GNC HOLDINGS, INC.
Form 10-Q
July 28, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

[ ] 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: 001-35113

GNC Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of Incorporation or organization)	20-8536244 (I.R.S. Employer Identification No.)
300 Sixth Avenue Pittsburgh, Pennsylvania (Address of principal executive offices)	15222 (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. [X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
[X] Yes [ ] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]

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

As of July 22, 2016, there were 68,382,474 outstanding shares of Class A common stock, par value $0.001 per share (the “common stock”), of GNC Holdings, Inc.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(unaudited)
(in thousands)

	June 30, 2016	December 31, 2015
Current assets:		
Cash and cash equivalents	$48,220	$56,462
Receivables, net (Note 4)	158,349	142,486
Inventory (Note 3)	602,679	555,885
Deferred income taxes	10,927	10,916
Prepaid and other current assets	40,730	27,114
Total current assets	860,905	792,863
Long-term assets:		
Goodwill	646,796	649,892
Brands	720,000	720,000
Other intangible assets, net	115,181	119,204
Property, plant and equipment, net	222,956	230,535
Deferred income taxes	3,358	3,358
Other long-term assets	33,416	38,555
Total long-term assets	1,741,707	1,761,544
Total assets	$2,602,612	$2,554,407
Current liabilities:		
Accounts payable	$185,767	$152,099
Current portion of long-term debt (Note 5)	4,550	4,550
Deferred revenue and other current liabilities	127,859	121,062
Total current liabilities	318,176	277,711
Long-term liabilities:		
Long-term debt (Note 5)	1,590,193	1,444,628
Deferred income taxes	305,650	304,491
Other long-term liabilities	57,348	59,016
Total long-term liabilities	1,953,191	1,808,135
Total liabilities	2,271,367	2,085,846
Contingencies (Note 7)		
Stockholders’ equity:		
Common stock	114	114
Additional paid-in capital	918,479	916,128
Retained earnings	1,144,795	1,058,148
Treasury stock, at cost	(1,725,349)	(1,496,180)
Accumulated other comprehensive loss	(6,794)	(9,649)
Total stockholders’ equity	331,245	468,561
Total liabilities and stockholders’ equity	$2,602,612	$2,554,407

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

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(unaudited)
(in thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenue	$673,218	$689,564	$1,342,123	$1,370,829
Cost of sales, including warehousing, distribution and occupancy	434,520	433,232	867,580	865,064
Gross profit	238,698	256,332	474,543	505,765
Selling, general, and administrative	138,984	140,090	282,056	279,858
Gains on refranchising (Note 4)	(16,885)	(1,149)	(17,900)	(1,491)
Other loss (income), net	375	(247)	98	155
Operating income	116,224	117,638	210,289	227,243
Interest expense, net (Note 5)	15,275	11,644	29,718	23,159
Income before income taxes	100,949	105,994	180,571	204,084
Income tax expense (Note 11)	36,921	38,637	65,728	73,457
Net income	$64,028	$67,357	$114,843	$130,627
Earnings per share (Note 8):				
Basic	$0.94	$0.79	$1.63	$1.51
Diluted	$0.94	$0.79	$1.62	$1.50
Weighted average common shares outstanding (Note 8):				
Basic	68,176	85,501	70,627	86,677
Diluted	68,303	85,777	70,760	86,934
Dividends declared per share	$0.20	$0.18	$0.40	$0.36

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

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(unaudited)
(in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net income	$64,028	$67,357	$114,843	$130,627
Other comprehensive (loss) income:				
Foreign currency translation (loss) gain	(70)	2,149	2,855	(3,162)
Comprehensive income	$63,958	$69,506	$117,698	$127,465

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

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
(unaudited)
(in thousands)

	Common Stock Class A Shares	Common Stock Class A Dollars	Treasury Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance at December 31, 2015	76,276	$ 114	$(1,496,180)	$916,128	$1,058,148	$ (9,649)	$ 468,561
Comprehensive income	—	—	—	—	114,843	2,855	117,698
Purchase of treasury stock	(7,926)	—	(229,169)	—	—	—	(229,169)
Dividends declared	—	—	—	—	(28,196)	—	(28,196)
Exercise of stock options	21	—	—	305	—	—	305
Restricted stock awards	33	—	—	—	—	—	—
Minimum tax withholding requirements	(22)	—	—	(622)	—	—	(622)
Net excess tax benefits from stock-based compensation	—	—	—	(281)	—	—	(281)
Stock-based compensation	—	—	—	2,949	—	—	2,949
Balance at June 30, 2016	68,382	$ 114	$(1,725,349)	$918,479	$1,144,795	$ (6,794)	$ 331,245
Balance at December 31, 2014	88,335	$ 113	$(1,016,381)	$877,566	$898,574	$ (3,829)	$ 756,043
Comprehensive income (loss)	—	—	—	—	130,627	(3,162)	127,465
Purchase of treasury stock	(3,668)	—	(164,798)	—	—	—	(164,798)
Dividends declared	—	—	—	—	(31,099)	—	(31,099)
Exercise of stock options	52	1	—	1,075	—	—	1,076
Restricted stock awards	237	—	—	—	—	—	—
Minimum tax withholding requirements	(7)	—	—	(423)	—	—	(423)
Net excess tax benefits from stock-based compensation	—	—	—	475	—	—	475
Stock-based compensation	—	—	—	3,080	—	—	3,080
Balance at June 30, 2015	84,949	$ 114	$(1,181,179)	$881,773	$998,102	$ (6,991)	$ 691,819

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

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Six months ended June 30, 2016	2015
Cash flows from operating activities:		
Net income	$ 114,843	$ 130,627
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	28,209	28,628
Amortization of debt costs	6,245	925
Stock-based compensation	2,949	3,080
Gains on refranchising	(17,900)	(1,491)
Changes in assets and liabilities:		
Decrease (increase) in receivables	15,121	(459)
(Increase) in inventory	(53,073)	(348)
(Increase) in prepaid and other current assets	(11,715)	(4,624)
Increase in accounts payable	36,751	17,549
Increase in deferred revenue and accrued liabilities	6,558	11,687
Other operating activities	2,901	(1,379)
Net cash provided by operating activities	130,889	184,195
Cash flows from investing activities:		
Capital expenditures	(20,809)	(20,131)
Refranchising proceeds	1,831	1,051
Store acquisition costs	(1,395)	(962)
Net cash used in investing activities	(20,373)	(20,042)

Cash flows from financing activities:		
Borrowings under revolving credit facility	182,000	—
Payments on revolving credit facility	(40,000)	—
Payments on term loan facility	(2,275)	(2,400)
Debt issuance costs	(1,712)	—
Proceeds from exercise of stock options	305	1,075
Gross excess tax benefits from stock-based compensation	156	475
Minimum tax withholding requirements	(622)	(423)
Cash paid for treasury stock	(229,169)	(164,798)
Dividends paid to shareholders	(27,974)	(31,017)
Net cash used in financing activities	(119,291)	(197,088)
Effect of exchange rate changes on cash and cash equivalents	533	(121)
Net increase in cash and cash equivalents	(8,242)	(33,056)
Beginning balance, cash and cash equivalents	56,462	133,834
Ending balance, cash and cash equivalents	$ 48,220	$ 100,778

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

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Supplemental Cash Flow Information
(unaudited)
(in thousands)

	As of June 30,	
	2016	2015
Non-cash investing activities:		
Accrued capital expenditures	$2,714	$2,716
Receivable related to sale of 84 company-owned stores to a franchisee	28,054	—

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

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GNC HOLDINGS, INC. AND SUBSIDIARIES
Condensed Notes to the Unaudited Consolidated Financial Statements

NOTE 1. NATURE OF BUSINESS

GNC Holdings, Inc., a Delaware corporation ("Holdings," and collectively with its subsidiaries and, unless the context requires otherwise, its and their respective predecessors, the "Company"), is a global specialty retailer of health, wellness and performance products, including protein, performance supplements, weight management supplements, vitamins, herbs and greens, wellness supplements, health and beauty, food and drink and other general merchandise.

The Company is vertically integrated as its operations consist of purchasing raw materials, formulating and manufacturing products and selling the finished products through its three reportable segments, which effective in the second quarter of 2016 include U.S. and Canada, International, and Manufacturing / Wholesale (refer to Note 10, "Segments" for more information). Corporate retail store operations are located in the United States, Canada, Puerto Rico, China and, beginning with the acquisition of THSD d/b/a The Health Store ("The Health Store") in 2014, Ireland. In addition, the Company offers products on the Internet through its websites, GNC.com and LuckyVitamin.com. The Company also offered product on the Internet through its 2013 acquisition of A1 Sports Limited d/b/a Discount Supplements ("Discount Supplements") up to and including December 31, 2015 when the assets of Discount Supplements were sold and operations were ceased. Franchise locations exist in the United States and approximately 50 other countries. The Company operates its primary manufacturing facilities in South Carolina and distribution centers in Arizona, Indiana, Pennsylvania and South Carolina. 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 various federal agencies, including the Food and Drug Administration, the Federal Trade Commission, the Consumer Product Safety Commission, the 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.

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements, which have been prepared in accordance with the applicable rules of the Securities and Exchange Commission, include all adjustments (consisting of a normal and recurring nature) that management considers necessary to fairly state the Company's results of operations, financial position and cash flows. The December 31, 2015 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("U.S. GAAP"). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's audited financial statements in its Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 10-K"). Interim results are not necessarily indicative of the results that may be expected for the remainder of the year ending December 31, 2016.

Revision for Sublease Rent Income

The Company revised its presentation of sublease income received from its franchisees for prior year periods to conform to the current period's presentation with no impact on previously reported gross profit, operating income, net income, shareholders' equity or cash flow from operations. The Company is the primary obligor of the leases for the majority of its franchise store locations and makes rental payments directly to the landlord and separately bills the franchisee for reimbursement. Accordingly, beginning in the first quarter of 2016, sublease rental income received from franchisees is appropriately presented as “Revenue” compared with the previous presentation as a reduction to occupancy expense in “Cost of sales, including warehousing, distribution, and occupancy" on the consolidated statements of income. In addition, the deferred rent asset associated with recognizing sublease rental income for lease agreements that contain escalation clauses, which are fixed and determinable, on a straight-line basis is now appropriately presented in “Other long-term assets” compared with the previous presentation as a reduction to the deferred rent liability in “Other long-term liabilities" on the consolidated balance sheets. This revision is not material to prior periods.

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The following table includes the revisions to the 2015 consolidated statements of income:

	Three months ended June 30	Six months ended June 30
Revenue:	(in thousands)	
Prior to revision	$678,520	$1,348,767
Revision	11,044	22,062
As Revised	$689,564	$1,370,829
Cost of sales, including warehousing, distribution and occupancy:		
Prior to revision	$422,188	$843,002
Revision	11,044	22,062
As Revised	$433,232	$865,064

The following table includes the revision to the consolidated balance sheet:

Other long-term assets:	December 31, 2015 (in thousands)
Prior to revision (*)	$ 32,891
Revision	5,664
As Revised	$ 38,555
Other long-term liabilities:	
Prior to revision	$ 53,352
Revision	5,664
As Revised	$ 59,016

(*) Includes the adoption of ASU 2015-03 and 2015-15 relating to the presentation of deferred financing fees as described below, which reclassified $3.3 million of debt issuance costs from "Other long-term assets" to "Long-term debt" at December 31, 2015 on the consolidated balance sheet.

Correction of Prior Year Immaterial Error

During the quarter ended March 31, 2015, the Company identified a $2.8 million error relating to prior periods in the calculation of the portion of the accrued payroll liability relating to certain amounts paid to store employees. The impact of this error was not material to any prior period. Consequently, the Company corrected the error in the first quarter of 2015 by increasing selling, general and administrative expense on the consolidated statement of income and deferred revenue and other current liabilities on the consolidated balance sheet by $2.8 million. The impact to net income was a decrease of $1.8 million for the six months ended June 30, 2015. This correction had no impact on cash flows from operations for the prior year six-month period.

Recently Adopted Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2015-03, which requires an entity to present debt issuance costs related to a recognized debt liability as a direct reduction from the carrying amount of that debt liability, consistent with the treatment of debt discounts. This standard does not affect the recognition and measurement guidance for debt issuance costs. In August 2015, the FASB subsequently issued ASU 2015-15, which clarifies that ASU 2015-03 does not address the presentation of debt issuance costs related to line-of-credit arrangements. This standard is effective for fiscal years beginning after December 15, 2015. Accordingly, the Company adopted these standards during the first quarter of fiscal 2016, with retrospective application. Net debt issuance costs in the amount of $3.3 million, which were previously classified as "Other long-term assets" at December 31, 2015, were reclassified as a reduction to "Long-term debt" on the Company's consolidated balance sheet to conform to the current year presentation.

Recently Issued Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, which includes multiple provisions intended to simplify various aspects of accounting and reporting for share-based payments. Currently, the difference between the deduction for tax purposes and the compensation cost of a share-based payment award results in either an excess tax benefit or deficiency. These excess tax benefits are recognized in additional paid-in capital and tax deficiencies (to the extent there are previous tax benefits) are recognized as an offset to accumulated excess tax benefits. If no previous tax benefit exists, the deficiencies are recognized in the income statement. The changes require all excess tax benefits and tax deficiencies related to share-based payments be recognized as income tax expense or benefit in the income statement as opposed to equity. The excess tax benefit in the cash flow statement will also change from its current presentation as a financing activity to being classified with other income tax as an operating activity. This standard is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. The Company is currently evaluating the impact this guidance will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, which requires an entity to recognize lease assets and lease liabilities on the balance sheet and to disclose key information about the entity's leasing arrangements. This standard is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2018. The Company is currently evaluating the impact this guidance will have on the Company's consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, which requires an entity to classify deferred tax assets and liabilities as noncurrent on the balance sheet. This standard is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. The Company does not believe the adoption of this guidance will have a material effect on the Company’s consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, which requires an entity that determines the cost of inventory by methods other than last-in, first-out and the retail inventory method to measure inventory at the lower of cost and net realizable value. This standard is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. The Company does not believe the adoption of this guidance will have a material effect on the Company’s consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, which updates revenue recognition guidance relating to contracts with customers. This standard states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB subsequently issued ASU 2015-14, which approved a one year deferral of ASU 2014-09 for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements.

Other Revisions

In addition to the sublease rent revision and the adoption of ASU 2015-03 as explained above, certain amounts in the consolidated financial statements for prior year periods have been revised to conform to the current period's presentation. The impact to prior periods of these revisions was not significant with no impact on previously reported operating income, net income, cash flows from operations or stockholders' equity.

NOTE 3. INVENTORY

The net realizable value of inventory consisted of the following:

	June 30, 2016	December 31, 2015
	(in thousands)	
Finished product ready for sale	$532,771	$487,075
Work-in-process, bulk product and raw materials	64,017	62,242
Packaging supplies	5,891	6,568
Total inventory	$602,679	$555,885

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NOTE 4. REFRANCHISING

Gains on Refranchising

The Company has begun to execute its previously announced refranchising strategy, which includes increasing the proportion of its domestic stores that are franchise locations. During the six months ended June 30, 2016, the Company refranchised 90 of its company-owned stores, including 86 refranchised during the three months ended June 30, 2016 and recorded refranchising gains of $17.9 million, of which $16.9 million were relating to the current quarter. The Company refranchised five and seven stores, respectively, during the three and six months ended June 30, 2015 and recorded refranchising gains of $1.1 million and $1.5 million during the respective periods.

These gains are calculated by subtracting the carrying value of applicable assets disposed of from the sales proceeds. In addition, the initial franchise fee received is included in the gain along with any other costs incurred by the Company to get the underlying assets ready for sale. The Company recognizes gains on refranchising after the asset purchase agreement is signed, the franchisee has taken possession of the store and management is satisfied that the franchisee can meet its financial obligations.

During the three months ended June 30, 2016, the Company completed the refranchising of 84 stores to one franchisee for $28.6 million of net proceeds resulting in a gain of $16.5 million. The Company provided a short term promissory note as bridge financing while the franchisee secured third party bank loans. The demand note of $23.0 million was recorded within "Receivables, net" on the accompanying consolidated balance sheet and was paid in July 2016. The remaining proceeds consist of a $0.5 million deposit and $5.1 million due to the Company primarily related to inventory recorded within "Receivables, net." The $28.1 million in combined receivables will be presented as an investing cash flow for the nine months ending September 30, 2016.

Held for Sale

The Company classifies assets as held for sale when it commits to a plan to dispose of the assets by refranchising specific stores in their current condition at a price that is reasonable and the Company believes completing the sale within one year is probable without significant changes. Assets held for sale are recorded at the lower of their carrying value or fair value, less costs to sell and depreciation is ceased on assets at the time they are classified as held for sale.

As of June 30, 2016, the Company classified as held for sale, within “Prepaid and other current assets” in the accompanying consolidated balance sheet, the applicable assets of 10 company-owned stores the Company expects to sell during the next 12 months with a corresponding reduction to inventory, goodwill and property, plant and equipment, net. The fair values of these assets exceeded their respective carrying values. The following table summarizes the financial statement carrying amount of assets classified as held for sale at June 30, 2016:

	(in thousands)
Inventory	$ 944
Goodwill	720
Property, plant and equipment, net	125
Total held for sale assets	$ 1,789

Goodwill

In connection with the Company's change in reportable segments described in Note 10, "Segments," the Company's Domestic Retail and Domestic Franchise reporting units were combined into one Domestic Stores reporting unit, consistent with how the segment manager now reviews this business effective in the second quarter of 2016. The amount of goodwill derecognized in a refranchising is determined by a fraction (the numerator of which is the fair value of the portion of the reporting unit being sold and the denominator of which is the fair value of the Domestic Stores reporting unit) that is applied to the total goodwill balance of the Domestic Stores reporting unit. The fair value of the portion of the reporting unit sold is determined by the sales price, which is generally based on the discounted future cash flows expected to be generated by the franchisee. Appropriate adjustments are made to the fair value determinations if such franchise agreement is determined to not be at prevailing market rates. In connection with the sale of 90 company-owned stores to franchisees during the six months ended June 30, 2016, the Company derecognized $3.5 million of goodwill that was included in the carrying value of the assets sold.

NOTE 5. LONG-TERM DEBT

Long-term debt consisted of the following:

	June 30, 2016	December 31, 2015
	(in thousands)	
Term Loan Facility (net of $1.9 million and $2.2 million discount)	$ 1,172,427	$ 1,174,369
Revolving Credit Facility	185,000	43,000
Notes	240,102	235,085
Debt issuance costs	(2,786)	(3,276)
Total debt	1,594,743	1,449,178
Less: current maturities	(4,550)	(4,550)
Long-term debt	$ 1,590,193	$ 1,444,628

The Company maintains a $1.2 billion term loan facility (the “Term Loan Facility”) that matures in March 2019. The Company also maintains a $300.0 million revolving credit facility (the “Revolving Credit Facility” and, together with the Term Loan Facility, the “Senior Credit Facility”) that matures in September 2018 as described in more detail below. On August 10, 2015, the Company issued $287.5 million principal amount of 1.5% convertible senior notes due 2020 (the "Notes") in a private offering.

At June 30, 2016 and December 31, 2015, the interest rate under the Term Loan Facility was 3.25%. The Revolving Credit Facility had a weighted average interest rate of 2.7% and 2.6% at June 30, 2016 and December 31, 2015, respectively. At June 30, 2016 and December 31, 2015, the commitment fee on the undrawn portion of the Revolving Credit Facility was 0.5%, and the fee on outstanding letters of credit was 2.50%.

Refinancing of Revolving Credit Facility

The Company amended the Revolving Credit Facility on March 4, 2016, to extend its maturity from March 2017 to September 2018 and increase total availability from $130.0 million to $300.0 million. In connection with this transaction, the Company incurred $1.7 million of costs, which were capitalized as deferred financing fees within "Other long-term assets" and will be amortized to interest expense over the new term of the Revolving Credit Facility. At June 30, 2016, the Company had $109.4 million available under the Revolving Credit Facility, after giving effect to $185.0 million of borrowings outstanding and $5.6 million utilized to secure letters of credit.

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Convertible Debt

The Notes consist of the following components:

	June 30, 2016	December 31, 2015
	(in thousands)	
Liability component		
Principal	$287,500	$287,500
Conversion feature	(41,787)	(46,271)
Discount related to debt issuance costs	(5,611)	(6,144)
Net carrying amount	$240,102	$235,085
Equity component		
Conversion feature	$49,680	$49,680
Debt issuance costs	(1,421)	(1,421)
Deferred taxes	(17,750)	(17,750)
Net amount recorded in additional paid-in capital	$30,509	$30,509

Interest Expense

Interest expense consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Senior Credit Facility:				
Term Loan Facility coupon	$9,657	$11,043	$19,323	$21,975
Revolver	1,445	170	2,061	338
Amortization of discount and debt issuance costs	592	462	1,184	925
Total Senior Credit Facility	11,694	11,675	22,568	23,238
Notes:				
Coupon	1,078	—	2,156	—
Amortization of conversion feature	2,252	—	4,484	—
Amortization of discount and debt issuance costs	280	—	555	—
Total Notes	3,610	—	7,195	—
Interest income and other	(29)	(31)	(45)	(79)
Interest expense, net	$15,275	$11,644	$29,718	$23,159

NOTE 6. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

Accounting Standards Codification 820, Fair Value Measurements and Disclosures defines fair value as a market-based measurement that should be determined based on the assumptions that marketplace participants would use in pricing an asset or liability. As a basis for considering such assumptions, the standard establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

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Level 1 — observable inputs such as quoted prices in active markets for identical assets and liabilities;
Level 2 — observable inputs such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, other inputs that are observable, or can be corroborated by observable market data; and
Level 3 — unobservable inputs for which there are little or no market data, which require the reporting entity to develop its own assumptions.
The carrying amounts of cash and cash equivalents, receivables, accounts payable, accrued liabilities and the Revolving Credit Facility approximate their respective fair values. Based on the interest rates currently available and their underlying risk, the carrying value of franchise notes receivable approximates its fair value.
The carrying value and estimated fair value of the Term Loan Facility and Notes (excluding the equity component classified in stockholders' equity) were as follows:

	June 30, 2016		December 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Term Loan Facility	$1,172,427	$1,148,978	$1,174,369	$1,145,010
Notes	240,102	200,348	235,085	188,940

The fair value of the Term Loan Facility was determined using the instrument’s trading value in markets that are not active, which are considered Level 2 inputs. The fair value of the Notes was determined based on quoted market prices and bond terms and conditions, which are considered Level 2 inputs.

NOTE 7. CONTINGENCIES

Litigation

The Company is engaged in various legal actions, claims and proceedings arising in 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.

The Company records accruals for outstanding legal matters when it believes it is probable that a loss will be incurred and the amount of such loss can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, the Company does not establish an accrued liability. Currently, none of the Company's accruals for outstanding legal matters are material individually or in the aggregate to the Company's financial position. However, if the Company ultimately is required to make a payment in connection with an adverse outcome in any of the matters discussed below, it is possible that it could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

The Company's contingencies are subject to substantial uncertainties, including for each such contingency the following, among other factors: (i) the procedural status of the case; (ii) whether the case has or may be certified as a class action suit; (iii) the outcome of preliminary motions; (iv) the impact of discovery; (v) whether there are significant factual issues to be determined or resolved; (vi) whether the proceedings involve a large number of parties and/or parties and claims in multiple jurisdictions or jurisdictions in which the relevant laws are complex or unclear; (vii) the extent of potential damages, which are often unspecified or indeterminate; and (viii) the status of settlement discussions, if any, and the settlement posture of the parties. Consequently, except as otherwise noted below with regard to a particular matter, the Company cannot predict with any reasonable certainty the timing or outcome of the legal matters described below, and the Company is unable to estimate a possible loss or range of loss.

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 effect on its business or financial condition, results of operations or cash flows. The Company currently maintains product liability insurance with a deductible/retention of

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$4.0 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 an 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. Consequently, the Company may incur material product liability claims, which could increase its costs and adversely affect its reputation, revenue and operating income.

DMAA / Aegeline Claims. Prior to December 2013, the Company sold products manufactured by third parties that contained derivatives from geranium known as 1.3-dimethylpentylamine/dimethylamylamine/13-dimethylamylamine, or "DMAA," which were recalled from the Company's stores in November 2013, and/or Aegeline, a compound extracted from bael trees. As of June 30, 2016, the Company was named in 28 personal injury lawsuits involving products containing DMAA and/or Aegeline.

As a general matter, the proceedings associated with these personal injury cases, which generally seek indeterminate money damages, are in the early stages, and any losses that may arise from these matters are not probable or reasonably estimable at this time.

The Company is contractually entitled to indemnification by its third-party vendors with regard to these matters, although the Company's ability to obtain full recovery in respect of any such claims against it is dependent upon the creditworthiness of the vendors and/or their insurance coverage and the absence of any significant defenses available to its insurer.

California Wage and Break Claims. In July 2011, Charles Brewer, on behalf of himself and all others similarly situated, sued General Nutrition Corporation in federal court, alleging state and federal wage and hour claims. In October 2011, plaintiff filed an eight-count amended complaint alleging, among other matters, meal, rest break and overtime violations on behalf of sales associates and store managers. In January 2013, the Court conditionally certified a Fair Labor Standards Act ("FLSA") class with respect to one of Plaintiff's claims, and in November 2014, the Court granted in part and denied in part the plaintiff's motion to certify a California class and granted the Company's motion for decertification of the FLSA class. In May 2015, plaintiffs filed a motion for partial summary judgment as to the Company's alleged liability for non-compliant wage statements, which was granted in part and denied in part in September 2015. On February 5, 2016, the Company and attorneys representing the putative class agreed to class-wide settlements of the Brewer case and an additional, immaterial case raising similar claims, pursuant to which the Company agreed to pay up to $9.5 million in the aggregate, including attorneys' fees and costs. Following a hearing on April 19, 2016, the Court preliminarily approved the settlement agreement, which remains subject to final Court approval. A hearing regarding final Court approval is currently scheduled for August 23, 2016. As a result of this settlement, the Company recorded a charge of $6.3 million in the fourth quarter of 2015, in addition to $3.2 million previously accrued in the first quarter of 2015.

On February 29, 2012, former Senior Store Manager, Elizabeth Naranjo, individually and on behalf of all others similarly situated, sued General Nutrition Corporation in the Superior Court of the State of California for the County of Alameda. The complaint contains eight causes of action, alleging, among other matters, meal, rest break and overtime violations. As of June 30, 2016, an immaterial liability has been accrued in the accompanying financial statements.

Jason Olive v. General Nutrition Corp. In April 2012, Jason Olive filed a complaint in the Superior Court of California, County of Los Angeles, for misappropriation of likeness in which he alleges that the Company continued to use his image in stores after the expiration of the license to do so in violation of common law and California statutes. Mr. Olive is seeking compensatory, punitive and statutory damages and attorneys' fees and costs. The trial in this matter began on July 20, 2016 and is ongoing. As of June 30, 2016, an immaterial liability has been accrued in the accompanying financial statements.

Oregon Attorney General. On October 22, 2015, the Attorney General for the State of Oregon sued General Nutrition Corporation in Multnomah County Circuit Court for alleged violations of Oregon's Unlawful Trade Practices Act, in connection with its sale in Oregon of certain third-party products. The Company intends to continue to vigorously defend against these allegations. As any losses that may arise from this matter are not probable or reasonably estimable at this time, no liability has been accrued in the accompanying interim consolidated financial statements. Moreover, the Company does not anticipate that any such losses are likely to have a material impact on the Company, its business or results of operations. The Company is contractually entitled to indemnification and defense by its third-party vendors,

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which have accepted the Company’s tender request for defense and indemnification. Ultimately, however, the Company's ability to obtain full recovery in respect of any such claims against it is dependent upon the creditworthiness of its vendors and/or their insurance coverage and the absence of any significant defenses available to their insurers.

Environmental Compliance

In March 2008, the South Carolina Department of Health and Environmental Control (the "DHEC") requested that the Company investigate contamination associated with historical activities at its South Carolina facility. These investigations have identified chlorinated solvent impacts in soils and groundwater that extend offsite from the facility. The Company entered into a Voluntary Cleanup Contract with the DHEC regarding the matter on September 24, 2012. Pursuant to such contract, the Company is completing additional investigations with the DHEC's approval. At this stage of the investigation, however, it is not possible to estimate the timing and extent of any remedial action that may be required, the ultimate cost of remediation, or the amount of the Company's potential liability, therefore no liability is recorded.

In addition to the foregoing, the Company is subject to numerous federal, state, local and foreign environmental and health and safety laws and regulations governing its operations, including the handling, transportation and disposal of the Company's non-hazardous and hazardous substances and wastes, as well as emissions and discharges from its operations into the environment, including discharges to air, surface water and groundwater. Failure to comply with such laws and regulations could result in costs for remedial actions, penalties or the imposition of other liabilities. New laws, changes in existing laws or the interpretation thereof, or the development of new facts or changes in their processes could also cause the Company to incur additional capital and operating expenditures to maintain compliance with environmental laws and regulations and environmental permits. The Company is also subject to laws and regulations that impose liability and cleanup responsibility for releases of hazardous substances into the environment without regard to fault or knowledge about the condition or action causing the liability. Under certain of these laws and regulations, such liabilities can be imposed for cleanup of previously owned or operated properties, or for properties to which substances or wastes that were sent in connection with current or former operations at its facilities. The presence of contamination from such substances or wastes could also adversely affect the Company's ability to sell or lease its properties, or to use them as collateral for financing. From time to time, the Company has incurred costs and obligations for correcting environmental and health and safety noncompliance matters and for remediation at or relating to certain of the Company's properties or properties at which the Company's waste has been disposed. However, compliance with the provisions of national, state and local environmental laws and regulations has not had a material effect upon the Company's capital expenditures, earnings, financial position, liquidity or competitive position. The Company believes it has complied with, and is currently complying with, its environmental obligations pursuant to environmental and health and safety laws and regulations and that any liabilities for noncompliance will not have a material adverse effect on its business, financial performance or cash flows. However, it is difficult to predict future liabilities and obligations, which could be material.

NOTE 8. EARNINGS PER SHARE

The following table represents the Company's basic and dilutive weighted-average shares:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Basic weighted-average shares	68,176	85,501	70,627	86,677
Effect of dilutive stock-based awards	127	276	133	257
Diluted weighted-average shares	68,303	85,777	70,760	86,934

For the three months ended June 30, 2016 and 2015, the Company had 1.1 million and 0.2 million time-based stock awards, respectively, that were not included in the computation of diluted earnings per share because the impact of applying the treasury stock method was anti-dilutive. For the six months ended June 30, 2016 and 2015, the Company had a combined 0.6 million and 0.2 million of time-based and market-based stock awards, respectively, that were not included in the computation of diluted earnings per share because the impact of applying the treasury stock method was anti-dilutive.

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Because certain conditions have not been met as of June 30, 2016 with respect to the Company's performance-based and market-based awards, the Company has determined these awards to be contingently issuable; as a result, all 0.3 million combined outstanding performance-based and market-based awards were not included in the diluted EPS calculation in the three months ended June 30, 2016. All 0.1 million performance-based awards were contingently issuable in the prior year period and excluded from diluted EPS in the three and six months ended June 30, 2015. The Company has the intent and ability to settle the principal portion of its Notes in cash, and as such, has applied the treasury stock method, which has resulted in all underlying convertible shares being anti-dilutive as the Company's average stock price in the current quarter is less than the conversion price. Refer to Note 5, "Long-Term Debt" for more information on the Notes.

NOTE 9. STOCK-BASED COMPENSATION PLANS AND SHARE REPURCHASE PROGRAM

Stock and Incentive Plans

The Company has outstanding stock-based compensation awards that were granted by the Compensation and Organizational Development Committee (the “Compensation Committee”) of Holdings’ board of directors (the "Board") under the following two stock-based employee compensation plans:

- the GNC Holdings, Inc. 2015 Stock and Incentive Plan (the "2015 Stock Plan") amended and adopted in May 2015, formerly the GNC Holdings, Inc. 2011 Stock and Incentive Plan (the “2011 Stock Plan”) adopted in March 2011; and
- the GNC Acquisition Holdings Inc. 2007 Stock Incentive Plan adopted in March 2007 (as amended, the “2007 Stock Plan”).

Both plans have provisions allowing for the granting of stock options, restricted stock and other stock-based awards and are available to eligible employees, directors, consultants or advisers as determined by the Compensation Committee. The Company will not grant any additional awards under the 2007 Stock Plan. Up to 11.5 million shares of common stock may be issued under the 2015 Stock plan (subject to adjustment to reflect certain transactions and events specified in the 2015 Stock Plan for any award grant), of which 7.1 million shares remain available for issuance as of June 30, 2016.

The following table sets forth a summary of all stock-based compensation awards outstanding under all plans:

	June 30, 2016	December 31, 2015
	(in thousands)	
Time-based stock options	1,300	688
Time-based restricted stock awards	329	194
Performance-based restricted stock awards	141	141
Market-based restricted stock awards	171	—
Total	1,941	1,023

Stock-Based Compensation Activity

During the six months ended June 30, 2016, the Company granted the following stock-based compensation awards:

	(in thousands)
Time-based stock options	643
Time-based restricted stock awards	214
Market-based restricted stock awards	171
Total	1,028

Time-based stock options vest 25% per year over a period of four years and the fair value was determined using the Black-Scholes model. Key assumptions used for the options granted during the current year period include

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a dividend yield between 2.31% and 3.39%, an expected term of 6.3 years, volatility between 30.1% and 30.7%, and a risk-free rate between 1.13% and 1.90%. Time-based restricted stock awards vest one-third per year over a period of three years.

Market-based awards vest at the end of a three-year period based upon total shareholder return compared with that of a selected group of peer companies. Total shareholder return is defined as share price appreciation plus the value of dividends paid during the three-year vesting period. Fair value of these awards was determined using a Monte Carlo simulation, which requires various inputs and assumptions, including the Company's common stock price. Compensation cost for these awards is recognized regardless of whether the market condition is achieved. Vested shares may range from 0% to 200% of the original target. Key assumptions used in the Monte Carlo simulation for the awards granted during the year include peer group volatility of 34.2% and a risk-free rate of 0.89%.

The above awards granted during the six months ended June 30, 2016 will result in compensation expense of $14.7 million, net of expected forfeitures, over the service period from the applicable grant date through the date of vesting.

The Company recognized $1.5 million and $1.8 million of total non-cash stock-based compensation expense for the three months ended June 30, 2016 and 2015, respectively and $2.9 million and $3.1 million for the six months ended June 30, 2016 and 2015. At June 30, 2016, there was approximately $19.1 million of total unrecognized compensation cost related to non-vested stock-based compensation, net of expected forfeitures, for all awards previously made that are expected to be recognized over a weighted-average period of approximately 1.7 years.

Share Repurchase Program

In August 2015, the Board approved a $500.0 million multi-year repurchase program in addition to the $500.0 million multi-year program approved in August 2014, bringing the aggregate share repurchase program to $1.0 billion of Holdings' common stock. Holdings repurchased $229.2 million of common stock during the six months ended June 30, 2016 and has utilized $802.2 million of the current repurchase program. As of June 30, 2016, $197.8 million remains available for purchase under the program.

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NOTE 10. SEGMENTS

The Company’s refranchising strategy, which is increasing the proportion of domestic stores that are franchise locations in 2016 and beyond, has resulted in a change in the Company’s organizational structure and the financial reporting utilized by the Company’s chief operating decision maker (its chief executive officer) to assess performance and allocate resources; as a result, the Company's reportable segments have changed effective in the second quarter of 2016. The Company believes that the new segments better present management’s new view of the business. The Company aggregates its operating segments into three reportable segments, which effective in the second quarter of 2016, include U.S. and Canada, International and Manufacturing / Wholesale. In connection with the change in the Company's segment reporting, warehousing and distribution costs have been allocated to each reportable segment, as appropriate. The Company's chief operating decision maker evaluates segment operating results based primarily on performance indicators, including revenue and operating income. Operating income of each reportable segment excludes certain items that are managed at the consolidated level, such as corporate costs. The following table shows the new reportable segments compared with the previous reporting structure.

Old	New
Segment: Retail Includes: Company-owned stores in the U.S., Puerto Rico and Canada, The Health Store and e-commerce including Discount Supplements, which was sold in the fourth quarter of 2015	Segment: U.S. and Canada Includes: Company-owned stores in the U.S., Puerto Rico and Canada, franchise stores in the U.S. and e-commerce
Segment: Franchise Includes: Domestic and international franchise locations and China operations	Segment: International Includes: Franchise locations in approximately 50 countries, The Health Store and China operations
Segment: Manufacturing / Wholesale Includes: Manufactured product sold to our other segments, third-party contract manufacturing and sales to wholesale partners	Segment: Manufacturing / Wholesale Includes: Manufactured product sold to our other segments, third-party contract manufacturing and sales to wholesale partners (no change from old)
	Other Includes: Discount Supplements, an e-commerce business which was sold in the fourth quarter of 2015

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The following table represents key financial information for each of the Company's reportable segments. Refer to Note 2, "Basis of Presentation" for a description of the prior period revision associated with sublease rent income.

	Three months ended June 30,		Six months ended June 30,	
	2016	2015 (*)	2016	2015 (*)
	(in thousands)			
Revenue:				
U.S. and Canada	$570,943	$582,584	$1,145,543	$1,161,522
International	43,077	44,159	79,919	83,783
Manufacturing / Wholesale:				
Intersegment revenues	56,556	72,984	119,587	139,238
Third-party	59,198	56,233	116,661	111,757
Subtotal Manufacturing / Wholesale	115,754	129,217	236,248	250,995
Total reportable segment revenues	729,774	755,960	1,461,710	1,496,300
Other	—	6,588	—	13,767
Elimination of intersegment revenues	(56,556)	(72,984)	(119,587)	(139,238)
Total revenue	$673,218	$689,564	$1,342,123	$1,370,829
Operating income:				
U.S. and Canada	$104,549	$105,519	$190,850	$206,073
International	13,649	15,694	26,752	31,908
Manufacturing / Wholesale	17,891	21,060	36,324	41,067
Total reportable segment operating income	136,089	142,273	253,926	279,048
Unallocated corporate and other costs:				
Corporate costs	(19,865)	(23,547)	(43,626)	(49,324)
Other	—	(1,088)	(11)	(2,481)
Subtotal unallocated corporate and other costs	(19,865)	(24,635)	(43,637)	(51,805)
Total operating income	116,224	117,638	210,289	227,243
Interest expense, net	15,275	11,644	29,718	23,159
Income before income taxes	$100,949	$105,994	$180,571	$204,084

(*) Prior periods have been revised to present the Company's new reportable segments.

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NOTE 11. INCOME TAXES

The Company recognized $36.9 million of income tax expense (or 36.6% of pre-tax income) during the three months ended June 30, 2016 compared with $38.6 million (or 36.5% of pre-tax income) in the prior year quarter. The Company recognized $65.7 million of income tax expense (or 36.4% of pre-tax income) during the six months ended June 30, 2016 compared with $73.5 million (or 36.0% of pre-tax income) for the same period 2015.

At June 30, 2016 and December 31, 2015, the Company had $6.8 million and $7.3 million of unrecognized tax benefits, respectively, excluding interest and penalties, which if recognized, would affect the effective tax rate.The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. The Company accrued $2.0 million and $1.8 million at June 30, 2016 and December 31, 2015, respectively, for potential interest and penalties associated with uncertain tax positions. To the extent interest and penalties are not assessed with respect to the ultimate settlement of uncertain tax positions, amounts previously accrued will be reversed as a reduction to income tax expense.
Holdings files a consolidated federal tax return and various consolidated and separate tax returns as prescribed by the tax laws of the state, local and international jurisdictions in which it and its subsidiaries operate. The statutes of limitation for the Company’s U.S. federal income tax returns are closed for years through 2011. The Company's 2010 and 2011 federal income tax returns have been examined by the Internal Revenue Service. The Internal Revenue Service closed the examination without making any material adjustments to the returns. The Company has various state and local jurisdiction tax years open to possible examination (the earliest open period is generally 2011), and the Company also has certain state and local tax filings currently under audit.

NOTE 12. SUBSEQUENT EVENTS

On July 21, 2016, the Board authorized and declared a cash dividend for the third quarter of 2016 of $0.20 per share of common stock, payable on or about September 30, 2016 to stockholders of record as of the close of business on September 16, 2016.

On July 28, 2016, the Company announced the appointment of Robert F. Moran, who has served as a member of the Board since 2013, as interim Chief Executive Officer, effective immediately. Also on July 28, 2016, the Company announced the departure from the Company and resignation from the Board of Michael G. Archbold, its former Chief Executive Officer, effective July 27, 2016. For the third quarter of 2016 in connection with Mr. Archbold's departure, the Company expects to recognize approximately $4 million in severance expense of which approximately half relates to the acceleration of non-cash stock-based compensation.

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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" of this Quarterly Report on Form 10-Q. The following information presented for the three and six months ended June 30, 2016 and 2015 was prepared by management, is unaudited, and was derived from our unaudited consolidated financial statements and accompanying notes. 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. Effective in the second quarter of 2016, we changed our reportable segments as described in more detail under "Change in Reportable Segments" below.

Forward-Looking Statements

This Quarterly Report on Form 10-Q and any documents incorporated by reference herein or therein include forward-looking statements within the meaning of federal securities laws. Forward-looking statements include statements that 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 often be identified by the use of terminology such as "subject to," "believe," "anticipate," "plan," "potential," "predict," "expect," "intend," "estimate," "project," "may," "will," "should," "would," "continue," "seek," "could," "can," "thi
thereof, variations thereon and similar 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. The following uncertainties and factors, among others including, but not limited to, those we describe under the caption "Risk Factors" in this Quarterly Report on Form 10-Q and our 2015 10-K, could affect future performance and cause actual results to differ materially from those matters expressed in or implied by forward-looking statements:

- significant and growing competition in our industry;
- unfavorable publicity or consumer perception of our industry or products, as well as general changes in consumer behaviors and trends;
- increases in the cost of borrowings and limitations on availability of additional debt or equity capital;
- our debt levels and restrictions in our debt agreements;
- incurrence of material product liability and product recall costs;
- loss or retirement of key members of management;
- costs of compliance or any failure on our part to comply with new and existing governmental regulations governing our products, including, but not limited to, proposed dietary supplement legislation and regulations;
- changes in our tax obligations;
- costs of litigation or investigations involving our company and any failure to successfully defend lawsuits and other claims against us;
- 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, including fluctuations in foreign exchange rates relative to the U.S. dollar;
- failure to keep pace with the demands of our customers for new products and services;
- limitations of or disruptions in our manufacturing system or losses of manufacturing certifications;
- limitations of or disruptions in our distribution network;

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- 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;
- failure to adequately protect or enforce our intellectual property rights against competitors;
- changes in raw material costs and pricing of our products;
- failure to successfully execute our growth strategy, including any delays in our planned future growth, any inability to expand our franchise operations or attract new franchisees, any inability to expand our company-owned retail operations, any inability to grow our international footprint, or any inability to expand our e-commerce business;
- any failure by our current marketing initiatives to timely produce the results that we anticipate;
- changes in applicable laws relating to our franchise operations;
- damage or interruption to our information systems;
- risks and costs associated with data loss, credit card fraud and identity theft;
- impact of current economic conditions on our business;
- unusually adverse weather conditions;
- natural disasters, pandemic outbreaks, boycotts, and geo-political events; and
- failure to maintain effective internal controls.

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 a global specialty retailer of health, wellness and performance products, including protein, performance supplements, weight management supplements, vitamins, herbs and greens, wellness supplements, health and beauty, food and drink and other general merchandise. We derive our revenues principally from: product sales through our company-owned stores; the Internet through our websites, GNC.com and LuckyVitamin.com; domestic and international franchise activities; and sales of products manufactured in our facilities to third parties. We sell products through a worldwide network of more than 9,000 locations operating under the GNC brand name.

Despite recent significant challenges explained below under "Executive Overview," we benefit from competitive strengths that we believe drive our business and position us for success, including our:

- well-recognized brand;
- customer base consisting of more than 6 million gold card members;
- strong operating cash flow;
- unique product offerings and innovation capabilities;
- diversified business model;
- vertically integrated operations;
- differentiated service model designed to enhance the customer experience; and
- highly experienced management team.

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Executive Overview

Our executive team is committed to our core principles and strategic evolution plan, which started during the second half of 2014 with the appointment of our new chief executive officer and other key executive positions. Foundationally, we remain focused on a customer-centric evolution of our brand and culture defined by core principles that we believe enable GNC to foster one-to-one customer engagement and, ultimately, to connect our customers to their best selves. These principles include development of:

- meaningful, long-term connections with our customers;
- deep expertise in health, wellness and performance;
- solutions tailored to meet our customers' unique goals;
- a best-in-class shopping experience; and
- customer-driven decision making and rigorous quality standards.

While our business remains profitable and we continue to recognize strong cash flow, with approximately 95% of our company-owned stores' cash flow exceeding our weighted-average cost of capital, we also have faced recent significant challenges to our business, including: increased competition; intensified regulatory and other governmental scrutiny, including inquiries from state attorneys general, and negative media coverage of our industry; year-over-year declines in same store sales; and consequently, heightened volatility in the trading price of our common stock.

In an attempt to reverse adverse trends that our business is currently experiencing and improve traffic to our stores, we are focused on the following:

- marketing effectiveness, including continued development of a precise plan on marketing spend across channels to improve the overall effectiveness in capturing the customers we are seeking, as well as improving our call to action messages designed to increase traffic and highlight our quality products;
- product innovation, including increasing our flow of new, innovative GNC branded and third party products that attract new customers; and
- promotion, including our recent all-store BOGO events, which have proven successful and we expect to continue to use them judiciously, conscious that we not develop a consumer reliance on discounting events. In addition, we are continuing to work with our franchisees to improve the participation in our corporate initiatives, including promotional events and expanded assortment.

In addition to the above, we continue to focus on our other strategic initiatives, which remain the following:

- Raising industry standards through the creation of an industry-wide coalition. We remain focused, together with other industry leaders and industry trade associations, on initiatives begun in 2015 to build an industry-led coalition aimed at raising the bar for quality and compliance throughout the dietary supplement industry. Coalition initiatives include: developing standardized raw material "good manufacturing practices" ("GMPs"), including "farm to factory" traceability standards; creating a product-registry database accessible to industry participants, consumers and the FDA; establishing minimum certification standards for manufacturing facilities, including an annual facility inspection process and product quality seals, and providing media support for a coordinated industry including positive messaging with accurate product information to help change the narrative around our industry. We believe that over time, these initiatives will prove beneficial for the industry, for the FDA and other regulators, and lead to substantial improvement in regulatory and consumer trust and confidence in our industry.
- Executing our refranchising strategy. We have undertaken an accelerated drive to increase the proportion of our domestic stores that are franchise locations, which we expect to accomplish both by increasing the proportion of new stores that are franchise locations and by transitioning company-owned stores to franchise locations. We are currently targeting a balanced portfolio of domestic company-owned and franchise locations over the next three to four years, beginning in 2016. As part of this effort, we remain focused on creating and nurturing franchise partnerships that support our brand image. We believe that this strategy can result in significant value creation for our stockholders. During the six months ended June 30, 2016, we refranchised 90 company-owned stores to franchisees.
- Implementing a revised pricing strategy. Early in 2016, we launched an intensive effort to develop and implement an improved pricing strategy to be applied primarily in our domestic company-owned stores. Our intent is to

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appropriately identify and price known value items, to create a clear definition of role and intent by product category, further improve the clarity of our price message and more closely align the customer's perception of our pricing with the quality and value of our products. We expect the results of this initiative to be evident in 2017 and beyond.

- Enhancing our customer loyalty program. Following extensive consumer research during 2015, we currently are in the process of reviewing various enhancements to our loyalty program, which currently includes more than 6 million Gold Card customers. We believe that further developing and encouraging active customer participation in a robust customer loyalty program is an important step toward our goals for building meaningful, long-term connection with our customers. We expect the results of this initiative to be evident in 2017 and beyond.

We believe that our combined efforts on these fronts will enable us to better leverage the competitive strengths that remain at the core of our business and will drive future success.

Recent Trends and Uncertainties

The following trends and uncertainties in our industry could affect our operating performance as follows:

- broader consumer awareness of health and wellness issues and rising healthcare costs may increase the use of the products we offer and positively affect our operating performance;
- interest in, and demand for, condition-specific products based on scientific research may positively affect our operating performance if we can timely develop and offer such condition-specific products;
- the effects of favorable and unfavorable publicity on consumer demand with respect to the products we offer may have similarly favorable or unfavorable effects on our operating performance;
- a lack of long-term experience with human consumption of ingredients in some of our products could create uncertainties with respect to the health risks, if any, related to the consumption of such ingredients and negatively affect our operating performance;
- increased costs and other demands associated with heightened regulatory scrutiny, including but not limited to complying with new and existing governmental regulation, and/or legal challenges associated with products that we sell may negatively affect our operating performance;
- consolidation within our industry and increasing participation in our market by mass market retailers and consumer product manufacturers could continue to intensify competition within our industry and could continue to negatively affect our market performance;
- a decline in disposable income available to consumers may lead to a reduction in consumer spending and negatively affect our operating performance; and
- an aging population in the United States may positively impact sales of some of the products that we offer.

Key Indicators

We evaluate segment operating results based on several indicators. The primary key performance indicators are revenues and operating income for each segment. Revenues and operating income, as evaluated by our chief operating decision maker (our chief executive officer), exclude certain items that are managed at the consolidated level, such as corporate costs. The following discussion compares the revenues and the operating income by segment, as well as those items excluded from the segment totals.

Same store sales growth represents the percentage change in same store point-of-sale retail sales in the period presented compared with 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. We include our internet sales of GNC.com in our domestic retail company-owned same store sales calculation and effective January 1, 2016 we are excluding Drugstore.com, which does not have a significant impact. When a store's square footage has been changed as a result of reconfiguration or relocation in the 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 franchise 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 sales during the

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period presented that occurred on or after the date of relocation to a different mall or shopping center or the date of a conversion.

Results of Operations

(Expressed as a percentage of total consolidated revenue)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenues:				
U.S. and Canada	84.8 %	84.5 %	85.4 %	84.7 %
International	6.4 %	6.4 %	6.0 %	6.1 %
Manufacturing / Wholesale:				
Intersegment revenues	8.4 %	10.6 %	8.9 %	10.2 %
Third party	8.8 %	8.2 %	8.6 %	8.2 %
Subtotal Manufacturing / Wholesale	17.2 %	18.8 %	17.5 %	18.4 %
Other	— %	0.9 %	— %	1.0 %
Elimination of intersegment revenue	(8.4)%	(10.6)%	(8.9)%	(10.2)%
Total net revenues	100.0 %	100.0 %	100.0 %	100.0 %
Operating expenses:				
Cost of sales, including warehousing, distribution and occupancy	64.5 %	62.8 %	64.6 %	63.1 %
Gross profit	35.5 %	37.2 %	35.4 %	36.9 %
Selling, general and administrative	20.6 %	20.3 %	21.0 %	20.4 %
Gains on refranchising	(2.5)%	(0.2)%	(1.3)%	(0.1)%
Other loss (income), net	0.1 %	— %	— %	— %
Total operating expenses	82.7 %	82.9 %	84.3 %	83.4 %
Operating income:				
U.S. and Canada	15.5 %	15.3 %	14.2 %	15.0 %
International	2.0 %	2.3 %	2.0 %	2.3 %
Manufacturing / Wholesale	2.8 %	3.1 %	2.8 %	3.1 %
Unallocated corporate and other costs:				
Corporate costs	(3.0)%	(3.4)%	(3.3)%	(3.6)%
Other	— %	(0.2)%	— %	(0.2)%
Subtotal unallocated corporate and other costs	(3.0)%	(3.6)%	(3.3)%	(3.8)%
Total operating income	17.3 %	17.1 %	15.7 %	