GNC HOLDINGS, INC.
Form 10-Q
April 26, 2018
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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 March 31, 2018

[ ] 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: 001-35113

GNC Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of Incorporation or organization)	20-8536244 (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. [X] 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).
[X] Yes [ ] No

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

Large accelerated filer [X]	Accelerated filer [ ]	Non-accelerated filer [ ]	Smaller reporting company [ ]	Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

As of April 23, 2018, there were 83,665,206 outstanding shares of Class A common stock, par value $0.001 per share (the "common stock"), of GNC Holdings, Inc.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(unaudited)
(in thousands)

	March 31, 2018	December 31, 2017
Current assets:		
Cash and cash equivalents	$53,871	$64,001
Receivables, net	114,712	126,650
Inventory (Note 4)	507,968	485,732
Prepaid and other current assets	78,677	66,648
Total current assets	755,228	743,031
Long-term assets:		
Goodwill	141,200	141,029
Brand name	324,400	324,400
Other intangible assets, net	97,963	99,715
Property, plant and equipment, net	179,547	186,562
Other long-term assets	29,423	25,026
Total long-term assets	772,533	776,732
Total assets	$1,527,761	$1,519,763
Current liabilities:		
Accounts payable	$175,151	$153,018
Current debt (Note 5)	213,111	—
Deferred revenue and other current liabilities	115,213	114,081
Total current liabilities	503,475	267,099
Long-term liabilities:		
Long-term debt (Note 5)	1,062,778	1,297,023
Deferred income taxes	56,923	56,060
Other long-term liabilities	83,831	85,502
Total long-term liabilities	1,203,532	1,438,585
Total liabilities	1,707,007	1,705,684
Contingencies (Note 7)		
Stockholders’ deficit:		
Common stock	130	130
Additional paid-in capital	1,002,604	1,001,315
Retained earnings	550,046	543,814
Treasury stock, at cost	(1,725,349)	(1,725,349)
Accumulated other comprehensive loss	(6,677)	(5,831)
Total stockholders’ deficit	(179,246)	(185,921)
Total liabilities and stockholders’ deficit	$1,527,761	$1,519,763

The accompanying notes are an integral part of the Consolidated Financial Statements.

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(unaudited)
(in thousands, except per share amounts)

	Three months ended March 31,	
	2018	2017
Revenue (Note 3)	$607,533	$654,948
Cost of sales, including warehousing, distribution and occupancy	400,659	435,086
Gross profit	206,874	219,862
Selling, general, and administrative	160,730	166,027
Other income, net	(245)	(1,133)
Operating income	46,389	54,968
Interest expense, net (Note 5)	21,773	15,894
Loss on debt refinancing	16,740	—
Income before income taxes	7,876	39,074
Income tax expense (Note 10)	1,686	14,330
Net income	$6,190	$24,744
Earnings per share (Note 8):		
Basic	$0.07	$0.36
Diluted	$0.07	$0.36
Weighted average common shares outstanding (Note 8):		
Basic	83,232	68,246
Diluted	83,368	68,300

The accompanying notes are an integral part of the Consolidated Financial Statements.

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(unaudited)
(in thousands)

	Three months ended March 31,	
	2018	2017
Net income	$6,190	$24,744
Other comprehensive (loss) income:		
Foreign currency translation (loss) gain	(846)	552
Comprehensive income	$5,344	$25,296

The accompanying notes are an integral part of the Consolidated Financial Statements.

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Deficit
(unaudited)
(in thousands)

	Common Stock Class A		Treasury Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Deficit
	Shares	Dollars					
Balance at December 31, 2017	83,567	$ 130	$ (1,725,349)	$ 1,001,315	$ 543,814	$ (5,831)	$ (185,921)
Comprehensive income	—	—	—	—	6,190	(846)	5,344
Dividend forfeitures on restricted stock	—	—	—	—	42	—	42
Restricted stock awards	149	—	—	—	—	—	—
Minimum tax withholding requirements	(54)	—	—	(223)	—	—	(223)
Stock-based compensation	—	—	—	1,512	—	—	1,512
Balance at March 31, 2018	83,662	$ 130	$ (1,725,349)	$ 1,002,604	$ 550,046	$ (6,677)	$ (179,246)
Balance at December 31, 2016	68,399	$ 114	$ (1,725,349)	$ 922,687	$ 693,682	$ (8,697)	$ (117,563)
Comprehensive income	—	—	—	—	24,744	552	25,296
Dividend forfeitures on restricted stock	—	—	—	—	242	—	242
Restricted stock awards	29	—	—	—	—	—	—
Minimum tax withholding requirements	(31)	—	—	(229)	—	—	(229)
Stock-based compensation	—	—	—	1,410	—	—	1,410
Balance at March 31, 2017	68,397	$ 114	$ (1,725,349)	$ 923,868	$ 718,668	$ (8,145)	$ (90,844)

The accompanying notes are an integral part of the Consolidated Financial Statements.

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Three months ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$6,190	$24,744
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	12,105	16,739
Amortization of debt costs	3,609	3,288
Stock-based compensation	1,512	1,410
Gains on refranchising	—	(124)
Loss on debt refinancing	16,740	—
Third-party fees associated with refinancing	(15,753)	—
Changes in assets and liabilities:		
Decrease in receivables	11,840	5,890
(Increase) in inventory	(22,766)	(15,921)
(Increase) in prepaid and other current assets	(9,473)	(11,871)
Increase in accounts payable	21,791	27,411
Increase (decrease) in deferred revenue and accrued liabilities	388	(5,660)
Other operating activities	(1,111)	197
Net cash provided by operating activities	25,072	46,103
Cash flows from investing activities:		
Capital expenditures	(3,732)	(13,906)
Refranchising proceeds	465	1,344
Store acquisition costs	(116)	(98)
Net cash used in investing activities	(3,383)	(12,660)
Cash flows from financing activities:		
Borrowings under revolving credit facility	50,000	64,000
Payments on revolving credit facility	(32,500)	(91,000)
Payments on Tranche B-1 Term Loan	(1,138)	(1,138)
Payments on Tranche B-2 Term Loan	(10,700)	—
Original Issuance Discount and revolving credit facility fees	(35,216)	—
Deferred fees associated with pending equity transaction	(2,183)	—
Minimum tax withholding requirements	(223)	(229)
Net cash used in financing activities	(31,960)	(28,367)
Effect of exchange rate changes on cash and cash equivalents	141	332
Net (decrease) increase in cash and cash equivalents	(10,130)	5,408
Beginning balance, cash and cash equivalents	64,001	34,464
Ending balance, cash and cash equivalents	$53,871	$39,872

The accompanying notes are an integral part of the Consolidated Financial Statements.

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Supplemental Cash Flow Information
(unaudited)
(in thousands)

	As of March 31,	
	2018	2017
Non-cash investing activities:		
Capital expenditures in current liabilities	$1,203	$2,259
Non-cash financing activities:		
Original issuance discount (Note 5)	$19,587	$—

The accompanying notes are an integral part of the Consolidated Financial Statements.

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Condensed Notes to the Unaudited Consolidated Financial Statements

NOTE 1. NATURE OF BUSINESS

GNC 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 global specialty retailer of health, wellness and performance products, including protein, performance supplements, weight management supplements, vitamins, herbs and greens, wellness supplements, health and beauty, food and drink and other general merchandise. The Company is vertically integrated as its operations consist of purchasing raw materials, formulating and manufacturing products and selling the finished products through its three reportable segments, U.S. and Canada, International, and Manufacturing / Wholesale. Corporate retail store operations are located in the United States, Canada, Puerto Rico, China and Ireland. In addition, the Company offers products on the internet through GNC.com, third-party websites, and prior to the sale of its assets on September 30, 2017, LuckyVitamin.com. Franchise locations exist in the United States and approximately 50 other countries. The Company operates its primary manufacturing facility in South Carolina and distribution centers in Arizona, Indiana, Pennsylvania and South Carolina. The Company manufactures approximately half of its branded products and 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 various federal agencies, including the Food and Drug Administration, the Federal Trade Commission, the Consumer Product Safety Commission, the 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.

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited Consolidated Financial Statements, which have been prepared in accordance with the applicable rules of the Securities and Exchange Commission, include all adjustments (consisting of a normal and recurring nature) that management considers necessary to fairly state the Company's results of operations, financial position and cash flows. The December 31, 2017 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”). These interim Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Footnotes included in the Company’s audited financial statements in its Annual Report on Form 10-K for the year ended December 31, 2017 ("2017 10-K"). Interim results are not necessarily indicative of the results that may be expected for the remainder of the year ending December 31, 2018.

Recently Adopted Accounting Pronouncements

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-09, which amends the scope of modification accounting for share-based payment arrangements. This standard states that an entity should account for the effects of a modification unless all of the following are met: 1) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified (if the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification); 2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and 3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The standard is effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company adopted this standard during the first quarter of fiscal 2018 which did not have an impact to the Company's Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15, which addresses changes to the classification of certain cash receipts and cash payments within the statement of cash flows in order to address diversity in practice. In November 2016, the FASB issued ASU 2016-18, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash and restricted cash equivalents.

Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Both standards are effective for annual reporting periods, and interim periods

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therein, beginning after December 15, 2017. In connection with the adoption of ASU 2016-15, the Company presented the third-party fees relating to the term loan refinancing as an operating cash flow on the Consolidated Statements of Cash Flows. The adoption of ASU 2016-18 did not have an impact to the Consolidated Statement of Cash Flows.

Adoption of New Revenue Recognition Standard

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which updates revenue recognition guidance relating to contracts with customers. This standard states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2017. The Company adopted ASU 2014-09 and its related amendments (collectively known as "ASC 606") during the first quarter of fiscal 2018 using the full retrospective method.

The adoption of ASC 606 does not impact recognition of point-of-sale revenue in company-owned stores, most wholesale sales, royalties and sublease revenue, together which account for approximately 90% of the Company’s revenue. The new standard has no impact on the timing or classification of the Company’s cash flows as reported in the Consolidated Statement of Cash Flows and is not expected to have a significant impact on the Company’s Consolidated Statement of Operations in future periods. The Company recorded a reduction to retained earnings, net of tax, at January 1, 2016 (opening balance) and December 31, 2016 of approximately $23 million primarily relating to an increase in deferred franchise fees. Below is a description of the changes that resulted from the new standard.

Franchise fees. The Company's previous accounting policy for franchise and license fees received for new store openings and renewals was to recognize these fees when earned per the contract terms, which is when a new store opens or at the start of a new term. In accordance with the new guidance, these fees are now deferred and recognized over the applicable license term as the Company satisfies the performance obligation of granting the customer access to the rights of the Company’s intellectual property. This change impacted all of the Company’s reportable segments. In addition, franchise fees received as part of a sale of a company-owned store to a franchisee are now recorded as described above as part of revenue and will no longer be presented as part of gains on refranchising.

Cooperative advertising and other franchise support fees. The Company previously classified advertising and other franchise support fees received from domestic franchisees as a reduction to selling, general and administrative expense and cost of sales on the Consolidated Statement of Operations. In accordance with the new guidance, these fees are now required to be classified as revenue within the U.S. and Canada segment. The new standard does not impact the timing of recognition of this income or the Consolidated Balance Sheet.

Specialty manufacturing. The Company previously recognized revenue for products manufactured and sold to customers at a point in time when risk of loss, title and insurable risks have transferred to the customer, net of estimated returns and allowances. Under the new standard, revenue is required to be recognized over time as manufacturing occurs if the customized goods have no alternative use to the manufacturer, and the manufacturer has an enforceable right to payment for performance completed to date. This change impacts contract manufacturing sales to third-parties recorded in the Manufacturing / Wholesale segment. The Company is now recording a reduction to inventory as applicable custom manufacturing services are completed with a corresponding contract asset including the applicable markup, recorded within prepaid and other current assets on the Consolidated Balance Sheet.

E-commerce revenues. The Company previously recorded revenue to its e-commerce customers upon delivery. Under the new guidance, the Company is now recognizing revenue upon shipment based on meeting the transfer of control criteria. The Company has made a policy election to treat shipping and handling as costs to fulfill the contract, and as a result, any fees received from customers are included in the transaction price allocated to the performance obligation of providing goods with a corresponding amount accrued within cost of sales for amounts paid to applicable carriers. The Company has not revised prior period balances for e-commerce revenues because the changes are not material.

Loyalty. Effective with the launch of the One New GNC on December 29, 2016, the Company introduced a free points-based myGNC Rewards loyalty program system-wide in the U.S. The Company utilized the new revenue recognition standard to account for this program in 2017, the difference of which was immaterial relative to the standard in effect at that time.

Refer to Note 3 "Revenue" for additional information relating to the impact of adopting ASC 606.

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Revisions to Prior Periods

As a result of adopting ASC 606 on January 1, 2018, the Company has revised its comparative financial statements for the years ended December 31, 2016 and 2017, and applicable interim periods within those years, as if ASC 606 had been effective for those periods. Additionally, the cumulative effect of applying the new guidance to all contracts with customers that were not completed as of January 1, 2016 was recorded as an adjustment to retained earnings as of January 1, 2016.

The impact of the adoption of ASC 606 on the Company's Consolidated Balance Sheet as of December 31, 2017 was as follows:

	As Previously Reported (in thousands)	Franchise Fees	Specialty Manufacturing	Total Adjustments	As Revised
Inventory	$506,858	$—	$ (21,126)	$ (21,126)	$485,732
Prepaid and other current assets	42,320	—	24,328	24,328	66,648
Total current assets	739,829	—	3,202	3,202	743,031
Total assets	$1,516,561	$—	$ 3,202	$ 3,202	$1,519,763
Deferred revenue and other current liabilities	$108,672	$5,409	$ —	$ 5,409	$114,081
Total current liabilities	261,690	5,409	—	5,409	267,099
Deferred income taxes	64,121	(8,868)	807	(8,061)	56,060
Other long-term liabilities	55,721	29,781	—	29,781	85,502
Total long-term liabilities	1,416,865	20,913	807	21,720	1,438,585
Total liabilities	1,678,555	26,322	807	27,129	1,705,684
Retained earnings	567,741	(26,322)	2,395	(23,927)	543,814
Total stockholders' deficit	(161,994)	(26,322)	2,395	(23,927)	(185,921)
Total liabilities and stockholders' deficit	$1,516,561	$—	$ 3,202	$ 3,202	$1,519,763

The impact of the adoption of ASC 606 on the Consolidated Statements of Operations for the year ended December 31, 2017, and interim periods within 2017, was as follows:

	Three months ended March 31, 2017					
	As Previously Reported	Franchise Fees	Specialty Manufacturing	Cooperative Advertising and Other Franchise Support Fees	Total Adjustments	As Revised
	(in thousands, except per share amounts)					
Revenue	$644,838	$ 983	$ 3,086	$ 6,041	$ 10,110	$654,948
Cost of sales (1)	431,867	—	2,624	595	3,219	$435,086
Gross profit	212,971	983	462	5,446	6,891	219,862
SG&A (2)	160,581	—	—	5,446	5,446	166,027
Gains on refranchising	(154)	30	—	—	30	(124)
Other income, net	(1,009)	—	—	—	—	(1,009)
Operating income	53,553	953	462	—	1,415	54,968
Interest expense, net	15,894	—	—	—	—	15,894
Income before income taxes	37,659	953	462	—	1,415	39,074
Income tax expense	13,809	350	171	—	521	14,330
Net income	$23,850	$ 603	$ 291	$ —	$ 894	$24,744

Earnings per share:						
Basic	$0.35	$ 0.01	$ —	$ —	$ 0.01	$0.36
Diluted	$0.35	$ 0.01	$ —	$ —	$ 0.01	$0.36

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	Three months ended June 30, 2017					
	As Previously Reported	Franchise Fees	Specialty Manufacturing	Cooperative Advertising and Other Franchise Support Fees	Total Adjustments	As Revised
	(in thousands, except per share amounts)					
Revenue	$640,994	$ 1,353	$ 1,542	$ 6,349	$ 9,244	$650,238
Cost of sales (1)	428,271	—	1,342	842	2,184	430,455
Gross profit	212,723	1,353	200	5,507	7,060	219,783
SG&A (2)	154,033	—	—	5,507	5,507	159,540
Long-lived asset impairments	19,356	—	—	—	—	19,356
Other income, net	(486)	—	—	—	—	(486)
Operating income	39,820	1,353	200	—	1,553	41,373
Interest expense, net	16,067	—	—	—	—	16,067
Income before income taxes	23,753	1,353	200	—	1,553	25,306
Income tax expense	8,092	497	73	—	570	8,662
Net income	$15,661	$ 856	$ 127	$ —	$ 983	$16,644
Earnings per share:						
Basic	$0.23	$ 0.01	$ —	$ —	$ 0.01	$0.24
Diluted	$0.23	$ 0.01	$ —	$ —	$ 0.01	$0.24

	Three months ended September 30, 2017					
	As Previously Reported	Franchise Fees	Specialty Manufacturing	Cooperative Advertising and Other Franchise Support Fees	Total Adjustments	As Revised
	(in thousands, except per share amounts)					
Revenue	$609,469	$ (360)	$ (1,925)	$ 5,769	$ 3,484	$612,953
Cost of sales (1)	412,663	—	(1,681)	679	(1,002)	411,661
Gross profit	196,806	(360)	(244)	5,090	4,486	201,292
SG&A (2)	150,961	—	—	5,090	5,090	156,051
Gains on refranchising	(230)	40	—	—	40	(190)
Long-lived asset impairments	3,861	—	—	—	—	3,861
Other loss, net	1,769	—	—	—	—	1,769
Operating income	40,445	(400)	(244)	—	(644)	39,801
Interest expense, net	16,339	—	—	—	—	16,339
Income before income taxes	24,106	(400)	(244)	—	(644)	23,462
Income tax expense	2,643	(146)	(91)	—	(237)	2,406
Net income	$21,463	$ (254)	$ (153)	$ —	$ (407)	$21,056
Earnings per share:						
Basic	$0.31	$ —	$ —	$ —	$ —	$0.31
Diluted	$0.31	$ —	$ —	$ —	$ —	