating activities	79,517	86,615
<u>CASH FLOWS FROM INVESTING ACTIVITIES:</u>		
Capital expenditures	(16,455)	(13,675)
Franchise store conversions	284	64
Investment in joint ventures	(1,020)	-
Store acquisition costs	(686)	(240)
Net cash used in investing activities	(17,877)	(13,851)
<u>CASH FLOWS FROM FINANCING ACTIVITIES:</u>		
Payment of 2007 Senior Credit Facility	(644,382)	-
Repurchase of Class A preferred stock	(223,107)	-
Payment on 2011 Senior Credit Facility	(300,000)	-
Redemption of Senior Toggle Notes	(300,000)	-
Redemption of Senior Subordinated Notes	(110,000)	-
Issuance of Class A Common Stock	237,253	90
Borrowings on 2011 Senior Credit Facility	1,196,200	-
Proceeds from exercised stock options	3,325	-
Tax benefit from exercise of stock options	1,612	-
Payments on long-term debt	(783)	(966)
Deferred financing fees	(17,346)	-
Net cash used in financing activities	(157,228)	(876)
Effect of exchange rate on cash and cash equivalents	(344)	72
Net (decrease) increase in cash and cash equivalents	(95,932)	71,960
Beginning balance, cash and cash equivalents	193,902	89,948
Ending balance, cash and cash equivalents	\$ 97,970	\$ 161,908

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

Table of Contents

GNC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. NATURE OF BUSINESS

General Nature of Business. GNC Holdings, Inc., formerly GNC Acquisition Holdings Inc., a Delaware corporation (Holdings), and collectively with its subsidiaries and, unless the context requires otherwise, its and their respective predecessors, the Company), 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 three primary 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 www.drugstore.com. Franchise stores are located in the United States and 50 international countries (including distribution centers where retail sales are made). The Company operates its primary manufacturing facilities in South Carolina and distribution centers in Arizona, Pennsylvania and South Carolina. 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.

In March 2011, General Nutrition Centers, Inc. (Centers), a wholly owned subsidiary of Holdings, entered into the 2011 Senior Credit Facility, consisting of a \$1.2 billion Term Loan Facility and an \$80.0 million Revolving Credit Facility, and utilized the proceeds to repay all outstanding indebtedness under the 2007 Senior Credit Facility, the Senior Notes, and the Senior Subordinated Notes.

In April 2011, Holdings consummated an initial public offering of 16.0 million shares of its Class A common stock (the IPO), at an initial public offering (the IPO) price of \$16.00 per share. The net proceeds from the IPO, together with cash on hand, were used to redeem all outstanding Series A preferred stock, repay approximately \$300.0 million of outstanding borrowings under the Term Loan Facility, and pay approximately \$11.1 million to satisfy obligations under the ACOF Management Services Agreement and the Class B common stock.

NOTE 2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been omitted. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the prospectus (the Prospectus) contained in the Company s Registration Statement on Form S-1, as amended (Registration No. 333-169618), which was declared effective on March 31, 2011 (the Registration Statement). There have been no material changes to the application of critical accounting policies and significant judgments and estimates since December 31, 2010.

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, 2011.

Principles of Consolidation. The consolidated financial statements include the accounts of Holdings, all of its subsidiaries and a variable interest entity. All material intercompany transactions have been eliminated in consolidation.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

Use of Estimates. The preparation of financial statements in conformity with GAAP 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 regular 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.

Financial Instruments and Derivatives. As part of the Company's financial risk management program, it has historically used certain derivative financial instruments to reduce its exposure to market risk for changes in interest rates primarily in respect of its long-term debt obligations. The Company has not historically entered into, and does not intend to enter into, derivative transactions for speculative purposes and holds no derivative instruments for trading purposes. Floating-to-fixed interest rate swap agreements, designated as cash flow hedges of interest rate risk, were entered into from time to time to hedge the Company's exposure to interest rate changes on a portion of the Company's floating rate debt. The interest rate swap agreements converted a portion of the Company's floating rate debt to fixed rate debt. Interest rate floors designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty if interest rates fall below the strike rate on the contract in exchange for an upfront premium. The Company recorded the fair value of these contracts as an asset or a liability, as applicable, in the balance sheet, with the offset to accumulated other comprehensive income (loss), net of tax. The Company measured hedge effectiveness by assessing the changes in the fair value or expected future cash flows of the hedged item. The ineffective portions, if any, were recorded in interest expense in the current period.

Derivatives designated as hedging instruments were recorded in the consolidated balance sheet at fair value as follows:

Balance Sheet Location		June 30, 2011 (unaudited)	Fair Value (in thousands)	December 31, 2010
Interest Rate Products	Other current liabilities	\$	-	\$ 4,395
Interest Rate Products	Other long-term liabilities	\$	-	\$ 3,074

For the period ended December 31, 2010, the Company had interest rate swap agreements outstanding that effectively converted notional amounts of an aggregate \$550.0 million of debt from floating to fixed interest rates. The four outstanding agreements were to mature between April 2011 and September 2012. Amounts related to derivatives were reported in accumulated other comprehensive income (loss) and reclassified to interest expense as interest payments were made on the Company's variable-rate debt. In conjunction with a refinancing transaction (the Refinancing) on March 4, 2011, the Company repaid in full the 2007 Senior Credit Facility (the 2007 Senior Credit Facility), its outstanding Senior Notes and its outstanding Senior Subordinated Notes (as defined below), and the four agreements were settled and terminated for an aggregate cash payment of \$8.7 million. During the

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first quarter of 2011, \$8.1 million of accumulated unrealized losses on the swaps was reclassified to interest expense, of which \$5.8 million was accelerated due to the debt retirement and swap terminations on March 4, 2011. No such derivative instruments are currently outstanding.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

Components of gains and losses recorded in the consolidated balance sheet and consolidated income statements for the three months ended June 30, 2011 and 2010 were as follows:

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
(unaudited) (in thousands)			
2011			
Interest Rate Products	\$ -	Interest income (expense)	\$ -
2010			
Interest Rate Products	\$ (1,616)	Interest income (expense)	\$ (3,577)

Components of gains and losses recorded in the consolidated balance sheet and consolidated income statements for the six months ended June 30, 2011 and 2010 were as follows:

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
(unaudited) (in thousands)			
2011			
Interest Rate Products	\$ (639)		\$ (8,108)

Interest income
(expense)

2010



Transaction Related Cost. The Company recognizes transaction related costs as expenses in the period incurred. For the six months ended June 30, 2011, the Company recognized \$12.4 million of such expenses.

Recently Issued Accounting Pronouncements

As of June 30, 2011, there were no recently issued accounting standards that are expected to have a material impact on the Company's consolidated financial statements.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****NOTE 3. INVENTORIES**

Inventories at each respective period consisted of the following:

	June 30, 2011 (unaudited)		December 31, 2010
		(in thousands)	
Finished product ready for sale	\$ 337,901		\$ 319,212
Work-in-process, bulk product and raw materials	70,876		57,165
Packaging supplies	6,943		5,572
	\$ 415,720		\$ 381,949

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 the standard on intangibles and goodwill, 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 35 years.

For the six months ended June 30, 2011, the Company acquired 16 franchise stores. These acquisitions were accounted for utilizing the acquisition method of accounting and the Company recorded 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 \$1.9 million, of which \$0.7 million was paid in cash.

The following table summarizes the Company's goodwill activity:

	Retail	Franchising	Manufacturing/ Wholesale	Total
		(in thousands)		
Balance at December 31, 2010	\$ 305,097	\$ 117,303	\$ 202,841	\$ 625,241
Acquired franchise stores	637	-	-	637
Balance at June 30, 2011 (unaudited)	\$ 305,734	\$ 117,303	\$ 202,841	\$ 625,878

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The following table summarizes the Company's intangible asset activity:

	Retail Brand	Franchise Brand	Operating Agreements (in thousands)	Franchise Rights	Total
Balance at December 31, 2010	\$ 500,000	\$ 220,000	\$ 146,223	\$ 1,001	\$ 867,224
Acquired franchise stores	-	-	-	431	431
Amortization expense	-	-	(3,427)	(379)	(3,806)
Balance at June 30, 2011 (unaudited)	\$ 500,000	\$ 220,000	\$ 142,796	\$ 1,053	\$ 863,849

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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

	Estimated Life in years	Cost	June 30, 2011 Accumulated Amortization (unaudited)	Carrying Amount	Cost	December 31, 2010 Accumulated Amortization	Carrying Amount
(in thousands)							
Brands - retail	-	\$ 500,000	\$ -	\$ 500,000	\$ 500,000	\$ -	\$ 500,000
Brands - franchise	-	220,000	-	220,000	220,000	-	220,000
Retail agreements	25-35	31,000	(4,670)	26,330	31,000	(4,143)	26,857
Franchise agreements	25	70,000	(12,017)	57,983	70,000	(10,617)	59,383
Manufacturing agreements	25	70,000	(12,017)	57,983	70,000	(10,617)	59,383
Other intangibles	5	1,000	(500)	500	1,150	(550)	600
Franchise rights	1-5	4,133	(3,080)	1,053	3,702	(2,701)	1,001
		\$ 896,133	\$ (32,284)	\$ 863,849	\$ 895,852	\$ (28,628)	\$ 867,224

The following table represents future estimated amortization expense of other intangible assets, net, with definite lives at June 30, 2011:

Years ending December 31,	Estimated amortization expense (unaudited) (in thousands)
2011	3,773
2012	7,244
2013	7,039
2014	6,762
2015	6,668
Thereafter	112,363
Total	\$ 143,849

NOTE 5. LONG-TERM DEBT / INTEREST EXPENSE

Long-term debt at each respective period consisted of the following:

June 30, 2011	December 31, 2010
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(unaudited)
(in thousands)

2011 Senior Credit Facility	\$	897,243	\$	-
2007 Senior Credit Facility		-		644,382
Senior Notes		-		298,372
Senior Subordinated Notes		-		110,000
Mortgage		4,936		5,711
Capital leases		28		34
Total Debt		902,207		1,058,499
Less: current maturities		(1,592)		(28,070)
Long-term Debt	\$	900,615	\$	1,030,429

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The Company's net interest expense for each respective period was as follows:

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
	(unaudited) (in thousands)		(unaudited) (in thousands)	
2011 Senior Credit Facility:				
Term Loan	\$ 10,064	\$ -	\$ 13,990	\$ -
Revolver	159	-	208	-
Deferred fees writedown - early extinguishment	4,016	-	17,418	-
OID writedown - early extinguishment	881	-	2,437	-
Deferred financing fees amortization	505	1,068	1,401	2,124
Mortgage	231	116	320	231
OID amortization	127	102	235	201
Interest income	(260)	(161)	(477)	(298)
Senior Notes	-	4,853	4,808	9,709
Senior Subordinated Notes	-	2,956	3,054	5,912
Termination of interest rate swaps	-	-	5,819	-
2007 Senior Credit Facility:				
Term Loan	-	7,228	4,815	14,783
Revolver	-	112	71	224
Interest expense, net	\$ 15,723	\$ 16,274	\$ 54,099	\$ 32,886

Accrued interest at each respective period consisted of the following:

	June 30, 2011	December 31, 2010
	(unaudited)	
	(in thousands)	
2011 Senior Credit Facility	\$ 2,004	\$ -
2007 Senior Credit Facility	-	4,173
Senior Notes	-	5,717
Senior Subordinated Notes	-	3,482
Total	\$ 2,004	\$ 13,372

On March 4, 2011, Centers entered into the 2011 Senior Credit Facility, consisting of a \$1.2 billion term loan facility (the Term Loan Facility) and an undrawn \$80.0 million revolving credit facility (the Revolving Credit Facility) and, together with the Term Loan Facility, the 2011 Senior Credit Facility). The Term Loan Facility will mature in March 2018. The Revolving Credit Facility will mature in March 2016. Interest on the 2011 Senior Credit Facility accrues at a variable rate and was 4.25% at June 30, 2011. Interest is accrued at a rate, at the Company's option, per annum equal to (A) the sum of (i) the greatest of (a) the prime rate (as publicly announced by JPMorgan Chase Bank, N.A. as its prime rate in effect), (b) the federal funds effective rate plus 0.50% and, (c) one month adjusted LIBOR (or if greater, 1.25%) plus 1.0% plus (ii) 2.0% or (B) the sum of (i) adjusted LIBOR (or if greater, 1.25%) plus (ii) 3.0%. Additionally, the Company is required to pay a commitment fee to the lenders under the Revolving Credit

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Facility in respect of unutilized revolving loan commitments at a rate of 0.5% per annum. As of June 30, 2011, \$8.2 million of the Revolving Credit Facility was pledged to secure letters of credit. The 2011 Senior Credit Facility is collateralized by first priority pledges (subject to permitted liens) of the equity interests of each of Centers and Centers' domestic subsidiaries. In connection with the Refinancing on March 4, 2011, the Company incurred \$17.3 million in deferred financing costs. The \$1.2 billion Term Loan Facility was recorded net of original issue discount of \$3.8 million. The Company used part of the net proceeds from the IPO to repay \$300.0 million of outstanding borrowings under the Term Loan Facility. In conjunction with the \$300.0 million prepayment, the Company recognized early extinguishment costs from deferred financing costs and original issue discount of \$4.0 million and \$0.9 million, respectively.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The 2011 Senior Credit Facility contains customary covenants, including incurrence covenants and certain other limitations on the ability of GNC Corporation, Centers, and Centers' subsidiaries to incur additional debt, guarantee other obligations, grant liens on assets, make investments or acquisitions, dispose of assets, make optional payments or modifications of other debt instruments, pay dividends or other payments on capital stock, engage in mergers or consolidations, enter into sales and leaseback transactions, enter into arrangements that restrict GNC Corporation's, Centers' and Centers' subsidiaries' ability to pay dividends or grant liens, engage in transactions with affiliates, and change the passive holding company status of GNC Corporation. The Revolving Credit Facility also requires that, to the extent borrowings outstanding thereunder exceed \$25.0 million, Centers and its domestic subsidiaries meet a senior secured debt ratio of consolidated senior secured debt to consolidated EBITDA (as defined in the Revolving Credit Facility). Such ratio test is 4.75 to 1.00 for the period from June 30, 2011 through and including March 31, 2013, and 4.25 to 1.00 thereafter.

As of June 30, 2011, the Company believes that it is in compliance with all covenants under the 2011 Senior Credit Facility.

At December 31, 2010, the interest rate for the 2007 Senior Credit Facility was 2.5%. At December 31, 2010, the interest rate for the Senior Notes was 5.8%. In connection with the Refinancing on March 4, 2011, the 2007 Senior Credit Facility, Senior Notes and Senior Subordinated Notes were repaid.

NOTE 6. FINANCIAL INSTRUMENTS

At June 30, 2011 and December 31, 2010, the Company's financial instruments consisted of cash and cash equivalents, receivables, franchise notes receivable, accounts payable and long-term debt. The carrying amount of cash and cash equivalents, receivables, accounts payable and accrued liabilities approximates their fair value because of the short maturity of these instruments. Based on the interest rates currently available and their underlying risk, the carrying value of the franchise notes receivable approximates their fair value. These fair values are reflected net of reserves, which are recognized according to Company policy. The Company determined the estimated fair values of its debt by using currently available market information and estimates and assumptions where appropriate. As considerable judgment is required to determine these estimates, changes in the assumptions or methodologies may have an effect on these estimates. The carrying amount and estimated fair values of the Company's financial instruments are as follows:

	June 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(unaudited)			
	(in thousands)			
Cash and cash equivalents	\$ 97,970	\$ 97,970	\$ 193,902	\$ 193,902
Receivables, net	100,706	100,706	102,874	102,874
Franchise notes receivable, net	6,185	6,185	4,496	4,496
Accounts payable	128,793	128,793	98,662	98,662

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Long-term debt (including current portion)	902,207	902,714	1,058,499	1,007,070
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Table of Contents

GNC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 7. COMMITMENTS AND CONTINGENCIES

Litigation

The Company is engaged in various legal actions, claims and proceedings arising in the normal course of business, including claims related to breach of contracts, products liabilities, intellectual property matters and employment-related matters resulting from the Company's business activities. As with most actions such as these, an estimation of any possible and/or ultimate liability cannot always be determined.

The Company continues to assess the requirement to account for additional contingencies in accordance with the standard on contingencies. If the Company is required to make a payment in connection with an adverse outcome in these matters, it could have a material impact on its financial condition, operating results, and cash flows.

As a manufacturer and retailer of nutritional supplements and other consumer products that are ingested by consumers or applied to their bodies, the Company has been and is currently subjected to various product liability claims. Although the effects of these claims to date have not been material to the Company, it is possible that current and future product liability claims could have a material adverse impact on its business, financial condition or cash flows. The Company currently maintains product liability insurance with a deductible/retention of \$3.0 million per claim with an aggregate cap on retained loss of \$10.0 million. The Company typically seeks and has obtained contractual indemnification from most parties that supply raw materials for its products or that manufacture or market products it sells. The Company also typically seeks to be added, and has been added, as an additional insured under most of such parties' insurance policies. The Company is also entitled to indemnification by a former owner of the Company for certain losses arising from claims related to products containing ephedra or Kava Kava sold prior to December 5, 2003. However, any such indemnification or insurance is limited by its terms and any such indemnification, as a practical matter, is limited to the creditworthiness of the indemnifying party and its insurer, and the absence of significant defenses by the insurers. The Company may incur material products liability claims, which could increase its costs and adversely affect its reputation, revenues and operating income.

Table of Contents

GNC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Hydroxycut Claims. On May 1, 2009, the FDA issued a warning on several Hydroxycut-branded products manufactured by Lovate Health Sciences U.S.A., Inc. (Lovate). The FDA warning was based on 23 reports of liver injuries from consumers who claimed to have used the products between 2002 and 2009. As a result, Lovate voluntarily recalled 14 Hydroxycut-branded products. Following the recall, the Company was named, among other defendants, in approximately 85 lawsuits related to Hydroxycut-branded products in 13 states. Lovate previously accepted the Company's tender request for defense and indemnification under its purchasing agreement with the Company and, as such, Lovate has accepted the Company's request for defense and indemnification in the Hydroxycut matters. The Company's ability to obtain full recovery in respect of any claims against the Company in connection with products manufactured by Lovate under the indemnity is dependent on Lovate's insurance coverage, the creditworthiness of its insurer, and the absence of significant defenses by such insurer. To the extent the Company is not fully compensated by Lovate's insurer, it can seek recovery directly from Lovate. The Company's ability to fully recover such amounts may be limited by the creditworthiness of Lovate.

As of June 30, 2011, there were 76 pending lawsuits related to Hydroxycut in which the Company had been named: 70 individual, largely personal injury claims and six putative class action cases, generally inclusive of claims of consumer fraud, misrepresentation, strict liability and breach of warranty. As any liabilities that may arise from these matters are not probable or reasonably estimable at this time, no liability has been accrued in the accompanying financial statements.

By court order dated October 6, 2009, the United States Judicial Panel on Multidistrict Litigation consolidated pretrial proceedings of many of the pending actions in the Southern District of California (In re: Hydroxycut Marketing and Sales Practices Litigation, MDL No. 2087).

Pro-Hormone/Androstenedione Cases. The Company is currently defending five lawsuits (the Andro Actions) in California, Florida, New Jersey, New York and Pennsylvania relating to the sale by the Company of certain nutritional products, between 1999 and 2004, alleged to contain the ingredients commonly known as Androstenedione, Androstenediol, Norandrostenedione, and Norandrostenediol (collectively, Andro Products). In each of the Andro Actions, plaintiffs sought, or are seeking, to certify a class and obtain damages on behalf of the class representatives and all those similarly-situated who purchased from the Company certain nutritional supplements alleged to contain one or more Andro Products. During the first quarter of 2011, the sole Andro Action filed in California was settled for an immaterial amount, pending approval by the court. Unlike the other states in which the plaintiffs reside, California law prohibits one of the ingredients; therefore, the Company does not believe that the outcome in California provides a basis for determining the potential outcome of the other Andro Actions. As any liabilities that may arise from these other Andro Actions are not probable or reasonably estimable at this time, no liability has been accrued in the accompanying financial statements.

Commitments

The Company maintains certain purchase commitments with various vendors to ensure its operational needs are fulfilled. As of June 30, 2011, such future purchase commitments consisted of \$6.8 million of advertising commitments. Other commitments related to the Company's business operations cover varying periods of time and are not significant. All of these commitments are expected to be fulfilled with no adverse consequences to the Company's operations or financial condition.

Environmental Compliance

In March 2008, the South Carolina Department of Health and Environmental Control (the "DHEC") requested that the Company investigate contamination associated with historical activities at its South Carolina facility. These investigations have identified chlorinated solvent impacts in soils and groundwater that extend offsite from our facility. The Company is awaiting DHEC approval of the scope of additional investigations in order to understand the extent of these impacts and develop appropriate remedial measures for DHEC approval. At this stage of the investigation, however, it is not possible to estimate the timing and extent of any remedial action that may be required, the ultimate cost of remediation, or the amount of the Company's potential liability.

Table of Contents

GNC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In addition to the foregoing, the Company is subject to numerous federal, state, local and foreign environmental and health and safety laws and regulations governing its operations, including the handling, transportation, and disposal of the Company's non-hazardous and hazardous substances and wastes, as well as emissions and discharges from its operations into the environment, including discharges to air, surface water and groundwater. Failure to comply with such laws and regulations could result in costs for remedial actions, penalties, or the imposition of other liabilities. New laws, changes in existing laws or the interpretation thereof, or the development of new facts or changes in their processes could also cause the Company to incur additional capital and operation expenditures to maintain compliance with environmental laws and regulations and environmental permits. The Company also is subject to laws and regulations that impose liability and cleanup responsibility for releases of hazardous substances into the environment without regard to fault or knowledge about the condition or action causing the liability. Under certain of these laws and regulations, such liabilities can be imposed for cleanup of previously owned or operated properties, or for properties to which substances or wastes that were sent in connection with current or former operations at its facilities. The presence of contamination from such substances or wastes could also adversely affect the Company's ability to sell or lease its properties, or to use them as collateral for financing. From time to time, the Company has incurred costs and obligations for correcting environmental and health and safety noncompliance matters and for remediation at or relating to certain of its properties or properties at which its waste has been disposed. The Company believes it has complied with, and is currently complying with, its environmental obligations pursuant to environmental and health and safety laws and regulations and that any liabilities for noncompliance will not have a material adverse effect on its business, financial performance, or cash flows. However, it is difficult to predict future liabilities and obligations, which could be material.

NOTE 8. STOCK-BASED COMPENSATION PLANS

The Company has outstanding stock-based compensation awards that were granted by the Holdings' Compensation Committee of Holdings' Board of Directors (the Compensation Committee) under the following two stock-based employee compensation plans:

- the GNC Holdings, Inc. 2011 Stock and Incentive Plan (the 2011 Stock Plan) adopted in March 2011; and
- the GNC Acquisition Holdings Inc. 2007 Stock Incentive Plan adopted in March 2007 (as amended, the 2007 Stock Plan).

Both plans have provisions that allow for the granting of stock options, restricted stock and other stock based awards and are available to certain eligible employees, directors, consultants or advisors as determined by the Compensation Committee. Stock options under the plans were granted with exercise prices at or above fair market value on the date of grant, typically vest over a four- or five-year period and expire seven or ten years from the date of grant.

Up to 8.5 million shares of Class A common stock may be issued under the 2011 Stock Plan (subject to adjustment to reflect certain transactions and events specified in the 2011 Stock Plan for any award grant). If any award granted under the 2011 Stock Plan expires, terminates or is cancelled without having been exercised in full, the number of shares underlying such unexercised

award will again become available for awards under the 2011 Stock Plan. The total number of shares of Class A common stock available for awards under the 2011 Stock Plan will be reduced by (i) the total number of stock options or stock appreciation rights exercised, regardless of whether any of the shares of Class A common stock underlying such awards are not actually issued to the participant as the result of a net settlement, and (ii) any shares of Class A common stock used to pay any exercise price or tax withholding obligation. In addition, the number of shares of Class A common stock that are subject to restricted stock, performance shares or other stock-based awards that are not subject to the appreciation of the value of a share of Class A common stock (Full Share Awards) that may be granted under the 2011 Stock Plan is limited by counting shares granted pursuant to such awards against the aggregate share reserve as 1.8 shares for every share granted. If any stock option, stock appreciation right or other stock-based award that is not a Full Share Award is cancelled, expires or terminates unexercised for any reason, the shares covered by such awards will again be available for the grant of awards under the 2011 Stock Plan. If any shares of Class A common stock that are subject to restricted stock, performance shares or other stock-based awards that are Full Share Awards are forfeited for any reason, 1.8 shares of Class A common stock will again be available for the grant of awards under the 2011 Stock Plan.

The Company will not grant any additional awards under the 2007 Stock Plan. No stock appreciation rights, restricted stock, deferred stock or performance shares were granted under the 2007 Stock Plan.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The Company utilizes the Black Scholes model to calculate the fair value of options under both of the Holdings' plans. The resulting compensation cost is recognized in the Company's financial statements over the option vesting period. The Company recognized \$1.4 million and \$0.7 million of non-cash stock-based compensation expense for the three months ended June 30, 2011 and 2010, respectively. The Company recognized \$2.2 million and \$1.6 million of non-cash stock-based compensation expense for the six months ended June 30, 2011 and 2010, respectively. At June 30, 2011, there was \$13.2 million of total unrecognized compensation cost related to non-vested stock-based compensation for all awards previously made that are expected to be recognized over a weighted average period of approximately 4.2 years.

During the six months ended, June 30, 2011 the total intrinsic value of awards exercised was \$4.4 million and the total amount of cash received from the exercise of options was \$3.3 million. The tax impact associated with the exercise of awards for the six months ended June 30, 2011 was a benefit of \$1.3 million and was recorded to additional capital. During the six months ended June 30, 2010, there were no options exercised.

The following table sets forth a summary of stock options under all plans for the six months ended June 30, 2011:

	Total Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value (in Thousands)
Outstanding at December 31, 2010	9,344,188	\$ 7.60		
Granted	1,605,000	19.06		
Exercised	(478,660)	6.95		
Forfeited	(449,700)	14.37		
Expired	(5,800)	10.81		
Outstanding at June 30, 2011	10,015,028	\$ 9.16	6.5	\$ 126,660
Exercisable at June 30, 2011	6,917,196	\$ 7.10	6.0	\$ 101,771

The Black Scholes model utilizes the following assumptions in determining a fair value: price of underlying stock, award exercise price, expected term, risk-free interest rate, expected dividend yield and expected stock price volatility over the award's expected term. Due to the utilization of these assumptions, the existing models do not necessarily represent the definitive fair value of awards for future periods. As Holdings has had minimal exercises of stock options under its plans, the option term has been estimated by considering both the vesting period, which typically for both plans has been five or four years, and the contractual term, which historically has been either seven or ten years. Until the IPO, the fair value of the stock was estimated based upon the net enterprise value of the Company, discounted to reflect the lack of liquidity and control associated with the stock. Following the consummation of the IPO, the fair value of the stock was based upon the closing price of the Class A common stock as reported on the New York Stock Exchange (the NYSE). Volatility is estimated based upon the Company utilizing its current peer group average

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to estimate the expected volatility.

The assumptions used in the Company's Black Scholes valuation related to stock option grants made during the six months ended June 30, 2011 were as follows:

Dividend yield	0.00%
Expected option life	4.5-7.0 years
Volatility factor percentage of market price	38.5%
Discount rate	2.2%-2.9%

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The following table sets forth a summary of restricted stock units granted under the 2011 Stock Plan and related information for the six months ended June 30, 2011:

	Restricted Stock Units	Weighted Average Fair Value
Granted	102,560	\$ 18.82
Vested	-	-
Forfeited	(12,020)	18.82
Outstanding at June 30, 2011	90,540	\$ 18.82

NOTE 9. SEGMENTS

The Company has three reportable segments, each of which represents an identifiable component of the Company for which separate financial information is available. This information is utilized by the Company's management to assess performance and allocate assets accordingly. The Company's management evaluates segment operating results based on several indicators. The primary key performance indicators are sales and operating income or loss for each segment. Operating income or loss, as evaluated by management, excludes certain items that are managed at the consolidated level, such as distribution and warehousing, impairments and other corporate costs. The following table represents key financial information for each of the Company's reportable segments, identifiable by the distinct operations and management of each: Retail, Franchising and Manufacturing/Wholesale. The Retail reportable segment includes the Company's corporate store operations in the United States, Canada and its GNC.com business. The Franchise reportable segment represents the Company's franchise operations, both domestically and internationally. The Manufacturing/Wholesale reportable segment represents the Company's manufacturing operations in South Carolina and the Wholesale sales business. This segment supplies the Retail and Franchise segments, along with various third parties, with finished products for sale. The Warehousing and Distribution and Corporate costs represent the Company's administrative expenses. The accounting policies of the segments are the same as those described in the Basis of Presentation and Summary of Significant Accounting Policies.

Table of Contents**GNC HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The following table represents key financial information of the Company's segments:

	Three months ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2011	2010	2011	2010
	(unaudited)			
	(in thousands)			
Revenue:				
Retail	\$ 384,304	\$ 342,834	\$ 768,007	\$ 693,668
Franchise	82,827	72,870	160,211	145,472
Manufacturing/Wholesale:				
Intersegment (1)	57,032	51,262	107,731	98,607
Third Party	51,404	40,026	96,325	81,609
Sub total Manufacturing/Wholesale	108,436	91,288	204,056	180,216
Sub total segment revenues	575,567	506,992	1,132,274	1,019,356
Intersegment elimination (1)	(57,032)	(51,262)	(107,731)	(98,607)
Total revenue	\$ 518,535	\$ 455,730	\$ 1,024,543	\$ 920,749
Operating income:				
Retail	\$ 63,409	\$ 49,382	\$ 127,006	\$ 99,578
Franchise	25,938	22,634	51,294	44,606
Manufacturing/Wholesale	21,043	16,367	37,597	