HEALTH FITNESS CORP /MN/
Form 10-Q
August 13, 2001

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

FORM 10-Q

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

For the quarterly period ended June 30, 2001

OR

[ ] 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: 0-25064

HEALTH FITNESS CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota	41-1580506
(State of incorporation or organization)	(I.R.S. Employer Identification No.)
3500 West 80th Street, Bloomington, Minnesota	55431
(Address of principal executive offices)	(Zip Code)

(952) 831-6830
(Registrant's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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. [X] Yes [ ] No

The number of shares outstanding of each of the registrant's classes of capital stock, as of August 10, 2001 was:

Common Stock, $.01 par value, 12,265,250 shares

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HEALTH FITNESS CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
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HEALTH FITNESS CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

ASSETS
Current Assets
Cash
Trade and other accounts receivable, less allowance for doubtful accounts of $159,600 and $262,600, respectively
Prepaid expenses and other

Total current assets

Property and Equipment, net
Other Assets
 Goodwill, less accumulated amortization of $2,384,600 and $2,183,400, respectively
 Intangible assets, less accumulated amortization of $498,300 and $551,900, respectively

 Trade and other notes receivable
 Other

LIABILITIES AND STOCKHOLDER'S EQUITY

Current Liabilities
 Note payable
 Current maturities of long-term obligations
 Trade accounts payable
 Accrued salaries, wages, and payroll taxes
 Other accrued liabilities
 Deferred revenue

 Total current liabilities
Long-term Obligations, less current maturities

Commitments and Contingencies
Stockholder's Equity
 Preferred stock, $0.01 par value; 5,000,000 shares authorized, none issued or outstanding
 Common stock, $0.01 par value; 25,000,000 shares authorized; shares issued and outstanding
 Additional paid-in capital
 Accumulated deficit

The accompanying notes are an integral part of the financial statements

HEALTH FITNESS CORPORATION
CONSOLIDATED STATEMENTS OF EARNINGS
(UNAUDITED)

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000
Revenue	$ 6,578,716	$ 6,284,961
Cost of Revenues	5,091,116	4,749,313
Gross Profit	1,487,600	1,535,648
Operating Expenses		
Salaries	526,633	467,319
Selling, general, and administrative	614,567	606,649
Re-engineering	--	66,867
Total operating expenses	1,141,200	1,140,835
Operating Profit	346,400	394,813
Other Income (Expense)		
Interest expense	(116,906)	(200,990)
Gain on sale of subsidiary	--	--
Other, net	5,771	8,875
Earnings Before Income Taxes	235,265	202,698
Income Taxes	13,087	(89)
Net Earnings	$ 222,178	$ 202,787
Net Earnings Per Share:		
Basic	$ 0.02	$ 0.02
Diluted	$ 0.01	$ 0.02
Weighted Average Common Shares Outstanding		
Basic	12,165,250	12,139,906
Diluted	12,711,750	12,541,911

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

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HEALTH FITNESS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Cash Flows From Operating Activities:

Net earnings
Adjustments to reconcile net earnings to net cash provided by operating activities:
Common stock and warrants issued for services and compensation
Depreciation and amortization
Amortization of financing costs
Gain on sale of subsidiary
Changes in operating assets and liabilities:
Trade accounts and notes receivable
Prepaid expenses and other
Other assets
Trade accounts payable
Accrued liabilities and other
Deferred revenue

Net cash provided by operating activities

Cash Flows From Investing Activities:
Purchases of property and equipment
Net proceeds from sale of equipment
Net proceeds from sale of subsidiary
Payments in connection with earn-out provisions
Payment for non-compete agreement

Net cash provided by (used in) investing activities

Cash Flows From Financing Activities:
Borrowings under line of credit
Repayments of line of credit
Proceeds from issuance of common stock
Repayment of long term debt

Net cash used in financing activities

Net Decrease in Cash
Cash at Beginning of Period

Cash at End of Period

The accompanying notes are an integral part of the financial statements

HEALTH FITNESS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. They should be read in conjunction with the annual financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. In the opinion of management, the interim consolidated financial statements include all adjustments (consisting of normal recurring accruals) necessary for the fair presentation of the results for interim periods presented. Operating results for the three and six months ended June 30, 2001 are not necessarily indicative of the operating results for the year ending December 31, 2001. The unaudited consolidated balance sheet as of December 31, 2000 has been derived from the audited balance sheet as of that date.

Certain reclassifications have been made to the consolidated financial statements as of and for the three and six months ended June 31, 2000. Such reclassifications had no effect on net income or stockholders' equity as previously reported.

NOTE 2. FINANCING

In July 2000, the Company entered into a credit agreement with Coast Business Credit for a $5.0 million working capital facility. The interest rate on the loan is prime plus 3.0%, with future reductions based on the achievement of certain tangible net worth levels. Available credit under the loan is based upon certain profitability and cash collection multiples. As of June 30, 2001, the available credit was approximately $1,837,000. Borrowings under the credit agreement are collateralized by substantially all of the Company's assets. Additionally, the Company is subject to certain financial covenants that measure net worth, interest coverage and debt capacity. The Company is in compliance with all of the covenants in effect on June 30, 2001.

NOTE 3. INCOME TAXES

Income taxes were calculated based on management's estimate of the Company's effective tax rate. Income tax expense represents minimum state income taxes as well as federal taxes due because of alternative minimum tax calculations.

NOTE 4. SALE OF SUBSIDIARY

Effective January 1, 2001, the Company sold its subsidiary, International Fitness Club Network (IFCN). The subsidiary was in the business of organizing and maintaining a network of commercial fitness and health clubs and marketing memberships in such clubs to employers and insurance companies. The Company received net proceeds of approximately $369,000, including selling costs of approximately $56,000, and recorded a gain on sale of approximately $229,000.

NOTE 5. RECENT ACCOUNTING PRONOUNCEMENTS

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, Business Combinations, and SFAS 142, Goodwill and Intangible Assets. SFAS 141 is effective for all business combinations completed after June 30, 2001. SFAS 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this Statement apply to goodwill and other intangible assets acquired between July 1, 2001 and the effective date of SFAS 142. Major provisions of these Statements and their effective dates for the Company are as follows:

o all business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001.

o intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability

- goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized. Effective January 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization.

- effective January 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator

The Company is currently reviewing the affect of these Statements on their financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL. Health Fitness Corporation and its wholly owned subsidiaries (the "Company") provides fitness and wellness management services and products to corporations, hospitals, communities, and universities primarily located in the United States and Canada. Fitness and wellness management services include the development, marketing, and management of corporate, hospital, and community based fitness centers, health related programming, and on-site physical therapy. Effective January 1, 2001, the Company sold its IFCN subsidiary, which maintained and sold memberships in a network of independently owned and operated commercial fitness and health clubs.

RESULTS OF OPERATIONS FOR THE QUARTER ENDED JUNE 30, 2001 COMPARED TO THE QUARTER ENDED JUNE 31, 2000.

REVENUES. Revenues increased $294,000 or 4.7% to $6,579,000 for the three months ended June 30, 2001, from $6,285,000 for the three months ended June 30, 2000. This increase is primarily attributed to a $162,000 increase in management fee revenues from the Company's corporate fitness division along with a $283,000 increase in management fee revenues from the Company's hospital-based fitness division. These increases are primarily attributed to new contracts secured during the latter half of 2000. Offsetting this increase was a decrease in revenues of $151,000, of which $132,000 relates to the Company's sale of its IFCN subsidiary, and $19,000 relates to the Company's on-site physical therapy business, which experienced a decrease in contracts over 2000.

OPERATING PROFIT. Operating profit decreased $49,000 to $346,000 for the three months ended June 30, 2001, from $395,000 for the same period in 2000. This decrease is primarily attributed to $25,000 of nonrecurring management revenues that were recognized during the second quarter of 2000, which had no related expense. The Company also experienced an increase in employee-related costs for its corporate and hospital-based fitness facilities, with most of the increase being attributed to higher workers compensation and other employee benefits.

OTHER INCOME AND EXPENSE. Interest expense decreased $84,000 to $117,000 for the three months ended June 30, 2001, compared to $201,000 for the same period in 2000. This decrease is primarily attributed to a decrease in the interest rate on the Company's borrowings, as well as decreased levels of borrowing.

INCOME TAXES. Income tax expense increased $13,000 for the three months ended

June 30, 2001 compared to the same period in 2000 due to minimum state and federal income taxes anticipated in 2001. The Company has offset the majority of its current income tax liability with the tax benefit of its recognition of previously incurred net operating loss carryforwards.

NET EARNINGS. As a result of the above, net earnings for the three months ended June 30, 2001 was $222,000, a $19,000 increase from the same period in 2000.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2001 AS COMPARED TO THE SIX MONTHS ENDED JUNE 31, 2000.

REVENUES. Revenues decreased $19,000 or .2% to $13,005,000 for the six months ended June 30, 2001, from $13,024,000 for the six months ended June 30, 2000. This slight decrease is primarily attributed to a $459,000 loss of revenue from the Company's IFCN subsidiary, which was sold by the Company in January 2001. Also contributing to this decrease was a loss of revenue of $38,000 from the Company's on-site physical therapy division, which experienced a decrease in contracts over 2000. Offsetting this decrease in revenues was an increase in fitness center management revenues, including a $457,000 increase in the corporate fitness division and a $22,000 increase in the hospital-based fitness division, that resulted from new contracts secured during the latter half of 2000.

OPERATING PROFIT. Operating profit decreased $225,000 to $736,000 for the six months ended June 30, 2001, from $962,000 for the same period in 2000. This decrease is primarily attributed to $105,000 of nonrecurring management revenues that were recognized during the first six months of 2000, which had no related expense. The Company also experienced a $92,000 loss of operating income related to the sale of the IFCN subsidiary in January 2001, as well as increased employee-related costs for its corporate and hospital-based fitness facilities, which was primarily attributed to higher workers compensation and other employee benefits.

OTHER INCOME AND EXPENSE. Interest expense decreased $119,000 to $247,000 for the six months ended June 30, 2001, compared to $366,000 for the same period in 2000. This decrease is primarily attributed to a decrease in the interest rate on the Company's borrowings, as well as decreased levels of borrowing. Also, the Company recorded a $229,000 gain on sale of its IFCN subsidiary.

INCOME TAXES. Income tax expense increased $48,000 for the six months ended June 30, 2001 compared to the same period in 2000 due to minimum state and federal income taxes anticipated in 2001. The Company has offset the majority of its current income tax liability with the tax benefit of its recognition of previously incurred net operating loss carryforwards.

NET EARNINGS. As a result of the above, net earnings for the six months ended June 30, 2001 was $680,000, a $50,000 increase from the same period in 2000.

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LIQUIDITY AND CAPITAL RESOURCES

The Company had negative working capital of $1,042,000 at June 30, 2001, versus negative working capital of $2,775,000 at June 31, 2000. The increase in working capital is due to the reduction of borrowings under the line of credit as well as the reduction of accounts payable and other obligations.

Until July 2000, the Company had a revolving credit facility with Abelco Finance L.L.C. and other affiliates of Cerberus Partners, L.P. (the "Credit Facility"). The Company's ability to draw down on the Credit Facility was tied to the borrowing base formula which was based upon the Company's EBITDA (defined as earnings before interest, taxes, depreciation and amortization), revenues, or collections, whichever is less. The Credit Facility was secured by all of the Company's assets, including its accounts receivable, inventory, equipment, and general intangibles and was guaranteed in part by the Company's founder and former Chief Executive Officer. The advances under the Credit Facility accrued interest at a rate equal to 7.0% in excess of Chase Manhattan's prime rate, with a minimum rate of 15.5%. The Company was required to pay monthly interest payments on outstanding borrowings at the prime rate plus 4.5%, with a minimum rate of 13.0%. The unpaid interest (2.5%) was added to the principal balance of the facility, and accrued interest until paid. The Credit Facility was due September 2000. The Credit Facility was subject to various affirmative and negative covenants customary in transactions of this type, including a requirement to maintain certain financial ratios and limitations on the Company's ability to incur additional indebtedness, to make acquisitions outside of certain established parameters, or to make dividend distributions.

In July 2000, the Company entered into a credit agreement with Coast Business Credit for a $5.0 million working capital facility (the "Working Capital Facility"). Interest on the loan is at the prime rate plus 3.0%, with future reductions based on the achievement of certain net worth levels after March 31, 2001. Available credit under the Working Capital Facility is based upon certain profitability and cash collection multiples. As of June 30, 2001 the available credit was approximately $1,837,000. Additionally, the Company is subject to certain financial covenants that measure net worth, interest coverage and debt capacity. The Company is in compliance with all of the financial covenants in effect on June 30, 2001. The initial proceeds of the Working Capital Facility were used to pay off the Credit Facility with Abelco as well as the holders of certain subordinated debentures. The facility expires in July 2003.

The Company believes that sources of capital to meet future obligations in 2001 will be in the form of cash provided by operations and by the Company's new Working Capital Facility. The Company does not believe that inflation has had a significant impact on the results of its operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments, derivative commodity instruments or other such financial instruments. Transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency hedges. As a result, the exposure to market risk is not material.

CAUTIONARY STATEMENT

This Form 10-Q contains forward-looking statements within the meaning of federal securities laws. These statements include statements regarding intent, belief, or current expectations of the Company and its management and specifically includes the statement regarding cash expected to be available from operations. These forward-looking statements are not guarantees of the future performance and involve a number of risks and uncertainties that may cause the Company's actual results to differ materially from the results discussed in these statements. Please refer to Management's Discussion and Analysis contained within the Company's Annual Report on Form 10-K for the year ended December 31, 2000, for cautionary statements on important factors to consider in evaluating the forward-looking statements included in this Form 10-Q.

PART II. - OTHER INFORMATION

Item 1. Legal Proceedings

No Change

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

(a) The Annual Meeting of the Company's shareholders was held on Wednesday, May 16, 2001.

(b) Proxies for the Annual Meeting were solicited pursuant to Regulation A under the Securities Exchange Act of 1934, there was no solicitation in opposition to management's nominees, and the following persons were elected directors of the Company to serve until the next annual meeting of shareholders:

Nominee	Number of Votes For	Number of Votes Withheld
James A. Bernards	8,764,906	181,860
K. James Ehlen, M.D	8,764,506	182,260
Jerry V. Noyce	8,856,576	90,190
John C. Penn	8,856,576	90,190
Mark W. Sheffert	8,764,706	182,060
Linda Hall Whitmen	8,856,576	90,190
Rodney A. Young	8,764,906	181,860

(c) By a vote of 8,515,641 shares in favor, 389,097 shares opposed, 42,028 shares abstaining, and no shares represented by broker nonvotes, the shareholders approved a 200,000 share increase in the number of shares reserved for the Company's 1995 Employee Stock Purchase Plan.

(d) By a vote of 8,301,986 shares in favor, 607,280 shares opposed, 37,500 shares abstaining, and no shares represented by broker nonvotes, the shareholders approved an amendment to the Company's 1995 Stock Option Plan to permit incentive stock options to remain exercisable following termination of employment.

(e) By a vote of 8,888,213 shares in favor, 22,692 shares opposed, 35,861 shares abstaining, and no shares represented by broker nonvotes, the shareholders approved the selection of Grant Thornton LLP as the Company's independent auditors for the current fiscal year.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

See Exhibit Index on page following signatures

(b) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 13, 2001 HEALTH FITNESS CORPORATION

By /s/ Jerry Noyce

Jerry Noyce
Chief Executive Officer
(Principal Executive Officer)

By /s/ Wesley Winnekins

Wesley Winnekins
Chief Financial Officer
(Principal Financial and Accounting Officer)

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

EXHIBIT INDEX
HEALTH FITNESS CORPORATION
FORM 10-Q

Exhibit No.	Description
3.1	Articles of Incorporation, as amended, of the Company - incorporated by reference to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 1997
3.2	Restated By-Laws of the Company - incorporated by reference to the Company's Registration Statement on Form SB-2 No. 33-83784C
4.1	Specimen of Common Stock Certificate - incorporated by reference to the Company's Registration Statement on Form SB-2 No. 33-83784C

10.1*	Health Fitness Corporation 1995 Stock Option plan as amended to date
11.0	Statement re Computation of per Share Earnings

*designates a management contract or compensatory plan or arrangement