BALLY TOTAL FITNESS HOLDING CORP
Form 10-Q
May 15, 2001

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, 2001

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, 2001, 28,877,148 shares of the registrant s common stock were outstanding.

BALLY TOTAL FITNESS HOLDING CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BALLY TOTAL FITNESS HOLDING CORPORATION

Condensed Consolidated Balance Sheet

(Unaudited)

	March 31 2001	December 31 2000
	(In thousands)	
ASSETS		
Current assets:		
Cash and equivalents	$ 43,323	$ 13,074
Installment contracts receivable, net	273,221	286,053
Other current assets	64,773	61,516
Total current assets	381,317	360,643
Installment contracts receivable, net	267,040	273,421
Property and equipment, less accumulated depreciation and amortization of $451,092 and $435,860	572,548	558,277
Intangible assets, less accumulated amortization of $74,079 and $72,071	151,911	153,113
Deferred income taxes	62,566	68,115
Deferred membership origination costs	116,279	114,129
Other assets	33,100	32,926
	$1,584,761	$1,560,624
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 56,997	$ 54,819
Income taxes payable	4,119	3,703
Deferred income taxes	43,135	49,217
Accrued liabilities	72,546	66,566
Current maturities of long-term debt	18,538	17,589
Deferred revenues	309,396	306,493
Total current liabilities	504,731	498,387
Long-term debt, less current maturities	604,873	674,349
Other liabilities	7,060	7,299
Deferred revenues	84,965	82,747

Stockholders' equity	383,132	297,842
	$1,584,761	$1,560,624

See accompanying notes.

BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Income

(Unaudited)

	Three months ended March 31	
	2001	**2000**
	(In thousands, except share data)	
Net revenues:		
Membership revenues--		
Initial membership fees on financed memberships originated	$ 146,201	$ 144,462
Initial membership fees on paid-in-full memberships originated	7,562	6,717
Dues collected	73,181	67,994
Change in deferred revenues	(5,121)	(16,301)
	221,823	202,872
Finance charges earned	17,831	16,374
Products and services	36,436	26,615
Miscellaneous revenue	4,246	4,024
	280,336	249,885
Operating costs and expenses:		
Fitness center operations	124,417	114,838
Products and services	23,121	17,369
Member processing and collection centers	10,604	10,828
Advertising	15,859	14,833
General and administrative	7,243	7,145
Provision for doubtful receivables	48,643	43,407
Depreciation and amortization	17,912	15,285
Change in deferred membership origination costs	(2,150)	(3,633)
	245,649	220,072
Operating income	34,687	29,813
Interest income	266	490
Interest expense	(15,958)	(14,811)

Income before income taxes	18,995	15,492
Income tax provision	(350)	(225)
Net income	$ 18,645	$ 15,267
Basic earnings per common share	$ 0.75	$ 0.65
Diluted earnings per common share	$ 0.65	$ 0.56

See accompanying notes.

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BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Stockholders' Equity

(Unaudited)

	Common stock					
	Shares	**Par value**	**Contributed capital**	**Accumulated deficit**	**Unearned compensation (restricted stock)**	**Co sto tre**
	(In thousands, except share data)					
Balance at December 31, 2000	24,352,946	$ 249	$ 508,639	$(188,514)	$ (11,757)	$ (1
Net income				18,645		
Issuance of common stock through public offering	2,238,821	22	53,805			
Exercise of warrants	2,207,104	22	11,587			
Issuance of common stock under stock purchase and option plans	79,018	1	1,447			
Other	(11,361)		(344)		105	
Balance at March 31, 2001	28,866,528	$ 294	$ 575,134	$(169,869)	$ (11,652)	$ (1

See accompanying notes.

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BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Cash Flows

(Unaudited)

	Three months ended March 31 2001	Three months ended March 31 2000
	(In thousands)	
OPERATING:		
Net income	$ 18,645	$ 15,267
Adjustments to reconcile to cash provided--		
Depreciation and amortization, including amortization included in interest expense	18,848	16,372
Provision for doubtful receivables	48,643	43,407
Change in operating assets and liabilities	(23,599)	(57,078)
Cash provided by operating activities	62,537	17,968
INVESTING:		
Purchases and construction of property and equipment	(23,569)	(32,071)
Acquisitions of businesses	(1,055)	(1,900)
Cash used in investing activities	(24,624)	(33,971)
FINANCING:		
Debt transactions--		
Net borrowings (repayments) under revolving credit agreement	(69,500)	4,500
Net repayments of other long-term debt	(5,048)	(3,272)
Cash provided by (used in) debt transactions	(74,548)	1,228
Equity transactions--		
Proceeds from issuance or common stock through public offering	53,827	
Exercise of warrants	11,609	
Proceeds from issuance of common stock under stock purchase and option plans	1,448	836
Cash provided by (used in) financing activities	(7,664)	2,064
Increase (decrease) in cash and equivalents	30,249	(13,939)
Cash and equivalents, beginning of period	13,074	23,450
Cash and equivalents, end of period	$ 43,323	$ 9,511

See accompanying notes.

BALLY TOTAL FITNESS HOLDING CORPORATION

Consolidated Statement of Cash Flows (continued)

(Unaudited)

	Three months ended March 31	
	2001	2000
	(In thousands)	
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Changes in operating assets and liabilities, were as follows--		
Increase in installment contracts receivable	$ (29,562)	$ (74,875)
Increase in other current and other assets	(4,676)	(3,462)
Increase in deferred membership origination costs	(2,150)	(3,633)
Increase in accounts payable	2,178	374
Decrease in income taxes payable	(117)	(25)
Increase in accrued and other liabilities	5,607	8,242
Increase in deferred revenues	5,121	16,301
	$ (23,599)	$ (57,078)
Cash payments for interest and income taxes were as follows--		
Interest paid	$ 8,890	$ 7,120
Interest capitalized	(1,031)	(695)
Income taxes paid, net	467	248
Investing and financing activities exclude the following non-cash transactions--		
Acquisition of property and equipment through capital leases/borrowings	$ 5,977	$ 5,734

See accompanying notes.

BALLY TOTAL FITNESS HOLDING CORPORATION

Notes to Condensed Consolidated Financial Statements

(All dollar amounts in thousands)

(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 approximately 385 facilities concentrated in 28 states and Canada. The Company operated 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, 2000.

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, 2001, its consolidated statements of income and cash flows for the three months ended March 31, 2001 and 2000, and its consolidated statement of stockholders equity for the three months ended March 31, 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 2001 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, 2001 and 2000 are not necessarily indicative of the results of operations for the full year.

Installment contracts receivable

	March 31 2001	December 31 2000
Current:		
Installment contracts receivable	$ 392,469	$ 403,777
Unearned finance charges	(48,413)	(49,601)
Allowance for doubtful receivables and cancellations	(70,835)	(68,123)
	$ 273,221	$ 286,053

Long-term:		
Installment contracts receivable	$ 355,475	$ 361,812
Unearned finance charges	(23,654)	(24,237)
Allowance for doubtful receivables and cancellations	(64,781)	(64,154)
	$ 267,040	$ 273,421

Allowance for doubtful receivables and cancellations

	Three months ended March 31	
	2001	2000
Balance at beginning of period	$ 132,277	$ 126,038
Contract cancellations and write-offs of uncollectible amounts, net of recoveries	(87,636)	(76,204)
Provision for cancellations (classified as a direct reduction of revenues)	42,332	49,995
Provision for doubtful receivables	48,643	43,407
Balance at end of period	$ 135,616	$ 143,236

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 24,816,783 in 2001 and 23,570,467 in 2000. Diluted earnings per common share for each period includes the addition of common stock equivalents of 3,935,644 and 3,794,965 in 2001 and 2000, respectively. Common stock equivalents represent the dilutive effect of the assumed exercise of outstanding warrants and stock options.

Income taxes

As a result of the Company s improved operating results and trends, the Company continues to evaluate the need for its approximate $105 million valuation allowance offsetting the deferred tax assets that otherwise arise from its approximate $450 million of tax loss carryforwards. As required by Financial Accounting Standard No. 109, *Accounting for Income Taxes*, management expects, during the current year, to complete its re-evaluation of the tax valuation allowance and determine an appropriate amount, if any, to be reversed. Any reversal of the tax valuation allowance will be reflected as a reduction of the income tax provision, therefore increasing net income.

New accounting pronouncements

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, which requires companies to recognize all derivatives as either assets or liabilities in the balance sheet and measure such instruments at fair value. The Company has adopted SFAS 133, as amended, as of January 1, 2001. There has been no impact on the Company s consolidated financial statements resulting from the adoption of SFAS 133, as amended.

BALLY TOTAL FITNESS HOLDING CORPORATION

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

Comparison of the Three Months Ended March 31, 2001 and 2000

Net revenue for the first quarter of 2001 was $280.3 million compared to $249.8 million in 2000, an increase of $30.5 million (12%). Net revenues from comparable fitness centers increased 9%. This increase in net revenues resulted from the following:

- Initial membership fees recognized, including the impact of deferral accounting, increased $12.8 million (9%), versus the prior year quarter. Membership unit sales were approximately flat with prior year, while the weighted-average selling price of full memberships increased 3%. As a result, membership fees originated increased $2.6 million (2%). Membership unit sales were reduced by a number of factors including the implementation of a new consumer-oriented sales process which has resulted in fewer cancellations, persistent severe weather in a number of our major markets, an earthquake, rolling blackouts in California, and one less retail day in February 2001.
- Dues collected increased $5.2 million (8%) from the 2000 quarter, reflecting both continued improvements in member retention and pricing strategies, as well as a growing proportion of dues from newly originated memberships.
- Finance charges earned during the first quarter of 2001 increased $1.5 million (9%) compared to the 2000 quarter, due to the growth in the average portfolio balance prior to the sale of a portion of the portfolio in March 2001. Membership receivables written off in the current period, as a percent of average membership receivables, was consistent with prior periods. The percentage of accounts current with all contractual payments was 89% at the end of both periods. The average interest rate for finance charges to members was substantially unchanged between the periods.
- Products and services revenue increased $9.8 million (37%) over the 2000 quarter, primarily reflecting the continued growth of personal training services and nutritional and other retail products.
- Miscellaneous revenue increased 6% over the 2000 quarter, primarily reflecting additional revenue from co-marketing partnerships.

The weighted average number of fitness centers increased to 385 in the first quarter of 2001 from 366 in the first quarter of 2000, including an increase in the weighted-average number of centers operating under our four upscale brands, which are modeled on smaller membership volumes, from 34 to 36.

Operating income for the first quarter of 2001 was $34.7 million compared to $29.8 million in 2000. The increase of $4.9 million (16%) was due to a $30.5 million (12%) increase in net revenue, offset, in part, by an increase in operating costs and expenses of $23.0 million (11%) and a $2.6 million increase in depreciation and amortization. The operating margin before depreciation and amortization increased to 19% from 18% for the 2000 quarter. Excluding the provision for doubtful receivables, depreciation and amortization and the effect of deferral accounting, operating costs and expenses increased $16.2 million (10%) from 2000. Fitness center operating expenses increased $9.6 million (8%) due principally to incremental costs of operating additional fitness centers. Products and services expenses increased $5.8 million (33%) to support the revenue growth of product and service offerings. Operating income from products and services increased to $13.3 million from $9.2 million in the prior year quarter, with an operating margin of 37% in 2001 compared to 35% in the 2000 quarter. Member processing and collection center expenses were substantially unchanged from the prior year quarter. Advertising expenses increased 7% compared to the prior year supporting clubs in new markets. General and administrative expenses were substantially unchanged from the prior year quarter. Depreciation and amortization expense increased $2.6 million (17%) largely as a result of the significant additions to property and equipment during the past two years.

The provision for doubtful receivables, including the provision for cancellations which is reported in the financial statements as a direct reduction of initial membership fees on financed memberships originated, totaled 41% of the gross financed portion of new membership fees originated in both periods. However, the provision for cancellations for the 2001 quarter was 19% compared to 21% for the first quarter of 2000 reflecting the significantly improved experience of actual cancellations from sales during the March 2001 quarter. Notwithstanding this improvement, which may have residual positive effects, the provision for doubtful receivables for the first quarter of 2001 was increased to offset this improvement and maintain a combined provision rate of 41%. The Company believes it is prudent to measure sustained collection improvements over a longer period before changing the overall provision rate.

Deferral accounting reduced earnings by $3.0 million for 2001 compared to a reduction of $12.7 million for 2000. The improvement from the prior year quarter reflects the net impact of an increase of $11.2 million in recognized revenues from member origination fees and dues offset by an increase of $1.5 million in the net expense recognition.

Interest expense was $16.0 million for the first quarter of 2001 compared to $14.8 million in 2000. The $1.2 million increase was due to higher average levels of debt outstanding during the first quarter of 2001 as compared to 2000.

The income tax provisions for the first quarter of 2001 and 2000 reflect state income taxes only. The federal provisions were offset by the utilization of prior years net operating losses.

Liquidity and Capital Resources

In March 2001, we sold 2,238,821 shares of our common stock to the public and the Estate of Arthur M. Goldberg, our former Chairman, exercised an outstanding warrant to purchase 2,207,104 shares of common stock. We received net proceeds from these transactions of approximately $65 million, which was used principally to reduce bank debt.

Also in March 2001, we sold to a major financial institution approximately 8% of our receivables portfolio at net book value. We received initial proceeds of approximately $45 million from this transaction, and used the proceeds to reduce debt.

Cash flow from operating activities was $62.5 million in the 2001 quarter compared to $18.0 million in the 2000 quarter. Exclusive of the proceeds from the sale of a portion of our receivables portfolio, net of the foregone principal and interest collections on these receivables, cash from operating activities for the March 2001 quarter was $21.1 million, an 18% increase over the prior year quarter.

Our bank credit facility, dated November 10, 1999, provides up to $175.0 million of availability consisting of a five-year $75.0 million term loan and a $100.0 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, 2001, our $100 million revolving credit line was unused and we had outstanding letters of credit totaling $4.6 million. The $75.0 million term loan is repayable in 19 quarterly installments, commencing March 31, 2000, of $250,000, with a final installment of $70.3 million due in November 2004. We have no scheduled principal payments under our subordinated debt until October 2007, and the principal amount of the certificates under our securitization facility remains fixed at $160.0 million through July 2001. Our debt service requirements, including interest, through March 31, 2002, are approximately $76.4 million. We believe that we will be able to satisfy these requirements for debt service, capital expenditures and any stock repurchases, out of available cash balances, cash flow from operations and borrowings on the revolving credit facility. It is anticipated that we will either refinance our securitization facility or complete further bulk sales of a portion of our accounts receivable portfolio prior to year-end, although there can be no assurance we will be able to complete these transactions.

We are authorized to repurchase up to 1,500,000 shares of our common stock on the open market from time to time. We have repurchased 625,100 shares at an average price of $18 per share. No purchases have been made since November 1999.

During the first three months of 2001, we invested approximately $23.6 million in property and equipment, including approximately $15.0 million related to new fitness centers and $2.0 million related to major upgrades and expansions, including new equipment, of existing fitness centers.

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.

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BALLY TOTAL FITNESS HOLDING CORPORATION

PART II. OTHER INFORMATION

Item 6. Exhibits and reports on Form 8-K

(b) Reports on Form 8-K:

Date	Items	Financial Statements
February 7, 2001	#5 and #7	None
February 14, 2001	#5 and #7	None
February 22, 2001	#5 and #7	None

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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 Treasurer

(principal financial officer)

Dated: May 15, 2001

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