BALLY TOTAL FITNESS HOLDING CORP
Form 10-Q
May 15, 2002

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

[X] Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the period ended March 31, 2002

or

[ ] Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

Commission file number: **0-27478**

BALLY TOTAL FITNESS HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-3228107**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
8700 West Bryn Mawr Avenue, Chicago, Illinois	**60631**

(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(773) 380-3000**

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. Yes: X No: ___

As of April 30, 2002, 32,866,147 shares of the registrant s common stock were outstanding.

BALLY TOTAL FITNESS HOLDING CORPORATION

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BALLY TOTAL FITNESS HOLDING CORPORATION

Condensed Consolidated Balance Sheet

(In thousands)

(Unaudited)

	March 31 2002	December 31 2001
ASSETS		
Current assets:		
Cash and equivalents	$ 9,530	$ 9,310
Installment contracts receivable, net	310,048	284,611
Other current assets	68,680	68,899
Total current assets	388,258	362,820
Installment contracts receivable, net	286,281	273,607
Property and equipment, less accumulated depreciation and amortization of $501,131 and $490,116	648,790	628,634
Intangible assets, less accumulated amortization of $80,408 and $80,256	242,097	237,037
Deferred income taxes	74,967	76,104
Deferred membership origination costs	117,003	112,959
Other assets	30,058	25,729
	$1,787,454	$1,716,890
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 65,721	$ 50,471
Income taxes payable	1,507	1,974
Deferred income taxes	26,733	32,346
Accrued liabilities	86,418	75,309
Current maturities of long-term debt	26,261	25,302
Deferred revenues	307,055	294,930
Total current liabilities	513,695	480,332
Long-term debt, less current maturities	653,557	639,869

Other liabilities	12,659	12,555
Deferred revenues	75,296	71,400
Stockholders' equity	532,247	512,734
	$1,787,454	$1,716,890

See accompanying notes.

BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Income

(In thousands, except per share data)

(Unaudited)

	Three months ended March 31	
	2002	**2001**
Net revenues:		
Membership revenues	$ 182,694	$ 173,180
Products and services	52,417	36,436
Miscellaneous revenue	5,315	4,246
	240,426	213,862
Operating costs and expenses:		
Fitness center operations	137,804	122,375
Products and services	33,033	23,121
Member processing and collection centers	10,952	10,496
Advertising	16,509	15,859
General and administrative	7,900	7,243
Depreciation and amortization	17,439	17,912
	223,637	197,006
Operating income	16,789	16,856
Finance charges earned	17,680	17,831
Interest expense	(14,643)	(15,958)
Other interest income	74	266
	3,111	2,139

Income before income taxes	19,900	18,995
Income tax provision	(498)	(350)
Net income	$ 19,402	$ 18,645
Basic earnings per common share	$ .61	$ .75
Diluted earnings per common share	$ .59	$ .65

See accompanying notes.

2

BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Stockholders' Equity

(In thousands, except share data)

(Unaudited)

	Common stock				Unearned	Co
	Shares	Par value	Contributed capital	Accumulated deficit	compensation (restricted stock)	sto tre
Balance at December 31, 2001	32,380,557	$ 329	$ 657,546	$(107,807)	$ (26,559)	$ (1
Net income				19,402		
Issuance of common stock under long-term incentive plan	60,000	1	2,519		(2,520)	
Issuance of common stock under stock purchase and option plans	37,246	1	970			
Purchases of common stock for treasury	(54,500)					
Balance at March 31, 2002	32,423,303	$ 331	$ 661,035	$ (88,405)	$ (29,079)	$ (1

See accompanying notes.

3

BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Cash Flows

(In thousands)

(Unaudited)

	Three months ended March 31	
	2002	**2001**
Operating:		
Net income	$ 19,402	$ 18,645
Adjustments to reconcile--		
Depreciation and amortization, including amortization included in interest expense	18,468	18,848
Change in operating assets and liabilities	(12,425)	25,044
Cash provided by operating activities	25,445	62,537
Investing:		
Purchases and construction of property and equipment	(23,032)	(23,569)
Purchases of real estate	(11,510)	
Acquisitions of businesses and other	(2,515)	(1,055)
Cash used in investing activities	(37,057)	(24,624)
Financing:		
Debt transactions--		
Net borrowings (repayments) under revolving credit agreement	17,500	(69,500)
Net repayments of other long-term debt	(5,779)	(5,048)
Cash provided (used) by debt transactions	11,721	(74,548)
Equity transactions--		
Proceeds from sale of common stock		53,827
Proceeds from exercise of warrants		11,609
Proceeds from issuance of common stock under stock purchase and option plans	971	1,448
Purchases of common stock for treasury	(860)	
Cash provided (used) by financing transactions	11,832	(7,664)

Increase in cash and equivalents	220	30,249
Cash and equivalents, beginning of period	9,310	13,074
Cash and equivalents, end of period	$ 9,530	$ 43,323

See accompanying notes.

4

BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Cash Flows (continued)

(In thousands)

(Unaudited)

	Three months ended March 31	
	2002	**2001**
Supplemental Cash Flows Information:		
Changes in operating assets and liabilities,		
Decrease (increase) in installment contracts receivable	$ (38,111)	$ 17,594
Increase in other current and other assets	(2,597)	(3,189)
Increase in deferred membership origination costs	(4,044)	(2,150)
Increase in accounts payable	15,250	2,178
Decrease in income taxes payable and deferred income taxes	(2,143)	(117)
Increase in accrued and other liabilities	11,210	5,607
Increase in deferred revenues	8,010	5,121
Change in operating assets and liabilities	$ (12,425)	$ 25,044
Cash payments for interest and income taxes were as follows--		
Interest paid	$ 6,879	$ 8,890
Interest capitalized	(719)	(1,031)
Income taxes paid, net	2,636	467
Investing and financing activities exclude the following non-cash transactions--		
Acquisitions of property and equipment through capital leases/borrowings	$ 2,885	$ 5,977
Common stock issued under long-term incentive		

plan	2,519

See accompanying notes.

BALLY TOTAL FITNESS HOLDING CORPORATION

Notes to Condensed Consolidated Financial Statements

(All dollar amounts in thousands, except share data)

(Unaudited)

Basis of presentation

The accompanying condensed consolidated financial statements include the accounts of Bally Total Fitness Holding Corporation (the "Company") and the subsidiaries that it controls. The Company, through its subsidiaries, is a commercial operator of fitness centers in North America with over 400 facilities concentrated in 29 states and Canada. The Company operates in one industry segment, and all significant revenues arise from the commercial operation of fitness centers, primarily in major metropolitan markets in the United States and Canada. Unless otherwise specified in the text, references to the Company include the Company and its subsidiaries. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2001.

All adjustments have been recorded which are, in the opinion of management, necessary for a fair presentation of the condensed consolidated balance sheet of the Company at March 31, 2002, its consolidated statements of income for the three months ended March 31, 2002 and 2001, its consolidated statement of stockholders equity for the three months ended March 31, 2002, and its consolidated statements of cash flows for the three months ended March 31, 2002 and 2001. All such adjustments were of a normal recurring nature.

The accompanying condensed consolidated financial statements have been prepared in conformity with generally accepted accounting principles which require the Company s management to make estimates and assumptions that affect the amounts reported therein. Actual results could vary from such estimates. In addition, certain reclassifications have been made to prior period financial statements to conform with the 2002 presentation.

Seasonal factors

The Company s operations are subject to seasonal factors and, therefore, the results of operations for the three months ended March 31, 2002 and 2001 are not necessarily indicative of the results of operations for the full year.

Installment contracts receivable

	March 31 2002	December 31 2001
Current:		
Installment contracts receivable	$ 428,958	$ 397,180
Unearned finance charges	(45,743)	(44,898)
Allowance for doubtful receivables and cancellations	(73,167)	(67,671)
	$ 310,048	$ 284,611
Long-term:		
Installment contracts receivable	$ 368,234	$ 358,115
Unearned finance charges	(21,088)	(21,675)
Allowance for doubtful receivables and cancellations	(60,865)	(62,833)
	$ 286,281	$ 273,607

Allowance for doubtful receivables and cancellations

	Three months ended March 31	
	2002	2001
Balance at beginning of period	$ 130,504	$ 132,277
Contract cancellations and write-offs of uncollectible amounts, net of recoveries	(90,833)	(87,636)
Provision for cancellations and doubtful receivables	94,361	90,975
Balance at end of period	$ 134,032	$ 135,616

Membership revenues

We are presenting gross committed membership fees to expand the presentation of originating membership data as the Company now operates under several brands, membership structures and an evolving menu of products and services accompanying certain membership programs. Gross committed membership fees represent the gross contracted value of memberships originated during the periods, inclusive of initial membership fees, monthly dues, finance charges, and products and services included in membership programs. The following is a reconciliation of gross committed membership fees to initial membership fees originated, net:

	Three months ended March 31	
	2002	2001
Gross committed membership fees	$ 320,747	$ 292,458
Less: Committed monthly dues	(64,340)	(40,150)
Provision for cancellations and doubtful receivables	(94,361)	(90,975)
Unearned finance charges and other	(42,516)	(42,127)
Products and services revenues included in membership programs	(19,341)	(14,086)
Initial membership fees originated, net	$ 100,189	$ 105,120

The following presents the components of membership revenues as presented in the accompanying consolidated statement of income:

	Three months ended March 31	
	2002	2001
Initial membership fees:		
Originated, net	$ 100,189	$ 105,120
Increase in deferral	(8,470)	(5,734)
	91,719	99,386
Dues:		
Dues collected	90,515	73,181
Decrease in deferral	460	613
	90,975	73,794
Membership revenues	$ 182,694	$ 173,180

Products and services

	Three months ended March 31	
	2002	2001

Net revenues:		
Retail and nutritional supplements--		
Membership programs	$ 8,785	$ 8,398
Direct sales	13,824	10,404
Personal training--		
Membership programs	10,556	5,688
Direct sales	17,701	10,508
Financial services	1,551	1,438
	52,417	36,436
Operating costs and expenses:		
Retail and nutritional supplements	16,346	13,248
Personal training	16,687	9,873
	33,033	23,121
Contribution margin	$ 19,384	$ 13,315

8

Earnings per common share

Basic earnings per common share for each period is computed based on the weighted average number of shares of common stock outstanding of 31,741,422 and 24,816,783 for the three months ended March 31, 2002 and 2001, respectively. Diluted earnings per common share for each period includes the addition of common stock equivalents of 1,253,857 and 3,935,644 for the three months ended March 31, 2002 and 2001, respectively. Common stock equivalents represent the dilutive effect of the assumed exercise of outstanding warrants and stock options.

New accounting pronouncements

The Company has adopted in the first quarter of 2002 the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*. As a result, the Company has ceased amortization of goodwill in the first quarter and, in accordance with the provisions of this new standard, has determined that recorded goodwill is not impaired . The following table presents prior year first quarter net income and earnings per share adjusted to add back goodwill amortization:

		Earnings per share	
	Net income	**Basic**	**Diluted**
As reported	$ 18,645	$ 0.75	$ 0.65
Add back: goodwill amortization	1,868	0.08	0.06
As adjusted	$ 20,513	$ 0.83	$ 0.71

Income Taxes

At March 31, 2002, for accounting purposes, the Company has approximately $100,000 of unrecognized federal net operating loss carryforwards. Separately, the alternative minimum tax ("AMT") net operating loss carryforwards have been substantially recognized. Therefore, having fully recognized AMT net operating loss carryforwards for reporting purposes, the Company s federal income tax rate on future earnings will increase to 20%. The 20% rate will remain in effect until such time as all of its AMT credits are fully utilized, which is not currently expected before 2004. In the first quarter of 2002, the Company reduced its valuation allowance against its net operating loss carryforwards by approximately $4,000 which offset charges related to its provision for alternative minimum taxes.

For federal income tax payment purposes, the Company has available net operating loss carryforwards exceeding $350,000 and AMT net operating loss carryforwards in excess of $230,000. Therefore, the Company currently does not expect to make any significant federal tax payments earlier than 2004. At such time, the Company will be required to pay taxes at the 20% AMT rate for periods currently estimated to extend beyond 2005, including those periods benefited by AMT credits. For accounting purposes, the 2002 federal tax provision will consist entirely of non-cash deferred income tax charges.

9

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

Comparison of the Three Months Ended March 31, 2002 and 2001

Net revenues for the first quarter of 2002 were $240.4 million compared to $213.8 million in 2001, an increase of $26.6 million (12%), inclusive of $17.5 million (8%) attributable to the recently acquired Crunch Fitness. Net revenues from comparable fitness centers increased 2%. This increase in net revenues resulted from the following:

- Membership revenues increased $9.5 million (5%) over the prior year quarter, including a 23% increase in dues revenue recognized during the period. The provision for doubtful receivables and cancellations, included as a direct reduction of membership revenue, was 41% of the gross financed portion of membership fee originations for both periods.
- Products and services revenue increased $16.0 million (44%) over the 2001 quarter, primarily reflecting the continued growth of personal training services, nutritional product sales and the addition of Crunch Fitness, which accounted for $5.2 million of the increase.
- Miscellaneous revenue increased $1.1 million (25%) over the 2001 quarter, primarily reflecting additional revenue from co-marketing arrangements.

The weighted-average number of fitness centers increased to 406 from 385 in the first quarter of 2001, an increase of 5%, including a 57% increase in the weighted-average number of centers operating under the Company s upscale brands from 35 to 55, largely resulting from the December 31, 2001 acquisition of Crunch Fitness.

To further clarify the presentation of membership revenue data as the Company grows with several brands, membership structures and an evolving menu of products and services accompanying certain membership plans, we are providing additional metrics in our discussion and analysis of results of operations. The following data is intended to more clearly report membership origination trends and the committed membership fees from originations during the period notwithstanding the different membership structures. Monthly membership fee averages and gross committed membership fees presented below include the retail value of products and services contracted as part of originating memberships during the periods, which are presented as an element of "Products and Services" revenue in the accompanying consolidated statement of income. Data is presented on a gross basis inclusive of finance charges and before any reduction for the provision for doubtful receivables and cancellations.

The number of new members joining increased 7% during the first quarter of 2002 compared with the same quarter a year ago, with 3% growth at our flagship Bally Total Fitness clubs. The gross committed monthly membership fees originated during the first quarter of 2002 averaged $45 versus $41 in the year ago quarter, a 10% increase. This increase results primarily from higher monthly dues included in memberships originated at our Bally Total Fitness clubs and the addition of Crunch Fitness with its higher membership fee structure. The average committed duration of memberships originated during the first quarter of 2002 was 31.2 months versus 32.8 months in the prior year quarter, a 5% decrease. This decrease resulted primarily from the shorter initial commitment of memberships offered at Crunch Fitness and the addition of five new clubs in states and provinces that limit contract duration to twelve months. As a result, and despite the negative impact of the earlier Easter holiday and spring break in March 2002, gross committed membership fees during the first quarter rose 10% compared to the 2001 quarter.

Operating income for the first quarter of 2002 of $16.8 million was unchanged from the prior year period. Net revenues increased $26.6 million (12%) for the first quarter of 2002, offset by a $27.1 million (15%) increase in operating costs and expenses, and depreciation and amortization decreased by $.5 million. Earnings before interest, taxes, depreciation and amortization, including finance charges earned ("EBITDA") was $51.9 million versus $52.6 million for the last year quarter, a 1% decrease. The EBITDA margin was 22% in the 2002 quarter compared to 25% in the 2001 period. This decrease is attributable in part to the lower level of deferred revenue available for recognition at the start of 2002 as compared to that available at the beginning of the prior year, and the growing proportion of clubs open less than three years which, due to deferred revenue accounting and their immature membership dues base, yield below-average margins compared to mature clubs. Additionally, operating margins on the recently acquired Crunch Fitness were historically lower than our mature clubs and are expected to improve as its operations are fully integrated. Fitness center operating expenses increased $15.4 million (13%) due principally to incremental costs of operating new fitness centers, including the 19 additional centers added with the Crunch Fitness acquisition, which represented approximately $11 million of the increase. Products and services expenses increased $9.9 million (43%) to support the revenue growth of product and service offerings. Contribution margin from products and services increased to $19.4 million from $13.3 million in the prior year quarter, a 46% increase, with a contribution margin percentage of 37% in both periods. Member processing and collection center expenses increased $.5 million from the prior year quarter, reflecting increased costs to serve the higher number of clubs and members as compared to the prior year period. Advertising expenses increased $.7 million (4%) compared to the prior year. General and administrative expenses increased $.7 million (9%) compared to the prior year quarter to support the Company s overall growth. Depreciation and amortization expense decreased $.5 million, resulting from additional depreciation and amortization expense of $1.4 million due to increased expenditures for property and equipment and acquired fitness centers during the past two years, offset by the elimination of goodwill amortization of $1.9 million in the prior year quarter as a result of the adoption of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*.

Finance charges earned in excess of interest expense totaled $3.1 million in the first quarter of 2002, an increase of $1.0 million over the prior year period resulting from lower interest rates on the Company s net borrowings.

Liquidity and Capital Resources

Cash flows from operating activities were $25.4 million in the 2002 quarter compared to $62.5 million in the 2001 quarter. During the first and third quarters of 2001, we sold a portion of our installment contracts receivable portfolio to a major financial institution at net book value, with combined proceeds of $105 million. Excluding the impact of the sales of receivables in 2001, and net of the change in dues prepayments during the periods, cash flows from operating activities were $41.1 million in first quarter 2002, versus $22.3 million in 2001, an $18.8 million increase. The following table sets forth cash flows from operating activities on a comparable basis to exclude the impact of last year s first quarter sale of receivables, to add back actual cash collections on the sold portfolio, and to reflect the impact of changes in dues prepayments during each of the periods (in thousands):

	Three months ended March 31 2002	Three months ended March 31 2001
Cash flows from operating activities, as reported	$ 25,445	$ 62,537
Acceleration of collections through bulk sale of installment contracts receivable		(45,000)
Collections on installment contracts receivable sold	16,957	3,598
Change in dues prepayments	(1,325)	1,130
Cash flows from operating activities on a comparable basis	$ 41,077	$ 22,265

Our bank credit facility, dated November 10, 1999, as amended in December 2001, provides up to $225.0 million of availability consisting of a three-year $135.0 million term loan and a $90.0 million three-year revolving credit facility. The amount available under the revolving credit facility is reduced by any outstanding letters of credit, which cannot exceed $30.0 million. As of March 31, 2002, the Company had drawn $35.5 million on its $90 million revolving credit line and had outstanding letters of credit totaling $5.9 million. The $135.0 million term loan is repayable in 13 installments. The first installment of $250,000 was paid in December 2001, 11 quarterly installments of $460,000 began March 31, 2002 and the final installment of $129,690,000 is due November 2004. We have no scheduled principal payments under our subordinated debt until October 2007. Our debt service requirements, including interest, through March 31, 2003 are approximately $76.3 million. During April 2002, the Company repaid the remaining balance outstanding on its 1996 securitization ($35.6 million at March 31, 2002) with proceeds from its 2001 securitization facility. We believe to the extent required, that we will be able to satisfy our short-term requirements for debt service and capital expenditures out of available cash balances, cash flows from operations and borrowings on the revolving credit facility. In addition to cash from operating activities, we believe our longer-term debt service requirements through 2004 can be satisfied by availability on our bank credit facility, including extensions, expansion of our securitization facility, other secured borrowings or through additional offerings of our common stock.

We are authorized to repurchase up to 1,500,000 shares of our common stock on the open market from time to time. We repurchased 625,100 shares between August 1998 and November 1999 at an average price of $18 per share, and 54,500 shares in February 2002 at $16 per share.

Capital expenditures totaled $23.0 million for property and equipment, and $11.5 million for purchases of real estate in the first quarter of 2002. Property and equipment expenditures are expected to total approximately $55 million for the remainder of 2002. The Company does not anticipate any additional real estate purchases in 2002.

Forward-Looking Statements

Forward-looking statements in this Form 10-Q including, without limitation, statements relating to our plans, strategies, objectives, expectations, intentions and adequacy of resources, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. These factors include, among others, the following: general economic and business conditions; competition; success of operating initiatives, advertising and promotional efforts; existence of adverse publicity or litigation; acceptance of new product offerings; changes

in business strategy or plans; quality of management; availability, terms, and development of capital; business abilities and judgment of personnel; changes in, or the failure to comply with, government regulations; regional weather conditions; and other factors described in this Form 10-Q or in other of our filings with the Securities and Exchange Commission. We are under no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

BALLY TOTAL FITNESS HOLDING CORPORATION

PART II. OTHER INFORMATION

Item 6. Exhibits and reports on Form 8-K

(a) Reports on Form 8-K:

Date	Items	Financial Statements
January 2, 2002	#5 and #7	None
February 13, 2002	#5 and #7	None

BALLY TOTAL FITNESS HOLDING CORPORATION

SIGNATURE PAGE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BALLY TOTAL FITNESS HOLDING CORPORATION

Registrant

/s/ John W. Dwyer

John W. Dwyer
Executive Vice President, Chief Financial Officer and Director
(principal financial officer)

Dated: May 15, 2002