

Edgar Filing: HEALTH FITNESS CORP /MN/ - Form 10-Q

HEALTH FITNESS CORP /MN/  
Form 10-Q  
August 13, 2002

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

FORM 10-Q

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

For the quarterly period ended June 30, 2002  
-----

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  
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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. ☒ Yes ☐ No

The number of shares outstanding of each of the registrant's classes of  
capital stock, as of August 12, 2002 was:

Common Stock, \$0.01 par value, 12,297,661 shares

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## HEALTH FITNESS CORPORATION CONSOLIDATED FINANCIAL STATEMENTS TABLE OF CONTENTS

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Consolidated Financial Statements	
Consolidated Balance Sheets as of June 30, 2002 and December 31, 2001	F-1
Consolidated Statements of Earnings for the three and six months ended June 30, 2002 and 2001	F-2
Consolidated Statements of Cash Flows for the six months ended June 30, 2002 and 2001	F-3
Notes to Consolidated Financial Statements	F-4
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	3
Item 3. Quantitative and Qualitative Disclosures About Market Risk	5
PART II. OTHER INFORMATION	6
Item 1. Legal Proceedings	
Items 2-3. Not Applicable	
Item 4. Submission of Matters to a Vote of Security Holders	
Item 5. Not Applicable	
Item 6. Exhibits and reports on Form 8-K	
Signatures	8

## HEALTH FITNESS CORPORATION CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2002	Dec 31, 2001
ASSETS	-----	-----
Current Assets		

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Cash	\$	135,680	\$
Trade and other accounts receivable, less allowance for doubtful accounts of \$84,200 and \$84,700		3,815,645	3
Prepaid expenses and other		225,375	
Deferred tax asset		537,500	
		-----	----
Total current assets		4,714,200	4
Property and Equipment, net		134,231	
Other Assets			
Goodwill		5,308,761	5
Intangible assets, less accumulated amortization of \$734,900 and \$ 619,100		70,939	
Deferred tax asset		1,249,100	
Other		20,658	
		-----	----
	\$	11,497,889	\$ 10
		=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Note payable	\$	995,827	\$ 1
Trade accounts payable		118,005	
Accrued salaries, wages, and payroll taxes		1,087,369	
Other accrued liabilities		481,225	
Deferred revenue		1,194,039	1
		-----	----
Total current liabilities		3,876,465	4
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 shares issued and outstanding		122,653	
Additional paid-in capital		16,982,522	16
Accumulated deficit		(9,483,751)	(11
		-----	----
		7,621,424	6
		-----	----
	\$	11,497,889	\$ 10
		=====	=====

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

F-1

HEALTH FITNESS CORPORATION  
CONSOLIDATED STATEMENTS OF EARNINGS

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(UNAUDITED)

	Three Months Ended June 30,		Six Months June 30
	2002	2001	2002
Revenue	\$ 6,686,808	\$ 6,578,716	\$ 13,374,202
Cost of Revenue	5,233,271	5,091,116	10,446,374
Gross Profit	1,453,537	1,487,600	2,927,828
Operating Expenses			
Salaries	690,096	526,633	1,356,077
Selling, general, and administrative	417,686	614,567	829,934
Total operating expenses	1,107,782	1,141,200	2,186,011
Operating Income	345,755	346,400	741,817
Other Income (Expense)			
Interest expense	(99,504)	(116,906)	(198,126)
Gain on sale of subsidiary	--	--	--
Other, net	(3,535)	5,771	(5,282)
Earnings Before Income Taxes	242,716	235,265	538,409
Income Tax Expense	(96,828)	(94,087)	(230,500)
Income Tax Benefit	625,300	81,000	1,250,600
Net Earnings	\$ 771,188	\$ 222,178	\$ 1,558,509
Net Earnings Per Share:			
Basic	\$ 0.06	\$ 0.02	\$ 0.13
Diluted	0.06	0.01	0.13
Weighted Average Common Shares Outstanding			
Basic	12,265,250	12,165,250	12,265,250
Diluted	12,486,488	12,711,750	12,439,384

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

F-2

HEALTH FITNESS CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

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(UNAUDITED)

	Six
	2002
Cash Flows From Operating Activities:	
Net earnings	\$ 1,558,509
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Common stock and warrants issued for services and compensation	--
Depreciation and amortization	120,036
Amortization of financing costs	58,166
Deferred taxes	(1,009,300)
Gain on sale of subsidiary	--
Changes in operating assets and liabilities:	
Trade and other accounts receivable	(426,789)
Prepaid expenses and other	(95,285)
Other assets	(9,249)
Trade accounts payable	(23,731)
Accrued liabilities	260,420
Deferred revenue	(49,907)
Net cash provided by operating activities	382,870
Cash Flows From Investing Activities:	
Purchases of property and equipment	(21,721)
Net proceeds from sale of subsidiary	--
Payment for non-compete agreement	--
Net cash provided by (used in) investing activities	(21,721)
Cash Flows From Financing Activities:	
Borrowings under note payable	13,178,903
Repayments of note payable	(13,625,380)
Repayment of long term debt	--
Net cash used in financing activities	(446,477)
Net Decrease in Cash	(85,328)
Cash at Beginning of Period	221,008
Cash at End of Period	\$ 135,680

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

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### 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, 2001. 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, 2002 are not necessarily indicative of the operating results for the year ending December 31, 2002.

Certain reclassifications have been made to the consolidated financial statements as of and for the three and six months ended June 30, 2001 to conform to the presentation used in 2002. Such reclassifications had no effect on net earnings or stockholders' equity as previously reported.

#### NOTE 2. NOTE PAYABLE

The Company maintains a credit agreement with Coast Business Credit for a \$5.0 million working capital facility which expires in July 2003. The facility bears interest at the prime rate plus 3.0% with a minimum rate of 9.0% (effective rate of 9.0% at June 30, 2002 and December 31, 2001). Available credit under the loan is based upon certain profitability and cash collection multiples and was approximately \$1,558,000 at June 30, 2002. 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 was in compliance with all of the covenants in effect as of June 30, 2002.

#### NOTE 3. INCOME TAXES

Income taxes were calculated based on management's estimate of the Company's effective tax rate. Income taxes for the six months ended June 30, 2002 include a reduction of the deferred tax asset valuation allowance totaling \$1,250,600, offset by \$230,500 of income tax expense, which includes the recording of federal and state income taxes and management's estimate of minimum state income taxes and federal taxes due because of alternative minimum tax calculations. The reduction of the Company's deferred tax asset valuation allowance is based upon the Company's estimate of future taxable income. The Company will continue to evaluate its results of operations and estimated future taxable income to determine when the remaining deferred tax valuation allowance of \$1,250,600 can be reduced.

#### NOTE 4. SALE OF SUBSIDIARY

Effective January 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. LEASE COMMITMENT

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On June 12, 2002, the Company amended its corporate office lease, effective November 1, 2002. The amended lease will move the corporate headquarters to a new office in the same building complex, and extend the term through October 31, 2007. In addition to base rental payments, the lease requires the company to pay its proportionate share of real estate taxes, special assessments, and maintenance costs. Minimum rent payments under this lease are approximately as follows:

F-4

Years ending December 31,

2002	\$17,000
2003	102,000
2004	104,000
2005	106,000
2006	108,000

### NOTE 6. RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2002 the Company adopted Statement of Financial Accounting Standards (SFAS) 141, "Business Combinations," SFAS 142, "Goodwill and Intangible Assets," SFAS 143, "Accounting for Asset Retirement Obligations," and SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

SFAS 141 eliminates the pooling-of-interest method of accounting for business combinations and requires intangible assets acquired in business combinations to be recorded separately from goodwill. The adoption of SFAS 141 did not affect the Company's consolidated financial position or statement of earnings.

SFAS 142 eliminates the amortization of goodwill and other intangible assets with indefinite lives and requires that these assets be tested for impairment annually or whenever an impairment indicator arises using the two step impairment test outlined in SFAS 142. Effective January 1, 2002, the Company discontinued the amortization of goodwill.

The first step of the goodwill impairment test, which must be completed within six months of the effective date of SFAS No. 142, will identify potential goodwill impairment. The second step of the goodwill impairment test, which must be completed prior to the issuance of the annual financial statements, will measure the amount of goodwill impairment loss, if any. The Company has completed step one of the transitional goodwill impairment test, and determined that no potential impairment exists at June 30, 2002. The Company has determined that its goodwill relates to one reporting unit for purposes of impairment testing and elected to complete the impairment test of goodwill annually on December 31. The Company believes the results of the impairment test will not result in a write-down of its goodwill balance.

The pro forma effect of adopting SFAS 142 on net earnings and net earnings per share for the three and six-months ended June 30, 2001 compared to actual results for the three and six-months ended June 30, 2002 is as follows:

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		Three Months Ended June 30,		
		2002	2001	
Net earnings as reported		\$ 771,188	\$ 222,178	\$ 1
Goodwill amortization		--	109,955	
Adjusted net earnings		\$ 771,188	\$ 332,133	\$ 1
Basic net earnings per share:				
	Net earnings per share as reported	\$ 0.06	\$ 0.02	\$
	Goodwill amortization per share	--	0.01	
	Adjusted net earnings per share	\$ 0.06	\$ 0.03	\$
Diluted net earnings per share:				
	Net earnings per share as reported	\$ 0.06	\$ 0.01	\$
	Goodwill amortization per share	--	0.01	
	Adjusted net earnings per share	\$ 0.06	\$ 0.02	\$

F-5

Amortization expense of other intangible assets totaled \$57,896 for the three months ended June 30, 2002 and 2001, and totaled \$115,798 for the six months ended June 30, 2002 and 2001. Amortization expense for the succeeding years is expected to be as follows:

Years ending December 31:	
2002	\$ 178,571
2003	\$ 58,166

F-6

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 programs to corporations, hospitals, communities and universities located in the United



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States and Canada. Fitness and wellness management services include the development, marketing and management of corporate, hospital and community based fitness centers, injury prevention and work-injury management consulting, and on-site physical therapy. While consumers of these services are typically corporate employees and individuals interested in a healthy lifestyle, revenues are generated almost exclusively through business to business, contractual relationships.

Effective January 1, 2001, the Company sold its subsidiary, International Fitness Club Network (IFCN), which organized and maintained a network of commercial fitness and health clubs and marketed memberships in such clubs to employers and insurance companies.

RESULTS OF OPERATIONS FOR THE QUARTER ENDED JUNE 30, 2002 AS COMPARED TO THE QUARTER ENDED JUNE 30, 2001.

REVENUE. Revenue increased \$108,000 or 1.6% to \$6,687,000 for the three months ended June 30, 2002, from \$6,579,000 for the three months ended June 30, 2001. Management fee and consulting revenue increased \$42,000 or .7% while occupational health services revenue increased \$66,000 or 37.1%. These increases are attributed to the addition of new contracts in our current lines of business and the expansion of existing contracts.

GROSS PROFIT. Gross profit decreased \$34,000 or 2.3% to \$1,454,000 for the three months ended June 30, 2002, from \$1,488,000 for the three months ended June 30, 2001. This decrease in gross profit is primarily due to higher direct costs to manage certain contracts.

OPERATING INCOME. Operating income for the three months ended June 30, 2002 remained constant at \$346,000 compared to the three months ended June 30, 2001. Operating income was affected by a decrease in gross profit, an increase in salary expense, and a decrease in selling, general, and administrative expense. For the three months ended June 30, 2002 as compared to the three months ended June 30, 2001, salary expense increased \$163,000 or 31.0% and selling, general and administrative expenses decreased \$197,000 or 32.0%. The increase in salary expense is primarily attributed to additions to the sales and marketing staff and increased employee benefits costs. The decrease in selling, general, and administrative expenses is due to lower contract service expenses and the adoption of SFAS 142, which eliminates the amortization of goodwill and intangible assets with indefinite lives. The amount of amortization expense related to goodwill in the three months ended June 30, 2001 totaled \$110,000.

OTHER INCOME AND EXPENSE. Interest expense decreased \$17,000 to \$100,000 for the three months ended June 30, 2002, compared to \$117,000 for the same period in 2001. This decrease is due to decreased levels of borrowing and a lower interest rate. The Company's cost of borrowed funds decreased from an average of 10.0% for the second quarter of 2001, to 9.0% for the second quarter of 2002.

INCOME TAXES. Income taxes on a net basis decreased \$541,000 to a benefit of \$528,000 for the three months ended June 30, 2002 compared to an expense of \$13,000 for the same period in 2001. The decrease is mainly due to a \$625,000 reduction of the Company's deferred tax asset valuation allowance, offset by \$97,000 of income tax expense. The reduction of the Company's deferred tax asset valuation allowance is based upon the Company's estimate of future taxable income. The Company will continue to evaluate its results of operations and estimated future taxable income to determine when the remaining deferred tax valuation allowance of \$1,251,000 can be reduced.

NET EARNINGS. As a result of the above, net earnings for the three months ended June 30, 2002 increased \$549,000 to \$771,000, compared to net earnings of \$222,000 for the same period in 2001.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2002 AS COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2001.

REVENUE. Revenue increased \$369,000 or 2.8% to \$13,374,000 for the six months ended June 30, 2002, from \$13,005,000 for the six months ended June 30, 2001. Management fee and consulting revenue increased \$226,000 or 1.8% while occupational health services revenue increased \$143,000 or 40.0% for the six months ended June 30, 2002, compared to the same period in 2001. These increases are attributed to the addition of new contracts in our current lines of business and the expansion of existing contracts.

GROSS PROFIT. Gross profit increased \$73,000 or 2.6% to \$2,928,000 for the six months ended June 30, 2002, from \$2,855,000 for the six months ended June 30, 2001. The increase in gross profit is primarily attributed to the addition of new contracts and the expansion of existing contracts.

OPERATING INCOME. Operating income for the six months ended June 30, 2002 increased \$6,000 to \$742,000, a .8% increase from \$736,000 for the six months ended June 30, 2001. This increase in operating income is primarily attributed to the increase in gross profit, a decrease in selling, general, and administrative expenses of \$274,000 and an increase in salary expense of \$342,000. The decrease in selling, general, and administrative expenses is due to lower contract service expenses and the adoption of SFAS 142, which eliminates the amortization of goodwill and intangible assets with indefinite lives. The amount of amortization expense related to goodwill in the six months ended June 30, 2001 totaled \$217,000. The increase in salary expense is primarily attributed to additions to the sales and marketing staff and increased employee benefits costs.

OTHER INCOME AND EXPENSE. Interest expense decreased \$49,000 to \$198,000 for the six months ended June 30, 2002, compared to \$247,000 for the same period in 2001. This decrease is due to decreased levels of borrowing and a lower interest rate. The Company's cost of borrowed funds decreased from an average of 11.2% for the six months ended June 30, 2001, to 9.0% for the six months ended June 30, 2002.

INCOME TAXES. Income taxes on a net basis decreased \$1,063,000 to a benefit of \$1,020,000 for the six months ended June 30, 2002 compared to an expense of \$43,000 for the same period in 2001. The decrease is mainly due to a \$1,250,600 reduction of the Company's deferred tax asset valuation allowance, offset by \$231,000 of income tax expense. The reduction of the Company's deferred tax asset valuation allowance is based upon the Company's estimate of future taxable income. The Company will continue to evaluate its results of operations and estimated future taxable income to determine when the remaining deferred tax valuation allowance of \$1,251,000 can be reduced. Based upon the company's current assessment of future profitability, the company expects to recognize its remaining deferred tax valuation allowance of \$1,250,600 by December 31, 2002.

NET EARNINGS. As a result of the above, net earnings for the six months ended June 30, 2002 increased \$879,000 to \$1,559,000 compared to net earnings of \$680,000 for the same period in 2001.

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### LIQUIDITY AND CAPITAL RESOURCES

The Company maintains a credit agreement with Coast Business Credit for a \$5.0 million working capital facility which expires in July 2003. The facility bears interest at the prime rate plus 3.0% with a minimum rate of 9.0% (effective rate of 9.0% at June 30, 2002 and December 31, 2001). Available credit under the loan is based upon certain profitability and cash collection multiples and was approximately \$1,558,000 at June 30, 2002. 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 was in compliance with all of the covenants in effect as of June 30, 2002.

In accordance with the credit agreement between the Company and Coast Business Credit, cash collected from all sources is first used to pay down the existing loan balance. Cash that is needed by the Company to pay for operating expenses is obtained from the working capital facility through requests for funding submitted by the Company to Coast Business Credit. As a result, the Company does not maintain any material cash balances for general operating purposes.

4

As of June 30, 2002, the Company has no off-balance sheet arrangements or transactions with unconsolidated, limited purpose entities. Refer to the footnotes in the Company's Annual Report on Form 10-K for the year ended December 31, 2001 for disclosure related to the Company's "Commitments and Contingencies."

On a short and long-term basis, the Company believes that sources of capital to meet future obligations will be provided by cash generated through operations and 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 and Management's expectations concerning the time period in which the Company will be able to recognize its remaining deferred tax valuation allowance of \$1,250,600. 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, 2001, 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 Monday, May 13, 2002.

(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. Bernardes	10,367,316	147,123
K. James Ehlen, M.D.	10,447,986	66,453
Jerry V. Noyce	10,423,686	90,753
John C. Penn	10,447,986	66,453
Mark W. Sheffert	10,368,316	146,123
Linda Hall Whitmen	10,318,316	196,123
Rodney A. Young	10,447,986	66,453

(c) By a vote of 10,012,410 shares in favor, 446,179 shares opposed, 55,850 shares abstaining, and no shares represented by broker nonvotes, the shareholders approved a 300,000 share increase in the number of shares reserved for the Company's 1995 Employee Stock Purchase Plan.

(d) By a vote of 10,453,527 shares in favor, 4,678 shares opposed, 56,234 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 12, 2002

HEALTH FITNESS CORPORATION

..

By /s/ Jerry V. Noyce

-----  
Jerry V. Noyce  
Chief Executive Officer  
(Principal Executive Officer)

By /s/ Wesley W. Winnekins

-----  
Wesley W. Winnekins  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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## 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	Agreement of Purchase and Sale of Stock of David W. Pickering, Inc. dated January 1, 2001 - incorporated by reference to the Company's Quarterly Report on form 10-QSB for the quarter ended June 30, 2001
10.13	Second Amendment, dated June 12, 2002, to Lease Agreement between the Company and United Properties Investment LLC, a Minnesota limited liability company
11.0	Statement re: Computation of Earnings per Share