GNC CORP
Form 10-Q
October 27, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
Form 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2006

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

For the transition period from __________ to __________.

Commission File Number: 333-116040

GNC CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	***72-1575170***
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
300 Sixth Avenue Pittsburgh, Pennsylvania	**15222**
(Address of principal executive offices)	(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. þ Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated þ

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

As of October 27, 2006, 50,563,948 shares of the GNC Corporation s $0.01 par value Common Stock (the Common Stock) were outstanding.

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EXPLANATORY NOTE

On July 27, 2006, the Company filed its Second Amended and Restated Certificate of Incorporation with the Secretary of State of the State of Delaware. The Second Amended and Restated Certificate of Incorporation authorized each issued and outstanding share of our common stock to be split in a ratio of 1.707 for one (the Stock Split) effective as of July 27, 2006. No fractional shares of common stock were issued as a result of the Stock Split. Unless otherwise indicated, all references to the number of shares in this report have been adjusted to reflect the stock split on a retroactive basis.

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements.

GNC CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except share data)

	September 30, 2006 (unaudited)	December 31, 2005 *
Current assets:		
Cash and cash equivalents	$ 87,360	$ 86,013
Receivables, net of reserve of $3,792 and $8,898, respectively	82,137	70,630
Inventories, net (Note 3)	313,531	298,166
Deferred tax assets, net	18,078	13,861
Other current assets	27,413	30,826
Total current assets	528,519	499,496
Long-term assets:		
Goodwill (Note 4)	81,044	80,109
Brands (Note 4)	212,000	212,000
Other intangible assets, net (Note 4)	24,011	26,460
Property, plant and equipment, net	169,843	179,482
Deferred financing fees, net	13,890	16,125
Deferred tax assets, net	676	45
Other long-term assets	6,295	10,114
Total long-term assets	507,759	524,335
Total assets	$ 1,036,278	$ 1,023,831
Current liabilities:		
Accounts payable, includes cash overdraft of $5,576 and $5,063, respectively	$ 112,356	$ 104,595
Accrued payroll and related liabilities	23,808	20,812
Accrued income taxes	7,327	2,280
Accrued interest	9,195	7,877
Current portion, long-term debt	2,143	2,117
Other current liabilities	70,991	64,826
Total current liabilities	225,820	202,507
Long-term liabilities:		
Long-term debt	469,668	471,244
Other long-term liabilities	10,828	10,891
Total long-term liabilities	480,496	482,135

Total liabilities	706,316	684,642
Cumulative redeemable exchangeable preferred stock, $0.01 par value, 110,000 shares authorized, 100,000 shares issued and outstanding (liquidation preference of $148,198 and $136,349, respectively)	139,063	127,115
Stockholders equity:		
Common stock, $0.01 par value, 160,000,000 shares authorized, 50,563,948 and 50,422,054 shares issued and outstanding, respectively	506	504
Paid-in-capital	129,845	177,407
Retained earnings	59,380	32,939
Accumulated other comprehensive income	1,168	1,224
Total stockholders equity	190,899	212,074
Total liabilities and stockholders equity	$ 1,036,278	$ 1,023,831

* Footnotes summarized from the Audited Financial Statements.

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

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GNC CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income
(unaudited)
(in thousands)

	For the three months ended September 30, 2006	For the three months ended September 30, 2005	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005
Revenue	$ 367,735	$ 322,559	$ 1,137,399	$ 992,341
Cost of sales, including costs of warehousing, distribution and occupancy	241,251	222,084	751,451	676,264
Gross profit	126,484	100,475	385,948	316,077
Compensation and related benefits	60,831	58,432	187,300	171,975
Advertising and promotion	10,982	8,639	41,337	36,780
Other selling, general and administrative	21,860	18,536	66,421	56,265
Foreign currency gain	(3)	(80)	(705)	(137)
Other expense (income)	1,078		1,078	(2,500)
Operating income	31,736	14,948	90,517	53,694
Interest expense, net (Note 5)	9,687	9,957	29,484	33,233
Income before income taxes	22,049	4,991	61,033	20,461
Income tax expense	8,181	1,816	22,644	7,439
Net income	13,868	3,175	38,389	13,022
Other comprehensive (loss) income	(12)	805	(56)	271
Comprehensive income	$ 13,856	$ 3,980	$ 38,333	$ 13,293
Income per share Basic and Diluted :				
Net income	$ 13,868	$ 3,175	$ 38,389	$ 13,022
Cumulative redeemable exchangeable preferred stock dividends and accretion	(4,100)	(3,646)	(11,948)	(10,626)
Net income (loss) available to common stockholders	$ 9,768	$ (471)	$ 26,441	$ 2,396

Earnings (loss) per share:				
Basic	$ 0.19	$ (0.01)	$ 0.52	$ 0.05
Diluted	$ 0.18	$ (0.01)	$ 0.50	$ 0.05
Weighted average shares outstanding:				
Basic	50,563,948	50,564,650	50,511,824	50,659,617
Diluted	52,475,750	50,564,650	54,423,626	51,593,403

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

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GNC CORPORATION AND SUBSIDIARIES
Consolidated Statement of Stockholders Equity
(in thousands, except share data)

	Common Stock Shares	Common Stock Dollars	Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders Equity
Balance at December 31, 2005	**50,422,054**	**$ 504**	**$ 177,407**	**$ 32,939**	**$ 1,224**	**$ 212,074**
Repurchase and retirement of common stock	(28,806)		(68)			(68)
Non-cash stock-based compensation	42,675		1,887			1,887
Exercise of stock options	128,025	2	448			450
Tax benefit from exercise of stock options			105			105
Preferred stock dividends				(11,849)		(11,849)
Amortization of preferred stock issuance costs				(99)		(99)
Net income				38,389		38,389
Restricted payment made by General Nutrition Centers, Inc. to GNC Corporation Common Stockholders			(49,934)			(49,934)
Foreign currency translation adjustments					(56)	(56)
Balance at September 30, 2006 (unaudited)	**50,563,948**	**$ 506**	**$ 129,845**	**$ 59,380**	**$ 1,168**	**$ 190,899**

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

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GNC CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Nine months ended September 30, 2006	Nine months ended September 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 38,389	$ 13,022
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	25,730	27,840
Fixed asset write-off	220	366
Loss on sale of subsidiary	1,078	
Deferred fee writedown early debt extinguishment		3,890
Amortization of intangible assets	3,471	2,985
Amortization of deferred financing fees	2,235	2,103
Increase in provision for inventory losses	6,176	5,889
Non-cash stock-based compensation	1,887	
(Decrease) increase in provision for losses on accounts receivable	(1,984)	1,894
(Increase) decrease in net deferred taxes	(4,848)	6,368
Changes in assets and liabilities:		
Increase in receivables	(11,660)	(7,665)
Increase in inventory, net	(20,890)	(13,431)
Decrease in franchise note receivables, net	3,598	7,568
Decrease in other assets	4,182	5,805
Increase (decrease) in accounts payable	7,214	(23,128)
Increase in accrued taxes	5,047	
Increase in interest payable	1,317	7,301
Increase (decrease) in accrued liabilities	7,693	(6,153)
Net cash provided by operating activities	68,855	34,654
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(16,050)	(13,819)
Sales of corporate stores to franchisees		23
Store acquisition costs	(591)	(547)
Net cash used in investing activities	(16,641)	(14,343)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restricted payment made by General Nutrition Centers, Inc. to GNC Corporation Common Stockholders	(49,934)	

Repurchase and retirement of common stock		(68)		(834)
Proceeds from exercised stock options		450		
Tax benefit from exercise of stock options		105		
Increase (decrease) in cash overdrafts		513		(1,067)
Proceeds from senior notes issuance				150,000
Payments on long-term debt		(1,550)		(186,500)
Debt and equity financing fees		(405)		(4,672)
Net cash used in financing activities		(50,889)		(43,073)
Effect of exchange rate on cash		22		4
Net increase (decrease) in cash		1,347		(22,758)
Beginning balance, cash		86,013		85,161
Ending balance, cash	$	87,360	$	62,403

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

GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. NATURE OF BUSINESS

General Nature of Business. GNC Corporation (GNC or the Company) (f/k/a General Nutrition Centers Holding Company), a Delaware corporation, is a leading specialty retailer of nutritional supplements, which include: vitamins, minerals and herbal supplements (VMHS), sports nutrition products, diet products and other wellness products.

The Company s organizational structure is vertically integrated as the operations consist of purchasing raw materials, formulating and manufacturing products and selling the finished products through its Retail, Franchising and Manufacturing/Wholesale segments. The Company operates primarily in three business segments: Retail; Franchising; and Manufacturing/Wholesale. Corporate retail store operations are located in North America and Puerto Rico and in addition the Company offers products domestically through www.gnc.com and drugstore.com. Franchise stores are located in the United States and 47 international markets. The Company operates its primary manufacturing facilities in South Carolina and distribution centers in Arizona, Pennsylvania and South Carolina. The Company also operates a smaller manufacturing facility in Australia. The Company manufactures the majority of its branded products, but also merchandises various third-party products. Additionally, the Company licenses the use of its trademarks and trade names.

The processing, formulation, packaging, labeling and advertising of the Company s products are subject to regulation by one or more federal agencies, including the Food and Drug Administration (FDA), Federal Trade Commission (FTC), Consumer Product Safety Commission, United States Department of Agriculture and the Environmental Protection Agency. These activities are also regulated by various agencies of the states and localities in which the Company s products are sold.

Acquisition of the Company. On October 16, 2003, the Company entered into a purchase agreement (the Purchase Agreement) with Koninklijke (Royal) Numico N.V. (Numico) and Numico USA, Inc. to acquire 100% of the outstanding equity interest of General Nutrition Companies, Inc. (GNCI) from Numico USA, Inc. on December 5, 2003 (the Acquisition). The purchase equity contribution was made by GNC Investors, LLC (GNC LLC), an affiliate of Apollo Management V L.P., together with additional institutional investors and certain management of the Company. The equity contribution from GNC LLC was recorded by the Company. The Company utilized this equity contribution to purchase the investment in General Nutrition Centers, Inc. (Centers). Centers is a wholly owned subsidiary of the Company.

A stock split of 1.707 for one was effective on July 27, 2006. This stock split has been reflected retroactively for all periods included in these financial statements.

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements and footnotes have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and related footnotes that would normally be required by accounting principles generally accepted in the United States of America for complete financial reporting. These unaudited consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements in the Company s Annual Report on Form 10-K filed for the year ended December 31, 2005 (the Form 10-K).

The accompanying unaudited consolidated financial statements include all adjustments (consisting of a normal and recurring nature) that management considers necessary for a fair statement of financial information for the interim periods. Interim results are not necessarily indicative of the results that may be expected for the remainder of the year ending December 31, 2006.

Principles of Consolidation. The consolidated financial statements include the accounts of the Company and all of its subsidiaries. The equity method of accounting is used for investment ownership ranging from 20% to 50%. Investment ownership of less than 20% is accounted for on the cost method. All material intercompany transactions have been eliminated in consolidation. The Company has no relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off balance sheet arrangements, or other contractually narrow or limited purposes.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. Accordingly, these estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Some of the most significant estimates pertaining to the Company include the valuation of inventories, the allowance for doubtful accounts, income tax valuation allowances and the recoverability of long-lived assets. On a regular basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results could differ from those estimates. There have been no material changes to critical estimates since the audited financial statements at December 31, 2005.

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

Earnings Per Share. Basic earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the period. Diluted earnings per common share is computed by dividing net earnings by the weighted average common shares outstanding adjusted for the dilutive effect of stock options, excluding antidilutive shares, under the Company s stock option plan. See Stock-based Compensation Plans note for additional disclosure. The following table represents the Company s basic and diluted earning per share.

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Net income	$ 13,868	$ 3,175	$ 38,389	$ 13,022
Cumulative redeemable exchangeable preferred stock dividends and accretion	(4,100)	(3,646)	(11,948)	(10,626)
Net income (loss) available to common stockholders	$ 9,768	$ (471)	$ 26,441	$ 2,396
Weighted average shares	50,563,948	50,564,650	50,511,824	50,659,617
Effect of dilutive employee stock options	1,911,802		1,911,802	933,786
Diluted weighted average shares	52,475,750	50,564,650	52,423,626	51,593,403
Basic earnings (loss) per share	$ 0.19	$ (0.01)	$ 0.52	$ 0.05
Diluted earnings (loss) per share	$ 0.18	$ (0.01)	$ 0.50	$ 0.05

Cash and Cash Equivalents. The Company considers cash and cash equivalents to include all cash and liquid deposits and investments with a maturity of three months or less. The majority of payments due from banks for third-party credit cards process within 24-48 hours, except for transactions occurring on a Friday, which are generally processed the following Monday. All credit card transactions are classified as cash and the amounts due from these transactions totaled $2.9 million at September 30, 2006 and $2.6 million at December 31, 2005.

Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157 (SFAS 157), Fair Value Measurements. Among other requirements, SFAS 157 defines fair value and establishes a framework for measuring fair value and also expands disclosure about the use of fair value to measure assets and liabilities. SFAS 157 is effective beginning the first fiscal year that begins after November 15, 2007. The Company continues to evaluate the adoption of SFAS 157 and its impact on the Company s consolidated financial statements or results of operations.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). This bulletin expresses the SEC s views regarding the process of quantifying financial statement misstatements. The interpretations in this bulletin were issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. This statement is effective for annual financial statements starting with the year ending December 31, 2006. The Company continues to evaluate the adoption of SAB 108 and its impact on the Company s consolidated financial statements or results of operations and based on current information, the Company does not believe that it will have material impact.

In June 2006, FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109 Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company continues to evaluate the adoption of FIN 48 and its impact on the Company s consolidated financial statements or results of operations.

In March 2006, the FASB s Emerging Issues Task Force (EITF) issued EITF Abstract Issue No. 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation) (EITF 06-03), that clarifies how a company discloses its recording of taxes collected that are imposed on revenue producing activities. EITF 06-03 is effective for the first interim reporting period beginning after December 15, 2006. The Company is evaluating the impact, if any, that EITF 06-03 may have on the Company s consolidated financial statements or results of operations.

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment (revised 2004) (SFAS 123(R)). SFAS No. 123(R) sets accounting requirements for share-based compensation to employees and disallows the use of the intrinsic value method of accounting for stock compensation. The Company is required to account for such transactions using a fair-value method and to recognize compensation expense over the period during which an employee is required to provide services in exchange for the stock options and other equity-based compensation issued to employees. This statement was effective for the Company starting January 1, 2006 and the Company elected to use the modified prospective application method. The impact of this statement on the Company s consolidated financial statements or results of operations has been historically disclosed on a pro-forma basis and is now recognized as compensation expense on a prospective basis. Based on the equity awards outstanding as of September 30, 2006, the Company expects compensation expense, net of tax, of $1.0 million to $2.5 million for the year ending December 31, 2006. Refer to the Stock Based Compensation Plans note for additional disclosure.

NOTE 3. INVENTORIES, NET

Inventories at each respective period consisted of the following:

	September 30, 2006		
	Gross cost	Reserves	Net Carrying Value
		(unaudited) (in thousands)	
Finished product ready for sale	$ 264,616	$ (8,427)	$ 256,189
Work-in-process, bulk product and raw materials	54,873	(2,157)	52,716
Packaging supplies	4,626		4,626
	$ 324,115	$ (10,584)	$ 313,531

	December 31, 2005		
	Gross cost	Reserves	Net Carrying Value
		(in thousands)	
Finished product ready for sale	$ 257,525	$ (10,025)	$ 247,500
Work-in-process, bulk product and raw materials	48,513	(2,128)	46,385
Packaging supplies	4,281		4,281
	$ 310,319	$ (12,153)	$ 298,166

NOTE 4. GOODWILL AND INTANGIBLE ASSETS, NET

Goodwill represents the excess of purchase price over the fair value of identifiable net assets of acquired entities. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), goodwill and intangible assets with indefinite useful lives are not amortized, but instead are tested for impairment at least annually. Other intangible assets with finite lives are amortized on a straight-line basis over periods not exceeding 15 years.

For the nine months ended September 30, 2006, the Company acquired 60 franchise stores. These acquisitions are accounted for utilizing the purchase method of accounting and the Company records the acquired inventory, fixed assets, franchise rights and goodwill, with an applicable reduction to receivables and cash. The total purchase price associated with these acquisitions was $3.2 million, of which $0.6 million was paid in cash. Also as a result of these acquisitions, the Company reclassified $2.1 million of goodwill and $6.0 million of brand intangibles from the Franchise segment to the Retail segment during the nine months ended September 30, 2006. The reclassification was determined based on the relative fair value of the acquired franchise stores.

The following table summarizes the Company s goodwill activity from December 31, 2005 to September 30, 2006.

	Retail	Franchising	Manufacturing/ Wholesale	Total
		(in thousands)		
Balance at December 31, 2005	$ 22,970	$ 56,693	$ 446	$ 80,109
Additions: Acquired franchise stores	935			935
Reclassification: Due to franchise store aquisitions	2,131	(2,131)		
Balance at September 30, 2006 (unaudited)	$ 26,036	$ 54,562	$ 446	$ 81,044

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

The following table summarizes the Company s intangible asset activity from December 31, 2005 to September 30, 2006.

	Gold Card	Retail Brand	Franchise Brand	Operating Agreements	Franchise Rights	Total
				(in thousands)		
Balance at December 31, 2005	$ 514	$ 59,659	$ 152,341	$ 24,296	$ 1,650	$ 238,460
Additions: Acquired franchise stores					1,022	1,022
Reclassification: Due to franchise store aquisitions		5,959	(5,959)			
Amortization expense	(386)			(2,208)	(877)	(3,471)
Balance at September 30, 2006 (unaudited)	$ 128	$ 65,618	$ 146,382	$ 22,088	$ 1,795	$ 236,011

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

	Estimated Life in years	September 30, 2006 Cost	Accumulated Amortization	Carrying Amount	December 31, 2005 Cost	Accumulated Amortization	Carrying Amount
			(unaudited) (in thousands)				
Brands retail		$ 65,618	$	$ 65,618	$ 59,659	$	$ 59,659
Brands franchise		146,382		146,382	152,341		152,341
Gold card retail	3	2,230	(2,119)	111	2,230	(1,784)	446
Gold card franchise	3	340	(323)	17	340	(272)	68
Retail agreements	5 10	8,500	(3,332)	5,168	8,500	(2,447)	6,053
Franchise agreements	10 15	21,900	(4,980)	16,920	21,900	(3,657)	18,243
Franchise rights	1 5	2,820	(1,025)	1,795	1,798	(148)	1,650
		$ 247,790	$ (11,779)	$ 236,011	$ 246,768	$ (8,308)	$ 238,460

The following table represents future estimated amortization expense of other intangible assets, net, with definite lives at September 30, 2006:

	Estimated amortization expense (unaudited)

Years ending December 31,		**(in thousands)**
2006 [1]	$	1,116
2007		3,688
2008		3,344
2009		2,494
2010		2,397
Thereafter		10,972
Total	$	24,011

(1) This period is a partial year and represents the period from October 1 to December 31, 2006.

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

NOTE 5. INTEREST EXPENSE

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

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
	(unaudited) (in thousands)			
Senior credit facility				
Term Loan	$ 1,973	$ 1,608	$ 5,693	$ 4,930
Revolver	158	160	477	459
8 5/8% Senior Notes	3,234	3,234	9,703	9,092
8 1/2 % Senior Subordinated Notes	4,569	4,569	13,706	13,706
Deferred financing fees	757	719	2,235	2,103
Deferred fee writedown early extinguishment				3,890
Mortgage	200	217	546	672
Interest income - other	(1,204)	(550)	(2,876)	(1,619)
Interest expense, net	$ 9,687	$ 9,957	$ 29,484	$ 33,233

NOTE 6. COMMITMENTS AND CONTINGENCIES

Litigation

The Company is engaged in various legal actions, claims and proceedings arising out of the normal course of business, including claims related to breach of contracts, product liabilities, intellectual property matters and employment-related matters resulting from the Company s business activities. As is inherent with most actions such as these, an estimation of any possible and/or ultimate liability cannot always be determined. The Company continues to assess its requirement to account for additional contingencies in accordance with SFAS No. 5, Accounting for Contingencies. The Company is currently of the opinion that the amount of any potential liability resulting from these actions, when taking into consideration the Company s general and product liability coverage, including indemnification obligations of third-party manufacturers, and the indemnification provided by Numico under the purchase agreement in connection with the Numico acquisition, will not have a material adverse impact on its financial position, results of operations or liquidity. However, if the Company is required to make a payment in connection with an adverse outcome in these matters, it could have a material impact on its financial condition and operating results.

As a manufacturer and retailer of nutritional supplements and other consumer products that are ingested by consumers or applied to their bodies, the Company has been and is currently subjected to various product liability claims. Although the effects of these claims to date have not been material to the Company, it is possible that current and future product liability claims could have a material adverse impact on its financial condition and operating results. The Company currently maintains product liability insurance with a deductible/retention of $1.0 million per claim with an aggregate cap on retained loss of $10.0 million. The Company typically seeks and has obtained contractual indemnification from most parties that supply raw materials for its products or that manufacture or market products it sells. The Company also typically seeks to be added, and has been added, as additional insured under most of such parties insurance policies. The Company is also entitled to indemnification by Numico for certain losses arising from claims related to products containing ephedra or Kava Kava sold prior to December 5, 2003. However, any such indemnification or insurance is limited by its terms and any such indemnification, as a practical matter, is limited to the creditworthiness of the indemnifying party and its insurer, and the absence of significant defenses by the insurers. The Company may incur material product liability claims, which could increase its costs and adversely affect its reputation, revenues and operating income.

Ephedra (Ephedrine Alkaloids). As of September 30, 2006, the Company has been named as a defendant in 134 pending cases involving the sale of third-party products that contain ephedra. Of those cases, one involves a proprietary GNC product. Ephedra products have been the subject of adverse publicity and regulatory scrutiny in the United States and other countries relating to alleged harmful effects, including the deaths of several individuals. In early 2003, the Company instructed all of its locations to stop selling products containing ephedra that were manufactured by GNC or one of its affiliates. Subsequently, the Company instructed all of its locations to stop selling any products containing ephedra by June 30, 2003. In April 2004, the FDA banned the sale of products containing ephedra. All claims to date have been tendered to the third-party manufacturer or to the Company insurer and the Company has incurred no expense to date with respect to litigation involving ephedra products. Furthermore, the Company is entitled to indemnification by Numico for certain losses arising from claims related to products containing ephedra sold prior to December 5, 2003. All of the pending cases relate to products sold prior to such time and, accordingly, the Company is entitled to indemnification from Numico for all of the pending cases.

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SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)

Pro-Hormone/Androstenedione Cases. The Company is currently defending itself in connection with certain class action lawsuits (the Andro Actions) relating to the sale by GNC of certain nutritional products alleged to contain the ingredients commonly known as Androstenedione, Androstenediol, Norandrostenedione, and Norandrostenediol (collectively Andro Products). In each case, plaintiffs seek to certify a class and obtain damages on behalf of the class representatives and all those similarly-situated who purchased certain nutritional supplements from the Company alleged to contain Andro Products. The original state court proceedings for the Andro Actions include the following:

Harry Rodriguez v. General Nutrition Companies, Inc. (previously pending in the Supreme Court of the State of New York, New York County, New York, Index No. 02/126277). Plaintiffs filed this putative class action on or about July 25, 2002. The Second Amended Complaint, filed thereafter on or about December 6, 2002, alleged claims for unjust enrichment, violation of General Business Law Section 349 (misleading and deceptive trade practices), and violation of General Business Law Section 350 (false advertising). On July 2, 2003, the Court granted part of the Company s motion to dismiss and dismissed the unjust enrichment cause of action. On January 4, 2006, the court conducted a hearing on the Company s motion for summary judgment and Plaintiffs motion for class certification, both of which remain pending.

Everett Abrams v. General Nutrition Companies, Inc. (previously pending in the Superior Court of New Jersey, Mercer County, New Jersey, Docket No. L-3789-02). Plaintiffs filed this putative class action on or about July 25, 2002. The Second Amended Complaint, filed thereafter on or about December 20, 2002, alleged claims for false and deceptive marketing and omissions and violations of the New Jersey Consumer Fraud Act. On November 18, 2003, the Court signed an order dismissing plaintiff s claims for affirmative misrepresentation and sponsorship with prejudice. The claim for knowing omissions remains pending.

Shawn Brown, Ozan Cirak, Thomas Hannon, and Luke Smith v. General Nutrition Companies, Inc. (previously pending in the 15th Judicial Circuit Court, Palm Beach County, Florida, Index. No. CA-02-14221AB). Plaintiffs filed this putative class action on or about July 25, 2002. The Second Amended Complaint, filed thereafter on or about November 27, 2002, alleged claims for violations of Florida Deceptive and Unfair Trade Practices Act, unjust enrichment, and violation of Florida Civil Remedies for Criminal Practices Act. These claims remain pending.

Abrams, et al. v. General Nutrition Companies, Inc., et al., previously pending in the Common Pleas Court of Philadelphia County, Philadelphia, Class Action No. 02-703886). Plaintiffs filed this putative class action on or about July 25, 2002. The Amended Complaint, filed thereafter on or about April 8, 2003, alleged claims for violations of the Unfair Trade Practices and Consumer Protection Law, and unjust enrichment. The court denied the Plaintiffs motion for class certification, and that order has been affirmed on appeal. Plaintiffs thereafter filed a petition in the Pennsylvania Supreme Court asking that the court consider an appeal of the order denying class certification. The Pennsylvania Supreme Court has not yet ruled on the petition.

David Pio and Ty Stephens, individually and on behalf of all others similarly situated v. General Nutrition Companies, Inc., previously pending in the Circuit Court of Cook County, Illinois, County Department, Chancery Division, Case No. 02-CH-14122). Plaintiffs filed this putative class action on or about July 25, 2002. The Amended Complaint, filed thereafter on or about April 4, 2004, alleged claims for violations of Illinois Consumer Fraud Act, and unjust enrichment. The motion for class certification was stricken, but the court afforded leave to the Plaintiffs to file another motion. Plaintiffs have not yet filed another motion.

Santiago Guzman, individually, on behalf of all others similarly situated, and on behalf of the general public v. General Nutrition Companies, Inc., previously pending on the California Judicial Counsel Coordination Proceeding No. 4363, Los Angeles County Superior Court). Plaintiffs filed this putative class action on or about February 17, 2004. The Amended Complaint, filed on or about May 26, 2005, alleged claims for violations of the Consumers Legal Remedies Act, violation of the Unfair Competition Act, and unjust enrichment. These claims remain pending.

On April 17 and 18, 2006, the Company filed pleadings seeking to remove each of the Andro Actions to the respective federal district courts for the districts in which the respective Andro Actions are pending. Simultaneously, the Company filed motions seeking to transfer each of the Andro Actions to the United States District Court for the Southern District of New York so that they may be consolidated with the recently-commenced bankruptcy case of

MuscleTech Research and Development, Inc. and certain of its affiliates (collectively, MuscleTech), which is currently pending in the Superior Court of Justice, Ontario, Canada under the *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, Case No. 06-CL-6241, with a related proceeding styled *In re MuscleTech Research and Development, Inc., et al.*, Case No. 06 Civ 538 (JSR) and pending in district court in the Southern District of New York pursuant to chapter 15 of title 11 of the United States Code. The Company believes that the pending Andro Actions are related to MuscleTech s bankruptcy case by virtue of the fact that MuscleTech is contractually obligated to indemnify the Company for certain liabilities arising from the standard product indemnity stated in the Company s purchase order terms and conditions or otherwise under state law. The Company s requests to remove, transfer and consolidate the Andro Actions to federal court are pending before the respective federal district courts.

Based upon the information available to the Company at the present time, the Company believes that these matters will not have a material adverse effect upon its liquidity, financial condition or results of operations. As any liabilities that may arise from this case are not probable or reasonably estimable at this time, no liability has been accrued in the accompanying financial statements.

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Class Action Settlement. Five class action lawsuits were filed against the Company in the state courts of Alabama, California, Illinois and Texas with respect to claims that the labeling, packaging and advertising with respect to a third-party product sold by the Company were misleading and deceptive. The Company denies any wrongdoing and is pursuing indemnification claims against the manufacturer. As a result of mediation, the parties have agreed to a national settlement of the lawsuits, which has been preliminarily approved by the court. Notice to the class has been published in mass advertising media publications. In addition, notice has been mailed to approximately 2.4 million GNC Gold Card members. Each person who purchased the third-party product and who is part of the class will receive a cash reimbursement equal to the retail price paid, net of sales tax, upon presentation to the Company of a cash register receipt or original product packaging as proof of purchase. If a person purchased the product, but does not have a cash register receipt or original product packaging, such a person may submit a signed affidavit and will then be entitled to receive one or more coupons. Register receipts or original product packaging, or signed affidavits, must be presented within a 90-day period after the settlement is approved by the court and the time for an appeal has ended. The number of coupons will be based on the total amount of purchases of the product subject to a maximum of five coupons per purchaser. Each coupon will have a cash value of $10.00 valid toward any purchase of $25.00 or more at a GNC store. The coupons will not be redeemable by any GNC Gold Card member during Gold Card Week and will not be redeemable for products subject to any other price discount. The coupons are to be redeemed at point of sale and are not mail-in rebates. They will be redeemable for a 90-day period beginning in the first calendar quarter after the settlement is approved by the court and the time for an appeal has ended. The Company will issue a maximum of 5.0 million certificates with a combined face value of $50.0 million. In addition to the cash reimbursements and coupons, as part of the settlement the Company will be required to pay legal fees of approximately $1.0 million and will incur $0.7 million in 2006 for advertising and postage costs related to the notification letters; as a result $1.7 million was accrued as legal costs at December 31, 2005. No adjustments were recognized during the quarter ended September 30, 2006. The deadline for class members to opt out of the settlement class or object to the terms of the settlement was July 6, 2006. A final fairness hearing is scheduled to take place on November 6, 2006. As the sales of this product occurred in the late 1990s and early 2000s, the Company cannot reasonably estimate (1) how many of the purchasers of the product will receive notice or see the notice published in mass advertising media publications, (2) the amount of customers that will still have sales receipts or original product packaging for the products and (3) the amount of customers that sign an affidavit in lieu of a register receipt or original product packaging. To date, there have been 612 requests for coupons. Due to the uncertainty that exists as to the extent of future sales to the purchasers, the coupons are an incentive for the purchasers to buy products or services from the entity (at a reduced gross margin). Accordingly, the Company will recognize the settlement by reducing revenue in future periods when the purchasers utilize the coupons.

Nutrition 21. On June 23, 2005, General Nutrition Corporation, one of the Company s wholly owned subsidiaries, was sued by Nutrition 21, LLC in the United States District Court for the Eastern District of Texas. Nutrition 21 alleges that the GNC Subsidiary has infringed, and is continuing to infringe, United States Patent No. 5,087,623, United States Patent No. 5,087,624, and United States Patent No. 5,175,156, all of which are entitled Chromic Picolinate Treatment, by offering for sale, selling, marketing, advertising, and promoting finished chromium picolinate products for uses set forth in these patents. Nutrition 21 has requested an injunction prohibiting the GNC subsidiary from infringing these patents and is seeking recovery of unspecified damages resulting from the infringement, including lost profits. Nutrition 21 asserts that lost profits should be trebled due to the GNC subsidiary s alleged willful infringement, together with attorneys fees, interest and costs. The Company disputes the claims and intends to contest this suit vigorously. In its answer and counterclaims, the GNC subsidiary has asserted, and is seeking a declaratory judgment, that these patents are invalid, not infringed, and unenforceable. The GNC subsidiary has also asserted counterclaims in the suit for false patent marking and false advertising. A hearing on claim construction issues was held on April 20, 2006 and the court has issued a claim construction order. The parties are presently pursuing discovery. The case is not presently set for trial, but we expect that it will be docketed for trial in the first half of 2007. As any liabilities that may arise from this case are not probable or reasonably estimable at this time, no liability has been accrued in the accompanying financial statements.

Franklin Publications. On October 26, 2005, General Nutrition Corporation, a wholly owned subsidiary of the Company was sued in the Common Pleas Court of Franklin County, Ohio by Franklin Publications, Inc. (Franklin). The case was subsequently removed to the United States District Court for the Southern District of Ohio, Eastern Division. The lawsuit is based upon the GNC subsidiary s termination, effective as of December 31, 2005, of two contracts for the publication of two monthly magazines mailed to certain GNC customers. Franklin is seeking a declaratory judgment as to its rights and obligations under the contracts and monetary damages for the GNC subsidiary s alleged breach of the contracts. Franklin also alleges that the GNC subsidiary has interfered with Franklin s business relationships with the advertisers in the publications, who are primarily GNC vendors, and has been unjustly enriched. Franklin does not specify the amount of damages sought, only that they are in excess of $25,000. The Company disputes the claims and intends to vigorously defend the lawsuit. The Company believes that the lawsuit will not have a material adverse effect on its liquidity, financial condition or results of operations. As any liabilities that may arise from this case are not probable or reasonably estimable at this time, no liability has been accrued in the accompanying financial statements.

Wage and Hour Claim. On August 11, 2006, Centers and General Nutrition Corporation, a wholly owned subsidiary of the Company, was sued in federal district court for the District of Kansas by Michelle L. Most and Mark A. Kelso, on behalf of themselves and all others similarly situated. The lawsuit purports to certify a nationwide class of GNC store managers and assistant managers and alleges that GNC failed to pay time and a half for working more than 40 hours per week. Counsel for the plaintiffs contends that Centers and GNC improperly applied fluctuating work week calculations and procedures for docking pay for working less than 40 hours per week under a fluctuating work week. The Company intends to vigorously defend the lawsuit and believes that it will not have any additional material impact on its consolidated financial statements.

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Visa/MasterCard Antitrust Litigation. The terms of a significant portion of the Visa/MasterCard antitrust litigation settlement were finalized during 2005. Accordingly, the Company recognized a $1.2 million gain in December 2005 for its expected portion of the proceeds and expects to collect this settlement in the fourth quarter of 2006.

Product Claim Settlement. In March 2005, an individual purchased a nutritional supplement containing whey at one of the Company s stores and, within minutes after preparing the mix, went into anaphylactic shock, allegedly as a result of an allergy to dairy products, and subsequently died. A pre-litigation complaint was presented to the Company alleging wrongful death among other claims. The product was labeled in accordance with FDA regulations in effect at the time. On July 18, 2006, the Company entered into a settlement agreement with the individual s estate pursuant to which the Company did not admit liability, but agreed to pay approximately $1.3 million to the estate, which includes a $100,000 payment to a bona fide insurer on behalf of the individual s sister in exchange for full general releases in favor of the Company. Under the applicable insurance policy covering the claim, the Company has a retention of $1.0 million, which was accrued in the second quarter of 2006. In the third quarter of 2006, the Company paid the $1.0 million retention and its insurance carrier funded the balance of the settlement.

Pennsylvania Claim

The Commonwealth of Pennsylvania has conducted an unclaimed property audit of General Nutrition, Inc., a wholly owned subsidiary of the Company for the period January 1, 1992 to December 31, 1997 generally and January 1, 1992 to December 31, 1999 for payroll and wages. As a result of the audit, the Pennsylvania Treasury Department has made an assessment of an alleged unclaimed property liability of the subsidiary in the amount of $4.1 million. The subsidiary regularly records normal course liabilities for actual unclaimed properties and does not agree with the assessment. The subsidiary filed an appeal, is currently involved in discussions with the Pennsylvania Department of Treasury staff and continues to vigorously defend against the assessment.

NOTE 7. STOCK-BASED COMPENSATION PLANS

On December 5, 2003 the Board of Directors of the Company (the Board) approved and adopted the GNC Corporation (f/k/a General Nutrition Centers Holding Company) 2003 Omnibus Stock Incentive Plan (the Plan). The purpose of the Plan is to enable the Company to attract and retain highly qualified personnel who will contribute to the success of the Company. The Plan provides for the granting of stock options, stock appreciation rights, restricted stock, deferred stock and performance shares. The Plan is available to certain eligible employees, directors, consultants or advisors as determined by the administering committee of the Board. The total number of shares of Common Stock reserved and available for the Plan is 6.8 million shares. Stock options under the Plan generally are granted at fair market value, vest over a four-year vesting schedule and expire after seven years from date of grant. If stock options are granted at an exercise price that is less than fair market value at the date of grant, compensation expense is recognized immediately for the intrinsic value. As of September 30, 2006 there were 4.8 million outstanding stock options under the Plan. No stock appreciation rights, restricted stock, deferred stock or performance shares were granted under the Plan as of September 30, 2006.

The following table outlines total stock options activity under the Plan:

	Total Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2005	4,706,403	$ 3.52	
Granted	485,641	5.65	
Exercised	(128,025)	3.52	
Forfeited	(285,323)	5.04	

Outstanding at September 30, 2006 (unaudited)	4,778,696		3.65	$	41,499
Exercisable at September 30, 2006 (unaudited)	2,337,769	$	3.56	$	20,501

The Company adopted SFAS No. 123(R), effective January 1, 2006. The Company selected the modified prospective method, which does not require adjustment to prior period financial statements and measures expected future compensation cost for stock-based awards at fair value on grant date. The Company utilizes the Black-Scholes model to calculate the fair value of options under SFAS No. 123(R), which is consistent with disclosures previously included in prior year financial statements under SFAS No. 123 Accounting for Stock-Based Compensation (SFAS No. 123) and SFAS No. 148 Accounting for Stock Based Compensation-Transition and Disclosure (SFAS No. 148). The resulting compensation cost is recognized in the Company s financial statements over the option vesting period. As of the date of adoption of SFAS No 123(R), the net unrecognized compensation cost, after taking into consideration estimated forfeitures, related to options outstanding was $4.4 million and at September 30, 2006 was $4.3 million and is expected to be recognized over a weighted average period of approximately 1.9 years. The amount of cash received from the exercise of stock options during the nine months ended September 30, 2006 was $0.5 million and the related tax benefit was $0.1 million. The total intrinsic value of options exercised during the nine months ended September 30, 2006 was $0.3 million.

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As of September 30, 2006, the weighted average remaining contractual life of outstanding options was 5.0 years and the weighted average remaining contractual life of exercisable options was 4.7 years. The weighted average fair value of options granted during the nine months ended September 30, 2006 and 2005 was $8.59 and $2.40, respectively.

SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. Stock-based compensation expense for the three and nine months ended September 30, 2006 includes $0.7 million and $1.6 million, respectively, of stock option expense recorded as a result of the adoption of SFAS No. 123(R).

As stated above, SFAS 123(R) established a fair-value-based method of accounting for generally all share-based payment transactions. The Company utilizes the Black-Scholes valuation method to establish fair value of all awards. The Black-Scholes model utilizes the following assumptions in determining a fair value: price of underlying stock, option exercise price, expected option term, risk-free interest rate, expected dividend yield, and expected stock price volatility over the option s expected term. As the Company has had minimal exercises of stock options through September 30, 2006, the expected option term has been estimated by considering both the vesting period, which is typically four years, and the contractual term of seven years. As the Company s underlying stock is not publicly traded on an open market, the Company utilized a historical industry average to estimate the expected volatility. The assumptions used in the Company s Black-Scholes valuation related to stock option grants made for the nine months ended September 30, 2006 and 2005 were as follows:

	September 30, 2006	September 30, 2005
	(unaudited)	
Dividend yield	0.00%	0.00%
Expected option life	5 years	5 years
Volatility factor percentage of market price	22.00%	24.00%
Discount rate	4.59% 5.10%	3.84% 4.18%

As the Black-Scholes option valuation model utilizes certain estimates and assumptions, the existing models do not necessarily represent the definitive fair value of options for future periods.

Prior to the adoption of SFAS No. 123(R), and as permitted under SFAS No. 123, the Company measured compensation expense related to stock options in accordance with Accounting Principles Board (APB) No. 25 and related interpretations which use the intrinsic value method. If compensation expense were determined based on the estimated fair value of options granted, consistent with the fair market value method in SFAS No. 123, its net income for the three and nine months ended September 30, 2005 would be reduced to the pro forma amounts indicated below:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
	(unaudited) (in thousands)	
Net (loss) income available to common stockholders, as reported	$ (471)	$ 2,396
Less: total stock-based employee compensation costs determined using fair value method, net of tax	(187)	(582)

Adjusted net (loss) income	$ (658)	$ 1,814
Earnings Per Share Basic and Diluted		
Basic (loss) earnings per share		
as reported	$ (0.01)	$ 0.05
pro forma	$ (0.01)	$ 0.04
Diluted (loss) earnings per share		
as reported	$ (0.01)	$ 0.05
pro forma	$ (0.01)	$ 0.04
Weighted average common shares outstanding:		
basic.	50,564,650	50,659,617
diluted.	50,564,650	51,593,403

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NOTE 8. SEGMENTS

The Company has three operating segments each of which is a reportable segment. The operating segments represent identifiable components of the Company for which separate financial information is available. This information is utilized by management to assess performance and allocate assets accordingly. The Company s management evaluates segment operating results based on several indicators. The primary key performance indicators are sales and operating income or loss for each segment. Operating income or loss, as evaluated by management, excludes certain items that are managed at the consolidated level, such as warehousing and distribution costs and other corporate costs. The following table represents key financial information for each of the Company s operating segments, identifiable by the distinct operations and management of each: Retail, Franchising, and Manufacturing/Wholesale. The Retail segment includes the Company s corporate store operations in the United States and Canada and the sales generated through www.gnc.com. The Franchise segment represents the Company s franchise operations, both domestically and internationally. The Manufacturing/Wholesale segment represents the Company s manufacturing operations in South Carolina and Australia and the wholesale sales business. This segment supplies the Retail and Franchise segments, along with various third parties, with finished products for sale. The Warehousing and Distribution costs, Corporate costs, and other unallocated costs represent the Company s administrative expenses. The accounting policies of the segments are the same as those described in the Basis of Presentation and Summary of Significant Accounting Policies included in our Annual Report on Form 10-K.

	Three Months ended September 30,		Nine Months ended September 30,	
	2006	2005	2006	2005
	(unaudited) (in thousands)			
Revenue:				
Retail	$ 274,156	$ 239,172	$ 853,806	$ 744,701
Franchise	60,727	53,144	180,341	163,525
Manufacturing/Wholesale:				
Intersegment (1)	44,770	45,749	130,500	150,467
Third Party	32,852	30,243	103,252	84,115
Sub total Manufacturing/Wholesale	77,622	75,992	233,752	234,582
Sub total segment revenues	412,505	368,308	1,267,899	1,142,808
Intersegment elimination (1)	(44,770)	(45,749)	(130,500)	(150,467)
Total revenue	$ 367,735	$ 322,559	$ 1,137,399	$ 992,341

(1) Intersegment revenues are eliminated from consolidated revenue.

Operating income:				
Retail	$ 31,012	$ 16,431	$ 99,921	$ 55,537
Franchise	17,213	14,640	48,311	37,607
Manufacturing/Wholesale	14,279	11,477	38,789	36,087

Unallocated corporate and other (costs) income:				
Warehousing and distribution costs	(12,644)	(12,565)	(37,965)	(37,435)
Corporate costs	(17,046)	(15,035)	(57,461)	(40,602)
Other (expense) income	(1,078)		(1,078)	2,500
Sub total unallocated corporate and other (costs) income	(30,768)	(27,600)	(96,504)	(75,537)
Total operating income	$ 31,736	$ 14,948	$ 90,517	$ 53,694

	September 30, 2006	**December 31, 2005**
	(in thousands)	
	(unaudited)	
Total assets:		
Retail	$ 466,698	$ 441,364
Franchise	284,795	290,092
Manufacturing / Wholesale	151,587	148,445
Corporate / Other	133,198	143,930
Total assets	$ 1,036,278	$ 1,023,831

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NOTE 9. SUPPLEMENTAL GUARANTOR INFORMATION

As of September 30, 2006 and December 31, 2005, the Company s debt included Centers senior credit facility, its Senior Notes and its Senior Subordinated Notes. The senior credit facility has been guaranteed by the Company and its domestic subsidiaries. The Senior Notes are general unsecured obligations of Centers and rank secondary to Centers senior credit facility and are senior in right of payment to all existing and future subordinated obligations of Centers, including Centers Senior Subordinated Notes. The Senior Notes are unconditionally guaranteed on an unsecured basis by all of Centers existing and future material domestic subsidiaries. The Senior Subordinated Notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of Centers domestic subsidiaries and rank secondary to Centers senior credit facility and Senior Notes. Guarantor subsidiaries include the Company s direct and indirect domestic subsidiaries as of the respective balance sheet dates. Non-guarantor subsidiaries include the remaining direct and indirect foreign subsidiaries. The subsidiary guarantors are 100% owned by the Company. The guarantees are full and unconditional and joint and several.

Presented below are condensed consolidated financial statements of the Company, Centers as the issuer, and the combined guarantor and non-guarantor subsidiaries as of September 30, 2006 and December 31, 2005 and for the three and nine months ended September 30, 2006 and 2005. The guarantor and non-guarantor subsidiaries are presented in a combined format as their individual operations are not material to the Company s consolidated financial statements. Investments in subsidiaries are either consolidated or accounted for under the equity method of accounting. Intercompany balances and transactions have been eliminated.

Supplemental Condensed Consolidating Balance Sheets

	Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(unaudited) (in thousands)			
September 30, 2006						
Current assets						
Cash and cash equivalents	$	$	$ 82,919	$ 4,441	$	$ 87,360
Receivables, net			80,804	1,333		82,137
Intercompany receivables		2,366	30,873		(33,239)	
Inventories, net			297,235	16,296		313,531
Other current assets	1,670	246	38,589	4,986		45,491
Total current assets	1,670	2,612	530,420	27,056	(33,239)	528,519
Goodwill			80,102	942		81,044
Brands			209,000	3,000		212,000
Property, plant and equipment, net			149,832	20,011		169,843
Investment in subsidiaries	331,839	802,310	9,794		(1,143,943)	
Other assets		14,096	39,482	74	(8,780)	44,872
Total assets	$ 333,509	$ 819,018	$ 1,018,630	$ 51,083	$ (1,185,962)	$ 1,036,278

Current liabilities						
Current liabilities	$ 1,181	$ 8,366	$ 205,527	$ 10,746	$	$ 225,820
Intercompany payables	2,366	19,362		11,511	(33,239)	
Total current liabilities	3,547	27,728	205,527	22,257	(33,239)	225,820
Long-term debt		459,451		18,997	(8,780)	469,668
Other long-term liabilities			10,793	35		10,828
Total liabilities	3,547	487,179	216,320	41,289	(42,019)	706,316
Cumulative redeemable exchangeable preferred stock	139,063					139,063
Total stockholders equity (deficit)	190,899	331,839	802,310	9,794	(1,143,943)	190,899
Total liabilities and stockholders equity (deficit)	$ 333,509	$ 819,018	$ 1,018,630	$ 51,083	$ (1,185,962)	$ 1,036,278

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SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)
Supplemental Condensed Consolidating Balance Sheets

	Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)			
December 31, 2005						
Current assets						
Cash and cash equivalents	$	$	$ 83,143	$ 2,870	$	$ 86,013
Receivables, net			69,518	1,112		70,630
Intercompany receivables		1,809	33,079		(34,888)	
Inventories, net			283,511	14,655		298,166
Other current assets		97	39,825	4,765		44,687
Total current assets		1,906	509,076	23,402	(34,888)	499,496
Goodwill			79,167	942		80,109
Brands			209,000	3,000		212,000
Property, plant and equipment, net			158,877	20,605		179,482
Investment in subsidiaries	340,880	809,105	7,081		(1,157,066)	
Other assets		16,331	45,120	73	(8,780)	52,744
Total assets	$ 340,880	$ 827,342	$ 1,008,321	$ 48,022	$ (1,200,734)	$ 1,023,831
Current liabilities						
Current liabilities	$ (118)	$ 5,801	$ 188,362	$ 8,462	$	$ 202,507
Intercompany payables	1,809	20,474		12,605	(34,888)	
Total current liabilities	1,691	26,275	188,362	21,067	(34,888)	202,507
Long-term debt		460,187		19,837	(8,780)	471,244
Other long-term liabilities			10,854	37		10,891
Total liabilities	1,691	486,462	199,216	40,941	(43,668)	684,642
Cumulative redeemable exchangeable preferred stock	127,115					127,115
	212,074	340,880	809,105	7,081	(1,157,066)	212,074

Total stockholders equity (deficit)						
Total liabilities and stockholders equity (deficit)	$ 340,880	$ 827,342	$ 1,008,321	$ 48,022	$ (1,200,734)	$ 1,023,831

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)
Supplemental Condensed Consolidating Statements of Operations

	Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(unaudited) (in thousands)			
Three months ended September 30, 2006						
Revenue	$	$	$ 348,570	$ 21,102	$ (1,937)	$ 367,735
Cost of sales, including costs of warehousing, distribution and occupancy			227,815	15,373	(1,937)	241,251
Gross profit			120,755	5,729		126,484
Compensation and related benefits			57,436	3,395		60,831
Advertising and promotion			10,836	146		10,982
Other selling, general and administrative	100	490	20,886	384		21,860
Subsidiary (income) loss	(13,932)	(14,716)	28		28,620	
Other (income) expense			(6)	1,081		1,075
Operating income (loss)	13,832	14,226	31,575	723	(28,620)	31,736
Interest expense, net		757	8,598	332		9,687
Income (loss) before income taxes	13,832	13,469	22,977	391	(28,620)	22,049
Income tax (benefit) expense	(36)	(463)	8,261	419		8,181
Net income (loss)	$ 13,868	$ 13,932	$ 14,716	$ (28)	$ (28,620)	$ 13,868

Supplemental Condensed Consolidating Statements of Operations

Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated

(unaudited)
(in thousands)

Nine months ended September 30, 2006						
Revenue	$	$	$ 1,081,953	$ 63,309	$ (7,863)	$ 1,137,399
Cost of sales, including costs of warehousing, distribution and occupancy			713,598	45,716	(7,863)	751,451
Gross profit			368,355	17,593		385,948
Compensation and related benefits			177,269	10,031		187,300
Advertising and promotion			40,798	539		41,337
Other selling, general and administrative	295	2,000	62,894	1,232		66,421
Subsidiary (income) loss	(38,575)	(41,238)	(2,767)		82,580	
Other (income) expense			(19)	392		373
Operating income (loss)	38,280	39,238	90,180	5,399	(82,580)	90,517
Interest expense, net		2,234	26,203	1,047		29,484
Income (loss) before income taxes	38,280	37,004	63,977	4,352	(82,580)	61,033
Income tax (benefit) expense	(109)	(1,571)	22,739	1,585		22,644
Net income (loss)	$ 38,389	$ 38,575	$ 41,238	$ 2,767	$ (82,580)	$ 38,389

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)
Supplemental Condensed Consolidating Statements of Operations

	Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(unaudited) (in thousands)			
Three months ended September 30, 2005						
Revenue	$	$	$ 307,427	$ 17,696	$ (2,564)	$ 322,559
Cost of sales, including costs of warehousing, distribution and occupancy			211,586	13,062	(2,564)	222,084
Gross profit			95,841	4,634		100,475
Compensation and related benefits			55,370	3,062		58,432
Advertising and promotion			8,501	138		8,639
Other selling, general and administrative	41	522	16,667	1,306		18,536
Subsidiary (income) loss	(3,202)	(3,990)	204		6,988	
Other income			(22)	(58)		(80)
Operating income (loss)	3,161	3,468	15,121	186	(6,988)	14,948
Interest expense, net		719	8,868	370		9,957
Income (loss) before income taxes	3,161	2,749	6,253	(184)	(6,988)	4,991
Income tax (benefit) expense	(14)	(453)	2,263	20		1,816
Net income (loss)	$ 3,175	$ 3,202	$ 3,990	$ (204)	$ (6,988)	$ 3,175

Supplemental Condensed Consolidating Statements of Operations

	Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated

	(unaudited) (in thousands)					
Nine months ended September 30, 2005						
Revenue	$	$	$ 947,920	$ 53,196	$ (8,775)	$ 992,341
Cost of sales, including costs of warehousing, distribution and occupancy			645,974	39,065	(8,775)	676,264
Gross profit			301,946	14,131		316,077
Compensation and related benefits			163,009	8,966		171,975
Advertising and promotion			36,365	415		36,780
Other selling, general and administrative	206	1,536	52,106	2,417		56,265
Subsidiary (income) loss	(13,154)	(17,967)	(1,350)		32,471	
Other income			(2,492)	(145)		(2,637)
Operating income (loss)	12,948	16,431	54,308	2,478	(32,471)	53,694
Interest expense, net		5,993	26,169	1,071		33,233
Income (loss) before income taxes	12,948	10,438	28,139	1,407	(32,471)	20,461
Income tax (benefit) expense	(74)	(2,716)	10,172	57		7,439
Net income (loss)	$ 13,022	$ 13,154	$ 17,967	$ 1,350	$ (32,471)	$ 13,022

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)
Supplemental Condensed Consolidating Statements of Cash Flows

	Parent	Issuer	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidated
			(unaudited) (in thousands)		
Nine months ended September 30, 2006					
NET CASH PROVIDED BY OPERATING ACTIVITIES:	$	$	$ 65,270	$ 3,585	$ 68,855
CASH FLOWS FROM INVESTING ACTIVITIES:					
Capital expenditures			(14,828)	(1,222)	(16,050)
Investment/distribution		50,693	(50,693)		
Other investing			(591)		(591)
Net cash provided by (used in) investing activities		50,693	(66,112)	(1,222)	(16,641)
CASH FLOWS FROM FINANCING ACTIVITIES:					
GNC Corporation investment in General Nutrition Centers, Inc.	23	(23)			
Restricted payment made by General Nutrition Centers, Inc. to GNC Corporation Common Stockholders		(49,934)			(49,934)
Repurchase/retirement of common stock	(68)				(68)
Proceeds from exercised stock options	450				450
Payments on long-term debt		(736)		(814)	(1,550)
Other financing	(405)		618		213
Net cash (used in) provided by financing activities		(50,693)	618	(814)	(50,889)
Effect of exchange rate on cash				22	22
Net (decrease) increase in cash			(224)	1,571	1,347
Beginning balance, cash			83,143	2,870	86,013
Ending balance, cash	$	$	$ 82,919	$ 4,441	$ 87,360

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GNC CORPORATION AND SUBSIDIARIES
SUMMARIZED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED CONTINUED)
Supplemental Condensed Consolidating Statements of Cash Flows

	Parent	Issuer	Combined Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
			(unaudited) (in thousands)		
Nine months ended September 30, 2005					
Net cash provided by operating activities	$	$ 4,672	$ 28,980	$ 1,002	$ 34,654
CASH FLOWS FROM INVESTING ACTIVITIES:					
Capital expenditures			(13,620)	(199)	(13,819)
Investment/distribution		36,569	(36,569)		
Other investing			(524)		(524)
Net cash provided by (used in) investing activities		36,569	(50,713)	(199)	(14,343)
CASH FLOWS FROM FINANCING ACTIVITIES:					
GNC Corporation return of capital from General Nutrition Centers, Inc.	834	(834)			
Repurchase/retirement of common stock	(834)				(834)
Payments on long-term debt third parties		(185,735)		(765)	(186,500)
Proceeds from senior notes issuance		150,000			150,000
Other financing		(4,672)	(1,067)		(5,739)
Net cash used in financing activities		(41,241)	(1,067)	(765)	(43,073)
Effect of exchange rate on cash				4	4
Net (decrease) increase in cash			(22,800)	42	(22,758)
Beginning balance, cash			82,722	2,439	85,161
Ending balance, cash	$	$	$ 59,922	$ 2,481	$ 62,403

NOTE 10. ASSETS HELD FOR SALE

In September 2006, a subsidiary of GNC entered into formal negotiations for the sale of 100% of the stock of the Company s Australian manufacturing facility, DFC Thompson Australia Pty. Ltd. (DFC). The Company is currently involved in continued negotiations regarding the details of a sale of DFC, which is expected to close in the fourth quarter of 2006. GNC recognized other expense of $1.1 million for the nine months ended September 30, 2006, which was the expected loss on the pending sale.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Item 1, Financial Statements in Part I of this quarterly report on Form 10-Q (the Report).

Forward-Looking Statements

The discussion in this section contains forward-looking statements that involve risks and uncertainties. Forward-looking statements may relate to our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, and other information that is not historical information. Forward-looking statements can be identified by the use of terminology such as subject to, believes, anticipates, plan expects, intends, estimates, projects, may, will, should, can, the negatives thereof, variations thereon an expressions, or by discussions of strategy.

All forward-looking statements, including, without limitation, our examination of historical operating trends, are based upon our current expectations and various assumptions. We believe there is a reasonable basis for our expectations and beliefs, but they are inherently uncertain. We may not realize our expectations, and our beliefs may not prove correct. Actual results could differ materially from those described or implied by such forward-looking statements. Factors that may materially affect such forward-looking statements include, among others:

- significant competition in our industry;
- unfavorable publicity or consumer perception of our products;
- the incurrence of material product liability and product recall costs;
- costs of compliance and our failure to comply with governmental regulations;
- the failure of our franchisees to conduct their operations profitably and limitations on our ability to terminate or replace under- performing franchisees;
- economic, political, and other risks associated with our international operations;
- our failure to keep pace with the demands of our customers for new products and services;
- disruptions in our manufacturing system or losses of manufacturing certifications;
- the lack of long-term experience with human consumption of ingredients in some of our products;
- increases in the frequency and severity of insurance claims, particularly claims for which we are self-insured;
- loss or retirement of key members of management;
- increases in the cost of borrowings and limitations on availability of additional debt or equity capital;
- the impact of our substantial debt on our operating income and our ability to grow; and
- the failure to adequately protect or enforce our intellectual property rights against competitors.

See Item 1A, Risk Factors included in Part II of this Report.

Consequently, forward-looking statements should be regarded solely as our current plans, estimates, and beliefs. You should not place undue reliance on forward-looking statements. We cannot guarantee future results, events, levels of activity, performance, or achievements. We do not undertake and specifically decline any obligation to update, republish, or revise forward-looking statements to reflect future events or circumstances or to reflect the occurrences of unanticipated events.

Business Overview

We are the largest global specialty retailer of nutritional supplements, which include VMHS, sports nutrition products, diet products and other wellness products. We derive our revenues principally from product sales through our company-owned stores and www.gnc.com, franchise activities and sales of products manufactured in our facilities to third parties. We sell products through a worldwide network of more than 5,800 locations operating under the GNC brand name.

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Executive Overview

In 2005, we undertook major specific initiatives to rebuild the business and to establish a foundation for stronger future performance. These initiatives were implemented in order to reverse declining sales trends, a lack of connectivity with our customers, and deteriorating franchise relations. In 2006, we have continued our focus on these strategies, and continued to see favorable results. These initiatives have allowed us to capitalize on our national footprint, brand awareness, and competitive positioning to improve our overall performance. Specifically, we:

- introduced a single national pricing structure in order to simplify our pricing approach and improve our customer value perception;
- developed and executed a national, more diversified marketing program focused on competitive pricing of key items and reinforcing GNC s well-recognized and dominant brand name among consumers;
- overhauled our field organization and store programs to improve our value-added customer shopping experience;
- focused our merchandising and marketing initiatives on driving increased traffic to our store locations, particularly with promotional events outside of Gold Card week;
- improved supply chain and inventory management, resulting in better in-stock levels of products generally and never out levels of top products;
- reinvigorated our proprietary new product development activities;
- revitalized vendor relationships, including their new product development activities and our exclusive or first-to-market access to new products;
- realigned our franchise system with our corporate strategies and re-acquired or closed unprofitable or non-compliant franchised stores in order to improve the financial performance of the franchise system;
- reduced our overhead cost structure; and
- launched internet sales of our products on www.gnc.com.

Favorable results in the third quarter of 2006 included the following:

- Our fifth consecutive quarter of positive same store sales in our Retail segment. Same store sales, including internet sales, increased 11.7% for the three months ended September 30, 2006 compared to the same period in 2005. We believe that this increase was driven by our strategic initiatives that included simplifying our pricing and a national, more diversified marketing program and developing a better overall experience for our customers.
- A realigned domestic franchise program, operating in a more unified way with our company-owned stores, which contributed to positive same store sales for our domestic franchised locations for the fourth consecutive quarter.

Results of Operations

The information presented below for the three and nine months ended September 30, 2006 and 2005 was prepared by management and is unaudited. In the opinion of management, all adjustments necessary for a fair statement of our financial position and operating results for such periods and as of such dates have been included.

As discussed in the Segments note to our consolidated financial statements, we evaluate segment operating results based on several indicators. The primary key performance indicators are revenues and operating income or loss for each segment. Revenues and operating income or loss, as evaluated by management, exclude certain items that are managed at the consolidated level, such as warehousing and distribution costs and corporate costs. The following discussion compares the revenues and the operating income or loss by segment, as well as those items excluded from the segment totals.

Same store sales growth reflects the percentage change in same store sales in the period presented compared to the prior year period. Same store sales are calculated on a daily basis for each store and exclude the net sales of a store for any period if the store was not open during the same period of the prior year. Beginning in the first quarter of 2006, we also included our internet sales, as generated through www.gnc.com and drugstore.com, in our domestic company-owned same store sales calculation. When a store s square footage has been changed as a result of reconfiguration or relocation in the

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same mall or shopping center, the store continues to be treated as a same store. If, during the period presented, a store was closed, relocated to a different mall or shopping center, or converted to a franchised store or a company-owned store, sales from that store up to and including the closing day or the day immediately preceding the relocation or conversion are included as same store sales as long as the store was open during the same period of the prior year. We exclude from the calculation sales during the period presented from the date of relocation to a different mall or shopping center and from the date of a conversion. In the second quarter of 2006, we modified the calculation method for domestic franchised same store sales consistent with this description, which has been the method historically used for domestic company-owned same store sales. Prior to the second quarter of 2006, we had included in domestic franchised same store sales the sale from franchised stores after relocation to a different mall or shopping center and from former company-owned stores after conversion to franchised stores. The franchised same store sales growth percentages for all prior periods have been adjusted to be consistent with the modified calculation method.

Results of Operations

(Dollars in millions and percentages expressed as a percentage of total net revenues)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006		2005		2006		2005	
	(unaudited)							
Revenues:								
Retail	$ 274.1	74.5%	$ 239.2	74.1%	$ 853.8	75.1%	$ 744.7	75.0%
Franchise	60.7	16.5%	53.2	16.5%	180.3	15.8%	163.5	16.5%
Manufacturing / Wholesale	32.9	9.0%	30.2	9.4%	103.3	9.1%	84.1	8.5%
Total net revenues	**367.7**	**100.0%**	**322.6**	**100.0%**	**1,137.4**	**100.0%**	**992.3**	**100.0%**
Operating expenses:								
Cost of sales, including warehousing, distribution and occupancy costs	241.3	65.6%	222.1	68.9%	751.5	66.1%	676.2	68.2%
Compensation and related benefits	60.8	16.6%	58.5	18.1%	187.3	16.5%	172.0	17.3%
Advertising and promotion	11.0	3.0%	8.7	2.7%	41.3	3.6%	36.8	3.7%
Other selling, general and administrative expenses	20.3	5.5%	17.3	5.4%	62.9	5.5%	53.2	5.4%
Amortization expense	1.5	0.4%	1.1	0.3%	3.5	0.3%	3.0	0.3%
Foreign currency gain		0.0%		0.0%	(0.7)	-0.1%	(0.1)	0.0%
Other expense (income)	1.1	0.3%		0.0%	1.1	0.1%	(2.5)	-0.3%
Total operating expenses	**336.0**	**91.4%**	**307.7**	**95.4%**	**1,046.9**	**92.0%**	**938.6**	**94.6%**
Operating income:								
Retail	31.0	8.4%	16.4	5.1%	99.9	8.8%	55.5	5.6%

Franchise	17.2	4.7%	14.7	4.6%	48.3	4.3%	37.6	3.8%
Manufacturing / Wholesale	14.2	3.8%	11.4	3.5%	38.8	3.4%	36.1	3.6%
Unallocated corporate and other (costs) income:								
Warehousing and distribution costs	(12.6)	-3.4%	(12.5)	-3.9%	(37.9)	-3.3%	(37.4)	-3.8%
Corporate costs	(17.0)	-4.6%	(15.1)	-4.7%	(57.5)	-5.1%	(40.6)	-4.1%
Other (expense) income	(1.1)	-0.3%		0.0%	(1.1)	-0.1%	2.5	0.3%
Subtotal unallocated corporate and other costs net	(30.7)	-8.3%	(27.6)	-8.6%	(96.5)	-8.5%	(75.5)	-7.6%
Total operating income	**31.7**	**8.6%**	**14.9**	**4.6%**	**90.5**	**8.0%**	**53.7**	**5.4%**
Interest expense, net	9.7		9.9		29.5		33.2	
Income before income taxes	**22.0**		**5.0**		**61.0**		**20.5**	
Income tax expense	8.1		1.8		22.6		7.5	
Net income	**$ 13.9**		**$ 3.2**		**$ 38.4**		**$ 13.0**	

Note: The numbers in the above table have been rounded to millions. All calculations related to the Results of Operations for the year-over-year comparisons below were derived from the table above and could occasionally differ immaterially if you were to use the unrounded data for these calculations.

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Comparison of the Three Months Ended September 30, 2006 and 2005

Revenues

Our consolidated net revenues increased $45.1 million, or 14.0%, to $367.7 million for the three months ended September 30, 2006 compared to $322.6 million for the same period in 2005. The increase was primarily the result of increased same store sales in our Retail and Franchise segments and increased revenue in our Manufacturing/Wholesale segment due to higher volume third-party customer contract sales.

Retail. Revenues in our Retail segment increased $34.9 million, or 14.6%, to $274.1 million for the three months ended September 30, 2006 compared to $239.2 million for the same period in 2005. Included as part of the revenue increase was $4.2 million in revenue for sales through www.gnc.com, which started selling products on December 28, 2005. Sales increases occurred in all major product categories, including VMHS, sports nutrition, and diet. Our domestic company-owned same store sales, including our internet sales, improved for the quarter by 11.7%. Similar to the sales trends in our domestic company-owned stores, our Canadian company-owned stores had improved same store sales of 13.8% in the third quarter of 2006. Our company-owned store base increased by 47 stores to 2,538 domestically, primarily due to franchise store acquisitions, and our Canadian store base remained at 133 at September 30, 2006 compared to September 30, 2005.

Franchise. Revenues in our Franchise segment increased $7.5 million, or 14.1%, to $60.7 million for the three months ended September 30, 2006 compared to $53.2 million for the same period in 2005. This improvement in revenue resulted primarily from increased wholesale product sales of $4.9 million to international franchisees and $2.5 million to domestic franchisees. Our domestic franchise stores recognized improved retail sales for the three months ended September 30, 2006, as evidenced by an increase in same store sales for these stores of 7.0%. Our domestic franchise store base declined by 141 stores to 1,071 at September 30, 2006, from 1,212 at September 30, 2005. Since the beginning of 2005, we have closed 78 domestic franchise stores and acquired 161 that were converted into company-owned stores. Our international franchise store base increased by 83 stores to 907 at September 30, 2006 compared to 824 at September 30, 2005.

Manufacturing/Wholesale. Revenues in our Manufacturing/Wholesale segment, which includes third-party sales from our manufacturing facilities in South Carolina and Australia, as well as wholesale sales to Rite Aid and drugstore.com, increased $2.7 million, or 8.9%, to $32.9 million for the three months ended September 30, 2006 compared to $30.2 million for the same period in 2005. This increase was generated primarily by the Greenville, South Carolina manufacturing facility, which had an increase of $4.5 million, principally as a result of third-party product contract manufacturing. These increases were partially offset by decreased sales of $1.4 million to Rite Aid and $0.5 million to drugstore.com.

Cost of Sales

Consolidated cost of sales, which includes product costs, costs of warehousing and distribution and occupancy costs, increased $19.2 million, or 8.6%, to $241.3 million for the three months ended September 30, 2006 compared to $222.1 million for the same period in 2005. Consolidated cost of sales, as a percentage of net revenue, was 65.6% for the three months ended September 30, 2006 compared to 68.9% for the three months ended September 30, 2005.

Product costs. Product costs increased $17.4 million, or 10.8%, to $178.5 million for the three months ended September 30, 2006 compared to $161.1 million for the same period in 2005. This increase is primarily due to increased sales volumes at the retail stores. Consolidated product costs, as a percentage of net revenue, were 48.6% for the three months ended September 30, 2006 compared to 50.0% for the three months ended September 30, 2005. This improvement was due to increased volume in our Retail and Franchise segments.

Warehousing and distribution costs. Warehousing and distribution costs increased $0.1 million, or 0.8%, to $13.0 million for the three months ended September 30, 2006 compared to $12.9 million for the same period in 2005. This increase was primarily a result of increased fuel costs that affected our private fleet, as well as the cost of common carriers, offset by cost savings in wages, benefits, and other distribution costs. Consolidated warehousing and distribution costs, as a percentage of net revenue, were 3.5% for the three months ended September 30, 2006 compared to 4.0% for the three months ended September 30, 2005.

Occupancy costs. Occupancy costs increased $1.7 million, or 3.5%, to $49.8 million for the three months ended September 30, 2006 compared to $48.1 million for the same period in 2005. This increase was the result of higher lease-related costs of $1.4 million and utility costs of $0.6 million, which were partially offset by a reduction in depreciation expense and other occupancy related expenses of $0.3 million. Consolidated occupancy costs, as a percentage of net revenue, were 13.5% for the three months ended September 30, 2006 compared to 14.9% for the three months ended September 30, 2005.

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Selling, General and Administrative (SG&A) Expenses

Our consolidated SG&A expenses, including compensation and related benefits, advertising and promotion expense, other selling, general and administrative expenses, and amortization expense, increased $8.0 million, or 9.3%, to $93.6 million, for the three months ended September 30, 2006 compared to $85.6 million for the same period in 2005. These expenses, as a percentage of net revenue, were 25.5% for the three months ended September 30, 2006 compared to 26.5% for the three months ended September 30, 2005.

Compensation and related benefits. Compensation and related benefits increased $2.3 million, or 3.9%, to $60.8 million for the three months ended September 30, 2006 compared to $58.5 million for the same period in 2005. The increase was the result of increases in: (1) incentives and commission expense of $1.6 million; (2) base wage expense, primarily in our retail stores for part-time wages to support the increased sales volumes, of $1.3 million; and (3) non-cash stock based compensation expense of $0.7 million. These increases were partially offset by decreased self-insurance costs of $1.2 million and other benefits expense of $0.1 million.

Advertising and promotion. Advertising and promotion expenses increased $2.3 million, or 26.4%, to $11.0 million for the three months ended September 30, 2006 compared to $8.7 million during the same period in 2005. Ad