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

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 September 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 November 9, 2001 was:

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

HEALTH FITNESS CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS

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HEALTH FITNESS CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 30, 2001

ASSETS	
Current Assets	
Cash	$ 55,041
Trade and other accounts receivable, less allowance for doubtful accounts of $159,400 and $262,600, respectively	3,496,435
Prepaid expenses and other	122,756
Total current assets	3,674,232
Property and Equipment, net	200,632
Other Assets	
Goodwill, less accumulated amortization of $2,494,600 and $2,183,400, respectively	5,382,821
Intangible assets, less accumulated amortization of $561,200 and $551,900, respectively	244,639
Trade and other notes receivable	--
Other	778
	$ 9,503,102
LIABILITIES AND STOCKHOLDER'S EQUITY	
Current Liabilities	
Note payable	$ 1,456,146
Current maturities of long-term obligations	45,397
Trade accounts payable	155,753
Accrued salaries, wages, and payroll taxes	1,117,900
Other accrued liabilities	412,489
Deferred revenue	1,195,997
Total current liabilities	4,383,682
Long-term Obligations, less current maturities	--
Commitments and Contingencies	--
Stockholders' 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; 12,265,250 and 12,165,250 shares issued and outstanding, respectively	122,653
Additional paid-in capital	16,982,522
Accumulated deficit	(11,985,755)
	5,119,420
	$ 9,503,102

The accompanying notes are an integral part of the financial statements

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HEALTH FITNESS CORPORATION
CONSOLIDATED STATEMENTS OF EARNINGS
(UNAUDITED)

	Three Months Ended September 30,		Ni
	2001	2000	2001
Revenues	$ 6,356,489	$ 6,495,863	$ 19,361
Cost of Revenues	4,837,067	5,020,621	14,987
Gross Profit	1,519,422	1,475,242	4,373
Operating Expenses			
Salaries	595,037	451,212	1,609
Selling, general, and administrative	601,416	563,915	1,705
Re-engineering	--	167,342	
Total operating expenses	1,196,453	1,182,469	3,314
Operating Profit	322,969	292,773	1,059
Other Income (Expense)			
Interest expense	(108,188)	(185,687)	(354
Gain on sale of subsidiary	--	--	228
Other, net	(16,736)	(596)	(11
Earnings Before Income Taxes	198,045	106,490	920
Income Taxes	15,169	28,622	58
Net Earnings	$ 182,876	$ 77,868	$ 862
Net Earnings Per Share:			
Basic	$ 0.01	$ 0.01	$
Diluted	$ 0.01	$ 0.01	$
Weighted Average Common Shares Outstanding			
Basic	12,264,163	12,272,792	12,198
Diluted	12,503,377	12,273,301	12,400

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

HEALTH FITNESS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months En September 3
	2001
Cash Flows From Operating Activities:	
Net earnings	$ 862,506
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Common stock and warrants issued for services and compensation	62,019
Depreciation and amortization	557,238
Amortization of financing costs	87,249
Gain on sale of subsidiary	(228,613)
Changes in operating assets and liabilities:	
Trade accounts and notes receivable	(163,381)
Prepaid expenses and other	(77,067)
Other assets	2,670
Trade accounts payable	(181,304)
Accrued liabilities and other	(196,239)
Deferred revenue	(16,945)
Net cash provided by operating activities	708,133
Cash Flows From Investing Activities:	
Purchase of property and equipment	(103,514)
Net proceeds from sale of equipment	--
Net proceeds from sale of subsidiary	368,555
Payments in connection with earn-out provisions	--
Payments for non-compete agreement	(30,000)
Net cash provided by (used in) investing activities	235,041
Cash Flows From Financing Activities:	
Net borrowings (payments) under line of credit	(1,229,656)
Proceeds from issuance of common stock	--
Payment on subordinated notes payable	--
Payment of financing costs	(50,000)
Repayment of long term debt	(81,407)
Net cash used in financing activities	(1,361,063)

Net Decrease in Cash	(417,889)
Cash at Beginning of Period	472,930
Cash at End of Period	$ 55,041

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 nine months ended September 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 nine months ended September 31, 2000. Such reclassifications had no effect on net earnings or stockholders' equity as previously reported.

NOTE 2. FINANCING

The Company maintains a credit agreement with Coast Business Credit for a $5.0 million working capital facility: the facility bears interest at prime plus 3.0% (effective rate of 9.50% and 12.50% at September 30, 2001 and December 31, 2000), with future reductions based on the achievement of certain tangible net worth levels, and expires in July 2003. Available credit under the loan is based upon certain profitability and cash collection multiples. As of September 30, 2001, the available credit was approximately $1,738,000. 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 September 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, net of 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 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

o 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.

o 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 effect of these Statements on its 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 SEPTEMBER 30, 2001 COMPARED TO THE QUARTER ENDED SEPTEMBER 30, 2000.

REVENUES. Revenues decreased $140,000 or 2.1% to $6,356,000 for the three months ended September 30, 2001, from $6,496,000 for the same period in 2000. This decrease is attributed to $223,000 of revenue that was lost from the termination of a multi-site contract at the beginning of the quarter. This decrease in revenue was partially offset by revenue derived from new management contracts secured during the latter half of 2000.

COST OF REVENUES. Cost of revenues, which is primarily comprised of wages and benefits for fitness center staff, decreased $184,000 to $4,837,000, or 76.1% of revenues for 2001, from $5,021,000, or 77.3% of revenues for 2000. This decrease is primarily attributed to the decrease in revenue explained previously. The decrease in cost of revenues as a percentage of revenues is primarily attributed to contract margin improvements.

OPERATING EXPENSES. Operating expenses consist primarily of administrative wages and benefits as well as selling, general and administrative operating expenses. For the three months ended September 30, 2001, operating expenses increased $14,000 to $1,196,000 from $1,182,000 for the same period of 2000. After subtracting from 2000 operating expenses a one-time charge of $116,000 relating to the Company's intent to merge with Healthtrax, operating expenses increased approximately $130,000. This increase is attributed to investments the Company has made, and will continue to make, in new personnel as well as sales and marketing programs to position for future growth opportunities.

OTHER INCOME AND EXPENSE. Interest expense decreased $78,000 to $108,000 for the three months ended September 30, 2001, compared to $186,000 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 September 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 reduction of a portion of the valuation allowance previously recorded to offset net operating loss benefits..

NET EARNINGS. As a result of the above, net earnings for the three months ended September 30, 2001 increased $105,000 to $183,000 from $78,000 for the same period in 2000.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 AS COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2000.

REVENUES. Revenues decreased $158,000 or .8% to $19,362,000 for the nine months ended September 30, 2001, from $19,520,000 for the same period in 2000. This decrease is primarily attributed to a $540,000 loss of revenue from the Company's former IFCN subsidiary, as well as the $223,000 that was lost at the beginning of the third quarter due to a terminated contract. Offsetting these decreases are revenue increases of approximately $605,000 related to new management contracts the Company has secured since the latter part of 2000.

COST OF REVENUES. Cost of revenues increased $223,000 to $14,988,000, or 77.4% of revenues for 2001, from $14,765,000, or 75.6% of revenues for 2000. This increase is primarily attributed to an increase of approximately $496,000 in staff wages and benefits related to new management contracts. Offsetting this increase was a decrease in costs of approximately $325,000 related to the Company's former IFCN subsidiary. The increase in cost of revenues as a

percentage of revenues from 2000 to 2001 is primarily attributed to the former IFCN subsidiary, whose ratio of costs to revenue through September 30, 2000 was 60.2%.

OPERATING EXPENSES. For the nine months ended September 30, 2001, operating expenses decreased $186,000 to $3,315,000 from $3,501,000 for the same period of 2000. After subtracting from 2000 operating expenses a one-time charge of $116,000 relating to the Company's intent to merge with Healthtrax , operating expenses from 2000 to 2001 decreased approximately $70,000. However, this decrease is beginning to reverse itself as the Company has made, and will continue to make, investments in personnel as well as sales and marketing programs to position for future growth opportunities.

OTHER INCOME AND EXPENSE. Interest expense decreased $197,000 to $355,000 for the nine months ended September 30, 2001, compared to $552,000 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. The Company also recorded a $229,000 gain on the sale of its IFCN subsidiary during the first quarter of 2001.

INCOME TAXES. Income tax expense increased $34,000 for the nine months ended September 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 reduction of a portion of the valuation allowance previously recorded to offset net operating loss benefits.

NET EARNINGS. As a result of the above, net earnings for the nine months ended September 30, 2001 increased $155,000 to $863,000 from $708,000 for the same period in 2000.

LIQUIDITY AND CAPITAL RESOURCES

The Company had negative working capital of $709,000 at September 30, 2001, versus negative working capital of $2,846,000 at September 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.

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 Working Capital Facility is at the prime rate plus 3.0%, with future reductions based on the achievement of certain net worth levels, and expires in July 2003. Available credit under the Working Capital Facility is based upon certain profitability and cash collection multiples. As of September 30, 2001, 5 the available credit was approximately $1,738,000. 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 September 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 Company believes that sources of capital to meet future obligations for the remainder of 2001, and in 2002 ,will be in the form of cash provided by operations and by the Company's 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 include 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 Whitman	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.

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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.

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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: November 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 - incorporated by reference to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2001
11.0	Computation of per Share Earnings

*designates a management contract or compensatory plan or arrangement